

Oil Imports and National Security: Is There Still a Connection?

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This article examines the impact of oil imports on U.S. national security. It reviews oil's links with national security, and questions the arguments for curbing imports. Debated since the 1950s, the links are based on oil's unique role in fueling the economy, its role for the sparring superpowers during the Cold War, and the political instability of the Middle East. The article challenges the "military externality" argument that U.S. imports require military protection. It compares U.S. import dependency with the much higher import dependency of most other industrial countries, none of which have expressed a national security concern similar to that of the U.S. It also points out that the source of imports is irrelevant, as the petroleum market functions globally with respect to volume and price: a shortage anywhere is a shortage everywhere. Finally, the article discusses the oft-used balance of payments argument for reducing oil imports, questioning the calculations on which it is based. It concludes that any argument for reducing oil imports for balance of payments reasons applies equally to other imported commodities.

INTRODUCTION

The impact of oil imports on U.S. national security—actual or potential—has been a subject of public debate since 1955 when President Eisenhower requested voluntary restrictions on the volumes of crude and fuel oil imports. In 1959 the restrictions were made mandatory and were maintained until 1970 when domestic crude oil production reached full operating capacity, and the growth in U.S. oil demand had to be met entirely from abroad. The legal basis for both the voluntary and the mandatory import restrictions was the "National Security" clause in the Trade Agreement Extension Act of 1955. Except for a relatively low and ineffective special import fee in the mid-1970s, there have been no real restrictions on U.S. oil imports since 1970. (The nominal import tariff has been unchanged since the 1950s).

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However, almost every Administration since President Eisenhower has been faced with the issue of oil imports and national security. President Carter in 1977 called the need to reduce our oil import dependency "the moral equivalent of war." The Reagan Administration left office in January 1989 with a last-minute finding by its Secretary of Commerce that "oil imports threaten to impair the national security" under Section 232 of the U.S. Trade Expansion Act. The Bush Administration did not act on its predecessor's findings but expressed concern about the impact of rising oil imports on energy security in its *National Energy Strategy* report which also predicted increased U.S. dependence on Middle East oil "under any realistic scenario for the foreseeable future."¹

President Clinton voiced similar concern during his election campaign. After his election he proposed the controversial Btu tax on energy, which Congress rejected, justifying the tax in part as a measure to reduce the national security risk of rising oil import dependency.² The debate continues with the recent request of the independent domestic oil producers' trade association for another finding by the Administration on whether oil imports threaten to impair the national security under Section 232 of the Trade Expansion Act.³ The Department of Commerce is expected to release its report on the subject by the end of 1994. Thus, the principal argument for curtailing U.S. oil imports is not the standard economic one of domestic enterprises, i.e., protection against lower-cost foreign competition. Rather, it is based on the political-strategic contention that "excessive" U.S. dependence on imported oil presents a potential national threat since a significant loss of these imports could not be offset from domestic oil supplies nor by fuel switching. This threat, it is further argued, also impacts our position in world affairs, and requires a military strategy designed to protect our access to these supply sources. These arguments are usually tied to the perceived reality that the bulk of the world's oil exports comes from "politically volatile regions of the globe."⁴

WHY OIL?

Unique Consumption

Why does oil have this unique status among imported commodities many of which can also be classified as essential? The first reason is oil's historically dominant role in the U.S. energy sector, and the key role of fossil energy in the U.S. economy (see Figure 1).

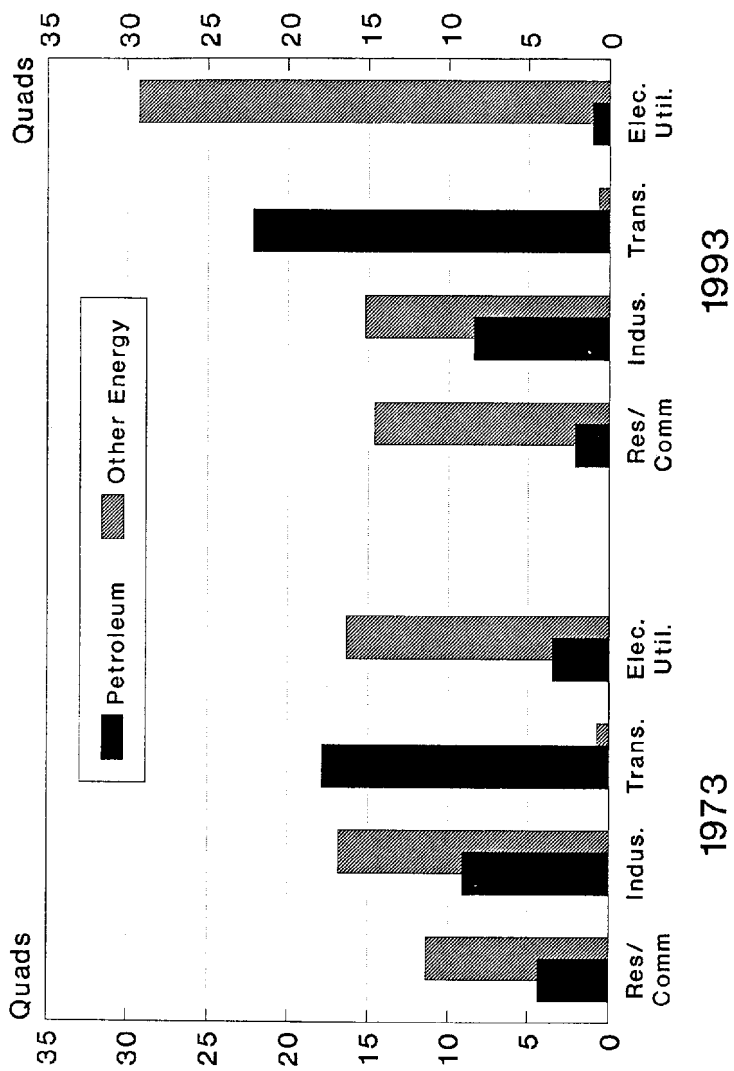
1. U.S. Department of Energy, *National Energy Strategy*, February 1991, p. 3.

2. U.S. Department of Energy, Statement by Secretary Hazel O'Leary, Feb. 17, 1993.

3. *The Oil Daily*, April 12, 1994, p. 5.

4. *National Energy Strategy*, op. cit.

Figure 1. Petroleum in the U.S. Energy Picture



Related to this is the unique aspect of oil's consumption. It is immediately and completely used up in the process of fuelling the equipment which consumes it, and, hence, must continuously be fully replaced to keep the equipment (and the economy) operating. This makes oil different from other essential commodities such as metals, non-fuel minerals, fibers, chemicals, etc. Incremental supplies of these are primarily required in the production of *new* goods, not to maintain ongoing activities. Thus, a disruption in the supply of any of these other commodities would have a much slower and more gradual effect than a disruption of oil supplies. One may argue that food and certain other agricultural products fall into the same category as oil regarding ongoing consumption. However, these products are much more interchangeable and substitutable than energy fuels. In the transportation sector, which accounts for 65% of U.S. oil consumption, fuel substitution is virtually non-existent and in most other energy sectors it is quite limited in the short term.

The Cold War

Another reason for the national security concern about oil imports can be found in the U.S.'s historical position as one of the world's two confronting "superpowers" in the Cold War period from 1948 to 1990. During this period, U.S. dependency on imported oil rose from almost nothing in the early 1950s to nearly 50% in 1977. It then declined sharply as Alaskan crude oil production came on, falling to 27% in 1985, but by 1988 it was back to 38%. During the same period the former Soviet Union, which was always self-sufficient in oil, slowly emerged as a major oil exporter, and by 1988 was the world's second largest exporter, after Saudi Arabia.

Clearly, the two superpowers' opposite movements on oil self-sufficiency and foreign trade during the Cold War had to be a consideration in shaping U.S. strategy during this period. The fact that the world's oil export center is located in the Middle East, just a few hundred land miles from the Russian border but several thousand sea miles from the U.S., greatly deepened U.S. concern about the national security risk of the U.S. and its allies' reliance on ever growing imports from this area. It was one of the reasons for the creation of the *Rapid Deployment Joint Task Force* in 1980 by President Carter.⁵

The Middle East

The demonstrated endemic political and strategic instability of the Persian Gulf region itself, regardless of Soviet intentions, was, at least in the public eye, an even more important consideration in viewing oil imports as a

5. Joseph J. Romm, *Defining National Security*, Council on Foreign Relations, 1993, p. 39

potential security risk. By now, the U.S. public has experienced the impact of three Middle East oil disruptions (1973, 1979-80 and 1990), each of a different nature, all causing oil price shocks and, in the first two instances, sporadic consumer shortages, caused more by dislocations and inventory hoarding than physical shortages. We have also seen in 1990-91 the biggest U.S. foreign military action since the Vietnam war, due in large part to the oil component of the Iraqi invasion of Kuwait. It has been said, incorrectly, that our oil import dependency forced us to take this action.

The questions that will be addressed here are (1) could we have avoided or mitigated the impact of the past oil disruptions under a different national oil or energy policy; and (2) should we now adopt a more pro-active energy policy to reduce future oil import dependency because of its perceived national security risk?

IMPORTS PAST AND PRESENT

To start the discussion, there is general agreement that at approximately the same price, a barrel of domestic oil is preferable to a barrel of imported oil; it helps the domestic economy and improves our foreign trade balance, both of which are calculable positive economic factors. However, this *commercial* aspect of oil imports does not carry over into U.S. *national security*, as will be discussed below.

The Military Externality Argument

The advocates of a policy to reduce imports as a national security measure argue that the cost of such a measure (presumably higher prices brought about by an import fee) would be a fraction of the supposed "externalities" of oil imports, i.e., the external costs of protecting access to certain foreign supply sources, primarily the Middle East. According to one recent estimate in *Foreign Affairs*, "Even before Iraq invaded Kuwait, U.S. forces earmarked for Gulf deployment were costing tax payers \$50 billion yearly—nearly \$110 per barrel of oil imported from the Persian Gulf."⁶ This is a highly questionable estimate, not only of the amount but also of the concept on which it is based. Suppose commercial conditions caused half of these imports to be shifted to other areas. Would that double the military cost per barrel of Persian Gulf oil? Or would our military forces in the region be cut in half? Or would they be doubled if our Middle East imports doubled? Of course not.

6. Amory B. Lovins and Joseph J. Romm, "Fueling a Competitive Economy," *Foreign Affairs*, Winter 1992/93, p. 47.

There is no direct relationship between the deployment of U.S. forces in the Middle East and our importation of Middle East oil. These forces were deployed there as part of our Cold War global strategy, just as they were deployed in Europe and the Far East. Commercial trade patterns clearly did not determine these deployment patterns. No doubt, the fact that the Middle East is the *world's* principal oil supply source played a role in locating some of our forces there. But this would have been so regardless of our own oil imports from the region. The one time we did have substantial military expenditures in the region, during Operations Desert Shield and Desert Storm in 1990-91, we were fully reimbursed by our allies, principally Saudi Arabia. This, incidentally, is a clear indication that these operations were international in scope and not related to our level of Middle East oil imports. In fact, our current role in the Middle East is primarily a function of our now singular superpower status, not our oil import dependency. Thus, a significantly lower import dependency in 1990 would probably not have changed our decision to use military action to drive Saddam Hussein's army out of Kuwait, since the vast increase in Iraq's oil wealth, if the international community had accepted the annexation of Kuwait, would have made Iraq the region's economic and military superpower including nuclear weapons, forcing Saudi Arabia, if it survived, to let Baghdad dictate its oil policy.⁷

The Conservation Argument

The argument has also been made that the national security would be served by a reduction in oil *consumption* which would at the same time have a positive impact on the environment. The advocates for this policy often conjure up images of "gas guzzler," "profligate" or "wasteful" use of oil to support their argument. These images make snappy editorials but they are not good economics. U.S. oil consumers over time have acted quite rationally in response to price signals. From 1953 to 1973 when oil prices were low by any standard of measurement and were declining in real terms, U.S. oil consumption grew by 128%, or nearly 10 million b/d. But in 1993 consumption was no higher than in 1973, about 17.3 million b/d.⁸ Yet the U.S. economy grew by 58% from 1973 to 1993.

Clearly, the energy efficiency of oil has improved dramatically since the first oil price shock at the end of 1973. Government legislation has played a role in it, principally through mandated improvements in automotive fuel

7. See George Horwich, Chapter 3, p. 27, in *International Issues in Energy Policy, Development & Economics*. Westview Press, 1992

8. If we take the average of the latest 3 years (1991-93) and compare it with the average of the 3 years 1971-73 the growth would be 5% for the 20-year period.

efficiency standards. So has new technology. However, the principal reason was consumer response to the price changes. This becomes clear when we examine the price and demand movements within this 20-year period. From 1973 to 1983, the period of the historic OPEC price explosions, U.S. demand fell by about 2 million b/d. From 1983 to 1993 when prices declined, then collapsed and generally remained low, demand rose by about 2 million b/d. Thus, the market functioned in response to the price signals.

It is of course true that the foreign oil price explosions of 1973 and 1979-80 caused substantial temporary economic dislocations in the U.S. through inflation and were partly responsible for the economic recessions of 1974-75 and 1982. However, any attempt by the government to reduce the level of oil imports through a pro-active policy in the post-1973 period would probably have had very meager results at substantial costs to the economy.

How Much Is Too Much?

The question is often asked at what level oil import dependency becomes excessive. There is no right answer to this question, either in terms of economics or national security. However, the figure of 50% is often cited as the tolerable upper limit of import dependency and several bills have been introduced in Congress to require some action, or at least an inquiry, if half or more of our oil is imported. The highest annual level ever reached was 46% of total demand in 1977. Net imports dropped to 27% by 1985, and then rose to last year's (1993) ratio of 43%. About half of the increase in imports since 1985 is due to rising demand, the other half to falling domestic production (see Figure 2).

How does our import dependency compare with that of other industrial countries? As Figure 3 shows, in many major industrial countries oil import dependency is close to 100%. Even with its substantial North Sea production, OECD Europe depended on imports from outside the continent for nearly 60% of its 13.6 million b/d consumption in 1993. Yet, there is no evidence, or public concern, that this level of import dependency is excessive and threatens to impair these countries' national security or weaken their economies. All of them have emergency provisions to deal with supply disruptions and they all belong to the International Energy Agency (IEA), one of whose main functions is to coordinate the OECD countries' response to international energy supply disruptions. But none have provisions, or announced plans to reduce their oil import dependency structurally for security reasons.

Another point to be made in comparing the U.S. with countries which rely for most of their oil supplies on imports is that in 1973-80, the impact of the price rise on the U.S. economy was greatly mitigated by domestic oil price controls which kept over half of U.S. oil supplies well below the world price.

Figure 2. Petroleum Supply and Import Dependency

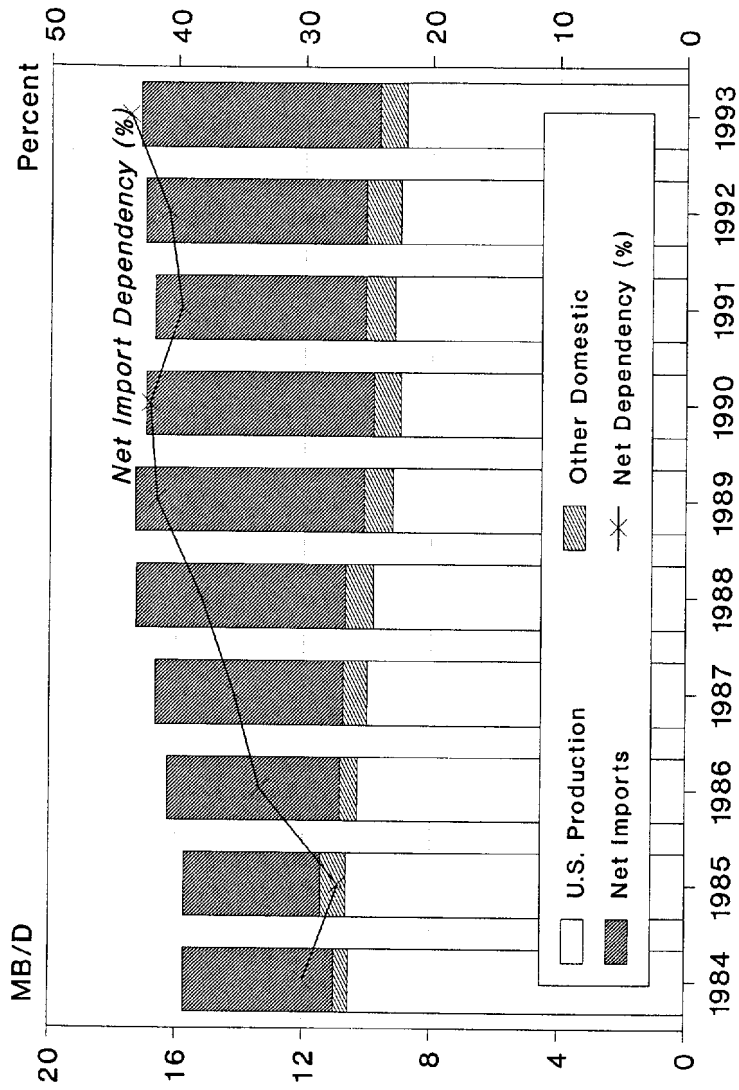
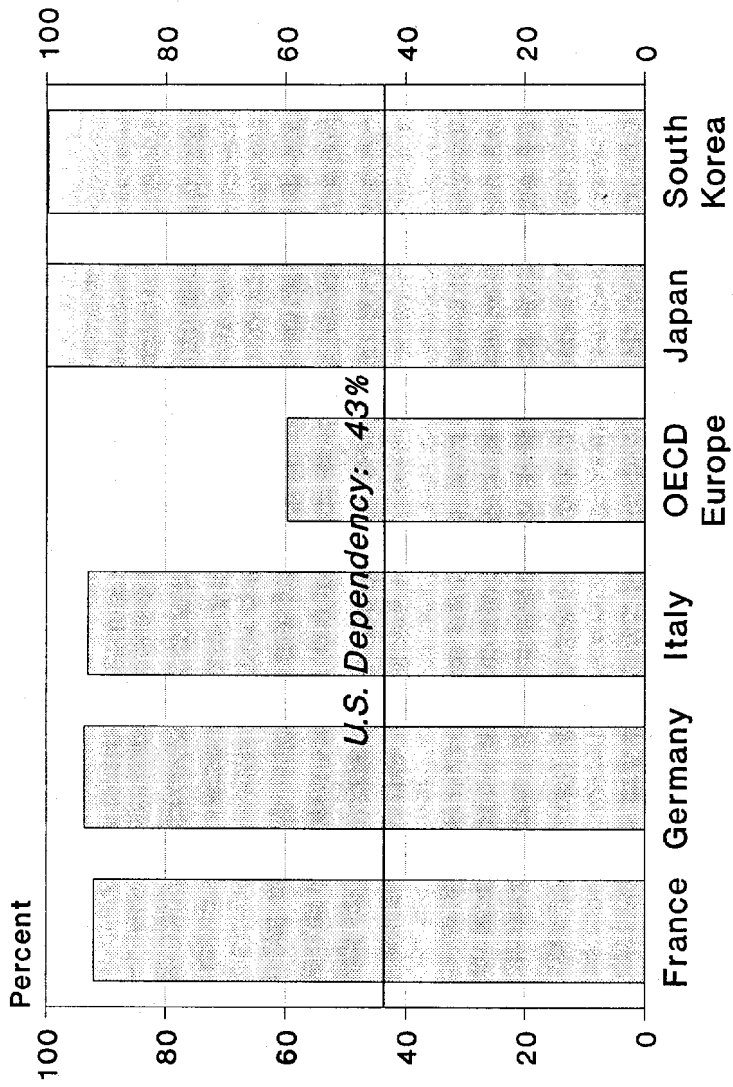


Figure 3. Net Petroleum Import Dependency, 1993



During the Persian Gulf Crisis in 1990, prices remained uncontrolled which meant that only \$8 billion of the \$21 billion oil price increase went to foreign suppliers.⁹ This gave the U.S. a significant economic advantage relative to other oil importers. But it did not affect our national security.

The Producers' Fear: Cheap Foreign Oil

Thus, the U.S.'s long-term concern, not to say fixation, with the "dangers" of oil import dependency is unique among the industrial nations. An explanation for this different approach can probably be found in the different history of oil imports. As pointed out, the U.S. was largely self-sufficient in oil from the end of World War II until the early 1960s. Even by 1970, nearly 80% of U.S. oil supplies were still domestic. Furthermore, prior to 1970, the U.S. always had spare producing capacity which could be quickly mobilized to deal with any shortfall in imports. Thus, except during the period 1974-85, the U.S. oil import debate has always evolved around the question of domestic vs. foreign supplies. For U.S. producers, it was primarily an economic problem; they were afraid that "cheaper" foreign supplies would shut in some of their production or at least reduce their ability to develop new domestic reserves. The 10% drop in world oil prices in 1993 to \$18.40¹⁰ and the further drop to \$16 in the first half of 1994 contributed to rekindling the oil import debate. But the debate does not stop at the economic impact of low prices on domestic supply, but nearly always moves into the presumed *national security consequence* of the economic impact.

Actually, a government policy of providing additional support to domestic producers, probably in the form of tax incentives and royalty reductions would probably be *economically* in the national interest through its contribution to wages, tax payments, etc. Over time such a policy might not cause a reduction in government revenue if it keeps production higher than would otherwise be the case. However, if we recall that Lower-48 production did not increase, but just remained flat, during the historically high price period 1974-85, despite the vastly increased drilling, and that the drop in Alaskan production since 1989 is due primarily to a predicted resource decline—not depressed prices—it is clear that no such measure can be expected to reverse, or even halt, the growth trend in U.S. oil imports. However, it could slow it down which would be a positive economic factor.

9. U.S. General Accounting Office, Transition Series, *Energy Issues*, December 1992, p. 8. The amounts are for the period Aug. 1 - Dec. 1.

10. WTI at Cushing.

Source is Irrelevant

Since the Middle East is widely perceived as the world's least stable oil exporting region, our dependency on Middle East imports has become a key factor in the oil import-national security debate. In 1989, the last full "normal" year before the Gulf War, 23 % of our imports come from that region. In 1992, the share had dropped slightly, and in 1993 it had dropped further to around 21 %. It is apparently dropping again in 1994. Import reduction advocates can be expected to view this as a move in the right direction, but are concerned that it may reverse itself.

Actually, the share of Middle East imports is irrelevant as a national security consideration. There is a single world oil export market with a single oil export price (after allowing for quality and freight differentials). Any disruption anywhere in this market large enough to affect world supplies causes the oil price to rise globally, including domestic crude oil prices.

Thus, the disruption of oil exports from Iraq and Kuwait in August 1990 caused as much of a price increase in the U.S.—which at the time relied for only 9 % of its oil imports, or 5 % of its total oil supplies, on these two supply sources—as it did in Japan or Germany where the reliance on these two supply sources was several times higher. The impact of a Middle East, or any other, oil supply disruption on any oil importer depends on the magnitude of the disruption relative to total world exports, and not on the extent to which a specific importer relies on the disrupted supply source. If the U.S. alone were to adopt a policy to reduce imports as a security measure, it would have to bear all the costs of such a policy, while other importers would benefit from it because more oil would be available to them, normally and during a disruption.

There is one partial special exception for the U.S. to this inherent disruption risk in import dependence: imports from *Canada*, our 2nd largest foreign supplier, which accounted for 13.5 % of total imports in 1993. Canada has no export outlet other than the U.S. and all Canadian crude is shipped to the U.S. by pipeline integrated into the U.S. supply system. Furthermore, under the NAFTA agreement, as well as an earlier U.S.-Canada treaty, oil shipments to the U.S. must be fully maintained in an emergency unless Canadian internal consumption is also reduced. Thus, during a disruption, Canadian oil imports would be more secure than other U.S. imports. Excluding Canada, U.S. oil import dependency was about 36-37 % in 1993.

THE FUTURE OF U.S. OIL IMPORTS

Looking ahead to 2005, we find there is general agreement among forecasters that U.S. oil imports will grow between now and then. The dual reasons are an increase in demand and a continuing decline in domestic

production. As shown in Figure 4, the Energy Information Administration's latest forecast Reference Case shows the net import volume to exceed 12 million b/d, or 60% of U.S. oil supplies, by 2005.¹¹ Excluding Canadian shipments, import dependency would be 52-53%.

This ratio would be just about as tolerable and workable as the current one, and would still keep the U.S. at a much lower level of import dependency than most other industrial countries. Any effective action to significantly reduce this import level would be quite costly to U.S. oil consumers and, hence, to the U.S. economy. Who benefits? The argument has been made that we must maintain a strong domestic oil producing industry. This is valid but it does not have to take the form of raising prices by restricting imports thereby causing substantial transfers of payments from the major oil consuming regions to the oil producing regions of the U.S., and benefitting certain domestic industries at the expense of others. Aside from its questionable justification, we have seen from past debates that such action may not be politically attainable in the U.S., where consuming states have more votes than producing states.

What Are the Real Risks?

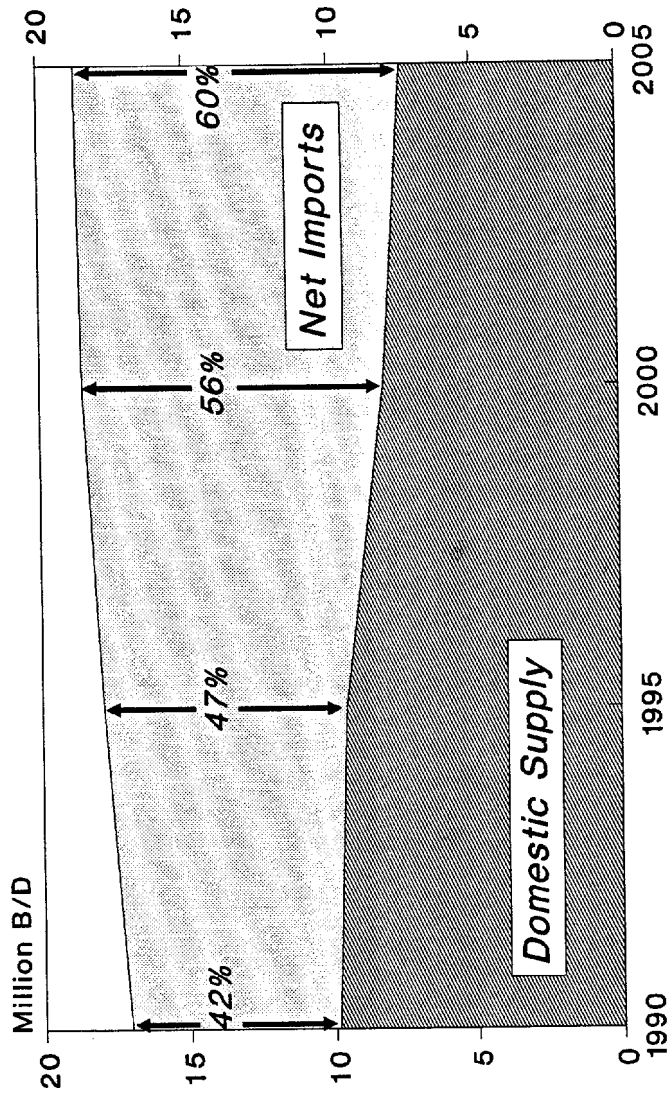
Thus, rather than endlessly debating a "national energy policy," which is supposed to reduce oil import dependency, we ought to ask the question, what is the real national security risk of our import dependency in the new post-Cold War world, and does the risk rise with the dependency level?

The risk of Middle East oil becoming a pawn in the East-West contest has of course ended with the Cold War. It had been considered a real threat during the Cold War period because of the high reliance of most industrial countries on Middle East oil imports for economic and military purposes. However, because of a publicly proclaimed Western sensitivity to any perceived Soviet threat against Middle East oil, Russia was careful to avoid any appearance of preparing to control this resource, so as not to escalate the Cold War.¹² It is even possible that had the Soviet Union's international position not declined as much by mid-1990, it could have dissuaded Iraq from attacking Kuwait.

11. Energy Information Administration, *Annual Energy Outlook 1994*, DOE/EIA-0383(94), January 1994.

12. In January 1980 President Carter issued what has become known as the "Carter Doctrine" in which he made it clear that "any attempt by any outside force to gain control of the Persian Gulf Region will be regarded as an assault on the vital interests of the U.S. ..." Quoted in Daniel Yergin, *The Prize*, Simon & Schuster, 1991, p. 702.

Figure 4. Domestic Supply and Net Imports to 2005



Future disruptions, if any, will likely come mainly out of local conflicts. They could still be large but they will be limited in scope and duration. It should be pointed out in this connection that the only time Middle East oil has been used as a political weapon by its *exporters* was the Arab oil embargo of 1973-74 which lasted for about four months without achieving its political goal. Since then all uses of oil exports as a political weapon have come from *importing* countries, principally the U.S. which has a restriction on oil imports from Iran, and a total ban on imports from Libya, and by the U.N., which has sanctions on nearly all Iraqi oil exports.

Given the urgent financial requirements of all oil exporters it is unlikely that a major oil exporter would deny supplies to the U.S. for political or other non-commercial reasons. Furthermore, given the efficiency of worldwide oil markets, the old model of a targeted embargo will not work. Today's market does not permit a seller to zero-in on a targeted purchaser, but responds with a higher market price to allocate the reduced supply among all purchasers. Thus, the impact of a destination restriction coupled with a production cutback would be a globally higher price. It would not have a worse impact on its intended target and could hurt the exporter more than its targeted customer. In addition, if necessary, the IEA would become involved in correcting any producer-imposed imbalance among importers.

From a historical perspective these occasional future disruptions may not appear significant. But at the time of their occurrence their impact on major importers such as the U.S. could be severe. Thus, the national interest requires the ability to offset the loss of imports for these limited periods, not only for domestic economic reasons but even more to give the U.S. the freedom to act during such a disruption, or when one is threatened, without being hamstrung by short-term oil supply considerations.

Our Strategic Petroleum Reserve (SPR) program has been created for precisely this purpose. Its publicly announced availability at the outbreak of allied military action in the Gulf in January 1991 was a commercially minor, but psychologically significant, factor in causing the historic price collapse at the time. Its contribution did not come from the volume used, which was very small, but from the fact that the Secretary of Energy had declared publicly that if and when military operations started the SPR would be made available. Had the SPR been made available in the early part of the Gulf crisis, prices might never have reached the high levels of October-November 1990.¹³

As Prof. Henry Lee, Director of Harvard University's Environment and National Resources program recently pointed out, "The world oil market runs on expectations. The objective here (the SPR) is to avoid an economic crisis, not

13. George Horwich, *op. cit.* pp. 26, 32.

replace lost oil."¹⁴ What should our SPR policy be? Obviously, our first priority must be to repair the system's draw-down rate which has been severely reduced by problems associated with the build-up of heat and gas in the stored oil. According to a recent report by the U.S. General Accounting Office (GAO)¹⁵ about two-thirds of the SPR's total stored oil of 592 million bbls is affected by this deterioration. The cost of the repair is estimated at about \$64 million. This is a small fraction of the price benefits a fully useable SPR could provide in case of another international supply disruption.

Whether the SPR should then be filled to its 750 million bbls capacity for which the infrastructure is already in place should be decided after the 2-3 year restoration and repair program is completed.

There are still other measures that could be taken, both to encourage domestic production and diversification of foreign supply sources. But in evaluating the diversification of U.S. oil import sources to 2005, several paramount, immutable factors regarding Middle East oil must be kept in mind:

- The Middle East contains two-thirds of the world's proven oil reserves, but accounts for only 30% of current world production.
- The region's reserve/production ratio is 100 years, compared to 20 years for the rest of the world.
- Middle East oil has the world's lowest development and production cost.
- All Middle East producers are under strong domestic political and economic pressure to increase their national income by exporting more oil.

The sum total of these factors is that the volume and share of Middle East oil exports will keep rising well into the next century. As the world's largest oil importer the U.S. will inevitably be affected by this trend regardless of its own level of imports from that region.

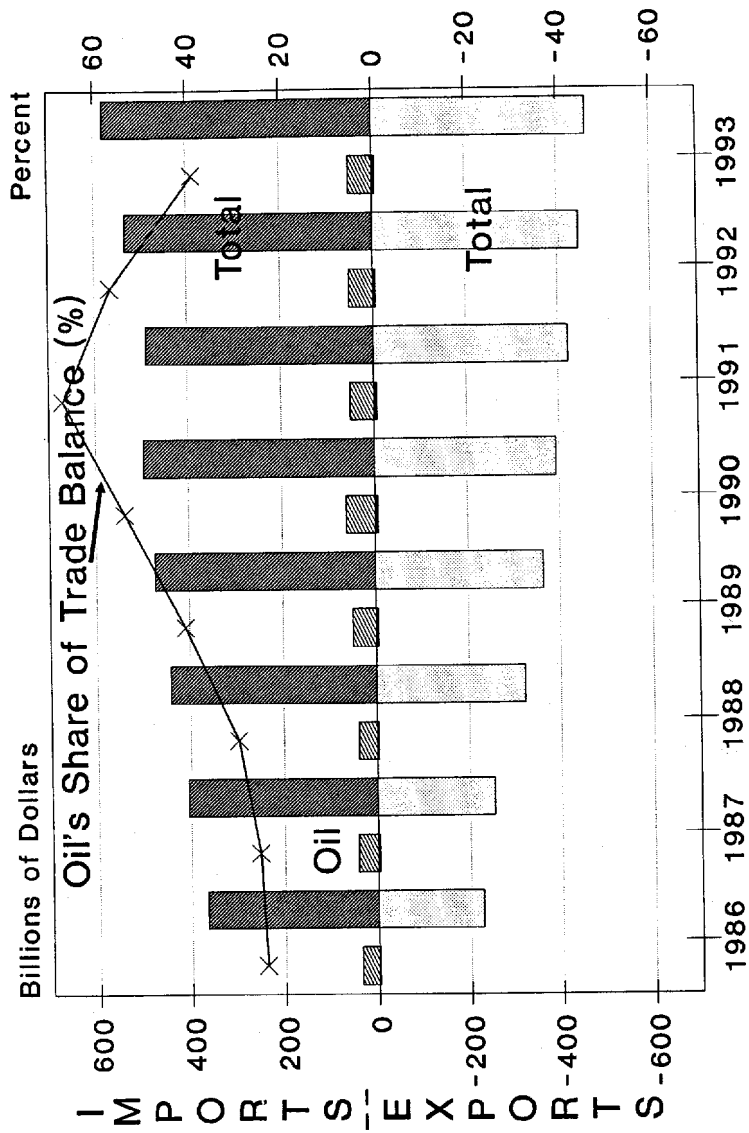
The Balance of Payments Debate

The subject of this article is the national security aspects of U.S. oil imports. But as President Nixon said when addressing the first inter-governmental Washington Energy Conference in 1974, "Security and economics

14. *Bloomberg Oil Buyers' Guide*, May 2, 1994, p.3.

15. quoted in *Oil Daily*, Washington, D.C. Sept. 12, 1994, p.3.

Figure 5. Oil in the Trade Balance



are inevitably linked and energy can not be separated from either."¹⁶ I would therefore like to end this article with a brief comment on the balance of trade aspect of U.S. oil imports, which is, of course, an *economic* issue.

The trade balance argument for reducing oil imports is a close second to the national security argument in public debate. It is based on the assertion that net oil imports are the largest item in our national trade deficit. While this has intermittently been true, oil's share in the trade balance has actually declined substantially in the last several years: from 66% in 1991 to 53% in 1992 and 39% in 1993 (see Figure 5). Yet, the dollar amount of our net oil imports has increased slightly during this period. The reason for the declining share was a substantial increase in net non-oil imports in both 1992 and 1993.

Thus, the increase in our trade deficit in the last two years is clearly not due to oil imports. Probably oil's share in the trade deficit will decline again in 1994. Since oil's changing share in our trade balance can be entirely a function of changes in the imports and exports of other commodities, it is not a meaningful measure of oil's role in our foreign trade.

A few other pertinent facts: the value of our net oil imports last year (\$44.8 billion) was almost the same as our net automotive imports, and last year's U.S. trade deficit with OPEC (\$12 billion) was about one-fifth of our trade deficit with Japan. Thus, from a balance of payments point of view, any argument for reducing oil imports applies equally to most other imported commodities.

CONCLUSIONS

The purpose of this article is not to denigrate or ignore the relationship between oil imports and national security. It is essential for a modern industrial nation to have adequate supplies of a vital commodity such as oil which must be continuously replenished. But in the present world order there is no reason to assume that international oil supplies will not be available on an ongoing basis. Supplies are plentiful for the foreseeable future and most oil exporters are urgently in need of growing export revenues. The international oil trade is therefore becoming increasingly interdependent. In the decade since 1983, we have witnessed a sea of change in this direction which is still continuing.

Supply disruptions of a political or military nature will still occur. But they are likely to be limited both in duration and volume. Therefore, our oil import policy should be designed to deal with sporadic disruptions while accepting growing long-term dependence on imported oil. A policy to reduce oil imports permanently, as a national security measure, would be excessive and unjustifiably expensive. Hence, it would not be in the national interest.

16. Henry Kissinger, *The Years of Upheaval*, Little, Brown & Co. 1982, p. 916.

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PART IX

Conclusions

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