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The Myth of the Iranian Oil Weapon

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1. Introduction

Every now and then, an Iranian official makes a statement to the effect that the Islamic Republic would not rule out using the oil weapon if the UN imposes sanctions on Iran or if the United States decides to carry out military strikes against its nuclear sites. In August 2006, Ali Larijani, the country's chief nuclear negotiator, announced that if the West imposes sanctions on Iran, then the Islamic Republic "will react in a way that would be painful for them (the West)". He then warned that the West should "not force us (Iranians) to do something that will make people shiver in the cold...we (Iranians) do not want to use the oil weapon. It is them (the West) who would impose it upon us."¹ Last month, Iran's OPEC governor, Hossein Kazempour Ardebili, made a similar statement declaring that "when the Americans say that military action in regard to the nuclear issue has not been put aside, Iran can also say that it will not put aside oil as a tool".²

Although Iran has many tools for deterrence or retaliation at its disposal, contrary to what many analysts believe, the oil weapon is not one of them. Many observers argue that importing countries' double dependence on oil and stable oil prices implies that Iran possesses a very powerful weapon with which it can 'blackmail' oil-importing governments to obtain political concessions. This argument lacks an understanding of the nature of the oil market. In fact, the oil weapon can prove costly for the country using it and restricting oil exports would most often be ineffective and counterproductive in the longer term.

2. The Oil Weapon

To begin with, the oil weapon cannot be targeted against a specific country or group of countries. This is due to the nature of the market where oil is easily and widely traded. Countries that are not blacklisted can obtain oil and then redirect it to countries under the embargo. Adelman (2004) makes this point forcefully where he argues that "whether a supplier loves or hates a customer (or vice versa) does not matter because, in the world oil market, a seller cannot isolate any customer and a buyer cannot isolate any supplier. But conventional wisdom... is that Middle Eastern nations wield an "oil weapon" that they can use to punish the United States or any other nation."³

For the oil embargo to be effective, it should result in the cutback of total global oil supplies. If the loss of oil due to Iran's embargo is counteracted by increases in

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supplies from somewhere else, the embargo would still have impact on oil prices but the impact would be short-lived. In this case, the embargo would only benefit other producers that have spare capacity to fill the shortfall. Thus, the effectiveness of an oil weapon depends to a large extent on whether market conditions are tight and the ability of Iran to convince or pressure other producers to also implement supply reductions. Regarding the latter, it is very difficult to envisage a scenario in which other major Middle Eastern producers such as Saudi Arabia, UAE, or Kuwait would agree to implement cuts along with Iran. Disagreement on oil embargos and exports cuts is the norm rather than the exception. In fact, it only occurred once, in 1973, when a large group of Arab producers decided to cut exports to countries “committing aggression or participating in aggression of sovereignty of any Arab state or its territories”.⁴ Given the uneasiness of Gulf States about Iran’s nuclear ambitions and the alliance in ‘need’ between US and GCC states, it is unlikely that any of the Arab oil exporters would participate in an oil embargo against the US. Thus, any cuts would have to be implemented by Iran alone.

In fact, if anything, Saudi Arabia may attempt to fill any shortfall from Iran’s cutback to mitigate the long-term impact of supply cuts on oil markets. Voluntary restrictions that result in sharp increases in oil prices depress demand and push consuming nations to pursue oil substitution policies undermining oil exporters’ long term interests manifested in healthy growth of global oil demand. As Leonardo Maugeri argues, “an oil shock can be a terrible experience for the industrial countries, but is not a fatal blow. As soon as they perceive the long term nature of such a shock they react, and their reaction can turn into a permanent nightmare for any producers. Any structural reaction implies not only reduction in demand, but also much more money devoted to research and development of alternative sources of energy or investment in new oil producing countries”(p.262-63).⁵

According to the latest International Energy Agency Monthly Oil Market Report, Saudi Arabia's spare capacity stood at 2.20 million barrels per day (b/d) which could cover all Iranian exports currently estimated at between 2 million and 2.5 million b/d.⁶ However, Saudi Arabia may not wish to be seen helping the US in attacking yet another Muslim country and may feel wary of the anger this may cause in some parts of the Muslim world and with its Shi’a population. Given these competing pressures, it is very difficult to predict whether Saudi Arabia would swing its production to meet any shortfall in Iran’s oil supplies. Most likely, Saudi Arabia would increase its oil exports but it would do it discretely so not to raise any opposition.

Like any oil exporter, Iran is highly dependent on oil revenues and hence cannot support production cutbacks for a sustained period. Oil accounts for 85 percent of Iran's exports and makes up 65 percent of government revenues which are used to pay for public-sector wages and to subsidize gasoline prices. That being said, a successful use of the oil weapon can raise prices to such levels that the loss due to the decline in production is compensated by the rise in total revenues. The ‘dependency on revenues’ argument for not using the oil weapon holds only if the country stops exporting oil altogether, which may be needed in the current case for the cutback to have a serious and sustained impact on oil markets. Reducing exports by a couple of hundred thousand of barrels a day would easily be counteracted by OPEC’s spare capacity and OECD strategic reserves.

Assuming that Iran decides to implement large cuts and the loss of oil supplies is not counteracted by increases from other oil exporters, the use of oil weapon has an additional serious drawback. It is indiscriminate in the sense that it does not distinguish between a friend and a foe. Currently, Iran sells substantial amounts of crude oil to China and India and a shortfall in oil supplies would alienate these key Asian importers. Furthermore, a successful use of the oil weapon would lead to a sharp rise in oil prices which would have an adverse impact on all countries regardless whether of they are rich or poor, friend or foe. It is always possible to devise schemes to compensate friendly regimes, but these schemes are difficult to implement in practice.

3. The Closure of Oil Trade Routes

The use of the oil weapon can also take the form of closing oil trade routes. The bulk of oil is transported using a maritime tanker fleet. More than 1.9 billion tons of petroleum products a year are shipped by maritime transportation constituting around 62% of all petroleum products. The remainder is transported using pipelines (38%) or trains and trucks but usually over small distances.⁷ International oil shipping lanes are forced to go through chokepoints. These are defined as locations “that limit the capacity of circulation and cannot be easily bypassed, if at all. This implies that any alternative to chokepoints involves a level of detour or use of an alternative that translated into significant financial costs and delays”.⁸ These chokepoints have certain physical characteristics such as width and depth of shipping lanes which make them vulnerable to blockades at least for a short period of time.

The Straits of Hormuz and Straits of Malacca constitute the world's most important oil chokepoint; close to 30 million b/d flow through these chokepoints. Oil tankers can avoid the Straits of Malacca but only at very high cost and longer journey times. It is virtually impossible nowadays to divert oil transit away from the Straits of Hormuz. The only significant outlet is the Saudi pipeline to Yanbu on the Red Sea, but this pipeline can only handle around 4.8 million b/d. Thus, the closure of the Straits of Hormuz represents the ultimate nightmare for the oil market as this chokepoint links the Persian Gulf oilfields to the rest of the world.

Many believe that the narrowness of shipping lanes and the difficulty of oil tankers to manoeuvre make the Straits of Hormuz vulnerable to politically motivated disruptions. History however suggests otherwise. In 1983, the Iranians threatened to close the Straits of Hormuz following the delivery of French planes to Iraq. In a radio announcement, Hashimi Rafsanjani, then Speaker of Parliament, threatened that Iran would block the Straits of Hormuz by sinking a VLCC at the mouth of the Persian Gulf.⁹ There were 554 attacks on oil tankers in the Straits of Hormuz in what was known as the Iraq-Iran ‘Tanker War’ which resulted in the deaths of 400 sailors and 400 wounded. Yet these attacks never caused a full blockage of transit. Even when the fight was at its most intense point, it did not disrupt more than 2 percent of ships passing through the Persian Gulf.¹⁰

In the current confrontations between the US and Iran on the latter’s nuclear program, threats to block the straits of Hormuz are being made again. In 2006, the Iranian deputy Basij commander, General Majid Mir Ahmadi, threatened to block oil traffic if

the West hurt Iran's economy over its nuclear program. He declared that "given Iran's authority over the Strait of Hormuz that is the passage for more than 40 percent of the world's energy, we have become so strong that the economy and energy security of the world is in hands of Iran".

It is, however, very difficult to envisage a scenario in which the Straits of Hormuz would be blocked for a long period of time. To begin with, blocking the Straits of Hormuz would defy international conventions and would increase Iran's isolation. The closure of this oil transit route would alienate Iran's allies in Asia and elsewhere as the adverse impacts of the blockade would spread across the globe. In other words, the use of this 'weapon' would be completely indiscriminate, and if Iran attempts to block international shipping, it will face a very wide and powerful coalition against it.

Blocking maritime activity also means that Iran would have to stop importing much needed petroleum products. Although it is one of the biggest crude oil producers in the world, Iran does not have enough refining capacity to convert crude oil into gasoline and hence the Islamic Republic has to import about 40 percent of its gasoline to satisfy domestic consumption costing the government around \$5 billion a year.¹¹ Sustained shortages of gasoline and rationing may induce social unrest and may pose a serious threat to the Mullah regime. Recent events paint a picture of what the current regime could face in the case of a blockade. The government's decision last month to ration monthly fuel allotments and increase gasoline prices at the pump triggered violent protest and riots in Iran's major cities.¹² It took the heavy hand of the security forces and the Basij militia to suppress the riots.¹³

Furthermore, there are doubts about whether Iran can physically block the Straits of Hormuz. In this respect, there are four possible ways of blockage: by placing military artillery on one of the islands located near the shipping channels; by using mines; by sinking vessels in the shipping channel; and by imposing a naval blockade.¹⁴ Shazly (1998) and Blair and Lieberthal (2007) assess these possible ways and conclude that none of these is militarily feasible. Artilleries on islands can be destroyed by waves of air strikes. Given the Straits currents and depth, mines can be removed with little difficulty by minesweeping operations. Furthermore, oil tankers are not as vulnerable as is commonly perceived. During the Iran-Iraq war many oil tankers went through mines without suffering any serious damage. Sinking modern oil tankers by mines and conventional warheads to block the Straits of Hormuz is very difficult and would require large missile stockpiles which a small naval power cannot maintain. As Blair and Lieberthal (2007:10) point out "in order to disable a modern-day tanker, an attack would have to include a salvo of eight to ten missiles with conventional warheads; a sustained campaign would quickly exhaust the missile stockpile of a medium-sized military power". Iran could resort to non-traditional offensive operations such as the use of explosive-packed "super-modern flying boats" piloted by suicide bombers or suicide planes. Although such actions can adversely affect maritime activity, the damages caused would likely be limited, and could not be sustained for a long time and would not lead to a full blockade of the Straits. Finally, Iran does not have a strong enough navy to enforce a blockade. The Iranian Navy would easily be defeated and neutralized by the strong US Fifth Fleet roaming the Persian Gulf.

Thus, only very extreme conditions would push Iran to use this ‘suicidal’ weapon and even then it may not succeed in achieving its objective of disrupting oil supplies. The above discussion does not imply that US military attacks on Iran will not have any impact on oil markets. On the contrary, if the US decides to attack Iran’s nuclear sites, the flow of oil would be disrupted, as oil tankers would avoid passing through the Straits of Hormuz during the military strikes. Iran’s production would most likely halt. This would likely cause panic in the oil market as countries would compete for oil access causing oil prices to overshoot to very high levels. The impact of this disruption by military action, which should not be confused with the use of the oil weapon, would be temporary and its effects could be mitigated by the use of OECD strategic and industrial reserves, which at the end of April stood at 1236 million barrels providing a forward cover of 54 days. The oil weapon may come into effect after attacks if Iran retaliated by cutting its oil exports. The impact of such a move would depend on the size of the cut and whether the shortfall is counteracted by the use of strategic reserves and/or Saudi Arabia’s spare capacity.

4. Iran’s strongest Tools lie Somewhere else

Thus, there are serious costs and risks associated with the use of the oil weapon. It is not always effective; it is indiscriminate; and it cannot be sustained for a long period of time. It is certainly not one of Iran’s strongest tools with which to confront the US. The strongest tools that Iran possesses, but which it cannot publicise, consist of very capable clandestine networks throughout the region through which it can launch deadly attacks against US and British forces in Iraq, Afghanistan, and in the Gulf. Furthermore, through its influence on client militia in Lebanon and Palestine and close alliance with Syria, Iran can also undermine stability in that part of the Middle East. Iran may respond to US attacks by inciting local rebellions among Shiite Muslim communities in the Gulf. Saudi Arabia whose Shiites population forms a local majority in the oil-rich Eastern Province could be one target. Another target could be the Island of Bahrain where the Shiites constitute the majority of the population.

Iran is already using some of these tactics in its fight against the US and would continue to use them with more severity if the US decides to attack Iran’s nuclear sites. Unlike the oil weapon, this strategy has many advantages: it can be targeted against US and British forces i.e. it is not indiscriminate; it is effective in discrediting US policy and can induce a certain momentum that may eventually force a full US military withdrawal from Iraq; and it can be sustained for a very long period of time. However, in contrast to the oil weapon, Iran cannot publicly endorse the use of such tactics without losing international and regional support. Indeed, Iran’s official position has been to deny the use of such tactics. Just recently, the Iranian Supreme Leader Ayatullah Ali Khamenei refuted accusations that Iran is interfering in Iraq, Lebanon, Palestine and Afghanistan placing such accusations in the context of an attempt by Washington to hide and shift responsibility for its drastic failures in the region.¹⁵ It seems that Iran has created a novel approach in international relations: publicise its weakest weapon (oil) and keep silent and even deny its strongest and most effective tools. But in doing so, Iran has managed to highly politicize the issue of oil supplies at times when the oil market could benefit from some tranquillity.

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¹ Simon Tisdall "Iran threatens to use 'oil weapon' in nuclear standoff", *The Guardian*, August 7, 2006.

² "Iran says won't rule out using oil as a weapon", Reuters, June 19, 2007.

³ M.A. Adelman, "The Real Oil Problem", *Regulation*, Spring 2004.

⁴ See Stephen J. Randall, *United States Foreign Oil Policy since World War I*. McGill Queen's University Press, 2005.

⁵ Leonardo Maugeri. *The Age of Oil: The Mythology, History, and Future of the World's Most Controversial Resource*. Praeger Publishers (May 30, 2006)

⁶ This counter-response however is not perfect as the rise in Saudi Arabia's production will reduce the spare capacity in the system. This would push prices upward as market participants increase their demand for precautionary inventories and as speculation rises.

⁷ For details see Jean-Paul Rodrigue, "Straits, Passages and Chokepoints: A Maritime Geostrategy of Petroleum Distribution", *Les Cahiers de Géographie du Québec*, Vol. 48, No. 135, 2004, 357-374.

⁸ *Ibid*, p. 359.

⁹ For more details see Nadia El-Sayed El-Shazly, "The Gulf Tanker War: Iran and Iraq's Maritime Swordplay". Palgrave Macmillan, 1998.

¹⁰ See D. Blair and K. Lieberthal, "Smooth Sailing: The World's Shipping Lanes Are Safe", *Foreign Affairs*, May/June, 2007.

¹¹ Nazila Fathi and Jad Mouawad "Unrest grows amid gas rationing in Iran" *The New York Times*, June 29, 2007.

¹² "Protesters torch Iran gas stations", CNN website, June 28, 2007.

¹³ It is interesting to note that just after these events, US Representative Mark Kirk (Republican-Illinois) and Representative Rob Andrews (Democrat-New Jersey) introduced a legislation that aims to broaden sanctions against Iran to include companies that export gasoline to Iran. They declared that "as Iran continues to defy the UN Security Council and International Atomic Energy Agency, we need to explore new economic sanctions to augment our diplomacy. Legislation targeting gasoline imports offers the best way for IAEA safeguards to succeed". Platts, Website, accessed 29 June, 2007.

¹⁴ See Shazly (1998), "The Gulf Tanker War", 1998.

¹⁵ Al Manar TV, 1 July, 2007.