The Road to America’s First Energy Crisis:


By Jay Hakes

The Arab oil embargo launched in October of 1973 shocked an unprepared American government, jolted the nation’s driving public, and by the time it ended in March of 1974 had delivered a major blow to the broader economy – historic impacts still remembered many decades later. Less well remembered is that an almost as great reduction in Arab oil production after the 1967 Six-Day War scarcely affected the American market. Why was the 1973 embargo different? The explanation requires an investigation into major trends in the six years leading up to it that made the United States increasingly vulnerable to an abrupt interruption in global oil supplies.

Three overarching factors explain America’s growing weakness: sagging domestic oil production, new policies limiting market flexibility during market disruptions, and emerging assertiveness and unity among Arab oil producers. Although the basic nature of these factors has been known for some time, additional insights can be explored based on materials released to the public only in recent years and many additional years of historical perspective. New research reveals that acts of omission and commission by senior leaders in the U.S. government helped weaken
the country’s energy posture and rapidly increase its vulnerability to the use of the “oil weapon” by Arab oil producers.

**The World’s Leading Oil Producer Loses Momentum**

The international influence of the United States in 1967 was bolstered by its position as the world’s largest oil producer. A quarter of the world’s crude oil at that time originated in the United States, and year after year its output continued to rise. Moreover, American-based multinational corporations controlled much of the production elsewhere in the world. An extensive network of domestic refineries that converted crude into valuable consumer products like gasoline and heating oil also contributed to American dominance in the world oil market.

Less obvious but even more important, the oil industry in America retained the ability to increase production on short notice during times of emergency. By not producing at full capacity on the regular basis, these domestic producers were providing “surge capacity” -- a cushion that could offset shortfalls when regular production elsewhere suddenly dropped.

For the oil companies, developing capacity they did not fully use was not motivated by short-term profits. The exploration and development of wells needed to enlarge capacity were expensive. If quarterly returns were the major driver, the companies would have produced at full capacity. However, the Texas Railroad Commission and its counterpart in Louisiana required excess capacity (generally called at the time “pro-rationing”), including wells on federal lands. The original goals of the program were to promote reservoir conservation and market stability but after World War II national security also came into play. As part of a grand bargain, the companies were aided by generous tax deductions and protection from foreign competition by federal import quotas; federal and state governments expected them, in turn, to maintain stable prices and the capability to respond in case of an international fuel
shortage. U.S. policy included a commitment to protect European markets, as well as its own.

The Suez Canal crisis of 1956 and the Six-Day War vividly demonstrated the importance of American excess capacity. During these events, additional U.S. oil (along with that from Iran and Venezuela) was able to offset substantial losses of oil from the Middle East.

By the start of the presidency of Richard Nixon in 1969, slowing growth in production and raging domestic demand were eroding America’s dominant position in oil. U.S. production peaked in 1970 and then began a period of gradual decline. The reversal in the trend line seemed to confirm the views of “peak oil” analysts like noted geologist M. King Hubbert, but the decline was not solely a matter of geology. With cheaper investment opportunities abroad, oil companies diverted their capital elsewhere. A dramatically televised oil spill off Santa Barbara in 1969, moreover, made it more difficult to sustain the rapid expansion expected in offshore drilling. Vast new supplies were available in Alaska, but federal permits for an oil pipeline had not yet been approved.

In a free market, foreign imports would have replaced lagging domestic supplies. In 1970, however, President Richard Nixon overrode the recommendation of a task force headed by his Secretary of Labor George Shultz and retained long-standing quotas on foreign oil imports (albeit with occasional adjustments to the limits). Because of the specific provisions of the quotas, a virtual ban on imports of oil from the Middle East remained in place. Thus, declines in domestic production led to very tight U.S. oil markets and talk of “energy shortages,” even with production in the Middle East rising rapidly to supply markets in Europe.

Aggravating the situation, U.S. consumption of oil was surging. People were driving more, due in part to the continuing expansion of the interstate highway system. The fuel efficiency of automobiles – increasingly incorporating weight-adding features
like air conditioning – was dropping. The Clean Air Act of 1970 also contributed to the growth in oil demand for transportation, since a mandated shift to unleaded gasoline meant new cars had to install catalytic converters, which further reduced fuel economy. Because of new restrictions on pollution, a substantial portion of electricity generation was being shifted from coal to cleaner-burning oil. In all, oil demand rose by 3.8 million barrels per day (30 percent) from 1967 to 1972.6

Even with these disturbing trends, American contingency planning for interruptions in oil supplies – a staple exercise throughout the Cold War rivalry with the Soviet Union – saw some prospects for American resiliency in the event of an interruption in oil supplies. Energy experts viewed high per capita energy use as a potential asset of sorts. Considerable consumption of oil was optional as opposed to essential, suggesting it could be curtailed if needed by adjusting thermostats or cutting back on travel. Perhaps the exploding demand for energy contained opportunities for offsetting short-term breaks in supply with short-term cuts in consumption.7

But in the early 1970s, the squeeze in oil supplies was creating both economic and political problems for the White House. One casualty of the escalating pressure on oil supplies was America’s long-time excess capacity. To supply people who needed gasoline and heating oil, the country chose to give up its capacity for surge production. In December of 1970, Nixon approved the recommendation of his energy advisors to end the requirement for excess capacity on federal lands.8 At the White House, there seemed to be little discussion of the relative merits of short-term political gains from increasing domestic oil production vs. the loss of a major bulwark of national emergency preparedness, nor much recognition of a tectonic shift in American national security policy.9 The following year, the Texas Railroad Commission ended its requirements for excess capacity.10

Senior diplomats around the world failed to fully grasp the vanishing American cushion against an oil interruption, as illustrated by a State Department telegram in November of 1970 concerning conversations between American and NATO officials.
about joint emergency energy planning. The Europeans were still counting on two million barrels per day of surge capacity from the United States in their contingency plans, whereas the Americans believed the amount had fallen to only 500,000 barrels. But even the American estimate was too high. By the fall of 1973, American surge capacity was effectively zero.

Several of Nixon’s advisors advocated for an innovation that would deal with the loss of the surge capacity. The United States could build a reserve of crude oil available for interruptions in foreign oil – a functional equivalent of surge capacity. There would be a cost to build the needed infrastructure and fill the reserve, but the oil in storage could serve as an insurance policy against a break in foreign deliveries. White House officials discussed this option privately on several occasions, and the Shah of Iran even made an offer to provide the oil at $1 a barrel. Aides suggested building an oil reserve directly to the President, but he always rejected the idea as a “hot potato,” fearing it would aggravate political tensions between oil-producing states and the rest of the country.

Nixon finally accepted the argument of his aides that he terminate quotas on foreign oil. His announcement in April of 1973 that the old trade barriers were falling led to a rapid surge in imports from Saudi Arabia. New supplies helped ease tight markets by mid-summer. In effect, the United States had ended its boycott against oil coming from the Middle East just about six months before Arab exporters placed their boycott on oil coming to the United States.

The Government Expands Controls on Oil Markets

Two years earlier, in August of 1971, President Nixon announced a massive intervention in the economy that would affect oil markets for many years. Goaded into action by a Democratic Congress and committed to having low inflation heading
into his reelection year, his new program included a sweeping wage and price “freeze” that later morphed into wages and price “controls.” Oil was not a specific target of the surprise move from a Republican administration rhetorically committed to free-markets.

The freeze had particularly adverse impacts, however, on domestic oil markets. Previously, price signals set by the market had helped manage regional imbalances in fuel supplies or seasonal shifts in demand between heating oil and gasoline. Now, government bodies with little expertise in the subtleties of oil markets would set prices.

Nixon originally intended to ease out of price controls during his second term. When the investigations of the Watergate scandal intensified, however, the political danger of allowing prices to jump suddenly became too great. As a result, controls on oil prices were still entrenched in the fall of 1973.

In the case of an interruption in international oil supplies, inflexible price controls would make it particularly difficult to balance supply and demand with higher prices. Less flexible pricing would make the rebalancing of regional disparities more difficult. Coastal states supplied by imports would be more affected by an embargo than mid-country states utilizing domestic sources. Like the removal of requirements for surge capacity, the installation of price controls achieved a short-term political goal but sacrificed an important defense against foreign intimidation.

Mandatory government allocation of oil supplies compounded the problems of government regulation. The Nixon administration announced mandatory allocation of some oil supplies to protect farmers and other privileged groups on October 10 of 1973 – just after war had broken out in the Middle East but at a time his top advisors still thought an embargo unlikely.14
The political nature of Nixon’s support for allocation is now well documented. The previous month, energy advisor John Love and budget chief Roy Ash had informed Nixon that voluntary allocation by the industry had failed, but creating a mandatory program run by the government would make matters even worse. They wrote “most of your advisors fear the effects of further regulation of a major industry and the creation of another major government bureaucracy.” They added, “[F]ew believe that a mandatory allocation program will contribute to the resolution of the supply problem.” Love explained in a separate memo why most Nixon advisors, nevertheless, felt mandatory controls were necessary: “Right or wrong, people believe the Government can and should act by instituting such a program.” In short, the Nixon administration adopted an oil policy it recognized as counterproductive for the efficient operation of oil markets based on political pressure.

Government allocation followed government price controls, so it might be assumed that the inability of markets to distribute fuels by market forces led to the need for additional government intervention. The available records, however, make it clear there was a different impetus for federal allocation of oil. The imports quotas, terminated in April of 1973, had over the years spawned numerous preferences, particularly for farmers and small refineries. In the spring and summer, political pressure grew to restore the special benefits lost in April. The administration eventually gave in to members of congress representing affected constituencies. Thus, it was the end of the quotas rather than price controls that created the push for allocation.

Whatever the cause of its adoption, the new system of fuel allocation, like price controls, substituted government action for market mechanisms and slowed adjustments to unusual situations. For instance, government allocations were generally established on a monthly basis, sharply inhibiting day-to-day flexibility. As it turned out, new government regulators had to hone their skills in the midst of
the nation’s greatest shortage of oil, their inexperience increasing the risk of missteps.

**Arab Nations Make Dramatic New Demands**

The years following the 1967 war saw increasing militancy and unity among Arab oil producing nations. From 1967 to 1973, Arab oil producers more than doubled their output to 14.8 million barrels a day and became more assertive about using their burgeoning output to gain economic and political leverage.

The aggressiveness of Arab militants toward Western oil interests took a major step forward with the ascension to power of Libya’s Muammar Qaddafi. Under King Sayyid Muhammad Idris, the country had cooperated with the industrialized nations and upped its oil production after the 1967 war. But Qaddafi, who seized power after a 1969 coup, espoused a contrary view. The flamboyant colonel was prepared to challenge both the Western powers and the traditional Arab kingdoms allied with them. This small North African country of about two million people played a critical role in world markets by supplying 30 percent of Europe’s oil.

With Qaddafi’s rhetoric breaking new ground, Libya demanded unprecedented increases in oil prices. In early 1970, he warned international oil companies he would shut down production to get higher prices. “People who have lived without oil for 5,000 years,” he declared, “can live without it again for a few years in order to attain their legitimate rights.” By the fall of 1970, Qaddafi had won his initial confrontation over prices.

In a summary of the situation near the end of the year, the American Ambassador to Libya sent a telegram to Washington warning that Qaddafi’s actions had created “new rules for the oil game.” The “practicality of controlling supply as a means of exerting pressure for raising [the] price of oil has been dramatically demonstrated.”
He included the political ramifications of Qaddafi’s victory: “Rationale of those who call for use of Arab oil as a weapon in the Middle East conflict also has been strengthened in present circumstances.”18

Other oil exporting nations made repeated demands for ownership of the resources within their boundaries and increased revenues. Saudi Arabia and (non-Arab) Iran – both allies that many observers expected to protect U.S. interests – approached the multinational corporations more gingerly than Qaddafi. They still were able to wrest major concessions with little push back from American oil companies or the U.S. government. Whether the challenges came from militants or more traditional kingdoms, the industrialized nations repeatedly gave in to the demands of increasingly assertive oil exporters.

As Middle Eastern oil exporters expanded their control over the mineral assets in their countries, the multinational oil companies found they had little leverage to slow down the transformation of oil ownership. They turned to the American government for support but were rebuffed. Nixon, Kissinger, and others at the top of the foreign policy pyramid, focused on a graceful exit from Vietnam and bold initiatives with China and the Soviet Union, relegated the Middle East to secondary status. Moreover, the Nixon administration feared that aligning itself too closely with the major oil companies would provoke charges of colonialism or anti-Arab bias. At times, Arab leaders were themselves surprised at how little resistance they got as they demanded greater shares of ownership and profits.

Nixon received his most urgent warning about the eroding U.S. position in the Middle East from his former Treasury Secretary and arguably most trusted advisor John Connolly. At a meeting in the Oval Office on January 25 of 1973, the Texan reported on a recent trip to the Middle East and rang the alarm bells early in the conversation: “This energy crisis is much deeper, much broader, much more severe than anybody in this country realizes.” He advised the President that oil supplies
were already running short in some sections of the country, and World War II-type rationing would likely be necessary by the summer.

To deal with the rising nationalism in the Middle East, Connolly suggested to the President the novel idea of establishing an “energy resources corporation.” The government entity would offer to buy 50 percent of the oil reserves of companies with major holdings in the Middle East. In this scenario, the United States could tell exporting nations you are not just taking the companies oil, “you’re taking our oil.” Without such an arrangement, he said, the United States would lack the leverage to deal with Arab governments. Despite this and other warnings, the Nixon administration avoided any effort to prevent the decline in Western influence over oil affairs in the Middle East.

Competition among oil exporters to demonstrate to their people they were getting a good deal greatly influenced the economic transformation going on in the Middle East. Growing Arab rage over the humiliating loss of land in the 1967 war united Arab exporters and affected a regional political transformation.19

Connolly also warned Nixon in their January meeting about the potential link between oil from the region and tensions between the Arabs and Israel. King Faisal was “obsessed with Israel” and did not want to talk about anything else, he reported. “No Arab leader,” even the most moderate Saudi voices he asserted, “can ever accept the status quo on the Israeli situation.”20

In the spring of 1973, several ominous warnings about major problems in the Middle East were being circulated privately within the government. A prescient State Department analysis – not publicly released until January of 2013 – stated that without some resolution of the Israeli-Egyptian impasse, “the resumption of hostilities by autumn will be better than even odds.” The analysis concluded that the unlikelihood of a military victory by Egypt did not preclude it taking military action. “From Sadat’s point of view, the overriding consideration is some form of
military action which can be sustained long enough, despite Israeli counterattacks, both to activate Washington and Moscow and to galvanize the other Arab states, especially the major oil producers, into anti-American moves.” The report foresaw several possibilities for retaliation, including “prolonged oil embargoes.”

King Faisal’s intense dissatisfaction with that status quo on the issues of the Palestinians and Jerusalem was hardly a secret. In one provocative statement broadcast to American audiences on NBC in August of 1973, the King asserted that U.S. support of Israel “makes it extremely difficult for us to continue to supply the United States’ petroleum needs and even to maintain our friendly relations.”

American officials were justifiably perplexed on how to interpret the signals from Saudi Arabia. Some members of the royal family, and at times even the King himself, said that oil should not be used as a weapon. Yet the preponderance of evidence, including private warnings from Saudi oil minister Sheik Zaki Yamani and the executives of oil companies with operations there, was that without U.S. participation in a Middle East peace process, access to Arab oil would likely be denied.

Nixon and Kissinger chose to focus on positive communications (all of which had some legitimacy) and downplay the negative. For the President, the summer of 1973 brought testimony against him by his former counsel John Dean, announcement of a White House taping system that might resolve disputed allegations, and a serious hospitalization for pneumonia – all making an expanded focus on the Middle East more difficult. To pleas that Kissinger use his negotiating skills in the region, the National Security Advisor responded that the timing was not right.

Both privately and publicly, Nixon and Kissinger remained confident the oil weapon would not be used against the United States. Kissinger testified before a congressional committee on September 12th (less than a month before the
embargo): “We have excellent relationships with our principal Middle Eastern suppliers of oil, Saudi Arabia and Iran, and we do not foresee any circumstances in which they would cut our supply.”

Attacks on Israeli forces by Egypt and Syria on October 6th came as a complete surprise to Kissinger and Nixon. Both Israeli and American intelligence, misled by earlier feints, regarded the military preparations leading to the operations as “bluffs” intended to pressure the West without actually initiating military conflict. When Israeli forces fared worse than expected in the Yom Kippur War (as it was widely known), the United States launched massive deliveries of weapons, despite the risk of further antagonizing Arab oil producers.

Kissinger at a Sunday morning meeting in the White House Situation Room on October 14 asked Secretary of Defense James Schlesinger, Chairman of the Joint Chiefs of Staff Thomas Moorer, Director of Intelligence William Colby, and Assistant to the President for Energy John Love: “What do we do if the oil is cut off?” Love summarized his detailed study of the situation:

We would be able to surge our own oil production and get 100,000 to 200,000 barrels a day. From coal we could get 200,000 to 300,000 more barrels a day but this would take a major effort [that] has legal restraints. By cutting demand we could save from 150,000 to 300,000 barrels a day. By changing the speed limit we could get another 100,000 barrels a day and reduce the level further by [a] gasoline tax.

Later in the conversation, he said Iran might be able to supply another 200,000 barrels a day, but all the estimates of surge capacity and additional supplies were unrealistic and insufficient, in any case, if the interruption in oil supplies was substantial.

Love warned “Faisal is talking about a cut of five percent a month.” But Kissinger replied that his talks with Arab leaders made him confident that the war and the delivery of American weapons to the Israelis would not lead to an oil boycott. He
noted: “An oil cut off was not mentioned in any of the conversations I have had in the last three weeks. All I have received are hysterical calls from oil companies.”

On Tuesday morning, CIA Director Colby provided Kissinger and others with further assurances on the Saudi position. He reported: “King Faisal is upset by the American air supply, but this is only temporary... He is inclined to blow off emotionally about things, but he usually calms down.” But Love countered the CIA view with credible evidence from the oil companies that Arabs were about to cut production. Kissinger retorted: “The oil companies cause us more trouble than the Arabs. When this is over I am really going out to get the oil companies.”

On October 17, Kissinger and Nixon met with four Arab foreign ministers who represented fourteen others not in attendance. They called for U.S. help in persuading Israel to return lands seized in the 1967 war, but did not mention oil. The Americans regarded the meeting as another signal that the risks of an oil boycott due to the weapons airlift were minimal. Kissinger told the President in the early afternoon that their meeting that morning with foreign ministers had been “very successful,” because the ministers “were happy.” Nixon, who had feared a strong reaction against massive U.S. military aid to Israeli forces, privately gloated over the discussions: “This meeting with the Arabs just about killed the damn press people. They expected all hell to blow up.”

About two hours after Nixon and Kissinger celebrated their apparent success, White House aides delivered the message that Arab oil ministers meeting in Kuwait had just announced they were immediately cutting oil production by five percent and would impose an additional cut of five percent each month until Israel withdrew to 1967 lines. Six nations at the meeting – including Libya, Saudi Arabia and Kuwait – called for a total embargo against the United States. The embargo had officially begun.
Conclusion

The growing American vulnerability in the late 1960s and early 1970s to an interruption in foreign supplies of oil can be linked to several historic transformations occurring during that period. The ascendancy of anti-colonial attitudes around the world contributed to a growing Arab nationalism that resisted the foreign domination previously accepted and reluctance on the part of the industrial nations to resist the new pressures. In addition, an American lifestyle dependent on massive consumption of oil was creating challenges for American production, well into its second century, to keep pace. With energy ranking low in public priorities, addressing its long-term challenges would have been formidable for any set of national leaders.

Nevertheless, there were choices to be made, and the United States managed to make its position more precarious with decisions geared more towards short-term political contingencies rather than national and economic security. One option would have been to end the quotas on imported oil earlier to ease market imbalances, but keep requirements for oil producers to maintain excess capacity until a strategic petroleum reserve could be filled. Among White House aides, many potential useful ideas for foreign and domestic policy were being discussed, but it was hard to argue that energy should eclipse improving relations with China and Russia or ending the war in Vietnam or that the regionally divisive issues of energy should be confronted in a presidential first term.

Top American officials found it difficult to read the intentions of the Arabs, in part because the signals from Saudi Arabia were often contradictory. It proved easier to remain in denial about the looming risks in the Middle East and regard frequent warning signs as figments of the imagination of people at the State Department or the oil companies than to grapple with the challenges of adapting to the revolution in world energy markets.
In the weeks approaching reelection and about a year before the embargo, Nixon mused with his top domestic advisors – Secretary of Treasury George Shultz, Federal Reserve Chairman Arthur Burns, Budget Director Casper Weinberger, Council of Economic Advisors Chairman Herb Stein, and Counselor to the President Donald Rumsfeld – about priorities for his expected second term. Among his private concerns that day was energy. Recently briefed on moves by members of the Organization of Petroleum Exporting Countries to assume ownership of oil production in the Middle East and on a potential shortage of heating oil in the United States, he told those gathered in the Oval Office: “It should scare the hell out of people. What are we going to do about energy and some of these other problems? I don’t know.” The President quickly moved on to other topics.

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1 The author has written previously about the Arab oil embargo in A Declaration of Energy Independence (Hoboken: John Wiley, 2008), Chapter 1; and “35 Years after the Arab Oil Embargo,” Journal of Energy Security, October 6, 2008. Additional information and analysis on this topic will be provided in his next book tentatively titled Forks in the Road: The United States and the Energy Crises of the 1970s. Tammy Nemeth and Tyler Priest provided helpful suggestions for this article.

2 The term “embargo” is used in this paper to include the actions of Arab oil producing nations to block deliveries of their oil to American and a few other ports and to broader production cuts that made evading the impacts of the embargo more difficult.


4 Classic accounts of the 1973 oil embargo can be found in Daniel Yergin, The Prize: The Epic Quest for Oil Money & Power (New York: Simon & Shuster, 1991), especially Chapters 28-32; Henry Kissinger, Years of Upheaval (Weidenfeld & Nicolson, 1982), Chapters 11-14 and 18-20; and Richard Vietor, Energy Policy in America Since 1945 (New York: Cambridge University Press, 1984), Chapters 9-10. Considerable new material, largely from presidential libraries, has become available to researchers since these early works.

5 Tyler Priest, The Offshore Imperative: Shell Oil’s Search for Petroleum in Postwar America (College Station: Texas A&M Press, 2007), pp. 156-158.

6 Energy Information Administration, Annual Energy Review, Table 5.1a.

7 This perspective is most evident in the working papers for the Shultz task force on oil imports. The best original sources on the deliberations of the task force can be found in Lincoln Briefing Book, Box 41, RG220, Nixon Presidential Library


9 For Nixon’s briefing on the subject, see Foreign Relations of the United States, Vol. 36, Doc. 63. Priest, Offshore Imperative, p. 158.

10 Department of State to Embassy in the Netherlands, November 19,1970 in FRUS, Vol. 36, Doc. 62.

11 One instance when a reserve was seriously discussed is described in Hakes, Declaration, pp. 146-147.

12 Public Papers of the President.
After the embargo, Congress passed mandatory regulation legislation (with Nixon’s blessing) that broadened the products subject to allocation. Given its previous momentum, the legislation probably would have passed even without the war or embargo.

Love and Ash to the President, 9/21/73 and Clarke to Kehrli, 9/27/73, William Simon Papers (Lafayette University), 15:28.

A large number of documents at the Nixon Library and in the Simon Papers demonstrate the role of the loss of preferences with the termination of the quota system as the driving force behind adopting oil allocation.

Yergin, *The Prize*, pp. 577-78.


On the economic issue, Iran joined with the Arab states in the leapfrogging on oil prices. On the political issue, non-Arab Iran sided with Israel.


Available on-line from National Security Archive at http://www.gwu.edu/~nsarchiv/NSAEBB/NSAEBB415/

*Oil Daily*, 9/13/73.


Memorandum of Conversation and Transcript of Telephone Conversation, *FRUS, Vol. 25*, Docs. 195 and 197.