CUT OIL DEPENDENCE.
SECURE AMERICA.

THE HIDDEN COST OF OIL

- U.S. oil imports: $309.4 billion in 2006, over three times the 2001 level.
- Cost of oil-related defense expenditures: $137 billion in 2006.
- Loss of current economic activity outflow: $117 billion in 2006. The money Americans spend on oil imports is not repatriated through international trade.
- Loss of local, state and federal tax revenues: $43 billion in 2006.
- In 2003 it was estimated that our import dependence deprived the U.S. economy of 828,400 jobs.
- Economic toll of periodic oil supply disruptions over the past three decades: between $2.3 trillion and $2.5 trillion.
- Amortized costs of supply disruptions: $133 billion annually.
- **The grand total of all oil-related external or "hidden" costs stands on $825 billion per year. This total is nearly twice the figure authorized for the Department of Defense in 2006.**
- **To put the figure in further perspective, it is equivalent to adding $8.35 to the price of a gallon of gasoline refined from Persian Gulf oil, making the cost of filling the gasoline tank of a sedan $214, and of an SUV $321.**

JANUARY 2007

INTRODUCTION

The American public has long equated the cost of energy with whatever is happening at that moment with gasoline prices. This emphasis on short-term price fluctuations is misplaced because it ignores broader costs America's oil import dependence imposes on the domestic economy. **The simple truth is that no matter what the customer is charged at the pump, the price they pay is only a fraction of the real cost to the domestic economy.** Indeed, the lion's share of petroleum's economic burden is never seen by the consumer because it takes the form of what economists term "externalities": costs that are not reflected in the price of a commodity, but are nonetheless real. These "hidden costs" make the reduction of our import dependence an economic imperative.
The external or "hidden costs" of our oil imports derive from a number of different elements. These include:

- The Cost of Oil-Related Defense Expenditures
- The Loss Current Economic Activity Due to Capital Outflow
- The Loss of Domestic Investment
- The Loss of Government Revenues
- The Cost of Periodic Oil Supply Disruptions

Any of these elements would be a significant economic burden in its own right, but taken together, they constitute a financial drain of unprecedented magnitude. Indeed their total cost is nearly twice that of national defense. It is therefore important to understand more fully what each element represents, and how it affects our nation's economic well-being.

OIL-RELATED DEFENSE EXPENDITURES

The first and most obvious external or "hidden" cost related to outlays related to the defense of America's oil supplies. The need to defend our access to foreign crude is not a new development. It was clearly understood in 1945, when President Franklin Roosevelt met with King Ibn Saud aboard the USS Quincy and reached an agreement whereby the U.S. would guarantee Saudi Arabia's security in exchange for access to its oil. Every successive President, regardless of party, would reaffirm this commitment from that time forward. The mission to protect Middle East oil was first publicly recognized when President Carter created the Rapid Deployment Force in 1979 following the Iranian Hostage Crisis. In 1983, mission to defend Middle East oil was made even more explicit when President Reagan created the U.S. Central Command and specifically included the defense of Middle East oil in its mission statement.

In October of 2003, the National Defense Council Foundation (NDCF) released the results of a year-long review of oil-related defense costs that entailed the most comprehensive analysis of that subject ever conducted. The entire order of battle of the United States armed forces was examined down to the battalion or equivalent level, including close scrutiny of roles and mission statements and unit histories. In addition, the entire Department of Defense budget was reviewed to determine if there had been any extraordinary expenditure that could be directly related to protecting oil supplies.

The analysis concluded that the fixed costs of defending Persian Gulf oil amounted to $49.1 billion annually. These estimated, however were based on data compiled prior to the initiation of Operation Iraqi Freedom. As a result, in 2006, the Foundation revisited the issue to take into account any additional outlays that could be reasonably assigned to the protection of oil supplies. Based on a review of current circumstances, the initial estimate was increased to $137 billion.

LOSS OF CURRENT ECONOMIC ACTIVITY

One of the least appreciated costs associated with the nation's reliance on imported oil is the loss of domestic employment and related economic activity that results from the huge capital outflow required to pay for our imported oil. The magnitude of this drag on the economy has steadily increased over the years as import levels have grown. But in the last several years the magnitude of the burden has increased dramatically as global competition for limited oil supplies pushed prices to record levels. This is a situation that is unlikely to change. The Chinese economy has been growing at nearly 10 percent annually for at least two decades, and India is not far behind. Newly independent nations in Eastern Europe, too, are experiencing dramatic economic expansion. This burgeoning economic activity will continue to create intense competition for resources.

Some economists argue that expenditures to purchase oil from abroad have no real effect on the domestic economy. They argue that in a global market, purchases of domestic goods by oil producing nations or their trading partners will more than offset the loss of revenues that would have been generated had the capital remained at home. This line of reasoning would be valid if there were any evidence that the oil exporting nations did in fact purchase significant volumes of American goods. The facts, however, do not support this conclusion. This point is illustrated by an analysis of Saudi Arabia's trade relations.
In 2005, Saudi Arabia had a negative trade balance with the United States amounting to nearly $20.4 billion. In the first ten months of 2006, the Saudi's trade deficit with the United States already exceeded the prior year's number. Advocates of the global market argument would respond to this fact by saying that Saudi Arabia's trading partners would make purchases from the U.S. to make up the deficit. Again, the facts dispute this line of reasoning. Saudi Arabia's principal trading partners (besides the United States) are Germany, Japan, China, France and Italy. These nations have a cumulative trade deficit with the United States of almost $330 billion. Moreover, by and large their major trading partners also have negative balances of trade with America. In short, **the money Americans spend on oil imports is not repatriated through international trade.** Therefore it represents a genuine loss to the domestic economy. The question is how great is that loss?

In 2005, the United States spent almost $243.5 billion for imported crude oil and refined petroleum products. This was more than 2.4 times the 2001 energy trade deficit of $99.2 billion. In the first ten months of 2006, outlays for imported petroleum increased to almost $257.8 billion. This equates to an annual deficit of roughly $309.4 billion, or more than three times the 2001 level.

In 2003, the NDCF determined that the direct loss of economic activity arising from U.S. oil import dependence amounted to $36.7 billion annually. In 2006, skyrocketing oil prices increased that loss to $117.4 billion. As significant as the import-related loss of current economic activity and employment are, the loss of domestic direct and indirect investment is even more of a concern.

LOSS OF DOMESTIC INVESTMENT

Historically, the energy industry has had one of the highest rates of reinvestment. As a result, the reduction in investment capital that results from our dependence on foreign oil is significantly higher than would be the case with some other industries. In 2006, the loss of investment arising from our import dependence rose to an estimated $394 billion.

LOSS OF GOVERNMENT REVENUES

The adverse economic impact of foreign oil imports is not limited to the private sector. Government, too, suffers a substantial loss of revenues. Individuals involved in the production and refining of crude oil in other countries are not subject to taxation by local, state or federal authorities. Properties on which production and processing of foreign crude take place are not part of the local tax base. Service industries which support overseas production and processing are similarly not subject to taxation by domestic political jurisdictions. In 2006, the dramatic increase in outlays for foreign oil purchases increased the loss of domestic tax revenues to $42.9 billion per year.

EMPLOYMENT EFFECTS

It is important to understand that there is more than a monetary cost associated with America's addiction to foreign oil. There is also an enormous penalty in terms of domestic employment. When capital flows overseas, jobs flow with it. In 2003 it was estimated by NDCF that our import dependence deprived the U.S. economy of 828,400 jobs. With the increased cost of imports, this figure has also grown, now estimated at a loss of 2,241,000 jobs.

LOSSES FROM OIL SUPPLY DISRUPTIONS

A final category of external or "hidden" cost is the economic toll periodic oil supply disruptions impose on the domestic economy. In 2003, NDCF estimated the cumulative economic impact of the oil supply disruptions of the past three decades (1973, 1979 and 1990) at between $2.3 trillion and $2.5 trillion. It should be noted that other estimates of the cost of these disruptions ranged as high as $8 trillion.

Because the effects of oil supply disruptions extend beyond the actual event, it was determined that the aggregate cost should be amortized over a 30-year time frame. At the upper limit, this resulted in an annual cost of $82.5 billion, bringing the 2003 estimate of the total of all costs associated with oil supply disruptions to $304.9 billion. When adjusted for the higher cost of imports in 2006, the estimate of amortized costs of supply disruptions increased to $132.8 billion annually.

The total of all oil-related external or "hidden" costs of $825 billion per year. This total is nearly twice the figure authorized for the Department of Defense in 2006. To put the figure in further perspective, it is equivalent to adding $8.35 to the price of a gallon of gasoline refined from Persian Gulf oil. This would raise that figure to $10.73, making the cost of filling the gasoline tank of a sedan $214.60, and of an SUV $321.90.

CONCLUSION

It is clear that America's continuing reliance on imported crude oil and refined petroleum products is imposing an enormous financial burden on the nation's economy – a burden that is a threat to the nation's economic and military security. Eliminating this perilous dependence must therefore be an urgent national priority.

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Set America Free is a coalition of leading national security, religious, and environmental leaders working to reduce our nation's dependence on foreign oil.