**EconoFact Chats: The War in Iran, Oil, and the Global Economy**
**David Victor, UC San Diego**
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**Michael Klein**
I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

**Michael Klein**
In the wake of the 1979 Iranian revolution the price of oil, in today's dollars, reached more than $140 per barrel. This contributed to the already high inflation of the late 1970s, and – along with the spike in interest rates that began in October 1979 – to the deepest recession at that time since the Great Depression. Now, in the wake of the war on Iran by the United States and Israel, oil prices have spiked once again, rising to more than $100 per barrel in the wake of the attack. This represents a more than 40 percent increase since the end of February and more than 50 percent since the beginning of 2026. What are the implications of this increase in the price of a vital input to the world's economy? How might the dramatic rise in the price of oil, and also liquified natural gas (LNG), affect growth, employment, and prices in the United States, Europe, Asia, and beyond? To address these, and other, questions, I'm pleased to welcome back to EconoFact Chats David Victor of the School of Global Policy and Strategy at UC San Diego. David is also the Co-director of the UCSD's Deep Decarbonization Initiative which focuses on strategies for bringing the world to nearly zero emissions of warming gases, and a nonresident senior fellow at Brookings. David, thanks for joining me today.

**David Victor**
Michael, it's just great to be back with you.

**Michael Klein**
So, David, how unprecedented is $100 per barrel oil in today's dollars?

**David Victor**
Well, so $100 barrel oil is…it's a big number. At least four times before we've seen events like this. First oil crisis in the 1970s we saw oil prices go up by a factor of three, not to the current levels inflation adjusted. Then with the Iran-Iraq War and Iranian revolution, we saw prices go up over $100 a barrel. We saw in 2008 with rising demand, or the expectation of rising demand across the emerging economies, and possibly some speculation in the oil market, some other things like that, we saw prices actually go above $200 a barrel, just very briefly, came back down very quickly with recession. And then we saw oil prices up, but bouncing around current levels

in around 2022 when Russia invaded Ukraine, and Russian oil started coming offline, and we started sanctioning the Russian oil. So it's not completely unprecedented, but it's relatively rare.

**Michael Klein**
Some people speak about the current price rise as a result of the actions of speculators, or, as the President put it, "a bad vibe." Is the only source of an oil price rise due to fear itself, or greed? And are there any lessons from past price spikes that are applicable today?

**David Victor**
Well, I think frankly the markets are working pretty well. It's astonishing that the markets are revealing as much information as they're revealing. They're in a period of high volatility. We're also in an unprecedented era of at least the risks of a long term crisis…leaving the Straits of Hormuz closed for a long period of time and so on. So there's always going to be speculation in that context, and to some degree, we want to welcome that speculation, because it helps reveal information. To me, the really interesting lesson watching the last week or so is how sensitive the markets are to the kind of chaotic information coming out on all sides of this conflict here. People don't know if and when the conflict is going to end. They don't know what to expect. They don't know how long the Straits of Hormuz might be closed, or effectively closed, because the cost of transit is going to be so high. And I guess last comment on that is, in the news, we've seen finally, an agreement to release, plausibly, 400 million barrels of oil from strategic stocks around the world. That seems like a giant number, but on the order of 20 million barrels a day going through the Straits of Hormuz in normal times, you can use up that buffer very, very quickly. And so that's what people are really worried about, is that this thing drags on forever, there's damage done to the infrastructure, and that there'll be a systemic, long term consequence from that. And the current markets are reflecting that.

**Michael Klein**
So 400 million barrels per day, 20 million barrels going through the Straits of Hormuz. That's only 20 days. That's not that long a time.

**David Victor**
And that's true, if the straits remain fully closed. There's some anecdotal reports that some ships are going through by turning off their transponders, especially ships headed to China with Iranian crude. The Iranians themselves, five years ago, opened another port, an export port, smaller than Kharg Island, that's in the Gulf of Oman, so on the other side of the Strait of Hormuz, that's allowing some exports. The Saudis, quite some time ago, built a big pipeline that goes out to the Red Sea. I mean, that we're talking about the Red Sea as a kind of sea of tranquility right now is a sign of how the world has changed. That moves oil out to the Red Sea. That capacity seems to be 5 to 7 million barrels per day. The real challenge there is all the logistics in particular around the Red Sea, and getting the ships there and getting them loaded and so on. So for April, Saudi

Aramco has already sent notice out to their large buyers that they need to be planning loadings in both the Gulf and in the Red Sea, because they don't know what's going to happen. So if you close 20 million barrels through the Straits of Hormuz, some of the oil gets out, but certainly not 20 million barrels.

**Michael Klein**
So you mentioned several times the Strait of Hormuz. Why is this such a choke point, and why has shipping through it ceased? And also, there are goods other than oil that go through the Strait of Hormuz, right?

**David Victor**
Yeah, so a lot goes through the Strait of Hormuz. And frankly, with the takeoff of the Persian Gulf economies, there's a lot going into those economies. There's also a lot of infrastructure on the Straits of Hormuz. There tends to be an obsession with the straits, and people forget that there's a lot of soft infrastructure, desal plants, power plants and so on. We've seen attacks on the airports…Dubai and the Emirates more generally. Qatar, certainly their LNG terminal is now basically shut down completely. But the focus on Hormuz is really, really important because the global oil market is a little more than 100 million barrels a day. Of that, about 50 million barrels a day is traded in international trade, mainly by ship. Oil is relatively easy to store, and so it's a global commodity. So even though the oil from the Gulf goes mainly to Asia, prices come out of that global market. And of the 50-ish million barrels a day that are traded internationally, you know, 20 million barrels or so go through Hormuz, and so it really is a choke point. It's not the only choke point in the world. The opening of the Red Sea is one, Malacca is another, but it's a really, really important choke point.

**Michael Klein**
The President has talked about sending in the military to protect shipping through the Strait of Hormuz. Is that likely to happen, and if it did, how effective would that protection be?

**David Victor**
It's hard to say. There had been some tweets that the US Navy had escorted one or more ships that turned out not to be true. I expect at some point we are going to not just escort ships, but also do mine sweeping operations, and clearing the ship channels and so on. At the end of the day, the problem is that the ships are soft targets. And so even if they're surrounded by naval ships, they're soft targets. And it's not just Hormuz, it's the entire Gulf. I mean, we've already seen attacks on ships in various places, including Iraqi waters in the Gulf. And so what's happened is that the overall risk level has gone up. It's a war zone, their insurers are charging 6 to 10 times the original rates. And on top of it, the crews are on edge, and the captains are on edge. And so even if you could get insurance coverage, as some anecdotal reports, some Greek ships have gotten coverage…and so even you can get coverage that actually moving the ships in a

reasonable way according to a reasonable schedule, that that's going to be the real problem…and some naval escorts might help with that, but that's the kind of fundamental.

**Michael Klein**
I introduced the podcast by mentioning the spike in oil prices in 1979 after the Iranian Revolution, and the havoc this played with the world economy. What are the differences between then and now that could point to a different economic outcome across these two episodes.

**David Victor**
Well, I think the most important difference, and we talked about this last time we talked about the oil markets, we were talking about the Russian invasion…one of the most profound differences is the wealth in the global economy. And so oil consumption has gone up. Many projections show it continuing to go up steadily despite visions of decarbonization and moving beyond oil and so on. That's, you know, another whole topic. But there's been a decoupling between the amount of oil that's consumed, and the size of the global economy. So the economy is able to weather this to a greater degree. And then the way oil gets used is really radically different. In the 1970s Western economies used a lot of oil, for example, for example, for making electric power. Almost all of that is gone now, and so we're using oil in places where it really doesn't have any rivals, especially in transportation and petrochemicals and so on. And there's some innovations chipping away at that, for example, electric vehicles reducing the need for oil and transportation, maybe, eventually alternative fuels for airplanes. There's 20 or more ships from Maersk alone I believe that are dual fuel. They can use methanol as well as oil. So there's a long term change in the global economy and its industrial metabolism that's making it less dependent on oil, but the changes are very, very slow.

**Michael Klein**
Officials in the United States and other countries are attempting to mitigate the effects of the fall in oil supply. One possibility is to tap into Strategic Petroleum Reserves. What are these? How much oil is in them? And can they help alleviate the shortfall?

**David Victor**
Yeah, I think it's hard to run the counterfactual, but had we not seen, over the last week, the announcement of plans to release…a coordinated release of about 400 million barrels, plausibly, we see oil prices a lot higher than they are today. You know, been bouncing around. We've seen them up in the $120 range. It seems like every day we have a different story about oil prices, because the volatility is incredibly high, but they're playing a significant role. It is also important to remember that there's only so much you can do. If Hormuz is closed, or there's a lot of damage to the infrastructure in the Gulf region for a sustained period of time, we're going to blow through 400 million barrels pretty quickly. 400 million barrels is about a third of the global reserves. It's a little hard to pin down the exact numbers, partly because some of the reserves are

held by private companies under government contract, and not all of them qualify for the obligations that countries have under the International Energy Agency, but it's on the order of a billion, a billion two barrels of oil are in some kind of reserve that could be put on the market over a period of time.

**Michael Klein**
Are there any technical issues about withdrawing oil from the strategic petroleum reserves?

**David Victor**
Yeah, I think the last time I checked the US maximum capacity is on the order of 4 million barrels per day. That'll be an important limitation. There are also going to be disruptions caused by where the oil is and the characteristics of the oil. Depending on your refinery, for example, you can't just immediately refine any kind of oil. This is one of the reasons why the Indian story is so interesting. The Indians import a significant amount of oil from Russia, and have a waiver now so they're going to continue importing oil from Russia, and they have a very modern refinery complex that allows them to basically refine anything. Most of the refining complex in the Gulf of Mexico and the United States is not like that, and so it's going to take a while for the market to adjust to these kinds of logistics. And when you're talking about millions of barrels a day of stuff moving around, you can imagine the complexities.

**Michael Klein**
You mentioned the sale of Russian oil to India. And there's some talk about no longer sanctioning the sale of Russian oil anywhere. How effective have those sanctions been in keeping Russian oil off the market, and how important could Russian oil be as a counterweight to the decreased supply from the Middle East?

**David Victor**
Well, the Russian story, I think, is very, very interesting and hard to parse. My sense is that the value of the sanctions has been more on limiting the price that the Russians can charge, because it's limited the number of countries they can sell it to, think China and India. And China and India know that. And on top of that, we've had a little bit of a regime around price caps. I think the research suggests it's had kind of a mixed impact. So the goal has been to limit the amount of money the Russians can get from this. But the barrels themselves, the volumes that are on the market, are really important, and India is a great test case, because I think the US tends to describe the Indian waiver as we're letting India import Russian oil. I was in India last weekend, for a couple days for the Raisina Dialogue, kind of their version of Davos, middle powers organized by India talk about the new world order. And one of these really striking to me is that the Indians are going to go off and do this anyway. And so the waiver is a way to hold the political relationship together between the United States and India, to continue to put pressure on

Russia and to get those barrels on the global market, meaning that India wouldn't need to buy 1.8-2 million barrels per day from somebody else.

**Michael Klein**
So these developments are actually going to help Russia, right, not just by removing whatever sanctions there are on the sale of its oil and removing the cap, but just with higher oil prices, that's going to help Russia quite a bit won't it?

**David Victor**
Anybody that's getting their oil in the market is a huge beneficiary from that. That's not just Russia, but it's the Western oil companies that have oil that they're selling outside the Persian Gulf bottlenecks. This is plausibly helpful to Russia. I think the long term picture, though, for Russia is pretty bleak. I mean, in addition to all these things that are going on, the European Union has doubled down on their commitment to eliminate the remnants of the oil and natural gas that they get from Russia. That'll happen by the end of next year. So the long term trajectory for Russia, although they're getting higher prices right now, I think is pretty bleak.

**Michael Klein**
Some people are making a big deal out of the case that the US has become a petroleum exporter over the past decades, but the price of oil is set in the global market, not just within the borders of this country. So how much does increase US oil production help offset the price of gasoline, heating oil, jet fuel, and other petroleum products in the United States?

**David Victor**
Well over the short term, not much. I'd expect that if the war in the Gulf expands, and it's kind of hard to put the toothpaste back into the tube…and there's a huge amount of damage that you'll see some US production, look at expansion, in particular the shale fields and so on. The problem with that is that they've been through this before, and a whole lot of companies borrowed a lot of money, did huge expansions in shale and then lost a boatload as oil prices came back down. And so there's this fear about what things look like beyond six months or three years and so on. So I think you're gonna see more caution by US producers. And therefore, basically what's happened is the marginal barrels are coming off due to what's going on in the Persian Gulf. But, last comment on this, which is the shale production and the cost of that in the kind of twenties, thirties, forty dollars a barrel, that range got a huge range, but relatively low because of all those innovations…basically, that's added a huge chunk of supply into the global supply curve, and that chunk is outside the Persian Gulf bottlenecks.

**Michael Klein**
So we've been talking about oil, but liquefied natural gas, LNG, is also being stymied in its supply to the world. What are the differences in the effects of the shortfall in oil as compared to LNG coming from the Gulf states.

**David Victor**
Well, the dominant, the only real LNG exporter from the Gulf states is Qatar, and Qatar is sitting on top of a giant gas field…actually, it's a gas field they share with Iran. But the situation in Iran has always been so troubling that basically all the investment for gas exports happens in Qatar. They are about 20% of global LNG exports. Australia has about a similar volume. The United States is now approaching maybe 50% larger…that US LNG expansion has been extraordinary. For oil, because you can move it [in] ways other than ships, there are some options for moving oil out of the Persian Gulf that are not 20 million barrels a day to completely bypass the Straits of Hormuz, but they're the pipeline we talked about going to the Red Sea, they're the Iranian port in the Gulf of Oman. For LNG here's nothing else. All that LNG production from Qatar, most of which goes to India and Asia and beyond, that is now shut in. There's been damage to the facility in Qatar itself. Though I haven't seen characterization of the damage yet, but it's been a while for them to come back online. And so what it's done is it's created this incredible magnetic force, or almost like a black hole, for LNG cargoes in Asia, such that spot prices for LNG are on the order of $25 to $30 for a million BTU of LNG delivered. And for comparison, gas in the Gulf of Mexico is about $3…add another $3 to get it liquefied and put on a ship and so on. And so you've got $6 gas LNG sitting in the Gulf of Mexico that can go to places all around the world at radically higher prices. So far, majority of that gas is going to the European market. The majority of what the Europeans import as LNG is coming from the United States because of the crisis with Russia. We may see some of those cargos pulled away from the European market and sent to Asia.

**Michael Klein**
Sort of dancing around a broader question, what's the scope for substituting away from oil and LNG towards other sources of energy in the short run, and in the long run, especially if there's this ongoing shortfall in oil and LNG shipments due to the Iranian war?

**David Victor**
Yeah, so I think it's the key question. And here, oil and gas are very different, because over the short term, there's not a lot of elasticity in oil consumption, because there's just not a lot of alternatives. It's not like you put natural gas in your car, or coal in your car or whatever it is. So short term elasticities for oil tend to be relatively low, and one of the main effects is actually on the demand side. If we induce recession, people just doing less, then that'll bring a few million barrels a day out of the oil market and help soften prices. Over the long term, there are a lot of ways to move beyond oil. Traditionally, the main way has been to either eliminate the use of oil

and things for which there are alternatives, like not burning oil for making electricity and efficiency. Efficiency has been a really, really big effect. And here, the US market and the European market are really diverging. The European market has a long term plan to reduce their dependence on oil, reduce their dependence on natural gas. They're doubling down on that plan more nuclear, which is important for replacing natural gas and making electricity. A third of the natural gas in Europe is used for generating electricity…more heat pumps, more energy efficiency, so basically electrifying as much of the European economy as possible, and then not relying on hydrocarbons for generating that electricity. One last part of that story that I find interesting is the renewed interest in nuclear power. How the European Union, in fact, just a few days ago, announced that the walk back from nuclear power was a strategic mistake in Europe. And so we're seeing renewed interest there, renewed interest in India, renewed interest here in the United. States, it's a really extraordinary turnaround.

**Michael Klein**
I had on the podcast some time ago, my colleague Gib Metcalf, who was a professor at Tufts, he's now Emeritus, and he told the story of how in the 1970s he went to jail because he was in the Clamshell Alliance and tried to stop the nuclear power plant in Seabrook, New Hampshire. And now he's in favor of nuclear power because the alternatives are so damaging to the environment. So David, do you think that there's going to be a shift, both in terms of market choices and public policy towards alternative sources of power – wind power, solar power, the use of EVs and so on. The current administration seems to be quite hostile to this kind of shift. Do you think it might change?

**David Victor**
I don't think the current administration is going to change. This crisis, this energy crisis, like most energy crises, is a little bit of an ink blot test. And so people see in the ink blot different things. The Europeans have seen in that ink blot evidence that they should be doubling down on their goals to cut emissions, and especially reduce their dependence on imported hydrocarbons, natural gas, and oil. I'd say the Chinese mostly have seen that story, at least with regard to oil and gas, maybe a little less so with regard to coal. India has seen that story. The United States, at least under the current administration, the United States has seen this as evidence that we need to double down on oil production. And then you're going to see a lot of the other political agendas come in. So the President has had some loose talk about using extreme executive powers to search for [inaudible] production of oil off the coast of California. I don't think that's going to go very well. And so a lot of those old debates, it's like the very familiar debate, the details change every time, but the backbone, the through line, is the same.

**Michael Klein**
Do you think there's a possible silver lining to this, that perhaps we'll move to a more environmentally friendly energy world?

**David Victor**
I think this is a huge reminder of all the above, which is we need to have diversity in energy sources. Traditionally, it's been really, really hard to get diversity in the main uses of oil, which are in transportation. That's now changing. Not that rapidly, but it's changing. It's changing very rapidly in some places with electric vehicles. Look at the Chinese…extraordinary success of the Chinese Electric Vehicle program, a lot of the European Electric Vehicle program, California, to some degree, as electric vehicles get better, we're seeing that across the rest of the United States, just the market forces alone. So I see this as a reminder of that, unless the war really drags on for a long, long time, and we see sustained extremely high oil prices, I don't think it's going to change the fundamentals, but it's no question that a lot of clean energy projects look a whole lot more attractive in a world where oil is dancing around $100 and when it's dancing around $50.

**Michael Klein**
Well, David, the last time we spoke about these issues it had to do with the Russian invasion of Ukraine. Now another military action has caused a disruption in world energy markets, and I really appreciate you coming on once again to help us understand the implications of this issue. So thanks for joining me on EconoFact Chats.

**David Victor**
Well, Michael, it's always a pleasure.

**Michael Klein:**
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