1976-03

The impact of the Arab decision-makers on the oil market.

Hull, Lee Blanton

THE IMPACT OF THE ARAB DECISION-MAKERS ON THE OIL MARKET

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NAVAL POSTGRADUATE SCHOOL
Monterey, California

THESIS

The Impact of the Arab Decision-Makers
On The Oil Market

by

Lee Blanton Hull

March 1976

Thesis Advisor: J. W. Amos, II

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

REPORT DOCUMENTATION PAGE		READ INSTRUCTIONS BEFORE COMPLETING FORM
1. REPORT NUMBER	2. GOVT ACCESSION NO.	3. RECIPIENT'S CATALOG NUMBER
4. TITLE (and Subtitle) The Impact of the Arab Decision-Makers On The Oil Market		5. TYPE OF REPORT & PERIOD COVERED Masters Thesis: March 1976
		6. PERFORMING ORG. REPORT NUMBER
7. AUTHOR(s) Lee Blanton Hull		8. CONTRACT OR GRANT NUMBER(s)
9. PERFORMING ORGANIZATION NAME AND ADDRESS Naval Postgraduate School Monterey, California 93940		10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS
11. CONTROLLING OFFICE NAME AND ADDRESS Naval Postgraduate School Monterey, California 93940		12. REPORT DATE March 1976
		13. NUMBER OF PAGES
14. MONITORING AGENCY NAME & ADDRESS(if different from Controlling Office) Naval Postgraduate School Monterey, California 93940		15. SECURITY CLASS. (of this report) UNCLASSIFIED
		15a. DECLASSIFICATION/DOWNGRADING SCHEDULE

16. DISTRIBUTION STATEMENT (of this Report)

Approved for public release; distribution unlimited.

17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)

18. SUPPLEMENTARY NOTES

19. KEY WORDS (Continue on reverse side if necessary and identify by block number)

Arab Oil, Arab Decision-Makers, OPEC, OAPEC, Oil, Saudi Arabia, Iraq, Kuwayt, Libya.

20. ABSTRACT (Continue on reverse side if necessary and identify by block number)

This thesis examines the political arena of the oil industry, and the decision-makers of the Arab oil countries. The two primary areas of study are OPEC and the various political relationships, both inter-Arab and Arab-Western. The oil weapon strategies are analyzed as a form of deterrence.

The main hypothesis is that these countries have three options available in which to utilize their oil weapon: embargo;

production slow down; and price fixing and raising. The potential of each option is analyzed in detail based on the attitudes, goals, reactions and various oil market roles of the countries involved. The conclusion reached is that, with only those three options available, the oil weapon is becoming less of a credible deterrent. Only total embargo currently remains as a plausible option. Both sides are beginning to realize that an equilibrium state of supply and demand is the only realistic alternative to ensure that all parties derive maximum benefit from an expendable resource.

The Impact of the Arab Decision-Makers
On The Oil Market

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Submitted in partial fulfillment of the
requirements for the degree

MASTER OF ARTS IN NAVAL INTELLIGENCE

from the

NAVAL POSTGRADUATE SCHOOL
March 1976

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I. INTRODUCTION

A. STATEMENT OF THE PROBLEM AND METHODOLOGY

The Middle East is an area that has become exceedingly important politically, militarily and economically. The area's political role is articulated through the involvements of all the major powers thus making the Middle East a major "actor" in international relations. The Arab-Israeli conflict and the area's emergence as a leader in the Third World are just two examples of this region's political importance. The main facet of the area's military importance is the strategic location of the Suez Canal. The canal provides a quick means of circumventing the long trip around Africa by military warships of various countries which shuttle back and forth between the Mediterranean Sea and the Indian Ocean. Oil tankers and merchant ships also utilize the Suez Canal as an efficient means of reaching Western markets. However, from the standpoint of this thesis, the area's economic importance takes precedence over the other two factors. The Middle East is the primary supplier of oil, the world's major energy source. For this reason, the region quite possibly holds the key to international economic stability, since this stability can be directly linked to the supply and demand cycle for oil consumption. Consequently, the oil situation has been transferred into the political arena. Now, whenever key issues on such topics as international agreements, treaties, trade, foreign aid, etc., are considered, the oil situation takes on new importance as an essential factor in the decision-making process for all nations.

This thesis examines the political arena of the oil industry, and the decision-makers of the Arab oil countries (Saudi Arabia, Iraq, Kuwayt and Libya). The analysis will be based on an understanding of their goals, strategies, reactions, interactions and various roles in the oil market and the effect that these factors can have on oil supplies.

One of the primary foci of study will be the Organization of Petroleum Exporting Countries (OPEC). OPEC was organized in 1960 with the principle aim being "the unification of petroleum policies for the member countries and the determination of the best means for safeguarding the interest of member countries individually and collectively."[1] The Middle East members of OPEC used an oil embargo in 1973 to demonstrate to the world just how much power the oil weapon could wield against the strategic alliance between the United States and other Western powers, particularly since Middle Eastern oil supplies were crucial to the economies and energy requirements of the European countries of NATO and Japan. Understanding the various Arab policy makers and their roles in OPEC is critical in order to determine just

[1]Rouhani, F., A History of OPEC, p. 78, Frederick A. Praeger, 1971.

what might compel them to employ the oil weapon again and by what means they would choose to utilize it.

The other main area of study will be the various political relationships both inter-Arab and Arab-Western. One of the most important areas for consideration here is the relationships which evolve from interactions between the host states and foreign oil companies. The foreign oil companies have become prime political pivots between two opposing sides concerning the issue of control, development and market of this vital and expendable economic resource. The oil companies "constitute a substantial foreign element in the midst of a society whose general tendency is to free itself from dependence on external powers and influences."[2] The attitudes of the various oil producers toward the issues involved in this context will certainly influence any decision-making process.

The main hypothesis of this thesis, therefore, is that Arab oil countries today have three options available in which to utilize their oil weapon: embargo; production slow down; and price fixing and raising. The Arabs are by nature very cautious in their role as actor states; their political environment highly restricts their policy options. The environment can become a major factor when decision-makers try to operate rationally.

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[2] Lenczowski, G., Oil and State in the Middle East, p. 3, Cornell University Press, 1960.

The methodology employed for this thesis will be an analysis of the Arabian oil countries' policies utilizing the Allison Governmental Politics model and the Snyder Decision-making model. Their strategies will be analyzed as a form of deterrence proposed by Herman Kahn. Areas of analysis will be (a) various viewpoints of the Arab decision-makers for the four major oil producing countries (Saudi Arabia, Iraq, Kuwayt and Libya), (b) interrelationships with other Middle Eastern nations, (c) the roles played by the four countries within OPEC, and (d) various strategies and scenarios in which policy options may be exercised. Prior to beginning this analysis, some background information on the history of oil development and the oil environment today will be presented.

B. BACKGROUND INFORMATION

1. Development of the Oil Industry in the Arab Nations

Ever since the advent of the Crusades, which saw the decline from glory of the Islamic Empire, the Middle East has been a region under the constant domination of foreign influence until the mid-twentieth century. However, the foreign domination has not necessarily been totally detrimental to the area's development. The waves of Crusaders brought economic prosperity and increased trade; the Ottoman Turks encouraged some industrial and agricultural reforms and also education (mostly through allowing the entrance of Western missionaries). In the late 1700's, European desire for control of the countries on the Eastern Mediterranean began with the French invasion of Egypt. However, full control was not relinquished by the Turks until the mid-1800's. In the beginning, much of the European and American domination of the area was not political or economical, but cultural, in the form of missions, schools, hospitals, and colleges that had lasting effects on the ideas and life-styles of the region. The Americans were in the area not to rule, but to help establish a better way of life (and thus helped to prepare the people for the economic impact of the oil discoveries) through the establishment of colleges, such as the Syrian Protestant College (now the American University of Beirut) and the American University of Cairo, and through the work of organizations such as the Near East Foundation and the Arabian Mission. As Charles Hamilton pointed out:

> "Many persons feel that American commercial interests might not have had the opportunity to participate in the development of the great oil fields of the Middle East had it not been for the splendid work of the Arabian Mission."[3]

The birth of the oil industry occurred in the nineteenth century when animal and vegetable fats and oils became inadequate in meeting the domestic and industrial needs of a growing world population. Development and drilling began in America, Europe and Russia; since the potential of the Middle East was not realized until the early twentieth

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[3]Hamilton, C.W., Americans and Oil in the Middle East, p. 12, Gulf Publishing Company, 1962.

century, even though both the Bible and early Greek literature recorded the surface signs of hidden liquid and gaseous petroleum reserves.

Exploitation and control of the area was mostly in the hands of the British with the exception of Saudia Arabia. American participation did not begin until the late 1920's after much diplomatic struggling, and the influence of this participation was to promote the idea of a free-enterprise system. The idea of free-enterprise slowly gained ground as British domination began to diminish.

The first major watershed in the exploitation of Middle Eastern oil reserves occurred in 1913 in Iran when the British Admiralty under Winston Churchill decided to fuel the Royal Navy with oil instead of coal, and in the years to follow British, American, French and Canadian oil companies were operating in all the various oil producing countries. By the end of World War II, "the oil industry that operated in the Middle East represented an international cartel...who in essence had usurped sovereignty over the Middle East's most important economic resource."[4] In the mid-50's, the Middle East had formed a closely connected oil region of producing and transporting states, and became the "major single supplier of oil in the

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[4]Ismael, T.Y., The Middle East in World Politics, p. 227, Syracuse University Press, 1974.

international market."[5] Today, with 60% of the world's proven oil reserves and control in the hands of the individual countries, the area has the capability of meeting world requirements. However, maintaining the necessary production levels and realistic prices, so that enough oil is available, has become a political as well as an economic issue.

The major Arab oil producing nations are Saudi Arabia, Iraq, Kuwayt, and Libya. Other nations involved in oil politics are minor Arab producers Egypt and the United Arab Emirates, oil transiting nations Syria, Lebanon and Jordan, and the major non-Arab oil producing nation Iran. The following is a brief history of oil development for some of the major producers.

Saudi Arabia, now the area's largest producer, was the only country exploited completely by American oil companies. The original concession granted in 1933 to Standard Oil of California was taken over by ARAMCO (Arabian American Oil Company) with interests held by Standard Oil of California, Texas Company, Standard Oil Company (N. J.) and Socony Mobil Oil Company. Two major issues arose between ARAMCO and the Saudi government. The first was the financial terms of the concession, which was settled when Saudi Arabia served as a pioneer and introduced the 50-50 tax plan, which while serving to increase Saudi revenues did not affect

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[5]Shwadran, B., The Middle East, Oil and the Great Powers, p. 436, Frederick A. Praeger, 1955.

American companies since the tax was paid on profits before paying foreign taxes and served as a credit against payment of U.S. taxes. The other dispute involved land, and ARAMCO relinquished several areas of its vast territories to be explored and developed by Petromin, the Saudi Arabian National Oil Company, organized in 1962. Petromin became the most active national oil company in the realm of diversification and promotion of oil-related industries and developments, especially in the field of petrochemicals.[6]

Iraq was chronologically the second big oil producing country (the first being Iran). The original concession was granted to Germany prior to World War I, and secured by the British and French after Germany's defeat. In 1925, the Iraq Petroleum Company was formed (interests were held by British, French and American companies) and acquired the right to develop over almost all of Iraq with a concession granted until 2000. This concession underwent many modifications culminating in 1961 with the Iranian takeover of 99.5% of the area. The IPC, with their five percent, still maintained control over most of the producing area, but all exploratory and future exploitation of the remainder of the land was granted to the Iraqian National Oil Company. IPC still, however, remains important to Iraq for its services in marketing.[7]

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[6] Schurr, S., and others, Middle Eastern Oil and the Western World, p. 129, American Elsevier Publishing Company, Inc., 1971.

[7] Ibid., p. 115-116.

Kuwayt, a British protectorate until 1963, is one of the biggest producers when the country's total land area for oil development is taken into consideration. The concession for development granted in 1934 to the Kuwayt Oil Company was jointly owned by American (Gulf) and British (Anglo-Persian) oil companies. In 1962, the Kuwayt National Petroleum Company was formed to develop areas relinquished by the KOC. Kuwayt, with the highest per capita income of the region, has become a country so rich that it now "banks oil" against a fluctuating monetary market by establishing a daily ceiling on oil production.[8]

Libya evolved as a significant oil source following the initial Suez Canal in 1965. Initial exploration began in 1954 but development was soon intensified with commercial production beginning around 1961. Unlike the other countries that granted concessions for exploration and development, Libya passed a Petroleum Law in 1955 and invited oil companies to bid for concessions. By 1968, there were 37 companies holding grants, representing American, British, French, Italian and German interests. The upsurge in concessions, coupled with the recognition of the country's geographical advantage to European markets caused the Libyan government to establish the National Oil Company LIPETCO (Libyan General Petroleum Corporation) in 1968 to oversee all new concessions.[9] Under Muammar al Qadhafi, Libya became

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[8]Ismael, T.Y., op. cit., p. 233.

[9]Schurr, S., and others, op. cit., p. 118.

one of the first nations to successfully seek total nationalization and control of oil companies operating within the country.

Though the four countries mentioned above produce the bulk of exported oil, small quantities are produced in Egypt, Bahrain, Qatar, Neutral Zone (Kuwayt-Saudi Arabia), Turkey and Israel. Egypt, unlike the other countries did not grant a major concession. Instead the land was divided into plots to be developed by various foreign companies either solely or in partnership with Egyptian enterprises.[10] Oil for the United Arab Emirates was developed mainly by American and British Companies, and there was one Japanese concession in Qatar.

Of importance here is the impact of one non-Arab oil producer, Iran (Persia). Iran, the first country to produce oil, granted the original concession to W.K. D'Arcy, but the Anglo-Persian oil company acquired full control over the area in 1909. The oil produced at this time was important for fueling the British Royal Navy. For the next 40 years Britain successfully dominated the region. Prior to World War II, Russia had unsuccessfully tried to assert claim over oil rights in Northern Iran. In the mid-50's the government of Iran took over the properties and entrusted the oil operations to an International Consortium (mostly British and American with a small French interest) which

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[10] Lenczowski, G., op. cit., p. 21.

would operate on behalf of the state, under the administrative responsibility of the National Iranian Oil Company. In central Iran the NIOC carried out some exploration and drilling on its own.

Furthermore, in the late 50's Iran also allowed other foreign oil companies to bid for development of areas which were outside the territory of the Consortium, and in most cases would then enter into a partnership with these companies (examples are the Iran Canada Oil Company and the Iran Pan American Oil Company). Following World War II, Iran had made the first attempt of any of the oil producers to gain full control of the oil companies, mainly desired because of the increasing difference between oil revenues paid the country and tax payments paid to foreign governments. This attempt, though unsuccessful, pointed out the tension of the oil producing countries over the control held by foreign companies and the desires for nationalization--a situation which exploded in the seventies.[11]

The so-called transit group (Egypt, Syria, Lebanon and Jordan) are important because even though these countries do not produce oil, their actions and policies are relevant to the foreign interests that import oil and the foreign companies that produce oil and need to find ways to get it to the markets. Oil transits Syria, Lebanon and Jordan thru pipelines, and when open, transits Egypt via the Suez Canal. The oil produced in Iraq and Saudi Arabia (two of

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[11]Schurr, S., and others, op. cit., p. 114-115.

the four major producers) must cross Syria giving that country a highly strategic position. The other major route used to be the Suez Canal, which transported the exports of Iran, Kuwayt, and Saudi Arabia, and will now probably resume this role since it has reopened.[12] Permission to lay pipelines is a big area of negotiation between the oil companies granted concessions to develop and export, and the transit countries. It is thus easy to understand how Libyan oil became so important in such a short time-frame, due mainly to its ready availability for European markets without involving other countries.

Historically speaking, it was the Suez crisis and shutdown of the Canal in 1956 that served as a forewarning of the dependence of Europe on oil from the Middle East. Supplies had to be rerouted or received from other sources. The Suez Canal was reclosed during the 1967 war and did not reopen until late 1975. This required a major shift in the routes used to get the oil to the consumers. New pipelines had to be planned and constructed and supertankers were designed to carry more oil around the Cape of Good Hope. The impact of the Canal's closing on Egypt's economy was enormous, since oil tankers paid a high percentage of the Canal's tolls. By 1971, plans had been made for both the SUMED (Suez-Mediterranean) and IRTUP (Iran-Turkey) pipelines. Construction for the SUMED pipeline across Egypt was approved by the

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[12] Lenczowski, G., op. cit., p. 25-26.

government in May, 1972. The fate of these various pipelines is undecided at this time due to the reopening of the canal.

2. Overview of Today's Environment and the Foreign Interests/Dependence

Today, the United States, Europe, Japan and the Soviet Union (including the East European bloc) are in some way interested in or dependent on the oil supplies of the Middle East, and this dependence can only increase unless other energy resources are developed into functional products. While Europe and Japan are the most dependent, the United States is attempting to become free from any dependence on foreign oil, since this dependence is so important for American political and economic influence. Additionally, the Soviet Union has recently taken a hard look at its policies and has realized the importance and necessities of the Middle Eastern oil fields for that country.

Though the United States is the world's largest consumer of oil it is not solely dependent on Middle Eastern oil. Most U.S. oil comes from the Western Hemisphere, with the bulk of it produced within the country. However, as consumption increases and reserves dwindle, increased dependence on Middle Eastern oil, can be projected into the future. The United States does, however, have important interests in the Middle East oil fields since five out of seven of the major international oil companies, which explore, produce, transport, refine and market the major share of the world's oil, are U.S. corporations.[13] This economic link has a tremendous effect on United States' foreign policy and its relations with the Middle East, even though the United States has sought to develop policies limiting dependence on foreign oil imports by investigating and developing other sources, e.g., Alaskan oil, and by setting limits and tariffs on the amounts of oil imported for consumption.

Western Europe, having converted largely from a coal based economy to an oil based one, is highly dependent on Middle Eastern oil. With few developed oil deposits, Europe is leading the market in oil importation, mainly from Mediterranean area sources. The importance of oil supplies to meet growing requirements, and therefore, the necessary reliance on imports has become a situation of pressing interests to European economists and policy makers. The area is seeking other energy alternatives mainly through the development and exploitation of natural gas and nuclear power, now that coal is seemingly in a decline. However, even with the development of these resources, imported oil will still account for a high level of Europe's energy consumption.[14]

While Europe is the world's largest importing region, Japan is the world's largest importing country. Like Europe,

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[13]Schurr, S., and others, op. cit., p. 1.

[14]Ibid., p. 42-48.

in the mid-50's Japan, a country with no exploitable oil deposits, moved from an energy program based on consumption of coal and hydroelectric power to one based on oil; and the country's reliance on importation has been steadily increasing since that time. Japan currently imports oil mainly from the Middle East, with additional supplies available from Southeast Asia, and possibly China. Unlike Europe, however, Japan does not have alternative resources available that could serve to lessen the dependence on oil supplies. Coal and hydroelectric power are rapidly depleting sources; reserves of natural gas are so small that they are virtually unexploitable and account for a very small fraction of the country's energy consumption. Development of nuclear power is more risky for Japan than for other areas due to the problem of earthquakes and dense population centers that together could cause catastrophic accidents while the country is experimenting with development of the technology and product. The Japanese Atomic Energy Commission, nevertheless, did adopt a Long Range Program in the early seventies for development of atomic power with operational power supplies projected for the late 1970's. The projected capacity, however, will have little effect in lessening the amount of oil imported. Thus, Japan, like Europe, must seek measures that serve to guard against future possible supply interruptions.[15]

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[15] Ibid., p. 48-52.

While the Soviet Union is not directly interested in Middle Eastern oil for internal consumption, a hard look at policy has taken place resulting in an increasing interest in the oil problems and policies. Up until the mid-60's, the Soviets produced a surplus of oil, which was exported to the East European bloc countries, and, therefore, the Soviets were only interested in Middle Eastern oil for (a) its contribution to the industrial and military power of the Western nations, and (b) its value as a means of propaganda. The Soviet Union could denounce the "International" (basically Western) oil companies as imperialist agents and thus use this anti-Westernism as a means of forming closer ties with the Arabs. The Soviets thus encouraged nationalization of the oil companies as a means of weakening Western power. In the late 60's, the situation reversed itself, and with consumption surpassing production, and the desire to retain the markets currently importing oil from the U.S.S.R., the Soviets have had to contemplate either importing oil or exploiting at very high expense the Siberian oil fields.[16] By both importing and exporting oil, certain economic and technological benefits could be gained, in addition to retaining the ability to maintain oil independence, and avoiding depletion of the home source. The Soviet entrance into the Persian Gulf market has necessitated some compromises with ideological and propaganda beliefs, which surely

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[16]Berry, J.A., "Oil and Soviet Policy in the Middle East," <u>The Middle East Journal</u>, Vol. 26, no. 2, Middle East Institute, Spring 1972.

did not come easily. Attitudes towards Western imperialism and all the evils involved have had to be altered.[17] Entry into the Persian Gulf oil market has further served to complicate foreign relations in such matters as the Arab-Israeli conflict, since the issues evolving around that region are constantly intertwined with the oil decisions.

With the understanding that oil has now developed into a political weapon between the Third World countries possessing the oil resources and the powerful Western and Eastern nations requiring this vital energy source, it is easy to comprehend why it has become essential to analyze the thoughts and attitudes that lie behind policy decisions of the oil rich nations, and the strategies that might possibly develop as a result of their decision-maker's viewpoints, country interactions and the unity or disunity of the group within OPEC.

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[17] Hunter, R.E., "The Soviet Dilemma in the Middle East, Part II, Oil and the Persian Gulf," Adelphi Papers, no. 60, The Institute of Strategic Studies, 1969.

II. ATTITUDES AND VIEW-POINTS OF THE ARAB DECISION-MAKERS

A. THE FOUR MAJOR ARAB OIL PRODUCERS

Though many countries in the world produce oil, when an analyst tries to determine what or whose policies could impact on world oil consumption, he needs to study the Arab nations to find the policies that could affect oil supplies the most. The study could be narrowed even further to the four major Arab oil producing nations--Saudi Arabia, Iraq, Kuwayt and Libya. Algeria, Arab and most radical, is not a major producer, and Iran, the second largest producer, is non-Arab. These two countries will be discussed only briefly in the following section since they influence more than control policy, due to their quasi-independent status. The Big Four, as they shall be referred to throughout this thesis, will each be analyzed as separate entities in this subsection and then considered as a group for the rest of the chapter.

1. Saudi Arabia

Saudi Arabia is both the largest country and by a slight margin the largest oil producer in the area. This monarchial state is the seat of the Muslim religion; it is also the most powerful nation in the Arab world in terms of wealth. Saudi Arabian oil production capability, reported to be 423 million metric tons in 1974 is almost equivalent to the combined amount produced by all the other Arab countries in the region.[18] This fact, however, does not enable the country to maintain a leadership position over all the other Arab oil countries. The country's viewpoints toward oil are extremely important in determining Arab oil policy, since Saudi Arabia does take the lead on any issue for the conservative group, which includes Kuwayt, the United Arab Emirates, and the smaller producers. Thus, this country is one of the major barometers for interpreting or forecasting any trends concerning various phases of oil production and exportation.

Saudi Arabia is a family-ruled monarchy with many members of the king's family serving as the ministers and deputies. Thus one royal family basically runs the country even though factions may arise within it. The oil industry and modernization has created a new working middle class from this formerly predominant Bedouin nation, but the government has not allowed any outlet for their political thought, such as political parties, and consequently, policy decisions are autocratic in nature, and influenced by religion, extreme conservatism and traditionalism.

Saudi Arabia has the most conservative oil policies of any of the major countries to be considered. In 1962, the country was one of the last to establish its own national oil company, PETROMIN, the Saudi Arabian General Petroleum and Mineral Organization, with the mission to develop all

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[18] Arab Report and Record, Issue 1, p. 67, 1-15 January 1974.

minerals and not concentrate strictly on oil.[19] Unlike the other states, Saudi Arabia has not sought to nationalize the foreign oil companies, but stresses the moderate stand of participation. Two factors bearing directly on the Saudi position of participation is Aramco's efforts to "Saudize" its operations and the Saudi's awareness that Aramco is backed by vast financial reserves which may be needed for development of several new fields.[20]

For the past year the country has been negotiating with Aramco for full takeover of the company's assets. Oil Minister Yamani stressed the Arab's right "to control their oil industry." However, the government also took the position that this takeover did not constitute nationalization and would only take place following agreement of terms by both sides.[21] The Saudi aim is mainly to ensure greater control over market price and production capacity. Saudi policy makers believe that the quantities that each company could produce should be tied to the industrialization projects and development programs within the country, in other words, program production levels exclusively in terms of national interest. This attitude is complicated by a "moral responsibility" that results from the awareness of not only

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[19]Schurr, S., and others, op. cit., p. 129.

[20]Mosley, L., Power Play, Random House, 1973.

[21]"Aramco: End of the Road," An-Nahar Arab Report, v. 6, no. 6, p. 2, 10 February 1975.

needs of oil consumers, but also the needs of poor, developing Third World nations, which require financial aid from oil revenues.[22] The country thus presses for adequate consumer-producer dialogues and working relationships so that the best interests of all parties may be served in all areas of production capacity.

The assassination of King Faysal Ben Abdul Aziz on March 25, 1975, created concern over how Saudi oil policies might be affected. Faysal had been a leader in both instigating and ending the 1973 oil embargo and served as the OPEC moderating influence by constantly opposing price increases and production cutbacks. Also he sought to maintain friendly ties with the U.S., while simultaneously being very willing to let the U.S. try to solve the conflict while he sided with the Arab nations against Israel.

Now, even though King Kalid is on the throne, Crown Prince Fahd controls internal politics. Indications are such that he will probably see that Saudi Arabia pursues the same moderate policy lines, since he still remains head of the Supreme Petroleum Council, the body that formulates guidelines for the country's oil and investment policies. Continuity can be maintained since membership in the council is unchanged from Faysal's reign. Prince Fahd does not believe in threatening the oil weapon in advance as a means of

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[22] "Saudi Arabia: Changing Face of the Oil Industry," An-Nahar Arab Report, v. 6, no. 28, p. 3, 14 July 1975.

exerting negative pressure at bargaining session. This does not mean that he wouldn't hesitate in favoring another embargo should there be an Arab military defeat. The main conflict that could have a future affect on Western ties lies between Oil Minister Yamani and Prince Fahd. Yamani favors closer ties with the U.S. than Fahd, who leans more towards Europe. The conflict was present prior to King Faysal's death and fueled by rumors that Yamani would be removed and replaced by Saud al Faysal. Installation of Prince Saud as State Minister for Foreign Affairs has left Yamani's position secure, at least for the present.[23]

As will be brought out later in the discussion of OPEC, Saudi Arabia leads the moderates on prices and production levels. The country itself has not started regulating production as a means of conserving its resources for the future. This lack of regulation is probably due to the fact that the world's largest proven reserves lie within its borders. Saudi Arabia is the strongest proponent of consumer-producer dialogues, which it believes should serve as the foundation for working relationships and mutual agreements on all issues relating to oil development, production and exportation within the world. Not all countries are so conservative, however, and Iraq, the next country to be considered, has at times been one of the most radical in terms of its Arab nationalist ideology and politics.

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[23]"The Death of Faysal: A Void to be Filled," An-Nahar Arab Report, v. 6, no. 16, p. 1-2, 7 April 1975.

2. Iraq

Iraq is one of the more radical Arab oil producing nations. The revolutionary government, headed by President Ahmed Hassan Bakr, continually seeks to link oil operations with politics. Also, by maintaining ties with Communist bloc countries, Iraq hinders Western oil company operations. Iraq was one of the first countries to start nationalization of oil companies by having the state-owned Iraq Company for Oil Operations take over the Iraq Petroleum Company (IPC) in 1972. IPC was at that time responsible for production of approximately 55% of the state's oil. The state also owns the Iraq National Oil Company.[24] The 43% American share in Basrah Petroleum Company was nationalized in October, 1973, as a result of U.S. support of Israel during the war. Nationalization of the oil industry in Iraq has been so successful thus far, that when Saddam Hussein, Vice-President of the Revolutionary Council, spoke to oil ministry personnel on June 1, 1975, concerning the implications of nationalization, the speech served as a warning to the remaining foreign countries with shares in the Basrah Petroleum Company that a third takeover might be on the horizon. This takeover would eliminate the last foreign oil concessions remaining in the country. Public confidence in the Iraqi regime has been bolstered by the increased oil revenues and statements by

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[24] Mosley, L., op. cit., p. 432.

Hussein to the effect that "had it not been for the nationalization decision, 'we would not have been an independent state'."[25]

Iraq believes that production programming is the key plank to maintaining supply-demand-surplus equilibrium and has currently scaled down its target for production and exporting capacity from the 1972 plan of 325 million tons/year to be reached by 1980, to a present target of 200 million tons/year to be reached by 1982. According to Oil Minister Tayih 'abd al-Karim the production policies are determined by the extent of oil reserves, the world market conditions, and the country's financial needs for development.[26] Currently, Iraq's ambitious development plans need money making the problem of surplus oil revenues nonexistent. The Iraq National Oil Company has the highest priority in exploration and development since the roles of foreign firms are highly restrictive. Unlike other nations, Iraq does not believe in any joint ventures or production sharing with foreign interests.[27] The main ideology driving the country's policies is the Ba'th party's idea of a "rapid development of the economy in a limited period of time," a policy requiring large and immediate revenues.[28]

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[25]"Iraqi Oil: Takeover and Development," An-Nahar Arab Report, v. 6, no. 23, p. 2-3, 9 June 1975.

[26]Middle East Economic Survey, v. 28, no. 35, p. 2-3, 20 June 1975.

[27]Ibid., p. 1.

[28]Ibid., p. 4.

Iraq remains one of the main countries consistently seeking oil price increases. Oil Minister al-Karim stresses a "fair price for oil linked to the prices of food commodities, other raw materials and manufactured goods and to see the adoption of a new international economic system based on justice and equal international relations without harming anyone."[29] This policy is in support of President al-Bakr's conviction that Iraq would be against any policy harmful to consumers as long as the rights and interests of producers are not violated. Iraq views U.S. interests as an imperialist plan to dominate the world's economy and to exploit the national resources of various countries. Thus all policies are directed towards confronting imperialism and insuring legitimate interests in such a way that they may serve as an example to other struggling countries, and thus attempt to promote unity and solidarity among oil producing nations.[30] This philosophy is particularly reflected in Iraq's role within OPEC.

3. Kuwayt

Kuwayt, the tiny amirate on the Arabian Peninsula, is the richest Arab oil producing nation when country size and per capita income are considered as factors of determination. Though ruled by the amir, His Highness Shaykh Sabah

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[29]"Iraqi Oil Minister," Foreign Broadcast Information Service - Middle East and North Africa, v. V, no. 181, p. A2, 17 September 1975.

[30]Ibid.

as-Salim as-Sabah, the actual day-to-day policy decisions and announcements are determined by the various members of the Council of Ministers in accordance with the constitution. The government itself is largely a family affair with officials appointed from among the amir's relatives. The regime's leanings toward moderation are threatened by the non-voting non-Kuwayti majority, many of whom are intelligent and resentful Palestinians.[31] Since oil constitutes approximately 95% of the state's income and results in roughly 99% of its total exports,[32] the Kuwayti Oil Minister 'abd al-Mutalib Kazimi wields much of the power for any type of policy decision which involves oil revenues.

In 1972, the Kuwayti government began to worry about the extent of oil reserves which at the then current rate of production would be exhausted by the late 1980's.[33] Since that time they have been controlling daily production levels to conserve oil reserves and spread out oil revenues, much of which is funneled back to other Arab nations thru the Kuwayt Fund for Arab Economic Development. This fund has been providing capital to other developing Arab countries since 1961.

The country's own Kuwayt National Petroleum Company is not beginning to serve as the "administrative right arm

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[31]Mosley, L., op. cit., p. 430.

[32]"Oil: Kuwayt Digs Deeper," An-Nahar Arab Report, v. 3, no. 10, 6 March 1972.

[33]Ibid.

for its oil policy." The country has been negotiating for a full takeover of the Kuwayt Oil Company, the original foreign oil concession company. Currently Kuwayt holds a 60% share and seeks takeover terms of compensation and technical cooperation that would be agreeable to all parties concerned.[34] The government has never sought outright nationalization, but has adopted the policy of negotiation leading to amicable takeover. However, if agreement can not be reached nationalization could be the only answer.[35]

In an address to the National Assembly on July 12, 1975, Oil Minister Kazimi issued a long statement delineating the Kuwayti oil policies and objectives. The four main points were to "assure the conservation of oil resources by applying the most advanced production techniques....to develop as much as possible the processing industries, especially refining, petrochemicals and gas processing....to assure that the largest possible share of Kuwayti exports is carried on tankers carrying the Kuwayti or other Arab flag, (and)... to protect Kuwayti consumers of oil products by reduced prices of products destined for local consumption."[36] In line with this policy the Higher Petroleum Council was

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[34]"Oil Market Trends," The Middle East Economic and Oil Review, Arab Press Service, no. 99, p. 11, 30 June 1975.

[35]"Kuwait: Still on the Conservative Path," An-Nahar Arab Report, v. 6, no. 34, p. 4, 25 August 1975.

[36]"Kuwait: Oil Policy Statement," An-Nahar Arab Report, v. 6, no. 30, p. 1, 28 July 1975.

established by the government as part of a total restructuring of the oil sector in order that full government control may be maintained. This council is charged specifically to "define policy for the conservation and exploitation of oil resources, develop oil-based industries, and establish an integrated national oil industry."[37] This oil policy is basically conservative and on a domestic level only. Nothing is stated explicitly with regard to the international scene, though as will be shown, Kuwayt takes a moderate stand with regard to oil prices and generally falls in line with conservative Saudi Arabia on OPEC issues. At present the production level is the biggest factor in Kuwayti oil development and exportation and this level is determined by both the technical criteria for conservation and the country's financial requirements, including the various economic aid programs.

Kuwayt appears to be the country that has best learned how to control oil revenues and allocation of funds in a non-wasteful manner. Having achieved the most "sophisticated and extensive network of business and financial institutions" on the Gulf, the country is now branching out into industry and agriculture. Progress in these areas is hindered by a lack of water resources and power, but the government is expanding in three major industries (fishing, food production, and construction) and exploring development of industries

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[37] Ibid.

that are related to petrochemicals. Until these areas are fully developed, however, the government must still seek foreign investments for its massive oil revenues, investments which force the country to maintain friendly ties with the "developed" Western nations, much to the dismay at times of the Arab World which feels that investments should be made at home.[38]

4. Libya

Though an Arab oil producing nation, Libya is different from any of the other countries previously discussed. The geographical location, government, and relative newness of its oil industry all contribute to this dissimilarity. Located directly on the Mediterranean Sea, Libya's oil industry of today is a direct result of the necessity of Western consumers to find convenient oil sources following the two Suez Canal closures of 1956 and 1967. The industry developed in an entirely different vein from all other countries in that oil companies were invited to bid for concessions under the Petroleum Law of 1955. This resulted in many independent developers as well as conglomerates and much foreign interest. These interests served to exploit the industry and revenues right under the eyes of the government until 1968 when a national oil company, Libyan General Petroleum Corporation (LIPETCO), was established to oversee the concessions.

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[38]"Kuwait: Spending the Oil Money," An-Nahar Arab Report, v. 5, no. 48, p. 3, 2 December 1974.

When the oil industry was in fledgling status the government was basically conservative and similar to Saudi Arabia in its stand on oil policy decisions. Today the government is revolutionary and theocratic. The ruling body is a military junta in which Colonel Muammar al-Qadhafi serves as chairman. Colonel Qadhafi's second in command is the Premier, Major 'abd al-Salam Jalud.[39] Though there are various ministers, including a Minister of Petroleum, 'Izz ad-Din al-Mabruk, most policy decisions are handled directly at the top and on important issues, mainly oil prices, it is Colonel al-Qadhafi, himself, who issues any necessary statement. Libya is a strong proponent of high and ever-increasing oil prices and believes the price of oil should have a direct link to the price of commodities. Colonel al-Qadhafi has stated that "the Libyan Arab Republic is prepared to reduce the price of its oil in return for reductions offered by the oil-consuming countries in the prices of their industrial exports."[40]

The major conflict in the Libyan oil industry sector is nationalization. Since his takeover, Colonel al-Qadhafi's ambition has been total nationalization of all foreign oil interests. Major Jalud, on the other hand, recognizes the Libyan need for the foreign oil companies to provide a sales

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[39] Mosley, L., op. cit., p. 432.

[40] "Al-Qadhafi on Oil Prices," Foreign Broadcast Information Service - Middle East and North Africa, v. 5, no. 190, p. A1, 30 September 1975.

outlet and favors participation agreements.[41] At present, Libya controls slightly over 75% of the country's oil production and Oil Minister Mabruk has stated that there is currently no intention to seek further control due to "marketing difficulties, commitments to exploration by the companies, and the question of investment for the maintenance of production from the existing oil fields."[42]

The big issue faced by the government with regards to revenue decisions is the amount of oil reserves and just how production levels should be adjusted to maintain the supply of revenue and still resolve the varied economic problems that face the country. Libya has no oil producing surplus capacity which could yield extra revenue if world demand would increase. All 1975 oil produced was under contract to world companies and markets, and none was available for the country to sell outright. Oil Minister Mabruk has also stated that it has been necessary to cutback production within the Republic to "prevent draining the productive capacity of some fields."[43] The Libyan economic planners are now aware that oil can no longer serve as the only source of revenue and are seeking development in other sectors of

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[41] Mosley, L., op. cit., p. 432.

[42] "Libya: 1975 Industrial Plans," An-Nahar Arab Report, v. 6, no. 20, p. 4, 19 May 1975.

[43] "Libya Has No Surplus," Foreign Broadcast Information Service - Middle East and North Africa, v. 5, no. 179, p. A1, 15 September 1975.

the economy such as agriculture, construction, petrochemicals and shipping. However, development in these areas is still dependent on the revenues from the fluctuating world market in its demand for Libyan oil.[44]

The attitudes of the four major Arab oil producers which have been considered thus far, have the greatest effect in determining what would constitute an Arab oil policy. However, other Arab countries and one non-Arab state can strongly influence or have an effect on any decision or policy made by one of the big four. Before discussing some of the policy interactions that have taken place between these four countries, it becomes pertinent to review the influence of these other countries, namely Algeria, Iran, Egypt, Syria and Lebanon.

B. OTHER COUNTRY INFLUENCE

Algeria, a relatively important Arab oil producer, is the most radical of any to be considered, since it does not usually fall into line with other Arab nations. Algerian President Boumedienne is the spokesman for Algerian oil policies, which favor high prices due to the low development level of the country and the need for immediate revenues. Algeria views exploitation of oil and the demand for lower prices as imperialist actions. As a leader of developing Third World nations, Algeria consistently seeks higher revenues, though the country has learned to moderate its position

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[44]"Libya: 1975 Industrial Plans," <u>op. cit.</u>, p. 4.

whenever the result could threaten Arab unity. President Boumedienne's position favors closer ties between the Arab World and Western Europe as a means of exchanging raw materials and labor with technology and experience in a way to benefit all interests.[45] Quite possibly he views Europe as a lesser threat than the United States since Europe faces more rampant inflation, a problem shared by the Arab world, and is seemingly less responsible for the "artificial raising" of oil prices.

Another oil producing nation directly affecting the Arab states is Iran. Iran, the second largest producer in the area behind Saudi Arabia, is non-Arab. In 1951, Iran tried unsuccessfully to nationalize its oil assets. By 1953, the Shah of Iran had reached agreement with the international oil consortiums that enabled Iran to become an active participant in the oil industry. Control of the country's share is managed through the National Iranian Oil Company, whose founding was the only successful phase of the 1951 Nationalization laws. The oil industry in Iran has been constantly expanding; over half of its exports go to Japan and other parts of Asia, as well as Western Europe. Iran's continued success at industrialization, modernization and the ability to increase the standards of the country's socioeconomic structure are all hinged on the amount of oil revenues.

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[45] "Boumedienne States Arab Oil Position," Middle East Monitor, v. 4, no. 23, p. 5-6, 15 December 1974.

Iran is now into the fifth Seven-Year Plan for economic development, which is still highly dependent on oil revenues, even though each succeeding plan tries to reduce economic dependence on oil income.

As a strong Western Ally, Iran can foresee a constant demanding market for the oil supplies no matter what the Arab oil producers should decide to do. Since Iran is not torn by movements of Pan-Arabism that could conflict with the country's own national identity and interests, this independent state is free to either support other Arab nations or to "go it alone" on oil matters, such as it did during the oil embargoes by continuing to supply oil to Israel. Iran wields enough power to be the main contender against Saudi Arabia for not only domination of all facets of the oil industry, but outright leadership in the Persian Gulf region. As will be seen in the chapter on OPEC, this country is a major factor to be dealt with on all issues, and without favorable ties the Arab world could lose out in any attempt to employ the oil weapon.

Additionally, three non oil producing Arab nations that must be reckoned with are Egypt, Syria and Lebanon. Egypt and Syria are at the heart of the Middle East conflict between the Arab world and Israel, and this conflict is one of the main political factors affecting any oil policy. The fighting between Egypt and Israel in both 1967 and 1973 resulted in the two oil embargos. In effect, these embargos were called for by Egypt as a request for support from its

Arab brethren and in retaliation for Western support of Israel. Egypt is also important in relations with its Arab neighbors relative to the oil market because of the country's control of the Suez Canal.

The two previous closures not only forced Western consumers to seek alternative means of obtaining oil, but forced the Arab states to stop and consider just how to get their oil to the demanding markets. The importance of good relations with Syria and Lebanon and the requirement for due consideration of their attitudes when policies are decided upon lie in the area of pipelines. A large supply of oil from major Middle East Arab oil fields, mainly Iraq and Saudi Arabia, must pass through pipelines within the borders of these countries prior to loading on ships in Mediterranean ports for transport to market.

As Syria has already demonstrated, the oil flow can be stopped or slowed down without the Arab producers even contemplating embargo actions. Syria and Lebanon have also had a strong impact in determining the prices of Iraqi oil, agreements which the Iraqi government formerly described as "blackmail under duress." Iraq has recently, however, completed plans for its own pipeline, the Fao-Haditha, which will put Iraq in position to exert its own pressure by threatening to cancel or reduce the flow of oil through the old pipelines.[46] All these factors make it clear why even

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[46]"Iraq-Syria-Lebanon: The Strategic Pipelines," An-Nahar Arab Report, v. 7, no. 1, p. 2, 5 January 1976.

some of the non oil producing Arab nations can influence Arab oil policy decisions.

No mention has been made thus far concerning the United Arab Emirates. This unified "conglomerate" of small shiekdoms produces a fair amount of oil. In 1974 they produced 83.3 million metric tons which amount to approximately 10% of the total Arab oil production for that year.[47] However, they are highly conservative and usually follow the lead of Saudi Arabia on major issues. It is a rare occurrance for the group to stand on its own for policy actions. The largest, Abu Dhabi, has recently run into difficulty over the decrease in oil demand. The country has not only had to reduce production but has also had to abandon plans for nationalization of its oil industry, since the oil companies are still needed not only to provide the technology in managing the markets but also to sell the bulk of the oil produced. Oil and Industry Minister for the United Arab Emirates, Ma'ni Utayba, has viewed Abu Dhabi's problem as an example of "political pressure" by the oil companies to try to influence prices. Supposedly, the UAE was chosen for this action because of its enormous wealth, most of which is committed to foreign aid.[48] Like the others, Abu Dhabi has

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[47] Arab Report and Record, Issue 1, p. 67, 1-15 January 1975.

[48] "Abu Dhabi: OPEC's Soft Underbelly," Arab Report and Record, v. 6, no. 18, p. 1-2, 5 May 1975.

now been forced into the position of learning to program production levels and conserve its petroleum resources.

C. PAST AND PRESENT INTERRELATIONSHIPS BETWEEN THE ARAB OIL COUNTRIES

When interrelationships involving oil and the oil producers are considered, there are four main areas that should be highlighted: oil revenue spending, crises actions, OPEC, and power plays. Oil revenue spending mainly in the form of economic aid, and power plays will be summarized briefly while interactions in past crisis actions, such as embargos, will be analyzed in depth. These are important since past embargos can be viewed as the foundation for determining the future. The interrelationships of the various Arab States as members of OPEC and OAPEC will be considered in the following chapter because these organizations are most likely the backbone for any form of joint policy or for possible evolution of certain forms of disunity.

1. Spending the Oil Revenues

The various oil producing nations spend their revenues in two major ways: internal development and external financial aid. In addition, some countries invest in foreign enterprises. Spending money for growth and development has served to increase the countries' standards of living, with resultant benefits to industrialization, education and agriculture. There is not much interaction between nations in this area that could influence oil policy unless the point of inequality of oil revenues is brought into the picture.

This inequality, as will be shown in the next chapter, has led some nations to seek a production allocation level among OPEC members in order that all nations might obtain their fair share of oil revenues relative to the amount of oil production capability of each particular country.

The other main area of spending that does lead to some interplay among nations is the various forms of financial aid. The Arab nations, similarly to the United States, are very generous with their wealth. There are many programs, both joint and individual, that supply funds for economic assistance to the many underdeveloped Third World countries. Among these are OPEC sponsored plans of loans or contributions to the International Monetary Fund and the World Bank, and some individual country aid programs, such as the Saudi Arabian Monetary Agency, the Kuwayt Fund for Arab Economic Development, and revenue funds set up by Iran, Libya, and the United Arab Emirates.

Some additional funding programs established jointly by two or more participating states include the Islamic Bank to aid Moslem Countries, the Arab Bank for Africa and Special Arab Fund for Africa, and the Aid Bangladesh Consortium.[49] These various programs help to serve as a unifying factor among the Third World nations, but quite possibly could lead to problems if a "fair share" is not distributed. A potential problem area, especially for the OPEC sponsored programs,

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[49]Wariavwalla, B., "The Energy Crisis, The Developing World and Strategy," Adelphi Papers No. 115: The Middle East and the International Security System, p. 33-34, International Institute for Strategic Studies, 1975.

is related to the declining oil revenue surplus that could affect just how much an individual country might wish to contribute versus what the others feel should be contributed.

The major oil producers have also spent a fair amount of money in assisting to rebuild the war torn nations following the two major Middle East wars. Additionally, Saudi Arabia aided Egypt following closure of the Suez Canal, an event that had a major impact on that country's economy due to loss of revenue from shipping tolls. Interrelationships in the area of spending between the haves and have nots could lead to problems in a future crisis situation. Since most of the countries involved here are members of OAPEC, it would seem that some of the recent joint ventures of this organization, for example, the Arab Shipbuilding and Repair Yard Company, the Arab Petroleum Investment Company, and the Arab Maritime Petroleum Transport Company,[50] are attempts to maintain solidarity.

2. Crisis Situations Involving the Arab Oil Producers

There have been several crisis situations since development of the oil industry began, involving such concepts as prices, nationalization, and employment of the oil weapon. Pricing problems will be dealt with in the following chapter on OPEC and nationalization problems have already been mentioned. This section will deal with the two employments of the oil weapon--the embargos of 1967 and 1973.

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[50]"OAPEC: Projects Started," An-Nahar Arab Report, v. 6, no. 1, p. 3, 6 January 1975.

Understanding the impact of these actions is important since one of the three options open to the Arabs, should they wish to adopt any future strategies involving use of their oil as a political tool, is embargo, the other alternatives being prices and production levels. A brief resume of the two embargos will be presented first to be followed by a comparison of the similarities and impacts which took place that could be used to assist in forecasting a new embargo.

a. The 1967 Oil Embargo

The Arab Oil embargo of 1967 came about basically due to Nasser's proclamation of 4 June that the United States and Great Britain were aiding Israel in the attack on Egypt and Jordan. Iraq then called a conference in Baghdad of all Arab oil producing countries. The aim of the conference was to get a consensus to withhold oil from any country backing aggression against an Arab state. Attendees at the conference were the oil producers Iraq, Saudi Arabia, Kuwayt, Algeria, UAR, Bahrain, Qatar, and Abu Dhabi. Also in attendence were Lebanon and Syria since they controlled oil pipelines. The conference unanimously decided on 5 June to suspend the flow of Arab oil and to prevent both direct and indirect shipments to any state which committed or supported an aggression against another Arab nation or any Arab territory. The participants also appealed to Iran to take measures to prevent Persian oil from reaching Israel.[51]

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[51]Middle East Record, v. 3, p. 244, Israel University Press, 1971.

The actual embargo actions took place on 6 June when Iraq suspended pumping, Kuwayt banned oil exports going to the United States and Britain, Syria closed all pipelines from Iraq and Saudi Arabia, and Lebanon banned loading of oil on any ships, no matter what flag was carried, at the Iraq and Saudi pipeline terminals. Algeria not only banned oil exports but also placed all U.S. and British companies under state control. On the seventh of June Saudi Arabia announced that oil supplies were being cut off to supporters of Israel and all exports ceased from Libya, Bahrain and Qatar as well. Libya, however, did not ban shipments to West Germany, which were large enough to be diverted to the United Kingdom.[52]

The oil embargo was officially lifted at the Khartoum conference on August 29, 1967. However, most countries by then had resumed production with only an embargo on tankers destined to the United States or Great Britain. Saudi Arabia resumed Aramco operations on 13 June, Kuwayt and Iraq on 14 June, and Libya had resume operations on 7 June. Most states had not been enthusiastic about an export embargo so that the lifting of it was not unexpected. The Arab producers had reached a more realistic and moderate view. Their new approach was based on the idea that "oil could be put to the best use as a positive weapon, providing the necessary funds for reconstruction and resistance."[53]

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[52] Ibid., p. 244.

[53] Middle East Economic Survey, v. 10, no. 45, p. 1, 8 September 1967.

The Cairo radio later described the percentage of oil production stopped by the Arab countries during the oil embargo as follows: Libya, 79%; Saudi Arabia and Kuwayt, 37%; Algeria, 57%; and Qatar, 7.6%.[54]

Broadcasts from various countries showed that the Arabs were now aware of the "oil weapon." However, they also became painfully aware of how weak and ununited OPEC was, and how much they themselves suffered economic damage as a result of their actions. Various budgets had to be cut and development plans curtailed. Furthermore, the non-Arab OPEC nations such as Venezuela and Iran had increased production and reaped in the profits. The boycott had been ineffective in hurting the supporters of aggression and had only really hurt the boycotters, themselves. Next time the oil weapon would have to be employed more judiciously.

b. The 1973 Oil Embargo

Unlike the hastily devised 1967 oil embargo just summarized, the 1973 embargo, evolving as a result of actions during the October War, was a well organized and carefully planned scheme, which made a lasting impact on the Western nations and world economy. The 1973 employment of the oil weapon was a two step process, only one of which could be linked directly to the fourth Arab-Israel conflict. Both stages followed conclusion of the actual fighting, unlike

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[54] Middle East Economic Digest, v. 11, no. 33, p. 600, 24 August 1967.

the previous embargo, which denotes a carefull and well structured attempt at retaliation. The first action was the decision on October 16, 1973, by six Gulf oil producing states, Abu Dhabi, Iraq, Kuwayt, Saudi Arabia, Qatar and Iran, to unilaterily raise prices. This action was not connected with the war itself and was quickly overshadowed by succeeding events.[55] However, the increase was eventually adopted by the rest of OPEC countries so that the long range and far reaching effect never became terminated.

The main stage of the crisis was the quick decision by Arab oil producers, acting in concert under the structure of OAPEC, 24 hours later to restrict production levels to 25% of the amount produced in September. The cutback was to remain in effect until Israel withdrew from Arab territories occupied since 1967. A selective total embargo against the United States and Holland for their support of Israel was also levied. Other Western nations suffering from the reduced production levels sought to establish either friendship with the Arabs, or tried to maintain a demonstrated neutrality towards the conflict.[56]

Western Europe was hurt indirectly by Holland's embargo since the dutch port of Rotterdam acts as a pipeline

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[55]"Oil Consumers Prepare as Prices Rise and Supplies are Cut," Middle East Economic Digest, v. 17, no. 43, p. 1238, 26 October 1973.

[56]"Arab Oil Policy: A First Comment," An-Nahar Arab Report, v. 4, no. 47, p. 1, 19 November 1973.

terminal for much of the crude oil destined for this area. Japan was told to sever all ties with Israel or face an embargo instead of just a production cutback. Following the Algerian Summit Conference on November 29, 1973, the cutbacks were eventually lessened for Europe with plans made for shipments direct to countries losing supplies as a result of the embargo on Holland.

The European states, along with Japan and the Philippines, could now enjoy a "favored nation" status and would not suffer any further reduction in oil supplies. Japan joined this group on November 22, when a policy statement "calling on Israel to withdraw from all Arab territory occupied in the 1967 war and asking for the recognition of and respect for 'the legitimate rights of the Palestinian people' in accordance with the United Nations charter" was issued.[57] The conference also extended the selective embargo to include South Africa, Rhodesia and Portugal,[58] and threatened embargoes on any country reexporting to an embargoed nation. The production cutbacks caused austerity plans to be implemented throughout the world. Many of the plans would remain in effect for an indefinite time period, probably as a result of a Kuwayti oil company consultant's

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[57] "Japanese Statement Brings Arab Oil Reward," Middle East Economic Digest, v. 17, no. 48, p. 1390, 30 November 1973.

[58] "Arab Oil Embargo: Worse to Come?" An-Nahar Arab Report, v. 4, no. 50, p. 1-2, 10 December 1973.

warning that all producers would probably continue to impose some sort of limitations as a means of conserving reserves.[59]

Two important factors make this employment of the oil weapon unique. First, though the main thrust was an all-Arab action, one of the main Arab oil producing nations did not participate. Iraq chose not to join the "otherwise unanimous policy" of reduced production and in fact actually raised its oil output. Iraq was not against using oil as a political weapon, having urged such measures on more than one occasion.[60] However, the country "refused to be party to the general Arab cutback" because it had sought much stronger measures against the United States.[61] The Iraqi plan, reflecting the conviction that the United States is a principal enemy, involved nationalization of American oil interests, withdrawal of Arab deposits from American banks and a break off of all diplomatic and economic relations with the United States.[62]

In contrast to this, many observers believed that the real Iraqi position for not participating was based

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[59]"Oil Cutbacks Could Remain After the War," Middle East Economic Digest, v. 17, no. 46, p. 1334, 16 November 1973.

[60]"Iraq: A Lonely Rider," An-Nahar Arab Report, v. 4, no. 53, p. 1, 31 December 1973.

[61]"Arab Oil: A Gesture of Good Will," An-Nahar Arab Report, v. 4, no. 48, p. 1, 26 November 1973.

[62]"Iraq: A Lonely Rider," op. cit., p. 1.

on a grievance with the Arab combatants over not being consulted during the actual phases of the war, as well as the pressing financial requirements for oil revenues to complete urgent development work.[63] This second position seems to merit more credibility. In any event the fact that Iraq, in addition to Iran, did not support the Arab actions points out the difficulty of maintaining a solid front on policy matters.

The other important point is that though this action seemed to come as a shock, the Western world had been warned of the impending possibility for many months preceding actual implementation. Egypt, unable to dislodge Israel through military force, had become an ardent advocate of the oil weapon and sought Arab assistance in an economic war. On June 2, 1973, the Saudi foreign minister, Omar Saggaf, had declared: "The Arabs are ready to freeze the levels of deliveries of crude oil to countries which support Israel...do not see any justification for increasing output for the benefit of states which support an expanionist and racist state."[64] Even King Faysal voiced the attitude in August that a freeze or reduction of oil production levels would be ordered if the United States did not modify its pro-Israeli policies. These warnings, however, went unheeded and many felt that even if such slowdowns came to

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[63] Ibid., p. 1.

[64] "Arab Oil: The Saudi Stand-1," An-Nahar Arab Report, v. 4, no. 31, p. 2, 24 September 1973.

pass, the reductions would be in stages of gradual restriction of production growth rates, none of which could be implemented before early 1974.[65] The world was unprepared for the massive sudden production cutbacks that followed as an aftermath of the war.

c. Some Similarities

A few comparisons between the two oil weapon embargos may now be drawn. Both resulted from support for Arab nations involved in conflicts, nations that are not oil producers, and both were against aggressive supporters of Israel. This fact shows the strength of feelings relative to Arab unity and mutual support. The first embargo was unorganized and relatively ineffectual. However, the action revealed to the Arab nations the potential value of an organized employment and thus enabled them to be more than ready for the second, highly successful, embargo. Both events showed some disunity due to lack of participation by all Arab nations, which becomes more relevant as today's reduced world oil demand makes the market more competitive. Finally, unless Iran can be brought into concert with the Arabs, the Western world will always have an ally for filling the gap of supply interruptions, thus lessening the effect of any Arab embargo action. This "assistance," however, when used will probably become very expensive.

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[65] "Arab Oil: The Saudi Stand-2," An-Nahar Arab Report, v. 4, no. 40, p. 1, 9 October 1973.

A final type of interrelationship between oil producing nations that should be considered is inter-Arab politics. Various oil countries have vied at one time or another for leadership among the Arab world, within the Middle Eastern region, or within the structure of OPEC. A few of these will now be discussed to show how they could influence oil policies.

3. Inter-Arab Politics

The main oil producing nations involved in Arab power politics are Saudi Arabia, Iran, Libya, and Algeria. The Saudi Arabian steadfast support for the 1973 oil embargo actions and warnings prior to actual implementation quite possibly resulted from a struggle between Libya and that country for leadership of the Arab world. Libyan President Mu'ammar al-Qadhafi, has pursued the personal ambition of becoming the future leader of the Arab world. The Saudi conviction maintains that "Arab unity must be centered on Saudi Arabia as the guardian and temporal head of Islam."[66] Consequently, King Faysal was forced in 1973 to lessen the relationship with the United States in favor of a stronger and more tangible support of the Arab cause. By doing this Egypt would continue to seek its main economic and political support from Saudi Arabia instead of Libya.

Another potential leader is Iran. This country has made consistent attempts at filling the region's power vacuum,

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[66] Ibid., p. 1.

created by the British withdrawal, by seeking various security arrangements and alliance structures amongst the Arab states. Prospects in this area that would put Iran in a leadership position are slim because of the many Arab issues involved. Saudi Arabia and Iran are usually at opposite poles in the "Arab Cold War" and various pressures from Egypt and the other more revolutionary states continually keep a wedge driven between these two nations. Each nation is powerful in its own right, but neither is strong enough to suppress the other, and the diverse attitudes preclude any joint role. Nevertheless, Iran, as one of the principal Gulf powers, continues to aspire to a leadership role in partnership with the other states.[67]

Both Saudi Arabia and Iran are at odds for leadership among the oil producing members of OPEC. Their roles are challenged here by Libya and Algeria. Algeria seeks leadership of the underdeveloped Third World countries as a unified body and uses their support in asserting its position. Power struggles within this organization are a determining factor on just whose policy decisions are adopted. Though much of this will be brought out in the next chapter, it is important to note that not all interactions by countries seeking some sort of leadership role are directly related to oil. But since they all involve oil producing

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[67]Ramazani, R.K., <u>Iran and the Persian Gulf</u>, Research Analysis Corporation, p. 67-77, Report no. RAC-010.134, 1971.

nations, quite possibly oil policies may be affected should any major producer decide to assert its position and take over or withdraw from the group when it feels powerful enough to survive on its own.

D. SUMMARY

This chapter has discussed many facets concerning the attitudes and actions of the Middle Eastern oil producing states. All are relevant when any type of oil policy or political employment of the oil weapon is to be focused upon. How the countries are able to manage their own oil industries will determine their ability to assert independence in the oil market. The attitudes of other neighboring Arab states will help decide such state policies as price, shipment levels, etc. Their individual strengths will aid in resolving just whose ideas carry the most weight. Finally, knowledge of how they spend their money is a prerequisite for determining the amount of revenues required, and a comprehension of how they reacted together in past uses of oil weapon tactics will assist in predicting similar actions in the future. The next chapter on OPEC will deal with the main form of interrelationship among the oil producing states.

III. ANALYSIS OF OPEC

The purpose of this chapter is to examine the Organization of Petroleum Exporting Countries and the roles that the four major Arab states (Saudi Arabia, Iraq, Kuwayt and Libya) play within it. The analysis will concentrate mainly in the areas of viewpoints held by the countries considered, major decisions since the Arab-Israeli War of 1967, and pricing policies, with a brief treatment of the parallel group OAPEC (Organization of Arab Petroleum Exporting Countries). Prior to looking at the individual countries and their relationships within OPEC, some background information on the history and functions of the Organization will be presented, followed by an analysis of the policy and price decisions for recent years.

A. A BRIEF BACKGROUND STATEMENT ON OPEC

The Organization of Petroleum Exporting Countries was chartered on September 14, 1960, during a meeting between Saudi Arabia, Iraq, Kuwayt, Iran and Venezuela. At this time the five nations held 67% of world reserves of petroleum, accounted for 38% of the total world production of petroleum, and furnished nearly 90% of the oil in international trade. In particular, in order to indicate the gravity of the task that OPEC had set itself -- that of forming a united front vis-a-vis the major oil companies -- it should be added that these companies, taken together, produced just over 50% of the total volume of crude oil extracted in the whole world.[68]

The initial thoughts for creating an intergovernmental organization surfaced during the first Arab Petroleum Congress, held April, 1959, in Cairo, with Iran and Venezuela as invited observers. This Congress looked at problems concerning Arab national companies and Arab participation in the oil enterprise. Slowly, though, during private talks representatives began thinking of an organization in which all oil producing countries would participate. The main areas of concern were prices and company control. OPEC was created as a direct result of an oil price reduction. Prior to 1950, the oil companies and host governments operated on a 50-50 principle for sharing profits that benefited both sides due to tax liabilities and credits. During the late 50s the main issue of posted prices arose. These prices were used to compute profits and determine tax liabilities. Under the 50-50 plan nothing changed until 1957 when a less than satisfactory market situation forced the oil companies to start reducing posted prices. Since this action actually reduced country revenues, governments wanted to participate in any future decisions concerning prices as well as to renegotiate the present change. The reductions of 1959 and

[68] Rouhani, F., A History of OPEC, p. 77, Praeger Publishers, 1971.

1960 forced the countries to unite and demand stable prices and a return to the pre-1960 price level.[69]

OPEC's first resolution reveals the hard-core basis for creation of the Organization:

> "That members can no longer remain indifferent to the attitude heretofore adopted by the oil companies in effecting price modifications; that members shall demand that oil companies maintain their prices steady and free from all unnecessary fluctuations; that members shall endeavor, by all means available to them, to restore present prices to the levels prevailing before the reduction; that they shall ensure that if any new circumstances arise that...necessitate price modifications, the said companies shall enter into consultation with the member...to fully explain the circumstances..."[70]

The principal aim of OPEC, as stated previously in the Introduction, was coordination and unification of the petroleum prices. The organization also sought to "devise ways and means of ensuring the stabilization of prices in international crude-oil markets with a view of eliminating harmful and unnecessary fluctuations" and to give due regard to (a) protecting interests of producing nations, (b) securing a steady income to producing countries, (c) maintaining an efficient, economic and regular supply of oil to consumers, and (d) enabling petroleum industry investors to realize a fair return on their capital.[71]

Headquartered in Geneva, membership in OPEC now numbers thirteen; the five founders plus Algeria, Ecuador, Qatar,

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[69] Schurr, S., and others, op. cit., p. 120-123.

[70] Rouhani, F., op. cit., p. 78.

[71] Schurr, S., and others, op. cit., p. 123.

Indonesia, Libya, United Arab Emirates, Nigeria and the Republic of Gabon. The structure of the Organization consists of the following six functioning units: the Conference, the supreme authority which meets twice yearly and consists of delegations from each country; the Consultative meeting, which convenes at any time between the Conferences to examine any questions; the Board of Governors, with one representative from each country; the Secretariat, which is seated permanently for organization and administration; the Economic Commission, which examines world petroleum prices on a continuing basis; and the Coordination Committee of National Companies, which was established to coordinate the activities of the national oil companies within member countries.[72]

B. MAJOR OPEC DECISIONS AND PRICING POLICIES

OPEC mainly concerns itself with decisions regarding oil production and pricing with respect to the international markets. The other major type of decision that could be considered is employment of the oil weapon, i.e., the embargo during the 1973 Arab-Israeli War. However, an embargo decision will not be considered here, since it usually does not reflect concurrence by all members; and it has previously been discussed in detail. The major decisions dealt with here go back as far as 1970; these are sufficient to permit an analysis of OPEC decision-making patterns.

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[72]Rouhani, F., op. cit., p. 121-128.

OPEC's main objectives can be categorized into two areas: The first is stabilization of petroleum prices in such a way that members may reap maximum economic benefits for oil exports both in terms of balance of payments and gross national product. Additionally, members are also aware of the importance of diversifying their economic activities through "oil-based or oil-sponsored industrialization, and direct and active participation of national agencies in the ownership and management of various stages of the domestic and international oil industry." The second is achieving the "elimination, reduction, or at least the preclusion of further increases in trade restrictions and barriers," and concern about "fiscal discrimination against import and consumption of OPEC area oil and derived products."[73]

OPEC adopted five main resolutions between 1960 and 1962. Principal resolution #4 is directly related to the pricing standards they use today. When this resolution was adopted their main concern was posted prices that were approximately 13 cents per barrel lower than previous lowest prices set in July, 1953. Since the oil industry amounts to a public utility, the countries could no longer remain indifferent to the determination of prices, and their aim was for each country to negotiate prices with its own respective companies to at least restore the pre-1960 level. If

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[73] Mikdashi, Z., The Community of Oil Exporting Countries, p. 50, Cornell University Press, 1972.

agreement could not be reached, they would unite and take any steps deemed appropriate. The formula finally adopted by OPEC for price determination reflected their desire that price structure take into account the needs and interests of both producers and consumers in terms of severe fluctuation, predictability of change compensation for increases in manufactured goods, producing capacity, and consistence within various exporting countries.

The Organization has maintained this idea, even though methods of implementation have varied, since they have no wish to create a monster that would affect world economic balance and/or country development plans on a constantly shifting basis. In April, 1966, the adoption of a resolution for basing computation of taxes and royalties, that were payable to the host countries, on posted prices or reference prices became applicable to all existing and future oil agreements.[74] This was OPEC's first significant resolution on price structure and served to stabilize host country revenues and to create a bottom limit for realized prices. Since that time OPEC has met to consider and change the basic reference price, but has not altered the basic aims related to world economy (as a group, individual countries often have individual goals).

OPEC did not really become recognized or successful in accomplishing the objectives which led to its creation until

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[74]Rouhani, F., op. cit., p. 208.

the Twenty-first Conference of December, 1970. This conference culminated a crisis year in which the new Libyan government had raised the posted price and tax rate and started a trend throughout the oil-producing countries, but not a unified stand. At this time, Libya was the most prominent oil exporter and thus in a powerful bargaining situation: other Arab nations were recovering from the 1967 war conditions that had affected their shipment and production levels.[75] At the conference OPEC resolved to establish 55% as the minimum rate of taxation on oil companies, to eliminate all existing disparities in posted prices on the basis of the highest applicable (after accounting for differences in gravity and geography), to establish a uniform increase to reflect market conditions and to adopt a new system for adjusting the gravity differential.[76] The Tehran Agreement of February 15, 1971, averted a proposed embargo should an acceptable pricing agreement not be reached and established an immediate increase of 35 cents per barrel in the posted price of all crude oils. This agreement also promised over-all stability for a five year period. The Tripoli Agreement of March 20, 1971, between Libya, Algeria, Saudi Arabia and Iraq, gave Libya higher prices than the Tehran agreement to satisfy that country's interests. The major consequences of the 1970 conference and the two

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[75] Ibid., p. 19.

[76] Ibid., p. 11.

agreements that followed proved to the world that a shift of power from the international oil companies to the governments of the oil producing countries had taken place. It was a seller's market now instead of a buyers market.[77]

Since the early 1970's, OPEC has had difficulty in agreeing on the price of oil, and relationships with the oil companies has been fairly tenuous. In January, 1972, OPEC concluded an agreement granting an immediate increase of 8.49% in crude oil prices, to compensate for dollar devaluation, over and above the increment reached in Tehran. At this point consumers were having to reevaluate their demand and producers were reevaluating production levels. This new increase resulted from negotiations by Arab countries. While it confirmed OPEC solidarity, the change could also seriously affect output consumption for countries like Venezuela, who had just lowered production levels in order to maintain a steady flow.[78]

In 1973 the Arabs states employed their "oil weapon" by placing an embargo on Western states who supported Israel in the October War. This action had been previously discussed and was not an OPEC action. However, during this time frame OPEC did act to raise posted prices both in October and December. They claimed their actions were not

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[77] Rifai, T., The Pricing of Crude Oil Economic and Strategic Guidelines for an International Policy, p. 263-276, Praeger Publishers, 1975.

[78] "OPEC: Arab Role Reassessed," An-Nahar Arab Report, v. 3, no. 5, p. 1, 31 January 1972.

a consequence of the War but were a means of bringing oil prices in proportion to the minimum cost of extracting energy from other sources. The era of cheap oil had ended.[79] The December price of $11.65 per barrel actually resulted from an October decision of six Gulf oil exporters to set prices in order to insure that posted prices for the future are maintained at a constant 40% above realized prices. Since other nations followed suit, the Organization had to make it an official stand. It was at this point that OPEC also adopted a new scheme for defining prices. In this case, their plans would become a means to ensure freedom for exporting states to modify prices, and to establish a clear relationship between posted prices and realized profits. Indications of the growing cohesion and power of OPEC was becoming more relevent with each successive conference decision.[80] As one organization spokesman stated following the October decision, "the governments now determine prices."[81]

The year 1974 marked the real beginning of constant demand for price increases by members despite the five year stabilization of oil prices agreed upon at the beginning of the decade. In March at the Beirut meeting, the members expressed the need for full compensation as a result of the

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[79]"OPEC Raises Oil Prices Again," Arab Report and Record, Issue 24, p. 59, 16 December 1973.

[80]"OPEC: Policy Confirmed," An-Nahar Arab Report, v. 4, no. 60, p. 2, 10 December 1973.

[81]"Oil Consumers Prepare as Prices Rise and Supplies are Cut," Middle East Economic Digest, p. 1238, 26 October 1973.

dollar devaluation. They tempered their resolve by saying that this was not a demand for higher prices but a desire for a share of the greater profits that companies could now make as a result of the devaluation.[82] Since the meeting in April with Western oil companies produced no mutual agreement, OPEC issued an ultimatum giving the companies ten days to put forth new offers to compensate for the dollar devaluation.[83]

Talks were still deadlocked at the May meeting in Tripoli and Geneva, but at a meeting in Quito, Ecuador, on 1 June, OPEC agreed to freeze prices at $11.65 per barrel for three months, but they would raise the royalties that oil companies pay by 2%. This meeting showed a marked conflict emerging between Saudi Arabia, who had consistently sought to keep prices stable or lower, and those countries wishing to increase prices. Saudi Arabia threatened to put three million barrels per day on the market at a reduced price if the meeting tried to increase taxes on oil exports by more than $3.00 per barrel. This move was immediately countered by Iran and others who threatened to decrease production.[84] Such conflicts are now inevitable at all meetings, and cutting deeper each time. The tax increase

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[82]"OPEC Demands Higher Prices," Arab Report and Record, Issue 6, p. 147, 16 March 1974.

[83]"OPEC Meeting: No Agreement," Arab Report and Record, Issue 8, p. 195, 16 April 1974.

[84]"OPEC Agrees to Freeze Prices of Oil," Arab Report and Record, Issue 12, p. 268, 16 June 1974.

was levied at 3.5% though Saudi Arabia dissented in the decision. The tax increase would raise the price of oil by 33 cents according to OPEC sources though the oil companies figured it would be more like 46 cents. However, Saudi Arabia complicated the unified stand and announced that it would maintain it's existing price level.[85]

By late 1974, OPEC had established a working committee to "study and recommend a new system for long term oil pricing." This system was to revolve around a single base reference price for crude oil and would dispense with posted prices and distinctions between taxes paid by companies, buy-back prices and realized prices. The new system evolved from a desire to link oil prices with other commodity prices as well as reduce the oil companies huge and continually increasing profits. Presented at the December, meeting it provided for a minimum price for crude oil (after accounting for freight charges and quality differentials) that would be adjusted quarterly based on an inflation rate escalation formula. OPEC's Secretary-General 'abd al-Rahman Khini had previously stated the position favoring price increases:

> "OPEC's countries' moderate warnings to the governments of consumer countries to control inflation have apparently served no purpose. It is clear that freezing our prices with inflation still galloping away would be tantemount to accepting a return to the status quo ante..."[86]

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[85]"OPEC Raises Taxes but Holds Prices," Arab Report and Record, Issue 17, p. 389, 1 September 1974.

[86]"OPEC: Rational Pricing," An-Nahar Arab Report, v. 4, no. 44, p. 1, 4 November 1974.

However, when the members finally reached a decision on the proposal, they agreed to a single market price of $10.46 per barrel to be applied for a nine month period regardless of inflation. Thus, though the change represented a large increase of 4% over the current price, the price would remain stable for nine months, instead of being reviewed and possibly changed quarterly.[87] This decision supported the original aim to not subject world economies to uncertain fluctuations too often.

Since prices were now stabilized until September, 1975, the first nine months of the year reflected growing dissention in agreement among the member countries over changes to be made, if any, at the end of the period. At the oil minister's meeting in February, Iraq, Algeria and Kuwayt were pushing exclusion of the dollar in pricing of oil. A move which would have effectively increased the price of oil to the United States, and dealt a heavy blow to the dollar's position as an international trading currency. Strong pressure by Saudi Arabia and Iran, averted this move.[88]

The declaration issued following the March Summit Conference stressed OPEC's stand that "oil prices should be linked to the rate of inflation and cost of manufactured

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[87] "OPEC Adopts New Price System," Arab Report and Record, Issue 23, p. 568, 1 December 1974.

[88] "Before the OPEC Summit: Being Reasonable But Firm," An-Nahar Arab Report, v. 6, no. 9, p. 1, 3 March 1975.

goods and technology."[89] The Conference, however, was a case study in compromises as a means of preserving unity. The radicals led by Algeria, Iraq and Libya called for more drastic stands on price and production issues based on "real value terms" and in response to U.S. actions, while the conservatives led by Saudi Arabia, sought to supply as much oil as the world needed and viewed consumers efforts to "restrict demand and pull back prices as a natural market response and not artificial pressure."[90] However, no real decisions affecting prices were reached.

The major meeting that could affect oil prices prior to the September deadline was in June when oil ministers faced the important issue of determining oil price policies which would be presented at the September Conference. These policies would determine applicable rates to become effective in October. With the exception of Saudi Arabia, almost all the OPEC member countries agreed that present oil prices should be "increased in absolute value to make up for the erosion of purchasing power of the exporters' revenues caused by inflation and the depreciation of the dollar." Saudi Arabia championed a freeze on prices and a reopening of the dialogue between oil exporters and consumers. The Saudis argued that a new increase in oil prices would be "catastrophic"

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[89]"OPEC Summit: Unity Before All Else," An-Nahar Arab Report, v. 6, no. 11, p. 1, 17 March 1975.

[90]Ibid.

for the whole world. Deputy Director-General for the Saudi Information Ministry Hassan Ben Said had expressed on 28 May the Saudi belief that "oil prices will drop as soon as an acceptable solution is found to the Middle East conflict."[91] Iran favored an increase due to loss of purchasing power. When the meeting adjourned the only decisions made were to reaffirm the maintenance of crude oil prices at their present level until September, and to readjust oil prices after that, calculating those prices on the Special Drawing Rights (SDR's) of the International Monetary Fund (IMF).

No state spoke of a planned increase; rather a compensation for inflation and depreciation was discussed. However, replacing the dollar with the SDR as the unit of account in calculations would result in a significant price increase. The radicals, Iraq, Libya, Algeria and Nigeria, sought replacement of the dollar by the SDR to become effective in July but Saudi Arabia insisted that this action be held in abeyance until September since the resultant 11 cent increase per barrel was relatively insignificant.[92] Iran's position was to argue for an alternative to both the dollar and SDR; an argument based on the premise that if the dollar improves much will be lost by calculating in SDR's, Iranian Oil Minister Amuzegar proposed indexing oil prices

[91] "OPEC Conference in Gabon: Pegging the Price of Oil," An-Nahar Arab Report, v. 6, no. 24, p. 2-3, 16 June 1975.

[92] "OPEC Conference in Gabon: A Minimum of Progress," An-Nahar Arab Report, v. 6, no. 25, p. 1-2, 23 June 1975.

against prices of a basket of goods and commodities in international trade to compensate for loss of purchasing power and inflation. Amuzegar favored a price increase but not at the forecasted 30% level. Other members felt that Iran's position was the result of U.S. pressure, and seemingly might prove too difficult to implement; thus this plan was discarded.[93]

The OPEC ministerial conference convened in Vienna on September 24, 1975, with oil prices as the main topic and a non-united membership. Three basic attitudes prevailed. The first was in favor of a moderate increase in the price of oil; this was advocated by most non-Arab states. The radical view held by Algeria, Libya, Iraq (and even Iran, to a certain extent) demanded an increase of over 10% claiming that purchasing power of oil revenues had decreased over 30%. The third position, that of Saudi Arabia and the Gulf States, was to keep prices at their present level so as not to upset world economic order; provided, however, the industrialized world would take steps "toward controlling the prices of goods it sells to the oil producers."[94]

The year 1975 revealed an overall 14% drop in oil production on the part of Middle Eastern producers as compared to a comparable period in 1974. This resulted to a large

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[93]"The World Oil Scene: Signs of Trouble Ahead," <u>An-Nahar Arab Report</u>, v. 6, no. 26, p. 1-2, 30 June 1975.

[94]"OPEC Conference: Asserting Positions," <u>An-Nahar Arab Report</u>, v. 6, no. 37, p. 1, 15 September 1975.

extent from policies adopted by the United States and other industrialized countries. Additionally this drop became an incentive for producers to raise prices so that they would be able to achieve the necessary level of imported capital goods required for their development projects. The biggest drop was felt by Libya (41%), with Saudi Arabia second. Only Iraq maintained its production level.[95] Thus when the conference adjourned on 27 September a 10% increase in price (to be frozen for nine months) was announced. This final decision was viewed as a major concession to the industrialized nations because the oil exporters were facing projected 20% increases in the cost of imports since January. The compromise decision had not come easily, and had followed bitter disputes between Saudi Arabia and most other states.

Saudi Arabia refused to agree to any price above 10% and at one point tried to limit the increase to 5%. Iran, Iraq, Libya and Nigeria had pressed for at least a 15% increase and Iraq advocated a 20% raise. The United Arab Emirates and Kuwayt had proposed a compromise of 12% with a one year price freeze, but this plan was also unacceptable to the Saudi delegation.[96] Surprisingly, Algeria was the mediator in bringing about the final compromise. Algeria sided with Saudi Arabia. This was contrary to Algeria's

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[95] Ibid., p. 2.

[96] "OPEC Increases Price of Oil by Ten Per Cent," Arab Report and Record, Issue 18, p. 538, 16 September 1975.

usual hardline stand on prices, but was mainly a move to keep Saudi Arabia from withdrawing from the Organization.[97] In a television interview on 29 September, Iranian Interior Minister Jashmid Amuzegar accused "Saudi Arabia and another OPEC Moslem country of entering into an 'unholy alliance in this holy month of Ramadan' to try to limit the proposed increase to five percent."[98] Iran, did believe that the unity of OPEC would be threatened by the withdrawal of one member and was thus incensed at the result: the final vote on the 10% increase was 10 for, 2 against and one abstination. Decision was postponed on replacing the dollar with the SDR due to the dollar's new strength on the European market.

Following the meeting the Saudi Minister of Petroleum and Minerals Ahmed Yamani said that he hoped to see prices frozen until 1977 vice June, 1976. The Saudi stand was that "any increase right now, if it does not hurt the economy of the world will at least delay the recovery of those economies. We have a vital interest in seeing the economy of the West recovering as soon as possible, both politically and economically."[99]

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[97]"OPEC: The Price Goes Up," An-Nahar Arab Report, v. 6, no. 39 and 40, p. 1, 6 October 1975.

[98]"Minister Says Saudi Arabia Almost Left OPEC," Foreign Broadcast Information Service - Middle East & North Africa, vol. V, no. 192, p. 2, 2 October 1975.

[99]"Oil Prices Should be Frozen Until 1977," Middle East Economic Digest, v. 19, no. 46, p. 11, 14 November 1975.

The one main observation that can be made here is that though the unity of OPEC survived, it was indeed shaken, and to a greater degree than ever before. A new rivalry had begun to develop between Saudi Arabia and Iran that could have serious implications in the future. The major issues between the two countries seem to be a struggle for OPEC leadership and the calculating unit for oil revenues and price differentials. If differences can not be settled OPEC unity will be subject to dissolution every time a major issue is at stake.[100]

Other OPEC concerns are oil production levels, economic aid to underdeveloped nations and embargos. Embargos have been discussed previously and economic aid is not an issue this paper proposes to discuss. The problems of oil production levels are a current question, but no definitive policies have been established as yet. These issues pose serious problems for OPEC's future and will be looked at in the concluding topic of this section.

C. THE ROLES OF THE MAJOR ARAB OIL PRODUCERS IN OPEC

After looking at the Organization of Petroleum Exporting Countries as a unified group, consideration will now be made concerning particular roles within the structure of some of the various countries -- especially the four large Arab exporters, Saudi Arabia, Iraq, Kuwayt and Libya. Since these

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[100] "OPEC: Issues Threaten Unity," An-Nahar Arab Report, v. 6, no. 41, p. 2, 13 October 1975.

countries have all been analyzed in the earlier chapter, only their role in OPEC will be discussed. As one of the original members of OPEC, Saudi Arabia is perhaps one of the most conservative members. Saudi Arabia has remained the largest producer of oil since the organization's founding. Currently the country is trying to gain leadership of OPEC with the biggest opposing contender Iran. As the most pro-Western Arab nation, Saudi Arabia is not a proponent of oil increases. The Saudi policy leans more toward consumer-producer dialogues to settle disagreements, with prices raised only when mutual agreements can not be reached, or if consumers are not willing to undertake meaningful discussions concerning mutual and/or Arab problems. Since OPEC's creation, Saudi Arabia has been a strong advocate of policies that seek cooperation and participation of the states and oil companies.

On September 17, 1974, Shaikh Ahmad Zaki Yamani, Saudi Arabia's Minister of Petroleum and Mineral Affairs delivered an address titled "A Policy for Oil Towards a New-Producer-Consumer Relationship." In it he stressed the need for a better relationship between exporters and importers, a relation such that oil companies would not remain in the middle. According to Yamani, this relationship should rest on the availability of crude oil, prices and the recycling of oil surplus funds. Since this non-renewable resource constitutes the major share of a country's livelihood, the revenues received must meet necessary requirements. But a build-up of surplus funds is not the answer to the problem. Prices, revenues and production costs must maintain an equilibrium that can only be achieved through meaningful working relationships.[101] In late 1974 Saudi Arabia was the only OPEC member "resolutely set against" the policy of maintaining a single unified price for oil and in fact seemed to favor an overall oil price decrease.[102]

In 1975, Saudi Arabia again did not favor the massive price increases and in fact almost left OPEC because of them. With the world's largest proven oil reserves, the country could supply approximately 50% of the projected oil demand for the remainder of the 70s, and thus in effect determine whether oil supplies would be in abundance or shortage.[103] Consequently, the Saudis can act alone to affect oil prices as well as any other oil policy on which OPEC might decide to attempt.[104] Saudi Arabia's membership in OPEC is important to the West as a means of keeping the price ceiling from skyrocketing. The country's cooperation in OPEC and OAPEC is also important to the other members in order to keep their oil supplies in demand. However, as far

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[101] "Saudi Arabia-U.S.: Prospects for Cooperations," An-Nahar Arab Report, v. 6, n. 41, p. 2, 13 October 1975.

[102] "Yamani: A Policy for Oil," Arab Report and Record, Issue 17, p. 391, 1-15 September 1974.

[103] "Gulf Oil: Saudis Go Their Own Way," An-Nahar Arab Report, v. 5, no. 46, p. 2, 18 November 1974.

[104] Carpenter, W.M. and Gilber, S.P., Great Power Interests and Conflicting Objectives in the Mediterranean - Middle East Persian Gulf Region, Stanford Research Institute, Report No. DAAG 39-74-C-0082, p. 39, December 1974.

as OAPEC alone is concerned the issue is more that of Arab Unity; and Saudi Arabia is a strong proponent of unity, and could split with the west over this issue. Al-Yamani proposed that the country would resort to anything--"expulsion from the U.N., an embargo on oil, and use of our monetary power" if Israel can not agree to an acceptable settlement of the Middle East and Palestinian question.[105]

Contrary to Saudi conservatism, Iraq is one of the more radical Arab members of OPEC, and strong proponent of price increases. Iraq is also, however, isolated within the organization. It did not support the oil embargo and production cutback of 1973, arguing that the measure was not practical. Oil and Minerals Minister Dr. Sa'adun Hammadi explained this action by saying that oil could not be considered just a commodity produced and sold for economic gain, but was a resource closely linked to the producer state's development.[106] This explains Iraq's current stand since not only did Iraq profit greatly by the actions in 1973, but continues to seek higher prices so as to have more revenues for internal development. Iraq is not against employment of the oil weapon, however, and would probably support OPEC and OAPEC on these issues if they should arise. Having an ambitious development program, it is believed that the country today would cooperate with its OPEC partners in

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[105]"Saudi Views of Oil Prices," Middle East Economic Survey, v. 18, no. 45, p. 1, 29 August 1975.

[106]"Iraq: A Lonely Rider," An-Nahar Arab Report, v. 4, no. 53, p. 1, 31 December 1973.

any way to maintain the purchasing power of oil revenues and continually seeks to link oil prices to a commodities index. At present Iraq is the OPEC advocate of allocating oil supplies among members so that demand may be met while controlling production and programming reserves, market conditions, etc.[107]

Considering the country's size, Kuwayt is OPEC's richest producer on an output per capita basis. On its own initiative, this country has controlled production to the extent of banking its oil by keeping it in the ground and maintaining an established daily output. Kuwayt is one of the moderates, advocating prices much lower than Iraq, Algeria and Libya, and seeking to establish compromises when disagreements arise. Generally, Kuwayt follows the Saudi lead. Prior to the October, 1975, increase the Kuwayt Minister of Finance Mr. 'abd al-Rahman al-'Ataghi stated that oil price stability depended on effective producer-consumer dialogues, and that Kuwayt only wanted to recover the loss of purchasing power resulting from the present freeze. Additionally, Kuwayt seeks establishment of prices on a yearly basis to help keep world economic order.[108] Kuwayt's main position on prices within the Organization is to support any decisions that will safeguard the unity of OPEC since oil pricing is

[107]Seymour, I., "Iraqi Oil Policy in Focus," Middle East Economic Survey, v. 28, no. 35, p. 2, 20 June 1975.

[108]Middle East Economic Survey, v. 28, no. 47, p. 1, 12 September 1975.

economical not political. The Kuwayt government feels this way due to the belief that oil prices fall within the control of an international organization that has both Arab and non-Arab members and can never hope to form a unified political viewpoint.[109]

The other big Arab member of OPEC is Libya. This country started out in both OPEC and OAPEC as a conservative, but with its change in government has become more militant although not to the extent of Algeria. Libya supports the idea of coordinating production and advocates any action necessary to establish a realistic and flexible system for determining quality and freight differentials. Libya suffers the heaviest losses in the area of crude oil differentials and is, therefore, the strongest proponent of a system applicable to all OPEC members.

Other countries affecting the OPEC organization are Algeria and Iran. Algeria is Arab and highly radical, even though it compromised goals and joined Saudi Arabia last October in order to preserve OPEC unity. However, the country can not be counted on to continue similar actions unless these are felt to be in its own best interests. Iran, on the other hand, is non-Arab. As the second largest producer behind Saudi Arabia, this country is also vying for leadership of the organization. Additional conflicts beyond that of

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[109]Middle East Economic Survey, v. 28, no. 47, Supplement, p. 2, 12 September 1975.

October could split up the structure irreparably. OPEC needs Iran's cooperation as much as it needs Saudi Arabia's. However, unlike Saudi Arabia, Iran seems to put domestic concerns as first priority.

Though each country has its own particular role to play in the organization, each "would sacrifice a measure of economic gain for the sake of a fuller control of their economies" in such a way as to negate the presence of "powerful expatriate economic interests."[110] Thus any OPEC policies along this line of reasoning would get top priority and full support. How the countries could affect the future of OPEC is analyzed in the conclusion. Before turning to that, the structure of the parallel organization OAPEC will be reviewed.

D. THE ORGANIZATION OF ARAB PETROLEUM EXPORTING COUNTRIES

OAPEC was formed on January 9, 1968, by the governments of the three largest Arab oil exporting countries, Saudi Arabia, Kuwayt, and Libya. OAPEC's creation cemented an alliance between three more or less politically homogenous states with conservative leanings and marked a parting from Arab revolutionary states, Iraq and Algeria, within the OPEC organization. Major differences among the OPEC members had existed since its founding due to domestic, regional, or international problems that, though not necessarily oil

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[110] Mikdashi, op. cit., p. 200.

related, plagued solidarity. The real problem became realized during the June, 1967, Arab-Israeli War when an oil embargo was attempted, called by some the "petroleum defense line."

The embargo has been previously discussed and should be remembered as a hasty decision based on political pressures without considerations of economics. The Saudi Minister of Petroleum and Mineral Resources summed it all up with his comment that the embargo decision "hurt the Arabs themselves more than anyone else, and the only ones to gain any benefit from it were the non-Arab (oil) producers." For instance, the main target of the embargo, the United States, was enjoying greater revenues from the resultant price increases on petroleum products and maintaining oil supplies from other sources. Also, other OPEC suppliers were making handsome profits by continuing to supply oil to embargoed countries. Following failure of the selective embargo, the Arab Ministers of Finance, Economy and Oil held a conference to determine a new course of action. Two diametrically opposed solutions were presented. The first supported by Iraq and Algeria involved a three month stoppage of all Arab oil exports to deplete European oil stocks, even though some Arab governments would suffer severe domestic problems. The second solution, favored by Saudi Arabia, Kuwayt and Libya, offered a policy that would maximize oil revenues and use oil proceeds to aid war-torn Arab states in rebuilding. A concensus was finally reached and oil flowed. However, the latter group, having suffered heavily in the oil embargo, "thought it in their best interests to coordinate their policies outside the Arab League in order to exclude other Arab states from their affairs."[111] These formed OAPEC, an organization designed as a substitute for various oil activities of the Arab League.

Membership in OAPEC now numbers nine: Saudi Arabia, Iraq, Kuwayt, Libya, Algeria, Qatar, United Arab Emirates, Syria and Egypt. Any Arab nation is eligible for OAPEC membership if petroleum constitutes the principle and basic source of its income. While OPEC's main objective is stabilization of prices, OAPEC is organized as a partnership involving all phases of the oil industry; so that member states are able to maintain the oil sector within the framework of their national economy instead of having it remain the external factor that it currently seems to be.[112] Like OPEC, OAPEC now has political differences between the conservative camp and the revolutionary group (Libya joined this side in 1970 with the change in government) that threaten its solidarity. However, both groups "have in common the ultimate aim of unity among Arab countries," and they also presume that "oil can be a means to political integration."[113]

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[111]Mikdashi, op. cit., p. 83-87 and 104.

[112]Who's Who In The Arab World, 4th Edition, p. 151, Publitec Publishers, 1975.

[113]Mikdashi, op. cit., p. 90.

The first crucial test of OAPEC solidarity and success as a functioning unit came in October, 1973, during the fourth Arab-Israeli conflict, when both an embargo and production cut-back was levied. On the day following OPEC's price increase decision, OAPEC succeeded in quickly adopting an acceptable embargo strategy. A minimum cutback was proposed and each nation became responsible for settling on their own rates and procedures for implementation. Thus a solid front of reduced production and selective embargo, with the exception of Iraq, ensued.[114]

The OAPEC statement issued following the Vienna Conference on March 17, 1974, revealed that the Ministers had: "reevaluated the results of the Arab oil measures in light of its main objective, namely to draw the attention of the world to the Arab cause...were aware of the fact that oil is a weapon which can be utilized in a positive manner in order to lead to results the effectiveness of which may surpass those (results) if the oil weapon was used in a negative manner."[115]

OAPEC also lifted the embargo on oil supplies to the U.S., though Syria and Libya did not assent to the decision, and Algeria claimed the action provisional in nature until the first of June. However, the most forceful part of their

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[114]"Arab Oil Policy: A First Comment," An-Nahar Arab Report, v. 4, no. 47, p. 1, 19 November 1973.

[115]"OAPEC Statement," Arab Report and Record, Issue 6, p. 120, 16-31 March 1974.

statement is embodied in their attitude towards Israel:

> Israel alone will bear the dangerous responsibility if the forthcoming events lead to the undertaking of more severe oil measures, in addition to the other various resources which the Arab world can master in order to join the battle of destiny.
>
> Israel alone is to be blamed for the effects suffered by the countries which came under the embargo or which suffered as a result of the reduction of the oil production, and it (Israel) remains responsible today for the maintaining of the production of Arab oil at the level which is below the needs of the market.[116]

OAPEC, even with its conservative members, is thus more radical than OPEC, though both are organizations based on oil production. OPEC is international in statue, with a common objective, price stabilization, that can be applied equitably throughout the world. OAPEC, on the other hand, is regional with a more narrow goal of Arab unity, to be achieved in part through integration of the oil industry.

OAPEC's biggest problem is that Iran, a principle oil exporter in the region, is non-Arab, and thus ineligible for membership. Therefore, any Arab decisions on production cutbacks and embargos do not affect supplies from that country unless Iran chooses to support the Arab cause, something that seems highly unlikely, since friendly ties between Iran and the other Arab states are tenuous at best. Though it is doubtful for OAPEC to expect support from Iran, the majority of oil from that nation must pass thru pipelines that cross Syria, which is a member of OAPEC, and possibly in light of this fact the plans of the organization to

[116] Ibid.

employ the oil weapon may circumvent or remove this major obstacle.

Another factor is the problem that OAPEC presents to OPEC due to the fact that a large percentage of countries are members both organizations. This dual membership will definitely have an affect on any decisions, especially those concerning a united front. Thus, it can readily be seen that though separate and distinct entities, OPEC and OAPEC are complexly related.

E. OPEC'S OUTLOOK FOR THE FUTURE

In conclusion, the question concerning OPEC's future, its solidarity, chances for success, and possible actions must be analyzed on the basis of past performance as well as future potential. OPEC's unity has been threatened many times since its conception. The organization did not really become a solid and successful working body until 1970. In 1972, the solidarity that the members had struggled for was severely threatened over the issue of nationalization of oil companies with the two opposing sides led by Iran and Saudi Arabia. Iran favored direct and close cooperation with oil companies while the Saudi side sought shares in the oil companies. Iraq, having just nationalized its oil stood in the middle and was having difficulty marketing its product.

This split further served to highlight the rifts between the producers, who now viewed oil as both an economic means of growth and development and a political weapon, and the oil companies, which still maintained vital Western interests.

How the OPEC countries should deal with oil companies has been a major issue ever since.[117] In 1972, they compromised with a decision of 51% participation in concessionary companies to be reached by 1983; Kuwayt and Iraq dissented from the agreement.[118] Solidarity was again threatened during the 1973 October War when some members staged a boycott and some members profited by continuing to supply oil.

The most recent and strongest threat to OPEC unity came in October, 1975, over a price issue. The circumstances involved at this time have been discussed earlier in this chapter. At present, it seems to be touch and go as to whether the two big OPEC producers will remain. Iran may leave at any time and begin dealing directly with Western nations in order to not have the interests of radical Arab oil producers interfering with the country's specific desires over prices and its many goals on how to spend revenues. Saudi Arabia may also leave the organization at any time should future disagreements over price increases versus consumer-producer dialogues become more heated. The aftermath of any such pull-out is uncertain. Lower prices may result as oil supplies are negotiated for on a direct basis with individual suppliers. Or, less stable supplies at higher costs may prove to be the case should consumers try

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[117] "OPEC: End of Solidarity," An-Nahar Arab Report, v. 3, no. 34, p. 1-2, 21 August 1972.

[118] "Oil Agreement Reassessed," An-Nahar Arab Report, v. 3, no. 50, p. 1, 11 December 1972.

to secure a continuing supply through rash actions.[119] So far, the organization is united, but the undercurrent of a power struggle is definitely threatening to the structure's foundation, and would seem to result in a lessening of the power that could be gained in any employment of the so-called oil weapon.

Another important factor that threatens the solidarity of OPEC, is the supply and demand of oil versus the production rates of the various countries. At present OPEC has only been able to control taxes and prices. The organization often considers plans for programming and allocating but has never adopted any such policies, since members can generally only come to agreement on prices. OPEC has only been concerned with maximizing all revenues (or seeing that they don't fall during any adverse market conditions) and has never dealt with the distribution of wealth among the various states. This wealth can vary greatly when the differentials of quality and transport costs for the various crude oils are considered.

For the past year, world oil demand has slackened and production in all countries has declined. (Kuwayt is the exception since production cutbacks were a government instituted decision and not due to a lessening of demand.)[120]

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[119] Gilbert, S.P., and others, U.S. Security Interests in The Persian Gulf Area, Stanford Research Institute, Report no. DAHC 15-73-C-0245, p. 65, July 1973.

[120] "Can OPEC Hold the Line," Middle East Economic Survey, v. 28, no. 19, p. 1-9, 28 February 1975.

OPEC could be strengthened should it adopt a production distribution policy among members, but a real rift could occur if it chooses to ignore this vital path of action. As demand goes down countries with large development plans and small reserves (Algeria, Indonesia), or small production capacities (Iraq) would definitely be hurt. Others with large reserves and a financial cushion (Saudi Arabia, Kuwayt) would not. The end result might be a break-up with each country lining up its own buyers in a cutthroat competitive style. OPEC may never have to face this problem since the general feeling among members is that they would be worse off alone (especially during any crisis). But, a break-up could surface at anytime, especially so in light of the dwindling OPEC revenue surpluses resulting from the massive aid programs to under-developed Third World nations and aid programs additional to each country's internal development program.[121]

The final area of stress to OPEC is the possibility that competing oil may be obtained from sources managed by Western or Asian states (North Sea, Alaskan, Chinese); these alternative sources could negate its power to control prices. The large producing countries could be forced into a balance of payments deficit because of this should the price remain constant; and smaller countries might have to drastically

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[121] "Vast Spending is Rapidly Reducing OPEC Surpluses," Middle East Economic Digest, v. 19, no. 46, p. 3, 14 November 1975.

lower prices just to maintain a share of the market.[122] Consequently, the issue of competing oil supplies is one area in which OPEC agreement and control could be shattered.

The future of OPEC, therefore, hinges on many external factors, among these are political issues, member oil policies, prices, other sources of supply, and current demand. At the moment its future appears secure. However, within the next decade the organization will most likely collapse if no policies concerning production allocation and distribution are implemented along with pricing policies.

IV. STRATEGIES AND IMPACT

This chapter is concerned with analyzing some of the strategies of the Arab decision-makers relative to their use of oil as a political weapon and the various options that are available to them. It will also consider the overall impact both present and future that any or all of the possible actions might have on the Western nations and world economy. As has been brought out earlier in this work, the three main options are available to the Arab states should they wish to employ their oil weapon: price fixing and raising, reduction of production levels and embargo. In order to determine just how and when these strategies

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[122] Enders, T.O., "OPEC and the Industrial Countries: The Nest Ten Years," Foreign Affairs, v. 53, no. 4, p. 625-627, July 1975.

will be adopted, it becomes pertinent to consider the underlying factors of ideology, environment and resources.

A. IDEOLOGY, ENVIRONMENT AND RESOURCES

Where ideology is concerned the overriding idea is one of nationalism. Not nationalism of individual countries, but nationalism as an ideal that spreads across geographic and political boundaries to encompass an "Arab World," a world populated by members of different races and religions. It is a movement that encompasses a cultural and emotional identification with a somewhat intangible philosophy known as the "Arab Cause." Because of this strong sentiment there is a great effort made to remove any traces of foreign influence. Relative to the oil industry this desire can be shown to be the driving force behind the massive push to remove all forms of control that foreign oil companies have over the oil industries, thus ridding the countries of imperialist influence.

Another unifying feature of Arab nationalism is the desire of each country to enhance its own military economic and social development. These countries also seek to aid those less fortunate financially in their development, which is another example of this nationalistic movement. The growth and development plans require enormous amounts of money. Thus control of oil prices to insure vast profits and revenue reserves becomes another pressing element which is related to nationalism.

Besides ideology, the environment that the Arab states operate under becomes important when evaluating their possible actions and reactions. By nature, Arab oil states are generally very conservative. There are exceptions, however, such as the governments of Iraq, Libya and Algeria, which are more revolutionary. This extreme conservatism is based in part in Islam. Islam predominates through the Arab world, though it is not the only religion in the area. The religious factor is most obvious in countries such as Saudi Arabia and Kuwayt, whose governments still maintain the traditional ways of the past. The revolutionary governments lacking this conservatism also lack the traditional regime.

The relationship between host countries and the foreign oil companies supports the pragmatic attitudes of the Arab oil states. The conservative countries seek participation agreements and mutually agreeable takeovers. On the other hand, the non-conservative nations have opted for nationalization. Pricing attitudes is another example of Arab conservatism or radicalism. The more conservative the state, the less it clamors for higher prices; since conservatives are concerned for the Western economic state as well as their own financial status. Additionally, lower prices are sought only by those states still holding onto ideals from the past as a means of maintaining the socio-economic structure currently present.

However, the increasing roles of the new middle classes within these conservative countries, a direct outgrowth of the oil industry, could bring about the downfall of these family structured regimes. The new middle classes are more concerned with the overall Arab nationalist cause and less bound by the family and religious ties on which the conservative rulers still depend. Challenges from this sector could create more revolutionary states and result in the entire Middle East becoming a more militant region in which the values of Islam no longer can temper the overriding nationalist goals. Requests for higher prices would then percolate throughout the region.

In addition to ideology and environment, resources of the Arab oil producers are a third contributing factor in determing what strategies and options the Arab decision-makers have available. Resources can be defined as either natural or industrial; and they can be considered both as presently available or feasibly possible for development. Resource becomes a factor that will determine the capacity for economic development and play an important role in any decision.

The Middle East lacks (other than oil) any other natural resource, including water. Since most of the main Arab oil producers are desert-oriented economies, agricultural development has been very slow. A high percentage of oil revenues have been used in attempting to make improvements in irrigation facilities. Lack of water also means lack of hydroelectric power, thus slowing down industrial development. The big boom in industry for these countries has been in construction, but even development along this line is hampered by the basic rural nature still maintained by the majority of the Arab populations.

The only commodity the Arab states can export with assured profit, is oil. Their economies depend on oil revenues, everything must be imported and oil revenues used to maintain a balance of payments. The consequences of this state of affairs can possibly put the Arab decision-makers in a precarious position. As world demand for oil decreases and internal demand for imports increases, a more favorable bargaining position for oil consumers is likely. This is true because these highly developed and industrialized Western nations produce the commodities required by the Arab states. Even local technological development is still highly dependent on Western expertise and assistance.

B. THE AVAILABLE OPTIONS OF THE OIL WEAPON

In oil, the Arabs hold a political weapon that can be employed against the majority of the world, both the democratic industrialized West and the Communist bloc. (Little has been mentioned thus far concerning the growing importance of Middle East oil to the Soviet Union. The Soviets increasing concern over this resource has recently started to become another factor to be dealt with. However, should the Soviet Union decide to undergo the expensive development of their Siberian oil fields, their requirements for importing oil could be alleviated.) The Arab states have demonstrated a remarkable capacity for quickly learning the most effective and efficient methods for employing this newest form of "political blackmail."

Oil can, therefore, be viewed as the deterrence which Herman Kahn described in his book On Thermonuclear War as Type III deterrence, or controlled deterrence. Type III deterrence "refers to acts that are deterred because the potential aggressor is afraid that the defender or others will then take limited actions, military or nonmilitary, that will make the aggression unprofitable."[123] The oil weapon has all the desirable characteristics of a successful deterrent. It is cheap, non-accident prone, persuasive, inexorable, and since 1973, somewhat frightening.[124]

1. Price Fixing and Raising

The first strategy that the Arab oil states can adopt as a means of utilizing oil as a political weapon is price control. Arab states that have the controlling interest in foreign oil companies have the means by which to set and control the prices to be paid by consumers. This price control was the basis for the creation of OPEC. Over the past few years, especially following the October War of 1973, the oil states have demonstrated the ability to set prices as high as desired, for both personal and political gains.

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[123]Kahn, H., On Thermonuclear War, p. 126, Princeton University Press, 1961.

[124]Ibid., p. 146.

However, is price control still an effective alternative? World demand for oil as the predominating energy source is slowly decreasing. The oil producers could be pricing themselves right out of the market and into debt. The debt would arise from a balance of payments deficit due to their continual need to import military arms, industrial products and agricultural goods. Another factor affecting the role of price control is the possibility that the Arab-Israeli conflict might eventually end. Though an official declaration of price reductions on Arab oil in return for settlement of the dispute has never been made, it could become a strong Western bargaining point. Should the Arabs lower their prices to obtain this goal, the other non-Arab countries would be forced to follow suit. Since the non-Arab nations have nothing to gain, the prospect could forecast a break-up of OPEC.[125]

The break-up of OPEC seems too drastic at this point to be very realistic, because its demise is contrary to the Arab desires. However, it does merit some concern, since the Arab nations stand to gain much by the settlement of the conflict and could well afford a price reduction if this became necessary to achieve a settlement.

The Arab states have their own goals for revenue spending, and surpluses are not equally distributed. This unequal distribution of wealth could conceivably force

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[125]Rifai, T., op. cit., p. 375-377.

individual countries to begin juggling prices in an attempt to obtain a larger share of the market. This action would not only threaten OPEC unity, but it would totally destroy the option of using price fixing as a deterrent. Since individual pricing falls in line with national interests, this seems to be the most likely situation for the future. However, the oil weapon can only be employed by the entire group acting as one. Not only would a price war remove the blackmail effect of price control, but one of the most powerful international cartels would certainly tumble. But, Arab states may have already priced themselves into a situation where this alternative no longer can be considered realistic. Price raises have become so commonplace that they are expected to be implemented at periodic intervals and not perceived as a possible political threat.

2. Reduction of Production Levels

The second option is reduction of petroleum production levels. Since the producers now control their industries, they are in a position to control the amount of oil that is produced for consumption over any given period of time. Production cutbacks were the main tactic when the oil weapon was successfully wielded in 1973. The reduced supplies took the consuming countries by surprise, and left them at a loss for dealing with the situation. This enabled cutbacks to become the most effective and efficient tactic of the three alternatives. Today, however, this approach is not as promising since reduced production levels through voluntary cutbacks have become the standard mode of operation. OPEC oil production for 1975 averaged 17% below the 1973 third-quarter peak.[126]

Two factors are important in explaining this action. The main one is reduced world demand for oil. Though the United States has not been very successful in reducing its consumption of petroleum products, both Europe and Japan have successfully cut consumption by an average of slightly over 10% since 1973.[127] This is a direct result of the 1973 embargo and cutback which forced these countries to lessen their dependence on Middle Eastern oil both by seeking other energy sources and by instigating measures to lower the amount of consumption. The other factor is the desire of some states to begin conserving their resource against its eventual exhaustion. This is especially true of countries with vast revenue surpluses such as Saudi Arabia and Kuwayt.

Unlike in 1973 and early 1974, the consequences of future production cutbacks will be felt more by the producers than by the consumers, since revenue surpluses will dwindle causing the smaller producers to begin operating at deficits. These deficits could not be compensated for by more price

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[126] "Vast Spending is Rapidly Reducing OPEC Surpluses," Middle East Economic Digest, v. 19, no. 46, p. 9, 14 November 1975.

[127] Ibid., p. 9.

increases either.[128] Thus, if the Arab states should decide to use production cutbacks as their option they would be hurting themselves in the long run, even though the consumers would still suffer the immediate effects. It would probably become a waiting game which could result in an embargo of industrial products to the Arabs as a countermove.

3. Embargo

The final option is embargo. This is the only alternative of the three that is not an ongoing action, since it would most likely require another war to cause its implementation. The possibility of this strategy being as effective as it has been in the past grows doubtful. The lessened world demand and the probable availability of new non-Arab sources of petroleum have served to make the Western consumers less fearful of this form of blackmail. The fact that the Arab states require vast amounts of oil revenues, coupled with the Western belief that Iran will not join in an oil boycott in the event of another Arab-Israeli conflict, aids in supporting this Western conviction. The Shah has stated explicitly that "we need the last cent of the money which comes from oil."[129] Iran views oil as an economic product and not a political weapon, and could easily take up the slack in supply.

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[128] Ibid., p. 10.

[129] "Iran Would Not Join an Oil Embargo," Middle East Monitor, v. 5, no. 4, p. 4, 15 February 1975.

A further possibility is that, even though all the Arab states currently declare their support of an embargo in the event of future hostilities, when the time for actual implementation comes one or more might decide to boycott the action. Action of this sort would most likely be caused by internal financial requirements that are more compelling than the Arab cause, similar to Iraq's actions in 1973. In all probability Algeria and Iraq would be the prime candidates for maintaining supply. They stand to lose the most in lost revenues. Libya can also ill afford to cut down on exports, but al-Qadhafi's ambition for leadership would force him to support the Arab group. Only Saudi Arabia, Kuwayt and the United Arab Emirates have enough surplus revenues to tide them over if this action becomes necessary, but they do not supply enough oil to stand alone on the issue and create a massive impact. The contention of this thesis is that should another war break out between the Arabs and Israelis, the Arabs will no doubt levy an embargo on the supporters of Israel. However, the overall effect will not reach the proportions achieved in 1973, and as more alternative energy sources become available even this action will decrease in its effect of deterring Western support of Israel.

Taken together, the three options available to the Arab decision-makers in determining their strategies seem to show that the oil weapon is becoming less of a credible deterrent. All sides are beginning to realize that supply can not exist without demand, and that an equilibrium to the mutual agreement and satisfaction of both parties is actually the only realistic alternative available. Recent pressing concern on the part of some of the more influential oil producers for achievement of more constructive producer-consumer dialogues supports this claim. Oil must be taken out of the political arena and treated strictly as the exhaustable and scarce economic resource that it is in such a way that both the supplier and user can benefit without taking advantage of each other.

C. THE IMPACT OF THE ARAB DECISIONS ON THE WESTERN WORLD

The Western oil consumers have taken many varied actions since 1973 to lessen the impact of any future Arab decisions. The actions have been functions of the amount of energy dependence. The United States has sought, as yet unsuccessfully, to establish policies that would secure energy independence and prevent further blackmail attempts. France, Italy, Britain and Japan have negotiated billion dollar arrangements with the oil producers in an effort towards securing long term oil supplies as well as creating new markets for their own goods.[130]

Most of the oil producing nations now have almost total control of their oil industries. Since foreign companies represented predominantly Western interests, loss of control

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[130] Itayim, F., "Strength and Weaknesses of the Oil Weapon," Adelphi Papers No. 115: The Middle East and the International System, p. 5, International Institute for Strategic Studies, 1975.

has taken away all possibilities for the consuming countries to have any impact in determining production levels, prices and other similar policies. In most cases technical experts are available to lend the still needed assistance and advice to the Arab countries, and this could enable Western interests and requirements to be at least brought out whenever the Arab policy makers decide to instigate a new action.

This diverse attitude concerning prices could be both harmful or beneficial to consuming nations. Constant price increases could price Arab oil right out of the market. If prices get too unmanageable, a price war amongst the states could result. This would definitely threaten the unity of OPEC and make oil a competitive commodity, thus allowing consumers to pick and choose.

Reduced production levels are not having the impact on consumers that was prevelent in 1973. Widely instigated conservation measures have successfully lowered world demand. Arabs have to be aware that unless they could implement very drastic cuts they really can not effectively threaten the oil weapon in this manner any more. Further reductions in production levels would seriously harm some of the smaller producers who absorb all the revenues now being realized, and have the capacity to utilize even greater amounts if available.

The main impact that Arab decision-makers could have on the oil market is their perception that another embargo is necessary should oil be needed to insure Arab military victory in a future conflict. They also feel that an embargo could be used as a lever, should peace negotiations be stymied or completely stopped. This option of embargo remains a perceived and practical deterrent at the present time. Though the demand for consumption has been reduced, the Western nations have not obtained energy independence. These consumers still require importation of Middle Eastern oil. However, the consumers are constantly working towards the acquisition of alternative oil sources, and the possibility of the Arabs being able to threaten embargo now lacks the element of surprise that was once present.

The world is still in an energy crisis situation, but seems to be working towards an acceptable solution. Oil will always remain a prime economic resource, and a political issue. However, since the Arabs are also faced with the problem of revenue requirements, the petroleum problem is slowly becoming much less of a political issue and becoming strictly the economic issue that it probably always should have been.

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