

# Sir William Luce Memorial Fund



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Born in 1907, Sir William was educated at Clifton College and Christ's College Cambridge, where he read History and Modern Languages. Entering the Sudan Political Service in 1930, he served in Berber, Darfur, Blue Nile and Equatoria Provinces and finally as Adviser to the Governor-General on Constitutional and External Affairs in the immediate period leading to the Sudan's independence in 1956. He was later able to bring his many talents to other offices.

He was Governor of Aden from 1956 to 1960. From 1961 until 1966 and again from 1970 to 1972 he was intimately connected with the Gulf area, first as Political Resident, based in Bahrain and then recalled from retirement - as the Foreign and Commonwealth Secretary's Personal Representative for Gulf Affairs.

Sir William was held in the greatest respect and affection by the peoples of the Middle East, and among the many tributes paid to him by prominent Arab statesmen on his death in 1977 were:- *'He served the Arab World with the same zeal and dedication as his own country'* and *'He understood our problems and aspirations.'*

The object of the Fund is to support the study of those parts of the Arab world to which Sir William devoted his working life, to stimulate research, discussion and publication about them and to encourage collaboration and co-operation between institutions of learning, specialising in the places which aroused Sir William's own interest. An annual Sir William Luce Fellowship is tenable jointly in the University of Durham's Institute for Middle Eastern and Islamic Studies and Trevelyan College.

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**THE ARAB OIL WEAPON OF 1973-74 AS A DOUBLE-  
EDGED SWORD: ITS IMPLICATIONS FOR FUTURE  
ENERGY SECURITY**

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*by*

**Robert Copaken**

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**Dr. Robert Copaken** was the 2003 Sir William Luce Fellow. Former Senior Analyst at the US Department of Energy.

# **THE ARAB OIL WEAPON OF 1973-74 AS A DOUBLE-EDGED SWORD: IT'S IMPLICATIONS FOR FUTURE ENERGY SECURITY**

Based on a lecture given by the 2003 Sir William Luce Fellow

**Dr. Robert R. Copaken**

## **Acknowledgements**

I would like to begin this afternoon by expressing my deep appreciation to the Chairman of the Sir William Luce Fund, Sir Donald Hawley and to Lord Luce, son of the late Sir William Luce and Lord Chamberlain of H.M. Household and to the Director, Dr. Paul Starkey and to Dr. Ali Ansari and to Professor Anoush Ehteshami and the entire Academic Staff of The Institute (IMEIS) and to the Principal of Trevelyan College, Dr. Nigel Martin.

Let me also indicate at the outset of my remarks, what I will and will not cover in the course of my lecture. I will cover in some depth, the use by Arab oil exporters of the oil weapon in the period before the 1973-74 embargo, i.e. its use in 1956 at the time of the Suez crisis and in 1967 at the time of the Six Day War and also of course its use during the October War of 1973-74. But I do not intend to cover the so-called "Second Oil Shock" which arose at the time of the Iranian Revolution of 1979-80, nor the impact of the Iran-Iraq War upon the oil consumers, or even the dramatic oil price decline of the mid-1980s. My reasons for not covering these events, dramatic though they may have been in their effects on consumers, is basically that I do not feel that they are comparable to the original use of the Arab oil weapon, which was explicitly aimed at getting the United States, as Israel's primary ally, to modify its foreign policy toward Israel for its continued occupation of Palestinian lands. The other oil shocks, serious though they may have been, did not arise out of such causes, but were rather external to the Arab-Israeli conflict altogether.

## **THE ARAB OIL WEAPON OF 1973-74 AS A DOUBLE-EDGED SWORD: ITS IMPLICATIONS FOR FUTURE ENERGY SECURITY**

**Dr. Robert R. Copaken**

The Arab oil weapon, an embargo of oil exports against the United States and The Netherlands, imposed by the Arab oil exporting countries, led by Saudi Arabia, during the October War, together with the dramatic shift in the balance of power over the setting of prices for oil in favour of the producers rather than the consumers were two of the transformative energy events of the 1970s. The primary purpose of this article is to explain why the Arabs' use of this "oil weapon" was actually a double-edged sword. By this I mean that using this weapon ultimately hurt those nations that wielded it at least as much as it did its intended targets. The Arab oil states have paid a heavy price for its use ever since. My subsidiary purpose is to explore some of the implications for future energy security that flow directly from my thesis that this economic weapon was ill-suited for use as a means of politically influencing the United States and other targeted states to change their Middle Eastern foreign policies to be more sympathetic to the Arab perspective in the Arab-Israeli conflict.

In fact, I will contend that Saudi Arabia, in particular, has learned from its past mistake in this regard and has not repeated it, although the same cannot apparently be said about Iraq. Its suspension of oil exports in April 2002 followed the first overt call to oil producers for many years to use oil as a weapon once more to shape political events. But this time no one heeded its call to cut oil production and there was practically no effect on the international oil market. During the Iraq crisis, the Saudis' behaviour demonstrates quite the opposite approach to what they did in 1973-74. In the current oil market crisis, they are going to great lengths to reassure their primary customers - the industrialised economies - that as energy consumers they need not fear an oil shortage in the event of an Iraq crisis. They have clearly indicated that they anticipate making up any oil production shortfall coming from hostilities with regard to Iraq. The Saudi Oil Minister, Ali al-Naimi, has explicitly promised that his country, the world's largest oil producer, will stabilize the oil market if a war disrupts supplies *regardless of the political background* (emphasis added). "Our commitment is to the stability of the market, not the cause of the shortage."<sup>1</sup> In fact, OPEC agreed at its January 2003 ministerial level meeting in Vienna to increase its overall production quotas by 1.5 million barrels per day (mbpd) beginning on February 1<sup>st</sup> and the Saudis are responsible for producing the lion's share of that additional amount. OPEC's action was meant to calm the market jitters not only caused by the prospect of war with Iraq, but also stemming from the unrest in the political situation in another of its member states, Venezuela. In fact, it was a Venezuelan, Ali Rodriguez, as OPEC's Secretary General when the news broke about the September 11 attacks on the United States, who assured the market that producers would make good any oil supplies which might be lost. This is the kind of assurance that vulnerable consumers wanted to hear at a time of crisis like the September 11 attacks.

The volatility and uncertainty associated with the world oil market are ample evidence, if any were needed, that oil and politics do not mix, as the late Saudi King Faisal once remarked. But they do certainly interact with each other, often in unintended ways!

### **Arab Use of Embargoes pre-1973**

In the long history of the global oil industry there have been several times in which trade in oil with one's trading partners has been embargoed for various reasons. In 1956, Egypt's President Nasser, in response to the Anglo-French-Israeli attack, blocked the Suez Canal. Nasser's action made passage impossible and eliminated an important route for supply of oil. Also at Nasser's instructions, Syrian engineers blew up some pumping stations of the Iraq Petroleum Company so that supply of oil became even tighter. Saudi Arabia imposed an embargo against France and Britain and Kuwaiti installations were sabotaged. The United States even brought some indirect pressure of its own by waiting until the Western European countries decided to withdraw from Egypt before it organized an emergency supply operation, known as the "Oil Lift."<sup>2</sup>

Through a joint adjustment operation on the part of governments and the oil companies, Western Europe was again supplied with oil, and by the spring of 1957, the "crisis" was over and had not affected the targeted countries very severely. Ten years later, during the Six Day War, in June 1967, when Egypt closed the Strait of Tiran, an international waterway meant to be open to free navigation by all nations and asked the buffer force, United Nations Emergency Force (UNEF) to leave its territory, the Arab states once again embargoed oil to countries that supported Israel: the United States, Britain, and, to a lesser extent, West Germany. Again the Suez Canal was closed, this time for a longer term. But, the situation for the oil importing countries was more precarious this time than in 1956, since not only had Arab oil exports dropped by 60 percent, but Nigerian oil was cut by 500,000 barrels per day after a civil war broke out there in late June. Nevertheless, the embargo was short-lived and the failure of the Arab oil weapon was borne out by the emergence of different supply patterns. Once again, the western oil companies had successfully managed to divert oil flows from non-Arab countries to those countries that were targeted by the embargo, while Arab oil destined for the United States, Britain and West Germany ended up elsewhere. The lasting effects of this Arab oil embargo were relatively brief. The United States increased its own domestic production and was able to import additional amounts from Iran, Indonesia and Venezuela. Israel also turned to other oil exporters for its supplies, including Mexico, Norway and interestingly, in light of later developments, Iran.

### **Background to the October War of 1973**

The Arab-Israeli conflict, which continues to plague the region after more than fifty years, had resulted in a rather short, quick victory by the Israelis in June of 1967, humiliating the frontline states of Egypt, Syria and Jordan. The years following that victory were marked by what has come to be known as the war of attrition between Israel on the one hand, and Egypt, Syria, and Jordan on the other. The idea of an embargo had become discredited as a failed policy and at the Khartoum conference in August 1967, the collective Arab leaders chose a positive strategy which would focus on increasing production in order to gain oil revenues, part of which would be given to the confrontation states in the form of annual donations from the affluent Gulf Arab states.



The stalemate between the Arab states and Israel was not broken until Nasser's successor, Anwar Sadat, as a calculated risk, decided to plan a coordinated surprise attack against Israel, together with President Hafez al-Assad of Syria. These two Arab leaders thought that they could win such a battle, given the important elements of surprise and superior numbers of men under arms and of equipment. In retrospect, there were several significant early intelligence indications of Egyptian preparations for war and even sizeable military manoeuvres and exercises. For various reasons, Israel and even its ally, the United States, chose either to ignore or to discount heavily these early signs as indicative of real Arab intentions to go to war against Israel. The war aims of both belligerents were to regain territories lost in the 1967 war with Israel, but their tactics stressed different objectives and were not necessarily that well coordinated.

The war, when it finally did erupt on the holiest day in the entire year, Yom Kippur,<sup>3</sup> October 6, 1973, caught Israel almost completely by surprise. After all, why would anyone choose that day to attack Israel? Although the date was apparently chosen fortuitously, in retrospect it was a date which gave Israel a slight advantage in terms of activating its entire population in a national military mobilization. Why? Because on that particular holy day one could expect to find most Israelis in either one of two places: either they would be in their local synagogue praying or else at home with their families.<sup>4</sup>

One of the best kept secrets of the eventful period leading up to the October attacks was the agreement by Egypt's President Sadat and Saudi King Faisal to use the oil weapon in conjunction with the surprise attack. This accord was reportedly reached during an unannounced meeting between the two leaders in Riyadh on August 23 1973.<sup>5</sup> As noted earlier, Faisal did not want to mix oil and politics, and thought to do so was positively dangerous for Arab interests,<sup>6</sup> but the very fact that Saudi Arabia was now by far the largest oil exporter made King Faisal more vulnerable to pressure from his Arab colleagues and the danger of an embargo more likely. He could not afford to be left out of the developing Arab consensus, which suggested that military force backed by an oil embargo may be the only way for the Arab position vis-à-vis Israel to be taken seriously by the Nixon administration in Washington. The Saudi ruler ultimately came to the realization that he must demonstrate to the Americans where their long-term interests in this key geopolitical region really lay i.e. with the Arabs and not with the Israelis.

The Saudis had repeatedly expressed through their American Aramco partners their deep and growing misgivings about the perceived direction that U.S. foreign policy was taking toward the Arab-Israeli conflict. On October 12, John J. McCloy, chief lawyer for ARAMCO, hand-delivered a letter to Alexander Haig, Kissinger's Chief of Staff. He enclosed a memorandum to be passed on to Kissinger and Nixon from the ARAMCO company chairmen recommending against military aid to Israel and asserting that the Saudis would reduce production as a result of actions already taken. This letter seemed to have had no effect. Admittedly, ARAMCO and its parent companies were in an awkward position during the embargo. On the one hand, they enforced the embargo against the United States. On the other hand, the oil companies minimized its impact by diverting non-Arab oil from other destinations to the U.S.

and the Netherlands. The Saudis had threatened to use “the oil weapon” again unless the US government’s position moved closer to the Arab point of view. Their anger and impotence to confront Israel militarily eventually led them to take this ultimately self-defeating step against the United States. The pro-Israel lobby in Washington was also very effective in its efforts to shore up U.S. support for Israel.

### **The Oil Market Situation in the Pre-Embargo Period**

Until the period of about 1970 the United States had possessed the world’s single largest productive capacity of petroleum. However, because of the dramatic and ever-growing post-war demand for petroleum in all its various forms, the U.S. oil industry was unable to keep pace with the rapid growth in demand by drawing strictly from domestic production. Eventually the U.S. had to resort to filling the gap with oil imports. The U.S. government resorted to price controls at the moment the oil economy moved into a net-importing condition and this led to inevitable shortages, even before the Yom Kippur war and the OAPEC embargo. Meanwhile oil imports into the United States, which were restricted by quotas during the 1960s, became subsidized under a new and complex entitlements programme meant to equalize refiners’ acquisition costs, but which, perversely, were tantamount to a subsidy on imported oil. One author has suggested that the consequences of this overly regulated regime were to significantly “heighten the impact of the Arab oil embargo” because the US regulatory programme had already created shortages in the market.<sup>7</sup>

### **The Saudis as the Swing Producer**

The United States shifted from being the marginal supplier to the world oil market to becoming a net oil importer. The Kingdom of Saudi Arabia thereafter assumed the status of marginal or “swing” supplier to the world oil market. One of the most important concepts to understand the impact that the Arab oil embargo had upon the United States and its fellow energy consuming nations is the concept of *the swing producer*, which is the country with the most surplus productive capacity. This means that the Saudi oil industry currently has the installed capacity to bring on to the market within a very short period of time (30 -60 - 90 days) an additional 2.5-3 million barrels per day of oil production. This surplus productive capacity, by its very existence, gives the Saudis a significant and disproportionate influence upon the price of a barrel of oil in the world oil market. Since oil is a fungible commodity except for quality differentials and the logistics of transportation and refinery configuration, it will go wherever a demand for it exists. In late 1972 and early 1973 three developments converged to produce “the greatest crisis in the history of world oil”. First of all, the producers were demanding ‘participation’ that is part-ownership of the concessions given to the oil companies. Secondly, as I have already indicated, there were increasing signs of an oil shortage due to the unanticipated high growth of demand for oil and refined products. As one oil journalist put, it, “the problem is not whether oil will find markets, but whether markets will find oil.”<sup>8</sup> Finally, the Arab-Israeli situation seemed again headed toward renewed conflict.

In quick succession on three dates in mid-October, 1973, OPEC and more particularly the six core Arab Gulf oil ministers of the cartel, meeting in Kuwait, took three decisions which, viewed collectively, transformed the entire world oil market. What were these three decisions? First, they increased the official selling price of Saudi Arabian Light Marker crude oil by 70% from \$ 3.01 per barrel on October 4, 1973 to \$ 5.12 per barrel on October 16 and secondly, on October 17 they unilaterally set a new oil price (which previously had been jointly negotiated between the international oil companies and the host Arab governments) and finally on October 18 they progressively cut back on their oil production on a monthly basis by (at least) five percent to the United States and the Netherlands. Then, on October 20<sup>th</sup> 1973, after the announcement by President Nixon of a \$2.2 billion military aid package for Israel, Libya and Saudi Arabia responded with a total embargo –an act of economic war. The other oil states followed within days. Several other countries were later added to the initial list of embargoed countries including Rhodesia, South Africa and Portugal. Oil importing countries were then categorized based upon their stance on Israel as “friendly,” or “preferred,” “neutral” or “hostile”. For my purposes here the United States, which was categorized as “hostile”, was the single most significant targeted country by the Arab oil embargo.

Ostensibly, the embargo was in retaliation for the very public and very substantial US government’s military resupply of Israel. The embattled Jewish state very quickly found that resupply of its military was a critical life-or-death issue. Israel lost 60 aircraft in the first 3 days of the war and a couple hundred of tanks. All NATO allies except the Netherlands, Portugal and Germany (until October 22, when it too shifted position) prohibited US over flights and basing for airborne surveillance and resupply of Israel. Britain’s denial to the United States of the right to use British bases, both in the UK and in Cyprus, for its airlift to resupply Israel, forced the US to ask Portugal to grant the U.S. refuelling rights on its Azores islands in the South Atlantic Ocean. This action Portugal did agree to do, thereby enabling the United States to circumvent the British denial.

It should be remembered that the US action was done to offset the massive arms supply by the Soviet Union to both the Egyptians and the Syrians. The U.S. did not want an Arab victory with Soviet arms to alter the balance of power in the region against its own geopolitical interests. One should not forget either that the oil exporters stopped short of complete and total nationalization of all American business in the Arab world, the withdrawal of all Arab funds from American banks and the institution of a total embargo against the United States and other countries friendly to Israel, as Iraq had argued they should. The Algerian minister chairing the meeting of Arab oil ministers felt that this was pushing things too far and rejected the proposal as impractical and unacceptable. On that note, the Iraqi delegation left the meeting and boycotted any further consultations with the Arab oil ministers in subsequent months<sup>9</sup>.

Collectively, these three decisions by the Arab members of OPEC revolutionized the world oil market from that time forward. Its actions quadrupled the world price of oil in a period of less than four months and generated massive new levels of wealth for the oil exporters of the world. The impact of the shortfall on the United States struck at one of our fundamental beliefs i.e. our inalienable national right to drive our automobiles wherever and whenever we chose, without providing any clear or

immediate understanding of why this new restriction was occurring. Inexplicably, in a matter of a few months American motorists, used to seeing low retail gasoline prices, saw them rise by 40 percent and keep rising – sometimes going up as often as once a day, but never seeming to come down.

The shortage became so pervasive that the Administration had to institute “odd/even” gasoline purchase days which entitled motorists to purchase fuel only on the day of the week that corresponded to whether their license plate ended with an odd or even number. This system resulted in long “gas lines” in which motorists would queue – often for as long as an hour or more just to get to the pumps to fill or even to “top up” their tanks with precious petrol. Motorists, who had been used to driving their cars until they were half full or less, now were anxious to keep their tanks nearer the full mark, thus adding to the lengthening lines. In some cases, a gasoline station owner would have to go down the long line of cars and put a sign on the back of the last car to be served, saying in effect, “SORRY, NO MORE GAS TODAY” because he was running out of the limited allocation of gasoline that he had been given for filling his customers’ gas tanks.

These gas lines became the most visible and the most pervasive symbol of the Arab oil embargo and they severely undermined Americans’ confidence in the reliability of their oil suppliers. It was this perception of unreliability of our oil suppliers, based upon our direct personal experience of the Arab oil embargo that I think, perhaps more than any other single factor, caused the Arab oil weapon to become a double-edged sword. Another factor which was briefly considered before being rejected by the administration because it was perceived as too difficult and ultimately self-defeating was the actual mounting of a military takeover of the oilfields by the industrial powers. The rejection of a military takeover of the oilfields as an option was crucial to allowing the militarily weak Arab oil exporters to raise oil prices with impunity.<sup>10</sup> The United States was central to the political rationale for the Arabs using the oil weapon because it was the only state thought capable of persuading Israel to alter its policies, although the Arabs tried to use the Europeans as surrogates to try to influence the U.S.

### **The Imposition of the Arab Oil Embargo**

The imposition of the Arab oil embargo caused several reactions, some predictable, others not. There was a wave of panic buying of oil on the volatile spot market by Japanese and Europeans and of course by US-based international oil companies. This, in turn, led to the bidding up of oil prices and eventually to a global recession and a massive debt burden for the Less Developed Countries (LDCs) which were simply financially unable to bear the tremendous increase in the cost of their imports caused by the run-up in world oil prices. The two largest recessions in the post-war period (1974-75 and 1979-80) were associated with disruptions in the world oil market. The price hike of late 1973 was effective, even though OPEC production scarcely changed in 1974 because the threat of reduced supplies raised fears of shortages and provoked precautionary inventory build-ups by users.

As Brookings Institution economist George Perry, has written, this first big OPEC price rise was the main shock behind the deep recession of 1974-75, depressing the U.S. economy through two channels. First, it siphoned purchasing power away from consumers, much as the sudden imposition of a large excise tax on petroleum products would have. Second, by adding to an already high inflation rate resulting from surging food prices and the removal of the general price controls that had been imposed in 1971, it forced an even more protracted tightening of monetary policy than would otherwise have been needed.<sup>11</sup> In addition there was an unseemly rush by European and Japanese customers of the oil exporters to conclude special bilateral deals for Arab oil, coupled with strenuous attempts by their governments to dissociate their Middle Eastern foreign policies from the United States' position, especially vis-à-vis Israel.

United States energy policy during the initial stages of the oil embargo was a mixture of muddling through and longer range strategy. In general, the government deferred to the international oil companies as it had done in the previous instances of oil embargoes, to implement the equitable sharing of oil scarcity through allocation programmes and price controls. There were also different problems arising from competing classes of customers, whether industrial, commercial, residential or agricultural, each seeking its own special priority for its own specific user group's consumption, which was generally based upon some baseline pattern of past use. Unfortunately, these formulas did not always take account of growth or shrinkage in demand in the periods since the baselines were originally established. So "changed circumstances" often were used as the basis for an appeal for a larger allocation of a specific refined petroleum product, by virtue of an exception to the customary baseline allocation. Of course there was never enough fuel supplies to go around, so suppliers willingly paid handsomely for the effective lobbying efforts exerted by various interests on behalf of their constituencies, both in Washington, D.C. at the Federal level and also at the fifty state capitals where the lobbyists' efforts could be more directly applied to state, county and local level officials.

In terms of national and international energy policy the US government organized itself for the Washington Energy Conference, which was eventually held in February 1974 in the nation's capital. The French delegation, among the consuming nations, was the single one that chose to attend the energy conference as a "courtesy", but acknowledged in advance that it was unable to agree to the formation of any consumer organization. This neo-Gaullist attitude of trying to curry special favour with the Arab oil producers in hopes of getting preferential treatment for its consumers and trying to avoid open confrontation with the oil exporters, was all the more ironic when it turned out that the International Energy Agency (IEA), formed as a result of the conference, would be headquartered in Paris, the site of The Organization of Economic Cooperation and Development (OECD). France eventually did join the IEA in 1991 and its new Executive Director, Claude Mandil, who was influential in getting France to join the IEA and who assumed his post in February 2003 is French.

We have recently experienced another example of the French neo-Gaullist attitude toward the alliance of western nations, whose impact has been to split the alliance just when the need for unity of purpose is greatest, i.e. when "serious consequences" were

set to flow from Dr. Hans Blix's February 14<sup>th</sup> report on the status of the Iraqi government's cooperation with UNMOVIC, the UN's disarmament agency. The French President Jacques Chirac, together with his German counterpart, Chancellor Gerhard Schroeder, came up with a joint initiative to greatly increase the size of the inspection force, backing them up with UN troops to improve the UN's capability to discover and destroy Iraq's weapons of mass destruction (WMD). The effect however, of this unilateralist proposal was quite the opposite. It made it appear, even to the most casual observer that its purpose was to delay and possibly evade the clear intent of the UN Security Council's resolution 1441, passed unanimously last November, which gave Iraq one last chance to disarm. The objective which we are all seeking i.e. Saddam's cooperation, has been sadly absent for more than a decade or more recently, under the real threat of UN armed force, grudging and not wholehearted. Anti-war demonstrators in the US and Europe wave "No Blood for Oil" signs, but clearly, this war is about more than oil and shouting such simplistic slogans does not change that.

There is no doubt that Saddam would use his oil as a political weapon if he could. In fact, as I indicated earlier, he tried to do so last April by stopping all Iraqi oil exports - -but with minimal effect on the oil price. More recently, Malaysia's Prime Minister, Dr. Mahathir Mohamad, called on all Islamic countries to consider an oil embargo to stop the U.S. from attacking Iraq, but admitted that there was no consensus on the proposal. The oil exporters have delinked oil from politics and see little utility in self-defeating measures. But it seems that some of the consuming countries are still seeking some sort of diplomatic advantage from their "independent" stand, without regard for the long-term damage that their stance creates for the transatlantic alliance and for the UN's credibility.

The energy crisis resulting from the Arab oil embargo evolved against the political backdrop of the Watergate scandal and the final phase of the divisive war in Vietnam. These two watershed events may even have overshadowed the oil shock itself. But according to one author, President Nixon thought that by lifting the embargo and by getting his Energy Independence project proposals through the Congress, he could rescue his administration from the morass of the Watergate crisis.<sup>12</sup>

How many of you can recall the famous October 19<sup>th</sup> "Saturday Night Massacre" when an embattled President Nixon fired his Attorney General, Mr. Elliott Richardson, and his Deputy, for their unwillingness to dismiss Mr. Archibald Cox as the Special Watergate Prosecutor? Nixon was so preoccupied with the investigation into the "high crimes and misdemeanours" of Watergate, his credibility was so diminished by this attack on his Office and authority that he simply could not provide the necessary Presidential leadership required. As Steven Bosworth, director of the State Department's Office of Fuels and Energy recalled, "Congress was mesmerized by Watergate, the executive branch was mired in it, and the White House was circling the wagons. It was difficult to get a political decision on anything on an inter-agency basis. There was no real decision-making apparatus in Washington ---other than Henry Kissinger."<sup>13</sup>

## **Why Did the Arab Oil Embargo Fail?**

### **(1) Economic Reasons**

By clearly and explicitly linking its oil exports to U.S. Middle East policy, Saudi Arabia was trying to engage in political blackmail and thereby created serious doubts in the minds of its major consuming customer, the United States, about its reliability as a supplier. We depend on Saudi Arabia for oil market stability. In other words this country is hard to ignore when it comes to its dominant role in maintenance of the global oil market's stability, but it is difficult to find the Saudis very likeable in their performance of that self-interested but essential role. They have been termed "the central bank" of the oil market. A senior Saudi official spokesman for Crown Prince Abdullah, Adel al-Jubair, has said much the same: "To say that you can marginalize Saudi Arabia in the oil market is like saying you're going to marginalize the United States in the world economy."<sup>14</sup> In a strange way; its role may be likened to the global superpower role now performed by the United States, as the sole remaining superpower in the world. The United States commands fear and respect, but not affection. As I have suggested, the Saudis severely shook consumer confidence by their actions in the 1970s and they have spent the better part of the past thirty years, especially since 1991, when they became the world's largest oil producer, in trying to restore their previously well deserved reputation as a reliable supplier. Over that period of time, Saudi Arabia saw itself losing market share to non-OPEC producers and it took various actions to counter that negative development, including temporarily abandoning its position as swing producer for a period of time in order to focus primarily on improving its market share by using a system of netback oil pricing. This was a system based upon the realized prices for a slate of refined products derived from a barrel of crude oil, rather than on the market price of the crude oil itself. It took two decades to get the "call on OPEC" back to where it was in 1973.<sup>15</sup> The Kingdom needs its earnings from oil revenues even more now than ever before in order to maintain internal stability. Its fast-growing, youthful population -- one of the fastest in the world -- is clamouring for employment opportunities and all the benefits of a modern welfare state. Recent suggestions that the United States wants to increase its efforts aimed at democratization in the region must also be matched by domestic reforms initiated by the governing Saudi power elites, if continued progress is to be made.<sup>16</sup>

### **(2) Political Reasons**

Saudi Arabia, as a key Gulf state, did not want to become isolated from the developing Arab consensus during the Yom Kippur war that seemed to see the exercise of raw economic power-- "resource nationalism" it has been called ---as the only way to express its frustration with the perceived pro-Israel trend of American foreign policy. Nevertheless, the Saudis did realize the importance of their relationship with the West and especially with the United States, privately acknowledging the relative leverage which the United States could exert, in challenging their interests. In the end, the Saudis ultimately found a face-saving way out of its dilemma vis-à-vis the United States, by relating (not linking) its lifting of the embargo to the status of the disengagement of forces between Israel and Syria. This position by the Saudis in effect gave Syria's Hafez al-Assad a veto on when the embargo would be lifted. The American Secretary of State, Henry Kissinger, was

adamant that there was going to be no quid pro quo (no linkage) in exchange for the lifting of the embargo and he made two trips to Saudi Arabia to see King Faisal to explain the U.S. position. The understanding reached between the Saudis and the Syrians and the Egyptians by early February 1974 was that the embargo had outlived its usefulness and might well work against Arab interests. Faisal agreed to the ending of the embargo, so long as there was “constructive effort,” promoted by the United States, toward a Syrian-Israeli disengagement. On March 18, 1974 the Arab oil ministers agreed to end the embargo. Syria and Libya dissented, but the parties involved left little doubt that a “diplomatic” solution had finally been found.

Since that date in March 1974 ending the Arab oil embargo, the Saudis have tried hard to re-establish their close relationship with the US, offering the use of their territory as a base of operations against Iraq during the 1990-91 Gulf war. They have also striven to maintain their position as one of our top four or five oil suppliers.<sup>17</sup>

#### Since the September 11<sup>th</sup> attacks on the United States

Because the al-Qaida terrorist attacks on the United States of September 11<sup>th</sup> 2001 involved a majority of Saudi citizens and were financed and organized by Saudi dissident Usama Bin Laden, they have reawakened American governmental and public concerns about Saudi Arabia's role in the indirect support and financing of Wahabi Islamic fundamentalists in their terrorist attacks against Western interests around the world. Unfortunately, these new concerns have caused US-Saudi relations to deteriorate of late and it is still difficult to see exactly how they can be easily repaired or restored to their former close cooperative status. Even before the United States has successfully dealt with Saddam Hussein, the Saudis' de facto ruler, Crown Prince Abdullah has already let it be known that he will ask the US military forces to gradually disengage from the Kingdom, in order to remove a perceived irritant to improved US-Saudi relations. The war against Iraq for its “material breaches” of several of the UN's Security Council resolutions over the past 12 years and the degree of coalition cooperation and support that the US receives from Saudi Arabia is likely to prove an important test of the future prospects for repairing its close ties with the Kingdom or alternatively for allowing them to drift further apart.

The United States has apparently already seen fit to hedge its bets somewhat by gradually establishing the al-Udeid air base in Qatar, with a complete command and control centre, the longest runways in the region, and pre-positioned troops and equipment there. The Qatari air base is very similar to the Prince Sultan air base which already exists in the Saudi desert, but which the Saudis have to date been somewhat reluctant to allow allied forces to utilize as a base from which to launch attacks on Iraq.

#### (3) Energy Industry/Oil Market Related Reasons

The transformative impact of the use of the Arab oil weapon has perhaps been most clearly seen in the contrast between then and now in the role of the international oil companies (IOCs) and in the consolidation and restructuring of the entire world oil industry. In the IOCs' intensified search for alternative sources of oil and gas, they have sought to diversify away from US' too heavy dependence upon oil from that potentially insecure geopolitical region. The decades since 1973 have seen the creation of a host of national oil companies (NOCs) on three continents and their emergence as dominant



players in the oil market: Saudi Arabia's Aramco, Kuwait's KPC, Venezuela's PDVSA, Iran's NIOC, Nigeria's NNPC, and of course Mexico's PEMEX, whose nationalization dates to the late 1930s, are prominent examples of these new NOCs.

New oilfield technology development has also contributed to the finding of more oil in remote and previously inaccessible areas such as the North Sea, Alaska, West Africa, offshore the US Gulf coast, the Caspian Sea, Russia, China, India, etc. 3-D and 4-D seismic mapping of reservoirs, slant drilling of wells, and deepwater offshore technology have all lowered the costs of finding and developing oil deposits; some costs have been lowered dramatically.

The integrated nature of the world oil market, which takes oil from the wellhead to the end user, the nature of oil as essentially a fungible commodity, the shift from long-term contracts to the more volatile, but more transparent spot and futures markets (The NYMEX), with their various financial hedging instruments to manage risk, the shift from holding large primary and secondary inventories, to "just-in-time" inventories in order to minimize carrying costs – all of these oil market developments have found their niches in the post-1973 oil market and have collectively made other industrialized countries less dependent on Gulf oil in general and Gulf Arab oil in particular, more than 2 million barrels per day less dependent on Gulf Arab oil currently, as a fraction of their total oil consumption, than they were in 1973.<sup>18</sup>

Finally, there has also been a clear shift to nuclear, coal and gas in the OECD nations with a concomitant reduced dependence on oil, insofar as these alternative fuels can be used to meet energy needs. The establishment of a 55 mph speed limit on the interstate highway system and the enactment of CAFÉ standards for the American fleet of automobiles to improve the efficiency of the use of motor gasoline and the recent development of hybrid-powered cars were other important energy-saving results of the oil embargo. Unfortunately for those interested in conserving energy, the recent trend in car sales has emphasized the less fuel efficient SUVs (sports utility vehicles). The development of synthetic fuels, renewables, and the decline in the energy intensity of our economy (i.e. the use of oil per unit of GDP produced) have also come about, at least indirectly, because of the dramatic increase in the cost of oil in the wake of the embargo. The consumer response to the embargo also included the congressional decision to build the Strategic Petroleum Reserve (SPR) in 1977, which peaked at 592 million barrels in 1994-95. Acting as a form of insurance policy against the possibility of another sudden disruption in oil supplies, the SPR gives the US a cushion a number of months of oil supplies to counter such a sudden disruption. Finally, I would like to turn my attention to the implications for future energy security of the past misuse of the Arab oil weapon.

#### The Implications for Future Energy Security

I have heard it said that there are both pluses and minuses about writing about the future, as opposed to writing about the past. One of the pluses is that you do not have to worry so much about footnotes; but one of the minuses is that the reviews of what you write can be scathing! When I am asked why I have chosen to focus on an event that occurred almost exactly thirty years ago, I am forced to reply by saying that there are implications to be drawn from that experience regarding our future energy security.

1. An Arab oil embargo is extremely unlikely to be used again as a means of trying to influence U.S. foreign policy.
2. The war with Iraq will not be protracted and will be decisively won by the UN coalition of nations, led by the US and UK, although its aftermath may be long and somewhat “messy” until regime stability can be restored and the process of democratization can be begun. This is a war about pre-emptively disarming Iraq of its weapons of mass destruction (WMD) and perhaps even about creating a new potential rival to Saudi dominance of OPEC.
3. The world oil market will continue to be volatile and then eventually stabilize, once the outcome of the war becomes clearer, at an average level of around \$18--\$22/barrel for the OPEC basket of crudes, down from its estimated war-time peak of \$35 – \$40/barrel.
4. Europe and the United States may drift apart on common energy security issues, with Europe more sympathetic to a gradual move toward a common European energy strategy, similar to the still nascent move toward a common European foreign policy. But the common vulnerability of both Europe and the United States to disruption of their imports remains and the likelihood of other “oil shocks” remains substantial.

I would like to conclude with a quote from Henry Kissinger, the former Secretary of State in President Richard Nixon’s administration. In Years of Upheaval, Volume II of his memoirs he wrote the following:

*In fact, the Arab embargo was a symbolic gesture of limited practical impact. To be sure, Saudi and other Arab oil was [sic] not shipped to the United States. But since the companies were operating a common pool, they simply substituted nonembargoed non-Arab oil for embargoed Arab oil and shifted other allocations accordingly. The true impact of the embargo was psychological. The fear that it might be extended – that Arab production might shut down further – triggered a wave of panic buying by Europe and Japan, which constricted supplies and drove prices up even more. It was in fact the production cutbacks that really transformed the market, sharply accelerating the tilt in the balance between supply and demand and demonstrating the extraordinary leverage of the producing countries [The consuming countries] reluctance to cooperate with one another perpetuated their vulnerability, virtually guaranteeing a permanent crisis.”<sup>19</sup>*

Dr. Kissinger may have been wrong about the “permanence” of the energy crisis but I am sure he was right to focus on the need for consumers to cooperate. I would also add the need of the producers to cooperate as well, for it is only through cooperation, not through conflict that we will be able to transform what is still a finite, depletable strategic commodity into a blessing instead of a curse.

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## ENDNOTES

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<sup>1</sup> The Economist, January 18, 2003, p. 70.

<sup>2</sup> Anthony Sampson, The Seven Sisters (New York, The Viking Press, 1975), 137-8.

<sup>3</sup> The war, which coincided with the Islamic fasting month of Ramadan, is referred to by some Arab sources as the Ramadan War.

<sup>4</sup> A. Eban, Personal Witness: Israel Through My Eyes (New York, Putnam, 1992), p. 529.

<sup>5</sup> D. Yergin, The Prize (New York, Simon and Shuster, 1991), p. 597.

<sup>6</sup> Yergin, op. cit., p.594.

<sup>7</sup> Edward L. Morse, "A New Political Economy of Oil?" in Journal of International Affairs, Fall 1999, 53, no. 1, p.12.

<sup>8</sup> Sampson, op. cit. p.248, citing Ian Seymour in The New York Times, October 7, 1973.

<sup>9</sup> Yergin, op.cit. 607.

<sup>10</sup> R. Licklider, *Political Power and The Arab Oil Weapon: The Experience of Five Industrialized Nations* (Los Angeles: University of California Press, 1988),p. 15.

<sup>11</sup> G. L. Perry, *The War on Terrorism, the World Oil Market and the U.S. Economy*, Analysis Paper #7, October 24, 2001(Washington, D.C.: The Brookings Institution).

<sup>12</sup> Yergin, op.cit. 619.

<sup>13</sup> Ibid.

<sup>14</sup> Dan Morgan and David B. Ottaway, "War Weary Saudis Move to Increase Oil Market Clout," The Washington Post, November 20, 2002, p.A1, 14.

<sup>15</sup> Herman Franssen, personal communication with the author.

<sup>16</sup> A recent review of reform in the oil monarchies of the Gulf Cooperation Council (GCC) suggests that there is room for some more optimism about the prospects for political reform in the Arabian Peninsula states today than at any time since the massive influx of oil income in the last quarter of the twentieth century. See Anoushiravan Ehteshami, "Reform from Above: the politics of participation in the oil monarchies," International Affairs (London: Royal Institute of International Affairs) 79, 1 (2003) 53-75.

<sup>17</sup> They have been less than fully cooperative, however, in pursuing the alleged perpetrators of the al-Khobar Towers bombing of 1996, which killed 19 American servicemen. Some intelligence sources have indicated that this terrorist incident may have included either high level Iranian involvement or internal Saudi dissidents, but no one has yet been officially charged in this still unsolved episode.

<sup>18</sup> See Oil Import Data for the OECD, by source, for a rough comparison between OECD dependence in 1973 versus in 2002, on Gulf Arab oil imports in Oil Statistics.  
(<http://www.eia.doe.gov/emeu/ipsr/t31.xls>)

<sup>19</sup> H. Kissinger, *Years of Upheaval* (Boston: Little, Brown, 1982), pp. 873-874.