United States and the Middle East: Policies and Dilemmas
By Amy Myers Jaffe[1]

Introduction

The purpose of this paper is to explore the topic of the externality costs associated with rising U.S. oil consumption that are not easily quantifiable by strictly economic or monetary calculations. These hard to measure externalities include the strategic and diplomatic costs that, particularly since the attacks on the US on September 11, 2001, have heightened relevance in American foreign policy debate. They also include the rising cost of US military intervention of the protection of the flow of oil to the international community, both in terms of dollar expense and human lives.

While it is hard to put an absolute number on what Americans pay for our overwhelming dependence on oil as a transportation fuel, clearly the gasoline price at US gasoline stations does not reflect the real cost to the American taxpayer. This paper is aimed to heighten awareness that oil is not as "cheap" as it seems to the average American motorist. Rather the seemingly higher costs of alternative fuels may not be so out of line with the cost of gasoline when juxtaposed against the real cost for depending on foreign oil that includes the taxpayers' bills for US expanded military operations abroad as well as the diplomatic and security challenges associated with this dependence.

For the past two decades or so, United States international oil policy has relied on maintenance of free access to Middle East Gulf oil and free access for Gulf exports to world markets. American policy in the Persian Gulf is not designed, as conspiracy theorists might argue, simply to keep the price of US gasoline cheap or to make sure that

[1] Amy Myers Jaffe is a well-known commentator on oil and oil geopolitics and is a principal author of the James A. Baker III Institute's series of energy studies on the Persian Gulf, Caspian Basin, China, Japan and Russia. She is the author of several articles and book chapters on the subject of the politics of oil, including the chapter on oil geopolitics for the Encyclopedia of Energy, and co-author of "The World Of Cheap Oil" with Robert Manning, which appeared in Foreign Affairs in January 2001. She holds a degree in Arabic studies from Princeton University and served as the chief correspondent covering Saudi Arabia and Iraq for respected oil consulting letter Petroleum Intelligence Weekly for over a decade.

American companies get handsome oil exploration contracts. Neither of these goals would likely merit the intense level of US intervention in the region.

Rather, America ensures that oil flows from the Persian Gulf are available to fuel international trade and economy as part of its global superpower responsibilities. More simply put, the physical oil needs of the US economy can certainly be met fully by protecting oil flows closer to home, from Canada, Mexico, South America, the North Sea and Africa. But the United States must consider the health of the overall global economic system since a massive shortfall of oil elsewhere would not only effect the price of oil everywhere but almost certainly collapse the global economic system.

The Persian Gulf today represents 25-30% of world oil supply. Saudi Arabia is the world's largest oil producer and controls the majority of the world's excess production capacity, which it uses to stabilize and control the price of oil by increasing or decreasing production as needed during times of market crisis or instability. The sudden loss of the Saudi oil network would paralyze the global economy. Thus, the United States has a concrete interest in preventing any hostile state or internal groups from gaining control over the Persian Gulf region and using this control to amass power or blackmail the world community.

But this strategic and economic reality is costing the United States dearly in terms of military operations, diplomatic freedom and national security. At $20 billion a year in military expenditure to protect the flow of oil, the US taxpayer is spending roughly an extra hidden $4 to $5 a barrel for the crude oil beyond its market price.

Continued dependence on Middle East oil can potentially place costly constraints on the US freedom of maneuver in international relations. Such constraints are evident already in such areas as terrorist financing, human rights, political reform in the Middle East and the status of women. In important areas of national security, such as the US campaign in Afghanistan, Middle East sensitivities were relegated to a lesser plain, but it is not out of the question that the United States could face, one day, a tough choice

between the global economic hardship of a destabilized oil market and a foreign policy or national security imperative. Similarly, in a tight oil market, an important oil producer could try to use access to its exports as a lever to attain access to sophisticated military hardware or technology from a major oil-consuming nation.

Finally, high dependence on Middle East oil has been cited as a troublesome factor in shutting down dangerous state-sponsored terrorism, terrorist financing and proliferation of weapons of mass destruction. Many important US analysts argue that oil sales proceeds can be directed by authoritarian governments to fund terrorist organizations or to aid regional governments that harbor them. Some foreign policy analysts are now arguing that low oil prices – in addition to providing substantial economic benefits for the US and global economies – will reduce the revenue available to oil states, which sponsor terrorism or pursue the acquisition of weapons of mass destruction. This argument has powerful logic, but raises the question as to whether the link between oil rents and terrorism is really bonafide. While the link between terrorism and oil is neither necessary nor sufficient, as this paper will discuss, several oil states remain on the US Department of State terrorism list, and there are also private donors to terrorist groups who benefit from the trickle down of oil budgets into several key Middle East, Asian and North African societies.

US Dependence on the Middle East: Status Quo policies

For the past two decades or so, United States international oil policy has relied on maintenance of free access to Middle East Gulf oil and free access for Gulf exports to world markets. This policy was accelerated in the 1980s as the US strengthened its special relationships with key Middle East exporters, notably Saudi Arabia and Kuwait. These exporters expressed and exhibited a common interest in stable oil prices and adjusted their oil output to keep prices at levels that would neither discourage global economic growth nor fuel inflation. Then Saudi Oil Minister Hisham Nazer announced in the late 1980s that Saudi Arabia intended to make available an "ocean of oil" in exchange for "security of demand,"[i] and Saudi Arabia made the bold step of purchasing a

50% stake in US refiner Texaco to ensure a permanent, guaranteed outlet for its oil in the United States.[ii]

Taking this dependence a step further, the US also counted on these countries to make the sizable investments needed to maintain enough surplus capacity to form a cushion against disruptions elsewhere in the world. This spare capacity has served as a vital protection to US energy security. In August 1990, when Iraq attacked Kuwait, so much spare capacity existed in the international oil market that the 5 million barrels a day (b/d) of lost production from Iraq and Kuwait was easily replaced by production increases from Saudi Arabia, Venezuela, Abu Dhabi and other OPEC (Organization of Petroleum Exporting Countries) members.[iii]

The quid pro quo of this special relationship with the Arab Gulf was that the United States would guarantee the security of Saudi Arabia and its small Gulf neighbors in return for the Gulf Arabs' cooperation in keeping a reliable flow of moderately priced oil to international petroleum markets.[iv] The United States communicated its willingness to intervene militarily should Saudi Arabia or another Gulf Arab ally be threatened by implementing a strategy through the 1970s and 1980s referred to in US military circles as "offshore balancing," that is, keeping American troops, pre-positioned equipment and navy positioned in and around the Persian Gulf and Indian Ocean.[v] Washington demonstrated its willingness to intervene more concretely in the mid-1980s when its navy escorted Gulf Arab oil shipping through the Persian Gulf to protect it from Iranian warplanes and mines during the Iran-Iraq war, and, most notably, in 1990-1 when it rushed troops to Saudi Arabia after Iraq invaded Kuwait.[vi]

Protecting the Oil: US Military Costs in the Persian Gulf

The policy, while producing relatively moderate oil prices over the 1980s and into the 1990s, was still an expensive one. The US General Accounting Office (GAO) estimates that from 1980-1990 about $33 billion a year of the US military budget was spent on defending oil supplies from the Middle East. Other studies that tried to refine

the GAO's approach to eliminate more general Mideast initiatives not directly related to the protection of oil flows attribute lower numbers of $6.4 billion to $14.3 billion.[vii] A more recent 1996 study projected that annual costs of US military operations in the Persian Gulf would range between $20 to $40 billion in peacetime.[viii] Exports from the six Gulf Cooperation Council countries –Saudi Arabia, Kuwait, UAE, Qatar, Yemen, Oman—total about 12 to 13 million barrels a day or 4.4 to 4.7 billion barrels of oil a year. At $20 billion a year in military expenditure to protect the flow of oil, the US taxpayer is spending roughly an extra hidden $4 to $5 a barrel for the crude oil beyond its market price.

Prior to 1980, the United States maintained only three naval ships in the region and limited pre-positioned equipment in Oman and Bahrain.[ix] After 1990, the US forged new agreements with most of the states of the Gulf Cooperation Council (GCC), fostering multilateral exercises, command and control coordination (now in Qatar), a defense initiative against chemical and biological weapons, and a multilateral missile launch early warning system.[x] The GCC is a regional security grouping founded in May 1981 in Abu Dhabi in reaction to the Islamic revolution in Iran, the Iran-Iraq war and the Soviet invasion of Afghanistan. The GCC membership includes Saudi Arabia, Kuwait, Bahrain, Qatar, Oman and the United Arab Emirates. US readiness in 2000 entailed rapid access to two combat divisions, three carrier battle groups, and 14 tactical fighter squadrons, with 25,000 soldiers and one to two aircraft carriers permanently assigned to the Persian Gulf.[xi]

Beyond these routine costs, there has been the cost of occasional military actions to defend the region and its oil supply. During the latter years of the Iraq-Iran war, which began in 1980 and lasted eight years, the US Navy engaged in an active escort campaign for Kuwaiti oil tankers in the Persian Gulf. This activity is estimated to have cost $200,000, according to the GAO.

Operations Desert Shield and Desert Storm (the 1991 Gulf War), which removed the Iraqi army from Kuwait, is estimated to have cost $61 billion, according to press

reports and the GAO.[xii] The majority of this expense was paid for by Saudi Arabia and Kuwait, with the total cost to the US taxpayer pegged at around $7 billion.

Iraq's invasion of Kuwait was considered a major infraction to the international system, and the Bush Administration began its efforts to utilize coercive diplomacy to pressure Iraq to withdraw.[xiii] As diplomacy and economic blockage failed to motivate Iraqi strongman Saddam Hussein, the US led a coalition to eject Iraq from Kuwait by military means. Although the Gulf War was not just fought about oil, senior Administration officials acknowledged that the need to go to war also had a large energy security component.

In testimony to the Senate Armed Services Committee in 1990, then Secretary of Defense Richard Cheney said, "Iraq controlled 10% of the world's reserves prior to the invasion of Kuwait. Once Saddam Hussein took Kuwait, he doubled that to approximately 20% of the world's known oil reserves…Once he acquired Kuwait… he was clearly in a position to dictate the future of worldwide energy policy, and that gave him a stranglehold on our economy and on that of most of the other nations of the world as well."[xiv]

That sentiment was echoed in "A World Transformed," a 1999 book published by President George Bush Sr. and his National Security Advisor Brent Scowcroft. "… no hostile regional power could hold hostage much of the world's oil supply." President Bush Sr. explained the need to go to war in an address before a joint session of the Congress on the Persian Gulf crisis and the Federal Budget Deficit on September 11, 1990, "Vital issues of principle are at stake. Saddam Hussein is literally trying to wipe a country off the face of the Earth. We do not exaggerate. Nor do we exaggerate when we say Saddam Hussein will fail. Vital economic interests are at risk as well. Iraq itself controls some 10% of the world's proven oil reserves. Iraq plus Kuwait controls twice that. An Iraq permitted to swallow Kuwait would have the economic and military power, as well as the arrogance, to intimidate and coerce its neighbors –neighbors who control

the lion's share of the world's remaining oil reserves. We cannot permit a resource so vital to be dominated by one so ruthless. And we won't…"

General Scowcroft in an interview in Frontline's series the Decision Makers, first broadcast on January 9, 1996, noted that reversing Iraq's invasion of Kuwait mattered because…" at the heart was naked aggression against an unoffending country, that was the firm and legal position, but what gave enormous urgency to it was the issue of oil…Principally because there was a struggle and had been a struggle going on within OPEC over, if you will, control of OPEC and it was a struggle basically between Saudi Arabia and the radicals, over keeping production flowing and keeping prices reasonable or trying to squeeze, if you will, the industrialized world. And the notion of Iraq, which was an oil powerhouse in itself, acquiring the Kuwaiti resources and thus perhaps of being able to dominate, OPEC was a tremendous danger to the United States and to the industrialized world."

Surprisingly, the debate surrounding the Gulf War and its aftermath did not lead to a strident political debate in the US about the risks of heavy reliance on Middle East oil. The subject entered the American political debate from time to time, especially around 1999 to 2000 when oil prices rose significantly following a concrete agreement within the Organization of Petroleum Exporting Countries to reduce production to defend a $25 oil price. But, it was not until the terrorist attacks on the United States on September 11, 2001 that the question of import dependence on Middle East supply became a more central concern among U.S. foreign policy elites.

Tightening Oil Markets and the Role of Saudi Arabia

The renewed focus on energy security post-September 11 comes in the context of increasing US vulnerability to a disruption of oil supply from the Middle East. This exposure is more pronounced because there has been an extraordinarily rapid erosion of spare capacities at critical segments of the energy supply chain over the past decade. Sustained growth in oil use world-wide, combined with under investment in OPEC oil

fields, has eaten away at the amount of spare capacity carried by key OPEC countries. The constraints to OPEC investment in expanding oil productive capacity has been driven by social/economic pressures in many oil producing countries whose government spending has had to be shifted away from capital investment to social programs in an effort to relieve the pressures of rapidly growing populations and an accompanying growth in unemployment. OPEC capacity has also been constrained by international and American economic sanctions policy, which has discouraged investment in key producing countries such as Iraq, Iran and Libya.[xv] In the late 1980s, OPEC had planned capacity expansions to a total of 32.95 million barrels a day targeted for 1995, but by early 1997, OPEC capacity had reached only 29 million barrels a day. Iran, Libya and Iraq all failed to achieve production targets due to international sanctions policy.[xvi] The decline in spare capacity means that the rapid and sizable replacement of disrupted supplies implemented by OPEC in 1990 would be difficult to repeat.

During the 1985 oil price collapse, OPEC was estimated to be carrying some 15 million b/d of shut in production capacity, equal to 25% of world oil demand. Saudi Arabia's shut-in capacity represented 60% of total spare capacity. When oil prices came under pressure in the early 1980s, Saudi Arabia agreed to play the role of swing producer, pulling back its oil production single-handedly to help OPEC stabilize fixed oil prices set by the producer group. By 1984, a glut of oil supplies from non-OPEC countries and flagging demand meant that Saudi Arabia had been forced to cut its production to 2.3 million b/d, down substantially from its production capacity of 10 million b/d.

By 1990, when Iraq invaded Kuwait, OPEC had about 5.5 million b/d of spare capacity, enough to replace the oil from those two countries and representing about 8% of global demand. Again, Saudi spare capacity represented about 60%. But by 2000, OPEC's spare capacity was a negligible 2% of world oil demand and resided almost exclusively in Saudi Arabia, roughly about 90% of current world spare capacity. That situation carries forward to today, leaving the oil markets extremely vulnerable to short term disruptions. These persistently tight crude oil markets highlight the concentration of

spare capacity in Saudi Arabia and the vulnerability of the global economy to domestic conditions there.

In late 2002, Venezuela's deepening social and financial problems and increased political polarization eventually prompted extra-constitutional attempts to remove Chavez from power. Violence became more prevalent until December 2002, when Venezuelan opposition groups organized a nation-wide strike that crippled the oil sector, bringing oil production to a virtual halt. The strike was designed to force an early referendum on the President's rule. President Chavez declared the strikers' demands as unconstitutional and called in loyal factions of the military to put down the protests.

The strike quickly curtailed close to 3 million barrels a day of Venezuelan oil production, prompting oil prices to rise but not dramatically so because the strike was not expected to last for a long time and other OPEC members had producing more than their production quotas mandated by the group. When OPEC met on December 12 and agreed to restrain output, prices began to rise more precipitously, reaching $31 by year end.[xvii] As prices climbed to a two-year high, OPEC producers met on January 12 and agreed to increase output to cool markets but failed to replace fully the lost Venezuelan volumes. This, combined with fears of an impending US attack on Iraq, kept oil prices high throughout most of the spring of 2003.

Saudi Arabia's place in the oil world is unrivaled despite the existence of other countries, notably Russia and the United States, whose total hydrocarbons liquids production is of similar magnitude. The kingdom is the only oil producer in the world that can replace single-handedly, within months, the total loss of *exports* of any other oil producer on the globe. The kingdom currently carries about 1 to 2 million barrels a day of sustainable spare production capacity, that is, production that can be maintained for more than 30 to 60 days. But Riyadh has the ability to surge its production temporarily by 3 to 4 million b/d in an emergency for 30 days or so. With massive investment, the kingdom could also increase its capacity by significant volumes more quickly than other

oil producers because of its prolific geology and giant oil export facilities. No other nation currently has enough spare capacity and investment revenue to claim this role.

Saudi Arabia's cushion of spare capacity has provided security and stability to world oil markets for two decades. The kingdom has intervened to calm markets on numerous occasions in recent years by quickly raising its production and exports, most notably during the 1990 Gulf crisis; immediately following the September 11, 2001 attacks; and most recently during the U.S. campaign in Iraq, preventing oil prices from soaring above $40 for any length of time during major supply interruptions from the Gulf. Saudi Arabia raised production to 9.5 million barrels a day in March and April 2003 (up from its OPEC quota allocation of 8.256 million b/d) to limit the rise in oil prices caused by the US campaign in Iraq.[xviii] Despite coaxing the International Energy Agency (IEA) to forego a major consumer strategic stock release, the kingdom did not use surge capacity to replace fully all Iraqi exports lost to the market, but chose rather to push out just enough oil to keep prices close to the OPEC price target range of $22 to $28 a barrel.[xix]

The kingdom derives its international clout from this custodial role and is unlikely under the current regime to relinquish it. The oil market regulator role played by Saudi Arabia is also an important element to its strategic relationship and alliance with the United States.

Yet, despite the kingdom's general reliability in oil emergencies as the supplier of last resort, key voices in the United States policy community have increasingly voiced their discomfort with continuation of a high level on dependence on Saudi largesse. Senior U.S. officials have publicly expressed the need to reduce dependence on Middle East crude. These concerns stem not only from worries that a deterioration of the U.S.-Saudi relationship might adversely affect the kingdom's willingness to continue to act as the world's oil superpower but also about the anxiety about the future stability of the desert country.

Saudi Arabia's Internal Stability under Pressure

Western Middle East studies analysts are increasingly writing specialized articles and books showing that the kingdom of Saudi Arabia is becoming a less stable place.[xx] Population growth rates in Saudi Arabia are among the highest in the world at over 3% per annum. The kingdom's population is expected to double over the next twenty years or so. Moreover, in the year 2000, 42% of the total Saudi population was 15 years or younger.[xxi] This demographic boom is placing the Saudi regime under increasing pressure, with the state being called upon to create more jobs and provide more services with lower per capita resources than in the past. The kingdom has, in recent years, been lowering subsidies for basic services, and has called upon the private sector to enhance its ability to provide jobs, but many Saudis lack basic job training and the Saudi education system faces fundamental challenges. Many Saudis are graduating from the Islamic university system with degrees in Islamic law, sciences or religious studies.[xxii] The Saudi economy to date remains highly dependent on foreign labor, which represents about 75% of those employed in the kingdom.[xxiii]

Saudi Arabia has a long history of forging closer ties with outside powers to promote its national security. As far back as 1957, it supported the "Eisenhower doctrine" that aimed to check communism in the Middle East. The move towards the United States was driven in part by a then revolutionary movement in Iraq whose foreign policy included support for national liberation movements that sought to overthrow conservative monarchies such as the regime in Saudi Arabia.[xxiv] By 1979, Saudi anxiety about its northern neighbors worsened with the establishment of the Islamic Republic of Iran. Prior to the revolution, the Shah of Iran was seen as a key guardian of the status quo in the Gulf.[xxv] Saudi-Iranian relations became greatly strained following the Islamic revolution, especially in light of the 1979 Mecca Grand Mosque takeover and the 1981 disturbance in Medina where a number of Iranian pilgrims were arrested and deported for distributing leaflets calling for the overthrow of the Saudi government.[xxvi]

With the toppling of the regime of Saddam Hussein of Iraq and an improvement in Saudi-Iranian relations following the election of President Mohammed Khatami, the

threat to Saudi stability is shifting and may become more internal than external. This has prompted the United States to announce the withdrawal of its decades long military presence inside the kingdom. Both U.S. Secretary Donald Rumsfeld and Saudi Defense Minister Prince Sultan Bin Abdul Aziz attributed the imminent end to the American air force presence in the country to the success in the war on Iraq, stressing that there is no longer a need for American flights to use the Prince Sultan airbase outside Riyadh to patrol the southern no fly zone over Iraq. The withdrawal of U.S. troops was meant to mollify the kingdom's fundamentalists and even moderates who opposed ongoing American military presence in the Gulf country for both political and religious reasons.[xxvii]

The announcement by the Bush Administration on April 29 that it was effectively ending its military presence in Saudi Arabia, with most of the 5,000 American troops (save a 500-member training crew) leaving the Kingdom by the end of the summer, surprised most observers, who were prepared for an eventual announcement but were caught off guard by the timing and immediacy of the move. The U.S. has already moved the U.S. Combined Air Operations Center from the Prince Sultan air base to Qatar's Al Udeid air base, which the tiny emirate built in 1996 at a cost of $1 billion to encourage the U.S. military to base its regional aircraft there.

Ironically, the announcement of the U.S. withdrawal was followed almost immediately by an attack on Westerners in the Kingdom. The simultaneous suicide bombing attacks carried out by 15 Saudis on three compounds housing foreigners in Riyadh on May 12 that wounded 200 people and killed at least 34, including eight Americans and seven Saudis, highlights the threat that internal groups now pose inside the kingdom.[xxviii]

Seven of the Americans killed had worked for the subsidiary of the U.S. defense contractor Northrop Grumman, Vinnell Corp., a Virginia firm that has a contract to train the Saudi National Guard and Saudi and civilian officials. The fact that employees of a U.S. defense contractor providing training and support for the protection of the Saudi

regime were specifically targeted is highly significant. The action was interpreted within the Saudi leadership as an indication that not just American targets were at risk but attacks might be directed at the Saudi regime itself. The incident, now linked to the Al-Qaeda terrorist network, is not the first internal attack but one in a series of incidents in recent months.[xxix]

Worries about Saudi Arabia's stability started creeping into US foreign policy literature prior to September 11. And, it was observed that a less stable Saudi Arabia mightn't have as much flexibility to carry and use spare oil capacity to help the industrialized West. "Things have changed," observed a 52-person task force sponsored by the James A. Baker III Institute for Public Policy and the Council on Foreign Relations on Strategic Energy Policy Challenges for the 21st Century in April 2001. "These Gulf allies are finding their domestic and foreign policy interests increasingly at odds with U.S. strategic considerations, especially as the Arab-Israeli tensions flare."

Neo-Conservative Critique of the Special Relationship between the US and Saudi Arabia

But post-September 11, the neo-conservative critique of the special relationship between the US and Saudi Arabia became sharper in the aftermath of the attacks on New York and Washington DC. It entered the mainstream US foreign policy debate as never before.

Department of Defense advisor and prominent neo-conservative Richard Perle sponsored a 2002 briefing at the Pentagon in which Saudi Arabia was described as the "kernel of evil."[xxx] Victor Davis Hanson went as far as to title a summer of 2002 article in Commentary Magazine "Our Enemies, The Saudis."[xxxi]

Summing up the dangers of heavy reliance on Middle East oil, former CIA director R. James Woolsey wrote in "Defeating the Oil Weapon" in Commentary in September 2002, "We had a working partnership with the Saudis for much of the cold

war, offering them protection against the Soviets (and Soviet clients states) in exchange for a reliable supply of cheap oil. But in light of the direction taken by the Saudis for nearly a quarter-century now (accommodating extremist Wahhabi views) it is also imperative that we take steps to reduce their hold over us."

"The wealth produced by oil is what underlies, almost exclusively, the strength of three major groups in the Middle East –Islamists, both Shiite and Sunni, and Baathists—that have chosen to be at war with us. Our own dependence on that oil, and the effect this has had on our conduct over the past quarter-century, have helped encourage each of these groups to believe that we are vulnerable," Woolsey argued.

Ariel Cohen, key analyst at the conservative Heritage Foundation, explicitly argued that access to oil revenues was a critical aspect of the export of radical Islam. "The oil bonanza funded the worldwide export of radical Wahhabi Islam, the ideological breeding ground of al Qaeda and the Taliban, over the last three decades. Government sponsored foundations, supervised by members of the Saudi royal family, fueled jihad from New York to Kabul, and from Miami to Manila, by funding brainwashing for violence in Wahhabi academies (madrassas), and terrorism training under the guise of charity. Hamas and Yasser Arafat's al Aqsa Martrys Brigades, which undermined the Oslo process and now are busily blowing the roadmap to bits with their weapon of choice brainwashed Palestinian suicide bombers are partially funded through Saudi telethons and hailed by preachers in Saudi government-supported mosques worldwide."[xxxii]

"Bin Laden understands both economics and the politics of terrorism. He has proclaimed that if he takes over his native land, he will drive oil to $125 a barrel…and Bin Laden's engineering and managerial skills can conceivably suffice to stage a super attack on the kingdom's oil infrastructure, one that could neutralize Saudi Arabia's 2 million barrels a day surplus oil producing capacity, vital for price stability," he warned.

Such concerns among analysts transcend the direct economic impact of high oil prices and volatility on the US economy. They center on a belief that oil revenues permit Middle East countries to sustain authoritarian regimes and promote anti-American policies such as support for international terrorism or pursuit of weapons of mass destruction. Under this analysis, state-owned oil companies in major Middle East producers serve as a government agent for the collection of economic rents that would, under a privatized system, flow to the people of the countries themselves. Collusion on production levels through OPEC, in turn, sustains those rents at a high level.

Saudi Arabia, though an ally of the United States, plays a particularly pernicious role in neo-conservative analysis, using its immense oil revenues and leadership in OPEC to promote the Kingdom's own brand of fundamentalist Islam – Wahabism – in the Middle East and Central Asia. "Saudi Arabia is a special case, being the home of Osama bin Laden himself and fifteen of the nineteen suicide hijakers, the seedbed of the ideas that stand at the heart of the Taliban, and the source of much of the funding of Islamist networks around the world. Although Saudi authorities have managed a working relationship with the West for decades, they have also permitted the kingdom's public discourse to be taken over by militant Islam, " wrote Daniel Pipes, "Who is the Enemy" Commentary January 2002. Pipes criticizes the close relationship between Saudi officials and the Bush Administration, which approved the evacuation of dozens of influential Saudis, including relatives of Osama bin Laden, from the United States in the days after September 11 despite the fact that most air travel was grounded.[xxxiii]

Growing Bi-Partisan Consensus

However, concerns about Saudi Arabia, its stability and its foreign policy are not limited to the neo-conservative vein. Mainstream policy leaders are voicing similar concerns in mainstream journals. "The flow of funds to certain oil producing states has financed widespread corruption, perpetuated repressive regimes, funded radical anti-American fundamentalism, and fed hatreds that derive from rigid rule and stark contrasts between rich and poor. Terrorism and aggression are byproducts of these realities. Iraq

tried to use its oil wealth to buy weapons of mass destruction. In the future, some oil-producing states may seek to swap assured access to oil for the weapons themselves. It is also increasingly clear that the riches from oil trickle down to those who would do harm to America and its friends. If this situation remains unchanged, the United States will find itself sending soldiers into battle again and again, adding the lives of American men and women in uniform to the already high cost of oil" wrote Timothy E. Wirth, C. Boyden Gray, and John D. Podesta, in "The Future of Energy Policy" Foreign Affairs, July/August 2003.

Harvard University's John F. Kennedy School of Government hosted an executive seminar on "Oil and Security" in May 2003, noting that "developments in the Middle East have highlighted the need to reassess the economic and political implications of the United States' growing dependence on imported petroleum, and to evaluate the changing relations between the United States and the Middle East oil producing countries." The seminar, which brought together many of America's top experts on oil and security, concluded, "Terrorism has emerged as a key concern in two regards. One is the risk to the oil industry's infrastructure and its "soft targets" in both consuming and producing countries. The other is the use of the proceeds from oil sales to fund terrorist organizations and the governments who harbor them."

The discussion at the Harvard seminar regarding Saudi Arabia focused on the Saudis critical role in oil markets and elaborated the obstacles to reducing or diluting their importance. The Rapporteur's report, published by the Environment and Natural Resources Program at the Belfer Center for Science and International Affairs, concluded that the global oil market benefits from having a "swing producer" who can raise production to regulate oil prices and noted that there are few, if any, other countries besides Saudi Arabia who might play this role in the coming decades. "The criteria for candidates are essentially economic," noted the seminar report. "The swing producer would need to be the low cost producer, and someone with sufficiently centralized and enforceable policies. It is unlikely to be Russia given the multitude of private producers with different interests, and the limited discretionary power of the central government.

While Iraq may have the prerequisite volume of reserves, its economic needs will make it virtually impossible for it to forego 20-25 percent of its production capacity. In the short- to medium-term, this leaves only Saudi Arabia."

The Harvard report posited the possibility that Saudi Arabia could experience a change in government, and that this could negatively impact its international oil market regulator role but suggested, "Economic necessity would constrain the government to adopting export-friendly policies in the medium- and long-term." Still, the report qualified this optimism by noting that "a change of regime in itself might be problematic." It added that the exodus of skilled personnel and foreign expertise might result in a loss of adequate personnel required to operate the system, resulting in a drop in production, or at the very least a curtailment of the investment needed to maintain and expand production. "History has not been kind on the impacts of regime change on oil production," explained the report. "It took approximately 10 years for Russia to start reviving its former production levels, and Iran has yet to return to the levels it was producing in 1980. It is thus conceivable that world oil supplies could be disrupted considerably longer than the "few months" that analysts have hinted at so far."

The Links between Terrorism and Oil: Real or Imagined?

As discussed above, some analysts are arguing that low oil prices – in addition to providing substantial economic benefits for the US and global economies – will reduce the revenue available to oil states, which sponsor terrorism or pursue the acquisition of weapons of mass destruction. This argument has powerful logic, but raises the question as to whether the link between oil rents and terrorism is really bonafide.

The proposition that oil producing countries have the resources to sponsor international terrorism seems, at first glance, to have merit upon glancing at the State Department list for such "states of concern." In the 1990s, several among the top violators, Iran, Iraq, Syria, Sudan, and Libya, all have state budgets supplemented by oil export revenues. Sudan is no longer on the list, and U.S. military sits in Iraq. On the US government's current watch, Iran registered annual oil revenues of $18 billion in 2002,

with $22 to $24 billion in foreign assets; Syria, oil revenues of $5.4 billion; and Libya, oil revenues of $11 billion, with $25 billion in foreign assets.[xxxiv] However, it should be noted that oil revenue is not a necessary and sufficient requirement to host terrorist networks or to develop nuclear weapons since many states lacking oil resources (or in fact, wealth of any kind), hold this dubious distinction including Afghanistan, Pakistan, and North Korea.

Iran's economy is highly dependent on oil export revenues, which constitute roughly 80% of total export earnings and 40-50% of the government budget and 10-20% of GDP. The US Department of State concluded in its 2002 Patterns of Global Terrorism Report that Iran remained "the most active state sponsor of terrorism in 2002." Oil revenue represents a significant portion of Iran's disposable income. The State Department report concluded that Iran provided Lebanese Hizbollah and Palestinian rejectionist groups such as HAMAS, the Palestine Islamic Jihad, and the Popular Front for the Liberation of Palestine-General Command, with funding, safehaven, training and weapons. Iranian funding for Hizbollah was reportedly about $60 million to $80 million a year in the 1980s. The State Department report also asserted that Iran provided support to extremist groups in Central Asia, Afghanistan, and Iraq with ties to Al-Qaeda.

The US first placed Iran on the State Department terrorism list in 1984, in response to allegations of Iranian involvement in the 1983 suicide attack by Hizbullah on US marine barracks in Lebanon.[xxxv] Iran was also linked to the bombing of Khobar Towers in Saudi Arabia, where 19 American servicemen were killed. On June 21, the Justice Department announced that it had indicted thirteen Saudis and one Lebanese who were members of Saudi Hizbollah. The indictment said that these individuals belonged to groups that were "inspired, supported and supervised" by elements of the Iranian government.[xxxvi] In April 2001, Iran sponsored an international conference supporting Palestinian groups, including groups promoting violence in Israel. In January 2002, a shipment of fifty tons of arms from Iran to the Palestinian Authority was uncovered.[xxxvii] The US maintains economic sanctions against Iran because of its terrorist links, and American firms are not allowed to purchase oil from Iran, nor invest in its oil fields.[xxxviii]

Oil-rich Iraq was also reported to fund terrorist training and operations prior to the US invasion. Iraq defector interviews published on the internet include stories of terrorist training camps and US troops encountered such camps during the recent campaign against the regime of Saddam Hussein as reported on CNN. Press reports also covered Iraq's generous support of Palestinian suicide bombers. Saddam Hussein reportedly pledged $25,000 each for the families of suicide bombers. The Arab Liberation Front, a Palestinian group, said that it had distributed between $30 million to $35 million in Iraqi money.[xxxix]

But by far the most controversial in the debate of terrorist financing is the direct and indirect role of Saudi oil revenues to assist terrorist groups. Oil and oil derived products account for roughly 90-95% of total Saudi export earnings, 75% of budget revenues, and approximately 30-35% of GDP. A 34 page private study compiled at the end of 2002 at the request of the President of the United Nation's Security Council concluded that Saudi-funded charities and businesses are still supporting Al-Qaeda terrorist networks. "Al-Qaeda was able to receive between $300 million and $500 million over the last 10 years from wealthy businessmen and bankers, whose fortunes represent about 20% of Saudi GNP, through a web of charities and companies acting as fronts" Jean-Charles Brisard, the report's author and former analyst for French intelligence told the London Times.[xl]

The government of Saudi Arabia has declared its support for the US War on Terror but has been fairly open in support of Palestinian terrorist groups. Saudi Crown Prince Abdullah, the de facto ruler of Saudi Arabia, met with a delegation from Lebanon's Hizbollah, praising resistance to Israel's attacks against southern Lebanon.[xli] Newsweek Magazine also reported in July 2003 that while the Saudi government has cracked down on Islamic extremists since September 11, it has increased its support of HAMAS.[xlii] Newsweek quoted a US Senate staff memo citing an Israeli national assessment that Saudi Arabia is funding more than 50% of HAMAS's needs. Newsweek reported that US assessments of the Saudi contribution to HAMAS are higher than those

cited by Israel.[xliii] The Newsweek article says documents seized by Israel during a raid showed that Khaled Mishai, a top HAMAS leader, was the guest of a Saudi-government backed charity, the World Assembly of Muslim Youth, at a convention in Riyadh. The convention was sponsored by Crown Prince Abdullah. A Saudi Government spokesman acknowledged at a Washington press conference in June 2003 that the Saudi government provides some funding for the "political wing" of HAMAS.

The Newsweek article also asserted that R. Richard Newcomb, director of the Treasury Department's Office of Foreign Assets Control, "has apparently told (Senate) staffers that virtually every attempt by the Treasury Department to impose sanctions on wealthy Saudi businessmen or entities that have been linked to terror financing has been "blocked" on foreign-policy and national-security grounds—usually invoked by the State Department but on some occasions by the FBI and CIA. In other words, other agencies of the government were worried sanctions would upset Saudi-American relations or disrupt ongoing investigations in other areas."

A Council on Foreign Relations Task Force on Terrorist Financing concluded similar findings, saying "For years, individuals and charities based in Saudi Arabia have been the most important sources of funds for Al-Qaeda; and for years, Saudi officials have turned a blind eye to this problem."[xliv]

Middle East analysts say that Saudi Arabia has increased its support for the War on Terror since the bombing attacks on three compounds housing foreigners in Riyadh. Reports of Saudi police raids on Al-Qaeda hideouts have become more common place, and US officials have been quoted in the press as saying the Kingdom is providing more cooperation in shutting down Al-Qaeda. But recent Saudi cooperation comes against a backdrop of emerging reports of past Saudi aid for the Taliban and possible indirect connections to funding for Al-Qaeda. Starting in 1999 and extending into mid-2000, Saudi Arabia gave 150,000 barrels a day of free oil exports to Pakistan and the Taliban government in Afghanistan, according to Petroleum Intelligence Weekly.[xlv] Oil trading community sources say that these shipments exceeded Afghanistan's oil use and may

have been resold to arm the Taliban.[xlvi] Saudi Arabia also extended an oil grant (the Saudi Oil Facility (SOF)) to Pakistan, following nuclear tests conducted by Islamabad in May 1998, to help Pakistan avoid defaulting on its international loan commitments. Pakistan was, at the time, building debt arrears in the wake of nuclear proliferation-related sanctions imposed by the West.[xlvii]

More concerning are reports in the Boston Herald that assert that two Saudi billionaire families are being scrutinized by US authorities for possible financial ties to Osama Bin Laden's terrorist network.[xlviii] Evidence for the allegations revolve around a 1999 audit conducted by the Saudi government that reportedly discovered that the Bin Mahfouz family's National Commercial Bank, had transferred at least $3 million to charitable organizations believed to be fronts for Bin Laden's terrorist networks, including Islamic charity Blessed Relief, whose board members include Abdul Rahman bin Mahfouz, son of Khalid Bin Mahfouz. In October 2003, the US Department of Treasury named Blessed Relief as a front organization providing funds to Bin Laden.

US and British authorities also reportedly looked at Al-Amoudi's Capitol Trust Bank in London and New York for similar activities. Mohammed Hussein Al-Amoudi is based in Ethiopia and oversees a vast network of companies in construction, mining, banking and oil, many of which have cross ownership with businesses owned by Saudi defense Minister Prince Sultan. Al-Amoudi has categorically denied any links to Bin Laden and declared himself "unalterably" opposed to terrorism, according to the Herald article. Both the bin Mahfouz families and Al-Amoudi families have close business links to the Saudi government.

The Bush administration has tried to press Saudi Arabia to crack down on Saudi charities, businesses and individuals who have links to terrorist groups. But the US is limited in how much of a conflict it can generate with Riyadh over the issue –despite its importance-- given the importance of Saudi largesse in keeping oil markets stable. The US must also concern itself not to press the kingdom for cooperation too stridently, thereby prompting such a negative reaction that Saudi Arabia opts to cut its oil

production in retaliation or refuses to assist the international community should a new oil supply disruption emerge. Similarly, the US has to worry that too much US diplomatic pressure for sweeping changes might precipitate Saudi policies that could lead to the fall of the current Saudi government in favor of a more radical one. Finally, the US is closed off --by the inexorable dependence on Saudi swing capacity in times of unexpected crisis—from using the kind of tools that might be utilized to pressure regimes with similar "issues" such as denying the country access to international lending, instituting oil sanctions or other economic sanctions or banning its businesses from the US market.

The reality of US policy constraints toward Saudi Arabia is demonstrated dramatically by a comparison of US-Iranian relations versus US-Saudi relations. The US maintains no diplomatic ties with Iran, has branded it a member of the "Axis of Evil," continues comprehensive economic sanctions against Iran and actively supports opposition groups and internal unrest inside Iran in hopes that the government will fall from power. The rationale for this policy is, of course, Iranian support for terrorism and its pursuit of weapons of mass destruction.

Ironically, however, Iran's support of terrorist groups includes two organizations that are the same groups reportedly receiving support from Saudi Arabia. As to Iran's weapons programs, Saudi defector Mohammed Khilewi, who was first secretary to the Saudi mission to the United Nations until 1994, alleges that Saudi Arabia sought to buy nuclear reactors from China, supported Pakistan's nuclear program[xlix] and contributed $5 billion to Iraq's nuclear weapons program between 1985 and 1990.[l]

In contrast to US-Iranian relations, the US, rather than sanction Saudi Arabia for these actions, has a historically close alliance with the kingdom. Indeed, the US has few means at its disposal to influence Riyadh if it chooses to block US efforts to close down terrorist funding or operations, except to withdraw US support for the country's security which, given the importance of its oil resources, would be counterproductive.

Chances are only the most extreme revelation, such as direct evidence that Saudi Arabia is officially attacking US citizens, is likely to tip the balance for open hostility towards the kingdom. That is because a US-led attack on Saudi Arabia that would lead to a change of government would almost certainly spur a crisis in international oil markets, damaging the US and international economy. Markets would have to be well-assured that chaos, sabotage or looting wouldn't disrupt oil exports as it has in Iraq, were the US to engage in a war in the kingdom. An economic blockage on Saudi Arabia, though actually proposed in the US Congress, would have a similarly deleterious impact on the world economy.

The constraints that dependence on Saudi oil creates on US foreign policy are not, however, necessarily limited to issues related to terrorism or policies related directly to Saudi Arabia itself. The Saudi "relationship" could also be called into force to influence other US foreign policy choices -should a potential American policy choice be considered of vital national interest to Saudi Arabia.

"To a certain extent, we let US foreign policy be dictated to us by the house of Saud," private oil consultant and former senior advisor in the Carter Administration Philip Verleger told the New York Times.[li]

Robert Baer, author of "Sleeping with the Devil" and Atlantic Monthly article "The Fall of the House of Saud"[lii] warns of the dangers in Saudi Arabia's position as the "market regulator for the global petroleum industry" when Saudi oil is controlled by "an increasingly bankrupt, criminal, dysfunctional, and out-of-touch royal family that is hated by the people it rules and by the nations that surround its kingdom."

While it might seem hard to imagine, beyond terrorism or banking, what other areas of undue pressure could realistically be drawn, it needs to be remembered that Saudi Arabia cooperated with the US in the mid-1980s to lower the price of oil to weaken the Soviet Union as well as Iran and Iraq. Those choices to pressure Moscow, Tehran and Baghdad suited US interests. In fact, to the extent that low oil prices helped foster a

change in government in the USSR, the US was ecstatic. But what of a case where an aggressive Saudi oil pricing policy threatens an important US allied leader?

Such was the case in 1998 when extremely low oil prices put the last nail in the coffin of a friendly Venezuelan government and ushered into power the unfriendly regime of Hugo Chavez. Prior to the change of leadership in Caracas, Venezuela had been actively expanding its oil production capacity through an opening up to foreign direct investment by American oil companies initiated in 1992. The program was expected to take Venezuela's oil production as high as 7 million barrels a day by 2010, a level almost rivaling Saudi Arabia. For a period of many months, Saudi Arabia warned Venezuela to stop overproducing and to abandon its plans to expand its oil market share. It threatened to initiate an oil price war to knock out the incentives for continued investment in Venezuela and to "punish" the Venezuelan government. Venezuela failed to heed Saudi warnings and Saudi Arabia sat back as oil prices moved into a free fall. When oil prices reached a low of $8 a barrel in 1999, Venezuela was forced to cry "uncle" and the new Venezuelan government immediately trimmed back plans to expand oil production capacity. In fact, continued political unrest in Venezuela, in the aftermath of the entire financial debacle stimulated by the 1998 crash, led to an oil workers strike that has set Venezuela's state oil industry back tremendously. Venezuela's production capacity has fallen from 3.7 million barrels a day prior to the election of Hugo Chavez to roughly 2 million b/d today, contributing dramatically to the tightening of oil markets in recent years and related high prices.[liii] Concluded the Harvard seminar report about this Saudi strategy, it "has been costly for countries attempting to challenge the position of Saudi Arabia. The Saudis have responded aggressively and ruthlessly to protect their leading role in the world market."

Riyadh could easily use the same trick down the road to weaken the base of support for Russia's President Vladimir Putin or to dislodge a new Iraqi or Mexican government not to its liking. One motivation could be one of these countries stepping up to the plate with investments (or an opening to massive foreign direct investments) designed to overtake Saudi Arabia as the pivotal oil superpower.[liv]

There has been speculation that Russia could replace Saudi Arabia as the key US energy ally, and this has prompted some speculation (and Saudi public warnings) that Riyadh might start a price war to hinder rising Russian production. In reality, however, Russia possesses next to no unutilized capacity, nor is Russia likely to develop such capacity in the future. This stands in stark contrast to Saudi Arabia, who, as discussed above, has spare capacity that can be offered in times of market emergencies.

The unique ability of Saudi Arabia to serve as market guarantor makes the costs of an unexpected change of government a major concern to the West. The establishment of a radical or openly hostile government in Saudi Arabia would be a major problem for international oil markets. History has shown that sudden changes of government – whether by military take-over or by a shift to democracy—is often followed by a sharp drop in oil production levels for a sustained period of time, frequently ten to twenty years. This is because a major government change is often accompanied by bureaucratic confusion and/or internal chaos for a period of time. In the case of Iran, the country's oil production levels have still not recovered to pre-revolutionary levels despite the passing of over 30 years. Russia too is just now recovering after a 10-year slump in oil production following the collapse of the Soviet Union. A bin Laden style government would not need to reduce production purposely to grab higher oil rents but may simply do so by accident through disorganization or the politically motivated replacement of knowledgeable technocrats.

Conclusion

October 17, 2003 marks the 30th anniversary of the 1973 Arab oil embargo. Thirty years later, oil remains, incomprehensibly, a continuing worry for the international community. Ironically, despite three decades of liberalization and the development of global markets and free trade, the world has not been able to shake off the "threat" of political interdiction of oil supplies. And now, new worries have emerged that oil

revenues are being diverted to support international terrorism and development of weapons of mass destruction.

Diplomatic creativity by the United States and the other industrial democracies in the 1970s helped counter and limit the economic and political damage wreaked upon the West by OPEC's oil weapon. Renewed focus on similar efforts is imperative for U.S. and its allies. Serious efforts need to be made to lower dependence on oil and to marginalize oil supplies from the Middle East and elsewhere that are not available to our citizens on terms suitable to our interests. This can be done by simultaneously nurturing sources of "new" oil such as Russia, the Caspian and Canadian tar sands while at the same time allocating more substantial resources towards developing alternatives.

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[i] "Search for New World Order Confronts Oil World" Petroleum Intelligence Weekly, Monday, February 11, 1991 and February 4, 1991, page 1.

[ii] "Texaco, Saudis Finalize Joint Oil Venture" Associated Press, November 11, 1988, as printed in the Wall Street Journal p. 16

[iii] "The Political, Economic, Social, Cultural, and Religious Trends in the Middle East and the Gulf and Their Impact on Energy Supply, Security and Pricing, available at www.bakerinstitute.org; also Petroleum Intelligence Weekly covered these production increases in great detail in various issues from August 1990 to January 1991

[iv] Strategic Energy Policy: Challenges for the 21st Century, Report of an Independent Task Force Co-sponsored by the James A. Baker III Institute for Public Policy of Rice University and the Council On Foreign Relations, 2001, available at www.bakerinstitute.org. While no formal written treaty to this affect exists, the quid pro quo of oil pricing policy was a common feature of private discourse between US officials and Saudi officials during the mid to late 1980s. For discussion of the Gulf Arab pricing policies to keep pricing artificially low, see F. Gregory Gause, "Iraq's Decision to Go to War" Middle East Journal, Winter 2002 (Volume 56, No. 1) and Lawrence Freedman and Efraim Karsh, The Gulf Conflict 1990-1991 Princeton University Press, Princeton, 1993) as well as The Washington Post, January 15 1991 which described Iraq's dissatisfaction with the Gulf Arab policy of keeping oil prices low. Also, William Quandt, Saudi Arabia in the 1980s: Foreign Policy, Security and Oil, The Brookings Institution, Washington DC, 1981

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[xii] Hu, Patricia Op cit; Congressional Research Service, Document on Persian Gulf War: US Costs and Allied Financial Contributions, Washington DC CRS, IB 91019, September 21, 1992. Also, Patrick Tyler and Richard W. Stevenson, "Profound Effect on US Economy Seen in a War with Iraq" The New York Times, July 30, 2002.

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