Shaking the Sheiks

by David Ignatius

It is now more than a year since the Organization of Petroleum Exporting Countries (OPEC) cartel quadrupled the price of oil. The dire predictions of economists and political scientists about the consequences of the price increase have proven to be all too accurate. The world monetary system has been unable either to balance the massive deficits of consumers with the massive surpluses of producers, or to develop an effective system for transfer payments between the two. This monetary instability has in turn bred a lack of confidence among investors and consumers–creating the conditions for a chronic and sustained world depression. All this was forecast a year ago by those who looked carefully at the new oil balance sheet; yet the U.S. and its allies have been unable to lower the oil price by so much as a penny.

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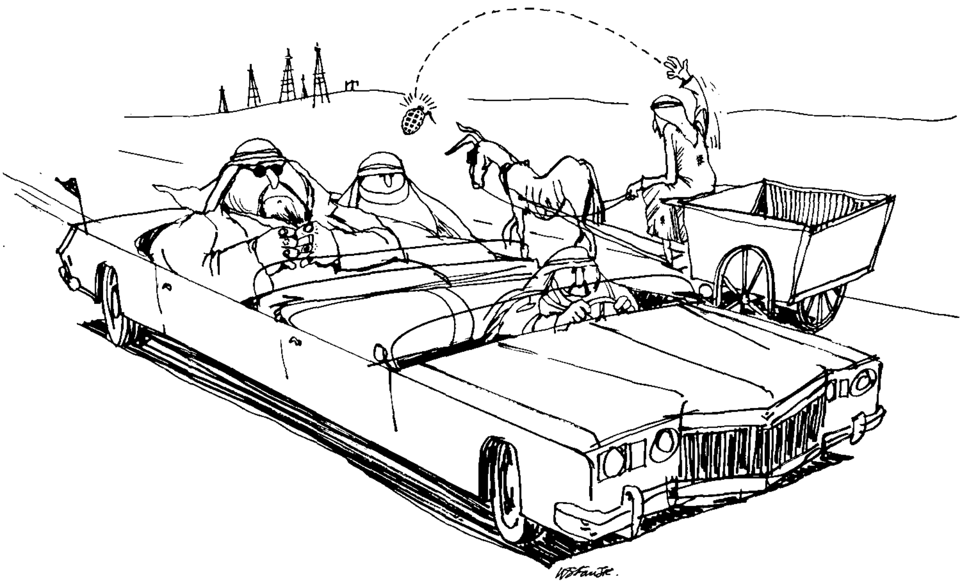
Have we, then, no leverage whatsoever over the OPEC countries? Is the economic lesson of the past year that a disciplined cartel can, if it chooses, simply draw its prices out of a hat?

In the last several months, there has been a grim debate in foreign policy circles, examining just what options *are* available to the U.S. and its industrial allies for use against OPEC. In January, Secretary of State Kissinger openly admitted that *military intervention* against the oil kingdoms might be necessary "if the United States were faced with economic strangulation." Earlier, in November, Kissinger had joined with Treasury Secretary William Simon in endorsing head-on economic confrontation with the OPEC countries. The Kissinger-Simon plan called for concerted action by the oil–consuming countries toward a variety of goals:



reducing demand for OPEC oil, devising some means for the industrial countries to share the balance-of-payments burden, and rationing available oil in the event of another embargo. There have been several other proposals for cooperative action, as well as calls for tit-for-tat reprisals like anti-OPEC tariffs, counter-cartels, food embargos, and diplomatic harassment.

For the most part, the oil sheiks have ignored the provocation and continued with their money-counting. Because they assume that the U.S. will not risk nuclear confrontation with the Soviet Union in the Middle East, the Arabs do not fear our military threat. And because they know that the industrial countries simply cannot reduce their oil consumption enough to alleviate the payments crisis, they discount our threat of concerted economic action. The futility of the reduced-consumption approach, by itself, was well illustrated by George McGhee in a January article in *The Washington Post*. He pointed out that the government's conservation goal—which so far has proven to be too optimistic—is a six-percent reduction in our consumption of oil. Even if we were able to meet that goal, McGhee continues, the declining production from our own domestic wells would force us to import more oil than we do today.

To put it bluntly, the OPEC nations act as if they are doing us a favor by producing oil. Their ultimate rejoinder to talk that the price of oil is too high is a simple "take it or leave it."

There is, however, one threat that seems to terrify the oil magnates. Surprisingly, it has gone almost unreported, for the OPEC nation's fear on this issue belies confidence on so many others. The threat is the potential ability of the U.S. and its allies to manipulate the price of gold.

When the U.S., France, and other countries began to alter the terms of sale and valuation of gold late in 1974, there was consternation in the Persian Gulf. In a December 19 interview with the Associated Press, the Shah of Iran warned that any fluctuation in the value of gold would send oil prices so high that international commerce would quickly collapse. The Shah's immediate concern was an agreement reached earlier that week between U.S. President Ford and French President Giscard d'Estaing at their Martinique summit. The two presidents agreed that governments should be allowed to revalue their gold reserves upward, from the official price of $42.22 an ounce to the market price, then about $185 an ounce. This would more than *quadruple* the value of the industrial countries' gold reserves, and thus help these countries to pay their oil deficits. Since the U.S. alone has some 275 million ounces of gold in reserve, this one move would increase its purchasing power by more than $40 billion.

Surprisingly, most major newspapers failed to carry the AP interview. Few readers were able to note the Shah's panic, "If our purchasing power is lost, everything goes," and his Kissingeresque warning, delivered, ironically, before the Secretary of State's use of the same metaphor in *Business Week*, "If they want to strangle us. . . . we will be like people who are drowning, having recourse to anything. It won't be just a question of a few percent inflation. It could even be the collapse of the whole monetary system."

So we *do* have something that can shake the Shah. He may be wrong in perceiving it as an immediate threat, for it would seem that the Arabs would respond to a rise in the valuation of gold by once more raising the price of oil. It's immediate potential for disaster would be confined to the poor countries which possess little gold or oil, which may explain why the leftist government of Iraq, which seldom agrees with the Shah on anything, bought a full-page ad in *The New York Times* in December to protest the Ford-d'Estaing gold agreement.

But the Shah may well have seen beyond the plight of the Chads and Nigers and realized that the rise in the valuation of gold could be a second step in the cycle of economic attack and retaliation that was initiated by the OPEC price increases. Whatever his reasons for concern, the important thing is for us to take advantage of it to begin to make the Shah and other oil princes focus on the dangers of a mutually suicidal economic struggle with the industrial powers.

Going Down with Faisal

The simple fact the oil powers seem to have forgotten is that any seller, even a monopolist, can survive only as long as he has a buyer. In the absence of trade, oil is worth almost nothing to the Middle Eastern producers. They typically have no industrial plants of their own to fuel; and worse, unlike gold or other mineral resources, oil is not even decorative. In the long term, then, the Arabs can best sell their oil, and maximize their earnings, under world economic conditions not so different from those of the sixties: a higher price for oil, perhaps, and a larger share for the developing countries in general, but the same steady growth, reasonable inflation, and reliable outlets for investments as prevailed during those years. The Arabs depend on the West not only to buy their oil but also, ironically, to preserve the purchasing power of their enormous reserves. With the dollars, pounds, and marks that pile up, the OPEC countries can, over time, buy all the useful or decorative assets, goods, and services they can absorb. Unless, that is, inflation causes their money to lose its stability as a store of purchasing power. In that case, the producers will look for assets, other than cash, such as land abroad, or in foreign capital assets, like luxury automobile factories.

But even these assets will lose their reliability as stores of purchasing power in an unstable political/economic environment. If the host country feels that it is being exploited by the foreign investor--that its economic difficulties, in other words, are directly related to the swollen profits of the foreign investors—the foreign-owned assets will very likely be nationalized. For years, American investors have encountered this problem, and U.S. multinational corporations have been forced to tread a line between "acceptable" profits abroad and the "excess" profits which invite retaliation. So will the OPEC countries.

By their actions to date, the OPEC countries have not exactly created the ideal conditions for investing in foreign countries. If the world economic situation gets worse—that is, if the oil price remains at its present level—where will the OPEC countries be able to put their money? Like misers of other eras they may shift toward scarce commodities, such as gold and Old Masters. But even here, they are not secure, because of the recent tampering with the price of gold and its wild fluctuation in European and U.S. markets. If the stable purchasing power of gold is lost, then OPEC oil–in the ground or out of it—cannot be measured against any fixed standard of value. As traders, the members of the OPEC cartel must have some standard denominator of value (or *numeraire*) if they are to survive. But they cannot establish such a standard alone; they must do so with their trading partners. If the current situation can be compared to a chess game, the Arabs clearly hold most of the chess pieces. But we own the board upon which the game is played.

Over the Top

The question which OPEC must ponder is whether, in the world it is creating, the stability necessary for GNP growth and trade will exist. Already, most currencies have lost their dependability. As the Western economies grow more slowly—and, with the onset of Depression, actually decline—the value of capital assets becomes questionable. And now, the perceived "attack" on gold.

Thus, for the OPEC cartel, there is in effect an absolute ceiling price for oil—beyond which OPEC risks losing everything. Many analysts (see particularly the article by Hollis Chenery in the January 1975 issue of *Foreign Affairs*) argue that the current price schedule is well above the ceiling, and that adherence to it will destroy the very trading system on which OPEC depends.

The great irony is that the oil consumers' only credible threat to the Arabs is that, if the Arabs continue to hold their price above the long-term ceiling, the world economy will collapse, and with it the value of their money, their financial holdings, and their oil in the ground.

Our most important and immediate political task, then, is to make sure the Arabs understand that their long-run survival cannot be separated from our own. By their actions to date, they have created a world in which people have begun to talk about steps which would have been considered grotesque and outrageous two years ago—U.S. military intervention in the Persian Gulf, the creation of an "Organization of Grain Producing Countries," and denying the Arabs the machinery they need to get the oil out of the ground.

A spokesman for the Petroleum Equipment Suppliers Association notes that in 1974 over $1-billion worth of American oil equipment was exported. Ninety-nine per cent of OPEC oil rigs, averaging $2 million each, were made in America, and the most valuable parts—mud pumps, rotary drilling bits—can best be replaced by American companies. Of course, denying the Arabs equipment to produce oil that we need would be self-destructive, just as military action and the use of the grain weapon by us and other countries would be outrageous. But it defies human nature to think that if countries feel they have been pushed to the limit, they will not lash back with whatever weapons they have. Perhaps the reason the Arabs have not considered this possibility is that they have assumed their commodity to be the only one the rest of the world really needs. The fact is, of course, that as the world economy has become more complex and as world trade has grown, dozens of countries have acquired control over commodities and services as powerful as oil. Bauxite, chromium—these and many other resources lack oil's positive power to fuel an industrial world, but they have its negative power to disrupt and destroy. Even the world financial market is part of this category. A handful of western countries have it in their power to deny the services of the international money market to everyone else, and thereby destroy whatever currency they choose. They have not done so, of course, for they would destroy themselves in the process; and what the Arabs must understand is that the oil situation is not so very different.

The point which must be made to the Arabs is not that our "gold weapon" or even our "food weapon" can beat their "oil weapon," but that if we continue to use the weapons against each other all of us are going to lose. Even on their home ground the Arabs are threatened by the economic crises they have created. Although the stereotype of the oil producing country is Kuwait, with its 900,000 people and its $9 billion in oil revenue last year, not all the countries fit this model. There are 30 million people in Iran and 35 million in Egypt—which, though it has no oil, is of enormous political influence within the Arab bloc. Even Saudi Arabia has a population of eight million. The distribution of wealth within these countries is, to put it mildly, not ideal, and as the pressures of worldwide inflation continue, someone is going to get the idea that all those billions of oil dollars should be seized for "the people." Then it will be no more Cadillacs for the sheik, no more villas in the south of France, but a bullet hole in the stomach—and not from a Yankee soldier, but from his own people. Such a possibility is more than mere speculation; on the first day of this year, more than a thousand workers rioted in the streets of Cairo, complaining about their low pay and the quickly rising cost of living. If the rulers of the other Arab countries are as hard-minded as they pretend to be in dealing with the West, they must realize that the same, and far worse, can happen to them.

All of this is unpleasant talk, to be sure, but it is not unrealistic, and if the ugly consequences are made clear soon enough, they may never be any more than talk. ■

Getting Tough With Israel

by J. William Fulbright

I believe that the current situation in the Middle East is shaped by two central facts. One is the volatility of the Arab-Israel conflict, and the high probability of another, greater war if the central issue of the occupied territories is not soon resolved. The second—which for domestic political reasons we are exceedingly reluctant to acknowledge—is the close relationship between the Arab-Israel conflict and the price and availability of oil.

The danger of a fifth Arab-Israel war is acute, and if such a war comes, it will almost certainly be more violent and more protracted than the previous wars. In the period of truce since the October 1973 war both sides have rearmed heavily. The consensus of military experts is that the strategic balance is shifting to the Arab side, not only because of Soviet supplies but also because of the greatly improved training and technical competence of the Egyptian and Syrian armed forces. Egypt and perhaps Syria are now armed with Russian surface-to-surface "Scud" missiles, which would enable them to attack Israeli cities as well as Israel's vulnerable oil storage facilities. Israel, for her part, is generally assumed to have acquired nuclear weapons, and if Joseph Alsop—whose Israeli connections are excellent—is to be believed, Israel is prepared to use those weapons if her cities are attacked. In Alsop's view, Israeli warnings already issued amount to a veiled but unmistakable threat of nuclear war.

The alternative to war—and the only alternative—is a general settlement. It is no derogation of Secretary Kissinger's achievements to note that the disengagement agreements of the past year and the limited Israeli pullbacks in Sinai and the Golan Heights were no more than preliminary accomplishments. The difficult issues remain—in particular Jerusalem and the West Bank—and unless they are resolved, there will almost certainly be war, a war that would devastate Israel, quite possibly provoke a Soviet-American confrontation, and most certainly bring on a new, ruinous oil boycott. This prospective crisis is not remote or hypothetical; it is closer to being a clear and present danger.

It cannot be permitted, and it is up to the United States, not alone but in collaboration with the Soviet Union and the United Nations, to prevent it. Israel, it appears, is stalling, and with nothing concrete in mind except to get all the arms and money she can from the United States, so as to try to hold off the inevitable. The Israeli leaders might have made good use of time gained since last year's truce to prepare for the necessary accommodations. They might have been telling their people, as Israel's first and wisest leader, David Ben-Gurion, tried to tell

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