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UNIVERSITY OF CALIFORNIA,  
IRVINE

The Petrodollar Era and Relations between the United States  
and the Middle East and North Africa, 1969-1980

DISSERTATION

submitted in partial satisfaction of the requirements  
for the degree of

DOCTOR OF PHILOSOPHY

in History

by

David M. Wight

Dissertation Committee:  
Professor Emily S. Rosenberg, chair  
Professor Mark LeVine  
Associate Professor Salim Yaquub

2014



## **DEDICATION**

To Michelle

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- “Petrodollar Promise and Peril: The Middle East Economy and Changing American Conceptions of Power in the 1970s,” SHAFR Annual Meeting, Arlington, VA, June 22, 2013.
- “‘A Klondike without Ice’: American Businesses, Petrodollars, and the Middle East and North Africa in the 1970s,” Berkeley International and Global History (Big-H) Graduate Student Conference, Berkeley, CA, March 16, 2013.
- “Analyzing Propaganda Posters & Films from WWII,” Guest Lecture for course History 40C: The Formation of American Society: The Twentieth-Century at UCI, Irvine, CA, April 29, 2011.
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## **ABSTRACT OF THE DISSERTATION**

The Petrodollar Era and Relations between the United States  
and the Middle East and North Africa, 1969-1980

By

David M. Wight

Doctor of Philosophy in History

University of California, Irvine, 2014

Professor Emily S. Rosenberg, Chair

This dissertation is the first study, based on newly available governmental and nongovernmental sources, to comprehensively explain how the surge in petrodollar profits of oil exporting states in the 1970s dramatically changed logics of power and relationships between the United States and the Middle East and North Africa (MENA). This research makes several interpretive contributions. First, it argues that monetary and financial considerations (distinct from the resource of petroleum) achieved sudden and unparalleled importance in diplomatic and transnational exchanges between the United States and the MENA during the 1970s, and that rapidly rising commercial ties between the two regions contributed to an unprecedented level of economic and cultural exchange. Second, by employing a regional framework that looks at both oil-rich and oil-poor countries, while also disaggregating the impact of petrodollars upon specific countries and groups, it examines how various American, Arab, and Iranian efforts to structure petrodollar flows reshaped relationships within the region. In particular, it explains how petrodollar flows contributed to the rising importance of Saudi Arabia to the United States, Egypt's diplomatic shift toward America, the deterioration of relations between the United States

and Iran, and the course of the Arab-Israeli conflict. Third, it analyzes how petrodollars brought the Treasury Department and US banking and corporate interests to a new level of significance in US relations with the MENA and suggests the varied consequences of this complex policy environment. Finally, using both English and Arab language sources, it demonstrates how petrodollars became important in structuring popular cultural narratives about globalization, interdependence, sovereignty, and identity in both the United States and the MENA. The goal of this dissertation, in short, is to establish that many of the foundational transformations in US-MENA relations during the 1970s cannot be properly understood without an analysis of the role of petrodollars.

## INTRODUCTION

Petrodollars, the money acquired by countries through the export of oil, played an extremely important role in reshaping and defining relations between the countries of the Middle East and North Africa (MENA) and the United States during the 1970s, a decade when the rapid rise in oil prices brought a sudden, unprecedented, and very large amount of wealth to the oil-rich countries of the MENA. Despite the magnitude of the petrodollar profits pouring into oil-rich MENA countries during the 1970s, most studies of US-MENA relations largely overlook the impact of petrodollars (as distinct from the resource of oil) or treat their role in a fragmentary way as a minor side-note. Scholarship primarily explains the evolution of US-MENA relations during the 1970s through other key forces like the Arab-Israeli conflict, access to oil, the strategic rivalry of the United States and the Soviet Union, the rise of political Islam, and terrorism; petrodollar wealth is treated as ancillary to these major issues. It is not my intention to argue that any of the aforementioned subjects are not important to understanding US-MENA relations during the 1970s; what I do argue, however, is that during this period petrodollars were of comparable significance to any of these other issues in understanding how and why US-MENA relations developed as they did. This dissertation seeks to elucidate and explain the wide ranging consequences of MENA petrodollar wealth to US-MENA relations in the 1970s, and to argue that petrodollars should be understood as a shaping factor in US-MENA relations in the 1970s on par with other important issues like access to oil, the Arab-Israeli conflict, and the US-Soviet rivalry.

The transformative impact of petrodollar flows during the 1970s and 1980s has been recognized in other areas of study. Histories of the MENA, for example, whether analyzing the

entire region or individual countries, emphasize the role of petrodollars in political, economic, social, cultural, and environmental developments. General histories of the MENA typically include the petrodollar boom of the 1970s as a significant episode in understanding the development of the region. William Cleveland's *A History of the Modern Middle East*, for example, notes that petrodollar revenues transformed the oil-rich countries of the Arabian Peninsula from "impoverished, sparsely populated" states of "little international concern" into nations with "the highest per capita incomes in the world" that were "crucial participants in the global economy" by the 1970s. "Oil wealth," the argument continues, "was used on the one hand to generate enormous material and social changes in the producing states and on the other hand to prevent changes in the existing political order."<sup>1</sup> Roger Owen and Şevket Pamuk's *A History of Middle East Economies in the Twentieth Century* argues that "the quadrupling of the international price of oil in 1973 precipitated one of the largest and most rapid transfers of wealth in the twentieth century. In the Middle East, the inflow of unprecedented amounts of foreign exchange led to a major economic boom, first in the oil exporting countries and then in other parts of the region, as the labor-scarce oil exporters and capital-scarce labor exporters became tightly linked through massive flows of labor and capital including remittances across national borders."<sup>2</sup> General histories like these draw from a large body of specific studies on the impact of the 1970s petrodollar revolution on the MENA. Topics of study have ranged from how petrodollars were used to develop systems of governance, patronage, and repression within individual MENA countries; were used to develop national economies; brought about new social ties between and tensions for the peoples of oil-rich and oil-poor countries through immigrant labor; transformed Arab foreign aid; contributed to the origins of the Iranian Revolution;

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<sup>1</sup> William L. Cleveland, *A History of the Modern Middle East*, 3<sup>rd</sup> ed. (Boulder: Westview Press, 2004), 451.

<sup>2</sup> Roger Owen and Şevket Pamuk, *A History of Middle East Economies in the Twentieth Century* (London: I.B. Tauris Publishers, 1998), 100.

intersected with debates over Islamic economics; shaped the education and social expectations of women; and enhanced governments' ability to reshape the natural environments of their countries.<sup>3</sup>

Similarly, there is an important body of scholarship on the impact of petrodollars on the global economy during the 1970s and 1980s. The massive and unexpected balance of payment imbalances created by the petrodollar boom of the 1970s are widely considered by economists to have been among the greatest challenges to the international monetary system since World War II. Interpretations of how and why petrodollars accumulated by the oil-exporting countries were recycled back into the global economy vary, but there is agreement that it is an important issue to study.<sup>4</sup> Similarly, there is substantial scholarship on the role that oil costs and petrodollar-funded lending played in generating the 1980s Third World debt crisis.<sup>5</sup>

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<sup>3</sup> Scholarly works on different facets of the impact of petrodollars on MENA societies are numerous, and what follows is only a small sampling of examples from the wider literature. For examples of works on the role of oil wealth in shaping and maintaining state structures through patronage and violence, see Steffen Hertog, *Princes, Brokers, and Bureaucrats: Oil and State in Saudi Arabia* (Ithaca: Cornell University Press, 2010); Luis Martinez, *The Violence of Petro-Dollar Regimes: Algeria, Iraq, and Libya* (New York: Columbia University Press, 2012); and Charles Tripp, *A History of Iraq*, 3<sup>rd</sup> ed. (Cambridge: Cambridge University Press, 2007). For examples of works on the role of petrodollars in MENA economic development, see Jahangir b, *Managing the Oil Wealth: OPEC's Windfalls and Pitfalls* (London: I.B. Tauris Publishers, 1999) and Yusif A. Sayigh, *Elusive Development: From Dependence to Self-Reliance in the Arab Region* (London: Routledge, 1991). For a thought provoking study on the impact of petrodollars on both domestic and transnational Arab social relations, see Saad Eddin Ibrahim, *The New Arab Social Order: A Study of the Social Impact of Oil Wealth* (Boulder: Westview Press, 1982). An early study that explored the fundamental shift in the nature of Arab foreign aid brought about by the petrodollar boom is Andre Simmons, *Arab Foreign Aid* (East Brunswick: Associated University Presses, 1981). For an example of scholarship connecting the Iranian Revolution to the petrodollar revolution, see Robert E. Looney, *Economic Origins of the Iranian Revolution* (New York: Pergamon Press, 1982). An example of a study on the intersections of petrodollars and Islamic economics is Timur Kuran, *Islam & Mammon: The Economic Predicaments of Islamism* (Princeton: Princeton University Press, 2004). For an example of the impact of petrodollars (and in this case particularly their decline) and the role of women in society, see Eleanor Abdella Duomato, "Education in Saudi Arabia: Gender, Jobs, and the Price of Religion," in Eleanor Abdella Duomato and Marsha Pripstein Posusney, eds., *Women and Globalization in the Arab Middle East: Gender, Economy, and Society* (London: Lynne Rienner Publishers, 2003). For an example of the impact of petrodollar wealth on governmental control and manipulation of the environment, see Toby Craig Jones, *Desert Kingdom: How Oil and Water Forged Modern Saudi Arabia* (Cambridge: Harvard University Press, 2010).

<sup>4</sup> For different interpretations of the recycling of petrodollars, see Robert Z. Aliber, *The New International Money Game* 6<sup>th</sup> ed. (Chicago: University of Chicago Press, 2002), 152-167; Harold James, *International Monetary Cooperation Since Bretton Woods* (Washington, D.C.: International Monetary Fund, 1996), 251-466; David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets* (Ithaca: Cornell



In short, petrodollars are widely recognized as being pivotal to developments in the MENA and the global economy during the 1970s. Furthermore, very few people would argue that either the MENA or the global economy was not of great importance to the United States during the period. Despite this, the connections between petrodollars and US-MENA relations remain understudied and underappreciated.

The lack of attention to the role of petrodollars is demonstrated in the general histories of US-MENA relations of the last decade. While many of these works provide insightful and detailed analyses of matters like the Arab-Israeli conflict, Cold War strategies, and the role of oil as a source of global energy, there is little or no interpretation about the impact of the new sums of petrodollars/oil-generated wealth acquired by oil-rich MENA countries during the 1970s. Some passingly reference petrodollar recycling as evidence of the continuity of US power in the MENA and nothing more. In *Shifting Sands*, for example, Joel S. Migdal devotes a single line to analyzing petrodollars: “Even during that crisis [of the Arab oil-producers’ boycott of the United States during 1973 and 1974], though, the United States contrived to steer a huge portion of the petrodollars that accrued from the spike in oil prices to American banks.”<sup>6</sup> Similarly, Ussama Makdisi in *Faith Misplaced* only mentions petrodollars in two sentences, arguing that Saudi recycling of petrodollars back into the US economy demonstrates that Saudi Arabia quickly fell back into the US fold after the 1973 War and that the Arab oil weapon posed no real threat to US

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University Press, 1999); Brian Tew, *The Evolution of the International Monetary System, 1945-88* 4<sup>th</sup> ed. (London: Hutchinson & Co., 1988), 187-195, 236-244.

<sup>5</sup> For examples of scholarship primarily concerned with the 1980s debt crisis that include an analysis of the role of petrodollars, see Elmar Altvater et al., eds., *The Poverty of Nations: A Guide to the Debt Crisis from Argentina to Zaire*, trans. Terry Bond (London: Zed Books Ltd, 1991) and Penelope Hartland-Thunberg and Charles K. Ebinger, *Banks, Petrodollars, and Sovereign Debtors* (Washington, D.C.: Lexington Books, 1986).

<sup>6</sup> Joel S. Migdal, *Shifting Sands: The United States in the Middle East* (New York: Columbia University Press, 2014), 98.

hegemony in the Middle East.<sup>7</sup> Other works briefly note that oil wealth in the 1970s helped Iran and Saudi Arabia expand their militaries and better serve as US proxies. Douglas Little's only mention of 1970s oil wealth in *American Orientalism* is that it was helpful in implementing the Nixon Doctrine (the strategy of relying on regional allies to militarily defend US interests) in Iran and Saudi Arabia.<sup>8</sup> The same is true of Gary Sick's chapter "The United States in the Persian Gulf" in *The Middle East and the United States*.<sup>9</sup> Some books limit themselves to passing economic commentary. Peter Hahn in *Crisis and Crossfire* notes that an ancillary benefit of applying the Nixon Doctrine to Iran was an improvement in the US balance of trade.<sup>10</sup> In *Unexceptional*, Marc J. O'Reilly makes one passing reference to a quote from US Assistant Secretary of State for Near Eastern and Southern Asian Affairs Alfred Atherton that one US aim in the Middle East was "to recycle [OPEC] surplus revenues into the world economy in an orderly and nondisruptive manner." No additional context or analysis is provided.<sup>11</sup> F. Gregory Gause, III dedicates the greatest amount of time to petrodollars, providing in *The International Relations of the Persian* a few lines arguing that petrodollars encouraged a deepening of US economic and military cooperation with Iran and Saudi Arabia and that stronger financial ties between the US and the MENA incentivized stronger military ties.<sup>12</sup> Rashid Khalidi's *Sowing Crisis*, Melani McAlister's *Epic Encounters*, Michael B. Oren's *Power, Faith, and Fantasy*,

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<sup>7</sup> Ussama Makdisi, *Faith Misplaced: The Broken Promise of U.S.-Arab Relations: 1820-2001* (New York: PublicAffairs, 2010), 305.

<sup>8</sup> Douglas Little, *American Orientalism: The United States and the Middle East Since 1945*, 2<sup>nd</sup> ed., (Chapel Hill: University of North Carolina Press, 2004), 137-146.

<sup>9</sup> Gary Sick, "The United States in the Persian Gulf: From Twin Pillars to Dual Containment" in David W. Lesch and Mark L. Haas, eds., *The Middle East and the United States: History, Politics, and Ideologies*, 5<sup>th</sup> ed. (Boulder: Westview Press, 2012).

<sup>10</sup> Peter L. Hahn, *Crisis and Crossfire: The United States and the Middle East Since 1945* (Washington, D.C.: Potomac Books, 2005), 70-71.

<sup>11</sup> Marc J. O'Reilly, *Unexceptional: America's Empire in the Persian Gulf, 1941-2007* (Lanham: Lexington Books, 2008).

<sup>12</sup> F. Gregory Gause, III, *The International Relations of the Persian Gulf* (Cambridge: Cambridge University Press, 2010), 31-34. See also F. Gregory Gause III, "From 'Over the Horizon' to 'Into the Backyard': The US-Saudi Relationship in the Gulf" in Lesch, *The Middle East and the United States*.

Patrick Tyler's *A World of Trouble*, and Steve A. Yetiv's *The Absence of Grand Strategy* omit petrodollars entirely.<sup>13</sup>

There are some more narrowly focused works that devote significant description and analysis of certain facets of the impact of 1970s petrodollars on US-MENA relations. Some scholarship analyzes US monetary, trade, and investment policies through the framework of MENA petrodollars.<sup>14</sup> Other works explore the intersections of petrodollar flows and the arms trade between the United States in the MENA.<sup>15</sup> Still others consider the impact of petrodollars on pro-Arab lobbying efforts within the United States.<sup>16</sup> These various works suggest that petrodollars had a greater impact on US-MENA ties than indicated by most general histories of relations between the two regions.

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<sup>13</sup> Rashid Khalidi, *Sowing Crisis: The Cold War and American Dominance in the Middle East* (Boston: Beacon Press, 2009); Melani McAlister, *Epic Encounters: Culture, Media & U.S. Interests in the Middle East since 1945* 2<sup>nd</sup> ed. (Berkeley: University of California Press, 2005); Michael B. Oren, *Power, Faith, and Fantasy: America in the Middle East, 1776 to the Present* (New York: W. W. Norton & Company, 2007); Patrick Tyler, *A World of Trouble: The White House and the Middle East – from the Cold War to the War on Terror* (New York: Farrar, Straus and Giroux, 2009); Steve A. Yetiv, *The Absence of Grand Strategy: The United States in the Persian Gulf, 1972-2005* (Baltimore: John Hopkins University Press, 2008).

<sup>14</sup> See Simon Bromley, *American Hegemony and World Oil: The Industry, the State System and the World Economy* (Cambridge: Polity Press, 1991); Benjamin J. Cohen, *In Whose Interest?: International Banking and American Foreign Policy* (New Haven: Yale University Press, 1986), chapters 5 and 6; Peter Gowan, *The Global Gamble: Washington's Faustian Bid for World Dominance* (London: Verso, 1999), 19-37; Ethan B. Kapstein, *Governing the Global Economy: International Finance and the State* (Cambridge: Harvard University Press, 1994), chapters 3 and 4; Diane B. Kunz, *Butter and Guns: America's Cold War Economic Diplomacy* (New York: The Free Press, 1997), chapters 11 and 12; Spiro, *The Hidden Hand of American Hegemony*.

<sup>15</sup> See James A. Bill, *The Eagle and the Lion: The Tragedy of American-Iranian Relations* (New Haven: Yale University Press, 1988); Rachel Bronson, *Thicker Than Oil: America's Uneasy Partnership with Saudi Arabia* (Oxford: Oxford University Press, 2006), chapters 5, 6, and 7; Andrew Scott Cooper, *The Oil Kings: How the U.S., Iran, and Saudi Arabia Changed the balance of Power in the Middle East* (New York: Simon & Schuster, 2011); Thomas W. Lippman, *Inside the Mirage: America's Fragile Partnership with Saudi Arabia* (Boulder: Westview Press, 2004), chapter 9; John P. Miglietta, *American Alliance Policy in the Middle East, 1945-1992: Iran, Israel, and Saudi Arabia* (Lanham: Lexington Books, 2002); Timothy Mitchell, *Carbon Democracy: Political Power in the Age of Oil* (London: Verso, 2011), 155-162; Jonathan Nitzan and Shimshon Bichler, *The Global Political Economy of Israel* (London: Pluto Press, 2002), especially chapter 5; Joanna Spear, *Carter and Arms Sales: Implementing the Carter Administration's Arms Transfer Restraint Policy* (London: MacMillan Press, 1995).

<sup>16</sup> Mitchell Bard, *The Arab Lobby: The Invisible Alliance That Undermines America's Interests in the Middle East* (New York: HarperCollins, 2010); Janice J. Terry, *U.S. Foreign Policy in the Middle East: The Role of Lobbies and Special Interest Groups* (London: Pluto Press, 2005). An example of the extremely polemical nature of *The Arab Lobby* is the statement that "the behavior of both the Saudis and the oil companies [during the 1973-1974 Arab oil embargo] was reminiscent in a way of the Nazis. The Saudi goal was to isolate the Jews from their supporters, and the Saudis used threats to attract collaborators." Quote from page 93.

Yet while these works are valuable, there are limitations in their utility for understanding the role of petrodollars in US-MENA relations during the 1970s. Part of this is due to the interests and parameters of the scholarship; they only study particular strands of the petrodollar economy and its impact on US relations. One will focus upon monetary policy, one will focus upon arms sales, one will take a more holistic approach to the relationship between the United States and an individual MENA country. Furthermore, in most of these works petrodollars is just a single topic of many. There is no piece of scholarship that takes as its focus the impact of petrodollars on relations between the United States and the MENA as a region during the 1970s. Additionally, the existing scholarship provides a variety of interpretations that are sometimes mutually incompatible. The claims of these competing arguments are usually reliant upon secondary sources rather than based in archival materials. All of these factors contribute to the lack of broader understanding and appreciation of the role of petrodollars in US-MENA relations during the 1970s.

This dissertation is the first study, based on newly available governmental and nongovernmental sources, to comprehensively explain how the surge in petrodollar profits of oil exporting states in the 1970s dramatically changed logics of power and relationships between the United States and the MENA. This research makes several interpretive contributions. First, it argues that monetary and financial considerations (distinct from the resource of petroleum) achieved sudden and unparalleled importance in diplomatic and transnational exchanges between the United States and the MENA during the 1970s, and that rapidly rising commercial ties between the two regions contributed to an unprecedented level of economic and cultural exchange. Second, by employing a regional framework that looks at both oil-rich and oil-poor countries, while also disaggregating the impact of petrodollars upon specific countries and

groups, it examines how various American, Arab, and Iranian efforts to structure petrodollar flows reshaped relationships within the region. In particular, it explains how petrodollar flows contributed to the rising importance of Saudi Arabia to the United States, Egypt's diplomatic shift toward America, the deterioration of relations between the United States and Iran, and the course of the Arab-Israeli conflict. Third, it analyzes how petrodollars brought the Treasury Department and US banking and corporate interests to a new level of significance in US relations with the MENA and suggests the varied consequences of this complex policy environment. Finally, using both English and Arab language sources, it demonstrates how petrodollars became important in structuring popular cultural narratives about globalization, interdependence, sovereignty, and identity in both the United States and the MENA.

The goal of this dissertation, in short, is to establish that many of the foundational transformations in US-MENA relations during the 1970s cannot be properly understood without an analysis of the role of petrodollars. Its basic conclusion is that omitting a serious account of the petrodollar economy in an account of US-MENA relations during the 1970s should seem as unthinkable as making no mention of the Arab-Israeli conflict, the Cold War, or oil. This is not to argue that petrodollars were the sole or predominant factor in shaping US-MENA relations during the 1970s, but it is to argue that petrodollars were a major issue that intersected with and shaped the other significant matters of the period.

The first chapter begins with a presentation and analysis of economic data that demonstrates the stunning magnitude of the rapid economic changes that occurred due to the rise of oil revenues in the oil-rich countries of the MENA. This data is provided in order to establish that the petrodollar era of the 1970s was a significant break from past US-MENA economic relations; whereas economic ties between the United States and the MENA before the 1970s had

been relatively small, the emergence of the petrodollar economy brought about sudden and major increases in the levels of economic exchange and interdependence between the two regions. A brief examination of the general course of economic and political relations between the United States and the MENA up to the late 1960s is then provided. This survey serves as a baseline for US-MENA relations so that there is a basis for comparison of the petrodollar era and the period before it. The chapter then concludes with a more detailed study of events between 1969 and 1973 with the aim of explaining how the price of oil steadily rose during this period until culminating in the 1973 oil shock, how petrodollar ties between the MENA and the United States developed during this same period, and the relationship between the two. It argues that during the early years of the Nixon administration, some US officials and businesspeople, including at times President Richard Nixon, sought to encourage a rise in OPEC oil revenues, as they perceived opportunities to utilize MENA petrodollars for US political and economic interests. They thus began laying the early framework for petrodollar ties between the United States and the MENA. Nixon and most of his administration were reluctant to take significant measures to assist in raising OPEC oil revenues, however, if this meant higher energy costs for Americans. It was instead the oil-rich countries that largely drove the successful charge for higher oil prices, often in opposition to the US government and US oil companies, that culminated in the 1973 oil shock.

The second chapter analyzes the various goals of the key actors in the petrodollar economy and outlines how systems of recycling petrodollars developed in the first few years after the 1973 oil shock. Three main arguments run through this chapter. First, the Nixon and Ford administrations sought to reduce both the price of oil and the petrodollar surpluses of the MENA oil-exporting countries in order to establish global economic conditions favorable to

perceived American interests. While MENA petrodollar surpluses existed, however, the United States attempted to utilize them toward its own ends, such as purchases of US government debt, long-term investment in the US private sector, purchases of US exports for military and economic development, and grants of aid to oil-poor less developed countries (LDCs). Second, a significant but rarely appreciated strategy of the Nixon and Ford administrations was to utilize MENA petrodollars to make the countries of the MENA economically and politically interdependent with the United States. The 1973 War, the Arab oil embargo, and the OPEC price hike had all suddenly and dramatically demonstrated the importance of the MENA to US interests and the growing power of the countries in the region. The United States, as part of a deliberate strategy, strove to draw MENA petrodollars into American banks, investments, and military and development programs to ensure that if the MENA countries attempted to harm the American economy, they would severely harm their own economic interests as well. Third, the Nixon and Ford administrations opposed increasing grant aid and conciliatory lending to oil-poor LDCs, either from the U.S. government or from multinational organizations like the IMF and World Bank, because high officials believed that the resultant deterioration of conditions in the oil-poor LDCs would force the oil-exporting countries to either provide aid themselves or lower the price of oil. In this way, the United States could better preserve its political and economic hegemony, shift the costs of funding high oil prices back upon the oil-exporting countries, and undermine attempts at Third World solidarity. Despite the significance of such a strategy, I have found no mention of it in the secondary literature.

The third chapter analyzes cultural understandings of petrodollars during the 1970s in both the United States and the MENA. Americans in the 1970s were both fascinated by and conflicted over the sudden petrodollar wealth of the oil-exporting countries of the MENA. Arab

and Iranian use of petrodollars to invest in the United States and to purchase US exports generated new debates in America about the nature of power and sovereignty in an increasingly interdependent world. These debates have not received the scholarly attention that other American cultural topics regarding the Middle East in the 1970s have had, such as terrorism or the Arab oil embargo. Yet during the period sensational discussions about MENA petrodollars and their effects on the United States were popular fare in American media. Petrodollars informed American ideas about the global standing of the United States, the relationship between nation-states and multinational corporations, and the phenomenon that came to be called globalization. Some Americans feared MENA petrodollars would be used to undermine the security and sovereignty of the United States and other allies (particularly Israel). Other Americans argued that MENA petrodollars strengthened US influence in the MENA and benefitted the US economy. This chapter also compares American and Arab narratives regarding petrodollars. While understandings about petrodollars varied greatly throughout the Arabic speaking world, Arab media promoted a common theme of pride in the new economic power of the Arab countries. The new surge in petrodollar profits was widely understood by Arabs to be hard won and overdue compensation for a resource that had been unfairly extracted from their lands by Western oil companies in the past. The Arab perception was the inverse of the common American perception that higher oil prices were an unjust price hike imposed by the cartel of OPEC. Even American discourses that enthusiastically supported the recycling of petrodollars into the US economy often maintained that oil prices were artificially high, and that most petrodollars should have remained in American pockets to begin with. This contradiction in viewpoints generated a considerable amount of tension between the United States and the MENA even as leaders attempted to mutually recycle petrodollars.



In the fourth chapter, the largely overlooked impact of the petrodollar economy upon US relations with the oil-poor countries of the MENA is analyzed. Petrodollars served an important role in creating and sustaining Egypt's shift toward the United States due to the US government's efforts to steer petrodollars to Egypt. The belief of Egyptian and US government officials that petrodollars from the oil-rich countries could be recycled into Egypt through aid, investment, and remittances and then used to purchase needed US goods and services facilitated the strengthening of Egyptian-US ties. Even when immediate goals went unattained, these schemes and dreams helped inspire and sustain interest in US-Egyptian cooperation between the two countries. Petrodollars thus in many ways served as a bridge that facilitated the gradual strengthening of what became the US-Egyptian alliance, an outcome that might well not have occurred otherwise in the fragile period of the mid-1970s. Yet while petrodollars served to strengthen US-Egyptian ties, they also paradoxically held the potential to disrupt or possibly even undo US-Arab ties across the MENA. For while the United States had pursued interdependence with the Arab world in order to ensure that the Arabs would be harmed if they tried to damage the interests of the United States, it became increasingly clear that interdependence was a double-edged sword. By becoming increasingly tied to the oil-rich Arab countries, the United States also became increasingly tied to the repercussions arising from a conflict-torn region. When crises erupted in the region, often due to the actions of oil-poor actors like Egypt, Israel, or the PLO, US policymakers increasingly feared that Arab petrodollars would no longer flow to the United States or that petrodollars could be used as a financial weapon against the United States and its allies.

The fifth and final chapter analyzes the Carter administration's efforts to curb the petrodollar-fueled arms race in the MENA. The Carter administration's lobbying efforts for a

few high profile arms sales to MENA countries has obscured the genuine dedication and success of the Carter administration in reducing arms transfers to the MENA and the rest of the world during its first two years. This effort constituted the most powerful challenge yet mounted to the petrodollar-arms complex in the MENA, and was based in strategic, political, and moral calculations. But in 1979 the structural constraints of the petrodollar-arms complex coupled with a series of regional crises led the Carter administration to abandon its earlier efforts to curb the conventional arms trade and to instead reengage with it in earnest. The lack of restraint by the other major arms exporting countries and the persistent desire of wealthy MENA states to acquire advanced weapons significantly enabled the global arms trade to continue to grow from 1977 to 1978, even as the United States unilaterally and significantly reduced its own arms sales. The series of crises in the MENA that started with the Iranian Revolution then raised significant fears within the US government about the security and dependability of US allies in the MENA. In response to these concerns, the Carter administration abandoned the goal of arms transfer restraint and instead embarked upon a surge of weapons sales to the MENA designed to both improve the security of allied governments and reassure client regimes of the United States' commitment to them. The ultimate failure of the Carter administration's efforts to reduce the global arms trade demonstrates the structural strength of the petrodollar-arms complex.

The conclusion provides a brief explanation of the significant decline of the petrodollar economy during the 1980s and its impact on US-MENA relations to the twenty-first century. It then explores the parallels and differences in the new petrodollar economy that has emerged between the United States and the MENA due to the renewed rise in oil prices of the last decade, and suggests aspects of the 1970s petrodollar era that might provide perspective for the issues of the present.

## CHAPTER ONE

### The Road to the Oil Shock

#### “As Mr. Mossadegh Learned”

As the summer of 1973 drew to a close, President Richard M. Nixon faced anger and distrust from the American public not only because of the unfolding Watergate scandal but perhaps even more so because of economic problems, which included high rates of inflation and the contributing factor of rising oil prices.<sup>17</sup> Looking abroad, Nixon likewise confronted seemingly intractable problems, including a surge in public threats from both hostile and allied Arab governments that they would cut oil production, and thus the Western world’s supply of readily available energy, if the United States did not move closer to Arab positions on the Arab-Israeli conflict. On September 5, 1973, Nixon gave a White House news conference to discuss the problem of rising energy costs, American dependency on Middle East oil, and the Arab-Israeli conflict. While insisting that he had made a resumption of the Arab-Israeli peace process a top priority of his administration, Nixon denied that he would allow intimidation to determine his course of action, and he issued his own threat to Arab leaders who might seek to continue to raise oil prices or nationalize American oil facilities without fair compensation. “Oil without a market, as Mr. Mossadegh learned many, many years ago, doesn’t do a country much good,” Nixon warned. “We and Europe are the market.”<sup>18</sup>

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<sup>17</sup> In September 1973, Gallup poll asked Americans to name the number-one problem facing the United States. Only 14 percent of respondents said Watergate and political corruption, while 89 percent said “the high cost of living.” This was the largest percentage to mention inflation as an answer to that question since the poll began in 1935. Allen J. Matusow, *Nixon’s Economy: Booms, Busts, Dollars, & Votes* (Lawrence: University Press of Kansas, 1998), 240.

<sup>18</sup> Bernard Gwertzman, “A Mideast Pledge: President is Seeking a Settlement to End Oil Threats by Arabs,” *New York Times*, September 6, 1973.

Nixon's reference to the former Prime Minister of Iran Mohammad Mossadegh would have been instantly recognizable to the leaders of the Middle East and North Africa (MENA). In 1951 Mossadegh nationalized the British owned Anglo-Iranian Oil Company after it refused a fifty-fifty split of profits between the company and the Iranian government. In retaliation, the governments and oil companies of the United Kingdom and the United States coordinated a near global boycott of Iranian petroleum, causing Iran's oil exports to drop from 666,000 to 20,000 barrels per day and the Iranian economy to plummet. The Churchill government and the Eisenhower administration (which Nixon served as Vice President) then helped fund and organize a right-wing coup that overthrew Mossadegh in 1953, which was made easier by the unrest generated by the economic damage of the oil boycott.<sup>19</sup> Nixon's warning to the oil-exporting countries of the MENA in the 1973 press conference was clear: if the governments of oil-exporting nations went too far in threatening Western access to cheap and abundant oil, the United States and its allies would retaliate and inflict dire economic and political punishment.

Yet whether Nixon made his threat due to ignorance or to his penchant for aggressive bluffing in the face of an implacable foe, the global circumstances that had facilitated Mossadegh's overthrow in 1953 had largely disappeared twenty years later. In 1953, the United States was an oil exporter and produced more oil than the entire MENA, and Western oil companies feared a surplus of petroleum on the world market rather than shortages. The future members of the Organization of the Petroleum Exporting Countries (OPEC) had weaker governments and fewer resources to counter the power of the West; indeed, many were still formal colonial possessions of Europe or had not yet discovered their oil fields. By 1973, the United States had become dependent upon foreign oil imports to meet its own energy needs, and the only significant, readily available oil surplus capacity in the world resided in the MENA,

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<sup>19</sup> Little, *American Orientalism*, 56-58; Mitchell, *Carbon Democracy*, 144-145.

which had by now supplanted the United States as the largest oil producing region.<sup>20</sup> With a dominant share of the global oil supply, the countries of the MENA were in a strong position to dictate significantly higher prices, a position further enhanced by the increased strength of their governments and their willingness to cooperate with each other. Oil prices had steadily risen in the first few years of the 1970s. In late 1973 the price of petroleum would skyrocket due to the actions of the countries of the MENA, an event that would come to be called the “oil shock” by Western observers. Petroleum prices would remain above pre-1973 levels for over a decade, bringing unprecedented revenues to the oil-exporting MENA nations and turning them overnight into powerful financial centers and booming markets for foreign goods and services. The new wealth and economic power obtained by the oil-exporting countries of the MENA brought such sudden and profound changes that it constituted a new order, the petrodollar economy. This petrodollar economy would profoundly reshape the economic, political, and cultural relations between the MENA and the United States.

This chapter begins with a presentation and analysis of economic data that demonstrate the stunning magnitude of the rapid economic changes that occurred due to the rise of oil revenues in the oil-rich countries of the MENA. This data is provided in order to establish that the petrodollar era of the 1970s was a significant break from past US-MENA economic relations; whereas economic ties between the United States and the MENA before the 1970s had been relatively small, the emergence of the petrodollar economy brought about sudden and major increases in the levels of economic exchange and interdependence between the two regions.<sup>21</sup> A

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<sup>20</sup> Mitchell, *Carbon Democracy*, 144, footnote 1.

<sup>21</sup> There already exist works that describe and analyze certain aspects of the change in US-MENA economic relations due to the petrodollar boom of the 1970s. Spiro’s *The Hidden Hand of American Hegemony*, for example, is an excellent source on OPEC (and particularly Saudi) investment patterns, while Miglietta’s *American Alliance Policy in the Middle East* provides a wealth of information on US arms sales to Iran and Saudi Arabia. To my knowledge, however, no one has attempted an overview of all major trade and investment relations between the United States and the MENA as a region during the petrodollar era.

brief examination of the general course of economic and political relations between the United States and the MENA up to the late 1960s is then provided. This survey serves as a baseline for US-MENA relations in order to compare the differences between the petrodollar era and the period before it.

The chapter then concludes with a more detailed study of events between 1969 and 1973 with the aim of explaining how the price of oil steadily rose during this period until culminating in the 1973 oil shock, how petrodollar ties between the MENA and the United States developed during this same period, and the relationship between the two. Many works on the recycling of petrodollars begin only after the 1973 oil shock. In part this is because it was only by 1973 that petrodollars began to flow at relatively high levels. But it is also because these works do not attribute the rise in oil prices to an interest on the part of the US government and/or US corporations to generate greater amounts of petrodollars. In other words, these authors do not argue that US actors set out to raise OPEC oil prices in order to generate petrodollars that could then be recycled into projects serving US interests. The oil price rise is instead explained by other forces, typically the desire and independent efforts of the OPEC countries to acquire higher oil revenues.<sup>22</sup> Other authors take a contradictory view. They argue that the US government and/or corporations conspired to raise OPEC oil revenues in order to produce the petrodollars needed for various schemes, ranging from enhancing the power of Wall Street to strengthening the militaries of allies under the logic of the Nixon Doctrine to lining the pockets of US arms and oil industries. Within this argument there are differences of degree in how high the US government wanted OPEC oil revenues to go. Some works suggest that the Nixon administration sought oil prices to soar as high as they did in the 1973 oil shock. Other works argue that the US government and certain corporations desired only a moderate increase in

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<sup>22</sup> Examples of this are Cohen, *In Whose Interest?* and Kunz, *Butter and Guns*.

OPEC oil prices but then lost control of the forces they had unleashed, leading to far larger oil price hikes in 1973 that they had not anticipated or desired.<sup>23</sup>

Based on the currently available evidence, it is clear that some US officials and businesspeople, including at times Nixon, encouraged a rise in OPEC oil revenues. The Nixon administration recognized the opportunities to utilize MENA petrodollars for perceived US political and economic interests, and thus began laying the early framework for petrodollar ties between the United States and the MENA. Still, it appears that Nixon and most of his administration were reluctant to take many measures to assist in raising OPEC oil revenues if this meant higher energy costs for Americans. My in-depth research shows that it was the oil-rich countries that largely drove the successful charge for higher oil prices, often in the opposition of the US government and US oil companies, that culminated in the 1973 oil shock.

### **The Old Economy and the Petrodollar Economy**

Before the oil shocks of the 1970s, the oil-rich countries of the MENA collectively had approximately the same economic output as the combined output of the oil-poor countries of the MENA, and the entire MENA represented a relatively small share of the global economy.

Figure 1.1 shows the percentage of global gross national income (GNI) held by each economic bloc within the MENA.<sup>24</sup> In 1970 the two blocs were nearly the same, with oil-poor MENA countries taking 0.83 percent of the world GNI total and oil-rich MENA countries taking 0.85 percent. The global economic share of the oil-rich countries, however, was gradually pulling

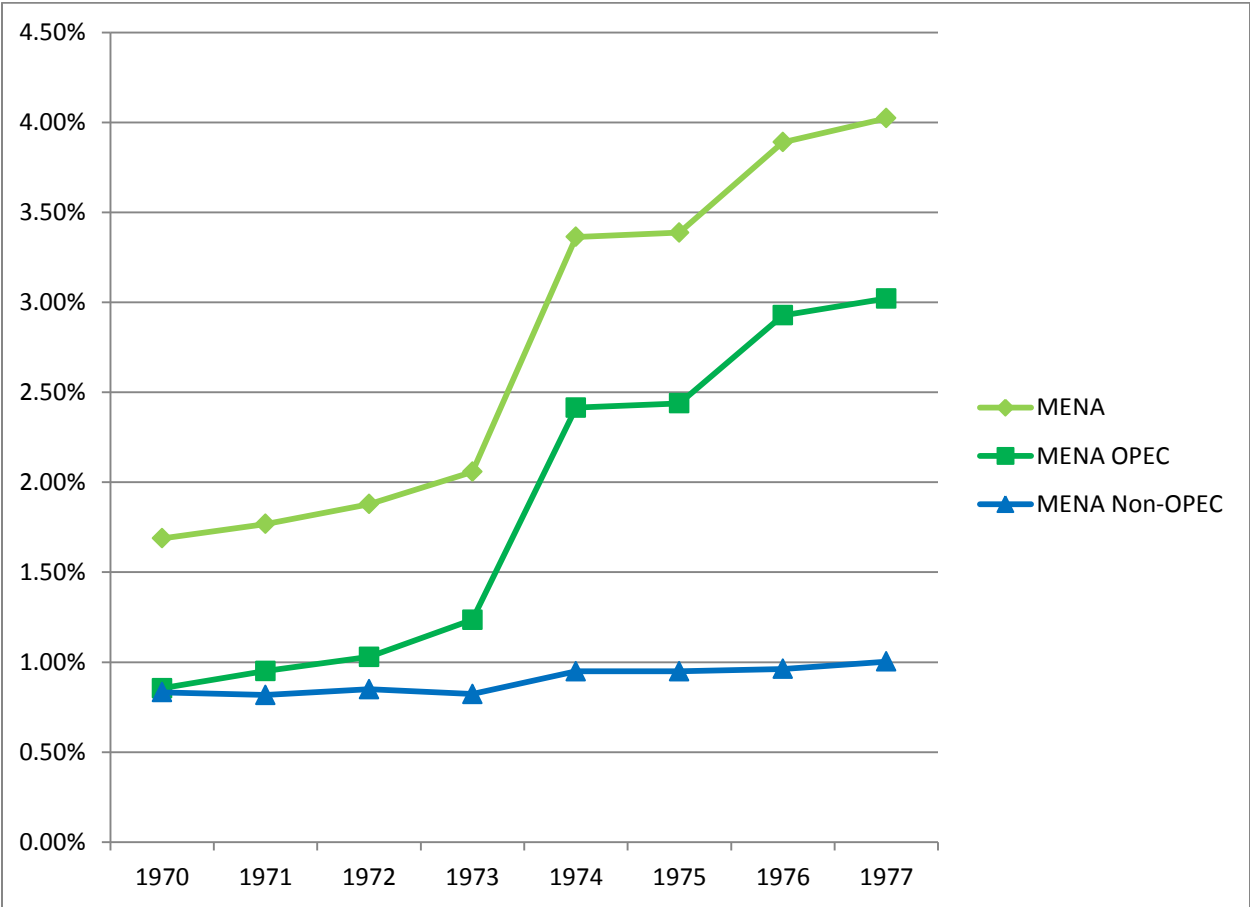
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<sup>23</sup> Gowan, *The Global Gamble* and Nitzan and Bichler, *The Global Political Economy of Israel* suggest that the US government and certain corporations sought oil prices to hit as high as they did in the 1973 oil shock for the interests of Wall Street and the US arms industry, respectively. Bromley, *American Hegemony and World Oil* and Cooper, *The Oil Kings* suggest that the US government and certain corporations desired a moderate increase in OPEC oil prices but then lost control of the forces they had unleashed, leading to far larger oil price hikes in 1973 that they had not anticipated or desired.

<sup>24</sup> Economic data for Figure 1.1 and this paragraph taken from [unstats.un.org/unsd/snaama/dnltransfer.asp?fID=18](http://unstats.un.org/unsd/snaama/dnltransfer.asp?fID=18).

ahead as oil revenues increased, and then it surged with the 1973-74 oil shock. By 1976 the percentage of world GNI held by the oil-rich nations of the MENA had more than tripled from the start of the decade, and the following year it surpassed 3 percent of the world total. The petrodollar economy instituted a new era in which economic power had shifted within the MENA to the oil-rich states. Furthermore, by undergoing such a rapid increase in income, the oil-rich MENA states suddenly commanded the financial interest of the world.

**Figure 1.1. Sectors of the MENA as Percentage of World GNI, 1970-1977**

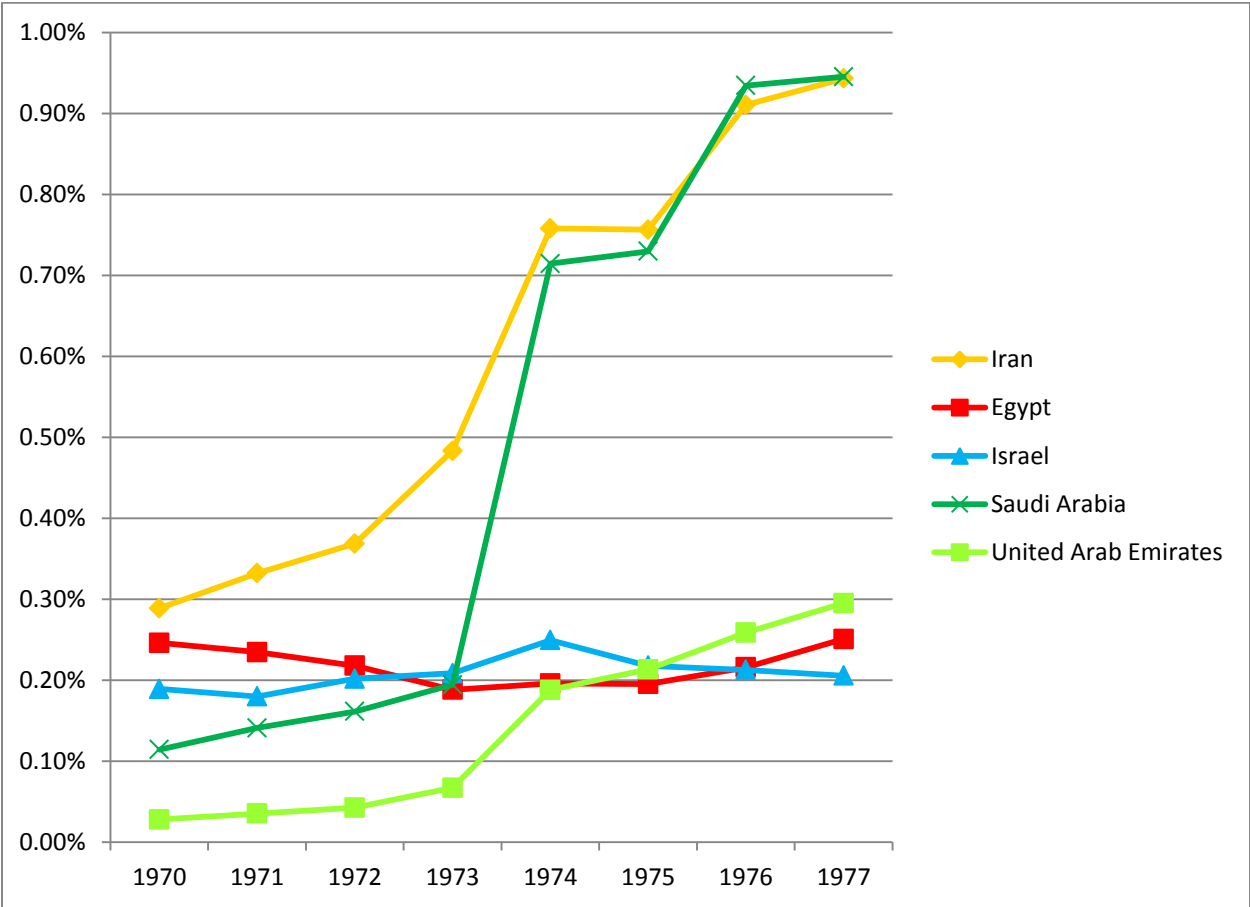


Source: United Nation Data



When looking at individual countries, additional important contours of the petrodollar economy appear. In 1970 the five nations with the largest economies in the MENA were, in descending order, Iran, Egypt, Israel, Algeria, and Morocco; only two of them (Iran and Algeria) were members of OPEC. Rather than oil production, a large population was the common characteristic of all the countries but Israel. Furthermore, as can be seen in Figure 1.2, the gap between the largest economy, oil-rich Iran, and the second largest economy, oil-poor Egypt, was

**Figure 1.2. Selected Countries as Percentage of World GNI, 1970-1977**



Source: United Nation Data

relatively small.<sup>25</sup> In 1970 Iran's GNI was \$9.5 billion while Egypt's GNI was \$8.1 billion. In 1976, by contrast, the five largest economies in the MENA all belonged to OPEC-member states and were topped by Saudi Arabia and then followed by Iran, the United Arab Emirates (UAE), Algeria, and Libya. Egypt and Israel had fallen to the sixth and seventh largest economies, respectively. Furthermore, Saudi Arabia and Iran were now the unrivaled economic powers of the MENA, both far ahead of the third-ranked UAE and both boasting a GNI more than four times larger than Egypt's.

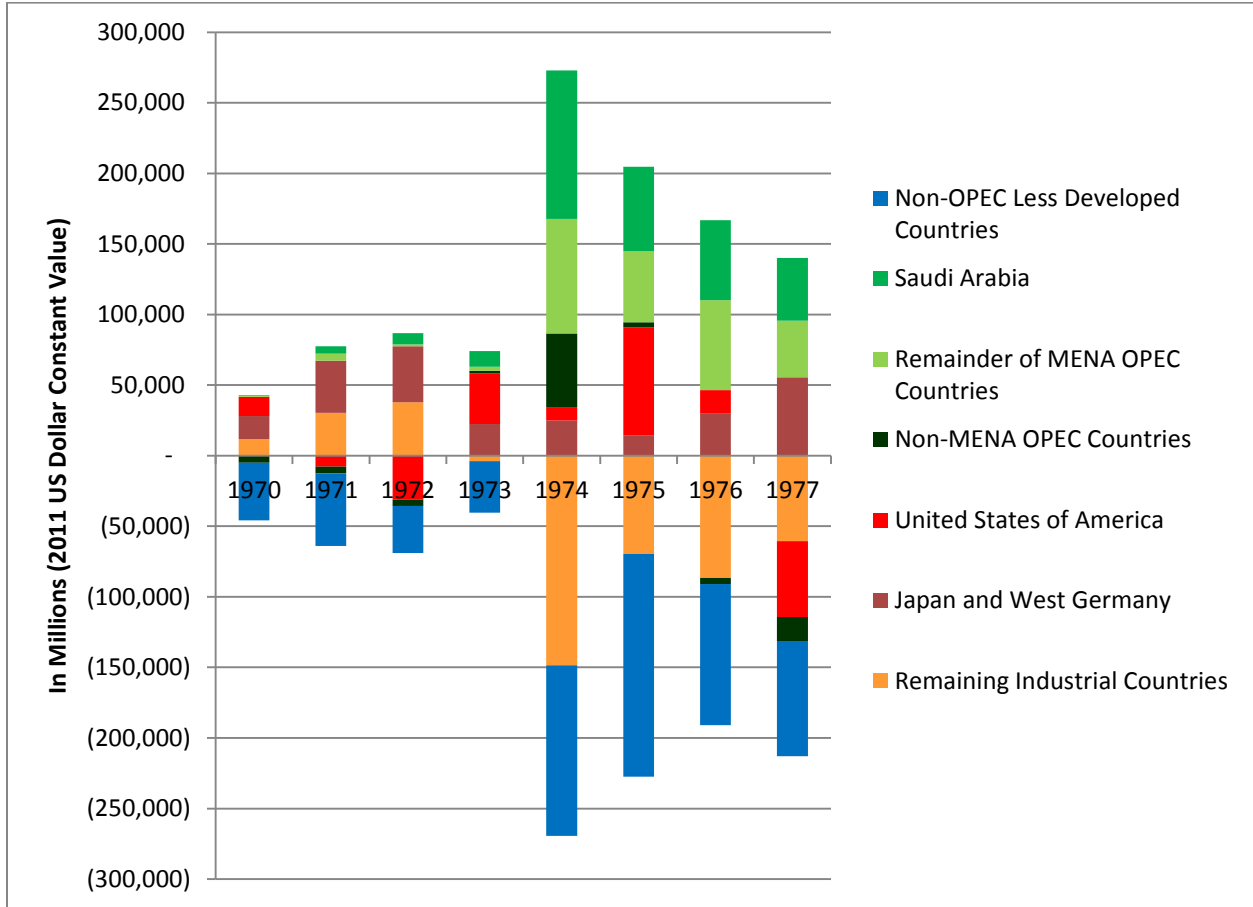
But the rising share of global GNI, significant as it was, does not fully capture the suddenness and scale of the new wealth of the oil-rich nations. This is because the higher revenues of the oil-exporting nations not only raised their economic clout, but also caused massive global financial imbalances between the oil-exporting nations and the oil-importing nations. Figure 1.3 shows the current account balance (the sum of merchandise and service purchases and sales and private and governmental direct transfers) of the non-communist world among the OPEC states (further subdivided between Saudi Arabia, remaining MENA OPEC countries, and non-MENA OPEC countries), the industrialized countries (further subdivided between the United States, Germany and Japan, and the remaining industrialized countries), and the non-OPEC LDCs.<sup>26</sup> One can immediately see the impact of the oil shock, which would have its first year of full effect in 1974. In the years immediately prior to the oil shock, the industrialized nations collectively enjoyed current account surpluses, the states belonging to OPEC collectively ran far smaller current account surpluses, and the rest of the LDCs

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<sup>25</sup> Ibid.

<sup>26</sup> Economic data for Figure 1.3 and this paragraph taken from *International Monetary Fund Balance of Payments Yearbook* and *International Monetary Fund Balance of Payments Statistics*. Data for each year is taken from the latest publication where it is made available. Constant value throughout this dissertation is determined with the CPI inflation calculator from United States Department of Labor Bureau of Labor Statistics at <http://data.bls.gov/cgi-bin/cpicalc.pl>.

**Figure 1.3. Current Account Balances of the Non-Communist World, 1970-1977**



Source: *International Monetary Fund Balance of Payments Yearbook* and *International Monetary Fund Balance of Payments Statistics*

collectively accrued current account deficits. In the new petrodollar economy, current account imbalances became far larger, with the OPEC states of the MENA and especially Saudi Arabia reaping massive current account surpluses while both industrialized and less developed countries tended to incur large current account deficits. The largest industrialized economies appear to have had an edge in maintaining a surplus in the petrodollar economy against the other oil importing nations. The three largest economies, the United States, Japan, and West Germany, collectively never ran a deficit in the years between 1973 and 1977, and in each of those years at least two of the three nations accrued a surplus.

As the oil-rich nations of the MENA rapidly accrued enormous current account surpluses, both public and private US entities (along with the rest of the world) eagerly sought investment funds from them. Since organizations like the US Treasury and the Bank for International Settlements do not disaggregate OPEC foreign investments by each OPEC country or make clear the share of OPEC investments acquired by US financial branches overseas, it is nearly impossible to establish precisely the value of MENA petrodollars invested in US institutions. It is reasonably clear, however, that the large majority of OPEC investments abroad come from MENA countries, and that a large share of these petrodollars were placed in US investments. It is estimated that Saudi Arabia alone invested 30 percent of its foreign assets in the US government and an additional 25 percent in US private investments and US owned banks in the mid-1970s. From 1974 to 1976 the net increase in OPEC investments in domestic US institutions increased by \$30.7 billion; it is all but certain that US firms abroad constituted a significant share of the \$45.7 billion in new investments in the rest of the industrialized world during the same period.<sup>27</sup>

While the sum of investments by oil-rich MENA countries in US institutions was almost certainly larger than the value of US exports to oil-rich MENA countries during the mid-1970s, the increase in the value of US exports to the MENA after the oil shock was still quite large. For these values country-specific statistics are readily available. Figure 1.4 shows US exports to the MENA from the start of the post-World War II era to 1977 in 2011 US dollar constant value.<sup>28</sup> The impact of the oil shock is stark. In 1970 the current value of US exports to the oil-rich MENA countries was \$773 million, whereas just five years later in 1975 it had risen to \$6.794 billion. Even accounting for inflation, this was an increase of 533 percent. For America's two

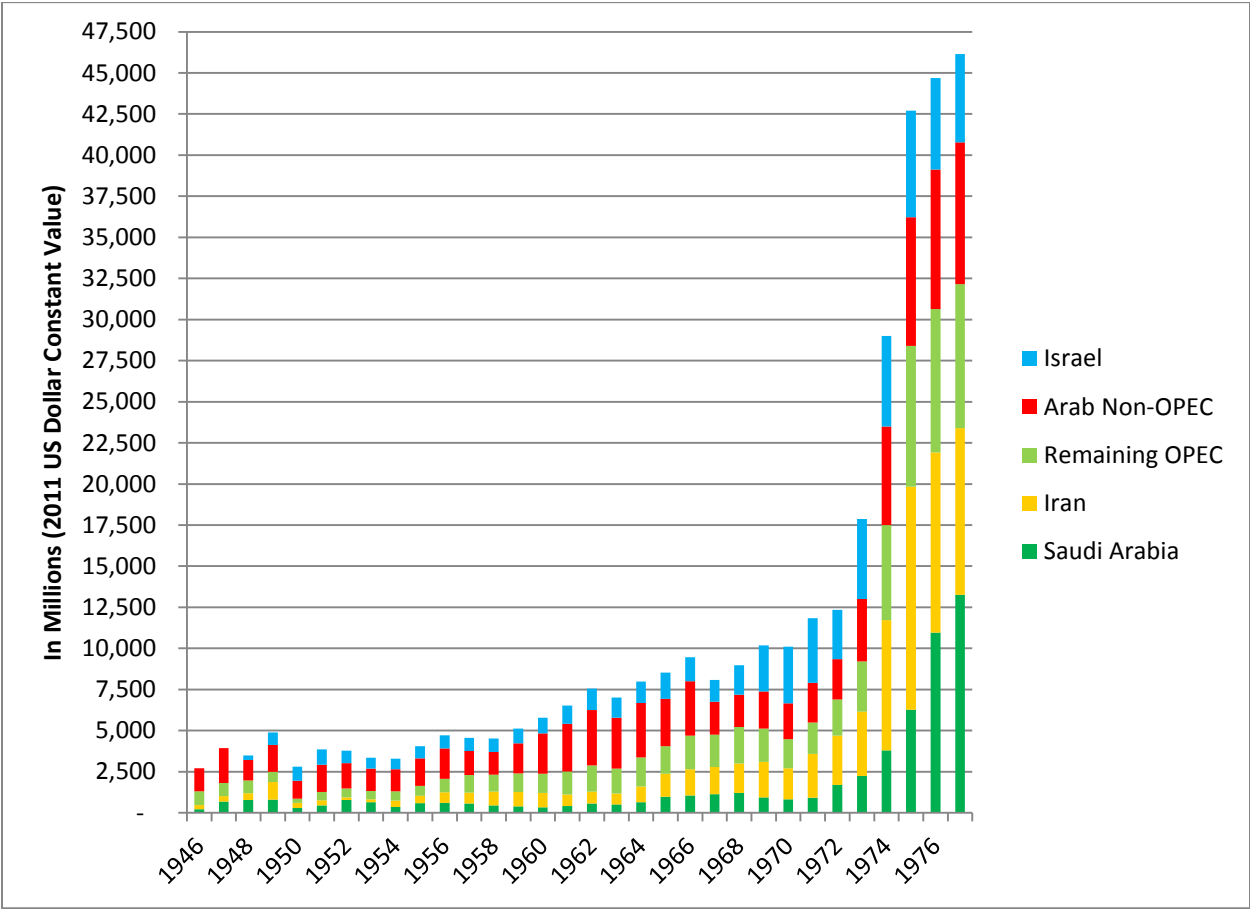
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<sup>27</sup> Spiro, *The Hidden Hand of American Hegemony*, 57-60.

<sup>28</sup> Economic data for Figure 1.4 and this paragraph taken from *Statistical Abstract of the United States*. Data for each year is taken from the latest publication where it is made available.

key oil-rich allies in the region, the pace of growth beat this extraordinary average; in the same period the value of US export purchases adjusted for inflation increased for Iran by 617 percent and Saudi Arabia by 667 percent. While this rapid growth in US exports to the oil-rich MENA countries slowed in the following two years, as a group it continued to move upward, and for Saudi Arabia it again doubled.

**Figure 1.4. Value of US Exports to the MENA, 1946-1977**



Source: *Statistical Abstract of the United States*

The ramifications of the massive new wealth accrued by the oil-rich MENA countries, the sharp and sudden current account imbalances, and the skyrocketing rates of trade occurring

in the petrodollar economy were numerous, but it is important to here underscore a few key points, which will be recurring themes pertaining to US-MENA relations throughout this dissertation. First, the rapid rise of income by the oil-rich MENA countries made them especially attractive and important new markets and sources of investment for US companies, banks, and financial institutions, whereas before they had been largely peripheral to the US economy outside of the petroleum industry. Second, the petrodollar economy led the US government to increasingly rely on the oil-rich MENA states in order for America to maintain a favorable trade balance, finance government spending, and maintain the value of US currency (both by purchasing American exports and government debt and by pricing oil in US dollars). Third, the new wealth in US-aligned states like Saudi Arabia and Iran enabled them to purchase far larger military capabilities and thus serve as more powerful proxies in the region. All three of these factors quickly and drastically increased the economic and political connectedness of the United States and the MENA.

### **US-MENA Foreign Relations to 1968**

Having established the magnitude of the economic changes signaled by the petrodollar economy, we now turn to how that petrodollar economy came into being, and how it intertwined with the long-term relations between the MENA and the United States. Virtually from the beginning of its creation, the United States had economic ties with the MENA. America signed a treaty of amity and commerce with Morocco in 1787, and American trade ships were sailing through the Atlantic and Indian Oceans to the port of Muscat near the entrance of the Persian Gulf by the first quarter of the 19<sup>th</sup> century. American Christian missionaries likewise had an early start in the MENA, with the first mission departing for the Ottoman Empire in 1819. Political ties

followed trade and missionary work, as the United States sought treaties of friendship and protection of its citizens by local governments. The United States established a small naval presence in the Mediterranean in case these diplomatic measures proved insufficient.<sup>29</sup> Yet while these interactions were significant to those who participated in them, they were firmly on the periphery of the economic, social, and political concerns of the larger societies involved. Similarly, by the late 1890s several thousand immigrants from Greater Syria were arriving in the United States each year until World War I, but this flow of immigrants was very small in comparison to the 25 million European immigrants who entered the United States between 1880 and 1914. Within this wave of immigrants, roughly 3 million were Jewish, and some of them and their descendants would later form the nucleus of the pro-Zionist movement in the United States. Further immigration from the MENA to the United States was effectively halted by World War I and the miniscule non-Western European immigration quotas imposed by the Johnson-Reed Act of 1924, which stayed in force until 1965.<sup>30</sup>

The resolution of World War I was up to that point the most significant political event to intertwine the MENA and the United States. With the defeat of the Ottoman Empire, Arab nationalists sought the creation of their own state or states. When it became clear the British and French instead intended to colonize most of the lands inhabited by the Arabs, these nationalists turned to the United States in the hope that it would fight on their behalf to uphold the Wilsonian ideal of national self-determination. To the disappointment of the Arab nationalists, the US government hastily retreated from the world political scene, and all of the MENA except Turkey,

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<sup>29</sup> James A. Field Jr., *America and the Mediterranean World: 1776-1882* (Princeton, Princeton University Press, 1969); Michael A. Palmer, *Guardians of the Gulf: A History of America's Expanding Role in the Persian Gulf, 1833-1992* (Toronto: The Free Press, 1992), 1-12.

<sup>30</sup> Ussama Makdissi, *Faith Misplaced: The Broken Promise of U.S.-Arab Relations: 1820-2001* (New York: PublicAffairs, 2010), page 93 for Greater Syria immigration figure, chapters 1 and 2 for general overview of extent and nature of U.S.-Arab relations during the 19<sup>th</sup> century; Mae M. Ngai, *Impossible Subjects: Illegal Aliens and the Making of Modern America* (Princeton, Princeton University Press, 2004), 18; H.W. Brands, *Into the Labyrinth: The United States and the Middle East 1945-1993* (New York: McGraw-Hill Inc., 1994), 1-4.

Iran, and the unwanted expanses of the Arabian Peninsula remained or came under European rule as colonies, protectorates, or mandates.<sup>31</sup> World War I thus left Britain and France as the supreme military and political powers in the MENA. In the interwar years, some American oil companies founded operations in the Persian Gulf, most notably in Saudi Arabia, and these connections would have important consequences in the future. During the period, however, economic ties were fairly minimal; the United States was the largest producer of oil in the world and could easily provide for its own fuel needs and sell oil as an export. On the eve of World War II, the United States domestically produced about 60 percent of the world's petroleum, whereas total petroleum from the Persian Gulf totaled .055 percent.<sup>32</sup>

World War II dramatically changed the outlook and relative power of the United States. Axis declarations of war spurred an American war effort that would bring US troops to North Africa and Lend-Lease aid to Iran and Saudi Arabia. But of even greater consequence for the long-term relations of the United States and the MENA was how World War II ended. The war devastated Germany, Italy, and Japan while France and Great Britain achieved a pyrrhic victory that ended their status as major powers and significantly contributed to the gradual unraveling of their empires. The United States and the Soviet Union emerged as rival superpowers, becoming adversaries in the Cold War. World War II convinced most US foreign policy makers that preventing any single power from dominating Eurasia was vital to America's security and economic interests, and it likewise convinced a majority of Americans (policy elites and otherwise) that "appeasement" of dictatorships only encouraged further aggression. Because of these generally accepted lessons and the political vacuum created by World War II, the United States did not again recede into geopolitical isolation but rather asserted its power across the

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<sup>31</sup> Makdissi, *Faith Misplaced*, 125-155.

<sup>32</sup> Palmer, *Guardians of the Gulf*, 13-19, petroleum production figures are from page 261 under endnote 78.



world in order to counter what most Americans considered menacing Soviet expansionism. This assertion of power extended to the MENA.

Indeed, some of the earliest Cold War struggles occurred in the Middle East, including the Soviets' attempt to retain a military presence in Iran in 1946 and the United States declaration of the Truman Doctrine in order to fund anti-communist governments in Greece and Turkey in 1947. The MENA was seen as critically important to America's anti-Soviet strategy for two key reasons. First, the region's close proximity to the USSR made it an important spot for military bases and intelligence outposts, and US strategists believed a strong military position in the Middle East would be vital to ensuring victory against the Soviet Union in a ground war. During the first two decades of the Cold War the United States largely relied upon the British to maintain a military presence in the Middle East.

Oil was the second reason for the MENA's importance. While the United States remained the largest producer of petroleum after the war, the MENA had the world's largest proven reserves of oil, the supply of global oil from the MENA was rapidly increasing, and Arab oil in the late-1940s already supplied half the oil consumed by the US military and fueled most of Western Europe's reconstruction under the Marshall Plan.<sup>33</sup> Oil was also an important element of the new economic order instituted by the United States at the conclusion of World War II. Hoping to avoid the exchange rate volatility, trade protectionism, and trend toward autarky that characterized the interwar period and was widely blamed for contributing to the extreme nationalism that sparked the Second World War, the United States helped champion what became known as the Bretton Woods System. The Bretton Woods System created the International Monetary Fund, a global organization dominated by the United States (which held sole veto power over decisions) and that acted to monitor national economies and extend balance

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<sup>33</sup> Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (New York: Free Press, 2009), 391-412.

of payments financing to at-risk countries. Under Bretton Woods the US government also guaranteed the convertibility of the dollar to gold at \$35 per ounce, and all other participating nations used the dollar as their reserve currency and pegged the value of their currencies to the dollar. The United States intended the Bretton Woods System to increase international trade and investment and thereby contribute to global stability. To a large degree this vision of expanding economic connections depended on cheap oil used to transport goods; furthermore, in both volume and value, oil was the single largest commodity in the world. International agreements stipulated that oil had to be sold in the home currency of the company which controlled its production; since the vast majority of oil was controlled by US corporations, the vast majority of oil sales were conducted in dollars. Consequently, oil money was usually quite literally constituted in “petrodollars” rather than any other petro –currency, such as “petro-yen” or “petro-pounds.”<sup>34</sup> With so much trade conducted in dollars, nearly every country had to purchase large sums of dollars to conduct commerce. Because the value of the dollar declined over time due to inflation, the United States was essentially taxing the rest of the world to use money it printed as an international trade and national reserve currency. Cheap oil thus facilitated the remarkable post-war economic growth of the United States and its industrialized allies, cheap trade that undergirded the new international monetary system, and a profitable bonus to the value of the US dollar.<sup>35</sup>

American oil companies likewise saw Middle East petroleum as key to their interests after World War II. Five US corporations, Standard Oil of New Jersey (Esso), Standard Oil of New York (Socony), Standard Oil of California (SoCal), Gulf Oil, and Texaco, along with the

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<sup>34</sup> It should be noted, however, that a sizeable portion of oil sold from the MENA were “petro-pounds” as British oil companies held large shares of production in countries like Iran and Iraq.

<sup>35</sup> Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System*, 2<sup>nd</sup> ed. (Princeton: Princeton University Press, 2008), 91-115; Mitchell, *Carbon Democracy*, 39-42, 109-143.

Anglo-Persian Oil Company from the United Kingdom and Royal Dutch Shell from the Netherlands, dominated the international petroleum market, and were known as the “Seven Sisters.”<sup>36</sup> In the middle of the twentieth century there was a surplus of readily available oil reserves; if production exceeded a certain point, oil would flood the market and bring down its value. The Seven Sisters thus sought a dominant share of global oil production so that they could regulate output. Since the largest known oil reserves lay in the Persian Gulf, the Seven Sisters sought, and succeeded in obtaining, a controlling interest over the petroleum industries of the region. At the same time that they set production levels in the Persian Gulf, they also shared as little of the oil revenues with the host countries as they could. By controlling pricing, production levels, and revenue sharing in the Persian Gulf, the multinationals generated immense profits and maintained significant influence over the global petroleum market. Conversely, the host governments in the Persian Gulf earned far less revenue and often found that their oil reserves were purposefully left undeveloped because extraction would undercut the profitability of the multinationals’ oil production elsewhere. The international order envisioned by the US government and oil multinationals meant low oil revenues for the MENA states, and this meant the MENA would remain a small economy and thus be of marginal interest to most US industries outside of the petroleum sector.<sup>37</sup>

While some US oil executives and government officials had reason to focus on the MENA, the average American gave the region only passing attention. One of the few major constituencies within the United States that significantly cared about the MENA was pro-Zionist

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<sup>36</sup> Today, Standard Oil of New Jersey and Standard Oil of New York have merged to form ExxonMobil; Standard Oil of California, Gulf Oil, and Texaco merged to form Chevron; the Anglo-Persian Oil Company has been renamed British Petroleum; and Royal Dutch Shell retains the same name. The Seven Sisters actually had an eighth, smaller partner in France’s French Petroleum Company, which participated in sharing access to the oil fields of Iran and Iraq. Yergin, *The Prize*, 485.

<sup>37</sup> Little, *American Orientalism*, 48-58; Mitchell, *Carbon Democracy*, 113-123, 166-167.

Jews, although their aspiration for an Israeli state was increasingly supported by other Americans as a form of humanitarian support and restoration for the Jews after the Holocaust. Despite the warnings of the State Department that it risked losing the goodwill of Arab governments and impairing America's strategic interests in the region, the Truman administration determined that on the issue of Palestine the humanitarian needs of European Jews, the desires of European states to resettle displaced people, and the need to retain the traditionally Democratic Jewish vote in the key state of New York in the upcoming and tight presidential election were of greater importance than what it deemed to be hollow Arab protests. The Truman administration thus worked vigorously to ensure that the United Nations approved a partition plan for Palestine, which would include a Zionist state, and promptly recognized the new state of Israel once it declared its independence.<sup>38</sup>

In the opinion of many in the MENA, both the creation of Israel and the inability of local governments to control their own oil resources stemmed from the problem of Western imperialism. Across the MENA, people yearned for an end to formal and informal Western rule and an improvement in their standard of living. These goals were largely seen as mutually intertwined; ending imperialism would bring greater local economic control and strength, and achieving greater local economic control and strength would bring the end of imperialism. Control of oil became a focal point for this logic. But local control would not be easily achieved, as was demonstrated when the United Kingdom and United States orchestrated the overthrow of Mossadegh in 1953 after he nationalized the British owned Anglo-Iranian Oil Company. At this point, the global oil market was experiencing an extended period of surplus, and the MENA did not produce a large enough share of world oil production to dominate the market. Furthermore,

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<sup>38</sup> Brands, *Into the Labyrinth*, 17-30.

local governments in the MENA were still relatively weak, with many countries still either formal colonies or very dependent upon the Western powers.<sup>39</sup>

But while European powers fought and delayed decolonization, nationalism was on the rise. In two of the most striking victories for Arab nationalists, Egypt's President Gamal Abdel Nasser seized control of the Suez Canal from the British in 1956, and an eight year guerilla war waged by the National Liberation Front (NLF) forced the French out of Algeria in 1962, making both Nasser and the NLF heroes of the Third World. During the same time, the center of global oil production was shifting toward the MENA; in 1953 the MENA surpassed Latin America and the Caribbean as the second largest region of oil production, and in 1963 it supplanted the United States as the largest producer. With a larger share of world oil production came larger revenues and a stronger negotiating position.<sup>40</sup> In 1960 OPEC was formed at a meeting in Baghdad as a cooperative Third World effort to challenge the power of the Western multinationals over oil. Four of the five founding members of OPEC were from the Middle East; Kuwait, Iran, Iraq, and Saudi Arabia; they were joined by Venezuela. In the following thirteen years, OPEC would acquire four additional members from the MENA; Algeria, Libya, Qatar, and the United Arab Emirates; as well as Ecuador, Indonesia, and Nigeria.<sup>41</sup>

But even with the creation of OPEC, local control of oil came slowly. The Seven Sisters engaged in a series of stalling tactics with MENA countries to avoid or minimize further price or production concessions and to prevent nationalization of their industries. Political instability was both fomented and capitalized upon by the multinationals toward this end, particularly in Iraq.<sup>42</sup> The 1967 War would likewise show the current limits of both Nasser's brand of nationalism and

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<sup>39</sup> Little, *American Orientalism*, 56-58; Mitchell, *Carbon Democracy*, 144-145.

<sup>40</sup> Mitchell, *Carbon Democracy*, 144, footnote 1.

<sup>41</sup> Yergin, *The Prize*, 501-522.

<sup>42</sup> Michell, *Carbon Democracy*, 144-151.

the power of the Arab oil producers. Following a period of heightened tensions, Israel launched a surprise attack on June 5 against Egypt, Jordan, and Syria; six days later the war was over with the Arab armies defeated and Israel in control of the formerly Egyptian-held Sinai Peninsula and Gaza Strip, Jordanian-held West Bank, and Syrian-held Golan Heights. Angered by years of US military aid to Israel, which had surged under the Johnson administration, and hoping to induce Western support for the Arab position in the conflict, Algeria, Iraq, Kuwait, Libya, and Saudi Arabia banned the sale of oil to the United States and the United Kingdom while strikes by workers disrupted the production and distribution of oil throughout the Arab world and Iran. But the readily available supply of non-Arab oil in the world was still sufficient to offset Arab production cuts, and the multinationals diverted non-Arab oil to the embargoed markets while redirecting Arab oil to make up the difference. With revenues plummeting with nothing to show for it, the Arab states became divided and within a few months abandoned the embargo and production cuts. Global conditions were still not yet ripe for the MENA states to dramatically alter the political and economic order via the “oil weapon.”<sup>43</sup> The 1967 War left the Arab world in disarray and increasingly angry at the United States, and it created many of the conditions that would in part lead to the oil shocks of the following decades.

Yet if the Arab world was in a state of crisis following 1967, the United States likewise felt beleaguered. Above all else, the Vietnam War was tearing America apart. By 1968 the conflict had cost the United States more than twenty-five thousand lives and 10 billion dollars, and a significant anti-war movement bred a growing radicalism of the American left and undermined the previous consensus that America must contain communism abroad. Average Americans were becoming increasingly polarized over the war with those on both sides of the issue frustrated by the seeming endless nature of the conflict. As the ability of America to exert

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<sup>43</sup> Yergin, *The Prize*, 536-540.

power overseas, and even the logic of doing so, fell into question, the Soviet Union had simultaneously reached nuclear parity with the United States, and its prospects of exporting communism to Third World countries like Vietnam appeared enhanced. At the same time, conservatives attacked President Lyndon B. Johnson's Great Society and War on Poverty, and the price of paying for these domestic programs and the Vietnam War was proving untenable. To many, the peaceful civil rights movement of the early 1960s appeared to have given way to inner-city violence and riots. Americans were further shocked in 1968 by the assassinations of the Reverend Martin Luther King Jr. and Democratic presidential candidate Robert Kennedy. While most Americans did not welcome the tensions in the MENA, most did not consider the region a high priority concern given the other issues of the day.<sup>44</sup>

Although US foreign policy and social issues were the source of much discord in the late 1960s, to most observers the US economy appeared stable and prosperous. There were poor individuals and disfranchised groups in the United States in the 1960s, but the defining trends of the US economy since World War II had been the highest standard of living in the world, steadily rising incomes and a broadening in the quality of life for all classes, a simultaneous shrinking of the gap between rich and poor, and a bipartisan consensus in pursuing Keynesian economic policies.<sup>45</sup> Still, warning signs of the economic storms loomed on the horizon. Government spending on the Vietnam War brought inflation, and in 1968 average prices would rise 4 percent.<sup>46</sup> By the mid-1960s the United States' trade competitiveness fell behind that of Western Europe and Japan as those regions recovered from the devastation of World War II and

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<sup>44</sup> Robert Dallek, *Nixon and Kissinger: Partners in Power* (New York: HarperCollins Publishers, 2007), 60-64.

<sup>45</sup> Judith Stein, *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (New Haven: Yale University Press, 2010), 1-28.

<sup>46</sup> Matusow, *Nixon's Economy*, 15.

benefitted from US military protection.<sup>47</sup> The Bretton Woods System was on the verge of completely collapsing as rising deficits in America's balance of payments had become so large that the United States was incurring speculative attacks on the dollar that rapidly depleted US gold reserves. Fearing that these speculative attacks could ruin the US and global financial systems, the Johnson administration toward the end of its term removed the gold backing of the dollar from private transactions and kept it only for intra-governmental exchanges.<sup>48</sup> And while few realized it at the time, the United States was on the verge of losing its energy independence as rising American consumption moved apace to exceed domestic production.<sup>49</sup> But none of these issues figured largely, if at all, in the foreign policy debates that most preoccupied Americans at the end of the 1960s, as these changing economic circumstances had not yet manifested themselves in any dramatic way and as there were more immediate foreign policy and social issues seizing public attention.

At the close of the 1960s, the petroleum sector remained the most important US industry in the MENA. The US multinational petroleum companies had spent the decade delaying increased local control of oil and had largely succeeded, enjoying massive profits as a result. Whether the US multinational oil executives realized it or not, however, the MENA countries were fast approaching the point where they would have the requisite expertise, share of the oil market, and political unity to take control of the petroleum industries. During the 1960s there had likewise been an increase in US arms sales and development contracts, particularly to Iran. American weapons, aerospace, automotive, electrical, and engineering companies all stood to gain if the economies of the MENA grew and were able to purchase more of their goods and

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<sup>47</sup> Thomas W. Zeiler, *American Trade and Power in the 1960s* (New York: Columbia University Press, 1992).

<sup>48</sup> Francis J. Gavin, *Gold, Dollars, and Power: The Politics of International Monetary Relations, 1958-1971* (Chapel Hill: University of North Carolina Press, 2004).

<sup>49</sup> Matusow, *Nixon's Economy*, 242-245.



services, and new markets would be in particularly high demand once the United States reduced military spending as it drew down its involvement in Vietnam. Rising oil revenues for the MENA would thus benefit these US industries. The multinational oil companies, however, were loath to share any more of their profits with the MENA countries than they absolutely had to do.<sup>50</sup>

### **The Nixon Administration**

Against this backdrop of domestic and global conditions, Richard Nixon assumed the presidency in January 1969. Nixon's focus, by both inclination and circumstance, was on foreign affairs. Both Nixon and his primary foreign policy advisor, National Security Advisor Henry Kissinger, desired to fundamentally reshape global affairs but had minimal interest in economic issues; Nixon once dismissively described the latter as "building outhouses in Peoria."<sup>51</sup> Regardless of Nixon's inclinations, the demands of the Vietnam War would have forced their way to the top of any president's agenda. Nixon knew that both the United States' standing abroad and his own political fortunes would be tied to the conflict; indeed, he in large part owed his presidential victory to the Democratic Party's divisions over the issue. Nixon thus paid little attention to the selection of his top economic advisors or the policies they pursued. With the unemployment rate at the very low rate of 3.3 percent at the start of 1969 and inflation the previous year averaging the somewhat high level of 4 percent, Nixon's fiscally conservative economic staff prioritized an incremental battle against inflation. Nixon's benign neglect toward economic policy would be

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<sup>50</sup> Mitchell, *Carbon Democracy*, 144-170.

<sup>51</sup> Quote from Dallek, Nixon and Kissinger, 99; see also Jussi Hanhimäki, *The Flawed Architect: Henry Kissinger and American Foreign Policy* (Oxford: Oxford University Press, 2004), 13.

overturned, however, if economic matters threatened his reelection prospects or his governing coalition. For Nixon, votes were the supreme calculus for economic decisions.<sup>52</sup>

Nixon and Kissinger's passions lay in foreign policy, and it was here where they hoped to leave their mark upon history. They recognized that the United States, while still the dominant power of the globe, had experienced a relative decrease in military and economic power vis-à-vis both its adversary the Soviet Union and its allies in Western Europe and Japan, as these regions had recovered from World War II. The Vietnam War had likewise demonstrated the limits of US power and had generated doubts about America's ability to uphold its foreign commitments. Nixon and Kissinger sought to address these new realities while maintaining American hegemony in the world. The Soviet Union and the spread of communism remained Nixon and Kissinger's primary foes, but they also sought a lessening of tensions with the Soviets, dubbed *détente*, which could help avert crises, lower US military costs, and aid in a favorable resolution of the situation in Vietnam. They likewise sought rapprochement with Communist China as a means of putting pressure on the Soviets and perhaps of extricating the United States from Vietnam. Western Europe and Japan were to remain key allies, but were also to be watched over lest they develop independent policies that undercut US supremacy within the alliance. Nixon and Kissinger were less attentive to the Third World, and typically only paid attention to it when they believed a regional crisis was either an act of Soviet adventurism or a threat to their domestic standing. In principle they sought a shifting of the human and financial costs of regional defense in the Third World away from the United States and to local allies. The United States would continue to train and assist its allies in defending themselves as well as serve as a protector of last resort, but a greater share of the military burden would be placed upon the local

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<sup>52</sup> Matusow, *Nixon's Economy*, 7-18.

allies. This policy became known as the Nixon Doctrine, and would be used by many as shorthand to justify increased militarization of American allies in the MENA.<sup>53</sup>

From the beginning, the Nixon administration viewed the MENA as a crisis region that could endanger vital US interests. On January 21, 1969, the first National Security Study Memorandum issued by the US National Security Council (NSC) under Nixon pertained to Vietnam; the second, issued on the same day, called for an analysis of the situation in the Middle East vis-à-vis the Soviets and if and how the Arab-Israeli conflict might affect the United States' position.<sup>54</sup> Two days later Nixon personally asked the NSC whether an Arab oil boycott against the United States and its allies could be successfully conducted and what its impact would be on Western Europe and Japan; whether conflict between Saudi Arabia, Iraq, and/or Iran was likely; what the prospects were for US-allied Libya under an aging King Idris; and whether there were any spots that had a 1 in 10 chance of reaching a crisis level that would hold his urgent attention within the next year.<sup>55</sup> Before January ended, the NSC had prioritized the Middle East, Berlin, and Korea as the three locations for which the United States should develop crisis contingency plans.<sup>56</sup> The Nixon administration had reason to worry. Western energy dependence upon MENA oil had only increased, with a third of the non-communist world's oil supply coming from the Persian Gulf alone.<sup>57</sup> Israel's 1967 territorial seizures had inflamed a large segment of Arab opinion against the United States. Soviet-leaning governments ruled in populous Egypt, Iraq, and Syria, and it was feared that popular revolts could at any time topple pro-US regimes in

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<sup>53</sup> George C. Herring, *From Colony to Superpower: U.S. Foreign Relations since 1776* (Oxford: Oxford University Press, 2008), 760-791.

<sup>54</sup> National Security Study Memorandum (hereafter NSSM) 2, Middle East Policy, January 21, 1969, Richard M. Nixon Presidential Library, Yorba Linda, CA (hereafter NL), <http://www.nixonlibrary.gov/virtuallibrary/documents/nationalsecuritystudymemoranda.php> (accessed 01/02/2013).

<sup>55</sup> NSSM 9, Review of the International Situation, January 23, 1969, NL.

<sup>56</sup> NSSM 12, Contingency Planning, January 30, 1969, NL.

<sup>57</sup> Andrew Scott Cooper, *The Oil Kings: How the U.S., Iran, and Saudi Arabia Changed the Balance of Power in the Middle East* (New York: Simon and Schuster, 2011), 19.

countries like Jordan, Lebanon, Libya, Morocco, Saudi Arabia, and Tunisia. With the British planning to withdraw from its remaining Gulf possessions by 1971, the Nixon administration likewise feared that Iraq might try to seize Kuwait or that Iran and the Arabs might come into conflict over filling the power vacuum in the Gulf. The United States, meanwhile, only had a seaplane tender and two destroyers in the Gulf.<sup>58</sup> Seeking influence and powerful allies in the region without increasing the direct US presence, the Nixon administration sought to maintain a strong relationship with Iran and Saudi Arabia, which were considered the “two pillars” of the United States in the Middle East.

### **Iran, the Shah, and Grand Visions**

The United States valued Iran for its fiercely anticommunist ruler Mohammad Reza Shah Pahlavi, large military (which could be used to deter local forces aligned with the Soviet Union), fast-growing economy, presumed stability, and amicable relations with Israel. The Shah valued the ability to purchase US weapons and to receive US assistance against foreign and domestic foes. It was arguable that the Shah, who had ascended to the monarchical throne in 1941 at the age of 21, was able to retain and consolidate his power only due to the American-supported coup that deposed Mossadegh. The Shah, however, desperately wanted more for Iran than to be a mere US client, and he felt increasingly secure about his own power. As Kissinger wrote to Nixon, “the Shah is a man with a mission – putting Iran on its feet as a modern nation before he dies.”<sup>59</sup> The Shah sought to prove that Iran no longer needed “Great Power tutelage” and to instead establish Iran as the dominant power of the Middle East and attain a European standard

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<sup>58</sup> Ibid.

<sup>59</sup> Kissinger to Nixon, October 22, 1969, folder “Visit of the Shah of Iran, October 21-23, 1969 [1 of 2],” box 920, National Security Council Files VIP Visits (hereafter NSC VIP), NL.

of living within twenty years.<sup>60</sup> With the British withdrawing from the Persian Gulf and Iran's economy growing at nearly 10 percent annually, the Shah felt poised to make his dream a reality.<sup>61</sup> Many of Iran's weapons and development expenditures were made to US companies, and while this constituted a small fraction of overall US business, it was the embryonic beginnings of the petrodollar economy.

Iran's spending, however, was far outpacing revenue and pushing the limits of manageable debt. The Shah needed more funds, and he sought it from oil revenues, which constituted over half of total government revenue.<sup>62</sup> Iranian oil production, however, was still controlled by Western companies. After the overthrow of Mossadegh, drilling rights to Iran's oil fields were granted to the Seven Sisters, which was referred to as the "Consortium" within Iran. The Seven Sisters, seeking to preserve their control of global oil production levels and their profits, resisted the Shah's push for greater production and sharing of revenues, and instead made offers that the Shah felt were a personal insult.<sup>63</sup> With clear bitterness, the Shah told US Ambassador to Iran Douglas MacArthur II that the Consortium, by denying him needed revenue, was endangering the stability and defense of Iran, which was something that both the Shah and the Consortium depended upon. Texaco and SoCal, the Shah continued, were the "most uncooperative and obstructive of any of [the] Consortium companies, probably because they have only a 7% interest each in [the] Consortium and far greater interests in [Saudi Arabia based Arabian American Oil Company] ARAMCO." He threatened to replace the US oil companies

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<sup>60</sup> Suggestions on Approaching Iranians and Topics of Conversation, folder "Visit of the Shah of Iran, October 21-23, 1969 [2 of 2]," box 920, NSC VIP, NL.

<sup>61</sup> Ibid.; Douglass MacArthur II to William Rogers, October 9, 1969, folder "Visit of the Shah of Iran, October 21-23, 1969 [1 of 2]," box 920, NSC VIP, NL.

<sup>62</sup> Background – Iran's Petroleum Industry, folder "Visit of the Shah of Iran, October 21-23, 1969 [2 of 2]," box 920, NSC VIP, NL.

<sup>63</sup> Thomas L. Hughes to William Rogers, March 13, 1969, folder "Iran Vol. I, Jan. 20, 1969 – May 31, 1970 [2 of 3]," box 601, National Security Council Files Country Files – Middle East (hereafter NSC CFME), NL.

Texaco and SoCal with German and Japanese corporations for this reason.<sup>64</sup> US government officials dealing with the Seven Sisters shared the Shah's conclusion that the US companies were the least inclined to increase production in Iran.<sup>65</sup>

But if the US oil companies in the Consortium were undermining the Shah's plans, he had other US corporate allies. General Electric (GE) wanted Iran to earn higher oil revenues so it could afford to hire its services in installing a massive electrification program of the country, which would include the construction of two new power plants at an expected price of \$100 million. Planet Oil and Mineral Corporation, a smaller US company excluded from the Consortium, sought to break the Seven Sisters' monopoly over Iranian oil production.<sup>66</sup> Since 1959 the United States had imposed a quota system that limited the amount of foreign oil imports in order to protect domestic petroleum companies from competition by more cheaply produced foreign oil.<sup>67</sup> The two companies and the Shah sought to convince the US government to increase Iran's quota to allow for 200,000 barrels of Iranian oil a day, to be extracted by Planet Oil, to enter the US market, either commercially or stockpiled for a national emergency. Iran would guarantee that all revenue earned from the oil quota increase would be placed in block accounts in New York and then spent solely on US products and services, such as GE's electrification work. Herbert Brownell, a former Attorney General under Dwight D. Eisenhower, served as a representative for Planet Oil and used his connections to pitch the proposal to the Nixon administration. Writing to Kissinger in March 1969, Brownell argued that the plan would measurably alleviate "two critical problems confronting the United States, its deteriorating trade

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<sup>64</sup> MacArthur to Rogers, August 2, 1970, folder "Iran Vol. II, June 1, 1970 – Dec. 1970 [2 of 2]," box 601, NSC CFME, NL.

<sup>65</sup> Peter Flanigan to Kissinger, January 10, 1970, folder "Iran Vol. I Jan. 20, 1969 – May 31, 1970 [1 of 3]," box 601, NSC CFME, NL.

<sup>66</sup> Herbert Brownell to Kissinger, March 10, 1969, folder "Iran Vol. I, Jan. 20, 1969 – May 31, 1970 [2 of 3]," box 601, NSC CFME, NL.

<sup>67</sup> Matusow, *Nixon's Economy*, 243-244.

balance and the Middle East” by “guaranteeing export sales from the United States which will otherwise be lost, while strengthening Iran economically, socially, and militarily.”<sup>68</sup> Without the deal, Brownell argued, US companies, of which GE was but one example, would lose contracts to competitors in other countries like Italy and Japan which had governments that would agree to guaranteed oil purchases and other forms of subsidies, and the US balance of trade would continue to deteriorate. Likewise, in the troubled region of the Middle East, Iran had made great strides in modernizing its society and had served as a loyal ally, but it needed additional revenue in order to continue its progress. “The maintenance of Iran as a bulwark of freedom” justified the quota increase on national security grounds.<sup>69</sup> Brownell also pushed for Nixon to meet with Reza Fallah, the Vice Chairman of the Board for the National Iranian Oil Company.<sup>70</sup>

After Fallah was denied an opportunity to meet with Nixon, the Shah told Ambassador MacArthur that he would personally raise the plan as matter of importance when he met with Nixon on his upcoming trip to Washington DC in October. The Shah told MacArthur that “Iran was well satisfied with U.S. equipment and in period ahead when Iran must be electrified and further industrialized there would be a need for a wide range of heavy equipment... produced by General Motors and General Electric, agricultural equipment, heavy industrial and construction equipment, etc., to purchase such item, and also military equipment, from U.S.”<sup>71</sup> He noted US trade balance problems and argued the deal “served not only commercial but also political

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<sup>68</sup> Herbert Brownell to Kissinger, March 10, 1969, folder “Iran Vol. I, Jan. 20, 1969 – May 31, 1970 [2 of 3],” box 601, NSC CFME, NL.

<sup>69</sup> Ibid.

<sup>70</sup> Memorandum for H.R. Haldeman, August 4, 1969, folder “Iran Vol. I, Jan. 20, 1969 – May 31, 1970 [2 of 3],” box 601, NSC CFME, NL.

<sup>71</sup> MacArthur to Rogers, October 13, 1969, folder “Iran Vol. I, Jan. 20, 1969 – May 31, 1970 [3 of 3],” box 601, NSC CFME, NL.

interests of the U.S. since he knew we wished to see a strong stable and independent Iran that could contribute to stability in this unstable area.”<sup>72</sup>

Hopes for an increase in Iran’s petroleum exports to America were in part driven by the Nixon administration’s decision in February 1969 to appoint a Cabinet task force led by Secretary of Labor George Shultz to review and possibly alter the oil import quota system. The review was implemented not due to a concern about future shortages of oil, but rather due to complaints that the system caused artificially high petroleum prices for American consumers by denying them access to cheaper foreign oil; the average US domestic price of crude oil in 1969 was \$3.30 a barrel while the world price was \$2.00, causing Americans to pay an estimated additional \$5 billion.<sup>73</sup> Assistant for International Economic Affairs C. Fred Bergsten advised Kissinger that while “completely free trade in oil might expose us to blackmail by the Middle Eastern suppliers,” the options being considered by the task force, which ranged from keeping the current system of limiting foreign oil imports to 20 percent of US consumption through quotas to increasing the amount to 40 percent and changing the method of protectionism to tariffs, “do not raise serious security problems.”<sup>74</sup> Shultz, State, and Treasury all preferred changing to a tariff system and aiming for 40 percent of US oil needs to be supplied by foreign imports.<sup>75</sup> By the time Shultz formally proposed this in a report submitted to the president in February 1970, however, Nixon had determined that increasing foreign oil imports would be too politically costly to independent Texan oil producers and their allies and could lead to the loss of

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<sup>72</sup> Ibid.

<sup>73</sup> Matusow, *Nixon’s Economy*, 245.

<sup>74</sup> C. Fred Bergsten to Kissinger, December 2, 1969, folder “Oil 1970 [Dec. 1969 – 1970] [1 of 2], box 367, National Security Council Files Subject Files (hereafter NSC SF), NL.

<sup>75</sup> Ibid.



several Republican seats in that year's elections, including that of Senator George Bush, so Nixon shelved the proposal.<sup>76</sup>

During the period of the task force, there was little interest in the Nixon administration toward providing Iran with preferential access to the American market. The task force overwhelmingly agreed that preferences for foreign oil should remain with nations in the Western hemisphere; only a few voices in the State department suggested extending these preferences to Iran.<sup>77</sup> Preparing Nixon for his October meeting with the Shah, Kissinger noted that the Shah had made the quota increase proposal "very much his own," but Kissinger did not dispute Special Counsel Clark Mollenhoff's appraisal that the Shah's hopes should be cooled down given the uncertainty that any change to the quota system would occur and that the US press, in light of recent scandals involving oil allocation decisions, would "put the worst possible interpretation on any decisions by this Administration that might be of substantial benefit to one of Mr. Brownell's clients."<sup>78</sup> Nixon did not want to deal with the political problems of changing the quota system, but he also did not want to upset the Shah. While there is no available record of Nixon and the Shah's conversation on the matter when they met in October, later records show the Shah left understanding that Nixon would do everything he could to increase Iran's import quota.<sup>79</sup> Nixon had already written to Kissinger that he wanted increased Iranian revenue to come from the Consortium rather than through an increase in Iran's quota, however, so it appears that Nixon may have overstated to the Shah his willingness to help on the matter.<sup>80</sup>

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<sup>76</sup> Matusow, *Nixon's Economy*, 245.

<sup>77</sup> Bergsten to Kissinger, December 2, 1969, folder "Oil 1970 [Dec. 1969 – 1970] [1 of 2]," box 367, NSC SF, NL.

<sup>78</sup> Kissinger to Nixon, October 22, 1969, folder "Visit of the Shah of Iran Oct. 21-23, 1969 [1 of 2]," box 920, NSC VIP, NL.

<sup>79</sup> MacArthur to Rogers, November 24, 1969, folder "Iran Vol. I Jan 20 1969 - May 31, 1970 [3 of 3]," box 601, NSC CFME, NL.

<sup>80</sup> Kissinger to Nixon, October 22, 1969, folder "Visit of the Shah of Iran Oct. 21-23, 1969 [1 of 2]," box 920, NSC VIP, NL.

Nixon had also pledged to the Shah, in this case with greater sincerity, that he would pressure the Consortium to increase Iran's revenues.<sup>81</sup>

The Shah continued to press the United States in the following months. Hearing reports in November that the task force was not inclined to recommend a special arrangement with Iran but rather a general import increase which might actually advantage Arab oil producers over Iran, the Shah complained to MacArthur with a sardonic smile that a "substantial part of money US oil companies paid for Kuwait [sic], Saudi, and Libyan oil went to Egypt to finance Nasser's vilification of the U.S.," which reminded him of US commercial interests before World War II exporting "tremendous amounts of scrap iron to Japan only to have it returned in finished form at Pearl Harbor."<sup>82</sup> In December the Shah sent a letter to Nixon that continued his swipes at the Arab states, criticizing the Consortium members for favoring increased production in "countries which do not need the money and which in many cases have several hundreds of million pounds deposited in foreign banks" while Iran needed to pay for economic and military development to counter increasing radical threats to the Gulf as the British withdrew from the Middle East.<sup>83</sup> But in January 1970 Assistant to the President Peter Flanigan, who had been tasked by Nixon in front of the Shah to put pressure on the Consortium, found that talks with the Seven Sisters to increase Iran's revenue were going nowhere, with the companies insisting that the Shah's demands were "insatiable."<sup>84</sup> During the same month Flanigan informed Brownwell and Fallah that there would be no movement on Planet Oil's proposal "in the near future" and Iran should

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<sup>81</sup> Flanigan to Kissinger, January 10, 1970, folder "Iran Vol. I Jan. 20, 1969 – May 31, 1970 [1 of 3]," box 601, NSC CFME, NL.

<sup>82</sup> MacArthur to Rogers, November 27, 1969, folder "Iran Vol. I Jan. 20, 1969 – May 31, 1970 [3 of 3]," box 601, NSC CFME, NL.

<sup>83</sup> Shah to Nixon, December 17, 1969, folder "Iran Pahlavi Shahanshah [1969-1974] [2 of 2]," box 755, National Security Council Presidential Correspondence (hereafter NSC PC), NL.

<sup>84</sup> Flanigan to Kissinger, January 10, 1970, folder "Iran Vol. I Jan. 20, 1969 – May 31, 1970 [1 of 3]," box 601, NSC CFME, NL; Flanigan to Kissinger, January 21, 1970, folder "Oil 1970 [2 of 2]," box 367, NSC SF, NL.

not expect support from the Cabinet task force on oil imports.<sup>85</sup> In February Iranian Prime Minister Amir-Abbas Hoveyda told MacArthur that the Shah “was deeply disturbed” by Nixon’s apparent “deception” regarding Iranian oil exports and refusal to help him, which he found baffling as “Iran is [the] only country in [the] Gulf region that can make [a] major contribution to stability of that area which is so essential not only to Iran but also Japan, Europe, and [the] U.S.”<sup>86</sup> Nixon in turn wrote to Flanigan to “tell them [the members of the Consortium] unless they help us on this I shall reverse the oil import decision. This is an order.”<sup>87</sup> Nixon apparently believed he could bluff the Seven Sisters into helping Iran with the threat of an unfavorable decision on Shultz’s report which he had already decided to table. Whether or not Flanigan relayed Nixon’s threat to the Consortium is unknown, but if so it did not appear to have much of an impact. In April and again in July Nixon was forced to write to the Shah in response to the latter’s unceasing calls for greater oil revenues, expressing sympathy for the Shah’s goals but admitting that an increase in Iran’s quota would not be possible in the near future.<sup>88</sup>

The effort by Iran and its US corporate allies in non-oil sectors to achieve an increase in Iranian oil revenues had limited results in the first two years of the Nixon presidency. Most of the Nixon administration did not support an increase in the amount of Iranian oil exports to the United States, and the Consortium maintained a strong negotiating position against the Shah. Some of the key elements of the coming petrodollar economy, however, were taking form. US companies were increasingly noticing Iran as a potentially lucrative market if oil revenues went up, and some of them were forming networks with each other and with the Iranian government to

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<sup>85</sup> Ibid.

<sup>86</sup> MacArthur to Rogers, February 17, 1970, folder “Iran Vol. I Jan 20 1969 - May 31, 1970 [2 of 3],” box 601, NSC CFME, NL.

<sup>87</sup> Kissinger and Flanigan to Nixon, February 25, 1970, folder “Oil 1970 [Dec 69 - 1970] [1 of 2],” box 367, NSC SF, NL.

<sup>88</sup> Nixon to the Shah, April 16, 1970, folder “Iran Pahlavi Shahanshah [1969-1974] [2 of 2],” box 755, NSC PC, NL; Nixon to the Shah, July 30, 1970, folder “Iran Pahlavi Shahanshah [1969-1974] [2 of 2],” box 755, NSC PC, NL.

try to capitalize upon future opportunities. Nixon, moreover, while unwilling to take steps that might incur him a political cost, was sympathetic to the Shah's desire for increased oil revenues.

### **The Dilemmas of Saudi Arabia**

Saudi Arabia was the second pillar for the United States in the Middle East. From the United States' perspective, Saudi Arabia had some disadvantages that hindered its ability to serve as usefully as Iran as a military proxy in the region. Saudi Arabia lacked the population size and infrastructure necessary to serve as a large military force. Furthermore, Saudi Arabia's ongoing conflict with Israel made heavily arming the Saudis problematic. But Saudi Arabia had important economic and diplomatic assets for America. Aramco was the largest single US foreign investment in the world, and Aramco's repatriated profits and the United States' favorable trade balance with Saudi Arabia contributed over half a billion dollars to America's current account in 1968.<sup>89</sup> Perhaps even more importantly, Saudi Arabia had the largest proven reserves of oil of any country. The United States also appreciated the ruling House of Saud's tendency to serve as a moderate voice in inter-Arab dialogue and its vociferous opposition to communism and the atheistic Soviet Union. The House of Saud in turn had relied upon Aramco in maintaining its hold on power and developing Saudi Arabia, and it had relied upon the US government for support against the Soviet Union and its allies in the region.

Like Iran, Saudi Arabia sought greater control of its oil resources, from which it obtained 80 percent of its revenues.<sup>90</sup> Indeed, when Saudi Prince Fahd bin Abdulaziz al-Saud and Minister of Foreign Affairs Omar al-Saqqaf came to Washington DC for the first high level Saudi visit with the Nixon administration in October 1969, the State Department noted that

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<sup>89</sup> Kissinger to Nixon, October 13, 1969, folder "Prince Fahd Visit [Oct 1969] [1 of 1]," box 937, NSC VIP, NL.

<sup>90</sup> "American Economic Interests in the Arab World," July 19, 1970, fold 17, box 7, William E. Mulligan Papers, Georgetown University Special Collections (hereafter GUSC).

Aramco and the Saudi government were engaged in one of their worst ever disputes over revenue, and Fahd requested the US government to put pressure on Aramco to accede to greater Saudi profits in order for Saudi Arabia to develop and better serve as a force for stability in the region.<sup>91</sup> The Saudi government, like the Iranian government, desired an increase in oil revenues to fund domestic development and an expansion of its military. Saudi Arabia had limited infrastructure and business outside of oil at the beginning of the 1970s. Furthermore, the Saudi government watched the military buildups of neighboring Iraq and Iran with alarm, fearful that either country might seek to dominate or even conquer the Saudi Kingdom.

In addition to these economic and military matters, Saudi Arabia was also deeply concerned about the Arab-Israeli conflict. Saudi King Faisal bin Abdulaziz al-Saud and many other Saudis were personally angered at what they perceived to be Israeli aggression against Arabs, but the House of Saud also feared the failure to resolve the Arab-Israeli conflict fueled Arab radicalism that threatened to topple their monarchy and made it harder for the Saudis to work closely with the United States. The House of Saud was alarmed by the success of Arab leftists taking power through military coups in Libya and Sudan in the middle of 1969. Libya was the source of particular dismay to the Saudi government, as the failure of the United States to preserve fellow pro-American monarch King Idris prompted fears that the US government might not protect the House of Saud if it faced its own crisis.<sup>92</sup> When meeting with Nixon, Fahd maintained that “Saudi strength derived to [a] large extent from [the] U.S.” and that Saudi Arabia would continue to fight communism “because of its interest in democracy and freedom. However, everything depended on a just and fair Middle East settlement.” Fahd expressed his

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<sup>91</sup> Foreign Service Officer William Stoltzfus to Rogers, October 9, 1969, folder “Prince Fahd Visit [Oct 1969] [1 of 1],” box 937, NSC VIP, NL; Rogers to US Ambassador to Saudi Arabia Hermann Eilts, October 15, 1969, folder “Prince Fahd Visit [Oct 1969] [1 of 1],” box 937, NSC VIP, NL.

<sup>92</sup> Ibid.; Kissinger to Nixon, October 13, 1969, folder “Prince Fahd Visit [Oct 1969] [1 of 1],” box 937, NSC VIP, NL.

hope that Nixon, who had been vice president when the United States had forced Israel's withdrawal from Egypt after the 1956 War, would show the same leadership as president. Nixon assured his Saudi guests that after Vietnam, the Middle East problem was his highest priority, and considerable energy was being taken to bring a satisfactory resolution to the conflict. Saqqaf reiterated the point, however, that the "Saudis feel time is working against them... they feel a rope around their neck. A Middle East settlement cannot wait too long."<sup>93</sup>

### **The Arab-Israeli Conflict**

American financial and petroleum companies were also concerned about the Middle East conflict. On December 9, 1969, some of the most prominent men in these two industries met with Nixon to express their concerns about the situation. Among them were David Rockefeller, the grandson of the legendary oil tycoon John D. Rockefeller, the current chairman and chief executive of Chase Manhattan Bank (one of the largest financial institutions in the world and highly invested in the US multinational oil industry), and brother of Nelson Rockefeller, Republican Governor of New York and former patron of Kissinger; Ken Jamieson, the chairman of Exxon Corporation, one of the Seven Sisters; and John J. McCloy, a top legal adviser to the Consortium and a US foreign policy veteran belonging to the ranks of the "Wise Men." They expressed to Nixon their concern that if the United States was not seen as moving toward progress on the Arab-Israeli impasse, the moderate Arab states would get swept along by the radical Arab states and either impose restrictions on US oil concessions in the region or nationalize US oil facilities outright. They feared this might occur as soon as the next Arab League summit on December 20, 1969. They recommended that a US envoy be sent to some of the moderate Arab states and perhaps Egypt with a new peace process proposal in hand in order

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<sup>93</sup> Rogers to Eilts, November 18, 1969, folder "Prince Fahd Visit [Oct 1969] [1 of 1]," box 937, NSC VIP, NL.

to stave off the radical threat. McCloy spoke of his contacts with Egyptian officials, who expressed their desire not to leave Egypt solely in the orbit of the Soviet Union but wanted improved relations with the United States, and of his personal belief that increased engagement should be pursued with the Egyptians.<sup>94</sup>

The American oil men had reason to worry. Ever since the coup that overthrew Idris, Aramco employees repeatedly received letters with Libyan postage stamps that violently denounced America. One letter, which arrived in mid-December, read in part:

Every American is your enemy. That American standing in front of you, or masquerading as a merchant or a tourist, works for the American intelligence. Whether in embassy offices or in companies, these Americans, even the ambassadors among them, are but an evil group of enemies whose business is to weave plots. And there is never a lack of opportunity to kill them in an alley with any weapon.... The Americans are scheming to destroy the Arab nation through their masters, the Zionists. Take up arms to strike at Americans and at anyone favoring or sympathizing with our American enemy.... Strike at the American companies, their establishments, their life and their property.... America is our enemy. It is she that keeps saying that Israel is American and America is Israel. That American in front of you is thus no different from any Zionist enemy fighting against you. To kill him is a national duty.... Death is much better than the kind of life our American enemies want for us.<sup>95</sup>

The US oil companies and their financial backers knew firsthand that America's support for Israel was generating anti-American sentiment, and they feared this sentiment could endanger their enormous investments throughout the MENA and the lives of their employees. They thus pushed the Nixon administration to solve the Arab-Israeli conflict so as to eliminate a major source of anti-Americanism amongst Arabs.

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<sup>94</sup> "Memorandum From the President's Assistant for National Security Affairs (Kissinger) to President Nixon," December 8, 1969, *Foreign Relations of the United States, 1969-1976 vol. XXXVI, Energy Crisis, 1969-1974* (Washington, D.C.: United States Government Printing Office, 2011); "NSC Meeting," December 10, 1969, folder "NSC Minutes Originals 1969 [5 of 5]," box H-109, National Security Council Institutional Files (hereafter NSC IF), NL.

<sup>95</sup> Principal Officer in Dhahran Lee F. Dinsmore to Rogers, December 23, 1969, folder "Libya Jun 69 - Jan 70 Vol I," box 738, National Security Council Country Files – Africa (hereafter NSC CFA), NL.

Nixon wanted to prevent crises in the MENA, which he believed created openings for Soviet adventurism, and he wanted to strengthen US-aligned Arab regimes like Saudi Arabia. And he was aware that the failure to resolve the Arab-Israeli conflict was increasing instability and anti-American sentiment in the region. He also, however, wanted to maintain Israel's military superiority over its Arab neighbors. During the Johnson administration, the United States had become the primary arms supplier of Israel, while Israel's main military adversaries, Egypt and Syria, had been armed by the Soviet Union.<sup>96</sup> Nixon wanted to demonstrate that the benefits of an alliance with the United States were superior to the benefits of aligning with the Soviet Union. Nixon's dual outlooks on the Middle East conflict were accentuated by the opposing views of Secretary of State William Rogers and National Security Adviser Henry Kissinger. At an NSC meeting on the Middle East conflict held the day after the Rockefeller group met with Nixon, Rogers argued what he believed was a hard truth. "Our position [in the Middle East] has deteriorated because we are seen as the principal supporters of Israel," Rogers said. "We send [Israel] planes and economic aid... We are never going to escape from this problem unless we discontinue our support for Israel." Kissinger contended it was possible the United States would not gain any significant or lasting benefits from the Arabs if America sacrificed its standing with Israel, and instead suggested that "the longer Israel holds its conquered Arab territory, the longer the Soviets cannot deliver what the Arabs want. As that time drags on, the Arabs must begin to conclude that friendship with the Soviet Union is not very helpful." Nixon straddled both arguments, saying that if he was going to "squeeze" Israel, the United States "ought to get as much as possible in return for it. The Soviets should not come out

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<sup>96</sup> Miglietta, *American Alliance Policy in the Middle East*, 133-140.



ahead. The Arabs played a substantial part in bringing on the war, and the Soviets should pay some price for picking up the pieces.”<sup>97</sup>

At first Nixon allowed Rogers and the State Department to take command of the Middle East peace initiative, as he was preoccupied with Vietnam, believed Kissinger’s Jewish origins would be a liability, and was skeptical of the likelihood for success. In October 1969 Rogers had privately put forth a plan to the Soviet Union, and later put forward to Egypt, Israel, and Jordan, that called for an end to hostilities, a return to pre-war borders, and negotiations on the status of refugees and Jerusalem. Rogers publicly described the plan in a speech on December 9, the same day that David Rockefeller and his associates met with Nixon.<sup>98</sup> To Roger’s disappointment, Egypt was noncommittal to the plan; Israel rejected it outright; and Jordan, while supporting the plan, could not move forward without the other two countries. As the stalemate persisted into early 1970, the “War of Attrition” between Egypt and Israel escalated. Unable to counter Israeli air superiority and experiencing increased bombing raids at the outskirts of Cairo, Egypt petitioned for and received an influx of Soviet missiles and planes as well as Soviet military “advisers” to operate the new weapons against Israeli forces. Alarmed by the prospect of a superpower crisis occurring due to skirmishes between the Soviets and Israelis, Rogers managed to obtain a three-month cease-fire between Egypt and Israel in August 1970.<sup>99</sup>

But in September a new crisis erupted, this time in Jordan between the Palestinian Liberation Organization (PLO) militias based there and the pro-US government of King Hussein bin Talal. While Fatah, the largest faction within the PLO and led by Yassir Arafat, did not desire a direct military conflict with Hussein, it was outmaneuvered the Popular Front for the

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<sup>97</sup> “NSC Meeting,” December 10, 1969, folder “NSC Minutes Originals 1969 [5 of 5],” box H-109, NSC IF, NL.

<sup>98</sup> I have not found any evidence indicating whether or not the two events had any relation to each other.

<sup>99</sup> William B. Quandt, *Peace Process: American Diplomacy and the Arab-Israeli Conflict since 1967*, 3<sup>rd</sup> ed. (Washington D.C.: Brookings Institution Press, 2005), 55-76.

Liberation of Palestinian (PFLP). The PFLP hijacked four commercial jetliners and held their passengers, many of whom were Americans, hostage, in the hope of provoking a Jordanian response that would galvanize the PLO and perhaps Iraq and Syria to militarily depose Hussein. The PFLP's actions succeeded in sparking heavy fighting between the Jordanian army and the various militias of the PLO, but the Jordanian forces quickly gained the upper hand. At that point Syrian armor probed Jordan's northern border, raising the PLO's hope and Hussein's fear that Syria might decisively intervene in favor of the Palestinian forces. Desperate for his regime's survival, Hussein pleaded with the United States to provide military assistance to thwart any Syrian attack, even if that military assistance came from Israel. Nixon and Kissinger saw Syria's move as confirmation that the Soviet Union was behind events; they did not believe Syria would move without at least tacit Soviet approval. With insufficient US forces in the area to repel a full Syrian ground assault, Nixon made plans with Israeli Prime Minister Golda Meir to launch an air and ground assault against Syria. As Israel mobilized its forces, however, Syria withdrew from Jordan, averting the need for an Israeli assault and allowing Hussein to defeat the PLO. Nasser, seeking to avoid the complete destruction of the PLO, pressed Arafat, Hussein, and other Arab leaders to come to Cairo, where he negotiated a ceasefire between Jordan and the PLO on September 27. The following day, after seeing off the last of his guests at the airport, Nasser, age 52, had a fatal heart attack. A shocked Arab world mourned the unexpected death of the battered but still reigning leader of Arab nationalist aspirations.<sup>100</sup>

The 1970 Jordanian Crisis confirmed to Nixon that the best strategy in the Middle East was to support Israel and act tough against the Soviet Union and its Arab allies. Kissinger's calculus on the Middle East conflict now reigned supreme: wait out the Arab left and rely on a militarily superior Israel as the best course for preserving US influence in the MENA. Despite

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<sup>100</sup> Quant, Peace Process, 76-83.

the growing fears of Saudi royals and American oil executives, there would be minimal US movement on the Arab-Israeli peace process for the next three years. The Nixon administration's neglect of the issue increasingly frustrated Arab governments, most critically the Saudi regime, and increased the likelihood that they would work together to challenge the United States' interests, including access to cheap oil.<sup>101</sup>

### **Nixon and the Economy**

But if Nixon was pleased with events in the Middle East in September 1970, he was angered by domestic events in November. Unemployment, which had been at 3.3 percent at the start of Nixon's term, had reached 5 percent by the beginning of 1970 and continued to rise to 6 percent by the end of the year. Nixon had campaigned for Republicans in the midterm election in the hope that they would win the Senate, but the Democrats retained both houses of Congress and picked up seats in the House of Representatives. Nixon blamed the high unemployment rate for the lackluster Republican results, and he blamed the inflation fighting policy of gradualism for the high unemployment rate. Fearing for his reelection prospects in 1972, Nixon overcame his aversion to economic matters, scrapped gradualism, and insisted that his economic policymakers reduce unemployment to below 5 percent before the next national election. In the next two years, Nixon would cut taxes and increase government spending to promote economic growth and higher employment while implementing wage and price controls to inhibit inflation. These measures largely appealed to voters, but the combination of economic growth and wage-price controls artificially masked rising inflation, which would have significant global consequences down the road.<sup>102</sup>

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<sup>101</sup> Quant, *Peace Process*, 83-97.

<sup>102</sup> Matusow, *Nixon's Economy*, 76-181.

The Nixon administration's attention was also pulled toward international economics during 1971. The remnants of the Bretton Woods System continued to falter as the United States failed to defend the value of the dollar to gold and US balance of payments deficits continued to balloon. In 1971 America also incurred its first trade deficit since 1893. The Nixon administration closed the gold window in August 1971, ending the remnants of the Bretton Woods System and ushering in a new era where floating currency exchange rates dominated the international monetary system. At the same time the Nixon administration devalued the dollar and successfully pressured Germany and Japan to appreciate their currencies in an effort to avoid speculative attacks on the dollar and to improve the competitiveness of US exports. Nixon's personal interest in exchange rate matters flickered when they garnered him headlines, but then quickly receded. Like Nixon, Kissinger never mastered the economic details of these policies, but the summitry involved with them increased his awareness of the political element of international economic negotiations, which would be an important lesson he carried with him during the petrodollar era. More broadly, the Nixon administration was increasingly implementing policies to compete with Western Europe and Japan in foreign trade, a trend that would only increase during the petrodollar economy.<sup>103</sup>

The international oil market was rapidly changing as well. The Arab states were unsuccessful in deploying the oil weapon in the 1967 War, but the conflict did close the Suez Canal, making it more expensive to transport oil from the Persian Gulf to Europe. In May 1970 Europe's other lifeline to the Gulf, an oil pipeline running from Saudi Arabia to Lebanon called the Tapline, was destroyed in Syria. Western demand for oil continued to rise but almost all spare capacity now came from the MENA. The countries of the MENA had finally accumulated a large enough share of the oil market, as well as enough technical expertise and political unity,

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<sup>103</sup> Ibid.

to take control of the pricing and production of petroleum. Libya's new leader, Colonel Muammar Gaddafi, was the first to break through the old order. He capitalized upon the fact that Libya was now supplying 30 percent of Europe's oil needs and successfully used production cuts to negotiate from the California based Occidental Petroleum Corporation a 43 cent per barrel price hike for the posted price of oil and an increase in Libya's share of revenues from 50 to 55 percent in September 1970. The Shah capitalized on Gaddafi's moves and the changing market situation by forcing the Consortium to likewise increase Iran's share of revenues from 50 to 55 percent in November. The Seven Sisters then felt compelled to make the same offer to the Arab Gulf states. Libya and Venezuela then made new demands by the start of 1971, demonstrating that the OPEC nations planned to continually leapfrog each other. The Seven Sisters proved unable to maintain the control they had previously enjoyed. With increasing revenues and the ability to control world oil supply, the OPEC nations soon increased not just their revenue shares and the posted price of oil but their ownership of the petroleum companies in their own lands as well. By 1972, Iran and Saudi Arabia had negotiated gradual takeovers of their national oil industries, while Iraq completely nationalized its industry outright over the protests of the Seven Sisters.<sup>104</sup>

By mid-1970 the US government recognized the potential danger of a looming energy crisis in America and its dependence upon Middle Eastern oil, but the Nixon administration was unable to change the course of events, in part because many factors were out of the United States' control. The State Department kept in close contact with the oil companies during negotiations with the governments of the MENA, but neither party knew how to stop the ever

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<sup>104</sup> Yergin, *The Prize*, 545-569.

increasing control of oil being garnered by the MENA states.<sup>105</sup> Nixon signed letters and sent officials to leaders like the Shah insisting that oil prices must be “reasonable” lest they harm relations with the West, but it is unclear if these efforts had any effect, and the price of MENA petroleum rose regardless.<sup>106</sup> Seeing no way to prevent increased revenue sharing with the host governments, the Seven Sisters determined that their only hope for maintaining their profits was to abandon the effort to control pricing and production and instead raise costs for consumers while placing the blame on the MENA states. As Bergsten put it to Kissinger, “the companies have apparently concluded that the Gulf states are going to get what they want, either through negotiations [between the oil companies and the host governments] or unilaterally [by the decrees of the host governments]. The issue thus becomes who gets the blame for the sharp increase in oil prices.... The companies apparently would rather have the Gulf states legislate and thus get the blame, rather than reach a negotiated settlement, even if it were a few cents per barrel cheaper for the consumers.”<sup>107</sup>

Arguably, it would have been easier for the United States to make changes to its own energy policies than to try to control the decisions of other nations, but here Nixon delayed action due to political considerations. In March 1970, shortly after shelving Shultz’s oil import report, Nixon was warned by Chairman of the Council of Economic Advisors Paul McCracken that the United States would face a serious fuel shortage in the next five years if significant action was not taken. Nixon, however, believed that brownouts and heating shortages would be less politically costly to him than any effort on his part to champion new legislation to increase domestic energy production, efficiency, or conservation, so he insisted that no action be pursued

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<sup>105</sup> US Under Secretary of State John N. Irwin II to US Ambassador to Libya Joseph Palmer II, January 6, 1971, folder “Libya Jul 70 - Vol II,” box 739, NSC CFA, NL.

<sup>106</sup> Nixon to the Shah, January 16, 1971, folder “Iran Pahlavi Shahanshah [1969-1974] [2 of 2],” box 755, NSC PC, NL.

<sup>107</sup> Bergsten to Kissinger, February 1, 1971, folder “Oil 1971 [1 of 2],” box 367, NSC SF, NL.

until the 1972 election was over. Facing oil shortages in 1972, Nixon periodically relaxed import quotas, but never enough to keep up with ever increasing consumer demand.<sup>108</sup>

### **An Embryonic Petrodollar Economy**

While rising oil prices were gradually becoming a thorn in the Nixon administration's side, they were also enabling oil-rich US allies in the MENA to purchase more from America. This coincided with the Nixon Doctrine's imperative to reduce the manpower and material costs of American hegemony in the world and shift them to willing allies. On November 7, 1970, Nixon approved National Security Decision Memorandum (NSDM) 92, which reaffirmed Iran and Saudi Arabia as the United States' two key allies in the Persian Gulf and which directed the NSC to "review plans for U.S. technical and educational assistance and cultural exchange in this area [the Persian Gulf] through *private* [emphasis added] as well as public programs consistent with the strategy of promoting orderly development and local responsibility for maintaining stability."<sup>109</sup> By shifting the defense of the Persian Gulf to local allies, the Nixon administration sought to reduce expenses and avoid getting drawn into future conflicts as the United States had in Vietnam. By shifting the development of defenses of local allies to private sources, the Nixon administration likewise hoped to reduce expenses and risks to the United States while maintaining the security of US interests. Increased oil revenues were the funding source that made these two tactics a plausible strategy.

The Nixon administration viewed Iran as its most viable military ally in the region, noting in NSDM 92 that while Iran and Saudi Arabia were both important to maintaining US

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<sup>108</sup> Matusow, *Nixon's Economy*, 245-247.

<sup>109</sup> National Security Decision Memorandum (hereafter NSDM) 96, U.S. Policy Toward the Persian Gulf, November 7, 1970, NL, <http://www.nixonlibrary.gov/virtuallibrary/documents/nationalsecuritystudymemoranda.php> (accessed 01/02/2013).

regional influence, “the preponderance of Iranian power” had to be recognized.<sup>110</sup> Nixon increasingly came to personally see Iran as the key to US strategy in the region. Meeting with Ambassador MacArthur in April 1971, Nixon asked if Iran could fill the vacuum created by the British withdrawal from the Persian Gulf, noting “that the Department of State and some of his staff had suggested that this might be placing too great a burden on Iran.” MacArthur maintained that Iran was economically sound and that while “frequently the Shah tended to inflate his [military] requirements,” the US embassy ensured that he did not overspend. In any case, MacArthur argued that the “U.S. could not fill the vacuum [in the Persian Gulf]. If Iran does not, then it would be filled with radical Arab states, probably supported by the Soviet Union.” Nixon agreed that “Iran was a key country in the area and would serve as a crucial force during the turbulent period facing the area... our relations with the Shah must be carefully nurtured and strengthened.”<sup>111</sup> Nixon’s confidence in Iran’s military capabilities was heightened on November 30, 1971 when, after Britain’s withdrawal, Iran militarily seized three small Gulf islands which were also claimed by the Arab states. While the Arab nations uniformly denounced Iran’s actions, they did not challenge Iran’s military presence. Subsequent events underscored to the Nixon administration the need for a strong US ally in the region. During the December 1971 India-Pakistan War, the US-backed Pakistan suffered a swift and dramatic military defeat at the hands of Soviet-backed India, raising US fears that the Soviets might soon dominate Central Asia and the Indian Ocean. In April 1972 the Soviet Union signed a treaty of friendship with Iraq, further increasing the specter of US interests in the Persian Gulf being imperiled by Arab radicals.<sup>112</sup>

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<sup>110</sup> Ibid.

<sup>111</sup> Memcon, Nixon, MacArthur, and Deputy Assistant to the President for National Security Affairs Alexander M. Haig Jr., April 8, 1971, folder “Iran Vol. III 1 Jan - 31 Aug 71 [1 of 2],” box 602, NSC CFME, NL.

<sup>112</sup> Cooper, *Oil Kings*, 51-59.



US industries were eager to sell arms and infrastructure projects to Iran, and Nixon increasingly looked to Iran to act as a credible extension of American power in the region. The Shah was eager to increase the capabilities of Iran's military and had rapidly increasing revenues to make this happen. When Nixon visited Tehran in May 1972, he told the Shah that he could purchase some of the most advanced non-nuclear weapons devised by the United States, including the F-14 and F-15 fighter jets and laser guided missiles, to aid him in his role as America's guardian of the Persian Gulf. The Shah, who had been pushing on the Nixon administration for more advanced weapons from the start, eagerly agreed. From here on Nixon insisted that "decisions on the acquisition of military equipment should be left primarily to the government of Iran. If the Government of Iran has decided to buy certain equipment, the purchase of US equipment should be encouraged tactfully where appropriate."<sup>113</sup> Nixon desired a strong Iran and good relations with the Shah, but he and others in his administration also recognized the economic benefits of Iran's arms purchases from the United States. Harold H. Saunders noted to Kissinger that "salesmen from England, France, and Italy [are] putting the hard sell on the Iranian armed forces to buy their equipment" while the United States had been "hesitant to push US equipment... [since] there is a point of view in some echelons of our government to the effect that we should prevent Iran from overbuying." But now "the President's policy is to sell Iran what Iran feels it needs and to encourage the purchase of US equipment since that helps our balance of payments."<sup>114</sup> And buy the Shah did. In early 1973 Iran announced that it would be purchasing over \$2 billion in US arms for that year, including

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<sup>113</sup> Kissinger to Rogers and Secretary of Defense Melvin Robert Laird, July 25, 1972, folder "Iran IV 1 Sep 71 - Apr 73 [1 of 3]," box 602, NSC CFME, NL.

<sup>114</sup> Saunders to Kissinger, July 18, 1972, folder "Iran IV 1 Sep 71 - Apr 73 [1 of 3]," box 602, NSC CFME, NL.

McDonnell Douglas F-4 Phantom fighters. The Shah also expressed interest in future purchases of the Grumman F-14 Tomcat fighter and Hughes AIM 54-A Phoenix missile.<sup>115</sup>

While Iran was seen as America's strongest ally in the region, the oil-rich Arab states were also enjoying record profits, and many of them used some of their revenue to purchase US arms. In the first three years of the Nixon administration, the value of arms sale agreements with Saudi Arabia averaged \$28 million; in 1972 it hit \$330 million, and in 1973 rose to \$689 million.<sup>116</sup> In 1971 Nixon approved US weapon sales to Kuwait as a means to counter threats posed by the withdrawal of Britain, Iraqi claims to Kuwait, and unrest among the large Palestinian population in the country. In arguing for the arms sales, the Nixon administration noted that Kuwait's strong balance of payments status meant it could readily afford to make such purchases with little threat to its economy.<sup>117</sup> On August 18, 1972, the NSC implemented NSDM 186, which took the logic of NSDM 92 of promoting private US arms sales to Iran and Saudi Arabia in order to enhance regional security while reducing US burdens, and extended it to the Lower Persian Gulf States and Oman.<sup>118</sup>

The benefits to the United States from increased MENA oil revenues were not reserved to increased arms sales. As Kissinger noted to Nixon in a memo preparing him for his meeting with King Faisal in May 1971, Saudi Arabia was the "wealthiest state in the Arabian Peninsula," and it was hoped the Saudis could be encouraged to "be more active in support of moderate governments in Northern Yemen, Oman, and the Persian Gulf... [and] to continue their financial aid to [Jordan's] King Hussein." Kissinger also noted that the Saudis had been a "constant"

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<sup>115</sup> Juan de Onis, "Roger Terms U.S. Arms Sales to Persian Gulf 'Stabilizing,'" June 12, 1973, *New York Times*; Drew Middleton, "Shah of Iran Due in U.S. to Seek Weapons," July 22, 1973, *New York Times*.

<sup>116</sup> Miglietta, *American Alliance Policy in the Middle East*, 212.

<sup>117</sup> Nixon to Rogers, Presidential Determination No. 71-6, undated, folder "Presidential Determinations Thru 71-10 [Feb 1969 - Mar 1971] [2 of 3]," box 370, NSC SF, NL.

<sup>118</sup> NSDM 186, US Military Supply Policy for the Lower Persian Gulf States and Oman, August 18, 1972, NL, <http://www.nixonlibrary.gov/virtuallibrary/documents/nationalsecuritystudymemoranda.php> (accessed 01/02/2013).

supporter of the dollar, which would be increasingly important as Saudi Arabia's foreign exchanges reserves were expected to rapidly rise as its oil profits increased.<sup>119</sup>

By the end of Nixon's first term, then, many of the elements characterizing the petrodollar economy between the United States and the MENA were taking shape. US allies in the region were using rising oil revenues to purchase increased amounts of US goods and services to develop their militaries and economies. The US government was increasingly relying upon allies in the MENA to both pay for and play the role of defender of US interest in the region. And US military and engineering companies were finding the MENA to be an increasingly important market.

### **Looming Confrontations**

As the petrodollar economy took shape during the first term of the Nixon administration, the Arab-Israeli peace process deteriorated. Egypt's overwhelming defeat in the 1967 War forced Nasser to seek rapprochement with Saudi Arabia, a country he had antagonized for most of his rule. Nasser ended his support for leftist militias in Yemen hostile to the Gulf monarchies, and in return received financial aid from Saudi Arabia to rebuild Egypt's military.<sup>120</sup> When Nasser died in 1970, he was succeeded by Anwar Sadat, who continued Nasser's efforts to improve relations with Saudi Arabia and increasingly came to see improved relations with the United States as essential to regaining the Sinai from Israel. Kissinger had supplanted Rogers as the key figure in Middle East policy, however, and Kissinger continued to see the region's conflicts through the prism of the Cold War. Kissinger's belief that a strong Israel would force the Arab states to view Soviet assistance as unhelpful prevailed in the Nixon administration, and increased

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<sup>119</sup> Kissinger to Nixon, May 26, 1971, folder "Saudi Arabia May 71 King Faisal Visit [1 of 2]," box 937, NSC VIPV, NL.

<sup>120</sup> Miglietta, *American Alliance Policy in the Middle East*, 138.

levels of US arms flowed to the Israelis. Hoping to consolidate his power and to prove his shift toward the United States, Sadat purged his government of many pro-Soviet officials, and in May 1972 he expelled the thousands of Soviet military advisers based in Egypt. Despite his moves, Sadat was told by Nixon and Kissinger that they could not earnestly address the Arab-Israeli peace process until after Nixon was reelected in November.<sup>121</sup>

The year 1972 would prove to be the pinnacle of Nixon's career. The US economy boomed and unemployment dropped to 5.5 percent by the election, in part due to Nixon's expansionist policies. Inflation was momentarily checked by price and wage controls.<sup>122</sup> Nixon boasted major foreign policy achievements in engaging in summits in Beijing and Moscow in 1972, and an end to US involvement in the Vietnam War was within grasp. Nixon's Democratic challenger to the presidency, George McGovern, ran a disastrous campaign that hemorrhaged centrist Democrats into Nixon's new coalition. On election day, November 7, 1972, Nixon won 60 percent of the popular vote and every state in the Electoral College except Massachusetts. In January 1973 the United States signed the Paris Peace Accords, formally ending US military involvement in the Vietnam War.

Yet Nixon's triumph in 1972 also contained the seeds of his political downfall and the several-year-long period of recession and stagflation that would soon befall the United States. Nixon's efforts to cover up the role of his administration in the Watergate burglary began in the summer of 1972, and while the incident was little noticed during the election, by the summer of 1973 it was a major public scandal that increasingly consumed the administration and led to the resignation of some of Nixon's closest advisers. Watergate increasingly distracted Nixon from dealing with the other crises engulfing America. In 1973 inflation exploded in the United States,

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<sup>121</sup> Quandt, *Peace Process*, 86-97.

<sup>122</sup> Matusow, *Nixon's Economy*, 182-213.

more than doubling from its 1972 rate to a 1973 average of 8.4 percent. The inflation was in part fueled by the Nixon administration's overheating of the economy, by the continued depreciation of the value of the dollar, and by a global food production crisis during 1973 that drove up prices. The Nixon administration's price and wage controls had played a significant role in masking inflationary pressures, and while the Nixon administration arguably took the right long-term measure by implementing phased decontrol of prices and wages in August 1973, the short-term effect was to further increase inflation by freeing accumulated production costs. Nixon's refusal to respond to the changing nature of the domestic and world oil market before the election likewise became a critical problem shortly thereafter. Heating oil shortages appeared during the 1972-73 winter, with the shortages exacerbated by price controls that reduced the profitability of increasing domestic oil production even as artificially low prices discouraged conservation.<sup>123</sup>

In 1973 the United States remained the largest single producer of petroleum in the world, but it was no longer a net exporter but rather a net importer of oil. Nor was a large percentage of the United States' oil imports from the Middle East; in 1973, 35 percent of US oil came from foreign imports, but Middle East oil accounted for only 18 percent of this figure.<sup>124</sup> But while US oil imports from the Middle East might have been modest, the nations of the MENA were now the only major source of excess capacity in the global oil market. Combined with their successful efforts to wrest control of production and pricing from the multinational oil companies, the MENA countries increasingly dictated the conditions of the global oil market which the United States was now dependent upon, and the MENA countries were driving oil

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<sup>123</sup> Matusow, *Nixon's Economy*, 219-249.

<sup>124</sup> Matusow, *Nixon's Economy*, 255.

prices up and keeping global supply only a half percent above world demand.<sup>125</sup> Nixon attempted to put pressure upon oil exporters like Iran and Saudi Arabia to moderate prices, but he proved unable to offer any effective carrots or sticks to counter the economic interests of even the closest allies.<sup>126</sup> Domestically, Nixon gave the first presidential speech on energy in April 1973 and ended all quotas on foreign imports of oil, as foreign oil no longer undersold domestic oil and a lack of supply was threatening energy shortages.<sup>127</sup> In September the Nixon administration modified price controls on oil, but these changes still reduced incentives for the exploration of new domestic oil while simultaneously reducing incentives for consumers to conserve. Even with controls, US petroleum prices were rising (albeit at a lower rate than the global average) and contributed to rising inflation, both of which were becoming major sources of concern for American consumers.<sup>128</sup>

As oil revenues continued to rapidly increase for countries in the MENA in 1973, more American business and political leaders began to seriously contemplate the potential consequences of the emerging petrodollar economy. In May, Columbia University Political Science Professor Zbigniew Brzezinski attended the Bilderberg Meeting, an annual invitation-only gathering of North American and Western European business and political leaders, where he “was struck by the enormous concern by those in attendance over the longer range monetary implications of the growing reserves in Arab hands.” Brzezinski was currently busy forming the beginnings of the Trilateral Commission with David Rockefeller, and after the Bilderberg Meeting Brzezinski wrote to economics professor and Yale provost Richard N. Cooper asking for recommendations of a scholar knowledgeable about the matter of growing Arab reserves who

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<sup>125</sup> Yergin, *The Prize*, 568-574.

<sup>126</sup> Cooper, *Oil Kings*, 91-96.

<sup>127</sup> Yergin, *The Prize*, 572.

<sup>128</sup> Matusow, *Nixon's Economy*, 249-255.

could join the Trilateral Commission's Monetary Task Force, arguing the matter "doubtless will become an increasingly important one."<sup>129</sup> When George Shultz, now Secretary of the Treasury, privately consulted a group of top US businessmen and economic scholars to discuss the economic problems facing America, Roy Reiersen of Crocker International Bank argued that the energy crisis would profoundly restructure the international monetary system as the Middle East accumulated billions of dollars, and Gottfried Haberler of the American Enterprise Institute warned that the oil-importing nations might soon engage in trade wars in an attempt to pay for the rising cost of energy.<sup>130</sup> In September the House Foreign Affairs Committee requested testimony from Secretary of Commerce Frederick Dent on the matter of "potential investment of oil producing countries in the United States."<sup>131</sup> Policymakers' interest and concern about the petrodollar economy and the expectations about its scope were gradually growing during the first nine months of 1973.

The rise in petrodollar profits for the MENA coincided with increasing exasperation among the Arabs regarding what they considered American foot-dragging on the Arab-Israeli conflict. While Kissinger did begin secret talks with the Egyptian government in early 1973 about reviving the peace process, Kissinger provided little tangible support for the Arabs and maintained that there was no point in conducting direct talks between Egypt and Israel until after Israel's elections in late October. All the while, US arms continued to be delivered to Israel.<sup>132</sup> Saudi King Faisal was losing patience. While Faisal had privately pressed Nixon for action from

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<sup>129</sup> Brzezinski to Cooper, May 14, 1973, folder 1062 "Monetary Task Force: A) Correspondence," box 95, Trilateral Commission Collection (hereafter TC), Rockefeller Archive Center (hereafter RAC).

<sup>130</sup> "Summary of Views on Longer-Term Economic Problems," September 18, 1973, folder "Departmental Correspondence: Council of Economic Advisors 1973 (2 of 2)," box 47, Executive Secretariat Files, 1966-1975, Record Group 56 General Records of the Dept. of the Treasury (hereafter RG 56), National Archives at College Park, Maryland (hereafter NARA II).

<sup>131</sup> Robert G. Pelikan to Deputy Secretary William E. Simon, September 19, 1973, folder "Memos from Staff: Hennessy 1973 (3 of 3)," box 45, Executive Secretariat Files, 1966-1975, RG 56, NARA II.

<sup>132</sup> Quandt, *Peace Process*, 98-105.

the start of his presidency, Faisal had resisted calls from the other Arab states to publicly raise the threat of the “oil weapon” through 1972. Faisal was in part reluctant to raise the threat of an oil embargo due to the failure of 1967. But the world oil market was rapidly changing in the Arabs’, and particularly Saudi Arabia’s, favor, as the United States had finally become dependent upon (and thus vulnerable to fluctuations in) foreign oil exports, and Saudi Arabia’s share of the global total of oil exports increased rapidly from 13 percent in 1970 to 21 percent in 1973.<sup>133</sup> In 1973 Faisal decided it was both fortuitous and necessary to press the United States harder. In the spring of 1973 Faisal told executive owners of Aramco that if the United States did not soon change its policies toward Israel, “you will lose everything.”<sup>134</sup> The oilmen frantically relayed the threats to the White House, but the Nixon administration discredited the notion that the Saudis would actually risk their relationship with the United States anytime soon. Texaco, Chevron, and Mobil then publicly called for a change in US policy in the Middle East. In the summer Faisal made the rare move of directly interviewing with the American press, including the *Washington Post*, *Christian Science Monitor*, *Newsweek*, and NBC Television, where he warned that Saudi oil exports to and friendship with the United States was conditional on a change in stance toward the Arab-Israeli conflict.<sup>135</sup>

While Saudi Arabia attempted to use its growing dominance in the global oil export market as leverage with the United States, the Saudis also sought to use their new petrodollar wealth as an important bargaining tool. In September 1972 the Saudis proposed a special oil sale arrangement with the United States, similar to the one previously proposed by Iran, where the revenues of increased Saudi oil exports to the United States would be guaranteed to be spent or invested in America. Rogers noted that given world market conditions, there was little to no

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<sup>133</sup> Yergin, *The Prize*, 576-578.

<sup>134</sup> Quote from Yergin, *The Prize*, 578

<sup>135</sup> Yergin, *The Prize*, 578-579.



market incentive for the Saudis to secure sales to the United States when it could easily sell the oil closer to home. Rather, the Saudis appeared to be attempting to increase the United States' financial integration with, and thus dependence upon, Saudi Arabia.<sup>136</sup> Nixon ignored the proposal, but the United States' financial dependence upon Saudi Arabia was growing regardless. When Zaki Yamani and Prince Saud Faisal, Saudi Minister and Deputy Minister of Petroleum, respectively, met with Kissinger in April, they warned that if the United States did not get the Arab-Israeli peace process moving, Saudi Arabia might be forced to wreak havoc on the United States' balance of payments by raising oil prices and refusing US exports. "Other Arabs – even Europeans talking to Saudi Arabians – asked why Saudi Arabia should only talk with the US and only invest its oil revenues in the US," Saud Faisal noted in a veiled threat.<sup>137</sup> Saudi Arabia's growing economic power, which the Nixon administration hoped would make the country a stronger US ally, also meant the Saudis could more substantially threaten US interests in the region. In September Kissinger met with US Ambassador to Lebanon William B. Buffum and discussed the Middle East situation, asking what incentive Israel had to negotiate in the current situation. Militant Arab groups "will have finances if Faisal gives the aid it looks like he will" Buffum answered. "The Commandos will have additional resources to acts of desperation" against both Israel and pro-US Arab governments like Lebanon.<sup>138</sup> Rather than protect American interests, Saudi petrodollars might be used to fund attacks against US allies and further destabilize the region.

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<sup>136</sup> Rogers to Nixon, November 4, 1972, folder "Saudi Arabia King Faisal ibn Abd al-Aziz Al Saud [1972]," box 761, NSC PC, NL.

<sup>137</sup> Memcon, Yamani et al., April 17, 1973, folder "Memcons April-Nov 1973 HAK+Presidential [5 of 5]," box 1027, National Security Council Presidential / HAK Memcons (hereafter NSC PHAK), NL.

<sup>138</sup> Memcon, Kissinger, Buffum, Richard Campbell, September 20, 1973, folder "Memcons April-Nov 1973 HAK+Presidential [3 of 5]," box 1027, NSC PHAK, NL.

Nixon and Kissinger paid far more attention to the Arab-Israeli conflict in 1973, but they did not make much progress. Nixon was increasingly consumed by Watergate. Kissinger conducted secret talks with the Egyptians but did not see a way to bridge the gap between the demands of Egypt and Israel. Kissinger assumed that the Arabs would not attack Israel because the Arabs would then face an even greater military defeat than 1967. Israel shared and reinforced the American belief that the Arabs were not likely to launch an attack. The Arabs, it was believed, were making vocal threats to try to prod an American reaction and for their domestic consumption. A new chance for talks might open once the Israeli elections were over in October, but not before.<sup>139</sup> In the meantime, the United States would try to assuage the concerns of its increasingly wealthy Arab allies in part by selling them more sophisticated weapons. In the spring of 1973 the Nixon administration made available the sale of the F-4 fighter jet to Saudi Arabia and Kuwait, an advanced plane which the United States had previously only made available in the MENA to Iran, Israel, and NATO allies. The Israeli ambassador issued a strongly worded protest to the United States regarding the offer, but the Nixon administration stood firm, believing the sale would shore up the moderate Arab regimes and keep them aligned with America.<sup>140</sup> “I can assure Your Majesty of the constancy of our strong interest in Saudi Arabia’s security and welfare,” Nixon wrote to Faisal at the end of August. “Our recent statement of willingness to sell F-4 Phantom aircraft whenever your air force is ready to receive them is, as Your Majesty knows, only one part of our continuing

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<sup>139</sup> Quandt, *Peace Process*, 98-105.

<sup>140</sup> Saunders to Kissinger, June 1, 1973, folder “Kuwait Vol. 1 Jan 20, 1969 - Jun 30, 1974 [1 of 2],” box 620, NSC CFME, NL.

security programs in Saudi Arabia designed to help modernize and fully equip the Kingdom's armed forces."<sup>141</sup>

### **The 1973 War and the Oil Shock**

The Nixon administration erred in believing it had more time to address the Arab-Israeli conflict before another major crisis erupted. In April 1973, fed up with American delays, Egyptian President Sadat and Syrian President Hafez Assad secretly agreed to launch a joint-assault on Israeli positions on Egyptian and Syrian territory in six months. Sadat did not expect to defeat Israel, but he hoped that a limited war would result in Egypt recovering some of its land and pride while shaking the status quo that left Israel uninterested in negotiations. Sadat knew a war with Israel was a gamble due to its military strength. Sadat also knew, however, that a continued stalemate would leave Egypt's economy on a war-footing it could not afford, impoverishing his country while cultivating popular frustration about Israel's continued occupation of the Sinai, which could lead to the overthrow of his regime. On August 23 Sadat visited Faisal, revealed Egypt and Syria's plan, and secured Faisal's assurance that Saudi Arabia would support the two countries with funding and the use of the oil weapon against those who might support Israel.<sup>142</sup> At midday Middle East time on October 6, the date of Yom Kippur, Egyptian and Syrian forces attacked Israeli positions in the Sinai and Golan Heights.<sup>143</sup>

Sadat and Assad's efforts at secrecy succeeded; Israel and the United States were caught off-guard by the surprise attack, and in the first few days the Arab armies scored impressive victories and pushed back the position of Israeli forces. Kissinger, who had recently been

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<sup>141</sup> Nixon to Faisal, August 31, 1973, folder "Saudi Arabia King Faisal ibn Abd al-Aziz Al Saud [1972]," box 761, NSC PC, NL.

<sup>142</sup> Kirk J. Beattie, *Egypt During the Sadat Years* (New York: Palgrave, 2000), 127-133; Yergin, *The Prize*, 574-580.

<sup>143</sup> Quandt, *Peace Process*, 105.

confirmed as Secretary of State while retaining his job as National Security Advisor, was as surprised as any. Assessing the situation, Kissinger saw tremendous opportunities and dangers arising from the war. Kissinger recognized that Egypt's early military success created a potential opening for long-term peace negotiations, as it upended Israel's belief that it was militarily invulnerable and thus did not need to offer concessions to its Arab neighbors. He hoped to achieve a ceasefire before either side inflicted too much damage to the other and then pursue a step-by-step peace process which would improve relations with Arab allies like Saudi Arabia and perhaps bring Egypt into America's orbit as well. If either side in the conflict came too close to total victory, however, either the United States or the Soviet Union might feel compelled to directly defend its clients from ruin, which would in turn risk a superpower confrontation. Kissinger thus worked frantically to achieve an early ceasefire. On October 12, Golda Meir, her forces still in a precarious position, reluctantly agreed to an-American proposed ceasefire. Sadat, however, rejected the ceasefire offer, instead holding out for Israeli assurances for a lasting peace settlement involving a full Israeli withdrawal from the lands it seized in the 1967 War.<sup>144</sup>

Back in mid-September, OPEC had scheduled a meeting with the oil multinational companies to renegotiate oil prices in Vienna on October 8. Thus when the oil ministers and corporate executives arrived in Austria for the meeting, they were greeted with the news that a new Arab-Israeli War had begun. The members of OPEC were already looking for drastic changes before the conflict, and the war and the potential threat of another Arab oil embargo, this time under far more favorable market circumstances for the oil producers than in 1967, only strengthened OPEC's resolve. The oil companies opened with an offer of increasing the posted price of oil by 15 percent. OPEC countered with a demand of raising the price by 100 percent. The oil company executives were stunned. Such a massive and sudden increase in the price of

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<sup>144</sup> Quandt, *Peace Process*, 104-113.

oil was uncharted territory, certain to have global ramifications. The oil companies conferred with the governments of the United States, Japan, and Western Europe about OPEC's position, requesting their advice. The response was to refuse anything close to OPEC's demands. On October 12 the oil executives asked OPEC for a couple weeks to formulate a new offer. After spending the night unsuccessfully trying to force an offer out of the multinationals, Saudi Minister of Petroleum Yamani coldly told the oil executives that they would hear of his next move over the radio and then adjourned.<sup>145</sup>

Meanwhile, the war in the Middle East continued to rage. The United States was heartened that there had not yet been an oil embargo or any attacks on Americans in the Arab world. But to the Nixon administration's dismay, on October 10 the Soviets began military resupplies to Egypt and Syria. Even more ominously, the Israelis were sending desperate calls for an American military resupply, warning that Israel's survival possibly depended upon it. On October 12 the chairmen of Aramco rushed a letter to Nixon warning that overt US assistance for Israel could provoke an Arab retaliation that would produce a major oil supply crisis and supplant the influence of the United States in the entire Arab world. The fog of war made it unclear as to whether or not Israel was truly in dire need of resupply, but Nixon and Kissinger determined that, despite the risk of alienating the Arabs, they could not take any chance in allowing Soviet arms to bring about the defeat of an American ally. On October 13 the United States began an airlift of arm supplies to Israel via US military planes. In an attempt to not antagonize the Arabs, Kissinger tried to keep the airlift a secret by restricting flights to the cover of nighttime darkness, but weather problems forced the American planes to arrive in Israel in

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<sup>145</sup> Yergin, *The Prize*, 581-584.

broad daylight on October 14. As anticipated, there was an outcry against the United States in the Arab world.<sup>146</sup>

On October 16, Arab and Iranian oil officials, including Yamani, reconvened in Kuwait City and announced that they would unilaterally raise the posted price of their oil by 70 percent. The move caused an immediate and massive increase in the price of petroleum around the world. Furthermore, by declaring the price hike unilaterally, rather than through negotiations with the oil companies, the MENA nations had successfully declared a new era in which they, not the West, had control over their oil resources.<sup>147</sup> The combined result was that the oil-exporting countries of the MENA were to make unprecedented and enormous profits in the coming months and years. The petrodollar economy had begun in earnest.

While coinciding with the 1973 Arab-Israeli War, the price hike by the Arabs and Iran on October 16 was largely independent of the conflict. It can be speculated to what degree the war improved the bargaining position of the oil-producers or stiffened the resolve of the Arabs. But the key factor was the change in the global oil market. By 1973, it was clear that the MENA countries were now the only ones with significant excess oil capacity, while global oil demand had continued to rise. At the same time, the nations of the MENA had secured the control of their oil through either the nationalization or negotiated shared control of their domestic oil industries. In a matter of just a few years, the need for the MENA states to negotiate price or production levels with the multinationals had ceased to exist.<sup>148</sup> The leaders of the oil-exporting countries were jubilant. “This is a moment for which I have been waiting a long time,” Yamani

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<sup>146</sup> Quant, *Peace Process*, 111-115; Yergin, *The Prize*, 585-587.

<sup>147</sup> Yergin, *The Prize*, 587-588.

<sup>148</sup> For a detailed description and argument about the changing oil market and political forces resulting in the October 16 decision, see Ian Skeet, *OPEC: Twenty-Five Years of Prices and Politics* (Cambridge: Cambridge University Press, 1988), 58-91.

told a fellow delegate. “The moment has come. We are masters of our own commodity.”<sup>149</sup> A couple months later the Shah made a public, and more pointed, statement regarding the shift in control over oil from the West to the Middle East during an interview with the *New York Times*. “The industrial world will have to realize that the era of their terrific progress and even more terrific income and wealth based on cheap oil is finished,” he lectured. “If you want to live as well as now, you’ll have to work for it. Even all the children of well-to-do parents who have plenty to eat, have cars, and are running around as terrorists throwing bombs here and there – they will have to work, too.”<sup>150</sup>

While the members of OPEC utilized the export of oil for economic gain, this did not preclude oil’s use as a tool for more overtly political goals. The day after announcing their 70 percent price hike, the Iranian delegation departed Kuwait City while the Arab officials reconvened to discuss the unleashing of the oil weapon in retaliation for the US military resupply of Israel. The Iraqi delegation proposed that the Arabs unite in withdrawing all funds from American banks, nationalizing all American property in the Arab world, and instituting a total oil embargo against the United States. The other Arab participants in the meeting feared such drastic all-out economic warfare against the United States would take them into unpredictable and dangerous territory, however, and rejected the Iraqi proposal, prompting the Iraqis to leave the meeting. The remaining Arab delegates drafted and announced a more moderate embargo. The Arab states would cut oil production by 5 percent from September levels, and continue to cut production by an additional 5 percent each month, until Israel had withdrawn from all Arab territories. Countries deemed to be favoring Israel would receive steeper drops in exports, while countries deemed to be playing a positive role would receive normal export levels. In light of the

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<sup>149</sup> Quote from Yergin, *The Prize*, 588.

<sup>150</sup> Bernard Weinraub, “Oil Price Doubled by Big Producers on Persian Gulf,” *New York Times*, December 24, 1973.

tight world oil market, the plan was particularly effective in applying political pressure and in raising the price of oil, as the production cuts ensured that most of the world had to compete for Arab oil and made it harder for the United States or others to organize a redirection of oil from other sources in order to make up for the loss of Arab exports. The Nixon administration still did not fully appreciate the new political and economic environment. Apparently gambling on continued Arab restraint and hoping to win Israeli gratitude for the expected upcoming peace negotiation, on October 19 the Nixon administration proposed a \$2.2 billion aid package for Israel to Congress. Within the next two days, Abu Dhabi, Algeria, Bahrain, Dubai, Kuwait, Libya, Qatar, and most notably Saudi Arabia imposed a complete oil embargo against the United States.<sup>151</sup>

On October 20, the same day that Faisal angrily declared Saudi Arabia's embargo against the United States, Kissinger flew to Moscow in the hopes of negotiating a ceasefire with the Soviet Union that the two superpowers could then impose upon their clients. Shortly after Kissinger landed, he learned that Nixon had fired the special prosecutor who had subpoenaed for White House tapes in order to investigate the president's role in Watergate, in turn prompting the resignations of the Attorney General and his chief deputy. The press dubbed it the "Saturday Night Massacre," and it would prove to be a critical point in making credible the calls for Nixon's impeachment.

Kissinger pressed forward with the business at hand, and quickly obtained the Soviets' agreement to impose a ceasefire in place. By now Egypt and Syria's early military gains had been reversed by the Israelis, and the Egyptian army faced the prospect of collapse. The Soviets did not want to see their clients humiliated. Kissinger pledged to impress upon Israel to accept an immediate ceasefire. A ceasefire was implemented on October 22, but the following day it

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<sup>151</sup> Yergin, *The Prize*, 588-591; Cooper, *Oil Kings*, 122-124.



broke down and the Israelis resumed their assault on the trapped Egyptian Third Army. The Soviets were furious. That evening Kissinger received a message from Soviet General Secretary Leonid Brezhnev stating that if Israel did not immediately abide by the ceasefire, the Soviet Union would publicly call for a joint American-Soviet force to intervene in the conflict, and that if the United States declined, the Soviets would not rule out acting unilaterally. Kissinger decided to hold an emergency meeting of top presidential advisers without Nixon, as he was emotionally spent from battling Watergate charges and purportedly drunk and/or passed out in a drug induced stupor. In Nixon's name, Kissinger replied back to the Soviets expressing strong American opposition to Soviet military action in the Middle East, and Kissinger ordered the US military to raise its nuclear threat level to DEFCON 3, the highest level of US nuclear alert in normal peacetime conditions, in order to make clear the seriousness of American determination. The superpowers had entered their most serious nuclear standoff since the Cuban Missile Crisis. Fortunately, a lasting ceasefire between Egypt and Israel took hold the next day, and the superpower crisis, along with the 1973 Arab-Israeli War, came to an end.<sup>152</sup>

Yet while the 1973 War was concluded, the petrodollar economy had just begun. Before the October 8 meeting in Vienna, the average price of Persian Gulf crude oil had been \$3.00 per barrel. The 70 percent price hike announced in Kuwait City on October 16 had raised the price to \$5.10. By mid-December, the average price of a barrel of Persian Gulf crude had reached \$11.65; in less than three months, the price had nearly quadrupled.<sup>153</sup> The Nixon administration convinced most of the Arab states to lift the oil embargo against the United States within a matter of months, but it would be many years before the relative oil revenues of the MENA would decline back to anywhere close to where they had been before 1973. The oil-exporting

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<sup>152</sup> Dallek, *Nixon and Kissinger*, 525-533; Cooper, *Oil Kings*, 123-126.

<sup>153</sup> Little, *American Orientalism*, 70.

countries of the MENA had become centers of financial power which the government, corporations, and financial institutions of the United States could not ignore.

In the decades before the 1970s, the MENA was peripheral to the economy of the United States outside of providing cheap oil to facilitate world trade. During this period, Iran and the Arabian states struggled to end formal and informal colonialism and develop their economies. For the oil-rich countries of the MENA, obtaining control over their oil resources figured prominently in both of these goals. As the MENA's share of the world's readily available oil increased and local countries developed their political strength and technical expertise, they were able to wrest control of pricing and production away from the Western oil companies during the early 1970s. Having achieved this, the oil-exporting nations of the MENA earned rapidly increasing revenues, and by the end of 1973 it was clear that these countries were important new markets and centers of financial power. The MENA had entered into a booming petrodollar economy that would profoundly reshape the economic, political, and cultural relations between the MENA and the United States. Even before the skyrocketing prices of 1973, some American corporations and banks had realized the potential of the emerging MENA markets and had worked to develop networks with Arab and Iranian partners. At the same time, government leaders in the MENA and the United States had begun to contemplate how rising petrodollar revenues for the oil-exporting countries could be used to either strengthen political alliances between the two or could be used against American interests. With the rise in oil revenues for the MENA during 1973 and for many years thereafter, all of these considerations became magnified, and the petrodollar economy became central to American, Arab, and Iranian foreign relations.

## CHAPTER TWO

### Structuring Petrodollar Flows

#### The Final Frontier

On November 5, 1974, as massive balance of payments surpluses were being accumulated by the oil-exporting countries, White House Chief of Staff Donald Rumsfeld sent a memo to Deputy Assistant to the President for National Security Affairs Brent Scowcroft. Rumsfeld began the memo by arguing that “financial, nuclear, and space capabilities represent a unique triad of symbols of power in today’s world.” While the United States’ nuclear and space capabilities remained powerful, “America’s financial preeminence has dwindled, as reflected in the decline of the dollar... the financial power of the future is clearly the Arab Nations.” The newfound petrodollar wealth of the Arabs meant that they could likely “buy either a nuclear or space capability if they wanted it, from any of several suppliers.” Following this line of reasoning, Rumsfeld proposed:

that these inevitable developments be preempted by having the U.S. offer the Arabs an immediate space capability that will make them virtually the equals of the U.S. and U.S.S.R. in this field within a decade. Specifically, we propose a project by a consortium of Arab nations, with full American cooperation, to develop, manufacture, and operate a retrievable orbital vehicle, comparable to the ‘Shuttle’. The research and development would be purchased by the Arabs, mostly from U.S. contractors, with some R&D contributed by NASA. The vehicles and fuels would be manufactured in the Arab countries, with technical help from the U.S. A special launch complex would be constructed in Arab territory... Manned vehicles would be jointly manned by American and Arab astronauts.

Rumsfeld estimated that such a project would cost four to six billion dollars for research and development, three to four billion dollars for construction of manufacturing and launch facilities, and one billion dollars annually for facility operations and space launches. Funding would

largely come from the sparsely populated oil-rich Arab states, while the labor force would largely be drawn from more populous Arab states, both oil-rich and oil-poor. While Rumsfeld admitted the endeavor would be expensive, he maintained that the costs would not be prohibitive for the Arabs due to the projections of Arab balance of payments surpluses totaling at least \$50 billion in 1974 alone, money that Rumsfeld claimed “the Arabs are now frantically seeking some use.”<sup>154</sup>

Rumsfeld argued that a space program would appeal to Arab leaders as a means toward modernization. “While the Arabs do not wish to become Americanized or Europeanized or Christianized,” Rumsfeld stated, “they do wish to become modernized – to have the intellectual as well as physical advantages of the modern western world.” The space program would bring new industries and the education of “technicians, scientists, engineers, managers” to the Arab world, inculcating modern industrial, economic, social, and political systems. In short order, the Arab countries would “undertake their own technology developments” alongside advanced nations like “Japan, the Germanies, and the U.S. and U.S.S.R.” Rumsfeld also argued that a space program offered a more positive alternative to the stalemated struggle against Israel for generating national and pan-Arab pride. “The common people – the fellahin – are anxious to start another war, but that must be the last thing that rational Arab leaders want,” Rumsfeld contended. “From their point of view, diversion of interest from Israel would in itself make the space effort promising.” Above all, Rumsfeld insisted, Arab leaders wanted “‘honor’ which translates into prestige.” “Remember how proud the Egyptians were when they broke even in the Yom Kippur war?” Rumsfeld asked rhetorically. “How much more proud they would be to

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<sup>154</sup> White House Chief of Staff Donald Rumsfeld to Deputy Assistant to the President for National Security Affairs Brent Scowcroft, November 5, 1974, folder “‘Cheney/Rumsfeldgrams’ (1),” box 3, National Security Adviser Kissinger-Scowcroft West Wing Office Files, 1969-1977 (hereafter NSA KSWW), Gerald R. Ford Presidential Library (hereafter FL).

be world leaders in space. How much more pleasant for our sheikh to fete a returning Arab astronaut rather than a returning Arab terrorist.”<sup>155</sup>

For Rumsfeld, the primary benefit for the United States of a joint American-Arab space program would be stronger ties with a more stable Arab world. “We must not consider the Arab world as our enemies in the long term,” Rumsfeld insisted. “The U.S. must live in a world in which the Arabs not only control petroleum which the U.S. needs for survival, but are among the world’s major powers who [sic] must be dealt with on any subject. It is essential that we be friendly with the Arabs, and this will only be possible if we give them something they want and which they cannot easily obtain elsewhere.” A joint space program would establish the United States as a valuable partner to Arab development, serve as leverage for obtaining Arab cooperation on issues like oil prices, and shift energy away from the disruptive Arab-Israeli conflict. Rumsfeld further argued that the modernization of Arab societies would reduce radicalism in the area, stating that “the mullah or mufti would be harder pressed to sway an electronic technician than a camel herder toward some reactionary political position.” Rumsfeld also noted the potential benefits to the US economy, arguing that most contracts for the project would be awarded to American firms and that Arab spending could be used to subsidize the expense of the US space shuttle program. Rumsfeld concluded his pitch by invoking the Cold War, noting that the only other country that could offer comparable space technology to the Arab countries was the USSR. “If the Arabs were going to develop a space mission in cooperation with either the U.S. or the U.S.S.R.,” Rumsfeld asked, “which would we rather it be?”<sup>156</sup>

It does not appear that the Ford administration ever seriously considered pursuing Rumsfeld’s proposed scheme. In some ways, it was one of the more outlandish American ideas

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<sup>155</sup> Ibid.

<sup>156</sup> Ibid.

on how to recycle Arab petrodollars. But in many ways, Rumsfeld's proposal was quite typical of the thinking of the Nixon and Ford administrations regarding Arab and Iranian petroleum profits. These two administrations sought to increase the economic and political interdependence of the oil-exporting MENA countries and the United States in the expectation that this would strengthen relations between the two regions. The two administrations also sought maximal influence over how MENA petrodollars were used. They believed petrodollars could fund projects that would serve US goals in the Cold War and even assist the Arab-Israeli peace process. They believed that modernization programs funded by petrodollars could positively alter the economic and cultural makeup of MENA societies in both the oil-rich and oil-poor countries. And they expected that a large amount of MENA petrodollars would return to the United States in the process.

Above all, Rumsfeld's memo evinces the widespread fascination with petrodollars and the common belief that MENA petrodollars would reshape the world. Many American leaders believed that how the Arabs and Iranians expended their petrodollars would have momentous ramifications for global economic and political structures. For this reason, they felt they had to do everything in their power to ensure that the bulk of Arab and Iranian petrodollars were used in ways that benefitted the United States. Americans were not unified over what constituted the best course of action, however, nor were they the only ones with ideas about how petrodollars should be used. Not least of these were the peoples of the Arab nations and Iran, as well as the leadership of virtually every other nation, the councils of international organizations, and the executives of international corporations. This chapter examines the various goals of the key actors in the petrodollar economy and outlines how systems of recycling petrodollars developed in the first few years after the 1973 oil shock.

At the outset, it is important to note that the surge of petrodollars flowing to the oil-exporting countries of the MENA posed a policy dilemma for the United States because it constituted a very large and sudden shift in the international monetary system and in the balance of global economic power. Furthermore, this shift had occurred in a region where the United States' position appeared tenuous. The Arab oil embargo and the OPEC oil price hikes had shaken America's confidence and seriously strained the US relations with key allies in the MENA. If the United States could repair and expand its relationship with the MENA countries, petrodollars could be channeled toward American political and economic goals. If the United States failed to do this, however, petrodollars would likely be used to challenge American influence in the MENA and the world.

Even if the United States secured support from key MENA countries, there was widespread fear that petrodollars would still cause significant damage to the global economy. The concern was that the oil-exporting countries would accumulate increasingly large monetary surpluses while the rest of the world accumulated corresponding deficits. The oil-exporting countries, particularly the sparsely populated Arab kingdoms of the Gulf, might not be able to spend or invest their petrodollars at a pace that kept up with their revenues. As money piled up in the oil-exporting countries, an increasing number of countries in the rest of the world would lose access to revenue and credit at the same time that they needed to pay more for oil imports, generating a global depression. At that point, both the United States' economy and its network of Cold War foreign alliances could face unknowable dangers. Fears were compounded by the fact that no one really knew how large OPEC monetary surpluses would grow. During the summer of 1974, a World Bank report commonly cited in the press predicted the accumulated reserves of the OPEC countries could reach \$1.2 trillion by 1985, a sum roughly equivalent to

the GDP of the United States in 1973.<sup>157</sup> The United States had been caught off guard by OPEC's oil shock; it did not want to underestimate the OPEC countries again. In sum, the United States was seeking a solution to one of the greatest threats to the post-war, American-led international economic order. The response that the US government adopted consisted of three interlinked strategies.

First, the Nixon and Ford administrations sought to reduce both the price of oil and the petrodollar surpluses of the MENA oil-exporting countries in order to establish global economic conditions favorable to perceived American interests. While MENA petrodollar surpluses existed, however, the United States attempted to use them toward its own ends. The two administrations sought to direct MENA petrodollars toward purchases of US government debt, long-term investment in the US private sector, purchases of US exports for military and economic development, and grants of aid to oil-poor LDCs (particularly those that aligned themselves with the United States). The Nixon and Ford administrations had only modest success in reducing the global price of oil; in dealing with the two largest oil exporters, Saudi Arabia and Iran, the United States obtained limited cooperation with the former and little assistance from the latter. The Nixon and Ford administrations were far more successful, however, in gradually reducing the oil-exporting countries' surplus and in steering petrodollars toward American projects and institutions.<sup>158</sup>

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<sup>157</sup> Terry Robards, "Spending the Oil Money: Producing Nations Have an Embarrassment of Petrodollars," *New York Times*, August 4, 1974, 154.

<sup>158</sup> Scholars have been divided over the Nixon and Ford administrations' policies on oil prices and petrodollars. Some scholars have argue that at least some powerful elements of the US government desired oil prices to remain high so that there would be ample petrodollars to direct toward projects like enhancing the power of Wall Street finance or the arming of regional allies in the MENA. See Gowan, *The Global Gamble* and Nitzan, *The Global Political Economy of Israel*. Other scholars believe the US government was largely unified in its desire for lower oil prices, but sought to manage petrodollar recycling toward desired ends (such as increasing investment in the United States and arming regional allies in the MENA) while simultaneously working to bring down the price of oil. For examples, see Kunz, *Butter and Guns* and Spiro, *The Hidden Hand of American Hegemony*. My findings tend to support the scholarship of the latter.



Second, a significant but rarely appreciated strategy of the Nixon and Ford administrations was to use MENA petrodollars to make the countries of the MENA economically and politically interdependent with the United States. The 1973 War, the Arab oil embargo, and the OPEC price hike had all suddenly and dramatically demonstrated the importance of the MENA to US interests and the growing power of the countries in the region. In many ways, these events demonstrated that the economic and geopolitical well-being of the United States was at least partly dependent on the decisions of MENA leaders. The United States, as part of a deliberate strategy, strove to draw MENA petrodollars into American banks, investments, and military and development programs to ensure that if the MENA countries attempted to harm the American economy, they would severely harm their own economic interests.<sup>159</sup>

Third, the Nixon and Ford administrations opposed increasing aid from either the United States or multinational organizations like the IMF and World Bank to oil-poor LDCs to assist them in dealing with higher oil prices. Scholars have argued the US government resisted an increase in bilateral or multilateral aid for a variety of reasons: there was wide-spread disenchantment within the US government about the effectiveness of economic aid; Treasury believed it was competing with organizations like the IMF to obtain petrodollar investments for both the government and the private sector; US officials feared governmental loans might not be repaid; US officials embracing neoliberal economics believed private banks would do a better job allocating petrodollars than public institutions; and US officials feared financing oil deficits would help maintain high oil prices. While all of these concerns likely played a role in the

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<sup>159</sup> Many works have recognized the economic and military benefits the United States stood to accrue from MENA countries using their petrodollars in particular ways, whether it be investing funds in the United States or purchasing US arms. For example, see Cohen, *In Whose Interest?* and Miglietta, *American Alliance Policy in the Middle East*. The argument that the United States sought greater independence with an oil-producing country is presented in Bronson, *Thicker Than Oil*, but only regarding Saudi Arabia.

policies of the Nixon and Ford administrations, they also omit one of their key rationales. The Nixon and Ford administrations believed that if the United States and other more developed countries did not increase aid to oil-poor LDCs, the resultant deterioration of conditions in the oil-poor LDCs due to high oil prices would force the oil-rich countries to either lower the price of oil or provide aid to oil-poor LDCs themselves. By pitting the oil-rich and oil-poor countries against each other, the United States could better preserve its political and economic hegemony, extracting either lower oil prices or a decrease in its aid commitments.<sup>160</sup>

### **Outlook of the MENA Countries**

All of the governments of the oil exporting countries in the MENA had an interest in engaging with the United States on the use of their petrodollars, as the United States could offer a variety of valuable goods and services, including advanced industrial and military technology, large and varied opportunities for financial investment, and geopolitical favors that only a superpower could bestow. All of those governments, however, had particular reservations as well.

The Pahlavi regime demonstrated the greatest enthusiasm for economic collaboration with the United States immediately after the oil shock. The Shah dreamed of establishing Iran as a major world power, and he believed that the dramatic rise in oil prices made this a near-term possibility. Speaking to US Ambassador Richard Helms in December 1973 about the need for a new oil pricing system that disciplined the industrial nations, the Shah noted that he expected “Iran will soon be one of these industrial nations” and that in ten years “it will be equivalent to

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<sup>160</sup> See Catherine Gwin, “U.S. Relations with the World Bank, 1945-1992,” in Devesh Kapur, John P. Lewis, and Richard Webb, eds., *The World Bank: Its First Half Century* (Washington, D.C.: Brookings Institution Press, 1997), 213-218; James, *International Monetary Cooperation Since Bretton Woods*, 316-322; Spiro, *The Hidden Hand of American Hegemony*.

Britain or France.”<sup>161</sup> The Shah continued to prefer to industrialize his country and expand his military by purchasing US products and hiring American services, which he generally considered to be superior to all others. The Shah expressed particular interest to US officials about undertaking co-production of advanced military weapons and constructing nuclear power plants as an alternative form of domestic energy.<sup>162</sup> The main point of contention between Iran and the United States regarded oil prices. The Shah adamantly pursued ever higher oil prices to increase the revenues needed to pursue his ambitious plans, and he attacked any efforts to curb his petrodollar profits as an assault on Iran’s national security and the stability of the region.<sup>163</sup>

The oil-wealthy kingdoms of the Arabian Peninsula, Saudi Arabia, Kuwait, the United Arab Emirates (UAE), and to a lesser extent Qatar likewise desired to channel many of their petrodollars back to the United States. The leadership of these countries desired access to advanced American technology to assist their efforts to rapidly industrialize and diversify their economies. When Kissinger visited Saudi Arabia in December 1973, for example, Saudi officials requested that a Saudi mission be admitted to the United States to explore the possibility of obtaining American technology in sectors like agriculture that was currently unavailable on the private market, despite the fact that Saudi Arabia was still at the time leading the oil boycott against the United States.<sup>164</sup> Unlike Iran, however, the Arab Gulf kingdoms were sparsely populated and the bulk of their oil revenues could not be immediately spent on products and

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<sup>161</sup> Ambassador Richard Helms to Kissinger, December 21, 1973, folder “Iran Vol. V May – December 1973,” box 602, NSC CFME, NL.

<sup>162</sup> Under Secretary of State for Political Affairs Joseph J. Sisco to Secretary of the Treasury William E. Simon, April 8, 1974, folder “FEO – International ’74 GLP,” box 4, Records of Executive Assistant to the Deputy Secretary Gerald R. Parsky, 1973 – 1974, RG 56, NARA II; Helms to Kissinger, September 10, 1974, folder “Iran - State Dept. Telegrams For SECSTATE-EXDIS (1),” box 14, Presidential Country Files for Middle East and South Asia (hereafter PCF MESA), FL.

<sup>163</sup> For a detailed account of the Shah’s struggle to maintain high oil prices, often in conflict with the United States, see Cooper, *The Oil Kings*.

<sup>164</sup> Memorandum of Conversation, Minister for Economic Planning in Saudi Arabia Hisham Nazir, Kissinger, et al., December 15, 1973, folder “Memcons December 1973 HAK+Presidential [1 of 2],” box 1027, NSC PHAK, NL.

services. The Arab kingdoms therefore sought, even before the Arab oil embargo ended, to invest much of this money in US portfolios and dollar denominated savings. In February 1974 the American consul in Zurich, after talking with “a rather large sample of the banking community,” reported to the State Department that “the amount of Arab money handled in various ways by Swiss banks is enormous” and that liquidity, currency stability, and safe investments with high returns were all prominent criteria for Arab investors. Along with the mark and yen, bankers reported that “dollar investments are favored by Arab customers because of their general belief in the relative strength and stability of the United States, the American economy, and the dollar.” US Treasury Bills were particularly popular.<sup>165</sup>

Escalating tensions regarding US policy toward Israel, however, threatened the Arab kingdoms’ preference to increase their economic and political ties with the United States. Arab fears that relations might worsen hindered their investment in America; bankers privately reported to the US government that the Arabs sought to “camouflage” their investments in the United States so as to make them untraceable to Arab sources as a precaution.<sup>166</sup> If sufficiently angered or frightened, it was conceivable that the Arabs would pull out of American financial institutions entirely, both domestically and in the Euromarkets.<sup>167</sup> When Yamani visited the United States in December 1973, he told Secretary of the Treasury George Shultz and Deputy Secretary Bill Simon that the Arab oil producers were “anxious to find some justification for removing the [oil] embargo” and to collaborate with the United States on issues like ensuring the stability of the international monetary system in dealing with the massive projected Arab monetary surpluses, but that the United States needed to take action that demonstrated a change

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<sup>165</sup> American Consul in Zurich to Department of State, February 7, 1974, folder “Investment in the US by Oil Producing Nations (5),” box 113, National Security Council Institutional Files (hereafter NSC IF), FL.

<sup>166</sup> Ibid.

<sup>167</sup> This fear periodically emerged in the press. One example is Clyde H. Farnsworth, “Arabs Cut Funds At Banks of U.S.,” *New York Times*, December 7, 1973, 1.

in policy toward the Arab-Israeli conflict. It was up to the United States, Yamani warned, to uncover what would change Arab opinion and thus help save the Saudis “from this painful dilemma” that undercut “the traditional Saudi friendship for, and mutual interests with, the U.S.”<sup>168</sup>

Algeria, Iraq, and Libya were the three Arab oil-exporting countries with the worst relations with the United States in 1973. Algeria and Iraq lacked formal diplomatic relations with the United States since they severed them in response to American support for Israel in the 1967 War, and while Libya retained diplomatic ties with the United States, relations were mutually cold. Aside from the issue of US-Israeli relations, Algeria resented American aid to its geopolitical rival Morocco; Iraq and Libya were at odds with the United States over the issue of nationalization of Western oil companies; and Iraq was outraged by American material support for its geopolitical rival Iran and Kurdish rebels within Iraq’s borders. Yet despite these grievances, all three of these countries also considered the possibility of closer collaboration with the United States. In April 1974, Algerian President Houari Boumediene told Kissinger “we have some far-reaching projects [that] we would like to depend on U.S. cooperation – like refineries, fertilizer plants, factories for producing electronic components... iron and steel plants... these are very important projects, to which the United States could contribute to a great extent.”<sup>169</sup> Libya desired access to weapons deliveries frozen by the United States when King Idris was overthrown, particularly the Lockheed C-130 military transport plane, and Libya made initial overtures for improving relations with the United States in early 1974, quite possibly in

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<sup>168</sup> Memorandum of Conversation, Yamani, Shultz, et al., December 10, 1973, folder “Dec 73 Vol 1 Action-Briefing Memos & Memcons,” box 1, Office Assistant Secretary for International Affairs AB Memos 1973-75, RG56 GR DoT, NARA2.

<sup>169</sup> Memorandum of Conversation, Boumediene, Kissinger, et al., April 30, 1974, folder Memcons HAK+Presidential March 1-May 8, 1974 [1 of 4], box 1028, NSC PHAK, NL.

the hope of securing these arms.<sup>170</sup> Iraq, after completing its nationalization of the previously Western controlled Iraqi oil industry, sought political rapprochement with the West as early as March 1973 and began to shift its contracting of new development projects from the Soviet Bloc to Western corporations. The majority of contracts were awarded to European firms, but the US Interest Section in Baghdad noted in the summer of 1974 that “US firms have obtained [a] significant share of [the Iraqi] market. American firms re-equipping and providing training for Iraqi airways at [a] cost that may exceed 300 million dollars... U.S. firms Brown and Root, Bechtel, Standard Dredging and H C Price are playing key roles in development of new terminal and pipeline facilities in [the] Basra area and US businessmen continue to find [a] warm, albeit non-public, welcome in Baghdad.”<sup>171</sup>

The thirteen sovereign oil-poor Arab countries constituted a diverse group of societies and governments, but they shared many common aspirations and concerns regarding the new petrodollar regime. The sudden and dramatic rise in the cost of oil raised the cost of living, negatively affected the balance of trade, and reduced hard currency reserves. These countries faced the prospect that high oil prices would force the curtailment of development plans or even the decrease the current standard of living. But the oil-poor countries of the less-developed world also had reason for optimism. The success of the OPEC countries in securing control over the production and pricing of oil in opposition to Western interests, while at the same time generating enormous increases in profits, raised a renewed hope in other less-developed nations that they could do the same with their raw material exports, ushering in a new era of economic equality between the more-developed and less-developed worlds. Most less-developed countries

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<sup>170</sup> US Chargé d’Affairs Harold G. Josif to Kissinger, November 19, 1973, folder “Libya July 1970 - Vol II,” box 739, NSC CFA, NL; US Chargé d’Affairs Robert A. Stein to Kissinger, March 5, 1974, folder “Libya July 1970 - Vol II,” box 739, NSC CFA, NL.

<sup>171</sup> US diplomat Arthur L. Lowrie to Kissinger, August 2, 1974, folder “Iraq,” box 603, NSC CFME, NL.

also hoped for increased foreign assistance to deal with rising energy costs, whether from the United States, the Soviet Union, international organizations like the International Monetary Fund (IMF) and the World Bank, the OPEC countries, or a combination of these four. The oil-importing Arabs in particular had reason to be optimistic. Apart from economic considerations, many Arabs in oil-importing countries felt vindicated as they watched fellow Arabs seize control of their oil from foreigners and successfully use oil to put pressure on America for assisting Israel. Newspapers in oil-importing Arab countries celebrated the triumph of the “oil-weapon” as much or even more than the newspapers of the nations of OPEC. Arabs in oil-poor and oil-rich countries alike felt renewed hope that oil considerations could lead the United States to pressure Israel to provide concessions toward the resolution of the Arab-Israeli conflict. Arabs in oil-importing countries likewise anticipated that they would garner larger than average amounts of aid, investment, and remittances from the oil-exporting Arab countries due to their common political, linguistic, and social ties. The Egyptians, Syrians, and Palestinians, who bore the brunt of combat with Israel, expected additional compensation from their more distant and wealthy Arab allies. Sadat in particular hoped to parlay Egypt’s status as the most formidable military threat to Israel in the region as a means of acquiring both Arab and American aid as he pursued economic development and a Middle East peace plan.

For Israel, the global energy crisis and the rapidly rising petrodollar wealth of the oil-exporting Arab states constituted a dual threat. First, rising oil prices added further woes to the Israeli economy, increasing the rate of already rampant inflation and compounding the expense of military rearmament after the costly 1973 War. At the same time, the oil-rich Arab states could be expected to use petrodollars to rebuild the armies of Egypt and Syria, fund the Palestinian resistance, and obtain increased global influence. Israel thus hoped to acquire as

much economic assistance as it could from the United States and international institutions, and it generally sought to divide the United States from the Arab nations where possible.

### **Vantage Points Outside of the MENA**

Western Europe and Japan were other important players in the emerging petrodollar economy. They constituted an important alternative to the United States as a source for technologically advanced exports and as a location for investment for the oil-rich MENA countries. They were potentially powerful voices for the shaping of any internationally agreed mechanism for petrodollar recycling. In theory, Western Europe and Japan, in conjunction with the United States, could also form a coalition of industrialized nations that could take counter measures against the price hikes of the oil-exporting nations, including a retaliatory boycott. Such a uniform front did not materialize, however, as each nation quickly sought to secure access to oil and outlets for exports to pay for the higher energy bills.<sup>172</sup> The leaders of the MENA quickly grasped the divisions among the Western countries and pushed them to their advantage. A US official reported that Yamani warned two US Congressmen visiting Saudi Arabia, just weeks after the start of the oil embargo, that “any effort by the United States to boycott machinery exports to Saudi Arabia would fail. The Japanese were eager to sell machinery to Saudi Arabia. The Saudis prefer to continue to purchase machinery from the United States, but they would purchase from the Japanese if they had to.” Earlier, another Saudi minister made a similar argument regarding food exports, stating “that a U.S. boycott of wheat and other food exports

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<sup>172</sup> One of the primary reasons why Western Europe and Japan were so eager to secure deals with the oil-producing countries of the MENA was because they relied upon them for the majority of their energy needs and had no viable short-term alternatives short of entering into an economic depression. The United States, while a net importer of oil by 1973, still had vast reserves and local production that could offset the worst effects of the Arab oil embargo. For an analytical overview of the relationship between the United States, Japan, and Western Europe regarding petrodollar recycling, see Spiro, *The Hidden Hand of Hegemony*, particular chapters 2-4.



would also fail. There are other countries willing to supply wheat to Saudi Arabia... given the Saudis' foreign exchange position and low level of demand, they could out-compete other countries for their food import requirements."<sup>173</sup>

The Soviet Union likewise vied with the United States to provide economic and military supplies and services to the MENA. Unlike Western Europe and Japan, however, the Soviet Union acted not only as an economic competitor but as a Cold War superpower rival seeking to deny and reverse American political influence in the region. By the time of the 1973 oil shock, the Soviet Union had well-established military ties with two of the Arab oil-exporting countries, Algeria and Iraq, having provided in terms of monetary value over 90 and 80 percent of those nations' foreign arms acquisitions in the decade before 1973 respectively. After the overthrow of King Idris by Gadhafi in 1969, Libya also obtained a large portion of its weapons from the Soviets. Some oil-poor Arab nations likewise relied heavily upon Soviets arms, including the large armies of Egypt and Syria, both of which acquired over 90 percent of their foreign weapons from the Soviets during the period from 1961 to 1975. The far smaller foreign arms markets of Mauritania, Somalia, and South Yemen also predominantly derived from the Soviet Union in the early 1970s.<sup>174</sup> The Soviet Union desired to draw an increasing number of MENA states and petrodollars into its orbit, both to expand its geopolitical influence and to bring needed revenue and hard currency into the Soviet economy. Indeed, the oil price rise orchestrated by OPEC provided a double opportunity for the Soviet Union to improve its economic standing, both by

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<sup>173</sup> US Special Assistant to the Deputy Secretary for Energy and Natural Resources William A. Johnson, "Trip Report to the Middle East," November 12, 1973, folder "Oil – Nov. & Dec. 1973 GLP," box 1, Office of the Deputy Secretary of the Treasury Records of Executive Assistant to the Deputy Secretary Gerald L. Parsky, 1973 – 1974, RG56 GR DoT, NARA2.

<sup>174</sup> Michael Brzoska and Thomas Ohlson, *Arms Transfers to the Third World, 1971-85* (Oxford: Oxford University, 1987), 339-350.

increasing the potential market capacity for Soviet arms sales and by increasing the value of the Soviet Union's growing trade in oil exports.<sup>175</sup>

The two major international organizations dedicated to the global economy, the IMF and the World Bank, also sought a role in managing petrodollar flows. The role of the IMF and the future stability of the international monetary system had already been put into question by the global shift toward floating exchange rates spurred by Nixon's decision to end the convertibility of the dollar to gold in 1971. Johannes Witteveen, a former Dutch politician who had taken the position of IMF Managing Director in September 1973, believed that the IMF needed to create a new program designed to ensure an orderly recycling of petrodollars in order to avoid an international monetary crisis.<sup>176</sup> Privately, he strived to ensure that any such new program would be primarily geared toward benefitting the oil-importing LDCs.<sup>177</sup> Former US Secretary of Defense and current President of the World Bank Robert McNamara held similar concerns about the dangers the oil price rises posed for the oil-poor LDCs. Upon becoming the President of the World Bank in 1968, McNamara had worked vigorously to defend the autonomy of the organization and to significantly expand aid to the less-developed world.<sup>178</sup> In January 1974, McNamara privately told his senior staff that "he still had not heard anyone suggest how the problems of large non-oil-producing developing countries would be solved in 1974 when they

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<sup>175</sup> Observers at the time noted that the Soviet Union was increasingly looking to support its economy and supply of hard currency reserves through weapons sales, particularly to the Middle East. See Clyde H. Farnsworth, "Import-Hungry Soviet Wants Arab Cash," *New York Times*, October 22, 1973, 20; and Kunz, *Butter and Guns*, 251-252.

<sup>176</sup> James, *International Monetary Cooperation Since Bretton Woods*, 309-317.

<sup>177</sup> A. D. Crocket, "Extended Fund Facility," March 6, 1974, folder Chron. Jan-Mar 1974, box 1, IMF Office Managing Director - Witteveen - Chronological Files, International Monetary Fund Archive (hereafter IMFA), Washington, D.C.

<sup>178</sup> A good article using newly declassified World Bank documents is Patrick Sharma, "The United States, the World Bank, and the Challenges of International Development in the 1970s," *Diplomatic History*, no. 3 (2013): 572-604.

would run a heavy current account deficit” and directed them to sound out Saudi Arabia on its views for possible collaboration on the issue.<sup>179</sup>

### **Views within the United States**

American banks had a conflicted outlook on petrodollars. On the one hand, many banks were excited by the prospect of acquiring large new pools of capital via MENA petrodollar deposits. On the other hand, however, banks worried about two significant problems that might make significant levels of petrodollar recycling unfeasible. The first problem was that Arab lenders tended to insist on depositing their petrodollars on terms that ensured high liquidity, often stipulating that they be allowed to withdraw their funds only a week or less after deposit. Most bank loans, however, were scheduled on a far longer time frame. As bank holdings came to increasingly consist of highly liquid petrodollar holdings, these banks were at ever greater risk that a sudden decision by the Arabs to withdraw their deposits would leave them overextended. The second problem was that Arabs, seeking security, tended to insist upon lending to only the largest banks, and capital markets in 1973 and 1974 were unstable and insecure. Two of the world’s largest banks, the American Franklin National and the German Herstatt, failed in 1974, lowering confidence in interbank lending. This meant that the larger banks receiving the majority of petrodollars might determine that lending to smaller banks was too risky, creating a situation where the larger banks no longer wished to acquire petrodollars and the smaller banks could not obtain access to them, potentially precipitating a credit squeeze and a global recession

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<sup>179</sup> “Meeting on Energy,” January 22, 1974, Memoranda for the Record - Memoranda 08, Folder ID: 1771495 ISAD(G), Reference Code: WB IBRD/IDA 03 EXC-10-4543S, Series: Memoranda for the record, Sub-Fonds: Records of President Robert S. McNamara (hereafter RPRSM), Fonds: Records of the Office of the President (hereafter ROP), World Bank Group Archives (hereafter WBGA), Washington, D.C.

or depression.<sup>180</sup> Furthermore, even if banks did lend, they would not necessarily lend to all countries, as many oil-importing LDCs, hard hit by the rise in oil prices, did not appear to be credit-worthy.<sup>181</sup> In short, while American and other Western banks were in many ways a logical place for the Arabs (and to a lesser extent the Iranians) to invest their petrodollars, there was no guarantee that these banks would recycle them back into the global economy.<sup>182</sup>

Americans outside of the banking industry were also divided over the issue of petrodollars. American corporations poised to sell goods and service to the MENA largely welcomed the increased wealth of that market, as they anticipated that some surplus petrodollars would flow to them. Prosperous foreign markets looked even more appealing to those who could access them as the US economy entered into a recession in 1974.<sup>183</sup> For arms and defense related engineering companies this was particularly true, as they were also dealing with a decline in sales now that the United States had withdrawn from the conflict in Vietnam.<sup>184</sup> For Americans who owned businesses or worked in jobs that did not have the possibility of directly obtaining MENA petrodollars, however, there was a tendency to focus upon the dollars being spent on petroleum. Many of these Americans attributed their economic woes to the Arabs and Iranians and resented what they considered to be ill-begotten wealth. Emblematic of the issue was the popular outcry that occurred during two unrelated attempts by Arabs (a Saudi and Lebanese national, respectively) to obtain controlling shares of two modest-sized banks (assets in the \$300 million range) in San Jose, California and Pontiac Michigan in early 1975. Local resistance included a contemplated boycott by Jewish merchants, the withdrawal of deposits by

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<sup>180</sup> Spiro, *The Hidden Hand of American Hegemony*, 32-37.

<sup>181</sup> Kapstein, *Governing the Global Economy*, 64-65.

<sup>182</sup> Despite the high inflation of the period, David Spiro states that in the mid-1970s “some banks reportedly offered negative interest rates on OPEC capital.” Spiro, *The Hidden Hand of American Hegemony*, 33.

<sup>183</sup> Walter McQuade, “The Arabian Building Boom is Making Construction History,” *Fortune*, September 1976, 112-115, 186-190.

<sup>184</sup> “Armaments: The Arms Dealers: Guns For All,” *Time*, March 3, 1975.

bank patrons, bank directors directing opposition campaigns to stockholders, and pursuit of a court injunction. One liquor store owner in San Jose summarized popular local sentiment by saying “It worries me that with all those petrodollars, the Arabs will come in and buy us all up.”<sup>185</sup>

Policy debates on petrodollars similarly divided local governments and the US Congress. Some congressmen wished to take retaliatory action against the Arab oil embargo. Weeks into the embargo, some congressmen proposed a retaliatory food embargo (likely the source of Saudi warnings to the United States of the futility of such an effort).<sup>186</sup> One proposed congressional resolution called for an embargo of all US exports to countries participating in the oil embargo against the United States.<sup>187</sup> Other congressmen, already receiving complaints about rising levels of European and Japanese investment in the United States, wished to sound the alarm about the danger of growing Arab and Iranian investment and purchasing power.<sup>188</sup> Ohio Senator Howard Metzenbaum warned that only 75 percent of the annual excess dollar earnings of the oil states would be required to purchase a controlling share of eleven of the largest American corporations, including AT&T, Boeing, General Motors, IBM, ITT, US Steel, and Xerox.<sup>189</sup> Initially, however, Congress largely left policymaking on petrodollars in the hands of the executive branch. In part this was because Congress was preoccupied by other matters such as Watergate and the energy crisis. Furthermore, some congressmen and other government officials were attracted to the potential of attracting Arab and Iranian trade and investment for

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<sup>185</sup> A San Jose physician had a somewhat more reflective view on the matter, commenting that “now I understand why nationals of other countries have resented American investments in their corporations.” Both quotes from “A Local Arab Banker?” *Time*, February 3, 1975; see also “Breaking a Bank Barrier,” *Time*, February 17, 1975.

<sup>186</sup> “Food Ban on Arabs Will Fail, U.S. Told,” *New York Times*, November 23, 1974, 4.

<sup>187</sup> State Department Assistant Secretary for Congressional Relations Marshall Wright to Representative Thomas E. Morgan, December 1973?, folder “Investment in the US by Oil Producing Nations (2),” box 112, NSC IF, FL.

<sup>188</sup> James P. Gannon, “Buying In: Increasing Investment in U.S. by Foreigners Irks Many in Congress,” *New York Times*, January 22, 1974, 1.

<sup>189</sup> “The Oil Money,” *New York Times*, July 20, 1974, 30.

their communities. State and territorial governors proved to be particularly amenable to this possibility. The Governor of Puerto Rico Rafael Hernandez Colon and Governor of South Carolina John C. West were early pioneers in this movement, meeting with Saudi and Kuwaiti businessmen to encourage investment in their respective commonwealth and state in 1974.<sup>190</sup>

### **The Objectives and Strategies of the United States Executive Branch**

The executive branch took the commanding role in implementing US policy regarding petrodollars. While there were occasional disputes over priorities or tactics, the Nixon and Ford administrations were largely unified in their goals. Five main points regarding executive policy thinking are worth emphasizing.

First, after the 1973 oil shock it was a high priority of the Nixon and Ford administrations to bring down the global price of oil. The US government was not unaware of the potential benefits for the United States that could materialize from MENA countries accruing massive petrodollar surpluses, but it considered the harmful aspects of high oil prices to clearly outweigh these benefits. High oil prices were contributing to inflation and economic stagnation domestically, driving a wedge between the members of the NATO alliance, and creating a capitalist crisis that threatened to ignite popular support for communist parties in countries across the world, including Western Europe. The Nixon and Ford administrations urgently sought to combat high oil prices in order to mitigate these mounting problems.

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<sup>190</sup> John M. Porges, "Visit with the Governor of Puerto Rico," August 26, 1974, folder "IMF World Bank - 1974 Meeting 1974," box 23, William E. Simon Papers (hereafter WSP), Special Collections and College Archives, Lafayette College, Easton, PA; "Investors, West, Tour Kiawah," folder "West, Clippings, 1974 Apr-May," box 41, John Carl West Papers at the South Carolina Political Collections at the University of South Carolina (hereafter JCWP); John C. West to Anne C. Pratt, December 10, 1974, folder "Kuwait – Kuwait Investment Company/Kiawah Island, South Carolina (2 of 2)," box 8, JCWP.

Second, one of the ways that the United States sought to force down the price of oil was by not increasing the amount of American and international financial aid sent to oil-poor LDCs. The strategy was outlined in a January 1974 Treasury Department memorandum. The memorandum explained how the combined current account deficit of the oil-importing LDCs was projected to more than double in 1974, and that most of these countries would exhaust traditional means of paying for imports by the end of the year. Many oil-importing LDCs were thus likely to seek increased financial assistance from the United States. In response, the memorandum “recommended that the U.S. establish a general policy position that its economic and financial assistance to the LDCs (including debt rescheduling) should not and cannot be increased to cover the additional costs of oil imports.” This was justified for two reasons. First, “the developed countries could, at best, provide only marginal assistance to the LDCs in 1974 given the estimated increased oil costs.” Second, denying additional assistance to oil-poor LDCs “could result in LDC efforts to have the Arab OPEC countries reduce oil prices.”<sup>191</sup> The plan, in effect, aimed to pit the poorest countries in the world against the newly cash wealthy but still less-developed oil-exporting countries in the hope that this would force down oil prices. If this tactic did not succeed in lowering oil prices, the Nixon and Ford administrations hoped it would at least pressure the oil-exporting countries to assume a larger share of foreign grant aid and thereby relieve pressure on the more developed countries such as the United States. By February the United States was also attempting to persuade the IMF to eschew increased lending to oil-importing LDCs, arguing that they were likely to default on such loans and could only be helped

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<sup>191</sup> “U.S. Economic and Financial Assistance to Soften Impact of Recent Oil Price Increases” January 29, 1974, folder “Jan ‘74 Volume II Action-Briefing Memos & Memcons,” box 1, Office of the Assistant Secretary for International Affairs AB Memos 1973-75, RG56 GR DoT, NARA2.

by a reduction in oil prices or grant assistance from the oil-exporting countries.<sup>192</sup> The US strategy was soon recognized by other countries. As the Chancellor of the Duchy of Lancaster Harold Lever put it to the British Prime Minister Harold Wilson in December 1974, “the other [oil] consumers feel that the Americans’ present position still hinges around their earlier unrealistic policy of trying to bring about a major roll-back of the [oil] price. Rightly or wrongly the Americans give the impression that they hope to squeeze the [oil] price by leaving the less developed countries short of cash.”<sup>193</sup>

The Treasury Department championed this policy, and it largely directed the actions of the Nixon and Ford administrations. The State Department interjected, however, that in determining assistance on LDC debt, “priority often should be given to political factors” rather than strictly economic considerations.<sup>194</sup> This would prove to be an important caveat for American policy toward particular oil-importing LDCs in the MENA.

The third key aspect of executive policy regarding petrodollars was that while the Nixon and Ford administrations did not desire high oil prices or the petrodollar surpluses they produced in the oil-exporting countries, these two administrations did welcome the entry of OPEC petrodollars back into the American economy and international financial markets. The reason for this was not simply the prospect of generating new exports and investment opportunities, although these were factors.<sup>195</sup> The larger aim involved encouraging greater interdependence

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<sup>192</sup> “New Oil Facility,” February 14, 1974, folder “Chron Jan-Mar 1974,” box 1, IMF Office Managing Director - Witteveen - Chronological Files, IMFA.

<sup>193</sup> Harold Lever to Harold Wilson, “The Oil Money Problem,” December 13, 1974, PREM 16-49, United Kingdom National Archives (hereafter UKNA), London, United Kingdom.

<sup>194</sup> Assistant to the President for International Economic Affairs Peter M. Flannigan, “LDC Debt Problems,” January 30, 1974, folder “Memos for the White House 1974 (1 of 2),” box 61, Exec Sec 1966-75, RG56 GR DoT Exec Sec 1966-75.

<sup>195</sup> The Department of Commerce, for example, anticipated in January 1974 that the oil producing nations “will be increasingly interested in acquiring technology for internal economic investment and for acquiring foreign investments through direct and portfolio commitments. The United States will be a major supplier of technology to the oil producing countries and the earnings generated could be a valuable current account receipt offsetting our



between the economies of the OPEC countries and the economy of the United States. The rationale behind this plan was laid out in a January 1974 research report composed by the Office of the Assistant [Treasury] Secretary for International Affairs (OASIA). The report began by recognizing that in addition to the “oil weapon,” the projected surpluses of the OPEC nations could constitute a second potential weapon that could be aimed at disrupting financial and exchange markets, but argued that a such a financial attack was unlikely since it would likely do as much or more economic damage to the attacking country as it did the United States, whereas an increase in oil prices would harm the United States and enrich the offending country. Therefore, the report concluded that the United States should “encourage OPEC countries to invest heavily in financial institutions such as brokerage houses, investment banks, and market-making operations so that they will have a stake in the smooth functioning of the markets and that disruptive activities will be doubly costly – in the first instance to the value of their security portfolios and in the second instance to the value of their direct investment.” Furthermore, “as the OPEC countries accumulate financial assets [in foreign countries]... their stake in the continued economic growth and stability of these countries will increase. To the extent that OPEC members are concerned about the aggregate size of their wealth, they will be significantly less likely to attempt to disrupt the economies where they hold assets. Therefore as their wealth increases, the possibility of their pursuing policies designed to hamper other economies like cutting off their oil – is likely to decline.” The same logic applied to OPEC direct investment in the United States. Such investments would not threaten American interests; instead OPEC countries would be in danger of having their assets seized if they took serious action against the

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rising oil import costs.” Department of Commerce Assistant Secretary for Economic Affairs Sidney L. Jones to Department of the Treasury Deputy Under Secretary for Monetary Affairs Jack F. Bennett, “Technology Transfer Program,” January 18, 1974, folder “Investment in the US by Oil Producing Nations (5),” box 113, NSC IF, FL.

United States.<sup>196</sup> In short, the Treasury Department believed interdependence between the economies of the United States and the OPEC countries would significantly reduce the chance that the OPEC countries would pursue economic policies that harmed the United States, including access to affordable oil. The State Department shared the Treasury Department's outlook. "It is our thought that a close economic relationship will provide a more tangible basis for cementing US-Saudi relations," Kissinger wrote to Nixon in June 1974. "One of our concerns is to avoid a reposition of the oil embargo, but we are also seeking Saudi support for our approach to Arab-Israeli negotiations."<sup>197</sup>

The fourth point is that the Nixon and Ford administrations actively worked to steer the investment, import, and foreign aid strategies of the OPEC countries. There were important incentives for OPEC countries to do business with the United States without additional inducements from the US government; American markets offered an enormous depth of investment opportunities and were generally open to foreign capital, and America's advanced technological products and services were highly desired by LDC countries for military and economic development. The United States benefitted from the fact that it already provided a large number of exports to Iran and Saudi Arabia, the two largest oil-exporting economies of the MENA. The United States was also already a popular location for foreign investment by Saudi Arabia, the member of OPEC projected to generate the far-largest current account surplus. The United States had reason to believe it could build upon this earlier foundation of economic ties to expand them in the ballooning petrodollar economy.<sup>198</sup> Both Treasury and State recognized,

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<sup>196</sup> OASIA Research, "Financial Consequences of OPEC Investment Funds," January 17, 1974, folder "Investment in the U.S. by Oil Producing Nations (3)," box 113, NSC IF, FL.

<sup>197</sup> Kissinger to Nixon, June 6, 1974, folder "Saudi Arabia June 6-7, 1974 Visit of Prince Fahd [1 of 3]," box 937, NSC VIPV, NL.

<sup>198</sup> The economic relations between the United States and Iran and Saudi Arabia up to 1973, of course, had themselves developed not purely due to economic considerations but due to decades of political efforts conducted by the US government.

however, that countries like Iran and Saudi Arabia could pursue economic actions that simultaneously harmed both themselves and the United States if they determined the political benefits outweighed the economic costs to themselves.<sup>199</sup> There was also the risk that other industrialized countries, competing for access to both oil and credit, would undercut the United States through offers of economic and political special preferences. Treasury and State therefore worked to provide American incentives for economic collaboration with the oil-rich countries. They also worked to improve political relations, such as demonstrating progress on the Arab-Israeli peace process, in order to remove political disputes that might deter economic ties.

The fifth and final point is that the Treasury Department considered Saudi Arabia far and away the most important MENA country to successfully implement US policy goals regarding petrodollars, while most other federal agencies (including the State Department) tended to consider Iran to be equal to or more important than Saudi Arabia in ensuring American interests in the MENA. This was because Treasury focused almost exclusively on economic considerations like energy supplies, the international monetary system, and US government debt. The combination of Saudi Arabia's small population (and hence comparatively smaller budgetary requirements) and inordinate share of OPEC surplus oil capacity meant that Saudi Arabia was the most important country in determining both the global price and supply of oil and the investment patterns of petrodollars in the world economy. Iran did not have large enough oil reserves to unilaterally control the world oil market, and it was not expected to be a significant supplier of international capital due to Iran's large population and budgetary demands. Other departments like State recognized Saudi Arabia's economic importance, but they also placed importance on military strength and intelligence gathering, areas where Iran was of far more

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<sup>199</sup> Volcker to Reuss, November 29, 1973, folder "Investment in the US by Oil Producing Nations (2)," box 112, NSC IF, FL; OASIA Research, "Financial Consequences of OPEC Investment Funds," January 17, 1974, folder "Investment in the U.S. by Oil Producing Nations (3)," box 113, NSC IF, FL.

value. At times, this difference in perspective would cause policy divisions within the Nixon and Ford administrations.

### **Initial Efforts**

Petrodollar flows intersected with two primary concerns of the Nixon administration at the end of the October War: enhancing stability and American influence in the MENA, and restoring greater influence over oil supplies and pricing. The potential power of petrodollar surpluses to influence global markets and geopolitics added to the factors of oil and superpower competition that already made the MENA a region of vital concern to the United States. Kissinger, who had previously spent little time on Middle East affairs, now engaged in a frenzy of direct negotiations with Arab and Israeli leaders that came to be called “shuttle diplomacy.” Kissinger achieved early successes in disentangling the Egyptian and Israeli armies. He argued to Arab leaders that his peace efforts demonstrated the United States’ good faith and that the continuation of the oil embargo would only hinder the Nixon administration’s ability to champion Arab positions to the American public. The Egyptian and Saudi governments were persuaded, and on March 18 all Arab countries except Libya and Syria (the latter having only marginal oil exports) agreed to end the oil embargo against America.<sup>200</sup> Yet while the United States welcomed the end of the embargo, world oil prices remained high.

In a separate effort to lower oil prices and establish agreements on petrodollar recycling, Kissinger attempted to organize a united front among the more-developed countries in opposition to the OPEC countries. Kissinger hoped to form a cartel of consumers to counter the oil cartel, using their collective purchasing power to drive down the price of oil. He also sought agreement

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<sup>200</sup> Quant, *Peace Process*, 124-147; Juan de Onis, “Most Arab Lands End Ban on Oil Shipments for U.S.; Saudis Plan Output Rise,” *New York Times*, March 19, 1974, 1.

among the more-developed nations to not pursue bilateral deals with the OPEC countries, either in purchasing oil or selling exports, or to implement any other “beggar-thy-neighbor” policies. Toward this end, in February 1974 the United States held the Washington Energy Conference with Japan, West Germany, the United Kingdom, France, Italy, Canada, the Netherlands, and Norway in attendance. Japan and the countries of Western Europe were reluctant to offend the OPEC countries by adopting such a confrontational approach as Kissinger proposed, however, for unlike the United States, which relied on the MENA for only a small fraction of its oil needs, most of the Western European countries and Japan relied on MENA oil for the majority of their *entire* energy needs. The United States thus had neither a carrot nor a stick substantial enough to impose order on its allies, and the conference concluded with the signing of a mild agreement, devoid of enforcement measures, calling for increased cooperation in the OECD; France refused to sign even this statement. The more-developed nations thus delved into a mutually harmful spiral of competition.<sup>201</sup>

At the same time, the LDCs proposed new international financial systems of their own. Algerian President Houari Boumediene organized a special session of the United Nations General Assembly in April 1974 to address income inequality between the more-developed and less-developed worlds. Boumediene designed the special session to promote unity between the LDCs and avoid a split over the rising cost of oil. He argued before the General Assembly that the oil-exporting countries were leading a new movement in the Third World to take back rightful resources and wealth from the West, and that other LDCs should nationalize resources like bauxite, copper, and iron-ore and control their sale through cooperative associations modeled after OPEC. “The raw-material-producing countries insist on being masters in their

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<sup>201</sup> Spiro, *The Hidden Hand of American Hegemony*, 80-88.

own houses,” Boumediene declared.<sup>202</sup> Five days later at the session, Kissinger attempted to staunch Third World support for Boumediene’s position with his own speech. Kissinger warned against uncompensated nationalization and commodity cartels, arguing that these actions would divide the world and cause global economic suffering that would affect everyone. Kissinger stressed the theme that the world, both rich and poor, had become interdependent, and only mutual cooperation, rather than recrimination, held any hope for improving the lives of the less-developed world.<sup>203</sup> The LDCs largely ignored Kissinger, and they dismissed a last-minute US proposal to establish a US-led aid facility through the UN (of unspecified funding) as a trick to distract and divide the Third World coalition. The LDCs instead approved a declaration of principles and an action program designed to establish a “new international economic order.” The principles included implementing raw material trade arrangements that were more favorable to the LDCs, increasing the power of LDCs in determining international monetary policy, and assertion of the right of countries to nationalize foreign property with compensation left to the discretion of the host country. While the resolution was nonbinding, the Nixon administration was disturbed by the militancy of the LDCs and their rejection of American leadership in global economic affairs.<sup>204</sup>

### **Squeezing the LDCs**

The International Monetary Fund pursued one of the largest efforts to institutionally recycle petrodollars to the oil-poor LDCs in late 1973 and early 1974. Witteveen first proposed increasing the allotment of Standard Drawing Rights (international reserve assets issued by the

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<sup>202</sup> Kathleen Teltsch, “Poor Lands Urged to Control Goods,” *New York Times*, April 11, 1974, 73.

<sup>203</sup> Kathleen Teltsch, “Kissinger, at U.N., Tells Poor Lands to Avoid Threats,” *New York Times*, April 16, 1974, 1.

<sup>204</sup> Kathleen Teltsch, “Poorer Lands See Start Toward New Era as U.N. Session Ends,” *New York Times*, May 3, 1974, 2.

IMF to supplement member countries' official reserves; abbreviated SDRs) available to countries, which would have the analogous effect of a central bank implementing expansionary policies to monetize balance of payment deficits. The US Treasury Department argued this would fuel global inflation, however, and vetoed the idea. Witteveen then turned to the idea of creating a new IMF facility that would borrow money from the oil-exporting countries and the more-developed countries and lend the funds to oil-importing countries with current account deficit problems.<sup>205</sup> Witteveen intended for the facility to primarily assist LDCs, with the possible addition of more-developed countries in serious balance-of-payments difficulties.<sup>206</sup> Witteveen sought to acquire as much money as he could for the fund, which came to be called the "oil facility."<sup>207</sup>

The Treasury Department disliked this plan as well, as the oil facility undermined its strategy of squeezing the oil-poor LDCs to bring the price of petroleum down. In February 1974 Under Secretary of the Treasury for International Monetary Affairs Paul Volcker told Witteveen that the United States was concerned about the ability of poorer countries to repay oil facility loans, and that what was instead needed was grant assistance from the oil-exporting countries or a rollback in oil prices.<sup>208</sup> Secretary Shultz likewise raised the concern of the ability of the less-developed countries to repay IMF loans to Witteveen in early March. Witteveen wrote a passionate defense of the proposed oil facility to Shultz in response. He maintained that there

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<sup>205</sup> Spiro, *The Hidden Hand of American Hegemony*, 96-97.

<sup>206</sup> A. D. Crockett, "Extended Fund Facility," March 6, 1974, folder "Chron. Jan-Mar 1974," box 1, IMF Office Managing Director - Witteveen - Chronological Files, IMFA.

<sup>207</sup> A. D. Crockett, "Financing the Oil Facility," March 22, 1974, folder "Chron. Jan-Mar 1974," box 1, IMF Office Managing Director - Witteveen - Chronological Files, IMFA.

<sup>208</sup> This is Witteveen's account to his staff of Witteveen and Volcker's conversation the night prior. A. D. Crockett, "New Oil Facility," February 14, 1974, folder "Chron. Jan-Mar 1974," box 1, IMF Office Managing Director - Witteveen - Chronological Files, IMFA.

was good reason to expect the LDCs to be able to repay loans, but argued this was not the most important point:

Even if there may be a certain risk with respect to repayment, this should not, in my view, be an argument for the Fund's refusing to extend assistance under the proposed oil facility. For what would be the alternative? It would not be preferable for developing countries to borrow in private markets at higher cost, and without the Fund's conditionality which has been so helpful in restoring balance of payments equilibrium in the past. Nor would import restrictions or cuts in development programs be advisable – indeed such an approach might reduce their future ability to repay further. The most desirable alternatives are, of course, a reduction in the price of oil or more concessionary aid. *We must ask ourselves, however, whether we can reasonably withhold assistance from our poorest members, and thus adversely affect their credit-worthiness and development programs, in the uncertain hope that this might lead to lower oil prices or sufficient concessionary aid* [emphasis added].<sup>209</sup>

Witteveen's letter indicted the economic and moral validity of the Treasury Department's strategy to squeeze the LDCs. Commenting upon Witteveen's letter to Shultz, Volcker argued that the oil facility would have the unfortunate effect of turning the IMF into a “welfare institution.”<sup>210</sup>

Despite American resistance, Witteveen pressed forward with his efforts to fund the oil facility. The more-developed countries refused to sign-on to the plan first, so Witteveen traveled to the Middle East in April to seek pledges from the oil-exporting countries. Arriving in Riyadh, Witteveen and his assistants found the small city inundated with so many private bankers and government finance ministers that there were not enough hotels to house all of them. “We [the IMF delegation] got special treatment,” Witteveen's aide Andrew Crockett later recalled. “Three of us from the Fund shared a room in a rundown hotel with cockroaches and bedbugs. I had a

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<sup>209</sup> Witteveen to Shultz, March 21, 1974, folder “Chron. Jan-Mar 1974,” box 1, IMF Office Managing Director - Witteveen - Chronological Files, IMFA.

<sup>210</sup> Volcker to Shultz, “Letter from Witteveen re Oil Facility,” March 26, 1974, folder “Mar 74 Vol 1 Action-Briefing Memos & Memcons,” box 1, Office of the Assistant Secretary for International Affairs AB Memos 1973-75, RG56 GR DoT, NARA2.



cot, and that was high-level treatment. If you were just a regular president of a bank you had to rent a cab and sleep in the back seat for a hundred bucks a night.”<sup>211</sup> With so many prospective borrowers, Witteveen discovered that he could not obtain the highly concessionary loans for which he had hoped. The Governor of the Saudi Arabian Monetary Agency (SAMA) Anwar Ali pledged the equivalent of one billion SDRs (roughly 1.2 billion dollars) for the oil facility with the possibility of additional funding, but insisted on interest only slightly below market rates and also made clear that he was “actively interested in the possibility of Saudi Arabia appointing an Executive Director [to the IMF] – hence his willingness to lend to the Fund.”<sup>212</sup> Witteveen’s reception in Kuwait City was downright hostile. Kuwaiti Minister of Finance and Oil Abdul Rahman Al-Ateeqy argued that Kuwait’s surpluses were already invested abroad or granted as aid; thus Kuwait was not depriving the world of any money. “Kuwait had always adopted an attitude of constructive cooperation, and yet the Arabs were reviled in the rest of the world,” Al-Ateeqy protested. “The world would have to realize that if the Arabs were treated as devils, they would start to act accordingly.” Ironically, while the United States feared the oil facility would maintain high oil prices, the Kuwaitis feared the oil facility was a Western trap. The Kuwaitis reasoned that if the oil-rich countries were expected to bear the majority of the burden of committing loans to the oil-poor LDCs, and the oil-poor LDCs then defaulted on the loans, the oil-rich LDCs would be sacrificing their petrodollar wealth to prop up the oil-poor LDCs while the Western countries sacrificed little to nothing. “This would benefit the industrial world,” Al-Ateeqy argued, “the very countries that had exploited the Arabs for so long.”<sup>213</sup>

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<sup>211</sup> Quoted from Spiro, *The Hidden Hand of American Hegemony*, 99.

<sup>212</sup> Crockett, “Saudi Arabia: Conversations with authorities,” April 19, 1974, folder “Chron Apr-Jun 1974,” box 1, IMF Office Managing Director - Witteveen - Chronological Files, IMFA.

<sup>213</sup> Crockett, “Kuwait: Conversation with Authorities,” April 24, 1974, folder “Chron Apr-Jun 1974,” box 1, IMF Office Managing Director - Witteveen - Chronological Files, IMFA.

Kuwait would eventually agree to fund the oil facility, but the United States never did. Treasury stuck to its strategy of squeezing the LDCs. While it is unclear if Nixon was aware of Treasury's plan, his views on geopolitical strategy disinclined him to multilateral aid regardless. "The United States should move away from multilateral to bilateral aid" Nixon told his cabinet on May 28, 1974. "We need it [bilateral aid] for foreign policy... the IMF sort of thing is OK, but we need this tool [bilateral aid] for our foreign policy." Nixon mused that direct US food aid, for example, could be very helpful to "develop a new relationship with the Arabs, [as] the Middle East is one of the hungriest areas of the world."<sup>214</sup> The IMF oil facility was established on June 13, 1974, without an American contribution. It was funded by the LDCs of Iran, Kuwait, Nigeria, Oman, Saudi Arabia, the UAE, Venezuela and the more-developed countries of Canada and the Netherlands. A second oil facility was approved by the IMF in 1975. Again the United States declined to offer any loans, although this time Belgium, Sweden, Switzerland, and West Germany contributed. Lacking the support of the United States, the IMF oil facilities would have only a minor impact on petrodollar recycling. The two oil facilities contributed roughly \$7.9 billion to countries with balance of payments difficulties at only slightly below market interest rates. The IMF fund's loans were dwarfed by the estimated \$140 billion surplus accumulated by the OPEC countries between 1974 and 1976.<sup>215</sup>

The World Bank likewise felt the squeeze of the United States.<sup>216</sup> After the 1973 oil shock, McNamara hoped to double the World Bank's general capital stock to \$40 billion, in

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<sup>214</sup> Nixon et al., Memorandum of Conversation, May 28, 1974, folder "Memcons 8 May, 1974-31 May 1974 HAK+Presidential [1 of 3]," box 1029, NSC PHAK, NL.

<sup>215</sup> Kunz, *Butter and Guns*, 263-264; Kapstein, *Governing the Global Economy*, 63.

<sup>216</sup> The first squeeze actually came from Congress rather than the Treasury Department. In January 1974, growing disenchantment with the potential of foreign aid and concern over the Arab oil embargo prompted a bipartisan vote in the House of Representatives against the United States replenishing its \$4.5 billion funding to the International Development Association, the World Bank agency that provided low interest loans to the world's poorest countries. The Nixon administration, fearful that this move would harm the United States' international standing, pressured

large part to provide increased assistance to oil-importing LDCs.<sup>217</sup> McNamara believed loans from the oil-exporting countries could fund a significant portion of this increase. The World Bank generally borrowed from the oil-exporting countries at near market rates at the insistence of the oil-exporting countries. The Treasury Department opposed this, as it wanted the oil-exporting countries either to offer grants or concessionary loans or to invest in the US government and private markets. “The oil exporters get most of the political credit for helping the LDCs through these purchases [of World Bank bonds] even though they are fully backed by the callable capital of the U.S.,” argued one Treasury document. “The Bank bonds are basically directly competitive with Treasury issues, and funds not invested in such bonds would tend to reach the U.S. market directly or indirectly. This basically commercial investment tends to reduce political pressures on the oil countries to provide the highly concessional assistance most needed by the LDCs.” Furthermore, “the Bank’s growing dependence on borrowing from governments is changing the nature of the World Bank – further eroding its support for the private sector in LDCs and for the sound financial policies needed to have full support from private capital markets... [it] is also giving the lending governments much increased influence on the Bank... for example, it appears Libya has pressed the Bank strongly, and perhaps successfully, to move into mineral development in Africa through support of public sector enterprises for projects which U.S. private concerns were trying to organize.”<sup>218</sup>

McNamara, however, found (just as Witteveen had) that it was hard to attract loans from the oil-exporting countries unless set at close to market rates, as the oil-exporting countries were

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Congress to pass replenishment, which it did in July. Sharma, “The United States, the World Bank, and the Challenges of International Development in the 1970s,” 583-584.

<sup>217</sup> Ibid., 584-587.

<sup>218</sup> Department of the Treasury Assistant Secretary for International Affairs Charles A. Cooper to Secretary of the Treasury William E. Simon, “Guidance to McNamara on Borrowing from Oil Exporters and Related Issues,” August 3, 1974, folder “Aug 74 Vol 1 Action-Briefing Memos & Memcons,” box 2, Office of the Assistant Secretary for International Affairs AB Memos 1973-75, RG56 GR DoT, NARA2.

swarmed with prospective borrowers. McNamara thus continued to obtain near market rate loans. In an effort to maintain good relations with the oil-exporting countries, McNamara also resisted American calls to end assistance to the oil-exporting LDCs, which further angered the Treasury Department. Kissinger, attempting to blunt the militant Third Worldism evinced at the 1974 General Assembly Special Session, publicly came out in favor of an increase in the World Bank's capital base and its programs to assist the less-developed world in 1975. At the same time, however, Treasury Secretary Simon, who had succeeded Shultz in May 1974, worked behind the scenes with other wealthy countries to blunt the growth of the World Bank's capital increase in order to curtail its power. In 1975 they succeeded in limiting the World Bank's capital increase to \$8.5 billion, rather than the \$20 billion McNamara sought. The United States contributed only \$1.6 billion.<sup>219</sup> The struggle over Bank funding would persist to the end of the Ford administration. "The [US] Treasury's position" McNamara angrily told his staff in January 1976 "seemed to be that the needs of the LDCs had been exaggerated, that the LDCs don't deserve external assistance, that the external world cannot afford such assistance and that, in any event, private finance is doing a better job."<sup>220</sup>

### **Securing American Markets**

While undermining the efforts of the IMF and the World Bank, the Nixon and Ford administrations simultaneously worked toward advancing the interdependence of the economies of the United States and the OPEC countries. In January 1974, Treasury made it a top objective to "achieve major Middle Eastern Countries' investment in the United States, utilizing dollars

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<sup>219</sup> Sharma, "The United States, the World Bank, and the Challenges of International Development in the 1970s," 584-586.

<sup>220</sup> McNamara et al., Memorandum for the Record, January 28, 1976, Memoranda for the Record - Memoranda 12, Folder ID: 1771499, ISAD(G), Reference Code: WB IBRD/IDA 03 EXC-10-4543S, Series: Memoranda for the record, RPRSM, ROP, WBGA.

earned by oil exports; and develop a national program for attracting such investments to the United States.”<sup>221</sup> Due to the unrivaled size of Saudi Arabia’s projected monetary surpluses, as well as its unrivalled power in determining the world’s oil supply, the Saudis were the primary target. As early as December 1973, Kissinger was sounding out Saudi officials about establishing a “new mechanism” for “cooperative arrangements” for things like technology transfers.<sup>222</sup> “We are going all out now with the Saudis” Kissinger told US Deputy Secretary of Defense William P. Clements on March 7, 1974. “I worked it out with the King [Faisal]... we are going to send out a military mission and an economic mission... the King like the idea.”<sup>223</sup> On March 11 Kissinger told Nixon “we had approached the Saudis on bilateralism and their response has been so enthusiastic, in fact so wildly enthusiastic that I can’t help but believe this must effect their decision on the embargo.” Along with “a military relationship and a long-term economic relationship,” Kissinger noted, the Saudis would have “the commitment of the U.S. strategically to them against their enemies in Iraq and South Yemen and so forth” as well as against internal enemies.<sup>224</sup> Seven days later Saudi Arabia, along with most other Arab states, ended the oil embargo against the United States. Saudi Arabia also pledged to raise its oil production and successfully pressured the other members of OPEC not to raise the official price of oil by 15 percent for the next three months, a measure all of the other OPEC countries had supported.<sup>225</sup> Saudi Arabia received considerable hostility for these acts from the Arab world and the other members of OPEC, and the US embassy in Jiddah noted that the Saudis expected

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<sup>221</sup> “Updating Fiscal Year 1974 Objectives,” January 2, 1974, folder “Jan 74 Vol 1 Action-Briefing Memos & Memcons,” box 1, Office of the Assistant Secretary for International Affairs AB Memos 1973-75, RG56 GR DoT, NARA2.

<sup>222</sup> Memorandum of Conversation, Nazir, Kissinger, et al., December 15, 1973, folder “Memcons December 1973 HAK+Presidential [1 of 2],” box 1027, NSC PHAK, NL.

<sup>223</sup> Telephone Conversation (hereafter telecon), Kissinger, Clements, March 7, 1974, 2:45 pm, <http://foia.state.gov/Search/Search.aspx>.

<sup>224</sup> Telecon, Nixon, Kissinger, March 11, 1974, 5:50 pm, <http://foia.state.gov/Search/Search.aspx>.

<sup>225</sup> De Onis, “Most Arab Lands End Ban on Oil Shipments for U.S.”; Juan de Onis, “Saudis Said to Have Issued Ultimatum to Prevent Oil-Price Increase at Parley,” *New York Times*, March 20, 1974, 26.

American support due to its efforts.<sup>226</sup> In April, the United States publicly announced its decision to establish joint commissions for economic and military development in Saudi Arabia.<sup>227</sup> In June, Nixon and Kissinger completed a nine day trip to Egypt, Saudi Arabia, Syria, Israel, and Jordan aimed at strengthening the peace process and US economic ties with the region.<sup>228</sup>

On June 8, two days before Nixon and Kissinger departed for their trip, Prince Fahd oversaw the official signing of the two joint commissions, one economic and one military, in Washington DC. They were the first agreements of their kind between the United States and an Arab country. The US contingent of the joint economic commission was headed by the Department of the Treasury, and the military commission by the Department of Defense.<sup>229</sup> The US-Saudi joint economic commission (JECOR) was the first joint commission to be headed by Treasury; previous joint economic commissions had either been headed by State to provide aid to the developing world or by Commerce to increase trade with developed nations. Treasury's appointment as head of JECOR was indicative of the fact that monetary issues would be a key issue for the organization.<sup>230</sup>

Simon was eager to implement the economic cooperation agreement between the United States and Saudi Arabia that Kissinger had initiated. Simon endeavored to lower US oil prices, first as director of the new Federal Energy Office starting in December 1973 and then as Secretary of the Treasury starting in May 1974. More than most, Simon strongly believed that Saudi Arabia was the key to lowering the cost of petroleum. Simon held this conviction in part

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<sup>226</sup> US Ambassador to Saudi Arabia James E. Akins to Kissinger, March 21, 1974, <http://foia.state.gov/Search/Search.aspx>.

<sup>227</sup> David Binder, "U.S. Will Supply Arms and Factories to Saudis," *New York Times*, April 6, 1974, 1.

<sup>228</sup> "Nixon Off Today on Trip to Five Mideast Nations," *New York Times*, June 10, 1974, 1.

<sup>229</sup> Bernard Gwertzman, "'Milestone' Pact is Signed by U.S. and Saudi Arabia," *New York Times*, June 9, 1974, 1; US Staff Director Wreatham E. Gathright, "NSDM 278: Draft Report on Joint Commissions in the Near East and South Asia," January 28, 1975, folder "Joint Cooperation Commissions (3)," box 8, NSA IEASF, FL.

<sup>230</sup> Spiro, *The Hidden Hand of American Hegemony*, 88-89.

because of Saudi Arabia's primacy in world oil exports, but also because he correctly gauged that the Saudi monarchy was far more disposed to lower prices than the Shah of Iran. Simon earned the personal ire of the Shah when he testified before Congress in February 1974, heatedly countering statements the Shah had publicly made on the CBS New program *60 Minutes* that the United States was not in fact short of oil and that US oil companies were breaking the Arab embargo by rerouting tankers at sea. Simon described the Shah's views as both "irresponsible and just plain ridiculous" and "insane."<sup>231</sup> After this media spectacle, Simon was persona non grata in Iran.

Considering the Shah a lost cause, Simon aimed to pit Saudi Arabia against Iran. At the beginning of July Simon privately tried to convince Yamani that the Saudis were "strengthening their enemies – the high price [of oil] now helps the others [members of OPEC], not them."<sup>232</sup> A few days later, just before he arrived in the Middle East for his first visit to discuss economic policy, Simon made his case public in an interview with *American Banker*. "The shah is a nut," Simon told the magazine. "He wants to be a superpower... he is putting all his oil profits into domestic investment, mostly military hardware... maximization of the oil price is in his best interests, as he see it." Then, the hard sell to Saudi Arabia: "But it is not in the Saudis' interest. It is crazy from their point of view. The Saudis' helping keep oil prices high is making Iran, their natural rival, strong."<sup>233</sup>

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<sup>231</sup> Quoted from Cooper, *The Oil Kings*, 156.

<sup>232</sup> Memorandum of Conversation, Nixon, Simon, Scowcroft, July 9, 1974, folder "Memcons 1 June 1974 - [Aug 8, 1974] HAK+Presidential [2 of 3]," box 1029, NSC PHAK, NL.

<sup>233</sup> Simon's comments, not surprisingly, further worsened his relations with the Iranian government and caused a panic within the US State Department. A few days later Simon stated that his quote about the Shah being a "nut" was "entirely misleading and misunderstood," claiming that he was "using the vernacular in the same way anyone would describe himself as a nut about tennis or golf. I was using a slang expression to show that the shah has very firm ideas about oil." The Shah remained ill-disposed toward Simon. While privately speaking with the Chancellor of the Duchy of Lancaster, the Shah "dismissed Simon as a 'stock-broker,'" a reference to Simon's earlier career as a Wall Street bonds salesman. "Simon Quoted: Iran 'Shah's a Nut,' *Los Angeles Times*, July 16, 1974, A5; James L.

Simon was also concerned about the international banking system's ability to continue to recycle petrodollars. In June 1974, bankers from Europe, North America, and Japan gathered for an international monetary conference in Williamsburg, Virginia. The bankers largely focused on their fear and dismay that Arab deposits continued to be largely short-term. One economist for a major New York bank recalled being ridiculed by the head of its foreign department for asking how much one-year money the bank had received from Arab investors. "One-year money!" the banker replied incredulously. "I wish I could get it for more than 24 hours."<sup>234</sup> The consensus among the bankers was an increasing unwillingness to accept additional short-term deposits; the banks would not risk such an imbalance between their short-term deposits and long-term loans, even though this meant a drying up of credit for businesses and countries. Simon feared disaster. "With all the states with money and nowhere to spend it, the banks and financial markets are in trouble" Simon told Nixon on July 9, right before his trip to the Middle East. Businesses and investors "are afraid of future inconvertibility moves and interest hikes... the financial markets are close to panic. There are major corporations which are unable to borrow."<sup>235</sup> Simon sought to convince the Arab countries to increase their long-term investments so that banks would continue to offer loans to other customers.

A related issue was Simon's concern about how to fund the increasing debt of the US government. A traditional conservative, Simon would have preferred to reduce the federal debt by cutting the budgets of government social programs. Simon strongly opposed reducing the deficit by raising taxes; he believed higher taxes would discourage business investment and slow

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Rowe Jr., "Simon Calls Shah Quote 'Misleading,'" *Washington Post*, July 17, 1974, A2; Memorandum of Conversation, Harold Lever, the Shah, December 3, 1974, PREM 16-49, UKNA.

<sup>234</sup> Edwin L. Dale Jr., "Prudence by Bankers Foreseen For Financings Related to Oil," *New York Times*, June 19, 1974, 47.

<sup>235</sup> Memorandum of Conversation, Nixon, Simon, Scowcroft, July 9, 1974, folder "Memcons 1 June 1974 - [Aug 8, 1974] HAK+Presidential [2 of 3]," box 1029, NSC PHAK, NL.



economic growth, and felt taxes instead needed to be lowered. In the same July 9 conversation with Nixon in which he discussed the recycling problem, Simon urged Nixon to “demand restraint. Taxes cut... take \$5 billion out of social security... send a bill up, say government spending has gone on long enough. Send up five bills like that.”<sup>236</sup> Congress would not allow the cuts Simon desired, however, so he was forced to pursue a third option: increase government borrowing. Simon felt that Treasury borrowing in the US domestic capital market presented its own problem, however, as it took away funds that would otherwise be potentially available to private borrowers.<sup>237</sup>

A partial solution to both promoting private lending and financing the government’s debt was to sell government debt to the petrodollar-flush Arab countries. This way, the US government could fund its debts without crowding out private borrowers. Simon harkened back to his days as a Wall Street bond seller and prepared to sell the Arab countries special US Treasury securities outside of the normal auctions held by the Federal Reserve Bank of New York (this had previously been done with countries like West Germany).<sup>238</sup> “The advantages to us [of selling special US treasury securities to Kuwait and Saudi Arabia] would be that we could know in advance when large amounts would be coming to us and we would achieve some lowering of interest rate levels in the U.S.” Simon wrote to Nixon. “The advantage to them would be that by dealing directly with the Treasury they could avoid the adverse price movements which would harm them when they tried to move large amounts into or out of the

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<sup>236</sup> Ibid.

<sup>237</sup> Spiro, *The Hidden Hand of American Hegemony*, 110.

<sup>238</sup> Simon’s goal of selling Treasury securities was widely reported by the media during his trip. For an example, see “Simon’s Tough Tour,” *Time*, July 29, 1974. For a detailed explanation of the sale of Treasury securities and the efforts of the US government to use them to recycle petrodollars Spiro, *The Hidden Hand of American Hegemony*, 105-116.

private markets.”<sup>239</sup> Simon believed that there was an economic rationale for the Arab kingdoms as well as the United States to enter into this deal. Simon was also aware, however, that political considerations could provide an additional incentive. “For the Saudis the close relationship with the U.S. assures them of a great-power supporter against hostile neighbors,” Simon noted to himself in preparing for his trip, “and the hope of obtaining the best available technology and skills for the rapid economic development of their country.”<sup>240</sup>

Simon visited Egypt, Israel, Kuwait, and Saudi Arabia during his July 1974 trip. His visits to Egypt and Israel will be discussed later. Regarding his meetings with Kuwaiti and Saudi officials, Simon came away pleased, particularly with the Saudis. On the matter of oil, Simon believed there was a good chance of a “significant reduction” in oil prices in the next few months if “we play our cards right.” The Kuwaitis stated that they did not see a benefit to lowering oil prices, but the Saudis did. “The Saudis recognize that it is not in their interest to hold prices up today by withholding Saudi production when the probabilities are that the current benefit goes to Iran and the large Saudi oil reserves will end up being sold at much lower prices in the future,” Simon wrote to Nixon after his trip.<sup>241</sup>

Simon was likewise impressed by the possibilities for developmental cooperation. Simon reported that when the Saudi delegation had come to the United States in June, “the Saudis were skeptical that cooperation with the U.S. Government on industrialization could really amount to much... they suspected we were just going to offer the services of private U.S. companies which they figure are already fully available to them. Now after our various discussions... the Saudis are now enthusiastic over the benefits obtainable from direct cooperation with the U.S.

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<sup>239</sup> Simon to Nixon, “Necessary Follow-Through On My Mid-East and European Discussions,” July 30, 1974?, folder “Memos for the White House 1974 (2 of 2),” box 61, Executive Secretary 1966-75, RG56 GR DoT, NARA2.

<sup>240</sup> “Saudi Arabia,” date illegible, circa. July 1974, folder “Saudi Arabia 1974-1976 (2),” box 26, WSP.

<sup>241</sup> Simon to Nixon, “Necessary Follow-Through On My Mid-East and European Discussions,” July 30, 1974?, folder “Memos for the White House 1974 (2 of 2),” box 61, Executive Secretary 1966-75, RG56 GR DoT, NARA2.

government.” It was determined that a number of US officials would work full time in Riyadh to oversee the development of economic, industrial, and petroleum sectors.<sup>242</sup>

On the more immediate issue of monetary cooperation, Simon found great reason for optimism. “Considerable mutual benefit can be – and will be – derived from the services which the U.S. can offer the oil producers in relation to their financial investments abroad,” Simon wrote after his visits. “We found both the Saudis and the Kuwaitis more than willing to cooperate with us. They feel – I think rightly – that in this area they are both responsible and conservative.” Furthermore, Simon left “confident that they [Kuwait and Saudi Arabia] will decide to purchase a considerable amount of our special [Treasury securities] issues primarily for economic reasons, *but probably also to some extent to demonstrate their desire to cooperate with us*” [emphasis added].<sup>243</sup> While Simon was loathe to admit it publicly, he privately conceded that the “free market” alone was not determining the flow of petrodollars, but rather that political influences pursued by the United States were inducing decisions.

## **The Results**

The significant drop in oil prices Simon hoped for did not materialize during his tenure as Secretary, but the real price of world oil underwent a minor reduction from its high in 1974 to the end of 1976. Iran was the main obstacle to lowering the price of oil further. The Shah determinedly fought to maintain high oil prices, and Iran’s status as the second largest oil-producer in OPEC made it the most significant counterweight to Saudi policies on production and pricing. From 1974 to 1976, Saudi Arabia produced 27 percent of OPEC’s total oil output

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<sup>242</sup> Ibid.

<sup>243</sup> Ibid.

per barrel; Iran produced 20 percent.<sup>244</sup> Simon wished to cut arms sales to Iran to force the Shah to lower oil prices, but Kissinger believed Iran would rally most of the oil-exporting Arab states to his side and that Western Europe and Japan would not hold ranks with the United States against the oil-producers. Simon shared Kissinger's skepticism of the Europeans. Kissinger argued the United States could not withstand the opposition of both OPEC and the OECD. Alienating the Shah would thus do more harm than good to restraining the price of oil. US arms flows would continue to Iran.<sup>245</sup> The United States instead continued to rely upon Saudi Arabia to moderate OPEC policies. The Saudis did not seek a significant real price decrease, as they desired to maintain their high profits and to not alienate themselves from the rest of OPEC and the Arab world. The Saudis did prevent significant price hikes from OPEC, however, allowing inflation to slowly bring down the real price of oil, due to their desire for close ties with the United States. The result was that petrodollar surpluses in the oil-exporting countries did not grow as rapidly and continuously as earlier in feared in 1974, bringing partial relief to the international monetary system, just as Simon had hoped.

The Nixon and Ford administrations achieved greater success in recycling MENA petrodollars back into the economy of the United States and the Western financial system. In addition to the US-Saudi commissions, in November 1974 the United States and Iran announced the creation of the Joint US-Iranian Commission on Cooperation to expand ties in "political, economic, defense, cultural, scientific, and technological fields."<sup>246</sup> Iran rapidly spent its petrodollars on US exports; the real value of Iranian purchases more than doubled from 1973 to 1974, and nearly doubled again from 1974 to 1975. Saudi Arabia increased its purchase of US

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<sup>244</sup> Skeet, *OPEC*, 240-244.

<sup>245</sup> Memorandum of Conversation, Kissinger, Simon, et al., August 3, 1974, folder "Memcons 1 June 1974 - [Aug 8, 1974] HAK+Presidential [1 of 3]," box 1029, NSC PHAK, NL.

<sup>246</sup> Gathright, "NSDM 278: Draft Report on Joint Commissions in the Near East and South Asia," January 28, 1975, folder "Joint Cooperation Commissions (3)," box 8, NSA IEASF, FL.

exports at an even more dramatic rate; from 1973 to 1976 the real value of Saudi imports from the United States rose five-fold and had come to virtually match the size of Iran's.<sup>247</sup> The value of Japanese and West European exports to Iran, Kuwait, Qatar, Saudi Arabia, and the UAE also skyrocketed.

**Table 2.1. Net Change in Deployment of OPEC's Capital Surplus, 1974-1976**

Location	Value (Billions)	Percentage
United States (Domestic Holdings)	30.7	24.5%
Other Industrialized Countries Bank Deposits (Includes US Foreign Branches)	45.7	36.5%
Other Industrialized Countries Non-Bank Investments	20.7	16.5%
IMF and World Bank	10.3	8.2%
Obligations of Developing Countries	17.8	14.2%
World Total	125.2	100.0%

US Dollars, Nominal Value. SOURCE: Spiro, *The Hidden Hand of American Hegemony*, 58.

OPEC investments likewise flowed to the United States and its allies; roughly 78 percent of the net change in the deployment of the OPEC countries' foreign assets from 1974 to 1976 was invested in the more-developed countries. A report conducted by the US Senate's Committee on Foreign Relations estimated that of the approximately \$125 billion in OPEC investments that can be traced from 1974 to 1976, roughly \$48 billion was invested in government paper, portfolio, and long-term investments in the more-developed world, and roughly \$49 billion was deposited in private commercial banks, primarily in New York and London.<sup>248</sup> As Simon had hoped, the OPEC countries, and particularly Saudi Arabia, purchased a large amount of US government debt, constituting 13 percent of the net change in the

<sup>247</sup> Source data from *Statistical Abstract of the United States*, [http://www.census.gov/compendia/statab/past\\_years.html](http://www.census.gov/compendia/statab/past_years.html). Constant value determined with CPI inflation calculator from United States Department of Labor Bureau of Labor Statistics at <http://data.bls.gov/cgi-bin/cpicalc.pl>.

<sup>248</sup> Kapstein, *Governing the Global Economy*, 63.

deployment of the OPEC countries' foreign assets from 1973 to 1976. Saudi Arabia's contribution to this is made clear by the fact that by the end of 1976 roughly 30 percent of Saudi Arabia's foreign investment portfolio consisted of purchases of US government debt.<sup>249</sup>

American bankers shared the optimism of the executive branch. In part, this was because by 1975 Arab investors had begun to noticeably increase their long-term investments.<sup>250</sup> While some economists in the summer of 1974 predicted the accumulated surplus of the oil-exporting countries could exceed a trillion dollars by 1985, in February 1975 the *New York Times* reported that there was widespread belief among economists that the surplus would peak at \$300 billion in the late 1970s or early 1980s and then decline. The drastic change in outlook was due to the declining real price of oil and the unexpected volume of imports the OPEC countries were able to purchase in so short a time.<sup>251</sup> Discussions amongst bankers behind closed doors held the same consensus. "Private bankers are more confident now than last year" a panel of executives from major US banks privately informed Treasury in 1975. "More recent estimates of probable OPEC financial accumulation... appear much more manageable than earlier estimates." Nor did they expect any problems to arise from the new Arab investors. "Most of the OPEC financial accumulations will be by Kuwait, Saudi Arabia, the United Arab Emirates. These are all very conservative governments, and conservative investors. Not interested in takeovers, but in portfolio and real estate investments... they recognize their lack of infrastructure and management capability."<sup>252</sup>

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<sup>249</sup> Spiro, *The Hidden Hand of American Hegemony*, 58-60.

<sup>250</sup> "Volcker's Successor Takes Tough Job," *New York Times*, July 10, 1974; Clyde H. Farnsworth, "Middle East Lenders Bypassing Banks," *New York Times*, March 3, 1975.

<sup>251</sup> Michael C. Jensen, "Petrodollar Outlook: Economists, With New Data, Revise Predictions of Surplus Oil Revenues," *New York Times*, February 13, 1975.

<sup>252</sup> The bank executives were from Bank of America, First National City Bank (renamed Citibank in 1976), and Chase Manhattan Bank; there was also a consultant to the US Council of the International Chamber of Commerce participating. "Summary of Panel Discussion on Outlook for Current Account Financing Via Private Capital Markets," William A. Hurst et al., 1975, folder "International Economic Policy 1975-1976," box 23, WSP.

A few oil-exporting countries of the MENA do not appear to have recycled a significant amount of petrodollars into the American economy, but this did not pose a significant problem for the US government, as these countries had far smaller economies than those of Iran or Saudi Arabia. Qatar did not purchase many imports from the United States, but it did from America's allies, and remained politically aligned with the West. Algeria, Iraq, and Libya, by contrast, pursued a policy of non-alignment and purchased most of their arms from the Soviet Union.<sup>253</sup> The Nixon and Ford administrations, however, were busy with bigger targets. In 1974, they were re-securing the allegiances and furthering the interdependence of those MENA countries with the largest reserves of petrodollars and oil production, Iran and Saudi Arabia, along with the other Gulf monarchies; they were undertaking a labor intensive peace process between Israel and some of the Arab countries; and they were attempting to turn Egypt, the most populous Arab country, away from the Soviets and into the American camp. The Nixon and Ford administrations were open to the possibility of closer relations with Algeria, Iraq, and Libya, and indeed the United States and Algeria restored diplomatic relations at the end of 1974. These countries lacked previous economic or political ties of significance with the United States, however, and older foreign networks from the Soviet Union and France typically seized the new petrodollar opportunities there (just as the United States had in countries like Saudi Arabia). Furthermore, the United States was or would soon become a primary benefactor of a key military antagonist of each nation; Morocco against Algeria, Iran against Iraq, and Egypt against Libya. The Nixon and Ford administrations did not seek to risk their other regional goals to woo Algeria, Iraq, and Libya; these countries appeared to offer neither large enough reward nor significant enough threat. Algeria, Iraq, and Libya likewise found no compelling and workable reason to chart a new course of close cooperation with America.

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<sup>253</sup> Brzoska, *Arms Transfers to the Third World 1971-85*, 339-345.

## **The Position of the MENA's Oil-Poor LDCs**

While Western banks received a large share of petrodollars and after 1974 felt increasingly optimistic about the international monetary system, this did not mean that banks were willing to lend to all oil-poor LDCs. Many oil-poor LDCs retained poor credit or seemed ill-suited to private investment. “Banks eventually will reach the limits of prudent credit exposure, especially with regard to countries where it is not clear how present balance-of-payments problems can be solved,” David Rockefeller had warned in June 1974. “This kind of [private] recycling is not even a temporary solution for lesser developed countries in a weak financial position.”<sup>254</sup> His warning was borne out with time. Banks generally behaved as one would expect banks to behave: they invested in companies and countries that showed promise for growth and unlikeliness to default. While Citibank CEO Walter Wriston famously argued in favor of lending to LDCs with the line “countries cannot go bankrupt,” most banks remained wary of lending to most oil-poor LDCs.<sup>255</sup> The vast majority of private lending went to the more-developed countries, to oil-exporting LDCs, and a select few newly industrialized countries (NICs) among the oil-poor LDCs with strong export markets. From 1973 to 1981, Brazil, Mexico, South Korea, and Venezuela received roughly half of all new private credit to LDC governments; all four were NICs and/or oil exporters.<sup>256</sup> Many of the oil-importing countries of the Arab world were generally considered poor locations for private investment due to economic and political conditions. Israel held some appeal to international financiers, but it also struggled with the twin costs of oil imports and rebuilding its military after the 1973 War.

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<sup>254</sup> Edwin L Dale Jr., “Burden of Oil Money Worries Bankers,” *New York Times*, June 7, 1974.

<sup>255</sup> The prominent British banker Lord Lever once called Wriston “the fairy of world banking for his obsessive optimism.” For both quotes, see Spiro, *The Hidden Hand of American Hegemony*, 41.

<sup>256</sup> Spiro, *The Hidden Hand of American Hegemony*, 71. For a comprehensive argument regarding where petrodollar were loaned and why, see pages 60-79.



In the face of skeptical private bankers, minimal available assistance from the IMF and World Bank due to the actions of the United States, and the need to pay for oil imports, the oil-importing countries of the MENA searched for options. One was to obtain direct Arab or Iranian aid and investment. A second was to obtain remittances from citizens working in the oil-exporting countries. A third was to persuade the Soviet Union or the United States that the oil-poor LDC in question was a strategically significant ally and thus worthy of additional aid. A fourth was to undergo economic and political restructuring that made the country more attractive to private foreign investment and/or increased revenues. Failing these options, oil-poor LDCs faced a final option: reducing oil imports and watching their economies stagnate.

In the MENA, the United States aimed to steer petrodollars to oil-poor LDCs that aligned themselves to America's interests and to prevent petrodollars from flowing to its antagonists. The United States' greatest effort to direct petrodollars to an oil-poor LDC in the MENA occurred in Egypt. After the 1973 War, US geopolitical strategists like Kissinger focused on the possibility of drawing Egypt out of the Soviet camp and into America's sphere of influence. Upon his first visit in July 1974, Simon likewise became enthralled by Egypt for a related but somewhat different reason: to "make it easier for Sadat to move even faster in the direction of [economic] liberalization" and "shuffle off" socialist controls. To that end, Simon "agreed to set up jointly a new institute to do project feasibility studies which can be used to attract investment not only from the U.S. *but from oil surplus countries*" [emphasis added].<sup>257</sup> The United States sought to assist Egypt in obtaining MENA petrodollars to fund projects that would liberalize the economy, hire US companies and purchase US products, and politically tie Egypt to America. This process will be covered in detail in chapter four.

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<sup>257</sup> Simon to Nixon, "Necessary Follow-Through On My Mid-East and European Discussions," July 30, 1974?, folder "Memos for the White House 1974 (2 of 2)," box 61, Executive Secretary 1966-75, RG56 GR DoT, NARA2.

## **America and the Petrodollar Economy**

The Nixon and Ford administrations achieved many of their goals regarding petrodollars, either in part or in full. Their efforts helped to mildly reduce real oil prices and significantly reduce the OPEC account surplus, while at the same time steering the flow of petrodollars in ways perceived useful to American interests. Utilizing petrodollars, the two administrations reestablished and expanded the economic and political interdependence of the United States and strategically important oil-exporting countries, particularly Iran and Saudi Arabia. And while it is unclear whether or not “squeezing” the oil-poor LDCs prompted the oil-exporting countries to increase their granting of foreign aid or to decrease the price of oil, the two administrations successfully minimized increases of foreign aid from the United States, the IMF, and the World Bank.

The United States’ strategy of pursuing interdependence between it and the countries of the MENA raised questions, however, both at the time and in retrospect. The Nixon and Ford administrations intended interdependence to increase the dependence of MENA countries upon the wellbeing of the United States. Critics, however, charged that interdependence increased the influence of MENA countries over the United States, and that the latter’s wellbeing now increasingly depended on the wellbeing of the MENA countries. For a variety of groups within American society, for a variety of reasons, this was an unsavory prospect and sometimes fueled hostility toward the MENA. For many groups and countries in the MENA, interdependence with America was opposed for mirroring reasons and generated resentment toward the United States. This debate will be explored in the following chapters.

At the same time that the Nixon and Ford administrations sought increased interdependence with strategic MENA countries, it sought to benefit from the economic woes of the oil-importing LDCs. In spite of the economic hardships that the oil price rise incurred on the

United States, America remained the far largest economy in the world with one of the highest standards of living. The oil shock was far more devastating to the many fragile and already impoverished oil-importing LDCs. While the Nixon and Ford administrations paid lip service to the goal of closing the wealth gap between the more-developed and less-developed countries, in practice they worked to pit LDCs against each other and redistribute some of the economic gains of the oil-exporting LDCs back to the oil-importing LDCs without diminishing the economic supremacy of the United States and its Western allies. For the Nixon and Ford administrations, most of the Third World was neither a significant strategic nor a humanitarian concern, and thus they unhesitatingly pursued policies that they themselves believed would bring great economic hardship to some of the poorest countries in the world in order to fulfil their own domestic and foreign policy aims.

The tensions generated by interdependence and rapid economic adjustment in turn generated an array of opposition to the petrodollar order established by the United States and its MENA allies. Chapter three turns to the political, social, and cultural struggles and debates over this petrodollar system.

## CHAPTER THREE

### Visions of Petrodollar Promise and Peril

#### “The Action in the Middle East”

“The city of Tacoma,” the Associated Press reported on November 15, 1974, “soon may have claim to a dubious distinction: the dung-exporting capital of the Northwest.” Farmers in the Northwest region of the United States had entered into a deal with R.J.B. Sales Inc., a company headed by Richard Briggs, patent holder of a process to liquefy and deodorize cow manure, and World Wide Marine Inc., a commodity barge transport company operated by Michael “Mitch” Randazzo, to provide monthly shipments of 50,000 metric tons of liquefied bovine excrement for three years to the Arab emirates of Bahrain and Dubai. Beginning early in the next month the muck was to be shipped out from Tacoma, Washington on barges to Lake St. Charles, Louisiana, where it would be pumped aboard oil tankers destined for the Persian Gulf. Upon delivery to Bahrain and Dubai by the tankers, the liquid waste would be mixed with pulverized wood chips and then spread as fertilizer upon the two countries’ arid sands and seeded with grass as part of a desert reclamation project. In return, the two Gulf states would pay \$1.2 billion. Such a massive and expensive development plan was possible, it was readily understood, due to the recent petrodollar fortune acquired by the oil-rich Arab nations. Briggs and Randazzo stood to make millions, and the cattle owners would soon have an additional source of badly needed revenue. “This will save our lives,” Virgil Baker of Mountain Viewing Farms declared. “The dairy business is so depressed right now we’ve been operating \$3,000 a month in the red. Now we can make up to \$4,000 a month on manure. It seems like a fairy tale.”<sup>258</sup>

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<sup>258</sup> “Tacoma due for dubious honor,” *Tri City Herald*, November 15, 1974, <http://www.google.com/archivesearch>; “Arab manure buy off,” *Ellensburg Daily Record*, March 29, 1975, <http://www.google.com/archivesearch>; “No pots

Within a few months, however, the fairy tale proved to be a farce. Randazzo had come up with the plan and approached Briggs in early 1974. Randazzo then made several trips to the Middle East, each time taking samples of Briggs's liquid dung, labeled "Nature's Own," allegedly to find an international market for the product. In the fall of 1974 Randazzo reported to Briggs that he had reached the \$1.2 billion deal with Bahraini Prince Mohammed Kahlil Ebrahaim, with \$10 million to be provided in advance to help cover initial costs. Briggs, Randazzo, and Mohammed signed a contract, and the Northwestern National Bank in Port Angeles, Washington, advanced about \$400,000, roughly half of the bank's total lending capacity, to fund the project. Randazzo, despite his poor credit rating, personally received \$94,000 from the bank to rent barges, but he failed to do so; he did, however, spend \$20,000 on Lincoln Continentals to entertain the Bahraini prince. Meanwhile, some of the farmers began to purchase expensive holding tanks for the project. In December, Randazzo reported that he had received the first check from Bahrain, written for \$16 million. But when the check was deposited, it was returned unpaid due to the account's insufficient funds. The Bahraini police then discovered that the man who had claimed to be a prince was actually an airline clerk, and they detained him. Officials in Bahrain and Dubai claimed no knowledge of the proposed fertilizer project. It was also later revealed that Randazzo had been convicted in 1972 of possessing a false ship master's license. Years later it was still unclear where the fraud had begun, but the business venture was unequivocally over. The Northwestern National Bank in Port Angeles barely survived the debacle; the FBI and Interpol investigated the matter; and multiple lawsuits were pursued.<sup>259</sup>

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of gold in piles of muck," *Ottawa Citizen*, March 31, 1975, <http://www.google.com/archivesearch>; Herbert G. Lawson and Ray Vicker, "An Idea That Failed: Spreading Manure to Spread Wealth," *Wall Street Journal*, March 31, 1977.

<sup>259</sup> Ibid.

This story was outlandish, but in some ways it was characteristic of larger economic and cultural trends that affected the United States and the Middle East during the 1970s. As one 1977 *Wall Street Journal* article put it, “these days, it seems, there are few limits to what would-be entrepreneurs will do to get a piece of the action in the Middle East.”<sup>260</sup> This “action” was the skyrocketing boom in Arab and Iranian investment in and consumption of goods and services from foreign nations after 1973. The size of Arab and Iranian petrodollar revenues, as well as the size of Arab and Iranian investments and purchases, captured the imagination of the world. The fertilizer export scheme denoted the widespread optimism that anything was possible with petrodollars; that the Middle East had become a place of such wealth that even dung transported half-way across the globe could conceivably be sold for a fortune. As the *Wall Street Journal* recounted from one investor in the failed fertilizer export business in 1977, “‘there’s no doubt in my mind now that the contract was a phony.’ But... under the circumstances ‘it was so logical’ to accept the legitimacy of the project.”<sup>261</sup> Yet while this news story captured the sense of optimism that petrodollars could engender, it ultimately served as a cautionary tale, reflecting fears that the petrodollar economy could bring disastrous consequences.

This chapter analyzes the rhetoric and assumptions that characterized American and Arab attitudes about the petrodollar economy and its role in US-MENA relations.<sup>262</sup> To set the economic context, the chapter begins with a brief overview of the increasing interdependence between MENA countries and US corporations spurred by petrodollars. MENA countries, in their desire for US goods and services, and US corporations, in their pursuit of petrodollars, significantly contributed to unprecedented economic, political, and cultural interdependence

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<sup>260</sup> Lawson and Vicker, “An Idea That Failed: Spreading Manure to Spread Wealth.”

<sup>261</sup> Ibid.

<sup>262</sup> Due to a lack of knowledge of Farsi, I am unfortunately unable to provide an in-depth discussion of Iranian narratives about the petrodollar economy.

between the MENA and the United States. As this interdependence rapidly developed, US multinational corporations and government allies increasingly championed, both publicly and privately, the perceived needs of their Arab and Iranian customers in the United States.

The chapter then proceeds with its main argument: that MENA petrodollars became a focal point for interconnected American debates about whether Arab countries and Iran should be considered partners or adversaries, and whether or not the interests of US-based multinational corporations were aligned with the rest of America in an increasingly globalized economy. While other countries or regions might have engaged in more trade with or invested more in the United States during the 1970s, for many Americans the MENA was the most sensational and controversial business partner. In part this was because the suddenness and size of the oil-exporting countries revenues were so unprecedented; in part it was because the Middle East already aroused strong attitudes and biases in many Americans. For some Americans, the Middle East came to embody hopes for individual and national enrichment in an increasing global and multilateral economy. These positive narratives often directly countered cultural understandings of the oil crisis and increased US economic interdependence with the world that posited American weakness or decline or cast Arabs and Muslims in negative and racist stereotypes. These optimistic expressions argued that the surge of US exports to the Middle East proved that US economic and technological power was still rising; that the United States remained secure, powerful, and respected in a rapidly changing and increasingly multilateral world; and that Arabs and Iranians could be America's partners. There were also strong American fears, however, that increased US exports to the MENA might be uniquely harmful to the United States. These critical narratives often intersected with other arguments that condemned the Middle East as dangerous to the United States' interests or that posited

America's general increase in economic dependence on other nations for resources and markets as a threaten to American security.

The diversity of American narratives about Arab and Iranian petrodollars during the 1970s is an understudied topic. Scholarship on US cultural images and debates regarding Arabs during the 1970s primarily focuses on ideas about the oil embargo, terrorism, and the Arab-Israeli conflict. In part due to the choice of topics, these works emphasize almost exclusively the negative descriptions or stereotypes of Arabs in US media. While these topics and negative depictions of Arabs are certainly important, petrodollar debates reveal additional US narratives about Arabs of popular interest during the 1970s. The rise of romanticized or positive narratives about Arabs due to their petrodollars has received very little scholarly attention, yet it reflects an important counter to the common anti-Arab narratives of the period. Furthermore, scholarship rarely considers Arab and Iranian trade and investment as important topics in the nascent US debates on globalization during the 1970s, but due to petrodollars this was in fact the case. Petrodollar debates thus reveal a new subject for which Arabs and Iranians served as symbols in American thought.<sup>263</sup>

Finally, Arab narratives on petrodollars will be analyzed. The Arab world, consisting of many nations and individuals, held a diversity of viewpoints on petrodollars and their utilization. Yet in contrast to the divisions within the United States regarding the beneficial or harmful nature of the petrodollar economy, most Arab media sources in the mid-1970s agreed that the

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<sup>263</sup> McAlister's *Epic Encounters* provides a wide range of US cultural understandings and debates regarding the Middle East, for example, but does not address the issue of petrodollars and globalization. Michael W. Suleiman, *The Arabs in the Mind of America* (Brattleboro: Amana Books, 1988), 145-155 and Janice J. Terry, *Mistaken Identity: Arab Stereotypes in Popular Writing* (Washington, D.C.: American-Arab Affairs Council, 1985), 86-89 briefly mention petrodollars, but only in terms of reinforcing negative stereotypes of Arabs as greedy and/or lazy. There are multiple works that consider pro-Arab lobbying efforts in the 1970s, but they rarely analyze the public narratives they deployed about petrodollars in order to generate US public support for Arab causes, and instead focus on the backroom lobbying of government officials. For example, see Bard, *The Arab Lobby* and Terry, *U.S. Foreign Policy in the Middle East*.



Arabs deserved their petrodollar windfall and that the petrodollar economy benefited their countries and the world. Arab divisions instead primarily focused upon how petrodollars should be invested and spent. To a large degree, this question was linked to the nature of Arab foreign relations with the United States. Arab governments and individuals collaborating with America sought evidence that petrodollar interdependence with the United States brought significant benefits to the Arab world, while Arab governments and individuals opposing cooperation with America sought to demonstrate the harm that US-MENA petrodollar collaborations produced. Notably, Arab media was often very attentive to US narratives on petrodollars and formed its own narratives in response to what was appearing in US media, but this interplay has not been studied, in large part since there has been little analysis of US petrodollar narratives in general, let alone on their transnational connections.

For both Americans and Arabs in the 1970s, petrodollars generated new debates about development, corporations, the global economy, political alliances, and the nature of power and sovereignty in an increasingly interdependent world. Although these debates have not received the scholarly attention that other American and Arab cultural narratives in the 1970s have had, such as terrorism, political Islam, or the Arab oil embargo, debates centering on petrodollars were of equal or greater importance to many Americans and Arabs; they played a major role in shaping the contours of political and economic relations between the two regions.

### **The Symbiosis of MENA Countries and US Multinational Corporations**

The previous two chapters have demonstrated how the early 1970s were a watershed moment when the MENA, once largely marginal to all but the petroleum sector, became economically significant to a wide range of US industries, particularly in the sectors of finance, engineering,

and arms. The inflation and recession that hit the US domestic and much of the global economy during the mid-1970s provided additional incentives to US corporations to seek capital and profits in the MENA. In 1974 and 1975 industrial output in the more developed countries plummeted by 10 percent, while the US stock exchange closed at the end of 1974 at a level nearly half of what it had been in 1972. The economies of most of the oil-poor LDCs suffered even greater repercussions.<sup>264</sup> In a world of recession and increased competition, the oil-rich countries of the MENA and their giant petrodollar surpluses glittered as golden oases of business opportunities for those able to reach them. At the same time, for all of their newfound wealth, the oil-rich MENA states lacked the industry, financial systems, infrastructure, technology, luxuries, and educational expertise that were the hallmarks of the more developed countries. The oil-rich MENA countries wished to utilize their petrodollars to acquire the material and educational foundations of the more developed countries in order to join their ranks. US-aligned states like Iran and Saudi Arabia to a large degree looked to US corporations to develop their economies, militaries, infrastructures, and state bureaucracies. US corporations and US-aligned oil-rich MENA countries thus entered into a symbiotic relationship of increasing magnitudes: US corporations provided expertise and technology that the oil-rich MENA states lacked, while the oil-rich MENA states provided the capital that US corporations increasingly could only obtain abroad.

As seen in chapter two, after initially fearing the manageability of petrodollar surpluses, by 1975 many US bankers and financial experts had become optimistic. MENA investments had become more long term, and they were not as large as originally projected. From 1974 to 1978 the investment position of Middle East oil exporters in US corporate stocks and bonds rose by at

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<sup>264</sup> Jeffrey A. Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (New York: W. W. Norton & Company, 2006), 364-372.

least \$8.2 billion. During the same period, the investment position of Middle East oil exporters in domestic US commercial bank liabilities rose by at least \$4.7 billion.<sup>265</sup> OPEC investments in US financial institutions overseas also rose by billions of dollars. While exact US numbers are hard to come by, foreign branches of US banks certainly captured a large amount of the \$60.7 billion that OPEC countries deposited in the other industrialized countries from 1974 to 1978.<sup>266</sup> MENA petrodollar investments provided badly needed capital to US banks, companies, and individuals in a tight economy. At the same time, US banks and corporations generally provided MENA countries with safe and profitable places to investment their petrodollars, contributing to the MENA countries' long term economic growth.

The US arms industry suffered from a significant decrease in US defense spending with the drawdown of US involvement in the Vietnam War; the constant value of post-Korean War US defense spending would peak in 1968 and then rapidly decline, bottoming out at a nearly forty percent reduction by 1976.<sup>267</sup> Exports to MENA countries provided arms companies a significant way to recover profits. The large petrodollar surpluses of the MENA countries meant that these states could purchase large quantities of the most advanced (and expensive) weapons in the world. Furthermore, any weapon that a US corporation sold to MENA countries had already been designed for the US government. That meant the company had already invested a large sum of money into research and development, and any additional sales of the weapon would not have to figure those costs into the company's bottom line. New sales of a weapon to

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<sup>265</sup> Cohen, *In Whose Interest?*, 120-126. Middle East oil exporters for these figures are Iran, Iraq, Kuwait, Qatar, Saudi Arabia, United Arab Emirates, Bahrain, and Oman. The actually levels of investment were likely considerably higher, as the source of this data, the US Treasury Department, did not take into account investments made through financial intermediaries on behalf of MENA countries.

<sup>266</sup> Spiro, *The Hidden Hand of American Hegemony*, 58.

<sup>267</sup> Ann Markusen et al., *The Rise of the Gunbelt: The Military Remapping of Industrial America* (Oxford: Oxford University Press, 1991), 10.

other countries thus significantly improved that weapon's profitability for the corporation that produced it.<sup>268</sup>

Both Iran and Saudi Arabia desired to significantly increase their military capabilities, and they both favored US arms due to their technological sophistication and in order to politically tie the United States to them. In 1975 Iran became the largest arms importer in the world, and from 1974 to 1978 the United States made \$16.8 billion worth of weapons agreements with Iran. The pinnacle came in 1977, when US arms sales agreements to Iran constituted half of all US foreign arms sales for the year.<sup>269</sup> Important arms sales included Grumman Aircraft Corporation's \$2 billion sale of eighty F-14 fighters, a sale that saved the company from insolvency.<sup>270</sup> Other major deals included 160 General Dynamics F-16 fighters costing about \$3.2 billion, 4 Litton Industries DD-963 Spruance-class missile destroyers costing \$1.5 billion, and 209 McDonnell-Douglas F-4 Phantom fighter-bombers for \$1 billion.<sup>271</sup> Saudi Arabia's military budget also rapidly increased; from 1974 to 1977 Saudi Arabia purchased \$11.7 billion in US arms.<sup>272</sup>

US engineering companies had also faced domestic difficulties. Like the arms industry, some faced declining defense contracts from the US government with the draw down from the Vietnam War. Many others were hit by the slump in the housing market, which suffered from inflation twice over, first in the form of higher priced supplies, and second due to the Federal Reserve's tight money policies aimed at reducing inflation that in turn reduced the number of Americans able to acquire the loans needed to purchase property.<sup>273</sup> Iran and Saudi Arabia,

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<sup>268</sup> Nitzan, *The Global Political Economy of Israel*, 206-219.

<sup>269</sup> Miglietta, *American Alliance Policy in the Middle East*, 65.

<sup>270</sup> "Armaments: The Arms Dealers: Guns For All," *Time*, March 3, 1975.

<sup>271</sup> Miglietta, *American Alliance Policy in the Middle East*, 64-69

<sup>272</sup> Miglietta, *American Alliance Policy in the Middle East*, 212.

<sup>273</sup> Yanek Mieczkowski, *Gerald Ford and the Challenges of the 1970s* (Lexington: University Press of Kentucky, 2005), 148-152.

looking to rapidly develop their infrastructure and economic diversity, sought the expertise of US engineering firms. Iran commissioned General Telephone and Electronic Corp to provide the telecommunications infrastructure for two million telephones as well as television service and increased international communication, to the tune of a \$500 million. Another Iranian project, this one contracted to E.I. du Pont, was the construction of a manufacturing plant near Isfahan that would be capable of producing 100 million pounds of polyester and acrylic fibers to supply Iran's textile mills; the project was estimated to cost \$450 million.<sup>274</sup> Saudi Arabia commissioned the largest engineering contracts, however, and US corporations landed the largest of these deals. In 1975 Bechtel Corporation signed an initial \$9 billion dollar contract to construct an industrial city for over 100,000 people, with a planned steel mill, petrochemical, fertilizer, and aluminum plants, and oil refineries, at the small fishing village of Jubail. This project would be extended and continues to expand to this day, having exceeded \$40 billion in costs. Jubail claims to be the largest engineering project in history, and the economic output of Jubail in 2013 accounted for more than 7 percent of Saudi Arabia's gross domestic product. A projected \$14 billion dollar project to construct a natural gas-gathering system was awarded to the Aramco and the Fluor Corporation. The construction of a new campus for the University of Riyadh, estimated to cost \$3 billion, was awarded to a consortium of four American businesses.<sup>275</sup> The Saudis also purchased extensive US military construction sales agreements which from 1974-1978 cost over \$12 billion.<sup>276</sup> US firms conducted business in other Arab

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<sup>274</sup> Miglietta, *American Alliance Policy in the Middle East*, 64-69; "Armaments: The Arms Dealers: Guns For All," *Time*, March 3, 1975; Brendan Jones, "'Made-In-U.S.A.' Label Helps Americans to Garner Large Share of Mideast Market," *New York Times*, June 30, 1975.; "Aladdin's Troubled Dream," *Forbes*, February 15, 1976, 28-40.

<sup>275</sup> Jones, "'Made-In-U.S.A.' Label Helps Americans to Garner Large Share of Mideast Market"; Walter McQuade, "The Arabian Building Boom is Making Construction History," *Fortune*, September 1976, 112-115, 186-190; Bechtel Corporation: Jubail Industrial City, [http://www.bechtel.com/jubail\\_industrial\\_city.html](http://www.bechtel.com/jubail_industrial_city.html); Steven Rattner, "Trade with U.S. is Enormous; 28,000 Americans Work in Saudi Arabia," *New York Times*, May 29, 1977; "Policy: Saudi Arabia's Growing Petropower," *Time*, July 11, 1977.

<sup>276</sup> Miglietta, *American Alliance Policy in the Middle East*, 209-237.

countries as well. Bechtel, for example, landed deals totaling \$950 million to develop gas fields and processing plants in the UAE in 1977 and a \$626 million deal to develop gas fields in Algeria in 1978.<sup>277</sup>

Many other US industries increased sales to the MENA as well. Purchases of US consumer products in the MENA, such as General Motors cars and General Electric appliances, rose considerably.<sup>278</sup> Iran and Saudi Arabia also hired educational services to modernize and train their workforce and militaries. The Shah made million dollar deals with multiple American universities to help train skilled Iranian workers, including an \$11.5 million deal with Georgetown University to help Ferdowsi University in Mashhad create schools for engineering, agriculture, and economics.<sup>279</sup> The Saudi Kingdom hired Vinnell Corporation of Alhambra, California, to train the 26,000-man Saudi National Guard in modern weapons use and military tactics under the supervision of former US army officers. This deal was the first instance of the Pentagon outsourcing the training of foreign armies to a private contractor; while the US military had and continued to train the Saudi and Iranian armies, the institution of the all-volunteer US military made the deployment of US soldiers to train foreign soldiers far more expensive, so private outsourcing was pursued as a cost-saving measure. For its part, Vinnell Corporation had primarily served as a construction company for both domestic projects like the Los Angeles Dodger Stadium and overseas projects like building military bases in East Asia. Faced with declining construction profits in the late 1960s and early 1970s, Vinnell decided to diversify its services by offering military training to foreign armies. For years the Pentagon had hired private engineering companies to develop foreign military bases; now the Pentagon had begun to

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<sup>277</sup> Thomas C. Hayes, "Bechtel: A Reclusive Giant," July 8, 1982, *New York Times*.

<sup>278</sup> Steven Rattner, "Trade with U.S. is Enormous; 28,000 Americans Work in Saudi Arabia," *New York Times*, May 29, 1977; "Policy: Saudi Arabia's Growing Petropower," *Time*, July 11, 1977.

<sup>279</sup> "Education: Pipeline from Iran," *Time*, April 21, 1975.

outsource the training of foreign armed forces to private companies as well.<sup>280</sup> Private contractors were soon also training Iranian military forces.<sup>281</sup>

Finally, it should be noted that the first US industry significantly involved in the MENA, the oil industry, remained an important force in the region and remained highly profitable. The Seven Sisters had lost control over oil production levels to OPEC, and many of their industries were either suddenly or gradually nationalized in the MENA countries over the course of the 1970s. The OPEC countries, however, still relied on the knowledge and networks of the major Western petroleum corporations to coordinate the global distribution of OPEC oil. Companies like Aramco continued to train Arab personnel and to facilitate development projects. Furthermore, OPEC's seizure of control over production levels and pricing led to far higher revenues for both the OPEC countries and the Western oil companies.<sup>282</sup>

As on-site jobs proliferated in the MENA, thousands of new Americans arrived in the region. By 1978, an estimated 28,000 Americans were working in Saudi Arabia, and an estimated 30,000 Americans were in Iran.<sup>283</sup> Americans often found it difficult to make the transition to the new culture and often rugged conditions. Many Americans chose to prematurely terminate their contracts after a few months on the job; some companies in Saudi Arabia reported a thirty percent early turnover of employees.<sup>284</sup> Local residents likewise often felt that Americans behaved poorly while in their countries. Sometimes disputes stemmed from cultural

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<sup>280</sup> "The Executive Mercenaries," *Time*, February 24, 1975. When *Time* interviewed two former US officers hired by Vinnell and raised the question of whether or not this constituted mercenary work, one officer said "We are not mercenaries because we are not pulling the triggers; we train people to pull triggers," while the other officer added with a laugh "maybe that makes us executive mercenaries."

<sup>281</sup> Eric Pace, "U.S. Influence on Iran: Gigantic and Diverse," *New York Times*, August 30, 1976.

<sup>282</sup> Nitzen and Bichler, *The Global Political Economy of Israel*, 224-228.

<sup>283</sup> Steven Rattner, "Trade with U.S. is Enormous; 28,000 Americans Work in Saudi Arabia," *New York Times*, May 29, 1977; "Policy: Saudi Arabia's Growing Petropower," *Time*, July 11, 1977; Pace, "U.S. Influence on Iran: Gigantic and Diverse."

<sup>284</sup> William P. Brown, "An Employee Orientation Program for Saudi Arabia prepared for Flour Corporation," August 28, 1975, fold 10, box 7, William E. Mulligan Papers, GUSC.

differences; in other cases Americans displayed a clear sense of imperial superiority that translated into a complete disregard for the dignity of Arabs and Iranians. One of the most egregious examples of the latter occurred in the Iranian city of Isfahan, when bored American helicopter pilot instructors for the Iranian military passed time by getting drunk, engaging in brawls, and driving motorcycles through a mosque.<sup>285</sup> Civilian American employees also occasionally found themselves the targets of acts of political violence carried out by dissidents who opposed US support for Arab and Iranian regimes.<sup>286</sup>

Other Americans appreciated and enjoyed their new jobs and lives in the Middle East, however, and corporate leaders became particularly interested in the needs and sensitivities of their Arab and Iranian hosts. Securing contracts in Iran and Saudi Arabia often depended upon good personal relationships with important members of the government or royal family. As Vinnell President John Hamill put it, his company “worked hard for this contract [to train the Saudi National Guard], sinking five years of effort in winning the confidence of the Persian Gulf countries.”<sup>287</sup> US corporate collaborations with MENA governments thus served as a space for mutual exchange, particularly for those at the top. Furthermore, US corporate leaders who invested in MENA business increasingly sought to ensure that the US government and public were sensitive to the desires of Arab countries and Iran.

### **US Multinational Corporations, the MENA, and the Ideal of Global Commerce**

The dramatic increase in US exports to the MENA, the flows of tens of billions of Arab petrodollars into American banks and investments, the massive American-led engineering projects, and the sales of advanced US military technology did not go unnoticed by the American

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<sup>285</sup> Pace, “U.S. Influence on Iran: Gigantic and Diverse.”

<sup>286</sup> Ibid.

<sup>287</sup> “The Executive Mercenaries.”



public. To the contrary, American media became saturated with (often sensational) stories about the impact of Arab and Iranian petrodollars on the economic and political wellbeing of the United States and the world. US multinational corporations with strong ties to the petrodollar economy, and the popular media catering to these business sectors, largely presented positive narratives in order to promote American support for their enterprises. These positive narratives often employed one or both of two themes. The first theme emphasized that the surge of US exports to the MENA and arrival of Middle Eastern investment in the United States proved that America remained an ascending economic and political power. This theme was used to refute those who maintained the Vietnam War or stagflation had left American institutions in decline. The second theme promoted US economic ties with the MENA as both a means toward and evidence of the feasibility of cooperation between Americans and Arabs and Iranians; these arguments countered cultural understandings of the oil crisis and petrodollars that posited Middle Eastern peoples as adversaries or enemies of the United States. Implicit in each of these themes was the belief that the increasingly globalized nature of the world economy, in part accelerated by the petrodollar economy, benefited both American economic and political interests.

To demonstrate the financial benefits the United States accrued from engaging in the petrodollar economy, writers often emphasized the high revenues that could be obtained abroad, in contrast to stagnant domestic markets. The *Fortune* article “The Arabian Building Boom is Making Construction History,” for example, described the staggeringly high figures of US engineering contracts in the MENA in dramatic and admiring prose: “At the San Francisco headquarters of Bechtel Corp.... word comes in from the Jiddah office that a contract has been signed with the Saudi Arabian government to oversee construction... of Jubail. The cost

estimate is--hold your breath--\$9 billion.”<sup>288</sup> Articles like this argued that increased American economic interdependence with the MENA was a solution to the problems of the stagnating economy of 1970s America. “This immense tide of construction is more than satisfying to American firms lucky enough to be hired by the Arabs” stated *Fortune*. “It may be keeping some of them in business. Fees on the [Arabian] peninsula are high, and promptly paid—not always true... back in Chicago or New York, where during the recent recession the building industry has been as hard hit as any.”<sup>289</sup>

Articles did not limit their pitch to dry economic figures, however. In a period of increasingly interdependent markets, increased foreign economic competition, concern about America’s power and image in the world, and domestic economic uncertainty, many writers sought to reassure American readers about the continued vitality of America’s internal spirit and its enduring influence abroad by showing that US corporations were thriving in the new MENA markets. Magazines advanced tried-and-true formulas. US engineers became exemplars of American ingenuity, resilience, and success. The deserts of the Middle East became a new frontier, a place where Americans struck it rich through a mixture of individualistic hard work and destiny. “The Arabian Building Boom is Making Construction History” described the litany of obstacles that engineers had to overcome in the Arabian sands: the need to import, train, and provide basic living necessities for thousands of laborers from around the world, prevent clashes between antagonistic nationalities in the work camps, adjust to work hours being lost to Muslims’ daily five prayer breaks and the fasting of the holy month of Ramadan, the need to import nearly all materials into a vast country with minimal infrastructure and port facilities, the lack of places of public socialization, the need to distill homemade liquor (*sadiqi*) to circumvent

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<sup>288</sup> McQuade, “The Arabian Building Boom is Making Construction History,” 113.

<sup>289</sup> *Ibid.*

the legal prohibition of alcohol, and so on. But the thrill of the challenge was the engineers reward:

The construction men who stay are not really out there for the money alone. There is a large element of romance in builders, especially the field men who have deliberately fled office routines. They like the building frontier, and this is it, a Klondike without ice except in the *sadiqi* and Schweppes. They like to innovate, and ingenuity is essential on these jobs. Try dirigibles for off-loading building materials from freighters? Why not? Didn't Bechtel build the largest hovercraft barge in history in Abu Dhabi for the Das Island job?

The adventure of the American engineer was only enhanced by his setting, which was presented as being simultaneously primitive and modern. “In the tiny sheikhdom of Abu Dhabi... word comes that the sheikh is out in the desert falconing,” but he is willing to accept a visit from the architects for Intercontinental Hotels Corp. and see their plans for a 450 room hotel. “The Americans jump in their cars, race to the camp, and unroll their drawings in a tent. The sheikh—who is financing the hotel—likes it, and suggests adding another three hundred rooms. ‘It can be done,’ says architect Benjamin Thompson.”<sup>290</sup>

The ability of US engineers to construct unprecedented marvels under difficult conditions projected American pride, even if these marvels were not in the United States. Proof of the continuing importance of America in the world was its vital role in achieving unprecedented engineering feats in Saudi Arabia. “Everything is or will be the biggest in the world: the biggest sea-water in-take and treatment plant, the biggest natural-gas liquid plants, the biggest crude oil terminal and loading facility and tank farm, the biggest oil refinery” one 1977 *New York Times* article read. “Jubail, a desert today, will be a city of 500,000 in five years.” While these projects

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<sup>290</sup> The literal meaning of “sadiqi” in Arabic is “my friend.” McQuade, “The Arabian Building Boom is Making Construction History,” 112-115, 186-190.

benefited Saudi Arabia, they also represented striking proof of enduring American greatness and global appeal.<sup>291</sup>

Engineers were not the only Americans esteemed in the new economy. US international businessmen in general received praise for their ability to capitalize on new markets in the MENA. A 1975 *New York Times* article recounted that “when describing the appeal of American products in the Middle East, foreign traders like to tell how a Lebanese merchant once got rid of some slow-selling bananas. The banana boxes were marked ‘Product of Central America.’ The merchant deleted the word ‘Central,’ and the boxes were soon empty.” This likely apocryphal story was meant to show the persisting preference Middle Easterners had for US goods. “Despite anti-Americanism in much of the region through the past decade and sharp Japanese and European competition, there is a marked preference for American products, American businessmen returning from the Middle East report.” The MENA became a location to assuage two major American concerns. The first fear was of rising anti-Americanism. The recognized superiority of American goods by Middle Easterners proved that the benefits of America and its economic system was evident to foreigners, or at the very least not threatened by them. The second fear was a decline in American jobs and economic growth due to increasing competition from Europe and Japan. The Middle Eastern preference for US products over those made in Europe and Japan reassured Americans that they could continue to succeed against other industrial economies.<sup>292</sup>

Some articles emphasized the belief that cooperation with Arab and Iranian leaders was both possible and necessary for the good of the United States and the world. In its first issue of 1975, *Time* declared King Faisal its “Man of the Year” for 1974. The cover story struck a

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<sup>291</sup> Leonard Silk, “Odyssey: Redefining the Strength of Nations,” *New York Times*, November 20, 1977.

<sup>292</sup> Jones, “‘Made-In-U.S.A.’ Label Helps Americans to Garner Large Share of Mideast Market.”

balanced tone between OPEC and the oil-importing countries, arguing that each side had legitimate grievances and needs. The article raised alarm about the danger of not successfully recycling petrodollars, and pushed for Western countries to help the oil producers industrialize, develop their agriculture, and find useful outlets for investment in the belief that this would benefit both sides and help alleviate dangerous global economic imbalances. “In the difficult decade ahead, the best hope is that all sides will realize that they are really interdependent—for resources, technologies, goods, capital, ideas,” *Time* concluded. “The old world of Western dominance is dead, but if the oil powers try to dominate the new world of interdependencies, the result will be bankruptcies and deflation in the West, and even worse poverty and hunger in the have-not developing countries... In this great global clash of interests, it is time for both sides to soften their anger and seek new ways to get along with each other. If sanity is to prevail, the guiding policy must be not confrontation but cooperation and conservation.”<sup>293</sup> In this view, only a recognition of the global interdependence caused by oil and petrodollars, in conjunction with a cooperative response to this interdependence, could avoid disaster for the United States, the oil-rich countries, and the world.

Other business pieces forcefully argued that the mutually beneficial economic cooperation envisioned in *Time*'s “Man of the Year” article on Faisal had indeed occurred. These articles maintained that the economic growth of MENA countries benefitted the United States and challenged widespread negative narratives about oil-rich sheiks gauging ordinary Americans through high oil prices. One 1977 *New York Times* article began: “The relationship between the United States and Saudi Arabia is most often perceived in simplistic images of tankers carrying oil west and billions of precious American dollars just as surely flowing east. But fortunately for the United States, those petrodollars are not resting in Saudi coffers nor are

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<sup>293</sup> “Faisal and Oil: Driving toward a New World Order,” *Time*, January 6, 1975.

they being used to buy out Western companies, as was the popular fear a few years ago. Instead, they are, for the most part being churned back into the world economy in general and into the United States economy in particular.”<sup>294</sup> From this view, Saudi Arabia was not an adversarial threat to America, but rather a beneficial partner. *Time* opined a few months later that the Saudis had shown that they “can be expected to wield their petropower prudently. Some of the other Arab oil producers want to use oil as a means of bringing the West to its knees and destroying Israel in the process. But the Saudis want to keep their customers healthy so that they can sell them plenty of oil. Also, as strict Muslims and fervent antiCommunists, they fear that an economic crisis in the West could so weaken Saudi Arabia's supporters that their own country would be vulnerable to Communist designs.”<sup>295</sup>

Other narratives argued the high demand for US products and services in the new MENA markets proved that the United States remained an ascending political power. “In the post-Cold War, post-Vietnam world,” a 1977 *New York Times* article read, “the United States is regarded in far-flung places as a center of stability in a world of economic slump, energy crisis, and terrorism... and a visitor [to the Middle East] is constantly reminded of the enormity of American ‘presence’ overseas—technological, military, business. Countries with as many differences as Israel and Egypt, Iran and Saudi Arabia, for all their intense nationalism, seek a close relationship to the United States.”<sup>296</sup> Arguments like these sought to counter American fears that the global political influence of the United States had declined due to the debacle of the Vietnam War; the proof of the endurance or even expansion of US global influence lay in the fact that all major parties in the Middle East sought US political and economic ties.

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<sup>294</sup> Rattner, “Trade with U.S. is Enormous.”

<sup>295</sup> “Policy: Saudi Arabia’s Growing Petropower.”

<sup>296</sup> Silk, “Odyssey: Redefining the Strength of Nations.”

The foreign investment of petrodollars in America was also defended as a benefit to the United States. A December 1974 *Time* article argued that investments from the oil-rich countries would improve the US economy and noted that the United States had championed broad freedom for foreign investment as an important international principle for many years. “OPEC equity investments in the U.S. are bound to be beneficial” *Time* maintained. “In the near term, they would ease a financial situation that threatens to be more devastating than the energy crisis... shifting OPEC money into longer-term accounts would provide what First National City Bank Chairman Walter Wriston calls ‘the quietude of markets.’ Beyond that, getting equity investments from oil producers can be more profitable for company managers than borrowing at inflated interest rates.” *Time* also discounted the notion that a controlling interest in a domestic US company would be dangerous to US interests, save for a few industries closely linked to national security, which generally already had legal restrictions on foreign control. *Time* argued that “the greater the OPEC share in the U.S. economy and the bigger its interest in U.S. businesses, the more the oil nations would become hostages to that economy and the less anxious they would be to impose another embargo that would damage their own investments,” and added with a note of bemused irony that “if any company controlled by petroleum potentates got out of hand, the U.S. could always nationalize.” Wriston, the tireless advocate of private petrodollar recycling, argued that Arab investors could be expected to behave as economically rational actors just like anyone else: “The purchase of equity control of a company does not remove market forces and does not remove the law. Lever Brothers is wholly owned by foreigners, and it has to get in and shlep along in the U.S. soap market with everyone else.”<sup>297</sup>

Other writings emphasized foreign investment as a source of American power and even moral greatness. A 1978 *Los Angeles Times* opinion piece titled “Foreigners Buying Up U.S.?”

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<sup>297</sup> Davidson, Spencer L., “The U.S. Should Soak Up that Shower of Gold,” *Time*, December 16, 1974.

That's Good" celebrated the fact that the world generally viewed "the United States economy as one of the world's safest havens for their savings." It cast as misguided American fears that "the Arabs and other oil-rich countries would proceed to swallow corporate America and buy enough real-estate to build their own interstate highway from New York to Los Angeles," arguing that the oil-producing nations had proven "smart enough not to bite the hand that feeds them, and their subsequent investment patterns appear more conservative than sweeping in scope." The article concluded with the idea that "This country was built by foreigners seeking political and economic freedom. That concept should not be diminished. Moreover, foreign investment cash can't help but bolster the capital needs of our economy."<sup>298</sup> Petrodollar investments were not undermining America's sovereignty, the article argued; rather, foreign investment was and remained a foundational pillar of the American state. Furthermore, petrodollar investments were not evidence that the US economy was weakening; rather, its ability to attract petrodollars proved that the US economy, due to its commitment to the free, open markets, remained one of the strongest and most attractive in the world.

Some articles on petrodollar investments even accused opponents of Arab investment in the United States of being bigots. The conservative magazine *National Review*, for example, ran an article in 1975 advocating that Arab (and any other) foreign investment should be allowed to enter the United States unimpaired by legal restrictions beyond national security concerns. The *National Review* castigated opponents of Arab investment, lamenting that:

it seems that there is nothing they [the Arabs] can do with the[ir] money that would please their Western critics. Buying commodities is condemned as inflationary speculation; buying arms or nuclear power plants is viewed as ominously militaristic; investing in short term assets is considered a threat to Western banking, and longer term investments are described as a 'takeover' or 'invasion.' Though Arab spending is thus considered undesirable, withholding Arab spending through the [boycott of Israel] blacklist is somehow even worse—

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<sup>298</sup> Ronald L. Sobie, "Foreigners Buying Up U.S.? That's Good," *Los Angeles Times*, February 5, 1978.



and quite unlike our own boycott of Rhodesia. The infusion of petrodollars is a threat to the banks, but keeping petrodollars out of certain banks is an intolerable indignity... the Arabs have managed to make the ethnic slur respectable in liberal circles. One can say things about the Arabs that would sound petty and parochial if applied to [oil rich] Venezuelans or Canadians.<sup>299</sup>

The *National Review* further insisted that “shrinking the area in which resources flow freely-is never desirable from the point of view of economic efficiency... we need to encourage an inflow of foreign capital to balance the outflow of dollars for oil imports, and also to provide funds for our domestic capital markets.” It thus combined a call for global free trade with the ideal that Arabs should be treated as respected members of the international community and partners of the United States.

### **US Government Advocates of Interdependence in the Petrodollar Economy**

Since the Nixon and Ford administrations determined that recycling MENA petrodollars back into the US economy in the form of investments and export sales would benefit their economic and geopolitical aims, they generally advocated for and facilitated the growing interdependence between US corporations and MENA governments. Congressional representatives and local government officials sympathetic to the goals of the White House and interested in securing petrodollar revenues and investments for their states and communities likewise worked to facilitate business between US companies and MENA countries.

The Nixon and Ford administrations advocated and defended the openness of the United States to OPEC investments. The Commerce and Treasury Departments connected US businessmen with potential Middle Eastern investors and provided advice on how to draft

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<sup>299</sup> “Petrodollars are Dollars,” *National Review*, April 11, 1975, 384.

investment proposals that would appeal to Arab and Iranian sensibilities.<sup>300</sup> Treasury also fought to ward off the implementation of stricter foreign investment laws that it feared might curtail the flow of MENA petrodollars into the United States. One Treasury memorandum for Simon, summarizing the view within the Department, stated “we stand to lose much more if we were to take action which seemingly supported the already distressing tendency in many other countries to restrict foreign capital, than we could possibly lose from any oil producer attempts to peddle their influence or manipulate U.S. firms.”<sup>301</sup> Major US multinational corporations encouraged Treasury to hold fast in protecting open access for foreign investment. A memorandum of conversation of an April 1975 meeting between told the Economic Policy Board (chaired by Simon) and business leaders from General Electric, BF Goodrich, Rockwell International, Carrier Corporation, and Hewlett-Packard recorded that on the issue of foreign investment in the US “there was agreement of the panel that investment was good, regardless of its source... aside from defense items, any attempt to control or regulate investment would encourage retaliatory action by foreign governments toward U.S. investments abroad, which is very undesirable.”<sup>302</sup>

The Nixon and Ford administrations also worked hard to encourage an increase in US exports to the MENA. US business leaders had been pushing for greater government support in promoting US exports in the face of rising foreign competition. The business leaders at the April 1975 Economic Policy Board meeting “stressed the small scale of U.S. Government programs relative to our major competitors for export sales... they stressed the important role of

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<sup>300</sup> Parsky to Leonard J. Keller, January 28, 1975, folder “Chron Jan 1975,” box 1, Office of Under Secretary for Monetary Affairs Chronological Files Gerald L. Parsky, RG56 GR DoT, NARA2.

<sup>301</sup> “Talking Points for Discussion with Secretary Kissinger,” February 3, 1975, folder “Feb 75 Vol 1 Action/Briefing Memos & Memcons,” box 2, Office Assistant Secretary for International Affairs AB Memos 1973-75, RG56 GR DoT, NARA2. The State Department held some reservations about the potential of foreign investments to manipulate strategically important US industries, but even it only pushed for limited increases in legal restrictions in key sectors.

<sup>302</sup> “Business Outlook Panel,” April 23, 1975, folder “International Economic Policy 1975-1976,” box 23, WSP.

commercial officers abroad, especially in new market areas such as the Middle East.”<sup>303</sup> To increase private US exports to the MENA, both the Treasury and Commerce Departments (and sometimes in cooperation with the National Association of Manufacturers) connected US businessmen with relevant Middle Eastern contacts, personally introduced US businessmen and Middle Eastern delegates at federal events, and provided information on MENA projects seeking goods and services.<sup>304</sup> For JECOR, Simon, with the support of the State Department, wrote that as a general guideline “where both the U.S. Government and the U.S private sector have the capability to provide assistance desired by the Saudi Arabian Government under the U.S.-Saudi Arabian Joint Economic Cooperation Commission, there should be a strong presumption in favor of utilizing the private sector. As a matter of fact, we are required to the maximum extent possible to carry out programs of assistance under the Foreign Assistance Act through private channels and to utilize wherever practicable the service of U.S. private enterprise... this policy should result in the greatest longterm [sic] benefits to our economic relations with Saudi Arabia and will prevent the inequities and criticisms attendant on U.S. Government preemption of the U.S. private sector.”<sup>305</sup>

State governors, aiming to attract commerce and investment for their states, also worked to facilitate business relationships between local industries and the MENA. It is unlikely that many US state politicians gave the MENA much thought as a source for economic growth before the 1970s. With the rise of the petrodollar economy, however, US state politicians increasingly studied and visited Arab countries and Iran, met with Arab and Iranian leaders, and concerned themselves with the region’s affairs. Sometimes these state politicians pressed very hard to

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<sup>303</sup> Ibid.

<sup>304</sup> Parsky to Simon, September 24, 1974, folder “Memos from Staff: Parsky 1974,” box 54, Executive Secretary 1966-75, RG56 GR DoT, NARA2.

<sup>305</sup> Simon to Department of the Interior Acting Secretary Kent Frizzell, September 30, 1975, folder “Department Correspondence: Interior 1975,” box 65, Executive Secretary 1966-75, RG56 GR DoT, NARA2.

achieve high level connections with MENA leaders. Idaho Democratic Governor Cecil D. Andrus, Idaho Republican US Senator James McClure, and ten Idaho business leaders, including the Chairman of the Board of the American Potato Company and other executives from nuclear power, oil refining, construction, mining, livestock, irrigation, and agricultural companies, planned to visit Iran for a trade mission in April 1976. Andrus was determined to see the Shah while in Tehran and requested a letter of introduction from Ford in order to arrange the meeting.<sup>306</sup> The Ford administration had a policy against granting presidential letters for private American business travel abroad, however, and thus politely declined Andrus's request.<sup>307</sup> Andrus then wrote again to Ford, stating that while he was sure it was a State Department position not to grant presidential letters, Andrus was "certain that you [Ford] would not have allowed the State Department to dictate to you whether or not you could write a letter of introduction on behalf of a governor, a United States Senator and ten prominent business executives to a foreign leader."<sup>308</sup> Andrus then repeated his request for a presidential letter. The Ford administration appreciated Andrus' past support for President Ford and assistance on programs such as human resources and block grants that the administration considered important, so White House officials attempted to get around the issue of the letter by having Ambassador Helms arrange a meeting for Andrus with the Shah. Helms had his own policy against personally arranging private meetings with the Shah, but Scowcroft wrote to Helms that "this is a very unusual case... I – and I am sure the President – would be very grateful for any help you might feel able to provide."<sup>309</sup> Helms "pulled out all [the] stops with Minister of Court

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<sup>306</sup> Governor Cecil D. Andrus to Ford, March 2, 1976, folder "Andrus, Cecil D.," box 1, NSA PNF, FL.

<sup>307</sup> Counsellor to the President John O. Marsh, Jr. to Andrus, March 26, 1976, folder "Andrus, Cecil D.," box 1, NSA PNF, FL.

<sup>308</sup> Andrus to Ford, March 31, 1976, folder "Andrus, Cecil D.," box 1, NSA PNF, FL.

<sup>309</sup> Scowcroft to Helms, April 20, 1976, folder "NSA Backchannel Messages Box 4 (6) Mideast-Africa," box 18, RAC, FL.

Alam” to secure a meeting with the Shah for Andrus, and ultimately succeeded.<sup>310</sup> “The Shah undoubtedly [now] knows more than he needs to about raising potatoes” Scowcroft wrote to Helms after the ordeal, “but I want you to know once again how much we appreciate the way you came through on an awkward one.”<sup>311</sup>

Meetings between US governors and MENA government officials sometimes forged new political alliances. Mississippi Democratic Governor William L. Waller led a state trade commission to Kuwait, Iran, and Iraq in April 1975 to attract foreign investment and secure export deals of food and manufactured materials. Waller returned to Iraq in October 1975 and met with top Iraqi officials, including Foreign Minister Fadoon Hamadi, to further the progress toward agreements on Mississippi commodity sales to Iraq. Shortly after returning from his second visit to Iraq, Waller wrote a letter to Ford in which he urged the Ford administration to “address itself to a strong political position in favor of a just and permanent peace for all nations in the Middle East and in favor of extended trade relations with all Arab states... [and] immediate consideration of steps to be taken to establish formal diplomatic relations with Iraq,” which Iraq had severed in 1967. Waller offered his diplomatic services toward these ends, arguing that “since Mississippi’s friendship and relationship with Iraq might be better than that of any state at the present time, I respectfully suggest that Mississippi be invited to participate in any discussions furthering and improving the relationship with Iraq and with other Arab states. We respectfully urge a meeting with designated officials of your office or of the State Department to advance this most important matter.”<sup>312</sup>

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<sup>310</sup> Helms to Scowcroft, April 24, 1976, folder “NSA Backchannel Messages Box 4 (6) Mideast-Africa,” box 18, RAC, FL; Scowcroft to Helms, April 25, 1976, folder “NSA Backchannel Messages Box 4 (6) Mideast-Africa,” box 18, RAC, FL.

<sup>311</sup> Scowcroft to Helms, May 3, 1976, folder “NSA Backchannel Messages Box 4 (6) Mideast-Africa,” box 18, RAC, FL.

<sup>312</sup> Governor William L. Waller to Ford, November 3, 1975, folder “Waller, William L.,” box 2, NSA PNF, FL.

It appears that the Ford administration did not seriously consider Waller's offer to pursue better relations with Iraq, but that does not mean that all interactions between US governors and MENA officials resulted in minimal political consequences. Arguably the strongest case for this was South Carolina Democratic Governor John C. West. West had demonstrated no apparent interest in the Arab world before the mid-1970s; he had visited Israel and India, but nowhere in between. He was, however, an active proponent of attracting foreign investment to South Carolina, primarily from Western Europe and Japan. When Kuwaiti investors purchased the South Carolina island of Kiawah in early 1974 from a private individual and announced plans to develop a resort with projected costs of up to half a billion dollars, West quickly made the Middle East a new focus for South Carolina's foreign investment attraction efforts, and he ingratiated himself with the Kuwaitis while hosting them on a visit of their new purchase in April 1974.<sup>313</sup>

Many Americans opposed the development plan for Kiawah, however, either because they desired to preserve the wilderness of the island or harbored feelings of anti-Arab xenophobia. Rumors circulated that the Kuwaitis were stockpiling weapons on the island.<sup>314</sup> Sometimes preservationist and anti-Arab sentiment intertwined, as was the case for one concerned citizen from New Jersey, who wrote to West that "I feel very sorry for the people of South Carolina after reading of the planned rape of Kiawah Island... for an unspoiled island – a real rarity in the U.S. – to be sold to the Arab oil mongers who have milked so much money from the American public – it is a real crime."<sup>315</sup> Environmentalist groups led a national campaign to

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<sup>313</sup> "Investors, West, Tour Kiawah," unattributed newspaper article clipping, circa April 1974, folder "West, Clippings, 1974 Apr-May," box 41, JCWP.

<sup>314</sup> Priscilla S. Meyer, "Kuwaitis' Resort Project Off Coast of Carolina Proceeds Amid Wild Rumors, Stiff Opposition," February 26, 1975, *Wall Street Journal*.

<sup>315</sup> "Dear Governor West, I feel very sorry..." October 1974, folder "Kuwait, Kuwait Investment Company-Kiawah Island South Carolina (1 of 2)," box 8, JCWP.

cancel the deal and instead turn the island into a protected natural park, and the Charleston Natural History Society telegraphed Kuwaiti Emir Sabah al-Salem al-Sabah with a request that he delay the development of Kiawah until the people of South Carolina could decide if they wanted to establish a natural park there instead.<sup>316</sup> West assured the Kuwaitis that the Society did not represent the views of the majority of South Carolinians and attempted to persuade the Society to cease its efforts.<sup>317</sup> West visited Kuwait at the end of 1974 and met Kuwaiti officials, including the crown prince and prime minister. West assured the Kuwaitis that South Carolina desired trade with and investment from them, but also suggested that the Kuwaitis create television spots and hire a public relations firm “to guide your efforts in changing the image of Arabs... and Arab investments.”<sup>318</sup> The Kuwaitis heeded West’s advice, launching a media campaign to address the concerns of preservationists.<sup>319</sup> Development on Kiawah moved forward, and the new resort welcomed its first guests in May 1976.<sup>320</sup>

While West ended his term as governor in early 1975, his interest in the Arab world continued. West served as one of four principal founders of Arab-American Development Services, a company that provided information, contacts, and negotiation services for US businesses seeking market opportunities in the MENA. West likewise oversaw a South Carolina

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<sup>316</sup> Henry Eason, “Kiawah Island Conflict Unfolds,” June 2, 1974, *Greenville News*, folder “Clippings, 1974 June-Dec.,” box 41, JCWP.

<sup>317</sup> Charleston Natural History Society to West, December 8, 1974, folder “Kuwait, Kuwait Investment Company-Kiawah Island South Carolina (2 of 2),” box 8, JCWP; West to Al-Sabah, December 10, 1974, folder “Kuwait, Kuwait Investment Company-Kiawah Island South Carolina (2 of 2),” box 8, JCWP; West to the Charleston Natural History Society, December 10, 1974, folder “Kuwait, Kuwait Investment Company-Kiawah Island South Carolina (2 of 2),” box 8, JCWP.

<sup>318</sup> “Welcome to the State of Kuwait,” circa December 1974, folder “Kuwait, Kuwait Investment Company-Kiawah Island South Carolina (2 of 2),” box 8, JCWP; West to Chairman and Managing Director of the Kuwait Investment Company Bader Al-Dawood, December 30, 1974, folder “Kuwait, Kuwait Investment Company-Kiawah Island South Carolina (2 of 2),” box 8, JCWP.

<sup>319</sup> Priscilla S. Meyer, “Kuwaitis’ Resort Project Off Coast of Carolina Proceeds Amid Wild Rumors, Stiff Opposition,” February 26, 1975, *Wall Street Journal*.

<sup>320</sup> Jan Stucker, “West’s Firm Seeks To Tie Economic Knot With Arabs,” unattributed newspaper article clipping, May 17, 1976, folder “Clippings, 1976,” box 41, JCWP.

State Development Board trade mission in 1976 to Saudi Arabia, Kuwait, and Jordan.<sup>321</sup> One participant in the trade mission, Lockwood Greene Engineers, signed a contract with Saudi Arabia to engineer a major port facility for roughly \$150 million.<sup>322</sup> West's friendship with Jimmy Carter and early support for Carter's presidential bid enabled West to successfully lobby to become the US ambassador to Saudi Arabia, a position he held from June 1977 to March 1981.<sup>323</sup> As ambassador, West continued to connect American and Arab officials and businesspeople. His growing network of personal connections with Arabs also led him to sympathize with many of their causes, and both during and after his ambassadorship he spoke out in favor of issues such as congressional approval of weapons sales to Saudi Arabia and greater American attention to the plight of Palestinians. The Saudi government, very pleased with West, donated \$500,000 to the non-profit John C. West Foundation shortly after he retired from the ambassadorship.<sup>324</sup> West's encounter with Kuwaiti investors and his interest in petrodollar investments for South Carolina had profoundly affected his life, and in turn he became a significant conduit for exchanges between the United States and the Arab world.

In addition to the current government officials, former government officials facilitated business between US corporations and the MENA in jobs in the private sector. By 1974 many former top officials in the US government had business careers linked to the petrodollar economy. William Rogers legally represented the Shah's real estate investment firm, the Pahlavi Foundation. Former Attorney General Richard G. Kleindienst and Defense Secretary Clark M. Clifford worked for oil interests of the Algerian government. The Houston law firm of former

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<sup>321</sup> Ibid.

<sup>322</sup> Lockwood Greene Engineers Vice President Bennett L. Helms to West, September 8, 1976, folder "Middle East, South Carolina State Development Board, South Carolina Trade Mission, General, 1976 Apr. and c. Apr.," box 27, JCWP.

<sup>323</sup> West to Secretary of State Cyrus Vance, January 20, 1977, folder "Ambassador to Saudi Arabia, 1977-1981, Appointment, 1977, General," box 11, JCWP.

<sup>324</sup> Ghazi Algosaiibi to West, April 20, 1981, folder "West, Personal, Topical, Middle East Correspondence, Saudi Arabia Correspondence, 1981 Apr – Oct.," box 28, JCWP.



Texas Governor and Treasury Secretary John Connally represented an Arab-owned private investment banking firm. Former Vice President Spiro Agnew, having been disbarred from practicing law and thus unable to legally represent MENA (or any other) clients, instead traveled across the Middle East to offer consultative services in real estate. Bechtel Corporation, which had some of the largest engineering contracts in the MENA, acquired four high level former government employees, including former Secretary of Health, Education, and Welfare Caspar Weinberger, Chief Executive of the Atomic Energy Commission Robert Hollingsworth, and Assistant to the President Peter Flanigan. Bechtel's most notable hire, however, was George Shultz, who announced that he was joining the company as a vice president the day after resigning from the Nixon administration. By May 1975, Shultz had been promoted to president.<sup>325</sup> Utilizing their knowledge of US policy and law and their contacts with government and business leaders across the world, former US government officials furthered the development of commercial networks between the United States and the MENA while enriching themselves in the process.

### **American Opposition to Interdependence in the Petrodollar Economy**

Yet while many Americans, especially those connected to globalizing businesses, argued that the United States profited from increased economic ties between the United States and the MENA, many other Americans countered that this trend portended peril and that increased interdependence with the Arab nations and/or Iran undermined American or international interests. The sources of such concerns varied. Some were rooted in convictions and narratives

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<sup>325</sup> "Ex-Nixon Aides in Mideast Roles," January 4, 1975, *New York Times*; Nick Thimmesch, "Birth of a Salesman," October 26, 1975, *New York Times*; Bob Wyrick, "Nixon Aides Who Pushed Private Atomic Fuel Industry Now Have Top Jobs in It," November 16, 1975, *Los Angeles Times*; "Shultz Is Joining Bechtel; Bennett in Volcker Post," May 10, 1974, *New York Times*; "Shultz Named Bechtel Corp. President," May 25, 1975, *Washington Post*.

that long predated the 1970s. The oldest of these were orientalist and racial tropes that cast Middle Eastern peoples as an inferior, irrational, and perverse other to enlightened and rational Americans. People viewed in this light could hardly be expected to use their petrodollars in a beneficial way. Americans had likewise long come to expect, consciously or not, a culture of high consumption based upon cheap raw resources from the less developed world, of which oil was one of the most important. The significant increase in the cost of petroleum and related products unsettled Americans, and many blamed and resented the oil producing countries for undermining the foundations of American consumption. Moreover, many Americans had supported the creation and defense of Israel and some now feared that the lure of Arab petrodollars might undermine US support for Israel's interests or promote arms sales to Arab states that would disadvantage the Israeli military.

American concerns about petrodollars also intersected with the more contemporary issues of the 1970s. The oil price hike coincided with the severest US recession since the 1930s. Americans were particularly concerned and upset about economic matters, and many believed there was a causal link between higher oil prices and their own financial misfortunes. The increasingly globalized nature of the US economy raised fears that financial considerations would lead corporations and government leaders to undermine US interests and might even curtail US sovereignty in significant ways. The Vietnam War had challenged faith in US power, and MENA petrodollar power, for some, represented additional evidence of US decline. Watergate and other revelations of governmental malfeasance had bred a popular skepticism of government competency and morality that extended to petrodollar issues. The rise of human rights discourses in the 1970s raised attention to the violence of many petrodollar regimes. Americans thus had many different reasons to be concerned about MENA petrodollars.

Sometimes these concerns overlapped, sometimes they did not. Collectively, however, this wide array of concerns over petrodollar posed a serious challenge to corporate and governmental leaders in the US and the MENA who sought to increase the interdependence of the two regions. Increasingly, many US organizations and legislators worked to undermine the flows of the petrodollar economy.

### **Oil Prices, Inflation, and Recession**

By the end of 1973, inflation had become a great concern in the United States. The price stability of the post-World War II era had started to erode in the late-1960s, and in 1973 the annual rate of inflation was 6.2 percent. In 1974 this rate jumped to 12.2 percent.<sup>326</sup> While high inflation persisted, an economic recession also began in 1974, and unemployment gradually increased from 5.4 percent in August 1974 to a high of 8.9 percent in May 1975.<sup>327</sup>

Simultaneous high inflation and unemployment challenged the contemporary economic orthodoxy that held that inflation and unemployment naturally worked in opposition to each other, and prescriptions to the crisis were contradictory. One easy answer was to blame US economic difficulties on the rapid rise in the cost of raw materials from the LDCs, particularly oil. Most economists then and now cite the oil shock of 1973 as only one of many factors contributing to the inflation and recession of the 1970s, albeit an important one. Many Americans at the time, however, found it particularly galling to watch American-held dollars become MENA-held petrodollars, and they held rising oil prices to be a particularly harmful and unfair source of economic difficulty.

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<sup>326</sup> Mieczkowski, *Gerald Ford and the Challenges of the 1970s*, 99.

<sup>327</sup> Mieczkowski, *Gerald Ford and the Challenges of the 1970s*, 125, 154.

Some critics challenged the oil producers' right to higher prices by claiming that rising oil prices constituted not economically justified commerce but political coercion. At the beginning of 1975 the AFL-CIO called for the boycott of oil from countries that had participated in the 1973-74 boycott against the United States. "The response [of the US government to Arab oil price increases] should have been, 'not one cent for tribute,'" AFL-CIO President George Meany stated. "Instead, Henry Kissinger had a new quotation for the history books: 'Pay.' And pay we did. And we will continue to pay until the United States deals with the blackmailers in the manner that they deserve. No tribute, no foreign aid, no trade, no jet fighters to these people—nothing until the blackmail stops." Meany admitted that boycotting Arab oil would bring some economic hardship to Americans, but argued that "allocations and rationing are a small price to pay to avoid total economic collapse and to take America's economic destiny out of the hands of the Arab oil sheiks."<sup>328</sup> Other critics maintained that America had a right to cheap MENA oil because Americans had played a key role in extracting it, while Middle Easterners had little right to the oil in their lands because they had done little to develop it. "One is startled by the current idiocy which permits some ten million Arabs and Berbers to dictate yet-unmeasurable economic insecurity, hardship and downright deprivation upon the urbanized and mechanized Atlantic world and Japan," read one December 1973 letter to the editor in the *New York Times*. "These ten million people would still be sitting in the sand contemplating their navels had it not been for American and European ingenuity, risk and business acumen, which discovered, mined, processed and sold oil that nature stored under those sands—without the slightest help from the herders drifting from oasis to oasis."<sup>329</sup> Statements like these grossly

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<sup>328</sup> Anthony Ripley, "Labor Chiefs Urge A Curb on Arab Oil; Support Rationing," January 24, 1975, *New York Times*.

<sup>329</sup> L. Edward Shuck Jr., "10 Million vs. 600 Million," December 8, 1973, *New York Times*.

overlooked the historical experience of Middle Eastern peoples and reinforced negative stereotypes in the service of economic nativism.

While the Nixon and Ford administrations generally sought good relations with the MENA countries regarding the petrodollar economy, and did not adopt the disparaging rhetoric seen above, they did participate in the narrative that high oil prices harmed the US economy. Both Nixon and Ford made fighting inflation and recession top priorities, and their top goal for the petrodollar economy was to gradually bring the price of oil down. The Nixon and Ford administrations thus regularly pushed the MENA oil producers, both publicly and privately, to lower oil prices. This issue created varying levels of tension between the US and MENA governments. One of the worst flaps developed from an interview Kissinger granted that *Business Week* published in early January 1975. Asked by the interviewer if military force was the only solution to breaking up OPEC, Kissinger responded that such a move would be “a very dangerous course. We should have learned from Vietnam that it is easier to get into a war than to get out of it.” Kissinger then added, however, that “I am not saying that there’s no circumstances where we would not use force. But it is one thing to use it in the case of a dispute over price; it’s another where there is some actual strangulation of the industrialized world.”<sup>330</sup> Arab governments interpreted the second half of Kissinger’s statement as a threat and responded with outrage.<sup>331</sup> In the face of this outrage, however, Ford decided to double down on Kissinger’s statement. “I wanted it made as clear as I possibly could that this country, in case of economic strangulation—and the key word is ‘strangulation’—we had to be prepared without specifying what we might do, to take the necessary action for our self-preservation,” Ford

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<sup>330</sup> “Kissinger on Oil, Food, and Trade,” January 13, 1975, *Business Week*.

<sup>331</sup> Juan de Onis, “Oil Producers Meet in Algiers With Bid that West End Threat,” January 25, 1975, *New York Times*.

declared during an interview on NBC with Tom Brokaw. “I think the public has to have a reassurance—our people—that we are not going to permit America to be strangled to death.”<sup>332</sup>

The Saudi Kingdom privately expressed great alarm at the *Business Week* interview and follow-up interviews. Yamani told US Ambassador James E. Akins that “he had never seen the King [Faisal] so depressed, so worried and so questioning of his relationship with the United States” and warned that the Saudis could sabotage their oil fields and deny the United States supplies for ten years if faced with invasion.<sup>333</sup> Akins also believed that European and Japanese ambassadors and other diplomatic officers were playing upon Saudi fears of a US invasion in an attempt to garner larger shares of government arms purchases and engineering contracts at America’s expense.<sup>334</sup> In response to Saudi fears, the Ford administration sent repeated messages reaffirming the United States’ commitment to the Kingdom, including a personal letter from Ford to Faisal.<sup>335</sup> The Saudi-US relationship survived the incident, but it underscored how domestic concerns about petrodollars could threaten US-MENA partnerships.

### **Fears of a Petrodollar Invasion and American Sovereignty**

Critics of the new petrodollar economy not only worried about dollars leaving the United States to the MENA, they also worried that the MENA countries would then bring those dollars back into the United States through an economic takeover of US businesses and property. Many Americans expressed fear that Arabs and Iranians would gain control over key sectors of the US economy and have far reaching influence in US public opinion and government decision making.

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<sup>332</sup> “Excerpts from President’s Interview,” January 24, 1975, *New York Times*.

<sup>333</sup> US Ambassador James E. Akins to Kissinger, January 5, 1975, folder “Saudi Arabia - State Department Telegrams To SECSTATE-EXDIS (1), box 29, PCF MESA, FL.

<sup>334</sup> Akins to Kissinger, January 18, 1975, folder “Saudi Arabia - State Department Telegrams To SECSTATE-NODIS (3), box 29, PCF MESA, FL.

<sup>335</sup> Kissinger to Akins, January 11, 1975, folder “Saudi Arabia - State Department Telegrams From SECSTATE-NODIS (2),” box 28, PCF MESA, FL.

While Arab and Iranian investors would rarely engage in direct investment in the United States, let alone seek controlling shares in major businesses, US media repeatedly described the size of oil-exporting countries' account surpluses in terms of how many US corporations they could buy out, reinforcing in the mind of the American public the notion that Arab and Iranian control of the US economy was a real possibility. As *Time's* article naming Faisal the "1974 man of the year" put it:

Saudi Arabia's new wealth is simply the most spectacular symbol of the rising fortunes of the OPEC nations. With their surplus of some \$60 billion last year, they took in \$164 million more each day and \$6.8 million more each hour than, by best estimates, they can currently spend. At that rate of accumulation, the Economist of London calculates, OPEC could buy out all companies on the world's major stock exchanges in 15.6 years (at present quotations), all companies on the New York Stock Exchange in 9.2 years, all central banks' gold (at \$170 an ounce) in 3.2 years, all U.S. direct investments abroad in 1.8 years, all companies quoted on stock exchanges in Britain, France and West Germany in 1.7 years, all IBM stock in 143 days, all Exxon stock in 79 days, the Rockefeller family's wealth in six days and 14% of Germany's Daimler-Benz in two days (which in fact Kuwait did in November—though for that little country, the purchase represented all of 15 days of oil earnings).

On occasion MENA investors did themselves no favors in reassuring American opinion, such as when Masoud Sharif Hamdan requested to purchase the Alamo as a birthday gift for his son, who had spent time in Texas studying in a training program for foreign military officers. Texas Governor Dolph Briscoe flatly denied the possibility of selling the treasured Texan historical site, but left open the possibility of Hamdan instead investing "in some kind of energy production such as offshore drilling."<sup>336</sup> Even when engaging in relatively commonplace business deals, however, Arab investors faced American backlash, such as the successful

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<sup>336</sup> One entrepreneur named Bud Boldt did, however, offer to sell Hamdan a full-scale terra cotta reproduction of the façade of the Alamo that he possessed. When asked by reporters how much he wanted for it, Boldt replied "Well, he is a sheik. I guess he could afford just about anything." See "May the Sheikh Buy the Alamo?," January 24, 1975, *Washington Post*, in folder "Clippings, 1975, Foreign Investments (1)," box 41, JCWP; "He Says This Alamo Is Definitely for Sale," January 28, 1975, *Washington Post*, in folder "Clippings, 1975, Foreign Investments (1)," box 41, JCWP.

resistance that the directors of two US local bank directors posed to the first two attempts by Arabs to gain a controlling share of an American bank (see chapter two).<sup>337</sup> The Treasury Department was so concerned about the possibility of the Arabs and Iranians inciting popular American anger over foreign investments that they directed George Shultz, while on a mission to the Gulf states as an unofficial government envoy, to advise the Arabs and Iranians that it “would be the benefit to the investing oil-producing countries in carefully and publicly... longer term investments in industries not closely related to national defense, public opinion formation, or negotiations with the producing countries themselves... [as these] would be likely to generate disruptive public debate and overlie restrictive regulations.”<sup>338</sup>

Narratives reflecting and seeking to spread US fears that the investment of petrodollars could be used against US interests were not restricted to newspapers and magazines, but found their way into other forms of popular media like films and fiction novels. The 1976 Academy Award-winning film *Network* deployed the fear that Arab petrodollars could be used as an economic weapon to destroy the sovereignty, power, and values of the United States as a key plot device. In this dark comedy the protagonist, popular news anchor Howard Beale, informs his audience that a Saudi Arabian conglomerate is moving to purchase the television station where he works. Beale passionately warns that the Arabs “despise this country and everything it stands for,” and that “a couple of dozen nomadics are going to own where you work, where you live, what you read, what you see, your schools, your churches... Right now the Arabs have screwed us out of enough American dollars to come right back and with our own money buy General Motors, IBM, ITT, AT&T, DuPont, US Steel, and twenty other American companies... the Arabs are simply buying us.” The only way to prevent this, Beale concludes, is if the

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<sup>337</sup> “A Local Arab Banker?,” “Break a Bank Barrier.”

<sup>338</sup> Jack F. Bennett to Simon, January 8, 1975, folder “Middle East 1975-1976,” box 23, WSP.



American people flood the White House with telegrams and phone calls demanding that Arab purchases of Beale's network and other US companies be blocked by the US government. The film both assumed and promoted a wide-spread populist demonization of Arabs amongst American film-goers, a demonization anchored in the twin assumptions that Arabs were inherently inimical to American values and that Arabs were seeking to control the United States. The film implied that American power and sovereignty could only be reasserted if American citizens reengaged themselves in politics for the purpose of preventing foreign economic takeovers.<sup>339</sup>

The chairman of the company that owns Beale's station, Arthur Jensen, then meets with Beale in private, whereupon Jensen launches his own tirade against Beale's actions. "The Arabs have taken billions of dollars out of this country, and now they must put it back!" Jensen declares, but not for America's sake, but rather for the sake of international finance. Jensen continues:

You are an old man who thinks in terms of nations and peoples. There are no nations. There are no peoples. There are no Russians. There are no Arabs. There are no Third Worlds. There is no West. There is only one holistic system of systems, one... multinational dominion of dollars... It is the international system of currency which determines the totality of life on this planet... You get up on your little twenty-one inch screen and howl about America and democracy. There is no America. There is no democracy. There is only IBM, and ITT, and AT&T, and DuPont, Dow, Union Carbide, and Exxon. We no longer live in a world of nations and ideologies, Mr. Beale. The world is a college of corporations, inexorably determined by the immutable bylaws of business.

The film cast multinational corporations as coconspirators with the Arabs in undermining America's sovereignty. The pursuit of money had led corporate executives to sell out America to the Arabs; indeed, some of these executives had become so consumed by the pursuit of wealth that they no longer recognized a difference between the two. For businessmen like Jensen, the

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<sup>339</sup> *Network*, directed by Sidney Lumet (1976).

new globalized economy, of which petrodollar recycling was a key part, erased all identities and values other than money.<sup>340</sup>

Other films depicted American heroes pitted against petrodollar-rich and nefarious Arab sheikhs. The popular orientalist stereotype of the Arab sheikh as a dimwitted, opulent, sex-crazed, and/or bloodthirsty tyrant had loomed large in American popular culture well before the oil shock of 1973. The new petrodollar economy boosted the appearance of this stereotyped sheikh as a character in films and granted him a new backstory in that he had obtained his unearned wealth and power from oil profits.<sup>341</sup> The 1976 sexploitation and captivity film *Ilsa: Harem Keeper of the Oil Sheiks*, for example, casts the Arab oil sheikh El Sharif and his Nazi SS accomplice Ilsa as the villains. The film was laden with graphic depictions of orientalist tropes: El Sharif uses his petrodollars to create a harem of abducted beautiful white women, including an American heiress, who are forced into El Sharif's sexual service and brutally tortured for disobedience by harem master Ilsa. An occasional man or young boy is also shown as sex slaves. Other Arab sheikhs bid for El Sharif's slaves at an auction; one sheikh has all of the teeth removed from a slave girl he purchases. A US diplomat, Dr. Kaiser (who resembles Kissinger down to the German accent), and a US secret agent posing as Kaiser's aide, Commander Adam Scott, fly to El Sharif's kingdom in the hope of either convincing El Sharif to increase oil production or to discover information they can use to blackmail him with. "That small patch of desert sits on top of a bottomless pit, an ocean of oil, and we need it!" Dr. Kaiser tells Scott. "Not just a trickle, a torrent... we are being held to ransom by an unscrupulous son of a bitch who just happens to rule a few hundred acres of sand. Hell, our companies helped to build this

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<sup>340</sup> Ibid.

<sup>341</sup> For background on the history of the stereotype of the "Arab sheikh" in American film, see Jack G. Shaheen, *Reel Bad Arabs: How Hollywood Vilifies a People* (New York: Olive Branch Press, 2001).

bloody country: roads, refineries, pipelines, military equipment.”<sup>342</sup> By having Kaiser describe the situation as one of ransom, the film parallels the situation between the United States and oil producers with the captivity and abuse of the Western women in El Sharif’s harem.

Dr. Kaiser’s attempts at diplomacy with El Sharif fail and he departs, but Scott remains at El Sharif’s palace, as he is in the process of seducing Ilsa. Despite being a powerful, ruthless, and sadistic woman, Ilsa falls madly in love with Scott when he forces Ilsa to have sex with him at knife-point. Scott and Ilsa then launch a successful armed revolution against El Sharif. Scott secures the allegiance of the new ruler, a young nephew of El Sharif, while Ilsa is thrown in a dungeon due to her continued cruelty and killing of innocents (love does not trump Nazi habits, apparently).<sup>343</sup> The film, through the failure of Kaiser and the success of Scott, suggests to Americans that a violently masculine and sexually dominating approach, rather than impotent diplomacy, will defeat the villainous designs of petrodollar-rich sheikhs. Ironically, however, it is the villainous acts of El Sharif that attract the audience to the film in the first place. The film invites viewers to indulge in the orientalist fantasy of absolute power over women and the images of sex and violence. It is only after over an hour of sadistic and/or masochistic voyeurism that the film then advances a second, contradictory indulgence: that of righteous American violence succeeding against the very oppression the viewer was previously living through vicariously.

In contrast, the 1977 comedic film *The Happy Hooker Goes to Washington* worked to reassure American audiences of their ability to thwart Arabs and their petrodollar power through a tale of liberated female sexual empowerment. The heroine of the film is Xaviera Hollander, a Dutch immigrant to the United States who has become America’s most famous sex advice

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<sup>342</sup> *Ilsa: Harem Keeper of the Oil Sheiks*, directed by Don Edmonds (1976).

<sup>343</sup> *Ibid.*

columnist, advocate for sexual liberation, hooker, and madam. A conservative US senator calls Xaviera to a congressional hearing on sexual excess in America in order to demonize her and thus distract public attention from the failings of Congress. During a recess from the hearing, a CIA agent recruits Xaviera for an urgent undercover mission. “The Middle East men are meeting this week in Miami Beach to confirm the starting of a war which would be disastrous for the economy of the free world,” the agent explains to Xaviera. Showing slides of a gaudily dressed Arab surrounded by harem girls, the agent states “this most militant of Arab leaders is Sheikh Ali. Sheikh Ali is the most ruthless, egocentric, self-indulgent oil billionaire of the Middle East.”<sup>344</sup> The agent explains that a military assault or covert assassination is not an option, implicitly due to the Vietnam War and the checks that Congress recently placed on CIA activities. Instead, Xaviera must keep Ali from the meeting in order to prevent the declaration of war. Xaviera goes to Miami Beach and meets Ali, who speaks in an effeminate, nasally lisp. Ali brags that his harem girls “say that my mighty member is like an oil derrick, gushing a hundred barrels a day,” but when Xaviera grabs Ali’s crotch, she frowns and says “it’s not much of a gusher is it?” Ali sobs that “it’s a mirage,” but Xaviera assures him she can help fix his problem. Xaviera then beds Ali and keeps him from the meeting, thus preventing the war. She then discovers that the senator trying to deport her through the congressional hearing is secretly involved with Ali in the “white slave trade.” Xaviera returns to Washington and exposes the senator, to the cheers of the assembly.<sup>345</sup>

In linking the senator to Ali, *The Happy Hooker Goes to Washington* played to post-Watergate American cynicism about their government leaders, and to their fears that Arab

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<sup>344</sup> For good measure, the agent also says about Sheikh Ali that “he is also the absolute ruler of 48 million subjects whose average per capita income is forty nine dollars and eleven cents a year, before taxes. His people hate him, and wherever there is that kind of natural unrest, there’s always the danger of communist revolution.” *The Happy Hooker Goes to Washington*, directed by William A. Levey (1977).

<sup>345</sup> Ibid.

petrodollars could be used to subvert American democracy and the interests of US citizens. By stating that the US government could not militarily or covertly overthrow Ali, the film appeared to decry the checks on US power passed in the wake of the Church Committee hearings of the mid-1970s. Despite the failings of their leaders, however, the film affirms that the American people can still defeat the oil-rich Arabs, as shown by the cunning of a sexually liberated hooker. Indeed, the film suggests that the Arabs are in fact not nearly as powerful as they are projected to be if they are actually confronted by Americans. Ali, described as the most “ruthless” and “militant” of the Arab leaders, proves to be comically inept, insecure, and unmanly. The power of the Arabs and their petrodollars, just like Ali’s “derrick,” proves to be a mirage.

### **Efforts to Regulate Foreign Investment and Counter the Arab Boycott against Israel**

Some actual members of Congress, responding to concerns about petrodollars being used to subvert US interests, sought to pass legislation implementing stricter oversight and controls over foreign investment. Congressional concerns about foreign investment in the United States were not limited to Arabs and Iranians. From 1969 to 1973 direct foreign investments in the United States, largely from Western Europe and Japan, increased more than fifty percent, and some Americans expressed concern about European and Japanese competition in the US domestic economy. The projected gigantic surpluses of the oil-exporting countries after the 1973 oil shock brought a new sense of urgency to American debate on the issue, however. In January 1974, Democratic Representative John Moss submitted a bill that would limit foreign ownership of US energy and defense companies to ten percent in order to protect national security interests, while Democratic Representative John Dent submitted a bill that would prohibit foreign

ownership of more than five percent of any US corporation's voting stock.<sup>346</sup> In February 1975 Democratic Senator Harrison A. Williams Jr. sponsored a bill that would grant the president discretionary power to prevent any foreign investment totaling more than five percent of the stock of any US company with assets of \$1 million or more and would require domestic companies to fully disclose all foreign and domestic ownership, in part due to reports that Arabs had used their petrodollars to harm Jewish banks in the United States. “[We should be] leery of claims that economic power will never be used to win political objectives,” Williams declared. “The dangers inherent in our traditional open-door policy toward foreign investment can no longer be ignored.”<sup>347</sup>

The Nixon and Ford administrations resisted these congressional efforts to increase the regulation of foreign investment, as they sought to preserve petrodollar flows into the United States, retain good relations with allied MENA countries, and to preserve the broader US commitment to minimally restricted foreign investment as a global norm.<sup>348</sup> Treasury spearheaded the effort to dissuade Congress from limiting foreign investment into the United States, insisting that foreign investment helped the US economy and that there were already adequate protections for national security interests. “To the degree we are successful in attracting additional capital we facilitate to that degree economic recovery,” Under Secretary of the Treasury for Monetary Affairs Edwin Yeo testified before Congress.<sup>349</sup> The Ford administration also raised the danger of retaliation against US direct investment in other countries, which was six times larger than the total of foreign direct investment in the United

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<sup>346</sup> James Ganon, “US ripe for sheikhs,” January 28, 1974, *The Guardian*.

<sup>347</sup> “Williams Sees Take-over Threat,” February 27, 1975, *New York Times*.

<sup>348</sup> Pranay Gupte, “Move to Study Foreign Investing in U.S. Reflects Concern on Rising Trend and Lack of Fresh Data,” August 29, 1974, *New York Times*; Brendan Jones, “Ford Aides Fight Senate Bill With Plan To Control Foreign Investment in U.S.,” March 5, 1975, *New York Times*.

<sup>349</sup> Statement, *Multinational Corporations and United States Foreign Policy*, Hearings before the Subcommittee on Multinational Corporations, Senate Foreign Relations Committee, Part 15 (Washington: July-October 1975), 22, quoted in Cohen, *In Whose Interest?*, 128.

States, if the United States increased restrictions.<sup>350</sup> The Chamber of Commerce of the United States, the National Foreign Trade Council, and the United States Council of the International Chamber of Commerce joined the White House in publicly opposing legislation proposing greater regulation.<sup>351</sup> Treasury also privately lobbied Congress. “Each corporation must abide by a host of Federal and State laws which have been written to protect the economy, consumer, the public, and the government from undesirable corporate activity, regardless of the extent of foreign ownership,” Assistant Secretary of the Treasury for International Affairs Gerald L. Parsky wrote to Democratic Senator Floyd Haskell in response his concerns about foreign investment. “In addition, no profit oriented enterprise can survive the rigors of the market place very long unless it operates in a consistent manner meeting the challenges of competition and offering the consumer the best product at the lowest possible price.”<sup>352</sup> The Ford administration ultimately proved successful in its efforts; Congress never passed new legislation increasing restrictions on foreign direct investment.<sup>353</sup> Critics could take heart, however, in having created a discouraging environment for Arab and Iranian direct investment in the United States, and in the fact that direct investment in the United States by oil-exporting MENA countries remained relatively small, increasing by only \$68 million from 1974 to 1976.<sup>354</sup>

The Ford administration had more difficulty dealing with Congress on the issue of the Arab boycott. The member states of the Arab League implemented a boycott against Israel in 1948, and over time extended the boycott to many companies that engaged in business with Israel; enforcement varied at the secondary level, with many companies receiving exemptions if

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<sup>350</sup> Jones, “Ford Aides Fight Senate Bill With Plan To Control Foreign Investment in U.S.”

<sup>351</sup> Brendan Jones, “Issue and Debate: Should U.S. Curb Investing by Foreigners?” April 7, 1975, *New York Times*.

<sup>352</sup> Parsky to US Senator Floyd Haskell, February 3, 1975, folder “Chron Feb 1975,” box 1, Office of Under Secretary for Monetary Affairs Chronological Files Parsky 1975-76, RG56 GR DoT, NARA2.

<sup>353</sup> Kunz, *Butter and Guns*, 257.

<sup>354</sup> Cohen, *In Whose Interest?*, 125.

their services were needed by the Arab countries. Many Arab countries also expelled their native Jewish populations and denied Jews from entering their borders or engaging in business with their country. By 1972 the Arab countries had blacklisted an estimated 1,500 American companies due to their business ties with Israel.<sup>355</sup> Before 1973 most companies had ignored or were unaware of the Arab blacklist, but after the oil shock many corporations reportedly avoided business with Israel for fear of losing access to Arab petrodollars.<sup>356</sup> In February 1975 the Arab boycott garnered headlines in the United States when the Kuwait International Investment Company dropped out of two lending syndicates because the deals involved the blacklisted banking firm Lazard Frères as an underwriter.<sup>357</sup> Republican Senator Jacob K. Javits and Democratic Senator Harrison Williams publicly called upon the Ford administration to investigate the matter and determine if the Arab boycott illegally discriminated against Jewish or other Americans.<sup>358</sup> Shortly thereafter the Anti-Defamation League of B'nai B'rith charged that the Army Corps of Engineers, the Overseas Private Investment Corporation, and six private US companies were illegally discriminating against the hiring of Jewish employees in onsite jobs in Arab countries.<sup>359</sup> The Senate Foreign Relations Subcommittee on Multinational Corporations, chaired by Democratic Senator Frank Church, held hearings on the Arab boycott in late February and early March, where the Anti-Defamation League called for a ban on Arab investment in the United States until the Arab boycott issues was addressed.<sup>360</sup>

The Ford administration did not condone discrimination against Jews, but it did not want to challenge the boycott of Israel for fear of angering the Arab countries. On February 26, Ford

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<sup>355</sup> Edward Cowan, "List Is Extensive For Arab Boycott," February 26, 1975, *New York Times*.

<sup>356</sup> Seymour Topping, "Arab Oil Wealth Puts pressure on Israel," January 4, 1975, *New York Times*.

<sup>357</sup> Juan de Onis, "Kuwait Quits 2 Deals Here With Boycotted Financiers," February 13, 1975, *New York Times*.

<sup>358</sup> Michael C. Jensen, "2 Senators Assail Arabs' Blacklist," February 15, 1975, *New York Times*.

<sup>359</sup> Edward Cowan, "Arabs' Blacklist Deplored By Ford," February 27, 1975, *New York Times*.

<sup>360</sup> Cowan, "Arabs' Blacklist Deplored By Ford"; Brendan Jones, "Curb on Arab Investors Who Use Boycotts Urged," March 7, 1975, *New York Times*.



told reporters that economic discrimination against individuals or institutions on religious or ethnic grounds was “totally contrary to the American tradition and repugnant to American principles,” and that he had instructed the Justice, Commerce, and State Departments to investigate any violations of US law committed by Arab states. Ford did not push for action on the Arab boycott of Israel, however, and on the same day State Department Deputy Assistant Secretary Harold H. Saunders testified to Congress that the Arab boycott “is best dealt with through quiet diplomacy and persuasion, without following a policy of confrontation.”<sup>361</sup> Many members of Congress disagreed with the Ford administration’s preference for quiet diplomacy and instead pushed for new laws that would criminalize participation in the Arab boycott. In July 1975 Democratic Representative Elizabeth Holtzman and nearly a hundred cosponsors submitted a bill that would make participation in the secondary boycott against US individuals or organizations punishable by prison time and fines up to \$1 million.<sup>362</sup> Anti-boycott bills angered Arab governments, particularly the Saudi Kingdom. Scowcroft informed Ford that “the leaders of Saudi Arabia... have told us clearly that there is room for quiet, practical improvement in the application of visa and business policies related to the Arab boycott but that they will react very strongly against any attempt to force their hand by public pressure and U.S. legislation.”<sup>363</sup> The Ford administration thus sought to prevent Congressional action on the Arab boycott.

Hoping to co-opt the issue, in November 1975 Ford proposed legislation that would prohibit businesses from using “economic means to coerce any person or entity to discriminate against any United States person or entity on the basis of race, color, religion, national origin or sex,” a measure that would not extend to the Arab boycott against Israel, and in January 1976 the

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<sup>361</sup> Cowan, “Arabs’ Blacklist Deplored By Ford.”

<sup>362</sup> Thomas P. Ronan, “Holtzman Bill Designed To Defuse Arab Boycott,” July 12, 1975, *New York Times*.

<sup>363</sup> Scowcroft and Ed Schmuls to Ford, circa November 20, 1975, folder “Country File - Saudi Arabia (1),” box 2, NSA IEASF, FL.

Justice Department filed its first case pertaining to the Arab boycott, suing Bechtel for violating antitrust law by refusing to subcontract its work to US companies that were blacklisted and thus restraining trade within the United States (Bechtel angrily responded that it had not violated any US laws).<sup>364</sup> Despite the Ford administration efforts, Congress continued to push confrontational legislation. The House of Representatives passed multiple bills in 1976 aimed against the Arab boycott. One bill criminalized taking part in any trade boycott “against any country which is friendly to the United States.”<sup>365</sup> Democratic Senator Abraham A. Ribicoff proposed a bill that would deny certain tax breaks to companies that participated in the Arab boycott; Treasury determined the loss of the tax benefits “would render much investment by U.S. firms in Arab countries economically untenable.”<sup>366</sup> The Ford administration privately lobbied congressmen not to support anti-boycott bills, insisting that confrontation with the Arabs was counterproductive to ending the Arab-Israeli conflict.<sup>367</sup> The Ford administration defeated bills aimed at criminalizing participation in trade boycotts, but Ribicoff then successfully attached his legislation as an amendment to a tax revision bill. Ford believed this tax revision bill would be an important initiative to improve the economy and thus did not want to veto it, but he was also unable to get the amendment removed. In October 1976 Ford reluctantly signed the tax revision bill that included Ribicoff’s amendment.<sup>368</sup> The Saudi government then privately warned both the US government and major US corporations that any additional anti-boycott legislation might force Saudi Arabia to stop holding the price of oil down since they would not have any examples

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<sup>364</sup> Philip Shabecoff, “Ford Takes Steps To Protect Jews In Arab Boycott,” November 21, 1975, *New York Times*; “U.S. Suit Over Bechtel’s Boycott Actions Raises Fears About Harm to Mideast Ties,” January 19, 1976, *Wall Street Journal*.

<sup>365</sup> “House Passes Another Bill to End Compliance With Arab Boycott,” September 23, 1976, *New York Times*.

<sup>366</sup> Henry H. Happel to Parsky, April 23, 1976, folder “Arab Boycott - 1976 (Jan-May),” box 1, Office of the Under Secretary for Monetary Affairs Records Assistant Secretary of International Affairs 1973-76, RG56 DoT, NARA2.

<sup>367</sup> Robert B. Oakley to Scowcroft, William Seidman, May 18, 1976, folder “Middle East - General (15),” box 1, PCF MESA, FL.

<sup>368</sup> “The Arab Boycott,” September 14, 1976, *New York Times*; “Ford Signs Tax Revision Measure; Calls It ‘Positive and Long Overdue,’” October 5, 1976, *New York Times*.

of US reciprocity for Saudi help.<sup>369</sup> Despite the Ford administration's efforts, the actions of Congress strained Saudi-US relations. The issue would remain an irritant in US-Arab relations into the Carter years, when additional legislation was passed that made it illegal for US corporations to enforce foreign boycotts or to enter into any agreement that stipulated boycotting a third country as a condition of conducting business. Despite their irritation at these measures, Arab countries generally proved willing to continue business with US corporations, although a few contracts were likely lost to foreign competitors due to the new US laws.<sup>370</sup>

### **Debates over US Arms and Petrodollars**

Another important area of petrodollar contention was the massive size and technological capability of US arms sales to oil-exporting MENA countries. Many Americans contended that US arms sales to the MENA were a potential danger to US strategic interests, peace, and human rights. For supporters of Israel, US arms sales to Arab countries were often considered particularly ominous.

Many commentators raised the possibility that US arms sales to Middle East allies might be used against US interests or fall into different hands. A 1975 *Time* cover article on US arms exports argued that weapons sales had reached "insane" levels and warned that "today's favored arms customer may become tomorrow's Frankenstein monster. Governments can change abruptly; a coup in Iran or Saudi Arabia might bring to power a regime as radical as that of Libya's Colonel Muammar Gaddafi. The new leader would inherit a cache of the latest military

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<sup>369</sup> US Ambassador William J. Porter to Kissinger and Secretary Designate of State Cyrus Vance, folder "Saudi Arabia - State Dept Telegrams To SECSTATE-NODIS (15)," box 30, PCF MESA, FL.

<sup>370</sup> Concern about the Arab boycott would fade from popular attention in the 1980s, not reappearing again until the late-1990s when Arabs and Arab-Americans in the United States and the MENA launched a new grassroots campaign to boycott particular US goods in protest of US policy on the Israeli-Palestinian conflict. See Terry, *U.S. Foreign Policy in the Middle East*, 93-109.

hardware, which he would almost surely use against the interest of the Western states that originally provided it.”<sup>371</sup> In 1976 the *New York Times* opined that foreign arms sales had become “mindless” and “excessive” and argued that the sophistication of weapons sold to countries like Iran required thousands of on the ground American personnel that could draw the United States into a regional conflict, raising the memory of the deployment of US military advisors in Vietnam as the start of US involvement in the Vietnam War.<sup>372</sup>

*The Crash of '79*, a 1976 novel by Paul E. Erdman, merged petrodollar concerns pertaining to both arms sales and investments to imagine an apocalyptic near-future. Making the *New York Times* Best Seller List for 45 weeks, *The Crash of '79* is a fictional account, set in 1979, of a series of global disasters brought about due to America’s reliance upon Saudi and Iranian petrodollars. Throughout the novel, the recurrent motif is that money, usually petrodollars, causes people to do very stupid things.<sup>373</sup> While fictional American bankers and government officials are savaged in the book, the real life Shah of Iran is casted as the main villain of the story. The Shah is secretly planning an invasion of his Persian Gulf neighbors. The Shah has bided his time by gaining the trust of the United States, all the while secretly planning to establish Iran as the third superpower of the world by conquering the territorial boundaries of the ancient Persian Empire of the Sassanids, which will leave him in sole control of the oil reserves of the Persian Gulf. For good measure, the Shah also plans to wipe out Israel. The Shah employs many tricks to implement his plan, including a secret nuclear weapons program. A crucial element in the Shah’s plan, however, is creating a massive army by using petrodollars to purchase American arms and American constructed military bases. The greed

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<sup>371</sup> “Armaments: The Arms Dealers: Guns For All.”

<sup>372</sup> “Mindless Arms Sales,” August 11, 1976, *New York Times*.

<sup>373</sup> Paul E. Erdman, *The Crash of '79* (New York: Simon and Schuster, 1976); <http://www.hawes.com/1976/1976.htm>; <http://www.hawes.com/1977/1977.htm>.

and myopia of US corporations and the US government in pursuing petrodollars makes the Shah's plan easy to realize; by 1979 Iran has even rented two US aircraft carriers. As Iran launches its assault, Erdman goes out of his way to list the names of advanced American military aircraft and missiles as they are used to conquer Iraq and the Arab Gulf Kingdoms, and to attribute Iran's battlefield successes to the schooling provided by the US Air Force. The fact that Iran was in reality buying many of these weapons and receiving training from US military personnel when the book was published lent an air of possibility to the doomsday scenario presented in the novel. As the Shah oversees Iran's assaults, Erdman describes his command bunker as "a marvel of modern technology... constructed by Bechtel Corporation of San Francisco and equipped by Raytheon, Westinghouse, Litton Industries, and Texas Instruments with the very best in communications equipment. Nothing in either the Pentagon or the White House in Washington even came close."<sup>374</sup> The admiring prose used by so many real newspaper and magazine articles to describe American engineering projects in the Middle East is parodied by Erdman to great sardonic effect.

Whereas the economic and military catastrophes in *The Crash of '79* are futuristic speculation, the Shah's atrocities against human rights within his own country needed little embellishment. The book underscored the brutality of the Iranian Army and SAVAK against its own people repeatedly. When one of the more idealistic characters of the book, Ursula Hartmann, learns that her father is helping the Shah develop nuclear weapons, she protests to him that the Shah

does not need these weapons for defense... he intends to use them. To suppress and murder other people, deliberately. Just as he has been using every weapon at his disposal thus far to deliberately suppress and murder—his own people.

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<sup>374</sup> Erdman, *The Crash of '79*, 317.

Haven't you seen what goes on in this country [Iran]? It is as bad as Spain under Franco, or Chile under the generals. It is almost as bad as Nazi Germany.<sup>375</sup>

The juxtaposition of the Shah's actual and fictional brutality, along with the regular mentioning of US made weapons in the Iranian armed and security forces, raised the question of the moral soundness of US arms sales to Iran.

The Shah nearly succeeds in conquering the Middle East, but he is ultimately killed by an American nuclear warhead. This does not occur in time, however, to prevent several Iranian cobalt nuclear bombs from being detonated in the Persian Gulf. The cobalt contaminates the entire region's oil supply, making it inaccessible for a minimum twenty-five years. At the same time, the conflict in the Middle East triggers a global panic in which much of the world withdraws its investments in the United States, in turn generating local bank failures and panics within the United States. The US government then attempts to shore up the banking system by rapidly increasing the US money supply, causing instant hyperinflation. The destabilization of the dollar and the loss of half the world's oil reserves in the same week cause the entire Western economic system to collapse, and the United States is set back to the technological level of the nineteenth century. Erdman's novel suggested, in a sensational fashion, that the shortsightedness of US government officials and the greed of US arms and engineering companies were dangerously eroding America's power to control events in the Middle East, and that the United States' growing financial dependence on Middle Eastern tyrants and their investments, oil, and business could result in egregious consequences for the world.<sup>376</sup>

Americans who supported Israel's position in the Arab-Israeli conflict were one of the most vocal and organized groups to criticize US arms sales to the Arab countries. These Israeli

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<sup>375</sup> Erdman, *The Crash of '79*, 149.

<sup>376</sup> Erdman, *The Crash of '79*, 317.

advocates often raised the specter of Arab weapons being used to kill Jews. A letter to the editors of *Time* magazine stated “What billions of petrodollars will not buy is Israel, a sovereign nation, and this must be made abundantly clear to the Palestinian people. Arafat wishes to complete what Hitler and Stalin were unable to do: the wholesale extermination of the Jewish people. This cannot be tolerated. But will the world wake up?”<sup>377</sup> As US arms sales to Arab countries increased, so did the efforts of pro-Israeli groups in the United States to challenge them.

In 1974 Congress passed legislation requiring that it be notified of any proposed foreign arms sales exceeding \$25 million, and empowering Congress to veto the sale if both houses passed resolutions to do so within thirty days of the notification. The Ford administration faced the greatest amount of resistance to MENA arms sales from Congress in 1976. The year began with the release of a report prepared by Republican Representative Pierre du Pont IV charging that the United States could not prevent weapons sold to the Gulf states from being transferred to Arab states bordering Israel in the case of renewed conflict, and that the US government lacked a coherent policy on foreign arms sales.<sup>378</sup> Members of Congress proposed and drafted new regulations on the arms trade, ranging from a ban on sales to countries engaged in the Arab boycott to setting a cap on the value of US arms exports that could be approved in a year.<sup>379</sup> Democratic Senator William Proxmire charged that massive arms sales to countries like Iran had diverted critical manpower and weapons needed by the US military, and urged that American needs be reprioritized.<sup>380</sup>

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<sup>377</sup> Richard Rebhun, “Forum, Dec. 2, 1974,” December 2, 1974, *Time*.

<sup>378</sup> “U.S. arms sales in Persian Gulf called ‘beyond control,’” January 3, 1976, *Chicago Tribune*.

<sup>379</sup> Lauren Stern, “Arms Sales Bill Opposed,” February 1, 1976, “Cutting Arms Sales,” February 24, 1976, *New York Times*.

<sup>380</sup> Kenneth H. Bacon, “Foreign Military Sales Program Strains Pentagon Resources, Causes Problems,” February 17, 1976, *Wall Street Journal*.

Proposals to curb arms sales alarmed the Shah, and he publicly spewed vitriol at the idea. “If you try to take an unfriendly attitude toward my country, we can hurt you as badly if not more so than you can hurt us,” the Shah warned the United States in an interview with *U.S. News & World Report* in March. “Not just through oil; we can create trouble for you in the region. If you force us to change our friendly attitude, the repercussions will be immeasurable.”<sup>381</sup> Despite the Shah’s strong words, in April Congress passed a bill that capped total US foreign arms sales at \$9 billion per fiscal year starting in 1977 and allowed Congress to bar sales to countries with human rights violations. Ford vetoed the bill, arguing that these measures limited the United States’ ability to help allied countries and “obstructs U.S. industry from competing fairly with foreign suppliers.”<sup>382</sup> While the Ford administration sought congressional approval for a massive arms sale to Iran, including the purchase of the F-16 fighter, Democratic Senator Hubert Humphrey released a report warning that the thousands of US personnel needed to train Iranians in the use of US weapons could become hostages of Iran should that country enter into a conflict against the will of the United States. The report urged a significant reduction in US arms sales to Iran.<sup>383</sup> Humphrey’s report outraged the Shah. “Can the United States or the non-Communist world afford to lose Iran?” the Shah asked journalists in Tehran while a visiting Kissinger stood beside him. “What will you do if one day Iran will be in danger of collapsing? Do you have any choice?”<sup>384</sup> Serious opposition to the transfer of the F-16 to Iran did not materialize, and Congress allowed the sale to go forward, but the ability of congressional protests to strain Iran-US relations had been made clear.<sup>385</sup>

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<sup>381</sup> “U.S. Is Warned by the Shah Against Cutting Arms Flow,” March 15, 1976, *New York Times*.

<sup>382</sup> Bernard Gwertzman, “President Vetoes Aid Bill, Charging It Restricts Him,” May 8, 1976, *New York Times*.

<sup>383</sup> Leslie H. Gelb, “Study Finds Iran Dependent On U.S. In Using Weapons,” August 2, 1974, *New York Times*.

<sup>384</sup> Bernard Gwertzman, “Shah Cautions U.S. Against Arms Cut,” August 7, 1976, *New York Times*.

<sup>385</sup> Don Oberdorfer, “Saudi Missile Dispute Stirs Call for new Arms Sales Policy,” October 1, 1976, *Washington Post*.



US arms sales to Saudi Arabia faced far greater congressional opposition. In July 1976, the Ford administration requested the sale of 2,000 Sidewinder and 1,800 Maverick missiles to Saudi Arabia. Many members of Congress objected both due to concerns about the security of Israel and the general surge of US foreign arms sales.<sup>386</sup> The Saudi government, which desired tangible proof that its assistance to the United States in holding down oil prices produced reciprocal benefits, was bothered by congressional resistance to the sale. US Ambassador William J. Porter reported that the cuts in missiles, combined with threatened anti-boycott legislation, “could easily change Saudi preferences for maintaining [rather than raising] present oil prices.”<sup>387</sup> Faced with strong congressional opposition but hoping to salvage a deal that would appease the Saudis, the Ford administration reduced its request to 850 Sidewinder and 650 Maverick missiles.<sup>388</sup> When the Senate then attempted to deny the sale of the 650 Maverick missiles, Kissinger personally met with Senate leaders to impress upon them the damage this could cause to Saudi-US relations and secured the passage of the sale.<sup>389</sup> While US arms sales to Saudi Arabia were increasing, congressional resistance to this trend threatened Saudi-US relations and the efforts of the Ford administration to secure lower oil prices.

Jimmy Carter exploited the recent controversies over the Arab boycott and US arms sales to the Gulf states to attack Ford during the presidential contest of 1976. In doing so, Carter targeted Americans’ concerns about Israel, US strength in the world, and human rights. Carter pledged that as president he would end the Arab boycott, and he condemned the Ford administration for pressuring Congress into selling the Sidewinder and Maverick missiles to

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<sup>386</sup> Leslie H. Gelb, “U.S. Ready to Sell Missiles to Saudis,” August 1, 1976, *New York Times*.

<sup>387</sup> Porter to Kissinger, August 28, 1976, folder “Saudi Arabia - State Department Telegrams To SECSTATE-NODIS (14),” box 30, PCF MESA, FL.

<sup>388</sup> “Bowling to Critics, U.S. Cuts Request On Saudi Missiles,” September 2, 1976, *New York Times*.

<sup>389</sup> John W. Finney, “Effort Collapses in Congress to Block Sale of Missiles to Saudi Arabia,” September 29, 1976, *New York Times*; Oberdorfer, “Saudi Missile Dispute Stirs Call for new Arms Sales Policy.”

Saudi Arabia. “We should not simply sell weapons to get oil,” Carter declared.<sup>390</sup> During a televised debate between Carter and Ford on foreign policy on October 6, Carter declared that if any Arab country imposed an oil embargo on the United States while he was president, he would respond with a total trade embargo on that country.<sup>391</sup> Carter also questioned Ford’s commitment to Israel, stating that during the Democratic presidencies of John F. Kennedy and Lyndon B. Johnson sixty percent of US arms sent to the Middle East excluding Iran were sent to Israel, but during the last fiscal year under Ford the amount had dropped to forty percent. Carter argued that instead of Ford’s policy of exporting arms to the Arabs in return for oil, “there ought to be a clear, unequivocal [U.S.] commitment, without change, to Israel.”<sup>392</sup> Carter also criticized Ford for planning to deliver new arms like the F-14 to Iran before the US armed forces received any.<sup>393</sup>

Carter’s attacks put Ford on the defensive. During the television debate, Ford countered Carter’s criticism of arms sales to Iran by arguing that Iran was a “good ally” that faced threats along its borders with the Soviet Union and Iraq.<sup>394</sup> Ford attempted to demonstrate his support for Israel by announcing that his administration would disclose the names of companies that participated in the Arab boycott (which it did starting October 18) and by emphasizing that his administration in less than three years had provided forty-five percent of the total American economic and military aid to Israel since its creation.<sup>395</sup> Ford could not shake his association with the oil-rich Arab countries, however. When Ford visited New York City on October 12,

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<sup>390</sup> James T. Wooten, “Carter Vows To End Boycott Of Israel,” October 20, 1976, *New York Times*; Charles Mohr, “Carter Scores Ford On Missile Sale,” October 1, 1976, *New York Times*.

<sup>391</sup> “Carter Attacks, Ford Defends U.S. Foreign Stance in 2D Debate,” October 7, 1976, *New York Times*.

<sup>392</sup> *Time* stated that the figure of forty percent of Middle East arms sales going to Israel under Ford was inaccurate and was in actuality forty-five percent. “The Nation: The Battle, Blow By Blow,” *Time*, October 18, 1976.

<sup>393</sup> “Carter Attacks, Ford Defends U.S. Foreign Stance in 2D Debate.”

<sup>394</sup> *Ibid.*

<sup>395</sup> “Carter Attacks, Ford Defends U.S. Foreign Stance in 2D Debate;” Edward Cowan, “U.S. Issues Reports About Arab Boycott,” October 19, 1976, *New York Times*; “The Nation: The Battle, Blow By Blow.”

protestors opposed to his administration's arms sales to Arab countries and leniency on the Arab boycott greeted him with jeers and effigies of him and Kissinger.<sup>396</sup> While strategic and economic imperatives had driven Ford to encourage petrodollar interdependence between the United States and the MENA, this course proved to be a political liability.

### **Petrodollar Consensuses in Arab Media**

In contrast to the United States, media in the Arab countries in the mid-1970s largely agreed that Arab petrodollar profits were both justified and beneficial. Oil-rich or oil-poor, radical or conservative, Arab countries celebrated the new petrodollar economy. In part this reflected popular aspirations to pan-Arab cooperation; in part it reflected a shared struggle against Western dominance. These positive Arab understandings of the petrodollar economy contradicted negative US narratives, sometimes directly. This divergence of views loomed as a potential stumbling block in Arab-US cooperation.

One theme celebrated across the Arab world was the increase in Arab political and economic power that coincided with the new petrodollar economy. In contrast to most US media (including those promoting Arab-US cooperation), Arab media overwhelmingly characterized the rise in oil prices and Arab control over local oil as just and beneficial. The Iraqi newspaper *ath-Thawara* regularly celebrated Iraq's nationalization of the Western-controlled Iraq Petroleum Company for years afterward, exulting that this established the basis for a prosperous future for the Iraqi people. One cartoon, for example, illustrated a simple equation: a fist titled "nationalization" smashing the head of a man labelled "the monopolies" (a term regularly used by the Iraqi press in reference to the Western-controlled Iraq Petroleum Company), plus a

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<sup>396</sup> Frank Lynn, "Ford, Campaigning in New York, Seeks Support of Jewish Voters," October 13, 1976, *New York Times*.

worker inscribed with the words “resilience and increase of production,” equaled joy and prosperity for Iraqi children.<sup>397</sup> Despite the fact that Egypt was relatively oil poor, the newspaper *al-Ahram* celebrated OPEC’s control over pricing and supply of oil as a pan-Arab political and economic success. One cartoon with the caption “the philosophy of petroleum” showed a happy Arab standing with his hand on the spigot of an oil barrel and telling an eager-to-please Uncle Sam that “as long as the hands are mine.. that are on the spigot.. I am able to open and I am able to close!”<sup>398</sup> A 1979 cartoon in *ash-Sharq al-Awsat*, a London based newspaper owned by Saudis and marketed to Arab readers across the world, exemplified the newfound economic optimism of many Arabs in the 1970s. The cartoon depicted a happy Arab couple with eight children and another infant on the way standing across from a dour British family of two parents and an only child. The Arab husband wryly tells his wife that the British “have an energy crisis.”<sup>399</sup> With reproduction serving as an allegory for economic production and “energy” being used as a sexual double entendre, the cartoon contrasted the economic boom of the Arab world with the economic recession of the West. Such nationalist cheerleading encouraged a sense of antagonism among Arabs against the United States and the West.

Sometimes Arab media directly countered US narratives. In January 1975, when Ford approvingly reiterated Kissinger’s *Business Week* statement about the hypothetical need of the United States to militarily respond if facing “strangulation” by exorbitantly high oil prices, *Al-Ahram* responded with a cartoon. Playing on Ford’s use of the word “strangulation,” the cartoon depicted a man labeled “the West” being strangled not by the Arab oil producers but by a giant brute labeled “inflation.” Arab readers would readily understand that this inflation was due to American economic policies rather than rising oil prices, as this view was constantly repeated by

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<sup>397</sup> “Untitled Cartoon,” *Ath-Thawara*, February 12, 1974.

<sup>398</sup> “Untitled Cartoon,” *Al-Ahram*, March 14, 1974.

<sup>399</sup> “Untitled Cartoon,” *Ash-Sharq Al-Awsat*, June 20, 1979.

Arab leaders. In the cartoon, however, Ford threatens to use force against the Arab oil-producers to save the West, despite the obvious fact that the giant “inflation” stood before Ford strangling the West while the Arabs innocently minded their own business in the background.<sup>400</sup>

Arab media also widely argued that the oil-rich Arab utilized petrodollars for beneficial ends, in sharp contrast to American descriptions of Arab sheikhs and dictators living lives of opulence while their subjects lived in squalor. *Ath-Thawara*, for example, argued that when “Arab oil [was] for the Arabs,” rather than Western oil companies, the result was large sums of money for national development.<sup>401</sup> In this way, the Iraqi government (through the closely controlled press) could bolster its popularity and legitimacy by reminding its citizens of both its stand against Western imperialism and that oil-funded government development projects and jobs were boosting the country’s economy and living standards. When King Faisal visited Egypt in August 1974 and donated \$1 billion to the country, *al-Ahram* made the donation its headline news story and emphasized that Saudi Arabia had provided the money “to the fighting people of Egypt” as part of the ongoing pan-Arab effort to combat Israeli aggression, demonstrating how the petrodollar wealth of the oil-rich Arab countries served the defense and livelihoods of the oil-poor Arab countries.<sup>402</sup> Arab media also highlighted the unprecedented sums of aid that oil-rich Arab countries donated to non-Arab oil-poor LDCs. *Ar-Riyadh*, for example, highlighted on World Health Day 1974 that Saudi Arabia pledged \$50 million to aid programs aimed at combating world hunger.<sup>403</sup> Stories of aid from the oil-rich Arab states affirmed the benevolence of these Arab countries and countered Western criticism that high oil prices were harming the economies of LDCs.

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<sup>400</sup> “Untitled Cartoon,” *Al-Ahram*, January 15, 1975.

<sup>401</sup> “1 Adthar – ‘Eid al-Intisar,” *Ath-Thawara*, March 1, 1977.

<sup>402</sup> “1000 Milliyun Dular Hadiyya min al-Malik Faisal ila Sh‘ab Misr al-Maqatil,” August 3, 1974, *Al-Ahram*.

<sup>403</sup> “Untitled Cartoon,” *Ar-Riyadh*, April 7, 1974.

## **Petrodollar Divisions in Arab Media**

Significant divisions over petrodollars also existed across Arab media, however. One of the most important divisions centered upon whether the Arabs should pursue friendly or hostile relations with the United States. Arab governments and individuals that spent or invested large numbers of petrodollars into the United States could and did criticize America, but they also had to justify their collaboration with Americans (and especially the US government) in the face of widespread Arab anger over American policies on matters like the Arab-Israeli conflict. These Arab governments and individuals emphasized the perceived benefits of economic and political collaboration with the United States. Arab governments and individuals that did not spend or invest a significant amount of petrodollars in America, by contrast, often criticized Arabs who did align themselves with the United States. This Arab debate in many ways mirrored the debate American debate over interdependence.

Due to the Saudi government's close cooperation with the United States, Saudi media presented Saudi-US collaboration on petrodollars as a means of extracting benefits from the United States for the Arab world. For example, when *ar-Riyadh* announced in April 1974 that the Saudi government was entering into talks with the US government to see if relations could be improved, the Saudi newspaper emphasized that the Saudis stood to gain US assistance "in the areas of economics, technology, manufacturing, and supplying the Kingdom what it needs for defensive purposes." Furthermore, the Saudi government insisted that Saudi-US economic collaboration would be predicated upon the US government reaffirming its commitment to "achieving a just and lasting peace in the region of the Middle East to be enjoyed by its entire people in stability, and to work toward the development of the region and its prosperity."<sup>404</sup> The

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<sup>404</sup> "Tawsi'a wa Taqwiyya 'Awamal at-Ta'aawun bayna al-Mamlika wa Amrika," *ar-Riyadh*, April 6, 1974, 1.

Saudi government, *ar-Riyadh* assured its readers, would only cooperate with the United States and utilize its petrodollars in American projects if they would benefit the Arab cause.

Media in countries like Iraq that had poor relations and minimal commerce with the United States, by contrast, tended to argue that petrodollar flows to the United States harmed the Arab cause. *Ath-Thawara*, for example, charged that the United States was launching an “invasion of American exports to the Arab region [to] plunder and impoverish its economy” by selling overpriced and worthless goods to the Arabs in order to recoup the petrodollars America paid for Arab oil. The newspaper called for all Arab countries to avoid commerce with the United States in order to avoid this imperialist trap.<sup>405</sup> Iraqis also faced the reality that its aggressive neighbor Iran spent billions of petrodollars on US arms. Some of these US arms fired upon and killed Iraqi soldiers, either in combat with Kurdish resistance forces armed by Iran or in border skirmishes with the Iranian army. Newspapers like *ath-Thawara* regularly reminded its readers that adversaries like Iran were using their petrodollars to purchase US weapons. In one cartoon addressing Iraq’s border tensions with Iran in 1974, a banner reading “preparation for popular Arab conference in Baghdad to denounce Iranian aggression” causes a trampled and bruised Iranian soldier to not only flee in terror but to also drop his gun, which has a “USA” label.<sup>406</sup>

US-allied Arab governments thus depended upon positive examples that petrodollar interdependence with the United States brought significant benefits to the Arab world, while Arab governments with poor relations with the United States sought to demonstrate the harm that US-MENA petrodollar collaborations produced. This partially explains why US allies like the Saudis placed so much importance on the US government approving arms sales to them;

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<sup>405</sup> “Gazu as-Sadarat al-Amirkiyya lil-Mintaqa al-‘Arabiyya,” *ath-Thawara*, October 26, 1974, 1.

<sup>406</sup> “Untitled Cartoon,” *ath-Thawara*, December 20, 1974.

approval of a sale could be used by the Saudi Kingdom to justify its collaboration with the United States, while disapproval of a sale could be used by detractors to attack the legitimacy of the Saudi monarchy's rule. Conversely, attacking petrodollar flows to the United States served Arab governments like the Baathist regime in Iraq by tapping into anti-American sentiment and affirming the anti-imperialist credentials of Iraqi leaders.

### **The Ongoing Debate over Petrodollar Interdependence**

The petrodollar economy created a heightened level of interdependence between the MENA and the United States, intimately affecting governments, corporations, and individuals. For both Americans and Arabs in the 1970s, petrodollars generated new players with diverse interests in the new economic arrangements and fostered debates about development, corporations, the global economy, political alliances, and the nature of power and sovereignty in an increasingly interdependent world. Some Americans, Arabs, and Iranians expressed optimism that the petrodollar economy and new levels of interdependence would generate political and economic benefits. Other Americans, Arabs, and Iranians, however, expressed fears that interdependence and petrodollars brought harm to the interests they held dear.

Petrodollars galvanized both support and resistance to US-MENA cooperation, at the same time petrodollar debates both helped and harmed those involved in the debates. President Ford discovered that pushing for the approval of missile sales to Saudi Arabia helped Saudi-US relations but harmed his appeal to some American voters. Rising arms sales strengthened Iranian-US ties but also created the potential for rifts when congressmen argued for arms sales reductions. Bechtel garnered lucrative projects from Arab governments but also faced lawsuits due to the anti-Arab boycott movement. The struggle over whether or not the MENA and the



United States would collaborate in the petrodollar economy would not be resolved during the period of the Nixon and Ford administrations, but rather would continue into the presidency of Jimmy Carter, one of the more prominent individuals who had attacked Ford for his ties with the oil-rich MENA countries.

## CHAPTER FOUR

### The Triangle to the Nile

#### **Petrodollars for the Oil Poor**

“As you undoubtedly observed while you were in Egypt, the economy of that country had been brought to an advanced state of deterioration by the socialist controls of Nasser,” Simon wrote to Nixon in July 1974 upon Simon’s return from his trip to Egypt, Israel, Saudi Arabia, and Kuwait. “Now Sadat and his able economic ‘czar’ [Abd El Aziz] Hegazi, appear dedicated to freeing-up the economy and bringing in foreign private initiative as fast as political realities permit.”

Simon, excited by this prospect, argued that “the public evidence of the extent of the U.S. Government commitment to cooperation will undoubtedly make it easier for Sadat to move even faster in the direction of liberalization.” To demonstrate the United States’ commitment to help Sadat open Egypt’s economy to the world, Simon had begun a series of US-Egyptian initiatives, including an agreement “to try to set up jointly a new institute to do project feasibility studies which can be used to attract investment not only from the U.S. but from oil-surplus countries.” Simon expressed enthusiasm about Egypt’s prospects, “for I believe there will be attractive investment opportunities to make use of the large quantity of under-utilized educated Egyptian manpower as Socialist controls – which seem alien to Egyptian nature – are shuffled off.”<sup>407</sup>

Simon believed that if the Gulf countries invested petrodollars in Egypt, this would help lead that country away from the stagnation of a closed, state-run economy and into a new era of prosperity created through private enterprise and global trade. He also recognized that US companies could benefit from the opening of Egypt’s market and the investment of petrodollars.

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<sup>407</sup> Simon to Nixon, “Necessary Follow-Through on My Mid-East and European Discussions,” circa July 1974, folder “Memos for the White House 1974 (2 of 2),” box 61, Executive Secretary 1966-75, RG56 GR DoT, NARA2.

American and Egyptian officials began to use the term “tripartite” or “triangular investment” to describe the goal of combining oil-rich Arab investment funds with US technology and service expertise to produce profitable private ventures in developing sectors of the Egyptian economy such as industry, agriculture, tourism, finance, and mineral extraction. Triangular investment, as envisioned by its advocates, would recycle Arab petrodollars back into the world economy with a profit to the Gulf states, bring needed development to Egypt, and provide US companies with new opportunities for profitable investments.

Petrodollars served an important role in creating and sustaining Egypt’s shift toward the United States during the years of the Nixon and Ford administrations, the plan of triangular investment being just one example. Egyptian and US government officials believed that petrodollars could facilitate the strengthening of Egyptian-US ties in the realms of aid, arms, investment, and political stability, and serve the interests of their countries (even if perceived interests did not always perfectly match). Yet despite the centrality of petrodollars to the plans of Egyptian and US officials during this period, the importance of petrodollars in facilitating the improvement in US-Egyptian relations is largely ignored in historical accounts. Furthermore, the extent of US efforts to encourage petrodollar aid and investment in Egypt is understudied.<sup>408</sup> In part, this lack of attention can be attributed to a focus on US mediation efforts between Egypt and Israel. It can also be explained by the fact that many US-Egyptian plans to utilize petrodollars during the period failed in their immediate goals. Very little triangular investment had occurred by the end of 1976. Kissinger’s scheme to get around Congress by having Saudi

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<sup>408</sup> Histories on the improvement of US-Egyptian relations during the 1970s tend to focus upon Sadat’s interest in US assistance in the Arab-Israeli peace process and in US aid. Egypt’s desire to combine Arab petrodollars with US goods and services is sometimes acknowledged in passing, but US efforts to encourage petrodollar flows to Egypt are all but ignored. See Beattie, *Egypt During the Sadat Years*; William J. Burns, *Economic Aid & American Foreign Policy toward Egypt, 1955-1981* (Albany: State University of New York Press, 1985); Joseph Finklestone, *Anwar Sadat: Visionary Who Dared* (London: Frank Cass, 1996); Mohammed Heikal, *Autumn of Fury: The Assassination of Sadat* (London: Andre Deutsch, 1983); Marvin G. Weinbaum, *Egypt and the Politics of U.S. Economic Aid* (Boulder: Westview Press, 1986).

Arabia purchase US arms and then transfer them to Egypt was scuttled before it began. US, and especially Egyptian officials, found oil-rich Arab aid to Egypt to be less forthcoming than expected. Yet if the immediate goals often went unattained, these schemes and dreams did help inspire and sustain interest in US-Egyptian cooperation between the two countries. Petrodollars in many ways served as a bridge that facilitated the gradual strengthening of what became the US-Egyptian alliance, an outcome that might not otherwise have occurred in the fragile period of the mid-1970s.

Yet while petrodollars served to strengthen US-Egyptian ties, they also paradoxically held the potential to disrupt or possibly even undo US-Arab ties across the MENA. The Nixon and Ford administrations had, as we have seen, consciously endeavored to make the petrodollar rich countries economically and politically interdependent with the United States in order to deter them from acting against US interests. The Nixon and Ford administrations largely achieved this goal. Furthermore, through cooperation with Saudi Arabia and the oil-rich Gulf states and the leveraging of petrodollars, many oil-poor Arab countries including Egypt became increasingly tied to both the United States and Saudi Arabia in what might be described as a “US-Saudi Arab bloc.” Yet while the Nixon and Ford administrations had pursued interdependence with the Arab world in order to ensure that the Arabs themselves would be harmed if they tried to damage the interests of the United States, it became increasingly clear that interdependence was a double-edged sword. By becoming increasingly tied to the oil-rich Arab countries, the United States also became increasingly tied to the repercussions arising from a conflict-torn region. When crises erupted in the region, often due to the actions of oil-poor actors like Egypt, Israel, or the PLO, US policymakers increasingly feared that Arab petrodollars would no longer flow to the United States or that petrodollars could be used as a financial

weapon against the United States and its allies. The threat of confrontation with the Soviet Union, increased anti-US radicalism, and another oil embargo are commonly cited as the main reasons why the United States sought to avoid another Arab-Israeli conflict after 1973; the petrodollar weapon is largely overlooked. In fact, US policymakers considered the petrodollar weapon a serious threat that augmented the other dangers to US interests more commonly listed, and it contributed to the policymaking calculations of these officials.

### **Oil-Poor Arab Countries and the Petrodollar Economy**

The dramatic rise in oil prices in the 1970s offered both pain and opportunity to the oil-poor Arab countries. Steady economic development in these countries had been predicated upon cheap petroleum during the 1950s and 1960s; unless an oil-poor country found a way to offset the cost of rising oil imports, it would experience rising debt and/or economic stagnation. Yet the oil-poor Arab countries could also obtain petrodollars in the form of aid, investment, and remittances, and they had a particular claim on such assistance. The widely proclaimed goals of Arab nationalism and unity in the different Arab countries lent support to the calls of the oil-poor Arab countries for aid and investment from the oil-rich Arab countries. For both sentimental and strategic reasons, the oil-rich Arab countries felt a particularly strong obligation to lend economic support to actors like Egypt, Syria, and the PLO that were in direct hostilities with Israel. A common language and widespread transnational business and governmental networks also encouraged the oil-rich Arab countries to invest petrodollars in the oil-poor Arab countries. These same factors likewise significantly eased the ability of laborers from oil-poor Arab countries to obtain work in oil-rich Arab countries.

Before the 1970s, the Arab states had only made limited contributions to foreign aid and investment programs, whether bilateral or multilateral. In 1974, Saudi Arabia became the world's second largest contributor of foreign aid in absolute terms, surpassed only by the United States. While limitations in record keeping and disclosure keep all figures of Arab foreign aid in the 1970s rough, it is estimated that in 1974 Saudi Arabia provided \$1.62 billion in aid, Kuwait \$1.25 billion, and the UAE \$750 million, for a total of \$3.62 billion. In 1975 the three countries increased their aid to a total of \$5.39 billion, and to \$5.84 billion in 1976. Again, while figures are rough, the majority of this aid was provided to oil-poor Arab countries.<sup>409</sup> The oil-rich Arab countries generally remained conservative in investing funds for profit, but they did increase concessionary lending as a form of aid that could develop economic projects throughout the Arab world. At a time of increasing financial difficulties and growing public opposition to foreign aid in the United States, the US government hoped Arab foreign aid could offset demands for US assistance around much of the globe, but particularly in the Arab world, with Egypt holding a pride of place.

Beyond attracting aid and investment, oil-poor Arab countries also obtained a significant amount of petrodollars through the remittances of laborers who obtained employment in oil-rich countries. The oil-rich Arab Gulf states and Libya desired foreign laborers, both menial and advanced, to augment their own sparse populations. These countries often hired employees from Arab oil-poor countries due to commonalities in language and culture, proximity, and the range of useful skills these laborers could provide. The 1973 oil shock dramatically increased the ability and desire of the oil-rich countries to hire foreign laborers, and the number of inter-Arab migrant laborers rose from a pre-October 1973 estimate of 679,000 to 1,296,000 by the end of

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<sup>409</sup> Simmons, *Arab Foreign Aid*, 58-60, 174.

1975.<sup>410</sup> Of the 1975 total, Saudi Arabia imported 54 percent of all inter-Arab migrant laborers, Libya 24 percent, and Kuwait 11 percent. Egypt exported 31 percent of the total, the Yemen Arab Republic 22 percent, and Jordan-Palestine 20 percent.<sup>411</sup> The value of Egyptian remittances in the 1970s grew at a phenomenal rate. In 1970 Egypt accrued \$10 million in reported remittances; in 1979 this figure had risen to \$2 billion, a sum equivalent to the annual revenues from cotton exports, the Suez Canal, tourism, and the value added from the Aswan Dam combined. While not all of these remittances came from work in oil-rich countries, most did.<sup>412</sup>

The economic connections created by aid, investment, and remittances meant that the economic fortunes of the oil-poor Arab countries rose with the petrodollar boom of the oil-rich Arab countries. This is not to say that the oil-poor Arab countries benefitted from rising oil prices to the same extent as the oil-rich countries (they did not), but it is to say that the oil-poor Arab countries as a whole experienced higher rates of economic growth in the period from 1973 to 1982 than they had in the previous decade.<sup>413</sup> Egypt exemplified the trend, experiencing an average annual GDP growth rate of 8.1 percent for the years 1973 to 1981/82, compared to 3.1 percent for the years 1964/65 to 1973.<sup>414</sup>

The high rate of economic growth in oil-poor Arab countries in the petrodollar economy, coupled with improved relations between the United States and much of the Arab world, resulted in a rapid increase in US business in the Arab oil-poor countries. In 1972, US exports to the oil-poor Arab countries totaled \$454 million, of which \$76 million went to Egypt. By 1976, the

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<sup>410</sup> These numbers exclude unemployed dependents that traveled with migrant laborers to the foreign country of their employment. Ibrahim, *The New Arab Social Order*, 33-35.

<sup>411</sup> Many Arab governments during this period used Jordan-Palestine as an identification for both Jordanian citizens and Palestinian refugees in their record keeping. It is believed that the majority of migrant laborers were Palestinian refugees. Ibid.

<sup>412</sup> Ibrahim, *The New Arab Social Order*, 68-72.

<sup>413</sup> Owen, *A History of Middle East Economies in the Twentieth Century*, 100-101.

<sup>414</sup> Owen, *A History of Middle East Economies in the Twentieth Century*, 252.

total had risen to \$2.149 billion, of which \$810 million went to Egypt. Even accounting for inflation, this constituted in just four years a nearly 350 percent rise in the value of US exports to the oil-poor Arab countries, and an over 750 percent increase to Egypt.<sup>415</sup> American businesses that sold products and services to the oil-poor Arab countries welcomed this increase in trade, as did US government officials who sought to strengthen the political and economic ties of the United States and the Arab world. At the same time, the governments of oil-poor Arab countries that purchased arms, other goods, and services from the United States appreciated acquiring advanced US technology and expertise, while many citizens of these countries appreciated the increased availability of US consumer goods.

It has been demonstrated that the Nixon and Ford administrations sought to limit foreign aid from the United States in order to pressure the member nations of OPEC to lower oil prices and/or increase financial aid to the oil-poor LDCs. At the same time, the Nixon and Ford administrations worked to directly encourage investment and aid from the OPEC nations to oil-poor LDCs. “All [oil-exporting] countries may be interested in secure and remunerative [sic] ways of using their liquid assets,” stated a January 1974 Treasury Department memorandum on the foreign aid activities of the oil countries. “Efforts to develop mechanisms to facilitate their flow to those who need and can afford them can certainly make an important contribution. Over and above such mechanisms, however, the truly wealthy countries should be regarded as potential sources of aid over the future and efforts made to highlight their interest in development, encourage them to move in that direction, and assist them in in making their programs as constructive as possible.”<sup>416</sup> The US government viewed Arab and Iranian aid and

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<sup>415</sup> *Statistical Abstract of the United States*. Data for each year is taken from the latest publication where it is made available.

<sup>416</sup> “Current Foreign Aid Activities of Oil Exporting Countries,” January 18, 1974, folder “Investment in the U.S. by Oil Producing Nations (4),” box 113 NSC IF, FL.



investment as a general measure to ward off economic instability in the less-developed world, and as a more targeted tool that could strengthen US allies.

US financial institutions and other businesses also looked for new market opportunities in the oil-poor Arab countries with new interest, intrigued by the possibility that petrodollar flows from the oil-rich Arab countries to the oil-poor Arab countries might stimulate economic growth. US private enterprise would not enter these countries, however, unless they believed there were lucrative opportunities for them. While it became a common refrain that OPEC petrodollars were recycled through private Western banks to oil-poor LDCs that needed to finance their higher oil bills, all through the “invisible hand of private markets,” the truth was more complicated. First, the vast majority of private lending went to a select few LDCs that were either newly industrialized with large economies (such as Brazil or South Korea) or oil exporters with large populations (such as Algeria or Mexico). Second, there was no correlation between an individual LDC increasing its oil imports and that same LDC obtaining an increase in private lending during the 1970s; if anything there was a slight correlation between *decreased* private lending and higher oil imports.<sup>417</sup> In short, while private lending significantly increased during the 1970s, private Western investors did not magically loan money to all LDCs in order to cover their oil bills; instead, they tended to finance projects in select LDCs that were deemed secure and remunerative investments, much as one would expect a profit-seeking institution to do. Businesses selling goods and services similarly appraised foreign markets on the merits of profitability rather than the need of the host country. Oil-poor countries in the MENA could attract US investment and sales, but only if they were attractive markets. By acquiring petrodollar aid and investments from their oil-rich neighbors, Egypt and other oil-poor Arab countries hoped to do just that.

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<sup>417</sup> Spiro, *The Hidden Hand of American Hegemony*, 60-79.

## **Petrodollars and Aspirations for a New Era in US-Egyptian Relations**

By 1974 the Egyptian government considered acquiring foreign currency one of its most urgent tasks. The burdens of war and a stagnating economy had caused Egypt to run critically low on foreign currency reserves in the late 1960s, and by the spring of 1974 Egypt had accumulated \$15 billion in foreign debt, an equivalent of six years of export earnings. Without foreign currency, Egypt would be unable to purchase the foreign arms it needed to counter Israel, the foreign imports like grain for the basic needs of its population, or the foreign technology and services needed to develop Egyptian industry and agriculture. Furthermore, Egypt urgently needed new sources of foreign currency in order to avoid defaulting on its existing foreign debts; default, many feared, would significantly worsen Egypt's ability to attract additional foreign capital. Sadat calculated that after the 1973 War he now had a golden opportunity to press the petrodollar wealthy Arab countries to provide Egypt with massive infusions of capital to sustain Egypt's military and diplomatic pressure upon Israel. Multinational corporations from the United States and other industrialized countries would then invest in and sell to Egypt to acquire Arab petrodollars, providing Egypt with additional foreign capital and advanced technology and services. This triangular investment would then enable Egypt to develop its industrial and agricultural sectors for local consumption and exports, restore its balance of trade, and escape the cycle of growing debt.<sup>418</sup>

Obtaining petrodollars and attracting US business required some changes to the tight economic controls imposed by Nasser. After the Suez Crisis of 1956, Nasser had increasingly restricted foreign investment and nationalized many foreign and domestic private enterprises. To entice a return of foreign investors, the Sadat regime in 1971 passed legislation that protected foreign companies from nationalization and established "free zones" where they would be

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<sup>418</sup> Kirk J. Beattie, *Egypt During the Sadat Years* (New York: Palgrave, 2000), 135-139.

offered special privileges such as tax holidays.<sup>419</sup> Nasser had also placed numerous restrictions on the ability of Egyptian citizens to work abroad. In 1971 Sadat's government began to repeal these restrictions and enacted new incentives to work abroad, with the objectives of increasing petrodollar-funded remittances and to reduce what it considered an overcrowded domestic job market.<sup>420</sup> It is important to note that Sadat's regime did not seek to reverse all government controls over the economy, however. The Egyptian government continued to own and run most sectors of the economy, directly employed a large portion of its population, placed official limits on income, and set prices for key commodities that it also subsidized. While some within the Egyptian government sought to liberalize these aspects of the economy as well, most remained committed to socialist planning, with Sadat's apparent support. Most Egyptian officials pursued the opening of Egypt to foreign investment and trade strictly as a measure to obtain foreign currency, not as a step toward a general liberalization of Egypt's economy along capitalistic lines.<sup>421</sup>

In addition to assisting Egypt through triangular investment, the Egyptian government expected direct economic and military aid from the United States due to its shift away from the Soviet Union. The Nixon administration strongly desired to grant Egypt's aid requests in order to further pull Egypt into the US sphere of influence. The Nixon administration faced strong congressional resistance to any new major assistance program to Egypt, however, both due to Egypt's state of conflict with Israel and due to growing American opposition to foreign aid programs in general. The Nixon administration thus moved gradually in increasing US aid to Egypt. In January 1974 it announced a commitment of \$8.5 million for an initial program to

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<sup>419</sup> Owen, *A History of Middle East Economies in the Twentieth Century*, 130-134.

<sup>420</sup> Ibrahim, *The New Arab Social Order*, 68-72.

<sup>421</sup> Beattie, *Egypt During the Sadat Years*, 134-146.

reconstruct the Suez Canal after the first separation of forces accord between Egypt and Israel, and in March requested Congress to approve \$250 million in aid to Egypt for fiscal year 1975.<sup>422</sup>

In early 1974, however, the Soviet Union withheld economic and military support to Egypt in an attempt to force it back into the Soviet camp. With the Egyptian economy and military seriously weakened from the 1973 War, the lack of significant and immediate support from either superpower placed the Sadat government under extraordinary strain. On April 1, 1974, US Ambassador Hermann Eilts reported to Kissinger that Egyptian Foreign Minister Ismail Fahmi had made to him an impassioned plea for US economic aid. Fahmi told Eilts that the Soviets had “made it crystal clear that any further Soviet help, military or economic, is conditioned on Egyptian endorsement of direct Soviet participation in all further [Arab-Israeli] peace talks” and that the Soviets “are ‘squeezing Egypt’ and Egypt is feeling the pinch. In the past four months the president [Sadat] and he have drastically reoriented Egyptian policy [toward the United States]. They have done so at great political and personal risk to themselves and have as yet gotten little from the [US government] in return... he hopes the [US government] realizes that the disengagement agreement [between Egypt and Israel], while helpful, is no [repeat] no answer to Egypt’s serious political and economic requirements.”<sup>423</sup> Three days later Fahmi again warned Eilts that “Egyptians at all levels will shortly begin to contrast what Egypt has been getting in past twenty years from Soviets with meager US support to date. If there are any commodity shortages in Egypt, as there currently are because [the] Soviets have refused to provide needed economic help except on [a] cash basis, these will be laid at the door of Sadat’s

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<sup>422</sup> Weinbaum, *Egypt and the Politics of U.S. Economic Aid*, 32.

<sup>423</sup> Eilts to Kissinger, April 1, 1974, folder “Arab Republic of Egypt Mar - Jun 30, 1974 [2 of 4],” box 639, NSC CFME, NL.

and his policy shift.”<sup>424</sup> On April 20 Sadat personally told Eilts that obtaining US arms in order to diversify Egypt’s weapons sources was an urgent matter and that he hoped the United States would be responsive.<sup>425</sup> It was clear that the Egyptians considered economic and military assistance to be vital requirements for a US-Egyptian alliance; progress in the Arab-Israeli peace process alone would be insufficient.

The State Department, eager to encourage Egypt’s political reorientation toward the United States but also aware that Congress would prevent a quicker allocation of aid than Egypt desired, looked for alternative means of assistance to Egypt that bypassed the legislative branch. Many proposals incorporated Arab petrodollars. As early as January 1974 the State Department suggested encouraging the World Bank to “provide a framework in which Western and Arab money would be combined with Western technology to make Egypt one of the fastest growing LDCs.”<sup>426</sup> In late January the State Department began secretly serving as an intermediary to avoid the dissolution of the first major triangular investment project in Egypt that had been established a week before the outbreak of the 1973 War: the construction of the SUMED pipeline, which was to be co-financed by Arab and American lenders (including Chase Manhattan) and constructed by Bechtel. In January 1974 pricing and financing disputes between Bechtel and the Egyptian government threatened to scuttle the entire venture, an outcome Fahmi told Eilts “would be catastrophic.” In response, Eilts pressed both Bechtel and the Egyptian government to achieve a resolution.<sup>427</sup> While Bechtel ultimately reduced its role from building

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<sup>424</sup> Eilts to Kissinger, April 4, 1974, folder “Arab Republic of Egypt Mar - Jun 30, 1974 [2 of 4],” box 639, NSC CFME, NL.

<sup>425</sup> Eilts to Kissinger, April 20, 1974, folder “Arab Republic of Egypt Mar - Jun 30, 1974 [2 of 4],” box 639, NSC CFME, NL.

<sup>426</sup> Charles A. Cooper to Kissinger, “Economic Assistance for the UAR,” January 10, 1974, folder “Arab Republic of Egypt 1 Jan 1974 - Feb 24 [1 of 2],” box 639, NSC CFME, NL.

<sup>427</sup> Eilts to Kissinger, January 29, 1974, folder “Arab Republic of Egypt 1 Jan 1974 - Feb 24 [1 of 2],” box 639, NSC CFME, NL; Eilts to Kissinger, February 6, 1974, folder “Arab Republic of Egypt 1 Jan 1974 - Feb 24 [1 of 2],” box

the pipeline to acting as a management supervisor (the actual construction would be taken up by Italian firms), the State Department's mediations may have helped prevent a complete collapse of the plan and preserved hopes for future joint US-Arab investment in Egypt.<sup>428</sup>

The State Department also looked to Arab petrodollars to smooth early US weapons transfers to Egypt. On May 1, while in Egypt, Kissinger told Sadat that his immediate arms assistance requirements from the United States "could be sold to Kuwait and/or Saudi Arabia and be transferred to Egypt by one or another of these governments." Later arms sales, credits, and grants could then be made directly between the United States and Egypt. Kissinger explained that he wanted to pursue a gradual increase in arms transfers to Egypt, beginning with indirect transfers, in order to blunt the effectiveness of Israeli lobbying. "We should sell those items first which are not likely to create public furor," Kissinger explained to Sadat. "We can permit the Saudis to purchase [McDonnell Douglas F-4] Phantom [II fighters] since there has already been talk of Phantom sales for Saudi Arabia."<sup>429</sup> Saudi petrodollars could thus serve to facilitate the transfer of weapons from the United States to Egypt that Congress might not be ready to approve. Notably, Harold H. Saunders had earlier expressed his concern to Kissinger that since such transfers of US arms between another Arab country and Egypt would legally require notification of Congress and would also inevitably be observed and publicized by Israeli intelligence, such indirect transfers might create more anger in US public opinion than a concerted campaign by the administration to develop support for a direct arms transfer to Egypt,

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639, NSC CFME, NL; Eilts to Kissinger, February 7, 1974, folder "Arab Republic of Egypt 1 Jan 1974 - Feb 24 [1 of 2]," box 639, NSC CFME, NL.

<sup>428</sup> Henry Tanner, "Bechtel Withdraws From Egypt Oil Role," *New York Times*, April 13, 1974; Henry Tanner, "Egypt Counts on Canal and Oil To Bolster Self-Sufficiency," *New York Times*, January 25, 1976.

<sup>429</sup> Memcon, Kissinger, Sadat, et al., May 1, 1974, folder "Memcons: Secretary-Sadat 1974," box 44, Record Group 59 General Records of the Department of State Records of Joseph Sisco, 1951-76, NARA2.

but Kissinger apparently preferred to raise the indirect arms transfer scheme with Sadat anyway.<sup>430</sup>

The Treasury Department also became involved in petrodollar recycling schemes for Egypt, and while both Simon and Kissinger recognized the political opportunities that could be achieved through petrodollar recycling to Egypt, Simon also focused on the opportunities created by petrodollars to change Egypt's economic structures. By the spring of 1974 Simon and his Treasury staff operated under the belief that Sadat "wishes to move Egypt to more traditional ways, to reverse the "Nasserization" of the economy and progressively return to a more liberal, open system." This prospect excited Simon, a staunch supporter of liberalized markets. The Treasury Department also believed, however, that Sadat needed "considerable financial aid if he is to open up the economy." While amenable to US assistance to Egypt, Treasury also recognized that "many of the Arab oil producers have publicly indicated their willingness to provide substantial financial assistance for Egyptian development if feasible projects can be found. Our assistance in identifying projects will thus help the oil producers make good on their pledge of shouldering a share of the aid burden." To pursue this goal, Simon planned to propose to Egypt the establishment of "a Project Development Institute to identify growth areas and viable projects to absorb the capital provided by Arab oil producers. The Institute could contract out to private firms in the U.S. or other countries for project feasibility studies."<sup>431</sup>

Yet while Treasury anticipated petrodollar investments could help smooth Egypt's economic liberalization, Treasury also considered economic liberalization measures as necessary to attract petrodollar investment in Egypt. Treasury believed Simon would have to impress upon Egyptian officials "that Egypt's short-term need is to restore its international credit-worthiness...

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<sup>430</sup> Saunders to Kissinger, March 26, 1974, folder "Arab Republic of Egypt Mar - Jun 30, 1974 [1 of 4]," box 639, NSC CFME, NL.

<sup>431</sup> "Egypt," undated, circa June 1974, folder "Egypt," box 21, WSP.

[and] advise the Egyptians against debt rescheduling or a moratorium which would undermine the image they are trying to build as a reliable borrower... as a long-term measure... urge a liberalization of the present system of pervasive government controls over the allocation of resources. Progressive liberalization is vital to achieve a satisfactory climate for attracting the private investment needed for economic development.” Specific proposals Treasury desired Egypt to pursue in liberalizing its economy included the decontrol of prices and interest rates, allowing more public enterprises to compete for goods and capital, and depreciating the Egyptian currency, which they considered artificially overvalued.<sup>432</sup> Treasury supported such economic liberalization as a point of principle, but it also believed that this program was particularly important for Egypt if it was to attract sufficient amounts of petrodollar investments. It also appears Treasury underestimated the level of resistance many of these proposed changes would encounter from Egyptian officials who desired both foreign capital and government intervention in most aspects of the economy.

### **Pursuing Triangular Investment**

Governmental efforts to promote foreign investment in Egypt and economic cooperation between Egypt and the United States appeared to make steady progress in the first half of 1974. On February 11 Sadat established the Agency for Arab and International Cooperation to attract foreign investment. In April Sadat publicly announced his plans for an “opening” (*intifah*) of Egypt to foreign investment and trade through a relaxation of governmental controls.<sup>433</sup> The same month Sadat publicly declared that Egypt would end its reliance upon Soviet military

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<sup>432</sup> Ibid.

<sup>433</sup> Beattie, *Egypt During the Sadat Years*, 138-143.



equipment by purchasing Western arms with the assistance of the oil-rich Arab states.<sup>434</sup> On May 31 Egypt and the United States formally formed a joint cooperation committee to improve economic relations between the two.<sup>435</sup> On June 10 Egypt passed Law 43, which opened previously protected areas of the Egyptian economy to foreign investment, allowed the entry of foreign banks, and provided taxation and repatriation incentives to foreign investors.<sup>436</sup> Two days later Nixon arrived in Cairo to a sea of cheering Egyptians on the first leg of his Middle East tour that also included Saudi Arabia, Syria, and Israel. On June 14 Nixon reiterated the United States' commitment to providing Egypt with aid and private investment, and he announced an agreement to provide Egypt with nuclear technology for peaceful energy purposes.<sup>437</sup>

All of this set the backdrop for Simon's visit to Egypt in July, the first leg of a Middle East tour that also included Israel, Saudi Arabia, and Kuwait. One of Simon's top priorities was to reinforce the Egyptian government's push toward attracting foreign investment and to promote additional measures that he believed would entice foreign investors. While encouraged by recent Egyptian laws and rhetoric aimed at liberalizing the economy and attracting foreign investment, Simon believed far more could be done. Meeting with Egyptian government officials, Simon and his assistants emphasized the need to improve Egypt's credit rating by paying off outstanding debts, to simplify tax codes, and to allow a larger percentage of profits and liquid investments to be repatriated by foreign companies.<sup>438</sup> Simon also told Hegazi of his idea to establish a Project Development Institution as part of the Joint Cooperation Committee to

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<sup>434</sup> Henry Tanner, "Egypt Will End Total Reliance On Soviet Arms," April 19, 1974, *New York Times*.

<sup>435</sup> "Egypt-U.S. Cooperation Group OKd," June 1, 1974, *Los Angeles Times*.

<sup>436</sup> "Egypt Liberalizes Laws On Foreign Investment," June 11, 1974, *Washington Post*; Beattie, *Egypt During the Sadat Years*, 138-139.

<sup>437</sup> Henry Tanner, "Nixon and Sadat Sign Sweeping Accord on Cooperation," June 15, 1974, *New York Times*.

<sup>438</sup> Eilts to Kissinger, July 16, 1974, folder "Arab Republic of Egypt July 1, 1974 -," box 639, NSC CFME, NL.

identify and create feasibility plans for projects within Egypt that would attract foreign investment from both Arab and American sources. Treasury planning materials for Simon's visit instructed him to emphasize to Hegazi that "the Project Development Institute... could uniquely combine oil producing capital, U.S. know-how and private capital, and Egyptian land and personnel."<sup>439</sup> Hegazi publicly agreed during Simon's visit to establish the Project Development Institute.<sup>440</sup> Hegazi and Simon also signed a bilateral investment-guarantee agreement that stipulated that the US government could take up claims with the Egyptian government for US companies that felt it had not received satisfactory treatment in the case of a dispute with the Egyptian government. On the same day of the agreement's signing, Egypt also announced it was allowing Chase Manhattan, First National City Bank, American Express Company, and Bank of America to open banking offices in the country, the first foreign banks allowed to do so in seventeen years.<sup>441</sup>

The Egyptian government recognized that promises of petrodollar financing would go far in attracting US business, and it worked to promote this idea. When the US-Egyptian Joint Commission met at the offices of the US Department of Commerce on August 15 to discuss measures to further advance investment and trade between the two countries, it was the Egyptian delegation that raised "the concept of 'tri-partite' investment, which would combine U.S.-Egyptian investment projects with capital from third countries – most probably from Arab oil-producing areas... in this way, the technical information and skills of the U.S. private sector can make a vastly greater contribution to Egypt than if the U.S. partners had to provide all of their own capital." The Egyptian delegation offered to introduce US investors to such third-party

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<sup>439</sup> Parsky to Simon, "Additional Points to be Raised with Hegazi," July 14, 1974, folder "Egypt – 1974 File 1," box 2, Records of Assistant Secretary of International Affairs 1973-76, RG56 General Records of the Department of the Treasury, NARA2.

<sup>440</sup> "Simon's Tough Tour," July 29, 1974, *Time*.

<sup>441</sup> Henry Tanner, "Egypt to Admit 4 Big U.S. Banks," July 17, 1974, *New York Times*.

capital as an additional inducement to do business in Egypt. The US officials agreed to help make American businesspeople aware of opportunities in Egypt and to pass along information from the Egyptian government. The Joint Commission also “agreed to form a ‘joint business chamber’ type organization to provide a continuing forum in which U.S. and Egyptian businessmen can meet on their own terms, to discuss matters of mutual interest.”<sup>442</sup>

When Ford succeeded Nixon as president, the US effort to utilize Arab petrodollars to draw Egypt into the American orbit continued. In the first days of Ford’s presidency, Kissinger impressed upon Ford the importance of both the Middle East conflict in general and Egypt in particular to US interests. “The Middle East is the worst problem we face,” Kissinger told Ford the morning of August 12. “The oil situation is the worst we face... we can’t afford another embargo. If we are faced with that, we may have to take some oil fields.” At the present, Kissinger argued that “the critical issue is Egyptian military equipment. The Soviet Union is turning them off. If that continues, the military will have to turn out Sadat or go back to the Soviet Union.” In order to preserve the Sadat government and its tilt toward the United States, the Ford administration needed to offset the loss of Soviet arms. Kissinger noted that an initial step towards this was “equipping them [with US arms] through Saudi Arabia. The first step would be to send it to Saudi Arabia and let Egyptian troops train in it... Saudi Arabia is willing to use 200 million [presumably dollars] for Egypt.”<sup>443</sup> That evening, the visiting Fahmy again impressed upon Kissinger Egypt’s need for US arms in the wake of the Soviet freeze. Kissinger attempted to placate him with assurances that US arms would soon arrive to Egypt through Saudi

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<sup>442</sup> “SUBJECT: Report of August 15, 1974 Meeting of the Joint U.S.-Egyptian Commission, Sub-Committee on Foreign Trade,” undated, folder “Egypt: Visit to U.S. by Ismail Fahmy, Minister of Foreign Affairs August 1974,” box 2, Records of Assistant Secretary for International Affairs 1973-76, RG56 GR DoT, NARA2.

<sup>443</sup> Memcon, Ford, Kissinger, Scowcroft, August 12, 1974, box 4, NSA MC, FL.

Arabia.<sup>444</sup> The next day Kissinger provided Ford with a list of weapons that the US could provide Egypt through Saudi Arabia, and again encouraged Ford to approve it. “You think we should go ahead then?” Ford asked. “I think we should,” Kissinger answered. “Egypt is in a difficult situation. If we can’t encourage the switch away from the Soviet Union and they turn back, there will probably not be another opportunity in our generation.” “I think we should do it,” Ford concluded.<sup>445</sup>

Treasury and Commerce likewise continued their push to attract Arab petrodollars for US-Egyptian projects under Ford. In the fall of 1974, Treasury was committed as ever to the scheme, and many US companies had expressed interest to Treasury about entering the Egyptian market: AT&T and Western Electric were interested in providing telecommunications technology, Northrop in establishing a research foundation, Genesco a textile plant, Union Carbide a petrochemical complex, and Occidental phosphate mines and fertilizer plants. Concerns did loom in the minds of Treasury officials; the Egyptian government did not seem capable of producing the satisfactory feasibility studies needed to attract most investors, did not seem to understand the purpose of the US proposed Project Development Institution to assist them in creating investment proposals, and struggled to pay off or even comprehensively catalogue its foreign debts.<sup>446</sup> But Treasury pressed forward in its efforts with Egypt, and by November had developed the term “triangular investment” as a useful shorthand. “We have spent a good deal of time focusing on individual jointventure [sic] projects and on the concept of triangular investment, which involves bringing together U.S. technology, Egyptian projects and other Arab financial resources,” Parsky wrote to Kissinger in a November status update on

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<sup>444</sup> Memcon, Fahmy, Kissinger, NSC Staffer Peter W. Rodman, August 12, 1974, folder “Memcon: Secretary-Fahmy, 1974,” box 45, Records of Joseph Sisco, 1951-76, RG59 GR DoS, NARA2.

<sup>445</sup> Memcon, Ford, Kissinger, Scowcroft, August 13, 1974, box 4, NSA MC, FL.

<sup>446</sup> “Bilateral Briefing Book: IBRD/IMF Annual Meeting – 1974, Volume 1, Major Countries,” September 24, 1974, folder “IBRD & IMF Annual Meeting – Egypt,” box 31, WSP.

activities of the US-Egyptian Joint Cooperation Commission. “This latter concept interests the Egyptians very much.”<sup>447</sup> The same day Parsky also wrote to Shultz, now a vice president at Bechtel, about Shultz’s upcoming trip to Egypt. Parsky described to Shultz his efforts toward “developing the concept of tripartite or triangular investment.” Parsky also asked Shultz “for any thoughts you have after your talks [in Egypt] – especially the feelings of the government about our efforts... you may also gain some views on the role the private sector, both domestic and foreign, can play in each [sector of the Egyptian economy] and of the most important barriers to such investment. Of particular interest, of course, will be opportunities for U.S. business to play a major role for the mutual benefit of our two countries. I would be delighted to talk to you about these and any other issues when you return.”<sup>448</sup>

### **Israeli Resistance to the Petrodollar Order**

But where the US government saw potential to utilize petrodollars toward a more US-aligned and stable Middle East, the Israeli government saw an existential threat. The Israeli government realized that petrodollars were reshaping the balance of economic and military power between Israel and the Arab world to Israel’s disadvantage, and sought US assistance in offsetting this. To strengthen its bargaining position, the Israeli government tied its cooperation in the peace process to US assistance.

The Israeli economy languished in the mid-1970s. The oil price surges contributed to Israel’s energy bill rising from an average of one percent of GNP in the 1960s to over seven percent from 1973 to 1979. Israeli defense expenditures also ballooned in response the 1967 and

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<sup>447</sup> Parsky to Kissinger, “Status of Economic Aspects of Joint U.S.-Egyptian Commission on Economic Cooperation,” November 5, 1974, folder “Egypt - 1974 File 1,” box 2, Records of Assistant Secretary of International Affairs, 1973-76, RG56 GR DoT, NARA2.

<sup>448</sup> Parsky to Shultz, “Your Visit to Egypt,” November 5, 1974, folder “Egypt - Parsky Visit, Nov. 1974,” box 2, Records of the Assistant Secretary for International Affairs, 1973-76, RG56 GR DoT, NARA2.

1973 wars and the arms race between Israel and the Arab states. Arab petrodollars largely funded the arms aimed and used against Israel, and the rise in petrodollar profits raised the specter of both an augmented Arab military threat and an Israeli economic collapse from unsustainable military expenses. During the October 1974 Rabat Summit, not only did the Arab League unanimously declare the PLO the sole representative for the Palestinians, but the oil-rich member countries also pledged annual aid of \$1 billion each to Egypt and Syria, \$300 million to Jordan, and \$50 million in annual assistance for the PLO for the next four years, in addition to any previously existing aid agreements. Both the oil shocks and increased defense expenditures contributed to rampant inflation in Israel, averaging an annual rate of 55 percent from 1972-1980. Unrelated structural changes in the Israeli economy, such as a drop in immigration levels, further contributed to the stagnation of Israel GNP and productivity. The Israeli government thus urgently sought both military and economic assistance to counter the rising power of the Arab countries.<sup>449</sup>

At first Israeli officials emphasized to the US government an alleged contrast between the large flows of Soviet weapons to the Arabs and the paltry arms deliveries from the United States to Israel. On August 1, 1974, for example, Israeli Deputy Prime Minister and Minister of Finance Yigal Allon harangued Simon about “the Soviet arms build-up in Syria and Iraq and to a lesser extent in Egypt” and stated that “he was surprised... to see how unprepared the U.S. is to meet challenges around the world and is unable to help friends and allies with needed minimum supplies of conventional arms.” Allon insisted that he could not go to any peace conference “so long as Israel’s bilateral military, economic, and political problems with the U.S. are not solved,”

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<sup>449</sup> Owen, *A History of Middle East Economies in the Twentieth Century*, 176-184; “Arabs Agree on Vast Aid To Main Foes of Israel,” *New York Times*, October 30, 1974.

and said that “war can be averted if a balance of military strength is maintained.”<sup>450</sup> As US arms sales to Arab countries grew, the Israeli government not only continued to demand increased US aid but also pushed the United States to limit arms sales to the Arab countries. One example of this occurred on February 5, 1975, among Kissinger, Scowcroft, and Israeli Ambassador Simcha Dinitz, and is worth quoting at length. The discussion began with Dinitz protesting the delay in receiving a letter of offer for the US sale of the McDonnell Douglas F-15 fighter to Israel, but he quickly digressed into a complaint about news reports of US arms sales to Saudi Arabia:

- Dinitz: With all this in the papers about the millions in arms going to Saudi Arabia....
- Kissinger: Most of it isn't true. And it is [Northrop] F-5E [fighters], which you wouldn't take.
- Dinitz: We have the reports. With the [Hughes AGM-65] Maverick [missile], the laser-designator, according to the papers. There is not a single item that some Americans in the Pentagon aren't worried about this equipment going -- getting into the hands of the Russians.
- Kissinger: “Some Americans.” They are the ones who made the decision. It was never checked over here in detail. F-5E's aren't even considered sophisticated weapons.

After complaining that the Saudis were also acquiring at least 48 of the most advanced French Mirage fighters, Dinitz returned to the issue of the F-15s:

- Dinitz: The fact is it [the F-15] was promised us by President Nixon and also by President Ford. It was in a letter by President Nixon – “the most advanced planes.”
- Kissinger: That doesn't mean you can expect to come in and get it the next day. But let's see whether the technical teams can come. We will check.
- Dinitz: I know you get upset.
- Kissinger: I get upset because whenever I want to talk about the [peace process] negotiations, to get you in a good mood you want weapons. And I know Rabin's strategy!
- Dinitz: From our point of view, whenever there are negotiations, something is withheld.
- Kissinger: Because whenever you get something you come in with new items, so there is something always outstanding.

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<sup>450</sup> Memcon, Yigal, Allon, et al., August 1, 1974, folder “August '74 Volume I Action Briefing Memos & Memcons,” box 2, Office of the Assistant Secretary for International Affairs, 1973-75, RG56 GR DoT, NARA2.

Dinitz: But the decision on the F-15 was made. First there was a delay in the pricing data, then a requirement of a letter of offer was invented.

Kissinger: Look into this, Brent. And tell him (Dinitz) 15 minutes before he leaves (for Israel), otherwise he'll find out some other item.

Dinitz: If you want, I'll document how long it takes for us to get stuff compared to what the Saudis get. And we feel, frankly, that you are doing too much, with no guarantees, they [the Saudi fighter planes] won't go to the Egyptians.

Scowcroft: They [the Egyptians] have to learn to fly them first.

Dinitz: But you're training them [the Egyptians]. It's a great concern to us, I have to say.

Kissinger: I call you in for a half hour, and within minutes I am on the defensive.<sup>451</sup>

Dinitz clearly registered to Kissinger the Israelis' concern that the Saudis were acquiring too many weapons and that they might be transferred to Egypt, endangering the balance of power between Israel and the Arab countries. The conversation also makes clear that Kissinger was well aware of, and frustrated by, the Israeli strategy to link cooperation in the peace process to US military and economic assistance to Israel.

Yet while the Israeli government attempted to utilize the peace process to extract US aid, the US government attempted to utilize US aid to extract Israeli concessions in the peace process. Nixon, Ford, and Kissinger all used US aid as a carrot to reward Israeli territorial withdrawals and to balm concerns over strengthening US-Arab relations. Nixon, Ford, and Kissinger also readily used the threat of withholding US assistance as a stick to prod Israel forward in the peace negotiations when they deemed the Israelis to be too intransigent.<sup>452</sup> In 1974, however, Israel received more carrot than stick. In part due to the massive rearmament needs of Israel during and after the 1973 War, in part due to American efforts to keep Israel progressing in the peace process, and in part to assuage Israeli fears about rising Arab petrodollar power, the United States provided Israel with an unprecedented amount of aid in 1974. In that

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<sup>451</sup> Memcon, Dinitz, Kissinger, et al., February 5, 1974, box 9, MC, FL.

<sup>452</sup> For more detailed examples and explanation of these dual strategies, see Quandt, *Peace Process*, 130-173.



year the US government provided nearly \$2.6 billion in aid to Israel, a sum larger than the total amount of US aid provided to Israel during the first the first five years of the Nixon administration (\$1.9 billion) or of all US aid to Israel from 1961 to 1973 (\$2.5 billion). Furthermore, whereas all US military aid and most economic aid to Israel had previously been provided in the form of loans, the 1974 aid package included \$1.5 billion in military grant aid. 1974 marked the beginning of a dramatically new era in US aid to Israel; whereas before the United States had only been a modest financial contributor to the Israeli government, from 1974 to 1980 US aid would supply 85 percent of the Israeli defense budget.<sup>453</sup> This dramatic shift was in part the result of Israel's and the United States' responses to the new petrodollar economy.

The dramatic increase in US aid to Israel displeased most Arabs, and the Egyptian government had particular reason to be dismayed at the end of 1974 when it compared the actual US disbursement of \$2.6 billion to Israel during that year to the relatively meager \$250 million in non-military aid the United States had pledged to Egypt for fiscal year 1975. In December 1974 Saudi Acting Foreign Minister Muhammad Mas'ud confidentially informed US Ambassador James Akins that Egyptian Security Advisor Ashraf Marwan had recently visited with Faisal and Fahd and told them that "the Egyptians were becoming increasingly disillusioned with their new relationship with the United States. They [the Egyptians] had broken with the Russians at the urging of the United States and Saudi Arabia, but what had they achieved? The United States had made promises of economic and military support and had given nothing. They had promised that Israel would withdraw further from the occupied Arab lands, yet it was increasingly evident that Israel would not do this." Akins believed that "at least some Saudis... are concluding that our words of conciliation and our 'special relationship' [with Saudi Arabia] are merely covers for aggressive plans," and that Marwan's complaints had made a strong

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<sup>453</sup> Miglietta, *American Alliance Policy in the Middle East*, 168-173.

impression upon Faisal.<sup>454</sup> On December 18 Faisal sent a strongly worded letter to Ford echoing the Egyptian complaints. “What benefits did the Egyptian Arab Republic obtain by changing its position toward the Soviet (Union)?” Faisal pointedly asked. Faisal contrasted the lack of US support to Egypt with US assistance to Israel, and stated that while he was grateful for the efforts of the United States in pursuing the peace process, “I assure you that the delay in reaching a complete withdrawal from all the Arab territories, and in giving the Palestinian people its right to self-determination and to return to its fatherland, shall undo all the efforts that have been made, and the reaction in our Arab world will be intense toward the United States.”<sup>455</sup> The Saudi government clearly feared that an imbalance in US aid and a failure to oversee progress in the peace process could undo Saudi efforts to create a US-Saudi aligned Arab bloc in the Middle East, and could even force Saudi Arabia back to a position of hostility toward the United States.

Ford wrote back to Faisal stating that while progress had not occurred as quickly as he wanted, significant steps had been made in the first withdrawals of Israel forces from Egyptian and Syrian territory and in establishing the resumption of US aid and economic development plans for Egypt. Further advances could be made soon, Ford insisted, so long as Faisal continued to support US efforts.<sup>456</sup> The Ford administration did not want to see the US-Saudi led Arab bloc break apart any more than the Saudis did, but pressure increasingly mounted for further US action. A CIA assessment sent to Scowcroft on March 14, 1975, stated that if another disengagement agreement was not achieved soon, Sadat would likely force the UN Emergency Force to leave the Sinai by allowing its mandate to lapse on April 24, and “if progress [on the

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<sup>454</sup> Akins to Kissinger, December 18, 1974, folder “Saudi Arabia - State Dept Telegrams To SECSTATE-NODIS (2),” box 29, PCF MESA, FL.

<sup>455</sup> Ibid.

<sup>456</sup> Kissinger to Aikens, December 27, 1974, folder “Saudi Arabia - State Dept Telegrams From SECSTATE-NODIS (1),” box 28, PCF MESA, FL.

peace process] were not quickly achieved... or at least an assurance gained that it could be effected soon, the odds are high that Egypt, in conjunction with Syria, would reopen the war.”<sup>457</sup>

This, then, was the backdrop when Kissinger failed to achieve a second Egypt-Israeli agreement in a round of shuttle diplomacy in March 1975. Rabin refused to return a pair of strategic passes to Egypt without a formal pledge of non-belligerence; Sadat refused to make any deal without the return of the passes while stating that for purposes of political cover in the Arab world he could only pledge to not resolve the Arab-Israeli conflict through military force. Despite pressure from Ford and Kissinger to accept the Egyptian formula, the Israeli government refused. At this point, Ford publicly declared that his administration would reassess its Middle East policy, making clear that he blamed Israel for the breakdown of the peace process and hinting that the special relationship between Israel and the United States might suffer for it.<sup>458</sup> At an NSC meeting on March 28 the Ford administration expressed consensus that aid and policy coordination with Israel would be restricted while cooperation with the Arab countries would continue relatively unchanged. Many voiced concern that if the United States failed to persuade Israel to resume the peace process along lines minimally acceptable to Egypt, another war would break out. The likely result would be a significant loss of US influence in the Arab world, another Arab oil embargo against the United States, and the movement of Soviet military forces into the region to protect their Arab allies. Vice President Nelson Rockefeller, back from a visit to Saudi Arabia to attend the funeral of King Faisal, who had been assassinated in late March, reported that Prince Fahd had told him that “unless there is a ‘just, equitable and lasting peace within one year,’ – and those are his exact words – the Soviets will move back in, the

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<sup>457</sup> Arthur Houghton to Scowcroft, “CIA Analysis of Egyptian Military Intentions and Contingency Planning,” March 14, 1975, folder “Outside the System Chronological File 3/11/75 – 3/20/75,” box 2, NSA OSCF, FL.

<sup>458</sup> For background on Kissinger’s March 1975 negotiations and Ford’s Middle East policy reassessment, see Quandt, *Peace Process*, 159-170.

radicals will be reinvigorated and rearmed by the Soviets while the moderates will move away from the US and establish a close relationship with Western Europe. The Europeans have arms they want to sell, we have the money to buy... the Arabs will keep building their military strength as long as it takes from the USSR and Western Europe and in time we will crush Israel.”<sup>459</sup> From the vantage point of the Ford administration, the Israelis had dangerously imperiled the new order of petrodollar interdependence between the United States and the Arab world.

The Ford administration decided to suspend all new economic and military agreements with Israel and hoped that the pressure would lead Israel to reverse its course before the outbreak of another war. At first Rabin resisted the pressure, and pro-Israel voices in the US media applied their own pressure against the Ford administration. On May 21 Ford received a letter from seventy-six senators calling on him to be “responsive to Israel’s economic and military needs.”<sup>460</sup> The Ford administration stood fast, however, and in June Rabin and his cabinet determined that they should reengage in the peace process along US lines. Sadat also made concessions, agreeing that US civilians could be stationed at observation points in the Sinai to further assure that Egypt would not resume hostilities. On September 4 Egypt and Israel formally signed the Sinai II Accord, which granted most of the territorial concessions Egypt had insisted upon in return for a commitment to solving the Arab-Israeli dispute without military force. To ensure Israeli cooperation, however, Kissinger also pledged about \$2 billion in additional aid to Israel.<sup>461</sup> The Ford administration had managed to keep the peace process moving. Yet the protracted struggle over the Sinai II agreement underscored how Israel’s fears,

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<sup>459</sup> Rockefeller added that Fahd “is right about the Western Europeans. The French sent their Defense Minister to the funeral with a list of items for sale and models of aircraft and tanks. This offended the Saudis.” Memcon, NSC Meeting, March 28, 1975, box 9, MC, FL.

<sup>460</sup> Quoted from Quandt, *Peace Process*, 165.

<sup>461</sup> Quandt, *Peace Process*, 163-170.

in part due to Arab petrodollar power, could potentially lead to a new conflict in the region that would undo the fragile new US-Saudi led Arab bloc, a coalition largely linked together by petrodollars. The episode also underscored how the United States was supplying both sides of the Arab-Israeli arms race, a race that was sharply escalating due to rising petrodollar profits.

### **The Predicaments of Egypt**

While the Ford administration grappled with Israeli unyieldingness, it also faced the growing economic and military frustrations of the Egyptians. On the economic front, triangular investment largely failed to materialize. The Treasury Department and US businesses largely attributed this failure to the inadequate actions of the Egyptian government. The Egyptians declined the US proposal to establish a Project Development Agency, apparently due to an expectation that US corporations should create feasibility studies instead. This approach baffled Treasury officials, who wanted to create their own feasibility studies as an inducement to US companies rather than leave the job to them as an additional hurdle.<sup>462</sup> Lists of potential projects for triangular investment that the Egyptian government was supposed to provide Treasury were delayed for months.<sup>463</sup> Simon persisted in commending Egypt's initial steps toward liberalization while advocating for additional action. Visiting Egypt in March 1976, Simon stated in a news conference that he and Sadat had discussed the idea of "a private sector Marshall Plan" for Egypt.<sup>464</sup> Nothing so grandiose would actually occur during Simon's tenure as Secretary of the Treasury, however. Despite Egypt's reforms to attract foreign investment, US

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<sup>462</sup> Jerry Newman to Parsky, "Checklist of Outstanding Issues with the Egyptians for Discussion Ambassador Eilts," January 16, 1975, folder "Egypt - 1974 File 2," box 2, Records of the Assistant Secretary for International Affairs, 1973-76, RG56 GR DoT, NARA2.

<sup>463</sup> Robert B. Anderson to Parsky, "Summary of Embassy Talks with Egyptians Re JWG on Economic and Financial Cooperation," March 28, 1975, folder "Egypt - 1974 File 2," box 2, Records of the Assistant Secretary for International Affairs, 1973-76, RG56 GR DoT, NARA2.

<sup>464</sup> Henry Tanner, "Simon Commends Sadat on Economy," *New York Times*, March 8, 1976.

businesspeople felt many obstacles remained. US businesses criticized Egyptian law that set a two-tier exchange rate for the Egyptian pound, which forced those bringing money into Egypt to accept an artificially low value for their currency while maintaining a higher value for money taken out of the country. US businesses also complained that Egyptian investment laws remained too vague and that the Egyptian bureaucracy imposed too many requirements and delays on proposed projects. By the end of 1976, the only US businesses to open major branches in Egypt were a few banks like Chase and Citibank. These banks conducted a busy business in currency exchanges but little in the way of financing.<sup>465</sup>

The Egyptian economy did grow rapidly from 1974 to 1976 in terms of GDP, in large part due to aid and remittance flows into the country. Much of the aid and remittances Egypt garnered was spent on foreign arms, consumable goods, and debt repayment rather than invested in Egyptian industry or agriculture, however, leaving Egyptian exports and import-substitutes relatively stagnant. Egypt thus remained reliant upon foreign imports for basic food and security needs, while simultaneously relying upon foreign assistance to pay for these imports. At the same time, the influx of foreign aid and remittances, high levels of government military and domestic spending, and rising oil prices all contributed to high rates of inflation in Egypt. To protect lower-income Egyptians from the harm of inflation and preserve popular support for Sadat's regime, the Egyptian government rapidly increased government subsidies for basic consumer goods. Since many of these goods were imported, the subsidies further harmed Egypt's balance of trade. The end result of all of this was that between 1973 and 1976 Egypt's foreign debt nearly tripled while domestic subsidies increased thirteen-fold.<sup>466</sup>

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<sup>465</sup> "U.S. Businessmen's Study Tells Egypt Why Foreign Investment Lags," *New York Times*, November 26, 1976.

<sup>466</sup> Beattie, *Egypt During the Sadat Years*, 207; Owen, *A History of Middle East Economies in the Twentieth Century*, 135-137.

With US and other foreign investment failing to materialize in significant amounts, the Egyptian government pushed the Ford administration to both increase US aid and lobby oil-rich and more developed countries to increase their aid to Egypt. Despite unprecedented levels of aid from the oil-rich Arab countries already being sent to Egypt, in May 1975 Egypt told the United States that they needed an additional emergency aid package of \$1 billion for import financing; if this sum was not quickly delivered, the Egyptian government would either have to default on foreign loans, thus further damaging Egypt's creditworthiness and economic prospects, or severely cut back on imports, which could lead to political unrest that would threaten the Sadat regime. The State Department noted that "the Egyptians turned to the United States, rather than the IBRD [International Bank for Reconstruction and Development, a branch of the World Bank] and IMF, to represent their case for [the emergency] non-project aid to the other potential donors because they evidently feared that a consortium managed by the international agencies [the IBRD and IMF] would attach politically troublesome economic reform conditions to its pledges."<sup>467</sup> While the Ford administration agreed with the IMF and World Bank that Egypt needed to undertake additional economic reforms, it also desired to incur political favor from the Egyptian government and to support the stability of Sadat's regime. In this instance, the Ford administration favored its political calculations over its economic concerns, and proceeded to lobby on Egypt's behalf for foreign aid without economic restructuring stipulations.

The Ford administration first lobbied Saudi Arabia and Iran to join the United States in forming an aid package in which the three countries would each contribute roughly \$250 million for fiscal year 1975. This "nucleus group" would then use their pledges as an inducement to encourage other Western and oil-rich countries to add contributions. The Saudi government

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<sup>467</sup> "Issues/Talking Points: Emergency Assistance for Egypt," October 1975, folder "10/26-29 /75 - Egypt President Sadat (20)," box 15, NSA PBM VIPV, FL.

quickly agreed to the plan, provided the Saudis could make their contribution bilaterally and it was impressed upon Egypt not to expect expanded aid to be repeated the following year lest it become a habit; the United States readily agreed.<sup>468</sup> The Iranian government expressed less enthusiasm about the plan, complaining that while it supported Sadat, lower oil prices made it harder for Iran to be as generous in foreign aid.<sup>469</sup> Iran eventually went along with the plan, pledging \$150 million and an additional \$100 million conditioned upon Egyptian procurement of Iranian goods, while Saudi Arabia quickly dispatched its \$250 million in aid. In addition to \$250 million from the United States, West Germany and Japan also each pledged \$50 million.<sup>470</sup> The Ford administration had facilitated a critical petrodollar aid package to Egypt, helping to preserve Sadat's government and Egypt's economic prospects, while at the same time demonstrating the benefits of a closer relationship with the United States.

In addition to aid, Sadat's government urgently desired US arms. Obtaining US military support had been a significant justification for Egypt aligning itself with the United States, but at the beginning of 1975 such support had yet to materialize. By April 1975 the Ford administration had determined that attempting to secretly sell arms to Egypt through Saudi Arabia would not work after all, having apparently come around to Saunders' argument that it would be both illegal and inevitably leaked to the public, creating a scandal that could set back future US arms sales to Egypt. Eilts informed Sadat of the change in policy on April 19. Eilts noted that the United States was not opposed to Saudi funding of a public US arms sale to Egypt, but also added that the Ford administration could not guarantee any arms sales at the present.

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<sup>468</sup> Akins to Eilts, May 22, 1974, folder "Saudi Arabia - State Dept Telegrams To SECSTATE-EXDIS (2)," box 29, PCF MESA, FL.

<sup>469</sup> Helms to Kissinger, May 29, 1975, folder "Iran - State Dept Telegrams To SECSTATE-NODIS (2)," box 14, PCF MESA, FL.

<sup>470</sup> Kissinger to Eilts, September 15, 1975, folder "Egypt - State Dept Telegrams From SECSTATE - EXDIS (2)," box 4, PCF MESA, FL.



Sadat expressed disappointment, but held out hope for a US arms sale to Egypt in the near future.<sup>471</sup> As months passed without a US arms proposal, the United States received reports of growing unrest in the Egyptian military. “It is the Egyptian armed forces that Sadat must watch carefully for signs of unease or disaffection,” Kissinger wrote Ford on October 24. “Egyptian military officers must be concerned that Sadat’s policies have placed the Egyptian armed forces at a serious disadvantage with Israel.” Hoping to ease Sadat’s position, but also anticipating that Congress and the American public would need to be eased into advanced military sales to Egypt, Kissinger proposed starting with the sale of non-lethal military equipment, including the C-130 military transport plane.<sup>472</sup> Ford supported the idea, and after overcoming some initial Congressional resistance, gained approval in April 1976 for the sale of six C-130s to Egypt. Saudi Arabia provided the money to pay for the C-130s. From a military standpoint, the \$65 million arms deal in itself was of marginal significance. Symbolically, however, the sale marked a turning point in US-Egyptian relations after a twenty year US-arms embargo against Egypt.<sup>473</sup> It was also significant as the first instance of an oil-rich Arab country purchasing technologically advanced arms from the United States for Egypt. While not exactly an example of “triangular investment,” the C-130 deal could be called the first Egyptian “triangular military sale.”

### **Petrodollars and the Civil War in Lebanon**

While the United States moved toward establishing a military relationship with Egypt underwritten by Saudi Arabia, events in the Middle East again threatened the US-Saudi

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<sup>471</sup> Eilts to Kissinger, April 19, 1975, folder “Egypt (6),” box 4, PCF MESA, FL.

<sup>472</sup> Kissinger to Ford, “Strategy for the Sadat Visit,” October 24, 1975, folder “10/26-29/75 - Egypt - President Sadat (10),” box 15, NSA PBM VIPV, FL.

<sup>473</sup> Bernard Gwertzman, “Administration Decision to End Arms Embargo on Egypt by Sale of C-130’s,” March 20, 1976, *New York Times*; Bernard Gwertzman, “Kissinger and 3 Senators Meet on Egypt Arms Issue,” March 26, 1976, *New York Times*; “Congress is Silent; Cairo Arms Deal On,” April 15, 1976, *New York Times*.

petrodollar coalition in the Arab world, this time in Lebanon. Civil war erupted there in April 1975 due to disputes over governmental power sharing and policy toward the Palestinian Resistance based in the country. The Lebanese Right defended the status quo in governmental apportionment and sought to remove the Palestinian militias from Lebanon, while the Lebanese Left demanded reforms in governmental apportionment and defended the presence of the Palestinian Resistance. The PLO allied itself with the Lebanese Left, and the PLO's militias, well-armed from petrodollar assistance, helped turn the tide of the conflict against the Lebanese Right. As the position of the Lebanese Right deteriorated, Israel warned that it would not accept a Palestinian-Lebanese Left victory, and would militarily intervene if necessary. The Syrian government also considered the Lebanese Civil War to be a threat to its stability and security, and by the beginning of 1976 it had determined that the PLO and Lebanese Left needed to be reined in lest they spark a broader war with Israel that would pull in an unprepared Syria. Ironically, Israel and Syria each sought to apply military force to subdue the PLO and Lebanese Left, but each also warned that the military entry of the other in Lebanon would be cause for war. Despite sharing a common goal to end the Lebanese Civil War, Israel and Syria also feared that the other country would gain long-term military advantages over the other if they occupied Lebanon and brought it into their orbit. Yet as the Palestinian-Lebanese Left forces increasingly neared total victory over the Lebanese Right in March 1976, Israeli and/or Syrian intervention became increasingly likely.<sup>474</sup>

By March a Syrian military intervention appeared imminent, but Israel continued to maintain both publicly and privately to the United States that it would launch its own military intervention into Southern Lebanon in response. The Ford administration believed this scenario

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<sup>474</sup> For an analysis of the Ford administration's role in the Lebanese Civil War, see David M. Wight, "Kissinger's Levantine Dilemma: The Ford Administration and the Syrian Occupation of Lebanon," *Diplomatic History* 37, no. 1 (2013): 144-177.

would inevitably lead to war between the two and then lead to a wider regional conflict. “The Syrians could not stand still and face the charge of partitioning the country [Lebanon] to share it with Israel,” Kissinger professed at an NSC meeting on April 6. “They would have to attack [Israel].” At that point, Kissinger predicted the Jordanians and Egyptians would be forced to join in the war against Israel. Even worse, Kissinger believed that if another Arab-Israeli war erupted, “there is a high probability that the Soviets will come in in some form. They can't allow Syria to be smashed again. It would be total humiliation for the Soviets to allow Arab countries they arm and support to be totally defeated for the fourth time.” Lastly, Kissinger anticipated that “Saudi Arabia would support them [the Arab states] and there would be an oil embargo.” Rockefeller then added there would “not only [be] an oil embargo. The Arabs own twenty billion [dollars] in American assets they could dump. The disruption would be terrible.” This prompted Kissinger to note that “[Chairman of the Council of Economic Advisers Alan] Greenspan says the only way the Western Europeans can live within their means is thanks to Arab deposits. If the Saudis and Kuwaitis got out of the British pound, it would collapse.”<sup>475</sup>

The US-Saudi petrodollar order in the Middle East was once again imperiled by local actors. Furthermore, while petrodollar concerns were not the sole concern of the United States regarding the outbreak of another Arab-Israeli War, they did feature prominently. Petrodollar investments, the Ford administration feared, could be used to wreak havoc on the US economy and to either blackmail Western Europe into not cooperating with the United States or to punish it.

The Ford administration endeavored into May to prevent either Israel or Syria from launching an overt military intervention into Lebanon; it also worked toward establishing a ceasefire between the Lebanese Left and Right. The Ford administration refused to address the

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<sup>475</sup> Memcon, NSC Meeting, April 7, 1976, box 2, NSC MF, FL.

key demands of the Lebanese Left, however, and the fighting continued. Either with or without a previously agreed understanding with the United States (the Ford administration maintained there was no such understanding, a claim supported by the available documentary record), the Syrian military invaded Lebanon on the night of May 31. The Ford administration then pressed Israel not to challenge the Syrian intervention or launch its own invasion into Southern Lebanon. The Israeli government privately agreed not to take action as long as Syrian forces did not enter Southern Lebanon, an offer the Syrians readily accepted.

After initial setbacks, the Syrian army severely weakened the militias of the PLO and the Lebanese Left in September. Saudi Arabia then called for negotiations to end the conflict in Lebanon. Arab disunity, the Saudis argued, had weakened the Arab position in the Arab-Israeli conflict. A new opportunity would soon be available to advance the peace process and obtain concessions from Israel with the conclusion of the US presidential election, but only if the Arabs were united. In October Saudi Arabia, Kuwait, Syria, Lebanon, the PLO, and Egypt convened in Riyadh and then Cairo to hammer out an agreement. The PLO and Syria agreed to a ceasefire, and the oil-rich Arab countries agreed to fund an Arab Deterrent Force of thirty thousand (mostly Syrian) troops to maintain order in Lebanon until stability held. Deprived of the military support of the PLO, the Lebanese Left was forced to accept the ceasefire for the time being as well, and a relative state of peace temporarily returned to Lebanon.<sup>476</sup> The Saudis had succeeded in preserving the US-Saudi Arab bloc through the first phase of the Second Lebanese Civil War, and had even increased Saudi ties with Syria. The core issues of the conflict remained unresolved, however, and the Lebanese Civil War would continue for another fourteen years, with repeated intermittent escalations that would again endanger US-Arab relations.

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<sup>476</sup> Itamar Rabinovich, *The War for Lebanon, 1970-1985 Revised Edition* (Ithaca: Cornell University Press, 1985), 54-56.

## **Egypt and the Trials of Economic Restructuring**

While the Ford administration had helped put together a multilateral aid package for Egypt in the spring of 1975 in order to shield Egypt from IMF and World Bank stipulations, by the fall of 1975 the Ford administration had concluded that Egypt needed to seriously begin the processes of restructuring its economy in order to improve its balance of payments. The US government sought to ease this transition and reward Egypt for its turn to the United States by increasing US aid from \$372 million in fiscal year 1975 to \$987 million in fiscal year 1976.<sup>477</sup> But the Ford administration also increased pressure on the Egyptians to curb government spending. In October 1975, in preparation for Sadat's visit to the United States, the State Department drafted a briefing paper to address the issue. State noted that the Egyptian government hoped to see a continuation of high levels of aid from foreign donors in 1976, including about \$2.5 billion in non-US aid, but believed this was unlikely to occur. "The planned sharp increase in U.S. aid and the easing of Egyptian confrontation with Israel [after Sinai II] may give Arab and other countries the excuse to cut back on aid to Egypt" State wrote. "The refusal of Japan and Germany to provide the full \$100 million requested of each of them in 1975 reflects, in part, their dissatisfaction with Egypt's economic mismanagement and their belief that the United States and the rich Arab countries will keep Egypt afloat." In short, "the U.S government cannot successfully repeat in 1976 the role it played in raising emergency aid [from Western and Arab governments] for Egypt this year [in the summer of 1975]." Instead, State advocated that Egypt seek aid from the World Bank. "U.S. political interests in Egypt preclude unilateral U.S. pressure on Sadat for economic reforms," State noted. "Coordinated and politically anonymous approaches to these policy issues by Arab and western [sic] leaders can be achieved only under

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<sup>477</sup> Burns, *Economic Aid and American Foreign Policy Toward Egypt*, 220.

IBRD leadership.”<sup>478</sup> State could have included the IMF along with the World Bank, but the point was clear: since the United States did not want to strain its relationship with Egypt by forcing it to restructure its economy, and other donor countries including Saudi Arabia were resistant to continued high levels of unconditional aid, Egypt would instead be forced to obtain aid from the World Bank and/or IMF on the condition that it would restructure its economy.

The IMF and World Bank had been eager to participate in a restructuring of Egypt’s economy as early as the beginning of 1974, buoyed by Sadat’s declarations of an open door policy.<sup>479</sup> As time passed, however, the two institutions became frustrated with Egypt’s inability to make good on its stated goals. In November 1975, for example, IMF official John Gunter privately complained that the Egyptian Minister of Finance Ahmed Abu Ismail “showed little interest in foreign exchange policy and his draft 1976 budget makes little progress in coming to grips with the deep-seated fiscal problems. For example, the planned reduction in outlays for consumption subsidies reflects mainly lower international prices rather than any significant change in the subsidization policy.”<sup>480</sup> Similarly, in April 1976 McNamara expressed to Egyptian Planning Adviser to the Prime Minister Helmy Abdel Rahman his “concern about what [McNamara] considered two major problems affecting Egypt’s economic recovery: overspending and administrative inefficiency.”<sup>481</sup> The Egyptian government, lacking the United States’ support for gathering direct international aid without conditions as it had in 1975, went to the IMF in the spring of 1976 and agreed to reduce subsidies and lower the overvalued exchange

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<sup>478</sup> “Issues/Talking Points: Emergency Assistance for Egypt,” October 1975, folder “10/26-29 /75 - Egypt President Sadat (20),” box 15, NSA PBM VIPV, FL.

<sup>479</sup> Division Chief, EM1DA, Adi J. Davar, “EGYPT – Mr. McNamara’s Meeting with Some Cabinet Ministers,” April 10, 1974, folder “Contacts with member countries: Egypt - Correspondence 02,” McNamara Papers, WBGA; John W. Gunter to Witteveen, March 7, 1974, folder “C-Egypt-810 Mission Gunter, John Feb. 1974,” box 6, Central Files Country Files: Egypt, IMFA.

<sup>480</sup> John W. Gunter to Witteveen, November 25, 1975, folder “C-Egypt-810 Mission Gunter and Staff Oct.-Nov. 1975,” box 6, Central Files Country Files: Egypt, IMFA.

<sup>481</sup> Director of EMENA I Martijn J. W. M. Paijmans to McNamara, April 19, 1976, folder “Contacts with member countries; Egypt - Correspondence 03,” McNamara Papers, WBGA.

rate of the Egyptian pound in return for IMF lending. The Egyptian government quickly reneged on the offer, however, apparently believing it could obtain additional aid from the oil-rich Arab countries instead.<sup>482</sup>

Saudi Arabia, however, had become increasingly reluctant to extend aid to an Egyptian government that appeared incapable of putting its finances in order. Throughout 1976 the Ford administration continued to encourage Saudi Arabia to extend generous aid to Egypt, but it also internally noted that “the Saudis have grown increasingly critical of Egypt’s inability to manage its finances over the past year.” A July 26 speech in which Sadat criticized the levels of Gulf Arab aid to Egypt also seriously angered the Saudi government.<sup>483</sup> In September Saudi Arabian officials told the IMF that it agreed with its efforts to force Egypt to address its balance of payments deficit and debt. The IMF welcomed Saudi support for its position, but also encouraged the Saudis to be forthcoming in pledged aid to Egypt, arguing the country would be in a tight spot even with Saudi aid.<sup>484</sup>

Arab petrodollar aid remained slow, and in October Sadat wrote to Ford in the hope that he could arrange a new emergency international aid package in order to avoid IMF conditions for lending. Sadat feared that restructuring along IMF lines could cause massive social upheaval directed against him.<sup>485</sup> On November 30, Ford delivered his reply to Sadat. Noncommittal about the prospects of a new emergency aid package outside of the IMF, Ford noted to Sadat that “I understand that you are considering further economic policy measures in consultation with the International Monetary Fund... only you can make the decisions as to what will best serve the

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<sup>482</sup> Henry Tanner, “Cairo Reaps a Wind,” January 21, 1977, *New York Times*.

<sup>483</sup> “Saudi Arabian Aid to Egypt,” circa August 1976, folder “Saudi Arabia (15),” box 28, PCF MESA, FL.

<sup>484</sup> Gunter to Witteveen, folder “C-Saudi Arabia-810 Mission Gunter, John W. Sep 1976, box 3, Country Files - Saudi Arabia, IMFA.

<sup>485</sup> Scowcroft to Ford, “Letter from President Sadat on Egyptian Economy – Proposed Reply,” November 29, 1976, folder “Egypt - President Sadat (2),” box 1, NSA PCFL, FL.

interests of your country. My own judgment is that the immediate problems arising from sound albeit difficult economic decisions will be more than compensated by a greater willingness on the part of potential donors to increase assistance to Egypt.”<sup>486</sup> Egyptian and IMF officials met in Cairo in mid-December to renew discussions about lending and restructuring. IMF officials noted that while the Egyptian officials “acknowledged the need for a program to bring about a major change in the direction of economic policy... they [also] realized that an adequate program would result in a substantial price adjustment with consequent political problems and were under pressure from other members of the [Egyptian] Cabinet to reduce the impact of the programs.” Toward the end of the meetings, the Egyptians attempted to water down the IMF restructuring program; the IMF told the Egyptians they would only consider “minor adjustments.” The meetings ended without the Egyptian government committing to a decision.<sup>487</sup> In early January 1977 Foreign Minister Fahmy made a final appeal to Saudi Arabia and Kuwait for increased assistance, but they refused.<sup>488</sup> The Egyptian government concluded that they had no choice but to adopt some of the IMF’s recommendations. On January 18 the Egyptian newspapers publicly announced that government subsidies for some thirty commodities, including many basic essentials such as rice, sugar, butane gas, and petroleum, would be reduced.<sup>489</sup>

The decrease in subsidies, while amounting to pennies for basic items, would constitute an onerous burden to the millions of lower-class Egyptians. Thousands of ordinary Egyptians, outraged upon learning of the decision, expressed their anger with two days of protests, lootings, and destruction of property in cities across the country, the worst civil disturbances in Egypt to occur since the ousting of the British in 1952. Leftist activists joined the protests and riots,

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<sup>486</sup> Ford to Sadat, November 30, 1976, folder “Egypt - President Sadat (2),” box 1, NSA PCFL, FL.

<sup>487</sup> Gunter to Witteveen, “Egypt – Discussions Concerning Use of the Fund’s Resources,” December 23, 1976, folder “C-Egypt-810 Mission Gunter and Staff Dec. 1976,” box 6, Central Files Country Files: Egypt, IMFA.

<sup>488</sup> Tanner, “Cairo Reaps a Wind.”

<sup>489</sup> Beattie, *Egypt During the Sadat Years*, pp. 207 and footnote 315, pp. 311.



arguing that Sadat had betrayed the legacy of Nasser. Crowds, making a mockery of Sadat's proudest moment, the crossing of the Egyptian army over Israeli lines in the Sinai during the 1973 War, chanted "oh hero of the crossing, where is our breakfast?" Order was only restored once Sadat promised to preserve the previous level of subsidies and deployed the army in the city streets. Egyptian security forces killed at least seventy-nine people, arrested two thousand, and wounded thousands more before the civil unrest ended.<sup>490</sup> Sadat's first attempt at restructuring the Egyptian economy had ended in failure as soon as it had begun. What the longer-term implications of the "food riots" meant for Egypt, the United States, and petrodollar flows remained to be seen.

### **The Paradoxes of Interdependence**

The petrodollar revolution served as a significant factor in the shift in US-Egyptian relations during the 1970s. This was true despite the fact that most of the plans devised by Egyptian and US policymakers to utilize petrodollars to strengthen US-Egyptian relations had either failed or produced less than anticipated results in their immediate goals at the conclusion of the Ford administration. Oil-rich Arab aid and investment had been less forthcoming than desired. Secretly selling US arms to Egypt indirectly through Saudi Arabia was abandoned. Very little triangular investment had occurred. The United States had managed only to approve the sale of six C-130s to Egypt, although they were financed by the Saudis. United States efforts to compel Egypt to restructure its economy as a step toward attracting petrodollar aid and investments had limited success and had helped lead to the January 1977 food riots.

Yet while the immediate goals of these plans went largely unmet, they did significantly serve the core objective of sustaining and improving US-Egyptian relations. US efforts to

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<sup>490</sup> Beattie, *Egypt During the Sadat Years*, 206-212.

encourage Arab and Iranian aid and investment to Egypt did produce critical sums of aid that Sadat could use to maintain power and grow Egypt's economy, even if the sums were less than what Sadat desired. Such successful lobbying efforts also provided evidence of the value of cooperating with the United States. The Saudi-financed US arms sale agreement to Egypt in 1976 may have been relatively small, but it sustained hopes that larger agreements could be achieved in the near future. Triangular trade had not yet appeared to a significant degree, but Egyptian and US officials remained enthusiastic about its potential to eventually reform the Egyptian economy. Along with seeking a satisfactory settlement of the Arab-Israeli conflict, the Egyptian government shifted its orientation to the United States in the hope of acquiring US economic and military assistance. Due to the difficulties of rapidly changing US levels of support to Egypt, petrodollar aid and investment served as a useful, perhaps vital, alternative source of assistance that could sustain the US-Egyptian relationship until the United States was able to increase its levels of assistance.

Yet while petrodollars served to strengthen US-Egyptian ties, they also held the potential to disrupt or even undo US-Arab ties across the MENA. When crises erupted in the region, often due to the actions of non-oil rich actors, US policymakers feared that Arab petrodollars would no longer flow to the United States or that petrodollars could be used as a financial weapon against the United States and its allies. When Israel resisted Arab and US demands in the peace process in the spring of 1975, in part due to their concern about Arab petrodollar strength, their stance threatened to undo US-Arab interdependence in the fires of another Arab-Israeli war. The same threat of a new Arab-Israeli war emerged in the tragedy of the Lebanese Civil War. The unsuccessful pursuit of petrodollar investment and a paucity of petrodollar aid contributed to the food riots that threatened Sadat's government, and thus US influence in the MENA and the basis

for its Arab-Israel peace process. The issues of how to proceed in the US-Egyptian relationship and the US-Arab-Iranian petrodollar relationships more generally remained at the fore of US concerns as Jimmy Carter succeeded Gerald Ford as US president on January 20, 1977, the day after the Egyptian food riots ended.

## CHAPTER FIVE

### The Carter Administration and the Petrodollar-Arms Complex

#### “The Arms Merchant of the Whole World”

On October 6, 1976, during the second presidential debate between Carter and Ford, Carter opened with a broad critique of the Ford administration’s foreign policy and listed different areas where he argued Ford had failed the American people. One of the issues Carter raised was US foreign arms sales. Under Ford, “we’ve had a chance to become now – contrary to our longstanding beliefs and principles – the arms merchant of the whole world,” Carter charged. “We’ve tried to buy success from our enemies, and at the same time we’ve excluded from the process the normal friendship of our allies.” Carter returned to the theme later in the debate, explicitly linking the issue to the Middle East. “When this Republican administration came into office we were shipping about \$1 billion dollars worth of arms overseas, now \$10 to \$12 billion dollars worth of arms overseas to countries that quite often use these weapons to fight each other,” Carter stated to an estimated 100 million American television viewers. “The shift in emphasis has been very disturbing to me, speaking about the Middle East. Under the last Democratic administration 60 percent of all weapons that went into the Middle East were for Israel. Now 60 percent goes to the Arab countries and... only 20 percent goes to Israel. This is a deviation from idealism; it’s a deviation from a commitment to our major ally in the Middle East, which is Israel; it’s a yielding to economic pressure on the part of the Arabs on the oil issue.”<sup>491</sup>

The fact that Carter hit upon the theme of arms transfer restraint twice in his televised debate with Ford indicated that his campaign believed voters cared about this issue. Part of

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<sup>491</sup> “Transcript of Foreign Affairs Debate Between Ford and Carter,” October 7, 1976, *New York Times*.

Carter's pitch on arms restraint was calculated to appeal to supporters of Israel, but it also aimed to appeal to Americans who opposed the growing global arms trade in general. During his first two years as president, Carter would pursue policies that appeared to violate his campaign pledges to reduce US foreign arms transfers and maintain a special commitment to Israel, battling Congress to allow the passage of multi-billion dollar arms sales to Iran and Saudi Arabia, perhaps most notably the sale of 60 F-15s to Saudi Arabia in 1978. Yet despite these high-profile arms sales and legislative battles, the Carter administration possessed a genuine moral and strategic commitment to reducing the global conventional arms trade, and during its first two years the Carter administration made significant progress in reducing the authorization of new US arms transfers to both the MENA and the rest of the world. This effort constituted the most powerful challenge yet mounted to the petrodollar-arms complex in the MENA. But by 1979, the structural constraints of the petrodollar-arms complex, coupled with a series of regional crises, led the Carter administration to abandon its earlier efforts to curb the conventional arms trade and to instead reengage with it in earnest.

Historians have largely overlooked the Carter administration's initial effort to significantly reduce the global conventional arms trade. In part this is because scholars have focused on other multilateral efforts of the Carter administration like nuclear arms control and human rights. In part this is also because the early overall success of Carter's policy of curbing US conventional arms transfers was obscured by a few high profile but comparatively small arms sales advocated for by Carter, and because by 1979 the effort to curb US foreign arms sales was all but abandoned.<sup>492</sup> Despite this, the Carter administration's original commitment and efforts

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<sup>492</sup> There is one book that takes the Carter administration's efforts to reduce conventional arms sales, as its topic but its focus is on why the policy failed from a bureaucratic standpoint. See Spear, *Carter and Arms Sales*. For works that study aspects of the Carter administration's multilateral foreign policies but not conventional arms transfer reductions, see Betty Glad, *An Outsider in the White House: Jimmy Carter, His Advisors, and the Making of*

to reduce the global arms trade is significant for two reasons. First, it helps to explain the Carter administration's initial understanding of, priorities for, and strategy toward the world, and particularly the MENA. For the Carter administration, reducing the arms trade offered a moral opportunity to channel petrodollars toward the material well-being of people in the less-developed world rather than toward militaries, and it offered a strategic opportunity to reduce competition with the Soviet Union and decrease destabilizing tensions in the MENA that threatened US interests. Importantly, the Carter administration believed it could retain its allies in the MENA while gradually reducing arms sales to them, especially if it could achieve multilateral agreements on arms sales with the Soviet Union and the countries of Western Europe. Second, the ultimate failure of the Carter administration's efforts to reduce the global arms trade demonstrates the structural strength of the petrodollar-arms complex. The lack of restraint by the other major arms exporting countries and the persistent desire of wealthy MENA states to acquire advanced weapons significantly enabled the global arms trade to continue to grow from 1977 to 1978, even as the United States unilaterally and significantly reduced its own arms sales. Then, a series of crises in the MENA, starting with the Iranian Revolution, raised significant fears within the US government about the security and dependability of US allies in the MENA. In response to these concerns, the Carter administration abandoned the goal of arms transfer restraint and instead embarked upon a surge of weapons sales to the MENA designed to both improve the security of allied governments and reassure client regimes of the United States' commitment to them.

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*American Foreign Policy* (Ithaca: Cornell University Press, 2009); Jerel A. Rosati, *The Carter Administration's Quest for Global Community: Beliefs and Their Impact on Behavior* (Columbia: South Carolina, 1987). For works that emphasize continuity or growth in arms sales levels to the MENA under the Carter administration, see Miglietta, *American Alliance Policy in the Middle East* and Quandt, *Peace Process*.

## **A New Arms Transfer Policy**

As seen in chapter three, a growing backlash developed in the United States against the rapidly expanding US arms trade with the MENA during the mid-1970s. The reasons behind this backlash varied: some feared for Israel's military strength vis-à-vis the Arab states; some worried the arms race in the MENA could undermine the stability of the region to the detriment of US strategic interests; some cautioned that advanced weapons technology could accidentally fall into the hands of groups opposed to the United States or its allies; some protested the United States should not provide arms to human rights abusers; some argued that money spent on arms could be put to better use developing the economies of the LDCs. There was no universal agreement on who should be denied US arms; different parties might cite Saudi Arabia, Egypt, Israel, Iran and/or any other number of countries, depending on their interests and perspectives. Taken together, however, these constituencies created a patchwork of resistance to the US arms trade with the MENA.

Support for and against aspects of the US-MENA arms trade could be found in significant factions of both major political parties, but Democrats in particular seized upon the issue out of conviction, to galvanize their base, and to attack the Ford administration during the 1976 election. Throughout 1976, many future members of the Carter administration spoke out against the rise in US arms exports. Carter himself criticized arms sales to the MENA for nearly every reason other than the undesirability of arming Israel, hoping to appeal to Democratic voters who sympathized with pro-Israeli, humanitarian, and geostrategic objections. Future Vice President and then Democratic Senator from Minnesota Walter Mondale made similar arguments during the Carter presidential campaign, criticizing the Nixon and Ford administrations for allowing the arms races in the Persian Gulf to increase tensions in the region and for "selling

arms to all comers, no matter how repressive or tyrannical the government.” Mondale also argued that the arms race in the Middle East ultimately took money away from the American taxpayer, because “if we sell a half-billion dollars in arms to Saudi Arabia, we then will need to give more economic and military aid to Israel to preserve the balance.”<sup>493</sup> Future Secretary of State Cyrus Vance also supported reducing the US and global arms trade while Vice-Chairman of the private United Nations Association. A report published by the United Nations Association and endorsed by Vance in November 1976, before he was appointed to the Carter administration, included proposals for an immediate US moratorium on the transfer of advanced weapons to Third World countries; US-Soviet negotiations to turn the Indian Ocean into a demilitarized zone; and multilateral cooperation between the United States, Soviet Union, United Kingdom, and France to curb global arms exports.<sup>494</sup> Carter’s election to the presidency thus elicited optimism from many arms-control advocates. The editorial board of the *Washington Post*, for example, cheered after the 1976 presidential election that “things looked brighter” since there would now soon be “a President who professes to be outraged by the moral and political implications of the United States’ being ‘the world’s leading arms salesman.’”<sup>495</sup>

In some ways, the Carter administration, once in power, did not prove to be a radical break from the Nixon and Ford administrations on US arms transfers to the MENA, campaign rhetoric notwithstanding. Like its predecessors, the Carter administration considered the Middle East to be strategically vital as a source of Western oil, as a bulwark against Soviet expansion, and as a center of global financial power. The Carter administration’s Presidential Directive/NSC-18, which outlined the national strategy toward the Soviet Union, directed the US government to “counterbalance, together with our allies and friends, by a combination of military

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<sup>493</sup> Linda Charlton, “Mondale Scores Ford Arms Sales,” August 31, 1976, *New York Times*.

<sup>494</sup> Jonathan Steele, “Carter’s invitation to a new kind of club,” January 27, 1977, *The Guardian*.

<sup>495</sup> “Getting a Handle on Arms Sales,” November 15, 1976, *Washington Post*.



forces, political efforts, and economic programs, Soviet military power and adverse influence in key areas, particularly Europe, *the Middle East* [emphasis added], and East Asia.”<sup>496</sup> This meant that arms transfers, as well as close political cooperation and economic exchange, would continue to be a cornerstone of US foreign relations with Iran, Israel, and Arab allies under the Carter administration. Carter knew that humanitarian demands and pro-Israeli rhetoric appealed to core Democratic constituencies, but he also believed the strength of US global influence and the US economy remained dependent upon good relations with Saudi Arabia, Iran, and Egypt.

Despite this, Carter’s campaign to decrease US arms transfers to the MENA and other parts of the less-developed world was not just empty rhetoric. The Carter administration believed that US arms transfers could and should be reduced, but that to be successful this process would have to be undertaken gradually and ultimately in cooperation with other arms-exporting countries. Furthermore, devising an arms transfer policy for the Middle East that would simultaneously address the goals of maintaining good relations with regional allies, improving the prospects of the Arab-Israeli peace process, and reducing the global arms trade would require a careful balancing act. The Carter administration thus held reducing arms transfers as a priority, but one that had to be pursued carefully and with other important objectives taken into consideration. In its initial attempt to meet all of these goals and develop an arms transfer policy, the Carter administration largely followed the blueprint laid out by the United Nations Association and endorsed by Vance. In the first weeks of Carter taking residency in the White House, his administration implemented an undeclared moratorium on new foreign arms sales, ordered an NSC review of US arms transfers with the goal of devising a new policy aimed at stemming the global proliferation of weapons, and began diplomatic overtures to the

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<sup>496</sup> “Presidential Directive/NSC-18,” August 24, 1977, folder “Presidential Directive 1-20,” box 100, Vertical File, Jimmy Carter Presidential Library [hereafter JCL].

Soviet Union, United Kingdom, France, and West Germany regarding multilateral efforts to curtail the global arms market.

On January 26, 1977, six days into his presidency, Carter issued Presidential Review Memorandum/NSC-12, which called for an interagency review of US arms transfer policy. The memorandum called for an examination “identifying the benefits and disadvantages of arms transfers as a policy tool” and “the feasibility and desirability of various unilateral and multilateral initiatives to restrict arms transfers on a national, regional, and global basis.”<sup>497</sup> The Carter administration also imposed an undeclared moratorium on arms sales at its outset, sending no new arms sale proposals to Congress and freezing \$6 billion worth of arms sales approved by the Ford administration, including major packages for MENA countries, until they could be reviewed by Carter officials. Furthermore, while many previously approved arms packages were eventually reapproved, the Carter administration did cancel some of them, including the sale of certain kinds of percussion bombs to Israel, a decision made in February 1977.<sup>498</sup> The moratorium and review process was meant to underscore to Congress, the American people, and the world that the Carter administration was taking the issue of arms control seriously. That some of the earliest arms transfer cancellations were made against Israel was likely done in part to reassure Arab governments of Carter’s evenhandedness in dealing with the Arab-Israeli conflict after Carter’s stridently pro-Israeli rhetoric during the 1976 presidential campaign.

Carter also made overtures to the Brezhnev about mutually reducing conventional arms transfers in the first months of his presidency. In March Vance visited Moscow and, in addition to SALT II negotiations, raised the issues of bilateral arms transfer reductions. The Soviets at

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<sup>497</sup> “Presidential Review Memorandum/NSC-12,” January 26, 1977, folder “Presidential Review Memorandum 11-35,” box 105, Vertical File, JCL.

<sup>498</sup> Lee Leseaze and George C. Wilson, “Arms Sales Of \$6 Billion Are Held Up,” March 27, 1977, *Washington Post*; Bernard Gwertzman, “U.S. Reviews Missile Sales to Saudis,” March 3, 1977, *New York Times*; “Military Sales of \$2 Billion Are Confirmed,” March 30, 1977, *Washington Post*.

first insisted on limiting discussions on reductions to the Middle East, and only after a political settlement of the Arab-Israeli crisis, as to do otherwise would be implausible. Vance managed, however, to persuade the Soviets to agree to form a working group to study possibilities for global arms reductions.<sup>499</sup>

Carter likewise informed Western European allies early on his desire to curb the global arms trade. Carter informed the British in January that he would pursue arms restraint in the Middle East and that while “he did not expect early results, and recognized the difficulties,” conventional arms control “meant a lot to him and he would be persistent.”<sup>500</sup> Meeting with British Prime Minister Callaghan, French President Valery Giscard d’Estaing, and West German Chancellor Helmut Schmidt in London on May 8, Carter sought to gently encourage the Western European powers to curb the global arms trade. Carter shared with them an internal memorandum that directed his administration to “reduce the thrust of arms sales.” He reassured his NATO allies that this would not apply to countries with which the United States had treaty obligations, but noted Iran and Israel as countries to which he aimed to reduce arms transfers. Carter stated this was “a unilateral decision on his part,” but left open the possibility that the European leaders could join his efforts, a measure explicitly solicited in the ACDA paper he shared with them. To offset European fears that a reduction in arms sales to LDCs could harm their defense industries and economies, Carter even offered the carrot of increased US purchases of European arms for its own military at the expense of US arms manufacturers, stating that “on

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<sup>499</sup> Callaghan, Carter, et al, March 11, 1977, PREM 16/1486, UKNA; Callaghan, Vance, et al, March 31, 1977, PREM 16/1488, UKNA.

<sup>500</sup> United Kingdom Ambassador to the United States Peter Ramsbotham to United Kingdom Foreign & Commonwealth Office, January 26, 1977, PREM 16/1909, UKNA.

[NATO] arm procurement... he genuinely wanted more two way traffic, and again repeated that he had no obligations to the military complex in the United States.”<sup>501</sup>

On May 19 the Carter administration announced the new policies it planned to implement based on the findings of PDD/NSC-12. In a statement, Carter argued that as the world’s largest arms supplier, the United States bore “special responsibilities” to reduce the global sale of weapons. To that end, Carter declared, “I have concluded that the United States will henceforth view arms transfers as an exceptional foreign policy implement, to be used only in instances where it can be clearly demonstrated that the transfer contributes to our national security interests. We will continue to utilize arms transfers to promote our security and the security of our close friends. But in the future, the burden of persuasion will be on those who favor a particular arms sale rather than those who oppose it.” Carter also announced the implementation of several new policies: that the United States would not be the first to supply advanced weapons to a region that previously did not have such capabilities, stricter limits on the coproduction of advanced weapons systems, the prohibition of developing or significantly redesigning weapons for the sole purpose of foreign sale, and the requirement of State Department authorization for any governmental or private efforts to promote foreign arms sales. Finally, Carter pledged that the value of US foreign arms transfers in FY 1978 would be reduced from FY 1977.<sup>502</sup>

There were important caveats to the new arms policy. Carter exempted all NATO member countries, Japan, Australia, and New Zealand from its provisions. The backlog of previously approved arms sales, valued at \$32 billion, would remain largely untouched.<sup>503</sup> Cases that the president determined involved either “extraordinary circumstances” or where “countries

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<sup>501</sup> Callaghan, Giscard, Carter, Schmidt, May 9, 1977, PREM 16/1267, UKNA; “Quadripartite Summit, 9 May 1977: Arms Transfer Restraints,” circa May 1977, PREM 12/1267, UKNA.

<sup>502</sup> Edward Walsh, “Arms Sales Curbs Set By Carter,” May 20, 1977, *Washington Post*.

<sup>503</sup> “Carter Sets Rules To Curb Sales Of Arms Abroad,” May 20, 1977, *Wall Street Journal*.

friendly to the United States must depend on advanced weaponry to offset quantitative and other disadvantages in order to maintain regional balance” could also receive exemptions from the new provisions. As the *Washington Post* put it, “how well the new policy works in practice is likely to depend largely on the extent to which Carter exercises his authority to grant exceptions to it.”<sup>504</sup> Despite these points, the new policy represented an important shift in the executive branch’s attitude toward arms transfers. Americans endeavoring to curb the international weapons trade could cite the provisions of the policy, particularly the pledge to reduce the value of arms transfers in the upcoming fiscal year, to hold the Carter administration accountable. The Carter administration could likewise cite the policy to allies to justify reductions in arms transfers. This new policy, coupled with the efforts to negotiate bilateral and multilateral arms transfer reductions with the Soviet Union, France, United Kingdom, and West Germany, constituted a distinctly different strategy from the Nixon and Ford administrations efforts to encourage US arms sales to the MENA with few restrictions. Such a shift in US policy would not go unchallenged, however, by the MENA countries themselves.

### **AWACS for Iran**

The Carter administration’s emphasis on arms reductions, among other matters, concerned the Shah greatly. Declining oil revenues was forcing Iran to partially scale back its rate of military purchases, but the Shah remained determined as ever that Iranian access to the most advanced US arms would remain a foundation of US-Iranian relations. For its part, the Carter administration sought to gradually wean the Shah from its large defense expenditures in a manner that did not significantly strain US-Iranian ties. A first step in establishing a mutually satisfactory new relationship between the Carter administration and the Pahlavi regime appeared

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<sup>504</sup> “Arms Sales Curbs Set By Carter.”

to be the US sale of seven Airborne Warning and Control System aircraft (AWACS) to Iran. AWACS were among the most advanced and expensive planes in the US fleet, designed to provide surveillance and direction of battle commands over a large area using state-of-the-art radar and communications equipment. Despite their high cost (\$170 million per plane), the Carter administration considered the sale an arms reduction measure, as the Iranian acquisition of seven AWACS would enable a sixty or seventy percent reduction of a proposed ground radar system for Iran projected to cost \$32 billion. Furthermore, the Carter administration hoped that the reconnaissance and coordination capabilities provided by the AWACS would reduce the number of Iranian combat planes needed to defend the country through better lead time and logistics. Because they were surveillance planes, the Carter administration could also bill the AWACS sale as completely defensive in nature. For the Iranians, the AWACS deal appealed as a cost saving measure, an acquisition of new US military technology, a quicker augmentation of its surveillance capability compared with the ground radar plan, and a demonstration of the new administration's commitment to continue previous levels of access to advanced US arms.<sup>505</sup>

The Carter administration announced its intention to propose the AWACS sale on April 26, and formally notified Congress on July 7. It constituted the first major arms transfer to Iran proposed by the Carter administration, as well as the first major weapons sale proposed since the declaration of the administration's new arms transfer policy.<sup>506</sup> To Carter's chagrin, seven senators from both parties quickly sponsored a resolution to block the sale, citing his own administration's new policies as justification.<sup>507</sup> "This program goes contrary to President

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<sup>505</sup> William Branigan, "Iran Said to Plan Cutbacks in Ambitious Radar Program," March 26, 1977, *Washington Post*; "Carter OKs Plane Sale to Iranians," April 26, 1977, *Los Angeles Times*; Norman Kempster, "U.S. to Sell 5 Radar Planes to Iran in Half-Billion-Dollar Deal," April 27, 1977, *Los Angeles Times*.

<sup>506</sup> "Carter OKs Plane Sale to Iranians;" "Battle Expected on Radar Sale to Iran," June 23, 1977, *Washington Post*; "Clash Expected Over Plan To Sell Iran Radar Planes," July 8, 1977, *New York Times*.

<sup>507</sup> Bernard Weinraub, "Controversy Grows Over Carter's Move To Sell Iran Planes," July 12, 1977, *New York Times*.

Carter's own stated policy on arms sales, which declares that sales are exceptions, to be used only when it can be clearly demonstrated that the sale contributes to our own national security interest," Democratic Senator for Iowa John Culver declared. "The President also has stipulated that the United States will not be the first supplier to introduce advanced weapons into a region that gives greater combat capability."<sup>508</sup> Democratic Senator for Missouri Thomas F. Eagleton and Senator Culver released portions of a confidential General Accounting Office (GAO) report on the AWACS sale that suggested cheaper, alternative surveillance system were ignored by the Defense Department, and that "the justification presented to Congress in support of the proposed AWACS sale to Iran is inadequate."<sup>509</sup> Culver and Eagleton also raised the possibility that a single Iranian defection could lead to secret US technology falling into the hands of the Soviets, endangering the US air force and Western European defenses. "I doubt that most Americans would wish us to surrender control of our look-down radar and assorted AWACS secrets to the Shah's secret services," Eagleton stated before a Senate subcommittee. "Iran's governmental status, centered on a mortal leader, is fragile and subject to radical change. To endorse this sale is to take an imprudent risk to American national security."<sup>510</sup> Finally, congressional critics charged that the Air Force had pushed the Iranian AWACS sale in order to offset research and development costs and thus make the aircraft more affordable for US and NATO purchases.<sup>511</sup>

Congressional opponents of the sale gained a major boost to their cause on July 21 when CIA Director Stansfield Turner testified to the House of Representatives that he stood by a statement he had made in a letter to the GAO (and had subsequently been leaked by the opponents of the AWACS sale in the Senate) that the transfer of AWACS to Iran could result in

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<sup>508</sup> Bernard Weinraub, "Congressional Agency Denounces Plan to Sell Radar System to Iran," July 16, 1977, *New York Times*.

<sup>509</sup> Ibid.

<sup>510</sup> Bernard Weinraub, "Two Senators Oppose Sale of Radar Planes to Iran," July 19, 1977, *New York Times*.

<sup>511</sup> "Controversy Grows Over Carter's Move To Sell Iran Planes."

the United States losing technological secrets to the detriment of its military advantage.<sup>512</sup> The next day Senate Majority Leader and Democratic Senator for West Virginia Robert C. Byrd wrote a letter to Carter asking him to withdraw and delay his request for the AWACS sale to Iran until the next year in order for the Senate to have enough time to properly study the disputed security risks.<sup>513</sup> In response to Byrd's letter, the US embassy in Iran reported that "Senate approval of the [AWACS] sale *at this time* [emphasis added] is vital... as the President has already written the Shah informing him that AWACS would be available, the President's personal prestige would suffer a serious blow in Tehran if the sale were now cancelled... [and] Brezhnev can have a field day during his upcoming visit to Iran."<sup>514</sup> The Carter administration duly informed the Senate on July 25 that it would not grant Byrd's requested delay.<sup>515</sup>

Yet even as a State Department official formally told the Senate the Carter administration's stance, House Speaker and Democratic Representative for Massachusetts Thomas P. (Tip) O'Neill publicly declared that the AWACS sale "ought to be held up for a while" since the AWACS contained "highly sophisticated equipment that might fall into the hands of the Soviet Union."<sup>516</sup> The Democratic, majority leadership in both houses of Congress was now openly calling for a delay in the sale on the basis that security concerns needed additional study, and congressional hostility had been piqued by Carter's refusal to grant Byrd's request for an extension to enable further review. On the morning of July 28 the House International Relations Committee voted 19 to 17 to block the sale, moving the House closer to passing a resolution against the deal. The Senate Foreign Relations Committee was set to vote

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<sup>512</sup> Harold J. Logan, "Turner Stands by Warning On Radar-Jet Sale to Iran," July 22, 1977, *Washington Post*.

<sup>513</sup> Harold J. Logan, "Senate Leader Would Delay Sale of Airborne Radar to Iran," July 24, 1977, *Washington Post*.

<sup>514</sup> Executive Secretariat: Bureau of Intelligence and Research, "Current Reports," July 25, 1977, NLC-SAFE 17 B-3-14-1-5, JCL.

<sup>515</sup> "Administration Bars Delay Asked by Byrd In Radar-Plane Sale," July 26, 1977, *New York Times*.

<sup>516</sup> Harold J. Logan, "Carter Plans Radar Sale To Iran Despite Opposition," July 26, 1977, *Washington Post*.



on the issue later that day, and White House staffers believed all Democrats on the Senate committee would vote for a resolution of disapproval against the sale, striking a second blow to the deal. At this point the Carter administration beat a tactical retreat, agreeing to resubmit the sale to Congress in September after it returned from recess in order to allow further Congressional study.<sup>517</sup> In response, on July 31 Iranian newspapers suggested that the Iranian government might refuse to purchase the AWACS due to anger over Congress' treatment of the issue.<sup>518</sup>

When the Carter administration did resubmit the AWACS sale to Congress in September, it stipulated that the AWACS sold to Iran would not include some sensitive cryptographic equipment, obtained an Iranian guarantee to only use the aircraft for defensive purposes, and guaranteed that US air crews would not fly the planes in operational missions for the Iranians. In hearings, State and Defense officials assuaged Congressional fears, and the Senate arms transfer subcommittee chairman, Democratic Senator for Minnesota Hubert H. Humphrey, came out in favor of the sale's passage.<sup>519</sup> Despite a last-ditch effort by 21 senators, the AWACS deal passed the deadline for Congressional disapproval on October 7 without incident. Yet while the AWACS sale to Iran was ultimately approved, Congress had demonstrated a new willingness to challenge the petrodollar-arms complex between the United States and the MENA, and had succeeded in imposing stipulations upon the original package proposed by the executive branch. Evincing this shift in mentality, Senator Byrd declared that after the AWACS, the US government should impose a moratorium on arms sales to Iran until it could be determined if the

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<sup>517</sup> NSC Middle East Staff to National Security Advisor Zbigniew Brzezinski, "Evening Report," July 26, 1977, NLC-10-4-3-9-4, JCL; Graham Hovey, "Carter Delays Iran Plane Sale After House Panel Opposes Deal," July 29, 1977, *New York Times*.

<sup>518</sup> "Iranians Are Canceling Purchase Of U.S. Airborne Radar System," August 1, 1977, *New York Times*.

<sup>519</sup> "AWACS for Iran, Continued," September 9, 1977, *New York Times*; Richard Burt, "Iran Plane Deal Gains in Congress," September 20, 1977, *New York Times*.

Iranians could use advanced US weapons without US personnel.<sup>520</sup> Senator Culver boasted that by delaying the AWACS sale into FY 1978, Congress had kept the FY 1977 value of arms transfers over \$1 billion lower, meaning the Carter administration's self-imposed ceiling of a lower value of arms transfers in FY 1978 would have to be that much lower.<sup>521</sup>

Yet while the Carter administration believed the AWACS sale to Iran had been necessary to maintain the strong strategic alliance between the two countries, it also continued to desire and believe that it could reduce US arms transfers to the less developed world, and to the MENA in particular. National Security Advisor Zbigniew Brzezinski suggested to Carter that clearly explaining to the Shah "the political realities (as evidenced by the AWACS case)" could help induce him to pursue a "moderating and stretching out of his arms requests" in order to avoid a Congressional struggle that "could damage the Administration's credibility and undermine the basis of our [US-Iranian] continued cooperation."<sup>522</sup> The Carter administration continued to pursue its gradual reduction in US arms sales with Iran while maintaining the US-Iranian alliance.

Carter also continued to resist economic incentives to sell arms to countries like Iran. Concerned about the declining value of the dollar and widening US trade deficits, Carter solicited policies from his Cabinet to address these issues. One of Secretary of the Treasury Michael Blumenthal's recommendations was to pursue a "moderate expansion of [foreign] military sales" of roughly \$500 million per year, stressing that this not be publicly linked with balance of payments. Vance and Council of Economic Advisers Chair Charles Schultze opposed

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<sup>520</sup> Harold J. Logan, "Senators Introduce Resolution to Block Plane Sale to Iran," October 2, 1977, *Washington Post*; Adam Clymer, "Senate Majority Leader Proposes Moratorium on Arms Sales to Iran," October 8, 1977, *New York Times*.

<sup>521</sup> Seymour M. Hersh, "Proposed Sale of Fighters to Iran Challenged Within Administration," October 9, 1977, *New York Times*.

<sup>522</sup> Brzezinski to Carter, "Relations with the Shah," circa November 1977, NLC-6-28-7-32-3, JCL.

Blumenthal's proposal, arguing that "the low level of temporary impact is not significant enough to warrant contradiction of your [Carter's] present arms sales policy." Carter sided with Vance and Schultze.<sup>523</sup>

### **Fighters for Egypt, Israel, and Saudi Arabia**

But if Carter eschewed pure economic incentives as a reason to support arms transfers, he did return to strategic rationales. Beyond Iran, the Carter administration believed, just as its predecessors had, that Saudi Arabia, Egypt, and Israel were critical countries for US interests. Saudi Arabia held significant power to influence world oil prices, the global economy, and the financing of regional actors. Egypt and Israel possessed two of the strongest militaries in the region, and the Carter administration pinned its hopes on these two countries to achieve new results in the Arab-Israeli peace process. Despite their differences, all three countries looked to the new administration for arms, both for military purposes and as a signal of political intentions. The Israelis looked to preserve their special relationship with the United States, and pro-Israeli groups in the United States successfully lobbied the Carter administration during its review of arms transfer policies to maintain important arms agreements like US-Israeli coproduction of the F-16.<sup>524</sup> Egypt continued to look to the United States as a source of arms to replace the Soviet Union, whose relations with Egypt remained poor. Saudi Arabia felt it was surrounded by larger and better armed regional neighbors that coveted its wealth and influence. Over the course of 1977, the Saudis pushed for the purchase of McDonnell Douglas F-15 fighters. Fahd told Schlesinger during a visit to the Kingdom in January 1978 that "the Soviet Union is giving unlimited aid to Saudi opponents in the area... sophisticated weapons like MiG-23s and MiG-

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<sup>523</sup> Stu Eizenstat and Kitty Schirmer to Carter, December 19, 1977, NLC-126-10-14-1-4, JCL.

<sup>524</sup> "Arms Sales Curbs Set By Carter."

25s.”<sup>525</sup> While Fahd left the names of Soviet aid recipient countries unstated, it was well known that countries hostile to Saudi Arabia that had also received the listed fighters included Iraq, Libya, and Ethiopia.<sup>526</sup> Fahd was likely also concerned about Iranian and Israeli military buildups, but tactfully left these US allies out of his pitch. “Saudi Arabia now desperately needs some high-performance aircraft to defend itself” Fahd continued. “Saudi Arabia does not know from which direction the threat will come but it does know that a threat will materialize some day if Saudi Arabia does not have an adequate defense... if the Kingdom is attacked and Saudi Arabia is shown to be defenseless, how could the present regime face the people?”<sup>527</sup>

With the hope of improving US relations with all three countries, the Carter administration announced on February 14, 1978 a package sale of fighters to Egypt, Israel, and Saudi Arabia, which it then formally submitted to Congress on April 28. Under the proposal, the Saudis would be allowed to purchase 60 F-15s, Israel would be granted 15 F-15s and 75 F-16s, and Egypt would acquire 50 F-5s. The value of total arms in the package came to \$2.5 billion for the Saudis, \$1.9 billion for the Israelis, and \$400 million for the Egyptians. The US proposal to sell to Saudi Arabia the F-15, considered by many to be the most advanced fighter in existence, was notable in that the United States had never before offered the transfer of such a powerful fighter to any Arab country. Furthermore, while the F-5 was far less sophisticated than the F-15 or F-16, the deal still constituted the first time the United States had ever offered a fighter of any kind to Egypt, and marked a significant step in establishing a military relationship between the two countries. Anticipating opposition from pro-Israeli forces as well as general arms control advocates, Carter administration officials stressed that the package was designed to further the cause of peace in the Middle East, maintain a military balance in the region, and deter

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<sup>525</sup> Vance to Carter, January 20, 1978, NLC-16-42-5-40-9, JCL.

<sup>526</sup> Brzoska, *Arms Transfers to the Third World 1971-85*, 40.

<sup>527</sup> Vance to Carter, January 20, 1978, NLC-16-42-5-40-9, JCL.

aggression from countries like Libya. They insisted that the Egyptians and Saudis needed these weapons for legitimate defensive purposes, and that Israel's security would not be threatened by the deal. Importantly, the Carter administration insisted that the deal was a package; Congress could not pick and choose parts of the deal, lest it upset the strategic balancing act envisioned by the administration. Congress would have to either accept or reject the entire proposal.<sup>528</sup>

The announcement of the arms transfer proposal prompted an immediate outcry from pro-Israeli and anti-weapons proliferation voices; what would follow was one of the most visible and sustained public debates over the petrodollar-arms complex in US history. Most criticism focused upon the sale of F-15s to the Saudis. *The New Republic*, attempting to link Israel's strategic interests with the United States, rhetorically asked who "will wager that Saudi Arabia, once superbly armed by the US, will not, through an assassination or a[n up]rising, be found in the vanguard of the revolutionary left, like Algeria or Libya?"<sup>529</sup> Other critics emphasized the idea that the United States had a moral obligation to support Israel and not arm countries at war with it. "Selling Arabs the means to destroy Israel is a moral disaster for America," William Safire wrote of the F-15 deal in the *New York Times*. "As long as the Saudis refuse to negotiate directly [with Israel] and as long as they are the financial backers of the P.L.O., it ought to be repugnant for any congressman to sell them American weapons."<sup>530</sup> Anti-proliferation concerns removed from Israeli considerations were also raised. Democratic Representative for Maryland Clarence D. Long argued that arms should not go to any of the three countries as it would not help the peace process or any of their general welfare. Long stated he was "profoundly

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<sup>528</sup> Graham Hovey, "U.S. Plans First Jet Sale To Cairo, Reduces Israeli Order For Craft; Saudis Get 60; Debate Is Expected," February 15, 1978, *New York Times*; Bernard Gwertzman, "Vance Asserts Arabs Must Get Warplanes Along With Israelis," February 25, 1978, *New York Times*.

<sup>529</sup> "No Eagles for Arabia," March 4, 1978, *The New Republic*.

<sup>530</sup> William Safire, "Word of Dishonor," May 1, 1978, *New York Times*.

disgusted” by the proposal and said the United States was “the salesman of slaughter.”<sup>531</sup> In short, the many different narratives that demonized petrodollar purchases of arms were all present in the debates over the latest Middle East arms package. Furthermore, they appeared to be effective. In an early House International Relations Committee vote on May 2, twenty-two of the thirty-seven members disapproved the sale. “This conclusively shows that there are votes to defeat the Administration’s proposed arms package in the Middle East in the absence of any effort on the part of the Administration to reach a compromise” stated Democratic Representative from New York Stephen J. Solarz after the vote.<sup>532</sup>

The petrodollar boom had created an increase in Saudi interactions and connections with Americans, however. The Saudis now had a better understanding of how to petition Congress and the American public, powerful US allies, and the wealth to fund an aggressive lobbying campaign. Petrodollars had helped the Saudis to better learn the methods of lobbying the US government and public that pro-Israeli groups had been utilizing for years. The Saudis applied these new advantages in their battle to obtain the F-15. The Saudi government hired US advertising companies to direct a media campaign to build public support for the F-15 sale, and the Saudi government hired American law firms to lobby US congressmen. One such lobbyist was Fred Dutton. Dutton had been a lawyer and prominent figure in Democratic politics for over a decade and a half when he accepted the lucrative position of chief legal representative for the Saudi Kingdom in 1975. Dutton used his knowledge of and connections in Washington to apply the Saudi lobby campaign to full effect.<sup>533</sup> An important element of the campaign involved drafting US corporations to lobby on the Saudis behalf. Companies like Bechtel and Computer

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<sup>531</sup> “Vance Asserts Arabs Must Get Warplanes Along With Israelis.”

<sup>532</sup> Bernard Weinraub, “‘Package’ Plane Sale To Mideast Opposed By House Committee,” May 3, 1978, *New York Times*.

<sup>533</sup> Steven V. Roberts, “The Saudi Connection, Fred Dutton,” *New York Times*, April 2, 1978.

Sciences Corporation promptly lobbied members of Congress to support the sale, not because they were directly tied to the F-15 deal, but because they feared the failure of the sale could strain Saudi-US relations and thus endanger their companies' present and future business activities in Saudi Arabia.<sup>534</sup> The urgency felt by Bechtel was likely enhanced by the fact that Dutton also held a position in the Saudi Industry Ministry, where he negotiated contracts with Bechtel on projects like the construction of the industrial city of Jubail.<sup>535</sup>

Whether lobbying to individual members of Congress or to the general public, the message of the pro-Saudi campaign was the same: interdependence between the United States and the Arab world. In advertisements published in *Time* and *Newsweek*, and then mailed to members of Congress, glossy color images celebrated the “special relationship” between Washington and Riyadh.<sup>536</sup> Aware of the broad sensitivity of Americans to the idea of oil money being used to subvert US institutions, the pro-Saudi campaign emphasized a soft sell that argued for the many ways that Americans and Arabs needed each other and could positively work together on issues like trade, defense, and stability in the MENA. The campaign also presented a harsher subtext, however, that a failure to cooperate could damage US interests like lower oil prices and continued Saudi support for the dollar.<sup>537</sup> Other voices in the media joined the hired lobbyists in arguing that interdependence was in the best interests of both the Arabs and the United States. The editorialists of the *New York Times*, for example, argued that since the Saudis could easily purchase French fighters (which France was aggressively marketing to them), it made sense for the United States to sell the F-15 to the Saudis in order to more easily control how Saudi planes were used. “Whoever makes the sale will also train the pilots and man the

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<sup>534</sup> Richard Harwood and Ward Sinclair, “Lobbying for Warplane Brings Saudis Out of Isolation,” May 7, 1978, *Washington Post*.

<sup>535</sup> Roberts, “The Saudi Connection, Fred Dutton.”

<sup>536</sup> Steven V. Roberts, “Saudis Are Learning Public Relations Ways in U.S.,” May 12, 1978, *New York Times*.

<sup>537</sup> Steven V. Roberts, “Arab Lobby’s Specialty: Soft Sell, Tough Message,” April 30, 1978, *New York Times*.

extensive facilities in Saudi Arabia for maintaining the planes and their complex support equipment,” the *New York Times* concluded. “Those ground crews will be in a position to ascertain whether the planes are being used for aggressive purposes. It seems inconceivable that either Americans or Israelis would wish that monitoring potential to slip out of Americans hands.”<sup>538</sup>

As the pro-Israeli and pro-Saudi lobbies battled in early May, it appeared the Senate might vote to block the sale, which could in turn lead the House to do likewise and scuttle the entire deal. As a concession to pro-Israeli forces, on May 9 the Carter administration offered to give twenty additional F-15s to Israel; combined with previous sales, passage of the arms package would leave the Israelis and the Saudis with sixty F-15s each. The Carter administration also provided written assurances that the Saudis would not be provided certain missile capabilities for the F-15s and that the Saudis would not base the planes near Israel.<sup>539</sup> Despite these concessions, the Carter administration still failed to dissuade the Senate from holding a floor debate and vote on the sale.<sup>540</sup> At that point Carter sent a letter defending the arms package to every single Senator. “The long-term interests of Israel are served by the proposed sales to Egypt and Saudi Arabia,” Carter wrote. “It is in Israel’s interest to encourage the forces of moderation in the Middle East and to promote their close relationship with the United States.” The question for the Senate, Carter maintained, was “shall we support and give confidence to those in the Middle East who work for moderation and peace? Or shall we turn them aside, shattering their confidence in us and serving the cause of the radicals?”<sup>541</sup> On May 15, the

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<sup>538</sup> “A Troubled Package for the Middle East,” April 27, 1978, *New York Times*.

<sup>539</sup> Bernard Weinraub, “Vance Offering To Sell Israel 20 More F-15’s,” May 10, 1978, *New York Times*; Bernard Weinraub, “Brown Says Saudis Will Accept Curbs On The Use Of F-15’s,” May 11, 1978, *New York Times*.

<sup>540</sup> Bernard Weinraub, “Senate Panel In Tie On Vote To Thwart Mideast Jet Sales,” May 12, 1978, *New York Times*.

<sup>541</sup> Bernard Weinraub, “Carter Letter to Senators Pleads for Plane Package,” May 13, 1979, *New York Times*.



Senate held its vote to block the deal, and the senators upheld the arms package 54 to 44.<sup>542</sup> This vote effectively ensured that the arms sale would go ahead.

The Carter administration celebrated its success, but also endured a final barrage of criticism toward it and Saudi Arabia. “What do we want to do with the Israelis?” Republican Senator Jacob Javits asked before the Senate vote. “Sap their vitality? Sap their morale? Cut the legs out from under them?” After the bill was passed, Democratic Senator Daniel Patrick Moynihan lamented that “the bond of trust [between America and Israel] has been broken.” More than 1,000 Jewish students from New York demonstrated outside the White House, some carrying coffins symbolizing “the death of American morality.”<sup>543</sup> Commentators noted that many Jewish Americans, a significant demographic for the Democratic Party, were ceasing to support Carter because they felt that “Carter’s Mideast policy [was] strongly influenced by the dependence of the U.S. and world economies on Arab oil and petrodollars” and opposed policies like the Saudi F-15 deal. Despite Carter’s successful mediation of talks between Egypt and Israel at Camp David in September 1978, many US supporters of Israel voted Republican in the November 1978 elections, apparently as a protest against the perceived pro-Arab bias of Carter’s foreign policy.<sup>544</sup> While candidate Carter had attacked Ford for tilting too much toward the Arabs, President Carter found himself attacked for much the same reasons as he attempted to balance foreign policy concerns.

Yet while the pro-Israeli lobby in the United States remained strong, the arms package sale also portended a shift in US politics. The interdependence between Saudi Arabia and the United States born of petrodollars had given the Saudis far greater influence in Washington than

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<sup>542</sup> Bernard Weinraub, “Debate Is Intense,” May 16, 1978, *New York Times*.

<sup>543</sup> “Nation: F-15 Fight: Who Won What,” *Time*, May 29, 1978;

<sup>544</sup> Robert Shogan, “Carter’s Mideast Policies Erode His Jewish Support,” *Los Angeles Times*, July 23, 1978; Miglietta, *American Alliance Policy in the Middle East*, 232-237.

they had before. The Saudis could now call upon the long number of corporations working in Saudi Arabia to lobby on its behalf, hire the slickest and best connected public relations firms in the United States, and remind the US government and public alike of the ways Saudi Arabia could either help or harm the US economy through both oil prices and petrodollar investments. Furthermore, these Saudi tactics had translated into a major legislative victory that provided the Saudis with one of the most advanced weapons in the world, over the concerted objections of the pro-Israeli lobby. While the pro-Israeli lobby in the United States remained a more influential power in the United States than any Arab-lobby, pro-Israeli advocates were shaken by the vote. The extreme imagery used by Israeli supporters was evidence of their fear that Arab supporters, funded by petrodollars, were gaining serious ground in the battle over governmental opinion. “There was a time when members of Congress didn’t care what Arabs thought about them,” one pro-Israeli lobbyist conceded. “Now there’s been a general softening in that attitude. They worry that the Arabs won’t like us.”<sup>545</sup> If pro-Arab groups could continue to increase their influence remained to be seen, but Israeli supporters were worried.

### **Assessment of Carter’s Arms Restraint Efforts Up to October 1978**

Having used sweeping language about the need to limit US arms transfers as a presidential candidate and in his new arms sale policy proclamation of May 1977, Carter found himself the subject of much disappointment for many advocates of conventional arms control and supporters of Israel. His critics had some valid points. As we have seen, the Carter administration had become the staunch defender of particular arms transfers. Carter had authorized the sale of some of the most advanced weapons in the world to new countries, notably the AWACS for Iran and

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<sup>545</sup> Roberts, “Saudis Are Learning Public Relations Ways in U.S.”

the F-15 for Saudi Arabia. Carter had also made significant steps in establishing a military supply relationship between the United States and Egypt that had previously not existed.

Internally, the Carter administration also found reason to be disappointed in the effort to curb the global arms trade. A confidential CIA report issued in July 1978 reported that while in 1977 the United States had decreased its foreign arms sales by 6 percent, total global arms sales had increased by 12 percent, in large part due to increases in Western European and Soviet arms sales. “Even though Western governments and the USSR are paying lipservice to cooperation in [arms] sales restraint, none has yet seriously entertained sales restrictions,” the report stated. “Instead, they continue to pursue arms sales vigorously in their traditional markets and to look for new sales opportunities.” It was expected that if the United States continued its unilateral arms sale restraint, LDCs oriented toward the United States would increasingly acquire weapons from Western Europe instead, while LDCs aligned with the Soviet Union would continue to acquire weapons from the Warsaw Pact countries. Western Europe was not expected to decrease its arms exports because they provided jobs, generated export earnings, and lowered unit costs. The Soviet Union was also not expected to decrease its arms exports because they provided the Soviets with badly needed hard currency and helped the Soviets gain and maintain influence over client states.<sup>546</sup>

Yet the Carter administration could also point to successes in reducing US military transfers. It had met its goal of reducing the value of military transfers (arms and construction of military facilities) to “ceiling countries” (countries other than NATO members, Japan, Australia, and New Zealand) in fiscal year 1978 from the year prior by eight percent.<sup>547</sup> The eight percent decrease was admittedly modest and the result of the Carter administration’s reluctance to cancel

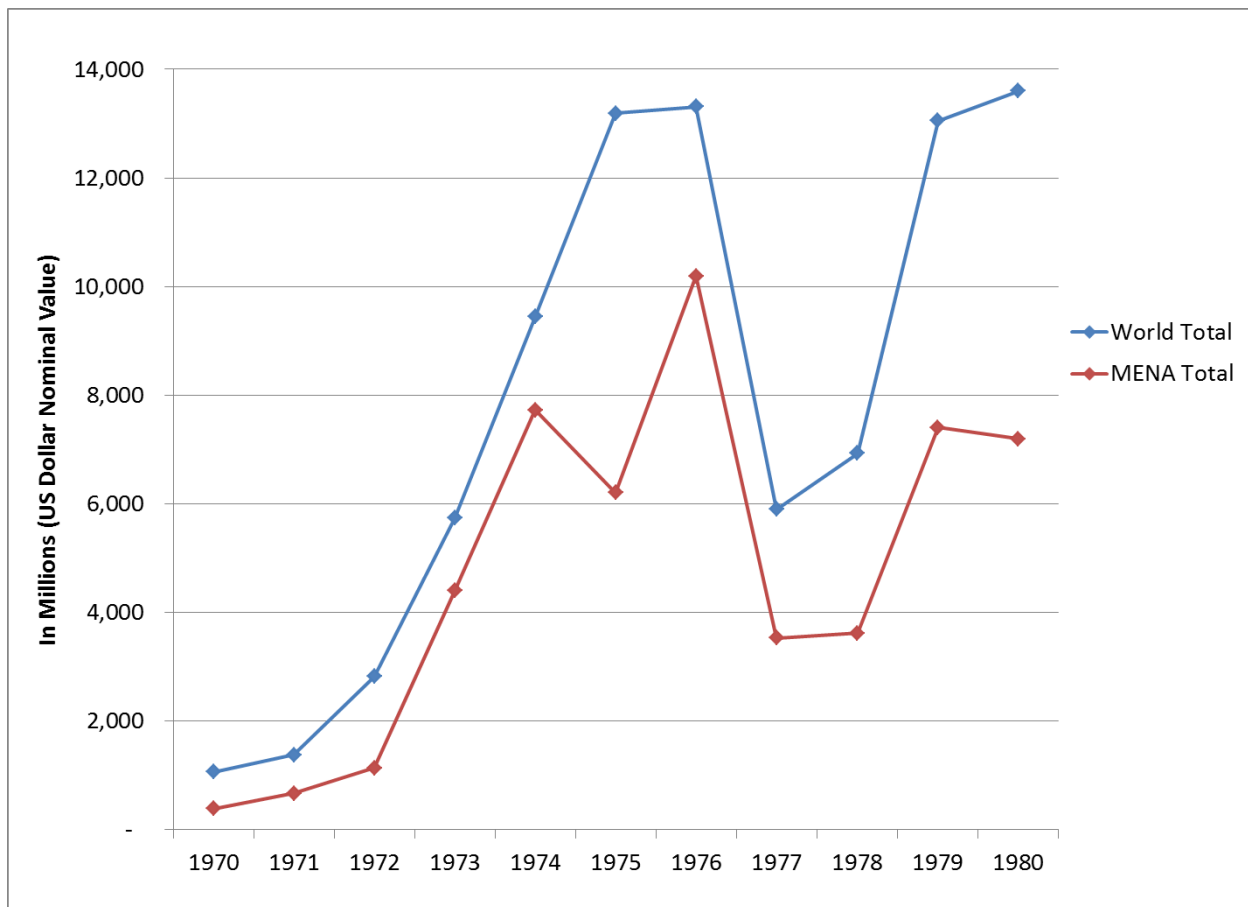
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<sup>546</sup> National Foreign Assessment Center, “Impact of US Arms Sales Restraint Policy,” July 1978, NLC-28-6-5-4-6, JCL.

<sup>547</sup> George C. Wilson, “Carter’s Arms Sales Policy Is Assailed,” October 6, 1978, *Washington Post*.

a significant number of previously agreed to sales. The Carter administration's reduction of new military sales agreements was of a far greater magnitude. For the period of fiscal years 1973 (when oil prices began to soar) to 1976, total US military transfers had averaged \$9.81 billion a year, while the annual average for fiscal years 1977 and 1978 came to \$6.42 billion, a decrease of 35 percent. New military sales agreements to the MENA were decreased by an even greater magnitude during the same two periods, dropping from an annual average of \$6.71 billion to

**Figure 5.1. US Military Sales Agreements per Fiscal Year, 1970-1980**



Source: Department of Defense Security Cooperation Agency, *Fiscal Year Series*.

**Table 5.1. US Military Sales Agreements per Fiscal Year, 1970-1980**

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
World Total	1,067	1,382	2,822	5,737	9,443	13,186	13,313	5,899	6,931	13,056	13,600
MENA Total	385	667	1,136	4,398	7,730	6,202	10,192	3,532	3,622	7,403	7,199
Saudi Arabia	63	15	300	2,171	2,037	3,604	7,114	1,664	1,766	5,974	4,194
Iran	134	348	427	2,065	3,231	1,180	1,332	1,159	241	14	-
Israel	151	285	380	146	2,344	767	948	451	1,319	730	507
Egypt	-	-	-	-	-	-	80	1	155	396	1,808
MENA % of World	36.08%	48.26%	40.26%	76.66%	81.86%	47.03%	76.56%	59.87%	52.26%	56.70%	52.93%

Millions of US Dollars, Nominal Value. Source: Department of Defense Security Cooperation Agency, *Fiscal Year Series*.

\$3.58 billion, a decrease of 47 percent.<sup>548</sup> The decrease in new military sales agreements was not attributable to US policies alone. The gradual drop in real oil prices during fiscal years 1977 and 1978 were a major factor in the decrease of new military sales agreements to the MENA; Iran, for example had postponed planned requests for US arms, including 140 F16s and 70 F14s.<sup>549</sup> Still, the emphasis on arms transfer restraint by the Carter administration, bolstered further by a more active Congress, significantly contributed to the decline in US military sales abroad.

The Carter administration could also point to statistics and diplomatic successes in the MENA to justify its arms transfer decisions to both pro-Israeli and pro-Arab supporters. For pro-Israeli supporters, Carter could note that the dollar ratio of US military sales to Arab countries vs Israel during fiscal years 1977 to 1978 had been 2.25 to 1, whereas the ratio had been 3.93 to 1 for the fiscal years 1973 to 1976. For Arab supporters, Carter could note the unprecedented US sale of F-15s to Saudi Arabia and F-5s to Egypt as proof of his administration's desire for military balance in the region. To all, Carter could cite his personal involvement in the Arab-Israeli peace process and the Egyptian-Israeli Camp David Accords of September 1978 as both

<sup>548</sup> Figures determined from data in the Department of Defense Security Cooperation Agency, *Fiscal Year Series*, [http://www.dsca.mil/sites/default/files/fiscal\\_year\\_series\\_-\\_30\\_sep\\_2012.pdf](http://www.dsca.mil/sites/default/files/fiscal_year_series_-_30_sep_2012.pdf).

<sup>549</sup> Kenneth A. Bacon, "U.S. Arms Sales to Expand in Fiscal 1979 Despite Carter Bid to Curb Some of Them," October 19, 1978, *Wall Street Journal*.

proof of his commitment to achieving peace in the region and the wisdom of his foreign policy, arms transfers included.

By the fall of 1978, then, the Carter administration had a mix of successes and failures on the issue of global arms transfers. The failure to achieve bilateral or multilateral arms reduction agreements with the Soviet Union or the countries of Western Europe was the most important, as it raised the specter that the global arms trade would continue to grow in spite of whatever policies the United States pursued. Yet the Carter administration had significantly reduced US military sales agreements while still maintaining its strategic alliances. Furthermore, Carter's success held out the hope that, with time, other countries would join the United States in curbing the arms trade.

Little did the Carter administration realize in September 1978 that the Camp David Accords would mark the pinnacle of its foreign policy successes. In short order, a series of crises in the MENA would destroy or seriously threaten key alliances between the United States and Middle Eastern countries, and the system of interdependence between the United States and the MENA forged by petrodollars would face its greatest challenges yet. A looming crisis in Iran had already become apparent to an increasing number of American observers. During a House hearing on arms transfer reductions on October 5, Democratic Representative from New York Stephen J. Solarz, criticizing the Carter administration's arms transfer policy and alluding to growing unrest in Iran, sarcastically asked Undersecretary of State for Security Assistance Lucy W. Benston if the State Department had made arrangements "if and when the shah should feel obliged to go into exile for him to fly out on one of the AWACS we sold him." Benston

lamely replied that no such arrangements had been made, and attributed the unrest in Iran to the Shah's human rights reforms.<sup>550</sup>

### **The Iranian Revolution and the Isolation of Egypt**

Starting in January 1979, there would be major anti-regime protests in Iran every month until the abdication of the Shah. The Shah initially sought to squash the protests through the use of as much armed force as necessary, and persisted to believe that state violence would be the source of his salvation for most of 1978. The Iranian army and SAVAK killed an estimated 10,000 to 12,000 Iranians and injured 45,000 to 50,000 more during the fourteen months of the Iranian Revolution, unprecedented casualties for any domestic crisis in modern Iranian history.<sup>551</sup> Yet the violence against the protestors only served to swell the ranks of active opponents of the regime. The Shah compounded his problems by attacking both conservative Islamists and secular leftists at the same time, helping to unite the otherwise unlikely coalition arraigned against him. By late 1978, the Shah increasingly feared that even a sea of blood could not preserve his rule.

While the Iranian Revolution had several causes, many of them were, ironically, exacerbated by the US-Iranian petrodollar ties that both governments had pursued in the hope of strengthening the stability of the Pahlavi dynasty. The Iranian government's rapid spending on industrialization, military, and urbanization projects, all pursued with the encouragement and exports of the US government and US corporations, fueled rampant inflation and official corruption that left large swaths of the Iranian population increasingly impoverished while record

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<sup>550</sup> Solarz's prediction came rather close to the mark. The AWACS is a modified Boeing 707. When the Shah fled Iran for the final time on January 16, 1979, it was in an unmodified Boeing 707. Wilson, "Carter's Arms Sales Policy Is Assailed."

<sup>551</sup> Bill, *The Eagle and the Lion*, 235-236.

oil export profits enriched the well-connected few. The government's neglect of the agricultural sector spurred millions of Iranian farmers to move to cities in search of jobs, where many found no work and only alienation. These problems worsened when declining oil revenues prompted an economic slowdown starting in 1977; inflation persisted, but unemployment now rapidly rose as well. Heavy handed attempts by the Iranian government to cut the budget and stem inflation angered both Iranian consumers and merchants. The Shah's use of US arms, intelligence equipment, and training against dissidents ultimately fueled revolutionary fervor rather than extinguish it, while at the same time linking America with the Shah in the minds of millions of Iranians.<sup>552</sup>

The Carter administration had not created the US-Iranian alliances or the petrodollar order that undergirded it. The White House had taken steps to try to encourage the Shah to improve human rights and decrease military sales, but it had not moved away from strongly supporting his dictatorship. The Carter administration sought to avoid the difficult decision of strategic and economic concerns versus human rights by maintaining the US-Iranian alliance while gradually leading Iran to liberalization. The crisis in Iran obviated this preferred path, and the US government in this instance favored strategic and economic concerns over human rights. The Carter administration, largely at the urging of Brzezinski, supported the Shah's violent attempts to cling to power until late December. Carter finally ceased to support the Shah only when he belatedly realized that the Shah's removal provided the only hope for a restoration of order and the establishment of an Iranian government not overtly hostile to the United States. In January 1979 the Carter administration supported the Shah's decision to go into exile in the hope

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<sup>552</sup> For an account that emphasizes the role of US-Iranian military and intelligence ties in fueling both the Revolution and anti-Americanism in Iran, see Bill, *The Eagle and the Lion*, particularly chapters 6 and 7. For an account emphasizing the economic factors contributing to the Iranian Revolution, see Looney, *Economic Origins of the Iranian Revolution*.



that his last appointed prime minister, Shapour Bakhtiar, would be able to establish a new and relatively moderate government. Once again, however, the wishes of US leaders were overtaken by events on the ground. Ayatollah Ruhollah Khomeini, the exiled Shia religious leader, symbol of the Revolution, and advocate of an Islamic theocracy for Iran, returned to Iran on February 1. Four days later Khomeini directly challenged Bakhtiar's rule by declaring the establishment of a government with Mehdi Bazargan, a former ally of Mossadegh, as provisional prime minister. Fighting broke out between the two factions, and Bakhtiar's supporters were quickly overwhelmed by Khomeini's. On February 21 the United States, reluctantly accepting the latest realities, recognized the new Bazargan government with the hope that something could be salvaged from the situation.<sup>553</sup>

Even before the fall of the Shah, the Iranian Revolution had precipitated the second great oil shock of the 1970s, eventually raising the average price of a barrel of oil from thirteen dollars to thirty-four. In November 1978, strikes in the key Southeastern oil fields of Iran crippled Iranian petroleum output, and by December 25 Iran had ceased to export any oil. Nearly every oil exporter seized upon the sudden drop in the world oil supply by repeatedly raising its prices. The Western oil companies and oil consumers in turn panicked and repeatedly outbid each other in their quest for supplies of petroleum. The only notable practitioner of price restraint was Saudi Arabia, which stuck to selling its oil at "official prices" well below the actual market rate. More important for the average global price of oil, however, was Saudi oil output. The Saudis either refused or were unable to significantly increase their levels of oil production, and thus the global oil panic continued. Even when significant (albeit still lower than Shah-era level) Iranian

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<sup>553</sup> Glad, *An Outsider in the White House*, 167-173.

oil exports resumed in the spring of 1979, the panic persisted, and the cycle of rising oil prices continued.<sup>554</sup>

The US government had pursued petrodollar interdependence between the United States and the MENA in the belief that this would provide both carrots and sticks to ensure friendly behavior from key countries like Iran and Saudi Arabia. The Iranian Revolution proved to be the greatest failure of this policy. For both Iran and the Arab world, US policymakers expected US cooperation in modernization programs, military buildups, and security services development to strengthen the stability of allied regimes and tie them to the United States. Iran defied these predictions, and popular anger swept away the pro-American regime of Iran, the American business presence in Iran, and the American military and security ties with Iran. Furthermore, the Iranian Revolution precipitated a second oil shock, one of the key outcomes the United States sought to prevent through petrodollar interdependence.

While Iran forcefully withdrew itself from the US petrodollar order, Egypt was being (partially) evicted from the MENA petrodollar order. The first significant move in this direction occurred in December 1977, when Algeria, Iraq, Libya, Southern Yemen, and Syria called for a pan-Arab diplomatic retaliation against Egypt as punishment for Sadat's recent visit to Israel. Egypt promptly severed its relations with the five countries, and no other Arab states joined in the push against Sadat at that time.<sup>555</sup> When the terms of the Camp David Accords were announced, however, the other Arab leaders balked, as the agreement left the fate of the Palestinians unresolved while establishing an Egyptian-Israeli peace that would end the united

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<sup>554</sup> Yergin, *The Prize*, 656-680.

<sup>555</sup> "Egypt Cuts Relations With 5 Arab Nations Opposed To Peace Bid," December 6, 1977, *New York Times*.

Arab front. The Arab countries offered Egypt a guarantee of \$50 billion over ten years if it repudiated the Accords, but Sadat refused.<sup>556</sup>

With Egypt rejecting carrots, the other Arab states increasingly turned toward sticks, and an Arab League meeting held in Baghdad without Egypt in November 1978 issued a warning that Egypt would face economic sanctions, albeit ambiguous ones, if it signed a separate peace treaty with Israel.<sup>557</sup> The Saudi government found itself in a painful dilemma: it did not want to lose US support by too strongly criticizing the US peace initiative, but it also did not want to see the united Arab front further dissolved or face Arab efforts to overthrow the Kingdom by defending the Egyptian-Israeli peace treaty. When Brzezinski visited Saudi Arabia in mid-March 1979 in a bid for Saudi cooperation on the issue, Ambassador West reported that the Saudis were relieved that they were not presented with an ultimatum to publicly support the treaty or else face a serious repercussions like the cancellation of the F-15 sale or other indications of a decline in US security commitments for Saudi Arabia. The Saudis privately pledged to work to minimize any hostile rhetoric and sanctions placed upon Egypt by the other Arab League members when they met in Baghdad in late March after Sadat formally signed the peace treaty.<sup>558</sup> Observers reported that the Saudis pursued this pledge, but that they were ultimately overwhelmed by the anger of the other Arab delegations. Arafat called for tough sanctions against not only Egypt but the United States as well, including a resumption of the oil boycott against the United States. Libya and Syria vocally supported the PLO's position on the United States, but the other Arab countries demurred.<sup>559</sup> Regarding Egypt, however, there was far more support for the PLO's position, and on March 31 all members of the Arab League other

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<sup>556</sup> "Arab League Appeals to Egyptians To Renounce Accord With Israelis," November 6, 1978, *New York Times*;

<sup>557</sup> *Ibid.*

<sup>558</sup> West to Vance, March 19, 1979, NLC-128-11-22-11-1, JCL.

<sup>559</sup> Marvine Howe, "Arabs, Deeply Split, Bar Stronger Steps Against U.S., Egypt," March 29, 1979, *New York Times*.

than Egypt, Oman, and Sudan declared their support for a suspension of diplomatic ties with Egypt, its suspension from the Arab League, and an end of all financial aid and investment to the country.<sup>560</sup> By the end of April, all Arab League members other than North Yemen, Oman, Somalia, and Sudan had made good on the pledge, and Iran also severed diplomatic relations with Egypt (North Yemen would honor the pledge by June).<sup>561</sup>

The United States had avoided another oil embargo, but Arab and Iranian petrodollar aid to and investment in Egypt had been lost for the foreseeable future. US corporations had continued to pursue triangular investment during the Carter administration, and some successes had finally materialized. In 1978, for example, American Motors opened a factory in Cairo and produced military jeeps for the Arab Organization for Industrialization, a consortium that utilized Egyptian labor and Saudi, Qatari, and Emirati financing worth \$1.4 billion. This collaboration ended in May 1979 when the Gulf Arabs withdrew their petrodollars.<sup>562</sup> The US government, having relied upon Arab and Iranian aid to help prop up Sadat's government, would now need to find other sources of money for Egypt. The Saudis even reneged on their previous pledge to pay for the purchase of Egypt's F-5s, leading the Carter administration to postpone the sale.<sup>563</sup>

In some key ways Egypt was not deprived of MENA petrodollars. First, large numbers of Egyptian workers continued to work in petrodollar-rich MENA countries with the permission of both Egyptian and host governments, thus maintaining one of the largest petrodollar flows into Egypt.<sup>564</sup> Second, Egypt increasingly generated its own petrodollar export revenues,

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<sup>560</sup> Marvin Howe, "Arabs Agree To Cut All Ties With Egypt Because Of Treaty," April 1, 1979, *New York Times*.

<sup>561</sup> Christopher S. Wren, "Egyptians Shrug Off the Arab Boycott," May 1, 1979, *New York Times*; Christopher S. Wren, "Sudan Gets Arab Aid Despite Sadat Links," June 22, 1979, *New York Times*.

<sup>562</sup> Christopher S. Wren, "Saudis Scuttle a Billion-Dollar Arms Consortium With Factories in Egypt," May 15, 1979, *New York Times*.

<sup>563</sup> Graham Hovey, "U.S. Puts Off Jet Sale To Egypt After Saudis Delay on Paying Costs,"

<sup>564</sup> This was largely the result of pragmatic considerations on both sides of the inter-Arab dispute. The Arab Gulf countries and Libya had come to depend on Egyptian laborers for a wide variety of skilled and unskilled jobs; deporting and replacing the tens or hundreds of thousands of Egyptians in each country would be extremely

particularly with the development of oil sites in the recently reclaimed Sinai. While these Egyptian oil exports paled in comparison to those of OPEC's, they helped the Egyptian economy and balance of payments. Third, Egypt received increased levels of US aid to offset the hostile actions of other Arab countries. In much the same way that Israel had situated itself in the petrodollar economy, Egypt now parlayed Arab petrodollar threats into a rationale for increased US assistance. The result of these three factors was that in the immediate years after the Arab embargo against Egypt, the Egyptian economy actually experienced some of the highest growth rates in the world.<sup>565</sup>

Yet if Sadat's gamble for peace appeared to have benefited Egypt's economic and territorial interests, the Arab reaction further complicated US considerations in the MENA. The Egyptian-Israeli peace agreement did firmly cement Egypt into the US orbit, a long-standing US policy goal. Beyond this, the United States found its influence in the MENA had rapidly diminished. The United States' major remaining allies, Egypt, Israel, and Saudi Arabia, all distrusted each other and were unlikely to work together toward US goals in the region. Furthermore, the collective failure of these three countries to obtain greater support for (or to have at least muted more of the opposition to) the Egyptian-Israeli peace agreement raised concerns about their ability or willingness to defend US objectives.

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disruptive and costly. At the same time, Egypt had come to depend upon and structure its economy around the valuable remittances that Egyptian foreign workers sent back to the country, and reabsorbing the hundreds of thousands of Egyptian foreign workers back into the job-tight and lower paying domestic economy would pose huge challenges for Sadat's government. See Ibrahim, *The New Arab Social Order*, 154-159.

<sup>565</sup> Christopher S. Wren, "Egypt Seems to Be in Best Shape Since '67," August 27, 1979, *New York Times*; Owen, *A History of Middle East Economies in the Twentieth Century*, 135-136.

## **Retrenchment on Petrodollar Interdependence**

The Iranian Revolution came after a series of smaller crises over the previous few years in the Horn of Africa, Yemen, and Afghanistan, in which communist forces had expanded their regional influence, often through violent force. The Saudi government had from an early stage understood these smaller crises to be serious threats to their continued rule, believing the Soviets and their allies were seeking to encircle the Kingdom and then topple it. The Saudis felt the Carter administration had not taken an active enough role in deterring the communists in these regions. The Iranian Revolution placed a new and potentially far more hostile regime at the helm of one of the most powerful countries in the region. At the same time, the fall of the Shah raised the question of the United States' commitment or ability to protect its allies. These fears occurred at the same time that the Saudis attempted to navigate a path through the minefield created by the Camp David Accords, a path that would avoid inflaming Arab opinion against the Kingdom and at the same time enable the US-Saudi alliance to persist. Faced with this situation, the Saudi government sought tangible reassurance from the United States in the form of increased arms sales and joint planning of coordinated responses to potential threats in the region. Ambassador West summarized the Saudis' position by quoting a knowledgeable Saudi official who stated that they were looking for a commitment from the United States "such as you have with the Israelis... there is no treaty, but you always respond to Israeli needs... that is the kind of understanding we want and need here in Saudi Arabia."<sup>566</sup>

For its part, the Iranian Revolution increased the concern of the Carter administration about the stability of US allies in the Middle East. On January 23, a week after the Shah fled Iran for the final time, many of the top leaders of Carter's administration met for a Presidential Review Committee meeting to discuss the subject of "Southwest Asia and Saudi Arabia."

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<sup>566</sup> Untitled and unaddressed White House memorandum, February 6, 1979, NLC-1-9-5-10-5, JCL.

Administration officials expressed to each other their fears that rapid development could generate destabilization, believing this had been the case in Iran. Brzezinski argued that the area from Yemen to Bangladesh constituted an arch of crisis. The countries of Southwest Asia, he insisted, “face a cumulative burden of social change for which their structures are not suited,” and thus left them vulnerable to Soviet expansionism. Blumenthal lamented that “we face a paradox: additional economic resources do not necessarily improve the situation. Indeed they can worsen it by accelerating the disintegration of social structures. For instance in Saudi Arabia if we urge too rapid exploitation of oil we will cause instability.”<sup>567</sup> At a later meeting on February 1, Brown admitted he did not know if the Saudi monarchy was any closer to its people than the Shah was to the Iranians, and acknowledged that US military assistance could not solve serious internal problems in an allied country.<sup>568</sup>

Despite the concerns about social unrest, top Carter officials rarely if ever considered that the United States should withdraw its level of engagement or presence in the Middle East. The United States, they felt, needed to address social unrest in the region rather than run from it. Furthermore, they did not see a US presence or ties to the region as inherently destabilizing, but usually the opposite. Much of the talk after the Iranian Revolution focused upon reassuring worried allies in the Middle East. “The Saudis and others [in Southwest Asia] are unsure of our commitment [to them]” Chairman of the Joint Chiefs of Staff General David C. Jones argued at the January 23 meeting. “We need to develop a clear and coherent policy, something like a ‘Carter doctrine.’ It is not clear to me what this would contain but we need to reestablish confidence. Perhaps we need a small US military presence at Masirah [Oman] or elsewhere and

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<sup>567</sup> Memcon, Presidential Review Committee Meeting, January 23, 1979, NLC-15-3-6-8-8, JCL.

<sup>568</sup> Memcon, Policy Review Committee Meeting,” February 1, 1979, NLC-15-32-4-7-9, JCL.

maybe joint planning with the Saudis.”<sup>569</sup> Brzezinski agreed. “The word there [in the Arab region] is ‘reassurance’” Brzezinski declared. Brown added, to Brzezinski’s approval, that the Saudis “need to see results, not just to have consultations.”<sup>570</sup>

The officials of the Carter administration varied in their emphasis on how to restore Arab confidence in the United States. Brzezinski, who had raised the idea of developing a military rapid deployment force for Southwest Asia as early as 1977, pushed particularly hard for the establishment of a large naval force and bases in or near the Persian Gulf. He argued that such a force would reassure Arab allies and warn the Soviets that the United States would defend its interests in the region. Brzezinski argued that such a force was essential after the loss of Iran, as there no longer existed a regional power in the Persian Gulf that could militarily defend US interests. Brown and Deputy Secretary of Defense Charles Duncan, noting that Saudi Arabia and others had been quiet about a US military force in the region but very vocal in requesting the purchase of US arms, emphasized the sale of weapons and training to Saudi Arabia and other allies for the purpose of countering both external and internal threats.<sup>571</sup> The two strategies were not mutually exclusive, however, and the Carter administration decided to pursue both. A statement made by Brown to the press on February 10 while visiting Saudi Arabia exemplified the dual commitments:

Arabs have a new role to play in the world, new power to wield... We welcome your new role. We can provide the best training and equipment in the world. We will do so. We can provide the extra strength needed to meet a foe from outside the region. We will do so.<sup>572</sup>

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<sup>569</sup> Memcon, Presidential Review Committee Meeting, January 23, 1979, NLC-15-3-6-8-8, JCL.

<sup>570</sup> Memcon, Presidential Review Committee Meeting, January 23, 1979, NLC-15-3-6-8-8, JCL.

<sup>571</sup> Ibid; Memcon, Policy Review Committee Meeting,” February 1, 1979, NLC-15-32-4-7-9, JCL; Memcon, Special Coordination Committee Meeting,” May 11, 1979, NLC-25-124-2-6-9, JCL. On Brzezinski’s early interest in developing a Rapid Deployment Force, see Glad, *An Outsider in the White House*, 201.

<sup>572</sup> Bernard Weinraub, “Brown Pledges Aid To Saudis’ Defense,” February 11, 1979, *New York Times*.



In addition to security concerns, the Carter administration strongly desired to bring down the skyrocketing price of oil, and Saudi Arabia was understood to be the key to achieving this. Blumenthal argued at the January 23 meeting that the United States had little economic leverage to persuade Saudi Arabia to moderate its pricing, increase its current production levels, and to expand its output capabilities, all steps that would be needed to secure cheaper oil for the United States and its allies. Saudi Arabia thus had a great deal of economic leverage over the United States. The Saudis, however, looked to the United States for its security, both purchasing US arms and training for its own forces and relying upon the US military to deter external threats. The United States thus had a great deal of security leverage over Saudi Arabia. “We need to face the issue,” Blumenthal concluded “of how we can use our security relationship to get what we want from them on the economic side.”<sup>573</sup> The key officials of the Carter administration agreed that Saudi help on oil prices would be a quid pro quo for US security assistance, the only debate was over how explicit this linkage should be made to the Saudis. It was also noted that Congress was more likely to approve arms sales to Saudi Arabia if the Saudis demonstrated moderation on oil prices, and that this should be stressed to the Saudi government.<sup>574</sup>

Thus, much like the Nixon and Ford administrations, for the reasons of bolstering the confidence of regional allies and bringing down the price of oil, the Carter administration lavished US allies with weapons. During FY 1979, the United States authorized \$7.4 billion worth of military sales agreements to the MENA, a sum exceeding the previous two years combined. The largest share of FY 1979 sales went to Saudi Arabia, which totaled \$5.97 billion.

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<sup>573</sup> Memcon, Presidential Review Committee Meeting, January 23, 1979, NLC-15-3-6-8-8, JCL.

<sup>574</sup> When Deputy Secretary of State Warren Christopher argued that the Saudis would likely react poorly to an explicit linkage of US security for Saudi oil price moderation, Brown retorted that the Saudis “must know that we only love them for their oil.” Memcon, Policy Review Committee Meeting,” February 1, 1979, NLC-15-32-4-7-9, JCL; Memcon, Special Coordination Committee Meeting,” May 11, 1979, NLC-25-124-2-6-9, JCL.

This was the highest sum yet for Saudi Arabia in a single year.<sup>575</sup> Furthermore, in contrast to sales agreement totals in the early and mid-1970s that were heavily weighted toward costs of constructing military infrastructure, the FY 1979 total was almost entirely for armaments and military training.<sup>576</sup> One package included \$1.2 billion worth of arms and training to modernize the Saudi National Guard, which was charged with internal security. The notification of the sale was made to Congress in July 1979, shortly after the Saudis announced they would increase oil production by a million barrels a day. Unlike the F-15 sale, Congress was overwhelmingly quiet about the National Guard modernization deal, allowing it to go forward without incident.<sup>577</sup>

In short, while the Iranian Revolution caused concern within the Carter administration about the stability of the remaining US allies in the MENA, it did not lead to a weakening of the US government's commitment to petrodollar ties that would create interdependence between the MENA and the United States. To the contrary, the Iranian Revolution increased the Carter administration's resolve to see to it that the United States' remaining Arab allies would become further tied to the United States through petrodollars. The Carter administration abandoned its policy of arms transfer restraint to the MENA of the previous two years and instead wholeheartedly used increased arms sales as a tool to tie countries like Saudi Arabia to the United States and pressure them to moderate oil prices. Additional crises in the MENA starting in November 1979 would only strengthen this trend in US foreign policy.

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<sup>575</sup> In FY 1976 the United States authorized \$7.11 billion in military sales agreements to Saudi Arabia, but due to the shift in defining the start of the fiscal year, FY 1976 was 1.25 calendar years; averaged out this would mean \$5.69 billion was authorized in a calendar year length period of time during FY 1976. Department of Defense Security Cooperation Agency Fiscal Year Series, [http://www.dsca.mil/sites/default/files/fiscal\\_year\\_series\\_-\\_30\\_sep\\_2012.pdf](http://www.dsca.mil/sites/default/files/fiscal_year_series_-_30_sep_2012.pdf).

<sup>576</sup> Department of Defense Security Cooperation Agency *Fiscal Year Series*, [http://www.dsca.mil/sites/default/files/fiscal\\_year\\_series\\_-\\_30\\_sep\\_2012.pdf](http://www.dsca.mil/sites/default/files/fiscal_year_series_-_30_sep_2012.pdf).

<sup>577</sup> Bernard Gwertzman, "U.S. To Sell Saudis \$1.2 Billion In Arms," July 14, 1979, *New York Times*; "Pentagon Plans to Sell \$1.23 Billion of Arms To Saudi Security Unit," July 30, 1979, *Wall Street Journal*.

## **A Wave of Crises in the MENA**

On November 4, 1979, Iranian students stormed the US embassy in Tehran and held its American staff hostage, thus initiating the 444 day Iranian hostage crisis. The hostage crisis ended the last vestiges of US-Iranian petrodollar trade. The few remaining US companies in Iran quickly fled the country. The Carter administration ordered an embargo of Iranian oil exports on November 12, froze Iranian assets in US banks on November 14, and cut diplomatic relations and instituted a full embargo against Iran on April 7, 1980.<sup>578</sup> Despite these actions, for many observers the hostage crisis appeared to underscore the lack of US power in the Middle East.

Shortly after the start of the Iranian hostage crisis, a series of events occurred that seemed evidence of growing Muslim anger at the United States and its allies. On November 20, 1979, hundreds of armed Sunni militants seized control of the Sacred Mosque in Mecca, the holiest site in Islam. The insurgents, comprised of both Saudis and Arab immigrants from several other countries, denounced the House of Saud for corruption, drinking alcohol, and generally allowing for a collapse of morality in Saudi Arabia. The militants declared the formation of a new Muslim nation under their rule. The Saudi military was forced to lay siege to the Sacred Mosque, and it took two weeks and hundreds of casualties on both sides until the Saudi forces captured or killed all of the insurgents.<sup>579</sup> On November 21, thousands of Pakistanis, responding to rumors that the Mecca mosque siege had been initiated by Americans and Jews, attacked the US embassy in Islamabad, US cultural centers in Lahore and Rawalpindi, and the US consulate in Lahore. At the US embassy in Islamabad, two Americans, two Pakistani embassy clerks, and two Pakistani protestors were killed in the riot, and part of the embassy building was burned,

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<sup>578</sup> For an overview and analysis of the financial aspects of the Iranian hostage crisis, see Cohen, *In Whose Interest?*, 147-176.

<sup>579</sup> Youssef M. Ibrahim, "New Data Link Mecca Takeover To Political Rift," February 25, 1980, *New York Times*.

before the Pakistani army restored order.<sup>580</sup> In late November, thousands of members of the oppressed Shia minority concentrated in Eastern Province, Saudi Arabia, a major oil center, launched demonstrations supporting Khomeini and denouncing the United States; the Saudi government responded with a deadly crackdown and the deployment of 20,000 troops.<sup>581</sup> On December 2, about 2,000 Libyan protesters, chanting their support for Khomeini and their opposition to the United States, set fire to the US embassy in Tripoli; all embassy personnel managed to escape unharmed.<sup>582</sup> The wave of crises raised American fears that rising Islamist anger at the United States could further destabilize the region and overthrow the governments of US allies.

Yet in Carter's opinion, the Iranian Revolution, the hostage crisis, and rising anti-American Islamist violence all paled compared to the danger that the Soviet Union unleashed on Christmas morning 1979. On that day, the Soviet army invaded Afghanistan as part of an effort to replace the current communist government with new leadership. The Soviets feared that the dogmatic communism of the old government was fueling a growing Islamist insurgency in Afghanistan, and hoped the newly installed leadership would adopt a more moderate stance and thus prevent Islamist radicalism from spreading in Afghanistan and the Soviet Union's Central Eurasian territories. Brezhnev hoped that Carter would understand and tolerate the Soviet move in Afghanistan. Carter did not. Talking to Chief of Staff Hamilton Jordan about the news, Carter stated that the Soviet invasion of Afghanistan was more far serious than the Iranian hostage crisis:

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<sup>580</sup> Graham Hovey, "Troops Rescue 100 in Islamabad; U.S. Offices Are Burned in 2 Cities," November 22, 1979, *New York Times*; Michael T. Kaufman, "Body of 2d American Is Found in Islamabad Embassy," November 23, 1979, *New York Times*.

<sup>581</sup> "Saudis Reportedly Quelled Large Pro-Iran Protests," December 4, 1979, *Los Angeles Times*.

<sup>582</sup> "Embassy Of The U.S. In Libya Is Stormed By A Crowd Of 2,000," December 3, 1979, *New York Times*.

Capturing those Americans was an inhumane act committed by a bunch of radicals and condoned by a crazy old man. But this is deliberate aggression that calls into question détente and the way we have been doing business with the Soviets for the past decade. It raises grave questions about Soviet intentions and destroys any chance of getting the SALT Treaty through the Senate. And that makes the prospects for nuclear war even greater.<sup>583</sup>

The Cold War had resumed with earnest, and the Carter administration immediately set to work to develop strategies to counter the Soviet penetration of Southwest Asia.

The strategies that the US government developed quickly came to be called the “Carter Doctrine.” Most importantly, the US government for the first time extended US military guarantees to the Middle East. “An attempt by any outside force to gain control of the Persian Gulf region will be regarded as an assault on the vital interests of the United States,” Carter declared in his State of the Union address on January 23, 1980. “It will be repelled by the use of any means necessary, including military force.”<sup>584</sup> The Carter administration likewise dedicated itself to establishing security arrangements with countries in Southwest Asia, developing the US rapid deployment force in the region, and supporting opponents of the communist governments in Afghanistan and South Yemen.<sup>585</sup> Brzezinski led the way in shaping the contours of the Carter Doctrine, arguing that Soviet aggression in Afghanistan had reaffirmed the need “to complete the third phase of the great architectural task undertaken by the United States after World War II. We constructed an alliance in Western Europe; we undertook explicit defense commitments in the Far East... now we need to shape a more flexible framework for security in the Middle East.”<sup>586</sup>

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<sup>583</sup> Quote from Glad, *An Outsider in the White House*, 197-198.

<sup>584</sup> Quote from Glad, *An Outsider in the White House*, 200.

<sup>585</sup> Odd Arne Westad, *The Global Cold War: Third World Interventions and the Making of Our Times* (Cambridge: Cambridge University Press, 2005), 326-330; Glad, *An Outsider in the White House*, 199-205.

<sup>586</sup> Brzezinski to Carter, January 30, 1980, NLC-25-99-18-7-0, JCL.

The Carter administration anticipated Saudi petrodollars would play an important role in the success of the Carter Doctrine. The Near East and Southwest Asia “is the most rapidly changing area in the developing world” stated one discussion paper for a January Special Coordinating Committee Meeting. “Instability is inevitable... the issue is how to direct change toward constructive goals—not how to prevent it.” The document argued that appealing to Islamic and “independent” nationalist sentiments that ran counter to communism were significant advantages in promoting this goal. The paper went on to encourage the US government to encourage Saudi Arabia to cooperate with the United States in establishing and financing military and economic development in the area with the aim of increasing regional security. The paper also argued for the Carter administration to “continue working to draw Saudi Arabia and other Gulf states more closely into the Western economic system.”<sup>587</sup> For their part, the Saudis were eager to acquire additional US arms, pressing the Carter administration on this point and even complaining that deliveries were not arriving fast enough.<sup>588</sup> The Saudis also actively funded and funneled US arms to anti-communist forces in Afghanistan and Yemen.<sup>589</sup> By March 1980, the Carter administration was even pushing the Saudis to construct military sites in Saudi Arabia and purchase advanced arms not for themselves but as bases and reserve weapons that US troops could occupy and use in the case of a military emergency.<sup>590</sup>

Yet for the Carter administration, improved cooperation with the Saudis constituted a rare silver lining to ever darkening clouds. US military leaders discussed contingency plans for a feared Soviet invasion of Iran, debating “the wisdom of U.S. air attacks on invading Soviet

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<sup>587</sup> “Elements of a U.S. Strategy for Security and Orderly Development in the Near East and Southwestern Asia,” circa January 14, 1980, NLC-17-18-28-4-0, JCL.

<sup>588</sup> Brzezinski to Carter, May 14, 1980, NLC-1-15-4-9-1, JCL.

<sup>589</sup> Westad, *The Global Cold War*, 326-330.

<sup>590</sup> Memcon, “Special Coordination Committee Meeting,” March 17, 1980, NLC-132-111-1-1-9, JCL.

forces... versus emplacing U.S. forces at some point where the Soviets had not yet arrived.”<sup>591</sup>

On April 24, 1980, the US military failed in its aborted attempt to rescue the US hostages in Iran, but not before the deaths of eight Delta force members when one of the mission’s helicopters collided with a C-130 fuselage and caused an explosion. Despite the apparent best efforts of the Saudis to maximize their oil output and jawbone other members of OPEC, the price of petroleum continued to rise as the wave of crises in the Middle East fueled fearful bidding and hoarding by the Western oil companies. And just when it appeared the oil market might finally be calming to the consumer’s favor, Iraq invaded Iran on September 22. In the initial round of fighting, the Iraqis and Iranians destroyed much of each other’s oil production and distribution facilities, abruptly reducing the total of OPEC’s oil output by 15 percent. In December OPEC held its latest meeting in Caracas, Venezuela, and all of the members except Saudi Arabia (which maintained a lower price) agreed to raise their oil prices to a new record: thirty-six dollars a barrel. Sales on the rapidly growing spot market had already fetched prices in the fifty dollar range.<sup>592</sup>

By the time of the Caracas meeting, Carter had already lost his reelection bid to the Republican candidate, Ronald Reagan. It would be hard to argue that the Iranian Revolution, with its impact on world oil prices, the US economy, and Americans’ sense of their government’s power in the world, did not contribute mightily to Carter’s defeat at the polls. Yet if the effects of the Iranian Revolution helped deny Carter’s attempt to win a second term as president on November 4, 1980, it had long before ended the Carter administration’s efforts to curb arms transfers to the MENA. The Iranian Revolution and the series of crises that followed

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<sup>591</sup> Air Force General Jasper Welch to Brzezinski, February 19, 1980, NLC-31-206-5-5-9, JCL.

<sup>592</sup> Yergin, *The Prize*, 681-695.

it decisively extinguished the first series attempts by the US government to challenge the petrodollar-arms complex.

### **The Rise and Fall of US Foreign Arms Transfer Restraint**

When the Carter administration began, there were many reasons to believe the United States could help curb the arms trade in the MENA and the world. Carter and many of his officials supported the effort to reduce arms transfers for moral and strategic reasons, and they made the issue a priority from the start of their tenure in the White House. They had support from a Congress that often desired even more stringent reductions in US arms sales. Significant interest in and support for arms control existed amongst the American public and key constituencies of the Democratic Party. Because of this favorable domestic environment, the Carter administration succeeded in meaningfully reducing US arms transfers to the MENA and the rest of the world during its first two years in office. On the international scene, however, the Carter administration encountered far greater resistance to its efforts. The other major arms exporting countries of Western Europe and the Soviet Union studiously avoided US entreaties for multilateral agreements to curb the global arms trade, and instead increased their military export sales to levels that made up for and surpassed the unilateral US cuts. Petrodollar rich countries in the MENA continued to desire to modernize their militaries, and they could purchase equivalent arms from other countries if the United States declined to sell. The Carter administration had not developed a solution to these problems when the Iranian Revolution began in earnest. At that point, the Carter administration's fear that MENA allies might not be able to defend themselves or lose confidence in their support from the United States rapidly eclipsed concern for arms control. The succession of additional crises in the MENA, the Iran



hostage crisis, the revolts in Saudi Arabia, the attacks on US embassies, the Soviet invasion of Afghanistan, and the Iran-Iraq War, all worked to ensure that the Carter administration never returned to the issue of arms transfer reductions. Instead, the massive flow of US military sales to the MENA resumed to levels similar to those under the Nixon and Ford administrations, a feat made all the more impressive by the fact that Iran was no longer a purchaser.

In short, the petrodollar-arms complex persisted and rebounded during the Carter years, despite a sincere and concerted effort by the US government to undermine it. With the onset of the second oil shock and the second major increase of petrodollars accumulating in the oil-rich MENA countries during 1979 and 1980, it appeared to many observers that the economic, political, and military power of the oil-rich MENA countries would only increase with time. The numbers of active and latent conflicts in the MENA, most notably the vicious, stalemated, and total war underway between Iraq and Iran, raised the prospect that the petrodollar-arms complex would remain particularly strong. Yet while the militarization of the MENA would persist through the 1980s, the petrodollar power of the oil-rich MENA countries would prove far less durable. While it was not apparent to most observers at the time, 1980 to 1981 would mark the high water mark of petrodollar power, to be followed by a dramatic decline back to virtually pre-1973 levels in a matter of only a few years.

## CONCLUSION

### **The End of the Petrodollar Era**

The Reagan administration enthusiastically continued the efforts of its predecessors to direct Arab petrodollars toward projects that it believed would further US interests. Looking to strengthen US ties with Saudi Arabia and ensure the Saudi government's security, the Reagan administration approved major arms sales to the Kingdom, including five AWACS in 1981. Congressional opposition to US arms transfers to Saudi Arabia remained high, in part due to anger that Saudi Arabia had not supported Egypt's peace accord with Israel, and the AWACS sale avoided rejection in the Senate by a margin of only four votes. Congress posed far less resistance to the Reagan administration's enthusiastic collaboration with Saudi Arabia to fund and arm anticommunist guerilla forces in Afghanistan and elsewhere across the globe, an endeavor that eventually reached billions of dollars in expenditures. The Reagan administration also supported the Arab Gulf states' financial support of Iraq to support Saddam's war against Iran and thus keep the power of Khomeini in check. Unlike other petrodollar flows, however, the US arms industry did not accrue much benefit from the Iran-Iraq War, as US legal restrictions barred US arms sales to both Iraq and Iran; aside from a few small and illegal sales, US arms manufacturers watched as foreign competitors obtained the tens of billions of dollars that Iran and Iraq spent on foreign arms during their eight year war.<sup>593</sup>

Yet the basis of the petrodollar economy, high oil prices, would steadily diminish during the 1980s. Oil prices peaked in 1981, leveled off, and then rapidly declined in the mid-1980s. A variety of factors led to the dramatic drop in oil prices. The efforts of non-OPEC countries to

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<sup>593</sup> Bronson, *Thicker than Oil*, 152-190; Miglietta, *American Alliance Policy in the Middle East*, 238-259; Nitzan, *The Global Political Economy of Israel*, 258.

increase energy efficiency, switch to alternative sources of energy, and develop new oil fields during the 1970s all began to bear significant fruit in the 1980s, diminishing the importance of OPEC oil to global energy needs. The repeal of oil price controls in the United States, initiated by the Carter administration and sped up under the Reagan administration, provided an additional and important boost to these trends. Petroleum companies became increasingly confident that the Iran-Iraq War and other political factors would not cause a cutoff of oil supplies, so they ceased their costly stockpiling and instead leveraged their now very large oil reserves to force oil producers to offer lower prices. The member countries of OPEC compounded these threats to higher oil prices with their own lack of unity. Suddenly faced with a buyer's market and dwindling revenues, members of OPEC failed to maintain agreed upon production limits or set-prices meant to stabilize the price of oil; instead nearly every OPEC country exceeded its production quotas and lowered prices in an effort to simultaneously boost revenues and underbid competitors. The divisions in OPEC manifested themselves most sharply in the war between Iran and Iraq, as each country desperately attempted to sell as much oil as possible in order to fund the war effort against the other. In 1981 the OPEC-set price for a barrel of oil hit a record of thirty-four dollars; by 1986 it ranged from fifteen to eighteen dollars.<sup>594</sup> Adjusted for inflation, OPEC oil revenues in 1986 had fallen to less than half of what they had been in 1974.<sup>595</sup> Into the late 1990s, the price of oil continued to trend downward.

The sustained and dramatic fall in the price of oil meant that the petrodollar economy had come to an end by the mid-1980s. Due to the economic integration of the oil-rich and oil-poor Arab countries, lower oil prices depressed the economies of both. The problem of low oil prices was compounded by the global scarcity of credit and the destruction from the drawn-out wars

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<sup>594</sup> Yergin, *The Prize*, 693-703, 724-749.

<sup>595</sup> Skeet, *OPEC*, 244; inflation calculated with US Bureau of Labor Statistics CPI inflation calculator, [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm)

that racked the MENA during the 1980s and early 1990s. In the late 1980s the Egyptian government felt compelled to adopt an increasing number of austerity measures due to its weakening economy, and Egypt only barely avoided default by obtaining emergency US aid. The combined weight of lower oil revenues and the enormous costs of eight years of war helped induce Iran to agree to a ceasefire with Iraq in 1988 and left the Iranian economy hobbled at the start of the 1990s. Kuwait and Saudi Arabia experienced a sharp decline in their international financial clout during the 1980s, and then witnessed the remainder of their savings wiped out by the 1990-1991 Gulf War. Saddam's invasion of Kuwait was particularly costly for that nation, as Iraqi forces pillaged the country and destroyed many Kuwaiti oil facilities before retreating. Saudi Arabia incurred massive military costs due to the conflict, and in the mid-1990s the Saudi Kingdom was barely able to maintain its military payments to the United States. Iraq, having pursued two self-defeating attempts to increase its oil revenues through military invasion, suffered the worst economic reversal of any Arab country. The Iran-Iraq War, the bombing campaign of the US-led coalition during 1990 and 1991, and the international sanctions against Iraq during the 1990s all damaged Iraq's infrastructure while also significantly reducing its revenues from oil exports. By 1986, and certainly by 1991, the economic and political power of the oil-rich MENA countries, which had seemed so substantial in the 1970s, slipped once again to marginal status.<sup>596</sup>

### **Change and Continuity after the Petrodollar Era**

The end of the petrodollar era generated important changes in US-MENA relations. One of the most dramatic shifts occurred in the realm of finance. Petrodollar deposits and investments in

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<sup>596</sup> Yergin, *The Prize*, 739-760; Scott B. MacDonald, Margie Lindsay, and David L. Crum, eds., *The Global Debt Crisis: Forecasting for the Future* (London: Pinter Publishers, 1990), 68-89; Bronson, *Thicker than Oil*, 185-210; Spiro, *The Hidden Hand of American Hegemony*, 156; Tripp, *A History of Iraq*, 215-254.

both domestic and overseas US institutions dropped dramatically during the 1980s. The US government shifted to borrowing primarily from Japan and West Germany as Arab deposits in US Treasury securities were withdrawn. The Treasury Department and banks no longer worried about Arab petrodollars causing imbalances in the international monetary system. US exports to the MENA declined.

Yet in many other ways the ties between the MENA and the United States that had developed as a response to the petrodollar revolution persisted long after the price of oil dropped. The US government had pursued stronger economic and political ties with MENA governments in the 1970s in large part to ensure that petrodollars were used for, and not against, perceived US interests. This strategy failed in regard to Iran after 1979, but it did strengthen US ties with Saudi Arabia and the other Arab Gulf kingdoms. Petrodollars had likewise helped to establish Egypt as a US ally. The US government maintained its close political ties with Saudi Arabia, the other Arab Gulf kingdoms, and Egypt even after petrodollars no longer served to ease such relationships or provide a rationale for them. In part closer ties reflected the US government's general preference not to lose alliances once they were established as well as the continued reliance that these MENA countries had on the United States for security and economic stability. More importantly, however, these continued ties persisted because neither the United States nor its Arab allies wished to see Iran or Iraq come to dominate the region. These two countries had developed massive armies during the petrodollar era, and the United States and its regional allies sought to curb both countries' efforts to expand their influence or control over the Persian Gulf. Oil was cheap and freely flowing, and the United States wanted to keep it that way; it did not want a hostile power like Iran or Iraq to obtain a controlling share of oil supplies and be able to undermine the US-led global order. For their part, states like Saudi Arabia and Kuwait sought to

preserve their own autonomy in the face of larger neighbors by keeping good relations with the United States. Arms and military bases that Saudi Arabia had purchased from the United States during the petrodollar era would be used to deter Iran during the Iran-Iraq War and then used again on a far larger scale against Iraq during the 1990-1991 Gulf War. After the September 11<sup>th</sup> terrorist attacks of 2001, combating violent Islamist groups that opposed both the US government and US allied governments in countries like Egypt and Saudi Arabia provided an additional reason for the United States and friendly MENA governments to maintain close ties.

US arms companies continued to generate strong sales in the MENA long after the decline of the petrodollar economy. The loss of Iran was a big blow to US arms manufacturers, but the threat of Iranian and Soviet expansion in the 1980s helped to increase sales to allied Arab Gulf countries as well as domestic orders. Iraq's invasion of Kuwait in 1990 provided an additional boost in US arms sales, as did the 2001 terrorist attacks and the subsequent US invasions of Afghanistan and Iraq. The large levels of US military aid to Egypt and Israel, in part a legacy of the petrodollar economy, continued into the twenty-first century, which maintained healthy US arms sales to these two countries. For all of these MENA countries, military expenditures consumed an increasingly large portion of national budgets at the expense of badly needed economic development and investment.

### **The Second Petrodollar Era**

The age of cheap oil did not last forever, however; during the mid-2000s rapidly rising petroleum prices ushered in a new petrodollar era. A number of factors contributed to the rise in oil prices that began in 2003. Political crises in oil-producing regions, notably including the war-torn chaos of Iraq after the US invasion of that country in 2003 and fears that a conflict over Iran's

alleged nuclear arms program could close the vital oil transfer point of the Straits of Hormuz, spurred higher oil prices through decreased oil supplies and increased speculative purchases. The booming economic growth of LDCs like China, India, and Brazil during the new millennium generated growing demand for oil. At the same time, the preceding slump in oil prices had discouraged the development of new oil production capacities, and oil producers proved slow to catch up with demand. Both political and economic factors thus once again combined to create a tight petroleum market that favored sellers over buyers, and oil prices rose accordingly. The average price of a barrel of oil, which had been around \$30 in 2003, soared to \$145 in 2008.<sup>597</sup> While oil prices would then plummet in 2008 in response to the global Great Recession and bottom out near \$40 per barrel at the beginning of 2009, the stabilization and gradual recovery of the world economy, and particularly the resumed rapid economic growth of rising LDCs like China, brought a quick restoration of high oil prices. Political concerns ranging from Iran's nuclear program to the Arab Spring to the Russian seizure of Ukrainian territory also helped to keep oil prices high. From 2011 to the present (May 2014) the average futures price of light sweet crude oil, WTI September 2011 (NYMEX), a major benchmark for oil commodities trading, typically maintained a value on the NASDAQ ranging between \$90 and \$110.<sup>598</sup>

The rise in oil profits brought trillions of dollars to the MENA oil-rich countries. US financial, arms, and engineering companies looked to these Arab states with renewed interest. The sparsely populated Arab kingdoms invested billions of dollars in individual US financial firms, including a \$7.5 billion investment in Citigroup by Abu Dhabi's sovereign wealth fund, helping to keep these US financial firms afloat during the 2007-2008 financial crisis.<sup>599</sup> US

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<sup>597</sup> Yergin, *The Prize*, 766-769.

<sup>598</sup> NASDAQ, <http://www.nasdaq.com/markets/crude-oil.aspx?timeframe=10y>

<sup>599</sup> Eric Dash, "Big Payday For Rescuers In the Crisis," December 7, 2009, *New York Times*; Andrew Critchlow, "Abu Dhabi Has Gotten Lost in Citi," December 17, 2009, *Wall Street Journal*.

exports to the MENA, particularly those related to military and security interests, also boomed. In 2010, for example, the US government approved a ten year, \$60 billion dollar arms sale package to Saudi Arabia. As part of this sale, in 2011 the United States sold 84 new Boeing F-15s and related parts and training to Saudi Arabia at the price of \$30 billion. This sale greatly contributed to the United States selling a record \$66.3 billion in overseas weapons sales in 2011, which constituted over three-fourths of total foreign arms sales for the world that year. These F-15s are planned to be delivered to Saudi Arabia in 2015.<sup>600</sup>

As demonstrated by the 2011 F-15 sale to Saudi Arabia, the new petrodollar revolution intersected not only with economic concerns but political ones as well. The rise in petrodollar profits, coupled with the power vacuum created in Iraq after the US invasion in 2003, markedly increased the relative strength and influence of Iran. The Iranian government amplified its sway in the Middle East by funding and arming regional allies in Iraq, Lebanon, and Syria. Iran also strengthened its military. The United States and its Gulf allies in turn worked to use Arab petrodollars as a counterweight to Iranian petrodollars. Military buildups by the Arab countries along the Persian Gulf were intended to counter Iranian armed forces. The Arab kingdoms likewise funded and lent military support to their own allies in countries like Bahrain, Iraq, and Lebanon.<sup>601</sup> These policies have found their most violent culmination in Syria, as the opposing MENA petrodollar powers poured billions of dollars in arms to the opposing sides of the Syrian Civil War. The US government reportedly coordinated with the Arab Gulf countries in the

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<sup>600</sup> Mark Landler and Steven Lee Myers, "Healing a Rift, U.S. Agrees to \$30 Billion Fighter Jet Sale to Saudi Arabia," December 30, 2011, *New York Times*; Thom Shanker, "U.S. Arms Sales Make Up Most of Global Market," August 27, 2012, *New York Times*.

<sup>601</sup> Gause, *The International Relations of the Persian Gulf*, 148-183.



dispersal of these arms to groups rebelling against Bashar al-Assad and his Iranian supported government.<sup>602</sup>

Petrodollars also continue to play an important role in US-Egyptian relations. But whereas the US government in the 1970s sought increased petrodollar support for the government of Sadat in order to improve US-Egyptian relations, in 2013 Arab kingdoms used petrodollar aid to Egypt to flout US influence over that country. During the late 1980s, Arab governments restored and repaired relations with the Egyptian government, now under the rule of President Hosni Mubarak. The Gulf Arab kingdoms in particular looked to Egypt as a potential counterweight to Iran and later Iraq. The failure of the United States to prevent the popular overthrow of Mubarak during the Egyptian Revolution of 2011 dismayed the governments of Saudi Arabia, Kuwait, and the UAE, which feared that the Arab Spring was bringing instability to the MENA and might inspire public opposition to their own regimes. These Arab governments likewise distrusted the Muslim Brotherhood as an ideological and political rival. Saudi Arabia, Kuwait, and the UAE thus vigorously supported the July 2013 military coup in Egypt that deposed the Egyptian President and Muslim Brotherhood leader Mohamed Morsi. The following month the Egyptian army launched a crackdown on encamped Morsi supporters who were peacefully protesting Morsi's ouster; an estimated one thousand Egyptians were killed and thousands more wounded. The Obama administration and the European Union publicly raised the possibility of cutting aid to Egypt to signal their disapproval of the Egyptian military massacring its own citizens. In response, the Saudi government declared that it and its Arab allies would make up the difference in any Western aid cuts to

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<sup>602</sup> Farnaz Fassihi, Jay Solomon, and Sam Dagher, "Iranians Dial Up Presence In Syria," September 16, 2013, *Wall Street Journal*; Martin Fletcher and Michael Evans, "How Obama spy agency is helping to reach the 'right' Syria rebels," March 26, 2013, *The Times*; Nabih Bulos, "Tiny Qatar a big player in Syria," January 12, 2014, *Los Angeles Times*.

Egypt. Saudi Arabia, Kuwait, and the UAE had already pledged an emergency aid package totaling \$12 billion to the Egyptian government a week after the military coup, a sum that dwarfed the US average annual aid rate to Egypt of \$1.5 billion and the European Union's annual rate of \$1.3 billion. The Saudis had made clear that Arab petrodollars could effectively challenge US leverage in the region.<sup>603</sup>

No one can know for sure how long the current petrodollar economy will persist into the future. Already, however, this second petrodollar era has significantly reshaped the economic and political structures of the MENA and the world, just as the first did. The effects of how petrodollars are used will be felt in the MENA and the United States many years after they are initially spent or invested, continuing to shape the strategic, business, and moral decisions made by people in the United States and the MENA.

Hopefully this dissertation has demonstrated that balancing the competing interests and players related to petrodollars is no simple task. Nor does it advocate that Americans adopt the hubristic mindset commonly displayed during the 1970s that held that Arabs and Iranians did not deserve the profits from the sale of their own resource or that petrodollars should be spent and invested solely as Americans saw fit. But as the largest economic and political power in the world today, the United States will inevitably play a significant role in shaping the international environment, which will influence how petrodollars are used. The governments and peoples of Arab countries and Iran have important responsibilities to avoid conflict, repression, and kleptocracy within and along their own borders. Yet the diplomacy, international agreements, and military actions undertaken by the US government profoundly shape the parameters and

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<sup>603</sup> Notably, Qatar went against the other Arab Gulf kingdoms and supported the Muslim Brotherhood in Egypt. Qatar's ongoing support for the Muslim Brotherhood led Saudi Arabia, Kuwait, the UAE, and Egypt to recall their ambassadors from Qatar in March 2014. See Rod Nordland, "Saudi Arabia Promises to Aid Egypt's Regime," August 20, 2013, *New York Times*; David D. Kirkpatrick, "Egypt Pulls Ambassador From Qatar," March 7, 2014, *New York Times*.

incentives for how the MENA will use its petrodollars. The role of US corporations, organizations, and individuals in lobbying for government policies, conducting trade, and engaging in other forms of exchange are also of great significance.

Americans, Arabs, and Iranians thus have a shared responsibility to work together and with others to ensure that petrodollars are used for the welfare and enrichment of all people rather than for destruction, inequality, and repression. If the experience of US-MENA relations during the 1970s teaches anything, it is that there is no simple path to formulating and implementing such goals. The record of the past provides little optimism for the ability of the United States or the MENA countries to overturn the structures of power and conflict that lead to petrodollars being used for arms races, strengthening dictatorships, and generating inequality. But ignoring petrodollar structures will not make it any easier to address the problems they help generate. Let us hope that current and future leaders demonstrate the imagination and cooperative spirit needed to use petrodollars in a manner that creates positive interconnections between Americans, Arabs, Iranians, Israelis, and the rest of humanity.

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