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MEMORANDUM FOR THE RECORD

SUBJECT: Middle East Oil Policy

The attached briefing paper was prepared for the D/OER briefing of the President's Foreign Intelligence Advisory Board (PFIAB). The briefing was given on 5 December. The responsible analysts are [redacted]

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Middle East Oil Policy

I. Current Middle East oil policy is determined by the desire of all the producing nations to maximize per barrel oil revenues and of the Arab producers to settle the Arab-Israeli question on their terms.

A. These countries want to maximize their per barrel revenues.

1. The producers believe that maximizing per barrel revenues is the most efficient method of maximizing total revenues over the long run.

2. Most producers already have more money than they now can spend effectively.

3. Oil is an exhaustable resource which should be conserved for future generations.

B. Most Arab oil producers wish to take oil pricing out of the political arena.

1. Most Arab oil producers would not lower the price of their oil significantly if an Arab-Israeli peace settlement were reached.

2. Oil prices probably would go up even higher if a high level of fighting commenced and production cuts were introduced.

3. Iran would not go along with any political decision made by the Arabs, but would certainly benefit financially.

II. The desire for maximum per barrel revenues is reflected by the recent price decisions made at the Abu Dhabi Oil meeting.

A. In early November Saudi Arabia, Abu Dhabi and Qatar agreed on a proposal which would result in an increase of 40-50 cents per barrel in the average price of Saudi Benchmark crude.

1. This was accomplished by:

a. A 40 cent per barrel cut in posted prices.

b. An increase of royalty payments from 16 2/3% to 20%.

c. An increase in the taxes on profits from 65 3/4% to 85%.

2. Since January the average price per barrel of benchmark Saudi crude has been raised nearly $1.00 per barrel -- from about $9.34 to a $10.25-$10.37 range.

B. Iran, who with Iraq and Kuwait originally did not back the Saudi proposal, has recently notified the consortium of a similar price increase of about 50 cents in average costs per barrel on its crude.

1. Iran acted under the auspices of its most favored nation agreement which it has with the international oil companies.

2. Consortium costs per barrel have been increased from $9.38 in January to $9.86 in October. The latest price move has raised it to $10.58 effective 1 November.

C. This new agreement is subject to change pending the outcome of the next OPEC ministerial meeting on 12 December. Other producers will readjust their prices in compliance with decisions made by OPEC.

III. The Middle East countries have the ability of supporting prices by production cutbacks.

A. Table 1 shows annual oil revenues and the resulting surpluses after import expenditures are made.

1. Total Middle East revenues in 1974 are expected to reach $84 billion. Taking into account $22 billion of import expenditures, surplus revenues of $62 billion are expected -- nearly three-quarters of total revenues.

2. Surpluses vary from country to country. Saudi Arabia has the greatest ability to influence pricing policies as its 7 million b/d surplus is nearly one-half of total surplus. Algeria, on the other hand, is just barely holding its own with 70,000 b/d of surplus. The remaining countries

Table 1

Middle East Oil Revenues and Expenditures 1974

	Annual Oil Revenues Billion $	Preliminary Estimates of Import Expenditures Billion $	Surplus Revenues 1/ Billion $	Surplus in Millions of Barrels Per Day 2/
Algeria	4.1	3.8	0.3	.07
Iran	20.3	7.7	12.6	3.50
Iraq	5.8	1.0	4.8	1.59
Kuwait	8.6	1.7	6.9	2.02
Libya	6.7	2.7	4.0	.98
Qatar	1.9	0.3	1.6	.43
Saudi Arabia	29.9	3.5	26.4	7.43
U.A.E.	6.6	1.4	5.2	1.39
Totals	83.9	22.1	61.8	17.41

1/ Surplus is from oil revenues only. Investment income significantly increases the surplus for several of the oil rich Arab states.

2/ Using October average weighted revenues per barrel.

have excesses ranging from as little as nearly one-half million to 3.5 million b/d.

B. Iran, the only non-Arab Middle East country, would be willing to cut production to maintain the current price level.

IV. Bilateral negotiations between major oil producing and consuming countries have been highly publicized during the last year.

A. So far bilateral oil deals have not played a very significant role in the international oil market.

B. These deals have involved relatively small volumes of oil. None of the larger deals reported so far has resulted in sales prices significantly lower than those prevailing in the market.

C. Of these bilateral deals currently under negotiation, only that between Saudi Arabia and France appears significant.

1. The Saudi-French deal started as a deal for 800,000 b/d of oil over the next 20 years.

2. It has now been scaled down to 400,000 b/d over the next ten years.

3. Saudi Arabia apparently was reluctant to commit itself for a longer period. The future of this deal is still uncertain, but the French hope to sign early next year.

D. There are three fairly large bilateral deals currently in effect.

1. The UK concluded a one year deal in January with Iran for 100,000 b/d.
2. France signed a three year agreement in January with Saudi Arabia for 300,000 b/d.
3. Japan signed a 10 year agreement in August with Iraq for 180,000 - 200,000 b/d.

Oil and Another War in the Middle East

I. In the absence of a new Middle Eastern war, it is unlikely that a new embargo will be instituted. It is possible, however, that the Arab nations might respond to continued frustrations in negotiations with a non-discriminatory production cutback.

A. Such a cutback would put pressure on Europe and Japan without appearing to be directed at countries in those areas -- most of which now accept the Arab position in most respects. Europe and Japan would in turn pressure the US.

B. Such a program could be adjusted to reflect progress in negotiations.

C. It would not be opposed by non-Arab producers.

II. If war does break out, the Arabs' use of the oil weapon will be determined largely by the way the outbreak originates, its timing, and the positions of the consuming nations. It is unlikely that all the Arab producers will adopt the same position.

A. If war begins with an Israeli preemptive strike and the consuming nations strongly condemn the Israeli action, most of the Arab states would probably not embargo Europe and Japan.

1. The United States would probably be embargoed unless its denunciations of Israel were accompanied by a cutback in military aid to Israel. The Arab states

would recognize that such a one-country embargo would be more symbolic than effective.

2. If the war drags on, the Arab states might adopt a non-discriminatory cutback in production.

B. If, on the other hand, the next Middle East War were to begin with an Arab attack on Israel, the oil weapon probably not be used immediately.

1. Saudi Arabia would probably hold off the reimposition of an embargo until it became clear that the US or other consuming countries were heavily resupplying Israel.

a. Most of the other Arab Persian Gulf oil producers would be likely to follow the Saudi lead.

b. Some countries, such as Iraw, might institute a symbolic embargo against the United States, but probably would not cut back production.

III. Any embargo that was more than symbolic would have to be accomplished, as it was last year, by Arab oil production cutbacks.

A. The Arab states currently produce about 17.5 million b/d of oil -- about 38% of the Free World's oil supply.

1. By reducing the amount of oil they produced, the Arab states could reduce the total amount of oil available to all the consuming countries, and offset oil sharing arrangements and oil swapping by the international oil companies.

2. In the short run the Arab states have surplus oil revenues large enough to permit them to reduce their production substantially without suffering setbacks to their economic development programs.

    a. For example, Saudi Arabia could reduce its oil production from the current level of about 9 million b/d down to about 2 million b/d and still have extra money.

B. Unfortunately the Arab states' power to cut oil production is not offset by the ability of other nations to increase their oil output.

1. Indeed most of the world's excess productive capacity is now located in the Arab states.

2. The major non-Arab oil producers who might be able to increase production in the short run are: the US, Venezuela, Canada, Norway, Iran, and Indonesia.

3. We estimate that all Free World non-Arab producers could increase their production

by only a total of 3 million b/d -- less than 20% of current Arab production.

4. It is unlikely that the non-Arab Free World producers would increase production by the full 3 million b/d that is technically possible. Legal, environmental, and political considerations would inhibit such a response even in the United States.

IV. The International Energy Program (IEP) -- an emergency oil sharing plan agreed to by most important consuming nations except France -- has by its existence raised the stakes for both the consumers and producers.

A. The belief is widespread among both consumers and producers that the system would not work if put to the test.

B. If the plan is tried and fails, talk of effective consumer cooperation will have been shown to be hollow.

C. If the plan is tried and is successful, a strong and effective consumer group will have been created. This consumer group would then be in a stronger position to work on prices and other non-embargo issues.

1. It will spread the burden more evenly over the consuming countries.

2. It will provide a mechanism for coordinating oil conservation thereby limiting non-crisis dependence on Arab oil.

D. Both consumers and producers have ample reasons to fear such a test. The response of both groups to a new Arab-Israeli war will be influenced -- but probably not determined -- by a desire to avoid such a test.

V. The timing and expected duration of a new war is also important.

A. At present there is sufficient oil in tankers at sea and in storage to delay the impact of an oil embargo for two to three months. This knowledge might induce the Arabs to impose only a symbolic embargo.

VI. If the embargo and cutbacks were to be maintained for more than three months, the effects on the consuming countries would be quite serious.

A. The consuming countries would be forced to introduce more drastic oil conservation measures which would inevitably depress economic activity.

B. After several months the situation could become politically unacceptable in some countries and might bring about economic retaliation against the producers.

VII. The Arabs would probably not let things go that far, however.

A. Last year they monitored the effects of their embargo on the consuming countries rather carefully. When the going looked like it might get too rough, Saudi Arabia began to increase its oil production.

B. In a future embargo the Saudis are likely to try to set their production at a level that they judge the consuming countries will just be able to tolerate. The Saudis might, however, step up the pressure if they were strongly convinced of the necessity of obtaining a political settlement in the near term. The other Arab Persian Gulf producers would probably follow Saudi Arabia's lead.