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외교학석사 학위논문

# A Study on the Role of Saudi Arabia as a Swing Producer

사우디아라비아의 공급조절 역할에 관한 연구

2012년 8월

서울대학교 대학원

외교학과

강 승 연

# A Study on the Role of Saudi Arabia as a Swing Producer

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이 논문을 외교학 석사학위 논문으로 제출함

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## Abstract

The Organization of Petroleum Exporting Countries (OPEC), established in 1960 by the oil producers in the Middle East, have been considered as an oil cartel seeking to control the world oil market. And the OPEC members have confronted severe criticism from Western governments and press. Saudi Arabia, in fact, has played a very unique role as a ‘swing producer’ in world oil production since the First Oil Crisis, compared with other OPEC member states. The Kingdom has struggled to maintain the moderate level of oil prices by raising or lowering the volume of its oil production. For instance, the Saudis decreased the production of crudes in the early 1980s when oil prices were expected to plunge due to the glut in the market.

However, Saudi Arabia abruptly decided to boost its oil production in August 1985 despite the tight environment of the world oil market. Riyadh’s daily oil production rose by 2.340 MBD from August 1985 to December 1985. Consequently, the international oil prices collapsed to a large extent in 1986. The paper elaborates on the research question, ‘even though Saudi Arabia had tried to keep the oil market stable, why did it suddenly increase the production volume of crudes in 1985 to make the oil prices collapse?’

A number of researches have explained that the Saudis’ oil policy in 1985 was driven by the national economic depression. The economic approach provides a considerably convincing story, but it was not able to contribute to a comprehensive understanding of the political concerns the Saudis had felt. This paper insists that Riyadh made an oil

policy shift due to political concerns. As the international and regional threats to the national security got higher, Saudi Arabia needed to boost its oil production in August 1985 and to reduce its swing-producer role as a way to contain the perceived military threats and strengthen its security.

According to the analysis of the paper, the Kingdom had been under the political and military pressures outside its own territory both regionally and internationally since the beginning of the Cold war. In the late 1970s, the Iranian revolution and the Iran-Iraqi war occurred to threaten the security of the Kingdom. Particularly, Iran posed a direct threat to the Saudi security. The Khomeini regime publicly denounced the Kingdom as a U.S. lackey and attempted to export its radical revolutionary ideas to the territory of secular Saudi Arabia. At the height of the tanker war between 1984 and 1985, the Iranian troops attacked the oil-export facilities of the Kingdom and the oil tankers carrying Saudi Arabian oil. In response to the Iranian aggressive policy, Saudi Arabia made efforts to establish close cooperative relations with the United States as well as to import advanced arms from the West. Therefore, these historical facts confirmed the main hypothesis arguing that the reduction of Saudi swing-producer role resulted from its urgent need for building up the military capability.

In conclusion, the paper has its implication for the study of the oil producers since the exploration of the Saudi behavior in 1985 helps us widen our understanding of the oil producers' market behavior based on political considerations. And the paper shows that the negotiation within OPEC is an empirical evidence useful for demonstrating that the

cooperation among cartel members is hard to reach due to political concerns. Thus, it will contribute to assessing how well energy cartels as Gas Exporting Countries Forum work in the future.

**Keywords:** Saudi Arabia, Swing Producer, Saudi Arabian Oil Policy, Saudi-U.S. Relations, Saudi-Iranian Relations, Organization of Petroleum Exporting Countries (OPEC)

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# **I. Introduction**

## **1. Research Question**

### **1) Background**

Energy security is one of the most important issues in the study of international relations today. Increasingly every nation pays sharp attention to procuring energy resources for sustaining economic growth. “An exceedingly tight oil market” and “high oil prices, which have doubled over the past three years” have shifted many policy-makers’ focus into energy security.<sup>1</sup> Many problems including “the threat of terrorism, instability in some exporting nations, a nationalist backlash, fears of scramble for supplies, geopolitical rivalries”<sup>2</sup> and natural disasters have contributed to high interest in energy security. Since late 2010, pro-democracy movements as well as anti-government protests unleashed in the Middle East and North Africa have fueled political unrest in these regions, which has resulted in unstable international energy security. In April 2011, for instance, the three major benchmark crude oils (West Texas Intermediate, Brent, and Dubai) are traded at the price beyond \$110 per barrel. This “oil price has hit the highest

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<sup>1</sup> Daniel Yergin, “Ensuring Energy Security,” *Foreign Affairs*, Vol. 85, No. 2 (March-April 2006), p. 69.

<sup>2</sup> Yergin, 2006. pp. 69-82.

level since the financial crisis,”<sup>3</sup> so that the concerns over energy security have deepened accordingly.

The uneven geographical distribution of natural resources is the fundamental factor that threatens international energy security. A vast majority of natural resources are buried in a small number of countries. As an example, about 90 percent of the world’s proved oil reserves are concentrated in 15 countries.<sup>4</sup> There are 90 percent of global natural gas supplies lying under 20 countries and just 9 countries possess 90 percent of the world’s coal reserves.<sup>5</sup> Therein lies the rub. Today, many energy consumers have become heavily dependent on energy imports from a few producers and the competition among energy importers for securing energy supplies gets intense and stiff. Finally we are witnessing a power shift to energy exporters, given the fact that their diplomatic leverage has grown to exploit their natural resources as strategic weapon in order to accomplish their ends. Resource-rich nations’ strategic behaviors which are termed as ‘resource nationalism’ tend to occur more frequently and to ramp up the price of energy accordingly.

The establishment of the Organization of Petroleum Exporting Countries (OPEC) and the First Oil Crisis are both symbolic events where energy exporters started to act and make political decisions

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<sup>3</sup> Alex Hawkes, “Oil Price Hits Two and a Half Year High,” *The Guardian*, 4 April, 2011, Available at <http://www.guardian.co.uk/business/2011/apr/04/oil-price-two-half-year-high>

<sup>4</sup> WTO, *World Trade Report 2010: Trade in Natural Resources*, p. 48. Available at [http://www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/world\\_trade\\_report10\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report10_e.pdf)

<sup>5</sup> WTO, 2010, p. 71.

based on the strategy of resource nationalism for the first time. These incidents were caused by the international major oil companies<sup>6</sup> which “cut the posted price approximately 6 percent without discussing it with the producer countries, which stood to lose large amounts of revenues”<sup>7</sup> in the summer of 1960 when there was a glut in the global oil market for the first time, which was likely to push oil price down.<sup>8</sup> “The oil-producing countries acted swiftly, and on September 14, 1960, representatives of Iran, Iraq, Venezuela, Saudi Arabia, and Kuwait, meeting in Baghdad, agreed on the establishment of OPEC.”<sup>9</sup> The creation of OPEC doubtlessly signified group cohesiveness of energy producing countries which had been overpowered by the international major oil companies.

The First Oil Crisis of 1973-74 has been considered as the case where the member states of OPEC successfully used their oil as a political weapon. It was referred to as the ‘Oil Price Revolution’<sup>10</sup> since the oil price had quadrupled during this period and led to an upcoming era of high oil prices. Because of the oil price spikes and the

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<sup>6</sup> The seven largest oil multinational companies include Exxon, Mobil, Gulf, Texaco, Standard Oil of California (United States), British Petroleum (Great Britain), and Royal Dutch Petroleum and Shell Transport and Trading (Netherlands). These companies termed ‘major’ or ‘the Seven Sisters’ had dominated the global oil market before OPEC emerged as a new power.

<sup>7</sup> Rajendra K. Pachauri, *The Political Economy of Global Energy* (Baltimore: Johns Hopkins University Press, 1985), p. 58.

<sup>8</sup> Pachauri, 1985, pp. 57-58.

<sup>9</sup> Pachauri, 1985, pp. 57-58.

<sup>10</sup> See Steven A. Schneider, *The Oil Price Revolution* (Baltimore: Johns Hopkins University Press, 1983).

change in the structure of the international oil market, the energy exporters including the OPEC members confronted severe criticism from Western governments and press. The United States government and press, in particular, publicly denounced the Arab's energy exporters contending that the First Oil Crisis was totally attributed to them, so that there arose widespread animosity toward the Arab world across the United States.<sup>11</sup>

However, considering the stability in the international oil market during the period between the constitution of OPEC and the First Oil Crisis, it rather seems to be invalid to argue that both the First Oil Crisis and the Oil Price Revolution were driven merely by the cartel of OPEC as the United States did. In fact, the international oil market and the oil prices had remarkably remained stable for approximately 13 years since the OPEC cartel had been launched in 1960 (See Figure 1-1). Surprisingly, the prices had kept calm even though the OPEC member states had enforced the oil embargoes and cut oil supplies several times before the outbreak of the First Oil Crisis. Furthermore, the fact that demand for oil supplies had never fallen but had steadily risen over the period gave little influence on the prices of oil.

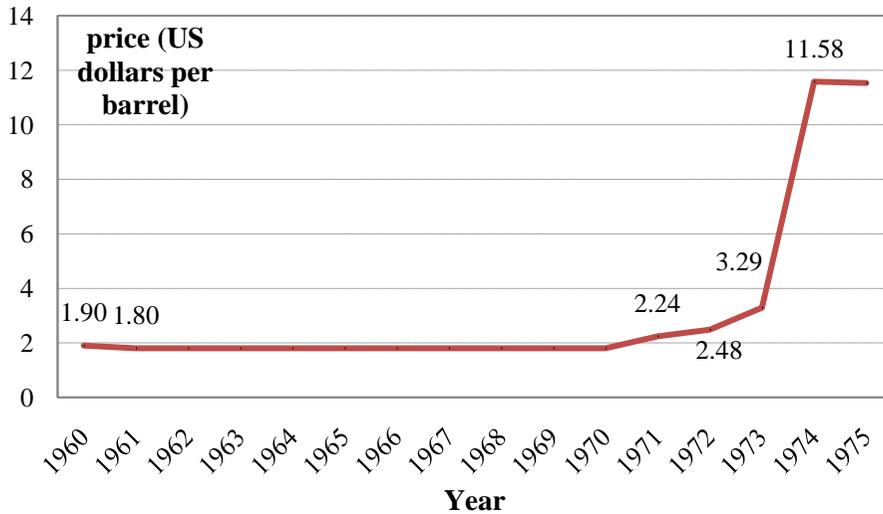
If the argument was right that the previous rises in oil prices were ascribed solely to the OPEC cartel, how could we explain the stability in the global oil market during this period? Too much reliance upon the factor of the OPEC cartel leads you to fail to capture the complex

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<sup>11</sup> See A. F. Alhajji, "The Failure of the Oil Weapon: Consumer Nationalism vs. Producer Symbolism." *Bridges*, Vol. 11, No. 1-2 (Spring/Summer 2004), pp. 29-67.

international politics of oil as a whole.

**<Figure 1-1> Crude oil price, 1960 - 1975**



Source: British Petroleum, *BP Statistical Review of World Energy June 2010*

Instead of OPEC, this paper will take the role of the Kingdom of Saudi Arabia into consideration so as to deeply understand how the oil market participants have acted and responded to the fluctuations in the global oil market and oil prices so far.

Saudi Arabia, in fact, has played a very unique role in world oil production since the First Oil Crisis, compared with other OPEC member states. Most OPEC countries used to decide on the amount of oil production only considering their national economic incomes. Paying less attention to balancing the world oil prices, they usually preferred to accelerate their profits from oil exports. That is, economic interests were a significant factor in determining how most of OPEC countries took their actions.

Contrary to them, Saudi Arabia, as a ‘swing producer,’ has attempted to adjust the price of world oil by controlling its own oil outputs.<sup>12</sup> Swing producer is defined as “a company or country that changes its crude oil output to meet fluctuations in market demand.”<sup>13</sup> In order to play a role of swing producer in the oil market, therefore, a company or country should meet two requirements. First, it should have tremendous spare capacity so that it can manage the oil prices by controlling its own output. Second, it should be willing to sacrifice its short-term revenues from the sale of oil to tranquilize the market. And Saudi Arabia has been considered as the only country that meets these criteria in the global oil market.

The Saudi role as swing producer has been performed successfully by virtue of its bountiful oil reserves which accounted for one-fourth of the world’s oil reserves and high capacity for oil production.<sup>14</sup> And the Kingdom, with its enormous capacity for oil production, has willingly served to maintain the proper balance in the

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<sup>12</sup> M. A. Adelman, “An Unstable World Oil Market,” *The Energy Journal*, Vol. 6, No. 1 (1985), pp. 17-22; Henry Rowen and John Weyant, “Will Oil Prices Collapse?” *Challenge*, Vol. 24, No. 5 (November-December 1981), pp. 11-17.

<sup>13</sup> As cited in the glossary of terms by the Energy Intelligence Group. Available at <http://www.energyintel.com/Pages/ReferenceTools.aspx?tabId=3>

<sup>14</sup> In 1990, Saudi Arabia’s proved oil reserves were 260.3 billion barrels and they accounted for 25.95% of the world’s reserves. Its reserves were 262.8 billion barrels and its oil production averaged 9.491 million barrels per day by the end of 2000. British Petroleum, *BP Statistical Review of World Energy 2011*, pp. 6-8. (available at [http://www.bp.com/liveassets/bp\\_internet/globalbp/globalbp\\_uk\\_english/reports\\_and\\_publications/statistical\\_energy\\_review\\_2011/STAGING/local\\_assets/pdf/statistical\\_review\\_of\\_world\\_energy\\_full\\_report\\_2011.pdf](http://www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2011/STAGING/local_assets/pdf/statistical_review_of_world_energy_full_report_2011.pdf))

global oil market and to defend a certain oil price at which the Saudis or other OPEC countries agreed to sell their oil through regulating its oil output.<sup>15</sup> For example, since 1973, the Kingdom has cut its own oil production sharply in order to maintain the market share of OPEC.<sup>16</sup> When the Iranian Revolution took place in 1979 and Iran cut its daily production of oil sharply from 5.242 million barrels per day (MBD) in 1978 to 3.168 MBD in 1979<sup>17</sup>, Riyadh increased its supply of crude oil to offset a sharp drop in oil supplies from Iran. As the competition among oil exporters became severe so that there was a glut on the world oil market in the early 1980s, the Kingdom lowered its oil production to play the roles of swing producer and oil “price cushion.”<sup>18</sup>

As Saudi Arabia presented itself as swing producer, it began to draw up considerably distinctive oil policy different from those of other OPEC countries. One of the most conspicuous characteristics of the Saudi oil policy was that it preferred the low level of oil price in the

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<sup>15</sup> Paul Aarts and Michael Renner, “Oil and the Gulf War,” *Middle East Report*, No. 171 (July-August 1991), p. 27.

<sup>16</sup> Charles F. Doran, “OPEC Cohesion: The Myth of Perpetual Unity,” in Charles F. Doran, *Myth, Oil, and Politics: Introduction to the Political Economy of Petroleum* (New York: Free Press, 1977), pp. 143-144.

<sup>17</sup> Energy Information Administration, *Historical Monthly Energy Review 1973-1992* (Washington: EIA, 1993), p. 302.

<sup>18</sup> The world oil market used to be cushioned from the worst effects of various political and economic factors such as U.S. oil production peaked and increase in non-OPEC suppliers by Saudi production. Charles F. Doran, “Life after Easy Oil,” *The American Interest*, Vol. 3, No. 6 (July-August 2008), pp. 44.

dispute<sup>19</sup> on “how prices should go.”<sup>20</sup> At that time, OPEC countries divided into two camps with regard to optimal pricing: the countries preferring high price of oil (price hawks) and those in favor of low oil price (price doves). These price hawks, comprised of Iran, Iraq, Nigeria and Libya, were “characterized by large populations, massive development programs, major plans for military buildup, and hence demand for amounts of revenue, provided in part by high export prices for crude.”<sup>21</sup> They felt that they had lost lots of incomes from oil exports because of Western governments and multinational companies. Therefore, they wanted to increase oil prices as much as possible so that they could develop their economies to meet national requirements and cared little for resolution of sudden rise in oil price or for long-term approach to petroleum production. Saudi Arabia and the Moderate Arabs such as Egypt, Jordan, and Palestine<sup>22</sup> referred to as the price doves, by contrast, were “characterized by small populations, limited capital absorption capability, large and vulnerable financial reserves, and huge untapped reserves of petroleum.”<sup>23</sup> “The doves were willing

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<sup>19</sup> See more details in Doran, 1977, p. 142; Harry Hurt, “The New Energy Crisis: OPEC Versus OPEC,” *Texas Monthly*, August 1982, pp. 185-186; Robert K. Schaeffer, *Understanding Globalization: the Social Consequences of Political, Economic, and Environmental Change* (Lanham: Rowman & Littlefield, 2005), p. 259. (The third direct quotation is from Schaeffer.)

<sup>20</sup> Schaeffer, 2005, p. 259.

<sup>21</sup> Doran, 1977, p. 142.

<sup>22</sup> These three countries have not joined OPEC. Though they participated in the discussion on the level of optimal oil prices since they as the Arab countries were deeply related to the OPEC members’ decision making process on oil pricing.

<sup>23</sup> Doran, 1977, p. 142.

to settle for lower prices than the hawks because they did not want high prices to cripple the world economy”<sup>24</sup> and they rather wanted to extend the lifespan of oil resources.

As one of the doves, Saudi Arabia was the only OPEC country which continued to criticize the OPEC's pricing decision to increase its selling price of crude oil as well as disagreed to “increase the royalty rate on the companies’ 40% crude entitlement (known as equity oil) from 12.5% to 14.5%.”<sup>25</sup> When the world economy was contracting in the aftermath the Iranian Revolution, Saudi Arabia issued the ‘Yamani Edict’ which “stated that Saudi Arabia would keep to official prices, no surcharges.”<sup>26</sup>

In addition, Saudi Arabia insisted that the four Aramco companies<sup>27</sup> sell at those official prices both to their own affiliates and to third-party buyers.”<sup>28</sup> When the industrialized countries and the major companies suffered from a drop in the Iranian oil supplies in 1979, it was, as mentioned above, the Kingdom that supplied the increased volume of crude oil to the market at a reasonable price by preventing the Aramco companies from attempting to increase the selling price of crude oil. According to the Yamani Edict, Aramco partners would be restricted to “reselling Saudi oil at anything other

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<sup>24</sup> Schaeffer, 2005, p. 259.

<sup>25</sup> EUR, *The Middle East and North Africa 2003* (London: Routledge, 2002), p. 120.

<sup>26</sup> Daniel Yergin, *The Prize: the Epic Quest for Oil, Money & Power* (New York: Simon & Schuster, 1992), p. 690.

<sup>27</sup> They include Exxon, Mobil, Texaco, and Chevron.

<sup>28</sup> Yergin, 1992, p. 690.

than official prices”<sup>29</sup> and Aramco companies “would not renew crude oil sales contracts, including a new round of anxiety and creating serious supply problems for many independent refiners.”<sup>30</sup>

In 1982, the oil minister of Saudi Arabia, Yamani Sheikh affirmed after the March meeting in Vienna that the Saudi consistent role in OPEC had been “the stabilization of the price of oil” and the Kingdom had been trying “to avoid any sharp increases in the price, and at the same time to avoid any energy crisis.”<sup>31</sup> His announcement clearly mirrors what had bothered the Saudis. The Saudi policy makers were “concerned about the impact of high energy prices on the economic stability of the West, the source of its technology and guardian of its own increasingly anachronistic political regime.”<sup>32</sup> In a word, the Saudis’ low-price preference was directly related to its political survival.

To cope with the instability of world oil market and price volatility, Saudi Arabia acted as a swing producer. It was the Saudi swing-producer role that “supplied the balancing quantities to meet market requirements”<sup>33</sup> and maintained the proper level of OPEC prices. The Kingdom obeyed the official OPEC price even though other members were routinely cheating on the OPEC agreements and informally offering special discounts to their customers as the

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<sup>29</sup> Samuel Van Vactor, *Introduction to the Global Oil & Gas Business* (Oklahoma: Pennwell Books, 2010), p. 113.

<sup>30</sup> Vactor, 2010, p. 113.

<sup>31</sup> Hurt, 1982, p. 184.

<sup>32</sup> Doran, 1977, p. 142.

<sup>33</sup> Yergin, 1992, p. 721.

competition between the OPEC and non-OPEC suppliers got bitterer. Saudi Arabia repeatedly warned other members of OPEC that if they kept cheating on OPEC's fixed prices and production quotas, "it would not indefinitely tolerate and underwrite quota violations by other OPEC countries and increased production by the non-OPEC nations."<sup>34</sup>

## **2) Research Question on the Saudi Role as Swing Producer**

As of August 1985, Saudi Arabia seemed to take a completely opposite stand on fluctuations in the global oil market and prices. The Saudis chose to defy quota rules by beginning to pump more oil than its quota allotted. From August 1985 to December 1985, Riyadh's daily oil production rose by 2.340 MBD.<sup>35</sup> Driven mainly by the Kingdom's rapid overproduction, in 1986, the international oil prices suddenly collapsed. The WTI crude oil price fell down from \$31.75 per barrel in November 1985 to approximately \$10 per barrel in 1986 and some crude oil from the Persian Gulf was traded at \$6 per barrel. Nevertheless, rather than reducing the amount of oil production in order that it could fulfill the swing-producer role, the Kingdom raised up its own oil outputs. And Saudi Arabia ceased trading its oil at official OPEC price. The Saudi policy makers abandoned the OPEC-administered pricing system and at the same time adopted the market-friendly 'netback pricing system'<sup>36</sup> in 1986.

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<sup>34</sup> Yamani, 1992, p. 747.

<sup>35</sup> EIA, 1993, p. 309.

<sup>36</sup> The netback pricing system involved a general formula in which the price of crude

As above, sudden change in the Saudi policy for oil production could not be clearly understood based on its previous behaviors. Riyadh tried to stabilize the world oil prices by controlling its own output during the period between the 1970s and the early 1980s. The Kingdom's policy change in August 1985 surprised the West then and there arose many questions as to the Saudi choice. Therefore, this thesis elaborates on the research question as follows: even though Saudi Arabia had tried to keep the oil market stable, why did it suddenly increase the production volume of crudes in 1985 to make the oil prices collapse? And this paper insists that Riyadh made a policy shift and decided to boost its oil production in August 1985 as a way to contain the perceived military threats and strengthen its security.

To explore the research question, I will review the previous literatures in which Saudi Arabia and OPEC have been analyzed overall in the next section and reflect them in my main assumption throughout the rest of the thesis. The following section will introduce some of the researches covering the Saudis' oil policy and other studies analyzing the behaviors of Saudi Arabia and OPEC.

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oil was set equal to the *ex post* product realization minus refining and transport costs. The countries with it were likely to attract many Western oil companies since it provided oil companies with a guaranteed refining margin even if oil prices were to collapse. Bassam Fattouh, "The Origins and Evolution of the Current International Oil Pricing System," in Robert Mabro (eds.), *Oil in the 21st century: Issues, Challenges and Opportunities* (Oxford: Oxford University Press, 2006), pp. 51-52.

## 2. Literature Review

On the Saudis' sharp increase in their production of crudes in August 1985, most researches have emphasized the poor economic situation of the Kingdom in the mid-1980s and made two key assumptions. First, some of the researchers assumed that Saudi Arabia suffered a serious economic depression that obliged it to suddenly increase the oil-production volume in August 1985. Krimly(1999)<sup>37</sup> argued that in the mid-1980s the Saudis faced with declining revenues and a budget deficit, which caused the Saudi leaders to pump up more oil to meet the demand for national incomes. Focusing on the Saudi agricultural sector, Looney(1990)<sup>38</sup> gave a hint that Riyadh called for a large increase in oil production to realize the Saudi Fourth Development Plan which came into effect in 1985.

Second, other researchers placed considerable attention to the shrunk market share of Saudi Arabia as a determinant factor of the Kingdom's increasing its oil production. Based on this assumption, Gately(1986)<sup>39</sup> accounted for Riyadh's increased production as an

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<sup>37</sup> Rayed Krimly, "The Political Economy of Adjusted Priorities: Declining Oil Revenues and Saudi Fiscal Policies," *The Middle East Journal*, Vol. 53, No. 2 (Spring 1999), pp. 254-267.

<sup>38</sup> Robert E. Looney, "Saudi Arabian Budgetary Dilemmas," *Middle Eastern Studies*, Vol. 26, No. 1 (January 1990), pp. 76-87.

<sup>39</sup> Dermot Gately, "Lessons from the 1986 Oil Price Collapse," *Brookings Papers on Economic Activity*, Vol. 1986, No. 2 (1986), pp. 237-284.

intention to extend its market share. Similarly, Parra(2004)<sup>40</sup> argued that “the Saudis could not afford to wait any longer before taking action to restore their sadly eroded market position.”<sup>41</sup>

From the perspectives of collective action theory or game theory, some researches underlined the Kingdom’s intention to retaliate on other OPEC members to understand its increased oil-production in 1985. Griffin(1992)<sup>42</sup> and Griffin and Neilson(1994)<sup>43</sup> stated that the Kingdom determined to increase its oil-production volume as a tit-for-tat strategy in order to punish some of OPEC members which overproduced crudes beyond their quotas permitted. Gause III(2000)<sup>44</sup> also argued that the Saudis increased production in an attempt to “discipline overproducers inside and outside of OPEC.”<sup>45</sup>

Notwithstanding several meaningful researches presented, it seems necessary to rest upon the studies which have dealt with the general pattern of Saudi Arabia’s market behaviors because of the small number of researches trying to explain the Saudis’ production

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<sup>40</sup> Francisco Parra, *Oil Politics: A Modern History of Petroleum* (London: IB Tauris, 2004).

<sup>41</sup> Parra, 2004, p. 284.

<sup>42</sup> James M. Griffin, “OPEC and World Oil Prices: Is the Genie Back in the Bottle?,” *Energy Studies Review*, Vol. 4, No. 1 (1992), pp. 27-39.

<sup>43</sup> James M. Griffin and William S. Neilson, “The 1985-86 Oil Price Collapse and Afterwards: What Does Game Theory Add?,” *Economic Inquiry*, Vol. 32 (October 1994), pp. 543-561.

<sup>44</sup> F. Gregory Gause III, “Saudi Arabia over a Barrel,” *Foreign Affairs*, Vol. 79, No. 3 (May/June 2000), pp. 80-94.

<sup>45</sup> Gause III, 2000, p. 87.

policy in 1985. There have been many efforts to grasp the behaviors of Saudi Arabia and OPEC by setting models to analyze and predict them. Among those researches, many authors have focused on identifying the Saudis' action as a swing producer as well as on explaining OPEC as a cartel.

Many researchers developed over the past 36 years show that Saudi Arabia tried to set its own diplomatic position in OPEC as a swing producer. Adelman(1982a, 1985)<sup>46</sup>, Al-Yousef(1998)<sup>47</sup>, Doran(1977, 1991, 2008)<sup>48</sup>, Gately(1984)<sup>49</sup>, Mabro(1975, 1991)<sup>50</sup>, and Stevens(1982, 1991)<sup>51</sup> identified that the Kingdom had strongly influenced on the world oil prices and had played the role of swing producer during the period from the 1970s to the mid-1980s by

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<sup>46</sup> M. A. Adelman, "OPEC as a Cartel," in James M. Griffin and David J. Teece (eds.), *OPEC Behavior and World Oil Prices* (London: George Allen & Unwin, 1982(a)), pp. 39-61; Adelman, 1985, pp. 17-22.

<sup>47</sup> Nourah AbdullRahman Al-Yousef, "Modelling Saudi Arabia Behaviour in the World Oil Market 1976-1996," *Economic Studies*, Vol. 3, No. 6 (1998), pp. 11-47

<sup>48</sup> Doran, 1977, pp. 133-156; Charles F. Doran, "Gulf Security in Perspective," in Charles F. Doran and Stephen W. Buck (eds.), *The Gulf, Energy, and Global Security: Political and Economic Issues* (Boulder & London: Lynne Rienner Publishers, 1991), pp. 189-208; Doran, 2008, pp. 43-51.

<sup>49</sup> Dermot Gately, "A Ten-Year Retrospective: OPEC and the World Oil Market," *Journal of Economic Literature*, Vol. 22, No. 3 (September 1984), pp. 1100-1114.

<sup>50</sup> Robert Mabro, "Can OPEC Hold the Line," in R. Mabro (eds.), *OPEC and the World Oil Market: The Genesis of the 1986 Price Crisis* (Oxford: Oxford Institute for Energy Studies, 1975), pp. 13-22; Robert Mabro, "OPEC and the Price of Oil," *The Energy Journal*, Vol. 13, No. 2 (April 1991), pp. 1-17.

<sup>51</sup> P. Stevens, "Saudi Arabia's Oil Policy in the 1970's: its Origin, Implementation and Implication," in T. Niblock, *State, Society and Economy in Saudi Arabia* (London: Croom Helm Ltd. 1982), pp. 214-234.

controlling its own outputs. Mabro(1975) argued that Saudi Arabia was reckoned to be a ‘residual supplier’ in the 1970s because it could sell some oil reserves in the situations in which the market demand for oil was in excess of the oil supplied in the market. Relying on the dominant producer theory, he also contended that Saudi Arabia was able to act as ‘the Stackelberg price leader’<sup>52</sup> in the early 1980s when the decline in demand for OPEC oil caused difficulties in maintaining the official OPEC prices.

In order to explain why Saudi Arabia has taken the swing-producer role, several scholars have applied numerous economic models to the role of Saudi Arabia and the Saudi decision-making process during the periods of the 1970s and 1980s. Based on the assumption that the cartel of OPEC had so dominated the world oil market that it became monopolistic or oligopolistic rather than competitive, several economic approaches have been made to explain what OPEC or Saudi Arabia intended to: the dominant firm model, the competitive model, the Cournot model, and the Stackelberg model.

First, the dominant firm model argues that “the dominant firm has control over world oil prices but not its competitors’ output.”<sup>53</sup> The answer to who the dominant firm is, however, varies according to researchers: Saudi Arabia, OPEC as a whole, and OPEC core countries.<sup>54</sup> Some authors mainly consider Saudi Arabia as the dominant firm. Elaborately designed surveys focusing on Saudi Arabia

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<sup>52</sup> The Stackelberg game will be dealt with on pages 13-14.

<sup>53</sup> Alhajji and Huettner, 2000, p. 33.

<sup>54</sup> The core consists of four members, Saudi Arabia, Kuwait, the UAE and Qatar.

are conducted by Adelman(1985)<sup>55</sup>, Alhajji and Huettner(2000)<sup>56</sup>, Erickson(1980)<sup>57</sup>, Mabro(1986)<sup>58</sup>, Plaut(1981)<sup>59</sup>, and Singer(1983)<sup>60</sup>. The paper by Adelman(1985) is one of the most notable studies which developed the way to understand the behavior of Saudi Arabia. He notes that the Kingdom has played the role as the dominant firm whenever the OPEC cartel failed to fully cooperate on its output. Alhajji and Huettner(2000), comparing the dominant firm model with a wide range of models including the competitive, Cournot, and non-competitive models, draw a conclusion from this quantitative statistical test that neither OPEC, nor the core fits the dominant firm model but Saudi Arabia does. Eckbo(1976)<sup>61</sup> and Pindyck(1978)<sup>62</sup> treat the core countries of OPEC as dominant suppliers. Pindyck(1978) introduces the dominant firm model to show that behaviors of OPEC

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<sup>55</sup> M. A. Adelman, "An Unstable World Oil Market," *The Energy Journal*, Vol. 6, No. 1 (1985), pp. 17-22.

<sup>56</sup> A. F. Alhajji and David Huettner, "OPEC and World Crude Oil Markets from 1973 to 1994: Cartel, Oligopoly, or Competitive?," *The Energy Journal*, Vol. 21, No. 3 (2000), pp. 31-60.

<sup>57</sup> N. Erickson, "Developments in the World Oil Market," in Rajendra K. Pachauri (eds.), *International Energy Studies* (New York: Wiley and Sons, 1980).

<sup>58</sup> Robert Mabro, *OPEC and the World Oil Market* (Oxford: Oxford University Press, 1986).

<sup>59</sup> Steven Plaut, "OPEC is Not a Cartel," *Challenge*, Vol. 24, No. 5 (November-December 1981), pp. 18-24.

<sup>60</sup> S. Fred Singer, "The Price of World Oil," *Annual Review of Energy*, Vol. 8 (1983), pp. 97-116.

<sup>61</sup> Paul Leo Eckbo, *The Future of World Oil* (Cambridge: Ballinger, 1976).

<sup>62</sup> Robert S. Pindyck, "Gains to Producers from the Cartelization of Exhaustible Resources," *The Review of Economics and Statistics*, Vol. 60, No. 2 (April 1978), pp. 238-247.

are predictable because the decisions by OPEC core countries make OPEC move only when they are certain that these actions are likely to bring them optimal economic gains.

Second, the studies based on the competitive model believe that the market is intrinsically competitive, and thereby we do not necessarily model the behaviors of Saudi Arabia or of OPEC. So the scholars who employ this model assume that oil price fluctuations were caused not by the intention of OPEC to maximize their economic profits or political leverages but by the competitive nature of the market. In the literature, Verleger(1987)<sup>63</sup> ascribes oil crisis to the demanders of energy and Adelman(1982b)<sup>64</sup> contends that the Second Oil Crisis was fueled by excess demand of oil in the world market. The paper conducted by Crémer and Salehi-Isfahani(1989)<sup>65</sup> asserts that “a high price equilibrium must exist”<sup>66</sup> in the market and the oil crises can be explained considering “the move from the low to the high price equilibrium must be followed by expectations of a long run price increase.”<sup>67</sup> In the updated studies of 1991<sup>68</sup>, they underline that Saudi

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<sup>63</sup> P. K. Verleger, “The Evaluation of Oil as a Commodity,” in Richard L. Gordon, Henry D. Jacoby and Martin B. Zimmerman, *Energy-Markets and Regulation: Essays in Honor of M. A. Adelman* (Cambridge: MIT Press, 1987).

<sup>64</sup> M. A. Adelman, “Coping with Supply Insecurity,” *The Energy Journal*, Vol. 3, No. 2 (1982b), pp. 1-17.

<sup>65</sup> Jacques Crémer and Djavad Salehi-Isfahani, “The Rise and Fall of Oil Prices: A Competitive View,” *Annales d’Economie et de Statistique*, No. 15-16 (July-December 1989), pp. 427-454.

<sup>66</sup> Crémer and Salehi-Isfahani, 1989, p. 431.

<sup>67</sup> Crémer and Salehi-Isfahani, 1989, p. 432.

<sup>68</sup> Crémer and Salehi-Isfahani, *Models of the Oil Market* (New York: Harwood

Arabia influences little on the world market in the long run because the world demand and supply of the fringe<sup>69</sup> are far more elastic.

Third, the Cournot model rests on the assumption that two companies compete with each other on the quantity of output in a duopolistic market and that the quality of their products is homogeneous, which means their marginal costs are the same. The Cournot solution which means the equilibrium price is set at the level that each firm's "market share divided by the elasticity of demand"<sup>70</sup> maximizes its profits. In the Cournot model, OPEC can choose its optimal output given the previous outputs of non-OPEC countries. Griffin and Neilson(1994)<sup>71</sup> adopt the Cournot model and game theory to the strategies executed by OPEC in the 1980s. According to them, OPEC accepted to play the role of swing producer seeking to maximize the profits of its own cartel during the period from 1983 to 1985. By August 1985, however, the Kingdom abandoned the swing-producer role and endeavored to boost the oil price to the Cournot level since its market share fell down "below the trigger market share at which Cournot profits would be higher."<sup>72</sup> And Saudi Arabia adopted a tit-for-tat strategy to punish other OPEC countries for rampant cheatings on production quota.

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Academic Publishers, 1991).

<sup>69</sup> This term here is referred to as all the energy suppliers in the world minus Saudi Arabia.

<sup>70</sup> R. Preston McAfee and Tracy R. Lewis, *Introduction to Economic Analysis*, Available at <http://www.mcafee.cc/Introecon/IEA.pdf>

<sup>71</sup> Griffin and Neilson, 1994, pp. 543-561.

<sup>72</sup> Griffin and Neilson, 1994, p. 558.

Finally, there have been made consistent attempts to take advantage of the Stackelberg model<sup>73</sup> beyond the Cournot model in the literature as well. In the Cournot model, analysts' main concern is each player's output on which two players compete with each other in a duopolistic market and they have little interest in the sequence of choices made by players. On the other hand, the concept of sequence is a matter of critical importance to the researchers who make use of the Stackelberg model. In the Stackelberg market, players are divided into a Stackelberg leader and followers. The leader company decides how much products it will produce considering the follower's production strategies as the games reiterate. The followers respond to the leader's choice accordingly. Even though the followers react to the leader by planning a new strategy, their pay-offs are always lower than that of the leader. As mentioned earlier, Mabro(1975)<sup>74</sup> defines Saudi Arabia as the Stackelberg leader within OPEC. In the situation in which Saudi Arabia is considered as the Stackelberg leader, the Kingdom decides the optimal oil price and output based on its own estimation of other OPEC members' outputs or likely impacts of its decision on them.<sup>75</sup> And Huppmann and Holtz(2010)<sup>76</sup> explicitly state that Saudi Arabia,

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<sup>73</sup> See Patrick T. Harker, "Generalized Nash Games and Quasi-variational Inequalities," *European Journal of Operational Research*, Vol. 54 (1991), p. 91; Eric Rasmusen, *Games and Information: an Introduction to Game Theory* (Malden: Blackwell Publishing, 2007), pp. 89-90.

<sup>74</sup> Mabro, 1975, pp. 13-22.

<sup>75</sup> Andrew Pickering, "The Oil Reserves Production Relationship," *Energy Economics*, Vol. 30, No. 2 (March 2008), p. 357.

<sup>76</sup> Daniel Huppmann and Franziska Holz, "Global Oil Markets Revisited: Cartel or Stackelberg Market?," *Paper presented at the Annual Meeting of the Verein für*

not OPEC as a whole, only acts as the Stackelberg leader with the ability “to increase its own profits at the expense of other suppliers”<sup>77</sup> and “to enforce joint profit optimization.”<sup>78</sup>

As seen ahead, the studies from an economic point of view have provided a few assumptions on the whole. First, Saudi Arabia and OPEC have an ability to control oil prices. In this sense, the Saudis’ behavior has been labeled as a swing producer or a dominant firm. Second, they also can choose their optimal oil outputs in the market. Third, Saudi Arabia decides on its output considering other OPEC countries’ strategies. Finally, any fluctuations in the oil market are rarely driven by the Kingdom or OPEC.

The approaches employing several economic models have the advantage of simplifying research objects and clarifying the relationship between variables. But their research objects, the world oil market in particular, are not as simple as in the models. Rather, the world oil market and both internal and external structures of OPEC are extremely complex and complicated. Many political concerns such as the Arab-Israel war and the Gulf war are actually intertwined with economic ones and they exert huge influence on the decision-making process of OPEC members.

Too much simplification of the realities and little consideration on political factors have led some scholars to turn themselves onto alternative literatures. And the political explanations, despite the small

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*Socialpolitik 2010*, pp. 1-22.

<sup>77</sup> Huppmann and Holz, 2010, p. 13.

<sup>78</sup> Huppmann and Holz, 2010, p. 12.

number of those examined yet, have newly emerged as a persuasive alternative literature. Claes(2001)<sup>79</sup>, Doran(1977) and Moran(1982)<sup>80</sup> have made an meaningful attempt to give special consideration to key political variables. Doran(1977) points out that there is no hard evidence to suppose OPEC cohesion is permanent and shows what hinders the unity of OPEC.<sup>81</sup> He particularly presents a theory of cartel conflict<sup>82</sup> as a framework for assessing the possible interplay of OPEC members. Moran(1982) concludes that Saudi Arabia, taken as the dominant firm of the world oil market, has attempted to control oil prices seeking to maximize its political interests. Claes(1999, 2001)<sup>83</sup>,

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<sup>79</sup> Dag Herald Claes, *The Politics of Oil-Producer Cooperation* (Colorado: Westview Press, 2001).

<sup>80</sup> Theodore Moran, "Modeling OPEC behavior: Economic and Political Alternatives," in James Griffin and David Teece (eds.), *OPEC Behavior and World Oil Prices* (London: Allen and Unwin, 1982).

<sup>81</sup> He insisted that OPEC member states were hard to reach cohesion owing to conflicts of intra-OPEC market interest, inability to agree on market shares, Saudi reluctance to assume full burden of production constraint, growing appetite in OPEC for revenue, and slow growth of world energy demand. During the 1970s the world economy contracted so severely due to the oil shocks that the demand for energy began to decrease in the late 1970s. The global demand for energy resources, of course, has risen since the Gulf War. Doran, 1977, pp. 142-146.

<sup>82</sup> For an analysis of cartel conflicts, he identifies two source of potential OPEC conflict, type A and type B. Type A conflict is the tension between the members of the cartel arising over an equitable and efficient distribution of market shares and Type B conflict is the tension generated by external pressure on the cartel from policies of the consumer nations and from other entrants into the market (through large new discoveries). These two types of conflict are interrelated and cannot meaningfully occur in isolation. Doran, 1977, pp. 149-152.

<sup>83</sup> Dag Herald Claes, "What Do Theories of International Regimes Contribute to the Explanation of Cooperation (and Failure of Cooperation) among Oil-Producing

based on the assumptions of Gilpin(1981)<sup>84</sup>, defines the roles of Saudi Arabia in the cases of the First Oil Crisis and the early 1980s, and the one in the aftermath of the oil price collapse in the middle 1980s as incapable hegemon, benevolent hegemon, and coercive hegemon<sup>85</sup>

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Countries?,” *ARENA Working Paper*, Vol. 12 (1999), pp. 1-17. Available at [http://www.sv.uio.no/arena/english/research/publications/arena-publications/workingpapers/working-papers1999/wp99\\_12.htm](http://www.sv.uio.no/arena/english/research/publications/arena-publications/workingpapers/working-papers1999/wp99_12.htm); Claes, 2001.

<sup>84</sup> “Gilpin has outlined five assumptions concerning states’ behavior leading to what he calls international political change: (a) an international system is stable if no state believes it profitable to attempt to change the system. (b) A state will attempt to change the international system if the expected benefits exceed the expected costs. (c) A state will seek to change the international system until the marginal costs of further change are equal to, or greater than, the marginal benefits. (d) Once equilibrium between the costs and benefits of further change is reached, the tendency is for the economic costs of maintaining the status quo to rise faster than the economic capacity to support the status quo. (e) If the disequilibrium in the international system is not resolved, then the system will be changed, and a new equilibrium reflecting the redistribution of power will be established.” He captured the environment under which the international political system changed and his explanation for hegemon provided a theoretical basis for Clae’s analysis on the Saudi behaviors. Robert Gilpin, *War and Change in World Politics* (Cambridge: Cambridge University Press, 1981), pp. 10-11. Cited in Claes, 2001, p. 204.

<sup>85</sup> The Saudi policy from 1973 to 1981 is characterized as incapable hegemon since the Kingdom failed to occupy a hegemonic position due to the market conditions and the policies of other OPEC countries. During the period from 1982 to 1985, Saudi Arabia was willing to sacrifice its market share and oil incomes to sustain the OPEC system by playing a role of swing producer, which makes the Kingdom be considered as a benevolent hegemon. From the summer of 1985 to 1996, Riyadh gave up the benevolent strategy and increased its production of crudes. It was a signal sent to other OPEC members to observe their quota discipline. Claes defines the Saudi behavior during the period as coercive hegemon. Claes, 2001, pp. 217-234.

respectively. Besides, Krapels(1993)<sup>86</sup>, with his emphasis on international political factors, argues that the preference of the United States has wielded a deep influence on the Saudis' policies on OPEC.

As an overview of the research trend in the global politics of energy field presented ahead, many studies have been developed mostly to analyze the behaviors and strategies of Saudi Arabia and OPEC so far. Most of them take economic approaches to grasp what caused the oil crises or price disruptions. Resting on several economic models such as the dominant firm model and the Cournot model, they have provided useful tools for quantifying the behaviors of Saudi Arabia and OPEC, calculating them, and predicting them. Economic approaches, however, have met criticism on their applicability to the real world market as they ignored alternative, political in particular, influences on the international oil market, treating them as '*ceteris paribus*.' The poor performance of economic approaches leads a small number of economists like Alhajji and Huettner(2000) to conduct more comprehensive surveys by applying political factors to them, and yet they do not cover the internal dynamics of OPEC or decision making in the Saudi government.

Hence, I will present a comprehensive approach to analyzing the behaviors of Saudi Arabia by covering the economic and political dimensions, while giving more consideration to political factors such as military threat and bilateral relations with US. To provide a clear empirical support, the paper will address the Saudis' oil-production

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<sup>86</sup> Edward Krapels, "The Commanding Heights: International Oil in a Changed World," *International Affairs*, Vol. 69, No. 1 (January 1993), pp. 71-88.

policy in 1985. Most researches dealing with the Saudi oil policy in 1985 have assumed that the Saudis increased its oil-production volume in August 1985 as they intended to punish some of OPEC members which overproduced crudes beyond their quotas allotted or as they, suffered from seriously sunk revenues, wanted to restore their eroded market share. As I will cover the negotiations within the OPEC, the domestic economy of the Kingdom, and the political pressures on the Saudi government, the paper will be able to answer to what triggered the Saudis' decision to sharply increase their oil-production volume in 1985.

### **3. Research Hypothesis and Methodology**

#### **1) Research Hypothesis**

The dependent variable of the study is Saudi Arabia's urgent need for national incomes. And during the second half of 1985, it was met by a substantial increase in the Kingdom's oil outputs which ignored other OPEC members' expectations. In the early 1980s, OPEC adopted a ceiling for OPEC production and allocated individual quotas to the respective OPEC countries. However some of OPEC members cheated rampantly on their production quotas allotted. It was solely Saudi Arabia among the OPEC members that cut its output to stabilize the world oil prices. As a swing producer within OPEC, Saudi Arabia controlled its oil outputs not to exceed the overall OPEC ceiling. Since

other OPEC countries were consistently reluctant to decrease their oil production, the Saudis' attempt to raise its revenues in August 1985, therefore, signifies the reduction in the Saudi swing-producer role.

And I presume two independent variables to have affected the dependent variable. The first independent variable is Saudi Arabia's recognition of a serious threat to its security. The second one is Saudi Arabia's need for its economic development. Based on these variables, I will offer two hypotheses of the study.

The fundamental hypothesis of the study is that *Saudi Arabia needed to boost its oil revenues as the international and regional threats to its security got higher* (Hypothesis (A)). Since the early 1980s, the Kingdom had been under the political and military pressures outside its own territory both regionally and internationally, which meant that it had very few policy options at its disposal. There broke out the Iran-Iraq war in 1980 and Israel invaded Lebanon in 1982. In the aftermath of the 1979 Iranian Revolution, the Union of Soviet Socialist Republics (USSR) had been on the alert for an opportunity to expand its influence upon the Middle East and the Northern Africa and it awakened the US government to the realization that supremacy of the US in these regions was rattling. Under these insecure environments, Saudi Arabia had nothing to do but minimize its economic sacrifices which it had managed to make, faced with a large-scale collapse of oil price. The Kingdom increased sharply its oil output in August 1985 in order to enhance its military security and to strengthen the bilateral relationship with the United States. In other words, the Kingdom attempted to employ economic means (reducing its swing-producer role)

for achieving political aims (external political stability).

Of course, other factors could have influenced the Saudis behaviors in 1985. As numerous researches highlighted, *Saudi Arabia might have needed to boost its oil revenues so as to develop its national economy* (Hypothesis (B)). Riyadh suffered from the shrinking oil revenues in the early 1980s and growing sub-regional and social inequalities. Since the Saudi economy was highly depended on the oil industry, the plummeted oil incomes might have caused social unrest. Dissatisfied with the decreased benefits, the Saudi people could have threatened the political stability of the Saudi royal regime. The domestic economic problems were, therefore, intertwined closely with the social and political problems in the Kingdom. To tackle these economic problems, the Kingdom might have decided to increase the production of oil in August 1985 and to sell its crudes at a discounted price. Even though the Hypothesis (A) is the main idea with which I will deal, the paper will also cover the domestic economy of Saudi Arabia to examine the applicability of the hypothesis to the analysis on the Saudi behaviors in 1985.

## **2) Methodology**

In terms of methodology, this study, to cope with the shift in the Saudi policies with regard to its oil output and to the swing producer role in the international market, requires a theoretical appreciation of ‘International Political Economy (IPE).’ As the IPE tradition mainly focuses on “how the state and its associated political processes affect

the production and distribution of wealth and, in particular, how political decisions and interests influence the location of economic activities and the distribution of the costs and benefits of these activities,”<sup>87</sup> the study employs IPE as a conceptual framework.

To explore the research hypotheses, I will look at the Saudi economy and the political context of the Saudis in the mid-1980s. In terms of the external political stability, I will investigate the historical contexts, arms transfer, and the Saudi military expenditures. And I will cover several economic indicators such as oil revenues, GDP, and governmental expenditures to analyze the causal relations between the 1985 oil-production policy and the Kingdom’s economy. Several issues including sub-regional inequality and foreign labors will be addressed as well.

In the study, a broad period of time will be examined. I will investigate Saudi Arabia’s historical context during the second half of the 1990s particularly in the chapter 4. A long-term analysis will be necessary since I have to dig into what had posed a serious threat to Saudi Arabia’s security. I will find out when the critical point was by scrutinizing the political contexts under which the Kingdom was placed. In the chapter 2, the period during the early 1980s will be highlighted. The early 1980s was the important period to study on the Saudis’ behavior because the competition between the suppliers was harsh in the market and the quota system was introduced in OPEC. The quotas allotted to the OPEC countries will be provided in the chapter 2 so as to

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<sup>87</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987), p. 9.

witness some of OPEC members' cheating on the quota system.

And various data will be used throughout the paper. As primary sources, several published reports from OPEC, BP, and SAMA will be cited. I will also quote some articles from a few newspapers and journals to capture the decision-making process of Saudi Arabia in 1985. And various documents and journals will be quoted in the following chapters and help me to prove the plausibility of the hypotheses.

#### **4. Organization of the Thesis**

For coping with the main research question, the analysis of the study consists of three parts. The first part introduces the historical background to the Saudi decision in the chapter 2. It will deal with the brief historical review of the negotiations within the OPEC to establish a price and production structure. In the chapter 3, I will present the analysis of Saudi Arabia in terms of its domestic economy. It covers the reason for attributing the Saudi behavior in August 1985 to the economic vulnerabilities of the Kingdom and simultaneously refutes the economic explanation. Chapter 4, the last part of the study, will draw an explicit conclusion on what motivated Riyadh to increase its oil output from the close and prudent analyses on the political dimension of the Persian Gulf and Saudi Arabia. The conclusion will give a summary of the paper and its implication for the researches on the Kingdom's behaviors, the oil market and energy security.

## II. Historical Background

### 1. Foundation of OPEC and the Coalition between the Members

Substantial studies have defined OPEC as a cartel. These impressions have served us to expect OPEC to act in coalition. It might be plausible at first glance, but within it, meaningful cooperation cannot easily occur between the member countries since the member countries have different interests and perspectives.

Most studies have drawn on the concept of cartel to define OPEC behaviors. The conventional cartel model identifies cartel as “a group of sellers trying to fix prices and outputs in concert, in order to maximize wealth.”<sup>88</sup> And OPEC has been usually construed as a profit-maximizing producer cartel by a lot of researchers in the sense that it was organized in pursuit of common desires “to put an end to price reductions<sup>89</sup> and to adopt the necessary measures to stabilize

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<sup>88</sup> M. A. Adelman, *The Economics of Petroleum Supply: Papers by M. A. Adelman 1962-1993* (Cambridge: MIT Press, 1993), p. 283.

<sup>89</sup> Since the posted price reductions of February 1959, the oil prices had continued to decline due to increases in oil reserves, surplus oil production capacity and the appearance of independent companies whose importance grew as they started controlling, together with the governmental oil concerns, nearly 20 percent of the volume of world oil trade until the creation of OPEC in 1960. Mana Saeed Al-Otaiba, *OPEC and the Petroleum Industry* (New York: Halsted Press, 1975), pp. 107-108; Parra, 2004, pp. 96-98.

prices.”<sup>90</sup> OPEC clarified its common objectives the founder members sought to achieve in full in the form of statute.<sup>91</sup>

## Article 2

A. The principal aim of the Organization shall be the coordination and unification of the petroleum policies of Member Countries and the determination of the best means for safeguarding their interests, individually and collectively.

B. The Organization shall devise ways and means of ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations.

C. Due regard shall be given at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on their capital to those investing in the petroleum industry.<sup>92</sup>

These goals clearly show that OPEC intended to stabilize oil prices as well as to ensure their interests individually and collectively by unifying their individual oil policies.<sup>93</sup>

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<sup>90</sup> Al-Otaiba, 1975, p. 107.

<sup>91</sup> The statute of OPEC was adopted by a unanimous decision of its founder members, Iran, Iraq, Kuwait, Saudi Arabia and Venezuela, under Resolution II.6 at its second meeting held in January 1961 in Caracas, Venezuela. The complete text of the statute is fully available at [http://www.opec.org/opec\\_web/en/publications/345.htm](http://www.opec.org/opec_web/en/publications/345.htm)

<sup>92</sup> OPEC, *OPEC Statute* (Vienna: OPEC Secretariat, 2008), p. 1.

<sup>93</sup> The foundation of OPEC and cartelization of oil producers were, without a doubt, a surprise to the West, and the Western oil media bitterly denounced OPEC. The *Petroleum Press Service*, in its August 1962 issue, stated that “OPEC would

It was the fourth OPEC conference of 1962 when the members of OPEC began to look as a cartel operating by reason that they acted in unison with each other to establish a new price structure as well as to buck the downward trend in oil prices. Pérez Alfonzo, the Venezuelan minister of Mines and Hydrocarbons, strongly required OPEC to introduce a principle of proration at the first session in April 1962. His argument led OPEC to issue three resolutions “calling for negotiations with the (major oil) companies”<sup>94</sup> on modifying the tax system levied on the companies and restoring posted prices not lower than the pre-August 1960 levels.<sup>95</sup> Continued efforts made by the members culminated in “agreements with the companies accepting an offer of partial royalty-expensing, subject to a phase-out of the discounts proposed by the companies.”<sup>96</sup> And at two conferences in 1965, the OPEC Economic Commission set forth a production program with individual quotas allocated to each member, led by Venezuela.<sup>97</sup> Even though it could not be put into effect successfully mainly because of some members including Libya and Iraq against Venezuela’s suggestion, the initial production program could be said to pave the way for the quota system introduced later.

At the beginning of the next decade, OPEC eventually succeeded

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discourage new investments, and undermine confidence in the future of the petroleum industry. *Oil and Gas International* of January 1962, advised the oil companies to resist “the squeeze.”” See Al-Otaiba, 1975, pp. 60-61.

<sup>94</sup> Parra, 2004, p. 101.

<sup>95</sup> Parra, 2004, pp. 101-102; Al-Otaiba, 1975, p. 109.

<sup>96</sup> Parra, 2004, pp. 104-105.

<sup>97</sup> Parra, 2004, pp. 105-106.

in arriving at agreements with the majors to change fundamentally “the petroleum market from a buyers’ market to a sellers’ market, thereby strengthening the position of the producing countries and weakening the position of the companies”<sup>98</sup>.<sup>99</sup> Triggered by the Libyan revolution and several events, the Tripoli Agreement was concluded in September 1970 and during the Tripoli conference period, the Libyan government reached settlements in turn on increasing the posted prices of Libyan crudes<sup>100</sup> with the companies including Exxon, BP, Texaco and Chevron.<sup>101</sup> The Tehran Agreement of February 1971 increased “the posted price at Gulf terminals by \$0.33.”<sup>102</sup> The second Tripoli Agreement, 20 March 1971, ramped up “the posted price to \$3.32 per barrel of 40° API<sup>103</sup>.”<sup>104</sup> It was followed by the Geneva agreement of January 1972 “increasing the posted price in compensation for the loss in value of the US dollar and the subsequent loss of the real income of

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<sup>98</sup> The companies indicate the major oil companies such as Exxon, BP, Texaco and Chevron.

<sup>99</sup> Al-Otaiba, 1975, p. 116.

<sup>100</sup> Libyan crude oil prices had been “under-posted in comparison with prices in the Middle East, after taking the factors of density, quality, sulphur content and geographic location into account.” See Al-Otaiba, 1975, p. 117.

<sup>101</sup> Parra, 2004, pp. 121-125; Al-Otaiba, 1975, pp. 115-117.

<sup>102</sup> Shukri Mohammed Ghanem, *OPEC, the Rise and Fall of an Exclusive Club* (London: Taylor & Francis, 1986), p. 36.

<sup>103</sup> API gravity expresses the gravity or density of liquid petroleum products devised jointly by the American Petroleum Institute and the National Institute of Standards and Technology. The definition of the term is available at [http://www.engineeringtoolbox.com/api-gravity-d\\_1212.html](http://www.engineeringtoolbox.com/api-gravity-d_1212.html)

<sup>104</sup> Ghanem, 1986, p. 37.

the producing countries.”<sup>105</sup> The member countries, through a series of conferences held in the early 1970s, reconstructed the international oil market to be marked by the dominance of the oil-producing countries.

The development of OPEC price structure as well as its creation proved conclusively that the OPEC nations had commonly sought to increase both collective and individual interests. Owing to the increased posted prices, OPEC as a whole and the member states all could wrest “control over oil pricing policy from the major Western oil companies.”<sup>106</sup> And “petrodollars flooded into the central coffers of oil-producing countries in what amounted to one of the most dramatic transfers of wealth in human history” as oil prices “soared to previously unimaginable heights” to the end of the 1970s.<sup>107</sup>

As the logic of collective action indicated, the group of OPEC definitely aimed at common objectives, stabilization of oil prices and profit-maximizing, which were collective benefits “that by its very nature would benefit all of members of the group.”<sup>108</sup> Of course, these benefits, so-called collective goods, could not be given to the members without an organization operating to provide collective goods. Olson mentions that a state or organization can be a provider and that an individual member “will not have a noticeable effect on the situation of his organization, and he can enjoy any improvements brought about by

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<sup>105</sup> Ghanem, 1986, p. 37.

<sup>106</sup> Toby Craig Jones, *Desert Kingdom: How Oil and Water Forged Modern Saudi Arabia* (London: Harvard University Press, 2010), p. 4.

<sup>107</sup> Jones, 2010, p. 4.

<sup>108</sup> Olson, 1965, p. 21.

others whether or not he has worked in support of his organization.”<sup>109</sup>

However, in the case of OPEC, individual member seems to play a crucial role in providing collective goods for other members. Saudi Arabia is the member state of OPEC that can considerably contribute to the provision of collective goods since it has incomparably bountiful oil reserves (See Table 2-1) and production capacity. Saudi Arabia’s dominant position in the world oil market has been maintained owing to its high governmental revenues and flexibility in oil production driven by a small number of populations,<sup>110</sup> and high efficiency of its oil production back then.<sup>111</sup>

**<Table 2-1> Proved reserves of Saudi Arabia and major OPEC members (in 1980, 1985)**

Year	1980		1985	
Country \ Reserves	Proved Reserves <sup>a</sup>	Share of Total (%)	Proved Reserves	Share of Total (%)
Iran	58.3	8.73	59.0	7.65
Iraq	30.0	4.49	65.0	8.43
Kuwait	67.9	10.17	92.5	11.99
<b>Saudi Arabia</b>	<b>168.0</b>	<b>25.17</b>	<b>171.5</b>	<b>22.24</b>

<sup>109</sup> Olson, 1965, p. 16.

<sup>110</sup> Doran, 1977, p. 136.

<sup>111</sup> Hill and Fee argued that Saudi Arabia had a spare production capacity of 3 million barrels per day and a highly competitive cost structure with only about \$1.50 per barrel production costs. See Fiona Hill and Florence Fee, “Fueling the Future: the Prospects for Russian Oil and Gas,” *Demokratizatsiya*, Vol. 10, No. 4 (Fall 2002), p. 469.

United Arab Emirates	3.6	4.55	33.0	4.28
Qatar	3.6	0.54	4.5	0.58
Total Middle	362.4	54.29	431.7	55.97
Total World	667.5	100	771.3	100

Source: reconstituted from BP, 2010

Notes: The unit of the proved reserves above is billion barrels.

a: Generally taken to be those quantities that geological and engineering information indicates with reasonable certainty can be recovered in the future from known reservoirs under existing economic and operating conditions. BP, 2010, p. 6.

Similarly, many economists have reckoned Saudi Arabia as “a residual supplier or restrictor of last resort”<sup>112</sup> in the sense that it could adjust its own oil outputs so as to ensure other OPEC member nations’ market shares and revenues. Adelman gave an explanation for the Saudi action as a residual supplier based on the willingness of the Saudis. According to him, the Saudis recognized well that its overproduction could generate a glut in the market and exacerbate world price instability. So “instead of installing 20 million barrels per day (MBD) capacity, as they once planned, they hesitated over going to 14 MBD.”<sup>113</sup> And in 1979 when demand exceeded supply extremely, the Kingdom operated only “fifteen fields out of a known fifty, and instead of drilling 177 oil

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<sup>112</sup> Adelman, 1993, p. 395.

<sup>113</sup> Adelman, 1993, p. 425.

wells (1973) they were down to 55 (1979).”<sup>114</sup> Paul Jabber claimed in a similar way as follows:

..... Saudi Arabia and Kuwait could shoulder most of the cutback burdens by themselves if necessary to safeguard the cartel.

In January-June 1975, at the lowest demand point in recent years, Saudi Arabia and Kuwait combined were producing at less than two-thirds (63.5 percent) of their capacity. Their output (Saudi Arabia: 6.82 MBD + Kuwait: 2.13 MBD = 8.95 MBD) amounted to 33.7 percent of total OPEC production.<sup>115</sup>

On account of these contributions of Saudi Arabia to OPEC, OPEC have performed as a cartel and the member nations of OPEC have been successfully provided OPEC’s collective goods, that is to say their market shares and revenues obtained by the moderate oil prices. In other words, Riyadh has acted as an OPEC’s swing producer or residual supplier, raising or lowering its output. And its action has helped other OPEC countries ensure their benefits from their participation in the organization.

## **2. Market Change in the Early 1980s**

In the early 1980s, the OPEC countries witnessed a change in demand

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<sup>114</sup> Adelman, 1993, p. 425.

<sup>115</sup> Paul Jabber, “Conflict and Cooperation in OPEC: Prospects for the Next Decade,” International Organization, Vol. 32, No. 2 (1978), p. 386.

pattern. While the tripled oil prices<sup>116</sup> pushed by the Second Oil Crisis had brought oil-producing countries great wealth by the end of 1981, a trend of falling demand for OPEC oil was becoming gradually discernible among the industrialized countries of the West, the major consumers of oil market.

The main reason for the fall in demand lay in the fact that the West had struggled both to conserve energy resources and to increase efficiency since the late 1970s.<sup>117</sup> Two Oil Crises cast a dark shadow over the global economy and the developed countries were gravely affected by precipitously skyrocketing oil prices as they had counted on oil imports from the Middle East for sustainable development of their energy-intensive economy. The harrowing experiences of the 1970s led the industrialized countries to substantially decrease their consumption of oil (See Table 2-2).

**<Table 2-2> Oil Consumption, 1978-1983 (Developed Countries)**

Year Country	1978	1979	1980	1981	1982	1983
US	18,756	18,438	17,062	16,060	15,295	15,235
Japan	5,185	5,250	4,739	4,519	4,243	4,243
Europe	24,587	25,117	24,389	23,507	22,773	22,344
Total	62,983	64,135	61,569	59,665	57,985	57,684

<sup>116</sup> During the 1979-1981 period, the oil price tripled from \$13 per barrel to \$35 per barrel. See Parra, 2004, p. 242.

<sup>117</sup> Sean Macdonald, *Saudi Arabia Oil Policy, 1981 to 1990: Continuity or Change?*, Ph. D. Dissertation, University of Oxford, 1993. p. 16.

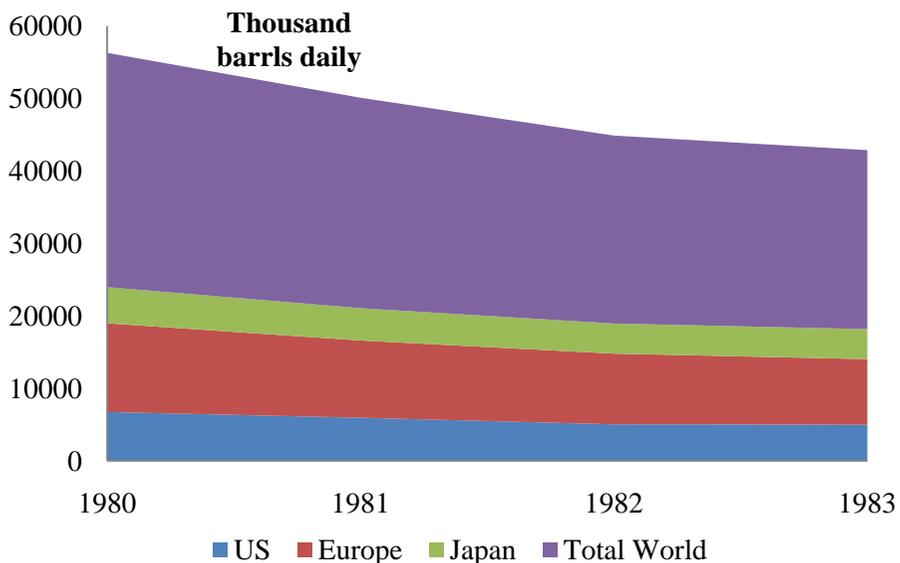
OECD	43,474	43,771	40,853	38,702	36,813	36,333
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Source: reconstructed from BP, 2010.

Note: The unit of the consumption above is thousand barrels per day.

And the world oil trade flow obviously had declined since the sudden outbreak of the Second Oil Crisis (See Figure 2-1). The total crude imports had fallen 24 percent from 1980 to 1983. Over this period, the oil imports to United States had decreased by 1,745 thousand barrels per day (KBD) while the imports to Europe had plunged from 12,244 KBD in 1980 to 9,038 in 1983.

<Figure 2-1> Oil Imports of Industrialized Countries, 1980-1983



Source: BP, 2010

Note: Europe excludes Central Europe (Albania, Bulgaria, Czech Republic,

Former Republic of Yugoslavia, Hungary, Poland, Romania, and Slovakia).

Given the fact that the Middle East supplied more than half the world's oil needs and that imports from Communist countries were restricted for political concerns, the West was given several policy options. Firstly, most Western European nations began to diversify import routes in an effort to reduce energy dependence on the Middle East. Secondly, they also endeavored to invest heavily in energy efficiency R&D projects. Finally, the United States, in particular owing to "large domestic energy production and the opening up of Alaska,"<sup>118</sup> sought to foster economic and military ties with oil-rich countries like Saudi Arabia. The desire to ensure the domestic energy security by reinforcing the special relationship with the exporters of the Middle East was advocated commonly "by Mr. Kennedy on the left, Mr. Connally on the right, and Mr. Carter somewhere in between" during the 1980 presidential campaign.<sup>119</sup>

The first option, diversifying import routes, was highlighted mainly by emergence of non-OPEC suppliers on the oil scene (See Figure 2-2). As shown in the figures presented below, the amount of oil production from non-OPEC sources was by no means more than 25 MBD during the 1970s while the OPEC share of global oil production

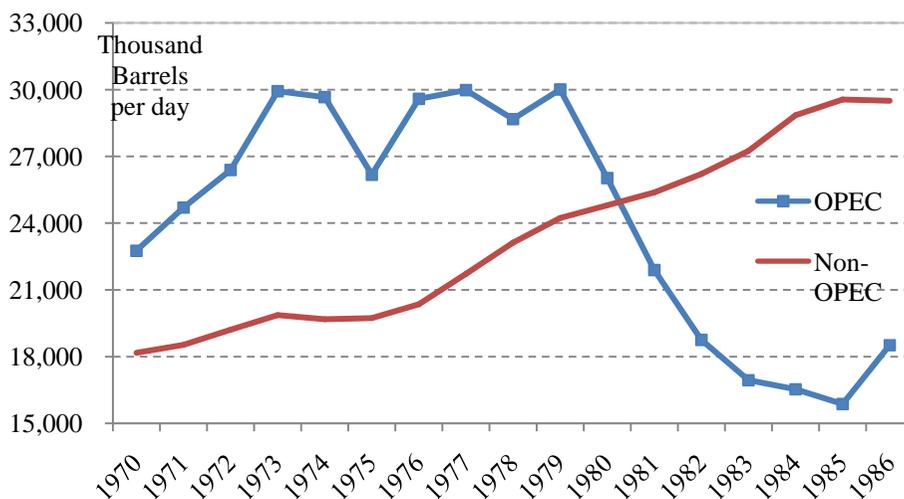
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<sup>118</sup> Jean Waelbroeck and Jacob Kol, "The Evolving Pattern of World Trade, EC Trade Policy and Exports from the South," in L. B. M. Mennes and Jacob Kol (eds.), *European Trade Policies and Developing Countries* (New York: Routledge, 1987), p. 64.

<sup>119</sup> Adelman, 1993, p. 517.

reached approximately 48% over the same period.<sup>120</sup>

<Figure 2-2> Oil Production by Region, 1970-1986



Source: BP, 2010

Note: Non-OPEC suppliers exclude Former Soviet Union.

However, by the end of 1979, the market changed entirely in favor of non-OPEC suppliers. “Non-OPEC oil invaded the export markets in huge quantities, more than doubling and shooting up by 4.2 MBD.”<sup>121</sup> Out of these increases, one-quarter “came from Mexico, almost

<sup>120</sup> OPEC produced more than 30 MBD in 1979 when the Iranian Revolution impaired both the oil market and the global economy. Even though supplies from Iran were cut extremely sharply from 5.3 MBD in 1978 to 3.21 MBD in 1979 (1.48 MBD in 1980), the rest of OPEC produced more than the previous year to fill in the losses. The OPEC’s production in 1979 had been recorded as the largest production for almost two decades until 1998.

<sup>121</sup> Parra, 2004, p. 259.

one-quarter from the United Kingdom (UK), 15 percent from the Soviet Union, and the rest mostly from Norway, Canada and Egypt.”<sup>122</sup> The Soviet Union and Mexico had accounted for approximately 83 percent of non-OPEC supplies over from 1973 to 1979. Other supplies from the UK, Norway and Canada had become important as well since the early 1980s.

It was the North Sea where the UK and Norway got involved in discovering new fields other than the Middle East region. The UK embarked on massive oil explorations of the northern sector of the North Sea in 1964, and Norway began to undertake energy exploration of the Norwegian offshore in the next year, 1965.<sup>123</sup> “The number of exploratory wells drilled in the Norwegian and UK (north) sectors of the North Sea rose rapidly, from 16 and 15 in 1967 and 1968, respectively, to 42 in 1972 (plus several field extension wells).”<sup>124</sup> Owing to those ardent endeavors after the upstream sector, the two countries ultimately began producing 500 KBD of the oil in 1976. “By 1980, production from the two countries was up to 2.2 MBD, and 3.5 MBD by 1985.”<sup>125</sup>

The increasing share of non-OPEC production was totally a bad news for OPEC, under pressure from a substantial decrease in world demand for oil, because it signifies that the competition for limited market shares was becoming unimaginably harsh. Non-OPEC

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<sup>122</sup> Parra, 2004, p. 259.

<sup>123</sup> Parra, 2004, p. 267.

<sup>124</sup> Parra, 2004, p. 268.

<sup>125</sup> Parra, 2004, p. 268.

producers, in fact, produced and developed oil at nearly full capacity, “as much as they could as fast as they could,”<sup>126</sup> in contrast to the nations of OPEC which maintained a moderate level of oil prices through production controls. Non-OPEC suppliers “produced just above 16 MBD in aggregate in 1979, as compared to an OPEC total of nearly 32 MBD. In 1981, the shares of the two groups in overall exports to the non-communist world were equal, and the year after, OPEC covered less than 45 percent of the shrinking market.”<sup>127</sup> Until 2005, OPEC had in no way pumped more oil than non-OPEC exporters since 1981 when non-OPEC production surpassed OPEC’s outputs for the first time.<sup>128</sup>

And OPEC was fretted over the sharp “price cuts by Britain’s British National Oil Corporation (BNOC), Norway, Egypt, and the Soviet Union”<sup>129</sup> which were possibly likely to lead to a decline in OPEC’s market share. The UK, in particular, “initiated its policy of taking small oil price cuts in 1982.” And on February 18, 1983, BNOC announced that it would reduce the price of Brent Blend, “the oil which functioned as the North Sea reference oil,”<sup>130</sup> by 10 percent. And Norway immediately followed suit.<sup>131</sup>

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<sup>126</sup> Parra, 2004, p. 263.

<sup>127</sup> Raino Malnes, “OPEC and the Problem of Collective Action,” *Journal of Peace Research*, Vol. 20, No. 4 (1983), p. 346.

<sup>128</sup> BP, 2010, p. 8.

<sup>129</sup> Parra, 2004, p. 263.

<sup>130</sup> Bernard Taverne, *Petroleum, Industry, and Governments: a Study of the Involvement of Industry and Governments in the Production, and Use of Petroleum*, 2<sup>nd</sup> edition (New York: Kluwer Law International, 2008), pp. 99-100.

<sup>131</sup> Malnes, 1983, p. 352.

In spite of several price cuts undertaken by the UK, Margaret Thatcher, British Prime Minister, claimed on February 23 that a sharp decline in oil prices would tumble down the world financial market, and that the oil price should not go under at least \$23 per barrel. While looking confusing, London's intention was reflected in her speech that its "oil exports functioned as a weapon against the moderate bloc of Saudi-led OPEC producers, which were allied to the United States."<sup>132</sup> It signaled that OPEC were placed in such a situation that it had to defend not only its market share but also its dominant position in the world market.

### **3. Negotiations within OPEC**

Falling demand for oil and new supplies from non-OPEC sources made the members of OPEC find very difficult to maintain their strong positions in the global oil market. Followed by BNOC, Norway, Egypt, and the Soviet Union, some OPEC countries began to reduce its oil prices one after another in 1982. Venezuela, in January, "cut heavy crude prices by \$0.58 per barrel," and Iran reduced its oil prices by \$4 per barrel during a few weeks in February.<sup>133</sup> "A number of sellers, both OPEC and non-OPEC, were obliged to reduce their official prices

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<sup>132</sup> Judith Wyr, "The Oil-price Drop: How Far, How Fast?" *EIR Economics*, Vol. 10, No. 9 (March 8, 1983), p. 5.

<sup>133</sup> Parra, 2004, p. 277.

sharply.”<sup>134</sup> A breakthrough was urgently required to deal with the problems surrounding OPEC at hand.

In an effort to address these new challenges OPEC faced, negotiations among the OPEC nations had been conducted from the beginning of the 1980s. The OPEC members strived to respond to volatility in the world oil market by changing its official prices or production quotas at regular or irregular conferences as follows:

*- 58th (Extraordinary) Meeting of the Conference, Vienna, September 1980*

The Ministers of Petroleum of the OPEC countries convened in Vienna and consulted on the market trends to unanimously decide to fix the price of the Marker Crude (Arabian Light 34° API ex Ras Tanura) at the level of \$30 per barrel and to freeze the other official prices of OPEC member countries’ crudes at their present levels.<sup>135</sup>

*- 59th Meeting of the Conference, Vienna, December 1980*

The price of the OPEC benchmark crude oil rose by \$2 per barrel in three months. The conference decided to fix the official market crude (Arabian Light 34° API) at a level of \$32 per barrel. And the member states agreed to adjust the prices of OPEC crudes on the basis of an oil price ceiling for a deemed marker crude of up to \$36 per barrel. A Maximum price for OPEC crude oils were set at \$41 per barrel as

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<sup>134</sup> Parra, 2004, p. 277.

<sup>135</sup> OPEC, *OPEC Official Resolutions and Press Releases 1960-1983* (Oxford: Pergamon Press, 1984), p. 190.

well.<sup>136</sup>

*- 60th Meeting of the Conference, Geneva, May 1981*

The maximum OPEC price and a price ceiling for the deemed marker crude remained the same. Instead, most OPEC members agreed to cut its production by at least 10 percent (effective on June 1, 1981)<sup>137</sup> in a response to declining demand for oil.

*- 61st (Extraordinary) Meeting of the Conference, Geneva, October 1981*

As the global oil market was rapidly changing, the member nations of OPEC finally agreed to adopt a unified pricing system for OPEC crudes in order to stabilize the market. As a result, the official price of the marker crude (Arabian Light 34° API) was set at \$34 per barrel (effective until the following month). And they recognized the necessity for a set of value differentials for the pricing of all other OPEC crudes in accordance with their respective qualities and geographical locations.<sup>138</sup>

*- Extraordinary Meeting of Ministerial Conference, Qatar, March 1982*

Ministers of Petroleum of the Arab members of OPEC convened in Qatar and reconfirmed the marker crude price of \$34 per barrel.

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<sup>136</sup> OPEC, 1984, p. 192.

<sup>137</sup> OPEC, 1984, p. 194.

<sup>138</sup> OPEC, 1984, p. 199.

Yamani, the Saudi oil minister, made it clear that Saudi Arabia would be willing to support the \$34 marker price by production controls.<sup>139</sup>

- *63rd (Extraordinary) Meeting of the Conference, Vienna, 20 March 1982*

While the marker crude price remained unchanged, other measures were adopted to stabilize the market. First of all, the OPEC countries resolved to impose a ceiling for OPEC production at 18 MBD as of April 1, 1982.<sup>140</sup> Yamani announced that the Kingdom would reduce its “output ceiling to 7 MBD for the month of April 1982”<sup>141</sup> so as not to break the overall ceiling for the total OPEC production. And individual production quotas were allocated to the respective countries to meet the OPEC target of production. There was discussed further on the price differential, and they agreed to set the price differential for light and extra light crudes in relation to the marker crude at the same levels as in 1978.<sup>142</sup>

- *66th Meeting of the Conference, Vienna, December 1982*

OPEC determined to raise its production ceiling to 18.5 MBD.<sup>143</sup>

- *67th (Extraordinary) Meeting of the Conference, London, March*

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<sup>139</sup> Parra, 2004, pp. 277-278.

<sup>140</sup> OPEC, 1984, p. 202.

<sup>141</sup> Parra, 2004, p. 278.

<sup>142</sup> OPEC, 1984, p. 202.

<sup>143</sup> OPEC, 1984, p. 206.

1983

On March 14, 1983, the OPEC Conference was held in London and the members arrived at an agreement meaningful in terms of several issues.

1. To set the official price of the marker crude (Arabian Light 34° API) at \$29 per barrel.
2. To maintain the existing differentials among the various OPEC crudes at the same level as agreed upon the 63rd (Extraordinary) Meeting of the Conference held in Vienna, Austria, in March 1982, with the temporary exception that the differentials for the Nigerian crudes should be \$1 over the price of the marker crude.
3. To establish a ceiling for total OPEC production of 17.5 MBD, within which individual Member Country quotas were allocated. This ceiling is to be observed as an average for the remaining part of 1983.<sup>144</sup> No quota is allocated to the Kingdom of Saudi Arabia which will act as a swing producer to supply the balancing quantities to meet the market requirements.
4. The Member Countries shall avoid discounts in any form whatsoever and refrain from dumping petroleum products into the world oil market at prices which will jeopardize the crude oil pricing structure.<sup>145</sup>

Throughout the history of OPEC oil negotiations in the early 1980s, the Sixty-third (Extraordinary) OPEC Conference marked a

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<sup>144</sup> At the 68th and 69th Conferences, the London agreement was reconfirmed by the OPEC countries concerning price and production levels.

<sup>145</sup> OPEC, 1984, p. 208.

decisive turning point. In March 1982, OPEC introduced, for the first time, formal OPEC production ceiling of 18 MBD and informally distributed it into individual quotas. Since the Tripoli-Tehran Agreements which had taken the determination of posted prices to the oil producers, OPEC, in fact, had not bound “its members together in ways that would limit the range for individual action in subsequent moments of divergence and disagreement”<sup>146</sup> until nearly ten years later. In an effort to stabilize the international market, OPEC finally attempted in solidarity to build a mechanism to regulate OPEC outputs.

The Sixty-seventh Conference was also very important in the history of OPEC’s discussion since Saudi Arabia officially did not get a quota allocated. No quota allotted to Saudi Arabia signified the Kingdom’s swing-producer role in the OPEC’s quota system. With no official quota, Riyadh was able to raise or lower its oil-production volume to maintain the OPEC’s ceiling and the world oil prices. The Kingdom’s quota and its role explain the reason why its outputs had steadily decreased from 1982 to 1984 (See Table 2-3, 2-4 and 2-5 in the following section).

#### **4. Broken Coalition**

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<sup>146</sup> Theodore Moran, “Managing an Oligopoly of Would-be Sovereigns: the Dynamics of Joint Control and Self-control in the International Oil Industry Past, Present, and Future,” *International Organization*, Vol. 41, No. 4 (Autumn 1987), p. 598.

With a steeply declining demand for OPEC oil, a growing number of non-OPEC supplies, and considerable loss of the organization's market share, OPEC realized that it had become increasingly unlikely to reach a full cooperation among the OPEC nations in terms either of the level of oil prices or of individual countries' production quotas, despite Saudi Arabia's strenuous efforts to maintain the moderate level of oil prices. Even though the ministers from the OPEC countries convened at the OPEC Conferences and pledged full compliance with the decisions on posted prices and production quotas, several OPEC countries kept cheating on the OPEC agreements to exceed their production quotas and sell their petroleum products at discounted prices.

*- Violation of Production Quotas*

As explained above, an output ceiling was introduced to OPEC for the first time in March 1982. This was intended to deal with the shrinking demand and simultaneously to circumvent imminent price crash. Until the 1982 Vienna Conference was held, OPEC had put its priority on raising up the price of the Marker Crude (Arabian Light 34° API) as a response to the drop in market demand. The official price of the Marker Crude was set at a level of \$30 per barrel in the Fifty-eighth Extraordinary Conference, which rose to \$32 per barrel in December 1980, and finally to \$34 per barrel in October 1981.<sup>147</sup> Saudi Arabia, in particular, declared its commitment to defending this level of the Marker Crude price by means of controlling its own outputs.

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<sup>147</sup> OPEC, 1984, pp. 190-208.

Shortly, it turned out that the structural change in the market could not be satisfactorily resolved just by relying on price controls. Contrary to OPEC's attempts to raise the oil prices, non-OPEC producers did cut the prices instead of following the OPEC's decisions.<sup>148</sup> Non-OPEC exporters took advantage of a close relationship with the major companies, thereby earning a lot of profit. For nearly a decade, the major oil companies were wrested its dominance over the oil market by the OPEC countries, particularly Libya, and stood against the OPEC countries raising the prices of their crudes. The press reports delivered their arguments using such an expression: the major companies, "in a tough mood that hasn't been seen in many years, are demanding that oil prices be shaved further."<sup>149</sup> And the companies' implacable stance was reported as follows:

After years of submission to the price demands of the exporters, the willingness of oil companies to force a showdown with at least some producers has come as quite a shock. .... The producing countries have responded to this effrontery with threats of blacklists, diplomatic protests and even economic sanctions against the oil companies' home countries—everything but a significant price cut. .... But times have changed. .... "We are no longer slaves to our capital investments in

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<sup>148</sup> Mexico was the only non-OPEC country that promised to restrict its output by producing at 10 percent below its capacity, in early 1983 when OPEC decided to assign individual quotas to the members by fear for the shrinkage of demand for oil. See D. G. Aperjis, "Oil Export Policy and Economic Development in OPEC," *Annual Review of Energy*, Vol. 9 (1984), pp. 180-181.

<sup>149</sup> *The Wall Street Journal*, June 18, 1981. Quoted in M. A. Adelman, *The Genie out of the Bottle: World Oil since 1970* (Cambridge: MIT Press, 1995), p. 204.

these countries.”<sup>150</sup>

These pressures heavily forced OPEC to take into consideration an introduction of production ceiling mechanism.

As a result of the Vienna agreement, the production ceiling for OPEC was set at 18 MBD, and it was distributed to the member states. Saudi Arabia was allotted 7.65 MBD<sup>151</sup> as “already announced as its ceiling before the Vienna meeting.”<sup>152</sup> The Kingdom, after the conference, lowered its ceiling to 7 MBD<sup>153</sup> voluntarily so as to effectively accommodate the OPEC ceiling of 18 MBD. Considering the fact that Saudi Arabia produced its own oil of 8.7 MBD at the end of 1981, Riyadh was willingly endorsing the idea of losing its level of output by 1.7 million barrels every day.

It was a huge sacrifice for the Saudis, of course. But this decision was backed by the Royal family of the Kingdom. The Royal family had for a long time opposed an expansive production policy. “According to a group of ‘conservationists,’ both the contemporary interest of the Kingdom in an orderly economic development and a sense of obligation to future generations give grounds to slow down the pumps.”<sup>154</sup> Instead the production level around 5 MBD was favored by

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<sup>150</sup> *The New York Times*, July 13, 1981. Quoted in Adelman, 1995, p. 204.

<sup>151</sup> Adelman, 1995, p. 203.

<sup>152</sup> Ian Skeet, *OPEC: Twenty-five Years of Prices and Politics* (Cambridge: Cambridge University Press, 1988), p. 185.

<sup>153</sup> Skeet, 1988, p. 185.

<sup>154</sup> Malnes, 1983, p. 348.

them.<sup>155</sup> Thus, the internal stance on the low production level led to the Saudis' loss of market share, thereby making other OPEC members reconfirm Saudi Arabia's strong willingness and responsibility.

On the other hand, some OPEC countries, particularly non-Gulf states such as Libya and Venezuela, overtly produced their own oil outputs at nearly full capacity in disregard of their production quotas (See Table 2-3).<sup>156</sup> At the end of 1982, Libya exceeded its quota by 1.05 MBD (140 percent), and Venezuela by 0.7 MBD (52 percent). Iran also overproduced its oil by 1.5 MBD (125 percent) in violation of its allotted quota.

**<Table 2-3> OPEC Oil Production and the National Quotas  
Adopted in March 1982**

	Production Quota According to the 1982 Accord	Outputs (December 1982)
Saudi Arabia	7.65	5.3
Iran	1.2	2.7
Iraq	1.2	0.8
Kuwait	0.8	0.8
UAE	1.0	1.2
Nigeria	1.3	1.0
Algeria	0.65	0.7

<sup>155</sup> Malnes, 1983, p. 348.

<sup>156</sup> By the end of 1982, Saudi output was at only 45 percent of capacity, other OPEC at 60 percent. See Adelman, 1995, p. 210.

Libya	0.75	1.8
Venezuela	1.5	2.2
Indonesia	1.3	1.3
Others	0.65	0.7
<b>Total OPEC</b>	<b>18</b>	<b>18.5</b>

Source: Adelman, 1995, p. 203 (production quotas); Malnes, 1983, p. 347 (outputs).

Note: The Unit is million barrels per day.

At the 1983 London Conference, the OPEC ceiling was lowered by 0.5 MBD, and set at 17.5 MBD. It was also Saudi Arabia that accommodated the cheatings on the quotas. Despite the conference's conclusion allocated no quota to it, the Kingdom accepted its quota of 5.0 MBD. And Riyadh produced its own oil of 3.93 MBD in April to implement the decision.<sup>157</sup> It mirrors the Kingdom's willingness to act as a swing producer to meet the production ceiling delicately.

But, it turned out again that the acrimonious meetings of the London Conference changed nothing, apart from Saudi Arabia and other modest countries. OPEC could not effectively deter the cheaters from violating their quotas again (See Table 2-4). Most countries barely exceeded their quotas given, yet two non-Gulf countries, Venezuela and Algeria, broke their quotas. They exceeded their combined assignments by 369 TBD towards the end of 1983. Even though the violations were smaller in quantity than the year before, the fact that

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<sup>157</sup> EIA, 1993, p. 309.

violations occurred again was not ignorable. It signified that OPEC could not control its member countries' defection under the situation which the competition between the oil suppliers got stiff in the world market.

**<Table 2-4> OPEC Oil Production and the National Quotas  
Adopted in March 1983**

	Production Quota According to the 1983 Accord	Outputs (Average 1983)
Saudi Arabia	5.0	5.086
Iran	2.4	2.440
Iraq	1.2	1.005
Kuwait	1.05	1.064
UAE	1.1	1.149
Nigeria	1.3	1.241
Algeria	0.725	0.968
Libya	1.1	1.105
Venezuela	1.675	1.801
Indonesia	1.3	1.343
Others	0.65	0.6
<b>Total OPEC</b>	<b>17.5</b>	<b>17.802</b>

Source: Adelman, 1995, p. 203 (production quotas); EIA, 1993 (outputs); Aperjis, 1984, p. 181 (production of other OPEC members).

Note: The unit is million barrels per day.

In October 1984, Saudi Arabia gave up 0.647 MBD of the 5 MBD market share. And the Kingdom kept its outputs within the limit to fulfill the OPEC production quota. In 1984, it produced an average 4.92 MBD of crude by the end of September and, an average 3.388 MBD of crude in 1985. While the Kingdom struggled to produce oil under the ceiling (See Figure 2-3), Venezuela broke the quota again. It overproduced its quota by 243 TBD in 1984, and 121 TBD in 1985. Nigeria overproduced an average 206 TBD from November 1984 to December 1985.<sup>158</sup> The production of Algeria was over its quota by 374 TBD (See Table 2-5).

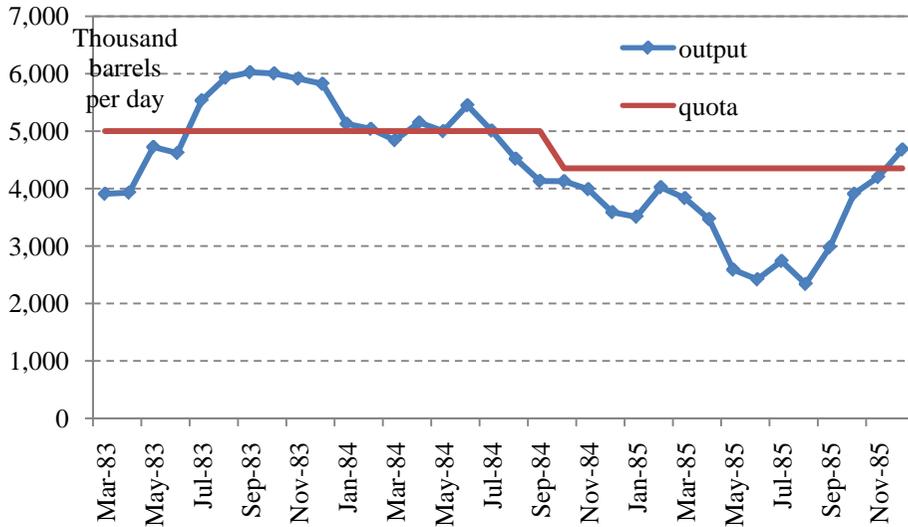
As Table 2-4 and 2-5 show, violations on the OPEC's quota system got larger in quantity during the period from 1983 to 1985. The exceeded volume of produced oil among OPEC members was 302 TBD in 1983. In 1985, the exceeded volume increased by 352 TBD and averaged at 654 TBD.

Therefore, rampant cheatings on the national quotas assigned to the OPEC countries succinctly show that the institution of new production ceiling achieved little other than to prove itself that the OPEC members could not cooperate on defending their market shares. To make things worse, the cheaters not only broke their quotas but also offered discounts on sales as is outlined in the next section.

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<sup>158</sup> EIA, 1993, p. 309.

**<Figure 2-3> Saudi Oil Production and its Quota<sup>159</sup>, March 1983-December 1985**



Source: EIA, 1993

**<Table 2-5> OPEC Oil Production and the National Quotas Adopted in October 1984**

	Production Quota According to the 1984 Accord	Outputs (1985) <sup>a</sup>
Saudi Arabia	4.353	3.388
Iran	2.3	2.25

<sup>159</sup> At the 1983 London Conference, OPEC did not allocate an official quota to Saudi Arabia to oblige it to play a role of swing producer within OPEC. Though The Kingdom voluntarily accepted the quota rules and set its quota at 5 MBD in 1983 and 4.353 MBD in 1984.

Iraq	1.2	1.433
Kuwait	0.9	1.023
UAE	0.95	1.193
Nigeria	1.3	1.495
Algeria	0.663	1.037
Libya	0.99	1.059
Venezuela	1.555	1.677
Indonesia	1.189	1.325
Others	0.6	0.774
<b>Total OPEC</b>	<b>16</b>	<b>16.654</b>

Source: Adelman, 1995, p. 203 (production quotas); EIA, 1993 (outputs); BP, 2010 (productions from Qatar, Gabon, and Ecuador)

Note: The unit is also million barrels per day.

a: In order to clarify the effectiveness of the ceiling policy adopted in late 1984, the average production data in 1985 are selected.

### *- Price Discounts*

Price discount was frequently granted among the OPEC countries. As an example, there increased the number of news that reported price discounts and cheating of the OPEC members. The Table presented below “the frequency of leading stories about price discounts in *Petroleum Intelligence Weekly*, which had dropped to one every twenty weeks on average in the period 1971-73, climbed to once every four weeks on average 1974-78, and once three weeks on average

1979-85.”<sup>160</sup>

**<Table 2-6> Leading Stories on Price Discounting (Petroleum Intelligence Weekly)**

	1962-1970	1971-1973	1974-1978	1979-85
Number of weeks	8	20	4	3

Source: quoted in Moran, 1987, p. 600.

Unreasonable price cuts were offered in the forms of “barter arrangements, extended credit, absorption of freight costs, and cut in refined product prices.”<sup>161</sup> Barter deals, technically referring to a way of exchanging goods other than cash or gold, were “viewed as discounts,”<sup>162</sup> and criticized for erosion of the market. “But most important, in terms of volume of oil affected, was the manipulation of differentials.”<sup>163</sup> Since a large variety of crude oils existed, the differences between the crude oils<sup>164</sup> provoked a bitter and lengthy

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<sup>160</sup> Moran, 1987, p. 599.

<sup>161</sup> Moran, 1987, p. 600.

<sup>162</sup> *The Economist*, July 21, 1984, Quoted in Adelman, 1995, p. 217.

<sup>163</sup> Moran, 1987, p. 600.

<sup>164</sup> The price of crude oils varies according to the quality (hydrocarbons and other chemicals content) and location of production. Namely API gravity and sulfur content are considered as decisive determinants. See Robert Bacon and Silvana Tordo, “Crude Oil Differentials and Differences in Oil Qualities: a Statistical Analysis,” *ESMAP Technical Paper*, vol. 81 (October 2005), p. 5. Available at [http://www.esmap.org/esmap/sites/esmap.org/files/08105.Technical%20Paper\\_Crude%20Oil%20Price%20Differentials%20and%20Differences%20in%20oil%20Qualities%20A%20Statistical%20Analysis.pdf](http://www.esmap.org/esmap/sites/esmap.org/files/08105.Technical%20Paper_Crude%20Oil%20Price%20Differentials%20and%20Differences%20in%20oil%20Qualities%20A%20Statistical%20Analysis.pdf); Moran, 1987, p. 600.

dispute among the oil-producing countries.

In particular, these price differentials were a matter of grave concern to the OPEC countries since their national revenues were heavily depended on the price of their crudes. In the early 1980s, new non-OPEC suppliers emerged in the market. Industrialized countries began to import crude oil from the Soviet Union, Mexico, UK, Norway and Canada in the aftermath of the Iranian Revolution. With their market shares shrunk, OPEC countries could not help but compete with each other on oil prices. If the quality of a crude oil was graded well, it would be inevitably appraised at a high price. And it meant that the higher the crudes price, the lower their revenues. Most OPEC countries sought to sell their oils at as low prices as they could so that they could earn maximum profits. The economies of most OPEC countries were accordingly vulnerable to change in the oil prices.

OPEC had addressed the problem of these differentials at the Sixty-first conference held in Geneva, in October 1981. The ministers from the member nations unanimously felt keenly the necessity for establishing a set of values for crude differentials, and as a result, price differentials for light and extra crudes were set in relation to the Marker Crude at the March Conference in 1982. It resulted from “a potent practical calculation: revenue calculated on a price of \$34 was self-evidently greater than revenue calculated on any lower price.”<sup>165</sup>

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<sup>165</sup> Skeet, 1988, p. 182. However, this theory was faced with a dilemma, “because it ceased to be true only if at a lower price production, and therefore exports, could be boosted sufficiently to make up for the loss of unit revenue at the higher price level.” It resulted in dissension within OPEC in terms of the difference of crudes prices.

The negotiation upon the differences ostensibly proceeded smoothly, specifically backed by Saudi Arabia. Though, there were heated discussions between the African producers and the Gulf-Arab producers. The Arabs, including Saudi Arabia, argued strongly that the African crudes of higher quality, produced by Nigeria, Libya and Algeria, be priced at \$1.50 per barrel to the price of the Marker Crude.<sup>166</sup> The Kingdom, in fact, “wanted the premium raised by between \$3.00 and \$3.80,”<sup>167</sup> and met with a barrage of criticisms from the Africans, of course. Towards the March 1983 Conference, Yamani kept persuading the Africans to “charge higher premiums for their crudes,” and yet his suggestion was refused by them.<sup>168</sup> Finally at the Sixty-seventh Extraordinary conference, these price differentials maintained with the exception of the Nigerian crudes whose price was imposed an extra \$1 per barrel to the price of the Marker Crude.

Given the higher prices of the Nigerian crudes, Nigeria, in particular, had relatively high incentives to cheat on the OPEC’s pricing rules. Nigeria might have lost its consumers to other Non-OPEC countries which had attempted to sell the oils of similar quality at lower prices if Nigeria had abided by the decisions on its crudes. Nigeria had already experienced the harsh impacts of BNOC’s price reduction on its economy. During the first quarter of 1982, BNOC had announced a reduction of the North Oil twice.<sup>169</sup> Besides, Lagos

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<sup>166</sup> Malnes, 1983, p. 349.

<sup>167</sup> Malnes, 1983, p. 349.

<sup>168</sup> Malens, 1983, p. 350.

<sup>169</sup> Skeet, 1988, p. 183.

“was at the time experiencing severe problems in finding outlet for its oil,”<sup>170</sup> and consequently its production slid and became uncompetitive.

So, it was without a doubt unsurprising that Nigeria peremptorily “cut \$5.50 a barrel off the price of its crude to bring it into line with comparable North Sea grades, and reportedly vouched to follow ‘cent by cent’ whatever further cuts Britain and Norway might undertake”<sup>171</sup> in a response to the price cuts by BNOC and Norway. On February 18, 1983, BNOC cut its crudes price by 10 percent, from \$33.50 to \$30.50 per barrel and Norway followed suit. The North Sea oil, which was supplied from the UK and Norway, possessed the same quality as the Nigerian crudes, yet was priced \$2 per barrel lower by these decisions.<sup>172</sup>

The following year, the OPEC countries as well as non-OPEC suppliers rushed to reduce their crudes price. “OPEC requested in the second half of 1984 the UK government to persuade BNOC, the UK national oil corporation, to maintain the price of Brent Blend, the oil which functioned as the North Sea reference oil and which was connected to the price of oil exported from member state Nigeria” to prevent Nigeria from breaking the price rules.<sup>173</sup> But it had no effect. In September, Nigeria and Iran began a reduction of their light crudes price, and the UAE announced a price cut of its light crudes in

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<sup>170</sup> Malnes, 1983, p. 352.

<sup>171</sup> Malnes, 1983, p. 352.

<sup>172</sup> Malnes, 1983, p. 352.

<sup>173</sup> Taverne, 2008, p. 99.

October.<sup>174</sup> “So when Statoil, the Norwegian state oil enterprise, started in October 1984 to sell its oil at a discount, BNOB reacted by lowering the price of its Brent Blend from \$30 per barrel to \$28.65 per barrel.”<sup>175</sup> Nigeria, in a reaction to these moves, “lowered the price of its Bonny-Light by \$2.0 to \$28.0 per barrel.”<sup>176</sup>

This bitter ‘price war’ required again Saudi Arabia’s sacrifice. OPEC determined “to cut as from 1 November 1984 and on a temporary basis the global production ceiling of OPEC from 17.5 to 16 MBD” so as to defend its price structure of the Marker Crude at the \$29 level (since the March 1983 agreement) and stabilize the world oil market.<sup>177</sup> Of course, Saudi Arabia accounted for the largest reduction in oil outputs, whereas Nigeria and Iraq were granted zero reductions.<sup>178</sup>

Therefore, during the first part of the 1980s, OPEC was marked by a loose cooperation among the member countries and by the organization’s weakening position in the global market. It means that cohesion or collusiveness of OPEC as a whole began to be faltering. OPEC could not manage to keep its member countries in conformity with its policy decisions and rules any longer. When the number of non-OPEC suppliers increased, some OPEC members such as Nigeria and Venezuela found that the payoffs from defection outweighed those from cooperation, thereby producing crudes over their quotas and

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<sup>174</sup> Adelman, 1995, p. 218.

<sup>175</sup> Taverne, 2008, p. 99.

<sup>176</sup> Taverne, 2008, p. 99.

<sup>177</sup> Taverne, 2008, p. 100.

<sup>178</sup> Taverne, 2008, p. 100.

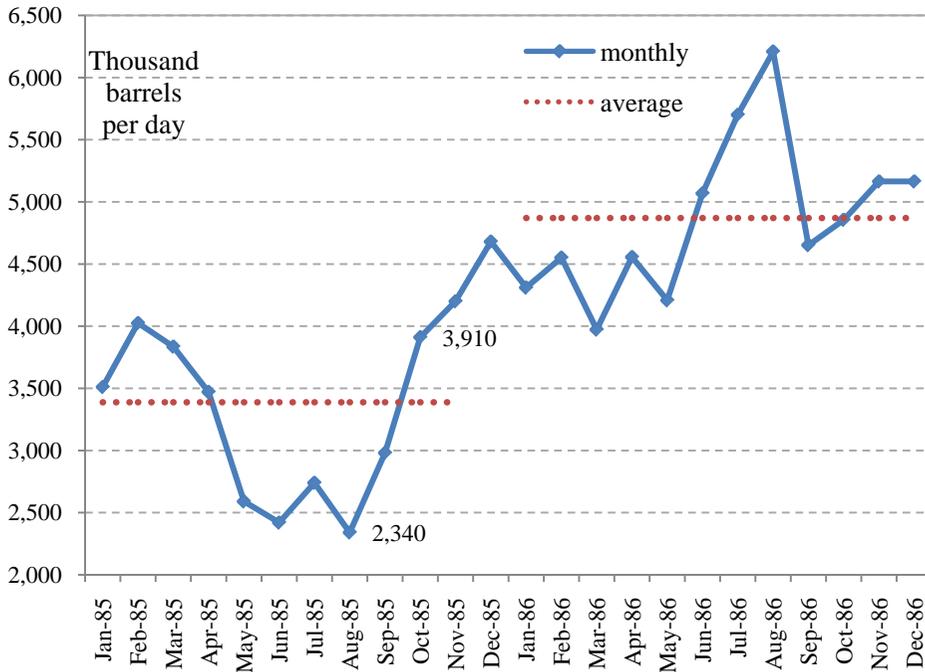
selling their oil at discounted prices. Under these circumstances, Saudi Arabia, as the OPEC's swing producer or residual supplier, had to choose whether to continue to lower its output for accommodating the cheaters and adhering to OPEC's production ceiling, or to violate its quota and price norms for retaliating against the defections. The latter would lead to a glut in the world oil market, thereby pushing oil prices further down.

## **5. Saudi Arabia's Determination to Increase its Oil Production**

With the negotiations within the OPEC coming to a deadlock, Saudi Arabia finally made a stark decision in August 1985. For three-fourth of the year, the Kingdom overtly had reduced its oil outputs in compliance with the OPEC's decision to lower the production ceiling. Riyadh had produced an average 4.663 MBD of crudes in 1984, but it decreased its outputs to an average 3.388 MBD of crudes next year to meet the quota (See Table 2-5 and Figure 2-4).

However, in August, the Saudi Kingdom suddenly changed its production policy, and began to boost its oil production. In October, the amount of oil production was beyond the quota level of 4.353 MBD. In two months, the Saudi outputs amounted to 4.680 MBD, exceeding its quota by 0.327 MBD. Towards August 1986, its production rose by about 159%.

**<Figure 2-4> Saudi Arabia's Oil Production (monthly), 1985-1986**

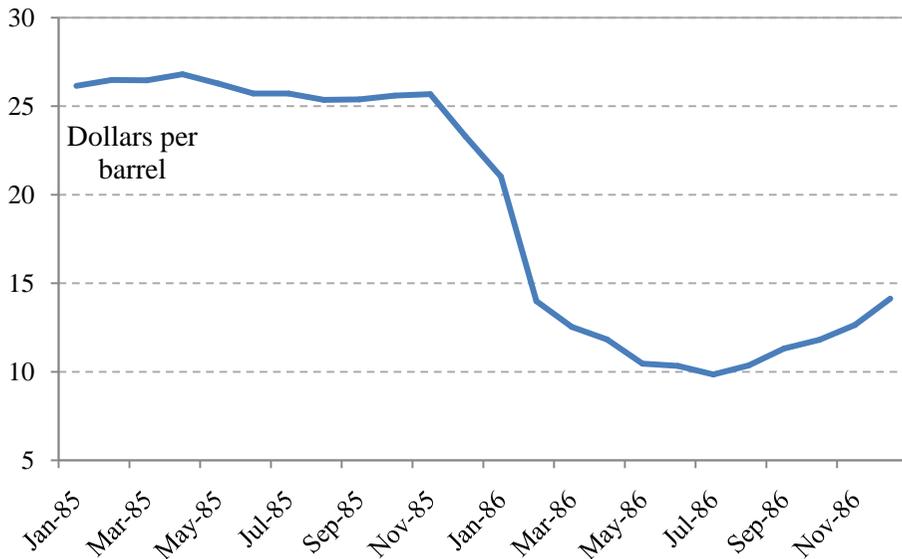


Source: EIA, 1993

The Kingdom's sudden policy shift immediately led to a huge supply glut in the global oil market. Riyadh chose to increase its oil production during the second half of 1985, and oil prices accordingly began to weaken (See Figure 2-5) in the end of the year. When the oil prices collapsed severely in 1986, "OPEC's share of the smaller oil market fell heavily and its total petroleum revenue dropped below a third of earlier peaks, causing severe economic hardship for many

member countries.”<sup>179</sup>

**<Figure 2-5> The Collapse of Oil Prices, 1985-1986**



Source: EIA, 1993

Note: In the figure, the price of crude oil means the F.O.B. (Free on Board) cost of crudes oil imported by US from the total OPEC countries.

Many researches have considered the Kingdom’s resolution to overproduce its crudes as an example of a major cartel member’s retaliation (tit-for-tat strategy) against recurrent cheatings by other members. According to them, the Saudis’ overproduction and discount sales were predictable consequences as Riyadh had repeatedly warned other OPEC countries that it would stop supporting prices fixed by the

<sup>179</sup> [http://www.opec.org/opec\\_web/en/about\\_us/24.htm](http://www.opec.org/opec_web/en/about_us/24.htm)

cartel. In June 1985, for instance, Saudi King Fahd announced that Saudi Arabia “can no longer tolerate the persistent indiscipline in OPEC ranks with regard to production and prices.”<sup>180</sup> And Saudi oil minister Yamani delivered Fahd’s message saying that “if other members increase their production above quota levels, Saudi Arabia will put additional volumes of oil into the market”<sup>181</sup> to “the five-member OPEC executive council, which was set up to monitor oil production and prices in the cartel’s 13 member countries.”<sup>182</sup>

Ostensibly, Riyadh’s rapid change of policy direction was intended to coerce the countries repeatedly cheated on the fixed prices and output quotas into bearing a share of the costs of the OPEC’s common actions. However, given the Kingdom’s remarkable capacity, the question is still raised on whether the behavior of Saudi Arabia would be understood just as a punishment for the defections or not. It requires more examination on the economic and political contexts of Saudi Arabia to find out what drove Saudi Arabia to increase its own outputs in August 1985. The Kingdom might have needed to boost its oil production to develop its national economy or to reduce the military threats posed to its security. So as to clearly answer the research question, the following two chapters will review the Saudi behaviors by exploring the economic and political dimensions of Saudi Arabia’s actions.

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<sup>180</sup> “Saudi Arabia Warns Cartel to Stop Cheating on Accord,” *The Journal Record*, June 11, 1985.

<sup>181</sup> *The Journal Record*, June 11, 1985.

<sup>182</sup> *The Journal Record*, June 11, 1985.

### **III. The Domestic Economy of Saudi Arabia**

A number of studies have placed substantial emphasis on the domestic instability of Saudi Arabia to give a plausible explanation for the unexpected policy change in its oil production in August 1985. Most of them called into question the plummeting oil revenues and worsening government deficit of the Kingdom. They say that economic issues with which the Saudis faced forced the Saudi government to make a decision to increase its oil outputs even beyond the quota. These economic explanations obviously contribute much to broadening our understanding of the Saudi government under the domestic pressures.

Despite a great deal of findings on the Saudi economic concerns they offered, they have drawn criticism from the researchers who emphasize the bright side of the Saudi economy. This chapter presents why most researches addressing the Saudi role as a swing producer have underlined the economic downturn of the Kingdom and turns to these issues in more detail in favor of the domestic stability of Saudi Arabia. As I will show: notwithstanding the domestic economic contraction, the Saudi Kingdom was not under much popular pressure for policy shift into a sharp increase in its oil output. In a word, the Hypothesis (B) which argues that *Saudi Arabia might have needed to boost its oil revenues so as to develop its economy* cannot be the answer to why Riyadh chose to boost the production of its crudes, thereby reducing its swing-producer role at that time, as will be argued below.

## 1. Saudi Arabia's Economic Vulnerabilities

### 1) High Dependency on Oil and Decline in Oil Revenues

The economy of Saudi Arabia, with the largest oil reserves in the world, had benefited from its oil sales. Since the early 1970s and the First Oil Crisis, the Kingdom had accumulated the massive oil wealth (see Table 3-1) owing to highly increased world demand for its oil.

<Table 3-1> Governmental Revenues, 1970-1984 (In SR<sup>183</sup> million)

Year	Oil Revenues	Other Revenues	Total Revenues
1970	7,122	818	7,940
1971	9,685	1,435	11,120
1972	13,480	1,888	15,368
1973	39,285	2,420	41,705
1974	94,190	5,913	100,103
1975	93,481	9,903	103,284
1976	121,191	14,766	135,957
1977	114,042	16,617	130,659
1978	115,078	16,427	131,505
1979	189,295	21,901	211,196

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<sup>183</sup> Saudi Riyal. For most of the 1970s and early 1980s, trading at between \$1 = SR3 and \$1 = SR4. Fixed at \$1 = SR3.75 since 1986. Tim Niblock and Monica Malik, *The Political Economy of Saudi Arabia* (New York: Routledge, 2007), p. xiv.

1980	319,305	28,795	348,100
1981	328,594	39,412	368,006
1982	186,006	60,176	246,182
1983	145,123	61,296	206,419
1984	121,348	50,161	171,509

Source: Saudi Arabian Monetary Agency, *Forty-First Annual Report* (Riyadh: SAMA, 2005).

An unprecedented boom the Kingdom enjoyed was driven by the sharp rises in oil prices during the period between 1970 and 1985.<sup>184</sup> The world oil prices had soared to the highest level up to that time whereas the world economy had been ravaged by two major oil crises. In 1980 when the Middle East countries were devastated in the aftermath of the Iranian Revolution, the spot price of Brent oil surged dramatically to \$36.83 per barrel.<sup>185</sup> The price of Arabian Light crude hit \$35.69 per barrel in the same year — the price had hardly been going up again beyond this level until 2005.<sup>186</sup>

The high level of oil prices and abundant governmental revenues were unquestionably good news to the Kingdom. But they, on the other

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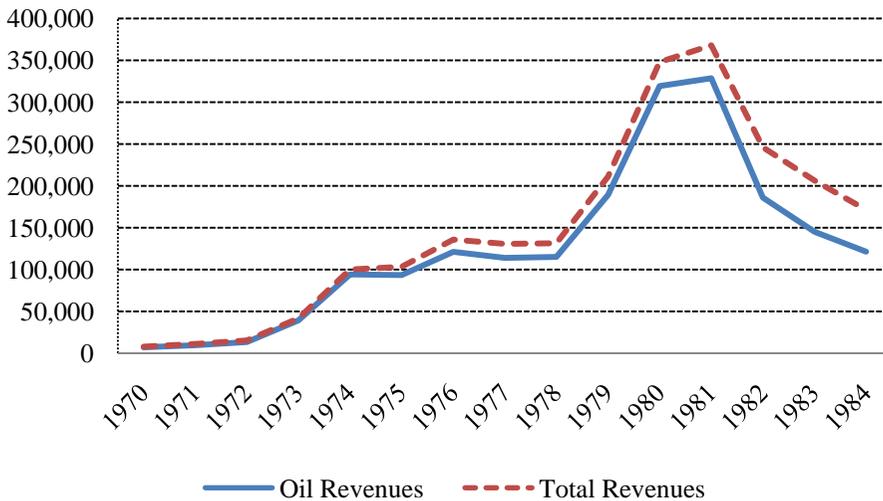
<sup>184</sup> The spot price of Dubai crude oil was \$2.83 per barrel in 1973. After the OPEC's embargo, its price soared to \$10.41 per barrel in 1974. In the aftermath of the Iranian Revolution, Dubai crudes were traded at \$35.69 per barrel. In 1985, the price decreased to \$27.53 per barrel. However, it had been the highest price recorded until 2004. BP, 2011, p. 15.

<sup>185</sup> BP, 2010, p. 16.

<sup>186</sup> BP, 2010, p. 16.

hand, indicated that the Saudi Kingdom had been heavily depending on oil exports (See Figure 3-1) and that the Saudi economy was especially vulnerable to external uncertainties such as downward oil price fluctuations.

**<Figure 3-1> The Share of Oil Revenues of the Total Revenues, 1970-1984 (In SR million)**



Source: SAMA 2005

These concerns were realized in late 1985 when the oil price began to plunge. Both gradual decline in demand for oil<sup>187</sup> and growing oil supplies from non-OPEC sources caused oil price crash, as

<sup>187</sup> According to an expert’s analysis issued in 1985, “world energy consumption declined from 289 quadrillion BTU in 1980 to 284 quadrillion in 1984” and it was already “expected to slip further to 280 quadrillion BTU in 1985.” *Houston Chronicle*, 12 July, 1985.

discussed in the previous chapter. In January 1985, the assessed price of Arabian Light crude was \$28.08 per barrel.<sup>188</sup> And it fell down to \$26.92 per barrel in December of the same year.<sup>189</sup> The downward trend in oil prices became remarkably clearer next year. In January 1986, Brent was quoted at about \$17 per barrel and WTI at almost \$15 per barrel.<sup>190</sup> The world was shocked at the rapid speed at which the oil prices dropped since the slump in prices continued with Brent touching \$14 per barrel and WTI \$12.6 per barrel, each down about \$3 per barrel from the previous month.<sup>191</sup> In 1986, “from May to July, crude oil spot prices witnessed a continuation of the year’s downward trend, falling below 1974 levels in July.”<sup>192</sup> Even though the OPEC countries endeavored at the several regular conferences to revive the market, “the general level of crude and product prices towards the end of 1986 was down by more than \$10 per barrel compared with 1985.”<sup>193</sup>

The oil price collapse led to a precipitous revenue loss (See Figure 3-2 and Table 3-2), and thereby a sharp retrenchment in the governmental budget of Saudi Arabia in the following years (See Table 3-2). Over the periods from 1985 to 2000, the aggregate oil revenues of Saudi Arabia were way “below the 1980-2 level.”<sup>194</sup>

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<sup>188</sup> OPEC, *Annual OPEC Report: 1985* (Vienna: OPEC Secretariat, 1985), p. 10.

<sup>189</sup> OPEC, 1985, p. 12.

<sup>190</sup> OPEC, *Annual OPEC Report: 1986* (Vienna: OPEC Secretariat, 1986), p. 9.

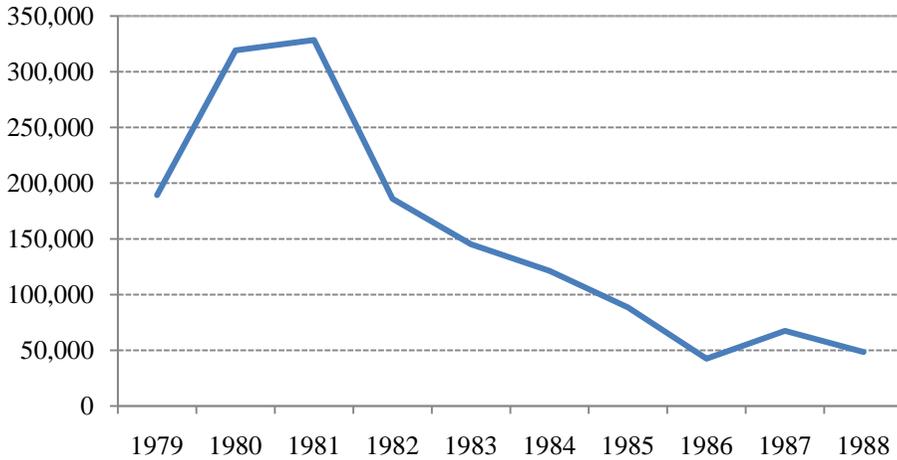
<sup>191</sup> OPEC, 1986, p. 9.

<sup>192</sup> OPEC, 1986, p. 10.

<sup>193</sup> OPEC, 1986, p. 11.

<sup>194</sup> Niblock and Malik, 2007, p. 94.

**<Figure 3-2> Oil Revenues, 1979-1988 (In SR million)**



Source: SAMA 2005

**<Table 3-2> Actual Governmental Revenues and Expenditure, 1979-1986 (In SR million)**

Year	Total Revenues	Total Expenditures	Surplus/Deficit
1979	211,196	185,724	25,472
1980	348,100	236,755	111,345
1981	368,006	284,650	83,356
1982	246,182	344,912	1,270
1983	206,419	230,186	-23,767
1984	171,509	216,363	-44,854
1985	133,565	184,004	-50,439
1986	76,498	137,422	-60,924

Source: SAMA, *Forty-Third Annual Report* (Riyadh: SAMA, 2007)

As a result of the decline in the oil revenues, the Kingdom's government could not help but set up belt-tightening policies. Saudi Arabia decreased drastically the national development policies as a first step to respond to the budgetary deficit. The Kingdom's government had implemented the 'Five-Year Development Plans' since 1970 to deal with the growing economic burdens imposed in the immediate aftermath of the 1967 Middle East War and, in the long run, to raise "the living standards and welfare of its people" by ensuring "economic and social stability"<sup>195</sup> of the Kingdom. Though, its government spending on the Development Plans began to be shrinking in the wake of the 1986 oil price collapse. The figures on the expenditures on the Development Plans provided in Table 3-3 show that the total expenditures for the Fourth and Fifth Development Plans went down remarkably compared with those for the previous Plans. And the severe reduction in the governmental expenditures over the Fourth and Fifth Development Plans periods indicates evidently not only that the Saudi government had considerable trouble in securing necessary budgets but also that the Saudi economy, as a result, would be likely to be contracting. On the basis of this fact, a number of researches have tried to explain that Saudi Arabia had lost its capability to control the world

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<sup>195</sup> Saudi Arabian Ministry of Economy and Planning, *The First Development Plan 1970-1975* (Riyadh: Ministry of Economy and Planning, 1970), p. 23. All chapters are available at <http://www.mep.gov.sa/index.jsp;jsessionid=6A5E26621DA3AF13D3E1061EDC0A63E3.beta?event=ArticleView&Article.ObjectID=6>

oil prices due to the governmental revenue loss.

**<Table 3-3> Diminution in the Actual Government Expenditures  
for the First, Second, Third, Fourth and Fifth Development Plans**

		Economic Resources	Human Resources	Social and Health	Infra structure	Total
First Plan (1970-75)	SR billion	9.5	7.0	3.5	14.1	34.1
	Share (%)	27.7	20.6	10.3	41.4	100
Second Plan (1975-80)	SR billion	97.3	51.0	27.6	171.3	347.2
	%	28.0	14.7	8.0	49.3	100
Third Plan (1980-85)	SR billion	192.2	115.0	61.2	256.8	625.2
	%	30.7	18.4	9.8	41.1	100
Fourth Plan (1985-90)	SR billion	71.2	115.1	61.9	100.7	348.9
	%	20.4	33.0	17.7	28.9	100
Fifth Plan (1990-95)	SR billion	34.1	164.6	68.0	74.2	340.9
	%	10.0	48.0	20.0	22.0	100

Source: Saudi Arabian Ministry of Economy and Planning, *The Seventh Development Plan 2000-2004* (Riyadh: Ministry of Economy and Planning, 2000)<sup>196</sup>

<sup>196</sup> See p. 43. All chapters of the document whose some parts are saved in the Rich Text Format are available at <http://www.mep.gov.sa/index.jsp;jsessionid=6A5E26621DA3AF13D3E1061EDC>

Table 3-3 tells us one more thing. Saudi Arabia suffered several symptoms of Dutch disease after the two oil crises. In general, a nation's economy suffering from Dutch disease shows a loss of market share in the non-resource sector and is unable to diversify its export products since its non-resource sector cannot enhance competitiveness due to "lack of technology, inefficient management, and lack of certain skills."<sup>197</sup> And the resource boom causes galloping inflation as well as economic inequalities (uneven income distribution) in the domestic economy. The nation which has Dutch disease, therefore, has to stimulate the non-resource sector and to distribute the national welfare to low-income workers in non-resource sectors, thereby diffusing public discontent with the government.

As shown in Table 3-3, despite the total expenditures diminished between 1980 and 1995, Saudi Arabia increased its spending on the development plans of human resources and social and health services. Increased spending on these sectors represents the Kingdom suffered from Dutch disease and attempted to abate public discontent with its economic policy.

The brief sketch of the Saudi dependency on its own oil reserves that I presented above is describing in outline the strong argument of the supporters of 'the Hypothesis (B).' They assert that Saudi Arabia's economy suffered from Dutch disease and its decrease in oil-production

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[0A63E3.beta?event=ArticleView&Article.ObjectID=41](https://ojs.berkeley.edu/view/olAA63E3.beta?event=ArticleView&Article.ObjectID=41)

<sup>197</sup> Eman Hassan Ismail, *Saudi Arabian Economy and the Dutch Disease: a Recent Look at a Small Open Economy*, Ph.D. Dissertation, University of California, 2005, p. 4.

volume until July 1985 had exerted a huge impact on the Saudi economy. The economy of Saudi Arabia was structurally susceptible to the fluctuations in its oil exports since the proceeds from the oil export sales had occupied more than half its economy. According to them, the sudden contraction of the Saudi economy and the substantial diminishment of the development plans pushed the Saudis to increase their own outputs to diffuse public discontent with the economy.

Besides the contraction of the economy, Saudi Arabia's economy suffered from the growing inequalities in the nation. This inequality issue had developed during a decade and was likely to provoke the public protest against the Saudi regime. It will be addressed in the following section.

## **2) Sub-regional<sup>198</sup> and Social Inequalities**

Apart from the spending cut on the Development Plans, the Saudis were certainly at stake in terms of the growing sub-regional inequality. Despite an enormous oil wealth Saudi Arabia had amassed, not every sub-region benefited from the Kingdom's oil exports. The Saudi government failed to redistribute the wealth throughout the Kingdom and sub-regional economic inequality kept increasing.

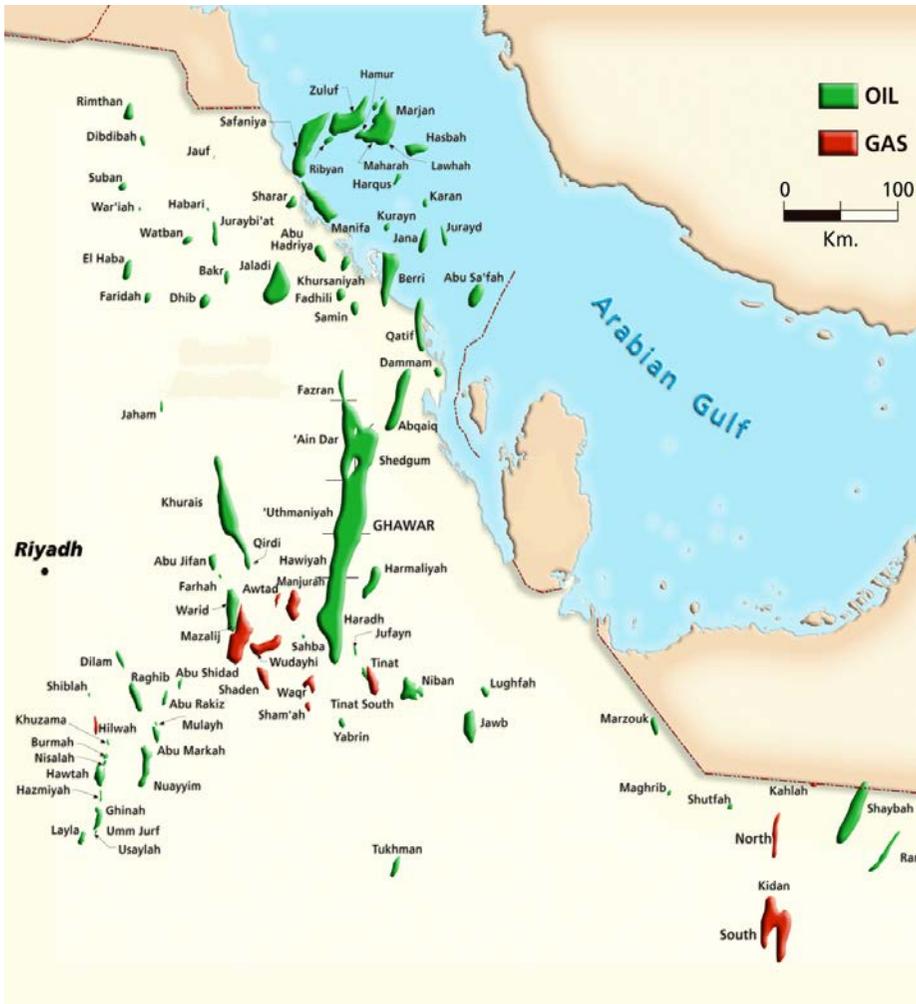
Sub-regional inequality in incomes had arisen from the uneven

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<sup>198</sup> The term 'sub-region' is used here to draw a distinction between 'region' and 'sub-region.' Sub-region is referring to a set of provinces of a country whereas region implies a broader area of land which shares cultural characteristics or geographical features, e.g. the Middle East region is comprised of a group of countries which share the common religious culture.

distribution of the oil reserves. The majority of the Kingdom's oil and gas reservoirs were located in the Eastern Province of the country (See Figure 3-3).

<Figure 3-3> Map of Oil and Gas Fields in Saudi Arabia



Source: U.S. Energy Information Administration (EIA)

Although the Eastern Province, Al-Hasa or Al-Sharqiyya,<sup>199</sup> had been relatively less populated,<sup>200</sup> it had occupied most of the Kingdom's energy resources.<sup>201</sup> It had been producing the greater part of the Saudi oil products, and consequently perceived as the economic heartland of the Kingdom. It was also the Eastern Province that had attracted most of inward industrial investments. "Enabled by oil, some of the kingdom's biggest environmental engineering projects were undertaken first in the east. The region was often a testing ground for new development initiatives, a place to measure success, failure, and the political effectiveness of scientific experiment."<sup>202</sup>

The resource-rich but less populated sub-region, the Eastern

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<sup>199</sup> Mordechai Abir, *Saudi Arabia in the Oil Era: Regime and Elites, Conflict and Collaboration* (London: Croom Helm, 1988), p. 17.

<sup>200</sup> Saudi Arabia has officially consisted of five major sub-regions since 1932 when it was united: The Western sub-region (Hijaz), the Eastern Province (Al-Sharqiyya), the Central sub-region (Najd), the Southern sub-region (Asir), and the Northern sub-region. About 14.5 percent of the Kingdom's population was residing in the Eastern Province. The Western sub-region is the most populated with about 32.7 percent of the total population followed by the Central and Southern sub-regions with about 27.2 and 17.4 percent each. And the Northern sub-region is the least populated with 8.2 percent of the total population. See M. M. SH. Al-Kahtani, "Regional Development Planning Policy in Saudi Arabia," *Paper presented in the 2003 Hawaii International Conference on Social Sciences*, (Honolulu, the United States, June 12-15 2003), p. 8, 11 (Available at <http://www.hicsocial.org/Social2003Proceedings/M.M.SH.%20Al-Kahtani.pdf>); Abir, 1988, p. 17.

<sup>201</sup> The Eastern Province is marked by its possession not only of oil but also of subterranean water resources including many fertile oases. It enables the Eastern Province to develop agriculture as well as the petroleum industry. See Al-kahtani, 2003, p. 6; Jones, 2010, p. 16.

<sup>202</sup> Jones, 2010, p. 18.

Province, had been likely to become the key factor in provoking widespread discontents at the government among the people in the marginalized sub-regions. In an effort to address the glaring sub-regional disparity in wealth, “the United Nations and Ford Foundation missions who visited the Kingdom” recommended the government in 1964 to establish “a government department in each region to stimulate local development possibilities, and to coordinate the activities of the various government ministries and agencies when setting up projects and programmes in the sub-regions (revised from ‘regions’).”<sup>203</sup> By the end of the 1970s, the Saudi government had attempted to implement several development policies in line with the recommendations, but most of them culminated in failure. Jones(2010) argue that the 1979 massive uprising revealed “how community resentment over the politics of development, marginalization, and the failure of the state had continued to simmer after the mid-1950s.”<sup>204</sup>

Besides sub-regional inequalities, the problem associated with social inequalities arose in Saudi Arabia. Social inequalities were, in fact, caused by the Kingdom’s Dutch disease. The oil boom during the period between 1970 and the early 1980s called for massive labor force. However the Saudis could not meet the rising demand for workers in the oil sector. Instead, a number of foreign workers were employed in the oil sector of Saudi Arabia. From 1980 to 1985, the foreign labor force grew at an average annual rate of 11.7%.<sup>205</sup> And “out of a total

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<sup>203</sup> Al-Kahtani, 2003, p. 24.

<sup>204</sup> Jones, 2010, p. 176.

<sup>205</sup> Gil Feiler, “Migration and Recession: Arab Labor Mobility in the Middle East,

increase of 1.42 million workers,”<sup>206</sup> the share of foreign workers was 1.13 million.

The increase in the number of foreign workers fueled economic, social, and political difficulties in Saudi Arabia. The level of wages given to the foreign labors was lower than that of the Saudis’. Moreover, the foreign workers’ wage level slid steadily due to a harsh competition between them. The living standards of foreign workers got worsened. This market pressure was likely to generate the public discontent with the Saudi regime.

Since most of the foreign workers came from different countries with different cultural and religious backgrounds, “a cultural and religious alienation” had been “beginning to take hold”<sup>207</sup> since the early 1960s. Besides heterogeneous workers absorbed in the Kingdom’s economy, Saudi Arabia had not yet promoted the national integration as the Saudis had been comprised of various ethnic groups. Between the Badu (nomads) and the Hadr (the settled) existed cultural variations. And the Najdis who lived in the Central sub-region were significantly different from the rest of the population for they considered themselves aristocratic, politically conservative, and religiously puritan.<sup>208</sup> In the circumstances, the influx of foreign labor force, thus, caused the national disintegration.

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1982-89,” *Population and Development Review*, Vol. 17, No. 1 (March 1991), p. 146.

<sup>206</sup> Feiler, 1991, p. 146.

<sup>207</sup> Tim Niblock, *Saudi Arabia: Power, Legitimacy and Survival* (Oxon: Routledge, 2006), p. 68.

<sup>208</sup> Abir, 1988, p. 18.

The Kingdom's rulers were, of course, well recognized that the widening gap in distribution of wealth and the growing population of foreign workers could result in massive popular protests undermining the political foundation of the Royal regime. So the Saudi government set up the Five-Year Development Plans as a means of equitably allocating resources and economic activities to the five administrative sub-regions.

It was the Second Development Plan implemented between 1975 and 1980 where the Kingdom set out to endeavor to incorporate "a broad scale regional development objective."<sup>209</sup> One of the key elements of the Second Development Plan was directly addressing the challenge of sub-regionally equitable development as follows:

The development strategy consists of three key elements..... Development of the economic regions of the country by wide distribution of productive investment based on the distinctive physical and human resources of each region, and social programs applied in accordance with need, thereby extending the benefits of national development to all sectors of the population without removing the incentives to individual effort and achievement.

..... The development of regional economic resources and the provision of social services in accordance with need are intended to distribute the wealth, at present generated by the Kingdom's oil, to all sectors of the population.<sup>210</sup>

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<sup>209</sup> Al-Kahtani, 2003, p. 25.

<sup>210</sup> Saudi Arabian Ministry of Economy and Planning, *The Second Development Plan 1975-1980* (Riyadh: Ministry of Economy and Planning, 1975), p. 58. Available at

The Plan additionally stated the general designs for the development of each region such as agricultural and minerals developments and construction of pipelines.<sup>211</sup> The Third Development Plan showed in 1980 the Kingdom's mounting concern over assisting the rural areas "to develop productive activities which would enable them to retain as many of their inhabitants as possible" and extending "the distribution of services"<sup>212</sup> and introduced a more concrete system for the sub-regional development than that for the Second Plan. According to the Third Plan, the Kingdom intended to construct "national, regional, and district centers, spread throughout the Kingdom, for the provision and effective coordination of development services."<sup>213</sup> These service centers were established to "stimulate growth or satisfy particular welfare needs" as well as to provide "the requirements for each area to realize economic expansion according to its own potential."<sup>214</sup>

In spite of the Kingdom's constant emphasis on balanced development nationwide, the question was raised whether the implementation of its ambitious plans ended unsuccessfully or not.

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<http://www.mep.gov.sa/index.jsp;jsessionid=6E359395088FE9F6BFAF96CB21D4B53B.beta?event=ArticleView&Article.ObjectID=7>

<sup>211</sup> See Saudi Arabian Ministry of Economy and Planning, 1975, pp. 58-61.

<sup>212</sup> Saudi Arabian Ministry of Economy and Planning, *The Third Development Plan 1980-1985* (Riyadh: Ministry of Economy and Planning, 1980), p. 107. Available at

<http://www.mep.gov.sa/index.jsp;jsessionid=5C907DF942C3F0576821C7E0CD22A6AE.beta?event=ArticleView&Article.ObjectID=36>

<sup>213</sup> Saudi Arabian Ministry of Economy and Planning, 1980, p. 108.

<sup>214</sup> Saudi Arabian Ministry of Economy and Planning, 1980, p. 109.

Al-Kahtani argues that the Saudis failed to deal with the regional disparities for the reason that most villages of the country had remained “largely inaccessible to services provided at these centers,”<sup>215</sup> and the service centers had “done little to prevent the increased polarization of development towards the urban centers of the country at both national & sub-regional (revised from ‘regional’) levels.”<sup>216</sup> And the centers failed to overcome their limits in the light of the fact that they provided only the specialized facilities such as hospitals and colleges while ignoring the needs of particular regions.<sup>217</sup>

‘The Hypothesis (B)’ could be readily drawn from the foregoing descriptions of the wide disparity among the sub-regions and the increasing number of foreign workers. Sub-regional and social inequalities were rampant in the Kingdom and remained unresolved. These tight economic circumstances could have stirred up the Saudis’ dissatisfactions with the government’s policies which had been utterly incapable of tackling the inequality issue and put the rulers in a dire predicament.

## **2. Saudi Arabia’s Economy in the mid-1980s: Examination of the Hypothesis (B)**

The Hypothesis (B) which argues that *Saudi Arabia might have needed*

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<sup>215</sup> Al-Kahtani, 2003, p. 29.

<sup>216</sup> Al-Kahtani, 2003, p. 31.

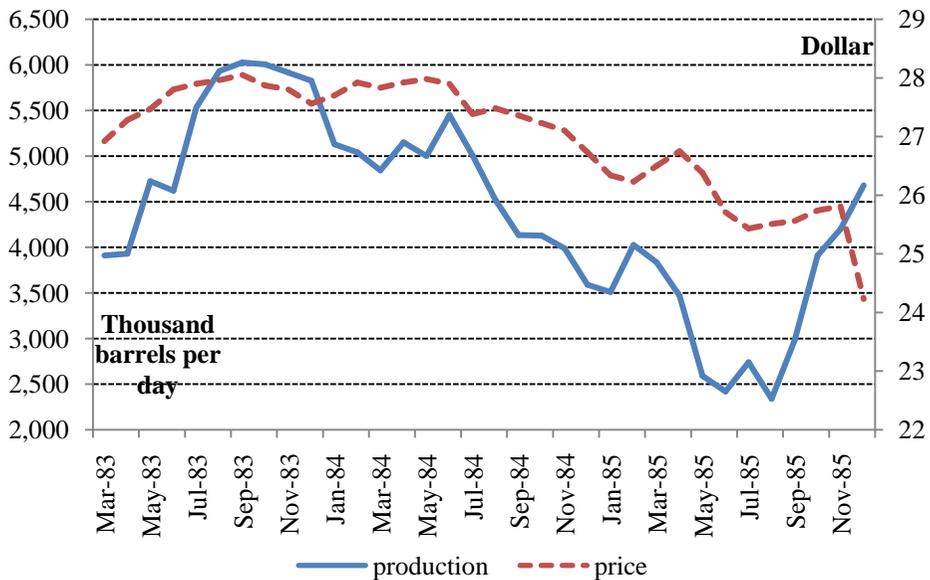
<sup>217</sup> Al-Kahtani, 2003, p. 31.

*to boost its oil revenues so as to develop its national economy* tells very clearly that Saudi Arabia needed to pump out more oil than before as its economy shrank more than it had expected. Saudi Arabia's economy was extremely vulnerable to external factors due to its high dependency on oil exports which had accounted for more than half the government's earnings in the mid-1980s. Internally, there had been growing a significant factor threatening the Saudi Royal regime as the sub-regions of the Kingdom benefitted disproportionately from the skyrocketing wealth which had been created by oil exports until the early 1980s.

The rulers made several efforts to equitably distribute economic activities and physical infrastructures in order to prevent massive popular movements opposing to the monarchy. These economic vulnerabilities, as many argued, could have led the Saudi government to determinate to raise its production of oil in August 1985.

However, the declined oil revenues during the first half of the 1980s did not push the Saudis to boost its oil production in August 1985. As an example of Figure 3-4, the price of oil had maintained at the level of \$27 per barrel since 1983.

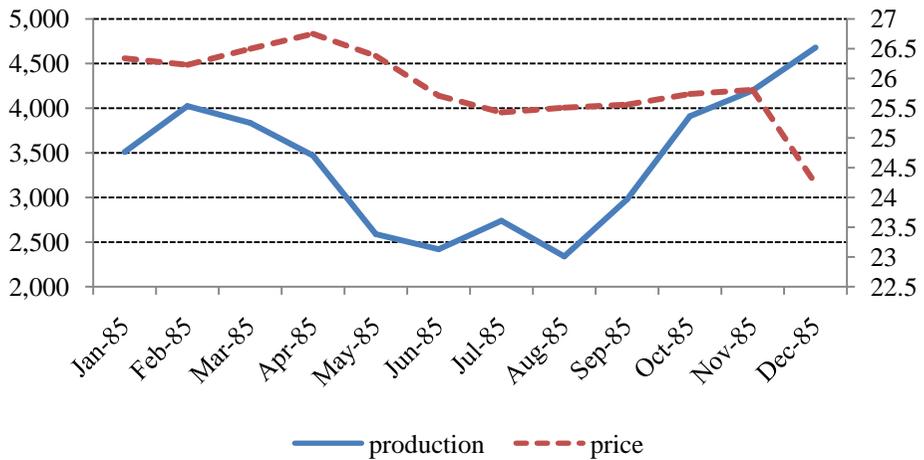
**<Figure 3-4> Saudi Arabia's Oil Production (monthly) and the Price of Oil, 1983-1985**



Source: EIA, 1993

The average price of oil in 1983 was \$27.81 per barrel and \$27.60 in 1984. During the first half of 1985, the price maintained approximately at \$26 per barrel (See Figure 3-5). These figures tell us evidently that the oil prices did not affect the Saudis' decision to suddenly increase oil-production volume in August 1985. If the price of oil had faltered until the summer of 1985, the Saudi Kingdom would have increased the oil production to earn its revenues. However, the price could be said to have kept stable at that time. The price was not a determinant factor in the shift of the Saudis' oil-production policy.

**<Figure 3-5> Saudi Arabia’s Oil Production (monthly) and the Price of Oil, 1985**



Source: EIA, 1993

Besides, the shrinking oil revenues during the first half of the 1980s, in fact, did not wipe out the Saudi economy. Of course, the reduction in oil outputs doubtlessly led to a sharp decline in the Saudi government’s revenues from the petroleum sector in the mid-1980s. In spite of the Saudis revenues plunged drastically (See Figure 3-2), its impact on the overall economy was relatively weaker than economists described, looking at several economic indicators over the period.

First of all, Saudi Arabia’s gross domestic product (GDP) at ‘constant prices’<sup>218</sup> for the period between 1985-1990 shows that its

<sup>218</sup> Saudi Arabia’s economy in the late 1980s is portrayed very differently according to from which perspective you see it. Niblock and Malik(2007) strongly argue that the way to measure GDP becomes a matter of great importance when it comes to

economy adjusted well to the contracted economic circumstances. Table 3-4 and 3-5 illustrates that the Saudi economy had a gradual upward trend over the period. Even though “the year 1985 constituted a low point, due to fall in oil production and the impact of cuts in government expenditure on development in all sectors,”<sup>219</sup> there was an evident trend toward recovering in the Saudi economy shortly thereafter.

**<Table 3-4> GDP by sectors, 1985-1990 (constant prices at 1999 SR million)**

Year Sector	1985	1986	1987	1988	1989	1990
Oil <sup>a</sup>	92,525	131,172	116,103	140,769	136,966	170,076
Non-oil <sup>b</sup>	312,160	294,004	292,649	296,423	302,272	306,149
Total	404,685	425,166	408,752	437,192	439,238	476,225
Import Duties	4,289	3,627	3,917	9,415	7,648	7,881
GDP	408,974	428,792	412,670	446,608	446,887	484,106

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looking at the Saudi economy. If the measure is in current prices, you can describe the Saudi economy to seriously have shrunk in the wake of the oil price collapse. “GDP at current prices in 1986 had declined to little more than one-half what it had been in 1981. While it grew through most of the rest of the 1980s and 1990s, it only regained the 1981 level in the year 2000.” However, the current prices measure of GDP, according to them, “is not a useful measure of the overall strength of the economy. The decline in GDP at current prices after 1981 simply reflected the unprecedented heights to which oil prices had risen in the early 1980s, and the sharp falls thereafter.” See Niblock and Malik, 2007, pp. 116-117.

<sup>219</sup> Niblock and Malik, 2007, p. 117.

Source: Saudi Arabian Central Department of Statistics and Information

Note: The oil sector and the non-oil sector are not necessarily apart from each other since the latter includes economic activities associated with petroleum refining. It shows Saudi Arabia's high dependency on the oil industry.

a: The oil sector refers to the production activity pertaining to the extraction and supply of crude oil.

b: The non-oil sector represents the production activity in manufacturing, industry and services through private enterprise, including that segment of the non-oil sector in which government enterprises operate. Within the non-oil sector is also subsumed petroleum-related processing and other value-added activity.<sup>220</sup>

And "by 1992, GDP in constant prices had surpassed the peak reached in 1981."<sup>221</sup> With regard to the gradual recovery of the Kingdom's economy, the government in the Fifth Development Plan reported that the economy "exhibited considerable resilience"<sup>222</sup> between 1985 and 1990.

It was the oil industry that promoted the Kingdom's economic

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<sup>220</sup> Masudul A. Choudbury and Mohammed A. Al-Sahlawi, "Oil and Non-oil Sectors in the Saudi Arabian Economy," *OPEC Review*, Vol. 24, No. 3 (September 2000), p. 237.

<sup>221</sup> Niblock and Malik, 2007, p. 117. In 1992, GDP amounted to SR 552,625 million and that of 1981 was SR 542,093 million. Figures are available at Saudi Arabian Department of Statistics and Information, [http://www.cdsi.gov.sa/english/index.php?option=com\\_docman&task=cat\\_view&gid=200&Itemid=151](http://www.cdsi.gov.sa/english/index.php?option=com_docman&task=cat_view&gid=200&Itemid=151)

<sup>222</sup> Saudi Arabian Ministry of Economy and Planning, *The Fifth Development Plan 1990-1995* (Riyadh: Ministry of Economy and Planning, 1990), p.25. Available at <http://www.mep.gov.sa/index.jsp;jsessionid=6A5E26621DA3AF13D3E1061EDC0A63E3.beta?event=ArticleView&Article.ObjectID=38>

recovery to reach the 1981 level again. On the contrary to the Hypothesis (B), the petroleum industry actually did not push the Saudi economy into a long-term regression to consider reducing its swing-producer role. Even though it took a serious hit in 1985 and 1986, it was the one of the sectors that recovered swiftly to regain its dominance in the market. In 1988, the upstream sector accounted for 26.53 percent of GDP, which exceeded the 1983 level, 23.26 percent (see Table 3-5).<sup>223</sup>

**<Table 3-5> GDP by Economic Activities, 1983-1990**  
**(constant prices at 1999 SR million)**

	Mining & Quarrying	a) Crude Petroleum and Natural Gas	b) Other	Manu-Facturing	a) Petroleum Refining	b) Other	GDP
1983	105,632	103,875	1,757	28,902	10,344	18,558	447,440
1984	95,315	93,595	1,720	32,350	10,828	21,522	432,793
1985	74,305	72,649	1,657	35,565	12,868	22,697	408,974
1986	111,086	109,475	1,611	37,439	15,378	22,061	428,792
1987	95,953	94,378	1,575	37,534	15,547	21,987	412,670
1988	120,089	118,496	1,593	38,940	16,295	22,645	446,608
1989	117,536	115,888	1,648	38,657	15,110	23,547	446,887
1990	148,381	146,733	1,648	40,560	17,392	23,168	484,106

Source: Saudi Arabian Central Department of Statistics and Information

Note: The oil sector divides into the activities of exploration (mining and

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<sup>223</sup> The figures are roughly calculated due to the inaccessibility to detailed data the Saudi government provided to which I can refer for distinguishing the upstream oil sector from the natural gas sector.

quarrying) and the activities of manufacturing.

The growth of the oil sector in the late 1980s was driven by the robust physical infrastructures which had been constructed during the First, Second, and Third Development Plans period. During the period from 1970 to 1985, the Saudi government already built up “a sound basis on which to frame a more ambitious development programme than before”<sup>224</sup> and by virtue of the previous efforts, “the government was no longer concentrating on mega-projects aimed at economic and social transformation.”<sup>225</sup> Instead, it commenced maintaining these structures for further economic development and utilizing the resources at its disposal in more diversified ways. The Saudi intention at that time is reflected in the Fifth Development Plan:

Recognizing the expected limitations on revenues during the (Fifth) Plan period, priority has been given to creating appropriate conditions to achieve planned economic growth through: a moderate increase in total government expenditures (and) institutional measures and policies for the optimal utilization of budget resources, the development of the financial market and support for the private sector<sup>226</sup>

These facts explain why the oil-based Saudi economy improved relatively at a good pace despite the sharp drop in oil revenues having suffered it.

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<sup>224</sup> Niblock and Malik, 2007, p. 53.

<sup>225</sup> Niblock and Malik, 2007, p. 104.

<sup>226</sup> Saudi Arabian Ministry of Economy and Planning, 1990, pp. 93-94.

The Saudi government endeavored to partially finance the falling governmental accounts “by selling foreign assets and raising loans on the international market”<sup>227</sup> in order to defuse popular resentment against the Kingdom’s rule. Even though a deficit in the governmental revenue amounted to SR 60,924 million (US\$ 16.2 billion)<sup>228</sup> in 1986 (See Table 3-2), its foreign assets which added up to US\$ 73.7 billion in the same year<sup>229</sup> could cover up the budget deficit. In addition to the government’s holding of foreign assets, it tried “to rely on in private-sector investment to compensate for falling public-sector investment.”<sup>230</sup> Between 1986 and 1990, the private sector’s contribution to GDP had increased by SR 6,162 million<sup>231</sup> (in 1999 constant prices) and it had accounted over 40 percent of the total GDP throughout the period. A series of its efforts to prompt the private sector enabled its economy not to be much affected by the shrunk production of its crudes.

Owing to the oil wealth accumulated until the early 1980s, Saudi Arabia had the capacity to cope with the nationwide inequalities. As mentioned in the previous section, Riyadh intended to solve the sub-regional disparities and the problem of inequalities among the workers by introducing the Development Plans and the oil wealth, of

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<sup>227</sup> Niblock and Malik, 2007, p. 94.

<sup>228</sup> Calculated based on the fixed SR exchange rate for dollars (\$1 = SR3.75) since 1986.

<sup>229</sup> Niblock and Malik, 2007, p. 103.

<sup>230</sup> Niblock and Malik, 2007, p. 94.

<sup>231</sup> Calculated from data in Table 3-4.

course, financed the Plans.

Saudi Arabia began to implement the Third Development Plan in 1980 and during the five-year implementation period the Kingdom's attention centered on "the completion of infrastructure facilities."<sup>232</sup> Downturn in its governmental revenues notwithstanding, Riyadh managed to complete the construction of large-scale modern infrastructures throughout the nation by the end of 1985: The paved road network expanded to more than 30,000 km and the capacity of ports increased to approximately 50 million tons. The number of working telephone lines and air passengers increased to 903,000 and 24 million respectively.<sup>233</sup>

The Third Plan's strategy was worked out for improving both urban and rural areas. The Plan was designed to select the areas which had not been developed but had "potential to become growth centers for productive economic activities" and to attract "the population from other areas which lacked such potential."<sup>234</sup> Riyadh also endeavored to distribute welfare services to rural areas by launching integrated development system. The integrated development system was implemented among the municipal areas "in order to coordinate the provisions of utilities, public service infrastructure for productive projects and other facilities."<sup>235</sup>

Saudi Arabia also attempted to tackle the growing influx of

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<sup>232</sup> Saudi Arabian Ministry of Economy and Planning, *The Fourth Development Plan 1985-1990* (Riyadh: Ministry of Economy and Planning, 1985), p. 5

<sup>233</sup> Saudi Arabian Ministry of Economy and Planning, 1985, p. 5.

<sup>234</sup> Saudi Arabian Ministry of Economy and Planning, 1980, p. 77.

<sup>235</sup> Saudi Arabian Ministry of Economy and Planning, 1980, p. 78.

foreign workers. The Second and Third Development Plans were marked by the enormous investment in the heavy industry including the downstream oil sector. Owing to the Kingdom’s enthusiasm, “major petrochemical plans were operational, and most primary production facilities were completed by the end of 1985.”<sup>236</sup> The growth of the petroleum industry inevitably demanded for more workers to be employed (See Table 3-6).

**<Table 3-6> Number of Labor Force by Economic Activities,  
1970-1990**

	1970	1975	1980	1985
Agriculture	445.8	426.1	545.6	538
Mining	25.7	45.6	47.0	62.9
Manufacturing	36.1	46.5	170.4	424.1
Utilities	12.2	18.3	67	112.2
Construction	141.5	314.2	638.9	1470
Commerce	130.2	211	323.1	688.7
Transportation	62.1	103.2	180	316.5
Services	250.2	357.2	654.6	1163.1
<b>Total</b>	<b>1103.8</b>	<b>1522.1</b>	<b>3026</b>	<b>5244.6</b>

Source: Saudi Arabian Ministry of Economy and Planning, *The Five-year Development Plan*, from 1975-1990.

Note: The unit is thousands.

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<sup>236</sup> Robert E. Looney, “Oil Revenues and Viable Development,” *American-Arab Affairs*, Vol. 27 (Winter 1988-89), p. 30.

And the rising demand for labor force was accommodated by the massive migration of foreign workers. Before 1985, the Saudis preferred to work in the public sector. Most of the educated and skilled Saudi workers preferred “managerial and administrative jobs rather than technical and vocational jobs that were largely occupied by non-Saudi workers, because these jobs had low wages and they were socially considered menial jobs.”<sup>237</sup>

The growing number of foreign workers possibly threatened the unity of Saudi Arabia since its population was quite small. And the wage gap was widening to provoke the foreign workers’ dissatisfaction. Thus, the presence of foreign workers in Saudi Arabia could have undermined the internal political stability of the Kingdom and the Royal regime itself.

As a solution, Riyadh determined to lower the number of foreign workers in the Kingdom. Instead, it attempted to substitute the foreign workers “by Saudi natives across occupations.”<sup>238</sup> And the ‘Saudisation’ policy was adapted in late 1985 in order to “force firms in the private sector to recruit among Saudi nationals.”<sup>239</sup> Under the policy implemented, the companies in the private sector had to “prove conclusively the absence of adequately trained indigenous workers

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<sup>237</sup> Sayid F. Ahmed Al-Khouli, “Labour Shortages, Migration, and Segmentation: The Case of Saudi Labour Market,” p. 2. The paper is available at <http://inmgard-conix-shifting.de/fileadmin/user-upload/pdf/roundtable07/mahdi.pdf>

<sup>238</sup> Al-Khouli, p. 5.

<sup>239</sup> Al-Khouli, p. 6.

before being permitted to hire foreigners.”<sup>240</sup> The Kingdom also “decided that the contracts of expatriates would be renewed only if Saudi nationals could not be found to fill the vacancies.”<sup>241</sup> A series of the policies which aimed to curtail the number of foreign workers showed the Kingdom’s efforts to stabilize the labor market and the state.

As the Hypothesis (B) argued, the Saudi economy suffered from decrease in its oil exports, shrinking revenues and the problems of inequalities until August 1985. However, as explained above, it can be argued that the Saudi economy had possessed the capability to defend itself from external market stimuli and attested to its restore at the end of the decade. The Saudis had earned enormous governmental revenues until the early 1980s and an overriding emphasis was placed on the construction of “a physical infrastructure supporting both the producing and consuming sectors and that linking them together.”<sup>242</sup> Based on the oil wealth accumulated until the early 1980s and firm infrastructures constructed or under construction, the Saudi government could deal with a sharp drop in its oil exports and governmental revenues in 1985. For the very reason, it is hardly appropriate to assert that the Saudi rulers boosted the Kingdom’s oil production in August 1985 and consequently reduced its swing-producer role to develop its domestic

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<sup>240</sup> Fieler, 1991, p. 146.

<sup>241</sup> Fieler, 1991, p. 146.

<sup>242</sup> Some of the words are revised from the original passages. Saudi Arabian Ministry of Economy and Planning, 1970, p. 26.

economy. Another explanation is required to understand the Saudi behavior in the mid-1980s and the Hypothesis (A) will be examined in the following section.

## **IV. Saudi Arabia's Politics in a Structural Context**

As shown above, Saudi Arabia, despite the substantial economic pressures from the structural change of the global market, managed to cope with the loss of its market share and a decline in governmental revenues. The Kingdom's economic capacity and the relatively stable domestic economy at the time, then, raises two important questions: First, did the Saudi government have an incentive to overproduce its crude oil for a political factor? Second, provided that a political factor led the Saudis to reduce its swing-producer role, what constituted the most important element of the political factor? Coping with these questions will lead to an understanding of the Saudi's policy in the mid-1980s.

In fact, outside the Kingdom, the political dimension of the Middle East region gives a hint that Saudi Arabia might have resolved to overproduce its crudes and to distort the market prices on account of a growing military tension. Since the late 1970s, tensions among the Middle Eastern countries had escalated, and it was fueled by intense international competitions between the U.S. and the Soviet Union. This chapter traces back to the period from the late 1970s to 1986, thereby trying to answer the main question of the research.

### **1. Growing International Tensions in the Middle East**

The Middle East region had become an arena of superpower competition during the Cold War. It had gained strategic importance because of massive oil reserves it had and, for its geographical location which occupied the middle ground between Western Europe and the Soviet Union, both the communists and the capitalists had great concern in this region as means of defending or expanding their blocs. The United States, the Soviet Union, and Western Europe all raced to hold a dominant position in the Middle East and to preempt any potential threats from the opposite bloc.<sup>243</sup>

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<sup>243</sup> During the bipolar Cold War, both camps attempted to exclude each other from regional affairs or at least to maintain a regional balance of power in the Middle East. While these great powers struggled to balance each other, the local states could extract “diplomatic support, financial aid, and military assistance from them wishing to prevent their rivals from becoming dominant. See Benjamin Miller, “The International System and Regional Balance in the Middle East,” in T. V. Paul, James J. Wirtz, and Michel Fortmann (eds.), *Balance of Power: Theory and Practice in the 21st Century* (Stanford: Stanford University Press, 2004), pp. 240-241.

<Figure 4-1> The Middle East



Source: U.S. CIA the World Factbook

The United States, in fact, had exerted influential leverage over the region and particularly over Saudi Arabia, even before the Second

World War. Saudi Arabia and the U.S. had established diplomatic relations in 1933 due to geopolitical concerns, and built up strong economic ties. “Saudi King Abd al-Aziz saw the United States as a natural political and economic counterbalance to what was then de facto British dominance of the Gulf,” and as an opportunity for the Kingdom to explore and develop its natural resources in a relatively independent way.<sup>244</sup> As an example, one of the biggest oil companies in the world, the Arabian American Oil Company (Aramco), was founded when King “Abd al-Aziz ratified a concession with Standard Oil of California (SOCAL)<sup>245</sup> to find, develop, produce, and market internationally any oil that could be found in the larger part of his Kingdom.”<sup>246</sup> His “selection of SOCAL for a sixty-year concession” prompted massive development of oil industry in the Eastern Province, covering “360,000 square miles of a thinly populated area.”<sup>247</sup> Increasingly recognizing the importance of Saudi Arabia in the geo-economic and geopolitical senses, the Franklin D. Roosevelt administration, on February 16, 1943, declared that “the defense of Saudi Arabia was a vital interest to the United States” and dispatched the first United States military mission to the Kingdom.<sup>248</sup>

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<sup>244</sup> Anthony H. Cordesman, *Saudi Arabia Enters the 21st Century* (Westport: Greenwood Publishing Group, 2003), p. 105.

<sup>245</sup> It was renamed Standard Oil later.

<sup>246</sup> Parker T. Hart, *Saudi Arabia and the United States: Birth of a Security Partnership* (Bloomington: Indiana University Press, 1998), p. 8.

<sup>247</sup> Hart, 1988, p. 37.

<sup>248</sup> Darrell J. Bennett, Jr., “From the Carter to the Bush Doctrine: an In-Depth Analysis of US Middle Eastern Policy,” *Policy Analysis Paper of the Center for the Study of the Presidency* (April 2007), p. 4.

Saudi Arabia's geostrategic importance also had encouraged the U.S. government's sizable military aid to the Kingdom. In the immediate aftermath of the Second World War, Harry Truman sent a letter in 1950 to King Ibn Saud saying that "The United States is interested in the preservation of the independence and territorial integrity of Saudi Arabia. No threat to your Kingdom could occur which would not be a matter of immediate concern to the United States."<sup>249</sup> Truman's letter succinctly mirrors the fact that the U.S. considered the Saudi Kingdom to be a strategically significant place for establishing capitalists' defense line against the Communist Bloc.

In contrast to the dominant influence of the U.S. traditionally had exercised upon the Middle East region by the help of the pro-Western Arab states including Saudi Arabia, the Soviet Union had carried political clout, to a lesser extent, on the region. In the 1950s, the Soviets had presumed on the relatively cordial bilateral relations with Egypt, ruled by Pro-Soviet Gamal Abdul Nasser in an effort to extend its influence and to spread communist ideas through the region. During the Middle East crisis in 1956, the Soviets buttressed Egypt by providing military aids to the Egyptian troops. Yet Nasser by no means endorsed the Soviet Union's intervention in the development of its infant domestic communism. Instead, he simultaneously "sought major economic assistance from the United States, explicitly inviting it "to compete" with the Soviet Union."<sup>250</sup>

Between the late 1960s and the early 1970s, the Soviet Union

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<sup>249</sup> Bennett Jr., 2007, p. 5.

<sup>250</sup> Hart, 1988, pp. 53-54.

came into close relations with Egypt, Syria and Iraq.<sup>251</sup> A rapprochement between the Soviets and Egyptians was triggered, most of all, by Nasser's death in 1970 and Anwar Sadat's succession to power. Sadat took up more pro-Soviet stance, thereby resulting in an aggravation of the relations both with the United States and with the pro-Western Arabs. In April 1972, the Soviet Union and Iraq signed "the Soviet-Iraqi Treaty of Friendship and Cooperation, in which both countries pledged to help one another in times of danger and refrain from entering into hostile alliances directed against the other country."<sup>252</sup> Owing to the treaty, the Soviet-Iraqi relations were bolstered to a larger extent compared with those in the wake of the 1958 Iraqi revolution.<sup>253</sup> The Soviet-Syrian relationship improved during the Arab-Israeli conflict in 1967. On April 7, 1967 the Syrian jets were downed by the Israel fighters and in May Israel threatened to occupy Damascus. Syria, with the mutual defense pact with Egypt, attempted to exploit the Soviets by means of confronting Israel.<sup>254</sup>

However, a turning point of great importance came on December 27, 1979 after Soviet troops invaded Afghanistan and "installed Babrak

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<sup>251</sup> Peter L. Hahn, "The Cold War and the Six Day War: US Policy towards the Arab-Israeli Crisis of June 1967," in Nigel John Ashton (eds.), *The Cold War in the Middle East: Regional Conflict and the Superpowers, 1967-73* (New York: Routledge, 2007), p. 17.

<sup>252</sup> Kazem Sajjadpour, "Neutral Statements, Committed Practice: The USSR and the War," in Farhang Rajaei (eds.), *Iranian Perspectives on the Iran-Iraq War* (Gainesville: University Press of Florida, 1997), p. 29.

<sup>253</sup> Sajjadpour, 1997, p. 29.

<sup>254</sup> Hahn, 2007, p. 17.

Karmal as Afghanistan's new leader.”<sup>255</sup> The Soviets' invasion immediately aroused Washington's fear since “it was the first time that Soviet troops had massed inside a non-Warsaw Pact country, and the invasion represented a dramatic emboldening of Soviet policy.”<sup>256</sup>

Under the direct pressure from the Soviets, the U.S. government increasingly found it difficult to counterbalance the Soviet Union in the first half of 1980s. As the Iran-Iraqi war, broken out in 1980, had dragged out for too long, some Arab countries began to hope for a military support from the Soviet Union. In 1984, “the Soviet Union and North Yemen signed a 20-year treaty of friendship and cooperation,”<sup>257</sup> and the Soviets concluded an arms deal with Kuwait, “reportedly to cost \$300 million.”<sup>258</sup> Kuwait turned to the Soviet Union for missiles shortly after its request for “the shoulder-launched ground-to-air Stingers”<sup>259</sup> was rejected by the Reagan administration.<sup>260</sup> Moscow succeeded for the first time in establishing diplomatic relations with Oman and the UAE in 1985.<sup>261</sup> Oman's decision to set up diplomatic ties with the Soviets was unexpected news for the U.S. government

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<sup>255</sup> Rachael Bronson, *Thicker than Oil: Partnership with Saudi Arabia* (Oxford: Oxford University Press, 2006), p. 148.

<sup>256</sup> Bronson, 2006, p. 148.

<sup>257</sup> Celestine Bohlen, “Soviets, Oman Establish Relations; Step Seen as Setback for U.S.,” *The Washington Post*, September 27, 1985.

<sup>258</sup> Bohlen, September 27, 1985.

<sup>259</sup> David B. Ottaway, “Kuwait Appeals to U.S. for Missiles,” *The Washington Post*, June 19, 1984.

<sup>260</sup> “Kuwait Shopping for Soviet Missiles,” *The Associated Press*, June 26, 1984.

<sup>261</sup> Robert O. Freedman, “Moscow and the Middle East in 1985,” in Itamar Rabinovich and Haim Shaked (eds.), *Middle East Contemporary Survey: 1984-1985* (Boulder: Westview Press, 1987), p. 50.

since the Kremlin had regarded Oman as “a right-wing puppet of the United States and Great Britain.”<sup>262</sup> The U.S. government had contributed to strengthening Oman’s military capacity by offering “more than \$300 million,” and gained access to the Omani airfields and ports in return for its military supports.<sup>263</sup> Considering the relationship between the United States and Oman, the establishment of the Soviet-Omani diplomatic relations was all the more surprising. And during the Iran-Iraqi war, the Kremlin continued to provide military arms to Iraq, despite the fear of losing Iraq to “the region’s pro-American camp.”<sup>264</sup> On the basis of deepened bilateral relationship between the Soviets and Syria, the Soviet troops intervened in a series of Syrian-Israeli conflicts.<sup>265</sup>

The Soviets’ military aid given to the Arab states is reflected in the table presented below. Until 1987, the Soviet Union had been the largest arms exporter to the Middle East, followed by the United States (See Table 4-1). The Soviets’ willingness to give military assistances helped widen its diplomatic influence in the Persian Gulf to a large extent. Diplomatic ties with several Gulf States established in the mid-1980s, without a doubt, meant that the Soviet Union’s presence in the Gulf region was expanding and it was at the height of its involvement in the Gulf politics. It was, of course, a nightmare scenario that the U.S. government had expected.

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<sup>262</sup> Bohlen, September 27, 1985.

<sup>263</sup> Bohlen, September 27, 1985.

<sup>264</sup> Freedman, 1987, p. 51.

<sup>265</sup> Freedman, 1987, p. 50.

**<Table 4-1> Agreements of Arms Transfer to Middle East,  
1984-1990 by the U.S. and the Soviet Union (In Billion of Current  
Dollars)**

Supplier Year	World	United States		Soviet Union	
		Agreements	Share (%)	Agreements	Share (%)
1984	28.1	5.2	18.5	12.8	45.6
1985	36.0	5.4	15.0	6.4	17.8
1986	15.3	2.3	15.0	4.2	27.5
1987	21.3	2.7	12.7	8.6	40.4
1988	34.3	7.5	21.9	1.3	3.8
1989	13.2	5.9	44.7	0.2	1.5
1990	16.1	6.8	42.2	3.0	18.6

Source: reconstituted from U.S. Arms Control and Disarmament Agency

The period from the late 1970s to 1985, hence, was marked by mounting tensions between the two camps in the Middle East region. In the sense that the Cold War led the great powers to constantly intervene in the regional politics and in the conflicts among local states, the bipolar international system could be said to have wielded a great influence on the region, and consequently Saudi Arabia. Under these environments, the Soviet Union as well as the United States came to be considered by Saudi Arabia as a political constraint on the state. It implied that the Kingdom's policy choice was hardly constructed

without considering its possible impacts on the U.S. and the Soviets, and vice versa.

## **2. Regional Conflicts**

An increase in the number of conflicts and wars among the Middle Eastern countries created growing military tensions in the region. Even though these conflicts in the Middle East were caused in part by the superpowers' interventions in the regional affairs, most of them were believed to take place as a consequence of the intense competitions among the Arab states vying for a dominant role in the region. Saudi Arabia, as a traditional power in the region, attempted to take the leadership and to maintain a regional balance of power and stability in the region with the U.S. government's support for the Kingdom. Yet, as the Soviets' influence upon the region had been growing since the late 1970s, the number of regional conflicts over which the Saudi Kingdom could rarely handle by exerting a dominant influence increased.

### **1) Traditional Rivalry between Saudi Arabia and Egypt**

One of the factors threatening the unity of Arab as well as the regional peace was the rivalry between Saudi Arabia and Egypt. Egypt was one of the regional great powers which had played a role of police since the 1950s. For the Soviet Union, Egypt had been a strategically important

state which had linked it to the Middle East region by leapfrogging the 'northern tier'<sup>266</sup> states. The Egyptians had been given military and financial supports from the Soviet Union in return for their cooperation, and threatened Saudi Arabia.

However, Egypt's influence on the region had begun to diminish since the late 1970s on account of the Sadat regime's change in its attitude towards the Israelis. The Egyptians and Israelis opened up a negotiation at Camp David in September 1978 and signed a peace treaty in 1979.<sup>267</sup> The Camp David accords immediately gave rise to a break-up of diplomatic relations between Saudi Arabia and Egypt. Even though the Sadat regime sought for practical supports and intended to gain "access to U.S. economic resources" by becoming a part of "the Egyptian-American-Israeli axis,"<sup>268</sup> its pro-Israel stance led to the loss of its political influence and isolation from the anti-Israel Arab states. The Kingdom's efforts to ostracize Egypt after the Camp David accords led to the foundation of Gulf Cooperation Council (GCC) in which the Saudi Kingdom, the UAE, Bahrain, Oman, Qatar, and

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<sup>266</sup> Western powers endeavored to prevent the Soviet Union from penetrating into the Middle East by establishing the Baghdad Pact in 1955 which comprised Iraq, Iran, Pakistan and Turkey. Since these northern tier countries were located between the Middle East and the Soviet Union, Western powers intended to make those states serve as a geographical barrier against the Communists. Despite the treaty elaborately designed, the Egyptians' sharp rebuff to Western request to join the Baghdad Pact and their attitude tilted in a pro-Soviet direction stalled the West's efforts. Miller, 2003, pp. 244-245.

<sup>267</sup> Bronson, 2006, p. 291; William B. Quandt, *Saudi Arabia: Policy, Security, and Oil* (Washington: The Brookings Institution, 1981), p. 40.

<sup>268</sup> Miller, 2003, p. 245.

Kuwait participated on May 25, 1981.<sup>269</sup>

## **2) Tension between Israel and Pro-Palestine Arabs' Camp**

There had been mounting tension between Israel and pro-Palestine Arabs' camp in the Middle East up to 1985. Israel had been regarded for a long time as a revisionist backed by the imperialist Western powers. Israeli Zionism had since the start of the Cold War caused a number of conflicts among the Arab states. A long-standing quarrel between them began in 1948 when the armies of Egypt, Iraq, Jordan, Lebanon and Iraq invaded Israel on account of the creation of the state of Israel and the consequent deportation of Palestinians. The 1948 Arab-Israeli conflict signified the beginning of the confrontation between Arab nationalism and Israeli Zionism. The 1952 coup d'état led by Nasser in Egypt and nationalization of Suez Canal ignited the war between Egypt and Israel. After a decade, two countries started a war again and Syria, Jordan and Iraq suffered a bitter blow. The 1973 Arab-Israeli conflict began on Yom Kippur due to the Egyptian armies' surprise attack on Israel. It caused the Arab countries to enforce an oil embargo, thereby leading to the quadrupling oil prices.

Meanwhile, the 1979 Camp David accord chilled the relations between pro-Palestine Arabs' camp (represented by the GCC) and Israel. The accord aggravated the talk between them because Egypt, the previous forefront of the pro-Palestine camp, and Israel signed a peace

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<sup>269</sup> <http://www.gcc-sg.org/eng/index895b.html?action=Sec-Show&ID=3>

treaty through the mediation of the United States. The Egyptians' abandonment of its role in restoring the state of Palestine served as a momentum toward the unity of other Arab states against Zionism.

The relations between them terribly worsened in June 1982 when the Israeli forces attacked Lebanon. Saudi Arabia got involved in the process of solving the Israeli invasion of Lebanon since it had "long seen Lebanon as a proxy arena to outmaneuver its regional competitors" and "to raise its leadership profile on the pan-Arab stage."<sup>270</sup> And the U.S. government endeavored to minimize any detrimental effect on political stability in the Gulf region "by proposing to the Saudis joint military exercises of American, Saudi and other GCC forces."<sup>271</sup> Yet, the relations among the Arabs deteriorated rapidly, with the Iran's rejection of the terms of settlement offered by Iraq and its invasion of Iraq on July 14.<sup>272</sup>

### **3) Threats from Iran: Iranian Revolution, Iran-Iraqi War and Attacks on Tanker**

The greatest threat to the Saudis' national security came directly from Iran. Between Saudi Arabia and Iran, there had existed a long-standing

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<sup>270</sup> Frederic Wehrey, Theodore W. Karasik, Alireza Nader, Jeremy Ghez, Lydia Hansell and Robert A. Guffey, *Saudi-Iranian Relations since the Fall of Saddam: Rivalry, Cooperation, and Implications for U.S. Policy* (Santa Monica: RAND Corporation, 2009), p. 78.

<sup>271</sup> Nadav Safran, *Saudi Arabia: the Ceaseless Quest for Security* (New York: Cornell University Press, 1988), p. 384.

<sup>272</sup> Safran, 1988, p. 384.

rivalry which dated back to the 5<sup>th</sup> century B.C. when the Persian Empire conquered the Arabian Peninsula. Other than the historical background there was also linguistic difference between the Arabs and the Iranians; the Arabs speak Arabic and the Iranian speak Iranian. Arabic has a Semitic origin, whereas Iranian is a branch of the Indo-European languages. These differences led most of the Arabs including the Saudis to distinguish themselves from the Iranians and perceive the Iranians as potential antagonists.

The Arabs' political rivalry with Iran deepened to bring about several territorial disputes in the Gulf region over the 1960s and 1970s. "In the late 1960s, Iran seized an ARAMCO oil rig" over the median line in the Gulf and the Shah regime occupied Abu Musa and the Tunbs islands<sup>273</sup> in 1971.<sup>274</sup> These territorial issues tell the reason why the Arab world has been concerned about the Iranian actions. Although the political stance of the Shah's regime was similar with that of other Arab countries in the sense that it was anti-Communist and pro-Western, the Arabs had a deep suspicion that the Iranians had had

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<sup>273</sup> The UAE (Sharjah, Ajman, Umm al-Qawain) and Iran had long competed for their claims to both Abu Musa and the Tunbs islands. The question of sovereignty over these islands had not been resolved easily on account of the geopolitical and economic significance they had. These islands were "located near the route which oil tankers and most other maritime traffic uses *en route* to and from the Straits of Hormuz at the head of the Gulf." And oil was discovered in 1972 near Abu Musa. For a clear understanding of territorial disputes among the Gulf states, see John Duke Anthony, "Aspects of Saudi Arabia's Relations with Other Gulf States," in Tim Niblock (eds.), 1982, pp.149-153.

<sup>274</sup> David E. Long, "Saudi Arabia and its Neighbors: Preoccupied Paternalism," in H. Richard Sindelar III and J. E. Peterson (eds.), *Crosscurrents in the Gulf: Arab, Regional and Global Interests* (London: Routledge, 1988), pp. 191-192.

imperial ambitions in the Gulf.<sup>275</sup>

The 1979 Iranian Revolution and the demise of the Shah regime were seen by the Arabs as the event which confirmed their suspicion and placed a great threat to the Arabs' security. And the Iranian threat was perceived particularly serious by its Gulf neighbors since the threat "had an ideological, as well as political and military, dimension."<sup>276</sup> The Iranian revolution, the Iran-Iraqi war and the tanker war were a mixture of ideological, political and military competition.

### **(1) Iranian Revolution**

As the Egyptians' relative power had declined in the aftermath of a talk with Israelis at Camp David in 1978 and the U.S. had been losing its dominant position in the Gulf since the late 1970s, a power vacuum occurred in the region. Under these circumstances, Iran, with the overthrow of the Shah, emerged as a revisionist state in the wake of the 1979 Iranian revolution. Immediately after the process of subversion of the Shah monarchy, the Khomeini regime sought to shake the foundations of the political and religious systems of the Gulf countries. Until 1979 Iran had shared its conservative political values (pro-monarchy and pro-Western perspective) with its other Gulf neighbors, but the revolutionary government of Iran took a tough stance against the monarchy system of the Gulf and secular Sunni Muslim and began to oppose any action in favor of the United States.

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<sup>275</sup> Long, 1988, p. 191.

<sup>276</sup> Long, 1988, p. 190.

For example, Iran highlighted its willingness to act as a revisionist power in the Gulf region by officially denouncing the United States as well as Saudi Arabia. Iran, “which had emphasized secular values and strategic cooperation with Saudi Arabia under US patronage,” challenged “the Saudi claim to Islamic leadership.”<sup>277</sup> In the governmental statements and through the media, the Khomeini regime portrayed “the Kingdom as outdated, corrupt, compromised by its relationship with the United States and (for all these reasons) unfit for a leadership role in global Islam.”<sup>278</sup>

And the Khomeini regime and other Iranian revolutionary leaders attempted to export revolution to the neighboring Gulf nations. The diffusion of revolutionary ideas and anti-monarchical sentiment could be said to be more dangerous than the political and territorial disputes with Iran in the sense that ideas had generally changed people’s thinking and resulted in mobilization of the masses of people as a means of turning a society upside down. In the immediate aftermath of the Iranian revolution, the revolutionary ideas began to spread across the Arab countries, which heightened grave concern of the monarchs of the conservative Arabs. Influenced by the Iranian activism, Juhayman al-Otaibi and his associated group of radical Islamists seized the Great Mosque in Makkah<sup>279</sup> in late November 1979.<sup>280</sup> The bloody uprising continued only for seven days and was put down quickly due to the

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<sup>277</sup> Niblock, 2006, p. 69.

<sup>278</sup> Niblock, 2006, p. 69.

<sup>279</sup> It implies the city of Saudi Arabia, Mecca.

<sup>280</sup> Niblock, 2006, p. 68.

small number of the radical group and the violent suppression of the state security forces. The 1979 uprising was an event which reflected the growth of a new generation of the Shia Islamists and obviously indicated that the immediate influence of the revolution was likely to expand to the neighboring Sunni countries, Iraq, Kuwait as well as Saudi Arabia.<sup>281</sup>

“For rulers in Riyadh, the fall of the Shah and the rise of Khomeini was a veritable earthquake.”<sup>282</sup> Since a small population of disenfranchised Iranian Shiites lived in the Eastern Province of the Kingdom on which the core petrochemical plants were centered, the impartment of the revolutionary ideologies could threaten its economic backgrounds as well as the stability of the monarchy. As an example, the Shiites constituted “one-third of the work force of Aramco, the state-owned oil monopoly”<sup>283</sup> and they took a deep and strong antipathy to the government which had treated them “as second-class citizens.”<sup>284</sup> Mobilization of the Shiites, in an attempt to express their anger at the regime, could have led to a nation-wide anti-government protest.

What made it worse is the fact that the Khomeini regime

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<sup>281</sup> In the conflict-prone Middle East region, “states will tend to balance local rivals, especially revisionist states, which pose the greatest threat to other states’ security and territorial integrity.” Fearing of possible impact of the Iranian revolution on the domestic politics, other status-quo states began to balance Iran in pursuit of Sunni dominance over the Islam world and Arab unity. See Miller, 2003, p. 243.

<sup>282</sup> Wehrey et al, 2009, p. 13.

<sup>283</sup> Jack Anderson, “Saudis Less Stable than U.S. Claims,” *The Washington Post*, 14 March, 1985.

<sup>284</sup> Anderson, 14 March, 1985.

struggled to provoke the Shiites' hatred for Riyadh in the Kingdom. "For seven dramatic days in late November 1979, bloody violence between state security forces and thousands of frustrated Shiites rocked the Eastern Province of Saudi Arabia"<sup>285</sup> where the mass of radical leftists against the Royal Family had gathered. And "in 1984, Khomeini challenged the Saudi legitimacy over the Two Holy Mosques in Mecca and Medina by calling for a shared Islamic sovereignty over these Two Holy Sites."<sup>286</sup>

It was the radical Shiites' revolution that gave a direct and substantial impact on the domestic politics of Saudi Arabia, thereby arousing the Kingdom's sharp attention. In response to the Shiites' uprising, the government of Saudi Arabia stressed the role of religion, "the Islamic and Wahhabi identity of the state,"<sup>287</sup> as a measure to restore national unity and regime stability. The religious leaders became more influential in the process of decision-making and Islamic education was strengthened in the educational system. The government curbed "public behavior deemed to be un-Islamic"<sup>288</sup> and emphasized its role as a leader of Islamic world in the international politics.<sup>289</sup> Moreover, the Kingdom was flooded with anti-Shi'a publications during the 1980s "by the Saudi clerical establishment designed to blunt

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<sup>285</sup> Jones, 2010, p. 180.

<sup>286</sup> Ibrahim Mahmoud Yaseen Alnahas, *Continuity and Change in the Revolutionary Iran Foreign Policy: The Role of International and Domestic Political Factors in Shaping the Iranian Foreign Policy, 1979-2006*. Ph.D. Dissertation, University of West Virginia, 2007, p. 114.

<sup>287</sup> Niblock, 2006, p. 71.

<sup>288</sup> Niblock, 2006, p. 71.

<sup>289</sup> Niblock, 2006, p. 71.

the ideological appeal of the Iranian revolution.”<sup>290</sup>

## **(2) The Iran-Iraqi War and Attacks on Tanker**

In September 1980, Iraq launched an invasion of Iran mainly due to a long-standing border dispute among the two neighbors. The war lasted for eight years, letting the neighboring Arab states get involved in fights. During the war, it was the ideological threats from the radical Iranians that caused most of Gulf countries to be in the war to financially and militarily support the Iraqis. “Attempts by the Iranian leadership to export the Islamic revolution to the region led to deterioration of ties with the GCC states, which all have Shiite minorities within their populations.”<sup>291</sup> As the 1979 uprising of Saudi Arabia cited above, the revolutionary ideas injected by the radical Iranian activists could let the people’s frustration boil over into an anti-monarchical action. And “there was a widespread perception that if Iraq were to suffer defeat, the Kingdom would be the next domino to all, with a tide of Iranian Shiite expansionism covering the region.”<sup>292</sup> It was the very reason why GCC sided with Iraq in the Iran-Iraqi war by financing “the building of Iraq’s weapon arsenal.”<sup>293</sup> Conservative Arab states began to balance the revisionist Iran in the Iran-Iraqi war.

There were geo-economic threats as well that pushed the Gulf

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<sup>290</sup> Wehrey et al, 2009, p. 26.

<sup>291</sup> Riad Kahwaji, “Gulf Cooperation Council Threat Perceptions Deterrence Objectives,” *Comparative Strategy*, Vol. 22, No. 5 (2003), p. 517.

<sup>292</sup> Niblock, 2006, p.146.

<sup>293</sup> Kahwaji, 2003, p. 517.

nations involved in the Iran-Iraqi war. Particularly over the period 1984-1985, the war, “stalemated on the ground,” put the Arab states under direct military pressures as the war moved into the Persian Gulf waters.<sup>294</sup> Most Arabs shipped essential goods including oil and gas resources through the Persian Gulf and the Strait of Hormuz (See Figure 4-1 in the previous section). The war doubtlessly posed grave threats to the flow of goods.<sup>295</sup> Therefore, it drew sharp attention not only from Iran and Iraq, but also from other Arab countries such as Saudi Arabia, Kuwait, Qatar, the UAE and Oman.

Saudi Arabia, on alert to any potential political upheavals driven by the Shiites’ revolution, “discreetly sided with Iraq.”<sup>296</sup> The Kingdom’ relationship with Iraq considerably improved during the 1980 Iran-Iraqi war since the two “regimes were worried about the Islamic revolution in Iran; both expressed concern about the superpower rivalry in the Persian Gulf; both opposed the Camp David accords.”<sup>297</sup> As an example of the progress in the bilateral relationship, “early in 1981, the Saudis allowed Iraq to take delivery of 100 East European tanks at Saudi Red Sea ports” and “by fall of 1981 more arms were reaching Baghdad via Saudi Arabia than by any other route.”<sup>298</sup>

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<sup>294</sup> Robert H. Reid, “Five-Year Iran-Iraq Conflict Shifting to Sea,” *The Associated Press*, November 11, 1985.

<sup>295</sup> Iraq claimed to destroy Khark Island, one of the places on which Iran’s principal refining and terminal facilities were centered, and Iran responded to Iraq’s recurrent attacks on Khark Island with retaliatory strikes against other Gulf countries’ ships or ports.

<sup>296</sup> Quandt, 1981, p. 40.

<sup>297</sup> Quandt, 1981, p. 21.

<sup>298</sup> Quandt, 1981, p. 21.

Riyadh also “subsidized Iraq’s war effort against Iran to the tune of nearly \$26 billion.”<sup>299</sup> Besides the military cooperation, “in 1982 Iraq and Saudi exchanged a dozen to-level visits”<sup>300</sup> to bolster the bilateral relationship.

Relatively small Gulf countries,<sup>301</sup> from lack of capacities to defend themselves on their own, leaned on the GCC so as to build up “collective defenses against the disruptive effects of the Iranian revolution and the war between Iraq and Iran.”<sup>302</sup> Fearing of “an outright Iranian victory over Iraq that would provide Tehran’s leaders with self-confidence and freedom to turn their energies to exporting revolution elsewhere,”<sup>303</sup> these states had since the beginning of the war poured “about \$35 billion into Iraq to help President Saddam Hussein repel the Iranian forces.”<sup>304</sup> Out of \$35 billion, approximately \$25-6 billion was covered by the Kingdom’s grants and low-interest

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<sup>299</sup> Gause III, 2000, p. 82.

<sup>300</sup> Bronson, 2006, p. 164.

<sup>301</sup> Except for Saudi Arabia, most GCC members comprised small and militarily weak states, Kuwait, Bahrain, Qatar, the UAE, and Oman. “Most of these countries are small and difficult to defend, and have tiny indigenous populations that are often outnumbered by the immigrant workers their oil fields attract. In all of them, Sunni Moslems monopolize power, causing represent among the many Shiite Moslems, some of whom are clearly attracted by the revolutionary doctrines preached by the Shiites in Iran.” Therefore, these countries had shared interests in preventing the brand of Iranian revolution from spreading throughout the region. See Paul Lewis, “Fears Unifying Small Nations in Gulf,” *The New York Times*, July 12, 1984.

<sup>302</sup> Lewis, July 12, 1984.

<sup>303</sup> Lewis, July 12, 1984.

<sup>304</sup> Lewis, July 12, 1984.

loans.<sup>305</sup>

Despite the GCC's massive financial and military support provided to Iraq, the war reached a phase of "tanker war" during the period between 1984 and 1987. The tanker war, "characterized by a major escalation of the conflict,"<sup>306</sup> began in February 1984 "following Baghdad's acquisition of French-made Super Etendard aircraft and Exocet missiles."<sup>307</sup> The economy of Iran, as that of Saudi Arabia, depended heavily on oil exports,<sup>308</sup> all of its oil exports as well as most of its imports were delivered through the Strait of Hormuz. Any attack on its tanker or oil-export facility located near the Strait of Hormuz could burden the national economy of Iran. "Iran thus was unwilling to tolerate any threat to the free flow of trade through this strategic waterway." In response to the Iraqis' attacks on the Iranian oil tankers, Tehran began to retaliate against Baghdad by bombing the Iraqis' oil facilities, thereby escalating the war.

For the period, most of the combats, in fact, took place at sea and the oil tankers and oil-export facilities in the Persian Gulf were the principal targets of attack. As the tension between two countries mounted, Tehran asserted its hardline stance on the allies of the Iraqis. Thereafter, the Iranian bombs were targeted not only at the Iraqi tankers

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<sup>305</sup> Niblock, 2006, p. 146. For the period of war, two-thirds of the total soft loans given to Iraq came from the Saudi Arabia. Iraq was known to receive about between \$46 billion and \$60 billion from the Arab states. See Macdonald, 1993, p. 68.

<sup>306</sup> Christopher C. Joyner, *The Persian Gulf War: Lessons for Strategy, Law, and Diplomacy* (New York: Greenwood Press, 1990), p. 45.

<sup>307</sup> Joyner, 1990, p. 47.

<sup>308</sup> The revenues from oil exports accounted for 90 percent of the Iranian government's budget. Joyner, 1990, p. 47.

but also at the neutral tankers.

Out of the neighbors' ships, the Iranian troops selectively stroke "tankers carrying Kuwaiti and Saudi oil"<sup>309</sup> since both countries "provided financial support and other assistance to Iraq"<sup>310</sup> and "a large portion of Iraq's military resupply was received through Kuwaiti and Saudi ports."<sup>311</sup> Due to the Iranians' perception of Riyadh and Kuwait, "since the spring of 1984, Iranian aircraft had regularly retaliated for Iraqi attacks on Kharg Island by hitting merchant vessels bound largely for Kuwait or Saudi Arabia."<sup>312</sup> Particularly "by 1984 the attacks on shipping were alarming the GCC countries; their fears increased after a Saudi Arabian oil tanker was damaged by an Iraqi-laid mine in April, and again in May when Iran initiated a retaliatory policy against Arab shipping."<sup>313</sup> In 1985 there were several bombings in Riyadh and several Saudi diplomats was "held hostage in Beirut."<sup>314</sup>

The escalation of the tanker war caused the GCC countries to take mediatory actions. "They used the GCC medium to launch a campaign of mediation first during the fifth summit of November 1984 in Kuwait and then during the ministerial meeting of March 1985 and especially during the sixth summit of November 1985 in Muscat."<sup>315</sup>

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<sup>309</sup> Joyner, 1990, p. 48

<sup>310</sup> Joyner, 1990, p. 48.

<sup>311</sup> Wayne E. White, "The Iran-Iraq War: A Challenge to the Arab Gulf States," in H. Richard Sindelar III and J. E. Peterson (eds.), 1988, p. 97.

<sup>312</sup> White, 1988, p. 97.

<sup>313</sup> Joyner, 1990, p. 47.

<sup>314</sup> Long, 1988, p. 191.

<sup>315</sup> Rouhollah K. Ramazani and Joseph A. Kechichian, *The Gulf Cooperation Council: Record and Analysis* (Charlottesville: University Press of Virginia, 1988), p. 128.

Even though there were several high-level talks between Iran and Saudi Arabia in 1985<sup>316</sup> as a result of the GCC's earnest efforts, the Iranian strikes at the tankers passing through the Strait of Hormuz did not halt. Tehran saw the actions taken by the GCC as a threat to its security, particularly warning the GCC "against aligning itself with the United States, for America was the archenemy."<sup>317</sup> Iran publicly denounced particularly "Kuwait and Saudi Arabia as U.S. lackeys and threatened unspecified punitive actions against those states and American interests in the region."<sup>318</sup> Iran thus intended to continue the war in order to prevent the United States from exerting its influence on the Gulf nations as well as to seek supremacy over the Gulf region.

In response to the Tehran's retaliatory policy, the GCC states operated "a joint program to defend tankers calling at their ports against Iranian attack,"<sup>319</sup> following "their first joint military exercises"<sup>320</sup> conducted in October 1983. In November 1985, the GCC countries convened to denounce Iran's attacks on Iraqi ships and oil tankers, and "called on Iran to "observe the principles" of U.N. Security Council resolutions affirming the right of free navigation in the gulf for

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<sup>316</sup> Prince Saud of Saudi Arabia visited Tehran in May 1985 and the Iranian Foreign Minister, Ali Akbar Velayati, in return, visited Riyadh in December. See B.E.S.J. Bastiampillai, "Unity and Division in Relation to Politics, Religion and Oil in the Persian Gulf: An Historical Review," *Sri Lanka Journal of Social Sciences*, vol. 15, No. 1-2 (1992), p. 79. (available at <http://dl.nsf.ac.lk/handle/1/4958>)

<sup>317</sup> Bastiampillai, 1992, p. 78.

<sup>318</sup> Hermann Frederick Eilts, "Foreign Policy Perspectives of the Gulf States," in H. Richard Sindelar III and J. E. Peterson (eds.), 1988, p. 20.

<sup>319</sup> Lewis, July 12, 1984.

<sup>320</sup> Long, 1988, p. 194.

non-combatants.”<sup>321</sup>

An exchange of diplomatic visits among the GCC states and Iran and military exercises notwithstanding, the GCC-Iranian tensions were not likely to be eased. The Saudi-Iranian ties deteriorated rapidly shortly after the Iraqis damaged seriously “Iran’s oil-export terminal at Kharg Island”<sup>322</sup> in August 1985. On account of the iterated warnings from Tehran, Riyadh was caught in a dire predicament. In addition, the Kingdom was vulnerable to the Iranian navy. Along the Strait of Hormuz, there were “more than 85 offshore oil platforms, any of which would be nearly impossible to defend against a naval attack.”<sup>323</sup> The poor military position of Saudi Arabia required sufficient armament to defend itself from the Iranian threats. Supplies of arsenal and strengthened US-Saudi ties, thus, seemed to be the solution that would alleviate Riyadh’s concern over the national security.

In short, the growing tensions and conflicts among the Gulf States were perceived to be serious threats to the Kingdom’s security. The Eastern Province of Saudi Arabia, where the bulk of the oil reserves had been buried, was bordered by “Kuwait, Iraq, Bahrain and the Arabian Gulf”<sup>324</sup> (See Figure 4-1 again). On account of the oil reserves’ geographical concentration, Iran threatened in 1984 to attack the Saudi oil fields.<sup>325</sup> Moreover, the Kingdom had not only exported

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<sup>321</sup> Reid, November 11, 1985.

<sup>322</sup> White, 1988, p. 96.

<sup>323</sup> White, 1988, p. 98.

<sup>324</sup> Macdonald, 1993, p. 4.

<sup>325</sup> Milt Freudenheim, Henry Giniger and Richard Levine, “Another Push for Arms

its oil and gas but it had also imported goods “through at least one of the three choke points, the Suez Canal, Bab al-Mandeb, and the Strait of Hormuz.”<sup>326</sup> Hence, the Saudi Kingdom was extremely vulnerable to any military actions the other Gulf States might take.

### **3. Saudi Arabia’s Response to the Growing Tensions: Overproduction of its Crudes and Reduction of its Swing-Producer Role**

#### **1) Increases in Military Spending and Arms Purchases**

While the tension among superpowers had escalated in the Middle East region since the late 1970s, long-simmering rivalries and disputes between the Middle Eastern countries had led them to get involved in the Cold War, backed by the U.S. or the Soviet Union. The 1979 Iranian Revolution, Camp David Accords, Iran-Iraqi War, and Israel’s invasion of Lebanon took place as part of superpower competitions. Washington and Moscow supported the Gulf-Arab nations by dishing out financial and military assistances for heading off each other’s efforts to expand their influences throughout the region. Since all these actions were occurred in the immediate vicinity of the Kingdom’s territory, Saudi Arabia had to keenly pay attention to the regional

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Sales in Middle East,” *The New York Times*, 8 September, 1985.

<sup>326</sup> Safran, 1988, p. 222.

security. And the Kingdom increasingly realized the necessity of ensuring its security in a self-directed way as follows:

The new view of potential friends and foes, of the nature of the most likely threats, and of the resources at the Kingdom's disposal that emerged by early 1979 led to a revision of the defense concept worked out in 1974-75. The Saudis now sought to achieve as independent a defense capability as possible to take account of their changed relations with the United States, placed greater reliance than ever on high technology to compensate for the constraints of vast space and scarce manpower, emphasized air and naval defense in the face of threats from revolutionary Iran, sought defense coordination with the small Gulf countries to protect their flanks, and endeavored to enlist military contributions from Pakistan and Jordan to buttress their thinly stretched armed forces.<sup>327</sup>

Riyadh sought to reinforce the national defenses by relying on two approaches. On the one hand, the Saudi government exploited cooperative relations with other Gulf countries. In 1981, the Kingdom played a leading role in establishing the GCC and it used the collective defense system of the GCC as means of hampering the Soviets' penetration of the Persian Gulf and of counterbalancing the revisionist regional rivals such as Egypt, Iran, and Syria.

On the other hand, the Saudis' new defense plan aimed at building up its military power primarily by purchasing military weapons and supplying its arsenal. Riyadh's mounting emphasis on

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<sup>327</sup> Safran, 1988, p. 228.

arms purchases was reflected in the fact that the ratio of the Kingdom's military expenditures to the central governmental expenditures tended to increase, in particular, after the Saudis reduced its swing-producer role in October 1985 (See Table 4-2) despite the governmental revenues which continued to plummet in the mid-1980s, after peaking in 1982.

**<Table 4-2> Saudi Arabia's Military Expenditure and Central Government Expenditure, 1984-1988**

Year	Military Expenditure (ME)		Central Government Expenditure (CGE)	CGE/ME (%)
	Current	Constant 1994	Constant 1994	
1984	20,400	28,230	97,340	29.0
1985	21,349	28,490	105,500	27.0
1986	17,330	22,530	70,410	32.0
1987	16,210 <sup>a</sup>	20,430 <sup>a</sup>	44,120 <sup>a</sup>	46.3
1988	13,600 <sup>a</sup>	16,510 <sup>a</sup>	45,730 <sup>a</sup>	36.1

Notes: The unit of the expenditure is million US dollars.

a: Estimated value.

Source: U.S. Arms Control and Disarmament Agency

And during the period from 1984 to 1986, the share of arms imports in

the total imports rose by 17.1 percent (See Table 4-3).

**<Table 4-3> Saudi Arabia's Arms Imports and Total Trade,  
1984-1987**

Year	Arms Imports		Total Imports		Total Imports/Arms Imports
	Current	Constant 1994	Current	Constant 1994	(%)
1984	7,100	9,287	33,700	46,640	21.1
1985	7,000	9,348	23,620	31,550	29.6
1986	7,300	9,493	19,110	24,850	38.2
1987	6,800	8,570	20,110	25,350	33.8

Notes: The unit of the imports is million US dollars.

Source: U.S. Arms Control and Disarmament Agency

Spike in arms purchases over the period 1984-1986 reveals the Saudis' overriding concern for military threats posed by continuing strife among the Arabs and by the Iranians. Therefore, Riyadh's unexpected decision to overproduce its crudes and sell them at a discounted price could be interpreted to be shaped out of the Saudis' concern for the national security.

Nearly most of the imported arms came from, given Saudi Arabia's strategic alliances, the capitalist camp. And the U.S. government was willing to supply the weapons for political concerns. It

was spurred mainly by the Soviets' approach to the Persian Gulf. Since the early 1980s, Moscow provided Egypt, Syria, and, if not always, Iraq with substantial arms and weapons, thereby bolstering the relations with them (See above Table 4-1 in the previous section). Washington, to block the Soviet move, was willing to offer military aid to the moderate Arab countries. Saudi Arabia was a country of great importance for the U.S. government for reconfirming its dominant power in the Middle East.

And a chance came quickly. In the wake of the Iranians' threat to attack the Saudi oil fields in 1984, the Saudi government desired again to rely on Washington in order to protect themselves from external threats. In 1984, the Kingdom "bought 400 Stingers from the United States, saying the missiles were necessary to protect Saudi territorial waters and oil centers against Iranian attacks on oil tankers."<sup>328</sup> And according to a confidential Reagan administration report disclosed in 1985, Saudi Arabia had told "the United States that it will allow American military forces to use its bases in case of Soviet "aggression" or if it is unable to handle a Persian Gulf crisis on its own."<sup>329</sup> As a response to the Saudis' request, the U.S. government considered on meeting the demand of Saudi Arabia for "two more squadrons of F-15 fighters, 40 planes in all, to add to the 40 they now possess, as well as additional Stinger shoulder-fired, antiaircraft missiles, and advanced

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<sup>328</sup> *The Associated Press*, June 26, 1984.

<sup>329</sup> Bernard Gwertzman, "Saudis to Let U.S. Use Bases in Crisis," *The New York Times*, September 5, 1985.

Sidewinder air-to-air missiles.”<sup>330</sup>

Meanwhile, the Saudis sought to diversify “their arms procurement program”<sup>331</sup> and to purchase aircrafts from Western countries such as the UK and France other than America. In January 1984, the Kingdom and France “clinched a contract believed to be worth up to Dollars 4bn (Pounds 3.3bn) for Shahine mobile surface to air missiles, based on the Crotale missile” and France “supplied AMX-30 tanks, frigates for the Saudi navy.”<sup>332</sup> In August 1984, the Saudis tried to make an arms deal with the British government in order to import “24 Hawk trainers” and add “20 Tornado ground attack aircraft” to 385 Tornado which they had already ordered from the UK, Germany and Italy.<sup>333</sup> Saudi Prince Sultan bin Abdul-Aziz, as the Saudi Defense minister, visited London in September 1985 and initialed “a \$5.7 billion oil-and-cash deal for 132 swing-wing Tornado combat jets and training planes.”<sup>334</sup> Saudi Arabia already had “three squadrons totaling 62 American F-15’s, one of the world’s most advanced interceptor aircraft, and 65 American F05E’s,” and also possessed “15 much older British Lightning F-53 interceptors.”<sup>335</sup>

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<sup>330</sup> Gwertzman, September 5, 1985.

<sup>331</sup> Bridget Bloom and Roger Matthews, “World Trade News: Saudis Keep Arms Deal Options Open – UK Fears It May Lose out on – Pounds 1bn Aircraft Contract,” *Financial Times*, December 21, 1984.

<sup>332</sup> Bloom and Matthews, December 21, 1984.

<sup>333</sup> Bloom and Matthews, December 21, 1984.

<sup>334</sup> “Saudi Arabia Orders 132 British Jets,” *Houston Chronicle*, September 27, 1985.

<sup>335</sup> Bernard Gwertzman, “Saudis Say Reagan Cleared Purchase of British Planes,” *The New York Times*, September 16, 1985.

## **2) Influence of the United States on Saudi Arabia**

Since the late 1970s, Saudi Arabia had been placed under huge military pressure. The Soviets had expanded its clout within the Middle East and years of strife among the Arab states had lasted. In this environment, the Saudis realized that they could not “stand alone against the various threats they perceive” and estimated that it “could defend itself against the Soviet Union for 2 or 3 days at the most.”<sup>336</sup> With its limited military capability, Riyadh planned to build up its military power by a closer relationship with the United States as well as by arms deals.

With the increasing requests for arms purchases, Saudi Arabia sought to raise its own capability to ensure both its security and regional stability by strengthening the bilateral relations with the United States. The Kingdom’s ties with Washington have been one of the relations sustained successfully owing to the United States has ardently called for the partnership with the Saudis. Washington has seen Riyadh as its important place for two factors; other than oil, Saudi Arabia’s strategic location and religious identity have been considered crucial by the American leadership.<sup>337</sup> Above all, the close U.S.-Saudi relations stemmed from the Americans’ paramount concern over the Middle East. As explained above, the Soviets had sought to expand its influence throughout the Middle East since the beginning of the Cold War. And Nasser’s Egypt, with its military capability, grew to become

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<sup>336</sup> <http://www.globalsecurity.org/military/library/report/1987/ASE.htm>

<sup>337</sup> Bronson, 2006, p. 23.

a regional power in the Middle East. Having feared that the Gulf region might be surrounded by an anti-American Communist bloc, Washington sought a partner to defend the region against common enemies. It was the fact Saudi Arabia had long competed with Egypt for a Muslim leadership that drove Washington to attempt to “transform the Saudi king into a globally recognized Muslim leader”<sup>338</sup> and to support the Saudis in their arming. In addition, the Saudi monarch and religious leadership denounced the notions of totalitarian Communism. Both the Kingdom and Washington, thus, faced common enemies, the Soviets and Egypt, and had a common interest in preventing them from exercising their influence on the Middle East and in curbing their interference in the Gulf politics.

Due to these two factors, the Americans have reinforced economic ties with Saudi Arabia. “Between 1947 and 1980 Saudi Arabia bought \$56 billion-worth of US goods”<sup>339</sup> and “in 1978 Saudi Arabia imported nearly \$ 4.4 billion-worth of US goods, making it the seventh largest US export market.”<sup>340</sup> The mutual economic ties were thriving drastically by virtue of the Kingdom’s support for the dollar system. The Saudis paid for “most of their foreign transactions”<sup>341</sup> in American dollar and deposited most of their reserves in the United States.

The relationship between Washington and Riyadh was fostered

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<sup>338</sup> Bronson, 2006, p. 22.

<sup>339</sup> Niblock, 1982, p. 132.

<sup>340</sup> Niblock, 1982, p. 132.

<sup>341</sup> Niblock, 1982, p. 132.

to a large extent as the Soviets' military involvement in the Middle East increased. The Saudis called for a cooperative relation with Washington for guarding themselves from the Soviets. The Kingdom's concern for its national security was considerably eased since the U.S. government had a long-standing and particular interest in keeping the Soviets at bay.<sup>342</sup> Washington insisted on keeping out the Soviets' influence in the Persian Gulf.<sup>343</sup> The Soviets' invasion of Afghanistan in 1979 spurred the U.S. government to reconfirm its dominant position in the Middle East. President Reagan made a statement in 1981 with regard to the importance of the containment policy of the Soviets:

One of the essential elements of the administration's Southwest Asia strategy will come before Congress for review in the near future. It is provide Saudi Arabia with a package of equipment and training to improve its air defense capabilities. The package will include E3A AWACS aircraft as well as enhancements for the F-15 aircraft we have agreed to provide.

I am convinced that providing the AWACS to Saudi Arabia will improve the security of our friends, strengthen our own posture in the region and make it clear both to local governments and to the soviet leadership that the United States is determined to assist in preserving security and stability in Southwest Asia.<sup>344</sup>

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<sup>342</sup> Michael Binyon, "Focus on the USA 1785-1985 (9): The Russians Bogy That Won't Go away," *The Times*, November 6, 1985.

<sup>343</sup> Binyon, November 6, 1985.

<sup>344</sup> Nicholas Laham, *Selling Awacs to Saudi Arabia: The Reagan Administration and the Balancing of America's Competing Interests in the Middle East* (London: Greenwood Publishing Group, 2002), p. 80

In order to head off the Soviets' penetration into the Middle East, Washington struggled to build up friendly relations with the moderate Arabs including the Saudi Kingdom. The Nixon administration adopted a 'Twin-Pillar policy' in order to share its burden of holding the Soviets off in the Middle East with Saudi Arabia and Iran. On the one hand, the Reagan administration endeavored to maintain the pro-American stance of Saudi Arabia by dispatching an emissary to the Kingdom with a letter saying that it was "ready to provide "material assistance" if Persian Gulf countries need it to protect shipping and oil facilities."<sup>345</sup> Washington helped the Saudis bolster their defense capability by means of exports of its advanced weaponry and collaborative military training. Particularly in the 1980s, the Reagan administration attempted to bolster the U.S.-Saudi relations by avoiding publicly addressing the issue of human rights. Unlike the Carter administration whose focus of foreign policy had been on the human rights issue, Reagan chose to denounce the Communist countries as totalitarian governments. Over his eight-year tenure as president, Saudi Arabia was described as authoritarian governments, which was given less pressure.<sup>346</sup>

On the other hand, the United States saw Iran's role as a buffer zone as crucial for stopping the Soviets' advances on the Middle East. The Reagan administration announced that Iran, as the Kingdom, was strategically crucial for its interests because the Iranian "geography

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<sup>345</sup> "U.S. Affirms Willingness to Aid Saudis in Gulf," *The Wall Street Journal*, May 22, 1984.

<sup>346</sup> Niblock, 2006, p.146.

gives it a critical position from which adversaries could interfere with oil flows from the Arab states that border on the Persian Gulf.”<sup>347</sup> Apart from oil’s importance in Washington’s thinking, Iran was considered to be able to play a vital role for U.S. interests since it was located to the immediate south of the Soviet Union.

However, the 1979 Iranian revolution altered the regional balance in the Middle East. The Islamic revolution’s attitude to Saudi Arabia was negative on the religion denouncing the Kingdom outdated and corrupt since the Kingdom’s Sunnis emphasized secular values.<sup>348</sup> And the Khomeini regime considered Washington, the Kingdom’s strategic ally, to have wielded a great influence on the Middle East as an Imperialist state. Based on its perception of Riyadh and Washington, Iran, therefore, attempted to oust U.S. in the Gulf region and to seize the power. The Iranian regime broke its political and economic ties with the West including U.S. and indoctrinated hatred for America to the population. In a word, the Iranian pillar was completely crushed.

Due to the collapse of the Iranian pillar, Saudi Arabia took on added significance to the U.S. foreign policy. The United States “needed a strong local partner to provide diplomatic and strategic support”<sup>349</sup> so as to prevent the Khomeini regime from jeopardizing the Americans’ national interests as well as to build up “its potential for

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<sup>347</sup> Edwin S. Rothschild, “Is Iranscam Really about Oil?; At Last: A Conspiracy Theory with Saudis, Iran and George Bush,” *The Washington Post*, December 28, 1986.

<sup>348</sup> Niblock, 2006, p. 69.

<sup>349</sup> Niblock, 2006, p. 145.

direct military action in the region”<sup>350</sup> against the Soviets and Iran. And Washington had the Saudis as its strategic partner in the Persian Gulf.

However Saudi Arabia was not able to totally defend itself against any possible military threats from the Soviet Union as well as from Iran. The territory of Saudi Arabia was so vast and empty. But the military system of the Kingdom was not sophisticatedly designed to the national territory and its borders since “the imperial family relied on a small army of dubious loyalty and a haphazard security apparatus.”<sup>351</sup> Fear of attack spurred Riyadh on to arrange arms deal with the West and to import high-tech weaponry.

The Kingdom’s poor defense was considered as a chance to gain more political leverage from the perspective of the United States. Iran warned the Kingdom in 1984 that it would attack the Kingdom’s oil-export facilities and the oil tankers bound for Saudi Arabia. In the following year, “Iran was advancing rapidly towards Iraq and Saudi Arabia.”<sup>352</sup> Tehran’s aggressive policy towards the Kingdom put the Saudis in a predicament. In this environment, the Reagan administration set up the ‘Iranian initiative’ to pressure to suppress its revisionist actions. The initiative was aimed at lowering the world oil prices “so as to harm Iranian attempts to raise funds for the war.”<sup>353</sup> Since “Iran had to fund most of its war effort from oil sales”<sup>354</sup>

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<sup>350</sup> Niblock, 2006, p. 145.

<sup>351</sup> Anderson, 14 March, 1985.

<sup>352</sup> Macdonald, 1993, p. 124.

<sup>353</sup> Macdonald, 1993, p. 124.

<sup>354</sup> Macdonald, 1993, p. 125.

whereas Iraq, supported financially by the Gulf neighbors, was “less dependent directly on oil,”<sup>355</sup> Washington’s ambitious plan to deter the Iranians’ further efforts to continue the war and attack the Kingdom, of course, needed Saudi Arabia’s help.

Washington sought for the Kingdom’s participation in the project of containing Iran’s any anti-American behaviors. And the evidences directly indicated that Saudi Arabia had overproduced its own oil in pursuit of implementing the Iranian initiative.

In February of 1985 King Fahd and his then-Oil Minister Ahmed Zaki Yamani and his back-channel operative, Adnan Khashoggi visited Washington. ... Suddenly, the king found out that the Reagan administration was not interested in high prices. ... In the spring of 1985, ... King Fahd of Saudi Arabia warned members of OPEC that the kingdom was going to increase its oil production, unless other oil producers reduced theirs. ... A few days after the king’s statement, an official of the U.S. Treasury announced that “any decline in oil prices would only benefit the world economy and should be welcomed.”<sup>356</sup>

According to the report, the Saudi king’s visit to Washington gave another indication that the Saudi plan to decrease the global oil prices by its own overproduction was designed in cahoots with Washington. And the major oil companies, including Exxon, Chevron, Texaco, and Mobil, which “had for many years used as an arm of U.S.

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<sup>355</sup> Macdonald, 1993, p. 125.

<sup>356</sup> Rothschild, December 28, 1986.

foreign policy in the Persian Gulf,”<sup>357</sup> helped the Reagan administration to persuade the Saudis. Following the U.S.-Saudi summit talks, Exxon, Chevron, and Texaco met the Saudi oil minister, Sheikh Yamani, in May 1985 to ask the Kingdom to cut oil prices.<sup>358</sup> In March 1986, “the Aramco companies again met with Saudi officials and demanded additional price discounts” which “gave the Aramco Partners the lowest-priced crude in the market, enabled them to raise Saudi production from 4 million to 6 million barrels per day.”<sup>359</sup>

The cooperation between Riyadh and Washington worked quite successfully. “The sharp decline in oil prices had a profound effect on Iran. Oil revenues of \$16 billion in 1985 fell to \$6 billion in 1986. The Iranian economy went into a tailspin. Gasoline had to be rationed. Unemployment soared, and with it social and political discontent.”<sup>360</sup> Exerting its influence on the Saudis’ oil-production policy, the United States contained the Iranians’ revisionist behaviors in the Middle East effectively.

Another story tells again that the Kingdom’s sudden change in its oil policy in August 1985 resulted from the U.S.-Saudi negotiation. Immediately after the king Fahd’s visit, the Reagan administration began to prepare “a new arms package for Saudi Arabia.”<sup>361</sup> The State Department confidentially persuaded the Congress members to help

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<sup>357</sup> Rothschild, December 28, 1986.

<sup>358</sup> Dominic Lawson, “Saudis under Pressure to cut crude oil price,” *Financial Times*, June 3, 1985.

<sup>359</sup> Rothschild, December 28, 1986.

<sup>360</sup> Rothschild, December 28, 1986.

<sup>361</sup> Anderson, March 14, 1985.

Saudi Arabia shore up its arsenal in order that the U.S. could prevent the helpless Saudi regime from being replaced by an anti-American government as the example of Iran.

The royal rulers are vulnerable, for instance, to harassment by Shiite fanatics who respond to that wily old octopus, Ayatollah Ruhollah Khomeini. What makes this all the more ominous is that the Shiites are concentrated in the Saudi oil fields and constitute one-third of the work force of Aramco, the state-owned oil monopoly. ... One cannot totally reverse Shia antipathy toward the government, amounting in some cases to deep and abiding hatred for the royal family, which years of neglect has bred.<sup>362</sup>

Riyadh's resolution to curb its oil production also seemed to come from the U.S. government. In April 1986, King Fahd visited again Washington and had a 2 1/2-hour meeting to agree "on the need to reestablish stability in the oil market," and in two months, he announced that "oil prices stabilized at a price of \$20."<sup>363</sup>

Thus, the United States gave a huge influence on the Saudis' decision-making process in terms of the Kingdom's oil production and the global oil prices in 1985. Reagan and King Fahd made decisions on the Kingdom's oil output through several covert meetings. And through these meetings, two countries endeavored to strengthen the bilateral relationship among them. On the one hand, the United States aimed to

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<sup>362</sup> Anderson, March 14, 1985.

<sup>363</sup> Rothschild, December 28, 1986.

contain the Soviets and Iran in the Middle East. On the other hand, Saudi Arabia sought to build up its military arsenal and to put itself under the protection of Washington.

## V. Conclusions

The establishment of the OPEC in 1960 was believed to signal a birth of cartel and suspicion grew over the West that the oil-rich countries' action might have been taken out of common interests in ramping up the oil prices. In the immediate wake of the First Oil Crisis, they nearly reeled under a barrage of criticism of spike in oil prices from Western governments and media. And the temporary erosions of the market encouraged a number of researches to define OPEC as a cartel whose aim was to raise oil prices.

As many researches indicated, the OPEC was originally founded in pursuit of common objectives, to make the oil market stable as well as to ensure the member states' interests. And the OPEC nations had consistently made efforts to set up a binding price structure commonly applied to them. During the period from 1960 to the early 1980s, OPEC countries had built up the common structures of price and production through communication and cooperation between them.

Unlike other OPEC members, Saudi Arabia has been considered to play a unique role of swing producer or as residual supplier within the OPEC and the world oil market. The Kingdom, with its massive oil reserves, has the enormous capacity to raise or lower its oil output to support OPEC oil prices. The role of Saudi Arabia as the cartel's swing producer was particularly stressed in the situation under which the world oil prices rapidly dropped. For instance, Riyadh decreased its oil output by more than 50 percent in 1979 when demand exceeded supply

extremely in the market, by operating only 15 fields out of a known 50 and drilling 55 oil wells out of 177.

Despite the Kingdom's painstaking efforts to fulfill the OPEC price structure, other members began to cheat on the OPEC decisions. Since the late 1970s, the market share of OPEC had increasingly declined due to the shrinking demand for OPEC oil. Growing oil supplies from non-OPEC sources and the West's endeavors to reduce its reliance on OPEC oil spurred some OPEC countries to lift the burden for the provision of OPEC collective goods. Non-Gulf OPEC member states such as Nigeria and Venezuela sold their crudes at a discounted price and produced their outputs in violation of their quotas allotted by the OPEC.

Saudi Arabia continued to support the OPEC's production ceiling and official prices by trimming its output and further giving up its market share to a large extent. However, in August 1985, Riyadh rapidly changed its oil policy and decided to raise its output. This decision means that the Kingdom cut back its swing-producer role within the OPEC.

The paper asks why Saudi Arabia raised its production of crudes abruptly in August 1985 to reduce its swing-producer role. The paper begins with this main research question and attempts to provide a plausible answer to it by exploring the two research hypotheses; Hypothesis (A) which argues that *Saudi Arabia needed to boost its oil revenues as the international and regional threats to its security got higher* and Hypothesis (B) which insists that *Saudi Arabia might have needed to boost its oil revenues so as to develop its national economy*.

Hypothesis (B) explains as many researches that the Saudis' unexpected action might have been intended to develop their national economy. Since the early 1980s, Riyadh had collected enormous revenues from exports of its crudes thanks to high oil prices. The high level of oil prices led the industrialized countries to decrease consumption of oil from the Middle East and develop new sources of energy. In addition, as new suppliers emerged in the market, the competition between oil producers got stiff. Adverse market conditions notwithstanding, a considerable number of data indicated that the Saudi economy was stable in 1985 enough to accommodate itself to the changed environment of the market.

Instead, the paper argues in favor of Hypothesis (A) that Saudi Arabia boosted the production of its crudes in 1985 and reduced its unique swing-producing role mainly due to political reasons. Saudi Arabia, in fact, had been threatened by the international and regional conflicts. The Middle East had been construed as an important arena of superpower competitions since the beginning of the Cold War. And the Gulf countries had got involved in a number of conflicts by reason of traditional local rivalry or of the great powers' intervention. The Saudis began to pay keen attention to its security for the fact that the Soviets' invasion of Afghanistan, the Iranian Revolution and the Iran-Iraqi were occurred in the immediate vicinity of the Kingdom's territory.

The most serious threat to the Saudi security came directly from Iran. As a result of the Iranian revolution, the Shah monarchy was replaced by the Khomeini regime. The rational revolutionary regime challenged Saudi Arabia to oust it from the regional power, asserting its

claim to Islamic leadership. And Iran publicly denounced the United States as Khomeini's propagandas expressing anti-American sentiment and required Washington not to interfere with the politics of the Middle East. In 1984, Tehran warned the Saudis that it would destroy the Saudis' oil facilities in the Eastern Province and in the following two years the Iranian troops attacked the Kingdom's oil facilities and the tankers carrying Saudi Arabian oil. Since a vast majority of its oil reserves were buried in the Eastern Province, the Kingdom had no other choice but to strengthen its ties with the U.S. government for depending on the U.S. military assistances.

The Reagan administration was willing to support Riyadh as it had given its top foreign policy priority to keeping out the Soviets in the Middle East. In the early 1980s, some Gulf countries, worn out by the prolonged war between Iran and Iraq, began turning to the Soviets. The Soviets sought to support the Gulf States as means of broadening their influence in the Persian Gulf and succeeded in providing Iraq and Kuwait with their advanced weapons and in establishing diplomatic relations with Oman and the UAE. The Soviets' move in the Gulf encouraged Washington to strengthen the bilateral relation with the Kingdom.

Therefore, the paper argues that Saudi Arabia and the United States agreed to lower the oil price level as means of decreasing the Iranians' oil revenues used to finance the war. The U.S.-Saudi summit talks and Yamani's meeting with the major companies during the first half of 1985 show clearly the intention of the Reagan administration. The oil price crash of 1985-6 was intended to weaken the influences of

the Soviet Union and Iran and simultaneously to reconfirm Washington's dominant power in the Middle East region. In return for the overproduction of their crudes, the Saudis could obtain a firm assurance of military support from the United States in case of aggression by the Soviets or the Iranians. Riyadh also expanded its spending on arms purchases from the West including the United States. These historical records, therefore, confirm the Hypothesis (A) of the paper as an answer to what triggered the Saudis to increase the production of oil.

The paper can be said to have its implication for the study of the oil producers since the exploration of the Saudi behavior in 1985 helps us widen our understanding of the oil producers' market behavior. The paper tells us that the oil-producing countries' decision on their oil output comes not only from economic concerns but also from political thinking. Furthermore, the paper's analysis of the Saudis' production policy in 1985 shows that the negotiation within OPEC is an empirical evidence useful for demonstrating that the cooperation among the oil producers is hard to reach due to political concerns.

Even so, the paper still needs to be supplemented by further research. Most of all, the paper lacks a comprehensive understanding of Saudi Arabia's political intentions behind its change in oil policy since it mainly explores the Saudi policy in the first half of 1980s. A case study of other time periods should be conducted so as to heighten the applicability of the main hypothesis of the paper. And further research needs to be carried out to accumulate empirical evidence to draw a clear picture of what the discussion between the Reagan administration

and Riyadh was about.

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## 국문초록

1960년 중동의 산유국들을 중심으로 한 OPEC의 창설은 석유 독과점시장 환경 내에서 생산국 간의 유기적 담합을 노리는 카르텔의 탄생으로 비춰졌고, OPEC의 이기적 동기에 대한 서방세계의 비판이 쏟아졌다. 그러나 OPEC 가입국 중, 사우디아라비아의 경우는 OPEC의 창설부터 현재까지 OPEC의 석유 생산량과 세계 유가를 적정 수준으로 유지하는, 소위 ‘공급조절자(swing producer)’의 역할을 담당해왔다는 점에서 주목을 받아왔다. 예컨대 사우디아라비아는 OPEC 원유에 대한 수요가 급감하고 석유 과잉공급으로 인한 유가 하락이 예상되던 1980년대 초반 OPEC 석유 생산량 쿼터제를 도입하는 데 주도적 역할을 하였고, 다른 국가보다 가파른 감산정책을 취하면서 유가 유지에 기여하였다.

그러나 OPEC에 불리한 시장 상황이 여전히 개선되지 않은 1985년 8월 사우디아라비아는 갑자기 증산정책을 단행하여 같은 해 12월까지 일일 원유생산량을 약 100% 끌어올렸다. 그 결과 1985년 말까지 약간의 감소세를 보이던 유가는 1986년 완전히 폭락하게 된다. 본 논문은 자국의 증산으로 세계 유가 폭락이 충분히 예상됐던 상황에서도, “이 시기 사우디아라비아가 기존의 공급조절자 역할을 대폭 축소할 배경이 무엇인가?”라는 연구질문에 대한 대답을 시도하고 있다.

사우디아라비아의 석유 정책에 관한 기존 연구들은 1985년에 이뤄진 증산정책이 급격한 재정난으로 파탄된 국내 경제에서 비롯되었다고 설명하고 있다. 이러한 설명이 상당한 적합성을 제공함에도 불구하고, 본 논문은 사우디아라비아의 증산정책을 이끌어낸 가

장 결정적인 요인은 사우디아라비아의 정치적 고려였다고 주장한다. 즉, 정치적 요인이 사우디아라비아의 정책결정과정에 작용했다는 데 초점을 두고, 사우디아라비아의 안보에 대한 국제적, 지역적 위협이 증가함에 따라 사우디아라비아가 증산을 통해 석유 수출 수익을 늘려 안보에 힘을 쏟는 대신 공급조절자의 역할을 축소하게 되었다는 가설을 연구질문에 대한 잠정적인 대답으로서 제시하였다.

본 연구에 의하면 냉전으로 인한 국제적 미-소 갈등이 중동 지역의 역내 긴장관계를 조성 및 강화하였으며, 1970년대 후반에는 이란혁명과 이란·이라크 전쟁이 발생하여 사우디아라비아의 안보에 큰 압력으로 작용하였다. 특히 이란은 사우디아라비아의 친미정책과 종교적 타락을 문제 삼으며 사우디아라비아를 자극하는 데 이어, 1984년과 1985년에는 사우디아라비아의 핵심 정유시설과 유조선에 상대로 공격 및 테러를 거듭하여 사우디아라비아의 안보에 큰 위협을 가하였다. 이에 대한 방안으로 사우디아라비아는 적극적으로 서방의 선진 무기 구입에 나서는 한편, 미국의 레이건 행정부와 긴밀한 협력관계를 도모하였다. 이러한 사실들은 사우디아라비아의 증산정책은 안보 능력 증강을 하는 과정에서 국가수입을 증가시킬 필요가 있었다는 가설을 확인시켜 주었다.

본 논문은 산유국의 생산 정책이 가격과 같은 시장요인에 대한 고려에서만 비롯되는 것이 아니라, 군사적 위협 인식과 같은 정치적 요인에 의해서도 큰 영향을 받을 수 있다는 것을 보여준다는 점에서 의의를 찾을 수 있다. 또한 카르텔로 대표되는 산유국의 경제적 협력이 가입국의 위협 인식 때문에 무산될 수 있다는 사실을 확인할 수 있어, 가스수출국포럼과 같이 현재 국제 에너지 시장에 형성되어 있는 카르텔의 미래를 가늠하는 데 있어 실증적으로 도움

을 줄 수 있을 것으로 보인다.

주요어: 사우디아라비아, 공급조절자, 사우디아라비아 석유 정책, 사우디아라비아·미국 관계, 사우디아라비아·이란 관계, 석유수출국기구

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