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USAWC MILITARY STUDIES PROGRAM PAPER

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**OIL AND POWER:
AN ANALYSIS OF UNITED STATES
ECONOMIC INTERESTS AND STRATEGIES
IN THE MIDDLE EAST**

AN INDIVIDUAL STUDY PROJECT

by

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**U.S. Army War College
Carlisle Barracks, Pennsylvania 17013**

31 May 1988

ABSTRACT

AUTHOR: Charles D. Poche, LTC, FI

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The United States met virtually all of its oil needs from domestic sources until the early 1970s. This self-sufficiency gradually eroded as our internal production failed to keep pace with rising levels of energy consumption. As a result, our new energy needs have been satisfied primarily by petroleum imports. The 1973 Arab oil embargo and supply curtailments associated with the Iranian Revolution in 1979 were painful experiences for the nation. By 1980, the United States was importing 8.5 million barrels of oil per day at a cost many times higher than the going rate in earlier years. Dependence on Middle East oil had become a frightening reality. During the same period, trade deficits, inflation, interest rates, and balance of payment problems were increasing at an alarming rate. Since that point in time, the United States has made progress in building a strong foundation for energy security. Despite these gains the United States is rapidly approaching another critical juncture in its battle to reduce dependency on imported oil. As in the 1970s, declining internal production and growing energy needs will significantly increase the need for Middle East petroleum in the 1990s. Given this forecast, the attached paper will attempt to identify our current economic interests in the Middle East. It also suggests national economic strategies that could be employed to improve America's energy prospects for the future. Though certainly related to the problem at hand, political and defense issues do not receive major attention in this study. The non oil producing states of the region are given similar treatment.

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**OIL AND POWER:
AN ANALYSIS OF UNITED STATES
ECONOMIC INTERESTS AND STRATEGIES
IN THE MIDDLE EAST**

CHAPTER I

INTRODUCTION

At the present time, there is an abundance of oil on the world market. The price of petroleum products has declined in recent years and there have been no serious supply interruptions for almost a decade. Energy conservation methods and utilization of alternative energy sources have helped to reduce our oil imports to approximately 15 percent of our total needs. Most Americans are complacent about energy security. They seem to have forgotten that our major trading partners, Western Europe and Japan, must still import the vast majority of their petroleum needs. It is important to note that the inter-relationships of the United States economy with those of Europe and Japan are such that their problems soon become our problems.

It is doubtful that Americans will be able to remain complacent about our energy needs for any extended period of time. Our nation must be made aware that all serious economic forecasters agree that, by the 1990s, the free industrial nations of the world will grow more dependent on increasingly expensive petroleum supplied by the Middle East. The problem at hand goes far beyond simple dependence on a scarce commodity. Trade

deficits, international market shares, investment strategies, and the overall economic stability of the United States could be adversely affected by expensive oil imports or supply interruptions. As indicated above, our nation has made significant progress toward a stronger foundation for energy security. Despite these gains, it is obvious that the United States is rapidly approaching another critical juncture in the state of its energy security.¹

Given the threatening forecast provided above, this paper will specifically identify America's vital economic interests in the Middle East. It also provides suggestions as to what national economic strategies could best be employed to reduce the threats posed by increased dependency on Arab oil. It is impossible to discuss economic interests and strategies without touching on defense and political issues. These related considerations, though vital in nature, will not receive major attention in this study. Middle Eastern states with either limited or no oil-producing capacity will be treated in the same manner.

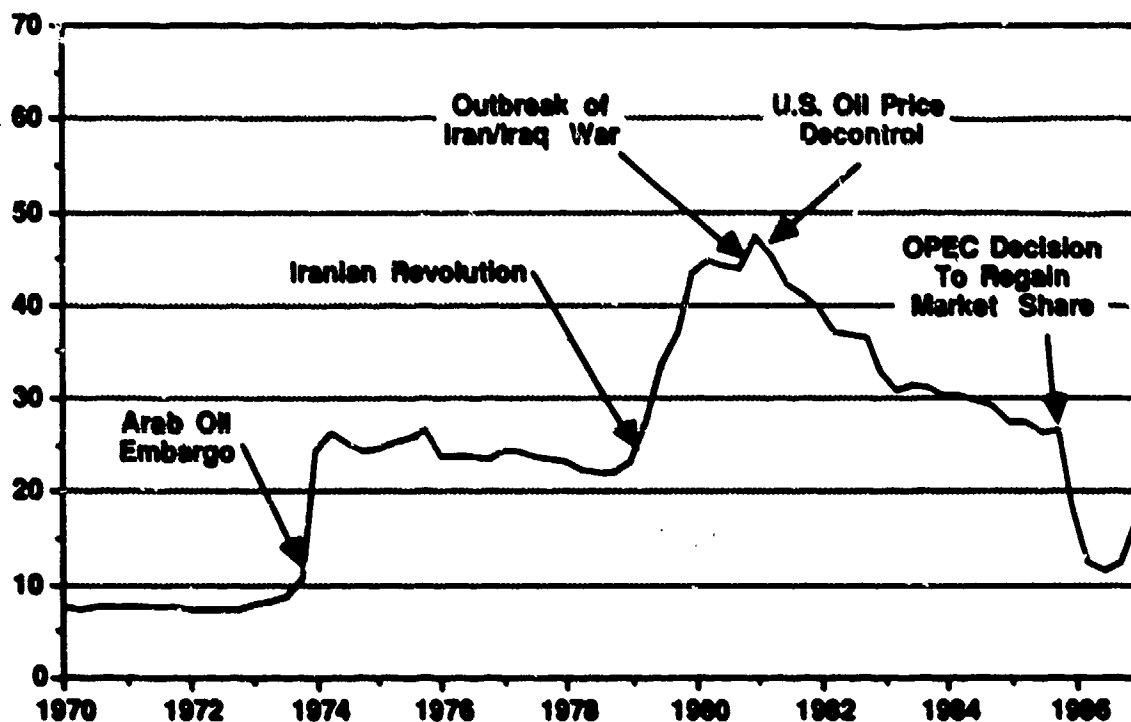
BACKGROUND

The United States satisfied the majority of its oil and energy needs from internal sources until the 1970s. This self-sufficiency gradually declined as our domestic production output fell behind our rising demands for energy. As a result, our new energy needs have been satisfied primarily by petroleum imports from other nations.² The 1973 Arab oil embargo and

curtailments associated with the Iranian Revolution in 1979 were both painful lessons. As shown in Figure 1, both events precipitated major oil price increases. President Carter did not

FIGURE 1

Oil Prices Reflect International Events



* Average quarterly cost of crude oil imported by U.S. refiners.

Source: U.S. Energy Information Administration

exaggerate when he called the situation "a clear and present danger to our national security."³ Economic dependence on Middle East oil had become a frightening reality for the United States and other free industrialized nations.

At the same time, trade deficits, inflation, interest rates and balance of payment problems were growing in America at an alarming rate. The high price of oil contributed to these problems. During the same time period, Arab states chose to reinvest a large portion of their expanding petrodollar reserves in the United States. As a result, there were fears that the future of American business and industrial activities would be significantly influenced by Arab interests.

Despite the decrease in oil costs resulting from the current oil glut, this situation has not improved with time. As discussed in 1987 by Conant, "the Middle East now supplies about one-half of all oil in the international market. It also possesses over 75 percent of the world's spare production capacity and 60 percent of the world's oil reserves. For all practical purposes, there is now no spare production capacity outside of the Middle East and OPEC. The share of internationally traded oil originating in Arab and Gulf states is growing and could provide as much as three-fourths of all traded oil by the mid-1990s." Trade deficits, growing national debt levels, and related economic problems also continue to cause significant concerns over the future of the United States economy.

THE ECONOMIC THREAT

Projected growth in energy dependency poses a significant economic threat to the United States and its allies. Given the continuing Arab-Israeli-Palestinian conflict and the Iran-Iraq

War, the Middle East remains a volatile area. Superpower competition and religious fundamentalism in the area do nothing to help this situation. A continuous supply of reasonably priced Middle Eastern oil is vital to the economic health of free industrialized nations. Any interruptions to this flow would result in immediate and dire economic conditions. For example, 'the sudden loss of Persian Gulf oil for a year would devastate the world's economy like no event since the Great Depression of the 1930s. The Congressional Budget Office has estimated that the loss of Saudi Arabian oil for a year would cost the United States \$272 billion, increase unemployment by 2 percent and boost our inflation rate by 20 percent. The economic costs to our allies would be even greater. The loss of all Persian Gulf oil would cut our GNP by 13 percent; Europe's, 22 percent; and Japan's, 25 percent. Even if these estimations are overstated, the potential economic threats they present are clearly terrifying.'" The effect of such oil supply cutbacks on our defense and political interests would be equally negative.

CLOSING

The above remarks provide historic highlights of our economic relationships with the oil producing sector of the Middle East. Thoughts were also offered concerning the significant threat that dependence on Arab oil presents to world economic stability. Many in this country feel that the United States should more fully recognize its vital interests in the

Middle East and develop a more coherent strategy for oil and energy security. The remainder of this paper will attempt to further analyze these issues and recommend the adoption of national economic policies that support our economic interests in the region.

ENDNOTES

1. John S. Herrington, Report of the Secretary of Energy to the President of the United States on Energy Security, p. iii.
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3. Joseph S. Nye, "Energy and Security," in Energy and Security, ed. by David A. Dease and Joseph S. Nye, p. 3.
4. Melvin A. Conant, "Recognizing U.S. - Arab Interdependence: The U.S. Stake in Gulf Oil." American - Arab Affairs, September 1987, p. 57.
5. Nye, pp. 3-4.

CHAPTER II

AMERICAN ECONOMIC INTERESTS IN THE MIDDLE EAST

The people of the United States hold widely divergent views as to what our true economic interests are in the Middle East. Many Americans believe that Middle East oil imports and commercial relationships are no longer important and feel that market forces now set the price of oil in the international arena. This group also views Arab imports as a small fraction of our total overseas purchases. As a majority of Americans think in this manner, their elected officials in Washington pay little attention to our relations with the Middle East.¹

Another group of Americans agree with an opinion recently presented by Alsamarrai. He stated that "it is wrong to assume that the present glut of oil is permanent and doubly wrong to believe that one can dispense with dependence on Arab oil. Under the aura of plentiful and cheaper oil, the temptation is strong to treat regional problems with benign neglect. Nothing could be more dangerous."²

The author of this paper agrees with Alsamarrai and views the following as the primary American economic interests in the Middle East:

- * Ensuring the region as a market for our goods, services, and technology.

* Assured access to continuous and reasonably priced Middle East petroleum resources for the United States and its allies.

* High levels of Middle East capital investments in the United States.

Each of these interests will be discussed separately in the following sections of the chapter.

ACCESS TO COMMERCIAL AND MILITARY MARKETS IN THE MIDDLE EAST

A review of current literature indicates that existing political policies in the United States are costing the nation numerous opportunities for expanding both commercial and military trade with the Middle East. Given present trade deficits and unemployment in America, this condition cannot be ignored. The Arab market is still large. It accounts for some \$30-plus billion a year in exports of goods and services from the United States. This amount represents 10 to 12 percent of our total exports. About three million American jobs are supported directly or indirectly by our trade in the Middle East. On the surface, it appears that all is well in terms of our trade with the Middle East. Such is not the case. There are still another one million Americans who have lost their jobs and livelihoods due to politicization of our trade relations with the Arab world. We can measure our losses by comparing American exporters' share of the Middle East market with our share of export markets for the entire world. In this regard, America currently enjoys about 16

percent of all world trade.³ Figure 2 indicates how selected Middle East states fare against this standard.

FIGURE 2

U.S. Share of
Middle East Markets

1983 - 1985

<u>Country</u>	<u>U.S. Market Share</u>
Saudi Arabia - - - - -	20%
Algeria - - - - -	6%
Iran - - - - -	1%
Iraq - - - - -	6%
Libya - - - - -	3%
Syria - - - - -	4%
Israel - - - - -	16%
All LDCs - - - - -	15%

Source: American-Arab Affairs, No. 6, Spring
1986, p. 13.

Examples of our trade shortfalls in the Middle East are obvious. We have captured only \$100 million of Iran's \$15 billion annual import market. American exports to Algeria, Libya, Syria, and Iraq are also low. These and other countries are strongly opposed to our current relationship with Israel. As a direct consequence, our market share in the four countries mentioned above is reduced by about \$4 billion a year. This equates to a loss of 400,000 jobs in America.⁴

We are also losing important market shares in the military sales arena. For example, potential arms sales to Saudi Arabia and Jordan totaling \$20 billion have been lost as a result of political opposition to these weapons transfers in the United States. The Commerce Department has estimated that the loss of these sales cost America 500-600 thousand jobs.* It is important to note that the Israeli lobby in America strongly opposed these sales and undoubtedly played a key role in stopping the proposed arms transfers. The controlled sale of arms to moderate states in the Middle East is in the best interest of the United States. If we don't supply weapons to our friends in this region, other nations, including our allies, will be more than happy to provide whatever equipment is desired.

There are numerous other examples of lost trade opportunities in the Middle East, but those mentioned above clearly illustrate the problem at hand. Given the fact that our merchandise trade deficit rose to \$160 billion or 4 percent of our GNP in 1987, the country must increase its overseas market shares.* The real question seems to be how long will America endure these losses before they affect our relationships and our policies toward Israel.

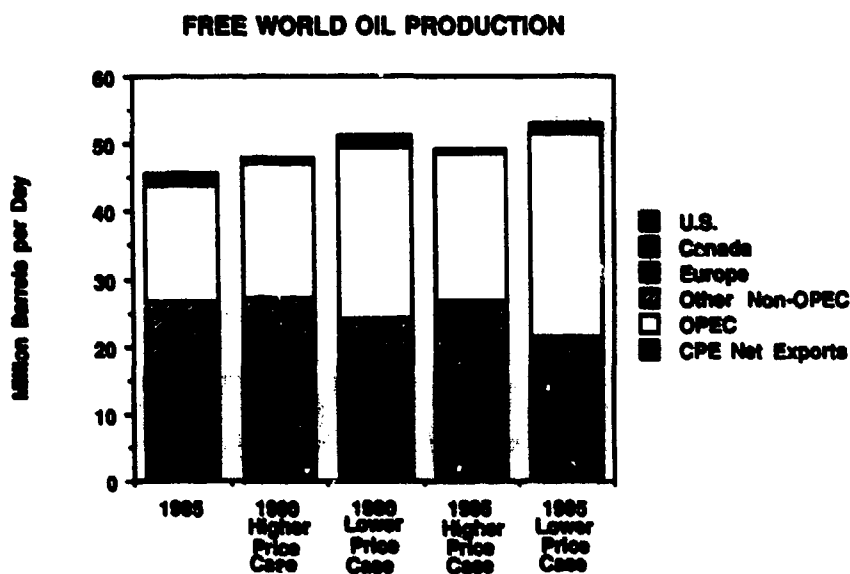
UNINTERRUPTED ACCESS TO REASONABLY PRICED MIDDLE EAST OIL

Most writers agree that securing a continuous flow of reasonably priced oil to America and its allies is our only vital economic interest in the Middle East. It is therefore important

that this issue be reviewed in much greater detail than that provided in the introduction to this paper. Accordingly, this section will address our increasing demands for Middle East oil in coming years.

Estimates indicate that by the end of this century, demand for Middle East oil will grow to 28 million barrels per day. This represents a 50 percent jump in demand since 1985 (see Figure 3). Given the magnitude of this increase, it is clear that the United States and other oil importers will inevitably turn to the Middle East to satisfy their future petroleum requirements.⁷

FIGURE 3

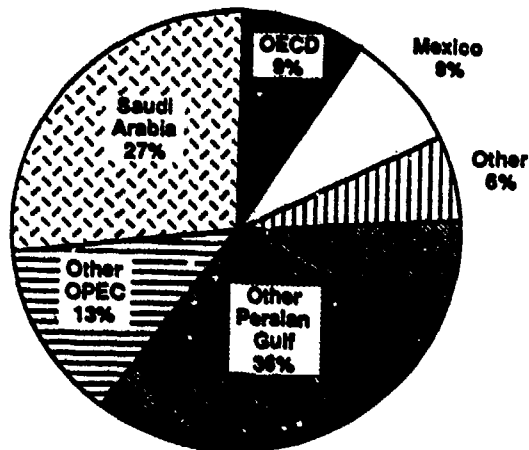


Source: U.S. Department of Energy

"During 1985, Middle East producers exported 11 million barrels of oil a day. This provided about half of the total oil imports to the rest of the world. More importantly, they possessed about 10 million barrels a day of installed but unutilized production capacity, about 85 percent of the world's total. Outside the Middle East, there may be a million and a half barrels a day of unutilized capacity among OPEC members and perhaps 200,000 barrels a day among the non-members of OPEC. Similarly, Middle Eastern exporters possess a conservatively estimated 433 billion barrels of proven but undeveloped oil reserves, which represent 70 percent of the free world total (see Figures 4 and 5 for specific shares). So what do all these statistics mean? They mean that when demand growth exceeds the unutilized production capacity outside of the Middle East, something less than 2 million barrels a day, market forces will inexorably direct oil buyers and those seeking imports to that 10 million barrels a day of unutilized production capacity in the Middle East. And when, somewhat further down the road, that unutilized production capacity is used up, those proven but undeveloped reserves will also attract the attention of oil importers. It is therefore certain that the importance of Middle East oil will grow."

FIGURE 4

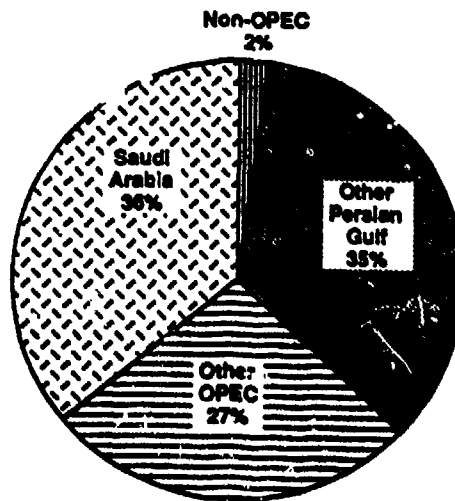
**Shares of Free-World Oil Reserves
(as of January 1, 1987)**



SOURCE: U.S. Energy Information Administration

FIGURE 5

**Shares of Surplus Oil Production
Capacity in 1986**



SOURCE: U.S. Energy Information Administration

Given the above, the question becomes what will Arab oil exporting nations do with the supply leverage they attain by increased world demand for petroleum in the future. Will they use this new power in a cooperative or confrontational manner? Only time will provide an answer to this question.* To ensure continued access to Arab oil in the future, we must begin now to improve our relationships with the Arab Middle East. Changes to certain of our policies must be considered. For example, we should work to balance our relationships between Israel and Arab states in the Middle East. Or perhaps we should provide more economic and security assistance to the poorer Arab nations. Additional thoughts on how we might modify our national economic policies to secure future energy security will be provided in Chapter IV.

CONTINUATION OF MIDDLE EAST INVESTMENTS IN THE UNITED STATES

Many individual citizens of the United States and certain of our political leaders are concerned over the high level of Arab financial investments in the United States. The majority of these fears are based on the assumption that significant investments will allow Middle Eastern states to exert a detrimental influence over our business entities and possibly generate financial disruptions (e.g., short notice withdrawals of major Middle East deposits in our banks, large scale sales of American stocks and bonds held by Arabs, etc.). Given the volume of media coverage addressing this issue, the public concerns mentioned above are

not surprising. A much smaller group of Americans, this author included, views Arab investments as both a blessing and an important economic interest of the United States. The remainder of this chapter will examine Arab investments in the United States and attempt to make a case for encouraging and enlarging these capital inflows.

America has been an inviting market for overseas investors since the late 1970s. This condition was fostered by the relative safety of our markets and the fact that our massive deficit financing requirements produced high interest rates that attracted external entrepreneurs. For example, "investors from all regions of the world held \$230 billion in publicly-owned Treasury securities in 1985. These holdings financed almost one-fifth of the nation's borrowing requirements for that year. The Arab investment community has also played heavily in our Government securities markets as one method of recycling their reserves of petrodollars. In 1982, Arab investors held \$42 billion or 5.8 percent of all our Government securities. The Treasury undoubtedly welcomed these investments as a valuable means to finance our growing deficits."¹⁰

Middle East interest in our financial markets goes far beyond Treasury securities. They also invest considerable amounts in American corporations. In 1983, the world's major oil exporters held \$14 billion in American corporate stocks and bonds. At the same time, they placed \$17 billion in American bank deposits and were active participants in our real estate markets.¹¹ There and other investments work to stimulate our

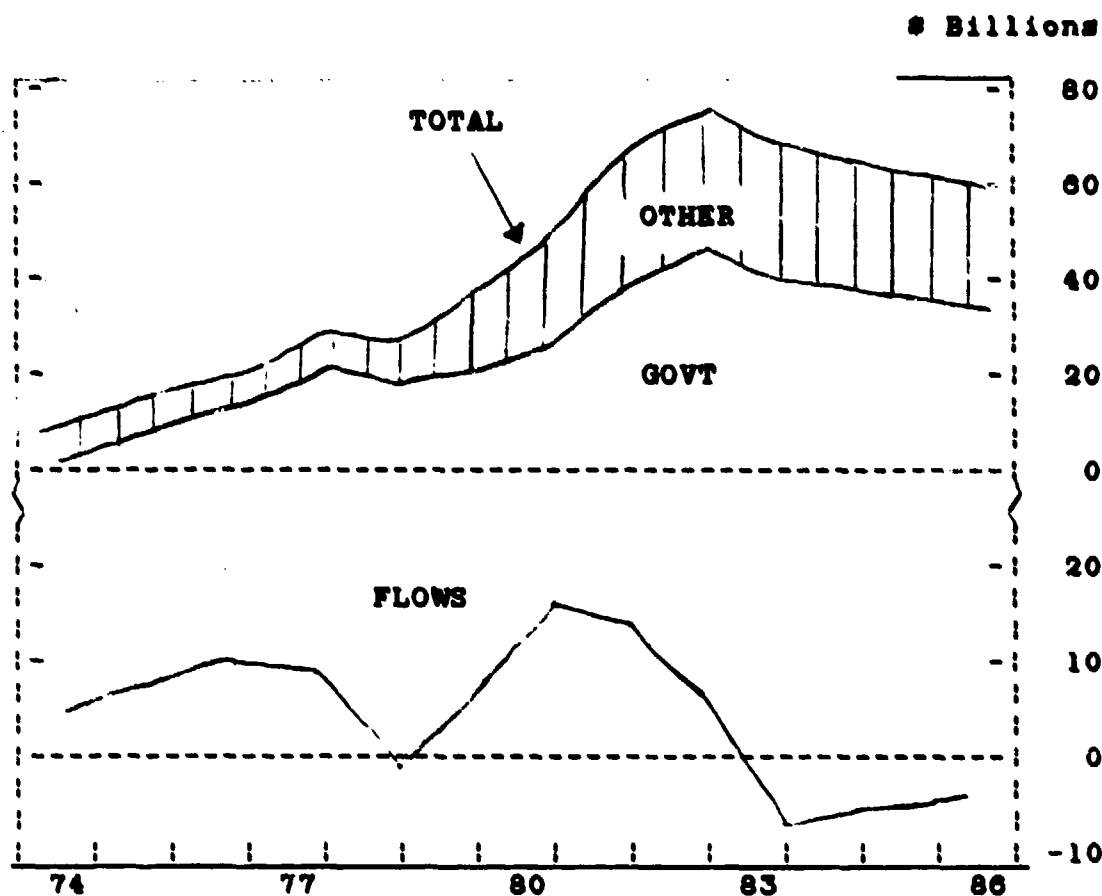
economy and provide jobs and business opportunities for the American workforce. Arab investments have also provided vital cash liquidity to our banking system that is still suffering from non-performing loans granted to corporations and developing countries.

Determining the total value of Middle East foreign investments is a very difficult task. Current economic statistics for the region are hard to come by and 'errors and omissions' are common. Given this limitation, records of the U.S. Treasury indicate that major oil producers in the Middle East accumulated \$240 billion in total foreign investments placed throughout the world during the period 1973-84. This amount fell to \$205 billion in 1985 as declining oil prices and Arab domestic needs decreased investments in foreign markets.¹²

As indicated in Figure 6, official Treasury estimates of Middle Eastern investments in the United States totaled \$60 billion in 1986. After this amount is adjusted for unrecorded capital flows into America that are not included in Treasury statistics, it is estimated that Arab investments in America were \$70-75 billion. This amount represents a significant decline from a similarly adjusted total of \$100-105 billion for 1982.¹³ The major cause of this decline was the falling price of oil on the world markets and Arab needs for domestic investments. This adverse trend will continue as long as world oil prices remain at their current depressed levels.

FIGURE 6

OAPEC* INVESTMENT IN U.S.



Source: U.S. Departments of Treasury and Commerce

* Organization of Arab Petroleum Exporting Countries

Do Arab investments currently have the potential to cause economic disruptions in this country? This author feels that "no" is the appropriate answer to this question. Arguments that support this response are as follows. Total Arab investments in the United States pale in size when compared to America's massive GNP of \$4.2 trillion. More specifically, Middle East investors

held less than 1 percent of the \$1.72 trillion total value of stocks issued by our corporations. Comparisons of a similar magnitude could be provided for Arab investments in American banks and Federal securities. It should also be noted that Middle Eastern states rarely make majority investments in any one firm and do not have significant financial control over the energy or defense sectors of the American economy.¹⁴

In summary, Middle East investments, though considerable in size, pose no serious threat to American commercial interests, and it would be difficult to manipulate these holdings in a manner that would result in major financial disruptions in the United States.¹⁵

CLOSING

The information provided in this section strongly suggests that the fears of the American public concerning Arab investments in our country are unfounded. Middle East capital placed in this country since the 1970s has helped the country through a difficult economic era. Continued Arab investments in the United States are beneficial to Middle East and American interests. They should definitely be expanded.

ENDNOTES

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3. Thomas R. Stauffer, 'Economic Implications of Lost Trade Opportunities in the Middle East, Military and Commercial,' American - Arab Affairs, Spring 1986, p. 10.

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11. Richard P. Mattione, OPEC Investments and the International Financial System, pp. 38-48.

12. Bruce F. Henderson, 'A Historic Perspective of U.S. - GSC Economic and Financial Interdependence,' American - Arab Affairs, p. 44.

13. Sulimirski, p. 32. Amounts reported for 1982 were derived from chart on p. 33.

14. Mattione, pp. 40-48.

15. Ibid., pp. 48-52.

CHAPTER III

CHALLENGES TO UNITED STATES ECONOMIC INTERESTS IN THE MIDDLE EAST

The United States is currently faced with many political and economic problems that limit our ability to protect and promote our interests in the Middle East. Our special relationship with Israel, declining security assistance budgets, and instability in the region are examples of our major economic challenges. There are no short-term solutions to such difficulties. These and related problems will continue to challenge the political and economic leaders of the nation for many years to come. The following paragraphs will identify the major challenges that affect our economic interests. Strategies and courses of action that might be implemented to accomodate our Middle East economic interests will be discussed in the following chapter.

LOSS OF WEALTH ASSOCIATED WITH REGIONAL INSTABILITY

No region of the world can match the Middle East for conflict and instability. The Iran-Iraq war, conflict in the Western Sahara, the clash between Libya and Chad, conflict in the Gulf, the continuing Israeli-Arab clash, and the Palistinian issues are all problems that seem to defy resolution. As is always the case, political instability and conflict invites

economic disorder. Continuation of this strife is costing billions and diminishing chances for accomplishing our economic objectives. It is estimated that markets and other business opportunities lost due to conflict in the Middle East cost the United States hundreds of thousands of jobs each year. In Lebanon, an estimated 750,000 citizens with professional skills have left the country and industry is operating at 40 percent of capacity. Iran has experienced financial losses of \$309 billion during the Gulf War.¹ The spread of fundamental religious movements and growing debt levels in certain states of the region also pose considerable political threats to moderate Arab states. Economies in the United States and the Middle East will continue to operate at less than optimal levels until such time as conflict in the region is brought under control. No end is in sight.

SPECIAL RELATIONSHIPS WITH ISRAEL

Our economic and political connections with Israel, as well as the power of the Jewish lobby in the United States, limit our ability to maintain equitable economic relations with many states in the region. Israel is the major recipient of our declining security assistance aid and relies heavily on arms supplied by the United States to ensure its national survival. Despite strong encouragement from the United States, the Israelis still refuse to come to grips with the Palestinian problem. We have endured "the U.S.S. Liberty" incident and Israeli covert intelligence

operations within our government. Given the above, 'we continue to defend even Israel's most outrageous actions from censure or sanction in the United Nations.'² Adjustments to our political relationships with Israel are obviously necessary.

FREE RIGHTS OF PASSAGE IN MARITIME SLOCs

Since the beginning of trade relationships between the various states of the world, the strategic lines of communication (SLOCs) located in the Middle East have been important commercial routes. These passages include the Suez Canal, the Straits of Gibraltar, Bab-El-Mandeb, the Straits of Hormuz, and other strategic waterways. It is vital that free rights of passage be maintained. Continuation of free passage has been challenged by both combatants in the Gulf conflict. The economies of Western Europe and Japan, our primary trading partners, are heavily dependent on oil imports that pass through these waterways. The United States must continue the dangerous business of using its naval power to guarantee free passage. The prolonged closure of any of the primary SLOCs would be an economic disaster for the free industrial nations of the world.

THE NEED FOR MIDDLE EAST OIL

This is a bottom-line issue. As stated above, the economies of allies, and to a certain extent our own, depend heavily on continuous availability of Middle East oil. The states of the

region are aware of this dependence. Accordingly, our economic power and leverage in the Middle East are reduced.

POOR IMAGE AND CREDITABILITY OF THE UNITED STATES

We are viewed as a nation that is primarily interested in the region's oil resources as opposed to the welfare, security, and human rights of the Arabs. Our obvious bias toward Israel is another stumbling block that limits our ability to foster our economic interests in the area. The political folly of recent clandestine arms sales to Iran has caused serious and perhaps permanent damage to our credibility throughout the Middle East. To put it bluntly, our 'moral authority' to act in affairs of the region has declined.

DECLINING SECURITY ASSISTANCE PROGRAMS

The Congress has severely curtailed the funding allocated for security assistance programs during the past two fiscal years (see Figure 7). Though small in size, these programs have proven to be cost-effective in terms of supporting our political objectives. "Security assistance aid to Egypt and Israel increased from \$2.7 billion in 1980 to \$5.1 billion in 1987. This increase accounts for almost one half of the total growth in the United States foreign aid program." The deficit reduction proposals in the Gramm-Rudman Act will make further cuts in

security assistance programs. This and other foreign aid reductions tarnish our image in the region and reduce our ability to provide economic help to the poorer countries in the Middle East.

FIGURE 7

U.S. FOREIGN AID BUDGET AUTHORITY, 1980-1987*
(in millions of dollars)

	1980	1982	1984	1985	1986	1987
DEVELOPMENT						
Multilateral						
Development Banks	2,306	1,262	1,324	1,548	1,143	949
International						
Organizations	260	315	315	359	261	237
AID	1,596	1,847	2,013	2,492	2,026	2,066
PL-480	886	1,000	1,377	1,964	1,243	1,083
Other	483	589	533	612	544	689
Offsetting Receipts	-296	-361	-493	-479	-457	-583
Total	5,237	4,552	5,069	6,496	4,760	4,441
SECURITY						
Military Assistance						
Program	110	179	712	805	798	800
Foreign Military						
Sales	2,095	3,883	4,818	6,623	4,947	4,040
ESF	1,942	2,919	3,389	6,160	3,762	3,600
Other	291	221	110	214	95	56
Offsetting Receipts	- 33	-199	- 86	- 71	- 58	- 76
Total	4,405	7,003	8,943	13,731	9,544	8,520
GRAND TOTAL	9,642	11,555	14,012	20,227	14,304	12,961
Security Assistance						
(as % of total)	46%	61%	64%	68%	67%	66%

*Figures for FY 1980-FY 1986 are actual; FY 1987 are estimates.
Source: Office of Management and Budget, Budget of the U.S. Government

AMERICAN PUBLIC OPINION

Most Americans possess only limited knowledge of the Middle East and its problems. They are not concerned about future energy security and are unaware of the fact that our oil dependency will increase in the future. Unquestioned support of Israel is common. Given this lack of public interest and understanding, members of Congress, when faced with issues concerning the Middle East, seem to be more influenced by the Israeli lobby than by an objective appraisal of American interests in the region.

CLOSING

This chapter has outlined what this author considers to be the major challenges or factors that limit our ability to accomodate our economic interests in the Middle East. When these factors are combined with our political, defense, and ideological challenges in the region, they present formidable obstacles that reduce the ability of our leaders to accomplish our national objectives in the Arab world. The challenges listed above were fully considered by this author when formulating the recommended economic policies and strategies that are presented in the following chapter.*

ENDNOTES

1. Percy, pp. 9.
2. George W. Ball, 'America's Waning Moral Authority,' American - Arab Affairs, Summer 1987, p. 3.
3. Christine E. Contee and John W. Sewell, 'Foreign Aid and Gramm-Rudman,' Foreign Affairs, Summer 1987, p. 1023.
4. Wayne K. Brown et al, The Middle East: A Regional Appraisal, 24 February 1988, p. 8. Note: The author participated in the development of the appraisal referenced in this endnote and prepared the section addressing the factors that affect United States economic interests in the Middle East.

CHAPTER IV

CONCLUSIONS AND RECOMMENDED ECONOMIC POLICIES AND STRATEGIES FOR THE MIDDLE EAST

CONCLUSIONS

Previous chapters in this study examined our vital economic interests in the Middle East and reviewed the factors that lessen our ability to pursue our interests in the region. Consideration of the information developed earlier in this review has led to the following conclusions.

- * America and its allies, most notably Japan and Western Europe, will increase their demands for a continuous supply of reasonably priced Middle East oil in the future.

- * Increased dependence on Arab oil presents a threat to the energy security of the United States and its allies.

- * Middle East investments in the United States have a positive influence on the American economy and growth of these capital inflows should be encouraged.

- * American political policies hurt our image and limit our ability to pursue our national interests in the Middle East.

- * The politicization of United States trade policies in the Arab world reduces America's commercial market shares in the region.

* Conflict and strife in the Middle East produce significant economic losses for both the United States and the Arab world.

* Congressional reductions to both security assistance programs and the American foreign affairs budget diminish the ability of the United States to support its interests in the Middle East.

* American policies toward Israel must be adjusted to reflect these realities.

These conclusions pose formidable challenges for American leaders charged with the responsibility for the development of our national economic policies and strategies for the Middle East. These matters will be discussed in the following section.

RECOMMENDED ECONOMIC POLICIES AND STRATEGIES

American political involvement in the Middle East has been a relatively recent phenomenon. We became involved only after the conclusion of World War II. Before that time, our political relationships had been limited to commercial connections that had been developed in the 1800s.¹ By the late 1940s, we had developed strong interests in Middle East affairs with regard to the then expanding Arab-Israeli conflict. These interests would continue to grow during the next two decades. It took the oil shocks of the 1970s, however, to focus public attention on Arab perspectives in the region. America has often been criticized for the shortfalls of our recent policies and strategies in the Arab

world. Many of the criticisms are well founded. Our policies have not always supported our vital interests in the region. Changes to our economic strategies for the region are certainly in order. The remainder of this paper provides this author's views as to what would be a coherent set of economic policies for the Middle East. It is fully understood that certain of the recommendations may not be politically feasible. Others may take years to implement."

STABILITY INITIATIVES

* The presence of United States naval forces in the region must be continued to insure free passage in the SLOCs. Our 'neutral' status as far as the Gulf crisis is concerned should be maintained.

* America should continue encouraging the nations of the world to support U.N. Security Council Resolution 598 calling for a cease fire in the Gulf conflict and limiting arms shipments to the region.

* The United States must revise its Middle East policies in a manner that will insure equitable relationships between Israel and moderate Arab states of the region. Our one-sided approach cannot be continued if we are to have creditability in the Middle East.

* America must work with the IMF and other nations to improve economic conditions and reduce debt levels that cause instability in the poorer countries in the Middle East. American

backing for rescheduling of international debt in the lesser developed countries of the region would also be appropriate.

* America should take the lead in efforts to convene an international conference to address peace and stability issues for the Middle East. Our primary interests at the proposed conference would be to seek resolution of the Palestinian issue by attempting to have the West Bank and the Gaza Strip established as a Palestinian homeland. Promotion of improved relations between Israel and the Arab world would also be an objective. These issues are central to resolution of other issues facing the region.

ENERGY SELF-SUFFICIENCY

* The United States must improve incentives for domestic oil exploration and production. Oil depletion allowances should be continued. Investment credits on tax returns would also be recommended.

* America must continue to distribute its oil purchases throughout the world to minimize dependence on Arab petroleum imports. It is recognized that this approach is limited by the fact that most of the world's petroleum reserves and production capacity are located in the Middle East.

* Conservation of energy resources should be a high priority national objective. Individual tax incentives for energy saving investments should be continued. The taxing of imports or domestic gasoline sales must be considered.

* The United States should provide incentives to corporations and individuals that develop and use alternative energy sources. We have only scratched the surface in this area. Improved safety for nuclear power stations must be fostered and utilization of this source of energy should be continued.

* The Strategic Petroleum Reserve must continue to be enlarged to reduce the dangers associated with interruptions to oil imports. Though this reserve continues to grow in size, its ability to sustain our needs during emergencies is declining due to rising rates of energy consumption in the United States.

* The American public must be made aware of the importance of our economic interests in the Middle East.

MIDDLE EAST INVESTMENTS AND MARKETS

* The nation must improve economic relations with all states in the region and provide economic incentives for trading with the United States. Awarding 'most favored nation' trading status for moderate Arab states would be recommended.

* America must neither support nor encourage protectionist trade legislation that might limit commerce with the Middle East and the rest of the world. Tariff barriers should be removed whenever possible.

* The United States must encourage American corporations to initiate cooperative business ventures in the Middle East. Enhanced tax credits for overseas earnings would also be appropriate.

* Arab investments in America should be encouraged as a means to increase economic activity and finance our trade and budget deficits. This is essential.

* Arms sales to moderate states in the region should be encouraged. Such transfers provide employment opportunities in America and reduce the per unit cost of equipment used by both Arab and American military forces.

SECURITY ASSISTANCE PROGRAMS

* The Congress must support much needed increases to the foreign affairs budget and related security assistance programs. Recent funding cuts in these areas are reducing our ability to promote defense objectives.

* Security assistance programs must be redistributed in a more equitable fashion. We can no longer afford to provide the majority of our security assistance to Egypt and Israel while ignoring the poorer states in the region.

CLOSING

The policies discussed above would serve only as a start toward achieving our economic interests and improving our overall relations in the Middle East. Even if implemented immediately, the recommended strategies would not work wonders. The military and political confrontations in the region are much too complex for quick-fix solutions. When these problems are compounded by

aggressive religious fundamentalism and social disorders, one must certainly think there are no discernible solutions to the difficulties being experienced in the Arab world.² Nevertheless, the United States must continue to work toward regaining its previous political stature in the region. As the leader of the western world, we must renew our efforts to assist the Middle East in solving the enormous problems that are plaguing that region. We cannot afford to do less. The stakes in the Arab world are much too high for policies of benign neglect.

ENDNOTES

1. Mahmud A. Faksh, 'U.S. Policy in the Middle East: Incongruity in Political Strategy and Action,' American - Arab Affairs, Winter 1987-88, p. 38.

2. Brown, et al, p. 18. Note: The author participated in the development of the appraisal referenced in this endnote and prepared the section addressing recommended economic policies for the Middle East.

3. Udo Steinbach, 'No Way Out of the Crisis: The Middle East in the 1980s,' German Foreign Affairs Journal, 3rd Quarter 1987, pp. 272-289.

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