CHAPTER V

IRAN-IRAQ WAR AND ITS IMPACT ON OIL RELATIONS OF SAUDI ARABIA AND US

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The Iran-Iraq war erupted in September 1980. September 22 is the day generally credited as the start of the war, when Iraq's airforce bombed every major airbase in western Iran.1 It lasted nearly for a decade to ceasefire on August 20, 1988.2 The Iran-Iraq war was tragic by any account. When one considers its economic costs, physical destruction, and human toll, there is merit in the claim that the Iran-Iraq war was the third world's first Great war.3 It was one of the largest and bloodiest wars of the twentieth century, and one of the most expensive. Indeed, it became in many respects one of the most significant longest conventional wars.4 Not since the Korean war (1950-53) has the world witnessed battles of such size and intensity, or losses of such magnitude. The war lasted longer than the Korean war and world wars and resulted in more deaths and destruction than all the Arab-Israeli wars combined.5 Even if one uses conservative figures, the combined military, economic and social cost was at least half a trillion dollars.

**Causes of the War:**

War, like any social phenomenon, has both its general and specific causes. On the general level, war can be an occasional outburst of a deep-rooted historical conflict. Such a conflict may arise from ethnic, national or religious enmity from competition over natural resources or territory.

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5. Ibid.
or over regional or global hegemony.

The specific causes of war lie in the subjective interpretations of such historical conflict and assessments regarding adequate means of handling it at a given moment. Assessments derive from such factors as the world views, images and beliefs of the relevant leaders, from bureaucratic politics (power struggles within the ruling elites), and from a combination of these factors. In the case of the Iran-Iraq war, the general cause is often attributed to the ethnic and religious divide that has separated Arabs and Persians, Shi‘i and Sunni Muslims since at least the seventh century.

On the immediate level, the outbreak of the war is commonly explained by Grand Design theory. According to this theory, the Iraqi invasion of Iran in September 1980, reflected President Saddam Hussein's ambitions. These ranged from the occupation of Iranian territory (the Shatt al-Arab and Khuzistan), through the infliction of a "humiliating and perhaps decisive defeat on the Iranian revolution, which he found troublesome"\(^\text{6}\) to desire to assert Iraq as the pre-eminent Arab and Gulf state.

According to Efraim Karsh Geopolitics is the most important single factor that has influenced Iranian-Iraqi relations for generations and, in consequence accounts for the outbreak of the war. The eruption of war according to Karsh is neither the direct extension of the ancient Arab-Persian rivalry nor the outcome of a premeditated Grand Design; rather it is the product of the geopolitical interaction between two desperate neighbours. More concretely, the war began because the weaker state, Iraq attempted to resist the hegemonic aspirations of its neighbours, Iran to

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reshape the regional status quo according to its own image. 7

The Iranian revolution and the inception of the Islamic Republic changed - Iran's strategic relationship with Iraq fundamentally as the revolutionary regime sought to overturn the status quo provided for by the Algiers agreement. Even though revolutionary ambitions were also related to the rest of the Gulf states as well, several factors made Iraq the primary target for the export of the revolution. With Shi'as accounting for approximately 60 per cent of Iraq's total population, the revolutionary regime in Teheran could, and certainly did entertain hopes that this community, which had always viewed itself as a deprived group, would emulate the Iranian example and rise against its "oppressors". These expectations were further fueled not only by the secular 'heretic' nature of the Ba'ath which was adamantly opposed to the very notion of an Islamic political order, but also by the location of the holiest Shi'i shrines - Karbala, Najaf, and Kazimiyya on Iraqi territory, a combination that could serve as a potentially powerful weapon in the hands of the Islamic regime.

The Algiers agreement between Iran and Iraq, signed in 1975 opened a new era in regional relations the era of Pax Irana. The agreement reflected Baghdad's painful realization that an effective enforcement of Iraq's internal sovereignty depended on the goodwill of its neighbour to the east. Within less than a decade, the Shah had managed to achieve his goal to substitute a relationship that presupposed unquestioned Iranian dominance for the old Iraq-Iran status quo based on the 1937 agreement. Having attained this goal Iran naturally evolved from a revisionist into a status quo power and began to advocate the perpetuation of stability in the Gulf. Iraq for its part, was neither in the position to undermine the newly established regional order nor did it have any inclination to do so. Instead, the Ba'ath regime turned inward to halt Kurdish insurgency,

to reconstruct its armed forces, and to stabilize the country's social, economic and political systems. Consequently, the Algiers agreement was followed by a period of much reduced tension between Iraq and Iran, a period that lasted for four years until the overthrow of the Shah.

The agreement defined the southern border between the two countries as a line along the middle of the Shatt al-Arab waterway. In the ensuing years, however, Iraq had become increasingly dissatisfied with the 1975 agreement, and also desired the withdrawal of Iranian forces from Abu Musa and the Tumb Islands, which Iran had occupied in 1971. The Iranian revolution of 1979 exacerbated these grievances. Conflict soon developed over Arab demands for autonomy in Iran's Khuzeistan region (named 'Arabistan' by Arabs), which Iran accused Iraq of encouraging. Border disputes occurred in the summer of 1980, and more extensive fighting began after Iran ignored Iraqi diplomatic efforts, demanding the withdrawal of Iranian forces from the border area of Zain ul-Qos in Diali province. Iraq maintained that this area should have been returned under the 1975 agreement. In September 1980, Iraq abrogated the agreement and Iraqi forces advanced into Iran.

President Hussein may have seen war as inevitable because of the incompatibility of Iran's Islamic Fundamentalism and Iraq's state and pan-Arab Nationalism and because of Khomeini's personal hatred for him. Iraq, at the Shah's request had expelled Khomeini in 1978 following 15 years in exile. Khomeini later identified Hussein as one of three mortal enemies along with the Shah of the United States.

After overthrowing the Shah, Khomeini declared that the government of Iraq belongs to the 'dustbin of history' and called for the Shi'ite Muslims in Iraq to overthrow Hussein's secular, unholy Ba'athist regime. President Hussein may also have seen it as a propitious time for Iraq to

attack. Iran appeared to be weak, vulnerable and in chaos. The Iranian military in particular, was assumed to be in disarray after extensive purges and the cut off of military supplies and training by its former major supplier, the US. Hussein probably expected victory in a matter of days, with little international criticism and considerable regional support.

In addition to pre-empting a possible Iranian attack Hussein could make political, economic and territorial gains. By recovering territorial rights ceded to the Shah, he could simultaneously bolster the security of the Ba'athist regime. Potential bonuses included the overthrow of Khomeini and control of Iran's oil rich Khuzestan province through 'liberation of Arabs' there.

Hussein had badly miscalculated the situation. Iran, with the initiative, since 1981 viewed the war as a jihad (holy war) to crush the 'blasphemous' Iraqi regime and gain control of the Shi'ite holy sites in Iraq. Khomeini's demand for an end to the war included the ouster of Hussein and to end to the Ba'athist rule, and $300 billion in war reparations.9

The war also involved a wide range of regional and outside states. All the southern Gulf states had to become deeply involved in the politics of the war and all had to restructure their military forces. The US (United States) and the Soviet Union were indirectly involved in the Iran-Iraq war from its start. They supplied tons of billions of dollars worth of arms to the two belligerents, and later became militarily involved in escorting ships through Gulf waters. China and North Korea became leading actors as arms suppliers to Iran.

As the war continued, the USSR, several western countries and most Arab states provided armaments and other means of support to Iraq, while Iran remained diplomatically isolated. In November 1986, however, it emerged that the US

9. Sipri Year Book, n.4, p.301.
despite its discouragement of the sale of armaments to Iran by other countries, had been conducting secret negotiations with the Islamic Republic, since July 1985 and had made three shipments of weapons to Iran in late 1985 and 1986. These shipments were allegedly in exchange for Iranian assistance in releasing US hostages detained by Shi'ite groups in Lebanon, and an Iranian undertaking to relinquish involvement in international terrorism.

A CRITICAL ACCOUNT OF THE IRAN-IRAQ WAR

Five different explanations for the Iran-Iraq war regularly appear in academic commentary.

(i) The first account draws attention to the deeply rooted cultural enmities between Iran and Iraq. It invariably is premised upon a sense of incompatible and immanently hostile societies characterized in racial, sectarian or religious terms - Aryan/Persian v Semite/Arab; Shi'i v Sunni; and secular versus fundamentalist. The outbreak of war was thus the latest conflict between two societies destined to collide.10

(ii) A second explanation calls attention to the megalomaniacal tendencies of Saddam Hussein. Hussein exaggerated notions of historical destiny led him to invade Iran when the opportunity presented itself. This explanation finds confirmation in the fact that Iraq named the war Qadisiyyat Saddam after its leader.

(iii) A third reason for the war emphasizes Iraq's regional aspirations in the face of Iran's post-revolutionary turmoil. Iran's troubles, so this argument runs interrupted a long standing balance of power between the two countries. Iraq simply sought to fill this regional

(iv) A fourth argument addresses Iran's attempts to foment a Shi'i uprising in Iraq. Baghdad thus moved against Iran in order to neutralize this source of external agita-

tion.

(v) A fifth explanation focusses on the border dispute along the Shatt al-Arab waterway. Iraq preferred to see the boundary drawn along the eastern shoreline, thereby giving it full sovereignty over the waterway. In contrast, Iran preferred to see the boundary drawn according to the Thal-
weg, or mid channel principle. From this perspective, the war was the result of an intractable territorial conflict.

In September 1980, ostensibly to assert a claim of sovereignty over the disputed Shatt al-Arab waterway, Iraqi forces invaded Iran along a 500 km (300 miles) front, with the aim of achieving a rapid military victory. Iraq's stated war aims for its 22 September 1980 attack on Iran were to recover rights of exclusive navigation of the Shatt al'Arab to regain several islands held by Iran since 1971, and to end Iranian interference in Iraqi internal affair. Iranian forces displayed strong resistance, however, and the war developed into a conflict of attrition with neither side able to launch a decisive offensive.

The Iran-Iraq war profoundly affected the balance of social forces in both countries. By further eroding the social power of oppressed groups and classes, it worked to the near exclusive advantage of the ruling regimes. The Iran-Iraq war, to state it baldly, had two victors: the Ba'th regime in Baghdad and the Theocratic regime in Teheran.

In Iran, the prosecution of the war allowed the radical clerics to consolidate the Islamic Revolution. It did this in a number of ways: by delegitimizing political opposition,

by providing a pretext for extensive political, repression, by providing a natural context for the theocratic-populist strategy of the clerics (an approach that inter alia helped to keep the population politically mobilized), by maintaining a coherence and common focus among the clerics in power, by necessitating the expansion of revolutionary institutions under clerical control, and by providing a permanent excuse as to why the revolution had failed to deliver on its promises to the poor.

In Iraq, the war created similar opportunities for the Ba'ath regime. It allowed the Baghdad regime to enhance its political power by engaging in its own 'war populism' (a strategy that partially overcame the fissured character of Iraqi society and enhanced the regime's image as defender of the Arab nation), by providing the regime with a forum to raise the profile and image of Saddam Hussein, by allowing the Ba'ath regime to continue to carve out a modest social base among Iraq's rapidly expanding capitalist class, by encouraging the expansion of the military, by providing a 'wartime exigencies' foil for the repression of internal political opposition, and by weakening the cohesion and domestic image of Iraq's opposition forces. Both regimes, in short were able to parlay the protracted military stalemate into concrete political gains.

The social corollary of these dynamics allows us to identify the real losers of the eight year Iran-Iraq war. The strengthening of the regimes in Baghdad and Teheran translated into the increasing marginalisation of sub-altern groups in both countries - especially women, the urban poor, the working classes, and the Kurdish peoples.

Estimates suggest that upwards of one million lives were lost: a further two million people were wounded. Almost 40 per cent of the adult male population in the two countries took part in the war. Material damage has been estimated at upwards of $350 billion; and the overall costs of the war have been estimated at $1,190 billion. More than one million people were uprooted in the course of the fighting; at least 157 Iranian towns with populations of more than five thousand were damaged or wholly destroyed; and
some 1,800 border villages were virtually wiped off the map. The Iranian and Iraqi economies suffered steep declines in oil revenues and economic productivity. And the belligerents flirted with the nadir of humanity, using chemical weapons and employing teenaged boys on the battlefield.\textsuperscript{12}

\textbf{IMPORTANCE OF OIL}

Oil was the main source of revenue for the two belligerent governments before the beginning of the war and continued to be so throughout the conflict. In the light of the importance of oil as a major source of revenue and foreign exchange to meet the enormous cost of the war, the collapse of oil prices at the beginning of 1986 may well have had a major impact on the duration of hostilities.

The decline in the price of oil affected both belligerents, thus leaving the balance between them unchanged. But the fact that Iran has a much larger population, and hence much larger civilian import needs, must have contributed to its change of mind in the course of 1987. Once it became that prices could not regain their pre-1986 level, a part of the Iranian leadership concluded that the situation had become economically untenable. By mid-1986, this ultimately led to the termination of hostilities under the United Nations (UN) auspices. Other factors no doubt also contributed to this and may even have been more important than economic considerations. Yet this dependence on world oil prices remains the most important connection between the duration of the war and the fact that the two belligerents are major oil producers.\textsuperscript{13}


\textsuperscript{13} Giacomo Luciani, \textit{Oil and Instability: the Political Economy of Petroleum and the Gulf War} in Mauill and Pick, n.11, pp.21-22.
IMPACT OF IRAN-IRAQ WAR ON SAUDI ARABIA AND US
PHASE-1
RISE IN PRICE

At the outbreak of the war the combined production of Iran and Iraq accounted for one-sixth of OPEC production. Both countries targeted oil facilities and in the early stages of the war the two parties were able to mutually destroy or disrupt its oil production and exporting capabilities. One month after the war broke out Iraq's oil production plummeted from 3.4 m.b.d. to 400th barrels a day. Iran's production receded from 1.3 to 450th barrels a day. The combined output of Iran and Iraq fell to 4.7 m.b.d.

The Iran-Iraq war pushed prices up causing OPEC oil revenues to reach $285 billion in 1980 to $263 billion in 1981. The price of oil jumped from $13.03 per barrel in 1978 to $34.32 in 1981. Saudi Arabia's oil income increased from $40 billion in 1978 to $116 billion in 1981.15

In the course of Iranian Revolution and Iran-Iraq war, the Saudi policy continued to increase output to dampen the unprecedented rise in oil prices and to offset the decline in output caused by the conditions of revolution and war. But the high level of output was subsequently continued at a time when the world market was no longer deprived of all of Iraq's and Iran's oil. This policy of overproduction, which was intended to create an oil glut, was acknowledged publicly in April 1981 by Saudi oil minister Ahmad Zaki Yamani in an interview with the NBC news programme 'MEET THE PRESS', which is further discussed in the chapter.


Saudi Arabia applied a policy of increased production designed to foil a rise in prices.16 In an immediate effort to calm world oil markets Crown Prince Fahd announced on September 26 that the 9.5 m.b.d. Aramco production ceiling would remain in force through the end of the year. After learning of the extensive damage to oil facilities, however, Foreign minister Sa'ud Faysal told the Washington Post in early October that the kingdom had decided to boost production. Indeed Aramco production surged to an average 10.3 m.b.d. in October.17

The kingdom had both economic and political objectives in raising crude output to contain oil prices.

Economically, it wished to prevent a deepening of the recession that the industrial world had entered in 1980. Moreover, Saudi Arabia wished to limit price-induced energy conservation and substitution away from oil.

Politically, the Saudi production increase served the American connection.

First, it reciprocated for the prompt US response to Saudi security anxieties when the war broke out. The United States had immediately dispatched Air Force AWACS planes. United States later sent ground radar and communications equipment and specialised personnel to fill gaps in Saudi air defences in the vicinity of the oil fields.18

Second, the Saudis saw the production increase as helpful in building a favourable political climate for a package of advanced American military equipment (including AWACS) the kingdom hoped to purchase.

Economically, Saudi Arabia continued to worry about the potential impact of the price run up on the world economy. The Saudis feared that further price rises would deepen or extend the recession or perhaps even push the industrial world into a deep depression. In the last half of 1980, the seven major OECD economies real economic growth, declined an aggregate 0.4 percent against the previous half year on a seasonally adjusted basis. Saudi Arabia's stake in the health of the world economy had if anything grown with the marked increase in its financial holdings abroad which reached perhaps $160 billion by the end of the second explosion. In October 1980, a high ranking Saudi technocrat, Farouk M. Akhdar, Secretary General of the Royal Commission for Jubayl and Yanbu, had observed:

"Our destiny is tied to the future of the world economy in general and the US economy in particular. We understand that we are in a vital part of the interdependent global economic system." 19

Beyond the short-term concern for the health of the world economy, the Saudis began worrying profoundly about the potential longer-term impact of the second price run up on world oil demand. In January 1981, Yamani revealed his fears in a presentation which was apparently not meant for publication at the University of Petroleum and Minerals in Dammam-Having long chided the west for not doing enough to conserve energy he now argued that conservation and substitution were liable to go to far. Yamani warned:

If we force western countries to invest heavily in alternative sources of energy, they will. This would take no more than seven to ten years and would result in reducing dependence on oil as a source of energy to a point which will then jeop-

ardize Saudi Arabia's interest. Saudi Arabia will then be unable to find markets to sell enough to meet its financial requirements. This should be well understood. 20

Limited oil demand would, Yamani predicted, eventually lead to disputes over market share, with the kingdom inevitably cast in a swing role.

On the political side, the Saudis, for their part, sought the new administration of United States consent to the sale of a large arms package to the kingdom and its commitment to pushing the sale through Congress. The Saudis were aware that there was bound to be bitter fight in the senate. To co-ordinate and promote the Saudi arms purchase, Defence Minister Sultan dispatched his son, Bandar to Washington.

The Reagan administration announced on March 6, 1981, that it would notify Congress of its intention to sell a large arms package to Saudi Arabia. The package comprised an airborne surveillance system (later clarified as being AWACS planes) and add-ons for Saudi Arabia's F-15 fleet. The add-ons included spare fuel tanks (contrary to the Carter administration's 1978 pledge that they would not be provided) and sidewinder air-to-air missiles.

In its effort to beef up the American view of Saudi Arabia generally and refurbish the kingdom's moderate pricing image in particular Riyadh dispatched Yamani to the United States in April. Disregarding the affront to fellow OPEC members, Yamani answered to a question raised in MEET THE PRESS:

Q. As a result of conservation a stagnant economy, and other factors, there is now an oil glut on the international market... would your country have any plans to lower production or to lower prices?

A. Well, as a matter of fact, this glut was anticipated by Saudi Arabia and almost done by Saudi Arabia. If we were to reduce our production to the level it was at before we started raising it, there would be no glut at all. We engineered the glut and want to see it in order to stabilize the price of oil.21

Two days later he told the Foreign Policy Association that the kingdom's high production level was a sacrifice in the interest of protecting the world economy as a whole from dire consequences too unpleasant to discuss.

Saudi Arabia maintained as a matter of principle it alone had the sole right to decide on the level of its output. It was not until the second half of 1980s and mainly in the aftermath of the 1986 price collapse that the Saudi government finally agreed to the adoption of a formal system of quotas.

In May, Treasury Secretary Donald Reagan publicly praised Saudi oil policy during a trip to the Kingdom in May. He reportedly asked the Kingdom to continue its pricing course at the upcoming mid year OPEC meeting in Geneva.

At OPEC's mid year meeting in Geneva (May 25 and 26), Saudi Arabia came under strong political pressure to raise its prices and cut its production. Every OPEC member but Saudi Arabia was lined upon deemed marker above $34. The members aimed to avoid a Saudi induced price-cut, which would lead to an immediate economic loss and depending on the member political humiliation as well.22

Ignoring the Iranian assertion that Saudi Arabia had been isolated, Yamani told fellow OPEC members that the kingdom would cut its production only in return for unification on a $34 marker and a concomitant commitment to a price


22. For several OPEC members, a cut in crude prices promised to be doubly painful economically. Under contract provisions, the pricing of liquified natural gas (LNG) exports was tied to official crude oil prices. OPEC's largest LNG exporters were Algeria and Indonesia.
freeze through 1982. In the face of the Saudi stubbornness, the majority of OPEC members (excluding the Iran and Iraq, which were granted dispensation because of the war) adopted a half-hearted programme to control production.

In the AWACS debate, the Reagan administration (and presumably Saudi Arabia as well) was caught of guard by the level of Senate opposition. Fifty-four senators signed a June 24 letter to President Reagan stating their strong belief that the Saudi arms sale would not be in America's "best interests". They recommended that the President refrain from sending the proposal to Congress.

By the Spring of 1981 the Saudis had adopted an active, if restrained approach to the Iran-Iraq war. Realizing that the war would not be a short one. Riyadh felt that Gulf stability could be preserved only through an enhanced Saudi role in events. As the Saudis came to see logistical and financial support to Iraq as necessary to help preserve the battlefield stalemate, Riyadh's initial wait and see posture gave way to a low-keyed support to Iraq. At the same time Riyadh undertook an effort to stress the need for some type of negotiated settlement. And finally the Saudis moved to strengthen their defences.

At a consultative meeting in Geneva from August 19 to 21, Saudi Arabia again resisted efforts by the OPEC majority to force the kingdom to cut production and raise prices to the $36-a-barrel level. Saudi Arabia applied a policy of increased production designed to foil a rise in prices. As a fall-back position, most members seemed ready to accept

24. Ibid.
a $35 marker as the basis for OPEC unity. Yamani, however, stuck to his government's previous position - a $34 marker, with a freeze through the end of 1982. In pressing the majority's case, the leaders of several states (Indonesia, Iraq, Kuwait and Venezuela) personally contacted King Khalid. While Saudi Kings have not always been able to withstand such concerted high-level pressure, this time the Saudi ruler refused to countermand his oil minister.

Although the conference reached no decision, Saudi Arabia decided to reduce Aramco output by 1 m.b.d. to 9 m.b.d. while serving as a goodwill gesture to fellow members who had faced a steady erosion in the market share, the production cut also served the purpose of price support. Yamani was fearful that spot prices had fallen to the point where they might jeopardize his $34 proposal. By late August spot prices had dipped below the $32-a-barrel level.

Saudi Arabia had simultaneously expanded its share of total OPEC output to as much as half mid 1981 against 36.4 percent in 1980 and 27.9 percent in 1978.

While the Saudis worked to force a $34 compromise on fellow OPEC members, high to turn the Senate tide on AWACS. Defence Secretary Casper Weinberger, for example, told the Senate Armed Services Committee in September that Saudi Arabia had

increased its oil production in order to make up the shortfall [resulting from the Iran-Iraq war] while continuing to maintain prices lower than those of OPEC colleagues. This is another example, one of many of the aid Saudi Arabia provides for our national interests.

When finally sending the Senate the $8.5 billion Saudi arms package on October 1, President Reagan became personally engaged in the political battle. He publicly stated that it was "not the business of any other nation to make American

foreign policy" and that US would not permit Saudi Arabia to become another Iran.\textsuperscript{28} Although the Senate Foreign Relations Committee voted against the package (9 to 8) on October 15, the Senate as a whole narrowly let the sale proceed (52 to 48) on October 28.

In October Saudi Arabia had increased Aramco output to an average 9.5 m.b.d. succumbing to Saudi pressure, at an extraordinary meeting in Geneva on October 29 the OPEC conference established a $34 marker price for Saudi Arab Light the return of 1982. In return the Saudis agreed to immediately cut production to 8.5 m.b.d. Upon learning of the OPEC decision, US Energy Secretary James Edwards congratulated Yamani.

Developments in both Iran and Iraq contributed to Saudi Arabia's ability to pursue its $34 compromise proposal. In the course of the war, Iraq had grown increasingly dependent on Saudi financial aid. In mid-July 1981, the Saudis even volunteered to pay the full cost of reconstructing the Iraqi nuclear reactor which Israel had destroyed. The Saudis were also willing to help Iraq boost its export capability. The Saudis publicly announced in September 1981 that Iraq would be permitted to build a crude oil pipeline on Saudi territory for exports at the Red Sea. While the Saudis won the 1981 price unification battle on their terms, the price explosion had dealt Yamani's Long term strategy (LTS) plan a fatal blow. Prices had risen so high that the Saudis ceased to have an interest in a long-term strategy designed to guarantee nominal let alone real, price increases.

OIL SITUATION AT 1982

Events in 1982 illustrate a pattern of interaction between the war and OPEC decisions, which was repeated several times in the following years - the cycle of military attacks leading to decline in exports of one of the contenders, which then reacted by offering discounts and mounting a major export drive as soon its physical export capacity was

\textsuperscript{28} Haig, n.23, p.190.
restored, throwing the market off balance.

Thus in August 1982 the Iraqis attacked Kharg, temporarily reducing Iranian exports. These were restored in September and continued at a high level in the following months, directly leading into a new spot collapse at the end of the year. The world demand for oil in 1982 continued to fall and, after a further OPEC meeting in March and Saudi government declared a new upper limit of 7.5 m.b.d. for the country's production. In reality, output had already dropped below that figure. Saudi Arabia switched over to a policy of reduced production to stabilize prices. It reduced its production from 9.7 m.b.d. a day in 1980 to 5 m.b.d. in 1982.29

Traumatized by the 1979-80 price run up, the Saudis seemed only concerned about potential upward pressure on the $34 marker in the aftermath of the October 1981 meeting. By holding production at 8.5 m.b.d. in late 1981, the Saudis intended to ensure that the OPEC mandated freeze would not be upset by any potential renewed strengthening of the oil market. In addition to ensuing the price freeze, the Saudis had another purpose in holding production at 8.5 m.b.d. A fresh reduction in world oil prices, even if modest, would continue the process of refurbishing the Kingdom's image as a moderating force in OPEC. With this end in mind, Yamani promised the industrial world that a little Christmas gift would emerge from the year-end OPEC meeting in Abu Dhabi (December 9 and 10). Indeed, combined cuts on higher and lower quality crude prices trimmed the average official selling price of OPEC crude from an estimated $34.05 a barrel in November 1981 to $33.85 in January 1982.

Still fearful of a potential near-term strengthening in world oil prices the Saudis held the Aramco production ceiling at 8.5 m.b.d. for the first two months of 1982. Additionally, high Aramco production continued to serve a political purpose connected to Iran.

29. Morsi, n.14, p.36.
The Saudi viewed high Aramco production as a reasonable method of communicating the kingdom's anger at Teheran's alleged complicity in the Bahrain plot and at the Islamic Republic policy of exporting its revolution. Iranian output, already at low levels, fell from an estimated 1.2 m.b.d. in December 1981 to 1 m.b.d. in February 1982. While Saudi Arabia continued to produce at high levels, international oil companies had begun a major first quarter drawdown of long bloated inventories. Highly disturbed by pricing developments, OPEC members demanded a cut in Saudi production and called for an emergency meeting of the conference.

Fending off criticism of their 8.5 m.b.d. production level the Saudis disingenuously argued that they were merely letting the market determine the level of Saudi output. Yamani, however, recognised that the Aramco partners would be reluctant to trim offtake for fear of antagonizing the regime. The partners owed a lot to Saudi Arabia including several recent years of enormous refining profits. The American oil companies were reluctant to do anything which might jeopardize their long term access to Saudi crude supply.

Underlying Yamani's brinkmanship was his assessment of the size of first quarter stock liquidation and the level of underlying demand. Yamani's appraisal turned out wrong on two counts. While consumption proved to be less than he expected owing to a new recession, the actual inventory drawdown proved much deeper than he had anticipated. The non-communist world ran down first quarter inventories at the unusually high rate of 4.1 m.b.d.

As OPEC's largest producer, the kingdom stood to suffer a considerable financial loss in the short term as a result of a sharp break in prices. In an effort to instill discipline and thereby limit any further need for the kingdom to reduce output, the Saudi Royal Cabinet stated in conjunction with its production cut that it must

...warn those who acted impulsively to lower their oil prices whether openly or covertly, that their
behaviour will lead to the collapse of the OPEC oil price structure, and that they and the others will in such eventuality pay a very high price which they cannot sustain. The lowering of their oil prices will not increase their sales but will eventually cause their oil revenues to contract sharply, in which case his majesty's government will find itself incapable of exercising its constructive role in protecting the common interests of the member countries of OPEC.

The Saudis timed the announcement to coincide with a meeting of the organization of Arab Exporting Countries in Doha. In addition to the seven Arab members of OPEC on hand for the meeting Indonesia and Nigeria had sent representatives to participate in informal discussions on OPEC production levels. Saudi Arabia stayed neutral during consultations. Encouraged by the discussions, Yamani informed fellow OPEC members that the kingdom was willing to attend an OPEC consultative meeting. Meanwhile spot prices continued to slip.

The consultative meeting, held in Vienna on March 19 and 20, was subsequently transformed into an extraordinary meeting. OPEC members adopted a production programme for the first time since their ill-fated 1965-66 experiment. Leaving Aramco output at the already announced 7.5 m.b.d. level the conference established individual quotas which added up to a ceiling of 18 m.b.d. To monitor the unstable market situation, the conference set up a committee, subsequently known as Ministerial Monitoring Committee (MMC) composed of Algeria, Indonesia and Venezuela.

At and immediately, after the March 1982 OPEC meeting, Saudi Arabia demonstrated its resolve to maintain OPEC's $34 marker in several ways.

First, Yamani accepted a conference decision to permit African producers to set their differentials at $1.50 over the $34 marker. In as much as the previous $2.50 to $3.00 level was in line with relative product of OPEC crudes.

Second, the kingdom reduced the Aramco ceiling to 7 m.b.d. (starting in April), effectively lowering the overall OPEC level to 17.5 m.b.d.

Fearful of setting a precedent of OPEC involvement in the setting of Saudi production levels, Yamani deliberately waited until after the meeting to make the announcement. He stated that Saudi Arabia's "official position" is not [to] associate itself with "any production programming in OPEC" since the kingdom did "not regard OPEC as the place to decide the level of Saudi production." 31

Third, Saudi Arabia, along with Kuwait, pressed the international oil companies to increase lifting of Nigerian crude. Against 1.8 m.b.d. earlier in the year, Nigerian production had declined to less than 1 m.b.d. in March and April.

**RE-EMERGENCE OF IRAN (SECOND PHASE)** 32

Boosting the revolutionary government's international image and self-confidence, Iran made significant battlefield advances in the Spring of 1982. The new self confidence manifested itself in OPEC affairs. Not long after the March OPEC meeting Teheran rejected its assigned 1.2 m.b.d. production quota.

While formally rejecting Iran's request for a readjustment of quotas at three OPEC meetings between May and December 1983, Saudi Arabia informally yielded considerable market share.

At OPEC's mid year meeting in Quito, Ecuador, on May 20 and 21, 1982 Iran formally demanded a redistribution of quotas within the 17.5 m.b.d. ceiling. At the time, Iran produced an estimated 2 m.b.d. (800 thousand b.d. above quota) and Aramco 5.7 m.b.d. In defending Teheran's refusal

31. Ibid., p.156.

32. During this phase stalemate emerged in the Iran-Iraq war and Iran re-conquered all the territory between 1982 and 1983 which it had lost to Iraq.
to honour its assigned quota, the Iranian oil minister, Muhammad Gharzi, contended that Iran, which had only received a 6.9 percent share of actual OPEC output in 1978, had the right to recover lost market share.

Saudi Arabia vetoed a redistribution of quotas at the May meeting. While the Kingdom already had plenty of reasons not to formally yield a higher quota to Iran, a further factor came into play when Damascus closed down the trans-Syria pipeline denying Iraq a critical means of moving its oil to market.33 With Baghdad no longer capable of reaching its own 1.2 m.b.d. quota, Saudi Arabia was highly reluctant to grant a higher quota to Iran. Unable to resolve the quota disagreements, the OPEC conference issued communique simply noting that it had "decided to keep the present ceiling on total OPEC production."34

Shortly after the Quito meeting King Khalid died of natural causes. Crown Prince Fahd smoothly succeeded to the throne, while 'Abdallah' the Commander of the National Guard, moved up to Crown Prince. Defence Minister Sultan, a full brother of Fahd, moved up to second-in-line. For many years, Fahd had been personally overseeing oil policy as head of the Supreme Advisory Council for Petroleum and Minerals. While priding himself on his own understanding of the world oil industry, King Fahd kept Yamani in place as oil minister. The other concerned commoners also kept their jobs - Muhammad Aba al-Khayl at the Finance ministry, Hisham Nazir at the Planning Ministry, and 'Abd al-Aziz al-Qurayshi at SAMA.

The OPEC conference held an extraordinary meeting on July 9 and 10, 1982 in Vienna. Instead of focussing on quota discipline quota levels were debated. Flushed with

33. Iran had agreed in advance to compensate Syria for lost transit fees.

its military success at Khorramshahr, Iran aimed again for an increased quota. Iran's criticism of Saudi Arabia's self-set quota stuck a more responsive chord at this meeting. Some members agreed that it was unfair that Saudi Arabia should have lion's share of OPEC production when it was richer and had far fewer people than many members.

At the time of the meeting, Aramco production ran 6 m.b.d. (1 m.b.d. below quota), while Iran produced 2.2 m.b.d. (1 m.b.d. above quota). With Yamani staying home, reportedly in observance of Ramadan, the Saudi case was presented at OPEC's July meeting by Deputy Oil Minister Abd al-Aziz al-Turki. The conflicting Iranian and Saudi perspectives could not be reconciled.

Although Saudi Arabia refused to formally yield market share at the July meeting. Aramco output slid to 5.3 m.b.d. in August. Fearful of running a budget deficit in fiscal year 1982-83, the Finance Ministry embarked on a policy in September, 1982 of trimming projected spending by 20 percent.

In reaction to what was becoming an uncomfortably low level of oil production, Saudi Arabia engineered a strong warning to OPEC (and non-OPEC) producers from the Gulf Co-operation Council. Representing the GCC's first public foray into the field of international petroleum affairs, the warning was issued at a gathering of GCC oil minister on October 14, 1982 in Salala, Oman.

The Salala statement criticized OPEC members for blatantly disregarding production quotas and pricing agreements. The statement accused members of discounting crude in a variety of disguised ways: barter deals, extended credit terms, changing tax and royalty treatment, packaging crude with gas liquids with the later sold at significant discount, and dumping products from crude processed abroad.

The Saudis hoped that the Salala statement would promote self-restraint by OPEC members during the coming fourth quarter when Yamani expected a substantial rise in oil demand. Instead of rising as he expected, however, OPEC crude production actually declined against the like period
the year before. In December 1982, Aramco production only amounted to 5.1 m.b.d. (1.9 m.b.d. below quota).

Originally, OPEC's year-end meeting had been planned for Lagos on December 9, 1983. The Conference finally met in Vienna on December 19. Supported by other OPEC members (including Libya, Nigeria and Venezuela), Iran again pressed Saudi Arabia to accept a lower quota. Refusing to lower Saudi production in the context of an OPEC prorationing decision, Yamani countered with a demand for an increase in the level of African differentials.

Without setting new quotas, the members ended up agreeing on a new overall OPEC production ceiling of 18.5 m.b.d. for 1983. Following the meeting, the conference announced that it was taking "the necessary measures to stabilize the market and to defend the OPEC price structure". With the old quotas widely ignored and no new quotas agreed upon the new ceiling however, appeared to have little prospect of stabilizing the market or defending the OPEC marker.

**OPEC'S MARCH 1983 PRICING DECISION AND PRODUCTION AGREEMENT**

The Saudis were hardly unaware of the downside risks involved in a substantial cut of the marker price. There was a possibility that consuming governments would counter a price reduction with oil import tariffs. With its large domestic oil industry, the Saudis understood that the United States would be particularly prone to move in this direction.

Despite the risks, Saudi leaders decided in early 1983 against continuing to hold their prices at the $34 level. The decision stemmed from a combination of economic and political factors. A large price reduction would have beneficial consequences for the world economy and world oil demand.

35. Ibid., p.206.
Second, believing that too much of the benefit of the cuts in Saudi production since the March 1982 production accord had redounded to the benefit of political adversaries, the kingdom felt that a price cut might have a salutary effect on future quota discipline.

Third, the Saudis were responding to fierce pressure for price relief from the Aramco partners. During the Iranian shortfall, it is worth noting, Saudi Arabia had exploited buyer panic to markedly increase the crude oil sales of state-owned Petromin. These sales at official prices, were negotiated largely with governments or government owned oil companies. Despite these government-to-government sales, Aramco remained by far the largest offtaker of Saudi crude. Aramco liftings, which had never ceased being crucial to the health of the kingdom's economy, because all the more critical as buyers walked away from high-priced Petromin crude when cheaper crude became available elsewhere.

Once having decided to reduce its prices, Saudi Arabia proceeded with care. The government aimed to engineer a price cut in a way that would both limit the regional political fall out and minimize the risk of an uncontrollable downward price slide. For these reasons, the Saudis sought the approval of OPEC (or at least a majority of its members).

The kingdom worked in close co-ordination with its GCC allies. The GCC-4 invited three other OPEC members [Indonesia, Iraq and Nigeria] to participate in informal oil discussions in Manama, Bahrain on January 15, 1983.

Following the Manama meeting OPEC members held a consultative session on January 23 and 24 in Geneva. Discussions focussed on a new set of quotas within a 17.5 m.b.d. ceiling to support the beleaguered marker. Although willing to accept lowering of its own quota, Saudi Arabia, fully backed by its GCC colleagues, made acceptance of a quota cut conditional on an increase in African differentials and an end to Iranian discounting. Despite the deadlock, non-GCC support for a price cut had evaporated in the week between
the Manama meeting and the Geneva meeting. Rather than take independent action with its GCC allies, the Saudis decided to let market developments follow their natural course.

Following informal discussions in London throughout the first two weeks of March, an extraordinary meeting of OPEC issued a decision on March 14. While accepting the kingdom's (and the GCC's) demand for a deep cut in the marker price to $29, OPEC members aimed to fully exploit the Saudi (and GCC) quest for OPEC approval by gaining major concessions from the kingdom. Saudi Arabia effectively agreed to accept near-term production rates below its previous 7 m.b.d. quota.

Second, the kingdom dropped its long repeated demand that African differentials be raised and agreed to permit Nigerian prices to stand temporarily at the $30 level.

Third, it accepted a far higher quota for Iran (2.4 m.b.d. versus the previous 1.2 m.b.d.).

**SWING PRODUCER**

The OPEC Conference established a new set of quotas within a 17.5 m.b.d. ceiling. Receiving no specific quota, Saudi Arabia was designated to act as a swing producer to supply the balancing quantities to meet market requirements. While the swing role certainly stood to depress Saudi production in the near term, Yamani fully expected it to redound to Saudi Arabia's benefit by the end of the year based on his projection of a rise in fourth-quarter oil demand. Indeed, Yamani predicted that OPEC would soon be back in the driver's seat in the world oil market.

**AMBIVALENCE TOWARD THE SWING ROLE**

In the months following OPEC's March 1983 agreement, demand for OPEC crude failed to rise to the levels Yamani had projected. Over the same period Saudi oil revenues

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36. Ibid., p.208.
dropped precipitously. From $78.1 billion in 1982, they dropped to $44.8 billion in 1983 and to $36.3 billion in 1984. The decline in oil revenues not only threatened the kingdom's industrialization plans, it also threatened to undermine the ongoing defense build-up and the kingdom's large foreign aid programme. Furthermore, Saudi leaders had to be concerned that a prolonged recession in the kingdom's economy might engender hostility toward the royal family in the expanded ranks of the new middle class. The decline in revenues raised difficult questions regarding the management of the kingdom's foreign financial reserves.

Given the economic and financial constraints, the kingdom developed an ambivalent attitude toward a swing role that was steadily yielding less rather than more income. The ambivalence found expression in several forms. Without announcement, Saudi Arabia created an international oil trading company in Zug, Switzerland in the Summer of 1983.

On August 12, 1983, Iraq had declared a 'naval exclusion zone' covering the month of the Shatt al-Arab extending southward to include Kharg island, Iran's central export facility. For its part, Iran had threatened to close the strait of Hormuz if it were denied access to it. Iraq and Iran's tanker war began in earnest in March 1984. Shortly after Iran's military struck a Saudi tanker in mid-May, the Saudi airforce shot down an Iranian reconnaissance plane.


38. This was the third phase of the Iran-Iraq war beginning in 1984. It was signalled by increase Iranian efforts to penetrate Iraq's heartland and to cause its Shi'ite (Arab) majority population to rise against Saddam Hussein's Sunni minority regime. It was also highlighted by Iraq's launching in March 1984, of tanker warfare aimed at undermining Iran's ability to sustain its war effort. This development soon began to have an impact on Saudi Arabia and Kuwait, whose shipping became the target of Teheran's retaliatory attacks (May and July 1984 and February 1985) because of the two countries growing aid to Iraq.
While Saudi Arabia strove to ensure higher production OPEC members (including GCC allies) strove to limit Saudi production to a maximum of 5 m.b.d. (including the neutral zone). This was the amount nationally left for Saudi Arabia after subtracting the twelve established production quotas from OPEC's 17.5 m.b.d. ceiling. According to published estimates, Saudi output (including the neutral zone) had indeed reached 5.5 m.b.d. in July and 5.9 m.b.d. in August.

Given the Saudi production (including neutral zone) to an estimated 6 m.b.d. in September and October, it was hardly surprising that Iran strongly attacked the kingdom for not properly performing the swing role at OPEC's year end meeting in Geneva from December 7 to 9, 1983. Some members suggested that the kingdom's acceptance of a firm 5 m.b.d. quota served as a litmus of Saudi support of OPEC and the organization's $29 marker price. Refusing to take the bait, Yamani castigated other OPEC members for exceeding their explicit quotas and giving discounts below official prices. The meeting ended without any decision being taken.

Saudi ambivalence to the swing role is perhaps best illustrated by the kingdom's contradictory actions in July 1984. At OPEC's mid year meeting in Vienna on July 10 and 11, 1984, Saudi Arabia went out of its way to support the organization by entirely underwriting temporary quota increases granted to Nigeria. The conference granted Nigeria an additional 100 thousand b.d. for August and 150 thousand b.d. for September.

OPEC formally decided at the July meeting to seek help from non-OPEC producers in shoring up oil prices. The conference authorised the establishment of 'contacts' with non-OPEC producers with a view to gaining their help in "stabilizing the oil market and defending the oil price structure." Yamani agreed to play a leading diplomatic


40. OPEC Annual Report, Vienna, Austria, 1984, p.72.
role in OPEC's quest for non-OPEC support

BARTER DEAL

In a major departure from established Saudi policy, Riyadh entered an oil-based barter deal. Prior to its final authorization, the barter deal was hotly contested at the highest levels of the Saudi government. Sensing the danger that the deal would pose to Saudi Arabia's (and his own) standing in OPEC, Yamani vigorously opposed the deal in the kingdom's private counsels. The royal family, however, overruled Yamani. The barter deal destabilized the tenuous balance which had existed between supply and demand.

Yamani's effort to stabilise the oil market seemed to succeed. To help accomplish this, Yamani had to dramatically cut already low Aramco output. From July's 4.8 m.b.d. level, Aramco produced 4.3 m.b.d. in August and even lower 3.9 m.b.d. in September. Yamani received help in his market stabilization effort from an unexpected quarter - Iran. Due to a temporary easing in the tanker war Teheran had attempted to boost oil revenues by reducing its discounts off official prices.

Given the kingdom's continuing financial pressures, the renewed market stability did not last long. At a September 24 cabinet meeting, King Fahd reviewed ministerial expenditures over the first half of the 1984-85 fiscal year and the difficulties concerning timely government payment to contractors.

Four days later, Yamani notified the Aramco partners of a shift in the mix of export crudes effective October 1. Expecting a considerable rise in fourth-quarter oil demand, Yamani hoped to pre-empt a substantial portion of the increase for the kingdom.

During negotiations in Geneva from October 29 to 31, conference members transformed their consultative session into an extraordinary meeting. Reflecting heavy pressure from OPEC members and genuine concerns about a price collapse, the Saudis accepted a disproportionately large contribution to the agreed 1.5 m.b.d. ceiling reduction of the
total 1.5 m.b.d. ceiling reduction, the kingdom accepted 43 percent, yielding a new national quota of 4.35 m.b.d. At that level, however, Saudi Arabia still accounted for 27 percent of OPEC production versus 29 percent under the previous quota regime.

OIL SITUATION IN 1985

In 1985 oil production from non-OPEC countries reached such a level that it became clear to the Saudis the market was not stable and their revenues were being eroded to an unacceptable level. Since mid 1985, Saudi Arabia applied a policy of direct dealings with the end consumer. It raised its production and let the price collapse. It was relatively able to neutralize the international market and to contain the effects of the North Sea oil.

At the beginning of 1985, oil prices fell to $28 a barrel. It soon appeared that certain OPEC countries sold oil below such price and outstripped its quotas. Hence, Saudi Arabia stopped defending the price as of December 1985. It accepted to reduce its production and proceeded to define its quota. Hence, the price deteriorated further in 1986 reaching less that $10 a barrel. With the rapid decline of the price of oil, division prevailed among the OPEC members.

The Saudis faced with a May 1985 production level of 2,590,000 b.d. and a June 1985 production level of 2,420,000 b.d. drastic action was necessary to improve revenues. Saudi exports were running at little more than 1.5 m.b.d., earning the country around $1.25 billion a month, while the country's budget required oil income of almost $3 billion a


42. Morsi, n.14, p.36.

43. Ibid.
ABANDONMENT OF THE SWING ROLE

In June 1985, the Saudis decided to abandon their role as swing producer in OPEC. In the autumn of 1984, the 13 OPEC nations had sought to maintain their weakening grip on the market by reducing their production from 17.6 m.b.d. to 16 m.b.d., with Saudi Arabia reducing its production from 5 m.b.d. to 4.35 m.b.d. This level was seen as the maximum that Saudi Arabia would produce rather than as an average production level. The persistent increase in non-OPEC production coupled with concealed price cuts and production increases by many OPEC states made Saudi Arabia's position untenable.

The decision to abandon the Swing-Producer role was not made easily. It meant challenging the other leading oil producers, whether in or out of OPEC. Riyadh demanded of its partners in OPEC that they adjust their output to allow Saudi Arabia to produce additional crude up to its 4.35 m.b.d. ceiling. Yamani also reiterated that OPEC nations must strictly adhere to official selling prices and agreed production quotas.

At the OPEC consultative session in Vienna from July 5 to 7, Yamani told fellow members that Saudi Arabia had decided to give up the role of Swing Producer. Making an argument that no OPEC member had heard previously. Yamani claimed that the October 1984 agreement had assigned the kingdom a fixed quota (namely 4.35 m.b.d). Having been granted a fixed quota, he argued the kingdom, was no longer obliged to perform in a Swing capacity. Apart from Yamani, Saudi leaders had in circumstances of mid 1985 come to view the Swing role as debilitating for both economic and political reasons.

44. Story, n.41, p.115.
45. Ibid., p.114.
Unlike the previous two budgets which had been predicated on drawing down financial reserves, the budget for the fiscal year beginning March 22, 1985, contemplated no further drawdowns. (Estimated foreign reserves had already been run down from a peak of some $160 billion to below $70 billion). At the same time, the Saudi Arab government ruled out borrowing in International markets. Given these financial strictures, the government opted to cut budgeted expenditures by 23.1 per cent.

King Fahd was determined to meet the budget's revenue requirements in order to avoid an even greater deterioration in the domestic economy and potential alienation of the new middle class. Within weeks after the new fiscal year began, the bottom dropped out of demand for OPEC crude. The two scissors blade-falling world consumption and rising non-OPEC output-cut deeper yet into OPEC production.

Far from having to hike its 16 m.b.d. ceiling as Yamani had predicted in January, the call on OPEC crude fell below 15 m.b.d. from May through August. Contrary to the projected budget, the kingdom felt compelled to sharply drawdown financial reserves on the estimated order of $1.5 to $2.0 billion a month. In the name of price stability and OPEC success, Saudi leaders faced the absurd prospect of the Swing role ultimately forcing their crude output down to zero. Under the circumstances, the swing role had become an insupportable liability.

For a final time, Saudi Arabia had warned that OPEC discipline must improve. Discounting and overproduction by other members have King Fahd asserted, led to a deterioration in the oil market, with Saudi production falling to unacceptable levels. The king warned that if members continued to feel free to act outside the collective interest, then such freedom would have enjoyed by all members. Yamani delivered the king's warning to OPEC at an MEC meeting in

46. Gavin Shreeve, "Saudi Capitalists where are you?" Euromoney, July 1985, p.149, Quoted in Axelrod, n.16, p.188.
Taif on June 3, 1985.

Two weeks after the early July consultative meeting a majority of OPEC members in an effort to appease Saudi Arabia approved a small decrease in the prices of the heavier Saudi crudes. Three OPEC members - Iran, Libya and Algeria disagreed with the price reduction and disassociated themselves from the majority decision. Separate from the pricing issue, several OPEC members demanded increased quotas at the Geneva meeting.

Saudi Arabia repeated its early July assertion that it had fixed 4.35 m.b.d. quota and that it was no longer serving as 'Swing Producer'. Without endorsing any change, the conference resolved to address the quota issue again at an extraordinary session in October.

Following the July OPEC meetings, Yamani had probably been the most reluctant Saudi leader to give up the swing role out of concern for a market collapse, took primary responsibility for thinking through alternative marketing strategies designed to rebuild Saudi output to the 4 m.b.d. level. The Saudi oil minister discussed with the Aramco partners which had progressively cut their total liftings to some 500,000 b.d., the kinds of sales terms which might spur them to increase their purchases.

Based on these discussions the main development was a dramatic shift in pricing policy. The kingdom relinquished its former adherence to contract sales, opting instead for what came to be known as Netback System.

NETBACK DEALS

On September 15, [1985], Ahmad Zaki Yamani, the veteran Saudi oil minister

...hinted that his country was now preparing to adopt a system of 'netback' deals with the oil companies that would substantially boost its flagging exports...[in other words] the world's leading oil exporter was preparing to declare a price war at the expense of other producers, including its own partners in OPEC. Instead of the long standing traditional policy - of defending the price of oil on its own or OPEC's behalf
it would seek to re-establish its legitimate share of the market.47

According to this arrangement, Saudi Arabia agreed to determine the price of crude oil as a function of the value at which it was sold when already refined. This meant that crude oil would be sold at a later time when the contract was actually signed. In a declining oil-price market, this also meant cheaper oil. The benefit for the oil companies was that cheaper oil prices would increase demand and profit. The benefit for the Saudis was an increased demand which, in turn, would allow them to regain their share of the market. The spot market was still avoided. These Netback deals were arranged with the four former US shareholders in Aramco.

The Netback deal had three component parts: (i) Product yield, (ii) Product prices, and (iii) Fees.

Product yield refers to the portions of the individual refined products that, when combined add up to 100 percent. Product prices are based on spot assessments in published sources. The fees include refining costs, freight and other elements that are deducted to arrive at a net value of the crude back at its point of origin. The two parties must also decide on how long after the crude oil has been loaded the netback calculation will be computed and on the number of days product prices which might be rolled together to determine the product prices used in the calculation. Each component part is subject to negation.

Once the pieces have been set down in a contract, a netback price for a particular crude sale may be determined in the following manner:

First, product prices for the indicated time period are multiplied by their proportionate yields.

Second, the results are summed up to produce a weighted average.

Third, the fees are deducted from this total (called gross product worth). The amount remaining is the netback price of the crude.

Through contracts based on netback terms, the Saudis aimed to ensure that buyers would continue to lift on a sustained basis. In addition to offering buyers an attractive refining margin, Netback deals also offered fixed margins. The fixed aspect was as crucial to the Aramco partners who hoped to avoid further refining losses, as it was to the Saudis who wished to guarantee a desired sales volume.

Saudi Arabia's first Netback deals was signed in September 1985 with three members of the Aramco partnership - Exxon, Texaco and Mobil. In mid October the last of the four partners, Socal, signed as well. What was good enough for Aramco partners was good enough for many other International refining companies - majors and independent alike. For example, Petromin signed Netback deals with shell, Ashland and Marathon. Concomitantly, existing Petromin sales contracts (with such companies as British Petroleum, the French State Companies and Finland's Neste) were converted to a Netback basis.

According to Saudi contract rules, only refiners were eligible for the netback contracts and resale of the crude was strictly prohibited. Taking effect on October 1, 1985, the Netback deals were set to last either three or six months. Importantly, the contracts contained no floor price at which the kingdom would cease sales.

Bothered by low utilization rates at its new export refineries at Yanbu and Jubayl, the government additionally converted the basis of feedstock sales to a netback basis. The two plants had been operating at less than one-third of their combined capacity of 500,000 b.d. The Yanbu plant was held 50 percent by Mobil and Jubayl, 50 per cent by Shell.
At the OPEC conference meeting in Vienna on October 3 and 4, Yamani confirmed press reports that the kingdom had begun signing Netback deals. Notwithstanding the new Saudi policy, other members (including Ecuador, Gabon, Iraq and Qatar) made requests for increased quotas within the 16 m.b.d. production programme. Further complicating matters, Iran demanded two barrels for any additional barrel allocated to Iraq while agreeing unanimously to maintain the 16 m.b.d. production programme the majority of members decided at the October meeting to postpone further discussion of quota redistribution to a later date.

In the meantime, the new Saudi Netback deals came into force without any immediate deterioration in prices. Against 2.2 m.b.d. in August Aramco produced some 3.7 m.b.d. in October and 4 m.b.d. in November. OPEC as whole produced at 17.4 and 17.9 m.b.d. in October and November respectively. Despite the rise in OPEC supply prices actually advanced in the fourth quarter. The rise in oil prices reflected a seasonal increase in consumption and a contra-seasonal stock build.

**PRICE COLLAPSE**

This was the first in a series of events whose consequences were to be felt well beyond the oil producing states. By early July 1986, the Saudi Arabian policy initiative had permitted the Saudis to increase their daily production to 3.8 m.b.d. less than one-third of what they had hoped to produce. The important point, however, is that in raising their production, the Saudi Arabians also instigated the most dramatic fall in oil prices that was ever witnessed.

The flood of Saudi oil onto the market prompted the dramatic oil price collapse of 1986. Saudi production in August 1985 was only 2,340,000 b.d., the lowest monthly

49. *OPEC, Annual Report*, Vienna, Austria 1985, p.34.
total since the post 1973 oil boom began, it was up to 2,980,000 b.d. in September of the same year, and to 3,910,000 b.d. in October. In November 1985, it broke the 4 m.b.d. mark, and in the following months Saudi Arabia pumped steadily at between 4 and 5 m.b.d. On at least one occasion it tested its production capacity with a brief burst of up to 6 m.b.d.50

Oil prices dropped below $10 a barrel in 1986. The Saudi aim was to deliver a sharp shock to the market, so that they would regain market share and then hold it at a satisfactory price level. The Saudis estimated that if prices went down to a level of $16-18 a barrel, the market should then start coming to its senses, with the producers of more expensive non-OPEC crude more prepared to reach an accommodation with OPEC on prices and production levels. In the event, prices dropped well below these anticipated temporary floors as oil markets overreacted to Saudi Arabia's return to substantial levels of oil production, in a complementary manner to the way they had overreacted in 1979 to the downfall of the Shah. As of July 1986, the markets had yet to stabilize properly, and the OPEC ministers had not been able to reach a consensus on new prices and quotas.

The drop in oil prices was of such a magnitude that economists indicated that the real incomes, allowing for inflation, of the Middle Eastern oil producing states, from Algeria to Iran were lower in July 1986, than they had been prior to the October war of 1973, when posted prices were US $3.01 per barrel. Saudi Arabia had an income of US $22 billion in 1985, as compared to US $108 billion in 1981-82. Despite the fact that it reduced its budget from US $83 billion in 1981-82 to US $46 billion in 1985, it had to make use of its reserves, and so lowered them from an estimated US $140 billion in 1983 to US $80 billion in 1986.51

50. Story, n. 41, p. 115.

51. Bresheeth and Davis, n. 47, p. 188.
The situation remained relatively stable through the remainder of 1986 and the first half of 1987. In August 1986, the GCC producers were able to reach a temporary two-month OPEC agreement. Saudi Arabia agreed to cut its output from 6 m.b.d. to 4.35 m.b.d. Oil prices immediately jumped some $4 to $5. In the midst of the pricing turmoil and sharply curtailed Saudi income, oil minister Zaki Yamani was abruptly fired by King Fahd in October. His replacement was Hisham Nazir, a former Yamani deputy and a long-time minister of planning. The Kingdom pointed out that its oil revenues had fallen by 80 percent between 1980 and 1986.

Yamani's dismissal reflected differences over the questions of oil policy and personality differences along with disagreement over barter deals. The king viewed Yamani as less than enthusiastic about leading OPEC to a fixed-price system at that level. Yamani apparently favoured keeping prices lower for the positive impact that this would have on OPEC (and Saudi Arabia's) longer term market share. The oil minister probably feared that a premature return to fixed prices, at two high a level, would force Saudi Arabia into a painful return to the swing role.

The dismissal also served two royal political purposes. Domestically, Yamani's removal helped to insulate the ruling family from public perceptions of an ill-conceived oil policy. Regionally, it served to underline the king's attempt to accommodate Iran, which had Yamani as evil mastermind of OPEC's market share strategy.

**IMPACT OF PRICE COLLAPSE ON SAUDI OIL SITUATION**

In the course of the early 1980s oil prices witnessed a sharp decline under 1986, when the price of oil reached less than $10 per barrel. During this period Saudi Arabia produced more oil than it needed for its development projects or financial obligations. Saudi Arabia was motivated by a

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52. Story, n.41, p.120.

53. Ibid., p.124.
number of factors: 54

First, it claimed that it was in the interest of oil producing countries to maintain moderate prices of oil because higher prices would force oil consumers to search for and develop alternative energy sources.

Second, it argued, the sharp increases in oil prices would harm the global economy by increasing inflation and creating other economic problems.

Third, it believed the developing countries in particular would suffer as a result of sharp increases in oil prices.

Another factor, it did not mention was that all the Gulf Sheikhdoms have investments in the West and they would consequently suffer from any economic crisis in the West.

Following the 1986-87 price collapse, prices sank to about 9 dollars a barrel, Saudi Arabia abandoned its crusade for a fair share of the market largely aimed against non-OPEC producers. At the December 1986 OPEC Summit, Saudi Arabia was one of the main proponents of the decision to limit the organisation's total production to 15.5 m.b.d. (it was 32.5 m.b.d. in 1980-81) and to set a reference price of 18 dollars a barrel. This decision caused prices to rise to 12-13 dollars a barrel by the beginning of 1987, and even higher when it became evident that OPEC members had actually reduced their production to the prescribed limit. 55

Shortly afterwards Riyadh declared its determination not to serve any longer as OPEC 'Swing Producer' and gradually raised its share of OPEC's production to nearly 25 per cent, equivalent to its share of the non-communist world's proven reserves. 56 Subsequently Saudi oil production which


55. Abir, n.2, p.150.

56. In 1981 its share was 42 per cent but it declined by 1985 to about 20 percent. Financial Times (London), 22 January 1990.
at one point in 1987 had shrunk to under 3 m.b.d. from 10 million in 1979 rose by mid 1988 to 4.35 m.b.d. Riyadh's insistence on achieving a 25 percent market share of OPEC's total production, while other members of the organisation also exceeded their quotas, caused oil prices to remain under 15 dollars a barrel in the second half of 1987. Oil rose to about 16 dollars in the beginning of 1988 only to collapse again to about 12 dollars a barrel shortly afterwards, owing to a glutted market.

In view of the kingdom's grave financial situation, the Saudi government implored its OPEC partners to observe their production quotas so that the price of oil would rise to as close to 18 dollars a barrel as possible. Such a price ceiling did not contradict the kingdom's long-range oil policy based on its enormous proven reserves which necessitated low oil prices to encourage higher consumption. However, Saudi Arabia's efforts in the first half of 1988 to maintain OPEC production discipline in order to raise oil prices did not succeed. This was largely due to Iraq's refusal to participate in OPEC's quota agreements.

At the beginning of 1988, there was no sign of improvement in the Saudi economy. This was reflected in the 1988 budget, announced at the end of December 1987. Expenditure remained at 37.6 billion dollars while revenue from oil, projected at 37.6 billion dollars, was by year's end only about 16.5 billion (the lowest since the mid 1970s). The projected budget deficit was about 10 billion dollars. As the kingdom's liquid assets had shrunk dramatically since 1982. Saudi Arabia decided to launch another internal bond issue of about 8 billion dollars, rather than continue to draw on the remnant of its financial reserves.

Government expenditure on subsidies for agriculture and a variety of commodities and services, in 1987, amounted to

57. Estimated to suffice for 150 years at its 1988 rate of production.

3 to 4 billion dollars. In addition, Riyadh spent many billions on its extensive welfare services. These subsidies and services were a pillar of the paternal relations between the regime and the Saudi people. But, as the kingdom's oil revenue was not likely to rise, and Riyadh was no longer willing to draw upon its reserves, it preferred to reduce its substantial subsidies for gasoline, electricity, basic foodstuffs, airplane tickets and some services.

In October 1988, the Saudi government announced a special development plan for the year 1989-93 with the following targets:

To continue to develop the kingdom's defence forces and to strengthen loyalty of citizens.

...to increase the state's revenues providing this does not lead to undesirable social or economic effect...

To improve the performance and efficiency of the government administration which will lead to reducing government expenditure without affecting the level of services... to citizens.

To increase the activity of the private sector in the notional economy.

To achieve a balanced development among the various regions of the kingdom.

To encourage the private sector to provide job opportunities for citizens.

To replace non-Saudi manpower with Saudi manpower.

Evidently, the regime believed that its stability in the 1990s depended on its ability to revive the country's prosperity and development for the benefit of all the Saudis.59

IMPACT OF PRICE COLLAPSE ON US

The US oil industry was hit first and hardest by the price collapse. Many stripper wells60 located primarily in the American Southwest, had to be shut in because they were

59. Abir, n.2, p.150.

60. Wells producing less than 10 b.d. oil.
no longer profitable and their relatively high operating costs. Over the course of 1986, some 300,000 to 400,000 b.d. of high cost US production (largely stripper, but also some enhanced recovery wells as well) was terminated. 61

The price collapse placed the Reagan administration in a quandary. When prices first started dropping US officials expressed no anxiety. Indeed, President Reagan merrily claimed that his Energy Policy had shaken up oil prices and brought OPEC to its knees. But as prices fell lower and the potentially negative economic consequences became clearer, another line began to emerge from the administration which could not be obscured by the simultaneous (and politically obligatory) touting of free-market principles. On March 31, 1986 Energy Secretary John Herrington stated:

It has got to be apparent to the Saudis and the rest of OPEC what damage is being done to our oil industries. There is a point where forcing lower prices or increasing production more has political ramifications. The Saudis have a lot of friends in the world, and forcing prices down by excess production, has ramifications among their allies. I am sure they are conscious of this. 62

Vice-President Bush, who had strong ties to both the domestic oil industry and Texas, also publicly addressed the issue. For reasons of national security, he argued the United States required "a visible strong domestic oil industry." 63 If oil prices "stabilized at less than $12 a barrel", Bush declared the "US government would become involved." 64 Bush delivered his message directly to king Fahd and oil minister Yamani during a visit to Saudi Arabia in early April. The Vice-President reportedly hinted at the

61. IEA, Annual oil market report 1986, p.28, Quoted in Axelrod, n.17, p.201.
64. Ibid.
possible imposition of a large oil-import tariff, which major sectors in the US oil industry had already begun to demand.

Despite the Reagan administration's often repeated public stance that taxes would not be raised, the Saudis could by no means discount the possibility that the administration would impose a substantial oil import tariff. Beyond National Security worries and concern for the economies of the American oil producing states, the Saudis had to fear that the administration might be inclined to see the tariff as a quick-fix revenue raising measure to help trim the federal budget deficit.

CONQUEST OF FAW PENINSULA

The relative stalemate in the Iran-Iraq war came to an end in February 1986 with the conquest by Iran of the Faw Peninsula, the larger part of Iraq's Persian Gulf coast, and by renewed Iranian efforts to take Basra. Iranian soldiers were now virtually positioned on Kuwait's border, a short distance from Saudi Arabia's Eastern province and its oil fields. Teheran, thereafter, often threatened Riyadh and Kuwait that it would attack them unless they ceased their massive financial and logistic assistance to Iraq. The conquest of Iraq's Faw Peninsula by Iran in 1986 was undoubtedly, a turning point in Riyadh's policy concerning Iran-Iraq war.

The severe recession experienced by the kingdom as a result of the sharp decline of oil sales and prices, which affected the Saudi expenditure budget (slashed from over 90 billion dollars in 1982 to 37.5 in 1987, while revenue from oil declined from 108 billion dollars to 17.8 billion dollars in the same period. Many Saudi businessmen and entrepreneurs faced growing cash-flow difficulties or went bankrupt. In as much as Saudi Arabia endeavoured to protect the 'lower-income' Saudis from hardship, it reduced by various means, some subsidies on consumer goods and in-

65. Abir, n.2, p.133.
creased indirect taxation. By mid-1987, Saudi Arabia took steps to curb the growth in the number of students in domestic and foreign universities and its expenditure on them. Many graduates were unable, moreover, to find work, following the government's decision in 1987 to freeze the hiring of new employees.

The second part of 1986 witnessed intensified Iranian attempts to conquer Basra, Iraq's second largest city. Teheran announced its intention to launch a new 'final' offensive against Iraq at the end of the year. On its part Baghdad escalated its strategic bombing of Iran proper and its oil installations in the Gulf. To counter, Teheran's propaganda attacks against the Saudi regime and his own piety, king Fahd, inter alia, adopted the title of 'Servant of two Holy Shrines', instead of 'His Majesty', and further strengthened the authority of the ulama's Morality Police.

ENTER THE SUPER POWER - STAGE TWO (1986-88)

A new stage in the Iran-Iraq war began in March-April 1987 after US had officially agreed to protect the reflagged Kuwaiti tankers and despatched a powerful Armada to the Arabian sea. The escalation in the 'tanker war' and United States and Soviet Union's involvement in it, moreover, prompted the Security Council to produce on 20 July Resolution 598 which called upon Iran and Iraq to declare a ceasefire. The Council agreed, as well, to meet again as necessary to consider further steps to ensure compliance. Baghdad immediately acquiesced but Teheran delayed its answer, again demanding that Iraq first admit to being the aggressor and that Saddam Hussein be removed from office.

As the economic recession deepened and oil revenues declined in 1987 to about 18 billion and government expenditure to less than 37 billion dollars all classes of Saudis and the private sector of the economy experienced increasing hardship. Among other things, the administration reduced subsidies and allocations to higher education and further limited the hiring of university graduates by the administration and government agencies. Although the government even attempted to cut subsidies for foodstuff and services,
Fahd prudently continued to protect the standard of living of lower income Saudis. The monarch furthermore, instructed administrators to improve services to citizens and to handle their requests more efficiently.66

Later in October 1987, a Saudi offshore oil field near Kuwait was sabotaged by a pro-Iranian Shi'ite underground group. When Iran escalated its attack on Saudi and Kuwaiti tankers in retaliation for Iraqi strikes against its oil installations, Riyadh unsuccessfully requested the US to protect its tankers on a basis similar to the Kuwaiti arrangement with Washington. As the situation continued to deteriorate, the Saudis again pressured US and other members of the Security Council to declare an arms embargo against Iran.

LAST STAGE - SAUDI ARABIA AND IRAN (1988-89)

February and March 1988 saw the renewal of the 'war of the cities', with Iraq and (to some degree) Iran terrorising each other's populations with Russian made Scud-B missiles. This was followed by an Iranian offensive in Kurdistan, which turned out to be Teheran's last. Iranian forces, moreover, frequently violated Kuwaiti territorial water and, on one occasion landed on its Bubyan Island. As Baghdad intensified its air strikes against Iranian oil targets, Teheran, in turn, escalated its attack on Saudi and Kuwaiti tankers.

April 1988 saw the opening of the final stage in the Iran-Iraq war. In a surprise attack which met with minimal resistance, Iraq recaptured the Faw Peninsula. Thereafter, the initiative passed into Baghdad's hands. In addition the Reagan administration was now ready to take its gloves off and teach Teheran a belated lesson for past humiliations. Thus, renewed Iranian mining of the Gulf's navigation routes, which caused damage to the US Roberts on 14 April, led to the destruction by US forces of two oil platforms used by Iran's Revolutionary guards. Following additional

incidents, the US navy destroyed about half of the Iranian navy.

Repeated Iraqi victories in May, June and July, following the total collapse of Iran's military and logistical infrastructure, forced Ayatollah Khomeini to accept reality. Teheran informed the UN Secretary General on 18 July that it was ready to accept ceasefire unconditionally. A ceasefire was declared on 20 August.

POST IRAN-IRAQ WAR WORLD OIL MARKET

The cessation of hostilities provoked a fresh collapse in market petroleum prices. While the war had not affected oil exports from the two belligerent countries much more than those of non-belligerents, the cease-fire did not bring peace, but simply the beginning of a new phase in a deep-seated rivalry. Iraq and Iran immediately bid for an increase in their oil revenue, both because they needed it badly for reconstruction to make up for a lost decade in investment and economic development, while continuing to keep up military expenditure, and because neither could tolerate falling behind the other. This situation for OPEC was more difficult to deal with than the previous one.

Iranian oil minister Gholmreza Agazadeh while speaking in an interview said that the decline in the price of oil in 1986 was due to the declaration of the policy of acquisition of a fair quota from the market by the former oil minister of Saudi Arabia, Zaki Yamani which led to the glutting of the market. He described OPEC as a non political organization and said the market problem could be solved by keeping OPEC away from political issues. But the oil minister regretted that GCC (Gulf Co-operation Council) member states wanted political issues linked with the market problem.

He warned that the competition by OPEC members for more production would only damage their own interests and jeopardize the organization's economic life. For this reason, he added Iran was not willing to enter the competition. A lack of unity among the OPEC members could only benefit the consumers, he reiterated. World economy could no more
tolerate instability in the oil market, the oil minister warned that any crisis would befall on all those connected with the crisis in some way or the other.

Aqazadeh expressed hope that the joint meeting of long-term strategy and pricing committee that Iran agreed to Iraq having an oil export quota equal to its own, but objected to the two countries having an equal production quota.67

At the end of the meeting of OPEC's long term strategy and pricing committee on 24th October 1988, Aqazadeh agreed to the two countries having an equal production quota. He charged Iraq of over producing in stark violation of assigned quota. At that time Iraq was producing 2.6 m.b.d. of which 300,000 barrels were used for domestic consumption, whereas Iran produced 2.639 m.b.d. of which one million barrels was consumed internally and 1.369 million was exported. In other words, Iran was selling nearly one million barrels less than Iraq. Aqazadeh further said that Baghdad was breaching all regulations by producing an m.b.d. in excess of its OPEC production quota.68

Eight year war with Iran ruined Iraqi economy but even after the war ended, the economy continued to slide. Iraq needed to import eighty percent of its foodstuff and its export earnings were not adequate to meet the cost of its imports with the result that its debt burden after the war showed no signs of coming down. Having failed in its effort to obtain loan from the rich Arab countries it turned its attention towards Kuwait. Its annexation could easily solve Iraq's economic difficulties.

Hence, immediately after the Iran-Iraq war, Iraq started accusing Kuwait of stealing oil from its region since 1980. The world became aware of Iraq's grievances against its small neighbour when on July 17, Foreign Minister of Iraq Tariq Aziz, addressed a letter to the Arab League


68. Ibid.
accusing Kuwait of stealing oil from the Rumaylah oil field which he claimed legitimately belonged to Iraq. He accused Kuwait and United Arab Emirates (UAE) of deliberately marketing more oil than their OPEC quota with a view to lower the international oil price and thereby ruin the economy of Iraq.

Iraq demanded that Kuwait should renounce its claim to Rumaylah oil field, pay $2.4 billion in compensation for the lost revenue write off $10 billion interest free loan which it had given during the Iran-Iraq war, either renounce its claim to the Bubiyan island or give it to Iraq on a long term lease. It also wanted loan of $10 billion. Iraq won the first round without any resistance from any quarter when OPEC meeting in an emergent session in Geneva agreed to raise oil price to $21 per barrel. At the meeting its demand for higher oil price was supported by erst while enemy Iran.

This by itself would have brought sizeable revenue to Iraq but President Saddam Hussein was not satisfied. Kuwait was willing to pay one billion dollars in compensation but was not willing to discuss Iraq's territorial claim nor was it willing to write off its loans to Iraq. In order to put pressure on Kuwait, President Saddam Hussein massed troops on Iraq's border with Kuwait on 2 August 1990.

CONCLUSION

The Iran-Iraq war occurred at a time when oil markets were awash with crude supplies. During the war world oil production capacity had increased greatly and demand declined due to recession, OPEC's market share too declined even more. In addition, energy conservation during the years of high prices had proved far more effective than anticipated because the consuming countries had learned to be much more energy efficient. The increased supply and reduced per capita consumption further accelerated the swing to a buyer's market.

Saudi Arabia enhanced its oil production by 900,000 barrels a day to a new average peak of 10.4 m.b.d. mainly to
keep the oil price low. Saudi Arabia not only produced more oil and flooded the world oil market but wanted to keep the price stable. Despite agreement to cut production proportionately, the overwhelming temptation was to maintain revenue levels by pumping as much as possible. The Saudis as swing producer, were forced to cut production to maintain price stability.

Saudi production dropped from 9.8 m.b.d. in 1981 to a low of 2.34 m.b.d. for August 1985. For the Saudis maintaining the position of swing producer was untenable. Although they were confident that demand would eventually pick up, their revenues in mid 1985 were less than half of their budgetary expenditures. As a result, they again increased production, causing prices to drop briefly below $10 per barrel in 1986 but ultimately forcing other OPEC producers to share the burden of production cuts to stabilize prices and regain lost market share. OPEC discipline could not be maintained.

One of the important changes occurred in the price structure of oil. During Iran-Iraq war the price of oil inflated beyond its true market value, and it continued to decline. The price of oil collapsed in 1986. Yamani was held responsible for it and was dismissed in 1986. The move was interpreted as heralding a damage in Saudi oil policies, as the Kingdom confirmed its unwillingness to continue in the role of Swing Producer. Being Swing Producer in the 1980s brought the Saudis none of the benefits of the 1970's.

During 1980-83, crude production of the United States practically remained constant while her consumption demand decreased by nearly 4 per cent annually. A remarkable phenomenon for the United States was that the decrease in the absolute US consumption level for the early 1980s also translated into a decrease in US share of market economies consumption, which had reached the lowest level ever.

The fall in US consumption in the late 1970s and early 1980s also translated into a lesser US dependence on foreign oil, absolutely and relatively. Net imports (of crude and refined product) into the United States went down by approx-
approximately 9 percent annually from nearly 8 m.b.d. in 1979 to 4.3 m.b.d. in 1985. With the 1985-88 period production fell substantially. US consumption of refined products dropped only slightly in US crude production coupled with a steady increase in OPEC production.

The US oil industry was hit hardest by the price collapse. Many stripper wells had to be shut because they were no longer profitable and also due to their high costs.

The decline in the price of oil 1986 affected both belligerents, thus leaving the balance between them unchanged. Once it became clear that prices could not regain the pre 1986 level a part of the Iranian leadership concluded that the situation had become economically untenable. By mid 1988, this ultimately led to the termination of hostilities, under UN auspices. In 1988 Saudi Arabia again increased its production with collapsed prices.

Eight year war with Iran ruined Iraqi economy but even after the war ended, the economy continued to slide. Immediately after the war, Iraq started accusing Kuwait of stealing oil from its Rumaylah oil field. The foreign minister of Iraq accused Kuwait and United Arab Emirates of deliberately marketing more oil than their OPEC quota with a view to lower the international oil price and thereby ruin the economy of Iraq. The Iraqi invasion of Kuwait on Thursday 2 August 1990 led to the Gulf crisis.