

MERIA

THE DOUBLE-EDGED CRISIS: OPEC AND THE OUTBREAK OF THE IRAN-IRAQ WAR

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The outbreak of the Iran-Iraq War in 1980 followed a decade of rising oil prices and fluctuating oil supplies, both of which had fueled the ascendance of OPEC (Organization of Petroleum Exporting Countries). The industrialized oil-importing nations of the non-Communist world and their major oil companies feared that the Iran-Iraq War would compound these trends. But ironically, the outbreak of the war saw the importing nations display a resurgence of initiative, while OPEC's bargaining power declined. Despite persistent efforts to maintain the high prices and leverage it had enjoyed throughout the 1970s, the cartel ultimately suffered the consequences of internal disunity and increased caution on the part of the importing nations' consumers, governments, and oil companies.

Since World War II, the oil-rich nations of the Persian Gulf have served as reliable reservoirs for the petroleum needs of much of the industrialized, non-communist world. By the early 1970s, this role had expanded dramatically in importance, particularly where the United States was concerned. In the early 1970s, Saudi Arabia and Iran both surpassed Venezuela to become the world's two largest exporters, while the U.S.'s share of world oil production dropped from one-third to one-quarter between 1970 and 1973. Meanwhile, energy consumption in the United States, Western Europe and Japan, continued to rise. On October 16, 1973, the Gulf members of the Organization of Petroleum Exporting Countries (OPEC) decided to unilaterally raise the price of their oil by more than 70 percent, a move of unprecedented gravity for the organization.(1) The following day, the Organization of Arab Petroleum Exporting Countries (OAPEC) began a sales boycott against the United States for its support of Israel, which had been attacked by Syria and Egypt on October 6th.(2) The boycott and the price hikes combined to push an already stagnating

global economy toward recession, and pushed the United States in particular toward its first serious energy shortages in the post-World War II era.

More troubles were to come. In January of 1979, the Shah of Iran, traditionally the strongest U.S. ally in the Gulf, abdicated his throne in the face of an outpouring of popular discontent. The Iranian Revolution would culminate in the accession of the Ayatollah Khomeini's militantly anti-Western Islamist government and a second oil crisis. Iranian exports plunged, and panicked oil companies began oversupplying their inventories, fearing that Khomeini's revolution would spread beyond Iran's borders and undermine the Gulf Arab monarchies. The potential for instability in world oil markets seemed boundless.

In September of 1980, war broke out between Iraq and Iran, and it seemed like a new oil crisis had begun. But ironically, the outbreak of the war saw the importing nations display a resurgence of initiative, while OPEC's bargaining power declined. Before the war, relations between OPEC and the oil-importing countries had been shaped by importer

dependence and weakness in the face of OPEC assertion and strength. The war, however, allowed the major oil companies, most of them American, to reassert themselves in the face of OPEC disunity, and to act upon the lessons they had learned from previous oil crises. It gave the International Energy Agency (IEA) an opportunity to coordinate the importers' energy policies in a unified manner. Most importantly, the immediate outbreak of war showcased the power of changed consumer habits, which helped stave off a shortage and a price crisis by maintaining demand at a relatively low level. These developments could not relegate OPEC to its formerly subordinate position, nor undo the wave of oil nationalizations that had swept the Gulf throughout the 1970s. But taken together, they helped restore a semblance of balance to OPEC's relationships with its principal customers.

BOMBS OVER KHUZISTAN

On the night of September 22nd, 1980, Iraqi soldiers stormed across the Iranian border at eight different points. Their air force's Soviet-made jets preceded them, dropping bombs and firing missiles at Iranian air bases. Among other objectives, the Iraqi army sought to capture the oil refinery at Abadan and the vast, oil-rich southern province of Khuzistan, where they hoped Arab civilians, 35-40 percent of the population, would rise up against the Iranian government.(3) Surprisingly, the first day's fighting seemed to indicate that each side might avoid attacking the other's oil fields, for fear of reciprocal retaliation. While army divisions began battering each other in Khuzistan and naval forces battled off of the Iranian naval base at Kosrowabad (20 miles south of Abadan), Iranian and Iraqi forces avoided attacking each other's oil installations at Abadan and Basra, respectively. An official at the National Iranian Oil Company told the Associated

Press that he "believed Iranian forces had consciously not fired at oil installations in the Iraqi port city of Basra 'because they can do the same to us.'" Similarly, though fighting raged near the Abadan refinery, it survived the first day entirely unscathed by Iraqi shelling.(4)

This, however, would prove a one-day trend in an eight-year war. By the early morning of September 23rd, Iraqi planes began strafing Abadan, turning oil and gas tanks into balls of flame. Iran, for its part, announced that it refused to allow any ships to pass through the Straits of Hormuz to the ports of its enemy. "With the rivals striking for the first time at the petroleum installations that are the basis of the region's wealth, the long-simmering border conflict now directly threatens the industrialized world's oil supplies, as well as having the potential to spread into the nearby shipping lanes of the Persian Gulf, through which most of the Western world's oil supply passes," the *New York Times* noted. In the Western business community, such assessments were greeted with extreme nervousness.(5) "Insurers quadrupled their rates on war risk insurance for oil and other freight transportation to and from Iran and Iraq, because of the hostilities."(6) Spot prices--the price at which oil is selling on the cash market--sprang up.

In Washington, Deputy Energy Secretary John Sawhill tried to reassure the U.S. government, telling a Senate subcommittee that "the nation's oil inventories are so high that the United States could entirely offset a supply disruption more serious than that provoked by the four month 1973-74 Arab embargo," and that few of America's exports came from Iraq or Iran, anyway.(7) This, of course, ignored the fact that Iran might block the Straits of Hormuz, through which more than two-fifths of the West's oil passed. Even if this did not occur, the oil companies operating in the Gulf could suffer

crippling insurance costs if the fighting persisted and escalated. Moreover, on the day that the war began, all of the member nations of OPEC except Saudi Arabia announced a commitment to 10 percent production cuts. Few of them shared the fears of Saudi energy minister Shaykh Yamani, who predicted that continued crises and production cuts would lead the oil companies and importing nations to hoard oil inventories, eventually producing a surplus.(8) Prior to the outbreak of the war, some Western energy analysts would have agreed with him. At the beginning of the war, world oil production was running two to three million barrels a day above demand. Without the Saudis, “the cutback program would not seem sufficient to meet its aim--eroding the surplus.”(9)

But on September 25th, both Iraq and Iran halted their oil exports through the Gulf, effectively removing 2.7 million barrels of oil a day from world markets. Alternative outlets for this oil were few. Iraq could utilize its two major pipeline routes, one of which extended through Syria to Tripoli on the Mediterranean coast, and the other, which terminated at the Turkish port of Iskenderun. Iraqi-Syrian relations, however, were badly strained following a failed National-Union pact in 1978. In any case, “both pipelines [could] only accommodate about 800,000 barrels a day--a small portion of Iraq’s total exports of 2.8 million barrels a day.”(10) Iran, for its part, had exported considerably smaller amounts of oil for some time since the Revolution. The vast bulk of it had passed through the Gulf loading terminal at Kharg Island, now under bombardment from the Iraqi air force. “If this fight is not over within a week, and if these guys go on hitting oil facilities, you can kiss the glut goodbye,” warned one American oil executive.(11)

Such fears of a vanishing oil surplus depended on more than the “missing oil” from Iraq and Iran alone. Iran warned again on the 25th that it would close off the Straits of Hormuz if any outside force dared interfere on behalf of the Iraqis. Mainly, this warning was aimed at the United States, capping a decade of strategic crises for the Americans in the Gulf. There is reason to believe that American President Jimmy Carter knew of the impending Iraqi attack and even tacitly condoned it, hoping that war might inspire the Iranians to release a number of American civilians taken hostage in Tehran the previous November.(12) But once the war began, he committed the United States to a position of neutrality. Only the closure of the Straits would precipitate preventive action, to be undertaken by an international naval force rather than the United States alone. Otherwise, he believed that “the consuming nations can compensate for this shortfall,” because of the high level of oil inventories.(13)

FEARS, LESSONS, AND RESPONSES

Many held less sanguine views. Some, like the oil executive quoted above, did not think the inventory glut could be sustained if the war continued, OPEC continued to cut production, and costs of transport for Persian Gulf oil became prohibitive. Others feared that the Carter administration had neglected the SPR (strategic petroleum reserve) to a point where it would only provide three months worth of oil if Iran suddenly closed the Straits.(14) Indeed, the government only began refilling the SPR on September 23rd, a year and a half after they had stopped. Still others worried about the prospect of shortages, but feared that the expectations of shortages could be just as dangerous. They recalled the panic buying of 1979, when the immediate loss caused by the Iranian Revolution inspired the oil companies to build up their

inventories in anticipation of a more massive shortage in the near future. This process on the supply-side was compounded by parallel behavior on the part of consumers in the oil-importing countries. The average Western motorist had switched from driving with their gas tanks one-quarter full to driving with three-quarters of their tanks full, anticipating higher future prices and long "gas lines."⁽¹⁵⁾ "In retrospect, the major industrial countries have realized that the great grab of early 1979 was a dreadful mistake," wrote the editors of the *Washington Post*. "They have further agreed never to do anything like that again. No one can really control speculation in uneasy times, or the occasional desperate buyer. But governments of the industrial countries have enough influence over the oil trade to prevent any long, sustained, dangerous rise in the spot prices for oil."⁽¹⁶⁾

This "influence," though, had been in doubt ever since OPEC had begun to assert itself seriously in the early 1970s. For the "governments of the industrialized countries" to have "influence over the oil trade," they would not only have to curb their companies from over-buying on spot markets, but would need to trust that OPEC would withhold further production cuts. At first, such a hope seemed realizable. At the OPEC conference in Vienna before the outbreak of the war, Saudi Arabia "reminded [its] recalcitrant colleagues...that [it was] still the world's swing producer with the power to make or break the international oil market."⁽¹⁷⁾ In times of crisis, this meant that the Saudis could increase their own production to make up for shortages elsewhere, and could use their clout within OPEC to bring other member nations along. On September 27th, "oil experts confirmed that OPEC members were shelving plans for production cuts later this year to tighten a slack oil market, and they said Saudi Arabia had

suggested the postponement."⁽¹⁸⁾ The Saudis initially denied the reports, which reported that "the cutback and its goal of price stabilization had already been achieved by the Iranian-Iraqi fighting...the ten percent cutback would cause chaos in the world oil market."⁽¹⁹⁾

On October 4th, Saudi Foreign Minister Saud Faisal officially announced his country's intent to increase its own production and "organize similar efforts by other major producers."⁽²⁰⁾ Yamani set off on a two-day tour through the Gulf region, hoping to convince the other Arab Shaykhdoms to increase their oil production. By October 6th, he reported having secured the agreement of the United Arab Emirates, Qatar, and Bahrain; further away in Asia, Indonesia also announced that it would refrain from production cuts. Six days later, oil ministers from Saudi Arabia, the U.A.E., Qatar and Kuwait met in the Saudi summer capital of Taef, and agreed to increase their crude production by a million barrels jointly. Kuwait's government did not actually agree to a production increase, but simply pledged that "the yearly Kuwait production average will stay on target" - it would not follow through with cuts.⁽²¹⁾ Outside the Gulf, other OPEC countries were less forthcoming. Nigerian president Shehu Shagari responded to the Saudi moves by stating: "OPEC has agreed not to increase but to decrease production in order to maintain our prices. And that is the policy that Nigeria is going to follow."⁽²²⁾

It seemed that it would not be OPEC's crisis to solve. In the absence of any kind of unified cartel policy, no one expected the organization to be able to alter prices in any significant way. Even on October 14th, only a few days after the Taef meeting, many had already begun to doubt the efficacy of the measures agreed to there. "The decision to increase production," according to one industry official, "is expected to replace less than one-third of the oil exports from Iran and

Iraq.” Officials from the Gulf states argued that they had not intended to plug the shortage, but merely to “aid those countries most affected, such as India and Brazil.” “We only want to help those who are really in trouble,” remarked one Arab oil official. “The others can live off their fat.” They dismissed the Venezuelan and Indonesian production increases as “cosmetic.”(23) The OPEC “moderates,” led by the Saudis, had abdicated their previous hopes for a long-term push for slow, systematic price increases in favor of damage control. The upper hand belonged to the price “hawks,” formerly led by the Shah’s Iran, and now by Libya, Algeria, and Nigeria. With Saudi Arabia at its production limits, all hoped to push OPEC to capitalize on the war, and believed that demand would soon exceed supply once again.

Remarkably, this belief was not shared by the major importing nations, at least at the end of October. The International Energy Agency concluded on October 21st that “the industrialized world should be able to get through the winter with little or no supply problems even if the Iranian-Iraq war goes on for some time.” The agency’s executive director, Ulf Lanatske, “attributed this to the success of the emergency decision the agency announced October 1, calling on the I.E.A.’s 20 member states to use their ample stockpiles and to stay away from the psychologically volatile spot market.” The Agency’s early warnings against panic buying had begun to pay off. In the Gulf itself, U.S. companies continued to go about their business. They had overcome their fears of the war disrupting transport through the Straits of Hormuz. “There have been a lot of queries about the impact of the fighting, but there’s no reduction of personnel, or slowing down of plans to build joint-venture factories,” consultant Laron Jensen told the *Middle East Economic Digest*. “I have been surprised with the relative sophistication

of U.S. firms--they recognize that Saudi Arabia is not Khuzistan.”(24)

By mid-November, the Iranian and Iraqi armies were locked in a bitter stalemate inside Iranian territory. On November 10th, the Iraqis captured the key Khuzistani city of Khorramshahr. By the middle of the month they had taken about 10,000 square miles of Iranian territory, much of it in the oil-rich south. The Iranians managed to fend off collapse by forcing their better-armed enemy into fierce hand-to-hand fighting, making the best of popular anger at the invaders and of their superior manpower reserves. Still, they were in no position to interfere with Gulf shipping. Maintaining an open port at Abadan provided Iran with sufficient challenge, for the time being. The Iranians also lacked the strategic leverage to draw Kuwait and Saudi Arabia into the fray, as many had feared they might. Both countries lent billions of dollars to the Iraqi regime, and allowed the Iraqis to use their airfields and airspace. Yet in the early part of the war, both escaped serious retribution from the Iranians (although Iran bombed Kuwaiti border posts on November 12th and 16th).(25)

DUELING OPTIMISMS

Thus, talk of a “third oil crisis” had quieted somewhat by the end of November. Indeed, many in the West began to murmur about the weakening of OPEC. “OPEC in the 1960s kept the prices from collapsing, but today I don’t think the organization means a damn thing,” sneered one Western oil businessman. “Many experts,” reported the *New York Times*, “feel that the exporters got what they wanted out of OPEC over the past 20 years and are only keeping the organization together as some kind of gimmick.”(26) The war between Iraq and Iran, for many, magnified the larger issue of OPEC disunity: the rifts between price “hawks” and “moderates,” socialists and

capitalists, Africans, Middle Easterners, and Asians, the U.S.'s allies and its enemies. The organization might be "too useful to its members to be allowed to die," but it would not be strong enough to impose the political aims of its members upon the United States, as it had attempted to do in 1973. "For 20 years OPEC has been a successful association of oil producers who went after the best price for their commodity," remarked oil economist Robert Masbro. "They only run into difficulties when they try to be something more than that."(27)

These assessments, of course, were far from universal. The member nations of the I.E.A. could not continue to draw upon stockpiled oil indefinitely. Even by December, however, they continued to use an average of 2.5 million barrels a day to avoid the spot markets, where prices had begun to rise again, to \$43 a barrel. Furthermore, only an estimated 900,000 barrels of that 2.5 million were seasonal reserves. The rest were leftovers from the 1979 panic buying. The *Lundberg Letter*, an industry publication, predicted that December would see "a reduction in the size of the gasoline surplus" and price increase of "1.5 cents to 2 cents a gallon per month to petroleum product prices for the next twelve months," making "the current \$1.21 per gallon something like \$1.40-1.45 per gallon by December 1981, based on the premise of about a \$3 per barrel increase."(28) The lull in Iraqi-Iranian fighting might have assuaged short-term fears about oil availability. But, as MIT economist Robert Pindyck opined, "The stuff that oil price nightmares are made of was abundant well before the war, and the threat to world oil would remain even if a treaty were signed tomorrow. The problem is that most of our imported oil comes from inherently unstable and insecure sources. The Iranian Revolution and the Iranian-Iraqi War are only examples of what we can expect in the future."(29)

As Western energy experts debated, OPEC was eager to prove that reports of its weakness had been greatly exaggerated. On December 15th, the organization's member nations sent delegates to Bali to discuss a price increase. "Hopefully," declared Indonesian President Suharto, "the current OPEC meeting in Bali can produce a fresh outlook for mutual understanding, fraternal relations and close harmony among its members."(30) The atmosphere at the meeting itself was actually far from harmonious. The Indonesian delegation had to be strategically placed between Iraqi and Iranian delegates to prevent blows (they would have been seated next to each other in deference to alphabetical order). Iraqi troops had captured the Iranian oil minister before the meeting, and his replacements propped up a two-by-three foot photograph of him on a chair, where it glowered at the other attendees. Despite such symbolic melodrama, all 13 member nations not only attended the meeting, but agreed generally to a \$2 to \$3 per barrel price increase, to take effect on the 16th. "OPEC will survive," proclaimed Venezuelan oil minister Humberto Calderon Berti.(31) Even the Saudis agreed to the increase, recommitting themselves to the position they had taken at Vienna prior to the war and the Taef production increases. OPEC, by this time 20 years old, proved that it could brook a war between Iraq and Iran, broken diplomatic relations between Libya and Saudi Arabia, and general tension between Iran and the Gulf sheikdoms at large--all in the name of advantageous pricing.

By Christmas Eve, Venezuela had announced a price increase of \$3 to \$5.50 per barrel, as did Mexico, which was not an OPEC member but usually followed the cartel's lead on pricing. Nigeria and Libya followed suit shortly thereafter. In response, oil companies began preemptively raising prices for their

products by 5 to 7 cents a gallon. (32) Optimism among oil executives seemed to wane. Experts at Shell predicted “free world supply constraints by the middle of 1981,” when inventories would no longer sustain the loss of 4.5 million barrels a day from Iran and Iraq. “If, in fact, the Iran-Iraq situation doesn’t improve by the end of the first quarter, prices for petroleum are going to be very volatile,” worried Lawrence Goldman, an energy analyst. Some even worried that the oil-importing nations would consume all of their inventories by the second quarter, leaving only five months of emergency reserves “between oil consumers and a crisis in the market.”(33) Energy analysts Daniel Yergin and Robert Stobaugh warned that a crisis could even precede an actual shortage, should the companies resort to panic buying. “Unless the Iran-Iraq war eases sufficiently to allow the export of significant quantities of oil from Iraq and Iran by the latter half of 1981, a real shortage could occur next winter. The companies, fearing a winter shortage compared with a summer one, would likely begin to build up inventories during the summer, thereby, in effect, moving the shortage forward into the summer. The likely result: higher crude oil prices in the summer 1981,” followed by a true crisis.(34)

THE DECONTROL OPTION

Yergin and Stobaugh argued for incoming President Ronald Reagan to lift the remaining price controls on domestic crude oil, which the Nixon administration had set in 1971. Carter had actually begun decontrol in April of 1979, in the aftermath of the Iranian Revolution. Full decontrol was to be achieved by the beginning of October 1981. Decontrol would proceed whether Reagan accelerated the process or not, but a decision to speed up the process might have major effects on the U.S. economy. Accelerated decontrol, argued its proponents, would undoubtedly result in

short run price rises. This, however, would help curb consumer demand enough to reduce oil imports, and in the long run, stave off inflationary pressures in world oil markets.(35)

Since the early 1970s, many had argued that for the United States and its industrialized allies to regain the upper hand in energy politics, crucial changes would need to take place on the demand side of oil markets. The supply side would remain governed by the OPEC countries indefinitely. They, after all, lay claim to the bulk of the world’s petroleum, and geological facts would not be altered by the economic needs of the West and Japan. But changes in consumption patterns could stay the hand of the exporters; this was precisely the goal of the U.S.’s decontrol policy. By January 1981, it had achieved highly successful results. “Total U.S. energy consumption in the first nine months of [1980] fell 4.5 percent compared to 1979 even though the 1980 recession knocked only 0.5 percent off economic activity in the same period... Petroleum use was off most of all. Gasoline consumption dropped more than 6 percent to 277 million gallons, or about 6.6 million barrels a day. But gasoline consumption fell in 1979, too, so that use in 1980 was 11.1 percent below that of 1978.” Consumers had begun purchasing smaller and more fuel-efficient cars, carpooling or taking public transportation to work, and driving less in general. New federal fuel efficiency standards for automobiles had also helped to decrease gasoline consumption. “More experts believe that the United States will never again use as much gasoline as it did in 1978,” reported the *Washington Post*.(36) An acceleration of decontrol would hopefully consolidate these trends, and bring them in line with the new market pressures created by the Iran-Iraq War.

Critics of decontrol policy saw it as a cynical attempt by the major oil companies to increase revenues.

“Decontrol,” wrote one, “means handing a blank check to the oil companies and asking OPEC to fill in the amount.”(37) The major oil companies, they argued, had profited enough from the panic buying of 1979. The net earnings of the five major American oil companies (Exxon, Mobil, Texaco, Socal, and Gulf) rose from \$6.6 billion to \$11.2 billion between 1978 and 1979, and the first nine months of 1980 alone netted more than \$12 billion. With this in mind, critics of decontrol refused to accept the explanation that present market conditions could be preventing the exploration of new oil resources and a subsequent move away from cheap imported oil.(38) This reasoning by the critics of decontrol, however, ignored the possibility that the major oil companies might not find voluminous new sources of oil, even if they increased exploratory activity. It also disregarded the root cause of the 1979 panic buying: the fear that the entire Persian Gulf would fall prey to the forces of social instability and revolution, a possibility now magnified by the Iran-Iraq War. Present profits and real fear of an impending crisis were not mutually exclusive. Even advocates of decontrol like Yergin and Stobaugh acknowledged that decontrol would undoubtedly result in short-term price rises. The most effective argument for decontrol was thus not to “get the government off the backs of the oil industry,” though it was this line that drew the lion’s share of criticism.(39) Optimally, however, decontrol would not serve the purpose of enriching the oil companies under the guise of a professed loyalty to free market policies. It would instead enlist the American consumer as an active participant in the politics of oil, helping the United States and the other Western importers regain the upper hand by reducing demand.

Ronald Reagan became president of the United States on January 20th, 1981. Many of his top economic policy advisors

had already promoted accelerating decontrol, particularly Dave Stockman, the director of the Office of Management and Budget. Stockman had written to Reagan late in 1980: “If the Iran-Iraq war is not soon terminated, today’s excess worldwide crude and product inventories will be largely depleted by February or March. Under those conditions, heavy spot market buying, inventory accumulation, and eventually panic bidding on world markets will once again emerge.” Stockman had urged Reagan to complete the process of decontrol immediately. “Unless the whole remaining system of crude oil price controls, refiner entitlements, gasoline allocations, and product price controls as administratively terminated ‘cold turkey’ by February 1,” he warned, “There is a high probability of gasoline lines and general petroleum market disorder by early spring... The Administration would lose the energy policy initiative and become engulfed in defensive battles.”(40) Once inaugurated, the President moved quickly to follow his advice. On January 8th, he announced the “elimination of remaining Federal controls on U.S. oil production and marketing.”(41)

This decision capped the long decline in consumer demand for oil that had begun in 1980, a trend increasingly obvious to petroleum importing and exporting nations alike. That February, Shaykh Yamani joined the chorus of international oil analysts and government officials who predicted another oil glut in 1982, which could be quite large if the Iran-Iraq war were to end by that time. He cited the West’s “reduction in oil use” as the major reason to expect such a surplus. World oil use had dropped a remarkable 7.5 percent in 1980, and Yamani expected similar results in 1981.(42) Oil companies renegotiating contracts with OPEC producers cited such predictions when they argued against paying “additional premiums over

official prices.” Kuwait oil minister Ali Khalifa al-Sabah responded by saying that his country had no “‘ideological’ commitment to the present premium level.”(43) OPEC had already begun to lose what had seemed like newly renewed might to the changing habits of Western consumers, who were in turn responding to the economic recession and steadily rising oil prices of the previous decade. Experts predicted that this would peak in response to sharp spikes in the prices of heating oil and gasoline following Reagan’s January 28th decision. “By buying less, motorists make it more difficult and risky for the sellers to keep pushing up their prices,” wrote the editors of the *Washington Post*. “As a counterstrategy for consumers, that’s not always easy or convenient. But, unlike all the others, it works.”(44)

The impetus to focus on demand also depended in large part on the dynamics of the war itself. Iran launched its first major counteroffensive on January 5th, and engaged the Iraqis in heavy ground fighting around Ahwaz, Susengard, and Abadan in Khuzistan--all occupied or besieged by Iraqi troops.(45) By mid-January, however, fighting tailed off into a stalemate once again. In general, the two sides had lessened their attacks on each other’s oil facilities, with the exception of two late-January air attacks on offshore terminals at Iran’s Kharg Island facility and the Iraqi refinery complex on the Fao peninsula.(46) Furthermore, by the end of January, Iran’s oil production rose to 700,000 barrels per day from 450,000, while Iraq produced 300,000 per day, up from 150,000 at the start of the month.(47)

Additionally, on January 18th, the Americans finally reached an agreement with the Iranians for the release of the 52 American hostages still in Tehran.(48) Though no one expected the Iranians to move to repair relations with the United States, few thought that Iran would want to risk confrontation after the release of

the hostages and while their forces were embattled in Khuzistan. The release of the hostages served to remind the world that the Islamic Republic had held the United States at bay for more than a year. Destabilizing the Gulf at large would not be necessary. This meant that while the United States still had to face the problem of an ongoing loss of Iranian and Iraqi oil exports, they could move effectively against OPEC’s renewed bid for supply-side dominance through decontrol. The American government could forgo its prior preoccupations with the closure of the Straits of Hormuz and act aggressively to forestall more immediate problems.

SAUDI ARABIA’S DILEMMA

As forecasts of a coming glut grew in number, Saudi Arabia found itself faced with an unprecedented dilemma in its role as OPEC’s largest but also most “moderate” producer. On the one hand, the Saudis faced demands from their more “hawkish” counterparts within OPEC to reduce output and continue to push prices up. These demands carried political as well as economic gravity. Willingness to use the “oil weapon” had served as a litmus test of Third World solidarity for OPEC members. The Saudis had no desire to be accused of toadying to the West by OPEC “radicals” like Qadhafi and Khomeini. On the other, the Saudis, especially Yamani, had long worried that OPEC’s rush to reap the short-term fruits of price rises might produce damaging consequences in the long run--consequences now taking the form of a supply glut and declining Western demand. "If we were to force the Western countries to invest large sums of money in alternative energy resources, it would take seven to ten years to bring about some results of these investments, which would reduce oil demand to a level that would affect Saudi Arabia, which at that time would not find enough markets

to sell its oil to meet its economic demands,” Yamani told an audience at Dhahran’s University of Petroleum and Minerals. “Other countries have a clear interest in obtaining the largest possible income in dollars for each barrel for the short period it can sell for.”(49)

Iranian oil exports had reached a total of 1.5 million barrels a day by mid-February, nearly twice their immediate prewar level. Even if the war continued to drag on, a glut seemed inevitable. The Saudis had already begun to respond. They increased the price of oil supplied under temporary contracts to \$36 per barrel, a \$4 increase from the \$32 standard Saudi price. Yamani began hinting at Saudi willingness to eventually cut production in half, to 5 million barrels per day.(50) In mid-March, rumors began to spread that the kingdom would cut between 500,000 and 650,000 barrels per day. The Saudis denied this, saying that they sought to “unify prices within OPEC” and that “market conditions will not allow anyone to raise prices.” They still regarded the long-term goal of maintaining world demand for Saudi oil and moderating OPEC behavior as paramount, surpassing even the immediate problems posed by the war and the supply glut. Raising prices, they warned their fellow OPEC producers, would eventually compound the problems posed by the war by driving down the quantity of oil demanded even further.(51) On March 21st, the Saudis held a secret meeting in Jeddah with representatives from the other Gulf states. Many oil analysts assumed that they had gathered to discuss a price-moderating strategy, an agenda item to be addressed at the next OPEC conference at Vienna in May.(52)

PRICES, PREMIUMS, AND PILGRIMAGES

By April, one American oil analyst could confidently proclaim, “We’re back to where we were before the Iran-Iraq

War started.” Worldwide inventories were estimated to be running a full 400 million barrels above the total quantity demanded, which ran a full 8 percent behind quantity demanded in 1980. “Prices will go down - it's only a question of when,” remarked one oil industry executive. “The heat is really on.”(53)

Attempts to reduce the aforementioned heat were largely beyond the exporters’ capabilities. In early April, the Kuwaitis began to exhibit the “ideological objections” to cutting premiums that they had initially denied. After oil companies Shell, British Petroleum, and Gulf Oil refused to pay their \$2-3 premiums per barrel, the Kuwaitis temporarily suspended their sales to them. The companies did not seem overly upset with this gesture. Instead, they appeared willing to bide their time and wait for the market to force the Kuwaitis’ hand. One analyst commented: “Anything could happen to disturb the current balance of supply and demand, but right now, the Kuwaitis are living in a dream world. They seem to be programmed only to oil shortages.”(54) In fact, the Kuwaitis’ struggle to maintain higher prices betrayed more than the arrogance or stubbornness assumed by Western oil analysts. The Kuwaiti economy had suffered considerably since 1980. The war had reduced the country’s retail business by 45 percent and cut off the lucrative trade that accompanied Mecca-bound pilgrims who had formerly traveled through Iraq and Kuwait from Iran.(55) By the end of April, the Kuwaitis relented and cancelled the premiums. Such an action would probably have been unthinkable even two years earlier, and it boded poorly for the future of OPEC.(56)

GENEVA

The OPEC oil ministers and their entourages made their way into the lobby of a Geneva hotel on May 25th knowing the exact nature of the battle that lay

ahead of them. All expected the Saudis to make a bid to decrease their output in exchange for an OPEC-wide price freeze and production cuts. Kuwait had already trimmed its production from 1.5 million barrels per day to 1.25 million, and U.A.E. Petroleum and Mineral Resources Minister Manaa Bin-Said al-Otaibah had announced his agreement to both production cuts and a price freeze on May 19th.(57) Even though the fighting between Iraq and Iran had ground into stalemate (albeit a particularly vicious one), the atmosphere at the meeting was even tenser than the one that had preceded it in December of 1980. Yamani had appeared on American television the previous week and admitted: "We purposely engineered the glut, in order to stabilize the price."(58) The hawks were understandably unhappy to hear this confession, and some, like Algeria, continued to push for price increases in the face of overwhelmingly harsh economic realities. Its fellow hawk Libya, by contrast, seemed ready to give in. Even prior to the meeting, Libyan oil minister Abd al-Salam Muhammad Zaqar publicly spoke of his willingness to agree to production cuts to stabilize supplies.(59) Still, almost all the OPEC producers, save the Saudis, hoped to avoid actually lowering their prices. Years of continuous price rises had conditioned them to settle for nothing less than a price freeze, even in bad times.

The meeting lasted only two days. For the first time since the organization's birth in 1960, its members agreed to reduce output, by a collective 10 percent. Prices would remain frozen through the end of 1981. The most acrimonious split occurred around a Saudi bid for the other producers to lower their base price of \$36 per barrel in exchange for a Saudi price increase, guaranteeing overall price stasis. Even Venezuelan oil minister Humberto Calderon Berti, a relative moderate, snapped: "We are going to remain at \$36... If our clients don't want

to buy our crude at \$36, they can go elsewhere."(60) The larger Saudi goal of price unification within the cartel would continue to elude Yamani and his compatriots. Remarkably, however, demands for any kind of price increase had been reduced to a bare whimper. Even the African hawks grudgingly agreed to the freeze. Their higher priced \$40-41 crudes had been selling particularly poorly in light of the glut. "I can't call it a failure, but I can't call it a complete success," admitted Libyan oil minister Zugaar, "It's somewhere in the middle."(61) After OPEC's price euphoria in the 1970s, however, the middle must have seemed scant consolation.

The major importers of OPEC oil watched these proceedings with a kind of guarded optimism. The Geneva meeting affirmed the fact that the world oil situation would not return to that of the 1970s at any point in the near future. American oil imports had shrunk to 35 percent of U.S. oil consumption, down from 42 percent in April of 1980 and 45 percent the previous year.(62) The United States had also drilled some 65,000 new wells in 1980, and were on pace to drill 75,000 more in 1981. Increased drilling in the North Sea meant that Western Europe could expect its imports to decline from 12.8 million barrels a day in 1979 to 12.5 million by 1985. About 200,000 of those "missing" barrels would have come from the Gulf.(63) "It is possible, theoretically, that the world is now moving into a halcyon time when, unlike the 1970s, there will be no more nasty surprises," wrote the editors of the *Washington Post*.(64)

The United States and its industrialized allies, however, were unwilling to place their bets on such optimistic predictions. Only the United States, with its massive untapped oil reserves, seemed to stand a chance at reestablishing its position vis-à-vis OPEC in any serious way, and that would

probably not occur until the second half of the 1980s. Western Europe and especially Japan (which had virtually no alternative energy sources) would remain dependent on the Gulf and on OPEC, albeit slightly less so.(65) Daniel Yergin, who had argued for Reagan to decontrol oil prices 6 months earlier, warned of a collective “glut psychology” that might keep the industrialized world from developing long-term strategies for using less imported oil. “Important progress has been recorded in the oil consumption of the Western world. But it is much too soon for complacency and self-congratulation. The supply system remains fragile and crisis-prone - making the Western world vulnerable to further oil shocks, and devastating price increases in the years ahead.” Paradoxically, better economic fortunes for the West might lead to an increase in demand for oil and a renewed dependence on OPEC oil. The best long-term plan, argued Yergin, was to maintain efforts toward increased energy efficiency and toward the development of alternative energy sources. Glut psychology, however, might facilitate a lack of interest in such pursuits.(66)

EPILOGUE

In October 1981, OPEC’s members finally came to a pricing agreement. The Saudis would raise their prices from \$32 to \$34 per barrel, while the others agreed to bring overall prices down from \$36 to \$34. World oil prices, as a result of these changes, were to go up between one and two dollars. It would be the last price increase enacted by OPEC until the 1990s.(67) No longer would the West be so powerless and vulnerable to the economic desires of OPEC. The cartel’s period of ascendancy, which had lasted roughly eight years, from October 1973 to October of 1981, was over.

This is not to say that the Iran-Iraq War did not give the Western importing countries cause to worry, particularly

after the spring of 1984, when the Iraqis first began bombing Iranian ships in the Gulf, initiating the so-called “tanker war.” Fearing the scope of Iranian retaliation, the United States sent the Saudi military an arms shipment that included 400 Stinger anti-aircraft missiles and a super-AWACS plane. By 1985, the Iranians began to mine the Straits and used armed patrol boats to attack Kuwait and Saudi boats as well as Iraqi shipping. Late in 1986, the Kuwaiti government asked the U.S.S.R. and the United States if it could put its tankers under either American or Soviet flags, and both responded positively. It was at this point in the war that American policy became obviously pro-Iraqi as well. Reagan condemned the Iranians for their attacks on Gulf shipping while remarking that the Iraqis “had not gone beyond bounds in hitting Iranian vessels which were legitimate economic targets.” Diplomatic recognition had long been denied to the Iraqis, but was finally offered on November 7th, 1984. This orientation towards Iraq would last until its invasion of Kuwait in the summer of 1990.(68)

This invasion, and the subsequent war that followed, proved Yergin’s point about “glut psychology,” made ten years earlier. The United States and the rest of the industrialized world might have forced OPEC to heed the laws of supply and demand. But they had not developed a sufficient solution for their own energy needs that would preclude having to fight wars for the purposes of energy security. Today, as Western energy analysts debate the best possible means of achieving energy independence from an increasingly unstable Middle East, they are grappling with the same essential dilemmas that existed at the start of the Iran-Iraq war.

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NOTES

1. Fiona Venn, The Oil Crisis (London: Pearson Education, 2002), pp. 7-9, 17.
2. The OAPEC continually augmented the boycott's list of targets between October 1973 and June-July 1974, when it finally ended. The initial target was the United States, and by October 20 the Netherlands and Portugal were boycotted as well. Over the next two months, the nations of the OAPEC further refined their policy to encompass four different types of relations with their customers. Oil historian Fiona Venn has described these as follows: 1) "most favored" countries, who could obtain as much oil as they wanted, 2) "preferred" countries, who would receive oil at the levels prevailing in September 1973, 3) neutral countries, whose purchases would reflect prevailing market conditions, and 4) hostile countries, who would be boycotted entirely. This final category eventually included the United States, the Netherlands, Portugal, South Africa, and Rhodesia. See Venn, The Oil Crisis, pp. 17-20.
3. Dilip Hiro, The Longest War (London: Grafton Books, 1989), pp. 40-41.
4. Washington Post (WP), September 22, 1980.
5. New York Times (NYT), September 23, 1980.
6. WP, September 23, 1980.
7. NYT, September 23, 1980.
8. Daniel Yergin, The Prize: The Epic Quest for Oil, Money, and Power (New York: Simon and Schuster, 1992), pp. 703-705.
9. NYT, September 24, 1980.
10. NYT, September 23, 1980. See also NYT, September 24, 1980.
11. NYT, September 24, 1980.
12. Hiro, The Longest War, p. 71.
13. NYT, September 25, 1980.
14. Hobart Rowen, "A Near Empty Policy on Petroleum Reserve: The Shame and Crime of U.S. Policy," WP, September 28, 1980.
15. Yergin, The Prize, pp. 685-687.
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28. NYT, December 1, 1980.
29. Robert Pindyck, "The War and Oil Prices," NYT, December 9, 1980.
30. "Address by the President of the Republic of Indonesia, His Excellency Suharto, at the Opening of the 59th Meeting of the OPEC Conference," OPEC Bulletin, Vol. 21, No. 1, p. 3.
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33. NYT, January 11, 1981.
34. Daniel Yergin and Robert Stobaugh, "Decontrol the Price of Oil Now," NYT, January 3, 1981.
35. Yergin and Stobaugh, "Decontrol the Price of Oil Now."
36. WP, January 11, 1981.
37. Edward Markey, "Decontrol of Oil is No Cure," NYT, January 9, 1981.
38. Joel Jacobson, "Government and the Oil Industry: The Myth and the Reality," NYT, January 11, 1981.
39. Jacobson, "Government and the Oil Industry."
40. "How Republicans Can Avoid An Economic Dunkirk," Christian Science Monitor (CSM), January 29, 1981.
41. Ronald Reagan, "Statement on Signing Executive Order 12287, Providing for the Decontrol of Crude Oil and Refined Petroleum Products," Public Papers of the Presidents of the United States: Ronald Reagan 1981,

- (Washington, D.C.: U.S. Government Printing Office, 1982), p. 45.
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 43. NYT, February 7, 1981.
 44. "Counterstrategy for Consumers," WP, February 14, 1981.
 45. "Iran Strikes Back," Middle East Economic Digest, Vol. 25, No. 2, pp. 9-10.
 46. NYT, January 31, 1981.
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 48. CSM, January 19, 1981.
 49. CSM, February 5, 1981.
 50. NYT, February 10, 1981.
 51. WP, March 14, 1981.
 52. WP, March 21, 1981.
 53. NYT, April 10, 1981.
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 56. NYT, April 24, 1981.
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 60. NYT, May 26, 1981, p. A1.
 61. "OPEC Makes Stopgap Deal," Middle East Economic Digest, Vol. 25, No. 22, p.2.
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 65. Terzian, "The Energy Balance in the Gulf," pp. 43, 47-49.
 66. Daniel Yergin, "The Energy Outlook: Lulled to Sleep by the Oil Glut Mirage," NYT, June 18, 1981.
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