AFTER THE SETTLEMENT:
NEW DIRECTIONS, NEW RELATIONSHIPS

A Summary Record

The 28th Annual Conference

of

The Middle East Institute

Washington, D. C.
October 11-12, 1974

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28th Annual Conference of the Middle East Institute
in Conjunction with Georgetown University

The Mayflower Hotel
Washington, D. C.
October 11-12, 1974

Program

Friday, October 11

8:30 to 9:30 am Registration

9:30 am Opening Remarks

Lucius D. Battle
President, The Middle East Institute

Welcome from Georgetown University

Peter F. Krogh
Dean, School of Foreign Service

10:00 am Keynote Address

George W. Ball, Senior Partner, Lehman Brothers, former Undersecretary of State

10:45 am Plenary Panels

Panel I

PALESTINIANS AND ISRAELIS: RAMIFICATIONS OF SETTLEMENT, MODALITIES OF COOPERATION

Presiding: *Lucius D. Battle*

Amos Elon, Israeli journalist and co-author of Between Enemies: A Compassionate Dialogue between an Israeli and an Arab

Emile A. Nakhleh, Associate Professor of Political Science, Mount St. Mary's College

John P. Richardson, President, American Near East Refugee Aid

12:30 pm — Adjournment for Lunch

2:30 pm

Panel II

THE SUPERPOWERS AND THE MIDDLE EAST: WILL THE RIVALRY CONTINUE?

Presiding: *Majid Khadduri, Distinguished Research Professor and Director, Middle East Studies Program, School of Advanced International Studies, The Johns Hopkins University*

Arnold L. Horelick, Member, Technical Staff, The Rand Corporation

William B. Quandt, Associate Professor of Political Science, University of Pennsylvania

4:00 pm — Concurrent Panels

Panel III

REGIONAL POLITICAL DYNAMICS: HOW WILL SETTLEMENT ENHANCE THE PROSPECTS FOR GENERAL STABILITY?

Presiding: *Robert John Pranger, Director, Foreign and Defense Policy Studies, American Enterprise Institute for Public Policy Research*

Charles D. Cremeans, Research Consultant, Institute for Defense Analyses

Fuad Jabber, Assistant Professor of Political Science, University of California at Los Angeles

Bernard Reich, Associate Professor of Political Science, The George Washington University

Panel IV

THE MIDDLE EAST, EUROPE AND THE THIRD WORLD: WHAT NEW RELATIONSHIPS WILL EMERGE IN LIGHT OF THE GREATLY INCREASED POWER OF THE MIDDLE EAST OIL PRODUCERS?

Presiding: *Parker T. Hart, Special Representative for the Middle East and North Africa, Bechtel Corporation*

Helen A. Kitchen, Director, African Study, Committee on Critical Choices for Americans

A.R.M. De Segonzac, Chief Correspondent, France Soir

Howard Wriggins, Director, Southern Asian Institute, Columbia University

7:00 pm — Cocktails and Banquet

8:00 pm — Dinner

Toastmaster: *Raymond A. Hare, National Chairman, The Middle East Institute*

Banquet Speaker: *Sidney Sober, Deputy Assistant Secretary of State for Near Eastern and South Asian Affairs*

Saturday, October 12

9:30 am — Concurrent Panels

THE NEW ECONOMIC REALITIES

Panel V

THE MIDDLE EAST OIL PRODUCERS AND THE MAJOR IMPORTERS: WOULD SETTLEMENT PAVE THE WAY TO A MORE STABLE AND BALANCED RELATIONSHIP?

Presiding: *George Lenczowski, Professor of Political Science, University of California at Berkeley*

John D. Burn, Second Vice President, Continental Illinois National Bank and Trust Company of Chicago

Richard Erb, Assistant Director, Council on International Economic Policy

John H. Lichtblau, Executive Director, Petroleum Industry Research Foundation

Panel VI

THE DEVELOPMENT OF NEW INDUSTRIES, TECHNOLOGIES AND SKILLS IN THE MIDDLE EAST: WHAT ROLE FOR AMERICANS?

Presiding: *John H. Davis, Chairman of the Board, American Near East Refugee Aid*

Jerome Fried, Research Associate, The Middle East Institute

Joseph J. Malone, President, Middle East Research Associates

Theodore Rosen, Middle East Specialist, Office of Energy Policy, Department of the Treasury

Edward W. Overton, President, Transworld Management Corporation

Panel VII

THE DIALECTIC OF OIL, FOOD AND POPULATION GROWTH: ANARCHY OR POSITIVE INTERDEPENDENCE?

Presiding: *Sidney Sherwood, Member of the Board of Governors, The Middle East Institute*

James W. Howe, Senior Fellow, Overseas Development Council

Robert J. Lapham, Deputy Director and Chief of Evaluation, MCH/FP Unit, The Population Council

John L. Simmons, Education Economist, Population and Human Resources Division, International Bank for Reconstruction and Development

12:00 noon	Summation
	Roderic H. Davison, Professor of History, The George Washington University
12:45 pm	Adjournment of Conference
	Lucius D. Battle

THE PURPOSE AND STARTING ASSUMPTIONS OF THE CONFERENCE

The aim of this year's Conference, titled *"After the Settlement,"* is to look beyond the current process of achieving a reasonably stable peace between Israel and her neighbors to the kinds of new political and economic relationships which may evolve regionally and internationally. These new relationships, the issues and questions they raise will be the subject of discussion to be led by a number of distinguished scholars, government officials and other specialists.

In order to look beyond the 26-year stalemate, or further than the step-by-step negotiations which are a necessary prerequisite, here we make assumptions, without advocacy, on a kind of settlement. They are not a prediction; that would be foolhardy. Nor is "settlement" solution. The latter, in any real sense, probably lies beyond all our powers to conceive.

Therefore, here we assume that some kind of Palestinian entity comes into being. Regardless of precise borders, we assume as well that the West Bank and the Gaza Strip are its basic components. All Palestinians who now consider themselves refugees should have the right to return there, among other options available to them. We make no assumption as to the relationship of this entity with the Kingdom of Jordan, whether on the federal model that King Husayn has mentioned, or another, or none - or as to the future status of Jerusalem.

Recognizing all the difficulties, we also posit that third-party guarantees of this settlement will enable Israel on the one hand, and Syria and Egypt on the other, to accept borders which would not totally satisfy any of them without such guarantees. Having thus dealt with the so-called "confrontation" states, we finally assume that problems between the other Arab states and Israel do not demand early settlement in the way the former seem to do.

KEYNOTE ADDRESS

George W. Ball

The discussion at this conference would have been much simpler had it taken place before the October 1973 war and the events that immediately followed - had it occurred, in other words, thirteen months ago. At that time we could have focussed on the Arab nations and Israel and how they would develop their mutual relations and their relations with the rest of the world once the settlement was achieved.

But with the October war the Arab nations discovered the potency of the political leverage available to them through their control over world oil supplies and, by a confused chain of causation, this led the OPEC countries to discover that, by maintaining a solid front, they could vastly increase their revenues at still somewhat uncertain costs to the whole non-Communist world.

Thus, in considering the subject of today's meeting we cannot confine our discussions solely to those Middle Eastern nations party to an Arab-Israeli settlement. We must also examine the issue and consequences, both economic and political, that result from the fourfold increase in oil prices by non-Arab as well as Arab countries.

Nor, once having assumed that an Arab-Israeli settlement has been effected, can we proceed far without asking what trade offs and accommodations and other factors were involved in that settlement. This is particularly important, for example, in considering Soviet relations with the Middle East and with America and, indeed, the whole complex issue of East-West relations. Is it realistic, for example, to suppose the Arab-Israeli conflict could be finally settled unless the Soviet Union at least refrained from interfering? Moreover, if the Soviet Union does in fact hold its hand, what are the implications of such acquiescence for the future relationships of the Middle East with other nations?

The essential element in the shuttle diplomacy Secretary Kissinger practiced in bringing about the redeployment of forces - the disengagement in the jargon term - first on the Egyptian and then on the Syrian front was not merely that it gave scope to the Secretary's flair for personal diplomacy but that it permitted him to concentrate diplomatic effort within a bilateral setting. Thus it minimized the influence both of the Soviet Union and the activist Arabs - though it did not completely neutralize the activist Arabs since they succeeded in postponing the lifting of the oil embargo, promised when the Egyptian disengagement was agreed on, until efforts to arrange a similar result on the Syrian front were already well underway. Nor can one be quite sure that shuttle diplomacy fully neutralized the Soviet Union, though it certainly made the Soviet role difficult. The Kremlin could hardly have enjoyed the undignified spectacle of Mr. Gromyko rushing into Damascus every time Secretary Kissinger left town, like the frantic suitor of the wife of a traveling salesman.

The hard substantive issues involved in the Arab-Israeli struggle will certainly not be settled by bilateral or - more accurately - trilateral - diplomacy; in fact, that technique has just about run its course. I suspect that Secretary Kissinger would be happy to turn now toward bringing about a final agreement between Egypt and Israel - involving a withdrawal from the Sinai, the determination of agreed borders, the problem of Sharm al-Shaykh, and so on- all issues that would seem soluble if the Israeli-Egyptian problem could be considered as a discrete one. But I doubt very much that the more activist Arab states would permit such a settlement to take place before the difficult substantive issues of Palestine and Jerusalem are resolved. One can take for granted their reluctance to see Egypt opt out of the conflict, in view of its special significance as the largest Arab state. Nor would it seem likely that much could now be done in achieving a disengagement of Israeli and Jordanian forces without raising the tangled problems of the West Bank.

The point to be remembered is that, for quite different reasons, the complex and sensitive issues of a Palestinian entity <u>and</u> of Jerusalem engage the interests of all of the Arab states and thus must be resolved in a multilateral setting - which presumably means Geneva. There are few if any Arab states that do not have an active interest in Palestine since the Palestinian diaspora sent Palestinians all over the Arab world, and there is scarcely an Arab state where individual Palestinians do not play significant roles - very often highly influential roles at the second level of government. Similarly the issue of Jerusalem necessarily engages all of the Arabs but as Muslims since it involves both religious and political issues.

Yet at Geneva, as I have suggested, not only will the more activist Arab states be represented, but the Soviet Union, as co-Chairman, will be able to exercise its influence quietly and directly. So here I find myself in a state of logical confusion. If, as the basis for our discussion, we are to assume that these sensitive issues have been solved, that presumably presupposes that the Soviet Union has played an acquiescent role, for, if it chose to do so, it would probably have the leverage to prevent a settlement. Not only could it encourage the Arab nations to insist on conditions unacceptable to Israel but it could also hold out the option of a military solution as an alternative to a political settlement. The extent of the military buildup in Syria since the October war would suggest that the Soviet Union may be pursuing that course.

I find it hard to believe that the Soviet Union would sit idly by while a settlement was worked out without at least attempting disruptive tactics.

Prior to the October war I took it for granted that the Soviets saw profit in a situation in which tension and turbulence continued to exist between Israel and the Arab world so long as it did not lead to a head on confrontation with the United States. Such turbulence provided the Soviet leaders with an opportunity to improve their beachhead in the Middle East and Mediterranean by capitalizing on Arab disenchantment, while the fact that the Western nations were far from united in their policies with regard to Israel helped divide the Western camp.

Today the Soviet interest in blocking an Arab-Israeli settlement would seem to me even greater, because continued Arab-Israeli tension would presumably help solidify OPEC and hence the continued maintenance of high oil prices that could prove costly and disruptive to the whole non-Communist world. That it is dangerously disruptive seems obvious for there is a sharp difference of opinion among oil-consuming nations with regard both to the urgency and tactics of resolving the oil problem. It is leading individual nations to pursue competitive rather than cooperative lines of action through bilateral oil deals with individual producing states. In Europe and Japan it is contributing to a mounting suspicion of the United States since because of our indigenous oil resources, we appear in a preferred position while at the same time we differ from several of our allies in our special sympathy for Israel.

Beyond that, however, I do not see how the Soviets can look with anything but gratification at the disturbing effect of the present level of high oil prices on the economies of nations within the non-Communist world. If those prices are maintained and the United States does not take the lead in developing adequate facilities for recycling excess oil revenues, the effect of massive capital flows on the financial structure of the market economy countries - the capitalist countries to use a four letter word spelled with ten letters - might over a period of time, prove catastrophic.

Here again one finds the learned economic doctors disagreeing. Some, such as Professor Milton Friedman and the members of his cult, assure us that the existing private banking system is quite capable of handling the reflow of excess oil revenues without serious breakage. Others are equally convinced that, unless an urgent attempt is made not merely to create special facilities for recycling but to engage the producing nations in that effort, the financial structure of the West will be dangerously weakened.

Personally I belong to the latter school though Administration spokesmen seem to be whistling the happier line.

Does the Kremlin in fact wish to see the financial structure of the West in a state of disarray? There are, I know, some who would give a negative answer. They contend that the USSR now has such a stake in the prosperity of the West that it would not wish to see a serious depression, but I find that fanciful. After all, it is written in their sacred books that the capitalist system will ultimately collapse of its own internal inconsistencies and I cannot imagine the Kremlin leaders - brought up as they have been in the Communist Church - wishing to make liars of Marx and Engels when events might vindicate them. Confronted by the possibility of a Western financial collapse they would have every reason to stimulate it - at least so long as they could do so without being blamed for all the consequences.

How then does one account for what appears to me the complacency of the Administration? Is it possible that Secretary Kissinger is counting on some complex strategy to induce the Soviet Union to refrain from playing an obstructionist role in the Arab-Israeli negotiations as part of the strategy of "linkage" - that mystical concept that seems to elude definition? Since the Administration's current posture of happy confidence seems so wildly imprudent and unrealistic on any other assumption, I am tempted to construct some theory of that kind. Convinced as he apparently is that the Soviet leadership is irrevocably committed to the procurement of Western technology and capital, is Mr. Kissinger deliberately holding back on the resolution of East-West trade issues in the hope of pressuring the Kremlin to refrain from playing a negative role in the Arab-Israeli discussions? Could there, in other words, be some special linkage between the abrupt withdrawal of the key letter of assurance in his negotiation with Senator Jackson over the MFN issue and Mr. Kissinger's forthcoming visit to Moscow? That is no more than a whimsical speculation but, since I am by nature a suspicious fellow, I confess it has crossed my mind.

Let us turn for a moment from a consideration of the connection between an Arab-Israeli settlement and détente - that ambiguous French word which even the French do not seem to understand - to the relations between the Middle Eastern nations and both the non-Communist industrial nations and the Third World. At this point it is necessary to make some further assumptions. If, for example, the OPEC nations hang together and maintain something close to the present level of high oil prices - or even increase those prices to keep pace with the increasing cost of other commodities - will tensions between the consuming nations and the OPEC countries continue to build up, or will some kind of reconciliation be attempted?

At the moment I find that question difficult to answer, partly because the current Administration seems opposed to exploring the possibilities of a combined effort between the producing and consuming nations to mitigate the effect of the massive flow of oil dollars in the world financial structure.

I can only assume that this reflects the tactical preference of the Secretary of State for bilateral diplomacy based on a concern that discussions either with OAPEC or OPEC would tend to freeze the producing nations in a common position largely determined by their most activist and intransigent members. But there is danger that we ourselves may be too doctrinally rigid on this point. Certainly we are getting nowhere by the present posture of impotent confrontation. Within the past month - presumably more from frustration than logic - both President Ford and Mr. Kissinger have been led to make muttering noises with strong overtones of sturm und drang that have, I suspect, done more to consolidate the opposition within the OPEC countries than to impress them with the wrath to come.

I hope that the Administration's present attitude, which seems to oscillate between dire predictions of disaster and blissful inaction, is a transient aberration and that, if the level of oil prices is maintained - as I suspect it will be - some serious conversations can be undertaken to try to ease the strains of massive capital movements on the world financial structure.

If that does, in fact, occur it could mark a major step not merely in the political development of the Middle Eastern members of OPEC but in their political and economic relationships with the industrialized nations of the West. But cooperation can be achieved, it seems to me, only if the industrialized nations are willing to deal with the OPEC nations on a basis of equality and shared responsibility. If the present oil price levels continue several of the OPEC countries will become so rich that they will be not only able but obligated to play a significant role in world affairs. As they build an adequate infrastructure and increase their absorptive capacity they can concentrate an increasing share of their current revenues on their own development. Beyond that, they can and no doubt will assist the development of the nations of the Middle East that do not produce much oil. Some, in fact, are already making a considerable effort in that direction - and even extending their assistance to less developed countries outside the area. If this were an almost perfect world one might even hope that - with a settlement achieved - Israel could contribute technological resources to help make the Middle Eastern deserts blossom, while the Western industrialized nations and Japan could stimulate the economic evolution of the area by trading technology and equipment for oil.

It will, of course, take some time before many of the Middle Eastern states develop a sufficient body of educated, sophisticated technical people to be able to operate on their own. But that should begin to come about in a generation or two.

If one is to make an optimistic forecast for the nations of the Middle East the first assumption should, of course, be the one we have been given as the basis for this meeting - that the Arab-Israeli conflict is settled. That will mean, of course, that the world need no longer remain in fear of a new oil embargo and that a dangerous area of turbulence has been removed. A second assumption would be that oil prices decline yet remain sufficiently high to provide ample revenues for the rapid development of the Middle Eastern countries and that either through some decline in prices or effective cooperation between the consuming and producing nations in the development of recycling mechanisms, the world financial system is saved from major disruption. The third is that the Soviet Union ceases to stir up discontent and dissension in the area and that the peaceful settlement becomes a permanent aspect of the Middle Eastern scene.

In the course of these few brief comments I have suggested a number of considerations that cast doubt on the reality of these assumptions, and there is one more which it seems to me particularly important. That is the tendency of nations through out the area to use their excess revenues to fill up the desert with tanks, F-4's, and more and more sophisticated weapons. At the moment the Middle East is rapidly becoming a gigantic arsenal, and, though the purchase of tanks and airplanes and rockets no doubt assists the process of recycling oil dollars, it still has ominous implications.

The immediate effect of these large programs of military procurement is, of course, to accentuate the dangers of another Arab-Israeli explosion. But it is not merely the Arabs and Israelis who are building vast arsenals. The most ambitious of all is Iran. The Shah's justification for this is, at least for the time-being, that Iran has inherited the essential role of protector of the Persian Gulf and the vast oil resources to which it provides access. With British withdrawal from East of Suez and the appearance of at least token Soviet fleet units in the Indian Ocean, that argument has plausibility - at least within limits - yet the viability and magnitude of the Iranian buildup is causing apprehensions on the other side of the Gulf, and one hears bits and pieces of speculation that Iran may seek to extend its influence Eastward as well as Westward.

If détente meant what many people like to think it means and the Soviet Union were genuinely eager to help restore tranquility to the Middle East, it might be possible to reach an agreement between Moscow and the West to limit the flow of arms into the area. That would, in fact, be a significant test of détente, but it is not a test Moscow is likely to pass on the basis of any evidence observable so far.

A more pessimistic hypothesis is that, even though the Arab-Israeli issue is settled, the OPEC countries will continue to maintain oil prices at something approaching the present high level, that a spirit of confrontation will persist between the oil-producing and the oil-consuming countries, and that capital flows to the producing countries will seriously strain the financial fabric of the West even to the point of serious breakdown.

The consequences of such an evolution of events are hard to predict, and even the contemplation of such a possibility creates such frustration as to lead to fanciful and violent speculations which reflect not only fear but a kind of atavistic colonialist reaction. How dare a group of relatively small nations, recently poor and relatively undeveloped, exact such heavy "tribute" - that is the word normally used - from the industrialized Western nations, some of which have long dominated the area!

The threats inspired by these frustrations, anxieties and injured pride will not be carried out. The Western nations will not undertake to redress this situation by economic sanctions or the denial of military hardware. Because of the exiguous magnitude of their requirements in relation to world supply the OPEC nations cannot be brought to heel by economic sanctions nor would the West have the discipline to impose them were it possible to do so. Though they might have to shift to the Soviet Union for some supplies the oil-producing nations would be able to buy the commodities and equipment they needed and even the military hardware they desired. That the Kremlin would be prepared to assist the process seems clear enough since it would give it an unparalleled chance to extend its power and influence.

Even less should one take seriously dark mutterings about a possible military solution. Whenever one hears such talk in Europe - where it especially prevails - it invariably means that the Europeans expect America to use her planes and tanks and marines for that purpose. But such a prospect is an archaic fantasy.

This, after all, is no longer the nineteenth century. One might assume we had fully settled the question of such military adventures when we forced the British and French to pull back from Suez in 1956, but if that were not the case, developments since then have rendered the issue moot. For this is a period of nuclear parity and strategic stalemate.

There is a powerful Soviet fleet in the Mediterranean, Soviet missiles targeted on major Western capitals, the Soviet Union has a substantial position in the Middle East, and it does not intend to abandon it. There is, moreover, an absolute assurance that any military move by one superpower in that area would be countered by the other, as was demonstrated a year ago at the time of the American worldwide military alert. So no one should take the current bellicose utterances seriously. No responsible government in Washington will turn the oil-producing areas of the Middle East into a nuclear Armageddon.

Still, if the international financial system does suffer damage and nations are driven to reduce standards of living as a result of deterioration of their international accounts, resentment against the OPEC countries could prevent them from playing the economic and even the political roles to which they are entitled by virtue of their accumulating wealth. That would, in my judgment, be a misfortune which I would certainly hope we will have the foresight and good judgment to prevent.

What is needed now on the part of the American people and the other nations of the West is first and foremost a greater degree of maturity than we have so far displayed. What is required, among other things, is an effort to understand the situation as it appears from the point of view of the countries blessed with what is currently a monopolistic position with regard to energy. In other words, if we are to avoid irresponsible reactions, we should try to see the problem as it looks from Riyadh or Kuwayt or Tehran. If the consuming countries regard the OPEC countries as indulging in conduct that verges on extortion, the OPEC countries consider that they are behaving reasonably. They recall that the world for many years enjoyed the benefits of extremely cheap energy or that for a long period of time, as they see it, the terms of trade moved consistently against them. Had they not taken their recent price actions they would, in their view, have been further penalized by rapid rises in the prices of manufactured goods, raw materials and the foodstuffs they needed to import.

Thus the OPEC countries believe that they have done little more than correct - or perhaps slightly anticipate - an inequity in the terms of trade. Though many of us in the oil-consuming nations feel, on the other hand, that they have created a new inequity by overcompensating for past disadvantages, we would still be well advised to acknowledge the broad direction of their logic, since only in that way will we be able to approach the problem with some comprehension as to how it is seen in the Middle East. No matter how strongly we feel that the OPEC analysis is totally wrong-headed, we must still recognize that it is a matter of deep conviction throughout the area and thus constitutes a political fact that cannot be ignored. "What is truth on this side of the Pyrenees," Blaise Pascal once wrote, "is error on the other."

I would hope that in the course of the discussions to follow we may gain a considerably clearer picture of what a post-settlement Middle East might look like. All I have sought to do is to raise a few questions, most of which I do not have the wit to answer.

PALESTINIANS AND ISRAELIS: RAMIFICATIONS OF SETTLEMENT, MODALITIES OF COOPERATION

It is difficult today to see the road to peace in the Middle East. In the short run the role of the Soviet Union is crucial for the achievement of a settlement. But in the long run there will be no true peace short of compromise between the Palestinians and the Israelis. Two rights - and justices - clashed in Palestine and compromise is necessary not only for practical reasons, but for moral ones as well. Martin Buber and Judas Magnes went further than other Zionists in the attempt at conciliation but even Ben Gurion and Weizmann advocated "parity," i.e. binationalism, in the 1930s. Many opportunities for peace were missed between then and now.

Palestinian Arabs and Israelis should let bygones be bygones and plan for a repartition of Palestine within a multilateral settlement. The Palestinians must find their own identity, just as the Jews did. Their problems, such as those with King Husayn, should be solved by themselves. Their right to self-determination, if they are willing to live in peace with their neighbors, should be recognized. But no dramatic reconciliation should be expected, but rather a slow process of accommodation in a search for a better life based on turning a new leaf.

The tragic sense does not exist in the traditions of Judaism or Islam, yet the Palestinian Arabs and Israelis are locked in the entrails of a high Greek tragedy. The sooner it is realized that no one is completely right or completely wrong, the sooner the accommodation can begin.

What configuration would an Arab Palestinian entity take and who would administer it? To examine these possibilities, it must be assumed that "some kind of Palestinian entity" would include the West Bank and Gaza. A second premise is that Palestinians living elsewhere would be entitled to come and live in the new entity. A third premise is that the economy would become robust enough (through internal activity and external support) to keep the entity alive. A fourth premise is that the new entity's political relations with its immediate neighbors would be sufficiently benign to permit national energies to be applied to major internal tasks.

The current population of the West Bank and Gaza is estimated at more than one million. Agriculture is the most important feature of the economy both in employment and income. The West Bank also has a tradition of entrepreneurship. Although university education is available to only a small portion of the population, the secondary certificate is earned by some 4,000 students each year. They would be well suited for technical training that could be utilized in the new entity. Although the number of Palestinians who might return to the new entity can not be estimated, the high level of education and achievement of Palestinians in the diaspora is a talent pool of great potential.

Creation of a Palestine entity would very likely generate development assistance from friendly states and international organizations. Such assistance would have to be channeled through mechanisms to be established in the new entity. Pre-existing institutions could play an important role in establishment of the national mechanisms. These institutions are both governmental and non-governmental and the best equipped and best qualified are the non-governmental. This network - of schools from kindergarten through university, including special training schools, women's programs and social welfare organizations - is already contributing to the longer term goals of economic and social development of the region. These institutions have leadership, physical plant, established patterns of activity and acceptability to the people in the region. Significant expansion of activities would be possible with increased funding.

The largest channel of development in the Gaza and on the West Bank is UNRWA, with an experienced Palestinian staff. If UNRWA were phased out in the context of peace, its plant and personnel could remain intact to handle training and absorption of large numbers of immigrants. Most of the estimated 100 non-governmental institutions rely on the dedication of a small group of talented and committed individuals, the programs usually serving the needs in the immediate area. Such organizations could be strengthened by closer communication through shared information and policies.

Development of institutions is only one facet of the complex challenges of a Palestinian entity. But the potential of area institutions shows that much progress can be made now, in preparation for a future existence of this territory and its people. If the dedicated but financially hard-pressed institutions in the area could obtain much-needed expansion funds, they would be all the more able to play an active role in the future of the West Bank and Gaza.

Looking to the future requires the transition from the concept of "entity" to that of "statehood." In order to analyze the regional/international behavior of a future Palestinian state at least two models can be utilized. The first model, often referred to as a "realist" approach, starts with the basic assumption that international politics is a reflection of a world of nation states, each pursuing its own national interest and cooperating only when common problems are perceived.

A second and more novel model is that of "world order." This approach is based on two assumptions:

1. Basic human problems, the substance of international politics, are too broad in scope to be understood within the framework of nation states;
2. These problems are of serious importance because human survival itself is threatened.

Five basic values are central to this approach: peace, ecological stability based on limited growth, economic well-being based on the redistribution of wealth, social justice and participation based on a larger role for the individual in decision making.

The two models differ in three primary areas:

1. The role of the nation state in future world order;
2. The definition of national security and power; and
3. The degree to which major problems are seen as interrelated problems.

The intricate nature of the present Palestine conflict and the complexity of the peace that will follow clearly indicate that either of these two approaches to international relations would, if applied to a new Palestinian state, operate under very serious constraints. Although this Conference approaches the new Palestinian state from a nation state perspective, the regional and international nature of the problems which the new state must face can readily be seen. Such problems as the exchange, relocation or resettlement of population, economic development, commercial activity and political and administrative restructuring are basically transnational. The solutions to any of these problems would by geographic necessity involve such other countries as Israel, Jordan and Lebanon, and most likely Syria and Egypt. Also any credible international guarantees governing the establishment of the new state will definitely involve the superpowers. A synthesis of the nation state and world order models will perhaps prove to be the best tool for understanding the regional role of the new state in Palestine.

However, the operative assumption of the present Conference falls within the nation-state approach. Specifically, a Palestinian state would be created somewhere on a part of Palestine as a realization of the national aspirations of the Palestinian people. This assumption is based on three principles:

1. A Palestinian state in Palestine would re-establish a natural relationship between the people and the land - a basic requirement for statehood under international law.
2. By giving the homeless a home, this solution would reduce the potential of organized violence and hence contribute to the management of conflict.
3. The establishment of a Palestinian state by negotiation would

contribute to the normalization of commercial intercourse and hence further the cause of economic stability in the region.

It is assumed that a Palestinian state will be created. It is now necessary to look into the future behavior of this new state and determine the extent of its positive contribution to regional harmony.

In order to deal with the "ramifications of settlement and modalities of cooperation," one must examine the behavior of the new state in relation to at least three issues: the viability (economic and political) of the Palestinian state, the responsibility of such a state and the contribution of the new state to international peace. To analyze these issues, four dimensions of the new state must be stressed:

1. The psychological dimension;
2. The political dimension;
3. The legal dimension;
4. The economic dimension.

The Psychological Dimension

Statehood and nation building, following on the heels of a generation long conflict and a several years old war of national liberation, would naturally be marked by very deep psychological experiences which would require long and painful adjustments. The formative years in the life of any state are extremely sensitive and demand optimum patience and understanding. The crises of nation building are varied and complicated. The international behavior of the new state will definitely reflect the internal agonies of its birth. The psychology of statehood and the massive political socialization required to overcome the crisis of identity, the first in a series of statehood crises, must be thoroughly understood if one is meaningfully to analyze the behavior of the new Palestinian state.

The inhabitants of the new Palestine will experience the full trauma and euphoria of statehood, and in time they will undoubtedly adjust to these experiences. The Palestinians in the new state must be allowed time to adjust to their new condition. Once the crisis of identity is overcome, the new state can chart a path of cooperation with its two closest neighbors: Israel and Jordan. In practical terms, the most that these neighbors can hope for in terms of the new state's willingness and ability to cooperate is for Palestine to discharge only those specific regional and international obligations that were dictated by the agreement which created the state. During this period also the new state must make the psychological adjustments necessary to plan for cooperative programs in population exchange, public services and marketing of crops.

The Political Dimension

The political context into which the new Palestinian state will be born is familiar to all. Whatever political structure and national ideology the new state will profess, it is bound to find allies and adversaries among its neighbors. Ideologically, the new state will not be an alien growth in the region. Most likely, the new state will be a republic based on representative government. The religious makeup of the Palestinian population will most likely dictate that religious tolerance become an operative principle in the new Palestine. In addition, the new state will probably support the principle of participatory democracy, for lack of a better term. On ideological grounds, the new state will find ample common grounds for cooperation with its neighbors, especially when the citizenry is apprised of the benefits of such cooperation.

Administratively, non-governmental institutions already in existence could significantly contribute to the bureaucracy of the new state as well as the state's economic and social progress.

The Legal Dimension

Legally, the new Palestinian state will be created as a result of negotiations which would include its neighbors, the superpowers and international organizations. The new state should expect to enjoy full statehood, as the term is defined in the United Nations Charter. It will have rights and duties, and it will be expected to adhere to the principles ennuciated by the Charter. The expected cooperation between the new Palestinian state and its neighbors will obviously be a function of its sovereign existence as a fully independent state.

In the light of the present conflict, the new Palestinian state's most difficult responsibility would be a commitment to the pacific settlement of disputes and a rejection of aggression. However, from a practical point of view and in all candor, the most that can be expected is that the new Palestinian state would be, in terms of legal responsibility, no less responsible than its neighbors. As a sovereign state, the new Palestine state cannot, and should not, be expected to be more conscientious in its obligations and responsibilities than its neighbors. The degree of consensual and voluntary compliance with the dictates of international law expected of the new Palestinian state cannot be different from that expected of its neighbors.

However, because of the nature of the Palestinian conflict, the new state will find it necessary, indeed imperative, to cooperate with its neighbors. Such issues as displaced persons, statelessness and economic and cultural exchanges will require the new state to negotiate with its neighbors, perhaps under the auspices of the United Nations, for a solution.

The Economic Dimension

Political stability and economic viability are opposite sides of the same coin. This twin relationship cannot be more obvious than in the case of the new Palestinian state. In a context of cooperation between the new Palestinian state and its neighbors, it is possible to develop a viable economy on the West Bank. Such cooperation would include sharing Jerusalem's tourist earnings and trade agreements with Israel and Jordan. This type of cooperation would certainly seem to be possible.

In conclusion, the new Palestinian state has all the makings of a responsible, viable and open society. If, as was originally postulated, the creation of the new Palestine will usher in a generation of peace in the Middle East, the risk of statehood is well worth taking.

THE SUPERPOWERS AND THE MIDDLE EAST: WILL THE RIVALRY CONTINUE?

Long before the present Western superpowers interacted in the Middle East, other "superpowers" wielded considerable influence in the area. Foreign conflict and competition of varying degrees has indeed permeated the history of the Middle East. Current problems and conflict are internal in nature, yet superpowers have effectively intervened and continue to exert some degree of control. In a post-settlement period, what will be the roles of the two superpowers, the United States and Soviet Union, in the Middle East?

Prospects of settlement in the Middle East present the Soviet Union with a complex dilemma. While it is clear that the United States favors settlement in the Middle East, Soviet attitudes toward settlement are multi-faceted. Although settlement may reduce the risk of confrontation with the United States, peace in the Middle East would also serve to reduce substantially Soviet influence in the area. The character of a settlement in the region is of utmost concern to Moscow, i.e. the satisfaction of local parties involved, the extent and character of the residual tensions left in the wake of settlement and new ones created as its consequence, and the impact of these factors on subsequent relations with both the United States and Soviet Union. Thus the Soviet Union, in the face of increasing American leverage and consequent responsibility, remains passive, with a stock of alternative postures during the negotiatory process depending on assessment of Soviet interests at any given moment.

A totally passive Soviet role, however, would prove disappointing to those Arab factions seeking Soviet support for their partisan preferences. One might expect, for example, Soviet alignment with Cairo. The recent action of the USSR toward adopting the cause of the PLO reflects Soviet strategy in this matter. While providing the Soviet Union with the possibility of obstructing progress toward a settlement by supporting positions that the United States could not bring Israel to accept, PLO support also serves to woo potential clients among the least satisfied Arabs, should settlement nevertheless be negotiated.

Arms supply remains the dominant factor of superpower leverage in the Middle East. Although a peaceful settlement might conceivably reduce the appetite for weapons, it would not totally eliminate it. Soviet-American agreements might include some sort of arms transfer restrictions, yet even a resemblance to an embargo is doubtful. Competition in arms supply will continue. Moreover, resulting transfers of territory after a settlement will probably result in at least a short term military buildup for security purposes.

The future of Soviet-Egyptian relations may well be the key to the future of any forthcoming settlement. Egypt is sure to come out of any settlement the most satisfied Arab party, in a position to improve relations with the United States and the West in the post settlement period. It is not a prospect relished by the Soviet Union.

The world energy situation constitutes a dramatic factor in superpower rivalry in the Middle East. The Arab-Israeli conflict can most assuredly exacerbate the oil crisis, but a settlement will in itself hardly resolve it. The Soviet Union stands to benefit from continued stresses and tensions associated with escalated costs of energy. However, there is little Moscow can do, independently, either to cause major disruptions in the world energy market or to ameliorate the situation. A rapid rate of growth in Soviet energy production may well increase Soviet maneuvering capability in the international energy market, yet leaves little hope of substantial influence in the formulation of a common international energy policy aimed at warding off an acute energy crisis.

* * *

The US position on settlement in the Middle East is considerably more concise. The following discussion is based on the assumption that the United States strongly favors a settlement, for, in that environment, US interests will be most easily pursued. An overall survey will reflect ever improving American relations with each country in the Middle East.

American-Israeli relations will inevitably be stronger after settlement in the Middle East. United States persuasion is fundamental in bringing Israel to settlement, particularly to give up territory. As a result, the United States, at minimum, will have to assure Israel of continuing arms support; at maximum, a security treaty may result.

Future Palestinian-US relations are much less predictable. However, the United States will most assuredly want to support whatever political entity lies to the east of Israel, especially if it includes the West Bank and provides a basis for refugee settlement. The United States will want to insure Jordan-Palestine from being an area of Soviet influence. As in the case of Israel, American-Palestinian relations will grow increasingly closer.

The two Arab countries of particular interest to the United States are Egypt and Saudi Arabia. Because Egypt will be the key to maintenance of Arab-Israeli stability, the United States will try to establish a "special relationship" with Cairo. Inability to provide long term aid will probably lead the United States to seek a partner in aiding Egypt; Saudi Arabia is the likely candidate. Washington will continue efforts to provide incentives to keep oil production at high levels, involving aid in industrialization of Saudi Arabia and joint development/investment projects in Egypt.

American arms supply to Egypt is a strong possibility in a post settlement period. The recent alleged Soviet cutback on arms to Egypt has created a new uncertain situation. The question of how badly this cutback has hurt Egypt is debatable. In any case, any US arms support to Egypt would carry with it the usual American "strings" attached to such aid, i.e. prohibition of any third party transfers and offensive use of American arms. Conflict with Israel will remain the major consideration in any arms deal with Egypt. Israel would indeed make it difficult for the existence of such an American change in policy. Israel has formidable influence in the United States, and any administration supplying arms to Egypt would suffer the wrath of strong pro-Israeli sentiments within the United States.

Although US priorities for improved relations with Middle Eastern countries rest with Egypt and Saudi Arabia, other countries in the area will also experience overall improving relations with Washington. Iraq, another large oil producer, will establish a similar relationship as Egypt with the United States. As for the Northern Tier (Turkey and Iran), there will be little substantial difference in American relations after a settlement.

Oil will continue to be a key factor in American-Middle Eastern relations. The United States, now concerned with the need of imported oil, will be actively involved with physical supply, prices, and especially the recycling of petrodollars. Iran and Saudi Arabia will prove keys to these problems. The major United States objective will be to prevent conflict between Iran and Saudi Arabia from emerging.

Thus, settlement in the Middle East will not lead the United States to reduce involvement, but rather be more selective in their relations and less directly competitive with the Soviet Union. The basic premise of future United States policy will be that the United States can have close relations with Israel <u>and</u> the Arab nations.

American-Soviet rivalry will not be eliminated in the area after a settlement. The United States will not go out of its way to include the Soviets in any peacekeeping arrangements (e.g. UN forces, formal guarantees). The United States will try to minimize Soviet influence in key areas of interest but will not concern itself with "normal" Soviet presence and relations. Above all, the United States will not want to give the impression that it is determined to expel all Soviet influence from the area.

In sum, the United States will become deeply but selectively involved in the area, coupled with less competition *vis-à-vis* the Soviet Union. There will be avid American interest in oil, development, recycling, transfer of technology and arms supply. The United States influence will not be overwhelming, as settlement will probably render the Middle Eastern countries increasingly autonomous.

The most dangerous aspect of post settlement American-Middle Eastern relations will stem from the responsibility the United States will have adopted as guarantor of the settlement. If the settlement does not hold, the United States will once again face the dilemma of sacrificing one set of interests for another. US-Israeli relationships would probably take precedence, with considerable risk of damaged US-Arab ties. The Soviets, in turn, would have ample opportunity to exploit the situation to their own advantage. Thus the prevention of this scenario will be the major US objective, reflecting the necessity for continuing American involvement after a settlement.

REGIONAL POLITICAL DYNAMICS: HOW WILL SETTLEMENT ENHANCE THE PROSPECTS FOR GENERAL STABILITY?

A peace settlement between the Arab countries and Israel may appear to many observers to be a utopian fantasy after more than a quarter century of hostility and violence, yet the prospects for such an agreement have never seemed so bright. It is worth considering, therefore, what the effect of a peace settlement might be on the domestic affairs of the countries in the region and on their relations with each other. Would a settlement lead to regional stability and under what conditions? What factors are likely to play a major role in shaping relations between the Israeli and Arab states in the post-settlement period? What would be the effect on those countries of the area which are not directly involved in the dispute, such as Turkey and Iran? These are some of the questions which need to be considered as we reflect on the possible course of future events in the Middle East.

From the vantage point of the Arab states, the specific nature of the peace settlement itself is likely to be the most important factor affecting subsequent Arab-Israeli relations. In this respect one of three alternative situations is likely to emerge in the post-settlement period, depending on the comprehensiveness of any political agreement and, more importantly, on the provisions for the establishment of a viable Palestinian entity. Assuming that the two sides are able to reach a negotiated settlement in which most major issues are resolved and to which both are committed, a slow but steady progression toward normal relations would be the likely outcome. Over time, this could be expected to lead to economic and political cooperation between Israel and the Arab countries, to a general reduction of tensions in the region and finally to a winding down of the arms race as each side gained confidence in the sincerity and good intentions of its opponent. The end result would be regional stability.

Stable relations might also emerge from a less comprehensive settlement in which some major issues were left unresolved, but they would be the result of a balance of terror rather than a process of reconciliation. In this case peaceful but armed and suspicious coexistence would be the main characteristic of Arab-Israeli relations. Diplomatic recognition would be afforded by both sides, but economic, political and human contacts would be extremely limited. Arab fears of Zionist expansion and Israeli suspicions of Arab irredentism would continue to fuel the arms race with a nuclear balance of terror one of the possible results. Yet, in spite of the grimness of such an Arab-Israeli cold war, it could reduce the possibility of armed conflict compared to the present state of tension and provide the foundation for relative stability in the area.

A third alternative is continued instability resulting from the inability of the parties to agree on the status of a new Palestinian entity and to make provisions for its economic viability. This is the *sine qua non* of any permanent settlement to the Arab-Israeli dispute and, regardless of the degree of agreement reached on other issues, the failure to provide for the establishment of a Palestine entity or to institutionalize its relations with Jordan and Israel would inevitably lead to further conflict and perhaps to the creation of a regional Baluchistan.

Post settlement relations among the Arab countries will also depend to a large extent on the character of the agreement reached with Israel. In the past inter-Arab politics have generally revolved around two core issues. The first is Arab nationalism and its embodiment in the political union of all Arab states. The attempt to realize this dream has itself divided the various states into rival factions for power and leadership and has resulted in more sound and fury than substantive achievements. The second line of cleavage separates the so-called "progressive states" from the conservative regimes in the area. Incompatible visions of society and politics have led to bitter hostility and at times violent action between the two camps, thus further diminishing the hope of unity. Since 1967 these inter-Arab disputes have been quiescent in the face of the external threat posed by Israel and its occupation of Arab lands. However, if a permanent solution is found similar to the first alternative discussed above, these ideological rivalries may well reassert themselves as the perception of an outside threat rescinds into the background. On the other hand, if a peace settlement should result in continued instability or at best in peaceful coexistence coupled with mutual suspicion and an increasing arms build-up, these disputes may well remain latent as long as attention is focused on Israel.

Nevertheless, if inter-Arab relations do become more important after a settlement, they are likely to have a different quality compared to the situation before the June War. Two factors not present in the earlier period can be expected to reduce conflict and rivalries among the various Arab states. The first of these is the rapid increase in recent years of disposable income derived from surplus oil revenues. Saudi Arabia, for example, has helped to finance Egypt's war effort and this should help to foster good relations between them compared to the open hostility which existed when Nasser was President of Egypt and the two countries backed rival factions in the Yemen civil war. The second factor is the emergence of a new style of Arab political leadership best exemplified by Sadat of Egypt and Boumedienne of Algeria. Both of these leaders are more pragmatic than their predecessors and are likely to pursue the goal of Arab unity much more cautiously than was true in the past. Both of these factors cut across former ideological lines and can be expected to encourage moderate policies aimed at cooperation among the Arab countries rather than confrontation. In this respect the Arabs have learned from their past experiences and in the future Arab unity schemes will almost certainly be pursued more slowly by building on lower level contacts and exchanges of ideas and information, rather than by quick but ultimately ineffective agreements between national leaders. The contacts now being carried out between Sudan and Egypt in which various joint commissions have been established to work out plans for union over the long term and which envision annual meetings between the presidents of the two countries give an indication of how the goal of Arab unity is likely to be pursued in the future. The union of Egypt, Libya and Syria, on the other hand, is best seen as a tactical maneuver within the overall strategy of the confrontation with Israel rather than a continuation of past policies of union, as the subsequent cautious attitude of Egypt toward Libya clearly demonstrates.

There is, therefore, some reason to be optimistic about the future course of relations among the Arab states in the post-settlement period. But the best indicator of the future will almost certainly be the nature of the agreements concerning the establishment of a viable Palestinian entity. It remains the vital precondition for any lasting settlement.

Many of these same factors will have their affect on Israel as well. The character of the peace settlement and Israeli estimates of the sincerity of the Arabs in living up to the agreement will be the primary considerations in any decision to curtail the arms race. Traditional Israeli self reliance in military matters is symptomatic of the view that no outside power can be totally relied on for assistance should a settlement break down. Therefore, Israel will seek guarantees and can be expected to test Arab compliance with various treaty provisions before she feels confident enough to reduce her military commitment.

If the Israelis are convinced that a "real" settlement has been achieved, there will be a decrease in Israeli dependence on outside powers for economic and military aid. This will mean a reduction of US influence on government policy, though relations between the two countries will continue to be close. Under these conditions the possibility also exists that relations would be restored with the Soviet Union and with other Third World countries in Africa and Asia. All of this would inevitably lead to a revaluation of security and foreign policy which up to now has been predicated on the hostility of the Arab states and the vulnerability of the state in its present condition of diplomatic isolation. As sensitivity to these concerns are reduced, one can expect a transfer of funds and personnel away from defense, thus making more capital and manpower available for other domestic needs such as housing and education.

The new availablity of such funds will also provide incentives for a renewed debate on domestic priorities within Israel itself. The role of religion in Israeli society, questions of social status and the political participation of the young and of Oriental Jews can be expected to come to the fore as the external threat diminishes. Such a debate on domestic policy questions will have the tendency to unleash centrifugal forces within Israel, but these differences are not likely to reach the boiling point. There is adequate room for compromise on most issues: the economic debate between those who would like to see free enterprise capitalism on the one hand and socialists on the other might well find common ground in the desire for a society with a high standard of living for all and orthodox Jews and secularists could compromise by agreeing on the existence of a Jewish state. Even a debate on the future course of Arab-Israeli relations might find its resolution in the point of view that no war is better than war.

In terms of foreign policy, one of the most important aspects of the post-settlement period will be Israel's relationship with any new Palestinian state based on the West Bank and the Gaza Strip. The establishment of such an entity would, of course, depend on the nature of the peace settlement, but the Israelis, once convinced that the Arabs are serious, are prepared to deal with Palestinian groups who are willing to live with Israel. Apart from this, there would have to be coöperative relationship between the two states by the very nature of their geographical position. Agricultural development, technical assistance, transport and, at least in the initial phase, a continuation of the present policy of employing Arab labor in the Israeli economy are all areas of potential cooperation between the two states which could have mutually beneficial effects. From the Israeli point of view, such contacts could be the beginning of wider contacts with the rest of the Arab world, perhaps leading to a situation in which Israel could again become a major connecting link between the Eastern and Western Arab lands, a traditional function performed by Palestine before the creation of the State of Israel. The realization of this kind of cooperative relationship would clearly enhance the prospects for regional stability; it would also benefit United States' interests in the region, while reducing the potential for great power, as well as local, conflict.

In general, the achievement of a lasting political settlement will both open up new opportunities for regional stability and introduce destabilizing factors into Israeli society. In the long run, however, the prospects for regional cooperation and peace will outweigh any negative effects on internal Israeli politics.

For the peripheral states of Turkey and Iran, a settlement of the Arab-Israeli conflict would not bring any important changes either to their domestic policies or to their relations with other states in the Middle East. Neither country has natural allies among the disputants and both are unique in culture, language and history. More importantly, Turkey's interests have been focused on her relationship with Europe and the United States rather than in the Middle East area itself, and, though Iran aspires to play a major role in the Gulf area and the Indian Ocean, the Shah has great power ambitions extending beyond the limits of regional politics. As a result, an agreement between the Arabs and Israel is unlikely to have any important effect on the policies of either country.

Of the two, Turkey has the least interest in the region and the weakest institutional links. Once the overlord of much of the Middle East, Turkey has almost exclusively focused on her own national development and on her relationship with the West since the Kemalist Revolution of the 1920s. In more recent times Turkey's relationship with the United States, her fear of the Soviet Union and membership in NATO have been the primary determinants of foreign policy and, as a result, the Turks have been willing to accept Israel's claim to nationhood and to deal with Israel in spite of Arab hostility. If a settlement is reached, there would be little change in this respect, though contacts would probably be pursued more openly than has been true in the past.

By the same token, Turkey's relations with the United States as a friend and ally are much more important, and it is here that problems have emerged in recent years. The role played by the US in the Cyprus crises in the 1960s, the current debate over continued arms supplies to Turkey and the disagreement over the Turkish government's decision to reintroduce poppy cultivation have produced strains in the alliance which the current mood of détente between the Soviet Union and the US can only encourage. If these issues are not satisfactorily resolved, Turkey's relationship with the US might well change and, although Turkey will continue to be conscious of the power of the Soviet Union and would not, therefore, take any precipitate action to cut off relations with the US and NATO, she might, nevertheless, view the USSR increasingly in terms of potential trading partner and supplier of arms.

For the time being, therefore, Turkey seems likely to continue to focus on her own national political and economic problems, on Cyprus and her relations with Greece and on a changing relationship with the US and USSR. This will mean a continued aloofness from the problems of the Middle East, though geographic proximity and problems related to oil supplies and the Soviet role in the region may pull Turkey into regional affairs, despite her strong disposition to the contrary.

Iran, too, is concerned with domestic development but, unlike Turkey, the Shah is also eager to parlay oil dollars into influence and power on the international stage. Just as the Shah celebrated the 2500th anniversary of his throne in the style befitting an Emperor, so now he offers to buy or bail out German steel companies, American aircraft firms and the French nuclear reactor industry. Closer to home the Shah seeks to proclaim the Indian Ocean a zone of peace and to set himself up as the gatekeeper of the Straits of Hormuz, while in South Asia and the Pacific he announces a new sphere of prosperity. To add substance to his ambition, the Shah has been a conspicuous shopper in the arms markets of the West, spending $3 billion last year in the US alone and with talk of some $4 billion in current orders for electronic equipment and more sophisticated arms.

As his actions indicate, the Shah is ambitious both for himself and his country and he is laying the foundation now for the role which he envisions for Iran in the long run. He is a thoughtful monarch, skilled and experienced in the use of power, and therefore needs to be taken seriously. Nevertheless, the Shah has ruled for a long time with an iron hand and the possibility of domestic political discontent must therefore be kept in mind. At the same time, Iran's oil reserves are smaller than those of Saudi Arabia and by 1990 her income will begin to decline. Consequently, the Shah feels a sense of urgency in his policies and this may lead him to overreach himself by attempting to accomplish too much too fast.

Iran and the policies of its leader are also viewed with some suspicion by the Arab countries. The Arabs, for example, suspect that the Shah's proposals for collective security arrangements in the Gulf and his offer of leadership in other fields such as oil price policy are oriented more toward his own self aggrandizement rather than any shared interest in cooperation. Above all the Arabs fear Iran's military buildup and reject the Shah's view of Iran as the great power of Western Asia and this has resulted in a corresponding program of Arab arms purchases, especially by Saudi Arabia. Arab-Iranian rivalry in the Gulf or the boundary dispute between Iraq and Iran could therefore lead to a confrontation. Such a conflict is not inevitable and cooperation between Iran and Saudi Arabia in Oman is one indication of the alternatives. Nevertheless, as the Cyprus conflict has shown, the US policy of arming its allies does not mean they will get along and, in fact, could lead to confrontations among regional powers over narrower national interests.

In conclusion, it appears that a political settlement to the Arab-Israeli dispute would have little impact on either Turkey or Iran whose policies and relationships in the area are largely determined by other factors. For the Arab countries and Israel, a peace settlement may well be achieved before the old habits of mind change, yet a settlement cannot be lasting unless the Arabs and Israelis modify their traditional views of each other. For the US, danger lurks in the possibility of overselling a settlement to the contending parties on the basis of differing perceptions of what the post-settlement situation would be like. Still, the possibility of peace exists and if a comprehensive agreement can be worked out which includes a provision for the creation of a viable Palestinian state, the prospects for regional stability are good indeed. Whether such an agreement can be reached, however, remains the central question.

THE MIDDLE EAST, EUROPE AND THE THIRD WORLD: WHAT NEW RELATIONSHIPS WILL EMERGE IN LIGHT OF THE GREATLY INCREASED POWER OF THE MIDDLE EAST OIL PRODUCERS?

Cooperation not confrontation! This is the key to understanding the developing relations between Europe and the Middle East. The Europeans have resigned themselves to the fact that the era of cheap oil has passed and that the current price structure is here to stay. As a result, an attempt is being made to adopt a new, more energy-conservative life style; while at the same time continuing in the search for new sources of energy. In the meantime, a spirit of cooperation is an absolute must considering the almost total dependence of Europe on Middle East oil.

The Europeans are confident that the Middle East oil producers will not exploit their current short run advantage to the extreme, for these same oil producing states are rapidly diversifying their economies and will eventually be in need of a financially solvent West as a market for their output. Nonetheless, it is felt in Europe that the oil producers deserve a fair price in light of the non-renewable nature of their resource.

It is this same need for a future market that the Europeans feel offers them special opportunities or relations with the Middle East. The United States is now, and probably will still be in the future, mainly interested in selling to the Middle East, not buying from it anything but oil. The Soviet Union could possibly become an outlet for Middle East products, but the Europeans feel that they make up the greatest potential market for the output of those new Middle East industries. With this end in mind, the current dialogue between the European Economic Community and the Middle East states is being conducted. The Europeans want to help in the building of modern, industrially diversified states in the Middle East and expect oil in return. Two basic questions provide the focus for these talks: what type of economy is desired, and what industries would find a market in Europe. A broad framework of cooperation will be developed within which a great number of bilateral deals will operate.

If this plan for cooperation is realized, Europe will become the number one market for Middle East output, petroleum related and other and could, perhaps, play a welcome role in limiting the hegemony of the two superpowers in the area.

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For the past two years, relations between sub-Saharan Africa and the Middle East oil producing states have developed at a mind boggling pace. This has been accomplished at the expense of African-Israeli relations. In 1962 Israel had 32 diplomatic missions in Africa, but Uganda's severance of diplomatic relations in 1972 was the start of a landslide that by 1973 had left only one black African state, Malawi, having relations with Israel. Why did Africa turn its back on a state that had been so helpful in the development of the new states especially in the field of agriculture?

The spread of Islam undoubtedly played some role in the development of closer ties between the Arab world and Africa. Untainted by an association with imperialism, and more adaptable to traditional African customs, Islam has for many years been growing faster than Christianity. Many political leaders have made symbolic conversions to Islam lately, and it is seen as a possible key to pan-African unity. All this would explain a turn towards Mecca, but in itself does not necessitate the close association with the Arab states that has been witnessed.

There are important factors involved besides the Islamic umma. On a strictly numerical basis in the UN the Arabs have 18 votes, the Israelis one; and the Africans have almost always been able to count on Arab support on those questions most important to them. Also, the African states, most of whose borders were drawn up in government chambers in Europe, strongly believe in the principle of the sanctity of borders, and Israel's refusal to abide by UN Resolution 242 is viewed with alarm.

After a settlement of the Arab-Israeli conflict can one expect to see African-Israeli relations returning to their pre-1972 condition? Probably not. Israel is extremely bitter over what it considers the ingratitude displayed by the African states. As well, most of the factors involved in the African turn away from Israel toward the Arabs would remain relevant even after a settlement. The Arabs will probably still be strong supporters of the African side of important issues. The four Arab states who are members of the OAU contribute one third of that organization's total budget. Arab states have given $191 million to the Arab-African Development Bank, and a large number of bilateral deals are being consummated between Arab and African states. In other words, the current and potential benefits derived from close ties with the Arab world far outweigh those which existed or could be envisaged from a renewal of relations with Israel.

The one large question mark that clouds the future of Arab-African relations concerns the devastating effect high priced oil is having on the struggling economies of the African states. At the moment the Africans feel helpless and even derive a certain amount of pleasure in seeing the "West" squirm on the oil hook. How long the current situation can go on is unknown. It is generally felt, however, that the oil producers will have to, and it would undoubtedly be greatly to their advantage if they should, do something to lessen the hardship presently being endured by Africa and the developing world in general, which is partly a result of the increase in oil prices.

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Relations between Asia and the Middle East oil producing states have greatly increased in the past year and appear likely to continue to improve in the foreseeable future. This interaction is not a new phenomenon, but is rather a renaissance of historic patterns of influence which date back to the 16th century.

The three nations most closely examined were Ceylon, Pakistan and India. All three have suffered new hardships as a result of the increase in the price of oil and are being forced to do a certain amount of belt tightening on already meager economies. Prior to the oil price rise the government of Ceylon had initiated some strict measures to cut spending and was beginning to see results. With the price rise, however, all of the gains made were wiped out in six weeks. One finds a similar reaction in Ceylon as in Africa to this move by oil producers. The Asian states have felt for a long time that they were on the short end of declining terms of trade with the industrial West and see in the oil issue "brothers" who have fulfilled their common dream of turning the table around. These new hardships and attempts to overcome them in large part explain the increase in contacts between Asia and the Middle East. The other factor, which is not unrelated, is the growing power in the area of the Middle East states, especially Iran, in a military and diplomatic sense.

In the case of Pakistan, if one were to look at the flow of skilled technicians out of the country one would see a definite shift in their destinations away from the West toward the Middle East oil producing states. This is very natural development considering the large number of skilled people needed in the development plans of the Middle East oil producing states and the fact that Pakistan is a Muslim state. A result of all of this is a strengthening of the ties between the Arabs and Pakistanis. Saudi Arabia has provided Pakistan with cash to purchase military hardware and Libya's Qadhdhafi has been willing to aid Pakistan as long as it behaves as a good Muslim state.

India has sought to improve relations with Iran in the hope of getting the oil it so desperately needs at a reduced price. This is basically the desire of all the Asian nations. If they are not able to get a reduced price, they at least hope to find the money to borrow to pay for the oil and its derivatives, i.e. fertilizers, which they must have.

Iran's growing military and diplomatic position vis-à-vis the subcontinent and the Indian Ocean carries with it some interesting ramifications. Iran and Pakistan have a common border plus a common perceived threat, the Soviet Union, to draw them closer together, and this is happening. Iran and India, for the economic reasons previously mentioned plus the fact that they are the two major powers bordering the Indian Ocean, are necessarily drawn together. What does this mean for the future? It was speculated that if these relations do continue to develop there is the possibility that Iran could play a mediating role between India and Pakistan to lessen the antagonisms that exist between the two. Also, if India can worry less about Pakistan and develop confidence in its relations with Iran it would be able to lessen the degree of its dependence upon the Soviet Union, something that would seem to be agreeable to the Indians.

Regardless of what happens in the Arab-Israeli conflict, it would appear that for economic and military-strategic reasons, contact and interdependence between Asia and the Middle East oil producers will continue to grow.

BANQUET ADDRESS

Sidney Sober

Thank you Ambassador Hare. Ambassador Hare is one of several of my former bosses in their capacity of Assistant Secretary for Near Eastern and South Asian affairs who are here tonight. Ambassador Battle is another. Ambassador Hart is another. Two others who have followed them, one in the past and one today, as Assistant Secretaries are out on a trip as you have been told.

I came back from the trip to the Gulf that Ambassador Hare mentioned, about 10 or 12 days ago, not knowing what a wonderful future lay in store for me. I found that Roy Atherton had promised a long time ago to speak to you tonight. He asked me if I could substitute for him. And then Ambassador Battle invited me. I thought that they both were being rather foolhardy - Mr. Atherton for risking the reputation of the Department of State and Ambassador Battle for risking the reputation of the Middle East Institute. But I figured that if they wanted to be that reckless that I didn't have much to lose. So here I am.

Now the theme of this conference is "After the Settlement: New Directions, New Relationships." Ambassador Hare said that people today have been brain-stretching. I think that is the right term and it's a great term. It's the type of thing that not enough of us do. There are tremendously exciting perspectives in the Middle East. This is a thing that we who are government people don't really pay enough time to because we are dealing with yesterday's mess and today's problems; it is a type of very important exercise that we in government have to look to experts, scholars and other people who have experience and interest in the area to think about and to talk about and to come up with ideas about. And, Luke, I will tell you we have our spies, our friendly spies, in the Conference taking notes because we hope to be able to benefit from the wisdom which is being propounded.

When I was asked to talk, I was told what the subject of the Conference was and then I had to decide what I would talk about. I didn't have any speech left for me, and so you cannot blame Roy Atherton tonight. I am afraid I'm it. I thought first, I could talk about political trends in the area because it's a very timely subject. Secretary Kissinger is on his sixth or seventh trip in this last year to the area and things are happening, and they are exciting things. And then I figured, well, most of you people have access to the New York Times and the Washington Post and you are about as well informed as we are. We try to read our telegrams about as fast as you read about them in the New York Times and sometimes we make it and sometimes we don't. And I figured I would leave that aside and talk about something else.

The subject that I am going to talk about is a little less exciting, but you've all had a very good meal and probably it's better for your digestion not to offer too much in the way of excitement just after dinner. But I am going to talk about some developments which I consider are pretty dramatic, if not quite as exciting as some of the things you are talking about at this conference. And, indeed, the things that I want to talk about are related closely to the over-the-horizon look that you are taking, "After the Settlement" - very much related to the problems of forging a peace and new relationships in the Middle East. I will talk about the foundations of a new American stake in the Middle East.

I think we all would have to agree that it is dramatic to look back to where we were a year ago and where we stand today. Then the Middle East was at war. The United States was seen, at least by one side, by many people, as taking a one-sided stance. The oil embargo was very soon to be imposed and we were to start queueing up at the gas pumps. The Soviet Union was riding very high with at least some of the Arab states; at the same time, our name seemed pretty much like mud.

Since that time there have been some very important changes in perceptions, I think of farreaching significance, both in the Middle East and in the United States, and I think that these changes in perceptions are very basic and germane to the possibilities of a new future, which is the subject of this Conference.

Israel still sees us as its main support and indeed we have reiterated the constancy of our support. But there is a perception that things simply cannot go back to where they were before the Yom Kippur war. As for the Arabs, they see their hope for peace linked closely to our efforts. And they see more clearly the benefits of continued and close cooperation with the United States. As for ourselves, the October War and its aftermath, including the oil embargo and sharp increase in oil prices, brought home to us more sharply, I think, than ever before, the importance to the United States of good relations with the Arab states and more broadly of peace between the Arabs and Israel.

I would like to talk of these various areas of relationship one by one. First the United States and Israel. Relations remain very close despite changes of administration in Jerusalem and Washington. The new leadership on both sides has reiterated a policy of closeness which has marked our relations since Israel emerged as a new state. Tremendous sympathy remains in this country for Israel in its problems and its desire to survive and indeed to prosper. And as for us, we recognize Israel's need for sufficient military strength, sufficient economic help to defend itself and look out for its requirements.

Coming to the question of the United States relationship with the Arab states, there have been major changes in all aspects of our relationship with the Arabs: diplomatic, political, economic, security, cultural, you name it, there have been changes and they are important changes. Yesterday, talking to the staff of the American Embassy in Cairo, Secretary Kissinger said, and I quote: "I have the profound conviction that the United States and the Arab people are natural friends. I think we have begun a new and lasting period in which our relationships will grow ever closer." And he then referred to this development as: "...one of the most exciting trends in American foreign policy that I can remember." On the diplomatic side, within the past year we have seen the restoration of our diplomatic relations with Egypt and Syria. There are still several Arab states with which we do not have such relations. I hope that that situation will change. It depends on them. I hope that one or more of those states will decide that is is in their interest to restore diplomatic relations soon. We want it and we're ready. During the past summer, only since the end of June and in July, we sent for the very first time ambassadors to four smaller states in the lower Gulf. For the first time we are now represented by ambassadors in Bahrayn, Oman, Qatar and the United Arab Emirates. I happen to have visited each one of these ambassadors during my very recent trip. They are well established, and they are very well received. This is a great thing for us.

On the political side, I think the trip of my leader out in the Middle East at this time is symptomatic. We continue to have close and cooperative relations, currently reflected in the consultations following on those which led earlier this year to disengagement on the Sinai front and on the Golan front. I mentioned Secretary Kissinger's sixth or seventh, I have lost count, trip to the area within the last 12 months. President Nixon visited. Secretary Simon visited. August in Washington we called NEA month, because we had a round of visitors from all of the confrontation states and others who came in for a successive and intensive round of consultations. They didn't have to be pulled, they wanted to come. I think we have to accept the probability the Arabs can indeed say who else but the United States can help us make peace. And I don't think they find anybody but the United States that can fill that particular role.

On the economic side, for various reasons there is a sharply expanded desire for American products in the Middle East and for American participation in their economic growth. They want American investment. I am trying to talk in broad terms. I know that there are some countries that vary from the general rule. But by and large they want American investment, they welcome American technology, they want the benefits of what we have been able to do in advanced science, they are looking at solar research with us, they want various types of advanced industrial activity that we have to offer. They aren't looking to us exclusively, but I do think it is correct to say that they look to American industry, American economic know-how, more than they look to any other country.

And in this country there has been a sharp increase in interest in doing business in the Middle East. Ambassador Hart, whom I happen to be looking at, knows this; he has been back and forth I don't know how many times in the last year. His company and many others see sharply increasing opportunities. During the coming months there will be at least two trade missions of senior American business executives going out to the Middle East. In many cases these are men who have not been to the area; maybe their firms have been active but the individuals at the top are now aware of the opportunities and want to respond to them. Before the Congress at this very minute, and this happens to be caught up in the problem of getting a foreign aid bill, there is an administration request for a large new economic aid program for Egypt measuring $250 million for this fiscal year, and a request for $100 million for what we call a special requirements fund, much of which I think if appropriated will go to reinstitute an aid program in Syria. US exports to the Middle East are going up quickly. In the area from Morocco through to Iran roughly, they may reach as much as $6 billion this year, as against well less than half of that in 1972. This means coming up to about 6 percent of American exports as against 4-1/2 percent a couple of years ago. Now unfortunately, I have to admit that there has been another factor on the opposite side, in imports. We are paying a lot more for oil and in fact we are going to come out with probably a billion dollars in trade deficit with this region. You take the good with the bad, or you have to mix them. But the fact is that things are moving.

Now on the security side it's very hard to talk about "security" questions without getting into the political. I think it is nevertheless accurate to say that there is a considerably enhanced interest among various of the Arab states in the desirability of close cooperation with the United States on various matters affecting their own security. We have had long-standing relationships of defense cooperation with Jordan and Saudi Arabia. These continue and remain strong, in fact stronger than ever. A number of the states in the area including Jordan and Saudi Arabia are interested in procuring American military equipment. The Keynote Speaker said today that there may be some good and some bad in that, and I think we all have to agree with that. But the fact is that they feel the need for some defensive equipment and some of the countries which have not had this type of relationship with the United States are now approaching us because they want that. There is one more thing I would say on the security side. A year ago during the heat of the war the Bahrayn government decided that it should withdraw the privilege given to the US Navy to have a very small force stationed at Bahrayn. We call it the Middle East Force or MIDEASTFOR. There have been vast changes since then and the government of Bahrayn is reviewing that particular decision at this time.

On the cultural side, it's very hard to get statistics. We have the impression, however, that there is a considerable increase in interest on the part of various of the countries in the Middle East in sending the good students to the United States for higher education. We welcome them, we want them to come. As a government we are trying to facilitate their coming. Fortunately many of the countries in the area don't need any financial help, they can afford it, but we want their students to come and we are encouraging their coming. We are trying to develop cultural exchange. Probably next spring, for the first time in six, seven or eight years we will have here the visit of an Egyptian parliamentary delegation. There is another cultural event that I think is taking place, or was supposed to be taking place during this present trip of Secretary Kissinger to the area. As I recall it, the Egyptian foreign minister sent word that he had discovered a new and sensational belly dancer who had not yet been seen by Secretary Kissinger; I have not yet had confirmation that this visit has taken place, but I do hope that we can confirm it for you.

We have established a new instrumentality to help us in building up our relationships with the Middle East countries in the last several months and we call this instrumentality "joint commissions." A number have been formed and have assumed such importance that one is tempted to talk of a new method of international relations which is international relations by joint commission. But, seriously, they are an important effort which serves to highlight the interest which governments on two sides have in intensifying and diversifying their relationship and also in mobilizing their efforts to make sure that something happens. The policy direction in all cases on the United States side is from the Secretary of State. Thus far, joint commissions have been established with Egypt, Jordan, Israel and Saudi Arabia. All relevant US government agencies participate and the scope of these joint commissions varies from country to country, but it may encompass the whole area of our relationship - economic, scientific, cultural, security, medical research, educational exchange. We have given a lot of impetus to this effort with the Saudis, for example. We have met in joint working groups with Saudi Arabia this summer in the fields of industrialization, manpower training, agriculture, and science and technology. Dr. Hostler, who was introduced to you this evening, is in fact the head of the United States side of the joint US-Saudi working group on industrialization. The Saudis have sent a team over here. They were exposed to large numbers of senior US business people just a couple of weeks ago. With Egypt and Israel we've also received here within the last month, month and a half, several technical working groups that have exchanged ideas and program suggestions with American groups; and within the coming month, we will be sending our own working group delegations to Cairo and to Tel Aviv.

I have been talking about our relationship more broadly with the Middle East. After mentioning the Arab world and Israel, I cannot fail to mention Iran. We have had a very close relationship with Iran for these many years, especially since 1947 or so, and that close cooperation and relationship flourishes. Much has been made of our military relationship with Iran. Indeed it is large, in that last year Iran placed orders for military equipment in the United States valued not very far from $4 billion. And, indeed, we continue to share many mutual concerns with Iran on security issues. But that is not the beginning and the end of our interest and relationship with Iran. There is an extremely active economic development program, and an intense desire on the part of Iran for the United States to be associated with it; we welcome it. American business is actively participating and I think that I can foresee nothing but increasing enhancement of that particular relationship.

On my trip that Ambassador Hare mentioned, from which I came back just in time to have this delightful opportunity to talk to you, I did have the chance to go up and down the Persian Gulf, the Arabian Peninsula and Iran. If one thought has remained with me more clearly than any other, it is that the United States counts for a great deal in that region. It is very good for those of us who spent the hard Watergate summer in Washington and witnessed the self-denigration and the self-criticism that we go through, some of it well merited and maybe some of it not, to go abroad and have the chance to talk with leadership in these countries as I did and to have a very clear thought left with one that they value the United States, that they recognize our importance in the world at large and to their own well being and that they want very much to be associated with us. Now that does not mean, God knows, that they agree with us on everything, nor should we want an association with countries which always agree with us. I think, for myself and many of us, we would rather have friends who can stand up and differ and many of these do. But when that is all said, it is very impressive that they wish the United States to work with them and they want to do what they can to this end.

I think it is very tough these days for anybody to talk about the Middle East and not mention oil. Our Keynote Speaker today did get into oil and I'm not intending a rebuttal because I happen to agree with much of what he said. When one talks of dramatic changes in the last year, we cannot leave out oil. In fact, I think, we have to term the changes in the oil situation of the world in the last year as revolutionary. We are talking about the Middle East: it doesn't produce all the oil in the world, but it is very important and the Persian Gulf area alone has at least two-thirds of the world's known reserves of petroleum. Now it is no secret to you or to others to say that we have serious concerns over the degree and way in which oil prices have been raised. I think is it also very fair to say that we in the United States recognize the importance of oil to the producing countries and the fact that it is a nonrenewable resource - once you deplete the well you don't have it anymore. In many cases for the oil-producing countries oil is their only significant resource and they depend on it for their welfare. We understand why the oil-producing countries should feel the need to get a reasonable return, or to maximize the return from their point of view, so that they can use the income to diversify and develop their economies. We do not begrudge the oil producers the strengthening of their economic position. I would point out that the two largest exporters of petroleum in the world are Saudi Arabia and Iran, and I have spoken a few words about the very warm and continuing close association between the United States and Saudi Arabia and Iran. Many of the oil-producing countries look to us not only for technology to help to develop their own systems, as I have mentioned, but they also look to the United States as by far the largest and safest financial market in which to invest some of the funds which are accruing to them from oil and which they cannot use at home. You know this rather awful term of economic jargon - what the economists like to call "recycling petrodollars." It is an important thing whatever you call it. Now the fact is that we want to work with the oil countries and indeed, we intend to, and we are working with them.

We do have a concern, nevertheless, that the abrupt quadrupling of oil prices over the past year can have very serious consequences for many oil-consuming countries in terms of immediate payments strains, increasing debt burden, and inflationary pressure. Oil is very important in world trade. At the present price it comes up to perhaps 15 percent of the value of all imports among non-communist countries. Despite efforts by a number of the oil-producing countries - very substantial efforts by some of them - to give financial help to various countries which are buying oil at the higher price, the producers in the Gulf alone are building up their financial reserves by about \$3 billion a month. Now that's fine, but one also has to look at the obverse. It means that consuming countries, some of which happen to be very poor and some of which although highly industrialized are in poor financial condition, are also experiencing a corresponding drawdown of about \$3 billion a month, which is a very heavy burden to bear. And thus we see a number of individual consuming countries under very sharp pressure. We see the international financial situation in a certain ferment, and the world's financial system and structure struggling to adapt to revolutionary changes. We think that no country can stand apart, should it even think it could, in what is obviously an increasingly interdependent world economy. Now these in brief are among the concerns which were highlighted in recent speeches by President Ford and by Secretary Kissinger which got so much publicity a couple of weeks ago. They are real concerns and there need be no doubt about that. Because of our own resources and our strength, we in the United States are relatively less affected, and are going to be less affected, than many other net oil importers. But we have felt that we cannot afford not to take a world view of this particular problem. There has been a lot of talk about confrontation. I happened to be in the Persian Gulf region, arriving in Tehran the day after the President's speech at Detroit and the Secretary of State's speech at the United Nations, to be met with headlines there as in the Arab world talking about confrontation and ultimatums by the United States. The need is clearly for cooperation, not for confrontation. Cooperation is very badly needed to meet a major world problem and that is the American desire - for cooperation. We have tried to make that clear. I did have a chance to talk with various of the leaders, some in Iran and some in other producing countries, and tried to make that clear. I think there is some increase in understanding, that indeed we want cooperation because we think it is absolutely essential. But we owe it to our friends and to ourselves to be frank. This is not a problem which can be swept under anyone's Persian carpet, or Arabian carpet, or Venezuelan carpet, or Indonesian carpet, or you name it. All countries and all men of good will have a stake in seeing that this particular problem be contained. During my trip, in discussing this among other subjects, I found a diversity of views about various aspects of the oil problem and certainly a readiness not to agree with our view on some individual points. But I did find a general willingness among responsible leaders to acknowledge that there is a need and an important need for a cooperative approach to reduce the risk of the negative economic consequences and the prospective political repercussions from which it would be very hard to isolate even the producing countries. So we have a challenge on this important problem of the day - to find a common ground for cooperation among consumers and producers which is essential if we are going to cope with this particular problem.

In ending my talk on the subject of oil, I recognize that there would be a danger of ending on a down-beat. I have wanted deliberately to emphasize the positive while being frank about a problem that we cannot afford not to be frank about and to be frank about the concerns we feel. I commented that we have a lot going for us in our relations with the countries of the Middle East and that is for sure. I am confident that the positive aspects of our relationship will remain. They are a fact and a verity which are important to us and on which we are determined to continue to build. We are determined to have our relationships progress along positive lines. We welcome the dramatic improvement in our relations with various countries of the Middle East. Oil is a factor on which we intend to do our very best to deal constructively with our friends as we continue the broad basic positive lines of our relationship with the countries of the area. We value their friendship. We welcome their cooperation and that is the general framework in which we are determined to see our relations progress.

I think that the development of US relations with the countries of the Middle East, as I have described our intent as well as their current fact, is entirely consistent with the new directions and the new relationships of the future which is the motif of this year's Conference. I think that what I have said is consistent with what is taking place in the Middle East this very evening in the visit and the consultations of Secretary Kissinger and Assistant Secretary Atherton. What they are doing is entirely consistent with the theme, the motif of this Conference, in the effort to bring about peace. Now I say, to avoid the criticism of being totally pollyanna about this, that our eyes are open. No one, I think, is counting any chickens before they are hatched. We realize that there are tremendously difficult problems ahead for us and our friends in forging the type of peace which we think is so essential. But as we continue to do our best to help our friends in the area find that path to peace, we will continue to do our best to build a firm foundation for our relationships with the various countries. We would hope and we are determined that the new strengths which have emerged in our relationships with the countries of the area during the last year will continue.

As a final word to Ambassador Battle and the other leaders of the Middle East Institute, I want to say that you have the admiration and the deep respect of the Department of State. We value very much the contribution which the Institute has been making over the years to us, to us Americans, in the field of foreign affairs. And I want to say that I have to congratulate you, as Ray Hare did, on selecting this very imaginative subject for this year's Conference, for which we wish you all the best of success.

THE MIDDLE EAST OIL PRODUCERS AND THE MAJOR IMPORTERS: WOULD SETTLEMENT PAVE THE WAY TO A MORE STABLE AND BALANCED RELATIONSHIP?

Address by *John D. Burn*

The investment of Arab oil revenues continues to be the cause of considerable speculation and there are widely differing estimates, not only as to the amount of investment funds which will be accumulated, but to the geographic and industrial spread of investments which the Arabs will favor.

It isn't possible at this stage to talk in anything but very rough estimates, firstly, because of the many variables involved in forecasting both future prices and production rates, and secondly, because the producers themselves - especially Saudi Arabia, which dominates the whole position - have by no means reached a stage where any firm production rate decisions or long term investment decisions can be made.

Some predictions can be made by an examination of the trends which have emerged in recent months and of the people who will be making the final investment decisions.

I think it is fair to say that, beyond the medium term, the people involved will be from Saudi Arabia, Kuwayt, Abu Dhabi and Libya as these are the only countries which will have substantial excess funds which they cannot absorb into their own economies.

These are countries led by very conservative men; countries which have little or no natural resources other than oil. The leaders are greatly concerned with the preservation of their own political regimes and are looking to their investments to provide for their countries when the oil runs out, say, three generations from now. The small size of their population makes large scale, domestic industrialization a difficult proposition, unless they increase their foreign labor forces - which, of course, can create political instability. Looking abroad they are faced with currency fluctuations, with political hostility, threats of nationalization and, very importantly, they are faced with an inability because of a shortage of skilled personnel, to evaluate and manage for themselves a multiplicity of investments spread around the world. The only real domestic investment choice which they have is to leave most of their oil in the ground. In this regard I understand that a Saudi economic committee has recently advised their government that they should pledge to maintain production at its present levels only until 1980 to allow time for world economies to adjust themselves and, thereafter, to cut back production to 2-1/2 million barrels a day at which level the revenues would be absorbable by the Saudi economy.

But the interests of the oil consuming nations require the producers to continue to pump oil, irrespective of their domestic situations, so if we are to persuade them to do this, we must make it our responsibility to provide the producers with safe and, potentially profitable, investment opportunities in the United States, and to assist them, as far as possible, to develop their own economies without causing the rampant inflation which they are now beginning to experience.

Attracting their funds to this country will pose no great problem. I believe that, leaving aside the Israeli question, the four countries mentioned previously, with the possible exception of Libya, are going to look to the United States in the last resort as their "protecting power" and that the United States, because of its relative economic size, its strength and political stability, is going to be the major beneficiary of their investment plans. Treasury estimates covering the first eight months of this year show that 25 per cent of OPEC funds are already coming to America - and this percentage was increasing rapidly in the latter part of the period. The great attractions which this market offers could well bring us to a position where we have the Arabs buying up too many assets in the United States, rather than trying to achieve a more general geographic spread of investments, and this would leave us with the problems and credit risks of recycling the capital inflows to third countries to help balance those countries' oil payment deficits. This could make it necessary to impose controls on capital inflows to avoid the political repercussions which would result from an Arab buying spree in this country. We presently adopt an open-door policy toward foreign investment except for a few limits and prohibitions in such cases as defense industries, coastal shipping, air transport and atomic energy.

But in bringing up this question of controls there is the danger that they will become so prohibitive that the Arabs will be forced back on their alternative of leaving their oil in the ground. I think we can expect a cooperative attitude from the Arabs towards any reasonable controls we propose. They fully realize, even without their being constantly reminded in political speeches, that their foreign investments are vulnerable and the funds they invest here are, in effect, being put in trust in this country for the benefit of future Arab generations. Once their oil runs out, or is superceded by alternative fuel sources, they have no leverage to use against threats of nationalization. We have to persuade them that if they sell us oil and leave the proceeds under our ultimate control, we are able to act responsibly as their trustees.

It is well known that so far this year surplus oil funds have found their way mostly into short term financial investments, mainly government securities and bank time deposits. There has been some willingness on the part of the Arabs to go as long as 4 or 5 years in time deposits, but only for relatively limited amounts, although terms are beginning to lengthen. The conservative nature of their approach has been clearly in evidence in their short term investment policy from the limited number of banks they are prepared to deal with and ceilings they are imposing on deposits with any one bank on their list. There will always be a good proportion of the investment portfolio held on short term, simply because of the rapidity with which the money is flowing into their treasuries and the limited expertise available to them to channel this income into properly evaluated, more complex, longer term situations.

There is, of course, a limit to the amount which the banking system will take on short term, especially from a small group of depositors, and 1975 is going to bring the banks very near to this limit. Government securities are going to have to absorb the bulk of the new money.

Long term investments, however, pose some very different problems but again, government to government action must play the major part. The most visible long term item in which the oil producers have shown interest has been real estate. I have seen inquiries from the Middle East concerning investment in office buildings, residential property, tourist developments, cattle ranches - almost anything which results in the ownership of land. However, even the vast US real estate market cannot begin to absorb the amounts which are being forecast for OPEC reserves. Estimates as diverse as \$300 billion and \$600 billion accumulated by 1980 have been put forward and by looking at present trends I think it is fair to assume that perhaps up to 40 per cent of this may come to the United States. This could give us up to \$240 billion over the next six years and the effects of this money entering the real estate market can be easily illustrated. Less than \$15 billion would be needed to purchase all the buildings of significance in downtown Chicago. One hundred billion dollars would purchase, at present prices, almost 30 per cent of the farmland in the continental United States.

There is, of course, room for some direct foreign investment in real estate but the best entry for the Arabs into this sector would perhaps be to provide capital support to the construction and housing industries - to become, in effect, mortgagees rather than owners. This could give them a good return while promoting an image of the Arabs as benefactors, and may well result in enough favorable publicity so that, at a later stage, they can buy into other, more visible areas, of the real estate market.

A second long term investment choice which has been the subject of inquiries from Arab investors is the purchase of bank equity and, although two small banks in California have passed into Arab hands, we are once again in a politically sensitive area especially with the recent growth of foreign banks in this country. The entire equity of Bank of America could, in theory, be purchased at present prices for only $2 billion and there is, therefore, only limited scope for further foreign investment in this sector without its meeting strong hostilities.

Equities are another outlet for surplus oil wealth, but a large movement of funds, held by a limited number of investors, into the stock exchanges, would introduce an unwelcome, and even dangerous, element of volatility. The uncertainty of future values and the amount of expertise needed to effectively supervise a large equity portfolio will not endear this type of investment to Arab governments. But, if any interest in equities <u>does</u> materialize, the United States will surely be its main target. Total value of stocks quoted on the New York Stock Exchange at present prices is about $565 billion, which makes it by far the largest exchange in the world and the only one which could conceivably handle funds of the magnitude we are talking about. The Tokyo exchange, which ranks second in the world, is valued at only $60 billion. Obviously, significant portions of the oil wealth channelled into United States equities would soon bring an unacceptable number of companies under foreign voting controls, which would be most unwelcome.

We keep coming back to the problem of the size of the potential capital inflows compared with the overall value of the investments available, and to our unwillingness to make the political and social adjustments which would allow us to accept the idea of foreign ownership. This problem is especially acute when we remember that $240 billion by 1980 may be only a beginning. Foreign investment in this country at present aggregates only $18 billion, compared with our own overseas investment of $107 billion, but changing this ratio is an issue which will need careful handling if we are to avoid strong opposition.

Better public relations and less biased reporting would certainly do much to ease the situation, but, by <u>sensitive</u> handling of their investments, the oil producers can do much to further their <u>own</u> cause, and prevent the imposition of government controls, aimed at relegating Arab capital to a subservient position. Arab investment guidelines, at least in the case of Kuwayt, apparently include their demanding for themselves a say in a company's management and policy-making processes commensurate with the size of their capital investment. This is not an unreasonable position to take, but it can easily be construed as hurting the capacity of US companies to remain independent and it is important that the Arabs do not project an image of seeking to control US industry. Ideally, they must appear to invest primarily for return, not for control, and must seek to illustrate the benefits which their capital will bring along with it.

If they were to concentrate on the acquisition of smaller companies, and on taking only minority positions, they would not attract the adverse publicity that a bid for a well known name would bring. They might, for example, seek to form joint ventures with some smaller chemical and fertilizer companies which could be used to illustrate the positive aspects of foreign investment by the Arabs guaranteeing the joint ventures a future supply of competitively priced oil.

We have been seeing evidence in the commodity markets that Arabs are seeking to secure their own basic needs especially in agricultural produce and here again, a guarantee of future oil supplies could be used to good effect by publicizing "oil for grain" or "oil for technology" barter deals which they could arrange with American companies. The stressing of the oil side of the deal would deflect the type of criticism the recent Russian grain deal attracted and talk of guaranteed oil supplies would comfort public opinion.

There are numerous profitable situations of this type, where the Arabs can be made to appear as benefactors, rather than as predators, and these should be kept in the forefront during the investment buildup. It is a public relations exercise as much as a financial problem insofar as once a beneficial image has been projected it will be so much easier to extend foreign investments into areas which previously seemed unacceptable.

However, this is not to say that foreign domination of any sector of the economy will <u>ever</u> be acceptable and we will need to take action if this is not to become a stumbling block to our achieving a stable relationship.

Reducing demand for Middle East oil is an important way of attacking the problem at its roots and finding methods of helping the Arab world itself, and the developing countries, to absorb oil into their own economies also merits urgent attention.

But this will not be easy.

Governments like that of Saudi Arabia are being innundated with feasibility studies which they can't hope to cope with and for private business to compound the problem by submitting further studies is self-defeating.

Development is going to be slow and will need planning and advice on a scale which only government-to-government cooperation can provide.

Private business will have its part to play but first let us put more emphasis on getting to know and understand the Arabs. Let us look at their basic needs and begin to train their people so they can learn to run their own economies. We need to create an atmosphere of mutual trust by talking less of what harm their oil prices are doing to us and thinking more of what we can do to help them.

I'm sure we can find ways by which we can all profit, but if we listen to those who talk of military solutions, there will be no profit for anyone.

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Address by *John H. Lichtblau*

The impact of the long Arab-Israeli dispute on world oil supplies is now so well known that little needs to be said about it. Of the four Arab-Israeli wars since 1948 oil figured significantly in all but the first one. In 1948 Arab oil production was still relatively small. Iran was the only major Middle East producer then, and the British still had complete physical control over the Suez Canal. After that oil's involvement escalated with each war. In 1956 the oil transit countries blocked the flow to the Mediterranean via the Suez Canal and the pipelines from Iraq and Saudi Arabia for six months. In 1967 the Suez Canal was indefinitely closed. For the first time the producing countries actively took part by shutting down all Arab production during the six day war. Libya continued this policy for another 30 days. In October 1973 the Arab oil weapon fully came into its own with the five month total embargo of shipments to the United States and the Netherlands and the partial embargo of exports to other countries.

The increased role of the oil weapon in each of these conflicts reflects the increased world dependency on Arab oil which rose from 34 per cent of world oil exports in 1957 to 54 per cent in 1973. There has been no decline in this dependency in the year since the October War. Hence, the persistent Arab warning: if there is another war, they will again use the oil weapon and probably on a larger scale than last time, must be taken very seriously.

How effective another Arab oil embargo would be is difficult to judge at this point. Two developments have occurred since the last one which will produce opposite effects. On the one hand, the Arab oil countries are much richer today than they were a year ago so they could bear the economic cost of an embargo much better and longer. On the other hand, there is the recently formed 12-member Energy Coordination Group which includes all major oil importers except France and has an elaborate self-triggering scheme to share oil supplies in case of an embargo. Arab oil could, therefore, no longer be denied selectively, as it was last time. The embargo would have to be applied against all industrial countries, friends as well as foes.

But whatever the over-all effect of these two developments, the threat of another Arab oil embargo will hang over the entire world until some sort of settlement is reached between Israel and the Arab states. Its use in case of a war is almost axiomatic. But even short of war, a total breakdown in negotiations or Israel's refusal to start them or a particularly sharp flare-up in Arab guerrilla warfare with Israeli retaliation could trigger it. With 54 per cent of world oil exports coming from Arab sources currently and a potentially much larger share in the future, it is obvious that all oil importing nations have a vital interest in a settlement of the Arab-Israeli conflict. Without it access to Arab oil will never be secure and non-political.

But the reason oil is again in all the headlines and is the principal subject of discussion at international and domestic summit meetings is not the threat of another oil embargo - although everyone is concerned about that, too - but the 400 per cent rise in world oil prices which has taken place in the last 12 months and is endangering the entire world financial structure. The question in the context of the theme of this conference is, will Arab oil prices fall if a settlement is reached? If they do, all world oil prices will have to decline and the specter of an international financial breakdown would recede.

The leaders of the Arab oil countries have never officially promised a specific price reduction in return for a settlement of the Arab-Israeli dispute on their stated terms. But they have indicated that after such a settlement they would be far more amenable to it than now. This is not surprising. Nothing has higher priority in the eyes of the Arabs than regaining all the occupied territories and repatriating the Palestinian refugees. To achieve these goals would be well worth a few dollars a barrel, particularly since of the seven Arab OPEC members only two - Algeria and Iraq - can actually absorb all the oil revenues they currently receive. The problem is that neither the United States nor the other major Western industrial nations are willing, or able, to guarantee to the Arabs their maximum demands in return for a lower oil price.

Hence, if there is to be a true settlement, rather than the imposition of terms by the stronger party on the weaker one, it will have to result from a give and take on both sides with neither side satisfied with the outcome and the settlement accepted, at least initially, reluctantly, provisionally and with many external and internal reservations. Hopefully, both sides will eventually learn to live with it. But when it is signed or otherwise agreed on, the Arabs will hardly feel a moral obligation to lower the oil prices in gratitude for the help received from the West.

An equally if not more important consideration in now lowering the price of oil in the wake of an Arab-Israeli settlement is that such an action could bring about the demise of OPEC, the most successful international cartel in modern times. This instrument enabled its members to move from relative poverty to real richess within a matter of years. The five Arab members with surplus oil revenues - Saudi Arabia, Kuwayt, Abu Dhabi, Qatar and Libya - would be opposed by the eight other members of the organization who strongly want oil prices to stay at least where they are now but preferably move up in line with world inflationary trends. Six of these members - including Iran and Venezuela, the second and third largest exporters - are not Arabs and have, therefore, nothing to gain by accepting any price cut in return for a settlement of the Arab-Israeli dispute. Algeria and Iraq would oppose the price cut for economic reasons. The fact that Iraq refused to join the Arab production curtailments last October and actually increased its exports during the embargo period is a clear indication of that country's priorities.

If OPEC breaks up because of Arab insistence on lowering prices for political reasons the price decline could become uncontrollable, subject only to market forces. No Arab oil producer would want to bring this about. The notion that Saudi Arabia, the most likely proponent of a price reduction related to an Arab-Israeli settlement, could single-handedly bring down the OPEC price because of its vast production potential is somewhat exaggerated. An increase in export capacity by 2.5-3.5 million b/d which is all the country would be physically capable of in the next three years could be largely offset by corresponding reductions in countries with surplus oil revenues. A sustained much bigger increase over and above commercial requirements would take a long time to develop and would also be opposed by most of Saudi Arabia's upper echelon technical and financial administrators, some of whom consider even current production levels excessive. They would certainly find it difficult to justify the enormous cost of creating this capacity for the sole purpose of forcing down prices.

All this does not mean the Arab-Israeli dispute had no impact on world oil prices. In the absence of the October War and the resulting Arab oil export embargo, prices would not have risen so rapidly in so short a period. On October 5, 1973, the government revenue per barrel of Saudi Arabian crude oil (including buy-back provisions) was about $1.90. On March 18, 1974, when the embargo officially ended the revenue had risen to $9.25. The increase occurred in three steps.

The first one on October 16 was relatively uninfluenced by the war because it had been decided prior to it. It represented a 70 per cent increase in the tax-paid cost of Arabian and other Middle

East oil but only a 25-30 per cent increase in the actual market price. In fact, the official OPEC communiqué claimed that the real market price increase amounted to only 17 per cent.

The next price increase announced on December 22, 1973, raised tax-paid cost by 126 per cent above the October 16 level. Again, the prevailing market price formed the basis for OPEC's calculations. But as a direct result of the embargo that price rose from $3.65 in late October to $15-17 per barrel in December. The Iranians argued that posted prices should be adjusted upward to reflect fully this new market price. They were strongly opposed in this by Saudi Arabia which proposed a much smaller increase, because it wanted to keep the politically motivated embargo separate from OPEC's pricing policy to avoid the impression that the embargo had been imposed for monetary reasons. The non-Arab oil producers, led by Iran, had no such compunctions. To maintain OPEC unity a compromise was worked out which raised tax paid cost to somewhere between the two proposals. Thus, in this instance the Arab-Israeli War added several dollars per barrel to the cost of world oil. Since cartel prices by definition are immune to market conditions, the price increase was not reversed when the embargo was lifted.

The next cost increase during the embargo period was the 60 per cent participation formula announced by Kuwayt at the beginning of 1974. This was in sharp contrast to the 25 per cent formula that had been adopted by a number of other Middle East countries in 1972. Under the most favored nation philosophy prevailing within the OPEC community, Kuwayt's new formula cut the volume of the companies' relatively low-cost "equity" crude oil to less than half and raised the level of oil prices around the world by well over $1 a barrel. The Kuwayt action had little to do with the Arab-Israeli dispute. It was merely an acceleration of a development which began in earnest at least a year before the October War, namely, the complete nationalization of resources by all major oil producing nations.

Further price increases since the embargo's end were justified mainly on grounds of world inflation and a desire to reduce the companies' profit margins. The OPEC current strategy of shutting-in excess producing capacity to protect existing prices was first proposed nearly 15 years ago by the then Venezuelan Oil Minister Juan Pablo Pérez Alfonso, one of the OPEC founders. It was Perez Alfonso's theory that an oil producing country faced with a choice between maximizing production or maximizing unit prices should always opt for the latter. Because he realized that this option could only be enforced on a global basis, Perez Alfonso helped to found OPEC.

Thus, the current world oil price has emerged as a result of a world petroleum revolution against the established order - the international oil companies and their home countries. The first shot in that revolution was fired in Libya in October 1970 with the breaking of the long existing 50 per cent tax formula and an unheard of 30¢/bbl increase in government revenue. The last shot has not yet been heard. So far, the revolution has raised government revenue per barrel of Middle East crude oil from 91¢ to about $9.40, or nearly $100 billion on an annual basis for all OPEC nations.

The Arab-Israeli dispute has aided the psychological underpinning of this staggering development. But essentially it was a classical revolution designed to seize control from the established powers and to effect a radical redistribution of wealth. The principal reasons for OPEC's enormous success were its good organization, its high degree of cohesiveness at all times and, above all, the fact that the oil companies were unable and the oil importing countries (for a variety of reasons) unwilling to resist OPEC's demands. Each time the producers' organization tested how far it could go, it found that it could more or less set its own limit. Only now are there signs that this situation is beginning to change - perhaps.

Of course, OPEC does not see it that way, at least not publicly. Their leaders have used economic rationale in justifying their actions. But this is just rhetoric which cannot stand up under analysis. For instance, they have tried to blame the price increase in large part on oil company profits. It is true that profits will be at an all time high for 1974. But between 1972 (a relatively bad year for the industry) and 1974 total private world oil company profits will probably rise about $12 billion. During the same time OPEC revenues will rise by $91 billion. And if in 1975 OPEC increases its revenue by a modest 50¢/bbl this would probably increase revenue another $6 billion. Meanwhile, the oil companies will, in all probability, register a decline in earnings. Clearly, the reason for the increase in world oil prices lies with OPEC, not the oil companies.

OPEC also insists that the increase in oil prices was necessary to offset world inflation trends. As the following table shows, that argument had some validity between 1955 and 1970. Since then, oil prices have soared astronomically relative to the increase in world export prices of manufactured goods.

	Index of World Export Prices*	Index of Government Oil Revenue per barrel**
	(Base: 1959 = 100)	
1955	93	108
1960	102	99
1965	107	110
1970	123	116

1971	129	166
1972	140	190
1973	164	508
1974 (estimated)***	184	1,224

[*United Nations monthly Bulletin of Statistics. Export prices of Manufactured goods of 11 industrial countries.

**Total Saudi Arabian government revenue per barrel of Arabian Light crude (includes "equity" and "participation" oil).

***1974 estimates provided by author.]

The increase has many times offset any decline OPEC suffered in the period prior to 1970. World export prices of manufactured goods have risen by about 50 per cent in the last four years and per barrel government oil income by 950 per cent. Thus, none of the oil revenue increases in the last 12 months can possibly be justified on grounds of correcting earlier inflationary price increases of imported goods. In fact, using any postwar year prior to 1970 as a base, world prices would have to rise at an annual rate of 13-14 per cent for the next 15 years to catch up with the world oil price increases that have taken place.

There also is the rhetoric about making up for the many years of previous exploitation by the oil companies and their customers. Again, if one goes back far enough this argument is legitimate. But one would have to go back extremely far. Since the establishment of the 50/50 principle of sharing the margin between production cost and sales price which was adopted in Venezuela in 1948 and in the Middle East in 1951-1952, it is difficult to make the case for exploitation, particularly since the integrated oil companies made most of their profits at the crude oil producing level and not in refinery and other downstream operations. Furthermore, by 1969 the statutory 50/50 split had de facto become a one-third two-thirds split in favor of the producing countries because discounts off the posted prices were absorbed entirely by the oil companies.

Finally, there is the argument that the oil producing countries should be able to price their principal exportable resource at a high enough level to finance their maximum attainable economic development. This is not an unreasonable argument. But the financial problem immediately facing most oil importing countries stems directly from the fact that the current level of oil prices gives OPEC a collective revenue far in excess of their ability to absorb funds. It is OPEC's $60 billion surplus revenue in 1974, the money left over after all imports and capital investments have been paid for, which is causing such concern to financial institutions around the world. If OPEC were to set its price only high enough to meet its collective maximum import and internal investment requirements, there would be no world oil price crisis today.

But the debunking of the rhetoric of the petroleum revolution is no more likely to bring world oil prices down than proof of the contradictions in Marxist dialectics would have forced Lenin out of the Kremlin after the October Revolution.

No return to the old order is possible. The transfer of power has taken place and must be accepted as permanent, within the inherent impermanence of all institutions. The only danger the oil producers now face is that of extremism. As history shows, every successful revolution is threatened by extremism in the immediate aftermath of victory. It creates internal dissention and solidifies external opposition. Many revolutions have eventually become its victims. The increases in world oil prices of last December together with those since then clearly constitute extreme actions. The rest of the world is beginning to respond. The question is will OPEC get the message?

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Address by *Richard Erb*

My subject today concerns the financial aspects of the oil revenue surpluses and deficits. It's such a beautiful day outside that I find it difficult to get into the spirit of gloom and doom that seems to pervade such discussions. I also suffer from two other disabilities. It was only about five days ago that I began writing a paper with the Council on Foreign Relations on the so-called oil recycling problem, and consequently I am still at an early stage in my thinking. In addition, eight days ago I was a government bureaucrat, and we all know that that's not very conducive to clear thinking either.

I would like to summarize the basic ideas of this presentation in the following ways:

1. While current world-wide inflation and financial market problems have been exacerbated by the oil price increase, the basic problems are caused by poor fiscal and monetary policies at home and abroad.

2. The primary ways of getting the price of oil down will be through conservation measures and an all-out effort to find alternative oil sources.

3. While many are exaggerating the financial problems stemming from current and future oil money flows, there are real problems. These problems could be substantially reduced if consumer countries worked with producer countries in the following ways:

a. Establish a long-term oil money recycling facility.

b. Allow producers into the developed countries financial "club" by giving them a stronger voice in the IMF, World Bank, OECD, GATT and other channels of cooperation which the developed countries use to exchange information and discuss policies.

c. Work with the producers on a multilateral basis to support internal and regional development.

4. The consuming countries should begin working immediately with the oil producers on the financial problems stemming specifically from the oil money flows. We should not wait for a "solution" to the oil price problem, nor should we use the financial side as a club or level to get the price of oil down.

There exists a tendency to lump many things together under the label: oil crisis. The impact of the oil embargo is confused with the impact of the higher price of oil. The oil embargo meant a sharp reduction in the supply of fuel to run cars, heat homes, and operate plants, but that impact ended when the embargo was lifted. The higher price of oil continues, however, and affects our lives in a number of related but distinct ways. Fuel costs more to run cars and heat homes. Oil producer countries have more money to buy goods from industrialized countries; consumers in the industrialized countries have less money. In effect, they must adjust to being poorer than they were before the price increase. Consumer countries are faced with the problem of financing oil deficits since producer countries do not have the capacity to spend all their oil revenues on goods. The list could go on, but the point I am making is that there are many ways of looking at the impact of the oil price increases. I plan to focus, however, on the financial consequences of the oil deficits and surpluses.

There also exists a tendency to blame too much on the higher oil price and the resulting financial flows. The high rates of inflation and the disarray that exists in our financial markets, both at home and abroad, were exacerbated by the oil price increases, but the roots of our current economic problem go deeper. Those roots can be found in the poor fiscal and monetary policies pursued by industrialized countries over the last decade. Even before the oil price increases at the end of 1973, extraordinarily high inflation rates were expected for 1974. We are now experiencing a worldwide economic slowdown, but that is primarily the result of relatively tight monetary policies enacted by monetary authorities in Japan, Germany and the United States over the last year. Surely a substantial reduction in the price of oil would go a long way toward easing inflation and boosting the world economy, but that would not be sufficient to deal with the underlying problems.

We all hear that the oil related surpluses and deficits are large and are expected to continue in the future. Some of the major oil oil producer nations, for example Saudi Arabia, will be able to spend only a small proportion of their oil revenues for domestic consumption and investment and thus will experience large surpluses which will need to be invested in other countries. The World Bank estimates that by 1980 the OPEC nations will have 650 billion dollars invested outside their own borders. The OECD has a smaller estimate - theirs is around 300 billion dollars. In either case, the numbers are very large and have led many people to talk about a future collapse of our world financial system.

Yet, we can look at the oil investment flows in a more positive way. The investments provide both the consumer and producer nations with a method of adjusting to the real economic consequences of the price increases. If the Middle Eastern countries, or the oil producers in general, bought goods with <u>all</u> of their oil revenues, we would have to send tremendous amounts of capital equipment and consumer goods to the oil producers. Thus, there would be fewer goods for domestic consumption and much more severe inflation. For countries like Saudi Arabia or Kuwayt, it may take decades if not centuries for them to turn their financial investments in for real goods.

To date, oil consumer governments have been relatively ambivalent about cooperating with the oil producer governments in the financial area. We stuck our toe in the water in several instances, the IMF facility being one example, but governments have not been willing to take the plunge and make an all out effort. Indeed, the consuming countries have been reluctant to cooperate among themselves to deal with the financial flows, let alone work out a cooperative arrangement with the oil producers.

There are at least three reasons why governments have been ambivalent about making an all out effort to collaborate in handling the financial implications of the oil money flows. First, there appears to be a fear that if we cooperate with the producers or even amongst ourselves to a greater extent in dealing with the oil money flows per se, we will be implicitly accepting the current price level of oil. Second, there is a difference of opinion even among experts as to how serious the financial problem is and what specifically governments need to do in a cooperative effort. There are people on the one hand who say that the financial system is going to collapse because of the large oil money flows. At the same time there are other bankers and economists who argue that the private market mechanism plus the IMF and the existing intragovernmental institutions can handle the oil money flows. A third factor inhibiting cooperation is that there are conflicting as well as mutual interests among oil consumers, among oil producers, and between consumers and producers with respect to how financial arrangements can be worked out in a cooperative way.

Although a major cooperative effort has not been initiated to deal with the oil money flows, I do not want to give the impression that nothing is being done. On a bilateral basis, for example, the US Treasury proposed a plan to some governments that would allow them to buy US Government securities directly from the US Treasury rather than having to buy through the market place. One purpose of that proposal was to reduce the burden on the private market mechanism of having to handle the large transactions. In another bilateral effort, the United States government set up a joint economic commission with Egypt and also with Saudi Arabia. These economic commissions are aimed not only at furthering the development of Saudi Arabia and Egypt in particular, but also the Middle East in general. To the extent that we can accelerate over time the internal development of these countries, and of the Middle East as a region, we will reduce the long run magnitude of the external financial holdings.

In addition to the bilateral efforts of the United States, other governments have taken steps to deal with the impact of the financial flows. The French, the Italians and the Japanese governments have each negotiated loans with various oil producing countries to help meet their oil deficits. Also, earlier this year the US government along with several European governments eliminated capital controls that would have inhibited movement of international funds. Many of the Middle Eastern countries have established public investment banks to finance both regional and domestic development. To the extent that these banks serve to enhance the development of the Middle East and allow increased spending on goods, the financial flow problem will be reduced.

Some action on a multilateral basis is also being taken. The IMF oil facility was established and is being financed by the oil producers. Its purpose is to allow countries facing severe balance of payments deficits to borrow in order to finance those deficits. The IMF also has proposed the establishment of an extended fund facility to provide some additional balance of payments financing for developed countries as well as developing countries. The United States continues to work with other consuming countries in traditional multilateral channels of financial cooperation including the OECD and the Bank for International Settlements.

While some steps are being taken on a bilateral and multilateral basis to handle the large financial deficits and surpluses, a broader and more sustained effort is required for financial collaboration and cooperation not only among consumer nations, but perhaps even more importantly, between consumer and producer nations. As a first step, it would seem desirable to separate any initiative aimed at lowering the price of oil from an initiative aimed at handling the financial consequences of the oil revenue surpluses.

This does not imply that consumer nations should passively accept the current level of oil prices. There are several direct ways to attack the price of oil, however, that do not require a financial component to the strategy. Downward pressure on prices could be created through conservation measures, or by developing alternative energy resources. There are those, however, who would like to deal with the oil price problem in part through the financial side. There have been proposals to impose restrictions on the financial investments of the oil producers as a way of getting them to lower their prices. That kind of approach would simply boomerang and we would end up with a lower level of oil production. On the other side there have been those who advocate using financial subsidies or inflation guarantees as a way of getting the price down. However, that turns out simply to be another way of paying for oil, but a way that has some bad side effects. For example, if a financial subsidy reduces the price of oil a little bit, the incentive for consumers to lower consumption would be less.

The most compelling reason for immediately establishing a means to cope with oil surplus and deficits is that unless we do cooperate - consumers and producers - we may face serious political, economic, and financial problems caused by the deficits and surpluses per se. Thus, it would help if we could separate the financial recycling problem from the oil price problem and deal with the financial issues immediately.

I would like to propose today three financial areas where collaboration between oil consumers and producers is desirable. First, there exists a need for a long-term recycling facility. Second, the industrialized countries should assist, on a multilateral basis, in the regional development of the Middle East. And third, the industrialized countries should give oil producers a larger role in the formal and informal channels of monetary and economic cooperation that link the industrialized countries including the Organization for Economic Cooperation Development (OECD) as well as the IMF and World Bank.

The justification for a long-term oil money recycling facility stands on broad economic and political grounds; it is not simply a financial matter. We currently face a historically unique situation. From an economic point of view, we know that one group of countries, the oil producers, must hold financial assets in other countries because they cannot spend all of their revenues on goods. Another group of countries, the oil consumers, must in the aggregate run annual deficits and face a build up in external debt over time. One problem arises, however, in distributing the financing of that aggregate deficit among individual consumer countries. Some countries, in an attempt to eliminate their individual deficits because they do not want a build up in their external debt, may trigger off trade wars as they attempt to pass their deficits onto other countries. Press reports and official statesments suggest that the Germans would like to keep their large surplus, that the French in three years plan to be in balance and the Japanese expect to be in balance in the near future. I also suspect that internal political pressures for trade measures will develop within the United States if we run a large deficit.

If we are to avoid trade conflicts and related political problems, we need to design a recycling facility in a manner that will make it politically acceptable for governments to run balance of payments deficits and to accept a build up in their external debt. At the same time, the facility also needs to be designed so that countries that cannot obtain financing from the private sector to cover their share of the aggregate consumer deficit will be able to borrow from the facility.

To meet these requirements, I believe that an oil recycling facility will need to have the following characteristics. As I mentioned earlier, my thinking at this stage of my work is quite preliminary, thus, the following characteristics are put forward in a sketchy manner:

1. Automatic but limited access: Individual countries would have automatic access to borrow from the facility (i.e. no political or economic review), but the amount that a country could borrow in any one year would be determined by a formula based on that country's oil deficit.

2. Long-term obligations: Borrowing from the facility would be for twenty-five year periods with countries having the option to repay after five years and also to renew for another twenty-five year period.

3. Spreading of Risk: Heavy sanctions would be imposed on any country that defaulted. In addition, an insurance fee would be charged borrowers to build up an insurance fund to meet possible defaults. Exchange rate risks would be handled by denominating the facility's assets and liabilities with a multi-currency unit.

4. Facility Creditors: Funds for the facility would be through private placements with governments and through issues in the open market to private investors. A market rate of interest would be paid, there would be no interest rate subsidy. Direct participation of oil producers technically is not necessary but is desirable.

5. Borrowing cost: The interest rate on borrowing from the facility would be floating and tied to the average cost of funds for the facility plus a small insurance fee for the default of insurance fund.

6. Administration: The facility would be established out-

side of existing multilateral institutions to reduce the possibility of economic or political pressures being applied to users and to leave these other institutions to deal with balance of payments problems that arise beyond those caused by the oil deficit.

I would like to turn briefly to the two other areas where there could be greater consumer country collaboration on a multilateral basis with oil producers and in particular those in the Middle East. One would be to provide technical and management assistance to support the regional development of the Middle East. More analytical work needs to be done to determine the developmental capacity of the Middle East and the rate at which it can successfully absorb capital goods. A second fundamental question concerns the politics of regional development in the Middle East. For example, some have talked about the fact that Saudi Arabia has all the money and that a country like Egypt does not, while Egypt has all the people and Saudi Arabia does not. This leads many to conclude that money will flow naturally from Saudi Arabia to Egypt. Yet, is it politically feasible for either Saudi Arabia or Egypt to accept a transfer of money in a magnitude that would really have an impact on development in Egypt?

I am not an expert on politics among the Arab countries and thus would ask that question of those of you attending this Conference who are. I would also ask what a third party role, whether an individual developed country or a group of developed countries, could be in providing assistance for the regional development of the Middle East? Perhaps we can discuss these issues in the question and answer period.

The third potential area of financial cooperation between the consumer and producer countries involves bringing some of the oil countries into the intergovernmental framework that exists among the developed countries. Because of the sudden increase in the price of oil, many of the oil countries have a level of wealth that puts them on par with many major developed countries. Yet, these countries are not part of, or play only a minor role in, the extensive intergovernmental infrastructure that exists among the developed countries. The developed countries take for granted the central bank and finance ministry relationships that grew over time and exist not only on a country-to-country basis, but also through institutions such as the OECD and the Bank for International Settlements. Because of the large amounts of money which they will control and the potential impact their decisions will have on the international money and capital markets, many of the oil producing nations need to be brought into the day-to-day consultation-decision making process that exists among the major developed countries.

I have presented a very general outline of some ways in which the oil consumer and producer nations could work together to cope with the financial impact of the currently large oil revenue surpluses. During the question and answer period, I hope that we can go more deeply into some of these areas.

DISCUSSION

The rise in oil prices, inflation, the developmental needs of Middle Eastern countries, the investment of surplus oil funds and the durability of OPEC were all reviewed during the ensuing discussion.

Since January 1973, the rapid rise in the price of petroleum has contributed to current world wide inflationary pressures. The magnitude of its impact, however, remains an area of disagreement. Studies by the governments of Saudi Arabia and Kuwayt were cited as indicating that the rise in oil prices had increased inflation by only 1-1/2 to 3 per cent. One panelist estimated the inflationary impact to be between 4 and 5 per cent but went on to note that the OECD had predicted, prior to 1973, that high inflation rates were in the offing. Furthermore, with inflation rates in the United States and abroad reaching 11, 15 and even 20 per cent, factors other than the rise in oil prices had to be considered. These included price rises in other primary commodities such as agricultural products, plus the excessively inflationary fiscal and monetary policies pursued by the United States and Europe in the 1970-1972 period. The US, Germany, Japan and France ultimately moved to counter this over-acceleration of their economies by pursuing contractionary monetary policies coupled with fiscal policy restraints which together resulted in high interest rates, increased unemployment and a general recession. Yet, in spite of these problems, one panelist reiterated his belief that even those countries facing serious economic dislocations should be able to deal effectively with these difficulties through traditional government domestic management policies combined with external aid, whether from multilateral sources, a recycling mechanism or directly from the oil exporting countries.

With general agreement that oil prices have at least contributed to inflation, it was felt that a downturn in those prices would help to dampen inflation. But the two avenues explored, namely, increased supply from new sources and a weakening of OPEC, were found wanting. New supplies from the North Sea and Alaska's North Slope would not be substantial enough to alter world prices. Production estimates vary for the North Sea from 3-1/2 to 7 million barrels per day and for Alaska from 2-1/2 to 3 million barrels per day. Yet, with oil consumption in the US alone increasing at approximately 5 per cent per year, these new supplies could be easily absorbed. Furthermore, if the oil find in Mexico should encourage that country to move aggressively into the export market, she would probably apply for entry into OPEC in order to benefit from its control over prices rather than take actions which might tend to undermine that control.

There was still the possibility that political factors might weaken OPEC, reduce its effectiveness and thus help bring down oil prices. One query raised the possibility that Iran's endeavor to secure a dominant military, political and economic position in the Gulf region might cause a rupture with Saudi Arabia; or that Algeria, a major influence in the Third World, might try to divert OPEC down more radical paths. The conflict between Iraq and Iran was also raised as an area of tension which could disrupt OPEC solidarity. However, even though it could be argued that OPEC contains the political seeds of its own destruction, the effective operation of OPEC still remains highly beneficial to all its members, radical and conservative. It seems unlikely that Saudi Arabia or Iran, both conservative monarchies, would seek to subvert a good thing. Algeria, though more radical than most other OPEC members, remains too small a producer to have a sizable impact on oil prices, even if it tried. Iraq and Iran, despite their political differences, have extensive development programs requiring massive funding, placing both of them on the side of higher prices.

Comments from the floor and the panel underlined the evidence of increased American interaction with the Middle East. Both the changing pattern of US oil imports and US participation in the development programs of these countries were cited as key signs of this trend. In recent years the United States has grown more dependent upon Middle Eastern oil. Between 11 and 12 per cent of current US petroleum demand - approximately 2 million barrels per day out of a total demand of 17 million barrels per day - is supplied by Middle Eastern producers. This constitutes about 33 per cent of America's 6 million barrels per day of oil imports. In addition, the need for cooperation, as opposed to confrontation, between oil consumers and oil producers was stressed. For American businessmen interested in taking advantage of new sales opportunities in the Middle East, an active campaign to increase their familiarity with the people and societies in the Middle East was encouraged. Americans should travel to the Arab countries not just to sell products but to learn about the area, its needs and its capacity to absorb the products being offered. Initiatives by organizations such as the National Association of Manufacturers (NAM), aimed at studying development and sales possibilities in the region should be supported and expanded. High Arab development expectations were characterized by an anecdote recounting one Saudi official's belief that the US could put a man on the moon in ten years it should be able to help Saudi Arabia develop in five years.

The desire of the Saudis to cooperate with the US on a bilateral basis was also underscored. A series of initiatives _via_ the Joint Economic Commissions have been embarked upon by the two governments. The NAM effort was pointed to as an example of action taken under the auspices of these commissions. Furthermore, the April US-Saudi Arabian communiqué authorized the establishment of five work groups and during Treasury Secretary Simon's two-week trip to the Middle East, the industrialization and manpower work groups were set up. Institutionalizing training program arrangements with the US was also emphasized as the Saudis were said to be anxious to have greater US governmental involvement in the early planning stages of their educational and manpower training programs, with participation by private US institutions augmented later. On the other hand, criticism of American policy also surfaced as one participant lamented that recent statements and actions by some US officials seemed to indicate an American tendency to "grandstand" rather than strive for the development of constructive modes of cooperation and joint efforts.

An element of irony emerged as one questioner wondered how Americans could be uneasy about large scale foreign investment in the United States when a number of foreign countries have accepted, though not necessarily without objection, massive American control in their economies. It was pointed out, however, that whether or not American apprehension was seen as justified, it does exist and must be taken into consideration when formulating policies dealing with US-Middle East cooperation. In this regard, the US can still use its sovereign power to channel any new wave of foreign investment into positive areas. America has a choice in determining the direction new investment will take in its economy, Europe and Great Britain had no choice. Therein lies the difference.

Further comment on fears concerning the domination of the US economy by foreign oil producers was placed in a global perspective. If the total requirements of not only the United States, but Eastern and Western Europe and the Soviet Union as well are considered, then the magnitude of the problem of economic domination is diluted. Unfortunately, forecasts indicate that the United States will be the focal point for a major portion of this oil money investment - between 40 and 60 per cent - leaving the risk of domination ever present. This argument posits that the Arab oil producers are not going to be willing to take the risk of supporting, on a long term basis, such countries as Britain and Italy. As a result, the major financial flows will have a trilateral characteristic with the principal hard currency flow into the Middle East originating in Europe while the return flow will be directed primarily toward the United States leaving America in a central "recycling position." The optimal operation of this function will require cooperation between the countries of the Middle East and Western nations. To facilitate this cooperation these wealthy producing states must be brought into the decision making process. Yet, there is hesitation on both sides in the area of international financial reform. It is not only major Western nations who are reluctant to act, but Saudi Arabia and Kuwayt, among other major oil producers, also seem unsure of the role they want to play.

In conclusion, the discussion returned to the original focus of the topic, underscoring how a settlement of the Arab-Israeli crisis would affect the relationship between oil producers and consumers. In October 1973, there was a direct and obvious link between the embargo and a settlement of the Middle East crisis. However, the major oil price hikes in December 1973 emanating from Tehran, were encouraged by the non-Arab oil producers and indeed, ran counter to the political objectives of the Arabs. They made the price of oil almost as great a hardship as the embargo and hurt friend and foe alike. Thus, at first, there was no connection between the price issue and a settlement of the Arab-Israeli conflict but after the lifting of the embargo and with the passage of time, a link has been established. The discussion closed noting that the future of US-Middle Eastern relationships will turn on whether the US wants to listen to the Arabs or to challenge them, to commence a dialogue or to reinforce confrontation.

THE DEVELOPMENT OF NEW INDUSTRIES, TECHNOLOGIES AND SKILLS IN THE MIDDLE EAST: WHAT ROLE FOR AMERICANS?

Two decades ago the attitude of many scholars, to use the words of one of them, was that "the Arabs have not been an important people in the modern era." The conclusion seemed to be that whatever significance could be attached to the Arabs derived from their position on the great land bridge and maritime routes between East and West, rather than from whom they were.

The classic phrase which has become known as Issawi's Law Number One, "Where there are Arabs there is oil"[1] even if it still reflects an erroneous and dangerous attitude of many people, is now looked upon as archaic. Has the generation of pragmatic Americans that advocated the "fifty-fifty" oil agreement in the 1950s been the starting point for the realistic understanding of the special relationship that is now being shaped between the US and the Arab world? In any case, those who made that agreement were contributing in their own way to the special relationship which began with the establishment of American educational and philantropic institutions in the Middle East during the nineteenth century.

Eleven years ago, the concept of development of human resources was already in difficulties. At that time, it was felt that the Middle Eastern countries had failed sufficiently to understand that the successful development of human resources demanded that a country concern itself with training as well as educating its manpower. Where education and training clearly complement each other, there had been so much emphasis on higher education that the practical training needed to provide competent technical, professional and administrative operating skills has been badly overlooked.

The reasons why manpower resources have not become more productive can be identified. Firstly, most of the countries have developed elementary and secondary school systems whose curriculum points entirely toward higher education. Secondly, in the employment

[1] Issawi's Law Number Two being that "The converse is not necessarily true."

field itself, promotion and advancement possibilities were really based very little on individual skills and capabilities or job performance but on the level of the academic degree the individual happened to hold. Thirdly, wage and salary levels were tied to very arbitrary classifications and there was no way for productivity to become a basic criterion for increasing wage levels. One must point out that the individual who had fallen out of the educational system was forever going to be geared to a lower level despite what his experience, initiatives and basic intelligence were. In this field, Ministries of Education held important responsibilities and played very little role in promoting a larger education and training effort. Today, the picture has not changed very much. The saddest part of this is that it is very hard to come to grips without moving into vested interests and small empires. There will have to be a serious dedication at a high governmental level totally to revamp the whole effort that goes into making manpower productive. The basic dilemma, in every Middle Eastern educational system that produces either overeducated and undertrained or undereducated and nontrained manpower, still exists and remains unanswered. The first category will end up in governmental positions without actual operating responsibilities, the second will end up at the bottom of the ladder.

In the United States today, what is taken for granted is the strength of the secondary school system which puts into higher education or training in industry and business, individuals that understand the need to be able to analyze, reason and absorb information in order to use these capabilities productively. Higher education requires the capacity to learn at this level; an adequate secondary school system will be necessary, if the university system is to function at its highest level. Two basic facts reflect the state of the educational system in the Middle East. On one hand, if graduate schools exist, they graduate unemployables. The fundamental reason for it is that the instructors have never been trained in industry or business. On the other hand, the rural areas are deprived of efficient schooling which could turn out individuals skilled in modern agricultural techniques or able to provide the basic skills which are needed in those particular areas. Until the Middle Eastern countries pay more attention to the secondary school level, until they become concerned with the fact that the individual who stops his education has to be productive and they abrogate the government rule which equates a man's promotion with the academic degree he holds; until they promote a meaningful program for employment of graduates and for the development of the rural areas, the potential of the region will simply not be achieved.

Education and technological transfers are the key elements for a homogeneous development. Given the needs of the region, technological transfers of the latest sophisticated techniques in various fields might solve some of the problems faced by the Middle Eastern countries. As a specific example, the problem of water supply must be considered now before it becomes a crucial issue in the coming years. Meaningful agricultural development cannot be achieved if water supplies are not secured. In this light, assuming the settlement, a feasible scheme related to desalting technology would be suitable for the area.

What will be described further is one example of a specific technological transfer which would benefit the whole area and where Americans would have a role to play.

In the past years, progress in reducing the cost of desalted water has been made. The problem was that the cost of water exceeded the value of the agricultural output which could be realized. Before the energy crisis, the cost might have been within a range that would have served a scientifically organized agriculture. With oil price increases, the cost of fuel eliminates this method unless some alternative ways of supplying cheap energy fuel can be conceived.

Assuming a peaceful settlement in the area, it is possible to conceive a way of approaching this problem with reference to the North Sinai area. Desalting plants would be set up in the South of the Gaza Strip and in the Al-Arish area supplying 125,000 acres with a sufficient volume of water. The economic objective would be to develop a high income producing modern sector, the basis for generating economic activity in the region. The aim of an agricultural program of this kind is not to maximize employment but rather income per person and this is quite possible with this kind of technology and this type of agriculture.

At that point, two basic assumptions must be made. Firstly, a large amount of capital (700-800 million dollars) would be available. Secondly, a low cost fuel would be available. As to the second assumption, a possibility would exist. In Saudi Arabia's oil fields, one thousand miles from North Sinai, the gas associated in the production of oil is presently being flared and the Saudis are making plans to use it productively. Given the amount of gas produced in association with the production of ten million barrels of oil a day, the Saudis might have some difficulties to use all of the gas for the next ten or fifteen years. The desalting program would need five to ten per cent of this gas. This gas could be piped and in order to control its cost, a price with an upper limit could be assigned, the upper limit being the price the Saudis would receive if they were to sell this gas for export in the form of liquified natural gas (LNG).

The gas would produce steam energy for the desalting-power project. The lower ranges of temperature, which have little value in terms of electric power production could be used for the desalting plants and the more efficient higher temperature steam would be used for producing power which could fit into the power system of Egypt and satisfy an important part of her expanding power requirements in the next ten or fifteen years.

This particular program is an example of the kind of technological transfer which might contribute to the development of the Middle East. Three countries, namely the future state of Palestine, Saudi Arabia and Egypt would benefit from the efficient use of a presently wasted resource, and of a high income-power-agricultural program in a strategic area. The use of desalting technology is one of the many potentialities which exist in the Middle East. Many other sectors can provide similar opportunities either in the field of pure technology and management or in the field of education and training. On the one hand, the Middle Eastern governments and, on the other, the business community are conscious of the mutual benefits of cooperation.

The establishment of the Saudi Arabia-United States Joint Commission on Economic Cooperation reveals a new awareness of the need for a united effort. A delegation from Saudi Arabia, headed by Prince Fahd, came to Washington on their own initiative to seek a new and special relationship with the United States. That new relationship was realized through the establishment of the Joint Commission on June 8, 1974. The number of Joint Commissions with the United States has quickly multiplied. Separate Commissions have since been set up with both Egypt and Israel and discussions with Jordan about a similar Joint Commission will soon be completed.

The Saudi-American Commission will be headed by the Secretary of the Treasury for the United States and by the Minister of State for Finance and National Economy for Saudi Arabia. At the heart of the Joint Commission are four Joint Working Groups which are as follows: the Group on Industrialization, the Group on Science and Technology, the Group on Manpower and Education and the Group on Agriculture. All the appropriate US government agencies are represented in the Joint Working Groups.

Unlike the other Joint Commissions countries, Saudi Arabia is a financially independent developing country. This financial independence gives the Saudis the freedom to pick and choose consultants and projects in a way which stresses quality and efficiency rather than the financial costs. During the next five years, Saudi Arabia "hopes" to spend about fifty-five billion dollars in various development and industrialization projects. Saudi Arabia is simply unable to expend and absorb these large amounts of money she receives from oil. For this reason, Saudi Arabia has turned to the industrialized countries and, in particular to the United States government through the Joint Commission and to the US private sector.

The Saudis expect that by 1976 American business will capture about sixty per cent of their market. To encourage foreign participation in her industrial development, Saudi Arabia has promulgated a new industrial policy statement with an eleven point incentive program. These incentives include: liberal terms of equity capital, assistance in the preparation of feasibility studies, exemption of imported equipment and raw materials from custom duties, tax holidays, preferences for local goods in governmental purchases, custom protection against competitive imported products, financial assistance in the technical training of Saudi employees and concessionary terms for spaces at industrial parks.

Since its establishment, the Joint Commission has come out with surveys and recommendations which have already been implemented. Another role of the Joint Commission has been to introduce the Saudis to leading US businessmen and to encourage American investment in Saudi development and industrialization projects. The Joint Working Group on Industrialization explained that its objective is the diversification of the productive base of the Kingdom, development of the industrial sector, improvement of agriculture, creation of the necessary infrastructure and development of natural resources.

The Joint Commission seems to be an important step in catalyzing initiatives from both sides. It might be an adequate channel for educational and technological improvements like the development of accelerated methods in education, so that the existing facilities could be upgraded or for the realization of the previously described desalting program. At that point, it seems to be of some interest to distinguish some governing propositions for a new pattern of relations with the Arab world. Firstly, if Americans are to participate for mutual benefit in the development of new Arab skills and technologies, they must understand that they are dealing with peoples whose culture and value system are rooted not only in Islam, but in pre-Islamic and pre-Christian era. Secondly, the Arabs need to traverse, within a few decades at most, an historical terrain which the West entered over four centuries ago and is traversing still. Thirdly, despite efforts to destroy it, which on occasion seem almost deliberate, the special relationship or good will between Arabs and Americans continues to provide opportunity for American participation in the development of new Arab skills and technologies. Such good will, however, will be expended for naught unless there are major shifts in economic and political attitudes toward that part of the international market place which is the Arab world - and that part of the fragile fabric of world peace which covers the same area. Fourthly, Americans must be acutely sensitive to potentially disruptive influences stemming from an increased involvement with Middle Eastern societies. Fifthly, it has to be remembered that in the Arab countries the role of the Minister of Education is usually more important and determinative than that of the Ministry of Foreign Affairs. This argues in favor of giving high priority to facilitating educational reform, curriculum development, improved means of dissemination of educational programs. Sixthly, if such crucially important goals are to be attained, the Americans must understand the state of their own institutions. The pace of change in America's universities in the mid-seventies is rapid, and the prism through which such change is viewed from Washington tends to distort reality. There is, as well there should be, understanding among government officials of the political reasons for the spread of feelings of alienation or even hostility toward the government, of a diminution of trust by the American people. The American university system is responsive to such trends.

Such circumstances will influence the American role in developing new Arab skills and technologies. American education and training expertise, in close cooperation with American business and industrial know-how, could, if used effectively, greatly accelerate the current rate of manpower training in the Middle East.

Fresh thinking by government officials, greater involvement by the American business community and reexamination of priorities by educators will be necessary if the United States is to contribute to making the years ahead an era of peaceful change and progress in the Middle East.

THE DIALECTIC OF OIL, FOOD AND POPULATION GROWTH: ANARCHY OR POSITIVE INTERDEPENDENCE?

In the year since oil prices first started to rise sharply, enough has taken place to demonstrate the reality of interdependence and to permit some preliminary judgments about the impact of higher oil prices on agricultural production and population growth. In order better to understand some of these linkages between oil, food, and population growth and how these things can be expected to interact in a post-settlement Middle East, each issue will be briefly described in isolation, the linkages will be identified, and the possible future developments will be outlined.

The problems associated with unchecked population growth in the world have been recognized for decades in both the developed and developing world, and at the recent population conference held in Bucharest three views on restricting population growth emerged. Some developing countries expressed support for policies designed to reduce the rate of population increase without having specific policies to accomplish the goal; some countries, such as Iran and Egypt, not only supported the goal of population growth rate restriction but had instituted policies to reduce fertility; and some countries were hostile to suggestions that population growth rates should be reduced, either because of the conviction that such advice was a form of neo-imperialism or because population reductions were expected to follow a general increase in economic development and living standards. In the Middle East most of the countries fall into the first or second groups, and only the smaller states of the Persian Gulf are relatively unconcerned about population fertility levels.

The reason for such a general concern with fertility control in the Middle East can be illustrated by some figures comparing the growth rates of various regions of the world. The estimated annual rate of increase in the world's population in 1973 was 2.0 per cent, compared with 0.8 per cent in the developed world, 2.5 per cent in the developing world as a whole, 2.7 per cent in Africa, 3.0 per cent in tropical Latin America and 3.3 per cent in the southwest Asian Arab countries (excluding Egypt). Such rates of increase in the developing world are significant because they erode any progress made in the pursuit of economic development.

Two other interesting issues relating to population in the Middle East become increasingly important in the event that a settlement is achieved; the current population of Israel and its ethnic composition, and the location of the postulated state of Palestine, its current population and the number and type of refugees which would return in the event of a settlement.

The state of Israel has a population with some special characteristics, one of the most significant of which is the different fertility levels which can be observed among different segments of the population. The gross reproduction rate declined slightly for Jews of Asian or African origin between 1955 and 1971, rose slightly over the same period for Jews of Israeli or European birth, with the net effect that the gross reproduction rate for Jews as a whole was constant during the period. For the Christian population of Israel the rate was similarly constant over the period and was virtually identical to the Jewish rate; the rate of reproduction of the Druze population was more than twice the Jewish level, and the Muslim rate of increase was almost three times higher. In 1970 the natural rate of increase for the Jewish population was 1.7 per cent while the same rate for the non-Jewish portion was 3.9 per cent. Projected forward under various assumptions these fertility levels and trends produce interesting insights into the possible internal population and composition of a state with finite and defined boundaries, although some of the non-Jewish population could be expected to emigrate to whatever Palestinian state was created as the result of a settlement.

For the sake of discussion, it is assumed the new Palestinian state would include the West Bank, the Gaza Strip and East Jerusalem. Reliable estimates of the number of Palestinian refugees suggest that the total number of refugees in East and West Jordan, Gaza, Lebanon and Syria approaches 1.5 million, with another 500,000 Arabs in Israel itself in 1973. Given these figures it is possible, while making certain assumptions about the number of refugees which would return to such an entity, to estimate that a post-settlement Palestine would have initially a population of between 1.5 and 2.0 million, with a sufficiently high fertility level to increase the population to as much as three million within a generation.

Whether the current food crisis is of a short or long duration is debatable, but there is at least a short term distributional shortage: 500 million people are acutely hungry and, according to the UN, 300 million children are "grossly physically distorted" as a result of inadequate diets, and many of them are mentally inadequate for the same reason. The current crisis in the Sahel, the food shortage in the Indian subcontinent, and the worldwide shortage of grain all testify to the existence of a food crisis of malnutrition and starvation.

While a return to food surpluses in the developed world might be of some assistance in preventing mass starvation, it is unlikely that this would represent a permanent solution; world trade in food is in some respects similar to that in oil, and it would be unwise for any country to develop a great degree of dependence on foreign suppliers of food. North America controls a greater share of world trade in grain (wheat, corn, sorghum and rice) than the Middle East does in oil, and while it is generally believed that American agricultural policy has never been directed at political goals the contrary is in fact the case. Until 1974 60 million acres in the United States alone were kept out of production in order to maintain farm prices and incomes, in 1972 large amounts of grain were sold to the Soviet Union at concessional rates in the name of improved relations, in 1973 exports of selected agricultural commodities were restricted in order to moderate pressure on prices in the United States, and similar controls were imposed in 1974 on additional sales to the Soviet Union.

In addition to the effective monopoly on food exports controlled by North America, an equally dominant position in fertilizer exports is enjoyed by Europe, Japan and the United States. The export of fertilizers has been effectively embargoed since the price of oil started to rise, and the net effect has been similar to an embargo on food exports. The developing countries which embarked on the Green Revolution have developed a dependence on foreign supplies of fertilizer, and as a result of this dependence the lack of one ton of fertilizer will lead to a shortage of ten tons of food at the end of the crop year.

In the context of the global agricultural crisis the situation in the Middle East is relatively good, in that mass starvation is not threatened. The Middle East is not a homogeneous agricultural area, but in general production has been declining for a number of years. Between the early 1960s and 1972 agricultural production per capita declined by 16 per cent in Algeria, by 2 per cent in Syria, remained unchanged in Tunisia, increased by one per cent in Egypt, by 13 per cent in Morocco and by 41 per cent in Israel. This illustrates the heterogeneous nature of the area, but it also identifies a crucial problem; in those countries where production per capita declined, there is now less available for consumption than in the past, and there are no surpluses elsewhere in the world which could cover the deficit. There is no simple explanation for the relatively poor performance of the agricultural sector in the Middle East, although one of the primary problems has political roots. In many countries political changes have brought with them changes in the system of land tenure and land management which have created difficulties, and these have been compounded by a failure to understand the economics of agriculture and the motivation of farmers to increase production. In addition to this there is a remarkable lack of market sophistication, particularly in the area of export promotion, which has restricted agricultural expansion.

While the current state of agriculture in the Middle East is not particularly encouraging, exciting developments are currently unfolding in Saudi Arabia. Agricultural production has been rising at a rate of 5 per cent per year, as fast as in Israel, and one of the most important reasons is the structure of the Saudi economy. Since government control is minimal there are few restrictions on imports and exports and farmers have been able to purchase necessary inputs like advanced seed varieties, and they have been free to exploit export markets where possible. The farmers have raised productivity because of the incentive of increased profits, and are now producing crops like cauliflowers, french beans and carrots that did not exist in the country ten years ago. Since the 1967 War Saudi Arabia has replaced Jordan as the primary supplier of the Beirut market, in part because the farmers were free to react to market forces. Another important factor in Saudi Arabia's long term agricultural development is the surprisingly large amount of water which can be found in subterranean deposits. One of the largest untapped fossil and groundwater reserves in the world is under the Arabian peninsula, and the government has conducted extensive soil and water surveys to identify the most promising development prospects. Some of these have been isolated and development is scheduled for the near future. The description of agriculture in Saudi Arabia is significant not only because of the prospects it holds for that country, but also because of the useful lessons which can be drawn from it by other states in the area which have the potential to increase agricultural production.

Although both the issues of population and agriculture are important in the Middle East, the area is best known for its oil. The fourfold increase in oil prices has had a staggering impact on both the Middle East and the world as a whole; it is estimated that the OPEC surplus in 1974 will be $60 billion from a total income of about $90 billion, and this surplus must be matched by a corresponding deficit elsewhere in the world. Between $48 and $50 billion of the deficit will fall on the OECD countries and the remainder, $10-$12 billion, will be incurred by the developing world. While the price rises themselves create economic dislocations, the most difficult problem relates to the size of the surplus income. With a surplus of this size it must be returned to circulation so that the deficits may be financed; the alternative is that the world's economy shrink by the amount which is not recirculated. This recycling has caused some structural problems because much of the deposits are being held in short term accounts, but some funds are being loaned for longer periods. Although private banking institutions cannot continue this and absorb all of the surplus funds, they have been quite successful in smoothing the recycling process, and there are reasons to believe the surplus will be a more tractable issue than had initially been supposed. In the first place, OPEC's demand for imports has risen more quickly than had been predicted. In addition, much of the surplus has moved from short to long term accounts with relative speed. Finally, governments have been actively creating investment opportunities in order to absorb surplus funds. Thus the problem of recycling, while involving some logistical and systemic difficulties, is hardly insoluble. Of greater significance is the problem of loss of wealth on the part of the oil importers as a result of the price increase.

The earnings of the OPEC members will be about $110 billion for the year ending June 30, 1975, compared with $15 billion in the previous year. This represents an increase of $95 billion: the total GNP of the non-communist world was estimated to be $4 trillion in 1974, and if one assumes a 20 per cent increase in fiscal year 1975 as a result of inflation, the increase of $95 billion in OPEC revenues, is something under two per cent of non-communist world GNP. In this perspective the transfer of purchasing power is not nearly as awesome as the figure itself would suggest. That these issues pose a threat to the world economic order is indisputable, but they are neither calamitous nor insoluble, and there is nothing in the figures which are a legitimate cause for despair.

What makes the problem of oil particularly formidable is its importance to the world economy; the same is true of agriculture and of population, and the linkages among the three issues and the interdependence among states which is thereby suggested are the cause of the complexity and confusion. These relationships can be grouped under the headings of political and economic linkages, and they describe not only the relationships between the three issues but also the relations between the developed and the developing world and between the oil producers and consumers.

Under the political heading the relationships are diffuse and difficult to isolate, but one of the most surprising results of the increase in oil prices has been the lack of animosity on the part of the developing world toward the oil producers. The statements of solidarity with the producers are certainly motivated in part by a desire to curry favor and possibly obtain aid from the producers on concessional terms, and in part by the prospect of forming other commodity arrangements which could increase export earnings, but a large amount of the support is the result of a feeling of satisfaction that the developed world has found that one group of commodity exporters has been able to resist exploitation. How long this Third World solidarity will survive in the face of continued high oil prices is impossible to guess, and the oil producers may have to spend much of their surplus in order to sustain such feelings of goodwill. In the short run, however, the degree of support that OPEC has received from the oil consuming members of the Third World has been remarkable.

An additional political linkage exists between oil and food: one of the initial responses in the United States to the use of the "oil weapon" was a debate on the possible use of food as a weapon. This debate continues, and whatever its outcome the fact remains that the credibility of the United States as a supplier of grains has been eroded in part because of the debate and in part because OPEC's action made the issue of dependence on foreign suppliers of any commodity a sensitive one. In addition, the impact of the oil price increases has increased the desire on the part of many groups to seek groups to seek greater self-sufficiency and to reduce foreign commitments.

By far the most important linkages are the economic ones, and these are the most difficult to deal with. Probably most significant is the differential impact of high oil prices on different countries and different groups within particular countries. Prior to the price increases the UN estimated that more than 100 developing countries were making some progress in developing their economies. Many are still making acceptable progress and some, most notably the members of OPEC have solved their financial difficulties. There remains, however, a group of between 35 and 40 countries which were in some difficulties even before the oil/food/fertilizer price explosions, and this group was hit particularly hard by those explosions. While some of the more advanced countries have lines of credit available with which to finance deficits in the short term, this lowest group is not able to borrow because of a poor credit rating, and sources of international assistance are not proving adequate to the task. Within countries the problems are no less difficult; even in the oil producing states the proportion of the population which benefits directly is quite small, in some cases as low as one per cent, and the increased costs of food have harmed the poor in the producing as well as the consuming countries. All of the people in the Middle East receive some indirect benefits from oil revenues through government expenditures on food subsidies, health, education and housing, but most of these benefits accrue to the small middle class living in cities and towns, a group which is between 20 per cent and 30 per cent of the population of the larger countries. In 1972, for example, per capita income in Algeria and Iraq was about $350, roughly $300 in Tunisia and Syria, and about $2,000 in Israel.

In addition to the unequal impact of the price increases on different countries and population groups, a particularly insidious relationship exists among economic development, population growth, and demand for energy. With a growing population, demand for energy will increase even if the economy is stagnant; if the economy is growing at all then energy demand per capita is likely to rise, compounding the effect of the population increase. In addition, much of the technology which is imported in order to further development is relatively energy intensive and the necessary technology for economizing on energy consumption is not accessible to developing countries. Even if it were available many of the countries are now committed in one way or another to economic development paths which imply a high level of energy use. An example of this is the high demand for fertilizer built into the

Green Revolution; any country which adopted the techniques for increasing agricultural output which fall under this rubric is now committed to high levels of fertilizer application if yields are to be maintained at current levels, and the rise in the price of fertilizer, both in real and balance of payments terms, has drawn needed resources away from other development investment.

Although no conclusive evidence exists which could establish a definite causal link between current oil prices and rates of population growth, if there is any impact at all it will be to retard the rate of decline in population growth rates. There is general agreement among population specialists that declines in fertility generally accompany substantial and sustained economic growth, such as took place in Europe following the Industrial Revolution, so if the effect of high oil/food/fertilizer prices is to retard economic development then an indirect result may be a postponement or at least a retardation in the process of reducing fertility levels and hence a slowing of the process of controlling rates of population increase.

With all of these interrelationships, the prospects for positive interdependence seem slight but the possibility of anarchy appears to be equally unlikely. Three scenarios, defining the extremes and some compromise outcome, can be described. The first possibility, suggested in some circles, is that the major oil consumers would confront OPEC on the issue of oil prices. The result would be severely impaired relations between the producers and consumers, severe damage to the international economic order, no resolution of the oil price issue, with the possibility that the United States would be tempted to act irresponsibly with its monopoly over food exports. All countries would suffer under such a scenario, and the poorest countries would be the most severely damaged.

The second possible outcome would be an arrangement worked out directly between the oil producers and the developed world in which surplus oil dollars would be recycled directly from the producers to the developed countries. This would solve many of the problems relating to the issue of recycling, but it would overlook the economically less important part of the world which contains one fourth of the world's population. Such a solution would work after a fashion, but it would not mitigate the problem for those living in the developing world.

The third possibility can be described as positive interdependence, elements of which would be humanitarian management of American food supplies in such a way that the damage which has been inflicted on the world by the increased cost of food could be reduced and a similar gesture on the part of OPEC to lower the real cost of oil, especially to developing countries. In attempting to recycle the surplus oil dollars, the OPEC countries could direct some of their funds through some of the poorer countries of the world, who would then use the funds to purchase goods and services from the industrialized world. Finally, an energetic attempt would be made to restrain population growth and expand food production in the Third World, where it can be done most efficiently and at the lowest cost.

While the third possibility seems slightly optimistic, it offers a challenging target for the policies of the oil producers and consumers and the developed and developing countries of the world. What will probably happen in the Middle East in a post-settlement environment will not meet the expectations of the third scenario, and developments must be evaluated according to four criteria: in the first ten years after a settlement will agricultural production in and exports from the area increase, will such increases encourage cooperation or competition, what are the areas of possible cooperation between the Arabs and Israelis, and will any changes in the above materially improve the condition of the poorest 40 per cent of the population in any of the larger countries?

Dealing with the issue of agricultural production and exports, it is possible that there may be a decline in output in the non-oil countries. The change in oil prices has already altered factor price ratios significantly, and farm profitability has been reduced. The oil exporting countries could raise agricultural production, but this would require a willingness to eliminate current distortions in their production and marketing systems and in addition a policy of subsidizing farmers with oil revenues. Iran, Iraq and Algeria, among others, have the potential to follow Saudi Arabia's example and increase agricultural production dramatically.

The impact of increased production on competition or cooperation would depend on a number of factors including the magnitude and composition of exports. A trade war in oranges is not out of the question, for example, because Morocco and Tunisia, possibly subsidized by Saudi Arabia, could substantially erode Israeli foreign exchange earnings, 68 per cent of which are derived from citrus exports. Since Tunisia, Israel and Morocco supply most of European demand for oranges, however, they could substantially increase profits and stabilize earnings if they did cooperate.

Israel has significant expertise in efficient production and marketing systems, specifically in water supply and pricing, quality control of production, the organization of collective agriculture, and a special expertise in training other people of other cultures around the world. All of those skills are in short supply and could be rapidly absorbed in the Arab countries. It is optimistic to expect that these kinds of exchanges could take place rapidly, but small steps in that direction could come in the area of plant and animal materials exchange.

Whatever progress takes place in the above three areas, it is unlikely that the living standards of the bottom 40 per cent will be raised significantly. Throughout the area literacy rates are low, few children of school age are in primary or secondary school, infant mortality is still high, and deaths due to malnutrition are high. Improving the lot of the poor requires the transfer of income and wealth from the top of distribution patter to the bottom. There are no substitutes for this, and it is as much an internal political decision as it is an economic one.

Thus, if there were to be a settlement it would not effect the underlying political and economic forces which now determine the level of agricultural production, exports and poverty. If the settlement produced a spirit of cooperation between Arabs and Israelis, it would make some of the problems of development easier to deal with, and the reduced political tension could have a beneficial impact on oil prices. On balance, however, positive interdependence remains a goal of policy rather than something which can be expected in the logical course of events.

SUMMATION

Roderic Davison

Thank you very much. President Battle did not tell you the real reason he asked me, which is that I have the splittest personality that he could find. Being bifurcated, dichotomous, and bilateral - even trilateral this morning - this worked out very well. Frankly, I have had the help of rapporteurs in the various sessions for which I am very grateful; otherwise I might not have known some of the things that transpired and there will still be many omissions. It is obviously hard to summarize all that has been said. Nothing, I think, is harder than to try to coordinate the prophesies of 23 (I counted them) 23 uncoordinated prophets. Nevertheless, I, your poor, ignorant, humble servant will try. I fell flat on my face in a session this morning, literally, tripping on the carpet; I hope this is not a repeat of that. It was not a very good carpet, it was an American machine made, it was not a good Middle Eastern carpet, I assure you.

I am going to divide my remarks into three parts. First, assumptions; then, caveats; and finally, projections. There will be five assumptions. There's only one caveat, and there are many projections. And of the three parts, projections will occupy us most, for this is what we have really been concerned with.

First as to assumptions. They were set out in the beginning, but I think they should be repeated. I count five assumptions, but I will give you four at the beginning.

(1) A long view is both desirable and possible.
(2) There will be a settlement of the Arab-Israeli conflict, if not a "solution."
(3) There will be some kind of Palestine entity, West Bank and Gaza based.
(4) There will be international guarantees enabling Israel, Egypt, and Syria to accept borders involving compromise.

Now as our specialists have spoken and as our participants have asked questions from the floor, I sense, as I think you also do perhaps, a certain lack of ease with the assumptions. Aside from the question of whether a settlement will in fact be achieved - which we have agreed to bypass - I think I detect two additional concerns. One is this: will a settlement, once arrived at, be perceived differently by different parties, so that breakdown may result? May in fact the same phraseology of a settlement be presented to and accepted by each party with somewhat varying emphases or shadings? That's concern number one.

The second concern, I think, is even greater. Speaker after speaker indicates that he cannot easily project probable or even alternative developments unless the settlement's terms are known in more detail, for on its exact nature would depend much of what he might forecast.

There are, then, some doubts about the assumptions. We don't know exactly what settlement there might be. This situation brings to mind a remark made by the Ottoman foreign minister in 1827, a year of the Greek revolt against Ottoman rule in which the British and French Mediterranean squadrons utterly destroyed the Turkish and Egyptian combined fleets in the harbor of Navarino. But Britain and France were not at war with the Turks or the Egyptians. When someone asked the Ottoman foreign minister whether this changed the situation - would it be peace or would it be war? - his reply was, "When a woman is with child, who knows if it will be a boy or a girl." And this is somewhat our situation in regard to this settlement. We don't know what the gender or the nature of the settlement will be. Nevertheless, we live with these assumptions.

We can rule out one assumption. I've just had it on a good authority that the recreation of the Ottoman Empire is not a proposed solution - although I think that asking me since I work in Ottoman history to do a summary represents some subconscious desire among the organizers of the Conference to see this great international empire recreated and all the external problems we now have made into internal Ottoman problems again. I'm told, however, that the Secretary of State does not consider this an option in his current swing through the area and I am also sure that the Turks would not consider it.

Now, there's a fifth assumption that I think we have added here or has been understood all along. Beginning with George Ball's opening speech, that assumption is that Russia will at least acquiesce in a settlement, for otherwise there is not likely to be one. So that is a fifth assumption.

Now as to the caveat, the second part. It seems to me that really we have been discussing two questions. I think this has been recognized in several of the sessions, yesterday and today. The questions are linked, but they have independent life. The first is the Arab-Israeli settlement. The second is oil's supply, price, capital flow, recycling and so on. Our assumptions do not posit any settlement of the energy crisis. It has been, I think, cogently pointed out here more than once that a settlement of the Arab-Israeli question will not bring a settlement to the energy crisis. These two things are separated and separable even though they have been linked in the past and even though a settlement of the political kind that we have been considering might have some helpful effect on the energy situation. But this is the caveat. We have been mixing two subjects, I think, which are related, but are separable.

Now, as to the projections. I try to do this not by sessions, but by a logical - as logical as I can make it - approach starting with geography, and I will give you a heading for each little bit of this attempted summary. The first is: What is foreseen for a Palestine entity? - always assuming it is created. Among the things that are predicted by some of our speakers are these: The Palestinian entity or state - many of them used the term state even though this was not in the assumptions - the Palestinian entity or state would give the homeless a home and so it would reduce the tendency toward violence in the future. Further, such a state will have psychological problems and perhaps an identity crisis at its start, but it presumably would be able to overcome that. Third, this Palestinian entity must - I think there has been complete agreement on this - must have cooperative relations with its neighbors on either side. Cooperative relations must be worked out: hopefully open borders, free commerce, free tourism and so on.

What our speakers have not been willing to project is the internal complexion of a Palestinian entity. There were some questions about this, but no one seemed to want to predict what the political complexion of such an entity would be, although many said that other things in the end, even America's relations to it, would depend on what kind of government or organized state it turned out to be, and of what political shading. But no one has predicted that. One speaker did forecast rather gloomily a West Bank entity torn by strife, riddled by irredentisms, likely to become dependent on Russia. This was not the general opinion, I think. The Palestinian entity also will have some start in life through the organization which now exists among Arabs on the West Bank. There are institutions, there is leadership. More of each is needed, but the greatest need is probably money for a new state to start in life. Schools exist, women's organizations exist, and there is need not only for money but for an inventory of resources, for a study on economic development plans, and for some kind of a planning group, an elite planning group.

It seemed to me as I listened that there was not much consideration of what is an important question, to my mind: how the Palestinian refugees will be resettled or assimilated - the political and economic and social and psychological dimensions of this. It was touched on, but I don't think there was really much discussion of this question and I regret that. So much, then, for the Palestinian entity.

What about its neighbor, Israel, after a settlement? In one session these points were made: that any settlement will probably arouse much debate within Israel, and the only agreement within Israel will be that no war is better than war. But otherwise there will be many arguments. The ultimate result will probably be at least two things. (1) If the settlement is genuine and works, a redirection of Israeli attention and funds to internal problems, away from their foreign problems and questions of defense - the "Wars of the Jews," as one speaker put it; their discussions about religion and so on among themselves. (2) A new rethinking, on a whole new set of assumptions, of Israeli foreign policy, which up to this point has always been predicated on the assumption that there is a state of war, latent or actual. This, if there is a real settlement, will change slowly and tentatively at first perhaps, but must be re-thought; the foreign policy must be re-thought and will change.

Then what of Arab states in the region - the neighbors of Israel and of a Palestine entity? It seemed very hard for anyone to project the inter-Arab relations after a settlement. One of our specialists pointed out three possibilities. "Scenarios" are creeping into the Middle East Institute just as they have crept into government, and there are three scenarios presented here. One was for a gradual improving of Arab relations with an Israel being integrated into Middle East society more and more, along with the improving of Arab relations among themselves. Second might be a peace of suspicion between Arab states and Israel, and third, a completely unstable settlement. But the gloomy prediction of number three - an unstable settlement - was mitigated somewhat by the hope of more peaceful times based on two facts. The two facts are that there are now rather more moderate and less ideological governments in a good many countries of the area, and also that a rise in oil profits produces better economic conditions and a willingness in many cases to share some of the profits.

One trouble with the Middle East is that it produces more history than it can consume locally. I am about to turn from the area itself to its relations with the great powers, and this is what leads me to say this. It is pointed out by historians that the Middle East has never produced a world war. World wars in the past have been produced by Germans or Serbo-Croats or Poles or French or Russians or Englishmen but not by Middle Easterners. Yet the rest of the world gets involved in the arguments of the area. Much of our discussion here, then, has been pointed toward the relationships of the United States with the area after a settlement. Now what would this be like according to our predicters?

Obviously, and several of them said this, the United States will continue to play the chief role in relations with Israel. Perhaps even a closer association will develop than before, because if the United States uses its influence to persuade Israel to accept a settlement involving compromises, then Israel will want from us a guaranteed arms supply and some kind of security guarantee in addition. This relationship then may be closer than it is today, after a settlement. But United States' relations with Jordan would also be very close, particularly if the Palestine entity were included within Jordan. This is, of course, not assumed; there is no assumption about this. If there is a separate Palestine state, the United States' relations with it would be determined very much by the nature of the government of that state. But still there would be some kind of close relations, presumably, with that entity.

In more than one session, it was said that the key to American relations with the Near East - I'm sorry; I'm a historian and I say Near East, for as you know the Middle East didn't exist until recently - the key to American relations with the Middle East will be Egypt. Two or three speakers said this in one way or another: that our relationship with Egypt has changed and will continue to change and to improve after a settlement and that there is a possibility of a kind of trilateral relationship developing between the United States and Egypt and Saudi Arabia in which Egypt and Saudi Arabia would become closer and there would be financial aid from one to the other. Naturally, the interest of this country in the oil supply and in its price continues unabated, and the interest in recycling the oil dollars that are flowing into the area continues unabated, and would so continue after a settlement of the Israeli-Arab question.

It is pointed out by more than one speaker also - I think more than one - that the United States' relations with countries in the area have improved on many fronts and that this improvement can be expected to continue after a settlement. These fronts are not only diplomatic and political, but cultural and economic. One of the examples given for such improvement is the increase in orders for armaments in the United States from countries of the area. This brought forth a warning in another session that arming one's friends does not necessarily mean that the friends will get along with each other. And there is an implicit danger in this situation. The example which was brought out on two occasions was particularly a Saudi-Iranian clash, which would be most unfortunate, in the Gulf. And it's possible that this clash, if it ever should occur, would be fought with weapons purchased in this country. Nevertheless, the relationships of the United States with countries in the area seem to be projected as closer generally, more cooperative generally, after a settlement - although the process has already been initiated.

This theme was carried over into one of the sessions this morning which involved questions of education, training, management, technology and so on. It was made very clear that the United States needs to share its skills and technology with peoples in the area; to continue to improve secondary school education there, and where possible management skills. It was made clear also that there is a fund of good will in the area for the United States but that this needs to be complemented by a counterpart from our side of sending the best talent we can find - educational and other talent - because there is much to do and a big role for the United States to play. One of the examples to which one speaker devoted himself was the joint commissions set up - commissions jointly with US members and with members from countries in the area, each commission having working groups within it on science, agriculture and other matters. There was expressed some disenchantment with new feasibility studies. Someone said there are drawers full, closets full, of feasibility studies and it's better to get on with the job in the private sector and make the government administration more efficient. One example of the latter was a joint working group which reduced the number of signatures necessary for importing goods through customs into a Near Eastern country from 15 to 3, and thus imparting greater efficiency.

Then we come to the question of relationships with the Soviet Union and of the Soviet Union as a party to area questions after a settlement. The predictions, as far as I can make out from our speakers, were these: First, that the United States-Soviet relations should become somewhat easier after a settlement, that Russia is unlikely to disrupt the settlement because what controlled chaos or tension Russia needs she can get from the energy crisis that affects the West anyway, independent of the settlement question. One or two speakers expressed the view that the key to better American-Soviet relationships in the area was Egypt. It was said that the United States could certainly live with Russian supply of armaments to Egypt after a settlement; that Egypt after a settlement would probably be either the most satisfied or the least dissatisfied country in the area; that with that country (Egypt) Russia would seek to have good relations; and that the United States should not seek to block this but also to maintain good relations. The Russian-American relationship may or may not extend to any kind of limitation of arms shipments to the area. It seems in the view of at least one of our specialists unlikely that there would be any limitations or, if there were some limitations, certainly there would be no embargo, no complete prohibition.

Turning to Europe and the settlement in the area - Europe, it appears, will continue to be dependent on the oil of the Middle East and must inevitably seek cooperation, not confrontation, just as must the United States also. But Europe will be the better market as it is now, for Arab oil, better than the United States as a market. The EEC and the Arab countries are already initiating a dialogue and the European role in a settlement may be a kind of a moderating one, after the settlement. This is because if European countries, particularly Western European countries, play a bigger role in trade and in the Middle East generally, the comparative role of the superpowers, Russia and the United States, will be somewhat reduced, and for the peoples in the area that might be desirable.

There are two countries in the area so far unmentioned. Someone asked yesterday a question in one session, "What about the Northern Tier? Where has it gone?" There was very little discussion of this, but there was some. Turkey and Iran, it becomes clear, will remain important no matter what the settlement. After any settlement, they will continue to be important, Iran increasingly so because of its oil and the profits which oil brings. Turkish policy, it appears, will not be much affected by a settlement. Her questions are, of course, Greek, Cypriot, Russian relations, and United States relations. In the case of Iran, the Shah makes great plans for the use, constructive use, of oil dollar revenues, and also undertakes a role which may be difficult in the future, that of policeman in the Gulf. After a settlement, this role presumably will still be his, and there could be some difficulty in this connection.

As for Africa, or the Third World, one speaker spoke of the continuing trends in Africa, one long term, one recent. The long term trend is the spread of Islam. The recent one is the end of the honeymoon between Israel and the African countries. The question is: will a settlement, an Arab-Israeli settlement, bring a change in Africa? Probably not, is the answer. The future benefits of closer relations between African and Arab countries will probably outweigh the past benefits of relationships between African countries and Israel. As for countries in Asia, especially in the sub-continent, there was very little discussion of what a settlement would do. The discussion related mostly to the oil question and the price rise. It appears that the countries of the sub-continent and of Asia are, as we know, very much hurt by the price rise. But they do not complain as much as one might expect because they enjoy seeing the Western countries squeezed by the same phenomenon and squirming, and the Western squirming gives them psychological and perhaps political satisfaction. There was again, in connection with Asia, a prediction that Iran will play a bigger role in the future, not only in the Gulf, but in relation to Pakistan and India, both economically and politically.

What I'm going to say now is like one of those Near Eastern historical accounts or chronicles which are entitled "The Confluence of the Seas" or "A String of Pearls," a lot of little bits if wisdom strung along in a chain, without very close relationship, because I have missed much of what went on. We've been dealing so far with politics. This is perhaps in the French tradition, that politics is the most important subject. But there is also an Anglo-Saxon tradition, of which the French have complainingly accused them, that economics has a primacy over politics. There was a good deal of economics in the sessions and in these, of course, the questions of oil were the greatest. But there are some others too which are important, and it's these pearls which I'm afraid I might have missed, but I will give you what pearls I can.

So far as oil goes, it's clear that the threat of another Arab oil embargo hangs over the West until a settlement is reached. There might be a new embargo. But the more important matter probably is the price rise - the 400 percent price rise - which took place recently, and the question is: will the price fall when a settlement is reached? It is pointed out that the Arabs have made no promises, though they have said they would be more amenable to consider something if there were a settlement. They certainly are interested in a settlement. But the consensus seems to be that prices will not fall, certainly not much. Some major oil producing countries are not Arab. Would Iran and Venezuela want to reduce prices? It's also not realistic to assume that the Saudis can bring down the prices by themselves, even if they increase production greatly. Many countries and many individuals apparently would resist price reduction. Therefore, it seems that high prices, in the view of our specialists, are here to stay.

Also permanent, of course, is the interest of the United States in continuing oil production, in the physical supply of oil to this country, and in the question of the dollars. It was made clear by our dinner speaker that the United States takes a very serious view of the price increase. But it is not a selfish view, he said, it is a world view. Also it became clear that the United States seeks not confrontation but cooperation, and this is the point of all recent remarks on the oil questions. One speaker made it eloquently clear that neither economic warfare nor military action will solve anything, that neither course can be or will be undertaken in the future, and that anyone who thinks so is indulging in "an archaic fantasy," - these were his words. Instead, what is called for is a mature outlook to insure cooperation between industrialized nations and oil producing nations.

For what do we need beyond the supply of oil? Obviously a recycling of the petrodollar, a long term recycling facility, a regional development emphasis on the Middle East, and the bringing of wealthy oil producers into the decision making club. We need further a special effort by the United States to make the public understand that recycling will involve investment of those dollars in this country, an inflow of funds to which we are unaccustomed but to which we must become accustomed.

So far as the effect of oil on agriculture goes, it appears that we will not have an important change in agriculture in the Middle East because the oil producing countries already have as much money as they can apply to agriculture and what they need more is management skills. Desalting technology may do something, but desalting technology depends on the cost and the cost is becoming difficult because of the rise in oil prices. It may be that population will go down, but if the increased price of oil slows the improvement in the overall standard of living, population growth rate decline would be retarded. This is so because fertility rates tend to decline when the standard of living rises, so the oil crisis is related to population.

What I have missed most is the question of the international economic order. I was pleased to hear one speaker say that all the international economic questions are solvable, but that there is much to do in aligning the American monopoly of basic grain foods with the Middle East monopoly of oil. In fact, the American monopoly is percentage-wise greater. There are again three scenarios predictable: a clash of these two great monopolistic systems, or some kind of deal, or some real interdependence.

Now I have come to the conclusion, Mr. President, excepting for something which I think needs emphasis. If there's one note that went through all this Conference, it seems to me, it was cooperation. It's a single word - cooperation.

I am an historian, an Ottoman historian, and I cannot look into the future like other people, but I was looking in the Ottoman archives and I found a report on cooperation by an astrologer. You know that the Ottoman sultans had a Münejjim-bashi, or chief astrologer, and this report was in the archives dated in Turkish 14 Jemaziyelevvel (Jumada al awwal), 1279. It's a prediction for 25 Ramazan (Ramadan), 1394. That's almost today, and you will have to bear with me in my translation of this. This is a kind of rough translation of the Ottoman but it tries to convey the spirit.

1. Now it came to pass, in the days when Gerald was ruler over the land of the Yankees, that there abode in that land a tribe.

2. And this was the tribe of the Middle East Institute, called of men the MEI, and was one thousand and again half a thousand strong.

3. Now the chief men of the tribe of MEI lifted up their eyes and beheld the state of the earth and said, one to another, "Verily, verily, the Middle East waggeth not as it ought."

4. And they reasoned with themselves, what they should do.

5. And they said, "Let us assemble together the learned men, them that can fathom mysteries and secret lore, and them that have learned to read and write and extrapolate, that they may counsel us, and prophesy."

6. Then were swift messengers sent to the uttermost parts of the earth, to assemble the wise men and seers at the new moon.

7. And they came from far and near, from the universities and the corporations, from the think tanks and the government, from the research outfits and the fourth estate, from the eleemosynary institutions, yea, and from Lehman Brothers and from the Continental Illinois National Bank and Trust Company of Chicago.

8. And by all manner of conveyance and creeping thing they converged upon the Mayflower hostelry.

9. And there also did the multitudes come, saying unto the wise men and the prophets of the MEI, "Prophesy unto us."

10. Then did the chief prophet among them, even Luke (may peace be upon him), lift up his voice and answer, saying:

11. "Lo, there shall be a settlement between the children of Ishmael and the children of Isaac, and there shall be a Palestine entity, and the settlement shall enjoy international guarantees."

12. And the multitudes shouted, "Prophesy further unto us!"

13. And then did the whole company of prophets (on them also be peace) speak further, saying, "Hard times shall there be ahead, for narrow is the way and strait the gate that leads to political accommodation."

14. "But we say unto you, all things are possible to men of good will."

15. "For our old men have seen visions, and our young men have dreamed dreams, and this is what they have dreamed."

16. "There shall be peace, and nation shall not lift up sword against nation, neither shall they learn war any more."

17. "And from the arsenals of the United States shall the Middle Eastern peoples import large quantities of ploughshares, for into such shall the swords have been beaten."

18. "And from the arsenals of the Soviets shall the Middle Eastern peoples import large quantities of pruning hooks, for into such shall

the spears have been beaten."

19. "And the foolish virgins shall have oil equally with the wise, by reason of recycled petrodollars."

20. "And every man shall sit under his own fig tree, and shall have a guaranteed fig tree to sit under."

21. And even as the prophets of the MEI prophesized, so was it.