7th July, 1967

CABINET

ARAB ATTITUDES AND BRITISH ECONOMIC INTERESTS
IN THE MIDDLE EAST

Memorandum by the Secretary of State for Foreign Affairs

At our meeting on 20th June (CC(67) 40th Conclusions, Minute 2), I was invited to circulate a memorandum assessing the manner in which the attitude of the Arab countries to the supply of oil to this country might develop and the consequences for our economic interests.

2. The assessments in this paper and its annex are necessarily no more than informed guesses, since they depend on a series of variable factors which cannot be accurately predicted and over some of which we have little or no control. But British policy will have its own bearing on these factors. It is therefore important to consider the relationship of possible policies to our economic interests.

British Policy

3. The three occasions in the past 20 years on which our oil supplies and general economic interests in the Middle East have been dangerously threatened by political developments have been the Arab/Israel wars of 1948, 1956 and 1967:

(i) In 1948 our economic stake was not so vital and our political posture, although not regarded as favourable by the Arabs, was less unfavourable than that of any other great power. Our economic interests greatly expanded during the succeeding period.

(ii) In 1956 we deliberately took the Israel side and incurred intense odium in the Arab countries. Our political position suffered permanent damage. Nevertheless, by a policy of lying low and disengaging from political involvement to the extent that was possible, we recovered remarkably quickly, Our economic interests in the area have expanded considerably during the past 11 years to our great advantage.

(iii) In 1967 for reasons varying from spontaneous public reaction to United Arab Republic (UAR) policies to downright misrepresentation and malice we became identified to a wholly unreal degree with the Israel side and this has done much damage to our position in Arab countries, Memories of 1956 aggravated this.
4. In both 1956 and 1967 our national interests, political and economic, would have been endangered if Israel had been defeated and Nasser's hegemony in the Arab world firmly established; it would also have been difficult for us to maintain a purely neutral position if Israel was being overwhelmed. But Israel has now demonstrated her ability, by her own efforts, to secure her existence, and her right of passage through the Straits of Tiran is again assured. With United States diplomatic support for Israel on these points, there is no serious danger that either of these rights will be threatened for the foreseeable future, whether there is a peace settlement or not. Nothing that we do can fundamentally improve Israel's position; nor is it likely to affect substantially the chances of a peace settlement. Apart from Arab attitudes, the chances of a settlement turn on the acceptance or not by the Russians of the need to come to an agreement with the Americans on terms which can be pressed on the Arabs and Israelis. We are unlikely to have more than a marginal influence on the outcome of such a dialogue if it takes place, and, since the terms are likely to be unpalatable to both sides, we cannot gain by being associated with it. (We may be compelled to take some diplomatic part e.g. in detailed negotiation in the United Nations if some general United States/Soviet understanding is reached).

5. But if our actions and our attitudes to the Arab/Israel problem are unlikely to affect the chances of a settlement, they can very substantially affect our economic and other interests in the Middle East. There are limits to the extent to which we can take a position based on a calculation of national interest alone; these limits include both public sentiment about the issue of principle involved in the right of a small country to survive and special pressures in this country. But, except to the extent to which we can take a position based on our interests which involves leaning if anything towards the Arab side, our interventions in the Arab/Israel problem will work counter to the salvaging of our economic interests in the area. If we follow the post-Suez policy of disengagement, there may be a better chance of restoring our situation than there was in 1957 because:

(a) We have after all a far better case for our actions in the past six weeks than we had over Suez; this should gradually come to be recognised.

(b) Although it is too early to strike a balance with any certainty, the post-war position of Nasser in the Arab world is weaker instead of stronger. The same may prove to be true of the Russian position, though the Soviet Government will do everything within their power to redress this and they have active allies in the Arab world.

6. The Americans are differently placed (see paragraph 8 below), but there are signs that our need (as opposed to that of the Americans) to cultivate the moderate Arabs is now better understood in Washington, and recognised as being indirectly in the American as well as in the British interest.

7. The critical factor in the future of our economic interests is thus not so much whether the Arab/Israel problem will continue to disturb the area, but what role Britain will continue to play. The more retiring our role, the better our prospects seem likely to be, and vice versa.
American Policy

8. The United States Government are differently situated for the following reasons:-

(a) They are not so vulnerable to economic pressures as we are, and the Arabs (and Russians) know it.

(b) The domestic political pressure which the Israelis can bring to bear is stronger.

(c) American influence over the Israeli Government and American ability to provide aid as part of any settlement are things of which the Arabs must take account, however hostile they feel.

These factors taken as a whole give the Americans more scope than we have for manoeuvring independently of Arab attitudes. Arab hostility to the United States is at present greater than to us; but the Arab need to come to terms with the United States is stronger. Moreover, in the last analysis it is Soviet fear of a military confrontation with the United States which imposes limits on Soviet support for the Arabs of a kind which could bring matters to a 'brink'.

Soviet Policy

9. In the long term, Russian policy in the Middle East is likely to continue to be directed towards:-

(a) The maintenance or creation of pro-Soviet regimes in the area and the encouragement of local Communist or "National Liberation" movements.

(b) The erosion of Western influence, including the economic interests of the United States and Britain.

In the pursuit of these aims the Russians will be subject to two important limitations:-

(a) The wish to avoid a military conflict involving the United States referred to above. During the crisis their role was undoubtedly one of caution and restraint as soon as they appreciated that this risk was a possibility. They are unlikely to wish to see the recreation of a situation in which the Arabs might draw them into a conflict with the United States over Israel.

(b) The fact that even if they can afford to sustain the UAR economy for a period (and it is questionable whether they can take this on as a permanent commitment) they certainly cannot also afford the scale of economic support which will be necessary to tide other Arab countries over a prolonged period over which oil revenues and other trading connections with the West are interrupted.
10. So far the Russians have shown few overt signs of looking beyond the short-term tactical need to re-establish their credentials with the Arabs. The Israeli victory and the subsequent accusations that they failed to come to the assistance of the Arabs dealt a considerable blow to their prestige. But the effect of this should not be exaggerated. The Russians probably consider that the damage to Western interests in the area has been, and is likely to continue to be, very great. This short-term Soviet aim of consolidating their position with the Arabs is likely to over-ride other considerations for some time, and during this period they will continue to exploit and stimulate Arab hostility to Britain and the United States. Moreover, if it is correct that they wish to avoid another Arab/Israel war, they will probably see less risk and more political benefit to themselves in continuing to deflect Arab hostility primarily against Western interests even after the present phase of consolidation is over. Soviet policy, directly or indirectly, will encourage the maintenance of punitive measures on the oil trade and/or passage through the Suez Canal. They will also presumably continue their "foothold in Africa" policy, exemplified by their arming of Somalia and their interest, which must be assumed, in the future of the Yemen and Aden.

11. There are some factors which may in due course modify Russian Middle East policy at least in part. It is possible that if the dislocation caused by the policy described were prolonged without any corresponding political benefits, we could expect an Arab reaction against the Russians. The Russians may also become aware that they can only hope to deliver political satisfaction to the Arabs in the shape of an Israeli withdrawal if they can come to some arrangement with the Americans.

12. Moreover, anticipating this reaction and as a result of the reappraisal of their policies in the area which they must also be undertaking, the Russians may decide that their interests will be better served and the economic burden less by placing greater emphasis on Algeria, Syria, Iraq and/or other Arab countries rather than by continuing to back Nasser.

Israel Policy

13. It is to be expected that the Israelis will pursue a firm policy, i.e., no substantial concessions without a quid pro quo in the way of peace negotiations or acceptance of Israel's right to exist. Since economic warfare against us is the most substantial weapon in Arab hands, this will tend to harden Arab action against our economic interests on the pretext of British sympathy with and the belief in British influence over Israel. There are nuances to this: if the Israelis are provocative on e.g., Jerusalem or the West Bank, then the Arab will to maintain punitive measures against us will be correspondingly strengthened; unless we succeed in dissociating ourselves convincingly from Israel's actions. On some points we shall be able to do this, but there will be limits and they may arise soon.

Inter-Arab Policies

14. Much will depend on the development of relations between the Arab Governments. For some time ahead, we must abandon any hope of modifying the attitude of total hostility on the part of the "revolutionary"
Arab countries: the UAR, Algeria, Iraq and Syria. But domestic pressures may cause even them to modify their punitive economic measures; and these and other pressures - e.g. Asian and African economic interests - may cause the UAR to reopen the Suez Canal. In the main, however, we must assume that this group will do all they can to hurt us, and will use all the means of pressure at their disposal to induce other Arab governments to do likewise. In this they will have Soviet and other Communist support.

15. Our hopes of easement therefore depend basically on the non-revolutionary governments and the extent to which they are able to act independently of the UAR Government. It is in any case in these countries that the preponderant part of our economic interests - oil supply, oil investment and trade - are situated: the two important exceptions are the Suez Canal and Iraqi oil.

16. As time passes, we can expect disenchantment with Nasser and recriminations between the Arab Governments about responsibility for defeat to weaken Arab solidarity and the will to maintain a state of affairs which hurts the Arabs at least as much as it hurts the targets of their hostility. There is some evidence of this happening already: from the start the UAR, Algeria and Syria have taken a more extreme line on oil stoppages.

17. A key element will be the position of President Nasser. If he disappeared, then there would almost certainly be a strong trend towards a less heroic and less cavalier attitude to the Arabs' own economic interests. At present, his disappearance does not seem likely to happen; but it is not impossible and, short of it, the trend of his prestige and influence seems likely to be downward, unless he can produce some new political success.

18. Nevertheless, it must be expected that the deep Arab sense of humiliation resulting in wholesale blaming of others and affecting non-revolutionary as well as revolutionary governments alike, will continue to be a strong influence on governments' actions for many months. This will be so, even though emotions may cool and material factors begin to re-exert their influence.

19. The attitudes of Governments are only part of the problem. We must also take account of popular pressures on moderately disposed governments. The propaganda of the UAR and the other revolutionary Arab governments will continue to incite anti-Western hostility among mass opinion and industrial labour and to encourage subversive activity. This has been important in recent weeks when oil stoppages have often been either the direct result of action by organised labour or because governments have found it necessary to appease popular feeling by acting themselves. Although the more moderate Arab Governments seem to be regaining control of the general situation in their countries, they will have to pay great heed to these dangers for many months. They must therefore be expected to be cautious about any return to more normal relations with the West which could excite popular passions, stimulate strike action or facilitate subversion and sabotage. However successful these governments are in maintaining general control, we must still allow for at least sporadic outbursts of popular action against Western interests.

-5-
20. Finally, the attitudes of the Arab Governments will to a large extent be affected by the course of events and the policies of other governments. These are discussed above. The two biggest unknowns are the future of Nasser, and the immediate direction of Soviet policy in the area; in particular the extent to which the Russians will decide to continue to back Nasser or, as a result of their own reappraisal, put more money on Algeria and other Arab horses. This memorandum assumes that early progress towards a definitive settlement of the Arab/Israel problem is unlikely, and that it will remain a disturbing political element for the foreseeable future, though without a renewal of hostilities.

21. The annex to this memorandum attempts to relate these Arab attitudes to our specific economic interests: oil (which is looked at more widely than the narrow question of supply to the United Kingdom), exports generally, arms sales, the Suez Canal and sterling.

Conclusions

22. The conclusions are in fact set out in paragraphs 4 and 5 above. We have an important and vulnerable industrial and financial stake in the Arab countries. We therefore have a strong interest in rebuilding our relations with these countries. But the degree to which we can follow a purely self-interested course of this kind is limited by public feeling on the merits of the Arab/Israel dispute and by special pressures existing on this subject in Britain. We are therefore in a highly vulnerable position.

23. Given that the Israelis have shown an outstanding ability to defend themselves without our support, our best policy would appear to be that of the maximum practicable disengagement from this dispute. We cannot wholly disengage, e.g. from discussion under United Nations auspices. But in general, in our present military and economic situation, where we cannot intervene decisively, we stand to lose more from activity which may be misunderstood (and exploited by Cairo Radio and the Soviet Government) than we gain from the wisdom and experience we may contribute to the problem. This may not sound an heroic stance but it corresponds to the realities governing our economic interests in the area.

G. B.
This annex looks at oil matters more widely than just in the context of supplies to the United Kingdom. As regards our other economic interests it deals with our direct interests in the Arab countries and only marginally with the wider implications for our economy and the balance of payments, which would call for study by other departments concerned.

The United Arab Republic, Syria and Algeria can be expected to continue to press the other Arab countries to make maximum use of economic weapons, oil being the most powerful, against those countries which in their view oppose or do not sufficiently support the Arabs in their confrontation with Israel. Kuwait, Saudi Arabia, Libya (even though at present its oil exports have only been partially resumed) and the Persian Gulf Sheikhdoms can be expected, with varying degrees of determination and skill, to attempt to return fairly quickly to something approaching normal relations with the West. Saudi Arabia is the government most likely among the oil exporters to take an independent line, and the Gulf Sheikhdoms can be expected to follow her lead, at a safe distance. Kuwait is less reliable owing to the régime’s predilection for nationalist gestures. Of the other Arab countries, Iraq is the most likely to be influenced by the U.A.E. line in spite of the fact that it is in the worst position of all to forego its oil revenues for any length of time. Even in Iraq, however, there is bound to be a reaction against the pro-Nasser line as the economic effects begin to be felt; indeed exports have already been resumed on a selective basis.

The likely effects on our oil interests are best considered...
In the short and the longer terms. In the short term there is a good hope that Libyan exports will soon return to normal except to the United Kingdom and the United States. If she accepted U.K. and U.S. destinations this would put her in the same position as all the other oil producers. Assuming that there is a change of government in Iraq, our best guess is that the Iraqis are likely to be the least reliable and the most selective regards oil exports and in any case they cannot ignore the Iraqis' physical control over the pipelines from North Iraq to the Mediterranean.

In the other oil countries the ban on exports to the U.K. and U.S. may well not be removed for many weeks. This is what the are moderate governments have judged to be the least they could get away with as a gesture of solidarity and a safety valve for popular pressures. Fortunately its practical effect is limited since we can replace supplies of Arab oil with non-Arab oil. (It will, however, have some balance of payments effects which the Treasury and the Ministry of Power are keeping under review.)

In the short term, therefore, the supply situation as regards Arab oil should not be too serious as long as there is a sufficient degree of international co-operation to deal with it. However, even if the problem of Nigerian oil supplies is resolved satisfactorily, there will continue to be a supply problem, primarily tanker availability, arising from the closure of the transit routes. This will almost certainly last for some months. On top of this the possibility of interruptions of exports by popular action must be allowed for. For the next few weeks at least it would probably be prudent to assume that at any one time strikes, demonstrations or sabotage or a combination of these will reduce
The immediate availability of Arab oil supplies by, say, 1.5 million barrels a day (75 m. tons a year).

A separate study is being made by the Departments concerned for dependence on Arab oil supplies in the longer term.

Turning from the supply problem to the future of our investments, our oil assets in the Arab countries are likely to be affected adversely in the longer term, though it is impossible to be precise about this. The assets most in jeopardy are those of the Iraq Petroleum Company (IPC) in which British Petroleum and Shell together hold nearly a half interest. At the very least, the chance of the IPC's settling its long-standing dispute with the Iraq Government in a fashion which would open the way to considerable expansion of its activities is now very much slimmer and may be lost for good.

Our oil assets in the other Arab producing countries run less risk of expropriation or similar drastic action. However, the fact that during the last few weeks the oil companies have been subjected to direction and control by the concessionary governments to an unprecedented degree and with impunity so far as effective intervention by the parent governments of the companies concerned, may encourage the concessionary governments to be similarly assertive in future even in less abnormal circumstances. The manifestation of this is likely to be increased pressure on the companies from concessionary governments for a larger slice of the cake, to the detriment of our balance of payments: i.e. an acceleration of the process of erosion of the profitability of oil production operations which we had already accepted as inevitable. There are also other foreign interests e.g. French, Italian
Italian and Japanese, who might be ready to take advantages thrown open by our difficulties.

British Exports to Arab Countries

Annexed to this paper is a table showing British exports to Arab countries (including arms) in 1965 and 1966, with a projection for 1967 of the likely figures of exports had the crisis, the fighting, and its consequential effects not intervened. This shows that British exports to the Arab countries were likely in 1967 to be nearly £220 million. The table divides the countries into two groups: the first being the four "revolutionary" countries, the second group the others. In the first group the figure of £17.5 m. for exports to the "revolutionary" countries is likely to be greatly reduced by the reduction in purchasing power from the stoppage of oil and the suspension of receipts from Canal dues. This will apply even if the countries concerned do not maintain a ban on British imports for the rest of the year or most of it. On the other hand, there will to some extent be pressures to buy spare parts for goods already imported and consumers' and merchants' pressures to continue to buy from traditional suppliers. If the ban continued to be strictly applied for the rest of the year, our exports to the "revolutionary" countries for 1967 would probably only amount to £20 - 25 million of which £5.6 million would have been exported prior to the end of April. If the ban were raised fairly quickly our exports for 1967 might come to something as high as, say, £35 million.

The remaining countries, i.e. the "non-revolutionary" countries in group B, will not necessarily all behave in the same way. Most of this group of governments will wish to avoid imposing any restrictions but will have to take account of popular opinion.
opinion and pressure from the "revolutionaries". How successful they are in this will depend on events, other governments' attitudes, and our policies. In any case as a result of war damage, lack of confidence during the crisis period, some losses in oil deliveries and other factors, our exports to these countries are likely to fall well below £171 m. this year.

Re Sales

1. It is no easier as regards arms sales to work out with any precision either what would have happened had there been no war or what is likely to happen now there has been one. There is little doubt that the Saudi Arabians and the Lebanese will wish, provided it is politically feasible for them, to continue with the arrangements made (Saudi Arabia for the air defence scheme and the Lebanese for the Bloodhounds). Of the rest the only country with significant contracts outstanding is Iraq - £1,760,000 for miscellaneous ammunition and spare parts; it is unlikely that they will wish to cancel these contracts although, since money will be short, they cannot be regarded as a good risk.

2. As regards the question of what contracts might yet be signed during the course of 1967 of any consequence, the effects of the war on our interests may not be very severe, provided political conditions are favourable for "non-revolutionary" Arab states to trade with us. Apart from the possibility of selling Jet Provosts for Iraq, which might be worth £1 or £2 million, our lucrative markets lie in the moderate or less radically orientated Arab states, namely Libya, Kuwait and Saudi Arabia. The air defence scheme for Libya is due to be presented shortly and it seems on the whole unlikely that the Libyans will turn it down on political grounds, unless the pressures on them are severe.

The same
the same would probably apply as regards Lightnings for Kuwait at the Airwork part of the air deal for Saudi Arabia. (We have the possibility of selling naval equipment to Libya and Saudi Arabia.)

5. At a very rough guess, which must be treated with great reserve, we might quantify the losses to us of arms sales as a result of the war as of the order of something under £1 million even if Syria, Sudan and the U.A.R. cancel existing orders. The losses as a result of a further deterioration in our relations with the "moderate" Arab countries are unquantifiable, but could be very considerable.

Suez Canal

1. The closure, and prospects of continued closure of the Suez Canal, have important implications for our commercial interests over and above its effect on oil supplies and oil prices. So long as the Suez Canal is closed to all shipping a competitive advantage in the markets of East Africa, South Asia, the Far East and Australasia is given to our main competitors in the region, i.e. the Japanese, Australians and the South Africans. If the Canal were opened but still closed to U.K. and U.S. ships, the competitive position of our own exports would not be so seriously affected, assuming that they could find shipping space on other flag carriers, but there would obviously be a prospect of loss to British shipping earnings unless all the British ships concerned could be profitably employed on journeys to other destinations. A closure of the Canal to British and American goods, irrespective of the flag of the ship in which they were carried, would, of course, place British goods at a substantial commercial disadvantage. /against
against virtually all competitors in virtually all Asian, Australasian and East African markets.

Sterling Balances

1. Continued denial of oil to the U.K. by Arab states, any more general difficulties experienced by our oil companies in those states, a prolonged closure of the Suez Canal, and an effective embargo of U.K. exports to Arab countries would be bound to affect confidence in the pound because of the extra strain which they would throw on our balance of payments. We must also bear in mind the possibility that the Arab states might decide to link with the oil boycott a massive withdrawal or switch of holdings of sterling. The Arab Governments which hold large reserves in sterling would probably be reluctant to lend themselves to manoeuvres of this kind, which would involve them in considerable financial loss, but they might not be able to hold out against pressure from others. A large Arab withdrawal from sterling might of course produce a chain reaction which could put us in a difficult position. The Treasury would no doubt wish to express views on this question.
## United Kingdom Exports to Arab Countries
**(including arms)**

**UNIT £ million**

<table>
<thead>
<tr>
<th>Country</th>
<th>1965 (actual)</th>
<th>1966 (actual)</th>
<th>1967 (projected, assuming - crisis had not arisen)</th>
<th>(of which arms)</th>
</tr>
</thead>
<tbody>
<tr>
<td>E.A.R.</td>
<td>19.5</td>
<td>18.0</td>
<td>16.5</td>
<td>0.685</td>
</tr>
<tr>
<td>Iraq</td>
<td>21.6</td>
<td>25.9</td>
<td>23.0</td>
<td>1.8</td>
</tr>
<tr>
<td>Syria</td>
<td>6.1</td>
<td>6.9</td>
<td>5.0</td>
<td>0.005</td>
</tr>
<tr>
<td>Algeria</td>
<td>6.9</td>
<td>3.0</td>
<td>3.0</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>54.1</td>
<td>53.8</td>
<td>47.5</td>
<td></td>
</tr>
<tr>
<td>Jordan</td>
<td>8.3</td>
<td>9.0</td>
<td>9.0</td>
<td>0.600</td>
</tr>
<tr>
<td>Lebanon</td>
<td>14.7</td>
<td>16.4</td>
<td>17.0</td>
<td>6.033</td>
</tr>
<tr>
<td>Sudan</td>
<td>16.6</td>
<td>16.3</td>
<td>15.5</td>
<td>0.065</td>
</tr>
<tr>
<td>Libya</td>
<td>21.8</td>
<td>28.8</td>
<td>31.0</td>
<td></td>
</tr>
<tr>
<td>Tunisia</td>
<td>3.9</td>
<td>2.7</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>4.5</td>
<td>5.1</td>
<td>5.0</td>
<td></td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>12.6</td>
<td>20.4</td>
<td>30.0</td>
<td>15.0</td>
</tr>
<tr>
<td>Kuwait</td>
<td>18.8</td>
<td>25.8</td>
<td>25.0</td>
<td>0.272</td>
</tr>
<tr>
<td>Bahrain</td>
<td>8.7</td>
<td>7.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Qatar</td>
<td>3.7</td>
<td>3.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Abu Dhabi</td>
<td>1.5</td>
<td>3.4</td>
<td>23.5</td>
<td></td>
</tr>
<tr>
<td>Minor States</td>
<td>2.7</td>
<td>2.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trucut &amp; Oman</td>
<td>2.2</td>
<td>3.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Arabia</td>
<td>13.9</td>
<td>13.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>113.9</td>
<td>157.9</td>
<td>171.5</td>
<td></td>
</tr>
<tr>
<td><strong>GRAND TOTAL</strong></td>
<td>168.0</td>
<td>211.7</td>
<td>219.0</td>
<td></td>
</tr>
</tbody>
</table>

*Note: Saudi Arabia - Depending on contracts, rate of delivery, figures could be as high as £91 m. and £76 m.*