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The economic impact of the Oil Crises on the US.

Petrodollar recycling

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## **Abstract**

This master's thesis examines the economic effects of the oil crises on the United States, focusing on the notion of petrodollar recycling. The dissertation is divided into three chapters. The first chapter presents a summary of the history of oil shocks in the globe after World War II, focusing on the second oil shock of 1979, the oil counter-revolution of the 1980s, the 1990 oil price shock, and the 2003-2008 oil price shock. This chapter examines the connection between oil and the macroeconomy, as well as the connection between oil, debt, and crises. The second chapter offers an overview of the petrodollar idea, covering its origin and evolution, as well as the worldwide competition and petrodollar ambitions. This chapter also examines the potential and risk of petrodollar visions in relation to the U.S. economy. The third chapter focuses on the recycling of petrodollars in the American economy, covering the distribution of petrodollar surpluses and the reinvestment of petrodollars in the American economy. This chapter also examines the influence of the petrodollar on the political and economic dominance of the United States.

Key words: Economy, oil, petrodollar, recycling, crisis

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## INTRODUCTION

Oil is one of the world's most essential commodities. It is the principal source of energy for transportation, heating, and the creation of electricity, as well as the raw material for several industrial activities. Numerous countries, notably the United States, have invested extensively in ensuring access to this critical resource due to its strategic value.

However, the global oil market's history has been defined by a number of crises, notably the 1973 oil embargo and the 1979 Iranian Revolution. These crises had a tremendous influence on the worldwide economy, especially the United States, which is one of the world's top oil users. In this thesis, we will investigate the economic impact of the oil crises on the United States, with an emphasis on the recycling of petrodollars. This thesis examines the influence of the oil crises on the U.S. economy, with a particular focus on petrodollar recycling. Specifically, we will examine the historical backdrop of petrodollar recycling and its good and negative effects on the US economy.

Understanding the economic effects of the oil shocks on the United States is crucial for a variety of reasons. The United States is the largest economy in the world, and its economic performance has enormous effects on the global economy. Second, the global oil market is a vital driver of economic development and geopolitical stability, and policymakers and investors must grasp its dynamics. Lastly, petrodollar recycling, which refers to the process of oil-exporting countries investing their oil revenues in the US economy, has played a significant role in shaping the US economy over the past several decades, and it is essential to comprehend its impact in order to comprehend the long-term sustainability of the US economy. Research question is the following: What is the impact of petrodollar recycling on the US economy in the historical context of the oil crises, and what are the positive and negative consequences of this phenomenon?

This thesis's research technique will consist of a literature review. This methodology was selected since the purpose of the research is to investigate the historical backdrop of petrodollar recycling and its effects on the U.S. economy, which can be accomplished most

effectively by analyzing current academic literature. The literature evaluation will include a thorough examination of all peer-reviewed publications, books, and reports published on the issue of petrodollar recycling and its influence on the US economy.

Petrodollar recycling refers to the process through which oil-exporting nations, notably those in the Middle East, reinvest their oil income in the United States economy. The genesis of petrodollar recycling may be traced back to the 1970s, when the U.S. dollar became the major currency used for oil commerce. This was due to a variety of factors, including the stability of the US economy, the dominance of US oil firms, and the fact that the United States was one of the top oil users in the world.

As a result of their reliance on the US dollar, oil-exporting nations began to amass substantial sums of US cash. In order to invest this cash, they resorted to the United States' financial markets, namely government bonds. This produced a substantial market for US government debt, which helped finance the US budget deficit and maintain low interest rates.

Recycled petrodollars have had a huge influence on the U.S. economy. On the one hand, it has contributed to US economic growth by providing a continuous stream of foreign investment, which has helped fund the US budget deficit and stimulated economic activity. However, it has also produced a huge source of economic vulnerability, since the United States has become increasingly reliant on foreign investment to cover its budget deficit.

To sum up the introduction the purpose of this thesis was to investigate the historical backdrop of petrodollar recycling and its effect on the U.S. economy. By reviewing the current literature on this subject, we were able to obtain a clearer knowledge of the intricate link between oil, petrodollar recycling, and the U.S. economy, as well as the problems and possibilities that this relationship has produced over the last few decades. Ultimately, this research has significant consequences for politicians and investors as they attempt to negotiate the complexities of the global economic landscape in the coming years.

# CHAPTER 1

## ROAD TO THE OIL SHOCK

### 1.1 Oil's promotion as a black gold and macroeconomy

Throughout history, human needs have increased and changed according to the needs of the time. One of the best examples of this can be industrialization, which is an element of the transition to the modern world. With industrialization, most of the daily needs have changed. Oil, which was previously used for lighting fires and lighting, has taken its place in world history as an indispensable raw material in many fields from daily life to industry and military needs, together with its use in internal combustion engines.

Those who were the first to exploit the oil industry after seeing its potential and exploiting its worth became as powerful as the emperors, and the businesses they established were as wealthy as the governments. Those individuals who initially recognized and developed this concept gave birth to the oil businesses that continue to dominate the oil industry as the world's top financial titans. These businesses, which are powerful thanks to the organizational structures they have in place, have also become political and economic actors in the international conjuncture (Stevens, 2013). They have done so by gaining an effective freedom of political action along with the economic returns of oil as a result of the part they have played in the historical process. In addition, they have technology that is combative, courageous, and well-equipped. At the same time, the states that have a stake in these enterprises are able to establish a space for both their national interest and their national security through the corporations. As an illustration, the United States of America displayed political and diplomatic reactions such as sending a message to the country in question if the interests of Standard Oil in that country were in danger.

The formation of these international oil firms was not just motivated by a desire to collaborate economically. In other words, oil demonstrates that it is the most important item of the current and future order, whether in terms of its commercial and economic



dimension or its political-strategic place in the international conjuncture. This is because oil is the source of the raw materials that are used to construct the modern world.

In addition, the speedy expansion of the oil industry over the past century has resulted in intense levels of rivalry as well as intricate new commercial arrangements that have never been seen before. Specifically, the fact that it is a necessary component of industrialization as well as industrial society makes oil a factor that modifies and transforms worldwide political, economic, and commercial aspects as well as the relationships between them. The first commercial oil well was drilled in Pennsylvania, United States in 1859. The discovery of this well marked the beginning of the petroleum industry and the growth of oil as a commodity. In the following decades, oil became an important source of energy, used primarily for lighting and as a fuel for transportation. The growth of the oil industry was slow, however, until the development of the internal combustion engine in the late 19th century. With the advent of automobiles and the growth of transportation networks, oil consumption increased rapidly, and the demand for oil grew along with it.

The first major oil companies emerged in the early 20th century, including Standard Oil, Royal Dutch Shell, and Anglo-Persian Oil Company. These companies played a central role in the development of the global oil industry and the growth of the world economy. They used their resources to explore and extract oil from around the world, creating vast reserves and a reliable supply chain. They also developed new technologies for refining and distributing oil, allowing for a greater use of this resource and making it accessible to more people (Jones, 1981).

Oil's status as a valuable commodity became more pronounced after World War II, when it became the dominant source of energy for many countries. The growth of the world economy, especially in the United States, was closely tied to oil, as the country's vast oil reserves and the development of new oil-related industries led to economic expansion and prosperity. The oil-producing countries, particularly those in the Middle East, also

experienced significant economic growth as a result of the high demand for their oil (Hamilton, 1983).

In the 1970s, the world experienced a major oil crisis, triggered by the decision of several oil-producing countries to reduce production and raise prices in response to the U.S. support for Israel in the Yom Kippur War. This crisis had far-reaching economic and political consequences, as many countries found themselves dependent on oil imports, and some even experienced economic recession as a result of the high oil prices. The oil crisis also led to the development of new policies aimed at reducing dependence on oil, including the promotion of alternative sources of energy and the development of energy-saving technologies.

Oil is the main driving force of the global economy, it is one of the commodities that have a great economic and political impact on the global economy. It is one of the cornerstones of human civilization. Among all other energy sources, oil is one of the most strategic products in the world (Kitamura & Managi, 2017). The oil price corresponds to the cash price of a barrel in crude oil benchmarks for sellers and buyers of crude oil price, such as WTI, Brent blend, Dubai crude, and the OPEC reference basket. Still, world oil prices are determined by a market-related pricing system that links oil prices to the market price of a particular crude oil sample. Oil prices have been subject to many changes and price instabilities known as oil shocks (Farrell et al., 2001).

Recently, oil has become a strategic product controlled by economic, political and security dimensions. So much so that this product affects a wide variety of parties in the market. There are many reasons for the factors affecting prices, including geological factors such as the fact that the major oil countries have reached their peak in production and that there is no reserve to benefit from their oil, as well as economic factors such as in China and India. There are many reasons for these oil prices, such as the increase in producers and consumers, and the differences in innovation and interest between them. However, supply and demand remain the main determinants of oil price, as in all other products.

Inventory levels have remained above these record levels for the past five years, with the volatility seen in 2008 due to the financial crisis that caused the financial crisis throughout the year, mainly because there was no shortage in the level of oil supplies, which cast a shadow on the global oil market, a key factor behind any rise in prices. For businesses seeking capital, uncertainties affecting the cost of capital are beneficial because they eliminate and reduce compliance costs. The circumstances of the First World War affected US crude oil prices because they had risen to initial levels at the end of the war. Prices continued to rise after the First World War as a result of increasing global demand for crude oil, which is a strategy that replaces coal as an alternative energy source and enters most industries as one of the main inputs. This caused the US crude oil price to rise from \$1.98 in 1918 to \$3.07 per barrel in 1920 (Claes, 2018).

The Great Depression of the 1930s caused oil prices to drop to as low as \$0.97 per barrel in 1935. In 1944, during the Second World War, global oil prices rose to \$1.2 per barrel. After the Second World War, due to the rapid development of the international oil industry and the invention of diesel engines and internal combustion engines, oil prices rose to \$2.0 per barrel. As a result of the closure of the Suez Canal following the tripartite attack against Egypt in 1956, this resulted in very significant changes that directly and indirectly affected the global market conditions for crude oil. In 1957, oil prices rose to \$3.07 per barrel, but there was a 10% drop in crude oil supply (Libecap, 1989). From 1958 to the end of 1970, the Organization of the Petroleum Exporting Countries began to strengthen itself, but with no price-setting power because that power continued to rest in the hands of transnational Western oil companies, which maintained relatively stable global oil prices of \$3 per barrel (Yan, 2012). In early 1959, oil companies operating in Venezuela lowered Venezuelan crude oil prices, set from \$3.07 to \$2.92 per barrel, in response to actions taken by the Venezuelan government (Yan, 2012).

## **1.2 Oil shocks in the world since World War II**

### **1.2.1 1973-1974 oil shock**

The oil shock of 1973–1974 was a time of rapidly increasing oil prices and severe economic upheaval that had far-reaching effects on economies all around the world, particularly in the energy industry. It was brought on by a confluence of circumstances, the most significant of which were the political unrest in the Middle East, the diminishing oil reserves in the United States, and the rising demand for oil in both Europe and Asia. Oil has emerged as a key source of geopolitical tension and the focal point of worldwide attention in both the economic and political spheres as a direct result of the oil shock, which marked the beginning of a new age in the global energy sector (Corbett, 2013).

The Arab members of the Organization of Petroleum Exporting Nations (OPEC) made the decision to impose an embargo on oil supplies to countries that had supported Israel in the Yom Kippur War. This decision was the impetus for the oil shock that occurred between 1973 and 1974. Because of the abrupt fall in supply that was caused by the embargo, there was a shortage on the global market and as a result the price of oil skyrocketed. The price of a barrel of crude oil increased by more than 400% between September 1973, when it was selling for \$3, and January 1974, when it was selling for over \$12 (Corbett, 2013).

The sudden surge in the price of oil had a significant and widespread influence on economies all across the world. The rise in prices resulted in inflation and a subsequent decrease in consumer expenditure since individuals had less money available with which to purchase additional products and services. As a result, this led to a slowdown in economic growth, as firms faced a diminishing demand for the goods and services they offered. Additionally, as a result of the rise in the price of oil, businesses were forced to pay a greater amount for the energy resources necessary to the production of their goods and services, which led to an increase in operating expenses.

Different governments in different parts of the world reacted in a variety of different ways to the oil shock. Several nations, including the United States, have made efforts to lessen their reliance on oil by diversifying their energy portfolios to include coal, nuclear power, and hydroelectric power, among other alternative energy sources. Others, such as Japan, have made efforts to improve their energy efficiency by enhancing their energy conservation and efficiency techniques. In addition, many nations instituted price restrictions and rationing schemes in an effort to mitigate the negative effects of increased costs on their respective populations (Kilian & Lee, 2014).

The global energy sector was also significantly impacted by the oil shock in a substantial way. As a result of the increase in the price of oil, businesses have boosted their spending on oil exploration and production in an effort to discover new oil reserves and expand their overall supply. This, in turn, led to the discovery of new oil resources, such as the oil fields in the North Sea, which are located in the pertinence of the United Kingdom and Norway. These discoveries helped to offset the loss in oil reserves in the Middle East and the United States.

The price shock in oil also had significant repercussions for geopolitics, as it exacerbated existing tensions between countries that were net importers and exporters of oil. As a result of the increase in the price of oil, oil-exporting states such as Saudi Arabia and Iran have gained more bargaining power in their dealings with nations that are net consumers of oil. This resulted in a shift in the balance of power in the global energy sector, as the oil-exporting nations became more influential and the oil-importing nations became more dependent on their supplies of oil. This was caused by the fact that this shift led to a shift in the balance of power in the global energy sector.

Before 1973, the price of a barrel of oil was approximately \$3.6. Before this time, there were seven companies that came to an agreement on the quantity of supply that would determine the price of fossil fuels and, consequently, the stability of markets (Adelman, 1993). However, as a result of the war on October 6, when it was used by the Arabs, and when they placed the 1973 Arab oil embargo into place, the pricing turned completely

upside down. The decade of the 1970s was dominated by two significant occurrences. The first incident took place after the war in October 1973 and involved the Arabs employing oil-based weaponry. The first incident referred to in the question is known as the 1973 oil crisis or the Arab oil embargo. In October 1973, a group of Arab countries led by Saudi Arabia and including other members of the Organization of Arab Petroleum Exporting Countries (OAPEC) implemented an embargo on oil exports to several Western countries, including the United States, in response to their support for Israel during the Yom Kippur War (Nwaezeigwe, 2021).

This embargo resulted in a significant reduction in the supply of oil, which led to a sharp increase in oil prices and widespread shortages in many countries heavily dependent on oil. The embargo had a major impact on the global economy and marked a turning point in the history of the oil industry, leading to the emergence of the Organization of the Petroleum Exporting Countries (OPEC) as a powerful cartel in the international oil market.. The second significant event was the beginning of the Iranian Revolution in 1978-1979. This took place in Iran. These two occurrences unmistakably left their mark on the oil markets, which resulted in an unprecedented increase in oil prices and spurred developed nations to adopt preventative steps in an effort to cut back on their usage (Deutch et al., 2006).

### **1.2.2 Second oil shock (1979)**

The Second Oil Shock of 1979 was a significant event in the history of the global energy industry, characterized by a sudden and dramatic increase in the price of crude oil, a commodity that serves as the backbone of the world's energy sector. The Second Oil Shock was caused by a confluence of factors that had a profound impact on the world's economies, including geopolitical instability, economic recession, and changes in the balance of power in the global oil market (Lomax & Lomax, 1986).

The Iranian workers' strike and the Iranian revolution in early 1979 led to a reduction in Iran's oil supply from 6 million barrels to 1.5 million barrels, which led to an

increase in prices and a second oil crisis in the world in 1979 (Fatemi, 1980). This reduction in Iran's oil supply caused prices to rise, which led to a second oil crisis in the world in 1979. In this particular instance, the price of Arab light oil increased from \$12.7 per barrel in March 1979 to \$24.5 per barrel in December of the same year, representing a significant increase (Stournaras, 1985). As a direct result of the conflict that broke out between Iran and Iraq in November 1981, oil production was severely hampered, which caused prices to more than double. The combined oil production of the two nations was only 1 million barrels per day, which resulted in a 10% decrease in the production of crude oil around the world and caused prices to increase from \$14 per barrel in 1978 to \$35 per barrel in 1981 (Rowen & Weyant, 1981).

The sudden reduction in oil supplies from Iran was compounded by events elsewhere in the world. The United States, which was already grappling with high inflation and a sluggish economy, saw its oil supplies curtailed by a series of refinery strikes and other disruptions. Meanwhile, the Soviet Union, which was locked in a struggle with the United States for global dominance, had begun to experience its own oil supply problems.

The confluence of events in the Middle East, United States, and Soviet Union created a perfect storm in the global oil market, as oil prices skyrocketed and the world struggled to keep up with demand. The price of crude oil, which had averaged around \$15 per barrel in the mid-1970s, rose to more than \$40 per barrel by the end of 1979. The price of gasoline and other refined products followed suit, causing significant strain on the world's economies (Kleit & Foreman, 2022).

The Second Oil Shock had far-reaching impacts on the global economy. The sudden and dramatic increase in oil prices led to a rapid inflation of energy costs, which cascaded through the economies of the world, driving up the cost of everything from food and transportation to industrial production and consumer goods. This, in turn, led to a rapid decline in economic activity, as consumers and businesses cut back on spending in an effort to cope with the rising costs. The result was a global recession that lasted for several years and had significant impacts on the world's economies, including high unemployment and

reduced economic growth. The Second Oil Shock also had profound impacts on the geopolitics of the world. The sudden increase in oil prices and the resulting recession led to a shift in the balance of power in the global oil market, as the world's major oil-importing nations were forced to rely on OPEC and other major oil-exporting nations for their energy needs.

### **1.2.3 Oil crisis of 1980s**

The Oil Counter-Revolution of the 1980s was a response to the Second Oil Shock of 1979, which had resulted in a rapid increase in the price of crude oil and the global recession that followed (Petrini, 1980). In 1979, the Second Oil Shock had caused a rapid spike in the price of crude oil. The Oil Counter-Revolution was characterized by a series of actions taken by governments, businesses, and consumers around the world to reduce their dependence on oil and shift towards alternative sources of energy. These actions were taken in an effort to counteract the effects of the original revolution, which was fueled by oil. The Oil Counter-Revolution had a significant impact not just on the international energy industry but also on the economies and geopolitics of the world at large (Basosi et al., 2019).

One of the most important factors that led to the Oil Counter-Revolution was the realization, on the part of governments and corporations all over the world, that continuing to rely so heavily on oil was not viable over the course of the long term (Fesharaki & Hoffman, 1985). After the abrupt and dramatic surge in oil prices in 1979 had revealed that the world's economies were sensitive to price spikes and supply disruptions, several countries began looking for ways to minimize their dependence on oil. The year 1979 was a watershed year for the global economy. This was especially true in the developed world, which had been hit particularly hard by the effects of the Second Oil Shock (Sabin, 2012).

The governments of the developed world responded to the Second Oil Shock by enacting a number of programs that were designed to lessen their reliance on oil. This includes investments in several types of energy, such as hydroelectric power, nuclear



power, and renewable energy sources. The implementation of building codes that required improved insulation and more efficient heating and cooling systems, as well as the promotion of the use of public transportation and other forms of alternative transportation, were both examples of the actions that governments took to improve energy efficiency and reduce energy consumption (Lomax, 1986).

Businesses also responded to the Oil Counter-Revolution by researching and implementing alternative energy sources and increasing their energy efficiency. This included investments in research and development aimed at producing new technologies, such as high-efficiency engines and more energy-efficient appliances, as well as the adoption of more energy-efficient industrial techniques. As people became more aware of the effect that their energy use had on the environment and the economy as a whole, consumers also played a role in the Oil Counter-Revolution. This resulted in a growing demand for energy-efficient items as well as other sources of energy, such as solar panels and wind turbines. This, in turn, helped to fuel the development of new technologies as well as the creation of industries that focus on alternative forms of energy.

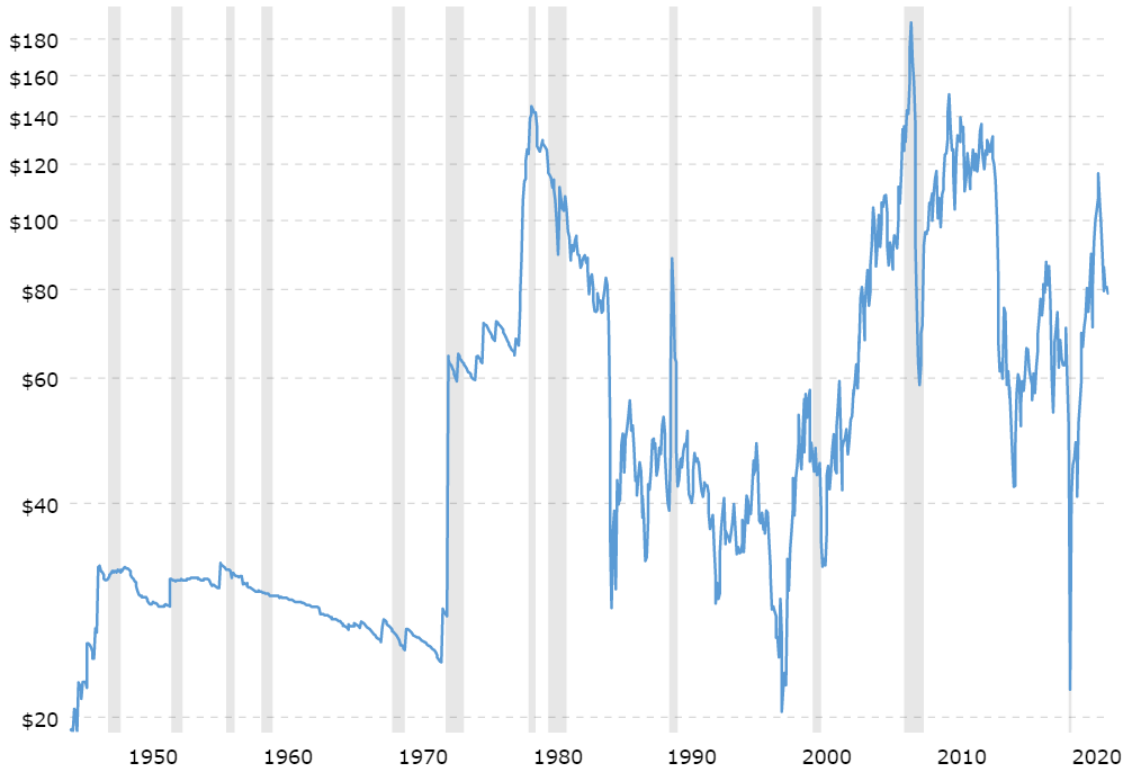
Oil prices were put under pressure as a result of the Oil Counter-Revolution, which also had substantial effects on the global oil industry. The Oil Counter-Revolution was responsible for the decline in demand for oil as well as the shift toward alternate sources of energy. This was especially true in the United States, which had been a key driver of the Second Oil Shock. At the same time, the country was becoming more self-sufficient in terms of energy production and less dependent on oil imported from other countries. Because of this, OPEC and other major oil-exporting nations saw a decrease in their power and influence as they tried to maintain their dominance in the global energy market. The result was a decline in both power and influence (Panikar, 1991).

The shift toward alternative sources of energy and the reduction in demand for oil led to a decline in the importance of the oil sector in the global economy, which was another significant impact of the Oil Counter-Revolution. The Oil Counter-Revolution also had significant impacts on the economies of the world. This was especially the case in the

industrialized world, where the oil industry had traditionally been a significant driver of economic expansion and wealth. Other industries and sectors, such as technology and manufacturing, grew increasingly vital as the importance of the oil sector decreased. This led to a shift in the balance of power in the world's economies, which led to a shift in the balance of power in the world's economies.

The 1986 oil shock was known as the reverse shock because it had the opposite impact of previous oil shocks—its negative repercussions hurt oil-producing countries instead than oil-consuming ones, as opposed to earlier oil crises (Lee et al., 1995). Because OPEC members neglected the fact that prices fell as a result of an imbalance between oil demand and supply, it is also known as a price collapse shock. Because there was so much oil available, prices decreased until 1986. With overall revenues less than one-third of previous peaks, OPEC's share of the oil market has also shrunk dramatically, putting many member nations in dire economic straits. The Organization's first adoption of a production cap, as well as the division of the production quota between member countries, resulted in the stabilization of prices. However, prices have since increased again, and OPEC's share of global output has made significant progress in negotiations with oil-producing nations outside the Organization. The graph displays the change in Brent crude oil prices (Sadorsky, 1999).

Figure 1. WTI Spot Price in 1950-2020 (Dollars per barrel)



Source: [Crude Oil Prices - 70 Year Historical Chart | MacroTrends](#)

#### 1.2.4 1990 oil price shock

After the invasion of Kuwait in the early 1990s, this oil shock was the third to occur. With the price of oil averaging \$31.17 in 1989 and \$26.22 in 1990, oil prices increased from \$17 per barrel in June to \$36 per barrel in October of 1990, when things started to get worse with the oil price. Oil prices decreased as worries about future oil supply constraints diminished, and price volatility persisted until the oil prices crashed in 1998. The average barrel price was 69.9 dollars due to competition for market share among production nations and a fall in global oil demand after the financial crisis that impacted the economies of South Asia (Adelman, 1990).

Because oil output in the Asia-Pacific region had fallen for the first time in 16 years in 1998, the Organization of the Petroleum Exporting Countries increased its quota by 10% to 2.5 million barrels per day.

The second shock occurred in 1997 with the so-called Southeast Asian financial crisis, which fueled global economic recession. Especially in crisis-affected nations, where oil prices dropped to about \$15 per barrel, it had a detrimental impact on capital flow movements (Vo & Daly, 2005). In April, OPEC upped its daily quota to 1.25 million barrels, then in July, it increased it to 1.33 million barrels. When OPEC announced a price range of \$22–\$28 per barrel for the Organization of the Petroleum Exporting Countries in 1999, oil prices started to decline (OPEC) (Kohl, 2002).

A third phase of production cuts was agreed upon in March 1999 after prior rounds of production reductions agreed upon in collaboration with non-OPEC members Mexico and Norway failed to reverse the price decline. It was expected for this round of production reduction to go into effect right away. This new agreement was created as a direct result of the collapse of the previous ones. Crude oil prices started to increase, going from \$14 in March to \$27 a full year later. Almost a 100% rise can be seen in this. Along with this, the price of the OPEC oil basket<sup>1</sup> decreased for the remainder of 2001, falling to \$1.23 per barrel from \$6.27 per barrel in 2000. In contrast to the price of the oil basket in 2000, this change took place. The awful things that happened on September 11 were a big reason why the price of crude oil dropped. Although these events frequently resulted in price increases, crude oil prices have stayed at manageable levels. Furthermore, these levels are in line with OPEC's strategy for stabilizing the oil market and achieving oil price levels that would be acceptable to both oil-producing and oil-consuming nations.

Crude oil prices drastically decreased after September 11<sup>th</sup> (Ye et al., 2006). At the close of 2001, OPEC decided to stick to its promise to cut production by 1.5 million barrels per day starting on January 1, 2002. From the start of 2002, OPEC members started to reap the rewards of this choice. This is because the price of the OPEC crude oil basket has increased and remained stable while keeping within the organization-established price

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<sup>1</sup> The OPEC oil basket is a weighted average of oil prices from various OPEC member countries, including Algeria, Angola, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, Congo, Saudi Arabia, United Arab Emirates, and Venezuela. It is used as a benchmark for pricing OPEC crude oil exports and is published daily by the OPEC Secretariat.

band (\$22–\$28). Additionally, Venezuela's production declined as a result of the strike that was there. During the months of January and February 2003, the Organization of the Petroleum Exporting Countries (OPEC) increased its daily output cap by 2.8 million barrels (Barsky & Kilian, 2004).

### **1.2.5 2003-2008 Oil Price Shock**

The conflict in Iraq, high oil demand from China, concerns about the oil summit, the depreciation of the US dollar, and the fact that some reports indicate that a decline in oil reserves at Broadway Bay in Alaska indicates a bankruptcy in the region are just some of the factors that have contributed to the reoccurring temporary difficulties in oil flow in some countries around the world. The price of oil has been extremely unstable as a result of political calamities such as the war in 2006 between Lebanon and Israel, the North Korean missile tests, fears about Iran's nuclear program in 2006, and other geopolitical factors. The price of oil has been affected in the short term by these factors, but in the long term, they have had a substantial impact. In the United States, Hurricanes Katrina and Rita sparked widespread panic in the oil markets and had a terrible impact on the economy of the entire world. This was on top of the earthquake that struck the Chinese province of Sichuan, which led to a considerable rise in the use of generators and subsequently drove up costs (Hamilton, 2013).

The price of a barrel of oil increased from \$30 in 2003 to \$60 in 2005 as a direct result of political unrest in the majority of oil-exporting countries. When compared to the average for 2002, the price of oil around the globe increased by 19 percent. Because Iraq held such a large proportion of the world's oil reserves, the invasion of that country in 2003 was a critical event for the world's oil markets (Mokni, 2020). The conflict, which occurred at the same time as an increase in the demand for oil around the world, not only resulted in a fall in oil output in Iraq but was also accused for contributing to an increase in the price of oil (Stevens, 2013).

In locations such as Mexico's Cantarell region, the use of innovative technology to extract crude oil has maintained oil production stability over the years. This means that oil production in Iraq may reduce the price of oil in the short run, but prices won't decline in the long run, according to Simmons. According to Simmons, the invasion of Iraq was a direct response to the sustained rise in oil prices; however, there is a way to alleviate the strain on oil production by retaining some of Iraq's oil reserves. This has directly led to a reduction in the amount of oil that can be produced, which is now down to 2 million barrels (Simmons, 2006).

#### **1.2.5.1 2008 shock in oil prices**

After oil prices sharply increased at the end of 2007, the years 2007–2008 are regarded as the peak of oil prices. In July 2008, it climbed from \$60 to \$80 a barrel and subsequently broke a record at \$147.3 per barrel, becoming its highest point in recorded history. However, the price immediately decreased as a result of worries about global demand during the 2008 high-risk mortgage crisis-induced recession. When oil prices dropped to \$40 per barrel at the end of the year, OPEC decided to meet and remove more than 4.5 million barrels from the market, which allowed prices to gradually rise to the \$100 mark by 2011. Reserve capacity decreased to below one million barrels per day, and crude oil futures market speculation was very noticeable (Verick & Islam, 2010).

The mortgage market crisis, often known as the financial crisis of 2007–2008, was the worst economic downturn the world has seen since the Great Depression (1929-1932) (Martin et al., 2018). The global economic crisis led to the failure of numerous financial institutions, and the losses that resulted cost the United States economy trillions of dollars. After hitting a high of \$70 a barrel in early June 2009, the price of oil continued its downward trend for the rest of the year, falling to a low of \$36 a barrel in November. This was after reaching a high of \$70 a barrel in early June 2009. The price of a barrel of crude oil increased from \$70 at the end of 2009 to \$83 at the beginning of 2010, marking the highest price since October of 2008. This increase occurred against the backdrop of increased economic growth and cooler weather in the northern hemisphere (EIA 2013).

From \$72 per barrel in 2010 to \$82 per barrel in 2011 and then to \$91 per barrel in November of this year, the average monthly price ranges have climbed significantly (Hamilton, J. 2013). In 2010, there was a noticeable improvement in the state of the world economy, as seen by the monthly rate increasing by 4.3%. This is a debatable reflection of the recession that occurred in 2009, and it substantially explains the increase in oil prices that was observed in 2010. The significant increase in the price of oil that was observed between 2003 and 2008 may primarily be explained by shocks in the business cycle as a whole (Kilian,2009).

### **1.3 Oil, Debt, and Crisis**

OPEC nations each contributed a sizeable portion of their collective budgets to various projects designed to foster economic expansion. During this time period, investments were mostly focused on modernizing and retooling the production of the domestic economy. Spending on infrastructure building and industrial expansion in industries such as steel manufacture, the petrochemical industry, and electrification projects increased and remained stable over the entirety of the Middle East. In the end, the goals of these projects were to improve social welfare and achieve financial autonomy. The vast amount of resources that have been committed in these efforts is demonstrated by the fact that Saudi Arabia's Second Five Year Plan earmarked a startling 141 billion dollars to be used for various development programs. This megaproject, which was extremely ambitious but ultimately failed, was supposed to render the Arabian Desert green and turn Saudi Arabia into a net exporter of agricultural goods.

However, it did not achieve either of these goals. As a result of these initiatives, there was a significant increase in the use of imports, migrant labor, and foreign labor, which established a trend that is still prevalent today. The growth of showy consumerism among the inhabitants of the Arab World, which are experiencing rising levels of prosperity, has contributed to an increased reliance on imported goods. In spite of the fact that the expansion of domestic industry was intended to foster economic autonomy, the

result was an increased reliance on imports as well as the revenue generated from the export of oil in order to cover the rising costs associated with the creation of a diverse industrial sector.

The importation of firearms is an additional significant secondary recycling approach that has a direct impact on the primary recycling operation. Despite the fact that the 1973 Shock provided OPEC's Middle Eastern members with tremendous sums of money for expansion, a sizeable portion of that money went toward funding an arms race among Saudi Arabia, Iraq, and Iran. During the 1970s, these countries were involved in a triangle battle, during which they expanded the strength of their armed forces and increased the number of weapons they purchased. After the oil embargo of 1973, the Shah of Iran was the first major participant to drastically boost spending levels. The amount of money spent by Iran on its military climbed consistently throughout the course of the decade, going from \$1.8 billion in 1973 to \$4 billion in 1974. Following this major surge in weapon purchases by Saudi Arabia and other Gulf monarchies, which led to Saudi Arabia being the world's largest consumer of US armaments by the year 1980, the growth in arms sales was not restricted to Iranian aspirations alone. Following suit, the remainder of the Gulf region made arms purchases in 1977, the sum of which amounted for 10.6% of all known transactions involving the purchase or sale of arms. Between 1973 and 1982, a total of 35 different nations sent an estimated \$80 billion worth of armaments to the Middle East, according to estimates compiled by the Stockholm International Peace Research Institute (SIPRI).

Concerns over Iran's military aspirations gave rise to the beginning of an economic conflict that began in 1977 and became known as the Oil War. Iran's capacity to generate finances to bolster its military has been severely hampered as a result of unilateral actions taken by Saudi Arabia to expand production and decrease its price. As a direct consequence of this, Iran went through a period of acute instability, which was a significant contributing factor to the Iranian Revolution of 1979. This pricing war coincided with a comparable decline in OPEC's investible surplus in 1977 and 1978, which demonstrates that the Oil



War had a significant influence on oil earnings throughout the region. Prior to the eventual fall of the Iranian government, which was the cause of the 1979 Oil Shock, this pricing war was a direct cause of the 1979 Oil Shock (Barsky& Kilian, 2002).

Unfortunately, this arms race had consequences for the populations of Iran and Iraq that lasted for a significant amount of time. The Shah of Iran diverted large funds intended for economic growth and invested them instead in his military agenda. The autocratic leadership of the Shah, his use of the region's oil wealth in his quest for regional hegemony, and his extravagant displays of ostentatious spending all contributed to the Shah's policy mistakes becoming even more severe. The Iranian economy was already in a precarious state before the Oil War of 1977 and 1978, which was an economic battle that began as a result of concerns over Iran's growing military potential. This conflict made the situation substantially worse.

These factors helped to feed the flames of discontent that eventually resulted in the Iranian Revolution in December of 1978. Fears of the revolution spreading were exacerbated in 1980 by Iran's substantial military might and the occupation of the Mecca Grand Mosque in Saudi Arabia by Wahhabi radicals, both of which occurred after the Shah of Persia was deposed. As a result, the Iraqi military wasted no time in putting the weapons it had purchased with revenue from oil sales to immediate use. The failed invasion of Iran, which was financed and armed by the Gulf monarchies, the Soviet Union, and the United States, was the beginning of an eight-year conflict that resulted in the deaths of over one million people. During this conflict, Iraqi forces used chemical weapons widely for the first time since the First World War, including the first known use of nerve gas on a battlefield.

These war debts would later become one of the factors that led to Saddam Hussein's invasion of Kuwait in 1991, which was the event that kicked off the conflict in the Persian Gulf. Despite the fact that it lasted for just a short time, this fight resulted in the terrible murders of Iraqi Kurds and Marsh Shi'a, set the stage for twelve years of crushing sanctions, and paved the way for the invasion of Iraq by the United States in 2003. The deadly convergence of oil money, regional aspirations, and the thirst for profit by

international weaponry dealers led to the first of a series of clashes that are still going on today. These conflicts are still going on because of this fatal confluence. In spite of the fact that the expenditures on the arms race were driven by a number of different factors, the immediate influence that the arms race had on the stability of the Middle Eastern members of OPEC had significant ramifications for the markets and players that were now deeply involved in the industry of petrodollar recycling.

This new cycle of borrowing, which was powered by petrodollar, was directly responsible for the third and final phase of the broader petrodollar recycling process, which was a significant increase in the overall volume of international indebtedness. It was inevitable that the private sector would control a large portion of this expansion of debt given that the private sector was in command and governments were reluctant to undertake any form of significant debt reduction or financial relief initiatives to lessen the effects of the 1973 Oil Shock. The worldwide wave of oil-driven inflation and the rising demand for oil throughout the era both contributed to the rate of growth for these loans throughout this time period. The global wave of oil-driven inflation drove up the cost of these loans (El-Gamal & Jaffe, 2009).

Table 1. The Scope of International Finance and the Development of the World Economy, 1975–1983.

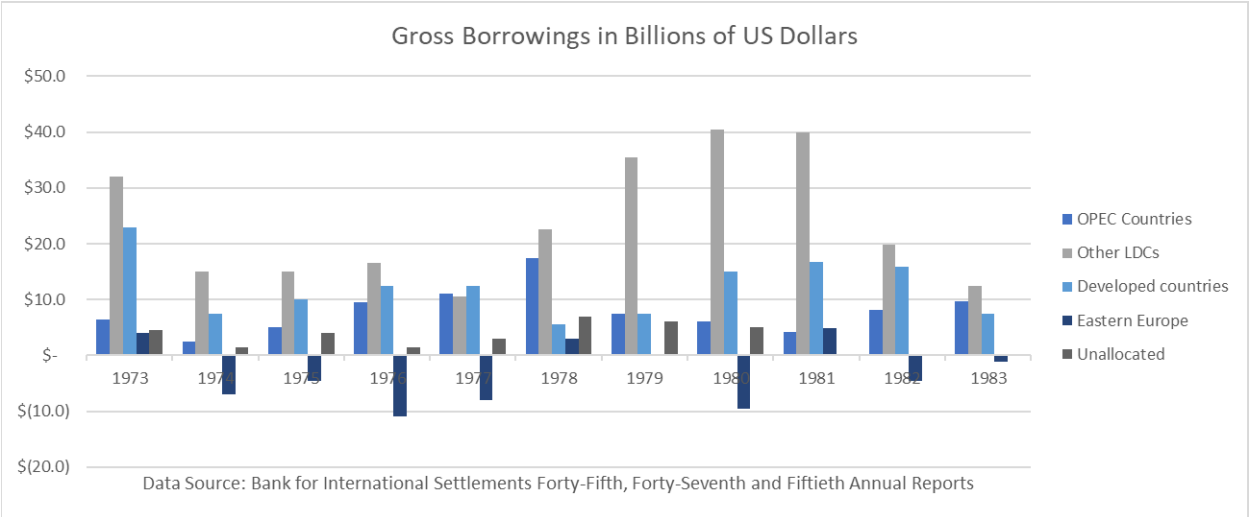
Rate of Growth	1975	1976	1977	1978	1979	1980	1981	1982
Gross World Product	0.6%	5.0%	3.8%	3.8%	3.0%	1.9%	1.9%	0.4%
Estimated Bank Assets	46.2%	11.9 %	16.1 %	17.8%	13.45 %	6.6%	2.6%	-0.9%
Growth of New Lending	-86.0%	35.5 %	-0.1%	3.9%	16.7%	12.7 %	-8.3%	-48.4%

Total Value, OPEC Investments	- 104.4%	- 16.8 %	-6.4%	- 175.0 %	76.1%	27.3 %	- 100.8 %	7701.5 %
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Between the years 1974 and 1980, the total amount of lending and credit made available by banks under the supervision of the BIS climbed from an estimated nominal value of \$214.1 billion to \$1,323.1 billion. This was the final high point for OPEC petrodollar capital during the recycling period. This reflects a gain in total value of 73.45% when adjusted for inflation, which is far higher than the rate of growth in the size of the world economy, which grew by just 21.38% during the same time period. This is because the rate of growth in the size of the world economy was far lower than the rate of growth of lending (Smith, 2022).

The people who borrow money and the institutions from which they do so have also seen significant shifts in recent years. It is not surprising that a significant number of these new sources of capital demand originated in the Global South. This region was badly impacted by the shock that occurred in 1973 and is currently undergoing decolonization while also being plagued by terrible poverty.

Figure 2. Total gross borrowings by region from 1973 to 1983.



According to Altamura, who describes this leg of petrodollar recycling, enormous sums of money were transferred in the form of loans to developing countries. These countries were considered worthy borrowers due to the favorable terms of trade for primary commodities and due to the fact that they had better growth prospects in comparison to developed countries (Altamura, 2015). A similar analysis of the process is provided by Kopper, who asserts that, for the first time in the history of the world, second-rate emerging borrowers, such as the developing nations of Latin America, Africa, and Asia were able to get sizeable long-term loans at rates that were competitive. Kopper analyzes the procedure in the same way. The combination of a low real interest rate and good competition for borrowers contributed to the maintenance of historically low interest rates (Kopper, 2009).

Real interest rates were extremely low, even negative, due to high inflation and a flexible monetary policy, which encouraged many emerging nations to take on additional debt. The vast bulk of this debt was granted to countries with a middle income, many of whom were oil exporters themselves and desired to speed up their industrialization by borrowing against their prized oil assets. These evaluations on the expansion of global debt during the time of petrodollar recycling are mostly in agreement with the material that is presently accessible on petrodollar recycling and the Debt Crisis of 1982.

The linkages between oil, loans, and financial crises are extremely important to comprehending the consequences and results of the petrodollar recycling era that took place between 1974 and 1982. Windfall revenues created by OPEC made it possible for the new environment of significantly raised levels of international debt and a global financial system that is dependent on it. Because of this, it is necessary to conduct a more in-depth investigation into the effects that these funds had on the global monetary environment that was supporting these transactions, how their demands forced and accelerated some of the most significant changes to financial practices that have taken place since the end of World War II, why they stopped flowing, and how this stop in OPEC deposits impacted a system that had become accustomed to accepting, processing, and leveraging a source of funding that appeared to be reliable. Understanding these effects—

which remain largely unexamined in the existing scholarly literature—shows the true extent of the influence of petrodollar recycling on the growth of financialization. This can be demonstrated by fully illuminating the ways in which these funds irrevocably changed finance into the international, largely autonomous field it developed into over the course of the 1980s and 1990s.

## **CHAPTER 2**

### **OVERVIEW OF PETRODOLLAR CONCEPT**

#### **2.1 The emergence and development of the concept of the petrodollar**

The petrodollar is a term used to describe the US dollar's dominant position as the global currency for oil transactions. The petrodollar system, which emerged in the 1970s, refers to the arrangement whereby oil-exporting countries would only sell their oil for US dollars, and in return, the US would provide military and economic support to these countries. The petrodollar system has had a significant impact on the global economy, the US dollar's status as the world's reserve currency, and international political relationships (Clark, 2005).

Following the conclusion of the Second World War, there was a time when the United States of America (USA) held the political and economic upper hand across the rest of the world. In point of fact, before to the outbreak of World War II, the United States of America held the position of having the greatest economy in the world. Prior to the start of the Great Depression in 1929, the United States was responsible for 44.5% of the world's industrial production. Despite this, the United States was not a preeminent force in the globe in terms of global management despite the fact that they were a super production power.

After the successful completion of the Normandy landing in June 1944, which demonstrated that the United States and its allies would win the Second World War, the concepts of economic and diplomatic stability in the post-war period began to be discussed. This success showed that the war would end with the victory of the United States and its allies. The Bretton Woods conference, which was conducted within the context of these debates, was responsible for the birth of a new monetary system. According to this system, one ounce of gold is equivalent to 35 dollars in today's value, and the dollar is the main international reserve currency, together with the British Pound Sterling. In addition, as a

direct result of the conference that took place at Bretton Woods, organizations such as the World Bank and the International Monetary Fund were founded in order to assist the United States in achieving its goal of becoming the single sovereign power in the world (Fareed et al., 2019).

The United States was able to cement its economic supremacy over the rest of the globe in large part because to the role that organizations like as the IMF and the WB played in the reconstruction of European and Asian nations that had been ravaged in the immediate aftermath of World War II. In addition, the onset of the cold war in the immediate aftermath of World War II between the United States of America and the Soviet Union, as well as the founding of the North Atlantic Treaty Organization (NATO) in 1949, both contributed to the consolidation of the United States' position as the preeminent military power in the world. The recently formed monetary system at Bretton Woods also contributed to the stabilization of the global economy. Because of its huge gold reserves and robust production structure, the economy of the United States has been given a more robust structure as a result of this new order. The relative economic stability that has been maintained has made possible the speedy expansion of manufacturing and international commerce all across the world. The United States of America pushed the development of an economic union on the European continent with the assumption that it would be a market for its exports. With the signing of the Treaty of Rome in 1957, the European Economic Community was founded.

This economic arrangement persisted all the way up until the beginning of the 1970s. Countries in Asia and Europe that had been ravaged by war were able to rebuild their infrastructures with the assistance of the United States during the period between 1949 and 1970. As a result, these nations progressively established a production structure that was both sturdy and competitive. The origins of the petrodollar system can be traced back to the early 1970s. The world was undergoing significant economic and political changes, including the collapse of the Bretton Woods system of fixed exchange rates and the rise of OPEC (Organization of the Petroleum Exporting Countries). In response to these

developments, the US government, together with major oil-producing countries, worked to create a new system that would ensure stability and support US economic interests (Robinson, 2012).

In August 1971, President Nixon announced the end of the convertibility of the US dollar into gold, virtually ending the Bretton Woods system. This move was aimed at addressing the US balance of payment deficit, which was threatening the stability of the US dollar. At the same time, OPEC was emerging as a significant player in the global oil market, with the power to control the price of oil and influence the global economy, most evidently after the first oil shock of the Fall of 1973 (Ghizoni, 2013). In response to these developments, the US government reached an agreement with Saudi Arabia, the world's largest oil producer, to sell oil only in US dollars. This agreement established the foundation of the petrodollar system, with other OPEC countries soon following suit. As a result of this agreement, the US dollar became the currency of choice for international oil transactions, and the demand for US dollars increased globally.

At the beginning of the 1970s, the existing economic order began to be shaken as a result of the growing competitiveness of economies in Europe and Asia, as well as the weight of expenses incurred by the United States as a result of the Vietnam War. The central banks of significant nations, most notably France, have made a demand for gold from the present gold-dollar parity in return for the dollars that they now own. This demand came as a result of the recent price volatility in the gold market. As a consequence of these occurrences, the pace at which gold was removed from the United States Federal Reserve quickened in the middle of 1971, and the gold reserves held by the United States reached a dangerously low level. Even the Bank of England, the most important ally of the United States, participated in this operation by purchasing 2,600 tons of gold in exchange for their \$3 billion dollar reserve. As a direct consequence of these occurrences, the Bretton Woods System, which had maintained a parity of one ounce of gold to thirty-five dollars in US currency, was abolished on August 15, 1971, and all national currencies started to float



freely thereafter. This change was brought about by the Nixon administration in the United States (Gray, 2007).

The simultaneous factors of allowing the US currency to float, growing international trade deficits for the United States, and escalating expenditures related to the Vietnam War all contributed to the depreciation of the US dollar throughout the 1970s. During this period, the Organization of Petroleum Exporting Countries (OPEC) began to consider the potential of conducting oil trading via a currency basket consisting of a number of other currencies. This discussion was based on the trends in the value of the US dollar. The United States of America launched high-level negotiations with Saudi Arabia, the world's largest oil producer, in order to retain the supremacy of the dollar by prohibiting oil commerce from being carried out with a money basket. This was done for the purpose of keeping the dollar the dominant currency.

As a direct consequence of these conversations, the Saudi government covertly purchased US treasury notes with oil profits totaling \$2.5 billion, despite the fact that there was no reason for this action at the time. As a result, the process that is commonly referred to as the "recycle of petro-dollars" (petrodollar recycling) and that is favoring the financial system of the US and the UK had already commenced. These discussions with Saudi Arabia, as revealed by US Treasury Secretary General Blumenthal at a later date, were intended to give guarantees that Saudi Arabia would conduct oil trading solely in dollars. In addition to the causes that have already been highlighted, the economic shock that was caused by the quick rise in oil prices in 1973-1974 placed pressure on the volatility in the value of the US Dollar, causing it to grow. Every nation that bought oil, from Germany to Japan, struggled with the same issue: how to pay their ever-increasing oil expenditures with the cash they made from exports (Spiro, 1999).

The member nations of OPEC, on the other hand, were confronted with the challenge of determining how to make use of the petrodollars that they had acquired as a direct result of the rise in the price of oil and which were in excess of the amount required to satisfy their national requirements. The majority of the petrodollars were transferred to

financial institutions in London and New York, which allowed the issue to be resolved. Mulford, who works for the eurobond business Weld and Co., (Burk, 1992) devised a system for Weld and Co. to use in order to better manage the money that had been generated as a result of the jump in the price of oil. The Saudi Arabian Monetary Authority was implicated in the conspiracy that underpinned this method(Joyner, 1975).

This transition took place as a direct result of high oil prices in 1973-1974. The implementation of the aforementioned mechanism began with Saudi Arabia and other OPEC member countries depositing their oil revenues in banks located in the United States and the United Kingdom. Subsequently, these capitals were distributed to the rest of the world in the form of euro-dollar bonds or loans through these banks in order to cover the rising costs of oil. People in the United States remember the years 1973 and 1974, often known as the first oil shock years, as having high inflation and long lines at petrol stations.

People in other nations, on the other hand, recall those years as having enormous foreign debts that had to be paid in US dollars at the time. During the 1960s and 1970s, Japan's economy expanded at an astounding rate, and as a result, it became the United States' most important trading partner. The United States of America was the recipient of a sizable trade surplus of Japan. During the time when Japan was using a portion of its surplus to pay its oil bill, the country was also using the excess to purchase US treasury notes, which allowed it to collect interest revenue. As a result of the turbulence that was experienced, some people in Japan have proposed that the yen, the mark, and the US dollar should all be used as international reserve currencies. On the other hand, due to the enormous economic and military strength of the United States, these voices were rapidly silenced. It has been suggested that the United States of America founded the Group of Seven (G7) during the aforementioned time period in order to maintain Japan and European countries as participants in a system predominated by the US dollar.

After the oil shock, the turbulence in the world, which included high inflation and high interest rates, was straining all economies, especially those of the underdeveloped and developing countries. During this time, the IMF acted as the gendarmerie to repay the debts

taken from the banks in the United States and the United Kingdom with the programs it had imposed on debtor countries. Because of the pressure that the International Monetary Fund (IMF) has put on debtor countries, those countries have cut back on the amount of money they spend on things like education, healthcare, and infrastructure.

This resulted in a decline in both the immediate and long-term quality of life for the people who live in those countries. As a direct consequence of this procedure, Mexico, which was at the time one of the developing market economies, announced in August 1982 that it would not be able to pay its loan payments, which sparked a debt crisis all over the world. The decades of the 1980s and 1990s were marked by a rise in economic instability as well as an increase in the frequency of economic crises, particularly in countries that were just beginning to emerge on the market.

The idea of an economic crisis became more prominent around the world in the 1990s, particularly as a result of developments in technology, an increase in the weight of the financial sectors in the economies of the countries, and the fact that these sectors have a very fragile structure. All of these factors combined to bring the concept of an economic crisis to the forefront of people's minds. Up until the end of the 1990s, the United States continued to enjoy all of the benefits that came with the dollar being the only worldwide reserve currency as well as complete control over petrodollars in the nation's economy.

The benefits of the petrodollar system for the US were significant. The increased demand for US dollars gave the US government more control over the global monetary system and ensured the US dollar's status as the world's reserve currency. This, in turn, allowed the US to print money and borrow at lower interest rates, supporting its economic growth. The petrodollar system also provided the US with a source of global power and influence, as countries around the world were forced to hold US dollars and rely on the US for access to oil. However, the petrodollar system was not without its drawbacks. The US was required to provide military and economic support to oil-producing countries, which often meant supporting undemocratic regimes and intervening in conflicts in the Middle East. The system also led to the concentration of wealth and power in the hands of a few

oil-producing countries, exacerbating global economic imbalances. In recent years, the petrodollar system has faced increasing challenges. The rise of alternative energy sources, such as renewable energy and shale gas, has reduced the world's reliance on oil, leading to a decrease in demand for US dollars. Additionally, countries such as Russia and China have started to challenge the US dollar's dominance, by working to establish alternative currencies for oil transactions and promoting the use of their own currencies in international trade. Despite these challenges, the petrodollar system remains a significant part of the global economy and continues to shape international political relationships. While the future of the petrodollar system is uncertain, its impact on the global economy and US power and influence is likely to be felt for many years to come.

## **2.2 Global competition and petrodollar**

In recent years, the United States dollar's dominant position as the currency for oil transactions has been challenged by global competition. The emergence of non-traditional energy sources such as shale gas and renewable energy has posed a threat to the United States dollar's position as the preeminent medium of exchange for the purchase and sale of oil. As the globe becomes less reliant on oil, the demand for US dollars is projected to drop, and the use of alternative currencies may become more appealing for the transaction of oil-related goods and services.

Countries such as Russia and China are also working to establish alternative currencies for oil transactions and promote the use of their own currencies in international trade. At the same time, the United States dollar has been the currency of choice for international trade.

The desire of countries to lessen their reliance on the United States dollar and lessen their vulnerability to the political and economic sway of the United States is one of the primary forces that is fueling this battle. The status of the United States dollar as the world's

reserve currency has provided the United States government with significant control over the global monetary system. On the other hand, this status has made other countries susceptible to the economic policies and decisions made by the United States.

For instance, nations that retain significant quantities of US dollars and debt issued by the US are susceptible to the danger of devaluation and inflation in the US economy. In addition, the United States has used its influence over the global monetary system as leverage in political and economic discussions, which has led to animosity among other countries and a desire on their part to establish other currencies and diminish their reliance on the dollar.

The creation of alternative payment methods for transactions involving oil is one of the most noteworthy examples of this rivalry. In recent years, a number of nations, including Russia and China, have made efforts to develop alternative currencies for the purpose of conducting oil trades. These currencies include the Chinese yuan and the Russian ruble. These initiatives have been undertaken with the goal of lessening these countries' reliance on the US dollar and fostering a greater utilization of their own currencies in international trade. Additionally, countries like as Russia and China have been working toward the establishment of gold-backed payment systems for oil transactions. This would lessen the danger of devaluation and create an alternative currency that is more stable than the US dollar. These efforts are directed toward decreasing their exposure to the economic and political power of the United States as well as establishing a framework that is more stable and secure for the transaction of oil.

When it comes to the struggle between the US dollar and the euro, the roles played by some nations and groups of nations, such as Russia and OPEC, are of the utmost importance. In an effort to reassert itself as a major player on the international stage and regain its status as a world power, Russia has begun selling oil in euros, a goal that the country has had on its agenda since 2003. In this sense, the European Union, and particularly Germany and France, provided a significant amount of support for Russia. Following the conclusion of the Cold War, the national interests of Germany and France

have been in persistent competition with those of the United States. The aspiration of the European Union (EU), which is making progress toward becoming a global equal force under the leadership of Germany and France, is undeniably the root cause of this dispute. The one currency used in all transactions involving the European Union and Russia right now is the euro.

In a similar fashion, Malaysia began transacting its oil and natural gas business in euros rather than the US dollar in June of 2003. Since the first of the year 2003, Iran has been paying for its oil exports in euros. Additionally, Venezuela and Indonesia partially converted to the euro in their oil trade, which brought to a backlash from the United States of America. On the other side, Malaysia and Iran suggested that international trade between Islamic nations should be conducted using the newly minted gold dinar currency rather than the United States dollar or the euro. It wasn't until November 2000 that Iraq became the first nation to make the transition in its oil trade from the US dollar to the euro.

There is a widespread belief that the decision made by Iraq was the true impetus for the United States to launch a war on Iraq. As was just discussed, the goal of Germany and France, and by extension, the European Union, to become a worldwide power was the driving force behind their out of the ordinary stance of resistance to the United States' invasion on Iraq. The manufacture of nuclear weapons appears to be the source of the tension that exists between the United States of America and Iran, which is well known to be on the verge of escalating into a violent clash at any given moment. It is inarguable that the costs of a potential battle between the United States of America and Iran will be significantly higher than those of the war in Iraq.

Iran's aspirations to produce nuclear weapons are not the source of tension between the United States and Iran. Iran's attempts to change the regime in oil trade and the probability of these activities causing harm to the United States are significant when taking into consideration Iran's oil production capability as well as its geographical location. This is the true concern. As was mentioned briefly earlier, Iran is working on developing various options for the existing oil pipelines in order to break the control and weight that the United

States and companies based in the United States have in this market. This is in addition to Iran's efforts to lessen the significance of the US dollar in the international oil trade.

## **2.3 Promise and Danger of Petrodollar Visions**

The promise and danger of petrodollar visions are a result of the vast economic and political power that this system has generated (Spiro, 1999).

### **2.3.1 Promise of Petrodollars**

- Stabilization of the US Dollar: The petrodollar system has contributed significantly to the stability of the US dollar as the world's primary reserve currency. With countries around the world demanding dollars in exchange for their oil, the demand for dollars has skyrocketed, giving the US a significant advantage in terms of its ability to control the global financial system.

- Increased US Influence: The petrodollar system has also given the US significant influence over other countries. Because countries need dollars to pay for their oil, they are often forced to maintain large reserves of US dollars, which in turn increases the US's ability to dictate economic and political conditions around the world.

- Promoting Global Trade: The petrodollar system has also played a significant role in promoting global trade. With countries around the world demanding US dollars to pay for their oil, this has created a vast network of international trade and investment, which has helped to spur economic growth and development in many parts of the world.

### **2.3.2 Danger of Petrodollars**

- Dependence on the US Dollar: The petrodollar system has also created a dangerous dependence on the US dollar. With countries around the world relying on US dollars to pay for their oil, they are also highly vulnerable to fluctuations in the value of the US dollar, which can cause significant economic instability in these countries.

- Heightened Political Tension: The petrodollar system has also contributed to heightened political tension around the world. With the US having significant influence over the global financial system, this has led to resentment and anger in many parts of the world, which has in turn fueled anti-American sentiment and geopolitical conflicts.
- Increased Inequality: The petrodollar system has also contributed to increased economic inequality around the world. With the US dollar being the primary currency used in the global financial system, this has given the US and other developed countries a significant advantage in terms of their ability to access and control global financial resources. This, in turn, has contributed to the widening wealth gap between developed and developing countries.
- Environmental Concerns: The petrodollar system has also contributed to environmental concerns around the world. With the focus on increasing oil production to meet the growing demand for energy, this has led to a significant increase in the extraction and consumption of fossil fuels, which in turn has contributed to global warming and other environmental problems.

The Nixon and Ford administrations, in general, supported and facilitated the increasing interdependence between US corporations and Arab governments because they believed that recycling petrodollars back into the US economy in the form of investments and export sales would benefit their economic and geopolitical objectives (Spiro, 1999). Congressional representatives and local government officials who shared the objectives of the White House and were eager to secure petrodollar earnings and investments for their states and localities worked to increase trade between US businesses and oil-producing nations.

Both the Nixon and Ford administrations were strong proponents of and supporters of opening up the investment market in the United States to OPEC companies. The United States Departments of Treasury and Commerce provided guidance to American



businesspeople on how to draft investment offers that would be acceptable to Arab and Iranian sensibilities, and they connected American businesspeople with potential investors from the Middle East (Mieczkowski, 2005).

In addition, the Treasury Department worked to block the implementation of stricter laws regarding investments made in foreign countries because it believed that these regulations would halt the influx of petrodollars into the United States (Sharma, 2013). According to one Treasury memorandum for William E. Simon<sup>2</sup> that summarized the department's viewpoint, we stand to lose a great deal more than we could possibly lose from any oil producer attempts to sell their influence or manipulate U.S. firms if we were to act in a way that seemed to support the already distressing trend in many other countries to restrict foreign capital. If we did this, we would be contributing to a situation that would cause us to lose much more than we could possibly lose from any attempts by oil producers to sell their influence (Baird, 2000).

The Treasury Department was asked to be persistent in its defense of unfettered access for foreign investment by big US multinational corporations. However, despite the claims of many Americans, particularly those involved in globalizing businesses, that the United States benefited from closer economic ties with the MENA, many other Americans disagreed with this trend and argued that it portended danger and that closer ties with Iran or the Arab countries undermined American or international interests. This is despite the fact that many Americans involved in globalizing businesses claimed that the United States benefited from closer economic ties with the MENA. These concerns originated from a wide variety of different places. Some of them can be traced back to myths and legends that date from much further in history than the 1970s.

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<sup>2</sup> William E. Simon (1927 - 2000) served as Deputy Secretary of the Treasury under Secretary George P. Shultz and, beginning in 1973, served concurrently as the Director of the Federal Energy Office during the oil shortage. He was named Secretary of the Treasury by President Nixon in 1974 and continued under President Gerald Ford. Domestically, he faced a growing economic slump as he entered office. In response to the oil crisis, he convinced the oil-producing nations to place their petrodollar surpluses in U.S. bank deposits but discouraged them from direct investment in U.S. corporations.

The oldest of these were orientalist and racial stereotypes that painted people from the Middle East as the reverse of enlightened and rational Americans; they were portrayed as being twisted, inferior, and as having a lower level of intelligence. It is difficult to have faith that these individuals will spend their petrodollars in a responsible manner when they are perceived in this light. In a similar vein, the culture of high consumption in the United States had long been accepted, whether purposefully or not, because it was based on the availability of inexpensive raw materials from developing countries. Oil was one of the most significant of these raw materials. The dramatic increase in the price of gasoline and other such products caused unease among Americans, and many of them felt hatred and contempt toward the nations that produce the oil for undermining the foundation of consumer culture in the United States. In addition, a large number of Americans had supported the establishment and defense of Israel, and some of them were now worried that the allure of Arab petrodollars might cause the United States to reduce its support for Israel's interests or encourage the sale of arms to Arab nations at the expense of the Israeli military (Wight, 2014).

Concerns over the petrodollar in the United States can also be traced back to more contemporary issues in the 1970s. In tandem with the rise in the price of oil, the United States had its most severe economic downturn since the 1930s. Many people in the United States of America were under the impression that the rising price of gasoline was to blame for their own personal financial difficulties. This led to widespread anxiety and resentment among the population. Concerns have been raised as a result of the increasing globalization of the United States' economy, which has given rise to the fear that business and political decision-makers will put US interests at risk and may, at the very least, significantly restrict US sovereignty in order to protect their own financial interests. The Vietnam War, which contributed to the evidence of the United States' decline, put some people's faith in the might of the United States to the test. As a result of Watergate and other disclosures of political misconduct, which extended beyond petrodollar issues, the general public had developed a growing level of skepticism regarding the morality and competency of their

government. The rise of human rights discourses in the 1970s brought to light the violent policies of many petrodollar countries. Therefore, there were many other reasons why people in the United States should be concerned about petrodollars (Tallman, 1988).

There were times when these concerns converged and other times when they did not. Nevertheless, when viewed as a whole, this extensive range of concerns associated to the petrodollar posed a considerable impediment for corporate and governmental leaders in the United States who intended to strengthen the interdependence between the two regions. The flood of petrodollars into the US economy has been the focus of increased effort from a variety of US groups and lawmakers. At the close of 1973, the level of inflation in the United States had greatly increased. The price stability that had existed in the years following World War II started to deteriorate in the late 1960s, and by 1973, annual inflation had reached a rate of 6.2%. In 1974, this percentage rose to a new high of 12.2 percent. (Mieczkowski, 2005).

High inflation and a recession both began in 1974, and unemployment steadily increased throughout the year, reaching a high point of 8.9 percent in May 1975 after starting at 5.4 percent in August 1974. (Mieczkowski, 2005). The fact that unemployment and inflation inherently worked against one another and that there were solutions to the problem that were incompatible with one another was called into question by the simultaneous occurrence of high unemployment and inflation. One of the more simplistic responses was to attribute the issues facing the economy of the United States to the significant increase in the price of raw resources originating from LDCs, most notably oil. When considering the inflation and recession that occurred throughout the 1970s, the majority of economists, both at the time and now, look to the 1973 oil shock as merely one of numerous significant reasons that contributed to these economic outcomes. However, many people in the United States at the time found it especially frustrating to watch their dollars change into petrodollars, and they thought that increasing oil prices were an especially awful and unfair cause of economic misery (Barsky & Kilian, 2002).

Opponents of the new petrodollar economy were concerned not only that money would leave the country but also that Arab nations would acquire control of US corporations and real estate and use it to send money back to the US. This was one of their primary concerns. Many people in the United States have expressed their concern that Iranians and Arabs may come to dominate substantial parts of the US economy and have a significant influence on both public opinion and the decision-making process of the US government. The idea that Arab and Iranian control of the United States economy was a real possibility was frequently expressed in the media in the United States in terms of how many US corporations oil-exporting countries could buy out with their large account surpluses.

This served to reinforce in the minds of the American public the concept that Arab and Iranian control of the United States economy was a possibility. On the other hand, investors from Arab countries and Iran hardly ever made direct investments in the United States, much less tried to acquire controlling stakes in big corporations. Stories reflecting and attempting to convey US concerns that petrodollar investments could be exploited against US interests made their way into other forms of popular media, such as movies and fiction books, in addition to newspapers and magazines. These stories reflect US concerns that petrodollar investments could be exploited against US interests (Smith, 2022).

Between the years 1969 and 1973, the amount of money invested directly from abroad increased by more than 50 percent. The majority of this growth came from Western Europe and Japan, and several Americans voiced concern about the level of competition posed by Japan and Europe in the US domestic market. However, a new feeling of urgency was brought to the issue in the United States as a result of the oil shock that occurred in 1973 and the massive surpluses that were expected to be produced by oil-exporting nations. In January of 1974, Democratic Representatives John Moss and John Dent introduced bills in the House of Representatives that would place a 10% limit on foreign ownership of US energy and defense corporations and prohibit foreign ownership of more than 5% of voting

stock in any US corporation, respectively, in order to protect the interests of the country's national security (Eifert et al., 2002).

In order to keep petrodollar flows into the United States, keep positive relations with oil exporting nations, and uphold the broader U.S. commitment to minimally restricted foreign investment as a global norm, the Nixon and Ford administrations resisted these congressional efforts to increase the regulation of foreign investment. In doing so, they were able to maintain positive relations with oil exporting nations (Reichley, 2010).

Treasury took the lead in the effort to persuade Congress not to restrict foreign investment into the United States by claiming that foreign investment was beneficial to the United States economy and that national security interests were already being properly protected (Graham & Krugman, 1991). In addition, the Ford administration issued a warning about the potential for retaliation against direct investment made by the United States in other countries, which at the time was six times more than the total amount of direct investment made by foreign countries in the United States.

The substantial quantity as well as the high-tech quality of the United States' military sales to countries that export oil was a primary source of contention in the petrodollar controversy. Many people in the United States of America claimed that sending weaponry to the Middle East would be detrimental to the strategic interests of their country, as well as to international harmony and human rights. There was a common sentiment among supporters of Israel that it was especially troubling when the United States shipped weapons to countries in the Arab world. The possibility that United States arms supplies to allies in the Middle East could be turned against the interests of the United States or fall into the wrong hands was brought up in commentary on a regular basis.

Everyone in the United States, including governments, corporations, and individuals, felt the effects of the petrodollar system, which led to an increase in reliance. In the 1970s, petrodollars generated conversations between Americans and Arabs about the nature of power and sovereignty in a world that was becoming increasingly

interdependent, as well as about the nature of development, corporations, the global economy, political alliances, and the global economy. As a result of these conversations, new participants with a wide range of interests in the new economic arrangements have emerged. Some people in the United States, the Arab world, and Iran have expressed optimism on the prospects of achieving political and economic success as a result of the petrodollar economy and the increased levels of interdependence that have emerged. On the other hand, some Americans, Arabs, and Iranians expressed fear that their most important interests could be jeopardized as a result of their reliance on petrodollars.

Petrodollar debates resulted in both positive and negative outcomes for the individuals who took part in them, and they also sparked support for as well as opposition to US-MENA cooperation. Ford found out that while campaigning for the approval of missile sales to Saudi Arabia was beneficial to the relationship between the United States and Saudi Arabia, it was detrimental to his standing with some voters in the United States. Increasing armament sales boosted relations between the United States and Iran; yet, this put congressmen at conflict with one another since they lobbied for reduced exports. The discussion on whether or not the Middle East and North Africa (MENA) and the United States would collaborate in the petrodollar economy did not come to a conclusion during the administrations of Nixon and Ford; rather, it continued throughout Jimmy Carter's term as president. Carter was one of the more notable personalities who had condemned Ford for his connections to the oil-rich MENA countries, and he was one of the people who had criticized Ford.

## CHAPTER 3

### PETRODOLLAR RECYCLING IN US ECONOMY

#### 3.1 Allocation of petrodollar surpluses

The vast majority of petrodollar surpluses are held not just in institutions located in the United States and Western Europe but also in other short-term securities and bills issued by the United States Treasury. The bulk of Saudi Arabian, Kuwaiti, Qatari, Bahrain, United Arab Emirates, and Omani banks' monetary assets are held in European and American institutions, according to an analysis of the balance sheets of those countries' respective financial institutions. Additionally, petrodollar surpluses have been utilized to augment the official reserves held by oil-exporting states at the International Monetary Fund and the International Bank for Reconstruction and Development (Spiro, 1999).

Table 2. Net change in the deployment of OPEC capital surplus, 1974-1982 (\$billions)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1982 level	1982 %
United States											
Bank deposits	4.2	0.6	1.9	0.4	0.8	5.1	-1.2	-1.9	4.7	17.0	5
U.S. government obligations	6.2	4.2	6.3	3.8	-1.9	0.8	11.6	12.7	6.4	57.4	16
Other portfolio investment	1.1	3.2	3.0	3.1	1.6	1.1	4.7	4.6	-0.4	20.0	5
Total	11.5	8.0	11.2	7.3	0.5	7.0	15.1	15.4	10.7	94.4	26
United Kingdom											
Sterling bank deposits	1.7	0.2	-1.6	0.3	0.1	1.5	1.4	0.5	1.2	5.0	1
British government stock	0.9	0.4	0.2	0.3	-0.4	0.2	2.1	0.9	0.1	3.2	1
Treasury bills	2.7	-0.9	-1.1	-0.3	0.1	-	-0.1	-0.1	-	0.1	0
Other sterling placements <sup>a</sup>	0.7	0.3	0.5	0.4	0.1	0.4	0.2	0.2	-0.6	2.0	1

TOTAL	6.0	0.0	-2.0	0.7	-0.1	2.1	3.6	1.5	0.7	10.3	3
Eurocurrency Deposits in U.K. and bank deposits in other industrialized countries <sup>b</sup>	23.9	9.3	12.5	12.5	3.0	34.8	43.9	2.7	-21.9	116.1	32
Other investments in other industrialized countries <sup>b</sup>	3.4	7.4	5.9	5.7	3.7	3.6	15.0	19.6	6.7	71.6	20
IMF and World Bank <sup>b</sup>	3.5	5.3	1.5	-	-0.4	-0.5	3.3	2.3	2.1	18.6	5
Loans to developing countries	4.9	6.5	6.4	7.0	6.2	9.7	6.3	7.2	3.9	54.0	15
Reductions (-) in deployed assets	53.2	36.5	35.5	33.2	12.9	55.7	87.2	48.7	2.2	365.0	100
Net movements <sup>c</sup>	n/a	3.0	9.0	11.0	11.0	2.0	4.0	8.4	19.8		
Current balance	n/a	31.8	36.0	24.7	-2.9	58.2	108.6	48.9	-13.9		

a- Mainly loans and holdings of equities.

b - Includes foreign branches of U.S. banks.

c - Net borrowing by OPEC countries.

Source: Spiro, 1999

Table 2 displays the net change in the deployment of OPEC's investable surplus. From 1974 to 1982, As of 1981, 75% of the overall OPEC surplus was invested in developed nations, according to the statistics. This amount was distributed as follows: 25% to the United States, 25% to the rest of the industrialized world, and 30% to Eurobanks. When we combine the numbers for OPEC investments in Eurobanks, local branches of U.S. banks, and British banks, we discover that 38% of all OPEC investments were bank deposits. It may look as though 40% of this portfolio was invested in private banks and 20% was recycled straight to LDCs. But, Table 2's Net borrowing by OPEC countries. row provides a more thorough perspective. According to these statistics, one-third of all bank deposits in 1977 were compensated for by OPEC borrowing. In other words, although there were



\$68 billion in bank deposits, OPEC borrowed \$23 billion from banks to balance off the deposits. After accounting for borrowing, bank deposits comprised almost the same share of foreign assets as purchases of government debt and direct loans to LDCs, each comprising roughly 20% of the portfolio. The remaining amount consists of market investments other than government debt, OPEC financing to itself through banking institutions, and loans to the IMF and World Bank.

The changes in the data can be attributed to various factors, such as changes in interest rates, inflation, economic growth, and government policies. For example, the increase in bank deposits in 1979 may have been due to high interest rates, while the increase in U.S. government obligations in 1980 and 1981 may have been due to government policies aimed at stimulating the economy. It's also true that a policy to raise the value of the dollar was in place during the Reagan administration. Yet, rather than explicitly encouraging people to invest in government bonds, this strategy was primarily focused on reducing inflation and enhancing the competitiveness of American exports. It is impossible to identify any one element as the only explanation, but it is probable that a number of variables had a role in both the rise in bank deposits and the rise in U.S. government liabilities throughout the relevant periods. The decrease in other portfolio investments in 1982 may have been due to a shift in investor preferences or changes in economic conditions (Goodhart, 1989).

The surpluses of petrodollars have been recycled through international organizations and commercial institutions in the United States as well as other rich nations. The volume of money that banks lent out was able to expand thanks to a strategy that involved the use of petrodollar surpluses to make deposits or purchase certificates of deposit. The most obvious customers for bankers were developing countries, most of which were located in Latin America and included countries like Mexico, Brazil, and Argentina (Momani, 2008).

The practice of recycling petrodollars makes it possible for commercial banks in industrialized nations, international lending institutions, and Arab banking consortiums to

provide monetary assistance to less developed states (LDCs). The United States of America, Western Europe, and Japan all buy their oil from countries that are considered to be exporters of oil (OECs). Least developed countries (LDCs) pay for oil imports and other items and services purchased overseas with money borrowed from commercial banks in western nations. The recycling process is finished when commercial banks and institutions obtain funds and investments from OECs. This marks the end of the process (Spiro, 1999).

The Soviet Union dealt with the dollar market when it created a dollar account in London in the 1950s, and petrodollar surpluses helped contribute to the growth of that market. Its purpose was to protect the Soviets against the possibility of having their money frozen at a bank in the United States, which could occur if such savings were placed in American banks. The United States' balance-of-payments deficits were the principal source of Eurodollars prior to the first oil shock that occurred in 1973. These deficits had expanded from \$17 billion in 1964 to \$96 billion in 1970 during this time period. In addition, numerous restrictions imposed by the Department of the Treasury prevented American multinational corporations from repatriating profits earned from operations conducted outside the United States. As a result, these deposits remained in Europe and served as a source of international finance (Dickens, 2005).

The United States' balance-of-payments deficits quadrupled in 1971, which led to a significant increase in the amount of dollars held by banks located in other countries as well as a massive expansion of the money supply in countries that were members of the Organization for Economic Cooperation and Development (OECD) (Jones & Christiansen, 1979).

One further significant application of petrodollars has been in the field of international aid. Since 1973, countries in the Middle East that sell oil have been among the most generous donors in the world (Villanger, 2007). There are various sources of funding for development projects in foreign countries, including bilateral agreements, multilateral arrangements, Official Development Assistance (ODA) flows, several Arab funds that were established specifically for this purpose, as well as international financial

institutions such as the International Monetary Fund and the International Bank for Reconstruction and Development. (Tok & Calleja, 2014).

It is estimated that between 1973 and 1980, oil-exporting Arab states donated a total of \$44 billion to various international causes. When compared to the United States and the rest of the world, Arab oil exporting nations have the highest official development assistance (ODA) flows as a percentage of their gross national product. This is an important fact to keep in mind. In point of fact, Arab institutions for economic growth nevertheless retain an active lending policy even if there has been a major fall in oil profits (Farid & Sirriyeh, 2022).

After the deficits in the United States' balance of payments, the petrodollar surpluses that were produced during the oil crises that occurred in 1973 and 1979 were the second greatest source of foreign currency that fed the Euromoney market. These surpluses whetted the appetites of Western banks, who were already aggressively looking for borrowers for the fresh deposits from the Euromarket. Before 1979, Iran had accumulated some petrodollar surpluses, but Arab OPEC countries had accumulated more than 90 percent of OPEC's investable surpluses. This led to Iran's isolation from the international financial system (Alnasrawi, 1979).

The acquisition of United States government debt was a significant method that was utilized in the distribution of petrodollars in the United States. The nations that sell oil, such as Saudi Arabia and Kuwait, utilized their excess wealth to buy US Treasury bonds, which assisted in financing the budget deficit of the United States government. In exchange, the government of the United States of America provided these nations a risk-free investment with a guaranteed rate of return. This strategy, which eventually became known as "recycling petrodollars," enabled the United States to reduce the cost of financing its debt (Higgins et al., 2006).

The use of petrodollars to invest in the United States financial system was not restricted to the purchase of government debt. Countries that export oil also made

investments in other financial instruments including equities in the United States. The acquisition of stocks provided foreign nations a foothold in the economy of the United States, and it allowed them to benefit from the expansion of enterprises based in the United States. In addition, petrodollars were invested in the real estate market of the United States, notably in the country's most populous cities like New York and Los Angeles. The buying of real estate contributed to an increase in property values in these cities, which had a consequential effect on the economy of the United States (Reed, 1975).

The distribution of petrodollars in the United States has a significant impact on the economy of that country. The constant flow of surplus revenues assisted in financing the budget deficit of the United States federal government, which enabled the federal government to spend more money on social programs and infrastructure. The flood of capital also assisted in bringing about a decline in interest rates, which made it less expensive for companies as well as customers to take out loans. This, in turn, contributed to the stimulation of economic growth and the creation of jobs (Spiro, 1999).

However, the distribution of petrodollars in the United States was not without its share of unintended effects. In the 1980s, an infusion of capital into the financial system of the United States helped fuel a stock market boom, which in turn led to the formation of a new class of investors who were extremely wealthy. This disparity in wealth has remained up until the present day and has developed into a big problem in the United States. Additionally, the distribution of petrodollars in the United States contributed to the fueling of a real estate boom in big cities, which made it impossible for average Americans to buy properties in these locations (Spiro, 1999).

The distribution of petrodollars in the United States has also had a substantial effect on the value of the United States dollar. The dominance of the US dollar as the reserve currency in the world has been aided to be maintained by the petrodollar system, in which the price of oil and its commerce are both conducted in US dollars. Because of this, the United States has been able to fund its debt at a lesser cost, and the United States government now has greater flexibility in the way it manages its monetary policy.

However, because of this over-reliance on the US dollar, the world economy is extremely sensitive to any changes that may occur in the economy of the US. In addition to this, the petrodollar system has made it possible for the United States government to employ its financial system as an instrument in the conduct of its foreign policy (Spiro, 1999).

In recent years, there have been a few shifts made to the way that petrodollars are distributed in the United States. Because of rising oil production in the United States, the importance of oil-exporting countries in the US oil market has decreased in recent years. This has the effect of slowing down the flow of petrodollars into the United States, which in turn has caused a shift in the distribution of petrodollars. Petrodollars are currently more likely to be invested in developing economies such as China and India since these countries are experiencing robust economic expansion and provide a wide variety of investment options. This has not only helped fuel economic growth in these nations, but it has also lessened the dependency of oil-exporting countries on the banking system in the United States (Spiro, 1999).

The United States is still a primary receiver of petrodollar surpluses, despite the fact that petrodollar inflows have been on the wane. In recent years, Saudi Arabia has maintained its heavy investment in the government debt and stock markets of the United States. In addition, other oil-exporting nations like Kuwait, Qatar, and the United Arab Emirates have maintained their investment activity in the United States banking system. The distribution of petrodollars in the United States continues to be a contentious issue, with some arguing that it has contributed to economic growth and the creation of jobs, while others arguing that it has contributed to an increase in wealth inequality and made it difficult for average Americans to afford homes in major cities. Over the past several years, there has been a rising push to re-direct the flow of petrodollars away from the United States and towards other regions of the world. As a result of this, new investment structures have emerged, such as sovereign wealth funds, which are intended to invest petrodollar surpluses in a manner that is more diverse and strategic.

### **3.2 Reinvestment of petrodollars in the U.S. economy**

The injection of petrodollars into the economy of the United States generated considerable opportunities for investment across a variety of sectors (Karl, 1997). The real estate business was a large beneficiary of this investment, and it was one of the most significant. The Department of the Treasury of the United States claims that petrodollars were utilized in order to finance various real estate developments, notably those located in New York City. The arrival of petrodollars caused a jump in property values, which in turn caused a boom in the real estate market in the United States (Spiro, 1999).

One of the most noteworthy examples of this occurred when the government of Dubai used petrodollars to finance the building of the Emirate Towers in Dubai. These towers are located in Dubai. The Emirate Towers was a mixed-use building that included both office space and luxury residential and hotel accommodations. It was finished in the year 2000. The investment of petrodollars made it feasible for the building of the development, which was intended to be a symbol of the city's expanding economic strength. The development was planned to be a symbol of the city's growing economic might. In a parallel manner, the investment of petrodollars in the real estate business in the United States generated substantial prospects for real estate developers and investors. Specifically in large cities like New York, Los Angeles, and Miami, the investment fuelled the creation of office buildings, luxury apartment complexes, and hotels (Sherman, 2005).

The acquisition of the Rockefeller Center in New York City by a consortium that was led by the Mitsubishi Estate Company of Japan was one of the most substantial investments made in the real estate sector of the United States economy. The investment of petrodollars from oil-exporting countries, mainly from Kuwait, made it feasible to complete the acquisition in 1989. Petrodollars were particularly helpful in this regard. The acquisition was one of the most important real estate deals in the history of the United States and served as evidence of the influence that petrodollars have had on the real estate market in the United States (Sassen, 2016).

The investment of petrodollars in the economy of the United States has not only contributed to the growth of the commercial real estate market, but it has also driven the expansion of the residential real estate market. petrodollar investments in the economy of the United States led to a surge in demand for luxury flats and homes, which in turn led to a boom in building and development. For instance, the infusion of petrodollars in the economy of the United States was a driving force behind the expansion of the market for luxury condominiums in Miami.

The petrodollars were invested in a variety of other markets, including the energy market, in addition to the real estate market. In the 1980s, Saudi Arabia made significant investments in the United States energy industry, especially in oil and gas exploration and production, as stated in a study published by the United States Energy Information Administration (EIA). Other oil-exporting nations, such as Kuwait and Iran, have also made investments in the energy sector of the United States. These investments have mostly been made in refineries and petrochemical facilities (Conge & Okruhlik, 2009). During this time period, Saudi Arabia boosted the amount of money it invested in the energy industry of the United States from \$5 billion in 1974 to \$31 billion in 1981. Only in 1980 did Saudi Arabia spend \$15 billion in energy projects in the United States, which was equivalent to almost 25% of the entire foreign investment in the industry during that year. By the year 1982, it was believed that Saudi Arabia's overall investment in the United States was somewhere in the neighborhood of \$50 billion, the bulk of which was invested in the energy industry (Luke, 1983).

During this time period, oil-exporting nations such as Kuwait and Iran made investments in the energy sector of the United States, especially in refineries and petrochemical facilities. Other oil-exporting nations, such as Saudi Arabia, also participated. One of the most significant foreign investments in the United States at the time was made by Kuwait in a petrochemical facility in the state of Louisiana. This investment was valued at \$2.2 billion. On the other side, Iran made an investment in an oil

refinery in Oklahoma that cost a total of \$2.5 billion. This was one of the largest foreign investments made in the United States at the time.

During the 1970s and 1980s, oil-exporting countries made investments in the energy sector of the United States, which resulted in a number of advantages. First and foremost, it was instrumental in the financing of the expansion of the energy sector in the United States, which was essential to the expansion and growth of the economy in that nation. In addition to this, it gave US firms the ability to interact with companies from other countries, which contributed to a rise in the amount of innovation and productivity within the industry (Eifert et al., 2002).

In addition, the petrodollars were invested in the stock market of the United States, which provided a major boost to the equities market. According to a research conducted by the Federal Reserve Bank of St. Louis, the flood of petrodollars contributed to a rise in stock prices in the United States. From 1974 to 1980, the S&P 500 index increased by more than three times its initial value (Abraham et al., 2001). These petrodollars were invested in a variety of assets, one of which being the stock market in the United States. According to a research conducted by the Federal Reserve Bank of St. Louis, the flood of petrodollars contributed to a rise in stock prices in the United States. From 1974 to 1980, the S&P 500 index increased by more than three times its initial value.

One of the reasons for the rise in stock prices was that petrodollar investments raised the demand for US shares, which in turn led to a rise in the value of those equities. According to the findings of the study, petrodollar investments had a role in mitigating the consequences of inflation as well as the slowdown in productivity development that took place during that time period. The use of petrodollars as investments had a substantial influence on the stock market in the United States. For example, in 1974, the level of the S&P 500 index was somewhere around 68. By the year 1980, it had increased to somewhere about 223. This indicates a growth that is greater than three times that of the previous six years. According to the findings of the study, the increase in stock prices was



not exclusive to the S&P 500 index but was seen in other indices as well, including the Dow Jones Industrial Average and the Nasdaq Composite (Harris, 1989).

Although it opened up huge prospects for investment in the United States economy, the flood of petrodollars also brought about a number of concerns. The development of the Dutch illness was one of the most important concerns that may have occurred. The Dutch sickness is a phenomena in which a rise in profits from natural resources, such as oil, leads to a loss in the competitiveness of other sectors of the economy. This can happen when natural resources like oil are used more.

The flood of petrodollars led to an increase in the value of the US dollar, which resulted in a decrease in the competitiveness of exports while simultaneously leading to an increase in imports. This resulted in a decrease in the manufacturing sector, as the cost of items produced in the United States increased in comparison to the cost of goods produced in other countries. Because it was initially noticed in the Netherlands after the discovery of natural gas in the 1960s, this condition got its name, "the Dutch illness," from that country (Ísheri, 2009).

Inflation was another another concern that was brought on by petrodollar investments. As a result of the flood of petrodollars, banks were able to provide more loans in order to finance investments, which contributed to a rise in the overall money supply. Because of this, the prices of goods and services went up, which contributed to an increase in overall inflation. The level of inflation in the United States reached its highest point of 13.3% in 1979, according to a report that was produced by the Congressional Research Service of the United States (Hojjat & Bhagyavati, 2009).

In addition to contributing to inflation, the flood of petrodollars was also a factor in the budget deficit in the United States. In order to finance its deficit, the United States government took out significant loans from several international financial institutions, particularly those located in the Middle East. This resulted in a rise in the national debt of the United States, which reached a total of one trillion dollars in the year 1981.

In recent years, the effect that petrodollars have had on the economy of the United States has become less significant. The drop in the price of oil combined with the trend toward other forms of energy has caused oil-exporting countries to see a reduction in the money they produce. Because of this, the number of petrodollars that are available to be invested in the economy of the United States has decreased. However, several nations that export oil continue to invest in the economy of the United States. For instance, the Public Investment Fund (PIF) of Saudi Arabia is an example of a sovereign wealth fund that has made considerable investments in the technology industry of the United States.

The Abu Dhabi Investment Authority (ADIA), which is the sovereign wealth fund of the United Arab Emirates, has also made considerable investments in the economy of the United States. According to the annual report that the ADIA released in 2020, the organization invested a total of \$11.4 billion in the United States, the majority of which was spent on real estate (Seznec, 2008). Although the amount of petrodollars invested in the United States economy has decreased over the past several years, the dangers that are connected with such investments have not diminished. The budget deficit, the trade imbalance, and inflation all continue to be serious worries for the economy of the United States.

### **3.3 The impact of the petrodollar on the U.S. to become political and economic power**

Oil is not only the most significant commodity traded everywhere in the globe, but it also holds the title for the most valuable. It is the most significant industrial mineral and plays a critical role in contemporary economies; without it, no modern economy could run. It is essential to the functioning of modern economies. Oil is something that must be purchased if it is not already possessed, and if it is to be purchased on international markets, then dollars are the currency of choice. This provides a basic foundation for the status of the dollar as a reserve currency: other countries buy and store considerable dollar reserves (in the same way that they buy and store gold), as a result of the fact that they are unable

to buy oil without dollars. Because of this, the petrodollar became the de facto substitute for the gold-dollar standard that had been in existence previous to 1971. This ensured that there was a continuous demand for dollars whose value was related to oil through the use of OPEC pricing guidelines (Gökay & Whitman, 2010).

The United States dollar's role as the reserve currency for international transactions involving oil helps to ensure that there is always a "artificially" high demand for the currency. This enables the United States to manufacture dollars at a cost of nearly nothing, which in turn permits the country to subsidize higher levels of consumer spending on imports and military spending. Effective operation of the system is guaranteed so long as there are no significant rivals to the United States and other countries continue to place their faith in the dollar (Spiro 1999). This has been the scenario and the key underpinning for US economic hegemony ever since the 1970s. Evidently, this approach also helps the government of the United States to maintain its preeminent position in the international oil market. The dominance of the dollar is not only related to the size of the economy in the United States; rather, it is also the result of global politics and financial markets. In this arrangement, industrialized nations were required to acquire oil from OPEC or one of the smaller oil producers, but in order to do so, they were required to price and purchase oil in dollars, so reestablishing the role of the dollar as a vital reserve currency (Gokay and Whitman 2004).

The United States federal government was given a loan that was doubled in value so long as the price of OPEC oil was quoted in US dollars. The oil industry was given priority for the initial allocation of the loan. Because OPEC used dollars as the unit of payment for everything that was exchanged, the government was able to print dollars in order to pay for oil, and the economy of the United States was not obligated to supply goods and services in exchange for the oil. It is self-evident that the strategy would be unsuccessful if money could not be used to purchase oil (Spiro 1999). The second component of the loan was provided by all of the other economies that were unable to print their own currency and were therefore forced to pay for oil in dollars. These nations were

forced to sell their goods and services in return for dollars in order to compensate OPEC producers for the oil they purchased (Spiro 1999).

Under these conditions, cash began to rapidly accumulate in overseas banks, particularly those that serve nations that are major exporters of oil. This petrodollar surplus presented an additional financial challenge. Unlike Western Europe and Japan, the majority of oil-exporting nations had limited opportunities for domestic development and consumption, and as a result, they were unable to invest the majority of this money. This contrasted with the situation in Japan, which had ample opportunities for both. A significant portion of these local economies are wholly reliant on oil rents, which make up the overwhelming majority of the profits made from exports and the revenue received by the government. Despite having large amounts of oil reserves, the oil-producing countries of the Middle East have not been successful in diversifying their economies. All manufactured goods as well as services in the fields of finance and high technology are imported from the West and controlled by multinational businesses.

Some efforts were made to share the wealth created by the oil industry among the communities it affected by providing financial assistance in the form of subsidies for housing, education, and healthcare. However, the majority of the money from oil was used to pay wasteful spending, corruption, and excessive spending. The response that Nixon's government came up with was ingenious: they convinced these countries to buy US Treasury bills and bonds, which acted as an additional subsidy for the US economy. In the early 1970s, President Nixon's administration, launched the policy of getting other nations to purchase US Treasury bills and bonds in order to manage the country's massive trade imbalances and keep domestic interest rates low. President Nixon unveiled a variety of economic initiatives in August 1971, including the suspension of the dollar's convertibility into gold and the imposition of a 10% import fee. At the time, the United States was having massive trade deficits, and the decision to halt the dollar's convertibility into gold was viewed as a solution to this problem.

Due to this decision, several nations were left with significant quantities of US dollars that they were unable to convert into gold. In order to prevent a catastrophe, the Nixon administration persuaded foreign nations to invest their extra US dollars in US Treasury bills and bonds, which helped finance the nation's budget deficits and maintained low domestic interest rates. Nixon's administration was the first to employ this technique to control trade deficits and maintain low interest rates in response to the economic concerns of the early 1970s. Other administrations have also utilized this approach. Since that time, this strategy has been the primary one utilized by the United States government in order to manage the country's large trade deficits by keeping domestic interest rates at historically low levels (Spiro 1999).

The system of the petrodollar has had far-reaching economic repercussions for the United States, particularly with regard to the country's trade balance and the soundness of its currency. Because the great majority of the world's oil transactions take place in United States dollars, there is a significant demand for United States money around the globe. This, in turn, helps to increase the value of the dollar. Because of its strength, the United States has been able to import products and services at lower prices, which has further contributed to the country's positive trade balance.

In addition to the country's overall trade surplus, the petrodollar system has been an important contributor to the growth of the United States economy. The petrodollar system has created a demand for United States dollar. This has resulted in a consistent supply of inexpensive capital for the United States government as well as for American enterprises. Because of the contribution of this money, the economy of the United States has grown to be robust and thriving, which has made the country an appealing location for the investment of capital from other countries.

In addition, the petrodollar system has made it easier for the United States to finance its military activities, which has been an essential factor in the rise of the country to the position of world superpower. The United States of America spends more money than any

other country on its armed forces, and the use of the petrodollar system has made it possible for them to do so at a reduced cost (Clark, 2005).

The petrodollar system has had a considerable influence on United States foreign policy as well as the position that the United States plays in the political arena on a worldwide scale. The United States of America has been successful in accomplishing its foreign policy objectives by utilizing the petrodollar system to leverage its position as the preeminent currency used in the worldwide commerce of oil. This has included the implementation of economic sanctions as a means of punishing nations that do not share the interests or values of the United States (Art, 1996).

For instance, the United States government has implemented economic sanctions on nations such as Iran, Venezuela, and Russia in order to restrict those nations' access to global financial markets and put economic pressure on the regimes that govern such nations. These sanctions have been successful in altering the conduct of the nations that have been targeted, and they have been an important instrument in the United States' arsenal of options for its foreign policy (Hufbauer & Jung, 2021).

The United States has been able to keep its position as the world's preeminent superpower thanks to the petrodollar system. The United States has been able to keep a robust military presence all over the world because of its capacity to finance its military activities at a reasonable cost. This has made it possible for the United States to project its power and influence in a variety of locations, as well as to respond rapidly and effectively to crises on a global scale (Isheri, E2009).

The United States military has been significantly impacted as a result of the petrodollar system. The United States has been able to make significant investments in its military capabilities as a result of its robust and thriving economy as well as its consistent supply of inexpensive money. The petrodollar system has been a substantial contributor to the growth and development of the United States military, which is currently the most technologically sophisticated and well-funded force in the world. The United States has

been able to keep a military presence in a number of different places all over the world because of its capacity to finance military activities at a relatively modest cost. This presence has been an essential instrument in advancing the interests of the United States and defending American individuals and enterprises operating in other countries. Additionally, the petrodollar system has made it possible for the United States to finance the research and development of its military, which has resulted in enormous leaps forward in the field of military technology. These advancements have helped to contribute to the military supremacy of the United States, which has made it a formidable power on the international scene. In other words, the United States has been able to finance its military operations through debt, which has allowed it to maintain a large and well-funded military without having to raise taxes or cut spending on other programs.

In 2020, the United States spent \$778 billion on its military, which is more than the following 10 nations combined, according to a research published by the Stockholm International Peace Research Institute (SIPRI). This accounts for 39% of the total spending on the world's militaries. In addition, the study reveals that the United States government has boosted its expenditure on the military by 4.4% since 2019, despite the economic impact of the COVID-19 epidemic (Smithberger, 2021).

Even though it is not currently involved in a major conflict, it is interesting to note that the United States spends more money on its military than any other country in the world. This fact is noteworthy. This would imply that the United States regards its military as a major weapon for advancing its interests across the world, including preserving its status as a global powerhouse and safeguarding its access to oil supplies.

The petrodollar system has enabled the United States to make substantial investments in military technology, which has provided the nation with a considerable competitive edge vis-à-vis other nations. The United States of America spent \$732 billion on military research and development between the years 2000 and 2018, as stated in a report by the Congressional Research Service. This amount is greater than the total expenditures of the following nine countries combined (Tian et al., 2020).

This investment in military technology has enabled the United States to create sophisticated weapon systems, such as drones, stealth fighters, and precision-guided missiles, which have provided the United States with a major edge over other countries in military confrontations. For instance, during the Gulf War in 1991, the United States utilized precision-guided missiles to target Iraqi command and control facilities, which resulted in a significant reduction in the strength of the Iraqi armed forces (Keaney, 1993).

Additionally, the United States has been successful in forging partnerships with other nations by leveraging its superior military technology. For instance, the United States has helped to strengthen its position as a dominating actor in the Middle East by providing modern weaponry to other nations, such as Saudi Arabia and Israel. This has contributed to the consolidation of the United States' current role. In return, these relationships have made it possible for the United States to safeguard its access to oil supplies and foster stability throughout the area.

Additionally, the petrodollar system has made it possible for the United States to have an extensive network of military outposts all over the world. The United States maintains about 800 military bases in more than 70 different nations, as stated by the Pentagon. The United States has been able to project its military strength into many other parts of the world because to the establishment of these facilities, including the Middle East, Asia, and Europe.

The amount of arms sold to the region reached its peak in 1988, when the Administration proposed increasing US arms exports by \$3.3 billion, to a level that exceeded \$15 billion – with proposed shipments worth \$3.6 billion to Israel, \$2.7 billion to Egypt, 4950 million to Saudi Arabia, and \$1.3 billion to other Middle Eastern countries. This was the year that the amount of arms sales to the region reached its zenith (Bichler & Nitzan, 2004). The sharp intensification of armed conflict and quickly rising tensions in the Gulf region, Central Asia, and North Africa, including the conflict between Pakistan and India, meant much greater involvement of the United States military in the region, as



well as greater consolidation of the alliance between US arms manufacturing trade and energy interests.

In order to recycle their excess dollars back into the US economy, the US government aggressively encouraged foreign governments and central banks to invest their petrodollars in US Treasury securities throughout the 1970s and 1980s. This supported the US dollar's value and helped to fund the country's current account deficit. The US government engaged in "strong dollar" diplomacy in the 1990s with the goal of preserving the US dollar's value and luring international capital into US Treasury securities. United States continued to encourage using the petrodollar/weapon-dollar overhang as an opportunity to promote the purchase of US Treasury bonds and bills, in order to deal with its current account deficit. This was done rather than promoting sensible social investments in its allies in the Middle East. This had the effect of artificially increasing prices, which led to an inflationary surge that eventually weakened the perceived value of the dollar, which in turn triggered an acute fall in demand for dollars, which in turn resulted in a subsequent upward spike in US interest rates. As a result of this, the United States came to depend increasingly on foreign investors as the primary financial source for domestic account management. This had the effect of artificially increasing prices, which led to an inflationary surge that eventually weakened the perceived value of the dollar.

All of this was an unsteady attempt by the US administration to restore the global role of the dollar and US economic supremacy by linking the dollar to two key commodities of the world economy: petroleum and weapons. This was done in the hopes that this would restore the global role of the dollar and restore US economic supremacy. This weapondollar-petrodollar system was able to work for very obvious reasons, which underpinned its very existence. The first was an economic one, in that the Bretton Woods system never found a way to effectively recycle the massive profits and extensive speculation that were produced by the global oil trade; the second was a political one, in that the administration shifted the focus of global politics to the acquisition and

construction of weapons, as well as to the production of petroleum and conflict in the Middle Eastern region (Gokay, 2005).

The current state of US hegemony and the underlying causes of its direct military involvement in the region since the end of the Cold War can be better understood by gaining an understanding of how that system was initially constructed and how it was advanced despite all of its inherent flaws and contradictions. This understanding reveals important insights (Gokay, 2005).

In addition, the petrodollar system has made it possible for the United States to make use of its military power in order to protect its interests in a variety of places all over the world. The United States of America has been successful in using its military might to preserve its access to energy resources and to foster stability in regions that are important to the nation's interests. The necessity of securing oil supplies and protecting American interests in the Middle East, for example, has been a partial driving force behind the military operations carried out by the United States in that region.

## CONCLUSION

Oil is a critical and strategic commodity for the global economy, and it has played a significant influence in defining the economic and political landscape of the world during the past century. The oil crises of the 1970s had a significant influence on the economy of the United States and the global financial system. The United States' solution to the oil crisis was the creation of a petrodollar recycling system that assured the dollar remained the leading currency for international oil transactions, which has enormous ramifications for the world economy. The purpose of this thesis was to analyze the economic impact of the oil crises on the United States, with an emphasis on the petrodollar recycling system.

The history of oil is intricately related to the history of the global economy. Over the past century, the world's dependence on oil has expanded dramatically, with oil being the dominant source of energy for transportation, industry, and agriculture. Intense competition between governments for control over oil deposits has repeatedly led to geopolitical tensions and conflicts as a result of the worldwide need for oil. The oil crises of the 1970s had a huge influence on the global economy and revealed the global financial system's susceptibility to variations in oil prices. The oil crisis resulted in a major shift in the global economic order, with the United States losing its status as the main economic power to Japan and the OPEC nations emerging as key actors in the global economy.

The technique of recycling oil profits gained by oil-producing countries back into the US economy is known as petrodollar recycling. This method includes oil-producing nations depositing their excess oil income in U.S. banks, which are subsequently used to finance U.S. government deficits and finance economic projects. The petrodollar recycling system was created in response to the oil crises of the 1970s, when the United States attempted to preserve its economic supremacy and safeguard the dollar's value.

Saudi Arabia had a significant influence in the evolution of the petrodollar recycling system throughout time. The United States and Saudi Arabia signed the "petrodollar recycling agreement" in 1974, which allowed the United States to purchase Saudi oil in

exchange for a pledge to invest in Saudi Arabia and recycle the country's oil income back into the US economy. This arrangement established the petrodollar recycling mechanism and entrenched the US-Saudi partnership as a pillar of the global financial system.

The petrodollar recycling scheme has resulted in enormous economic benefits for the United States. One of the greatest advantages of the system is that it has helped finance US government deficits, allowing the country to pay its military and domestic programs without resorting to austerity measures. In addition, the petrodollar recycling mechanism has helped fund enterprises and infrastructure projects in the United States, which has stimulated economic growth and employment creation. A further advantage of the petrodollar recycling scheme is that it has assisted in maintaining the dollar's status as the leading currency for international trade. This has important ramifications for the global economy, as the US dollar is utilized by many central banks as a reserve currency and is the preferred currency for international commerce and finance. The petrodollar recycling mechanism has also helped to stabilize the US economy by giving US banks and financial organizations with a steady supply of money.

Despite its numerous advantages, the petrodollar recycling system has had severe effects on the U.S. economy. One of the most fundamental disadvantages of the system is that it has established a dependence on foreign oil-producing countries, namely OPEC nations. This reliance has made the United States susceptible to variations in the price of oil and geopolitical tensions in the Middle East, so creating substantial economic and political risks. The petrodollar recycling mechanism has contributed to the U.S. trade imbalance, which is an additional negative impact. This arrangement has resulted in a substantial influx of foreign cash into the United States, which has helped support the government's deficits and investments. However, this capital inflow has also increased imports, which has contributed to the US trade imbalance. In addition, the petrodollar recycling system has contributed to the deindustrialization of the U.S. economy, as the country has become increasingly reliant on foreign goods and services.

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