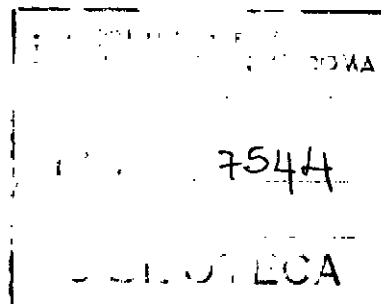


"ECONOMIC AND POLITICAL FACTORS IN MEDITERRANEAN STABILITY"
Consiglio per le relazioni fra Italia e Stati Uniti, Porto Cervo, 14-16/V/1986

- (1) Bernabè, Franco: "Regulating the oil market after the countershock - economic and political factors"
- (2) Prince Hassan: "Address by HRH Crown Prince Hassan to the Conference"
- (3) Ronzitti, Natalino: "International Terrorism in the Mediterranean - a legal response"



THE COUNCIL FOR
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1
CONSIGLIO PER LE RELAZIONI
FRA ITALIA E STATI UNITI

Conference

"Economic and Political Factors in Mediterranean Stability"

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"REGULATING THE OIL MARKET AFTER THE COUNTERSHOCK -
ECONOMIC AND POLITICAL FACTORS"

by Franco Bernabè

For conference participants only

Not for quotation or citation

REGULATING THE OIL MARKET AFTER THE COUNTERSHOCK - ECONOMIC AND POLITICAL FACTORS

by F. Bernabé

1. The background

In the early months of 1986 a collapse in the market has brought oil prices back to their 1973 levels - In real 1973 prices the \$ 12 currently paid for a barrel of crude correspond approximately to the \$ 3 then prevailing (chart 1).- After two oil crises, which have deeply changed the energy market and have radically altered the way of life in western countries, we are seemingly brought back to the times of cheap energy.

In the industrialised West inflation is rapidly decreasing, the trade balances of the OECD countries are improving very considerably and there are positive real expectations for the recovery of a sustained growth process, abruptly interrupted by the Kippur war and the ensuing embargo enacted by the Arab countries.

Further, few today appear to be seriously concerned with the oil market, assuming that the bonanza for the West is bound to continue for a long time.

Today's facts would seem to bear out the optimists.- Besides the drop in prices, other changes took place in the first few months of the year.- Changes that reinforce the structurally favourable economic environment of the consumer countries.- First, there is no longer an OPEC price for crude but rather there are as many different prices for crudes as there are individual contracts for these.- With net-back contracts crude is valued on the basis of a price of petroleum products in the consumer markets, net of refining and distribution costs incurred by the purchaser.- Thus the price of crude is not established by the producer, but by the interplay of demand

and supply in the consumer countries.

A second new factor is given by the quasi-disappearance of the spot or free market which represented an element of high instability in the past.- Net-back contracts require, in fact, that purchaser and seller agree upon a formula that guarantees both sides.- In particular this formula guarantees the purchaser in that his processing and distribution costs are recognized, as well as the seller who does not suffer any erosion of market shares by the crude sold outside of the official channels.

All appears to point, therefore, to a configuration of the crude market, in these first months of 1986, as one where relative positions of producer and consumer countries are inverted vis-à-vis the past 15 years.- Not only has the price of crude diminished in real terms by a factor of four with the respect to 1980 levels, but also the perception given by behaviours coming from the market seem to warrant continuing favourable conditions for the consumers over the long period.

It is noteworthy that, corresponding to this reversal in economic relations, an analogous change is taking place in the relations between the West and the oil-producing countries of the Mediterranean and Middle Eastern area.- In the early 70s, the front of the "hard line" countries prevailed, and the system of alliances had an anti-West bias.- It was no mere chance that the first oil crisis coincided with the Kippur war.- Thirteen years later, all countries, with the exception of Libya and South Yemen, have restored normal diplomatic relations with the United States including, in many instances, military cooperation programmes.

It is too early to draw the conclusion that OPEC has ceased to exist as such; that the market has become once more competitive to the extent it ever was; that there no longer exists a petroleum problem.- In point of fact there are a number of elements indicating that the current situation all but reflects a market-clearing long run equilibrium.- These elements are not to be sought in the prevailing demand and

supply conditions which - as will be seen - are structurally weak but rather in the market regulating factors of political and geo-economic nature.

In the following, some of these factors will be briefly analysed namely OPEC's role in market stabilisation and Saudi Arabia's attitude with respect to political and economic equilibria within the Middle Eastern area.- Furthermore, the prospects for a recomposition of market stability will be explored from the point of view of the different actors involved.

2. The Structural Roots of the Oil Market Weakness

At the root of today's weakness in the petroleum market have been significant shifts, during the last decade, both in demand and supply schedules as a consequence of the very high oil price.

Demand dropped sharply as total energy consumption flagged as a result of the conservation and saving processes introduced, together with the recessionary policies enacted in Western countries following the oil crisis (chart 2) and the substitution of petroleum by solid fuels, nuclear energy, natural gas and, marginally, with other renewable sources (chart 3).

Between 1973 and 1985 world levels of oil consumption remained practically stationary while levels of OECD consumption - very significant for its important bearing on export markets - declined by 20% - 32 million bbl/d in 1985 vs. 40 million bbl/d in 1973 (chart 4).

Supply has been increased by new discoveries in marginal areas, economically exploitable by virtue of high prices.- These areas are responsible for a growing additional production (6 million bbl/day in 1973 to 10 million in 1979 and to almost 14 million in 1985), precisely during the period when oil consumption dropped by 8 million bbl/day (chart 5).

These developments enhanced also by the very way in which

prices increased: the price trajectory was not smooth and well behaved, presenting two steps in 1973 and in 1979-80, brought about by favourable market conditions coupled with physical shortage also linked to extra-ordinary events (the Kippur war, the Iranian crisis and the accumulation of stocks firstly and the Iran-Iraq war subsequently).- Both discontinuities were followed by a progressive decrease in prices, also in nominal terms, and hence in oil revenues (chart 6).

The structural factors, so far outlined, although relevant, do not appear sufficient to justify a collapse in the price of crude of the magnitude that has taken place in the last few months.- Two more factors should therefore be taken into consideration: the determinants of short term market behaviour and the role played by the different actors involved, notably Saudi Arabia.

Granted that advantageous short run circumstances were instrumental in amplifying the long run factors acting in favour of the prices hikes of the 70s, there is no reason to rule out that we are witnessing today a similar phenomenon of opposite sign.- The short run factors that we are witnessing today may therefore very well have determined a decline in price well beyond the levels that would have been obtained in the absence of favourable contingent conditions.

In fact the mainstream opinion of experts is that the market equilibrium price for crude is more in the range of \$ 20 per barrel than today's about \$ 12.- This price level would, in fact, come close to approximate cost indifference between various available energy sources (Chart 7).- The accelerated substitution of oil performed in the last decade would consequently drastically slowdown, and comparative costs would make exploration and production in marginal regions far less competitive, with the obvious advantages for OPEC crude.

Once more this is a purely theoretical hypothesis which, similarly to others that have been advanced in the last thirteen years based on the relative economic returns of individual fuels very much runs the risk being disproved by

the whims of market.

Actually it is quite impossible to make any reasonable prediction concerning the future price of crude since OPEC seems to possess little capacity to regulate the market.- Rather than OPEC as such, it is at Saudi Arabia and its economic and political medium-short run tactics and strategy that one should look in order to understand what has happened and for how long this situation will last.

3. OPEC's Limits as a Market Regulation Instrument..

Regarding OPEC behaviour, the very process followed of practicing step-wise discontinuous oil price increases strongly suggests that the Organisation, exploiting particularly favourable market conditions was unable to look beyond the characteristics of the short run demand curve facing OPEC which, by definition, is much more inelastic than the medium-long run demand schedule.

In practice, OPEC has "charged what the traffic could bear" without considering the factors governing the shifts in the long run elasticity of demand and supply.- A very different attitude than that of the cartel of oil companies which in the forty years-following the creation of the Texas Railroad Commission - guaranteed a constant and substantial increase in the share of oil in the world energy market.

Actually until the early eighties, OPEC (with the exception of Saudi Arabia) did not believe that there was any need for regulation, convinced as it was that the market would remain a seller's market.- The difficulty met within the Organization by the idea of "production programming" is significant in this connection.- This idea was introduced, together with a price reduction only in 1983, when the difficulty of maintaining not only the price levels established by the Organization but also production volumes and, consequently, revenues sufficient to satisfy their needs, was already evident.

The introduction of quotas proved not only to be too tardy, but also counterproductive, giving way to the process of

disgregation of the market culminating in the events of recent months.- To circumvent the quotas assigned to each country, in fact, crude was channelled on the spot market or even to final consumption markets through processing agreements with refiners.- In this way a network of intermediaries was created which destabilised the market, determining a paradoxical situation in consumer markets where products became cheaper than crudes.

With the market falling a part, the ultimate resistance of Saudi Arabia in its attempt to protect prices by reducing its levels of production was no longer effective.- With its production down to 2 million bbl/day in summer 1985, Saudi Arabia was exploiting only approximately 1/5 of its productive capacity: a level economically unbearable for the Kingdom.

Responsability for the situation that was created during 1985 was attributed by OPEC largely to the high production levels the North Sea producers insisted in maintaining (U.K. and Norway).- Hence the decision to reduce prices was principally aimed at pushing North Sea "free rider" producers out of the market.- In any case it is impossible to establish whether overt or covert acceptance of a cartel discipline by the United Kingdom and Norway would have been sufficient a condition for the market to approach equilibrium.

Saudi Arabia's decision probably had also more complex motivations.- Shifting the determination of prices from the crude market, no longer controllable, to the products market in consumer countries was probably aimed at laying the foundations for a new system of stable and consistent price levels and reliable conditions for regulating the market.

The instrument used to link the divergent paths of prices and market in the attempt to reconduct them on an integrated and coordinated trajectory consisted in the net-back agreements.- However, this type of contract inevitably tends to generate overproduction in an "artificial" product market, sparking off a downward price spiral which will continue to operate in the very short term, since supply is incentivated to expand beyond

effective market demand.

This could trigger off counter-trends, all the more radical the longer and the deeper the present crisis persists.

But the risk of a new price hike in the short term inconsiderate of medium-to-long-term equilibrium conditions - hence once again harmful to all agents - suggests that the evolution of the present crisis will necessarily be more complex and the change in the market more radical: more so since the whole pattern of the market will require reconstructioning as opposed to the previous crises.

An assessment in general terms of the required restructuring of both prices and markets, must also consider the other factors involved, especially general economic and political factors.- The former will make it possible to time the process of re-equilibration and the latter to outline the roles that the various actors can perform.

4. Macroeconomic Implications of the oil Countershock

Macroeconomic models of the oil market such as the one developed by DRI show that a limiting hypothetical price of \$ 10/bbl is not tenable even in the short to medium run, since it would imply oil consumption increasing in the seven major industrialized nations at a rate of 5%, equivalent to a total of almost 4.5 million bbl/day, meaning 6 million bbl/day including the rest of the world.

Allowing for the fact that the non-OPEC production, on this assumption would decrease by at least 2 million bbl/day already in the short time, due to the abandonment of high cost marginal US fields, the demand for OPEC crude in 1988 could reach up to 25 million bbl/day, a value which is close to the present productive capacity of the area.

Furthermore, on this assumption U.S. imports would increase from the 4 million bbl/day in 1985 to 7 million in 1987 and to over 7.5 million in 1988, in the absence of import duties.

A similar evolution of the oil market might appear in keeping with OPEC's goals of overcoming its current "marginalization", and recovering production levels and market shares.- This scenario, however, appears all but compatible at general economic and political level, for the devastating effects it implies over time for the producer countries.

The totally negative effects on the economies of OPEC "high absorbers" (Algeria, Iran, Iraq, Nigeria) and "low absorbers" (Saudi Arabia and Kuwait) are extremely eloquent: the overall deficit of the balances of payments would amount in the three-year period - 1986-1988 - to 100 billion dollars, and gross national product would decrease by 3.2% in 1986, by 5.1% in 1987 and by 2% in 1988; imports could decrease by 15% p.a.; foreign assets of the countries would be greatly reduced (for Saudi Arabia from 150 billion prior to the three deficit years 1983-1985, to \$ 30 billion in 1988; and the debts of the most exposed countries would increase, creating a financial crisis.

Considering, therefore, the actual crude price level to hold only in the very short run, but strictly not compatible in the short-to-medium run, due, also, to the anticipation of "expectations", we attempted at ENI to explore more reasonable hypotheses of possible equilibrium prices.- The relevant simulations have been carried out with the "Interdependence Model" which ENI built in collaboration with OAPEC, on the basis of a project initiated by ENI in 1980.

Simulations carried out in April with the Interdependence Model (see annexed Tables), according to an hypothesis of low oil prices (\$ 14/bbl in 1986 and 1987, subsequently increasing at a rate close to world inflation reaching the value of \$ 23.1/bbl (nominal) in 1995 in a market share expansion oriented design of Saudi Arabia, coupled with a devaluation of the US \$, in particular with respect the Yen and the D.M.), point toward Saudi Arabia re-affirming and consolidating its leadership within the oil market and regaining much of its market shares (31% of total OPEC production in 1995, with OPEC once again producing close to 40% of total world crude at that

same date vs. the 30% relative to 1985).

A similar strategy is of course not exempt from cost.- In fact, the Gulf area would be growing at real negative GDP rates between 1985 and 1990 (- 1% p.a. on the average) picking up only in the subsequent five years (+ 5% p.a. averagely) to be entirely imputed to the oil sector) as the strategy begins paying-off - implying that the 1990-95 growth in income (viz. wealth) is rather the product of large quantities of crude exported at low prices than of economic diversification and development (the Gulf countries' purchasing power of crude exports in 1990 and 1995 being, respectively, 42% and 68% of its 1985 value).

Furthermore, the balance of payments position of these countries will undergo a continuous worsening at least up to 1990 (reaching a cumulated deficit close to \$ 100 billion).- In the medium-long run, however, the Gulf countries are well in a position to sustain these costs, since their strategy will begin paying-off at the latest in the 1990s even if this implies, in the meantime, further drawings on cumulated assets as well as recourse to foreign borrowing.

For the other Arab oil producing countries of the Mediterranean with limited reserves of crude (Egypt, Algeria and Tunisia, in particular) the stakes are definitely too high and these countries would be the hardest hit by persistent low crude prices (this holds also for the sharp reduction in Algeria gas revenues: these - with the four tier crude price indexation governing export contracts - would pick-up only concomittently with a rebound in oil prices and significant increases in gas demanded in an already glutted market).- Simulation results show average annual real GDP growth rates for these countries in the range of 2% during 1985-90 in face of demographic growth rates in the order of 3% p.a.- The capital inflows necessary to finance the balance of payments deficits of these countries taken together are staggering, amounting to approximately \$ 20-25 billion yearly over the decade (the simulated normalised current account (i.e. ratio of current account to GDP) for these countries is - 24% and

- 22% in 1990 and 1995 respectively, as opposed to - 8% and + 8% for the Gulf countries) signifying that recourse to foreign borrowing and relative debt servicing will greatly limit and condition planned development aspirations, not to mention the inevitable implicit ensuing risks of social destabilisation.

The effects of the oil "counter-shock" followed by a smooth price trajectory, as simulated by the Interdependence Model, are highly positive for the economies of the industrialised oil importing countries and for the OECD in general.- Real GDP grows at rates ranging between -3% and 4% p.a. over the 1985-1995 decade, accompanied by low inflation and substantial increases in oil demand.

While intra-OECD trade is subjected to a positive impulse, it is to be borne in mind that imports in the Arab petroleum exporting countries are expected to decline sharply between 1985 and 1990 (- 3% p.a. in volume) as opposed to the high rates experienced even during the not too brilliant recent past (+ 5% p.a. in Gulf and + 3% p.a. in other Arab Mediterranean countries between 1980 and 1985).- Further, in 1985 total merchandise imports from Italy, Germany FR, France and the U.K. accounted for approximately 50% of OAPEC's total merchandise imports, of which over 55% were represented by high tech and high value added investment goods.

The few elements reported regarding the simulations are to be carefully considered in attempting to outline the conditions for a stable long-run (market-clearing) price of crude.- In a nutshell, the most disequilibrating factor in the current and foreseeable situation appears certainly to be the financial imbalances which result from the huge income transfers stemming from the low oil prices.- Much will depend, therefore, on the behaviour of the consumer countries (especially Europe and Japan, the principal OECD importers) in the management of their big current account surpluses which by far exceed the heavy deficits of the Arab petroleum exporting countries, Mediterranean in particular.

5. Political and Market Implications: Prospects for a Recomposition of the System

The simulations that have been briefly recalled clearly illustrate the negative effects for producer countries and the positive ones for consumer countries associated with an excessively low price level.- Since the overall balance is positive - as trade between OPEC and OECD is considerably inferior to that within OECD - it would appear that the international economy could in any case benefit from the current situation.

It would be a mistake however to view the "history" of energy during the last fifteen years as a mere, non-repeatable episode and, therefore, to consider the improvements in the macroeconomy as definitive.- A factor which is not considered in the macroeconomic models examined, is the effect of low oil prices on the oil industry and the feedbacks that this has on the oil market.

The sharp reduction in the mining profits is already causing heavy cuts in exploration and development programmes of extra-OPEC sources as well as in energy saving policies.- In a situation where consumption grows much faster than the net increase in oil reserves, the decline in investments in the energy sector can only foster - in a long run perspective - a new period of energy shortage accompanied by considerable price increases.

A converging interest (albeit with different degrees of intensity) exists therefore between producer countries, oil companies and also consumer countries, in reaching equilibrium in the market and in the establishing long run stability conditions in the energy sector.- There exist, however various possible configurations for a similar equilibrium, each of which would have very different implications for the actors involved.

A first implication is related to the achievement of a homogeneous behaviour of OPEC members.- The drastic decline in oil revenues in recent months could in fact induce the more

turbulent members to accept the kind of cartel discipline that has so far been lacking.- While this might very well occur even in the short term, it would still leave wide open the basic problems that led to the present situation, problems stemming mainly from the incapacity of OPEC countries to define common objectives in terms of oil policies and thus of agreeing on a strategy to implement them.

In this context, political factors which have played and which are still playing an important role in contrasting a truly cohesive OPEC structure (in particular, among the Arab members of the organization) are also to be considered.- The diversity of interests and objectives is the root of tensions within the area, the most significant case at point being the Iran-Iraq war.

Saudi Arabia has an immediate interest in avoiding the formation of a similar truly cohesive system.- Not being in a position to claim direct political hegemony due to the very nature of its regime, its small population and its limited domestic development potential, it has sought to prevent situations of political dominance, also through the management of its dominant position in the oil sector.

In short, the cartel has been able to survive thanks only to the fact that Saudi Arabia, for political as well as economic reasons, has acted as swing producer.- With the progressive decline of its oil output, Saudi Arabia has had to pay excessive economic costs without cashing in any political benefits to the point of a progressive "marginalisation" with respect to the consumer countries and even within OPEC as well as of a severe down-scaling of its economic potential.

If OPEC's effectiveness were to be re-established through Saudi Arabia's action, this could not represent a condition of definitive cohesion, but OPEC would still remain subject to the test of the area's balances and of Saudi Arabia's interests in relation to them.

A second condition is represented by the extension of the cartel to all other producer nations.- In the present economic

situation, this is very likely the aim of the OPEC countries, and to achieve it they are even willing to bear a very high price.- However, a decision by the United Kingdom and Norway to forego maximum production levels, while making a contribution towards the recovery of the market in the short run, would not be sufficient to overcome the structural problems of the market of which mention has already been made.

This is in any case a hypothesis that clashes with the political motivations which have so far determined the behaviour of the North Sea countries, and it is doubtful whether there would be sufficient economic advantages to bring them to cut their production.- The overall economic improvement in the non-oil sectors, in fact, more than compensate the reduction in oil revenues linked to the collapse in prices.

Neither of these conditions, however, solves a basic problem that was created at the time of nationalisations of Western oil interests in the Middle East.- Namely the clear cut separation between downstream activity and the upstream activity which vanifies the possibility of governing the overall market.- It was precisely the integration of these two activities that guaranteed the stability of the market for about 40 years.- With the system of net-back contracts, a first but still an insufficient step has been taken towards restoring this integration.- For full integration to materialise, the adequate conditions must be re-established both in producer countries and in the oil companies.

In both, we are today witnessing a process of rationalisation and of concentration.- The companies have made a series of mergers in the last four years which have led to higher concentration in the industry.- If the crisis were to continue during the next few years, a further process of concentration within the industry could take place.

In producer countries, also, a process of concentration and selection is taking place.- The decision to create the Gulf Cooperation Council, which produces 40% of OPEC's oil and

accounts for 60% of its proven reserves, gives life to a system that is much more manageable by a country like Saudi Arabia which has a strategic interest in stabilising the market.

The highly negative effects that the price collapse will have on the economies of OPEC countries will dampen their resistance to the Saudi oil policy, but from experience gained of OPEC countries' behaviour, Saudi Arabia can hardly rely on any lasting acceptance of its dominant role in the cartel, or on the functioning of the cartel without the constant violations of the past.

Precisely, for this reason, the country would appear to have an interest in combining a strategy of overt or covert alliances with a strategy recovering as far as possible the reliability of the cartel.- In this way, the Saudi position would no longer be dependent upon OPEC, but would have its own autonomous chances, consolidating what is presently occurring in the oil market with the net-back deals; OPEC would, from time to time, act as a cartel or as a mere "advisory" organisation, with little or no detriment to Saudi Arabia.- On the other hand, the strengthening of the country's political role in the area is already evident from that assumed by the Gulf Cooperation Council.- Recovery of a dominant position in the oil sector would complete the process of stabilisation of the area, with the marginalisation of the more unruly countries.

If Saudi Arabia remains isolated in its action, there is a strong likelihood that the current slack market continue to last for a long time.- A similar situation is at variance with the general stability requirements of energy policy implementation, since it paves the way for a new oil crisis in the 90s.- A situation in which no new investments being made in exploration and development owing to the insufficient cash-flow generated by oil activity - in conditions where consumption will be growing at a faster rate than the increases in reserves - will inevitably lead to a new period of scarcity.- The recurrence of conditions which led to the

first oil shock is not in the interest of Western countries.-
The circumstances will therefore also exist for favourable attitudes on behalf of consumer countries and oil companies to do their share in stabilising the market against further disruptions which jeopardize smooth economic progress in the industrialised countries.

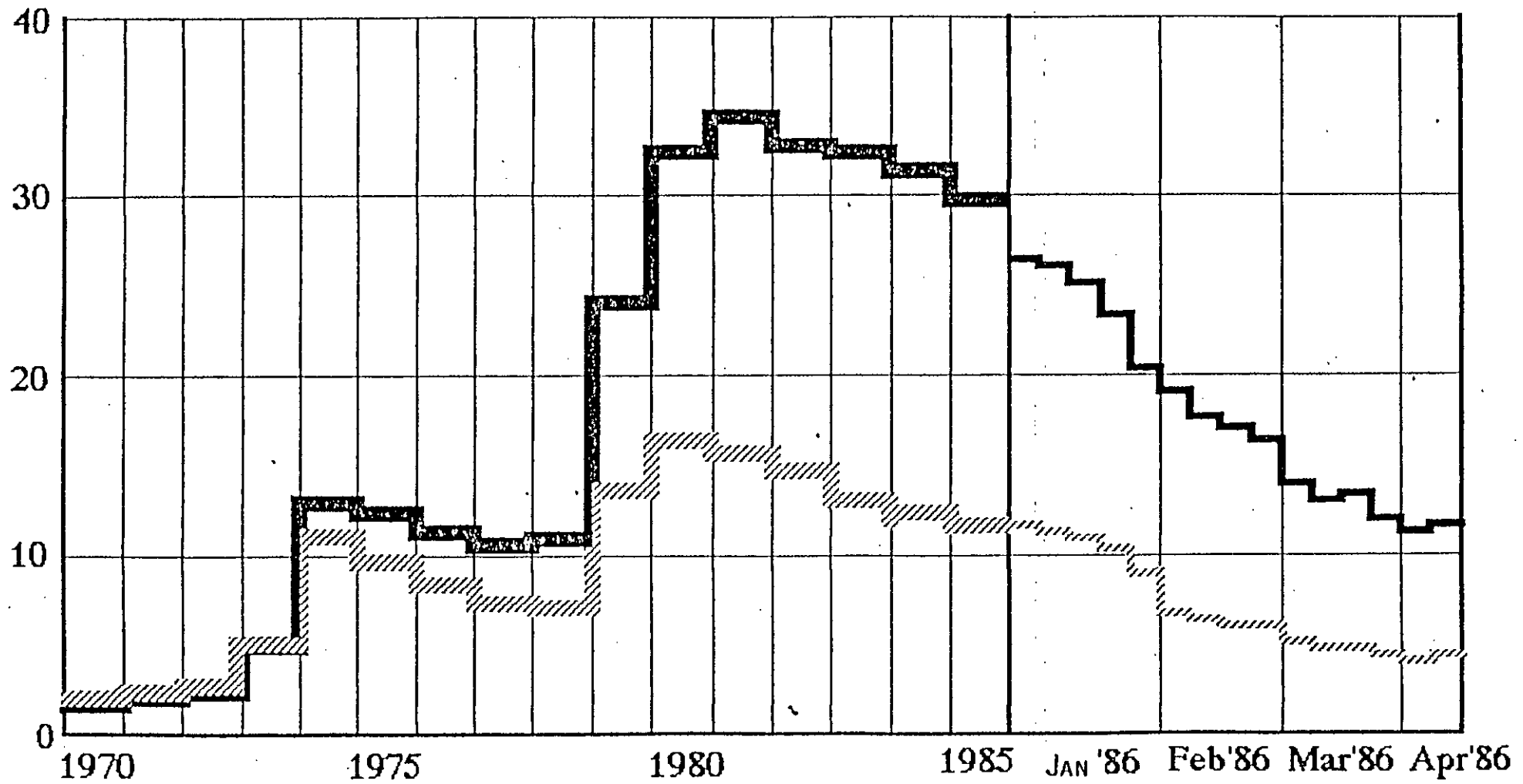
The conditions, therefore, exist to re-establish strong economic links by stipulating bilateral agreements between consumer countries, companies and producer countries; agreements midway between contracts based on OPEC prices and net-back deals, eliminating the negative or out-dated elements of both.

This will help to reinforce the pro-West orientation that has become manifest in most Middle Eastern countries over the last few years, fostering the possibilities of a political solution to the problems still open in the area.

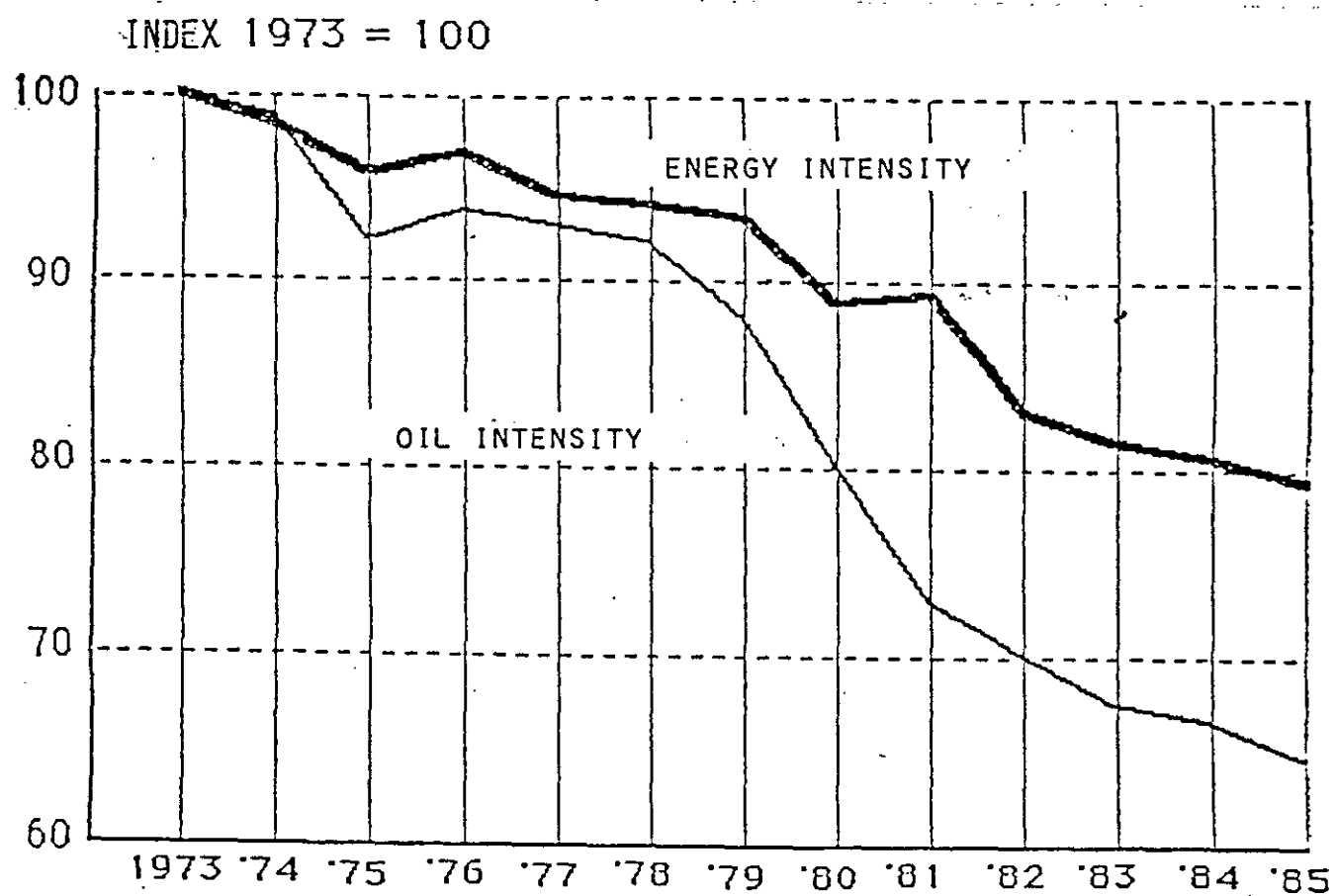
OIL PRICES

■ \$/BL CURRENT PRICES

▨ \$/BL 1973 PRICES

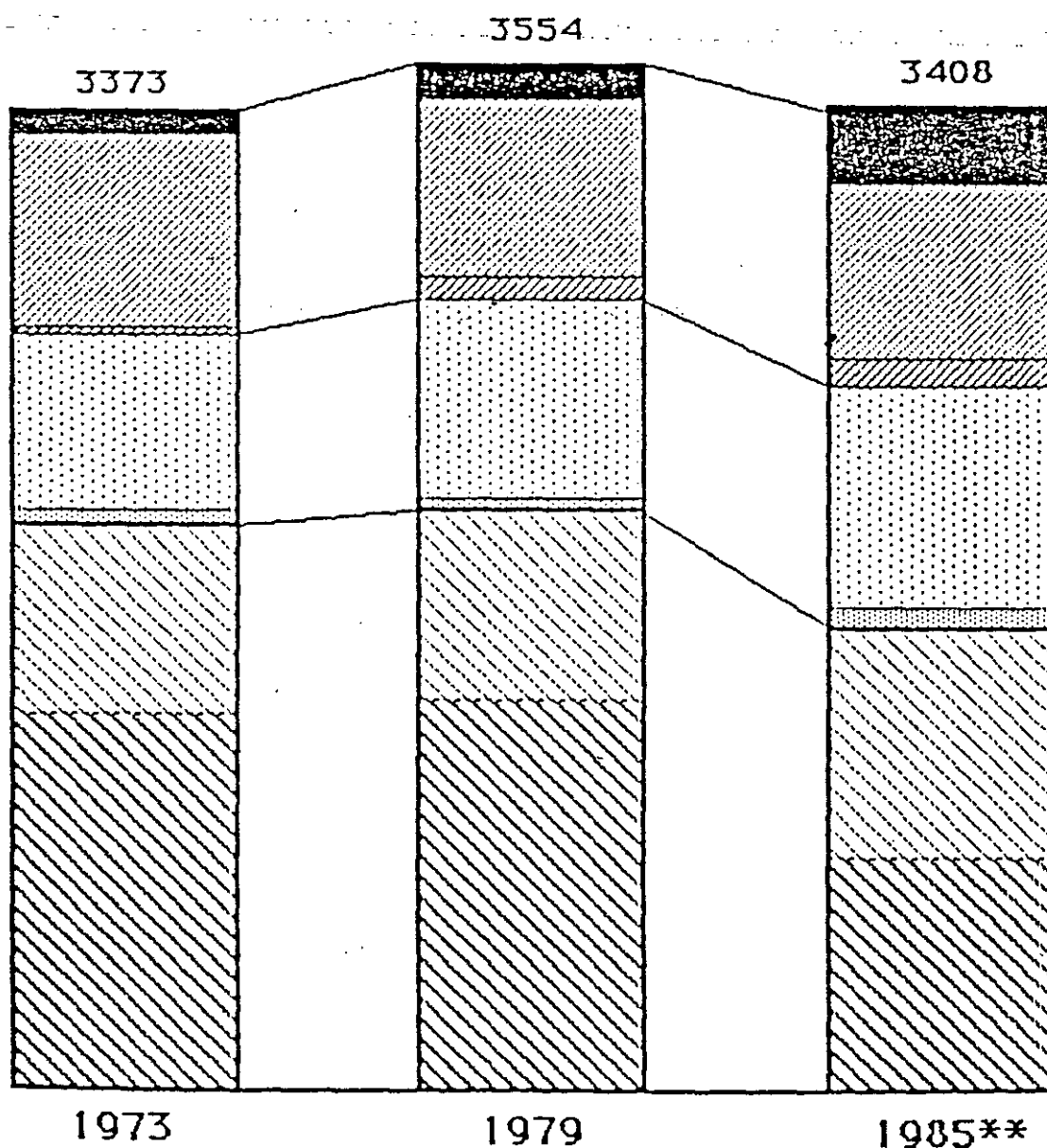
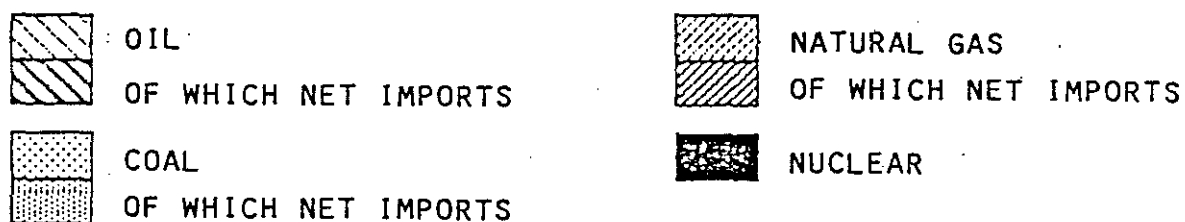


ENERGY AND OIL INTENSITY



ENERGY DIVERSIFICATION IN OECD*

(MILLION TOE)

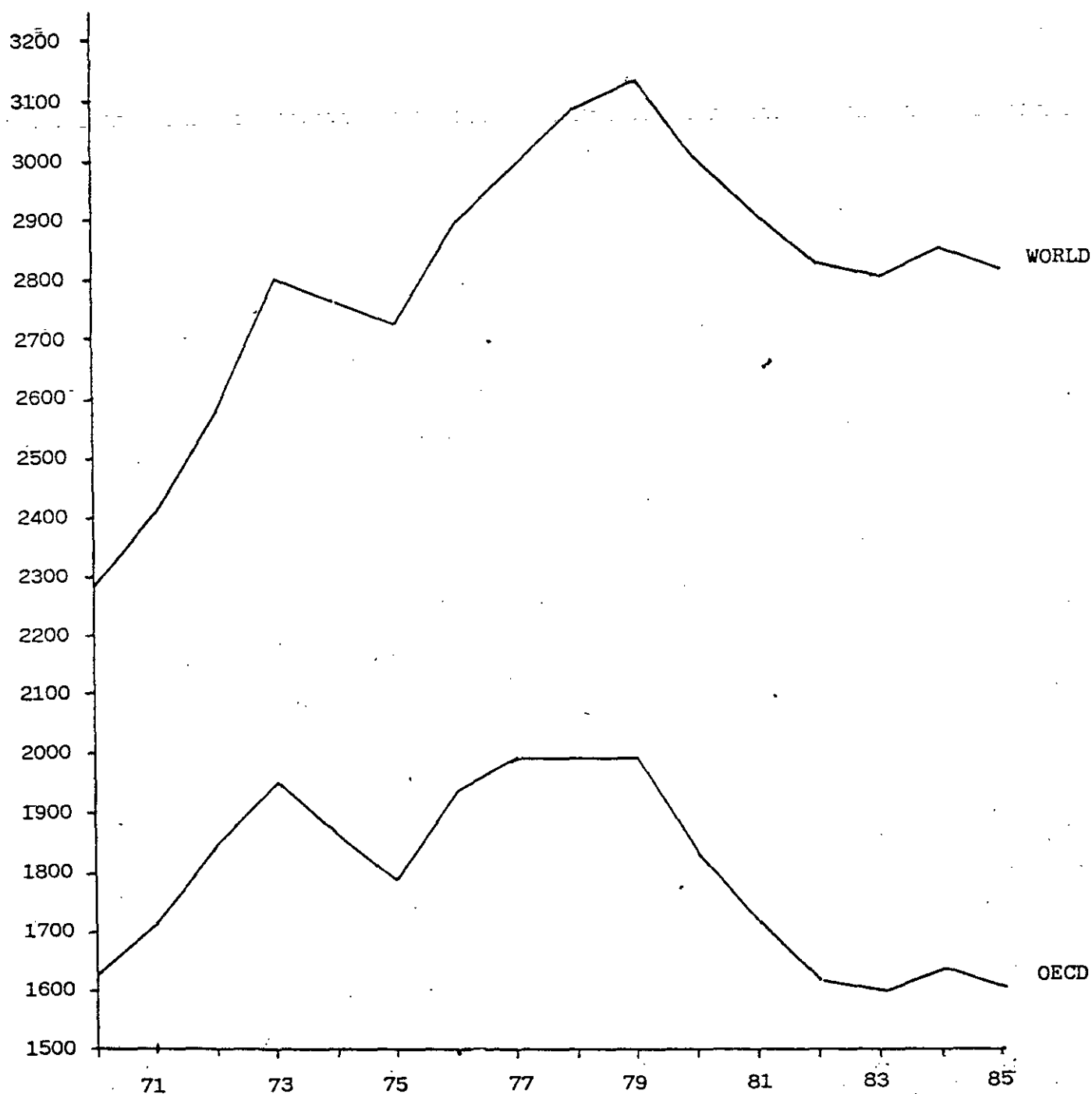


* EXCLUDING INTRA-OECD TRADE

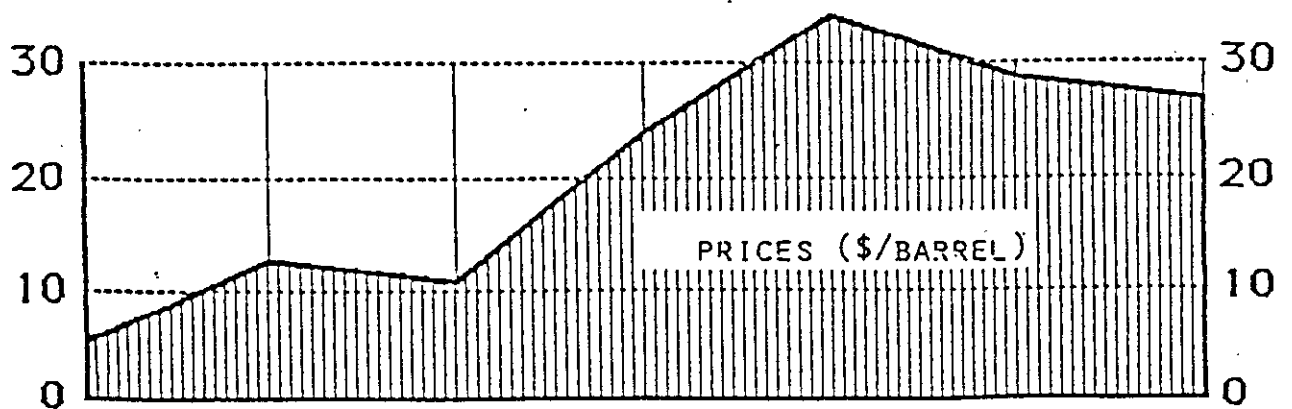
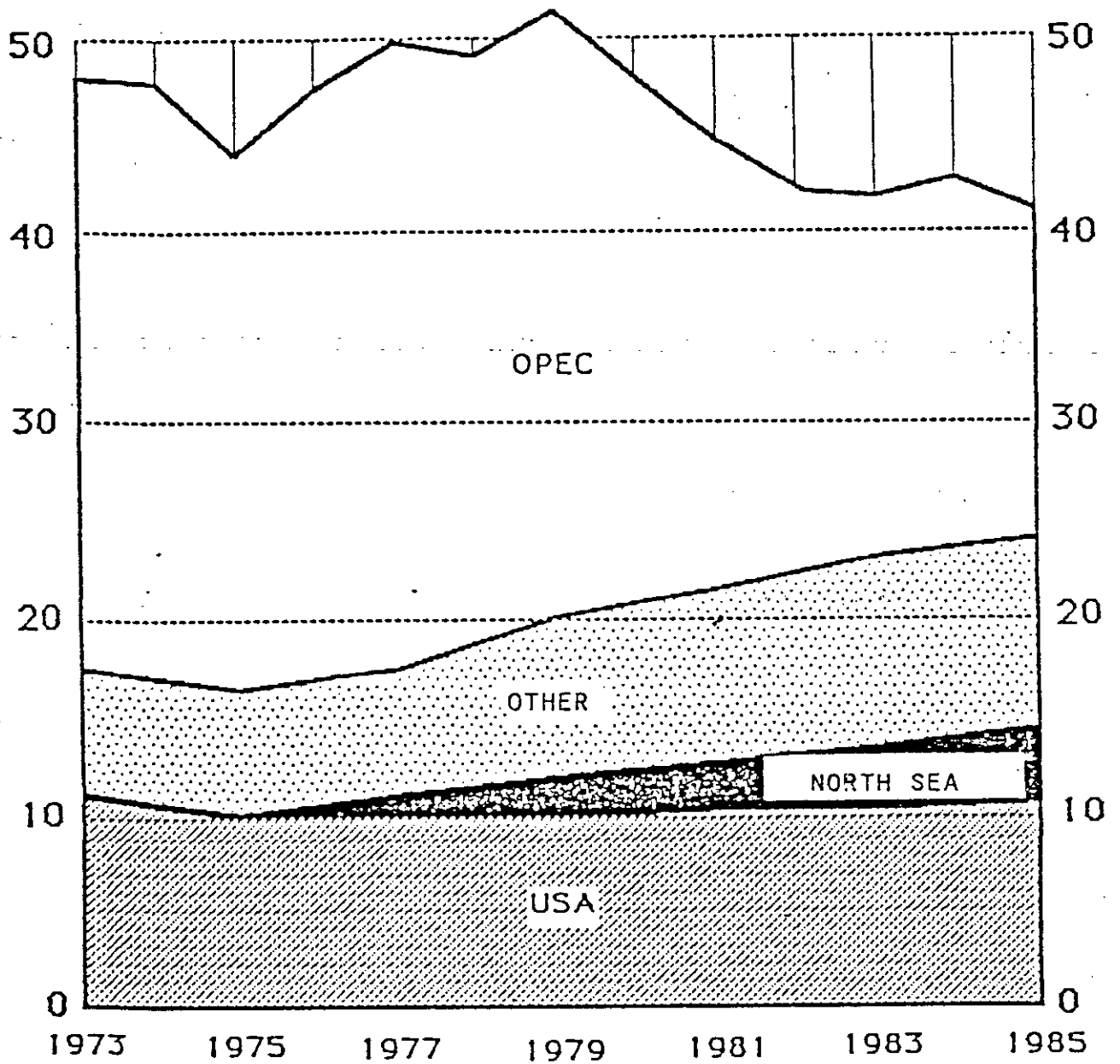
** PRELIMINARY

OIL CONSUMPTION

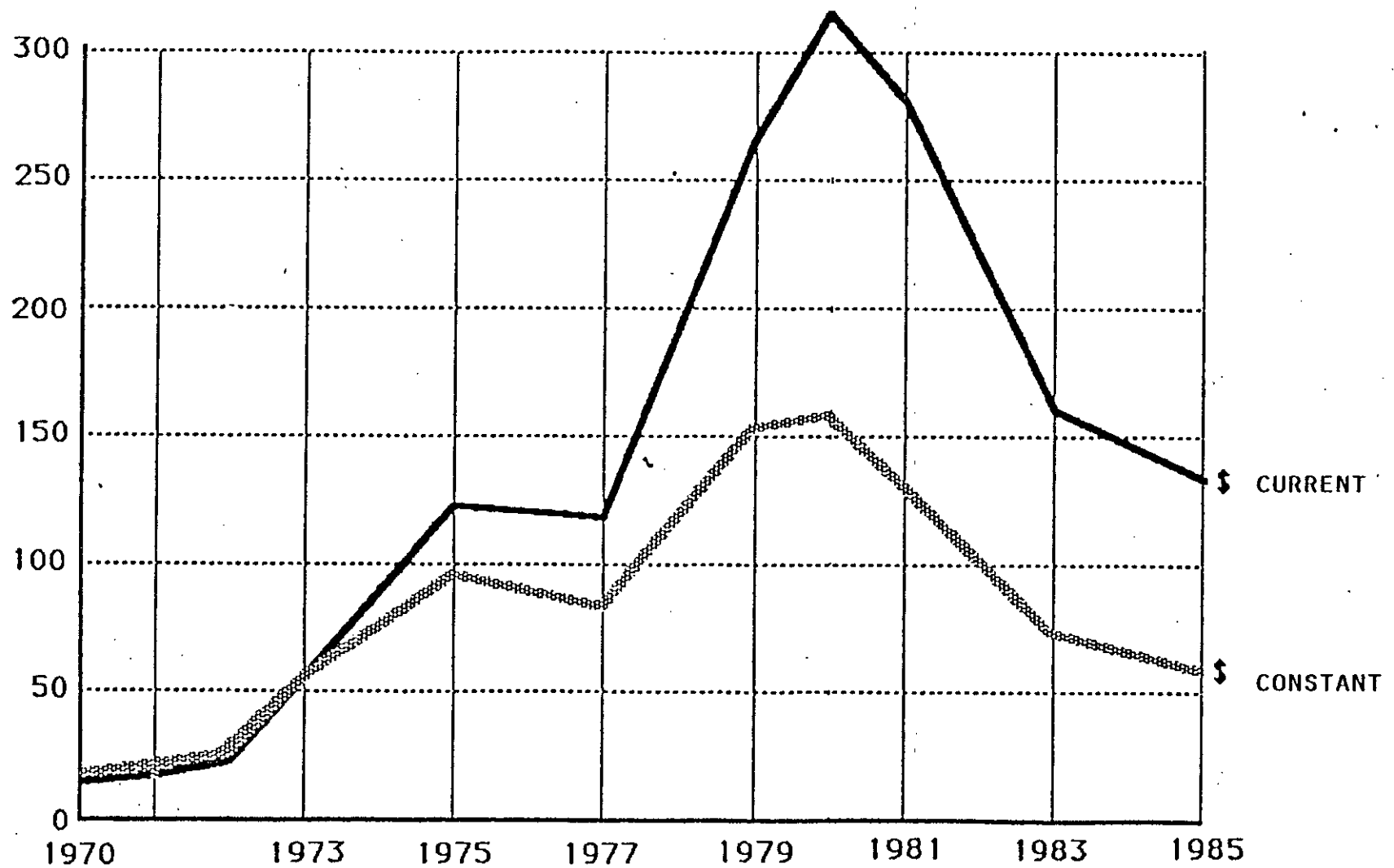
Million toe



WORLD OIL PRODUCTION (MILLION B/D) AND PRICES

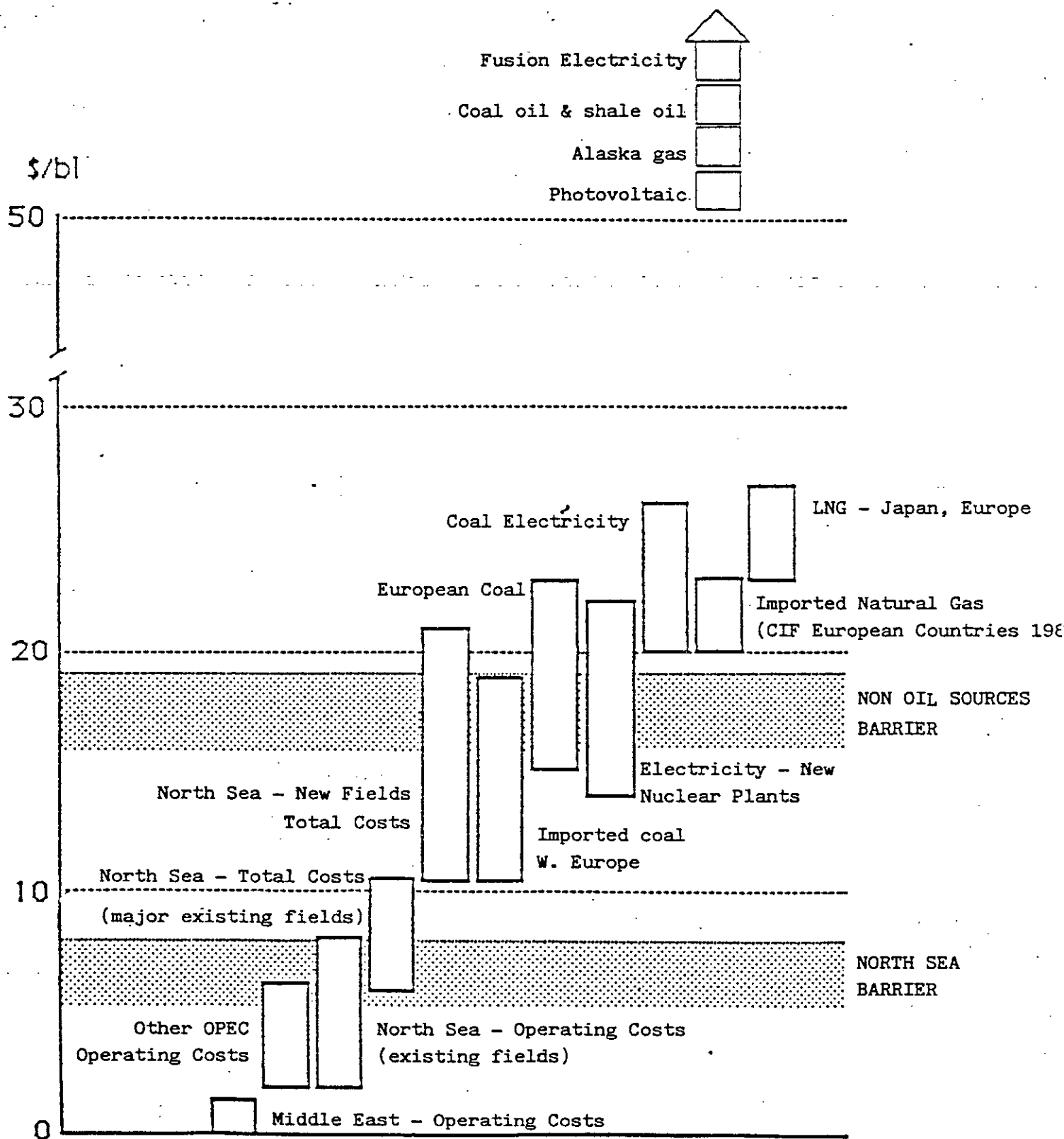


OPEC OIL REVENUES , CURRENT AND CONSTANT 1973 PRICES (BILLION US DOLLARS)



ENERGY SOURCES SUBSTITUTION SCALE

(\$/BL OR \$/BL EQUIVALENT)



SOURCE: From Cambridge Energy Research Associates; OECD; SHELL; PIW.

THE ECONOMIC IMPLICATIONS OF THE OIL PRICE COLLAPSE

MAIN SIMULATION RESULTS OF THE ENI-OAPEC INTERDEPENDENCE MODEL



Rome

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E N I
Interdependence Model

Table 1 == MAIN EXOGENOUS VARIABLES ==

EXCHANGE RATES

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
GERMANY (DM/\$)	2.55	2.85	3.00	2.21	2.75	2.05	2.01	1.97	1.93	1.89	1.86	1.82	1.78
FRANCE (FF/\$)	7.62	8.74	9.50	7.25	7.44	7.53	7.62	7.71	7.80	7.90	7.99	8.09	8.19
ITALY (L/\$)	1513.81	1757.00	1900.05	1627.01	1555.00	1573.88	1593.00	1612.35	1631.92	1651.75	1671.81	1692.12	1712.67
U.KINGDOM (POUNDS/\$)	0.62	0.75	0.85	0.69	0.67	0.66	0.65	0.65	0.64	0.63	0.63	0.62	0.62
JAPAN (YEN/\$)	227.52	227.76	229.52	178.25	177.97	176.21	174.46	172.74	171.03	169.33	167.66	166.00	164.35
U.S.A.	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

OIL PRICES (\$/B)

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
	30.5	27.5	27.0	14.5	14.5	15.4	16.3	17.2	18.2	19.4	20.6	21.8	23.1

Simulation run April 1986

E N I
Interdependence Model

Table 2

WORLD OIL BALANCE
(K tonnes)

	<u>1985</u>	<u>1990</u>	<u>1995</u>
U.S.A. OIL DEMAND	715000.00	753349.12	764893.19
JAPAN OIL DEMAND	204000.00	208355.75	238329.56
EUROPE OIL DEMAND	463927.87	554844.12	600275.06
REST OF WORLD OIL DEMAND	1338935.00	1380290.00	1485138.00
WORLD OIL DEMAND (*)	2721862.00	2896839.00	3088635.00
NON OPEC OIL SUPPLY	2285301.00	2365906.00	2369655.00
OAPEC OIL EXPORT DEMAND	436561.00	539033.00	718980.00
OAPEC OIL DOMESTIC DEMAND	90029.31	87179.31	101356.37
OAPEC OIL PRODUCTION	493900.00	618109.12	820334.75
OPEC OIL PRODUCTION	847200.00	1038109.12	1250938.00
WORLD OIL DEMAND (INCLUDING OAPEC'S)	2811891.00	2984018.00	3189991.00
RATIO OAPEC EXPORTS TO WORLD OIL DEMAND	0.16	0.18	0.23
RATIO OAPEC PRODUCTION TO WORLD OIL PRODUCTION	0.18	0.21	0.26
RATIO OPEC PRODUCTION TO WORLD OIL PRODUCTION	0.30	0.35	0.39
WORLD OIL PRODUCTION MBD	56.46	59.92	64.06
OAPEC OIL PRODUCTION MBD	9.92	12.41	16.47
OPEC OIL PRODUCTION MBD	17.01	20.85	25.12

(*) (Less OAPEC demand)

Simulation run April 1986

E N I
Interdependence Model

Table 3

EURO-ARAB OIL BALANCE
(K tonnes)

	1985	1990	1995
European crude oil demand	462927.87	554844.12	600275.06
European crude oil imports	353730.37	432734.31	468016.75
European crude oil imports from OAPEC	163100.62	236546.50	270795.87
Ratio of OAPEC imports to Eur. oil demand	0.35	0.43	0.45
Ratio of OAPEC imports to Eur. oil imports	0.46	0.55	0.58
OAPEC production	493900.00	618109.12	820334.75
OAPEC Exports	552685.12	530938.75	718986.25
Ratio European imports from OAPEC to OAPEC production	0.33	0.38	0.33
Ratio European imports OAPEC to OAPEC export	0.30	0.45	0.38

Simulation run April 1986

E N I
Interdependence Model

Table 4

ARAB -1 * AVERAGE ANNUAL GROWTH RATES BY ECONOMIC ACTIVITY (1980 PRICES)

Years	1977-1980	1980-1983	1983-1985	1985-1990	1990-1995
Gross domestic product	3.32	-0.59	6.34	2.12	1.94
Value added oil	2.44	-15.04	6.87	4.04	2.02
value added non oil	11.89	6.57	6.09	1.61	1.88
value added industry	19.74	0.48	8.72	2.59	2.75
value added services	9.65	10.05	5.45	1.42	1.77

(*) Algeria, Egypt, Syria, Iraq.

Simulation run April 1986

E N I
Interdependence Model

Table 5 ARAB -2* AVERAGE ANNUAL GROWTH RATES BY ECONOMIC ACTIVITY (1980 PRICES)

Years	1977-1980	1980-1983	1983-1985	1985-1990	1990-1995
Gross Domestic Product	3.32	-7.46	3.91	-0.99	5.13
Value Added Oil	0.13	-16.92	5.88	-1.83	6.89
Value Added non Oil	8.46	5.39	2.26	-0.22	3.63
Value Added Industry	5.29	4.10	2.25	0.89	4.51
Value Added Services	11.26	6.38	2.28	-1.08	2.88

(*) Saudi Arabia, Kuwait, U.A.E., Libya, Bahrain, Qatar.

Simulation run April 1986

E N I
Interdependence Model

Table 6 GROSS DOMESTIC PRODUCT: AVERAGE ANNUAL GROWTH RATES (CONSTANT PRICES)

Years	1970-1980	1980-1983	1983-1990	1990-1995
Germany	2.814	-0.143	2.463	3.047
France	3.630	1.063	2.510	3.100
Italy	3.127	-0.482	3.424	3.759
U. Kingdom	1.920	1.536	2.449	1.954
Japan	4.970	3.493	3.161	5.783
U.S.A.	3.151	1.327	3.374	2.347

Simulation run April 1986

E N I
Interdependence Model

Table 7/1

BALANCE OF PAYMENTS (MILLION CURRENT DOLLARS)

	1984	1985	1986	1987	1988	1989	1990
<u>TRADE BALANCE</u>							
OECD	-10562.75	-20999.19	15596.87	13837.81	7057.56	1017.94	-4723.06
U.S.A.	-64769.75	-83046.50	-83396.00	-91847.69	-98342.06	-98695.56	-92265.12
JAPAN	28776.50	30607.94	59035.25	69232.69	73254.56	75044.06	74670.00
EUROPE-4*	18728.19	19445.87	40979.19	42887.25	39834.31	37450.44	35275.94
ARAB-1**	-15035.86	-28268.42	-28172.33	-29107.34	-29314.22	-29714.71	-29737.06
ARAB-2***	30841.75	43835.37	818.11	-398.75	779.19	3051.62	6860.75
R. WORLD	-23777.51	-20952.20	-12731.41	-16933.00	-18261.96	-24013.60	-35128.29
<u>CURRENT ACCOUNT</u>							
U.S.A.	-57920.12	-81285.69	-85823.87	-95589.62	-102850.50	-104154.25	-96700.06
JAPAN	17009.91	13527.51	57807.94	57713.49	61505.05	64947.94	66717.50
EUROPE-4	-8706.39	-10998.86	22300.44	23343.87	17810.66	9771.27	3213.97
ARAB-1	-11608.61	-21822.29	-39917.65	-36000.19	-36052.66	-37226.23	-37442.36
ARAB-2	15940.09	21916.73	-32131.99	-32002.54	-25368.65	-20419.81	-14878.49
R. WORLD	107091.37	137264.81	141806.12	141898.75	140315.06	133916.19	129774.31
<u>CAPITAL MOVEMENTS</u>							
U.S.A.	52128.10	73157.12	77241.50	86030.69	92565.44	93738.81	87030.06
JAPAN	-15308.92	-12174.75	-52027.14	-51942.14	-55354.54	-58453.14	-60045.77
EUROPE-4	7835.75	9898.98	-20070.39	-21009.48	-16029.60	-8794.14	-2892.57
ARAB-1	10447.75	19640.05	35925.89	32400.17	32447.39	33503.60	33698.12
ARAB-2	-14346.08	-19725.05	28918.79	28802.29	22831.79	18377.83	13390.64
R. WORLD	-96382.25	-123538.31	-127625.56	-127709.00	-126283.37	-120524.56	-116796.81

* GERMANY F.R., FRANCE, ITALY, UNITED KINGDOM

** ALGERIA, EGYPT, SYRIA, IRAK

*** SAUDI ARABIA, KUWAIT, U.A.E., LIBYA, BAHRAIN, QATAR

Simulation run April 1986

E N I

Interdependence Model

Table 7/2

BALANCE OF PAYMENTS (MILLION CURRENT DOLLARS)

	1991	1992	1993	1994	1995
<u>TRADE BALANCE</u>					
OECD	-10058.69	-13814.31	-17195.69	-19220.56	-19657.50
U.S.A.	-99970.50	-99272.25	-92716.06	-80693.94	-63396.87
JAPAN	77865.62	78410.94	75535.81	73107.75	71137.44
EUROPE-4	38672.69	38980.06	39247.25	38232.87	35287.25
ARAB-1	-30209.61	-30906.78	-31608.36	-32344.43	-33113.97
ARAB-2	14690.00	22675.69	31410.81	40217.37	49374.62
R. WORLD	-45086.98	-55962.52	-69807.31	-87101.81	-107235.37
<u>CURRENT ACCOUNT</u>					
U.S.A.	-101570.56	-97644.25	-88063.50	-70041.87	-46045.72
JAPAN	70240.37	71600.37	67523.75	64124.20	59444.48
EUROPE-4	-270.17	-6148.34	-12668.76	-20116.13	-29606.00
ARAB-1	-37975.47	-39375.07	-40610.79	-42026.13	-43593.20
ARAB-2	-6069.74	1204.40	9309.44	16369.57	23235.66
R. WORLD	128408.31	127628.44	126932.75	119425.00	112062.37
<u>CAPITAL MOVEMENTS</u>					
U.S.A.	91413.50	87879.87	79257.12	63037.73	41441.14
JAPAN	-63216.39	-64440.38	-60771.42	-57711.78	-53500.03
EUROPE-4	243.15	5533.51	11401.89	18104.52	26645.39
ARAB-1	34177.92	35437.57	36549.71	37823.52	39233.87
ARAB-2	5462.77	-1084.03	-8378.49	-14732.61	-20912.09
R. WORLD	-115567.37	-114865.56	-114239.31	-107482.50	-100856.12

TABLE 1
OPEC'S SHARE OF WORLD OIL PRODUCTION
(mbd)

<u>Year</u>	Oil Production: <u>OPEC</u>	<u>World</u>	OPEC % of World <u>Production</u>
1973	31.0mbd	55.7mbd	55.7%
1974	30.7	55.9	51.4
1975	27.2	52.9	51.4
1976	30.7	57.3	53.6
1977	31.3	59.7	52.4
1978	29.8	60.1	49.6
1979	30.9	62.5	49.4
1980	26.9	59.6	45.1
1981	22.6	55.9	40.4
1982	18.9	53.3	35.4
1983	17.6	53.0	33.2
1984	17.6	54.1	32.5
1985	16.0	53.3	30.0

SOURCE: Calculated from data in U.S. Department of Energy, Monthly Energy Review, August 1985, p. 106, and December 1985, p. 106.

R.J. Lieber
1 May, 1986
[CUSI.1]

TABLE 2

POTENTIAL ENERGY CRISIS CATALYSTS

122 / *THE OIL DECADE: Conflict and Cooperation in the West*

Table 7.3. Potential Energy Crisis Catalysts

Type of Event	Examples
Arab(s) versus Israel	Israel vs Syria Israel vs Iraq Israel vs Jordan Israel vs Egypt Israel vs Libya Israel vs PLO Israel vs Saudi Arabia Various combinations of above, plus other Arab states
Regional Wars (not Arab-Israel)	Iran-Iraq (intensified) Iraq-Syria Syria-Jordan S. Yemen-Saudi Arabia Iran-Saudi Arabia Iran-Kuwait Iraq-Kuwait S. Yemen-Gulf States Libya-Egypt
Revolution or Civil War	Iran Iraq Kuwait Saudi Arabia Libya Gulf States U.S./USSR support or involvement
Sabotage	Attacks by terrorists, internal dissidents, regional antagonists, on ports, pumping facilities, and shipping
Wars with Superpower Involvement	USSR incursion (e.g., Iran, Persian Gulf) USSR-Israel U. S.-Iran (in Persian Gulf) U. S.-Libya Proxy War - e.g., use of Cubans, S. Yemenis, N. Koreans U. S./USSR conflict on opposite sides in civil or regional wars
Others	Nuclear explosion (terrorism, accident, result of war) Natural disaster

SOURCE: Robert J. Lieber, *THE OIL DECADE: CONFLICT AND COOPERATION IN THE WEST* (NY: Praeger, 1983), p. 122.

2

ADDRESS

BY

HRH CROWN PRINCE HASSAN

TO THE

CONFERENCE ON THE SECURITY OF THE MEDITERRANEAN

14-16 May 1986, Porto Cervo, Sardinia

Ladies and Gentlemen,

Distinguished Guests,

I believe it was Lord Carrington who told the story of a schoolboy who when asked what he knew about Socrates replied, "Socrates was a Greek. He made speeches and was poisoned." Let me assure you that it is no fear of either that keeps me away today and that I deeply regret being unable to join you at this timely and important meeting. I have however, taken the liberty of jotting down a few thoughts which I hope will be conducive to further discussion and analysis.

Doomsday scenarios are so common in the Middle East that any prediction of Armageddon seems anticlimatic. All signs, it is true, point to imminent dangers, but perhaps, to you, this is nothing out of the ordinary. Indeed, any change would seem unreal. Security and peacemaking are a question of linkages, of equilibrium and interdependence - the balance of power. Yet today, as one surveys the international scene, it would seem that the slightest spark might light a fire that could never be extinguished. I am reminded of Sarajevo, and the old adage that those who cannot remember the past are condemned to repeat it.

Peace and stability in the Arab world are of paramount

importance not only to the regional states, but also to the international community. The security of the Mediterranean is inextricably linked to Middle East stability. The wars in the Gulf and in Lebanon, in addition to Israeli intransigence, all point to a singular conclusion which directly concerns the position of Europe, the superpowers, and international conflict. It is abundantly clear that the seismic line of political agitation and conflict extending from the Black Sea in the west, to the Caspian Sea in the east, has dropped southward to run from the Gulf in the east, and westward, to the East Mediterranean - Red Sea Basin. This conflict-ridden area: Palestine, Lebanon, Iraq-Iran, to which may be added the famine-ravaged countries of Africa, has become the soft underbelly of superpower confrontation, underlined by potent social, economic, as well as political factors that could bring about the total collapse of the present state structures.

Superpower confrontation moreover, would no longer necessarily exclude nuclear weapons and we have all recently had a harsh reminder of the devastation these can cause. The Middle East is neither immune nor isolated from the threat of a nuclear conflagration. Nuclear weapons are already in the Middle East. The US maintains a nuclear presence in Turkey and aboard nuclear submarines in and around the waters of the region. More significant, Israel has both a sizeable nuclear capacity and is known to deploy nuclear missiles. Its nuclear programme has benefitted from

the direct and indirect support of nuclear and near-nuclear powers, including South Africa. Moreover, the development and proliferation of mass destruction weapons are as hazardous to man's future and to the region's security as are nuclear weapons, perhaps even more so, since these weapons are more readily accessible and can be more easily produced.

The possibilities of regional conflict, miscalculations leading to a US-Soviet confrontation, or terrorist operations triggering off a nuclear war, make the Arab-Israeli dispute probably the most serious flashpoint in the world today. Such an eventuality is conceivable either on the basis of a conventional war escalating into a nuclear exchange or a nuclear first strike by a small country on account of a perceived threat to its national security. In either case, it is unlikely that the conflict could be contained within regional limits. It is not just to arouse people's fears that for decades we have been warning of the possibility of a nuclear exchange in the Middle Eastern context.

Despite the absence of any ultimate international authority, governments often bind themselves to mutually advantageous courses of action. And, though no international sovereign stands ready to enforce the terms of agreement, states can realise common interests through the creation of international regimes. Because reciprocity

requires flexibility however, control is as important as recognition.

A credible superpower approach to the Middle East requires an effective diplomacy that allows for the moral imperative to be clearly determined. Neither the ephemeral pricing of oil, nor the prevailing concern with the problems of international terrorism, should blind us to the fundamental and basic problems of the region. For too long US policy-makers have sought short cuts to the problem, without defining its content or delineating its diverse and divergent aspects. Mere statements of foreign policy objective are no substitute for coherent and comprehensive diplomacy. The aim should not be the imposition of a settlement, but the manipulation of the leverages of influence to induce constructive results. The objective must be to ease tension so that normal peaceful means of conflict resolution can be pursued. Strategic rationality is fundamental to the pursuit of international politics. Such rationality assumes states have goals, but it is the means of implementing these goals that ought to be changed or questioned.

Europe and the US are called upon to resist domestic pressure that may adversely influence the direction of foreign policy orientation. Measures for a more activist approach to peace-making are required to propel the protagonists in the region and the machinery of foreign

policy-making, as well as its institutions, into moves that can support and nourish developments in the peace process.

Recent months have witnessed an overriding international concern with the problem of terrorism. News bulletins are daily reminders of violence and its inherent dangers. We live the continuing cycle of bloodshed and its bitter legacy. More people have been killed during the recent decades of so-called 'peace', than in the last two World Wars put together. Repression, injustice and tension around the globe further our despair. Moreover, the resort to violence not only eliminates, but also shuns dialogue, and sadly, the belief in the 'efficacy' of violence continues to spread.

The use of violence and terror is denounced by some as the work of power-hungry lunatics and vindicated by others from an ideological stance. Both guises conceal the nature of what is rightly considered a repugnant form of violence. The indiscriminate use of force to achieve political ends, whether it is perpetrated by individuals or groups, acting individually or with the assistance and sponsorship of states, or by governments themselves, shares a common feature - it dehumanises still further the materialistic world we claim to share as human beings. It is surely the antithesis of freedom and cannot be confused with the struggle for liberation from ^{self} freedom and want.

There has been much talk of retaliation, yet

retaliation alone cannot reduce or eliminate terrorism. Sadly, it seems there is a greater interest in mobilising political and public opinion to deal with incidental, and not with structural, victimisation. When such mobilisation leads to action, it is often disproportionate in scale, misplaced in its targets, and counterproductive in its results. It boasts a false self-righteousness, but more damaging, it adds to the insecurity, rather than reinforcing the security, of the Mediterranean.

The temptation to perceive Middle East conflicts in isolation from the northern Mediterranean, or even from Western Europe is replete with miscalculation. It is not just geographic proximity that should impel us otherwise. Equally important is the volume of human and economic interdependence. Oil and other trade are obvious, quantifiable areas of interdependence. Often overlooked however, is the fact that some million Arabs live or work in West Europe and some half a million Europeans live or work in the Arab world, while the annual number of people travelling between the two areas amounts to more than three million. In such a complex symbiosis, there are obvious limits to the use of military, police and technological means of insuring stability in the Mediterranean. We have to strike at the root causes of the problem. The primary cause of terrorism is the unresolved Palestine issue. The US and Europe have done much in the past to attempt to mediate a solution to this problem, and rather than

relegate it to the back burner now, it is my firm belief that we should redouble our efforts to secure for the Palestinians the right to self-determination in their homeland.

The protracted armed conflicts in the Middle East continue to exact a phenomenal price - tens of thousands of lives and tens of billions of dollars, annually. The volume and intensity of human suffering, anguish and despair are incalculable, and have created the disposition for extremism and violence amongst a growing number of Middle Eastern youth. Furthermore, the recent collapse of oil prices and the consequent economic recession in the area are likely to compound their frustration and despair. The disposition towards violence, I am afraid, is liable to grow. The US Administration recently provided an additional \$4.4 billion to protect its embassies abroad from terrorist attack. By contrast a portion of this figure could well be invested in alleviating the suffering in the camps and ghettos where terrorism has traditionally festered.

Non-violent society proceeds with the restoration of dignity to individual human beings. Despite increasing polarisation and the ascendancy of extremism and fundamentalism throughout our region, on both the Arab and Israeli sides, Jordan has resolutely and steadfastly adhered to a policy of centrism and moderation. For four

decades we have consistently emphasised social and economic development in the firm belief that socio-economic development provides the strongest underpinnings for future peace and for dealing effectively with the consequences of war and violence. Respect for the individual human being, protection of minorities, and building on complementarities have been underlying features of our actions and policy throughout these decades.

Our perception of the future is based on complete implementation of the provisions of international law and respect for the dignity of man. The guiding principles of our peace-making endeavours are the recognition of the sovereignty, independence and territorial integrity of all the states in the region. These principles are embodied in UN Resolutions 242 and 338 which still provide the broad framework for peace in the Middle East. The implementation of these Resolutions would lay the solid foundations on which peace, mutual confidence and collaboration could be built. No one state or ethnic religious community should, or can establish hegemony over all the others.

Our concept of Jordan, the West Bank and Gaza is as a terra media, a middle ground, which could combine the huge purchasing power of the oil-producing countries of the Arabian Peninsula in the hinterland, with the skilled manpower and technological skills available in the northern region. The aim is the transformation of this middle ground

into the productive, as well as experimental, workshop of the Middle East.

This notion conforms with our centrist approach in the conduct of public affairs which totally rejects the Politics of the extreme. Religious fanaticism and national irredentism threaten the peace of the region, as well as the social fabric of every country in the Middle East. Social diversity has assumed an ever-increasing importance among the contending populist movements, all of which have divergent aims. The denial of legitimate rights to the Palestinians has been compounded by the absence of authoritative institutions to safeguard their interest under Israeli occupation. The politics of despair and suppression can trigger off a new dimension of social conflict and communal polarisation which could lead to the Balkanisation of all the states in the region, including Israel. Furthermore, Israel's nationalistic claims to Arab lands will inevitably undermine the spirit of compromise and moderation among the Arabs. In the long run, our collective security, both in Europe, and by extension along the indivisible line of detent in the Middle East, depends on policies where people matter, for it is people who are the vectors of stability in this resource rich region.

Time is of the essence. The international community can no longer afford to leave the Middle East in a vacuum, concentrating on the phenomenon of terrorism, for the

middle ground is rapidly being lost to extremism. My country, Jordan, has suffered from violence and terrorism as much as, if not more than any other country. In the last year alone, our passenger planes have been hijacked or blown up. Some of our diplomats have been kidnapped or assassinated. Jordan was and still is one of the most vulnerable countries in this regard. Our geographic location and stance of political moderation have contributed to this vulnerability. If some of your countries have become alarmed by inter-state violence and terrorism in recent months, we have been victimised by it for years, and the same applies to many other Arab countries - such as Egypt and Kuwait. Yet if Jordan and other moderate Arab countries have suffered much from terrorism in recent years, we have all suffered more from the absence of a clear and implementable Western policy in the Middle East. Western diplomacy has to take cognisance of the latent threat to the security and stability of the region. The centrist approach has to be fostered and protected before fanaticism overwhelms the whole area. The superpowers are called upon to evolve the kind of diplomacy which is consonant with the interests of all the states in the region and those of its allies in Europe and the Far East, and employ its formidable influence to encourage new initiatives for peace and to arrest the dangerous process of polarisation now in progress. There is a desperate need for diplomatic effort, based on policies which can break

the long-standing deadlock in regional disputes, so that all energies are directed towards constructive endeavours in a region of enormous potential.

It is evident that world security can only be enhanced in the long run by regional stability. Bilateral relations are no substitute for regional cooperation and collaboration. The geo-political reality of the Middle East, and the economic and cultural interdependence which, as a result of our long historical interaction has evolved in our relations with the West, should contribute to mutual understanding and cooperation. It is imperative that Europe and the superpowers take into account that peace in our troubled region is the only insurance against instability and the continuous fanning of the flames of war.

To say that world politics is anarchic, does not imply that it is entirely lacking in organisation. Cooperation for the long term benefit of all can exist. Haven't we all too often asked ourselves who bears the responsibility for change? It is time that people of wisdom and goodwill, such as this distinguished gathering, not only articulate the obvious, but also act upon the necessary. We need more than mere declarations or short-term plans which are rarely operationalised or pursued with any persistence. What is required is a sound Western policy on the Middle East - joint action on the part of the US, Western Europe and all Middle Eastern countries and other willing parties. Only

movement towards a just a lasting solution to the problems that beset us can gradually transform the atmosphere which breeds despair and violence into one in which hope and a sense of human dignity are re-installed. Security for all states and justice for all peoples are truly two sides of the same coin.

I look forward to learning of your recommendations and in the meantime may I wish you Godspeed in your deliberations.

Thank you.

THE COUNCIL FOR
THE UNITED STATES AND ITALY

CONSIGLIO PER LE RELAZIONI
FRA ITALIA E STATI UNITI

(3)

Conference

"Economic and political factors in Mediterranean stability"

Porto Cervo, May 14-16 1986

"INTERNATIONAL TERRORISM IN THE MEDITERRANEAN-

A LEGAL RESPONSE"

by Natalino Ronzitti

For conference participants only
Not for quotation or citation

INTERNATIONAL TERRORISM IN THE MEDITERRANEAN - A LEGAL RESPONSE

by

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I

INTRODUCTORY

There is no clear definition of international terrorism. In effect we can only identify a certain number of criminal actions, forbidden by international conventions, which are commonly labelled "terrorism", such as aircraft hijacking, hostage taking or crimes against internationally protected persons.

Terrorism can be either a kind of low-intensity conflict, or a means of combat. As a low-intensity conflict, terrorism must be distinguished from piracy, civil war and wars of national liberation. Piracy is a criminal act defined by customary and conventional law of the sea, that applies to acts committed for "private ends" and requires the presence of two ships or aircraft. Civil war is distinguished from terrorism since it presupposes the establishment of an insurgent party having authority over a well-defined portion of territory and population. Wars of national liberation are defined by Article 1(4) of the 1977 I Additional Protocol to the four Geneva Conventions as those conflicts in which peoples under colonial, racist or alien domination are

fighting to implement their right to self-determination.

Terrorism can also be examined in the perspective of the law of armed conflict. In this second meaning, terrorism is an unlawful means of combat which can be employed in either international or internal armed conflict. Instances of acts of terrorism committed within the framework of the law of armed conflict are resort to barbarous means of warfare, such as killing of civilians, hostage taking and systematic disregard of the law of warfare.

The purpose of this paper is not to examine terrorism in time of armed conflict. Here, only international terrorism in time of peace, as a kind of low-intensity conflict waged by a group of individuals acting alone or with the support of a State, is taken into consideration.

II

RESCUE OPERATIONS

Humanitarian considerations require that individuals in the hands of terrorists be freed whenever a rescue operation is feasible. International law offers a variety of options. The following grounds for intervention are here worth focusing upon, bearing in mind that they are designed only to rescue people and should not have any punitive goal.

a) Intervention to protect nationals abroad

States can have recourse to this ground for intervention with or without the consent of the local sovereign.

No problem usually arises as far as the lawfulness of use of force is concerned, when the local sovereign gives its consent to the entry of a rescue team. Instances of this kind of intervention are the German Raid on Mogadishu (1977), where a German commando team successfully stormed a Lufthansa plane, or the recent action taken by the Egyptians in Malta (1985), in order to free the hostages in a hijacked aircraft belonging to Egyptair.

Should the local sovereign be unable to mount a rescue operation, insofar as it is without military capability, one might wonder whether there is an obligation to seek the intervention of the State whose citizens are in the hands of terrorists. This obligation might stem from the duty to protect foreigners.

Intervention to protect nationals abroad without the consent of the local State is available when this latter State is either unable or unwilling to free the hostages. In other words, when the local sovereign is unable to free the hostages since it has no military capability, or when a civil war is taking place in its territory and the situation is more or less that of a state of anarchy. It may also happen that the local sovereign is an accomplice of the terrorists instead of doing its best to free the hostages.

Force has been threatened or actually exerted to rescue nationals abroad in more than a dozen cases since the Second World War. However it is still a moot point whether this ground for intervention is permitted by international law, since state practice shows that only Western States, with the remarkable exception of Egypt, have up till now tried or justified the use of force on this particular ground. It is possible to trace a trend

towards the justification of the use of force to protect nationals abroad, but not a wide consensus on its lawfulness. The present writer's opinion is that this kind of intervention cannot be labelled as an act of aggression but only as a minor violation of the U.N. Charter, provided that action in foreign territory is properly limited in time and space.

b) Intervention on the High Seas

As a rule, ships on the high seas are under the exclusive jurisdiction of the State whose flag they fly. Should the ship fall into the hands of terrorists as was the case with the Achille Lauro, the remedies invoking the crime of piracy would not be available. These remedies would entitle any State to seize the ship. However, the case in point is not one of piracy, for two reasons: first, because the two vessel requirement is lacking - as previously stated, a piratical act is an act committed by a private ship against another ship -, secondly, because piracy is a crime committed for private ends, whereas terrorist organizations act for political aims.

In consequence, the ship remains under the jurisdiction of the flag State, notwithstanding her being in the hands of terrorists. Obviously, the flag State can give its consent to outside intervention, by setting up a joint rescue operation. Can third States resort to the use of force without the consent of the flag State? The present writer's opinion is that in this particular case force might be lawfully employed by the State whose nationals are in mortal danger, should the flag State be

either unable or unwilling to free the hostages. The doctrine of state of necessity can be invoked and intervention by foreign States on the high seas seems more sound than an intervention in foreign territory, since the former does not entail the violation of another State's territorial integrity.

c) Humanitarian Intervention

Humanitarian intervention is the use of armed force by one State (or by a group of States) in order to protect the citizens of the State against which intervention is directed from inhuman and cruel treatment. This kind of intervention is not of great help for fighting international terrorism. It could be exerted to restore law and order in regions which are in a state of anarchy and are thus exploited as sanctuaries by terrorists. However, humanitarian intervention is usually regarded as an unlawful use of force in international relations.

III

RESORT TO COERCION AGAINST INTERNATIONAL TERRORISM

States employ both military and non-military coercion to meet international terrorism. The first category includes self-defense, armed reprisals and demonstration of force. Economic sanctions are the typical manifestation of the second category of measures, even though less intensive actions are often taken, such as representations, claims for compensatory damages or interruption of diplomatic relations.

a) Self-defense

There are two main readings of Article 51 of the U.N. Charter, which allows the right of self-defense.

1) A broad interpretation, under which self-defense is permitted either to preempt an attack or when an armed attack has occurred. According to this view, the armed attack need not necessarily be directed against the territory of a State, its navy or air force. For an attack against nationals abroad or merchant ships and private aircraft would also give the right to react in self-defense.

2) A strict interpretation, on the contrary, suggests that self-defense is available only when an armed attack has occurred and only if the targets are the State's territory, its navy or air force in international space. Even this second view, however, has lately been under review in order to give the target State greater possibility of meeting outside threats.

For those who share a strict reading of Article 51, self-defense does not allow much room for taking action against terrorist activities. The following conditions must be present in order to have legitimate recourse to the doctrine of self-defense:

- The terrorist act must be attributable to a State.
- The terrorist act has to be of such intensity that it can be equated to an armed attack.
- The target of the armed attack must be the State's territory, its army lawfully stationed abroad or its navy or air force in or over international waters.

b) Armed Reprisals

Acts of terrorism sponsored by a State entail its responsibility. According to the international law in force before the adoption of the U.N. Charter, States whose nationals had suffered injuries were permitted to retaliate both to seek redress and to deter the offending State from committing further wrongful acts. Armed reprisals were considered as a lawful means of enforcing international law. Reprisals involving the use of armed force are nowadays prohibited by the Charter of the United Nations and its Article 2(4). Post-Charter practice shows that the Security Council has often condemned action taken as reprisals. Thus this doctrine is no longer available to fight international terrorism. For this reason, States are trying to move from the reprisals rationale to self-defense whenever they intervene in foreign territory, i.e. they are widening the concept of self-defense.

c) Demonstration of force

Demonstration of force can sometimes be equated to threat of force and is prohibited by Article 2(4) of the U.N. Charter, unless it is excused under a valid legal justification. Demonstration of force occurring during the vindication of a right can be lawfully exerted, as proven by the Corfu Channel Case. The International Court of Justice did not condemn the United Kingdom for the passage through the Corfu Strait with a naval squadron, notwithstanding Albania's claim that transit without consent of

the coastal State was not permitted. The same is true for other maritime claims. The U.S. naval maneuvers in the Gulf of Sidra were lawfully exerted since the Libyan claim has not any foundation in international law.

d) Economic Sanctions

States can have recourse to economic sanctions even if they are not taken by the U.N. Security Council. The Security Council, acting under Article 41 of the U.N. Charter, can make these measures mandatory. As shown by the recent consensus resolution of the General Assembly on terrorism, there is a common belief within the international community that action should be taken. Whenever terrorism is supported by a State, the unlawful act is attributable to it and recourse to economic sanctions is legitimate even though the measures taken constitute a breach of international law towards the target State (as for instance would be the case of the breach of a treaty according landing rights or obliging to sell or buy a certain amount of goods). As a rule, sanctions can be taken by the State whose nationals are the victims of acts of terrorism. However, this crime can nowadays be considered as a breach towards all members of the international community, with the consequence that every State is authorized to react and it need not to be authorized by the U.N. Security Council.

IV

THE NATO TREATY AND INTERNATIONAL TERRORISM

Western States, both the European and the United States, are nowadays the main target of international terrorism. Since most of these States are members of the NATO Treaty, it is here worth ascertaining whether they can use the NATO organization to fight international terrorism.

a) Has the Organization any competence to deal with international terrorism?

Under the Nato Treaty the parties have a) a duty of consultation, whenever the territorial integrity, the political independence or security of a member State is threatened; b) a duty to help the State which has become the target of an "armed attack". Terrorist attacks, which do not threaten the territorial integrity, political independence or security of a member State or which do not amount to an "armed attack" within the meaning of Article 51 of the U.N. Charter, are outside the NATO Treaty, even if they take place in the region covered by NATO.

The competence of the Atlantic Council under Article 9 is limited to matters related to the application of the Treaty, with the consequence that, as a rule, the Council should not deal with international terrorism. However, practice shows that member States have de facto widened the competence of the organization, so that endowing it with the power to deal with international terrorism is only a matter of political will. Taking into account

that the Council has the power to set up subsidiary organisms, a special body entrusted with the aim of studying measures against international terrorism could be envisaged.

b) American bases in Italy, military response to international terrorism and neutrality.

Up till the Sigonella incident, American bases in Italy have not been used for operations connected with the fight against international terrorism. Recently, there have been rumors concerning the possibility that Italian territory be used for operations against international terrorism. The operations would be conducted either by special corps (for instance the Delta Force) or even by a wider and more powerful task force. The use of Italian territory by a foreign power for intervention abroad raises the following problems:

a) The Force could operate as a rescue mission or for launching a reprisal against the State responsible for hosting the terrorists. However, Italy and the United States do not always share the same view on the lawfulness of having recourse to force. For instance, it is highly debatable if there is a common view, between Italy and the United States, on the lawfulness of intervention to protect nationals abroad, without the consent of the territorial State. Again, it is certain that Italy regards armed reprisals as an unlawful use of force, while the United States does not have a completely negative view (one has also to take into account that the United States has a broad view of the doctrine of self-defense). There are also different opinions on the definition of international terrorism and terrorist organizations (for instance, the liberation movements).

b) Should an operation be launched from Italian territory, Italy's neutrality could not be maintained, since the neutral State is obliged not to allow its territory to be used for hostile operations. Therefore, the State against which the operation is launched could react against military objectives located in Italian territory.

c) Article 6 of the NATO Treaty.

Under Article 5 of the NATO Treaty, member States are obliged to give assistance to the State which has been the object of an armed attack. Article 6 defines the notion of armed attack, which includes an attack against ships or aircraft that are on or over high seas, provided that they are located in the area covered by the treaty. The North Atlantic sea stretching north to the Tropic of Cancer is textually covered by the Treaty. The territorial waters of the southern members are also covered, since the Treaty refers to the territory of member States in Europe. However, it is not clear whether the waters of the Mediterranean lying outside the jurisdiction of member States are covered by the NATO Treaty. Supposing that they are, the following problems would arise:

a) Does a terrorist operation against a private ship or aircraft amount to an "armed attack" which triggers the duties of assistance that member States are obliged to carry out? The answer is in the negative, since the ordinary notion of armed attack means an attack launched by a State and not by a group of

individuals who are not acting on behalf of any State. Besides, as a rule, the definition of armed attack, as a notion valid for reacting in self-defense under the U.N. Charter, means that the attack be launched against warships and military aircraft.

b) A more difficult problem arises if the fleet of a member State, without actually using force, is nevertheless engaged in a demonstration of force to deter a State held responsible of being an accomplice of terrorists. If the State is attacked - as was the case of the United States in the Gulf of Sidra - are the member States obliged to render assistance under Article 5 of the NATO Treaty?

V

BRINGING THE CULPRIT TO JUSTICE

The fight against international terrorism has not only a military and humanitarian dimension. It also has a legal dimension, consisting in seizing terrorists and punishing them. In this paragraph, we propose to assess the following points: a) the duty to punish; b) the interception of foreign aircraft; c) extradition.

a) The duty to punish.

Under general international law States have the duty not to tolerate acts of international terrorism within their own territory and have the duty to punish those who have committed such acts. The duty in point is often restated by conventional

international law. However, a norm of customary international law obliging States to punish acts of international terrorism committed outside their territory or on board foreign ships and aircraft in international space has not yet come into force. A duty to punish is now established by a number of international conventions, as a substitute for extradition. For States are primarily obliged to extradite the offender; should extradition prove not to be possible, they are obliged to punish the offender even if a special title of jurisdiction is lacking. For instance Article 8 of the 1979 International Convention Against the Taking of Hostages obliges the parties to establish jurisdiction over the alleged offender present in their territory if they do not extradite him.

b) Interception of foreign aircraft

Recent practice shows that States have had recourse to interception of foreign aircraft in flights over international space. The aircraft on board of which the interceptor State had reasons to believe that there were persons having committed the crime of terrorism, were forced to land in order to capture the alleged offenders. The most recent instances are the interception of an Egyptian aircraft and its forced landing in Sigonella by the U.S. and the interception of a Libyan aircraft, in flight over the Eastern Mediterranean and bound for Syria, by Israel. The second incident originated a sharp debate within the Security Council. After having equated terrorism to piracy, Israel justified the interception stating that "... a nation attacked by terrorists... [was] permitted to use force to prevent or preempt future attacks". "It is simply not serious" - the Israeli representative

added - "to argue that international law prohibits us capturing terrorists in international waters or international airspace". The Israeli view was supported by the United States, which released the following statement: "As a general principle the United States opposes the interception of civil aircraft. The safety of international aviation must be protected... At the same time, we believe that there may arise exceptional circumstances in which an interception may be justified. ...The United States recognizes and strongly supports the principle that a State whose territory or citizens are subjected to continuing terrorist attacks may respond with appropriate use of force to defend itself against further attacks. The appropriateness of a particular action will always raise considerations of necessity and proportionality. Where the target of a defensive action is an aircraft, heightened attention must be paid to considerations of safety. Because of the inherent risk involved in an action directed against an aircraft, such measures should be undertaken only in exceptional circumstances".

The interception was obviously condemned by Arab and Communist countries which took the floor in the debate. The other western members of the Security Council, namely France, Denmark, Australia and the United Kingdom, did not excuse the Israeli move. France said that "... necessary action against terrorism cannot be legitimized through or by violation of international law". The United Kingdom, after having stated that there was no evidence that the aircraft "constituted a threat to Israeli Security", said that the interception was without justification. This precedent shows quite clearly that an alleged right to intercept foreign

private aircraft for apprehending persons suspected of having committed the crime of terrorism has not a sound basis in international law. The interventionist theory relies on a broad interpretation of the right of self-defense, but it is difficult to reconcile this interpretation with a balanced reading of Article 51 of the U.N. Charter.

c) Extradition

To escape punishment, those who commit acts of terrorism usually flee to foreign countries where the punishment is lenient or where they are not punished at all. Extradition is an important tool for apprehending the offender and securing him to justice. The main obstacle to the extradition process for terrorist acts is represented by the political colour of the crime, political offences being - as a rule - not extraditable crimes. To make extradition workable, the only way is represented by the abolition of the concept of political crime for acts of terrorism. The 1977 European Convention on Suppression of Terrorism is an example. However, conventions of this kind are feasible only among countries sharing the same democratic values and with a high human rights standard. Even so, the conventions designed to abolish the notion of political crime as far as the extradition of terrorist offenders is concerned often permit reservations that might void their aim. Such might be the case of the European Convention which gives the parties the power to enter a reservation according to which a State is entitled to refuse extradition for a crime that it considers as having a political

nature. However, in this case the State on whose territory the offender is present is obliged to punish him. In other words the principle aut dedere aut punire is applied.

CONCLUSION

From a legal point of view, there are two main responses to international terrorism sponsored by States. The first, which can be labelled as a moderate one, implies the claim of monetary compensation by the State whose nationals are victims, collaboration among the police and intelligence of target countries in order to prevent the commission of terrorist acts, and recourse to extradition to punish the offender. This school of thought also recommends the severance of diplomatic relations and the adoption of economic sanctions. These last measures can be more effective than is commonly believed, particularly if they are taken against countries which depend heavily on the export of oil and other raw materials. The moderate response does not preclude action in foreign territory, but only as a last resort and solely to rescue people in mortal danger, not to punish terrorists.

The second alternative is a radical response and implies recourse to military action, such as self-defense and armed reprisals. However, the doctrine of self-defense is not easily available against terrorist actions and its implementation often ends by having the colour of an armed reprisal, an act which is prohibited by the Charter of the United Nations.