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Issue Brief

US-Saudi Tensions: Implications for the Petrodollar System

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S*ummary*

With the US and Europe becoming less dependent on West Asian oil imports and China and India becoming the main markets for GCC hydrocarbons exports, the petrodollar system that came into existence in the 1970s has come under stress, with oil being traded increasingly in non-US denominated currencies. The recent tensions between the US and Saudi Arabia over a range of issues, in the wake of the ongoing Russia-Ukraine war, and growing ties of GCC states with both Russia and China has only worsened problems for the petrodollar system, which may potentially have serious implications for the global financial and economic order.

Recent tensions between the United States and Saudi Arabia, an influential member of the Organization of the Petroleum Exporting Countries (OPEC) countries, in the wake of the ongoing Russia–Ukraine war, has revived concerns about new challenges to the so-called ‘petrodollar system’, which plays a pivotal role in the functioning of the global financial and economic order.

With the emergence of Asian countries as the main consumer of petroleum products, oil is being increasingly traded in currencies other than the US dollar, even as Western states are rapidly shifting their energy dependence out of oil and into alternative, mainly renewable, sources of energy. This has weakened the petrodollar system, which for almost half a century made the US dollar the standard for global trade and finance.

At the heart of the petrodollar system lies the relationship between the US and Saudi Arabia, the leading member state of the OPEC.

Tensions in US–Saudi Relations over Oil Production

In 2022, tensions between the US and Saudi Arabia over issues related not only to production of oil, but also to trading of oil in US dollars has revived fears over the future of the petrodollar system.

In March 2022, relations between the US and OPEC member states became so tense, that leaders of Saudi Arabia and the United Arab Emirates (UAE) declined to arrange calls with US President Joe Biden as the US and its allies sought to contain a surge in energy prices caused by Russia’s invasion of Ukraine.¹

This led to a flurry of Western Heads of State visiting Riyadh, mainly to urge Saudi Arabia to stand with the US and Europe and increase oil production to ease rising petroleum prices during the Russia–Ukraine war.

Thus, UK’s then Prime Minister Boris Johnson visited Riyadh in March last year.² In June, Joe Biden himself visited Saudi Arabia.³ In July, Crown Prince Mohammed bin Salman (popularly known as MBS) was invited by French President Emmanuel Macron to Paris for talks.⁴ In September, German Chancellor Olaf Scholz visited

¹ Edward Helmore, [“Saudi Arabia and UAE Leaders ‘Decline Calls with Biden’ Amid Fears of Oil Price Hike”](#), *The Guardian*, 9 March 2022.

² [“Saudi Crown Prince Meets British PM Johnson in Riyadh”](#), *Reuters*, 16 March 2022.

³ [“FACT SHEET: Results of Bilateral Meeting Between the United States and the Kingdom of Saudi Arabia”](#), The White House, 15 July 2022.

⁴ [“Macron Greets Saudi Arabia’s MBS With Handshake As He Arrives for Elysée Visit”](#), *France 24*, 28 July 2022.

Saudi Arabia and other Arab states.⁵ The theme of all these meetings was to keep Saudi Arabia away from the Russia–China club and to urge it to increase oil production for the energy-starved economies of Europe and the inflation-hit US.

In fact, President Biden outlined a five-part “new framework for the Middle East” that included supporting economic development and military security.⁶ However, Saudi Arabia did not accept demands of the US and its allies to increase oil production to reduce prices, and did not take up Western calls to join countries putting sanctions on Russia. The Kingdom also decided to side with the decision of the 23-member state OPEC Plus organisation, founded in 2016 that includes Russia, to cut daily oil production by 2 million barrels per day. This resulted in a 2 per cent reduction in global oil supply, the biggest cut in the last two years.⁷ The Saudi decision was perceived by the White House and Western commentators as being coordinated with Russia, which currently sells more crude oil than Saudi Arabia.

Even when Biden asked Saudi Arabia to delay its decision on oil output by a month, until after the US mid-term elections, the MBS-led Saudi government did not relent, but defended its output cut by saying all OPEC decisions are based solely on economic forecasts and needs.⁸

In fact, Saudi Arabia’s Kingdom Holding Company invested US\$ 500m in Russia’s three main energy companies, almost at the time of the commencement of the Russia–Ukraine war.⁹

What is more surprising is that Saudi Arabia in 2022 more than doubled its import of Russian oil to meet its domestic requirements such as for electricity generation, even as it sold much of its costlier oil around the world.¹⁰

This behaviour peeved Joe Biden no end, who issued a warning to the Kingdom of ‘consequences’ in early October last year.¹¹ Similarly, Democratic Senator Bob

⁵ Dalia Samra-Rohte, [“German Chancellor Olaf Scholz Visits Saudi Arabia”](#), German-Saudi Arabian Liaison Office for Economic Affairs, 24 September 2022.

⁶ [“US Won’t Let China and Russia Dominate Mideast, Biden Tells Arab Leaders”](#), *The New York Times*, 16 July 2022.

⁷ Jon B. Alterman, [“What Did Saudi Arabia Just Do”](#), Centre for Strategic and International Studies, 6 October 2022.

⁸ Natasha Turak, [“Biden Administration Asked Saudi Arabia to Postpone Opec Decision by a Month, Saudi Says”](#), *CNBC*, 13 October 2022.

⁹ [“Saudi Prince Made \\$500 mn Russia Bet as Ukraine War Started”](#), *Financial Times*, 14 August 2022.

¹⁰ [“Saudi Arabia Doubles Q2 Russian Fuel Oil Imports for Power Generation”](#), *Business Today*, 15 July 2022.

¹¹ [“Biden Vows ‘Consequences’ for Saudi Arabia After Oil Output Cuts”](#), *Al Jazeera*, 12 October 2022.

Menendez of US Senate Foreign Relations Committee threatened to stop the sale of weapons to Saudi Arabia while other Democrats even asked the US to withdraw the 5,000 remaining American troops from many of the bases in the Persian Gulf.¹²

US Efforts to Salvage Ties with Saudi Arabia

Despite this initial outrage, Biden administration has backtracked and has tried to woo its old ally back into the fold. On 2 October 2018, *The Washington Post* columnist and alleged CIA agent Jamal Khashoggi was murdered by a Saudi Arabian hit squad inside the Saudi consulate in Istanbul. In February 2021, a US intelligence report finally charged that the hit squad was working under the express command of the Saudi Crown Prince MBS.¹³ Yet as a goodwill gesture to appease an old friend, the Biden administration ruled in November that because Muhammad bin Salman is the head of state of a friendly country, he enjoys immunity from the jurisdiction of US courts. The ruling by the Biden administration actually left the federal judge in Washington with no choice but to reluctantly dismiss the lawsuit against MBS with this observation: “Despite the Court’s uneasiness, the United States has informed the Court that he (MBS) is immune”.¹⁴

Again, the Biden administration quelled the passage of the ‘Nopec’ antitrust legislation, after quietly excluding it from a bill in December 2022. The bill, if passed, would have allowed cases to be filed against OPEC’s attempts to limit production of petroleum to increase prices.¹⁵

President Biden made another appeasing overture towards the Crown Prince. On 13 December, yielding to strong opposition from the US administration, Democratic Senator Bernie Sanders withdrew his war powers resolution—The Yemen War Powers Act—that would have ended US support for the Saudi-led war on Yemen.¹⁶

¹² Rebecca Kheel, [“Oil Dispute Prompts Call to Remove US from Saudi Arabia, UAE”](#), *Military.com*, 6 October 2022.

¹³ Nicole Gaouette and Jeremy Herb, [“US Intelligence Report Finds Saudi Crown Prince Responsible for Approving Operation That Killed Khashoggi”](#), *CNN*, 26 February 2021.

¹⁴ Dan Whitcomb, [“Judge Dismisses Khashoggi Lawsuit Against Saudi Crown Prince; Biden Granted Him Immunity”](#), *Reuters*, 7 December 2022.

¹⁵ Emily Meredith, [“US Holds Back on Saudi Moves as Tensions Ease”](#), *Energy Intelligence*, 27 December 2022.

¹⁶ Trita Parsi, [“While MBS Undermines America, Joe Biden has his Back on Yemen”](#), *MSNBC*, 16 December 2022.

Causes behind Souring of US–Saudi Relations

Yet all these unseemly overtures did not change the Saudi Crown Prince’s stance. In fact, MBS went ahead with his invitation to the Chinese President Xi Jinping to visit Saudi Arabia, which the latter did on 9 December, when the two countries signed a ‘Comprehensive Strategic Partnership’, in which China promised to continue importing large amounts of oil from Saudi Arabia and GCC and even stated that the oil transactions will be paid at least in part in Yuan. In fact, Xi himself spoke about the prospect of a petroyuan to several other Arab leaders present in Riyadh, where he said “The Shanghai Petroleum and Natural Gas Exchange platform will be fully utilized for RMB (renminbi) settlement in oil and gas trade”.¹⁷

It is noteworthy that China has been leading the world in oil and natural gas imports, much of which comes from the GCC region. China introduced yuan-priced oil contracts in 2018 as part of its efforts to make its currency tradable across the world, although 80 per cent of global oil transactions are still conducted in US dollars.¹⁸

There are several reasons for the apparent falling out between the US and Saudi Arabia. The first obvious reason is the difference in the polities themselves—the US is a modern, secular republic, while the Saudi Arabia is a Wahhabi kingdom. The West has for a long time blamed Saudi Arabia and its Wahhabi brand of Islam as being the source of international terrorism.¹⁹

Even during the tenure of former President George W. Bush, if not earlier, the dependence of America on Saudi and Gulf oil was raised as a concern, as a somewhat toxic addiction, which the West should purge itself off.²⁰ This did not go down well in Gulf countries.

Over the last 20 years, Western economies have to a great extent decoupled themselves from depending on Arab hydrocarbons with Europe developing renewable sources of energy, and the US increasing its own oil and gas production as well as in making breakthroughs in potential future sources of energy like nuclear fusion technology.²¹

¹⁷ [“Keynote Speech by Xi Jinping, ‘Building on Past Achievements and Jointly Creating a Brighter Future of China-GCC Relations”](#), Ministry of Foreign Affairs of the People’s Republic of China, 9 December 2022.

¹⁸ Summer Said and Stephen Kalin, [“Saudi Arabia Considers Accepting Yuan Instead of Dollars for Chinese Oil Sales”](#), *The Wall Street Journal*, 15 March 2022.

¹⁹ Carol E. B. Choksy and Jamsheed K. Choksy, [“THE SAUDI CONNECTION: Wahhabism and Global Jihad”](#), *World Affairs*, Vol. 178, No. 1, 2015, pp. 23–34.

²⁰ David B. Sandlow, [“President Bush and Oil Addiction”](#), Brookings, 3 February 2006.

²¹ Esme Stellard, [“Nuclear Fusion Breakthrough – What Is It and How Does It Work?”](#), *BBC*, 14 December 2022.

This has over time peeved the Saudis who increasingly believe that the US is no longer the reliable security provider it once was. The US overtures towards Iran, and not even informing let alone involving Saudi Arabia and Gulf states about the JCPOA negotiations has made the Kingdom suspicious of US intentions.²² Some Saudi strategists also blame the US for having allowed the Shia Crescent to rise in the region, with US wars causing Shia ascendance in Iraq, Lebanon, Syria and in Yemen.²³

And yet, it is at this critical time for Saudi Arabia that the US forces have been planning to pivot to Asia, i.e., to the Indo-Pacific. To most Saudi strategists, the US did not fully commit itself to fighting the Yemen war for it.²⁴ It even failed to keep its word about defending Saudi Arabia’s critical oil installations as per the 1974 agreement, as Iranian-backed drones easily attacked Abqaq-Khuraiz oil refineries in September 2019, despite the US’ much vaunted air defence systems.²⁵

Gulf countries are also afraid of the rise of electric cars replacing the combustible engine driven vehicles in the future.²⁶ They are wary of US’ own oil production (including shale oil) and sudden energy independence, and its emergence as a bigger producer of oil and gas than the GCC.²⁷

The Saudi family chose a young leader in Mohammad bin Salman to meet the aspirations of its expanding youth bulge. He has drawn an ambitious economic development plan under its Vision 2030 programme, which was recently hit by the COVID-19 pandemic.²⁸ The initiative is critical for the survival of the state because two-thirds of its aspirational and restive population is now under the age of 35.²⁹ The US keeps raising issues of human rights, labour laws, religious and gender equality

²² Bruce Reidal, [“What the Iran Deal Has Meant for Saudi Arabia and Regional Tensions?”](#), Brookings, 13 July 2022.

²³ Jose Miguel Alonso-Trabanco, [“Understanding the ‘Shiite Crescent’ as Iranian Grand Strategy”](#), Geopolitical Monitor, 17 October 2022.

²⁴ Annelle R. Sheline and Bruce Reidel, [“Biden’s Broken Promise on Yemen”](#), Brookings, 16 September 2021.

²⁵ Sebastian Robelin, [“Why U.S. Patriot Missiles Failed to Stop Drones and Cruise Missiles Attacking Saudi Oil Sites”](#), *NBC News*, 23 September 2019.

²⁶ [“Zero Emission Vehicles: First ‘Fit for 55; Deal Will End the Sale of New CO2 Emitting Cars in Europe by 2035”](#), European Commission, 28 October 2022.

²⁷ [“US Overtakes Saudi Arabia as Top Oil Exporter”](#), Anadolu Agency, 13 September 2019.

²⁸ Sebastian Castelier, [“Post-COVID Saudi Arabia Doubles Down on Vision 2030”](#), *Al-Monitor*, 6 April 2021.

²⁹ Varun Godinho, [“Two-thirds of Saudi Arabia’s Population is Under the Age of 35”](#), *Gulf Business*, 10 August 2020.

issues that often even affect Saudi mega projects like Neom city and The Line.³⁰ However, China is willing to overlook all such issues and seems keen to help Saudi Arabia with its technology, investments and defence cooperation.³¹ Saudi Arabia also thinks it would have more leverage against Iran, if China was on its side.³²

There is also a personal grudge between MBS and Biden. As a presidential candidate, Biden had promised to make Saudi Arabia an international "pariah" state over its dismal human rights record and had said he would cut off all arms shipments to Saudi Arabia and had even castigated by saying there is “very little social redeeming value in the present government in Saudi Arabia”.³³

Thus, the Saudi rethink on ties with US is quite simple. Even during his visit to Saudi Arabia, President Biden said he had raised the murder of journalist Jamal Khashoggi during his meeting with Saudi Crown Prince Mohammed bin Salman.³⁴

With reduced Western dependence on Saudi oil and the US drawing down its security forces from West Asia, Saudi Arabia feels it is left to fend for itself in its confrontation with Iran, Iraq and Yemeni threats. As the main oil consuming nations of Saudi and GCC oil are now China and India, Saudi Arabia finds little benefit in continuing to trade oil in US dollars and not in its own currency or that of its consumers.³⁵

The Petrodollar System

This ongoing tension in US–Saudi relations could undermine the petrodollar system and the existing global financial system in its wake.

Simply put, the petrodollar is the combination of two words “petroleum” and the “US dollar”. Most of the oil traded worldwide today is in US dollars. This arrangement goes back to a 1974 US–Saudi agreement, arrived at in the aftermath of the Yom Kippur War and the subsequent oil embargo imposed by the Gulf states. In June 1974, then US Secretary of State Henry A. Kissinger and then Crown Prince Fahd of

³⁰ [“Saudi Arabia: Labour Reforms Insufficient”](#), *Human Rights Watch*, 25 March 2021.

³¹ [“China, Saudi Arabia Strengthen Partnership on Energy, Defence”](#), *Al Jazeera*, 9 December 2022.

³² Tala Taslimi, [“China's Embrace of Saudi Arabia Leaves Iran Out In The Cold”](#), *Nikkei Asia*, 13 December 2022

³³ David E. Sanger, [“Candidate Biden Called Saudi Arabia a ‘Pariah’. He Now Has To Deal With It”](#), *The New York Times*, 25 February 2021.

³⁴ [“Saudi Arabia: Biden Raised Khashoggi Murder with Crown Prince”](#), *BBC*, 15 July 2022.

³⁵ Summer Said and Stephen Kalin, [“Saudi Arabia Considers Accepting Yuan Instead of Dollars for Chinese Oil Sales”](#), *The Wall Street Journal*, 15 March 2022.

Saudi Arabia signed an agreement to establish two joint commissions—the US–Saudi Joint Commission for Economic Cooperation (JCEOR) and the US–Saudi Arabian Joint Security Commission (JSCOR).³⁶

According to these agreements, the US government promised to provide increased economic and military innovation and aid to Saudi Arabia and in exchange Riyadh agreed to exclusively price all of its oil in US dollars.³⁷ Thus, any nation that would import Saudi oil was required to exchange their currency to US dollars before completing the transaction. The remaining OPEC countries followed Saudi Arabia’s petrodollar precedent in 1975.

The US aim in establishing this new petrodollar system was to protect the value of and increase the demand for the US dollar. Countries around the world started purchase of US dollars and kept them as reserves often in US banks to buy oil for their country, which made the greenback strong and the reserve currency of the world. Other commodities, such as gold, copper, agricultural products, natural gas, etc., are today also traded in US dollars. The rising strength of the US dollar had many world leaders and economists worried for a long time. It was former French finance minister Valéry Giscard d’Estaing who first alleged that the US enjoyed an “exorbitant privilege” on account of the reserve status of its currency.³⁸

The US dollar, though, fell precipitously in value after President Richard Nixon decoupled the currency from the gold peg in 1971. It found a new support in the proverbial ‘black gold’ or petroleum. This started the age of the petrodollar.³⁹

It is the peg of the US dollar to petroleum, which has started shaking again with major oil producers like Saudi Arabia, Russia (now a major producer of petroleum) and other OPEC Plus countries increasingly trading oil in currencies other than the US dollar. Even India and Russia plan to drop all use of the US dollar and the euro in bilateral settlements and conduct all trade transactions in rupee and rouble, a senior Russian official has said.⁴⁰

³⁶ Ava Vered Zieff, [**“The U.S. Shale Revolution: The Threat to Saudi Arabia and the The U.S. Shale Revolution: The Threat to Saudi Arabia and the Future of the U.S.-Saudi “Special Relationship” Future of the U.S.-Saudi “Special Relationship”**](#), Fordham Research Commons, Fordham University, 2022.

³⁷ James Chen, [**“What You Should Know About Petrodollars”**](#), *Investopedia*, 19 May 2021.

³⁸ Barry Eichengreen, *Exorbitant Privilege: The Rise and Fall of the Dollar*, Oxford University Press, 2012.

³⁹ Andrea Wong, [**“The Untold Story Behind Saudi Arabia’s 41-Year U.S. Debt Secret”**](#), 31 May 2016.

⁴⁰ Dipanjan Roy Choudhury, [**“Russia, India Plan to Drop Use of US Dollar, Euro in Bilateral Trade: Russian Diplomat”**](#), *The Economic Times*, 24 December 2022.

BRICS and the New Reserve Currency

It is worth noting that Saudi Arabia, whose oil customers are now mainly China and India, has recently evinced interest in joining BRICS, a grouping which includes Saudi Arabia’s major oil markets—India and China. The issue of expansion of the bloc will be on the agenda of the BRICS Summit scheduled to take place in South Africa this year.⁴¹

In this context, it is curious to note that in June last year, Russian Foreign Ministry proposed a new BRICS reserve currency, based on a basket of BRICS currencies, backed by gold and other commodities. Saudi Arabia’s bid to join BRICS, with its petroleum reserves, may give an added boost to this concept.⁴² The BRICS reserve currency proposal comes as an alternative to the US dollar and the International Monetary Fund’s (IMF) Special Drawing Rights (SDRs) currency. The SDR currently holds five currencies in its reserves—the US dollar constitutes 43 per cent of these reserves, euro 29.3 per cent, Chinese yuan 12 per cent and Japanese yen and British pound 7.5 per cent each. However, SDRs are units of account for the IMF, and not a currency *per se*. They are standard numerical monetary unit of measurement of the market value of goods, services, and other transactions.

The big issue here is how relevant are these developments for the Indian economy. The US dollar is today a very costly currency for buying an essential commodity like crude oil. In fact, the share of US dollar reserves held by central banks in countries around the world has fallen to 59 per cent—its lowest level in 25 years—during the fourth quarter of 2020, according to the IMF’s Currency Composition of Official Foreign Exchange Reserves (COFER) survey.⁴³

But does that mean that India should back China-backed petroyuan initiative, as it would be tantamount to moving from one currency’s exorbitant privilege to that of another. The US’ central bank, the Federal Reserve, takes independent decision on monetary policy to serve the interest of the US economy. But as the US dollar is also the global currency, the Federal Reserve’s monetary policy actions at times affect the value of other countries’ currencies and commodities, which has particularly detrimental impact on the currencies of developing countries.

The time has come for India to not only keep a tab on the developments on the global financial front, but also perhaps participate in bringing about a more just and broad-based monetary system, involving a basket of currencies and commodities, for a more secure and fair financial and monetary order for the future of the world.

⁴¹ Dipanjan Roy Choudhury, [“Saudi Arabia Wants to Join BRICS, Says South African President”](#), *The Economic Times*, 20 October 2022.

⁴² [“BRICS Explores Creating New Reserve Currency”](#), *The Economic Times*, 3 October 2022.

⁴³ Serkan Arslanalp, Barry Eichengreen and Chima Simpson-Bell, [“Dollar Dominance and the Rise of Non-Traditional Reserve Currencies”](#), IMF Blog, 1 June 2022.

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