Proceedings of the 3rd International Conference on Global Politics and Socio-Humanities
DOI: 10.54254/2753-7048/88/2025.22259

How Conflicts and Wars in the Middle East Promotes Economic Development in the United States

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Abstract: The Middle East, owing to its strategic location at the intersection of Asia, Europe, and Africa, and its huge oil reserves, plays a significant role in global economic frameworks. This paper analyzes the impact of regional wars and crises on the hegemony of the US dollar and capital flows in the United States. It employs theories of petrodollar recycling and Military Keynesianism to examine American interests in recent Middle Eastern conflicts and the impact of military expansion on the petrodollar system. This article utilizes data on arms transactions and oil trades amid Middle Eastern wars, primarily sourced from the Stockholm International Peace Research Institute, to investigate the relationship between arms and oil trading by extrapolating trends and patterns. The results indicate that the instability in the Middle East promotes the petrodollar circulation, gives the US chances to consolidate US dollars as a primary currency and could lead to a large number of US dollars backflowing to the American economy.

Keywords: The Middle East, the United States, Petrodollar, Weapondollar, Weapondollar-petrodollar Coalition

1. Introduction

After World War II, with both the Soviet Union and the United States voting in favor of Resolution 181 to support the creation of the State of Israel, the Middle East has become an area of vital importance in geopolitical strategists' view and the forefront of great power confrontation.

The Middle East has long driven the global trade in armament for a long time. Such trade can be one of the factors contributing to the tension across the region, but it also helps with the circulation of capital within the world economy. By comparing the value of military exports between countries every year, the United States has been the single largest armament seller in this area for over two decades. In the past two decades, the total amount of armament exported to the Middle East has been stable at around 3000 million dollars [1]. The United States' focus on the region is due in large part to the reliance of the US dollar's hegemony on oil transactions in this area, as well as the substantial role that money generated from arms exports plays in the national economy. Previous studies have largely focused on the significance of the Middle East in the consolidation and promotion of the petrodollar system and the interaction between the weapon import and the oil export, in simple words, the weapondollar-petrodollar coalition [2,3]. While these studies have discussed the revenue generated by selling weapons before wars and the effect of weapon trading on the petrodollar recycling, little attention has been given to the deeper analysis of American interests in regional wars and the additional impact these conflicts have on global capital flows.

This paper examines how regional conflicts and wars in the Middle East affect US capital flows and the US dollar hegemony. It analyzes American interests in recent Middle Eastern conflicts and the effects of military expansion on the petrodollar system using theories of petrodollar recycling and Military Keynesianism. By analyzing the relationship between arms and oil trading, extrapolating trends and patterns from data on arms transactions and oil trades during Middle Eastern conflicts—primarily sourced from the Stockholm International Peace Research Institute—this study aims to provide a new perspective for historians to reassess the impact of Middle Eastern wars on global economic and political patterns.

2. The Strategic Significance of the Middle East

The Middle East's special geographic location, vast energy wealth, and demographic composition are three major factors that helped shape the conflict in the Middle East and make it highly anticipated [4]. Located at the crossroads of Asia, Europe, and Africa, the Middle East serves as a crucial transportation and trade hub. Several critical global shipping lanes, including the Strait of Hormuz—responsible for a significant portion of the world's oil shipments—pass through this region.

Arab countries in this area account for 55.2% of global oil reserves, 26.9% of natural gas reserves, 27.4% of global oil production and 16% of gas production [5]. The control over critical maritime chokepoints like the Strait of Hormuz—a conduit for over 20% of global oil shipments—grants the region outsized influence on energy security and trade dynamics. For any superpower, a big influence over the Middle East means a vast international discourse and global impact. Such important strategic significances make world powers maintain military bases in the Middle East, including the U.S., which has bases in countries like Qatar, Bahrain, Kuwait, and the UAE. These bases are essential for projecting U.S. power in the region and globally. With its abundant oil reserve and military presence, the situation in the Middle East becomes an important factor for the US Dollar Hegemony and US economic development.

3. Petrodollar

The petrodollar plays a significant role in the USD hegemony the US capital cycle. It refers to the revenue generated from crude oil exports denominated in USDs. Due to the vital role played by crude oil in the world industry, the petrodollar stabilizes the U.S. dollar as the primary currency for global oil transactions, creating a long-lasting demand for the U.S. dollar and reinforcing the economic and geopolitical power of the United States.

The petrodollar recycling system is an important component of the petrodollar system. The core of this mechanism is to bind oil with the US dollar, making major oil exporting countries in the Middle East use USDs in all their oil transactions. This allows these countries to earn large amounts of US dollars to purchase things like US national debt or US goods and services. Such economic activities reintroduce the US dollar into the US economic system and further promote the international circulation of the US dollar. Apart from consolidating the USD as a primary currency, the repatriation of petrodollars provides a stable source of financing for the US government, enabling it to maintain long-term fiscal deficits for investments and expansionary policies without causing depreciation of the dollar. Moreover, the petrodollar system also strengthens Wall Street's position as a global financial center.

The formation of the petrodollar system was a pivotal strategy adopted by the United States to salvage its dollar hegemony after the collapse of the Bretton Woods system. Under Bretton Woods, the U.S. dollar was pegged to gold at a rate of $35 per ounce, establishing the U.S. dollar as the primary global reserve currency. However, the 1971 Nixon Shock terminated the convertibility of

USD to gold, leading to the collapse of the gold standard and causing the USD to devalue and fluctuate [6].

The First Oil Crisis gave the United States an opportunity to vitalize the influence of the US dollar on international trade. During the 1973 Energy Crisis triggered by the Fourth Middle East War, Saudi Arabia promised to fully price all its oil exports in US dollars in exchange for the military support. This agreement effectively tied the U.S. dollar to global oil trade, thereby formalizing the petrodollar system. As oil is the most important source of energy for human survival and industrial development, linking the US dollar to oil and maintaining high influence in the Middle East has further solidified the petrodollar system. Unlike the Bretton Woods system, where the exchange rate between the US dollar and gold was fixed at $35 per ounce, the petrodollar system allows the price of oil in USD to freely increase. Apart from maintaining the US dollar’s monopoly situation in the oil market, the petrodollar system also provides the US government with a sustainable source of funding when there is an increase in demand of USD following the rise in the price of crude oil.

4. Weapondollar

While petrodollar is oil-export revenues denominated in U.S. dollars, weapondollar could be defined in simple words as revenues generated by military exports based on USDs. The United States has maintained the highest military expenditure in the world over the past seventy years [7,8]. *Military Keynesianism*, a concept derived from Keynesian economics, posits that sustained military spending stimulates aggregate demand and drives economic growth. *Military Keynesianism* simply means increasing military expenditures in order to improve the economic situation or to foster economic growth within the country.

Previous studies have shown that there is a close-positive correlation between the US military expenditure and the annual GDP growth, suggesting that military spending can promote economic growth for the United States [3]. One possible explanation is that the economic policies of tax cuts and deregulation from the Reagan administration during the 1970s made the influence of large U.S. corporations on civilian markets decline. To avoid the competition with foreign companies in civilian markets, plus the price of exported weapons is often much higher than that of similar weapons selling domestically, a large number of American companies shifted into the military market. Another contributing factor is the increased imports. The petrodollar system diverted worldwide USD liquidity into U.S. financial markets, which marginalized American manufacturing investments and intensified dependence on imported goods [9]. Thus, the United States needs armament manufacturing to stimulate its industrial and technological development.

The Middle East plays an important role in promoting weapondollar. From NATO countries to the mainland of the United States, the U.S. has delivered arms to 107 states, with the Middle East being the largest recipient of U.S. military exports. Between 2019 and 2023, 38% of U.S. arms exports were directed to Middle Eastern countries, accounting for 52% of the region's total military imports during this period [10].

In contrast, the total number of militaries imported from the United States in other countries located in Asia and Oceania only account for 31% of all US military exports from 2019 to 2023. This disparity can be explained by the ongoing instability and years of armed conflict in the Middle East, which have resulted in the region being the largest importer of U.S. arms.

5. Weapondollar-petrodollar Coalition

The weapondollar-petrodollar coalition refers to the alliance of major oil-producing nations that guarantees the preservation of the petrodollar system. In return for transacting oil in U.S. dollars, the United States offers military protection and assistance, along with investments in infrastructure and security. Analyzing the correlation between arms imports to the Middle East and oil export revenues from the region reveals a consistent pattern: a notable surge in arms imports precedes a dramatic spike in oil export revenue during an oil crisis triggered by armed conflict. This sequence points out a possibility that the increase in the number of weapons imports stimulates the outbreak of conflicts or wars and indirectly causes the outbreak of oil crises. Countries in the Middle East will have a rise in their oil-export revenues due to the oil crisis pushing up the price of energy [7]. Through the petrodollar recycling system, the US dollar accumulated in these countries will then be used in the further increase of weapon imports, which form a closed loop of weapondollar and petrodollar interaction and continuously promote the USD as a major currency.

Weapondollar also play a role in the petrodollar system. Evidence from Middle Eastern conflicts shows that the U.S. uses military forces to protect its interests in the global oil trade and ensure the petrodollar system. One example is the Iran-Iraq War (1979–1989), which can be seen as a key moment in consolidating the petrodollar system. The Shatt al-Arab River, which forms part of the border between Iran and Iraq, plays a critical role in regional economic and strategic positioning as an important oil export route. Whoever completely occupies the river has a chance to increase its influence on the global oil transaction. Meanwhile, Iran also sought to reduce its reliance on the U.S. dollar by seeking alternative currencies for trade, and in particular, it pushed for the use of gold and other currencies in oil transactions. Actions done by Iran had shown a possibility that the victory of Iran could have a chance to damage the oil interests of the U.S., especially the petrodollar system, and threaten Saudi Arabia who is an important ally for America in the Middle East [11]. American direct or indirect support to Iraq truly guards its petrodollar system. Similar dynamics can also be observed during the Gulf War and the Iraq War, where U.S. actions successfully prevented Arab countries from gaining control over the Middle East's oil trade, thereby ensuring the U.S. dollar remained the dominant currency in oil transactions in the region.

Wars in the Middle East are also pushing a higher demand for the US dollar. Because of the instability, there must be a decrease in oil exports, which results in an oil crisis or, at least, an increased price of crude oil. By putting times when there are sudden increases in the price of oil and times when large-scale armed conflicts and wars happened in the Middle East, a causal link between wars or conflicts in this area and the increased oil price can be found. Since most oil transactions in the Middle East are based on USDs, there will be a higher demand for US dollars and more U.S. Treasury Securities within the world economy. The three oil crises in the twentieth century, although having a profound impact on global inflation, also spread the US treasury to the world. From 1974 to 1990, the size of US treasury securities held by foreign official institutions increased from $52.3 billion to $285.9 billion, which is an increase of more than five times [12].

More and more petrodollars are being used to purchase US Treasury bonds, which may lead to a decrease in bond interest rates, which means a reduction in the outflow of the US dollar from the US economy. As long as other countries use US dollars in economic activities, like the petrodollar earned by oil-exporting countries in the Middle East, which is mostly deposited into American commercial banks or used to purchase American goods, including weapons, the supply of US dollars in the market increases, causing the US dollar to depreciate, which makes US dollars flow back into the US market. Thus, Middle East wars and armed conflicts could lead to a further consolidation in the position of the US dollar as a global reserve currency and a completion of the closed loop of the petrodollar system. The revenue of oil-exporting countries will also rise, lead to higher investment and consumption in the American market, and result in a larger-substantial flow of capital back into the United States.

6. Conclusion

The instability in the Middle East prevents the oil reserve from being monopolized by a single power and gives the US chances to continue its influence. This makes the oil-exporting countries in the

Middle East use US dollars in most of their oil transactions, which consolidates the US dollar as the dominating currency. Then, because of the instability, many of them buy arms from the US with the aim of security and because of distrust, which lets the US dollar back into the US economy, gives a sustainable source of funding to the US government for investment, and promotes government policies to promote economic growth and issue national debts. Subsequently, war or conflict erupted due to the accumulation of arms, resulting in the oil crisis, which heightened the demand for the US dollar to address the surge in oil prices, thereby supplying the US with substantial capital net inflows due to the depreciation of the dollar and the reduction of interest rates on US Treasury securities. Through the reflow of USD, the United States can resume oil purchases, initiating a new cycle. This paper is specifically focusing on two factors, the oil transaction and the international arms transfer, that play a significant role in the American economy and the world market. Other emerging and potential factors having possibilities to change the world energy market have not been given sufficient attention. With the rise of renewable energies led by the growing concern about climate change and the increase in the international influence of other countries, like China, the petrodollar system is facing new challenges as there is a trend of de-dollarization slowly growing. Further research about the effects of multipolarity as well as the new source of energy on the dominant position of the US economy is needed.

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