Introduction

Opec ‘will be a thorn in the eyes of those who deviate from the right path’. So said General Kassem, President of Iraq, speaking at interminable length to an educational conference in Baghdad the day after its foundation.¹

Opec has, over twenty-five years, achieved a reputation that embraces extremes of response. It has been commended, reviled, supported, opposed. It has been held responsible for the incipient destruction of the world economy and the international financial system and has been congratulated on releasing the Third World from the grip of economic colonialism. It has been variously envied and derided for the transfer to itself from the oil importing nations of hundreds of billions of dollars, and for having been, or not been, a successful cartel. It has created headlines in newspapers and headaches in boardrooms. All this, and much else besides, is a notable achievement of contrary and opposite image-making.

Opec was not created out of nothing one September day. It emerged out of the environment and the attitudes of those around it. Its creation was an expression of nationalism. Its inspiration came from two persons, Perez Alfonzo of Venezuela and Abdulla Tariki of Saudi Arabia. Like other organisations it may deserve some of what people claim for or against it, but will be innocent of other parts.

This book will try to disentangle dream from reality and determine what role was in fact played by Opec, what were its achievements and what it failed, or did not even try, to do.

While it is clear that Opec was not created without planning and design, it is true that there was, as there so often is, a clearly defined proximate cause of its birth. For Opec the equivalent to the murder of Archduke Franz Ferdinand at Sarajevo was the decision by Esso to reduce the posted price of Arabian light crude by 14 cents a barrel in August 1960.

By 1960 the oil industry had developed on a massive international scale. It provided opportunity, risk, profit, growth and competition in a manner unparalleled by any other industry. It had another characteristic.
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Table In. 1 Oil consumption and production, 1950–59 (m b/d)

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<th>1950</th>
<th>1955</th>
<th>1959</th>
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<tr>
<td><strong>Consumption</strong></td>
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<tr>
<td>US</td>
<td>6.5</td>
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<td>W. Europe</td>
<td>1.3</td>
<td>2.3</td>
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<tr>
<td>Japan</td>
<td>0.1</td>
<td>0.2</td>
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<tr>
<td>Non-Communist World (NCW)</td>
<td>9.9</td>
<td>14.1</td>
<td>17.4</td>
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<td>USSR</td>
<td>0.9</td>
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<tr>
<td><strong>Production</strong></td>
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<td>US</td>
<td>5.9</td>
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<tr>
<td>Venezuela</td>
<td>1.5</td>
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<td>Middle East</td>
<td>1.8</td>
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<td>USSR</td>
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Although almost entirely in the hands of private companies, oil as a commodity represented the primary, and often only, resource of the countries from which it was produced and an important, and often prime, energy input for the countries in which it was consumed. Private enterprise was sandwiched between strong governmental interests.

The 1950s had already transformed the scale of the industry and the stakes that were at risk. Three directly oil-related elements determined what had already developed and the attitudes of those who were involved in its unfolding—oil demand, oil supply, and oil price. Oil demand (that is, consumption) had grown greatly during the decade, and oil supply had without difficulty filled the demand.

The figures (Table In. 1) for supply and demand illustrate a number of key elements in the international balance for oil in 1959: (1) the US in the 1950s was the largest consumer of crude and the largest producer; (2) Venezuela was the single largest producer outside the US, which in turn provided the nearest and most natural market for its production; (3) the Middle East had already developed as the main alternative producing area to the Western Hemisphere and was already a strong competitor in international oil trade; (4) the USSR was developing its oil industry with vigour, both for its internal needs and for export.

Behind the supply/demand balance and the competitive opportunities this provided there lay the smouldering question of price. Price determined the level of company profit and the amount of state revenue. Control of price was a matter of legal contractual right for the companies, a matter of sovereign importance for the state. While the state had
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derogated the right to set oil prices to the companies under the terms of their concession agreements it became a matter of national security, and also of national pride, when prices were lowered rather than raised. The effect upon the national exchequer, particularly for states whose tax and foreign exchange revenue depended almost entirely upon oil, was direct and destabilising.

Three factors were relevant to the oil price. First, its absolute level, which determined the base from which the shares of the state and concession holder were calculated. It also determined, of course, the amount of foreign exchange required by importers to pay for their oil supply. Second, the applicable tax regime, which determined how the total revenue from oil exports would be shared between the state and the concession holder. Third, there was the crucial point about its low production cost and, therefore, its high margin of profit. Production costs in Venezuela were around 80 cents per barrel, in the Middle East only about 20 cents. The economic rent, high in Venezuela but higher in the Middle East (and in comparison with any other energy source almost unmeasurably high) was the basis for the competitive strength of oil in general and for Middle Eastern oil in particular. It was the existence of the high economic rent, translated into government tax revenue and company profit and offering such scope for competitive inroads into energy supply, that led to the enormous growth of oil consumption in the 1950s. It was also the basis of the tensions created between company and government, both in respect of the share of economic rent attributable to each, and of control over natural resources.

In the case of oil production, tax was levied on the basis either of the posted price of the crude or on the price actually realised by the sale of the crude. In theory, both posted price – the price at which the crude was officially and publicly offered – and the realisation price – the price actually received – were the same. In practice, however, this was not necessarily the case. If demand for crude was strong, it was possible that a premium might be offered by a buyer to obtain that crude; if demand was slack or if the potential supply of crude exceeded what was required, the seller might need to discount the official price in order to sell it, or to sell more than his competitor. It was the latter case that was relevant in the late 1950s. The competition to supply crude became greater as more was discovered and as more sellers sought the same buyers.

For those countries where the tax was based on posted price it was only the reduction of the posting, not a discounted price, that directly affected their tax revenue; for those countries where tax was based on realisations the greater the discount given the less tax revenue was received.

For the companies working under a posted price tax system there was a
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direct interest in ensuring as far as possible that the posted price reflected the realised price since any discount came exclusively out of the company profit margin; for companies working under a system of taxation based on realisations there was less interest in trying to maintain prices at high levels in the face of extreme competition. The large international companies, moreover, in most cases held oil production concessions both in Venezuela, which was the prime example of a country where taxation was based on realisations, and in the Middle East, where the general rule was that taxation was based on the posted price.

During and immediately after the Suez war of 1956 prices, both realised and postings, had increased because of uncertainties in supply continuity, but in the years following a relapse set in as supply, both new and traditional, competed for market outlet. Discounts from postings were not published but were generally known in the trade to be running at up to 40 cents/bbl in 1959/60, and this was the main reason for the reduction in posted price both in 1959 and, more dramatically, in August 1960.

The other important variation in the tax regime concerned royalty – whether it was expensed or credited against tax. This was to be the subject of the first main Opec negotiation with the companies, as the posted price question would be the trigger for the creation of Opec.

If the supply/demand balance, price and the relationship of price and taxation to revenues and profit were the most immediate tactical questions of the late 1950s (as they continued to be through the 1960s), another underlying, and strategically perhaps more tendentious, factor facing the oil industry was the concession system and the ownership of crude oil that it implied.

Concessions, negotiated as a contract between state and company, gave the concessionaire the right to explore for oil and, if discovered, develop and market it. In return the concessionaire paid the state for this right; in the early days a royalty and, later, a tax based on a 50/50 split of profit (however that calculation might be made in detail).

Partly because of the risk factor and the high capital cost of oil development, but more because of the political ramifications deriving from the pretensions of the US and European powers towards trade and empire and their need for security of oil supply, these concessions had grown up as joint ventures between what were at the time the few large companies involved in international oil investment and trade. They were commonly referred to as the Seven Sisters – five US companies (Esso, Mobil, Standard of California, Gulf and Texaco), one British (BP) and one Anglo-Dutch (Shell), to which was later added one French (CFP). These companies, in various combinations, held the concessions, or were
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at least the majority partners in them, in Iran, Iraq, Saudi Arabia and the rest of the Arabian Peninsula; they were also active in Venezuela.

Through the contractual right to the oil that was produced from the concessions the companies, in their various combinations, were able, to some extent at least, to ensure that oil supply, through production planning, more or less coincided with oil demand. The companies, as equity holders of the concessions, owned the oil and in practice determined its rate of depletion from year to year. The county, unsurprisingly, saw this ownership in terms of economic imperialism and increasingly, as each became more sophisticated in political outlook and development, found intolerable the relationship between its sovereignty and the limitations imposed by the concession system on its most important and valuable resource. The governments of the oil producing countries, in varying degree but in all cases with increasing fervour, viewed the system under which the companies operated as an outdated example of imperialist domination.

It has to be added that in many cases the companies and their operating personnel did little to discourage this view. They could be, and often were, arrogant, but their arrogance must be understood in the context both of the period and of two fundamental certainties – that a contract was sacrosanct, and that their operations under it were of genuine benefit to the country which had granted them the concession.

One of the major changes in the oil industry environment of the 1950s was, indeed, the breakdown of the primacy of the international consortia. It began with the introduction of ‘independents’ (so called to distinguish them from ‘majors’) into the Iranian Consortium in 1954, but gathered pace as independents grew, sought investment opportunities and were welcomed, on terms more attractive to them, by countries who looked for development by non-traditional oil companies either in areas not covered by old concession agreements or in areas that had been relinquished under the terms of those agreements. In the late 1950s a great new opportunity was opened up as Libya began to negotiate concession rights and chose as a matter of policy to conclude a majority of these with independents rather than with the majors.

These factors, then – price, revenue, sovereignty, supply/demand – were the main oil-related tensions, both political and commercial, that existed in 1959 and which formed the background to the creation of Opec in 1960. There were, however, other currents of influence, some political, some specific to one country, some personal. Putting these into the perspective of the whole scene is done most easily by a brief look at the background of each of Opec’s founder members: Venezuela, Saudi Arabia, Iraq, Iran, Kuwait.
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Venezuela had already by 1960 had long experience of the oil industry, oil companies and the political and commercial problems of exporting oil to the US, its main market. Venezuela began oil production in 1917 and by 1950 its production was 1.5m b/d; by 1956 it was 2.5m b/d. The market characteristic that determined Venezuelans oil policy was straightforward; Venezuela was defending a volume share of the market linked to a price that provided a revenue level to the state from a relatively high cost of production, around 80 cents/bbl; its main competitor, the Middle East, was expanding and competing for volume and revenue from a low production cost of around 20 cents/bbl. In this competitive environment the advantage was clearly with the Middle East, where high increasing volumes tended to imply higher overall revenue even if unit revenue was falling.

Perez Alfonzo was precisely the right person in these circumstances to become Minister of Mines in Venezuela. He had established himself long since as the leading intellectual of oil policy and had been minister back in 1945 when he was responsible for introducing 50/50 and for restraining expansion of oil production. During the 1950s and the dictatorship of Perez Jimenez he had been in effective exile from his country but returned with Romulo Betancourt in 1958 and, as an old colleague, friend and advisor, became a minister in the new government that was formed in early 1959. One of his first decisions was to attend the 1st Arab Petroleum Congress which was being held in Cairo in April of that year.

Perez Alfonzo applied a mixture of ideology and commerciality to oil policy. He believed strongly that oil, as a depleting resource, should be produced on the principle of long-term optimisation. He was by nature a conservationist. This ideological principle was consistent, in the case of Venezuela, with commercial reality. As a high-cost established producer his optimal objective was clearly to encourage other producers to maintain higher price with lower volume rather than unrestricted higher volume at lower price – in other words, to establish a cartel system for international oil. He did not refer to this in terms of a cartel but as production programming. For many years he had propagated this concept, but as a prophet unheard, during the Jimenez regime, in his own country. To be effective, however, it was in the Middle East that he needed to find an ally. He was lucky to find in Saudi Arabia a person who listened to him with enthusiasm and who was prepared to join him in his crusade.

Saudi Arabia was in complete contrast to Venezuela, an Islamic desert kingdom with a small population, no political traditions, a new oil producer with massive reserves, remote from its markets. There was one similarity, the oil companies who held the concession there: the Aramco consortium of Esso, Mobil, Texaco and Standard of California; a strong
US connection. Oil production started in Saudi Arabia in 1938, but developed only after the war; by 1950 its production was 0.5m b/d, and in 1956 1.0m b/d.

Aramco was the quintessential oil industry joint venture – US oriented, technological, motivated by economic calculation, paternalistic, tough. Superimposed, almost literally (down in the Eastern Province at Dhahran), on an environment that had little comprehension of the political and commercial intricacies of international oil the potential for manipulation and deception was almost infinite. If Aramco practised manipulation it was, in their own interest and in the tradition of the oil industry, strictly within the limits, or at least their interpretation of the limits, of their contractual obligations to Saudi Arabia. To do anything else was to act against their own long-term interest which in the case of Saudi Arabia was, in expectation, the longest term imaginable.

Abdulla Tariki², the friend and admirer of Perez Alfonzo, was an improbable character as a Saudi Arabian and even less imaginable as the responsible person for oil affairs in that country. He became General Director of Oil and Mining Affairs in 1955, having returned to Saudi Arabia from US in 1948 as the only Saudi with university training in both geology and chemistry. During the 1950s he represented Saudi Arabia at meetings of the Arab League Oil Experts and, in the heady atmosphere of Cairo and the corridors of the Arab League, developed his inclinations as a strong Nasserist and Arab Nationalist, a combination highly unsuited to a public figure in Riyadh. In June of 1958 he was being quoted in the New York Times: 'we will soon have a constitution; this country will shortly become a constitutional monarchy'. What is surprising, perhaps, is that Tariki kept his post. It is less surprising, however, given the tortuous progress of Saudi politics in those years under King Saud.

King Saud had reacted strongly against the Baghdad Pact, signed in 1955, as a threat to his position in the Arab world. He feared that the influence and power of Iraq would grow and that, if Jordan and Syria were persuaded to join, the Northern Tier bloc would devalue his own position and influence. He signed a mutual defence treaty with Egypt in 1958, supported Nasser in the nationalisation of the Suez canal and carried out a series of anti-British and anti-US measures. By 1957 he was having second thoughts and during that year renewed his links with the US and exchanged visits with King Faisal of Iraq. Egypt, meanwhile, was developing what turned out, in February 1958, to be the union of Egypt with Syria as the United Arab Republic. Iraq and Jordan retaliated by forming the United Arab Kingdom. Both asked King Saud to join but, prudently and in Saudi fashion, he made no commitment to either. Far less prudently, he was caught out financing a plot to overthrow the Syrian regime and to
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assassinate Nasser. Faisal, the Saudi Prime Minister and Crown Prince, at this juncture retaliated by instigating a family crisis and resigning, fed up with Saud’s loss of financial and political control. He then returned, on his own conditions, as effective ruler, although there was to be a see-saw of power switching between himself and Saud until finally, on November 3 1964, Saud formally abdicated.

Tariki was clever enough to obtain support both from Saud and Faisal, even though Saud and, as it later turned out, Faisal were ideologically at odds with all he stood for. He was promoted to minister by Saud in December 1960. His fall finally came in March 1962. He was rash enough to accuse Faisal in Council of malpractice concerning an oil sales contract, so that when Faisal was again in power he sacked Tariki from his position and exiled him from Saudi Arabia.

The combination of Tariki’s nationalist ideals and his conversion to Venezuelan-style conservation policies combined to give Saudi Arabia an initiating role in 1959/60 that was not to be expected from a country that was cautious and conservative by nature. Its conservatism had been shaken up by the internal bickering to which it was provoked by Saud as well as by the rifts created in Arab politics by the rivalry of Egypt, Iraq and Syria. In this Tariki was probably lucky; if there had not been these challenges to Saudi society that kept the leadership preoccupied with its own future and security it is to be supposed that Aramco might have succeeded in getting Tariki removed. For he was a thorn in their side, not only as Director of Oil Affairs and, subsequently, Minister, but also as a Director of the Aramco Board to which he had engineered his appointment in 1958.

Iraq stood in as great contrast to both Saudi Arabia and Venezuela as those countries to each other. In July 1958 the Iraqi revolution took place. General Abdul Karim Kassem brutally deposed King Faisal, disposed of his Prime Minister, Nuri el Said, and created an environment of revolutionary nationalist fervour that was to inaugurate years of internal power play.

Up to this time Iraq had, under the British mandate and then as an independent kingdom, been Western-oriented. It had recently, in 1956, been a prime mover in setting up the Baghdad Pact. Its oil regime was as traditional as any in the area, the concession having been granted to Iraq Petroleum Company in 1914 and then, after the First World War and protracted international negotiations, transferred to an expanded IPC in 1928. This consortium consisted of five of the ‘sisters’ – BP, Shell, Esso, Mobil, CFP – with 5% held by the ubiquitous Armenian entrepreneur, Gulbenkian. Production began in 1928, by 1950 had reached 0.15m b/d and by 1956 0.65m b/d.
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The Kassem revolution began with friendship and cooperation with Nasser but this quickly degenerated into hostility as Kassem was compelled to protect himself against the attractions of Nasserist nationalism. By April 1959 Iraq was refusing to attend the 1st Arab Petroleum Congress in Cairo.

His relations with IPC were from the start bellicose. IPC was perceived by the Iraqi revolution as a long-established symbol of imperialism and as such had to be transformed into something more consistent with the new social order. Kassem’s technique was, as he was, revolutionary. In mid-1959 he lodged demands for a higher profit share, for state participation in the concessions and for relinquishment of acreage. This began a long and bitter series of negotiations which ended in nationalisation of the IPC Northern concession in June 1972.

Iran provided another set of contrasts as between the future Opec members. Iran was a constitutional monarchy with an autocratic monarch. The Shah, reinstated with full powers in 1953 after the Mossadeq interregnum, was in the late 1950s feeling his way into the developments that he intended would reestablish his country as a respected regional power.

The financial and economic basis for Iran’s resurgence was the agreement reached in 1954 with the Consortium to take over oil production in the areas that had been nationalised in 1951 under Mossadeq. The nationalisation had failed in its attempt to free Iran from foreign concessionaires through the ability of the international oil industry to isolate Iranian oil as illegal – to ‘black’ it in later terminology – and to replace it with crude from other producing countries. Oil production had started in Iran in 1913, reached 0.65m b/d by 1950 but in the years 1952–54 had fallen to a nearly non-existent trickle.

The failure of the Iranian attempt at nationalisation carried a potent lesson for other oil producing countries, a bogey that was not laid until the Libyan revolutionary government began in 1970, in very different supply and demand circumstances, to demonstrate that the oil industry could successfully be challenged.

The Consortium took over what had been a BP concession. It was made up of most of the large integrated international companies together with a group of US independents. It represented what was acceptable, in political and commercial terms, to the governments of Iran, UK, US and the companies themselves. Its immediate job was to get Iranian oil back into the markets. A specific production level – 300 000 b/d for 1955 rising to 600 000 b/d in 1957 – was written into the agreement.3 The implication was that other countries’ production must make way for Iranian oil. The Saudis accepted this need and it was arranged, through the various joint
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venture agreements, that other Gulf crude production was restrained. The rivalry for volume, an advantageous share of annual incremental demand, may have been inevitable but it was guaranteed by the nature of these 1954 agreements that underlined the desire for and interest in both market share and absolute volume.

Iran’s relations with Iraq had always, and would always be, strained. The most immediate cause of trouble was the border demarcation of the Shatt el Arab. The Iraqi revolution of 1958 was likely to provoke renewed recrimination in this matter as well as cause general concern to Iran, and in late 1959 Kassem announced the revocation of the 1947 agreement under which Iran had received certain rights beyond those of the previous 1914 agreement. The Shah reacted strongly but this quarrel was superseded by one with Nasser who, with his relations with Iraq already strained, broke relations with the Shah over oil supply by Iran to Israel. Iran found itself in a rather unnatural sympathy with Iraq over Egyptian expansionist pretensions that each opposed and feared for different reasons.

Kuwait, the fifth future Opec founder, was, compared to the other four, free of these varying but extreme characteristics. In the 1950s Kuwait was still linked, under the 1899 Treaty, with Britain who looked after its foreign affairs; full independence came in 1961. Oil production was in the hands of a joint venture between BP and Gulf and at this stage Kuwait was the largest producer in the Gulf. Production had started in 1946 and by 1956 had reached 1.1m b/d. Its revenues, enormous for a country and population of its size, had provided an infrastructure of public services and education and a per capita GNP far in excess of most of its neighbours. This success was viewed enviously by some and tended to exacerbate relations, never equable, between itself and Iraq. Kuwait, however, as a potential member of Opec was relatively uncomplicated and straightforward although with only marginal political influence to bear upon its heavyweight colleagues.

Thus, the five countries who were to form Opec had little in common except oil resources, a concession system under which oil was developed and marketed, and a dependency upon oil revenues for their economy. They were driven towards the unlikely outcome of a joint organisation by the circumstances of international oil supply and demand in the period following the Suez War of 1956 and by the strengthening of nationalist political sentiment. The main element of compulsion, however, that led them to Opec in 1960 was the supply/demand/price balance. The figures for increased production by the leading producers and increased consumption are shown in Table In. 2.

In brief, what was happening was that US consumption was at the