OPEC: A SUSTAINED CARTEL?

THESIS

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By

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The problem with which this paper is concerned is that of examining some ideas and predictions of some American economists about the survival of the Organization of Petroleum Exporting Countries (OPEC).

This paper is divided into three parts; the first part includes the introduction, examines the importance of oil, and analyzes the history of the oil industry. This part is composed of Chapters I and II.

Part two examines OPEC's formation and objectives and the cartel theory with concentration on OPEC. This part is composed of Chapters III and IV.

Part three analyzes some economists' ideas regarding OPEC survival. It examines the economic and political realities of OPEC during the last two decades and discusses its present problems. This paper concludes that OPEC is a strong and sustained cartel.
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PART ONE

BACKGROUND AND IMPLICATIONS

"Oil . . . the Medium of Miracles."

(American Advertisement)
CHAPTER I

INTRODUCTION

There is not the least doubt that the Organization of Petroleum Exporting Countries (OPEC) is important. The critical importance of the oil industry within the economic and political situation in exporting countries as well as in importing countries, combined with OPEC's control over more than two-thirds of the world's most accessible petroleum reserves, make OPEC one of the most important organizations in the modern world. It has probably influenced the functioning economies of more countries worldwide than any other international organization. Because of its widely-felt influence, OPEC has become a controversial subject of economic, political, and industrial analysis.

Although OPEC has proven to be a strong and effective cartel, some of its analysts have always felt that it would fail. An aspect of the world oil market has led some scholars like Friedman and Adelman to predict that economic conditions will be responsible for the eventual collapse of this organization. This seems a safe expectation when seen in light of the cartel theory. This theory proposes that any cartel will break down when the economic
basis upon which it is built is weakened or broken. This has already been the case for cartels in other industries, but the OPEC cartel in the oil industry has so far proven to be an exceptional case. It is supported not only by economic conditions but also by political factors. Those scholars who see the imminent collapse of the oil cartel, fail to see the role of the Organization of Arab Petroleum Countries in OPEC. They fail to see the political pressure that most of the people of OPEC make on their governments to keep their organization alive and healthy.

The insistence that OPEC is an economic organization in which economic forces are the sole determinants of its future success will be examined in this thesis. Political factors that give life to OPEC and make it a sustained cartel will be examined also.

This paper will study the history of the oil industry before OPEC, the historical background and evolution of OPEC, the cartel theory, the economic interest of OPEC's members, their political interest, the organization's position in the last two decades, and its expected future in the 1980's.

Because of the present problems facing the Organization (price war, production war, etc.) which may determine its future, this thesis cannot be considered complete
without an examination of current news. A careful monitoring of media coverage on informal meetings and dialogues of oil industry personalities (inside and outside OPEC) is especially important in our final analysis and conclusions.

This thesis will use only the most simple economic concepts accessible to people without a specialized background in economic theory. Part One is an introductory section outlining the history of the oil industry before OPEC. In it we will examine the importance of oil as a commodity and see the main highlights of the industry evolution. Part Two will examine the oil industry with the coming of the Organization of Petroleum Exporting Countries (OPEC). This leads us to look at the evolutionary process of OPEC, its formation, aims, objectives, etc. This part contains a revision of the cartel theory and how it works with concentration on OPEC. Part Three includes chapters concerning the main subject of this thesis: economic factors affecting OPEC, the wishful thinking of the West regarding the survival of OPEC, and the economic and political realities of OPEC. The last part will show the current problems facing OPEC, what we expect to see at present and in the future. Our remarks and final analysis conclude this part.
A Look at Oil

All inventions, products, and creative activities have their own stories. The oil story is one of the most significant and controversial in recent history. Certainly if the computer can be seen by *Time Magazine* as the Man of the Year for 1983, oil can be personified as the Man of the Twentieth Century. It has affected our lives in all economic, social, political, cultural, and educational aspects.

Relations between countries are as critical as those between various states of the same country. In the modern world, no industry is more far-reaching in its international complications than is oil. A study by the United States Senate Committee on Energy and Natural Resources made the statement that without oil no modern economy could exist. This Committee's study concluded that at its most fundamental level the energy problem was a problem of oil. This observation was based on the fact that oil has become not only the most important source of energy throughout the world but that it has also become an indispensable raw material for a large number of products in the modern economy. Oil has become so central a feature of our modern existence that scarcely any modern human
endeavor in science, technology, or international relations can fail to take it into account.

The nature of oil has been known for centuries. It was known to earlier civilization as bitrumen, asphalt, or naphta, for the term "petroleum" (petra oleum, or rock oil) did not come into use until about one thousand years ago. Because life was simple and the needs of primitive man were few, his uses for the substance were those associated with mystery. With oil he "healed the living body and embalmed the dead, fed the black art and gave luster to devotional ritual, enlivened feasts, caulked ships, cemented buildings and highways, and helped welfare."\(^2\)

In the modern world, oil is the most important commodity in international trade, accounting for half the tonnage traded in commodities in international markets. In both volume and monetary value it far outstrips any other internationally traded commodity. In our daily lives oil provides light and heat. It can be used--directly or indirectly--to meet most energy needs, to fertilize crops, to make clothing, and to provide food.\(^3\) To appreciate the importance of oil, one only needs to look at the wide variety of goods for which it is the raw material: textiles, medicines, plant foods, and precision instruments. The list is staggering.
Oil is a unique commodity in this world, not only because of the variety of its usage but also for the unique characteristics it has.

The Importance of Oil

An obvious question is why oil has assumed such a critical value and importance. Why is it different from other products? Why has so much attention been given to it? An oversimplified answer is that over the decades, and especially in this century, oil has been found to have superior qualities over other forms of energy. Not only oil's physical, but its technical features, make it unique among the commodities, and make it the much-sought substance it has become. Some of these major features are summarized below.

The bulk and expense of storage is important for many products, especially those with a limited lifetime. The length of time that oil is stored has little influence—if any—on the life of the product; its marketability is not adversely affected. It can wait under the ground indefinitely for either a profitable market or an appropriate means of transportation. Moreover, once an oil well has been drilled, its production level can be altered to meet market needs by a series of either valves or pumps.
However, once oil has been taken from the ground, its storage is not free. Because oil is both liquid and flammable, it can only be safely stored in steel containers which (depending on the relative costs of steel and oil) have been known to cost as much as the commodity they hold.

From the ease of curtailing production point of view, "Oil production requires small cadres of technicians and managers."5

Regarding absence of substitutes in one or two sets of essential uses, it has proven quite difficult, if not impossible, to find adequate substitutes for oil in many vital areas. Certainly coal and natural gas have been successfully used for heating and electricity (ten per cent of the world's energy) as have, to a lesser degree, hydro-power and atomic energy (one per cent). However, for the world's automobiles, buses, trucks, airplanes, and ships, there are no real substitutes for oil. The same is true for oil used as a lubricant and as a raw material for the chemical industry.6

There is a great variety of usage. Oil's usage is not limited only to a few industries. Moreover, in some industries, the auto industry being the best-known example, oil is essential and has no substitute.

There is recycling problem. Oil is an exhaustible
resource. Unlike many mineral resources—gold, silver, copper, and the like—oil cannot be recovered for salvage use. In fact, once oil is used, it becomes a liability, for used oil becomes air pollution.

Oil has been discovered in most continents, and no special environment has been found as likely to produce it. Yet it is an irony of the modern world that oil is found in much smaller quantities in the highly-developed countries that need it most. By far the greatest quantity of the world's oil—and all of it that can be produced for under fifty cents a barrel—is found in Third World countries.

Another consideration that can influence policy in OPEC is that a majority of its members are from the Middle Eastern, Islamic countries. This feature is important in light of the strong religious feelings affecting the social value system governing national policies. It will be seen that this plays a significant factor in determining the economic aspects and behavior of those countries.

After we have discussed the importance of oil and its unique characteristics, let us trace the main highlights in the history of the oil industry. This may be necessary to understand the current problems in the oil market and the position of OPEC and how it deals with these problems.
ENDNOTES

1Abbas Al-Nasrawi, Arab Oil and United States Energy Requirements, (The Association of Arab-American University Graduates, Inc., 1982), p. 3.


3Ibid., p. 32.


5Ibid., p. 71.

6Ibid., p. 72.

7Ibid.
CHAPTER II

THE OIL INDUSTRY: EVOLUTION HIGHLIGHTS

The oil industry is like any other important industry. It not only affects but is affected by the society around it. The desire on the part of man to get all the benefits he can from the world in which he lives has fostered modern technological advancement which in turn has fostered this huge and prosperous demand for oil.

Yet the oil industry in its industrial form is not a new one. It first emerged as a viable force in the marketplace in the late 1880's. By this time the development of advanced drills and rigs had made possible oil production in quantity. Raymond Vernon explains that:

The exploration, production, refining, and distribution of oil encourage important economies of scale, partially due to the physical characteristics of the facilities, their indivisible capital, and their high fixed costs, but also as a result of insurance principle. Many aspects of this principle occur in the oil industry.¹

These natural economies of scale made it inevitable that early in its history the petroleum industry experienced the evolution that would result in the commodity being controlled worldwide by a handful of companies.² With these companies providing an early example of
industry dominance, it is hardly surprising that once oil-producing countries began achieving their independence, they were eager to attempt total market control.

By the end of the nineteenth century, the industry had become highly developed, and the U.S. and U.S.S.R. took the lead as major producers. Nevertheless, the recognition of oil's importance in the new developing industries led to an accelerated competition for its discovery. By the 1870's the supply of oil in the United States had risen to the point that two-thirds of American oil was shipped overseas. Once the oil industry started to structure itself, the Standard Oil Trust emerged. The entity not only attained almost absolute market control in the United States, but was able to extend its influence worldwide.3

The twentieth century started its first decades with the First World War (1914-1918). The need for gas was strong for military usage and for other fields of industry. The war accelerated those needs, giving the final push for the rapid development of the industry.

Strong competition between oil companies became clear, leading some of these companies to look outside their homelands for sources of oil. The major companies began, in the 1920's, a push to control the Middle East. Elsewhere both British and American oil companies
competed for the right to drill in less-developed countries. "By 1928 Venezuela was the second largest oil-producing country in the world."\textsuperscript{4}

Already the industry was heading toward oligopoly. "By the late 1930's world oil production was successfully controlled by the seven majors."\textsuperscript{5} These companies dominated all aspects of the oil industry, making the entry of small firms difficult. The majors could see that vast sources of crude would be readily available in Saudi Arabia and Kuwait.

New oil discoveries continued and encouraged oil companies to improve the industry in general. While the world was preparing itself for a second war, the oil companies were active in making discoveries which provided increased profits. In 1938 the world witnessed World War Two, which has often been cited as the turning point in the changing structure of the oil industry. "The war itself caused some assets to be destroyed, but these were renewed rather quickly. In fact, in the Middle East, refining capacity increased during the war years due to Aramco's Ras Tanura refinery."\textsuperscript{6}

The war showed the importance of oil not only for military usage but also for sub-related industries. By the end of the war the industry was not only thriving, but was
undergoing dramatic changes. New exploration of hitherto untouched areas—the continental shelf areas, for example—were made possible by improved techniques. Both demand for and production of petroleum soared. Not only the statesmen, but citizens in general began, in the under-developed countries, to evince an interest in the problems and profits of the oil industry. These developments occurred simultaneously in the Eastern and Western hemispheres.  

The end of the war witnessed also the start of new independent nations eager to exploit their resources. They started to recognize the value and importance that their hidden treasures had for helping to build their new economies. In trying to free themselves from foreign "exploitation" and to formulate their new economic and political identities, many new independent countries found themselves trying to enter the oil industry. The postwar era witnessed the emergence of several independent countries, thus constituting the beginning of the "decolonization" process. Naturally these new countries were eager to develop their own economies and to become industrialized. As a result, they often opened their doors to the large international oil companies, welcoming the foreign capital investment to develop their potential oil industry.  

The post-World War Two period has been termed "ten
golden years." By this time most of the Third World countries were either under direct colonization or were newly independent. Lack of expertise in the industry as well as other problems of providing capital and stability made these countries relatively uncritical of the policies practiced by the large oil companies. These companies, free to develop as they chose, reaped enormous profits, for oil consumption was rising dramatically. "Between 1948 and 1972, consumption of petroleum in foreign countries increased elevenfold, as it rose from 2.4 billion bbL/day to 26.2 million bbL/day." Before we approach the fifties, the decade of several calls to formulate the OPEC, let us have a look at one important aspect of the relationship between the majors and the producing countries, the contracts, negotiations, and concession agreements.

The concession agreements conducted between the majors and the host countries, mostly concluded in the inter-war period, formed a close system whose salient features captured the throat of the host countries. The concession areas generally covered a whole country. The duration of the agreements was very long, stretching up to and beyond the end of the century. The determination of f.o.b. prices for crude oil was the responsibility of the majors. Even production and export levels were determined by them.
Payments to governments in the form of royalties or taxes were set at given rates for the entire duration of the agreement and could not be altered without the consent of the concessionaries. Furthermore, disputes could be settled only by means of international arbitration and not the national courts of the host countries. ¹¹

Before OPEC came to the scene and just a few years before its foundation, the world oil industry was still dominated by the major international oil companies. Ian Seymour, the auditor of the Middle East Economic Survey and a popular reporter of petroleum and energy affairs, explains that:

By the mid-fifties the majors were in control of over 90% of production, refining and marketing facilities in the non-communist world outside the United States. They owned a smaller portion of the tanker fleet, but overall control through the ownership and time charters also amounted to over 85%.¹²

By the mid-fifties, the scene in the international community relations was prepared for new understanding for better relations in the international trade. New proposals started to come from various locations of the world calling for change. Some economists, notably those associated with the United Nations, believed that there is a persistent long-run tendency for the terms of trade of the developing countries to deteriorate.
Professor Raoul Prebish has laid great emphasis on deteriorating terms of trade as a factor inhibiting the development of developing countries. He noticed that the developing countries were badly hurt by the deterioration of their terms of trade in the 1950's. Using the United Nations' figures about the relative prices of exports and imports of under-developed countries from 1876 to 1948 to support this argument, he recognized that technical progress seemed to have been greater in industry than in the primary production of developing countries. Prebish concluded that we need cartels for the survival of international relations. Cartelization of developing countries' industries can minimize the effects of any future deterioration.

The value and importance of oil was recognized by the developing countries as the world advanced technologically and became energy intensive. The massive expansion and increased competition in the crude and product markets, compounded by the availability of many new crude sources, caused the control held by the majors to diminish. The late fifties were the turning point for a new formula of international economic relations. The oil market was prepared for a radical change to take place.

The change will undoubtedly affect the world economy. Before we follow the oil industry with the formation of
OPEC, let us have a look at the cartel theory. It is necessary to understand the cartel theory and its implications in the oil industry because of the so-much-said about OPEC as a cartel. This is covered in the next chapter.
ENDNOTES

1Raymond Vernon, Sovereignty at Bay: The Multi-
national Spread of U.S. Enterprises, (Banc Books, New York,

2Ibid., p. 32.

3Dankert A. Rustow and John F. Mugno, OPEC Success
p. 77.

4N. H. Jacoby, Multinational Oil, (Macmillan Publish-

5The seven majors are: Exxon, Shell, Texaco, British Petroleum, Standard Oil of California, Mobil, and Gulf.

6Jacoby, op. cit., p. 52.

7Fuad Rohani, A History of OPEC (Praeger Publishers,

8Jacoby, op. cit., p. 52.

9Ibid.

10Vernon, op. cit., p. 36.

11Ian Seymour, OPEC: Instrument of Change, (St.

12Helmut J. Frank, Crude Oil Prices in the Middle East,

13Benjamin Higgins, Economic Development: Principles,
Problems and Policies, (W. W. Norton and Company, Inc.,
PART TWO

THE OIL INDUSTRY WITH OPEC

"I think a good number of you think that this is the end of OPEC. I don't think so. Everybody needs OPEC including the consumers."

(Sheikh Yamani to the Press in the 67th OPEC Conference)
CHAPTER III

CARTELS AND CARTELIZATION

The premise of OPEC as a sustained cartel cannot be clearly understood without fully knowing the economic meaning of the term cartel. Dr. Heinz Schmidt defines the cartel as "a combination of fundamentally independent firms" which, on the basis of an agreement, influence the market "for the goods or services which they supply or which they consume."\(^1\) Another definition of cartel, very similar to the first, is that a cartel is "a voluntary association of business policies by the members, and enforceable in the courts."\(^2\) A third definition, taken from the Encyclopedia of Social Sciences, maintains that cartels are "associations based upon contractual agreement between enterprises . . . which, while retaining their legal independence, associate themselves with a view to exerting a monopolistic influence in the market."\(^3\)

Robert Liefmann observes that the term cartel was virtually unknown to the American language two generations ago. Like most borrowed words, when it was first absorbed into the language it meant different things to different persons. Time was required to crystallize its meaning.

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In this country it has come to refer to any international marketing arrangement.  

Thus, the essential characteristics of a cartel are that within it independent concerns get together on the basis of an agreement. The purpose of the combination or association is to interfere with price formation as the cartel operates under free or full competition in a market economy and to change the price in order to keep or increase profits. The profit incentive is central to the undertaking. A point worth mentioning here is that the profit motive is denied by most members of OPEC. Instead they claim to be motivated by "the right to have a just price." Just price seems to mean having an equal or "good" value for a commodity that is a diminishing resource. 

But what about the combination process itself? What are its aspects and how does it work? In general, with cartels it seems that the combination process is voluntary. Within the cartel the individual firm retains its legal independence and economic freedom to the degree that this position cannot later be restricted by the cartel agreement. Cartel agreements are usually arranged for lengthy periods of time, but this is not essential to the definition. It seems that membership is decided "not on the branch or storage of production but upon the goods and
services dealt in. The view is also still widely held that the cartel dominates the market. This is clearly not the case everywhere. Differentiation between a monopolistic and a nonmonopolistic domination of the market does not meet the case either."

The fact that behind the influencing of the market is usually the will to dominate, indeed, even to achieve complete monopoly, must not cause us to define the term cartel too narrowly. The term "influencing the market" may also include the domination of it. For the member-firm, the cartel is merely a means for reaching its economic goal. The member therefore reserves the right to leave the cartel when this means no longer seems suitable or profitable. This situation is unlikely, however, since leaving the cartel would result in a member's market share being negatively affected. The cartel protects its "weak" members as well as its "strong" ones. Strong members are those who are leading where, in most cases, the others will follow.

In short, a successful cartel creates a monopoly or near monopoly that exploits the market with prices higher than those the product would obtain in a competitive market. Such cartels flourished during the 1920's and 1930's in chemicals, explosives, matches, glass, steel, pharmaceuticals, and aluminum, as well as in many raw materials.
One study done by the U.S. Department of Justice revealed that in 1934 international cartels numbered 179. Of these 179 cartels, 109 produced manufactured and semi-manufactured products, thirty-two covered minerals, eight controlled agricultural products, and the remaining were in services. 6

To achieve a successful international exporting cartel like OPEC, several criteria are fundamental. The commodity dealt in must be scarce in nature. The producers must have the advantage in dealing in the commodity. The producers (countries) try to dominate the world market by controlling the exports of member-producers located in many different parts of the world. 7

The unique characteristics of the oil industry, as well as its vital importance in the world economy, all helped in making OPEC a "successful" cartel with price solidarity as the base for its cohesion. So, if OPEC is really a successful and sustained cartel, then how does it get there and what is its future? The answers for these and other questions about OPEC will follow the discussion on its formation and objectives.
ENDNOTES

1 Heinz Schmidt, Cartels and Trusts, (The International Union of Food and Drink Workers' Associations, Copenhagen, Denmark, 1931), p. 24.


CHAPTER IV

THE FORMATION, ORIGINS, AND OBJECTIVES OF OPEC

It is logical to assume that the formation of the Organization of Petroleum Exporting Countries did not happen in a vacuum. Its creation was not accidental or without planning. The first decades following the end of the Second World War witnessed the formation of many organizations either on regional or international levels. Some of these were the United Nations, the Arab League, the Non-Alignment Movement, NATO (North Atlantic Treaty Organization), OECO (Organization for Economic Cooperation and Development), OAS (Organization of American States), OEEC (Organization for European Economic Cooperation), etc. In the oil industry two organizations have special importance: the Organization of Arab Petroleum Exporting Countries (OAPEC) and the Organization of Petroleum Exporting Countries (OPEC). We will cover OAPEC in later chapters of this thesis. For OPEC, let us trace with Albert Danielsen the process of its formation, evolution, and implications.

The formation of OPEC in 1960 should be regarded in terms of an evolutionary process. It was a natural, although not inevitable, development based on the distribution
of world petroleum reserves. As leaders in the host countries became aware of the potential value of their resources, they began to devise institutions that would afford them a greater share of revenue to be derived from producing oil. The process of building these institutions involved the interaction of corporate and government officials from many consuming and producing countries.

Faced with a persistent oversupply at prevailing prices, the majors unilaterally reduced posted prices again in August 1960. This led directly to the first organizational meeting of OPEC. During September 9-14, 1960, representatives from the leading export countries--Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela--met in Baghdad and founded OPEC. The immediate purpose of the meeting was to restore the posted prices and to ensure that prices would not be reduced further. To accomplish these ends, the founding members agreed to stand united against the companies should the latter try to switch production from one country to another or to offer higher prices to a particular country in order to produce disunity.¹

OPEC's founding members--five of the principal oil-exporting countries that attended the Baghdad conference--include Saudi Arabia, Iran, Kuwait, Iraq, and Venezuela. Eight other countries have since been admitted as full
members, bringing the total membership to thirteen (see Table I). The founding members have veto power over the admission of new members, but otherwise all full members have equal rights within the organization. Any country which is a "substantial net exporter" and has whole petroleum interests which are "fundamentally similar" to those countries is eligible to join.

From Table I we can follow the evolution of OPEC with respect to membership by noticing the date of admission for each new member who has joined the organization.

Despite its political influence, OPEC is essentially an economic organization. It does not constitute a political community. OPEC makes "recommendations" on oil policy to its members, but its functional role is that of facilitating communication, coordination, and information gathering.

OPEC did not emerge as the result of revolution; rather, it emerged as a result of economic necessity as a loose confederation of independent nations. Within this confederation, the power of individual members is mainly dependent on the magnitude of their reserves and their level of production.

Algeria, Nigeria, Libya, and the U.A.E. are relatively recent entrants in the oil industry, but they have become
<table>
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<th>Type and Year</th>
<th>Reserves (billion bbls)</th>
<th>Population (millions)</th>
<th>Land Area (thousands of square miles)</th>
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<td><strong>FOUNDING MEMBERS</strong></td>
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<td>165.0</td>
<td>8.1</td>
<td>873</td>
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<td>Iran (1960)</td>
<td>67.5</td>
<td>36.9</td>
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<td>Kuwait* (1960)</td>
<td>64.9</td>
<td>3.0</td>
<td>8</td>
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<td>Iraq* (1960)</td>
<td>30.0</td>
<td>12.8</td>
<td>172</td>
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<td>Venezuela (1960)</td>
<td>17.8</td>
<td>12.7</td>
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<td><strong>FULL MEMBERS</strong></td>
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<td>23.0</td>
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<td>9.5</td>
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<td>16.7</td>
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<td>0.6</td>
<td>103</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td>438.5</td>
<td>329.5</td>
<td>5,057</td>
</tr>
</tbody>
</table>

*Arab country.

¹Date of admission shown in parentheses.

²United Arab Emirates includes Abu Dhabi, Dubai, Sharjah, Ras Al-Khaimah, and Umm Al Qaywayn. The largest of the Emirates, Abu Dhabi, joined in 1967.

important forces. Libya is particularly remarkable. Having struck oil in 1961, it had become the fourth-largest producer in OPEC by 1970. Libya played an important role in restricting output and raising prices in 1970 and 1973. Qatar is a relatively small producer which has been active since 1949. Ecuador began producing in 1918, but its production remains comparable to that of Gabon, which began producing in 1957.

The economic objectives of OPEC are clear, but it would be naive to say OPEC has no political objectives. While it is difficult to draw the line between economic and political objectives, it is clear that these objectives are not contradictory. OPEC members are not of the same political identity. Neither are they of the same political interests. Yet there is among members a certain common denominator of international politics within the framework of the principles of the United Nations Charter. Obviously there will be differing opinions regarding particular political questions. Such a difference of opinion manifested itself in connection with the Arab-Israeli conflict.

OPEC represented the first international cartel to include under its wings nations rather than companies. These nations were from the undeveloped Third World.
Consumers, especially those of the West, who were affected directly by the change in prices, reacted with outrage and anger. The major oil companies saw the new organization as a threat to their privileged position. They set about trying to undermine it by ignoring it and by causing dissatisfaction among member nations.

The governments of the countries to which the major oil companies belonged looked with distrust on OPEC's attempts to upset established order. They adopted a reserved, and in some cases a tacitly hostile, attitude toward it. The leaders of the energy policies of certain consuming countries discussed ways of creating a mechanism to protect the interests of consumers. The world petroleum press, generally reflecting the attitude of the major oil companies, expressed open opposition or withheld comment with a reticence in which their strong animosity was but thinly veiled.

Critics observed that OPEC was a collection of heterogeneous nations, some of which had interests that were radically opposed to those of certain fellow-members. They alleged, by way of example, that an unbridgeable gap separated the interests of Iran from those of the Arab nations. Only hidden designs, they maintained, could have enticed Venezuela to form an association with a cartel that
included Middle Eastern countries and Indonesia. These critics agreed that OPEC was doomed to dissolve rapidly, or at least to fade away gradually.\textsuperscript{2} They expected the end of OPEC with any major and serious economic crisis. They predicted the collapse of the Organization because of a weakness in its economic build-up. We will examine those economic factors affecting OPEC and then discuss those predictions.
ENDNOTES


PART THREE

OPEC: THE QUESTIONABLE CARTEL
Undoubtedly, there are economic factors that affect the well-being of any cartel in a negative as well as in a positive manner. OPEC is no exception. Some of the factors that can weaken OPEC are summarized below.

Less or weak demand: This can be the result of high pricing which leads to lower consumption. This is clear from the oil market experience in 1981 where high oil prices led to a great shift in consumption. In the non-communist world (omitting the OPEC countries where oil is too prevalent to be bought and sold as a normal commodity), oil consumption for the first half of 1981 was like that of the early 1970's. Nothing like this had ever happened before.

According to the principles of microeconomics, demand elasticity is not a constant, but rather depends on price. The higher the price of any product, the greater the reward of substituting something for it. Thus, in the 1981 price increase everyone began a more conservative policy of consuming oil and a more aggressive policy toward finding substitutes. From this we can assume, taking into
consideration the present problems of recession and unemployment, that these factors will determine the amount of reduction in demand for OPEC oil in the near term: (1) the timing and direction of the recession in various countries in reaction to recent oil price increases; (2) the response of consumers to these increases in terms of conservation and energy efficiency; and (3) the quantity of energy supply from non-OPEC sources, especially from the North Sea.

The uncertainties also include temperature and rainfall. (A cold winter, for example, pushes up total energy demand, and a very dry summer reduces the amount of hydroelectricity available and thereby adds to the need for oil in power stations.)

There is one more ingredient in our Pandora's Box of potential problems--human psychology and the way it influences market behavior. Experience has shown that a simple balance between supply and demand is not enough to eliminate pressure on oil prices. If the maximum availability of oil does not stay at least one or two million barrels a day above demand, the market gets nervous and the behavior of the main actors changes.

Strong competition from outside producers: This factor is very important to the survival of any cartel. The
cartel should be strongly glued not only to keep its unity but also to encourage outside competitors to join the cartel seeking their own self-interests since strong outside competition may create some problems for the cartel. Non-OPEC members' market share increased sharply in the last couple years. "While OPEC exports were 29.8, 24.6, and 21.6 (MB/D) for the years 1973, 1980, and 1981 (January to June), respectively; it was 17.9, 22.3, and 22.6 for the same period of time for the non-OPEC sources."¹ 

The previous factors (less demand and strong outside competition) will inevitably lead to a glut as in 1979-80 and 1982-83. The crisis of 1979-80 ended because of the reduction of oil from Iran with the coming of the Iranian Revolution. It is thus safe to conclude that the net result of stagnant consumption and non-OPEC increases in production is a decline of OPEC exports and market share. Professor Adelman notices that production has been limited by consumption. The amount of oil that consumers demanded of OPEC in 1981 was under 22 MMB/D. As recently as February 1983, it was only 17.5 MMB/D. Professor Adelman explains that "this does not mean that the cartel has made a mistake. Profits are far higher at the higher prices and lower sales."² 

OPEC had a successful market strategy in the early
1970's before other market factors caused fluctuations in the amount of oil sold. This success in the petroleum market led to substantial windfall profits which made it difficult for OPEC to accept less when economic factors signalled the need for a more lenient policy. Some of the conservative members were apprehensive of that situation, but could not resist the rest of the cartel. Anyway, the OPEC success indicates good and suitable policies in dealing with the oil industry.

Going back and examining OPEC's behavior for the last twenty-two years, we see that it has demonstrated several important cartel techniques that led to its success. Before examining them, it is important to mention that some aspects of these techniques were valid and good for a period of time but may now be no longer applicable. This indicates the flexible policy of OPEC as well as its behavior as a reactive power rather than as an active one.

**Price stability:** Pricing issues are related directly and strongly to demand factors. Prices can stabilize in the oil market affecting the oil market itself as well as affecting other related industries. Pricing stability can assure for some time a confident behavior for the consumers and the producers. Besides this, "price solidarity for a period of time can be a substitute for production quotas,
and indeed a superior one, because it will cause less contention among the cartel members—and with consumers—than would concerted production cutbacks.\(^3\)

As we observed, production quotas in OPEC are imposed on members officially or theoretically. In practice, members may not always abide by the quotas.

**Negotiating tactics:** OPEC has derived great strength from its flexible negotiating techniques. These techniques have sharpened with experience and time. Perhaps the most useful and flexible aspect of this technique is that members do not necessarily act in unison. Libya, for example, can raise the tax rate, Iran the posted price, and Saudi Arabia develop participation as a means of raising both. This approach not only allows for differences between one country's leadership and the next, but it gives each of them the chance to take the lead.\(^4\) Another point worth mentioning here is that the cartel's internal cooperation in matters of expertise exchange led to improved negotiation. The political identities of the OPEC countries (being outside the Communist Block) give OPEC a better negotiating stand. The cartel is able to remind the importing countries that the leadership represented in OPEC is a preferable opponent in negotiation than would be any of the radical groups which might come to power. OPEC countries
are quick to point out that it is better to buy your oil for this price than not to be able to buy it at all. This logic is, of course, oversimplified. However, it is a fact that consumers generally prefer the freedom of buying any desired quantity at given prices than restrictions on the quantities offered.

**Relationship with companies:** Dealing with the trading and producing companies is not a problem with OPEC. In most cases, OPEC deals with companies at a relatively low level of authority delegation. This does not indicate weakness, but gives OPEC the leverage of dealing with serious crises by raising the level of its delegations. Mugero and Rustow explained how relations between OPEC and the multinational companies can go for a "deal" relations:

OPEC has shown that a network of multinational producing and trading companies can become not only the enemy but the ally of governmental cartel. As long as royalties or taxes are finely adjusted to know different in quality and transport cost, the tax-paid costs plus transport will constitute a publicly known price floor which vertically integrated companies--without need for collusion--will enforce through their markets, meanwhile serving as the cartel's "tax collecting agency."5

Our conclusion for this chapter is that OPEC is successful in dealing with the market. But in spite of this, some scholars predicted OPEC's end as with any other cartel in this world. Who are these scholars and what are their
ideas about OPEC? This is what we will cover in the next chapter.
ENDNOTES


2 Ibid., p. 51.


4 Rustow, op. cit., p. 71.

5 Ibid., p. 74.
CHAPTER VI

OPEC: THE WISHFUL THINKING OF THE WEST

Since the formation of OPEC, expectations and comments on the Organization have reflected the world's widely-divergent view of the cartel. Ignoring those of Communist Block countries (since they are not consumers of OPEC oil), we will trace the history of these comments in the West. Usually comments and expectations of Western economists, scholars, and politicians have intensified with increases in prices, embargoes, and political and/or military events (especially in the Middle East). The timing of their "shouts" is mostly synchronized with each OPEC Conference. With so many political and economic upheavals, so many conferences (from 1967 to the present) for OPEC, it is no wonder we see a substantial body of Western writings about this Organization. To simplify our discussion, we will include only some of those ideas of the last decade, especially after the 1973 Arab Oil Embargo.

In his massive study, The World Petroleum Market, published in 1972, the very famous economist M.A. Adelman explains his expectation of the collapse of OPEC by saying that "unless the production nations can set production
quotas and, what is more important, obey them, they will inevitably chisel and bring prices down by selling incremental amounts at discount prices."  

After he explains the incentive for cheating, he concludes that "the World Oil Cartel of the 1930's was eroded by this kind of competition, and so will be the new one (OPEC) in the 1970's."  

Professor M.A. Adelman, one of the foremost authorities on the petroleum market, clearly expected that OPEC, like other cartels, would soon crumble and break down. Milton Friedman, a prominent figure and great economist, wrote in *Newsweek* in March 1974, saying:

> The world crisis is now past its peak. The initial quadrupling of the price of the crude oil after the Arabs cut output was a temporary response that has been working on its own cure. Higher prices induced consumers to economize and other producers to step up output. It takes time to adjust, so these reactions will snowball. In order to keep prices up, the Arabs would have to curtail their output by ever larger amounts. But even if they cut their output to zero, they could not for long keep the world price of crude at $10 a barrel. Well before that point, the cartel would collapse.

In December 1976, D.K. Osborne wrote in the *American Economic Review*:

> If the cartel is inherently unstable because of the sharing and deterring problems, let us wait a while and it will go away. Indeed, when the Organization of Petroleum Exporting Countries (OPEC) formed their cartel in October 1973, many economists
(myself included) predicted that it would collapse within a year. It is now thirty-six months later, and the cartel seems pretty healthy.\textsuperscript{4}

Many questions regarding how long the cartel would last or what the future of oil would be were the natural results of the sudden shock of the petroleum crisis of 1973-74. However, economists in the United States and other consuming countries maintained that OPEC would break up, that the price would come down, if not in 1976 or 1977, then in 1980 or soon after, and that everything would be back to normal in due course. Governmental authorities shared the wishful thinking, believing with William E. Simon, first U.S. Energy Administrator and later Secretary of the Treasury, that "the question is not where the price of oil will come down but when."\textsuperscript{5}

Apparently the attitude was that a drop in prices (despite their relative "lowness" in 1974) was to be the first step in OPEC's collapse. In sum, many scholars and economic experts and analysts agreed with Professor Adelman that OPEC would prove no exception to the general rule that cartels inevitably collapse because some members will attempt to cheat.\textsuperscript{6} However, when time and events had proven that OPEC was not breaking down, observers decided that the cartel might continue to function for a decade or more.
The question that comes to mind after reviewing the previous statements and predictions of prominent scholars is how do these people arrive at their conclusions?

In the first place, the scholars base their predictions for OPEC on the economic concepts and main theory of cartels as they exist in any industry. As we stated in the previous chapters about cartels and their nature, it is understood that cartels may break down because of economic factors. In a study made by D.K. Osborne, in *American Economic Review*, December 1976, he explains the problems that face the cartel, any cartel.

A cartel faces one external and four internal problems. The external problem . . . is to predict (and if possible, discourage) production by nonmembers. It is the one fatal problem. The internal problems are, first, to locate the contract surface; second, to choose a point on that surface (the sharing problem); third, to detect, and, fourth, to deter, cheating.7

While he over-emphasizes the external problems as the only reason for breaking a cartel, insisting that he can find no record of a cartel which died as a result of internal problems alone, he believes, correctly, that locating the contract surface and detecting cheating are essential to the internal stability of the cartel. "A cartel is inherently unstable only if it faces inherently insolvable problems."8
It seems safe to conclude that analyses about the break down and collapse of OPEC were built on what seemed to be reasonable grounds. These predictions were based on pure economic theory backed by previous experiences with other cartels (especially economic factors that led to their foundation, formation, and evolution). So, what is OPEC doing to survive? Let us have a look at the OPEC "puzzle."

From 1960 to 1983, OPEC defied Western economists and their economic theory of cartels. This is not because OPEC is a uniquely exceptional case of non-cartelization. OPEC has defied Western economists and their economic theory because of the political conditions (rather than merely the economic ones) that preserve its unity. But before handling these political conditions, let us summarize again the economic ones that still work the mechanism of the OPEC organization.

The world market, as it is obvious, consists of a variety of producers differing in their market power, extraction costs, and discount rates. This is important to remember because, as we consider OPEC to be the strongest institution in the industry, it is by no means the only producer and exporter. Competition from outside exporters, and in fact sometimes very strong competition, affects its
role as the price leader. Weak or strong demand for the commodity also affects the situation of its producers and exporters. Consumption of the product must be taken into consideration as must the availability of other substitutes for oil. Finally, the way that the cartel is managed can also affect the market. Let us summarize these conditions in these points: (1) Oil is a unique commodity (as explained in Chapter I). (2) It is affected greatly by price. This becomes a problem for consumers because of the non-availability of substitutive products. (3) Outside competition is one of the strongest and most crucial questions facing the cartel. (4) Every member of the cartel benefits from its membership. These benefits are mainly used for internal economic planning projects but sometimes for outside investments.

So the economic conditions that build up the cartel are a unique, high-demand commodity, the harmonious interests of its members, and the cartel's behavior in the international market. This situation suggests a need for re-evaluation on the part of some economists. Albert L. Danielsen wrote under the topic "The Theory and Measurement of OPEC Stability" that "the disintegration or stability of the Organization of Petroleum Exporting Countries (OPEC) is an empirical matter which cannot be decided on
theoretical grounds alone... The specific measures also depend upon the institutional structure of OPEC and the fact that oil is an exhaustible resource." 9

Demand can be seen as the cornerstone of the cartel building. Estimating world demand for oil for the next decade is a difficult task even under normal conditions (no wars, no unpredictable world economic or political crises). However, it is obvious that world demand for petroleum from OPEC is affected by some or all of the following factors: (1) substitution of non-oil fuels, (2) rate of discovery of new sources of petroleum, (3) overall demand for energy (especially with price increase or decrease, consumption rate), (4) oil production in communist countries, and (5) the price of energy. 10

Changing rates of industrialization in OPEC countries, rates of economic growth in non-OPEC and OPEC countries, political decisions made by the Soviet Union (as a leader for the Communist Block countries), and the potential for additional oil discoveries are only a few of the unknown facts that could affect the forecasts. Nevertheless, the following occurrences are anticipated: (1) oil consumption by OECD countries will double by 1985, while domestic oil production will increase by almost one-and-a-half times the 1970 level, (2) the Soviet Union may become a net oil
importer by 1985 as exports to Eastern European countries are cut back, (3) China will have the capacity to be an important oil supplier by 1985, and (4) domestic demands for oil in the OPEC countries will increase dramatically by 1985 as economic growth surges in these states. This may produce an intensified interest in oil conservation by selected OPEC states.  

Now let us review some of the forecasts for oil demand expected before the year 2000. The accompanying table shows the projections made by major region and the percentage of that region to the world total. As we can see from this table, predicted oil demand will exceed the available supply. A word of caution here is that the demand for OPEC oil may not measure up to this prediction. This depends on the previous conditions of demands mentioned.

Beyond the economic factors such as the demand and supply of the market there are other political factors that strengthen the cartel. Some of these political factors are the Palestinian question and the Islamic unity. But, before examining those factors, let us discuss a very related subject, the importance of OAPEC (the Organization of Arab Petroleum Exporting Countries) for OPEC.
TABLE II

WORLD DEMAND FOR ENERGY BY MAJOR REGION, 1980-2000

(In millions of barrels per day of oil equivalent, or MBDOE and per cent)

<table>
<thead>
<tr>
<th>Region</th>
<th>1980 MBDOE</th>
<th>% of World Total</th>
<th>1990 MBDOE</th>
<th>% of World Total</th>
<th>2000 MBDOE</th>
<th>% of World Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>38</td>
<td>27</td>
<td>41</td>
<td>23</td>
<td>45</td>
<td>20</td>
</tr>
<tr>
<td>Western Europe</td>
<td>27</td>
<td>19</td>
<td>33</td>
<td>18</td>
<td>38</td>
<td>17</td>
</tr>
<tr>
<td>Japan</td>
<td>8</td>
<td>6</td>
<td>10</td>
<td>5</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td>Industrial Countries</td>
<td>80</td>
<td>57</td>
<td>96</td>
<td>52</td>
<td>110</td>
<td>49</td>
</tr>
<tr>
<td>Centrally Planned Economies</td>
<td>42</td>
<td>30</td>
<td>55</td>
<td>30</td>
<td>68</td>
<td>30</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>18</td>
<td>13</td>
<td>33</td>
<td>18</td>
<td>48</td>
<td>21</td>
</tr>
<tr>
<td>WORLD TOTALS</td>
<td>140</td>
<td>100</td>
<td>185</td>
<td>100</td>
<td>225</td>
<td>100</td>
</tr>
</tbody>
</table>

ENDNOTES


3Milton Friedman in *Newsweek*, (March 1974).


5Rustow and Mugno quoting the *New York Times*, (November 12, 1974).

6M.A. Adelman, "Is the Oil Shortage Real?" p. 87.


8Ibid.


11Ibid., p. 325.
CHAPTER VII

THE IMPORTANCE OF ARAB COUNTRIES IN OPEC

The Arab oil exporting countries have their own organization. Although little importance is given to this organization in the Western media when analyzing OPEC, it is an important part of the decision-making process inside OPEC. We do not mean here that OAPEC (the Organization of Arab Petroleum Exporting Countries) is a cartel inside OPEC. However, looking at a map of the world oil market, we notice that there are twenty-eight developing countries that are also energy exporting countries. They can be divided into two groups: thirteen countries that comprise the membership of OPEC and fifteen other countries. Of the thirteen OPEC countries, there are seven Arab countries (Algeria, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, and United Arab Emirates). Of the other fifteen countries, there are four Arab countries (Bahrain, Egypt, Oman, and Syria). "The Arab countries that are members of OPEC produce the major share of oil produced by all members of OPEC, seventy-two per cent in 1980." Moreover, it is significant to note that the member nations of OAPEC supply approximately sixty-three per cent of the world's crude oil reserves.¹
It is furthermore important to note that Arab oil constitutes about three-fourths of OPEC oil and thereby conclude that the OAPEC countries form the backbone of OPEC. The importance of Arab oil to the international market cannot be overstated. Saudi Arabia, Libya, Kuwait, Iraq, the United Arab Emirates, and Qatar--these countries have been designated as Capital Surplus Oil Exporters. Together they supply a large percentage of current oil exports and it has been projected that they will furnish over three-quarters of all exported oil in 1990.\(^2\)

Given the present state of knowledge, technology, government policies, and the cost of oil and nonoil fuels, it is safe to say that Arab oil will continue to make a significant contribution to meeting world needs for energy in the years to come. World economic conditions, particularly in relation to supply and demand for energy, affect all the countries united by OPEC; however, the Arab member countries and their role in the future oil market are significantly intertwined with the two other major political considerations: the Palestinian Question and Islam Unity. The last few years of accelerating conflict in the region show that stability is greatly affected by these issues.
The Palestinian Question

The Palestinian Question is the essence of the Arab-Israeli conflict. The seven Arab members of OPEC are particularly sensitive to this issue. It is assumed by most of the importing countries that Arab countries put pressure on Western economies to change their position with respect to that conflict by threatening with the "oil weapon."

It is understood that the Arab peoples see oil as what the Libyan and Iraqi slogans call "the servant of our important issues" or "the weapon against our enemies." It is no wonder, then, that we see a new gathering of power in OPEC coming from the revolutionary government in Libya which justifies its movement to raise the oil prices on political grounds. This is not to imply that all OPEC members' attempts to gain control over their oil are based on political motives. Franklin Root explains that:

Libya paved the way for the 21st conference of OPEC in December 1970 to demand a general increase in posted prices, a standard tax rate of 55 percent in oil revenues, and compensation for inflation in the industrial countries... Libya... gained a 10 cent per barrel increase in the posted price and an increase in the tax rate from 50 to 55 percent in September.

Following these incidents were the Tripoli and Tehran Agreements in 1971. Colonel Muammar El-Qaddafi, in the Tripoli negotiations, threatened to end all exportation of
oil if his demands were not met.4

The Libyan victory led other OPEC members to try the same. We mention Libya here to show the importance of political changes on the future of OPEC. A change in a political regime often leads to a switch in its behavior and any switch may affect the whole OPEC structure. Thus, while the Tehran and Tripoli Agreements dealt only with economic issues (prices, taxes, revenues), more recent negotiations have dealt with such political issues as questions of ownership.

We have emphasized the role of the revolutionary government of Libya because that government has claimed to be the central force behind the Arab stand on the Palestinian Question. With this in mind, let us trace the events following the Arab-Israeli War of 1973.

On October 17, Arab countries agreed to use oil as a weapon in the Arab-Israeli War. Two days after that, October 19, Arab countries proclaimed an embargo on oil exports to the United States and some other European countries that sided with Israel in that war. Two weeks later, November 4-5, Arab countries agreed to cut oil production by twenty-five per cent of the pre-war (September) level.5

Most analysts believe that once the Palestinian Question is solved and Arab oil producers will no longer have
to bear the burden of military aid to frontline states, "it is certain that oil prices will sink considerably." This is particularly true, according to one Saudi Information Ministry Official, since peace and stability in the Middle East are important elements in the oil price policy.6

The nationalization of some oil companies in Iraq, Libya, and Algeria was also a political, as well as an economic, move. Even the Saudis and Kuwaitis are affected by the events of the Palestinian Question. Sheikh Abdulaziz Tariki, the founding Minister of OPEC representing Saudi Arabia, in a lecture in December 1979, related any serious economic development to a "just and peaceful solution to the Palestinian Question . . ." He stated that:

The Palestinians are our brothers. They are homeless. They ask the world for a state. All the area (he means the Middle East) is not settled because of this problem. Most of our revenues are going to the defense and military.7 Solve this problem and we and you will be okay.

In the last couple of years, some threats of closing the Hormes Canal or Strait came from some Palestinian officials. The PLO second man in leadership (Abu Iyad) stated that "we will close the canal if we do not get our right."8

Because the Arab Embargo of 1973 was not successful,
it does not seem likely it will be repeated. This does not mean that other actions motivated by political factors cannot be taken.

In summary, the Palestinian Question is an issue that affects oil policies made by Arab members. Many of their investments in their own countries or other Arab countries are for the short run. What happened in Lebanon last year reminds us of this fact. A considerable amount of oil revenues from those countries was going to the "frontline countries," Syria, Jordan, Lebanon, Egypt before the Camp David Accord and the Palestinian Liberation Organization (PLO). Another related factor, besides the Palestinian Question, is the Islamic Unity which came to the front after the Iranian Revolution in Iran.

The Islamic Unity

Arab unity is related in most Arab countries to the Palestinian Question. Because of that the Palestinian Question is considered the central point in any Arabian collective policy. Inside OPEC, Libya and Iraq, at least, are dedicated to this issue, but the dream of Arab unity, with one Arab nation having a strong economy supported by oil revenues and a strong army, is in most Arab minds. It is hardly surprising that all the revolutionary regimes
in that part of the world have that dream as their first objective. Even the conservative regimes of North Africa or the Gulf area do not and cannot say officially that they are not working for that objective. In this desire for unity, the Palestinian Question is of key importance. The Organization of Arab Petroleum Exporting Countires (OAPEC) was formed as a step for economic unity which could be seen politically as a step for greater Arab unity. The Arab members of OPEC cannot act in isolation from each other.

With the coming of the revolutionary regime in Iran in 1979, an old dream started to grow. The Arabs, tired of waiting without achieving any serious results either on the Palestinian Question or the Arab unity, have found in the Islamic unity a new hope. While all Arab countries are predominantly Islamic, most of the people feel that their political regimes are not completely in accord with the tenets of Islam. (Note: No data or independent and reliable source can be quoted here but it is the feeling of the writer from past experience.)

The revolutionary government of Iran, with its declared objective to create Islamic unity, created new potential political situations.

Changes in Iran resulted in deep changes in the political situation in the region. The Iran-Iraq War
may be just one of them. For OPEC, it has created a new equation for power inside the cartel. The Saudis, feeling threatened by the Khomeini government, side with the Iraqis in their war against Iran. Most of the Gulf countries are doing the same. The Iranians, losing most of their production capacity, found allies with the Libyans and Algerians in their war. The war led to the problem of overproduction by the Libyans to support the Iranians and the underpricing by the Iranians to get revenues to cover war expenses.

In relating the Islamic unity concept to OPEC, it is enough to remember that no Islamic oil exporting country is outside OPEC. And only three countries of the thirteen members of OPEC have populations that are not predominantly Islamic.

Any new changes or achievements in this subject can lead to consequences that seriously affect the whole cartel. What these effects will be will remain to be seen. However, an Islamic coalition inside the OPEC cartel means many things for the oil industry. Another Iran in the Middle East or inside OPEC could significantly alter policy, especially with the Iranians relating their war with Iraq and other "reactionary regimes" with that of "liberating Palestine and Jerusalem." Few consumers
want oil production to be stopped corresponding with the
five Islamic daily prayers and long religious holidays.

The Palestinian Question and Islamic unity are the
major political factors keeping the Arab members and Iran
from breaking the cartel. But what about the other members
in Latin America and Africa? And what about economic con-
flicts that may threaten? What about political changes
that can come to the region? This is what we will try to
answer in the next two chapters.
ENDNOTES


2 Ibid., p. 84.


4 Ibid., p. 440.

5 Ibid., p. 441.

6 *Middle East Economic Digest*, (June 6, 1975).

7 From a lecture given in the Southern Methodist University, Dallas, Texas, (December 1979).

CHAPTER VIII

POLITICAL CONFLICTS THREATENING OPEC

Crippling breakdowns in OPEC solidarity may be produced by intermember conflicts that can be broadly classified as either economic or political. Let us now look at the economic ones. Economic pressures felt by one or more members of OPEC will force adoption of pricing or production policies contrary to those favored by the cartel. Seeking higher incomes, the producer(s) with excess capacity would reduce prices unilaterally enough to attract importers away from other OPEC members (this is the current situation in which Iran is the "rebel" producer). Another economic conflict may arise when a major producer produces more than the market can bear. Although this situation is unlikely to happen, it is not impossible. Another theoretical contingency could be the change of one of the major producers' (like Saudi Arabia) views about the cartel. Such a member could try to break down the cartel, seeking other benefits (say, solving the Palestinian Question).

Even in such theoretical cases, it is not in the interest of the major producers or the importing countries
to attempt such maneuvers because of the unpredictable economic and political consequences. In view of likely oil-demand levels through the mid-1980's and the behavior of the oil producers during the rather severe slump in the demand of 1975, it is highly unlikely that OPEC's effectiveness as a cartel could be destroyed in the next decade by economically-induced conflicts among its members.¹

Any major economic conflict, like slackening in world demand, can be solved relatively easily since Saudi Arabia and Kuwait could, by themselves, cut back on production sufficiently to save the cartel. They have done this in the past.

Yet we can imagine theoretical situations where it might not be in the interest of the Saudis or Kuwaitis to do this. Again, it is in the interest of these producers to be the leaders in the cartel while losing nothing or relatively little by not producing as usual. In recent years, "depleting the oil" idea was remarkably welcomed, at least by the Kuwaitis.

From the previous analysis, it appears to us that OPEC is largely immune to disruption induced by economic pressures. But is that right from the point of view of political conflict between its members?

Before answering this question, let us go back and
remind ourselves of the major political conflicts among OPEC members: the Iran-Iraq War (now finished its third year), the Iran-Iraq hostilities until 1975, the Iraq-Kuwaiti hostilities in 1973-74, the Saudi-Abu Dhabi disputes over territories, and the Kuwait-Saudi territorial disputes. None of these political conflicts affected OPEC stability.

Thus, if we examine the question of OPEC's political vulnerability, we have significant historical experience on which to conclude that it is low. The reason for this resides in the nature and purposes of the Organization. OPEC's fundamental objective since its creation has been a simple and limited one: "stabilization of oil prices at desirable levels."²

One of the founding fathers of OPEC, Venezuela's Perez Alfonso, has candidly admitted, that he sees OPEC as a "cartel of governments, dedicated to protect and further the interests of its individual members by concerting pricing/production policies."³

Hence, it is not surprising that OPEC accommodates within its membership various representatives of different ideologies. It includes under its wings: "democratic" governments, military regimes, and absolutist monarchies. Often these regimes are in continuous conflict with each
other. Ironically, we can observe OPEC's huge success in the seventies, when its prominent members were engaged almost constantly in limited hostilities against one another (Iran and Iraq, Iraq and Kuwait).

It may be that the economic incentive in OPEC is so strong that even a state of war between two or more OPEC members might not lead to a breakdown in the cartel. Certainly, OPEC's members have learned that the cartel required only minimal coordination that can be handled best with subtlety and discretion.

Severe political conflicts are not new in the Middle East, the OPEC lion's home. These disputes revolve mainly around boundaries, jurisdiction claims, dynastic and religious issues, aspirations for regional hegemony, and ideological differences.

What can be assumed about the Middle East politics from the two decades of instability among the major oil producers? The following equation can generally be applied. Past experience showed the no-correlation relationship between political conflict plus OPEC stability due to the overall economic interest of the members equals OPEC survival. Although there may be problems here or there inside the equation, the overall equation still holds together.
The OPEC members are not united by politics, culture, or geography. In fact, their only grounds for common interest is in maintaining optional terms for the selling of oil to other nations. But some member countries are more eager to achieve this goal than are others. For some, this eagerness is the result of financial need; in others—particularly with regard to conflict between socialist and Western blocks—it is the result of ideology.

It seems that financial need of the members is stronger than any conflict, whether political or economic.

We have discussed at length the major producers in the Middle East, but what about other producers, especially those non-Arab countries in Africa, and the South American members.

Paul Jaber explained what drew those members to the Arab members:

Typically these states have fairly sizeable populations, limited oil reserves, and ambitious plans. They worry about lagging agricultural production and the cost of imported food, about the possible need to borrow development capital on the international money market over and above their oil income, and about the fact that, for them, petroleum is very much a wasting asset. Nigeria, with a population of 80 million, will eventually find no difficulty in investing $8 billion a year, although it cannot absorb it all now. Venezuela's reserves will run out in fifteen years at 1974 production rates, and Algeria's in twenty-three. Iran has a huge income ($22
billion in 1976) and huge reserves (63 billion barrels), but she also possesses a large population (34 million) and much the most ambitious programs both to develop her society and to equip her armed forces. 5

While talking about implication factors, it is important to note here how a change in the political identity of one or more of the regimes will probably not affect the cartel's chances to survive. This is a safe assumption because, despite differing political goals and ideologies, there is not now and there is unlikely to be in the future any reason to believe that any member country could achieve on its own the financial advantages that it gains as a member of OPEC. This would be true even if current conservative monarchies are overthrown by leftists. Such a coup would be certain to bring eager leaders desirous of press- ing OPEC to obtain ever-greater profits for the financing of social revolution and rapid growth. 6

Now, let us move from the hypothetical situations to see the current problems facing the Organization.
ENDNOTES


2 Ibrahim Kubbah, *OPEC Past and Present* (p. 22), as quoted by Jabber, p. 397.


4 Jabber, op. cit., p. 393.

5 Ibid., p. 396.

6 Ibid., p. 381.
CHAPTER IX

CURRENT PROBLEMS FACING OPEC

The major problems facing the Organization of Petroleum Exporting Countries are summarized in this chapter.

Pricing: This is the age-old problem facing any cartel, especially when demand declines because of outside competition. While in the last two months the British and the Norwegians have reduced the price of the North Sea oil to less than $30/bbl, some oil on the market, because of the present glut, is being sold much cheaper (sometimes for $6/bbl according to some unofficial sources). This is especially true for that oil coming from outside OPEC. Even inside OPEC itself, the Iranians have found themselves, because of political and financial pressures coming from the Iran-Iraq War, obliged to reduce their prices to secure immediate revenues.

Production ceilings: This problem arose from an attempt to solve the pricing problem by imposing quotas on members of the cartel. The official production ceiling agreed on at the sixty-fifth conference (September, 1982) and the sixty-sixth conference (December, 1982) was 17.5 mbbl/day. Quotas inside OPEC are based on: (1) each
country's quantity of reserves, (2) each country's production capacity, (3) each country's economic and social circumstances (as population, economic plannings, domestic consumption, etc.), and (4) the oil market, its supply and demand. The quotas set at these conferences were: "Algeria 750,000; Ecuador 200,000, Gabon 175,000, Indonesia 1,050,000, Iran 2,050,000, Iraq 1,200,000, Kuwait 1,150,000, Libya 1,200,000, Nigeria 1,500,000, Qatar 350,000, Saudi Arabia 6,650,000, U.A.E. 1,250,000, and Venezuela 1,700,000."²

But, once again, at the conference the Iran-Iraq War pressed the Iranians to go beyond their quota to get the money needed to cover the expenses of that war. This is a thorny problem in OPEC since the Iraqis are supported by the other Gulf states while Libya and Algeria seem to side with the Iranians.

**Price differentials:** The price differentials between heavy oil coming from the Gulf states and the light oil coming from Africa seemed to be so severe in the last crisis that in a statement to the Middle East Economic Survey, Yamani said, unless there is an agreement on differentials, Saudi Arabia would not be bound by the price of market crude. He declared, "I can tomorrow reduce my price to $30 a barrel from $34/bbl. Only our sense of
responsibility and our belief that in doing this we would hurt not only OPEC but the whole world prevented us from taking this action. But I am not ruling out the possibility of doing this.\textsuperscript{3}

This problem is related directly to the problem of oil pricing in general. However, in the last few months strong competition for light African oil has come from North Sea oil priced at about $30/bbl. The result has been that OPEC is on the edge of a price war.

**Discounting policies:** If some members discount the price of oil to their buyers, and probably some do, we must suspect Iran and Libya. Certainly, the Iranians and their allies the Libyans would be likely to do so because of the Iran-Iraq War. These unofficial and undeclared discounts are considered by most oil analysts to be the kind of cheating that can damage the cartel as a whole.

**Declining demand:** The main reason for a decline in demand may be the economic difficulties in the importing countries (recession, unemployment, high interest rates, etc.), the conservative consumption policies, and the severe outside competition from non-OPEC countries like Mexico and England. However, while the Mexicans declared last month their wish to abide by the OPEC pricing policies, Egypt reduced its prices by $2/bbl below that designated by
OPEC. Also, North Sea oil seems to be a concern for OPEC, especially the African members as we mentioned before.

After discussing the current problems facing OPEC in the eighties, let us try to know where we are now and what is going on.

Non-OPEC areas which supply energy are located primarily in the U.S.S.R., China, Alaska, North Sea (United Kingdom and Norway), Latin America (mainly Mexico), and South and Southeast Asia. 4

The future may be full of surprises on the political level, especially in the unstable area of the Middle East where the OPEC lion's home is. Yet it seems reasonable to assume that any change in the political equation in the area probably will lead to a stronger, better equipped, and more experienced OPEC.

Some of the surprises facing the OPEC structure may necessitate a new formation of OPEC resulting in the development of two or more groups of countries having similar political ideologies. The future beyond the year 2000 may bring other knights to the battlefield. Undoubtedly, the new map will depend on the political as well as the economic circumstances evolving in the world. It seems most probably OPEC, as it now is or a new OPEC with two or three "sub-OPEC's", will survive in the market. OPEC may
break down only by the end of the last drop of its oil. Indeed, a powerful irony might be seen in such a contingency such that OPEC might convert by that time to OPIC (Organization of Oil Importing Countries) just to prove they are together even in the time of trouble.

With the current problems of oversupply and price wars, the previous U.S. Interior Secretary, James Watt, made it clear just three days before the last OPEC meeting where he stands on the issue of oil pricing. His view is that OPEC is trying to punish the world for what it views as twelve years of exploitation. His view is an understandable reaction from a developed country in the position of consumer. "We are consumer-oriented, we don't believe in cartels. We believe in free markets."  

Henry Kissinger, the former Secretary of State, seemed to be less angry than Watt. He acknowledges an attempt on the part of the OPEC members to stabilize prices in the oil market, but feels that certain countries may have their own political axes to grind and so may use OPEC as a means to their own ends. Iran, for example, is, according to Kissinger, the most radical country in OPEC. It "continues to press for high prices, then sells oil at lower prices, in an effort to achieve political dominance in the Middle East." 6
Kissinger said the U.S. needs to take steps to ensure that it is never again held over a barrel by Iran or Saudi Arabia. "We should never let ourselves get in this type of situation again."  

Many economists, analysts, politicians, scholars, etc., try to see exactly where we are now and predict the future. However, OPEC actions seem to be of more importance than most analysts think. In March, 1983, a new agreement between OPEC members was signed, ending a major crisis in OPEC's life. This does not mean that this is the end of the cartel's troubles. It clearly shows how strong OPEC is. From the previous analysis of current OPEC problems, we can easily see the effect of the Iraq-Iran War on pricing, quotas, and production ceiling. However, as James E. Akins, former U.S. Ambassador to Saudi Arabia, said, "Those who look for the end of the Iran-Iraq War to drive down oil prices will have to look elsewhere for support in their fanciful but comforting views."
ENDNOTES


2Ibid., p. 43.

3Oil and Gas Journal, (September 27, 1982), p. 120.


5Quoted on the Satellite News Channel, February 11, 1983.

6North Texas Daily (the North Texas State University Newspaper), (Wednesday, March 9, 1983).

7Ibid.

8Cited from Oil and Gas Journal (September 27, 1982).
CHAPTER X

REMARKS AND CONCLUSIONS

The breakdown of the OPEC cartel, such that the world could expect a return of the free market of 1960, is difficult if not impossible to imagine. This does not mean that the cartel may not decline in the future, but expectations of its demise are probably only wishful thinking. The flexibility of the cartel's structure, the unique characteristics of the product, the economic and political factors stand behind its commitment for survival, and the huge market potential makes OPEC's survival almost inevitable for a long time to come. Jaber reminds us that the world oil market is different:

The experience of the 1970's shows two facts: (a) the era of cheap energy of the 1950's and 1960's is over--at least for the next two to three decades until major technological breakthroughs occur, and (b) while it will take a while to reverse the trend in supply and the price of energy now pegged to oil, there are avenues open to reduce the types of shock caused in 1973-74 and 1979-80.

OPEC has derived much strength and resiliency from sticking closely to its dual task, that of helping assert the full sovereignty of its member governments over the rest of the Third World with regard to subsoil hydro-
carbon resources, and of securing maximum monetary returns for them in the medium term from their petroleum exports. This dual aim can be agreed upon by leaders of "revolutionary" juntas as well as by sheikhs and kings with "conservative" regimes as a basis for coordinated action.\(^2\)

It seems clear that OPEC members are concerned with their respective self-interests more than the cartel entity interests. In spite of this, member interests are not seriously in conflict with those of the mother organization. Moreover, "the Organization's past performance in the times of inter-member conflict--occasionally of an overt military nature--testifies to its resilience and the value attached by the membership to its continued existence." \(^3\)

Generalizing, therefore, on the basis of past experience, it is likely that OPEC will continue to be a diverse oligopoly with a predominantly short-term, big discount rate, and a high-price orientation. The member nations will remain a group of producers willing to take risks in testing the power conferred by short-term elasticities without much downward pull from any single member who may, at the time, have the largest resources and the largest ostensible stake in the future. OPEC is a loose cartel that is less than the sum of its parts.

In recent years, it has traditionally been Saudi
Arabia which has been in this position. Nobody can predict how much the Saudis will be willing in the future to reduce their output for the sake of OPEC unity; nobody wants to find out. But if the current budget is around $88 billion, then there may be some difficulty if real prices decline below $25 and output drops below 6 MMB/D. ⁴

Like the Saudis, several other important OPEC members set oil production with reference to budgetary requirements, and internal and external constraints.

Oil prices began to fall a bit early in 1983. Far from being a sign of imminent collapse of the cartel, this was more likely an adjustment to the greater long-run demand elasticity, and might be a sign of successful adjustment to change. "Clearly, a price that is too low deprives the members of revenue; but so does a too high price, by inducing conservation, stimulating substitution, and damaging the economic health of the consuming countries. A price policy that is too timid will prove self-denying; a price policy that is too aggressive will prove counter-productive." ⁵

Analysts have, in recent years, been puzzled over OPEC's role in determining the world's oil price. While the economists in the West see OPEC as a cartel, Arab scholars commonly argue that OPEC is not. They maintain
that the price of oil remains competitive.  

Once again, it is necessary to accept fully the fact that OPEC's policies are in complete compliance with the concept of interdependence, applied in its global sense; that is, a two-way traffic system of economic, social and developmental needs. Bearing this in mind, it would be advisable to call upon the consumers to acknowledge that they and OPEC are in the same economic boat, and that no effort should be spared to prevent the boat from sinking. This is not an outlawed opinion; it is best expressed and explained by Dankert Rustow and John Mugno:

Our conclusion, in brief, is that OPEC has greater strength and hence better prospects than many observers, especially from the United States, have credited it with. It follows that many of the confident statements, heard so frequently in 1974, that OPEC, like any other cartel, would soon break down, or that the question was not whether the price of oil would come down, but when, were based on wishful thinking rather than on careful analysis of the international and political factors. Needless to say, such over-confidence on the part of OPEC's critics can only serve further to strengthen its own position.
ENDNOTES

1Ragaei Al-Mallakh, OPEC: Twenty Years and Beyond, (Westview Press, Inc., Colorado, 1982), Introduction XXI.

2Middle East Economic Digest, (June 6, 1975).

3Ibid., p. 399.


5Ibid., p. 273.


7Dankert A. Rustow and John F. Mugno, OPEC Success and Prospects, (New York University Press, New York, 1976), Preface VI.
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