O. P. E. C. ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES, BACKGROUND, REVIEW AND ANALYSIS

Algeria
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ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES

BACKGROUND AND REVIEW ANALYSIS

Foreword

Direct intervention by national Governments in international commercial relations is neither a new nor necessarily a negative factor in the political economy of trading scarce and strategically important commodities among nations. In recent history, however, governmental intervention has been more frequently practiced by the less developed producing countries (old colonies or protectorates) as they find themselves freed politically from the old empires but still closely involved with multinational business corporations.

Examples of governmental participation in international commercial activities have been the various commodity agreements for wheat, coffee, sugar, tobacco, tin and other natural resources. The most commonly stated objective is the "stabilization" of markets by providing "fair and equitable" prices to the producers. Although varying degrees of governmental intervention have been attempted, and have partly succeeded, for copper, aluminum and iron ore, petroleum has taken the center stage of commodities traded under governmental guidance, control or monopoly.

Since its inception, the Organization of the Petroleum Exporting Countries (OPEC) has established itself as a growing power in international petroleum relations, with no counterpart among the oil consuming nations. Its success has been derived by coordinating the policies of its members, while, in their view, harmonizing the interests of producers and consumers. The group has a highly dynamic evolution in the most important industry in the world after agriculture. The purpose of this paper is to present a general picture of OPEC, while allowing the existing literature to provide more detailed historical analysis and political interpretation. A selected bibliography is provided for this purpose in Appendix C.

Introduction

The Organization of the Petroleum Exporting Countries is an intergovernmental organization with an international status. Its General Secretariat has ultimately settled in Vienna, Austria. Its official language is English.

Historically, the initial moving force in the formation of OPEC was Venezuela. At the end of World War II the international importance of the oil industry was more apparent than ever, as the scarcity of petroleum in no small measure helped to defeat the German war machine. The international oil industry began a formidable expansion as it embarked on a radical transformation. New oil fields, new petroleum technology and new oil companies appeared on the scene, while demand, in appreciable measure induced by the oil industry itself, grew by leaps and bounds. The controlling power of every major decision in the international oil business was in the hands of a relatively few individuals.

All these developments were occurring on a global basis as the United States was losing the position of the predominant exporter of petroleum and rapidly becoming a net importer. In the Western Hemisphere, after the prolonged and extremely costly experience of the nationalization of the petroleum industry in Mexico (started in 1938 but settled during the war in 1943), the Venezuelan Government embarked on a vigorous campaign for securing more control over the foreign oil companies (American, British and Dutch) for the clear purpose of obtaining from them better financial terms on their concessions. This process was for the most part through the legislative route.

In the Eastern Hemisphere, the Iranian oil nationalization failed in the early Fifties, while Iraq experienced considerable difficulties in its negotiations with the Iraq Petroleum Company (owned by American, British, Dutch and French interests). Both of these experiences played a major role in the growing determination of the Middle Eastern oil-producing nations to assert some national rights which were signed away at the time the original oil concessions were granted. This determination was at first expressed in the publication of many articles in the local press dealing with economic problems of the industry, reflecting basically a spirit of research and objectivity along with a nascent awareness of national identity.

One extremely significant factor which influenced the post-war growth of the international oil industry was the industrial reconstruction of Europe with the aid of the Marshall Plan. World trade in oil at that time was exclusively in the hands of the seven major international oil companies (commonly known as the "Seven Sisters")[1/] who managed to increase the share of oil traded internationally from about one-sixth of total world production just before the war to more than a quarter before the Marshall Plan. The Marshall Plan needs and the subsequent economic growth of the early Fifties prompted the oil companies to develop very rapidly the oil resources in the Middle East where reserves were plentiful and production costs extremely low. This policy brought about a change in the oil epicenter by shifting the majority of world oil production outside the U.S. from Venezuela to the Middle East by 1950. It is commonly accepted now that this policy by the majors was also designed as a warning to the Government of Venezuela, whose own policy toward the imposition of heavier financial obligations on the oil companies was becoming increasingly firm.

Venezuela did not change its long-term policy, but clearly recognized the economic threat. Hence Venezuela set out to achieve a rapprochement with the

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1/ British Petroleum, Exxon Corporation, Gulf Oil Corporation, Mobil Oil Corporation, Royal Dutch/Shell Group, Standard Oil Company of California and Texaco Inc.

Middle East oil exporting countries, in order to have allies rather than rivals. Thus began a decade of establishing contacts and arranging a regular exchange of information of mutual interest pertaining to the oil experience. During this period the Middle Eastern countries also became aware of the necessity of forming a united front for the protection of their oil interests. The Arab League was active to that end but the insufficiency of an Arab group alone was very evident to the Arabs and the other oil-producers.

Meanwhile, the international oil companies displaced for all practical purposes the coal industry in Western Europe, and put substantial pressure on the British coal industry (in part resulting in its nationalization). However, they experienced political problems in the American domestic market where the American domestic oil industry wanted protection from the "cheap" foreign oil. The consequence was overproduction and a glut in world oil markets. Secret discounts and some open price cutting reduced the high earnings of the international oil companies. A prolonged state of depressed prices (and earnings) outside the United States led the majors to seek a remedy for their economic problems by resorting to the classic step of monopolistic buyers. They unilaterally cut the price paid for crude oil, without consulting the producer countries, in the Spring of 1959.

Specifically, the posted price for Venezuelan crude was reduced by 5 to 25 U.S. cents per barrel, while in the Middle East the reduction averaged 18 cents per barrel. The oil-producing countries by then had lived for some time with anxieties that such a move would be made by the majors. As a result of the cuts in the Middle East, the First Arab Petroleum Congress was assembled in Cairo to deal exclusively with Arab oil interests. Venezuela and Iran, however, participated as observers. During the intervals of the official meetings, the Saudi

Arabian and Venezuelan representatives met in frequent unofficial sessions, while consulting with all participants. The outcome of these private meetings resulted in an unpublicized understanding among all the oil-producing countries at the conference to organize into a united front. As a direct result of this understanding in principle, Venezuela and Saudi Arabia issued a joint statement in May 1960, urging all the oil-producing countries to adopt a common policy to safeguard their economic interests. In August 1960, the oil companies reduced further Middle East posted prices by 4 to 14 U.S. cents per barrel. Consultations started immediately between oil officials of the Middle East and Venezuela to consider measures for coping with price fluctuations and one month later OPEC was organized. To provide some perspective of the impact on the oil-producing countries in the Middle East, the price reduction caused them a loss of about $93 million for the year 1960, when a barrel of crude generated about 75 U.S. cents of income for the producing country and when the total oil revenue for the Middle East producers was about U.S. $1,400 million.

The birth of OPEC

The historical record shows that governmental contacts among the countries that eventually formed OPEC date as far back as 1949. In the summer of that year a Venezuelan delegation went to the Middle East for the express purpose of exchanging views on oil problems and establishing a regular and close line of communication. The Venezuelans visited every major oil producer in the Persian Gulf--Iran, Iraq, Kuwait and Saudi Arabia--which at that time produced together just about the quantity of crude that Venezuela alone was producing. The visit of the Venezuelan delegation to Egypt and Syria at the same time was indicative of its broad scope. Although neither was an oil producer, both were politically influential among the Arab group. In 1959, when the first cuts in the posted price of crude were made by the international oil companies, the First Arab Petroleum Congress was assembled in Cairo, sponsored by the Arab League. The presence of the Venezuelan observers became critical in arriving at the understanding mentioned earlier, which can be viewed as the basis of the agreement to organize OPEC in the following year.

OPEC was established in September of 1960, following a conference held in Baghdad by the then five major petroleum exporting countries: Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. The founding members were joined one year later by Qatar, while in 1962, Indonesia and Libya joined the ranks of OPEC.

The historical factors supporting the birth of OPEC are clear. The members are all considered less developed countries; they are net exporters of petroleum and, except for Indonesia, their oil revenues constitute the majority of their foreign exchange earnings which, over the years, have been used for their domestic economic development programs. In addition, the petroleum resources in all these countries were effectively controlled by the major international oil companies whose interests did not necessarily coincide with those of the host countries. The last bonding element among the founders of OPEC was the extreme similarity of the various concession agreements so that various countries were basically facing the same controversial issues in their dealings with the oil operating companies.

In this light the creation of OPEC seems a natural and logical step among countries, continents apart, who found it useful to consult and coordinate their national policies directly related to their national income. Before the establishment of OPEC, an individual oil-producing country often found itself dealing alone with a solid front of the international majors who happened to share concessions in its territory. Moreover, since all the majors controlled substantial oil production elsewhere, they sometimes used their ability to regulate the volume of the offtake among the various producing areas as an economic weapon to influence the policies of any individual exporting country and thus weaken its bargaining power. With regard to this tactic and other practices of the major oil companies, a substantial report was prepared by the staff of the Federal Trade Commission, titled "The International Petroleum Cartel" for a Senate Committee in 1952. (Committee Print No. 6, Subcommittee on Monopoly, Select Committee on Small Business, United States Senate, August 22, 1952, GPO).

The immediate cause that led to the creation of OPEC was, as we saw before, another in a series of adjustments in the posted price which from a high of $2.08 a barrel in 1959 went to $1.80 a barrel for Arabian light crude by 1961. Not only was it evident that the oil companies were able to change posted prices unilaterally, but they could do it without warning or consultation. The critical point was that the revenue of an oil-exporting country was then based primarily on 50 percent of the net profit of an operating company calculated on posted prices. Numerically, a country with a production of 1,000,000 b/d was losing a total of about $135,000 per day by the time all the price cuts were put into effect.

The text of OPEC's first Conference Preamble and of its first major resolutions adopted at the founding meeting in Baghdad are provided in Appendix A.

The principal stated aim of OPEC

The principal aim of OPEC as stated in the material contained in Appendix A was the restoration of the then reduced prices for crude oil to the levels preceding the price cuts through a unification of petroleum policies of the Member Countries. Corollaries to this purpose were a number of goals such as the stabilization of prices and the elimination of fluctuations, so as to insure a steady income to the producing countries. The group also envisioned an efficient, economic and regular supply of oil as a source of energy to consuming nations, while providing a fair return on the capital to those investing in the petroleum industry. There appears to have never been a clear understanding between the oil-producing countries and the operating oil companies on what constitutes a "fair return" on investments. There is clearly no such understanding now.

The main tool that OPEC Member Countries proposed to use in their effort to force oil companies to the negotiating table in respect to oil prices was a front of solidarity that they could display if confronted with an act of economic reprisal by any of the interested companies. The lesson of Mexico's tribulations with the New Jersey Standard Oil Company before World War II, when Mexico tried to gain control of its petroleum resources, was not lost on OPEC members and was especially well learned by Venezuela.

Thus, the emergence of OPEC was a new and active element in shaping the future of the international oil industry, as has been well recognized.

The organizational structure of OPEC

OPEC comprises the following basic organs:

1. The Conference, which is the supreme authority of the Organization through the adoption of its resolutions. The Conference consists of delegations representing the Member Countries and meets at least twice a year, normally at its headquarters. When meeting elsewhere it convenes generally in the capital of a Member Country.

The Conference formulates the general policy of the Organization and determines the appropriate means of implementing it. It also decides on new memberships; it confirms the appointment of Members of the Board of Governors; and directs the Board of Governors to submit reports or make recommendations on any matter of interest to the Organization.

2. The Board of Governors, which is responsible for directing the management

of the affairs of the Organization and implementing the decisions of the Conference, consists of one Governor for each Member Country and holds its meetings at least twice a year. The Board considers and decides on any reports submitted by the Secretary General before submitting them with recommendations to the Conference. In addition, the annual budget is prepared by the Board which is submitted to the Conference for approval. Other duties of the Board are: the nomination of the Auditors, consideration of the Statement of Accounts, appointment of the Chiefs of Departments, the convening of extraordinary meetings of the Conference, and the preparation of agendas for every Conference.

3. The Secretariat, carries out the executive functions of the Organization in accordance with the provisions of the Statutes and under the direction of the Board of Governors. The Secretariat consists of the Secretary General, the Deputy Secretary General (permanently residing at the headquarters) and such staff as may be required. Its seat was in Geneva, Switzerland, but was subsequently moved to Vienna, Austria, where it has functioned by treaty with the Austrian Government since 1965.

The Secretariat's responsibility is to organize and administer the daily work of the Organization under the management of the Secretary General who is also the Chairman of the Board of Governors as well as the legally authorized representative and spokesman of the Organization. The Secretary General is assisted in his duties by the following Departments, each under the leadership of a Chief:

a) Administration
b) Economics
c) Legal
d) Information
e) Technical

In addition, the Office of the Secretary General assists him in maintaining relations with governments, other international organizations and various delegations; it remains responsible for the enforcement of the Resolutions and it also deals with matters of protocol.

3a. The Administration Department among other responsibilities deals with personnel, budgets and accounting matters. Interestingly enough it also keeps abreast of the current administrative policies and/or policy changes taking place among the international oil companies which might affect the Organization or be of interest to it.

3b. The Economics Department reviews the economic aspects of the world petroleum industry and carries out continuing programs of economic studies for the express purpose of achieving speedy and successful results within the aims of the Organization. In this connection the work of the Statistical Unit, which collects and collates statistical information about petroleum from Member Countries, the oil industry and other sources, is of the utmost importance. This Unit is under the jurisdiction of the Information Department.

3c. The Legal Department reviews the legal aspects of the world petroleum business undertaking special legal studies consonant with achieving the best interests of the Member Countries within the framework of existing laws.

3d. The Information Department maintains an Information Center including a comprehensive Library with a vast documentation center. The Library is reputed to be the best in the world on petroleum matters. It is the function of this Department to establish the proper procedures for the most efficient utilization of its resources for the benefit of Member Countries and the public at large.

3e. The Technical Department reviews the technical aspects of the world petroleum industry carrying out studies of technical and technological content aimed at the realization of the goals the Organization has undertaken to pursue.

The staff of the Secretariat consists of international employees with an exclusively international character. In the performance of their duties OPEC's employees are charged neither to seek nor accept instructions from any government or from other authorities outside the Organization, their sole purpose being to serve the interests of OPEC's policies.

4. The Economic Commission. In 1964, during its Seventh Conference, OPEC established the Economic Commission with statutes of its own. The rationale for the formation of this organ can be found in the declining prices for petroleum while the price for manufactured goods had continued to increase.[2/] It was felt that the decreases in petroleum prices were contrary to the basic interests of Member Countries and resulted in a further deterioration of their terms of trade, i.e. the relative amount of exports needed to acquire a given amount of imports, which in periods of inflation tends to work in favor of the raw material importers and not exporters. OPEC members at that time concluded that "market forces" were not restoring the balance between supply and demand in oil, and considered it vital to establish a specialized body to examine the position of petroleum prices on a continuing basis, while studying all factors that influence oil prices and their structure.

The Commission consists of a Board, a Staff and National Representatives. The National Representatives are permanent liaison officers between the appropriate petroleum authority in their respective countries and the Commission Coordinator (who is *ex officio* the Chief of the Economics Department).

What makes this Commission unusual is that its representatives tend to be persons from the highest leadership of the various National Oil Companies of the member countries who, through their devices or the good offices of their central

2/ (OPEC), Resolutions of the Seventh Conference held in Djakarta from 23rd to 28th November 1964.

governments, are directed to obtain all relevant data and information from private and public sources, but especially from the oil companies engaged in export petroleum trade from their respective territories. All this was done in pursuit of the stated functions of the Economic Commission. Further, the Commission makes monthly reports and its activities are reviewed at every Conference. No clear details of the Commission's reports are available to the Congressional Research Service, but from fragmentary references in various private newsletters and other oil industry literature it appears that no major decision since 1970 has been taken by an OPEC Conference without a solid support on economic grounds prepared by this Commission.

A chart showing the organizational framework of OPEC is provided in Appendix B.

The legal framework of OPEC's activities

The fundamental premise of all OPEC Member Countries is that the State is the owner of all mineral resources. Some countries--Indonesia, Iran, Libya and Venezuela for instance--have enacted specific legislation setting conditions under which the State may enter into contracts or grant concessions. In the case of Venezuela the legal basis for the State's ownership of all mineral rights resides in the Napoleonic Code which prevails generally in Latin America. Other Member Countries have granted concessions without the legal basis of specific hydrocarbon laws but under general laws of the land.

The earliest concessions granted by the current OPEC members were negotiated under circumstances wherein the signatory governments did not foresee the full economic and legal implications of the agreements, particularly in the long-run, given the long life of concession agreements. In some cases the exercise of foresight was totally absent, because of ignorance or collusion.

The early attempts to revise the old concession agreements through renegotiation were slow and generally unproductive. Recently, however, considerable movement has been achieved. Real and fundamental changes have been brought about by the oil-producing countries' invocation of the doctrine of "changing circumstances." This meant that a Government told the operating oil company in no uncertain terms that if it wished to continue its operations it had better sit down to renegotiate an oil production agreement. In some cases, changes in the terms of concessions have been implemented through new legislation.

Until 1972 OPEC members felt strongly that there still were issues to be resolved in their relations with the oil operating companies, so that they could introduce benefits which have been common practice in some of the consuming as well as producing countries.

The most notable issues in contention before 1972 were:

1. The duration of the major concessions in force, particularly in the Middle East. The stumbling block of this issue was substantially overcome by the 1972 negotiations leading to the so-called Participation Agreements, some of which went into effect January 1, 1973. In these agreements the Government of a producing country in the Middle East acquired a 25 percent equity in the assets of the oil producing company or companies operating in its territory for an agreed compensation. Such equity generally was assigned to an existing National Oil Company which became owner and administrator of these assets. By the summer of 1974, the original Participation Agreements were almost in total disarray; certain oil-producing countries had achieved a legal ownership of 60 percent of the operating companies' assets, while in other countries current negotiations are expected to lead to a 100 percent takeover with a concurrent service contract negotiated

with the ex-operating companies. The present situation is extremely fluid in this area.

2. Royalty as a credit against income-tax liability. Of the various petroleum revenues of an oil-producing country, royalty and income tax are the two most important. Royalty is the payment that a concessionaire pays to the state for the right to exploit the mineral resources. Income tax, on the other hand, is a distinct item of liability levied directly or indirectly by a sovereign state on the income of an individual or company within its jurisdiction, generally based on net income or profit. In the oil-producing countries it was entirely based on the realization of profits, and was not related to the payment of royalties which are payable even in the absence of a profit (an unlikely situation in the oil industry). In the Middle East, royalty payments used to be credited directly against the income tax liability, which made its mathematical computation meaningless. OPEC negotiations remedied that situation so that, in all member countries now, royalty payments are deducted as an expense item before the income taxes are calculated.

Current trends suggest that before the end of 1975 royalties and taxes are going to be merged into a single package of financial obligations by oil companies to the governments. In correct fiscal terminology payments by the oil companies to the Governments of the producing countries, since the organization of OPEC, have not been "income tax" payments but straight excise or sales taxes. The term "income taxes," however, resulted in substantial benefits to the international oil companies in offsetting their home country income tax liabilities, generally on a dollar per dollar basis.

3. Legislative action to change tax laws. In a sovereign state, the Government may pass laws imposing or changing the rate of taxes within the

Constitutional limitations. But in the Middle Eastern countries the income tax rate was fixed for the duration of the concession irrespective of the rate of profitability of the oil industry. A clause in the concession agreements precluded the establishment of a progressive system of taxation on petroleum profits.

Alterations in all these areas have been secured, but again the fluidity of the current international oil situation does not preclude yet other changes. In this respect it should be noted that, in the recent highly concentrated North Sea oil exploration, the Governments of Great Britain and Norway (not OPEC members) have instituted obligations on the operating oil companies much stiffer than those currently in force within OPEC producing countries, perhaps with the exception of Indonesia, Iran and Venezuela. This is a generalized statement because only fragmentary information is known about all the developments in the relations between Governments and oil companies (inside or outside OPEC) dealing with exploration, production or service contracts. The oil industry and governments remain secretive in these matters.

<u>OPEC and its relation with U.N. agencies</u>

In accordance with Article 102 of the United Nations Charter, the agreement creating OPEC was properly registered with the Secretariat in New York on November 6, 1962, under order No. 6363.

Two and a half years later, in the summer of 1965, OPEC was officially recognized by the United Nations as an intergovernmental organization. In July 1965, the primary organ of the U.N. for discussion of economic and social questions ECOSOC (the Economic and Social Council), adopted a Resolution establishing relations with OPEC. As a result of that recognition by the United Nations, the OPEC Secretariat was invited to and has actually participated in meetings of many spe-

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The world oil situation in 1960

Total world crude oil production in 1960 was estimated at about 21.0 million barrels per day (b/d) of which 17.7 million b/d was produced outside the Communist bloc. Only 10.1 million b/d was lifted in the world outside North America and the Communist bloc countries. The founding members of OPEC produced about 7.8 million b/d or about 44 percent of all crude lifted outside the Communist bloc, and about 77 percent outside of North America and the Communist bloc. It should be noted that the major oil companies at that time controlled virtually all the production of crude oil in the five countries in question, while these oil companies taken together were producing about 69 percent of the volume of crude extracted in the whole world, or about 82 percent of that produced in the non-Communist areas of the world. None of the majors had any interests in the production of oil in Communist countries.

The importance of the founding members of OPEC to the international oil industry was also evidenced by the fact that in 1960 the five founding members of OPEC combined furnished nearly 90 percent of crude entering international trade channels, while holding some 67 percent of the then known and recoverable oil reserves of the world.

OPEC in 1974

As with any other organization, OPEC's structure has evolved through the years. Since Libya and Indonesia joined OPEC in 1962, bringing the membership to eight, five additional members have been accepted. Acceptance into membership requires a three-fourths' majority vote including the concurrent vote of all Founder Members. Thus any Founder Member has the power of veto over new memberships. Qualifications for membership are a substantial net export of crude oil and a fundamental similarity of interests to those of Member Countries.

Participants within OPEC may be:

FOUNDER MEMBERS, if they signed the original agreement;

FULL MEMBERS, if accepted into OPEC by a Conference;

ASSOCIATE MEMBERS, if unqualified for full membership but still accepted by a Conference, without the right to vote but all other benefits and privileges;

CANDIDATES, if an application for membership is pending; and

OBSERVERS, if they are invited to the proceedings of a Conference.

The following are dates and places of accession of members after the founding of OPEC:

January 15-21, 1961 in Caracas for Qatar
April 5-8, 1962 in Geneva for Indonesia and Libya
November 27-29, 1967 in Vienna for Abu Dhabi
July 8-9, 1969 in Vienna for Algeria
July 12-13, 1971 in Vienna for Nigeria
November 19-20, 1973 in Vienna for Ecuador, while Gabon became an associate.

In January 1974, the membership of Abu Dhabi was extended to the United Arab Emirates of which Abu Dhabi is a principal member.

During 1974 various newspaper accounts indicated that the following countries have been either observers, or have pending applications or are rumored as potential candidates for OPEC: Bolivia, Colombia, Congo, Malaysia, Norway, Peru and Trinidad.

The world oil situation in 1974

A whole book would not be enough to describe fully the current involved and tension-generating situation in the field of international petroleum relations. This brief section, by necessity, will highlight some comparisons with the previously described oil situation in 1960.

Current levels of crude production worldwide, although more uncertain than in any previous year because of production cutbacks designed to support high prices, indicate that in 1974 there will be a global crude oil production between 55 and 57 million barrels per day or between about 2,740,000 and 2,840,000 million metric tons (the usual denomination used internationally). This represents a jump of about 170 percent in the past 14 years. Within this global increase, the rise in the non-Communist areas was about 70 percent, while the Communist bloc increased its production about 300 percent over the same period. The Free World production of crude oil, however, accounts for about 82-83 percent of the world's total, with an increasing proportion being produced in the Middle East.

OPEC members, as a whole, are now providing about 85 percent of all crude oil sold internationally, but only about 40 percent of world crude production is sold in countries other than those in which it is produced. Noting that crude oil produced in the United States, Canada and the Soviet Union and consumed domestically in the three respective markets amounts to about 35 percent of total world's production, the geographic imbalance of crude supply and demand becomes very evident. Only about a quarter of world production is domestically produced and consumed by all other 135 nations or so currently comprising the roster of the United Nations. This fact underlies the massive economic imbalances resulting from the sudden and sharprise in world oil prices with which every industrial nation (and most less developed nations) is wrestling.

We are unable to estimate the share of 1974 world crude production that the major oil companies control, comparable to their 1960 experience of extracting almost 70 percent of the world's output. A study conducted this spring by this author indicates that the seven "majors" still controlled an estimated 46 percent of the 1973 crude production. The fast changing situation concerning the equity participation of various oil companies operating in the Middle East, and the varying forms of service contract under which the international oil companies produce crude in other countries, will completely change the meaning of control of crude production by the majors. In the future, the parameter that may become useful in analyzing the international oil situation, in terms of production control and market availability of oil in general, will be the ability of the various international oil companies to have access to crude rather than produce it, and to have the means of moving it into owned or controlled downstream operation, where the emphasis of profitability has already been shifted.

This has occurred in spite of a myriad of regulations that currently exist in the petroleum markets and industry. The giant oil companies still have a visible upper hand over independents or newcomers in the industry and strength with consumer governments.

A brief review of major OPEC's accomplishments

We have reviewed earlier the proclaimed goals of OPEC. In the past dozen years the following are its major achievements:

* It checked further unilateral price reductions by the oil companies, by playing an important role in stabilizing posted oil prices until the summer of 1972.

* Spearheaded by Venezuelan and Libyan national actions, it contributed

to agreements with oil companies, providing for higher crude oil prices and a higher income tax rate, especially since 1971.

* It focused on the international rate of inflation especially after the 1971 devaluation of the U.S. dollar, and achieved some compensation for inflation in the price for crude oil.

* It secured from the oil companies after the two devaluations of the U.S. dollar compensation for the eroded value of oil-producers' international reserves held in U.S. dollars by means of an adjustment of the dollar revenues for oil mostly used to purchase goods in the Western World markets.

* It helped to overcome a strong resistance by oil companies to the elimination of the tax practice in some OPEC countries of treating oil royalty obligations as credits against their income taxes. Since then royalty has been effectively paid as a separate item and is considered just another expense of the cost of operations.

* It was instrumental in negotiating the virtual elimination of a "marketing allowance" (largely claimed costs of marketing crude in markets outside the oil-producing countries) which the oil companies had used as a "cost" of crude production in determining their local tax liabilities. OPEC's argument was that a large portion of such costs consisted of promotional expenses outside the host countries and in addition generated international profits which totally escaped the tax system of the host countries. OPEC successfully argued that such costs be assigned to stages subsequent to crude production.

* It has worked on plans for the adoption of identical principles to become part of Member Countries' domestic legislation concerning laws regulating hydrocarbons.

* It has been helping Members in assessing and analyzing conditions in the international petroleum field, while it has trained nationals in the technical

and economic aspects of the oil industry.

* It has participated actively in international proceedings dealing with the oil industry.

* It adopted a Resolution, in the form of a "Declaratory Statement of Petroleum Policy in Member Countries" embodying the principle that in the producing countries the ownership of operating companies will be in the hands of the State.

* It has assisted the National Oil Companies of Member Countries in various activities of economic coordination.

* In the Summer of 1968 it agreed on principles of general conservation of petroleum presenting its case in a booklet titled "A Pro-Forma Regulation for the Conservation of Petroleum Resources." (This booklet was reprinted in January of 1973.)

* It became instrumental in providing the framework within which pressure from Middle East oil producers was translated into a tripling of the so-called transfer price of crude oil from producing companies to refineries between October and December 1973. Although these price changes were never uniform because of regional differences among OPEC members, this achievement provided increasing economic wealth to basically less developed countries with a concurrent increase in their diplomatic power.

Currently the two hottest issues being debated within OPEC are: the international price of oil (inevitably related and connected with world inflation) and the coordination of any cutback in production to manage real and potential surpluses of crude in the world markets.

Completely outside of OPEC, but not less important than any issue under consideration in OPEC councils, is the new arrangement being negotiated between the Saudi Arabian Government and ARAMCO officials. ARAMCO (Arabian American Oil Company owned by four U.S. oil companies) is almost the sole producer of crude oil in Saudi Arabia which is recognized in and out of OPEC to be the keystone to the international oil industry. The importance of what Saudi Arabia will arrange with ARAMCO cannot be underestimated, especially in view of the news just released by a private petroleum newsletter, that had it not been for the Saudis' strong opposition to a price increase, the OPEC group would have likely increased the crude price "50 percent higher" during the last several Conferences. This information is attributed to the U.S. Ambassador to Saudi Arabia, James E. Akins, who prior to his appointment to that country was the Director of the Office of Fuels and Energy at the U.S. Department of State.

An overview of OPEC

It is no trifling task to analyze the impact of OPEC in economic terms, and the attendant political content makes the task controversial. This report attempts to recognize salient points concerning OPEC from an international viewpoint.

OPEC follows a broad definition and framework employed in the creation of numerous other international organizations. One such group that has been examined frequently is the European Coal and Steel Community (ECSC). The word "community" could as well be Communauté, Gemeinschaft, Communità or Organization. In the definition of the ECSC "community" means first and foremost an original, realistic and pragmatic method of economic cooperation between states. According to ECSC, the scope of such an organization takes into account at the same time power relations between states as well as the necessity to offer some guarantee to small states against subordination to big states, while keeping open channels for common and dynamic economic action.

From the legal viewpoint, cartels may be formal or informal, loose or closely knit, broad or narrow in scope; they may consist of business enterprises or governments. Their existence does not necessarily have to eliminate competition. It is sufficient that an arrangement should be made to lessen competition in the form of restrictive pricing, output, investment, employment, trade or some other aspect of business policy in order to qualify as a cartel. OPEC in this respect is a cartel; so is the international oil business.

If one attempts to sort out the complex and often confusing reality of international oil economics and politics, a historical conflict becomes evident. Defensive forces are at work in the oil companies group (trying to retain the status quo), while among the producers there is a process of dynamic change (trying to forge new power bases). Yet while OPEC is a cartel as far as its objectives are concerned, it is a loosely knit one with respect to its collective or central decision-making power. Its looseness assisted OPEC's survival and the avoidance, so far, of defections. Moreover, the original scope of OPEC was, and has remained, narrowly confined to its original objectives in a framework of differing individual members' needs and requirements which have precluded the widening of OPEC's scope or the tightening of its decisions. OPEC does not have sufficient delegated power to act as a supranational authority, and it is doubtful if OPEC's Member Country Governments are willing to relinquish to OPEC the main responsibility for controlling prices and production of crude oil. Yet the competent work performed by the Secretariat appears to have won wide acceptance among less developed oil-producing countries, given the current roster of OPEC and the potential candidates for membership.

The strongest bond that seems to exist among all OPEC members is that they depend on oil--to varying degrees of course--as a foreign exchange earner and as a major factor in state revenues. OPEC countries' prosperity is generally affected by the export conditions of one or two commodities, and therefore there is some rationale in their attempt not to leave their economic fate to the vagaries of competition where its level is not set by buying consumers but by a small group of giant companies effectively controlling the market.

This evaluation, however, does not preclude the recognition of a certain degree of politicization of the world petroleum trade. But the main activities in this area are to be found on the home fronts or within the Arab group of oil producers, outside the OPEC framework. The fact that most of these political activists are also OPEC members and the fact that they assemble in their outside-of-OPEC meetings, often concurrently with OPEC gatherings, makes for a confused understanding and reporting of developing events by the newspapers. It should be noted, however, that most of the economic data and analysis that is being used by individual countries within the OPEC membership on their home fronts or in their diplomatic exercises is provided by the studies undertaken under the auspices of OPEC itself. This situation has been clearly recognized in certain statements by the Shah of Iran, the Petroleum and Finance Minister of Kuwait, the Mines Ministry of Nigeria and Chairman of its state oil company, and other high-ranking governmental officials of the oil-producing countries, when they take issue with the evaluation of world petroleum events as painted by interests close to or identifiable with the international oil companies group.

The geographic distribution of OPEC membership bears examination. It remains a fact that the gravitational center of OPEC is in the Middle East. This part of the world emerged from political colonialism only to find itself economically dominated by the Western powers. Combining the old troubles characteristic of the Middle East (similar to the historical position of the Balkans as a source of worldwide difficulties) with the rapid emergence of the Middle East as the major oil exporting area in the world, the results must be acutely unsettling. In the first place the Middle East oil situation developed because of its vast reserves and the very low production cost of lifting crude in quantities vastly larger than anything the region can consume. Secondly, the growing economic importance of the Middle East is emerging under an umbrella of revived efforts at cooperation schemes designed to promote local and regional economic development of the area. Lastly, the political economy developing in the Middle East is neither fully accepted by the generally conservative oil companies managers, nor it is palatable to the Western consuming public. The consumers feel injured and impotent after the international oil industry cartel accustomed Western economies to cheap and abundant oil. OPEC, to be sure, is not the central protagonist in all these events, but the Arab contingent of OPEC, with support from Iran, are the principal powers, and it is the coordination of their actions that gives it potency. Yet in this area too the current situation is fluid.

As for military considerations, the oil producers have been extremely aware of the economic and strategic importance of petroleum to Western military and civilian uses. The volume and value of international petroleum trade is staggering in comparison to any other commodity. This situation has been reflected in the most recent preliminary assessments by the World Bank Group and the Organization for Economic Cooperation and Development (OECD).

Has OPEC achieved its original goals? In the fourteen years of OPEC's existence it is abundantly clear that the Secretariat, in representing the interests held in common by member states, has been effective. A close examination of historic events surrounding the birth and later the existence of OPEC shows also that the group has been exposed to identifiable common threats by a few companies that held control of oil supplies and markets. This contributed in no small measure to a sense of community within OPEC and endowed its leadership with a momentum of its own. In the overall performance, however, the achieved results have fallen short of stated aims. In this connection it may be useful to suggest that although in absolute terms the organization has not achieved its proclaimed goals, it has indeed achieved results that are more than adequate, by its having pragmatically settled for less ambitious but more realizable plans.

Following the international developments in this area, one is confronted by an almost endless series of "claims" by the various interested parties which are passed as "facts". Much of the published and some of the unpublished material, including interviews, tends to be pleadings rather than expositions or explanations. Commercial oil spokesmen appear to have a proclivity to state facts and analyses, the "proof" of which is kept secret at the parent company's home office. Similarly, listening to a poltical leader of an oil-producing nation (and of some consuming countries), one has to take account of his ideology in order to understand his economics. The whole area of international petroleum not only raises a large number of complex questions; but almost all of the issues tend to be controversial for they affect not only the pocketbooks of the oil industry, but the fortunes of both the poor and the rich among the consuming nations.

A selected bibliography is provided in Appendix C.

A quick reference table of the main characteristics of the political, economic and social profiles of OPEC members is included in Appendix D.

Concluding observations

* The deterioration of results for international oil companies (and in a way for the average consumer of petroleum products) in their negotiations concerning international petroleum affairs can be directly related to the existence of OPEC in general. A major impact seems to derive from the service OPEC provides in training nationals of Member Countries in major economic and technical issues

concerning the oil industry. After these nationals return to their homelands armed with vastly increased knowledge and understanding of global oil economics, they are able to match the experts of the international oil companies in negotiations. A similar trend has existed in higher education with Western countries, notably the United States and Great Britain but also France, Germany and other industrial countries, offering opportunities to many nationals of the oil-producing countries. Most of these persons with their newly-acquired education in economics, political science, industrial management and other technical skills return home to significant positions of responsibility in the growing local governmental corps of civil servants and political appointees. They are versed in Western languages and international petroleum affairs, while retaining their domestic socio-political outlook. A Harvard-trained administrator working for an American oil company does not enter negotiations better equipped than a Harvard-trained administrator running an agency of an Arab government. The facts of today's petroleum economics are no longer in the hands of the former select few.

* Although inflation, national or global, has no direct relationship to this report, the international debate about how much petroleum prices have contributed to the inflation rate of various countries, makes the relationship real though indirect. Global political power has been diluting almost in direct proportion to the various rates of national inflation when world problems of global import are discussed in international councils. To judge from the gloomy pronouncements which emerged from the annual IMF-World Bank meetings last month, the main preoccupation of Western policy-makers is with mounting economic problems, all of these centering on the seemingly insoluble difficulties of inflation/oil prices/balance of payments. Everyone is asking how much the rise in oil prices has contributed to world (or national) inflation. But there are no authoritative

national or international analyses of that subject. Work done by the World Bank Group and the OECD has focused on the money value of international oil transactions, with an occasional attempt to evaluate the balance of payments implications. But the problem of oil and inflation is so massive, so new and so unquantifiable as to defy precise analysis. The main difficulty, as it was pointed out by the OECD, is that any fundamental research on this subject is hampered by a lack of the requisite data.

* Another visible effect of OPEC's existence has been on the attitude of the major oil companies in dealing with individual host countries. Just as the companies have been rigid in their dealings with OPEC as a group, so they have demonstrated by and large an accommodating attitude and flexibility toward some host countries. It would seem that the companies' managers have been anxious to impress on the Governments of the host countries that their interests lie in direct negotiations with the company rather than the collective action within the OPEC framework. The oil companies have appeared to identify OPEC as their proverbial boulder in the middle of a road which it is prudent to go around, rather than try to push out of the way. Perhaps the boulder is too big to be moved without breaking it up. As yet neither diplomacy nor modern technology has produced the means to break up OPEC. It is true, however, that OPEC could break itself up if it undertakes ventures wherein conflicting interests of its constituents cannot be reconciled.

Appendix A

THE ORGANIZATION OF PETROLEUM EXPORTING COINTRIES

Preamble

By invitation of the Republic of Iraq, the Conference of the Petroleum Exporting Countries, composed of representatives of the Governments of Iran, Iraq, Kuwait, Saudi Arabia and Venezuela, hereafter called Members, met at Baghdad from the 10th to the 14th September, 1960, and having considered :

That the Members are implementing much needed development programmes to be financed mainly from income derived from their petroleum exports :

That members must rely on petroleum income to a large degree in order to balance their annual national budgets :

That petroleum is a wasting asset and to the extent that it is depleted must be replaced by other assets ;

That all nations of the world, in order to maintain and improve their standards of living must rely almost entirely on petroleum as a primary source of energy generation ;

That any fluctuation in the price of petroleum necessarily affects the implementation of the Members' programmes, and results in a dislocation detrimental not only to their own economies, but also to those of all consuming nations

Have decided to adopt the following Resolutions :

Resolution I.1

1. That Members can no longer remain indifferent to the attitude heretofore adopted by the Oil Companies in effecting price modifications :

2. That Members shall demand that Oil Companies maintain their prices steady and free from all unnecessary fluctuations ; that Members shall endeavour, by all means available to them, to restore present prices to the levels prevailing before the reductions ; that they shall ensure that if any new circumstances arise which in the estimation of the Oil Companies necessitate price modifications, the said Companies shall enter into consultation with the Member or Members affected in order fully to explain the circumstances.

3. That Members shall study and formulate a system to ensure the stabilization of prices by, among other means, the regulation of production, with due regard to the interests of the producing and of the consuming nations and to the necessity of securing a steady income to the producing countries, an efficient economic and regular supply of this source of energy to consuming nations, and a fair return on their capital to those investing in the petroleum industry.

4. That if as a result of the application of any unanimous decision of this Conference any sanctions are employed, directly or indirectly, by any interested Company against one or more of the Member Countries, no other Member shall accept any offer of a beneficial treatment whether in the form of an increase in exports or an improvement in prices, which may be made to it by any such Company or Companies with the intention of discouraging the application of the unanimous decision reached by the Conference.

Resolution I.2

1. With a view to giving effect to the provisions of Resolution No. 1, the Conference decides to form a permanent Organization called the Organization of the Petroleum Exporting Countries, for regular consultation among its Members with a view to coordinating and unifying the policies of the Members and determining among other matters the attitude which Members should adopt whenever circumstances such as those referred to in Paragraph 2 of Resolution No. I. 1 have arisen.

2. Countries represented in this Conference shall be the original Members of the Organization of the Petroleum Exporting Countries.

3. Any country with a substantial net export of crude petroleum can become a new Member if unanimously accepted by all five original Members of the Organization.

4. The principal aim of the Organization shall be the unification of petroleum policies for the Member Countries and the determination of the best means for safeguarding the interests of Member Countries individually and collectively.

5. The Organization shall hold meetings at least twice a year and if necessary more frequently in the capital of one or other of the Member Countries or elsewhere as may be advisable.

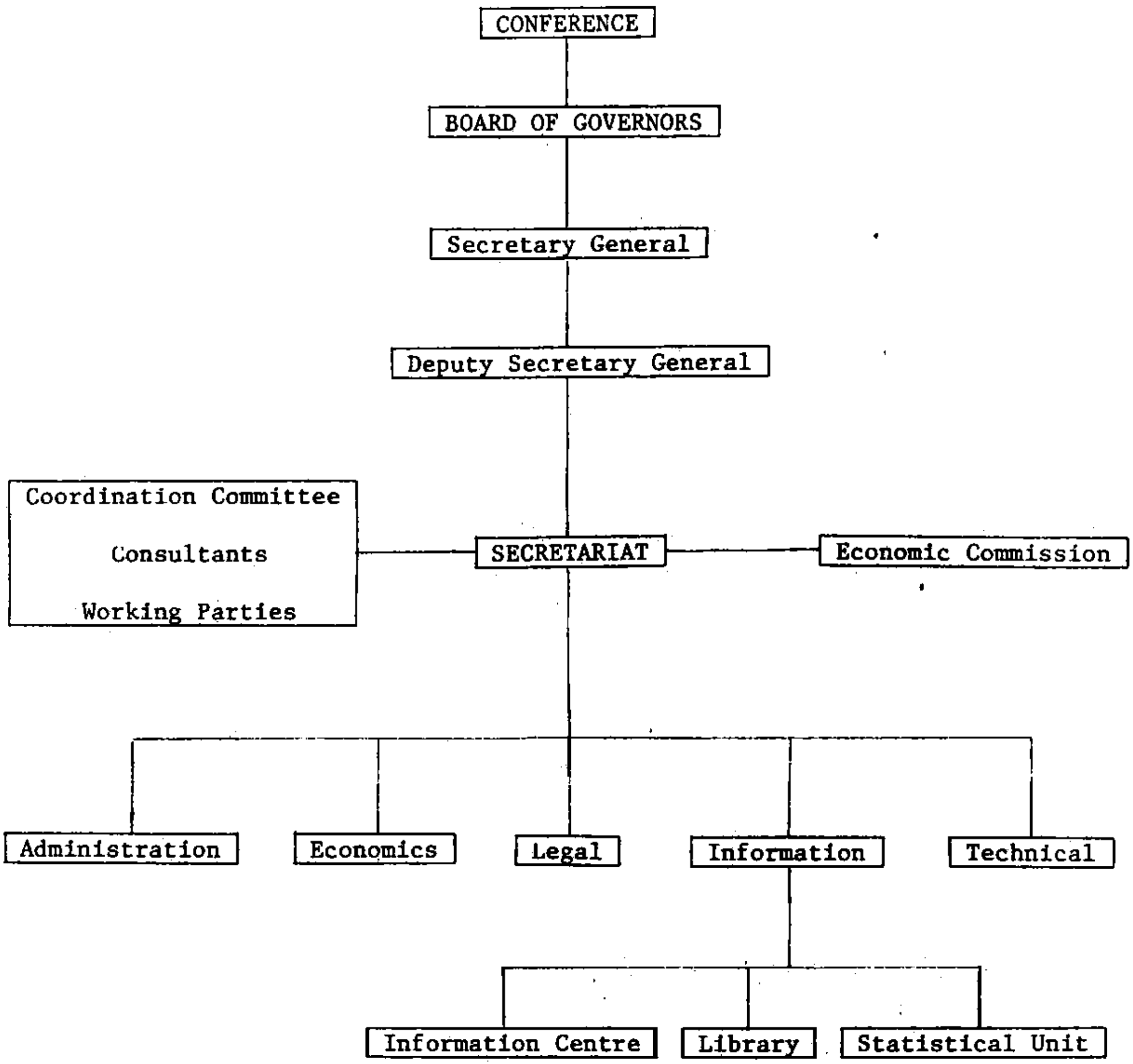
6. *a)* In order to organize and administer the work of the Organization there shall be established a Secretariat of the Organization of the Petroleum Exporting Countries ;

b) A subcommittee of not less than one member from each country shall meet in Baghdad not later than the first of December 1960 in order to formulate and submit to the next Conference draft rules concerning the structure and functions of the Secretariat ; to propose the budget of the Secretariat for the first year ; and to study and propose the most suitable location for the Secretariat.

Appendix B

THE ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES

(OPEC)



D. Scuka,Oct.'74,CRS - Eco.Div.

ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES

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SELECTED DATA OF A SOCIAL, POLITICAL AND ECONOMIC PROFILE OF O. P. E. C. MEMBERS

ITEM	Algeria	Ecuador	Gabon	Indonesia	Iran	Iraq	Kuwait	Libya	Nigeria	Qatar	Saudi Arabia	United Arab Emirates	Venezuela
Area (000 Sq. miles)	920	196	102	735	636	168	8	680	357	4	873	32	352
Estimated population (1971-72 in million)	14.8	6.5	0.5	119.2	30.3	9.8	0.9	2.0	65.9	0.1	8.0	0.2	10.7
Urban population as % of total	43%	30%	19%	17%	41%	47%	60%	27%	23%	68%	24%	52%	68%
Continent	Africa	S. America	Africa	Asia	Asia	Asia	Asia	Africa	Africa	Asia	Asia	Asia	S. America
Language	Arabic	Spanish	French	Bahasa Indonesia	Farsi/ Persian	Arabic	Arabic	Arabic	English	Arabic	Arabic	Arabic	Spanish
Capital City	Algiers	Quito	Libreville	Djakarta	Tehran	Baghdad	Kuwait	Tripoli	Lagos	Doha	Riyadh	Abu Dhabi	Caracas
Year of independence	1962	1830	1960	1949	1906	1932	1961	1951	1960	1971	1932	1971	1830
Diplomatic relations with U.S.	no	yes	yes	yes	yes	no	yes	yes	yes	yes	yes	yes	yes
Monetary unit	Dinar	Sucre	CFA Franc	Rupiah	Rial	Dinar	K. Dinar	L. Pound	N. Pound	Q.D. Riyal	S. Riyal	B. Dinar	Bolivar
GNP, 1972 (U.S. million $ equivalent)	6,950	2,014	488	10,620	17,400 1/	4,650	4,225	4,583	8,650 1/	NA	5,250 1/	NA	13,140
Industrial activity as share of total GNP	NA	18%	25%	16%	34%	40%	64%	63%	16%	NA	57%	NA	40%
GNP per capita in dollars - 1972	469	309	970	84	542	465	5,280	2,262	150	NA	920	NA	1,166
Total exports, 1973-(million U.S. $)	1,805	558	280e	3,062	6,943	2,292	3,790	3,600e	3,384	450e	7,600e	1,500e	4,000e
Total imports, 1973-(" " ")	2,342	517	166e	2,780e	3,400e	898	1,042	1,904	1,876	180e	2,000e	878e	2,950e
International reserves end 1972-(million U.S. $)	493	143	23	574	960	782	363	2,925	385	NA	2,500	NA	1,732
International reserves end 1973-(million U.S. $)	1,134	241	48	807	1,237	1,553	501	2,127	592	NA	3,877	NA	2,420
U.S. foreign aid to: FY 1972-(million U.S. $)	21.9	12.5	0.1	270.7	159.2	0.3	--	2/	39.9	--	13.9	--	53.4
U.S. foreign aid to: FY 1973-(million U.S. $)	187.8	17.8	0.1	331.8	283.2	0.3	--	--	15.3	--	0.2	--	27.4
Oil exports value as percentage of total exports - 1972 %	85	17	60e	51	92	93	95	99	83	99e	99e	80e	93
- 1973 %	88	45	65e	49	91	95	92	98e	83	99e	99e	85e	91e
- 1974 %	90e	55e	80e	70e	95e	98e	95e	95e	90e	99e	99e	90e	93e
Motor vehicles (in thousands, 1971)	260e	70e	11e	385e	410	116	165	160e	112	NA	125e	NA	800e
Telephones per thousand persons	1.3	2.4	1.4	0.2	1.1	1.2	8.8	2.0	0.1	13.1	1.0	7.1	4.2
Radio sets per thousand persons	52	279	124	114	93	180	132	45	27	NA	11	NA	163
TV sets per thousand persons	7	25	2	1	9	5	144	1	1	NA	1	NA	82
Net calories per capita/day available	1,890	1,890	2,180	1,930	2,030	2,050	NA	1,730	2,440	NA	2,080	NA	2,180
Population per physician (in thousand, period 1969-71)	8.2	2.9	5.1	27.7	3.1	3.3	1.1	2.6	20.5	1.0	11.0	NA	1.1

NA - not available
e - estimated

General note: For data that do not and cannot change substantially in a few years we have used the latest figures available without specifying what year for each individual entry. Any possible difference in magnitude of such data is statistically negligible.

1/ Other than Gregorian calendar year.
2/ Less than $50,000.

Sources: United Nations, World Bank Group, Departments of State and Commerce, CRS estimates.

R. Bamba, Oct. '74, CRS - Econ. Div.