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IS THE OIL SHORTAGE REAL?
Oil Companies As OPEC Tax-Collectors

by M. A. Adelman

The United States currently consumes more energy than any other country. Over the next dozen years, our energy consumption may double. Oil and gas provide three-fourths of our energy. Domestic reserves could supply this projected demand only at excessive costs, and large-scale supply of nuclear energy is more than a decade away. By the end of this decade, we will probably be importing very substantial quantities of our oil.

It is widely believed that this situation will constitute a major foreign policy problem in the coming decade with implications ranging from adverse effects on our balance of payments to a changed political balance in the Middle East. Negotiations between oil companies and oil-producing countries have been front page news almost continuously for the past two years, with the companies recently agreeing to producing-country “participation” in ownership. The New York Times has announced editorially that “the squeeze on oil has begun,” and the Ford Foundation is financing a large-scale study of world energy problems. Oil companies have spent considerable amounts on advertisements to inform us about the problem.

Given these views, it is rather startling to find a highly respected M.I.T. economist and oil expert stating that there is “absolutely no basis to fear an acute oil scarcity over the next 15 years.” Professor Adelman, while acknowledging that the United States is confronted with a local exhaustion of its low cost oil and gas, nevertheless argues in the following article that not only is the world energy crisis “a fiction,” but that to the extent that there is a foreign policy problem, it is in considerable part caused by inept policies of the U.S. government.
In Adelman's view, the State Department's interest in "stability" has reinforced the oil companies' and producing-countries' ability to maintain a monopoly price at 10 to 20 times the long-run incremental cost of producing oil. The only question that matters is whether the monopoly will flourish or fade. The success of the OPEC cartel of oil-producing countries largely depends, in Adelman's view, on the policies of the United States and other consuming countries, to which the oil companies will adapt as best they can. If, for a variety of reasons spelled out below (and by Theodore Moran in the last issue of FOREIGN POLICY) the oligopoly weakens, the sources of supply of oil on world markets will increase and the price will decrease.

In the meantime, contrary to popular myth, the multinational companies turn out to be agencies for taxing people in consuming countries—both rich and poor—and transferring the lion's share of the proceeds to the governments of the oil-producing countries. The amount of the resources transferred by this transnational system exceeds the amounts of resources transferred in bilateral governmental aid programs.

Adelman's article is longer than our usual articles, and his views are bound to provoke controversy. Nonetheless, the Editors of FOREIGN POLICY believe that the article makes an important contribution toward developing an informed debate on what has already become an important foreign policy issue.

The multinational oil companies have become, in the words of the board chairman of British Petroleum, the "tax collecting agency" of the producing nations. In 1972, the companies operated the greatest monopoly in history and transferred about $15 billion from the consuming countries to their principals. If the arrangement continues, a conservative estimate for 1980 collection is over $55 billion per year. Much of that wealth will be available to disrupt the world monetary system and promote armed conflict. Oil supply is

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now much more insecure. Monopoly, the power to overcharge, is the power to withhold supply. Among nations, an embargo is an act of war, and the threat of an oil embargo ushered in the Organization of Petroleum Exporting Countries (OPEC) cartel.

The oil companies are now the agents of a foreign power. They will be blamed for impairing the sovereignty of the consuming countries, and quite unjustly. They only did the will of the OPEC nations and of the consuming countries themselves, notably the United States. The consumers' "strange and self-abuse" is the key to how the events of 1970-71 turned a slowly retreating into a rapidly advancing monopoly.

The most important player in the game is the American State Department. This agency is deplorably poorly informed in mineral resource economics, the oil industry, the history of oil crises and the participation therein of the Arabs with whom it is obsessed; in fact, State cannot even give an accurate account of its own recent doings.

Prediction is unavoidable but risky. In 1963 I thought that, abstracting from inflation, a price of $1 per barrel at the Persian Gulf was not unlikely fairly soon. In terms of 1963 dollars it did go to 92 cents by early 1970. As predicted, supply remained excessive, and the companies could not control the market. But on the political side, the prediction went all wrong in 1970-71. Although I had warned that the producing countries might threaten a cutoff of supply, and urged insurance against it, I was much mistaken to call it an unlikely event. Nor did I expect the consuming countries, especially the United States, to cooperate so zealously.1 I may be equally wrong to

expect that consuming countries will continue this way for most or all of the 1970's.

The unanimous opinion issuing from companies and governments in the capitalist, Communist, and Third Worlds is that the price reversal of 1970 and 1971 resulted from a surge in demand, or change from surplus to scarcity, from a buyers' to a sellers' market. The story has no resemblance to the facts. The 1970 increase in consumption over 1969 was somewhat below the 1960-1970 average in all areas. The increase in 1971 over 1970, in Western Europe and Japan, was about half the decade average. In the first quarter of 1972, Western European consumption was only 1.5 percent above the previous year. By mid-1972, excess producing capacity, a rarity in world oil (i.e. outside North America) was almost universal and had led to drastic government action, especially in Venezuela and Iraq. The industry was "suffering from having provided the facilities for an increase in trade which did not materialize." A drastic unforeseen slowdown in growth and unused capacity would make prices fall, not rise, in any competitive market.

Some powerful force has overridden demand and supply. This force did not enter before the middle of 1970, at the earliest. Up to that time the trend of prices had been downward, and long-term contracts had been at lower prices than short-term, indicating that the industry expected still lower prices in the future, even as far as 10 years ahead.²

If demand exceeds supply at current prices, sellers and buyers acting individually make new bargains at higher prices. When supply exceeds demand yet prices are raised, the conclaves, joint actions, and "justifications" are strong evidence of collusion, not scarcity.

More precisely: in a competitive market, a surge in demand or shrinkage in supply

raises price because it puts a strain on the productive apparatus. To produce additional output requires higher costs; unless compensated by higher prices, the additional output will not be supplied.

If there were increasing long run scarcity at the Persian Gulf, discoveries falling behind consumption, the reservoirs would be exploited more intensively to offset decline, and to maintain and expand production. More capital and more labor would be required per additional barrel of producing capacity. In fact, between 1960 and 1970 (the last year available), the investment needed per unit of new crude oil capacity fell by over 50 percent, despite a rising general price level. Labor requirements (which are both for construction and operation) have fallen even more drastically. Supply has not only not tightened, it has been getting easier.

The world "energy crisis" or "energy shortage" is a fiction. But belief in the fiction is a fact. It makes people accept higher oil prices as imposed by nature, when they are really fixed by collusion. And sellers of all

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3 W.P.M., Ch. II and Ch. VII. For later data, see my paper, "Long Run Cost Trends" in John J. Schanz, (ed.), Balancing Supply and Demand (1972).

4 The United States "energy crisis" is a confusion of two problems. First, environmental costs are slowing down electric power growth and threatening blackouts. The worse the slowdown, the less the drain on fuel supply. Second, there has been gradual exhaustion of lower-cost oil and gas resources in the Lower 48 States. Natural gas deserves special mention, for the world has been deeply impressed by American business executives and cabinet members rocketing about the world like unguided missiles in search of gas supplies; particularly coming hat in hand to beg gas of the Soviet Union. One folly has led to another. Prices of American natural gas have been held at a level well below what would clear the market, generating a huge excess demand, all channeled overseas. Import prices have soared and will probably rise further if domestic price-fixing is not abolished. Profits to the overseas producing nations who own the gas will be lush. American companies have tried to arrange deals and obtain a part of the gains; American government officials have helped the stampede. The gas shortage could be abolished by the simple expedient of abandoning price ceilings. Gas might still be imported, but at lower prices, in smaller amounts. The strain on coal and oil resources would actually be less, since higher domestic prices would increase domestic supply of natural gas.

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fuels, whatever their conflicts, can stand in harmony on the platform of high oil prices. Twenty years ago, the Paley Commission made the classic statement of the problem:

"Exhaustion is not waking up to find the cupboard is bare but the need to devote constantly increasing efforts to acquiring each pound of materials from natural resources which are dwindling both in quality and quantity... The essence of the materials problem is costs."

It is worth assuming arbitrarily that in the future supply will tighten. The worst that can happen is zero new discoveries. Table I shows Persian Gulf production and reserves in the zero-discoveries model, recognizing that reserves in fields known in 1971 can be expanded by development and discoveries of new pools in the old fields. The assumption of 50 percent expansion is highly conservative in the light of American experience, considering also that probably most Persian Gulf reserves (like most production) are in fields discovered in the last 20 years.

In 1950, Persian Gulf reserves were estimated at 42 billion barrels, mostly in eight

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TABLE I
Persian Gulf Production and Reserves
Zero Discoveries Model, 1971-1985

<table>
<thead>
<tr>
<th>Year</th>
<th>Production</th>
<th>Reserves</th>
<th>Production/Reserves</th>
<th>Reserves plus 50 percent</th>
<th>Average Growth per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>6 BBY</td>
<td>367 BB</td>
<td>1.6 %</td>
<td>550 BB</td>
<td>8 %</td>
</tr>
<tr>
<td>1971-85</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>17 BBY</td>
<td>143 BB</td>
<td>4.0 %</td>
<td>6.7 %</td>
<td></td>
</tr>
<tr>
<td>Cumulative 1972-85</td>
<td>178 BB</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remaining</td>
<td>407 BB</td>
<td>372 BB</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production/Reserves</td>
<td>4.0 BB</td>
<td>6.7 BB</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

BB = billion barrels
BBY = billion barrels per year; a billion = one thousand million.

large fields still producing today at ever-higher rates with no peaking out. In 1951-71 inclusive, 47 billion barrels were extracted. At end-1971 reserves were 367 billions, mostly in 26 large fields, including the original eight. On the basis of production, one may estimate that nearly half the reserves are in fields operating in 1950, nearly a fourth in fields discovered in 1950-59, between a fourth and a third in 1960-69 discoveries, which have the greatest expansion potential (Reserve data from BP Statistical Review of the World Oil Industry and Oil & Gas Journal).

Production growth in 1971-85 is estimated first according to a recent BP forecast of 7.7 percent, which takes account of rising U.S. imports, to come mostly from the Persian Gulf. Doubtless also it registers, as does a Shell forecast, the cessation of growth in European imports as North Sea oil and gas takes over. Indeed, Persian Gulf shipments to Europe will probably be lower in 1980 than in 1972—rising and then falling in the interim. But to be on the safe side, we also estimate 1972-85 production by extrapolating the long time growth rate.

The cumulated production 1972-85 is subtracted from expanded end-1971 reserves. The higher the production-reserve ratio, the higher is cost, all else being equal. The zero-discoveries model is drastic to the point of absurdity. Moreover, it sets to zero the reserves of African and Persian Gulf natural gas, which at current prices are worth producing, and which equate to an additional 90 billion barrels oil equivalent. Even so, the 1985 production-reserve percent is much lower than is planned for similar, i.e. high

*Assume that American imports from the Persian Gulf rise at a constant percentage rate from 310 TBD (thousand barrels daily) in 1971 to 10 MBD (million barrels daily) in 1980 and to 15 MBD in 1985. Then cumulative imports are 7.3 billion barrels through 1980 and 23.4 billion through 1985: respectively 2 percent and 6 percent of end-of-1971 Persian Gulf reserves. In the next 15 years, many times more than these amounts will be developed into new reserves, even if there are zero discoveries of new fields. McFadzean, op. cit., Chart 11 on Western Europe.*

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capacity, reservoirs in the North Sea or Alaska, which are usually in the range of 7 to 11 percent.

Depletion of reserves at the Persian Gulf is only about 1.5 percent a year. It is un-economic to turn over an inventory so slowly. But Persian Gulf operators have not been free to expand output and displace higher cost production from other areas because this would wreck the world price structure. Therefore, it is meaningless to average production-reserve ratios for the whole world, as is too often done. A barrel of reserves found and developed elsewhere in the world is from five to seven times as important in terms of productive capacity as a barrel at the Persian Gulf. In other words, one could displace production from the entire Persian Gulf with reserves from one-fifth to one-seventh as large. And this is perhaps the only constructive aspect of the current drive for self-sufficiency in oil. This zero-discoveries model yields a much higher production-reserves percent, hence a substantial increase in investment requirements and current operating costs per barrel. Today at the Persian Gulf, capital and operating costs are each about 5 cents per barrel; under our extreme assumptions, they are roughly double. The difference between 10 and 20 cents measures the value of discovering new fields: it takes the strain off the old.

No Basis for Fears

The zero-discoveries model only estimates the worst that could happen; it is not a prediction of what will happen. When the procedure was applied in 1965, current and projected costs were higher than they are now, since many new discoveries have freshened the mix, not to speak of improvements in technology.

There is no more basis for fears of acute oil scarcity in the next 15 years than there was 15 years ago—and the fears were strong in 1957. The myth that rising imports (of the United States) will "turn the market around" is only the latest version of the myth.
that rising imports (of Europe and Japan) would "dry out the surplus in 1957-70".6

More generally: supply and demand are registered in incremental cost, which is and long will be a negligible fraction of the current crude oil price of about $1.90 per barrel. Hence supply and demand are irrelevant to the current and expected price of crude oil. All that matters is whether the monopoly will flourish or fade.

In Europe and Japan, there was a mild and temporary shortage of refining capacity in early 1970. At the same time, a tanker shortage put rates at the highest level since shortly after the closing of the Suez Canal, and raised product prices.

In May 1970 the trans-Arabian pipeline was blocked by Syria to obtain higher payments for the transit rights, while the Libyan government began to impose production cutbacks on most of the companies operating there, to force them to agree to higher taxes. Although the direct effect of the cutback and closure was small, the effect on tanker rates was spectacular, and product prices and profits shot up.

The companies producing in Libya speedily agreed to a tax increase. The Persian Gulf producing countries then demanded and received the same increase, whereupon Libya demanded a further increase and the Persian Gulf countries followed suit. Finally, agreements were signed at Tehran in February 1971, increasing tax and royalty payments at the Persian Gulf as of June 1971 by about 47 cents per barrel, and rising to about 66 cents in 1975. North African and Nigerian increases were larger. In Venezuela the previous 1966 agreement was disregarded and higher taxes were simply legislated. These taxes are in form income taxes, in fact excise taxes, in cents per barrel. Like any other excise tax they are treated as a cost and

become a floor to price. No oil company can commit for less than the sum of tax-plus-cost per barrel.\footnote{Tax is calculated as follows: output multiplied by posted prices equals fictional “receipts.” Production costs are subtracted, and however calculated they are very small. The difference is the fictional “profit,” which goes usually 55 percent to the nation. Thus the tax per barrel is completely independent of actual receipts, and only very slightly affected by costs, hence almost completely independent of profits. Therefore it is an almost pure excise tax.}

**Government-Company Harmony**

The multinational companies producing oil were amenable to these tax increases because as was openly said on the morrow of Tehran, they used the occasion to increase their margins and return on investment in both crude and products. In Great Britain the object was stated: to cover the tax increase “and leave some over,” and the February 1971 tax increase was matched by a product price increase perhaps half again as great. The best summary of the results was by a well known financial analyst, Kenneth E. Hill, who called the agreements “truly an unexpected boon for the worldwide industry.”

Mr. Hill rightly emphasized product price increases, but arm’s length crude prices also increased by more than the tax increases. When the producing countries made fresh demands later in 1971, an American investment advisory service (United Business Services) remarked that tax increases were actually favorable to oil company profits. And 1971 was easily the best year for company profits since 1963, although there was a profit slide off later in the year, as competition in products though not yet in crude again reasserted itself.

The price pattern is set for the 1970’s. From time to time, either in pursuance or in violation of the Tehran-Tripoli “agreements,” the tax is increased, whereupon prices increase as much or more, but then tend to erode as the companies compete very slowly at the crude level and less slowly at the products level. Thus prices increase in
steps, yet at any given moment there is usually a buyer's market, i.e. more is available than is demanded at the price, which is under downward pressure.

The companies' margin will therefore wax and wane, but they benefit by the new order. They cannot, even if they would, mediate between producing and consuming nations. As individual competitors, they are vulnerable to producing-nation threats to hit them one at a time. As a group, they can profit by a higher tax through raising prices in concert, for the higher tax is that clear signal to which they respond without communication. The Secretary General of OPEC, Dr. Nadim Pachachi, said truly that there is no basic conflict between companies and producing nations. The then head of Shell, Sir David Barran, spoke of a "marriage" of companies and producing governments. Most precise of all was Sir Eric Drake, the chairman of BP, who called the companies a "tax collecting agency," for both producing and consuming country governments. There is, however, a difference in kind between serving a government in its own country to collect revenue from its own citizens, and serving a government to collect revenue from other countries.

Leading Role of the United States

Without active support from the United States, OPEC might never have achieved much. When the first Libyan cutbacks were decreed, in May 1970, the United States could have easily convened the oil companies to work out an insurance scheme whereby any single company forced to shut down would have crude oil supplied by the others at tax-plus-cost from another source. (The stable was possibly locked a year after the horse was stolen.) Had that been done, all companies might have been shut down, and the Libyan government would have lost all production income. It would have been helpful but not necessary to freeze its deposits abroad. The OPEC nations were unprepared for conflict. Their unity would have been severely tested.
and probably destroyed. The revenue losses of Libya would have been gains to all other producing nations, and all would have realized the danger of trying to pressure the consuming countries. Any Libyan division or brigade commander could consider how he and friends might gain several billions of dollars a year, and other billions deposited abroad, by issuing the right marching orders.

Failure to oppose does not necessarily imply that the United States favored the result. But there was unambiguous action shortly thereafter. A month after the November agreements with Libya, a special OPEC meeting in Caracas first resolved on “concrete and simultaneous action,” but this had not been explained or translated into a threat of cutoff even as late as January 13, nor by January 16, when the companies submitted their proposals for higher and escalating taxes.8

Then came the turning point: the United States convened a meeting in Paris of the OECD nations (who account for most oil consumption) on January 20. There is no public record of the meeting, but—as will become clear below—there is no doubt that the American representatives and the oil companies assured the other governments that if they offered no resistance to higher oil prices they could at least count on five years’ secure supply at stable or only slightly rising prices.

The OECD meeting could have kept silent, thereby keeping the OPEC nations guessing, and moderating their demands for fear of counteraction. Or they might have told the press they were sure the OPEC nations were too mature and statesmanlike to do anything drastic, because after all the OECD nations had some drastic options open to them . . . but why inflame opinion by talking about those things? Instead an OECD spokesman praised the companies’ offer, and declined to estimate its cost to the consuming countries.

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8Neither the New York Times nor the Wall Street Journal, in their stories on the subject (January 14, 17, 19, 1971) had any reference to any retaliation or concerted action on the proposal.
He stated that the meeting had not discussed “contingency arrangements for coping with an oil shortage.” This was an advance capitulation. The OPEC nations now had a signal to go full speed ahead because there would be no resistance.

Before January 20, an open threat by the OPEC nations would not have been credible, in view of the previous failure of even mild attempts at production regulation in 1965 and 1966. But after the capitulation, threats were credible and were made often. (This is clear from a careful reading of the press in January and February 1971.) They culminated in a resolution passed on February 7 by nine OPEC members, including Venezuela but not Indonesia, providing for an embargo after two weeks if their demands were not met. The Iranian Finance Minister, chief of the producing nations’ team, said: “There is no question of negotiations or resuming negotiations. It’s just the acceptance of our terms.” The companies were resigned to this, but wanted assurances that what they accepted would not be changed for five years.

The United States had been active in the meantime. Our Under Secretary of State arrived in Tehran January 17, publicly stating his government’s interest in “stable and predictable” prices, which in context meant higher prices. He told the Shah of Iran the damage that would be done to Europe and Japan if oil supplies were cut off. Perhaps this is why the Shah soon thereafter made the first threat of a cutoff of supply. It is hard to imagine a more effective incitement to extreme action than to hear that this will do one’s opponents great damage.

Resistance to the OPEC demands would have shattered the nascent cartel. As late as January 24, the Shah told the press: “If the oil producing countries suffer even the slightest defeat, it would be the death-knell for OPEC, and from then on the countries would no longer have the courage to get together.”

When the Tehran agreement was announced, another State Department special
press conference hailed it, referring many times to “stability” and “durability.” They “expected the previously turbulent international oil situation to calm down following the new agreements.” They must really have believed this! Otherwise they would not have claimed credit for Mr. Irwin or for Secretary Rogers, or induced President Nixon’s office to announce that he too was pleased. They must have said this in Paris in January and again at an OECD meeting in May. We now live with the consequences.

State Department representative James Akins told a Senate Committee in February 1972: “The approach we made in the Persian Gulf [was] primarily because of the threat to cut off oil production. . . . We informed the countries that we were disturbed by their threats, and these were withdrawn very shortly after our trip.” The public record outlined above shows that the threats of embargo began after the Under Secretary’s arrival, culminated in OPEC Resolution XXII.131 on February 7, and were never withdrawn.

Scrap of Paper

The oil companies knew better than to take the “agreements” seriously; they had been there before. To be sure, one could cite many a statement by an oil executive about the “valuable assurances of stability,” but this was ritual. The London Economist, always in close touch with the industry, expected any agreements to last only a few months, given the “persistent bad faith.” The best summary was made by Petroleum Intelligence Weekly: “If such agreements were worth anything the present crisis wouldn’t exist.”

This was borne out in August of 1971. Devaluation of the dollar, the occasion for new demands, was of course an incident in the worldwide price inflation to which the Tehran and Tripoli agreements had adjusted by providing for periodic escalation. Moreover, Persian Gulf revenues were mostly not payable in dollars. The new element in the situation was not the increased dollar cost of

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imports to the producing countries, but the fact that prices in dollars increased, especially in Germany and Japan. This was another windfall gain to the companies, just as in early 1970. Again the producing countries were able to take most of that gain in the consuming countries because the multinational companies were the producers of oil as well as sellers of refined products.

The “oil companies had hailed the agreements as guaranteeing a semblance of stability in oil prices . . . they would seek to pass on the impact of any new cost [tax] increases.” The new demands, said the chairman of Jersey Standard (Esso, or now Exxon), were a violation of the Tehran agreements, but “the industry will solve these problems just as our differences with them were reconciled earlier this year and before,” i.e. higher taxes and higher prices. This was precisely correct both as to substance and as to ritual. The OPEC governments made their demands. The companies made an offer. The governments refused it and broke off the talks. The companies made a better offer, taxes were raised again, and crude oil prices with them.

Even before this deal, the producing nations had already made an additional demand, for so-called “participation.” The companies said they were distressed that the agreements “have not led to the long peace . . . that they had anticipated.” They would resist the demands as a violation of the agreements. Whereupon the governments “announced that they would take part in a ‘combined action’ if they didn’t receive ‘satisfaction,’ ” and the companies agreed to negotiate. In March, the Aramco companies who account for nearly all output in Saudi Arabia conceded participation “in principle.”

“Participation,” by recently negotiated companies and various Arabian governments, is a misnomer. “Pseudo-participation” would be more apt. “Participation” does not mean that the government actually produces or sells oil, or transfers it downstream for refining and sale. As we will see later, selling oil is
what Saudi Arabia wisely aims to avoid. "Participation" is simply an ingenious way of further increasing the tax per barrel without touching either posted prices or nominal tax rates, thus apparently respecting the Tehran agreements. Once the tax increase is decided, everything can be cut to fit. The same oil is still sold or transferred by the same companies. On the terms discussed early in 1972, "participation" would mean about 9 cents more tax per barrel. Those who believe that this assures supply, stable prices and a solution to the balance of payments problem will believe anything.

There has been unparalleled turbulence since the State Department special conference. Venezuela dispensed with the elaborate sophistry of "agreements," and legislated: an additional tax increase in 1971 and again in early 1972 with another expected in early 1973; nationalization of natural gas; the requirement that companies deposit increasing sums of money lest they permit properties to run down before the national takeover in 1984; and the extension of this "reversion" to all facilities rather than only producing facilities. Confronted with declining production because it was cheaper for the companies to lift additional output from the Persian Gulf, Venezuela set minimum production rates, with fines for insufficient output.

In Libya, the government followed the Persian Gulf countries in demanding and getting an increase on the same pretext of monetary adjustment; and also in demanding participation, whether "participation" or the real thing is not yet clear. In December 1971,

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*The concession company and host government need to determine four items: (a) The government owes the concessionaire a certain sum per year to cover the amortized cost of the equity share. (b) The government loses the taxes it formerly received on the share it now "owns." (c) The concessionaire owes the government the "price" of the oil which the government owns, and which it now "sells" to the company. (d) The concessionaire owes the government its pro-rata share of the year's profits of the operating company. The subject of the negotiation is by what amount (c + d) shall exceed (a + b). The 9 cent estimate is from Petroleum Press Service, April 1972, p. 118.
when Iran seized two islands near the mouth of the Persian Gulf, Libya seized the properties of British Petroleum in "retaliation"; any stick is good enough to beat a dog.

The Algerian government took two-thirds of the output of the French companies, who were "compensated" with what little remained after deducting newly calculated taxes.

In Iraq, the operating Iraq Petroleum Company cut output sharply during 1972 for the same reason as everywhere else in the Mediterranean (where the main field delivers via pipeline)—costs plus taxes were lower at the Persian Gulf, where capacity was being quickly and cheaply expanded. Iraq demanded that production be restored, and that IPC make a long-term commitment to expand output by 10 percent per year. The IPC counter-offer not being acceptable, Iraq made headlines by seizing the Kirkuk field June 1, then offered forthwith to sell at "reduced and competitive prices," for spot delivery or long-term contracts. This threat was aimed at the most sensitive point of the world oil industry: the permanent potential over-supply which in Iraq (and other countries) had already been made actual. Price-cutting is intolerable in a cartel; to avoid it, a flurry of complex negotiations began. A loan was soon made by other Arab OPEC members. "Behind the Arab nations' action . . . lies an offer by Iraq to sell its newly nationalized oil at a cut rate, which would have driven down the revenues received by the other countries for their oil."

This may also explain the gentlemanlike behavior of the expropriated IPC, which did not attempt to blacklist Iraq oil to be sold in non-Communist markets.

Onward and Upward with Taxes and Prices

The genie is out of the bottle. The OPEC nations have had a great success with the threat of embargo and will not put the weapon away. The turbulence will continue as taxes and prices are raised again and again. The producing nations are sure of oil com-
pany cooperation and consuming-country nonresistance. This is a necessary condition. There are two purely economic reasons why the situation cannot be stable.

1. The crude oil price can go much higher before it reaches the monopoly equilibrium or point of greatest profit.

The average price in Europe of a barrel of oil products in 1969-70 was about $13 per barrel. It is higher today. If the new tax rates were doubled, say from $1.50 to $3 per barrel at the Persian Gulf, a straight pass-through into product prices would be an increase of only 10-14 percent. It is doubtful that such an increase would have any noticeable effect on oil consumption. Moreover, about half of the European price consists of taxes levied by the various consuming-country governments. The producing nations have long insisted that in justice they ought to receive some or most of this amount. Be that as it may, most or all of this tax can be transferred from consuming to producing nations, with help from consuming-country governments who dislike unpopularity through higher fuel prices. The Italian government collaborated early in 1971.¹⁰

The current price of oil, however far above the competitive level, is still much less than alternatives. The producing nations are not a whit displeased by big expensive projects to produce oil or gas from coal or shale or tar sands, which are a constant reminder of what a bargain crude is, even at higher prices. Particularly outside the United States, nuclear power sets a high ceiling, coal a much higher ceiling. The price of British coal has long and well served sellers of fuel oil in Britain, who priced at or slightly below coal-equivalent. Small wonder that the head of Shell appealed in October 1971 for the maintenance of a British coal industry.

¹⁰Dr. M. S. Al-Mahdi, chief of the Economic Department of OPEC, in a paper partly summarized in Middle East Economic Survey, July 14, 1972, p. 11, estimates the 1970 Western Europe average consumer price as $13.14, of which 57.3 percent was tax. See also: Direction des Carburants: Rapport Annuel 1969. Italian collaboration: Petroleum Intelligence Weekly, May 24, 1971.
There has therefore been much discussion, mostly oral, of the goal for the Persian Gulf nations being the U.S. price; or $5 per barrel, etc. These are attainable goals, and we must therefore expect attempts to reach them.

2. The producing nations cannot fix prices without using the multinational companies. All price-fixing cartels must either control output or detect and prevent individual price reductions, which would erode the price down toward the competitive level. The OPEC tax system accomplishes this simply and efficiently. Every important OPEC nation publishes its taxes per barrel; they are a public record, impossible to falsify much. Outright suppression would be a confession of cheating. Once the taxes are set by concerted company-government action, the price floor of taxes-plus-cost is safe, and the floor can be jacked up from time to time, as in early 1971, or early 1972, or by "participation."

It is essential for the cartel that the oil companies continue as crude oil marketers, paying the excise tax before selling the crude or refining to sell it as products.

Were the producing nations the sellers of crude, paying the companies in cash or oil for their services, the cartel would crumble. The floor to price would then be not the tax-plus-cost, but only bare cost. The producing nations would need to set and obey production quotas. Otherwise, they would inevitably chisel and bring prices down by selling incremental amounts at discount prices. Each seller nation would be forced to chisel to retain markets because it could no longer be assured of the collaboration of all the other sellers. Every cartel has in time been destroyed by one then some members chiselling and cheating; without the instrument of the multinational companies and the cooperation of the consuming countries, OPEC would be an ordinary cartel. And national companies have always been and still are price cutters. 11

11 Petroleum Press Service, February 1972, pp. 53 and 64, notes that Algeria and Libya have shaved prices to move product.
Chiselling will accelerate if national companies go “downstream” into refining and marketing. One can transfer oil to downstream subsidiaries or partners at high f.o.b. prices, but with fictitious low tanker rates or generous delivery credits. The producing nation can put up most of the money or take a minority participation, or lend at less than market interest rates. One can arrange buyback deals, barter deals, and exchanges of crude in one part of the world for availability elsewhere. The world oil cartel in the 1930’s was eroded by this kind of piecemeal competition, and so will the new cartel of the 1970’s if the individual producing nations become the sellers of oil.

The Saudi Arabian petroleum minister, Sheik Yamani, who designed “participation,” warned in 1968 against nationalizing the oil companies, and making them “buyers and brokers” of crude oil. This would, he argued truly, lead to “collapse” of oil prices and benefit only the consuming countries. The experts retained by OPEC also warned in 1971 that “participation” must not interfere with marketing of the oil through the companies. More recently, in 1971, Sheik Yamani warned that “participation” had to provide the right kind of “marketing operations.” In 1972 he added: “We are concerned that prices in world markets do not fall down.”

OPEC has come not to expel but to exploit. And if the excess crude oil supply were not permanent, Sheik Yamani would have no cause for the “concern” he rightly feels.

We may therefore conclude: the producing countries can raise prices and revenues further by jacking up the excise tax floor, in concert. Conversely, if and when the consuming countries want to be rid of the cartel, they can take their companies out of crude oil marketing. To avoid taxation, they can decommission the tax collecting agents who are their own creation.

So far, the consuming countries have gone in precisely the opposite direction. As they develop high cost substitutes, and strive to
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get their respective companies, public or "private," into crude oil production and marketing, they will rivet the tax collection agency more firmly on their necks. It is time to ask why they do this, and whether the policy may change.

One can only guess at the unstated reasons why the United States has put OPEC in the driver's seat. First, American companies have a large producing interest in the world market. In 1971, American companies produced about 6.5 billion barrels outside the United States. For every cent of increase in prices above that in tax, there is an additional $65 million in profit.¹² Second, the higher energy costs will now be imposed on competitors in world markets; and in petrochemicals, higher raw material costs as well. Third, the United States has a large domestic oil producing industry. The less the difference between domestic and world prices, the less the tension between producing and consuming regions.

Fourth, the United States desired to appease the producing nations, buying popularity with someone else's money and trying to mitigate the tension caused by the Arab-Israeli strife, which, however, is irrelevant to oil. If the Arab-Israeli dispute were settled tomorrow, the producing nations would not slow down for one minute their drive for ever-higher prices and taxes. The acknowledged leader of the Persian Gulf nations in early 1971 was Iran, which has in one important respect—the Trans-Israel Pipe Line—actually cooperated with Israel more than the United States, which in 1957 and 1968 discouraged the pipeline.¹³

The State Department View

In a recent speech—to the West Texas Oil and Gas Association—the director of the State Department Office of Fuels and Energy,

¹²See W. P. M., Ch. VIII, note 32, for the calculation.

¹³Wall Street Journal, February 20, 1957 (the State Department thought a pipeline through Iraq would be preferable) and Platt's Oilgram News Service, April 22, 1968.
James Akins, professed he could not sleep for worry over the possibility of a "supply crisis" caused by even one Arab nation stopping oil production. Such a "crisis" is a fantasy. Five Arab countries produce an aggregate of one MBD; they would never be missed. In 1951, Iran, producing nearly 40 percent of Persian Gulf output, shut down; yet 1951 Persian Gulf output actually rose. No Arab or non-Arab country is nearly that important today. In the winter of 1966-67, Iraq—about 10 percent then as now—shut down, and there was not even a ripple on the stream.

If any proof were needed that an Arab boycott will hurt only the Arabs and soon collapse, the 1967 experience should suffice. The Wall Street Journal, for example, said that the former Secretary General of OPEC, Francisco R. Parra, "can't conceive of any political situation arising in the Middle East that would lead to confiscation of investments held by the oil companies. Should another Arab-Israeli war break out, Mr. Parra doesn't expect any repetition of the unsuccessful attempt by the Arab nations to embargo oil shipments to some Western nations. 'I don't believe oil can effectively be used as a political weapon by withholding supplies from market—there just can't be an effective selective embargo,' he asserted."

The Oil Import Task Force report, signed by the Secretary of State and not contested on this point by the minority, explained why partial shutdowns or boycotts could not be sustained, concluding: "Thus to have a problem one must postulate something approaching a total denial to all markets of all or most Arab oil." It might help if State explained why it no longer agrees.

Along with warnings about "the Arabs," the State Department has taken to warnings of oil scarcity. Thus Under Secretary Irwin warned the OECD in May 1972 of a worldwide "shortage" of 20 MBD by 1980, because of rising consumption. Mr. Irwin's speech was widely noted and commented on. Three
weeks later, Iraq moved at Kirkuk, confident of eventual success because of the "growing energy requirements of the industrialized countries," and growing U.S. imports.

Mr. Akins had already outdone Mr. Irwin in a speech to the Independent Petroleum Association of America, warning that "by 1976 our position could be nothing short of desperate," and that Persian Gulf reserves would decline after 1980. The basis of these fears is a well kept secret which the economist cannot penetrate. But the prediction of a Persian Gulf price of $5 by 1980 must be taken seriously. There was not even a perfunctory disclaimer of expressing only personal opinions in the speech or one to the National Coal Association. He is voicing government policy. In another speech, he spoke of the "widespread recognition . . . that it is not in the Arabs' interests to allow the companies to continue expansion of production at will, and that the producing countries, most notably Saudi Arabia, must [sic] follow Libya's and Kuwait's leads in imposing production limitations."

It seems odd to have an American official telling "the Arabs" they should restrict output. Kuwait has found the argument persuasive and has limited output. But this is the only clear example. Libyan oil is overpriced, i.e. overtaxed, and better bargains are available elsewhere. In fact, the expulsion of British Petroleum in December was seen as a "windfall" to the industry because of excessive supply. According to Platt's Oilgram News Service: "Companies have been anxious to reduce production in Libya but 'no company had the courage to do it and now Libya is making BP do it 100 percent,' one observer said." No other Arab country has restricted, and "few . . . are likely to follow Kuwait's lead," despite the State Department telling them they "must." Saudi Arabia is engaged in a record expansion of capacity. So is Iran, whose Finance Minister directly rejected the argument in March of 1972. For the whole Middle East, 1972 drilling was ex-
pected in February to exceed 1971 by a massive 74 percent.

Akins also makes the baffling statement (in the IPAA speech) that "the sellers' market" arrived in June 1967. Yet prices continued to slide for three years more, and Mr. Akins himself notes that neither buyers nor sellers knew the "sellers' market" had come. He never explains it. Almost surely he refers to the Suez Canal closure, which by raising transport costs should somewhat weaken the demand for crude oil. But the effect of the Suez closure is negligible either way. Reopening of the Canal would equate to a 9 percent addition to the world tanker fleet, which has been growing at nearly 13 percent per year: loss of the Canal is a loss of eight and one-half months growth. Indeed the presence or absence of the Suez Canal is less than the error of estimate of the tankers available at any given time.14

The same State Department source feared a world shortage because "the Arabs" [sic] would find it difficult or impossible to raise the "enormous sums of capital" needed for new production. In 1970 (most recent year available), total production expenditures in the "Middle East," i.e. Persian Gulf plus some substantial expenditures in Turkey, Israel, and Syria, plus some payments to governments, amounted to $300 million. In 1972, the revenues of the Persian Gulf nations will amount to about $9 billion. (See Table II below.) The expenditures are less than two weeks' revenues. The Kirkuk field just confiscated in Iraq requires less than $4 million annually to maintain the rate of output—revenues from one day's capacity output.

If the producing nations had to spend $300 million in order to obtain $600 million in revenue, i.e. a 100 percent return, they would spend that money; the alternative would be to receive nothing at all. And the $300 million net revenue would be about 3 percent of the tribute they obtain today by using the


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multinational companies. In other words, to talk about their “needs” and “plans” is totally irrelevant to how much they can get before they can spend.

Perhaps the OPEC countries (including the non-Arabs who do not exist for State but do produce 45 percent of OPEC oil) may be convinced they should restrict output in concert because oil in the ground will appreciate faster than money in the bank. Perhaps too there will be discussion in the United States: why our government is so poorly informed on oil economics; why it repeats “Arabs-oil . . . oil-Arabs” as though slogans proved something logic could not; whether the national interest is well served by sponsoring, supporting, and urging on the cartel; and whether our interests may change when, as is generally expected, our imports are substantially larger.

The Changing American Interest

First, security has been greatly impaired for all importing countries by the cohesion of the OPEC nations which made an embargo feasible.

Second, the balance of payments impact will soon turn unfavorable to us, as it is to all other importers.15

The fact will slowly be recognized, that nearly all of the oil deficit could be abolished by getting American companies out of crude oil marketing, to produce on contract for the producing countries, who could then compete the price way down. The companies’ profits (and contribution to the balance of payments) would not be much less, and in the long run they might be greater, as the experience in Venezuela proves: the companies producing there are at or over the loss line.

Larger American imports will if anything tend to put the world price down. The process was seen on a small scale after 1966, when

15Secretary of Commerce Peterson, in the New York Times, June 20, 1972, p. 51, estimates the American balance of payments deficit on oil account as $26 billion a year in 1980 if imports are 4.38 billion barrels. This implies $5.94 per barrel delivered, hence probably about the same $5 per barrel f.o.b. at which State aims.
quotas on (heavy) residual fuel imports were lifted. Imports increased considerably, and the price decreased. Moreover, concern over air pollution was growing rapidly, and alarm was felt over possible loss of markets for residual fuel oil. Hence the Venezuelan government made agreements with Esso and Shell granting them lower taxes on production of low-sulfur fuel oil. This bit of history was too rapidly forgotten.¹⁶

The declining price of fuel oil in the face of greater demand would be inexplicable in a competitive market, but is to be expected when the price is far above cost. It is exactly what happened in Europe to embarrass coal. The hope of greater profits on increased sales, and the knowledge that large buyers have now an incentive to roam the market and look for every chance of a better deal, means that one must reduce the price before one’s rivals tie up the good customers. As American quotas are relaxed, refiners who have a crude deficit will become exactly the kind of large-scale buyer whom Sheik Yamani rightly fears.

The prospect of world prices rising because of large-scale American imports has alarmed Europe and Asia, and the United States government has gladly fanned those fears. But they have no basis in theory or experience.

Let the reader excuse our saying again what needs to be said often: larger consumption only raises price in a competitive market, by raising marginal cost. In so awesomely non-competitive a market, cost is not relevant because price is 10 to 20 times cost. Supply and demand have nothing to do with the world price of oil: only the strength of the cartel matters.

Other Consuming Countries

Consuming governments are staying in the same groove which served them badly between 1957 and 1970, and worse afterward. Prices had risen in the 1950’s because the oil companies were able to act in concert without

¹⁶W.P.M., Ch. VII.
overt collusion: they responded to a signal from the United States. Prices then jumped for a time when the Suez Canal was cut. The reaction was fear of shortage. One heard in 1957 what one hears now—"True, reserves are ample, but in 15 years, say by 1972, they will mostly be gone! We must guard against the shortage, obtain concessions of our own, protect domestic energy industries against future scarcity, etc." Thereby the consuming countries committed themselves to high oil prices.

The consuming countries were all the more ready to fear these imaginary demons because they had invested heavily in coal. The decline in fuel oil prices after 1957 was greeted with disbelief and resentment. Prices of oil assumed in government energy plans and forecasts were always much higher than actual market. In 1962 (and 1964) the EEC energy experts made a long-term forecast of heavy fuel oil at $18 per metric ton, when it was about $13. They were bitterly denounced for so low a forecast. Yet even now in mid-1972, fuel oil in Western Europe is only $14.50, i.e., in 1962 prices $10.75 per ton. Seldom has so costly a mistake been so long and stubbornly maintained. Nationalized industries—and others which could be influenced or pressured—were and still are reserved to coal. Worse yet, the artificial European coal prices became a cost standard for building nuclear power plants; in Great Britain they are wildly uneconomic.

The costly insistence on self-sufficiency was mostly uninformed fear of the multinational oil companies. The more the companies lost control of the market and competed down the price of fuel oil, losing profits thereby, the more resentment at their "ruthless economic warfare." As late as 1972, a British economist still writes of the oil company "design" to drive out coal. Fear of the multinational firms leads consuming countries not only to protect coal but to seek "their own" oil through government-owned or sponsored companies. Thereby the consuming-country government acquires a vested interest in high oil prices.
Low oil prices, or the possibility thereof, become not an opportunity but a scandal, to be ignored as far as possible.

The fear of shortage in the 1970's as in the 1950's leads to attempts to obtain oil concessions. It may make sense to run risks in new areas where governments will keep taxes low. There is much oil which is profitable to find and develop at today's prices, even at costs 25 times that in the Persian Gulf. A non-Japanese can hardly object when Japan proposes to spend some $3 billion in the near future to find and develop new oil resources. If spent in new areas it will certainly add to the wealth of the world, and—perhaps—not be a loss to Japan. But there is nothing gained in seeking new concessions in the old areas, or buying into old concessions. Such a policy does not add any resources. The price paid for concession shares will discount the profits, which may not continue long. Perhaps worst of all, in committing itself to take oil from "its" concessions, the consuming country loses all independence in buying, and is worse exploited than it could ever be by the multinational companies.

The French Experience

The policy of seeking "independence" has been carried farthest in France. In 1962, agreements were reached with newly independent Algeria, inaugurating a "new type" of relationship, free from the burden of colonialism, etc. (One hears similar language today in Japan.) In early 1971, M. Fontaine described in Le Monde the dreary succession of broken promises, seizures, spoliation and the like. Yet no more than the French government could he or his newspaper bring itself to discard the policy; there were supposed political advantages, such as lessening Soviet influence in the Western Mediterranean. The logical result was the two-thirds confiscation in 1972 of what they had fondly thought to be "their own" oil.

The head of ERAP, the wholly-state-owned French company (as distinguished from Com-
pagnie Française des Pétroles, only 35 percent state owned), summed up 10 years' experience and loss of the Algerian oil as "une opération blanche." Had the funds been invested at a steady rate and drawn a 7 percent return, private or social (hospitals, schools, highways, etc.), it would have been worth one-third more in 1972. But that is only a small part of the real social cost. There has been substantial French aid to the Algerian economy and French oil prices have been among the highest in Europe. But the French insist on rose-colored glasses. A break-even operation is viewed as economic. High oil prices and aid to Algeria, loading French industry with heavy costs and taxes that reduce its export capability, are viewed as a help to the balance of payments.

Four months after Algeria was written off, Iraq approached France as soon as they seized the Kirkuk field from Iraq Petroleum Company. Their experience had taught them who was an easy mark. In 1961, they had seized the whole IPC concession outside of fields actually producing, but although the expropriated area included the great undeveloped North Rumaila field nobody leased it. Then in 1967, after the Six-Day War, France obtained a large concession in Iraq for ERAP, "ratified with great pomp in Baghdad (and hailed throughout the Middle East) as a great victory over Anglo-American imperialism." The usually sober _Le Monde_ was thrilled. Someone was needed "who would not flinch" when IPC "showed their teeth," someone "capable of braving the anger of the members of IPC." Because of France, the "Anglo-Americans [lose] any chance of expansion into the hitherto-unexplored parts of the country." They have been outmaneuvered; they cannot block France from "a place in the untouched zones of Iraq without provoking a grave political crisis." This is their just reward because "on the morow of the last war they would not let France into the game in this region."

Having used North Rumaila as bait to take
in the French, Iraq dangled it before others, then decided to develop the field itself, with Russian assistance. There was great annoyance in France, where doubt was expressed that Iraq was capable of developing the field. But in April 1972, shipments began in the presence of Mr. Kosygin, exclaiming “Arab oil to the Arabs!” By early 1971, ERAP had found three fields worth developing, whereupon Iraq demanded higher payments than in the contract. ERAP was willing to give more, but not as much as demanded, and negotiations dragged on. Predictably, the French blamed the deadlock on the machinations of IPC, trying to block their intrusion into what Le Monde called “the private hunting preserve of the Anglo-Saxons.”

In June 1972, when Iraq seized the Kirkuk field and threatened price cutting, they “preserved French interests in Iraq.” Surely, they told newsmen, the French ought to be no more scrupulous in Iraq than the Americans, who had offered to do business with Algeria after the confiscation of French interests there. France, said Le Monde, feared a rejection of the Iraq offer “would harm its prestige in the Near East and would be taken as a break with Gaullist policy in the region”; while acceptance would allow France to “serve as a bridge between the West and the left wing regimes of the Arab world, a role whereby she, alone, can hope to counterbalance the growing Soviet influence.” (Does the Gaullist policy help in oil matters, or does France accept higher oil costs in order to keep the policy going? One wishes for something intelligible.) A few days later came a Soviet-Iraq agreement on economic cooperation. This was no break in policy; the Baghdad regime had lifted its ban on Communist political activity, and accepted two Communists in the government. But of course, the greater the Soviet influence, the greater the need to counterbalance it, hence the more concessions would be made to the Baghdad regime in oil affairs.

When the strong man of the Iraqi cabinet,
Vice Premier Saddam Hussein, visited Paris in June, he had a resounding success. The agreement with France gave CFP (the French partner in IPC) "une position privilégiée," which comes to this: CFP is obliged to lift its full share of Iraq oil for 10 years under the same conditions as before the nationalization: exactly that long-term commitment which it rejected as too expensive when it was a partner in IPC. Small wonder that CFP did not want this "position privilégiée." "The reason is simple—the price is too high..."

France also acquired the "right" to buy additional crude—which Iraq had just offered to all the world at reduced prices. But France will buy not at reduced but at "commercial prices," i.e. higher than charged any knowledgeable arm's length buyer who has alternatives. Finally, France will extend about $80 million of long term credits to Iraq. This, and future credits and grants, is an unacknowledged addition to the price of the oil.

Thus the French have again been had, most royally, and by their own strenuous effort.

How are we to understand this rigid determination that France have "its own" oil, whereby France is humiliated and cheated?

Two elements of an explanation are worth suggesting, because they are not peculiar to France. One is the romantic political aura surrounding oil, which lets all manner of nonsense sound plausible. "Whatever touches on oil is at once adorned with romance. No other raw material stirs the imagination like this one, nor the taste for flowery language," wrote Edgar Faure in 1938. Another key is to be found in such phrases as "oil-hungry France" or "France assured of oil needs," etc. Similarly, in discussing Japan, Professor Brzezinski speaks repeatedly of "access to raw materials" as being so self-evident and

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17 Zbigniew Brzezinski, The Fragile Blossom: Crisis and Change in Japan (1972), pp. 46-47, 71. In justice to Professor Brzezinski, one should note that he slides quickly from "access" to "price" which is the only real problem.
serious a problem that it need not be explained. Yet we cannot point to one example of lack of access. To pay for "access," through higher prices or otherwise, makes no sense, no matter how one views the future:

1. The price of crude oil, set by a world monopoly, is many times what is enough to make it worthwhile to expand output. Therefore, even if price declines and especially if it rises, there will always be more crude oil available than can be sold, as there is now and has always been.

2. Assume the contrary: that oil is becoming increasingly scarce, and that the price will reach $5 or whatever. At this price, the market is cleared, and just as with a monopolized market, anyone who can pay the price gets all he wants.

3. There is real fear, exploited but not created by the U.S. government, that massive American oil and gas imports will somehow preclude buyers from other countries, especially if the producing nations take the advice to limit output. Let us assume they do so. Then lower-cost and more profitable companies will outbid their rivals for the limited supply. Japanese iron and steel companies, for example, are obviously much lower-cost than their American rivals. The dwindling of the American export surplus seems to show a higher cost level; if so, high oil prices will harm this country more than others.

4. One often-expressed fear is that the American multinational companies will divert supplies to American customers in preference to non-American. But if there is some constraint such that both groups cannot be fully supplied, then the price must rise. To imagine American companies deliberately holding down the price, in order to precipitate a shortage, in order to be able to discriminate, is fantasy. They would not wish to do it, and their masters the producing nations would not allow it.

5. The OPEC nations may wish to deny oil to some particular country. But if some or even most of them do so, the capacity of
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others will be available, and at most there will be a reshuffling of customers. Yet let us now assume that all OPEC nations unite to boycott one country. They must also prevent diversion of supplies of crude oil and products from other consuming countries to the victim. Yet nobody has suggested why the OPEC nations should join in this profitless persecution. Moreover, non-OPEC oil is large relative to a single consuming country's needs.

6. Even if all the foregoing is incorrect, and "access" is a real problem, it is useless to try to obtain access through a company owned by the consuming nation, since real power is in the producing nation.

The obsession with a false problem of "access to oil" wastes time and distracts attention from the real problem of security of supply. The old or new multinational companies can do nothing good or bad for security because they have no control of supply, no power to cut off anybody or to protect them from cutoff. Nobody owns oil at the wellhead or underground reserves any more except the governments who have the physical force above ground.

A Look Ahead

Oil supply is threatened by one and only one danger: a concerted shutdown by the OPEC nations. No single nation can do any harm. The rhetorical question "Would you like to see Saudi Arabia supply one-third of the oil?" is only marginally relevant. The fewer the sellers and the larger their market shares, the easier for them to collaborate and act as one. The central question is their union or disunion. If a single large seller breaks away, or a few minor ones, the cartel breaks down in a stampede for the exit. The cartel is only needed, only exists, to thwart the basic condition of massive potential excess capacity—ability to expand output at costs below prices—and prevent it from becoming actual.

Hence lower prices and secure supply are the two sides of the same coin: absence of monopoly, or impotence of disunion.
The monopoly may still have its finest hours before it, and prices should rise well into the decade. The fewer the sellers the better, and there will presently be fewer Persian Gulf states. Most of them have too few men, and stuffing them full of money makes them worth occupying. A decade ago, Iraq claimed Kuwait, and was only stopped by the threat of force: the British presence, now gone. Iraq will be all the more ready to occupy Kuwait if Iran occupies the Kirkuk area, site of the great oil field just expropriated. The local population are not Arabs but Kurds, Indo-European in language and Sunnite Moslem in religion, like the Iranians. If they behaved themselves the Iranian army might be hailed as liberators from the chronic bloody struggle with the Baghdad regime. A new pipeline to the Mediterranean could go through Iran and Turkey.

The important consuming countries show no sign of understanding their plight; in mid-1972 "European nations are believed to be concerned that another stalemate [on "participation"] could impair vitally needed oil supplies... The companies are under considerable pressure to reach an agreement."18

Also, the large consumer countries have export interests which will benefit by the higher oil prices because of oil nations' greater purchasing power. Export industries often have disproportionate political power, even if the real economic benefit to the nation, i.e. higher incomes to labor and capital than from the next best alternatives, are piddling compared to the outflow on oil.

Europe is rapidly becoming an important oil producer. Some European countries will become small net importers, some will be large net oil sellers. The head of Norsk Hydro oil operations recently noted Norway's "economic interest in high prices." He recognized that the OPEC gains "were forced through by threats of a boycott." Instead of mauldering about "political stability," he defined it:


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"first and foremost a political system under which agreements and terms of licenses are respected even if the circumstances may have changed . . . [and under which] everyone . . . feels secure that supply will be maintained in all circumstances." It is an indirect but devastating comment on American policy.

The less-developed nations will suffer the most, with no offsets. For example, India today consumes about 150 million barrels per year, and is expected to use about 345 in 1980. The burden of monopoly pricing is direct (paying higher prices for imports) and indirect (being forced to find and produce higher-cost domestic oil). It amounts in total to about $225 million ($1.50 x 150 million) per year, and increasing rapidly. Yet at the 1972 UNCTAD meeting there was no breath of criticism of the oil-producing nations. Solidarity prevailed: things were felt to be going well "on the oil front," and, said Le Monde, the same ought to happen on other fronts.

This favorable public attitude also holds in the developed countries. A private monopoly which extracted $1.5 billion per year from consumers would be denounced and probably destroyed; were they American, some executives would be in jail. An intergovernmental monopoly 10 times as big is viewed as a bit of redress by the Third World.

Now one may approve this double standard, or deplore it, or laugh to keep from crying, but it is a truth with consequences: no important resistance seems likely in the near term. In time, attitudes may change.

1. The fictitious "world energy crisis" will gradually fade as it did after 1957, and the slow growth of understanding of oil prices will resume. This influence is minor but not negligible.

2. In 1972, the transfer from consuming to the OPEC nations will be about $15 billion. (See Table II.) If the tax doubles (and the price is therefore about $3.35) and if output increases by 8 percent per year, then the 1980 transfer will be over $56 billion per year. This is a very conservative forecast as compared
with those of the Departments of State or Commerce as cited earlier.

3. Some of the billions will be spent in ways some consuming countries find irksome or dangerous. The large amounts paid to Libya have already cost the NATO nations additional payments to Malta, for which Mr. Mintoff could not have bargained without Libyan help.

**TABLE II**

Approximate OPEC Revenues, 1972

<table>
<thead>
<tr>
<th>Area</th>
<th>Estimated 1972 output (billion brls)*</th>
<th>Per-barrel revenues**</th>
<th>Total revenues ($ billions)</th>
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<tbody>
<tr>
<td>Persian Gulf</td>
<td>6.50</td>
<td>$1.42</td>
<td>$9.2</td>
</tr>
<tr>
<td>Libya, Algeria</td>
<td>1.20</td>
<td>2.14</td>
<td>2.6</td>
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<tr>
<td>Nigeria</td>
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<td>Venezuela</td>
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<td>Indonesia</td>
<td>0.37</td>
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<td>0.5</td>
</tr>
</tbody>
</table>

$15.3

*Output assumed at same rate as first quarter 1972.


4. Payments to the producing nations will total about $242 billion over the nine years 1972-1980. If these nations spend, say, three-fourths on goods and services from abroad and save 25 percent by buying foreign assets, the additions to their holdings will be about $61 billion. The oil companies see themselves as the decently paid investment managers for this fund; as Schumpeter said, “This is the way the bourgeois mind works, always will work, even in sight of the hangman’s rope.”

There will be monetary disorders when large holders speculate against a particular currency. Unlike the oil market, where the producing countries must act in concert or accomplish nothing, even a single nation with big enough foreign balances can do substantial damage to the world monetary system, or try to bring down a government it dislikes.

5. Security of supply has been severely impaired by the Paris capitulation and the great success of the threat of embargo. Hints of
“concerted action” since then have been too numerous to list. Even more upsetting than the threats are the assurances. For they imply power to stop the flow.

Security of supply—limited but genuine—can be had by stockpiling, combined with detailed plans for severe rationing supplemented by high excise taxes, to reduce oil consumption and thereby increase the effective size of the stockpile. The expense will be heavy (but had the consuming countries done this years ago, they would have made large savings).

The larger the reserves piled up by the OPEC nations, the greater their power to withhold oil. Hence the higher the price, and the greater the insecurity, the easier for the OPEC nations to make it still more expensive and insecure. The consuming countries can have cheapness and security only by a clean break with the past: get the multinational oil companies out of crude oil marketing; let them remain as producers under contract and as buyers of crude to transport, refine and sell as products. The real owners, the producing nations, must then assume the role of sellers and they should be assisted in competing the price of crude oil down. The Yamani prescription will be as sound then as in 1968, or 1971, or 1972.

It is a simple and elegant maneuver to destroy the cartel by removing an essential part—the multinational company as crude oil marketers fixing the price on a firm excise tax floor. But this would only minimize conflict and confrontation; it is too late to avoid them. The producing countries, like many raw troops, have been welded by success into a real force, and the huge sums they receive and accumulate will be both the incentive and the means to fight, by embargo, monetary disruption, or even local wars. There will be non-negligible damage. To have put the power and the motive into the producers’ hands was light-minded folly by the American government.

Moreover, clean breaks with past policy are rare. The honest confession of error is less
likely than anger at the cartel's local agents, the multinational companies, and attempts to restrict and penalize them. Yet this misconception is exactly what has led to past mistakes. Bypassing the companies to make direct deals with producing nations can be helpful only when the objective is clearly seen: to mobilize national buying power, encourage domestic oil buyers to avoid established channels, and help compete prices down. More usually such deals sacrifice all buying independence in a vain attempt to get a good “connection,” or placate a producing nation, and only raise costs.

The greatest difficulty in following the Yamani formula is the need for the leading consuming countries to act together. For example, the United States tax law might recognize, either by statute or judicial decision, that the “income” taxes paid to OPEC nations were really excise taxes, hence not deductible from U.S. income tax. Higher taxes coupled with the unceasing demands of the OPEC countries might well push one or more of these companies past patience or profit, and they would withdraw to become a contractor or buyer, helping to undermine the cartel.

Yet today other large consuming countries would fall over themselves trying to get one of their countries into the empty slot, and promising anything to the producing nation. Hence it would be literally worse than useless for the United States to take the first steps, without firm assurances from at least France, Germany, Italy, and Japan, that they would not try to replace the American company. These countries are still obsessed with vain notions of getting “access” or “security” through their own companies, and the suggestion that they refrain from taking their “just share,” and ending their long-resented “exclusion” from “the game,” seems an obvious attempt to help the American companies keep their predominance. It is an old sad story. If one looks for the “real motives,” he will never hear what is being said.
The multinational companies will probably survive the crisis. Yet there is a real danger that they will be forced out of crude oil production. This would be a grievous waste of resources and could precipitate a genuine shortage of crude oil.

What happens to oil in the 1970's depends altogether on the consuming countries. If they are as slow to learn as they have been, then the projection of $55 billion annual tribute paid the OPEC nations by 1980 may be surpassed. But they may also learn that transferring those billions is not only dangerous but unnecessary. Their energy economics would need to be updated at least to 1952, when the Paley Commission explained that shortage means only cost; they might then see that the "world energy shortage" is a myth, that crude oil continues in oversupply, as the Venezuelans, the Iraqis, and the Saudi Arabs have recognized. And the consuming nations' strategic thinking would need to be updated at least to 1914, when Winston Churchill, who was then a young fox, not an old lion, explained to the House of Commons that access to oil is only a special case of monopoly; the power to withhold is the power to overcharge.20