

OPEC IN THE ERA OF HIGH OIL PRICES

**POLICY IMPACTS
AND GLOBAL IMPLICATIONS**

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List of Abbreviations

b/d	Barrels per Day
BW	Business Week
CFP	Compagnie Francaise des Petroles
CPEs	Centrally Planned Economies
DAC	The Development Assistance Committee
ECOSOC	Economic and Social Council (of the United Nations)
GDP	Gross Domestic Product
GNP	Gross National Product
IEA	The International Energy Agency
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
LDC	The Less Developed Countries
mbd	Million Barrels per Day
MEES	Middle East Economic Survey
MNCs	Multinational Corporations
OECD	Organisation for Economic Cooperation and Development
OPEC	The Organisation of Petroleum Exporting Countries
R/P	Reserve to Production (ratio)
SDR	Special Drawing Rights
UN	The United Nations
UNCTAD	United Nation's Conference on Tariffs and Trade

List of OPEC Member Countries

Founding Members: September, 1960

Iran
Iraq
Kuwait
Saudi Arabia
Venezuela

Others:

Algeria	1969
Ecuador	1973
Gabon	1975
Indonesia	1962
Libya	1962
Nigeria	1971
Qatar	1961
United Arab Emirates	1974 (originally, Abu Dhabi - 1967)

PREFACE

OPEC is widely believed to be a kind of cartel for setting oil prices in the world market. Yet, it is an extremely complicated organisation to only be regarded as a simple commercial cartel. It includes various factors within its structure. On the one hand, it sometimes works as an international political party which can exert its influence on the diplomatic policies of the developed countries, or it sometimes functions as an organisation for supporting the lesser developed countries. On the other hand, each member of OPEC has her own domestic policies which may contradict the decisions of OPEC. In addition, the cultural tradition of each OPEC member is heterogeneous. Some of them have a Christian tradition while others have a Muslim tradition.

OPEC was founded in the year 1960 when nationalism and anticolonialism prevailed throughout the so-called third world. It started as an international organisation designed to liberate the oil-producing countries from the so-called Seven Sisters. Therefore,

early in the history of OPEC we can recognise a strong proclivity toward nationalism and a national liberation movement in its policies.

Yet, with the passage of time and changes in the world situation, OPEC itself has changed its nature. With the increase in the influential voice of the third world countries, it has changed its original militant attitude into a more moderate one. Furthermore, during these past thirty years the international situation surrounding the OPEC members has also changed quite dramatically.

The value of oil has relatively depreciated as oil is no longer an unique energy source for human activities. Man has obtained several alternative energy sources in these days. In addition, oil is regarded by ecologists and naturalists as one of the main sources of pollution.

OPEC is now forced to think about the earth and its environment. In fact, the key for solution of the environmental problems is in the hands of OPEC. It is not an exaggeration to say that the future of the earth depends on OPEC's policy for resolving environmental problems. OPEC will again be requested to play an important role, particularly in the field of environmental problems in the future. Therefore, OPEC has a special importance in the history of mankind. Yet, OPEC has not been well investigated and analysed or properly evaluated.

The author of this booklet, Mr. Emmanuel Adiole, has tried to highlight the real nature of OPEC and its changing processes and he has succeeded in this academic attempt. Readers of this booklet may therefore obtain an insight into OPEC and its future perspectives. He is currently a research fellow of I.M.E.S.

Akiro Matsumoto
General Editor

CHAPTER I

Introduction

I-1. Introduction

The appearance of OPEC (Organisation of the Petroleum Exporting Countries) in the international oil scene in the early '60s signalled the dawn of a new era in the structure of the world's system for obtaining and allocating crude oil. Consequently, OPEC and its ensuing policies have been viewed with treachery, and sometimes goodwill especially by Western oil consumers, most of whose agencies had dominated the oil industry prior to and even after the birth of OPEC. Western analysts have tended to explain the birth of the organisation by resort to comparing it to nationalism, as an engine driving the redistribution of power and wealth among nations (Tetraut, 1985). To these group of analysts, self-determination, national sovereignty and anti-colonialism all of which are "clinchés" of nationalism and some of whose imperatives are implied in the motive for the foundation of OPEC, now serve to explain and to justify the policies of the governments

of oil-exporting countries as much if not more than they do the activities of more conventional agents of national liberation. In other words, the formation of OPEC was perceived among Westerners as a step geared towards liberating the oil-producing third world states from the clutches of Western economic domination and exploitation. The devolution of oil control from older industrialised nations and their agents to newer oil-exporting countries and their agents which the foundation of OPEC apparently heralded was visualised as not just a direct and unjustified transfer of wealth to the poorer oil-exporting countries by their rich counter-parts through oil-importation but also a direct threat to the security of Western economies. Still others regard the new international oil regime under OPEC as an outcome of larger forces that are "changing the structure of the global system from a set of interacting hierarchical arrangements to the crisscrossed linkage of nations and transnational oil actors working in a network of inter-dependence" (Cooper, 1972).

However, the passing decades since the establishment of OPEC seems to fault most of the foregoing assumptions given the fact that not only the advanced industrialised oil importers but also non-OPEC oil producers alike have come to appreciate the important roles of the organisation not only as an ally but also as a moderator of variations in the policies of oil producers, and a friend in the almost intensive worldwide efforts towards ensuring the

stability of supply for the only relatively known safe but depletable source of energy at reasonable prices.

OPEC since its foundation has been as puzzling as it was the subject of various misconceptions by energy and associated scholars, to the extent that it has elicited debates over basic issues like the degree to which it is a cartel responsible for propping up hikes in world oil prices or whether it is just an organisation which simply ratifies oil prices determined as it were, by competitive market forces. It is our contention that at best, the organisation's policies are little understood by its numerous critics, be they politicians, economists, professional analysts and most unfortunate of all OPEC member countries themselves. The conventional wisdom is that cartels hardly pass through such agonising stages as OPEC did without disintegrations. OPEC's ability to weather the various problems buttress the argument that perhaps OPEC may not be a cartel in the conventional sense, and if at all it could be so conceived, the qualities or characteristics of conventional cartels evident in the organisation may be coincidental.

Our purpose in this piece is not so much to applaud OPEC's apparent achievements as to critically examining the organisation's policies since its foundation, with special reference to its second and third decades. OPEC has been accused of unfair cartelisation of the oil industry through its policies. The intention of this thesis is to examine the organisation's policies especially in the second and third decades of its existence. First, the theory of cartelisation would

be advanced to define the said OPEC policies, after which efforts will be made to explore to what extent the acclaimed impacts of those policies were far reaching. And by OPEC policies, we simply refer to the pricing and production arrangements as well as any other measures taken in support of, or resulting from such policies like the present trend in OPEC member countries' investments patterns. It is worth stating here that this thesis is not primarily concerned with confirming or infirming whether OPEC exists as a cartel, but employs the principle of cartelisation in advancing useful hypotheses for defining the said OPEC policies.

This essay intends to approach its propositions under a four-chapter arrangement namely:

Chapter one will introduce the whole exercise by looking at the nature of the oil industry before the foundation of OPEC as well as cite appropriate justifications and limitations of the research work. It will also examine the formation of OPEC and a brief review of available literature on conventional economic cartels through which possible hypotheses will be advanced for the examination of OPEC's policies.

Chapter two will attempt to examine OPEC policies in the more critical second and third decades of its existence in the '70s through the '80s. The advanced hypotheses will be employed in this chapter as basic guides in the elucidation of OPEC during the period. This will involve the full exploration of the period spanning the initial battle with the international oil companies for

'posted price' and 'participation', through the "three" oil crises, the culmination of which was in the near collapse of the organisation occasioned by fallen crude oil prices in the middle of the '80s.

Chapter three will survey the global impacts of OPEC's policies generally within the period under review and attempt to relate whether the acclaimed impacts have been really as devastating as previous analysts would want us to believe, or were they mere blessings in disguise for oil consumers and the oil industry.

The fourth chapter will be the conclusion, embodying attempts to look at the future of OPEC as well the possible impacts of its demise on the oil industry. Greater attention will be paid to OPEC at the inception of its fourth decade, as well as the advancement of possible propositions for averting future oil crises especially in the face of serious threats to the OPEC and its balancing functions. A final conclusion will not only summarise the major theme of the paper but also proffer suggestions on how OPEC could be truly perceived and possibly but perhaps perfectly predicted.

I-2. Justification of Study

While conceding that numerous literature exists on OPEC, it is my view that various authors tend to focus attention on OPEC's cartel behaviour, thus grossly neglecting the fact that OPEC is and will continue to be an association of independent sovereign (states) governments, who are neither accountable to shareholders nor

legally required to declare annual profits to retain their seats. It is worth noting that the sovereign heads of OPEC member countries do not need OPEC's continued existence to get re-elected into office or to retain their administration. As a result, their policy lines in OPEC need not be tailored to neither the expectations of their respective citizenries nor to what would ensure maximum benefits for the individual citizens' welfares.

This singular recognition places this research work in a new setting since it departs from comparing OPEC to corporate business entities, whose policies are bound to be tainted with profit motivations. It purports to contribute to a new knowledge on OPEC and the oil industry, given its claims to examine the stated issues (OPEC policies) from the points of view of what OPEC really is, and how best it could be conceived and understood. It claims to reveal an understanding of OPEC and its policies based on the twin roles as the moderator of the variations in the oil policies of radical and conservative oil exporters and stabiliser of the oil market.

While it claims to be neither a defence nor justification of OPEC and its policies, this research work, advances cogent arguments that seem to see the existence of OPEC as a necessity while some of its policies could be justified.

I-3. Limitations of Study

The exhaustiveness of this research work is limited by a lot of factors amongst which are the following:

Firstly, the research grant was grossly inadequate to support the conduct of a far-reaching research commensurate with the magnitude and requirements of this thesis. With due appreciation of the immense assistance for the grant, it would be best if such grants are made more extensive. The output of this research would have had more depth if the researcher had the opportunity to interview some Officials and Staff of the OPEC Secretariat as well as some OECD officials, and some key oil policy-makers in the OPEC member countries.

Secondly, most of the materials needed by the researcher were unavailable in the Matsushita Library & Information Center, necessitating the researcher writing extensively to numerous organisations for data, thereby incurring additional financial costs, not to mention the time spent for the materials to arrive at International University of Japan.

Thirdly, this little research work is by no means exhaustive in the examination of what seems a rather extensive subject. Nonetheless, it is the researcher's hope that at least, it will provide a useful frame of reference for a freshman researcher in the affairs of OPEC, in particular and the oil industry, in general. It has also evoked a lot of potential research questions which any interested researcher or group of researchers could pursue and discuss in greater detail.

Lastly, I wish to state that having come from an OPEC member country, it is inevitable that charges and assumptions of

favourable bias towards OPEC will be made. While I am not disclaiming being an OPEC apologist or otherwise, I wish to convey the impression that my choice of OPEC as a research topic is a matter of coincidence, if not a pure reflection of my own personal academic values and interests developed while studying at International University of Japan.

I-4. Literature Review

We intend here to review some of the available literature on operational cartels to enable us to propose appropriate hypotheses on the basis of which OPEC policies for the period under review will be critically examined.

I could gather from a series of consulted volumes that cartelisation seems to reflect a modern phenomena arising out of the conditions of modern economic life. According to Liefmann (1977), cartels are a reaction against the dominations of the modern principle of competition. In other words, it is a means of defence against the excessive competition extant in modern business enterprises. Further, it was here argued that economic science has come to use the word "cartel" side by side with what he called "producers association", a reference to the vague description of the phenomenon first observed in Germany. He proceeded to define cartels as voluntary agreements between associations or independent enterprises of similar type to secure a monopoly of the market. The monopolisation and domination of the market is

evidently the essential characteristic in cartel definition. This in essence means that cartels aim at excluding as far as possible, competition within their range of activity. The effectiveness of cartels for both good and evil to a large extent depends on this monopolistic character, which character cartels attain by an agreement to carry out or refrain from certain acts in the course of their business life. Liefmann further contends that this agreement "makes a group out of a mere association of enterprises"(p.7). In other words, it is Liefmann's opinion that cartels are only associations with monopolistic aims who take various steps including supply adjustments to influence the market.

In line with the preceding argument, Johanny (1980) understands cartel to refer to "an agency that makes pricing and output decisions for its members in order to monopolize the market." He further contended that an ideal cartel normally would establish not just any price but the monopoly price and rate of product output which maximises the wealth of either the group of sellers or producers, possibly adopting the formula of "setting production quotas" for each producer so that total output of the group will assure the monopoly price. One outcome of this behaviour, according to Johanny is that the market-monopoly price will seriously tempt members of the cartel to "cheat" by increasing production in a bid to earn greater revenue, which in time will result in not only excess production but also reduction in the set price. The cartel attempts to guard against this by instituting

monitors most of the time at prohibitive costs. Because the rewards for cheating are perceived by the cartel members to be too great, cartels usually and always collapse under the impact of its members' actions.

Again, a cartel could be seen as an institution or organisation that "seeks to raise the price of the cartelized product over and above the price that would rule if free competition prevailed" (Salah El Serafy, 1982). According to him, the logic behind cartelisation is that the conditions of demand for the product are such that a smaller supply would fetch higher revenue than a larger supply, a situation that enables the cartel members to limit supply by allocating the limited supply as quotas among members. He further contends that the artificially higher prices maintained by cartels bring forth supply expansion outside the cartel and also induces buyers to seek substitutes for the product, a situation that would then revert the market to free competition. This argument seems to support the position that cartels hardly last very long.

Recognising that cartel behaviour results from the actions of hitherto competitive firms, who in attempts to raise profits can collude on prices and ration output accordingly between themselves, Hallwood and Sinclair (1981) advanced the three essential elements of cartelisation namely:

- (1) an agreement among the cartel membership on the objective function to be maximised. This includes an assessment of whether to maximise profits or total revenue.

(2) an agreement on the price level needed to attain the maximisation of this objective function and

(3) an agreement on the output prorationing required to make the agreed prices stick.

In addition, they argued further that since the cartel cannot fix both output and prices, it may experiment on either setting output and allowing price to find its own level or setting price, thereby letting demand determine total output. But because the cartel does not have full information about demand and cost conditions, he prefers resorting to the second option of only fixing the price for his product. This seems to suggest that cartels mostly engage in fixing prices while adjusting outputs appropriately to support the cartelised price.

Adelman (1987) in consonance with Hallwood et al., further opines that no two cartels are the same, given that as historical individuals who change over time, cartels cannot afford to remain static. This he claims is especially the case for cartels involving mineral production where there is not only observable differences in costs but also vast differences in reserve positions which can influence the motivations and by implication the policies of the producers concerned. Further, advancing the argument that cartels similar to the residual-firm monopolists are possible, whose aim is usually to allow competitors to maximise profits individually by choosing appropriate output levels, he contends that the cartel then makes up the difference in production by varying his own output in

order to control price. (He here cited the example of the Texas and Louisiana prorationing schemes of 1935-70.)¹ Again, this load of residual supply is made easier the larger the cartel's share of the total market.

On the basis of the foregoing, some underlying deductions could form appropriate hypotheses to which OPEC policies could be related namely:

(1) The cartel producer or supplier, unable to fix both output and price simultaneously resorts to either setting the price at whatever output the market could absorb or producing at whatever price the market could offer.

(2) The cartel producer is capable of adjusting production to suit its price policy. In this regard the cartel limits supply to the extent that will extract the highest prices for its products. Essentially, operating a cartel involves the rather complicated business of reconciling various objectives, patching up compromises, following rules of the thumb and constantly revising bargains once made.

(3) The more the cartel exploits its monopolistic position to exact high prices, thereby offering a strong stimulus to new enterprises, the greater the prospect there is of latest competition intensifying, thus leading to the possible breakup of the cartel. In

¹ Texas and Louisiana states of the United States of America in 1935-70 were perhaps the first in the history of the oil industry to adopt a prorationing system of production that enabled them to vary production in order to control price. For more details see, Adelman, M.A., "OPEC as a Cartel" in Griffin and Teece (ed.), *OPEC Behaviour and World Oil Prices* (London: George Allen & Urwin, 1981).

other words, the cartel is bound to be destroyed mostly by the action of its own members taking advantage of the difference between the cartel price and the market price in a bid to individually maximise their revenue. This tendency is more, the greater the amount by which the fixed cartel price departs from the competitive price. Applied to OPEC, this hypothesis translates into the greater the difference between OPEC price and the spot market or other competitive prices, the greater the incentive and the ease for members to cheat by various output adjustments.

(4) Most cartels are residual producers or suppliers whose role revolves around meeting residual deficits from outputs of other producers. OPEC is here conceived as an institution whose motive is simply to produce as much crude oil as possible, subject to the limitations posed by supplies from non-OPEC producers. In other words OPEC production under this assumption could fall to zero if competitors can satisfy the needs of the oil market.

(5) Yet some analysts have agreed that OPEC's cartel behaviour is principally motivated by the strong desire among members to maximise wealth through unilateral price increases and output restriction.

(6) OPEC cartel behaviour conforms to the expenditure and budgetary requirements of member countries as well as internal and external political constraints. The assumption here is that higher prices for OPEC oil has the effect of production curtailment as

member's revenue needs could easily be met thus increasing the incentives to resort to conservation.

Intuitive and very convincing as the above hypotheses may seem on the surface to be feasible, it shall be demonstrated in ensuing arguments that non-economic factors are evident as much if not more than the advanced economic explanations for OPEC behaviour. We shall now proceed, if only briefly to examine the foundation of OPEC in 1960 and to explore to what extent the acclaimed economic motivations necessitated and actually did influence the formation of OPEC.

I-5. The Foundation of OPEC

I-5-1. Prelude to OPEC Formation

The Organisation of the Petroleum Exporting Countries, OPEC, was formed by five oil producing countries, four of which are from the Middle East and one (Venezuela) from Latin America in September 1960.

However, before looking at the establishment of OPEC proper, as well as the motivations behind such a rather bold step by the oil producing countries, it might be necessary to attempt a review, if only briefly, of the situation of the oil industry before this momentous but memorable September 1960 that gave birth to OPEC.

It could be recalled that prior to the foundation of OPEC, the governments of the oil exporting countries had been virtually

voiceless in making decisions affecting not only the development but also the production and pricing of their much-cherished oil resource, the entire system being under the strong control of western agencies and oil conglomerates directed by what was then known as the "Seven Sisters" (Majors).² It is therefore necessary, given the foregoing reality, to give a little background of the world oil scene in the years leading to the formation of OPEC, with a view to preparing for deeper appraisal of what was to direct OPEC policies immediately after its formation in 1960 and ensuing periods of the '70s when the organisation came strongly to assert itself as a strong international politico-economic group to be reckoned with.

The dominance of the Seven Sisters in the oil industry is as old as the industry itself. According to available statistics, the Seven Sisters (some authors quote eight with the inclusion of Compaigne Francais des Petroles (CFP), five of which were based in the United States of America) virtually controlled more than 95% of the world's oil exploration, production, refining, pricing and even marketing, or as Marchant (1990) puts it "playing the key roles and deriving the greatest benefits" before the advent of OPEC. Their operation's networks were such that "states-within-states" were

² The Seven "Sisters (Majors) were a conglomerate of Multinational Oil Companies, five of which were based in the U.S., that pioneered and indeed controlled virtually the entire oil industry for the greater part of its history. They include Standard Oil of New Jersey (now ESSO-EXXON), Mobil, Chevron, Gulf, Texaco, Shell and BP. Some authors prefer to identify with eight sisters with the inclusion of the latecomer Compaigne Francaise des Petroles, CFP. See Penrose, Edith T., *The Large International Firm in Developing Countries: The International Petroleum Industry* (Westport: Greenwood Press, 1968).

created in the oil producing countries, and controlled by the international oil companies, (the estimate excludes oil production from Centrally Planned Economies, CPES and the United States). In addition, they owned all the transportation facilities including tanker fleets and other storage facilities, as well as had absolute control over the quantity of oil extracted and sold, to whom it was sold and at what price. Small royalties, the value of which were more often than not "dictated" by these companies, were paid to host governments.

The power of these organisations derived not only from their technical and financial superiority which of course was crucial to the daily discharge of their enviable business networks but also from the highly but invaluable political strength offered by the strong backings of their home governments. In essence, the majors were agencies of their home governments through which most of their imperial economic ambitions were fulfilled and well extended into the oil producing countries. Besides, the entire concession ownership rested with this group, most of the time backed up by strongly worded documents, most of whose contents and implications could hardly be properly understood by the concessioner governments. While not in doubt about the tenacity of the economic agency roles played by the majors for their home governments, given their tight controls over the direction of then oil market, it seems they were assigned political roles as well, made evident in the very considerable pressures exerted by a large U.S.

government-sponsored buyer of Middle East oil.³ The international oil companies' control over the the oil industry extended to many areas and enabled them to sell large quantities of crude oil in support of post second world war restriction efforts thus reaping very large profits. Again, according to Seymour (1982, p.8) "the European Cooperation Administration (ECA) which from 1948 to 1952 financed oil supplies to Europe under the then U.S. Marshall Plan, very much wanted oil especially from the Middle East to be supplied to European consumers as cheaply as possible, and this effort, to a large extent led to the more than 20% undervaluation of Middle East oil prices of the period." By implication, the U.S. government was using the International Oil Companies to realise a major post war foreign policy goal revolving around assisting economic recovery in Europe via cheap energy in the form of crude oil. The impact of this was a freeze on oil prices over a long period of time, a development that could not help antagonising the oil producers especially at then period of intense resentment for any form of foreign political and economic domination. According to Odell (1986), oil shipments to Western Europe were paid for from the Marshall Plan funds, thus there was the need for it to be offered as cheaply as possible by the International Oil Companies.

³ The European Cooperation Administration (ECA) was an agency of the United States Government created under the Marshall Plan to finance the post war oil supplies to European countries in a bid to ensure a quick recovery of their war-battered economies. The oil bills of the beneficiary countries were paid by funds provided by the agency.

Further, it could be seen from the foregoing that the pent-up fury that eventually culminated in the formation of OPEC had been building over the years but could not be made manifest for fear of the producing countries suffering fates similar to what Mexico and Iran had experienced earlier in the hands of the 'Majors' backed up by their home governments.⁴

According to Seymour (1982), the concession agreements were such that the host governments out of ignorance of the legal implications, inadvertently but completely signed away their sovereign powers of actions in many vital areas of the oil industry, including pricing decision-making policies, production, export levels (based on need), tax as well as royalty expensing rates.

The formation of OPEC could therefore be partially attributed to the burning zeal and desire among patriotic elements of the concessioner oil producing countries to redress the glaring imbalances evident in the exploitative and economic dominance of the Majors in the oil industry. A buttress to this argument could be found in the fact that the end of the world war marked a tremendous increase in the demand for crude oil in both the U.S.

⁴ Mexico and Iran were the forebears in the early attempts to wrest the monopoly of the crude oil business from the Majors. In both attempts, the consequences were not only humiliating but also disastrous. While the Mexican government was compelled to pay a compensation of about 180 million dollars (a huge sum in today's values whose payment might have contributed to Mexico's intractable debt problems), Iran settled with a consortium agreement whose terms were in no way favourable to the country in spite of her loss of three years production. For details see Stockings, G.W., *Middle East Oil* (London: Allan Lane and Penguin Press, 1971), Edens, D.G., *Oil and Development in the Middle East* (London: Praeger, 1979) and Elwell-Sutton, L.P., *Persian Oil: A Study of Power Politics* (London: Lawrence and Wishart, 1955).

and the war-battered Europe, corresponding to prices shooting up to unprecedented levels especially after price controls were lifted in the United States. Contrastingly, there was only a marginal increase in the prices of Middle East crudes to about 2.22 dollars per barrel, while identical crudes from the gulf of Mexico were fetching about 2.75 dollars per barrel. While several reasons were advanced by the Majors to explain this behaviour including the idea of making Middle East crude oil more competitive in the oil market, the sustainability of the reasons were rather ludicrous.

In addition to resentments generated from economics of oil exploitation as dictated by the international oil companies, the need for OPEC came at the height of intense nationalism not only in the Middle East but also in virtually all third world countries. As Renner (1984) rightly opined, OPEC was a reflection of "a rising nationalist sentiment in the oil producing states" which tended towards securing greater local control over domestic affairs including the oil industry. It could further be recalled that this period corresponded with the era of massive decolonisation in most parts of the Middle East and Africa, resulting from the installation of new elites in power, most of who strongly abhorred all forms of colonial political and economic attachment, one of which was the exploitation of their natural resources by foreign institutions. The Middle East, at this period was under the strong influence of Nasserism, in addition to increased awareness among the

governments of oil producing countries regarding their rights and the finiteness of their oil resources.

Again, OPEC formation could be seen as a product of then Superpower rivalry and the bipolarity that characterised post world war international relations. The machinations of the two superpowers in their scramble for political allies and spheres of influence added boost to the determination of the oil producers towards OPEC formation. This assertion becomes more evident on realisation that OPEC history since its formation has been consistent with developments in the international political system. The performance of OPEC, as would be discussed in the next chapter will reveal that the organisation actually has something to do with the influence of the superpowers. OPEC strength had witnessed its peak at the height of super power rivalry and the cold war in the early '70s. Increased understanding among the super powers as being currently experienced had also correlated with faltering OPEC behaviour.

I-5-2. OPEC Formation

(a) The First Arab Petroleum Congress

Initial steps towards the foundation of what was later named OPEC could be traced back to 1949, when Venezuela approached the Middle East Founder members of OPEC to suggest their exchanging views on how to establish regular and closer cooperation with each other. This was subsequently followed up during the first Arab

Petroleum Congress, held in Cairo in April 1959 in which a Venezuelan delegation attended on observer status. At this congress, organised by the Arab League Petroleum Committee, the Venezuelan delegation was led by the country's oil minister, Alfonzo Perez, an ardent nationalist and one of the champions of the oil industry. The main accomplishment of this congress was that it enabled the first meeting of two similar minded but important personalities in the history of OPEC and the then oil industry, namely, Alfonzo Perez of Venezuela and Tariki Abdullah of Saudi Arabia.⁵ As earlier established both were imbued with personality traits characteristic of nationalist zeals to see an end to the exploitative manoeuvre of the multinational oil companies. The meeting of these two nationalists were therefore expected to and indeed had outstanding impacts in the bid to unite the then oil producers in a common front against the oil companies and their home governments, a development that was a big milestone in the history of the oil industry.

This congress not only agreed on the need for closer consultations but also successfully passed a resolution mandating all the multinational oil concessionaires to consult the governments of the oil producing countries, as a matter of policy before effecting any reductions in posted prices of oil henceforth.⁶

⁵ For a detailed work on the contributions made by Alfonzo Perez and Tariki Abdullah to OPEC foundation and the oil industry, see Seymour, Ian, *OPEC Instrument of Change* (London: Macmillan, 1980).

⁶ Prior to and even at this date, the system in the oil industry was for the International Companies to post and adjust crude oil prices, determined by

This resolution did not go down well with the oil companies and if it did have an impact it was completely ignored as subsequent events made evident. This lapse on the part of the Multinational Oil Companies was to cost them dearly in the next few months. The companies were not only drunk on the sacrosanctity of their concession contracts but were also full of the false belief that their activities were indispensable, being of immense importance to the oil producing countries as the main source of revenue without known available alternatives.

(b) The Maadi Pact

The Alfonzo-Tariki secret understanding was to develop, with the cooperation of other attendants at the congress into an agreement to establish what they called a Consultative Commission for the oil producing countries, whose role would be to meet at least once a year and address various issues related to the improvements of contractual terms and the requirements for consultation on price change. In addition, this commission was to adopt an integrated approach to oil industry operations as well as see to the increase of refining capacity in their countries, establishment of national oil companies and national coordination of the conservation, production and exploitation of oil resources in the member

whatever indices they deemed fit at any given point in time. The result of this system was a huge fluctuation in posted prices, which in turn negatively affected host government revenue, since royalty and tax calculations were based on it. See Taki, Rifai, *The Pricing of Crude Oil* (New York: Praeger, 1974).

countries. Thus the foundation was laid for the eventual emergence of the oil producers and their united bid to take over the affairs of their national resources but a trigger was still needed to build on this foundation. The sincerity of this agreement was confirmed in a gentleman's pact or what was named the Maadi pact, kept strictly confidential for most of the time. The significance of this congress was that it acted as the harbinger to OPEC formation, being not only the first conceived and articulate step but also laid the foundations which were later built upon by the founders of OPEC.

The reactions of the multinational oil companies and their governments could not be immediately assessed, but what had taken place could not escape the attention of the press and most watchers of the oil industry.

The much expected trigger was to be found in the decision of ESSO (now EXXON) to unilaterally reduce its posted price for Middle East crudes by about 14 cents on the 9th of August, 1960 without consulting the countries concerned. The reaction of the oil producers was quick and swift as this was the situation they very much envisaged. This singular action, especially the Oil Companies' blatant disregard of the 1959 Arab petroleum congress resolution requiring them to consult the governments of the producing countries in advance before effecting further price cuts were to lead to a series of developments, the costs of which were to be very immense to the companies, their position as well as investments in the oil industry. The big five exporters including

Venezuela, with little effort were able after only one month of consultative preparations to schedule a full scale Ministerial level Oil Conference in Baghdad, the Iraqi capital and it was here that OPEC was born.

(c) The Baghdad Conference

After the EXXON-led action, the stage was irreversibly set for the unity and cooperation of the major oil producers, in an attempt to challenge what they regarded as unfair treatment by the Multinational Oil Companies. However, the Companies did not take matters lying low, and had to belatedly make last minute efforts to thwart what seemed to be an ugly development in an industry that had witnessed their exclusive domination over the years. Their initial response ranged from blackmails, public propaganda and even the use of representation to the host governments to label the proposed conference as a big trick by Venezuela, fearful of market competition to deprive prolific low-cost Middle East oil of its rightful position in the market.⁷ In addition, they even used their influence with the Venezuelan

⁷ Some amount of truth could be found in the accusation levelled against Venezuela regarding competition in crude oil produced from different sources. It was observed that Venezuelan oil became increasingly uncompetitive in the oil market especially after 1958, following the rapid expansion of production from low-cost crudes exploited in the Middle East and North Africa. This situation was exacerbated by falling unit costs of transporting oil across the oceans, a development that tended to threaten then Venezuela's oil-reliant economy, and therefore compelled its officials to seek a compromise with other oil producers. See Odell, Peter R., *Oil and World Power* (London: Penguin, 1986).

Federation of Chambers of Commerce and Industry to instigate domestic opposition to the proposed organisation, whose role they saw as only to limit export of Venezuela's oil but all to no avail. The implication of these moves was that the companies were very much apprehensive of the reactions of the oil producers if they had to effect further reductions more so when such actions are taken without prior consultation. But why they went on to the unilateral decision to reduce posted prices in the face of mounting antagonism from the oil producers is anybody's guess. According to Seymour (1982), "it seemed that the multinational oil companies led by Exxon were so wedded to their contractual right of effecting unilateral price changes that they forgot an imaginative overture to the oil exporting countries", a step which could have defused the cohesion of the oil exporters to the advantage of the companies. Iran, perhaps might not have joined the proposed organisation if it had not felt humiliated from the companies' unilateral actions, given her oppositional stance on any system of production prorationing.

The choice of Baghdad for this all important conference was significant for a number of reasons. Iraq was then seen as a successful revolutionary country who would not hesitate to lend its support to any efforts to challenge the economic imperialism of Western governments and their agencies. It could be recalled that this period coincided with Iraq's negotiation with the Iraqi Petroleum Company (IPC) over its share of participation in the oil business. At this time, Iraq was therefore very much in need of a

solid support from its fellow oil exporters which were necessary to strengthen its position in the course of the negotiations.

In addition, the hosting of the conference represented an opportunity for Iraq to assert her political leadership of the region, as well as act as a support in her quest for increased better treatment of the Middle East oil producers.

At the end of the conference, after five days of exhaustive deliberations, the delegates of Venezuela, Saudi Arabia, Iran, Iraq and Kuwait (yet to be independent) announced to the listening world, their decision to unanimously form a permanent Intergovernmental Organisation, which they called the "Organisation of the Petroleum Exporting Countries", OPEC, charged with the full function of "instituting regular consultations among the member states with a view to coordinating and unifying their oil policies". Thus, OPEC was born as a compromise organisation, which has continued to plague the affairs of the organisation many decades after its birth. Marchant (1990) seems to have captured this essence in his claim that OPEC was born out of crisis, a product of its founder-members' perception of the prevailing market situation at the turn of the '60s, and a birth that has made the organisation pre-occupied with how to restore order in the oil market for the greater part of its life. That the price issue formed the first part of the resolutions seems rather interesting; a reflection of the fact that members had felt very strongly about the "Majors" indignations to adjust price at random.

As it was put "that members can no longer remain indifferent to the attitude heretofore adopted by the Oil Companies in effecting price modifications", so said OPEC's Resolution in 1960. In addition, the resolutions further called for the rolling back of prices to previous levels before the August reductions, as well as the need for mandatory consultations on future price movements. These resolutions were to be backed up by the decision of the members to collectively act in the face of sanctions imposed on a member country in pursuance of the objects of the resolutions by any of the Major Oil Companies (OPEC statute, 1961).

Initial OPEC resolutions could well be regarded as instruments of change in the world oil industry, a notice to the multinational oil monopolies that their exclusive right to oil concessions had a limit. It was therefore surprising that not only the oil companies, but also their home governments and sympathetic analysts saw OPEC formation as an affront to their legally protected rights in the oil industry and a confrontational threat to the interest of the oil consuming countries. But contrary to this view, OPEC after its formation regarded the Multinational Oil Companies as their natural allies. As Alfonzo surprisingly put it in an interview, "One point clearly brought out in the Baghdad proposals is that basically the oil companies are regarded as natural allies rather than the enemies of the oil producing countries" (Skeet, 1988). OPEC was neither established to fight the administration of pricing nor the legal right of the Multinational

Oil Corporations to execute this feat, cognisant as the members of OPEC were that oil was too sensitive a commodity and commands vital an industry to be left to the rather uncontrollable forces of demand and supply. Again as Skeet (1988) rightly described it, OPEC was not created out of nothing, but emerged "out of the environment and attitudes of those around it" with neither plan nor design. Perhaps what the producers wanted under OPEC was a fairer redistribution of the benefits of the oil industry as well as greater say in the determination of policies involving what they considered their naturally endowed depletable resources. As the then Iranian Shah had to put it, "as owners of the oil, we (the OPEC oil producers) must be treated as equal partners and the companies must realise that this is for their own good."

The companies reactions were rather mixed. Firstly, those companies that followed Exxon's lead in posted price reductions quickly effected an increase that brought them in line with their counterparts. These initial steps by the International Oil Companies were evidence of their apprehension of the likely impacts of the new organisation on their operations. Secondly, but unofficially, the companies, through the Iraqi Director of the Arab league Petroleum Department in their representation for the October, 1960 Arab Petroleum congress concretely assured the producers that no effort would be made to adjust prices in future without formal consultation of the producing governments. Above all, the companies blatantly refused to recognise OPEC for the ensuing

decades, till OPEC's strength was made manifest in the series of serious negotiations that took place in Tripoli and Teheran, when they (the oil companies) found the necessity of pleading to bargain with OPEC.

OPEC's membership has grown from strength to strength, since its inception, and by 1975 thirteen oil producing developing countries, all of which consider oil as a principal export commodity as well as foreign exchange earner had already become members of the organisation. The member states have been trying to live true to the organisation's foundation's aims of coordination and unification of individual member-countries' petroleum policies, a difficult task indeed to attain. We shall turn to OPEC's second decade, a period many analysts regard as the "OPEC Decade" as it witnessed the organisation's closest approximation to its set goals.

CHAPTER II

The Evolution of OPEC Policies

II-1. The Tripoli Breakthrough and the Teheran Agreements

II-1-1. The Tripoli Breakthrough

The period immediately succeeding the establishment of OPEC was very dormant as it was marked by rather uneventful resolutions, much attention being devoted to royalty expensing issues. OPEC members at this time preferred a more cautious approach being not only fresh with the memories of the Iranian experience, but also faced a period of gloomy economy resulting from the widespread surplus export capacity then prevalent in the oil market.

Libya, confident of the support of not only OPEC but also its equally radical Arab neighbors, Algeria and Iraq with which it had already concluded a secret pact of common understanding, led the way and proceeded to unleash a series of rather serious demands on all the oil companies operating in its domain. In addition, Libya derived extra support not only from the closer and more intimate

oil cooperation it had established with Algeria on issues of price, demand and regular consultations of an advisory nature but also the joint cooperative fund for reciprocal financial support in the event of economic damage resulting from any confrontations with the oil companies. Concentrating its terror-stricking demands first on the independents, confident of their capitulation in the face of exertive pressure, Libya was able to extract a 30-40 cent increase per barrel in posting plus a 5% increase in the tax rate (all made retroactive) which was later accepted by the helpless but reluctant Multinational Oil Companies.¹ Libya could thus be said to be the harbinger as well as an eye opener for OPEC members, most of whose negotiations with the International Oil Companies necessarily followed from the Libyan success.

The success of Libya in this regard could be attributed to a number of developments within and outside the oil industry during the period.

Firstly, Libya was highly advantaged in that most of its concessionaire Oil Companies were independents who had no alternative sources of making up for loss of supplies from their Libyan depots. They were therefore in a very precarious position to oppose the Libyan government's demand by possibly threatening shut-down measures given their huge financial investments in oil exploration in Libya. Besides, these companies were quite

¹ A detailed account of the Libyan negotiations with the oil companies could be found in Seymour, Ian, *op. cit.*, and Skeet, Ian, *OPEC: Twenty-Five Years of Prices and Politics* (Cambridge: Cambridge University Press, 1988).

apprehensive of the fact that the continuity of their newly established international oil networks very much depended on the continuity of their crude oil supplies from Libya which they could ill afford to toy with anyway. Besides, the Independents had no big interests in the Gulf outside Libya to worry about, especially with regard to freight rates falling later to precipitate further demands for price increases by other gulf producers.

In addition, at the time of the Libyan negotiations, the market for short-haul crude from Mediterranean terminals had already tightened considerably, made possible by the closure of the Suez Canal during the Arab-Israeli war. And given Libya's location on the 'market side' of the closed Suez Canal, added to other important geographical advantages inherent in Libya's position over other oil producers in the region, it was little surprising that it negotiated from a vantage point in contrast to the oil companies.² The situation was further worsened by the shut-off of about 500,000 b/d from Saudi crude deliveries to the Mediterranean after the Syrian disruption of the Trans-Arabian pipeline. Libya itself had already effected a production cutback of about 800,000 b/d for reasons of what it called national conservation measures. Those various

² Actually, the international oil companies operating in Libya had already planned to consolidate their positions and possibly reduce further expansion plans (after the 1966 comprehensive oil law), when they realised the immense geographical advantages in Libyan oil production, in respect of getting it to the markets of Europe and North America. The advantages of this shorter distance was boosted by the closure of the Suez Canal in 1967 and thus turned the oil companies' strategy into rapid expansion to benefit from these advantages of transportation cost. See Odell, P.R., *op. cit.*

cutbacks in addition to tightening the supply market to Libya's advantage was of immense assistance in strengthening the Libyan government's position in the course of the negotiations.

It therefore seems misleading to claim, as did the then Libyan revolutionary government that their prevalence over the oil companies was due only to their ingenuity, and that previous Libyan regimes had been passive in the course of their negotiations with the Oil Companies. In fact, they did show considerable strength and toughness which laid the foundations for the success of the revolutionary government. The pre-revolutionary government was known to be responsible for the first comprehensive oil law promulgated in 1966, which enabled Libya to a claim of equal share of the profits from production made by the "traditional Oil Companies" (Odell, 1986). Perhaps, the major difference between the two regimes was in their approach. While the previous regimes preferred negotiations, the radical revolutionaries got their way through various threats. According to Skeet (1988), the Libyan pressure on the oil companies was rather too excessive, beginning with the nationalisation of domestic product marketing operations of ESSO, Shell and Agip, blocking the start of exports from ESSO's new LNG plant and initiating contacts with Soviet and Hungarian experts on possible cooperation in oil development.

II-1-2. The Teheran Agreement

The Libyan triumph was indeed a watershed for the international oil industry and instigated the Gulf exporters to what was later known as the Teheran agreement. It further eroded the long-standing notions among many consumers that oil abundance was a permanent feature and that prices could only go down, not rise further, a development that Marchant (1990) described as signalling the "end of the era of ultra-cheap energy" (p.229). While OPEC's role remained minimal, limited only to moral support, the international oil companies had suffered for the first time, what amounted to a public humiliation at the hands of a producer government, and this lapse was immediately cashed into by other OPEC producers.³

The Teheran agreement perhaps was the toughest challenge to the International Oil Companies outside Libya, as it was held under a unanimous set of demands by the Gulf producers backed by OPEC. It was signed between six OPEC Gulf members and twenty-three International Oil Companies and was twice modified in Geneva to account for currency fluctuations and inflation, but was later abandoned when its terms could no longer hold given then economic conditions. As the then Libyan deputy Premier put it "the Teheran agreement did not fulfil the aspirations of the Gulf

³ Actually the resulting situation was one of hopelessness for the International Oil Companies. While Venezuela chose unilateral legislation, ignoring all forms of negotiations, the then Iranian Shah largely imposed his own terms on the oil companies. For details, see Tetraut, M.A., *Revolution in the World Petroleum Market* (Westport: Quorum Books, 1985).

producers... (even though) it did represent the first successful attempt at unity by the various governments to restore the people's rights, and to the extent that it was a joint stand of the producing countries against the industrialized countries and their monopolistic companies, it was a victory".⁴ Thus not only the Gulf producers but also other OPEC members excluding the radical Mediterranean producers escaped with a five-year agreement whose main terms included a general increase of 35 cents per barrel in Gulf posted prices for 40 API crudes, with necessary provisions for adjustments on heavier crudes, an annual escalation of 2.5% for inflation, stabilisation of the income tax rate at 55% and an assurance of no "leapfrogging" and embargo. The most significant aspect of the Teheran agreement was that it was conducted, for the first time in the history of the oil industry, with the oil companies, both majors and independents uniting against the oil producing countries and their OPEC. It should be recalled here that OPEC's role was only passive, limited only to the psychological support offered the negotiating producers by its Resolution 31 which, it was stated "strongly supported the Gulf producer's resolve to impose their price and revenue demands under the Caracas resolution 120 by means of unilateral legislation" if necessary.

⁴ This statement was made by the then Libyan deputy Premier and chief negotiator in the Tripoli negotiations, in a press conference shortly after the signing of the Teheran agreement. Details of the press conference could be found in Seymour, Ian, *op. cit.*

II-2. The Companies Band Together

Sequel to the new Libyan demand of January 1971, which itself emanated from the December 1970 OPEC resolutions in Caracas, the International Oil Companies, led by the Seven Sisters, found the ardent need to unite and present a common front to what they saw as the threat posed by the oil exporters' various demands supported by OPEC. The Oil Companies were especially apprehensive of the effects of "leapfrogging"⁵ which had then become a major characteristic of the oil industry. This step was the first of its kind in the history of the oil industry especially after the passing of the anti-trust laws in the United States. This agreement for the first time entailed the sharing of crude oil supplies among the International Oil Companies, especially those with production facilities in Libya, in the event of sanctions imposed on any of them by the Libyan Government. The "Libyan producers agreement" as it was then called provided for the replacement of such quantities of oil as may be lost by any one company from her oil sites in Libya at tax-paid cost. Prior to this step, the oil companies had sought for and obtained assurances from the U.S. Justice Department that their actions were not liable to anti-trust law provisions.

Further, the Oil Companies enlisted the assistance of the U.S. State Department to exert pressure on the heads of governments of

⁵ This is a term used by analysts of the oil industry to describe the various efforts by different oil producers who in attempts to supersede the terms of oil contracts obtained or accorded counterpart producers who were not signatories of the previous contracts, embark on a new set of demands.

the various oil exporters to enable them engage in fair and reasonable bargaining. This step was to work grossly to their disadvantage as the outcome of the negotiations attested. The Oil Companies at this time little understood the need to work more closely with the oil producing countries for their future profitability and even survival as events were later to make clear. It was a clear evidence of how much the power of the oil companies derived from the political support received from their home governments.

The united oil companies' resolve was first conveyed in a letter formally addressed to OPEC requesting for negotiations under its (OPEC) umbrella, as distinct from the erstwhile individual oil-exporter-country approach. This letter is very significant to not only the history of the oil industry but also OPEC for several reasons.

In the first place, it formally conveyed the oil companies public recognition of OPEC, an organisation they have not only refused to recognise but also with which they had nothing to deal since its formation a decade earlier. It was ironical that the oil companies who had all the years felt that OPEC not only does not exist but also does not represent the legitimate negotiating body for the interest of the major oil exporting countries, should then insist and plead that negotiations be conducted under the umbrella of OPEC. Perhaps this was the first victory for OPEC in the history of the oil industry, and paved the way for subsequent successes. To Odell (1986), OPEC's initial success was not unrelated to the fact that it was also accepted and welcomed in its new role by the same oil

companies, who when it was created earlier, declined even to recognise its existence, thanks to the Libyan demands which though were prompted by OPEC's Caracas resolutions. As their message had it "We have concluded that we cannot further negotiate the development of claims by member countries of OPEC on any other basis than one which reaches a settlement with all the oil producing governments concerned. It is therefore our proposal that an all embracing negotiation should be commenced between representatives of ourselves... on the one hand and OPEC as representing all its member countries on the other hand, under which an overall and durable settlement would be achieved."⁶

Secondly, having been recognised by the all important oil companies and their governments, OPEC felt highly strengthened to adopt further tough policies in its own interest as well as providing the much needed support for its members in their pursuance of fulfilling the provisions of the organisation's various resolutions as it did in the Teheran negotiations and the further Libyan negotiations. Henceforward, it was all demonstration of strength and muscle-flexing for OPEC and its members.

However, while not unapprehensive of the then organisation's strength and success, a lot of favourable developments both within and outside the oil industry contributed to make their huge successes possible. To this extent therefore, one

⁶ An excerpt from the letter written by the oil companies to OPEC while seeking for a comprehensive settlement under the umbrella of the organisation, quoted from Seymour, *op. cit.*, p.79.

could argue that OPEC success against the oil companies was the result of extra-OPEC developments and that in fact represented the cause rather than the result of the new OPEC strength as some analysts have claimed.

Firstly, perhaps for the first time in the history of the oil industry, political developments played in favour of the OPEC oil producers. Given the prevailing economic and political situation in the then oil industry, there was abundant evidence to suggest that the major consumer-countries and their governments were in no way prepared to face an oil shortage made possible by either embargo or shut-down by any of the OPEC exporters, in preference for support to the International Oil Companies confronting the oil exporters. Particularly important here was that the U.S. Government showed less concern about the details of the oil companies' negotiations with the oil exporters about any price agreement that might be arrived at, preferring to urge on the need to ensure continuity of oil supplies. This position was made clear by the then U.S. Under-Secretary, Irwin, on his arrival in Teheran after he had been dispatched by the State Department in response to the request of the oil companies. The failure of the companies against OPEC in Teheran therefore was more of this loss of the much-needed political support from the U.S. Government, the strength of OPEC members and the skill of their negotiating teams notwithstanding. And not only the U.S. State Department, but also the then British Foreign Secretary was optimistic that their

governments were not in any position to confront the oil exporters, especially after consultations with his European colleagues at the UN. The oil companies were therefore advised to do the best they could not only to extract as much concessions as would favour them and consumers but also warned to ensure that the oil producers are not compelled to embark on any action that would disrupt oil supplies. According to James Akins of the then U.S. State Department's Office of Fuels and Energy, it was in the best "U.S. interest for the companies to maintain a reasonable working relationship with the Libyans and the other producers."⁷ He further rightly argued that the oil companies could not succeed in blocking the sale of Libyan or any other producer's oil in Europe in the event of nationalisation or take-over as such a measure would likely provoke nationalisation of various interests held by the oil companies by European countries who were in no position to do without the highly needed Middle East oil. This situation galvanised itself when in the midst of deadlock during the Teheran negotiations, OPEC members threatened to embargo oil deliveries to the International Oil Companies, with Yamani proposing that consuming nations would still be able to maintain their oil supplies provided they were ready to purchase the oil directly from the

⁷ An extract from the reply by the U.S. State Department for Fuels and Energy, to the oil companies in response to the latter's demand for political assistance through the application of political pressure, in their negotiations with the oil producers. See Skeet, Ian, *op. cit.*

national oil companies of the producing countries at the prevailing prices.⁸

Besides, within this period was prevalent, the dissatisfaction and hostility of Arab governments with the Western countries, over the latter's continued support for Israel, given the effects of the 1967 Arab-Israeli war and more importantly, the insignificant achievements of the controversial oil embargo imposed by Arab oil exporters in the course of the war. This situation was compounded by the after-effects and the resulting inconveniences to the oil industry, generated by the closure of the Suez Canal. The International Oil Companies and their home governments, apprehensive of the immense wounds inflicted on the Arabs by this war were in no position to tread economic policies that would make it possible for the Arabs to unite in a common front against their all-time Western foes. Fully aware that neither an embargo nor any other form of supply disruption will be to their advantage, it was not surprising that the home governments withdrew the much needed political support to the oil companies, at least to reduce the tension of the negotiations, thanks to the emerging solidarity and the evident strength of OPEC as the rallying point of all the producers. Odell (1986) again argued that the U.S. Government had initially wished to see to the establishment of a new collective

⁸ The full text Yamani's address could be found in his paper at the Oxford Energy Seminar titled "Statement of Saudi Oil Policy" in Mabro R. (ed.), *OPEC and the World Oil Market: The Genesis of the 1986 Price Crisis* (Oxford: Oxford University Press, 1986).

stability in the oil system as a basis for renewed efforts to find a political solution to the Middle East problem, in its conviction that higher oil prices and the associated revenue could guarantee a higher degree of economic certainty for the Arab states and thus make it easier for them to accept a compromise settlement with Israel. In addition the U.S. was increasingly dissatisfied with the situation whereby the rest of the industrialised world were enabled to have access to very cheap energy, and thus initiated diplomatic efforts aimed at boosting the revenue of oil producers by high oil prices. In addition, the lingering effects of the 1967 war especially the closure of the Suez Canal left European oil markets in such a condition that it had to virtually depend on supply of short-haul crude from the Mediterranean. Against this background, coupled with the Syrian pipeline disruptions, the Libyan cutbacks in its Mediterranean crude exports, and above all the fact that the three Mediterranean major exporters were in the forefront of the new demands, the international oil companies could hardly contain the significant impacts in the European markets amongst which was market tightening and the consequent price increases of 1970-71. It was to this already grave situation that the Arab oil embargo of 1973-74 exacerbated to culminate in the first oil crisis.

II-3. The First Oil Crisis

As we earlier tried to establish, the oil market was already tight, given various developments both within and outside the oil industry, accompanied by the sharp price increases observable in the 1970-73 (early part) period.⁹ Prices were marginally eased but still remained high after the Saudi Tapline was again opened at the end of January 1971. While more pressure was exerted to the oil situation by Algeria's 51% unilateral nationalisation of French oil interests, the Arab oil embargo against the United States and Netherlands in particular and other European countries deemed to be less concerned with the Arab cause in their struggle with Zionist Israel, added further tension to the already volatile situation thus resulting in the first oil crisis. As much has been written on the crisis and its historical nexus, it would be our contention to dwell more on its significance especially in relation to OPEC's emerging strength and the transformation of the oil industry under OPEC. We would be particularly interested here on the roles played by OPEC as an organisation in either initiating or fuelling the crisis.

Nonetheless, the underlying developments that gave way to the crisis will be briefly examined here to pave way for an in-depth grasp of the significance.

⁹ Price increases had resulted from not only the increased demand for oil in the rather tight market coupled with the Tripoli successes, but also from the compensation made in lieu of the dollar's depreciation. The then price increase was in the nature of an adjustment based on currency parties and an index of the movement of currencies of the major industrialised countries of the world.

The 1973-74 supply disruptions and the associated price explosions or what some analysts chose to call the first oil crisis had its roots deep in a complex interplay of not only economic but also political factors in spite of the fact that its scale was significantly but exceptionally magnified. Contrary to the arguments of previous analysts that the oil price escalations of 1973-74 was the outcome of oil supply deficits made possible by the Arab oil exporters' embargo, we intend here to demonstrate that notwithstanding the significant contributions of the oil embargo in exacerbating the crisis, it (the oil embargo) was only one among several important causes of the crisis. Recognising the inevitability of the crisis, Odell (1986) has argued that it would perhaps have taken not more than three years for the state of imbalance evident in available oil supply and potential demand to manifest itself, if not for the opportunity offered by the embargo. There was no indication that any radical attempts were in the offing, especially in changes in lifestyles, to redress the negative trend in oil consumption evident among most West European and Japanese oil consumers, thus supporting the inevitability of the oil crisis, but perhaps much earlier than Odell has contended.

Again, it was already evident that OPEC members especially the Gulf producers, at the beginning of 1973 were already itching for a revision of their five-year Teheran and other related agreements. As we saw in the previous chapter, this urge emanated from not only the observable better terms obtained by the Mediterranean

exporters thus widening the differential price gap in the various crudes but also the gross erosion of other basic underlying assumptions under which the agreements were entered into. Among the basic assumptions was the idea of a stable dollar (the currency of all oil transactions) as well as the belief that the inflationary rate in the industrialised countries will remain within appreciable range.¹⁰ Unfortunately, the turn of events in the early part of 1973 was such that the dollar was not only highly depreciated (the Geneva adjustments notwithstanding) but also accompanied by rising inflation, the implications of which were that the oil exporters suffered losses in their purchasing power, the price of oil being based on the Teheran agreements. They therefore were right to demand as they did, a revision of the agreement to reflect latest developments in the world economic system, and this coincidentally fell within the period of turbulence in the oil industry and the Arab government's employment of crude oil as a weapon of war.

Added to this already difficult situation was what Seymour (1982, p.79) rightly called "the dramatic tightening of the oil market", the consequence of which was the escalation of market prices towards the end of 1972, a trend that continued well into the greater half of 1973. Further to Seymour, this situation was made

¹⁰ The 2.5% annual inflation factor built into the Teheran agreement was at that time considered more advantageous by OPEC members to the Oil Companies' suggestion of a formula linked to a UN Price Index which was later adopted. The 7-8% real inflationary rate in 1973 was a potent reason for OPEC members' further agitation for a revision of the Teheran agreement. See Skeet, Ian, *op. cit.*, p.86.

possible by a disruption in the supply-demand balance of crude oil, itself caused by the observable growth in the world economy in the early '70s which was necessarily accompanied by increased demand for oil energy.¹¹ The situation was further compounded by the diminishing potentials for alternative energy sources due to problems of cost as well as environmental resistance to most of the alternative energy projects. In addition, alternative sources to OPEC supplies were yet to be abundantly developed, hence reliance on the supplies from the single OPEC sources, from which there has been significant production cutbacks by various OPEC member-governments for reasons of what were labelled conservation and national interest.¹² It should be noted here that only a few of the OPEC governments used the conservation claim to effect oil production cuts, as some members used the opportunity to maximise their production and take advantage of the higher oil prices to increase total revenues.

In the light of the foregoing situation, spot market prices of crude oil, tanker freight rates, and refined product prices were observed to be adjusting upwards in the various oil markets in Europe and America. What OPEC did at that time was equal to

¹¹ In addition to increases from Western Europe and Japan, the U.S. had become a net importer of petroleum products to the tune of about 35% by the beginning of 1973, and this further tightened the demand for oil from the OPEC exporters.

¹² The then U.S. Secretary of State, Kissinger, had threatened and actually did propose the use of force to end the crisis. That Kissinger's position was immediately supported by then President Nixon was further evidence of the effects of the oil crisis.

mere adjustments to the price of its marker crude with the appropriate differential prices, to reflect the current state of the oil market.

Alongside these developments came the controversial desire for greater participation in, and control over their God-given depletable natural resources prevalent not only among the OPEC governments but also other oil producers, Mexico having set the lead much earlier. Perhaps these governments were right in their demand for participation in the process of exploiting their finite natural resources. However, the manner of the acquisitions leaves room for series of regret. This in itself was the result of not only reluctance but also stiff resistance by the International Oil Companies backed by their home government that the producer governments were in no way qualified to contract the necessary participation agreements. Thus were unilateral nationalisations most of which resulted in supply disruptions for some time. Algeria led with its 51% nationalisation of French oil interests in its territory. This step was followed by other producers especially Arab exporters most of which had found an added cause to react to western-backed Israeli intransigence over its occupation of Arab territories. A parallel argument to the foregoing points to the fact that the International Oil Companies recognising the helplessness of the situation, tacitly supported producing states' control of the oil industry provided the sanctity of their middlemen roles would be preserved. According to Tanzer (1984), the International Oil

Companies remotely supported the idea of immense state control in the oil producing countries, since such a development would mean that OPEC and its members rather than the companies would take the blame for price increases. Odell (1986) has further argued that the International Oil Companies, aware as they were about OPEC's growing strength as a new power in the realm of international oil, firmed a determination to protect their immediate best interests which lay in profit maximisation through cooperating with the efforts of the oil producers, against the oil consumers. This position was taken in the belief that OPEC's collective action in raising revenues could be used as a convenient argument to justify price increases and thus absolve the oil companies from any blame.¹³

Above all, the political front was the remote but immediate cause of the crisis. Political developments both within and outside the Middle East oil producers contributed as catalysts that fuelled the crisis. Not only had there developed admirable understanding and sympathy between Saudi Arabia and Egypt especially after the latter's dismissal of Soviet advisers in 1972, the Saudi king could no longer hide his disenchantment with the U.S. policy regarding Israel's defiance of UN Resolution 242, a feeling it conveyed through the various warning messages most of which were ignored as bluffs by the U.S. administration. While these messages were not

¹³ The truth is Odell's argument could be buttressed by the realisation that the International Oil Companies had been working together for some years since 1968 under what was then known as the London Oil Policy Group, with the intention of curbing if not eliminating the then weakness in the oil industry.

a direct affront to the oil industry, they nevertheless indirectly influenced the perceptions of analysts, forecasts, commentators and important watchful observers of the oil industry to the extent of making huge impacts on the already tight oil market. To these were added the Iraqi-Kuwaiti border skirmishes and President Nixon's April 1973 "New Energy Policy" under which the import quota system was to be suspended. According to Skeet (1988), these made the Saudi threats of production restraint "more ominous to those who, unlike the U.S. administration believed they were real" as it turned out to be. And with the threat of war looming in the background in 1973, the Arab governments saw the need to, and actually did employ the oil weapon in their war with Israel and its Western allies.

Given the foregoing situation, the first oil crisis could not be justifiably said to be a direct product of OPEC policies per se. It is possible that the Oil Companies, cognisant of this grave situation in the oil industry wanted to exploit for their own selfish ends, the advantage of reaping unprecedented windfall profits while being exonerated from any blame arising from it. Again according to Tanzer and Zorn (1984) the International Oil Companies in anticipation of the erosion of their traditional power base after the foundation of OPEC initiated a massive shift in investment strategy outside OPEC production areas as well as to non-oil energy sources. But these deliberate initial outlays were made when oil prices were not high enough to permit the more expensive oil from the non-

OPEC production to compete on the world market. The companies therefore wanted a situation of higher oil prices to make their alternative investments viable and the opportunity for this presented itself in the interplay of forces in the latter part of 1973 and early 1974 which was quickly exploited in fulfilment of the oil companies' strategy. Contrary to the allegations of various analysts, there has been no concrete evidence of any clear attempt or designed strategy of action by OPEC as an institution through either its production or pricing policies to instigate the crisis. Incidentally, one might not be too wrong to assert that OPEC members were just lucky to reap the rewards of developments in the oil market for which they little laboured.

At the same time, in recognition of the fact that the crisis had both direct and indirect consequences on OPEC and its ensuing policies, suffice it here to discuss some of the salient significance of the crisis. A more detailed examination of the impacts of the various oil crises will be left to the next chapter of this work, which concerns itself with the global impacts of OPEC policies generally.

The most significant aspect of the first oil crisis was perhaps the dramatic transformation of OPEC's role in the oil industry in the ensuing decades. OPEC not only won major concessions for its members on various aspects of the oil industry but also became highly strengthened both as an organisation for oil exporting countries as well as emerging as the champion of the cause of the third world. Thus OPEC was strong enough to demand and indeed

actually did influence the evolution of the first and ever conference on International Economic Cooperation or what has been labelled the North-South dialogue. Though this conference had no practical achievement, it was nevertheless a major breakthrough for LDCs in international economic relations. It was as Skeet (1988) put it, "a document that reflected the aspirations, hopes and optimism that OPEC had inspired in the third world."

In addition, it enabled OPEC to consolidate its previous victories in the Teheran, Tripoli and various other agreements. Skeet (1988) pointed out that OPEC members' demand for a 25% participation in the oil business soon gave way to majority control of the oil concessions, a victory point for OPEC, which also ended the era of negotiated price settlements forever. At the same time it exposed the weakness of OPEC in managing the oil industry. While it was able to take advantage of the fortunes offered by the crisis situation, it showed itself incapable of achieving its founder's primary motivations without the external assistance here presented by the Arab oil embargo. According to Hallwood and Sinclair (1981), the oil price rises of 1973 were not orchestrated by OPEC, rather while the October price rise was enforced by the Gulf Producers Ministerial Committee (though an offshoot of OPEC) the much bigger rise in prices in December was only a unilateral imposition by the Shah of Iran under the threat of withdrawing from OPEC if Saudi Arabia dared dissent. In all OPEC's price increases were limited only to adjustments of the marker price in reaction to the

then high prices obtainable in the spot market. The evidence for this could be observed in the fact that OPEC marker prices for the whole of this period only trailed behind spot market prices.

Again, this crisis enabled a fundamental change in the relationship between OPEC and the Transnational Oil companies. This change was made possible by the economic transformation of the majority of the oil-exporting OPEC countries and their integration into the world economy. As Tanzer and Zorn (1984) put it, the post first oil crisis era saw OPEC becoming an "intergrated entity within the structure of global oil, which is subject to the regulation of international capital, and this sets the limits of OPEC's oil revenue to the existing inter-regional differential productivities." Bina (1990), further observes that the transformation of the oil industry, including the development of significant global spot markets, oil price speculation and commoditisation which resulted in posted prices becoming totally dependent on the magnitude of market prices are all outgrowth of the first oil crisis. The resultant situation was such that long term oil contracts, increasingly became subsidiary to the all-embracing blind forces of the spot market.

Besides, the crisis significantly exposed the vulnerability of the oil consuming countries and their economy to instabilities in not only the international oil industry but also OPEC member states especially in the Middle East. Perhaps, for the first time, Western policy makers realised the precariousness of their excessive

dependence on Middle East oil as had become the case before the crisis. Thus was the competition for, and development of various bilateral negotiations by especially the industrialised oil consumers to secure adequate and stable oil supplies as well as markets for exports of manufactures. The increased closer contacts and greater attention to third world oil producers thus fostered increased government to government understanding. Coupled with this was the exposition of the consumers' lack of preparedness to cope with emergency situations such as the oil supply disruptions evident in the crisis. Secretary of State Kissinger's various threats, later to be positively upheld by President Nixon were evidences to this effect. The Western consumers were later to resort to various anti-crisis measures that tended to weaken the price before it was further beefed up by developments in the Middle East which culminated in the second oil crisis.

The wide-ranging significance of the first oil crisis would not be complete without a mention, if only briefly here, of its effects on the revenue of OPEC member countries. The high prices associated with the crisis ensured that not only were the revenues accruable to the oil exporters fully beefed up, but also the international oil companies as middlemen in the oil trade experienced magnificent increases in their profits. While the international oil companies found themselves financially adequately prepared to diversify their energy-related investment, through risking investments in hitherto unviable but alternative sources of crude oil outside the OPEC area,

the oil exporters embarked on a wide range of economic development projects, most of which were executed with Western technology and expertise. In addition, the extra revenue for low absorbers among OPEC members resulted into what was later called petro-dollar investments in both financial and the industrial realms of the developed countries. A detailed discussion of this will be made in the next chapter.

In conclusion therefore, some pertinent questions could thus be posed on the increased revenue potentials of OPEC oil exporters after the first oil crisis. In the first place, to what extent could one say that OPEC as an institution and given its lofty ambitions and the primary object of increasing members' accruable revenue, was responsible for the price increases and the accompanying boost in revenue achievements for its members? Secondly, to what extent could OPEC justify the cartel-like behaviour that was responsible for the price management and stability that followed the post crisis years of the oil industry down to 1978 and before the second crisis?

It is difficult to precisely state what role OPEC as an institution played in the first oil crisis especially in the price escalations that accompanied the crisis, the arguments of Western analysts to the contrary notwithstanding. Could it not have been the case that OPEC was responding to an influx of various factors beyond its control? As Yamani boldly put it, there were evident signals to the effect that "OPEC had no control over the situation." The impact of the Arab oil embargoes in addition to various other

developments outside the oil industry highly influenced the impacts of the crisis among which was price escalation, to the extent that OPEC could largely be absolved from the roles of a price setter. But to Skeet (1988), the uncertainty as to whether oil supply would continue to be available in predictable volume either immediately or far more vitally, in the future was the major reason for the high prices paid for short-term oil contracts in the period of the crisis, and in fact "had nothing to do with OPEC at all." This argument could be buttressed by the fact that OPEC official prices within the period were largely trailing behind spot market prices which had already approached unprecedented levels. Marchant (1990) identified the cause of this to be high volumes of stocking embarked upon by consumers especially the U.S.' Strategic Energy Reserve Program. There was nothing wrong with OPEC adjusting its official prices to reflect this trend in the spot market, if only to restore discipline to various member's uncoordinated individual pricing behaviour, which in all tended to see the spot market as guide and at least ensured that the organisation remained intact. This is not however to discountenance the merits of the argument that OPEC like the International Oil Companies could be selfishly exploiting the extant supply-tight situation to its advantage. Again, as Skeet (1988) would recount, OPEC as an institution had no clearly devised and observable strategy that would have led its members to embark on the kind of unilateral price increases evident in late 1973, which

were more of the Iranian Shah's imposition, using the threat of breaking away from OPEC if Saudi Arabia dared dissent.

Again, the issue of post-crisis price management could score points for OPEC, though not on the scale enough to earn her the rather abusive label of cartel used in reference by most Western analysts. Again, according to Skeet (1988) OPEC's management of the post 1974 prices of crude oil could be said to be effective to the extent of the distorted figures from which they started. But it would be rather erroneous to suggest, as some analysts would like to, that this outcome was the result of any concerted strategy or identity of outlook or even perception. It would seem very "ridiculous to claim that OPEC had acted as a cartel with any implications of joint supply programming." It could be justifiably assented that it was more by accident than by any strategically devised design that OPEC was able to sustain the higher prices of 1974 up to 1978, thanks to inflation, currency fluctuations and stock replenishment, the formers grossly eroding the real prices realised by OPEC members in 1973 monetary terms. Upon calculation, it was realized that \$12.70 per barrel which was crude oil price in 1978 was worth even less than \$7 in 1973 terms. This by implication meant only a doubling of OPEC's 1973 price of \$3.65, in real market terms, a development that would not have seemed outrageous to many market participants, Skeet (1988) asserts. In essence, OPEC apparently amassed huge wealth judging by the then crude oil price jumps, but a more critical look at the whole issue will reveal that OPEC members in real

terms lost tremendously judging by their new import bills and inflation.

The relative price stability of the 1974-79 period, was to be distorted by yet another series of developments in late 1978 and early 1979, most of which have nothing to do with the oil industry as such, but which culminated in the second price explosions of the period or what some analysts chose to call the second oil crisis.

II-4. The Second Oil Crisis

That OPEC survived the after-effects of the first oil crisis, remaining not only firm and united but also sustained the stability of the relatively high prices of crude oil evident after the crisis was a defeat for the various economic models advanced to explain the organisation's behaviour. This represents a commendable achievement to the extent that it expressed an evident confidence, the strength from which enabled the organisation to adopt a decision to pursue long-term strategy afterwards. In addition, it ushered in a situation whereby the U.S. seemingly had to display a less militant approach to OPEC pricing policies, in spite of her huge trade deficits made partly possible by the high oil prices. Again this signified as it rightly did, that the world should come to terms with OPEC as well as appreciate its various policies including pricing which were necessitated in most cases by external developments, and thus were not the organisation's fault. Perhaps the then OPEC Secretary-General was right to assert that "we (OPEC) have

hopefully banished forever the spirit of confrontation which for so long had bedevilled relations between OPEC and the industrialized consuming nations," unaware as he was that more difficult days awaited the oil industry as witnessed in a few weeks later.

Like the first oil crisis, a myriad of political and economic developments both within and outside the oil industry combined to convert the observable weakening of prices in late 1978 into the price explosions of 1979 and 1980 or the second oil crisis, as some will choose to call it.

First, there was the Camp David Accord concluded and signed in September, 1978 that nearly led to the break-up of the Arab world. The Arab oil exporters in particular felt greatly betrayed by Egyptian Sadat's action and left no doors closed to express their indignation to this act of what was understood to be nothing less than a political sell-out. On the diplomatic front, reactions were sparked off by an Iraqi-led offensive, supported strongly by Syria, and which resulted in an emergency summit of the Arab League. While this summit could not immediately agree on total severance of diplomatic relations with Egypt, discussions on oil related issues were more volatile. There were no evidence of any agreements on plans to use the oil weapon again, even if it meant using the strategy of high oil prices. However, the all-time Western moderate, Saudi Arabia was grossly weakened by this political development, to the extent that it was difficult for her to push for the usual price moderation during price discussions in the ensuing

OPEC's 52nd conference of December held in Abu Dhabi, aware as she was, that the entire Arab oil producers alienated from the accord would isolate her.

Added to this was the worsening of events in Iran, where the position of the Shah had become not only less predictable but where also oil production had been bedevilled by the strike embarked upon by oil industry workers to the extent of drastically reducing Iranian production to less than half of its September level (from 6 million b/d in September to 5.5 million barrels per day in October, 3.4 million b/d in November, and less than 2.4 million b/d in December, a quarterly average of about 3.8 million b/d). According to the 1979 edition of the BP Statistical Review of World Oil industry, the loss of Iranian supplies amounted to about 9% of total world oil production or 15% of the oil traded internationally. All the same, there was no evidence of supply deficits resulting from the loss of Iranian production as increased supplies from other oil exporting countries replaced more than half of the decline in Iranian production (PE,1979). Uncertainty and the fear of losing contractual supply connections and being caught without substantial inventory, or what Schneider (1983) calls failure of the consuming countries to take appropriate preventive measures, generated pressures that soared spot market prices. Marchant (1990) further argued that the suspension of Iranian oil exports in December 1978, triggered panic on the spot market, in spite of the fact that other OPEC member states raised their production levels in

a bid to compensate for the loss of Iranian supply. Besides the huge impact of this output reduction in the oil market, the Iranian influence in OPEC as another western moderate had become largely marginalised, if not non-existent. However, by January 1979 after the successful ouster of the Shah and the arrival of Khomeini, Iranian oil production had already fallen below the level of 500,000 b/d, though it was able to ascend up to 2.4 million b/d, in March 1979. But the impact was already glaring on the oil market. As Skeet (1988) sadly caught the situation "the uncertainty created by the Iranian revolution was such that Iranian oil suddenly became an unknown and possibly, a non-existent factor in international oil supply." The position became rather intense late in January 1979 when the Saudi Arabian Government, for reasons best known to them decided to leave the allowable output only at 9.5 million b/d for the first quarter of the year, a major shift from its hitherto position of making up the shortfalls from Iranian production through higher production. The Saudi actions could be explained by such reasons as the lack of appropriate sustainable capacity, a signal to the West regarding the need for energy conservation and political disenchantment with the U.S. Government's inability to support the Shah as well as the effects of the Camp David Accord earlier mentioned. Added to this was the role played by the International Oil Companies, especially those with consortium interests in Iran, who immediately cutback on their third party oil

sales at the inception of the crisis, a situation that led oil companies without access to enough crude oil to struggle in the spot market.

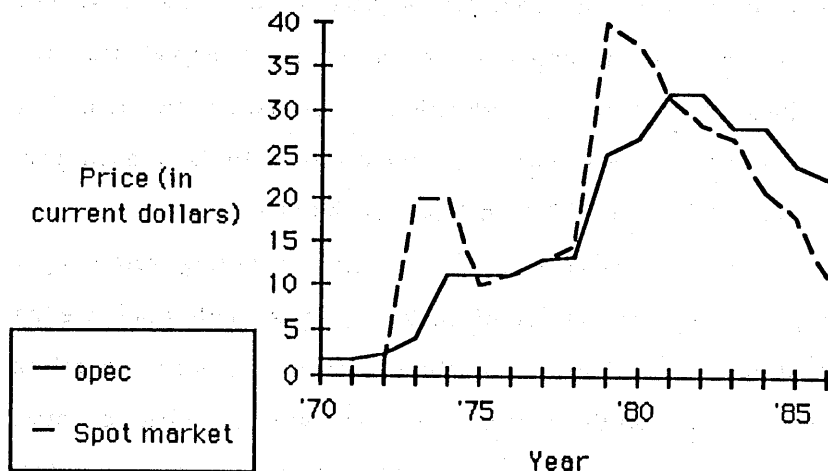
In the midst of the resulting situation in the spot market, some OPEC members found it inevitable to apply additional premia on OPEC's official crude oil prices, to reflect the current trends in the oil market. As Schneider (1983) again rightly pointed out, the wide publicity given to oil prices in the spot market instigated oil exporting governments to raise their official prices to levels comparable to spot market in order to reap the full benefits of the market situation. It was under this chaotic market environment that OPEC convened for its consultative meeting, which was later changed to a full conference in Geneva, in March 1979. Naturally, this conference should have responded to the exigencies of the time by effecting price increases but this was far from being the case. That OPEC refrained from exploiting the situation was a further reflection of her concern for the global impacts of high oil prices. As Renner (1984) rightly observes, this should be recognised as an indication of OPEC's immense usefulness in the world oil industry, for as he put it "instead of imposing price increases of its own (to take advantage of the situation), the producers (OPEC) simply followed the upward trend of spot market prices (See the attached chart) over which they had little leverage." In addition, OPEC members while raising the marker crude price to 18 U.S. dollars, declared a moratorium on the maximum price a member country could charge for its crudes, in spite of whatever advantages it may

have. Perhaps what could amount to OPEC's contribution to the crisis was its decision that the "setting of crude oil prices do not prevent member countries from making an upward adjustment in the light of their prevailing circumstances."

The announcement further went on that in the present circumstances, the actions of member countries in exercising their sovereign rights cannot be construed as "prejudicing the solidarity and unity of OPEC." Essentially, OPEC was reluctant as an organisation to follow the high prices obtainable in the spot market by officially announcing appropriate increases in prices (as a true economic cartel should have done in the circumstances), rather it chose to allow individual members to adjust their prices as they deemed fit based on their existing contractual relationships. As Skeet (1988) described the situation, OPEC had admitted that they neither had, nor wished to have any control in terms of price management in these two all important conferences. Even the inclusion of a ceiling price of \$23.50 per barrel in the June conference was a clear evidence of a weak effort to restrain the worst excesses of price greed and ended up without any practical effect. However, whether OPEC's decision to allow member countries to add market premia as it deemed justifiable in the light of its circumstances constitutes the much talked about cartel behaviour is obviously difficult to establish. It could be recalled that OPEC itself raised serious objections to the problems of price speculation very

rampant among the International Oil Companies and their agencies.

Chart-1: Yearly Average of OPEC and Spot Market Prices for OPEC's Marker Crude: 1970-1986.



It is possible to identify two marked differences between the first and second oil crises. In the first place, the immediate and remote causes of the two crises are remarkably different. While the 1973 December price increase which preceded the crisis proper in 1974, could be attributed to OPEC behaviour in response to developments in the oil industry, the 1978-79 price escalation was the end result of a series of developments both within and outside the oil industry and various decisions over a period that greatly

affected the oil market and most of which were beyond the control of OPEC as an organisation.

In addition, the 1973-74 situation could be said to have caught consumers unawares to the extent that there was no concrete consumer organisation in existence within the period to respond to whatever developments were taking place in the oil industry. But in 1979, the IEA was already in existence and was expected to play significant roles towards moderation of the market situation. But the second oil crisis was price determined, unlike the supply-determined crisis of 1973-74 that gave birth to the IEA.

The IEA, created to respond to crises resulting from supply shortfalls was therefore not adequately in a position to moderate the situation of the oil market in the second oil crisis and therefore helplessly watched the price escalation as it grew from bad to worse. In addition, the IEA lacked the appropriate mechanisms to deal with situations effected by a price-induced crisis, with the result that its efforts, even in conjunction with the OECD members most of whose efforts were concentrated on demand reductions could hardly be effective in arresting the escalating prices. All the same, the second oil crisis was a big test for the IEA and indeed helped the organisation consolidate its capability. Again, as Marchant (1990) has argued, the second oil crisis led to an intensive effort in the industrialised countries to reduce dependence on oil, which efforts were made under the auspices of the IEA. It further encouraged the introduction of wide ranging energy conservation measures, whose

execution in addition to increased intensive exploitation of crudes in less accessible regions eventually culminated in the third oil crisis.

It seemed to have been the case that none of the players in the oil market were able to learn enough lessons from the first oil crisis, judging from the behaviours they variously exhibited in the era of the second oil crisis. The OPEC oil exporters were not only confused but engaged in several forms of indiscipline in the market. Except for Saudi Arabia which to an appreciable extent exhibited some signs of wish to restrain the oil price movements of 1979, in spite of its lack of adequate production flexibility to manage the situation alone, as well as the apparent loss of political will, other OPEC exporters indulged in behaviours reminiscent of their interest in reaping the short-term financial advantages made possible by the crisis. They were later to painfully pay a cost for these behaviours through the serious erosion of prices that followed and culminated in the absolute collapse of real prices in spite of OPEC's resort to quota production.

Table II-1: OPEC Production and Capacity:

Sept. 1978 - Jan. 1979 (mbd)

	Production		Estimated Capacity
	Sept. 1978	Jan. 1979	
Saudi Arabia	8.6	10.1	10.7
Iran	6.1	0.7	6.5
Iraq	2.9	3.1	3.0
Kuwait	2.7	2.6	2.9
Venezuela	2.3	2.4	2.6
Libya	2.1	2.2	2.3
Nigeria	2.1	2.4	2.3
UAE	1.9	1.9	2.3
Indonesia	1.6	1.6	1.7
Algeria	1.3	1.3	1.3
Qatar	0.5	0.5	0.6
Ecuador	0.2	0.2	0.2
Gabon	0.2	0.2	0.2
OPEC Total	32.5	29.2	36.6

Source: *Business Week*, March 1979.**II-5. The Third Oil Crisis**

In contrast to the previous two crises, the third oil crisis (so called) was unique, conceived out of the shattering impact of declining oil fortunes in the revenues, and by extension the economies of the major oil producing countries. A major contrast relates to the fact that while the impact of the first two oil crises were mostly felt by oil consumers as it was characterised by supply deficits and high prices, the third oil crisis was fully oil-producer oriented in its impacts, the main features of which were excess supply, reduced demand and dwindling prices. These impacts on

the politico-economic situation of oil producing countries were so strong that it deserved to be treated as a crisis situation.

A major result of the first and second oil crises were the appreciable displacement of the medium role played by the International Oil Companies whose distribution facilities were complex, worldwide and very costly. This eventually developed into various marketing and distribution problems.

Since most of the oil producers could not easily duplicate and use these marketing and distribution facilities as well as their outlet services, with the panic inherent in the second oil crisis largely increasing government-to-government and government to distribution and refinery transactions as a channel for disposing of or effecting crude oil sales. The consolidation of this system was the first signal to the distasteful developments later in the oil industry, as the system largely involved the consuming governments seeking out the oil exporters instead of the other way round.

In addition, OPEC lost its coordinational roles as the high demand for their crude oil made the members loose the much-needed coherence and group discipline, two crucial characteristics for the sustenance of the organisation's operations. Each member acted out on its own way, disregarding the consequences which eventually cost them dearly. In defiance and out of sheer disregard for the realisation that the high prices have a time limit as was evident immediately after the first oil crisis, the producer's actions only stimulated the adoption of measures by the consumers to

reduce average consumption and by implication demand for oil fuels.

The adoption of rather late measures including controlled and quota production, monitoring of adherence to the quota, extension of credit time, a firm differential system and price reduction, above all did little to help the organisation, as total revenue continued to dwindle made possible by both demand and price reductions. In 1982, OPEC oil exporters suffered a staggering current account deficit of about \$10 billion, in contrast to the previous years' huge surpluses. Total oil revenue continued to drop from its all time high of \$255 billion in 1981 to a mere \$205 billion in 1982. While this represented an alarming but ominous sign of danger, as well as a matter of deep concern to OPEC members, little did they know that the worst was yet to come.

The extension of the impact of the then oil glut to non-OPEC producers evidently revealed the seriousness of the situation. Yet there was little response from the non-OPEC producers, most of whom have been used to taking advantages of the various stabilisation roles played by OPEC. Various steps were taken, leading to the little but short-lived understanding between OPEC and its competitors at the London consultative meeting where attempts were made for a collective action towards redressing the stark realities of the then oil market situation. With little or no commitment though, this consultative meeting later turned out to be a waste as it did not achieve anything tangible. According to then

chairman of the OPEC monitoring committee in April 1984 "we know that it is OPEC that has been bearing the brunt of measures to stabilize the oil market, whereas the non-OPEC producers in the North Sea and elsewhere have been producing to the maximum (taking advantage of OPEC). They talk nicely to us but I do not see what is their contribution to the stabilization of the market. And when the market was strong, they charged the highest prices possible (again taking advantage of our efforts)." This was a frank talk and very much reflected the situation of the then oil industry. OPEC has lost hope of cooperation by its competitors. At the same time, it was not sure of the commitment of its own members while further drops in demand for oil continued.

The most interesting aspect of this period was that while OPEC continued to reduce output, non-OPEC oil producers saw a big chance to increase production. In addition, production increases were accompanied by massive price cuts thus further depressing the already fragile oil market. As Marchant (1990) observed, while the non-OPEC world oil production fell steadily from 48.6 mbd in 1979 to 37.9 mbd in 1983, output from non-OPEC regions rose from 17.7 mbd to 20.9 mbd, thus saturating the oil market. This trend he attributed to have emerged from the high oil prices of the previous decades which rendered some of the economically unfeasible oil projects very viable.

As Dr. Subroto, the then Indonesian Oil Minister did point out, "oil market stability depends on three important elements: an

improvement in the world economy, particularly in the industrialized countries, a downward review of non-OPEC policy of production maximisation, and cohesion within OPEC, characterized by members' adherence to the Organisation's decisions on pricing and production levels." Hence to ensure market stability, trilateral cooperation is needed involving the industrialised oil consuming countries, non-OPEC countries and OPEC.

II-6. The Price Collapse of 1986

The dwindling oil fortunes continued unabated for the greater part of the middle '80s. As one analyst commented about OPEC, the realities of the time had pushed OPEC members into the corner together so tightly that it had tended to weld them together. And this perhaps was the major contributory factor against OPEC's disintegration.

It was in the midst of this alarming situation that OPEC members held the year-end conference in Geneva (December 1985). Available statistics revealed that OPEC output had steeply declined during the year to an all time low of 15.4 mb/d, perhaps the lowest in the history of the organisation, while market share had dwindled to 40.1%, a record low level for the organisation, with revenue plummeting to \$127 billion. The opening address of the then president of OPEC clearly depicted the reality of the situation. "Since our last meeting in Vienna, the relative strength that had then characterized the oil market has reversed dramatically. As of

the beginning of the last week of November, spot prices of crudes and products started to deteriorate with the biggest decrease being witnessed by light... (this) is attributable to several factors: increased production by OPEC and non-OPEC; the restoration of stocks to adequate levels; and the further anticipation of depreciations in the U.S. dollar." He further continued that "what we have been trying to accomplish over the past couple of years is to avert a situation of significant decline in oil prices, and in order to do this, we have had to assume the responsibility of a swing producer in the world oil trade. OPEC, its unity and discipline hold the key to the extent of the fall or rise in prices, yet OPEC is not the sole beneficiary of a stable oil market and the defence of the present price level, even though it alone currently makes all the necessary sacrifices."

The reaction of the oil market to these statements was rather swift, as it gave "official recognition to what was already a reality"--the expected reaction that OPEC will flood the market with oil. As the closing press communique declared "having considered the past and likely future developments in the world oil market and the persistently declining trend of OPEC production, the conference decided to secure and defend for OPEC a fair share in the world oil market consistent with the necessary income for member countries development." The immediate impact was a steep deterioration in prices which further paved way for increase in OPEC production to make up for dwindling revenue. It was observed that OPEC output

had climbed to about 19 mbd, in spite of the gloomy state of the market and the evident collapse of the entire price structure.

This state of affairs continued for the greater part of the year 1986, perhaps OPEC's worst year in history. While we leave the full impacts to the next chapter, it was observed at this time that many analysts were reaping fortunes based on their ill-fated assumptions that their predictions about OPEC's disintegration has come to pass, little aware as they were that their predictions and expectations were nothing more than wishful thinking as ensuing events later unfolded.

CHAPTER III

Global Impacts of OPEC Policies

OPEC has been vigorously criticised either fairly or unfairly for the resultant effects of the two most important oil crises. This chapter will be concerned with an attempt to explore the general impacts of the oil crises, bearing in mind our earlier observations that though OPEC, by various acts of omission and commission did contribute to fueling the oil crisis, it was not however the initiator, nor could it be made to bear the entire blame for the occurrence of the two price escalations of the '70s and early '80s.

One ignored issue among analysts of the oil industry is the fact that the new interdependence between producers and consumers, made possible by competing interests, goals, and perceptions of "crisis" as well as prescriptions for solution are largely the cause of the dilemma that had plagued the oil industry, ignoring for instance, the important roles of the International Oil Companies not only in the oil industry but also in international allocation of resources, including encouraging the actions of the

various producers (an important overlook, one may claim), blinds these set of analysts and adherents to their school of thought to their adamant conviction that the responsibility for oil price determination rests exclusively on OPEC and its oil exporting members who arbitrarily increase prices and the oil importing countries for their "excessive" dependence on oil energy.

Again, though the increase in petroleum prices especially in 1973-74 and 1979-80 were motivated by economic variants as claimed by analysts, their political effects could well be recognised and to this extent it could be claimed that the two crises were largely political in origin. It was not surprising therefore that the impacts were far reaching. Especially relevant here in most western analysts' preoccupation with viewing the two periods as "crisis" which to them implied nothing less than calculated efforts by LDC resource producers to threaten the economic and political interests of the oil-importing countries. This viewpoint also ignores the possibility that the crisis, as it was called could have been only artificial, being merely the results of contrived changes in market mechanisms rather than real shortages in petroleum supplies. It is perhaps worth reminding OPEC critics on the crisis that even before the foundation of the organisation, there has been no such time when the price of oil was governed by the mechanisms of a competitive market. The interdependence between buyers and sellers very often highlights basic political and economic conflicts

over who controls the price of oil, who determines output and how the international petroleum trade is regulated.

Be that as it may, we will now proceed with our examination of the impacts of the two oil crises, bearing in mind what roles OPEC and its policies might have played at various phases of the impacts. We shall attempt this exploration in categories, starting with the impacts on the major industrial oil consuming states .

III-1. The Major Industrialised Oil Consuming Countries

III-1-1. Balance of Payments

As would be revealed in the course of this paper, the oil price explosions of the '70s and early '80s as well as OPEC's major share in the control of the oil industry had not only economic but also political and social impacts on all consumers of crude oil. While the major oil consuming countries were plagued by fears that higher oil prices would mean slower rates of economic growth, increased inflation and unmanageable balance of payments deficits, the poorer nations were concerned with their inability to secure adequate funds to pay for their higher oil bills. In addition the financially buoyant nations further feared that the system of international finance and world trade would eventually collapse with all the associated effects, made possible by deficit nations resorting to import controls, restrictions on foreign exchange and debt repudiation, all in efforts to pay their oil import bills. Further fear was expressed that the surplus OPEC oil exporters, unable to

domestically absorb their huge oil revenues, and not sure of the security of their investments abroad, may resort to more production cuts, a move that will further aggravate the situation of the oil industry.

Perhaps, it would be fair to commence with an exhaustive survey of the economic imperatives to which many analysts of the oil industry have always placed emphases. One outstanding but general economic impact of the oil policies of the '70s and '80s had been in its influence on balance of payment situations of all the oil importing countries, especially the major industrialised countries whose oil import bills made significant reflections in their current account positions, a situation that was associated with problems of inflation, unemployment and how to manage the balance of payment deficits.

The issue of balance of payment deficits was the most conspicuous, and indeed attracted a lot of international attention among the several acclaimed effects of the oil crises. The fact clearly remains that the economic interdependence that evolved between oil producers and consumers was such that there developed both direct and indirect nexus in the balance of payments positions of both the group of oil exporters as well as the oil importers, to the extent that a surplus in the balance account of one group will correspondingly imply a deficit for the other group. Added to this was the extent of the influence which the international oil exerted on the financial interdependence that has grown between oil

consumers and producers. The higher the consumer countries' oil expenditure both in financial and monetary terms, the more negative impacts on their balance of payments position. And this impact was further dependent on the level and magnitude of imports of goods and services as well as investments from the oil exporters which was expected to redress the negative balance. Again, the oil consuming countries and the reflection of favourable or otherwise balance of payments position was a product of the extent of the International Oil Companies' ability to increase the volume of their repatriated profits as well as to reduce their overseas investments.

The huge oil import bills of industrialised oil consuming countries therefore, could not but make balance of payments deficits inevitable. According to Schneider (1983), the oil consuming countries paid \$88.86 billion for oil imports to OPEC in 1974 only, against the 1973 import bill of about \$22.8 billion. This, to him was equivalent to 2% of the total output of the OECD oil consumers combined, and about two-thirds of a normal year's growth rate. This directly translated into not only the huge current account deficits suffered by the oil importing countries in 1974 but also drastically reduced aggregate domestic demand for goods and services. This problem was compounded by the fact that it could not allow for the employment of counteracting measures like boosting domestic demand through monetary and fiscal policies, for fear of its impacts on the already high rate of inflation. It was

estimated within OECD circles that the 1974 oil price increase alone directly added about 1.5% to the OECD-wide rate of inflation then running at about 11.5%.¹ Again, this estimate excludes secondary effects, like the impact of the oil price increases on prices of alternative energy sources and the wage-price cycle, which if included will add up to about 2 to 4% to the inflation rate in most of the OECD countries in 1974.

At the same time, it could be observed that magnificent as the impact of high oil prices on the inflation rate was, all in all, the entire effect still accounted for less than one-third of the total OECD inflation rate at that period. Wherein lies the justification for all the hues and cries for OPEC blood among most western analysts. In addition, not unlike the effects of high oil prices on balance of payments of the consuming countries, its impact on inflation was less recurring. The stabilisation of oil prices in the middle of the '70s implied a drastic reduction in its effects on inflation while the problems of current account deficits continued. Yet the inflationary spiral within the OECD continued after this period on an annual basis and indeed was passed on to the existing rate of inflation within the region of the OPEC countries.²

¹ The effect of the first oil crisis OPEC inflationary rate was observed to be a 2.3% increase in the prevailing rate for Western Europe, 2.6% for Japan whose dependence on imported oil was almost 100%, and 0.4% for the U.S. given her relatively stable supply of domestic oil. See Schneider, S.A., *The Oil Price Revolution* (Baltimore: The John Hopkins University Press, 1983).

² A survey conducted by Data Resources Inc. revealed that the actual inflationary in the U.S. measured by the consumer price index was 11.08%, as against 8.1%. The entire rate was passed onto the OPEC oil exporters through inflated export prices by the OECD group. See *Business Week*, October 13, 1975.

Again, one of the most outstanding difficulties that grew out of the oil crisis was the new trade-off between high economic growth and adequate but affordable oil supplies. The situation of the then oil crisis generated fears that either or both of the need for adequate as well as affordable supplies of crude oil were rather distant to meet. A rapid economic expansion would imply increased oil consumption, which at the then prevailing situation could only translate into increased oil import bills. In addition, such a course of action could possibly increase demand above available supply levels thus further pushing up oil prices with the possibility of shortages emerging, all of which will halt economic growth. On the other hand a drastic slow rate of economic growth might result in absolute decline in demand for crude oil, the impact of which will be to reduce price of crude oil to levels below which it could hardly sustain the vigorous research into alternative energy. Alternatively, the low prices might compel exporters to cut output in order to raise prices or even stop production, all of whose effect will be detrimental to existing rates of economic growth. It was most unfortunate that the economies of oil consuming countries especially the OECD group had been so premised on low-price oil, an increase of which will reduce the average productivity of capital-plant given its dependence on low-cost energy. The resulting interdependence between producers and consumers was so serious that each side had to thread carefully in order not to hurt the other by its actions and thus provoke retaliatory response. This problem

was compounded by the suddenness of the price increases which gave little room for adjustments. Again, according to Schneider (1983) "had energy prices gone up slowly and steadily, business, labour, and all the consumers could have adjusted accordingly, but with prices skyrocketing in mere three months (as they did in the period of the oil crisis) there were bound to be substantial transitional costs, with business discovering suddenly that much of its energy-intensive plant was now obsolete, workers that their skills were no longer needed, and consumers that their appliances and life styles required too much energy."

On the contrary, it could be posited that the OPEC surpluses were not a waste, rather it did represent a rise in world savings that could have been used to increase capital spending. In other words, though the rise in energy costs and the surrounding uncertainty led to the rather hasty rush to develop less energy intensive technologies that eventually contributed to slowing the then rate of capital spending, adequate and meaningful utilisation of then OPEC surpluses was about an advantage to the world economy in that it did represent a huge block of investable capital savings.

However, the effect of the high oil prices on associated economic indicators like unemployment levels were not clear-cut. While energy and capital tend to be complementary, energy and labour, from all indications tend to be substitutable, since a less energy intensive economy by implication means the employment of less capital in preference for more labour. This not only

translates into a boost for employment but is also accompanied perhaps by a general decline in economic activity, and a reduction in both labour productivity and wage rate. The oil price increases of the crisis period have been accused of instigating most of these unhealthy economic indicators but sometimes analyses on this tend to contradict one another.

The end result of all these was the adoption of several macroeconomic policies that led to recession in the industrial developed oil consuming countries, a recession whose impacts extended beyond the borders of the OECD to the LDCs as would be seen in the next section. While most of the policies did pay off, like several countries' attempt to boost exports in order to enable them pay for the high oil import bills, they ended up creating further problems that widened the already extant deficit gap, and led to financial and economic antagonisms among members of the OECD group. Japan and West Germany in particular emerged from the oil crisis as economic giants to the displeasure of the U.S. and most Western European countries. However, on the average, the ensuing recession was not long lasting and above all did not precipitate competitive currency devaluations as would have been expected under such circumstances, Gisselquist (1979). And according to Schneider (1983), "No major trading nation adopted protectionism on a full-blown scale, while the success of private banks in recycling (OPEC) surplus funds, floating exchange rates, and the willingness countries to accept deficits in their balance of

payments all worked to prevent this", even though there were many instances of government intervention in the currency markets, an action that was interpreted to mean shifting "the (deficit) balance of payment burden of higher oil prices onto their neighbours", to use the words of Gisselquist (1979).

But contrary to expectations, there was no major breakdown in world trade. Though the growth rate appreciably slowed down from 8% per annum in real terms in early 1973 to 4% since the end of 1973, it was only a reflection of slowdowns in economic growth rather a decline in the importance of international trade in real terms (see the attached table 3-1). In fact since 1973, there has been a significant increase in both imports and exports as a percentage of the developed countries' GNP. This was partly accounted for not only by the increase in oil import bills but also the corresponding increase in the imports of the OPEC member countries. According to available statistics, while more than 4% of the OECD exports went to OPEC countries in 1973, the figure had risen to 9.3% in 1978, a reflection of OPEC members' willingness to recycle their oil revenue through imports, contracts and investments in the economies of the OECD oil countries. Besides, most of the evident wide gaps in the balance of payments positions of the oil consuming countries were merely the result of poor calculations resulting from failures to include gold flows as part of the receipts by the oil consuming countries, since such transactions are part of and indeed included in the oil exporters' investments in the economies of

recipient oil consuming countries or included in the repatriation of corporate profits on the investments by the International Oil Companies. Another factor that did influence the balance of payments positions especially after the oil crises could be linked to the relative ease or otherwise with which the oil exporters repatriated returns from their various investments in the oil consuming countries. As Choucri (1981) pointed out, there is evident correlation between the tendency to repatriate accumulated profits and the host country's current account balance, to the extent that the more revenue accruing to oil exporting countries, made possible by either increased demand or higher prices for their exports, the less the tendency towards repatriation of profits from investments and vice versa. And to this extent are the oil exporters likely to reinvest their accumulated profits further into the economies of the industrialised countries as there would be no rooms for the absorption of extra funds. Reduced revenue receipts from oil will on the other hand result into efforts to repatriate profits earned from investments to satisfy domestic revenue requirements. This results into increased capital flights from the industrialised oil consuming countries and thus further widens the balance of payments gap. In addition, reduced revenue for the oil exporters will also mean reduced trade, contracts awarded for goods and services from which most payments are made to the industrialised countries which implies reductions in the capital receipts of these countries.

**Table III-1: World Oil Imports and Exports as % of GNP/GDP:
1973-1980**

	Imports as % of GNP				Exports as % of GNP			
	1973	1978	1979	1980	1973	1978	1979	1980
U.S.	5.6	8.6	9.2	9.6	5.4	6.8	7.7	8.4
Japan	7.3	8.4	10.7	12.9	7.0	10.3	9.9	11.9
U.K.	23.8	22.6	26.1	23.6	18.9	20.7	23.1	22.6
France	14.6	16.6	18.8	20.4	14.2	16.1	17.7	17.6
W. Germany	11.0	17.4	21.0	22.7	13.5	20.3	22.6	23.3
Italy	25.7	21.2	24.5	26.4	20.5	21.1	22.6	20.6

	Imports as % of GDP			Exports as % of GDP		
	1973	1978	1979	1973	1978	1979
Developed Market Economies	13.2	15.4	17.2	12.5	14.6	15.7
Developing Market Economies	16.5	20.3	19.9	18.4	21.4	24.3

Source: UN, *Yearbook of International Trade Statistics* 1980.

III-1-2. Recycling the Petrodollars

OPEC oil exporters at the end of the first oil crisis found themselves in a very big dilemma over the disposition of their huge oil surpluses. Unable to absorb substantial levels of these surpluses domestically, the major oil exporters, especially the low-absorbers found resolution of their great predicament in their ability to recycle the oil revenue through various forms of investments. Again, this corresponded with the period of acute deficits in the balance of payments of the industrialised countries, most of whom were rather seen as safe havens for the OPEC surpluses. In addition to expanded import of goods and services, OPEC countries' foreign

investments represented a direct improvement in the consumer countries balance of payments and by implications huge reductions in the deficits already sustained. However, one lax aspect of this system was that it was neither uniform nor made according to the level of oil imports bills incurred by the oil consumers. Essentially, an imbalance resulted in the distribution of the recycled surpluses that tended to favour some consuming countries to the detriment of the others.

A look at the disposition of OPEC members' surplus will reveal at a glance that the greater proportion of these funds were invested in the U.S. and U.K. mostly in Eurocurrency accounts. The immediate implication was that while it quickly relieved the deficit burdens on the U.S. and U.K., other deficit-ridden states were plunged into deeper problems and seriously needed to be bailed out. The result was massive credit transactions between deficit West European states and multinational private banks most of who were based in the U.S. and U.K. Further implication was that international financial institutions were assigned only little roles in acting as financial intermediaries in the disbursement of OPEC surplus funds to balance of payments deficit and needy states.

It was further revealed that international and intergovernmental financial organisations officially handled about 20% of the then total deficit financing between 1974 and 1976, having been lent only \$9.75 billion by the OPEC surplus countries (Gisselquist, 1979). In contrast, more than \$49 billion of the OPEC

surplus was deposited with private commercial banks mostly in New York and London. These windfall sources of funds were a boom to most of the recipient banks, especially at a time when some of them were already saddled with liquidity squeeze resulting from the loss of domestic sources. Besides the effects of recession and the associated slumps in loan demands from their traditional customers, the multinational enterprises applauded the advent of OPEC surplus funds as a welcome relief, since it not only replaced the lost sources of funds but was also associated with deficit governments seriously in need of financial assistance. Further, the involvement of these banks in the recycling process implied that governments replaced private corporations as the largest clients to private international financial agencies, with the associated political gains for their home states.

Again, the recycling process implied further financial and economic interdependence between the OPEC investors and the recipient states to the extent that decisions to repatriate or leave accumulated profits from the investments will have a new but overriding impact on the balance of payments of the host states. Even decisions to reinvest the profit outlays will favour the recipient in the interim only to increase the overall foreign holdings of the investor-oil exporting states thus creating a relationship of interdependence that will imply that the action of one group (consumers or producers) will tend to destabilise the statusquo, and therefore precipitate counter reactions with the attendant effects.

The willingness of the oil consumers to either increase demand or bear high prices for crude oil thus determined the extent to which imports of goods and services by the OPEC group will increase or decrease as well as determine the level of investments and the repatriation of earned profits from the oil importing group.

From the foregoing arrangement, it is very easy to see the dispositional pattern of the bulk of OPEC members surplus oil revenue immediately after the first oil crisis. An up-to-date table of this dispositional pattern could be found in the appendix attached to the end of this thesis. The pattern reflects a trend of developments not inconsistent with the emergence of the U.S. and U.K. as financial intermediaries and the attendant political and economic implications.

Table III-2: Estimated Disposition of OPEC Investable Surplus:
1974-1976

	(in % and billion U.S. dollars)		
	1974	1975	1976
United States:	12.0 (19.9%)	10.0 (21.1%)	11.0 (28.4%)
Treasury bills and			
short-term Bank deposits	9.3	0.3	0.3
Long-term Bank Deposits		0.8	0.3
U.S. Treasury bonds, notes	0.2	2.0	4.2
Other domestic bonds, notes	0.9	1.6	1.2
Equities	0.4	1.6	1.8
Others	1.2	3.7	3.2
Eurobanking Market	22.5 (39.0%)	8.0 (21.4%)	10.5 (28.1%)
United Kingdom	7.5 (13.0%)	0.3 (0.7%)	-1.0 (-2.6%)
Other developed countries	6.0 (10.4%)	7.8 (20.7%)	8.0 (20.5%)
LDCS	4.0 (10.4%)	6.0 (19.4%)	6.0 (19.2%)
Non market countries	0.5 (0.9%)	2.0 (5.3%)	1.3 (3.2%)
International Financial			
Institutions (including IMF)	3.8 (6.5%)	4.3 (11.4%)	1.8 (3.2%)
Unidentified Investments	2.8	1.8	4.5

Table III-3: OPEC Surplus Disposition by % for Recipient Countries

	1974	1975	1976
United States	19.9	21.1	28.4
Eurobanking Market	39.9	21.4	28.1
United Kingdom	13.0	0.7	2.6
Other Developed Countries	10.4	20.7	20.5
LDCs	10.4	19.4	19.2
Non-market countries	0.9	5.3	3.2
International Financial Institutions	6.5	11.4	3.2
Total	100	100	100

Source: "International Debts, the Banks and U.S. Foreign Policy," *Document of the U.S. congress report*, August 1977.

III-1-3. The U.S. as an International Financial "Middleman"

As was earlier seen, while the oil crisis boosted OPEC members' regular revenue, with the highest surpluses accruing to U.S. allies in the Middle East, there was a tendency for these countries to be inclined to invest their excess revenue in the U.S. thus ensuring an increased but steady flow of OPEC money into U.S. financial institutions within the period. The U.S. Treasury Department conservatively estimated the value of OPEC bank deposits in the U.S. at this time to be \$49 billion out of the total known investment valued at about \$133 billion.³ The emerging

³ A discrepancy of about \$10 billion was discovered between OPEC's known investments and the cumulative current account surplus during the period. It was being suspected that this hidden portion must have been invested in secret assets, and no other place could have been privileged for this than the U.S. See U.S. Congress, Senate Committee on Foreign Relations, Subcommittee on Foreign Economic Policy, *International Debt, the Banks and US Foreign Policy* (staff report), 1977.

trend was such that there was not only surpluses in the U.S. current accounts and by implications, the balance of payments positions at a time when other oil consuming countries were sustaining huge deficits, this development became a discernible trend to the extent that the U.S. ability to sustain a favourable or otherwise balance of balance of payments could be observed to be linked to the price of oil. To the extent that higher oil prices obtained and by implication increased investable surplus for the U.S.'s OPEC allies, to that extent was the U.S. increasingly sustaining balance of payments surpluses in spite of her rather huge oil import bills. Besides, not only profits but also enormous powers were wielded by the U.S. through the use of these financial instruments to the extent that U.S. capital markets were placed in positions where they influenced both political and economic measures taken or prescribed to be taken by various deficit-ridden governments. As the IMF once put it, "in the period since 1974, there has been large inflows of foreign capital into the U.S., including substantial amounts from the oil exporting countries, and these have had as their counterpart sizeable outflows of capital reflecting to a large extent the role of U.S. money and capital markets as intermediaries on an international scale." (IMF: *World Economic Outlook*, 1977 p.21.)

The implications of this development in the international financial market were quite enormous to the extent that many nations adopted several measures to counter effects of the U.S.'s apparent financial superiority. It was not surprising that while the

U.S. and her institutions were battling to ease the deficit problems posed to many nations, Japan and Germany, through export promotions simultaneously declared large surpluses immediately after the first oil crisis, a development that further tended to worsen the already delicate economic balance. Not only were the size of the balancing deficit necessary for other nations expanded, the uncooperative attitude of the two (Japan and Germany) resulted in the inability of recycled OPEC funds to adequately redress the imbalances in existence. The end result was increased unemployment, expansion of the international debt level especially in the already heavily indebted LDCs, most of who found themselves sunk into bigger debts in order to pay interest to their U.S. creditor-financial agencies.

In addition, the political implications were quite large. While loans were advanced preferentially to U.S. allies and those sympathetic to her interests world wide, thus increasing U.S. influence in the domestic affairs of these states, the OPEC-country investors found to their dismay that they could not avoid being influenced themselves both at the domestic and even international levels, if only to ensure the security of their numerous investments. The underlying fear was further exploited to put pressure on OPEC surplus states to continue acting as sources of funds for the international financial markets under the control of the U.S.

Again, this development had to be necessarily associated with the U.S. and other international financial institutions increasing their dependence on OPEC funds for not only the continued sustenance of their business operations but also to maintain their dominant positions in the international financial arena. This tendency was necessarily associated with serious implications for oil prices as well as international politico-economic relationships. According to a U.S. staff report, the saving OPEC states have interposed the commercial banks and international lending institutions as a "buffer between themselves and the high risk borrowers, thus increasing as would be expected the risks to be borne by the U.S. and allied financial institutions as international financial intermediaries".

In spite of the foregoing constraints, there were still lots and lots of benefits to be gained by the U.S. financial agencies acting as international financial intermediaries, and which benefits were the primary attractions of the OPEC members surplus funds in the first place. While these institutions were heavily burdened by increased credit evaluation with all the associated political and economic influences that go with it, the financial agencies found increased business volume which by implication could only translate into more profits. To then U.S. Assistant Secretary for International Affairs in the Treasury Department, while testifying before a house committee in 1977, "Financial intermediateness between lenders and borrowers, which... had already reached sizeable dimensions

before 1973, has now become a central element in the world economy", and this by implication translates into the U.S., as home state of these institutions, becoming a central element in the running of the world economy.

And perhaps, it was this realisation that prompted a staff of the U.S. Senate Subcommittee on foreign economic policy to proclaim that though "the oil price increase was something close to a disaster for the world economy, it created a bonanza for the (U.S.) banks". OPEC surplus members' contributions to the IMF and the World Bank also enabled the institutions to expand the scope of their financial business activities, especially in rescuing debt-ridden third world states, most of whom were already too financially weak to be creditworthy enough for further private financial facilities.

Additionally, the symbiotic relationship that developed between the U.S. multinational financial institutions and the most creditworthy borrowers from the non-oil LDCs was found not to be to the best advantage of either party nor even the OPEC country investors. While the relationship could be compared to what did exist between the oil producers and the international oil companies, it fell short of satisfying the long term interests of the countries concerned. In spite of its role in alleviating the major financial constraints posed by the huge trade deficits, it significantly helped them weather then the recession without resorting to much "spend-cuts", though the high interests rates paid to private financial institutions represented a great cost. At the same time,

while it was observed that little political strings and less stringent conditionalities were attached to the private credit facilities access to them was not easy as it was well understood that major allies and sympathisers of U.S. interests received preferential attention. Thus, though it could be well contended that the OPEC surplus, being an increase in world savings, would result in expanded productive capacity through enhanced investment, it nevertheless did little to improve the earning power of the borrowing countries because its impact was largely to maintain domestic consumption levels.

Within U.S. financial circles in particular, developments in international finance after the first oil crisis made possible their return as international net lenders to non-residents, a position they once lost to Euro-based financial agencies. This restoration was further enhanced by the lifting of the U.S. capital export control measures in 1974, thus enabling U.S. based banks to actively participate in international lending operations unrestrained by legal liabilities, a development that greatly facilitated the redeployment of OPEC funds invested in the U.S. banks to various parts of the world. It also enhanced the redistributory role of the U.S. banking system once more lead the then strengthening of the previously sagged interconnections between the U.S. financial system and the Eurocurrency credit markets. It also enabled the U.S. banks to sustain and further improve their net financial positions which had deteriorated substantially in previous years.

III-1-4. Eurocurrency Financial Markets

Another area outside the U.S. where the OPEC surplus funds and their recycling had significant impacts was in the Eurocurrency financial markets. The most striking impact was in the capital supply structure of the market.

Before the oil crisis and the accompanying leap in OPEC oil exporters revenue, oil exporting countries had negligible, if any presence in the Eurocurrency financial market, and indeed had only an insignificant portion of their investable earnings deposited with these banks. However, the first oil crisis altered this situation, and witnessed an era of surplus boom for OPEC oil exporters, as their surplus funds assumed a dynamic supply position and in fact did influence the growth pattern of the market to the extent that OPEC sources accounted for well over 40% of the market's deposits between 1974 and 1975. Besides, the extent of the importance of this OPEC members' investments in Eurocurrency credit market activity becomes more glaring when one examines the net supply of funds, which in 1974-75 was to the tune of some \$13 billion annually, representing the highest net providers of funds to Eurocurrency credit markets. The new concentration of fund sources within a single group of countries, mostly third world countries, contrasts sharply with previous years when Eurocurrency banks depended on multiple sources including East European countries for a net inflow of capital.

Table III-4: Recorded Medium-Term Syndicated Eurocredits
(in billion U.S. dollars)

Borrowers	1972-73	1974-75
OECD Countries	17.2	24.5
OPEC members	3.8	3.9
Non-oil LDCs	7.1	15.2
International Organisations	—	0.1
Others(S. Africa, E/Europe, Yugoslavia)	2.0	4.9
Total	30.1	48.6

Source: OECD, *Financial Statistics*, 1976.

**Table III-5: Eurocurrency Financial Markets: Sources and
Uses of Funds: 1973-1975** (in billion U.S. dollars)

Sources	Cumulative Changes in 1974-75	Outstanding at end of 1973
Developed countries	35.5	123.1
Oil-Exporters(OPEC)	28.3	34.6
Non-oil LDCs	-2.1	16.2
Offshore banking centres	9.3	21.8
Eastern Europe	1.4	5.1
Unallocated	0.8	4.2
Total	73.0	205.0
Uses		
Developed countries	35.6	125.5
Oil-Exporters(OPEC)	2.8	5.3
Non-oil LDCs	7.7	19.5
Offshore banking centres	16.9	35.6
Eastern Europe	8.2	15.6
Unallocated	1.8	3.5
Total	73.0	205.0
Net position (1-2)		
Developed countries	-0.3	-2.4
Oil-Exporters(OPEC)	25.5	29.3
Non-oil LDCs	-9.8	-3.3
Offshore banking centres	7.6	-13.8
Eastern Europe	-6.8	-10.5
Unallocated	-1.0	0.7
Total		

* a minus (-) sign indicates that the group in question is a net user of Eurocurrency financial facilities.

Source: Bank for International Settlements, *Annual Report*, 1976.

Table III-6: Sources and Uses of Funds as Reported by U.S. Banks in 1975: Foreign Liabilities and Claims Reported by U.S. banks (Cumulative Changes in billion U.S. dollars)

A-Liabilities to (sources)	1972-73	1974-75
OECD Countries	6.4	4.6
OPEC members	1.2	10.5
Non-oil LDCs	3.0	4.0
Offshore banking centres	0.8	3.4
Others (Unallocated)	2.8	2.9
Total	14.2	25.4
B-Claims on (Users)		
OECD countries	5.2	11.7
OPEC members	0.4	0.9
Non-oil LDCs	3.2	10.0
Off-shore banking centres	0.9	9.2
Others (Unallocated)	0.1	0.9
Total	9.8	32.7
C-Net positions (A-B)		
OECD countries	+1.2	-7.1
OPEC members	+0.8	+9.6
Non-oil LDCs	-0.2	-6.0
Off-shore banking centres	-0.1	-5.8
Others (Unallocated)	+2.7	+2.0
Total	+4.4	-7.3

Note: A minus (-) sign indicates a net debtor, while a plus (+) sign indicates a net creditor.

Source: U.S. Federal Reserve Bulletin.

III-2. The Less Developed Countries (LDCs)

Suffice it to state here that a proper assessment of the impact of OPEC policies on the less developed countries will not be complete without appropriate distinctions between what some scholars call the financial and real effects. According to Powelson (1982), the former relates to money balances while the latter consists of real amounts of goods and services paid to the oil producing

countries (OPEC members inclusive) as a result of the increased price of crude oil in the early '70s. Money balances derive adequate redress through trade (imports), and investments by the OPEC oil exporters. Again, it would be necessary here to state that the discussion of the impacts relates to OPEC policies only to the extent of the oil prices and measures adopted by OPEC members to ease the burdens of the new financial developments on LDCs.

As was the case with the industrialised oil consuming countries, the LDCs could not escape the various impacts of high oil prices both in their political and economic lives. And like in the developed countries these impacts ranged from balance of payments difficulties to recession and in particular increased debt burden for the non-oil LDCs.

III-2-1. Balance of Payments

The immediate implications of the high oil prices in the period of the oil crisis were that oil importing countries (both developed and developing) necessarily had to pay more for their crude oil imports from the mostly OPEC oil exporting countries. This essentially means that these countries would have to sustain massive deficits in the balance of payments, or else step up exports enough to write off the higher bills resulting from oil imports. In addition, a country faced with this situation also had the option of reducing its demand for crude oil and oil-related products or get plunged into deficits in order to be able to finance its import bills.

For the LDCs both options seemed not immediately feasible given their huge dependence on oil imports, a situation that gave rise to the massive balance of payments deficits that befell all the non-oil LDCs within the period.

To Schneider (1983) the oil importing LDCs had to contend with an increase of about \$17.3 billion in their oil import bills for the period immediately following the first oil crisis in 1974. This huge import bill could neither be matched by increased exports to the developed countries who were already threatened by the recession accompanying the oil crisis, nor OPEC oil exporters, who though had the necessary surpluses to absorb increased exports from the LDCs, were rather akin to importing more from the advanced industrialised countries. This development as it relates to OPEC countries is quite understandable to the extent that increased revenues made OPEC countries more inclined to purchases of assorted kinds of hardware, industrial and technological components, in contrast to raw materials which constitutes the major exports of most LDCs. It was therefore not surprising that the LDCs were plunged into huge deficits if only to finance even a reduced level of oil imports.

Besides, an increased import from the LDCs at this period could hardly have redressed the deficits already sustained by the non-oil LDCs. It was then observed that though the export prices of most raw materials slightly appreciated, it was in no way comparable to the huge escalations in oil prices, which implies that

the LDC oil importers would have had no option than balance of payments deficits. As Powelson (1982) contends, while the LDCs generally spent about \$11.4 billion more for oil imports in 1975 only, OPEC members imports from the LDC group could only total about \$5.2 billion within the same period. Compared with the pre-oil crisis era, this translates into huge differences between what the LDCs had been paying vis-a-vis their capital receipts and the balance of their capital payments and receipts in the ensuing periods after the oil crisis.

Trade imbalance with oil exporters were neither the only indicators nor contributors of the predicament that befell the LDCs in the period following the oil crisis. As earlier advanced, the LDCs had suffered from huge deteriorations in not only their export volumes but also the total receipts from that sector. The main causes were attributed to the then recession in the developed industrial countries, most of whom were the major trading partners of the LDCs. In addition, the LDCs at this time were already burdened with the impacts of their accumulated foreign debts, some of which already absorbed a significant proportion of their capital receipts. The ratio of debt servicing to exports receipts and GNP were so high in most LDCs at this time that the oil price explosions were only an added burden to what had become the norm rather than the exception. Added to this, but most severe in its impact was the drastic reduction in overseas financial aid for most of these countries. It could be recalled that most LDCs depend heavily on

external financial aids from the developed countries to not only stabilise their annual balance of payments positions but also to reduce the effects of the high interests paid on external loans procured to finance some of their imports. The loss of this all important source signalled the dawn of economic danger in almost all the LDCs, a danger that was only transformed into real difficulties for their balance of payments by the oil crisis .

Again, it would be very interesting here to examine the indirect effects of the oil crisis and associated high oil prices, which as some analysts have contended is more severe than the more direct impacts. It could be recalled that only a negligible proportion of oil consuming LDCs before the first oil crisis had installed their own refining and other oil processing facilities. This implies that the bulk of the oil importing LDC countries had to contend with the increased price of crude oil as well as the additional increases in the prices of imported refined products. The situation becomes glaring upon realisation that most of the oil products both before and even processing subjected to various forms of taxation especially in the oil consuming countries where most of the processing also takes place. Essentially, the unfortunate LDC oil importers had to pay several times, the original cost of a unit of petroleum product, further inflated by the expected oil company margin, the cost of refining and in addition tax plus the double or triple transportation costs. Besides, these countries could not benefit from OPEC members decision to sell crude oil at concessionary discounted

prices to LDCs, given their large dependence on the international oil companies who have appropriate refining facilities as well as supply them with processed products. In the end, not only oil products but also petrochemical products like fertilisers, herbicides etc., all of which the LDCs import from the advanced industrial countries had to be procured at rather exorbitant prices, under the guise of the high oil prices. Given this situation, the LDCs suffered from deterioration in trade balances with the oil exporting countries, the advanced industrialised countries and above all from the hands of the international oil companies as the distributors of oil products. Their position was worsened by reduced export volumes, high debt service ratio, losses in financial aid from the developed countries, and above all the high oil import bills, all of which directly translated into the unprecedented huge balance of payments deficits sustained by the LDCs.

III-2-2. The Debt Crisis

The deteriorations in the international economic environment, which as earlier observed were partly caused by the high prices of crude oil gave birth to massive balance of payments deficits for most countries (developed and developing alike). However, the situation exerted a greater impact on the LDCs most of who have lost almost all their export potentials. Besides, neither the resort to use of foreign exchange reserves nor short-term financial assistance from different sources were able to appreciably

reverse the tide of economic woes already threatening the LDCs. While most LDCs resorted to further borrowing to help ease the payments deficit crunch, it was found out to their dismay that the burden of old debts generated enough forces to contend with. At the same time, further borrowing was realised to imply increased debts that further accelerated the already large debt burden to the extent that the balance of payments were worse off. The situation was chaotic enough to attract the label of "crisis" as most analysts would like to characterise the LDC's non-oil international debts.

According to the World Bank data, about \$20.1 billion was disbursed as debt redeeming loans to LDCs in 1975 only. The effect of this was that while it allowed the affected countries to settle their already matured loans by the amount provided by the World Bank, they were further subjected to deeper debt, though this time to a new creditor. In addition, the redemption of some existing loans meant an improved credit worthiness for these states and since the effects of the deficits continued unabated, they could not but go on borrowing. Thus, their debt position continued to further worsen, while the deficits approached irreversible levels to the extent that by 1978, in spite of improvements in the debt position and debt service ratio, made possible by inflation in the industrialised countries, the World Bank still felt the need to disburse as much as \$40 billion dollars of debt redeeming loans to the less fortunate LDCs. The impact of OPEC aid at this time, though not unappreciable could hardly alleviate the problems of the deficits, most of which had

been deemed to be persistent. Besides, OPEC aid was not only limited to particular regimes (mostly Arab and Islamic states) but also was not enough given the problems of the recipient states, though no one would have expected OPEC financial assistance large enough to redress the mounting debt burden of the non-oil LDCs.

Again, the LDCs continued to borrow to finance the accumulating deficits as a matter of last resort, but this time from multinational private financial institutions and Eurocurrency banks. The financial assistance received largely from loans by governments and public financial agencies in the industrialised world were helpful but not enough. Especially the World Bank and IMF facilities were such that the conditionalities attached to their credit extension facilities itself tended to cripple the economies of the beneficiary countries and in the end was more of a restraint than assistance to the LDCs. The resort to Eurocurrency banks as the last options were sort of economic suicide for most of the benefiting states. Though the conditions were neither as stiff nor strictly applied, the high interest rates charged by the Eurocurrency banks was more than damaging to the already deficit-ridden but fragile economies of the LDC borrowers. At the same time, these countries found no option than to continue patronising these financial institutions. However, critical moments arrived when the Eurocurrency banks, fearful of the ability of some of their debtor states to repay, given their economic situations, found need to apply stricter and more stringent conditions. The new terms in most

cases spelt catastrophe for the helpless LDCs. As Schneider (1983) described the situation, "by the end of 1978, the position of the poorest LDCs, such as India, Bangladesh and Pakistan had become severely strained, for these countries lacked access to the international financial markets and to the flow of direct investment that had contributed substantially to financing the current account deficits of the non-oil LDCs as a group." In addition, the loss from inflows of foreign financial aid continued for the greater part of this period, in spite of the increased pace of financial need by these countries. The concerns of credit security was not expressed by the creditor-multinational banks alone, most of who had already sought the assistance of their home governments as well as OPEC members in bearing the risks of additional loans to LDCs. The OPEC investors had even at this time become weary of the safety of their investments since the inability of debtor LDCs to repay their accumulated loans will result in a financial crisis the dimension of which has never been in the history of international finance. The impact of this would be a direct sweep-off for the massive oil surpluses deposited with the creditor Eurocurrency banks and other multinational financial agencies. The unanimous call for more IMF intervention in determining the credit-worthiness or otherwise of prospective LDC borrowers was based on these fears. And given the IMF's notoriety for stiff economic and structural conditionalities, it was obvious to the financially affected states that relief was not forthcoming. Notwithstanding the foregoing

problem, the banks could not afford not to offer further loans to needy LDCs, since the continuation of their operations depends very much on the patronage of the borrower LDCs as well as the need to ensure the continued ability of the countries to repay existing loans. Schneider (1983) even revealed instances when these same banks complained bitterly because some LDC debtor-states prepaid their loans thus reducing the banks' earning through interest payments.

The problems associated with excessive debts, as was the case for the LDCs are myriad. One ominous sign of danger from foreign debts results when such debts, as was also the case for the LDCs were specified in foreign currencies, the implications of which were that whatever available foreign exchange would be used in servicing the debts. That non-OPEC LDCs found themselves threatened by this signal of danger was rather unfortunate as such developments increased the threat as well as the ease at which bankruptcy was looming large over these countries in the '70s.

Table III-7: Debt among 11 Top LDC Borrowers: 1973-1979

	1973	1974	1975	1976	1977	1978	1979
Current account							
as % of GNP	1.2	4.8	5.9	3.5	2.2	2.2	3.1
Net Debt as % of GNP	5.0	6.5	9.9	10.6	12.3	13.6	13.6
Debt Service							
as % of Exports	14.5	11.5	13.7	13.4	16.9	20.5	21.0

Source: Citibank, *Monthly Economic Letter*, March 1980.

Table III-8: Disbursed Debt Outstanding of 87 Non-Oil Exporting LDCs and Annual Rate of Increase
(in million U.S. dollars)

Year	Outstanding	Increment
1972	62,067	
1973	74,110	12,043
1974	92,497	18,378
1975	112,648	20,151
1976	138,194	25,546
1977	169,946	31,752
1978	210,013	40,067

Source: World Bank, *World Debt Tables*, Vol. 1.

In addition, infant industries most of which were yet to develop solid roots suffered untold hardships. Not only were their operations stifled by the recession associated with the debt burden, most of the strings attached to external loans especially in relation to trade liberalisation further ensured that they lost all forms of protection from competition by goods imported from highly industrialised countries. The problems extended to the extent that the foreign exchange crunch made it extremely impossible if not difficult to procure basic spare parts for worn out machines. Technology transfer that was in the process of take-off had to be perpetually suspended, and in most cases abandoned.

The middle of the '70s, however saw signs of relief for the debtor LDCs as their debts increasingly were mitigated by not only

world inflation but also the increases witnessed in their GNPs, thanks to improvements in export prices and the volumes of the major export commodities. This relief was short-lived as the advent of the second oil crisis in 1979 wiped out what could have formed a stable foundation for the servicing as well as repayment of the non-oil LDCs' huge external debts. The associated increases in debt servicing ratios returned these countries once more to the poverty and impoverishment of the '70s. The non-OPEC LDCs were known to have spent about \$43.5 billion on oil imports in 1979 alone, and about \$57.8 billion in 1980 thus further strangulating the effects of previous steps taken to mitigate the cumulative balance of payments deficits and the associated debt burden. The new IMF-Witteveen \$10 billion oil-related-debts facility was hardly helpful in this regard, a programme Schneider (1983) argued involved the IMF in "committing as much in the LDC loans as it had, cumulatively over the previous seven years". The outstanding IMF involvement was made possible because the industrialised countries sustained less deficits in the '80s and therefore had little need to draw on the institution's financial facilities.

Besides, the high oil prices of the early '70s enabled intensified search for oil in most of the LDCs, to the extent that by 1979, majority of the non-OPEC LDCs had already become net exporters of crude oil

Finally, the oil crisis and the associated high prices of crude oil could not rightly be held entirely responsible for the economic

woes that befell the non-oil LDCs in the early and middle '70s, a situation that seems not to have eased even to the present day to the extent that some 'former' surplus OPEC members have now become victims. It would be nice to recognise the influence of other non-oil related factors, most of whose contributions had more severe effects than the oil crisis. One of these forces relates to the fluctuations in the prices of raw materials and other commodities which form the bulk of resources exported by the LDCs within the period under consideration and even to the present day. In addition to deterioration in both price and volumes of primary exports, vis-a vis the goods imported by the LDCs amongst which is crude oil and oil-related products, there were also very large fluctuations in the rate of growth of the export commodity values. To the extent that these fluctuations were extended to and indeed became visible in the rate of growth of non-oil LDCs' expenditure on imported goods, to this extent could it be said that oil prices were only a secondary contributor to the near economic collapse experienced by virtually all LDCs. A glaring evidence of the foregoing argument could be found in the fact that soon after the first oil crisis, most OPEC oil exporters were caught in the same web of economic predicaments to the extent of even becoming net borrowers like other non-oil LDCs, their oil revenues notwithstanding. Besides, the expected reliefs in the debt burden when the prices of crude oil came crashing towards the latter half of the '70s and indeed nearly collapsed in the middle '80s did not

materialise, thus portraying to what extent oil prices could be blamed for the debt problems of the LDCs. As Hallwood and Sinclair (1981) rightly argued, the non-OPEC LDCs had already accumulated huge foreign exchange reserves before the first oil crisis, which they could have easily fallen back to, as they rightly did in the era of the crisis to ease their balance of payments deficits. Further, they contended that the non-oil LDCs were in fact better prepared for the oil shock when it came in 1973, than in any other time, as their SDR real value had risen from SDR 15 billion dollars in 1960 to about SDR 33 billion dollars in 1973, an increase of over 46% as a proportion of their total annual imports.

At the instance of the first oil crisis, the accumulated reserve, even though accompanied by the loss of export market in the industrialised countries as well as rising prices of imported manufactured goods would have been able to sustain import levels without the dramatic increases experienced in foreign debts.

III-2-3. OPEC Aid

The OPEC special fund was among the newest concessionary financial sources available to LDCs in the aftermath of the impacts of the first oil crisis. Established by the joint aid efforts of all OPEC members (in other words, all donor developing nations) as a financial aid donor on highly concessional terms, the fund provides balance of payments assistance to countries with severe deficits in their current accounts as well as extends interest free and long-term

loans for economic development projects in non-OPEC LDCs. Again, it could be credited with being keenly interested in the search for new solutions to the development problem.

One rather interesting aspect of this fund is that it was organised by more fortunate developing countries (the OPEC group), to assist equally less developed but relatively less endowed sister LDCs caught in the webs of crippling economies. This realisation is reflected largely in the operations as well as the terms of reference, to the extent that its articles of agreement were not only more liberal than those governing other existing financial aid agencies, but also innocent of what Shihata (1982) refers to as the "long-standing policies" which often inhibit older institutions from trying untested ideas.

According to UNCTAD Review (1977), OPEC members committed a total of about \$15 billion, in 1975, representing about 7.5% of their combined GNP, in aid to debt-ridden developing countries (LDCs). While this figure has not been stable, it has never fallen below the \$10 billion level in any year since the first oil crisis. Given this figure, OPEC countries were ranked the sixth largest financial aid donors in 1976, using the proportion of the donor's GNP to the financial donation made as a measuring yardstick. In absolute terms, two OPEC members, Saudi Arabia and Kuwait were outstanding and respectively ranked second and fourth only to the United States of America. The most interesting aspect of the financial donation made available by OPEC members is revealed

when it is compared with what was made available by the OECD group in aid to economically disturbed LDCs. According to available statistics, the combined OECD financial aid to LDCs between 1975 and 1976 was only \$25.3 billion or about less than 0.7% of their combined GNP. And to express this in a relationship with OPEC aid would mean that less than a dozen LDC OPEC members financially committed more than 60% of what the total Development Assistance Committee (DAC) of the OECD made in response to alleviating the problems of debt-ridden non-oil LDCs.

In addition, the OPEC financial assistance unlike those of the DAC group is not tied to any particular strings regarding obligations to the sources. It could be recalled that DAC financial assistance to LDCs are usually made in such ways that they are generally recycled into the economies of the OECD donors, which implies that the financial aid eventually offers more economic relief to the donors than the recipient LDCs.

Besides, OPEC aid not only does not proffer any financial or economic returns to the donors OPEC countries but also simultaneously relieves the recipient non-OPEC LDCs while enriching the OECD group from whose economy the major bulk of non-OPEC LDCs make their import procurements. In essence, one could rightly argue that though financial aid of all kinds and from all sources may have their recipients among the non-OPEC LDCs, the major beneficiaries are always the advanced industrial economies.

In another development, OPEC inflows provided a substantial proportion of the financing for net oil imports of LDCs in 1975. Though this facility was not meant to provide compensation for the higher oil prices of the period, nevertheless, Shihata (1982) argued that it financed the equivalent of 99% of the entire value of net oil imports for the non-OPEC LDCs as a whole. The value of this aid alone was more than the aggregate increase in the oil bills of sub-saharan African nations and was about three times, the value of all incremental oil imports of many of the least developed countries, UNCTAD (1977). And in 1976 alone, this facility financed directly more than 26% of the current account deficits of non-OPEC LDCs. It would therefore not be erroneous to contend as UNCTAD's report did, that the entire deficit resulting in the period of the oil crisis may be thought of as having been financed by OPEC capital exports recycled via Eurocurrency banks and other, mostly western-based financial agencies.

The OPEC special fund, therefore as relatively new as it was then could be said to represent a broad transfer of resources from one group of developing nations (the fortunate group for that matter) to another group of less fortunate members of the same less developed states. While its activities had been extended through various channels including a combination of bilateral, regional and multilateral sources, its creation represents only the "most recent of several initiatives taken by OPEC members to consolidate their

position within and in solidarity with the rest of the developing world," to use the words of Shihata (1982).

Additionally, bilateral financial assistance feature more in OPEC members' aid than multilateral aid. This includes such facilities as the absorption of migrant labour from many non-oil LDCs whose remittances, though small represent a significant proportion of foreign exchange earnings for the home states.

The predominance of bilateral facilities in most OPEC members' aids facilities had enabled critics to argue that OPEC financial aid has been a masked attempt to secure political and security objectives rather than a genuine attempt to bail out the debt ridden, non-oil LDCs. The geographic concentration of the bulk of OPEC members' financial assistance could perhaps buttress this point, to the extent that the donor states expect to use aid facilities to secure greater political manipulative control over the recipient states. While the magnanimity of the OPEC donors especially the Arab countries is not doubtful, the mere concentration of aid beneficiaries within Arab and Islamic societies implied that the aid donations were used to further Arab cause. The preference given to the so-called "front line" Arab and Islamic LDC states in financial aid disbursements underscores the point that such aids were extended to support the beneficiary countries in their struggle with Israel, the West and other anti-Islamic agencies. This argument could be supported by reference to the rejection of a Nigerian suggestion that crude oil be sold to some poor African countries at

reduced prices at an OPEC conference in February 1975, Baker (1977). Some of the donors, especially Saudi Arabia have issued aid for security reasons as her principal recipient have been weak Islamic states very prone to communist influences, where the interests of her oil routes could be significantly threatened.

Table III-9: Outstanding External Debts of 87 Selected Non-OPEC LDCs: 1974-1977

	(in billion U.S. dollar)			
	1974	1975	1976	1977
Public debt	90.7	110.0	134.7	164.5
Official sources	55.6	65.0	75.6	89.0
Private sources	35.1	44.9	59.1	75.5
Private debt	29.3	35.2	41.2	46.8
Total	120.0	145.0	175.9	211.3
% Growth per annum		21.0	21.1	20.1

Source: IBRD, *World Debt Tables*, 1978.

Table III-10: Percentage Distribution of Outstanding External Debts for Selected 87 Non-OPEC LDCs: 1974-1977
(in billion U.S. dollars)

	1974	1975	1976	1977
Public debt	75.6	75.8	76.6	77.9
Official sources	46.3	44.8	43.0	42.1
Private sources	29.3	30.9	33.6	35.7
Private debt	24.4	24.2	23.4	22.1
Total	100.0	100.0	100.0	100.0

Source: IBRD, *World Debt Tables*, 1978.

CHAPTER IV

Conclusion

IV-1. The Future of OPEC and Its Implications for Global Oil Supply

IV-1-1. The Future of OPEC

In spite of OPEC's acclaimed feats, most of which were fraught with numerous failures, and the apparent cohesion currently within the rank and file of the organisation, some analysts still strongly believe that the continued existence of the organisation remains very doubtful. Some have even argued that given OPEC's foundation as an organisation whose members have only crude oil exports in common, a commodity whose relative importance as a source of energy, continues to dwindle as the years advance, its demise before the year 2000 is a foregone conclusion.

The primary point against OPEC's continued existence rests with the contrast presented by the extreme heterogeneity within the organisation. Such arguments point to the difficulties of reconciling the interests of OPEC's high absorbers like Nigeria and Indonesia with very large populations and by implications wider

revenue needs, and extra-low-absorbers like Qatar emirate or Kuwait whose tiny populations guarantee comfortable living even in the face of dwindling oil revenue. Besides, dissensions were expected to arise over political differences, given the multiple but heterogeneous political regimes within the member states. There seems to be observable gap between Saudi Arabia's preference for a monarchy based on a tribal structure, a system which seems to be grossly at odds with the pluralist parliamentary regimes of Venezuela, the two countries being responsible for OPEC's initial impetus. Further references were made to the Middle East members of the organisation whose relations could best be described as volatile. The persistent problems between Iran and Iraq as well as the now concluded long time border conflict between Iraq and Kuwait, which recently led to the Iraqi invasion of Kuwait and even threatened the sovereignties of Saudi Arabia and the United Arab Emirates, further buttress the assertion. Parallels were further drawn between radical OPEC state regimes whose strained relations with western values very much influence their positions on international issues, and the conservatives, most of whose policies are moderated if not dictated by the Western industrialised oil consuming nations and their allies, a situation now heightened by the role of Western allies in the just concluded liberation of Kuwait. In addition to ideological differences as exists between radical socialist Algeria and her well-known ambitions for industrialisation, the materialisation of which depends very much

on a stable but high oil revenue, and conservative Kuwait governed by a princely family and whose preference lay with being a perpetual oil exporter as well as to continue financial investments of its surplus oil dollars in industrialised mostly Western financial markets, the level of political and economic development differ widely among OPEC member states.

However proponents of these arguments fail to appreciate that these perceived differences were not only in existence but also quite realised before the foundation of OPEC and have continued to exist alongside the organisation for its thirty years thus far, without significantly affecting its operations. Though evidence of disagreements, as should be the case with a heterogeneous international organisation of that dimension are vividly observable, especially on issues bordering on price and production policies, OPEC member countries are conscious of their socio-political differences as a result of which no room has ever been created for an extreme interference in the affairs of the organisation. The member states of OPEC quite cognisant of their common denominator embedded in the economic interests of crude oil production and exports, or as Marchant (1990) argues, "a status deriving from abundant supplies of crude oil, the sales of which provides the bulk of their export revenues," seem to have directed the organisation specifically towards addressing this issue. The Iran-Iraq war which continued while the organisation waxed even stronger, with the representatives of the two belligerents sitting in

the same conferences is one evidence of OPEC's inter and intra members political neutrality. Even the current Gulf crisis is yet to show any significant influence on the operations of the organisation beyond the measures taken to make-up for the loss of supplies from the two belligerent states and the current efforts being negotiated to accommodate resumed production from the two states (Iraq and Kuwait) after the resolution of the conflict, within the existing OPEC quota ceiling. Individual OPEC member states were at the height of the crisis allowed to express their stands regarding the international political actions taken against Iraq. It is on record that though some members did show varying amounts of sympathy for Iraq against the positions of Kuwait and Saudi Arabia, such differences never went into any of the OPEC conferences within and even after the crisis. On no occasion did OPEC as a group come up with measures in support of either Iraq or Kuwait while the crisis lasted.

Perhaps a more optimistic contrast exists in the aspect of OPEC members' proven reserves and their Reserve to Production ratio (R/P ratio), where marked differences appear to be inexorably widening every year. Based on available statistics (see attached table) on proven reserves and reserve to production ratio, about eight members of the organisation may cease to be substantial net oil exporters in the next few decades. If this happens and only if it is realized, then the possibility of a few Gulf producers retaining the organisation may seem rather doubtful. Cognisant of this trend, the

organisation is geared towards a reappraisal of its long term roles which includes measures to accommodate the interest of the members with low R/P ratios. In a bid to help prolong their span as net oil exporters and by implication sustain their membership of OPEC, these countries have been advised and may possibly receive assistance to increase their exploration activities at the same time as diversifying their domestic energy consumption, possibly with a reduced attention to oil (Marchant, 1990). All the same the possible exit of these other members from OPEC makes one thing clear, and that's that an organisation by whatever name it may be called must exist to weld these producers together as well as to coordinate their various oil policies. The current members of OPEC are too aware of the need for this organisation to the extent that it is being suspected that OPEC may continue to exist.

Potential threat from non-OPEC production lies mostly in Mexico, a third world country whose territory is less than 15% explored for crude oil. There is considerable speculation that huge discoveries will be made considering the fact that Mexico is currently the capitalist world's third largest oil producer and has the fourth largest proven oil reserves. Most of the non-OPEC third world oil producers have received far less attention than the capitalist centres, just because of the political risks involved, especially as the companies were in no way ready to have a repetition of their experience in the hands of OPEC governments in the early '70s. The international oil companies' withdrawal from

exploration in areas where governments established direct control over production has been successful but results in the massive loss of significant oil reserves hidden in these areas, a trend that seems not to be a healthy development for the international oil industry. It was being expected that if exploration and production should become much more efficient, accompanied by substantial reductions in supply costs, especially in non-OPEC areas, the possibility exists that OPEC's dominance of the oil industry could be threatened. Again, despite that governments all over the world have shown increasing willingness to reduce their tax take on oil companies, thus improving the commercial economies of oil even in a low-priced environment, as well as the perceived willingness on the part of many oil companies to invest now in preparation for what is being regarded as the "likelihood of higher oil prices in the next decade" (Yergin,1988), there is still to be seen, evidence that a substantial change has been made in the level of proven reserves outside the OPEC region.

Besides, though with wide disparities, it is still evident that the bulk of world's proven reserves reside in the OPEC area, to the extent that the member countries collectively control about 84% of known oil reserves, estimated at about 900 billions barrels (Sarkis, 1988). The life span of OPEC group's production at present rates is well above 100 years, in contrast to the non-OPEC producers whose reserve to production ratio is estimated at about 16 years given the current rates of production. There is therefore little doubt that even

if OPEC has to produce at an estimated rate of 30 million barrels per day, it will still be the dominant crude oil producer in the next century, assuming there is no addition to current proven reserves. But at present, OPEC supplies only about 34% of world oil needs because of production from non-OPEC sources. This implies that about 66% of current world production comes from countries holding less than 23% of the world's total oil reserves. The same is also true of natural gas where OPEC's production share is less than 10% in contrast to its proven reserves of more than 37% of world total. Realising that non-OPEC production is already peaked, even declining, and given the estimated growth in demand for oil, a trend that will be outpaced by the new rate of world economic growth at current rates, OPEC could not but be sure that its share of the market will not only appreciate but will once more assume its dominant position. Another pointer to this effect is the fact that some OPEC member countries are now involved in vertical integration, having acquired or in the process of acquiring downstream assets in the oil consuming countries especially in Europe, the United States and to a limited extent Japan, a development that will further consolidate their market outlets as well as guarantee the uninterrupted flow of oil to consumers in their home markets. However the effect of tariffs and other forms of taxation imposed on imported oil and related products by the various governments of consuming countries continue to depress

the effectiveness of these efforts in stimulating demand for oil consumption.

Table IV-1: Proven Oil Reserves and R/P Ratio for OPEC Member Countries as at 1988

(in billion Barrels and Years, respectively)						
Country	1984			1988		
	Volume	%	R/P	Volume	%	R/P
S. Arabia	168.8	25.2	97.3	169.6	19.1	109.2
Iran	51.0	7.6	26.7	92.9	10.5	48.5
Iraq	43.0	6.4	33.9	100.0	11.3	78.8
Kuwait	66.7	10.0	161.0	94.5	10.6	199.8
UAE	32.3	4.8	77.5	98.1	11.0	188.2
Qatar	3.3	0.5	22.4	3.2	0.4	30.8
Libya	21.3	3.2	54.5	21.0	2.4	56.4
Algeria	9.2	1.4	41.5	8.5	1.0	35.9
Nigeria	16.6	2.5	32.2	16.0	1.8	35.4
Venezuela	24.9	3.7	39.9	56.3	6.3	96.9
Indonesia	9.1	1.4	17.5	8.4	0.9	19.4
Gabon	0.5	0.1	9.1	0.6	0.1	10.5
Ecuador	1.7	0.3	18.1	1.6	0.2	27.9
Total	448.4	67.1	70.3	670.7	75.6	83.6

Sources: *International Petroleum Encyclopaedia, Arab Oil and Gas Journal.*

**Table IV-2: Proven Reserves of Natural Gas
for OPEC Member Countries**
(in 10" Cubic Feet with %)

	1984		1988	
	10' Cubic Ft.	%	10' Cubic Ft.	%
S. Arabia	121.1	4.0	125.2	3.9
Iran	482.6	15.9	480.0	15.0
Iraq	28.8	0.9	31.2	1.0
Kuwait	34.1	1.1	35.2	1.1
UAE	28.6	0.9	31.2	1.0
Qatar	62.0	2.0	62.0	1.9
Libya	21.5	0.7	21.4	0.7
Algeria	111.3	3.7	110.2	3.4
Nigeria	32.4	1.1	34.8	1.1
Venezuela	54.1	1.8	54.5	1.7
Indonesia	29.6	1.0	30.2	0.9
Goban	0.5	—	0.5	—
Ecuador	4.1	0.1	3.5	0.1
OPEC Total	1010.7	33.2	1017.7	31.7

Source: *Arab Oil and Gas Journal*, 1988.

**Table IV-3: Proven Reserves of Natural Gas
for Outstanding Non-OPEC Member Countries**
(in 10" Cubic Feet with %)

	1984		1988	
	10' Cubic Ft.	%	10' Cubic Ft.	%
Bahrain	7.9	0.3	7.5	0.2
Oman	2.7	0.1	2.8	0.1
U.S.	204.0	6.7	198.0	6.2
Mexico	75.9	2.5	75.4	8.8
U.K.	25.4	0.8	25.4	0.8
Norway	58.0	1.9	58.8	1.8
Non-Market	1283.8	42.3	1446.8	45.3
World Total	3033.5	100.0	3200.0	100.0

Source: *Arab Oil and Gas Journal*, 1988.

In addition, even non-OPEC oil producers have to varying degrees become dependent on oil revenue to the extent that they would hardly support any measures that would lead to the collapse of OPEC, given her perceived roles in stabilising the oil market. Many third world oil producers have become completely dependent on oil revenue for economic growth and repayment of debts most of which were incurred for oil-related investments. Industrialised oil producing countries especially the net oil exporters are neither better in this predicament, as the high oil prices and associated revenue played immense roles in stabilising their economies. Britain's economic recovery in the '80s was fuelled largely by the huge oil revenue earned from the second oil crisis (Subroto, 1989). The U.S. and other developed oil producing countries suffered immense economic hardships following the 1986 collapse of oil prices, a situation whose reoccurrence could hardly be the dream of any oil producing country. As Senator Boren of the oil state of Oklahoma described the situation, the oil price collapse of 1986 had devastating effects on his state's oil industry in particular and the U.S. in general, to the extent that only a price recovery to over \$22 per barrel could revive the industry and once more stimulate exploration efforts (Sarkis, 1988). The level of unemployment, bankruptcies, bank failures generated were only comparable to the effects of the great economic depression. The 1987 collapse of the stock market could partially be traced to trends set in motion by the third oil crisis, while the huge investments in high cost oil

exploitation especially in the LDCs have become massive debts the redemption of which seems extremely doubtful.

Again, the current projection of proven reserves does not take account of recently stepped up efforts in the exploration activities of OPEC members. Supported by the higher oil prices and the accompanying revenue accruing to OPEC member countries, it is certain that exploration efforts will discover new oil reserves in most of the member countries with low R/P ratio. Nigeria has recently signed numerous new exploration agreements with many oil companies aimed at exploring the vastly left unexploited areas in the country (West Africa, 1991). It should be recalled that the oil glut of the previous decades seriously but adversely affected exploration activities since the much needed revenue for such investments hardly did exist. If anything, Saudi Arabia is particularly aware of not only its moderating role in the oil industry but also its newly acquired international prominence through the organisation, positions it very well knows are not possible outside the leverage of OPEC. One of the outstanding feats involving the use of OPEC to gain international recognition was demonstrated on the eve of the just concluded Gulf war where Saudi Arabia employed OPEC's sentiments to ensure uninterrupted supply of oil, a situation that may have been difficult given that most radical Arab states openly supported Iraq and could have used oil as a weapon to weaken if not forestall the allied efforts to compel Iraqi withdrawal from Kuwait.

Added to these fundamental differences seems to be the greater diversity evolving in the products exported by the great majority of OPEC members. While Algeria is more likely to export more refined products than crude oil in the next decades, Saudi Arabia and Kuwait are already following through developments of major refining capacities both in their domains and abroad. The implications of this is that these countries will be more sensitive to the evolution of the world price of refined products than for crude oil which the other members still predominantly export. But this seems to present only a small problem to the extent that OPEC as a competent organisation could easily have it addressed. The new quota arrangement could be such that it includes products to be domestically refined. In addition, it is possible to establish a direct link between crude oil prices and the prices of their refined counterparts in the international oil markets. But the further complexities surrounding OPEC's quota arrangements tend to compound the problem. The organisation has always attempted to proffer temporary solutions to a problem which evidently engenders a certain degree of market stability, particularly at the critical moments of the organisation's life. The quota problem is now under the critical review of a Ministerial Monitoring Committee whose appreciable roles may possibly lead to a permanent solution. The impact of such development will go a long way towards strengthening the organisation as well as assist weather the challenges ahead in the era of dwindling oil prices. A

further support to this will be the increased understanding and cooperation now shown by non-OPEC oil producers.

Another important contrast exists in recent attempts to bank on natural gas facilities to maintain or augment the level of revenue when oil reserves run out. Led by Algeria, most OPEC members have already reached advanced stages in the development of their gas resources as a supplement to crude oil. Again there does not seem to be any concerted effort on the part of OPEC as a corporate organisation to address this issue. The organisation's policies in this regard is to say the least incoherent enough to be of any use. The establishment of the Gas Price Commission notwithstanding, OPEC seems to have been relaxing over this all important issue. However, the organisation's apparent failure or incompetence (if that word could be allowed) in this regard seems to be more of the intrinsic complexity of gas problems than to the lack of urgency evinced by certain members towards any broadening out of the organisation's competence to cover new products. Besides, the vital roles of crude oil are not expected to diminish so fast to the extent of making natural gas production a contentious issue.

Even more incompetence has been exhibited by the organisation in terms of its petroleum prices currently outside the control of the organisation. The implications are vast advantages to those member countries with substantially installed refining capacity who could easily avoid the constraints of OPEC's pricing policies to the detriment of other members. The recent efforts to set

up a monitoring system for world prices of refined products had done little to redress this issue, in spite of the immense assistance provided to OPEC Secretariat by Foreign Consulates. Added to this is the establishment of market networks in the consumer countries by some OPEC member states with enough financial surplus, taking advantage of the relative weaknesses of the oil markets in the early '80s. Kuwait has been leading in this direction and is likely to be followed by Saudi Arabia in buy-outs of major oil facilities in Europe, North America and presently in Japan. These in addition widen the already extant divergencies among OPEC members, and may spell doom for the organisation especially when certain member countries can feel confident enough to go alone without eliciting the support of the organisation or its members. But recent indications are that more OPEC members may join in this international competition thus defusing any grudges against already successful member states.

In spite of the foregoing, it is my confident prediction that OPEC has and may continue to exist in the near and perhaps far future. Realising that since the advent of the oil industry followed by the foundation of OPEC, all members of the organisation have to an appreciable extent come to tie their economies to oil revenue, it is evident that the organisation's role will not be brushed aside. The implication is that these countries are, and may not be in a position to compromise the demise of their much cherished organisation, in spite of all the odds the organisation has gone

through in life. As Sheik Yamani once put it, "partial unity is better than no unity at all", referring to the fact that partial differences amongst member countries of OPEC cannot lead to the disintegration of the organisation. To OPEC members therefore, the organisation is of vital importance.

In addition, all the OPEC members are underdeveloped countries, and fully appreciate the extent of their dependence on oil revenues, an essential condition for their economic take-off. Cognisant of this, and the fact that oil will not exist forever, the member states will be in no position to compromise the roles of OPEC towards enhancing their revenue bases. As Subroto (1989) succinctly asks, "given the known dependence of OPEC member countries on the sale of their crude oil to develop their economies, how could they conceivably want to jeopardize their development process by killing the goose that lays the golden eggs?"

Moreover, the main actors in the oil industry namely the International Oil Companies, consumers of oil and OPEC aware as they all are that oil will continue to play important roles in satisfying energy requirements in spite of deep researches into alternative energy sources, and fully apprehensive of the stabilising roles of OPEC in the oil industry towards a smooth transition from oil to alternative sources of energy, will never allow a disintegration of the organisation. As Terzian (1985) interestingly believes, the international oil industry is still far from moribund, even though it sometimes exhibits signs of fatigue and weakness.

New discoveries in the OPEC area is far greater than in any other major oil regions including the U.S., and the North Sea. As Choucri (1981) claimed in a published statistic, since the advent of the oil industry there has been about 230 times more drillings for oil in the United States than in the entire under-explored OPEC region, yet more than 3.2 times of oil has been yielded in the OPEC area than in any other part of the world including the U.S. and the North Sea. This implies that OPEC members on the average still have very strong oil muscles to flex in at least the next century, especially if one considers the all important fact that the present reserves of OPEC member countries are based on calculations of approximately 25-30% recovery rates. With new developments in technology and the oil industry which are capable of enhancing the recovery rate to 40-50 % or more, as is now the case in the U.S., the reserves of the OPEC members will further increase by very high margins. The prospect becomes even brighter with rumours of availability of newer techniques that can guarantee up to 70% recovery. When one compares the estimated cost of a barrel of oil obtained by using detergents at about \$35 to \$46 and the current OPEC price of less than \$25 per barrel, it is obvious that the need for OPEC and its oil still has a long way to go. The oil production costs in OPEC countries are still relatively low, less than \$15 per barrel on the average, compared to over \$20 per barrel or even more in the difficult zones of the U.S., the North Sea and other North American

oil wells where the current drop in oil price if it continues can result in total cessation of production.

However, if the present relaxation of East-West trade barriers continues, then the Soviet Union's position as the world's leading oil producer, together with its abundance of natural gas will have profound impact on world energy supply patterns. This, especially becomes the case on recognition of increased roles being assigned to natural gas as an environmentally clean source of energy. But as Wendt (1985) has argued, a more market-oriented approach by Algeria (a prominent OPEC member) to natural gas sales might enable her and other OPEC members who are potential natural gas exporters to slow the pace of Soviet penetration of Western energy markets in natural gas supplies. This group has always been left out in the analyses of global energy balance, and given the Soviet Union's potential in natural gas reserves whose exploitation is yet to receive adequate attention, implications are that of increased competition with the OPEC sources is imperative especially with improved relations with the West. Much hope and exploration funds have also been committed to the People's Republic of China where available reserves have been estimated to be some one hundred million barrels in the South China Sea alone (Renner, 1984). At the same time, it has to be realised that the recent shifts to market economy in the centrally planned economies will mean increases in domestic energy consumption, which implies that

though oil production may increase in these regions, less of it will be available for exports.

Added to these are the current problems plaguing the Soviet Oil industry. According to sources close to Soviet Oil industry, Soviet Union is cutting oil exports by half for the greater part of 1991 (MEES,1991). Soviet oil production has been dwindling since 1990, from 3.4 mbd in 1989 to the present 1.2 mbd, and may continue to further decline in the years ahead unless urgent steps are taken to rectify the rather intractable difficulties facing the industry, a step the current state of the Soviet economy could hardly sustain. It is being predicted that the Soviet Union will become an oil importer in the middle and late '90s. And realising that Soviet oil and exports supply the greater part of Eastern Europe, and realising the current shifts to market economy in these countries, one could not but predict increased competition for OPEC oil in the immediate and near future.

Another possible area of concern for OPEC's continued prominence could be seen in the recent actions of governments of oil consuming countries who adopt policies geared towards throttling the demand for OPEC oil, which it is believed will lead the organisation to disintergrate (Subroto, 1989). Such actions range from quotas for imported oil to trade barriers and assorted kinds of taxes on crude and oil related products, actions also used to subsidise high cost domestic oil production as well as to prevent domestic oil consumers from enjoying the benefits of highly

reduced oil prices. The general impact of these policies suppress economic growth and consequently the much expected boost to demand for crude oil in the long run. OPEC as well as other LDC oil exporters have used every opportunity to impress the realisation of the enormous level of interdependence in international economic relations. It is a well known fact as Subroto (1989) argues that the OPEC oil exporters constitute a substantial market for service companies and the manufactured products from the industries of the oil consumers as well as a significant source of funds for their financial institutions. Given this interdependence, the extent to which the oil exporters experience buoyant economies made possible by increased revenue from oil exports, to that extent will there be increased demand for imports of goods and services from the industrialised countries. In addition retaliatory trade restrictions by the oil exporters will also harm the market for industrial manufactures from the developed countries, a situation best captured in the words of Subroto (1989), who opines that "just as OPEC countries have experienced (and will continue to experience) drastic decreases in their oil revenue, so too have the consuming countries felt (and will continue to feel) the impact of reduced export orders from OPEC". Persistent loss of revenue will in addition ensure that further exploration activities and related investments are suspended, a situation that may result in acute crude oil shortage in the future.

IV-1-2. Alternative Energy

OPEC critics further believe that breakthroughs in alternative energy will render oil redundant as a result of which OPEC could not but go moribund. However the expected breakthroughs in alternative energy are yet to be widely made manifest. The major alternative energy contenders to oil include coal, natural gas, nuclear fusion and to a limited extent uranium, oil shale and tar sands. As is the case with petroleum, most non-oil investments go to the capitalist centres and a few of the so-called other "safe" countries, as a result of which this group now account for about 56% of world coal reserves, 63% of all uranium deposits (80%, if Namibia and South Africa are included), 58% of oil shale resources, with the U.S. alone possessing 70-75% of high grade ores, and some 50% of tar sands deposits (Renner, 1984).

Coal is widely abundant and has expanded its share of the market in electricity and other energy generation as a major beneficiary of the stalemate over nuclear energy (Yergin, 1988). The coal industry has of late come under the grip of "Big Oil" to the extent that the world's twenty-five largest oil firms all own significant coal reserves across the globe. Coal conversion technologies are now priority projects of the major oil companies and their investments.

The major obstacles to increased use of coal as a source of energy relate to environmental considerations, the success of which still depends on appreciable progress in clean-up burning

technologies. Besides, the cost of transporting coal from one location to another, given its bulk will continue to depress interests in its increased use as an alternative source of energy.

Natural gas obtains in large abundance the world over, with consistent increases in proven reserves since 1978. Gas consumption continues to grow in both the U.S. and West Europe. In environmental terms, gas is a very attractive fuel and is most likely to be a beneficiary of concerns about the atmosphere and climate. The major disadvantage is that in contrast to oil, it is expensive to transport especially over long distances, while the cost of establishing new liquefaction projects based on currently available technologies is quite high. In order to continue, the conditions for liquefied natural gas projects would require a strong, environmentally based drive to use natural gas, advances in liquified natural gas technology, a realism on the part of sellers as to what markets will bear in terms of price and judicious view on the part of the exporting groups as to what they can expect as their take in taxes. Besides, natural gas believed by many to be the "greenest" of all major alternative energy sources, has been found to have what Marchant (1990) called an Achilles heel in the form of high rate of leakage into the atmosphere of methane, which as a recently published journal points out, is "molecule for molecule, twenty-five times more potent a greenhouse gas than carbon dioxide".

Nuclear power appears attractive to government policy makers in the wake of the oil crises because of its promise of

national autonomy and low cost, accounting for about 18% of total U.S. electricity consumption. However environmental considerations and the fear of effects of accidents similar to the Chernobyl disaster continue to discourage expanded use. In addition to headlines made by horrific accounts of the Chernobyl nuclear accident, reports of serious environmental malaise resulting from other nuclear installations revolving around the increased incidence of cancerous and other illness in the vicinity of nuclear plants, the problems of the reprocessing or disposal of nuclear waste and the full implications of decommissioning nuclear power stations, all have put pressure to bear on nuclear installations. Above all there was a revelation that at the worldwide level the construction and maintenance of nuclear power stations as well as their operational procedures and practices, were not always satisfying the stringent safety standards demanded. Even the financial argument for nuclear energy has lost weight when it was discovered that its true unit cost was much higher than that of fossil fuels. Currently, there are worries within circles of the electric power industry that a future nuclear plant accident similar to the 1986 Chernobyl disaster, anywhere in the world could lead to a strong political drive to "turn off" nuclear power plants (Yergin, 1988). This in turn may disrupt the economies of many nations that now depend on nuclear energy, force a quick return to oil, the consequences of which may be rapid surges in oil prices. This, it is argued, in addition to the escalation of environmental worries

especially the greenhouse effect and global warming, all of which could lead to an accelerated drive away from fossil fuels thus creating considerable quandaries for energy policy, great confusion in the energy industries and additional costs for consumers. As a result most plants in the U.S. are now converted to natural gas; the Swedish Government has mandated a phasing out of existing plants by 2010 while an effective moratorium has been placed on new plants in Germany.

The foregoing gives the impression that oil will continue to be pivotal in energy concerns for two reasons, namely: that petroleum is still by far the most important source of energy for the industrial world, and the one for which in transportation, there is still no significant available substitute. Secondly, in spite of the complexities associated with trade in oil, and the fact that most of the world's proven reserves of crude oil are located far from the world's major consumers, oil continues to attract the attention of numerous consumers worldwide. Oil crosses borders and makes long voyages by sea, land and through other means with little or no major concerns for safety.

IV-1-3. Implications for Global Energy

OPEC's continued existence or otherwise has wide implications for the world oil industry, and by extension the global energy balance. The roles of the organisation in ensuring stability in the international oil scene is no longer doubtful, a role an

individual oil producing country could hardly assume in the absence of OPEC. It is not surprising therefore that OPEC critics now agree to the continued existence of the organisation. As one commentator in the *Financial Times* glibly exclaimed, "come back OPEC, all is forgiven" reflecting not just his personal feelings but also captured the impressions of the great majority of other analysts in the wake of OPEC's stumbling after the third oil crisis. In addition, the just concluded Gulf war reinforced the thinking in various circles that OPEC perhaps is more useful than harmful, and more often than not, could justify its policies.

As we observed earlier, the demise of OPEC will imply that another organisation, by whatever name it may be called will be formed to weld and coordinate the oil interests of current producers. This may result into a situation where the radicals gain an upper hand in the running of the new organisation, given the limited membership, as a result of which moderation of oil policies as OPEC presently does, may be difficult. This kind of situation will spell doom for the oil industry as well as on the supply side of the oil business. Saudi Arabia often uses some of the low - R/P - ratio members to moderate oil policies from OPEC radicals.

Given that world energy demand is projected to rise to between 115 and 118 million barrels of crude oil equivalent per day in 1995, 120 million barrels per day in the year 2000 and about 136 million barrels per day in 2010, a projection that leaves oil demand somewhere between 54 million and 57 million barrels per day, or

about 48% of the projected increase, and granted OPEC's proven reserves thus far, the world could not but look toward the group for satisfaction of energy requirements. This will be coupled with increased loss of supplies from non-OPEC sources made possible by dwindling returns on investments in the high cost oil exploration areas, numerous accidents occurring as a result of ageing production facilities whose replacement continues to be made more difficult by diminishing returns and above all decreased exploration activities because investors' interests of maximum profits could no longer be realised. The implications of all these is nothing but a return to the OPEC group for meeting world requirements of oil supplies, given their already proven reserves, the low cost of exploitation and the fact that most investors are national oil companies whose profit-mindedness could not be compared to the more corporate bodies. While OECD growth rate of energy consumption is expected to decline by 1 or 2%, or remain constant at present levels, the developing countries especially the newly industrialising countries' energy demand growth rate is expected to be more than 2% annually due to their lower per capita energy base, while OPEC member countries' domestic energy requirements are expected to grow by about 1.5% per annum. In this regard, the share of oil may decline by about 2% to be taken over by the increased share for natural gas whose consumption is estimated at 22% by the year 2000.

While an oil crisis is out of our current expectation, present indications in the energy scene seem to make clear that the world

has changed since the first oil crisis, as radically different conditions now prevail contrary to then situation. Markets were then tight, as opposed to the present surplus; they were relatively rigid but now, are flexible; energy security measures that were then ignored have now been instituted coupled with the current impact of information revolution on energy markets, to the extent that today, much market information is instantaneously available to market players all over the world, the further implications of which are that reaction times are much shorter and that various energy markets are linked more closely and interact more immediately with each other. But behind these apparent successes lay a lot of problems for the oil industry. Consumers are yet to be strong enough to refrain from panicking and other psychological behaviours in the face of the slightest suspicion of crisis, as was made evident in the Gulf crisis. The problem in the oil industry is not whether there will be a crisis, as there would surely would be, but to what extent energy markets will be resilient as well as the effectiveness of energy security measures. The principal questions being asked within energy circles include whether the response to harsh experiences of the '70s has so fundamentally altered the landscape that consumers can look forward to a decade in which energy supplies will be neither economically nor politically constraining? And if new crises do emerge, are the consumers better prepared to weather them than they were in the '70s? The answers to these questions reside within the OPEC group, especially

in the Middle East where any form of political crisis directly translates into threats for oil supply. The demise of OPEC might mar any attempts to manage future oil crises.

IV-4. Conclusion

OPEC was founded in 1960 as an instrument to prevent posted oil prices from falling further. However, how far this has been realised seems now to be part of history. The history of the oil industry is replete with incidences of OPEC's massive failures to hold oil prices from falling and at one occasion even collapsing.

OPEC has been accused of cartelising the oil industry since the first oil crisis, largely due to the great importance attached to oil as a source of energy and as an important segment of the world economy. Proponents of OPEC's cartel behaviour have heavily relied on the magnitude of the sudden crude oil price changes in 1973-74, which was repeated in 1979-80, as a major argument against OPEC's alleged control of the oil industry. However, a critical look at the incidence of high oil prices, as this thesis has attempted to do, will reveal that contrary to the position of previous analysts, OPEC may share little of the entire blame for high oil prices, most of which were the results of circumstances beyond her control.

Cartelisation of the oil industry similar to the system instituted by the multinational oil companies required more than the OPEC members could muster. It is therefore the contention of this thesis that the issue of cartelisation as it relates to OPEC was

erroneously pursued. As was revealed in the definition of cartelisation earlier, the establishment of monopoly price and rate of product output that maximises profit (oil wealth, in the case of OPEC) are the defining characteristics of ideal cartels. But OPEC as an organisation constituted by sovereign states with varying economic and even political interests, could not have been in a position to develop the requirements for effective collaborative cohesion reminiscent of cartels. It is well known that the interests of OPEC members are as varied as the states themselves, and more often than not conflicts with one another, resulting in difficulties in establishing a consensus. And given the wide gaps evident in the oil production interests of low and high absorbers, as well as radical and conservative oil producers in OPEC, it is difficult to establish to what extent the organisation can agree on most issues of policy especially price and production levels. As earlier established, OPEC is a compromise organisation, a position it will continue to occupy for the greater part of its life, and which feature is the defining characteristic of its policies.

The administration of OPEC pricing and production issues presents the most interesting contrasts. It was earlier established that OPEC does neither fix nor administer oil prices. What constitutes OPEC-determined prices have always been mere ratifications of already existing market prices of crude oil. Besides, OPEC prices are not binding on the member countries, most of who follow their individual pricing policies according to the dictates of

their various governments and sometimes at odds with official OPEC prices.

Again, OPEC has been wrongly perceived as fixing production quotas for its members. As was revealed in the course of this thesis, OPEC's quota production arrangement, in addition to its numerous lapses, cannot be said to be production quotas, strictly speaking. There is neither compulsion nor enforcement instruments in the assigned quotas, the whole exercise relies on the moral conscience of sovereign states, who more often than not have shown flagrant disregard for their assigned quotas. More effective quota programs are assigned by the limitations offered by the individual oil exporter's share of the market.

In the first place, OPEC has marginal if any influence in the determination and administration of oil prices, being most of the time a price taker itself. The development and growth of oil price speculation and the spot market signalled the dawn of an era in the oil industry. Perhaps OPEC was a victim of the activities of oil market speculators as well as the developments in the spot oil market. The two periods corresponding to the highest oil prices ever recorded were known to have been influenced by developments which OPEC as an organisation could have hardly addressed.

Secondly, analyses have often neglected the roles played by fear and panic buying in the era of high oil prices. The rueful events of the '70s and '80s when the price of crude oil ascended to

unprecedented levels could best be accounted for by the focusing attention on the impacts of fear and panic among consumers of oil. This realisation will not only be revealing but also enrich the understanding of the oil industry, in contrast to the present attention focussed on OPEC. The fear derived from a number of variants, including whether oil supply will continue in abundant quantities. There was also the fear that various forces may combine to compel oil prices to astronomical levels when there was yet to be successful inroads into alternative energy developments. The same situation was about to be witnessed on the eve of the Iraqi invasion of Kuwait in 1990. It could be recalled that the various roles played by OPEC and IEA largely restrained the excesses of the Gulf crisis on the price of crude oil and oil-related products.

Besides, the oil industry was a victim of information technology, made possible by the undue publicity given to its events. OPEC in particular suffered from unfair publicity given to its policies. While Oil Companies earned additional revenue from arbitrarily increasing prices of crude as well as refined oil products at random with little or no media attention, OPEC policies were only at the mercy of the pens of international media houses. It is well known that oil companies always took the lead in effecting price changes on crudes from OPEC as well as alternative sources in the North Sea and Mexico, while OPEC prices, most of which were mere ratifications of prevailing market prices never escaped the negative publicity of the international media agencies. And

contrary to popular conceptions that higher oil prices from OPEC were pulling these other prices up, the reality as it was found out was that when the markets tightened as they did in 1973, 1979 and again in 1990 (shortly after the Iraqi invasion of Kuwait) the price of non-OPEC crudes often went up first and reached higher levels than did OPEC prices. This situation continued unnoticed because of the relatively little or no publicity usually given to it, in contrast to media quests for the least pronouncements by an OPEC official. In 1979 for instance, the North Sea suppliers raised their prices before OPEC could even meet to discuss the issue, without attracting the kind of publicity given to OPEC's conference in which the then price issue was discussed.

Publicity was also instrumental in exacerbating the effects of the high oil prices, while at the same time undermining efforts on successful management of crisis situations. Media reports usually orchestrated the various events leading to high oil prices as a result of which oil price speculators and the spot market found cause to over-react, as they always did by cashing in on the inherent advantages and thus stimulated the excessive impacts on oil prices. OPEC's successive failures in managing periods of slack markets largely result from the actions of unwanted media publicity.

Again, a detailed examination of the effects of high oil prices will reveal as we tried to do in the preceding chapters, that the acclaimed impacts were not as far reaching, and in most cases were more beneficial to oil consumers than to the producers. While it

was realised that higher energy prices were associated with greater inflation rates, increased balance of payments deficits and the accompanying reductions in economic growth, it is equally worth noting that by encouraging conservation and the development of new energy sources, higher oil prices promoted the availability of adequate energy supplies, while its impact on strengthening the position of conservative oil exporters especially in the Middle East very much contributed to their security.

Even the impacts on balance of payments were not outstanding as chapter three of this thesis attempted to establish. Though the first oil crisis was really devastating, resulting in virtually all consuming countries sustaining deficits in their balance of payments, subsequent high oil prices were not as badly felt especially among the advanced industrialised oil consuming countries. Japan and Germany, for instance were enabled to emerge as economic superpowers under the guise of the high oil prices associated with the first oil crisis. Besides, the recycling of OPEC members' oil surplus ensured that adequate redress was given to the deficits. Added to this were the increased volume of demand for goods and services that came from the OPEC member countries. It is worth noting most of these demands were executed at highly inflated prices by the agencies of the industrialised countries. Perhaps, the effects could well be said to be more damaging for the LDCs, most of which had neither goods, technology and services to export to OPEC member states, nor privileged to attract their

investments. It is the contention of this research that the high oil prices merely reflect one of those incidences that allow the developed countries to exploit the misfortunes of the Less Developed Countries. Not only were goods and services exported to these group at highly inflated rates, it was further revealed that the Developed Countries were the home states of the multinational financial agencies through which the bulk of OPEC surpluses were recycled. In addition, the same LDCs emerged victims of reduced imports of raw materials as well as suffered huge reductions in the volume of financial aid flowing from the industrialised countries, all in the name of the acclaimed effects of high oil prices.

Again, the debt crunch was hardest on the LDCs. It is little known if any major industrialised oil consuming country was as much in debt as the LDCs, even though their rate and level of oil consumption many times outnumber those of the LDCs. That most OPEC member countries subsequently became first class international debtor countries was further evidence that they still belong to the LDCs, their much vaunted oil wealth notwithstanding.

Moreover, the International Oil Companies made fortunes during the period. As was found out in the text of the thesis, no Oil Company sustained a net loss for the entire span of the period, having in most cases performed better than their counterparts in other fields of economic endeavour on the average. Yet, all the International Oil Companies had their origin or base in the various

industrialised oil consuming countries. Could it not have been the case that their activities more than contributed to the problems of the time?

Even the oil consuming governments benefited from the high oil prices. Their various actions contributed in fuelling the price explosions of oil and related products. This thesis was able to reveal that even after oil prices had fallen not only among OPEC exporters, but also in the international oil markets, reductions were never reflected in the domestic prices of oil and related products in the consuming countries. Wherein lies the blame for the alleged roles of OPEC. OPEC would never have been in a position to monitor nor enforce oil price reductions in the consuming countries, even if it succeeds in effectively managing oil crises. According to *The Economist* of April, 1975, the price per barrel of refined oil products before the first oil crisis in Western Europe was estimated at about 14.50 dollars, of which 51% or 7.395 dollars went to the consuming governments as tax take, while the oil producers were paid a token 16% or 2.32 dollars. About 33% or 4.785 dollars of this price usually went to the multinational oil companies as cost of production and handling charges.

Lastly, it is the candid opinion of this thesis that OPEC be best understood as what it really is: a moderator of oil prices in the international oil industry as well as an agent of stability for consumers' interests in oil supply. It is only a compromise organisation of sovereign states with varying, sometimes

incompatible political and economic interests. And being an association of sovereign governments, OPEC could never have been nor be imbued with potentials for emerging as a strong economic cartel capable of the feats of the first and second oil crises. Besides, given the heterogeneity of oil interests evident in the member countries, it will very difficult for the organisation to embark on the kind of price administration arrangements of the magnitude experienced within the era of high oil prices, neither was it able to exhibit the same feats when the price of crude oil came crashing in the latter half of the 1980s.

OPEC might have attempted cartelisation, but never succeeded in any form of the practices reminiscent of cartel behaviour.

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