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A STUDY OF THE EMERGENCE, DEVELOPMENT AND ROLE OF THE NATIONAL OIL COMPANIES OF IRAN, KUWAIT AND SAUDI ARABIA

by

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ABSTRACT

Most of the oil-exporting countries have now established state-owned companies to help exercise the ownership right of the state over oil and gas resources. This study is about three of these national oil companies, namely those of Iran (the National Iranian Oil Company), Kuwait (the Kuwait National Petroleum Company), and Saudi Arabia (General Petroleum and Mineral Organization). The combined oil production of these countries presently accounts for approximately one-third of the oil production in the non-communist world, and nearly half of the production in OPEC. The fact that national oil companies are now in a position to influence the oil policies of their respective governments, gives these companies some importance in the world petroleum market.

In this study, we discuss the emergence of national oil companies and the extent to which political considerations prompted the setting up of state oil companies and affected their structure and growth. National oil companies are placed at a junction of politics and economics where national economic decision intermingles with political design. Like private oil companies, state-owned ventures are aiming at the lowest possible production cost and profitable growth, but being the special instrument of the government for the oil policies, both at home and abroad, they have a public aspect. In this study we give particular attention to some of the consequences of this inherent conflict.

State oil companies for many years now have tried to enter international markets. One major constraint is now to achieve this objective without causing a drop in price levels of crude oil which their governments have agreed upon in the Organization of Petroleum Exporting Countries. The commercial policies of these companies and the method by which they are formed is of particular interest to this work. The government sets general policies for the national oil company with regard to prices and investment. But on the other hand, the state oil company, which has experience in marketing crude oil or petroleum products, plays an important role in formalizing government objectives with regard to oil and gas resources of the country. Taking into account the structure of these national oil companies and the nature of decision-making within each company we evaluate their likely role in the petroleum market. The aim is to look at the true place of national oil companies under study, both within their respective country, and in the international petroleum market.

INTRODUCTION

This study is about the establishment and operations of the national oil companies of Iran, Kuwait and Saudi Arabia and their developing role in the world petroleum markets. The thesis comprises five parts.

Part One gives a general background to the nature of the world oil industry, roughly between 1950 and 1975. The content of Chapter One relates to the formation and establishment of the National Iranian Oil Company in 1951 and gives the level of concentration of control of the world petroleum industry by the major international oil companies. Chapter Two discusses the 1960's when the Kuwait National Oil Company and the General Petroleum and Mineral Organization of Saudi Arabia were formed. Chapter Three discusses briefly the changes in the structure of the oil industry in the early 1970's which have affected the role of the national oil companies under consideration.

Parts Two to Four of this work discuss each of the national oil companies under study, namely the National Iranian Oil Company (Part Two), the General Petroleum and Mineral Organization (Part Three) and the Kuwait National Petroleum Company (Part Four).

Part Five deals with some specific questions concerning the nature of operations of national oil companies. These are mainly the prospects for downstream activities which the companies have long desired, and the consequences of their increasing involvement in the crude and petroleum product markets around the world. The concluding chapter of the study gives a comparative recapitulation, and discusses the future developing role of the national oil companies.

PART ONE

GENERAL BACKGROUND

CHAPTER I

CONCENTRATION OF CONTROL OF THE WORLD PETROLEUM INDUSTRY AT THE TIME OF ESTABLISHMENT OF NIOC

The National Iranian Oil Company was established after the nationalization of the Anglo-Iranian Oil Company's assets in 1951. In its first two years of operation the new-born company failed to market even one-tenth of the volume of crude oil and petroleum products sold prior to nationalization. This was due, to a large extent, to the structure of the world petroleum industry at the time, which was dominated by the seven international oil companies - Standard Oil Company (now EXXON), Socony-Vacuum Oil Company (now Mobil), Gulf Oil Corporation, Standard Oil Company of California, Texas Company, the Anglo-Iranian Oil Company (now BP), and the Royal Dutch-Shell group.

These companies controlled directly or indirectly most of the world's petroleum business, apart from the Russian controlled countries, the United States and Mexico.[1] They controlled not only reserves and production, but also transportation and marketing facilities through integrated networks. The extent of this control was emphasized in the United States Federal Trade Commission report published in 1952.[2] "The typical movement of petroleum from producer until acquired by the final consumer is through inter-company transfer within a corporate family. Outright sales, arms-length bargaining, and other practices characteristic of independent buyers and sellers are conspicuous by their absence. Control is held not only through direct corporate holdings, by parents, subsidiaries, and affiliates of the seven, but also through such indirect means as interlocking directorates, joint ownership of affiliates, intercompany crude purchase contracts and marketing agreements...."

Thus the big task facing the NIOC was to enter a market which was dominated by these seven major international oil companies, taking into account all the legal[3] and managerial problems which arose as a consequence of the nationalization of the former concessionaire(one of the majors). In order to understand the extent of the challenge which confronted the marketing side of the NIOC, the following tables show in some detail the control exercised by the seven major companies in some aspects of the world oil industry.

TABLE I.1

Estimated Crude Oil Reserves held by Seven International Petroleum Companies January 1949, excluding USA.

Name of the Company	Oil Reserves
Anglo-Iranian Oil Company	13.9
Gulf Oil Corporation	5.8
Royal Dutch-Shell	4.5
Standard Oil Company (New Jersey)	9.3
Standard Oil Company of California	2.8
Socony-Vacuum Oil Company	2.0.
The Texas Company	3.0
Total for 7 companies	41.3
Total estimated reserves 1st January 1949	50.3
Per cent of total 7 companies	82.1

Source: Figures were taken from Federal Trade Commission Report "The International Petroleum Cartel", p.23, (see note 1).

TABLE I.2

Crude Oil Production of Seven International Petroleum Companies 1949

Name of Company	Western[a] Hemisphere	Eastern[b] Hemisphere	Total
	In thousand barrels per day		
Anglo-Iranian Oil Company	-	705.7	705.7
Gulf Oil Corporation	175.3	127.7	303.0
Royal Dutch-Shell	458.9	187.2	646.1
Standard Oil Co. (New Jersey)	736.0	189.7	925.7
Standard Oil Co. California	3.6	158.6	162.2
Socony Vacuum Oil Company	49.8	97.9	147.7
The Texas Company	25.3	158.6	183.9
Total for 7 companies	1,448.9	1,625.4	3,074.3
Total production	1,799.2	1,692.1	3,491.3
Per cent of total 7 companies	80.5	96.1	88.1

a. Excluding the production of USA
b. Excluding the production of USSR and countries of Eastern Europe under Russian control.

Source: Figures were obtained from Federal Trade Commission Report, "The International Petroleum Cartel", p.24.

TABLE I.3

Crude Oil Refining Capacity Controlled by Seven International Petroleum Companies, 1950

Name of Company	Western[a] Hemisphere	Eastern[b] Hemisphere	Total
Anglo-Iranian Company	-	707.9	707.9
Gulf Oil Corporation	21.3	18.9	40.2
Royal Dutch-Shell	448.9	443.0	891.9
Standard Oil Co. (New Jersey)	818.9	145.6	964.5
Standard Oil Co. California	8.4	141.9	150.3
Socony-Vacuum Oil Company	3.5	128.6	132.1
The Texas Company	78.5	141.8	220.3
Total of 7 companies	1,379.5	1,727.7	3,107.2
Total capacity	1,825.7	2,185.2	4,010.9
Per cent of total 7 companies	75.6	79.1	77.5

a. Excluding refining capacity of USA.
b. Excluding refining capacity of USSR, Hungary and Rumania.

Source: Figures were obtained from Federal Trade Commission Report, "The International Petroleum Cartel", p.25

The control of the seven major oil companies over transportation facilities in 1950 was considerably less than that over production and refining. The seven companies controlled nearly 50 per cent of the world's tanker fleet out of a total tonnage of nearly 25 million. As more than 8 million tons of the tanker fleet were owned by the governments, the seven oil companies controlled nearly two-thirds of the total privately owned tanker fleet.[4] At the end of 1949 the Anglo-Iranian Oil Company alone, through its subsidiary the British Tanker Company, operated nearly

3.5 million dead-weight tons, which was approximately 14 per cent of the world's tanker fleet.[5]

Apart from tanker fleets, most of the pipelines outside the United States were owned by the same seven oil companies. This however did not affect the operations of the NIOC because the only major pipeline of the Anglo-Iranian Oil Company in Iran, which was extending from producing fields to the Persian Gulf, was nationalized, together with other assets of AIOC. The rest of the pipelines around the world were not essential for the transportation of Iranian crude and petroleum products at the time. It must be noted that the problem facing NIOC in its early years was to find customers for its oil, rather than how to transport the oil.

The control of the seven major oil companies over marketing of petroleum products throughout the world was highly concentrated, too. Each of these companies was integrated from crude production to wholesale and retail distribution of petroleum products. The movement of oil from producer to consumer was generally carried out by company-owned facilities within one corporate hierarchy.

The Anglo-Iranian Oil Company owned 100 per cent of oil production in Iran prior to nationalization. But apart from Iran, the company had access to other sources of crude in the Middle East. At the time AIOC had 23,75 per cent share in the Iraq Petroleum Company, together with Standard Oil Company of New Jersey (EXXON), Socony-Vacuum (Mobil), Royal Dutch-Shell, Compagnie Francaise des Petroles, and Participations and Investment Ltd. In Kuwait AIOC had

TABLE [illegible]I.4

OIL PRODUCTION IN THE MIDDLE EAST 1950-60

Thousand barrels per day

Years	Iran	Iraq	Kuwait	Saudi Arabia	Other Middle East	TOTAL	Per cent increase
1950[a]	660	140	340	550	60	1,750	
1951[b]	340	180	560	760	80	1,920	+ 9.7
1952	20	390	750	820	100	2,080	+ 8.3
1953	30	580	860	840	120	2,430	+ 16.8
1954[c]	60	630	950	950	150	2,740	+ 12.8
1955	330	690	1,090	970	170	3,250	+ 18.6
1956	540	640	1,090	990	180	3,440	+ 5.8
1957	720	450	1,140	990	230	3,530	+ 2.6
1958	820	730	1,400	1,020	290	4,260	+ 20.9
1959	920	850	1,380	1,100	330	4,580	+ 7.5
1960	1,050	960	1,620	1,240	350	5,220	+ 14.0

(a) Last year of AIOC's production in Iran
(b) Nearly half of this year's production was carried out by AIOC
(c) The last two months of operation was carried out by the Consortium

Source: BP Statistical Review of the World Oil Industry 1960., The British Petroleum Company Ltd., p.19.

access to half of Kuwait oil production which it shared with Gulf Oil through their subsidiary Kuwait Oil Company.[6] Furthermore, AIOC had 23.75 per cent interest in the Qatar Oil Company, together with other major oil companies which jointly owned the Iraq Petroleum Company.

When oil production was stopped as a result of dispute over the nationalization issue in Iran, AIOC was able to obtain oil from its other concessions to maintain its commercial operations. It is interesting to note that although Iran was the largest producer in the Middle East, and its oil production came to a standstill in a period of less than two years, the aggregate oil production in the Middle East was not affected, and was rising all the time. (See Table I.4 on previous page for the detailed production figures). This suggests that at the time there was a considerable excess production capacity available in the area. A fact which seems to have been disregarded by Iranian politicians.

The failure of NIOC to market Iranian oil after nationalization was due mainly to the nature of the petroleum market at the time. This view is shared, among others, by a prominent international oil consultant, Mr. Paul Frankel. In his book, Mattei Oil and Power Politics,[7] he explains the concentration of control in the petroleum market and the nature of the problem facing the National Iranian Oil Company:

> "The essential fact of this ubiquity of a few corporations is not their ability to set prices, and thus their margins of profit, in a system of oligopoly. This ability is in the longer run substantially curtailed by the competitive forces which remain in the system; what matters is that the decision as to where oil is to be produced in the first instance depends on their corporate policy and its possibilities, which are in turn determined by the company's status in the 'downstream' operations of refining and selling. If there existed an international petroleum market with many buyers, producer-countries would have a freedom of manoeuvre which they are lacking now. The origin of the failure of Dr. Mossadegh in 1951 was mainly the stark fact that - all legal niceties aside - there simply were no buyers for 'his' oil since practically all channels of transport, refining and distribution were pre-empted by companies which, for very good reasons, had a strong feeling of solidarity with the Anglo-Iranian Oil Company. Although the eventual solution of the Mossadegh crises showed that the Americans had not, to put it mildly, lost sight of their own ultimate advantage, there was at the critical period no open breach of the anti-Mossadegh front. I remember having been in New York at the time AIOC was dispossessed by Iran when an American journalist of decidedly anti-British leanings told me triumphantly that now American interests would walk right into the situation. I could disillusion him in the knowledge that this was not to be. Dog bites dog, but dog doesn't eat dog."

A Brief Account of the Petroleum Market in the 1950's

After the Second World War, the development of the Saudi Arabian and Kuwaiti oil continued, and large new reserves of oil were found and developed in these countries. The rate of increase in production capacity around the world during the 1950's was higher than the rate of increase in demand for petroleum products in spite of the reconstruction efforts of the post-war era. The developing pressure of increasing production capacity had temporarily subsided as a result of the dispute between the Iranian Government and the Anglo-Iranian Oil Company which shut down nearly one third of Middle East production for nearly four years. The ease with which the loss of Iranian production was replaced by other countries of the Middle East is an indication of the extent of production capacity developed between 1948 and 1952.

After the conflict with Iran was resolved and the consortium was formed in 1954, the reintroduction of Iranian oil in the world was achieved mainly by reducing the rate of growth of output of other producers in the Middle East (see previous Table). Had it not been for the Korean War and the Arab-Israeli conflict in 1956, the developed production capacity would have created considerable pressure on the ruling oil prices earlier. By 1958 the pressure of supply made it more difficult for the major oil companies to dispose of their crude at existing prices in view of competition by other oil companies. Consequently, the majors began discounting the posted prices first by offering better terms to their long-term buyers (outside their integrated network) and eventually by cutting posted prices for all purchasers.

Another important development during the 1950's which contributed to the price cutting in 1959 and 1960, was the rapid expansion of the independent oil companies, some of whom were partly or wholly owned by the governments. These companies began to search and develop their own sources of crude mainly because the cost of crude oil supplies available to them from the majors, who held the concessions, were high enough to justify such an undertaking. As a result, the share of the eight majors in the total production of crude in the non-communist world (outside North America) fell from 91 per cent in 1957, to 84 per cent in 1961.[8] Furthermore, towards the end of the 1950's, the Russians, who by then had developed considerable production capacity in excess of their needs, began exporting crude oil to the world markets and, in order to attract customers, offered marginally lower prices.

While, until the middle of 1957, the posted prices reflected the real price of crude oil transactions, the development of the events mentioned before forced the companies to give discounts under a variety of forms, and by 1959 posted prices were different from the real price of oil. The companies which paid taxes to host governments on the basis of posted prices regardless of how much they were selling it for in the market, decided to cut posted prices in 1959 and again in 1960. This move was resented by the oil producing states, and led to the formation of the Organization of Petroleum Exporting Countries - OPEC - in 1960.[9]

To sum up, taking all the major oil companies together in this period, they controlled - outside the United States and the Soviet Union - nearly 88 per cent of world oil production, 77 per cent of the world refining capacity, and two-thirds of the total privately owned tanker fleet. Major oil companies at this period (1950) also controlled more than 82 per cent of oil reserves outside the United States through their concessions in various countries. If the USSR is excluded, the figure would rise to more than 95 per cent. These seven companies operated through layers of jointly owned subsidiaries and affiliated companies, and it was through this corporate complex of companies that they controlled most of the world oil business.

Prior to the nationalization of AIOC, the Iranian officials did not sufficiently understand the nature of the world oil business and under-estimated AIOC's ability to replace Iranian oil from other sources. As the dispute with Iran developed, AIOC enlisted the support of other majors to ensure that none of the nationalized oil would be bought.

The failure of the National Iranian Oil company to market Iranian oil, even when it was offered at a much lower price, showed that at the time neither crude nor petroleum products could be sold easily without the co-operation of the international companies. The efficiency of the political support given to AIOC by the British government is worth noting, too. The support went as far as using the Royal Air Force to force a Panamanian ship with a cargo of Iranian oil into Aden's harbour, where its cargo was impounded. However, it would be wrong to assume that in the absence of British government support for AIOC, the marketing difficulties of NIOC would have been substantially alleviated.

During the 1950's, no fundamental changes occurred in the pattern of control of the oil industry. However, towards the end of the decade the increased competition to gain equity oil, especially by the newcomers, changed the terms under which concessions were obtained in the Middle East. Furthermore, there was increased competition in crude and product markets which led to reduction of posted prices and the formation of OPEC. While, for most of the 1950's, the supply of crude adjusted to demand at ruling prices, by 1958 this situation changed and the emerging excess production capacity began to exert pressure on prices in crude and product markets.

NOTES

1. *The International Petroleum Cartel*, Staff Report of the Federal Trade Commission (Washington, D.C., Government Printing Office, 1952), p.23.

2. *Ibid.*, p.23.

3. The Anglo-Iranian Oil Company brought law suits against all the companies who tried to purchase, refine or transport Iranian crude oil and petroleum products in the period of dispute (1951-1954).

4. Federal Trade Commission, *op.cit.*, p.27.

5. Annual Report to Stockholders, 31st December 1949, the Anglo-Iranian Oil Company Ltd.

6. Federal Trade Commission, *op.cit.*, Chart 13.

7. Paul H. Frankel, *Mattei Oil and Power Politics* (Faber and Faber, London, 1966), p.102.

8. Edith Penrose, *The Growth of Firms, Middle East Oil and Other essays* (Frank Cass, London, 1971), p.193.

9. For an alaborate discussion of oil prices in this period, see M.A. Adelman, *The World Petroleum Market* (The Johns Hopkins University Press, 1971), Chapters V and VI.

CHAPTER II

A BRIEF ANALYSIS OF THE WORLD PETROLEUM MARKET IN THE 1960's

The 1960's were a decade when a number of national oil companies were formed in both producing and consuming countries.[1] Two of the national oil companies under study in this work, namely the Kuwait National Petroleum Company (KNPC) and the General Petroleum and Mineral Organization (Petromin) came into existence in this period. The 1960's also witnessed some changes in the structure of the oil industry. Here we attempt to discuss briefly some aspects of these changes, not to show the pattern of evolution of the industry in the period, but to answer specific questions with regard to the development of the national oil companies. In order to evaluate the attempts of these companies to enter the oil business in a systematic fashion, we look at the market and the nature of changes in the industry during this period. This, in turn, requires discussion of demand, supply and price of oil, as well as foreign company/government relationship, and the oil revenues per barrel of exported oil.

Demand

The sixties was a decade of expansion for the international petroleum industry. Oil consumption in the non-communist world increased from 18.5 million barrels per day in 1960, to 39.6 million barrels per day in 1970, an increase of nearly 114 per cent.[2] By the end of the decade oil accounted for nearly 53 per cent of the OECD primary energy consumption, and natural gas about 20 per cent.[3] During this period the consumption of oil products rose by an average rate of 8 per cent per year. The total consumption was rising for several reasons. First, the demand for oil is highly income elastic, and during this period per capita income was increasing both in the industrialized countries and developing countries. Second, there was considerable progress in the technology of off-shore drilling for oil, as well as in refining and transportation. These helped to make oil even more competitive with respect to other sources of primary energy, and although coal was enjoying some protection from governments, it continued to lose its share of the energy market. Finally, total oil consumption was rising, not least because the prices of petroleum products (with a few exceptions) were falling in real terms.

For nearly all the major industrialized countries the cost of importing oil was still below 1957 levels. Table I below shows the index of landed and selling prices of crude oil as calculated by the Petroleum Intelligence Weekly,[4] with April 1970 used as the index base. The oil considered is the Iranian light crude.

Table. II.3 shows the payment per barrel to the oil producing states under study between 1957-70. Table II.4 gives an indication of product prices at Rotterdam between 1960-70.

TABLE II-1

Index of Landed and Selling
Crude Oil Prices 1957 and 1970
(April 1970 = 100 on index)

Country	Index of Landed Crude Oil Prices 1957	Index of Crude Oil Selling Prices F.o.b. 1957
Germany	174.2	167.5
Netherlands	166.5	153.1
Sweden	157.8	144.3
UK	115.3	125.3
France	86.0	100.0
Italy	134.6	143.7
Japan	183.7	144.9
USA	125.7	145.3

Source: Petroleum Intelligence Weekly, September 24, 1973, pp.7-8.

The decade of the sixties also witnessed some changes in the geographical distribution of oil consumption. The rate of consumption of oil by Japan and Europe was much higher than that of the United States, and new markets were emerging in Asia, Africa and Latin America. These markets opened up new opportunities for independent oil companies and national oil companies to expand their operations.

Supply

The sixties saw a continuous expansion of the existing oil fields and development of new fields by major oil companies and new comers all over the non-communist world. Oil production in this period increased by an average of 8 per cent annually rising from nearly 22 million barrels per day in 1960 to 47.9 million barrels by 1970. Middle East oil output went up, on average, by 10.3 percent per annum, and that of Africa by 36 per cent in this period.[5] Libya, Nigeria, Algeria and Abu Dhabi joined the group of major oil producers. Most of this oil was transported in the form of crude, and there was a relative decline in the trade of petroleum products in comparison with crude oil. This rapid expansion of production facilities, apart from expansion by the majors, was mainly due to the efforts of other international oil companies in building up production in new areas, as well as to technological changes, especially those connected with exploration and development of oil fields offshore.

The crude oil produced in the Middle East was still controlled by the major international oil companies through their joint production ventures. But as the old concession areas were gradually relinquished, other oil companies got a foothold in areas which had the lowest production costs and which were previously dominated by the majors. Independent oil companies were then able to secure some supplies for their eastern hemisphere operations at a cost which was lower than buying it from the majors. The cost here is the key word, since a company running a deficit in crude tries to get its own source of oil production if there is a possibility that the total cost of that oil will be less than buying it from other producers. The entry of the newcomers into the crude oil business in the sixties gradually reduced the majors' control over oil production. The share of oil and natural gas produced in the non-communist world (except the US) by companies other than the seven largest companies, went up from 22.8 per cent in 1960 to 30.8 per cent in 1970[6] in an industry whe re total production was increasing at a rate of nearly 10 per cent per year.[7]

During the sixties although the consumption of oil was more than doubled, the production capacity increased even more, and there was an overall pressure of supply within the industry. This spare capacity to produce oil in the free world outside the US was more than 16 per cent at any time between 1960 and 1970.[8]

Prices

After the Second World War, the major international oil companies were by far the main producers of crude oil and sellers of petroleum products in the international petroleum market. Since these few companies were engaged in joint ventures and sales contracts with each other, as well as being integrated into final consumer markets, they refrained from competing on crude oil prices. This was not an open collusion to reduce competition. The structure of the industry was such that each of these major oil companies knew about the others' development plans well enough to know that they were not attempting to capture its own market by openly cutting prices.[9] However, there were some covert price cuttings by established majors who were competing for additional crude outlet, particularly by those companies in a strong crude surplus position.[10]

During the sixties the concentration of control of output increased and a number of new firms began producing oil both in the relinquished areas and in new fields in the Middle East. The number of non-integrated refiners was also increasing all over the world, especially in the developing countries. Hence the arms-length sales of crude oil were increased considerably. The amount of oil which was sold at spot by a producer to a refiner increased from 1 million barrels daily in 1957, to 4 million barrels daily by 1968.[11] This oil, when used in the operation of non-integrated refiners, allowed them to compete more effectively in the sales of petroleum products. The competition in sales of petroleum products during these years, coupled with the fact that the major crude oil exporters were eager to sell larger quanitties of oil than the customers were ready to buy at posted prices, created a downward pressure on the price of crude oil in the international markets.

The reduction in posted prices was not acceptable to the Organization of Petroleum Exporting Countries, which was formed in 1960 as a reaction to the erosion of posted prices. OPEC managed to freeze the posted prices in spite of continuous expansion of crude oil supply and competition in the market. Under these conditions the posted prices became merely "reference prices" with no relationship to prices applicable to actual market transactions.

National oil companies under consideration were attempting to increase their sales during this period, but the progressive imbalance between world consumption of petroleum products and crude oil production, was generating intensive competition in oil marketing, and national oil companies could hardly secure a per barrel income higher than what their governments were receiving from the major international oil companies. It must be noted that as only about 10 to 20 per cent of the crude oil produced entered the open market, the force of spare capacity was concentrated merely on arms-length trade of crude oil, and national oil companies were attempting to get a foothold in this market.

Government Oil Revenues and Relations with the Companies

Another change in the structure of the industry in the 1960's was the change in the relationship of the oil companies with the oil exporting countries. As mentioned before, a direct result of the price reductions in 1959 and 1960 was the establishment of the Organization of Petroleum Exporting Countries (OPEC). For the first time the companies were confronted with a united front of the major exporters of crude oil. OPEC's aim of restoring the pre-1960 posted prices was not fulfilled, but it managed to prevent further reduction in posted prices in spite of continuous expansion in production capacity of the member states.

The formation of OPEC was originally not an event which changed the structure of the industry, but merely a reaction to the changes that had taken place previously, Once formed however, it gradually became an influential factor in the subsequent developments.

During the sixties there was a surplus of production capacity in the world, which by itself is not very uncommon in the oil industry.[13] The ironic point was that while the majors considered over-capacity as one of the main causes for downward pressure on prices, they were involved in exploration and development of oil both within OPEC and outside, and hence created more capacity. This was so for two main reasons apart from developing oil fields to meet future demand. First, the majors did not want to lose concessions to other oil companies by not developing oil and face the hostility of the host government. Second, they were interested in creating alternative sources of crude to minimize vulnerability to one producer country. Needless to say, independent companies, too, were building up production capacity for their relatively smaller outlets. All this means that there were large quantities of oil available at OPEC prices, with the government of the producing states eager to sell more in order to increase their revenues. Those national oil companies which had access to royalty oil at cost were not able to secure posted prices for it in the market. Consequently, the government revenues were higher if royalty oil was not sold by the national oil company.

The governments of the oil exporting countries during the sixties had two main objectives with regard to their oil industry. First, to increase revenues by expanding production, and if possible by getting more per barrel of oil exported. Second, the producers sought an enlarged role for their national oil companies in controlling the exploitation of the country's oil resources. These two objectives were at times contradictory, and when such a contradiction occurred, the maximization of the revenues tended to get more attention. During the sixties governments of nearly all major producing states committed themselves to massive development programmes, which were based on contemplated revenues from the oil sector. The result was a continuous pressure on oil companies to lift more from their countries within the OPEC price structure. This attitude towards the oil sector by the government of producing states affected the role of the national oil companies during this period which we attempt to analyse later.

During the 1960's the revenue of the producing countries was increased by nearly 10 cents, and their share out of the composite barrel of petroleum products in the main European markets remained the same. The Table below shows how the oil barrel was shared in 1961 and 1970.[14]

TABLE II.2

How the Oil Barrel was Shared in 1961 and 1970

	In US$ per barrel: 1961		1970	
	$	%	$	%
Revenue of producing government[a]	0.76	6	0.86	6
Taxes by consuming governments in Europe[b]	7.10	52	8.30	57
Company marging & various cost elements	5.70	42	5.30	37
Total Weighted Average	13.60	100	14.50	100

a On the basis of the Marker crude

b Calculated on Weighted Average of products consumption patterns.

Source: Petroleum Intelligence Weekly: Special Supplement, May 16, 1977, p.4.

TABLE II.3

PAYMENTS PER BARREL: IRAN, KUWAIT AND SAUDI ARABIA

(cents, US)

Year	Iran	Kuwait*	Saudi Arabia*
1957	86.8	79.6	88.2
1958	89.0	81.7	81.7
1959	83.6	77.8	75.8
1960	80.1	76.4	75.0
1961	75.8	74.4	75.5
1962	74.5	74.8	76.5
1963	79.7	74.3	78.7
1964	81.8	76.9	82.0
1965	82.9	78.9	83.2
1966	83.2	78.4	83.4
1967	82.5	79.3	84.8
1968	83.7	80.5	87.8
1969	80.9	80.8	87.1
1970	80.8	82.9	88.3

Source: Petroleum Press Service, September 1971, p.327

* Including half Neutral Zone

TABLE II.4

ROTTERDAM PRODUCT PRICES : 1960-1970

Year	Regular gasoline	Gas-diesel oil	Heavy fuel oil	Value per Barrel of crude charged
	cents per gallon		dollars per barrel	
1960 (June-Dec)	7.0	7.5	1.91	2.47
1961	6.8	7.8	1.86	2.45
1962	6.4	8.4	1.78	2.54
1963	5.4	8.8	1.79	2.49
1964	5.2	6.7	1.74	2.13
1965	5.3	5.7	1.81	2.02
1966	5.9	6.2	1.72	2.12
1967 (Jan-May)	6.1	5.8	1.70	2.05
1967 (July-Dec)	11.1	9.2	2.10	3.24
1968	7.2	8.1	1.76	2.53
1969	5.5	7.4	1.51	2.04
1970 (Jan-May)	5.0	6.6	2.10	2.24
1970 (June-Dec)	6.5	9.2	3.33	3.19

Source: M.A. Adelman, World Petroleum Market, Table VI.1, p.173

NOTES

1. By 1966 there were up to one hundred state oil companies in existence in the free world. For the list of these companies see: Petroleum Press Service, November 1966, pp.408-409.

2. British Petroleum Statistical Review of the World Oil Industry 1970, p.21.

3. Ibid., p.18 (percentages were calculated on the basis of these figures).

4. Petroleum Intelligence Weekly, September 24, 1977, pp.7-8. The Table is not produced completely, as the years 1971-1973 are not relevant to this discussion.

5. British Petroleum Statistical Review of the World Oil Industry, 1970, op.cit., p.19.

6. Multinational Corporations and US Foreign Policy. Hearings before the Sub-Committee on Multinational Corporations of the Committee on Foreign Relations, United States Senate (Washington, Government Printing Office, 1974), Part 7, p.348.

7. British Petroleum Statistical Review of the World Oil Industry 1970, op.cit., p.19. The figure was calculated by deducting US production from the rest of the non-communist world and then calculating the year average.

8. Multinational Corporations and US Foreign Policy, op.cit., Part 8, pp.591-605.

9. M.A. Adelman, The World Petroleum Market (The Johns Hopkins University Press, London, 1972), p.198.

10. Helmut J. Frank, Crude Oil Prices in the Middle East (Praeger Publishers, New York, 1966), p.174.

11. The World Petroleum Market, op.cit., p.199.

12. Crude Oil Prices in the Middle East, op.cit., pp.114-115.

13. Multinational Corporations and US Foreign Policy, op.cit., Part 7, pp.333-335.

14. Ali M. Jaidah, Pricing of Oil: Role of Controlling Power, Petroleum Intelligence Weekly (Special Supplement), May 16, 1977.

CHAPTER III

CHANGES IN THE STRUCTURE OF THE OIL INDUSTRY IN 1970-75

In the previous chapters the development of the world petroleum industry in the fifties and sixties which was relevant to this study was discussed. It was, however, the first half of the 70's which witnessed the most revolutionary political and economic changes in the history of the oil industry in the Middle East. Crude oil production and pricing decisions, which were traditionally controlled by the international oil companies, were taken over by the major oil producers through the Organization of the Petroleum Exporting Countries (OPEC). In addition to that, most of these countries had, by 1975, acquired either total or majority ownership of oil reserves and producing facilities. These fundamental developments in the structure of the oil business in OPEC countries altered the existing relationships between the three main groups involved, namely oil exporting countries, international oil companies and the oil consuming nations.

In this section we are mainly concerned with the changing relationship between the oil producing states and the major international oil companies. In addition to the full ownership of the reserves by these Middle East countries, the acquisition of effective control over oil production and pricing of crude oil has changed the structure of the oil business in the countries under study. As a result, the effective role of their respective national oil companies has changed considerably. The developments will be analyzed below by discussing each of these companies separately.

Factors which contributed to the changes in the oil industry in 1973

Almost all students of the oil industry and the Middle East, plus a variety of observers both from within and without the oil industry, have tried to analyze and explain the events which led to the so-called "oil crisis" in October 1973. To this list one must add the government officials' interpretations and numerous reports prepared by both oil producing countries and oil consuming nations.[1] Here an attempt is made to adopt this popular, and to some extent, repetitive discussion fpr the purposes of this study.

As mentioned before, the world oil industry outside North America and the communist countries was dominated by the seven large multinational corporations. Historically these companies jointly and separately invested large sums of money to find and develop oil resources for their needs. Furthermore, these companies sometimes co-operated openly or collusively, and on many occasions fought as rivals. But their underlying objective was mainly to control producing and potential sources of crude oil around the world, to ensure adequate supplies for their marketing efforts, and to avoid unnecessary price competition. Although their goals and objectives remained relatively unaltered, the company-government relationship underwent a rapid change with the establishment of OPEC in 1960. OPEC's initial success in reversing the decline of the posted prices in the early 1960's, and the expensing of royalty payments, although not spectacular, was gaining momentum in the second half of the sixties. The major oil exporting countries were becoming more determined in their pursuit of policies aimed at gaining more revenue and control over their oil industry.

In June 1968, at its 16th conference, OPEC adopted a "Declaratory Statement of Petroleum Policy in Member Countries". This statement declared that "changing circumstances" justified the revision of the contracts made between the international oil companies and OPEC member countries. The latter further asserted their rights to participate in ownership of the producing oil companies in their respective countries. This movement by the OPEC members collectively was followed by individual countries' efforts to secure more revenues from the companies. The Algerians in 1968 and the Iranians in 1969 succeeded in this respect, while the question of whether to nationalize the producing oil companies in the Middle East, as advocated by the militant regimes, or to go for government "participation" with these companies, initiated by Shaikh Zaki Yamani and supported by the moderate regimes, dominated the debates at OPEC.[2]

At the beginning of 1970, the Libyan government began negotiations aimed at increasing posted prices of Libyan crude and raising tax rates. These negotiations dragged on for nine months, and eventually the companies agreed to substantial increases in taxes and prices of the Libyan crude. During these negotiations Libya had the tacit support of other OPEC members, and the oil companies were involved in lengthy discussion with regard to the consequences of the acceptance of the Libyan demands, both within the oil industry and with their respective governments.[3]

The Libyan settlement with the oil companies was followed by demands from other oil exporters to obtain similar terms under the Libyan agreement. In December 1970, OPEC's 21st conference at Caracas established 55 per cent as the minimum tax rate, adopted the principle that differences in posted prices should be based only on quality and transportation differentials, demanded the adjustment of posted prices to reflect changes in foreign exchange rates, and instructed OPEC's Secretary-General to monitor oil company lifting and report on any "discriminatory production policy".[4] This was another indication of the growing awareness and determination of the OPEC countries to exercise more control over their oil industry. The oil companies realized that similar increases would have to be given to other oil exporting countries, in particular to the major exporters in the Middle East. However in order to protect themselves against any future leap-frogging the companies decided to negotiate collectively with OPEC and those American oil companies involved secured permission from the US government for such collective approaches which previously had not been allowed under the US Anti-Trust laws.

Negotiations began at Tehran between six Persian Gulf oil exporting countries and twenty-two oil companies in January 1971.

These negotiations proved difficult, and eventually the companies agreed to increase the posted prices and the tax rates after a special OPEC conference was called which decided on a "total embargo" by member states (except Indonesia) against any company that did not accept the 55 per cent tax rate.[5] The posted prices on Arabian Light* crude rose from $1.80 to $2.28 a barrel, with a 2.5 per cent annual escalation to offset the effects of inflation in the price of imported commodities, and the tax rate was raised to 55 per cent. The oil companies, on the other hand, got a five-year agreement from the Gulf producers and, in April 1971, concluded a similar five-year agreement with the Mediterranean producers (Libya, Algeria, as well as Saudi Arabia and Iraq for their Mediterranean pipeline throughput).

These agreements came under strain a few months later in the summer of 1971 when the continued depreciation of the United States dollar in relation to other major currencies eroded some of the financial gains of the oil exporters achieved by the Tehran and Tripoli agreements. Although there were no provisions for the fall in value of the dollar in the agreement, OPEC, referring to the Caracas resolution (XXI 122, see above), demanded an increase in posted prices, and in January 1972 the oil companies agreed to increase posted prices by 8.49 per cent to take account of these monetary adjustments. The price of Arabian Light rose from $2.28 to $2.48.[6]

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*Arabian Light crude gravity 34°API is considered as Marker crude.

As the oil exporting countries began to enjoy the power of their collective bargaining once more they focused on another long-standing demand, namely that of equity participation in the major concessions in their respective countries. In February 1971, Algeria nationalized 51 per cent of French oil concessions, and in July OPEC's 24th conference demanded "immediate steps towards the effective implementation of the principle of participation."[7] In December 1971, Libya nationalized British Petroleum concessions, and five months later, in June 1972, Iraq nationalized the Iraq Petroleum Company's concession (Kirkuk area) after an eleven year dispute. In September 1972, Libya acquired 50 per cent interest in two ENI concessions. Nationalization by the more militant Arab countries was followed by an agreement between Saudi Arabia and Abu Dhabi with the oil companies, in which the government share of participation was to start at 25 per cent in 1973, rising to 51 per cent by 1982.[8] In a situation of effective collective bargaining used by OPEC members and their concentrated efforts to obtain better financial terms and gain equity participation in the concession holding companies, it was only the growing demand for petroleum products during this period (1969-72) which represented a major factor in restraining the oil companies from an all-out confrontation, first in the Libyan negotiations of 1970, and later in response to the nationalizations by Algeria, Libya and Iraq.

As mentioned before, oil was in plentiful supply during the sixties, and a number of major discoveries of new reserves and fast development ensured the continuous rate of growth of production capacity to cope with the growing demand. By the end of the sixties, the oil discoveries and the additions to production capacity were not fast enough to act as a continuous safeguard against rising demand by Western Europe, Japan and the growing import of oil by the United States, as indicated in the Table below.

TABLE III-1

Oil Imports 1968-1973
United States, Western Europe and Japan

Thousand barrels daily

	1968	1969	1970	1971	1972	1973	Average yearly 1968-1973
USA	2,810	3,170	3,420	3,930	4,740	6,205	17.2
Western Europe	10,480	11,430	12,940	13,520	14,065	15,310	7.9
Japan	3,060	3,590	4,280	4,720	4,815	5,760	13.5
Rest of World	4,050	4,980	4,960	5,970	6,585	6,855	11.1
TOTAL	20,400	23,170	25,600	28,140	30,205	34,130	10.8

Source: British Petroleum Statistical Review of the World Oil Industry, 1973.

A continuation of the high rate of growth in the world oil consumption would have required - on the basis of 1973 oil imports of 34.1 million barrels and the rate of growth of 10.8 per cent annually - an additional 3-5 million barrels per day each year between 1974-1977, and the additional production of another 34 million barrels per day available for export by 1980. In addition to these extrapolations and predictions of a real supply crisis by the end of 1970,[9] the Trans-Arabian pipeline which carried nearly 500,000 barrels of crude per day from Saudi Arabia to the Mediterranean was shut due to an accident during 1970, thus increasing the importance of the Libyan oil in Europe. Furthermore, Libya and Kuwait decided to put a ceiling on their production of crude oil as a conservation measure, and it was probable that other producers in the Middle East might follow these countries to prevent rapid depletion of their oil resources.

Consequently, the market price for crude oil began to increase gradually from mid-1970. There was a temporary pressure of demand on the existing market supply, which led to higher prices offered by the buyers, and in particular the independent oil companies. Independent oil companies were eager to secure their requirements of crude oil as some major oil companies, who were worried by the consequences of equity participation of OPEC countries, showed some reluctance to sell their equity crude to third party customers. So, despite the oil companies' predictions, the petroleum exporting countries were able to sell participation oil, although in small quantities, at higher prices than determined by buy back prices under participation agreements, and in some cases even above the posted prices. As a result of this, the assumption of the Tehran and Tripoli price agreements that posted prices (which were the basis for division of profit between companies and governments) would remain higher than market prices was vitiated: therefore, the producers received tax-based prices for their oil which were lower than the going market price.[10]

By September 1973, OPEC members began to press harder for some revision of the prices negotiated under the Tehran and Tripoli agreements. These negotiations began on October 8th in Vienna, and were adjourned on the 12th for two weeks, never to be reopened again, and on 16th October 1973, the ministerial committee representing the six Gulf states of OPEC met and decided to raise the posted prices unilaterally. This momentous decision transferred the total control over the oil prices into the hands of the oil-producing countries. The posted price of Arabian Light crude was raised from $3.01 to $5.12 a barrel, an increase of approximately 70 per cent. This was to maintain posted prices at about 40 per cent above the applicable market prices, and if evaluated in this way, the increase was only about 17 per cent.[11] One of the reasons for this relatively swift victory of the six Gulf state producers in such an essential issue, was the outbreak of the fourth Arab-Israel war ten days earlier on 6th October 1973.

Perhaps more than anywhere else, oil has played a highly political role in the Middle East since its discovery nearly seventy years ago. Oil companies were blamed for using their financial influence to promote their own goals and those of their parent governments. Oil has been the focus of national aspirations in the area for more than twenty-five years. Until 1958 the states in the Arab world with abundant oil reserves, such as Saudi Arabia, Kuwait and Iraq, all had conservative, monarchical governments. Syria and Egypt, which had more radical regimes, could influence the oil business only via their strategic positions as transit countries.[12] The revolution in Iraq in 1958 was probably a major change in this stage of affairs allowing the oil companies to operate without fear of large-scale interruptions to crude oil supplies from this area. Another major change was the Arab-Israel war of June 1967, in which considerable areas of Arab countries were occupied by Israel. The oil weapon was used immediately after the war with little success, but the events which followed in the Arab world and the continuous occupation of Arab land by Israel increased the possibility, and also the determination, of major Arab oil-exporting countries to use oil as a "politico-economic" weapon. Even moderate Arab countries, such as Saudi Arabia, warned, prior to the October War, that the oil weapon might be used if the United States did not pursue a more "even-handed and just policy" in the Middle East.[13]

The decision to increase the posted prices of crude oil was taken not because of the Arab-Israel war, but was aimed primarily at maintaining the same relationship which once existed between posted and market prices of crude oil. However, its timing in the middle of the war and increasing uncertainty about future supplies of crude oil helped to reduce any likelihood of resistance from the major oil companies. Eleven days after the unilateral price increase, on 27th October, Arab oil-exporting countries adopted an output-and-destination restirction to aid their war efforts. This created an even narrower market for the third-party sales of crude oil, especially crude oil from non-Arab countries of OPEC. In November and December 1973, the price of non-embargoed oil in the market reached three to four times the level of the so-called "market price" which OPEC Gulf states had set in mid-October, and provided confirmation that companies short of crude, worried about their ability to secure supplies, would be ready to pay much higher prices than anticipated by the industry.[14] On December 22nd 1973, the six Persian Gulf producer states raised their posted prices again, and the price of the Arabian Light (Marker Crude) was increased from $5.12 to $11.65 per barrel, yielding a government "take" of $7.00 a barrel. This was considered to be the price which left the cost of oil below the cost of substitutes.[15]

The cost of oil to the major companies would have been in the region of $7.00 per barrel if all their purchases had been on the basis of "equity oil" with the posted price of $11.65 per barrel. However, the development on the other important issue concerning the oil business in the Middle East, namely the issue of "participation", changed the situation considerably. The states involved in the participation negotiations with the companies scrapped the previous framework, and demanded an immediate majority control of the foreign oil producing companies in their respective countries. In January 1974, Kuwait announced 60 per cent government participation in the BP Gulf concession, and Qatar followed this move a month later. Nigeria declared 55 per cent government participation in all concessions in May, and in June 1974 Saudi Arabia announced that it would demand 60 per cent participation in ARAMCO, Abu Dhabi's move against the companies holding concessions in its territory followed shortly. Consequently, by the end of 1974, the major oil companies' "equity oil" was reduced roughly to 40 per cent of the total out in those countries. The rest of the oil was sold under different price arrangements, such as "bridging" crude, "phase-in" crude, and the participation crude offered under long term agreements. In November 1974, Saudi Arabia, Qatar and the United Arab Emirates announced an increase in royalty - from 16.67 per cent to 20 per cent - and taxes - from 65.75 per cent to 85 per cent.[16] These events raised the average cost of crude oil to the major oil companies to more than $10.00 per barrel by 1975.

To sum up, the oil price increases in 1973 and 1974 were reflected primarily by the forces of supply and demand and a greater participation by the governments of exporting countries in the companies holding the concession rights. Indirectly, the Arab-Israel war also played a role, as the restrictions imposed were instrumental in creating an even narrower market for the non-embargoed oil and forcing up the market prices.

The new role of the International Oil Companies

Traditionally, the international oil companies invested large sums of money in all aspects of the oil industry - from wellhead to final markets - to satisfy the requirements of a variety of customers throughout the world in return for their continuous profitable growth. In performing this role,[17] the major oil companies sought to control crude oil production, its refining and transportation as well as marketing of petroleum products. Their supply mechanism was based on an integrated structure which on many occasions helped them to overcome various operational and political difficulties. This traditional role was considerably changed between October 1973, when the prices were raised unilaterally by the producers, and March 1975, when Kuwait, abandoning the participation agreement, seized the remaining 40 per cent equity of the Kuwait Oil Company.

The loss of control over price-determination of crude oil by the international oil companies considerably reduced the importance of their role in the oil business. Even more important than that, the decision of oil exporters to set oil prices unilaterally implied that the international major oil companies had lost control over the pricing of a large portion of their raw material supply. Although the companies' profits were mostly based on the sales of petroleum products around the world, their successful operations were partly due to their ability to control the price of crude oil entering the market, and thus slow down the incursions of newcomers in refining. In addition to that, the exporters effectively took over the decision-making concerning the amount of oil production in their countries. This was another important issue, since the vertically integrated major oil companies could use their control over jointly owned producing companies to adjust the rate of output of crude oil to the rate of demand for petroleum products. OPEC took over the determination of prices, but the production levels were left to each country and were based on market demand, conservation measures, and in the case of some producers, on political considerations.

Another fundamental change in the role of the international oil companies and the structure of Middle East oil, came after the 100 per cent ownership of the oil industry by the OPEC governments became a reality. The oil companies lost the equity crude to which they were entitled as concessionaires which has been available to them at tax paid cost. This low cost source of crude oil was extremely profitable to the oil companies, and gave them considerable economic advantage over other oil companies with no equity oil. For example, in early 1974 when the posted prices of Arabian Light crude oil was $11.65, the companies with 40 per cent equity holding had price advantage of nearly $4.00 per barrel, i.e., the difference between their 40 per cent equity oil and "buy back" oil, which was around 94.8 per cent of posted prices. And indeed the Saudi Arabian and some other producers' decision to raise royalty and tax was taken mainly to eliminate profitability of equity oil, effectively making the ARAMCO's equity oil nearly as expensive as participation oil.

Furthermore, the loss of concession reduced the profits of the concession holders, since the taxes paid to producers could no longer be off set against tax liabilities in the country of domicile. The fifty-fifty profit sharing arrangement which started in 1950 in effect increased the revenues of the oil producers in the cheapest way for the companies, as the (US companies) deducted these amounts against their taxes at home. With companies, as buyers of crude, unable to find other ways of reducing US tax on their foreign profits, their income will be reduced considerably.[18]

To sum up, what the companies have lost in the past few years is the control over pricing and production, plus their equity ownership of the reserves. The exporting countries now effectively control their oil output, and, via the Organization of Petroleum Exporting Countries, prices. However, the role of the international oil companies in the world oil business, inspite of changes, remains very important.

Together, the major international oil companies still own most of the refining and marketing facilities in the industrialized world and a large proportion of existing transportation facilities. In addition to that, they still have some equity oil in North America, the North Sea and some other areas. Their skills in exploration and production of crude oil and the marketing of petroleum products, makes them the ideal partner for the oil producing countries. As principal long-term buyers of crude oil, rather than the concessionaires, major oil companies can play an important role without being labelled "exploiters" and becoming the target in an internal political dispute within the exporting countries. Furthermore, as buyers of crude, they can shop around seeking the cheapest source of supply, since they do not possess fixed assets and valuable producing rights to restrict their actions. Indeed, from May 1974 and throughout 1975, the companies shifted their offtake from one producer to another in order to minimize their overall cost of crude supplies, thus creating considerable strain on the oil producers.[19]

The oil companies organizational adjustment in response to these changes is yet to be formalized. Gulf Oil was the first international major to change the structure under which its worldwide operations were conducted by separating the exploration-production sector from refining-marketing, with each sector seeking its own profitable growth - a process which was considered to be a "reverse integration".[20] Whether this will be the pattern for the future operations of the major oil companies, or whether they will choose to continue their vertically integrated structure by securing long-term offtake arrangements, is not clear at present. As for the financial aspects of oil companies operations, the most important issue will be the margin between costs and proceeds, rather than the absolute level of price determined by OPEC. This will depend on the discount on the price of crude allowed for the majors under long-term agreements with different exporting countries. In addition, some countries like Saudi Arabia, which need the assistance of the major oil companies in the expansion of their oil resources, may consider some form of service fee to the companies, either as a further discount on crude, or otherwise. This co-operation would further ensure relative security and continuity of crude supply for the companies in addition to financial rewards associated with having access to cheaper crude for their integrated networks.

NOTES

1. Some of the sources relevant to these events are listed below:
   The Oil Crisés, Daedalus (Journal of the American Academy of Arts and Sciences), Vol.104, No.4, Fall 1975.

   The Middle East Oil, Politics and Development, edited by John Duke Anthony (American Enterprise Institute for Public Policy Research, Washington, 1975).

   Oil Producers and Consumers: Conflict or Co-operation. An international seminar report by Elizabeth Monroe and Robert Mabro (The Centre for Mediterranean Studies, American University Field Staff, New York, 1974).

   Neil H. Jacoby, Multinational Oil (Macmillan Publishing Co., New York, 1974).

   Edith Penrose, Oil and International Relations, British Journal of International Studies 2, 1976, pp.41-50.

   Michael Tanzer, The Energy Crisis (Monthly Review Press, New York, 1974).

   Anthony Sampson, The Seven Sisters (Hodder and Stoughton, London, 1975).

   G.H.M. Schuler, The International Oil 'Debacle' Since 1971, Petroleum Intelligence Weekly (Supplement), April 22, 1974.

   Dankwart A. Rustow and John F. Mugno, OPEC Success and Prospects (Martin Robertson, London, 1976).

   Reza Fallah, The Energy Crises (Conference on Oil and the International Monetary and Financial System) (International Centre for Monetary and Banking Studies, Geneva, November 1974).

   Henri Madelin, Oil and Politics (Saxon House, England, 1975).

2. Edith Penrose, The Development of Crises, Daedalus, op.cit., p.40.

3. For a first-hand account of these negotiations see G.M.H. Schuler, The International Oil 'Debacle' Since 1971, op.cit., pp.1-8.

4. OPEC Conference (XXI) Caracas, December 9-12, 1970. Resolutions XXI.120, XXI.122 and XXI.125. Petroleum Intelligence Weekly, January 31, 1972, p.4.

5. OPEC Conference XXII, Tehran, February 3-4, 1971. Resolution XXII.125.

6. Petroleum Intelligence Weekly January 31, 1972, p.4.

7. OPEC Conference (XXIV) Tripoli, July 12-13, 1971. Resolution XXIV.135.

8. Petroleum Intelligence Weekly (Special Supplement), December 25, 1972, p.12.

9. See James E. Akins, The Oil Crisis, Petroleum Intelligence Weekly (Special Supplement, March 26, 1973.

10. For a comprehensive discussion of this issue see E. Penrose, op.cit., pp.47-49 and relevant notes.

11. Petroleum Intelligence Weekly, November 26, 197 . p.14.

12. A major oil pipeline from Iraq and Saudi Arabia to the Mediterranean passed through Syria and Egypt-controlled Suez Canal, carrying some portion of Middle East oil.

13. Petroleum Intelligence Weekly, July 16, 1973, pp.5-6.

14. Petroleum Intelligence Weekly, December 17, 1973, pp.1-2.

15. Reza Fallah, The Energy Crisis, op.cit., pp.3-4.

16. Royalties and income tax rates, prior to October 1974, were 12.5 per cent and 55 per cent of the posted prices respectively. On 1st October 1974, they were raised to 16.67 per cent and 65.75 per cent of the posted prices. See Petroleum Intelligence Weekly, November 13, 1974, p.2.

17. According to the Oxford Concise Dictionary, "Role" is one's function, what one is appointed or expected or has undertaken to do.

18. For more detail about new US tax laws in this respect, see Petroleum Intelligence Weekly, April 7, 1975, pp.5-6.

19. Robert Mabro, OPEC After the Oil Revolution, Millenium (Journal of International Studies, London School of Economics), Vol.4, No.3, 1975-76, pp.194-5.

20. Petroleum Intelligence Weekly, June 23, 1975, p.3.

PART TWO

THE CASE OF THE NATIONAL IRANIAN OIL COMPANY

CHAPTER IV

HISTORICAL BACKGROUND AND EVENTS WHICH LED TO THE NATIONALIZATION OF THE OIL INDUSTRY AND THE FORMATION OF THE NATIONAL IRANIAN OIL COMPANY

In this section attempts have been made to discuss very briefly the events which led to nationalization of the Anglo-Iranian Oil Company in 1951. The history of nationalization of the oil industry in Iran has been dealt with by a number of Iranian and foreign writers.* The purpose here is neither to repeat what they have said, nor to dispute it. This study is about the national oil companies, and it is essential that the emergence of each company under study be put into the right historical perspective. As for Iran, it is important to know under what political and economic considerations the decision to nationalize the Iranian oil industry was adopted. Again, the argument here is not the issue of nationalization, or whether such a

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* L.P. Elwell-Sutton, Persian Oil (Lawrence and Wishart, London, 1955).
M. Ghassemzadeh, An Analytical Comparison of 1933 and 1965 Agreements (Tehran, 1968, in Persian).
W.A. Ford, The Anglo-Iranian Dispute of 1951-52 (University of California Press, Berkeley, 1954).
M. Fateh, Fifty Years of Iranian Oil (Tehran, date in Persian).
F. Rouhani, History of the Nationalization of Iranian Oil Industry (Tehran,
H.S.H. Noori, "A Study of the Nationalization of Oil Industry in Iran", PhD dissertation, Colorado State College, Colorado, Spring 1965.
J. Walden, "The Inter national Petroleum Cartel in Iran", Journal of Public Law, Vol.2, 1962.
S.H. Longrigg, Oil in the Middle East (Oxford University Press, 3rd edition, London, 1968).

decision was the best alternative at the time, but a consideration of the circumstances which led to the formation and development of the National Iranian Oil Company.

Furthermore, this discussion reveals to some extent the degree of awareness of the Iranian decision-makers in the government and parliament (and later in the NIOC), of the nature of the world oil industry, and of the major international oil companies' relations with other oil producing countries in which they held concessionary agreements. It also shows what these people considered to be the main problems of the Iranian oil industry.

During World War II, Iran was occupied by the Allied forces despite its declared neutrality. After the war Russia was reluctant to move its troops out of the northern part of Iran. After lengthy negotiations, and some international pressure, the Russians agreed to withdraw their forces from Iran after signing an oil agreement with the Iranian Prime Minister, Ghavam-Saltaneh. The agreement was to run for fifty years giving the Russians concessions in the northern provinces of Iran. On 22nd October 1947, (30 Mehr 2506 Iranian year) Ghavam's oil agreement with the Russians was rejected by the Majles (lower house of the Iranian legislative body). The law passed on that day rejecting Ghavam's agreement with the Russians went further and instructed the government to enter into negotiations with the Anglo-Iranian

Oil Company,* which had a concession in the south of Iran.

Part (c) of the Bill states that:

> "The government is instructed to undertake such negotiations and measures as may be necessary to secure the national rights in all cases where the rights of the people have been violated in respects of the national wealth of the country, including its underground resources, with special reference to the southern oil, and must inform the National Assembly (Majles) of the result."[1]

Negotiations on the basis of the above bill continued between successive governments and the Anglo-Iranian Oil Company during 1948 and 1949. All matters of dispute with the company were brought out and studied by the Government which sought the opinion of a number of Iranian and foreign experts.[2] The results of this study and the views of independent experts were then handed over to the Majles.

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* This Company was established as the Anglo-Persian Oil Company in 1909. Prior to that in 1908, oil was discovered in southern Iran on a concession which had been granted to William Knox d'Arcy by Muzaffar al-Din Shat in 1901. The concession was to run for sixty years, and it included all Iran except the five northern provinces. The Company, in return, promised to give 16 per cent of the net profit to the Perisn Government. The Company started with a capital of £2 million, but in 1914 the British Government bought a controlling interest by supplying the Company with £2.2 million. According to the concession, Iran was entitled to share in the integrated profits of the Company. This issue was at the centre of the dispute between the Company and the Iranian Government. D'Arcy's concession was cancelled by the Iranian Government in 1931, and a new agreement was signed in 1932. The base of payment under this agreement was on the tonnage of oil exported rather than the profits of the integrated operations of the Company. It was this agreement which was the centre of dispute in 1946-1951, and which led to nationalization of the oil industry in Iran.
See: Mikdashi, Z., Financial Analysis of Middle Eastern Oil Concessions: 1901-65 (Praeger Publications, New York, 1966), Chapter 1. Also Longrigg, S.H., Oil in the Middle East, op.cit., Chapter 4.

The following memorandum gives the twenty-five points which the Iranian Government set out for discussion with the Company's delegation on 28th September 1948. The importance of these points is the centre of the debate, they are significant also because they illustrate the degree of awareness of the Iranian authorities at the time. In studying these points here the intention is not to discredit the Company, or to justify nationalization, as these have already been dealt with by others.

MEMORANDUM [3]

In connection with the opening of preliminary discussions with the representatives of the Anglo-Iranian Oil Company for the implementation of Clause (e) of the law of October 22, 1947, the following points, which the Persian government for the present considers to fall under the provisions of that clause, are set out as follows:

1. FLUCTUATIONS IN THE PRICE OF GOLD: Under Clause V of Article 10 of the 1933 concession, apart from agreements made at various times, the sums in sterling necessary to compensate the government at the gold rate have not been paid.
2. BRITISH GOVERNMENT TAXATION: The Persian government's share of the annual profits of the company ought not to have been included under the income tax regulations of the British government, and the deductions made from the Persian government's share on this account must be refunded.

The loss suffered by Persia on this account is shown in the appended table.

3. LIMITATIONS OF COMPANY DIVIDENDS: The limitation of dividends observed by the company on the basis of the British government's ruling ought not to have been applied to the Persian government's 20 per cent of the company's profit.

4. SALES AGREEMENTS WITH THE BRITISH ADMIRALTY AND AMERICAN COMPANIES: Under Article 21 of the 1933 concession the company must at all times and in all cases bear in mind the rights, dues and interests of the government, and must not undertake or refrain from any action in such a way as to injure the government; whereas in the sales agreements concluded with the British Admiralty and Air Force and with American companies, since the transactions have not taken place at the fair price of the day, the government's rights have been injured so far as 20 per cent of the profits are concerned. Compensation is requested for this.

5. OIL PRODUCTS CONSUMED IN THE COMPANY'S OPERATIONS: Persia's dues on the oil products consumed in the company's operations have not been paid, and must be refunded.

6. INSPECTION OF ACCOUNTS AND TECHNICAL INFORMATION: Supervision of Clause 1 of Article 16 and of Article 21 of the 1933 concession, and of the share of the government in the distributed profits and in the company's reserves (general reserve and depreciation reserve) requires that the Persian government should be able to examine the company's accounts and ledgers, and should have prior information on operations and decisions likely to affect the rights of Persia.

7. EXPORT OF CRUDE OIL: Under Article 21 of the 1933 concession, and in accordance with the legal powers of the Persian government, the refining of oil products must take place within Persia.

8. INSTALLATIONS OUTSIDE PERSIA: Arrangements must be made for the government to receive its share, at the end of the concession, in the installations established outside Persia from the company's revenues.

9. PRICE OF OIL PRODUCTS: The sale price of oil products within Persia must be fixed, in view of the fact that the arrangements incorporated in the 1933 concession are out of date.

10. OIL DISTRIBUTION FACILITIES: It is requested that there should be adequate expansion of oil distribution facilities, including places where there are already facilities and those where there are not.

11. REDUCTION OF FOREIGN EMPLOYEES AND WELFARE OF PERSIAN STAFF AND LABOUR: Implementation of the scheme handed to the company in November 1947, on the basis of Articles 16 and 17 of the 1933 concession.

12. PREVENTION OF GAS WASTAGE: Prevention of gas wastage by its consumption in the company's operations and the construction of pipes to the cities for general consumption, or else its retention in the wells under Articles 12 and 21 of the concession.

13. FOREIGN CONTRACTORS: Payment of income tax by foreign contractors in accordance with the law of the land.

14. INSURANCE: Insurance of the company's installations in Persia with the Iranian Insurance Company.

15. LENGTH OF THE CONCESSION: When the d'Arcy concession was revised, two matters were particularly in the minds of the two parties, Persia being interested in the royalty rate, and the company in the length of the concession. While the d'Arcy concession was still in force, with annual exports and sales of less than 4,000,000 tons, some £1,500,000 in gold was paid as royalty to the government. On this reckoning, on the basis od the d'Arcy concession, an annual export and sale of 18,000,000 tons (as recently achieved by the company) would produce more than £6,500,000 in gold in royalties for the government; whereas under the 1933 concession 18,000,000 tons of exports and sales has produced far less than £6,500,000. It is therefore not clear what the Persian government received, at the time of the cancellation of the d'Arcy concession, in exchange for the extension contained in the 1933 concession. This matter has been one of the greatest interest to the Persian government, and because of the complete lack of proportion with other similar concessions has attracted the attention and ultimately the opposition of the people more than anything.

Another point to be taken into account in connection with this comparison is that, under the d'Arcy concession, at the termination of the concession all the property and installations of the company, wherever they might be in the world, would have reverted to Persia whereas in the 1933 concession this condition applies only to the company's property in Persia. The importance of this matter comes out all the more clearly since the d'Arcy concession would have ended in 1962, whereas it was provided in the 1933 concession that it should run for another sixty years. It is evident what a vast difference there will be in the oil reserves in Persia, in comparing the dates of expiry provided for in the two concessions.

16. ROYALTY BASIS: The figure of four shillings a ton represented in 1933 one-eighth of the price of Persian crude oil, whereas now, on the basis of gold, it is according to the company's accounts less than one-sixteenth. Thus the total of the Persian government's royalties in relation to the total price of the oil extracted represented 33 per cent in 1933 and only about 9 per cent in 1947.

If the Persian government's royalty had been paid according to the concessions in force in Venezuela, the payment for 1947 would have been £22,000,000 instead of £7,000,000, that is, more than three times as much. The Iraq Petroleum Company can pay six shillings gold as royalty, and taking into account the free price of gold this is more than three times the royalty so far paid to Persia. In the new Kuwait concession, too, the royalty is three times that of Persia. Wherever one examines the accounts one finds that the current basis for royalties throughout the world is about £1 per ton extracted.

From the above figures, and with special attention of Paragraph 17 of this memorandum, it will be quite clear that the royalty basis in Persia is in now way fair or equitable. A proportion of the total royalty paid in Venezuela, Kuwait and Iraq can be taken in the form of crude oil.

17. EXEMPTIONS: Tax and customs exemptions must be carefully reckoned and assessed. The tax on the company's income in accordance with the Persian income-tax law would have amounted to £12,000,000 in 1947. At the same time under state regulations customs duties on goods and other articles imported into or exported from Persia by the company would have amounted in both 1325 (1946/47) and 1326 (1947/8) to some £17,000,000.

By way of further explanation it is pointed out that in 1933 the company paid to the Persian government in lieu of income tax the sum of £274,412, and to the British government £305,418, whereas in 1947 the Persian government's taxes came to £765,405, and the British government's to £15,266,665.

18: COMPANY'S SHARES: Conversion of Persia's portion of the company's reserves into shares, as was done to the stockholders.

19. FOREIGN EXCHANGE: A share of the foreign exchange arising from the sale of oil products throughout the world.

20. SALE OF OIL FOR EXPORT: Arrangements for the supply of oil products by the company to the Persian government or Persian nationals for the purpose of export.

21. NAFT-I-SHAH: Practical measures to be taken to secure Persia's interests and rights in Naft-i-Shah, in view of its proximity to Naftkhana (in Iraq).

22. ASSOCIATED COMPANIES: Regulations to be drawn up to cover associated companies.

23. CHANGE IN STATUTES: The Persian government must agree to any changes made or to be made in the company's 1933 statutes.

24. COMPANY'S RESERVES: Clarification of the position of the reserves and their calculation, and an exact definition of the government's rights in them.

25. AIR, TELEGRAPH, TELEPHONE AND OTHER COMMUNICATIONS: The methods, limitations and conditions of utilising air, telephonic and telegraphic communications, constructing ports, and so on, must be the subject of agreement.

YEAR	BRITISH TAXATION	PERSIAN TAXATION
	£	£
1933	305,418	274,412
1934	511,733	301,135
1935	408,635	291,169
1936	910,559	328,524
1937	1,651,588	362,734
1938	1,157,029	378,494
1939	1,955,606	466,204
1940	2,975,156	460,118
1941	2,920,682	568,667
1942	4,917,846	454,168
1943	7,662,764	606,948
1944	19,636,457	514,725
1945	10,381,364	646,644
1946	10,279, 241	768,599
1947	15,266,665	865,405
1948	28,310,353	1,369,328

N.B. This table constitutes part of the foregoing Memorandum.

The negotiations lasted for two weeks with no agreement, and eventually the AIOC delegate agreed to take the memorandum back to London for further study. The discussion on a new agreement was then started between the representatives of AIOC and the Iranian government. These discussions lasted for six months in 1949, and ended with the signing of an agreement known as the 'supplemental agreement'.* In this agreement provision for a number of changes were made which would have increased the Iranian Government revenues. However, with regard to other demands of the Iranian Government (listed in the twenty-five point memorandum), nothing was done. The points which were dealt with were British Income Tax, dividend limitation, domestic oil prices and the share of the general reserve. The rest of the points in the memorandum were not mentioned.

The supplemental agreement was laid before the legislative body in July 1949, which had ten days left in office before the election of the new parliament. As the discussion of the oil bill was not completed by the end of the ten days, it was left over to be laid before the next parliament. The new Majles was opened in February 1950, and in March Sa'ed's government, unable to secure a vote of confidence, resigned and was succeeded by Ali Mansour. The new Majles continued the debate on the supplemental agreement, and in June appointed a special committee (of eighteen deputies) to study the agreement and prepare a full report for the house.

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*. The agreement was prepared as a supplement to the 1933 agreement between the Anglo-Iranian Oil Company and the Iranian Government.

In July Mansour was dismissed and the Shah appointed General Razmara as the Prime Minister. By this time nearly one year had passed since the supplemental agreement was signed by Sa'ed's government, and the oppostion used it to attack successive governments. There were signs of disagreement, even among the members of the Razmara cabinet.

The Supplemental Agreement and Parliamentary Debate

The Supplemental Agreement was rejected by the Majles special committee. On 25th November 1950 (4th Azar 2509) the committee read its report to the official session of the Majles. It concludes, "the Sa'ed-Gass supplemental agreement is not adequate to secure the rights of Persia and it (the Commission) therefore expresses its opposition to it."[4]

Four days later, Dr. Mossadegh and the National Front proposed to the Commission the outright nationalization of the Iranian oil industry. The consideration of this proposal was postponed until the discussion on the supplemental agreement was completed. The resolution ran as follows:

> "In the name of the prosperity of the Persian nation and with the view to helping secure world peace, we the undersigned (Haerizadeh, Saleh, Dr. Mossadegh, Muki and Dr. Shaygen) propose that the oil industry of Persia be declared as nationalized throughout all regions of the country without exception, that is to say, all operations for exploration, extraction and exploitation shall be in the hands of the Government".[5]

Fifty days later, on 11th January 1951 (21st Dey 1329), the Majles passed a resolution authorizing the oil committee to prepare proposals for future government policy vis-a-vis the oil industry in Iran.

> "The National Consultative Assembly, in confirming and approving the report of the committee that the Sa'ed-Gass draft is not adequate to secure the rights of Persia, with a view to carrying out the law of 22nd October 1947, instructs the committee to take into consideration proposals put forward by the deputies, and within two months to prepare a report setting out a line of policy for the government, and to lay it before the Majles. The deputies may submit to the committee any proposals they may have within two weeks."[6]

On 8th March 1951 (17th Esfand 2509), the oil committee unanimously decided that nationalization was the only course of action which the committee could suggest to the Majles.

> "In view of the fact that, among the proposals received by the oil commission, the proposal to nationalize the oil industry throughout the country has been considered and accepted by the commission, and since the time left for studying the execution of this proposal is not enough, the special oil commission (of the National Consultative Assembly) requests the Majles to grant an extension of two months for this purpose."[7]

Seven days later, on 15th March, the Majles unanimously passed the resolution approving the extention requested by the oil committee.

> "The Majles (National Consultative Assembly) confirms the Special Oil Commission's decision of 8th March 1951, and approves the extention of the Commission's term of office for two months.[8]
>
> Note 1: The Oil Commission is permitted to send for and make use of local and foreign experts as may be necessary.
>
> Note 2: Deputies shall have the right to attend up to fifteen days after the reopening of the Committee in order to forward their views and discuss them in the Oil Committee."[9]

The above resolution was approved by the Senate on 20th March 1951, and hence the principle of nationalization was accepted by both houses. The Majles merely approved the principle of nationalization, and even then it was not defined in the law. Meanwhile, the Oil Commission was busy studying the ways in which nationalization could be implemented.

On 26th April, the Oil Commission approved a draft of a nine-point law to implement the nationalization bill. The day after, the Prime Minister, Hossein Ala, submitted his resignation. The Majles, however, went on to approve the draft law unanimously, and recommended to the Shah the appointment of Dr. Mossadegh to replace the outgoing Mr. Ala. The draft law was approved by the Senate on 30th April 1951 (9th Ordibehesht 2510), and was signed by the Shah two days later.

The nine-point law which legally brought the National Iranina Oil Company into existence, was as follows:

<u>Oil Nationalization Law of 1st May 1951</u>[10]

Article 1: With a view to arranging the implementation of the law of March 15 and 20, 1951, concerning the nationalization of the oil industry throughout Persia, a joint committee composed of five Senators and five Deputies elected by each of the two Houses and of the Minister of Finance or his deputy shall be formed.

Article 2: The government is required to dispossess at one the former Anglo-Iranian Oil Company under the supervision of the joint committee. If the company refuses to hand over at once on the grounds of existing claims on the government, the government may, by mutual agreement, deposit in the National Bank of Iran or in any other bank up to 25 per cent of current revenue from the oil after deduction of exploitation expenses in order to meet the probable claims of the company.

Article 3: The government is required to examine the rightful claims of the government as well as the rightful claims of the company under the supervision of the joint committee and to submit its proposals to the two Houses of Parliament in order that they may be implemented after approval by the two houses.

Article 4: Inasmuch as From March 20, 1951, when the Senate also approved the nationalization of the oil industry, all revenues from oil and oil products are the unquestioned right of the Persian nation, the government is required to audit the company's accounts under the supervision of the joint committee. The joint committee must also supervise closely matters relating to exploitation as from the date of the implementation of this law until the appointment of a board of management.

Article 5: The joint committee must draw up as soon as possible and submit to the two Houses for their approval the statutes of the National Oil Company, in which provision is to be made for a board of management and a board of supervision composed of experts.

Article 6: For the gradual replacement of foreign experts by Persian experts the joint committee is required to draw up regulations for the sending of a number of students to foreign countries annually on a competitive basis to engage in the various branches of study and practical experience connected with the oil industry, the said regulations to be implemented by the Ministry of Education after approval by the cabinet. The expenses connected with the studies of these students shall be met out of the oil revenues.

Article 7: All purchasers of the products of the oil deposits recovered from the former Anglo-Iranian Oil Company may purchase hereafter annually at the current international price the same quantityt of oil that they purchased annual from the beginning of 1948 up to March 20, 1951. For any surplus quantity they shall have priority in the event of equal terms of purchase being offered.

Article 8: All proposals formulated by the joint oil committee and submitted to the Majles for its approval must be referred to the special oil committee.

Article 9: The joint committee must complete its work within three months from the date of the ratification of this law, and must submit a report on its activities to the Majles in accordance with Article 8. Should an extension of the period be required, it must submit an application for extension, giving valid reasons. Until the extension of time is for any reason disapproved by the two Houses, the joint committee may continue its activities.

Discussion of the Memorandum

The twenty-five point memorandum gives a good indication of what the Iranian authorities thought was wrong with the country's oil industry, and nearly half of these twenty-five points were about the financial obligations of AIOC under the 1933 agreement. It was also claimed that the company had not served the 'best interest' of Iran in some of its trading. The financial advantages of the Anglo-Iranian oil concession to Iran in general did not come up to what Iranians considered to be their 'fair' share. It was argued that the British Government's revenues (taxes, dividends, etc.) out of the implementation of the concession exceeded Iran's profits. The fact that the company did not allow Iranians to inspect accounts and technical information (contrary to the 1933 agreement) made the government even more suspicious of the operations of AIOC both in the country and outside. Item 16 of the Memorandum suggests that considerable attention be given to the oil concessions in other oil producing countries for the purpose of comparison of royalty and taxes.

The Memorandum also shows the dissatisfaction of the government with regard to the employment policies of the company. The company discriminated against Iranian workers in the type of work, salary, housing, sanitation facilities and training programmes. The authorities argued that if the Anglo-Iranian Oil Company, after forty years of operations in the country, still employed foreigners for skilled or semi-skilled jobs, then it had not attempted to train the locals seriously. A large number of non-technical posts (as far as oil operations were concerned) in the company, such as construction, health services, railways, administration, etc., could have been gradually handed over to the Iranians. The housing facilities given to the Persian workers were totally inadequate - nearly eighty per cent of the Persian workers were living under tents or similar types of shelter.[11] It must be noted that these points were carefully studied over a relatively long period, and did not suddenly emerge for the sake of bargaining in the negotiations.

There are also some parts in the Memorandum which clearly show government dissatisfaction with the way that the company carried out its operations. For example, Item 12 shows the Iranian concern for conservation and demand for utilization of the associated gas which was being produced in the oil fields. Other issues in this category were the demand for the refining of crude oil in Iran, and the insurance of the company's installations with the Iranian insurance companies.

Item 20 of the Memorandum shows the desire of the government to obtain oil products from the company for the purpose of export. They argues that a proportion of the total royalty paid in Venezuela, Kuwait and Iraq could be taken in the form of crude oil (Item 16). The Iranians demanded the same, but it is not clear if they knew that Kuwait and Iraq at that time were not selling their royalty allowances in the market independently. Presumably these countries would have been engaged in selling royalty crude if the financial rewards were at least equal to what the companies (holding the concession) were offering for the same crude (provided that they could find a market).

The list of items which Iranians believed the company had violated in the concession agreement was extremely large, and had been compiled over a long period.[12] This list was reduced to twenty-five points by a team of Iranian and foreign experts, and clearly shows that the authorities in Iran were well aware of the AIOC's operations in the country. However, the same awareness with regard to the nature of the world petroleum market was not clearly manifested.

The Political Situation in Iran, and its Impact on the Nationalization Bill

The national Iranian Oil Company came into existence in 1951 by an Act of Parliament, as mentioned in previous sections. The study of the formation of the Company and its early development would be incomplete without considering the political situation in Iran during the period under discussion, i.e., between October 1947 and August 1953. During this period ten different cabinets were formed in the country.* Three Prime Ministers resigned. Two were given a vote of no confidence by the Parliament, two were forced out of office and one was assassinated, a clear indication of the political instability in Iran at this time. It is interesting to note that most of these changes were due to the failure of successive governments to find a solution to the dispute with the Anglo-Iranian Oil Company and formula to secure Iran's interests (mentioned in the Memorandum) acceptable to all parties both inside and outside Iran.

This period may be divided into two parts, namely pre-nationalization and post-nationalization. The pre-nationalization period is considered to be between October 1947, when Parliament passed a Bill in which the Government was instructed to enter into negotiations with the AIOC, and March 1951, when the oil industry was nationalized. The notable characteristic of this period was the gradual build-up of nationalistic feelings both among the intellectuals and the public at large. Added to this was the feeling of mistrust of the successive governments which talked of reforms, but failed to carry out many of their promises. In this

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* Ghavam-Saltaneh (1946-December 1947).
Ahmad Hakimi (December 1947-June 1948).
Abdol-Hossein Hazhir (June 1948-November 1948). He was assassinated less than a year after his term of office as Prime Minister ended.
Mohammad Sa'ed (November 1948-March 1949). Received vote of no confidence from the Parliament.
Ali Mansour (March 1949-June 1949). Was dismissed by the Shah.
General Ali Razmara (June 1949-March 1950). He was assassinated on 7th March 1950.
Hossein Ala (March 1950-April 1950). He resigned.
Dr.Mohammad Mossadegh (May 1950-July 1952). He resigned.
Ghavam-Saltaneh (17th July 1952-21st July 1952). He was forced to regisn after four days of rioting in Tehran by supporters of Mossadegh.
Dr.Mohammad Mossadegh (July 1952-August 1953). He was forced out of office by a military coup d'etat.

period the dispute with AIOC and the future of the Iranian oil industry were used by different groups opposing the government to win public support. The oil issue became a platform for the different political factions, and the significant question of which was the best alternative for the oil industry at that time became the centre of political discussions.

The main forces involved in the Iranian political scene were (1) the Shah as the constitutional Head of State and the Commander-in-Chief of the armed forces; (2) the Prime MInister and his Cabinet; (3) the Parliament, and (4) religious leaders who were involved in politics and had considerable numbers of supporters. There were also a number of extremists groups such as the Tudeh Party (Iranian Communist Party) who were campaigning against the monarchy, and were alleged to be responsible for an attempted assassination of the Shah. Another group were the 'Fedayan Islam' (devotees of Islam) who were struggling against British influence in Iran. This group were alleged to be reponsible for a number of political assassinations, including that of the Prime Minister Razmara; Hazhir, Minister of the Court, and Dr. Zangeneh, Minister of Education.

The representatives of AIOC were quite aware of the extent of these political rivalries among different factions in the parliament, and regularly informed their headquarters in London. In March 1951 the chief representative of AIOC in Iran, Mr. E.G.D. Northcroft, and the British Ambassador, Sir Francis Sheppard, met with Prime Minister Razmara to discuss the oil industry in Iran.

After this meeting, Mr. Northcroft sent a report to London in which he mentioned the Prime Minister's attitude as well as his own judgment of the points discussed. Some parts of this report were translated by Mr. Rouhani in his book The History of Nationalization of Iranian Oil Industry (see Note 1), and is used here only to show the circumstances under which the oil debate was carried out.

Mr. Northcroft in his report mentioned that Prime Minister Razmara had told him that if his government suggest any outline for the negotiations, his opponents in the parliament would discredit his suggestions, and propose their own. The AIOC representative in the same report supported the Prime Minister's view in this respect, and added that Razmara's opponents in the parliament were many, and would do anything to discredit him. So the outline of any arrangement prior to negotiations by his government and the company would be used by some deputies to attack General Razmara. But the Prime Minister agreed reluctantly to persuade the Oil Commission to authorize his government to renegotiate with the Company without giving any specific suggestions for a likely solution.

Further evidence of the nature of debate concerning the future of the oil industry in Iran, came when Prime Minister Razmara warned the Oil Commission that major problems could arise in marketing Iranian oil without the prior establishment of subsidiary companies in other countries, and preparation of a transportation network. In reply, Dr. Mossadegh argued that the Iranian people were convinced that they could sell even more oil than before nationalization, due to the nature of world demand. Two days later Mr. Maki, another member of the National Front in the Oil Commission, argued that the sale of 30 million tons of oil per year (approximately Iran's production at the time) would not be difficult. He added that many countries required Iranian oil and they would even send oil experts to Iran free of charge to help in this respect.[13]

Published material concerning these debates shows that little attempt was made to study the nature of the world petroleum market, or to obtain expert opinion on the demand for Iranian oil after nationalization. The period was marked by intense nationalistic feelings, with the demand for nationalization of the oil industry as a particular offshoot.

After the nationalization of the Anglo-Iranian Oil Company, the political atmosphere began to change in Iran, and for some months attention was focused on the results of negotiations of the Mossadegh government with the former AIOC and the British Government. The British Government's decision to send troops to the vicinity of Iranian borders did much to unite the opposing groups behind the Prime Minister. But Mossadegh gradually lost this unanimous support as the negotiations dragged on with no result, and the Iranian oil was not sold. Meanwhile, Mossadegh tried to extend the duration of the 'exceptional powers' previously granted to him by the Parliament to deal with the crisis. The opposition (which now included some of Mossadegh's friends who fought together with him on the oil issue) believed that he was using the oil crisis as an excuse to extend the duration of exceptional power from the legislative body, a move which in their mind, was endangering the principle of separation of powers in the country.

The first constitution of the National Iranian Oil Company was prepared in this period. The administration of the newly formed company was at the same time involved in the negotiations with the former AIOC. The directors of NIOC were also alarmed by the increasing tensions among the workers in the oil provinces, as they were frequently asking for more pay and other benefits. It must be noted that a number of political groups, including that of the Tudeh Party, were quite active in the region, and were behind some of the strikes and claims made by the NIOC employees. Meanwhile, in Tehran pro-government and anti-government demonstrations were quite frequent.

This was, in short, the political environment under which the National Iranian Oil Company came into existence. This period was characterized by uncertainty concerning future development, and extensive rivalry among different political groups.

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* 25th July 1951: Communist led anti-British and anti-American demonstrations in Tehran; estimated 20 killed and 300 injured.

6th December 1951: Communist led anti-Mossadegh demonstrations in Tehran clash with National Front supporters; estimated 5 killed and 200 injured.

21st July 1952: Ghavam forced to resign after four days of rioting led to a coalition of Communist and supporters of National Front Party; estimated 22 killed.

28th February 1953: A group of demonstrators supporting the Shah attacked Mossadegh's house. Prime Minister fled to adjoining house while guards opened fire on the crowds.

Source: H.S.H. Noori, A Study of the Nationalization of the Oil Industry in Iran, PhD dissertation, Colorado State College, Colorado, Spring 1965, pp.322-335. See also Elwell-Sutton, L.P., Persian Oil (Lawrence and Wishart), London, 1955. Note that the number of killed and injured differs in various sources.

Discussion of the Nationalization Bill

The decision to nationalize the oil industry in Iran, as discussed before, was taken to a large extent on political grounds. However, prior to nationalization, Prime Minister Razmara consulted a group of Iranian experts.[14] This group, which consisted of petroleum engineers, economists and technocrats, studied the issue of nationalization and prepared a report on its consequences. The report tried to assess the technical capability of Iran to maintain production and to market Iranian oil. The result of this study was not published by the government,[15] but the Prime Minister quoted some part of it in a press conference when arguing against nationalization. After this speech the members of the group who prepared the study, demanded full publication of the report, as they felt that their argument had not been used in the right context. However, after the assassination of Prime Minister Razmara a few days later, and the events which followed, the publication of the report was abandoned.

This report was probably the only study of the problems involved in creating the Iranian National Oil Company prior to nationalization. The report discussed in considerable detail the need for foreign experts to maintain and expand the production of the oil fields, and it also drew attention to the problems concerning the marketing of petroleum products. It suggested that prior to any marketing venture by the National Oil Company, steps must be taken to create subsidiary companies abroad, and form a tanker fleet (either by charter or purchase) to transport crude oil and petroleum products. Political events, however, did not allow discussion of this report nor any further study of the matter.[16]

A close look at the laws and resolutions shows that the word 'nationalization' was used by the National Consultative Assembly (Majles) without giving a proper definition of the term. The only occasion where the policy of nationalization was clearly defined was in a proposal made by Dr. Mossadegh and a group of MP's (see page 65), which suggested that "all operations for exploration and extraction and exploitation shall be in the hands of the government'. This definition was not clearly embodied in the laws that were passed by the legislative bodies, and these laws merely refer to "the principle of nationalization".

The above legal issue was raised repeatedly with different missions which came to negotiate with the government of Dr.Mossadegh, and later (after its collapse) during the Majles debate concerning the Consortium agreement. Dr. Mossadegh and his negotiating team considered "the principle of nationalization", mentioned in the law, to cover all stages of the oil process and, as stated above, this would have implied that all operations must be under direct government control. On the other hand, the government of General Zahedi which followed Mossadegh argued that the nationalization law as it stood did not prevent the government 'delegating' some of its responsibilities to one or a group of companies under government supervision. They argued that such a decision was vital, especially at a time when the whole future of the oil industry in Iran was at stake.[17]

Although the interpretation of laws and legal arguments concerning nationalization in general is out of context in this study, what the Majles meant is very important for the purpose of this work, in so far as it shaped the role of the National Oil Company. While one interpretation would have suggested that the National Iranian Oil Company shouldered responsibility for extraction, refining and selling of oil and its products, the alternative view would have reduced the role of the company to a mere agency responsible for supervision of the oil industry on behalf of the government.

The First Constitution of NIOC

The National Iranian Oil Company was formed on 30th April 1951 (9th Ordibehesht 2510) when the nine-point law explaining the implementation of the nationalization principle was approved by the Senate and was signed by the Shah. The company started its activities under a temporary board of directors, according to the provisions of the law.

The first constitution of NIOC legally came into force on 26-27th November 1953 (5th Azar 2511), nearly 20 months after the company's establishment, and approximately 18 months after the temporary board of directors took over all the activities of the Anglo-Iranian Oil Company.

According to the first constitution, the National Iranian Oil Company was formed to take over exploration, extraction and exploitation of oil resources. The capital of the company consisted of the assets of the former AIOC, and its area of operation was also the same as that of AIOC.

The constitution of NIOC provided for four main bodies, which were as follows:[18]

1) Board of Trustees (Supreme Council)

The group was formed of seven people of which four were elected by the country's legislative bodies. The other three were the Minister of Fiance, the Minister of Employment and the Director of Bank Meli of Iran.

The Board was to decide on the content of the annual report of the executive board of directors of the company, to approve the yearly financial report, decisions concerning the increase of the company's capital, ratification of the company's yearly budget, decisions about the formation of NIOC's subsidiaries, and ratification of the general policies and principal laws of NIOC.

2) Directorate Council

This group consisted of four directors (extraction, refining, marketing and administration) and one Iranian managing director. There was provision in the law for employing non-Iranian directors with the approval of the government and ratification of the legislative bodies.

The managing director's appointment for a period of three years was on the nomination of the Council of Ministers and required the approval of the legislative bodies and ratification of the Shah. The managing director nominated the directors with the approval of the Supreme Council and ratification of the Council of Ministers for six years.

The principal responsibilities of the Directorate Council were:

a) to determine the company's general policies and plans

b) to submit the company's annual budget to the Supreme Council

c) to draft laws and regulations according to principles set forth by the Supreme Council

d) to submit proposals on the formation of subsidiaries of NIOC to the Supreme Council.

Furthermore, the Directorate Council could sign agreements for sale of oil, provided that the duration of contracts did not exceed five years, and its amount did not exceed one third of total production. The minimum sale figure allowed was put at 3 million tons of oil. For amounts larger than one third of the total production or periods longer than five years, the ratification of the Supreme Council and the legislative bodies was required.

3) <u>Council of Inspectors</u>

This Council was formed of three members who were knowledgeable and experienced in accountancy and other operations of the oil industry. These people were chosen for a period of three years. They were responsible for the preparation of a report showing all the financial activities of the company every six months to the Supreme Council.

The first Constitution of NIOC allowed the employment of foreign nationals with the approval of the Supreme Council. It also had provision for the use of foreign contractors and for co-operation with foreign companies. The provision for employment of foreigners indicates that the authorities were aware that a complete take-over of oil operations in Iran might require the assistance of foreign technicians. The fact that the constitution of NIOC even allowed the position of a director to go to a non-Iranian, indicates that even the shortage of top administrators was anticipated at the early stages of the company's operations.

The Constitution allows the directors to sell up to one third of the country's total oil production for five years without prior government consent. This amount of oil was about 10 million tons prior to nationalization. (If the same procedure were applicable today at NIOC, it would have been 2m b/d, nearly the equivalent of Kuwait's oil production.) The directors were given full freedom to sell crude oil and products.

The Constitution even had provisions allowing NIOC to make agreements with foreign contractors and oil companies. It shows that the government was leaving all the options open to make the National Company a profit making organization, and not merely a government sales agency. It is important to note that as the Constitution of NIOC was being prepared, the temporary board of directors of NIOC encountered considerable difficulties in finding customers for Iranian crude oil and petroleum products.

This was, to my mind, one of the factors that influenced the structure of the constitution to give considerable autonomy to the company and its directors. Had the Constitution been drawn immediately after the nationalization bill, provisions for foreign employees, contracts and joint ventures with other companies would have been severely limited. The extreme nationalistic feelings in the parliament, mistrust of foreign employees and lack of information about the ability of government to sell oil, would have led to the drafting of the Constitution of NIOC in such a way as to make it very similar to other government bodies.

As for the profits of NIOC, the Constitution states that all the profits, after deducting an 'amount' for general reserves and a further amount for what was called 'future accounts', would go to the government. The amount for general reserves was stated to be not less than ten per cent of the net profits. The National Oil Company was further allowed to use up to twenty per cent of the government share for development projects of Khuzestan (oil province) and the welfare of the company employees.

Such an arrangement would give the company some financial independence and scope for future growth. Again, one can argue that at that time the government had probably realized the difficulty of selling nationalized crude on a government-to-government basis. Autonomy would permit the company to sell oil with less difficulty in the market. It is interesting to note that later, when the role of NIOC was changed by the Consortium agreement, most of this autonomy of NIOC was removed.

To sum up, the first Constitution of the National Iranian Oil Company was drawn up to allow the company's growth to be somewhat similar to that of private oil firms, but within the nationalization law. It was designed to the extent possible at the time, to accentuate rapid growth of the company so that it would eventually be capable of carrying out extraction, refining and marketing of Iranian crude oil.

NIOC's Effort to sell Iranian Oil (1951-1953)

NIOC's campaign to sell Iranian crude oil started immediately after the nationalization of AIOC. In order to attract customers the Government of Iran was ready to consider sizeable discounts on the price of oil, up to 50 per cent of the posted prices. Barter deals were also considered, and the government promised to compensate the prospective buyers for losses (if any) due to its dispute with the AIOC. By late 1951 NIOC's spokeman announced that the company had received up to 268 proposals for purchases of oil from all over the world, which amounted to nearly 17 million tons of oil.[19]

However, out of these 268 proposals not one was finalized during 1951. In the eighteen months which followed, NIOC could not sell more than 118,600 tons of oil. The main reasons were not the inefficiency of the National Oil Company in finalizing the deals, but mainly three factors. First, most of the prospective buyers changed their minds when they learned more about the escalation of the dispute between AIOC and Iran and the position of the British and American Governments in this regard. It is evident that these governments actively discouraged prospective buyers from any deal with Iran prior to the settlement of the dispute with AIOC. For example, the US State Department, when consulted by the American Independent Oil Company in connection with the purchase of Iranian oil, recommended that the company should not pursue the matter any further. This was revealed in a letter which the President of the above company wrote to the Secretary of State, apparently disatisfied with the arrangements in the Consortium, dated 15th October 1954.[20]

> ".....The impact of the Consortium Agreement with the Iranian Government upon our prospects is real and immediate, not remote and fanciful. After the expenditure of some 23 million dollars, this company which as you know, is comprised of a group of independent interests, discovered oil in the Kuwait-Saudi Arabia Neutral Zone in March 1953. The advent of a newcomer into the world oil market is never easy, and when that newcomer is a small independent operating in competition with the established colossi in the field, the development of a position is more difficult. As our marketing effort got under way, and after shutdown of the Abadan refinery and the Iranian expropriation of the Anglo-Iranian Oil Company properties, we were approached by Iranian interests and urged to take and sell certain quantities of their crude. This would have been highly advantageous to use because of the opportunity it would have provided for blending their high gravity product with our own comparatively heavier oil. Before pursuing negotiations in this direction, a representative of this company conferred with the appropriate officer of your Department and at their express request declined to pursue the matter further with the Iranians. We were prepared to accept this distinct detriment because of our desire to co-operate completely with the Government in a matter of serious national import...."

Second, the Government of Iran was not very anxious to finalize a sale agreement with the countries of the Eastern bloc because such a deal could affect their relations with the United States. The government of Dr. Mossadegh was hopeful that Americans would help to bring about a settlement between Iran and AIOC, and also help Iran in securing adequate loans for development plans. So the finalization of agreements by NIOC with these prospective buyers of Iranian crude oil was not seriously pursued due to political reasons. The government in this period did not follow a consistent and well-defined policy for selling oil, either because they were hoping for an over-all solution with AIOC, or due to other considerations. Hence, NIOC's marketing approach was at the mercy of political exigencies.[21]

As mentioned before, the total sales of NIOC in this period amounted to 118,600 tons, which was less than 0.4 per cent of production (33 million tons) prior to nationalization. The Japanese and Italians were the main pruchasers of NIOC's crude during this period. Total purchase by an Italian company (Supor) was 37,000 tons of crude. The first shipment of this crude (5,000 tons in a tanker called "Miriella") was the subject of a court case in Venice due to the legal action of AIOC. It was later released, as the court dismissed the claims of AIOC. When Mossadegh learned of the court's decision, he agreed that future sales of NIOC to Supor for six months would be given at 50 per cent discount.[22] Supor purchase of Iranian crude was stopped after the company faced trading difficulties in Italy.

The Japanese group, Idemitsu, also approached NIOC to buy crude oil, and its first tanker "Nissyo Maru" arrived at Abadan in March 1953. Similar legal problems as that of the Supor Company arose when the ship arrived in Japan. Again, the legal advisers of

NIOC helped the purchaser to fight AIOC claims in the court, which similarly dismissed AIOC's case, and the ship travelled to Iran twice more to purchase crude oil Total purchase of oil by both Italian and Japanese companies amounted to 54,600 tons and 64,000 tons, respectively. These amounts were miniscule when compared to the oil production capacity in Iran, and although discounts of up to 50 per cent were offered by NIOC, there were few buyers for Iranian oil.

The third, and probably the most important, factor which contributed to the failure of NIOC to market Iranian crude oil, was the nature of international petroleum markets at the time. The world petroleum industry was dominated by a few large international corporations, well established in the markets, and this made the job of a newcomer much more difficult. The next two chapters attempt to show this point more clearly.

NOTES

1. L.P. Elwell-Sutton, Persian Oil (Lawrence and Wishart, London, 1955), p.119. (The Persian text was compared with the English translation.)
   For Persian text see: Fuad Rouhani, Tarikh Melli Shodan Sanat Naft Iran (The History of the Nationalization of the Iranian Oil Industry) (Tehran, 1973), p.70.
   Dr. Rouhani was a staff member of the Anglo-Iranian Oil Company prior to 1951. He was appointed as Chief Legal Adviser of the National Iranian Oil Company, 1951-1954, and Director of NIOC in 1954. He also held the post of Managing Director and Deputy Chairman of NIOC in 1956, and Secretary-General and Chairman of the Board of Governors of OPEC, 1961-1964.

2. Elwell-Sutton, op.cit., p.171.
   Two French advisers were Professor Gidel and Jean Rousseau. Other foreign experts consulted were A.A. Curtice, who had advised the government in 1944; Max Thornburg, newly appointed adviser on the seven year plan; and C.S. Gulbenkian, the Armenian oil magnate, who for many years had been honorary commercial attache to the Persian Embassy in Paris.

3. Ibid., pp.165-170.
   For Persian text see Rouhani, op.cit., pp.73-77.

4. Ibid., p.184.

5. Correspondence between His Majesty's Government in the United Kingdom and the Persian Government, and related documents concerning the oil industry in Persia: February 1951 to September 1951. (Presented to the Parliament in December 1951.) London, Her Majesty's Stationery Office, p.25.
   See also Rouhani, op.cit., p.109.

6. Elwell-Sutton, op.cit., p.202.
   See also Rouhani, op.cit., p.110.

7. Correspondence concerning the oil industry in Iran, op.cit., p.25. (See 5 above.)
   See also Rouhani, op.cit., p.110.

8. Ibid., p.27.
   See also Rouhani, op.cit., p.110.

9. Elwell-Sutton, op.cit., p.208.
   See also Rouhani, op.cit., p.110.

10. Correspondence concerning the oil industry in Iran, op.cit., p.29-31. (See 5 above.)

11. Rouhani, op.cit., p.78. Also interview with Dr. Rouhani in London, March 1976.

12. Interview with Mr. Fathollah Nafici, London, April 1976.

13. Majles debates, October 1950. See also Rouhani, op.cit., pp.85-96.

14. Mr. Fathollah Nafici, Dr. Mohammad Keyhan (Professor of Economics at Tehran University), Mr. Baghor Mustofi (petroleum engineer).

15. Information concerning this report was obtained from Mr. F. Nafici in an interview in April 1976.

16. This was confirmed by Dr. Rouhani and Mr. Nafici in separate interviews.

17. Majles debates on 28th Mehr 2513 (October 1954).

18. Rouhani, op.cit., pp.509-54.

19. Ibid., p.397.

20. Multinational Corporations and US Foreign Policy. Hearings before the Sub-committee on Multinational Corporations of the Committee on Foreign Relations, United States Senate (Washington, Government Printing Office, 1974), pp.249-251.

21. Rouhani, op.cit., p.398. Also interviews with Dr. Rouhani and Mr. Nafici, April 1976, and interview with Dr. Fallah, December 1976.

22. Ibid., p.401. Official price was about $13 per ton.

CHAPTER V

THE CONSORTIUM AGREEMENT AND ITS EFFECTS ON THE ROLE OF THE NATIONAL OIL COMPANY.

Why the Consortium was Established

The government of General Zahedi which followed that of Mossadegh was very anxious to resolve the oil dispute with the former Anglo-Iranian Oil Company. In October 1953, Herbert Hoover, who was the US Secretary of State's special oil adviser, arrived in Tehran. He urged the Iranian government go accept the idea of a deal with a consortium of major international oil companies. The American government was especially interested in resolving the problem because of an imminent danger of a take-over by a Russian backed party in Iran. This was due to the economic problems which Iran faced after the failure of NIOC to sell sizeable quantities of oil. The role of the US government in setting up a consortium was summarized by Mr. H. Page, who was the leader of consortium negotiations in Iran:

> "Well, the role was this: that the US Government felt that if Iran was not saved and because they were going downhill pretty fast economically, with no oil out there, that Russia was going to take over and they had some very good reasons for this, and because I saw some of them when I was out there in Tehran later. Now, the British felt the same way, but probably not quite as strongly on whether or not Iran was going to collapse."[1]

Mr. Howard page was answering as a witness during hearings of the US Senate Sub-Committee on Multinational Corporations in 1974.

Some parts of the his testimony concerning the formation of the consortium are given here.[2]

SENATOR MUSKIE: But your primary motivation is the pursuit of financial advantage.

MR. PAGE: Of course.

SENATOR MUSKIE: Which is the free enterprise system and really what we seek to pursue with this inquiry is the question of whether financial advantage to private companies necessarily coincides with the public interest in the kind of situation that has developed in the oil industry in production of oil in the Middle East and the marketing of oil around the world..... Now, in the Iranian situation, you moved in there not in pursuit of financial advantage but at the request of the Government, as I understand it. Now has it proven to be a move which has produced financial advantage?

MR. PAGE: I have not seen the figures recently, but I would say that about up to this time, no, we haven't gotten our money back, but I would say that I am glad we did go in. But remember at the time we went in we put up all this money and there was no assurance whatever that we wouldn't lose the whole thing within a few months again. So that it turned out quite well, and it has turned out exceedingly well in a sense, and therefore, I think in the long run we will get our money back, and that with hindsight, and forgetting the risk that was involved in going in at the beginning, it has turned out to be a good investment, yes.

So it could be concluded that the formation of a consortium of major international oil companies to re-integrate Iranian oil in the world market, was more of a political compromise than a purely commercial undertaking. This was further manifested when the issue of shares within the consortium was considered, here.

the British interest had been kept under 50 per cent for the sake of Iranian public opinion. On the other hand, some American oil companies were persuaded by the State Department to join in order to resolve the crisis. Again, the Senate investigation in 1974 supports this view.[3]

SENATOR MUSKIE: So someone in the US Government decided that Exxon, Mobil, Texaco and Socal were to be the American companies to go in, but they were each to have 8 per cent and the total would be 40, that was their total without any input from the oil industry at all?

MR. PAGE: Naturally we had to agree to that.

SENATOR MUSKIE: Of course, and you had no notion on how that formula was decided on?

MR. PAGE: Well, I have some notion in the sense that, as I understood it, the 40 per cent for BP was the maximum that would be politically allowable within Iran. In other words, that the politics of it were such that they (the Iranians) felt that it would be impossible to renegotiate the thing if BP had a majority interest or even 50 per cent interest, and, therefore, that more or less established the 40. Now exactly how the others shaped out, I don't know, except that Shell had very large markets and not much crude oil in the Middle East and they could provide, they could certainly handle, their 14 per cent with no problem at all....

Members of the Consortium

As a result of extensive negotiations among the major international oil companies and considerable pressure from the US and British governments, a consortium was formed to negotiate with the

Iranian government with the view to solving the oil crisis in Iran. The companies which participated were as follows:[4]

Companies	Per cent share of consortium
British Petroleum	40
Royal Dutch-Shell	14
Exxon	8
Mobil	8
Texaco	8
Gulf	8
Standard of California	8
Compagnie Francais des Petroles	6
TOTAL	100

However, six months later in April 1955, on the State Department's suggestion, the five American companies, namely Exxon, Mobil, Texaco, Gulf and Socal, agreed to give one per cent of their share in the consortium arrangement to a group of independent oil companies, Iricon. The Iricon group originally consisted of Richfield, Signal, Hancock, Sohio, Getty, Tidewater, Atlantic, San Jacintho and Aminoil. After this the ownership of the consortium was as follows:

Companies	Per cent share in consortium
British Petroleum	40
Royal Dutch-Shell	14
Exxon	7
Mobil	7
Gulf	7
Texaco	7
Standard of California	7
Compagnie Francaise des Petroles	6
TOTAL	100

The consortium agreement was negotiated in the absence of the independent group, between the Iranian government and the major international oil companies.

Consortium Negotiations

In March 1954, the Iranian government appointed a commission to study and prepare the government case for the negotiation with the consortium delegation. This commission comprised Mr. Attaolah Etehodieh, Dr. Reza Fallah, Mr. Fattolah Nafici and Dr. Fuad Rouhani, all of whom were involved in the negotiations which eventually led to the consortium agreement between the Government of Iran, represented by Dr. Ali Amini (Minister of Finance), and the Consortium of International Oil Companies headed by Mr. Howard Page of Exxon. The importance of this agreement as far as this study is concerned, is is the change it brought to the role of the National Iranian Oil Company. In order to illustrate this point we shall go into some details here.[5]

In the early stages of negotiations with the consortium, the Iranian delegate suggested some sort of partnership between the consortium members and the National Iranian Oil Company. This would have secured a very active role for the National Oil Company in exploration, production, and marketing of Iranian oil. But this suggestion was rejected by the other side which argued that each of the companies in the consortium had a world-wide market share in selling petroleum products, and as NIOC had no such market it could not join the group. The domestic market of NIOC, plus its few sales agreements with small companies, was not considered by the consortium members to be an adequate basis for membership of NIOC in the consortium. Besides, such an arrangement would have triggered off similar demands from other oil producers (for example, Venezuela).

When participation in the consortium by the National Oil Company was rejected outright, the vital question for NIOC was to secure access to certain quantities of 'cost oil' to honour its commitments at the time and plan for future expansion. The Iranian negotiators were very keen to reach an understanding with the consortium on this issue. But the consortium team once again rejected any arrangement to supply NIOC with 'cost oil' to be marketed on its own account. They argued that as NIOC was not fully integrated, any amount of crude oil supplied to NIOC would be offered in the markets with discount and hence would create competition for the consortium sales in these markets. Furthermore, any such arrangement would be followed by similar demands from other oil producing states. The companies argued that if NIOC really wanted to have its own operation, it could use the equivalent amount of oil to the 'Stated Payment'[6] for this purpose.

This was a major blow to the future operations of the National Oil Company as it could not sell this oil at posted prices in the market. On the other hand, the consortium were paying the 'Stated Payment' to the government on the basis of full posted prices. The realization of the full posted prices by NIOC in the markets was not possible at the time as the 'realized price' of similar oil was considerably lower. Furthermore, any discount by the NIOC on sales would have meant considerable reduction in the government's revenues.

But NIOC, as mentioned before, already had commitments to sell oil to the Idemitsu Company of Japan and the Supor Company in Italy.[7] The Iranian delegation, and especially Mr. Bayat, NIOC's Managing Director, tried to arrange deliveries of a certain amount of crude oil from the consortium so that the National Oil Company could stand by its previous agreements. This issue was raised again, even after the signing of the consortium agreement. On December 9th 1954, Mr. Henderson, the American Ambassador in Iran, sent a telegram to the Secretary of State, in which he communicated his understanding of the NIOC's demand with respect to this issue.[8]

> ".....While original contract between Iran and Supor appears to have been loosely worded, Iran Government has consistently insisted that if committed provide oil thereunder. Moreover we informed that implementing agreements between NIOC and Plan Organization on one hand and private Italian firms on behalf of Supor on the other hand have called specifically for payment in crude oil with no alternative for payments in sterling or other currency.
>
> There is no doubt Iran Government understands that delivery of crude oil at price less than posted prices will result net loss to Iran in view consortium undertaking accept all "royalty" crude at full posted price. Aside claim that Iranian Government nevertheless committed to delivery oil to Italy (which of course they have right to within "royalty oil" quota) we believe main justification from Iranian and particularly NIOC viewpoint lies in determination to engage in international oil sales on their own account in order to gain experience and present impression Iran oil export is not solely in the hands of consortium.

> There some indication decisions re-proceeding with oil deliveries Italy under Supor contract was made at time when some Iranians were under impression special arrangements would be made by consortium to permit Iran meeting existing commitments over and above "royalty oil" clause. In other words Iranian Government appears to have expected that such oil sales would have provided revenue in addition to that delivered from consortium operations. This may explain fact that no alternative method of payment (i.e., in sterling) was provided in contracts. Henderson."

As consortium members were firmly against any provisions under which NIOC could continue its marketing operations, the Iranian side further agreed to undertake no more marketing commitments on their own if they got enough oil for previous arrangements with the Italian and Japanese firms. But even this compromise was not satisfactory for the consortium members. The arrangement which was eventually agreed by both parties was for NIOC to obtain refined products from the consortium on the basis of exchange with crude oil which NIOC was entitled to under 'Stated Payment' (royalty oil). Each unit of refined product was calculated as 1.2 units of crude oil. NIOC's sales based on the posted price, as mentioned before, were not possible under the marketing conditions of the time. Hence oil sales of the National Oil Company to Japanese and Italian parties did not last more than a few months. This was mainly because in their yearly round of negotiations, NIOC could not agree to the previous discounts requested by these companies.

Consortium members, similarly, refused to allow NIOC to obtain any amount of refined petroleum products out of Abadan refinery at cost for its marketing outside Iran. The National Oil Company was not even given the responsibility of supplying the bunker fuel needed for tankers at any oil terminals of the country (including any future loading ports in Iran).[10] Needless to say, Iranian delegates tried hard to obtain for NIOC the responsibility of supplying bunker oil at Iranian ports. But the consortium members did not agree to that, and argued that bunker oil must be treated as export of oil, in which NIOC had delegated it responsibilities to the consortium.[11]

Control of the Oil Operations in Iran

In the previous section we discussed how the role of NIOC with regard to international marketing was changed as a result of the consortium agreement. But the National Oil Company's international marketing was only part of the wide ranging responsibilities which were entrusted to the company by its constitution. The National Iranian Oil Company was made responsible for exploration, production and refining oil in Iran. The Iranian negotiating team at the early discussions with the consortium proposed that NIOC should exercise this right which meant control of all oil operations in Iran. Also any new organization was required to become an 'agent' of the NIOC or the government.

The consortium members were totally opposed to this arrangement. They wanted total control over all operations from the wellhead to the loading terminals. The consortium believed that this was the standard arrangement in all the other oil producing countries, and any change in the Iranian case could bring about similar demands from others. The Iranian side argued that NIOC, unlike similar organizations in other countries, was capable of handling these operations, and suggested that NIOC be allowed at least to participate in the organization which was given this responsibility - a suggestion which was even accepted by the Stokes* mission during negotiations with the Anglo-Iranian Oil Company. But the effective control over all operations was what the consortium wanted.[12]

The arrangement which was eventually agreed upon was to form two companies in London - Iranian Oil Participants and Iranian Oil Services. The former was the holding company (holding the shares of consortium members) responsible for the determination of total production, level of required investment and other general policies of the Iranian oil consortium. Iranian Oil Services was given the job of organizing all the maintenance work for oil operations in Iran with regard to both equipment and personnel. Two other companies (operating companies) were also formed, both of them registered in Iran and incorporated under the laws of the Netherlands - the Exploration and Producing Company and the Refining Company, which had all the rights and powers to carry out, within the terms of agreement, on behalf of Iran and the National Iranian Oil Company, all operations relevant to exploration, production and refining of crude oil in the area. It was agreed that the board of

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* Richard Stokes, the Lord Privy Seal, headed a mission to Iran to discuss a possible solution after the nationalization of AIOC.

directors of each company should consist of seven members, two of them nominated by NIOC. Furthermore, in one of the letters of understanding which was signed by both parties together with the agreement, it was indicated that the consortium would choose one Iranian director for each of these operating companies.[15]

As for marketing of Iranian oil, each consortium member formed a trading company to purchase from NIOC crude oil produced by the exploration and producing company according to its share in the consortium for the purpose of export. These trading companies were registered in Iran, and had the same nationality as that of the consortium member by which it was nominated, unless such consortium member considered that tax or foreign exchange requirements outside Iran made another nationality desirable.[16]

NIOC's role in the operations of the two companies responsible for exploration, production and refining of crude oil in Iran was limited to 'supervision'. The agreement clearly indicated that this supervision by the National Oil Company was with regard to what is known as 'good oil practice' carried out by the above companies. The supervision did not include NIOC's participation in any crucial decision-making by the consortium, such as determining the level of crude oil production or refinery throughput. NIOC, similarly, had no role in the operations of trading companies abroad.

The total quantity of crude oil to be produced by the companies according to the consortium agreement[17] was (a) the quantity required to meet NIOC's requirements for petroleum products for internal consumption in Iran, (b) the quantity (if any) required to provide NIOC with crude oil in kind instead of 'Stated Payment', and (c) the quantity required by the trading companies as determined by them.

The consortium agreement reduced the role of NIOC to a supervisory body with no control over the oil operations in Iran. NIOC's effective control in the consortium area concerned only so-called 'non-basic operations'.[18] But as we mentioned before, it was extremely difficult for the National Oil Company to find adequate outlets for Iranian oil at the time. To substantiate this point further, part of the testimony of Mr. Howard Page with regard to the formation of the consortium and its role is given here:[19]

SENATOR CHURCH:	.....What if there had been no consortium at all, what restraint would there have been on the Shah to increase production?
MR. PAGE:	Terrific, because they would have very little outlet.
SENATOR CHURCH:	You mean they had to market through your system?
MR. PAGE:	If they were going to get the big outlet certainly, I mean, because we had the tankers, we had the refineries, we had the marketing, taking all these companies together.

SENATOR CHURCH: Right, and if all those companies had not been together in a consortium, but if they were individually bidding for Iranian oil, the situation would have been quite different, wouldn't it?

MR. PAGE: Yes, quite different. We wouldn't have lifted any. I mean, remember that we had a concession that was able to supply all these requirements (Saudi Arabian concession) and we knew when we went into the consortium that as a business deal, a straight business deal it was for the birds. I mean in other words, we had to spend money for capacity and reserves that we already had and had freely available, so we lost money on every barrel. I mean, once we were there, of course, then you didn't lose money on every barrel except of course you had to pay for reserves, but the point was that we went in there as, to save the situation, and it was in the interest of the United States and Britain at that time.

SENATOR CHURCH: It is true that prior to the return of the Shah there had been a very effective boycott against Iranian oil and from the standpoint of Exxon it may very well have been to your company's advantage to have taken no oil under any other arrangements, but what about other independent oil companies? Do you think had there not been this consortium that they would not have been interested in bidding for Iranian oil?

MR. PAGE: There were very few that had any outlet worth mentioning. I mean by that let's say at that time there were probably 15 per cent of the entire market was shared by companies that were not among the majors that went into the area.

SENATOR CHURCH: Aren't you saying, Mr. Page, that the Shah had to deal with you if he was going to market his oil, since the majors did dominate world markets to the degree that otherwise Iran might only have sold about 15 per cent of its product to independent companies?

MR. PAGE: In a sense - I don't know about your word 'dominate'. The point is we had the outlets for the oil.

To sum up, the consortium of major international oil companies was formed with the help of the US Department of State to re-integrate Iranian oil into the world market. The consortium members only agreed to do this if they were given full control over all oil operations in Iran. On the other hand, the Iranian government, anxious to obtain oil revenues to the able to deal with urgent economic problems, had to agree with the terms of the consortium members. As a result, the effective powers and responsibilities of the National Iranian Oil Company with regard to oil operations of the former AIOC, to which it was entitled under the nationalization law and its constitution, were delegated to the consortium members. This reduced the role of the National Oil Company to merely non-basic operations, and was a turning point in the history of NIOC.

NOTES

1. Multinational Corporations and US Foreign Policy. Hearings before the Sub-Committee on Multinational Corporations of the Committee on Foreign Relations, United States Senate (Washington, Government Printing Office, 1974), Part 7, p.297. Mr. Howard Page was Executive Assistant to the President of Exxon after the war. He became Director of the Iraq Petroleum Company and its associated companies in 1947. He then became Director of the parent company in 1954, and was assigned the position of Primary Contact Director for the Middle East. In 1966 he was elected to the Executive Committee (Exxon) and Alternative Director for the Middle East. He retired from Exxon as Executive Vice-President and Director. He led the consortium members' delegation in the second stage of negotiations with Iran in 1954.

2. Ibid., p.301.

3. Ibid., p.302.

4. Ibid., pp.245-246.

5. The material regarding these negotiations was compiled from separate interviews with Dr. Fallah, Mr. Nafici and Dr. Rouhani.

6. The term 'Stated Payment' is used in the consortium agreement instead of the more common word 'royalty'. The Iranians insisted that the term 'royalty' was used in concessionary agreements, and as the oil industry in Iran was nationalized, they could no longer accept this term. But as far as the consortium agreement was concerned, 'Stated Payment' was similar to 'royalties' in other concessions in the Middle East (equal to $12\frac{1}{2}$ per cent of production at posted prices).

7. See Chapter IV of this work, p.87.

8. Multinational Corporations and US Foreign Policy, op.cit., Part 8, p.558.

9. Rouhani, op.cit., p.449.

10. The Persia-Consortium Agreement, The Petroleum Times, supplement to Vol.LVIII, No.1492 (reproduced in full from the official version), October 15, 1954, Article 26.

11. Rouhani, _op.cit._, p.450.

12. _Ibid._, pp.451-452.

13. The Persia-Consortium Agreement, _op.cit._, Article 4, (see note 10).

14. _Ibid._, Article 3, Part D.

15. Rouhani, _op.cit._, p.480.

16. The Persia-Consortium Agreement, _op.cit._, Article 18, Parts C and B.

17. _Ibid._, Article 19.

18. _Ibid._, Article 6.

19. _Multinational Corporations and US Foreign Policy_, _op.cit._, Part 7, pp.289-290.

CHAPTER VI

EARLY ACTIVITIES OF THE NATIONAL IRANIAN OIL COMPANY AFTER THE CONSORTIUM AGREEMENT

As mentioned in the previous chapter, the role of the National Iranian Oil Company was considerably changed after the consortium agreement. However, the task of distribution, sales and pricing of oil products throughout Iran was left to NIOC. To supply petroleum products to Iran's widely scattered centres of population was not an easy job. Apart from responsibility for domestic marketing, the company was handling all the "non-basic" activities in connection with oil production and refining within the consortium agreement area. But international activities of the company were not progressing, as NIOC had no crude oil production apart from the Kermanshah field, which was used for internal consumption. In this chapter we discuss the nature of NIOC's role in the so-called "non-basic" operations, the background and changes which the petroleum act of 1957 brought about, and the first attempts of the National Oil Company to enter into joint venture agreements for production and marketing oil outside the consortium area.

Non-basic Operations of NIOC

As mentioned above, the oil agreement between the government of Iran and the consortium of oil companies, gave NIOC the task of non-basic operations within the agreement area. Article 17 of the agreement states that "NIOC shall perform and carry out non-basic operations with due regard to economy and efficiency and in such a manner as to meet the reasonable requirements of the operating companies".[1] In this agreement, the term "non-basic operations" is clearly stated to include:

Housing estates
Maintenance of roads used by the public
Medical and health services
Operation of food supply systems of canteens, restaurants and clothing stores
Industrial and technical training and education
Guarding of property
Welfare facilities
Public transport
Communal water and electricity supplies
Other public services
Such further services as may be agreed upon between NIOC and relevant operating company

The transfer of all these operations to the national oil company was phased over several years, and was completed by 1963, more than eight years after the consortium agreement was signed. The operating costs of these activities were payable by the consortium companies ".....to such extent as is reasonable having regard to the costs actually incurred and to the approved operating expenses".[3] The capital required for non-basic operations was to be provided by NIOC and the operating companies in equal shares. In 1962 the non-basic services provided by NIOC included:[4]

6,700 houses for staff and 19,000 houses for daily rates employees located in ten major centres
955 hospital beds in 5 hospitals, a network of over 40 clinics and supporting medical personnell of more than 1,900
9 major training centres ranging from apprentice training shops to technical colleges, with combined full-time student bodies of over 1,000
18 commissaries and 37 food distribution centres
23 guest houses and pensions
1,150 men engaged in property protection
48 employee clubs and 41 cinema operations
Maintenance of roads used by the public
Public transport
Commercial water and electricity supplies

In order to run such an extensive and diversified list of services, the national oil company had to tie up a large number of skilled personnel, a group which could have been used for developing the country's oil resources outside the consortium agreement area. This was not a major problem before 1960, as the activities of NIOC in "basic" operations were very limited. The Petroleum Act of 1957 which led to the signing of joint venture agreements, enhanced the role of NIOC in the development of the oil resources of Iran outside the consortium area. As a result, the involvement of a large percentage of skilled personnel in non basic operations was no longer desirable for the company. But under the consortium agreement, NIOC was responsible for such activities, and the only solution was gradually to transfer them to the relevant government sector and local communities. This promised to reduce the total number of employees (see Table VI.1) and free scarce managerial skills for other projects.

Why the Petroleum Act was introduced

The consortium agreement was, in effect, very similar to other arrangements which major oil companies had under concessionary agreements with other Middle East oil producers. The major difference in the case of Iran was that the entire assets and oil reserves belonged to the nation, and the consortium was given the exclusive and total right to use them for the period of the agreement. Oil revenues were based on a

TABLE VI.1

WORKING FORCE IN IRANIAN OIL INDUSTRY
1955-1966

Year	Iranian Employees	Foreign Employees	Official Workers	Iranians and Foreigners Working under Contract	Total Work Force
1955	6,867	85	48,222	88	55,262
1956	7,166	480	47,582	7,913	63,147
1957	7,722	585	47,940	7,056	63,303
1958	8,139	693	48,477	4,724	62,033
1959	8,240	781	47,984	4,305	61,310
1960	8,544	838	45,646	3,206	58,234
1961	10,188	847	39,638	1,619	52,292
1962	9,787	717	33,764	1,554	45,817
1963	9,623	583	32,135	662	43,003
1964	9,888	474	31,564	727	42,563
1965	10,349	501	30,732	2,137	43,719
1966	10,740	506	30,213	1,663	43,122

Source: Lecture by Dr. M. Nezam Maffi, Department of Planning and Economic Studies in NIOC, delivered in Tehran, November 1967. Published by NIOC (in Persian), Table 7.

50-50 profit sharing method, which meant that the net profits on export sales of Iranian crude oil were divided equally between the consortium and the NIOC. In addition to this, there was provision for the royalty (stated payment) which was fixed at 12.5 per cent (one-eighth of total production). This amount was payable in cash or in the form of crude oil, and was included in the 50 per cent share of the producing country.

After the consortium agreement's ratification by parliament in October 1954, the Constitution of the NIOC was changed accordingly in order to allow the operating companies to exercise total control over the oil operation in the 100,000 square miles of the consortium agreement. This left NIOC with approximately 500,000 square miles in which to explore for oil but no legal basis for bringing in new foreign partners. Furthermore, such exploration activity would have required large sums of money which the government could not provide because of the financial losses incurred between 1951 and 1954. The only exploration under way which had started earlier, was in Qum - south of Tehran where oil was discovered in August 1956 and caught fire. Unfortunately, the oil discovered was not in sufficient quantities to justify large-scale development of this field. Consequently, NIOC was left with little oil production of its own for international markets. The only alternative was that of finding a partner to invest in exploration and development as well as assistance in marketing. The government, fully realizing this point, introduced the Petroleum Act of 1957, which created the legal framework for the national oil company to enter into joint ventures and contract agreements with foreign oil companies.

The Petroleum Act 1957

The purpose of the Petroleum Act was to expand as rapidly as possible the exploration and extraction of petroleum throughout the country and the continental shelf outside the consortium area, and to develop a refining and transportation network for marketing this oil, both in Iran and abroad.[5] NIOC was empowered to enter into any agreement which it deemed appropriate with any person whether Iranian or foreign, provided that such a step was not contrary to the laws of the country.[6] NIOC was to hold a minimum of 30 per cent ownership interest in any joint ventures formed with foreign oil companies.[7] The area allocated to any such joint ventures could not exceed in any one district and any time 16,000 square kilometres, and at least half of that had to be returned after ten years.[8] The government was not a party to these agreements, but Article 2 of the act required that NIOC must present the details of such agreements to the Cabinet for approval, after which it would be presented to parliament.

As for the financial arrangements governing such joint ventures, the Petroleum Act laid down certain annual rentals payable to NIOC. These rental payments could be included among operating costs until such time as income tax liability of the operator in any taxation period exceeded or equalled the rental payment.[9] The exploration cost would be paid by the partner, and would be recovered only if oil was found in commercial quantities. Development costs would be shared between NIOC and the foreign partner according to their equity holdings. In the case of oil discovery, only half of the oil would belong to the partner for which he was required to pay 50 per cent income tax. NIOC's share of crude could be marketed by the foreign partner.[10]

The First Group of Joint Venture Agreements

The first of the joint venture agreements was signed by NIOC in August 1957, less than a month after the ratification of the Petroleum Act, with AGIP Mineraria of Italy. This company was to spend a minimum of $22 million on exploration. In the case of commercial discovery, AGIP and NIOC were together to form a partially integrated venture called the Societe Iran-Italienne des Petroles (SIRIP) with the capital to be held in equal proportions by the two partners.

In May 1958, NIOC signed the second joint venture agreement with the Pan-Am Oil Company. The 16,000 square kilometres of territory under this agreement was off-shore, and the foreign partner agreed to spend a minimum of $82 million in exploration activities. In the event of oil discovery, the Iran-Pan-American Oil Company was to be formed. The nature of this company was somewhat different from SIRIP, as it was a non-profit making venture. The offtake was to be offered to the two partners equally, but if any of the parties decided to take less than its entitlement, IPAC was to market such quantities on behalf of the partners.

The third joint venture of NIOC was with Sapphire Petroleum Company of Canada in 1958. This venture, however, proved unsuccessful and in 1961 the foreign partner was forced to withdraw after paying compensation for failing to fulfil its minimum obligations.[11]

In these joint venture agreements, NIOC was responsible for a 50 per cent share of investment. Exploratory and initial development investment was financed by the foreign partner, and was repaid when the field was declared commercial. NIOC assigned crude oil to AGIP and IPAC, the two companies which found commercial quantities of oil, in lieu of its share of capital for development. All future investment was paid equally by the partners as it occurred. There was no interest applied to the advances made by the private partners for initial investment, and amortization was carried out normally in a ten year period.

Income in these joint ventures was based on each partner receiving one half of the production, which could be disposed of at market price. So NIOC's profit from half of the production was half of the realized price, minus half the accounting operating cost. The foreign partner had to pay income tax at 50 per cent to the government, based on the posted (tax reference) prices after deduction of operating costs. The government received half (realized price + $\frac{1}{2}$ posted price - 3/2 costs), which is equal to 0.5 realized price + 0.25 posted price - 0.75 operating costs.

Assuming a realized price of \$1.40 and posted price of \$1.80 and a cost and amortization of 20¢, this gives a per barrel income of \$1.00 to the government. Income from the consortium based on the same assumption, would have been approximately \$0.80. However, this was only true if NIOC had marketed all of its share of production. According to the agreements for any crude which NIOC did not take up, and which was marketed by the foreign partner, the national company would not get the full sales price, but the "half-way price" (half-way between the cost of production and the sales price). If all NIOC's share was marketed by the foreign partner, the government take based on our previous assumption, could drop to $0.70. The financial advantages of these oil agreements could materialise only if NIOC activtely marketed its share of oil in the international markets.

The importance of joint venture agreements was that for the first time after the consortium agreement, NIOC had access to considerable amounts of oil for its international marketing. NIOC's share became sizeable by the mid-1960's, in contrast to the earlier years when there was not enough oil produced to proceed with marketing crude on its own account (see Table below). NIOC's production referred to in this table refers to the Nafti Shah field, which has nothing to do with the joint ventures.

TABLE VI.2

Annual Production of Oil in Iran 1955-1965

1,000 b/d

Years	Consortium	NIOC	SIRIP	IPAC	NIOC's share of joint ventures
1955	326.0	4.9	-	-	
1956	535.9	5.2	-	-	
1957	716.8	5.4	-	-	
1958	820.2	5.2	-	-	
1959	922.8	5.2	-	-	
1960	1,049.4	6.5	-	-	
1961	1,171.8	8.5	3.0	0.4	1.7
1962	1,301.0	6.5	6.2	0.2	3.2
1963	1,444.0	7.9	14.8	0.2	7.5
1964	1,659.7	6.8	25.0	3.1	14.0
1965	1,807.6	7.6	23.9	46.2	35.0

Source: National Iranian Oil Company. Figures were given in cubic metres and changed to barrels based on 1 barrel equals 0.15.899 cubic metres.

The question is: Why did NIOC not market its share of oil in the joint venture agreements independently? Was it merely a problem of finding markets for this oil, without displacing consortium crude at the same time? Or did the NIOC's managers, after considering all costs involved, decide that the per-barrel revenue out of such marketing effort would not exceed what the company could get from allowing the foreign partner to lift all the production?

It is also possible that for political reasons and relations with other OPEC members, the government did not want its state oil company actively to embark on selling oil at discount while the foreign partner could cut prices without any embarrassment to the government. Finally, it might be argued that NIOC managers did not attempt to persuade the government to agree to such sales, either because they did not have the adequate manpower, or simply because they had no incentive for such projects. After all, discounting could have been done under specific conditions set by the government, and it would not have normally shown in the barter deals. As far as the displacement of the consortium oil was concerned, whether the oil was sold by the national company or by the foreign partner in consortium markets, the effect would have been the same. Before answering some of these questions, one must look at NIOC's activities in the 1960's, and this is what we attempt to do in the next chapter. The international marketing of NIOC in this period will be analyzed in view of the nature of the world petroleum market, which was briefly discussed before.[12]

NOTES

1. The Persian-Consortium Agreement, The Petroleum Times, Supplement to Vol. LVII, No.1492 (reproduced in full from the official version) October 15, 1954, Article 17A (3).

2. Ibid, Article 17B.

3. Ibid., Article 17E.

4. Petroleum Press Service, March 1963, p.104.

5. Petroleum Act 1957 and the Oil Agreements. White Book published by the National Iranian Oil Company in 1965. Article 1.

6. Ibid., Article 2.

7. Ibid., Article 6.

8. Ibid., Article 7.

9. Ibid., Article 9.

10. For further details about these joint venture agreements, see Paul J. Stevens, Joint Ventures in Middle East Oil 1957-1975) Middle East Economic Consultants, Beirut, 1976).

11. Ibid., p.31.

12. See this work, Chapter 2, Part 1.

CHAPTER VII

THE NATIONAL IRANIAN OIL COMPANY IN THE DECADE OF THE 1960's

Second Group of Joint Venture Agreements

Between 1960 and 1965 no new joint venture agreement was signed, mainly due to the dispute over boundaries within the Persian Gulf between Iran, Kuwait and Saudi Arabia. When these disputes were over, new acreage came on to the market which resulted in six new joint venture agreements in February and July 1965.[1] Two of these ventures, namely Iranian Marin International Oil Company (IMINCO) and Lavan Petroleum Company (LAPCO) discovered considerable amounts of oil and started exporting by the late 1960's. IMINCO was a partnership between NIOC 50 per cent, and the foreign partners were AGIP, Philips Petroleum Company and Oil and Natural Gas Commission of India, each 16.75 per cent. NIOC's partners in LAPCO were Atlantic Richfield Oil Company, Murphy Oil Corporation, Sun Oil Company and Union Oil Company, each holding 12.5 per cent.

The basic formula for these new ventures was the same. Royalty was added to these agreements and they carried provisions for buy-back policy. This meant that if NIOC did not wish to take its full entitlement of the crude oil produced, The foreign partners were obliged to buy this back at a halfway price.[2] There were also provisions for interest on capital which the company put in on behalf of NIOC's share of development of the commercial fields.

The government revenues were slightly higher than in the previous joint venture arrangements, as royalty was included in these calcualtions. The government take was theoretically half of the oil at realized prices, minus cost plus income tax and royalty out of the foreign partners' share of production. At the time when these agreements were signed, government take from foreign partners was $\frac{1}{2}$ $\frac{\text{(Posted Price} - \text{Cost} - 0.125 \text{ Posted Price}}{2} + 0.125 \text{ Posted Price)}$. Based on the example of the previous section, i.e. posted prices per barrel of $1.80, market price of $1.40 and cost and amortization at 20 cents, government revenues would be some $1.05 per barrel, which was about 5 cents higher than before. This was again divided into two parts, $0.60 out of sales of its portion of crude at $1.40 and $0.45 out of taxing the foreign partner. As with previous cases, the full financial benefit of joint ventures could come only if NIOC was selling its portion at market prices. If the foreign partner was lifting this oil at the halfway price, which was realized price plus cost divided by two, or $0.80 per barrel rather than $1.40, the per barrel income of the government was about $0.85.

The issue of pricing has always been the most difficult part of negotiations. Export by one of the producers, LAPCO, was reported to be delayed[3] for lack of agreement on prices. This was due to the fact that according to the agreements, government taxes were based on the posted prices, but it was also agreed that certain discounts were allowed, subject to the ratification of a special committee which would be set up for this purpose by the partners. In effect, the discounts on posted prices were so high that the new posting began to approach the level of realized prices. And as this posting was used for tax reference purposes, the government income per barrel was further reduced. For example, IPAC in 1969 posted a price for crude from its offshore Cyrus field at $1.34 per barrel for 18.5-19.4 API oil. Considering 2 cents per barrel per gravity, crude oil with the API of 31^{o} would be $1.58 and 34^{o} $1.64, which was 5 and 15 cents less than the corresponding consortium postings.[4] Some of this oil was sold in Japan at an f.o.b. price of $1.22 for the 33.4^{o} API gravity. Consortium sales to Japan for 34.3^{o} gravity crude oil in the same period averaged $1.46.[5]

These discounts by a newcomer were nothing new in the oil industry, and depended on the nature of the company's outlet for certain types of crude and the strength of the market, together with a variety of other factors. Here we only tried to show that because of discounts, financial advantages of the joint venture agreements per barrel were not very much higher than previous arrangements. What is important for us in this work is the extent of involvement of NIOC in this price cutting, and the way the national oil company chose to use its share of crude oil. During the sixties NIOC attempted to find some purchasers for its portion of crude from the joint venture agreements.

NIOC together with its partner in IPAC, the Pan-American Petroleum Company, entered into a partnership with the Indian government in the Madras refinery, of which the majority of the interest was held by the Indian government. NIOC and Pan-American each had a 13 per cent share in the refinery, and crude oil was supplied by IPAC, their joint venture subsidiary from the Darius field, which had facilities for 100,000 b/d production.[6] This was not the only attempt by NIOC to dispose of its share of the crude out of the joint venture agreements. A barter agreement was reported to have been concluded with Spain. Under this agreement NIOC would supply five million tons of oil from its LAPCO joint venture over a period of five years. Spain would pay for this oil by exporting Spanish industrial goods to Iran.[7] There was also a deal with Argentina for the purchase of 2.2 million barrels of oil in exchange for Argentina's wheat exports to Iran.[8]

To sum up, the joint venture agreements paved the way for the entrance of the National Iranian Oil Company into the world petroleum market. Although a number of agreements were signed between NIOC and prospective buyers, it seems that the national oil company did not fully utilize this opportunity. Another interesting point about the joint ventures is that although theoretically they increased the per barrel income of the government, in practice, considering all the discounts and effects of halfway price transactions between the partners of such ventures, government per barrel revenue was not changed much. On the other hand, government total revenues from the oil sector were considerably increased, and the national oil company also gained sizeable revenues out of its operations. The Table below shows the oil production in the joint ventures between 1962 and 1976.

TABLE VII.1

NET PRODUCTION OF CRUDE OIL IN IRAN'S JOINT VENTURES

(million barrels[a])

YEAR	SIRIP	IPAC	LAPCO	IMINICO	TOTAL	TOTAL IN 1,000 b/d
1962	2.3	-	-	-	2.3	6.3
1963	5.4	-	-	-	5.4	14.8
1964	9.2	1.1	-	-	10.3	28.2
1965	8.7	16.9	-	-	25.5	69.9
1966	8.7	23.2	-	-	31.9	87.4
1967	7.5	36.6	-	-	44.1	120.8
1968	6.6	37.5	5.0	-	49.1	134.8
1969	9.7	37.9	43.6	5.6	96.8	265.2
1970	11.7	33.8	52.9	21.0	119.4	327.1
1971	21.0	45.5	44.1	24.2	139.8	383.0
1972	31.3	49.4	61.4	29.1	171.2	469.0
1973	26.2	46.8	67.2	24.9	165.1	452.3
1974	27.7	48.3	71.0	21.3	168.3	461.1
1975	19.3	64.5	64.0	19.2	167.0	457.5
1976[b]	16.8	75.9	55.5	17.2	165.1	453.0
1977	16.4	99.6	66.4	16.8	199.2	545.7

Source: Iranian Oil Journal relevant years.

a One barrel of oil equals 0.15899 cubic metres.
b 1976 and 1977 production figures obtained from Middle East Economic Survey 10 April 1978.

NIOC's Sales to Eastern Europe

Soon after the Consortium Agreement was signed, and the flow of Iranian oil to the world markets was resumed, the government began pressing for an increase in off-take over what the Consortium Agreement envisaged, and above the average yearly increase in the Middle East. These claims were based on the need of the Iranian government for higher revenue in view of the size of the population and the country as well as political stability especially in the period after the Arab-Israeli war of 1967.

The members of the consortium did manage to keep the rate of increase in Iranian oil production higher than that of the Middle East average. But there were limits to such favouritism, since the companies wanted to keep the other oil exporters happy and it was not in their long-term interest to increase Iranian production at the expense of others. Furthermore, they were aware that the international market could not absorb additional supply without affecting prices (see section on the decade of the sixties, Part I, Chapter 2).

Towards the end of 1966 the Iranian government once more approached the consortium for increased revenues from oil exports. They indicated that if the consortium was unable to guarantee a suitable annual increase in oil revenues, Iran would act to take back some of the areas allocated for consortium operations.[9] These negotiations were mainly concentrated on three proposals:- an off-take percentage increase for the years ahead, relinquishment of part of the Consortium Agreement area and sales of oil to NIOC at cost to market on its own account. The third point was crucial to the operations of NIOC, as it could enhance the company's international role.

The NIOC could have obtained crude oil from a number of sources at cost. These sources at the end of 1966 were as follows:[10]

a) Stated payment (royalty) of 12.5 per cent could have been taken in kind in crude instead of cash. This amounted to nearly 250,000 b/d at the time.
b) SIRIP partnership (50 per cent), NIOC was assigning crude to AGIP in lieu of its share of capital for development. Production was 13,000 b/d.
c) IPAC partnership (50 per cent). NIOC was assigning crude to Pan-American as in SIRIP. Production was 30,000 b/d.

As for the stated payments paid in the form of crude oil, this was consistent with the terms of the agreement, but it was of little value to Iran as far as revenues were concerned. NIOC could not sell this oil at posted prices, and had to discount it at least by 25 per cent to be able to find a customer.[11] The government per barrel revenue from the consortium in 1966 was as follows:

		(Assuming no royalty)
Posted price	$1.79	$1.79
Posted prices considering 6.5 per cent OPEC discount in 1966	1.67	1.67
Less operating cost	0.14	0.14
Less stated payment (12.5%)	0.22	——
Putative company profit before tax	1.31	1.53
Tax (50%)	0.65	0.77
Plus royalty	0.22	——
Government take	0.87	0.77

The revenue of the government from royalty crude oil sales at 25 per cent discount was as follows:

Posted price	\$1.79
Less 25% discount	0.44
Less operating cost	0.14
Government take	1.21

Considering 100 units of oil production, the revenues if all sold to the consortium, would have been (100 x 0.87) = \$87. On the other hand, if sold at 25 per cent discount, the revenues out of 100 units of oil production would have been (12.5 x \$1.21 + 87.5 x \$0.77) = \$82.5. Only if the NIOC could sell this oil at \$1.57 per barrel, or only at 12 per cent discount, would they have secured the same revenue.

Crude oil from joint venture agreements was also not considered for NIOC's direct sales for mainly two reasons. As mentioned before, the NIOC was assigning crude to foreign partners in lieu of its share of capital for development. In addition to that, the foreign partner was ready to lift the NIOC's share at halfway prices, and there would have been little additional revenues per barrel out of NIOC's sale of its portion of crude. What the government wanted was mainly additional revenues which would have eventually meant an increase in the production of oil in Iran.

Needless to say, the members of the consortium were totally against the proposal to allow the NIOC to buy oil at cost from the consortium for its own marketing. This they considered to be a violation of the Consortium Agreement, and a demand which would be pursued by other state oil companies. Furthermore, even the members of the consortium were not allowed, according to the participation agreement among the companies, to lift any amount of oil at cost desired. They had to buy their extra requirements at a halfway price between costs and posted prices.

On 24th October 1966, a Department of State memorandum of conversations on Iranian demands on the consortium, indicated that the companies were not in favour of allocating oil to the NIOC for marketing in Eastern Europe. For example, Mr. Falmer from Texaco, referred to the question of a request for a loan of oil by Iranians, and declared that:[12]

> "If the companies granted this they would be faced with similar demands from all directions. Furthermore the countries would then have the means of going into business and competing with the companies without any investment whatever on the countries' part. He added that we know that as soon as oil is put behind the Iron Curtain it will come back out in competition with companies' production."

Similar views were also expressed by Mr. Law from Gulf Oil Corporation on the same topic. Among the proposals that were circulated during that period concerning the issue of the NIOC's marketing to Eastern Europe, there was one which envisaged the loan of oil to the NIOC for its marketing. This was raised in the briefing paper which preceded the United States-United Kingdom talks about Iranian demands upon the oil consortium, and evaluated as follows:[13]

> ".....A loan of oil to NIOC would provide an out for the consortium members if they want one. It has the advantage of apparently not being contrary to the agreement provisions. Although repayment seems dubious, the participants would be gaining a small mortgage for future bargaining. Also, NIOC might find by practical experience that the grass is not so green in Eastern Europe....."

Probably the best alternative for Iran was that of advancing royalty oil to NIOC as it was not in violation of the Consortium Agreement. The payments could accumulate until the end of the Consortium Agreement, when this "loaned oil" would be repaid either in cash or in kind.[14] This would have given Iran higher revenues and NIOC considerable amounts of cost oil. An agreement was eventually signed between the government of Iran and the consortium. Under the new arrangement, the consortium agreed to relinquish part of the area under the Consortium Agreement. In addition to that, it agreed to make available crude oil "on favourable terms" for the NIOC to market in Eastern Europe. The questions are, what were favourable terms, and what did NIOC get out of this agreement?

The agreement between the consortium and the NIOC was for five years, 1966-1971, inclusive. The crude oil supplied was priced halfway between posted price and cost according to the following formula:

Half the sum of the following:[15]

1. Posted Price
2. Less OPEC discount (6.5% in 1966)
3. Less adjustment for API gravity of crude ($0.002647 per barrel in 1966)
4. Plus operating costs ($0.142 per barrel in 1966)
5. Plus stated payment (12.5% of the posted price)
6. Plus government income tax.

On the basis of posted prices of $1.79 for Iranian light crude oil API 34°, the cost of oil to the NIOC would have been approximately $1.33 per barrel. Therefore, NIOC's profit from the sale of the oil considering the realized market price of nearly $1.40 was between 6 to 7 cents per barrel. In a report published by the NIOC at the end of 1968, the difference between purchase of oil from the consortium and sales to Romania was put at 14,450,00 Rials.[16] It was also reported that the amount of oil sold in 1968 was 2.4 million barrels. These figures gave a profit of 6 Rials per barrel which was roughly 7 cents, and confirms our figures based on the cost of crude oil to NIOC and market price. It must be noted that this oil was allocated for sale to Eastern European countries based on barter contracts, and hence it is very difficult to determine the real sale price of oil in such agreements. But the difference between purchase of oil from the consortium and sales in Eastern Europe, based on a barter deal by the state oil company, does not indicate clearly the sales prices. Again what is important is the government revenues out of these sales, which were between 65 to 75 cents per barrel, and were considerably lower than what the consortium was paying the government at the time. This shows that the government objective was to get more revenues and was ready to accept lower per barrel income.

By the end of 1969, NIOC had made several deals with Eastern European countries: Romania, 10 million tons over five years (following 3.5 million from 1968-70); Bulgaria, 2,375,000 tons 1967-70; Hungary, one million tons a year to begin in 1969. But the closure of the Suez Canal made these shipments uneconomical.[17]

TABLE VII.2

NIOC's EXPORT OF CRUDE OIL
TO EASTERN EUROPE

Year	Amount of crude oil exported Million barrels	 Barrels per day
1968	2.4	6,600
1969	11.3	31,000
1970	18.0	49,400
TOTAL	41.7	

Source: Petroleum Press Service, March 1971, p.109.

In the preceding pages we showed that the government pressure on the consortium to increase oil production in order to obtain more revenues led to a series of negotiations between the companies and the government. As the companies were not able to increase the Iranian oil output at the rate which the government desired, a number of alternatives were suggested, ranging from oil loan on future royalties to relinquishing some areas, etc. This bargaining involved, at times, the United Kingdom and United States governments, with their ambassadors taking part in the negotiations and meeting the Iranian government at the highest level. The idea of allowing the national oil company to buy certain quantities of oil from the consortium came as a compromise solution. Rather than as a commercial project, it was prepared and presented to the government by NIOC as an action designed to enhance the international role of the company.

The price which NIOC would pay for this oil was also determined in this package. It was the same price that the other members of the consortium had to pay for overlifting at the time, although this might have had little relevance as to why this price formula was adopted. The consortium was under the impression that even if overlifting arrangements changed for its members, it ought not to affect the price of oil sold to NIOC. Again this could be seen from the Department of State memorandum of conversations on consortium production plans for 1968-69. In this meeting it was suggested that if overlifting arrangements among the consortium members were changed from halfway price to quarterway price, NIOC, who got oil for barter deals at halfway price, would probably demand the same. To this Mr. John Oliver, a director in the US Office of Fuel and Energy pointed out that:[18]

> "The agreement to give NIOC barter oil was not connected with the overlift agreement; in fact at the time the agreement was concluded it is unlikely that NIOC even knew of the inter-consortium arrangements. And there would be no reason to connect the two at this time."

Throughout these negotiations NIOC's marketing objectives were considered only after allowing for the other main objective, namely to increase revenues for government development plans. It was not NIOC which persuaded the government to enter into such deals, but the government brought in the national company as a vehicle to carry out their policies. It was probably another occasion where the national oil company was called upon to fulfil a political or social task which a private oil firm could not have done.

Contract Agreements[19]

The joint venture agreements were the prevailing type of agreement between the oil companies and the host countries until 1966, when a different arrangement was introduced in the Middle East. In these new agreements, known as "contract agreements", the foreign company was no longer a concessionaire but a contractor to the national oil company for carrying out oil operations. In return, the contractor was allowed to lift a certain proportion of the oil discovered at a price halfway between cost and realized price. The first agreement of this type was signed between the two state-owned companies, namely Enterprise des Recherches et d'Activitees Petroliers (ERAP) and the National Iranian Oil Company in 1966.

The managen nt of the operations, with regard to all matters, was carried out by a subsidiary of ERAP, SOFIRAN, which was registered in Iran. However, the company's budget and the programmes of operation had to be approved by the NIOC, and in this respect the new set-up was not very different from joint venture agreements where partners jointly decided on such matters. ERAP provided the money for exploration activities, with repayments over 15 years at 10 cents a barrel on crude produced, and in case of no oil discovery ERAP would lose its money. This was not very new, either, as the joint venture agreements also required the foreign partner to carry the risk of exploration, which could be recovered only if commercial production was established.

Financing for the development of the discovered oil in the contract agreement was through interest-bearing loans from the foreign partner, with repayment over five years. In the case of the agreement with ERAP, if NIOC did not want to repay in cash, one million tons of crude oil annually was placed at ERAP's disposal and the proceeds at market price, less 2 per cent were credited to loan repayment. Again this was in principle similar to other joint venture agreements, as the share of NIOC for development of the fields was paid out of the proceeds of the operation.

ERAP's agreement differed from the established joint venture agreements mainly in three respects. Once sufficient oil reserves were found, and before any development of such fields, one half of the total oil found was set aside for "national reserve". Such allocation was made by mutual agreement between NIOC and the contractor, and if many oil fields were discovered a number of separate fields were allocated to NIOC. The arrangement did not exist in the previous joint venture agreements which NIOC signed with foreign partners. Availability of such known oil reserves in a defined area could encourage the national oil company to plan a more active role in the marketing of Iranian crude. It must be noted that after signing a new deal with the consortium in 1973 and events of the past few years, the importance of such a provision in the contract agreement does not seem to be as important now as it did in 1966. At that time the national oil company was trying to secure some cost oil for its own marketing, and in this sense this arrangement was superior to that which existed under the joint venture agreements.

Another aspect of the contract agreement which differed from previous arrangements was the guaranteed sales to the foreign partner. ERAP received from 35 per cent to 45 per cent of the output from one half of reserved allocated for development. ERAP paid no royalty, but for the oil lifted it paid operating costs, including amortization and reimbursement of its exploration expenses, plus 2 per cent of these items, plus an amount equal to 50 per cent of the difference between the cost items and the market price. So under the contract agreement the foreign partner gets a smaller proportion of the crude oil produced than the joint venture agreement. As for the income per barrel, as a result of contract agreements based on the oil produced and sold and not considering the reserves kept aside, it was similar to other joint venture agreements. The 50 per cent repayment ERAP made on the basis of market prices, was similar to 50 per cent income tax paid by other companies based on posted prices. This was so because in the past discounts allowed on the posting by the parties in joint venture agreements had, in effect, reached the level of market prices.

Furthermore, ERAP agreed to export at NIOC's request 3 million tons a year for the first five years, and 4 million tons a year for the following five years. In these sales ERAP only got a commission of 2 per cent. In the joint venture agreements, the foreign partner would sell 50 per cent of NIOC's share at "halfway" price. In the contract agreement, ERAP got only 2 per cent fee for marketing, but as the proceeds were used to buy French goods and services, the deal had an element of barter arrangement in it.

Another interesting point about these agreements was that the definition of a commercial field was based on realized prices. In most of the previous agreements, the quantity of oil produced was the basis for deciding if a field was commercial. In the ERAP agreement a field was regarded as commercial if it would afford a return of not less than 20 per cent of "discounted value", i.e., of the "present worth" of 25 years cumulative production valued at the applicable realized price after certain deductions.[20]

Here we do not attempt to evaluate these agreements - a task undertaken by a number of observers before.[21] Such calculations are merely done on the basis of what the government gets per barrel of oil exported. To reach exact figures, for example in the case of ERAP, a number of assumptions would have to be made including the size of the field that might be discovered, the price of oil in future, and the ability of the National Iranian Oil Company to operate its own share of the crude independently. Whether the ERAP contract was more profitable or less profitable than other contracts, we do not know, but it provided NIOC with the hope of getting crude oil at cost and entering the international oil market in 1966. This was a time when the government was in need of more revenues and the consortium could not guarantee the rate of increase in production desired by the government.

The joint venture and contract agreements provided NIOC with a role for the future at the time when they were signed. Without such agreements there was no hope of getting cost oil in the quantities that the company desired until the end of the consortium agreement in 1979. These agreements helped to bring back to life a national oil company which had surrendered its role in the oil business to the consortium in 1954. The negotiations, arguments and bargaining process which is inevitable in such deals, provided ample opportunities for qualified personnel at the national oil company to show their talents, and also to gain valuable experience in the oil business. It was also important for the company to show and justify its role in the Iranian oil industry which had been reduced to something akin to a distributor of petroleum products in Iran, and an operator of non-basic activities for the consortium. It could be argued that as a result of expansion in the operation of the company and the accumulation of experience in active oil negotiations and trading, NIOC secured a larger role for itself with regards to formulation of an over-all Iranian oil policy.

Furthermore, the contacts with a variety of different companies and entry into partnership with more than thirty independent and state oil companies at the same time, provided NIOC with a chance to get ample information and technical know-how in exploration development and, to some extent marketing of crude oil during this period. Whether the national oil company fully utilized this opportunity to learn, or whether it behaved passively in all the activities involving it, cannot easily be determined. Be that as it may, the changes which occured in the structure of the oil industry during the early part of the seventies, presented NIOC with an opportu-nity to fulfil its dream of becoming a commercially oriented company with a role to play in the international oil business.

FIRST GROUP OF SERVICE CONTRACTS

Companies operating	Companies comprising Second Party			Effective Date	Duration	Ownership of Wellhead
SOFIRAN	Enterprise des Recherches et d' Activitees Petroles (ERAP)		80%	6th December 1966	25 years	100% NIOC
	Societe Nationale des Petroles d'Aquitaine (ERAP 52.78%, Private 47.22%)		20%			
EGOCO	ERAP	French	32%	6th June 1969	25 years	100% NIOC
	AGIP	Italian	28%			
	HISPANOL	Spanish	20%			
	PETROFINA	Belgian	15%			
	OEMI	Austrian	5%			
CONIRAN*	Continental Oil Company US.		100%	4th June 1969	25 years	100% NIOC

Source: Iran Oil Mirror, 1969 (Published by NIOC)

* Philips Oil Company bought 50 per cent of Continental Oil Company's holdings, and Cities Services Petroleum Corporation bought 25 per cent (2974). The name of the operating company was therefore changed to PHILIRAN.

NOTES

1. For details of these agreements see: F. Fesharaki, Development of the Iranian Oil Industry, (Praeger, New York, 1976), pp.74-75.

2. P.L. Stevens, Joint Ventures in Middle East Oil 1957-75, (Middle East Economic Consultants, Beirut, 1976), pp.31-32.

3. Petroleum Press Service, March 1967, p.103.

4. Ibid., p.103.

5. Ibid., p.103. See also Petroleum Intelligence Weekly, December 19th, 1966.

6. Petroleum Press Service, August 1965, p.308.

7. Petroleum Press Service, December 1969, p.452.

8. Petroleum Press Service, March 1966, p.92.

9. Multinational Corporations and US Foreign Policy. Hearings before the Sub-Committee on the Multinational Corporations of the Committee on Foreign Relations, United States Senate (Washington, Government Printing Office 1974), Part 8, p.564.

10. Petroleum Press Service, December 1966, p.457.

11. Multinational Corporations and US Foreign Policy, op.cit., Part 8, p.567.

12. Ibid., p.572.

13. Ibid., p.567.

14. Ibid., p.586.

15. Ibid., p.575.

16. NIOC, Annual Report 1968, p.3.

17. Petroleum Press Service, December 1969, p.452.

18. Multinational Corporations and US Foreign Policy, op.cit.,

19. For detailed information about these agreements see: Petroleum Press Service, September 1966, pp.324-327, also Petroleum Press Service, February 1967, pp.59-62, also Petroleum Press Service, March 1969, pp.99-102, also Service Contract Agreements published by NIOC.

20. Petroleum Press Service, February 1967, p.60.

21. Rafael S. Macia, "Economic Evaluation of Petroleum Agreements and Contracts", Middle East Economic Survey Supplement to Vol.XV, July 21, 1972.
T. Stauffer, "The ERAP Agreement. A Study in Marginal Taxation Pricing", presented to the sixth Arab Petroleum Congress in Baghdad, December 1966.
P. Mina, "Changes in the Principle of Oil Contracts", Iran Oil Journal, February 1969.
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CHAPTER VIII

THE NEW ROLE OF NATIONAL IRANIAN OIL COMPANY AND ITS PRESENT POLICIES

In Chapter 4 we discussed the events which led to the nationalization of the oil industry in Iran and the formation of the national Iranian oil company in 1951 as a joint stock commercial company entrusted with undertaking all oil operations in Iran. NIOC failed to market Iranian crude oil and petroleum products after the nationalization mainly due to the conditions prevailing in the petroleum market at the time, and the political dispute which arose between the United Kingdom and Iran after the nationalization of the Anglo-Iranian Oil Company (see Chapters 1 and 5). The Consortium Agreement of 1954 did not reverse the nationalization act, but reduced the role of the national oil company to non-basic activities within the consortium agreement area (see Chapter 5). However, the company was in charge of sales of petroleum products throughout the country, and its role in the Iranian oil industry was further reinforced by the Petroleum Act of 1957 which gave NIOC the sole property rights to the petroleum industry in Iran.

In the previous chapters we discussed the joint venture and service contract agreements which NIOC pioneered in the Middle East. These agreements, together with the sales of crude oil to the Eastern European bloc countries, could be seen as a sign of the gradual restoration of the national oil company's role after the consortium agreement. Also there was a need for this change of role in view of the events occuring in the international oil industry in 1971 and 1972.

In July 1971, three more joint venture agreements were signed between NIOC and foreign oil companies as follows:

a) National Iranian Oil Company and a Japanese group (Teijin Ltd., North Sumatran Oil Company, and Mitsubishi Shoji Kaisha Company) formed a joint venture company by the name of Iran Nippon (INEPCO) to explore and develop oil in the Lurestan area.

b) NIOC and Mobil Oil Corporation formed the Hormuz Petroleum Company (HOPECO) offshore near to the Strait of Hormuz.

c) NIOC and Amerada Hess Corporation, and independent US oil company, set up the Busheha Petroleum Company (BUSHCO) offshore near Busheha.

These agreements contained more favourable terms for Iran compared to previous joint ventures. They provided for the royalty payments by the foreign partners to NIOC, and the period of exploration was reduced to six years from the previous twelve. Furthermore, the foreign oil company was obliged to take any quantity of crude oil made available by NIOC as its share of crude off-take, a provision which was voluntary in the previous joint venture agreements. There were also other advantages attributed to these new agreements with regard to cash bonuses, loan repayments, arbitration, etc,[1] which were mainly due to changing circumstances in the company-government relationship, but also showed that NIOC was now putting to use the experience gained from earlier joint venture agreements.

The Sale and Purchase Agreement of 1973

By the end of 1972 it was evident that the world petroleum market was changing from the "buyer's market" that had prevailed throughout the 1960's, to a "seller's market". The projection of high demand for the petroleum products based on the 1960's trend was not matched by anticipated growth in the supply at the time (see Chapter 3). In addition to that, the issue of participation of some oil states in the oil producing companies in their country was eventually finalized. Iran, which had nationalized its oil industry and had paid full compensation in the early fifties, was not a party to these negotiations. But partly due to the market conditions, and as a result of buy-back arrangements between the oil companies and the countries opting for participation, their per barrel yield of exported crude exceeded that of Iran under the consortium agreement. The participation crude was sold at prices higher than had been anticipated earlier, and so the oil states involved obtained additional revenues.

On 23rd January 1973, the Shah gave oil company members of the consortium two alternatives to choose from - either to agree to a full take-over by Iran of the consortium in return for a long term "secure" purchase contract, or the termination of the contract in 1979 provided Iran's financial yield per barrel until then was not less than other oil producing countries under the participation agreement. At the time Iran's three major demands from the consortium were additional investment by the consortium to expand its production capacity to 8 million barrels per day, allocation of a certain amount of crude (at prices near to tax paid cost) to NIOC for its marketing, and a per barrel revenue as high as the other producers in the area.[2]

All these demands and other relevant issues could have been settled under the old consortium agreement, apart from the full control over the oil industry. The Arabs, under participation agreements, had achieved an eventual 51 per cent control of their oil industry, and Iran could not attain that under the old consortium arrangement. So the negotiations to change the consortium agreement were not to give NIOC a more important role worldwide, but to protect Iran's interest with regard to both revenues and more control in the country's oil industry.

In July 1973, after lengthy negotiations, a new 20 year sales and purchase agreement was concluded between Iran and NIOC as one party, and all members of the international consortium as the other, replacing the 1954 consortium agreement.[3] Under this new agreement the National Iranian Oil Company, for the second time, became responsible for all the oil operations in Iran. As mentioned before, NIOC acquired this role when it was formed in 1951, but delegated all its operating responsibilities to the consortium within the agreement area in 1954. The scale of the company's operations as a result of this agreement was expanded considerably, and the company as "owner-operator' in the area became responsible for most of Iran's oil production.

Consortium members in return got security of supply for 20 years based on OPEC prices and compensation on unamortized facilities in the form of depreciation credits.[4] In order to make the terms of payment unaffected by future changes in the company-government relations elsewhere, a "balancing margin" was introduced in the price the companies paid for the oil lifted. This was in addition to the operating costs and the stated payment (12.5 per cent of posting) and was described in Article 6(3) of the agreement as[5] "the level of which, when taken together with all other financial and fiscal benefits accruing to Iran and NIOC, will be such as to assure Iran that the total financial benefits and advantages to Iran and NIOC under the Agreement shall be no less favourable than those applicable (at present or in future) to other countries in the Persian Gulf under the General Agreement and related arrangements". The companies were further paid interest on investment by NIOC and agreed to advance to NIOC 40 per cent of the funds required for capital expenditure for the first five years of the agreement.[6]

The National Iranian Oil Company for the first time planned an oil production policy for the former consortium area taking into account the production capacity of the oilfields, NIOC's commitment under the new agreement, internal consumption and its own crude export. The following table shows the anticipated production of crude oil from the former consortium area and its disposition between 1973-1993 as described by Dr. F. Fallah, who was the Director in charge of Technical and International Affairs of NIOC in June 1973.[7]

TABLE VIII.1

DISPOSITION OF IRANIAN CRUDE OIL PRODUCTION 1973-1993
(thousand b/d)

Year	Sale to Consortium	Internal Consumption	Export by NIOC	Total
1973	4,833	284	200	5,317
1974	5,074	304	300	5,678
1975	5,515	352	450	6,317
1976	5,959	388	600	6,947
1977	6,422	428	750	7,600
1978	6,237	463	900	7,600
1979	5,994	506	1,100	7,600
1980	5,764	550	1,300	7,614
1981	5,498	602	1,500	7,600
1982	5,445	655	1,500	7,600
1983	5,390	710	1,500	7,600
1984	5,342	771	1,500	7,613
1985	4,060	851	1,500	6,411
1986	2,970	929	1,500	5,399
1987	2,027	1,010	1,500	4,537
1988	1,364	1,090	1,259	3,713
1989	1,058	1,171	1,251	3,480
1990	704	1,251	704	2,659
1991	441	1,329	441	2,211
1992	211	1,410	210	1,831
1993	8	1,490	8	1,506

Source: Middle East Economic Survey, June 29, 1973, pp.2-3.

The new agreement provided for the take-over of the Abadan refinery, the major export oriented refinery in Iran, by the national oil company. Again, NIOC would process up to 300,00 barrels per day of crude for the consortium under a twenty year processing agreement.[8] But the trading companies kept the right of giving NIOC notice if they wished to process less than the above amount at the Abadan refinery.

Further discussion of the details of this agreement is not relevant to this study, although its importance cannot be underrated. As a result of this agreement the role of the National Iranian Oil Company was dramatically changed, and it could be argued that for the first time in two decades NIOC realized the chance to become an international oil company.

The Petroleum Act 1974

The sale and purchase agreement was finalized in the summer of 1973. In October 1973 war broke out between the Arabs and Israel, and in the same month OPEC decided to increase the price of crude oil unilaterally (see Chapter 3). The oil embargo and a subsequent increase of crude oil price in December 1973 by OPEC, changed the structure of the international oil industry. NIOC's auction of oil in December 1973 attracted prices of up to $17 per barrel,[9] and was one of the reasons for Iran's insistance on a price rice. NIOC, in principle, was operating under the Petroleum Act 1957 (see Chapter 6) which was no longer adequate considering the changes in the world petroleum market. The new role which NIOC had to play on behalf of Iran required a more up to date framework. After all, the Petroleum Act of 1957 did not give NIOC the power to engage in exploration and production inside the former consortium area, and even in this respect the formalization of a new petroleum act was necessary.

The new petroleum act was passed by the Iranian parliament in August 1974. This act consists of 30 articles dealing with a variety of issues concerning the Iranian oil industry. Article 1 of the act defines the different terms used in the oil agreement, such as "Service Contract", "Sale Contract", area, etc. Article 2 describes the powers and duties of the National Iranian Oil Company as follows:[10]

> The National Iranian Oil Company shall have the responsibility to carry out the duties and to exercise the rights and powers prescribed in this Act and to exercise control over implementation thereof. In performance of the said responsibility, the National Iranian Oil Company shall act according to its legal statute.

Article 3 states the exclusive authority of NIOC to conclude contracts on behalf of Iran, and determines the framework for such contracts:[11]

> 1. The Petroleum resources and the Petroleum Industry of Iran belong to the Nation. The exercise of sovereignty right of Iranian Nation over the Petroleum resources of Iran with respect to the exploration, development, production, exploitation and distribution of Petroleum throughout the country and its continental shelf is entrusted exclusively to the National Iranian Oil Company who shall act thereupon directly, or through its agents and contractors.

2. In order to carry out the exploration and development of Petroleum within the open Petroleum Districts, the National Iranian Oil Company may negotiate with any person, whether Iranian or foreigner, and may prepare and execute any Contract which it may deem appropriate on the basis of Service Contract and in conformation with the provisions and stipulations of this Act. Such contracts shall be put into effect after their approval by the Council of Ministers.

3. For the purpose of establishing refineries and refining Petroleum within the country, the National Iranian Oil Company may act directly or through participation with any persons whether Iranian or foreigner. The participation arrangements made for this purpose shall be subject to the following conditions:-
   a) The National Iranian Oil Company shall never hold less than 50 per cent of such participations.
   b) The period of participation in each contract shall be determined by the National Iranian Oil Company, but such period shall not exceed 20 years in any case.

4. The entire crude oil delivered to the refinery under Section 3 above shall be priced at the current market price and the refinery profits shall be subject to Iranian income tax.

5. For the purpose of carrying out Petroleum Operations outside Iran, the National Iranian Oil Company may participate with any person and in any way it deems appropriate. The provisions of this Act shall not be applicable to the operations of the National Iranian Oil Company abroad.

Articles 4 and 5 set out the declaration of open districts and the manner in which the foreign oil company bids must be made. Article 6 gives NIOC the "full and complete authority to accept or to reject any or all of the bids received".[12] The priority would be given to those firms which especially undertake to carry out refining operations within the country, and ensure, or at least facilitate, the entry of the National Iranian Oil Company into various stages of transportation, refining, distribution and sales of oil in the world market[13] (Article 7).

Articles 8-12 deal with the regulations concerned with signing of a service contract agreement, measurement of the area of operation, the period of the service contract, the obligations of the parties involved and the petroleum sale contract in case of commercial discovery. The rest of the articles in the Petroleum Act 1974 set out the framework for all the aspects concerning the service contracts and provides a basis for settlement of disputes, conservation measures, land acquisition, etc. Determination of the price is left to the National Iranian Oil Company according to Article 30 of this act.[14]

1. Notwithstanding any contrary provisions in the existing contracts, the National Iranian Oil Company shall determine the prices which shall be the basis for computation of royalty (stated payment) and income tax of crude oil and natural gas, and declare same in each case after their approval by the Council of Ministers.

2. The National Iranian Oil Company is authorized to determine and declare, in each case, the prices which shall be the basis for computation of income tax of petroleum products.

3. For the purpose of stabilizing the value and maintaining the purchasing power of foreign exchange accruing to Iran from the sale of oil and gas, the National Iranian Oil Company shall be authorized to take any action and make any agreement with the approval of the Council of Ministers.

4. All measures taken by the Government with respect to the foregoing three paragraphs; prior to the ratification of this Act are hereby approved and confirmed.

5. The National Iranian Oil Company shall be empowered to prepare the regulations and provisions required for the implementation of this Act, and to put them into effect after their approval by the Council of Ministers.

6. Upon the ratification of this Act, the Act concerning the research, exploration and extraction of oil throughout the country and continental shelf ratified in Mordad 7, 1336, shall be repealed and substituted by this Act.

The Statute of the National Iranian Oil Company

The new petroleum act outlined the responsibilities and power of the National Iranian Oil Company, which was entrusted with the exclusive right of carrying out all petroleum activities in the country and its continental shelf. Consequently a new legal statute was drawn up for the company determining NIOC's objectives, functions, organization and relations with the government. Here the significant parts of this statute as far as this work is concerned are mentioned.

The Statute of the National Iranian Oil Company was passed through the Majles on 22nd August 1974, and consisted of three chapters and sixty-two Articles. Chapter One deals with general provisions and capital of the company, and contains three Articles as follows:[15]

1. The National Iranian Oil Company, incorporated under the Act of ordibehesht 9th, 1330 (April 30th, 1951) and hereinafter called "the Company" is a joint-stock commercial company which shall carry out its operations with due regard to the functions, rights and powers provided for in the Petroleum Act approved on Mordad 8th, 1363 (July 30th, 1974) and in other special laws concerning oil, gas and petrochemicals, in accordance with the provisions of this Statute. In cases where no provision has been made in this Statute or in the aforesaid Acts, the provisions of the Commercial Code shall apply.

2. The registered Office of the Company is in Tehran. The Company may establish branches and agencies in Iran or abroad for the conduct of its operations.

3. The capital of the Company is one hundred thousand million Rials divided into ten thousand registered shares of ten million Rials each of which fifty per cent has been paid up. All the Company's shares belong to the Government of Iran and are non-transferable.
Note: Five thousand million Rials of the Company's paid-up capital has been paid by the Government and the remaining forty five thousand million Rials has been provided out of the credits received by the Company from the Plan Organization and transferred to the capital account. The holder of the shares has undertaken to pay the unpaid portion of the capital at the request of the Board of Directors and with the approval of the General Meeting. Any increase in the capital shall be subject to the request made by the Board of Directors, and to the confirmation of the General Meeting and final approval by the Council of Ministers.

Chapter Two of the Statute of NIOC consists of nine articles (4-12) outlining the objectives of the company, its functions in the Iranian oil industry and its legal rights and powers. Article 4 states the objectives of NIOC as follows:[16]

> The object and the principal function of the Company is to exercise the ownership right of the people of Iran in connection with oil and gas reservoirs throughout the Country, as well as in the continental shelf thereof, and to engage in oil, gas, and petrochemical industries operations as well as in related industries within the country and abroad as follows:
>
> a) To search, prospect, survey, explore, extract and produce, transport and refine crude oil, natural gas and other natural hydrocarbons (both liquid and solid); to manufacture and process all kinds of the main petroleum products such as gas and liquid gas, and gas derivatives, and various kinds of petrol, kerosene, gas oil, fuel oils, bitumen, asphalt and any other oil products which produce energy; to carry out also all kinds of operations for the marketing, transportation, distribution, export and sale of the said products in Iran and abroad.

Note: The exercise of functions mentioned in this Section throughout the country and in the Continental Shelf shall be exclusively undertaken by the Company, except where other firms have been or shall be in future authorized, by virtue of separate enactments, to participate in some of these operations; in which case the Company shall exercise full control over them to ensure the efficient conduct of such operations.

b) To manufacture by-products and oil derivatives such as motor oil, grease, paraffin, vaseline and to transport, distribute, export and sell them throughout the country and abroad.

Note 1 - Engagement in the operations mentioned in this Section by private persons and firms shall in all cases be subject to the Company's approval and to the obtaining of a special permit from the Ministry of Industries and Mines. The Company shall, however, exercise the necessary control to ensure that the quality of such products conforms to the international standards. Prices for these products shall be determined by the Ministry of Industries and Mines after consultation with the Company.

Note 2 - In the event that private persons and firms engaging in the manufacture of oil derivatives and by-products mentioned in the above note, produced, in the course of their operations, a certain quantity of the main products mentioned in Section (A) above, which may be exclusively produced by the Company, the distribution, sale and export of the said products shall in each case be subject to the Company's permission and shall be effected in accordance with regulations to be notified by the Company.

c) To make efforts and take appropriate measures for the development and progression of the Oil Industry, and in the related industries from scientific, technical, commercial, economic and other points of view and to make the necessary plans for the proper exploitation of the proven deposits.

d) To conserve the subterranean oil, gas and other hydrocarbon deposits and to do whatever is necessary to prevent these minerals throughout the country and in the Continental Shelf thereof from being wasted.

e) To engage in various branches of petrochemical, gas and the related industries.

f) To engage in such developmental and agricultural activities as are deemed necessary for the oil operations in the Company's operational areas. The Company shall also be authorized to conduct other industrial and commercial activities by the consent of the Shareholders General Meeting.

Article 5 of the Statute of NIOC gives details of the rights and powers entrusted to NIOC to carry out the above objectives. Following are some of these rights chosen from Article 5:[17]

> a) To establish Subsidiary and Affiliated companies, branches and agencies in Iran and abroad or to dissolve them.
> b) To enter into co-operation and partnership agreements with individuals and firms in Iran and abroad and to purchase and own shares in other companies with the right to sell or transfer them.
> c) To buy, sell, lease or take on lease movable and immovable property of every description, and to acquire any property or right which may be tranaferred to the Company under the laws of the country.
> d) To obtain and grant credits and loans within the Country or abroad for the purpose of achieving the Company's objectives.
> Note 1 - The granting of loans and credits abroad and or the obtaining of loans and credits from abroad shall be subject to the approval of the General Meeting of the Shareholders' Representatives.
> Note 2 - The granting of loans and credits in the Country shall be within the limits of the Company's approved budget.
> e) To conduct technical, scientific, commercial and economic studies and researches.
> h) To execute employment, contracting or consulting agreements with firms or individuals, both Iranian and expatriate.
> k) The Company may, whenever it deems expedient, have some of its operations carried out by agencies or contractors.

Article 6 provides NIOC with the legal framework to seek government support in securing the necessary legislation for the future operation of the company:[18]

> Whenever the execution of the operations of the Company or of any of its subsidiary or affiliated companies requires Government approval or the taking of any action on the part of Government the Company shall submit the necessary proposals to the Prime Minister for his appropriate instruction. Legal bills related to the Company shall be submitted to the Houses of Parliament by the Prime Minister or a Minister of State appointed by him.

The law governing the NIOC's income tax liability to the Treasury is stated in Articles 9 and 10 of the Statute as follows:[19]

9. The company's as well as its subsidiary and affiliated companies' income tax shall be collected on their net profits at the rates and in accordance with statutory regulations pertaining to income tax applicable to oil companies. No other taxes, charges, duties, etc., whatsoever shall be collected from the Company, its subsidiary and affiliated companies over and above those which may be collected from oil companies in accordance with the provisions of the law. Profits earned by the Company, its subsidiary and affiliated companies, derived from non-oil operations, shall be subject to the State's general taxation regulations.
Note 1 - Charges and fees imposed, by virtue of the law, by Government or local authorities for services rendered by them at the request of the Company or its subsidiary and affiliated companies for services rendered to the public generally, shall be payable by the Company, as well as its subsidiary and affiliated companies.
Note 2 - The Pension and Saving Funds of the Iranian employees of the Oil Industry, as well as retirement pensions paid to the Company staff employed shall be exempt from payment of any taxes. The interest payable on Pension and Saving Funds deposited with Iranian banks as well as the interest payable on loans granted out of the said Funds to Oil Industry staff or to the Company or its subsidiary and affiliated companies shall also be exempt from taxes.

10. The Company may, out of its revenues in foreign exchange and within the limit of its approved budget pay its foreign exchange expenses and commitments incurred in Iran and abroad. The Company shall, at the beginning of each year, obtain the overall approval of the Foreign Exchange Control Authorities for utilizing its annual exchange allocations, and shall submit quarterly statements of its foreign exchange expenditures to the said Authorities and to the Treasury General.

The rest of the Articles in Chapter Two, namely Articles 11 and 12 deal in detail with the acquisition of land, water and other materials needed by the company. Chapter Three is concerned with the company's organization, which is basically divided into three main sections according to Article 13.[20]

1. General Meeting of Shareholders' Representatives
2. Board of Directors and the Managing Director
3. High Board of Inspectors

Article 14 of the NIOC's Statute states that the shareholders shall be represented at the General Meeting by the following:[21]

1. The Prime Minister
2. The Minister of Economic Affairs and Finance
3. The Minister of Energy
4. The Minister of Industries and Mines
5. The Minister of Labour and Social Services
6. The Minister of State and Director of the Plan and Budget Organization
7. Another Minister to be nominated and introduced by the Prime Minister

Note 1 - The General Meeting shall be presided over by the Prime Minister and in his absence by one of the Ministers present at the General Meeting previously nominated and introduced by the Prime Minister.
Note 2 - In the event that any of the Ministers who is a member of the General Meeting is unable to attend one of the meetings, his substitute for the same meeting shall be nominated by the Prime Ministers from among other Ministers.

Articles 15 to 43 give functions and regulations concerning the General Meeting of shareholders' representatives, the Board of Directors and the Managing Director and the High Board of Inspectors. The main Articles concerning the balance sheet and profit and loss account are Articles 47 to 53, which are as follows:[22]

47. The Company's assets as shown on the Balance Sheet shall be evaluated at the purchase or cost price less depreciation. Doubtful claims shall be evaluated at their contingent value on the date of drawing up the Balance Sheet. Bad debts shall not be included in the assets.
Note 1 - Should the Board of Directors deem it necessary that whole or part of the Company's assets should be reappraised, it may, subject to the approval of the General Meeting, take measures for a reappraisal, and and any increase or decrease in the value resulting therefrom shall be transferred to the Special Reserves Account referred to in Article 49.

Note 2 - The rate of depreciation in respect of various types of the Company's assets shall be determined in accordance with sound principles practised in Oil Industry, and shall be applied after being approved by the Board of Directors.

48. The Company shall transfer to the General Reserve Account every year 1% of its total income.

49. The Company shall, subject to the approval of the General Meeting, set aside from its total revenue appropriate ammounts as special reserves to meet the Company's requirements according to the Oil Industry practice.

50. By the total revenue is meant the net profit plus the royalty (stated payment) and funds earned by the Company as bonus, rental, and refund of exploration expenditure as well as any amount earned from subsidiary and affiliated companies as their net profit after payment of their income tax.
Note 1 - Net profit means the income derived from the sale of crude oil, natural gas and other products as well as from Company's other direct operations less current expenditures and depreciations.
Note 2 - The Company shall draw up a regular quarterly report showing its estimated income for the next quarter and dispatch the same to the Minister of Economic Affairs and Finance.

51. The Company's revenues from the stated payment and the amounts earned by the Company as bonus and rental shall not be taxable.

52. The Company shall provide out of its total income and within the limit of its approved budget the capital required for the expansion of the Company's operations as well as for any other kind of investment, and in case the said income does not suffice, the General Meeting shall provide the same from any other source deemed appropriate.

53. Any balance remaining from the total income after deduction of the amounts which are paid in accordance with the provisions of this Statute shall be paid over to the Treasury General.

The remaining nine Articles of the NIOC's Statute deal with miscellaneous provisions. For instance, Article 59 deals with cases where a difference of opinion arises between the company and

Ministries, and Article 60 prohibits company employees from engaging in political activities within NIOC.[23]

> 59. In cases where a difference of opinion may arise between the Company and any of the Ministries, Organizations affiliated to the Government, or municipalities, the matter shall be reported by the Company to the Prime Minister, and the latter shall refer the matter in dispute to a committee composed of the representatives of the Prime Minister and those of both parties. The said committee shall endeavour to settle the dispute amicably, but if the dispute is not settled in this manner, the case shall be referred to the Council of Ministers, whose decision shall be binding on both parties.
>
> 60. Company employees shall have no right to engage in political activities in the Company's offices and places related to the Company's business. Nor shall they be permitted to hold meetings in the said offices and places, without prior permission from the Company. Furthermore, the foundation and publication of political newspapers and magazines and membership of the editorial board of this category of the press as well as publication of political articles by the Company employees shall be prohibited. Moreover, publication of any kind of information concerning the Company's operations shall be prohibited except by written permission of the Company. Those employees violating the provisions of this Article shall be liable to administrative and disciplinary action according to the Company's regulations.

Operations of the National Iranian Oil Company

The National Iranian Oil Company directs, controls and co-ordinates the activities of numerous entities of varying size and function active in the Iranian oil industry. The companies involved in the Iranian oil industry, apart from the wholly-owned subsidiaries of NIOC, are either joint venture companies in Iran and abroad, or major contractors of NIOC. The wholly-owned subsidiaries of NIOC are as follows:[24]

National Iranian Gas Company[a]
National Petrochemical Company[a]
National Iranian Tanker Company
Abwaz Pipe Mills
Iran Oil Company
Iranian Oil Company UK Ltd.
Iranian International Oil Company (USA)

NIOC's joint venture companies based on 50-50 equity basis in Iran are:[25]

Societe Irano Italienne des Petroles (SIRIP)
Iran Pan-American Oil Company (IPAC)
Iranian Marine International Oil Company (IMINCO)
Lavan Petroleum Company (LAPCO)
Iran Nippon Petroleum Company (INPECO)
Hormoz Petroleum Company (HOPECO)

The joint venture companies outside Iran in which NIOC participates are:[26]

Madras Fertilizer Company
Madras Refinery Ltd.
National Petroleum Refineries of South Africa

The companies acting as major NIOC contractors are listed in the following table.

a The statutes of these two companies have recently been changed and the available information suggests that they have now been given full independence and legal framework.

TABLE VIII.2

COMPANIES ACTING AS MAJOR NIOC CONTRACTORS

Service Contractors to NIOC	Owners	Per cent Share
Oil Service Company of Iran (private company)	Owned by Iran Oil Participants Ltd., which in turn is owned as follows:	
	British Petroleum	40
	Royal Dutch Shell	14
	Compagnie Francaise des Petroles	6
	Exxon	7
	Gulf Oil	7
	Mobil Oil	7
	Standard Oil of California	7
	Texaco	7
	Iricon Agency Ltd.	5
Total Iran	Compagnie Francaise des Petroles (CFP)	100
European Group of Oil Companies (EGOCO)	Enterprise de Recherches et d'Activiteas Petroliers (ERAP)	32
	Hispanica de Petroles SA (Hispanoil)	20
	Petrofina	15
	Oestevreichischt Mineralolverwaltung (OEMV)	5
	AGIP	28
Phillips Petroleum Company of Iran (PHILIRAN)	Phillips Petroleum Company	50
	Continental Oil Company	25
	Cities Service	25
Ultramar Iran Oil Company	American Ultramar Ltd.	100
SOFIRAN	ERAP	40
	Mitsubishi Oil Development Company	40
	Societe Nationale des Petroles d'Acquitaine	20

TABLE (continued)

Service Contractors to NIOC	Owners	Per cent Share
DEMINEX Iran Oil Company	Deutsche Erdolversorgungsgesellschaft mbh (DEMINEX)	100
AGIP Iran Petroleum Company	AGIP	100
Lar Exploration Company	Ashland Oil Company Pan Canadian	

Source: Petroleum Industry in Iran, published by Iranian Oil Industry Public Relations Affairs

Exploration and Production: NIOC's exploration activities started in 1954 when, under the revised statutes, it took over another state-owned company, the Iran Oil Company, which had been formed before nationalization to carry out exploration outside the Anglo-Iranian concession area. Oil was discovered near Qum, 80 miles from Tehran, in 1956, but further development proved that this discovery was not up to expectation for commercial exploitation. Apart from Qum, NIOC discovered the Sarajeh gas field near Tehran, Sarakhs near Mashhad and Tang-e-Bijar near Kermanshah.[27]

The present exploration activities in Iran are mainly carried out by the foreign companies working under contract to NIOC. The exploration and development of oilfields in the agreement area (most of the former consortium area) is carried out by the Oil Service Company of Iran, whose composition was given at the beginning of this section. Apart from the Oil Service Company, there are also other foreign oil companies who have signed service contract or joint venture agreements with NIOC and are involved in exploration activities in different parts of the country.

NIOC's own exploration and production development is concentrated mainly outside the above mentioned agreement areas. The company's policy in the past years has been to leave the risky business of exploration to the foreign oil companies whenever possible. However, the exploratory programmes of the existing joint venture and service contracts, under the agreements signed, are gradually ending and many areas will be returned to NIOC during the next five years. The twelve year exploration period of all the joint venture agreements signed in 1965 and that of the first service contracts are already over. NIOC would probably offer relinquished and new areas in the coming years to foreign oil companies to maintain the present exploration momentum in the country. The terms of the offer would be framed in such a way as to attract foreign oil companies' capital and expertise into exploration in Iran.. But this does not mean the absence of NIOC's control during the exploration period and its outright and full ownership of the oil discovered. Under these conditions it would probably unwise for NIOC to conduct all explorations on its own, even if the company had adequate expertise and the required capital for such an undertaking. At present NIOC's own exploration and development activities are concentrated on the Sarvestan oil field near Shiraz, and the Khangiran gas field near Mashad.

The production capacity of the southern oil fields reached 6.2 million barrels per day after considerable development drilling in various fields during 1976 and 1977.[28] Oil production in Iran is at present carried out by NIOC and some of its joint venture companies. It must be noted that after the sale and purchase agreement of 1975, NIOC became the owner-operator of the Khuzestan oil fields, an area somewhat snaller than what had previously been known as the consortium area. NIOC domestic requirements of crude oil are supplied mainly from this area. The remainder of the oil produced is available for export by NIOC and the former consortium members. The table below shows the crude oil production in Iran since NIOC became owner-operator in Khuzestan province.

TABLE VIII.3

CRUDE OIL PRODUCTION IN IRAN 1973-1977
(Thousand Barrels Daily)

	1973	1974	1975	1976	1977
NIOC Khuzestan Fields Oil Service Company of Iran	5,392	5,577	4,875	5,412	
NIOC Naft-e Shah	17	18	17	18	
Joint Ventures					
Iran Pan-American Oil Company (IPAC)	128	132	175	207	
Societe Irano-Italienne des Petroles (SIRIP)	72	76	175	152	
Lavan Petroleum Company (LAPCO)	184	195	53	45	
Iran Marine International Oil Company (IMINICO)	68	58	53	47	
TOTAL	5,861	6,056	5,349	5,883	5,663

Source: Middle East Economic Survey, Crude oil production statistics relevant years

The most ambitious and expensive project in the southern oil fields in the gas gathering, NGL recovery, and gas injection programme. This programme is aimed at increasing productive capacity and ultimate recovery rates in the major Iranian oil reservoirs by between 5 to 10 per cent. It is estimated that with the implementation of this programme, the productive capacity of these fields will be maintained at around 6 million barrels per day until 1983.[29]

In addition, this undertaking eliminates the wasteful flaring of the associated gas which was approximately 1 trillion cubic feet in 1976 (nearly three times the amount of gas sold to the USSR in the same year) and ensures adequate supplies of NGL's for petrochemical feed stocks, export and use in Iran. Nearly half of the gas for these programmes, which might be up to 2.9 trillion cubic feet a year by 1982, will be associated gas produced in conjunction with the crude oil from the existing oil fields. Additional quantities of non-associated gas will be required for the full implementation of this programme which might require up to 4.7 trillion cubic feet a year in the late eighties. It must be noted that much of the gas injected to enhance recovery of oil can be recovered over a period of years, and consequently this programme is the best way of storing associated gas which would otherwise be flared.[30] The following tables show the production and consumption of natural gas in 1976, and Iran's gas potential.

TABLE VIII.4

PRODUCTION: 1976[a]
(Billion Cubic Feet)

Company[b]	Produced	Utilized	Flared	% Flared
NIOC	10.1	6.2	3.9	38
NIOC/OSCO	1,674.4	703.4	970.9	58
IPAC	84.6	32.3	52.2	62
SIRIP	8.8	0.7	8.0	92
LAPCO	22.9	1.1	21.8	95
IMINOCO	16.6	0.8	15.8	95
TOTAL	1,817.4	744.6	1,072.8	59

CONSUMPTION: 1976[a]
(Billion Cubic Feet)

	Amount	%
NIOC/OSCO		
Producers' Fuel	72.5	10
Gas Injection	34.3	5
NIOC and Affiliated Companies	15.1	2
Domestic, Commercial and Other	83.4	11
Export to USSR via IGAT 1	327.7	44
Abadan Refinery	38.3	5
Shahpur Chemical Company	41.1	5
Net Deliveries to NGL Plants	65.7	9
Net Deliveries to Kharg Petrochemical Company	46.9	6
Errors and Omissions	19.3	3
TOTAL	744.6	100

a Figures may not add up to totals due to rounding

b NIOC: National Iranian Oil Company; OSCO: Oil Service Company of Iran; IPAC: Iran Pan-American Oil Company; SIRIP: Societe Irano-Italienne des Petroles; LAPCO: Lavan Petroleum Company; IMINOCO: Iran Marine International Oil Company.

TABLE VIII.4 (continued)

IRAN'S NATURAL GAS POTENTIAL[a]
(Trillion Cubic Feet)

Field	Proved	Probable	Possible
Khuzestan[b]	210	210	210
Khangiran	18	18	18
Tang-e-Bijar	0.5	0.6	0.6
Sarajeh	0.3	0.4	0.4
Gheshm	4	6	8
Kangan	11	15	21
Nar	14	17	21
Aghar	10	12	15
Pars "C"	54	65	75
Taqdis "B"	25	50	89
Taqdis "F"	9	17	66
Taqdis "G"	7	15	39
Sarkhun	5	7	10
Kashu	5	10	15
Baba Ghir	2	2	5
TOTAL	374.8	445	593

a National Iranian Gas Company estimates
b Associated gas only. The remaining fields are non-associated gasfields.

Source: Middle East Economic Survey, Supplement to January 23, 1977, "Energy Conservation in Iran and Hedging against the Energy Crunch", by Bijan Mossavar-Rahmani, pp.6 & 12.

As mentioned before, the total requirements for reinjection, export and domestic use, which might reach up to 7 trillion cubic feet by the late 1980's, exceeds the present supplies of associated and non-associated gas at present. Consequently, an intensive effort to develop the proven reserves of non-associated gas is underway. By the end of 1977, nearly one quarter of the rigs in operation were drilling for gas only, and the rest for combined oil and gas.[31]

Refining and Distribution: The National Iranian Oil Company owns four domestic refineries in Abadan, Tehran, Kermanshah and Shiraz. Abadan refinery is one of the largest in the world, and its capacity is approximately 600,000 b/d at present. In the past most of the products of this refinery were allocated for export, but the growing need of petroleum products for the domestic market in recent years has forced the company to divert a large portion of the lighter product for this market. Tehran refinery has a processing capacity of 225,000 b/d, and the capacity of Shiraz and Kermanshah refineries are 40,000 b/d and 15,000 b/d respectively. In addition to these refineries, NIOC owns two topping plants at Masjad-e-Suleiman (64,000 b/d) and Lavan on Lavan Island (20,000 b/d).

Construction of two major new refineries in Tabriz (800,000 b/d) and Isfahan (200,000 b/d) is near completion, and they are expected to be finished by the end of this year. The table below shows the existing refineries, those under construction and plans for new refineries by NIOC.

TABLE VIII.5

NIOC's PRESENT AND FUTURE REFINING CAPACITY

Thousand of barrels per day

Name	Present Capacity	Refineries under Construction	Planned Refineries
Abadan Refinery	600		
Tehran Refinery	225		
Shiraz Refinery	40		
Kermanshah Refinery	15		
Masjed-e-Suleiman	64		
Topping plants Lavan topping plant	20		
Isfahan		200	
Tabriz		80	
NIOC-Japanese venture			250

Sources: NIOC, OPEC Seminar on the National Oil Companies, October 10-12, 1977, OPEC Information Department, Vienna, p.6. Petroleum Economist, September 1977, pp.337-339.

Considering the above figures, the NIOC's refining capacity by the end of 1978 would reach nearly 1.2 million b/d, including the existing topping plants. This is approximately 20 per cent of the present production capacity of Iran.

Another major task of NIOC is the continuous expansion of the domestic distribution system within the country. NIOC owns all the facilities in this respect, except a few petrol filling stations which are privately owned. In 1976, NIOC's domestic distribution and sales network sold nearly 24 million cubic metres of refined petrols, which was up 18.6 per cent on the 1975 figures. Abadan refinery supplied nearly 49 per cent of this total (417,000 b/d) with the balance coming from Tehran (35.9 per cent), Shiraz (8.2 per cent), Kermanshah (4.1 per cent), plys some from the topping plants. In the first 10 months of 1977, NIOC's sales of petroleum products, including deliveries to Afghanistan, showed an increase of 15.4 per cent over the corresponding period of 1976. The following table shows NIOC's sales during this period.

TABLE VIII.6

NIOC SALES OF PETROLEUM PRODUCTS
January-October 1977

Million litres

Product	January-October 1977	% Increase over January-October 1976
Gasoline	3,684	19.0
Kerosene	4,078	8.9
Gas oil	7,060	19.7
Fuel oil	5,239	12.8
Aviation fuel	1,012	16.2
TOTAL	21,073	15.4

Source: Middle East Economic Survey, January 23, 1978, p.5.

NIOC was allowed to increase the price of domestically sold gasoline in March 1977. This was the first increase in gasoline prices since 1965. Regular gasoline will now cost 8 Rials p/b (42.5 cents per US gallon), an increase of nearly 33 per cent over the previous levels, which will increase the revenue to the government by nearly $100 million over the year.

Profit from domestic sales of NIOC constitutes a major portion of the company's cash flow. Domestic sales profits rose from $8.5 million in 1966 to $71 million in 1973. The cash flow of the company in the same years increased from $30 million to $386 million.[33]

International Activities of NIOC: The National Iranian Oil Company is engaged in various activities outside Iran. The company, in partnership with British Petroleum, is carrying out exploration in North Sea Blocs Nos.15-13 and 3-29. The second exploratory effort of NIOC is in the continental shelf of western Greenland, and is in partnership with British Petroleum, Standard Oil of California and SAGA of Norway.[34]

The refining activities of the National Iranian Oil Company outside Iran are limited to two countries at present. In India NIOC holds 13 per cent equity interest in the Madras Refinery, which was designed and constructed with the help of NIOC technicians. This refinery is a joint venture between the Indian government, AMOCO (a subsidiary of Standard Oil of Indiana) and

NIOC. At present 50 per cent of the crude oil supplies of the Madras refinery comes from the NIOC/AMOCO joint venture (IPAC) offshore Darius field. The refinery has the capacity for 58,000 barrels per day.[35]

NIOC's second refining activity outside Iran is in South Africa. The National Petroleum Refinery of South Africa (NATREF) went into operation in May 1971 with the designed capacity of 50,000 barrels per day (2.5 million tons per year), and most of its crude was supplied from Iran.[36] In this venture NIOC is in partnership with SASOL (South African Coal, Oil and Gas Corporation) and TOTAL (a subsidiary of Compagnie Francaise des Petroles). The present capacity of the refinery is about 75,000 barrels per day, nearly 3.75 million tons a year.[37]

In the early 1970's, plans for joint venture refineries in Greece, Belgium and the Philippines were under study, but were later abandoned for a variety of reasons. At present NIOC is involved in the design and construction of a refinery in South Korea in partnership with a private firm, Sang Yong. In late 1976 an agreement was signed by which the crude requirements of this refinery would be supplied by NIOC when it begins its operations in 1979. Another downstream investment of NIOC is in Senegal when it formed the Iran Senegalese Oil Company, a 50-50 joint venture. IRASENCO is planning to build a new 20,000 barrels per day refinery in Senegal. The list of NIOC's joint ventures in refining outside Iran is given below.

TABLE VIII.7

NIOC's JOINT VENTURES ABROAD

Company	NIOC Share Percentage	Share Capital $million	Capacity (Present) Barrels/day
Madras Refinieries Ltd.	13.00	2.34	58,000
National Pet. Refinery of South Africa	17.50	3.65	75,000
Korea-Iran Pet.Co.	50.00	17.00	60,000[a]
Iran-Senegal Pet. and Construction	50.00	15.00 (to date)	20,000[b]

a Under design and construction
b Under study

Source: NIOC, OPEC Seminar, October 10-12, 1977. The present and future role of the national oil companies prepared by OPEC Information Department, Vienna, p.12.

It is difficult to evaluate the profitability of NIOC's overseas refineries as detailed figures are not published. NIOC claims that its overseas investments in joint venture refining operations are financially sound and provide 15 per cent return on capital.[38] It is evident these refineries supply relatively long-term and guaranteed outlets for the company's crude, and this was particularly important in the 1960's when NIOC was finding it hard to obtain such markets. Whether stepping up such joint ventures in refining overseas is still desirable at present is not clear, as the long-term agreement to supply a refinery could be achieved without the national oil company investing large sums of money in the process.

Talks have been going on in the past three years between NIOC and Italy's ENI for the possible establishment of joint venture marketing. In return for an unspecified amount of money which NIOC would invest in ENI, the company would obtain a 59 per cent share of ENI's refinery and marketing activities in in Western Europe, excluding Italy.

Direct Sales of Crude Oil and Products by NIOC

Under the sale and purchase agreement which governs the relationship between NIOC and the former consortium members NIOC will take certain stated quantities of crude oil from the Khujestan oil fields for direct exports. This stated quantity of oil was envisaged to be 200,000 b/d in 1973, rising to 1.5 million b/d in 1981. By September 1973 it had sold its yearly entitlement of crude under this agreement mainly because of the right supply conditions which obtained at the time. The company for the first time managed to sell most of its half-share of production from the offshore joint ventures, which amounted to 230,000 b/d, and which was previously sold by the foreign partner.

In 1976 NIOC had concluded direct sales agreements with 35 companies and sold an average of 1,085,000 b/d, which secured \$4.6 billion in revenue for Iran.[40] It must be noted that stated quantities for this year were 600,000 b/d, (see Table XIII) which were exceeded by nearly 255,000 b/d, with the remaining amount of direct export coming from half of the joint venture productions.

The stated quantity for 1977 was 750,000 b/d, but again this limit was exceeded by nearly 50 per cent. The quantity of oil which was directly exported by NIOC reached 1.36 million b/d, which was slightly lower than the target of 1.4 million b/d which the company estimated in the summer of 1977. Towards the end of 1977 the pattern of Iranian oil exports was as follows:

TABLE VIII.8

PATTERN OF IRANIAN OIL EXPORTS

Thousand barrels per day

	November	October
Consortium companies	3,683.1	2,788.5
Deliveries to Abadan	156.7	113.4
NIOC Direct Exports:		
From Agreement Area	1,145.9	1,354.8
From Joint Ventures	335.0	272.0
Products	45.6	50.0
Foreign Joint Venture Liftings	223.5	351.0
TOTAL	5,889.8	4,929.7

Source: Middle East Economic Survey, January 14, 1978, p.7

TABLE VIII.9

TOTAL EXPORT OF CRUDE OIL AND PRODUCTS FROM IRAN AND NIOC'S DIRECT SALES IN 1977

Thousand barrels per day

	Total Production	Total Export from Iran	% Increase or Decrease of Exports	NIOC's Direct Export	% Increase or Decrease of Exports
January	5,058.5	4,116.6		750.5	.
February	6,052.3	5,648.5	+38.4	962.3	+28.3
March	6,275.0	5,447.9	-4.4	889.7	-7.5
April	5,413.7	5,080.4	-6.8	1,082.7	+21.7
May	5,745.5	5,229.4	+2.9	1,590.0	+46.7
June	5,104.4	4,550.4	-13.0	1,339.4	-15.7
July	4,713.8	4,180.9	-8.1	842.3	-37.1
August	5,659.6	5,205.3	+24.5	1,264.2	+50.1
September	5,971.2	5,340.4	+2.6	1,702.1	+34.6
October	5,527.7	4,929.7	-7.7	1,676.8	-1.5
November	6,085.8	5,589.8	+13.4	1,526.5	-9.0
December	6,384.9	5,773.1	+3.3	1,908.5	+25.0
Year Average	5,663.1	5,089.7	-4.5[a]	1,366.6	+26.0[b]

Sources: Figures for total production are obtained from Middle East Economic Survey, January 23, 1978, p.4. Figures for direct NIOC exports are gathered from different issues of MEES during 1977.

a Per cent change compared to 1976 exports of approximately 5,329,500 b/d.

b NIOC's direct export in 1977 amounted to an average of 1,085,000 b/d.

Marine Transportation: The National Iranian Tanker Company (NITC), a wholly-owned subsidiary of NIOC, owns and manages Iran's crude and product tankers. The company was established in 1966 with a capital of $2.1 million which has increased manifold since then. At the end of 1975 the NITC received two large tankers of over 200,000 dead weight tons, and its total tonnage reached approximately 600,000 d.w.t. In March 1976, NIOC and British Petroleum signed an agreement under which BP sold five tankers (three VLCC's and two product carriers) to NIOC for $60 million. Nearly one year before the agreement was signed the British Petroleum Tanker Company and NITC had formed a joint shipping company on a 50-50 basis to operate under joint management and to organize a shipping pool to be used by both sides.[42] In addition, BP undertook to contribute a further five tankers to the existing fleet. This purchase brought the total tonnage of NITC to nearly 1.2 million d.w.t, almost double the 1975 figure. The following table shows the tankers in service under NITC control.

TABLE VIII.10

TANKER FLEET OF THE
NATIONAL IRANIAN TANKER COMPANY

Name of Vessel	Year Built	Tonnage d.w.t.
Mohamed Reza Shah	1959	34,942
Reza Pahlavi	1960	56,900
Farah Pahlavi	1961	56,900
Sivand	1971	215,139
Shoush	1972	222,745
Mokran	1973	25,246
Marun	1974	25,245
Minab	1974	25,244
Khark	1975	228,054
Azarpad	1975	230,095
TOTAL		1,120,510

Source: Middle East Economic Survey, November 14, 1977 (Review of Arab and Iranian Tanker Fleets : a MEES survey), p.vii.

Petrochemicals: The National Iranian Oil Company began its productive activities in petrochemical industries in 1963 with the construction of the first petrochemical plant near Shiraz. In 1965 the National Petrochemical Company (NPC) was formed as a wholly-owned subsidiary of NIOC, and was entrusted with the responsibility for the establishment and development of the petrochemical industry in Iran. Since then the National Petrochemical Company has entered into various joint venture activities with other firms, and has formed a number of subsidiaries of its own. By the end of 1974 NPC had entered into six joint ventures and had established two wholly-owned subsidiaries.[43] The following tables indicate location, plant capacity and 1976 production outputs of some of NPC's subsidiary companies.

Source: NIOC-OPEC seminar on the present and future role of the national oil companies 10th-12th October 1977, prepared by the Information Department of OPEC, Vienna, October 1977, pp.7 and 8.

TABLE VIII.11

PLANT CAPACITY AND 1976 PRODUCTION OUTPUTS OF THE NATIONAL PETROCHEMICAL SUBSIDIARY COMPANIES

SHAHPUR CHEMICAL COMPANY AT BANDAR SHAHPUR

Plant and Products	Capacity (tons/year)	1976 Production (metric tons)
Sulphur	408,000	188,000
Ammonia	339,000	246,200
Urea	164,000	117,000
Sulphuric Acid	407,000	260,000
Phosphoric Acid	147,000	76,800
DAP (Di-Ammonium Sulphate)	200,000	174,300
MAP (Mono-Ammonium Phosphate)	180,000	2,750

SHIRAZ FERTILIZER FACTORY AT SHIRAZ

Plant and Products	Capacity (tons/year)	1976 Production (metric tons)
Ammonia	40,000	34,700
Nitric Acid	40,000	35,700
Ammonium Nitrate	40,000	25,900
Urea	50,000	37,300
Soda Ash	60,000	43,000
STPP	30,000	675
NPK	50,000	11,200 + 3,400 DAP

ABADAN PETROCHEMICAL COMPANY
(NATIONAL PETROCHEMICAL CO. & B.F. AND GOODRICH) ABADAN

Plant and Products	Capacity (tons/year)	1976 Production (metric tons)
Caustic soda	24,000	18,000
DDB	12,000	9,200
PVC	60,000	29,700
Polika	–	4,950

KHARG CHEMICAL COMPANY
(NPC & AMOCO INTERNATIONAL) KHARG ISLAND

Plant and Products	Capacity (tons/year)	1976 Production (metric tons)
Sulphur	200,000	199,800
Propane	132,000	129,000
Butane	82,000	89,500
C5	90,000	109,300

IRAN CARBON COMPANY
(NATIONAL PETROCHEMICAL CO., CABOT & PRIVATE BANKS) AHWAZ

Plant and Products	Capacity (tons/year)	1976 Production (metric tons)
HAF (V3) VM (V - M) FEF (S - O) GPE (S - V)	16,000	9,000

IRAN NIPPON PETROCHEMICAL COMPANY
(NPC., MITSUBISHI CHEMICAL INDUSTRIES, NISSHO-IWAI CO.)
BANDAR SHAHPOUR

Plant and Products	Capacity (tons/year)	
DOP	40,000	in operation in 1977
Phthalic Anhidride	5,000	

Gas: The National Iranian Gas Company (NIGC) was formed in 1967 as a wholly-owned subsidiary of the NIOC. This company has the responsibility for gathering, processing, transmission, domestic distribution, sales and export of natural gas in Iran. The major demands for gas at present are (a) the gas reinjection programme underway in Khuzestan's oil fields, mentioned before in this chapter, (b) exports to the USSR, (c) commercial and domestic consumption, (d) petrochemical feedstocks, and (e) producers' fuel.

Exports to the USSR in 1976 through the first Iranian gas trunkline reached 327.7 billion standard cubic feet (see Table VIII.4). This level of exports will be maintained until 1981 when the deliveries through the second trunkline to the USSR are scheduled to begin. Exports of gas to the USSR will reach nearly 600 billion cubic feet per year, and the Russians will, in return, export a certain amount of gas to Germany, Czechoslovakia, France and Austria. These four latter participants will pay Iran in hard currency for the amount of gas exported from the Soviet Union to their countries.

Domestic distribution of natural gas by NIGC is being expanded rapidly, and in a few years' time will cover most of the major cities in Iran. In 1976 commercial and domestic consumption of gas within the country reached 83.4 billion cubic feet. Detailed figures for 1976 production and consumption of natural gas in Iran are given in the preceding pages of this section.[44]

The activities of the National Iranian Gas Company and National Petrochemical are quite extensive. The reason why these activities have not been covered in more detail is that a new relationship is emerging between NIOC, on the one hand, and NIGC and NPC on the other. As a result of this development which embodies changes in the charters of NIOC, NIGC and NPC, the administration and operational control of the three companies will become separate and function independently. The Board of Directors of NIGC and NPC will be separate, and the heads of the above companies will no longer serve as Directors on the Board of NIOC.

Revision of the Sale-Purchase Agreement of 1973

The sale-purchase agreement which was signed in 1973 between NIOC and the consortium of oil companies has been under considerable pressure in recent years, and negotiations are going on for the revision of its terms. The sweeping changes in the international petroleum industry since 1973-74 have led to a situation where some of the more important provisions in the agreement had to be ignored for practical purposes. The new agreement, amongst other things, must resolve four basic issues on which NIOC and the foreign companies disagree. These are (a) the 'nomination' provisions under the 1973 agreement, (b) the future investment by the companies, (c) the future of petroleum product exports from Abadan refinery, and (d) the amount of the discount given to the companies on their oil exports.

Under the 1973 agreement the consortium each year in the autumn nominates the quantities of light and heavy crude oil that it intends to export from Iran in the following year. In addition to that a specific amount of crude oil (stated quantity) is reserved for NIOC's direct sale, which was 600,000 b/d in 1976 and 750,000 b/d in 1977.[45] NIOC claims that it no longer plans its direct crude oil export based on these amounts since the consortium has consistently failed to lift the amount of crude oil it has nominated. In other words, NIOC considers nomination as a contractual obligation by the consortium to export a certain amount of oil, while the companies seem to consider their nomination as an estimate, with the actual lifting of crude oil based on market conditions. NIOC's direct sales, as mentioned before, amounted to 1,085,000 b/d in 1976 and 1,366,000 b/d in 1977, while the consortium has exported less than its nominations.

Under the 1973 agreement the companies undertook to contribute 40 per cent of capital investment requirements for Iran's oil production programme. This payment was agreed to be made in advance for future deliveries of NIOC to the consortium. NIOC claims that the companies have failed to provide their full share of investment on time since mid-1975. The companies, on the other hand, argue that due to the "fundamental changes" which have occured in the past few years, their so-called 'fixed margin' on the sale of Iranian oil has dropped considerably, and honouring their commitments under the 1973 agreement with regard to investment programmes, would create a "serious negative cash flow".[46]

Another area of disagreement is the product exports by consortium members. Under the 1973 agreement the companies allocated up to 300,000 b/d of their crude purchases in Iran for refining at Abadan, and paid a tax-deductable refining fee to Iran. NIOC under this agreement has the right to obtain different products for its domestic distribution in the country. The soaring demand for light products in Iran in recent years has forced NIOC to use its right in obtaining these products from the Abadan refinery, and consequently consortium members have been left with mainly heavy fuel oil for export. The companies notified NIOC that they intended to cancel their offtake arrangement for Abadan refinery products as of January 1978.

Most of the problems concerning the 1973 sale-purchase agreement arose simply because the agreement was signed prior to the events of 1973-74 which radically altered the structure of the oil industry. It is evident that if the negotiations for this agreement had been extended for another three months, the nature of the agreement would have been totally different. The companies would not have committed themselves to such huge investments, and NIOC certainly would not have agreed to restrict its direct sales to certain quantities. The terms of the

July 1973 agreement became unworkable in less than a year after its finalization, and both parties ignored some of its more important provisions for all practical purposes.

Tables VIII.12-14 give some information about various aspects of the oil industry in Iran.

TABLE VIII.12

Number of Oil Agreements	Number of foreign companies involved in Iran oil industry	Oil revenues Million dollars	Internal consumption Million dollars	Crude oil export Million dollars	Crude oil production Million dollars	Years
1	1	62.28		418.8	483.9	1911-1932
1	1	406.4	56.5	1,753.1	2,030.0	1933-1951
1*	17*	16,171.0*	783.9	12,528.7	15,400.0	1954-1973
17	31	19,550.0	107.9	1,959.8	2,197.9	1974
16	33	18,600.0	128.5	1,704.9	1,952.7	1975

* Early 1955 after the Consortium agreement was signed.

Source: Lecture by Dr. P. Mina, Director of International Affairs, National Iranian Oil Company, delivered in Tehran, December 1976. Distributed NIOC's Public Relations Office, p.68 (in Persian).

TABLE VIII.13

Period	Prior to Nationalization 1911-1951	After Nationalization (Consortium Agreement) 1954-1972	The New Agreement 1973-1975
Number of years	40	19	3
Total oil export	2.5 billion barrels	11.5 billion barrels	5.9 billion barrels
Revenues	$479 million	$11,748 million	$42,500 million
Average revenue per barrel of exported oil	19 cents	102 cents	720 cents
Division of profits	20-80	According to Consortium agreement 50-50. In joint venture agreements 75-25, and in service contract agreement 90-10.	98-2
Role of Iran	Tax collector	Supervisory role in consortium agreement and partner in joint venture agreements.	Seller of oil

Source: Dr. P. Mina, Director of International Affairs of National Iranian Oil Company in lecture delivered December 1976 in Tehran, and distributed by NIOC's Public Relations Office (in Persian), p.12.

TABLE VIII.14

SUMMARY OF THE JOINT VENTURE ACTIVITIES OF THE NATIONAL IRANIAN OIL COMPANY OUTSIDE IRAN

Nature of Joint Venture	NIOC'S Partners	Per cent share of NIOC	Date of the agreement	Comments
Exploration in North Sea	British Petroleum	50	March 1972	Drilling in both blocks of this agreement have struck oil and gas.
Exploration in west of Greenland	B.P., Chevron and Saga	30	8th April 1975	Drilling will start in 1977
Madras refining in India	Amoco and Indian Government	13	18th November 1965	Operation started in July 1969. Capacity 50,000 b/d
Madras fertilizer companies in India	Amoco and Indian Government	24.5	14th May 1966	Operation started in July 1971
Refinery in South Africa	Socol and Total	17.5	26th November 1967	Operation started in February 1971. Capacity 50,000 b/d
Refinery South Korea	Sang Yang	50	13th October 1975	Capacity 60,000 b/d

Source: Dr. P. Mina, Director of International Affairs of National Iranian Oil Company in lecture delivered December 1976 in Tehran, and distributed by NIOC's Public Relations Office (in Persian), p.22.

NOTES

1. For further details about these joint venture agreements and comparison with other joint ventures, see: F. Fesharaki, Development of the Iranian Oil Industry (Praeger Publications, New York, 1976), pp.73-78.

2. Middle East Economic Survey, January 26, 1973, pp. 1-5.

3. For the text of the Agreement see: Petroleum Intelligence Weekly (Special Supplement), July 23, 1973. For the text of key annexes to Iran's 20 year pact see Petroleum Intelligence Weekly (Special Supplement), September 3, 1973.

4. Petroleum Intelligence Weekly, July 32, 1973, op.cit., p.5.

5. Petroleum Intelligence Weekly (text of the Agreement, see Note 3), op.cit., p.4.

6. Middle East Economic Survey, July 27, 1973, p.2.

7. Middle East Economic Survey, June 29, 1973, pp.2-3.

8. Petroleum Intelligence Weekly (text of the Agreement, see Note 3), op.cit., Article 4, p.4.

9. Petroleum Intelligence Weekly, December 17, 1973, p.1.

10. The Petroleum Act and Statute of the National Iranian Oil Company (published by the NIOC Public Relations Department, No.34, no date of publication, but possibly 1975), p.2.

11. Ibid., pp.2-3.

12. Ibid., p.4.

13. Ibid., p.5.

14. Ibid., p.15.

15. Ibid., p.17.

16. Ibid., pp.18-20.

17. Ibid., pp.20-23.

18. *Ibid.*, p.23.

19. *Ibid.*, pp.25-26.

20. *Ibid.*, p.35.

21. *Ibid.*, p.36.

22. *Ibid.*, pp.50-52.

23. *Ibid.*, pp.53-54.

24. OPEC seminar: On the present and future role of the national oil companies, 10th-12th October 1977, prepared by the Information Department of OPEC, Vienna, October 1977, p.1.

25. *Ibid.*, p.2.

26. *Petroleum Industry in Iran* (published by the Iranian Oil Industry Public Relations Office, 1975), p.17.

27. *Petroleum Economist*, August 1973, p.287.

28. *Petroleum Intelligence Weekly*, August 15, 1977, p.8.

29. *Middle East Economic Survey*, November 18, 1977, pp.4-5.

30. *Ibid.*, p.4.

31. *Middle East Economic Survey*, Supplement to January 23, 1978, p.4.

32. *Middle East Economic Survey*, April 4, 1977, p.8.

33. For detailed analysis of NIOC's domestic sales operations see: F.Fesharaki, *Development of the Iranian Oil Industry* (Praeger Publishers, New York, 1976), Chapters 9-12.

34. OPEC seminar: .. October 1977, *op.cit.*, p.12.

35. *Ibid.*

36. *Petroleum Press Service*, August 1973, p.284.

37. OPEC seminar: October 1977, *op.cit*, p.12.

38. *Middle East Economic Survey*, August 23, 1976, p.2.

39. Petroleum Press Service, September 1873, p.326.

40. Middle East Economic Survey, May 30, 1977, p.10.

41. Middle East Economic Survey, September 5, 1977, p.3.

42. Middle East Economic Survey, April 18, 1975, p.4, and March 15, 1976, p.6.

43. Petroleum Industry in Iran, op.cit., p.16 and pp.77-87.

44. For more information about the gas industry in Iran, see Middle East Economic Survey (Supplement) February 7, 1975, "Iran: Gas on the Move" by Charles Snow.

45. Middle East Economic Survey, June 29, 1973, p.2.

46. Petroleum Intelligence Weekly, January 26, 1976, p.2. See also Middle East Economic Survey for following dates: January 23/30, 1976, pp.2-3; February 13, 1976, p.5; May 3, 1976, pp.1-2.

47. Petroleum Intelligence Weekly, June 20, 1977, p.5. See also, Middle East Economic Survey, June 27, 1977, p.3.

PART THREE

THE CASE OF GENERAL PETROLEUM AND MINERAL ORGANIZATION (PETROMIN)

CHAPTER IX

A BRIEF HISTORICAL BACKGROUND OF THE SAUDI ARABIAN OIL INDUSTRY

After the First World War and the dissolution of the old Turkish Empire, the Turkish Petroleum Company in Iraq was controlled by the British, the Dutch and subsequently (via the 1920 San Remo Agreement) the French, and, later, American interests. But in other parts of the Middle East where the discovery of oil was considered probable, the rivalry among different companies to get favourable concessions continued. In Saudi Arabia, the first oil concession was granted to Major Frank Holmes, a representative of a British group of investors (The Eastern and General Syndicate) in 1922. This syndicate was not an oil company, but a group of entrepreneurs who hoped to get the support of oil companies and failed in this respect. The concession, with the exception of the Bahrain area, was formally declared void in 1928. In 1927, Gulf Oil took an option from the syndicate, but was faced with complications later on, as it was one of the companies holding interests in the Turkish Petroleum Company (later the Iraq Petroleum Company). Under the so-called Red Line Agreement, these companies in 1928 agreed that none of them would act independently within a prescribed area, which included Saudi Arabia. As the Red Line Agreement precluded Gulf Oil from taking over the concession, the company approached Standard Oil of California, which was not a party to the Red Line Agreement.[1]

The Gulf Oil option was assigned to Standard Oil Company of California (SOCAL) in December 1928. In 1932 oil was discovered in Bahrain, and SOCAL stimulated by this discovery approached the Saudi Arabian government to obtain a new concession. The concession was assigned to California Arabian Standard Oil Company (CASOC) in November 1933. Nearly three years later in 1936, the Texas Company (TEXACO) acquired a one-half interest in CASOC, and in 1944 the name of the company was changed to Arabian American Oil Company (ARAMCO). The original concession covered all Al Hasr Province, which amounted to approximately half of Saudi Arabia, and it was for a period of 60 years.

Oil was discovered in commercial quantities in October 1938, and six months later on May 1st 1939, the first cargo of Saudi Arabian oil was shipped from Ras Tanura. On July 21st 1949, a supplemental concession agreement was signed between CASOC and the Saudi Arabian government. This new agreement extended the exclusive concession area to about 440,000 square miles for a period of 60 years. The rate of royalty was to be four shillings gold or its equivalent per ton of oil. There were provisions for relinquishment of those areas of the concession which the company no longer wished to explore. There were also other payments and advances in the contract which made it more or less similar to other concessions in the area at that time.[2]

Between 1935 and 1939, the Anglo-Iranian Oil Company, Shell and the American group of companies party to the Red Line Agreement, tried to revise the restriction clauses of the agreement in order to enable them to participate in the exploration and development of oil in the Middle East, and in particular Saudi Arabia. World War II interrupted those unresolved negotiations, and at the end of the war when the issue arose again, Standard Oil Company of New Jersey (Exxon) and Socony Vacuum Oil Company (now Mobil) summarily declared the Red Line Agreement to be dissolved. This decision was followed by long negotiations among the companied concerned, and eventually Exxon and Mobil were freed to initiate negotiations with ARAMCO for acquisition of joint interest in Saudi Arabia. In 1947 these two companies joined the Arabian American Oil Company, and the shareholding of ARAMCO was consequently changed as follows: Standard Oil of California - 30 per cent; TEXACO - 30 per cent; Exxon - 30 per cent, and Mobil - 10 per cent. The new companies which joined ARAMCO had extensive markets around the world which helped ARAMCO to increase its production rapidly and meet the substantial production commitments to the King of Saudi Arabia. One reason for the merger which was given publicly by ARAMCO, was the need for capital to build a pipeline. - the Trans-Arabian Pipeline (Tapline). This pipeline was constructed by ARAMCO and extended from the Saudi oil fields to the Mediterranean.[3]

Between 1948 and 1951, the Saudi Arabian government was involved in a series of negotiations with the ARAMCO partners on a number of issues which included the offshore exploration rights, and 50-50 profit sharing arrangements. Eventually, ARAMCO was granted the offshore rights, and the government got back the concession for the Kuwait-Saudi Arabia Neutral Zone, and secured a higher royalty payment from the offshore production. But the focal point of the Saudi Arabian government's dissatisfaction with ARAMCO was that in 1949 it received from its oil a total less than the amounts which the US government was receiving as income tax from ARAMCO on such oil. In December 1950, ARAMCO agreed to pay, in addition to royalty, an income tax in such a way as to bring government receipts up to one-half of the company's operating profits after deduction of expenses.[4]

The 50 per cent income tax law on producers of petroleum was not a new idea, and was patterned after the Venezuelan tax law. The significance of ARAMCO's acceptance of this method of calculating revenues for Saudi Arabia was that other oil producers in the Middle East demanded similar treatment, and within a short while this method of payment was adopted in most of the oil producers of the Middle East. But the main reason behind this quick victory of the Saudis in this matter, was that their 50 per cent income tax on petroleum producers was recognized by the US Internal Revenue Service as a tax allowed to be credited against US income taxes on income generated by sales in Saudi Arabia. So ARAMCO credited its Saudi Arabian income taxes against its US income taxes on its foreign-source income.

Entrance of Other Oil Firms in Saudi Arabia

After the Second World War, the Saudi economy became heavily dependent upon the oil sector. In 1958 nearly 83 per cent of the Kingdom's revenues originated from the oil sector, compared to 67 per cent ten years earlier (see table below). Other sectors of the industrial activity took a minor part in the building of the national income. As the revenues from the oil sector were mainly coming from operations of one foreign-owned oil company (ARAMCO) which could arbitrarily change the level of the production, so the government wanted, if possible, to diversify its source of wealth and reduce its dependence on ARAMCO. In addition to that, neither the government nor any private Saudi citizen, owned any share in ARAMCO or had the right to partake in its management decisions. This was especially resented among the young foreign-educated Saudis who considered themselves capable of handling some of the positions which were occupied by foreigners.[5]

TABLE IX.1

ESTIMATED BUDGET RECEIPTS FROM THE OIL SECTOR IN 1948 TO 1957-58.

	1948	1951-52	1954-55	1957-58
Oil Sector Revenues	144,600	340,005	966,625	1,241,000
Total Sources of Budget Finance	214,587	489,900	1,355,001	1,498,200
Per cent share of Oil Sector	67.4	69.4	71.3	82.8

Source: Statistical Yearbook. 1385 A.H. Vol.1 (Riyadh, 1965), pp.250-256.

In 1948 the Shaikh of Kuwait granted the American Independent Oil Company (Aminoil) a concession on its half-rights of the Neutral Zone. This agreement gave the ruler of Kuwait the right of shareholding in producing and refining companies which were to be formed, and 12.5 per cent share in the locally made profits. The royalty and other terms of this agreement were by far better than any other concession in the Middle East at the time. ARAMCO, unwilling to match these terms on the Saudi side of the Neutral Zone, agreed to relinquish this area in 1948.[6] Thus an opportunity arose for the Saudis to bring in smaller independent companies who were eager to get a foothold in Saudi Arabia, and who were willing to offer more advantageous terms than the established majors.

In 1949 a concession was granted to the Pacific Western Oil Corporation (later renamed Getty Oil Company) in the one half share of Saudi Arabia in the Neutral Zone. This agreement provided for higher royalties per barrel of crude, and a share of the company's net profits. The terms of this concession were even more favourable to Saudi Arabia than the Aminoil agreement Kuwait. The two concessionaires arranged a working organization to carry out exploration in this region. The first major commercial oil deposit in the Neutral Zone was found in 1953.

Another concession was granted by Saudi Arabia to the Arabian Oil Company (Japanese interest) in December 1957, in the Continental Shelf outside the six mile territorial limits of the Neutral Zone.

The same company obtained Kuwait's half right in this area a few months later. The terms agreed to by the Japanese were even better than the Getty agreeement of 1949. The duration of the concession was much shorter, profits were divided 56 per cent in favour of the Saudis, and the government was granted the power of close supervision. The company started its operations in 1958 and struck its first commercial quantities of oil in 1960. The successful finalization of these concessions in the Neutral Zone was mainly due to the fact that at the time the independent oil companies were eager to get a foothold in the Middle East. In addition to that, some young Saudis who had finished their petroleum training, returned from America. These petroleum experts among Saudi officials were in a better position to stiffen the government's demands from the companies applying for concessions.[7]

The ARAMCO concession underwent no major changes in the decade of the fifties in spite of some government pressure to make it integrate into downstream operation. The company was involved in expanding its facilities for the future. ARAMCO's 1961 annual report of oil activities in Saudi Arabia showed that for the eighteenth consecutive year, crude oil production in the country had risen. The production in 1961 reached 1.4 million barrels per day, an increase of 11.7 per cent over that of 1960. Similarly, the amount of oil refined at the Ras Tanura refinery also increased by 10.6 per cent. ARAMCO in that year invested more money in construction, and its development drilling added some 2.6 billion barrels of oil to the country's reserves.[8]

Why State Owned Oil Company was Formed

The General Petroleum and Mineral Organization (Petromin) was established in 1962, nearly twenty-five years after the first oil discovery was made in Saudi Arabia. In these year the financial position of the country had changed drastically, and modern establishments grew in and around the main cities. But the form of government changed very little. The King was the Imam of the faithful, as well as the absolute monarch. The law of the land was the Sariah or religious Islamic law as recorded in the Koran. There was no written constitution beside the Koran, no parliament or other form of elected assembly, and tribal tradition influenced the administration of the law. The King had his Majlis (council) which was open to any citizen who wished to attend. The first Council of Ministers headed by the King was formed in 1953, most of the ministers being members of the Royal Family. The council's power and influence were gradually increased, by the late fifties it had the power to approve annual budgets, international agreements and concessions.

During most of this period the relationship between ARAMCO and the government of Saudi Arabia was based on co-operation, and - due to the nature of the Saudi society - free from political involvements similar to those with which the Anglo-Iranian Oil Company and the Iraq Petroleum Company had had to contend. In general, the company-government relations were well maintained and less acrimonious compared to Iran or Iraq, where the disputes which arose with the concessionaires led to nationalization and total deadlock in negotiations on a number of occasions. It is true there were times when Saudi Arabia brought strong pressure to bear on ARAMCO either to modify the terms of the concession, or to increase government revenues. But these disputes were all settled without any major break in the oil operations. Meanwhile, ARAMCO's involvement in the country, plus the fact that Saudi Arabia's foreign policy remained strongly anti-Communist, ensured continuous American support and assistance. With the help of America a Saudi monetary agency was established to perform the functions of treasury and central bank.[9]

Thus, Petromin was not established as a result of Saudi Arabian dispute with the Arabia-American Oil Company, or because of government dissatisfaction with the company's operations in the country. Furthermore, the assertion that Petromin was founded only because the Saudi government wanted to exercise more control over ARAMCO is equally unlikely. Such control could have been achieved through the Oil Ministry, and in fact even after the establishment of Petromin, the responsibility for all the concessions was still in the hands of the Oil Ministry.

Petromin was formed mainly for two reasons. First, in the decade of the sixties there was a move towards decentralization in Saudi Arabia. In 1961 a supreme council for economic planning was created. There were studies to draft an oil law for the territory, and an Oil Ministry was established to take responsibility for oil affairs.[10] Meanwhile, the Saudi Arabiam Monetary Agency was continuing its function of account keeping, and in general for the first time there was a tendency to establish specialized agencies to handle various tasks which, prior to that time were all decided by the King or the Council of Ministers. Petromin was established in line with this movement toward a more decentralized and specialized approach of running the country. The national oil company was also empowered to handle other individual projects apart from oil, and in this respect had a much broader base from which to operate compared with other national oil companies in the area.

The second main reason for the creation of Petromin was the fact that, at the time, other major oil exporters in the Middle East had shown a growing tendency to participate in the activities of their oil industry. Iran had nationalized her oil industry in 1950, and although the consortium agreement did not provide Iran with more revenue per barrel than that of ARAMCO, the assets used by the consortium were Iranian property, and the National Iranian Oil Company was responsible for all non-basic activities, as well as the marketing of projects in Iran. Furthermore, the Petroleum Act of 1957 (see section on Iran) provided the framework for more participation by NIOC in the country's oil industry.

The Kuwait National Petroleum Company was established in 1960, and was handling the internal distribution of petroleum products, and had plans for the international marketing of products. The Saudi government could not disregard all these developments across its borders and leave total control of its oil industry in the hands of the operating companies. So from this point of view, the establishment of Petromin was necessary to show that the state was interested to reduce the power of the foreign oil companies. It must be noted that although this line of thought must have played an important role in the establishment of Petromin, it is very difficult to document it.

The government objective, which also supported the argument in favour of establishment of the state oil company, was to enlarge the scope of the existing oil industry, and to establish essential basic industries around which other secondary industries would grow. This was states as the main reason for the creation of the state oil company in the official Petromin publication.[11] "The main aim behind establishment of this organization was the participation of the statement in industrial growth and the urging of foreign and local capital to invest in major vital industries which in turn would be the support of minor subsidiary industries... The main features of the Saudi economy called indeed for the establishment of such a policy of economic guidance and diversification of the sources of wealth."

Another explanation of why Petromin was formed, was given by Sheikh Yamani in 1967:[12]

> "....The basic philosophy behind our internal policy is that oil constitutes a valuable natural resource and represents the main source of our income. Therefore, it is a must for us to take an active role in its exploration and make the most out of it. The phrase 'active role' is relative term that changes with time and is governed by the practical means and capacities at one's disposal, not by one's dreams and imagination.

> We are working very hard to improve our means and capabilities through various efforts. The petroleum university will contribute from the educational standpoint, while Petromin and its many subsidiaries will provide us with good practical experience in the oil industry..."

It must be noted that for a while the Saudis tried to get some participation in decision-making within ARAMCO and to force it to integrate into downstream operations. But this approach was abandoned as the Saudi Arabian Oil Minister, Sheikh Yamani, stated five years later in 1967:[13]

> "Five years ago, we came to the conclusion that to press for the 'integration' of the oil companies operating in Saudi Arabia was a useless and impractical label which had stigmatized our oil policy for some time past. Nothing could be gained by having foreign company X undertaking integrated oil operations, even competing with its parent companies. The integration which we are now seeking is the integration of our own national oil company, Petromin, and with effort and dedication we shall get it."

Establishment of Petromin

On 22nd November 1962, Royal Decree No.25, was issued which brought into existence the General Petroleum and Mineral Organization. The Decree reads as follows:[14]

ROYAL DECREE NO.25

25 Jumada II 1382 (22 November 1962)

STATUTES FOR THE GENERAL PETROLEUM

AND MINERAL ORGANIZATION

Umm al-Qura No.1947

3 Rajab 1382 (30 November 1962)

With the help of God Almighty,

We, Saud ibn Abd al-Aziz al Saud, King of Saudi Arabia;

After reviewing Article 29 of the Regulations of the Council of Ministers, issued under Royal Decree No.38, dated 22 shawwal 1377 (11 May 1958); and

On the basis of what the President of the Council of Ministers has submitted to us:

Decree as follows:

1. We approve the establishment of a public organization by the name of General Petroleum and Mineral Organization and sanction its statutes attached hereto.

2. The President of the Council of Ministers and the Ministers, within their respective jurisdictions, put this decree of ours into effect as of the date of its publication.

Royal Signature

Saud

STATUTES OF THE GENERAL PETROLEUM[15]

AND MINERAL ORGANIZATION

Name, Juristic Personality, and Domicile of the organization

<u>Article 1.</u> A general organization for petroleum and minerals, to be attached to the Ministry of Petroleum and Mineral Resources, shall be established and shall be called the General Petroleum and Mineral Organization. It shall have juristic personality and be domiciled in the city of Riyadh.

<u>Objectives and Functions of the Organization</u>

<u>Article 2.</u> The objective of this Organization shall be to participate in the various phases of commercial (and) industrial activity connected with petroleum and minerals, with the purpose of developing, promoting, and improving both the petroleum and the mineral industries, and petroleum and mineral products and by-products, as well as related industries.

For this purpose the Organization shall, specifically:

a. Implement and administer public projects for petroleum and mineral in the Kingdom.
b. Import, either directly or through agents, the country's requirements of such mineral substances as shall be specified in a Decision to be issued by the Minister of Petroleum and Mineral Resources.
c. Conduct on its own or through others, theoretical and practical studies and research relating to petroleum and minerals.
d. Conduct, on its own or through others, such operations as the State may entrust to it in (the fields of) searching for, producing, refining, purchasing, selling, transporting, distributing, and marketing petroleum and mineral substances, whether inside or outside the Kingdom.
e. Cooperate with private organizations and companies carrying on petroleum and mineral activities, with the purpose of facilitating prospecting, exploration, and exploitation operations, including distribution or marketing.
f. Establish, either inside or outside the Kingdom, companies or enterprises in whose capital it will participate, with the purpose of engaging in all phases of the industry of petroleum or minerals, and their derivatives and by-products, and of trading in, transporting, selling, distributing and marketing them.
   The Organization may hold an interest or participate, in any manner whatsoever, in companies or organizations, which are engaged in similar activities or which may be of assistance to it in the attainment of its objectives, either inside or outside the Kingdom. It may also, subject to the limitations of regulations in force, buy, annex, or amalgamate such companies or organizations with it.
g. Invest its funds in securities pertaining to objectives similar to its own.

<u>Article 3.</u> The Organization may, for the purpose of attaining its objectives, contract loans, accept gifts and donations, and own movables and immovables.

Assets of the Organization

Article 4. The assets of the Organization shall consist of:

a. Funds contributed by the State Treasury.
b. The advance which the Saudi Arabian Monetary Agency may place at its disposal.
c. All movables and immovables under its administration.
d. Loans contracted by the Organization.
e. Income realized from its engaging in such commercial or industrial activities as fall within the scope of its objectives.

The Organization's Board of Directors and Functions

Article 5. The Organization's Board of Directors composed of the following nine members:
The Minister of Petroleum and Mineral Resources, or someone delegated by him, as chairman,

The Governor of the Saudi Arabian Monetary Agency,

The Governor of the General Petroleum and Mineral Organization,

The Deputy Minister for Economic Affairs in the Ministry of Finance and National Economy,

The Deputy Minister of Commerce and Industry,

Two senior officials of the Ministry of Petroleum and Mineral Resources, to be appointed by a Decision of the Minister of Petroleum and Mineral Resources.

Two Saudis from among prominent financiers, businessmen, or men associated with petroleum and mineral affairs, to be appointed for a period of three years by a Decision of the Council of Ministers which shall specify their remuneration.

Any Ministry that has more than one Deputy Minister shall selected the Deputy to represent it on the Board.

Article 6. The Organization's Board of Directors is the authority that controls its affairs and the conduct of its business and lays down the general policy to be followed, without being bound by the administrative and financial regulations applicable to Government departments. Specifically, the Board of Directors may:

a. Issue decisions as well as financial, internal, administrative and technical rules, including job descriptions and placements.
b. Draft without being bound by the rules and regulations applicable to Government officials and employees, rules governing the appointment and promotion of the Organization's officials and employees and fixing their Salaries, wages, remuneration, benefits in cash or in kind, etc. Such shall be issued by a Decision of the Council of Ministers.

The Labour Regulations shall apply to the (Organization's) workmen. With respect to the retirement right of its officials and employees however the Organization shall be found by the provisions of the Regulations for Retirement (from Civil Service issued under Royal Decree) No.6, dated 19 Safar 1381 (1 August 1961) and any amendments thereto.

c. Approve the Organization's budgets and arrange for the issuance of a Decree regarding it. The fiscal year of the Organization shall be that of the Government.
d. Approve the Organization's year-end accounts for verification by the competent authority.

Board Meetings and Decisions

Article 7. The Board of Directors shall be convened if at least five members are present.

The Board may, for the purpose of availing itself of their knowledge or experience, invite individuals to attend its sessions; such individuals shall have no voice in the deliberations. A Board meeting shall only be considered in quorum if attended by at least five members, including the Chairman, and Decisions shall be adopted by majority vote. However, if the Chairman of the Board opposes a Decision such Decision may be adopted only by a two-thirds majority vote of the directors present, provided the affirmative votes number no less than four.

The Organization's Governor and his Functions

Article 8. A Governor for the Organization shall be nominated by the Minister of Petroleum and Mineral Resources and appointed by a Decision of the Council of Ministers which shall fix his remuneration.

Article 9. The Organization's Governor shall exercise the following functions:

a. Make preparations for meetings of the Board of Directors,
b. Implement Decisions of the Board Directors,
c. Supervise the drafting of the Organization's budget and year-end account. The internal rules shall specify the date for submitting the draft budget and year-end account to the Board of Directors.
d. Supervise the Organization's officials, employees and workmen in accordance with the internal rules.
e. Issue the Organization's discursement orders, which function he may delegate.
f. Exercise the functions vested in him by virtue of Board Decisions and the Organization's Statutes and internal rules. Without prejudice to the provisions of these Statutes the Chairman of the Organization's Board of Directors shall be considered the higher authority to whom the Governor of the Organization reports.

Representation of the Organization by the Governor

Article 10. Within the limitations prescribed by internal rules, the Governor shall represent the Organization before the courts, accept gifts and donations on its behalf, contract loans, and enter into and sign contracts.

Fiscal Obligations of the Organization

Article 11. If the Organization engages in commercial or industrial activities, it shall be liable for the payment of all taxes and fee - due - and fiscal obligations to the agencies to whom they are payable. In respect of all other activities, the Organization shall enjoy the fiscal and tax exemptions enjoyed by Government agencies.

Audit of the Organization's Accounts

Article 12. Without prejudice to the provisions of Article 6 (d), the Board of Directors shall appoint as auditor one or more persons who meet the statutory requirements. The Board shall set the remuneration of the auditor, who shall have the rights and obligations of an auditor in a joint-stock company. If there is more than one auditor, they shall be held jointly and severally responsible.

General Provisions

Article 13. The Organization shall, immediately upon formation, exercise the functions vested in it by virtue of these Statutes.

Article 14. These Statutes shall be published in the Official Gazette and shall go into effect as of the date of publication.

Discussions of Petromin's Constitution

The Constitution of Petromin was set out in the previous section. It showed that Petromin is attached to the Ministry of Petroleum and Mineral Resources, and in effect is a project implementation agency.[16] One of the principal objectives of the Saudi State Oil Company was to participate in various phases of commercial and industrial activities connected with petroleum and mineral industries. To enable the company to function in such wide-ranging activities, it was empowered to implement and administer public projects for petroleum and minerals, import mineral requirements (i.e., raw materials) and conduct studies. Furthermore, the company had the right to conduct petroleum and mineral operations, namely exploration, production, refining, purchase, sale, transport, distribution and marketing. It could also co-operate with private organizations in the same fields which were established either in Saudi Arabia or elsewhere. Petromin could even buy its way into such organizations or invest its funds in securities pertaining to objectives similar to its own.[17]

Articles 5, 9 and 10 determined the structural aspect of the state oil company. Petromin was controlled by a Board of Directors, of which the Chairman was the Minister of Petroleum. Other members of the board consisted of the Deputy Ministers from the Ministry of Petroleum and Mineral Resources, the Deputy Ministers of Finance and Commerce and Industry, the Governor of the Saudi Arabian Monetary Agency, and two private businessmen. The Governor of Petromin was also a member of the Board, and was given wide powers in the company's statutes.[18] Petromin was the executive agency of the Ministry of Petroleum and Mineral Resources, whose function was regulatory and supervisory. The Minister of Petroleum and Mineral Resources was also the Chairman of the Board of Petromin. This, plus the fact that two of his deputies were also in the nine man board, indicates a very close link between the Ministry of Petroleum and Mineral Resources and the state oil company.

The division of responsibility between the Ministry of Petroleum and Mineral Resources and Petromin was not set out in the Fourteen Article Statutes of the Company. But the Ministry of Petroleum and Mineral Resources outlined the nature of the division of responsibility between Petromin and the Ministry in a Bulletin published in 1965.[19] The Ministry of Petroleum and Mineral Resources, which was founded nearly two years prior to the establishment of Petromin, was responsible for negotiating all concession agreements pertaining to petroleum and mineral resources, and for guiding and executing petroleum and mineral policies. In addition to that, the Ministry was responsible for supervising the activities of the concessionaires with regard to the concession agreement. So the Ministry was responsible for safeguarding the interests of the Saudi Arabian government.

The Ministry's Bulletin indicated that Petromin was a state corporation in the nature of an industrial development corporation, which undertook the development of industry in the Kingdom based upon its petroleum and mineral resources. Petromin also acted as a 'Think Tank' to the Ministry, providing it with new ideas which it would undertake to execute if the projects were deemed feasible. Petromin was not a substitute for private enterprise, but rather acted in collaboration with private capital investors, and undertook large schemes for which private capital on the required scale was clearly not available locally. It was envisaged that all its successful projects would be open for public shareholding participation.[20]

The role of private capital in activities of Petromin was specifically stated in Article 2 (e) of the company's Statutes. According to this Article, the company was allowed to co-operate with 'private' organizations and companies. On the other hand, part (f) of the same Article empowered Petromin to establish, acquire or participate in companies and organizations engaged in similar activities either inside or outside Saudi Arabia. This would allow Petromin to participate in any joint organization with other national oil companies.[21]

The financial aspects of Petromin are given in Articles 3, 4, 6 and 11 of the Statutes. The company would obtain its finance from the government (State Treasury). The advance which the Saudi Arabian Monetary Agency may place at its disposal, loans contracted by the organization and income realized from its engaging in commercial activities. For example, Petromin's 51 per cent share of capital in the Saudi Arabian Fertiliser Company (SAFCO) was supplied by the government. The profits to Petromin out of this venture would go to the government, except for Petromin's reinvestment requirements. As for taxes, Petromin's profits out of commercial or industrial activities were liable to the payment of all taxes. In respect of the other activities carried out by the organization, a tax exemption similar to other government agencies applied.[22]

NOTES

1. For further readings see S.H. Longrigg, Oil in the Middle East (issued under the auspices of the Royal Institute of International Affairs) (Oxford University Press, London, 1968). Also, The International Petroleum Cartel, Staff Report of the Federal Trade Commission (Washington, D.C., Government Printing Office, 1952). Also, ARAMCO Handbook, Oil and the Middle East (Dhahran, Saudi Arabia, Arabian-American Oil Company, 1968). Also J.E. Hartshorn, Oil Companies and Governments (London, Faber and Faber, 2nd edition, 1967).

2. S.H. Longrigg, Oil in the Middle East, op.cit., p.110.

3. Multinational Corporations and US Foreign Policy. Hearings before the Sub-Committee on Multinational Corporations of the Committee on Foreign Relations United States Senate (Washington, D.C., Government Printing Office, 1974), Part 7, pp.52-53. Also pp.81-85. See also S.H. Longrigg, Oil in the Middle East, op.cit., pp.106-110, pp.132-135, pp.174-175, p.201.

4. S.H. Longrigg, op.cit., p.210. See also Multinational Corporations and US Foreign Policy, op.cit., p.219.

5. Ramon Knauerhase, The Saudi Arabian Economy (Praeger Publishers, New York, 1975), p.179.

6. S.H. Longrigg, op.cit., p.215.

7. Ibid., pp.292 and 310.

8. Petroleum Press Service, July 1962, pp.261-263.

9. S.H. Longrigg, op.cit., p.292.

10. Ibid., pp.386-390.

11. The General Petroleum and Mineral Organization published by Petromin (no place or date of publication given), p.3.

12. Middle East Economic Survey (Supplement), Vol.X, No.25, 21st April 1967, p.5.

13. Ibid., pp.2-3.

14. *The General Petroleum and Mineral Organization*, *op.cit.*, p.21.

15. *Ibid.*, pp.23-28.

16. *Ibid.*, Articles 1 and 2.

17. *Ibid.*, Article 1.

18. *Ibid.*, Articles 9 and 10.

19. *Mineral Resources of Saudi Arabia*, Bulletin No.1, published by the Ministry of Petroleum and Mineral Resources, 1965, pp.9-10.

20. *Ibid.*, p.10.

21. *The General Petroleum and Mineral Organization*, *op.cit.*, p.24.

22. *Ibid.*, pp.24-28.

CHAPTER X

EARLY ACTIVITIES OF PETROMIN (1962 - 1972)

In this section we discuss the activities of Petromin during its early stages of development and prior to the participation agreement which gave Saudi Arabia a share in ARAMCO in 1972. But before listing such activities, a few words must be said about the way in which this organization was functioning.

Petromin was basically divided into two main sectors - planning and operations. The planning department consisted of technical, trade and industrial relations departments. Operations was divided into five sections, including financial control, industrial accounts, administration, public relations, and organization and methods. A project would be handled by the planning side where a feasibility study was carried out, and construction completed. All engineering studies, supervision of design and manpower planning was done by the planning side of Petromin. After the project started to operate, the operations section took over all responsibilities. When a project was launched, Petromin established an Executive Management Committee, which was responsible to the planning sector of Petromin. After the project was completed, this Executive Management Committee became the nucleus of a Board of Directors with responsibility to the Petromin operations side. Once the project reached the company stage, it had a separate juristic personality. This meant that some companies might be owned wholly and directly by Petromin, while others might be owned jointly with the private sector. The marketing of petroleum products in Saudi Arabia is controlled by organizations which are wholly-owned subsidiaries of Petromin with no separate juristic personality.

Domestic Market

Petromin was empowered by its Statutes (Article 2e) to market and distribute all forms of petroleum products within Saudi Arabia. Petromin took over the distribution of petroleum products in Saudi Arabia in stages. In March 1964, facilities in the Western Province were bought from ARAMCO. The company also obtained a 75 per cent interest in a refinery at Jeddah. The Saudi Arabian Refining Company (SARCO), initiated by a Saudi private company retained 25 per cent interest. This refinery went into operation in 1968 with a capacity of 12,000 barrels per day. The distribution of petroleum products by Petromin in the remainder of the country was started in July 1967, when ARAMCO's domestic marketing facilities in the Eastern Province and central and northern areas was bought. Petromin thus owned and operated bulk distribution plants in Jeddah, Dhahran, Riyadh, Al-Khanj, Hofuf and Turaif, as well as the airport refuelling facilities at Dhahran, Riyadh, Gasumah, Badonah and Turaif. Prior to the completion of Jeddah refinery, all products came from ARAMCO's Ras Tanura refinery. Consumption of petroleum products was reported to be some 30,000 barrels per day and increasing by 20 per cent annually in 1967.[1]

In this period Petromin handled only bulk distribution, and retail marketing was done entirely by the private sector. The exception to that was Petromin's distribution of retail supplies to remote places mainly in the north. Otherwise, Petromin supplied the filling-station owners in bulk at its depots. Filling-station owners were licensed by the government. Petromin also tried to unify bulk prices (with a transport differential) throughout the country in order not to give one centre a particular advantage over others.

TABLE X.1

CONSUMPTION OF PETROLEUM PRODUCTS IN SAUDI ARABIA, 1966-74

Years	Consumption in Barrels per Day	Yearly Change %
1966	26,400	-
1967	30,400	15.2
1968	36,500	20.1.
1969	39,000	6.8
1970	41,500	6.4
1971	47,000	13.2
1972	55,000	17.0
1973	68,000	23,6
1974	75,000	10.3

Source: Dr. Nicholas Sarkis (ed.) Arab Oil Directory, Beirut, Arab Petroleum Research Centre, 1974, p.318.

The Arabian Geophysical and Surveying Company (ARGAS)

This company was established in April 1964 by Petromin, 51 per cent, and Compagnie Generale de Geophysique (CGG), 49 per cent equity share holdings. The Arabian Geophysical Surveying Company, with a capital of SR.2,000,000, was formed to carry out geophysical and surveying operations in search for oil, gas, minerals and underground water in the Kingdom of Saudi Arabia and neighbouring countries. The company has established a training centre in Jeddah and so far has trained a number of Saudi nationals who are working with operating crews in the country. A number of Saudi nationals who have already completed their training in the Kingdom, have been sent to France to obtain higher qualifications in the field of their specialization.[2]

The Arabian Drilling Company (ADC)

The Arabian Drilling Company (ADC): this company was established with an authorized capital of SR.10,000,000 on 7th April 1964. Petromin has 51 per cent interest in the company, and the remaining 49 per cent belongs to two French companies, Ionex and Languedocienne Forenco. Objectives of the Arabian Drilling Company are to carry out drilling operations in search of oil, minerals and underground water both inside and outside Saudi Arabia, and also to undertake work-over operations of wells and rendering of other related services.

The agreement under which ADC activities were planned, provided for 10 per cent of the company's profits to be used for training Saudi nationals at its training centre in Jeddah. Some of the trainees have been sent to France to acquire higher qualifications in the areas of their specializations.

The Arabian Drilling Company has carried out drillings for ARAMCO in Saudi Arabia, Getty Oil in the Neutral Zone, and Sunpetrol of Spain in northern Kuwait.[3]

Jeddah Oil Refinery Company

This company was established by Petromin in 1968 with the participation of Saudi Arabian Refinery Company (Petromin owned 75 per cent of the shares, and the remaining 25 per cent belongs to Saudi shareholders). Jeddah refinery was built with the capacity of 12,000 barrels per day by Chiyoda Chemical Engineering and Construction Company, which is a subsidiary of Mitsubishi of Japan. The products of this refinery were sufficient for nearly 30 per cent of the total consumption of the Western Province, and the balance was supplied from Ras Tanura refinery owned by the Arabian American Oil Company (ARAMCO).[4]

On 7th January 1972, an agreement was signed in Riyadh with Chiyoda Chemical Engineering and Construction Company Ltd., of Japan for expanding Jeddah Oil Refinery by 33,000 barrels per day, thus raising its total capacity to 45,000 barrels per day by 1974.[5]

TABLE X.2

CAPACITY OF JEDDAH REFINERY BOTH BEFORE AND AFTER EXPENSION

	Barrels per day	
Product	Capacity before Expansion	Capacity after Expansion
L.P.G.	100	900
Regular and Premium Gasoline	2,527	11,600
Kerosene and Jet Fuel	1,380	9,790
White Diesel Fuel	2,870	12,290
Fuel Oil	4,080	8,000
Asphalt	500	14,000

Source: General Petroleum and Mineral Organization (Progress Report 1970-71), p.21.

The consumption of petroleum products in Western Province of Saudi Arabia was 6,612 barrels in 1970. Considering 12 per cent annual growth in consumption in this region, by 1975 the demand would be 11,600,000 barrels per year, and in 1980 it would reach approximately 20,000,000 per year. Hence, with expansion, the Jeddah refinery is capable of meeting the demand of the Western Province until 1979.[6]

Petromin, through its industrial training centre in Jeddah, organizes training programmes for personnel of the refinery in different areas of their responsibilities.

Riyadh Oil Refinery

This refinery meets oil product requirements in the Central Province of Saudi Arabia. Chiyoda Chemical Engineering and Construction Company Ltd., of Japan, signed an agreement in January 1972 to build Riyadh refinery. In return for this project and the expansion of the Jeddah refinery, Mitsubishi has agreed to purchase from Petromin approximately 70 million barrels of Arabian light and heavy crudes over a period of four to five years. This crude will be made available by ARAMCO under the Saudi Arabian government entitlement to receive all or part of royalty in kind rather than in cash.[7]

Riyadh Oil refinery annual production is shown in the table below.

TABLE X.3

RIYADH REFINERY'S ANNUAL PRODUCTION

Product	Quantity
L.P.G.	260,700 barrels
Regular Gasoline	1,500,671 barrels
Premium Gasoline	611,329 barrels
Kerosene and Jet Fuel	712,800 barrels
Diesel	1,029,600 barrels
Fuel Oil	194,700 barrels

Source: General Petroleum and Mineral Organization (Progress Report 1970-71), p.23.

This production is expected to meet the demand for petroleum products in the Central Province until 1977, when the refinery would be expanded to 20,000 barrels per day. Riyadh Oil refinery will be supplied with light crude of 33.2^{o} API gravity from Khurais oilfield, via a 150 milometres-long pipeline.[8]

At the time when negotiation for this refinery was in progress, there were suggestions that oil product demand could be purchased from ARAMCO's refinery at Ras Tanura, without any need for a separate refinery at Riyadh. On the other hand, Dr. Taher, the Governor of Petromin, argued that although some petroleum products are available in Ras Tanura, products such as LPG and asphalt, can be manufactured more cheaply in Riyadh, and building the refinery was also important in view of future demand for products in central Saudi Arabia.

Petroleum Lubricating Oil Company (Petrolube)

Petromin Lubricating Oil Company (Petrolube): this company was established in 1967 and is jointly owned by Petromin, 71 per cent, and Mobil Oil Investments, 29 per cent. Petrolube's objectives are to undertake all activities relating to the refining, processing, manufacturing, blending, transporting and marketing of lubricating oils and allied products. The capital of the company in 1968 was SR.3,000,000 ($666,900), and was later increased to SR.10,000,000 ($2,22 million). Construction of the lubricating oil plant, which is located near Jeddah refinery, was completed in September 1971, and began full production on 1st October 1971, The productive capacity in the first year of operation was approximately 50,000 barrels, but it was anticipated that the production of this plant would reach 100,000 barrels by 1978.[10]

Petroleum Tankers and Mineral Shipping Company (Petroship)

This company was established in 1970 as a Petromin subsidiary with authorized capital of SR.25 million ($5.56 million). In March 1971, Petroship took delivery of its first oil tanker, "Taiba". This tanker has a capacity of 27,232 d.w.t., and made its first trip from Ras Tanura to Jeddah carrying oil produced by ARAMCO to Jeddah oil refinery.[11]

Petroship has ordered two more tankers, each with a capacity of 40,000 d.w.t., which are being built by Yugoslavia, and would increase the total capacity of Petroship tankers to over 100,000 d.w.t. The payment for construction of these tankers was made by shipment of 1.8 million tons of crude oil, which is another example of barter type trading with royalty oil.[12]

The company has opened a class to prepare trainees to join naval institutes abroad. They will graduate as naval officers qualified to operate and maintain tankers.

The Saudi Marine Petroleum Construction Company (Marinco)

Another venture in the petroleum sector was the establishment of Marinco in 1969, which is a joint venture between Petromin, 51 per cent, and McDermott of USA, 49 per cent. The company built a jetty at Ras el Khafji for the Arabian Oil Company, which was completed in 1972. Marinco also constructed a gas oil separator on Abu Ali Island for ARAMCO in 1972.[13]

All these companies, together with Petroleum Marketing, which is responsible for operating petroleum product distribution facilities in the Eastern, Central and Northern Provinces of Saudi Arabia, constitute major activities of Petromin in oil and related industries in the period covered by this section. But Petromin's role goes further than the oil sector into the natural gas, petro-chemical and mineral industries. In fact, one of the main objectives of Petromin is to strive to diversify the sources of income and widen the economic base of the Kingdom of Saudi Arabia. In this respect Petromin is quite different from other national oil companies, as is evident from the name "Petromin", which is an abbreviation of the words "Petroleum" and "Minerals", and constitutes the basic activity of the General Petroleum and Mineral Organization. Next we turn to the activities of Petromin outside the oil sector.

The Saudi Arabian Fertilizers Company (SAFCO)

This company was the first national project to be established by Petromin in 1965, with 49 per cent participation of the private sector. The plant, which is located in Damman, uses natural gas from the Eastern Province to produce fertilizers. Construction of this plant started in 1967, and its production capacity is 1,100 tons of urea and 35 tons of sulpher per day. Petromin has signed an agreement with Intezone Company of USA to sell all quantities of fertilizers in excess of the requirement of local marketing. SAFCO has started a training programme for the Saudi operators in order to enable them to take over the responsibilities of the foreigners in all parts of the plant.[14]

SAFCO's $40 million gas based Damman plant had considerable technical difficulties, which affected the stability of production.

<u>The Petromin Sulphuric Acid Plant (Petrocid)</u>

Construction of this plant in Petromin's industrial area at Damman, was completed by the end of May 1971. This plant is wholly-owned by Petromin and its production capacity is 50 tons of sulphuric acid per day, which is extracted from natural gas sweetening process at SAFCO. It also gets its electric power-steam requirements from SAFCO's facilities.[15] Most of the output is used for local consumption.

<u>Steel Rolling Mill (Sulb)</u>

One of Petromin's objectives, as mentioned before, is to engage in exploitation and development of various metallic and non-metallic minerals available in Saudi Arabia. Petromin, in co-ordination with the Directorate-General of Mineral Resources, has prepared feasibility studies for the exploitation of iron ore deposits discovered in Wadi Fatima, Wadi al-Sawawan and Jabel Idsas areas. The steel rolling mill was established in Jeddah in 1967 with the production capacity of 45,000 tons a year. This company is wholly-owned by Petromin, with the aim of meeting the growing demand for iron bars used for building and construction purposes. The mill produced iron bars of standard commercial sizes from imported billets. It must be noted that although the capacity of the mill is 45,000 tons a year, the actual production until 1971 was much lower than this capacity.[16] Plans were considered in 1972 to manufacture billets in Saudi Arabia on a commercial basis, and also to increase the capacity of bar manufacture from 45,000 tons annually to between 250,000 and 300,000 tons annually. Manufacturing of sponge iron was also considered with plans either to import ore from abroad, or to utilize the Kingdom's vast reserves of iron ore deposits in Wadi Fatima, in western Saudi Arabia.[17]

Petromin's Joint Venture Agreements for Oil Production

The granting of concessions does not lie within the powers of Petromin, and is handled by the Ministry of Petroleum and Mineral Resources. But Petromin, like any other company, is granted exploration licences by the government of Saudi Arabia. Prior to the establishment of Petromin, Saudi Arabia's role in its oil industry was basically to supervise oil concessionaires and collecting royalties and taxes. Exceptions to that were the ownership of 10 per cent of the Arabian Oil Company of Japan, and the ownership of local retail product distribution facilities.[18]

As a first step towards more involvement in the search and production of crude oil in the Kingdom, an agreement was signed with the French group AUXIRAP (a subsidiary of the French state oil company, ERAP) in April 1965. This concession was granted for exploration of oil in specific areas along the Red Sea coasts and in the event of oil being discovered in commercial quantities, a new company would be formed by the foreign partner and Petromin for the exploitation of the oil deposits. This agreement is, in fact, a dual agreement - the first between the government and the foreign concessionaire, and the other between Petromin and the foreign partner for joint-structure exploitation. Petromin was entitled to take a 40 per cent shareholding in this joint-structure company, and exploration outlay made by AUXIRAP would count towards the French 60 per cent share. Although Petromin is the minority shareholder, it has equal voting and executive powers in the joint company.[19] In 1968 AUXIRAP signed a third of its interest over to the Tennessee Oil Company (TENNECO), and in 1973 signed the remaining two-thirds interest to the same company. By 1973 no commercial oil had been found.[20]

In December 1967, Petromin made its second joint venture agreement in oil exploration and development. This was a tripartite agreement, comprising an agreement between the Saudi Arabian government and Petromin, whereby the latter was granted a 6 year exploration licence, followed by a 30 year exploitation concession if oil was found. Secondly, a contract between Petromin and ENI's subsidiary AGIP, under which Petromin retained legal title, but assigned to AGIP its rights and obligations from the first concession agreement, reserving a percentage interest in the establishment of a joint operating company. Thirdly, an agreement between Petromin and ENI's subsidiary ANIC for establishment of a joint petro-chemical venture.[21] Petromin had a 30 per cent option on the equity of the Saudi Arabian Oil Company (SAOC), which would be set up to operate the exploitation concession. In 1968 AGIP assigned 50 per cent of its interests to Phillips, and by 1973 no commercial oil had been found.[22]

The third joint venture agreement was with the Sun Oil Group, whose members are Arabian Sun Oil Company, Natomas Arabian Oil, Dillingham Arabian Oil Inc., Santa Fe International Corporation, Ti Arabian Exploration Corporation, and the Oil and Gas Development Corporation of Pakistan.[23]

The motivation of Petromin in entering into joint venture agreements for production of crude oil was not similar to that of NIOC in Iran, which was mainly to secure more foreign exchange earnings for the government. In the case of Petromin, the general policy of the government diversifying the source of income and integrating the oil industry more fully into the economy, played an important role.[24] In the first joint venture agreement the Arabian Geophysical and Surveying Company, a joint venture of Petromin, did the seismic surveys, and the Arabian Drilling Company, another company where Petromin had 51 per cent interest, did the drilling.

NOTES

1. See Petroleum Press Service, November 1963, p.430: also October 1967, p.365, and May 1969, p.174.

2. General Petroleum and Mineral Organization (Progress Report 1970-71), published by Petromin (no date or place of publication given), p.12.

3. General Petroleum and Mineral Organization, op.cit., p.18. See also Middle East Economic Survey, February 4th 1972 (Petromin's Projects, an interview with the Governor of Petromin, Dr. A. Taher).

4. General Petroleum and Mineral Organization, op.cit., p.21.

5. Middle East Economic Survey (see note 3 above).

6. General Petroleum and Mineral Organization, op.cit., p.21.

7. Middle East Economic Survey (see note 3 above)

8. General Petroleum and Mineral Organization, op.cit., p.23.

9. Middle East Economic Survey (see note 3 above).

10. Ibid. See also General Petroleum and Mineral Organization, op.cit., p.29.

11. Middle East Economic Survey (see note 3 above).

12. Petroleum Press Service, March 1973, p.97.

13. General Petroleum and Mineral Organization, op.cit., p.35.

14. Ibid., p.38.

15. Ibid., p.43.

16. Ibid., p.47.

17. Middle East Economic Survey (see note 3 above)

18. Abdalhady Hassan Tahir. Petromin and its Role in the International Industry (a lecture delivered to the joint Harvard-MIT Seminar on Eastern Hemisphere Petroleum, Boston, Masslk April 26th 1966), published by Petromin, p.8.

19. The General Petroleum and Mineral Organization (Jazeerah Press, Riyadh), p.10. For details of the Saudi Arabian-ERAP Agreement, see Petroleum Press Service, May 1965, pp.186-87.

20. Paul J. Stevens, Joint Ventures in Middle East Oil 1957-75 (Middle East Economic Consultants, Beirut, 1976), p.35.

21. Petroleum Press Service, January 1968, pp.4-5.

22. Joint Ventures in Middle East Oil 1957-75, op.cit., p.36.

23. General Petroleum and Mineral Organization, op.cit., p.10.

24. Petroleum Press Service, May 1969, p.173. See also Joint Ventures in Middle East oil 1957-75, op.cit., p.34.

CHAPTER XI

THE CHANGING ROLE OF PETROMIN IN THE SAUDI ARABIAN OIL INDUSTRY

In the past two chapters we discussed the historical evolution of the oil industry in Saudi Arabia and the development of the national oil company Petromin during its first decade of operation. But the rapid changes in the structure of the oil industry in the Middle East since 1972 have affected the objective and the role of Petromin considerably. Like some other oil-producing countries, Saudi Arabia realized that its national oil company was not yet capable of taking over all the operations of the country's oil industry fully and required the presence of foreign firms. Consequently, the activities of Petromin had to be limited to what the authorities thought the company could efficiently do while considering the political and economic interest of Saudi Arabia in general, and the future relationship with the foreign oil firms in particular.

In this chapter we discuss the activities of Petromin since 1973 which have involved a number of joint venture activities with international oil firms, and a larger number of such planned ventures which were later changed or cancelled. We also deal with the direct sales of crude oil and petroleum products by Petromin, and the future role of the company *vis-a-vis* these sales.

It must be noted that the future of the oil industry in Saudi Arabia and the role of Petromin largely depend on the outcome of the settlement under negotiation with the Arabian American Oil Company, ARAMCO. The sources of information concerning these negotiations, and indeed any information about the oil industry in Saudi Arabia, are very limited. Petromin's publications are few and do not constitute an up-to-date source of information on the affairs of the company. Hence, this chapter relies heavily on the oil economic journals in general and the Middle East Economic Survey in particular, as it has reported the development of the Saudi Arabia oil industry in considerable detail.

The Size of the Oil Operations in Saudi Arabia

Prior to any discussion on the present and developing role of the national oil company of Saudi Arabia, it is essential to mention the scale of the oil industry in the Kingdom. Saudi Arabia's proved oil reserves (excluding those in the Saudi-Kuwaiti Neutral Zone) were estimated to be more than 100 billion barrels, with another 72 billion barrels probable. Thus Saudi Arabia's reserves are greater than any other country in the world, and constitute nearly one-fifth of the world's proven reserves.[1] With the present installed production capacity of nearly 12 million barrels daily and future developments, this country is emerging as the only OPEC member capable of increasing its production to meet the increasing demand for oil in the 1980's. The following table shows the evolution of Saudi Arabian reserves of crude oil between 1970 and 1974, broken down by company (Getty Oil and Arabian Oil are operating in the Saudi-Kuwaiti Neutral Zone).

TABLE XI-1

SAUDI ARABIAN OIL RESERVES
(billion barrels)

	1970	1971	1972	1973	1974
ARAMCO	135.00	134.72	133.83	133.68	136.85
Getty Oil	0.70	0.65	0.62	0.60	0.72
Arabian Oil	3.00	2.89	2.62	2.55	3.47
TOTAL	138.70	138.26	137.07	136.83	141.04

Source: Middle East Economic Survey, December 26, 1975, p.4.

Most of the oil exported from Saudi Arabia is produced by ARAMCO. The production of oil in the Neutral Zone shared by Saudi Arabia and Kuwait is less than 5 per cent of the total Saudi Arabian oil production. The following table shows the oil production in the Kingdom in recent years.

TABLE XI-2

CRUDE OIL PRODUCTION IN SAUDI ARABIA (1973-1977)
(thousand barrels daily)

Year	Production	Increase/decrease
1973	7,602	
1974	8,484	+11.6
1975	7,076	-16.6
1976	8,579	+21.2
1977	9,157 (estimate)	+6.7

Source: *Middle East Economic Survey*, February 21, 1975 and March 21, 1977.

Export of oil from OPEC countries amounted to 28.6 million barrels a day in 1976, and Saudi Arabia provided nearly 30 per cent of the total.[2] Considering the increase in production capacity within a few years to some 15 million barrels per day, which is nearly half of the present export of OPEC members taken together, the importance and the size of the oil operations in Saudi Arabia becomes apparent. This, together with the size of the revenues (see table below) accruing to the Kingdom, gives the country a unique opportunity and power to choose oil policies in such a way as to fulfil its political and economic objectives.

TABLE XI-3

SAUDI ARABIA'S OIL REVENUES

Year	Million US$	%Increase/decrease
1970	1,214	
1971	1,885	+55.3
1972	2,745	+45.6
1973	4,340	+58.1
1974	22,574	+420.1
1975	25,700	+10.7
1976	33,500	+30.3
1977	39,000 (estimate)	+16.4

Source: Middle East Economic Survey, July 18, 1975 (viii)

Direct Sales of Crude and Products by Petromin

As a result of a participation agreement which was signed in December 1972, certain amounts of crude oil became available for the direct sale of the national oil company, and a large number of buyers approached the Saudi Arabian government to conclude crude oil contracts.[3] The participation crude oil available for sale in 1973 was about 190,000 barrels per day, which was 2.5 per cent of ARAMCO's production that the government had not sold back to the producing company under "phase-in" and "bridging" agreements. This crude was mainly sold by the government, and the Supreme Oil Council even considered setting up a new Saudi "international oil company" to handle overseas operations.[4] Petromin was not directly involved in the early stages of these sales, and continued its operations within Saudi Arabia.

The involvement of the national oil company in these sales became more evident by August 1973, when the contracts were signed directly between the sellers and the General Petroleum and Mineral

Organization. In these contracts Petromin clearly indicated its policy towards such sales of participation crude oil on behalf of the government. The Saudis kept their right to increase or decrease volume by 10 per cent each year with notice to be given a few months in advance of the shipment. Buyers could not adjust their lifting volume, and had to pay the seller within 60 days. Lifting conditions were similar to those of ARAMCO, and Petromin demanded that the buyers must specify the actual destination of the oil and agree not to resell it. Selling prices were set at about 93 per cent of posted prices with this ratio to be kept if prices were to increase for any reason other than currency shifts.[5] Hence, from 1973 Petromin was actively involved in selling certain amounts of crude oil on behalf of the Saudi Arabian government to a number of national and international oil companies from Europe, Japan, Asia and Latin America. The following table contains the names of those companies who signed contracts to buy Saudi Arabian oil in the early stages of the government sales of participation crude.

TABLE XI-4

BUYERS OF SAUDI ARABIAN PARTICIPATION CRUDE

Name of Company	Volume (million barrels annually)
Ashland Oil	6-8
Tenneco	6
New England Petroleum	6
Coastal States	6
Shaheen Natural Resources	7-8
ICC Industries	1.5
Petro-Rico	3
Mitsui-Kyokuto	1.8
Mitsubishi Oil Co.	1.9
Idemitsu	1.9
Arabian Oil-Kyodo Sekiyu	1.9
C.Itoh-Toa Oil	1.9
Maruzen-Nichimen	1.9
Fuji Oil	1.9
Mineraloel Vertfried Kraffert	1.2
US Wesseling of Germany	3.2
Petrobras	9.3
Indian Oil Corporation	na
CPC (Taiwan)	na

Source Petroleum Intelligence Weekly, May 21, 1973, p.2.

The October War of 1973 and the oil embargo which followed, altered some of these agreements, although the availability of participation crude to Petromin was not changed as a result of production cut-backs.[6] The direct crude oil sales by the national oil company through auctions continued in 1974. The Saudi Arabian government, excited by the high bids which they received at the auctions, demanded similar prices for the 'buy-back' oil under the participation agreement. The four major producers in Saudi Arabia - Exxon, Mobil, Texaco and Socol - acceded to the government's demand, and prices on their 'buy-back' volume were based on 'market' price, which was defined as the audited price of the Saudi government's own sales.[7] This was the first time that a national oil company's sale prices were taken into consideration in the pricing policy of the Saudi government. Considering the small volume of sales by Petromin and its importance in determining the price of much larger volumes of 'buy-back' oil, the state oil company did not attempt to 'maximize' its sales by offering price incentives.

Petromin's direct crude oil sales contracts concluded in 1973 (see Table XI-4) were for 3 years - 1973-1975 - and provided for total deliveries of nearly 71 million barrels annually (195,000 b/d). Most of these contracts were renewed by Petromin in 1975.[8]

In addition to these contracts, Petromin concluded agreements with two French oil companies for the sales of crude oil in 1974-1976. The two French companies - the Compagnie Francaise des Petroles (CFP) and Elf/Acquitaine - agreed to buy 40 million barrels (116,000 b/d) in 1974, 65 million barrels (178,000 b/d) in 1975, and 95 million barrels (260,000 b/d) in 1976. These agreements were renewed in January 1977 between Saudi Arabia's Petromin and the two above companies for a further period of 3 years. The new crude sale contract envisaged a total volume of nearly 262,5 million barrels over the 3 year period, with an estimated 87.5 million barrels (240,000 b/d) annually over the life of the contract.[9] The following table shows the direct sales of crude oil by the Saudi Arabian state agency Petromin between 1971-1975.

TABLE XI-5

DIRECT SALES OF CRUDE OIL BY PETROMIN 1972-1975

Year	Crude Oil Sales		
	Million barrels	Barrels per day	Per cent increase
1972	20.5	56,164	
1973	88.2	241,644	+330.2
1974	142.8	391,233	+61.9
1975	149.2	408,767	+4.5

Source: Middle East Economic Survey, October 4, 1976, p.3

At the end of 1976, Saudi Arabia lifted its ceiling on the crude oil production from 8.5 m b/d to 10 m b/d, and resisted complying with the pricing policy of the majority of the members of the Organization of Exporting Countries. Consequently, considerable amounts of additional oil were potentially available for export at prices below the comparable quality of oil from other Middle Eastern countries. It would have been a golden opportunity for the national oil company to enter into a number of contracts with the prospective buyers and establish sizeable markets for its future sales. But the government of Saudi Arabia did not choose the state oil company as its agent for the sales of incremental crude oil output. Instead, the ARAMCO partners were instructed to sell this oil in accordance with the official prices and other related ground rules set up by the government.[10]

The ground rules issued by the Saudi Arabian Ministry of Petroleum and Mineral Resources were as follows:[11]

a) ARAMCO shareholders (Exxon, Texaco, Mobil and Socol) "have undertaken to market the additional quantities to be produced"
b) Saudi Arabian crude "will be available for export to countries in approximately the same proportions as Saudi crude has been exported to such countries in the past"
c) The additional crude oil output "must only be marketed to refiners/users at the prices specified by the government and not through brokers"

d) "Each offtaker company and subsequent buyer of Saudi crude is obligated to submit to the government audited reports covering all such crude marketed by them specifying prices, destinations and transportation costs".

Petromin was not given the responsibility to dispose of a part of this incremental oil output and was not seen to be the agency for similar sales in the future. Even in the case of sales to CFP, where Petromin already had a sale contract to supply this French company, the incremental supplies were contracted from Exxon and separate from Petromin's contracts.[12] The government reasons for keeping Petromin out of these sales were not reported but it could probably be summarized as follows:

1. The Saudi Arabian government's purpose was to ensure that its crude would reach the refineries at the lower prices set down by the Kingdom, and Petromin did not have adequate channels.
2. The government intended to export this incremental crude in the same proportion as the historical pattern of export destination, and in this respect the assistance of ARAMCO was vital.
3. The organization and management of the state oil enterprise was not adequate to handle this operation and the government did not want to hold auctions on this oil, which would have undermined its price objectives.
4. The government envisaged the two-tier pricing in OPEC would not last long, and it did not want the national oil company to enter into agreements which had to be altered later.

Petromin's Joint Venture Agreements

From mid-1974, a number of major international oil companies and independents approached the General Petroleum and Mineral organization with a variety of joint venture proposals. These proposals, which were mainly a matter of building export refineries and petrochemical complexes, were an attempt by the oil companies to secure future oil supplies in their new role as partners (rather than concessionaires) which was developing at that time. Even those companies such as Shell and Gulf, who had not been directly involved in the Saudi Arabian oil industry before, signed letters of intent committing themselves to huge investments in the Kingdom, partly because they did not want to be left out while the other majors were embarking on this new relationship. The rush of such joint venture agreements was not only in Saudi Arabia. In Iran and some other oil-producing countries, oil companies were also involved in such negotiations in the aftermath of the so-called "oil crises" of 1973-74.

Some of these joint venture projects were shelved at an early stage, due mainly to the changing circumstances within the oil industry in 1975, which created a cash-flow squeeze for some of the major international oil firms. For example, the Petromin-Gulf Oil joint venture proposal to build an ethylene-based petrochemical plant and a refinery in Saudi Arabia, was formally withdrawn by Gulf Oil. The cancellation was blamed on the shifting demand-patterns, restructuring within the company reduced earnings and rising requirements for investment in new energy resources.[13]

By the end of 1975, the situation of the proposed joint venture agreements between Petromin and international oil companies was as follows: Mobil Oil and Petromin agreed on a joint venture project involving construction of an oil refinery and petrochemical complex in western Saudi Arabia and a cross-country crude oil pipeline.

The crude oil pipeline is to be 100 per cent government-owned, with construction and management assistance from Mobil Oil. This pipeline will (a) open up the country's third major terminal for oil and gas exports; (b) supply oil and gas feed-stocks for the refinery and petrochemical industries at Yanbu; (c) deliver crude oil via branch lines to the domestic refineries at Riyadh and Jiddah; (d) provide a pipeline outlet for new fields; and (e) establish a focus for communities along the route by providing fuel requirements, road and other services. The 48-inch pipeline goes from Ghawar field in the east to Yanbu in the west, a distance of nearly 1,270 km. It will have a capacity of 1.85 million b/d at the initial stage, rising to 2.35 million b/d in the future. The construction of this pipeline was estimated to be completed by 1979-80, with an over-all cost of approximately $1.5 billion.[14]

The refinery and petrochemical complex owned 50-50 by Petromin and Mobil Oil will be supplied by the oil from this pipeline, and a 250,000 b/d natural gas liquid line, which will be constructed parallel to the crude line.

The refinery was projected to start up in 1979-80 with an initial capacity of 250,000 b/d, rising to 500,000 b/d by 1982. The required investment is estimated at $963 million (in 1979 dollars). The petrochemical complex will consist of a one billion pounds per year ethylene plant, with three additional plants to process the ethylene into low density polyethylene (440 million pounds per year), ethylene glycol (350 million pounds per year) and styrene monomer (930 million pounds per year). The cost of the project, which a start-up date around the mid-1980's, will be nearly $817 million. The majority of financing for these three projects, which could amount to some $3 billion, will be provided by the Saudi government.[15]

In addition to the above agreements, Petromin and Mobil Oil finalized a 25 year joint venture agreement for establishment of a refinery for the manufacture of lube oil-based stocks. The refinery will be owned 70 per cent by Petromin, and 30 per cent by Mobil, and it is estimated to cost $100 million. Mobil has agreed to purchase the surplus stocks which cannot be absorbed by the local market. Part of the output of this refinery will be supplied by Jeddah Petrolube blending plant, which is owned 61 per cent by Petromin, 36 per cent by Mobil, and 3 per cent by APSCO, a private Saudi firm.[16]

Another major agreement signed by Petromin in 1975 was a 50-50 joint venture agreement with Shell International of the US. It covers the construction of an export refinery with an estimated cost of $1,000 million, and an initial capacity of 250,000 b/d rising 500,000 b/d. The contract was for a period of 25 years and the completion date was envisaged in 1978-79. Shell US also signed another 25 year agreement with Petromin for construction of a petrochemical complex at a cost of nearly $1,000 million, and a capacity of 500,000 tons of ethylene glycol.[17]

In 1975, apart from Mobil and Shell, Dow Chemical Company of the US proposed a joint venture petrochemical project with Petromin. (The project, which will cost $800 million was approved by Petromin in May 1975.) The state-owned oil company also received proposals from Texas Eastern-Celanese Corporation, Exxon, Mitsubishi, Amoco and Stauffer Chemical.[18] Another joint venture agreement for an export refinery was signed between Petromin (50 per cent) and Texaco (25 per cent) and Socal (25 percent), which will be completed by 1981.

In addition to projects for export refineries, Petromin has begun a major expansion programme for the existing Jeddah and Riyadh refineries. This is mainly to meet the domestic consumption which reached 88,000 b/d in 1974, and is growing rapidly at a rate of 30 per cent annually.[19] The capacity of the Jeddah refinery is to be expanded from 50,000 b/d to 210,000 b/d, and that of Riyadh from 15,000 b/d to 120,000 b/d. These works, which might cost up to $1,000 million will be undertaken by Chiyoda Chemical Engineering and Mitsubishi.[20] The following table shows the existing and projected joint venture refineries of Petromin.

TABLE XI-6

PETROMIN'S EXISTING AND FUTURE JOINT VENTURE REFINERIES

Thousand barrels daily

Location	Ownership	Present Capacity	Planned Total	Probable Completion
Jeddah	Petromin	50	240	1979
Riyadh	Petromin	15	120	1979
Al Jubail	Texaco-Chevron-Petromin	-	120	1981
Al Jubail	Shell-Petromin	-	250	1981
Julaib al-Bahri	Mitsubishi-Petromin	-	250	1980
Yanbu	Mobil-Petromin	-	250	1981
Uncertain	Shell-Petromin	-	500	-

Source: Petroleum Economist, September 1976, pp.352-3, Middel East Economic Survey, December 12, 1975, pp.2-3.

Change in the Responsibility of Petromin

When Petromin was formed in 1962, its objective was to participate in various phases of commercial and industrial activities related to petroleum and minerals. The organization was empowered to promote and develop both mineral and petroleum industries, as well as petroleum and mineral products and by-products (see Chapter IX). But the development of the oil industry in Saudi Arabia and the changes which occurred in the nature of the petroleum industry in the Middle East, altered the size of Petromin's operation and future prospects considerably. Based on its statutes, Petromin was directly or indirectly made responsible for the industrialization of Saudi Arabia, a task which was expanding rapidly every month. Meanwhile, the reshuffle in the cabinet in October 1975 split the former Ministry of Commerce and Industry into two separate ministeries in an attempt to bring about a greater measure of portfolio specialization and to bring into the government additional representatives of Saudi technocrats.[21]

In consequence of these changes, the responsibility of Petromin was altered considerably. The Saudi Council of Ministers decided to transfer responsibility for the petroleum, gas and mineral companies and projects from the state oil agency to the Ministry of Industry and Electricity. Petromin's functions were reduced to refining, transportation, distribution and marketing of oil internally and abroad, and supervision of three companies. The following is the text of the decision of the Council of Ministers, plus the name of the companies still remaining under Petromin's exclusive control.

1. The Ministry of Industry and Electricity shall formulate policy regarding industry and electricity and shall supervise its implementation. It shall also provide technical and advisory facilities to private industrial and electrical organizations and companies, and shall plan, implement and follow up existing and future government industrial and electrical projects which the private sector cannot undertake on its own.
2. The following government departments and organizations shall be attached to the Ministry of Industry and Electricity:
   a) Government departments and organizations which were attached to the Ministry of Commerce and Industry previously namely:
      i) The office of the Deputy Minister for Industry;
      ii) the Department of Electricity Services;
      and (iii) the Centre of Industrial Research and Development
   b) Power stations attached to the Ministry of Urban and Rural Affairs
   c) Companies and projects for petroleum, gas and minerals and their derivatives and products shall be transferred from Petromin and attached to the Ministry of Industry and Electricity.
3. Petromin's Statutes, issued by Royal Decree No.25 of 25.6.1382, shall be amended to restrict the agency's functions to activities relating to the marketing, refining, distribution and transportation of petroleum internally and externally, and to the control of the following companies:
   a) The Arabian Geophysical and Surveying Company (ARGAS)
   b) The Arabian Drilling Company (ADC)
   c) The Arabian Marine Petroleum Construction Company (MARINCO)
4. The Ministry of Industry and Electricity shall propose the measures it deems suitable to supervise the companies and industrial projects attached to the Ministry.

Petromin's role in the new set-up is not very clear. For example, while it still has the responsibility for refining, all the projects for petroleum and gas have been transferred to the Ministry of Industry. Consequently, the construction of Petromin's 50-50 joint venture refineries with Mobil and Shell would be supervised by the Ministry of Industry, which indicates that Petromin's role will begin after the construction activities are ended.

In January 1975, less than a year before the change in responsibility of Petromin, the company's Board approved a budget of nearly $13 billion for the development programme of 1975-80. The plan, which was prepared with the help of the US consultants Arthur D. Little, covered investments in petroleum refining, gathering and liquefaction of gas, petrochemicals, iron, steel and aluminium manufacture.[23] The responsibility of all these projects, with the exception of the gas project, which is handled by ARAMCO, are now transferred to the Ministry of Industry.

The Saudi government have set up a new wholly-owned government company; the Saudi Company for Basic Industries, SCBI, with a capital of $2.8 billion to undertake large-scale industrial projects. The Board of Directors of this company consists of the Minister of Industry (Chairman), the Managing Director of SCBI, the Under-Secretaries of the Ministries of Planning, Industry and Electricity, and Finance, the Vice-president of the Saudi Development Fund, and one representative of the private sector. The government is to offer 75 per cent of its equity shareholding to the public after an initial six-year period.[24]

The projects to be set up by SCBI include three petrochemical complexes, iron and steel complexes, and an aluminium plant in Jubail, a steel rolling mill in Jeddah and two fertilizer plants.[25] Whether responsibilities for the joint venture refineries would be given to Petromin was not mentioned, but the 1977-78 budget of Petromin at SR56,270,000 (nearly $16 million) does not indicate that the agency would be involved in any big investment. This figure of SR56 million seems very small, especially when compared with the budget allocations of SR4.4 billion for the universities in Saudi Arabia during the same year.[26]

The future role of Petromin in shipping activities was revealed by the Governor of Petromin in 1976. Petromin would get involved in shipping only if other shipping agencies proved to be inadequate for the companies' operations. At present private Saudi concerns, the OAPEC-sponsored Arab Maritime Petroleum Transport Company, and foreign flag carriers are used by Petromin.[27] So Petromin's involvement in transportation, petrochemicals, mineral industries and gas projects has been reduced in the past two years. But until the terms of the final settlement between the Saudi government and the Arabian American Oil Company are known, it is difficult to speculate on the future role of Petromin.

The Role of ARAMCO in the Saudi Arabian Oil Industry

The negotiations between the Arabian American Oil Company and the Saudi Arabian government for the government's 100 per cent take-over of ARAMCO has been going on for more than 3 years, and the terms of final settlement between the two parties have not yet been published. The Agreement was reached on basic issues 2 years ago in March 1976. The importance of the Agreement as far as this work is concerned, is the future role of ARAMCO in the Kingdom and its possible co-operation with the national oil company. In this respect an important issue would be the volume of off-take of crude oil by the companies and their prices which might involve some discount for operational and other related services provided by the companies. Furthermore, the extent and the nature of these services by the former owners of ARAMCO is of considerable importance, as they might be replacing some of the activities of the national oil company.

For example, new responsibilities of Petromin, as mentioned before, do not include exploration and development of hydrocarbon resources of Saudi Arabia. This responsibility would most probably go to the former owners of ARAMCO in most of the prospective areas. The final terms of the settlement will show if the national oil company is allowed to take part in these activities.

Saudi Arabia is very keen to keep the companies in the country, as there is a great deal of oil development still to be done in different areas. In principle ARAMCO would remain to provide managerial, technical and operational services for the government. The future relations between the companies and the government would be "governed by the principles of commercial incentives".[28] The huge "gas project" in Saudi Arabia, which will have considerable effect on the future pattern of gas supplies worldwide is not co-ordinated by Petromin which seemed to be the natural choice as its old statutes gave the company the necessary legal backing.

The mammoth gas projects currently underway in Saudi Arabis are gas gathering, treatment and transmission of natural gas. The cost of the project, which is undertaken by ARAMCO on behalf of the Saudi Arabian government, has so far been estimated to reach $16 billion.

This compares with the estimates of $5 billion originally and $10 billion (with some expansion in scope) at the end of 1975. The scheme was basically scheduled for completion in 1979, but according to Dr. Taher, the Governor of Petromin, part of the project would be finished by 1981 and the rest might take up to 1985.[29]

The key to the programme is the gathering of associated gases - that is gas produced with crude oil - at six strategically located centres. At these centres associated gas would be treated (acid gas removed), natural gas liquids will be extracted and sweet dry gas (methane) will be compressed and distributed to provide fuel for several industrial areas, including Jubail and Dammam. The original $5 billion scheme provided for gathering and treatment of 3.5 billion cubic feet daily of associated gas produced at crude oil output level of around 8 million b/d. The expanded project will handle 5.5 billion cubic feet daily, which is nearly all the associated gas produced at a crude output level of 12 million b/d. The system has even provision for bringing in non-associated gas from Khuff dry gas field in order to reduce the dependence of the future gas exports on crude oil production levels.[30]

ARAMCO will build gas processing centres in which the sour gas will be treated ("sweetened") to remove the acid gas which will then be sent to a sulphur plant for recovery of sulphur. The sweet gas will be compressed and undergo partial fractionation to produce a dry gas stream and a wet gas stream. The dry sweet gas, which is basically methane, will be used as fuel and feedstock, the liquid gas stream containing natural gas liquids will be moved to fractionation plants.[31]

Fractionation is the process of separating the natural gas liquid stream - which is basically ethane, propane, butane and natural gasoline - into its component parts through controlled vaporization and condensation in a column. Ethane, the lightest component, will be used as feedstock for the petrochemical plants. Additional fractionation will separate the remaining component which then requires treatment for removal of mercaptans and sulphur-related compounds before being exported.[32] The table below shows the export availability in 1977, and the estimated availability in 1985, when this huge project is due to terminate.

TABLE XI.7

SAUDI EXPORT AVAILABILITY OF LPG (PROPANE AND BUTANE)

	1977		1980-82		1985	
	Mil.Tons	Thou.b/d	Mil.Tons	Thou.b/d	Mil.Tons	Thou.b/d
Ras Tanura	5.8	188	7.0	227	6.8	220
Ju'aymah	-	-	1.4	45	4.5	146
Yanbu'	-	-	1.5	48	4.0	130
Total	5.8	188	9.9	320	15.3	496

SAUDI EXPORT AVAILABILITY OF NATURAL GASOLINE

	1977		1980-82		1985	
	Mil.Tons	Thou.b/d	Mil.Tons	Thou.b/d	Mil.Tons	Thou.b/d
Ras Tanura	3.0	78	4.0	105	4.5	118
Yanbu'	-	-	0.5	13	1.3	34
Total	3.0	78	4.5	118	5.8	152

TABLE XI.7 (continued)

SAUDI EXPORT AVAILABILITY OF ALL GAS LIQUIDS (C_3+)

	1977		1980-82		1985	
	Mil.Tons	Thou.b/d	Mil.Tons	Thou.b/d	Mil.Tons	Thou.b/d
Ras Tanura	8.8	266	11.0	332	11.3	338
Ju'aymah	-	-	1.4	45	4.5	146
Yanbu'	-	-	2.0	61	5.3	164
Total	8.8	266	14.4	448	21.1	648

Source: Middle East Economic Survey, June 13, 1977, p.8.

At present the exploration and development of oil in Saudi Arabia, and the gas gathering and processing project are handled by ARAMCO on behalf of the Saudi Arabian government, and the national oil company is not directly involved in these operations. The outline of the ARAMCO activities was given by Sheikh Ahmad Zaki Yamani in an interview with The Saudi Arab News, as follows:[33]

> "Firstly, they provide for the state to assume full and real ownership of this sector. This means ownership which is not just formal, and differs from what some of our neighbours have done in the past.
>
> Secondly, they establish solid relations between us and the oil companies so that we can be sure that these companies will continue to discharge their duties as they have done in the past, even after the relationship between them and the Kingdom has changed from owning the installations to providing services only. The companies at first refused our requests and resisted these proposals for more than two years, but through persistence and patience we were able to arrive at these agreements.
>
> Thirdly, the companies will provide services and will receive compensation for these services. The compensation will vary with the size and type of the services and their success, which is to say that if the companies are negligent in providing services and the results are less than what is required, then the compensation they receive is less. If the services supplied surpass expectations then the compensation increases somewhat. This means that in future, relations between the government and the companies will be governed by the principles of commercial incentives.
>
> Fourthly, the companies will work both for their own account and on behalf of the Kingdom, in that they will invest money in drilling and if they are successful they will get their money back and receive as payment for their success a very small sum for each barrel produced from their discovery -

> a sum that cannot be equated with the risks they undertake. If the companies fail in their drilling, they bear the burden of the failure.
>
> There are also agreements on natural gas and joint investments in marketing operations, as well as agreements relating to administrative matters and the companies' clearly defined obligation to provide us with technical and administrative expertise. There is also an agreement regulating crude oil lifting arrangements.

To sum up, Petromin's role in the Saud Arabian oil industry has changed considerably in recent years. The responsibilities of the company which covered all the petroleum and mineral activities in the Kingdom at the beginning of its establishment has been reduced. All the petrochemical and mineral projects are now under the responsibility of a new state-owned company (Saudi Company for Basic Industries) and the gas gathering and processing, which is the largest project in the country at present, is organized, developed and managed by ARAMCO. Even Petromin's 50.50 joint venture projects with international oil companies for export refineries will be managed by the Ministry of Industry as far as the constructions are continuing. All together, Petromin, which in its statutes was given more responsibility than any other national oil company in the region, is now mainly handling the internal distribution of petroleum products, sells more than 400,000 b/d of crude oil on its account and controls three other companies active in exploration and drilling, as mentioned before.

However, these changes do not mean that Petromin will not play an important role in the future sales of crude oil and petroleum products; the activities of the company in the future operations of its joint venture export refineries are yet to be clarified. The operations of Petromin will now be more concentrated and specialized. Other oil-producing countries have also passed similar laws to divide the responsibilities of their national oil company, and have set up new organizations to handle different aspects of the oil industry. The future role of Petromin also depends on the developing role of ARAMCO in the Kingdom in general, and the nature of the final settlement reached between the two parties in particular.

NOTES

1. Petroleum Economist, January 1976, p.14.
2. Shell Briefing Service Document, "Oil and Gas 1976", prepared as an information brief for staff of the companies of the Royal Dutch-Shell Group.
3. Petroleum Intelligence Weekly (Special Supplement), Test of the Participation Agreement, December 25, 1972.
4. Petroleum Intelligence Weekly, April 30, 1973, pp.1-2.
5. For full text of "Petromin Contract" see Petroleum Intelligence Weekly (Special Supplement), August 6, 1973.
6. Petroleum Intelligence Weekly, November 26, 1973, p.5.
7. Petroleum Intelligence Weekly, February 4, 1974, p.9.
8. Middle East Economic Survey, November 28, 1975, p.4.
9. Middle East Economic Survey, February 7, 1977, p.9.
10. Middle East Economic Survey, January 24, 1977, p.1.
11. Middle East Economic Survey, January 17, 1977, pp.4-5.
12. Middle East Economic Survey, January 24, 1977, p.1.
13. Petroleum Intelligence Weekly, October 17, 1975, p.1.
14. Middle East Economic Survey, December 12, 1975, p.2.
15. Ibid., p.3.
16. Middle East Economic Survey, July 4, 1975, p.2.
17. Middle East Economic Survey, January 24, 1975, p.3 and December 12, 1975, p.3.
18. Ibid.
19. Middle East Economic Survey, December 12, 1975, p.3.
20. Ibid., see also Petroleum Economist, March 1977, p.113.
21. Middle East Economic Survey, October 17, 1975, p.4.

22. Middle East Economic Survey, December 5, 1975, pp.5-6.

23. Middle East Economic Survey, January 24, 1975, p.3.

24. Middle East Economic Survey, November 8, 1976, p.9.

25. Ibid., p.9.

26. Middle East Economic Survey, July 4, 1977, (ii).

27. Middle East Economic Survey, June 7, 1976, p.3.

28. Middle East Economic Survey, July 25, 1977, p.2.

29. Middle East Economic Survey, November 1, 1976, p.6.

30. Middle East Economic Survey, December 12, 1975, p.1.

31. Ibid., see also Petroleum Economist, December 1977, -p.494-5.

32. Ibid., see also Middle East Economic Survey, July 4, 1975, p.2.

33. Middle East Economic Survey, July 25, 1977, p.2.

PART FOUR

THE CASE OF THE KUWAIT NATIONAL PETROLEUM COMPANY

CHAPTER XII

THE OIL INDUSTRY IN KUWAIT AND THE FORMATION OF THE KUWAIT NATIONAL PETROLEUM COMPANY

Background

Kuwait is situated at the corner of the Persian Gulf and has an area of approximately 6,000 square miles (excluding the Neutral Zone, which lies between Kuwait and Saudi Arabia and since 1922 has been jointly administered by these two states). Kuwait is bordered on the north and west by Iraq, on the south by Saudi Arabia and the Neutral Zone, and on the east by the Persian Gulf. It is a flat desert country, arid and riverless.[1]

The population of Kuwait at present is estimated at nearly 1 million, of whom less than half are Kuwaitis. The non-Kuwaits comprise nearly 70 per cent of the labour force.[2] According to the 1965 Census the total population of Kuwait was 467,339, comprising 220,059 Kuwaitis and 247,280 foreigners. Most of the Kuwaitis are Sunni Muslims and are concentrated in the capital, Kuwait City, and in a small number of communities chiefly along the coast of Kuwait Bay.[3] The ruling dynasty in Kuwait was founded by Shaikh Sabah Abdullah. The Sabah family was originally part of the Anazah tribe in the Arabian Peninsula. In 1899 the then Ruler, Shaikh Mubarak, who feared the increasing authority of the Turkish government in Kuwait, concluded a treaty with the United Kingdom. The Anglo-Kuwaiti treaty of protection gave Kuwait the assurance of British protection, and in return the ruler agreed not to alienate any of his territory without British concent. In 1915 the British Government recognized Kuwait as an independent government under British protection. The full independence and sovereignty of Kuwait was achieved on 19th June 1961.[4]

Kuwait Oil Industry

As mentioned before, the Red Line Agreement restricted the competition among the major international oil companies for acquiring concessions within a prescribed area. Iran and Kuwait were specifically excluded from this agreement.

In 1927 Gulf Oil had secured concession rights in the Sheikdoms of Kuwait and Bahrain. The company withdrew from developing its Bahrain concession under its obligation as a signatory to the Red Line Agreement. But Kuwait was not part of the restricted area, and so Gulf Oil concentrated its attention on the concessions in this Sheikdom. At that time Kuwait was still under British control, and the British Government's policy reserved concession rights with British colonial areas to British companies. Gulf Oil had the obstacle of nationality, while its rival the Anglo-Persian Oil company, who was bidding lower for the same concession, had no such handicap. With respect to the nationality question, Gulf Oil requested the assistance of the State Department of the United States. The intervention of the State Department on behalf of Gulf to overcome the obstacle of nationality, led to a series of negotiations among the parties concerned, which led to a compromise allowing both companies to develop Kuwait's oil jointly with equal shares. Later these two companies formed their common affiliate - the Kuwait Oil Company - in February 1934. Concession negotiations with the Shaikh of Kuwait were finalized in December 1934. The area was 6,000 square miles, and the period of concession was agreed to be seventy-five years.[5]

Kuwait Oil Company

Kuwait Oil Company started its preliminary surveys in 1935, and in 1938 discovered Burgan field some 28 miles south of Kuwait Bay. Between 1938 and 1942 a number of other wells were drilled which confirmed the existence of one of the largest oil accomulations in the Middle East. Between 1942 and 1945 exploration activities of Kuwait Oil Company were suspended, and the already completed wells were plugged. With the end of the Second World War, the activities were resumed, and the first commercial shipment of Kuwaiti oil was exported in June 1946. Encouraged by the prospects of the Burgan field, the Kuwait Oil Company extended its exploratory operations to other regions of the State of Kuwait. As a result of these explorations, two new fields, Magwa and Ahmadi were brought into commercial productivity by 1953.[6]

The two parent companies of the Kuwait Oil Company, namely the Anglo-Iranian Oil Company[7] and the Gulf Oil Company, were both international oil companies with access to crude oil supplies surplus to their own integrated needs. Consequently, in order to obtain outlets for their share of Kuwaiti oil these two comapnies entered into long-term contracts for a large off-take with other major oil companies. Gulf Oil entered into such agreements with Shell, and the Anglo-Iranian Oil Company with Standard Oil (New Jersey) and Socony-Vacuum.[8]

Kuwait Oil Company's function was merely involved with the production of crude oil from Kuwait to be lifted by the two parent companies. Kuwait Oil Company was not concerned with world marketing, and did not possess any facilities in this respect. During the 1950's and 1960's the concession underwent changes in terms somewhat similar to those in other countries of the Middle East. The 50 per cent income tax was introduced, which involved the payment of taxation in addition to the tonnage royalty, and became effective in December 1951. The period of concession was extended by 17 years, and in 1962 2,200 square miles were relinquished. The production of crude by Kuwait Oil Company amounted to 800,000 tons in 1946, 2.19 million in 1947, and 6.3 millions in 1948. By 1952 the production reached 37 million tons, which meant an average yearly increase of nearly 90 per cent between 1946 and 1952. This rate was achieved partly due to the loss of production in Iran following the nationalization of the oil industry. (See section on Iran).[8]

The Kuwait Oil Company further built a refinery with the capacity of 25,000 b/d, which came on stream in 1949. The refinery capacity of the Kuwait Oil Company was rapidly expanded in the fifties, and by 1955 KOC refinery capacity was 250,000 barrels of crude oil daily. The main products of the refinery were kerosene, light gas oil and heavy gas oil. These constituted 42,5 per cent of the total volume of the refined products. The remaining 57.5 per cent comprised bitumen and other materials. KOC's Port Mina Al-Ahmadi was built to load about 3 million barrels of oil daily.[9]

Apart from Kuwait Oil Company, two other concessions were granted by the Shaikh of Kuwait. The first was the 60 year concession in the Neutral Zone (shared by Kuwait and Saudi Arabia) to a group of American companies in 1948. The American Independent Oil Company (Aminoil) was also granted the concession to look for oil in the islands of Kuber, Baru and Umm-al-Maradim, and territorial waters of these islands, in 1949.

The second concession was granted to a Japanese group with an operating subsidiary - The Arabian Oil Company (AOC) - in 1958. AOC comprises the off-shore of the Kuwaiti-Saudi Arabian Neutral Zone, with the exception of the territorial waters of the Neutral Zone and the above islands.

Why the Kuwait National Petroleum Company was formed

Unlike Iran, the establishment of the Kuwait National Petroleum Company was neither affected by the internal political disputes among various factions, nor resulted from a dispute with the international oil companies operating in the country. KNPC was established in October 1960, nearly seven months before the date when full independence was granted to Kuwait. Prior to that the political structure of the Shaikdom was similar to the traditional societies of the Arabian Peninsula. The ruler and his council were the executive and legislative branches of the nation, while the judicial branch was associated with the religious authorities, and was based on the Quran.

During this time, there were no political parties similar to those existing in Iran after World War Two. After independence, a constituent assembly was elected in 1962 which drew up the constitution, and in 1963 the first National Assembly was elected. There is little evidence that the formation of the KNPC in 1960 had a definite political motive. Furthermore, the establishment of the Kuwait National Petroleum Company was not the result of the government's discontent with the operations of the concessionaires. Before the discovery and extraction of oil in Kuwait, the economy of this small country had depended mainly on sea-farming and pearl fishing. The per capita income in this period did not exceed $35. Import duties ranging between 4 to 6 per cent constituted the main source of public revenue, and the total work force of the country was between 8,000 and 10,000.[10]

Within a few years after the export of oil began, Kuwait with a population of less than half a million was receiving oil revenues similar to those of Iran or Saudi Arabia. The phenomenal increase in oil revenues caused a drastic change in Kuwait's economic and social life. Kuwaitis were attracted away from pearling, sea-farming and boat building, into the oil industry, government service, construction and various service occupations of high income economy. In a small city like Kuwait, everybody was benefiting from the operation of the oil companies directly or indirectly. Kuwaitis were also using new roads, schools, hospitals and water distillation plants.

Even the foreign workers in Kuwait were benefiting as a result of this oil boom, and although their earnings were less than those of Kuwaiti workers, they were by far higher than other parts of the

Middle East. There were tensions and conflicts among various groups and nationalities, but they did not manifest themselves in hostility against the oil industry. The situation was not like that in Iran where opposition usually claimed that the root of the country's economic problems was in the government's mishandling of the oil industry. Hence the idea of creating a national oil company was not based on the dissatisfaction or dispute with the foreign owned operating companies.

KNPC's establishment, and its pattern of growth, have been affected by certain social and economic conditions which prevailed in the early days prior to the discovery of oil in Kuwait. Kuwaitis have a much more mercantile mentality compared to other countries of the region, and they were among the most ambitious and mobile traders in the Persian Gulf. This tradition of commercial entrepreneurship, which was obtained long before the discovery of oil in the area, was partly due to the existance of a natural harbour in Kuwait City. So free enterprise, trade and capitalism are traditional characteristics of Kuwaitis.[11]

These characteristics were further enhanced when oil was discovered in Kuwait and a whole new area of activities were open to the Kuwaiti merchants. The emergence of the oil industry and the expansion of trade encouraged the formation of a number of private and mixed shareholding companies jointly owned by the government and the private sector. By 1961, even some wholly state owned industries, such as sand-lime brick plant, a cement works and a chlorine factory, were transferred to one company

(Kuwait National Manufacturing Company) in which the private sector was allowed 49 per cent interest. Another example of public subscription in major projects in that period was the Kuwait Petro-Chemicals Company, in which the government held 40 per cent interest. The remaining 60 per cent was divided among an Italian chemical construction company (40 per cent), Kuwait National Petroleum (5 per cent), Kuwait National Manufacturing Company (3 per cent) and the private sector (12 per cent).[12]

Kuwait Tanker Company was formed by a group of local merchants. The company took delivery of its first tanker from Japan in 1959. Kuwait National Bank began its operations as a shareholding company owned by the private sector in 1952. Similarly, Kuwait Insurance Company was formed by the private sector. The extent of the government involvement in mixed ventures during this period varied from 98.72 per cent in Kuwait Trading Contracting and Foreign Investment Company, to 25 per cent in Kuwait Hotel Company.

The establishment of the Kuwait National Petroleum Company in 1960 as a mixed shareholding organization, with the private interest of up to 40 per cent, was an extension of this government policy of allowing the private sector to take part in major projects. It is true that there was a certain prestige attributed to the formation of the National Oil Company, but this was not the main reason for the establishment of KNPC. In other words, KNPC was not formed by the Kuwaiti Government simply to show that it had a National Oil Company similar to the other major oil producers. However, the government was eager to establish an organization for distribution of petroleum products in Kuwait which became part of KOC's responsibilities. So the formation of KNPC, as such, was an attempt by the government to create a profitable and efficient organization to take over domestic distribution of petroleum products and gradually engage in other oil activities.

> "The raison d'etre behind the establishment of KNPC is to give Kuwaitis direct participation in oil affairs. The Company in this respect offered a golden opportunity for the Kuwaiti capital as well as manpower to share in developing the only natural resource of the country, i.e. oil."[13]

As for the oil policies, the government reserved all matters within the jurisdiction of the Ministry of Finance and Oil. The Ministry represents the government in the Organization of Petroleum Exporting Countries, and the Organization of Arab Petroleum Exporting Countries. Furthermore, the Ministry conducted its oil policy directly with the oil companies which operated in the country. But the objectives set out for the KNPC in the "Articles of Association" envisaged a far broader scope of operation for the National Oil Company. The proposed operations, in fact, extended into areas far beyond the limited sphere of distributing petroleum products locally in Kuwait. It gave KNPC the right to explore, drill and produce crude oil and market petroleum products locally outside the concession area, and in foreign countries it could be argued that KNPC was given a free hand in its operation, with the exceptions of interfering in the affairs of KOC or getting its supplies of crude oil at cost.

NOTES

1. Ragali al Mallakh, Kuwait. The Middle East, A Handbook edited by Michael Adams, published by Anthony Blond Ltd., London, 1971, p.234.

2. The Financial Times Survey 'Kuwait', February 25th 1977, p.21.

3. The Expanding Role of KNPC. Kuwait National Petroleum Company publication (no date of publication given, but possibly 1966), p.11.

4. Ibid., p.10.

5. G. Lencjowski, Oil and State in the Middle East, Cornell University Press, 1960, pp.20-21.
   See also:
   S.H. Longrigg, Oil in the Middle East, Oxford University Press, London, 1968, pp.110-111.
   Multinational Corporations and US Foreign Policy, p.53.

6. The Expanding Role of KNPC, op.cit., p.25.

7. When the name "Persia" was changed to "Iran", the Anglo-Persian Oil Company became the Anglo-Iranian Oil Company.

8. Oil in the Middle East, op.cit., pp.222-223.

9. The Expanding Role of KNPC, op.cit., p.27.

10. Ibid., p.12.

11. The Middle East, A Handbook, op.cit., p.236.

12. Petroleum Press Service, July 1961, p.247.

13. The Expanding Role of KNPC, op.cit., p.37.

CHAPTER XIII

KUWAIT NATIONAL PETROLEUM COMPANY OBJECTIVES AND OPERATIONS

The Kuwait National Petroleum Company was established in October 1960 with the capital of K.D. 7,500,000 (US$21 million) divided into 1,000,000 shares. The Government of Kuwait had a controlling interest in the company by subscribing to 60 per cent of the capital. The remaining 40 per cent of the KNPC's capital was held by the public of Kuwait. The last instalment of the par value of the KNPC shares was paid by both the Government and the 2,700 private shareholders in 1964.

On 15th February 1967, the issue share capital of the company was increased by 1,000,000 shares, of which 500,000 shares were issued by the Company as fully paid by the capitalization of reserves, and the remaining shares were issued for cash at the nominal value of K.D. 7,500 per share.[1]

Objectives of the Kuwait National Petroleum Company, as described in the "Articles of Association (Article 5)" are as follows:[2]

1. To engage in the petroleum industry in Kuwait or abroad in any field of this industry including the exploration and drilling works for oil and natural gas and other hydrocarbons: the production, refining and storing of the said substances and any of their by-products and preparations including the chemicals produced from petroleum or natural gas and hydrocarbons; and to trade in these substances and their by-products and preparations; and to distribute, sell and export them.
2. To promote, develop and improve the petroleum industry and its products and preparations and the other industries relating thereto.

3. To establish subsidiary companies in Kuwait and abroad with the aim of engaging in the petroleum industry; to promote, develop, and improve this industry; and to trade in, transport, distribute and sell these materials.
4. To co-operate with similar petroleum companies with the aim of facilitating production, refining, transport, distribution, marketing and other operations and agreements concerning the quantities of production, the price of oil, the reduction of oil transport costs and development of facilities necessary for the realization of these aims...."

As it is clear from this Article, the proposed operations of KNPC go far beyond distributing petroleum products in the State of Kuwait. The activities, such as exploration, drilling, production, refining and marketing of petroleum products locally and in foreign countries are proposed to build Kuwait National Petroleum Company into an integrated oil company.

Organization and Manpower

Kuwait National Petroleum Company is the only national oil company which started as a mixed venture firm with the government participating 60 per cent of its capital, and the private Kuwait sector, 40 per cent. The Board of Directors of KNPC had ten members, of whom six represented the government, and four represented the private shareholders. In the first year of operation one Managing Director supervised the operations of the company on a part-time basis. The number of Managing Directors was increased to three as the operations of the company expanded. In 1964 the Board of Directors elected an Executive Committee, composed of a Chairman and three Directors - all on a part-time basis - to manage company affairs. Also a single full-time Executive Director became responsible for the daily operations of KNPC.[3]

One of the most important tasks of KNPC in the early days was to train technicians and Kuwaiti workers. In 1961 there were only 6 Kuwaiti employees who constituted 2.5 per cent of the company's total of 238 employees. More than 90 per cent of the company's manpower was from other Arab countries, and the rest from other countries. In 1976, after 16 years of work and training programmes, the Kuwaiti employees were only 15.6 per cent of the total of 2,632 work force of the company, which was eleven times larger than in 1961. The following tables over-leaf show the nationality of the employees in KNPC from 1961 to 1976, and the breakdown of manpower into Kuwaitis and other nationalities.

The Kuwait National Petroleum Company started a programme of scholarship and training for Kuwaitis in 1962. This programme was aimed at preparing Kuwaitis for technical and administrative positions in the company. The company sponsored a number of Kuwaiti students to study business administration and engineering. Apart from university scholarships, training courses were set up to train Kuwaitis for jobs such as station attendants and clerks. In 1973 the Department of Training and Career Development Programmes was reorganized and made responsible directly to the top management.

TABLE XIII.1

Kuwait National Petroleum Company : Manpower from 1961-1976

	KUWAITI No.	OTHER ARABS No.	WESTERNERS No.	OTHERS No.	TOTAL	KUWAITI as % of total
1961	6	216	2	14	238	2.52
1962	14	378	4	22	418	3.35
1963	15	429	6	20	470	3.19
1964	27	452	7	20	506	5.34
1965	47	485	16	23	571	8.23
1966	84	513	28	25	650	12.92
1967	116	793	89	51	1,049	11.06
1968	142	1,223	134	164	1,663	8.54
1969	211	1,311	128	177	1,827	11.5
1970	230	1,244	111	160	1,745	13.16
1971	261	1,198	100	153	1,712	15.25
1972	262	1,217	86	148	1,713	15.29
1973	318	1,267	88	153	1,826	17.22
1974	371	1,427	87	186	2,071	17.91
1975	373	1,570	90	244	2,277	16.38
1976	410	1,833	100	289	2,632	15.58

Source: Kuwait National Petroleum Company, Annual Reports 1973-75.

Kuwait National Petroleum Company is to a large extent dependent on the non-Kuwaiti work force. More than 80 per cent of the present employees are non-Kuwaitis, and although this is much less than the corresponding figure of 97 per cent for 1961, it is still high for a national oil company with the total work force of nearly 2,600 people. (The National Iranian Oil Company employs more than 42,000 people, of whom nearly 95 per cent are Iranians.) The high percentage of foreign workers at KNPC is partly due to the fact that the Kuwaitis were not adequately trained to take over the technical operations at the refinery level on international marketing. But the fact that most of the local marketing is done by non-Kuwaitis shows that other factors apart from mere training are involved. Kuwaitis enjoy a higher standard of living compared with other residents of the state of Kuwait, and they have more opportunities to engage in a variety of activities which are financially more rewarding. This, together with the fact that the old Kuwaiti men were traditionally not keen on manual work, helps to explain why KNPC have proportionately the lowest number of Kuwaitis working at the local distribution and the highest at the main office.

The involvement of foreigners in the national oil company had at least one major benefit for KNPC. The company, free from the usual restraints that were imposed on appointing foreigners in other national oil companies, used foreign experts and advisers in its operations. In other words, KNPC did not hesitate to employ foreigners if they were needed, especially in its international marketing side. This attitude further ensured that the Kuwaitis gradually learnt the oil business from highly qualified people. The table below gives the breakdown work force at KNPC in 1976.

TABLE XIII.2

Breakdown of manpower into Kuwaitis and other nationalities in the Kuwait National Petroleum Company 1976

	Kuwaitis	Number of Employees	Kuwaitis as % of total
Refinery	227	1,049	21.6
Main office	115	368	31.3
International marketing	20	105	19.1
Local marketing	48	1,110	4.3
TOTAL	410	2,632	15.6

Source: Kuwait National Petroleum Company Annual Report 1976, p.16.

Domestic operations of KNPC

Kuwait National Petroleum Company began its activities on June 1st 1961. On that day it took over all bulk and retail sales facilities from Kuwait Oil Company in the State of Kuwait. The total sum paid to KOC for the purchase of its tankage, plant and equipment at the time of take-over was approximately KD.336,000 (US$940,000). The source of supply for all fuels sold by KNPC was from Kuwait Oil Company refinery at Mina Al-Ahmadi. Lubricating oil was imported from Europe on a contractural basis under KNPC's brand name KUWAITOIL.[4]

KNPC's take-over of domestic distribution of petroleum products in Kuwait was achieved without any major problems. This operation was very profitable and provided the primary source of internally generated capital for the company. It must be noted that KNPC was the only agent of the Kuwait government for the distribution of petroleum products, and in this respect enjoyed a sheltered position similar to other national oil companies under study. To sum up, KNPC's main operation in the early days of its establishment was to market petroleum products made available by KOC in Kuwait.[5]

Nearly a year after the establishment of KNPC in May 1962, Kuwait Oil Company relinquished to the Government of Kuwait 9,262 square kilometres of its concession, mostly in the west of Kuwait. KNPC, in July 1962, formally approached the government for a concession to explore and exploit oil in the relinquished areas. The desired concession was granted to KNPC in October, and in the following year KNPC invited bids from foreign companies to enter into partnership in this concession. A number of international and small independent oil companies showed their desire to form a partnership with KNPC for oil exploration and development in the relinquished area. In July 1965, KNPC's Board of Directors selected Cia-Hispancia de Petroleous S.A. (Hispanoil) as partner in the concession, and a new company was formed.[6]

TABLE XIII.3

KNPC'S Sales of Petroleum Products : 1969-1976

Products	Unit[1]	1969	1970	1971	1972	1973	1974	1975	1976	Average yearly % increase
Super Premium Gasoline	K/Litres	5,850	12,343	14,993	23,142	43,058	65,993	81,557	84,902	47
Premium Gasoline	"	401,090	413,697	443,678	469,348	468,454	494,870	553,607	645,956	7
Total Gasoline	"	406,940	426,040	458,671	492,490	511,512	560,863	635,164	730,858	8.7
Kerosene	"	45,007	43,968	47,393	47,725	42,400	42,424	40,300	42,989	- 0.7
Gas oil	"	127,945	150,526	161,962	164,414	182,259	191,424	230,067	283,714	12
Lube oil	"	1,289	1,460	1,706	2,105	1,983	2,421	3,245	3,775	16.6
Light fuel oil	Metric tons	16,966	23,029	35,440	33,367	45,339	56,674	85,838	124,972	33
Heavy fuel oil	"	1,847	161	1,501	3,475	-	-	52,853	166,943	90.3
Marine diesel oil	"	3,367	2,928	3,648	1,801	4,261	10,069	16,665	19,820	28.8
Bitumen	"	19,490	29,774	25,645	39,357	51,868	57,776	80,730	85,404	23.5

1. These units were adopted in 1975 and 1976 Annual Reports of KNPC. Prior to that figures for fuel oil, bitumen and marine diesel oil were given in long ton and lubricating oils in imperial gallons. All previous figures were adjusted according to the units adopted in 1976 Annual Report using the relevant conversion factors.

Kuwait Spanish Petroleum Company (KSP): this company was established in June 1968, and began exploration activities in the concession area in 1969.[7] Kuwait Spanish Petroleum Company is the operator for Kuwait National Petroleum Company (which holds 51 per cent of the shares), and Hispanica de Petroleos S.A. "Hispanoil" (a Spanish company holding 49 per cent of the shares). The seismic field operations were finalized in January 1971. The company struck oil in 1971, but in view of the result of further drilling in that year and 1973, drilling was suspended and the companies' activities were restricted to conducting geological studies aimed at re-evaluating the prospects of the concession area.

The efforts of Kuwait Spanish Petroleum Company to find commercial quantities of oil in the area allocated to it by the government, were not successful. In 1976, KSPC decided to discontinue its exploratory activities, and informed the Government of Kuwait that it would return the concession area. Accordingly, the assets of Kuwait Spanish Petroleum Company were liquidated, and the company stopped all its activities.[8] While this early venture by KNPC was not profitable, another early subsidiary, namely Kuwait Aviation Fuelling Company, proved to be a much more profitable venture.

The Kuwait Aviation Fuelling Company (KAFCO): this company was established on July 1st 1963, with KNPC holding 51 per cent interest, and British Petroleum 49 per cent. KAFCO took over the aircraft refuelling services which were previously carried out by

BP (Eastern Agencies) Ltd. In 1966, the Articles of Association of KAFCO were changed, the KNPC's holding was increased to 80 per cent. KAFCO became a wholly owned subsidiary of KNPC on January 1st 1973. Also in 1973, the responsibility for operation and management of bunkering facilities at Shuwaik Port was transferred from the Kuwait Oil Company to the Kuwait National Petroleum Company.

KAFCO proved to be a very profitable venture for the Kuwait National Petroleum Company. Dividends received from this subsidiary amounted to KD.24,531 in 1963, the year in which the operation started. By 1967 it reached a figure of KD184,000, an average yearly increase of nearly 65 per cent. By 1975 the wholly owned Kuwait Aviation Fuelling Company had a net profit of KD3,735,000, which was a hundred times larger than what KNPC received as dividend at the beginning of the operation of its company.[9]

International operations of Kuwait National Petroleum Company

The first attempt in international operations by KNPC came immediately after its establishment in 1960. The company acquired a 5 per cent interest in the "Central African Petroleum Refineries Limited" in the Feruka Valley at Umtali, Southern Rhodesia. The 20,000 barrels per day Umtali refinery went on stream in March using Agha Jari crude as feedstock. KNPC, not possessing any crude of its own, had to purchase Aminoil crude and exchange it for Agha Jari crude to meet its supply right of crude (KNPC's 5 per cent share of supply was 1,000 barrels per day, or 50,000 tons per year). KNPC has interrupted the implementation of its 5 per cent supply right of crude to this refinery in compliance with the decision of the Government of Kuwait and the Security Council of the United Nations to place an embargo on all oil shipments to Southern Rhodesia.[10]

From 1962 the Kuwait National Petroleum Company was planning to build a refinery in the industrial area at Shuaiba. Such a refinery, in the view of the company officials, forms an integral link in the expanding operations of the company. The availability of nearby Burgan gas, which is associated with Kuwait crude production and was wasted by flaring, encouraged KNPC to build a refinery based on hydrogeneration process to convert crude oil into products. Furthermore, in hydrogeneration type of refining, sulphur content of the by-products is relatively lower than other types of refining. Considering the high sulphur content of the Persian Gulf crude, low sulphur products of this refinery would have been unique among the existing refineries in the area.

The refinery was designed to operate on the heaviest gravity crude (Eocene 18^{0} API), and the lightest gravity crude (Kuwait 31.5^{0} API). The contract formalizing the work was signed with the Middle East Fluor in November 1965, and the construction of the refinery ended in 1968.

Shuaiba refinery provided KNPC with a base for expansion. But the construction of the refinery ran into difficult technical problems, and the operation of the refinery was considerably delayed. The refinery was to be completed by 1967, but during 1966 there were some delays in delivery of refinery equipment and material, and it was reported that by October 1967, the refinery would be mechanically complete.[11] The deadline was not met, partly due to shipping problems which arose after the Arab-Israeli war of June 1967. By the end of 1967, the Isomax reactor, which was crucial to the final completion of the refinery, was still in the process of assembly.[12] the end of 1968, the construction of the KNPC's Shuaiba refinery was finished, with the exception of the Isomax unit, sulphur plant and the H-oil unit, and crude oil throughput reached 55,157 barrels per day in December 1968. The Isomax unit and sulphur plant were put on stream by July 1969, but the H-oil unit remained a non-continuous operating unit. The average throughput in December 1969 reached 90,450 barrels per day.[13] It was not until the fourth quarter of 1971 that all the units were operating successfully after a period of difficulty - 1968-1971 - following the initial start of the Shuaiba refinery. In this year the average yearly crude throughput reached 103,974 barrels per day. Tables on the following page show the yearly average crude oil throughput of KNPC, and also the quanitites of major products produced at the Shuaiba refinery.

While Shuaiba refinery was coming on stream, KNPC started a vigorous campaign to provide adequate markets for the products of the refinery. In 1966, the international marketing department opened its offices in London. Similarly, KNPC's subsidiary company was formed in Copenhagen to operate a terminal there and handle retail sales to customers. Fuel oil and kerosene storage facilities were bought in Copenhagen, but the continuous closure of the Suez Canal forced the company to sell these facilities and liquidate KNPC Denmark in 1970.[14] By 1971, the value of export of petroleum products by KNPC to different countries amounted to approximately 4.4 million tons.

But it was from 1972 that the exports of products by KNPC picked up, mainly for two reasons. First, the technical problems at Shuaiba refinery were over and the refinery could produce relatively low pollutent petroleum products. Such products were much in demand because of government restrictions against environmental pollution, especially in the USA and Japan. Second, KNPC's marketing activities were influenced by the developments in the oil industry during 1972. During this period the United States became increasingly dependent on imports of petroleum products. As the shortage of petroleum products continued to grow on the east coast of the USA, the government temporarily relaxed its import restrictions on distillates. This contributed to KNPC's increasing sales of low-sulphuric fuels to the east coast of the United States. During 1972, KNPC sold some 7.2 million tons of petroleum products, which was an increase of nearly 64 per cent over the preceding years. This figure included the products from the Shuaiba refinery, as well as purchases and exchanges.[15]

In 1973, the Kuwait National Petroleum Company sold more than 7 million tons of various products in the world markets. Nearly 5.8 million tons were exported from the Shuaiba refinery and 300,000

TABLE XII.4

Quantities of Major Products produced at the Shuaiba Refinery

Products	1976	Per cent of total	1975	Per cent of total	1974	Per cent of total
Fuel oil	2,990,500	36.8	1,826,500	29.9	2,172,100	37.6
Diesel oil	3,151,800	38.8	2,397,600	39.3	1,587,100	27.4
Naphtha	1,104,400	13.6	999,500	16.4	1,037,100	17.9
Kerosene	463,200	5.7	611,900	10.0	761,100	13.2
Gasolene	418,000	5.1	268,300	4.4	225,000	3.9
TOTAL	8,127,900	100.0	6,103,800	100.0	5,782,300	100.0

Source: Kuwait National Petroleum Company Annual Reports 1974, 1975 and 1976.

TABLE XIII.5

Crude Oil throughput of KNPC

Year	Million barrels	Barrels per day
1968	10.2	39,880
1969	23.5	64,520
1970	33.7	92,290
1971	37.9	103,970
1972	42.1	115,070
1973	46.0	126,104
1974	43.9	120,310
1975	47.1	129,064
1976	64.5	176,615

Source: Kuwait National Petroleum Company Annual Reports 1968-1976.

tons of products were processed at KOC refinery. The balance, which was about one million tons of oil products, was purchased from foreign suppliers and resold. This aspect of KNPC's operation was unique among national companies of the Middle East at the time. The extent to which KNPC was involved in marketing petroleum products around the world was not matched by NIOC or Petromin. In this year KNPC took over the bunkering facilities of KOC to supply all vessels with bunker fuel.[16]

Total sales of KNPC into the world markets in 1974 was reduced by nearly 12 per cent compared to the preceding year. The drop in sales was due to recession and the product conservation measures in the OECD countries. In May 1974, KNPC's bunkering terminal in Aden, the Yemen Kuwait Terminal Company, began its operations. In 1975, despite the further fall in consumption of petroleum products in the major industrial countries, the total sales of international marketing of KNPC was increased by 12 per cent. This was mainly due to the fact that towards the end of the year KNPC took over responsibility for sales of refined products processed at the Ahmadi refinery. This refinery, which as mentioned earlier, belonged to the Kuwait Oil Company, and according to the participation agreement, the government was entitled to part of its output.

By 1976 KNPC was responsible for production throughout the Ahmadi refinery. This, plus a 35 per cent increase in the output of the Shuaiba refinery and a larger amount of products purchased from foreign suppliers for resale, made the KNPC's international sales in 1976 nearly twice as much as in 1975. The following table shows the sales of petroleum products by the international marketing of KNPC between 1974 and 1976.

TABLE XIII.6

KNPC's Sales of Petroleum Products in the World Market

	thousand metric tons		
	1974	1975	1976
Sales from Shuaiba refinery	5,398.1	5,582.1	7,548.0
Sales from Ahmadi refinery	713.2	1,156.9	5,233.6
Purchase for resale from foreign suppliers	89.3	202.3	757.9
TOTAL	6,200.6	6,941.3	13,539.5

Source: Kuwait National Petroleum Company Annual Reports, 1974, 1975 and 1976

Financial Aspects of the Kuwait National Petroleum Company

The Kuwait National Petroleum Company was establishedin 1960 with a capital of KD.7,500,000 ($21 million) divided into 1,000,000 shares at a face value of KD.7,500 for each share. In 1967, in accordance with resolutions passed at the share-holders meeting, the issued share capital of the company was increased by 1,000,000 shares, of which 500,000 shares were issued by the company as fully paid by the capitalization of the reserves, and the remaining 500,000 shares were issued for cash at a face value of KD.7,500 per share.[17] The early activities of KNPC were financed from two main sources, internally generated capital which arose from profitable distribution of petroleum products in Kuwait, and loans from the government and foreign banks.[18] The following Table shows the growth of fixed deposits out of internally generated operations.

TABLE XIII.7

Fixed Deposits out of Internally Generated Operations

Year	Kuwaiti Dinar	Equivalent in US$	Per cent change
1961	2.2	6.2	–
1962	4.7	13.2	213
1963	6.3	17.5	133
1964	11.20	31.4	179
1965	12.7	35.6	113

Source: The Expanding Role of KNPC (KNPC Publication), p.62.

The second main source of funds to KNPC, as mentioned, was the government of Kuwait and loans from foreign banks. The loans granted to KNPC, or agreed on in principle, between 1961-65, amounted to $127.5 million, which included $70 million from the government of Kuwait, $50 million from Export-Import Banks of Washington, D.C., and $7.5 million from Chase Manhattan Bank.[19] Between 1961 and 1967 more than 80 per cent of the net profit of KNPC was attributed to the domestic marketing operations which were mainly sales of petroleum products in Kuwait. The Table below shows the details of the net profit for the years 1961-63.

TABLE XIII.8

Distribution of KNPC's Net Profits, 1961-67

					Thousand Kuwait Dinar		
	1961 (7 months)	1962	1963	1964	1965	1966	1967
Marketing Operations	789.2	1,586.9	2,067.2	2,382.9	2,562.7	3,135.5	2,386.0
Crude Sales	-	-	-	-	12.1	-	-
Interest Received and Receivable	42.4	158.7	224.9	437.2	997.3	837.1	377.4
Dividends Receivable from a Subsidiary	-	-	24.5	35.5	61.1	166.4	184.0
Sundries	-	-	1.0	3.2	5.1	4.8	5.9
TOTAL	831.6	1,745.6	2,317.6	2,858.8	3,638.3	4,143.8	2,953.3

Source: KNPC Annual Report 1967, p.21.

Net profits of KNPC for the first time in the six years of operations of the company dropped in 1967. This decrease was attributed to the increase in the cost of petroleum products for the yearss 1964-67 in compliance with the provisions of the Supplemental (Expensing of Royalties) Agreement of 1966 and the income tax amending Law No.8 of 1967. It must be noted that KNPC bought most of its supplies of petroleum products from Kuwait Oil Company and the increase in the cost of crude to KOC was passed to KNPC in the form of higher prices for petroleum products. In this year the Board of Directors approved a donation of K.D.100,000 towards the Arab war effort against Israel.[20]

The problems associated with the construction of the Shuaiba refinery and the inability of the company to raise the price of petroleum products in Kuwait, which is determined by the government, led to considerable financial losses in 1969. During 1968-69 no dividends were paid to the shareholders, and similarly no fees were paid to the directors. In 1970, the financial position of the company was substantially improved mainly due to increased margins of profit obtained through sales of aviation fuels. Again, no dividends were paid to shareholders.[21] Between 1971 and 1973, KNPC achieved a substantial improvement in its financial position. The net profits of the company from K.D.1.2 million in 1971 to K.D.2 million in 1972, and KD.26.1 million in 1973. The extraordinary performance of the company in 1973 was mainly due to the acute oil shortage after the oil cut back in the Arab countries, settlement between the company and its suppliers of crude (KOC) regarding the product delivered during 1968-72, and the increase in petroleum products in Kuwait.[22] The international marketing of KNPC, which started its operations in 1968, recorded net profits of nearly KD.16 million in 1973.

KNPC's net profits decreased in 1974. This was mainly due to the decline in refined product prices towards the end of 1974, but profits were high both in international and domestic markets. 1974 was the last year when the Kuwait National Petroleum Company operated as a mixture of the public and private interests. The reasons and effect of government acquisition of private interest in KNPC will be discussed in the next chapter. The following Tables show KNPC's net profits and losses between 1961-76 and profits attributed to domestic and international operations of the company between 1972-76.

TABLE XIII.9

Kuwait National Petroleum Company
Net Profits and Losses 1961-76

Million Kuwait Dinar

Year	Net profit for* the year	Total Sales
1961	0.83**	2.1*
1962	1.75	3.9
1963	2.32	4.7
1964	2.86	4.6
1965	3.64	4.9
1966	4.14	5.8
1967	2.95	6.6
1968	(4.81)	6.8
1969	(3.81)	26.0
1970	0.47	38.2
1971	1.23	50.2
1972	2.01	54.4
1973	26.10	87.1
1974	25.02	183.1
1975	10.12	193.8
1976	7.98	399.5

* Net profit includes interest, dividend, exchange and other income

** KNPC operated marketing facilities for 7 months during 1961 (June-December)

Source: KNPC Annual Reports 1961-76.

TABLE XIII.10

Kuwait National Petroleum Company
Sales and Net Profits 1961-76

Million Kuwait Dinar

	Domestic Operations			International Operations		
Year	Sales	Net Profit	Net Profit as % of the Sales	Sales	Net Profit	Net Profit as % of the Sales
1972	11.1	na	-	43	na	-
1973	13.7	8.5	62.0	73	16	21.9
1974	16	7.7	48.1	167	15	9.0
1975	17	4.9	18.8	176	(2.4)*	-
1976	20	2.7	13.5	379	2	0.5

* Taking into account previous year's adjustments the loss dropped to approximately KD.88,000.

Source: Kuwait National Petroleum Company Annual Reports 1972-76.

NOTES

1. Kuwait National Petroleum Company (KNPC) Annual Report, 1967, p.20.
2. *The Expanding Role of KNPC*, Kuwait National Petroleum Company publication (no date of publication given), pp.35-6.
3. *Ibid*., pp.39-40.
4. *Ibid*., pp.41-42.
5. *Ibid*., p.45.
6. *Ibid*., pp.45-46.
7. KNPC Annual Report 1970.
8. KNPC Annual Report, 1976, p.18.
9. KNPC Annual Reports 1967 to 1975.
10. *The Expanding Role of KNPC*, *op.cit*., pp.49-50.
11. KNPC Annual Report 1966, p.12.
12. KNPC Annual Report 1967, p.16.
13. KNPC Annual Report 1969, p.14.
14. KNPC Annual Report 1970.
15. KNPC Annual Report 1972, p.16.
16. KNPC Annual Report 1973, p.10.
17. KNPC Annual Report 1967, p.20.
18. *Expanding Role of KNPC*, *op.cit*., pp.61-62.
19. *Ibid*., p.62.
20. KNPC Annual Report 1967, p.20.
21. KNPC Annual Report 1970, p.17.
22. KNPC Annual Report 1973, p.22.

CHAPTER XIV

TAKE-OVER OF THE PRIVATE SHARES OF KNPC BY THE GOVERNMENT: CHANGES IN THE ROLE OF THE COMPANY AND ITS PRESENT POLICIES

In the previous chapter we discussed the activities of the Kuwait National Petroleum Company over its sixteen years of operation in Kuwait and worldwide. KNPC was the first national oil company in the Middle East and North Africa to establish a nationally owned export oriented refinery. The refinery came on stream in 1968, but in the first few years of its international operations the company registered substantial losses in this sector. These losses were compensated for mostly from the profits attributed to domestic activities of KNPC. By the end of 1974 both the international marketing operations and the domestic ones registered considerable profits, and it looked as if the financial problems of the company were over and KNPC seemed to be heading for a period of sustained profitable growth. But in 1975 the government of Kuwait took over the private share holding of the company and the Kuwait National Petroleum Company became a wholly state-owned share-holding company similar to other national oil companies in the Middle East. In this chapter the reasons behind this government take-over and its likely effects are discussed.

Why the Government decided to take over the Private Sector Share holding in KNPC

By 1975 several changes had taken place both in the world petroleum markets and in the oil industry in the Middle East (see Chapter 3, Part 1). The issue of participation was scrapped, and

Kuwait decided on a 100 per cent take-over of oil operation in its territory.by acquiring the remaining 40 per cent equity held by British Petroleum and Gulf Oil in the Kuwait Oil Company. The structure of KOC remained as it was prior to the full ownership by the Kuwait government, and the operation of the oil industry in the country was not affected by this decision. However, the changing circumstances which arose out of this government decision called for some adjustments in different aspects of the oil business in Kuwait.

One factor which facilitated the complete take-over of the Kuwait Oil Company by the Kuwait government was the fact that the Kuwait oil industry is stable. The oil fields are established and easy to produce, there are no risky and expensive exploration to be done, and even the facilities for secondary recovery are mostly installed. So the need for links with the former concessionaires for technical and managerial services through special service contracts was not an essential issue. Furthermore, out of the 2,900 work-force of KOC, 90 per cent were Arabs with only 140 Western employees, some of whom could be retained, if necessary, on a direct basis.[1]

The Kuwait National Petroleum Company was not involved in these negotiations, which were conducted at ministerial level with the former concessionaires. KNPC's international operations were based on selling petroleum products after processing Kuwaiti crude oil, bought from KOC, in the Shuaiba refinery. The responsibility for the sale of crude oil lay with the oil ministry, which made it clear that it intended to continue this role after the 100 per cent take-over of KOC.[2]

The Kuwaitis were successful in lining up some long-term buyers for the state crude. By June 1975, Kuwait had signed nine third-party customers, which diversified its crude sales considerably away from traditional concessionaire outlets, namely British Petroleum and Gulf Oil. The nine customers were Royal Dutch/Shell, Exxon, Idemitsu of Japan, Petrobras of Brazil, the Philippine National Oil Company (PNOC), the Chinese Petroleum Corporation (CPC) of Taiwan, Societa Italiana Resine (SIR) of Italy, the Romanian government and Maruzen of Japan. These contracts accounted for nearly 455,000 barrels per day of crude oil by May 1975.[3]

These third party sales together with the lifting by BP and Gulf accounted for most of the Kuwait oil production. At the time nearly 225,000 b/d were processed in Kuwait - 150,000 b/d at Shuaiba refinery, and 75,000 b/d at the KOC refinery. Thus the 2 million b/d of Kuwait production was used by three different groups - 1.4 million b/d to BP and Gulf, 450,000 b/d to third parties, and 225,000 b/d to the refineries in Kuwait.[4]

As the Kuwait government's effective control over its oil industry was growing in 1974 and 1975, the need for an organization, apart from the oil ministry, to take charge of government interests in the oil and gas operations, was increased. On 1st August 1974, the Kuwait Oil, Gas and Energy Corporation (KOGEC) was set up to take over all responsibility for the oil and gas sector, plus oil and gas based industries. But this new organization was not, by 1975, in a position to be responsible for all activities in view of the rapid take-over of KOC by the government.

What was needed was a national oil company as an operating arm for the application of the oil policy adopted by the government. KNPC was the only organization capable of filling this gap, as it already possessed the organizational framework and the necessary manpower. The only problem in utilizing this company in the same way as every other government in the Middle East was the existence of private interests in the company.

To expand the role of KNPC, the government wanted full control over the future policies of the company. It is true that the Kuwait government held 60 per cent of KNPC's shares, but this was not considered to be enough. The government argued that had it not been for the continuous financial support of the treasury for KNPC in the form of loans, financial assistance and allowing it to have monopoly in the sales of petroleum products in Kuwait, the company could not have reached that far. Furthermore, the Kuwait government in 1975 was still negotiating over its decision to take over the interest of privately owned foreign international oil companies, and it would have been ironic to hand over all these acquisitions to a company whose full control it did not have. The alternative would have been to create another national oil company wholly owned by the government, and make KNPC a private company or leave it as it was. It is not clear from published material whether such alternatives were considered, but the government opted for the take-over of private share holding in KNPC, which was probably the easiest way of exercising its full control, and also of utilizing the company for its long-term objectives.

On 6th April 1975, the Kuwaiti Council of Ministers decided to take over the 40 per cent private sector share holding in the Kuwait National Petroleum Company. The shareholders were paid KD.85 per share, which was the market price of the company's share at the time, plus KD.2 per share in lieu of the company's 1974 dividends. Altogether the shareholders received $325 million (KD.69.6 million) for their 800,000 shares. The nominal value of these shares, as mentioned before, was KD.7.5 in 1961, but ten years later in 1971, the market price of KNPC's shares was nearly KD.17. The company's share prices jumped nearly three times in 1972, and by 1973 reached its record high of KD.94.5 This figure decreased in 1974 to an average of KD.78, and rose against to KD.85 in April 1975 when the government take over was announced.

This government decision was raised in the Kuwait National Assembly, but a motion to discuss the move failed to obtain a majority vote. Some of the deputies alleged that the government take-over had violated Article 18 of the Kuwait Constitution. There were also some arguments concerning the price per share paid by the government to the former shareholders of KNPC.[6]

On 6th May 1975, the National Assembly approved the government take-over of the KNPC private share holding. Furthermore, under this law, the National Assembly confirmed that the operations of KNPC should be continued on a commercial basis and in accordance with its status without conforming to the special laws and regulations pertaining to government establishments.[7] So the government take-over did not affect the status of the company, although the nature of KNPC's operations and its objectives would certainly be changed. It must be noted that this government decision was based neither on political motivation nor represented the government's resentment of private enterprise. Kuwaitis are famous for their mercantile mentality, and as mentioned before, this affected even the formation of KNPC. The decision to go against the established pattern in Kuwaiti society resulted from necessity, rather than political or social convictions.

When the decision to take over the private share holding of the Kuwait National Petroleum Company was finalized, the Minister of Oil defended it in a special broadcast on Kuwaiti television. Following are the main reasons for the government's decision, as stated by the Oil Minister:[8]

1. The state has very recently acquired full ownership of its oil resources and must draw up a clear policy for oil and gas sectors.
2. Oil has become an effective instrument in carrying out the state's foreign policy and thus must be placed completely under government control.
3. There is a conflict of interest between the private and the public sectors - with the former seeking short-term financial gain and the latter the long-term financial, social and economic benefits.
4. KNPC must embark on new projects requiring large capital investments that would tie up the private sector's funds for a long time and put such funds at risk - this being a burden which, in the opinion of the government, the private sector should not be called upon to shoulder.
5. KNPC has failed to create the necessary expertise and form a new generation of technicians well versed in the oil industry.

He pointed out that the price of KD.85 per share paid to the shareholders of Kuwait National Oil Company was fair, both in respect of the market value of the shares and the company's total assets.

Government Oil Policy and the Role of KNPC

The Kuwait Oil Gas and Energy Corporation (KOGEC) came into existence by decree of the Ruler of Kuwait in August 1974. This organization was set up at the time by the Ministry of Oil and financed to take over responsibility for the entire oil and gas sector - including oil and gas based industries and projects in Kuwait. But with the separation of the Ministries of Oil and Finance, the prescribed functions of KOGEC under its constitution became increasingly difficult to continue. After the establishment of the separate oil ministry, it was decided that the creation of a single national oil company which embodied within one structure all the existing oil company's activities, was desirable. The framework of the Kuwait Oil Gas and Energy Corporation was not in line with this new approach in reorganization of the oil industry in Kuwait. So KOGEC was dismantled in June 1975, and later a liquidation committee was appointed to liquidate the company's assets and draw up a final balance sheet of the company.[9]

After the Kuwait government decided not to proceed with the establishment of the Kuwait Oil Gas and Energy Corporation, as discussed before, the members of KOGEC's board of directors resigned in July 1975. The next attempt by the government to bring together all public oil ventures within one framework, came in July 1975 with the formation of a supervisory co-ordination committee for oil industries. The eight member committee was headed by the Minister of Oil, and consisted of the heads of the Kuwait Oil Company, the Kuwait National Petroleum Company, the Petrochemical Industries Company, the National Gas Exploitation Project, the Under-Secretary at the Ministry of Oil, and two senior employees from this ministry. Article 5 of the ministerial decision, No.25, 1975, setting up this body, lists the functions of the committee as follows:[10]

1. Drawing up a plan to implement general policy for petroleum industries.
2. Supervision of companies and projects referred to in Article 2(c) above is implementation of the side plan. (Article 2(c) says that the chairmen of boards of directors of companies and managers of projects whose activities are primarily based on petroleum and gas, to be nominated by the Minister of Oil.)
3. Co-ordination between the activities of the companies and projects to achieve complementarity in the national petroleum industries.
4. Study and analysis of reports submitted by these companies and projects, and the adoption of appropriate decisions and recommendations in this regard.
5. Undertaking of studies for the development of petroleum industries and the provision of research facilities and scientific, technical and managerial expertise for these companies and projects.
6. Study and preparation of necessary arrangements to restructure the Kuwait National Petroleum Company with a view to making KNPC the executive arm for the Ministry of Oil in the field of petroleum based industries.

So the aim of the government was to integrate all oil activities into a single company with different sectors, such as production of crude oil, refining, petrochemicals, transportation and marketing. Each sector would be run by an executive committee whose chairman would represent it on the board of the unified company, while the supreme oil council remained as the high oil policy maker in the country. To achieve this aim the government took over the private shares in the Kuwait National Petroleum Company and Petrochemical Industries Company, in addition to full take over of the Kuwait Oil Company from British Petroleum and Gulf Oil. KOC was re-registered as a Kuwaiti share holding company in February 1975, and became responsible for crude oil production, which was its previous role. The government then instructed KOC, KNPC and PIC to carry out a joint study on their manpower needs and requirements in order to harmonize recruitment and training policies.[11]

KNPC's role as refiner and marketer of Kuwaiti oil both domestically and international was not extended to crude oil production, although it was asserted the KNPC would eventually become "The executive arm of the government in all oil activities". This role was not even emphasized in the objectives of the Kuwait National Petroleum Company's recent five-year plan, which was published in its 1975 Annual Report.

In 1975, the planning organization of KNPC was strengthened, and a five-year plan was drawn up for 1976-80. This plan was based on the company's new broad objectives, which were summarized as follows:[12]

1. Maintaining an effecient refining operation in Kuwait and producing a full range of high quality products.
2. Supplying the Kuwait domestic, bunker fuel and aviation markets.
3. Developing long term, secure, commercially sound export markets for petroleum products.
4. Carrying out an effective programme for the training and executive development of Kuwaiti employees.
5. Identifying and evaluating potential new investment projects and business opportunities in the petroleum and energy sectors.

The above objectives roughly determine the new role of the Kuwait National Petroleum Company, and as mentioned before, does not envisage a role for KNPC in the production of crude oil.

Another decision of the government which affected the financial position of KNPC considerably came a month after the take-over of its private share holding by the state. In May 1975, the Council of Ministers decided to lower the prices of refined products on the domestic market. The last increase in the price of products in Kuwait had come in August 1972, and the Council of Ministers' decision set the prices back to 1972 levels.[13] As a result of this move, the net profit attributed to domestic sales of the company was reduced by nearly 36 per cent, although the actual sales of products were increased considerably in this period.[14]

On the other hand, the government take-cver brought about more financial assistance for KNPC to expand the Shuaiba refinery and utilize new units to improve the quality of its products. The new product upgrading facilities which was installed by the Foster Wheeler firm, included a 42,000 b/d Chevron iso-cracking pressure unit and a vacuum tower, together with associated equipment for processing of 43,000 b/d.[15] The present capacity at Shuaiba refinery is nearly 250,000 b/d and, as mentioned before, this refinery is capable of producing less heavy fuel oil yield and higher production of light and middle distillates. The new additions to the Shuaiba refinery gives it even more flexibility to meet market demands, as it is capable of reducing fuel oil yield considerably.[16]

By 1976 it became clear that the merger of KNPC, KOC and PIC was further postponed, due to "considerable opposition in Kuwaiti circles", and that these companies would continue to operate separately under overall government supervision through the Supreme Petroleum Council. In July 1976, the Supreme Petroleum Council endorsed the status quo and appointed new boards of directors for each company, separately, from within the oil sector. So KNPC remained responsible for sales of refined products in Kuwait and international markets.

Meanwhile, the Kuwait Oil Company published its first annual report after the take-over which showed the company's role as the sole producer of crude oil in Kuwait, as well as its responsibilities for gas utilization projects and further drilling and development of all the oil fields. The first budget of KOC was approximately $770 million, which came mainly from the state subsidy allocated from the country's general budget.[17] During 1976, KOC supplied crude oil to the Kuwait National Petroleum Company's refinery at Shuaiba.

The latest addition to the network of state owned oil companies concerned with Kuwait's oil industry is the Kuwait Wafra Oil Company. This company was formed when the Kuwait government fully nationalized the American Independent Oil Company (AMINOIL) concession in the Neutral Zone. AMINOIL, together with Getty Oil, operated the oil field at Wafra and South Umm Gadair. The Kuwait Wafra Oil Company will be responsible for Kuwait's interests in the areas where AMINOIL previously operated. Prior to nationalization, AMINOIL refined most of its share of crude (about 90,000 b/d) at Mina Abdulla in Kuwait, and exported the products. So the new state owned company has production and refinery responsibilities.

An issue which is of some interest here is that given the present structure of the oil industry in Kuwait, it is no longer accurate to consider the Kuwait National Petroleum Company as the national oil company of Kuwait. The alternative would be to argue that KNPC, with its sister state owned companies Kuwait National Oil Company, and even Petrochemical Industries Company, are together the national oil company. The aims and objectives of KNPC under the new system would be somewhat different. For example, prior to take over of KOC by the Kuwait government, KNPC's intention was to secure its own source of crude oil, and for this purpose it entered into a joint venture with Hispan Oil to search for oil in the areas relinquished by KOC. The aspiration of KNPC was to become a vertically integrated oil company, as expressed in Article 5 of "Articles of Association",[19] but the new set-up does not allow the pursuit of this policy any further. The present division does not give KNPC a role in exploration and production of crude oil, or involvement in petrochemicals and other related industries.

It must be noted that the organization of the oil industry in Kuwait has not stabilized yet. In the past two to three years some policies regarding the eventual organization of the oil industry have been abandoned in favour of plans which eventually were not implemented fully.[20] It is debatable whether all the state oil companies in Kuwait, if brought under one company, would be more efficient and at the same time be more suitable for the implementation of government oil policies. In addition to that, as elsewhere, there are some internal power struggles and rivalries within the different state owned companies, which would make the plan for the merger of the three national oil companies unpleasant to some circles.[21]

To sum up, the Kuwait government take-over of private share holding of KNPC did not change the operation of the company to any great extent. However, the future role of the company will be determined by the Kuwait government will adopt towards state-owned oil companies. Originally there were plans to bring all these state owned companies which were involved in oil, gas and petrochemical business under one company, and KNPC was the only candidate among them. But this plan was postponed, and at present the structure of the oil industry in Kuwait is based on three state owned companies, which are linked together through the Supreme Petroleum Council, the highest body responsible for the oil affairs in the country. Each of the state-owned companies has its own board of directors, and is responsible for its own financial affairs.

NOTES

1. Petroleum Intelligence Weekly, April 14, 1975 (exclusive interview with Kuwait Oil Minister), p.10.
2. Middle East Economic Survey, March 14, 1975, p.2.
3. Kuwait Diversifies Crude Oil Sales, Middle East Economic Survey (supplement), May 23, 1975, p.1.
4. Ibid., p.2.
5. Middle East Economic Survey, April 11, 1975, p.3.
6. Ibid., p.4.
7. Middle East Economic Survey, May 9, 1975, p.10.
8. Middle East Economic Survey, April 18, 1975, p.5.
9. Middle East Economic Survey (supplement), September 12, 1975, p.1.
10. Middle East Economic Survey, August 1, 1975, pp.3-4.
11. The Kuwaitization of KOC, Middle East Economic Survey, December 19, 1975, p.iii.
12. KNPC Annual Report 1975, p.6.
13. Middle East Economic Survey, May 2, 1975, p.5.
14. KNPC Annual Report 1975, pp.13 and 22.
15. Middle East Economic Survey, May 2, 1975, p.5. See also KNPC Annual Report 1976, p.8.
16. Fuel oil yield as per cent of crude (based on weight) was reduced from more than 50 per cent in 1968 to nearly 30 per cent in 1976. See KNPC Annual Report 1976, p.10.
17. Middle East Economic Survey, July 5, 1976, p.4.
18. Petroleum Economist, October 1977, p. 409. See also Petroleum Intelligence Weekly, September 26, 1977, p.1.

19. See Chapter 12, p.

20. Case of Kuwait Oil Gas and Energy Corporation.

21. Middle East Economic Survey, July 19, 1976, p.4.

PART FIVE

COMMERCIAL POLICIES OF THE NATIONAL OIL COMPANIES

CHAPTER XV

NATIONAL OIL COMPANIES AND THE CONCEPT OF INTEGRATION

One of the well publicized objectives of the national oil companies under consideration is to become integrated oil companies. Article 2(f) of the Statutes of the General Petroleum and Mineral Organization, states that one of the objectives of the Company is to "Establish, either inside or outside the Kingdom, companies or enterprises in whose capital it will participate, with the purpose of engaging in all phases of the industry of petroleum or minerals, and their derivatives and by-products, and of trading in, transporting, selling, distributing and marketing them".[1]

The latest Statutes of the National Iranian Oil Company put one of the objectives of the organization as:[2]

> "To search, prospect, survey, explore, extract and produce transport and refine crude oil, natural gas and other natural hydrocarbons (both liquid and solid); to manufacture and process all kinds of the main petroleum products such as gas and liquid gas, and gas derivatives, and various kinds of petrol, kerosene, gas oil, fuel oils, bitumen, asphalt and any other kinds of operations for the marketing, transportation, distribution, export and sale of the said products in Iran and abroad."

Similarly, Article 5(1) of the "Articles of Association" of the Kuwait National Petroleum Company, describes one of the company's aims as:[3]

> "To engage in the petroleum industry in Kuwait or abroad and operate in any field of this industry including exploration and drilling works for oil and natural gas and other hydrocarbons, the production refining and storing of the said substances and any

> of their by-products and preparations including the chemical products from petroleum or natural gas and hydrocarbons: and to trade in these substances and their by-products and preparations; and to distribute, sell and export them".

Furthermore, a statement issued by the Kuwait Minister of Finance and Industry substantiates these objectives[4]..... "one of the major objects of the Government in establishing KNPC is to build this company into an integrated oil company, i.e., capable of performing such functions lying within the scope of all operations of an oil company". Similar statements have been issued by the Minister of Petroleum and Mineral Resources of Saudi Arabia (see section on formation of Petromin), and by the responsible authorities in Iran.

So, the state-owned oil ventures all have a common goal, which is to become an integrated international oil company. In this chapter we discuss how this common desire for integration originated, under what circumstances the major international oil companies integrated, and whether the same logic applies to the companies under study here. But prior to doing that, we must define what we mean by integration in an oil company, so that the arguments concerning this widely misused word be put in the right context.

What does Integration Mean?

The word "integration" is widely used by economists, politicians and government administrators. On many occasions it has been used by oil companies as an object of policy, and for governments as a target for action. For example, the Saudi Arabian government of 1962 talked of integrating the oil industry into their economy. On the other hand, as we have seen in the previous section, all the national oil companies under study announced that they were going to become international integrated concerns.

Integration, as defined by the Oxford English Dictionary, is "making things into a whole", or to "combine into a whole". In this discussion we are mainly concerned with the issue of integration with respect to the international oil industry in general, and the oil firm in particular. Applying the definition to the oil industry, it means bringing into a whole a number of integrated oil firms, which implies some degree of co-operation among these firms. For an oil firm it represents bringing the many activities under one administrative structure. But in the case of national companies and their desire to become fully integrated international oil companies, we are dealing with another argument. Here we attempt to find out if integration is more efficient or more profitable (in imperfect competition a profitable firm is not necessarily an efficient one in the strict economic sense) for these oil firms.

There are various types of integration which one comes across in oil literature. We have "vertical integration", "horizontal integration", "lateral integration", etc. The oil business (oil process) is commonly divided into five stages,[5] namely exploration, development, production, transportation and refining of crude oil, and by marketing of petroleum products. If an oil firm expands its activities by gaining control of two or more of the above "stages", it is said to have vertically integrated. A vertical integration could be backward or forward depending on the initial activities of the firm with respect to the new area into which it expands. For example, when an oil firm involved in production of crude oil expands into refining and marketing, it has integrated "forward". On the other hand, when a firm whose business is marketing petroleum products gets its own sources of crude oil it is said to have integrated "backward". A "Fully integrated" oil company is used for those companies who are involved in the production of crude oil all the way to the marketing of petroleum products.[6] As opposed to fully integrated oil companies, those firms whose sphere of activities is limited to one of the above stages of the oil business, are referred to as "non-integrated" oil companies.

It must be noted that vertical integration is not peculiar to the oil companies alone. Firms in aluminium, rubber, food and many other industries are also vertically integrated. Nevertheless, vertical integration in the oil industry is the most publicized aspect.

Horizontal integration, on the other hand, is the integration of the firm across the same level of the oil process. An oil company can expand its activities across refining, marketing or ownership of crude oil in a country or among a number of countries.

This type of integration has helped to bring about a certain degree of monopoly in some levels of the oil industry in the past. For example, the fact that seven large international oil companies control a large percentage of crude oil and own a large proportion of the distributing markets, shows the level of horizontal integration in the oil industry. Although this type of integration is very important, the notion of integration in the oil industry has been mostly associated with vertical integration.

Lateral integration normally refers to the expanding of the activities of an oil firm into other relevant fields, such as alternative sources of energy or petrochemicals. This type of integration, which is a diversification, does not enter into our discussion, and here we only deal with the concept of vertical and horizontal integration by the national oil companies.

Economic Advantages of Integration

It is widely believed that horizontal and vertical integration are necessary conditions for the efficient operation of an oil firm. Furthermore, such integration is said to be a necessary condition for a firm which wants to enter the oil business. This view is certainly held by the national oil companies, as we stated some of their objectives at the beginning of this section. The classic argument for economic advantages of extensive integration in an oil firm is based on four main points, which are: (1) assured outlet for crude oil produced by the firm or its security of supply of raw material; (2) advantages attributed to the large scale operation; (3) more flexible adjustment to short run changes in the oil industry, i.e., more staying power; (4) and finally, some tax advantages which could result from inter-affiliate price structure adopted by these firms.[7] These points, with the exception of the last one, are well stated by Mr. W.S. Farish, a former president of Standard Oil Company (New Jersey). He is quoted by Mr. P. Frankel in his book The Essentials of Petroleum:[8]

> "Integration is the uniting into one business of several of the stages through which a material passes before it reaches the ultimate consumer. The conditions under which integration is desirable are: (1) large volume of business in a single commodity group; (2) highly specialized production, manufacturing, transportation and distributing techniques; and (3) substantial advantages (at some stages) in large scale operation. These conditions characterize the petroleum industry, and it follows therefore, that the relations between any one of the stages of the industry and the other next to it are peculiarly close. The refiner needs to be assured of his market. The marketeer needs to be assured of his supply. Both need a steady flow of products for efficient operation. Neither is interested in other than one major product and its related group of by-products. Neither can transfer his specialized equipment to the handling of some different product. There is a high degree of mutual interdependence imposed by the facts".

It is further claimed that oil companies expand vertically because they can perform the complementary function themselves more "efficiently" than outside suppliers or customers. Vertical integration is alleged to have helped the oil companies to undertake the best utilization of crude, the most suitable refinery process and the most profitable outlets for products. A big size and vertical integration are said to be essential if oil companies are to take risks of huge investments in facilities which must be used in optimum size, and if efficient flow of crude oil and products are to be maintained.[9]

Why Major Oil Companies Integrated

So far we have discussed the concept of integration and its alleged advantages for an oil company. The desire for vertical integration by the national oil companies arises not only from the arguments in support of benefits to a firm of such integration, but by accepting that it is the only way of doing oil business. The argument goes that the major international oil companies are successfully carrying out most of the oil business around the world, and all of these companies are fully integrated firms. Hence, integration is somehow inherently necessary for the successful operation of any firm in the oil business. Here we attempt to show very briefly why major oil companies integrated during the course of their growth: whether the decision to integrate adopted as a general policy for the firm, or whether they integrated as the opportunities arose and circumstances forced them during the history of their growth. As it is not possible to go into the history of development of all major oil companies, we select two of them, namely Exxon (formerly Standard Oil Company, New Jersey), and British Petroleum Ltd. Exxon:[10] This company was incorporated in Ohio in 1870, and at present is the largest industrial corporation in the world. The company's founder, John D. Rockefeller, and his associates, organized a large alliance of oil interests, as well as other businesses which in a few years controlled most of the refining and pipeline capacity of the United States. At the beginning the Standard group did not enter into the field of crude oil production (which was a highly competitive business at that time) and concentrated on refinery and transportation. In less than one decade, Standard Oil owned most of the pipelines and 80 per cent of the refining capacity of the United States. But the rapid expansion of demand for petroleum products, which led to increasing competition for crude oil supplies, forced the company to look for its own sources of crude. So the Standard group integrated into crude oil production to assure its own sources of crude, and by 1911 the company became a fully integrated organization, producing up to two-fifths of its crude oil requirements. Furthermore, the group by this time had developed a dominant worldwide position in the marketing of petroleum products.

In 1911 the company's thirty-three subsidiaries became legally separated when the US Supreme Court decided that Standard Oil had violated the Antitrust Act. As a result of the break-up, the parent company, Standard Oil Company (New Jersey) (now Exxon) lost its companies outside the US which were responsible for sales of products in the United Kingdom and the Far East, but retained most of its South American and European marketing affiliates. But more than important than that, the company lost most of its crude oil production and transport facilities. Hence, the Supreme Court decision seriously affected the integrated structure of the company.

The company started a vigorous programme in search of crude oil, but the First World War jeopardized its attempts, and after the war its search for oil was intensified. In 1918 crude oil production of Standard Oil constituted only 16 per cent of its refinery runs. After the war, other companies entered into the marketing of petroleum products in Europe, and posed a serious challenge to Standard Oil's position in Europe. Hence it was essential for the company to obtain concessions, to push exploration, and even buy into existing producint companies, in order to obtain crude oil. An aggressive expansion into crude oil within the US was becoming increasingly difficult because of competition caused by growing fears that oil supplies there were running out. All these events, and probably a number of other constraints and opportunities led to the integration of the company into crude oil production around the world. In Venezuela, Standard Oil bought a major share in Creole Petroleum in 1928, and acquired the foreign properties of Standard Oil of Indiana in 1932.

So, Standard Oil did not start as a fully vertically integrated oil company. But it dominated the US domestic oil industry, and secured a dominant position in the international trade of crude and petroleum products by the turn of the century. The company was able to sustain that position without owning extensive crude reserves or production, because there was a readily obtainable surplus of crude oil produced by the others. As the structure of the Standard Oil Company was changed, very little crude oil production facilities were retained by the company. Furthermore, the growing fear that the US was running out of oil and the inability of the company to pursue an aggressive expansion in the US due to the unfavourable political climate, forced the Jersey Standard to look for its supplies of crude oil around the world whenever an opportunity.

British Petroleum Ltd: This company was formed as the Anglo-Persian Oil Company in 1909 after oil was discovered in Iran (see section on Iran). In 1914 the British government took a controlling interest in the company. British Petroleum is the only major oil company with such direct government representation. British Petroleum, contrary to Exxon, based its growth primarily on control of reserves and production of crude discovered in Iran. The company constructed a big refinery in Abadan and built pipelines to the oil fields.

Sales contracts with the British Admiralty and contracts to supply Indian and Iraqi railways gave the company outlets for its products from Abadan refinery. The British government, being the major shareholder of the company at the time, used its "good offices" to secure outlets for the crude oil and petroleum products of BP. In 1928, BP signed an agreement to supply petroleum produced to the Indian through the Burmah-Shell operating network. So, when the opportunity arose to get involved in the Indian market, the company seized it. By 1939 the company had established markets in Europe, Africa, India, Australia and the Middle East. The Abadan refinery was expanded rapidly to cope with the "forward integration" of the company, and other refineries were built in Britain and France.

In 1951 the oil production of the company dropped sharply as a result of the nationalization of the oil industry in Iran. The lostt of control of oil production in Iran was a severe shock to the integrated structure of the company, and it could be argued that what happened to BP in 1950 was similar to the Supreme Court decision to dissolve Standard Oil in 1911.

So, unlike Standard Oil Company, British Petroleum started its operations with the production of crude oil. When the Abadan refinery was completed, the company moved into refining, and later into marketing of petroleum products as the opportunities arose.

Some of the oil companies had decided to integrate during the course of their growth as a defensive policy. Gulf Oil is a good example of this "defensive integration". Gulf Oil was formed in 1907 to take the stock of two companies which were involved in oil discoveries in Texas and Oklahoma. As mentioned earlier, at that time Standard Oil was the main refiner and distributor, and therefore most of the crude producers were dependent on the Standard Oil Company. The company decided to develop its own integrated business in order to be able to compete with Standard Oil. So, as a result of extensive integration of one firm which created a monopoly position in one or few stages of the industry, others had to integrate vertically in order to protect themselves.[12]

Another example of why major oil companies integrated can be seen from the history of Royal Dutch-Shell. This company was formed from the merger of two integrated oil companies (although it expanded its business substantially after the merger, it started as an integrated group) - Royal Dutch and Shell Transport and Trading Company. The former had integrated "forward" into refining and marketing, and the latter had integrated backward into production and then refining. These companies were competing with each other and with the Standard group. Competition was one of the most important reasons for their respective integration.

The foregoing brief discussion of the motivations of major international oil companies to integrate, demonstrates that there were different motivations for integration, and the decision to integrate was not taken as a general policy of the firm. There is no specific point common to all companies after which vertical integration becomes a necessity, or even desirable.

A more sensible and convincing reason why all these major oil companies are vertically integrated, could be sought by looking at the fundamental objective of these firms. The international oil companies are operating all over the world, and their "profits" arise from selling crude oil and petroleum products. They reinvest these profits in expansion of the existing facilities or acquiring new ones, mainly for the sake of the "profitable growth". The oil companies try to maximize their profit and use it in the expansion of their operations in order to increase their "market share", (or at least to maintain it).

In general, the oil companies, considering the imperfections of the market and the degree of monopoly, integrated whenever they saw the possibility of more profits as a result of this integration (their profits could be immediate, or in the long run). They would no doubt abandon vertical integration as soon as it failed to serve its purpose.

Integration of National Oil Companies Inside their Countries

So far we have seen the motivitation behind integration in major companies and determined that integration by itself was not the planned objective of the firms. Vertical integration was used as a means to secure more profit, or as a defensive mechanism against those vertically integrated firms who had dominated the imperfect market at certain points of their growth. Many companies who became vertically integrated oil firms, did not start their operations as such, and their integration developed as a result of opportunities and constraints in the market.

The national oil companies under study, on the other hand, were all commissioned to become integrated ventures. In Iran, an internal power struggle and disputes with the former concessionaire, AIOC, led to the nationalization of the oil industry and the formation of NIOC, which was to become an internationally vertically integrated company and take over AIOC's operations. The formation of Petromin as an integrated oil company came in a Royal Decree (see section on Petromin), and although unlike NIOC it did not emerge as a result of political events, it was hoped that the company would integrate vertically and horizontally into all stages of the oil business. Kuwait National Petroleum Company also planned to become an integrated oil firm from the beginning. These companies, with the help of their governments which granted them the monopoly of distributing petroleum products in the country, achieved such integration inside their respective countries.

NIOC, for example, has a market of more than half a million barrels per day of petroleum products in Iran. The company produces and refines part of its requirements for internal distribution, and the balance comes from the former consortium area under long term agreements with the operating companies. Petromin and KNPC are also sole distributors of petroleum products in their respective countries. These firms refine considerable amounts of crude oil in their refineries, but so far are not involved in sizeable production of crude oil of their own. Their crude oil supplies are coming under agreements with the other oil companies operating in their country. So the national oil companies under study are vertically integrated at home, but desire to extend this integration outside their boundaries. The question is whether the national oil companies should pursue their goal of becoming internationally vertically integrated firms, or revise this well established objective. It must be noted that such a major expansion into refinery and marketing distribution networks by national companies cannot be undertaken without the approval of their governments, and hence, this decision is basically one of government policy with regard to the country's oil industry.

In the next section we proceed to show whether the advantages attributed to extensive integration by an oil firm apply to the operations of the national oil companies considered in this work. It must be noted that all through we will assume that such an integration is within the technical and managerial reach of the national oil companies. In other words, the discussion of the benefits of integration does not take into account the constraints and barriers in reaching this goal.

Is Extensive Horizontal and Vertigal Integration more Advantageous to the National Companies?

The alleged advantages of integration for an oil firm were given in the previous pages. They were mainly assured outlets or supply for the company, the ability to withstand changes in the industry, advantages of large-scale operation and tax benefits. Here we try to evaluate the extent of these advantages on the operations of the national oil companies.

As mentioned before, for an internationally integrated oil firm which has a number of affiliates around the world, there is an opportunity for fixing internal transfer prices which will have significant effects on the distribution pattern of its revenues. And as the effective rax rates differ from one country to another, the company can adjust profits in such a way as to minimize its taxes. This advantage of integration is not great for the national oil companies. As state-owned ventures, this tax advantage does not apply to their domestic activities, and even when the activities of the national oil company extend to other countries, it is normally in a joint venture with the country involved and very different from the operations of the major international oil companies, Hence, integration will bring about no tax advantage for the national oil company.

Another advantage attributed to integration is that it brings more flexibility to cope with the short-run changes in demand for petroleum products, which will affect the demand for crude oil, also it is not very important for the national oil companies under study. These state-owned companies are owned by major oil producers of Middle East, and the concept of staying power as such is not relevant. For example, in 1975 when the total oil production in Iran fell by 11.1 per cent compared to the year before, the NIOC's expansion programmes and operations were not affected. The changes in demand for crude oil reduces the revenues of the government which will affect all sectors of the country's economy, including the national oil company. However, in the past, especially in the case of Iran when the government was in need of more revenues from the oil sector, the activities of the national oil company were expanded more rapidly (see section on NIOC's sales to Eastern Europe and joint ventures).

Extensive vertical and horizontal integration by an oil firm brings about a large-scale oil operation all over the world. This is said to have created an advantageous position (at some stages) for the international oil companies. Large size does bring about economic power for international oil companies, but to what extent a national oil company must seek its power in this way is debatable. The national oil company can certainly rely on the political and economic bargaining position of its country, and can count on support from other government agencies with regard to its technical and managerial problems.

Probably the most evident reason for integration is the security of supply or outlets for the oil companies. Professor E. Penrose in her book The International Petroleum Industry, analyses this view as follows:[13]

> "There can be no disputing that refiners would be wise to acquire their own sources of crude oil if there is some likelihood that they would otherwise be deprived of a regular flow of supplies or charged monopolistic prices; also crude oil producers and refiners would sensibly seek to acquire their own outlet if they would otherwise be faced with monopolistic combination among buyers. And indeed, in the historical development of vertical integration in the industry these were originally the dominating considerations, since competition often took the form of some firms attempting to gain advantage over others by obtaining some sort of monopolistic position in a key sector of the industry. Thus whether or not vertical integration was a particularly efficient way of organizing the industry, it became a competitive necessity for at least the leading firms, its existence providing its own justification".

In short, the ownership control brought with it certain power for the major international companies in the past. But how far do national oil companies need this ownership control for their operations today? The events of 1973 led to changes in the relationship between the producing governments and the international oil companies. The major oil companies had lost their ownership of the crude oil production in the Middle East. But their pattern of off-take was not affected, and their ownership was replaced by long-term sales and purchase agreements. So the ownership aspect of the integration of the oil companies in production was, after all, not tooimportant for the worldwide operations of the companies. At present, the power of major oil companies arises mainly from their ability to provide outlets for the crude oil producers.

Similarly, the ownership aspect of a small portion of down-stream facilities around the world, does not give any additional strength to the national oil companies. Their power lies in the fact that they (or their respective governments) control the production of crude oil. Owning a refinery in Italy or buying into small marketing facilities in the US does not change their over-all position considerably. It must be noted that the major oil companies were never in control of the crude oil output as the OPEC countries are presently. After all, the majors were competing with each other and others on the product market, a disadvantage which the national oil companies do not have at present.

To sum up, the major international oil companies became horizontally and vertically integrated whenever it was profitable to do so, and an opportunity arose through their process of growth. Hence, integration is not inherently necessary for the successful operation of any firm in the oil business. National oil companies' well-stated desire to become integrated is based on the model of major international oil companies, and is an objective which requires considerable rethinking. The alternative for the national oil companies would be to look for opportunities as they occur. As the importance in ownership of facilities have changed, it might be possible to find adequate outlets by long-term contracts.

NOTES

1. General Petroleum and Mineral Organization, published by Petromin (no date or place of publication given), p.24.

2. Statutes of the National Iranian Oil Company, dated 22nd August 1974 (Public Relations Department, NIOC, Tehran), Article 4(a), p.18.

3. The Expanding Role of KNPC (Kuwait National Petroleum Company, Kuwait), pp.35-36.

4. Ibid., p.37.

5. J.G. McLean and R.W. Haigh, The Growth of Integrated Oil Companies (Harvard University), Boston, Mass., 1954), Chapter I.

6. It must be noted that the use of this term is only justified within our broad definition of the stages of the oil process mentioned here. There may be many technical operations and specialized services that are carried out by other firms which are not controlled by the oil company.

7. E.T. Penrose, The Large International Firms in Developing Countries (George Allen and Unwin, London, 1968), pp.42-46.

8. P. Frankel, Essentials of Petroleum (Frank Cass, London, new impression 1973, first edition 1946), p.76.

9. M.G. de Chazeau and A.E. Khan, Integration and Competition in the Petroleum Industry (Yale University Press, 1959), p.36.

10. See The International Petroleum Cartel. The Report of the Federal Trade Commission, 1952. See also, The Large International Firms in Development Countries, op.cit., p.90-101.

11. Ibid., p.109-116.

12. Integration and Competition in the Petroleum Industry, op.cit., p.84.

13. The Large International Firms in Developing Countries, op.cit., p.47.

CHAPTER XVI

SALES OF CRUDE OIL BY THE NATIONAL OIL COMPANIES

The consequences of national oil companies entering the crude oil market has been widely speculated upon by observers. For example, M. Adelman in his book The World Petroleum Market, suggested that the entrance of the national oil companies in the markets would lead to a reduction in the price of crude oil:[1]

> "....National oil companies will by nature be price cutters. The governments are now demanding large ready reserves for their national companies to have them enter the business soon and on a large scale. Every country can very profitably produce much more than any likely quota, and there is not automatic price-cost mechanism to regulate market shares.
>
> The governments are less able to operate a successful cartel than the companies. Not only do they lack the companies' experience, but they also lack the inter-company contacts at two levels, crude production and sales (the joint ventures) and the refined product markets.... Thus the increasing role of the governments in the market will tend to increase competition and reduce prices...."

What Professor Adelman predicted in 1972 has not happened yet, although the control of production and pricing of crude oil has been in the hands of the governments for more than four years. The national oil companies, or the governments of the producing countries, have crude oil available for sales outside their respective countries. Here we attempt to discuss the nature of the problem of the sales of crude oil by national oil companies. But prior to that, we have to look at the crude oil market before and after 1973.

The crude oil produced by the jointly-owned affiliates of the major international oil companies was not, as a rule, traded in armslength transactions in the markets. The crude was sold mainly to other affiliates of the same or similar allied integrated group for processing. The petroleum products were then sold in the market, and it was this sale of products which created most of the revenues of the multinational oil companies. The sales of crude by the major oil companies to third party customers outside the group of majors were a relatively small part of the crude offtake, and hence did not constitute a significant portion of their revenues. The majors had every incentive to limit sales of crude oil since they had a competitive advantage over other firms which did not have access to equity oil. Open competition in sales of crude oil in the markets would have eroded this advantage, thus ensuring that sellers of petroleum products, due to their higher average cost of supply, could not cut prices.

Regardless of this attempt by the majors to limit sales of crude oil in the open market, however, a growing amount of oil was entering crude markets in the decade of the sixties. For example, in 1957 the total amount of crude oil sold at spot or contract by producers to refiners was nearly one million barrels per day, sold mainly by the major oil companies. However, eleven years later in 1968, armslength transaction of crude oil in the markets had increased nearly four times, with the majors providing nearly three-quarters of it. The amount of oil traded in this manner by other oil companies reached nearly 7 per cent of the total world market.[2]

Since 1968 the share of the newcomers (the term used for the oil companies outside the seven majors) in the armslength transaction of crude has increase mainly because of their increasing production capacity. Meanwhile, those refiners who had no access to owned crude, began increasingly to use the growing crude oil market to secure part of their supplies. The majors also used the crude market occasionally in the course of competion among themselves and with the newcomers; or to maximize their profits. So even before the entrance of producer governments and their respective national oil companies, the crude oil market was active and growing.

The national oil companies had very little crude oil made available to them for export apart from their entitlement to royalties which was payable, if desired by the producers, in kind. None of the producers used their option in this respect mainly because there was a significant difference between realized prices that they could have obtained in the crude oil market, and the posted prices that were the basis of the company's payments (see Chapter 7, The Sales of NIOC to Eastern Europe). But as the joint venture and contract agreements in the producing countries began to produce considerable amounts of oil, the fear increased that the national oil companies might try to sell their crude entitlement under these agreements. It was assumed that national oil companies would offer their crude at cut prices which would enable the independent refiners to offer cheap products, and thus depress selling prices all around.[3]

The concern over future activities of the national oil companies was equally strong among the producers themselves. For example, Sheikh Yamani discussion the Saudi Arabian oil policy in 1967, clearly showed his concern about prices in the event of national oil companies entering the crude oil market without know-how:[4]

> "One might wonder whether the policy of focusing on local industrial activities could alone provide sufficient reason and justification for not entering the international oil market. Another reason for this delay is our deep concern with the world oil prices. To jump into the market without sufficient know-how and capability would definitely hurt us sooner or later, both directly and indirectly...."

This view was shared among most oil producers in the Organization of Petroleum Exporting Countries. In October 1966, the representatives of national oil companies in OPEC gathered in Caracas for the first time to discuss general policies. In this meeting it was agreed:[5]

> "That a committee from member companies be set up within OPEC Secretariat, to study the ways and means by which national oil companies might, in a co-ordinated way, contribute effectively to the marketing of oil and its derivatives in the international market, as a supplement to their present and future individual activities, with a view to avoiding the effect of wasteful competition and furthering the aims of OPEC. For the purposes of meeting the costs of these studies, adequate funds should be placed by the national oil companies at the disposal of the Secretary-General of OPEC".

The armslength oil sales outside the integrated network of the major oil companies was increased during the 1960's. And as a result, both the majors and the governments of producing countries were concerned about its effect on prices of petroleum products. Pressure on prices comes as a result of entry by any "newcomer", whether private or state owned company, whenever it is done in such a way as to induce price cutting. The OPEC members believed that co-operation among the national oil companies would minimize the effect of their entry into the market.

The developments in the industry since 1973 have changed the structure of the oil business in most of the main oil exporting countries (see section on changes in the oil industry in the early 1970's). The main features of these changes in the countries we are concerned with were the unilateral decision on crude oil prices by the members of OPEC and the government take-over of the concessions, which meant government control over the oil producing companies. This shift of ownership did not change the pattern of lifting in the major oil producing states immediately. In Iran members of the former consortium accounted for most of the crude oil exported from Iran under a new sale and purchase agreement with NIOC. In Saudi Arabia, ARAMCO remained the main exporter, and in Kuwait BP and Gulf continued to export most of the oil produced. This situation began to change later as some of the exporting countries, worried about the fall in their production, started their own direct sales drive, which further stimulated the activities in the crude oil markets.

Direct Sales of Crude Oil by the Oil Producing Countries

So far we have mentioned very briefly the conditions in the crude oil market in the 1960's, and the gradual involvement of the national oil companies in this market. Here we attempt to summarize the nature of the problem associated with the sales of crude oil by the national oil companies, which might directly or indirectly enter the armslength tranaction in the crude oil markets. The policies of the national oil companies of the three countries under study with regard to direct sales of crude oil, are very important because of the nature of their operation and the positions of their oil reserves.

At present, the National Iranian Oil Company is involved in a number of direct sales of crude oil, which amounted to nearly 1.4 million barrels per day in 1977, representing nearly 27 per cent of total exports. In Kuwait, KNPC and KOC have, so far, no significant sales of crude oil on their own account, but the Kuwait Oil Ministry has been involved in a number of direct sales. The situation in Saudi Arabia is not very clear, and depends to some extent on the outcome of final negotiations with ARAMCO. But Petromin has been involved in a number of crude oil sales since 1973, when under the participation agreement certain amounts of crude became available for export by Saudi Arabia. Other Gulf oil producers are also active in lining up customers for their direct crude oil sales. Abu Dhabi, for example, has signed nearly twenty deals for the sale of crude oil in 1978.[6] It must be noted that whether oil sales are made by the national oil company or the Ministry of Oil, it does not alter the result of this discussion. The likely effect of such sales on the crude oil market depends on the overall government policies vis-a-vis the amount of crude oil involved and the terms of sales.

The policies of the oil producing governments with regard to oil exports and prices of crude oil, largely depend on how they see the future development in the world petroleum market. The prevailing expectation at present, which is shared equally by consumer states, is that there will be a world scarcity of oil supplies in the coming years. The majority of reports by reputable organizations who have studied the world energy situation, are in line with this threat of oil scarcity, although they differ on the exact date of its occurrence. Whether this expectation is right or wrong is not the issue in this discussion, rather it is the policies based on this assumption and their consequences which we are aiming to analyse. The governments of Iran, Saudi Arabia and Kuwait have all indicated this expectation that, within a short time, oil supplies will become increasingly scarce, and it has been suggested that even without OPEC, market conditions would push the oil prices up in future.[7]

Immediately after the October War in 1973, and the Arab oil embargo which followed, the fear of future continuation of the tight oil supplies pushed up the price of non-embargoed oil, directly sold by some producers, to record levels. Even prior to the October War, the producing governments recognized the profitability of direct oil sales when the total demand for petroleum products was growing more rapidly than the supplies of oil entering the markets. It was from early 1973 that the national oil companies, or their governments, began to formulate policies for direct sales of crude oil. The full take-over of the concessionary companies by the governments further enhanced the future importance of such sales.

National oil companies' direct sales entered a new phase after the oil supply scarcity was over. By 1975, the demand for crude oil was nearly 10 per cent below 1973 levels. The export of oil from some of the oil producing countries was reduced considerably. The major oil companies, in their new role as the long-term purchasers of crude oil, reduced their off-takes, in some cases regardless of their prior commitments in this respect. Some of the governments of the producing countries stepped up direct sales to maintain their revenues. These direct sales by the producers occasionally involved barter deals, in which oil was exchanged for industrial goods and arms. (See Table XVI.1.)

Hence, the direct crude oil sales by the governments and the national oil companies of the exporting countries, which proved very profitable at the time of oil supply scarcity, did not lose its momentum as the market conditions were reversed. This time the sales were made to maintain revenues and diversify the outlets for the countries' crude. The amount of direct sales of crude oil by national oil companies will increase in future for a variety of reasons, and it could have a significant effect on the crude oil markets.

The Consequences of the Direct Sales of Crude Oil by National Oil Companies

The crude oil which enters the market for armslength trading at present comes from three main sources: (a) The major international oil companies, (b) other independent oil companies, and (c) the national oil companies. Major oil companies, as mentioned before accounted for most of the crude oil entering this market throughout the 1960's, and still play a very important role. Majors' activities in the market, apart from sales of crude oil, included exchanges of certain amounts of crude to obtain their desired quality of oil for downstream facilities. Prior to the recent changes in the structure of the industry, The major international oil companies together had access to considerable amounts of equity oil in excess of their refining runs, which could have been profitably sold or exchanged in this market. At present, most of their equity oil has been replaced by long-term sales and purchase agreements with the producing countries. The cost of crude oil to the majors under these arrangements is still less than the other purchasers of Middle Eastern crude, which gives them considerable advantage in this market.

The role of the independent oil companies in the armslength trading was also enhanced as their crude oil production expanded rapidly. Independents are also involved in some of the joint ventures with the national oil companies, and are direct purchasers of crude oil from these countries. Some of this oil will eventually enter the armslength trading through a number of brokers, or by special deals among the companies and refiners in need of such quality of oil.

The national oil companies are newcomers in crude markets. The amount of oil sold by them directly in the market in the past few years was not considerable. However, their sales to parties who would use this market to dispose of or exchange part of the crude oil involved, makes them a very important element indirectly for the years to come. In addition to that, as the national oil companies expand their activities in the product markets, it is probable that they may use crude markets to acquire the right package of crude and products desired by the customers. All this does not imply a drastic change in the structure of the armslength tranaction in crude oil. What it does mean is that few companies have been added to the list of suppliers in the market. The only question to be analysed is whether the newcomers will cut prices in competition with other oil companies, and move significantly in competition with each other.

In order to answer this question, we will consider two main cases. First, the case where total demand for the petroleum products is growing rapidly, and most major oil states are producing oil close to their desired production levels. Second, we consider the case where the demand for petroleum products is not growing faster than what the oil producers are ready to sell, and there is a considerable amount of unutilized production capacity in the major oil producing areas.

When the demand for petroleum products is rising rapidly, there follows a worldwide pressure on installed productive capacity in the producing countries. Furthermore, the prices of armslength transaction in crude oil markets will show an upward trend in general. The national oil companies, in this case, can enter into short and long-term agreements with the foreign oil purchasers at favourable prices. Whether these companies are integrated oil companies or non-integrated refiners is not very important. There will be a lot of tranactions, exchanges, etc., in the crude oil market as traders, refiners and the companies try to maximize their revenues on the amount of crude oil they have purchased in such conditions. Even if the state oil companies try to sell some oil in this market directly, the effects will not be much different, apart from the fact that some sales and purchases would then be shifted from the countries to crude oil markets. Although some types of crude oil will secure a higher price in such circumstances, it is very difficult to conclude whether this direct approach would be the best course of action for the producers.

On the other hand, when the amount of crude oil which the producers are ready to sell is in excess of market demands, there is no scarcity of oil supplies, the effect of crude sales by the national oil companies would be quite different. It is argued that the crude oil offered in the market by the national oil companies will induce price competition in both crude and product markets. The only way for the state oil companies to sell in such conditions is to trim prices, and as the cost per incremental barrel to them(considering only the cost of production and not their respective governmental tax regulations) is nearly fifty times less than the price at which that same barrel could be sold, there is every incentive for competition among the national oil companies.[8]

In the past, the major oil companies tried to limit sales of crude oil to "outsiders", and when they did, prices were set in such a way as to make the cost of crude oil to buyers so high as to restrain them from competition in the product markets. Whenever the rate of growth of supply in the market exceeded that of demand for oil, it led to a decline in the price of products. It is argued that national oil companies, lacking the experience of the major oil companies and incapable of restraining themselves from competiting will force the prices down.

But the national oil companies are not necessarily price cutters. The national oil companies of the oil producing states do not have their own policies with regard to production levels and prices of crude oil. These companies, as we have explained before, do not operate independently, and the nature of their operations is not similar to companies such as ENI of Italy and ERAP of France. The production and pricing policies are determined by the government, and national oil companies only influence this decision by providing the government with information regarding different markets, and act as the high advisory council on oil matters. Dr. A.H. Taher, the Governor of Petromin, discussed this point in 1974:[9]

> ".....If we assume that international political factors dictate a flow for production, and that at current prices this flow will involve revenues which exceed the requirements of producing countries even with the expansion of expenditure on development and industrialization facilities, then the matter goes beyond the recognized

> responsibilities of the national oil companies, since in my view their role stops at the level of production which corresponds to balanced national requirements, and at that point they will have seized the opportunity available and faced the challenges arising from it. But the matter is in fact much more complicated than that, since the national oil companies cannot be treated separately from the related oil and monetary policies of the country, and the question in reality needs to be seen in an over-all manner with the framework of OPEC and that of the international economy....."

Furthermore, the national oil companies try to sell oil only to the companies who use it themselves. When the sale of participation crude oil by the national oil company of Saudi Arabia, Petromin, started in 1973, it was not offered to traders, and the contracts contained provisos that the buyer must specify the actual destination and agree not to resell the oil purchased from Petromin.[10] Similarly, the National Iranian Oil Company has clear policies with regard to direct sales, which restrict the deals with those companies who do not use the purchased crude oil within their own network and are buying the oil for the purpose of reselling. In Kuwait, royalty crude was offered for direct sales by the state in early 1974. In this case too, the crude oil sales were restricted to the direct users. Direct sales by the State of Abu Dhabi, like Kuwait, included provision that the buyers must use the oil in their own refineries, and must not resell the crude without permission.[11]

In a short period, between 1973 and 1975, the national oil companies involved in the sales of crude oil were active in a market which was transformed rapidly from a seller's market to that of a buyer. In December 1973, the National Iranian Oil Company sold substantial quantities of oil to American and Japanese firms at prices up to $17 per barrel, nearly four times higher than the so-called market prices which OPEC countries had set in mid-October 1973.[12] The terms were negotiated during the Arab oil embargo and an extremely tight oil supply situation in the market.

A few months latter conditions were reversed, and the buyers tried to minimize their lifting under the contract. Some of the Japanese companies were reported to have sold the Iranian oil at 20 per cent discount from what they had paid for it.[13] In Kuwait only 25 per cent of the oil offered by the state was sold.[14] Sales by Iraq, Abu Dhabi and Qatar were all facing difficulty, but none of them effectively cut their prices, and none used the spot market or the crude oil traders to dispose of their oil.[15]

In 1975, regardless of the difficulties which the national oil companies faced in selling crude oil on their own account, a price war did not develop. In this year the oil production in the Middle East dropped by nearly 10 per cent, but the general price guideline of OPEC was observed by the national oil companies, and the disputes were mainly based on the prices of different types of crude oil (what is known as the market differentials).

In December 1976, Saudi Arabia lifted its former ceiling of 8.5 million b/d of crude oil production, and decided to go against the majority of the oil producers on the question of price increases at OPEC. Consequently there was more than a million barrels per day of oil production capacity available to the Kingdom for export. The state oil company, Petromin, was not allowed to market even a portion of this oil, and the government, through the Ministry of Petroleum and Mineral Resources, arranged for all of the sales. There is a political factor involved, both in relation to prices and to production levels. These decisions are taken in view of overall government policies, and are often used to obtain certain concession from the developed world. Hence the national oil companies are not allowed to enter into a price cutting game, even if the market situation allows it.

Finally, if the past some of the oil producing countries were in need of additional oil revenues for their development plans, and were pressing for more oil exports from their countries. Since 1974, the producing states under consideration have accumulated considerable financial reserves, and it is unlikely that they will indulge in price cutting methods for the sake of short run extra revenues. Considering the discussion above, and particularly the political nature of the decision-making with regard to production and pricing of crude oil, it is improbable that the national oil companies will start a major price war in the markets. Professor Adelman (see the beginning of this chapter) must have considered the national oil companies as organizations designed to maximize revenues for their governments. And in this way he disregarded a major factor, namely the political aspect of the oil business in the Middle East.

It must be noted that even if the national oil companies refrain from price cutting, as they have done so far, the crude oil market does not necessarily remain calm. The major oil companies will be active in this market as the prime exporters of the bulk of world crude oil to the downstream markets.[16] The position of independent oil companies, who are also involved in direct sales from the state oil companies, is less comfortable as the market prices fall under the official values, since they do not enjoy the same discount that the majors get under their long-term purchase agreements. National oil companies are urged by their governments to maximize their sales without discounting. All this would probably lead to an area of activity in the crude oil market which is characterized by rapid changes in demand and prices.

To sum up, the direct crude oil sales activities of the national oil companies have increased considerably in the past years, and their sales, at present, indirectly influence the crude oil markets. It is unlikely that the governments of producing states will allow the national oil companies to compete with each other by price cutting, as it would be counter-productive in the long run, and will not be in harmony with their other political and economic objectives. However, the market for crude oil will become increasingly important to both oil producers and consumers, major oil companies and independent oil companies and refiners.

NOTES

1. M.A. Adelman, *The World Petroleum Market*, (Johns Hopkins University Press, Baltimore, 1871), p.224.

2. *Ibid.*, p.199.

3. *Petroleum Press Service*, May 1969, p.163.

4. *Middle East Economic Survey* (Special Supplement), April 21, 1967, p.3.

5. *Petroleum Press Service*, November 1966, p.403, See also *Petroleum Press Service*, December 1966, p.458.

6. *Petroleum Intelligence Weekly*, December 5, 1977, p.3.

7. *Middle East Economic Survey*, December 5, 1977, p.1.

8. *Petroleum Economist*, January 1975, p.3. See also, *Petroleum Economist*, April 1975, p.123.

9. Dr. A.H. Taher, "Challenges and Opportunities for National Oil Companies", *Middle East Economic Survey* (Supplement), May 3rd 1974, p.3.

10. *Petroleum Intelligence Weekly*, Special Supplement: "Buyers may face tough terms in next Saudi Oil sale", August 6, 1973, p.1.

11. *Petroleum Intelligence Weekly*, February 18, 1974, p.5-6.

12. *Petroleum Intelligence Weekly*, December 17, 1973, p.1-2. For the name of these companies see, *Petroleum Intelligence Weekly*, March 11, 1974, p.3.

13. *Petroleum Intelligence Weekly*, February 4, 1974, p.6. Oil was bought from NIOC at approximately $17 and sold at prices between $13-$13.5

14. *Petroleum Intelligence Weekly*, March 4, 1974, p.3.

15. *Petroleum Intelligence Weekly*, March 11, 1974, p.6.

16. *Petroleum Intelligence Weekly*, August 8, 1977, p.6.

CHAPTER XVII

CONCLUSION

A Comparative Recapitulation and the Future Role of the National Oil Companies

Many of the countries of the world have set up their own national oil company regardless of their economic development or their geographical position. The number of national oil companies in the non-communist world has now exceeded the one hundred mark. They range from full-scale monopolies running an integrated operation to those newly established state oil companies holding a share in the capital of a single refinery on behalf of the government in some countries of Asia or Africa. The desire of governments to enter the oil business is based on a variety of reasons, but in general one or all the following arguments are often used in defence of the establishment of the state oil venture:

a) The international oil companies may fail to develop the oil resources of the country fully because they have other interests elsewhere.
b) A state-owned oil company adds to national security, especially if there are indigenous sources of oil and gas within the country.
c) The energy requirement and its development is considered to be among government responsibilities.
d) The national oil company can enter into a variety of barter agreements and state-to-state deals, especially with the eastern bloc countries, something that international oil companies do not provide.
e) There is considerable hostility towards the international oil companies and for political reasons some governments do not want to be seen as leaving oil matters entirely to the discretion of these firms.

This study is concentrated on the national oil companies of three major oil exporting countries of the Middle East, namely Iran, Kuwait and Saudi Arabia. Iran was the first country in the region to establish its oil company, more than twenty-seven years ago. Kuwait and Saudi Arabia formed their national oil companies in the early 1960's. The former allowed private capital to take part in the company, and for some fifteen years Kuwait citizens could buy shares in this company before the government bought all the shares, and became the sole owner. The significance of the state oil company of Saudi Arabia arises from the emerging and vital role of this country in the future world petroleum market.

We began this study with a general background which was relevant to the establishment and development of the national oil companies of Iran, Kuwait and Saudi Arabia. These included the importance of the concentration of control of the major international oil companies in the world petroleum markets, the development of the oil industry in the decade of the 1960's and the changes in the structure of the oil industry which happened in the early 1970's.

In Parts 2-4 the national oil companies of the above countries, namely the National Iranian Oil Company, the General Petroleum and Mineral Organization and the Kuwait National Petroleum Company were discussed in some length. The emphasis was placed mainly on the establishment of these companies, their development and the present role and activities of each within their respective country and outside. Two major issues - the concept of integration and the sales of crude by the national oil companies - were also discussed in the preceding two chapters.

In this chapter we shall conclude the study with a comparative recapitulation of the national oil companies under discussion and their future role in the world petroleum markets. Here we talk of the similarities and differences among these companies, considering their establishment, nature of development, activities and other relevant issues. Then the developing role of the companies will be discussed, with regard to their commercial policies and objectives. Within this framework the scope for conflict or co-operation among the national oil companies will be analysed.

Similaries and Differences of the National Oil Companies Under Study

The three state-owned oil companies discussed in this work, namely the National Iranian Oil Company, the Kuwait National Petroleum Company and the General Petroleum and Mineral Organization have some general resemblance in their objectives and the nature of their activities. To start with they all began their operations by taking over the distribution of petroleum products within the country. The governments granted these companies the monopolistic right to market products inside the country, and within a few years of their establishment, the state oil companies were in full control of internal marketing of petroleum products. These companies have constructed their own installations, or purchased the existing outlets owned by foreign companies for distribution of products in the local market.

The objectives of the national oil companies of the oil producing countries is general, and those of the above three companies in particular, are largely the same, despite minor differences which were included to take account of the particular aspects of the oil industry in each country. The first objective of the national oil companies was to undertake all petroleum operations within the country. The petroleum laws and statutes of the national oil companies are worded in such a way that foreign oil firms are also allowed to take part in the development of the oil industry in the country. In other words, the state oil companies were not given an exclusively monopolistic right for exploration, production and refining of oil, mainly due to the fact that they were not ready for the job and the assistance of large international firms was needed, especially for crude oil exports.

The development and exploitation of national oil and gas resources is also among the objectives of the national oil companies. The areas relinquished by the foreign companies were allocated for the exploration activities of the state-owned oil company. In Iran, NIOC signed its first joint venture agreement in 1957, and the first contract agreement in 1966. According to these agreements the foreign oil company becomes a partner or a contractor of the National Iranian Oil Company. In 1968, the Kuwait government granted KNPC a petroleum concession to be jointly operated with a foreign oil company in the areas relinquished by the Kuwait Oil Company. In Saudi Arabia, there are also similar joint venture agreements in which PETROMIN is a party.

Another common objective of the national oil companies is integration and diversification. The statutes of all the companies under study provide for their engagement individually or in participation with others, in both downstream and upstream operations inside or outside their respective countries (see Chapter 15). In Iran the National Iranian Oil Company is now in full control of production, refining and marketing of petroleum products within the country. Similarly in Kuwait the national oil company has now taken over from the foreign firms all oil production and refining in the country and in the Neutral Zone under Kuwait administration. While some of the national oil companies have achieved full integration in the oil industry of their country, their efforts to expand that integrated and diversified activity beyond their borders have so far been limited. NIOC, for example, has made a number of joint venture agreement with foreign firms for exploration and refining outside Iran. But these activities have been made on a very limited scale.

In the past one of the objectives of the national oil companies was the supervision and implementation of the concession agreements held by the foreigners. This responsibility was gradually shifted to the oil ministry, or other relevant government agency. With the 100 per cent take-over of the concessions by the governments, this objective, which was shared by many national oil companies, is no longer relevant.

Another similarity among the national oil companies is that they all depend on the government for financing of their projects. The revenues of domestic marketing of petroleum products are often not adequate, and the companies have to keep the prices of products at the level demanded by the government regardless of increases in their operating costs. In Kuwait after the take-over of KNPC by the government, the prices of petroleum products in the country were reduced considerably. Major expansion plans of the national oil companies are also controlled by the governments, and are adjusted to the over-all development plans within the country. Furthermore, most of the state-owned oil companies cannot rely on foreign borrowing on their own accounts. Such loans must obviously be approved by the government at the highest levels, as the government normally becomes the grantor of such loans.

Some of the national oil companies are involved in the sales of crude oil to various customers, but they have no pricing policy of their own. The governments give specific pricing instructions for such sales, which have increased considerably after the recent changes in the structure of the oil industry in the Middle East. KNPC was never allowed to sell substantial quantities of crude oil, and the oil ministry in Kuwait is mainly responsible for such sales. NIOC and PETROMIN, who are involved in sales of substantial quantities of oil, follow the government pricing policy very carefully. While national oil companies cannot deviate from the government pricing formula for crude oil, they have more flexibility in the export prices of products. KNPC has been involved in various deals for sales of products refined in its export refinery at Shuaiba. NIOC is also becoming increasingly involved in product sales from the Abadan refinery. The prices in such sales so far have been mainly determined by the state oil companies.

It must be noted that most of the national oil companies play an important role in advising the governments on their oil and gas policies. These companies employ a large number of engineers, economists and oil technicians, and are in a good position to advise the government on its projects. So indirectly they influence the over-all decisions of the governments vis-a-vis pricing, joint venture agreements and other major oil and gas projects.

The development of the oil industry in Iran, Kuwait and Saudi Arabia has also shown a certain resemblance in the past few years. In all these countries the operations of the only state oil company has been narrowed down by the establishment of other state-owned entities. In Iran the National Iranian Gas Company and National Petrochemical Company, which were among subsidiaries of NIOC, are now completely independent, NIOC is no longer involved in petrochemical and gas projects which would be handled by these companies. In Saudi Arabia PETROMIN is no longer responsible for all the oil and mineral resources. A new wholly-owned government company, the Saudi Company for Basic Industries, was set up to undertake industrial projects. PETROMIN's role was reduced to refining, transportation, distribution and marketing of oil internally and abroad. In Kuwait also, the responsibilities for oil production, refining for export and petrochemicals are given to their different state-owned oil companies.

In general, the activities of the national oil companies - which in most cases involved gas projects, petrochemical ventures and other activities - are now concentrated mainly on oil, and they no longer are directly responsible for other projects. This process was somehow contrary to the objective of diversification which was shared by most of the national oil companies at the time of their establishment.

The differences among the national oil companies under consideration are mainly their size and the role which they play in the oil industry of the country. NIOC's employs more than 40,000 people as against KNPC's total of 2,600, which consists of nearly 85 per cent non-Kuwaitis. PETROMIN's work force is also very small when compared to that of NIOC.

These national oil companies, regardless of their objectives, play a different role in the petroleum industry of their respective countries. For example, NIOC is at present active in all aspects of the oil industry in Iran. In the southern oil fields nearly all of the operations are controlled by the national oil company. The exploration for oil is generally left to the foreign oil companies who would act as NIOC's contractors. But the company has been involved in some exploration and development activities on its own, or in partnership with other oil companies. NIOC is also responsible for the role of crude oil and petroleum products on its own account.

KNPC on the other hand is mainly responsible for the domestic marketing and sales of petroleum products abroad. The company is neither involved in crude oil production, which is handled by another state oil company, nor in the sale of crude oil, which is the responsibility of the oil ministry. A major difference between KNPC and the other national oil companies until 1975, was that it was 40 per cent owned by the private shareholders. But the government, as mentioned earlier, bought the private shares after the full take-over of the Kuwait Oil Company.

PETROMIN's role, as mentioned before, has been reduced to marketing, refining, distribution and transportation of petroleum both inside Saudi Arabia and abroad. This company has been involved in sales of certain amounts of crude oil which were allocated to it by the government. It also controls three companies which are involved in exploration and drilling activities, but unlike NIOC, does not have any significant role in the actual crude oil production within the Kingdom. Crude oil production is carried out by ARAMCO, and it is probable that even after the full take-over of this company by the government, crude oil production and expansion of production capacity in the Kingdom would remain in ARAMCO's hands.

The Political Nature of the National Oil Companies

In the previous chapters we discussed the establishment of the national oil companies under consideration in great detail. This discussion showed that internal and external political forces had played a major role in the establishment and development of these oil companies. Politics still plays an important role in the affairs of state oil ventures and dominates their nature of operations and future plans. National oil companies cannot be judged wholly on economic criteria. They are sometimes assigned by the government to fulfil political and social tasks in which the private oil companies do not get involved. . . In many cases the state oil venture has to supply petroleum products at uneconomic prices and may have to carry excessive personnel.

It is very difficult for any successful oil company to operate and at the same time disregard the political nature of the oil business. The difference between a national oil company and the international oil companies in this respect is that the former's involvement in the oil business is primarily based on serving the interest of one country, while the latter's activities are motivated by its own profitable growth. Any attempt to evaluate the activities of the national oil companies based on the model of the international oil companies without due consideration of the political nature of the problem would not be feasible.

The establishment and development of the National Iranian Oil Company, which was discussed in Chapters 4 and 5, is an evident example of how the external and internal political forces in this period affected the operation of this company. Prior to nationalization of the Anglo-Iranian Oil Company, the government made no attempts to study the consequences of such a drastic measure at the time. There was only one study made by a number of experts, which pointed out some of the problems associated with nationalization of the oil industry in Iran (see Chapter 4). Even this report was not made available to the members of the parliament who were voting on this issue. On the contrary, the pro-nationalization lobby continuously emphasized that the free world needed the Iranian oil, and other countries would even be ready to send experts to help maintain the flow of oil.

NIOC was formed following the nationalization of the oil industry in Iran, which was a political act effected without adequate study as to its results. The negotiations for the settlement of the dispute between the Anglo-Iranian Oil Company and Iran failed mainly due to the argument on the issue of compensation which - politically - was not acceptable to Dr. Mossadegh's government. As a result of this, the National Oil Company lost a golden opportunity to begin its activities in full control over the production, refining and export of Iranian crude oil and products.[1]

The Consortium Agreement was reached after intensive political bargaining between Iran, the United Kingdom and the United States (see Chapter 5). This agreement reduced the role of the NIOC to "non-basic activities" within the consortium area. Consequently NIOC lost all its powers because of a political settlement. Between 1954 and 1973, the Iranian government had used its political weight to increase its revenues and to find alternative markets for the national oil company.

In the cases of KNPC and PETROMIN, there were no similar internal and external political forces involved in the early years of the development of their national oil companies. During the 1960's, both Kuwait and Saudi Arabia enjoyed considerable political stability, which helped the gradual involvement of KNPC and PETROMIN within the oil industry. During this period the relationship between the governments of these countries and the international oil companies was based on co-operation and co-existence, although certain disputes arose from time to time. But the Saudi and Kuwait governments were firmly in control of the activities of their national oil companies. The power and authority of these three national oil companies were often altered according to what the governments thought of their role in the country's oil industry.

The Autonomy and Motivation of the National Oil Companies

International oil firms with a large number of shareholders are self-governing organizations, whose management are in principle responsible to the shareholders. But in practice diversity, lack of organization, and large numbers of shareholders have resulted in autonomous control by the management.[2] The administration in the national oil companies are not autonomous in the sense that they have to carry out the oil policy of the governments. The government - being the only shareholder of these companies - can effectively control their operation.

National oil companies are basically highly centralized. They have a Board of Directors similar to the private firms, which in some cases include representatives from various government organizations. NIOC's Board of Directors does not include outsiders, but the government control is exercised through a body called 'The Shareholders Representatives', which consists of seven ministers headed by the Prime Minister. Similarly the Board of KNPC and other national oil companies in Kuwait, are mostly comprised of the company officials responsible to the Supreme Petroleum Council, which consists of government ministers and deputy ministers. PETROMIN's Board includes the government representatives, and is headed by the Minister of Oil in Saudi Arabia. The principal decisions in the national oil companies are taken not merely on the basis of profitable growth of the company, but with regard to the over-all oil objectives of their respective governments.

This does not imply that the managers of the national oil companies base their decisions on direct instructions from the government. The technocrats of the national oil companies are experienced and well informed about oil matters, and their views are respected by government officials, and when it comes to the implementation of the general policies, the managers of the national oil companies have an almost free hand. Most of the decisions at this stage are taken at the company level, which includes construction and expansion of local facilities and other relevant matters. In this respect the national oil companies can be considered as large, autonomous, bureaucracies inside the country.

Another interesting feature of the national oil companies under consideration, is the political weight that the top management has within the country. It could be said that the influence and importance of the national oil company depends partly on the relationship between the general manager and the person, or persons, who hold political power in the country. General Managers of NIOC in recent years have all been veteran politicians and former Prime

Ministers. These people had direct access to the highest authority in Iran, the Shah, and on a number of occasions had resisted carrying out government plans, and had proposed their own. The company is a large bureaucracy spread all over Iran, which has employed thousands of young educated Iranians. Many of the present senior government officials started their careers in this company, due mainly to the special privileges and high salaries offered by the company in the past compared to other government organizations.

The involvement of all the Chairman of NIOC in politics before reaching their positions in the company has added to the unique web of favouritism which normally exists in many government organizations in the Middle East. They bring along their friends - many of them qualified people - to NIOC in order to surround themselves with a group of men they trust. This is not uncommon even in European and American organizations, but is probably not carried out in such a manner that the organization loses some of its qualified personnel. This is an inroad of personalism and politics within NIOC which not only affects the implementation of some projects, but sometimes creates an uneasy relationship with the government in general, or with some ministries in particular.

In Saudi Arabia, also, the role of PETROMIN is partly dependent on the personality and political weight of its Governor. The political favouritism and personalism are probably as strong as in Iran, although they are more obscure to the foreigners, since everything is done in absolute secrecy. In addition, the family relationship also plays an important role in who is responsible for what within the Kingdom. As the Board of PETROMIN consists of a number of ministers and high authorities from different government organizations, the process of decision-making is different to that of NIOC, which theoretically has to get approval from the ministers who are not members of the Board.

The importance of the political position of the manager of the national oil company also determines the plans and implementation of policies in Kuwait. In 1976 the government of Kuwait decided to reorganize the entire oil and gas sector by merging the three national oil companies with an overall government corporation. This plan apparently ran into considerable opposition from certain circles in Kuwait, to the extent that the Chairman of the state-owned Kuwaiti Petrochemical Industries Company threatened to resign.[3] The plan was shelved at the time, possibly because of disagreement among the heads of national companies who wanted their own independent operations, and the government which opted for their merger.

In general, in the countries under considerations, and indeed in most countries of the Middle East, the government organizations co-operate with each other only to the limit of the personal relationships existing among the staff of these units, and particularly those relationships at the highest level in these companies. There is considerable conflict and bitter competition between the various government organisations, feelings which are sometimes rooted in the running political power struggle among the heads of different departments. The national oil companies are also involved in this highly political web of personalism and their personnel try to jump on the band wagon of whoever they think has the political muscle, knowing that their progress to large degree depends on their own personal relationship with those both within the company and with other government bodies.

The Developing Role of the National Companies

So far in this chapter, we have discussed the similarities and differences between the national oil companies under study, and their political role. Another important issue concerns the developing role of the national oil companies in the coming years. This role depends on a large number of variables, among which are (a) the role that the governments of these oil exporting countries envisage for themselves in the world oil scene, (b) the developing role of the international oil companies, and (c) their technical and managerial capabilities to play a more active part in the world petroleum market.

The governments of Iran, Kuwait and Saudi Arabia, which were among the founding members of OPEC, have all, on a number of occasions, indicated that they seek more involvement in the export of crude oil and products from their respective countries. Saudi Arabia and Iran, the two largest oil exporters in OPEC, have invested heavily in the gas and petrochemical ventures for export, and their role as mere sellers of crude oil to a number of international oil companies is changing rapidly. The national oil companies are the obvious vehicle for fulfilling the objectives of the producers. But as the nature of operation of the national company[a] expands from domestic marketing and refining to a worldwide operation, it becomes increasingly more difficult for the state to exercise full control. At the same time, commercial activities of the national company would probably be more successful if their government does not interfere in every aspect of their business. On the other hand, it is evident that these companies will not be given the full freedom of operating, regardless of the financial advantages that this policy might bring with it. So the development of the national companies depends largely on how their respective governments decide to define their future role in the oil, gas and petrochemical business.

The role of the international oil companies in general and the seven major international oil companies has changed considerably in the past few years (see Chapter 3). But their importance has not changed much, and they are the prime movers of most of the free world's crude oil to the downstream markets. The international oil companies offer some flexibility and security to both consumers and producers that the state-to-state deals do not provide. All the consumers want a variety of supplies, and all the producers prefer a variety of outlets. The international oil companies are in a good position to satisfy both parties for a fee, and in this respect they have a major role to play.

Another area where the international oil companies could play a major part is in the provision of technical and managerial needed by both producers and consumers. The transfer of technology

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a By national company here we mean state-owned organization which is involved in oil, gas or petrochemical business.

is mainly achieved by people actually working on the job in joint projects and other forms of mixed ventures. The alternative would probably be to buy technical and managerial skills by employing a number of foreigners, whose expertise might not be fully utilized by the national company. The international oil companies have the right combination of technical and management skills, which have been developed over the many years of their worldwide activities, and make them the ideal partners.

Finally, the capabilities of each of the oil exporting countries with regard to skilled manpower, infrastructure and technical and managerial know-how are not similar. The developing role of the national oil, gas or petrochemical company partly depends on the overall success of the government to surmount the above problems. In other words, the role of these companies in the world markets is determined by how quickly and efficiently they, with the help of foreign partners, can finalize the mammoth projects under way in their countries, and how they would go about securing the right markets for the future.

Integration: The attitude of the national oil companies towards integration was discussed in considerable detail in Chapter 15, and we concluded that the objective of integration, which was based on the model of the international oil companies, must be re-examined more carefully. Many of the long-term objectives of the national oil companies could be achieved with limited involvement in the downstream activities. The desire to control the oil from the wellhead to the petrol station, which was considered to be an important element in the successful operation of major oil companies, is neither the most easily attainable nor the most profitable from the point of view of the producing countries. The reasons which led to the horizontal and vertical integration by the major international oil companies in the past do not apply to the national oil companies. Even some of the majors have either changed their integrated structure, or have made appropriate changes to deal with changing circumstances. The national oil companies are aware of these changes. For example, in the recent OPEC seminar Mr. Abdulhady Taher, the Governor of PETROMIN, argued against the established desire for such integration.[4]

> "The typical downstream investment of the multinational in the past was guided by integration to establish a secure market position; counting on integrated profits to justify it. As of now, such integrated profits are greatly reduced and, in the case of a national oil company, may not exist. Furthermore, the security of markets for crude oil, in a short market, assumed a different perspective In other words, for the national oil company neither of the two major considerations in a downstream investment is any longer relevant.
>
> Under present and future market conditions, marketing crude oil for a national oil companies does not really present as big a problem as it used to when the market was in a surplus position. In particular downstream investment in refining and distribution does not seem necessary as a means of crude oil disposition, although it may still be desirable in order to improve returns on the heavier and ligh sulphur crudes."

<u>The role of the national oil company as marketer of crude oil</u>: In Chapter XV we analyzed the nature and the consequences of the sales of crude oil by the national oil companies. National Iranian oil companies' direct sales of crude oil have averaged nearly 1.4 million

b/d per day in 1977 and in early 1978 have increased to 1.7 million barrels per day.[5] NIOC had made it clear that it would market the remainder of the crude oil nominated by the consortium companies and not lifted by them. This amount of oil would be available only to consortium members again if it was not already sold by the national oil company. PETROMIN's sales from joint ventures and other sources at certain points have reached half a million barrels per day. KNPC and other state companies in Kuwait are not involved in sales of crude oil which is handled by the Oil Ministry. The future direct sales of national oil companies might reach 5 to 6 million b/d by 1985 if the present trend continues, and PETROMIN's role in the export of Saudi Arabian crude oil remains limited.

However, the national oil companies' sales of crude oil will increasingly influence the crude oil market. The effect of such sales on the market is, at present, indirect as a result of selling and swapping of certain amounts of oil bought by the international oil companies from national oil companies, or of various barter deals involving their companies.

The governments of the oil producing states most probably will not allow their national oil companies to compete with each other by price cutting, as it would be counter-productive in the long run for all of them, and in most cases would not serve the country's political and economic objectives. Furthermore, the countries which have enough oil to affect the market, such as Saudi Arabia, do not have much financial incentive for such price competition.[6] The national oil companies will follow the guidelines of OPEC pricing policies strictly. This, of course, does not mean that there will not be some discounts given by the producers at times to adjust their relative prices of different crude vis-a-vis the 'reference crude'.

In the case of surplus of production capacity in the producing countries and availability of different types of crude in the crude oil markets, the refiners will naturally choose those crudes which fit their particular requirements, and maximize their profits on the sales of products. As the particular requirements are different for each refinery and market demand for various products determines the refiners' profit on the product mix, there is a continuous change in the preference for different crudes, and hence discounts arise at the spot trading. The main factors governing the price differentials among various types of crude are (a) API gravity*, (b) sulphur content, and (c) location in relation to the main markets. These discounts must not be considered as a price war among national oil companies. They are mainly the by-product of market forces, and OPEC has so far shown flexibility in dealing with the problem of differentials. OPEC does not decide on the prices of each specific type of crude oil, and every country determines its own price with respect to the price of a 'reference crude' (Arabian light API 34) set by OPEC. Because the <u>a priori</u> judgment of the producers on

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* API gravity $= \dfrac{141.5}{\text{specific gravity at } 60^{\circ}\text{F}} - 131.5.$
The higher the gravity the higher the price of oil of particular type as it yields more valuable light products. The API for water is $\dfrac{141.5}{1} - 131.5 = 10.$

market reactions for different types of crude is often incorrect. They have to adjust these prices from time to time.

In general, the prevailing expectation today is that there will be an oil shortage in coming years, although experts differ widely on the exact time of its occurrence. Whether the shortage will actually happen in the mid-1980's or late 1980's is not the question here. Within this framework (see also Chapter XVI) the role of the national oil companies in the crude markets, directly or indirectly, will become increasingly more significant. The amount of oil bought or sold in this market would increase considerably, as both the international and national oil companies use this channel to buy, sell or exchange part of their oil. Given the present expectation of future demand for oil and the political situation in the Middle East, it is difficult to conclude that national oil companies will bring the prices down by fierce competition among themselves and with the international oil companies.

The role of the national oil companies as marketers of petroleum products: The national oil companies under study are becoming increasingly involved in the marketing of refined products: NIOC have taken over the marketing of products from Abadan refinery, which now has the refining capacity of 600,00 b/d. The company is also involved in building export refineries in co-operation with foreign oil firms. PETROMIN's involvement in the product markets on a large scale will begin by the mid-1980's when PETROMIN-MOBIL and PETROMIN-SOCAL/TEXACO joint venture export refineries are fully operational. KNPC has been involved in marketing of petroleum products outside Kuwait for the past ten years.

Marketing petroleum products in general involves processing of the crude oil, which comes in different API gravity and sulphur content, in a variety of markets. The profitability of this operation to some extent depends on the amount of different product yield, which in turn depends on the crude oil input. Some refiners mix different types of crude oil to obtain the most profitable product yields, but this is not possible in some oil producing states where there are limitations on the different types of crude produced. Light crude oil gives a higher yield of gasoline, naphtha and middle distillates, which have a higher demand compared to heavier products, such as fuel oil. The refiner normally ends up with certain products which face a lower market demand, and it cannot reduce the output of these products, after certain limits, without affecting its overall product yields. The discrepancies which exist between the products and their market demand are usually the cause of the dilemma existing in most companies involved in refining and marketing of oil.

This dilemma exists equally for the national oil companies, with the additional constraint that they must supply the domestic market, which further reduces the availability of the light part of the barrel for exports. The amount of products available for export by the three countries under study at present is approximately half a million barrels per day, which might increase three-fold by the mid-1980's. The sale of this amount of products far from the major consuming markets is not an easy task, but in this respect the national oil companies have a number of alternatives.

First, the share of the national oil companies of the products of the export oriented refineries could be left for the foreign partner to market in return for a certain fee for providing this service. The international oil companies might be ready to provide this marketing outlet in return for supply of a certain amount of crude oil at favourable prices. This approach gives the national oil company a passive role with regard to marketing products. Under the 1973 agreement NIOC had an arrangement with the companies in the consortium to process certain amounts of crude for their export in Abadan refinery. This arrangement, as discussed before, was terminated at the beginning of 1978, mainly because NIOC used its entitlement under the agreement to obtain products for the domestic markets, and the companies were left with the heavier part of the barrel. In some of the joint venture agreements which have been signed, the problem of who markets the products has been one of the main issues.

The alternative to leaving the marketing of the products of the export refineries to the foreign partner, is for the national oil company actively to engage itself in finding outlets for its share of the products. But the national oil companies do not have the same integrated facilities as the international oil companies around the world, and consequently have to rely on the major product markets, such as Rotterdam. This exercise, which makes available considerable amounts of products in the markets, could, in certain circumstances, harm their partners in the joint venture.

The national oil companies under consideration are not equally prepared to undertake such marketing ventures. KNPC has been involved in marketing of products outside Kuwait for the past ten years, and Shuaiba refinery is specially designed to reduce the amount of the fuel oil produced. NIOC's might also be able to handle this operation, although it does not have long experience in marketing products. Its problem would be the nature of the products available for export - mostly fuel oil. But PETROMIN's ability to sell a quarter of a million barrels or more of products within a few years is somewhat doubtful.

The market of the national oil companies will be mostly the third world developing countries, as the imports of petroleum products into major industrial areas of the world are governed by special regulations and quotas, which generally create unfavourable conditions for the entrance of the national oil company. Most of the third world developing countries have one or more refineries, which in the past were supplied by the international oil companies. In addition, these companies sometimes imported the balance of the products required and took back the excess products, and in this way catered for the imbalance between the internal market demand and the yield of the refinery. National oil companies can provide a similar service probably with the exception of buying back unwanted products in the future. Many third world developing countires might prefer to deal with the national oil companies if they felt this might bring about certain financial assistance from their respective countries.

Finally, another option for the producers would be to tie down the sales of crude oil to the international companies and governments to purchase of certain petroleum products. NIOC purchasers of light crude oil must commit themselves to the lifting of a certain amount of heavy crude. Similarly, the international oil companies might be asked to purchase some products and crude as a package. The governments of consumer states might also be persuaded to relax some of their restrictions in return for a guaranteed supply of crude.

But all options which seem possible at first glance, might well run into considerable practical difficulties. For the international oil companies the question of who gets what type of products and at what price, would require continuous negotiation. To arrange an acceptable deal for these companies, taking into consideration their different requirements and the changing markets in which they operate, is an extremely complicated undertaking. The negotiations on a government-to-government basis also have considerable drawbacks, as they are not flexible and cannot adequately account for the changing market structure.

The developing role of the national oil companies in marketing products would most probably comprise a combination of all these alternatives depending on the nature of each company's operations and the bargaining position of its government. In general, national oil companies will try to market part of the products available for export, while the international oil companies - and in particular the joint venture partners - will be asked to market the remainder of such products. In this process the national oil company relies heavily on the government to use its influence, whether it be with the government of the consuming country or with the foreign oil companies. What is important in this respect is that unless the national oil company embarks on a vigorous campaign to sell such products, it stands to lose. So the company must provide certain services for the customers and project its image as a reliable source of supply.

These services range from credit and storage facilities to providing the right package of crude oil and products for different customers. As mentioned before, some customers even expect the supplier to buy part of their excess products. But undoubtedly one of the essential factors in finding outlets for products, is for the national oil company to show its ability to deliver according to contract. If the customers realize that the national oil company is as reliable as the international oil companies, they might even prefer to deal with it instead of them.

The Kuwait National Oil Company is probably the only company of its kind in the Middle East whose international marketing operations approach what has been said above. KNPC's policy has been to secure its position by delivering the products on schedule and standing by its contracts regardless of changes in the market. On some occasions the company has had to deliver products to the customers, and incurred some losses. The company has also bought a certain amount of products from other oil companies to prepare the desired package required by its customer.[7]

If the sales of petroleum products are left to the international oil companies, the national oil company will not seriously attempt to find its own outlet, and consequently its refining activity would be partly dependent on the foreign marketer of such products. In the past, major oil companies sold most of the available products for export from the Persian Gulf countries; the only exception being the Shuaiba refinery. As the majors showed little interest in buying the products from this refinery when it came on stresm in the late 1960's, KNPC had to embark on its own marketing campaign. On the other hand, the consortium in Iran and the ARAMCO partners in Saudi Arabia bought most of the available products for export in these countries according to different agreements. Thus NIOC and PETROMIN had little incentive to secure their own similar outlets for petroleum products abroad.

Advantages of the national oil companies' involvement in the crude oil and product market: We have discussed the developing role of the national oil companies in crude oil and petroleum product markets. They seem to be determined to increase their activities in these markets in the future, as it is widely believed that such an undertaking is vital for their future role. Some officials believe that the producers cannot maintain effective control of their oil policies 'without gaining a minimum degree of control in downstream activities.'[8] It is very difficult to prove or disprove that the involvement of the national oil companies in the crude and petroleum markets is to their financial advantage. The evaluation of such an operation, even for each of these companies, would involve so many variables, that the outcome would be of little value.

But apart from the financial gains, such ventures, if carried out 'in a responsible way', would have considerable advantages for the national oil companies. To start with, the employees of the company would get a chance to be directly involved in the day-to-day selling and buying of products in different markets and so obtain valuable managerial skills and experience, which would certainly be of great value in the future operation of these companies.

Such involvement by the national oil company in the market could also provide the government with the most up-to-date information on the crude and product markets around the world. This information could be used to determine government policies with regard to crude processing and other relevant matters. Close contacts of the national oil companies' staff with brokers, refiners and traders would also enable the company to keep a watch on the way oil transactions are conducted.

Another advantage of having an international organization for selling crude oil and products is that it could be used at later stages for the export of LPG and petrochemicals. It is true that the nature of marketing of these products is different from that of petroleum products, but the active involvement of the national oil company in various markets worldwide would certainly facilitate sales of other products.

As discussed before, the governments of the oil-producing states, are not - for the political and economic reasons mentioned before -

going to allow the national oil companies to have such a commercial operation. The governments righly believe that they cannot leave the nation's most valuable and depletable resource in the hands of the national company without effective control. They argue that it is the national companies' monopoly of marketing petroleum products internally and the governments' effort within OPEC, which have created all the opportunities for these companies. Whether such arguments are right or wrong is not the issue here. The important point is that the government wants to be involved in the markets and at the same time cannot tolerate its national oil company operating in a strict commercial sense.

One possible method whereby the national oil companies could enter the crude and products markets without the damaging consequences of unnecessary competition among themselves, or getting involved in costly and inefficient operations, would be to form a subsidiary company for their international marketing of products. The operations of this company must be based strictly on commercial criteria. The company would buy its crude oil from the government or its parent company, at OPEC prices, or any price that is offered to the long-term purchasers of the same crude oil. This company would also pay a refinery fee if it decided to refine the crude within the country -- again similar to the majors' former arrangements in Iran.

In general, the company would be allowed to operate in the same manner as the international oil companies after it bought the crude at government prices. It could sell the crude and products in the most suitable package required by customers. In this way the government would not get involved with the sale of petroleum products as it is now engaged in the direct sales of crude oil. The control of such direct sales of crude oil by the governments is not very difficult, unlike the effective control of the national oil company's operation in the product markets. In this market there are numerous deals, exchanges, etc., and the market prices can change very rapidly around the world. The proposed subsidiary of the national oil company could be left on its own to prove its capabilities, and at the same time would embody an organization authorized to deal swiftly with the changes in the market.

It is also easier to evaluate the nature of the activities of such a company at the end of tne year, and to judge its efficiency. When the national oil company that is the producer, refiner and marketer of crude oil and products comes to account for its operations, it is very difficult to determine where the inefficiency lies and what changes must be made.

Among the exporting countries considered, only Kuwait has such an agency, although not in the exact sense of that suggested above. KNPC is responsible for marketing products abroad, and the company obtains its crude at the 'third party' price from the government.[9] NIOC and PETROMIN lack such an organization, and in the case of the former - which is now faced with the exports of some product from the Abadan refinery - such a set-up could be of some value.

The main point is that the government must make sure that such a subsidiary or independent company does not obtain its crude at a price lower than other international oil companies. Even if the proposed company loses some money at the beginning of its operation, it is worthwhile the government guaranteeing the continuous existence of this company, as it provides other advantages mentioned before. Meanwhile, the management would try to maximize its efficiency and would be judged on the basis of their efforts.

Co-operation among the national oil companies: Since 1973 there has been considerable speculation on the price war which could develop among the national oil companies as they become more involved in selling crude oil, and its consequences for producers and consumers alike. In the past four years OPEC countries have shown that, in general, they are capable of restraining themselves from damaging competition in this respect. The scenario for a price war among OPEC countries has now moved to the marketing of petroleum products by the national oil companies of these countries. An additional topic of discussion has been the growing and enormous investments by the Middle East oil producers, particularly Saudi Arabia and Iran, in petrochemical and gas projects. Whether these are going to be the seeds of conflict among the national oil companies in the 1980's, or whether the countries concerned will co-operate with each other, is debatable, and is not the main issue here.

Major refinery construction and expansion by the national oil companies in the Middle East will change the distribution of the world refining capacity over the next decade. Already the Middle

East shows the largest share of planned new capacity of nearly 2.2 million barrels per day.[10] The situation for the LPG exports is also alarming, as it is estimated that the LPG export availability is expected to rise five-fold from 9 million tons per year level in 1975 to nearly 47 million tons per year by 1985, and OPEC's share of this total is estimated to be nearly 80 per cent.[11] In the field of petrochemical ventures the Middle East countries, again particularly Saudi Arabia and Iran, have already committed themselves to huge projects in conjunction with the American and Japanese group. The concentration of the new capacity in these industries is certainly shifting towards the Middle East, while there is no indication that world demand for these products will pick up at such a rate as to account for over-capacity in future.

The share of OPEC countries of the total refining capacity of the non-communist world stands at nearly 7 per cent, while its share of crude oil production is more than 68 per cent.[12] Considering Saudi Arabia and Iran, which are the world's largest oil exporters, their present refining capacity and those under construction (not planned) amounts to about 2.8 million barrels per day (probably by 1982) which is less than the refinery runs of Exxon, Shell and Texaco in 1976. The refinery runs of the seven major international companies in 1976 amounted to 19.3 million barrels per day.[13] As for petrochemicals, OPEC countries expect to increase their share of production of ethylene from 1 per cent in 1976 to 6 per cent by 1990.[14] All these figures point to the fact that the share of the oil producing countries in the world refining and petrochemical industries is increasing, and there is a need for co-operation and co-ordination of projects among the national oil companies.

In general, the national oil companies could get together and organize their business in such a way as to avoid costly and damaging competition among themselves. This was what the major international oil companies are alleged to be doing with considerable success. On many occasions such co-ordination and co-operation would be welcomed and even encouraged by the majors, as they are marketing partners in most of the joint venture refining and petrochemical projects in OPEC countries, and any fierce competition among national oil companies would not serve their interests.

The major international oil companies have to be very careful not to be seen as a group of companies who are in close contact with each other on their production and marketing policies, because of consumer governments' anti-trust legislation. National oil companies, on the other hand, have no such fears. They already have the forum of OPEC to help in organizing joint actions, and have met several times in the past to co-ordinate their policies. The possibility of more co-operation among the national oil companies, as against price wars and conflicts, must not be dismissed. Already there are indications that the producing countries, realizing the advantages of such co-operation at the national oil company level - apart from OPEC ministerial meetings - are moving in this direction.[15]

One advantage of such co-operation among national oil companies is that as a group, they have a much more commercial bargaining position from which to secure markets for their products in view of protectionist legislation of some consumer countries. For example, the Arab oil-exporting countries have been involved in negotiations with the European Economic Community about future imports of petroleum products and petrochemicals into the EEC. The national oil companies will find it difficult to get preferential treatment on their own, and even together they probably need the political support of their various governments.

There are also some difficulties in the way of such a proposed co-ordination of activities among the national oil companies. The political nature of these companies could become a handicap, as strained relations between two governments could jeopardize co-operation among their national oil companies. Such friction and rivalries among the governments of the oil-producing countries are not rare, and would constitute the main obstacle in relations among the national oil companies. Furthermore, the fact that the operations of the national oil company are not predominantly motivated by financial criteria - unlike international companies - would add to this problem.

As for the national oil companies under study, there are plenty of opportunities for co-operation between them in all oil activities and sales of petrochemical products. It is difficult to say exactly what is the most suitable approach to such co-operation among these companies, but inter-company sales and purchases of products and crude could be considered more seriously. For example, NIOC at present faces a high demand for middle distillates within Iran, which require. high refinery runs by the company. In the refining processes a large volume of fuel oil will be made which is very difficult for NIOC to sell in the present world markets. On the other hand, KNPC's refinery at Shuaiba is designed to maximize the lighter part of the barrel, and the company needs a certain amount of crude oil to prepare the right package for some of its customers.

A marketing arrangement among the two companies, whether by straight sale and purchase agreement or otherwise (exchange, etc.) would be desirable. NIOC could reduce its refinery run and market the crude which could bring in a better overall return to the company compared to fuel oil sales. KNPC would get certain crude to prepare a more attractive package for its customers. It must be noted that at present such deals might not even be politically acceptable to the governments, as it is hard for the Iranian government to make their public realize why their country, a major producer, is importing certain products regardless of how strong the economic argument might be. But in future the national oil companies will find it increasingly essential to co-ordinate their policies with each other, and use OPEC for strengthening such co-operation.

NOTES

1. In an article which was published by Rastakhirz, a major national newspaper in Iran, Dr. Reza Fallah, who was one of the principal negotiations during the dispute with the Anglo-Iranian Oil Company, revealed the nature of the dispute after the nationalization of the oil industry in Iran. This article also helps to show that political consideration and lack of understanding of the oil business by some politicians was the main cause of the failure in these negotiations.

   A brief account of the history of nationalization of the oil industry in Iran (in Persian), Dr. Reza Fallah, Rastakhirz, 30 January 1978.

2. For further reading concerning the autonomy and motivation of international oil companies, see Edith Penrose, The Large International Firm in Developing Countries (George Allen and Unwin, London, 1963), p.28.

3. Middle East Economic Survey, 19 April 1976, p.4 and 19 July 1976, p.4.

4. Dr. Abdulhady Hassan Taher (Governor of Petromin), The Future Role of the National Oil Companies in the World Petroleum Industry, OPEC Seminar on the present and future role of the national oil companies, October 10-12, 1977, Vienna. Published by the Information Department of OPEC, p.191.

5. Middle East Economic Survey, 20 March 1978, p.5.

6. Edith Penrose, "Choices for the Oil Exporting Countries", Middle East Economic Survey, Supplement, 16 January 1978, p.3.

7. Interview with KNPC officials in June 1976: Mr. Nader Sultan, Marketing Director, and Mr. Giovanni Zacchiatti, Manager of Supply.

8. Dr. Ali Attiga (Secretary-general of Organization of Arab Exporting Countries), Regional Co-operation in Downstream investments in the case of OAPEC, OPEC Seminar (see Note 4), p.12.

9. Interview with KNPC officials (see Note 7).

10. Petroleum Economist, September 1977, p.337.

11. Middle East Economic Survey, 6 March 1978, pp.5-6.

12. Dr. Ali Attiga, _op.cit._, p.123.

13. _Petroleum Intelligence Weekly_ 8 August 1977, p.6.

14. _Petroleum Intelligence Weekly_ 13 June 1977, p.2 and 27 June 1977, p.4.

15. OPEC Seminar on the Present and Future Role of the National Oil Companies, is one example of such a move.

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