In the name of Allah
the most
Compassionate and Mercifull

The Center for the Publication of
the U.S. Espionage Den's Documents
Ayatollah Taleghani and Dr. Mofatteh intersection,
P.O. Box: 15815-3489 Tel: 824005

were also discussed with officials of Chase Manhattan Bank and Fir
National City Bank of New York, and with Walter Levy. At various
times, the broad subject, but not the specific questions, was dis
with a substantial number of second echelon officials of the comp
listed above and with officials of overseas affiliates of most of
The total number of individuals who contributed their views on the
list of questions was about 100. Conversations on the same subj
held during the last year with an additional 100 company officials.

Some companies had given a great deal of thought to the subj
changing conditions in company-government relations in producing
consuming areas; others apparently have preferred to react to ev
not to try to anticipate them. With a few exceptions, however,
not possible to speak of an unflawed, monolithic "company positi
Feelings and attitudes inside most companies, as in the Departme
State -- not to mention the Federal Government -- vary considera
And finally there are fairly well known differences in approach
attitudes among the top executives of the industry as a whole; s
traditionally have taken a quite rigid line, others a more comp
one. In this report, the specific views of no company and no i
will be identified.

IN THE NAME OF GOD, THE
COMPASSIONATE, THE MERCIFUL

Man's access to crude oil may be traced back to several thousand years, but it is not more than a century that he succeeded to drill oil wells in North America and pump out huge quantities of it. Ever since, this source of energy has been gradually making its place in industry. The oil industry has developed along with other industries, providing the possibilities of exploring, exploitation and refining of oil on a large scale. on account of being a cheap and profuse source of energy for meeting human needs, the flow of oil has become the life-vein of industries. Development of oil side-industries, like petrochemicals, during the last few decades has greatly enhanced the importance of oil as a raw material for these industries. The products of such industries like polymers and plastic goods have found numerous cases of utilization due to their low cost of production and facility of industrial application. Due to the rapid development of polymer technology and the scientific know-how, the utility and importance of this material is steadily increasing. For this reason use of petroleum as fuel is considered to be one of its wrost kind of utilization.

Despite the great efforts and large investments which have been put to work by the industrialized countries for finding an alternative source of energy, no significant

success has yet been achieved. Due to high costs and massive equipments, application of nuclear energy has its own limitations and cannot play such a significant role. It is worth mentioning that during the year 1975, 65.8% of the world energy requirement were met by gas and petroleum, and 26.7% by coal, whereas the share of other sources of energy (including nuclear energy) was a meagre 7.5% . In any case, petroleum has maintained its top position as the foremost source of energy and will continue to do so in the foreseeable future as well. If we look at this problem from the economic point of view, it assumes even greater and more significant dimentions. The problem of oil continues to influence the economic position of nations and their destinies with an ever faster pace, and the impact of the fluctuations in the oil market on their economies is deepening. In order to procure certain criteria in this regard, the remarks of one of the economics exports of the C.I.A. made in August 1978 about the increase in oil prices are quoted here:

"We calulate that on oil price increase of 10% now has the same economic impact as a 60% increase in 1973,* when the weight of oil in

---

*During the year 1973, the oil prices touched an unprecedented height in the world market, and increased from $3 per barral to $12 per barral. (These prices are approximates, which is subject to change according to various types of crude oil.)

economic activity was much smaller. Every 10% rise in real crude prices today would cut one-half a percentage point off OECD GNP growth, boost unemployment by some 500,000 persons, and add slightly more than one-half a percentage point to inflation, besides adding to the already severe balance-of-payments problems of many nations."

Frankly speaking, if the marginal changes taking place in the oil market can alarm the world plunderers to such an extent, so, how the control of oil market would be achieveable? How do they manage to suppress, the legitimate rights of the rightful owners of the oil income, i.e the oppressed people of the oil exporting countries, how do the squanderers of oil steer the ruling bodies of these countries in the direction of meeting their political purposes? How is it that different political parties coming to power in a country like America are transformed into an impeneterable united front on this issue? From where can be found the answers to these and many more such basic questions? The reality is that the information about many of these issues cannot be obtained through the study of reports and articles printed in mass media. In most cases confidential reports and classified materials can prove a useful guide for the scrutinizing and probing of such issues.

---

*Quoted form one of the analyses, made by the C.I.A., found among the documents of the Espionage Den.

Numerous documents of high significance which are mainly in possession of top clasification and dealing with oil issue, have been recovered from the U.S. Espionage Den. Before the seizure of the Embassy they were filed separately under the same classification by the Embassy authorities. The significance of these documents will be realized only when one comes to know that this is the first instance that such secret and highly confidential reports regarding the matter of oil are being published, and for the first time are brought to the full knowledge of the public. For the same reason, the inportance of their study and analysis is much more realized. These documents have been arranged in a proper order, and will be published eventually, may God will so.

The Present Document: The International Oil Industry In 1980:

After the discovery of vast oil fields in America the Europeans, who found themselves lacking this great source of energy, started to search for oil in their colonies and the countries that were under their influence. The Brithish discovered oil in the Middle East, particularly in the erea of the Persian Gulf, which the largest oil fields are located in that region. Their avarice and greed on the one hand, and the ignorance and carelessness of the regional rulers of the time on the other hand, incre-

ased the lust for exploiting the oil. Hence for the sake of plundering these sources, they tempted the regional rulers and allured them to sign unjust and unilateral agreements. The contracts signed between Naseruddin shah and Baron Julios De Reuter, who was an Englishman and Muzaffaruddin shah and William Knox D'Arcy, (also an Englishman), are among those agreements. Reuter obtained, the monopoly rights for all mineral resources, with the exception of gold, silver and precious stones mines, for a period of seventy years in exchange for the nominal payment of 40,000 pounds. But this agreement was annulled due to the strong opposition of Tzarist Russia. Afterwards D'Arcy secured special privileges and monopoly rights of exploring, drilling and exporting oil, petroleum, gas, tar and natural wax for a period of sixty years through the son of the previous Shah. These royalties were transacted for a payment of just 20,000 pounds in cash and 20,000 shares of the drilling company, whereas the total number of the shares of the company was more than 600,000. As a result of these contracts, technically named as concessionary agreements the national wealth of the poor countries was placed at the disposal of the plunderers, and day by day they became more dependant to their exploiters. For an example, in 1917 A.D. (1295-96 H. SH. Persian calander) the net profits of the Anglo-persian Oil Company (which was established in 1909 by the British government for the

purpose of maintaining the royalties obtained by D'Arcy who faced financial difficulties and was unable to continue.) after the deduction of depreciation, internal duties, and royalties was amounted to 344,109 pounds. In that year the royalties which were to be paid to the Iranian government totaled 3829 pounds, but was confiscated in liue of damages caused to the company's pipeline by the Iranian tribes.

Relations between the oil companies, the principal plunderers of oil, and the oil-producing countries were so one-sided that the American officials also had to criticize them in severe terms. In this context the following extract taken out from this very book is noteworthy:

"The attitude, common 60 or even 20 years ago, was that oil copanies made the resource, without their efforts, science and capital, the oil would stay in the ground. The natives, therefore, should be grateful for whatever the companies gave them--and this should not be very much."

"Unfortunately, there are still many in the governments and universities of the producing countries who have not seen that the oil companies have changed."

An analyses of such phrases as 'the changes in the companies', which are mentioned in an approving tone, and 'the changes in favour of the oil producing countries', which are referred to as an essential and positive step, is indicative of the fact that to what extent the royalty

agreements and business relations of the oil companies with the oil-producing countries, in the past, were one-sided. In any case, in the successive years, these agreements were renewed with minor changes, which were made, due to the pressure exerted by the public opinion of the countries possessing oil reserves. This was the sole determining factor in increasing the oil revenues of the real owners, who had yet received an insignificant part of the oil income.

The maturity of the public opinion and the relative disillusionment of the masses in these countries, along with the changes that occurred in governments to some extent have been disrupting regular oil exports by past conditions. Sharp reactions against this kind of pillage and repudiation of the plunderers had occurred in rapid succession. But these reactions were usually dispelled by means of political forces and sometimes were defeated by the means of more acute measures like coup d'etats. The deep-rooted struggle of the Iranian people during the years 1948-1953 A.D. (1328-1332 H.Sh.), which led to the nationalization of the oil industry in 1950 (1329 H.Sh.) and expelling of the British, is one of the most remarkable instances of a kind in this regard and the coup d'etate of Aug 1953 (Murdad 28) is an example of the kind of responses given by exploiting countries to these struggles.

With time the situation changed. The maturity of public opinion expanded to such an extent that it became difficult to suppress the public demands in oil producing countries and also their governments were inevitably co-mpelled to reflect them. Thus, the wave of dissatisfac-tion and anger grew uncontrollably explosive during 1970 (1348-1349 Sh.), and forced the plunderers to reevalulate the conditions with utmost care. A secret document of the U.S. State Department is included in this book, in which the above-mentioned issue has been studied and an-alyzed. As mentioned earlier, the specific conditions and circumstances prevalent in the oil market and the oil industry are such that they demand dpecific steps to be taken for controlling them. The circumstances have re-ached a stage that the OPEC countries may make certain decisions which could cause irretrievable losses to the oil companies and consumers, and this would leave them facing a completed act. Therefore, the U.S. State Depar-tment has decided to take certain measures in order to coordinate the deliberations of various groups and soci-eties that determine the oil policy of the U.S.A. These societies are in the following order:

-The authorities of the U.S. government in different departments such as the Department of Interior, the Dep-artment of Commerce, the Department of State, the Depar-tment of Justice and etc.

-The important and main American banks like, the Chase Manhattan, the First National City Bank of New York and etc.

-The management of the principal oil companies of America, the majority of whom are the members of the Seven Sisters, Texaco, Standard Oil California, Standard Oil New Jersy, Gulf and Mobil.*

-Independent American Oil companies:
Atlantic Richfield, Contintental, Marathon, Accidental and Standard Indiana. The main aims of the specific actions which come under the jurisdiction of the State Department are in the following order:

-To propound various questions whose answers will help to determine and resolve the present issues, and the decisions taken by the circles.

-Forwarding these questions to the above-mentioned special circles. To seek their opinion. (the questions are given in the later part of the relevant document in the form of an appendix.)

-A comprehensive analysis of the problems, enabling the decision-making bodies to have a clear picture of the existing situation.

-Proposing measures to be taken for the solution of the existing problems. The contents of the document are

*Two other English companies are Brithish Petroleum and Royal Watch Shell Hollandish.

quite clear and present a clear picture of the role that U.S.A. plays in the oil market and industry. This role is so monopolistic and unilateral that it cannot be fully comprehended unless one probes the contents of the documents, which are explicit statements of U.S. Administration officials. But there are some points in the quoted document, which should be considered with special attention. A minute study of these points gives us a much deeper insight into the crucial problem of oil, and enables us to prepare ourselves as an oil producer and as one of the important members of the OPEC to adopt effective measures vis-a-vis the politics of international oil devourers and their propaganda stunts.

Significance of Oil In American Economy:

Apart from being an industrialized counrty with the highest degree of energy consumption in the world,the U.S.A. is in vital need of this source of energy. From the economic point of view oil is of great significance to her. The huge and exhorbitant profits which are earned through oil transactions, are very important for the U.S.A. in many respects. It is enough to recall that five of the seven major oil companies that devour the world reserves are American, and they enjoy loin's share in exploiting, refining, marketing and supplying the oil of the non-comunist world. In this respect it will be

better to look at the subject from American point of view. We read the following excerpt from the remarks of a Department of State analyst:

"The contribution of the international oil industry to our balance of payments is about as great as that of all other investments abroad combined and, hence, is another reason for our concern that our oil companies remain healthy and productive."

It is for these reasons that the Americans are not prepared to give up even one cent of their huge profits, which is in fact the legitimate right of the oppressed peoples and the countries possessing oil reserves. Whenever the question of the partnership of the countries owning the oil feilds in the oil extracting companies, is raised by these countries, as a step towards receiving more profits, the wide spectrum of the U.S. authorities, apart from the nature of their connections with the problem of oil, form a united front to oppose them and declare such a demand as a threat to their interests:

"... each percentage increase in participation could mean a little less than an additional cent per barral of oil produced, ..."

In any case, it is clear that the Americans are not going to retreat even a step from their fortified position of making enormous profits:

"We would not wish, however, to indicate openly at any time that nationalization of oil and converting companies into purchasing contractors would be in any way acceptable to us."

Other Ways for Procuring Crude Oil for Reducing the Dependence on the Present Sources:

As mentioned in the beginning of this paper, various efforts have been made for finding other sources of energy, but due to various obstacles and limitations their production and utilization accompanies many difficulties. In this document the possibilities of obtaining crude oil have been assessed and analyzed. The most important approaches are as follows:

-Obtaining oil from coal.

-Extracting oil from tar sand.

-The secondary and tertiary methods of recovering oil from the wells, whose pressure has become low.

-Extracting oil from Shale.

In view of the high cost of production and extraction of crude oil by above-mentioned methods, the price of the crude oil obtained by these methods cannot compete with the price of oil obtained through the ordinary process. In this document also, as reflected in the following passage, a sentiment of disappointment and frustration can be noticed:

"In any case, there can be very little doubt that the hydrocarbon needs of the United States will ultimately beat least partially covered by oil produced from these two sources, or that these are the major reserves of the world. They are also the most costly of the reserves we are presently considering."

"... the consuming countries could take less oil, but this is scarcely a credible threat as they have no alternatives for this oil either from non-OPEC sources or from other types of energy."

This should be kept in mind that in the documents quoted above, the analyst himself has shown the difference between the cost of oil obtained through these methods and the current price of oil as lower than the actual cost in another paper prepared by the C.I.A., in which the subject was studied with greater technical accuracy, but more negative results are indicated. Therefore it ought to be believed that this subject has been viewed optimistically and these sources are given far greater value than they actually deserve.

The Power of Oil Producers vis-a-vis the Oil Devourers:

The expression, 'oil as a political weapon' has acquired currency in modern terminology. The spokesman who want to emphasize 'the issue of the power of the oppressed people of oil-producing countries' always make use of it. The use of oil as a political weapon has been always criticized by the industrially powerful countries and they denounce it as an act of injustice. Though in this kind of propaganda human moral values and principles are often being emphasized, but it is dubbed as an act of violation of the international agreements. yet if one studies its roots, its motives can be found lying somewhere else. The truth

is that the devourers of oil and the industrialized countries have been always greatly alarmed at the unity of the countries possessing oil reserves and have been always trying to create obstacles in the way of the formation of a united front of the oil producing countries. In this document the exterme weakness of the oil-devourers against the countries possessing oil reserves can be seen in the from of a clash of principles. In this way, even their attempt to seek refuge in the term 'weapon' is itself indicative of the kind of authority and power which the oil producing countries weild, and which the principal oil consuming countries try to weaken through creating obstacles. The organization of the Oil Exporting Countries (OPEC), as the only front formed by the countries possessing oil reserves, has always caused considerable dismay among the devourers of oil. The use of such epithets as 'Oil Cartel' "the organization of eagles" for this organization is illustrative of the fact that every factor of unity which results in the uniformity of the oil policies and consequently safeguards the interests of the real exporters of oil, always becomes the target of grudge and malice of the exploiting countries. The operations of this organization up to the date of the document (1971) gave rise to the sense of intense weakness among the devourers of oil vis-a-vis this organization, and this can be noticed in the following lines of

the document:

"With minimal cooperation inside OPEC, (and the cooperation in the last year has been considerable), the OPEC countries should be able to force prices considerably higher in 1976; at the conclusion of the Tehran agreements; and at the same time will be able to force the companies to accept "participation" on OPEC terms, in fact they could do this much earlier if they can work together.

Subsequently the analyst assesses the consequences of the coarse and incongorous attitude of the major oil companies in the following words:

"A return to an overtly, exclusively pro-Israel position would negate most and probably all of the other steps the United States could take to secure oil supplies."

From the political point of view, it should be noticed as to what extent the reactions of the countries possessing oil reserves were taken into account:

Now it is necessary to analyze reason for the monopolization of Saudi Arabian oil reserves by ARAMCO and the plundering assaults of industrialized countries and oil companies over the oil prices on the one hand, and on the other, the reason why the U.S. government shamefacedly is continuing to support the international zionism. Can its reason be other than the disunity and discard among the Muslims and the vaunt and dependence of the heads and rulers of the reactionary Arab states upon the imperialists?

It will not be improper to refer to the problem as discussed in the text of the document. Shaykh Zaki Yamani, the oil minister of Saudi Arabia, in the Beirut congregation of American students in the beginning of 1967, described ARAMCO as follows:

"In early 1967, Saudi oil minister Yamani described ARAMCO to Arab student in Beirut as a "milk Cow, not to be abused, so that the Saudi farmer can exploit it for all it is worth." "

Such a weak attitude, that too, for explaining the shameful actions of the past, shows where lies the main source of the problem. In the following statement, which gives an estimation of the opposite side as compared with the strengh of the oil producing countries, the difference between 'what has to be' and 'what is' can be understood in a better way:

"But even though some company officials as well, may yrean for the good old days, their strength in dealing with governments has been largely dissipated."

In short it can be summarized as follows:

---

* The Tehran Agreemenent was signed in 1971 between the OPEC and a three-member committee selected by oil companies. Of the most important features of this agreement it can be noted to a 55% increase in tax payable by extracting companies to the oil producing countries of the Persian Gulf area and an increase of 33 cents per barrel of the price of Persian Gulf crude oil. This agreement was enforced on February 15, 1971.

"In short, the high trumps are all in the hands of the producing countries and will be for next twenty years."

"The companies and the consuming governments, including our own, still have a few good cards which will be described in the next section, but they will have to be played very carefully to avoid a crushing defeat."

Western frauds for creating the desired situation and relations:

Under this heading the present solutions suggested by the various organization and bodies for reducing damages and losses incurred by the disruption of the oil supply, or the ways to froestall the possibility of such a situation have been studied. On the one side, the enormous amounts of foreign exchange which are paid by the industrialized countries for purchasing oil has come under great consideration. One of the objectives of the proposed solutions was to find out the ways of transferring back a considerable amount of foreign exchange to the countries by which it was paid. These solutions were conceived on the basis of affecting and intensifying economic, political and military dependence of oil-producing countries along with the expansion of trade relations with them. This can obviously seen in a portion of the document:

"The great manufacturing countries could win a large portion of this back from the producing governments in increased trade"

This aim was attained by the industrialized countries through the expansion of trade relations with the oil-producing countries. Let us now turn to scrutinize the purpose of these countries in giving technical, economic and cultural assistance to the countries possessing oil resources:

"As the OPEC countries develop, however, this relaince on foriegn goods and foriegn technical assistance will grow and it is certainly to the interest of the consuming countries to assist the development of the OPEC countries. The creation of large middle classes througout the OPEC area and the bringing of the entire population into the money economy, will indead increase these countries' reliance on the oil consuming countries, which supply goods in return."

When the third world countries are allured by the dream of a bright future with the slogans of 'advancement, progress and modernization' then on the propaganda front extensive cultural efforts are being made in order to keep the lid on real motives and intentions, and long-cherished hopes of the plunderers are fulfilled. The oil-producing countries are dispossessed of their weapon, and the opposite side determines as to what they have to do. This situaion is analyzed in the following words:

"This plan, which has been advanced by the EEC officials in Brussels, would favor the close integration of the economies of producing and consuming countries, and would guarantee that an oil embargo by

the producer would do at least as much demage to its own economy as it would to that of the consumer. This increasing mutual dependence would thereby provide adequate guarantee of stability of supply."

Supplying highly sophisticated weaponary and creating military alliances/dependencies would enforce the control leverage of oil-producing countries and enhance it's effectiveness. By fanning the fire of national, religious and territorial differences among the countries of a particular region the regional tensions are increased, so that a favourable ground for purchasing weaponary would be created. Subsequently, steps are taken to sell the weapons, so that in this way also, huge profits are made by the arms-manufacturers. On the other hand, they also make their political position stronger vis-a-vis the country purchasing these weapons. In this connection the following passage needs to be probed:

"The official U.S. position in Saudi Arabia is buttressed by growing Saudi desire for American military equipment and technical assistance, manifested by the corps of Engineers' consultant role, Roytheon's Hawk Missile program, and the growing American official and private roles in modernizing the Saudi Air Force, Army logistics, National Guard, coast guard and Navy.

In coclusion, it can be said that dependance of every kind and every form causes more harm than benefit to the oppressed countries possessing oil resources and is advantageous to the plunderer states, which are determined to

destroy these sources.

"And if it ever appears possible to tie any of the major producers firmly to the western consumers, considerable effort should be expended in doing it."

Rivalry in the Capitalist world:

The pillage of the oil resources of the oppressed countries by means of excessive exploitation of their oil-fields, purchasing it cheeply, and taking back all the money which were paid through imposing the economic alliance on them, has been discussed so far. Another noticeable point is the unsatiable greed and avidity of the capitalist countries which are keen to plunder each others' reasources. The situation is such that the U.S. endeavors to sign a contract with Canada for securing a part of its crude oil. The analyst proposes that in case Canada does not agree to sign this contract, the control and supervision of the Canadian oil should be lifted and its import into America should be declared free. As a consequence of this act greater commercial pressure will be exerted on the Canadian oil and gas, which will result in the greater exploration and exploitation of its resources.

The Last Word:

In the present circumstances wide-spread and escalating efforts are made by the oil devourers to weaken the united front of the oil-producing countries. These efforts which

are made due to the relative stagnation in the oil market, and are supported by the vast production of crude oil in the region of the North sea through England, Norway and other non-OPEC producing countries are aimed at launching the price war' among the oil producers and eventually entrusting control of the oil market to the purchasers instead of the producers with an escalating pace. Parallel to these efforts, it is also pretended that the days of the authority of the oil-producing countries are gone, and now the initiative is in the hands of the oil consuming countries. Due to the obstinate actions of certain oil-producing countries, among whom some members of the OPEC are also found, a favourable ground for the oil-devourers and the trumpeters of their propaganda machinary is prepared, who are declaring that the dissolution of the OPEC is proceeding. However beyond all these tumults what is apparent is the unending fear of the industrialized oil-consumer countries on the one hand, and the unprecendented power of the oil-producers on the other. If the producers of the oil, despite all their defects and weaknesses, take a firm stand to defend themselves against the conspiracies and varied front of the opposite camp, whithout any doubt their power will steadily increase in the forthcoming years. We should have a conviction that oil is a weapon, as said by our dear leader, the Imam Khomeini:

"Which weapon that you possess and the world does not possess is the weapon of oil. The world is in need of your weapon. It is the life-vein of the world. This weapon which is entrusted to you by the Almighty God is to be used by you in the path of the Almighty".

This weapon has proved its efficiency in some matters, but so far has never acted with its full strength. If we proceed with firmness and show patience against hardships, we can make full use of this weapon. No doubt, the fate of the multinational companies and the plunderer states, in their own words, will be 'an annihilating defeat'.

Muslim Students Following
the Line of the Imam.
Winter 86

SECRET

THE INTERNATIONAL OIL INDUSTRY THROUGH 1980

* * * * * *

Department of state

December 1971

SECRET

THE INTERNATIONAL OIL INDUSTRY THROUGH 1980

Summary and Conclusions

The world is now experiencing what is very likely its last brief buyers' market for conventional oil. By 1975, and possibly earlier, w will have entered a permanent sellers' market, with any one of severa major producers being able to create a supply crisis by cutting off o supplies. The United States itself can see its current relatively comfortable energy position continuously deteriorating to the point w by 1980, it will be forced to import half of its oil requirements -- largely from the Eastern Hemisphere.

The United States and its allies survived the current OPEC crisi without undue damage by a show of consumer solidarity and by diplomat pressure and persuasion in several of the OPEC countries. The prospe of success will probably be small and shortlived, even if achieved, unless the oil companies are willing to discuss with the producing go ments some form of a new relationship after 1976.

The USA and its allies have small chance of forcing OPEC to comp with our wishes. The oil producers will have to be convinced that th are being treated fairly, and that they have more to gain by stabilit over a long period than they can by creating chaos and high short te profits.

The USG should call an end to the interminable "studies" on energy problems and start taking action. Decisions must be taken in the United States within the next two years which will enable us to secure our own needs in energy for the next two decades. These decisions to reduce rate of growth of consumption and to raise domestic production and imports from secure sources will be as unpopular as they will be costly. They will require a good deal of political courage, and the State Department should play a leading role in proposing and defending them.

Action inthe OECD to follow coordinated policies on energy matters and a common front vis-a-vis the producing countries, and action in the OPEC to persuade it (or selected OPEC countries) to adopt policies which will insure stability in world oil supplies at predictable prices, will constitute a major diplomatic activity of the United States in the next two years.

The short-run problem of the current OPEC demand for revision of payments as a result of the dollar "devaluation" can probably be met only by the companies agreeing to some higher posted price, or some new basis for payments. We assume this will be done; the companies are already showing considerable flexibility here.

The second current OPEC demand for "participation" will be more difficult. The companies believe it is in contravention of the Tehran agreements and we agree. Most of them will resist the demand and we should give them diplomatic support. We believe, however, that it will be possible

to successfully forestall OPEC action which could go as far as confisca-
tion of properties, only if the companies are willing to start now
discussing new company-government relationships after 1976.

If it should not be possible to delay the current moves toward
participation, our timetable for working out the new producer-company-
consumer relationships will simply have to be advanced from 1976. A
steady supply of oil on reasonable terms, i.e., terms consumers can pa
and can count on over an extended period, is of first importance.

THE INTERNATIONAL OIL INDUSTRY THROUGH 1980

Contents | Page

I. Preamble 1

II. Goals of the Companies and the Government. 4

III. Reserves, Production and Demand. 8

IV. The Conventional Concessions 20

V. The Issues of Participation and Dollar Devaluation . . . 29

VI. Balance of Payments Considerations, and Income for OPEC Governments 34

VII. The Strength of the Producing Governments in Dealing with the Companies. 39

VIII. Strengths of the Companies 46

IX. Weaknesses of Consuming Countries vis-a-vis OPEC 51

X. Alternative Sources of Energy before 1980. 55

XI. Gas. 57

XII. New Relationships between Consumer and Producing Governments 62

XIII. New Relationships between Consumer Governments and the Companies 66

XIV. Political Relations with Producer States as They Affect Security of Oil Supplies. 70

XV. Capital Requirements of the Next Decade. 75

XVI. Conclusions. 79

XVII. Proposed Actions 85

I. Preamble

Over the last four years, officers of the Department of State have discussed the subject of the future of the international oil industry with officials of almost all of the oil companies which have interests abroad. Such discussions have been ad hoc and generally have been centered around events of immediate urgency. In 1970 and early 1971, the discussions grew in frequency, although they remain unstructured wit no agenda and few conclusions; and there were no recommendations for action. In July 1971, in an effort to focus attention more sharply on the subject, particularly on goals and on actions which might be taken by the industry and the government to achieve these goals, we drafted and sent to the industry a series of questions (Annex 1). The questions were not meant to be exclusive or to indicate any course of action; they were merely indicative of the problems which would have to be faced and answered before there could be any serious planning for the next decade.

In the last four months, we have had meetings with the five America majors, Gulf, Mobil, Standard Oil of California, Standard Oil of New Jers and Texaco; with Shell (but not with British Petroleum); with five large "independents", Atlantic Richfield, Continental, Marathon, Occidental and Standard Oil of Indiana. The questions were sent to several other independents but, at this writing, no response has been received. The questi

also discussed with officials of Chase Manhattan Bank and First
ional City Bank of New York, and with Walter Levy. At various other
s, the broad subject, but not the specific questions, was discussed
h a substantial number of second echelon officials of the companies
ted above and with officials of overseas affiliates of most of them.
total number of individuals who contributed their views on the specific
of questions was about 100. Conversations on the same subject were
d during the last year with an additional 100 company officials.

Some companies had given a great deal of thought to the subject of
ging conditions in company-government relations in producing and
uming areas; others apparently have preferred to react to events,
to try to anticipate them. With a few exceptions, however, it is
possible to speak of an unflawed, monolithic "company position."
lings and attitudes inside most companies, as in the Department of
e -- not to mention the Federal Government -- vary considerably.
several cases there were startling differences of opinion among senior
icials of the same company. Less surprising, the views expressed by
senior officers in the company were substantially different from those
ssed by more junior officers of the same company. And finally there
fairly well known differences in approach and attitudes among the top
utives of the industry as a whole; some traditionally have taken a
rigid line, others a more compromising one. In this report, the
ific views of no company and no individual will be identified.

We have also sent the list of questions and asked the views of our posts in OPEC capitals and in the main consuming centers. Their respon have also been incorporated in this paper. One post suggested that com panies have not been strictly honest in that they must know there will changes in the international oil scene and, therefore, must have made elaborate plans to meet these changes. This post believed that the companies deliberately had overstated their intransigence in order to try to gain full U.S. Government backing in future confrontations with the producers. In a sense it would be comforting to believe that the industry was foresighted and imaginative and had carefully orchestrated its plans for facing the serious problems of the 1970's. This, of cour would impute to the oil industry a prescience, a high degree of coordi- nation and a willingness to try to anticipate events. Such maturity an wisdom have notalways characterized even the Department of State. In a case, we have no evidence of such deliberate maneuverings by the indust and have assumed complete frankness and honesty on the part of those wi whom we have spoken.

. Goals of the Companies and the Government

At the start of the study, there were those in the industry who said that the interests and the objectives of the U. S. Government and those of the oil companies were not identical; indeed they might even be said to be broadly divergent. If this were true, cooperation of the industry and the government would therefore be difficult -- perhaps impossible. The companies, they said, were interested primarily in their continued existence as oil producers abroad; the government was interested only in keeping oil flowing and it was a matter of little concern who owned the oil. They quoted statements made by government officials to the effect that it was irrelevent whether U.S. companies or the Russians controlled Arab oil. The Arabs had no market but the West; they could not drink oil; the oil would continue flowing and there could, therefore, be no threat to real U.S. interests or security.

The first objective of the consultations with the industry was to try to define our goals. We hope that, in the course of the study, the concerns of the industry have been answered, and industry now sees that its interests are fully consistent with those of the U. S. Government. If the fate of the oil industry were a matter of indifference to the government, there would be no need for such a study, or for any proposals of action by the companies or the government. We would, with equanimity, let the companies move toward their inevitable confrontations with OPEC

and the OECD; we would be nothing more than mildly interested observers. Such, of course, is not the case. The control of the world's main sourc of petroleum is a matter of great concern to the United States. The U.S Government does indeed wish to see the uninterrupted flow of oil, but so do the companies.

The prospect of forces hostile to the United States controlling the oil of OPEC, or even of the Middle East, may not be disturbing to some. But no one in the Department of State could look on such a development with anything but alarm. We know the great currency reserves of many of the OPEC countries, which would enable them to survive long productio cut-offs; we know how small are their populations and how far many are from the money economy; we know their tendency to react out of emotion rather than self-interest (as defined by Anglo-Saxons). We remember what action was taken in Iran in 1950, and in the Middle East in 1956 and 1967. And we know how small Europe's and Japan's oil reserves are; how quickly their economies could be brought to a halt if oil supplies were cut off, and how powerless we in the United States would be to make good these losses.

One of the traditional and most important functions of the Foreign Service has been to protect American investment. This has not changed. The contribution of the international oil industry to our balance of payments is about as great as that of all other investments abroad combined and, hence, is another reason for our concern that our oil compani

remain healthy and productive. The United States Government is as interested in the continuing discovery and production of new oil as are the companies themselves; and we are highly skeptical of the chances of oil being found or developed if the international industry is removed from the production of oil or even if its role were severely curtailed.

In short, the industry and the government both wish to see a continuing major role for the U.S. industry in foreign oil production, as well as in transport, refining and marketing. The government and the industry are equally concerned about the need to have a stable atmosphere in which the companies can find and develop new oil reserves, and both believe that a considerable effort will have to be made by both government and industry to achieve the goals of stability and growth in world oil supplies.

This having been said there is a wide divergence of opinion on how best the goals could be achieved. The 200 oil company officials and others with whom we spoke could be broadly divided into five groups:

1. Those who say that the present concessionary system is good -- that any change will be for the worse, and that the only thing the companies should do is resist change with all the forces at their command. The only function of governments -- the consuming governments of Europe and Japan as well as the United States -- would be to back the companies in their confrontation with the producing governments of OPEC.

2. Those who say that change is probably inevitable, but must be resisted at every step. Anything which is given too soon means profits which are foregone. This group believes that they can most successfully prolong their

concessions in oil production by yielding only when absolutely forced to do so.

3. Those who believe change is inevitable, and who are willing to go gracefully into a new era — but may not themselves volunteer any modifications in agreements.

4. Those who are convinced that since changes will be forced on the industry, it would be preferable to anticipate their demands and to make new offers of new relationships to at least some of the OPEC countries. This would create a friendlier atmosphere for talk and might enable them to reach better arrangements than if forced to yield in a hostile confrontation.

5. Those who believe that complete nationalization is inevitable and will probably be soon. The companies should therefore start planning now their new role as purchasers of crude from national oil companies.

All five positions can be defended. Why yield something which is not immediately required? And yet must recognized that intransigence could provoke hostile action -- even complete nationalization -- which could not be resisted. If the future could be seen perfectly, all five groups would meld into one: just before change would be imposed, the companies would yield just enough to keep the producing governments satisfied. Unfortunately, none in government or industry is clairvoyant, and the cost of yielding too soon must be set against the danger of holding out too long. Weighing these alternatives and making recommendations for action is the second objective of this paper. The recommendations will be based on facts as far as we can know them, but the interpretation of these facts will inevitably be subjective.

I. Reserves, Production and Demand

A. Primary Reserves

Between two-thirds and three-fourths of the non-communist world's known reserves of oil are in the Arab countries of North Africa and the Middle East. The figures in the table below are generally accepted by the industry as reasonably accurate.

Reserves in billions of barrels:

U. S.	40	
Canada	10	
Venezuela	15	
Other Latin America	15	
Total Western Hemisphere		80
Arab World *	350	
Iran	55	
Indonesia	10	
Non-Arab Africa	10	
Other	5	
Total Eastern Hemisphere		430
Total Non-Communist World		510

More than half of the Arab total is in the Arabian Peninsula (Saudi Arabia, Kuwait, the Trucial States and Oman). Some geologists maintain that the DeGolyer and McNaughton estimate for Saudi Arabia of 130 billion barrels is underestimated; that the known reserves are considerably higher and that the probable recoverable reserves of that country are at least twice and possibly thrice this figure. The estimate used for Iraq of less than 30 billion barrels is also low; and the probable recoverable reserves are at least 100 billion barrels. There is a fairly widespread belief in the industry that by 1985 the production of all countries of OPEC except Saudi Arabia and Iraq will have "peaked-out" and will have started to decline, unless they have converted to secondary recovery methods.

The table above is a matter of considerable concern to the consumers of oil and to the oil companies which are devoting almost all of their exploration expenditures to areas outside the Middle East and North Afric They are looking for oil in Southeast Asia, in the Canadian and Alaskan Arctic, in the North Sea, in South America, indeed, wherever there are attractive sedimentary basins. But the fact remains that the great bulk of the world's conventional oil is in an area which is highly insecure and in many cases, is actually hostile to the United States.

B. Supply and Demand

The United States currently produces around 12 million barrels a day of the 15.5 million b/d of oil it consumes. By 1980, if there is no strong government action to reverse these trends, the United States will be consuming around 24 million barrels a day of oil,* but will be producing very little if anything more than at present. This includes the assumption that 3 million barrels a day will be produced in Alaska. Of the remaining 12 million barrels a day, very little more than one millio could be imported from Canada, unless the United States and Canada are able to reach an energy agreement, which would encourage Canadian oil

---

Estimates vary from 22 million barrels/day (Department of the Interior) to 26 million barrels/day (Chase Manhattan) and depend on a large number of assumptions -- most important of which is the state of the economy during this decade.

production, and perhaps 2 million from other Western Hemisphere sources. This leaves a total of 9 million to be imported from the Eastern Hemisphere, largely from the Middle East and North Africa.

The probable world production and consumption figures in 1980, as compared with 1971, are shown in the following table. They are based on the assumption that there will be an essentially laissez faire policy by most producer and consumer countries, no major disruption in the producing areas, and no major economic recession.

Figures in Millions/Barrels/Day
(Non-Communist Countries Only)

Consumption	1971	1980 2)
U. S.	15.6	24
Western Europe	13.4	27
Japan	4.8	13
Others	10.2	16
Total	44.0 1)	80

Production	1971		1980
U. S.	12.0		13
Total Arab	15.4		35
(Arab-North Africa)		(4.8)	
(Arab-Middle East)		(10.6)	
Iran	4.3		12
Venezuela	3.8		4
Others	7.5	3)	16
Total	43.0		80

1) The difference between total consumption and production figures is covered by 1 million b/d imports from Communist countries.

2) Assumes Soviet Union production/consumption in balance; i.e., essentially none will be exported and none imported, or imports will balance against exports. British and NATO studies indicate that the Soviet Union will continue to export around 800,000 barrel a day to the non-Communist world in 1980, as it does today. A CIA study has projected net Soviet imports of roughly the same amount. These figures are compatible and well within the range of error in predictions for 1980. In any case, it seems unlikely that either Soviet need for oil or Soviet competition with the OPEC producers of oil will soon be important considerations. The Communist countri of Eastern Europe, however, may, by 1980, import as much oil from the OPEC countries as they do from the Soviet Union. But given the very small base at which they begin, they are not likely by that time to be major factors in the world oil scene.

3) Includes 1.6 million b/d in Canada, 1.9 in other Latin America, 1.9 in Western Africa, and 1.5 in S. E. Asia.

4) Includes 3 million b/d in Canada, 2.5 in other Latin America, 4.5 in West Africa, and 3 in S. E. Asia.

Petroleum seems to be remarkably price-inelastic. This, however, been true only of fairly small changes in petroleum prices. When oline prices in the United States have gone up by 2 cents a gallon, re has been no noticeable decrease in gasoline consumption. Essentially same is true in Europe. If, however, we were to see very substantial nges in prices for example, if there were to be an increase in gaso- ne tax in the United States of 20 or 30 cents a gallon, there would rely be some drop in consumption, and there would certainly be some itch to smaller or more efficient engines. If ex-tax prices in Europe l Japan increase to something close to the American domestic price; at is, if the delivered price of crude oil in Europe and Japan were to crease from the current $2.50 to (say) $3.50 a barrel, then consumption oil would probably be decreased there, too. The question is how much uld it be decreased? * An OECD study of the elasticity of demand for l, with substantial increases in prices, might be a worthy project.

. Conventional Oil from Non-Arab Sources

The picture could be quite different as far as the United States is ncerned if action were taken now to ensure for ourselves new sources of ergy and more efficient use of available oil. For example, the United

---

n in Europe there is very little empirical data on this subject. itish gasoline taxes were raised by an equivalent of 10 U.S. cents/ S. gallon shortly after the Middle East War of 1967. Consumption opped somewhat but rose quite rapidly and within six months was almost actly at the point which had been projected before the taxes had been aised.

States could import much more from Latin America if the political and economic climate in those countries, notably in Venezuela, were such th the investments could be made to find and develop new reserves. Simila an energy agreement with Canada could result in substantially greater production and exports to the United States.

The discoveries of hydrocarbonsin the North Sea have been extrem important and production from that source may have been underestimate It might reach 2 million barrels a day in 1980, (one source estimates it could be as high as 3 million) but as total Western European consumptio will be around 26 million barrels a day at that time, North Sea product would still be small compared with imports. There has been a great dea of exploration for oil in Indonesia, but the first high hopes there hav not materialized. This does not augur well for the prospects of the rest of the East Asian offshore areas.

All companies agreed that there is almost certainly a large quanti of oil on the Outer Continental Shelf of the United States. It will, by definition, be impossible to develop it until leases are given beyon the 200-meter isobath. The present U.S. Government policy of giving no le beyond that depth may inhibit the development of the technology which w be required to recover this oil. However, in order for the granting o leases beyond the 200-meter depth to be consistent with the President's Oceans Policy Statement of May 23, 1970, such leases must be granted sub to the international regime to be established by the United Nations Law the Sea Conference which is presently scheduled for 1973. Nonetheless sev companies are now working on means to finish oil drilling on the ocean f Whenever this research is successfully completed, the depth restriction now set by the limits on the length of the legs of drilling platforms,

ll be removed and it may be possible to go to 2,000 meters or even per, in other words, onto the Continental Rise. In any case, a policy leasing in the deep sea would encourage development of this technology.

All this is relatively comforting for the United States -- but it ll do relatively little for Europe or Japan, and their dependence on Arabs and Iran has every likelihood of remaining almost as complete it is today. Two-thirds of their present consumption and one-third f the non-communist world production now comes from these countries; y 1980, three-quarters of Europe's and Japan's supplies and almost percent of the non-communist world's supplies will come from them. he absolute increases are even more striking as consumption will almost uble during that period.

It should be pointed out that, up to this point, we have referred nly to production from what shall be called here, "primary reserves." That is, oil that flows out of the ground under its own pressure, and whose cost of production is extremely low. A good deal more oil, perhaps wo or three times as much, could be recovered by more expensive secondary and tertiary recovery means in the Middle East.

D. Non-Conventional Oil

There are other major sources of hydrocarbons outside the Middle East. For the purposes of this report, they shall be called "secondary reserves" (this should not be confused with "secondary recovery").

These are the heavy oils of Venezuela and the tar sands of Canada and the United States; and the reserves are enormous. Venezuela certainly has a trillion barrels in its heavy oil belt, and possibly as much as 3 trillion. There may be a trillion barrels or more of oil in the tar sands of Canada. Although only a small proportion of this can be produ with present technology, 10 percent recovery (a completely reasonable figure) of a trillion barrels is a hundred billion barrels, or two and a half times present U.S. reserves. The cost of recovery of this oil is considerably higher than from "primary oil reserves." The Venezuela heavy oils, for example, could not be recovered economically with today' taxes in Venezuela and sold on the world market. Neither could the oil from the Athabasca tar sands in Canada. The Venezuelan oil, however, could be produced economically if it had free entry into the United Sta at the United States protected prices. This would be feasible if an agreement with Venezuela could be concluded which would protect our investments, and which would enable our companies to develop the heavy oils. Should this be done, imports from Venezuela in 1980 could be at least twice the figure quoted above. It will probably take a slight rise in U.S. prices, along with free entry into the U.S., to make the Athabasca oil profitable.

Finally, there are the "tertiary reserves" represented by shale and by coal. It is here where the United States is most blessed. The rese of shale in the United States are probably the greatest in the world;

imates of quantities vary, but most agree there are the equivalent well over a trillion barrels of oil in place. Our coal reserves are most as big as those of the rest of the world combined. Oil produced m shale or from coal is even more expensive than that of the "secondary serves", but there is a wide variance of opinion on what the costs ld be. Some believe oil from shale or coal could be produced profit-ly at prices only slightly above today's crude oil prices, say $4.00/rel. Others believe the figure would be much closer to $5.50/barrel. aspect of shale oil which does not always figure into cost estimates the fact that production of small quantities of oil from shale, with tle or no overburden and with adequate water available, may actually less costly than would be production of large quantities of oil from le. A large-scale operation would require deep mining or the removal enormous quantities of overburden, and enormous quantities of water.

There is also a considerable difference of opinion on whether oil ll be produced in large quantities first from shale or from coal. nion seems to be divided almost evenly on lines of interest; those have large shale holdings believe shale will come first; those with nificant positions in coal reserves insist that the problems of coal version are much simpler and the ultimate costs will be lower than oil from shale.

In any case, there can be very little doubt that the hydrocarbon ls of the United States will ultimately be at least partially covered

by oil produced from these two sources, or that these are the major reserves of the world. They are also the most costly of the reserves we are presently considering.

E. World Price of Oil Set by Cost of Production of Synthetic Oil

When oil is produced in large quantities from synthetic sources at prices there can be little domestic argument for keeping conventional oil prices low. Even if this were done, and it could be if oil prices were controlled as are gas prices by the FPC today, there is no reason to believe that the prices OPEC countries would command could be as easily controlled. We could put high import duties on imported oil, but it is impossible to believe that the major producers of oil, assum oil is in short supply, would be easily reconciled to letting the U.S. Government cream off the difference between the "real" value of the oi as expressed by the cost of shale or coal conversion, and the cost of imported oil. OPEC has noted repeatedly the income European governmen get from excise taxes on petroleum products. They say that the consum governments take far more revenue from the "OPEC barrel" of oil than d the producing governments, even after the recent negotiated price incr The consuming governments' argument that they are free to set taxes at any levels they wish, and that domestic taxes are irrelevant to prices charged by producers, is not entirely convincing to the producing gove ments. The producers' position is that the true value of the oil and

·■ products is expressed by the retail value of the product in the ·rkets, including taxes and duties. The consumer, by definition, is lling to pay these prices and therefore he has already set the value r the oil. The only other pertinent factor is the cost of alternative ·urces of energy.

While the cost of shale and coal conversion may be a major factor influencing producing governments to raise oil prices, it very likely ·ll also place an upper limit on the price of conventional oil. With ·■t quantities of shale and coal available, it can be presumed that, n the long run, consumers would switch to oil from these sources if ·nventional oil prices were to rise above the cost of synthetic oil ·oduction. This is not to imply that the entire world could or should ■ supplied by the coal and shale and tar sands of the North American ·ntinent -- at least not in the next few decades -- but a reasonable ·se can be made for producing the marginal barrel of oil from these ·urces by 1980 or 1990 if world prices rise above the cost of producing ·ynthetic oil.

The source or type of oil is today largely a question of economics. ·chnology has already advanced to the point where oil can be produced ·rom the Athabasca tar sands (indeed it is already being produced in ·all quantities), from the heavy oils of Venezuela or from the coal or ·hale in the United States; it is primarily the cost of this oil which ·nhibits its production. If the decision were to be taken to produce

oil from these non-conventional sources, then dependence of North Ameri
on Eastern Hemisphere oil could be reduced. Theoretically, oil could
be exported today. The Japanese reportedly have been looking into the
prospects of producing oil from the Athabasca tar sands, but this is
of questionable economics and we are not certain if the Japanese are
serious.

The Conventional Concessions

The present concessionary system has worked very well. It is a
ed and predictable system. It has permitted the efficient develop-
t of oil fields in large blocks. It has given a great deal of opera-
nal flexibility, and has assured the consumers of long-run stability
their supplies. It has enabled the producing governments to open up
ge areas to development and has been responsible for their economic
elopment, which in many cases has been dramatic. The system has
vided a floor for the revenues of producing governments and has made
unnecessary for them to become involved in the marketing of petroleum.
The companies provide the necessary capital and the technology to
duce the oil. The producing governments have nothing to supply
ept the land and the resources. This is looked on by some in the
panies as a gift they have bestowed on the producing areas. The
itude, common 60 or even 20 years ago, was that the oil companies
e the resource; without their efforts, science and capital, the oil
ld stay in the ground. The natives, therefore, should be grateful
whatever the companies gave them -- and this should not be very much.
re are some who still cherish this view, but most have adopted much
e enlightened stances. In fact, the concessions have in no way been
id documents but have been amended frequently over the course of the
t 30 years, almost invariably to the benefit of the producing government.

Unfortunately, there are still many in the governments and universities of the producing countries who have not seen that the oil companies have changed. They seem to believe that the companies are interested only in as rapid exploitation of the resource as they can manage, with as little as possible given to the government and the people of the country. But no matter how farsighted the company management, the inescapable fact is that, excepting the newer joint ventures, the companies exploiting the concessions in OPEC today are alien to the producing areas. They got their concessions some time ago and they set up their establishments, frequently very large ones, which have had many of the aspects of an extra-territorial or colonizing settlement. Indeed, the Arabic word for concession (imtiyaaz) is the same as the traditional Ottoman word for "capitulations" and many, particularly in the Arab world, consider the concessionary companies as very little different from those foreign communities established in the Ottoman Empire a hundred years ago.

There is no disputing the facts: the foreigners come; they produce oil; they give the governments money -- large quantities of it. But instead of expressing gratitude to the oil companies for their generosity and their initiative, the new nationalists say with increasing frequency that the concessionary system is degrading. That the government must have the final say over its own economic destiny is the new nationalist

atchword, and the nationalists believe that the only way this can be hieved is by controlling the oil companies which operate within eair boundaries.

Probably without a single exception, the producing governments also ave the idea that the profits made by the exploitation of oil in their untries are exorbitant; even with the new profit splits of 60-40 in vor of the producing governments (or 80-20 when based on realized ices) the governments look on company profits and on the total value the investment in their countries and compare them with "normal" mmercial returns of 10 or 15 percent. They conclude that the companies' ofits are entirely out of line with usual business practices. Some the fault of this, of cours, lies with the companies or with tax gulations in the United States and elsewhere, which make it to the vantage of the companies to ascribe all or a large part of their profits the production end and to show relatively little profit on the down-ream operations. The fact that industry returns on total investment om production wells to gasoline pumps is less than general returns in manufacturing industry is not recognized in the producing countries. is, in fact, even ignored in many of the consuming areas.

On the whole, the concession system in the Middle East and elsewhere proven of great benefit to the producing countries as well as to the panies. The company profits have not been large when the downstream rations are also taken into consideration; and, if the producing

countries were to look only at the economic benefits they could receive from the industry, it is quite likely that the present concession system would continue with only modest modifications to the end of the concessionary terms in the beginning or the middle of the next century.

However, economic considerations today seem much less important than emotion or nationalism and it seems highly likely -- in fact it seems to us certain -- that the countries of the Organization of Petroleum Exporting Countries (OPEC) in the next decade will demand, and very likely will get, in addition to greater revenue per barrel of their oil, some degree of control (possibly complete control), over the oil companies operating in their boundaries.

The Tehran agreements signed with the oil companies in February 1971 provided for gradually increasing posted prices, and hence increased tax and royalty payments, through 1975. The OPEC countries have agreed to abide by the terms of these agreements for their full term. The current demands they are making for "participation", they say, must be considered outside the Tehran agreements and in no way are a contravention of them.

It is difficult to see how the OPEC governments can make this assertion, either from a strictly legalistic reading of the texts of the agreement or from the sense of the agreement, and the companies are strongly disposed to resist these demands for participation, especially if it is to be without adequate compensation as current OPEC studies and statements indicate it will be.

In the February 1971 Tehran Agreement between the oil companies and the Persian Gulf States, it was agreed inter alia that:

1) "the existing arrangements between each of the Gulf States and each of the companies to which this agreement is an overall amendment, will continue to be valid in accordance with their terms;"

2) "the following provisions constitute a settlement of the terms relating to the government take and other financial obligations of the companies operating in the Gulf States, as to the subject matters referred to in OPEC resolutions and as regards oil exported from the Gulf for a period from the 15th of February 1971 through 31st December 1975."

In short, these agreements revalidated the companies' basic concession agreements with the governments; they stated that the provisions of the agreements settled the governments' tax, royalties, and other financial obligations for the period to the end of 1975.

It is also difficult to see how the United States Government can remain uninvolved in this issue. Under Secretary of State Irwin, in January 1971, met with the rulers of Iran, Saudi Arabia and Kuwait, and was assured by all three that any agreement they entered into with the oil companies would be honored for the full term. If the three make strong demands for participation, it may be necessary to make diplomatic representation at the highest level.

While most companies are reasonably optimistic about the possibility of maintaining the tax and royalty payments agreed in the Tehran/Tripoli/Baghdad Agreements, there is general agreement that after 1976, prices will go up, very likely by a substantial amount. The world will before

then have entered a permanent sellers market for oil; and the cost and availability of alternative sources of energy will be the main limiting factor for oil prices. Oil prices by that time may have gone up also in the United States to perhaps $4.50 a barrel (the present price is around $3.50/barrel ; delivered cost of Persian Gulf oil on our East Coast is about $2.50/barrel at the current low tanker rate). Although world prices in '76 may not have reached U.S. domestic prices, the difference will probably be considerably smaller than it is today. Subtracting from a $4.50 price in Texas, the 25 cent transport from the fields to the Gulf of Mexico and 75 cent transport from the Gulf of Mexi[illegible] the Persian Gulf would indicate a possible selling price in the Persian Gulf of $3.50. While prices may not be quite that high, it is a defensible calculation. In other words, the north coast of the Gulf of Mexico may again set world prices for oil as it did until 1950.

As stated in the previous section, the upper limit on prices in the United States itself will probably be set ultimately by the cost of conversion of coal or shale oil. There is considerable difference of opinion on what this price will be: $4.00/barrel (in today's dollars) as some companies maintain, or $5.50 as others do. Whatever it is, it will also set the upper limit for the price of conventional oil in the United States. At $5.50 a barrel, more conventional oil would, of course, be produced; but here too there are considerable differences of opinion on how much more oil would come out. Some companies maintain

that the $5.50 oil would bring forth vast new quantities of domestic oil through discoveries made by drilling in marginal areas, by deeper drilling, and by tertiary recovery means. In fact, some maintain that this price could double or even treble our recoverable reserves. Others maintain quite the opposite, that $5.50 oil would bring forth very little additional oil production in the United States. In any case, if the cost of shale oil is to be $5.50, we assume that conventional oil prices will be the same and that ultimately world oil prices will probably approach the same level. In this case, we could expect $4.50 oil in the Persian Gulf.

The situation beyond January 1976, when the agreements expire, will be quite different from that of today. It is likely that the only way it will be possible to avert participation now will be to assure the OPEC countries, and particularly Kuwait, Saudi Arabia and Iran, that while we (the companies and the government) expect the current agreements to be honored for their full term, some new relationship to go into effect after their conclusion can be considered. This approach will have a chance of success only if the companies are willing to start discussions now -- or at least quite soon -- on what these new relationships will be. Participation, of course, is not the only type of relationship which should be considered. There could, for example, be relinquishment of parts of the concession areas, and service contracts

or joint ventures on them. Possibly if this were done, the existing concessions could continue on their reduced areas. In any case, the word "concession" must be eliminated; it has too many unfortunate connotations. "Contracts" are acceptable and imply agreement between two equals; there is an Islamic tradition to honor them and a government which would be tempted to rescind a concession might hesitate before breaking a contract.

In short, it seems likely to us that the best way of preserving a healthy international oil industry would be, in the short run, to follow the lead of those in groups 1 and 2 described in Section II above: that is, to insist vigorously on the maintenance of the Tehran agreements through 1976. Then, for the long run, to follow those in groups 3 and 4; that is, to offer to discuss now with the OPEC countries a new relationship starting in January 1976. The reasons for this essentially pessimistic conclusion will be outlined in Sections VII, VIII and XIX below. Group 5, the most pessimistic of the lot, may of course be correct; nationalization may be inevitable. We would not wish, however, to indicate openly at any time that nationalization of oil and converting companies into purchasing contractors would be in any way acceptable to us. It would not be. We doubt that it would be in the interest of the oil producers. We cannot see how the OPEC cartel and high oil prices could be maintained in such a circumstance, and while a price war would be of immediate interest to the consumers, the advantages would be

ephemeral. We cannot see how, in such a case, necessary investment would be made in the new production and export facilities which the world will need over the next decade, if the national oil companies are operating for themselves and in competition with each other.

V. The Issues of Participation and Dollar Devaluation

The prime reason for the demand for participation in the oil companies is nationalism. The governments wish to be involved, perhaps to have the governing voice, in the main industry operating inside their borders. The Minister of Finance of Kuwait has said recently that "control" is the major issue and this need not necessarily mean much higher payments by the oil companies operating there. Other countries which are more short of cash than Kuwait, notably Iran and Iraq, are probably as much concerned with the increased payments as they would be with a voice in management.

The companies might not be particularly disturbed by the current demand for 20 percent participation in the Gulf countries, if they tho it could be limited to this amount. They are very disturbed, however, by the clear prospect -- stated openly by many OPEC members -- that thi is only a beginning and that the governments intend to end by taking 51 percent or even all of the production facilities. It might appear that this need not be particularly bothersome to many of the large int grated oil companies with shipping, refining and marketing outfits downstream. They could enter into purchasing agreements with the gove ments and their profits could indeed be as large as they are at presen or even larger. The smaller companies, however, with few if any marke outlets overseas and with limited access into the United States, would very likely be ruined.

Major companies would resist such a transformation for two reasons. The first is that, for tax purposes, they now show almost all of their profits on the production end. They count their payments to the host governments as "income tax", and subtract them as tax credit from income taxes they pay in the consuming countries. The result is that many of the large integrated companies have low effective income tax rates in the United States and elsewhere. If they were forced to show their profits downstream, the profits could be the same as they are today, but half would go in income tax. Given the companies' need for capital, this would have to be offset by higher product prices, perhaps substantially higher than those of today, and there would be severe consumer resistance. The second reason is that the companies doubt (as do we) that the producing governments, which would have many other claims on their funds, would make the necessary investments in oil to bring forth the new oil production required over the next decade or two.

In the absence of any concrete information from OPEC on exactly what the OPEC governments want or what they would settle for and when, it is difficult to make an accurate judgement on how much the participation demands would cost the companies. It is probably roughly accurate, however, to say that each percentage increase in participation could mean a little less than an additional cent per barrel of oil produced, assuming nominal company profits per barrel (based on posted prices) as between 80¢ and $1.00. For example, if a country asked for 20 percent participation, in Saudi Arabia this could mean an additional payment of 16¢ a

barrel to the Saudi Government. Libya's request for 51 percent parti-
cipation could mean an additional 50¢ payment to Libya. This, of course,
varies from country to country and depends i.a. on costs of production.
It would be much less if realized prices rather than posted prices were
used as the basis for calculating company profits. *

According to recent information from OPEC, compensation to the oil
companies is to be made for the book value of the assets -- which in
many cases is small. ** Payments are then to be made out of the profits
of whatever share of the company is taken over (to ensure no decrease
in government revenue) and are to be completed in a period not to exceed
five years.

The company income therefore could remain essentially unaffected
during the period of "compensation", or it could be reduced by whatever
amount the government took for its own use. In any case, whatever

---

The British believe that the basis for calculating the additional cost
would be the realized prices. In this case, a demand for 20% partici-
pation in the Persian Gulf would result in a net increase in cost to
the companies of only about 6 cents a barrel. The governments would
then give the companies a "marketing allowance" to sell their share of
the oil for them, and this 6 cents would be further reduced. The
demand for 20% participation could therefore mean as little as 2 or 3
cents a barrel. In fact, it could mean no additional costs whatsoever.
We doubt that the OPEC countries will start negotiations on the basis
of realized prices, although it is possible that the final compromise
will be somewhat on that order. In this case, there would be very
little consumer resistance (as distinct from company resistance) to
such an OPEC demand for participation.

The OPEC countries will probably use figures released annually by the
U.S. Department of Commerce on the value of U.S. investments abroad
as the basis for their calculations.

ditional costs would be levied on the companies would have to be passed on to the consumers, as it is quite unlikely that any of the companies could absorb substantial increases any more than they could the increases of January, 1971. As stated above, the U. S. Government will also have no choice but to protest OPEC demands for participation before the end of the Tehran agreements.

The OPEC demands for readjusting their payments as a result of effective dollar valuation is more complex. OPEC can argue with reason that this is a case of force majeure which automatically opened the agreements. The companies argue that the Tehran agreement escalation clause for inflation also takes care of devaluation matters. In any case, the United States would be hard-pressed to request the OPEC countries not to push for increased income. The current world currency problems were caused by action taken by the United States and it would be accepted kindly by the OPEC countries if we were to ask them not take measures to protect themselves. This is particularly true as reason for the N.E.P. was to increase the costs of foreign materials terms of dollars. If we were to say that we wished this to apply to manufactured goods or only to goods from certain countries, that we would like to see oil prices remain the same in terms of dollars, we would stand small chance of success in the OPEC countries. We have informed our oil companies that we would not be able to them active diplomatic support on this issue. They have said that

they did not wish it, but have asked for permission to work together themselves in facing the OPEC demands. Department of Justice Business Review Letters have been issued to the companies to enable them to do so. We raised the matter with Europeans and suggested that if they are disturbed by the OPEC action on this issue, they could well make their own protest to the OPEC governments. Few, if any, seem willing to do so.

Prospective Income for OPEC Governments and Balance of Payments Considerations

A. OPEC Income

The attached table gives conservative estimates of oil revenues to governments in the Middle East and North Africa in 1975. The aggregate rate of growth in production estimated is under 10 percent, well below current growth rate and rates in the past few years.

Should Middle East and North African OPEC governments succeed in forcing up the world price to the U.S. price by 1975, their estimated revenues would nearly double, from about $14.6 billion to $27 billion. The higher estimate was derived by taking the current U.S. wellhead price of about $3.30 to $3.60 per barrel, adding a factor for inflation and transportation to a U.S. coastal refining and export area and estimating this 1975 price at $4.50 per barrel. Government revenues in the Persian Gulf were estimated by deducting from $4.50 transport costs from the U.S. to the Persian Gulf, costs of production in the Persian Gulf, plus some profit or fee to producing companies and ending up with a figure of about $2.80 per barrel. The same calculation was made for government revenues in North Africa; because transportation costs to the U.S. are less from North Africa than from the Gulf, government revenue in North Africa based on U.S. prices comes to about $3.35 per barrel.

These figures must be regarded as only order of magnitude estimates. Transportation costs were assumed to be constant (which of course they

are not) and high (worldscale 100). Lower transportation costs would increase somewhat the estimate of government revenues.

Figures for Nigeria, Venezuela, Indonesia and other producers are not included in the table. Although it has been difficult to get acc[illegible] estimates for production there, it might be reasonable to assume that production and income figures for this group would be about one-third of the totals shown in the table. Production, therefore, of the OPEC group would be about 34 million barrels per day, and income about $20 billion if the Tehran agreements are honored; $35 billion if world prices rise to the U.S. levels by 1975.

Government Revenues (in billions of dollars annually)

Middle East	1970 Production	1970 Revenue	1975 Production	1975 Revenue under 1971 Agreements	1975 Revenue if World Prices based on U.S. prices
1. Iran	3,848	$ 1.1	6,500	$ 3.4	$ 6.6
2. Saudi Arabia	3,798	1.2	6,500	3.5	6.6
3. Kuwait	2,989	.9	4,000	2.1	4.1
4. Iraq	1,558	.5	2,600	1.4	2.8
5. Abu Dhabi	691	.2	1,000	.5	1.0
6. Qatar	361	.1	361	.2	.4
7. Oman	333	.1	400	.2	.4
8. Dubai	86	.03	150	.1	.2
9. Bahrain	77	.03	77	.04	.1
Total Middle East	13,741	$ 4.2	21,588	$ 11.4	$ 22.2
North Africa					
Libya	3,321	1.3	2,500	2.1	3.1
Algeria	990	.4	1,430	1.1	1.7
Total North Africa	4,311	$ 1.7	3,930	$ 3.2	$ 4.8
Total North Africa and Middle East	18,052	$ 5.9	25,518	$ 14.6	$ 27.0

SECRET

Producing governments' income in 1980 would be substantially higher. With world prices probably rising to U.S. domestic prices and those in turn set by the cost of shale or coal conversion, the net payments to governments could be as much as $3.00 per barrel and producing governments' income could be as high as $80 billion per year. This would be about ten times their 1970 income and over four times what would be expected in 1975 if the Tehran agreements are fully honored.

These projections have been discussed with the director of the new energy division of the IMF, who generally agrees with our assumptions on both future prices and volumes of oil in world trade. The Fund will soon start a study on the proportion of the OPEC income which could be expected to be returned to trade, the amounts which will be accumulated as reserves and what this will mean to international capital stability.

B. Balance of Payments Considerations

If the United States imports 12 million barrels a day of oil in 1980, and even if world prices were to remain the same as they are today, and if company remittances were not affected, the net cost to the U. S. balance of payments would be about $1.50 a barrel, or $6.5 billion a year. If, as seems much more likely, world prices rise to U.S. prices, and particularly those set by shale prices (as assumed above), the net payments to governments per barrel could be over $3.00 and the net import cost to the United States could be $3.50 per barrel. The balance of payments drain on the United States would then be $25 billion a year.

If the oil companies continue their present existence, that is, if the oil companies could continue in some profitable form of operation, their profits will be included in the currency drain and the cost per barrel to the European and Japanese consumers would therefore be somewhat higher than for the United States. In the case of dramatically higher world oil prices, the net cost to most of Europe (except the UK and the Netherlands) could be close to $4.00 a barrel. If Europe is consuming 26 million barrels per day in 1980, the total cost to Europe would be on the order of $38 billion a year. If Japan's consumption is 12 million barrels a day, as seems likely (perhaps conservative), the cost to Japan could be $17 billion a year.

The great manufacturing countries could win a large portion of this back from the producing governments in increased trade, although it seems unlikely that each country's expenditures would be balanced equally with additional sales. And any such increases would be disastrous for under-developed nations.

VII. The Strengths of the Producing Governments in Dealing with the Companies

In 1951 at the time of the nationalization of the Anglo-Iranian Company in Iran, world oil consumption was only a quarter of that of today. Iranian production stopped, but in a very short time, was made up from the Arab countries across the Gulf, Iraq, Saudi Arabia, and particularly, Kuwait. For the next 15 years, there was considerable surplus production capacity in the world. The United States was largely self-sufficient and had perhaps 2 million barrels a day of shut-in capacity. There was also substantial shut-in capacity in most of th major producing countries of the world. This surplus gave the oil companies a great deal of security and a gre deal of flexibility. With the violent overthrow of the monarchy in Iraq in 1958 and the subsequent moves against the oil companies, the companies' expansion plans for Ira were largely abandoned, but production itself was not cut back by the Iraqi Government. The radical regime of Abdal-Karim Qasim and the subsequent Arab Nationalist and Baathi regimes have all threatened to nationalize the Ir Petroleum Company (IPC). They have not done so because they knew, or at least they feared, that the oil compani

uld be able to make up Iraqi production easily outside
f Iraq and, failing the cooperation of the other
roducers -- something they were never able to achieve --
raq would be left holding its own oil but with no place
o market it, and therefore no income. The Iraqi Govern-
ment was perennially short of cash and could not easily
rego even one quarter's income from the oil production.

At the time of the Mid-East War in 1967 and the
losing of the Suez Canal, there was still a considerable
mount of shut-in production capacity in the Persian Gulf.
ut with the much longer tanker hauls there was no way
his oil could be brought to market. Libya then performed
he function of Kuwait in 1951; its production grew at
n extremely rapid rate and world dependence on Libyan oil
ecame acute. Shortly after the Libyan Monarchy was
verthrown in September 1969, the new radical Libyan
overnment realized that it was in its power to force
ew terms on the oil companies and it threatened to stop
il production unless its demands were met. These threats
ere far more credible than would have been those of any
ther country. The population of Libya was small and the
ibyan Government had over $2 billion in foreign exchange
o tide it over a protracted shutdown of production. It

was not at all certain, moreover, that Europe could tolerate the loss of Libyan oil. The Trans-Arabian Pipeline had been cut, and there was some evidence that the Iraqis would take advantage of any Libyan move against the companies to nationalize the IPC. This was a new situation for the consumers of oil and the companies. Never before had one country been willing or able to take on itself the burden of supply cutbacks in order to win economic gains from the companies operating there. Libya did so and the other countries of OPEC were quick to follow its lead and demand similar although usually not equal gains from the oil companies.

The situation has eased in recent months. Tanker rates have dropped and as the OPEC settlements in the Mediterranean were based on a continued high premium for short-haul oil, the Mediterranean, West African and Venezuelan oils are now overpriced, and production has dropped in all three areas. It has been made up out of the Persian Gulf. We can look with considerably more equanimity on the prospects of a confrontation with Libya than we could a year ago. Its production is now (November 1971) less than 2.5 million barrels/day while in early 1970 it had been as high as 3.8 million. If it moves

against the companies, and should production in Libya be closed down, it should not be impossible to make up the entire amount by increasing production through the Iraqi pipeline, through Tapline (which is currently operating near 50% of capacity), and from Nigeria and Venezuela. The remainder could be made up from the Persian Gulf.

This is not entirely comforting. If any "short-haul" country were to back Libya e.g., if Iraq were to nationalize the IPC and if the Tapline were cut, we would again face a crisis - although not as severe as would have been the case last year with the same loss of oil.

One danger is that the apparent ease with which Libyan production could be made up will create a spirit of complacency. It is most advantageous for the consumers of oil and for the companies to be in a "buyer's market" and we do indeed appear to be in one now. It must be recognized, that this will be short-lived and almost certainly will be the last one we will ever see.*

*In conversations with the British Government the end of October and the beginning of November, the British said they were somewhat more pessimistic than were the Americans in their characterization of the present oil market. Where we called it the "last gasp in the buyers market", the British said they thought it was merely a "temporary softening of the permanent sellers market the world entered into in 1967."

By 1975 world consumption will have risen so far and world production will be so concentrated in the Middle East and North Africa that two things are likely to have happened:

1) There will be so little surplus production capacity and so little storage in the world that a supply cutoff from any one of the major suppliers: Venezuela, Libya, Iran, Kuwait, or Saudi Arabia -- would provoke a supply crisis in Europe and Japan; that is five countries will find themselves in the same position as Libya did in 1970, although two of these five, Venezuela and Iran, will not have the currency reserves to withstand easily any loss of income, and

2) Most of the OPEC countries who have counted on continually increasing production -- and frequently at high rates of growth -- will be able to see, at some not too distant time, the leveling out of production and its eventual decline. OPEC as a group can therefore be expected to concentrate even more heavily than it has until now on increased payments per barrel; quite possibly there will be the first serious moves in OPEC to restrict production in order to conserve the oil for the future. The argument that the present value of oil produced in the year 1990 is nearly zero, is not impressive to many in OPEC. Whatever the theoretical merits are of such an argument, they are valid only if the income from this oil is put into productive uses, not if it is spent on luxuries or armaments.

By 1980 or 1985 at the latest, it seems likely that Venezuela, Nigeria, Algeria, Libya and Kuwait and Indonesia will all have "peaked out" or at least their primary

oduction will have reached maximum sustainable levels.
 1980, unless there are dramatic, new and unexpected
scoveries elsewhere in the world, only Saudi Arabia
d Iraq, for a certainty, and Iran possibly will still
 able to look forward to considerable increases in
eir production.

Production at these peaks could probably continue
r several decades to come and possibly well into the
xt century by converting to secondary and tertiary
covery methods. This would be costly, however, and
 order to make such a conversion, the governments
uld have to take lower revenues per barrel for their
l. This, of course, is not to say that the revenue
ed be lower than it is today, it would merely be lower
an it would be at the time of adopting secondary
covery methods. At that time, assuming coal, shale
d tar sand conversion would have set the world oil
ice, the producing governments could still be receiving
comes vastly greater than they are today -- even higher
come per barrel of production.

With minimal cooperation inside OPEC (and the
operation in the last year has been considerable) the
C countries should be able to force prices considerably

higher in 1976 at the conclusion of the Tehran agreements, and at the same time will be able to force the companies to accept "participation" on OPEC terms -- in fact they could do this much earlier if they can work together.

In short, the high trumps are all in the hands of the producing countries and will be for the next twenty years. The companies and the consuming governments, including our own, still have a few good cards which will be described in the next section, but they will have to be played very carefully to avoid a crushing defeat.

Strengths of the Companies

In the past, the major oil companies, in dealing with the producing governments frequently acted as if they were sovereign nations. In many cases, their technology, their income, their size, made them more formidable than many governments. The companies were able to deal with a government where they had concessions by threatening to close down production or pull out and move to more attractive fields. This sometimes cavalier fashion in dealing with governments accounts for at least part of the hostility felt toward the companies today. But even though some company officials, and probably some consumer government officials as well, may yearn for the good old days, their strength in dealing with governments has been largely dissipated. In a very short time, this will be evident to every OPEC producer, if indeed it has not already become so.

The companies, however, are not yet entirely deprived of power. They have three very important functions to perform:

1. The most important is as a supply and guarantor of capital.

The capital requirements of the industry outside the Communist world in the next ten years have been estimated by Chase Manhattan Bank at over $500 billion. Of this, $180 billion will be for working capital and other general requirements, including dividends, and $360 billion will be for capital expenditures. (This subject will be discussed in another context later in the paper). Of the capital expenditures, a third, or $120 billion will be in the upstream facilities, (i.e. discovery, development and production). Some of the OPEC countries may accumulate large quantities of capital, but most, very likely will not. In any case, the local demands for capital can be expected to take precedence over the demands for increased investment in oil. If the governments were to nationalize the companies or take over control of them, it is at least possible that the existing solidarity in OPEC would vanish; and if each producer were competing against every other producer rather than the present situation where the producing governments as a whole face the industry, it is quite possible that inter-government competition would drive prices down. This would benefit the consumer and even the companies might benefit in the short run by buying the oil and then handling its transport, refining and marketing. (There is considerable evidence that the OPEC countries recognize this danger and for this reason, if no other, will permit the companies to continue in some role in production). In this case, it seems even more certain that the necessary funds would not be invested in production and the world in a very short time would face a supply crisis from which there would be no escape other than forcible reduction of consumption.

It of course could be argued that the producing governments would be mature enough to devote a sufficient portion of their income to production facilities, and it is just possible that this

could be done in individual countries. It is less likely -- in fact it is almost inconceivable -- that any OPEC country would invest its money and production in another country, particularly if it risked losing its investment in the same manner the oil companies lost theirs.

There is also the possibility that the consuming countries could provide the capital necessary for the development of new supplies, but it is difficult to see how this could be accomplished without using the oil companies who alone have extensive experience in this field. The experiences of ENI and CFP and ERAP in production abroad cannot comfort those who hope government oil companies would provide the solution to the oil supply problem.

2. The second major strength of the industry is in the technology it masters and in the extreme complexity of the distribution and marketing of oil.

Most, if not all of the OPEC countries very likely could continue operating the oil fields in their countries today. The oil has been found and it would be relatively easy to ensure that oil would continue to be produced from existing wells. The drilling of new development wells, however, introduces new difficulties, and the discovery and development of new fields is very likely beyond the competence of most of the technicians in OPEC countries -- even in Venezuela, which is probably the most sophisticated and most advanced in technology of any OPEC country. As complex as would be the difficulties of developing new fields, these difficulties would be overshadowed by the problems of marketing the oil. There seems little doubt that this too is already recognized by the OPEC countries. The OPEC proposals for "participation" contain explicit demands that the companies themselves will continue to market the oil for them, presumably in the normal market patterns of the companies as neither the

governments or the companies could conceivably find new markets for 20 percent of the oil produced in the OPEC countries.

3. <u>The third point is the functioning of the companies as a buffer between producer and consumer governments.</u>

This is of great utility to both. Producer governments can threaten and bully companies. If they were to deal with other national oil companies or with consuming governments directly, national honor would be engaged on both sides and compromise would almost certainly be even more difficult. This need not always be the case, but there is little doubt that the Tehran/Tripoli/Baghdad negotiations of the first half of 1971 were carried out with as little involvement of national honor as possible. Had governments, rather than companies, been at Tehran, in January, 1971, it is difficult to envisage as happy an outcome to the negotiations as was in fact achieved.

The actions of the United States Government, through the Irwin Mission to the Persian Gulf, were limited a) to a warning that any country which cut off oil supplies to us or our allies would find that its relations with the United States severely and adversely affected, b) to a request for more negotiating time for the companies and c) to a request to an end to the constant leap-frogging of prices in OPEC. The other countries of the OECD limited themselves to backing the companies and endorsing the efforts of the United States.

There is another point which should not be overemphasized but it is at least worth mentioning. We frequently characterize the producing countries of OPEC as unconscionable bandits with no regard for international propriety and with no sense of morality. If this attitude is adopted uncritically by the companies and by the consuming governments, including our own, we will very likely have

created a selffulfilling prophesy. We must recognize that there are men in OPEC -- King Faisal, certainly, and the Emir of Kuwait and perhaps others -- who are men of honor and integrity. Without stretching reality they could be expected to act in a spirit of enlightened self-interest and with a sense of fair play. Some OPEC governments notably Iraq have behaved irrationally at times, but most of them look carefully at their own economic well-being. It should not be beyond the capability of the companies or of the consuming governments through diplomatic missions or special envoys to convince the producers that contracts signed in good faith and based on mutual confidence should be honored and are essential if new supplies of oil are to be found and if adequate facilities are to be built for its production, refining, transportation and distribution. And it should be equally evident that producers as well as consumers would benefit from stability in the world oil market.

IX. Weakness of Consuming Countries vis-a-vis OPEC*

The overwhelming dependence of OECD countries, especially Western Europe and Japan, on OPEC oil severely limits the possibility of effective action by them. Anything they would do would have to be almost immediately effective and, short of direct military action (which is not contemplated here), most policies demand time to be implemented. Moreover, the critical economic and ideologic[al] division of the world could mean that OECD action could be negated by actions of a coalition of less-developed nations outside of the OECD and of the countries of Easter[n] Europe and perhaps of China.

In the face of OPEC demands to raise oil prices indefinitely or to cut off oil supplies unless higher prices are paid, the consuming countries could take less oil, but this is scarcely a credible threat as they have no alternatives for this oil either from non-OPEC sources or from other types of energy.

*This chapter may be considered a corollary of the one on Strengths of the Producers. It is handled separately in order to discuss more fully various proposals which have been made in the last few years on possible consumer retaliatory action against the oil producers.

Three actions have been proposed at various times on moves the consuming countries could take against the OPEC countries in retaliation for the price increases on petroleum: trade embargo, the blockage of OPEC funds held in consuming nations, and elimination of aid to OPEC. None seems encouraging or even practical:

1. Trade Embargo

Many of the OPEC countries have relatively primitive social and economic systems. The majority of their population is engaged in agriculture and is outside the money economy. They would, in short, be less vulnerable to import denial than would more developed societies. Their development programs would undoubtedly be harmed and their growth rate would decline substantially. They might have to give up some luxury goods, but critical imports of foodstuffs and capital imports required for continuation of economy activity at a minimal level could almost certainly be obtained from other countries of Africa or Asia, or from the Soviet Bloc. Furthermore, trade embargos rarely work. The embargo on Rhodesia supported by most of the countries of the world has proven largely ineffective. An embargo of the OPEC countries would certainly not have the same unanimous backing.

The international reserve position of five major OPEC countries at the end of 1970 was as follows:

Country	Reserves
Iraq	$ 390,000,000
Saudi Arabia	946,000,000
Kuwait	223,000,000
Iran	315,000,000
Libya	2,331,000,000

Comparing total imports to total reserves, Iran is the most vulnerable, with enough reserves to cover only approximately a three-months import bill. Libya, at the other extreme, could hold out for approximately 41 months. Actually, the import bill during an embargo would be reduced due to the elimination of petroleum-related non-essential imports. At the same time, the import bill would not be as small as "critical" import figures would indicate, because higher-priced substitutes might be needed. However, on balance, even the weak link, Iran, could probably hold out for longer than three months, and certainly could hold out if Saudi Arabia and Libya gave financial assistance.

2. Blockage of Funds

Consuming countries, either in combination with the trade embargo or as an independent policy, could freeze the assets of the OPEC countries. Most of the OPEC funds seem to be in Switzerland and in Britain. The potential effectiveness of a freezing of the OPEC runds would be limited by the difficulty of implementing such a policy and the availability of short-term credit from the Communist countries. It is possible, thought highly unlikely, that Britain, in spite of its concern to maintain its position as an international financial and banking center, would agree to block those OPEC funds held in London. The willingness of Switzerland to implement a similar policy is even more doubtful. Even the United States would be unlikely to do so; there is considerable question as to whether we have the legal ability to do so in cases short of national emergency. Blockage of funds, in short, does not appear to be a realistic possibility, and even if it were, would very likely prove ineffective.

3. Cut-Off of Aid

Only Iran has been the recipient of significant amounts of foreign credit, and even it could be tided over for an extended period by Saudi Arabia, Libya or Eastern Bloc aid.

Any of these actions would, of course, ensure that the Soviet Union and possibly China would be greatly strengthened in the OPEC area, and the position of the consumers at the end of the confrontation would probably be weaker than at the beginning.

X. Alternative Sources of Energy before 1980

The estimates for production of oil from shale in the United States in 1980 vary from 100,000 to a million barrels a day, with 300,000 being generally the most optimistic estimate. One company heavily involved in shale oil has told us that with a combined government-industry effort and with controls on production similar to those in wartime, 3 million barrels a day might be produced by that time. No others thought this was achievable.

Coal conversion seems no more promising in the short run. Prospects for increasing hydroelectric power in the OECD area are negligible. Atomic energy, even with a crash program, cannot significantly reduce the dependence on oil we have calculated in this time frame. More exotic forms of energy - solar conversion or hydrogen fusion - might also be important sources of energy, but neither is likely before the end of this century. The more efficient use of energy, through the MHD or other, as yet undiscovered, methods, might also give some surcease sometime, but not yet.

It takes only a modest amount of faith to count on me dramatic new discovery or invention solving our ergy problems in the 21st century. It would not be sponsible to assume that a *deus ex machina* will interne on our behalf before 1980. In fact, we must work th the proposition, a *momento mori*, that despite best 'forts, Western Europe and Japan and possibly the United ates, will not be able to overcome, in the foreseeable ture (that is before 1980) their almost complete liance on OPEC oil.

XI. Gas

This paper concerns itself primarily with oil, but a few words should be said about natural gas. It has been called the "ideal fuel". It burns cleanly and its product are carbon dioxide and water. There is no dirt, no sulphu it is easily handled, it can be used equally in kitchen stoves and massive power generators. It has also been very cheap in the United States, as its price has been kept low by the Federal Power Commission. Existing gas sells for less than 20 cents a thousand cubic feet (MCF), and the newly discovered gas in some cases can now be sold for somewhat more than 25 cents a thousand cubic feet. This price is still much lower than oil. Even at the higher price of 25 cents an MCF, with 5,800 cubic feet of gas equal in thermal content to one barrel of oil, the equivalent price of oil would be only $1.45 cents a barrel. The present price of oil in the United States is $3.50 - $3.75 a barrel; even the spot rates in the Persian Gulf now average close to $2.00 a barrel, and the low sulphur crude of Nigeria and Libya, with which gas could most easily be compared, sells at close to $3.00 a barrel, f.o.b.

Natural gas reserves in the United States are dropping at an alarming rate. At present the United States consumes gas at the rate of 22 trillion cubic feet a year; and our finds of new gas are running at only half that level. In other words, our reserves are going down at the rate of 10 to 12 trillion cubic feet a year, and when total reserves are only slightly above 200 trillion cubic feet, it is scarcely exaggerated to call the situation desperate. In fact, it is agreed by the industry as a whole that supply shortages will limit consumption by 1975. As oil will be the only practicable equivalent for gas in 1980, the figures used elsewhere for oil consumption may be too low.

The gas industry maintains that the drop in new finds is in direct relationship to the artificially low price of gas in the United States, i.e., a case of post hoc ergo propter hoc. Others are not sure that this is true; they believe that a substantial increase in wellhead prices of gas would bring forth only marginally increased supplies of gas. It is absolutely essential that the industry and government determine with as great a degree of accuracy as possible what an increase in wellhead prices of gas in the

United States would do to our gas supplies. This has already been proposed by the State Department to the gas industry, the oil industry and the Federal Power Commission. A major trade journal will start a campaign on this soon.

Gas has been flared in the oil producing areas in the Persian Gulf for as long as oil has been found there. Some natural gas is now sold by Iran to the Soviet Union and some is reinjected, but still three-quarters of all the gas produced in the Persian Gulf is being flared. The oil companies have maintained that this gas is not a resource; it is produced in connection with the production of oil and cannot be used. At least ten billion cubic feet of gas are flared daily, and while it has been true that there was no market for the gas, this will change soon. Countries of North Africa, notably Libya and Algeria, which are fairly close to the European markets, are now selling liquefied natural gas (LNG) there. Algeria is banking on a large project to sell gas to the United States. The cost of this gas is quite high, compared with gas prices in the United States. Many of the prospective buyers of LNG have been scandalized at the proposals to sell Algerian gas in the United States

for 80 cents a thousand cubic feet. This is indeed high when compared with delivered U.S. gas at 40 cents a thousand cubic feet. It is not at all high when converted into oil prices. Eighty cents a thousand cubic feet, after all, is only equivalent to $4.64 a barrel for oil, and low-sulphur residual fuel oil, which is far less attractive and useful a fuel than gas, is now posted in New York at $4.40 a barrel.

Gas can be made from naphtha, but the process depends on a low price for naphtha. Prices are low today, but if naphtha were gasified, the price would be driven up; the price will be driven up in any case as the petrochemical industry gradually switches to naphtha as a feedstock. More reasonable, perhaps, are the projects to convert coal or crude oil into gas. Here, however, the price for the syngas at present is $1.20 a thousand cubic feet. This is equivalent to a price of $7.00 a barrel for oil. While the advantages of gas are considerable, it is doubtful that many users (except perhaps private homes) would be able to pay such a price.

Although the capital costs for production and export of liquefied natural gas are extremely high, the wellhe price of the gas is quite small. In Algeria, it appare is somewhat under ten cents a thousand cubic feet. Thi could be raised somewhat, but it is unlikely that gas f most countries will be a source of income comparable to their income from oil.

Shipping costs are so high a proportion of total co that gas imports from the Persian Gulf are not yet practical. In the future, with higher prices - and, particularly if the Suez Canal opens - the Persian Gulf will probably be the main source of gas as well as of oil.

I. New Relationship between Consumer and Producing Governments

Some consuming governments have noted that the insecurity of their oil supplies appears to spring largely from Arab hostility to the United States, which many Arabs believe actively opposes their interests to the benefit of Israel. There are those in some consuming countries (e.g. Italy, France and Spain) who believe that the only way their security can be preserved is to develop a new direct relationship with the producing countries which would bypass the "Anglo-Saxon" oil companies, and therefore avoid the consequences of any action the Arabs might take against the United States. This plan, which has been advanced by the EEC officials in Brussels, would favor the close integration of the economies of producing and consuming countries, and would guarantee that an oil embargo by the producer would do at least as much damage to its own economy as it would to that of the consumer. This increasing mutual dependence would thereby provide adequate guarantee of stability of supply.

It seems unlikely that all of the OECD or even a major part of it would face the domestic political consequences of a total repudiation of the United States position in the

Middle East. This would be a reversal of many of their own traditional policies. Germany, the Netherlands, Denmark, Norway, and Great Britain all have close ties to Israel. In spite of the French Government's position since 1967, a policy of total reliance on the Arabs would very likely be highly unpopular with the French people. Italy and Japan might wish to consider such action and would face fewer political repercussions at home, but the consequences of such a move could go well beyond the narrow problem of the Arab-Israel conflict into their relations with us, with the British, and with others.

The OPEC countries are heavily dependent on capital goods imports but in almost every case they could live without them, at least for a protracted period of time -- certainly longer than the Europeans could live without the oil. The tying of any highly developed European economy exclusively to the essentially primitive economy of (say) Libya, would give the Libyans such total control over the actions of its customer that it is difficult to see how such a proposal could be defended even by the most anti-American or ardent Arabist in the consuming state's government. As the OPEC countries develop, however, this reliance on foreign goods and foreign technical assistance

will grow and it is certainly to the interest of the consuming countries to assist the development of the OPEC countries. The creation of large middle classes throughout the OPEC area and the bringing of the entire population into the money economy will indeed increase these countries' reliance on the oil consuming countries, which supply goods in return. But this will be a long process, and in the interim any bilateral relationships would almost certainly be more hazardous to the consuming countries than is the present system of relying on a large number of oil companies to act as intermediaries in supplying their energy supplies for them.

The OECD countries might temporarily improve their relations with the producing governments by offers of aid, military assistance, or special bilateral trade advantages, but this does not appear to be particularly promising or necessarily desirable.

All this having been said, it cannot be denied that the position of the consumer countries would be improved if their political relations with the producing governments were improved. It is self-evident that the position of the United States, the Anglo-Saxon oil companies and the consumers would be enhanced if the political animosity of the Arabs to us

were removed or decreased.

And if it ever appears possible to tie any of the major producers firmly to the western consumers, considerable effort should be expended in doing it.

■. New Relationships Between Consumer Governments and the Companies

The commercial freedom of the oil companies in the various countries [of] the OECD varies from almost no restraints (beyond those on all industry) [in] the U.S., the UK, Germany and Benelux, to rigid controls in France or [the] requirement in Japan that foreign companies be in partnership with [Japa]nese firms.

A view was advanced some time ago by some in the EEC Secretariat, [and] adopted by some but far from all Italian government officials, that [oil] was too important to be left in the hands of the private companies; [since] the economies of every country in the OECD (except the U.S. and [Cana]da) depended on large quantities of imported oil. All those who [advan]ced this proposition admitted that the companies had performed [admi]rably in the past but, as one Italian put it, "their vaunted flexi[bili]ty was lost in the fall of 1970" when one country (Libya) threatened [the] world with a supply crisis and the companies were powerless to avoid [it].

This argument is that the companies should be reduced to the status [of] "regulated public utilities." The governments would contract for the [oil] from the producing states, and would set the prices. The companies [woul]d transport the oil, refine it and market it but the governments would [set] product prices, allowing the companies a "fair" return on their [inve]stment.

The charge that the companies had lost their flexibility is som unfair. The companies had scarcely been affected by the major traum the closing of the Suez Canal; they had absorbed the loss of Tapline' short-haul oil and even the cutback in Libyan production by three-qu of a million barrels/day did not create a supply shortage. The flexi bility, however, was not infinite, and the breaking point appeared w Libya threatened to cut off all oil deliveries. This was not a bad

The situation today is much easier. The Tripoli and Baghdad set ments put a heavy premium on short-haul oil. This was justifiable as long as tanker rates were high, but they have dropped recently -- th to a slower growth in consumption than had been anticipated and the mini-recession in Japan which has freed many of the oil-bulk-ore car from ore into the oil tanker market. With the lower tanker rates, Persian Gulf production has increased at the expense of production in Iraq, Libya, Nigeria and Venezuela; and Tapline is operating at half capacity. If Libya were to stop production today, it would be bothe but there would be no supply crisis -- provided, of course, that no major short-haul producer also closed down. The "vaunted flexibilit has been restored.

The European demands for moves toward control of the companies w probably be muted for as long as this flexibility is maintained. It won't, unfortunately, be maintained forever, or even for very long. Almost certainly before 1975, it will be gone or severely reduced.

question is then, can the consuming countries restore it with their own national oil companies or by regulating the international majors? The answer here seems to be clearly that they cannot. At least they have not had notably successful records until now. The national companies, e.g., ENI, have not been efficient in finding oil or producing it. ENI, in spite of government assistance, can barely compete with the major international oil companies yet it makes almost no profit. Nonetheless, if a new supply crisis looms, or if the companies cannot resist moving toward higher posted prices or the higher prices which would be inherent in "participation" without compensation, the Europeans will certainly raise the issue again. The chances of pressure by the Community will probably be in direct proportion to the size of the increase in the price of oil.

Some of the American oil company executives we have talked with have said that they could live with a new "regulated" status in Europe. Being allowed a "fair" return on their investment would be fine; they thought they could compete with European national companies and it would save them a lot of headaches in production as well as marketing.

This attitude was surprising and was strenuously opposed by more venturesome company officials. It should also be strongly opposed by the USG unless it can be demonstrated that such an arrangement would enhance security and would bring forth the new capital for the finding

and development of new oil reserves. Most European governments would share the same concerns, and would have the added concern of higher costs. Before the Community or the OECD moves in this direction, it should also be sure that it would not cost, in the end, substantially more than allowing the companies to make their own arrangements with producers.

OECD negotiations with OPEC are not as farfetched as they sounded a few years ago, but we should be quite sure of what we want to accomplish by such action, how we would plan to carry it out, what our strengths are in dealing with OPEC and what pressures we can and will put on the producers. OECD is not yet at that point.

Political Relations with the Middle East Producer States as They Affect Security of Oil Supplies

Business is easier conducted among friends, particularly in the Middle East. Demonstrably, preservation of a friendly U.S. political relationship with the producing governments provides an environment facilitating dealings between host governments and American oil companies, including negotiation of the changing relationships which may come in the 70's. The most striking negative examples are the adverse changes in the environment in which American oil companies have operated in Iraq and Libya since the revolutions there. A happier, but related, example is Under Secretary Irwin's mission to Iran, Saudi Arabia and Kuwait during the oil crisis preceding the 1971 "Tehran settlement." Drawing on the amicable political relationships between the United States and these producer states, he successfully urged that these governments not permit the threatened confrontation with the companies to disrupt the flow of Gulf crude and that they promptly enter into price negotiations with the companies on a commercial rather than a political basis. Libya at the same time was urging the contrary. Its premier told the oil companies negotiating there that his government intended to increase its demands on the companies, forcing them to raise their prices to the point where the consumers of the oil, America's allies,

would force the United States to change its pro-Israeli Middle Eastern policy.

These experiences suggest the importance of considering carefully U.S. interests in Middle East oil in developing our foreign policy toward the area. Insofar as the Arab producer-states are concerned, we cannot ignore their growing capability, briefly and imperfectly demonstrated in 1967, to use oil as a "political weapon" against the West. Traditionally, we have stressed our strategic interest in preserving the flow of Middle East oil to our NATO allies, implying some positive American ability to assure this flow. In reality, what we may be dealing with is a negative restraint on our Middle East policy -- to avoid provoking Arab producers into applying pressure on European consumers to break with U.S. Middle East policy and by-pass the American oil concessionaires in order to preserve their essential crude oil supplies.

To maintain strong bilateral ties with the Middle East oil producers, beyond seeking an Arab/Israel policy which they can tolerate, we should continue the basic approach we are now pursuing. The official U.S. position in Saudi Arabia is buttressed by growing Saudi desire for American

military equipment and technical assistance, manifested by the Corps of Engineers' consultant role, Raytheon's Hawk Missile Program, and the growing American official and private roles in modernizing the Saudi Air Force, Army logistics, National Guard, Coast Guard and Navy. In Iran, our influence rests on a history of support against Soviet pressure and, today, on supplying and financing military equipment and advisors. In Kuwait, we are in the process of increasing the American portion of the primary Anglo/American role in both security and economic development, and this process is likely to extend to the lower Gulf oil shaykhdoms as the formal British protective role there ends. These U.S. activities moreover, generally fulfill a technological need which would make them still desirable even if, say in Saudi Arabia, a nationalist revolutionary regime should come into power.

This American cooperation with producing states provides a general psychological atmosphere for friendly oil relations; it does not however constitute specific effective U.S. official leverage on these states on oil questions. Thus it is essential that we recognize the limitations on the capability of our political relations

with the producer states to secure our oil interests. The producer states have long been motivated by economic self interest, dictating maximizing financial benefits from oil. In early 1967, Saudi Oil Minister Yamani described ARAMCO to Arab students in Beirut as a "milk cow, not to be abused, so that the Saudi farmer can exploit it for all it is worth." The Irwin mission channeled the 1970-71 oil crisis back into commercial channels; it did not directly seek to determine the bill resulting from the ensuing bargaining. In the final analysis, we hope the mutuality of economic interests between producer states and American oil companies, particularly in the Arab producing states, will be given more emphasis than their political relations with the U.S.

Unfortunately, the producer states are increasingly motivated by an economic nationalism which moves in the OPEC forum along paths where political emotion tends to overcome economic nationalism. Whenever there has been a freely elected National Assembly in Kuwait it has (in 1964-66 and again this year) blocked government-company arrangements clearly in the financial interests of Kuwait by insisting on the principle of reviewing the validity

of the basic oil concession agreement. Iran, bulwark of U.S. political influence in the Middle East, spearheaded the assault on U.S. company interests there in 1970-71. This suggests that in the producing countries the politics of "participation" will not be significantly checked by friendly Anglo/American diplomatic relations with the host governments, even though such relations may improve the tone of negotiations.

It should be noted here that many of the moderates do not consider "participation" to be a radical step. Yamani has, repeatedly over the last few years, told Aramco that it must give the Saudi Government some say in running the oil industry in Saudi Arabia. He has always said he speaks as a moderate and as a friend of the companies. If the companies do not show flexibility on this issue, he maintains they will provoke a move by the radicals toward nationalization. In a meeting at the end of November, Yamani told Aramco that participation is now not a question of "if" but of "when and how". He has advised the company to accept the principle and come forward with suggestions on implementation.

XV. Capital Requirements of the Next Decade

As stated above, Chase Manhattan Bank has estimated that the international oil industry will require $360 billion for capital expenditures and $180 billion for working capital and other requirements in the next decade. This is considerably more than the entire industry has spent in its entire history, but the consumption of oil in the coming decade will also be more than has been consumed up to now - and the cost of finding and developing new oil will go up sharply as the industry turns to deeper and smaller fields and deeper waters off shore.

The present proven reserves in the world are about 500 billion barrels; which represents a fairly comfortable 30 years supply. (Statements to this effect are frequently misused. This is a comfortable position only from an engineering or technical point of view; our concern has been that most of these reserves are in the Middle East.) At the end of this decade, let us assume that we can tolerate a reserve - production ratio of only 20 years. Consumption at that time will be well over 30 billion barrels a year and the reserves should therefore be

[illegible]0 billion barrels -- 100 billion above present reserves. But 250 billion barrels will have been consumed in the decade, which means that a total of 350 billion barrels will have to be discovered in this period. To put these quantities in perspective, Prudhoe Bay has 10 billion barrels of oil; even Kuwait has only 70 billion. We have not been finding three Prudhoe Bays ever year recently; in fact the prospects for finding substantial new oil outside the Middle East are miserable.

Consumption will rise in the next decade by an average of 4 million barrels/day each year. To put this in perspective, the consumption of France today is 2 million barrel/day; of Germany 2.7 million and of the United Kingdom, [illegible] million.

Where will the capital come from? Traditionally the industry has generated the capital itself. In 1960 it borrowed only $900 million or 16 percent of its capital requirements of $5.5 billion. In 1970 borrowings had risen to $3.1 billion 27.2 percent of the $11.4 billion required. The long term debt of Standard Oil of New Jersey in 1961 was $[illegible]00 million; by 1970 it had risen to $2.44 billion.

The profits of the industry are not large relative to investment. The Chase Manhattan Bank's "group" of oil

companies, comprised of all international majors and the large independents which control most of the worlds oil production outside the United States, showed a return on its capital of only 10.3 percent in 1970 - a full percentage point below manufacturing industry in the United States.

In fact, it will be impossible for the industry to generate the amount of capital needed for this expansion in the 1970's if profits are kept at current levels. David Barran, head of Shell Oil Company, has said that oil company profits should be allowed to increase to $0.40/barrel (they are currently $0.33/barrel in the Eastern Hemisphere and somewhat higher in the Western Hemisphere). Even if this is achieved and if 250 billion barrels are consumed in the next decade, total profits will be only $100 billion. Of the remainder perhaps as much as $200 billion could be covered by depreciation of assets but this would still leave at least $200 billion or an average of $20 billion to be borrowed or raised through sale of equity for each of the next ten years. This would be almost seven times the $3 billion borrowed in 1970. Will it be possible to find these sums either through borrowing or sale of stocks? It will be high

k and the banks and investors may well find more useful tlets for their funds. If the projections published by e Manhattan are correct; if the City Bank figures can accepted, then it would hardly seem that Mr. Barran's piration for a profit of only $0.40/barrel is modest. is still less than one U.S. cent per gallon - a ll enough figure when compared with excise taxes of cents or more a gallon in the United States and four that in many European countries.

One intriguing prospect is that the oil producing ntries could use some of their capital accumulations the next decade to buy up new stock offerings, or even buy up company stock during periods when the stock market depressed. In a relatively short time the oil producers ld find themselves in a very strong position in the ernational oil industry, and, if they wished, could even ntrol several of the major companies.

XVI. Conclusions

The consuming governments are in a better position today than they were last year. Stocks are high, tanker rates are down, short haul production is down, and there is considerable spare capacity in Libya, Nigeria and Venezuela. It is therefore somewhat easier to face OPEC now than it was last year.

OPEC will make two demands on the companies in negotiations which have already begun. The first is for a readjustment of payments to the producers as a result of the dollar devaluation. The companies have tried to resist this as a contravention of the Tehran agreements but we do not believe they will succeed. They apparently do not either, as they are currently making plans for new offers to the producing governments. It is unlikely that the agreement will mean an increase in payments to the host governments equivalent to the full effective devaluation of the dollar in terms of (say) the German mark; it seems more likely that a formula will be reached based on increased trade costs and that it will mean about a three

or four percent increase in payments to the host governments in terms of dollars.

The demand for participation is much more serious, particularly as it is not likely to end with the 20 percent currently asked in the Persian Gulf, but would ultimately be raised to 51% or perhaps even 100%. We believe that this is clearly in contravention of the Tehran agreement. As such, the companies have no choice but to protest it, and we have no choice but to support them vigorously in their negotiations with the OPEC countries. We believe there is a substantial chance of success in averting a clash now provided the companies are willing to talk about new relationships with producing governments at the conclusion of the Tehran agreements in 1976. Should the OPEC governments, however, push through their demand for participation at present, then the United States position will have to be that the companies should be given "full, prompt and adequate compensation". There is very little that we could do in most OPEC countries, except Iran, in case they did not accede to our demands.

(We assume that Indonesia will not follow the general OPEC line on this matter; Venezuela is well on the way to the conclusion of the contracts in 1983; Iran, too, has alrea stated that it will not extend the consortium agreement after 1979 and so it may not demand 20% participation at present.) Most oil producing countries get no aid from us and the world needs the oil. If the demand for participation is legislated, then we see very little opportunity for the companies but to accede. They could, of course, also insist that the realized prices rather than the posted prices be used as a basis for calculating company profits and that they be given a substantial marketing allowance for handling the oil for the national company. In this case the actual financial burden to the company could be small.

In the long run, given the strength of the producing governments and given the demands of nationalism, the mov toward participation will almost certainly be irresistibl If the companies try to resist now, they could well provoke a move toward total nationalization which would have unfor consequences not only for company profits but for world o

plies. We believe that the companies therefore would wise to offer the producers now some new relationship for 1976. This could be a 50-50 arrangement similar the new concessions now being given, with adequate pensation for the company's surrendered share and with government putting up 50% of capital requirements in future. It could include downstream participation; companies have long resisted this, but they show their fit almost entirely on the producing end, and if OPEC ernments are willing to put up capital for new refining marketing outlets, then this perhaps should be given careful study than it has to date. They will st certainly have capital to spare.

The new relationship could alternatively consist of companies voluntarily relinquishing large sections of present concessionary areas (as was done by force in in 1960); the companies could then enter into new lationships with the producing governments and perhaps other companies from other consuming countries, in t government-company ventures in the relinquished areas. governments could be in from the beginning on development

of oil production above current levels.

The situation described by this paper is not encouraging. It is not new, however, The international situation has been studied by OECD and by NATO. The domestic situation and the dangers of reliance on imported oil have been studied repeatedly by the Department of Interior and the Department of Defense, by the National Petroleum Council, by the Science Advisor to the President, by the Domestic Council, and the Oil Policy Committee.

The conclusions reached by all are remarkably uniform and remarkably dreary. Indeed they are so unpleasant we have shown a tendency to ignore them, and to handle the problem by commissioning yet additional studies. The Senate Interior Committee under Senator Jackson recently started a comprehensive study which we had understood was a joint House and Senate investigation with the full participation of the Executive Branch of the Government. We had h[illegible] that the recommendations of this study would be accepted and acted upon, although there was some concern that the study might drag on for several years. This study has had difficulty in getting started and it has not won the full

backing of the Senate or the House. Senator Proxmire is conducting his own study and Congressman Aspinall, who has alleged that the Jackson study is to serve only as a support for Senator Jackson's presidential aspirations, has set up a Task Force on Energy and Resources.

We believe that the time has come to end the studies. Unless someone can demonstrate accurately the inaccuracy of the conclusions of previous studies, and do it very rapidly, the time has come for action both at home and abroad. We propose the specific State Department actions outlined in the following section:

XVII. Proposed Actions

A. Action to be Taken by Companies

1) Offer new production arrangements to OPEC, to go into effec[t] after 1976

The companies should recognize that 1976 will be the latest that they can hope to maintain their existing concessions without essentia[l] change. The end of the Tehran Agreement will almost certainly see a quantum leap in oil prices and the governments of OPEC will demand new company/government relationships if they have not already done so. Probably the only way of resisting demands for price increases at pres[ent] or participation this year or next will be to agree to work out a new relationship with the producing countries after 1976. This need not necessarily mean a reduction on company profits. It will mean giving the producing governments a voice in the management of the companies operating inside their borders.

2) Enlarge the composition of oil producing companies

Most of oil production is in the hands of the seven major oil companies, five of which are American, one British, and one British/Dut[ch]. The French have some stake in Eastern Hemisphere oil production, but barely enough to cover their own needs. The major oil consumers, notabl[y] Japan, Germany and Italy, have long aspired to control some of their ow[n] production. The oil companies should seriously consider opening up

existing concessions to companies from at least these three nations. For example, there could be an enlargement of the consortium in Iran, or ARAMCO in Saudi Arabia. More acceptable to the companies would be new joint ventures in new areas. A good example of this is the new Mobil/Japanese operation in Iran.

.....Specific Action (1) by the Department

The Secretary and the Under Secretary should call the Chief Executive Officers of the major oil companies and of a substantial number of the independents, outline our views on the probable developments in world oil in the next decade, outline the action we plan to take on their behalf (as described below), urge them to take the actions described above, and tell them we believe our chances of success in our diplomatic démarches will be minimal if they cannot inform the OPEC countries they will now consider changes for a new regime after 1976.

B. Action Taken by the USG in the United States on Behalf of the Companies

1) Form an international petroleum advisory group

This could be similar to the National Petroleum Council, which advises the Secretary of the Interior. It would advise the Secretary of State on international oil matters and could meet periodically or on an ad hoc basis. Depending on its function, such a group might require a Business Review Letter or other form of approval by the Department of Justice.

.....Specific Action (2) by the Department

When the company executives are called to Washington for the discussion on the future of the industry, the Secretary or the Under Secretary should raise this matter. It has already been discussed with a number of officials who are enthusiastic. An ad hoc committee could be selected at that meeting.

2) Allow companies to work together to attain certain restricted goals

The United States Government should permit the companies to operate together abroad to face a unified OPEC challenge without fear of anti-trust prosecution in the United States. European and Japanese companies operate with the full backing of their governments and it is essential that the American companies are shown to be supported by the United States. This has not always been the case; in fact, some producer governments seem to have the idea that the United States is willing to use the companies as pawns in a wider foreign policy game.

Action on behalf of the companies was taken in January 1971, and again on October 22, 1971, when the companies were given Business Review Letters by the Department of Justice allowing them to present a common front to OPEC.

.....Specific Action (3) by the Department

At the request of the Department of State, the Department of Justice gave the companies Business Review Letters in January 1971, and again on October 22, 1971, which permitted them to present a common front to the OPEC. The Department should keep in constant contact with the Department of Justice and with key Congressmen and Senators on this matter to ensure that there is a sound understanding of the reasons for the action and the benefits we expect both the companies and the consumers to gain from it. This is currently being done.

C. Diplomatic Approaches on Behalf of the Companies

1) In the Persian Gulf - as a result of the Irwin Mission

If the OPEC countries persist in demands for participation now, the United States Government should give the companies appropriate diplomatic support.

....Specific Action (4) by the Department

The Department should deliver notes to Tehran, Jidda and Kuwait, reminding the rulers that they had assured our President's envoy that they would honor their agreements with the oil companies for the full term of the agreements. The Department should point out the difficulties and the dangers to us, the other consumers and ultimately to the producer governments caused by demands for "participation" now, when the world had assumed that five years of stability in the oil market had been achieved in the Tehran agreement of February 1971. Finally, the Department could point out to the rulers that the United States, as a result of the assurances given Mr. Irwin, had counted on these agreements being honored and had so informed its allies. If necessary, this could be followed by letters from the President or another visit by a presidential envoy.

2) Review in the OECD the capital requirements of the industry in the next decade

....Specific Action (5) by the Department

The Department should ask all OECD countries their views and try to reach an understanding on the definition of "reasonable profits" which the companies could be allowed to generate in the next decade.

3) Discuss the need for stability in the world oil market

...Specific Action (6) by the Department

The Department should be prepared to discuss, but not necessarily support, the idea of a joint OECD approach, or an approach of selected OECD countries to some OPEC countries, for a new producer/consumer relationship such as has been raised by the EEC and the Italians.

4) Investment in unconventional oil

The Department could raise again, this time more formally than in the past, the possibility of European or Japanese investment i U.S. shale, Canadian tar sands or Venezuelan heavy oils. This would, of course, require the concurrence of the Canadian and Venezuelan gove ments and of our Congress. The EEC and Japan might be more willing to consider paying more for their oil, if they can have near-absolute guarantees of its security, than they were a year ago.

.....Specific Action (7) by the Department

The Department, after informing the NSC, should raise this possibility with the Venezuelan and Canadian governments, and with the Senate and House Interior Committees. Assuming there are positive responses, the matter should then be put on the OECD Oil Committee Agenda.

5) Increase Stocks

After the Mid-East crisis of 1967, the U.S. delegate to the OECD Oil Committee urged that OECD stocks be raised to 180 days. They were theoretically 60 days at that time, but most countries fell far short of that level. Many in the OECD now ruefully admit that the U.S. was right; that if Europe and Japan had had 180 days of stocks last y it might have been possible to have withstood the Libyan blackmail. OECD recommended stock level has now been increased to 90 days.

.....Specific Action (8) by the Department

The U.S. delegate to the Oil Committee should raise again this matter. He should propose a storage figure of 180 days but would be prepared to settle for 120 days, and if this is impossible, then the current 90 days -- but based on forward consumption and effective stocks, i.e., tank bottoms and oil in pipelines should not be counted as stocks.

6) Accelerate the development of nuclear energy with Europe and Japan

Some moves are being made on this point now. But not enough. The security, financial and other obstacles which the Joint Committee on Atomic Energy have established for permitting multi-national cooperation on uranium enrichment and related matters make meaningful cooperation doubtful. Failure to come to an early understanding concerning cooperation is likely to result in delayed action on the part of our allies in fully exploiting atomic power to meet their energy needs. In the longer term, it also could result in the U.S. being shut out of a large market for enriched uranium and capital equipment related to the nuclear power industry. A major effort should be made to accelerate joint US/European/Japanese development of nuclear energy perhaps through the establishment, at U.S. initiative, of an INTELSAT-type consortium with significant U.S. equity for the production of enriched uranium at various locations throughout the world.

.....Specific Action (9) by the Department

This will require strong State Department leadership and, subsequently, Congressional approval. It need not be incompatible with the current U.S. policy concerning the early transfer of enrichment capability to the private sector. The Department should raise the matter immediately with the NSC and the AEC, and then with the Joint Congressional Committee on Atomic Energy.

7) Maintain friendly relations with producing governments

.....Specific Action (10) by the Department

Maintain the programs with Saudi Arabia and Iran described in Section XIV above. Continue the present U.S. Government policy of trying to keep a balance in our relations with all states of the Middle East. A return to an overtly, exclusively pro-Israel position would negate most and probably all of the other steps the United States could take to secure oil supplies.

D. Action Taken by the USG to Increase Its Own Stability and Flexibility in Dealing with Producing Countries

1) Increase domestic supplies of oil

This could be done inter alia by:

(a) Giving immediate leases on the outer Continental Shelf. In order for these leases beyond the 200-meter depth to be consistent with the President's Oceans Policy Statement, they must be made subject to whatever international regime is established by the United Nations Law of the Sea Conference. Connected with this should be a new form of bidding based not exclusively on initial bonus payments, which enable only a few companies to participate. Offers of new tax arrangements or offers to maintain spare capacity (this may be a requisite for bidding) could be considered.

Specific Action (11) by the Department

The Secretary should write to the Secretary of the Interior and inform him that, while we still hoped to reach an international agreement on the Continental Shelf, we no longer would object to Interior's granting of petroleum leases beyond the 200 meter isobath. In order to be consistent with the President's Oceans Policy Statement, the leases must be made specifically subject to the international regime to be established by the Law of the Sea Conference.

(b) Giving leases on Naval Petroleum Reserve No. 4 in Alaska, with perhaps some requirement on maintaining spare capacity.

(c) Proceeding as rapidly as possible with the exploitation of shale oil and with coal conversion. This would mean giving leases immediately on the shale areas. It would also probably be necessary to give synthetic oil the same depletion allowances as are now given conventional oil.

(d) Encouraging the production of conventional oil and gas through new tax allowances for newly discovered oil, or for oil produced by tertiary recovery methods.

(e) Determine as accurately as possible how much more gas could be produced in the United States by raising the wellhead price of newly discovered gas by 10¢ increments up to delivered LNG prices. If the FPC, the Department of the Interior and the industry could demonstrate that significant quantities of gas would be produced in the United States by these higher prices,

then prices should be raised. We will be forced to pay th higher prices for imported LNG and, for both security and balance of payments considerations, should produce the gas in the United States to the degree we can.

.....Specific Action (12) by the Department

The Department Representative on the Domestic Council Subcommit on Energy and the Oil Policy Committee should review our conce at the projected energy shortages for 1980, and raise points (l (c), (d) and (e) above. He should point out that the Departme is, as yet, the only Department to have come out squarely for t Alaska pipeline, and should urge other Departments to make stat ments similar to that included in the OEP letter (quoting the Department) to the Secretary of the Interior. Department offic should discuss these same matters with the Foreign Affairs and Interior Committees of the Senate and House.

2) Encourage development of new forms of energy

Implicit in the President's Energy Message of June 4, 1971, was the conclusion that the United States Government would ensure th research on energy matters would receive the highest priority. This however, appears not to have been completely clear to all readers of message.

.....Specific Action (13) by the Department

The Secretary, in a letter to the President, should review our concern about supplies of energy, shall refer to the President's June energy message, and should ask him or his Science Advisor to state publicly that the Administration had taken a policy decision to accelerate development of new forms of energy;

and that from now on, whenever science can demonstrate adequately that it needs more funds for research and development, these funds will be made available; in other words, that money will no longer be the limiting factor in the development of new energy forms.

3) Take measures to decrease rate of growth of consumption of energy in the United States

This would include, inter alia:

(a) Raising taxes on gasoline and freeing gasoline taxes from the Highway Fund; using these taxes then for subsidies for mass transportation.

(b) Discouraging growth in consumption of electricity by eliminating special rates for large users.

(c) Encouraging use of electricity during off-peak hours. This could be done by lowering rates between 6:00 PM and 6:00 AM. New metering arrangements would have to be made. This is already done in Europe.

(d) Encouraging the recycling of aluminum or the reduction in use of aluminum. Aluminum production requires 15 times as much energy as does the production of the same quantity of steel. With higher rates on energy, aluminum production may, in any case, decline.

(e) Starting a national "save-a-watt" campaign to encourage Americans to keep their houses 5 degrees warmer in summer and

5 degrees cooler in winter. In connection with this, all advertising campaigns to increase the use of energy (particularly gas) should be stopped.

.....Specific Action (14) by the Department

The Department Representative should raise these matters in the Domestic Council and the Oil Policy Committee. The Department should also encourage Senators or Congressmen to introduce legislation which will accomplish these objectives.

N.B.: Legislation to remove gasoline taxes from the Highway Fund will be raised soon. We have discussed this with the major oil companies who will no longer oppose it as they have similar legislation in the past.

4) Coordinate energy policy

There is a growing understanding of the energy crisis the United States is now entering. There is, however, no coordination in the U.S. Government on energy matters. It seems to us to be essential that some one responsible group be in charge of all energy matters: oil, gas, coal, atomic energy, and non-conventional forms of energy. The President has announced that energy matters are to be centered in the new Department of Natural Resources, a move we heartily endorse. We believe, however, that we should not wait until this new department is set up before energy matters are coordinated under one head. The logical candidate for such a task seems to us to be the Secretary of the Interior.

.....Specific Action (15) by the Department

The Secretary, in his letter to the President in connection with proposed action (13) above, should urge him to appoint a high commissioner for energy, to face the energy problems of the seventies and propose solutions for them. This position could, of course, be absorbed in the new Department of Natural Resources when it is formed.

5) Conclude an energy agreement with Canada

This could be done on lines proposed to Canada at various times during the last year. If Canada is unwilling to enter into an agreement, we could unilaterally declare that the reasons for imposing controls on Canadian oil are no longer valid (this is indeed the case), that Canadian oil will be allowed freely into the United States, providing only that oil imported into Canada not come west of the Ottawa valley line (this is already Canadian policy) and that the pipelines crossing the border into the United States maintain some spare capacity for emergencies. We would have to assume, in this case, that commercial pressures to develop the Canadian oil and gas would be sufficient to ensure their development. We would have to assume, with perhaps less justification, that the Canadians would not impose export taxes on the oil and gas sent to the United States. The same arrangement might be made with Mexico.

....Specific Action (16) by the Department

Continue present efforts to conclude an agreement with Canada. Raise the subject again with Mexico.

6) Conclude an energy agreement with Venezuela and other Latin American producers

This would be in two parts: (1) guarantee on investments made in the Venezuelan heavy oils, and (2) U.S. permission for this oil to enter freely into the United States. Such an agreement, mutatis mutandis, might also be concluded with Colombia and Ecuador.

.....Specific Action (17) by the Department

The Department should raise with Venezuela, Colombia and Ecuador the possibility of entering into such agreements and, if so, to start negotiations leading toward their conclusion.

* * * * *

Postlude

If actions suggested in this section are taken, the position of the United States in 1980 could be quite different from that assumed other parts of this paper. Consumption could be only 22 million bar day (rather than 24 million). Domestic production could be as much 15 million barrels/day (rather than 12 million), and imports from th Western Hemisphere could be five or six million rather than three or four million. This would leave quite manageable imports of only 1-2 million barrels/day from the Eastern Hemisphere.

Attachment:
Questionnaire

12/22/71

Producer/Company Relationship

What are the advantages and disadvantages of the traditiona
sionary system?

What are the chances this concession system will last for
next 10 years? What type of new agreements will be
hod?

Are any OPEC governments brought into the decision making
ses of the oil companies now? If so, how?

What are the most probable demands of the producing
ries for concession changes in the next 10 years?

What would be the advantages and disadvantages to us,
r companies, to the consumers and to the producing
nments of such changes?

What possibilities are there for the USG to influence
lopments in the producing areas? for other consuming
nments?

What support should (could) the United States Government
possibly the British, Dutch and French governments) give
panies in their negotiations with the producing govern-
?

What are the possibilities of forming a "consumers cartel";
are the advantages and disadvantages of such an organization?

What are the merits and deficiencies in the ENI statement
"the regularity of petroleum supply must become an
tial component -- not alterable unilaterally -- in a
lex of an economic and political relationship which both
ies (producers and consumers) have an interest in main-
ing and reinforcing on the basis of reciprocal advantage"?

How valid is ENI's contention that the international oil
nies can no longer control their relationships with the
ing countries and that therefore the consuming countries
t continue to rely on these companies to supply oil at
able prices?

Consumer/Company Relationships

What might be the demands of the consuming governments
ntrol of the oil industry in the next decade?

12. What would be the advantages and disadvantages to th governments and to the consumers of such modifications?

13. What are the possibilities of the US Government influencing consumer governments' attitudes toward the oi companies?

14. Does ENI speak for the Italian government? What are its chances of doing so in the near future? What support will it have in other EEC countries? in the EEC Secreta How firm is ENI in its views? Might these be altered?

15. How much control is presently held over company ope elsewhere in the EEC? in Japan? What is the likelihood the ENI view will spread to other consumers?

16. How will US companies fare if the EEC adopts a syst of favoring "community companies"? Will US companies be allowed to qualify through their European subsidiaries?

III. Consumer Flexibility and Assets in Dealing with OP

17. What means, if any, do the consuming governments h to use against unreasonable increases in petroleum pric

18. What can the US do to "share the burden" in a new crisis? How much rationing can the US accept? How much could be made available to Europe and Japan?

19. How much flexibility will we get through the develo of synthetic oils or alternative sources of energy?

20. How much oil will be produced by the present OPEC in 1975? in 1980? How much spare capacity will there in each of these years? Where will it be?

21. How much oil can be expected to be produced outside present OPEC area by 1980?

22. Can production be expected to peak out in any of t present OPEC countries before 1980? 1985? 1990? If s what levels?

23. What are the divisive forces in OPEC; should these encouraged and if so how?

V. Capital Requirements

14. Assuming doubling of world consumption of petroleum by 1980, where will the necessary capital come from for this development under present concession systems and under modifications that we see are most probable?

15. What investment will be required (in dollars/bbl/day of new production) in OPEC in 1975? 1980?

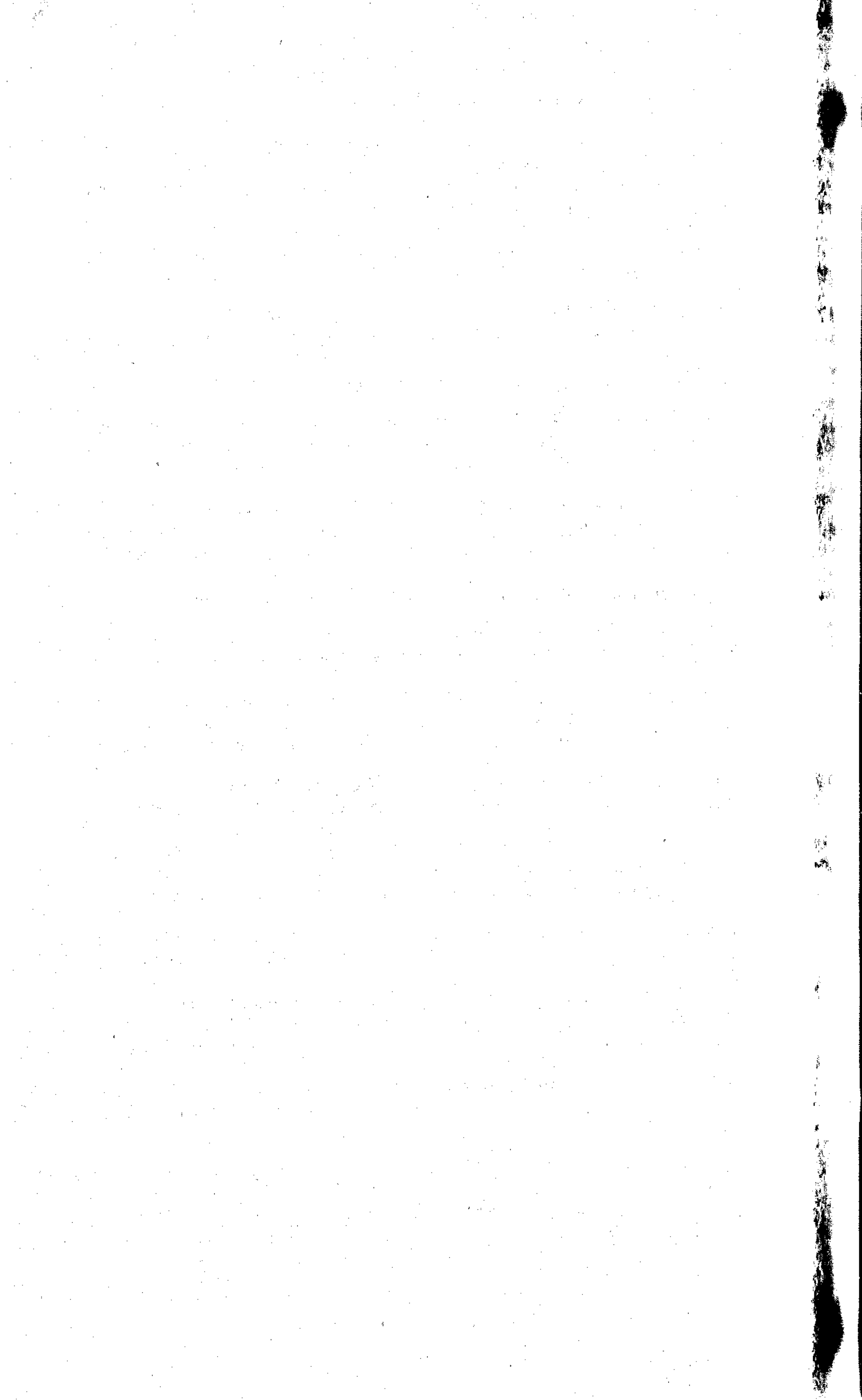
16. What will be the investment costs in downstream facilities in Western Europe, Japan, the USA by 1980?

17. How would investment be made in production and in downstream facilities under various cases of government control including the extreme case of complete regulation in Europe and Japan and nationalization in the production areas?

VI. Conclusion

18. What sort of company/producing government relationship would be most desirable in 1980? Is this attainable? What action can the USG and the companies take to bring about this development or its nearest practical equivalent?

/23/71



NOTE:

The two documents presented in the following pages, include American Embassy Oil Attache and Economic Counsellor's comments, returned to both the above officials after the draft document titled "International Oil Market through 1980" was reviewed.

Before an all-out distribution of this analysis, Office of Fuels and Energy of the U.S. Department of State sent copies to a number of embassies and circles including the U.S. Embassy in Tehran, to get their comments. The next documents contain comments made by two of the U.S. embassy officials.

It is to be noted that both documents have references made to certain pages of the original anlysis, while those are related to the draft copy and in no way coincide with the pages printed in this book. To follow up the issue, a subject-related search should be launched within the context of the original document.

Tehran, Iran

November 29, 1971

SECRET
OFFICIAL-INFORMAL

Mr. James E. Akins
Office of Fuels & Energy
Department of State
Washington, D.C. 20520

Dear Jim:

Thank you very much for your letter of October 27 enclosing the draft of your oil industry paper. Since the Charge has also received the NEA comments on your draft, I thought it would be best if our letter giving comments on your draft came from Bill Lehfeldt since this would put the Embassy's authority behind the comments and perhaps make them more useful to you in a bureaucratic sense.

I would like to make one comment here which is really mostly outside the scope of your draft, but which seems to me pertinent to it. I believe that well before 1980 we are going to find Iran, at least, making a more vigorous drive for downstream participation than the tone of paragraph two on pages 36 and 37 of your draft would suggest. I have had a deeply troubling interview recently with Mr. Hadi Entekhabi, who is Head of the Special Overseas Projects Group in the NIOC (this includes the Belgian refinery among other undertakings). Entekhabi is disliked by his colleagues as an incompetent and pompous jerk, but they have to endure him because of his closeness to Eghbal, whose protege he is. Entekhabi spoke specifically and by name on behalf of Eghbal when he made it clear that NIOC was headed downstream for nationalistic and emotional reasons as well as for economic ones, and that the NIOC would use its increasing control over accessability to Iran's oil to favor companies that are hospitable to Iran downstream and to shut out companies which resist, or compete with, Iran's refining and marketing ventures inside consumer countries. Much of the ornamentation on this statement, particularly references to the size and speed of Iran's initial ventures downstream, was, of course, overstatement

SECRET

and bluff, but the theme was clear and I accept it as true. Accordingly, I see beyond the participation issue, another and much more intractable problem of how to handle wealthy producing nations, increasingly sophisticated in the oil industry, who are determined that their flag shall follow their oil.

Sincerely,

John Washburn
Petroleum Attache

ON:JWashburn:jm

Tehran, Iran

November 29, 1971

SECRET
OFFICIAL-INFORMAL

Mr. James E. Akins
Office of Fuels & Energy
Department of State
Washington, D.C. 20520

Dear Jim:

This is in reply to your letter of October 27 to John Washburn enclosing your draft paper on the future of the international petroleum industry. John feels, as I gather he has already written to you, that these comments may be a little more helpful to you bureaucratically if I sign them. I am not sure I entirely agree, but have let myself be persuaded since we both want to help as much as we can in your very important effort.

We have also received a copy of NEA's comments, so that I will begin with a couple of thoughts on these. We like the suggested new chapter on consumer government-company relationships. We strongly agree that the offer of a new relationship with some Gulf countries is not likely to work out. On the other hand, we agree with you and not with NEA on the question of whether or not we are in the last buyers' market. It seems to us that after the overwhelming proof you provide in the first section of your paper, the "almost certainly" on page 29, and the use of "likely" on that page and on page 30 constitute abundant caution in making a forecast with which we entirely agree.

On the effect of the Tehran Agreement, we do agree with NEA that its opening paragraph was not intended to preserve all aspects of existing concessionary contracts for the next 5 years, but rather to define and limit the amendatory effect on these contracts of the Tehran Agreement itself without barring future changes on subjects other than those specified in the Tehran Agreement, i.e., financial arrangements and government take. Our certainty on this point is supported by the explanations of the companies' representatives to us last February, and by the companies' own legal argument which

characterizes participation as a specific violation of the particular ban in the Tehran Agreement on revision of financial arrangements. Also in this connection, therefore, we prefer to keep our options open as to what USG action in support of the companies should be, since the producing governments' demand for participation may or may not take a form which would be a clear change in financial arrangements or obviously result in an increase in government take.

Turning directly to your draft paper, we do not understand that the OPEC demand is for participation without any compensation whatever as you say in the last line of page 21. Your further discussion of this on pages 32-33 suggests that you mean that the book value compensation offered by OPEC is derisory, or that the proposed method of payment results in almost no real compensatory value to the companies. If so, you might wish to include this explicitly in your analysis of participation and compensation, and to insert this complete, fuller analysis at the bottom of page 21. Incidentally, we don't think that the companies would be embarrassed by OPEC's quotation of Department of Commerce figures on the value of U.S. investment abroad, as you indicate on page 33. If participation comes to a head in the Gulf, the companies will almost certainly ask for a review of all the relevant data, a review which would be like the current Vienna talks on currency revaluation.

Concerning your paragraph two on pages 36 and 37, Iran, at least, would have no real trouble hiring and developing from its own resources the necessary expertise to mount an adequate discovery and development program to replace that of the companies. Except for the tool-pushers, almost all crews on drill rigs in Iran are now 100 per cent Iranian, and we see no reason why Sedco, Reading and Bates, and others would refuse to work for Iran if the companies left.

A minor note to your paragraph "A" (I) on page 56 is that our impression is that the GOI would probably let the Constorium hang on until the main term of the 1964 Agreement expires in 1979, particularly if the Consortium makes the expansion in export capacity during the next few years which the GOI is demanding, and is willing now to discuss how participation will be brought about in 1979 and thereafter.

These are our comments. None of them should obscure our wholehearted agreement with, and our support of, your essential thesis which comes through very well indeed in the draft paper. We believe, with you, that the international oil industry is on the road to complete national control of development and processing of crude oil. Participation, joint ventures and service contracts are steps along the way. The companies' aces in ensuring that this evolution, when completed, leaves them with a viable and profitable international business are, as you point out, their refining and marketing skills and their ability to find capital. The first essential task for us in government is to insure that the companies understand and accept what is happening. Your paper, and your initiative of which it is a part, are clearly going to be essential in achieving this understanding.

With all good wishes.

Sincerely,

William W. Lehfeldt
Counselor of Embassy for
Economic Affairs

ECON:JWashburn:jm

(9)

DEPARTMENT OF STATE

Washington, D.C. 20520

January 26, 1972

SECRET

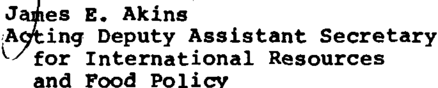
John Washburn, Esq.
Petroleum Attachè
American Embassy
Tehran

Dear John:

Enclosed are seven pages representing our final corrections to the report recently sent to you on the "International Oil Industry Through 1980." It would be appreciated if you could have them substituted for the corresponding pages in our original study.

We have had our final meetings on the oil paper and Under Secretary Irwin and I are now in the process of starting implementation by calls on Lincoln, Morton, Laird, Schlesinger, Haldeman, Stein and others. Towards the end of the month, the Secretary will send a letter to the President telling him what we have done and what we think should be done. In the meantime, we would appreciate any comments or observations you may wish to offer. Needless to say, our report should not be shown to the Iranian Government.

Sincerely,



James E. Akins
Acting Deputy Assistant Secretary
for International Resources
and Food Policy

Enclosures:

Corrected copies of pages 2,3,28, 85,86,90 & 91 of the "International Oil Industry Through 1980."

SECRET

We have also sent the list of questions and asked the views of our posts in OPEC capitals and in the main consuming centers. Their responses have also been incorporated in this paper.

ephemeral. We cannot see how, in such a case, necessary investment would be made in the new production and export facilities which the world will need over the next decade, if the national oil companies operating for themselves and in competition with each other.

II. Proposed Actions

Action which might be taken by companies to preserve their positions in international production.

1) Offer new production arrangements to OPEC, to go into effect after 1976

The companies should recognize that 1976 will be the latest t they can hope to maintain their existing concessions without essential nge. The end of the Tehran Agreement will almost certainly see a ntum leap in oil prices and the governments of OPEC will demand new any/government relationships if they have not already done so. bably the only way of resisting demands for price increases at present participation this year or next will be to agree to work out a new lationship with the producing countries after 1976. This need not essarily mean a reduction in company profits or a loss of control. will mean giving the producing governments some voice in the agement of the oil industry operating inside their borders.

2) Enlarge the composition of oil producing companies

Most of the world's oil production is in the hands of the seven jor oil companies, five of which are American, one British, and British/Dutch. The French have some stake in Eastern Hemisphere l production, but barely enough to cover their own needs. The jor oil consumers, notably Japan, Germany and Italy, have long ired to control some of their own production. The companies uld seriously consider opening up existing concessions to panies from at least these three nations. For example, there

could be an enlargement of the consortium in Iran, or ARAMCO in Saudi Arabia. More acceptable to the companies would be new joint ventures in new areas. A good example of this is the new Mobil/Japan operation in Iran.

......Specific Action (1) by the Department

The Secretary and the Under Secretary should call the Chief Executive Officers of the major oil companies and of a substantial number of the independents, outline our views on the probable developments in world oil in the next decade, outline the action we plan to take on their behalf (as described below), and tell them we fear that our chance of success in any diplomatic demarches we make on their behalf will be small if they cannot soon inform the OPEC countries that they will consider some new relationships after 1976. This of course need not necessarily be participation in the form currently being discussed.

B. Action Taken by the USG in the United States on Behalf of the Companies

1) Form an international petroleum advisory group

This could be similar to the National Petroleum Council, wh advises the Secretary of the Interior. It would advise the Secretary State on international oil matters and could meet periodically or on ad hoc basis. Depending on its function, such a group might require Business Review Letter or other form of approval by the Department of Justice.

.....Specific Action (2) by the Department

When the company executives are called to Washington for the discussion on the future of the industry, the Secretary or the Under Secretary should raise this matter. It has already been discussed with a number of officials who are enthusiastic. An ad hoc committee could be selected at that meeting.

Specific Action (8) by the Department

The U.S. delegate to the Oil Committee should raise again this matter. He should propose a storage figure of 180 days but would be prepared to settle for 120 days, and if this is impossible, then the current 90 days -- but based on forward consumption and effective stocks, i.e., tank bottoms and oil in pipelines should not be counted as stocks.

6) Accelerate the development of nuclear energy with Europe and Japan

The U.S. should continue to facilitate the development of ...ar power on a broad front including the development of international ...n and construction standards to meet safety and environmental ...rements and to simplify licensing and regulatory procedures. In ...cular, the U.S. should move forward with its international efforts ...richment cooperation as well as its domestic access program to ...e that installation of nuclear power plants either domestically ...road is not delayed by concern over an adequate supply of enriched ...um. The USG should take those actions necessary to put itself ...position to construct new enrichment facilities as needed. This ... require the resolution within the next two or three years of ...nisms for cooperation in a multinational plant and/or pro-...ns for construction of additional plants in the U.S. either ...e government or by private industry.

Specific Action (9) by the Department

The Department should encourage the Administration to proceed vigorously with actions to facilitate the construction of nuclear power plants both domestically and abroad including resolution of licensing and regulatory procedures, environmental requirements, design and construction standards and provisions for the construction of additional enrichment facilities domestically and abroad to meet requirements for enriched uranium.

7) Maintain friendly relations with producing governments

.....Specific Action (10) by the Department

Maintain the programs with Saudi Arabia and Iran described in Section XIV above. Continue the present U.S. Government policy of trying to keep a balance in our relations with all states of the Middle East. A return to an overtly, exclusivel pro-Israel position would negate most and probably all of the other steps the United States could take to secure oil suppli

D. Action Taken by the USG to Increase Its Own Stability and Fle in Dealing with Producing Countries

1) Increase domestic supplies of oil

This could be done inter alia by:

(a) Giving immediate leases on the outer Continental Shel

In order for these leases beyond the 200-meter depth to be consistent with the President's Oceans Policy Statement, must be made subject to whatever international regime is established by the United Nations Law of the Sea Conferen Connected with this should be a new form of bidding based exclusively on initial bonus payments, which enable only companies to participate. Offers of new tax arrangements offers to maintain spare capacity (this may be a requisit bidding) could be considered.