"PARTICIPATION POLICY" OF THE PRODUCING COUNTRIES IN THE INTERNATIONAL OIL INDUSTRY

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INTRODUCTION

WHEN THE LESS DEVELOPED countries seek to build up and develop their own autonomous national economies, a vital problem for them is the adjustment of relations with the so-called multinational enterprises which carry on transnational activities in the fields of capital and technology. For the pure exporters of primary products, such as the oil producing countries in particular, the most important policy problem is how to grapple with the historical fact that this basic industry, the most vital sector for their economic growth, has continuously been managed by a group of "international major oil companies" forming an enclave isolated from the local economy.

With the exception of the Mexican challenge in 1938,[1] the oil producing countries have avoided a resort to nationalization as an unrealistic policy after the tragic experience and results of the confrontation pursued by Mossadegh's Iran during 1951–54; rather they have tried to find a more moderate and realistic approach in order to foster their countervailing power against the international majors. Thus they have made efforts to attain a more adequate re-allocation of resources, based on a different point of view from that of the majors.

At the same time, the international oil market has steadily experienced an unprecedented expansion process, thanks to a skyrocketing increase in the world's energy demand, especially in Western Europe and Japan that have moved swiftly from postwar recovery to economic growth.

These and other factors led to the appearance of what the oil economists called the "Association System" between the consuming countries which sought the opportunity for new entry into the upstream operations and the producing countries which hoped to develop their resources without having recourse to the majors as an intermediary [7, p. 147ff.]. This has meant the opening of a road to achieve a "positive entry" into the oil business for the producing countries. And this type of

[1] The main reasons why the nationalization policy in Mexico under the leadership of President Cardenaz was successful may be summarized as follows: (1) The U.S. policy toward Latin America had just been changed into the new "non-interference" policy and/or "good neighbor" policy. (2) The international oil market became a seller's market following the outbreak of World War II. (3) In the long run, Mexico abandoned the status of a pure exporter. (4) Mexicans were eager to pay compensation to the companies concerned, etc. For further details, see [6].

joint partnership by the producers was defined by Muhammed A. Mughraby as "the control from within" [10, p. 54].

Other types of concessions have also appeared such as "Service Contract System" and "Production Sharing System" as non-equity partnership for the foreign investors. Thus, whatever the type it may be, joint partnership in which the public enterprise of the producing countries retains the management initiative has become prevalent in the present day oil industry.[2]

But on the other hand, the fundamental status of the international major oil companies has not changed, since the main sources of their low cost crude oil are protected by the long-term "Conventional Concessions" which are valid for another ten to thirty years' time. On the basis of these concessions, every decision regarding production and price has been made solely by the majors for the purpose of attaining their global optimum allocation of resources. The reduction of posted prices in February 1959 and August 1960 in the Persian Gulf area are examples of this.

However, the fact that the governmental revenues from the oil industry are calculated by using the posted prices as the taxation yardstick aroused the resentment of the producer countries, and encouraged them to establish OPEC (Organization of the Petroleum Exporting Countries) in 1960. The aim of this organization was to check and control the majors as much as possible through collective action, and for this reason, the OPEC approach has been defined as "control from without" by Mughraby [10, p. 117ff.].

The fundamental objective of OPEC, therefore, was to restore the pre-1960 price level in the Middle East, but no definite results were achieved aside from the handling of royalty as expenses in the main Middle East concessions and the adop-

2 Examples of the "Association System" can be listed as follows:

Iran: SIRIP (NIOC of Iran 50 per cent; ENI of Italy 50 per cent).
IPAC (the same as above; Pan American of U.S.).
FPC (the same as above; ERAP: SNPA of France).
IMINOCO (the same as above; ENI of Italy; Phillips of U.S., and Hydrocarbon of India).
IROPCO (the same as above; Tidewater group of U.S.).
LAPCO (the same as above; Atlantic group of U.S.).
PEGUPCO (the same as above; Gelsenberg group of W. Germany).

Egypt: COPE (EGPC of U.A.R. 50 per cent; ENI of Italy 50 per cent).
GUPCO (the same as above; Pan American of U.S.).
WEPCO (the same as above; Phillips of U.S.).

In the case of Algeria, the most famous example was Ascoop (Association Coopérative) between SONATRACH of Algeria and ELF-ERAP group of France.

Besides these partnerships, there are some examples of concessions in which the option to acquire equity shares in the future in accordance with the commercial production levels is recognized, such as Auxirap-Tenneco group, AGIP-Phillips group, and Natomas-Pakistan government group in Saudi Arabia, respectively; Ashland Oil, AGIP, and ERAP-SNPA in Libya; Qatar Oil, Abu Dhabi Oil, Middle East Oil in Trucial Coast, etc.

Typical examples of the "Service Contract System" are found in the ERAP-NIOC Agreement of 1966 and ERAP-NIOC Agreement of 1968, both of which stipulated the French partner as the general contractor of the state enterprise of the host countries.

The "Production Sharing System" is seen especially in Indonesia, and NOSODECO of Japan introduced this system into Egypt recently.

tion of the "tax reference price" in Venezuela where the realized price was used as the taxation standard rather than the posted price. Besides the fact that the majors, which were able to control the market, did not officially recognize the existence of OPEC, the main reason for the failure seemed to lie in the discrepancy of national interests among the member countries. But on the other hand, from August 1960 onward, the repeated reduction of the posted price was no longer possible, and this was recognized as an indirect success for OPEC. Aside from the abolition of various exemptions, however, no specific target was left against the majors, so that the raison d'être of OPEC as an organization came to be questioned.

Just before the opening of the OPEC Conference which was scheduled to be held in September 1967 after the "Six-Day War" in the Middle East, the *Times* of London carried an editorial titled "Deep Divisions Among the Oil Producers" and pointed out that this was, perhaps, the most crucial meeting in OPEC's history by reason of the widely different interests of the member countries and that it could even mean the end of OPEC as a real force in the world of oil [18]. Notwithstanding, OPEC avoided the crisis of disruption and continued its existence, and the member countries finally achieved their cherished desire to raise the posted price in 1971. Yet, before this achievement, they spent most of their time reconsidering the meaning of OPEC and preparing for the coming new age.

In the process of this reconsideration, the producing countries adopted the resolution on the Declaratory Statement of Petroleum Policy in Member Countries in 1968, in which they reconfirmed their common policy goals against the majors. Out of this statement arose an unexpected controversy involving what was called "the participation policy."

I. THE DECLARATORY STATEMENT AND THE PARTICIPATION POLICY

A. *The Declaratory Statement*

The Declaratory Statement of Petroleum Policy was adopted as Resolution XVI-90 at the Sixteenth OPEC Conference which was held in Vienna, June 1968 [13, pp. 11–12].

In the preamble of this statement, OPEC and its member countries reaffirmed that they do not necessarily intend to eliminate foreign capital, but expressed their intention to retain initiative concerning the oil business from a realistic point of view. This attitude underlies the whole text.

First of all, they recognized as the *Mode of Development* that (1) although they would endeavor as far as possible to develop their resources directly, the capital, specialists, and the promotion of marketing outlets required for such development may be complemented when necessary from alternative sources on a commercial basis; (2) when a member government is not capable of developing its resources directly, it may enter into contracts of various types with outside operators for a reasonable remuneration, taking into account the degree of risk involved, provided

that the government shall seek to retain the greatest measure possible of participation in and control over all aspects of operations.

Next, under *Participation*, they proclaimed that (1) where provision for governmental participation in the ownership of the concession-holding company under any of the present petroleum contracts has not been made, the government may acquire a reasonable participation, on the ground of the principle of changing of circumstances; (2) if such provision has actually been made but avoided by the operators concerned, the rate provided for shall serve as a minimum basis for participation.

Other than the above-mentioned clauses, (1) relinquishment, (2) posted prices and tax reference prices, (3) limited guarantee of fiscal stability, (4) renegotiation clause, (5) accounts and information, (6) conservation, (7) settlement of disputes, etc. were listed. Among other things, the price clause that "such price shall be determined by the government and shall move in such a manner as to prevent any deterioration in its relationship to the prices of manufactured goods traded internationally" actually had a potential influence during the Tehran negotiations in 1971, and has gained a vital significance in the traditional relations with the majors.

The second item of the text concerning "participation," however, is as much a remarkable proclamation as is the price clause.

B. *The Meaning of "Participation" and Its Background*

The expression of the resolution on participation is somewhat abstract and ambiguous, but according to Hasan S. Zakariya, Chief of the Legal Department of the OPEC Secretariat, who delivered a lecture to a seminar on petroleum economics organized by the Norweigian Petroleum Council, January 3–8, 1968, it has the following meaning:

> Government participation in the ownership of the concessionary companies has recently become a burning issue in the Middle East.... The introduction of the participation concept in the Resolution reflected the strong demand made by the representative of certain member governments more than six months ago for a share in the equity of concessionary companies operating within their territories.
>
> Of course, government sharing in the *profits* of the oil operations in one way or another, does not constitute participation in the true sense of the word. The most it can amount to is a *sleeping partnership*.... [In case of D'Arcy Concession of 1901, its amendment in 1933 and the IPC Concession of 1925, the governments concerned were given] the right to appoint a *commissioner,* a *representative* and a *director,* respectively, to attend the Board meetings of the operating companies concerned.
>
> It has become almost a generally accepted practice for OPEC member governments to nominate one or two representatives to the Board of Directors.... Nevertheless, such government representation on the Board has had in practice little or no influence on the decisions taken by these companies.... [It is, therefore, nothing but a] *symbolic or ceremonial* participation to the management.
>
> [But on the other hand,] it is to be noted that the San Remo Agreement concluded between Britain and France in 1920, stipulated that the Government of Iraq should be given the option of acquiring a 20 per cent share in any future oil concession in Iraq. In the IPC Concession of 1925, however, this stipulation was reworded in such a way as to make its implementation extremely difficult, if not impossible.
>
> The second paragraph of the Resolution concerning participation is designed to

> cover this specific case, making the 20 per cent share stipulated in the IPC agreement, but not yet implemented, the minimum rate of participation which Iraq is entitled to acquire.
>
> In practice, however, the major oil concessions will be the first and main target to be affected by the application of this policy.... We should also note that the doctrine of *changing circumstances* has also been introduced here as a justification for such participation. [20, pp. 3–6]

Thus the participation policy means a change from the idea of "control from without" to "control from within," and because of the latent importance that this change contained, an unexpected controversy arose thereafter.

II. NATIONALIZATION IS A NATIONAL NECESSITY: CRITICISM BY THE HAWKS

The first attack against the "participation policy" was made by Abdullah H. Tariki, a Beirut based consultant and former Saudi Arabian Minister of Oil.

After his resignation as Minister of Oil, he had maintained a hawk-like attitude toward the majors. In a paper he delivered to the Fifth Arab Petroleum Congress in 1965, he insisted that nationalization of the Arab petroleum industry was a national necessity [17]. In accordance with this belief, Tariki severely criticized the participation policy as being impossible to realize.

According to Tariki, since the existing concessions guarantee the oil companies' independence from the national economies of the host countries, only nationalization of the operating oil companies would free these commercial enterprises from the control of their parent companies and translate into reality the aspirations of the Ministers of Oil of Saudi Arabia and Kuwait. But if that is not feasible, the host governments can make use of their royalty crude to enter the international market and gain all the practical experience they are seeking. The independent entry of the host governments into the market should be accompanied by an expansion of the refining and petrochemical industries in the center of production because of the benefits this will bring to the local economies of their respective countries. In conclusion, he insisted that these benefits would contrast with the enormous economic burden which the host governments would have to shoulder if they were to acquire an equity interest in the transport, refining, and marketing installations of the parent firms of their operating companies, which would not yield a return on invested capital of more than 10 per cent [8, Nov. 1, 1968].

III. PARTICIPATION IS OUR GOAL: REPLY OF THE DOVES

In response to this bitter criticism, Sheikh Ahmad Zaki Yamani, Minister of Oil of Saudi Arabia, declared that he intended to support, in principle, the idea of participation in the "Conventional Concessions" by the producing governments and added that not he but the company introduced the idea in the first place and that the company agreed to the participation on the basis of the IPC concession. He also clarified that a part of the holding companies of the IPC has a connection with

the ARAMCO agreement and therefore King Feisal hoped to have a participation clause similar to that of Iraq [8, Nov. 29, 1968].

He elaborated further on the participation idea when he attended the third seminar on the economics of the international petroleum industry which was held at the American University of Beirut in 1969. In his speech entitled "Participation Versus Nationalization: A Better Means to Survive," he pointed out, first of all, the feasible results caused by nationalization under the present circumstances:

> Let us assume the optimum case, namely, that all nine—shortly to be ten—members of OPEC nationalize collectively and simultaneously.... What would be the consequences?
>
> Firstly, there is at the moment a substantial surplus of producing capacity in the oil market.... Secondly, nationalization of their upstream producing properties would inevitably deprive the Majors of any further interest in maintaining crude oil price levels.... Thirdly, we in the producing countries—having become the operators and sellers of our oil—would find ourselves involved in a competitive production race.... A situation of this sort could have only one outcome: a dramatic collapse of the price structure.... So it is clear that nationalization would be a disaster that would hurt all parties concerned in the oil industry. [19, pp. 214–15]

Then he referred to the participation concept as the antithesis of the nationalization approach, and said:

> Now, what about participation?... Perhaps it would be useful if I were to define exactly what I mean by the term *majors*.... I do not mean just the seven members of the club usually referred to.... The more price-conscious and market-conscious a company is, the better we like it; this is our criterion for the use of the term *major*.
>
> We like the consumers because they provide the outlets for our oil. And we like the majors because they provide the buffer element between us and the consumers which is indispensable for the maintenance of world prices.
>
> The majors, though still strong, are not what they once were. They are gradually losing their power in the market; their percentage share of the market will be diminishing year by year.... Notwithstanding, the majors are the only means of market stability available at the present moment. This is why they are valuable for us.... If prices start on a downward slide and the majors prove to be powerless to arrest it, then we shall have nothing to do with them.... This is why we are asking for participation with the majors now, before it is too late. *Our aim is firstly to strengthen the majors and their role, whether directly or indirectly, in the world market in order to maintain prices; and secondly to enable our national companies to grow in the market through the normal channels where we can really find our feet, with the benefit of the expertise of the majors, in downstream operations without hurting ourselves or anyone else in the process*.... It is clear that our motive for advocating participation with the majors is not financial....
>
> Now for the second question: In *what* do we want participation? In the production operations alone? The answer is no, not upstream only. *Our main target is the downstream operations.... What we want is a package deal comprising participation upstream and downstream, both together, to be introduced in a very gradual, reasonable and businesslike fashion.* [19, pp. 216–20] (italics added)

As cited above, Sheikh Yamani expressed his determination concerning direct equity participation into the global "Vertical Integration" management of the majors.

Yet it was not clear in his explanation as to whether he was seeking to acquire the equity shares of the parent companies such as Standard Oil Company (New Jersey) and the like, or hoping to join the operating companies such as ARAMCO, Esso Italiana, and so forth. However, it is quite apparent that he proclaimed transnational or international policy considerations from the standpoint of the oil producing countries.

Side by side with this opinion, Kuwait also made clear the same idea about a fully integrated type of participation through Ashlaf Lutfi, former Secretary General of OPEC as the spokesman, and the Chief of State in his State Message to the National Assembly afterwards, also officially recognized participation as one of the main policy goals [5] [8, Nov. 8, 1968] [8, Nov. 29, 1968].

Following this statement Abd al-Rahman al-Ateeqy, Finance and Oil Minister and the chief delegate of Kuwait, stated on the occasion of the opening speech at the Seventeenth OPEC Conference which was held in Baghdad on November 9, 1968, that the idea of participation had already engendered a favorable response in some of the member countries, and he urged that an effort be made to integrate and coordinate this problem [12, pp. 3–4].

Since the agenda of the OPEC conference is supposed to go through due formalities of the board of directors beforehand, this proposition was somewhat of a shock to all other member countries. For this reason the conference switched the meeting into a secret session at once in order to discuss the matter.

According to the informed sources, Rashid al-Rifa's, Iraqi, delegate, submitted a motion at this secret meeting to take up the participation matter for full discussion, and Kuwait, as might have been expected, seconded this proposal. Ultimately the seventeenth conference avoided adopting a definite resolution and ordered the secretariat to study the participation problem [8, Nov. 15, 1968].

This indicated that there was a disparity of interests among the member countries on how to treat the problem. In any case, the conference ended with the result of shelving the matter for the time being.[3]

IV. CRITICISM OF THE PARTICIPATION THEORY BY THE COMPANIES

It seemed, therefore, that the controversy on the participation policy had almost disappeared from the public scene but it was revived in another form when the

[3] According to the report made by Ian Seymour, the News Editor of *MEES*, the issue really only concerns the Middle Eastern members; of the other two, Indonesia already has its own production sharing pattern and Venezuela is not really interested in the idea as far as its own plans are concerned. The real standard bearers of participation, and those upon which the brunt of any future negotiations will fall, are Saudi Arabia and Kuwait. Iraq, of course, though also a keen partisan of participation, is somewhat handicapped by the formidable backlog of its other long-standing disputes with the IPC group. For their part Iran and Libya (which has the problem of the sheer proliferation and diversity of its concessionaires) appear to be content to adopt a wait-and-see position for the time being, leaving the front-line campaigning to the others [8, Nov. 15, 1968, p. 4].

majors, as the concessionaires, called the producing governments' attention anew in December to the sanctity of the contracts.

A. *Paper Submitted by Dr. Habachy*

R. I. Brougham, the President of ARAMCO, one of the biggest companies operating in the area, sent a letter to the editor of *Middle East Economic Survey* of Beirut, in which he wrote as follows:

> Publications in recent weeks, including *MEES*, have referred to claims by producing countries to a right to "participation" in oil concessions based on what is described as the legal principle of change of circumstances. I hope that in the interest of dispassionate analysis of such allegations you would be interested in bringing to the attention of your readers the views of a distinguished Arab jurist on this theory, and I enclose herewith a copy of a summary opinion by Dr. Saba Habachy on the subject. [8, Dec. 20, 1968]

Having received this letter to the editor, *MEES* carried the whole paper of Habachy in its December 20 edition of 1968. Although it was a letter from him to William L. Owen of ARAMCO, whatever the form, it can still be regarded as an informal opinion of the majors represented by ARAMCO.

According to this theory, an oil concession agreement is international or transnational in character and is governed in the first place by the law of the contract itself. The validity and binding force of such agreements have been recognized and upheld according to general principles of law recognized by civilized nations including, in particular, the Shari'ah. One of the major principles, among other things, is *pacta sunt servanda*, that contracts are to be fulfilled. There are some, however, who have recently asserted that this great principle should be qualified by the theory of *rebus sic stantibus*, or some analogous concept, arguing that a contract should be honored only so long as circumstances remain the same as they were when the contract was made, thus introducing dangerous elements of uncertainty and economic instability into contractual dealings. The theory of *rebus sic stantibus*, which seems to be more suitable for termination rather than alteration, has not found acceptance in international law [8, Dec. 20, 1968].

Dr. Habachy added in his concluding remarks that even the two fundamental sources of Islamic law, the *Quran* and *Sunna*, do not support the theory of *rebus sic stantibus*, and that an arbitration agreement concluded in 1955 between the government of Saudi Arabia and ARAMCO also recognized respect for all the obligations which they have undertaken and now undertake [8, Dec. 20, 1968].

In short, the opinion of Dr. Habachy, regarded as ARAMCO's official thinking, seems to have rejected the participation theory as a one-sided and selfish idea contrary to the original concept of the contract per se, and to have suggested the absolute necessity of the other contractual party's consent as the only way of changing the contract.

B. *The Opinion of Shell*

This type of opinion is not limited to ARAMCO alone but is common to all the

majors. The Shell group, for example, reproached the producing countries concerning the participation matter and other ill-considered ideas that they held.

In a statement to the Foreign Press Association in London on February 19, 1969, David Barran, the Chairman of the Shell Transport and Trading Company, gave a stimulating review of his company's attitude on the OPEC demand for equity participation in the established concessions, as follows:

> So we see the Middle East producing countries concerned about the future availability of money, anxious about the possibility of falling away in demand for their crude, and eagerly seeking ways of securing their position. The fashionable solution at the moment is to get what is politely called *participation*. Participation in what? Basically, in oil production of course, but beyond that participation in the whole chain of operations that takes the crude oil from the wellhead to the final customer in Europe, Japan, Australia, or wherever it may be.
>
> Markets for their oil are things that the international companies have built up with enormous care and vast expense over many years; we could not be expected to hand them out on a plate to anybody, whatever the pressures; nor, even given the will, would it be a practical possibility.
>
> There is really only one way of getting into the market, and that is the hard way. Spend your money, train your staff, build your refineries, create your distribution networks, and gradually work your way into a most competitive environment. It is a slow process and a very expensive one.
>
> I doubt whether the Middle East governments have either the time or the resources for it. Of course, arrangements between governments and the companies will not remain static, nor should they. The last ten years have brought many changes; the next will bring many more. But the basic structure, which has worked so well for so long, is not likely to be superseded. Realistic agreements will undoubtedly be worked out that will reflect changing circumstances. But they will continue to be firmly based upon the triple interdependence that exists between the producing countries who have the oil, the consuming countries who need it, and the international companies who provide at one and the same time the link and buffer between the two. [8, Feb. 28, 1969]

It is understood, therefore, that the opinion represented by Barran has reaffirmed an absolute negative answer toward the participation idea, pointing out that business management is not such a simple task as the producing governments think but is rather a thing to be built up through arduous work as well as paying out one's precious money. To talk arbitrarily in such vague terms about "participation" simply means the desire for a free ride.

V. LATEST DEVELOPMENT CONCERNING THE PARTICIPATION POLICY

As mentioned above, the majors, as the contracting parties, refused to accept the participation idea which aims at the conversion of "control from without" into "control from within" toward the conventional concessions.

These statements by the majors, however, aroused repercussions from the Arab side. A series of "letters to the editor" appeared in the *Middle East Economic Survey*. It will suffice here to note that almost all of these assertions rested on the

principle of changing circumstances in the light of the public interest [8, Jan. 31, 1969] [8, Apr. 11, 1969].

On the contrary, Sheikh Yamani, who advocated this idea of participation, deplored the legalistic wrangling which developed into an unexpected direction, and said, "we did not expect ARAMCO and the other oil companies to accept the principle of participation at the moment it was announced.... The road is long and difficult.... Legalistic wrangling is tangential to the main issue and engaging it would be in the interests of neither party. . . " [8, Jan. 17, 1969].

Taking the re-emerging controversy into account, OPEC, as the formal advocate of participation, discussed the matter again at the eighteenth conference held in Vienna on July 8–9, 1969, yet it ended with no specific conclusion [13]. Thus, the controversy on participation seemed to dwindle away.

A. *Toward the Concept of Internationalization*

Despite the unfruitful result mentioned above, since the participation idea is the policy ideal for the producing countries, there is a need to understand the reason why they are concerned about such a policy under the present circumstances.

The assumptions which underlie the participation idea seem to be derived, firstly, from their understanding of the fundamental structure and behavior of the international oil industry which has historically developed centering on monopolistic international or transnational enterprises that have transcended national boundaries, and, secondly, from the conviction that it is impossible for them to protect their national interests unless they enter and/or check the activities of the multinational enterprises through direct or indirect means.

As already elaborated by J. Fayerweather on the fictitious model of Colton Inc. and by Prof. E. J. Kolde on the conceptual model of the global management system [1, p. 50] [3, p. 250], the multinational enterprise has had a management philosophy which seeks the optimum allocation of the resources as a worldwide integrated industrial complex rather than the self-supporting system of the various unit operating companies separately.

In the case of the international oil industry, however, the systems of management are far more complicated than the above-mentioned models. But still it would be very useful to assume the models as appropriate in explaining the fundamental features.

Take the crude oil production in Saudi Arabia for example. The oil produced by the operating company named ARAMCO which is owned by Standard Oil Company (New Jersey), Texaco, Standard Oil Company of California, and Mobil Oil Corporation is sold, not all but more than half, to the subsidiary refining or marketing companies such as Esso Italiana, S.p.A., etc. in Europe, Japan, or elsewhere through the transferred price mechanism. And some of the profits derived therefrom would be allocated to other subsidiaries such as Esso Libya, etc. which are engaged in prospecting. Thus the majors are able to balance their respective optimum reallocation of the economic resources to such an extent that the anticipated level of growth of their total business organizations is kept constant.

According to Mrs. E. T. Penrose, the re-investment funds financed through the transferred price mechanism seem to be recognized as a sort of indirect tax levied on the consumers of the finished products [14, p. 41].

Nevertheless, if Saudi Arabia is taken as an example, there is a strong impression of exploitation by the majors because a part of the profits gained through the sales of the crude oil which is produced in her national territory is invested in other oil producing areas and this would give rise to a minus effect against the competitive position of its own crude oil in the international market afterward.

The same thought must have been in the mind of Premier Mossadegh of Iran when he asked Anglo-Iranian Oil Company for 50 per cent of the total profits derived by the latter not only from their operations in Iran but also from the downstream operations in Europe and other areas [9, p. 111].

Nationalization by a single country, however, does not guarantee effective results in controlling the business activities of the multinational enterprises which are vertically integrated, as Servan-Schreiber pointed out in his *Le défi américain*, and the tragic downfall of Mossadegh remains as a bitter experience in the memories of the producing countries [16].

The only means left to save their positions is entry into the international market as much as possible by themselves. The Iranian investment in the Madras Refinery project is an example of such an approach. Yet, the downstream investment such as refining and marketing requires a huge amount of financial resources and strenuous efforts to surmount severe competitions, so that it is generally beyond the capacity of the producing countries.

Even if it might be possible for them to create a global network of the downstream operations in the long run, it would affect the established market held by the majors. And this is not advisable, therefore, at least in a short-term perspective, for the revenues of the producing countries rest primarily on the oligopolistic market power of the majors.

Bearing those conditions in mind, the producing countries came up with the idea of sharing the taxi with the majors by paying as small a fare as possible under the name of participation [8, June 6, 1969].

B. *Development in Algeria*

There appeared, however, a country which has achieved a partial entry into the oil business by taking a unique opportunity which has nothing to do with the participation policy, and is likely to have almost perfect initiative in so far as the domestic oil industry is concerned. Needless to say, it is Algeria under the leadership of Boumedienne.

In the case of Algeria, the fundamental features lie in the fact that (1) the relatively short history of the oil industry which started in the latter half of the 1950s; (2) the French government as a colonial ruler limited the acreage of a unit concession in order to avoid the probable control by the majors from the outset, and adopted the system under which French capital can share in each concession; (3) for this reason, at the very moment of Algeria's independence as confirmed by the

Evian Agreement, the status of ownership held by the French government in the Algerian colony was succeeded automatically by the newly independent Algerian government, so that the latter could enter the oil business without any toil.

Since then, there appeared in 1965 a new direct partnership named "Association Coopérative" which was concluded between SONATRACH of Algeria and ERAP of France, and thus the road of participation into the actual operations was opened.

This fruitful result in Algeria depended mainly on the special relationship that existed with France. How efficient the Algerian management and technical know-how are needs closer examination, yet it is quite interesting that George Lenczowski recognized SONATRACH as almost the only successful exception among the state enterprises of the producing countries [4, p. 78].

Against the background of this special situation, the Algerian government decided to place the British and American properties in Algeria under governmental control as a countermeasure against their pro-Israeli policies at the time of the "Six-Day War" in 1967, and nationalized them in 1970 except for the Getty Oil concession which admitted the 50 per cent participation of SONATRACH.

This nationalization, however, seems to have an entirely new element compared with the traditional ones. The usual nationalization in the past meant the expropriation of the visible assets such as plants, port facilities, pipelines and the like, but in case of Algeria it meant the confiscation of the ownership of various concessions, i.e., the compulsory take-over of the equity shares held by the parties concerned. This was the transfer of so-called "invisible assets" called ownership, and therefore a sort of stock subrogation.

Accordingly, this type of nationalization resulted in SONATRACH, becoming the biggest shareholder in such operating companies as the Algiers Refinery, sitting with management and other shareholders such as French.[4]

The Algerian government later carried out a partial nationalization of the French oil interests in its territory on February 24, 1971. In other words, the Algerians expropriated 51 per cent of the French ownership instead of a 100 per cent take-over [8, Mar. 5, 1971]. This was regarded as a very shrewd tactic like a sort of scotching a snake, so much that the French requested a total nationalization [8, Mar. 5, 1971].

C. *OPEC Tehran Accord and the Confidence of the Oil Producing Countries*

It is very difficult to forecast at the moment whether or not Algeria's nationalization policy would be successful in the long run. However, it occurred under the

[4] At the moment of nationalization in June 1970, the properties of Royal Dutch-Shell group in Algeria were as follows:

CPA	65 per cent
CREPS	35 per cent
Algiers Refining Co., S.R.A.	24 per cent
Trapco Pipeline	35 per cent
Sofrapel	50 per cent

In this connection, Mobil Oil Corporation, whose properties in Algeria were expropriated in November 1970, regarded it as the transfer of ownership [8, Nov. 12, 1970].

changing circumstances in which the power balance has shifted favorably for the producing countries, thanks to the steady increase of the demand for oil beyond expectation, and this fact was publicly confirmed through the OPEC Tehran negotiations on the price matter.

At the Twenty-first OPEC Conference which was held in Caracas on December 9–12, 1970, a challenging resolution was adopted which was inspired by the unexpected success of the tough negotiations carried out by the revolutionary Libyan government a couple of months previously. Based on this resolution, the Gulf producers headed by Prime Minister Amouzegar of Iran held in January 1971 a series of collective bargainings with the international major oil companies operating in the area concerning a price increase of Middle Eastern crude oil.

The detailed process of the negotiations held in Tehran was reported by the newspapers almost daily, and it may suffice to say that a price increase was achieved in favor of the producing countries in the form of a sweeping victory for OPEC. Because this result was actually the fulfillment of their long-cherished desire during the decade since the establishment of OPEC in 1960, it was therefore recognized by one of the Western papers as a "clear shift in power" in favor of the producing countries [2].

Gaining great confidence, the producing governments began to turn their attention to the participation idea again. After the second increase of the crude oil price in relation to the dollar devaluation in January 1972 [8, Jan. 21, 1972], OPEC nominated Sheikh Yamani, who had championed the participation principle, as the chief negotiator for the Gulf states concerning partial participation in the conventional Middle East oil concessions.

The negotiations have been protracted since the latter part of January, yet according to the *Middle East Economic Survey*, at least one thing was clear from the preliminary soundings on the participation question between OPEC and the company representatives in Geneva on January 21–22. That is, the company response to the OPEC demand was far from being a flat no to participation as such, and there were sufficient indications of the companies' preparedness to get down to serious discussion in a more intimate atmosphere [8, Jan. 28, 1972].

As might have been expected, *MEES* continues, the principal and crucial disagreement has now been unmistakably identified as the question of compensation or, more accurately, the price that the OPEC countries are prepared to pay for the working interest that they propose to acquire in the concession ventures [8, Jan. 28, 1972].

The first round of talks between Sheikh Yamani and the company representatives, however, ended with strong opposition ostensibly by the companies. The main points demanded by Sheikh Yamani at this time may be summarized as follows:

(i) Payment for the interest in the concession venture which the OPEC governments plan to acquire would be effected *on the basis of net book value*. Payments would be made in cash installments over a period of five years or so, with interest at market rates.

(ii) *Proposal on a guaranteed "buy-back" arrangement* with the companies, under which the latter would undertake to purchase all or part (at the option of the

governments) of the governments' share of production *at a "half way" price* based on posted prices (that is to say half way between the tax paid cost and the posted price) *minus, if and where necessary, and incentive discount or sales commission* to be agreed upon by negotiation.

(iii) The actual percentage target for participation was left entirely to individual member states or groups of countries. However, the six Gulf states have apparently let it be understood that their *initial target is a minimum of 20 per cent, rising to an ultimate maximum of 51 per cent* over a period of time to be negotiated. [8, Jan. 28, 1972] (italics added)

In regard to this proposal, the company delegates were reported as describing participation on the basis of net book value as tantamount to "partial nationalization" or even "confiscation" of their producing properties, and to insist that the only fair basis for evaluating such cost of acquisition would be some formula which takes into account the companies' future loss of profits and damages [8, Jan. 28, 1972].

D. *Final Attainment of Participation*

Although the details of the negotiations are not yet clear, Saudi Arabia and other Gulf member states of OPEC rejected an offer made by ARAMCO on February 15, and the OPEC countries were scheduled to hold an extraordinary meeting of the ministerial council in Beirut on March 8 to decide upon what action to take.

Amidst the strained atmosphere prevailing in OPEC, the *New York Times* reported that on March 10 Sheikh Yamani received a letter from ARAMCO in which the company finally agreed in principle to the demand of the producing governments for a 20 per cent share in the company [11]. Although this offer is understood to be applied only for ARAMCO, this new position would unmistakably become the model sooner or later for the other concessions at stake.

CONCLUDING REMARKS

According to reliable sources in OPEC, further long and difficult negotiations lie ahead in order to finalize the agreement on the matters concerned, so that the time is not ripe to evaluate the whole picture [11]. However, the victory of the OPEC movement on what they call participation can be acknowledged.

Attention should be given, in this connection, to the fact that one of the reasons why they were successful was the tactic of limiting their target to the upstream sector. This means that their entry into the upstream business managed by the majors does not automatically include participation in the international business in the strict sense of the word, but they are able to exert an important effect upon the decision-making process of the international transactions carried out by the majors. Thus it would mean a great stride toward the emergence of a greater "internationalization" of business than the present day multinational system. If so, it would be an epoch-making event in the history of the oil industry.

In relation to this structural change of circumstances, Dr. Paul H. Frankel, one of the most eminent oil economists, has recently advocated a noteworthy way of thinking as follows:

Truly internationalizing oil—particularly in the main established Middle East oil areas—is the answer to today's energy supply situation, the changes that have occurred in the structure of the international oil system, and those that are yet to come. . . .

What is called for is entry of consumer-country *late-comers* into the main oil areas with the *full consent* of the producing governments and of the existing international oil companies. This would create a *triangularly balanced situation*—and if possible, it should be done by three-way agreement, not by direct government-to-government deals. [15]

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