CHAPTER - VI

SUMMARY OF FINDINGS

Oil plays a vital role in the economic life of the underdeveloped countries of the world, particularly for nations with enormous oil deposits. For the countries located in the Middle East, oil exports provide not only a large share of national income but also most of these countries' foreign exchange earnings. Oil thus represents the great asset which could potentially provide all the capital necessary for economic development of these countries.

World production of oil in 1930 was around 250 million tons and proven reserves were then a little more
than 4,000 million tons. Between 1950 and 1960 production doubled and proven reserves increased three-fold. Owing to the discovery of enormous oil fields, particularly in the Middle East, the cost of producing crude oil today is extremely low relative to its price. Historically, oil companies which hold monopolistic control over the world's crude oil play a prominent role in the oil industry, since they have the competitive advantage of relatively low cost products from their huge refineries in the Middle East. OPEC countries because of their huge oil resources, have been playing a significant role in production, supply and marketing of oil in the world.

Between 1965 and 1985 world crude oil reserves have increased from 353,218 million barrels to 741,237 million barrels, showing an increase of 52 per cent. In the case of OPEC, proven reserves have risen by 49 per cent from 260,345 million barrels to 509,723 million barrels during the same period. OPEC accounts for 78 per cent of the entire world oil proven reserves. However, the world crude oil proven reserves have increased at a faster rate (2.85 per cent) than OPEC crude oil reserves (2.19 per cent).
The world oil production takes place in three important areas viz., USA, USSR (Now Commonwealth of Independent States) and OPEC countries. World oil production has increased in 1984 for the first time since 1979. This rise in production occurred only outside the main exporting group, mainly in the northern sea and in some of the non-OPEC developing countries. OPEC countries had produced on an average 17.6 million barrels per day in the last quarter of 1985, whereas the production of non-OPEC countries was 28.6 million barrels per day. However, during the period from 1973 to 1989 different patterns of growth of production of oil in different countries is observed. OPEC has exhibited a negative growth (-2.99 per cent) while the non-OPEC and GCC states have recorded a significant positive growth. World crude oil production declined by 0.5 per cent in 1985 over 1984 and by 0.2 per cent in 1991 compared to 1990. The share of OPEC in the world production during 1990-91 stood at 39 per cent.

Prior to 1960s the supply of oil entering the OECD markets was controlled by a few large powerful oil companies. Between 1970 and 1989, the shares of seven majors in the crude ownership and product sales have fallen from 61 per cent to 37 per cent and 50 per cent to 39 per cent respectively. A reverse trend is observed.
in the case of government owned petroleum enterprises. The supply of oil has increased by a moderate pace reflecting the world demand for oil.

There is no consistency in the growth of world demand for oil and we notice fluctuations in world demand for oil. The world demand for oil varied between 46 and 52 million barrels per day during the period 1973-1989. The demand for oil has shown negative growth in all the countries except third world countries in which the demand for oil has grown substantially (2.57 per cent per annum) during the period from 1973 to 1989. The major factors responsible for decline in oil demand in most of the countries have been the slowing down of the world economy and the rise in the price of oil in 1990. There is positive relation between the rate of Gross Domestic Product (GDP) and rate of growth of oil consumption.

An effective means of pricing crude lies at the heart of a thriving international oil market, which in its turn provides a sound base for steady growth of the world's oil economy. The nature of OPEC pricing has been altered over the years when OPEC took over the oil pricing role from the multi-nationals in early 1970's. It adopted what was effectively administrative pricing. The situation
changed during the course of the 1970s when the rapidly rising prices in international market encouraged OPEC to set prices reflecting the prevailing market conditions. As crude oil prices started to fall in 1982 and 1983 due to the rapid decline in demand, the draw-down of stocks previously had to support higher oil consumption and to cushion against the disruption of oil. OPEC's effort to arrest the downward trend in crude oil prices through production management did not prove successful because of lack of cooperation from non-OPEC producers.

The oil market instability of the 1980s was primarily due to the wide gap that existed between supply and demand. Since the de-integration era of the 1970's neither the oil companies nor the producers had the capability to effect a smooth balance between demand and supply, as was the case previously under the majors. Following the deintegration of the upstream and the downstream activities in the 1970s, the emergence of the spot market served the useful purpose of relinking the two sectors. Thus uncoordinated efforts by the major participants to narrow the wide gap existed at the early part of the decade between supply and demand of oil market in the 1980s. It is expected that oil demand will continue
to rise in the 1990s although its share of energy-mix will fall from 46 per cent in 1990 to 43 per cent by the year 2000.

To producing countries, the significance of crude oil price was primarily related to their revenue from oil exports. In almost all cases, oil revenue accounted for the largest part of total government income, amounting to 99 per cent and more in some cases. However, between 1980-89, GCC oil production has experienced a significant fall (-3.18). As a result, both revenue and percentage change in revenue of oil producing countries from oil has fallen at -6.97 per cent and -311.54 per annum respectively.

Business agreements and unconscious parallel action to follow restrictive business practices are more frequent. The history of these agreements or understandings is one of cut-throat competition followed by understandings which break downs when there is excess capacity. In numerous cases in industry, governments support the business understandings to maintain price level when private industry by itself proves incapable of so doing. The history of oil is edifying in this respect. Without oil, the Middle East would be very different and indeed
oil has changed the political and economic structure of the Middle East and dramatically influenced political alignments, both within the region and the world's great powers.

The first Arab Petroleum Congress, which was held in 1959, has recommended that there should be no reduction in the posted price by the companies without consulting the oil-producing governments. However, the oil companies resorted to price cuts during 1959 and 60 without consulting the governments involved. Reacting sharply to this unilateral action by the companies, five countries which account for 80 per cent of world oil exports met in Baghdad and announced the creation of OPEC in September 1960. The creation of OPEC marks a turning point in the struggle of the Middle East countries to control their own resources. It marks the emergence in the 1950's of what might be called an 'Oil consciousness' among the producing countries.

The Organisation aims at safeguarding the interests of member countries individually and collectively. The membership of the organisation is divided into three types, viz., Founder Member, Full Member and Associate Member. The organisation comprises the five founding
members and eight other full members. There are three bodies, namely, the Conference, the Board of Governors and the Secretariat in the Organisation. The Conference is regarded as a supreme authority of the Organisation; Board of Governors includes one representative of each member country, nominated for two years by their respective governments and confirmed by the Conference. The Secretariat is permanently based in Vienna and the office of the Secretary-General is located in it. The functions assigned to the Secretary General are carried out by the office of the Secretary-General and five departments, viz. technical, administration, legal, economic and information.

The achievements of OPEC may be evaluated in terms of net benefits member governments have received, whether economic and non-economic. OPEC concentrated on establishing a uniform policy, ironing out the differences that existed between the oil producing countries and the oil companies with respect to price, royalties and production. During the first ten years of its existence, OPEC did not reach its goals, but since 1970 it has been increasingly effective. The first task which set for itself was to stabilize oil prices and keep them steady and free from
fluctuations. The OPEC members finally realised that they had insufficient power to force oil prices up. From 1982 they sought to obtain by means of increasing royalties what they had been unable to obtain by demanding price increases. Several factors explain OPEC's basic inability to obtain fundamental changes in the position of the oil exporting governments in the 1960s'. Nevertheless, the Organisation succeeded to some extent in preventing the oil companies from imposing further reductions in oil prices. After initial failures, OPEC bunched phase two of the campaign to secure better arrangements for producing countries by eliminating various allowances and discounts by which the large oil companies secured greater benefits. When OPEC is established, royalty payments to host governments were in the form of royalty per barrel, usually 12.5 per cent of the posted price. Later, the royalty in effect became a payment to the companies rather than countries. After 1970 OPEC was able to topple old oil regime and resorted control to the legitimate owners of the oil reserves and empowered them to make independent decisions within the framework of burgeoning national sovereignty. OPEC countries finally emerged as the sole determinants of their oil policies.
This rise in power brought in its wake enormous dividends. The price of oil quadrupled between 1972 and 1974 and doubled again between 1979 and 1980 and oil revenues increased substantially.

Since its inception, OPEC remained a powerful and effective organisation pioneering the rights of producers of primary commodities to have a say in determining the value and volume of these commodities. OPEC's objective is to coordinate and unify petroleum policies among member countries in order to secure fair and stable prices for petroleum producers, supply of petroleum to consuming nations, and a fair return on capital to those investing in industry. The GDP of OPEC countries has declined by an average of 2 per cent in 1985. This is due to reduction in oil export revenues, a fall in the oil output and a decline in petroleum prices.

The combined GDP of 13 members countries of OPEC was around $246.7 billion in 1975 and this was expected to increase to $385.2 billion in 1980 and $388.3 billion in 1985. Iran retained the largest GDP among the OPEC countries during the above period. Economic growth slaked in respect of Saudi Arabia and the UAE because of long-term problems and non-oil investment opportunities. The
total area of OPEC countries stood at 12,784 thousand Sq.Kms. Average GNP per capita for all the OPEC countries taken together stood at $ 1,599.

In respect of crude oil reserves, OPEC countries had 260,345 million barrels in 1965 which has increased to 509,723 million barrels in 1985. The increase in crude oil reserves works out to 49 per cent. The share of OPEC countries in the world oil reserves stood at 70 per cent during 1978. However, there was a decline in the share of OPEC in world oil reserves between 1979 to 1981. Afterwards an increasing trend is noticed in OPEC's share.

Production of oil of OPEC countries depends upon governmental plans, revenue needs and production capacity. Crude oil production of the member countries increased from 14,339 thousand barrels per day to 31,253 thousand barrels per day between 1965 and 1977. However, it has fallen by 50 per cent in 1985. As a result, OPEC's share in world oil production has fallen to 29 per cent by 1985.

The refining industries of the OPEC member countries expanded considerably in recent years. The refining capacity has increased from 2,651 thousand barrels per day
in 1965 to 6,610 thousand barrels per day in 1985, showing an increase of 149 per cent. The demand for OPEC oil has increased. Independent actions Governments of oil producing countries in the area of marketing and investment planning has led to serious consequences in marketing oil. The governments take per barrel of oil for OPEC was 78 cents in 1960 and 85 cents in 1968. Between 1960 and 1971, OPEC's bargaining power improved. The prices of oil had increased during 1973-74. However, the immediate impact was not felt. Between 1978 and 81 oil prices again increased due to panic buying and cutbacks in two OPEC countries.

In 1971, after the Tehran agreement another agreement was successfully concluded. This created a new pricing system under which the tax ratios were amended upwards, forced prices were increased substantially to reflect market increase through the withdrawal of all discounts and price rebates enjoyed by the companies and the system of price differential among the various quantities of crude oil was revised.

The domestic consumption of petroleum in the OPEC countries has been increasing at a very fast rate, the
rate of increase being as high as 16 to 20 per cent in some years. The petroleum exports of each OPEC country are assumed to be approximately equal to the countries production less domestic consumption of petroleum. The value of petroleum exports has increased by 1561 per cent between 1965 and 1985. Petroleum exports reached the peak level of $ 282,341 million in 1980. Afterwards, there was a continuous decline. In the case of non-petroleum exports, we notice a steady growth from $2,326 million in 1965 to $22,366 million in 1985, showing an increase of 826 per cent.

As far as revenue is concerned, prior to 1975 oil prices and government per barrel revenue differed by as much as 40 per cent with the difference going to the concessionary oil companies. OPEC followed more increasingly conservative approach in determining oil prices.

Combined imports by 13 member countries of OPEC (projected at $ 56.9 billion in 1975) were expected to reach $100.2 billion in 1980 and $122.3 billion in 1985. Out of it, approximately 69 per cent of the total OPEC imports came from eight member countries located in Middle East and North Africa. Between 53 and 59 per cent of the total United States exports have gone to OPEC countries.
OPEC states occupied the first six position in ranking among all donor countries in respect of aid. The OPEC fund began its operations in August 1976 with initial contributions of approximately $800 million. The transfer of funds to other agencies made the net resources available to OPEC fund for its direct operation of over $1.2 billion. The fund basically provides balance of payments assistance to countries with severe deficits in their current account and it extends loan for economic activity. During the course of its operations, the fund extended its activities with emphasis on helping low-income countries. Regarding geographical distribution of loans Africa stands at the top.

The role of OPEC member countries in cooperation with other developing countries through the difficult years to come may best be seen in the context of some objectives. OPEC's role has been generally seen as provider of funds on concessional terms. Furthermore OPEC's long-term strategy committee has already adopted a proposal advanced by Iraq for the establishment of a new global fund for energy and development to be financed by both industrialised countries and OPEC countries.

Petro-dollar surpluses of the OPEC increased substantially as a result of the two oil price hikes of
1973 and 1979. Immediately after the first price hike, the total investible surpluses of OPEC were $61.50 billion and reached the maximum of $123.25 billion in 1980, after the second oil shock. Yet after each peak period surpluses have tended to decline. Increasing OPEC funds in developing countries would bring about the necessary change in effective demand because of the existence of huge needs for investment there. Two thirds of the OPEC's assets are going into long-term portfolios such as equities and real estate as well as non-concessional transfers to the LDC's both bilaterally and through multilateral institutions. In recent times OPEC repeatedly claimed that the responsibility for stabilizing the aid market does not and should not fall on its shoulders alone.

The Islamic Republic of Iran was born out of the Iranian Revolution of February 1979. She is bounded by USSR (new Commonwealth of Independent States) and Caspian sea on the north, Gulf and Arabean sea of the south, Afghanistan and Pakistan on the east, and Turkey and Iraq on the West. Iran is an oil exporting country with very large oil revenues, substantial oil reserves and an extensive capacity to absorb the newly gained capital.
Of all the OPEC members, Iran may be in the best position to take the advantage of its increased oil revenues.

The population of Iran according to 1980s estimates was 37.9 million with a geographical area of 1,648,000 Sq.Kms. The GNP per capita in 1980 was US $ 1,970. Even though agriculture is the principal economic activity of the Iranian people, only 19 million hectares are cultivated, out of which five million hectares are fed with perennial irrigation. Agriculture employs 35 per cent of the country’s population and accounts for less than fifteen per cent of the Gross National Product. Wheat, barely and paddy are the chief cereals crops while cotton, sugarbeat, tea, almonds, pistachios and dates are the important commercial crops in the country. The average rate of growth in agriculture is 5.5 per cent.

Lead, zinc, chrome, red oxide, sulphur and iron ore are the chief minerals available in the country. Steel, petrochemicals and copper are the three basic industries. Between 1976 and 1985, the production of primary aluminum and copper has noticed an increasing trend while the production of other minerals declined.
Iran nationalised its oil industry in 1951 and the wholly state-owned National Iranian Oil Company (NIOC) was formed. Since then, Iran has signed many agreements and contacts and from March 1979, Iran has been selling oil directly to individually companies. Oil industry is considered as life blood to Iran's economy and it earned some $12.5 billion foreign exchange revenue in 1989. The country was producing 6 million barrels of crude oil per day.

The Iranian oil industry is steadily recovering from devastation of the country's war with Iraq and it is well on the way to regaining its earlier position as a leading oil and gas producer and exporter. The main producing fields of crude are the Agajare/Karani/Marun/Paris complex together with Gachsran, Bibi, Hakinech and Ahwaz. In 1968 NIOC embarked on a new formula for oil development in which foreign partners were brought in as contractors working for the company. With all the efforts Iran has become an important holder of crude oil reserves in the world. Three-quarters of the total oil reserves exist within the OPEC members, Iran ranks third. With regard to proven crude oil reserves Iran holds 92.9 billion barrels or 10.4 per cent.
Iranian production suffered a severe fall during the Anglo-Iranian war and recovered later with output of more than 5 billion barrels per day during 1970s. Iranian crude oil production increased from 1,908 thousand barrels per day to 5,350 thousand barrels per day between 1965 and 1975 and it declined to 2,000 thousand barrels per day in 1986. Iran experienced increase in oil production and corresponding revenue after the creation of OPEC. However, the country has not been able to repeat the production peak, partly because of the 1979 Iranian revolution, civil war, low oil prices and its strict adherence to OPEC production quota. The production capacity has slumped from 6.7 million barrels per day about 20 years ago to the current 3.5 million barrels per day.

The Iranian refining industry is long established. About 600,000 barrels of crude oil is refined per day. The Teharan refinery plays a vital role in meeting domestic supply. In 1965, 101 thousand barrels of refined products were utilised for domestic consumption. This has increased to 735 thousand barrels per day in 1985.

Regarding foreign trade balances, Iran experienced deficits in the early 1960s. However, she enjoyed a
current account balances of payments surplus between 1963-66. Iran enjoyed positive terms of trade throughout much of 1970s and most of early 1980s. The 1984 saw a tightening of the situation as oil export volume slipped. On the whole, Iran enjoyed a positive terms of trade from 1980-85. Oil exports which constituted on the average more than 93 per cent of total exports valued at 1969 prices increased at an annual rate of 8.2 per cent during 1956-69. As a result, total exports have grown at 73 per cent per annum. Even though Iran is essentially an oil based economy, she could export goods other than oil and gas in large quantities fetching sufficient foreign exchange. Imports of Iran increased from US $ 11,110 billion to US $ 30,520 billion between 1975 and 1985. Four Western European countries, United States, Japan and communist countries accounted for 98 per cent of Iran's exports. The growth of imports from Japan is higher (108 per cent) when compared to other regions.

The amount spent on imports in 1979-80 stood at $ 18,103 millions by 1980-84. The net oil receipts of Iran increased by 265 per cent between 1970 and 1985 while receipts from other exports and services increased
by 297 per cent. As a result, foreign exchange receipts increased by 285 per cent. The value of imports increased by 225 per cent. Except in 1975, we find deficit in the current account balance of Iran. With the improvements in the developmental expenditure by government of Iran, the GDP has increased by 108.88 per cent per annum while capital formation increased by 86.24 per cent per annum between 1975 and 1985. The increase was 58 per cent in GNP, 68 per cent in capital formation between 1968-1972.

In recent years, world petroleum market has been characterised by high degree of instability as indicated by wide fluctuations in oil prices. With the emergence of non-OPEC countries as leading suppliers of oil, OPEC has become a residual supplier. The recent developments indicate that instability in international oil market is mainly due to lack of adjustment in demand and supply, and drastic and procyclical price policies of OPEC. It is only via adjustments of demand to changed prices by oil importing countries and consistent supply and price policies of OPEC and other oil exporting countries can stability in international oil market be achieved. This is possible only when there is cooperation among oil producers - OPEC and non-OPEC countries - and consumers.