CHAPTER - III

GENESIS, OBJECTIVES, ORGANISATION AND PROGRESS OF OPEC

Introduction

Business agreements and unconscious parallel action to follow restrictive business practices are more frequent. They tend to take place in standardised products, costly to transport with limited number of sellers, as in iron and steel, non-ferrous metals, oil, coal, etc. The history of these agreements or understandings is one of cut-throat competition followed by understanding, which break downs when there is excess capacity. In numerous cases in industry, as in primary products (especially agriculture), governments support the business understandings to maintain price when private industry
by itself proves incapable of so doing. The history of oil industry is edifying in this respect.

Energy plays a pivotal role in the world economy today, and oil provides more than half of world energy consumption. Oil has become the primary fuel of the industrialised countries. In 1960, for example, oil supplied about one-third of Western Europe's energy requirements; by 1980 this figure has risen to 60 per cent. Japan depends upon oil for 75 per cent of its energy needs. During the 1960's the United States imported about 20 per cent of the oil consumed; by the end of the 1970s it imported about 42 per cent. Consequently, what happens in the Middle East with approximately 52 per cent of the world's proven oil reserves, is of major concern to all industrialized countries. ¹

Without Oil, the Middle East would be very different. Indeed oil has changed the political and economic structure and policies of the Middle East, and dramatically influenced political alignments, both within the region and the world's great powers. The world powers in their turn, have found their oil interests and ambitions in

Middle East intruding increasingly into their relationships with each other, thus launching the region into the centre stage of international tension.

The strategic geographical location of the Middle East, situated at the cross roads to Asia, Africa and Europe, has made the region from ancient times the centre stage of conflict among nations and empires as they vied for control over the trade routes to the East. The modern history of the region is not very different, with imperial conflict followed by the added attraction of the rich oil deposits discovered in the early part of this century. The construction of the Suez canal gave Britain unchallenged control over Egypt, which the British then used as a staging ground for ousting the Ottomans from the fertile crescent in 1918. France collaborated with Britain against the Ottomans and together they partitioned the fertile crescent between them in the Sykes-picot agreement of 1916, France taking Syria and Lebanon and Britain taking Iraq and Transjordan, and trusteeship over Palestine. This ensured Britain's hegemony over the oil fields and set the stage for other European nations to make similar claims for oil reserves and ultimately precipitated subsequent American inroads into the area. Control over the region's oil fields was implemented
through a series of concessions by which local authorities granted foreign companies long-term rights to explore, drill, extract and market local oil in return for small conditional cash payments.2

Oil Consciousness: Prelude to OPEC

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 small but important sections of the local population - an awareness of the strategic and economic value of Middle East oil to the West; of the mechanisms of corporate power and control over the producing countries; and of the amount of waste and exploitation that characterised the industry in its squandering of irreplaceable natural wealth. In decades past, the governments had been totally dependent on the companies for the economic information and analysis used in formulating concession terms and revisions. Ironically, it was the publication of the 1952 Federal Trade Commission Study on the international petroleum cartel that provided some factual basis and analytical insight for many Arab nationalists trying to

2. Ibid.
understand the operations of the oil industry in the Middle East. 3

The discovery took place in a climate of growing nationalism and had an electrifying effect on the political outlook of the Arab nationalist movement, as reflected in the pamphlets and books that began circulating in Cairo and Beirut in the mid-1950's until the end of the decade. However, information and radical analysis had little effect on the policies of the oil producing or transit states. The Arab League had set up an Oil Export Committee in 1951, and then a Department of Petroleum Affairs in 1954. But the only concrete result was the application of boycott against Israel. Attempts to formulate any sort of joint oil policy for particularly economic or political objectives had to await the appearance of small but growing number of Arabs with western technical training in petroleum engineering and economics. These people began to fill positions in the companies in the mid-1950s.

**Genesis of OPEC**

The first move towards the establishment of the

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organisation of the petroleum Exporting Countries (OPEC) took place in 1949 when Venezuela approached Iran, Iraq, Kuwait and Saudi Arabia and suggested that they exchange views and explore avenues for regular and closer communications between them.  

It was realised that real changes in company-government relations could only come about through concerted action by the producing countries. As early as 1957, it was felt that Arab States would own shares in any new pipeline to be constructed by a joint stock company. Under the auspices of Arabtegue the first Arab petroleum congress was held in April 1959 in Cairo, despite the last minute decision of the New Iraqi regime not to participate. Observers were present from Venezuela, Iran and Kuwait.

The Congress was the first concrete attempt to formulate a joint oil policy and this would transcend the political rivalries of the states involved. The presentations and arguments were models of moderation, technical precision, and political astuteness. The only real controversy was prompted by the paper presented by

5. Ibid., p. 32
the American Advisor to the Saudi Oil Ministry, which argued that a producing state has an inherent right to modify concession terms unilaterally in the public interest. The First Aras Petroleum Congress recommended that there should be no reduction in the posted price by the companies without prior consultation with the oil producing governments. At the congress Arabs and Non-Arabs exchanged views concerning the creation of an organisation of oil-exporting countries. This constituted the First Seed of the creation of OPEC.6

Soviet entry into the European market is incidental to the main forces evading the monopoly position of the majors in maintaining market prices. It soon became clear to company executives that the 1957 price hike was not going to hold in the face of increased production. In February 1952, and again in August 1960, official or posted prices at the Persian Gulf were cut to reflect the weakening market prices. The revenue of the producing states was directly tied to the posted price per barrel of crude multiplied by the number of barrels produced. This created no problem as long as the posted price was more or less equivalent to the selling price. The

financial interest of the countries only conflicted with the companies once the actual market price was less than the posted price on which the 50-50 profit split was calculated. By lowering the posted prices, the majors were able to pay less in taxes to the producing countries, thus making them pay for the erosion of monopoly profits in the European crude and product markets. The 1959 and 1960 price cuts were undertaken unilaterally by the companies, without informing, much less consulting, the government's involved. Enraged at this arrogant action that severely disrupted their national budget, of the five countries viz., Saudi Arabia, Iran, Iraq, Kuwait and Venezuela, which account for 80 per cent of the world's exports of oil met in Baghdad after the second price cut to attempt collective action in defence of their countries economic interests. The result was the formation of the 'Organization of Petroleum Exporting Countries (OPEC).  

Aims of OPEC

The creation of OPEC represented a major turning-point in the relationship between the producing countries on the one hand, and the oil companies and consuming

countries on the other. It was the first attempt by the governments of oil producing countries to organize themselves collectively.

The principles governing the organization are clearly stated in paragraph (4) of resolution (2) adopted by the founding members at their conference in Baghdad and stipulated the resolution of petroleum policies for the member countries and the determination of the best means for safeguarding the interests of member countries individually and collectively. The resolutions also made clear that the oil producers' chief opponents are the oil companies. In view of this, it was declared that members can no longer remain indifferent to the attitude hitherto adopted by the oil companies in effecting price modifications; that members shall demand that oil companies maintain their price steady and free from all unnecessary fluctuations; that members shall endeavour, by all means available to them, to restore present prices to the levels prevailing before the reduction; that they shall ensure that if any new circumstance arises that in the estimation of the oil companies necessitate price modifications, the said companies shall enter into consultation with the member or members affected in order fully
to explain the circumstances... 8

As defined by Fuad Rouhani, the first Secretary General of OPEC, the aims of the Organisation are:

1. endeavouring by all possible means to restore the price of crude oil to the level existing before the reductions;

2. ensuring that the oil companies maintain their prices at a stable level, avoiding any unnecessary fluctuations;

3. demanding that companies should consult the countries concerned each time they consider that the position of the market calls for a modification of prices; in such an event, they would have to furnish a full explanation to justify their point of view;

4. elaborating a formula to ensure the stability of prices, and for this purpose resorting, if necessary, to a regime of control of production;

5. conducting the organizations' studies and activities in conformity with the following objectives, guaranteeing a stable revenue to the producing countries, an effective, economic and regular supply of petroleum to consumers and equitable remuneration to investors; and

6. organizing a system of regular consultation among the members with a view to coordinating and unifying their petroleum policies and determining the best means of safeguarding their common interests, both individually and collectively. 9


body to form a common front vis-a-vis major expatriate oil firms and major oil importing countries, its aims were limited to the coordination of members' export policies in oil.

**Membership**

The OPEC statute stipulates that *any country with a substantial net export of crude petroleum, which has fundamentally similar interests to those of Member Countries, may become a Full Member of the organisation, if accepted by a majority of three fourths of Full Members, including the concurring votes of all Founder Members.*

The statute further distinguishes between three categories of Membership: Founder Member, Full Member and Associate Member.

Founder Members of the organisation are those countries which were represented at the OPEC First conference, held in Baghdad, and which signed the original agreement establishing OPEC. Full Members are the Founder Members, plus those countries whose applications for Membership have been accepted by the conference. An Associate Member is a country which does not qualify for

full membership, but which is nevertheless admitted under such special conditions as may be prescribed by the conference.11

Details relating to membership under various categories are set out below:

Members of OPEC

<table>
<thead>
<tr>
<th>Nature of Membership</th>
<th>Country</th>
<th>Year</th>
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<tbody>
<tr>
<td>Founder Member</td>
<td>Islamic Republic of Iran</td>
<td>1960</td>
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<td></td>
<td>Iraq</td>
<td>1961</td>
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<tr>
<td></td>
<td>Kuwait</td>
<td>1962</td>
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<tr>
<td></td>
<td>Saudi Arabia</td>
<td>1962</td>
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<td></td>
<td>Venezuela</td>
<td>1962</td>
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<tr>
<td>Full Members</td>
<td>Qatar</td>
<td>1961</td>
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<tr>
<td></td>
<td>Indonesia</td>
<td>1962</td>
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<td></td>
<td>Socialist Peoples</td>
<td>1962</td>
</tr>
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<td></td>
<td>Libyan Arab Jamahiriya</td>
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<td></td>
<td>United Arab Emirates</td>
<td>1967</td>
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<td></td>
<td>Algeria</td>
<td>1969</td>
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<tr>
<td></td>
<td>Nigeria</td>
<td>1971</td>
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<tr>
<td></td>
<td>Ecuador*</td>
<td>1973</td>
</tr>
<tr>
<td></td>
<td>Gabon**</td>
<td>1975</td>
</tr>
</tbody>
</table>

Note: * Joined as Associated Member and became a Full Member in November of the same year. ** Joined as Associated Member in 1973 and subsequently became a full Member.

Source: OPEC, OPEC: General Information and Chronology, February 1986, pp. 11-12.

11. Ibid., p. 11.
The OPEC has, at present, 13 member countries, with 5 founder members and 8 full members.

**Organization**

In January 1961, agreement was reached on the basic organizational structure of OPEC, and was embodied in the Caracas Declaration. Three main bodies were set up: the Conference, the Board of Governors and the Secretariat (See Fig.1).
The Conference is regarded as the supreme authority of the Organisation. It comprises one delegate from each member country. The conference meets at least twice a year. It formulates general policies and identifies how they will be implemented; decides on applications for membership; confirms the appointment of Governors; directs the Board of Governors to submit reports and recommendations and considers them when submitted; approves the liquidation of each year's accounts on the basis of auditors' reports; appoints the Chairman of the Board, the Secretary-General, his Deputy and the Auditor for each year; and approves any amendments to the statutes. 12

The Board of Governors include one representative of each member country, nominated for two years by their respective governments and confirmed by the Conference. The Board holds at least two meetings each year, and may hold an extraordinary meeting at the request of the Chairman, the Secretary-General or two-thirds of the Governors. The Chairman of the Board is designated for a one-year term by the Conference from among the Governors.

The functions of the Board are (1) to control the management of the Organisations' affairs and the execution

of the Conferences' decisions; (ii) to deliberate and
decide on reports submitted by the Secretary-General;
(iii) to submit reports and recommendations to the Confer-
ence on only subject of interest to the Organization;
(iv) to draw up the budget for each calendar year and
nominate an auditor for approval by the Conference; (v)
to consider the auditor's report for each year prior to
its submission to the Conference; (vi) to approve the
appointment of chiefs of departments designated by the
Secretary-General upon nominations by member countries;
and (vii) to prepare the agenda of the Conference.13

The Secretariat, which is entrusted with carrying
out the executive functions of OPEC under the general
direction of the Board of Governors is located in Vienna
permanently. The Secretary-General is the legally autho-
rised representative of the Organisation appointed by
the Conference for three years, and must be national of
one of the member countries. Until 1965 the Secretary-
General was also the Chairman of the Board of Governors.
This dual capacity was abolished by the Eighth Conference
and the Chairman of the Board has been nominated sepa-
ately each year.

13. Ibid., p. 36
The functions assigned to the Secretary-General are: (i) to organise and administer the work of the Organisation; (2) to ensure the proper functioning of the Secretariat's departments; (3) to prepare for the Board reports on studies requested by the Conference and on the implementation of decisions of the Conference; and (4) to carry out the instructions of the Conference. 14

These functions are performed by the office of the Secretary-General and five departments viz., Technical Administration, Legal, Economic and Information. The Secretary-General may when the need arises, call for legal and other professional advice from outside the Secretariat, and set up adhoc working parties.

OPEC's Achievements

OPEC's achievements may be evaluated in terms of the net benefits member governments have received, whether economic or non-economic. However, to judge its success or failure, one has to understand the main purposes which OPEC proclaimed for itself. 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 prices, royalties and production. During the first ten years of its existence, OPEC did not reach these goals, but since 1970 it has been increasingly effective.15

**OPEC and the Price of Oil**

One of the important factors that led to the creation of OPEC is the low price of oil. As Hartshorn points out "The Organisation of Petroleum Exporting Countries did not come out the blue... It came as a direct reaction... to one of the rather infrequent changes in price in this industry - a reduction, just about a month before, in the posted price of crude oil in the Persian gulf... The attitudes that were finally expressed in the formation of OPEC had begun to form many years before, too. But it took the price cuts of August, 1960 - which may turn out to have been the last that these companies were ever to make in these prices, in their then form - to crystallize them... Without the price cuts that Standard initiated... the Organization of Petroleum Exporting Countries (OPEC) would almost certainly not have come into being - at the time."16

The first task which OPEC set for itself was to stabilize oil prices and keep them steady and free from all unnecessary fluctuations. It was asserted that members can no longer remain indifferent to the attitude adopted by the oil companies in effecting price modifications. OPEC's initial declaration on price restoration was not followed up with a concrete policy to achieve that objective until two years later at the Fourth OPEC conference. However, OPEC's collective action during that time was not yet developed and the members achieved very little individually. Nevertheless, the organization succeeded, to some extent, in preventing the oil companies from imposing further reductions in oil prices. In this context Joe Stork observes, "Even though OPEC failed in its endeavour to restore posted prices, and in effect helped to diffuse the popular political momentum that had led to it's creation, the Organization, merely by its continued existence and potential power, did succeed in preventing any further cuts in the face of the continually declining oil prices on the European market".17

The OPEC members finally realised that they had insufficient power to force oil prices up, and from 1962

on, they sought to obtain by means of increasing royalties what they had been unable to obtain by demanding price increases. Griffin in an empirical analysis of the various approaches to the behaviour of OPEC has found that OPEC is only a cartel and residual supplier. It is assumed that, OPEC is able to control the price of crude oil through its production policies. The members of the cartel fringe set their price marginally below that of OPEC, so that demand initially met from non-OPEC sources. The demand for OPEC oil is then the residual. Thus, the cartel hypothesis is supported by the findings of Griffin.18

**OPEC and Oil Royalties**

Royalties were the producing countries major source of income from oil production. The concept of royalties has been developed with the evolution of the oil concession. In some of these agreements, royalties were defined as a fixed sum per ton of production, sometimes as a percentage of the cessionaries' profit.

After initial failures OPEC launched phase two of the campaign to secure better arrangements for the producing countries by eliminating various allowances and discounts.

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by which the large oil companies secured greater profits and improving the take off of the oil-producing governments from royalties.

When OPEC was established, royalty payments to host governments were in the form of royalty per barrel, usually 12.5 per cent of the posted price. The only OPEC member country that benefited from a rate higher than 12.5 per cent was Venezuela. The companies treated royalty payments as a necessary production cost in calculating profits. When the companies agreed on the 50/50 profit-sharing formula in the early 1970's they calculated the royalties as part of the government's 50 per cent, thereby making the governments actual share much less. The royalty, in effect, became a payment to the companies rather than the countries. In the context found Houhani observes, "Either the... companies are paying income tax at the full rate prescribed by law, but no-royalties, or they are effectively paying royalty but their income tax payment amounted to about 41% of income, not 50%". 19

OPEC's fourth conference in Geneva in 1982 adopted a resolution that each member country affected should

approach the company or companies concerned with a view to working out a formula where under royalty payments shall be fixed at a uniform rate that members consider equitable, and shall not be treated as a credit against income tax liability. The negotiation of this issue, which lasted from 1982 to 1985, have been characterized by OPEC as the 'longest, toughest and most revealing in the history of the international oil industry. Throughout the negotiations, the oil companies persistently rejected the principle of collective bargaining, which the OPEC countries adopted to deal with the companies. Although they were reluctant to recognize and accord a similar joint interest to the countries with which they dealt, finally it was agreed to improve the royalties of the oil-producing countries. Accordingly, royalties were to be deducted before profits were calculated and divided. This increased the actual government 'take off' per barrel of crude. However, the royalty settlement permitted the companies to discount the posted prices by 9.3 per cent in 1981, 8.3 per cent in 1985, 7.1 per cent in 1986 and 5.3 per cent in 1989 in calculating their income tax obligations.20 The settlement provided for consultation in 1986 between the governments and the companies on

possible future reduction in the discount rate. At OPEC's 22 conference in Vienna, the member countries have indicated steps towards the complete elimination of discount allowance granted to the oil companies.

Accordingly, negotiations soon reopened between the producing countries and the companies. However, as usual, negotiations proved difficult and there was no solution yet in sight as the Arab-Israel war broken out in 1967. Following the outbreak of war the Arab countries decided to boycott oil shipments to certain countries. The boycott, together with the closure of the Suez canal, resulted in the recovery of crude oil prices. The interruptions of oil supplies and the tightening of the oil market improved OPEC's bargaining position. At the OPEC conference in Rome in September 1967, the members decided that the five countries most concerned with expanding royalties (Saudi Arabia, Iran, Kuwait, Libya and Qatar) should meet for consultation on the issue in early October. On January 9, 1968, after a two-day conference in Beirut, the five OPEC members announced that they had accepted an offer submitted by the companies on January 6 to Iran and Saudi Arabia, binding all companies operating in OPEC member countries under the agreement reached, the discounts
were to be phased out over a four-year period, declining from 5.5 per cent in 1968 to 4.5 per cent in 1969, 3.5 per cent in 1970, 2 per cent in 1971 and ceasing entirely in 1972. The stage was set for the October oil revolution of 1973.21

**OPEC and Control of Oil Production**

Since its inception OPEC has examined the possibility of developing a system of overall production control. A fresh exchange of views on this subject took place at the Fifth World Petroleum Congress in June 1959 in New York. Although some difficulties are inherent in such a scheme, it was believed that through co-operation the oil producing countries would work out a formula to achieve their common objectives.

At the Second petroleum congress held in Caracas on 16 January 1961, OPEC acknowledged that a just-pricing formula supported by international pro-rating would require detailed study. An American Company was hired to make a comprehensive analysis of profits, prices and output in the international oil industry, and to put forward recommendations for increasing member countries' profits.

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control over production. However, the recommendations of the study were not encouraging to OPEC members.

Even before OPEC was founded, national companies were set up in many of these countries to participate in and monitor oil production. Some of these companies include: the National Iranian Oil Company (NIOC) set up in Iran, 1954; the Kuwait National Petroleum Company (KNPC) in Kuwait, 1960; Petromin in Saudi Arabia 1962; Sonatrach in Algeria 1963; the Iraq National Oil Company (INOC) in Iraq, 1965; and the Libyan National Oil Company (LINOLO) in Libya 1969. Their explicit aim was to take over a longer share of oil-generated rents. In many cases after 1960, these national companies took advantage of the new comer's desire to take up concessions, to sign contracts with them that gave the national companies some control over oil operations in their countries.22

OPEC's Success in the 1960s: An Assessment

During 1960s, OPEC achieved virtually no success and its impact was limited. However, it was felt that OPEC had been useful to its members, viz., the oil-producing countries, without which they would have been

22. Ibid., p. 42.
worse off. It also demonstrated that concerned action by Middle Eastern governments was feasible. In this context Don Peretz observes, "Continuation and flourishing of OPEC for over a decade has undermined one of the prevailing stereotypes about Middle Easterners; that they can now accomplish anything together".  

Several factors explain OPEC's basic inability to obtain fundamental changes in the position of the oil-exporting governments in the 1960s, and it's failure to achieve its principal objectives vis-a-vis the major oil companies. The major oil companies using legal procedures did not concede any point where their vital interests, particularly control over prices or production were at stake. Second, the principal consuming countries opposed the attempts by the producing nations to gain control over their national resources. Any attempt by OPEC members to control oil production was considered illegal and a direct interference with the free play of supply and demand. Countries like Libya, Algeria, Nigeria and Abu Dhabi, which were just beginning to export oil were not in a position to agree to restrict the growth


of their production, for fear of loss of revenues. At the time, they considered it more advantageous to increase the level of their total revenues by selling ever-increasing quantities, even at a relatively low prices rather than to restrict their production. Further, OPEC's great emphasis on negotiation and cultivating favourable world opinion was interpreted by both companies and consumers as a sign of weakness. Criticising this approach Tanzer felt that the Arabs should adopt forceful methods as a matter of sovereign right.25

Criticising sharply on the achievements of OPEC during 1960s, Abdullah Tariki, a co-founder of OPEC and Saudi Arabia's Director General of Petroleum and Mineral Resources argued that member countries should not follow that 'soft' path of negotiation and compromise; rather, they should assume the prerogatives of sovereignty by legislating simultaneously if positive results were to be obtained and expectations to be fully realized.26

The basis weakness of OPEC has been reflected by differences among member countries, which prevented them,

in the early 1960s, from creating a United front against the oil companies. Michael Tanzer Opines, "The companies (and their home governments alike) would only yield where there was a real danger of being forced into a worse situation if they did not." 27

During and after 1970s OPEC restored 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 to power brought in its wake enormous dividends. The price of oil quadrupled between 1972 and 1974, and doubled again between 1979 and 1980. Oil revenues increased substantially, for each member of OPEC and total group between 1961 and 1980. The turning point in 1973 has allowed these countries the opportunity to use oil as an instrument of economic and social development. 28

OPEC and Other International Organizations

The emergence of OPEC is the outcome of a joint action undertaken by several countries which are members of the United Nations. The OPEC Founder Members in establishing OPEC acted in strict observance of the UN principles and purposes. Because of the conformity between the principles and purposes of the two bodies the OPEC has become a regular participant in meetings of various organs, bodies and specialized agencies of the United Nations, particularly the United Nations Conference on Trade and Development (UNCTAD) the World Bank and the International Monetary Fund.29

Throughout its existence, OPEC has promoted the ideals of UN, a landmark being the "Solemn Declaration" adopted in 1975 by the First Conference of Sovereigns of Heads of State of OPEC Member countries in which they stressed that world peace and progress depended on mutual respect for the sovereignty and equality of all members of the international community, in accordance with the UN charter, and emphasized that the basic statements of the "Solemn Declaration" fell within the context of the

decisions taken at the sixth special session of the UN General Assembly on problems of raw materials and development.30

As an inter-governmental organization, OPEC has taken keen interest in solving concern the problems of the developing countries in particular. Inspired by the "Column Declaration", seven OPEC Member Countries participated in the meetings of the conference of International Economic Cooperation (CIEC), the so-called "North-South Dialogue", with other developing countries and eight major industrialized nations, with a view to achieving a more equitable distribution of the world's wealth and natural resources. The organization also demonstrated its concern for the plight of those developing countries most seriously affected by economic stresses, by establishing in 1976 the OPEC fund, and by playing a leading role in the setting up and financing of International Fund for Agricultural Development (IFAD).31

Thus with the pattern of the relationship existing between OPEC and the developing countries and also between OPEC and the developed countries will serve to promote

30. Ibid., p. 19.
31. Ibid., p. 20
promote international cooperation in achieving higher standards of living for all nations, full employment, and economic and social progress and development.