MEMBERS OF THE ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES.

* Persian Gulf states from north to south:
  - KUWAIT
  - BAHRAIN
  - QATAR
  - UN. ARAB EMIRATES

(Non-OPEC)

Source: Odell, P. R., (1988), "Draining the World of Energy", Rotterdam:
Center For International Energy Studies, Erasmus University,
P. 14.
OPEC FORMATION

4.1. INTRODUCTION

4.1.1. Events leading to the Formation of OPEC

After the Second World War, production of oil outside the United States increased considerably. The oil revenues grew correspondingly and provided a basis for conflict between the major oil companies and host countries. The pricing of crude oil in the international market was the center of the conflict between these two groups.

4.1.2. Pricing Policy

The Pricing policy followed by the multinational oil Companies (with a high degree of horizontal integration i.e., the ownership of and access to widely diversified sources of crude oil supply) had element of irrationality and an overwhelming self-interest.

The market price, the transfer price and posted price are the three oil prices used in pricing the crude oil and its product. The market price as the term signifies is the price of crude oil under free-market conditions. Transfer prices were essentially book value, which permitted an oil Company to obtain the maximum tax advantage. The most important pricing practice which began with earliest operations of the international oil majors outside the United States and Europe was the use of the posted prices.

Ninety per cent of oil production, refining and marketing facilities were in control of the multinational oil Companies in 1955. They also controlled almost Eighty Five percent of the tanker fleet.

According to Ian Seymour, "... the major Companies were endeavoring to maintain a system of administered prices designed to meet their own particular requirements, i.e., an appropriate price for transactions within a highly integrated set-up which at the same time could be justified to the authorities concerned with reference to a "Competitive Price".

This was in addition to their vertical integration through ownership of both upstream (crude oil production) and downstream (transport, refining and marketing) facilities.
4.1.3. Multinational Oil Companies and the Concept of Royalty

The international oil major Companies which had entered the Middle East through concessions by the political strength of a Western imperialism paid the host governments a fixed amount of royalty per barrel of oil produced. The concept of royalty or "Stated Payments" had been a part of all oil agreements ever since the first discovery of oil. This concept was used initially in the United States, where oil was owned by Private landlords. The Companies operating the oilfields were to pay the landowner one-eight to one-fourth (12.5 to 25 percent) of the oil produced as compensation for the depletion of oil reserves.

In the period preceding World War II royalties were generally twenty-to-twenty-five cents a barrel. The implications of a fixed royalty in an era of increasing prices were that producing countries suffered a worsening of their terms of trade when, paradoxically, oil prices were increasing in the international market. The Middle East oil-exporting countries lacked the will and strength to change the royalty arrangement. The first move was made by Venezuela, which passed a law in 1948 requiring the oil Companies to hand over Fifty percent of their profits. The Companies realizing, they had little alternative, agreed to this.

In 1949, Venezuela sent a delegation to Iran, Saudi Arabia, Egypt, Iraq, Kuwait and Syria in order to explain to the authorities in the countries visited, the advantages of having a co-ordinated oil policy and to illustrate the benefit to be derived from application of the profit sharing formula. This was the first instance of consultations being held amongst the oil exporting countries.

4.1.4. Nationalization of Oil Fields

In 1951, Iran nationalized her oilfields. This move was followed by a Western boycott of Iranian oil. This halt in Iranian oil production was compensated by Saudi Arabia, Kuwait and Iraq. The ability of major oil Companies to switch sources of supply at the time of conflict with a host government was the most potent weapon in the major's armory. Two years later, Western Governments intervened to bring down the revolutionary regime in Iran and re-establish a climate in which the Iranian Oil Industry could restart operations. At this stage, British Petroleum (BP) monopoly in Iran was broken and the "Seven Sisters" formed a consortium with Compagnie Francaise des Petroles (CFP) to continue the development of Iranian oil.
4.1.5. Co-operation Agreement

The Venezuelan initiative was followed in 1953 by another significant unifying development when the governments of Iraq and Saudi Arabia signed for the first time a co-operation agreement whereby the two countries undertook to exchange information and held periodic discussions concerning oil policy.

The next event of importance was the Suez crisis of 1956, as a result of which the Arab States imposed an oil embargo on the West. This caused an irreparable damage to relationship between the producers and the major Oil Companies. Perhaps the main feature of the embargo was that it showed that the producers could act together when sufficiently aroused.

Meanwhile, the American and European based oil Companies, known as "Independents" which had extended their operations overseas and offered better royalties than the "Sisters" were welcomed by the host governments.

The creation of the Arab League in 1945 provided the Arab producers with an organizational base upon which to develop further collaborative arrangements. Five years later a security pact, the Joint Defense and Economic Co-operation Treaty, gave oil an important position in the policies of the Organization. The Department of Oil Affairs in the Arab League has been largely responsible for both the diffusion of information on the petroleum industry and the increase in technical skills of Member nations.

The initial decision of the Middle East producers unlike other major producers elsewhere, to collaborate an oil policies had been primarily a political one.

4.2. POLITICS AND ECONOMICS OF OIL

The evolution of Middle East crude oil prices during the post Second World War period was also directly influenced by political pressure from the United States Government. The reconstruction of Europe's war torn economy required a huge quantity of money and oil. The U.S. Government committed itself to secure the necessary fund and to make the cheap Middle East oil available to Europe.
4.2.1. Independent Oil Companies Vs Seven Sisters

The big integrated oil Companies on the other hand, had to compete not only amongst themselves but against the "Independents" and the former Soviet Union as well. As a result the disposal of the large surplus production capacities became, increasingly difficult in view of price competition provided notably by the American independent oil Companies which were prevented by the law to sell their crude in the United States. The independent Companies having discovered oil in large quantities abroad had no other alternative but to dispose off their crudes in order to recover at least the amount spent on the development of their concessions.

Consequently, oil product prices declined sharply in Europe. For example, the price of heavy fuel oil in West Germany fell from its February 1957 peak of 142 DM/ton to 60 DM/ton during the second half of 1959.

The large reductions in posted prices by the international oil Companies in 1959 and undermining the development plans of the production countries could be the direct cause of the formation of OPEC.

Venezuela had taken the lead in opposing price cuts announced by the oil Companies (initiated by British Petroleum) in 1959. During that year posted prices in the Middle East were reduced by about 8 per cent amounting to $0.18 per barrel of oil.

During the same year, Shell oil Company of Venezuela reduced posted prices by $0.05 to $0.15 per barrel according to type of oil. More drastic price reductions (an 18-Cent cut in posted prices) were announced in 1959 by the British Petroleum Company, for their operations in Kuwait, Iran and Qatar. Similar reductions were posted in Venezuela to meet the Middle East cuts in posted prices. The producing Companies in Venezuela reduced the prices by $0.10 a barrel in April. It was explained as a move to "help restore the competitive position of Venezuelan crude in the World Market." A meeting of Arab Petroleum Congress quickly followed which produced no firm action.

There is a slightly different interpretation of the events leading to the creation of OPEC. In 1957, Venezuela increased the taxes on the petroleum Corporations working in Venezuela. These Corporations, in an attempt to forestall further tax increases and to demonstrate to other oil producers, their displeasure with such moves, reduced the prices of Venezuelan crude and increased production in Middle East. Venezuela responded by meeting with other oil producers and with the support of Sheikh Tariki of Saudi Arabia OPEC was created.
In August 1960, the international oil Companies reduced posted prices again by about 6 per cent, amounting to $0.10 a barrel. The cut meant a substantial loss of revenue to the exporting governments on the order of $300 million. However, the oil Companies (particularly Exxon and Shell) realizing that any further reduction in Venezuelan prices would create the counter reaction of Venezuelan Government, were deterred from doing so. This proves the degree of apprehension given by the major International Oil Companies to the host government power in Venezuela than in the Middle East.

In terms of prices, the five major Middle East producing countries started to sale their crude oil in 1960 at 7 per cent or 13 per cent per barrel lower than in Mid 1953.

On 5 September 1960, the Iraqi Government under the General Abdul Kerim Kassem called a conference of oil-producing nations in Baghdad. When it opened five days later in the City Hall it was found that despite the short notice, the delegates represented the most high powered collection of senior officials over to have been brought together round a single table. Mr. Juan Pablo Perez Alfonzo, the Venezuelan Oil Minister, often described as the "Father of OPEC", Dr. Faud Rouhani a managing director of the National Iranian Oil Company was there from Tehran, while the Saudi delegation was led by Sheikh Abdulla Tariki, and Kuwait's by Faisal Mezidi, one of the Government directors of the Kuwait Oil Company (KOC).

4.2.2. Formation of OPEC

As a result of this historic meeting on 14 September 1960, the formation of Organization of the Petroleum Exporting Countries (OPEC) was announced. The treaty established OPEC was registered at the United Nations Secretariat on November 6, 1962, under No. 6363 in accordance with article 102 of its constitution. Later, OPEC also established relations with the Economic and Social Council (Ecosoc) under United Nations Resolution 1053, adopted on July 30, 1965. From its formation in 1960 until 1965, OPEC had its Headquarters in Geneva, Switzerland. Since September 1965 the Seat of the Organization has been in Vienna, Austria.

31 API Kuwait crude from $1.72 per barrel in mid-1953 to $1.59 per barrel, 34 API Arabian crude was reduced from $1.93 per barrel in mid-1953 to $1.80 per barrel in August 1960.
4.3.1. OPEC: OBJECTIVES

The objectives set by the Member Countries were designed to unify their oil policies, and to lay down the best means for safeguarding their interests, individually and collectively, as well as to stabilize prices, with due consideration for the interests of both producing and consuming nations. In accordance with the Article 2 of the OPEC Statute:

A] The principal aim of the Organization shall be the Coordination and unification of the petroleum policies of Member Countries and the determination of the best means for safeguarding their interests, individually and collectively.

B] The Organization shall devise ways and means of ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations.

C] Due regard shall be given at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries, and efficient, economic and regular supply of petroleum to consuming nations, and a fair return on their capital to those investing in the petroleum industry.

The objectives show that OPEC was not created with a view to raising prices by creating an artificial shortage in oil supplies in World Market. In other words it was not intended to be an offensive but rather a defensive instrument.

However, Adelman points out that "... it is axiomatic that a good discovery of oil reserves means a dissatisfied landlord who wishes he had held out for more. He will look around for any possible way of getting more. Once this basic relation is understood a great deal of history can be compressed into a single page."22

4.3.2. Membership of OPEC

The Organization of the Petroleum Exporting Countries is an organization of thirteen Oil producing countries which have a total population of approximately 456 million and an

For a glance at each one of these Member Countries, See Appendix II

For the details of the Resolutions passed in the First Conference of OPEC in Baghdad during 10-14 September, 1960, refer to Appendix I.
area of 12,784,000 Square Kilometer\textsuperscript{23} scattered in Asia, Middle East, Africa and Latin America with great diversity of culture, religions and societies. They are as follows:

<table>
<thead>
<tr>
<th>OPEC Far East</th>
<th>Indonesia (1962)*</th>
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<tr>
<td>OPEC Latin America</td>
<td>Ecuador (1973), Venezuela (Founder)</td>
</tr>
<tr>
<td>OPEC Middle East</td>
<td>IR Iran (Founder), Iraq (Founder), Kuwait (Founder), Qatar (1961), UAE (1967), Saudi Arabia (Founder)\textsuperscript{24}.</td>
</tr>
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In accordance with the terms of Article 7(C) of the OPEC Statutes, "any country which is a net exporter of crude oil in a substantial quantity and whose petroleum interests are fundamentally similar to those of the Founder Members can become a Full Member of the Organization, if it is accepted by a three-fourth majority of the full Members, provided that this majority includes the five Founder Members."\textsuperscript{25}

Where a country whose oil exports exceed its imports yet, is considered ineligible for Full Membership in accordance with Article 7(C) of the Statutes, it may in accordance with Article 7(D) be admitted by the Conference as an Associate Members, provided that it satisfies all the conditions set by the Conference, and is accepted by a three-fourth majority, including the affirmative votes of the Five Founder Members. Paragraph (e) of the same Article stipulates that Associate Members may be invited to attend the meetings of the Conference, the Board of Governors, or the Consultative Meetings with the right of participating in their deliberations, but without the right to vote.\textsuperscript{26}

Each Member of OPEC has the right to withdraw from the Organization at any time, provided that it gives notice of its intention to the Conference. Such notices take effect from the beginning of the calendar year following the year in which the notice was received by the Conference. A Member who withdraws may rejoin the Organization by submitting a new application for Membership. The Conference will consider such an application in the light of Para (c) of Article 7\textsuperscript{27}

\textsuperscript{23} Indicates the year, the Member Country joined OPEC.
4.4. The Structure of OPEC

The Organization of the Petroleum Exporting Countries is composed of the following three main Organs:

I. The Conference
II. The Board of Governors
III. The Secretariat

4.4.1. The Conference

According to the Articles 10 and 11 of the OPEC statute the Conference is the supreme authority of the Organization which consists of the delegations of all Member Countries. It might also include consultants and observers.

Each Member Country must be represented at all Conference meetings. At least three-fourth of the delegations representing the Member Countries must be present for holding a Conference. Each Member Country has a single vote in the Conference. All decisions, except those relating to procedural matters, require the unanimous vote of all the Full Members. The Conference can invite a non-member country to a meeting as an observer.

The Conference holds two ordinary meetings a year. The Secretary General, after consulting the President of the Conference and with the simple majority of the Member Countries, can, at the request of a Member-Country, call for the holding extraordinary meeting. The Conference shall select an Alternate President at its first preliminary meeting. The Alternate President performs the duties of the President when the latter is absent or when unable to fulfill his duties.

4.4.2. The Board of Governors

The Board which shall meet not less than twice each year, is confirmed by the Conference for two years and consists of Governors nominated by Member Countries. A substitute Governor shall be nominated by the concerned Member Country whenever the Governor is prevented, for any reason, from attending a Governor's Meeting. Each Governor has one vote. The term of office of each Governor shall be two years.

* For the duties and responsibilities of the Conference, See Article 15 of the OPEC Statutes.
The chairman who presides over the Governors Meetings, attends the head office of the Organization in preparation for each Governors meeting and represents the Board of Governors at Conference and Consultative Meetings is appointed by the Conference from among the Governors for a period of one year, in accordance with the principle of alphabetical rotation. The date of membership in the Organization however, shall take precedence over the principle of alphabetical rotation. The Alternate Chairman shall assume the office whenever the latter is absent or unable to exercise his responsibility. According to Article 20 of the OPEC Statute the Board of Governors shall:

1) Direct the management of the affairs of the Organization and implementation of the decisions of the Conference;
2) Consider and decide upon any reports submitted by the Secretary General;
3) Submit reports and make recommendations to the Conference on the affairs of the Organization;
4) Draw up the Budget of the Organization for each Calendar year and submit it to the Conference for approval;
5) Nominate the Auditor of the Organization for a duration of one year;
6) Consider the Statement of Accounts and the Auditor’s Report and submit them to the Conference for approval;
7) Approve the appointment of Directors of Divisions and Heads of Departments, upon nomination by the Member Countries, due consideration being given to the recommendations of the Secretary General;
8) Convene an Extraordinary Meeting of the Conference;
9) Nominate a Deputy Secretary General for appointment by the Conference; and
10) Prepare the Agenda for the Conference.

4.4.3. The Secretariat

It is headed by the Secretary General who is the legal authorized representative of the Organization and Chief Executive of the Secretariat. It carries out the executive functions of the Organization in accordance with the provisions of the statute and under the direction of the Board of Governors. The Secretary General is appointed for the period of 3 years. Its term may be renewed once for the same period of time. The Secretary General shall be assisted in the discharge of his duties by:
i) **The Deputy Secretary General**: Who is responsible to the Secretary General for the co-ordination of the research and administrative activities of the Secretariat is appointed by the Conference for the period of three years. The Secretary General may delegate some of his authority to his Deputy, who also supervises the functioning of the various departments of the Secretariat.

ii) **The Division of Research**: The Article 34 (A) of the OPEC Statute states the responsibility of this Division as follows:

a) Conducting a continuous programme of research, fulfilling the needs of the Organization, placing particular emphasis on energy and related matters;
b) Monitoring, forecasting and analysing developments in the energy and petrochemical industries; and the evaluation of hydrocarbons and products and their non-energy uses,
c) Analysing economic and financial issues of significant interest, in particular those related to international financial and monetary matters, and to the international petroleum industry, and
d) Maintaining and expanding data services to support the research activities of the Secretariat and those of Member Countries.

iii) **The Personnel and Administration Department**: The responsibilities and activities of this Department have been stated in Article 34(B).

a) The Department shall be responsible for all organization methods, the provision of administrative services for all meetings, personnel matters, budgets, accounting and internal control;
b) Study and review general administrative policies and industrial relation methods used in the oil industry in Member and other countries, and advise Member Countries of any possible improvements; and
c) Keep abreast of the current administrative policies and/or policy changes occurring in the international petroleum industry which might affect the Organization or be of interest to it.

* For further detail see Articles 28 and 29 of the OPEC Statute.
iv) **The Public Information Department**: The Article 34, (3) explains the responsibility of this Department as follows:

a) It is responsible for: presenting OPEC objectives, decisions and actions in their true and most desirable perspective;
b) Carrying out a central public information programme and identifying suitable areas for the promotion of the Organization's aims; and
c) The production and distribution of publications and other materials.

v) **OPEC News Agency (OPECNA)**: It was established in November 1980 to serve as the news vehicle for OPEC countries in the oil, energy, economic and social development fields. It is a special unit responsible for collecting, producing and disseminating news of general interest regarding the Organization and the Member Countries. The Agency has set up a communications network which, emanating from Vienna, reaches the newsrooms of close to 1200 communication media in 83 countries.\(^3\)

vi) **The Office of the Secretary General**: According to the Article 33(3), this office shall provide the Secretary General with executive assistance, particularly in carrying out contacts with governments, organizations and delegations; in matters of protocol; in the preparation for, and coordination of meetings, and other duties assigned by the Secretary General.\(^3\)

vii) **The Legal Office**: It provides legal advice to the Secretary General, supervises the Secretariat's legal and Contractual affairs and evaluates legal issues of concern to the Organization and the Member Countries and recommends appropriate action.

viii) **The Economic Commission**: It is a specialized body operating within the framework of the Secretariat, with a view to assisting the Organization in promoting stability in international oil prices at equitable levels, to enable oil to retain its position as the prime global energy source in accordance with the objectives of the Organization. The Commission shall closely monitor developments in the energy market and keep the Conference abreast of these developments. The Commission is composed of a Commission staff, with the former consisting of the Organization's Deputy Secretary General, the National Representatives appointed by the Organization's Member Countries and a Commission Co-ordinator.\(^3\)
Having discussed the formation and structure of Organisation of Petroleum Exporting Countries, (OPEC), it would be appropriate to have a bird-eye view to various decisions taken by this Organisation relating to prices and production of crude oil.

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