CHAPTER I
In the recent years, the international oil industry has undergone fundamental changes that have altered both the subject of conflict and the principle players of the oil game. The early conflict was seen between oil producing countries acting mostly individually and the multinational oil corporations monopolizing oil industry whereby appropriating major part of the profit to themselves. By contrast, the present conflict is over pricing and production policies, and the players are now a collective front of oil exporters - the Organization of Petroleum Exporting Countries (OPEC), versus a disarranged collection of oil importers. Thus the conflict over oil pricing and production policies will continue unabated with its concomitant effects on the International Politics.

For these reasons, the present issue addresses three major questions. The first concerns the early conflict between

1. Oil and Gas Journal 1974, P. 11.
oil producers and Multinational Corporations (MNCs) relating to factors that strengthened the bargaining position of oil producers. The second question focuses on the present conflict between OPEC and oil importers. And finally the third question emphasises over production decisions in the oil producing countries in general and in the Arab countries in particular against the background of shifting conflicts in the international oil game.

In initial explorations for oil and in the early concessions arranged between heads of oil producing states foreign oil companies, the heads of producing states were not profit maximizers, because they were in no position to apply the marginal costs - marginal revenue criterion. The concept of profit maximization did not enter into early negotiations to any significant degree, because West Asian states had neither the technical expertise nor the financial resources necessary to develop independently their oil fields. The primary objectives of West Asian leaders were the development
of their resources and the attraction of sorely needed foreign
capital and technology. There is no doubt that these leaders
were skilled bargainers, but their immediate needs placed them
in a weak bargaining position with foreign oil companies. Thus,
the result of negotiations were inequitable agreements
characterized by long leases, a high degree of foreign control,
and relatively moderate royalties.

It is no wonder, then that, in the West Asian countries
the term 'concession' acquired an unfavourable connotation, so
much so that at times its use has been condemned as derogatory
to national honour. Nevertheless, the development of the modern
oil industry in the area began with this concept. Although
their concession agreements differed from country to country,

2. Naiem A. Sherbiny and Mark A Testler (eds.); Arab Oil
Impact on the Arab countries and Global Implications.
(Praeger Publishers, USA), P. 35.
however, a number of characteristics were common to practically all concessions granted by the producing countries. The common elements can be summarised as follows:

1. The area of concession was generally very large. In some cases it embraced the whole country (as in the case of Kuwait, Bahrain and Qatar); in others it covered a major region which, either because of its geological formation or because of its political character, constituted a well defined territorial entity (as in the case of Iranian concession, which excluded five northern provinces then under the Russian sphere of influence).

2. The privileges granted to companies included as a rule, the exclusive rights to explore, prospect, extract, refine and export crude oil and related materials (such as natural gas) within the area of the concession.

3. The duration of the concession was specified usually from 60 to 75 years.

4. Companies were generally required to supply the oil requirements of the host governments and oil products for local consumption. This clause was usually accompanied by a proviso that quantities thus supplied should not be subject to royalty calculation and should be calculated at prices below those prevailing in world markets.
5. Installations rights and the right of eminent domain were granted. Within these limitations, companies had the right to establish their own system of transportation and communication for the efficient conduct of their operations. Among these facilities, radio, telegraph and telephone as well as rail roads, vessels and air planes, were usually specified in the concession agreements.

6. Certain extra territorial rights, such as freedom from all direct and indirect taxation and freedom from government controls over the conditions of production and marketing, were granted.

7. Companies were required to present to the host government an annual report of their operations, including data on the discovery of new oil deposits and geological plans and records. Such information was to be treated as confidential by the host country.

8. The concession agreements made no mention of the surrender by the oil companies of unexploited areas after a certain period of time. Thus the companies were able to retain all the areas covered by the original concession agreement, although no actual operations were undertaken, on the other hand, the companies could refuse to allow other companies or the host government to exploit these areas.
Commenting on the injustices of the oil concessions, George W. Stocking, the well known oil economist said; 'Never in modern times have governments granted so much to so few for so long.' Thus it should come as no surprise that, after attaining political independence the oil producing countries began to ask for major revisions of the terms of the old concessions. Between the early 1940s and the formation of OPEC, the host government took actions ranging from direct negotiations between the governments and the oil companies for revision of concession agreements, to nationalization.

Quarrels between producing governments and their concessionaires over the amount of payments to governments did not spring forth full blown after World War II. In Iran, for example the 60 year D' Arcy concession of 1901 was suspended when the government having become aware of the importance of the oil to the British Navy during the first World War, expressed dissatisfaction with its revenues, and insisted on renegotiation. Iran concluded a new agreement with the company (now named Anglo-Persian, and later Anglo-Iranian oil company) in 1920, but the government soon was perturbed that during several years in the 1920's production had increased but Iran's revenue had gone down.


4. Andulaziz al-Sowayegh, see chap. 'Major Actors in the Oil Game' from Arab Petro Politics, (Croom Helm, Australia 1984), pp. 28-29.
In 1931 the government unilaterally cancelled the concession, citing the failure of the company to open its financial records to inspection. So a new agreement was concluded in 1933, guaranteeing the government a minimum royalty per ton, however until World War II, the two parties disputed whether the royalty should be calculated according to the English "long" ton (2,240 pounds) or the 2,000 pound "short" ton.

Since by that time it was the companies that decided where and when to prospect for oil; it was the companies again that determined how much oil to produce once it was found; and it was again the companies that, in the light of their assessment of the market set the price at which it would be sold. Although the companies operating in each country were legally distinct, there was a pattern of interlocking ownership. British Petroleum (BP), Shell, Mobil, and Exxon were part-owners of the three companies operating in Iraq; Exxon, Texaco, California Standard, and Mobil jointly owned Aramco, which operated in Saudi Arabia; Exxon, Shell and Gulf through affiliates, operated separately in Venezuela; Gulf and BP jointly held the concession in Kuwait.

5. According to the company the one major difference between itself and the Government during the period, until the outbreak of war, was the definition of the word "ton" in the concession. The company maintained that the English long ton of 2,240 pounds was meant, while the Government maintained that the ton of 2,000 Pounds was meant. On July 30, 1936 the company agreed to pay royalty on the basis of the ordinary ton, though it continued to maintain that it was the English ton that had been understood. Benjamin Shwadran, the Middle East Oil and the Great Powers 3rd, ed. (Wiley New York, 1973) pp. 13-47 annual production and revenues are listed on pp. 13f Cf. Raymond F. Wikeseel and Hollis Chenery, Arabian oil: American state in the Middle East (Chapel Hill: University of North Caroline Press 1949), p. 101.
Later, all seven of them held shares in the Iranian consortium that replaced BP after the crisis of 1951-54. In the world at large in 1949/50 these seven companies controlled 65% of proved reserves of Petroleum outside the Soviet bloc, 55% of its production, 57% of all refinery capacity and major pipelines, and through ownership or long-term leases, at least 67% of all privately owned tanker space.

There had also been earlier attempts to coordinate policies among the governments of oil producing countries. Venezuela had put out feelers to West Asian governments as early as 1947. Iraq and Saudi Arabia in 1953 had concluded an agreement calling for exchange of information and periodic consultation regarding the problem. And an Arab Petroleum Conference in Cairo in 1959 adopted a resolution insisting that any changes in posted price should be discussed with the government of the producing country. However, despite the strong position taken by the oil producing countries and their warning to the companies against a unilateral price reduction, the companies went ahead and, for the second time cut oil prices in August 1960. This action reduced West Asian posted prices to a level below that of 1953. The two price cuts of 1959 and 1960, of approximately 27 cents a barrel, resulted in a drastic loss of


revenue to the major West Asian oil-producing countries amounting to an estimated loss of $4 billion to the decade 1960-70.

Late in the fall of 1959 the Oil Exports Committee meeting in Jeddah, Arabia, with Iraq present, approved the boycott of companies operating in Algeria, counselled that no new concessions be granted in which Arab states did not participate in ownership and management, urged a standardized petroleum code for all members and the repossession of those parts of concession areas not being developed.

During 1960 Iraq continued discussions with IPC over cession of unexploited oil territory, discounts, and other grievances. Proposal met counter proposal, with ceaseless trips to London. Suddenly, on September 6, after the cartel had announced further price cuts, Kassim summoned the producing states to a conference in Baghdad to which Iran and Venezuela responded. On September 14 a new Baghdad Pact was proclaimed among the main exporters, and the Organization of Petroleum Exporting Countries was formally set up. Three resolutions were passed. The two principal ones provided:

1. The exporting countries, unable to remain indifferent to the attitude of the companies in effecting price changes, will require them to maintain stable prices, restore the cuts,

8. Oil Export Committee; was constituted in 1951 - under the guidance of Arab League (1945) to welding a common Arab oil Policy, to support for the transit states to get a fair share of Pipe line revenues; barring foreign government participation in concessions; employment of Arabs in labour and technical Posts, housing for Arabs to be equal to that of foreigners; encouragement of Kuwait, Bahrain and Qatar, British Protectorates, to join League oil meeting; and an invitation to Iran, a non-Arab country to consult on oil matters.
and in future change prices only with the consultation of the producing countries. A system will be devised to stabilize prices through control of production and the members will stand together in rejecting offers of advantageous treatment to one member through unilateral action by the companies.

2. The OPEC is formed by Saudi Arabia, Iraq, Iran, Kuwait and Venezuela, and they can accept new members by unanimous vote (Qatar being the first, 1961). The principle objective is the Unification of Petroleum Prices. Meetings are to be held at least twice a year, and a Secretariat is to be established.

The creation of OPEC was widely regarded as the most momentous event of the decade in the Near East. For the first time a cartel of countries faced the cartel of companies. Despite of price cuts, the countries were remained adamant in insisting that their income not be reduced and if any one was going to suffer from the price cuts, it would be companies not the OPEC partners.

The united front, transcending Arab countries and even the Near East through the inclusion of Venezuela was a triumph for the patient work of Abdullah al-Tariki, the imaginative resourceful and dynamic petroleum director of the Saudi government and equally for Dr. Periz Alfonzo, architect of Venezuelan oil policy. In the 'London Economist' 1960 Dr. Paul Frankel summed up the situation presented by OPEC: "The fact that international

9. For details of the OPEC resolution see the original text of the Organizations Statute approved by the conference in January 1961 in Caracas in Appendix No.1.
oil was for a long stretch of its history almost an American and British Preserve was an historical accident. The Americans were the first to have a persistent oil surplus. The British had no oil, but were the first to obtain command of oil abroad. A change was bound to come. The two countries could not hope that they should forever be Purveyors to the world of oil which they find and develop in countries which are not their own. It is probably true that the oil companies can hope to play their role of regulating the international market only in cooperation with governments, not against them."

The second Arab oil Congress opened in Beirut October 16, 1960. A new vote of confidence extended from the delegates. The representatives from Mexico, Brazil, Argentina, the Soviet Union, Rumania, Czechoslovakia, Indonesia and Italy's ENI attended it as observers. In contrast with the first Congress in Cairo, the Beirut meeting saw lively debate between the countries and the companies. Arabia's Hendryx reiterated his challenge to the sanctity of contracts. He was backed by Samir Shamma of Arabia; "I too am a Moslem and an Arab. Sharia (religious) law does not approve of a violation of a contract, but it implies violation is permissible where the needs are of the nation. Even the second Caliph of Islam had to do it."

Arabia's Tariki denounced the cartels' price formula as "fishy" and declared the 50 - 50 pattern of profit division an illusion. This the companies hotly denied. "You don't let us into the industry to see for ourselves," Tariki retorted, "when we asked to see, you refused." To the delegates he said, "they treat us like children."

George T. Ballou of Standard of California had a soothing answer to all this talk about prices and production; "the solution will be forthcoming through the action of the natural forces in the market place," to this Emile Soubly of Standard of New Jersey added, "we'd rather fight in an open jungle than in a cage."

The Iranian delegate was explicit, "Obviously we cannot allow the disposal of and payment for our petroleum to depend solely on the will and unilateral action of the other party. Within the past 18 months, the price paid for our petroleum has been cut down twice without so much as previous notice to the countries concerned." In this he was backed by the Shah who on another occasion had said; "The Oil companies must act not only as business men, who think only in terms of where they can make a cent per barrel more profit. They must also take into consideration political aspects and consider the Question of how long they will continue in the area."

11. Quoted from Haevcy O'CONNOR, see Chap. in "World Crisis in Oil". The Arabs Look to the future, (Elek Books Ltd. London 1963) PP. 374-84.
Unable to increase oil revenues through improving their relative shares, host governments were left with only one viable alternative, namely, raising oil production rates which itself became an issue of conflict. While the oil companies aimed at stabilizing production, especially from the "old" sources, host governments, because of development pressures, pushed for higher production rates.

This picture was to change in relatively short order; a number of independent factors were taking shape in the oil industry and in the oil producing countries. (over the past decade or so), that were eventually to shift the bargaining balance, and with it the division of revenue in favour of host countries. Chief among such factors were the following: (a) the size of proven oil reserves, (b) the rise of nationalism in the oil countries, (c) the weakening of vertical integration in the oil industry, and (d) the successful emergence of OPEC.

Since 1962 most of the governments have organised national oil companies which developed the local oil industries - from production to marketing - and the producing countries have gained full control of local refining and distribution. They contracted new concessions which made them the masters of the oil potential of their countries. Moreover during that period Israel became a very small and declining producer and entered the ranks of the major transporters, a number of the Trucial Coast Shaikhdoms became producers, and some of considerable magnitude. Persian gulf offshore magnitudes added great Quantities of oil to the
total production and reserves of the region; with loading facilities, storage capacity and pipelines were constantly added.
The region became a great natural gas producer, and a centre of Petrochemical industry. Egypt became a substantial producer, and although the Suez Canal was closed since 1967, it was reentering the transporter's group through the planned Sumed pipeline. Syria became a producer, and its role as transporter was enhanced by its nationalization of the IPC pipeline running through its territory. Iraq nationalized the IPC and MPC and was struggling to operate the enterprise and find markets for the crude produced. The consequences of these developments, economically and politically affect the oil production which was steadily increasing. It almost quadrupled between 1959 and 1971 and the percentage of the region's share in world production went up from 23.6% to 32.4%.

Even more impressive was the dazzling rise in the estimated reserves from 181.365 billion barrels in 1959, to 366.8 billion barrels in 1971, double what it was at the end of 1959 inspite of the constant heavy accelerated production. Curiously enough the share of the West Asia in total reserves did not increase since 1963; in fact it might have dropped somewhat. It should be noted that the United States share of world reserves dropped from 9.1% in 1963 to 6.8% in 1971, and

of the whole western Hemisphere from 20.4% to 13.4%. The slight drop in the West Asian share was primarily the result of the increment of reserves of the communist countries and of Africa.

Regardless of the drop of a few percentage, the outstanding fact remained that the West Asia had been for a long time the single huge oil reservoir of the world, and it was constantly expanding in absolute numbers of barrels as well as percentages of the other world reserve centres. It long surpassed the United States in reserves, it passed it also as a producer and it was destined to become the greatest producer in the world.

At the same time the West Asian oil rich countries had been obtaining steadily and increasingly enormous amounts of revenue from its oil. As the oil revenue statistics shows, it increased five fold in revenue from $1.274 billion in 1959 to $7.088 billion in 1971. Great portions of this enormous revenue were invested in economic projects which intensified the economic development of the region.

Even though until 1971 despite OPEC's efforts oil exporting countries were in a weak position, as MNC's unilaterally established production and pricing policies, for the most part was on the basis of the interests of the developed oil importing

13. Africa's share accounted for 4.7% in 1963 and that of the communist countries was 8.8% in 1971 Africa's share increased to 8.9", and that of the Communist countries to 15.4% Western Europe's share of reserves rose from 8% in 1963 to 2.3% in 1971. Ibid. P.526, BP, Statistical Review 1963, 5; 1971, 4.
countries. 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.

Thus, the first task which OPEC set for itself was to stabilize oil prices and keep them 'steady and free from all unnecessary fluctuations. Accordingly, the first paragraph of the first resolution asserted that, 'members can no longer remain indifferent to the attitude therefore 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 it was finally realized 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.

At the time OPEC was created royalty payments to host governments were in the form of royalty per barrel, usually 12.5% of the posted price. The only OPEC member country that benefited from a rate higher than 12.5% was Venezuela. In addition, 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 1950's they calculated

14. The applicable rate of Venezuela was 16.2/3%.
royalties as part of the governments' 50 percent, thereby 

making the governments' actual share much less. The royalty, in effect, became a payment to the companies rather than the countries. In the words of Fuad Rouhani, OPEC's chief negotiator with the oil companies:

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%.

Against the forcing background, 'Resolution 33, adopted at OPEC's Fourth conference in Geneva in 1962, demanded:

That each member country affected should approach the company or companies concerned with a view to working out a formula whereunder royalty payments shall be fixed at a uniform rate that members consider equitable, and shall not be treated as credit against income tax liability.

16. Quoted in Muhammad* A. Mughrabey, permanent Sovereignty over oil Resources: A study of Middle East Oil Concessions and Legal changes (Middle East Research and publishing Centre, Beirut 1968), PP. 141-2.
17. The 4th OPEC Conference (two sessions April 5-8 and June 4-8 Geneva) approved the admission of Indonesia and Libya to OPEC and recommended that Member Countries should enter into negotiations with oil companies to ensure the restoration of crude oil prices to the level which prevailed prior to August 9, 1960. For the formulation of a rational price structure, the conference deemed it necessary to link oil prices to an index of prices of goods imported by member countries. An expensing of royalties formula and the elimination of any contribution to marketing expenses of the oil companies were also recommended. Source - OPEC - General Information and Chronology, (Pub. by the Secretariat, OPEC, Vienna, June 1985). P. 25.
However, approaching the companies to discuss the issue of royalties was not an easy task. The negotiations on this issue, which lasted from 1962 - 1965, 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 'principles of collective bargaining' which the OPEC countries adopted to deal with the companies.

Eventually, the companies reluctantly agreed to bargain with OPEC. The protected negotiations ended in the companies 'agreeing' to improve the royalties of the oil producing countries; in other words, royalties were to be deducted before profits were calculated and divided, thus increasing the actual government take per barrel of crude. The settlement provided, moreover, for consultation in 1966 between the governments and the companies on possible future reductions in the discount rate. In April 1966, at OPEC's Eleventh Conference in Vienna, the member states adopted Resolution XI71, advising member countries to 'take steps towards the complete elimination of the discount allowance granted to the oil companies'.

In accordance with this recommendation, negotiations soon reopened between the producing countries and the companies. However, as usual, negotiations proved difficult, and there was no solution yet in sight when the Arab Israeli war broke 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 caused crude oil prices to recover. The interruption of oil supplies and the firming of 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 9 January 1968, after a two day conference in Beirut, the five OPEC members announced that 'they have accepted an offer submitted by the companies on 6 January 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 5.4 percent in 1968, to 4.5 percent in 1969, 3.5 percent in 1970, 2 percent in 1971, and ceasing entirely in 1972. Thus by 1970 the change was complete, in view of the West's political and military withdrawal from the West Asia whereby making company's resistance against government demands futile. And since the companies had run out of additional tax credits to claim and out of new markets to conquer, they could not meet any new financial demands by OPEC without cutting into their own profits or raising prices to their customers. Naturally they chose the second option.

In short, the companies in any new confrontation with OPEC, or its member countries, could be expected to yield, and to pass along any financial pressure to their customers. They were not exactly relegated, as the chairman of BP put it to being a vast "Tax collecting agency" for OPEC, since they continued in charge of

the world wide transport, refining and marketing of oil and made profits somewhat beyond a tax collectors' normal salary. But they had lost their controlling position at the upstream end from which their other powers once had flowed. And in view of Japan's and Europe's mounting (and America's prospective) dependence on oil imports, any concerted drive by OPEC for higher revenue would be sure to have repercussions throughout the entire industrial non-communist world.

Whether the strategies of OPEC and its member countries fully appreciated all the factors just listed is hard to tell. But several things were certain: that objective circumstances had fundamentally changed in their favour; that OPEC countries were ready to exploit fortuitous circumstances (such as the temporary closing in 1970 of the pipeline from Saudi Arabia to the Mediterranean and the resulting temporary tanker shortage) so as to probe defences on the other side; that they were ready to push ahead singly or in groups. However all earlier price increases were dwarfed by there of mid October 1973, which raised the posted price of the market crude from $3.01 to $5.12, which further raised it to as much as $11.65 - implying a "Tax take" of $7.01 in 1974. The first round of increases


accompanied the Arab's use of their long-heralded "oil Weapon" in the Yom Kippur war. Oil shipments were embargoed United States, the Netherlands, and certain other countries; production was cut by as much as 25% at once and further cuts of 5% a month were threatened; and posted prices were raised by 70%. The embargo and production cuts were fully applied only by the Arab producers of the Gulf (Saudi Arabia, Kuwait, Qatar, Abu Dhabi), and somewhat more unevenly by Libya and Algeria. Iraq, while participating in the embargo, soon restored full production, (among the major non-Arab countries, Venezuelan production remained steady, whereas that in Iran, Nigeria and Indonesia increased slightly), still the overall effect was a decrease of world oil supplies in international trade from 33 b. barrels per day (mb/d) in September 1973 to 288 mb/d in November 1973. Since

22. The misconception has long been prevailed that oil weapon for the first time used during the Oct. 1973 Arab-Israeli war. In fact the Arabs have always sought the shelter of oil for the implementation of their short term strategies, however it was for the 1st time that oil strategy was put into operation strictly against the United States and the developed countries to prevent them from supporting Israel and look at the Arab-Israeli conflict from a different point of view obviously as a long term strategic consideration. The principal lesson for the Arabs was that war in itself cannot within the foreseeable future - put an end to Israel's existence. War can at best supplement a political process that has reached a stalemate, 1967-77. A Ten year perspective of the Arab-Israeli conflict by Alouph Hareven Articke Pub. in the Middle East Review, Vol. IX No.4 P. 15 Summer 1977, Washington.

the allocation of the shortage had to be handled by the oil companies, which to this day control the world's network of tankers and refineries, the effects were fairly evenly distributed. But an even reduction of oil imports meant a much more severe energy shortage in Europe and Japan (which depended on Oil imports for three fifths or three fourths, respectively, of their total energy) than in the United States (where oil imports constituted only one sixth of total energy consumption) as the table shows.

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<td>Energy Consumption by Industrialized Power - 1974-75</td>
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<td>7. Energy per capita from sources other than oil imports</td>
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24. This statement is based on the above calculations, reproduced here from Rustow "Who won the Yom Kippur and Oil wars?" Foreign Policy No.17 (Winter 1974-75) P.168:
The new order that OPEC created restored control to the legitimate owners of the oil reserves and empowered them to make independent decisions within the framework of burgeoning national sovereignty, cooperative action with OPEC and world outside. Thus, the turning point in 1973 has allowed these countries the opportunity to use oil as an instrument of economic and social development. However, today all OPEC members face the same challenge; to stretch the exploitation period of their oil reserves long enough to enable them to establish a productive economic system capable of replacing oil as a source of income and export proceeds, in order to sustain comparable standards of living to those they are new at long last beginning to enjoy.

As long as oil is the only engine for growth, and it is likely to remain so within the foreseeable future, OPEC members will have to cooperate and harmonize their policies to sustain their collective benefits. However, the steep increases in OPEC's revenue represent a financial transfer not from the companies but indirectly from the consumers. OPEC's future prospects therefore depend largely on the response of the consumer countries in the near future.