CHAPTER XIV

PRICES OF OIL.

(1) Fifty-fifty
(2) The kind's Tax.
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Just when the Middle East was opening up its cheap oil, the price of gasoline in the United States was shooting up, with ending of wartime controls. The price of oil suddenly again became an explosive political issue, and there was a new surge of populist resentment against the old bogey, the Oil Cartel.

The four partners in ARAMCO were in some disagreement as to how they should price their cheap Arabian Oil. Exxon wanted to put it up far enough to be in line with its other oil suppliers, and to keep it out of the U.S. market; but there were objections from the original partners. A memo from Socony and Texaco in June 1947 warned that the Europeans (to whom much of the oil would be sold) were resentful of the high price of oil: “The people of Europe in general have had a despairing attitude toward their future rehabilitation if not survival. An increase in prices of middle east crude now would produce, in our opinion, a widespread reaction that we are squeezing and taking advantage of them.” In their desperate warning to President Acheson: “In the Middle East, where the oil companies are large in size and few in number, and where partnership arrangements are very common, it is particularly important to avoid anything which would look like monopolistic abuse. Forgoing localized high returns, would be an investment in future sound and satisfactory relationships.” But the board of Exxon were determined to maintain a high
price, and after bitter argument and the threat of legal action, the other partners eventually agreed to put up the price from $1.02 to $1.49.

Already before Exxon joined ARAMCO, there had been a major row about the oil price. Early in 1947 it transpired that Aramco was contracted to sell oil to France at 93 cents a barrel, and to Uruguay at $1 a barrel, while it sold oil to U.S. Navy for up to $1.23 a barrel. A senate committee, headed by Senator Brewster of Maine, then held hearings which brought into the open much of the devious wartime dealings of Texaco and Socony. The timing was poignant, for Exxon and Mobil were just contracting to acquire their shares in ARAMCO, and their contract was agreed to just two days before President Truman announced the "Truman doctrine", for support of Turkey and Greece, which made Middle East investments appear substantially safer.

The oil companies thus appeared to be getting rich on the backs of the government, and in April 1948 the Brewster Committee published a devastating attack on Socony and Texaco:

"The oil companies have shown a singular lack of good faith, a voracious desire for enormous profits, while at the same time they constantly sought the cloak of United States protection and financial assistance to preserve their vast concessions". The committee noted the number of government oil experts who had formerly been employed by oil companies, and recommended that congress should establish a special petroleum board and continue its investigation. The Attorney General, they said, should give the utmost consideration to
the question of Exxon and Mobile joining ARAMCO, "with its possible effect of lessening competition." The companies, in a memorandum, replied that they had contributed and risked for more in ARABIA than had the U.S. government, to which they had no special obligation. The Aramco sisters could now afford to flaunt their independence.

There was soon a more resounding outcry about prices, as a result of the launching in 1948 of the MARSHALL PLAN and its instrument, the European Co-operation Administration (ECA). Paul Hoffman, the administrator, discovered that American oil companies were charging ECA much more for their oil than they were charging their own affiliates; and Eugene Holman of Exxon when questioned, had to explain how the pricing of oil was still based on the "Gulf-Plus" system that had been consecrate at Achmacarry Castle twenty years before, and on the eerie concept of "Phantom freight". As he put it in inimitable oil jargon:

"Our announced F.O.B. (freight on Board) prices for crude oil supplies at the eastern Mediterranean or Persian Gulf are equivalent to the Caribbean price for crude plus freight at published United States Maritime Commission rates from the Caribbean to Western Europe less freight on the same basis from either the Eastern Mediterranean or the Persian Gulf, depending on the supply point to Western Europe."

In other words, the cheap Arabian oil was fixed at the high American price.

The oil companies eventually agreed under pressure to establish an alternative "basing point" for oil prices at
the Persian Gulf, oil from the middle East would therefore not be charged with phantom freight, provided it did not travel further than the Mid-Mediterranean. But the oil from the Persian Gulf was still to be charged at the same rates as the more expensive American oil. This formula in turn was modified as the Middle East oil increased in volume; The "equalization" point was moved from the mid-Mediterranean first to London and then to New York.

In early 1949 Hoffman charged the four members of ARAMCO with differential pricing, and instituted his own investigation. As a result the oil companies soon made cuts in their prices. But the question of oil prices continued to reverberate through Washington, with a succession of investigations. The old moat of antitrust, having gone under ground during the war, was coming up again to the surface.

Even with the cuts in prices, the sisters were making vast profits from Middle East oil. "It is difficult to say what would have happened," Commented one oil economist, Paul FRANKEL, at the time "had production in the Middle East not been in the hands of companies which had strong interest in the western Hemisphere." (FTC Report, 1952 : P.355) But for the time being, the sisters were safe. The new oil fields had been divided between the existing companies, nearly all of whom (except BP) also produced oil in America. So that they would not let the new oil under cut the Americans. Their interests were interlocked in IRAQ, KUWAIT, BAHRAIN and SAUDI ARABIA. So that though their competition in marketing was fierce, they all shared the same concern for maintaining
high prices and avoiding an uncontrollable glut between them they could avoid opening up too many new fields.

And meanwhile the world was clamoring for the stuff, and the car factories and highways were opening up Europe to a great new age of oil, transforming the landscape and way of life. In spite of the high profits, the oil was the cheapest of all fuels, soon threatening the coal miners with redundancy, and proving a cheaper cleaner and far less arduous alternative.

With America booming and Europe reviving and with oil profits constantly under fire, few people were anxious to suggest that oil was not too expensive, but too cheap or that the world was relying on a fuel whose supplies would be increasingly uncertain. The old optimism of the Pennsylvania drillers still seemed justified. Just when a shortage seemed imminent a vast new oil field would open up. If one foreign country, like MEXICO, became awkward, there was always another that was glad to make a deal, like Saudi Arabia or Venezuela. From their position of power, the oilmen were slow to realize that the producing countries, too, were gradually becoming closer to each other, and discovering their own potential strength.

FIFTY — FIFTY

It was on the other side of the world that nationalism first seriously confronted the oil companies and it happened in the middle of the Second World War, when it was hard for them to withstand it. The Mexican crisis had apparently been overcome, with the help of Venezuelan oil. During the war
years Venezuela, with an area bigger than Texas and a population of only six million, had rapidly become the chief exporter of oil in the world, and a vital source for the three companies most involved, EXXON, SHELL and GULF. The war in Europe, through the British public were unaware of it, was dependent on Venezuelan oil.

Venezuela had been transformed through oil into the richest country in Latin America. The capital, Caracas, filled up with automobiles and between 1920 and 1936 its population doubled. But the position of the companies had been basically unstable, as in Mexico, particularly since the collapse of Gomez in 1936 and they were attacked for their exorbitant profits and the wretched conditions in the oil slums. By 1938 Venezuelans, under the military regime of General Medina, demanded a revision of oil contracts to allow higher royalties and taxes, in return for a forty year renewal. They would not agree. The companies were at odds; Shell, under its diplomatic manager, John London, saw advantages in coming to terms; but Exxon had a major board room row, with the oldguard encouraged by their local manager in Venezuela appalled by the threat to "The sanctity of contracts". But the state Department was in mood to back up Exxon's militancy, and were conscious of Europe's desperate wartime need for oil. In contrast to Mexico, the way was open for a peaceful compromise. They recommended two mediators, including Herbert Hoover (the son of the ex-president), to help draft a new law. In fact the oil companies were soon glad to pay higher royalties in return for stability and a forty year contract. They still
made ample profits. They stepped up exploration and development, and soon doubled their output of oil.

In 1943, the radical party Acción Democrática came to power, and with it a new kind of oil minister, a scholarly and monkish economist called Pérez Alfonso, who really understood the economics of oil. He had watched closely the developments inside the United States, the drastic depletion of reserves, the greed of the companies, and the enforcement of conservation and rationing in Texas. He saw Venezuela's problems in the larger perspective of world supplies in future decades, and he was to become the chief architect of OPEC.

Alfonso insisted that the Venezuelan Government should have a fifty-fifty share in all oil profits. A basic new law was passed in November 1948, just before a new coup removed Alfonso temporarily from office. But the new law remained in force and the companies soon realized that it gave them greater security. It established the government as their partners, and it made foreign owned corporations much less vulnerable to nationalist attacks. The fifty-fifty arrangement soon became a rallying cry for other oil producing countries, and idea quickly crossed the six thousand miles to the Persian Gulf.

The King's Tax

In the Saudi Arabia, it was not long before the old king was demanding a bigger share in the profits. He was becoming increasingly extra vagrant; his huge family began travelling to America, bringing home large cars and gadgets and gourmet foods were flown in by plane to RIYADH. Aramco were
obedient to his whims, and built hospitals, schools and roads to try to satisfy him. He wanted a railroad from the Capital to Dhahran, the oil town, which was reckoned to be quite uneconomic but ARAMCO provided it, at the cost of $160 million, advanced out of future royalties. But the king still clamored for more revenue and asked why he, too, could not receive a 50 percent tax as in Venezuela. Relations between the king and ARAMCO became strained, particularly after two new companies had bought concessions on the edge of his kingdom on far better terms, ARAMCO were fearful of losing their concession, but reluctant to give up any of their huge profits.

ARAMCO's official met with the State Department in November 1950. They had a sympathetic hearing from the Assistant Secretary, George Mc Chee, the Texas oilman and son-in-law of the geologist Everett de Golyer; Mc Chee was convinced of the need to give the Saudis more income, (1) and the State Department was worried by the communist danger in the Middle East. (Multinational Hearing, Vol.4, Page 89).

The State Department and Aramco then agreed on a scheme of beautiful simplicity. Additional payments to the king should be regarded henceforth as constituting a foreign income tax, so that under the existing rules for double taxation, they would not be taxed inside the United States. The King's share would simply be deducted from the company's tax bill. There were misgivings for some State Department officials about "what in effect would amount to a subsidy of ARAMCO's position in Saudi Arabia by U.S. taxpayers".

The "Golden Gimmick", as it was later called, deprived
the United State Treasury of $50 million in Taxes the very next year, enriching the King by the same amount, and as
Arab oil production soared, the loss of taxes became much more spectacular. But the tax device suited the State Depart-
mant as well as the King and ARAMCO, for it was really a
means to provide foreign aid to a kingdom which was important strategically, without having to submit it to Congress; a
particularly embarrassing procedure when Israel was strug-
gling for survival. It was not until hearing six years later that the tax device was publicly aired.

Other oil companies and countries were soon forced to adopt the same tax dodge to compete with ARAMCO. This
technical change was to have vast diplomatic consequences,
and helped to change the basic balance of the big companies.
It provided a huge inducement to invest abroad, rather than inside America, to minimize taxation; so that by 1973 the
five American sisters were making two-thirds of their pro-
fits abroad, and paying no taxes to the United States
Government on these earnings. (Multinationals Hearing Vol. 4,
F. 12, 95).

It also changed the internal accounting of the comp-
panies, who soon realised that the more profit they made from
their business "upstream" producing oil abroad, and the less profit they made "downstream" refining and selling oil to
the consumers, the less tax they would pay in the United States, they thus took little trouble to make money out of
filling stations, which they regarded primarily as outlets for their flood of oil. They littered the free ways with
then, to attract customers at all costs, while the dynamic energy of the companies went into production and exploration. Engineers and geologists dominated the boards, while marketing men were at a discount. The Companies were preoccupied with the simple word, crude.

The new fifty-fifty arrangement had another result with far reaching consequences which few oilmen foresaw. Because the producing countries were now partners in the profits, they soon insisted that the crude oil must be sold at a price which must be publically fixed and not buried in the companies accounting. Accordingly, the companies agreed to publish a "posted price" at which they would offer their oil for sale to anyone and on that price would be based the taxes paid to each government. It seemed at the time a fair system, but it had a serious drawback. The countries became accustomed to a steady income derived from the fixed price, and could not imagine it coming down, so the posted price soon became an artificially high price on which companies paid their taxes.

The producing countries thus were increasingly insulated from the real market, and the companies went on paying taxes on the basis of the posted price, not the real market price, and obtaining tax relief on that basis. In terms of the tax laws, this was flagrantly improper. The producer countries were now really receiving taxes based not on profits but on sales and this relief allowed companies to pay lower U.S. taxes than any group of industries. In 1972, for instance, Exxon paid out of its global income only 6.5 percent in U.S. taxes, and Mobil only 1.3 percent. In the mid-sixties the
Internal Revenue Service tried to question the pricing system, which was costing huge sums to the treasury. But the attorney representing the five American sisters, John J. McCloy, reminded the then secretary of State, Dean Rush of the real rationale of the tax allowance: "If the companies did not provide the necessary revenues by paying substantial taxes to producing countries, large amounts of direct foreign aid might well be required". (Multinationals Report 1975 F.93)

Thus the role of the oil companies in foreign policy was firmly underlined. They were given private privileges to enable them to be the paymasters of the ARAB States. It was from the State Department's point of view a neat, even brilliant solution, for they could overtly support ISRAEL and covertly support the ARABS, effectively bypassing Congress. But it was a solution which also served greatly to increase the power of the oil companies, to which the government had virtually delegated part of its foreign policy. It was a power which they were not slow to exploit.