Chicago - August 1, 1972
File: W 527

Mr. G. A. Kellow:

The attached article from the July 29 edition of BUSINESS WEEK deals with expected world-wide crude oil supply and price problems during the next decade.

I believe there is now sufficient evidence to justify raising the annual price increase factor for diesel fuel, used in the electrification study, from 3.5 to 5.0 percent.

Donald Wylie

lc
attachment
cc: Messrs. B. J. Worley
F. G. McGinn
M. V. Garelick
D. C. Young
J. J. Drinka
G. R. Frazier

# The Middle East squeeze on the oil giants

## The future looks rougher as oil nations grab a bigger slice of the dollar

The power of the corporate "Seven Sisters" who have dominated the international oil industry during most of this century is crumbling. It has been undermined, ironically, by insatiable worldwide demand for the vital fuel that they produce and sell.

As long as oil was plentiful and alternate sources were available in the U. S. and abroad, the major oil companies, led by Jersey Standard and Royal Dutch/Shell, could largely set the terms for the petroleum trade, because they controlled the only worldwide marketing networks. Indeed, in the days of gunboat diplomacy and palace intrigues, the oil companies were often accused of hand-picking the rulers they dealt with in the banana republics and desert sheikdoms.

Now the roster of countries with reserves big enough to slake the world's growing thirst for oil has narrowed to a handful of suppliers, mostly in the Middle East and North Africa (chart). As a result, what was once a buyers' market for oil has become a sellers' market.

The shift has sharply tilted the balance of bargaining strength in a business that has always mixed geopolitics with commercial strategy. The Organization of Petroleum Exporting Countries (OPEC), a cartel-like grouping of 12 nations dominated by Persian Gulf and North African states, is demanding a bigger piece of the oil business. And since it holds most of the stakes at the bargaining table, it seems certain to get what it wants.

The result, inevitably, will be a profound restructuring of the international oil industry. For the seven majors—Mobil, Texaco, British Petroleum, Gulf, and Standard of California, along with Jersey and Shell—the basic issue is whether they will continue to be resource-based companies controlling their own supplies of raw materials, or whether they will end up competing in the marketplace as buyers of crude from OPEC governments.

"There has been an accelerating rate of change in the international oil situation," says Jersey Standard's Chairman J. Kenneth Jamieson, summing up the companies' plight, with considerable understatement. Jersey has 40% of its production and 69% of its proved reserves in the Middle East and North Africa.

### The assault came upstream

The international oil companies have always looked for their biggest profits "upstream" at the wellhead, rather than in refining or marketing. So when the producing nations hike crude prices and demand a greater role in production, Jersey and the other oil giants are hit where it hurts most.

As a starter, Arab oil countries around the Persian Gulf want a minimum 20% ownership share in oil producing operations within their borders, and intend eventually to take over 51%. Last weekend, negotiators from the 14-company Iranian consortium arrived in Teheran to work out a different sort of arrangement with the Shah, who wants an escalator price formula for crude, bigger crude supplies for the state-run National Iranian Oil Co., and other benefits.

Venezuela, the biggest exporter outside the Middle East, intends to level off its output at 3½ to 4-million bbl. a day to stretch out its limited reserves, while Iran and Saudi Arabia by contrast expect output to hit 8- to 10-million bbl. daily by 1980. But Venezuela is squeezing more tax money out of its oil and tightening controls on company operations, while waiting for major concessions to expire and revert to the government in 1983, along with oilfield installations and other properties.

Looking on as highly concerned third parties, as the majors and the OPEC countries work out these new relationships, are oil users and governments throughout the world. They paid out $25-billion for oil imports last year. They will be paying much more in the future, because the amount of oil they burn doubles every 12 years and the price per barrel is climbing fast. OPEC countries wielded their new bargaining power last year to push up prices sharply under the 5-year "Teheran agreement" with the oil companies. By 1976, James E. Akins, director of the U. S. State Dept.'s Office of Fuels & Energy, expects the average price of Middle East crude, now around $2.25 per bbl., will reach the current average U. S. domestic price of $3.75 per bbl. By 1980, he believes, it could go to $5 and perhaps considerably higher.

**How the international oil giants performed in 1971**

| | Sales (billions of dollars) | Net income (millions of dollars) | Margin on sales | Return on investment (percent) | Employees (thousands) | Sales per employee (thousands of dollars) | Common dividends (millions of dollars) |
|---|---|---|---|---|---|---|---|
| Jersey Standard | $18.7 | $1,516.6 | 8.1% | 11.5% | 143.0 | $130.0 | $851.0 |
| Royal Dutch/Shell | 12.2 | 847.0 | 5.4 | 9.2 | 185.0 | 66.2 | 454.0 |
| Mobil | 8.2 | 540.8 | 6.6 | 9.7 | 75.0 | 109.4 | 258.8 |
| Texaco | 7.5 | 903.9 | 12.0 | 11.0 | 75.1 | 100.1 | 435.7 |
| Gulf | 5.9 | 561.4 | 9.5 | 8.3 | 57.2 | 103.8 | 312.0 |
| Standard of California | 5.1 | 511.1 | 9.9 | 9.7 | 42.5 | 120.9 | 237.4 |
| British Petroleum | 5.1 | 357.0 | 6.9 | 8.6 | N.A. | N.A. | 182.0 |

Data: Investment Management Sciences, Inc., BW est.

Those figures will translate into higher gasoline prices, heating bills, and industrial costs. And the U. S. balance of payments is in for a double jolt, because domestic oil production is leveling off, even with the prospective addition of Alaskan oil. To fill the growing energy deficit, imports will rise from 3.5-million bbl. a day last year to an estimated 12-million by 1980, and 17-million by 1985. As a result, the net drain on the U. S. balance of payments for oil imports could climb from the current annual sum of $4-billion to a staggering $17-billion in 1980.

The growing dependence of the U. S. and its allies in Western Europe and Japan on imported oil supplies, which can be cut off in an emergency, has political significance as well. At stake, says Walter J. Levy, a New York-based consultant to oil companies and governments, is this country's security and even the "credibility of the U. S. as a world power." This theme was echoed by John G. McLean, chairman and chief executive officer of Continental Oil Co., in a speech to the American Chamber of Commerce in London a few weeks ago. "In the future, we will share with Western Europe the haz-

Joan Sydlow—BW

Jamieson: He must shift profits downstream.

# Tougher times for Jersey Standard

It is 5,700 mi. from Manhattan to Mecca as the carpet flies, but the minds of J. Kenneth Jamieson, chairman of Standard Oil Co. (New Jersey), and Milo M. Brisco, its president, journey to the Middle East many times a day. The top men at the world's largest oil company are confronted by serious demands from the Middle Eastern producing nations for equity positions in Jersey's operating subsidiaries there.

The Middle East, however, is only one of the afflictions that is making Jersey Standard's life uncomfortable. As a multinational company, it is beset by growing pressures from Congress, labor unions, and foreign governments to restrict its operations. As a producer of fuels, it must find new sources of supply to meet surging energy demands in the face of mounting exploration and production costs and the hostility of foreign nationalists. As a company in an industry identified as a primary source of pollution, it is under heavy fire from the environmental movement. And as a holding company, it struggles to be more directly responsive to its problems by becoming an operating company.

**History.** Since before the turn of the century, Jersey Standard has been the grand petroleum panjandrum of the world. It controls operating companies with combined sales of $18.7-billion, greater than the GNP of Austria. These companies earned $1.5-billion last year, more than the sales of 424 of the 500 largest U.S. industrial corporations. Last year, Jersey paid out $851.5-million in dividends, more than Ford Motor Co. earned in 1971. Jersey Standard's operating companies account for one sixth of all the oil in international trade. Its enterprises have grown so large and far-flung that its 1971 earnings were 15 times as great as the $95.4-million earned by the old Standard Oil trust in 1911, the year before it was broken up by the Supreme Court.

Success breeds confidence, and Jamieson reflects it when he says, "I can assure you that we have the resources to overcome our difficulties." The trouble is, however, that the international oil industry has shifted from a buyer's market to a seller's market, and nowhere more dramatically than in the Middle East and North Africa.

Jersey's interests there include a 100%-owned subsidiary, Esso Standard Libya, Inc.; a 30% interest in Arabian American Oil Co. (Aramco) in Saudi Arabia; a 7% interest in Iranian Oil Participants, Ltd., in Iran; a 12% interest in Iraq Petroleum Co., Ltd.; and associated companies operating in Iraq, Quatar, Abu Dhabi, Syria, and Lebanon. These operations accounted for net production of crude oil and natural gas liquids of 2,047,000 bbl. a day out of Jersey's total daily production of 4,795,000 bbl. last year. In proved reserves, they account for 34.5-billion bbl. of Jersey's total 50-billion bbl.

The bulk of both production and reserves are in Saudi Arabia, where Jersey's 30% share of Aramco amounts to production of 1,350,000 bbl. per day and reserves of 27-billion bbl.

Aramco was once the sole property of Standard Oil Co. of California. But Socal did not realize what it had. Pressed for cash after World War II, it brought in three other U.S. oil companies as partners. Jersey paid $74-million for a 30% interest in 1948. The other partners are Socal, with 30%, Texaco 30%, and Mobil 10%.

Under a 20% equity agreement with the Saudis—the formula now under discussion—Jersey's share of the remaining 80% would be 24% (30% of 80%). This would reduce its share of daily production by 300,000 bbl., and its share of proved reserves by 5.4-billion bbl. And should the settlement call for an eventual 51% Saudi interest, Jersey's total worldwide reserves would drop 27%, from 50-billion to 36.2-billion bbl., while its average daily production would drop by 14.5%, from 4.8-million bpd to 4.1-million bpd, based on a 14.7% (30% of 49%) equity position in Aramco.

The loss of such resources poses a serious threat to Jersey's ability to supply its extensive Western European market, which it built up at great cost. The company operates 36,240 Esso retail outlets in 14 European countries, pumping more gasoline than Jersey sells in the U.S. Virtually all its European gasoline is refined from Middle East and Libyan crude, so Jersey is faced with dwindling production while Western European energy demands are galloping ahead. The difference cannot be made up with crude from the U.S., where production has leveled off and imports are rising, or from Venezuela, where production fell last year.

**National pride.** Jersey's Brisco discounts the threat that Arab producing nations might be tempted to go into the distribution and retail sale of their oil products in competition with the oil majors. "People are concerned that the producing countries are going to go downstream in a big way," he concedes, "but it's a matter of national pride versus economics. The costs involved in going completely downstream don't necessarily make all that much sense when you don't have to make all those investments in a highly capital-intensive situation. They can get all the profit advantages without those investments."

But Jersey recognizes that it is going to have to move energetically to shift profits downstream. Its domestic integrated subsidiary, wholly-owned Humble Oil & Refining Co., is already moving in this direction by adding self-service stations and abandoning conventional but unprofitable outlets. Humble closed 900 of its stations last year alone.

As another hedge against the loss in crude production profits, Jersey has begun to diversify into other energy sources. Through a Humble subsidiary, Carter Oil Co., it has acquired 8-billion tons of coal reserves, the third largest in the nation. Through Jersey Nuclear, it now produces nuclear power plant equipment, while Humble is mining, milling, and producing yellow cake.

Jersey Standard has also moved into the venture capital field. A subsidiary, Jersey Enterprises, has equity positions in five fledgling enterprises in information storage and communication, energy storage and conversion, and high-performance materials.

And Jersey has applied its real estate expertise—acquired in dealing for service station locations and mineral rights leases—to land development businesses in Texas and the construction of a string of 50 motor hotels in Western Europe.

**At the pump.** The big thrust, however, is in domestic retail gasoline marketing,

(continued on next page)

in which Jersey could stand a little more oomph. Although it is the world's largest oil company, it ranks third in the U. S. gasoline market, trailing Texaco and Shell. According to Lundberg Survey, Inc., Humble pumped 6.6-billion gal. of gasoline in the U. S. in 1971, compared with Texaco's 7.8-billion and Shell's 6.8-billion. Humble's market share dropped from 7.41% in 1970 to 7.05% last year.

The most immediate effect of this drive for greater profitability downstream is Jersey's decision to abandon its role as a holding company. Since 1928, it has operated exclusively through wholly owned subsidiaries or through equity positions. It has few physical assets and only 1,200 employees, most of them occupying a few floors of a new building in Manhattan's Rockefeller Center, into which the company moved this year.

But this October, the stockholders will vote on merging Humble into Jersey, and if they approve, the resulting merged company will be very much an operator. The impact will be more direct control by Jersey's management as it strives for greater profits downstream in marketing.

"The name problem forced us to operate through a subsidiary," says Brisco, explaining the merger. "We were the only oil company organized that way. There are undoubtedly some areas where we can save money, such as in advertising, public relations, and public affairs."

While the merger occurs, Jersey will be shedding the corporate name it has held since 1882, when it was founded by John D. Rockefeller. The legal corporate name is Standard Oil Co., with (New Jersey)—its state of incorporation—tacked on in common usage to sidestep legal proscriptions against the use of its own name in 20 states.

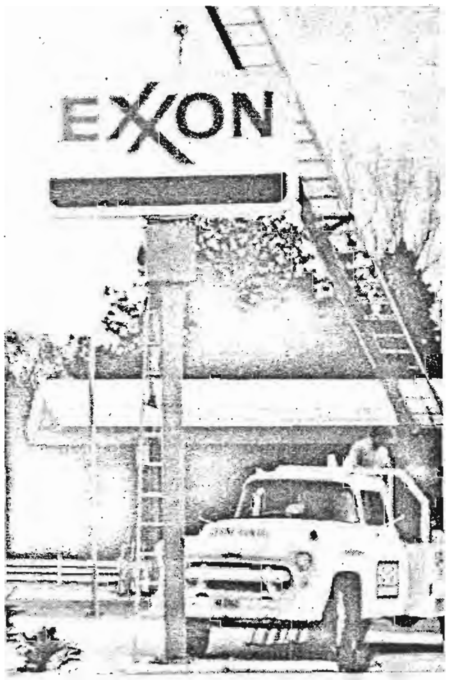
These legal barriers were set up because seven of the 34 competing companies formed after the 1911 Supreme Court ruling that broke up the old Rockefeller Standard Oil organization retained "Standard Oil" in their corporate names and used it in their marketing. Of the seven, the largest were Jersey, Standard Oil of California, and Standard Oil of Indiana. Subsequent court decisions barred Jersey from using its trademark "Esso" in many states. The grounds: The consumer associates "Esso" with Standard Oil, which is not the exclusive property of Jersey.

When the Supreme Court refused to hear its arguments in 1969, after a long series of court battles, the management of Jersey decided that a name change was inevitable.

**New handle.** Thus was conceived a new oil titan, Exxon Corp.—expected date of birth Jan. 1, 1973—with "oil" omitted rather glaringly from its name. Humble, merged with its parent, will be operated as a division of Exxon under the name of Exxon Co. U. S. A.

With the new name, Jersey will now be able to use a single trademark in its national marketing effort. Jersey will continue to use "Esso" abroad, where there are no bars to its use, but will use "Exxon" exclusively in the U. S. Humble tinkered unsuccessfully for years with an earlier substitute, "Enco"—from "energy company"—in markets where it could not use "Esso."

The name change will cost an estimated $100-million to switch identification signs at Humble's 29,105 retail outlets and to advertise a totally new national brand. The added expense comes at a time when basic operating costs are spiraling upward. "This industry is becoming more capital-intensive," Brisco notes. "Drilling is much more expensive, offshore or remote. We are swinging away from short-haul crude, so transportation costs are much heavier."



The new name omits the word 'oil.'

As these expenses have piled up, Jersey's long-term debt has risen to $2.6-billion, up from $932-million in 1965. "I can remember," says one former Jersey finance man, "that even as recently as five years ago we spent a lot of our time figuring out what to do with Jersey's excess cash. Now they're trying to figure out what to do to get the cash they are going to need."

Some of the money may have to come out of the big dividends that the shareholders of oil companies favor, and that the managements of large oil companies like to declare to keep in the good graces of powerful shareholders. Jersey paid $3.80 a share in 1971.

**Power bloc.** Investors in Jersey who might be described as influential include the Rockefeller family, which holds, directly or through trusts, "less than 2.2-million shares"; Rockefeller Foundation, 3-million shares; Rockefeller Bros. Fund, 395,000 shares; and David Rockefeller's Chase Manhattan Bank, in whose trust department the common stock holdings of Jersey rank second after IBM. The trust and investment division of Morgan Guaranty Trust holds 3.8-million shares. Prudential Insurance Co. has 1.1-million shares in its accounts, three IDS funds hold 1.9-million shares, and Affiliated Fund, 1-million shares. Jersey itself owns 2.4-million shares of its own stock, and the largest single shareholder account is the company's Trustee-Thrift Fund for employees, holding 2.8% of the total 224-million outstanding shares.

The opinions of the shareholders weigh heavily on the decisions oil companies make, and this weight is felt in negotiations with the Arab nations. The companies were warned at the time of the Suez crisis that the old concession system would be on its way out. They were told they would be better off taking the initiative in hammering out a new relationship with the producing states, giving them more active roles in the management of their resources. But the companies balked, arguing that their shareholders would object.

In the current negotiations, Jersey's strategy, worked in tandem with the other international oil companies, seems to be something of an arabesque on the old British policy of divide and rule; it is playing up the divergent interests of the OPEC nations. Jamieson hints at this when he says that in haggling with the OPEC negotiators "the situation is so different, country to country, that as a result nothing is accomplished."

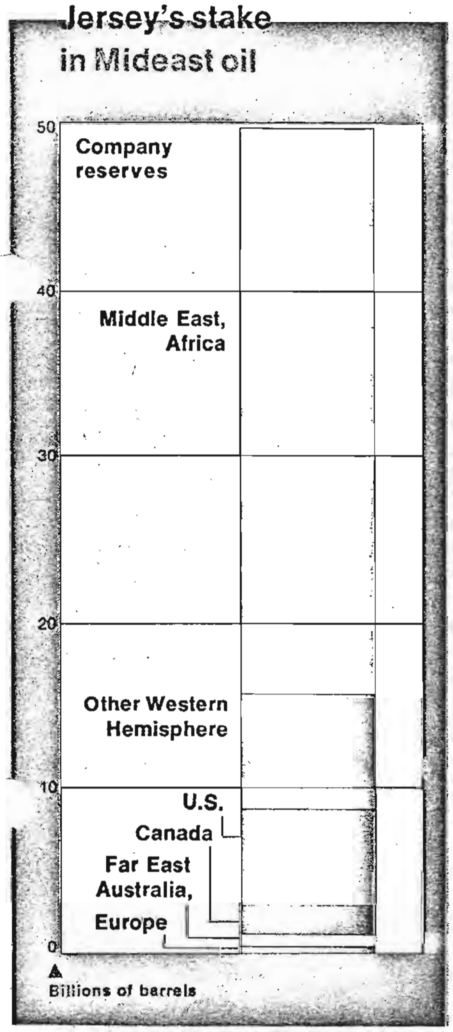
In Venezuela, though, Jersey is conducting little more than a holding action. Greatly increased taxes there have caused 95%-owned Creole Petroleum's contribution to Jersey profits to fall from 39.6% in 1958 to 13% in 1971.

Jersey says "sharply lower earnings in Venezuela as a result of lower export volumes and higher Venezuelan taxes" were a major factor in the decline of its first half earnings from $726-million, or $3.24 per share last year, to $686-million, or $3.06 per share.

In Canada, Jersey's other major Western Hemisphere producing area, 70% owned Imperial Oil, Ltd., increased its earnings from $105-million to $136-

million last year, largely because of expanc.d crude production. Echoing the downstream theme, Imperial's annual report says "this buoyancy in the producing end of our business should not be allowed to obscure the necessity of obtaining adequate returns in every phase of our operations."

**Top men.** Both Jamieson and Brisco have backgrounds in production and refining. Jamieson, 62, came out of Imperial. A native of Medicine Hat, Alberta, he exudes an aura of solidity and




Data: Standard Oil Co. (N.J.)

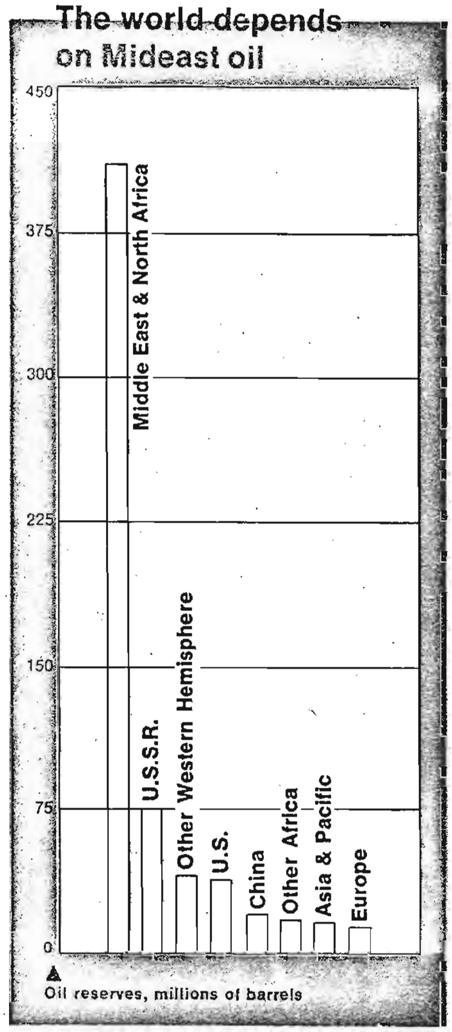
dependability that served him in good stead while building a reputation for himself as an effective mediator between clashing egos or points of view.

Brisco, 60, born in Maud, Okla., spent 22 years for Jersey in Colombia and Peru. When Jamieson left Coral Gables, Fla., in 1961 to join Humble, Brisco succeded him as president of International Petroleum Co., a Jersey subsidiary supervising all Latin American operations except Creole. Coral Gables has become the route to the top at Jersey, since former chairman Michael F. Haider also once headed it. Jamieson became chairman and Brisco president in October, 1969.

ards of interruptible supplies," McLean warned.

### Economic and political realignment

It is the future, more than the present, that is reshaping the international oil industry and the political environment in which it operates. The Arab countries in 1970 produced 15-million bbl. of oil a day, or about 60% of the 27-million bbl. that moved in world trade. By 1980, when international oil shipments will soar to around 70-mil-




Data: Oil & Gas Journal

Mario De Vincentis—BW

lion bbl., the Arabs may account for 50-million bbl., or 70%. "By then," says Akins, "Libya, Saudi Arabia, Kuwait, Iraq, and very likely Abu Dhabi will each have production greater than the spare capacity of all other oil producing countries combined. Any one of these countries could cause a supply crisis by cutting off its production, and any two could cause a very serious one."

McLean, who is chairman of the National Petroleum Council's Committee on the U. S. Energy Outlook, believes that this new supply-demand equation will bring about a "new and highly significant polarization of economic and political interests among countries of the Free World between now and 1985." Here is the way he describes it:

"At one end of the pole, we shall have OPEC and possibly a few others, interested in securing maximum benefit from the development of their natural resources and keenly cognizant of the power implicit in their near-monopoly position. At the other end of the pole, we shall have the major consuming countries, compelled to purchase oil in growing quantities for at least the next 15 years, since it will take us at least that long to develop significant alternatives. On the sidelines, we shall have Russia, an interested and possibly provocative spectator, resting comfortably in the knowledge that it will be the only major world power in this time span that is self-sufficient in energy resources."

The huge inflow of revenues into the oil producing countries will create a major new center of financial power, predominantly Arab, in world money markets. McLean figures that the oil revenues of OPEC countries between now and 1985 could total half a trillion dollars. Most of the big oil exporting countries, particularly the sparsely populated Persian Gulf states and Libya, cannot invest all that money at home. "One not unlikely possibility," McLean concludes, "is that the OPEC countries could become large equity holders in the financial institutions and industrial companies of the United States, Western Europe, and Japan."

### A test of diplomacy

For the oil companies, whose tax and royalty payments are the conduits for the huge money flows from consumers to oil producing countries, the changing international environment poses a critical test of their ability to evolve a new set of relations with the OPEC countries and to work out a new role for themselves in the international oil industry. Last year, the Seven Sisters, individually and in interlocking consortiums, accounted for well over half of the total world production of 48-million bbl. a day. This output, together with "downstream" operations in refining and distribution, brought them combined revenues of $62.7-billion and profits of $5.2-billion. Fully two-thirds of their crude or nearly 20-million bbl. a day, comes from fields in the OPEC countries—Saudi Arabia, Iran, Iraq, the Persian Gulf sheikdoms, Libya, Algeria, Nigeria, Indonesia, Venezuela, and newly added Trinidad-Tobago.

Whether the oil companies will continue to have full access to this crude, and to future increases in output, will be a crucial issue in negotiations with Persian Gulf countries on "participation." If the majors retain the right to market all or most of the governments'

# The debate over rising oil prices

In the face of an apparently permanent sellers' market, the oil-rich countries are steadily winning higher prices. That trend will likely accelerate in the years ahead, because the U. S., by far the world's biggest consumer of oil, will be scrambling for a growing share of its oil supplies overseas. But there are differing views over how much of a price rise U. S. oil consumers can expect.

Inevitably, most of the growth in imports must come from the Middle East, where the U. S. will be competing with Europe and Japan to line up supplies in a region that contains about two-thirds of the world's known reserves.

The U. S. now obtains some 67% of its oil from domestic sources, 20% from other Western Hemisphere countries, chiefly Venezuela and Canada, and only 3% from the Mideast. But because the U. S. is unlikely to obtain a larger proportion of its oil supplies from other Western Hemisphere countries, the ratio of imports from the Eastern Hemisphere is expected to soar to 40% of an estimated daily consumption of 30-million bbl. by 1985.

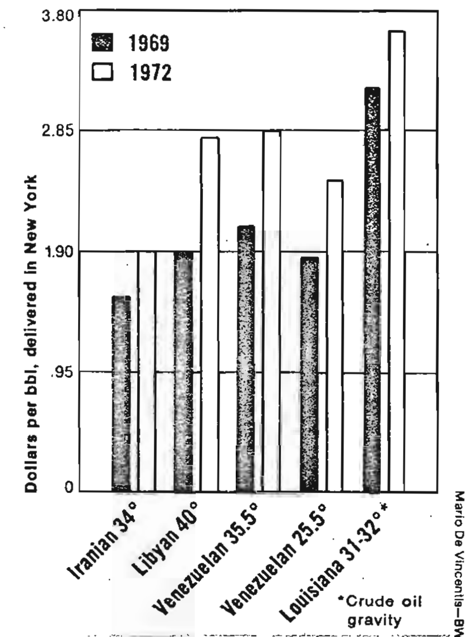
**More competition.** But higher prices in the Middle East and North Africa may, ironically, stimulate more oil production elsewhere and hasten development of synthetic fuels. Moreover, some economists minimize the threat of rapidly rising prices. "To the degree that the oil-exporting countries get control of their oil, the more price competition there will be," maintains Bruce C. Netschert, vice-president of National Economic Research Associates, Inc.

"I don't accept that the price of oil will reach $7 a bbl. by the end of this decade as some think," says Angus Beckett, a former British government oil specialist. "Increased competition in the Middle East may keep the price below that level."

Another British oil expert, Paul H. Frankel, head of London's Petroleum Economics, Ltd., questions present projections that Free World oil demand will almost double to around 76-million bbl. per day by 1980. "Environmental demands have become almost a religion which will impair the spirit of rapid industrial growth," Frankel contends. "Oil demand forecasts were based on an expectation of continued rapid growth."

Still, most oilmen expect a continuing rise in oil demand, at least until commercial nuclear energy comes into its own in the latter part of this century. Even if oil demand slackens in the industrialized countries, they expect a sharply rising need for oil in the developing nations because of the inevitable growth of energy consumption as per capita income rises.

A higher price tag for oil




Data: Oil and Gas Journal

Most oilmen also dispute the argument that selling competition between the producing nations and the oil companies will be intensive enough to dampen rising prices.

**Narrowing gap.** The surge of higher prices in the exporting nations (chart) is beginning to narrow the historic gap in prices between domestic U. S. oil and imports. A prolonged sellers' market is likely to bring prices of domestic and imported oil almost into parity within a few years. "I would expect sharp increases in both prices, with the spread between them tending to narrow," says John G. McLean, chairman of Continental Oil Co.

Higher prices, of course, are what the oil industry has been seeking in its efforts to tap "secure" but often marginal domestic energy sources. "If the price of domestic crude moves up a bit more," says McLean, "we can get at some additional reserves and produce them economically." He calculates that deeper drilling in older oil fields—tertiary recovery—will be economical when domestic crude rises to $4 a bbl. from its present average of $3.40.

Increasing reliance on foreign oil, and further pressure on the U. S. balance of payments, may help overcome strong resistance from environmentalists to expand offshore drilling on the nation's continental shelves. Geologists maintain that untold billions of barrels of oil and huge quantities of natural gas still await tapping in the Gulf of Mexico and along the East Coast.

Rising oil prices will also bring "synthetic" fuels into economic range. McLean figures that Alberta's big deposits of Athabasca tar sands could be processed into crude oil at a commercial rate when the price of regular crude reaches about $5 per bbl. Sun Oil Co. is already boosting output of tar sands oil after several years of technical trouble while several other companies are getting ready to produce.

McLean believes, too, that vast shale oil deposits in the Western states could be tapped economically at prices of $5 to $6 per bbl. But there are severe environmental problems that must be solved before the federal government can lease more shale lands. Mining shale produces huge heaps of waste material that must be disposed of in some way; processing the shale would require enormous amounts of scarce western water.

Even if shale and other domestic fuel sources should become economical and environmentally sound to produce, most oilmen are still convinced that the new sources will make up only a small fraction of soaring demand. And that is sure to mean rising dependence on the Middle East.

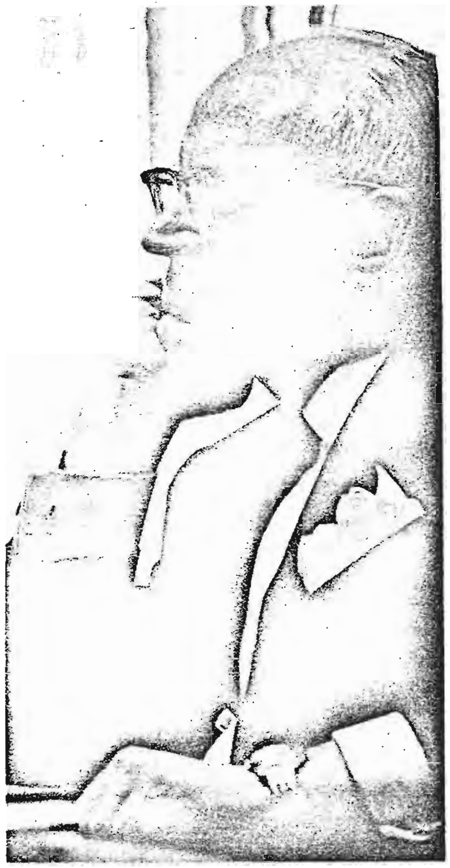
share, they should be able to keep more or less intact their integrated wellhead-to-filling station structure. But oilmen fear that without such an arrangement, oil production and downstream operations will become further separated, and that the international oil companies will become competitive buyers of crude, somewhat as coffee roasters buy coffee contracts.

The other big question is how much the Persian Gulf governments are willing to pay for a share in producing operations within their borders. OPEC has proposed compensation equal to the net book value of the local operating subsidiaries. Oilmen insist that they are entitled to compensation on future profits that they would earn from production and sale of their proven underground oil reserves—in effect, what their operations are worth as a going business. These positions are poles apart. By OPEC's formula, the total value of all the oil producing operations in the Middle East would be only about $1.4-billion, equal to less than 1¢ per bbl. of proven reserves. In the case of Arabian American Oil Co., jointly owned by Jersey Standard, Texaco, Standard of California, and Mobil, 20% of net assets would be $113-million, an amount the Saudi Arabians could recover out of a 20% share of profits on less than two months' operations.

These issues are likely to come to a head within the next few months. Saudi Arabia's Oil Minister, Sheik Ahmed Zaki Yamani, has been negotiating intermittently on behalf of five Persian Gulf states—his own country, Iraq, Kuwait, Qatar, and Abu Dhabi—with an oil company team that includes C. J. Hedlund, Jersey Standard's vice president for the Middle East. Iraq Petroleum Co., another consortium, has set an October 12 target for reaching an agreement with the Iraqi government on compensation for the Kirkuk fields that were nationalized June 1. Whatever IPC and Iraq agree on as a basis for compensation will probably set the pattern for participation talks with other countries.

### The Shah stakes his claim

The negotiations are complicated by parallel talks between Iranian Oil Participants, Ltd., a 14-company consortium, and the Shah. The Iranian monarch seemed to undercut the bargaining position of the other Persian Gulf countries when he declared in London last month that he wasn't interested in participation. Instead, the Shah said he had made his own long-term deal with the oil companies. He promised long-term stability of oil supplies for 15 years starting in 1979, when the present agreement with the consortium expires. But the oilmen who went to Teheran last weekend to work out the specifics could find that the cost is high. The Shah wants to tie the price of Iran's oil to a "basket" of international commodity prices as a hedge against worldwide inflation, which over the past two decades has eroded the purchasing power of the OPEC countries' oil revenues. Besides the price escalator, the Shah wants the consortium to turn over more of its crude oil production, reportedly at cost, to the government-owned National Iranian Oil Co. for processing and sale at home and abroad. Rounding out the package are Iranian demands for refineries and petrochemical plants to make more valuable products in Iran, along with aid to NIOC for expansion of its overseas production and marketing.


McLean: Turmoil is oil's way of life.

Other Persian Gulf countries have assigned Sheik Yamani the task of finding out just what Iran's getting from the consortium, so that they can demand the equivalent and a bit more. The eventual outcome seems likely to be a wide variety of "participation" deals tailored to the aspirations of each country. But the majors also see their traditional position as middlemen threatened by the expanding role of government oil companies in Europe and other consuming areas.

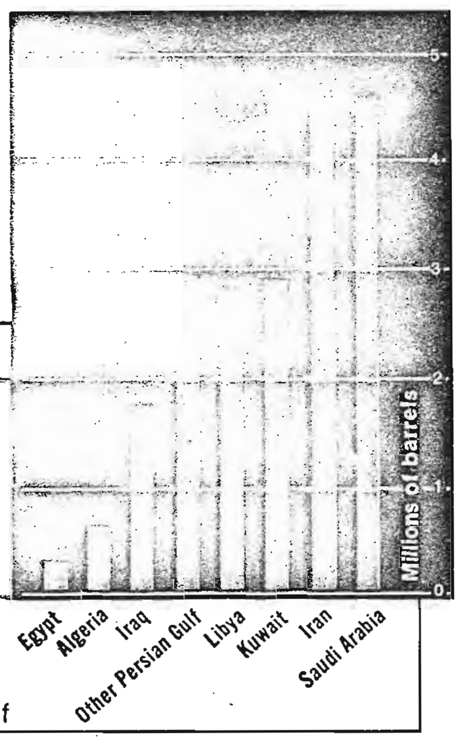
Since the beginning of the year, representatives of West Germany's Deminex, Spain's Hispanoil, Austria's Oesterreichische Mineralolverwaltung, and Japan's Petroleum Development Corp. have been meeting quietly in Zurich to coordinate their policies and establish themselves as a third force in international oil alongside OPEC and the majors. A basic aim is to assure their own supplies of crude by direct deals with the OPEC countries, such as long-term supply contracts and joint ventures in exploration and production, which would bypass the private companies. Italy's ENI, which already has a number of such arrangements in the Middle East, is working closely with the group, though France's ELF-ERAP so far has held aloof. Behind these initiatives is a growing concern that the international companies, as private intermediaries, can no longer guarantee continuity of oil supplies, so that consumer governments must step in.

The new agreement with Iran, and a settlement with Iraq if one is achieved, could widen the consortiums operating in those countries by bringing in as new members government companies from Western Europe and Japan, and possibly Eastern Europe. ELF-ERAP Chairman Pierre Guillamat asserts that the British, who dominate Iraq Petroleum, will have to decide whether to try to keep Iraq as a "British preserve" or bring in other European companies.

### The role of government

One way or another, most oilmen now concede, increased state involvement is inevitable from both the producing and consuming ends of the business. In Venezuela, the state-owned Corp. Venezolana del Petroleo is dick-

**The Middle East and North Africa: Where the oil is**

ering to get financing for exploration and development from Germany's Deminex in return for long-term supply contracts. In Europe, the Common Market Commission is trying to coordinate oil and over-all energy policies among its members. The U. S. government has been reluctant to get involved in oil negotiations. But proposals for cooperating with Canada and Venezuela in a "hemispheric" energy policy are becoming important issues in relations with those countries. Juan Pablo Pérez Alfonzo, the former Venezuelan oil minister who helped set up OPEC and is still influential in oil policy, argues that the U. S. should pay a "secure source premium" for Venezuelan oil.

**Strategic planning**

One risk, as governments play a greater part in the oil business, is that commercial disputes will become political confrontations, and vice versa. Traditionally, the oil companies have served as commercial buffers for the conflicting interests of producers and consumers—particularly important in relations between the U. S. and Arab oil suppliers because of American support for Israel.

If the international majors are squeezed out of oil production in the OPEC countries, or relegated to a secondary role, there is also doubt that government agencies of either the producing or consuming nations will be willing to risk the billions of investment dollars required in the years ahead to find and develop additional oil supplies. Indeed, only companies with worldwide crude oil sources and marketing outlets may have the capabilities for long-term strategic planning and organization required to keep the oil flowing. Recognizing this, Pérez Alfonzo rejects a dominant role for national oil companies, and favors instead an ownership share in activities of international companies by both local governments and private investors from the oil producing countries. He says: "We should not tamper with the oil company structures as they exist. This is one of the reasons I favor participation in order to gain experience, because there is no substitute for efficiency and we will need efficiency as oil becomes more difficult and costly to extract."

Yet despite the uncertainties that cloud oil's future, Continental Oil's McLean, for one, manages to be philosophical about the prospects. "I've been in this business 25 years now, and it has always been in a period of transition, turmoil, and change," he says. "We're going through it now, and I think we'll be going through it for the next 25 years." ■