Because of its importance as a fuel for modern industrial economies and for military forces, petroleum has long been the subject of domestic and international politics. Over the years, countries have sought to gain control of petroleum resources and to manage the use of those resources for their own political, military, and economic benefit. From the nineteenth-century battles over the Caspian Sea to the War in Iraq in 2003, oil has been the prize in numerous military conflicts. Since 1900, when oil became central to modern industry, multinational companies and both exporting and importing countries sought in vain to create international economic governance systems that would allow them to manage the supply and demand for petroleum, to no avail.

During the Bretton Woods period, the oil industry was dominated by a small group of multinational companies, most of which were headquartered in the United States. The U.S. government, perhaps unwisely, imposed quotas on imports of petroleum to protect the interests of domestic oil producers. This artificial restriction of supply in the United States produced dramatic pressures for increased prices in the early 1970s.

During the period of interdependence, a group of developing countries that produced and exported oil managed to seize control over the international oil system and to restrict supply in order to reap the benefits of much higher prices. For a time, it seemed that their model of unity and control could not only change the oil regime but also serve as a model and as leverage to alter the international economic system as a whole. But this was an illusion. The oil exporting countries did not have the necessary leverage to change the world. In fact, they did not even have the wherewithal to change their own economies. By the 1990s, a combination of low domestic economic growth rates and stable or declining world oil prices made it impossible for even the richest oil exporters to consider reducing production to raise prices.
The period of globalization witnessed important changes in the politics of oil. First, a new set of countries—the formerly communist countries—entered the world market for petroleum as buyers and sellers. The Soviet Union had been a major producer of oil for the Soviet bloc. After the breakup of the Soviet Union and about a decade of difficulties in making the transition to capitalism, Russia became a key player in world oil markets (see Chapter 10 and Figure 9.1).

The newly independent countries of the Caspian region—Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan—began to develop their petroleum and natural gas deposits. However, to do this they needed to build pipelines, so they looked for partners to help finance them. There were a variety of routes. Some went through Russia, others through Iran, still others through China and Pakistan (via Afghanistan). As a result, Central Eurasia became a new area of interest for students and practitioners of geopolitics.

Supply from the 1990s on fluctuated somewhat with wars and other conflicts, resulting in temporary price fluctuations, not as great as those experienced during the period of interdependence (see Figure 9.2), but still worrisome. U.S. participation in the Gulf War in 1991, its invasion of Iraq in 2003, and the subsequent occupation of Iraq were motivated at least in part by concerns about control over oil in the Middle East.

The first decade of the twenty-first century witnessed rapid growth in consumption in large, fast-growing countries like China and India resulting in major increases in global demand. Global supply could not keep up, leading to a major increase in the price of oil between 2005 and 2008.

In short, the politics of oil was a major concern for participants in the global economy in all three periods. While there were attempts to establish international regimes from time to time, no real global governance existed in this area.
CORPORATE OLIGOPOLY

Seven Sisters

For much of the twentieth century, the international oil system was controlled by an oligopoly of international oil companies headquartered in the United States, the United Kingdom, and the Netherlands. Known as the Seven Sisters, these companies dominated their home markets through vertical integration, that is, controlling supply, transportation, refining, and marketing as well as exploration and refining technologies. They also worked together to control international supplies of petroleum by keeping out competitors; entering into a series of cooperative ventures such as joint production and refining arrangements and long-term supply agreements; and by refraining from price competition.

In the late nineteenth century, the oil companies began to move abroad and obtain control of foreign supplies on extremely favorable terms. After World War I, the seven formed joint ventures to explore foreign oil fields, and eventually in the 1920s they began to divide up sources of supply by explicit agreements. They were thus able to divide markets, fix world prices, and discriminate against outsiders. Northern political dominance of the oil-producing regions—the Middle East, Indonesia, and Latin America—facilitated the activities of the oil companies. Governments provided a favorable political and military environment and actively supported the oil companies owned by their nationals.

In bargaining with the oil companies, the oil exporting countries faced an oil oligopoly supported by powerful Northern governments as well as uncertainty about the success of oil exploration and the availability of alternative sources of supply. It is not surprising that the seven sisters obtained concession agreements that gave them control over the production and sale of much of the world’s oil in return for the payment of a small fixed royalty to the seven sisters’ host governments.
Beginning in the late 1920s and continuing through the Great Depression, oil prices tumbled despite the efforts of the seven sisters to stabilize markets. At that time, the United States was the largest producer in the world and exported oil to Europe and elsewhere. Government efforts (including not only the U.S. federal government but more significantly the largest producer state, Texas) succeeded where the seven sisters could not in regulating production in order to create a price floor. Thus, the Texas Railroad Commission emerged as the single most significant political force in the international oil industry.6

Changes in this system began to emerge after World War II. In the 1950s, relatively inexpensive imported oil became the primary source of energy for the developed world. Western Europe and Japan, with no oil supplies of their own, became significant importers of oil. In 1950, U.S. oil consumption outdistanced its vast domestic production, and the United States became a net importer of oil. In the host countries, growing nationalism combined with the great success of oil exploration led to dissatisfaction with concession agreements and to more aggressive policies. In these years, the host governments succeeded in revising concession agreements negotiated before the war. They redefined the basis for royalty payments, instituted an income tax on foreign oil operations, and established the principle that the new royalties and taxes combined would yield a fifty-fifty division of profits between the companies and their respective host governments.7 As a result, profits accruing to host governments increased significantly.

Nonetheless, the seven sisters, also known as the majors, continued to dominate the system by controlling almost all the world’s oil production outside the communist world from wellhead to refining, transportation, and marketing. They blocked other companies from entering upstream operations such as crude oil exploration and production by locking in concession agreements with many oil-rich areas and by the long lead times required for finding and developing oil in territory unclaimed by the majors. The majors deterred competition downstream—that is, in refining, transportation, and marketing operations—by charging a high price for crude oil, which limited profits for downstream operations.

The management of the price of oil was facilitated by the highly inelastic demand for oil. Because there are no readily available substitutes and because it is difficult to decrease consumption, an increase in the price does not greatly decrease the demand for oil in the short run. Thus, if companies can maintain a higher price for oil, they will not lose sales volumes and so will reap high profits.

Price management by the majors was designed to keep the price of oil economically attractive but also low enough to discourage competing forms of energy. Developed country governments did not resist this price management. Europeans added a tax on petroleum in order to protect the politically powerful domestic coal industry. The United States supported higher oil prices to protect the domestic oil industry from lower international prices.8

Finally, the dominance of the seven sisters was backed by political intervention. One extreme example occurred in the early 1950s when the government of Iran sought a new agreement with the Anglo-Iranian Oil Company, a predecessor of British Petroleum, and nationalized the company’s assets in Iran. The British government became actively involved in the negotiations, imposed an
economic embargo on Iran, and threatened military intervention. After trying unsuccessfully to mediate between Britain and Iran, the United States worked with opposition parties and the shah to overthrow the Iranian government. A new concession was soon negotiated under which the U.S. companies replaced Anglo-Iranian.9

Decline of the Oligopoly

However, over time, changes in the international oil industry, the oil-producing states, and the oil-consuming developed countries undermined the dominance of the seven sisters.10 Competition increased upstream, as new players obtained concessions to explore for and produce crude oil in existing and new oil-producing regions such as Algeria, Libya, and Nigeria. Downstream, more refineries were built and competition grew in markets for refined oil. In 1952, the seven majors produced 90 percent of crude oil outside North America and the communist countries; by 1968 they produced 75 percent.11

As a result, the seven sisters were no longer able to restrict supply and maintain the price of oil. United States quotas on the import of foreign oil cut off the U.S. market and aggravated the problem. Quotas were instituted in 1958 ostensibly for national security reasons: to protect the U.S. market from lower-priced foreign oil in order to ensure domestic production and national self-sufficiency. In fact, quotas also helped domestic U.S. producers that could not have survived without protection.12 In 1959 and 1960, the international oil companies were forced to lower the posted price of oil, the official price used to calculate taxes. This act was to be a key catalyst for producer-government action against the oil companies.

Changes in the oil-producing states also weakened the power of the oil company cartel. Changing elite attitudes, improved skills, less uncertainty, and the emergence of new competitors increased the bargaining power of the host governments. In negotiations with the oil companies, producer states obtained larger percentages of earnings and provisions for relinquishing unexploited parts of concessions.13 As a result, the oil-producing governments, especially large producers such as Libya and Saudi Arabia, increased their earnings and began to accumulate significant foreign exchange reserves. Monetary reserves further strengthened the hand of the oil producers by enabling them to absorb any short-term loss of earnings from an embargo or production reduction designed to increase the price of oil or to obtain other concessions.

At the same time, producer governments began to cooperate with each other. Infuriated by the price cuts of 1959 and 1960 that reduced their earnings, five of the major petroleum-exporting countries—Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela—met in 1960 to form an Organization of Petroleum Exporting Countries (OPEC) to protect the price of oil and their government revenues.14 In its first decade, OPEC expanded from five to thirteen members (see Table 9.1), accounting for 85 percent of the world’s oil exports.15 Initially, the new organization had little success. OPEC was unable to agree on production reduction schemes. Nevertheless, the individual oil-producing states succeeded in increasing their revenues, and the posted price of oil was never again lowered.16
Finally, the Western consuming countries became vulnerable to the threat of supply interruption or reduction. As oil became the primary source of energy and as U.S. supplies diminished, the developed-market economies became increasingly dependent on foreign oil, especially from the Middle East and North Africa. By 1972, Western Europe derived almost 60 percent of its energy from oil, almost all of which was imported. Oil from abroad supplied 73 percent of Japan’s energy needs. And 46 percent of U.S. energy came from oil, almost one-third of which was imported. By 1972, 80 percent of Western European and Japanese oil imports came from the Middle East and North Africa. By 1972, even the United States relied on the Middle East and North Africa for 15 percent of its oil imports. This economic vulnerability was accentuated by declining political influence in the oil-producing regions and by the absence of individual or joint energy policies to counter any manipulation of supply.

## THE OPEC SYSTEM

### Negotiation

In the 1970s, these changes enabled OPEC to take control of oil prices and assume ownership of oil investments. The OPEC revolution was triggered by Libya. Libya supplied 25 percent of Western Europe’s oil imports; independent oil companies relied heavily on Libyan oil; and the country had large official foreign exchange reserves. After seizing power in 1969, Colonel Muammar al-Qaddafi demanded an increase in the posted price of and the tax on Libyan oil.
When talks with the companies stalled in 1970, the government threatened nationalization and a cut in oil production. It targeted the vulnerable Occidental Petroleum, which relied totally on Libya to supply its European markets. Shortly after production cuts were imposed, Occidental, having failed to gain the support of the majors and of Western governments, capitulated, and the other companies were forced to follow.

In December 1970, OPEC followed the Libyan example and called for an increase in the posted price of and income taxes on oil. The companies, with the backing of oil consuming governments, agreed to negotiate with all oil-producing countries for a long-term agreement on price and tax increases. In February 1971, following threats to enact changes unilaterally and to cut off oil to the companies, the companies signed a five-year agreement that provided for an increase in the posted price of Persian Gulf oil from $1.80 to $2.29 per barrel, an annual increase in the price to offset inflation, and an increase in government royalties and taxes. In return, the companies received a five-year commitment on price and government revenues. After the devaluation of the dollar in 1971 and 1972 and thus of the real price of oil, the producers demanded and received a new agreement that provided for an increase in the posted price of oil and continuing adjustment to account for exchange rate changes. The price of Persian Gulf oil rose to $2.48.

No sooner had the issue of price and revenue been settled than OPEC requested a new conference to discuss nationalization of production facilities. A December 1972 agreement among Saudi Arabia, Qatar, Abu Dhabi, and the companies provided a framework: government ownership would start at 25 percent and rise gradually to 51 percent by 1982. Individual states then entered into negotiations with the oil concessionaires.

Despite their successes, the oil producers were dissatisfied. Although surging demand for oil drove up the market price, the posted price remained fixed by the five-year agreements. Thus, the oil companies, not the oil producers, benefited. Furthermore, the companies were bidding for new government-owned oil at prices above those of the five-year agreements. Finally, increasing inflation in the West and continuing devaluation of the dollar lowered the real value of earnings from oil production.

Because of rapidly rising demand and shortages of supply, the developed market economies were vulnerable to supply interruption. Negotiations between OPEC and the oil companies began on October 8, 1973. The oil producers demanded substantial increases in the price of oil; the companies stalled; and on October 12 the companies requested a two-week adjournment of talks to consult with their home governments. The adjournment was not for two weeks but forever.

The First Oil Crisis: Unilateral Power

Political as well as economic conditions now enhanced the bargaining position and escalated the demands of the most powerful oil producers: the Arab states. The fourth Arab-Israeli war, called in Israel the Yom Kippur War, had begun on October 6, two days before the oil talks began. A common interest in supporting the Arab cause vis-à-vis Israel and its supporters unified the Arab members of OPEC...
in their confrontation with the companies and the consumers. On October 16, the 
Organization of Arab Petroleum Exporting Countries (OAPEC) unilaterally 
increased the price of their crude oil to $5.12. Other oil producers followed. On 
December 23, OPEC unilaterally raised the price of Persian Gulf oil to $11.65.

After the autumn of 1973, oil prices were controlled by OPEC. Operating 
in a market where supplies were limited and demand high, the producers nego-
tiated among themselves to determine the posted price of oil and the production 
reductions needed to limit supply and maintain price. The key to reducing sup-
ply was the role of the major reserve countries and large producers. Saudi Arabia 
and Kuwait were willing to support the cartel by themselves, absorbing a large 
part of the production reductions necessary to maintain the price. Tight oil mar-
kets meant that price could be managed when necessary by only limited produc-
tion reductions. Power over price was quickly translated into equity control. All 
the major oil-producing states signed agreements with the oil companies for 
immediate majority or total national ownership of subsidiaries located in 
those states.

The monopoly control of oil by OPEC, the unity of the producers, and tight 
market conditions undermined the position of the oil companies. Furthermore, 
the companies had little incentive to resist. They were able in most cases to pass 
the price increases along to consumers and thus did not suffer financially from the 
loss of control over price. Although no longer either the arbiters of supply and 
price or the owners of oil concessions, the seven sisters and their many smaller 
relatives still played a vital role in international oil markets. As owners of vital tech-
nology, global distribution networks, and significant refining capacity, they were 
needed by the newly powerful producer governments. As their holdings in OPEC 
countries were nationalized, the companies became vital service contractors to the 
producer states. Still, it was a far cry from the days when the companies divided up 
the producing regions among themselves and obtained control of the world’s oil 
for almost nothing.

With the decline of the companies, the Northern consumer governments tried 
but failed to agree on a common policy toward the producers. The United States 
urged Western Europe and Japan to form a countercartel that would undermine 
producer solidarity by presenting a united front and by threatening economic or 
military retaliation. The Europeans and Japanese—more dependent on foreign 
sources of oil, less interested in support for Israel, and somewhat fearful of U.S. 
dominance—instead advised cooperation with the producers. A consumer confer-
ence in early 1974 failed to reconcile these opposing views. The only agreement was 
to establish an International Energy Agency (IEA) to develop an emergency oil-
sharing scheme and a long-term program for the development of alternative forms 
of energy. France, the strongest opponent of the U.S. approach, refused to join the 
IEA and urged instead a producer-consumer dialogue.

After the conference, consumer governments went their own ways. The 
United States tried to destroy producer unity by continuing to press for consumer 
unity and the development of the IEA. The Europeans sought special bilateral 
political and economic arrangements with the oil producers and resisted consumer 
bloc strategies. In late 1974, a compromise was reached between the United States
and France. The United States obtained France’s grudging acceptance of the IEA, although France still refused to join, and France obtained the grudging support of the United States for a producer-consumer dialogue. The CIEC and the effort to achieve a forum for a producer-consumer dialogue began in 1975 and ended in failure in 1977 (see Chapter 7).

Stable OPEC Management

For five years OPEC under the leadership of Saudi Arabia managed the international oil system. Saudi Arabia accounted for close to one-third of OPEC’s production and exports, controlled the largest productive capacity and the world’s largest reserves of petroleum, and possessed vast financial reserves (see Figure 9.3).

In periods of excess supply, Saudi Arabia maintained the OPEC price by absorbing a large share of the necessary production reductions. The burden of such reductions was minimal because of the country’s huge financial reserves and because even its ambitious economic development and military needs could be more than satisfied at a lower level of oil exports. In periods of tight supply, Saudi Arabia increased its production to prevent excessive price rises. With a small population, limited possibilities of industrial development, and the world’s largest oil reserves, Saudi Arabia’s future was dependent on oil. Furthermore, with its financial reserves invested largely in the developed countries, it had a stake in the stability of the international economic system.

Thus, Saudi Arabia and the other Gulf states did not want a price high enough to jeopardize the future of an oil-based energy system and the viability of the world economy. The Saudis were willing and able to threaten or actually to raise production to prevent the price increases desired by other more
hawkish OPEC members. These countries, including Iran, Iraq, Venezuela, and Nigeria, had large populations, ambitious development plans, and smaller reserves and, therefore, they sought to maximize their oil revenues in the short term. For example, in 1975, Saudi Arabia and the United Arab Emirates forced the rest of OPEC to limit a proposed price increase, and in 1978, when oil markets eased, the Saudis maintained the price by absorbing the majority of reductions of production, exports, and earnings. In 1979 and 1980, when supplies became tight, the Saudis increased production to prevent a price explosion (see Figure 9.4).

A propitious environment also contributed to stability. In the mid-1970s, recession in the OECD countries, combined with conservation efforts arising from price increases, led to a stabilization of demand (see Figure 9.5). At the same time, the supply of oil was steady and even growing as new sources of oil—from the North Sea, Alaska, Mexico—came on line (see Figure 9.6).

Political factors also enhanced stability. OPEC states, pursuing ambitious economic development programs, were spending their earnings at a rapid rate and, therefore, had an interest in maintaining production, and therefore earnings, at a high level. Key OPEC states friendly to the West, in particular Saudi Arabia and Iran, were responsive to Western concerns about the dangers of economic disruption from irresponsible management of the price and supply of oil.

The Western countries remained divided, acquiescent and, as time went on, increasingly complacent. Although they were unable to restructure
energy consumption significantly and rapidly, the system stabilized at an acceptable level of price and supply. Furthermore, Western foreign policies—the U.S. policy of developing and relying on special relations with Saudi Arabia and Iran, and the European and Japanese policies of general political support for the oil producers—seemed to promise security of supply and stability of price. Indeed, after the beginning of 1974, the price of oil in real terms actually dropped, as the periodic price increases by OPEC were offset by inflation (see Figure 9.2).
The Second Oil Crisis: A System Out of Control

By 1978, however, the political and economic environment had become highly unstable, and the ability and willingness of the Saudis to manage the price and to ensure the supply of oil had diminished. The demand for oil imports increased as Western economies moved out of the 1974–1975 recession, as the initial shock effect of the price rise wore off, and as the real price of oil declined. Because world oil supplies were only barely adequate, any slight decrease in supply or increase in demand would precipitate a world shortage and put serious upward pressure on prices. If a supply reduction or demand increase was small, Saudi Arabia might be able to fill the gap and stabilize the system. But if the shifts were large, even the Saudis might not be able to control the system.

The event that created a world shortage of oil and disorder in world oil markets was the 1978 revolution in Iran. At the beginning of 1978, Iran exported 5.4 million barrels of oil a day, about 17 percent of total OPEC exports. At the end of 1978, as part of a successful effort to depose the shah, oil workers cut off all oil exports from that country. By the spring of 1979, the loss of Iranian oil had been to a great extent offset by increased production in the other oil-producing states including Saudi Arabia.22 However, the crisis led to greater demand for oil, as consumers tried to augment stocks to protect against anticipated future shortfalls in supply. The result was escalating prices and turbulence in the world oil markets.

In December 1978, OPEC agreed to increase prices above the expected Western inflation rates—the first real increase in the price of oil in five years. The new price, however, did not hold. The Iranian revolution set off panic in the spot market for oil, which spilled over into the long-term contract markets. Most crude oil was then sold by long-term contract between the oil-producing countries and the oil companies at a price determined by OPEC. Oil not under long-term contract was sold in spot markets where the price fluctuates according to market conditions. In 1978 and 1979, those conditions were very tight, creating severe upward pressure on the spot market prices. In early 1979, spot prices rose as much as $8.00 above the OPEC price of $13.34 for Saudi Arabian light crude, their chief traded oil. The differential between the OPEC price under long-term contract and the higher spot price benefited the oil companies, which were able to purchase contract oil at relatively low prices. Many OPEC members, unwilling to allow the companies to benefit from such a situation, put surcharges above the agreed OPEC price on long-term contract oil and even broke long-term contracts in order to sell their oil on the spot markets. Despite its production increases and its refusal to add surcharges, Saudi Arabia was unable by itself to restore order to the world oil markets.

In March 1979, OPEC announced an immediate 14.5-percent price increase and let members impose surcharges on their oil, demonstrating that even OPEC and the Saudis were unable to control the price of oil. In July 1979, OPEC raised the price again. As the oil minister of Saudi Arabia explained, the world was on the verge of a free-for-all in the international oil system.23

By the middle of 1980, the free-for-all appeared to be at an end. High levels of Saudi production and stable world consumption led to an easing of markets.
In this climate, Saudi Arabia and other OPEC moderates sought to regain control over prices, reunify price levels, and develop a long-term OPEC strategy for gradual, steady price increases geared to inflation, exchange rate changes, and growth in the developed countries.

But the plan was destroyed by the outbreak of war between Iraq and Iran. In September 1980, Iraq launched an attack on Iran’s oil-producing region, and Iran’s air force attacked Iraq’s oil facilities. Oil exports from these two countries stopped, world supplies fell by 3.5 million barrels per day—roughly 10 percent of world oil exports—and pressure grew in the spot market. In December 1980, OPEC members set a new ceiling price of $33 a barrel and spot prices reached $41 a barrel. As the hostilities continued, spot-market prices rose, putting further pressure on long-term prices. Furthermore, damage to the oil production and export facilities in both countries raised questions about oil supplies even after the cessation of hostilities.

As the market conditions disintegrated, the foreign policies of the West, particularly that of the United States, were substantially weakened. The special relationship of the United States with Iran under the shah became one of hostility under the new Islamic government. Even the relationship of the United States with Saudi Arabia seemed threatened. The Camp David agreement between Israel and Egypt had led to a cooling of Saudi-U.S. relations. For the Saudis, the overthrow of the shah and the inability of the United States to keep him in power or even to prevent the holding of U.S. hostages raised doubts about the value and reliability of U.S. support. The events in Iran and an internal insurrection in Mecca in 1980 also raised the specter of internal political instability for both Saudi Arabia and the United States, which Tehran was seeking to foster.

Unstable market conditions and political uncertainty gave rise to widespread pessimistic predictions of chronic shortages and periodic interruptions in the supply of oil. Few observers foresaw the profound changes that would undermine the OPEC system of management.

OTHER OPECS?

The success of the oil producers in the 1970s led to a revolution in the thinking of Southern raw material producers. Suddenly it seemed that producer cartels could bring an end of dependence. Producer organizations in copper, bauxite, iron ore, bananas, and coffee were either formed or took on new life after October 1973. In a variety of United Nations resolutions, the Third World supported the right of Southern exporters to form producer associations and urged the North to “respect that right by refraining from applying economic and political measures that would limit it.”

Yet by the late 1970s these new producer cartels had failed. None had succeeded in maintaining higher commodity prices in the face of depressed market conditions, most were fraught with internal dissension, and a few never even got off the ground. In contrast with OPEC, the failed cartels lacked several essential characteristics.
Several market factors set the stage for OPEC’s success in the 1970s. The demand for oil imports was high. Oil imports played an important and growing role as a source of energy in the North. Europe and Japan were dependent on foreign sources for oil. Even the once self-sufficient United States had become increasingly dependent on oil imports. In the medium term, the demand for oil and oil imports is also inelastic with respect to prices. No substitutes exist for petroleum as a transportation fuel in modern industrial economies, and there is no way to decrease consumption significantly except at much higher prices. Thus, an increase in the price of oil does not immediately lead to a noticeable decrease in demand.

Supply factors also favored OPEC in the medium term. The supply of oil is price inelastic; that is, an increase in its price does not lead to the rapid entrance of new producers into the market. Large amounts of capital and many years are required to develop new sources of oil. In addition, supply inelasticity was not relieved by the stockpiles of oil. In 1973, the developed countries did not have oil reserves to use even in the short run to increase supply and alleviate the effect of supply reductions.

Finally, at the time of the OPEC price increases, an extremely tight supply of oil existed in the international market. Rapidly rising demand in the consuming countries was not matched by rising production. As a result, a few important producers, or even one major producer, could be in a position to influence price by merely threatening to limit supply.

This economic vulnerability of consumers set the stage for OPEC’s action. Several political factors, however, determined whether such action would take place, and an understanding of the behavior of interest groups helps explain the ability of the oil producers to take joint action to raise the price of oil.26

First, there is a relatively small number of oil-exporting countries. Common political action is more likely when the number of participants is so limited, as the small number maximizes all the members’ perception of their shared interest and the benefits to be derived from joint action.

The oil producers were also helped by the experience of more than a decade of cooperation. OPEC encouraged what one analyst described as “solidarity and a sense of community.” It also led to experience in common action. Between 1971 and 1973, the oil producers tested their power, saw tangible results from common action, and acquired the confidence to pursue such action. This confidence was reinforced by the large monetary reserves of the major producers. The reserves minimized the economic risks of attempting some joint action such as reducing production or instituting an embargo. The reserves were money in the bank that could be used to finance needed imports if the joint effort to raise the price of petroleum was not immediately successful. According to one analyst, it enabled the oil producers to take a “long-term perspective,” to adopt common policies in the first place, and to avoid the later temptation of taking advantage of short-term gains by cheating. 28

The common political interest of the Arab oil producers in backing their cause in the conflict with Israel reinforced their common economic interest in increasing the price of oil. The outbreak of the 1973 war greatly enhanced Arab cohesiveness and facilitated the OPEC decision of October 16 to raise oil prices unilaterally.
Group theory suggests, however, that the perception of a common interest is often insufficient for common action. A leader or leaders are needed to mobilize the group and to bear the main burden of group action. Leadership was crucial to common oil-producer action. In 1973, the initiative by Arab producers in unilaterally raising prices made it possible for other producers to increase their prices. After 1973 the willingness and ability of Saudi Arabia to bear the major burden of production reductions determined the ability of producers to maintain higher prices.

Producer action was facilitated by the nature of the problem. Manipulating the price was relatively easy because it was a seller’s market. Given the tight market, it was not necessary to reduce the supply significantly to maintain a higher price. Ironically, the international oil companies also helped joint-producer action. Producing nations were able to increase their price by taxing the oil companies. The companies acquiesced because they were able to pass on the tax to their customers. Producing nations were also able to reduce the supply simply by ordering the companies to limit production. Increasing governmental control of the companies helped implement these reductions.

Finally, the success of the producers was assured by the absence of countervailing consumer power. The weakness of the corporations and the consumer governments was demonstrated by the Libyan success in 1970 and by subsequent negotiations. The disarray and acquiescence of the oil companies and the oil-consuming governments in 1973 sealed the success of the producing nations. Particularly important was the inability of the developed market economies to take joint action—in contrast with the group action of the producers—to counter the cartel.

In the aftermath of OPEC’s success, several factors seemed to suggest that in the short term, and perhaps in the medium term, some producer cartels might succeed. In the near term, economic conditions were propitious for many commodities, particularly for those on which consuming states are highly dependent. The United States, for example, relies on imports of bauxite, tin, bananas, and coffee. Western Europe and Japan, less endowed with raw materials, depend also on imports of copper, iron ore, and phosphates. Disrupting the supply of many of these commodities, particularly critical minerals, would have a devastating effect on the developed market economies.

In addition, over the short and medium terms, the demand for and supply of these commodities are price inelastic. As discussed earlier, with few exceptions, a price increase for these materials would not be offset by a decrease in consumption, which would lead to an increase in total producer revenues. Similarly, when supply is price inelastic, a rise in price will not immediately lead to the emergence of new supplies, because it takes time and money to grow new crops and exploit new mineral sources. It should be noted that for some critical raw materials, an inelasticity of supply can be cushioned by stockpiles, and developed countries have accumulated such supplies for strategic reasons. Nevertheless, although stockpiles can serve to resist cartel action over the short term, not all commodities can be stockpiled, and stockpiles in many commodities are generally insufficient to outlast supply interruptions that persist for more than a few months.
Tight market conditions favor producers in the short term. As demonstrated by the oil action, a seller’s market facilitates cartel action by enabling one or a small number of producers to raise prices, as occurred in 1973–1974. At that time, the simultaneous economic boom in the North and uncertain currency markets that encouraged speculation in commodities led to commodity shortages and sharp price increases. The developed countries were particularly vulnerable to threats of supply manipulation, and the producer countries were in a particularly strong position to make such threats. For example, Morocco (phosphates) and Jamaica (bauxite) took advantage of this situation to raise prices.

In addition to these economic factors, several political conditions also favored producer action, again primarily over the short run. For many commodities—for example, bauxite, copper, phosphates, bananas, cocoa, coffee, natural rubber, and tea—relatively few Southern producers dominate the export market, and some of these producers have formed associations with the goal of price management. Several political developments made producer cooperation more likely in the mid-1970s. One was a new sense of self-confidence. The OPEC experience suggested to other producers that through their control of commodities vital to the North, they might possess the threat they had long sought. Thus, many Third World states felt that they could risk more aggressive policies toward the North.

Another new development stemmed not from confidence but from desperation. The simultaneous energy, food, recession, and inflation crises left most Southern states with severe balance-of-payments problems. Some states may have felt that they had no alternative to instituting risky measures that might offer short-term economic benefits but that would probably prove unsuccessful or even damaging in the long run.

Reinforcing economic desperation was political concern. Political leaders, especially those in the Third World, tend to have short-run perspectives, as the maintenance of their power may depend on achieving short-term gains despite inevitable long-run losses. However, this argument is directly opposite to the OPEC model for a successful producer cartel, wherein monetary reserves enabled the producing nations to take a long-term perspective, to risk short-term losses for long-term gains. In other cases, producers with huge balance-of-payments deficits may be moved to risk long-term losses for short-term gains. And as has been argued, the short-term maximization of revenues may in fact be rational action for the long-term view; that is, if producers feel that their short-term profits will be sufficient to achieve economic diversification and development, they may rationally pursue short-term gains.

The emergence of leaders in some producer groups was yet another new development. Jamaica’s unilateral action in raising taxes and royalties on bauxite production and Morocco’s unilateral action to raise the price of phosphate altered the conditions for other bauxite and phosphate producers.

Finally, cooperation was sometimes made easier by the nature of the task of managing price and supply. In commodities such as bauxite and bananas, vertically integrated oligopolistic multinational corporations could be taxed according to the OPEC formula. In these and other commodities, production control was facilitated by increasing governmental regulation or ownership of production facilities.
With all of these factors working in favor of cartel success, why then were the raw-material producer associations so unsuccessful after 1974? Some of the reasons for the problems of cartels can be traced to the depressed economic conditions of the late 1970s and 1980s, whereas others are of a more general nature.

Although, as we have noted, the demand and supply of many commodities are price inelastic over the short and medium terms, in the long run the demand and supply are more elastic and thus less conducive to successful cartel action, as is illustrated by the OPEC experience of the 1980s. A rise in price above a certain level will generally lead to a shift in demand to substitutes. Aluminum will be substituted for copper; coffee will be replaced by tea. With time, it is also possible to develop new sources of supply for most commodities. New coffee trees can be planted; new mineral resources, including resources in the seabed, can be exploited. Of course, some of these new supplies may be relatively more expensive, as new production will often have to rely on costly technologies and lower-quality ores. Thus, it should be noted, new production may undermine a cartel, but it may have little effect on price.

Because of the long-term elasticity of demand and supply, the successful survival of a cartel generally depends on two complex factors. First, producers have to manage price so that it does not rise above a level that would encourage the use of substitutes. Such management requires sophisticated market knowledge and predictive ability. Because the threshold price may be lower than the preferred price for many producers, agreement on joint action may be quite difficult to achieve. Second, and equally difficult, the supply response from other producers must be managed. Currently existing cartels have been generally unable to manage successfully either prices or supply: price cutting among fellow cartel members has been common, and few producers have agreed to supply controls.

Despite some incentive for cooperation, there have been major problems in joint action. Although many commodities are supplied by a few producers, these producers often find they have more in conflict than in common. The copper producers, for example, are divided by political as well as economic differences. Moreover, although the foreign exchange crisis may encourage cooperation, it also may facilitate consumer resistance. Producing nations that have no reserves and that rely on the export of one commodity for the bulk of their foreign exchange earnings are not in a position to endure long-concerted corporate or consumer-government resistance. Furthermore, the temptation to take short-term profits from concerted action at the expense of longer-term gains is greater during a balance-of-payments crisis. And although the task of price management may be easy in some cases, as when there is a leader and multinational corporations are present, there are no such advantages for many commodity-producing nations.

One of the greatest barriers to producer cartels has been the task of managing supply. Few countries have a large enough share of production and large enough reserves to assume the kind of leadership role played by Saudi Arabia. No one country or small group of countries is able to bear the burden of supply reduction for the entire commodity group.

Without tight markets, then, supply can be controlled only through buffer stocks or export or production reductions—methods that are politically complex and economically costly. Many commodities are perishable and hence cannot be
stored in a buffer stock, whereas other commodities require enormous buffer stocks and financing to maintain prices. Export and production reductions are equally difficult to accomplish. Export reduction without production controls poses the same problems of storing and financing as buffer stocks do. And agreements to reduce production are difficult to achieve, as OPEC’s experience illustrates, and may be costly in terms of employment.

Perhaps the most devastating blow to the producer associations was dealt by the stagnant or declining demand for their commodities. In 1974 and 1975, as economic activity in the industrialized countries declined, the demand for industrial raw materials fell precipitously. Faced with reductions or slow growth in the demand for their commodities, the only hope for the producer associations was to reduce production and supply in order to maintain prices at desired levels. Yet, as we have indicated, most producing nations found it politically or economically difficult to cut back production, and many cartel members cut prices in order to increase their international competitiveness. The result was a general oversupply of many raw materials and a drop in their prices that the cartels were unable to counteract.

**OPEC in Decline**

In the 1980s, OPEC began to face many of the problems encountered by other producer cartels. OPEC’s difficulties stemmed from its success. Because of the cartel’s ability to increase the price of oil, the demand for oil fell, non-OPEC production grew, prices fell, and it became increasingly difficult for OPEC to manage prices. According to one expert,

> The oil price is high and unstable because the competitive thermostat has been disconnected. Producers no longer set output independently of each other, with higher-cost output disappearing by individual operator’s choices. Instead, a cartel of low-cost producer nations restrains their output to support prices. Since cooperation is usually difficult, reluctant, and slow, members’ output overshoots or undershoots the demand. Prices are volatile not because of methods of production or consumption, but because of the clumsy cartel.32

**The Impact of Higher Oil Prices**

Oil consumption in the industrial countries fell significantly in the 1980s after rising almost continuously for decades.33 Slow growth rates in consuming countries contributed significantly to the decline in demand. Oil price increases also played a critical role. Higher prices led to substitution of other fuels such as coal, natural gas, and nuclear energy for oil. They also stimulated conservation and more efficient use of energy. Government policy was also a factor. In Europe and Japan and to a lesser degree in the United States, government policy encouraged conservation. In the United States, the removal of price controls, which had cushioned the U.S. from the effects of the price increases, promoted energy conservation.34
Supplies also increased. Higher oil prices attracted new suppliers to the international market. OPEC’s management task became considerably more difficult, as the cartel lost a substantial portion of its share of world production to non-OPEC producers. OPEC’s share of the world oil market fell from 63 percent in 1973 to around 30 percent in 1983 but then rose again to 43 percent in 2007 (see Figure 9.7). Non-OPEC production rose steadily, from 22.5 million barrels per day in 1970 to 38.3 million barrels per day in 1988, but then it flattened out at around 40 million barrels per day in the first decade of the twenty-first century.

Several large reservoirs of new oil in the developed countries came into full operation in the 1990s. The North Sea made Norway and Britain players in the international oil game (see Figure 9.6). Higher prices and price decontrol in the United States promoted greater investment in the petroleum sector and encouraged new oil companies to enter the market, exploring for new crude sources as well as developing new purchase and distribution lines. Even though U.S. production did not increase during this period, it might have declined sharply without these new investments (see Figure 9.8). In addition, the Soviet Union increased its exports to noncommunist countries in order to boost its foreign exchange earnings.

As a result of conservation, adjustment, and increased domestic production, the noncommunist developed countries reduced their total demand for imported oil by 40 percent, decreasing their reliance on foreign oil from two-thirds of total consumption in 1979 to less than half in 1983.

Trends in the developing countries were different from those in the developed countries. Oil consumption in the developing countries expanded by approximately 7 percent a year from 1973 to 1979, attributable to relatively high rates of economic growth, generally low domestic oil prices, a lack of substitutes for fossil fuels, and a limited capacity for conservation. After the second oil shock, however, oil consumption in the developing world rose much more slowly, with most of the increase in consumption attributable to the net oil-exporting coun-

![Figure 9.7 OPEC and Non-OPEC Oil Production, 1970–2007, in Millions of Barrels per Day](source: Department of Energy, Energy Information Agency, International Energy Annual (various years).)

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Figure 9.7 OPEC and Non-OPEC Oil Production, 1970–2007, in Millions of Barrels per Day

A few oil-importing developing countries were able to expand their domestic oil production. Brazil increased its production by 50 percent between 1973 and 1983, and India raised its output fivefold. China and Mexico also increased their production of oil (see Figure 9.9).

Downward pressure on oil prices from the sharp drop in demand and the rise in non-OPEC production was exacerbated by an unprecedented drawdown of inventories by the international oil companies. Companies had built up their reserve stocks to their highest levels ever during the uncertainties of the 1979–1980 oil shock. Lower oil prices, high interest rates that raised the cost of holding inventories, and, most important, the growing realization that the sluggish world demand for oil
was the result of qualitative changes in demand and not merely a cyclical phenomenon led to a massive reduction in inventories.  

Shifting supply and demand depressed oil prices. On the spot market, prices fell from $40 per barrel in 1980 to $30 per barrel at the end of 1982, further lowering long-term contract prices. As a result, the GNP of the OPEC countries as a whole also fell. Although Saudi Arabia and some of the high-income OPEC countries maintained positive trade balances, the current-account surpluses of many OPEC members disappeared, constraining their development plans, imports, and, for heavily indebted countries like Nigeria and Venezuela, payment of debt-service obligations. The fall in demand imposed a particularly heavy burden on Saudi Arabia, which, in its informal role as OPEC’s market manager, was forced to reduce its production drastically, from a peak of 9.9 million barrels per day in 1980 to less than 3.4 million barrels per day by 1985, in order to defend OPEC’s prices. Saudi oil revenues fell from a peak of $102 billion in 1981 to $37 billion in 1983. The Gulf countries suffered similar production and revenue reductions.

The changing pattern of oil production and consumption increased OPEC’s management problems and undermined the cartel’s cohesion. Whereas the demand for oil had been inelastic in the 1970s, conservation and interfuel substitution increased elasticity by the 1980s. Whereas the oil supply seemed inelastic in the 1970s, by the 1980s, new sources had diminished much of the cartel’s original advantage as the main source of the world’s oil. New non-OPEC suppliers also made the cartel’s management more difficult. Finally, as the tight supply eased and prices fell, political differences within the cartel further undermined OPEC’s capacity for joint action. Excess supply gave rise to enormous strains within OPEC, and the hardship exacerbated traditional conflicts between those OPEC members who sought to maximize their short-term revenues in order to boost imports and hasten development plans and those like Saudi Arabia and the Gulf states who wanted to maintain foreign dependence on OPEC oil for as long as possible by limiting the price increases.

Eventually, OPEC became a victim of the classic cartel problem: cheating. In the 1980s, a number of OPEC members—in particular Algeria, Iran, Libya, Venezuela, and Nigeria—undercut the cartel’s price-management system by producing over their prescribed ceiling, offering price discounts, and indirectly cutting prices through extended credit terms, barter deals, and the absorption of freight costs by the seller. As long as Saudi Arabia was willing to shore up prices by restraining its own production, these countries were able to violate OPEC’s rules without creating a collapse of prices. The Saudis, however, became more and more unwilling to make that sacrifice in the face of rampant cheating by their fellow cartel members.

The expanded volume of oil traded on the spot market made it more difficult for OPEC to monitor its members’ oil transactions and thus aggravated OPEC’s price-management problem. With new non-OPEC sources of supply, greater availability of cheaper oil from OPEC cheaters, slackened demand, and less fear of rising prices, the oil companies saw less need for long-term contracts and more often met their supply needs through the spot market. Whereas in 1973 over 95 percent of all oil was traded on long-term contracts, by 1983 at least 20 percent of the world’s oil
was traded on the spot market.\textsuperscript{44} The situation improved somewhat for OPEC members in the second half of the 1980s, as demand recovered and everyone was able to increase production, including the Saudis (see Figure 9.4). But oil prices declined gradually (when controlling for inflation) so oil revenues did not increase as rapidly as they had in the economic recoveries of the 1970s (see Figure 9.2).

**Oil Price Wars**

Beginning in the early 1980s, OPEC fought a losing battle to maintain control over the declining price of oil. In 1983, OPEC was forced to reduce the price of oil for the first time in its history. Algeria, Libya, Iran, and Nigeria were selling oil as much as $4 below the $34 OPEC price. Saudi Arabia and its Gulf allies threatened to lower their prices to undercut the cheaters. Spot market prices fell, oil companies began depleting their inventories, and producers came under increasing pressure to reduce their long-term contract prices. Thus, in March 1983, OPEC reduced the price of oil, from $34 per barrel to $29 per barrel. To maintain this price, the members agreed for the first time to a concerted production reduction scheme that limited OPEC output and allocated production among the members. Saudi Arabia formally accepted the role of “swing producer” and committed to adjust its output to support the newly agreed-upon price.\textsuperscript{45}

The new production reduction scheme slowed but did not stop the decline in OPEC’s power as a price-setting cartel. Sluggish demand and increasing production by countries outside OPEC continued to put downward pressure on oil prices. Domestic economic problems and financial shortages tempted members to break ranks by reducing prices and expanding production to obtain more revenues. As non-OPEC production grew and as non-OPEC producers such as Norway and the United Kingdom lowered prices below that of OPEC, it became more and more difficult for the cartel to reach agreement on production ceilings and quotas among members. In 1984, OPEC lowered the price to $28 per barrel, reduced its production ceiling, and lowered individual production quotas. Despite OPEC’s production allocation scheme, virtually all of the decline in output was absorbed by Saudi Arabia. By August 1985, Saudi output had fallen to 2.5 million barrels per day, less than one-fourth of its production in 1980–1981.\textsuperscript{46} Saudi foreign exchange earnings suffered a steep decline.

In the second half of 1985, Saudi Arabia refused to play the role of swing producer. In order to increase its production and restore its market share, Saudi Arabia abandoned selling crude oil on the basis of official OPEC prices and instituted “net-back” sales contracts—a market-responsive price formula based on the value of products into which its oil was refined. Once this happened, OPEC was no longer able to manage the price of oil. In December 1985, OPEC abandoned the system of fixed official selling prices and concerted production reductions. For the first time since the seven sisters agreed to set prices, the oil cartel agreed to allow prices to be determined by the market.

Largely due to the dramatic increase in Saudi production, OPEC output soared and the price of oil in the spot market prices fell from between $27 and $31 per barrel in November 1985 to between $8 and $10 per barrel in July
Pressure to restore concerted production reductions and higher prices built both within and outside OPEC. In 1986, OPEC agreed on new production reductions and quotas and on a new fixed export price of $18 per barrel. Once again, the cartel pulled back from a price war and reestablished market discipline and prices, albeit at a lower level.

Nonetheless, economic and political conflicts continued to threaten OPEC’s ability to implement concerted production reductions. The traditional split remained between hawks like Iran and Iraq, which sought to maximize oil earnings in the short term, and moderates like Saudi Arabia and the Gulf countries, which sought to maximize oil earnings over the long-term. This conflict was complicated by an internal conflict over quota allocations. Although a number of OPEC members felt their quota allocations were unfair, the cartel was hopelessly divided and unable to revise the existing agreement. As concerted supply restraint weakened, prices of oil slipped downward.

The Iran-Iraq war signaled a change in oil markets. Iraqi air attacks on Iranian oil fields put them out of commission until the end of the war. Iranian attacks on Iraqi oil fields in Basra seriously reduced Iraqi production. Despite the bombing of oil fields, tankers, and shipping facilities in the Persian Gulf, there was no run-up in oil prices during the 1980s. The spare capacity of the other OPEC and non-OPEC oil producers, public stocks in consuming countries, as well as the oil-sharing arrangement of the International Energy Agency cushioned any potential threat.

The end of the Iran-Iraq war in 1988 posed a threat to oil prices. Iraq was in the process of significantly expanding its production capacity. Both countries faced higher revenue needs for rebuilding and resuming economic development after the lengthy war, and both felt justified in producing more because of post-war needs and because of their reduced production during the war. However, because of the mutual distrust and antagonism arising from the war, OPEC was initially unable to negotiate a new allocation scheme. In an effort to force other OPEC members to resume discipline, Saudi Arabia increased production, creating a glut of Saudi oil and leading to a fall in oil prices to $13 to $14 per barrel by late 1988. In real terms, oil prices were below the 1974 level (see Figure 9.2). The decline in prices hurt the finances of all oil exporters; put severe pressure on indebted oil exporters such as Nigeria, Mexico, and Venezuela; and contributed to political instability in Algeria. By November, action by Saudi Arabia and Kuwait had forced OPEC to agree on a new production agreement to limit production and raise prices to $18 per barrel. Iran received its old share allocation and agreed to allow Iraq to return to the OPEC system with a quota equal to its own. Iraq’s increase came at the expense of other cartel members, especially Saudi Arabia, whose quotas were decreased.

In the absence of OPEC discipline, some cartel members sought to protect themselves from price competition by buying refining and marketing operations in the major oil-consuming countries. During the 1980s, a number of OPEC members—Venezuela, Libya, Kuwait, Saudi Arabia, and the United Arab Emirates—acquired downstream operations in the United States and Western Europe. Petróleos de Venezuela, S.A. (PDVSA), for example, acquired 50 percent of CITGO in 1985 and the rest in 1990. CITGO owned and operated refineries and...
service stations primarily in North America. Moving downstream was intended to protect crude oil exporters when prices fall, because it guaranteed an outlet for oil and because prices for refined products fell less than prices for crude oil. As these OPEC members developed refining and marketing capacity, their oil operations came to resemble the large, integrated oil companies that once dominated the oil system. These members found themselves in even greater conflict with other OPEC members that remained dependent on crude oil exports for revenues and sought therefore to maximize oil earnings in the short term. The downstream diversification strategy, therefore, further weakened OPEC.

The events of the 1980s thus led to a major change in OPEC’s power as a price-setting cartel. Sluggish demand, sustained oversupply, competition from outsiders, economic temptations to break ranks by reducing prices and increasing production, and internal political conflicts undermined the role of the oil-producing cartel. Saudi Arabia could offset some cheating by other members but was no longer willing or able to single-handedly manage the cartel by playing the role of the swing producer.

ERA OF GLOBALIZATION

In the 1990s and beyond, oil remained central to the international economy and to international relations. However, unlike earlier periods, no one—not OPEC, the oil companies, or the consumers—was able to manage the international oil system. As we have seen, OPEC was severely weakened by new non-OPEC sources of oil and by internal conflicts. The fragmented oil industry was unable to control prices by limiting or increasing supply. Developed country governments, complacent because of the oil glut and the low prices of the 1980s, actually reduced their influence over energy markets through deregulation and the failure to formulate comprehensive, long-term national energy strategies.

Cooperation among the developed countries on oil issues remained weak and ad hoc. The International Energy Agency had never been strong and remained limited to facilitating cooperation on reserves in the event of an emergency. Nevertheless, oil played an important role in Northern foreign policy. France used diplomatic initiatives to forge ties with Iran and Iraq. The United States protected its oil interests by playing an active role in the Middle East and by maintaining a close relationship with Saudi Arabia. In the following sections, we discuss two important examples of the role of oil in global politics: the 1991 Gulf War when developed countries sought to protect Persian Gulf oil supplies and the effort to assure access to oil in the Caspian region.

The Gulf War

The Gulf War of 1991 dramatically demonstrated both the inability of OPEC to manage the international oil system and the critical importance of Middle Eastern oil for the North. Differences among OPEC members over the price of oil and
production quotas were a major factor in Iraq’s invasion of Kuwait in August 1990. Concern about the consequences of the Iraqi invasion for world oil markets was a central reason for the strong reaction of the United States, Saudi Arabia, and their allies.

In 1989 and 1990, Iraq and Kuwait were on opposite sides of a significant conflict within OPEC. Iraq emerged from its war with Iran, which lasted from 1980 to 1988, facing severe limits on its ability to produce and export oil. Huge debts made it impossible for Iraq to borrow funds to rebuild its oil production and export facilities. These constraints combined with its desperate financial situation led Iraq to advocate a policy of maintaining high prices within OPEC through greater member discipline. Kuwait took the opposite position. With a large production capacity of 2.5 million barrels per day and large reserves of 100 billion barrels, Kuwait, like Saudi Arabia, advocated lower prices as a way of discouraging production by alternative suppliers of petroleum and investment in alternative energy sources.

Because Kuwait was not as influential within OPEC as Saudi Arabia, it did not feel responsible for maintaining the organization’s effectiveness. Thus, Kuwait refused to go along with the production quota assigned to it by OPEC in the late 1980s. Although OPEC increased Kuwait’s quota in November 1989, the new agreement did not hold, and oil prices continued to fall to under $17 per barrel. Iraq claimed with increasing vehemence that Kuwait was deliberately undermining the Iraqi economy by overproducing, and that it was, in addition, siphoning oil from a disputed field on the border of the two countries. President Saddam Hussein began massing troops along the Iraqi-Kuwaiti border. A last ditch effort by OPEC to resolve the dispute collapsed in July, and on August 2, 1990, Iraq invaded Kuwait. The Iraqi invasion led to a spike in the price of oil to nearly $40 per barrel by October 1990. The invasion also led to a swift reaction by both producers and consumers of oil. The United States formed a broad international coalition that included Saudi Arabia, numerous Middle Eastern countries, France, and the United Kingdom. In October 1990, the coalition supported a U.N. resolution authorizing an embargo that would close all world oil markets to Iraqi exports. This embargo affected a flow of 4.3 million barrels per day of oil to world markets, about 7 percent of the world total. U.N. action combined with increased production by both OPEC and non-OPEC producers helped to reduce the impact of this very effective embargo on the rest of the world. In addition, the oil-consuming members of the IEA released their strategic oil reserves in order to cushion the impact of U.N. embargo on world oil markets. The coalition then sent military forces to the region and, on January 16, 1991, launched a military action that liberated Kuwait and led to a record short-term drop in oil prices from $33 to less than $18 per barrel. The allies did not succeed in toppling Saddam Hussein, however.

While numerous factors motivated the United States and its allies in reacting strongly to the invasion of Kuwait, concern about oil was one of the most important. Control over Kuwait’s petroleum reserves would have given Iraq control over a total of 205 billion barrels, about one-fifth of the world’s known oil reserves, and would have put Iraq in a position to dominate the weakened OPEC.
Iraqi and Kuwaiti daily production capacity would have been around 5.5 million barrels per day, still below that of Saudi Arabia (8.5 million barrels per day) but large enough to give the Iraqi government significant market power. Furthermore, with control of strategic military positions in Kuwait and with its large army, Iraq would have been able to threaten other key oil producers in the region, including Saudi Arabia. Such dominance of world oil markets by a single country was unacceptable to both consumers and producers of petroleum and helped to explain the unique alliance that formed against Saddam Hussein.

Following the war, due to Iraq’s continuing attempts to manufacture weapons of mass destruction and its refusal to agree to effective monitoring of its activities, the U.N. maintained sanctions on all exports to Iraq except for food and medical supplies and other humanitarian needs. The U.N. also maintained its embargo on exports of Iraqi oil. In 1995, the United Nations established an Oil-for-Food Program under Security Council Resolution 986 that was intended to permit Iraq to sell oil on the world market in exchange for food, medicine, and other humanitarian needs. The Clinton administration introduced the program as a response to the criticism that Saddam Hussein was shifting the burden of economic sanctions onto the backs of ordinary Iraqi citizens. The program suffered from corruption and abuse. It ended in 2003 when the United States and its allies invaded Iraq.53

Oil in the Caspian Region

The end of communism and the breakup of the Soviet Union unleashed a variety of political forces, including a new scramble to control oil resources in the former Soviet Union. In Russia itself, the Yeltsin government relinquished control over the oil and natural gas industries as a result of its privatization efforts (see Chapter 10 for details). The new private owners did not have sufficient resources to invest in exploration and exploitation of existing oil and gas deposits. Investment and production in Russia declined markedly in the 1990s (see again Figure 9.1). The political excesses of the Yeltsin-era oligarchs, many of whom owned controlling shares in the newly privatized oil and gas enterprises and openly opposed Putin’s rise to power, combined with their attempts to negotiate partnerships with foreign energy companies, gave Putin the opportunity he needed to wrest control of Russian energy resources from private owners. Putin then used renewed state control over oil and gas firms and pipelines to influence the politics of bordering countries that were formerly members of the Soviet Union (Belarus, the Ukraine, Kazakhstan, and Georgia) and more generally to reassert Russia’s role as a great power.

In the 1990s, new oil and natural gas deposits were discovered in the former states of the Soviet Union located in the Caspian region: Azerbaijan, Kazakhstan, and Turkmenistan. Russia and Iran also bordered the landlocked Caspian Sea and all five countries laid claim to seabed oil and gas deposits there. Caspian oil reserves were estimated to be approximately 47 billion barrels at the end of 2005—about 3 percent of world reserves—less than 20 percent of Saudi reserves but more than Libyan reserves. Natural gas reserves were estimated to be 6.6 trillion cubic meters. The largest deposits were in Kazakhstan.54
Development of the Caspian oil fields began in earnest following the breakup of the Soviet Union in 1991. In April 1993, Chevron concluded a historic $20-billion deal with Kazakhstan to create the Tengizchevroil joint venture to develop the Tengiz and Korolev oil fields. Tengizchevroil produced over 500,000 barrels per day of oil in mid 2008.

Development of the oil and gas industries in the Caspian region was hindered by the difficulty of transporting Caspian oil to world markets. Prior to 1997, exporters of Caspian oil had only one major pipeline option available to them, the Atyrau-Samara pipeline from Kazakhstan to Russia. In addition, smaller amounts of oil were shipped by rail and barge through Russia, and by a second, small pipeline from Kazakhstan to Russia. The Caspian region’s relative isolation from world markets, as well as the lack of export options, stilled exports outside of the former Soviet republics.

Thus, for the newly developed Caspian oil to reach world markets, it was necessary to build pipelines to transport the oil from the landlocked Caspian region to new foreign markets. The main alternatives were: (1) the Baku-Tbilisi-Ceyhan (BTC) pipeline, (2) the Baku-Tbilisi-Supsa (BTS) pipeline, and (3) the Baku-Novorossiisk (BN) pipeline (see Figure 9.10).

The BTC pipeline was built and operated by the Caspian Pipeline Consortium and was completed in May 2005. The Caspian Pipeline Consortium consists of BP, ConocoPhillips, ChevronTexaco, and ExxonMobil. The BTC pipeline goes from Baku in Azerbaijan to Tbilisi in Georgia to Ceyhan, a Turkish port on the Bosphorus, thus completely bypassing Russia.
The BTS pipeline goes from Baku to Supsa, a Georgian port on the Black Sea. Negotiations between the governments of Azerbaijan and Georgia for building it began in 1994. The contract was awarded to a Norwegian firm, Kraemer, and the pipeline was completed in 1998 at a cost of approximately $0.5 billion. It is essentially a refurbished Soviet-era pipeline with some newly built sections. The BTS pipeline was closed for repairs between October 2006 and August 2008. When Russia invaded Georgia in August 2008 some Russian bombs fell near the pipeline, and it was again shut down for a short time.

The BN pipeline goes from Baku to Novorosiisk, a Russian port on the Black Sea. It was built originally during the Soviet era and then expanded after the Caspian deposits were discovered. It travels through Azerbaijan and Russia only, and thus is the route preferred by the Russian government for Caspian energy flows. The Azeri portion of the BN pipeline is operated by the State Oil Company of the Azerbaijan Republic (SOCAR), and the Russian portion is operated by Transneft, a Russian state-owned pipeline firm.

The main goal of the Western countries was to assure that there were multiple routes for the export of Caspian oil and gas so that no one country had the capability to block the region’s exports or to use control of transportation routes for political leverage. Thus, plans were developed to build additional pipelines connecting oil fields in the Caspian region to Pakistan (via Afghanistan), Iran, and China. Natural gas deposits in the Caspian region were as large or larger than petroleum deposits so natural gas pipeline projects were planned in addition to the oil pipelines already noted.

Some observers compared this recent period of oil and gas development in the Caspian with an earlier period of great power competition sometimes called “the Great Game.” The Great Game was a competition between the British and Russian governments for supremacy in Central Asia that occurred between 1813 and 1907. The Anglo-Afghan war inspired Rudyard Kipling’s short story, “The Man Who Would Be King,” and George MacDonald Fraser’s novel, Flashman. Some scholars argue that the current competition between Russia and the United States over the Caspian is a new Great Game. And although the old Great Game was about control over territory, the new Great Game is all about control over energy.

**CHANGING ECONOMICS OF OIL AT THE END OF THE TWENTIETH CENTURY**

By the end of the twentieth century, the economic and political dynamics of oil had shifted. The Gulf War demonstrated that OPEC was no longer able to manage the international oil system. The divergent interests of OPEC members made price and production management increasingly difficult despite the powerful position of Saudi Arabia. As we shall see, even that dominant country began to face financial problems as the price of oil declined and the Saudi budget grew faster than the growth in oil revenues.
Furthermore, because OPEC’s share of the world oil market was smaller, price management increasingly required the cooperation of non-OPEC producers. Such cooperation could not be guaranteed, however, since many non-OPEC producers, like the United Kingdom, Norway, and Mexico, continued to pursue independent strategies. In Mexico, the NAFTA treaty, which opened up sectors of the oil industry to foreign investment, combined with the aftermath of the 1994 peso crisis to make it difficult for the Mexican government to think of cooperating with OPEC to bolster oil prices. OPEC’s weakness and the success of the coalition against Iraq set the stage for turmoil in international oil markets.

By the end of the twentieth century, oil markets came to resemble those of other commodities: highly volatile and subject to swings in supply and demand, but still subject at times to the actions of a small number of oil producers. The problem was not a shortage of petroleum in the world, as new fields were discovered and older fields made more productive through technology. For example, advances were made in secondary and tertiary recovery. Secondary recovery involves maintaining or enhancing reservoir pressure by injecting water, gas or other substances into the formation. Tertiary recovery involves technologies that, for example, heat the petroleum reservoir in order to reduce viscosity. While secondary and tertiary recovery are more expensive than primary recovery, improvements in technology can reduce the differences in cost.58

Advances in offshore drilling technology greatly reduced the per barrel cost of exploiting offshore petroleum deposits. North Sea oil costs were reduced as much as 80 percent in the 1990s, and per barrel costs descended to around $3 per barrel, making North Sea crude oil almost as inexpensive as oil from the Middle East.59

Despite advances in technology, however, worldwide capacity to extract, refine, and distribute petroleum was constrained for a number of reasons. Above all, falling real prices for oil in the 1980s and early 1990s reduced the incentive to make the massive investments in extraction, transportation, and refining capacity needed to exploit new sources of petroleum.

Investment was also complicated by environmental regulation. Environmental regulations, put in place to address concerns about oil spills and destruction of wildlife habitat, raised the costs of exploration and exploitation for energy companies in the United States and other industrialized countries. Energy companies were also burdened with expenses connected with cleaning up older or abandoned sites where environmental damage was extensive. In the United States, the so-called Superfund Program was of particular concern to the oil industry.60

While investment stagnated, global demand for petroleum increased steadily in the 1990s (see Figure 9.5). Because of the oil glut of the 1980s and their success in the Gulf War, the North became increasingly complacent about the need to implement national energy policies and to manage the international oil system. Although Europe and Japan encouraged conservation by imposing taxes on oil consumption, the United States rejected such taxes, maintaining relatively low prices of oil and encouraging a return to gas guzzling vehicles and high consumption of petroleum.

Meanwhile, developing countries consumed ever-greater quantities of petroleum to fuel development. Between 1960 and 1999, average annual growth in oil consumption the OECD countries was around 3 percent; in the developing countries it was 4.2 percent. Between 2000 and 2007, growth in OECD oil consumption was 0.3 percent;
China, which was short of hydrocarbon resources, posed a particular threat. Because of China’s high rate of economic growth, the demand for fossil fuels increased rapidly. China became the third largest oil consumer after the United States and Japan and in 1993 China became a net importer of oil. After that date, the gap between domestic production and consumption increased dramatically (see Figure 9.11). Rising energy demands combined with supply constraints created unstable conditions in oil markets. In such markets, OPEC was able to act only at the margins and only when oil exporters were desperate. One of the key factors affecting OPEC in this new era was the changed role of Saudi Arabia. Remember, the ability and willingness of Saudi Arabia to play the role of swing producer was weakened in the 1980s by growing non-OPEC production and by OPEC internal conflicts. In the 1990s, a new factor intervened: Saudi finances.

In the 1970s and 1980s, Saudi Arabia used its massive oil earnings to support its economy, social services, and foreign policy as well as to accumulate large financial reserves. The Saudis built an economy based on government ownership of industry and a social and political system built on extensive government services and assured employment. Saudi leaders also used oil earnings to support a costly foreign policy, which included significant financial support for Iraq—estimated at $26 billion—during the Iran–Iraq war, and for the coalition against Iraq during the Gulf War—estimated at $60 billion. The government also made significant purchases of foreign military equipment, largely from the United States. For many years, Saudi Arabia had been able support these expenditures without draining its vast financial reserves.

By the 1990s, lower oil prices, rising costs of inefficient domestic industries and of services for a rapidly growing population, and the burden of foreign and military expenditures had taken their toll. Saudi budgets were in chronic deficit, financial reserves declined dramatically (see Figure 9.12), and the country was obliged to borrow from both domestic and foreign sources to cover its expenses. In an effort to limit the financial drain, Saudi leaders implemented limited
economic reforms. However, they were unwilling to undertake significant economic and budgetary reforms that would lead to unemployment and a loss of government control over the economy that, in turn, would weaken their domestic political support. As a result, the Saudis became increasingly concerned about maintaining the price of oil, their market share, and their oil earnings.63

The Saudi dilemma became clear in 1998, when the price of oil collapsed. In 1997, despite the Asian economic crisis, OPEC increased production, driving oil prices down to $12 per barrel. Saudi Arabia now faced what other oil exporters had confronted: a dearth of government revenues, an inability to fulfill social and political demands, and the threat of political instability. In desperation, Saudi Arabia along with other OPEC and non-OPEC producers including Mexico, Norway, and Oman agreed on production reductions. Nevertheless, in December 1998, oil prices fell to below $10 per barrel. Saudi Arabia then led negotiations among OPEC and non-OPEC members to further reduce production. On March 23, 1999, OPEC announced that its members had agreed to reduce oil production quotas by a total of 1.7 million barrels per day.64 These reductions, combined with a more rapid than expected Asian recovery, helped to stabilize oil prices.

OIL IN THE TWENTY-FIRST CENTURY

Rising Price of Oil

At the dawn of the twenty-first century, the stage was set for a massive rise in the price of oil with its attendant political consequences. Global demand grew dramatically because of continued growth in the industrialized countries, the low
cost of oil during the 1980s and 1990s (which encouraged consumption and a shift toward less energy-efficient vehicles in the United States), and rapid economic growth in emerging markets, particularly large developing countries like China and India.

Supply could not keep up with demand because (1) low investments in refining capacity created a bottleneck in the supply chain; (2) new environmental regulations in industrialized countries made it more expensive to invest in refineries; (3) wars in the Middle East (especially the Gulf War and the war in Iraq) and the Iraqi insurgency reduced production in the Persian Gulf; (4) production in OPEC members Nigeria, Venezuela, and Mexico was declining; and (5) major non-OPEC sources like the North Sea were experiencing a major decline in production (see Figure 9.6).

As a result, there was less of a cushion in the form of excess production and refining capacity that could handle both real and threatened disruptions in supply. Events such as hurricanes in the Gulf of Mexico, political unrest in Nigeria, efforts by the Chávez government in Venezuela to nationalize foreign investment in the oil sector, attacks on oil facilities in Iraq, threats by Iran to interrupt flows of oil through the Straits of Hormuz, and breakdowns in refineries led to huge spikes in the price of oil. These major changes were reinforced by growing speculation on oil prices in financial markets during the commodity boom of the early twenty-first century.

OPEC remained weak and was unsuccessful in its efforts to manage the price of oil by allocating production quotas. Saudi Arabia was no longer in a position to impose discipline on the other members of OPEC. The Saudis did not control refining capacity, a key to maintaining control over prices. Oil markets became vulnerable to even limited disruptions in supply.

In 2003, oil prices began to climb once again. Oil prices rose again in 2005 and then accelerated at the end of 2007 (see Figure 9.13). Per barrel prices went above $100 for the first time in March 2008. By late summer prices had risen to over $140 per barrel before dropping back to around $80 in October. Again, steady supply and growing demand were the main reasons for price increases. Saudi Arabia increased production by about 0.5 million barrels per day in June. The Saudis were happy to receive the windfall revenues from higher oil prices, but were concerned about the possibility of a global slowdown. The price decreases in the autumn of 2008 were driven primarily by reduced consumption in the industrialized world resulting in growing fears of a global recession. Within OPEC, the price hawks—especially Iran and Venezuela—pushed for a reduction in production, while Saudi Arabia maintained the existing level of production (above its OPEC quota) as prices declined.

Gasoline prices in the United States quickly adjusted upward as crude oil prices increased (see Figure 9.14) and became an important issue in domestic politics including the 2008 election campaign. Republicans began to push for more offshore drilling and exploitation of Alaskan reserves. Democrats countered with demands for releasing oil from the Strategic Petroleum Reserve and new proposals for conserving fossil fuels. Others argued for greater use of nuclear power, solar power, wind power, biofuels, and other alternative energy sources.
Consumers reacted to higher gasoline prices by reducing their driving mileage and by trading in their gas-guzzling SUVs for hybrids and other more fuel-efficient vehicles.

The impact of higher oil prices on world politics was significant. Russia emerged as the world’s largest energy producer and increased global oil prices enabled Russia to become much more assertive on the world stage (see Chapter 10). Another major oil exporter, Iran, was able to shrug off international pressures to cease its nuclear weapons development program. Iran continued to fund Shi’ite insurgents in Iraq, Hezbollah in Lebanon, and Hamas in the Gaza Strip, and periodically threatened to disrupt world oil supplies from the Gulf.
which flowed through the Straits of Hormuz controlled by Iran. Venezuela challenged Brazil for regional hegemony in Latin America.

Because of their increasing dependence on imported oil and natural gas, the Western economies were more vulnerable to threats of disruption in oil supply. This was demonstrated in 2005 and 2006 when Russia disrupted oil and natural gas flows to Western Europe through pipelines in the Ukraine and Belarus.

In March 2005, the Russian natural gas company, Gazprom, demanded increased prices for natural gas exports to the Ukraine. In addition, the Russians wanted to pay lower fees for the transmission of gas to Western Europe through the pipelines. The Ukrainians traditionally demanded 15 percent of the gas flowing through the pipeline as payment for transit rights. Negotiations between the two governments to settle the dispute were unsuccessful. On January 1, 2006, Gazprom stopped the flow of natural gas to the Ukraine. The flow was restored three days later, with both sides claiming that a satisfactory agreement had been reached. Observers in Europe and the United States speculated that the dispute was motivated by Russia’s displeasure over the success of the Orange Revolution and the 2004 defeat of their favored candidate for the presidency, Viktor Yanukovych, by Viktor Yuschenko, who favored closer ties to Europe. Both the Russians and the Ukrainians later denied that this was a major factor in the dispute.

In Belarus, the dispute began in 2006 when Gazprom demanded increased prices for natural gas exports. The president of Belarus, Alexander Lukashenko, refused to pay, so Gazprom threatened to cut off gas supplies. Lukashenko backed down but then retaliated by upping the transit fees that Belarus charged Russia for the Druzhba pipeline, an oil pipeline operated by the Russian state enterprise, Transneft. When Transneft refused to pay the fees, the Belarus government began siphoning oil from the pipeline. In retaliation, Transneft shut down the pipeline entirely. Because most of the oil flowing through the Druzhba pipeline was destined for Western Europe, the European Union objected strenuously. Three days later, negotiations between Russia and Belarus resulted in the reopening of the pipeline.

Emerging countries like China and India became anxious to secure access to foreign sources of oil. China launched a diplomatic initiative, negotiating a series of agreements with oil-producing countries like Sudan, Somalia, Ethiopia, Kenya, and Sri Lanka. The Chinese National Overseas Oil Company (CNOOC) was one of the bidders in 2007 and 2008 for service contracts with the Iraqi national oil company. CNOOC and Taiwan’s state-run oil refiner, CPC Corporation, agreed to cooperate in developing offshore deposits in the East China Sea.

China’s need for oil also drove other Chinese diplomatic positions. For example, the Chinese blocked U.N. action on the humanitarian crisis in Darfur so as not to offend their new Sudanese partners.

India was competing with China in some places to secure access to foreign oil. The Oil and Natural Gas Corporation (ONGC) of India held talks in October 2008 with the Iranian government for exploring an oil block in Northern Iran, in competition with the Chinese company, Sinopec. Similar talks were going on with the Colombian government.
The War in Iraq

In addition to shaping a variety of political and diplomatic relations, access to oil again became a factor in issues of war and peace. Oil did not cause the United States and its allies to invade Iraq in 2003, but oil did become an important element in bringing peace and stability to that country and had ramifications for the oil market well beyond the Middle East.

After the 1991 Gulf War, as noted above, the regime of Saddam Hussein in Iraq had been subjected to severe sanctions by the United Nations and its members with the purpose of ending the Iraqi nuclear weapons development program. U.S. strategy during the 1990s had been to keep Saddam in check through these sanctions by imposing military no-fly zones in Northern Iraq. However, following the election of George W. Bush and the terrorist attacks of 9/11, concern grew (particularly in the United States and within the Bush Administration) about Iraq’s nuclear weapons program and its possible possession of other weapons of mass destruction as well as about Saddam’s alleged link to Al-Qaeda. Intelligence information—later proven to be false—suggested that sanctions had not stopped Saddam’s nuclear program and that the 9/11 terrorists had consulted with Iraqi officials.

Despite concern over Iraq’s possession of weapons of mass destruction (including Hussein’s refusal to permit U.N. inspection of Iraqi weapons facilities) and despite strong pressure from the United States, the United Nations did not authorize the use of force against Saddam. Instead, the Bush Administration convinced the U.S. Congress to authorize the use of force against Iraq in 2003. Although the U.S. government was not able to assemble a broad international supporting coalition as it had in 1991—a number of NATO allies including France and Germany refused to participate—the United Kingdom, Australia, and Poland did participate alongside the United States in the 2003 invasion in the so-called Coalition of the Willing.68

The major military battles were quickly concluded, and Saddam Hussein was eventually captured and executed. The U.S. intervention then turned into a difficult and lengthy occupation dealing with resistance from Sunni and Shi‘ite militias and extremist Islamist groups sympathetic to Al-Qaeda. Sectarian violence between Shi‘ites and Sunnis added to the deadly mix.

Oil rapidly became a factor in the Iraqi equation. The United States had anticipated that oil revenues would finance the Iraqi government operations and that new investment in the oil sector would fuel the economic recovery and political renaissance of Iraq. Instead, Iraqi oil fields and pipelines became a major target of terrorists. The Iraqi military, which had been disbanded after the invasion, and the weak and ineffective Iraqi police force were unable to protect Iraqi oil fields and pipelines; therefore, protecting those facilities fell to U.S. military forces in the aftermath of the invasion.

Despite U.S. military protection, Iraqi oil production declined (see Figure 9.14). U.S. efforts to promote new investment in the oil sector faltered. The inability of the Iraqi government to negotiate an agreement among the major political factions also delayed the recovery in production levels. As a result, the decline in Iraqi oil production after 2003 caused dislocations in the global supply of oil and contributed to the increase in world oil prices.
Looking Ahead

The future of oil politics will be shaped by a variety of factors. Supply and demand will continue to determine the price of oil. Future demand will depend on rates of economic growth in the oil-consuming countries. Because of their rapid growth, the newly emerging economies, particularly China and India, will increasingly shape the global demand for and price of oil.

Demand in the new century will also depend on whether developed and developing countries decide to address climate change by investing in energy-conserving technologies and other efforts to reduce consumption of fossil fuels including oil. The burning of fossil fuels (e.g., oil, coal) contributes significantly to the accumulation of greenhouse gases that cause global warming. Thus, in order to reduce greenhouse gases, both developed and developing countries will have to reduce the per capita consumption of fossil fuels by creating and deploying more efficient technologies or by switching to other sources of energy. One example of such an effort was the Kyoto Protocol, signed in December 1997, which called for international cooperation to create and enforce an upper ceiling for global CO2 levels. The ability of developed and developing countries to adopt national policies to reduce energy consumption and to reach future international agreements to reduce greenhouse gasses will be an important factor in the future political economy of oil.

Geopolitical forces such as political instability, war, and terrorism will also affect the political economy of oil in this century. High prices of oil will enable major oil producers such as Russia and Iran to attempt to wield the oil weapon to achieve foreign policy goals. The ability of terrorists to continue to threaten disruption of supply will be enhanced if oil is in short supply and if the price is high. A war in the Persian Gulf or the Caspian region could threaten economic and political stability. Thus, the politics of oil, a key element of international politics in the twentieth century, is likely to remain so in the twenty-first century.

ENDNOTES


2. The Seven Sisters were Exxon, Mobil, Gulf, Socal, Texaco, Shell, and British Petroleum (BP). See Anthony Sampson, The Seven Sisters: The Great Oil Companies and the World They Made (London: Hodder and Stoughton, 1975).

4. In 1928, for example, Shell, Standard Oil, and Anglo-Persian (the predecessor of BP) in order to bring order out of soft and volatile markets concluded the “As Is,” or “Achnacarry,” agreement to divide world markets and stabilize or determine world prices. In that same year a group of British, Dutch, U.S., and French companies agreed to divide up much of the old Ottoman Empire in the Red Line agreement. Also important was the basing-point pricing system that established a common price at several locations, or basing points, and standard, not actual, freight charges from the basing point to the destination. This system prevented low-cost producers from expanding their market share by reducing prices. See Penrose, *The Large International Firm*, 180–183. Apparently, there is some controversy about the success of the Achnacarry Agreement: see Yergin, *The Prize*, 264–265.


12. See, for example, Engler, *The Politics of Oil*.

13. See note 3.


15. Zuhayr Mikdashi, “The OPEC Process,” *Daedalus*, 104 (Fall 1975): 203. The new members were Algeria, Libya, Qatar, the United Arab Emirates, Nigeria, Ecuador, Indonesia, and Gabon.


19. There was some consultation by the developed market states. The U.S. Department of Justice issued a waiver to oil companies under antitrust law, enabling them to cooperate in bargaining to resist unreasonable demands for higher prices. See U.S. Senate, *Multinational Corporations and United States Foreign Policy*, Part 5, 145–173. President Nixon then sent Undersecretary of State John N. Irwin to the Middle East to encourage governments to enter into joint negotiations with the companies. Secretary Irwin, however, capitulated to the demand of the shah of Iran for separate negotiations.

20. The Organization of Arab Petroleum Exporting Countries was formed by three Arab states—Kuwait, Libya, and Saudi Arabia—in 1968. It was expanded in 1970 to include Algeria, Abu Dhabi, Bahrain, Dubai, and Qatar. The website for OAPEC is http://www.oapec.org/


45. *Ibid*.


55. The four firms that formed the joint venture were Chevron (25 percent); ExxonMobil (25 percent); LukArco (5 percent), a Russian firm; and KazMunayGas (20 percent), a Kazakh state enterprise.


61. Calculated by the authors from data used in Figure 9.5.


68. Other countries supported the invasion but did not participate. For details, see “Coalition of the Willing,” Perspectives on World History and Current Events, http://peace.org/willing.html.