Development of the petroleum industry

Historical background

Petroleum

In the beginning of the XX. century carbohydrates became more and more important in the world because they were pure, easily manageable, cheap, have huge energy capacity and were available in big amounts all over the world.

Petroleum can be used as a source of energy as well as a raw material in the manufacturing of plastics and fertilizers, and only very few commodities have become as vital as it, and petroleum has been the object of geopolitical confrontations as a commodity of strategic importance. At that period several geopolitical events were closely related to oil or had consequences on oil prices and supply. The decision in 1912 by the British Admiralty to convert warships from coal to oil propulsion because of speed and range advantages was the first event that led to the geopolitical importance of oil. Great Britain nationalized the Anglo-Persian Oil Company and committed itself to the protection of this resource in Persia – since 1934 the country is called Iran – because the country had no oil resources at all.

In the beginning the United States of America did the 60% of the total exploitation, but by 1990 the undeveloped countries took over it; the Near East gave 26%, Russia 21% and North America only 17% of the whole exploitation. 80% of the known and exploitable oil resources were found in 8 countries in the world: Saudi Arabia, Iraq, United Arab Emirates, Kuwait, Iran, Venezuela, Russia and Mexico.

The first oil crisis was only a local crisis; it had no significant effect on the world market. It took place in Iran, because Mohammad Mossadeq, the prime minister of Iran, nationalized the oil companies, so English professionals went home and the country went bankrupt in 3 years.

Then began the Suez crisis in 1956 when Nasser nationalized the canal. In the 50es annually 210-220 thousands of tons of cargo went through the canal and the 2/3 of it was petroleum that had to be transported to Western Europe. But after the arab-israeli war blow-up, Nasser made the canal totally unusable. As the canal had a great significance, it caused some outstanding problems – provisional petroleum shortage evolved in Western Europe, so consumption was decreased, higher taxes were levied on petrol, and petrol coupons were introduced.

Simultaneously Syria closed the petroleum lines in the Iranian areas and Saudi Arabia introduced embargo towards Great Britain and France.

By 1957 the crisis came to an end, 90% of the petroleum export that was not transported was compensated, and at that time petroleum utilization was not so important (1956 only approximately 20% of Europe’s energy use) and there were no considerable changes in the prices.

World War I demonstrated the increasing importance of the internal combustion engine on modern military operations, such as planes, trucks and tanks. In the 1920s motorization – automobile – was becoming an important mode of transportation and these years were characterized by exploding civilian demand for oil. At the same time a few primal corporations -that became the oil giants of today – started to control the industry quickly.

The oligopolistic commercial control on the price and the production of oil was in 1928 by the Achnacarry Agreements first established between the greatest oil multinationals of the time: the ‘ Seven Sisters’.

Seven Sisters of the petroleum industry

The term ‘ Seven Sisters’ refers to seven huge oil companies that dominated – since Rockefeller’s first gigantic monopoly – the mid 20th century oil production, refining and distribution.

Five of them were American and the two other were British. The American companies included Exxon, Mobil, and Socal which later became Chevron, Gulf and Texaco. The British companies were Royal Dutch Shell (it was a joint venture with the Netherlands) and British Petroleum (BP), whose interest in world oil expanded with the discovery of oil fields in Iraq and in Indonesia. Later through acquisitions and mergers the ‘ Seven Sisters’ have become four enormous oil companies; ExxonMobil, Royal Dutch Shell, BP and Chevron-Texaco.

These corporations have invested a lot in extraction infrastructures, particularly in the Middle-East and Latin-America. They were effectively in control of the oil supply and demand of the world with a set of strategies, such as fixing production, prices and quotas. However, in several developing countries a nationalization trend started to emerge, slowly leading to the future oil supply control and shocks. In 1938 Mexico vigorously took control of its entire oil industry by expropriations, undermining its accessibility to foreign markets for a while, but generating sympathy in a lot of developing countries as a symbol against foreign exploitation of national resources.

World War II. revealed to be a conflict that was strategically dominated by oil because the key weapons were air and armored forces. In 1941 the United States decided to establish an oil embargo on Japan, this was one event that triggered the war in the Pacific. The strategic objectives of Japan were to secure the resources of Southeast Asia, mainly the Indonesian oil fields, and the country has planned fast operations in order to achieve these objectives. The same year, Germany's invasion of the Soviet Union had the securing of the oil fields in the Caucasus region among its primal objectives, but both Germany and Japan failed to establish a secure source of oil, in 1945 that contributed to their overthrow by strategically more mobile allied forces. About 86% of the world's oil supply was controlled by the allied nations.

The increasing geopolitical importance of the Middle-East was underlined by the post World War II. era, as from that region the United States and Europe were importing growing quantities of oil. In1948 in Saudi Arabia a new source of oil was discovered, called Ghawar Field, that accounted for the largest conventional oil field in the world; more oil reserves were discovered in this region, so the supply was shifting rapidly. They were trying many times to integrate countries like Iran, Iraq and Saudi Arabia in alliances with Western powers, but a series of geopolitical events, just like the creation of the OPEC and Islamic nationalisms, would complicate access to oil resources.

The OPEC

The western Seven Sisters wanted to achieve a powerful economic control of oil production, so many producing countries – most of them were from the Middle-East – had a common goal: to gather a bigger share of the oil incomes by controlling supply.

In 1960 an organization called ‘ Organization of Petroleum Exporting Countries’ (OPEC) was founded at the Baghdad Conference. It contained five founding members: Iraq, Iran, Kuwait, Saudi Arabia and Venezuela, but by the end of 1971, six other nations had joined the group, they were the following countries: Qatar, Indonesia, Libya, United Arab Emirates, Algeria and Nigeria. They also wanted to maintain the oil prices. In 1968 the Arab countries founded the Organization of Arab Petroleum Exporting Countries.

Throughout the post World War II period exporting countries found increasing demand for their crude oil but there was a 40% decline in the purchasing power of a barrel of oil. The balance of power shifted in March 1971. And this month the Texas Railroad Commission set proration at 100 percent for the first time which meant that Texas producers were no longer limited in the volume of oil that they could produce. It meant – more significantly – that the power to control crude oil prices shifted from the United States – Texas, Oklahoma and Louisiana – to the OPEC. There was no more spare capacity in the United States and as a consequence no tool to put an upper limit on prices. A little over two years later OPEC – through the unintended consequence of war – achieved a glimpse of the extent of its power to influence prices.

The OPEC was unable to increase oil prices until the beginning of the 1970s. The major reasons were the importance of production in non-member countries and there OPEC members had some difficulties to agree on a common policy, since economic theory clearly underlines that cartels are bound to fail at fixing prices. Accordingly, developed countries were confident: the price of petroleum would remain relatively stable. In the early

1970s it was predicted by the American Government that by 1980 oil prices might rise to about 5 dollars per barrel. So the petroleum prices were very low and the economic growth was strong but this situation changed quickly.

During the period of the Six Day War (1967) OAPEC members announced an embargo towards countries aiding Israel; Iraqi and Saudi oil lines became shut down. Then 900 tons less were exported each day and also the Suez Canal was closed at that time, so the exploitation was raised in the United States, Venezuela, Iran and Indonesia.

In the end Iran and Saudi Arabia boycotted the embargo and they could manage to avoid a serious crisis. The only losers of this event were those Arab countries that were closing down the export.

The embargo

In the early 1970’s under President Nixon’s order, the United States of America began shipping arms to Israel.

In 1993 the Yom Kippur War broke out between Israel and Egypt (and several Arabian countries). This war gave the OPEC additional reasons to intervene: they imposed export quotas, reduced production by 25% and nationalized production facilities. The oil crisis started on October 17th 1973 and lasted until June 1974. Not long after the start of the War, when the Arab countries decided to turn to the ‘ oil weapon’ again; the Organization of Arab Petroleum Exporting Countries announced the reduction of oil exploitation by 5% each month in those countries supporting Israel in the conflict during the war. In their opinion Israel could stand against the attack of the other two counties because the West gave them help. They wanted to undermine Israel’s support, mainly the USA, so oil became a geopolitical weapon.

The market became controlled by supply by oil producers, causing the first oil shock.

The oil embargo affected the United States of America, its western European federates and also Japan. During this half year period the western world was facing with the strategic significance of oil and its shortage for the first time. For example in the States at the top of the crisis on even days only cars ending with even registration number and on odd days cars ending with odd number were allowed for a while to be refueled. This embargo damaged the U. S. economy so greatly that many were unsure if the country would escape such devastation.

Among the few countries that were affected, the United States suffered greatly, because after they gave aid to Israel the whole oil export ended toward them.

The ability to control crude oil prices was passed from the United States to OPEC, and it was removed during the Arab Oil Embargo. Prices increased 400% in 6 months, and the extreme sensitivity of prices to supply shortages became all too apparent at that time.

The world crude oil price was relatively flat from 1974 to 1978, ranging from 12. 21 dollars per barrel to 13. 55 per barrel, but when adjusted for inflation world oil prices were in a period of moderate decline.

The crisis in 1973 had a huge effect on the world market, because this year the oil export from the Near East amounted 1 billion tons, and 40% of the petroleum of the bourgeois world originates from this region – England 73%, France 83%, Italy 85% …

As a result of the shortage of oil petrol and gas oil prices increased, so the forestalling of fuel started. This resulted in bigger shortage and prices became higher and higher. In America the rise of prices almost caused a shock just like the world war.

Prices started to fall at the New York Stock Exchange, restrictions were introduced for car usage, and people were encouraged to use less energy.

With the start of the embargo, U. S. imports of oil from the Arab countries decreased from 1. 2 million barrels a day to a mere 19, 000 barrels. Daily consumption dropped by 6. 1% from September to February, and by the summer of 1974, by 7 percent as the United States of America suffered its first fuel shortage since World War II.

The impact of the embargo was drastic and it had an immediate effect on the whole economy. In the United States of America the retail price of a gallon of gasoline rose from a national average of 38. 5 cents in May of 1973 to 55. 1 cents in June of 1974. Meanwhile, The New York Stock Exchange shares lost $ 97 billion dollars in value in 6 weeks.

Prices were rising since 1971 and by 1973 the price of petroleum reached the 11, 68 USD/ton, this means that the prices became 10 times higher than they were originally. It could occur because of the disharmony of the consumer countries and so they could not make movements together against the embargo (for example anti-Americanism in France).

Conclusion

In times of shortage or oversupply crude oil prices behave much as any other commodity with wide price deflections. The crude oil price cycle may circulate over many years responding to changes in demand as well as OPEC and non-OPEC supply.

From 1974 to 1978 under the control of the OPEC, the price of oil still remained high but stable: around $12 per barrel. Many developed countries started to worry about the unreliable supply sources and the exhaustion of oil reserves, but they did not do much one on this regard. The Iranian revolution in 1979 and the ensuing Iran-Iraq War lasting from 1980 to 1988 caused the second oil shock where the price of oil surged over $35 per barrel, this imposed several drastic – but somewhat temporary – measures to lower oil consumption. This resulted in a relocation of energy-consuming industries, in strategies for consuming less energy, such as energy efficient cars and appliances, in relying more on national energy sources like petroleum, coal, natural gas, hydroelectricity, nuclear energy, in building strategic reserves, and in substituting petroleum for other energy sources when it is possible. About 2 billion barrels are estimated to be held in strategic reserves all around the world, the bulk of it in the United States, Germany and Japan. In 1980 the Carter Doctrine, which states that the United States would intervene militarily if its oil supply was compromised, is also the outcome of the uncertainties derived from the first and second oil shocks. The military presence of the United States in the Middle-East was extended, as the oil of the Persian Gulf was clearly perceived as of foremost significance to the national security.

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