Co-operation Between Producers and Consumers

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Introduction

The relationship between oil producers and oil consumers has had a history as long as the industry itself. Thus, producers create supply and consumers create demand. On this basis of course “… the real dialogue is in the market between billions of consuming households and enterprises and a few hundred producing organizations, some of which have much more importance than others” (Mitchell, 2005 page 5). However, interactions on this basis are coloured and directed by the broader interactions between supply and demand. These take place in a context influenced by three cycles which characterize the international oil industry (Stevens, 2008): the political cycle which refers to the attitude to state intervention in the allocation of economic resources in an economy; the resource nationalist cycle which relates to the attitude to allowing foreign company involvement in the sector; and finally, the obsolescing bargain cycle which concerns the willingness and ability of the state to revise the fiscal terms inherent in the agreement. As a result of the role of these cycles, traditionally, “producer-consumer dialogue” as a subject for analysis and study has come to refer to relationships between oil producer and oil consumer (i.e. importing) governments.

In much of the literature on producer-consumer dialogue, two strands of thought are common. The first strand is that the producers tend to work through state-owned enterprises (i.e. national oil companies) over which they have direct control and the consumers tend to work through private companies over which they only have indirect control. The second strand is that attempts at dialogue were (and still are) driven by oil price volatility and the problem that the dialogue was supposed to address was seen as that of oil price instability.

However, while both these generalizations have some validity, in reality they can be overstated. The political cycle tended to determine how much was left to markets and how much to state intervention. In other words, the balance between state-owned enterprises and private companies changes. As will be seen, for much of the time, the problems with the dialogue arose because there was often a serious mismatch between the respective attitudes of producers and consumers, based largely upon fundamental differences in ideology reflected in the political cycle. Thus in the 1980s and 1990s as the so-called “Washington Consensus”1 was gaining traction, the major consumer governments simply wanted to leave things to “market forces.”
The concept of “dialogue” implied interfering with these “market forces,” which was frowned upon, especially by successive US administrations. At the same time, producer governments were seeking greater intervention. The underlying approach of the majority of the OPEC members derived from what might be loosely described a “socialist” view of the world where state intervention ruled but where the rhetoric was of co-operation. The problem with rhetoric is that if it is repeated often enough, people begin at the very least to pay lip service to the ideas. It is interesting to note in this context that as will be developed below, France, always a major player in the “dialogue,” consistently found itself in the middle as a country that while being part of the Organization of Economic Co-operation and Development (OECD) did, with its indicative planning and general ideology, have a much greater belief in explicit government intervention in the economy that many of its comparator countries lacked.

As for the second generalization about the role of price, as will be developed below, while rising prices acted to encourage attempts at dialogue, at times the oil price volatility was so great (most obviously during the second oil shock of 1978–80) that ideas of multilateral co-operation and hence any form of “dialogue” were effectively ditched, not least between the consumer governments as they scrambled for supplies. Given this general context, what follows is a brief history of producer-consumer dialogue.

The early years: pre-1970s

In the early years before the oil shocks of the 1970s, the “consumers” were effectively represented by the major international oil companies; the so-called Seven Sisters. These companies, five American, one British and one Anglo-Dutch, were seen by the producer countries (both governments and people) as representatives of the colonial powers, although in the case of the USA this view developed during the 1950s and 1960s as part of the so-called “Cold War.” As such these companies were viewed with great suspicion, as were their host governments. As will be developed below this imperial/colonial legacy of suspicion continued to dog attempts at producer-consumer dialogue throughout the 1970s, 1980s and 1990s.

It was the producer governments who first presented a united front in the form of the Organization of Petroleum Exporting Countries (OPEC) created in 1960. This was a collective response to the actions of the consumers (as represented by the Majors) seeking to lower the posted price used to compute profits for taxation purposes. This inevitably led to a reduction in revenues for the producer governments. However, this was not per se an attempt by consumers to secure lower prices. Rather it was related to the legacy of trying to maintain what had been the traditional link between US domestic prices and the international price embodied in the Gulf Basing Point pricing system, developed as a consequence of the 1928 “As-Is” agreement. Final consumers saw relatively little benefit. In the words that were common at the time “only fools and affiliates pay posted prices!”

The oil shocks of the 1970s

Between October and the end of December in 1973 the international price of crude oil quadrupled following decisions taken by OPEC. This was in addition to the gradual increase in prices seen since the Tehran and Tripoli Agreements signed in 1971 between OPEC and the Majors. Central to the understanding of why this was a “shock” to the consumers and subsequent events was the position taken by the governments of the industrial consumers over the previous decade. Cheap oil had been a necessary condition for the “OECD Economic Miracle” which had seen the industrialized countries growing at unprecedented rates. Their governments had taken
the position during the 1960s that the Majors had been doing an excellent job; oil was abundant and prices had been falling in real terms. Thus, in the 1960s when the political cycle had persuaded the necessity of heavy government intervention in most aspects of economic activity, the Majors were declared “off-limits” to government intervention. This was to create a major problem. When the dramatic increase in prices hit in the last quarter of 1973, the politicians in the OECD consuming countries inevitably asked their bureaucrats what was going on. They received the answer that the bureaucrats had no idea because they had been instructed that the industry be left alone. Thus, part of the “shock” for the OECD was that no one knew what on earth was going on. This was compounded because the academic economists to whom the bureaucrats turned for explanation could only come up with the ideas of Harold Hotelling from his 1931 article (Hotelling, 1931). This was because for the most part, they had no idea about the practicalities of the international oil industry.6 Hotelling’s views were of little relevance to the events.

It was in this context of bewildered uncertainty that the first efforts were made by the OECD governments to try and create some sort of dialogue with OPEC. Unfortunately, it began with an effort to create an organization, the International Energy Agency (IEA), that was explicitly intended act as a counterweight to OPEC. Thus, from the very start, the “dialogue” was seen as being confrontational. In January 1974, President Nixon proposed to the major consumer governments that a ministerial level conference should be held in Washington to formulate a “consumer action programme” in order to “develop a co-ordinated consumer position … for producer-consumer relations” (Parra, 2004 page 190). The conference, held in February 1974 led to the creation of the IEA as part of the OECD with a secretariat based in Paris. In September 1974 the IEA members agreed on an international programme for oil stockpiling and a sharing programme in the event of any further disruptions to supply along the lines of the Arab Oil Embargo. Excluded from those among the OECD members was Norway who was about to become a significant oil exporter7 and France who was desperately trying to distance itself from US influence in the world and pursue what it saw as its own interests.8

A major problem with the IEA that was to follow it for some considerable time (and any attempt at dialogue) was that its creation was perceived in the Arab world as the brainchild of Secretary of State Henry Kissinger. As a result of his role in developing “shuttle diplomacy” in the context of the Arab-Israeli conflict, the Arabs regarded him with deep suspicion. His outrageous duplicity was further reinforced by the position taken by Kissinger and the US administration during and after the Yom Kippur War of 1973.9 The result was that the two sides, OPEC and the IEA, viewed each other with deep hostility. Thus OPEC saw itself as the champion of the Third World lined up against the forces of US-led imperialism.10 This was not a situation conducive to any sort of genuine co-operative dialogue.

In October 1977, the IEA Ministers adopted 12 principles for energy policy. In essence the policy was aimed at picking winners (coal, nuclear and conservation) and designating losers (oil and gas in power generation) (Skinner, 2005). This was in the context where “oil prices were not market driven, but subject to a foreign cartel” (ibid. page 4). However, the 12th principle was to encourage “appropriate co-operation in energy” and in 1979, the IEA Ministers agreed to a dialogue and urged the creation of a better system for regular exchange of information on world energy supply and demand.11
intended to establish a “New International Economic Order” to promote economic developments with “OPEC as a vanguard for the Third World” (Parra, 2004 page 191).

In September 1974 the European Economic Community Council of Ministers (that was beginning to feel marginalized by events) drew up a long-term energy strategy that included options for co-operation between oil consumers and producers. It then proceeded to open a Euro–Arab dialogue. In a stance that was to characterize much of producer-consumer dialogue for decades, this move was strongly opposed by the USA. In February 1975 in Dhaka, a conference proposed by President Giscard d’Estaing was held on the “Third World Strategy on Raw Materials and Economic Development” to consider energy and related issues. This was intended to be a tripartite conference involving the industrialized countries, OPEC and the rest of the developing world. Representatives of the developing world wanted the conference to consider all raw materials. While this failed, a resolution was adopted expressing “solidarity” between the oil importing developing countries and OPEC.

In March of the same year, at the OPEC Summit in Algiers a “solemn declaration” was passed with 14 points regarding OPEC’s relations with the developing countries. This was effectively a wish list that was described accurately but unkindly as “… a thoroughly unrealistic document” (Parra, 2004 page 192).

In December 1975, the First Plenary Conference on International Economic Co-operation (CIEC) was held in Paris co–chaired by Canada and Venezuela. Eight industrialized countries plus the President of the EEC representing all their members attended together with 19 developing countries and seven OPEC members. Four expert commissions were created for energy, raw materials, development and finance. The conference reconvened for the second plenary session in June 1977. Nothing emerged and the North South dialogue effectively disappeared.

All these efforts failed for a number of reasons. As already suggested, the USA was opposed to any sort of dialogue that even mentioned price on the grounds this would interfere with market forces. At the same time, the French took every opportunity to irritate the Americans by giving moral and verbal support to Third World and OPEC aspirations over commodity prices. Furthermore, many of the issues were already under discussion in the General Agreement on Tariffs and Trade (GATT) and the United Nations Conference on Trade and Development (UNCTAD) and there was a sense amongst some of the OECD participants that a producer-consumer dialogue was just duplicating effort for no good reason. Also, in this atmosphere there was increasing support for the view that solutions to the problems faced by consumers, both in terms of high prices and security of oil supplies, lay in the development of bilateral rather than multilateral relations. This took the form of a number of barter deals between oil exporters and importers to try and offset the damage done to the importers’ balance of payments. There were also many efforts by consumer governments to improve relations with individual OPEC members by using their aid policy and, or, their foreign policy stances on a number of issues. Probably the most extreme example of this was Japan. The government moved to make significant changes in its foreign policy to assuage Arab feelings in the hope of securing crude supplies (Koyama, 2001).

The final source of failure in these early attempts at producer-consumer dialogue was what can only be described an idealistic unreality. In the words of one observer “both sides displayed an extraordinary lack of realism” (Parra, 2004 page 193).

Even amongst the consumers there was a failure to manage the crisis presented by the second oil shock. As already alluded to, the competition for crude supplies between Japan and the USA was intensified as both governments encouraged their companies to fight for crude supplies. The IEA’s emergency sharing mechanism was not invoked despite the fact that a number of
countries experienced the trigger-level of loss of imports which would justify its introduction. This gave rise to a view that is prevalent today that in the event of real emergency and threat to physical oil supplies, the IEA’s scheme would be dropped in a frantic free for all.\textsuperscript{15}

If the consumers could not agree amongst themselves there was little hope for any fruitful producer-consumer dialogue. The oil price shock of 1986 that dramatically reduced international crude prices effectively killed the prospects for producer-consumer dialogue for the time being. Quite simply, the consumers lost interest, very much reflecting the role of prices as a driver of attempts to talk.

**A revival of interest**

The invasion by Iraq of Kuwait in August 1990 triggered a revival of producer-consumer dialogue and yet again it was the threat of price shocks that encouraged the revival of dialogue. Following the invasion the oil price (Brent) rose from an average of US$15.05 in June 1990 to $32.88 in November 1990. However, the price spike was short lived mainly because Saudi Arabia was able to deploy its existing spare producing capacity to good effect. Misunderstanding this key role of Saudi Arabia, there was a widespread view among many within the OECD, especially in the USA, that it was the triumph of market forces that had rescued the day. Thus, it was perceived that the doomsday scenario\textsuperscript{16} of severe constraints on oil exporters from the Persian Gulf had been managed because markets had been allowed to function. It was seen, based upon this fundamental error of analysis, that co-operation between producers and consumers was not a necessary condition to manage supply disruptions and price volatility. All that was needed was to leave things to the market. The absolutely key role of Saudi Arabia and its spare capacity was ignored.

However, the events of 1990–91 had frightened a number of consumer governments. In June 1991, following the liberation of Kuwait, a meeting was convened in Paris chaired by France and Venezuela. This consisted of ministers from both the exporting and importing countries. The focus was on oil and gas (Mitchell, 2005). However, the meeting was strongly opposed by the USA (Skinner, 2005) who in the event sent only a Deputy Assistant Secretary of State, which in diplomatic circles was about as close to a snub as can be imagined. This meeting, which has met on alternate years ever since, became known as the International Energy Forum (IEF) and, as will be seen below, eventually led to a new chapter in producer-consumer dialogue.

Meanwhile, oil prices throughout the post 1991 period remained relatively low and stable averaging around US$17 per barrel, eventually culminating in the oil price collapse of 1998–99. Thus, price as a driver of co-operation had yet again faded into the background for the consumers. Nevertheless, during the price collapse of 1998, OPEC sought help and support from a number of non-OPEC producers, mainly Mexico, Norway, Oman and Russia. This help was forthcoming, although Norway and Russia subsequently reneged on their commitments to help. In the event, it was co-operation between Saudi Arabia and Iran which saved the day and paved the way to price recovery.

However, the events of 1998–99 had disturbed the producers, and the idea of co-operation with consumers gained a certain amount of traction. In 2000 Saudi Arabia offered to host a secretariat for the IEF in Riyadh. This secretariat was to limit its efforts to technical activities such as organizing conferences and seminars together with gathering information. The underlying political dialogue was to be performed by ministers. In 2003 Ambassador Arne Walther of Norway was appointed the first Secretary-General of the organization. In 2007 Noe van Hulst from the Netherlands who had previously been the Director of Long-Term Co-operation and Policy Analysis at the IEA replaced him.
Robert Mabro had effectively outlined the function of the IEF in the context of the market in 1991:

… the role of the market needs to be supplemented by another mechanism in two areas: one that improves the flow of economic information necessary for good investment decisions and one that provides indicators to the market about a level around which prices can fluctuate freely up and down in response to short term economic forces

(Mabro, 1991 Executive summary).

To this end, one of the initiatives was the Joint Oil Data Initiative (JODI). The trigger for JODI was a widely held belief that a lack of transparency of oil market data was a major contributory factor to oil price volatility. It began in 2001 as the Joint Oil Data Exercise. Initially this was the product of co-operation between six pioneer organizations, the Asia Pacific Economic Co-operation (APEC), the Statistical Office of the European Communities (Eurostat), the International Energy Agency (IEA), the Latin-American Energy Organization (OLADE), the Organization of Petroleum Exporting Countries (OPEC) and the United Nations (through the UN Statistics Division). It was established as a permanent mechanism in 2003, renamed as JODI with the IEF Secretariat taking responsibility for co-ordinating the project in January 2005 and managing the JODI World Database. The JODI partner organizations covering some 90 countries submit monthly data to the IEF Secretariat on production, refining, trade, demand and stocks of seven product categories: crude oil, LPG, gasoline, kerosene, diesel oil, fuel oil and total oil.

There have been some efforts to extend JODI’s remit to considering estimates of oil reserves but this is unsurprisingly proving to be controversial given the strategic sensitivities of such data.

At the same time, the agenda for the dialogue was starting to become wider and very specific. On September 25th 2005, an OPEC Communiqué stated, “… dialogue must address all the issues of interest to the parties.” It then proceeded to list 14 specific agenda items. This was beginning to look a little like the wish list of the 1970s, described earlier as “thoroughly unrealistic.”

As these events unfolded, two issues began to emerge which were to influence producer-consumer relations in a very negative way by creating sources of conflict. These were the role of consumer government taxation and the rise of the “paper markets.”

In the aftermath of the second oil shock of 1979–81, the main industrialized countries met at two key G7 summits in Venice and Tokyo. Of central importance was how to counter the growing threat to their economies from rising oil prices. A major problem was that the obvious solution of increasing final prices increased the likelihood of countries acting to protect their competitive export positions. However, if all agreed to behave in the same way and increase energy prices, this problem could be solved. It was therefore resolved at these summits that each of the G7 would begin to increase final energy prices. In most cases for oil products, this was achieved by imposing sales taxes of various sorts onto the pump price.

As the 1980s progressed, the imperative to increase sales taxes at the pump came from another source. Oil products are ideal targets for tax collectors. They have a very large tax base that means a large potential pool of revenue. They have a very inelastic demand that allows very high tax rates to be imposed without reducing consumption levels. Thus the potential gross revenue is huge. Then, because of the limited number of outlets, tax collection costs are relatively very low increasing net revenue. Oil products became an increasingly important source of revenues for many governments. There was one further advantage of raising revenue from oil products. Politicians could impose such high taxes pretending to be...
concerned about the environment. They could hide their revenue greed behind a cloak of green respectability.

This propensity to impose taxes on oil products became a major source of concern to OPEC. There were two main issues. The first was that OPEC saw the taxes as being unfair. They pointed out that the proportion of the final product barrel going to the producer government for the crude oil was very much lower than that going to the consumer governments from sales taxes. In reality this argument was very poor economics. The money accruing to the producer governments from the sale of crude was value added and a net addition to their GDP. The money accruing to the consumer governments from the sales taxes was merely a transfer payment from the citizens of the country to their government. The two are not comparable.

The second issue arising from the sales tax policy of the consuming governments, which had much greater validity than the first argument, was that such high levels of sales taxes were a restraint on trade. In 1985 Saudi Arabia made a fundamental change in its oil policy. It was no longer willing to defend the relatively high prices of oil by absorbing the cheating by other OPEC members on the quota system. Instead it decided to pursue a policy of greater price moderation in an effort to reverse the damage done to oil demand by the oil price shocks of the 1970s. Thus they moved away from administered prices. A key part of this policy was to maintain the cushion of spare capacity (some 2 to 2.5mbpd) to avoid a price spike in the event of another geopolitical outage. However, throughout the 1990s this strategy was consistently being undermined as the lower prices of crude oil failed to translate into lower oil product prices because of the growing levels of sales tax acting as a wedge between producers and final consumers. This issue of ever increasing sales taxes began to aggravate poor relations between producers and consumers as, from the producers’ perspective, it was seen as part of a grand conspiratorial strategy to damage the vital strategic interests of the oil exporters. It also persuaded many of the producers that if there was money on the table from selling and taxing oil products why should it not accrue to them. It seemed to legitimize much higher crude prices.

The second issue that began to create a major source of discord between producers and consumers in the oil market context was the growing importance of “paper markets.” Up to the time of the second oil shock there had been no paper markets for oil. The explanation for this gap is simple. Such paper markets had been developed to hedge the price risk faced by producers and consumers of the commodity. Until 1986, because the international price of crude was an administered price, it was seen that there was little or no price risk. However, that did not prevent the development in the first half of the 1980s of “forward markets,” mainly for North Sea crude. These were unregulated markets where paper contracts to deliver crude oil at Sullom Voe within a fairly short period, usually three weeks, were bought and sold. However, there was growing unease with these forward markets due to a lack of control and regulation and questions over the reliability of some of the players.

An important consequence of the oil price collapse of 1986 and its aftermath was that administered prices were dropped as the basis for pricing crude and replaced by market prices reflecting (at first) market movements in spot prices. As a result price risks began to mount. In 1987 the New York Metal Exchange (NYMEX) began trading in contracts for West Texas Intermediate (WTI). A year later the International Petroleum Exchange (IPE) opened in London trading in Brent.

This is not the place to describe these developments and their consequences in detail, but one major consequence for producer-consumer relations concerns the fact that these “paper markets” began to impact upon oil price levels and their volatility. While the impact is uncertain and
extremely controversial (Stevens, 2008a) it meant that many began to perceive that oil prices were now being driven by the whims of Wall Street rather than the physical “wet barrel” markets where real people traded real barrels of crude oil.

Thus whenever crude prices began to rise, the consumer governments blamed OPEC for failing to supply the market with enough crude. In response, OPEC blamed the “speculators” on the paper markets for increasing the price. This conflict became greatly aggravated in 2008. In August 2007 the OPEC basket averaged US$68.71 per barrel. At the start of 2008 it was $88.35 and by June had reached $128.33. As the price increased, President Bush, Prime Minister Gordon Brown, and other leaders of the industrialized countries, began to make speeches about the need for OPEC to increase production to mute the rise in prices. They claimed in effect that the price rise was because of crude oil shortages. In response, the OPEC producers argued that the rising price had nothing to do with crude oil shortages but was the result of speculation and the lack of investment in refining.

Eventually, Saudi Arabia under great pressure from the USA announced it would host a meeting of the IEF in Jeddah in June. The purpose of the meeting was unclear. However, the outcome was that Saudi Arabia offered to put another 500,000 b/d onto the market. This was effectively a sop to the consumer countries. In the event, while they offered the crude, they did so at existing price levels. Given the crude on offer was heavy sour crude, not surprisingly there were no takers which allowed Saudi Arabia a rather dubious “I told you so” moment in the debate over the causes of higher prices. The meeting also announced that there would be a follow-up meeting in London in the December to review “progress.”

However, before the London meeting could take place, the oil market underwent a major trauma. In September, Lehman Brothers was declared bankrupt and the already fragile global financial system went into melt-down. The result was a collapse in oil prices driven by falling oil demand and by December the OPEC basket averaged $38.60 compared to the peak in July of $131.22. Yet again the imperative of prices as a driver of the producer-consumer dialogue, at least from the perspective of the consumers, weakened.

The next major event for the IEF was the 12th ministerial meeting in Cancun in March 2010. This represented a number of steps forward in consolidating and developing the IEF’s role. The meeting agreed that the IEF should continue on the following objectives:

1. Aim to narrow the differences among producing and consuming countries, both developed and developing.
2. Working together to promote transparency of data, stability of markets and predictability of energy policy.
3. Facilitating high quality analysis and wider collection, compilation and dissemination of data in order to focus debate more effectively.
4. Identifying principles and guidelines to enhance energy market stability and sustainability.

They also agreed to share analysis on i) present and future market trends, ii) links between physical markets, financial markets and regulation, and iii) enhancing transparency even further through collecting data on natural gas and annual investment plans on energy production. It was also agreed that an IEF Charter would be created.

Despite the apparent success of the Cancun Summit, the future of the IEF remains in question. The underlying divisions between producers and consumers concerning price, remain. The Secretariat has great difficulty in persuading staff to go and work in Riyadh and therefore those that are there are over-burdened with work. JODI continues but is based upon a fundamental misconception that more and better information will reduce price volatility. Given that much of
the volatility is the result of “herd behaviour” it is unlikely that better information will help to
smooth prices. Furthermore, historically, real price volatility stems largely from geopolitical
events that no amount of “better information” will pacify or neutralize. There are also a large
number of competing bodies that already discuss the sorts of issues covered by the IEF. These
range from the World Trade Organization (WTO), GATT, The Agreement on Trade Related
Investment Measures (TRIMs) and the Energy Charter Treaty. There are also a large number of
regional organizations discussing these issues such as the North American Free Trade Area
(NAFTA), the European Economic Area, the Association of South East Asian Nations (Asean)
and its various mutant offshoots, the Gulf Co-operation Council (GCC), the Southern
Common Market in Latin America (Mercosur) and the Latin American Free Trade Area
(LAFTA) to mention just a few. There are also a wide variety of other mechanisms to manage
oil price volatility for both producers and consumers (Skinner, 2005). These range from the use
of paper markets to hedge price risk, oil stabilization funds, rebates and payments to the poor,
reduced consumer taxes and a fund for poor countries.27

While the oil price remains important in national and international economies, so too will
producer-consumer relations. Extreme price volatility in either direction will revive interest and
provide a driving force for meetings and discussions. Sadly, however, the fundamental self-
interest of the market place will always provide a cold dose of reality to dampen desire for
dialogue and co-operation.

Notes

1 The Washington Consensus refers (disparagingly) to the revival of neo-classical economic thinking in
the 1980s and 1990s espousing the virtues of market forces being promoted by the International
Monetary Fund (IMF) and the World Bank Group

2 Of course a number of OPEC members, most obviously those in what is now called the Gulf
Cooperation Council espoused the joys of free markets and found Marxian concepts of “socialism” an
anathema. However, these were (and are) essentially tribal societies and it can be argued as such did
espouse the benefits of co-operation as opposed to the cut-throat competition of capitalism which
appeared to emerge from the concepts of Adam Smith.

3 Conventionally the French company CFP was also included. They were collectively referred to as
“the Majors.”

4 This needs some qualification since the international prices of crude did fall in real terms during
the 1960s as the control mechanisms exercised by the Majors came under strain. As will be developed
below this was the crucial ingredient that fuelled the “OECD economic miracle.”

5 Before 1970, the price was an administered price determined by the representatives of the majors.
Between 1970 and October 1973, OPEC joined the deliberations over price determination. This
period might be viewed as a form of “producer-consumer dialogue.” After October 1973, OPEC
unilaterally took over the setting of the administered price.

6 At the time, very few academic economists had the first idea about the international oil industry. The
exceptions were a small handful that included Edith Penrose, Maurice Adelman and Robert Mabro.

7 In 1974, Norway produced only 35,000 barrels per day but by 1978 this had risen to 356,000 barrels
per day (BP, 2010).

8 In the period between 1973 and 1978, France was leading in the attempt to develop bilateral relations
with the OPEC countries. At the same time in 1975, it had made the strategic decision to reduce its
dependence upon imported oil by developing a nuclear option to produce electricity.

9 At the time, it was widely rumoured that Kissinger had advocated invading Saudi Arabia as the
“solution” to the problems created by the Arab Oil Embargo. Subsequently released documents and
research confirm that this was actually true!

10 Indeed, OPEC was extremely concerned that the developing countries that had been seriously hurt
by the higher oil prices would turn against them and destroy the image of Third World solidarity. They tried
to reduce the risk of that by creating a fund for economic aid for importers. In late 1975, they converted this
into the OPEC Development Fund that began operations in late 1975 with resources of $800m.
11 In 1977, the OECD (not the IEA) produced the first World Energy Outlook. This consisted of 106 pages as compared to 731 pages in the 2010 World Energy Outlook.

12 This was part of the French strategy to take a leading role in relations with the Third World and at the same time (frankly) to irritate the Americans.

13 This then encouraged OPEC later in the year to create the OPEC Development Fund—see footnote 10.

14 It is interesting to note that despite all its efforts and gyrations, when the second oil shock hit, Japan saw absolutely no benefit for all its efforts and Japanese companies found themselves fighting tooth and nail with American companies to secure spot sales of crude oil. It was this competition which greatly aggravated the rise in oil prices seen between 1979 and 1980 (Mitchell, 1982).

15 Interestingly the US Strategic Petroleum Reserve (SPR) was also not used in the emergency. The SPR had been created in 1975 as part of the Energy Policy and Conservation Act. Construction of the infrastructure began in June 1977 and filling began in July. It is not entirely clear why the SPR was not used during the crisis but this author has heard the story that as the system was being created for the SPR, they had only got as far as the capability to fill the salt caverns that formed the basis of the storage. Apparently there was no infrastructure in 1979 actually to withdraw crude from storage for use above ground.

16 A doomsday scenario is a possible future that while having a low probability of occurrence would have very serious consequences. The cessation of Gulf exports of crude as a result of wars and other disruptions, for example the closure of the Straits of Hormuz had long occupied the minds of strategic planners in the West.

17 These included: demand security; downstream product taxation; consumers’ anti-oil policies; downstream integration; strategic petroleum reserves; the Kyoto protocol; sharing the burden of spare capacity; price bands; the Asian Premium; other trade related issues such as dual pricing and US restrictions of ethanol trade; reserve transparency; aid to poor developing countries; and finally political issues such as Israel-Palestine.

18 Given the sensitive nature of this discussion and the subsequent decision there is little by way of formal record.

19 It has been suggested to the author that an important motivation for Saudi Arabia’s negotiating and eventually joining the WTO in December 2005 was that this would allow it to raise the issue of oil product taxes as a restraint of trade.

20 By ”paper markets”, this chapter is referring to markets where promises to deliver or take delivery that are committed to paper are exchanged. They are often more commonly referred to as “futures markets” but this is somewhat misleading because this implies markets regulated by the financial authorities, as is the case for NYMEX in New York and the ICE in London. There are however an increasing number of paper transactions, often referred to as “over the counter trades” which fall outside these institutional contexts.

21 In 1978 there was only a very small futures market for gasoil in Chicago.

22 The first such market was created in Kyoto in 1710 for rice – the Dojima Rice Exchange.

23 This is the loading terminal for Brent on the Shetland Islands.

24 In 2001 the IPE was taken over by the Intercontinental Exchange (ICE).

25 OPEC also argued that there was a refinery story behind crude oil price movements. Thus they argued there had been insufficient investment in upgrading capacity. That put great pressure on the demand for light sweet crude oils thereby increasing their prices above a "norm." This had long been a source of irritation within OPEC since the nature of their crude exports was that of heavy sour crude. In June 2005 they changed the composition of the OPEC basket price from one of predominantly light sweet crudes to one of predominantly heavy sour crudes to better represent what they were receiving financially in the oil markets.

26 During the meeting apparently the most commonly heard comment from the other OPEC participants was “why on earth are we here?”

27 There have also been suggestions that the major oil producers should be made part of the IEA’s Emergency Sharing Scheme to encourage them to carry spare capacity or offset outages. Thus in the event of shortage, the producers would get first bite to supply at higher prices while the consumers held back their stocks (Stevens, 2008a).

Bibliography


