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Multinational Corporations and Economic Development - A Descriptive Survey of International Petroleum Companies in Developing Countries

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Abstract

Multinational corporations in oil industry played an important role in the economic development strategies of many less developed countries. The modern oil industry was developed almost entirely by seven large companies, each with colorful history of its own. They were privately owned and traditionally were taking the entrepreneurial risks of exploring for, discovering and distributing oil resources. For almost half a century they were controlling the world's oil supply, directing its worldwide distribution and marketing, and deciding the amount of revenue sharing between them and producing, mostly less developed countries.

This paper contributes to the literature concerned with multinational corporations' contribution to the national economies of less developed countries. Results from a study examining the development of the international oil industry over a period of seventy years reveal that the oil companies were exploiting oil resources of the less developed countries by damaging national economies. It also shows that the policies of the oil companies were affected by both the developed Western and less developed African, Asian and Latin American countries. General conclusion is that multinational corporations could make greater contribution to economic growth and development of all countries provided that some of the sources of discrimination and conflicts could be eliminated.

Abbreviations

AGIP	Azienda Generale di Petrolio
AIOC	Anglo Iranian Oil Company
AMOCO	American Oil Company
AOC	Arabian Oil Company
APC	Anglo Persian Company
ARAMCO	Arabian American Oil Company
b/d	barrels per day
BP	British Petroleum Company
CALTEX	California Texas Oil Company
CFP	Compagnie Francaise des Petroles
CFR	Compagnie Francaise de Raffinage
COPE	Compagnie Orientale des Petroles d'Egypte
CPC	Ceylon Petroleum Corporation
DC	Developed Country
ENI	Ente Nazionale Idrocarburi
FDI	Foreign Direct Investment
GNP	Gross National Production
GUPCO	Gulf Suez Petroleum Company
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IMF	International Monetary Fund
IPC	Iraq Petroleum Company
JPTC	Japan Petroleum Trading Company
LDC	Less Developed Country
MNC	Multinational Corporation
NIOC	National Iranian Oil Company
OPEC	Organization of the Petroleum Exporting Countries
PNO	Pakistani National Oil
R&D	Research and Development
SOCONY	Standard Oil Company of New York
STANVAC	Standard Vacuum Oil Company
TPC	Turkish Petroleum Company
U.K.	the United Kingdom
U.S.A.	the United States of America
UAR	United Arab Republic
UN	United Nations
UNCTAD	United Nations Conference for Trade and Development
WB	World Bank
WTO	World Trade Organization

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1. Introduction

This chapter gives the reader background information about the aim of the study. Then, the problem is discussed which leads into the purpose. Thereinafter, the scope and limitations and the outline of the study is presented.

1.1. Background

Multinational Corporation (MNC) is a large international firm that has business activities in a number of countries and consists of subsidiaries tied to the head office. Very often, administrative control of MNC, decisions taken, policies and executive actions of their head offices have substantial impact on the national economies in many parts of the world. Thus, MNC play an increasingly important role in the economic development strategies of many less developed countries. Oil, on the other hand, is the largest single commodity in international trade, as most of the oil consumed in the world today has moved from one country to another. According to Annual Energy Outlook (2005), nowadays, world consumes 70-80 million b/d of crude oil per day This, in turn, makes the oil industry one of the largest and most international of all industries in the world. Therefore, MNCs in the international petroleum industry are much powerful to influence the national economies of many developing countries compared to MNCs in any other industry. Indeed, the struggle occurred among the multinational oil companies, and their policies concerning the prices, supply and investment had a great impact on the economies of the developed as well as underdeveloped countries.

The modern oil industry was developed by seven Western oil companies or so called "Seven Sisters", who explored, refined and distributed greater part of the world's oil outside North America and ex-Soviet Union countries. However, while the major oil companies were exclusively the U.S. and Western European origin, crude oil was massively concentrated in some countries of the Middle East and Latin America, and was owned by the governments of those countries. Larger part of produced oil entered into international trade and only some of it was refined by the producing countries and exported as oil products. Furthermore, except North America and ex-Communist States, very little part of the produced oil was consumed by the major producing countries. Generally, greater part of the produced oil was imported by the industrialized Western countries, leaving some imports to African, Asian, particularly Japan, and Latin American countries.

The "Seven Sisters", as pioneers, retained their dominant position in the international petroleum industry till the 1950s. It was mainly achieved due to continuous cooperation among them; that cooperation, on the one hand, and refraining from price competition among themselves, on the other hand, gave

the multinational oil companies the power of regulating the supply and controlling prices, made possible to maintain high cash flows from their operations and earn enormous profits. After the Second Word War, however, the international petroleum industry underwent big political as well as economic changes; the major oil companies lost their absolute controlling power over the oil industry of the world and this fact become evident in the later 1950s.

The Governments of the crude-oil producing nations, on the other hand, desired to be independent from the multinational oil companies and to possess greater control over own petroleum industry. In Latin America, the countries achieved a political independence before the Second World War and, consequently, those countries were the first among the other underdeveloped African and Asian crude-oil producing countries who started nationalization of their national resource - oil. For example, Chile in 1927, Bolivia in 1937, Mexico in 1938 expropriated the properties of the multinational oil companies and established State owned companies. However, those were only few pre-war examples of nationalization of oil industry. Generally, the real wave of nationalization and different types of conflicts with the international oil companies began after the Second World War with changing economic, social and, political ideas. A small number of countries, Chile as an example, totally disallowed foreign companies; some other countries like Argentina, Bolivia and Turkey fluctuated between allowance and disallowance of foreign companies; Ceylon, Pakistan, India and all of the African countries (except Egypt and Algeria) did not took any actions against the foreign companies until they were convinced that some of the policies of the international oil companies function to their disadvantage.

Thus, the development of the petroleum industry took place under a strange relationship between industrialized Western countries and poor and undeveloped Middle Eastern, Latin American and African countries. The former were dependent on the scarce resource oil, and the latter on multinational oil companies for the exploration of oil. Penrose (1969) noted that the development of the oil fields was not beyond the abilities of less developed countries, however, at the time when oil was discovered in those countries, their governments were lack of the expertise and financial resources in order to explore their own resources, which, in turn, made them dependent on Western countries.

Certainly, the multinational oil companies were much stronger that some governments in many respects, which made it possible for them to take the risk of exploration, invest huge amounts of financial recourses and dedicate plenty of time and technical as well as managerial expertise to develop the oil industry of less developed countries. However, from the early evolvement of the Major Companies, the attitudes towards them were not positive everywhere;

developed as well underdeveloped countries cast substantial doubt to their operations.

Pollution, Western Imperialism, Damages to National Economies, Monopoly Power considered some reasons why the companies were treated with great suspicion from almost beginning of their activities. Penrose (1969) stated that the international oil companies began to consider the issues like unnecessary waste, the destruction of the countryside or water pollution only in the 1950s. Moser (2001) studied the contribution of the oil companies to the environmental protection and concluded that, the investigation of the Colombian and Peruvian petroleum industries illustrated that MNCs do not accord equal priority to environmental issues, as to financial objectives. Parra (2004) discussed that, even in the twenty first century the oil companies operating in foreign governments suspected in not doing what they should in order to save natural resources. Furthermore, the international oil companies always struggled to have greater control over the natural resources of another country and this "control" considered to be a characteristic of imperialism. Besides, political as well as economic history of imperialism is characterized by struggles among foreign powers to obtain control, and these struggles have shaped the history of the oil industry. Moreover, the international oil companies were much stronger vis-à-vis the governments of many developing countries, which gave them stronger bargaining power compared to a government. This power made possible for the companies to implement decisions which in fact could seriously damage the national economy of the considered country. Finally, Monopoly Power was another reason for suspecting the activities of the in international oil companies. According to Penrose (1995) even from the very old times monopolistic pricing has been recognized as an alternative to taxation as a means of raising money. Magdoff (1978) stated that, among the other factors, the development of monopoly enterprises, of multinational corporations leads to imperialism. Of course, due to very weak position of many crude oil producing countries vis-à-vis multinational oil companies, the former was not able for so many years to effectively fight against monopolistic commerce established by the latter. Furthermore, Baran (1962) pointed out that the economic surplus which is extracted by the monopolistic firms was not utilized for the purpose of economic development and increase the production. Rather, economic surplus was driven away by the monopolistic firms in unproductive manners, only a small amount was spent for the purchase of property.

Consequently, it seems like that the controversies concerned with the impact of the multinational oil companies on economic development of the less developed countries will never finish. Some argue that multinational oil companies were the "brightest" examples of the Western Imperialism and Capitalism, and critique their dominance policies of exploitation of the less developed countries. Others debate that multinational oil companies played a

great role in the economic development of the less developed countries by exploring and expanding the oil industries of those countries, by contributing extensively to a wide variety of social welfare activities, by subsidizing schools, hospitals, highways, and other amenities, by promoting technical training, by granting scholarships, etc.

The above mentioned issues related to the importance of multinational oil companies and their impacts on economic development of less developed countries, have contributed to the formulation of the problem for the analysis and study purpose to be explored within the present thesis.

1.2. Problem Discussion

MNCs, as any business entity, exist with the purpose of profit making. The main responsibility of top management of any large firm is to maximize the shareholder's value. Parra (2004) noted that:

> "...the primary function of companies is to be economically productive – that is, to make money-by harnessing the capital of its shareholders and the knowhow of its employees in their chosen field. They may do it well or poorly; conscientiously or unscrupulously; wisely or rashly, but in the end there is only one bottom line: investor invest for the sole purpose of financial return. Their other objectives are best pursued by other means".

Every government, on the other hand, is responsible for the overall economic development of its country; with this respect it should always track the activities of the international firms and should intervene when considers that firms do not act in the interests of the national economy. Parra (2004) stated that:

> "The function of government...is to provide an adequate regulatory infrastructure for companies to work as economically productive units, and to make sure they do not swindle the public, exploit their workers, pollute their surroundings, prosecute their business unethically, or do anything else that is morally or socially reprehensible..."

Given this situation, very often disagreements arose between governments and international corporations because of "goal conflicts" i.e. the inconsistencies in objectives and policies of governments and international firms. Eiteman et al (2001) discussed that:

> "Historically, conflicts between objectives of MNCs and host governments have arisen over such issues as the firm's impact on economic development, perceived infringement on national sovereignty, foreign control of key industries, sharing or non-sharing of ownership and control with local interests, impact on a host country's balance of payments, influence on the

> foreign exchange value of its currency, control over export markets, use of domestic versus foreign executives and workers, and exploitation of natural resources".

Historical development of the international oil industry revealed many conflicts among the international oil companies and the governments of the countries where they operated. Multinational oil companies, on the one hand, were operating according to the rules private-enterprise capitalism. They were always struggling to control productive territories, to expand their activities and to earn higher profits. The governments, on the other hand, were struggling to get independence and to control own resources; they considered that the oil companies were not acting in the interests of their national economy. As a consequence, either host governments intervened into internal policies of the oil companies or oil companies' home governments pushed them to pursue governmental policies. Besides, oil companies themselves too, were creating a monopoly power and effectively controlling the industry. All those worsened the relationship between developing countries and multinational oil companies, which in turn led to conflicts, price shocks, supply imbalances, cresses and even embargos. Of course, cost associated with consequences of those conflicts was very high for both the developing countries and international oil companies.

The above stated concerns about conflicts faced in general by the international petroleum industry have encouraged the author of this paper to focus on the structure of the petroleum industry and on the development of multinational oil companies within that industry. The particular interest towards the petroleum industry became the reason for considering economic influence of the oil companies on domestic economies of less developed countries. When summarizing the above section, several issues appear to be crucial for this study:

- Descriptive study of the development of international petroleum industry;
- Descriptive study of the growth of international petroleum companies;
- Consequences of pressures of developed Western countries on activities of the international oil companies;
- Analyses of the "Government-Company" relationship in the petroleum industry;
- Attitudes towards international oil companies in developing countries;

Thus, the main problem of this study is to contribute to the addressed issue of impact of multinational corporations in the petroleum industry with respect to local economies of less developed countries.

1.3. Purpose

From the result of the above discussion the research question of this thesis is formulated as follows: *What was the impact of multinational corporations in the petroleum industry on national economies of the developing countries?*

The author perceives that the mentioned purpose will be achieved through a developing clarification to the following objectives:

- To find out if the policies of the developed Western countries lead to restrictions on the development activities of oil companies in developing countries;
- To find out if the policies of developing countries lead to restrictions on promoting an economic development by the oil companies,
- To find out if the policies of multinational oil corporations led to exploitation of developing countries.

1.4. Scope and Limitations

Impact of the international oil companies on the Economic Development of the less developed countries could be studied from different perspectives. When studied from the oil companies' home government perspective, the research is mostly based on the information collected from the oil companies' home government. When it is the host government perspective, the information used in the study is collected mainly from the host governments. If the study is based on the company perspective then the information used will mainly be collected from the company. Every perspective was very important to investigate. However due to the time limit and the scope of the problem the author has been obliged to make some limitations.

The author is tackling this research issue from the point of view of the company since the policies of the oil companies were actually affected by both host and home governments. It is therefore believed that the research problem is well answered if the company perspective is used.

The study is also limited to eight major oil companies that factually were in position to provide information that can be used to better answer the research issue. Thus not all international oil companies are included in this study. Those

companies in this study were large and able to provide information needed. More about the choice of companies is included in the methodology part. Furthermore, the financial results is not compared with other companies or with industry average since the aim of the study is to survey collective impact of the oil companies on the national economies rather than to measure the performance of each of the studied companies against the others.

The timeframe of this study is limited to the development of international petroleum industry till the 1970s since the author wants to explore what had been done during the dominant epoch of the major oil companies. However, many important events such as The Tehran and Tripoli Agreements of 1971, The Crises of 1973 and 1979, the development of Non-OPEC supplies since 1970, Gulf War of 1990-1991, collapse of the USSR 1990-1991 took place after the timeframe considered in this study, which is not relevant to the task in hand.

The research is also limited to the developing countries of Africa, Asia and Latin America, excluding the U.S., Canada, Japan, Western European and the Communist block countries since the main activities of the major oil companies while the timeframe considered in this thesis took place in those countries.

1.5. Thesis Outline

Chapter one covers the research issues. It includes background information and the discussion of the research problem. The purpose of the study and the scope and limitation are also discussed in this chapter.

Chapter two is methodological discussion. It includes the description of the research approach, research design, data collection, and selection of companies and how the numerical data is calculated. The purpose of this chapter is to give a clear picture of how this study is carried out.

Chapter three refers to theoretical framework, which consists of two sub-chapters: Dependency Theory and Multinational Corporation. First part, after defining the theory, explains the implication of the dependency theory, the nature of dependency and relates it to MNC. Second part, after defining MNC, describes the scope of MNC and risks facing it and highlights the problems arising between MNC and government. The aim of this chapter is to provide the information that would help the reader to understand the role of MNC in the countries where it operates. Furthermore, this chapter intends to explain how less developed countries can be exploited by both the multinational companies and their governments.

Chapter four performs a historical survey of evolvement of the international oil industry from its earliest days till the 1970s. It describes the struggles of the international oil companies, on the one hand, and their governments, on the other hand, over the control of the markets and producing territories of the Far and Middle East, Latin America and Africa. Furthermore, it illustrates the effects of the Second World War and post-war changes, Iranian Consortium, and OPEC on the development of the international oil industry.

Chapter five is descriptive study of the eight international oil companies from the date of their establishment till the 1970s. Companies considered in this paper are Standard Oil Company of New Jersey, the Royal Dutch/Shell Group, British Petroleum Company, Gulf Oil Corporation, Texaco, Standard Oil Company of California, Mobil Oil Corporation and Compagnie Francaise des Petroles.

Chapter six deals with the activities of the international petroleum companies in the developing countries. First it describes the attitudes towards international oil companies in the less developed countries. Further, it illustrates the effect of activities of those companies on the national economies of the selected developing countries of Asia, Africa and Latin America.

Chapter seven summarizes the results of the activities of the international oil companies in the discussed less developed countries and performs the analyses of those findings.

Chapter eight covers the main conclusions that are drawn from the study.

Chapter nine includes the list of references, selected definitions and appendixes.

2. Methodology

This chapter explains the way in which the research is performed. The chapter includes the research strategy and design, and the choice of data collection and selection of companies. Finally, it gives details of how numerical data is calculated.

2.1 Research Strategy

Research strategy ensures that the collected data are consistent with the objectives of the study. After considering the type of research question and nature of the events, case study has been chosen as the most appropriate among the available research strategies. To begin with, the research question of this thesis, what was the impact of multinational corporations in the petroleum industry on national economies of the developing countries, is answered by describing first *how* the international petroleum industry and the international petroleum companies within it were evolving. According to Yin (1994) *how* and *why* are more explanatory and likely to lead to the use of case study as research strategy. Furthermore, the case study is helpful when the purpose of the research is to take a broad view in an analytical way.

However, there is no a generally accepted definition of case study. Yin (1994) stated that "even though each strategy has its distinctive characteristics, there are areas of overlap among them". Since different strategies are not mutually exclusive and since the boundaries between strategies are not always clear and sharp, more than one research strategy can be used for the purpose of this thesis.

Furthermore, the research objectives of this study are based on historical events rather than contemporary issues and Yin (1994) discussed that:

> "...the historical method is dealing with the dead past – that is, when no relevant persons are alive to report even retrospectively what occurred, and an investigation must rely on primary documents, secondary documents, and cultural and physical artifacts as the main sources of evidence. A case study can deal with operational links needing to be treated over time, rather than mere frequencies or incidence".

A theoretical model presented in this study is not going to be falsified or verified. Furthermore, the goal of this study is not to generate theory, but to present a basis for further research that can lead to a theoretical framework. Therefore, the inductive approach, the way of discovery, is considered to be appropriate.

2.2 Research Design

Any research process requires an efficient and relevant research design, which describes how the models, measures and treatments are performed in the evolution of the study in order to assess the results of a certain treatment. Depending on the objectives of the study, different research designs have certain advantages and disadvantages. There are five main categories of research design approaches: *descriptive, explanatory, explorative, predictive* and *prescriptive*.

The *descriptive approach* is mainly used when the researcher is concerned in showing the characteristics of a specific and often well defined problem area. The *explanatory approach* involves that the researcher wants to establish causal relationships between a fairly large numbers of variables. The *explorative approach* is used when the researcher has limited knowledge about the subject area and there is a need to identify what research issues to address. The *predictive approach* is adopted when the researcher aims to do a forecast for the future development of an event. The *prescriptive approach* is based on the researcher identifying what should happen.

This research is conducted with combination of the descriptive and explanatory approaches. The descriptive approach is used to describe the certain events but there is no attempt to generalize the findings into theory. In a descriptive approach only the essential aspects of the events are investigated. The reason for applying the descriptive approach is that the study aims to describe historical development of the international petroleum industry. Furthermore, this approach is also applied because the thesis aims to describe the historical affect of the international oil companies within the studied countries. The explanatory nature of this study is related to the way of analyses that attempts to explain what kind of external influences affected the policies of certain multinational corporation in the petroleum industry. These explanations try to answer the research issue on both a national and international level.

In order to answer the research question of this thesis, it is essential to carry out a study that extends over a quite long period of time. Cassirer (1957 cited Polesie 1991) stated that:

> "Highly developed theoretical thinking tends to consider time as an all-embracing form for all changes...Only when thoughts succeeds in composing the multiplicity of events into a system within which the particular events are determined in respect to their 'before' and 'after', do phenomena unite into the form of a totality of intuitive reality"

Thus, after considering timeframe and level of details, a period of seventy years is selected for the purpose of this study.

Finally, according to Polesie (1991) "when companies are placed together...and subjected to analysis, aggregate structures emerge". Therefore, the aim of this paper is to study selected companies from aggregated perspective and contribute their collective impact on answering the research question.

2.3 Data Collection

According to Booth et al. (1995) "research is simply gathering the information you need to answer a question and thereby help you to solve a problem". Two different types of data exist, primary data and secondary data. Primary data is information gathered and applied for the first time, and usually through direct examination, while secondary data consists of information already available, i.e. it is collected or produced by a third party and perhaps for a different purpose. Secondary data can be divided into two sub groups, internal and external. Internal secondary data is available within the organization and external secondary data is provided by sources outside the organization. There is no restriction on data collection and relevant research data can be obtained from a variety of sources. This paper is based on external secondary data.

Theoretical framework presented in this thesis is solely based on books and scientific articles. Relevant literature is gathered from the library computer systems at Gothenburg University, namely LIBRIS and GUNDA, which also gives an access to books from other Swedish universities. In addition, databases like ABI/Inform Global and Business Source Premier is used for searching the articles among the huge volume of journals. Key words used when searching in different databases are Oil, International Oil Industry, Oil Companies, Concession, OPEC, Economic Development, Developing Countries and Oil Revenues, Imperialism, Exploitation as well as key words referring to the names of selected oil companies and developing countries.

Empirical findings presented, among others, by using available Annual Reports and Financial and Operational Information of the companies and other statistical sources like Annual Energy Outlook and Statistical Review of the World Oil Industry. However, it should be noted that most of the studied companies do not disclose the information about their subsidiaries or affiliates owned 50 per cent or less. The key financial and production figures are included in the form of reference tables throughout the thesis or as Appendix. Each table for the different companies is reproduced in a consistent manner in order to improve the comparability. The comparison of the figures stating amounts of money is performed for the same year for each company, thus they are not adjusted for inflation over the years. For the comparison of the different years the annual percentage changes is used.

2.4 Selection of Companies

In order to increase the credibility of the research it is important to obtain a sample that is considerably representative, since a well-defined sample will result in that more significant conclusions can be drawn. Therefore, this study tries to obtain a sample of companies that will permit to fully tackle the research problem, rather than establishing a statistically acceptable level of assumptions. Due to time limitations and scope of this research it not possible to include all oil companies and certain criteria that companies must fulfill to be included are determined as important. Those criteria are the following:

- Should have a history stretching back to the earliest days of the evolvement of the oil industry. It is believed that the earliest participants in the development of the modern oil industry had much power to influence world economy during the timeframe considered in this paper.

- Should have wide geographically spread activities i.e. should be large and powerful, engaged in upstream as well as downstream activities and operate in international environment. It is believed that the policies of those companies were affecting national economies of many countries all over the globe.

- Should be growing during the same period of time. It is believed that it will result in higher level of comparability over the same period of time.

- Should have readily available information about the different aspects of their operations, like Annual Reports.

This selection process ended up with eight large multinational petroleum companies, namely Standard Oil Company of New Jersey, Royal Dutch/Shell Group, British Petroleum Company, Gulf Oil Corporation, Texaco, Standard Oil of California, Mobil Oil Corporation and Compagnie Francaise des Petroles.

2.5 Calculation of Numerical Data

Absolute values, the financial data that produced by the accounting system of each company, is presented referring to Annual Reports, statistical sources and research papers. Due to availability of vast amount of information about the problem of this research, presented numbers are compared with at least three sources in order to increase the validity. To achieve high level of consistency, different units of measure used by different information sources are converted into similar units. Production was given in "b/d per day"; metric tons per year are converted, where applicable, by multiplying by 0,02, which reflects an average world gravity. B/d per day can be converted to tons per year by

multiplying by 50. Financial data is presented by USD dollars ($); British pound sterling (£) are converted, where applicable, with exchange rate £1 = $ 2.8.

Absolute values are presented both in terms of monetary units and in percentage since they can be studied as annual changes, expressed in terms of percentage change. In addition, according to Bernstein (1993) a meaningful percentage change can not be computed where an item has value in a base year and none in the year after. Therefore, analyses of the key measures of the companies presented in this study include the absolute values of total assets, gross income, net income, cash dividends, capital expenditure and amounts retained, together with their annual growth rate expressed in ratio change.

3. Theoretical Framework

In this chapter the author reviews the theoretical background of Dependency Theory and highlights the issues related to the activities of Multinational Corporations.

3.1 Dependency Theory

3.1.1 What is Dependency?

There as many explanations of dependency as the number of writers on that topic. For example, Ghosh (2001) defines dependency as "…a type of mechanism which can explain the causes of economic development and underdevelopment". According to Dos Santos (1970), dependency is a conditioning situation in which the development of one set of countries is conditioned by the development and expansion of other more powerful and developed set of countries.

Generally, dependency refers to unequal international relationship between two sets of countries. One set of countries, the developed countries (DCs), is called the centre or metropolitan, whereas other set, less developed countries (LDCs), labeled as the periphery or satellite. Prebisch (1959) stated that "historically, the spread of technical progress has been uneven, and this has contributed to the division of the world economy into industrial centers and peripheral countries engaged in primary production, with consequent differences in income growth". Furthermore, the theories of dependence explain the dominant relation of more powerful capitalist countries over the weaker underdeveloped countries.

3.1.2 History of Dependency Theory

The Dependency Theory is mainly Marxist in origin because of two characteristics; firstly, it is based on the idea of exploitation of the LDCs by the DCs; secondly, it explains development and underdevelopment with reference to world of capitalism. The writers who develop this point of view are often considered as radicals; and because of significant divergence of the theory from the classical Marxist tradition in terms of radical explanations to the problem of underdevelopment, it is very often referred as the "Radical Theory".

The theories of dependence have a history stretching back to 1960s and 1970s and their academic roots can be found in the work of many economists of that time. The theory was firstly introduced by the Paul Baran in 1957 and he regarded as the father of the modern Dependency Theory (Palma 1978, Ghosh 2001). Further, the theory have been developed by other researchers like Celso

Furtado (1964), Andre Gunder Frank (1966), Dos Santos (1970), Arghiri Emmanuel (1972), Samir Amin (1974), and others.

Since the first introduction of the dependency approach in the 1960s, it has been continuously enriched by the different, sometimes contradicting views of many scholars. However, in spite of many individual differences, all developed theories have the certain arguments in common. Ghosh (2001) described the common characteristics or themes of the classical dependency theory as follows:

- Metropolitan capitalism is enforced on the satellite.
- Surplus is extracted from the satellite by exploiting it by the DCs.
- Surplus extraction leads to development of metropolitan and underdevelopment of satellite. It is believed that underdevelopment not the matter of national problem; rather, it is habituated by the world capitalist structure.
- There is unequal and uneven development between DCs and LDCs.
- Integration with world capitalist system worsened the problem of inequalities and underdevelopment.
- International trade between DCs and LDCs takes place on unequal conditions; it is a type of unequal relations favoring DCs and discriminating against LDCs.
- LDCs have subordinate status to DCs.
- The way of development of the LDCs lies through the breaking the relations with metropolitan capitalism.

Described above characteristics may be viewed as the fundament or the main idea of the Dependency Theory matured in the 1960s.

These days, however, there is ignorance of the dependency theory by some scholars in debates concerning development and underdevelopment. Some scholars argue that it dead forever and has no relevance in the modern world. Some other writers within the dependency school argue that it is misleading to look at dependency as a formal theory, and that no general implications for development can be abstracted from its analyses. But, certainly, the belief about not relevance of dependency theory is mistaken. For example, Palma (1978) stated that dependency theory still very useful methodology for

analyzing the micro perspectives of underdevelopment. According to Ghosh (2001), dependency theory gave new insights, raised new issues and provided new perspective for analyzing the development process of the backward countries.

Thus, the Dependency Theory is very valuable even in our times, as there are still great dependence of many underdeveloped countries for aid, technology, foreign capital investment, trade and so forth from the developed countries in the global economy. Furthermore, it plays a major role in explaining the growing economic distance between developed and developing countries.

3.1.3 Implication of Dependency Theory

Dependency Theory has been popularized by Paul A. Baran in 1957, in his radical work analyzing the problem of underdevelopment and development. Since that time many Neo- Marxist or radical theories have appeared in the academic literature. The following paragraphs present the description of mainstream theories of dependence.

There are different explanations of the Dependency Theory in the academic world. Some writers argue that the Dependency Theory concludes that development is impossible within the world capitalist system, thus making development strategies irrelevant, at least within that system. Others, on the other hand, dispute that it can be operationalized into a practical development strategy for dependent countries. For example, Ghosh (2001) concluded that the theories of dependence basically concerned with the impact of imperialism and neocolonialism on the economies of LDCs. He argued that the theory of dependency "…considers the fact that the social and the economic development of LDCs is conditioned by the external forces which are nothing but the central capitalism". Griffin and Gurley (1985) discussed that the theory of dependence can explain the worldwide action of the capitalist system during the neo-colonial era and the dependence of the development of the poor LDCs on the DCs. In addition, Palma (1978) concluded that there is no such thing as a single "Theory of Dependence" and under the dependency label "we find approaches so different that we may at best speak of a 'school of dependency'".

In spite of explanations and analyses of the theory from various perceptual angels by the different scholars at the different times, in common, it combines two systems: *macrocosmic system* and *microcosmic system*. Understanding of these systems is very essential for the analyzing dependency theories. As it is seen in Table I, the macrocosmic system represents developed capitalistic countries. It is economically more powerful, stronger and better organized. The macrocosmic system is controlling and influencing its subsystem or microcosmic system. In this situation, the study of the underdevelopment of the weaker micro system is related to the stronger macro system. However, the

micro system can not exploit the macro system because it is already submitted under the latter. Ghosh (2001) pointed that the main idea of relationship between micro and macro system is that the micro system can not derive any gain from the macro system.

TABLE I
Microcosmic and Macrocosmic Systems

Microcosmic system	Macrocosmic system
Pre-capitalist in orientation	Capitalist in orientation
Poor and backward	Advanced and rich
Produces and exports primary products and imports finished products and technology.	Produces and exports finished products and technology and imports raw materials and primary commodities.
Capital-poor system, its surplus is extracted by the macrocosmic system.	Capital rich system, its surplus comes from the microcosmic system.
Labour is abundant and cheap	Labour is scarce and costly
Since wage is very low at home, and high in DCs, unit import cost is high and export cost is low (unequal exchange working against the system)	Since domestic wage is high, and wage in micro system is low, unit import cost is low and unit export price is high (unequal exchange working in favour of the system)
Cannot develop itself for want of technology and capital	Already developed, and supplies capital and technology at high prices to the micro system.
Exploited by the macrocosmic system	It is not exploited by any system
It is dependent on the macrocosmic system	It is more or less independent

Source: Reconstructed from Ghosh (2001)

Furthermore, it is impossible to evaluate dependency theory without understanding the mechanism of surplus extraction, which is summarized in Figure I. First of all, the term of "surplus extraction" by itself is somewhat tricky and very difficult to precisely define for the understanding the process of development. However, Baran (1962) differentiated between two types of economic surplus: *actual economic surplus* and *potential economic surplus*. Actual economic surplus is the difference between society's actual current output and its actual current consumption; it is equal to the current savings or accumulation. Baran (1962) stated that actual surplus "…finds its embodiment in assets of various kinds added to society's wealth during the period in

question: productive facilities and equipment, inventories, foreign balances, and gold hoards". Potential economic surplus is the differences between what could be produced by available natural, technological and human resources, and what might be considered as essential consumption.

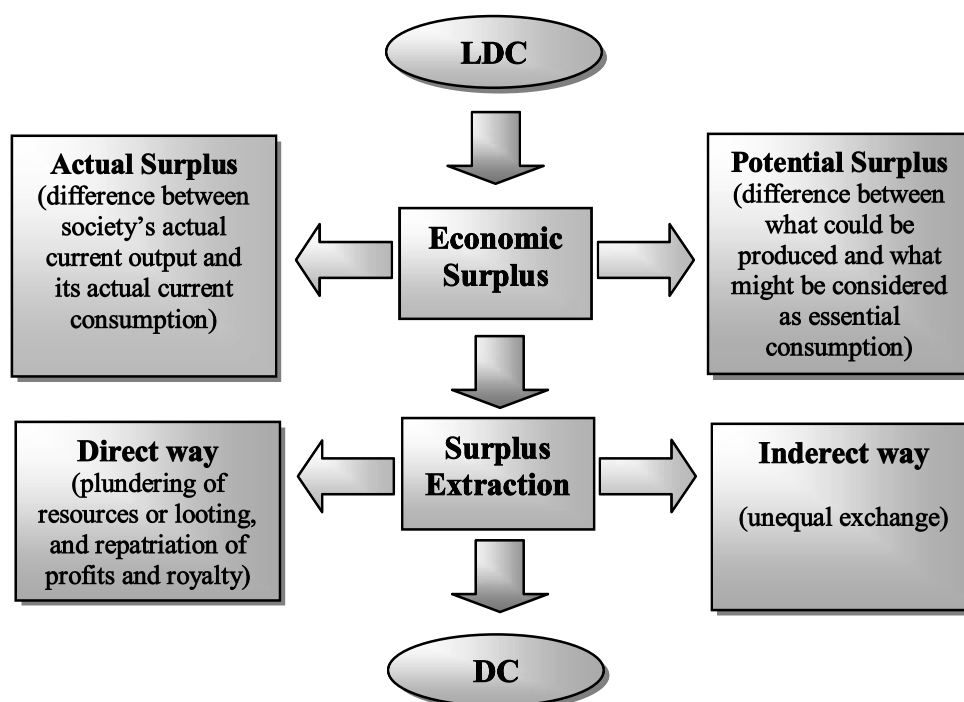

Figure I: **Mechanism of surplus extraction.**

Surplus extraction is the basic way by which the macro system exploits the micro system. Ghosh (2001) distinguished between two ways of surplus extraction; first, non-trading or direct way, which is plundering of resources or looting, and repatriation of profits and royalty, and the second, is indirect method, which is unequal exchange.

Dependency Theory suggests that, having micro and macro systems, the surplus is extracted from the former, which is dependent, by the latter. This process explains why the periphery is underdeveloped. Periphery is not able to snap its ties from the centre and the only way for it is to be dependent on the center. However, the theory also suggests that the dependent country is getting some indirect benefits from the centre, but those benefits are taken away by the exploitation. For example, Ghosh (2001) concluded that:

> "The growth of the centre, however, should produce some good effects for the peripheries with respect to technology, demand, market, knowledge and so on…These effects can produce new growth momentum for the poor peripheries. But this is possible only when the growth-retarding backwash

> effects are outweighed by the positive spread effects. This is not really happening for the peripheral poor countries".

To sum up, dependency theory polarizes the world into two systems: centre and peripheral or developed capitalistic countries and underdeveloped poor countries. It suggests that when peripheral country is integrated with the world capitalist system, the centre extracts the surplus from it and becomes developed, while the periphery becomes underdeveloped. Development of the periphery, according to dependency theory, is possible when its relationship with the centre is snapped. Further, the theory explains the relationship between the centre and periphery in terms of relation of domination in exchange, where the domination explained as the means of extracting surplus from LDCs. Dependency Theory concludes that the result of such kind dependency is widening inequality between economic development of DCs and LDCs.

3.1.4 The Nature of Dependency and Multinational Corporations

Santos (1970) suggested that dependency arises because "…some countries can expand through self-expulsion while others, being in a dependent position, can only expand as a reflection of the dominant countries, which may have positive or negative effects on their immediate development…" Furthermore, according to Ghosh (2001), nowadays, many issues and areas of development directly connected to the dependence and "…developing countries are made to depend on the developed countries which take full advantage of the situation in exploring poor countries". But how does the periphery become dependent on the centre? Or what is the nature of dependency? Indeed, there are different reasons why the periphery depends on the centre. For example, new technology and economic and financial aid requirements of the LDCs make them dependent on the DCs. Furthermore, assistance from the DCs in issues like capital accumulation or balance payment problems could be one more reason for the increased dependence of the LDCs on the DCs. In addition, LDCs strongly depend on DCs for selling raw materials and primary products. Among the others, Ghosh (2001) listed some of the neglected areas of dependency relations, where academic, cultural, financial, market, human resources, consumer, environmental, military and policy dependence were included.

Despite of dependence, although the LDCs are getting some help from the centre for their dependent variables. But cost associated with that assistance is extremely high. According to radicals, in the name of help and aid, in reality DCs are exploiting the LDCs. For instance, LDCs usually have the high marginal productivity of capital and by investing to them DCs are drawing a large amount of surplus. Further, it is fact that the prices in the LDCs are very

low and DCs can buy raw materials and primary products at low rates. This process creates unequal exchange, through which the DCs are getting surplus labor values from LDCs. Besides, DCs are able to sell their products at high prices in LDCs. Finally, DCs are also influencing the poor countries' internal economic policies by the imposition of control through financial aid and other means. Thus, DCs are exploiting LDCs in many ways (Ghosh 2001).

So far the types of dependency and their consequences have been discussed. The general conclusion drawn by many radicals, Baran (1957), Amin (1977), Ghosh (2001) as an example, is that in the name of helping the poor countries, the developed countries have been continuously trying to extract surplus from them through foreign aid, transfer of technology, unequal exchange and so on. This process has been implemented through a deliberate government policy or through the private channels of communication. According to Ghosh (2001) the agencies involved in this process are government, commercial enterprises, *private agencies* or international non-for-profit organizations. Moreover, among those agencies the greater role assigned to MNCs.

According to radicals, MNCs have always been taking an active role in the process of exploitation of the LDCs through the process of surplus extraction. For example, Griffin and Gurley (1985), Prahalad and Kenneth (2003) concluded that more weight was given to the role of the multinational corporations in imperialistic activities. There are number of ways how the MNCs have made LDCs to be dependent on them and some of them are discussed below.

Monopoly is the first broad spread tool of MNCs for the effective control and competition in the markets. Cobral (2000) defined monopoly as the well-defined market with one single supplier. *Monopoly power*, on the other hand, defined as the ability to sell at a price well above the cost. According to Penrose (1969) even from the very old times monopolistic pricing has been recognized as an alternative to taxation as a means of raising money. Magdoff (1978) stated that, among the other factors, the development of monopoly enterprises, of multinational corporations leads to imperialism. Of course, due to very weak position of many LDCs' governments vis-à-vis MNCs, the former is not able effectively fight against monopolistic commerce established by the MNCs. Ghosh (2001) argued that creating the monopolistic type of industry in the domestic economy of the dependent country shrinks the growth of industrial capitalism. In such condition shift to the domestic production becomes very difficult. Furthermore, Baran (1962) pointed out that the economic surplus which is extracted by the monopolistic firms is not utilized for the purpose of economic development and for the increasing production. Rather, economic surplus is driven away by the monopolistic firms in unproductive manners, only a small amount is spent for the purchase of property.

Besides, MNCs are highly involved in the process of foreign direct investment (FDI). Generally, Borensztein, Gregorio and Lee (1998), Balasubramanyam, Salisu, and Sapsford (1996), De Mello (1999), Li and Liu (2004) concluded that FDI directly as well as indirectly promotes economic growth. However, in order to analyze the impact of FDI on economic development of the underdeveloped countries, one should look for the significance of the investment made by the foreign enterprise. In fact, most companies reinvest its profits in order to expand its own operation and earn more profits. According to Baran (1962) the foreign firms do not bother about capital formation in the underdeveloped countries. The investments for the operations of the MNCs were easily available from the funds derived from the highly remunerative operations. Furthermore, many firms used to send a large amount of money abroad as hedges against foreign currency risk or political risk. For example, according to Penrose (1969), for some years USA and UK based international firms have been forced by those countries to pursue the governments' policies of improving balance of payments at the expense of the countries where those firms have been operating. International firms have been asked to cut their investments to foreign countries and send home more of their earnings resulting from foreign operations[1].

Moreover, MNCs are tightly involved in the process of *technology transfer*, which implies the transfer of technical knowledge from one country to another. In fact, technology supplied by the DCs to the LDCs is ether too sophisticated for LDCs to become accustomed or too obsolete to reduce the cost and increase efficiency. Accordingly, transferred technology is inappropriate and because of inconsistency of those inappropriate techniques and products with the requirements, standards and income levels of LDCs, they might be more harmful than helpful. Furthermore, the need for regulation and assimilation of the imported technology to the local conditions makes it inefficient. However, MNCs are supplying technology, usually secondhand, and any other means of know-how with very high prices. For example, manager in Mexico admitted that overpricing of their technology is a very common and overpricing varies from 300 to 680 per cent. According to Ghosh (2001):

> "The MNCs not only ask for a high price for the transfer of technology but also want to keep control over it so that the competitors are not able to know the secrets".

Furthermore, *oligopoly power* established by the MNCs is effectively restricting local development and competition. According to UNCTAD (1967

[1] It should be noted that, the restrictions on reinvestment of the profits earned in foreign country and on expansion, and, moreover, the demand of repatriating those profits results in strengthening of balance of payment of the parent country by putting pressure on host country (Penrose 1969).

cited Ghosh 2001), LDCs spend about $18 billon annually for the purchase of western technology and if this amount is spent on R&D programs, the LDCs can achieve technological self-reliance. However, MNCs are very reluctant to take up technology adoption programs, and in this way they restrict local development. Very often, the technology is sold to the LDCs only for the part of production process, which makes competing goods to depend on MNCs. Ghosh (2001) stated that "…in the name of technology transfer, MNCs are suppressing the potentially prospective sector which can otherwise become the source of development". Therefore, MNCs are likely to bring technological domination by and dependence on the foreign countries.

Globalization is another phenomenon of the MNCs to engage into unequal competition with the LDCs. It can be defined as the process of universaliation of market economy and relations, globalized accumulation, global dependency and global growth of a world system. It is the cross-national flows of investment, capital, goods, and resources and implicitly assumes the notion of win-win situation. However, the modern system of globalization is very different from the old system, and nowadays, the process of globalization is nothing else, just attempt to integrate the less developed countries into the world capitalism to make them more dependent and to subject them to unequal competition. In this way, LDCs can be exploited and significant amount of surplus can be extracted from them. Ghosh (2001) argued that:

> "Modern globalization is basically led by multinational corporations (MNCs). The production pattern of such corporations is extended to many countries simultaneously to take advantage of cheaper labour and organization cost".

In addition, the *liberalization* of the financial market is perhaps the most important determinant of globalization. The international organizations like IMF; IBRD, WB, WTO and IFC always pursue the programs of globalization, for example trade liberalization, capital market liberalization, privatization, deregulation, free market policies and so forth. And, equipped with better information system, with better operational knowledge of the financial markets, the western companies can expect to have big profits through speculation in the newly emerging markets. And, also, it is very common to call those speculations as "better capital management" or "the best portfolio investors". According to radical globalization is nothing else but the process of taking advantage of the newly emerged markets and Ghosh (2001) stated that "…the MNCs can hope to maximize their market share and profit. Globalization is a cash cow projects for these corporations".

3.2 Multinational Corporation

3.2.1 What is the Multinational Corporation?

We live in an organizational society (Barry and Salancik 1977). Organizations control most of the productive resources and capital, and provide most of the goods and services that we use in our every day lives. MNCs, as a type of organization, play an increasingly important role in implementing most of the organizational functions.

But, what is the multinational corporation? There different definitions of the multinational corporations; Penrose (1995) defined an international firm as an entity that has large number of operating assets in different countries, through branch, subsidiaries or affiliates owned wholly or partly. According to Eiteman, Stonehill and Moffett (2001) the multinational enterprise is one that has operating subsidiaries, branches, and affiliates located in foreign countries and includes firms in such traditional fields as manufacturing, mining, oil, agriculture, and service providing firms. Ross, Westerfield and Jaffe (1999) argued that corporation that takes significant foreign operations is referred as international corporations or multinationals. In addition, MNCs are headquartered all over the globe (Eitman et al 2001). Many of them are owned by mixture of domestic as well as foreign stockholders. Those companies are usually managed from an international perspective rather than from the perspective of any single country.

Furthermore, every international corporation has its *nationality*. Penrose (1995) discussed the significance of the nationality of the firm and concluded that every international firm has its nationality, which is that of the parent company, regardless of the local nationalities of the subsidiaries. The nationality of the parent company is the country where it has been established.

For the purpose of this study, an international corporation author considered the one that operates in a number of countries and have subsidiaries tied to the head office.

3.2.2 Scope of Multinational Corporation

Scope of every business entity limited to the activities it performs. However, there are some characteristics which are generally attributed to MNCs rather than to domestic firms. Hartshorn (1967) studied the role of the international firms by asking the question "what is the essential function of the internationally integrated companies?" and found out the following three functions:

- *Logistic* function - cumulating supplies from many sources to meet demands of many different sources and "setting the relative prices".

- *Technical and Social* function- selecting and training managers from different nationalities in order to acquaint them with international experience.

- *Financial* function - guarantee by specialized investment banks the sound development of an internationally vital resource

Hartshorn (1967) stated that "all these functions need an international viewpoint detached from the special interest of any one nation, so that the companies act as a political as well as economic middleman between nations"

Another type of activity, which is largely undertaken by the multinational corporations, is making investments to the economies of the foreign governments. Foreign investment is the transfer of capital from one country to another; usage of the savings generated in one country for the formation of the capital in another one. However, one should pay attention to the nationality of the international firm. Usually, investment made by international corporations is treated as an investment of the country in which the parent is incorporated. Penrose (1995) stated that:

> "From the point of view of national income accounts constructed on a national ownership basis, reinvested earnings are properly attributable to the country of which the investing Country is a national; from a geographical point of view, they are attributable to the country in which they were made."

For example, very often due to large amount of foreign investment, the U.S. treated as a country which contributes the savings of its rich economy to the rest of the world, although most of its investments are made by the private companies, especially by the multinational firms. Those firms usually earn most part of their profits through foreign subsidiaries in foreign country. However, those companies have been established in the U.S. so they are corporate nationals of the U.S. Consequently, it is wrong to treat all foreign investments made by the U.S. to its rich economy only, although, it should be attributed to corporate nationals of the U.S.

Moreover, because of many types of operations in many different countries with different degree of control, the observable measurement of the scope of the firm can be found in the consolidated financial statements of it. However, the financial statements of the group of companies are not always complete; many financial reports do not include separate information about affiliates owned less than 50 per cent and it is difficult to interpret them due to the different international accounting rules. Besides, relatively recent events

concerning under- or over-statement of numbers, Enron as an example, put a big question mark on reliability of the financial statements of the big firms, and particularly those of the petroleum industry. According to Penrose (1969) the size of large firms is usually understated and such financial understatement exists in every international oil firm.

3.2.3 Risks facing Multinational Corporation

We are living in a complex world of rapid changes and each business entity operating in this world faces different types of risks in its every day operations. *Financial* (credit, liquidity, interest rate, and capital), *foreign exchange*, and *political risks* can be counted among the most spread risks facing every firm. Ross et al (1999) defined *liquidity risk* as an inability of the firm to meet its short-term obligations; *credit risk* is the risk that clients will be unable to pay for goods and services received. Obviously, any time a client defaults there is a loss to the firm; the *interest rate* risk is the risk that changes in the underlying interest rate will increase a firm's interest costs. Any increase in costs will reduce the returns and highly leveraged firms will get into more financial difficulty; the *capital risk* determines the degree of losses that can be experienced by the firm before the creditors will start experiencing losses.

However, according to Eiteman et al (2001) there are certain unique risks in the business environment, which are not normally a threat to domestic operations. These unique risks are related to the foreign exchange risks and political risks. Consequently, those risks are unique to multinational operations and the main risks facing every MNCs. Foreign exchange risk can raise the cost of capital and lower the optimal debt ratios for MNCs. For the companies which heavily invest into the countries with volatile currencies, evaluation of the foreign exchange risk is important. Working capital management of the MNCs could be more complex, because of impact of foreign exchange risks on moving funds among countries. And finally, evaluation of the performance of foreign subsidiaries is more difficult because of the need to account for foreign exchange gains and losses. Political risk, which is important to consider in evaluating foreign activities of the business entity, arises in the relatively unstable countries, or even in countries with new emerging markets. In order to reflect political risk, MNCs very often require higher rate of return on the projects initiated abroad. Thus, one of the main concerns of the top management is to forecast political risk and to find and implement strategies to reduce its impact. This process often refers as political risk management, which defined by Eiteman et al (2001) as "the steps taken by firms to assess the likelihood of unexpected political events, to anticipate how such events might influence corporate well-being, and to protect against loss (or to attempt to gain) from such events".

Furthermore, as it is seen in Figure II, it is very important to differentiate between two types of political risk: macro and micro risk. *Macro political risks* are country-specific risks that affect all foreign firms in a country without considering what they do. These risks include expropriation and ethnic strife. Expropriation is the official government seizure of private property and it is recognized by the international law as the right of any sovereign country[1]. However, expropriated owners should be paid prompt compensation at fair market value. Ethnic strife is the second type of macro political risk resulted by ethnic, racial, religious, tribal or civil conflicts within the country. *Micro political risks,* on the other hand, are firm-specific that is specific for the particular industry, project or firm. Micro political risks arise from goal conflicts and political corruption. Goal conflicts, the most important type of micro political risk, arise due to different objectives of governments and private firms. Governments usually pursue the goal if increase the welfare of their citizens while private enterprise is responsible for profit maximization of its owners and shareholders. Of course, very often the objectives of both contradict to each other, although, government sets the rules. Consequently, governments impose restrictions on the activities of private firms as part of their administrative and legislative functioning (Eiteman et al 2001).

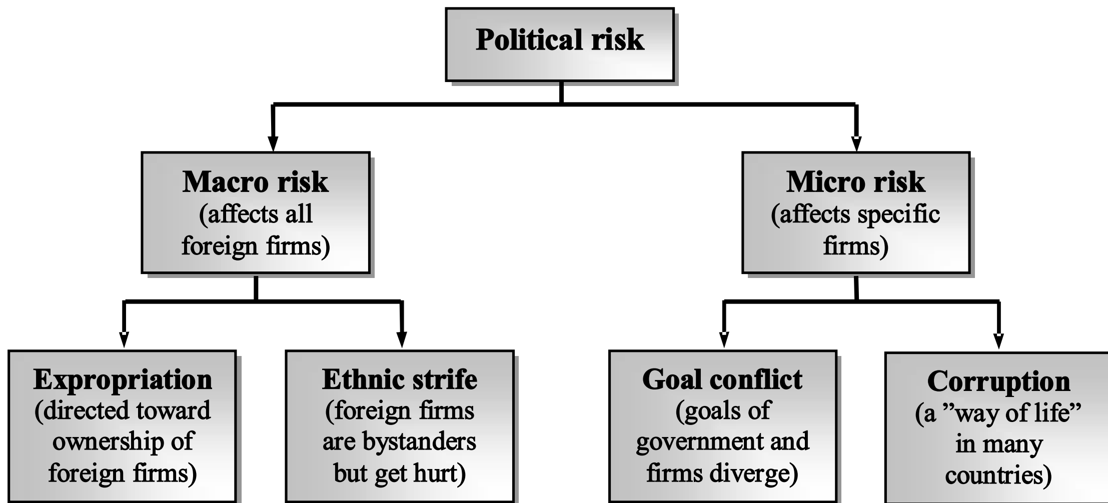

Figure II: **Types of Political Risk**
Source: Eiteman et al. 2001

3.2.4 Multinational Corporation and Government

International corporations are considered those which manufacture in a number of countries and have subsidiaries tied to the head office. Administrative control of international firms, their decisions, policies and executive actions of their head offices very often have substantial impact on the individual

[1] See Appendix I.

economies in many parts of the world. In view of the fact that government is responsible for the overall economic development of its country, it should always track the activities of the international firms and should intervene when considers that firms do not act in the interests of the national economy. International firm, on the other hand, should be a "good corporate citizen" in each country it operates and should comply with regulations of those countries. Nevertheless, according to Penrose (1969), MNCs often failed to comply with their duties, which caused the conflicts between them and governments where they operated. Therefore, different point of views exists concerning the relationship between government and international firm operating in it. Some radical writers consider the multinationals as tools of imperialism and capitalism, and critique their dominance policies of exploitation of the LDCs. However, some other researchers conclude that the role of the multinationals in the development of the state is very huge. For example, Penrose (1969) stated that international firms can make great contributions to the economic growth and development of all countries where they operate. Moser (2001) concluded that MNCs play an increasingly important role in the economic development strategies of many LDCs.

Generally, most of the international companies are privately owned and responsible for the profit maximization of their "shareholders". They operate according to the rules private-enterprise capitalism and very sensitive to any changes in financial markets of the host country, and also subject to all regulations of that country. Given this situation, very often disagreements arise between the governments and MNCs because of "goal conflicts" i.e. the inconsistencies in objectives and policies of governments and international firms.

According to Penrose (1969), the area of difficulty between governments and multinationals arises from two sources. Firstly, it arises from the *commercial* or *economic policies* of the firms. The international firm is privately owned entity and its main responsibility is profit maximization, which, in turn, contributes to increase in shareholders' wealth. Governments, on the other hand, are pursuing the policy of increasing welfare of its citizens, which comes from imposing additional taxes or from putting restrictions to the rate of profits of MNCs. Thus, conflicts arise between financial interests of the parent company and the economic interest of the countries where it operates. Secondly, difficulties arise from the type of *government intervention* to policies of MNCs. When international enterprise pursues the political interests of the government, it raises big conflicts rather that just bargaining for the economic interests of the private groups. Thus, privately owned international firms should not be treated as "tools" for the achieving political as well economic policies of either host or parent governments. In fact, many governments willing to accept an international firm with a condition that its policies and activities will not be influenced by the political as well as economic interests of any other

government. However, some countries, mainly the U.S. and U.K. have strong trends to use their political power to influence international firms to implement the interests of these countries at the expense of other countries. Consequently, host governments have strong reasons to protest against foreign interference to their economy, which occurs as result of political and economic interference of the parent governments to the commercial decisions of the firms.

Foreign direct investment by the MNCs is another area of conflicts between governments and firms. Firms always struggle for the increase in profits and foreign investment by such firms is not simply investment to their subsidiaries in foreign country from where profits would flow, but it involves management of those manufacturing subsidiaries in such way that will contribute to overall profit and loss account of the firm. In doing so, management may decide to adjust the prices charged to the subsidiary or restrict the amount or direction of its exports, establish subsidiaries in places with low income tax rates, use transfer pricing between parent company and subsidiaries. However, more of those policies are not acceptable or, even contradict to the objectives of any government and government very often intervenes to the business policies of MNCs in order to defend the national interests of its citizens. Penrose (1969) stated that:

> "...the chief danger of an international firm as a vehicle of international investment arises from the fact that it is forced to discriminate among countries, because of its legal status and because of the commercial and financial policies it is almost bound to persuade to minimize its tax payments".

Thus, very often FDI causes the conflicts between government and MNCs.

Management of the firms is also an area of conflicts between governments and firms. Very often disputes are going upon domestic versus foreign executives and workers participation in the management of the firm. Many governments believe that more local participation in the management of the international corporations contributes more to the domestic economy, since local managers are more interested in the economic development of own country. Although, Penrose (1969) sated that foreign managers would always resist to the influence of the local professionals to their affairs; this usually occurs in a case when locals have equity partnership in foreign subsidiary. For example, American firms always have "nationalist" approach, preaching ideology and always attempting to promote the interests of their home country or parent company by insisting on 100 per cent ownership of their foreign subsidiary and refusing to accept shrinkage of American managerial control. The international firms of other countries, for example Swiss firms, are less nationally oriented. However, it should be noted that many international firms, including the American, are establishing joint-ventures, spending large sums for the training of local management, making investment into local economies, etc.

Eiteman et al (2001) also observed the relationship between governments and multinationals and stated that

> "Historically, conflicts between objectives of MNCs and host governments have arisen over such issues as the firm's impact on economic development, perceived infringement on national sovereignty, foreign control of key industries, sharing or non-sharing of ownership and control with local interests, impact on a host country's balance of payments, influence on the foreign exchange value of its currency, control over export markets, use of domestic versus foreign executives and workers, and exploitation of natural resources".

Concluding, not all international companies have the same discriminatory policies and outlook against the affairs of the government where they operate. But, unfortunately, the differences in economic and financial policies of government and firm lead to "goal conflicts" between them. These "goal conflicts", in turn, cast doubts to the activities of the MNCs within foreign borders. Consequently, the foreign governments can not be sure that international firm will not discriminate against the local economy, will not escape tax payments, etc. For these reasons, many governments do not look at activities of international corporations as a simple commercial transaction which does not need close governmental control and interfere to their business.

4. The International Petroleum Industry *"Historical Development"*

Truth and Oil always come to the surface

Spanish proverb

The oil industry dates to five thousand years back. In the Middle East, oil was used in waterproofing boats and baskets, in painting, in lighting and, even, for medication. It also was used in the building of the walls of Babylon. Crude oil was produced from hand-dug wells as early as by 13th century in Burma and by 17th century in Japan.

Nevertheless, the modern oil industry started its development only from the 19th century, as a result of many technological achievements. It is generally accepted that the oil industry was born in Pennsylvania, U.S. in 1859; however, there was land oil wells in Europe since the 1920s. Odell (1974) stated that:

> "...American oilmen – and many of their countrymen – look upon the oil industry as an American 'invention' and continue to express scepticism as to the ability of any other nation to deal successfully with oil, and over the possibilities of organizing and running the industry in any way other than tested and tried in the U.S.A.!".

These attitudes emerged due to early development as well as early recognition of importance of domestic oil industry in the U.S. compared to the rest of countries in the world. In addition, the largest American firms had dominated the international oil business since its earliest days.

International petroleum industry has very interesting history of development. This industry was developed totally by seven large companies, referred as the "Majors" or "Seven Sisters"[1]. The "Seven Sisters" owned most of the world's exportable crude oil, refineries, most of the world's marketing facilities and most of the tank and pipeline transportation almost till the1960s and almost till the same time crude oil prices were mainly established by those companies. In the 1970s, crude oil production in most producing countries became national; the governments took the control over the producing oil fields. The power of the Organization of the Petroleum Exporting Countries (OPEC) raised and it became a cartel with control in the global prices from mid-1970s to the mid-1980s. In the mid-1980s, some factors, such as a falling demand of crude oil

[1] The seven largest oil companies was named as "Seven Sisters" by Enrico Mattei, head of Italy's national oil company, AGIP (Parra 2004).

and increasing production by non-OPEC members provoked the collapse of the OPEC pricing system and the development of a market-based pricing system took place.

Generally, the years starting from the earliest days of the development of the industry and going through The First and The Second World Wars till the 1970s can be characterized as the years of full control by the major oil companies. Further, establishment of OPEC weakened their position and broke the monopoly of the majors in the world oil market.

4.1 Early Development of the Industry

The development of the oil industry started from the 19th century and whole industry was developed by struggle between Americans and Europeans for the control of oil reserves, more precisely by competition of the American and the European companies. According to Penrose (1969) the early history of the international oil industry "was largely shaped by the rivalry between Standard Oil and its powerful European competitors and by the policies adopted to mitigate this rivalry in their common interest".

In the U.S., there were very rich discoveries and the large market opportunities motivated business people to find and exploit the country's oil reserves while developing the new technology as well. By expansion of the market, new refineries were built and marketing networks were established. In the 1860s, John D. Rockefeller was the most successful entrepreneur in the filed of refining. In the same years, he very quickly built or acquired control of many refineries and pipelines and organized a competent supply system closely linked with the railroads. Between 1873 and 1882 Rockefeller and his group joined with other oil men and the great Standard Oil Trust was created in the U.S. Soon, the company attained full monopolistic control over transportation and refining activities of the country. Penrose (1969) stated that:

> "...not only did Standard Oil dominate the domestic industry for the long time but it reached out to the markets of Europe and of the orient, quickly becoming the world's most important oil supplier of oil products".

Meanwhile, *in Europe* also were great discoveries of oil and large enterprise. Although Standard Oil Trust reached full monopoly in America, it could not entirely dominate by any means in European markets. By the 1880s production at the Russian fields was in full swing and by the 1890s even exceeded for a brief period that of the U.S.

Thus, the earliest participants in the development of the oil industry were American and European companies and rivalries among them occurred over the Far and Middle Eastern and Venezuelan oil reserves.

4.1.1 The Far East

Severe competition occurred among the American, Dutch and British Governments for the control of the oil production in the Far East. The consequences of those competitions, which were affecting the global oil market, led to a number of agreements among those companies for the mutual cooperation and control.

In the U.S.A, the development of the petroleum industry started with the formation of Standard Oil Trust. At that time, the kerosene was the most important petroleum product and the U.S. was the biggest exporter of the kerosene till the middle of the 20th century; in 1860-1880s it was mostly exporting almost half of kerosene refined to Europe. Consequently, those years Standard Oil had devastatingly dominant and nearly monopoly position in the Eastern hemisphere. Meanwhile, Nobel brothers, Rothschild and a group of Russian independents were important competitors in Europe. In addition, European producers and marketers had access to plentiful Russian fields and had low transportation cost throughout Asia, Eastern Europe, and Mediterranean, which made rivalry between Standard Oil and Europeans more intense.

In Europe, the development of the petroleum industry began with the support of the Dutch and British Governments. For the exploiting of the oil of the Dutch East Indies in the Far East, a small Indonesian company was established in 1890. In 1900, Dutchman Henri Deterding became its manager and soon after brought Royal Dutch, Shell and Rothschilds into one marketing organization -Asiatic Petroleum Company - to supply Asian markets; in 1907 he formed the Royal Dutch/Shell Group by agreement with British-owned Shell Transport and Trading Company. Furthermore, until the First World War, the Royal Dutch and the Dutch Government obstructed Standard's any efforts to acquire concessions to explore for oil in the Dutch East Indies. Meanwhile, Burmah Oil Company was an active producer, refiner and distributor in Burma and India, and had preferential position in the markets of those countries. With cooperation with Burmah Oil Company, British protected their interest in that region and prevented Standard's attempts to enter into the market. After many years of hard efforts just before the First World War, Standard Oil gained foothold in the Dutch East Indies through a Dutch subsidiary and only in 1922 it discovered oil in commercial quantities in south Sumatra. In 1928 Dutch Government gave permission to Standard Oil to obtain additional concessions in the territory under its control and, in the following decades, by the assistance of American State Department, other American Companies gained permission to work in South-east Asia, but only through Dutch subsidiaries.

Competition among Standard, Royal Dutch/Shell, and Burmah Oil for the Far Eastern markets was severe and followed by many "price wars" which led to different kind of agreements between Companies. For example, after a number of price conflicts in India between 1897 and 1905, Asiatic Petroleum and Burmah Oil came to agreement where they have determined their respective marketing zones in the Far East. This agreement also caused the alliance of Burmah Oil and Shell and formation of Burmah-Shell in 1928, joint marketing company through which both companies operated in India. The other price war between Standard of News York and Royal Dutch/Shell, which spread all over the world market, led to formation of "Achnacarry" or "As Is" agreement in 1928. This agreement was the first comprehensive effort of all major companies to regulate world petroleum market.

4.1.2 The Middle East

Compared to other oil markets, the Middle Eastern market were less important for the Western companies. However, in the Middle East, the large Western firms as well as their governments battled over the producing territories rather than for the market share.

In south-west Persia, great-oil was discovered by W.K. D'Arcy and Burmah Oil in 1908 and the Anglo-Persian Company (now British Petroleum) was formed in 1909 to develop that field, which soon after became an important competitor in the world oil industry. Firstly the company was partly financed by Burmah Oil and a year after the conversion of the British navy from coal to oil in 1913, the British Government made heavy investment into the company by purchasing a controlling stock interest.

In the Ottoman Empire, German, British and Dutch were deep involved in the Turkish politics in order to gain permission to operate in the oil rich lands of Mesopotamia. The consequences of their efforts were the emergence of the Turkish Petroleum Company (TPC) in 1911, owned by Anglo-Persian, Royal Dutch/Shell and German financial and industrial group. After the 1914-1918 war, exactly in 1920, according to San Remo agreement the German interests were transferred to the French, and the British and French obtained mandates over Mesopotamia and Syria. Consequently, all of the oil rights throughout the area became in hands of British, British/Dutch and French Companies.

Generally, throughout Asia, much of the oil promising territories were politically controlled by the British or Dutch Governments, who accustomed to give reserve concessions to their own nationals. Accordingly, America had small domination in the controlling of the crude-oil reserves outside the U.S. and it seemed that its oil interests was not satisfied, despite of raised fears of "Standard Oil Monopoly" in the US as well as in the Europe. Furthermore, after the war, it became clear to the "great powers" that oil plays essential role

for their political as well as economic power. Increased fears of the U.S. that its national reserves would soon be depleted made the U.S. Government anxious about British-Dutch control over the oil-bearing territories of Asia. Meanwhile, due to numerous treaties and financial interests in the oil companies, the British and French Governments became more straightly involved to the activities of those companies. The German Government, on the other hand, lost its right of participation in the development of the petroleum industry during the war and after it did not have any chances to retrieve it and come back to the region.

To sum up, in the Middle East, the British had political domination in Iraq and in the Persian Gulf and it struggled for those territories to be exploited by British Companies. The main aims of the American Companies were to get in, and they achieved it by the assistance of their Government. First, they got shares in Iraq Petroleum Company (IPC), the post-war successor to the old Turkish Petroleum Company, and later in the Persian Gulf and Arabian Peninsula.

Coming to the companies, by that time, the largest companies which obtained important concessions and made big discoveries were Jersey Standard, Royal Dutch/Shell and Anglo Persian. Furthermore, two other companies, Standard Oil of California, involved in exploration in Bahrain and Saudi Arabia, and Gulf Oil in Kuwait began to grow. However, according to the famous Red Line Agreement, which prevented international companies allied in the IPC to take an individual concession in the territory of the old Ottoman Empire, Standard Oil of California slipped in partly. In addition, in Kuwait, Gulf Oil and British Petroleum formed jointly-owned Kuwait Oil Company.

4.1.3 Venezuelan Oil

Venezuela was one of the world's major oil producing country of that time and the first oil in commercial quantities was discovered by Royal Dutch/Shell in 1914. The development of its oil reserves were concerned under the control of the same large oil companies, except British Petroleum. As for the British Petroleum, it was prohibited from operating in Venezuela, because of the Government's law of not allowing any foreign government-owned company to obtain oil concession.

As in the rest of the world, competition among oil companies for the oil concessions in Venezuela was also very severe and even took the corrupt nature as the ruling political regimes of that country. Extensive rivalry occurred between British and American companies, and the governments of both countries actively interfered to that competition. However, it should be noted that, the U.S. government, in which the fear of depletion of domestic reserves while the domination of British and Dutch in the oil fields of the rest

of the world were wide spread, took an active participation in the competition of American oil companies for the oil concessions. The most successful companies in discovering and producing of oil in Venezuela were Royal Dutch/Shell, Standard Oil of Indiana, and Gulf Oil and after the First World War those three companies were producing nearly all of the oil of Venezuela Despite of investing $ 20 million, Jersey Standard did not discovered oil in commercial quantities up to 1929. Yet, in coming six years Jersey got control over the 50 per cent of Venezuela's production. It had already bought Creole in 1928; in 1932 it acquired Indiana Standards interests with Aruba refinery; in 1937 by agreement with Shell it obtained the control over Gulf's production and concessions. By that time Jersey Standard produced 52 per cent, Shell 40 per cent and Gulf only 7 per cent of the total output of the Venezuela. (Penrose 1969)

4.2 The Second World War and Post-War Changes

According to *Statistical Review of the World Oil Industry* by British Petroleum (1966 cited Penrose 1969), world production of the crude oil in 1938 amounted to 5,6 million b/d per day (b/d), out of which 3,5 million b/d were produced in the U.S. and 570,000 b/d in the U.S.S.R. Furthermore, by that time, excluding the U.S. and U.S.S.R., Venezuela with production of 515,000 b/d was the biggest producer of crude oil in world, Iran and Indonesia with respective production of 210,000 and 150,000 b/d were the largest producers in Asia. In addition, Iraq was producing about 90,000 b/d and Bahrain 20,000 b/d in 1938; production from Saudi Arabia had just begun and from Kuwait had not yet started.

As before the war the oil production from those countries was mostly in the hands of the majors, leaving very small room for the "independents". Venezuelan production largely controlled by Standard and Shell, Iranian production was completely controlled by British Petroleum, large part of the Indonesian production was in the hands of Shell, leaving small portion to Stanvac (jointly owned by Jersey Standard and Socony - Vacuum) and Caltex (jointly owned by Standard of California and Texas Oil), production from Iraq was divided among the owners of the IPC group- Anglo-Iranian, Royal Dutch/Shell, Compagnie Francaise des Petroles, and Near East Development Corporation, and production from Saudi Arabia and Kuwait were exclusively controlled by the U.S. companies.

During the war a little further development in crude-oil production took place; operations in Middle East ceased completely because of shipment difficulties and material deficits resulted from Japanese occupation of Burma and Dutch East Indies. However, it was obvious even before the Second World War, that

after the war increased production would flow from Kuwait and Saudi Arabia, and the companies would not be able to sell that much oil due to insufficient markets of their own. This situation, in turn, put under the danger the stability of the oil market; many new entrants of low cost crude-oil producers could seriously damage the position and balance among the established companies, the lack of marketing capabilities of those new entrants could significantly effect the prices of the crude-oil.

Thus, many pre-war agreements were signed among the companies which made possible not to lose their monopolistic position in the global oil market. In 1936, Standard of California, which had huge production, and Texas Oil Co., which had many marketing outlets in Far East and Europe, agreed to operate together and Caltex, jointly owned affiliate, was established. Under that agreement, Texaco obtained 50 per cent interest in the Bahrain Petroleum Company and in the California Arabian Standard Oil Company (later Aramco) and Standard of California took 50 per cent interest in Texaco's manufacturing facilities in Suez. Further, in 1947, Jersey Standard and Socony Vacuum also got the interest in Aramco; Gulf made long-term contracts to supply Kuwait oil to Shell, and BP did the same with Jersey Standard and Socony Mobil. Consequently, capital as well as market had been guaranteed for the development of the Saudi Arabian oil fields. According to Parra (2004) those arrangements among the companies necessitated tight cooperation in the planning of investment and in the rate of development. In addition, Penrose (1969) noted that almost all reserves in the Middle East became under the control of the same Companies through the different groupings

Several studies showed that in 1950, the international oil companies owned over 70 per cent of the world's refineries, except in the U.S. and U.S.S.R., every important pipeline and 65 per cent of the world's privately owned tanker fleet (Penrose 1969, Odell 1986, Parra 2004). Consequently, because of their dominant position, the companies were able to regulate the rate of supply and to control prices by not entering into price competition among themselves. Furthermore, regulated supply made possible to yield high cash flows from their operations and to earn enormous profits.

However, soon after the Second World War, the circumstances in the whole world had changed. Post-war decade, also called "de-colonization" times, was characterized by the far reaching psychological, political as well as economic changes. Obviously, those changes had greatly influenced the international petroleum industry as well. In fact, the growth of the industry were slowed down by the war, but according to Penrose (1969) some of the problems of the industry arose due to inability of the international oil companies and their governments to analyze, perceive and adopt to post war changes quickly; some other problems caused by the emotional attitudes of the governments of the large crude-oil producing countries toward the companies.

The political consequences of the war speeded up the process of formation of the newly independent countries, which in turn altered the political map of the world as well as the political balance of powers. Newly independent Afro-Asian governments as well as their people changed the attitudes toward the dominant Western powers and people. Nationalist and independence movements in almost every Afro-Asian country with anti-(western) Colonialism and Imperialism manifests obviously weakened the moral and political influence of the West. Furthermore, economically as well as politically strong U.S.S.R. strongly supported anti-(western) and anti-capitalist movements in any government, which, in turn, led to more destructive attitude by those governments toward the oil companies than ever before. Protesting governments were very often forgetting their own economic interests and Penrose (1969) stated that:

> "For although post war development in some respect strengthened the position of the crude-oil producing countries vis-à-vis the oil Companies, they did nothing to improve the ability of those countries to market their own oil, and they hastened certain other types of change in the industry which were to the disadvantage of the producing countries".

Soon after the war the development of Saudi Arabian and Kuwait fields hastened. The production of Saudi Arabia increased from 160,000 b/d in 1945 to 548,000 b/d in 1950; production from Kuwait also rose from 16,000 b/d in 1945 to 345,000 b/d in 1950. From 1945 to 1950 production from Iraq rose almost by 50,000 b/d and reached 137,000 b/d. In addition, growing production contributed to increased fixed royalty payments and more revenues to the governments.

The oil producing governments, on the other hand, pushed the companies for the greater payments, despite of increased royalty payments due to increased production. As a result, firstly in Venezuela in 1943, the Hydrocarbons Law was designed to produce a 50/50 split of profits between the concessionaries and the government and only in 1948 it became the reality. After the Venezuela, 50/50 agreement spread all over the crude oil exporting countries; it was introduced in Saudi Arabia in 1950, in Kuwait in 1951, in Iraq in 1952.

Generally the pre- and post war periods, till later 1950s, could be characterized as the years of cooperation and control among the international oil companies (Penrose 1969, Odell 1986, Horsnell & Mabro 1993, Parra 2004).

4.3 The Iranian Consortium

From its earliest days the development of the Iranian oil fields was exclusively in the hands of the British, and only Anglo-Iranian Oil Company (AIOC) was

operating in Iran. According to the terms of the mutual agreement, AIOC was obliged to pay to the Iranian Government the amount equal to 20 per cent of its dividend payments over a specified sum in addition to royalty payment of 4 gold shillings per ton. Further, the British Government's discriminatory policy against Iran requested AIOC to limit its dividend payments. The Iranian government protested this policy and in order to find solution to this situation, in 1948, AIOC invited Iranian Government for the discussions. Both sides reached agreement during the negotiations; however, it was not ratified by the Iranian Parliament. Consequently, the relationship between the Company and the Government worsened by every day and arrived at its end by nationalization of the company in 1951. This conflict lasted fro two more years, involving the International Court, the United Nations (U.N.), the intervention of the U.S. with the issue of compensation, and finally, ended by fall of the Musaddiq regime and by formation of an International Consortium in 1953.

The International Consortium did not annul the nationalization, but allowed the oil companies to operate in the southern Iran, and assured for the Iranian Government 50 per cent of the net profits attributed to its crude-oil production. As a result, the oilfields of Iran was not any longer exploited by single company, but by a Consortium of Companies as in the Middle East, and their operations were largely controlled by the seven international majors.

The Iranian Consortium - outcome of the conflict between the Iranian Government and AIOC - did not put either the Iranian government or AIOC in winner position and both sides have lost substantially. Accoding to Parra (2004):

> "Iran, after three years of upheaval, got essentially what had been offered…a 50/50 deal - and lost its incipient way to democratic, constitutional rule…AIOC lost 60 percent of its concession".

Penrose (1969, p.67) concluded that:

> "Although in one sense the Anglo-Iranian Oil Company lost its struggle with the Iranian Government, it can hardly be claimed that the Government won…But the Consortium that was set up after the prolonged negotiations, great economic losses and severe political damage, brought little improvement in the direct economic benefits derived by the Iranian economy from the operations of the foreign Companies that could not have been obtained by less drastic means".

4.4 The Growth of the Markets and Competition, 1950-1975

The post-war years till the late 1950s were the years of strong cooperation and control by the major companies. According to Parra (2004), world oil demand increased almost five times, growing from 11 million b/d in 1950 to 57 million b/d in 1970. Production, on the other hand, as proposed by Odell (1986) increased from 10 million b/d in 1950 to 60 million b/d in 1975. Furthermore, till the late 1950s, the governments of the producing countries were in a relatively weak position compared to the Companies, which using their monopoly power dictated the rules of the game.

However, competition and 1958 price decline fundamentally changed the relationship between oil companies and crude-oil producing countries. Generally, those countries started to claim more financial returns for the government and more domestic control and participation in the activities of the oil companies. Since the Second World War, those countries had made steady gains by renegotiating the financial terms and reducing the coverage area of exploration and production concessions granted before and by enforcing regulations concerning drilling requirements and reservoir maintenance. All of these developments were in favor of crude-oil producing countries. Some of those improvements were due to increased oil production, and some due to increased bargaining power of the governments to pressure on the companies.

According to Penrose (1969) the increase of the bargaining power of the crude-oil producing countries was possible due to several factors. Firstly, after the Second World War, there had been an increased demand for oil in the industrialized world as well as increase in the cost of production in the US. That fact made very expensive for the oil companies to discover oil outside the US. For example, beginning from 1940s, Venezuela, firstly from all crude-oil producing countries, started to increase the taxes on the oil companies and reached its peak of 50 per cent in 1948. However, companies did not resist too much to imposition of high taxes by the Venezuelan government, fearing of its intervention. They did not want any conflicts with the government, as Venezuelan oil was close to the U.S. market and was well worth the price. Furthermore, it was clear for the oil companies that crude-oil producing countries of the Middle East would also insist on better terms than those offered under the existing concessions. Accordingly, companies were willing to grant improved terms on concessions for those countries, which in turn increased their bargaining power. Generally, Companies and Governments adopted “50/50” profit-sharing arrangements, which were appraised for its simplicity and “fairness”. Secondly, as oil revenues from new concessions grew, the economies of oil producing countries became more and more dependable on them. This, in turn, led to increased awareness of those countries not only on importance of those revenues, but also of the vital value

of their national resource. That awareness caused vocal political minorities to treat the foreign firms as "exploiters" of their national resource and the governments began to calm the aggressive nationalist groups. Ironically, this process increased the governments bargaining power as the government used to warn the oil companies to keep in mind the danger that more nationalistic groups could obtain the control over the government and to meet the terms of the existing government. Thirdly, revenues received from oil, had facilitated political, economic and administrative development of oil producing countries, which in turn decreased the inequality in the bargaining process between governments and the oil companies. Negotiators on behalf of government became more experienced and well-informed about the petroleum industry and could "fairly" weigh up arguments of the companies and assess how far and in what directions to press in order to get favorable results. Finally, formation of the OPEC in 1960 significantly increased the bargaining power of the governments.

In addition to the increased bargaining power of the producing governments, post-war years characterized as years of emerging of the new oil companies- "independents". Their emergence increased the competition among oil companies, and greatly affected the prices of the crude oil in the world market. The non majors were able to enter into the markets of the Venezuela, Libya, Persian Gulf, etc. For example, in Venezuela the production by the non-majors increased almost twice, growing from 300,000 b/d or 10 per cent of total Venezuelan in 1961 to 500,000 b/d or 15 per cent in 1966. In Iran the two contracts with non-majors were signed in the late 1950s; first in 1957 with AGIP (subsidiary of ENI) and NIOC; second in 1958 between AMOCO and NIOC to set up Iran-Pan American Oil Company. In 1957 Saudi Arabia signed contract with Japan Petroleum Trading Company (JPTC) and Kuwait signed with Arabian Oil Company (AOC) covering their 50 per cent share of the offshore neutral zone. According to Parra (2004) quantity of oil produced by the non-major companies in the offshore as well as onshore zones of Iran, Saudi Arabia and Kuwait increased from 229,000 b/d in 1961 to 609,000 b/d in 1966 and 1,025,000 b/d in 1970.

The entrance of the former U.S.S.R. also made intense the competition between the majors and non-majors. In the 1950s the production of the U.S.S.R. was not very significant, (about 100,000 b/d in 1956), therefore, it could not affect world oil market. However, in coming 10 years Soviet block exports increased rapidly, about 40 per cent in a year and reached 700,000 b/d in 1961 (Parra 2004).

Generally, the growing competition in the world petroleum industry led to enhancing the bargaining power of the governments of the crude-oil producing countries. Developments of the 1950s and 1970s brought into the direct relation the rate of supply of the crude oil to the amount of revenues for the

producing countries i.e. increase in supply was connected to increase in payment to the government. Consequently, each producing country, partly via OPEC, wanted to have wider position in the international petroleum industry and they had not seen the ways of achieving it, as before, simply through bargaining with the companies for higher profits than companies decided should be attributed to the crude oil.

4.5 Organization of Petroleum Exporting Countries, 1960-1970

From the years of tough cooperation among the companies, posted prices were agreed by them as the basis for calculation of the income taxes on crude-oil production. Furthermore, those prices could be reduced if the prices for the oil products were decreasing in the world market. Thus, as a response to the competitive pressures in the world oil market after 1958, the companies cut posted prices by 8 per cent in February 1959 and some lesser percent in August 1960. According to Edward (1963) between 1957 and 1959 production of crude oil in the Middle East rose by 30 per cent and payments by the oil companies to the governments of those countries rose by 26.5 per cent or from $1,022 million to $1,293 million. However, as a result of price cut, in 1959 – 1961, despite of 22 per cent increase in total production, the payments to the governments rose only by 13.7 per cent.

Those reductions in payments led to common belief among the producing countries that the companies did that in order to uphold their profits and they could straightforwardly not just raise the prices again, but also enforce them in the world market. Formation of the OPEC in 1960, with participation of Venezuela, Saudi Arabia, Iraq, Iran and Kuwait, was a direct outcome of "price cuts" by the companies (Penrose 1969, Odell 1986). One of the primary objectives of that organization was to restore posted prices to 1958 level.

OPEC grew in stature and size very quickly in the early days of its existence. However, OPEC was not able to restore prices to 1958 level, but it was able to avoid further cuts by the companies. In addition, taxes paid to the governments (except Libya) for the crude oil became 50 per cent of the difference between agreed cost and the posted price and the term "posted prices" was replaced by the "tax reference" and was used for the tax calculation purposes only, rather than for the actual transferring of oil as it was before.

To sum up, through the OPEC the oil exporting nations was able to reinforce new government policies which increased their own role in their oil industries by forming national oil companies, and by increasing their control of the producing companies. Moreover, the new agreements carried strict requirements concerning the size and speed of exploration and development

undertaken by oil companies. Al-Kuwary (1978) stated that those governmental policies have affected the scale of oil production and consequently the states' oil revenues.

5. The International Petroleum Companies

5.1 General Overview

Although there were many oil companies with significant operations outside their home country, the modern petroleum industry was largely developed by the seven large upstream oil companies of the Western world. According to Penrose (1969) Major Oil Companies played decisive role in shaping the history of the international petroleum industry. Parra (2004) also stated that "the international petroleum industry was developed almost entirely by seven large companies (the "majors"), each with colorful history of its own". Consequently, it is impossible precisely analyze any of the important economic characteristics of this industry without studying the policies of the major international oil firms.

Thus, the purpose of this chapter is to describe a historical development and characteristics of the major oil companies, referring to their strategic policies, exploration as well as distribution operations and investment activities. The seven international "majors" discussed in this chapter and ranked by their crude oil production in 1966, are:

- Standard Oil Company (New Jersey)
- Royal Dutch/Shell Group
- British Petroleum Company
- Gulf Oil Corporation
- Texaco
- Standard Oil of California
- Mobil Oil Corporation (formerly Socony Mobil)

In addition, Compagnie Francaise des Petroles, which was much smaller than any of the above listed companies, is discussed. It should be noted that, because of early participation in the developing of the international petroleum industry, Compagnie Francaise des Petroles is very often referred to as eighth "international major".

As it can be seen from the Table II, in 1966, seven Companies alone were producing 76 per cent and refining 61 per cent of the crude oil in the world outside the US, and Communist countries.

TABLE II
GROSS CRUDE-OIL PRODUCTION AND REFINERY THROUGHPUT SEVEN MAJORS AND THE WORLD
(Excluding US, Canada, USSR, Eastern Europe and Chine)
1950, 1960, 1966

	production			*refining*		
	1950	1960	1966	1950	1960	1966
		000 b /d			*000 b /d*	
Standard Oil New Jersey	1 020	1 920	3 150	750	1 760	3 000
Royal Dutch/Shell	770	1 600	2 390	870	1 930	2 750
British Petroleum	800	1 500	2 500	600	900	1 600
Gulf Oil	300	1 170	1 780	60	370	500
Texaco	240	790	1 440	390	650	1 170
Standard Oil of California	180	560	1 480	120	320	510
Mobil Oil	140	570	950	90	430	840
Total Seven Majors	3 450	8 110	13 690	2 880	6 360	10 370
Other Companies	620	3 120	4 230	1 120	5 540	6 630
Total	4 070	11 230	17 920	4 000	11 900	17 000

Source: Reconstructed from Penrose (1969).

It should be noted that in 2005, after number of mergers and acquisitions, only five large international oil companies –BP, ChevronTexaco, ExxonMobil, The Royal Dutch/Shell Group and TotalFinaElf - are left, all of which have their roots in the former seven major oil companies. Those five large companies of our days, as Parra (2004) noted, only are "…a shadow of their former (Seven) selves…" and they produce approximately 13 per cent, refine 21 per cent and sell 35 per cent of the world crude-oil and products.

5.2 Standard Oil Company (New Jersey)[1]

The Standard Oil Company (New Jersey), an American Company, was one of the largest petroleum corporations in the world in 1966. In 1966, it had total assets of $13,887 million and gross revenue of $ 13,582. The company had approximately 740,000 shareholders in 1966; the largest shareholders were institutions such as insurance and investment companies, pension funds and banks. It was fully integrated company, involved in upstream as well as downstream activities in over 100 countries. In 1966, the company produced nearly 14 per cent of the world's crude oil outside of the Communist bloc, had 1.6 per cent on long term production contracts, processed 11 per cent of the crude refined, and was accounted for 16 per cent of the total oil and oil products sales. As Table II depicts, Jersey accounted for 18 per cent of crude-oil production and refining outside Canada, the U.S. and U.S.S.R. In 1966, the Company was producing 4,109,000 b/d and buying another 459,000 b/d under

[1] The following discussion, if other sources are not indicated, is based primarily on the Annual Reports and E. T. Penrose, "*The Large International Firm in Developing Countries: The International Petroleum Industry*".

special arrangements and was refining 4,162,000 b/d, which indicates that it was self-sufficient in crude oil.

The first "Standard"[1] company was "Standard Oil Company", established in Ohio by John D. Rockefeller and his partners in 1870. In the following years, many business and oil interests aligned under the leadership of Rockefeller and greater part of the refining and pipeline capacity of the U.S. came under the control of a very few men. For the business activities, Rockefeller and his partners started to set up "Standard" companies in each State of the U.S. bound together by a Trust agreement and The Standard Oil Co. (New Jersey) was accordingly organized in 1882. In 1892, the "trust" method of control was abandoned due to legal difficulties and Jersey Standard became the holding company for the all group of Standard companies and interests.

In the beginning, the Standard group was concentrated only on refining and pipeline business, not entering into the crude-oil production. By 1879 Standard Oil refined 80 per cent of the oil in U.S. and controlled almost all pipelines; by 1904 it refined and marketed 85 per cent of the oil in the U.S. refineries. At the early stages of his business, Rockefeller, saw the controlling of the refining and transportation business as crucial element of the control of the entire industry. Soon the demand for the oil products increased and Standard Group increased their refining and transportation capacity. Furthermore, with expanding refining business as well as with increasing competition for crude-oil supplies, the company decided to have its own oil supplies. In 1911 Standard Oil become an integrated organization, producing 40 per cent of crude it refined and almost 35 per cent of the total crude-oil output of U.S.

The Standard Oil Company of New York (Socony) was the chief exporting affiliate in the Standard Oil group at that time. However, toward the end of the decade the group opened many marketing affiliates in Europe, Canada, and Mexico; some refining was also performed in Mexico, the West Indies and Europe. In the 1900s, the Standard Oil was rapidly increasing its foreign production, refining and marketing activities; in 1911 its shares in foreign market was around 60 per cent, it had 19 affiliates performing foreign trade through 52 subsidiaries in many parts of the world, and notably in Europe.

In 1911, Supreme Court of the U.S. decided that Standard Oil of New Jersey had violated U.S. Antitrust Acts and dissolved it. As a result, the company lost the control over its 33 subsidiaries. Those subsidiaries became independent entities and enjoined from paying dividends to their former parent. However, Standard Oil of New Jersey retained most of its South American and European marketing affiliates, but lost its companies responsible for the U.K. and Far East sales. Furthermore, it retained very little crude-oil production and few

[1] See Appendix II

transport facilities. Thus, the integrated balance of the activities of the company was destroyed. In spite of this, the parent company, Standard Oil Co. (New Jersey), remained the largest among its other subsidiaries and was the second largest industrial company in U.S. of that time.

From 1911 almost till the end of the First World War, the company engaged only in some crude-oil production activities in Mexico, Peru, Rumania, and in East Indies. In 1918, Jersey produced only 16 per cent of the crude-oil which it used in its refineries. However, after the war Jersey seriously considered the issue of extending its foreign crude-oil production and intensified its efforts in obtaining new concessions and in making new acquisitions of existing producing companies.

In Latin America, Jersey Standard acquired new interests in Peru, Columbia and in Venezuela. In 1928, it acquired a major share in Creole Petroleum; in 1932, the Company acquired the foreign properties of Standard Oil of Indiana, which enlarged Jersey's production in Venezuela and Mexico; in 1937 it acquired half-interest in Mene Grande Oil Company, a subsidiary of Gulf Oil, which was the third largest crude-oil producing company in Venezuela.

In the Dutch East Indies, Jersey Standard was facing strong opposition from the Royal Dutch Petroleum Company and its government for its efforts to gain concessions and exploration rights. However, Jersey entered into the market and in 1922 found oil in Sumatra and became in better position to compete with its greatest competitor, Royal Dutch/Shell, which was aggressively expanding at that time.

In the Middle East, the American companies gained concessions with the assistance of the U.S. State Department, and as early as in 1919 Jersey took the leading role among the other U.S. companies. The main competitors of the Jersey were Anglo-Persian Oil Company and the Royal Dutch/Shell. In 1920, with the assistance of the State Department, strong efforts have been made in order to get concessions in Northern Persia.

In Mesopotamia, the agreement with the Turkish Petroleum Company had been reached, which allowed U.S. companies explore for oil in that territory. Five U.S. companies - Jersey Standard, Socony Mobil, Atlantic Refining, Gulf Oil, and Pan American Petroleum and Transport Co .- aligned together and formed the Near East Development Corporation in 1928, which obtained an equal share with Anglo-Iranian, Royal Dutch/Shell, and Compagnie Francaise des Petroles in the ownership of the Iraq Petroleum Company, the successor to the Turkish Petroleum Company. Further, Atlantic Refining and Pan American Petroleum and Transport Co. in 1930 and Gulf Oil in 1934 sold their interests to Jersey Standard and Socony Mobil.

Further, Jersey Standard secured the next major source of petroleum supply in the Middle East through a long-term contract, agreed with Anglo-Iranian Oil Company in 1947. According to that agreement Jersey Standard was entitled to receive from AIOC production a total of 800,000,000 b/d of crude oil over the twenty-year period beginning in 1952.

In 1947s, AIOC and Jersey Standard were discussing the possibility of jointly building pipelines from the Persian Gulf to the Mediterranean and between IPC and American companies. While those discussions Jersey Standard proclaimed its desire to leave "The Red Line Agreement", which was preventing international companies allied in the IPC to take an individual concession in the territory of the old Ottoman Empire. According to that agreement, Jersey Standard and Socony Mobil did not have any rights for new concessions, while new comer Standard Oil of California (Socal) obtained a concession in Saudi Arabia and almost immediately discovered very large quantities of oil there. In 1948, Jersey Standard and Socony Mobil got out of The Red Line Agreement and Jersey Standard purchased 30 per cent interest in Socal's Arabian American Oil Company (Aramco). Thus, Jersey Standard assured additional 30 per cent of the oil produced from extremely productive fields of Saudi Arabia.

In 1954, Jersey Standard acquired 7per cent interest in the Iranian Consortium, which replaced AIOC in Iran; in 1959 Jersey Standard discovered oil in Libya and commercial shipments began in 1961.

Thus, in 1960s, Standard Oil of New Jersey totally assured its foreign crude-oil productions. In 1966, Venezuela with 1,380,000 b/d was the primary source of Jersey's crude-oil supplies outside of the U.S., followed by Saudi Arabia with 721,000 b/d and Libya with 536,000 b/d. In addition, the Company had productions in Canada, Iraq, Abu Dhabi and Iran.

Together with continuous increase of the foreign sources of crude oil supplies, Jersey Standard was actively expanding its foreign refinery activities, too. Between 1920-1927, Jersey increased its refining from 10,000 b/d to 23,000 b/d in Latin America and from 1,000 b/d to 13,500 b/d in the Eastern Hemisphere; totally, foreign refinery runs increased from 32,000 b/d to 85, 000 b/d, or from 15 to 20 per cent of the total crude oil refined by the company. In 1965, Jersey Standard owned or had a financial interest in 68 refiners in 34 countries; in 1966, its foreign refineries processed 80 per cent of the oil processed by the company.

Generally, between 1917 and 1927, Jersey's production of crude oil increased by seven times; the amount of refined crude-oil and company's assets increased by three times. This rapid expansion is explained as the company's strategy to assure its own crude-oil supplies and harmonize its imbalances in integrated

structure after the 1911 dissolution. In 1940, the company almost reached equilibrium between demand of its refineries and supply of its own crude. Between 1950-1960, crude oil production increased by 178 per cent, refinery processing increased by 159 per cent and sales increased by 157 per cent. Furthermore, most of the foreign expansion activities had been carried out by acquisitions, not by discoveries and exploration by Jersey and in most years those expansions was financed by retained earnings. In 1950-1966, the ratio of retained fund to capital expenditures averaged 93 per cent, which indicates that the company was retaining its earnings. Meanwhile, Jersey Standard also paid high dividends; in 1950-1957, on average 30-30per cent of Jersey's net income was paid out in dividends; in 1958, the proportion of dividends to net income reached its peak of 44 per cent and then, in 1959-1966, averaged again 35-37 per cent. In addition, total investment was much greater than cash dividends in the period 1950-1966. Thus, it is unavoidable to conclude that Jersey Standard put high emphasis on self-sufficiency and favored self financing rather than relying on external debts.

5.3 The Royal Dutch/ Shell Group[1]

The Royal Dutch/Shell Group (Shell) was the second largest petroleum company in 1966 in the world. As it is shown in Figure III, the company consisted of two parent Companies, The Royal Dutch Petroleum Company (Royal Dutch), which was Dutch and the "Shell" Transport and Trading Company Ltd. (Shell Transport), which was British. As parent companies they did not directly participate in the activities of The Royal Dutch/Shell Group. They received their income in the form of dividends and were responsible for the appointment of Directors to the Board. According to arrangement made in 1907, Royal Dutch entitled to 60 per cent and Shell Transport to 40 per cent interest in the Group. The Royal Dutch/Shell Group 100 per cent owned by those companies and not listed at a stock exchange. Shareholders that want to invest into the group have to invest into one of the parent companies.

The Royal Dutch/Shell Group, on the other hand, held its interests in two holding companies, "Shell Petroleum N.V." in Netherlands and "The Shell Petroleum Company Limited" in Great Britain. Those two holding companies, in turn, subdivided into Service and Operating companies. The main business of the Service Companies was to provide advice and services to other Shell companies. Operating Companies consisted of Exploration & Production, Gas and Power, Oil Products, Chemicals and Renewables and Other Industry segments. The management of each Operating Company was responsible for the performance of its segment.

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[1] The following discussion, if other sources are not indicated, is based primarily on the Annual Reports and E. T. Penrose, "*The Large International Firm in Developing Countries: The International Petroleum Industry*".

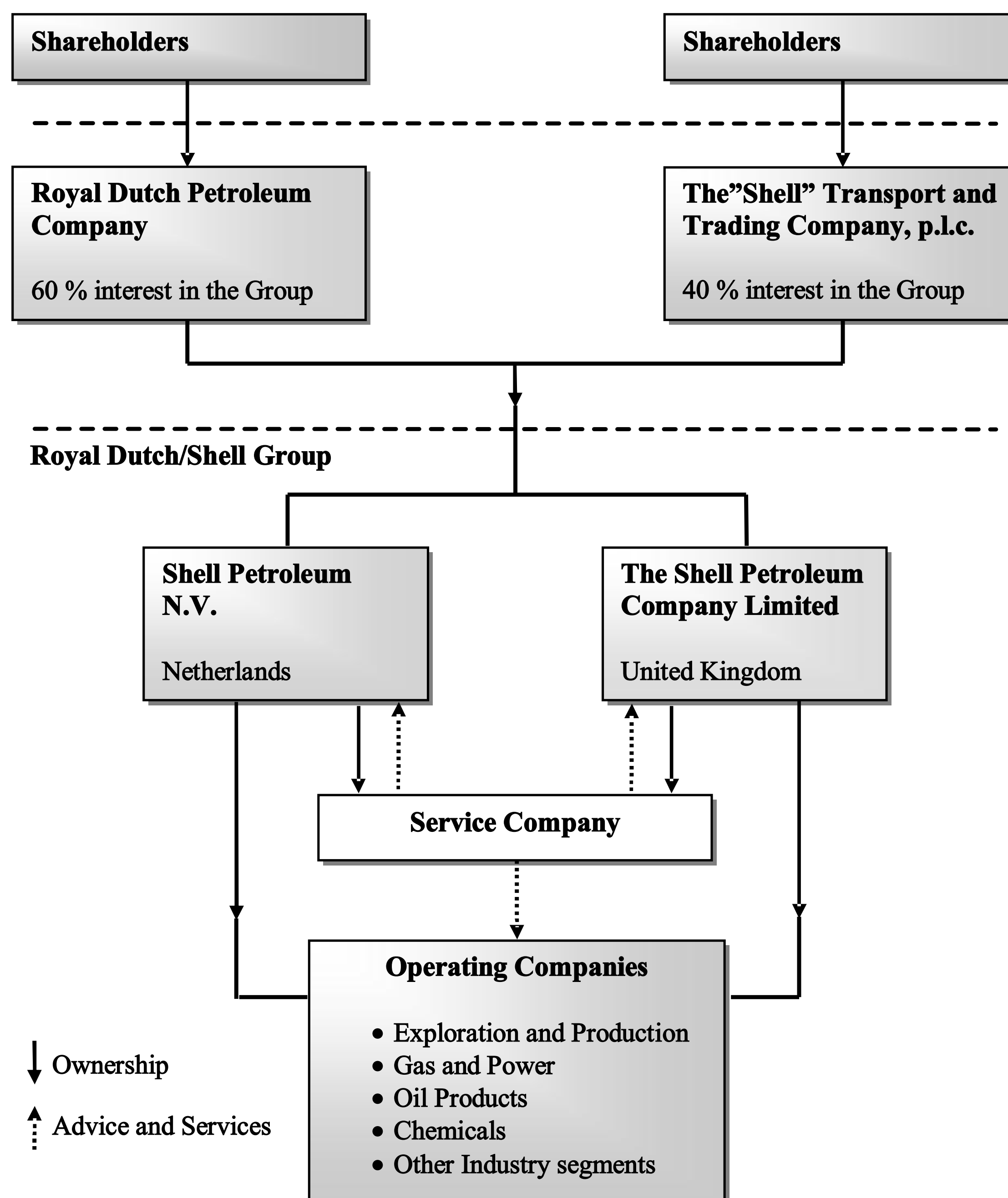

***Figure III:* Organizational structure of Shell.**
Source: Annual Report.

In 1966, Shell had total assets of $13,392 million and gross revenue of $11,396. The shares of Shell Transport were largely British owned, while the shares of Royal Dutch, despite of being Dutch Company, was mainly owned by the nationals of other countries. Like Jersey Standard, in 1966, Shell was fully integrated company, performing upstream as well as downstream activities in almost all parts of the world outside the Communist countries. As Table II, in 1966, the company produced nearly 13 per cent of the world's crude oil outside

of Canada, U.S. and U.S.SR, had 5 per cent on long term production contracts, and refined 16 per cent. At the same year, Shell was producing 2,981,000 b/d, while refining 3,650,000 b/d, which indicated that it produced less oil than it refined. Most of the supplies of crude was obtained under special supply contracts; the most important supply contract was with Gulf Oil Corporation, which agreed to supply the grater part of its Kuwait oil.

The history of the group goes back to 1907, when two independent companies, Royal Dutch and Shell Transport have merged. The decision of merging was a direct outcome of the stiff competition between the companies themselves and each of them with Standard Oil.

The origin of Shell goes back to the 1880s, when Marcus Samuel opened a small shop in London to sell sea shells. After some period of time it became successful import-export business. Years later, Marcus's son visited Caspian Sea cost and recognized an opportunity to export oil to the Far East through the Suez Canal. In 1892, Samuel transported 4,000 tons of Russian kerosene to Singapore and Bangkok. However, at that time, Asian markets were almost fully controlled by the Standard Oil, while European markets were tied up with arrangements between Standard Oil, a group of Russian independents, and Rothschild interests of Paris. In order to successfully compete with Standard in Asia, Samuel took sufficient advantage of its lower cost of bulk transport and local packaging. Shell was growing very rapid, and during the first year of bulk shipments, imports of Russian kerosene into India increased by 35 per cent. Meanwhile, oil was discovered by Dutch group in Sumatra, which started drilling in 1884. In 1890, the company Royal Dutch was formed in Netherlands to develop Asian oil fields. By 1896 it already was strong company, which was producing crude, building a refinery and pipelines, and creating its own marketing organization. Furthermore, at the same period Royal Dutch started to compete with Samuel in the Far East. To face this competition, Samuel also obtained a concession in North Borneo in 1896, where he found oil and built a refinery. In 1987 Shell Transport and Trading Co. Ltd. was established and Samuel entrusted his tankers and tank installations in the Far East to the new company.

Both Shell and Royal Dutch expanded rapidly; many painful and sharp competitions drew the history of development of both companies. In the 1900s, Royal Dutch and Shell were severely competing with each other, in addition to competitions of both with Standard Oil and European and Russian groups. However, in Europe, Shell had close ties with the Rothschild interests from which it was buying its Russian kerosene. In 1903, Royal Dutch, Shell and Rothschild joined together and organized Asiatic Petroleum Company for the transportation and marketing their products in the Far East. This arrangement eliminated the rivalry among them in the Far Eastern markets.

Standard Oil, on the other hand, attempted for many times to take control over Shell and Royal Dutch, but those attempts were unsuccessful.

Further, Royal Dutch and Shell entered into a number of cooperative arrangements and, finally, it was decided, that instead of competing with each other, Dutch and British companies would perform better if they merge. In 1907, The Royal Dutch/Shell Group was formed, with present 60:40 division of interest, in order to join their activities worldwide. Both companies were fully integrated when they merged; Royal Dutch started its business as the producer and refiner and moved forward to marketing and transport; Shell, in contrast, had begun in marketing and moved backward into production and refining. Thus, their operations were mostly complementary, and with merger, the strength of each was offset by the weakness of the other.

In 1907, Shell discovered oil in Rumania and in 1910 it became the largest producer in that country. In 1912, Rothschild transferred through Asiatic Petroleum Company its interests in Russian kerosene to Shell; further, at the same year, Royal Dutch/Shell group founded American Gasoline Company to sell gasoline along the Pacific Coast and Roxanna Petroleum to buy oil properties in Oklahoma. In 1915, The Royal Dutch/Shell group completed the construction of the first modern oil refinery. In 1921 the Company discovered The Signal Hill field in California, which became the most productive field in the U.S. In 1927, TPC discovered oil in Iraq and Shell, through Anglo-Saxon Petroleum Company, obtained a 23.75 per cent interest in it[1]. In 1929, Shell Chemical Company was founded and chartered to manufacture chemical products. In 1938, after Mexican nationalization of the petroleum industry, Royal Dutch/Shell Group lost its Mexican properties, which account for 17.5 per cent of its total production and 62 per cent of Mexico's total production. While the same period, the Group acquired 50 per cent of Jersey Standard's interest in Mene Grande, the third largest crude oil producing company in Venezuela, and expanded its operations in Argentina.

Short before the start of the Second World War, the company's crude oil supplies were mainly coming from Venezuela and South-east Asia; production in Middle East equaled to South-east Asian production only in the 1950s. The company's sales, on the other hand, were conducted in cooperation by the other major companies; mainly it marketed its products in the U.K., the Near East and in Africa through Anglo-Persian Company (BP); sales in India was performed trough Burmah Oil.

After the Second World War, the production from Venezuela and the Middle East was rapidly increased. *In the Middle East*, in addition to its interest in

[1] Anglo-Saxon Petroleum Company was wholly-owned subsidiary of Royal Dutch/Shell and one of the original shareholders in the old TPC, predecessor of IPC.

IPC, Shell also was receiving large quantities of Kuwait oil under a special contract with Gulf Oil Corporation. Furthermore, the company obtained a 14 per cent interest in Iranian Consortium. *In Africa*, Shell started first exploration in the 1930s in Nigeria, but much later in the other parts of Africa. In the 1950s, the production in Nigeria and Sahara was already in commercial quantities. In 1964, oil was discovered in Abu Dhabi by a company, where Shell had 23.75 per cent interest and in Oman by another company in which Shell had 85 per cent interest. In 1966, Venezuela, Iran, Iraq and Nigeria contributed to 75 per cent of total production of Royal Dutch/Shell Group.

Generally, upstream as well as downstream activities of Royal Dutch/ Shell group were balanced; the company produced almost as much as it refined in both the Western and the Eastern Hemispheres. From the early years of establishment, the company continued to search for crude oil and new discoveries had been made in South East Asia, Mexico, Venezuela, and even in the U.S. By 1920 the company was producing some 10 per cent of the world's supplies of crude oil. Till the Second World War the main sources of the company's crude supply were Venezuela and South-east Asia, while after the war, in the 1950s, more production started to flow from the Middle Eastern discoveries, in addition to long-term supply contracts; Middle East's proportion in the company's total supply increased from 16 per cent in 1950 to over 40 per cent in 1966. In 1954-1966, crude oil production increased by 212 per cent, refinery processing increased by 98 per cent and sales increased by 121 percent. Taking into consideration long term supply contracts, North America contributed 15 per cent, South America 28 per cent and Eastern Hemisphere 57 per cent of Royal Dutch/Shell's crude supply.

Shell, like Jersey has financed its expansion mostly from retained earnings. In 1954-1966, the ratio of retained funds to capital expenditures averaged 95 per cent. Furthermore, the Company were retaining around three-quarters of its earnings, compared to around three-fifth retained by Jersey. Shell also increased the amount of dividends it paid out; in 1954-1966, the ratio of dividends to net income averaged 19 per cent, it raised from 12 per cent in 1954 to 24 per cent in 1966, with maximum rate 26 per cent in 1964. Shell made large part of its capital investment in the Eastern Hemisphere, particularly in Europe. In 1966, $ 683 million or around 40 per cent out of total $ 1,697 million capital expenditure have been made in Europe. At the same year, the company estimated the geographical distribution of its net assets as follows: Eastern Hemisphere 65 per cent, the U.S. 14 per cent, and other Western Hemisphere 21 per cent.

Moreover, Shell's scientists invented new products in the area of oil refinery, agricultural fertilizers, and synthetic rubber industry; construction of the deepest producing well in the world at the time, introduction of new ranch-style

service station in 1958, testing CO_2 injection process may be counted among company's achievements in the international petroleum industry.

5.4 British Petroleum Company[1]

British Petroleum was considerably smaller company in 1966 than Jersey Standard and Royal Dutch/Shell. Over the years of establishment the name of the company was changed twice, first to Anglo-Iranian in 1935 and then to British Petroleum in the early 1950s. In 1966, it had total assets of $ 4,427 million and gross revenue of $ 4,068. In 1966, 48.9 per cent of the shares of the company were owned by the British Government, 23.23 per cent by Burmah Oil and the rest by 91,000 shareholders. It was vertically integrated company, involved in upstream as well as downstream activities, but it produced more oil than it refined. As Table II depicts, in 1966, British Petroleum produced 2,500,000 b/d which was 14 per cent of the world total production outside Canada, U.S. and USSR, while processed only 1,600,000 b/d or 9 per cent of the world total. Thus, the Company was considered as a net seller of crude oil, much of which was sold on long term contracts to other major companies. For example, in 1947, British Petroleum agreed to supply Jersey Standard with 800 million b/d of Middle East crude oil through a long-term contract; in 1948, similar arrangement for 500 million b/d was made with Socony Mobil.

The history of the company goes back to 1901, when William Knox D'Arcy bought a concession in south-west Persia and used a fortune his father had made in gold mining in Australia to finance oil exploration. In 1901-1908, no oil in commercial quantities was discovered. Further, D'Arcy ran into financial difficulties, which led to its partnership with the Burmah Oil Company. In 1908, great-oil had been discovered and in 1909, Anglo-Persian Company (now British Petroleum) was formed to develop those fields. In 1914, the British Government decided to convert its navy from coal to oil and made long-term contracts for fuel oil with the Anglo-Persian Company. At the same year, the British Government made heavy investment into the company by purchasing a controlling stock interest of £ 2.2 million. Thus, 51.65 per cent of the shares of the company were owned by the British Government and 24.3 per cent by the Burmah Oil[2].

The next important step, which the company took after the discovery of oil in 1908, was the building of pipelines from its oilfields to the coast and

[1] The following discussion, if other sources are not indicated, is based primarily on the Annual Reports and E. T. Penrose, "*The Large International Firm in Developing Countries. The International Petroleum Industry*".

[2] Till the end of 1960s, the British Government was the main shareholder of the BP. However, in 1966-1967, BP financed its acquisition of some interests of Distillers Company by exchange of shares, thus reducing the government interest to 48.9016 per cent.

constructing of refinery. In 1913, a small refinery at Abadan on the Shatt-al-Arab was completed and connected to the oilfields by pipeline. While the First World War, oil of Anglo-Persian Oil Company helped a lot to the fuelling of British navy. While the First World War the company interrupted the planned expansion program and till 1917, it could not benefit much from its resources. However, sales contracts with the British Admiralty and Indian and Iraqi railways increased the company's marketing territory.

Before the First World War the Anglo-Persian Oil Company was bargaining for the concession in the old Ottoman Empire, and even in 1909, D'Arcy's representative in Constantinople obtained preliminary agreement for exploration rights. Short before the start of the First World War, TPC was formed, where Anglo-Persian Oil Company obtained 50 per cent interest and the rest were divided between The Deutsche Bank and a subsidiary of Royal Dutch/Shell. However, the war changed the balance of powers as well as political map of the Middle East and resulted in establishment of the IPC as the successor to the old TPC. After the extended negotiations, remarkably among American, British, and French Governments, the Anglo-Persian Oil Company obtained only 23.75 per cent interest in IPC.

In 1928, the Company began to supply its products into Indian market through Burmah-Shell (a jointly owned affiliate of Royal Dutch/Shell and Burmah Oil). It should be noted that, this arrangement allowed the Anglo-Persian Oil Company to enter into the Indian market without competition with other companies which already existed there.

In 1934, the Anglo-Persian Oil Company secured oil production in Kuwait. Firstly, Gulf Oil was attempting to obtain an entire concession, but was opposed by the Anglo-Persian Oil Company. After long discussions, Gulf Oil with the assistance of the U.S. State Department reached agreement with the Anglo-Persian Oil Company, and Kuwait Oil Company was jointly formed for the purpose of obtaining concession from the Sheikh of Kuwait. In 1938, the oil in plentiful quantities was discovered by those two companies, but it was not possible to develop production from Kuwait because of the Second World War.

In 1935 the Anglo-Persian Oil Company was renamed into Anglo-Iranian Oil Company (AIOC), as Persia chose to call itself Iran. By 1939, AIOC was selling its products in Africa, Europe, the Middle East, India, and Australia. The Company made its Abadan refinery one of the biggest refineries of the world at that time; in addition, it built new refineries in Britain and France. Before the Second World War, the company had its main production in Iran and Iraq, together with some insignificant supplies from the U.K. and Argentina and was aggressively expanding its explorations in many parts of the world.

After the Second World War AIOC started to develop its oil fields in Kuwait and first exports began from 1946. In 1948-1951 AIOC's production in Kuwait increased almost four times, in Iraq increased almost two times; furthermore new fields in southern Iraq and in Qatar was discovered. Since 1951, AIOC made new acquisitions of oil properties in Canada, Trinidad, and the U.S.; it continued explorations in North and South America, Australia, New Zealand, North, East and West Africa, and Europe. Generally, production was steadily increasing after the second till 1951, when it decreased sharply due to dispute with Iran and further recovered due to increased output from Iraq and Kuwait. Dispute with Iran and subsequent Iranian nationalization have led to losing AIOC's exclusive exploration position in that country and formation of consortium with participation of seven majors plus Compagnie Francaise des Petroles. BP retrained only 40 per cent interest in the Consortium and was paid compensation from both the Iranian Government and the members of the Consortium.

In 1954-1966, BP's production of crude-oil increased by some 257 per cent and refining quantities rose by 220 per cent. Generally, for BP, after the Iranian crisis, recovery of production was much easier than recovery of refining. As for the production, it was easily compensated due to increased output from Iraq and Kuwait. But for the refining activities the company should either purchase or construct new refineries, as its refinery in Abadan was expropriated by Iran. Consequently, there followed a rapid extension of refining capacity and in 1965, the company refined more than 50 per cent of its crude-oil in Europe as compared with around 7 per cent before the war.

To sum up, from the early days of its business till the end of 1960s, BP produced more crude-oil than it could refine. However, how much was sold in world markets at market prices and how much moved under military and naval contracts and private long-term contracts at special prices was not known. The most serious problem which the company faced was losing its Iranian positions in the 1950s. This event for BP might be compared with the dissolution decree in 1911 to Standard Oil, after which both companies needed to make big changes in the structure of their activities. For BP this entailed hastening its refining activities in the U.K. and Europe. Before the Second World War, BP had strong position in the Middle East, had financial backing of the British Government as a shareholder and customer, and closely cooperated with other companies in the marketing of its products. Since 1950s, the company started to expand its operations more rapidly than before. However, till the end of the 1960s it still was much less widespread internationally than either Jersey or Shell and was more oriented towards Europe, the Commonwealth and particularly the U.K.

In 1950-1966 crude oil production increased by 212 per cent, refinery processing increased by 167 per cent and sales increased by 200 per cent. The company retained a large part of its net income. In 1957-1966, the ratio of dividends to net income averaged 20 per cent, with maximum rate of 23 per cent in 1964 and 1966. From 1962 to 1965 the Company paid extra dividends to stockholders from its capital reserves, which increased due to compensation paid to BP by companies entered into the Iranian Consortium. Furthermore, in 1957-1966, the ratio of retained funds to capital expenditures averaged 86 per cent. Generally BP had conservative dividend as well as investment policy, in spite of profitability of the company in pre-war period.

Like other international oil companies, BP also developed new sources of crude oil in the late 1960s. The most successful discoveries of those years were in Abu Dhabi together with IPC and CFP, in Libya together with American interest and in Nigeria together with Shell. The company did not publish the geographical distribution of its investments or income; however, in 1964 it reported that £ 450 million or 56 per cent of its total net assets were outside the U.K.

5.5 Gulf Oil Corporation[1].

In 1966, measured by crude-oil production, Gulf Oil Corporation was almost the same size as BP. It was vertically integrated company, involved in upstream as well as downstream activities, but, like BP, it produced more oil than it refined. In 1966, Gulf produced 2,293,000 b/d which was 10 per cent of the world total production outside Canada, U.S. and U.S.SR, while processed only 1,248,000 b/d or only about 55 per cent of what it produced. However, its assets and gross revenue were more than those of BP. In 1966, total assets were of $ 5,892 million and gross revenue of $ 4,717. It had only 167,000 shareholders, which were less in number than those of any of the other international American majors. Similar to BP, Gulf also considered as a net seller of crude oil, much of which was sold on long term contracts to other major companies. As an example, Gulf agreed to supply Kuwait's crude oil to Royal Dutch/ Shell Group under the long term contract, which gave Shell a contractual share in Kuwait oil up to unspecified amount. However, not much information published about those transactions; in 1958 Shell took 58 per cent of Gulf's share of the net crude production in Kuwait.

The Gulf Oil Corporation was established in 1907 with the purpose of acquisition the stock of two American companies which were involved in early

[1] The following discussion, if other sources are not indicated, is based primarily on the Annual Reports and E. T. Penrose, "*The Large International Firm in Developing Countries. The International Petroleum Industry*".

oil discoveries in Texas and Oklahoma. The Company, from the beginning was financed by Mellon banking and even in the 1960s was largely controlled by Mellon interests.

In early days of the U.S. petroleum industry Standard Oil had almost monopoly position in production and distribution of crude-oil; thus other oil producing companies were heavily dependent on Standard Oil to organize their business in the U.S. W.L. Mellon, on the other hand, was closely involved into financial issues of the two predecessor companies of Gulf and was its vice-president in 1907-1909, president in 1909-1930, and Chairman of the Board in 1930-1948. Consequently, Mellon believed that in order to effectively compete with Standard Oil, any independent company should organize its integrated downstream as well as upstream business, and particularly should develop its own crude production. Thus, in the U.S., from its earliest days in business, Gulf followed the integration strategy, with particular emphasis on crude oil discoveries, and possessed enough refining capacity to handle its own supply.

Foreign operations, on the other hand, Gulf started with exploration in 1913 in Mexico, which was the only source of foreign crude-oil until 1925. However, its Mexican production was very unstable; it increased from one million b/d in 1917 to 25 million b/d in 1922 and fell to 2 million b/d by 1930. Conversely, Gulf's Venezuelan production rose sharply; it increased from just over one million b/d in 1925 to 26 million b/d in 1929. Unfortunately, increased production from Venezuela exceeded Gulf's refining capacity and in the depression of the 1930s with much crude, falling domestic sales, and a scarcity of funds, the Company went into trouble. In those years, the main problems which faced Gulf were unavailability of sufficient outlets of its own to absorb the Venezuelan oil and unavailability of funds to rapidly expand those outlets. The company found solution by selling 50 per cent of its interests and assets of Mende Grande (the subsidiary through which Venezuelan operations were conducted) to International Petroleum Company of Canada (subsidiary of Jersey Standard) for $ 100 million in cash and the obligation of International Petroleum to pay half of the cost of production. In addition, Gulf also sold its Italian and French marketing interests.

In 1948, crude-oil from Kuwait began to compose a large part of Gulf's total supplies; in 1949, Kuwait oil exceeded that from Venezuela. At the same years, in addition to Kuwait and Venezuela, Gulf was receiving crude from Canada through two-thirds interests in British-American Company and it also had 7 per cent of interest in the Iranian Consortium. In the following years, particularly in 1950-1966, Gulf's crude-oil production increased almost by four times, which was much more than increase in production of the other major companies.

Gulf's refining and marketing operations, on the other hand, were always primarily tied with the U.S. market and in 1966 more than 50 per cent of its refining capacity was in that country. Gulf also was part-owner of the refineries in Venezuela, Kuwait, Iran, Canada, Taiwan, the Philippines, and Korea. In Europe, it had interests in refineries in Denmark, Holland, France, Spain and the U.K. Gulf built its first fully owned European refinery only in 1961. However, in the beginning of the 1970s, the company started to expand its refining and marketing activities in European markets. Generally, between 1950 and 1966, total refinery runs increased by almost three times.

Gulf's total earning, also, came from its U.S. domestic operations. However, it worth to note that, the U.S. production which contributed to 50 per cent of Gulf's total production in 1950 decreased to 25 per cent in 1966 and at the same year Kuwait alone contributed to 58 per cent of Gulf's total production. Even though, in 1966 more than 71 per cent of Gulf's total earnings came from its operations in the U.S.

In summary, from the earliest days of its business till the end of 1960s, Gulf Oil Corporation, like BP, was "long" on crude; for example, in 1960 in the Eastern Hemisphere the Company produced about eight times more crude-oil than it refined in that Hemisphere; However, at the same time, Gulf achieved a "balance" between crude production and refinery runs in the Western Hemisphere. Since the beginning of the1970s, the Company started to expand its European refinery activities more rapidly. However, till the end of the 1960s Gulf, like BP, still was much less widespread internationally and was more oriented towards the U.S. market. This explained by their easy crude position and effective control of price of crude, which made unnecessary for them to compete overseas for their survival like Jersey Standard and Shell. However, Gulf and BP could lose much when crude prices come under pressure.

In 1950-1966 crude oil production increased by 324 per cent, refinery processing increased by 165 per cent and sales increased by 159 per cent. The company retained a large part of its net income and financed itself largely from its retained earnings; in 1958-1966 its retained earnings were just enough to cover its capital investments, with the average 99 per cent ratio of retained funds to capital expenditures. In 1960-1966, Gulf also notably increased the amount of dividends paid out; in 1958-1966, the ratio of dividends to net income averaged 23 per cent, with maximum rate of 28 per cent in 1963.

Like other international oil companies, Gulf also developed new sources of crude oil in the late 1960s. The company began to produce in Nigeria, Bolivia and Colombia, where the Patamayo discovery in 1965 considered of "major importance". Furthermore, Gulf started exploring in other areas of North Africa and the Middle East, including Libya and Turkey, and in the North Sea.

The company did not publish the geographical distribution of its investments or income; however, in 1964 it reported that three-quarters of its investment expenditures in the previous ten years was in the U.S.

5.6 Texaco and Standard Oil of California[1].

Texaco and Standard Oil of California (Socal), were two independent American companies, operating independently in the Western Hemisphere and pursuing different policies. However, in the Eastern Hemisphere, almost all of their operations had been performed through the jointly-owned Caltex till 1967. Accordingly, for the purpose of this study, which is concerned with the activities of the international oil companies in the developing countries of the Eastern Hemisphere, Texaco and Standard Oil of California are discussed jointly, although, separate background information about historical development of each company is presented.

Texaco was considerably larger company in 1966 than Socal. In 1966, it had total assets of $ 7,370 million and gross revenue of $ 5,494. Socal, in turn, in 1966, had total assets of $ 4,800 million and gross revenue of $ 3,393 million. Texaco produced as well refined more crude oil than Socal. In 1966, the company produced 2,263,000 b/d and processed 1,972,000 b/d while Socal's production for the same year was 1,731,000 b/d and refinery equaled to 1,291,000 b/d. However, the greater production and processing by Texaco was mainly because of its greater production in the U.S. and Canada; in 1966, just in the U.S. the Company produced roughly 769,000 b/d and processed 808,000 b/d which were more than Socal's total 658,000 b/d production and 775,000 b/d refinery in the entire Western Hemisphere. In the Eastern Hemisphere, in 1966, Texaco produced approximately 1,086,000 b/d and processed 650,000 b/d while Socal produced about 1,073,000 b/d and processed 520,000 b/d w; this indicated that both companies were almost the same size in the Eastern Hemisphere. The Californian-Texas Oil Co. (Caltex), on the other hand, owned in equal shares by the two Companies, was responsible for the exploration, production, transportation, refining and marketing in the East till 1967. In 1967 Caltex was dissolved in Europe, but retained its operations in Suez and South Africa on behalf of parent companies, Texaco and Socal.

Despite of joint foreign operations, Texaco and Socal have very different origins and path of development, which in turn could considered as the main reason of their association in many foreign operations.

[1] The following discussion, if other sources are not indicated, is based primarily on the Annual Reports and E. T. Penrose, "*The Large International Firm in Developing Countries. The International Petroleum Industry*".

Standard Oil of California was one of the companies of the famous Standard Oil Trust. In the 1900s, Standard Oil failed to get production in Indonesia and in order to supply its Oriental markets in 1906 it purchased the California Company. Further in 1906, Standard Oil Company of California was formed to take over the Pacific coast marketing area of Pacific Coast Oil and Iowa Standard. After the dissolution of Standard Oil in 1911, Standard Oil of California became an independent company and was awarded Washington, Oregon, Nevada, Arizona, California, British Columbia and the territories of Alaska and Hawaii. In 1920-1930 it continued its expansion inside the U.S.; in addition, Socal joined other American companies for expanding its exploration abroad, mainly in Sumatra, Java, Netherlands New Guinea, the Persian Gulf and Saudi Arabia. In 1928 Socal acquired Gulf's concession in Bahrain and in 1930 Bahrain Petroleum Company was established. Oil from Bahrain was discovered in 1932 and production from Bahrain rose rapidly, increasing just from 31,000 b/d in 1933 to 1,200,000 b/d in 1935. Meanwhile, Socal obtained concession in Saudi Arabia in 1933 and immediately started exploration. Consequently, by 1935 Socal had much production in the Eastern Hemisphere, but, however, it did not have enough marketing outlets for its crude-oil. Therefore, Socal started negotiations with The Texas Company (Texaco), which had been operating in foreign markets since 1905, and in the 1920s and 1930s already had large marketing outlets in the Eastern Hemisphere.

The Texas Company, on the other hand, was established in 1901 and was an independent company which competed with Standard Oil and from the early beginning of its operations stressed full integration. The company started trade in retail markets as early as in 1905 and in 1908 had already possessed tankers in operations to European ports. In the 1920s, it obtained productive lands in Venezuela and Columbia. Further, Texas Oil gave preference to the strategy of developing of its refining capacity rather than production, and in 1933 it only produced 55 per cent of the crude it refined. Further, in the 1930s, cost of crude oil increased substantially in the U.S., and the company strengthened its activities abroad; by the same time, it had already had extensive marketing outlets in Latin America and in the Eastern Hemisphere.

In 1936, Socal and Texaco reached an agreement to operate together and at the same year Caltex was established to perform jointly-owned marketing activities. According to that agreement, Socal sold 50 per cent of its interest in the concessions in Bahrain, Saudi Arabia and the Netherlands East Indies in return for a huge amount of cash and 50 per cent of Texaco's marketing facilities in the Eastern Hemisphere. In 1947, Caltex purchased Texaco's marketing outlets in Europe and North America, thus completing the overseas consolidation of the two major companies. Meanwhile, Socal's Arabian American Oil Company (Aramco) produced more crude oil than it could market and for the expansion of marketing facilities the parent companies needed much money. Accordingly, negotiations was held with the purpose of

bringing Jersey Standard and Socony-Vacuum (Mobil Oil) into Aramco and in 1948 Jersey Standard purchased 30 per cent and Socony-Vacuum 10 per cent interest in Aramco; Socal and Texaco each retained 30 per cent interest in Aramco. Further, in 1954, Texaco and Socal obtained 7 per cent interest each in the Iranian Consortium.

Throughout the history, Socal and Texaco performed their marketing operations in the Eastern Hemisphere mainly via Caltex[1]. In 1966, the main producing facilities of Caltex were in Bahrain and Indonesia, from where it produced 367,000 b/d of crude oil. At the same year, Texaco and Socal each owned 30 per cent of Aramco and each had 7 per cent interest in the Iranian Consortium. From those three sources Texaco and Socal received some 2,062,000 b/d out of which 1,187,000 b/d was sold by Caltex in the form of crude and products in 1966. In addition, Caltex refined 1,178,000 b/d of crude in 1966. In May 1967, Caltex was dissolved in twelve European countries (the U.K., Ireland, Germany, Italy, Switzerland, Belgium, Luxembourg, the Netherlands, Norway, Sweden, Denmark and Greece) and its operations as well as assets in those countries were divided between two parent companies. After dissolution of Caltex, both companies became free to follow their own independent policies; Texaco had been expanding in Europe while Socal in North America. It should be noted that, Caltex was not publicly held company; therefore no financial statements were prepared. Furthermore, parent companies also did not present much information about their affiliates, like Caltex, Aramco, etc. Thus, it is impossible precisely describe in financial terms how much each parent company has received after the dissolution of Caltex. However Caltex continued to work in East of Suez and in East and South Africa for both companies.

To sum up, both companies, Texaco and Socal, like all other America major oil companies were responding to the rapid oil demand of the East compared to the U.S. after the Second World War. Texaco was considered as one of the most rapidly growing American companies, especially abroad. Although international activities of both companies, and particularly those of Texaco, were increasing in relation to their domestic operations in 1966, still large part of refining and marketing was performed in the Western Hemisphere; in 1966 approximately 75 per cent of Texaco's and 57 per cent of Socal's net income was derived from the Western Hemisphere. However, between 1952 and 1966, Texaco's refining activities in the Eastern Hemisphere increased from 25 per cent of its total refining to 33 per cent and sales from 25 per cent to 38 per cent of total sales. Similarly, while the same period of time, Socal's refining

[1] However, each company did some marketing independently; Socal used to sell crude, and Texaco oil products, primarily in England, through Regent Oil Company-in which it had 75 per cent holding interest-and in West Africa.

activities in the Eastern Hemisphere increased from 30 per cent of its total refining to 40 per cent and sales from 28 per cent to 34 per cent of total sales.

Furthermore, most of the foreign expansion activities of both companies were largely financed by retained earnings. In 1950-1966, the ratio of retained fund to capital expenditures averaged 99 per cent for Texaco and 91 per cent for Socal, which indicated that both companies relied on self financing. Meanwhile, both companies distributed on average 29 per cent of their net income as dividends.

5.7 Mobil Oil Company[1]

Mobil Oil was the smallest of the U.S. international majors in 1966. In 1966, it possessed total assets of $5,511 million and had gross revenue of $ 5,887. Mobil produced less oil in relation to its operations and considered to be out of "balance" in the U.S., however, in foreign operations it produced slightly more than it refined. As Table II shows, in 1966, with production of 950,000 b/d the company produced nearly 5 per cent of the world's crude oil outside Canada, U.S. and USSR. Total production in 1966 was 1,318,000 b/d, about one-third of that of Jersey Standard's, and refining was 1,540,000 b/d, which indicated that it was not self-sufficient in crude oil supplies. At the same year, total sales of the company were 1,579,000 b/d.

Mobil Oil has very complicated history, with a number of mergers and acquisitions, which is not possible to describe in details, however, some important roots in evolving of the company are discussed in this paper.

In 1882, Standard Oil Company of New York (Socony), in which Mobil Oil has it roots, was formed and administered most of the foreign territories of the original Standard Oil Trust. The main task of Socony was the development of the export business, and it was very successful in the selling of kerosene in the Far East, where it built its own outlets. In 1911 Standard Oil Trust was dissolved and Socony was left with large marketing outlets abroad and in the U.S. and with several refineries, but with no crude-oil production. Further, in the U.S., Socony assured its crude-oil supplies by acquiring some local producing companies; marketing activities abroad was expanded in cooperation with other companies. Outside the U.S., the company assured its foreign crude oil supplies by acquisition in 1925 of an interest in the IPC, in which it shared 23.75 per cent ownership with Jersey Standard through Near East Development

[1] The following discussion, if other sources are not indicated, is based primarily on the Annual Reports and E. T. Penrose, "*The Large International Firm in Developing Countries. The International Petroleum Industry*".

Corporation. However, only in 1934, Socony started to receive supplies of oil from Iraq.

Meanwhile, in 1866, the Vacuum Oil Company was established and specialized in a world-wide trade of lubricants. In 1879, Standard Oil group bought the Vacuum Oil Company and in 1911, after the dissolution of Standard Oil it became independent again; till the First World War Vacuum Oil continued its operation in the field of lubricants, however, after the war, the automobile changed the demand of the market and Vacuum Oil extended its product line by including gasoline to it. In 1931, Socony merged with Vacuum Oil Company and the new company became called Socony-Vacuum.

After the merger, the new company, Socony-Vacuum, still had little crude oil supplies abroad to supply its large Far Eastern markets inherited from the old Standard Oil of New York. Consequently, in 1933, Socony-Vacuum and Jersey Standard merged their Far Eastern activities with each partner having 50 per cent interest and formed the new company called Stanvac. Stanvac joined crude-oil supplies of Jersey Standard with marketing outlets of Socony-Vacuum and soon became an integrated oil company in the Far East; further, Stanvac expanded its operations and was operating in 50 countries from the East Coast of Africa to New Zealand.

In the meantime, Socony-Vacuum continued to expand its operations in the U.S. and Europe. In 1934 Independent Oil of Altoona, PA and Metro Oil of Jamestown, NY were added to the company. It started operations in Eastern Venezuela and in Colombia. In 1948, Socony-Vacuum acquired 10 per cent interest in Aramco in Saudi Arabia; in 1950, the Company discovered oil in Canada; in 1954, the Company got 7 per cent interest in the Iranian Consortium.

In 1955, the name “Socony-Vacuum” was changed to Socony Mobil as the company concentrated on a name it could market across the U.S. In 1959, Magnolia Petroleum, a Socony Mobil affiliate made up largely of former Standard Oil Trust companies, was absorbed into Socony Mobil. In 1960, Stanvac was terminated and the assets of that company were divided between two parent companies in 1962. In 1966, the company dropped the Socony name and became Mobil Oil, thus dropping the last hint of its Standard Oil origin.

Mobil Oil, in comparison with other smaller majors, was rapidly moving its operations into international markets. In the 1960s, it operated in Libya, had interest in discoveries in Abu Dhabi through the IPC and made discoveries in off-shore Nigeria. Overall, in 1966, Mobil Oil had interest in crude-oil production in 15 countries outside North America. In 1955-1966 Mobil’s crude oil production increased by 114 per cent, refinery processing increased

by 92 per cent and sales increased by 77 per cent. In addition, it should be noted that most part of its activities was performed outside the U.S. and Canada; in 1966, 75 per cent of total crude production, 50 per cent of total refinery runs and 50 per cent of total sales of Mobil Oil was performed outside U.S. and Canada.

Furthermore, most of the foreign expansion activities were carried out by acquisition of several small companies and the company was largely self-financed. In 1955-1966, the ratio of retained fund to capital expenditures averaged 91 per cent. Meanwhile, Mobil Oil was steadily paying higher dividends in comparison to other companies; in 1955-1957 the average proportion of dividends to net income was 25 per cent, with highest 28 per cent in 1959 and 1959.

5.8 Compagnie Francaise des Petroles[1]

Compagnie Francaise des Petroles (CFP) was much smaller than any of seven oil companies discussed so far. However, because of early participation in the developing of the international petroleum industry, it is very often referred to as eighth "international major". The roots of CFP goes back to the earliest days of the development of the international oil industry, more specifically to the time when French Government, together with British, Dutch, German and American imperials, entered into rivalry for the controlling of productive territories of the Middle East. Before the First World War, Germans had 25 per cent interest in the old TPC. However, in 1920, according to San Remo agreement the German interests were transferred to the French, and the British and French obtained mandates over Mesopotamia and Syria. It is generally accepted that San Remo agreement considered as the starting point when France entered into the international petroleum arena.

In 1920, Societe Francaise pour l'Exploitation du Petrole, in which Royal Dutch/Shell had 41 per cent and Banque de l'Union Parisienne 59 per cent interest, was formed to held French interest in the old TPC. However, there was strong opposition in France because of Shell's participation and in 1924 CFP was established. At the same year CFP reached an agreement with French Government, according to which it acquired the right of controlling the French international petroleum interests, including its interests in the TPC. In 1927 oil in large quantities was discovered in Iraq and the French Government decided to adopt national policy for promoting oil industry. Consequently, it passed a law to encourage refining in France in 1928. Further, the Government took 25 per cent share of the CFP and formed a refining company – Compagnie Francaise de Raffinage (CFR). CFR became the part of the CFP, and its 10 per

[1] The following discussion is based primarily on E. T. Penrose, "*The Large International Firm in Developing Countries. The International Petroleum Industry*"

cent shares were held by the Government and 56 per cent by CFP. At the same time CFR was given the right to refine 25 per cent of the needs of oil distributors in France.

CFP for so long time directed its operations only to meet demand of France. However, after discovery of oil in Iraq in 1950, its production rose from 20,000 b/d in 1945 to 160,000 b/d in 1953. Meanwhile, in 1945, the Government formed a bureau to develop exploration programs in France, the colonies and protectorates. Further, CFP together with that bureau, which had access to large government funds, obtained large concession in Algeria, where the cost and any discoveries would be divided equally between them. In 1956 the greatest Hassi Messaoud oil field and in 1957 the Hassi R'Mel gas field was discovered in Algeria. In 1954 CFP obtained 6 per cent interest in the Iranian Consortium. Later, among the first companies, it took concession in Libya.

By the increase in the supplies of crude, the CFP moved toward the integrated operations. It started marketing of crude-oil in Japan and Europe and signed refining agreements in France and Europe. Further, CFP made very popular its "Total" brand and established distribution channels to sell its products under that brand in Europe, Africa and Australia.

In 1966, the Company had total production of 806,000 b/d from the IPC, the Iranian Consortium and Algeria, with a small quantity from Abu Dhabi and Canada. At the same year, CFP refined 520,000 b/d of crude and its sales of products reached 540,000 b/d.

6. The International Petroleum Companies in Developing Countries

6.1 The Government – Company Relationship

The modern petroleum industry was largely developed by the infamously called "Seven Sisters", seven large upstream oil companies of the Western world. However, while the major oil companies were exclusively U.S. and Western European origin, crude oil was massively concentrated in some countries of the Middle East and Latin America, and was owned by the governments of those countries.

Industrialized Western countries were dependent on the scarce resource oil, while most of them were not able to satisfy their needs on their own. Developing countries, on the other hand, were lack of the expertise and financial resources in order to explore their own resources, which, in turn, made them dependent on Western countries. More than often, as it is shown in Figure IV, this relationship developed into *"strange triangle"* between the companies, the government of the host country and the government of the companies' home country. According to Parra (2004), in narrow, legal sense, the relationship itself came to life by concession agreements[1], but "there were of course other dimensions to the relationship - political, commercial and cultural"

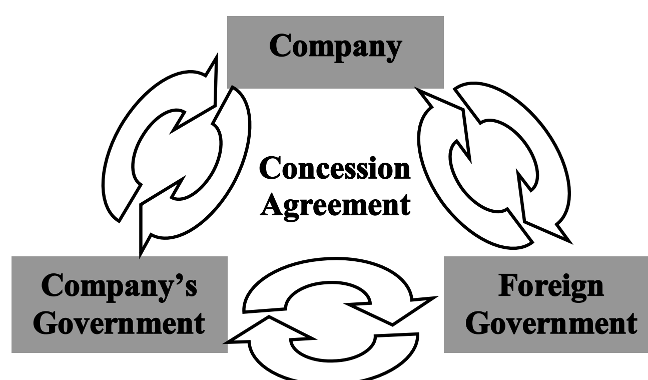

Figure IV: **Company-Government Relationship**

Since the earliest days of the development of the industry till the 1970s, according to Odell (1974), Venezuela and the four countries of the Middle East –Iran, Iraq, Kuwait and Saudi Arabia - were producing almost 90 per cent of

[1] See Appendix III

total world oil. Consequently, their interests dominated in the development of the international petroleum industry. Furthermore, after the Second World War many new producing countries had emerged and their interests also influenced the process of shaping the history of the oil industry.

Parra (2004) argued that there were two reasons for the struggle to control Middle Eastern and Latina American oil markets, even though they were politically unstable and volatile markets; Firstly, the crude oil in those countries was very cheaper than other sources of crude oil and, especially compared to sources in the U.S. Mancke (1975) also compared the cost of production in the Middle East and Western world and concluded that "total costs necessary to find, develop, and produce the typical new barrel of oil are less than 20 cents" in the Persian Gulf while the cost in the most U.S. fields "will be between $ 9 and $ 11 per barrel!". Al Kuwary (1978) too, noted that low cost of exploration was the main reason assured the high level of production. Thus, the control of those fields was very crucial for the developed Western countries and Parra (2004) stated that "whoever could control output was in a position to cash in on the huge economic rents to which this cost difference gave rise". Secondly, oil was perceived as a strategic recourse, and particularly after the Second World War many Western countries harshly increased their attention on its importance. Thus, the control of those territories was very important to maintain not just economic development but, also, dominant position of the Western Imperials and Parra (2004) stated that "whoever could control output was in a position to starve his enemies of a vital resource, and occasionally did so".

In almost all crude-oil producing underdeveloped countries the matter of foreign control had caused serious political conflicts. Many countries, and remarkably Mexico, Argentina, Brazil, Chile, Syria, Indonesia, Bolivia and Turkey, have insisted that their national resources should be exploited by the State Owned Companies. In some other countries the wave of nationalistic atmosphere and the dislike of foreign-dominated industry have caused serious problems for the international oil companies. In those countries the operations of the oil companies were restricted to refining, leaving distribution to the State owned companies, or in a case of distribution by foreign companies, they had been pushed to take their suppliers from State owned companies.

Besides to the major crude-oil exporting countries, many other countries were producing some crude oil and only some of them were self-sufficient and were importing crude-oil for the domestic consumption. Consequently, throughout the history, a large numbers of developing crude-oil importing countries, too, had different interests in the operations of the international oil companies. Commonly, those countries were looking for the cost minimization in their oil imports and development of domestic crude-oil suppliers.

Generally, the policies of the international oil companies were influenced not just by exporting countries, but also by developing importing countries. Each party – exporting as well as importing governments and the companies – was pursuing their own goals, which very often were contradicting and resulted in conflicts among them. In addition, the companies' home governments also very actively interfered to the activities of the major oil companies, sometimes forcing them to implement home governments' policies. All these made difficult and sometimes even impossible for the oil companies to do their own business, on one hand, and to maintain cooperative relationship with host governments, on the other hand.

6.2 Country specific considerations

In Africa, oil was discovered in large quantities in Algeria, Libya and Nigeria and exports from all three countries started to be important in 1958-1961. However, by that time, Algeria and France had close political relationship, which in turn affected the terms of the Algerian concessions. Consequently, the large international oil firms had played not significant role in the development of the oil industry of that country. Therefore, only Libya and Nigeria as oil exporting nations are further discussed. In addition, Egypt, which was self-sufficient, but sometimes importing crude oil and product in order to meet domestic demand is considered.

In Asia, oil in large quantities was discovered in the Middle East and Lebanon by the major international companies. Middle Eastern oil production dates back to the 1900s and it became the world's more important oil-producing and exporting region as soon as oil was discovered there. Even today, according to Parra (2004), there are thousands of oilfields in production throughout the world and "the reserves of the Middle East account for the two-thirds of the world's proved reserves". Persia (now Iran) was first leading nation in oil production in the Middle East, followed by Iraq, Kuwait, Saudi Arabia and later, United Arab Emirates. However, only Iran and Lebanon as oil exporting nations are discussed in this paper. In addition, India, Pakistan and Ceylon as major crude-oil importing developing countries are considered.

In Latin America, oil was discovered in Argentina, Chile, Mexico and Venezuela, and major oil importing nations were Brazil, Uruguay. However, only Venezuela, as a major Latin American exporter is discussed in this paper.

6.2.1 Libya

Libya was the biggest oil producing country in Africa. Developments of the oil fields of Libya were fully performed by the international oil companies and it was the only large exporting country that benefited much from the participation of the Companies in its industry. However, at the first, the terms of the

concessions were not favorable for the Libyan government. Exports started in 1961; in 1966 the production reached 1,050,000 b/d per day which was approximately equal to 13 per cent of total production of the Middle East and North Africa together.

The first oil law of Libya was formulated by the participation of the interested companies in 1955 and, thus, was very attractive to the operating companies. The government, in turn, initially deliberately granted such allowance in order to attract foreign companies to take the risk of exploration. According to Penrose (1969), the concession terms in Libya were not much favorable for the government compared to the other Middle Eastern countries, and it caused a lot of criticism from local community.

Further, in 1965, the Libyan Government was pushed by the OPEC to adopt the new tax regulation for the companies operating in it, even though, firstly, the companies opposed to accept that law. However, the Libyan government amended the Petroleum Law according to OPEC proposal and provided the provisions that any company refusing to change its existing concessions according to a new law would not be permitted to obtain any new concessions. Consequently, all of the companies operating in Libya accepted the new law.

Enforcement of the new Petroleum Law resulted in decrease of the profits of the oil companies by at least 35 per cent. Therefore, many of them turned to other producing countries and partly ceased their expansion programs. By that time, about eight groups of companies, embracing fourteen companies in all, were operating in Libya, many of which were achieving production for the first time. Thus, the overall production of that country did not decrease after the leaving of some companies or after ceasing their investments. Odell (1986) stated that Libya's rapid development of the oil production even after the enforcement of less favorable oil law occurred as a result of "the multi-company nature of the process of oil exploration". By 1969, its exports reached 3,000,000 b/d, which made Libya the fifth largest oil-exporting country in the world. According to Parra (2004) Libya nationalized its petroleum industry only in mid 1973.

6.2.2 Nigeria

In Nigeria, exploration for oil started as early as from 1938. However, the Second World War and some post war years delayed the development of the industry of that country. Therefore, oil was discovered in 1956 and export began in 1961. Nevertheless, production reached significant proportions only in 1961 and in 1966 reached 415,000 b/d, which made Nigeria the third largest producer in Africa, after Libya and Algeria. Shell and BP were two biggest producers in Nigeria; those two companies controlled about 70 per cent of the

total production of that country. Furthermore, only Shell and BP operated in Nigeria before the Second World War. Mobil was the first non-British company which came to Nigeria in 1955. In 1960 the country got its independence and many other companies were invited to develop Nigerian oil industry. According to Penrose (1969), the new companies entered into Nigeria in the 1960s were Gulf Oil, Tennessee Gas, Sunray DX, Sinclair, Texas Oil, Standard of California, Safrar (a French group), and AGIP and two of them, Gulf Oil and Tennessee Gas quickly found oil. However, Gulf Oil started it exports only from 1965.

Penrose (1969) stated that as in Libya, the financial arrangements with the companies were very unfavorable for the government compared to those of the Middle East. According to Odell (1986), the quick development of the Nigerian oil fields by the companies was due to very favorable petroleum law, provisions of which limited the government's revenues only to 35 per cent and that figure was almost half of that taken at the time by the major oil exporting nations. However, success in exploration resulted in intensive competition among oil companies and in 1966 Nigeria began to consider the issue of changing the terms of existing concessions. In January 1967, Nigeria also accepted and imposed the decree bringing tax and royalty arrangements more in line with the OPEC. Further development of the industry was interrupted by civil war of 1967. After the war, oil activities were fully restored in addition to the successful development of new oilfields and production reached 1,060,000 b/d in 1970. In 1971 production increased to 1,460,000 b/d and in 1974 to over 2,000,000 b/d, which made Nigeria the fifth largest oil-exporting country in the world.

6.2.3 Egypt

In Egypt, till the 1950s, production, refining, and distribution were totally in the hands of the international oil companies, especially of Royal Dutch/Shell. However, after the revolution in 1952, the Government started gradually to take control over the oil industry by giving strong support to State companies. In 1956, after the attack on Suez, General Petroleum Authority was formed to control imports and exports, production and refining. In 1957, the Compagnie Orientale des Petroles d'Egypte (COPE), jointly owned by the Government and ENI, was formed and it remained the most significant producing company till the 1968 in UAR.

Generally, exploration was permitted to other foreign companies, with a condition that in a case of discovery of oil, a company would be formed where the Egyptian State company would be entitled to 50 per cent interest. In this way, Pan America and Phillips started exploration, and discoveries of former were developed by the Gulf Suez Petroleum Company (GUPCO). Distribution,

also, was under the government control, however, Mobil and Esso had small shares in domestic distributions.

6.2.4 Iran

In Iran (former Persia), the Masjid-e-Sulaiman field had been discovered as early as in 1908 and British Petroleum (former Anglo-Persian Company) was formed in 1909 to develop those fields. In 1914, the British Government decided to convert its navy from coal to oil and made long-term contracts for fuel oil with BP. Thus, Iranian oil became very important for the Britain, the most influential western power in the Middle East in 1850-1950, as early as from 1914 and according to Odell (1986), "as a result of its close ties with Britain... Iran became the major oil-producing nation in the Middle East".

Since 1914 till the Second World War rapid development of oil fields in Iran did not interrupt and in 1939 it was already producing over 200,000 b/d. While those years, Gach Saran (1928) and Agha Jari (1938) giant discoveries were made. Further, after the Second World War, the international petroleum companies paid a little attention to the other Middle Eastern countries, such as Iraq, Kuwait and Saudi Arabia, and high trend of the development of Iranian oil fields was continued, thus allowing Iran to maintain its leading oil-producing position in the Middle East till 1951. According to Odell (1974), after the Second World War,

> "...disagreements between Britain, France and the U.S.A. over the political control and the development of the oil resources of other parts of the Middle East had delayed the expansion of production in other parts of the region".

Therefore in 1945-1950, high investment was made in Iran by BP and production rose from 320,000 b/d to 640,000 b/d.

However, in 1951 the Iranian Government nationalized its oil industry which led not just to cease the development, but also virtually stopped the production too. BP, which had an exclusive right to explore in that time in Iran, threat to take legal actions against any entity buying and using its Iranian oil and Iran lacked the ability to freely sell the oil produced. An agreement was reached only in 1954, and while those three years Iran was producing only 20,000 b/d required for the domestic consumption. An international oil market, on the other hand, while those three years was supplied from addition producing capacity established in Iraq, Kuwait and Saudi Arabia.

In 1953, an agreement reached between the oil companies and the Iranian Government lead to formation of The Iranian Consortium, where BP lost its exclusive right to explore in Iran, and several oil companies was brought into

that country. In addition, The Iranian Consortium established a new type of relationship between oil companies and government. Government retained ownership of the oil reserves and oil produced. New companies were allowed to produce oil in the fields of the former concessions of the BP and sell it abroad as contractors to the National Iranian Oil Company. Thus, from 1954 oil started to flow again from the existing fields of Iran.

In the 1960s the Iranian production was increasing with average rate of 15 per cent per annum. However, the Iranian Government was not satisfied with this rate of development. In 1966, the government argued that, the level of exploration, development and production should be related to the development needs of Iran, and particularly should be related to the total population that had to be sustained and provided for out of oil revenues. It also should be noted that, the suggested scheme by the Iranian Government was not new for the oil companies and, in fact, the oil companies established that principle in various countries. Controversies on this issue created a danger of a new upheaval in government-companies relationship.

In 1967 Iran insisted on at least 17 per cent rate of growth. This rate was physically possible given the known characteristics of the producing fields of that country and the companies, on the other hand, would not be challenged by increased production as they was exploring enormously successful. However, according to Odell (1986) they did not want to increase production for two main reasons; firstly, increase of their rate of offtake in Iran would mean decrease by the same rate in the other Middle Eastern countries. The other countries, with much less population than Iran, could not be expected to agree with Iran's proposal of relating development directly to the development needs of the local population. Secondly, oil companies calculated that to concentrate their oil development efforts in Iran would be more expensive than their in their several producing fields in the Middle East. Therefore, at first, the oil companies strongly opposed the proposal of Iran. Further Iran warned them to cancel their contractual rights and turn its face to the assistance of the Soviet Union. Consequently, the oil companies accepted Iran's proposal and in 1971 the overall production in Iran reached 4,000,000 b/d.

6.2.5 Lebanon

The historical development of the industry showed that not all of the countries of that period were eager to have control over their oil industry and to break the monopoly of the international oil companies and Lebanon could be a good example of those countries, who till 1967 was paying posted prices for its imports. Despite of small consumption (20 000 b/d) the country had two refineries with total capacity of approximately 34 000 b/d in 1969. Those refineries were built by the international oil companies and were subsidiaries of

Caltex, Mobil Oil and IPC. Furthermore, for the operations of those companies in the country, the Government assumed full protection of local market against imports and exempted them from all kinds of taxes and fees.

However, at that time, the crude-oil suppliers at lower prices than the posted prices were available in the world market. That fact resulted in a strong opposition of the refinery agreements and three of the most important arguments were related to the provisions of import at posted prices, to the exemption from all taxes and to the profit calculation method.

Nevertheless, the government gave to the international oil companies all kind of tax and fees exemptions and monopoly position in domestic market, with an intention to regulate refineries as a kind of public utility. Furthermore, the government regulated the prices in order to reach the "reasonable" rate of profit of 7.5 per cent for the operating companies. However, the subsidiaries of the international oil companies were purposely calculating rate of return by unusual accounting formula in order to produce the permitted 7.5 per cent rate of "profit". They were relating "net profit" to "gross assets", which is not usual way of calculating of rate of return, and were obtaining very low rate of return, that would not normally be accepted in accounting practice. Penrose (1969) noted that:

> "It is difficult to escape the conclusion that the companies took advantage of the political situation and their monopoly on the other hand, and of the lack of expert knowledge of the industry among the Government negotiators on the other, to charge prices in the Lebanese market considerably higher than would have yielded a properly calculated 7.5 per cent rate of return and one which made allowance for the discounts on crude oil prices that prevailed in world market."

Even though, till the end of 1967, despite of awareness of the government about abnormalities in the Refinery Agreements, Lebanon continued to pay for imports at the posted prices, exempted from all taxes and accepted the profit calculation formula.

6.2.6 India

In India, the idea of establishing the national refining industry on the imported oil evolved from 1928, however, the actions started to be taken only from 1954. Firstly, the international oil companies were unwilling to build refineries, arguing that India would not be able to compete with imported products. India, on the other hand, was anxious not only to reduce import costs, but also to get greater assurance of the national supply. After the Iranian crises in the1950s, from where more than 70 per cent of oil imports of India came, the companies

were not able to maintain needed supply and the Government insisted on building refineries.

Finally, three refineries was built by Burmah Shell, Stanvac (joint-venture of Jersey Standard and Mobil Oil), and Caltex (joint-venture of Standard of California and Texaco) in India in 1954-1957. According to Refinery Agreement reached among the international oil companies and the Indian government, the latter agreed not to nationalize the refineries for 30 years and to give the companies some exemptions on their operations. In addition, domestic prices were based on "import parity", the government paid for imported crude oil at "world market prices", and the most important, the international oil companies were free to choose their suppliers.

Soon, oil industry became one of the developing fields of the economy of the Indian government and the government decided to take that industry under the State control. For this reason it established the State-owned Indian Refineries Ltd. in 1958, the Indian Oil Company and The Oil and Natural Gas Commission in 1959. Meanwhile, the Indian government was very discontented with the pricing policies of the refining subsidiaries of the international majors in the late 1950s. This dissatisfaction reached its peak in 1960, when Russia offered crude oil to India on better terms than oil companies were importing to it, and, besides, the government knew that the same companies imported crude oil to Japan at lower prices than they did for India. According to Odell (1986), in 1960, India got offer from Russia at price 20 per cent less than the international oil companies were delivering. At the same year, the Government Committee on oil prices (Damle Committee) was appointed to inquire that issue.

In its first report in 1961, the Damle Committee criticized the policies of the refining companies by stating that they did not do their best to get cheapest crude-oil suppliers and did not acted in commercially independent way according to the freedom given them by The Refinery Agreements. In addition, the government had not been satisfied with the Companies' exploratory activities. According to Penrose (1969), despite of the large oil discoveries by the Burmah Oil, investments made in India were very small.

Consequently, it was very clear why the Indian Government decided to have its own refining industry. In fact, the international oil companies and their policies pushed the government to decide that industries of such importance should be State owned and under the control of the government, which in turn would make possible to the country to take advantage of cheaper suppliers, to make more investment on economy, etc. Establishment of domestic oil refineries was a gain to India, but, unfortunately that gain was reduced by the pricing policies of the international oil companies.

Lastly, in 1966, India was able to break monopoly position of the international oil companies and built up its domestically controlled industry by putting restrictions to the expansion activities of the private companies, by giving leading role to the Indian Oil Company and by assigning all imports to it, and, by completing the new Government Refineries.

6.2.7 Ceylon

In Ceylon, till 1962, the distribution of petroleum products and all distribution facilities had been solely controlled by the three international companies, namely, Caltex, Stanvac, and Shell, and the products were imported at posted prices from the Persian Gulf. In 1960, the government requested the companies to reduce import prices, but companies refused to do so by arguing, like they did in India, that the prices would force the desertion of "normal commercial pricing". As a result, in 1961, Government-owned Ceylon Petroleum Corporation (CPC) was formed, which expropriated some of the properties of the international companies and started its operations by importing oil products from Russia, at a price lower than those of international companies charged Ceylon.

Of course, as it was usual for such kind of disputes, in Ceylon also, the whole story was highly charged politically and CPC took over some selected parts of the companies' property in order to allow state-owned enterprise to enter into the business. The companies and their governments protested the expropriation and demanded compensation at "fair market value". However, the parties did not reach any agreement and the U.S. Government suspended aid to Ceylon in 1963 and the Ceylonese government expropriated the rest of the properties of the international companies in 1964.

6.2.8 Pakistan

In Pakistan, till the end of 1962, all oil products was imported and paid for at posted prices and the country had only one small domestically supplied refinery. At the same period, local private company Pakistani National Oil (PNO) was created as the way of reducing the country's dependence on the international oil companies and possessing greater control over the oil industry. However, exploration was carried out by the assistance of Russia, and the government had equity interests in local production and refining.

In 1962, Pakistan already had two big refineries in Karangi near Karachi and in Chittagong. The former was formed by 40 per cent of local capital and the rest by Esso, Shell, Caltex, and Burmah Oil, which were supplying the crude oil. The latter was formed by 70 per cent of Pakistani capital and the rest by

Burmah Oil, and the government had the right to supply a half of the crude-oil to the refinery.

Pakistan also had conflicts with the international oil companies over the prices of the supplied crude-oil, but it sold it in more diplomatic manner as compared to India and Ceylon. Crude-oil to refinery in Karangi was imported at "competitive prices" by the international oil companies. According to the Refinery Agreement, in a case if the Government was offered lower price crude oil, those companies would accept that offer. However, despite of availability of lower price suppliers, none of them were willing to supply that refinery, knowing that their offer would force the existed suppliers to reduce the prices. Consequently, the government benefited not much from the provisions of that agreement and, in 1965 the refinery was offered the crude oil by local company at the prices lower than those of the supplying companies. Despite of opposition of the international companies, the government insisted on taking that crude oil, and finally, in August 1965, the companies also reduced the prices for the crude-oil. For the refinery in Chittagong, PNO had sole right to import products and, in fact, it was importing it at very low price

In this way, the Pakistani Government took control over its oil industry, without discriminating the existing rights of the foreign companies. However, according to Penrose (1969), for some periods, Pakistan also had been pushed by the monopoly of the international oil companies to pay higher prices for its crude-oil imports comparing to countries with higher degree of freedom of actions.

6.2.9 Venezuela

Growth of the Venezuelan oil industry dates back to the 1900s. The first oil in commercial quantities was discovered by Royal Dutch/Shell in 1914 (Penrose, 1969). According to Odell (2001) Venezuela was the first nation which underwent "a meteoric rise to significance as a major producer and exporter" of crude-oil. However, the international petroleum companies turned their major attention to Venezuela only after 1938, when Mexican government expropriated their properties. Thus, since the 1940s, Venezuela became of more importance to major oil companies than the whole of the rest of Latin America put together. Penrose (1969) discussed that in the 1970s, the total investment by the Companies in Venezuela reached $ 4 billion while in the rest of Latin America it totaled only to $ 1,5 billion. Furthermore, those companies were earning on average $ 400 million after-tax profits in Venezuela compared to just $ 80 million from the rest of Latin America.

Major companies' early search for oil in Venezuela took place under extremely favorable political circumstances. According to Odell (1986) two main

circumstances made possible the rapid expansion of Venezuelan oil industry. Firstly, after Mexican expropriation of 1938, Shell and Esso - the main companies involved in Mexico- lost some 300,000 b/d production from that country. Therefore, they needed to develop enough oil-producing capacity as quickly as possible to replace their production from the Mexican fields. Secondly, rapidly growing oil demand of the wartime U.S. made it impossible for its domestic oil industry to meet the oil needs, which, in turn, gave greater stimulus to many oil companies to search for new sources of supply for the U.S. Because of Mexico's expropriation, its oil was embargoed by the U.S. and the only nearest external source of supply left was Venezuela, where the oil companies directed all their efforts. As a result, production in Venezuela rose from 400,000 b/d in 1937 to 600,000 b/d in 1941.

The post-war period, also, was very successful for the activities of the major companies. Firstly, as it was in pre-war period, politico-economic environment was again highly favorable for the investment in petroleum industry. At that time Venezuela was ruled under the dictatorial regime and Odell (1974) stated that that regime welcomed investment in oil "as a means whereby those individuals close to the regime could amass private fortunes". Secondly, in post-war period, there were general difficulties over energy supplies due to dislocation in many coal-producing areas. Consequently, the demand for the alternative supply sources such as Venezuela grew rapidly. Those two factors ensured continuation of the development of Venezuelan crude production as well as exports from the 1940s up to 1957. In 1946, its production reached over some 1,800,000 b/d, which made Venezuela the world's most important oil exporter until 1970. After, this position was given to Iran and Saudi Arabia.

While those twenty post-war years of growth of oil industry in Venezuela, the international oil companies only once, just for some months, have faced the potential political threat. In 1948, a leftwing party – Accion Democratica- came into the power. The leaders of that party called for the nationalization of the country's oil resources. The international oil companies reacted to the new Venezuelan Government's policy immediately; they decreased their investment and level of production. Thus, the fear of companies to invest into Venezuela resulted in dropped supply of crude to international markets from that country. However, after some months of ruling, Accion Democratica was overthrown. The political system of Venezuela was reverted to military dictatorship and lasted almost for ten years. While those years the oil companies began to benefit again from favorable political system. The oil production was again established on its strong upward trend at average rate of increase of 10 per cent per annum – about 25 per cent higher than the rate of increase in world demand. From 1948 to 1958, the Companies were lifting from 1,500,000 b/d to 3,000,000 b/d from Venezuela.

In 1958, Accion Democratica again came into the power. Despite of electoral manifesto calling for the ownership of the oil industry, after getting into the power, new government did not take any radical actions against the oil companies. In fact, by that time, the government was completely dependent economically on the oil industry. Penrose (1969) stated that, in those years oil industry accounted for 90 per cent of exports, for 60 per cent of all government revenues and for 20 per cent of GNP. Thus, the government's freedom of action in economic terms was heavily constrained and no steps leading to closing oil industry could be taken. However, in early days in power, the new Venezuelan government partly increased taxes and changed royalty arrangements, and achieved wage increase of the workers in the oil industry. This, in turn decreased the companies' income level from 45 per cent to 35 per cent.

The companies, on the other hand, were benefiting from low-cost supplies in the Middle East by 1958. Accordingly, they did not have any incentives to invest into the expansion of their activities in Venezuela. Furthermore, transportation cost from the Middle East was relatively low as compared to Venezuela. The companies just were willing to retain their Venezuelan production as the source of alternative geographical supplier. However, by that time, the oil companies were under the pressure of the U.S. State Department, which wanted to achieve the stability in the whole Caribbean area and strongly believed that it was possible only through the stability in Venezuela. But, stability in Venezuela could be achieved only by expansion of its oil industry. Thus, the policies of the oil companies were pushed toward achievement of the foreign policy needs of the U.S., which required oil companies to make it possible for Venezuela to attain its objectives of continued economic growth. All these, as noted by Odell (1986) demanded from companies to cooperate with Venezuelan government, which "they certainly disliked and probably distrusted" and because of no other acceptable alternative "they [Companies] could certainly not think of overthrowing as they had done in 1948".

Consequently, oil production in Venezuela after 1958 continued to expand, although it was not as rapid as in the pre-war period. In 1958-1973, Venezuela achieved an average 3 per cent annual growth rate in oil production compared to its average 10 per cent annual growth rate in past fifteen years and to an average 7 per cent growth in the world demand. Its production of 2,840,000 b/d in 1958 accounted for 17 per cent of world total while production of 3,640,000 b/d in 1972 was only 7 per cent of the total.

After 1972, the Venezuelan Government was mainly concerned with price level of its oil. Furthermore, it wanted to reduce the State's largely dependence on oil revenues. Having those strategies as a guide, it continuously tried to raise revenues from crude-oil exports and completely ceased granting of concessions. The companies, on the other hand, were unwilling to invest new

funds into Venezuela as their concessions were due to be terminated by 1983-1984. However, small investment was made in order to maintain enough level of production for extraction the profits of their past investments. This kind of relationship between the government and the companies lasted till 1 January 1976, when the properties of the international oil companies were expropriated.

7 Findings and Analysis

This chapter describes the general findings on the development of the international petroleum industry and international petroleum companies within it and the relationship between the oil companies, oil companies' governments and host governments, and analyses those findings.

7.1 Development of International Petroleum Industry

Early development of the international petroleum industry started as early as from the 19th century and was fully developed by struggle between Americans and Europeans for the control of oil reserves; In America, the development of the petroleum industry started with the formation of Standard Oil Trust, which while short period of time attained a monopoly position in American market. In Europe, the development of the petroleum industry began with the support of the Dutch and British Governments as well as with the interests of Nobel brothers, Rothschild and a group of Russian independents. In the Far East, American, Dutch and British Governments competed with each other for the control of the oil production, which led to their mutual cooperation and control via several marketing organizations and jointly-owned affiliates. In the Middle East, the producing territories were more important than markets. Thus, Western firms as well as their governments struggled for the control of those territories. Total production from Iran (former Persia) and greater part of production of Iraq were controlled by British through BP (former APC). In the Ottoman Empire, German, British and Dutch had political domination through jointly owned Turkish Petroleum Company; however, later the Germans lost their interest to France and several American companies entered into that territory. Venezuela was one of the world's major oil producing countries from the earliest dates of the development of the industry. First oil was discovered by Royal Dutch/Shell in 1914 and the further development of its oil fields was performed by the same large oil companies, except British Petroleum. Furthermore, American Government was broadly interfering into internal policies of that country.

This trend of control by the majors was maintained till the Second World War. Indonesian production was in the hands of Shell; Iranian production was completely controlled by British Petroleum; Iraq's production was divided among the Anglo-Iranian, Royal Dutch/Shell, Compagnie Francaise des Petroles, and Near East Development Corporation; Saudi Arabia and Kuwait's production were wholly controlled by the U.S. companies; Venezuelan production were largely controlled by Standard and Shell.

During the *Second World War* almost no further expansions in crude-oil production took place. However, soon after the war the production in the Middle East began to grow; in 1950 the production in Saudi Arabia reached 548,000 b/d per day, in Kuwait 345,000 b/d per day and in Iraq 137,000 b/d per day. Accordingly, in the 1950s, the international oil companies still had dominant position in the international oil industry by owning over 70 per cent of the world's refineries, every important pipeline and 65 per cent of the world's privately owned tanker fleet. Furthermore, the companies were regulating the rate of supply and the level of prices, which in turn contributed to enormous profits earned by them.

Post-War period characterized by changed attitudes toward the dominant Western powers; newly independent Afro-Asian governments as well as their people began to protest the Western Colonialism and Imperialism, which in turn, weakened the moral and political influence of the West. Furthermore, the governments of those countries began to insist on more royalty payments, and as a consequence, firstly in Venezuela and later in Saudi Arabia, Kuwait, and Iraq a 50/50 split of profits between the concessionaries and the governments were introduced. Parra (2004) stated that "the 50/50 deals doubled government revenues in the Middle East from 30-40 cents per barrel to 65-75 cents". Meanwhile, Iran was the only country where the British were not able to solve the dispute between AIOC and the Iranian Government and which expropriated the properties of that company. Further, this conflict was solved by the Iranian Consortium in 1953. Penrose (1969) discussed the reasons of the Iranian Nationalization of 1951 and concluded that it was outcome of "the British Government's discriminatory policy against Iran" which requested "AIOC to limit its dividend payments to the Iranian Government". In general, the pre- and post war periods, till the late 1950s, considered as the years of cooperation and control of the international oil companies.

Beginning of the 1960s described as *the growth of the markets and competition* in the international oil industry. World oil demand reached 57 million b/d in 1970; world oil production equaled to 60 million b/d in 1975. Many new "independents" entered into the scene of the international oil industry; supply and prices were not totally controlled by the major oil companies any more. Major companies, on the other hand, entered into competition among themselves, which in turn basically distorted the government-company relationship. The governments of the crude producing countries began to claim more financial returns and more domestic control and participation in the activities of the oil companies. They believed that having shares in the local producing companies, in addition to the financial benefits, would make those companies better operate in the national interest and their profits could be more effectively directed toward future economic development of the government. According to Penrose (1969), in a number of new concessions governments was allowed to buy shares in the local company. Thus, the governments

obtained an equity share of the profits of the companies in addition to income taxes. For example, in the NIOC-AGIP (AGIP is a subsidiary of the ENI) agreement (1957) the equity share was 50 per cent; in the Kuwait-Shell agreement (1961) it was 20 per cent. Depending on agreement, government either paid relative part of the company's profit or received dividends on its holdings in that company. In either case the government received bigger revenues from producing companies and might then use it either for general expenditures or reinvest in other industries.

By the beginning of the 1960s, the major oil companies began gradually to lose their dominant position in the international oil industry. The competition between themselves and with "new entrants", on one hand, and increased bargaining power of the governments of oil exporting as well as importing countries, on the other hand, weakened the ability of the international oil companies to effectively balance the supply of crude oil in the world.

Imbalanced worldwide supply of oil, in turn, led to the sharp declined of prices in 1958. The oil companies, as a response to the price decline, cut their "posted prices", which led to reduced payments to the crude-oil exporting governments. Consequently, Venezuela, Saudi Arabia, Iraq, Iran and Kuwait joined together and formed *OPEC* in 1960. According to Penrose (1969) "formation of OPEC should be characterized as a direct reaction of crude-oil producing countries to the 1960 cut, and from that time the companies lost their freedom to adjust posted prices, even if they go beyond the realized prices" .The main intention of OPEC countries were collectively enhance their bargaining power by standing together in order to prevent companies from using their monopoly power to influence revenues of those states. Therefore, the primary objective of OPEC was to restore posted prices to 1958 level. However, Penrose (1969) argued that, in fact, the companies cut posted prices in order to keep their profits, but they could not either raise them again or even enforce their effectiveness in the world oil market.

Meanwhile, the crude-oil importing developing countries also believe that having State owned refineries instead of the local refineries of the subsidiaries of the major companies would be more materially beneficial for the domestic economy. Crude-oil and oil products were imported from the international oil companies at very high prices. The prices of those products were set by the suppliers - International Oil Companies - which in turn was not willing to cut prices; furthermore, oil companies wanted to retain their dominant position in developing crude-oil consuming countries. Penrose (1969) stated that with a changing situation in world oil markets, the best way for the oil importing developing countries, particularly India, Pakistan and Ceylon, "to cease their exploitation by the international oil companies" was nationalization of oil industry and establishment of National Oil Companies. However, after nationalization and establishment of the State owned companies, almost all

importing countries needed the additional financial resources to continue operations. For this reason need for the aid and borrowings from the international financial organizations was very high. However, and oil companies, and international financial organizations, and the developed Western countries refused to assist to poor and developing countries. Odell (1986) stated that:

> "Since oil became such a dominant source of energy for most developing countries, it would appear to have been almost self evident that the financing of refineries would be viewed equally favorable by the international agencies. On the contrary, however, until the late 1960s-that is, until after fifteen years of aid and development programmes – no capital for refinery construction was made available for such purposes, either from the international organizations, such as the World Bank, or within the framework of bilateral aid from western nations, such as the credit extended through the U.S: Aid Programme".

As an example, the U.S. Government suspended aid to Ceylon because the latter nationalized its oil industry in 1964. According to the U.N. General Assembly Resolution[1], it was the right of the Ceylonese government to nationalize its oil industry, since the industry was controlled by the international oil companies in a manner contradicting to the national interests of that country. According to Penrose (1969), the "Hickenlooper Amendment" of January 1962, on the other hand, required the president to suspend aid under the Foreign Assistance Act to any country nationalizing American property. Thus, such retaliation might be serious if the country was dependent upon (or hoping for) economic aid in promoting its development. In fact, Ceylon needed the aid from the U.S. in order to develop its economy. Meanwhile, to attain economic development, it did not have any other choice except to take control over its oil industry, where "unfortunately" were operating American companies. Thus, a lot of questions arise from analyses of Ceylonese case; should Ceylon act according to its lawful rights under the UN Resolution or should it to consider the consequences of its actions under the U.S. law in choosing its economic system as sovereign State?; possibly, Ceylon should act according to the law of the most powerful entity, then, what is the criteria for comparison the power of the U.N. Resolution and the U.S. law?; or, maybe both laws are the different sides of the same coin called Western Imperialism, where one (U.N) enforces the charter of economic rights and duties of powerless States and the other (U.S.) enforces the laws refraining those States to freely exercise their economic rights and duties?, or maybe Ceylonese Government should not even think about its economic development and should allow the international oil companies to continue its exploitation by charging higher prices for its imports? The aim of this paper is not answering those questions, however, the findings of this work shows that after the U.S. ceased its aid, the Ceylonese government faced severe problems in foreign exchange

[1] See Appendix I.

and balance of payment, which in turn led to poverty and backward economic development.

However, in the late 1960s, despite of increased power of the oil exporting countries and relatively weakened position of the major oil companies, the seven majors were still having dominant position in the international oil industry. In 1966, *Standard Oil Company of New Jersey* with production 4,109,000 b/d was the biggest company, followed by *Royal Dutch/Shell Group* with production 2,981,000 b/d, *British Petroleum* with production 2,500,000 b/d, *Gulf Oil Corporation* with production 2,293,000 b/d, *Texaco* with production 2,263,000 b/d, *Standard Oil of California* with production 1,731,000 b/d and *Mobil Oil Corporation* with production 1,318,000 b/d. In addition to those seven majors, Compagnie Francaise des Petroles with production 806,000 b/d was the eighth important oil company because of its early participation in the shaping of history of the international oil industry.

7.2 The International Petroleum Companies in Developing Countries

The activities of the *International Petroleum Companies in Developing Countries* took place in a form of "strange triangle", where the relationship between the company and its home company, on one hand, and the relationship between the company and its host country, on the other hand, had existed. The policies of the host governments (crude importing and exporting) as well as the policies of the companies' home governments greatly influenced the operations of the international oil companies. Odell (1986) noted that:

> "This made for a strange kind of relationship between investor and host country, and one imbued moreover with colonialistic overtones, since some of the countries had been colonies or protectorates of Britain, or were in some sense client countries of either Britain or the United States and concession agreements signed with those countries were outside the jurisdiction of the host countries".

In fact, the companies' home governments used to control the subsidiaries in the foreign countries in order to achieve political targets. For example, according to *Petroleum Press Service* (1962 cited Penrose 1969) an American oil Company (Caltex) did not supplied a British ship with lubricating oil at Japanese port, which were carrying Cuban sugar to the Russia. Of course, that was a result of political difficulties between USA and Cuba. However, this discrimination of Caltex among its customers according to the policies of parent government was not welcomed by the host government, which in turn led to the conflicts among the Companies and the Governments where they operate.

Furthermore, the companies' home governments, in order to improve their balance of payments, requested the oil companies to cut their investments to foreign countries and send home more of their earnings resulting from foreign operations. All major companies discussed in this thesis was pushed by their governments to cut their investments to the country from where they earned profits and send them back to home country.

For example, *Standard Oil Company of New Jersey* stressed in its Annual Report that the main goal of its activities was to contribute as far as possible to the U.S. balance of payments and highlighted that "in every year after the Second World War, the flow of new investment abroad has been more than offset by the inflow of income from earlier investment". In 1964 Jersey Standard's net contribution to the U.S. balance of payments exceeded a third of billion dollars, with still greater amount reported for 1965. In addition, Penrose (1969) stated that

> "...in spite of international character of its operations, Jersey is very American in its outlook, with all that this implies for its foreign policy, for its attitude towards government social and economic measures, and for its views of the relation between big business and government..."

Thus the company considers that spreading of appropriate ideology is one of its tasks.

The *Royal Dutch/Shell* was also a net contributor to the balance of payments of the parent countries; its net credit to the U.K. balance of payments was some $ 252 million between 1961 and 1966, and to the Dutch balance of payments some $ 100 million between 1956 and 1966. Besides, Penrose (1969) noted that "because of the restrictive policies pursued by both U.S. and U.K. Governments after 1964 in the attempt to strengthen their respective currencies, the Company [Shell] began to resort to capital markets for funds".

British Petroleum, as well, was pushed to borrow large amounts of money abroad in the 1960s. After 1964 BP's capital expenditures rose sharply in comparison in earlier years and long term debt jumped from $ 260 million to $ 512 million between 1964 and 1966. According to Penrose (1969) one of the reasons was the foreign investments restrictions of the British Government in the interest of the balance of payments.

Mobil Oil Corporation was largely self-financed; however, according to Penrose (1969) it too had gone to the market for funds in the 1960s, and "particularly to European capital markets in view of the pressure on American Companies by their Government to reduce the drain of foreign investment on U.S. balance of payments".

The international oil companies were weaker than their home governments, and the former was not able to effectively fight against the latter's pressures and had no any other choice but just pursue the discriminatory policies of home governments. However, the international oil companies was much stronger than more of the developing oil producing and importing countries; it was found that very often the major companies themselves, without external pressures, were discriminating against those countries by using their monopoly power.

For example, in the beginning of the 1960s, the conflict between India, Pakistan and Ceylon and the international oil companies occurred over prices of the imported oil products and over the building of refineries in those territories. The oil companies solved those problems with India and Pakistan, because those countries had attractive markets for the oil products. However, in Ceylon, the international oil companies did not have much incentive, compared to India and Pakistan, to reach an agreement over "price" issue because their investment in that country was not so big. In addition, because of monopoly of those companies, Ceylon simply was forced to pay higher prices for their imports while other suppliers with low prices were available. Penrose (1969) found out that:

> "…the Companies were very clearly using their monopoly position in Ceylon to try to maintain prices there while giving way elsewhere. This was, equally clearly, a discriminatory exploitation of the country".

The only justification which the international oil companies could give for their high prices was that they were "commercial". In addition, the companies rejected to lend, lease and sell tankers or other facilities to the Ceylonese government in order the CPC could start its business.

Moreover, international borrowing agencies also refused to open line of credits for less developed oil importing countries to build up refineries. Thus, the decisions of those agencies not to give loans for developments of this sort were suspected to be the result of pressure from the international oil companies which were anxious to maintain their positions in developing countries. Odell (1986) stated that:

> "The developing countries saw the denial to them of official loan-funds for refinery construction as one of the strategies employed by the oil companies in their role as neo colonialists".

Furthermore, in Venezuela, the international oil companies were not in favorable position in 1948, when the Democratic Party came into the power and demanded from the oil companies more contribution to the national

economy. After a short period of democratic rule, the country reverted to a military dictatorship and the oil companies began to benefit again from the dictatorial and corrupted political situation in Venezuela. According to Odell (1986) this reversion "was almost certainly only made possible so quick with the active help of at least some of the oil companies involved in Venezuela".

In addition, the international oil companies themselves were not willing to invest big amounts into the developing oil producing countries, which would lead to further economic development of those countries. Instead, the companies were investing the profits earned from the less developed countries to the expansion activities in their home countries. For example, it was found that, in the 1950s, expansion of the Gulf Corporation's operations in the U.S. was possible from profits made in Kuwait. According to Penrose (1969) in 1955, Gulf's Chairman of the Board told to the U.S. Senate Committee that:

> "…Kuwait does give Gulf very remarkable profits. Against those profits which we have been able to retain in the company, we have put quite a number, hundreds of millions of dollars, into exploration here in U.S. and into the development of our reserves here which would not have been possible for us to do but for that income from out there…"

Country specific considerations revealed that in almost all crude-oil exporting as well importing developing countries the matter of foreign control by the international oil companies had caused serious political conflicts. Almost all of them insisted on establishment of National Oil Companies to control their oil industry. Nerveless, only some of them took radical actions and expropriated the properties of the international oil firms without prompt and adequate compensation. All the rest solved the conflict in more diplomatic ways.

In Africa, Libya and Nigeria as crude-oil producing and Egypt as crude-oil importing country was considered. It was found that in Libya and Nigeria, at the beginning the terms of the concessions were very unfavorable for the governments of those countries. However, Libya benefited most from the operations of the international oil companies, as its main aim was to increase the rate of development of its oil fields. Both countries, Libya in 1965 and Nigeria in 1967, amended the existing tax and royalty laws more in line with OPEC, which led to improved terms of the concessions in favor of the government. Egypt, was self-sufficient in production for the domestic consumption, however it sometimes needed to import in order to meet increased demand. The oil industry of this country gradually became State owned without any serious conflicts with the international oil companies.

In Asia, Iran as crude-oil producing and Lebanon, India, Ceylon and Pakistan as crude-oil importing countries were considered. Iran was the first nation in the Middle East which became an important oil-producing country. Its oil

fields were continuously developed and production was increasing since the first oil was discovered in 1908. However, for short period between 1951 and 1953, due to its nationalization of the oil industry, Iranian production totally stopped, except small quantities for the domestic use. India, Pakistan, Ceylon and Lebanon were the primarily importers of the crude oil. At first, however, those countries did not have their own refiners, which after prolonged negotiations were built later by the major companies. Further, those countries were pressed by the monopoly of the major companies to pay their crude-oil imports at "posted prices" which were higher than normal market prices. Disagreements between the governments and companies started to be obvious from 1960 and Ceylon in 1964, Pakistan in 1965 and Indian in 1966 nationalized their oil industry. Lebanon, on the other hand, still was welcoming the oil companies and exempting them from all kind of taxes till the 1970s, and the companies were using their monopoly power and charging Lebanon higher prices for its oil imports.

In Latin America, Venezuela as major crude oil exporting country was described. The development of the oil industry of that country dates back to the 1900s and in between 1946 and 1970 it was the world's most important oil producer. Like in the other parts of the world, in Venezuela too, the petroleum industry was developed by the major oil companies and their earliest as well as the post war period search for oil in Venezuela took place under extremely favorable political circumstances. While all that period Venezuela was ruled under the dictatorial regime, which welcomed investment in oil. Before The Second World War, the oil companies lost their properties in Mexico, which led to increased attention to the Venezuelan fields and after the war, the increased demand for the oil in the world led to rapid expansion of the Venezuelan fields. However, the companies had faced the difficulties with the government for two times, in 1948 and 1958, when Democratic Party came into the power and claimed from the oil companies more concentration on economic development of Venezuela. In 1948, the democratic regime was soon overthrown and the country converted into dictatorship and the companies again favored from policies of the Venezuelan government. In 1958, the U.S. government interfered into policies of the oil companies by requesting them to make it possible for Venezuela to attain its objectives of continued economic growth. Thus, the development of the Venezuelan oil fields almost have not been interrupted since its earliest days of evolvement and the international oil companies were continuing their operations till 1976, when they was expropriated. In fact, U.S. was not concerned with the economic development of Venezuela. It just wanted stability in all Caribbean regions after the Cuban crises, which was possible only with stability in Venezuela. Odell (1986) in his study of Latin American oil industry stated that:

"...the Cuban crisis and resultant pressures by the U.S. State Department can be seen as the main factors which saved the Venezuelan oil industry from serious decline in the 1960s..."

8 Conclusion

This chapter provides insights and concluding remarks on the impact of the multinational corporations in the petroleum industry on economic development in selected developing countries of Asia, Africa and Latin America by taking a closer look at the analysis of theoretical framework and empirical study. It also clarifies the objectives related to the purpose of this thesis.

Dependency Theory, presented in the theoretical framework, divides the world into developed capitalistic countries and underdeveloped poor countries. It suggests that the developed countries are continuously extracting "surplus" from the undeveloped countries by exploiting them. Thus, surplus extraction is seen as one of the reasons for not development of poor and backward countries. Furthermore, Dependency Theory suggests that, international firms are one of the means of the governments of developed imperialistic countries to extract the "surplus" from the developing countries. According to the theory, multinational corporations have always been taking an active role in the process of exploitation of the developing countries through the process of surplus extraction. This research reveals that, not just developed imperialistic countries, but also multinational corporations themselves in the petroleum industry were extracting surplus from developing countries. However, the reasons of not development of less developed can not completely be charged to multinational corporations since they were actually contributing to the economic development of the less developed countries.

The empirical study shows that the pressures of the developed Western countries on the policies of the international oil companies hampered the economic development of the less developed countries. All of the discussed oil companies were pushed to contribute to the balance of payment of their home countries which in turn limited investments in the less developed countries. Furthermore, intervention of home governments on the internal policies of the oil companies led to conflicts with the governments of the less developed countries. The research shows that conflicts in Iran and Ceylon were the results of the discriminatory policies of the U.S. and Britain against those countries. However, in Venezuela, the pressures from the U.S. Government on the international oil companies saved from decline oil industry of that country. Thus, this study allows concluding that very often the multinational oil corporations were the means of achieving the goals of the governments of the developed Western countries.

This research confirms that very often the policies of multinational oil corporations caused an exploitation of developing countries. Factually, the firms had established a monopoly type of market, where they refrained from competition with each other and controlled the rate of supply and prices till the

1960s. Of course, due to very weak position of many governments of the developing countries vis-à-vis multinational corporations, the former was not able to effectively fight against the monopoly established by the multinational oil companies. Hence, it is difficult to escape from conclusion that as a consequence of monopolistic control of the industry by the major companies, the economies of the developing countries were hardly damaged.

It is also apparent from this paper that the policies of developing countries towards oil companies led to restrictions on promoting an economic development. Indeed, after formation of OPEC, the major oil companies lost their dominant position in the world oil industry. Oil exporting countries began to dictate their rules and by pressures on the international oil companies they improved the terms of concessions and almost doubled oil revenues to the government. However, lack of managerial and administrative expertise, corruption and political interference into the policies of the oil companies prevented the economic development of the less developed countries.

The principal conclusion related to the research issue is that the multinational corporations in the petroleum industry were pursuing their goals of profit maximization by not taking into account the national interests of the less developed countries till the 1960s. After the formation of the OPEC in 1960, the greater power was obtained by the governments of the less developed countries that also did not contribute much to the economic prosperity of those countries. Furthermore, the policies of the multinational oil companies were greatly affected by the interests of different countries, both developed and undeveloped. Thus, multinational oil companies can not wholly be blamed because of the fact that many less developed countries considered in this research are not economically developed.

Finally, it worth to note that multinational oil corporations could make greater contributions to the economic growth and development of all countries than they were making provided that some of the sources can be eliminated of international discrimination and of conflict between their own interests and those of their parent countries on the one hand, and the interests of other countries in which they operate on the other.

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Selected definitions

Actual economic surplus - is the difference between society's actual current output and its actual current consumption and is equal to the current savings or accumulation.
Balance of payment
Bonus – is the initial payment at the time of signing an oil concession agreement, or payments paid according to some other conditions, such as level of production, discovery of oil, etc.
Capital risk - determines the degree of losses that can be experienced by the firm before the creditors will start experiencing losses
Concession – refers to exploration and production agreements between the companies and governments.
Credit risk - the risk that clients will be unable to pay for goods and services received.
Dependency – is an unequal international relationship between developed and less developed countries.
Economic surplus – the difference between total production and total consumption.
Expropriation - is the official government seizure of private property.
Financial risk – includes credit, liquidity, interest rate, and capital risks.

Foreign exchange risk – is the risk attributed to foreign activities and can raise the cost of capital and lower the optimal debt ratios.
Globalization – is the process of universaliation of market economy and relations.
Import duties – is duty on imported crude oil
Interest rate risk - is the risk that changes in the underlying interest rate will increase a firm's interest costs.
Liquidity risk - is an inability of the firm to meet its short-term obligations.
Macro risk - are country-specific risks that affect all foreign firms in a country without considering what they do.
Macrocosmic system - represents developed capitalistic countries and it is economically more powerful, stronger and better organized.
Metropolitan (centre) – represents developed countries.
Micro risk – is the firm-specific risk that is specific for the particular industry, project or firm.
Microcosmic system – represents less developed countries and it is economically weaker and poor.
Monopoly - is the well-defined market with one single supplier.
Monopoly power – is the ability to sell at a price well above the cost.
Multinational Corporation - an entity that has large number of operating assets in different countries, through branch, subsidiaries or affiliates owned wholly or partly.
Oil revenue – considered all revenue received by the states from all aspects of oil exploration, exploitation, and refining. These receipts appear under different headings, that is, royalties, income tax, and other payments.
Periphery (satellite) – represents less developed countries.
Political risk – is the risk attributed to foreign activities and arises in the relatively unstable countries and in countries with new emerging markets.
Potential economic surplus - is the differences between what could be produced by available natural, technological and human resources, and what might be considered as essential consumption.
Rent – is payment made annually in accordance with the concession agreement.
Surplus extraction - is the way by which the macro system exploits the micro system.

Appendix I: Charter of Economic Rights and Duties of States

ARTICLE 1

Every State has the sovereign and inalienable right to choose its economic system as well as political, social and cultural systems in accordance with the will of its people, without outside interference, coercion or threat in any form whatsoever.

ARTICLE 2

1. Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.

2. Each State has the right:

(a)To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws, and regulations and in conformity with its national objectives and priorities .No State shall be compelled to grand preferential treatment to foreign investment;

(b) To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, co-operate with other State in the exercise of the right set forth in this subparagraph;

(c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually asgreed by all State concerned that other peaceful means be sought on the basis of the sovereign equality of State and in accordance with the principle of free choice of means.

UN General Assembly Resolution 3281

Appendix II: Chronological list of Standard Oil Companies.

The first "Standard" company was "Standard Oil Company", established in Ohio by John D. Rockefeller and his partners in 1868. In the following years, many business and oil interests aligned under that company. Thus, before the Trust dissolution, there were other Standard Oils and the following is an abbreviated timeline of Standard's history for the better understanding what happened to them:

- **1868:** Standard Oil Company (Pittsburgh, Pennsylvania) was organized. This was the first Standard Oil.
- **1870:** The Standard Oil Company was incorporated in Ohio, which later became Sohio, and was the leading organization in the Trust for many years.
- **1877:** The Standard Oil Company of California (Ventura) formed by local businessmen in Ventura County, California.
- **1879:** The Standard Oil Company of California (Ventura) was acquired by the Pacific Coast Oil Company.
- **1880:** Imperial Oil of Canada founded.
- **1881:** National Transit Company formed to own and operate pipelines.
- **1882:** Standard Oil Company of New Jersey ("Standard") was established with an intention to take advantage of New Jersey laws that allowed corporations to own stock in other corporations. Furthermore, it provided administrative co-ordination to the Trust.
- **1882:** Standard Oil Company of New York also formed this year and was given the administration of most of the foreign territories.
- **1885:** Standard Oil Company of Iowa was formed to handle marketing along the Pacific coast.
- **1886:** Standard Oil Company of Kentucky was established.
- **1886:** Standard Oil Company of Minnesota was formed.
- **1886:** The Standard Oil Company of California (Ventura) liquidated.
- **1887:** Ohio Oil Company was established
- **1888:** Anglo-American Oil Company, Ltd. formed.
- **1889:** Standard Oil Company of Indiana was formed.
- **1892:** The Standard Oil Trust officially dissolved.
- **1892:** Jersey Standard became the controlling organization for Standard.
- **1906:** Standard Oil Company of California was formed to take over the Pacific coast marketing area of Pacific Coast Oil and Iowa Standard.
- **1906:** Iowa Standard was liquidated.
- **1906:** Standard Oil Company of Nebraska was formed.
- **1909:** Standard Oil Company of Louisiana established by Jersey Standard.
- **1910:** Standard Oil Company of Brazil was formed.
- **1911:** Standard Oil was declared a monopoly and broken up.

Among the company assets that were divided up was the right to use the well-known 'Standard' brand name. The companies left after the dissolution of “Standard Oil Trust” were following:

- Standard Oil Company of New York (a.k.a. Socony)
- Atlantic Refining (Atlantic)
- Standard Oil of New Jersey (Jersey Standard a.k.a. "Standard")
- Standard Oil of Ohio (The Standard Oil Company)
- Standard Oil of Kentucky (Kyso)
- Standard Oil of Indiana (Stanolind)
- Standard Oil Company of Louisiana (Stanocola)
- Waters-Pierce
- Standard Oil of Nebraska
- Continental Oil Company (Conoco)
- Standard Oil of California (Socal)

The Other 24 Companies that were broken off from the Standard Oil Trust:

1. Anglo-American Oil Company
2. Buckeye Pipe Line Company
3. Borne-Scrymser Company
4. Chesebrough Manufacturing Company
5. Colonial Oil Company
6. Crescent Pipe Line Company
7. Cumberland Pipe Line Company
8. Eureka Pipe Line Company
9. Galena-Signal Oil Company
10. Indiana Pipe Line Company
11. National Transit Company
12. New York Transit Company
13. Northern Pipe Line Company
14. Ohio Oil Company (a.k.a. "The Ohio")
15. Prairie Oil & Gas Company
16. Solar Refining Company,
17. Southern Pipe Line Company
18. South Penn Oil Company
19. Southwest Pennsylvania Pipe Lines Company
20. Standard Oil of Kansas
21. Swan & Finch Company
22. Union Tank Lines
23. Vacuum Oil Company
24. Washington Oil Company

Appendix III: Concession Characteristics

According to Parra (2004), concessions in developing countries vary significantly in content; however, all of them have essential characteristics in common:

- The government grants the company an *exclusive right* to carry out exploration, development and hydrocarbon production operations in a *defined area* and for a *limited period of time;*

- The company *acquires title to the hydrocarbons* and is almost always free to *dispose of them* without further restriction;

- The company *bears the financial and commercial risks* associated with the undertaking;

- The company *agrees to make certain payments* (signature bonus, surface taxes, royalties, production taxes, etc.) to the government in return;

- The concessions are *contracts* with the state, though this does not in itself imply insulation from the state's general power to pass legislation overriding the terms of the contract.

Appendix IV: Selected Financial Statistics of Standard Oil of New Jersey, 1950-1966

	Total assets $m	Gross income $m	Net income $m	Cash dividends $m	Ratio dividends/ net income	Capital expenditure $m	Ratio capital expenditur e/net income	Amounts retained Sm	Ratio amounts retained/ capital expend ture
1950	4,448	4,176	686	185	0.27	352	0.51	487	1.38
1951	5,075	5,119	829	292	0.35	443	0.53	524	1.18
1952	5.509	5,749	840	303	0.36	565	0.67	523	0.93
1953	5,912	6,041	911	317	0.35	587	0.64	581	0.99
1954	6.615	6,236	996	322	0.32	604	0.61	649	1.07
1955	7.346	6,866	1,158	381	0.33	705	0.61	746	1.06
1956	8,085	7,789	1,307	453	0.35	927	0.71	819	0.88
1957	8.925	8,509	1,362	486	0.36	1,137	0.83	841	0.74
1958	9.676	8,261	1,134	503	0.44	887	0.78	584	0.66
1959	10,080	8,714	1,233	507	0.41	750	0.61	676	0.90
1960	10.287	8,915	1,302	512	0.39	746	0.57	743	1.00
1961	10,689	9,356	1,380	522	0.38	844	0.61	810	0.96
1962	11,487	10,576	1,528	564	0.37	1,137	0.74	894	0.79
1963	12.051	11,392	1,711	623	0.36	915	0.53	1,017	1.11
1964	12,523	12,015	1,764	679	0.38	1,141	0.65	1,010	0.89
1965	13.108	12,744	1,804	712	0.39	993	0.55	1,005	1.01
1966	13.887	13,582	1.931	747	0.39	1,210	0.63	1.088	0.90
Totals/ Averages			**21,876**	**8,108**	**av.=0,37**	**13,943**	**av.=0,63**	**12,997**	**av.=0,93**

Appendix V: Selected Financial Statistics of Royal Dutch/Shell, 1954-1966

	Total assets $m	Gross income $m	Net income $m	Cash cividends $m	Ratio dividends/ net income	Capital expenditure $m	Ratio capital expenditure/ net income	Amounts retained $m	Ratio amounts retained/ capital expenditure
1954	5,090	4,802	809	95	0.12	650	0.80	697	1.07
1955	5,617	5,351	921	115	0.12	725	0.79	790	1.09
1956	6,311	6,026	1,047	137	0.13	916	0.87	893	0.98
1957	6,994	6,768	1,176	148	0.13	846	0.72	1,008	1.19
1958	7,622	6,661	972	154	0.16	815	0.84	798	0.98
1959	8,529	7,288	1,070	188	0.18	935	0.87	862	0.92
1960	8,898	7,574	1,098	207	0.19	871	0.79	868	1.00
1961	9,391	7,893	1,114	230	0.21	784	0.70	862	1.10
1962	9,976	8,481	1,190	272	0.23	820	0.69	893	1.09
1963	10,651	9,313	1,277	305	0.24	812	0.64	944	1.16
1964	11,248	9,853	1,280	333	0.26	1,156	0.90	916	0.79
1965	12,107	10,626	1,364	325	0.24	1,428	1.05	997	0.70
1966	13,392	11,396	1,459	356	0.24	1,431	0.98	1,050	0.73
Totals/ Averages			**14,776**	**2864.4**	**av.=0,19**	**12,188**	**av.=0,82**	**11,578**	**av.=0,98**

Appendix VI: Selected Financial Statistics of British Petroleum Company, 1957-1966

	Total assets $m	Gross income $m	Net income $m	Cash dividends $m	Ratio dividends/ net income	Capital expenditure $m	Ratio capital expenditure /net income	Amounts retained $m	Ratio amounts retained/ capital expenditure
1957	1,666	2,229	302	45	0.15	319	1.06	283	0.89
1958	1,918	2,338	344	50	0.15	386	1.12	319	0.83
1959	2,170	2,419	344	64	0.19	395	1.15	314	0.79
1960	2,442	2,579	356	73	0.20	305	0.86	314	1.03
1961	2,654	2,758	367	73	0.20	347	0.95	330	0.95
1962	3,161	2,904	389	87	0.22	350	0.90	342	0.98
1963	3,144	3,156	456	101	0.22	361	0.79	398	1.10
1964	3,475	3,480	456	104	0.23	473	1.04	395	0.83
1965	3,856	3,738	484	104	0.21	580	1.20	403	0.70
1966	4,427	4,068	504	118	0.23	577	1.14	442	0.77
Totals/ Averages			**4,004**	**817.6**	**av.=0,20**	**4,094**	**av.=1,02**	**3,539**	**av.=0,89**

Appendix VII: Selected Financial Statistics of Gulf Oil Corporation, 1958-1966

	Total assets $m	Gross income $m	Net income $m	Cash dividends $m	Ratio dividends/ net income	Capital expenditure $m	Ratio capital expenditure/ net income	Amounts retained $m	Ratio amounts retained/ capital expenditure
1958	3,426	3,222	614	87	0.14	401	0.65	517	1.29
1959	3,562	3,203	576	107	0.19	336	0.58	469	1.40
1960	3,822	3,241	595	110	0.18	346	0.58	476	1.38
1961	4,023	3,286	591	123	0.21	344	0.58	459	1.33
1962	4,244	3,455	616	162	0.26	556	0.90	445	0.80
1963	4,549	3,612	626	176	0.28	621	0.99	470	0.76
1964	4,667	3,844	687	186	0.27	599	0.87	490	0.82
1965	5,211	4,211	761	201	0.26	598	0.79	546	0.91
1966	5,892	4,717	872	227	0.26	715	0.82	620	0.87
Totals/ Averages			**5,938**	**1,379**	**av.=0,23**	**4,516**	**av.=0,75**	**4,492**	**av.=0,99**

Appendix VIII: Selected Financial Statistics of Texaco, 1950-1966

	Total assets $m	Gross income $m	Net income $m	Cash dividends $m	Ratio dividends/ net income	Capital expenditure $m	Ratio capital expenditure/ net income	Amounts retained $m	Ratio amounts retained/ capital expenditure
1950		1,507	250	76	0.30	149	0.60	169	1.13
1951		1,708	301	84	0.28	225	0.75	211	0.94
1952		1,861	325	82	0.25	230	0.71	236	1.03
1953		1,916	354	93	0.26	292	0.82	254	0.87
1954		1,991	398	104	0.26	299	0.75	287	0.96
1955		2,216	446	118	0.26	283	0.63	321	1.13
1956	3,258	2,555	507	131	0.26	503	0.99	367	0.73
1957	3,690	2,869	566	130	0.23	289	0.51	423	1.46
1958	4,061	2,913	558	138	0.25	426	0.76	408	0.96
1959	4,247	3,316	616	155	0.25	426	0.69	447	1.05
1960	4,508	3,681	665	174	0.26	433	0.65	477	1.10
1961	4,821	3,825	712	193	0.27	430	0.60	504	1.17
1962	5,012	4,044	775	236	0.30	453	0.58	525	1.16
1963	5,395	4,250	847	269	0.32	580	0.68	566	0.98
1964	5,815	4,426	885	298	0.34	561	0.63	574	1.02
1965	6,252	4,716	972	332	0.34	670	0.69	622	0.93
1966	7,370	5,494	1,112	340	0.31	865	0.78	743	0.86
Totals/ Averages			**10,289**	**2,953**	**av.=0,28**	**7,114**	**av.=0,70**	**7,134**	**av.=0,99**

Appendix IX: Selected Financial Statistics of Standard Oil of California, 1950-1966

	Total assets $m	Gross income $m	Net income $m	Cash dividends $m	Ratio dividends/ net income	Capital expenditure $m	Ratio capital expenditure/ net income	Amounts retained $m	Ratio amounts retained/ capital expenditure
1950	1,464	972	229	72	0.31	161	0.70	154	0.96
1951	1,645	1,159	262	75	0.29	143	0.55	185	1.29
1952	1,738	1,221	275	86	0.31	173	0.63	187	1.08
1953	1,915	1,302	299	86	0.29	224	0.75	211	0.94
1954	2,065	1,387	333	87	0.26	281	0.84	244	0.87
1955	2,266	1,548	371	90	0.24	347	0.94	278	0.80
1956	2,459	1,760	416	113	0.27	302	0.73	301	1.00
1957	2,697	1,951	439	129	0.29	373	0.85	308	0.83
1958	2,898	1,903	408	136	0.33	278	0.68	269	0.97
1959	2,979	1,909	404	135	0.33	328	0.81	261	0.80
1960	3,237	2,053	427	135	0.32	316	0.74	284	0.90
1961	3,568	2,577	469	135	0.29	377	0.80	326	0.86
1962	3,794	2,712	508	141	0.28	452	0.89	359	0.79
1963	3,960	2,906	524	148	0.28	388	0.74	368	0.95
1964	4,175	2,929	562	155	0.28	473	0.84	398	0.84
1965	4,187	3,116	628	175	0.28	547	0.87	441	0.81
1966	4,800	3,393	694	192	0.28	441	0.64	502	1.14
Totals/ Averages			**7,248**	**2,090**	**av.=0,29**	**5,604**	**av.=0,77**	**5,076**	**av.=0,91**

Appendix X: Selected Financial Statistics of Mobil Oil Company, 1955-1966

	Total assets $m	Gross income $m	Net income $m	Cash dividends $m	Ratio cividends/ net income	Capital expenditure $m	Ratio capital expenditure/ net income	Amounts retained $m	Ratio amounts retained/ capital expenditure
1955	2.630	2,764	377	87	0.23	240	0.64	279	1.16
1956	2.817	3,097	434	101	0.23	329	0.76	324	0.98
1957	3.102	3,343	425	118	0.28	359	0.84	297	0.83
1958	3.234	3,260	350	97	0.28	331	0.95	244	0.74
1959	3.336	3,517	365	97	0.27	263	0.72	258	0.98
1960	3.455	3,646	397	97	0.24	258	0.65	288	1.12
1961	3.608	3,802	426	109	0.26	331	0.78	306	0.92
1962	4.136	4,446	483	114	0.24	454	0.94	355	0.78
1963	4.660	4,915	549	128	0.23	353	0.64	396	1.12
1964	4.879	5,079	575	141	0.25	418	0.73	406	0.97
1965	5.214	5,517	634	155	0.24	534	0.84	448	0.84
1966	5,511	5,887	691	167	0.24	602	0.87	491	0.82
Totals/ Averages			**5,706**	**1,411**	**av.=0,25**	**4,472**	**av.=0,78**	**4,092**	**av.=0,91**