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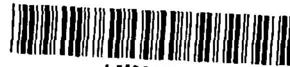
REPORT TO THE CONGRESS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Issues Related To Foreign Sources Of Oil For The United States

B-179411

Department of State

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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JAN. 23, 1974

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-179411

To the President of the Senate and the
Speaker of the House of Representatives

This is our report concerning issues related to foreign sources of oil for the United States. It deals with the Department of State's involvement in the international petroleum situation.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Secretaries of State, the Treasury, the Interior, Commerce, Transportation, and Defense; the Chairman of the Oil Policy Committee; the Administrator, Federal Energy Office; the Administrator, Environmental Protection Agency; and the Director, Office of Management and Budget.

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

GAO	General Accounting Office
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
NATO	North Atlantic Treaty Organization

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

ISSUES RELATED TO FOREIGN SOURCES OF OIL FOR THE UNITED STATES
Department of State
B-179411

D I G E S T

WHY THE REVIEW WAS MADE

This report discusses (1) the State Department's role before eruption of hostilities in the Middle East in October and Arab curtailment of petroleum exports and (2) the critical problems facing the Department in resolving the issues connected with the current and future availability of this vital raw material from sources outside the United States.

The fundamental issues involved in the international petroleum scenario, although altered somewhat by recent events, remain essentially unchanged. They include

--the future availability of petroleum imports,

--agreements with oil-exporting countries,

--agreements with oil-consuming countries,

--outlets, such as increased trade and investment opportunities, for the increasing monetary reserves of oil-exporting countries, and

--the Department's role in negotiations between oil companies and producer countries.

Facts basic to understanding the problem

Petroleum supplies about 44 percent of U.S. energy needs. Before Middle East countries cut off oil shipments in October 1973, the United States was importing 35 percent of its total petroleum requirements at a cost of about $7 billion annually.

Prior to the President's energy message of November 7, 1973, in which he called for the United States to be self-sufficient by 1980, experts were predicting that the United States might have to import up to half its total oil requirements within the coming decade.

Imports of that magnitude would result (according to estimates) in a $35 billion annual balance-of-payments deficit for the United States.

All major free-world powers are in a petroleum deficient position.

Unless alternative sources of energy are developed quickly, Russia is the only world power that will be self-sufficient in energy resources in the coming decade.

U.S. oil companies in mid-1973 controlled, or had rights associated with, about half the world's proven oil reserves; however, other countries receive about 90 percent of the oil exports from the major exporting countries.

In mid-1973, the United States was importing about 10 percent of total requirements from the Eastern Hemisphere. Within the coming decade, projections show, the United

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States will need to secure as much as 33 percent from the Eastern Hemisphere--largely the Middle East.

GAO's review was completed before the October outbreak of hostilities in the Middle East.

FINDINGS AND CONCLUSIONS

Until alternative sources of energy are developed, the availability of foreign petroleum products to the United States will, to a great extent, govern the future of American industry, transportation, and way of life. Therefore, the national policy on energy must be fully and mutally coordinated with U.S. foreign policy.

If future U.S. oil imports are to be insured, workable solutions are needed for a variety of foreign policy issues.

The increasing demand for Middle East oil and the sharply rising prices paid to the producer countries is resulting in their accumulating billions of dollars in monetary reserves. Authorities have calculated that the Arab nations could control more than one-half of the world's monetary reserves within the coming decade.

Such reserves--if satisfactory trade and investment opportunities are not found--may be a disincentive for further expansion of production and may permit the Arab nations to use their control of petroleum for political purposes. This is of significant concern when it is considered that U.S. foreign policy is offensive to several Middle East oil-producing countries. (See pp. 23 and ch. 6.)

Already oil-producing countries are taking over greater control of their petroleum resources through participation agreements with the oil companies and nationalization of oil company assets and are leveling off production in the face of rising demand. (See pp. 18 to 20.)

The Department has unsuccessfully attempted to negotiate bilateral agreements with several Western Hemisphere countries for a continuing supply of oil.

The Department has not sought similar arrangements with Eastern Hemisphere countries, which have the major portion of the world's supply of oil, on the grounds that such agreements would create difficulties with oil-consuming allies.

A number of oil-consuming nations, including some U.S. allies, have negotiated agreements with oil-producing countries to insure their future supplies.

Department officials have exchanged information and discussed energy problems with other major oil-consuming countries. In addition, they have been trying to conclude agreements with other consuming countries to develop alternative sources of energy and multigovernment contingency plans in case of supply disruption. No agreements have yet been concluded. (See ch. 5.)

The Department keeps abreast of the oil situation consultations with both the oil companies and the producing countries and has acted as the go-between for the negotiating parties. It has not, however, participated in a substantive way in negotiations between the oil companies and the producer countries.

Although the Department does obtain a great deal of information on these matters, it has not made regular comprehensive analyses of the probable impact of impending agreements. Its role in five agreements between oil companies and producer countries is discussed on pages 28 through 42.

Traditionally the State Department has used its influence and programs to promote an environment conducive to U.S. private investment in foreign countries. Only general guidance on the methods to be followed in creating such an environment has been established, much being left to the judgment of the Ambassador and the U.S. country team.

At the same time, the Department generally has avoided direct involvement in the nature, substance, and behavior of private industry. (See pp. 25 to 28.)

The Department must play a major role in developing the national policy on energy and influencing the substance of oil negotiations. Its responsibilities in protecting the Nation's interests in the rapidly evolving world energy situation obviously are important. It should, therefore, improve its capability to deal effectively with energy related problems.

It cannot be shown with any reliability that the outcome of negotiations would have been different if the Department had had the details concerning the negotiations. At the same time, it is clear that the results of recent negotiations, coupled with U.S. policy toward Israel, has left the United States with a less secure supply of oil than was the case before the negotiations were undertaken.

RECOMMENDATIONS AND SUGGESTIONS

During its review GAO made a number of proposals for action by the State Department. These were directed toward the Department's taking a more vigorous role in developing a national policy on energy, strengthening its capability to analyze the ramifications of ongoing oil negotiations, and influencing negotiations between oil companies and oil-exporting countries when vital U.S. interests are at stake.

GAO's proposals were designed to spell out priority areas in which action should be taken by the Department to accomplish these objectives. (See p. 59.)

In view of the highly volatile situation which has emerged in the Middle East since these proposals were made, GAO is deferring specific recommendations to the Department at this time.

AGENCY ACTIONS AND UNRESOLVED ISSUES

The State Department generally agreed with the basic conclusion of this report. Both the Department and the Office of Management and Budget expressed reservations about the Department's increasing its guidance and monitoring activities in oil negotiations.

They argued also against actual participation in the negotiations because this would be inconsistent with the traditional Government-business relationships. However, the Department recognized that the changing company role and the growth of large multinational companies required a changing U.S. Government role and indicated that the problem was being explored.

GAO did not call for direct participation but rather pointed to areas where the Department could intensify its capabilities to deal with the ramifications of the international oil situation.

The Department mentioned its efforts to develop trade and investment opportunities in the oil-producing countries and indicated its intention to increase its activity in these areas.

MATTERS FOR CONSIDERATION BY THE CONGRESS

Although the handling of the issues discussed in this report will be influenced by world opinion and the overall Arab-United States-Israeli relationships, the issues, in and of themselves, ultimately must be dealt with. This report contains information on this broad subject which the Congress should find useful as it considers future energy proposals and programs.

CHAPTER 1

INTRODUCTION

Today, cities and towns in various regions of the United States are feeling the effects of some fuel shortages. Before the end of this decade, the United States along with other industrial countries could be facing an even more severe energy crisis.

Our report to the Congress, "How the Federal Government Participates in Activities Affecting the Energy Resources of the United States" (B-178205, Apr. 6, 1973), noted that, in fiscal year 1972, 23 Federal departments and independent agencies--consisting of 64 offices, bureaus, commissions, and administrations--used 44,000 man-years for energy-related programs and activities.

The President has overall responsibility for U.S. foreign policy but looks to the Department of State for primary advice in forming and executing this policy. The Department maintains an Office of Fuels and Energy, with a staff of four, to act as a focal point for international petroleum matters.

In addition to the Department, the Cabinet-level Oil Policy Committee and the new Energy Policy Office are responsible for U.S. international petroleum policies.

The Chairman of the Oil Policy Committee is responsible for providing policy direction, coordination, and surveillance of the oil import program. At the time of our review, the Committee consisted of the Deputy Secretary of the Treasury, as Chairman, and the Secretaries of State, Defense, the Interior, and Commerce; the Attorney General; and the Chairman of the Council of Economic Advisers, as members.

At the time of our review, the Departments of Defense, State, the Treasury, Commerce, and the Interior had undertaken studies, requested by the National Security Council, on energy and its commercial and foreign relations aspects. As of July 1973, the studies had not been completed and no target date had been set.

In June 1973, however, the President created a new Energy Policy Office, to be responsible for formulating and coordinating energy policies at the Presidential level. He also asked the Congress to establish a new Department of Energy and Natural Resources. The new Cabinet-level department would be responsible for the balanced use and conservation of America's energy and natural resources and would assume certain responsibilities now assigned to other Federal agencies.

Although petroleum is the largest single source of U.S. energy, domestic sources are not meeting the country's petroleum needs. Industry and Government experts predict that reliance on foreign countries for oil will increase significantly in the next decade.

SCOPE OF REVIEW

Our review was directed principally to determining whether the Department of State's practices and diplomatic efforts were adequate to insure the continued availability of sufficient foreign oil to meet the U.S. demand until alternative domestic sources of energy were developed.

We reviewed (1) Department activities concerning five oil agreements negotiated in 1971-72 between Middle East countries and U.S. oil companies, (2) the Department's role in recent intergovernmental petroleum activities concerning Venezuela, Canada, Saudi Arabia, Ecuador, and Colombia, and (3) the Department's initial efforts to coordinate a petroleum policy with other major oil-consuming countries.

We took our statistics from information provided by the oil industry in various publications, congressional hearings on energy matters, and data supplied by Government officials. The work on this review was completed before the October 1973 outbreak of hostilities in the Middle East.

CHAPTER 2

PERSPECTIVE ON THE U.S. ENERGY CRISIS

The United States, with only 6 percent of the world's population, uses an estimated 35 percent of all the energy produced in the world. Petroleum provides about 44 percent of U.S. energy needs. (See chart on p. 8.) Although it is an essential ingredient in our economy and way of life, we have only about 7 percent of the world's known petroleum reserves.

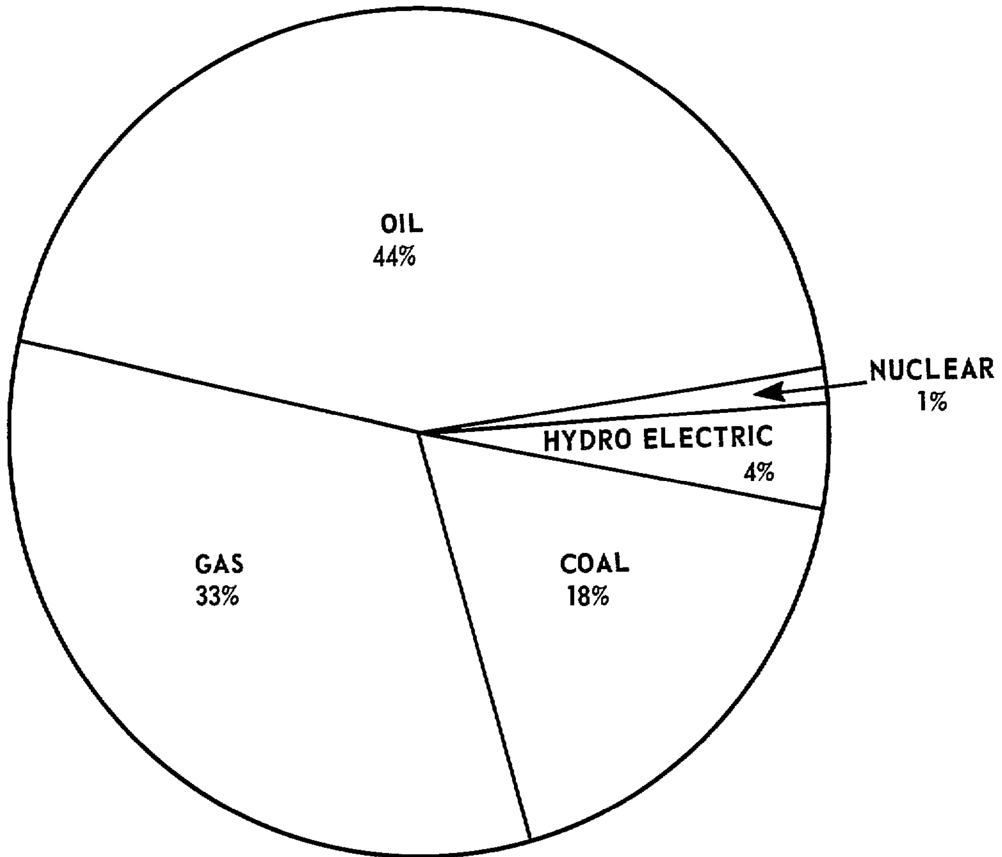
Every segment of our economy reflects this dependence on petroleum. For example, 54 percent of our petroleum requirement is used in transportation, 20 percent in industry, 14 percent in residences, 7 percent in electrical power generation, and the remaining 5 percent in commerce.

The recently discovered Alaskan North Slope oilfield, which is almost inaccessible now because of transportation problems, contains one-fourth of the known U.S. reserves. Even with these reserves, the United States had only an estimated 6.1 years' supply of oil in 1972, based on present demand. According to both Government and oil industry experts, future production in Alaska, estimated at 2 million barrels a day, will merely offset declining production elsewhere in the United States.

Although we have imported petroleum for at least 50 years, only in the last decade has our expanding domestic demand outstripped our productive capacity, thus necessitating a drastic increase in imports. In mid-1973 we were importing 35 percent of our total oil consumption-10 percent from the Eastern Hemisphere. Department officials estimate the current cost of petroleum imports to be $7 billion annually.

According to Government and oil industry experts, U.S. demand for oil will double in the next decade. Thus, if U.S. production remains constant, as predicted, new demands for oil must be met by increased imports. The magnitude of the projected demand may make alternative sources of energy more economically attractive or absolutely necessary. However, their availability, according to Government experts, in the short to medium term is unlikely.

SOURCES OF U.S. ENERGY



Goverment sources estimate that by 1980, unless major technological advances are made in the energy field, the United States could be importing about half (12 million barrels a day) of our predicted daily oil consumption. As much as two-thirds of these imports may have to come from sources in the Eastern Hemisphere, largely from the Middle East. U.S. imports from the Middle East today are relatively small; by 1980 they would well entail 7 million or more barrels a day.

Japan and the industrialized nations of Europe, which already use substantial quantities of oil, are also expected to significantly increase their oil use. As in the United States, oil has been the mainstay of their economies. Demand in Western Europe is projected to double from 12 million barrels a day in 1970 to 24 million barrels a day in 1980. Japan's percentage of increase will be even greater--from about 3.8 million barrels a day in 1970 to over 10 million barrels a day in 1980. However, unlike the United States, Europe and Japan already import most of their petroleum from the Middle East.

The problem is not one of quantity in the world but of availability to the United States and its allies.

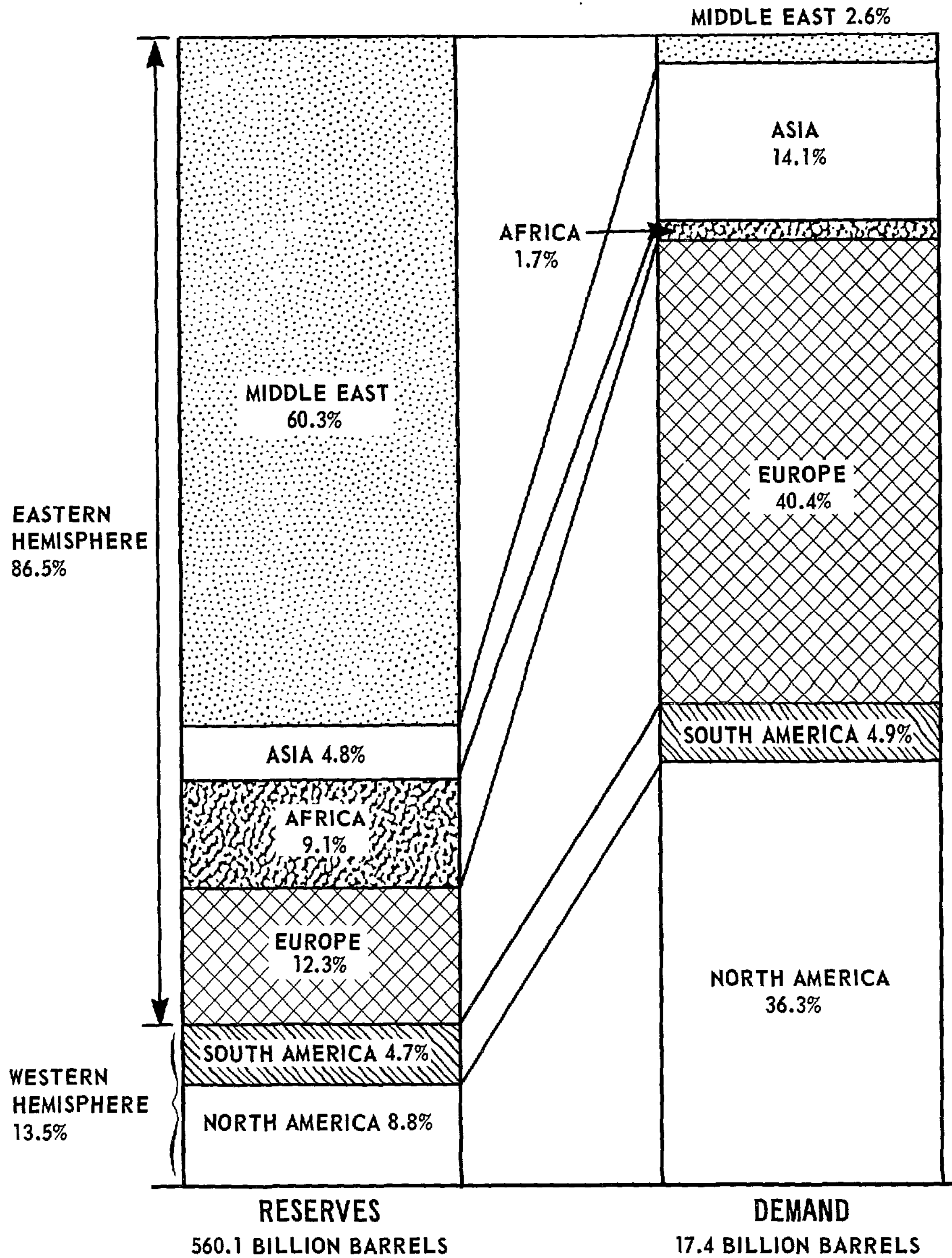
Nearly three-quarters of the world's proven reserves of petroleum are located in the Middle East. Saudi Arabia, Kuwait, and Iran have about half the world's reserves. Saudi Arabia alone has one and three-fourths times as much oil as all the Western Hemisphere countries combined. Thus, the Middle East will undoubtedly remain the main source of world petroleum in the foreseeable future.

Russia has about 10.5 percent of the world's proven oil reserves along with major gas reserves and coal deposits. Unless there are major technological advances, Russia is the only world power that will be self-sufficient in energy resources in the coming decade.

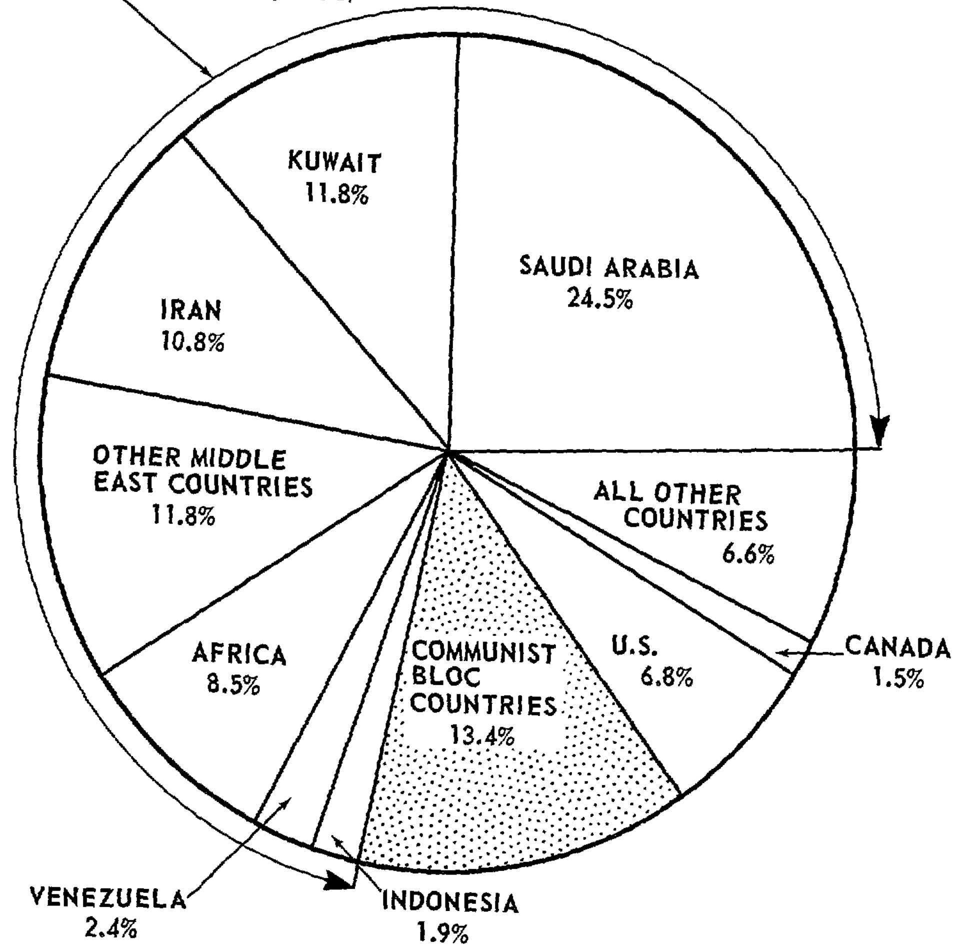
The following charts better indicate which parts of the world have the oil reserves and where oil is used.

Recent discoveries estimated at 9.6 billion barrels on the Alaskan North Slope have added significantly to known reserves but have not solved the impending energy crisis.

WORLD RESERVES AND DEMAND

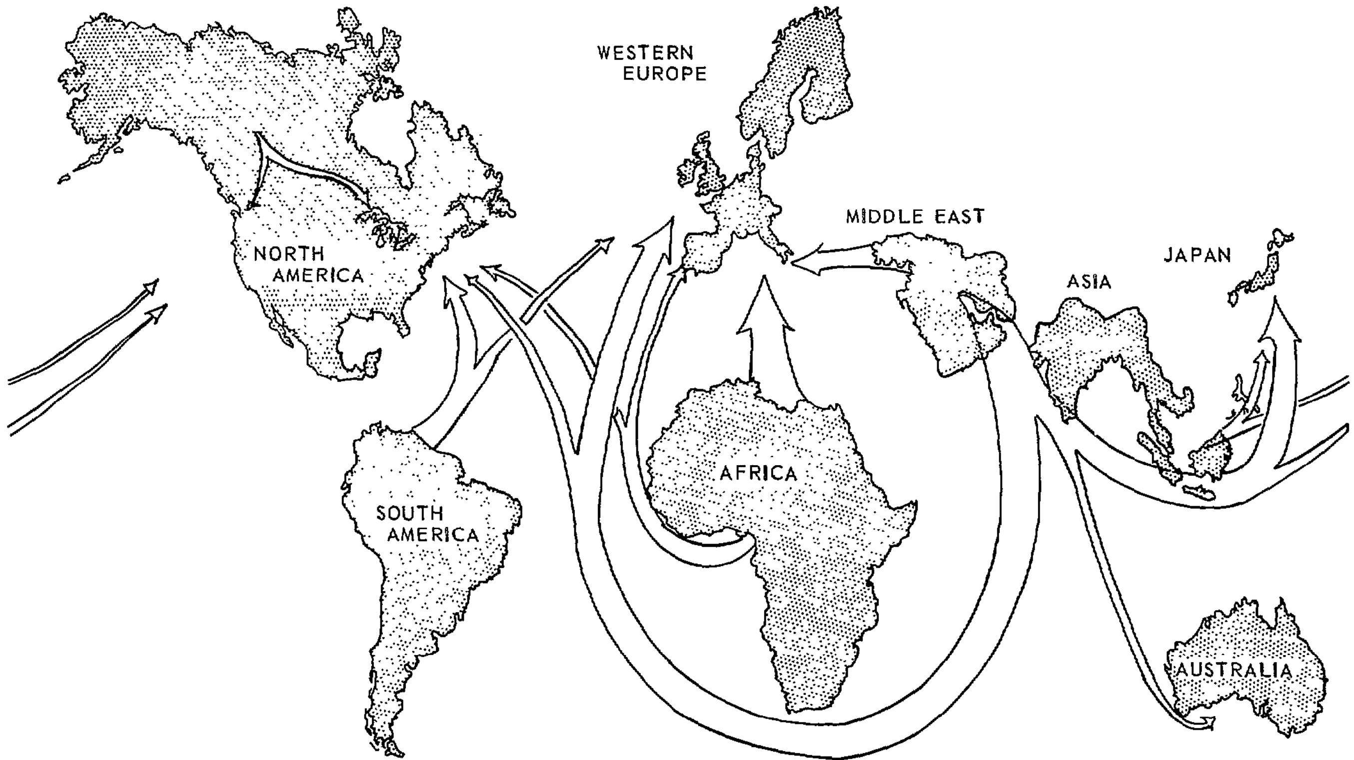


WORLD PETROLEUM RESERVES 1972



TOTAL RESERVES
560.1 BILLION BARRELS

MAJOR INTERNATIONAL OIL MOVEMENTS



Environmental problems connected with production and transportation have delayed the attempts to use this oil.

A Government official has indicated that, on the average, 7 years is required to develop an oilfield after its discovery. Thus, even if major new oil deposits were discovered, their contribution to the domestic oil supply could not be fully realized until near the end of this decade.

Geologists believe offshore areas may hold a great deal of oil. The Department of the Interior estimates that 171 billion barrels of crude oil are recoverable from offshore drilling under current technological and economic conditions, once it has been found. However, proven reserves for offshore wells are only 7.7 billion barrels.

According to geologists, domestic reserves of fossil fuels (oil, gas, and coal) and potential new resources of clean energy (nuclear, solar, and geothermal) are plentiful, but they are not being developed rapidly enough to meet increasing national requirements. None are expected to have a significant impact on short- and intermediate-term energy supplies because of economical, technological, environmental, and leadtime reasons.

Alternative sources of energy will require billions of dollars in new construction and conversion of existing facilities. For example, nuclear energy will require an estimated $190 billion investment by 1990; development costs for coal gasification could reach $20 billion in the next 10 years.

Following are the projected availabilities of some potential oil substitutes, according to Government and industry experts.

--Natural gas is in short supply and shortages are expected to increase. Domestic production is projected to decline about one-third during the next 15 years. With more imports of natural and liquified gas and synthetic gas (from naptha and coal gas), availability may stay at about its present level. This would satisfy less than half the potential gas requirements by 1985.

--Tar sands oil is not competitive today because of high costs for extraction and production and for environmental reasons. Although this oil is expected to be available by the mid-1980s, a capital investment of about $2 billion would be required to produce 1 percent of U.S. energy needs in 1985.

--Shale oil production is feasible but would require large outlays of capital. It should also be available by the mid-1980s, but a major environmental problem can be expected if strip-mining techniques are employed.

--Coal is plentiful, but strip-mining and deep-mining problems must be solved. Better sulfur emission controls and an economical method for converting coal to gas still need to be developed.

--Numerous nuclear power generating stations have been planned or initiated; but, because leadtimes are long and because nuclear power currently can be used only for electric power production, it cannot be considered a real substitute for most petroleum uses in the next decade.

--Geothermal technology must be further developed and environmental problems must be solved before it can be used on a national scale. By 1985 it might provide 1 percent of U.S. needs.

--Other energy sources, such as thermonuclear fusion, solar energy, tidal energy, and fuel cells, are unlikely to provide a meaningful energy contribution in the near future.

In June 1973 the President asked the Congress to create an independent Energy Research and Development Administration and proposed that a $10 billion program be initiated in fiscal year 1975. To give impetus to the plan, a $215 million program has now been proposed for fiscal year 1974.

On November 7, 1973, following the cutoff of Arab oil to the United States, the President proposed, as a national goal, that by 1980 the United States develop the potential to meet its own energy needs from its own resources.

CHAPTER 3

PROBLEMS RELATING TO FOREIGN SOURCES

Petroleum is vital to our national security and economic growth. Because our need for oil imports is increasing, foreign policy considerations are becoming more complex.

From 1959 until April 1973, the United States limited the amount of its oil imports primarily for national security reasons; that is, to prevent undue reliance on insecure foreign sources of petroleum. However, as our dependence on foreign oil increases, the need to develop an adequate foreign policy to protect our continued supply of oil becomes apparent.

The Armed Forces use only about 6 percent of the total U.S. consumption today, while in World War II they used almost 20 percent. The per capita consumption of the Armed Forces today, however, is about four times higher than in World War II. It is clear that petroleum is vital to military security. Not only would the Armed Forces be immobilized without it, but the production, use, and maintenance of almost all military equipment would be affected. The broader economic concern is the security of supplies for immediate requirements of the economy and for sustained future economic growth.

The freedom to conduct U.S. foreign policies and carry out international responsibilities can be adversely affected by the dependence on excessive amounts of foreign oil. The importation of oil is one of the most sensitive areas in which a nation is subject to pressures from outside sources. Oil-exporting countries are showing an increasing tendency to use energy resources to influence the foreign policies of importing countries. Government officials recognize that our diplomatic endeavors must take into account coercive outside influences arising from dependence on oil imports.

In December 1972 the Director of the Office of Emergency Preparedness stated that whoever controls Middle East oil in 1980 can have major leverage on the energy and foreign policies of any oil-deficient country, such as the United States.

Our preeminent world position depends largely on the uninterrupted flow of oil and its products to the Armed Forces and to the civilian economy. No practical substitutes currently exist for oil, and normal petroleum consumption cannot be reduced in significant quantities without seriously impairing production, transportation, heating, and military capabilities. The alternatives, such as stockpiling massive reserves to meet U.S. requirements for long periods, are not economically realistic. For example, a train loaded with oil, stretching from Washington, D.C., to Cincinnati, Ohio, represents only a 1-day supply for the United States.

Security requires that we consider the potential effect on our allies of significant increases in U.S. oil imports from sources now providing Europe with 85 percent of its oil requirements.

Although we imported 35 percent of our petroleum in mid-1973, numerous Government studies have concluded that reliance on insecure foreign sources for more than 10 percent of our oil endangers national security. A major study was prepared in 1970 by a Cabinet-level Task Force on Oil Import Control chaired by the present Secretary of the Treasury and adviser to the President on economic activities. It stated that national security would not be impaired until oil imports from the Eastern Hemisphere--identified as the least secure supply source--exceeded 10 percent of U.S. demand. The task force did not explain its reasoning in stating that this ratio would be safe in future years when all Western Hemisphere reserves had greatly diminished.

Political disruption of transport routes, production restrictions, and other noneconomic factors reduce the security of supply. Such interruptions have occurred at intervals in the Middle East since 1948 when Iraq closed a major pipeline. Starting in 1951 the Iranian oil industry was shut down for nearly 3 years, and virtually all exports were halted following the nationalization of the Anglo-Iranian Oil Company. In the 1956 Arab-Israeli War, the Suez Canal was closed and major pipeline pumping stations were destroyed. The Suez Canal was closed again and production was temporarily suspended in all major Arab oil-producing countries immediately after the start of the 1967 war. Subsequently, exports to the United States, Britain, and West Germany were briefly embargoed. The Trans-Arabian Pipeline, with a capacity of 175 million barrels a year, was sabotaged in 1969 and remained

closed for about 8 months. It has been sabotaged a number of times since. In 1971, British Petroleum's assets in Libya were nationalized and production from its fields was halted as retaliation against the British Government.

Most crude oil and petroleum products coming into this country by sea (including those from the Virgin Islands) are being carried by foreign-flag vessels. Thus, we are becoming increasingly dependent not only on foreign sources of oil but on foreign transportation. About 23 percent of the world tankship fleet is controlled by U.S. companies but sails under foreign flags for convenience and economy.

To date, the United States has been able to obtain most of its petroleum imports from Western Hemisphere sources because imports have not exceeded the supply available from Canada and Latin America (considered secure sources). Preferences given these Western Hemisphere sources, in the form of special allocations under the oil import quota system (before April 1973) and reduced tariffs and cheaper transportation costs, allowed them to compete favorably with the less secure sources of the Middle East. In 1972 the United States was receiving its oil from the following sources.

Origin of Oil Consumed in the United States by Percentage

	1960	1970	1971	1972 (note a)
Western Hemisphere:				
Domestic	81	77	75	71
Canada	1	5	5	7
Venezuela	12	11	10	10
Other Western Hemisphere (note b)	1	3	4	5
Eastern Hemisphere:				
Middle East	4	1	3	4
Africa	(c)	1	1	1
Indonesia	1	1	1	1
Other Eastern Hemisphere	(c)	1	1	1
Total	100	100	100	100

[a]Estimated.

[b]This data essentially represents refined products shipped from Caribbean refineries. Eastern Hemisphere sources provide over 80 percent of the input to these refineries.

[c]Negligible.

OIL-PRODUCING COUNTRIES UNITING AND TAKING CONTROL

A number of the world's major oil-producing countries have pooled their power in a group called the Organization of Petroleum Exporting Countries (OPEC). These countries which control 85 percent of the oil available for export to the free world are: Abu Dhabi, Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, and Venezuela. OPEC's primary accomplishments have been to deter price competition among themselves, increase profits, conserve oil reserves for future production, and gain participation arrangements with the oil companies. Their united efforts have not only substantially raised the price of oil but also lessened oil companies' control in OPEC countries.

An agreement concluded in December 1972 between several Arabian Peninsula OPEC countries and the oil companies has introduced a new principle into oil concession negotiations --gradually increasing host government control in oil operations. These governments become part owners of companies holding oil-producing concessions and are entitled to a share of the output proportionate to their share of ownership. This is in addition to taxes imposed by the exporting countries, which now amount to a minimum of 55 percent of the companies' net profits derived from each OPEC country.

The agreement provided for an immediate 25-percent interest increasing in steps until 1983, when the host countries will have attained a 51-percent controlling interest.

Libya, not a party to the Participation Agreement, has been taking control of its oil resources in the following ways.

--Expropriated British Petroleum Company holdings in late 1971.

--Fully nationalized one U.S. company in early 1973.

--Concluded agreement in mid-1973 with two major U.S. companies to acquire 51 percent of their holdings immediately.

--In September 1973, announced the takeover of 51 percent of the in-country holdings of five other companies.

As the oil producing countries' equity in oil increases, the American companies' control over oil production and distribution decreases.

OIL PRODUCTION LEVELING OFF

Some of the major oil-producing countries, including Libya, Kuwait, and Venezuela, have begun leveling off their oil production.

Despite having the second largest volume of proven oil reserves in the world, Kuwait imposed production controls in 1972 on the Kuwait Oil Company (its major oil company, owned by Gulf Oil and British Petroleum). In 1971 crude oil production averaged 3.2 million barrels a day, of which the Kuwait Oil Company produced 2.9 million barrels. In 1972 total production was 3.4 million barrels a day and Kuwait Oil Company's output was restricted to 3 million barrels. Kuwait officials have indicated that in 1973 production will increase 1 percent at most, exclusive of a small added output from the Neutral Zone.

Kuwait and Libya slowed production, at least in part, on the grounds that they did not need and would not use their present oil revenues. Saudi Arabia has indicated that it may not increase production to the extent that the world will require if it cannot invest the resulting income profitably. Venezuela, with dwindling reserves, has apparently "peaked out" on production of oil from conventional sources.

PROTECTION OF U.S. INVESTMENT ABROAD AND FOREIGN AID

The U.S. Government is generally committed to the protection of U.S. citizens, their rights, and their property abroad. In the case of the petroleum industry, their overseas investments total about $24 billion. Recent nationalization and participation efforts by OPEC countries have tended to increase the risk factor for this huge capital outlay.

In the past few years, there have been at least 15 situations involving nationalization, expropriation, or negotiated sale of petroleum assets. The significance of these and similar situations in other industries motivated the United States in 1971 to prohibit all assistance to any country which expropriates U.S. holdings without compensation. The President clarified this position in February 1972 by stating that:

"Henceforth should an American firm be expropriated without reasonable steps to provide prompt, adequate and effective compensation, there is a presumption that the expropriating country would receive no new bilateral economic benefits until such steps have been taken, unless major factors affecting our interests require us to do otherwise."

This, however, is not a strong deterrent to most major oil-exporting countries because they receive little or no U.S. foreign aid.

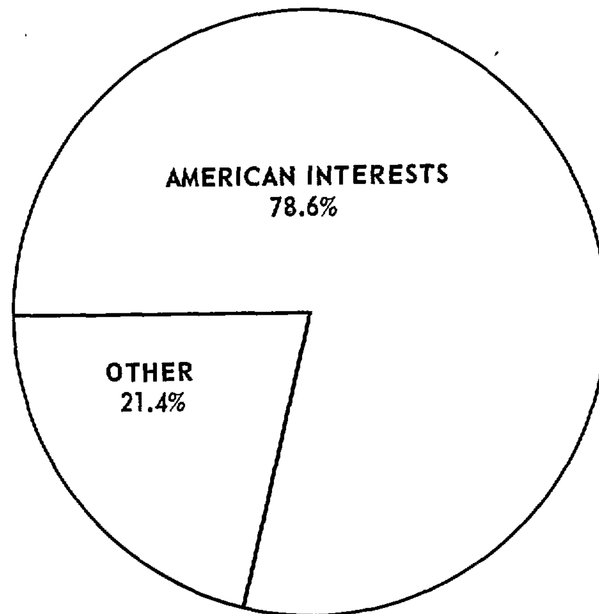
Since World War II, U.S. oil companies have progressed rapidly to a dominant position in the international oil industry. However, foreign markets, such as Europe and Japan, receive about 90 percent of the oil from the oil-exporting countries. The following chart and schedule (see pp. 22 and 23) show that U.S. oil companies controlled or had rights associated with more than half of the world's proven oil reserves in 1971. We have been informed that, although these figures have not been updated, in mid-1973 U.S. oil companies' interest in the world's oil reserves was still about 50 percent.

RESPONSIBILITIES OF U.S. OIL COMPANIES

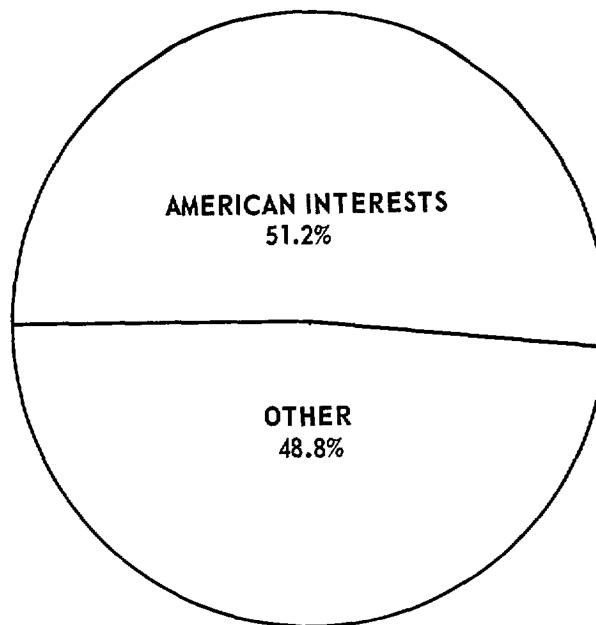
Although the U.S. Government is responsible for protecting American oil companies' rights and properties overseas, these companies are free to trade in any world market. The U.S. Government does not have any formal commitment from these companies to ship oil to the United States, even in emergencies.

Department of State officials indicated that U.S. firms are obligated to honor existing supply contracts with foreign purchasers and stated that, if the U.S. Government ever overrode the companies' contractual obligations, it should be prepared to see refinery and other facilities abroad adversely affected and U.S. relations with its allies seriously jeopardized.

AMERICAN INTERESTS IN WORLD RESERVES



WESTERN HEMISPHERE



EASTERN HEMISPHERE

Crude Petroleum Estimated Proven Reserves for World and Percent of U.S. Interests

Region	Total reserves Jan. 1, 1971	American interests (note a)	Percent
	(Thousands of barrels)		
North America	53,138,315	43,900,000	82.6
South America	25,576,068	18,000,000	70.4
Total Western Hemisphere	78,714,383	61,900,000	78.6
Europe (note b)	66,369,200	2,000,000	3.0
Africa	46,317,400	26,700,000	57.6
Middle East	342,133,500	210,400,000	61.5
Far East and Oceania	18,928,671	3,500,000	18.5
Total Eastern Hemisphere (note b)	473,748,771	242,600,000	51.2
World total	552,463,154	304,500,000	55.1

[a]Estimated.

[b]Including U.S.S.R. and Communist-controlled countries.

OFFENSIVENESS OF U.S. FOREIGN POLICY TO SEVERAL OIL-PPODUCING COUNTRIES

Several oil-producing countries, especially in the Middle East, have foreign policies that in some measure directly oppose those of the United States.

In 1972 Arabs in responsible or influential positions made 15 different threats to use oil as a weapon against their "enemies." Almost all of them singled out the United States as the prime enemy because of its pro-Israeli policies. For example, a punitive tax on foreign oil companies was formally proposed in November 1972 at the opening of the Arab Boycott Conference. Officials said the proposal was specifically aimed at U.S. companies.

The tax was to be proportionate to the military and economic aid provided to Israel by the oil companies' home countries. Proceeds from the tax would be paid into a special fund which would finance Arab armament factories and other

heavy industry needed in modern war. To date, however, the Arab oil-exporting countries have not acted on this proposal.

In October 1973 most of the OPEC countries in the Near East publicly announced a policy of cutting off oil to the United States in retaliation for the open U.S. support of Israel in the present Arab-Israeli hostilities.

CHAPTER 4

LIMITED DEPARTMENT OF STATE ROLE IN INTERNATIONAL PETROLEUM NEGOTIATIONS

The Department of State has traditionally used its influence and programs to promote an environment conducive to U.S. private investment in foreign countries. Only general guidance on the methods to be followed in creating such an environment has been established; much has been left to the judgment of the Ambassador and the U.S. country team. The Department has also generally avoided direct involvement in the nature, substance, and behavior of private industry. Department officials state that they get involved only in flagrant cases of bad corporate conduct.

The Department does keep abreast of the oil situation and holds meetings with oil company representatives and government officials from exporting countries. However, an official in the Office of Fuels and Energy did advise us that his office does not have enough employees to make detailed studies on energy matters. It does review reports and obtain information from field personnel in the Embassies and other agencies operating overseas.

We were also told that the Department did not participate in the negotiation meetings and that information on the progress of actual negotiations was passed on to them by the interested parties.

GENERAL POLICIES

The State Department's role in international petroleum matters is guided by several basic foreign policies, including

--maintaining friendly diplomatic relations with both oil-exporting and oil-consuming nations,

--allowing free enterprise to determine the terms of oil contracts,

--protecting and promoting U.S. investment, and

--helping to maintain national security by diversifying the sources of oil imports.

Although formal statements of U.S. policy and interests in the various oil-producing countries are generally broad in scope and are different for each country, the primary U.S. interest in most of these countries can be characterized in terms of oil. Its continued availability has been of vital importance to the economies of our North Atlantic Treaty Organization (NATO) allies and friends, and assured sources of petroleum to our own energy-hungry economy are rapidly increasing in importance. U.S. companies have invested heavily in developing oil resources abroad, and the returns on these investments have contributed substantially to our international balance of payments.

The Assistant Secretary of State for Near Eastern and South Asian Affairs, noting the U.S. strategic and commercial importance of oil in the Middle East region, recently stated that maintaining friendly relations with the governments of the area was important to insure an environment in which economic cooperation in petroleum and other activities can flourish.

Historically, the Department has seldom intervened directly in international petroleum agreements; negotiations have been left largely to the private sector. According to a policy background paper prepared in 1973 by the Senate Committee on Interior and Insular Affairs, the U.S. international oil policy has historically tended to mirror the oil industry's general interests and perceptions.

For national security reasons, the United States has attempted to obtain most of its petroleum imports from the Western Hemisphere. However, diversity of import sources also is considered a good way to minimize the effect of a major supply interruption from a single source.

BRIEF SUMMARY OF PAST DEPARTMENT INVOLVEMENT

After World War I the U.S. Government concluded that American interests should secure possession or control of reserves in foreign lands. In the 1920s, the Department carried out a campaign, against British and Dutch opposition, to make way for American enterprise. The first major

acquisitions by U.S. companies of rights to develop oilfields in Iraq, the Netherlands East Indies, Colombia, and Venezuela date from that era.

During World War II the emphasis was again on U.S. control of foreign oil, but this time the Middle East was the center of concern. Several American companies held large oil concessions in the Middle East. Company officials felt, however, that their operations were at the mercy of British diplomacy, which had long been paramount in most of the Persian Gulf region. Great Britain had acquired the right to supervise the foreign relations of many of the small Arab states. U.S. oil companies wanted the support of the U.S. Government to insure that their oil concessions would not be impaired by British diplomacy.

The U.S. Government's Inter-Departmental Committee on Petroleum Policy (composed of representatives of the Departments of State, War, and Navy and the Petroleum Administrator for War) was established to keep informed of international oil matters and to formulate policy and suggest actions on the future American oil position. How best to help the American oil companies in the Middle East became the most important concern of this group.

In early 1943 the Arabian-American Oil Company (a consortium of major U.S. oil companies) offered the U.S. Government an option to buy at a discount a great quantity of Saudi Arabian oil whenever it might choose. Until wanted, the oil could remain underground. The company would see that enough would always be available to meet a Government requisition; the company was sure that there was more oil underground than could be sold during the life of the concession.

This offer, apparently prompted by the wish to gain a semiofficial status for the concession, would be a trade of shares in the oil company in return for protection. The arrangement would show the importance the United States placed on the Saudi oil and would indicate that the United States considered this oil as part of its military reserves.

The President authorized the trade in July 1943. The purchase was to be made in the name of the Petroleum Reserves Corporation (an organization created to manage the activities of the U.S. Government in foreign oil matters). However, the consortium withdrew the offer before the formal completion of

the arrangements. The apparent reasons included fear of Government dominance; no obvious cash profit; expectation that the Government would still be concerned with the protection even without sharing ownership; and fear of becoming suspect in the eyes of other governments and at odds with all other U.S. oil companies.

In February 1944 the owners of the Arabian-American Oil Company and the Petroleum Reserves Corporation agreed in principle to the construction of a major pipeline system from the oilfields of Saudi Arabia and Kuwait to the eastern end of the Mediterranean Sea. The plan was rejected because of opposition by the American oil industry and the U.S. Senate.

In August 1944 the United States and Great Britain signed a petroleum agreement to promote an orderly development of the international oil trade to insure (1) equal opportunity in the quest for new concessions and (2) adequate supplies of oil to all countries. The agreement, subject to ratification by both Great Britain and the United States, encountered considerable opposition in the U.S. Senate and from the oil industry; as a result, the United States withdrew from the agreement.

A new agreement with Great Britain was signed in September 1945 and submitted by the President to the Senate for its advice and consent to ratification. The agreement encountered opposition in the Senate and from the U.S. oil industry, and the Senate took no positive action on it.

DEPARTMENT INFLUENCE IN RECENT OIL CONTRACT NEGOTIATIONS

The Department consciously avoided involvement in the details of the recent major oil contract negotiations but helped to insure that negotiations were successfully completed. The Department assisted in developing a climate conducive to successful negotiations between U.S. oil companies and oil-producing countries.

Officials indicated that the Department frequently discussed major issues with oil companies and foreign officials. However, when the Assistant Secretary of State for Near Eastern and South Asian Affairs was asked about his office's role in a recent oil negotiation settlement, he testified that:

"We have not and do not intend to take any substantive position on the negotiations * * *. If you are talking about U.S. really developing a substantive proposal, so to speak, and actually becoming part and parcel of the substantive negotiations, the answer is no."

SIGNIFICANCE OF THE AGREEMENTS

Although OPEC was established in 1960, it did not use its combined bargaining power effectively until 1970. Previously the international oil companies had operated essentially under a concession-type arrangement which allowed them to exploit a country's oil reserves, without production limitations and with nominal tax payments, for the time set in the agreement. Some of these agreements, canceled by the new agreements in 1971 and 1972, would not have expired for another 20 to 40 years.

Acting in concert, the exporting countries have negotiated eight agreements with oil companies that have significantly increased the cost of crude oil. As a result of the 1971 agreements, and taking into account production increases in the Middle East, revenues of these producing countries by 1975 will probably more than double the 1970 revenues. These agreements, though affecting different countries, were negotiated at approximately the same time, and the negotiations significantly influenced each other. Probably the most important agreement was the one which provided for the exporting country's participation or part ownership in the companies' operations.

We reviewed the Department's position and actions on the agreements listed below.

Date	Agreement	Exporting countries involved
Feb. 1971	Tehran	Abu Dhabi, Iran, Iraq, Kuwait, Qatar, and Saudi Arabia
Apr. 1971	Tripoli	Libya
June 1971	East Mediterranean	Iraq
Jan. 1972	Geneva	Abu Dhabi, Iran, Iraq, Kuwait, Qatar, and Saudi Arabia
Dec. 1972	OPEC Participation	Abu Dhabi, Kuwait, Qatar, and Saudi Arabia

Although not all companies were involved in all of these agreements, the major companies participated in most. For example, Mobil, Shell, Standard Oil of New Jersey (Exxon), and British Petroleum were involved in all five agreements,

while Texaco, Gulf, and Standard Oil of California were involved in four.

The Tehran Agreement raised the basic posted price of oil 35 cents a barrel. This followed a 9 cents a barrel raise negotiated in 1970. Additional increases for inflation and the rising demand for oil were established in four increments for the 5-year life of the agreement. The agreement also increased the host countries' taxes from 50 to 55 percent of net taxable income and established a system for adjusting the posted price according to the oil's specific gravity.

In the Tripoli and Eastern Mediterranean Agreements, the OPEC countries involved used the Tehran Agreement as a base and added to it by raising the basic posted price, getting a further increase for low-sulfur oil, and securing temporary increases to reflect (1) their geographical advantage while the Suez Canal was closed and (2) the high freight rates prevailing for oil tankers. All three agreements represented major achievements by OPEC countries and significantly increased the revenues of three countries.

The Geneva Agreement and the OPEC Participation Agreement were unlike the previous three. The Geneva Agreement increased the posted price to restore to the oil-producing countries the purchasing power lost because of the 1971 U.S. dollar devaluation. As described in chapter 3, the Participation Agreement provided the host countries with a 25-percent interest in the companies' ownership, increasing gradually to 51 percent by 1983. The countries have 2 years to pay the oil companies for their share of production. The added revenues from participation should allow all the host countries to meet compensation payments from their share of earnings. Thus, they can acquire control without expending any of their own money.

Negotiation of the Tehran Agreement

At an OPEC conference December 9 to 12, 1970, it was decided to initiate negotiations between the six Persian Gulf members and the oil companies within 31 days. On January 8, 1971, the U.S. companies advised Department officials that they did not believe they would be prepared to start negotiations by January 12, 1971.

The basic dilemma of the oil companies' representatives was the risk of offending OPEC either by requesting postponement of the negotiations or by beginning talks on a false basis. Department officials voiced their concern about the adverse effects of postponed negotiations. However the next day, the Department asked the U.S. Embassy in Tehran to explain to the appropriate authority that the companies were having genuine difficulties in reaching a joint negotiating position and to urge the countries not to overreact to any delays.

On January 10 the Shah of Iran and the Saudi Arabian Oil Minister threatened to stop production if OPEC demands were not met. The discussions did open on January 12, 1971, as planned but broke off after only 2 hours. No negotiations took place; the company representatives wanted only to obtain further information about OPEC's demands.

The oil companies agreed among themselves to negotiate only on the basis of reaching a 5-year settlement simultaneously with all producing countries concerned to avoid the leapfrogging effect of a series of agreements and to promote stability in the oil industry.

On January 16, 1971, the oil companies issued a joint letter notifying OPEC countries of their desire to negotiate a 5-year pact. At the same time, the U.S. Government stressed to OPEC officials that the United States

--believed the industry statement provided a basis for negotiating an equitable settlement for oil pricing in all OPEC countries,

--trusted that OPEC countries would give the industry an opportunity to discuss and negotiate the details of these proposals, and

--trusted that no hasty or arbitrary actions would be taken which could damage the interests of all parties involved.

Libya and Algeria issued a joint communique denouncing the oil companies' request of January 16, 1971, for collective bargaining. This made it evident that the Tehran negotiations would be limited to the six Persian Gulf countries.

The Under Secretary of State met with the heads of state of Iran, Saudi Arabia, and Kuwait and other high-ranking officials in those countries. Although details of the negotiations between the parties directly involved were not discussed, these leaders indicated that they had not been treated fairly by the oil companies over the years. This, plus a greater sense of solidarity and strength because of their OPEC memberships and the world oil situation, was the reason they were ready to stand up to the oil companies in negotiations.

In briefing industry representatives on the results of the Under Secretary's trip, a Department official stated that the Under Secretary had succeeded in impressing on the three rulers the seriousness with which the U.S. Government would view any cutoff of oil supplies for Europe and had clearly pointed out that the U.S. Government viewed the industry offer as a reasonable basis for negotiations. This Department spokesman reported that any agreement reached would be binding for the life of the agreement regardless of the terms of settlement reached in Libya or elsewhere in OPEC. He stressed that these assurances were made by the heads of state to a Presidential envoy and thus were very different from previous assurances given to the industry.

Talks between the OPEC negotiating committee and the company representatives were resumed on January 19, but the Gulf countries set a February 3 deadline for an agreement.

As the deadline drew near, industry representatives expressed grave skepticism about the negotiations. On January 31, 1971, they presented a counterproposal short of OPEC demands but feared the offer would be rejected, negotiations broken off, and oil exports suspended as early as February 1.

At this point, the U.S. Government position, according to a Department message, was:

--"The Government continues to fully support the coordinated approach by companies and governments of consuming countries in the oil negotiations and will promote this end wherever possible, including through OECD [Organization for Economic Co-operation and Development]."

--"The Government is in no position to judge whether the oil companies' offers to the Persian Gulf countries are reasonable or not under present circumstances. If companies believe they can make no further offers and must break off negotiations (with all the consequences that may ensue) that is for them to decide."

--"The Government is equally in no position at this time to say what its position would be in regard to hypothetical marketing arrangements and other commercial matters, should the Persian producers take drastic action."

--"The Government will of course remain in close communication with companies and governments and will continue to consult with the parties concerned as the situation develops."

On February 1, negotiations did break down because the companies considered OPEC's demands too great and the deadline too stringent. The Iranian Government was advised of the U.S. Government's concern about the oil talks because, if the talks broke off and OPEC took unilateral action, there would be major repercussions. The Saudi Arabian Government was informed that the United States Government, although not involved in the negotiations, was deeply concerned with the apparent breakdown and that it was convinced more time was needed to discuss these complex matters. In addition, Saudi Arabia's representatives were advised that the U.S. Government could not involve itself in the details of such aspects as price or weights of crude oil but wanted Saudi Arabia to be aware of U.S. concern with the underlying fundamentals. The Department's view was that no further Government approaches should be made unless a breakdown of negotiations was imminent.

On February 4, 1971, the oil companies sent a message to the OPEC countries urging that no immediate and irrevocable action be taken and that further negotiations could still produce a satisfactory settlement. At a meeting in London the next day, Embassy officials suggested to one of the oil company representatives that the companies prepare a more effective and simple presentation on their case concerning assurances. Department officials in Washington

met with oil company representatives on February 9 and repeated the Department's view that it would be highly desirable for companies to continue negotiations. The consensus of the companies was that they must make a new and improved offer before the February 15th deadline.

Just 3 days before the deadline, the oil company representatives stated that freight differentials were the most important unsettled element. The companies felt that the time might come in the next few days when the United States and Great Britian should intervene with the Government of Iran. Since the issues had been taken up informally, it was not felt that any formal demands could be made.

On February 13, 1971, U.S. company representatives stated that they expected an agreement to be reached within a day and suggested that, after its announcement, the United States should express gratification to the Persian Gulf countries that the negotiations were successful and would provide stability for 5 years. The agreement was signed on February 14. Two days later a Department spokesman in Washington said that, considering all the circumstances, the United States felt that a most satisfactory agreement had been reached. The Iranian Prime Minister expressed great appreciation for the U.S. attitude and position concerning the negotiations.

In October 1973 the Tehran Agreement was virtually scrapped when new price negotiations were broken off by the six Persian Gulf members of OPEC who had signed the agreement. This was immediately followed by a price increase which oil companies stated was a unilateral increase of about 66 percent. One oil company spokesman stated:

> "The effect of this decision would be to raise posted prices of gulf crude oils by about $2/bbl [barrel]. Income tax and royalty payments to producer governments would rise from about $1.75/bbl to about $3.00/bbl."

<u>Negotiation of the Tripoli Agreement</u>

In September 1970 Libya used the threat of nationalization on Occidental Petroleum (a major producer in Libya but with little production outside) as a means to secure a price increase. Then, using Occidental as a precedent,

Libya forced increases on other independent oil companies. Citing these increases as precedent, Persian Gulf oil-producing countries secured additional increases in November 1970.

On January 2, 1971, the Libyans claimed that the November 1970 increases given the other countries entitled Libya to further increases. This leapfrogging effect was the prime reason that the oil companies wanted a comprehensive 5-year settlement with all the OPEC countries during the Tehran negotiations.

U.S. representatives then met with Libyan officials to probe their timing and demands and to encourage them to give the companies time in their bilateral talks to develop a position responsive to the OPEC resolutions. Libya refused to negotiate, wanting only acceptance or rejection of its demands by January 16, 1971.

On January 8, 1971, the President of Occidental stated that Occidental would need help if the major oil companies wanted his company to stand firm in the negotiations in Libya. The next day Occidental representatives in Tripoli met with Libyan officials, who demanded even greater increases from Occidental and Bunker Hunt Petroleum Companies than those demanded on January 2.

On January 15, 1971, 1 day before the deadline set by Libya, the oil companies approved a production-sharing agreement aimed at helping companies, such as Occidental, if their production were shut down in Libya and enabling companies to form a united front to resist Libyan divide and conquer tactics. The companies briefed the Secretary of State on the problems involved, but the deadline passed without incident.

Libyan officials stated on January 20 that they would negotiate on terms applicable only in Libya. Libya's increased demands came when talks were about to begin in Tehran. The oil companies, anxious that these talks not be jeopardized, sought Department of State assistance to dissuade the Libyan Government from any precipitous action. Libya maintained that its desire was to negotiate with one company at a time but suggested its willingness to conduct negotiations with one company which was tacitly understood to be acting as the industry leader.

When the Tehran Agreement was signed on February 14, Libya's reaction was to declare firmly that the terms did not meet even its minimum expectations.

One week later, officials from Algeria, Saudi Arabia, and Iraq met with Libyan officials to assist in Libya's negotiations with the companies. Libya then threatened production cutoffs by all four countries to obtain its demands. It should be noted that Saudi Arabia and Iraq had signed the Tehran Agreement and had given assurances against production cutoff. Finally, on April 2 Libya and the oil companies reached an agreement.

<u>Negotiation of the Eastern Mediterranean and Geneva Agreements</u>

The Department had very little influence in the Eastern Mediterranean Agreement. U.S. diplomatic relations with Iraq had been broken off and the U.S. Embassy in Baghdad officially closed since 1967. As a result the oil companies had to negotiate the Eastern Mediterranean Agreement with Iraq without assistance from the Department.

The Geneva Agreement was designed to restore to the oil-producing countries the purchasing power lost because of the devaluation of the U.S. dollar.

Because oil companies paid oil taxes and royalties due either in U.S. dollars or a stated dollar equivalent, a devaluation of the dollar meant that producing countries received an amount of currency which would buy less on the world market. From August 15, 1971, the date of devaluation, until the agreement was signed on January 20, 1972, the oil companies had enjoyed a windfall profit because oil prices in Europe and Japan remained stable. The oil-producing countries sustained losses on the revenue received in the form of reduced purchasing power. The Geneva Agreement added about $670 million in revenues to the Persian Gulf countries. Department officials believed it was better to remain out of any negotiations on this matter because they felt that the U.S. Government had no effective leverage.

On March 22, 1973, the major oil-exporting countries decided to seek increased payments from the oil companies to compensate for the latest devaluation of the U.S. dollar.

Negotiation of the OPEC Participation Agreement

After years of discussions among the OPEC countries on how to better control the rewards from their oil resources, OPEC members announced publicly at their conference that they would discuss participation with oil companies in early 1972. Following the conclusion of the Geneva Agreement in January 1972, the oil company representatives and members of OPEC began discussions on the demands for participation in the companies. The Saudi Arabian Minister of Petroleum negotiated on behalf of OPEC. The companies originally held that OPEC's demands for participation were confiscatory and could not serve as a basis for opening discussions. The OPEC representative threatened that, if the companies were not prepared to negotiate, participation would have to be legislated on them. To break this initial impasse, the companies then proposed a form of partnership in concession areas that had undeveloped oil reserves.

Although the offer was rejected, Department officials felt that it represented a serious effort to start negotiations and that it was in line with the Department's previous recommendations that the companies take constructive steps in the negotiating dialogue. The companies then asked for Department assistance in dealing with this problem.

In February 1972 the U.S. Government pointed out to Saudi Arabia (1) the importance of successfully resolving this issue and (2) the feeling that participation on OPEC's terms would undermine the stability of the oil industry, which was insured in the previous agreements. Saudi Arabia was urged to start constructive negotiations, considering the companies' new and constructive proposal.

The Department believed that presenting U.S. views would help avoid a negotiating impasse and that the companies and major Persian Gulf countries would eventually be able to reach an agreement without a major crisis.

The Department's position, according to an intradepartmental message, was:

"We continue to believe that companies will inevitably find it necessary to accommodate political

forces behind participation moves. We have urged them to take [a] constructive approach and believe that proposals to Saudis and Iranians are first steps in [the] right direction. On [the] other hand, removal of U.S. companies from control of investment and production decisions could have an inevitable harmful effect on U.S. balance of payments and if precipitated through a crisis in negotiations, [it could have] a serious disruptive effect on stability and required expansion of world oil supplies. The United States Government is continuing to urge both sides to engage in constructive negotiations. We believe present OPEC demands for participation and compensation would drastically change the financial relationship between governments and companies. In our view, this change in relationship would be contrary to the terms of the Tehran Agreement, which promised stability in oil relationships for the five year period of the agreement. Should therefore OPEC insist on implementation before [the] Tehran Agreement expires, we believe it may be necessary to remind signatories of their commitments."

On March 10, 1972, the oil companies having concessions in Saudi Arabia accepted in principle the 20-percent-participation demands. The companies did not state, however, their position on the timing for participation, amount of compensation, disposition of the host government's share of production, future financing requirements, and assurances for the future. Department officials indicated that, while it was obviously impossible to predict the outcome, the decision seemed correct and the companies had chosen the least undesirable alternative. The companies' decision came after failure to block the participation push.

Qatar's Petroleum Director and OPEC representative subsequently stated that Qatar expected oil companies to move toward 20-percent participation along the lines of the commitment in Saudi Arabia. The Petroleum Director said he hoped the United States would help Qatar pressure the companies if necessary. However, the U.S. Government indicated that, because of the importance of the international petroleum industry, it placed great emphasis on the maximum degree of cooperation between all parties.

By March 20, 1972, the oil companies had informed Iraq, Qatar, Kuwait, and Abu Dhabi of the companies' readiness to accede to the governments' wishes to acquire 20-percent participation.

During the first round of participation negotiations, which began on March 20, the Minister of Saudi Arabia asked whether the oil companies thought the government or a national oil company should be the shareholder. He stressed that, whatever arrangement was worked out, Saudi Arabia had no intention of paying U.S. taxes on any dividends it might receive. The main outcome of the meeting was the decision to hold additional meetings.

Although limited progress was being made at these meetings, the countries became disturbed by the Secretary of the Treasury's statement to the House Committee on Interior and Insular Affairs that U.S. companies were seeking deals with other countries and were negotiating with foreign governments as though they were on a par. No company, he said, can deal with foreign governments on an equal basis. He recommended more U.S. Government involvement.

By the end of May, little substantive progress had been made. OPEC had pushed for (1) company acceptance of the principle of eventual assumption by the governments of 51-percent participation and (2) the immediate entitlement to oil equal to their equity participation. The companies were resisting both demands but were aware that the issue could become political if no progress was made by the end of June (the next scheduled OPEC conference).

As the OPEC conference drew nearer, terms of a participation agreement were not settled but progress was made. On the question of the timetable for 51-percent participation, oil companies indicated readiness to make commitments if the terms and guarantees were satisfactory. Compensation to the companies for host-government participation was the point of major disagreement. The companies and OPEC had also been unable to agree on the form participation should take--stock of the in-country company, share of oil production, or share of the profits.

At the conference, OPEC warned that, if the negotiations on participation failed, "definite concerted action" would

be taken by the member countries concerned and would be supported by all member countries. This presumably meant acquisition of at least 20-percent participation through legislation.

After the conference, the Secretary General of OPEC stated that, if oil companies did not come up with an acceptable participation formula, there would be wholesale nationalization. He said OPEC preferred a mutual agreement but would use the sovereign legal route if necessary. If this happened, he added, few countries would be satisfied with only 20 percent.

Subsequently, Saudi Arabia approached the United States to encourage the oil companies to be flexible in their negotiations. This was the first time Saudi Arabia asked for U.S. Government intervention in negotiations. The Deputy Minister of Petroleum (the King's son), while on a visit to the United States in July 1972, conferred with various U.S. officials involved in the energy field to explain his government's position on participation. In response, the Saudi Arabia Government was told of the need for reciprocal flexibility by the OPEC countries to provide fair compensation for participation.

An oil company representative then suggested the possibility of sending a Presidential envoy to see the King to indicate the depth of U.S. feelings on compensation because the only way to make sure the King knew the U.S. views was to send an envoy. The Department of State advised the company representative that the idea of sending an envoy was a poor one.

On August 31, 1972, oil industry representatives reported that, although no agreement had been reached, talks were constructive and, compared to previous meetings, some progress was being made.

During a visit to the United States in September, the Saudi Arabian Minister of Petroleum was advised that the U.S. Government did not wish to get involved in the details of the compensation to be given companies in return for host government participation but did want to be sure that compensation was recognized as fair and equitable.

The Minister stated that only a few obstacles remained and these could be resolved. He concluded that an agreement could be the starting point of a new relationship between the oil companies, the producer governments, and the consumers and that full cooperation among all three would be needed to achieve stability.

The Minister was informed of the U.S. Government's concern about the attitude of other OPEC members. Given OPEC's support for the law of changing circumstances, the United States hoped other OPEC members would accept the results of the negotiations and not try to disrupt them.

On October 5, 1972, an agreement was initialed in New York City by company representatives and the Saudi Arabian Minister of Petroleum acting on behalf of the four OPEC countries involved. The agreement, subject to final approval of the rulers of Saudi Arabia, Qatar, Kuwait, and Abu Dhabi, was broad and left considerable scope for details for each country.

After an OPEC conference on October 27, Saudi Arabia, Kuwait, Abu Dhabi, and Qatar announced their willingness to become parties to the proposed agreement. On December 20, 1972, the agreement was signed.

The only surprise in the final agreement was that the host governments' initial share would be 25 percent, instead of the 20 percent agreed to in principle at the start of negotiations. The change apparently occurred during final negotiations. The agreement also provided for government majority ownership (51 percent) of producing concessions by 1983.

CHAPTER 5

ATTEMPTS AT GOVERNMENT-TO-GOVERNMENT OIL AGREEMENTS

The Department of State has tried to negotiate bilateral treaties with several Western Hemisphere countries. Department officials have also been (1) exchanging information, (2) discussing energy problems with other major oil-consuming countries, mainly through OECD, and (3) trying to conclude formal agreements with other major oil-consuming nations to develop alternate sources of energy and multigovernment contingency plans in case of supply disruption.

However, the United States has not concluded any firm agreements with friendly oil-producing countries to secure a continuing supply of oil.

DEPARTMENT EFFORTS CONCERNING OIL AGREEMENTS WITH PRODUCER COUNTRIES

The Department does not have the sole prerogative to initiate negotiations for government-to-government agreements. Such actions must be carefully coordinated with many other U.S. Government agencies.

However, the Department has followed a policy of striving to secure agreements with Western Hemisphere countries for national security reasons, and, at the same time, it has avoided formal agreements with Eastern Hemisphere countries on the grounds that it would create difficulties with oil-consuming allies. The Department has been unable to conclude any agreements with Western Hemisphere countries although Eastern Hemisphere countries have approached the United States with proposals for bilateral oil agreements.

In 1959 the President stated:

> "The United States recognizes, of course, that within the larger sphere of free world security, we, in common with Canada and with the other American Republics have a joint interest in hemisphere defense. Informal conversations with Canada and Venezuela looking toward a coordinated approach to the problem of oil as it relates to

this matter of common concern have already begun. The United States is hopeful that in the course of future conversations agreement can be reached which will take fully into account the interests of all oil producing states."

Nevertheless, the U.S. Government maintained a low profile in foreign petroleum matters until 1970, preferring to allow oil companies to determine U.S. oil-related policies.

On February 20, 1970, the President, recognizing that all the members of the Cabinet-level Task Force on Oil Imports had agreed that a unique degree of security could be afforded by moving toward an integrated North American energy market, directed the Department to:

--Continue to examine with Canada measures for a freer exchange of petroleum, natural gas, and other energy resources.

--Explore more fully the possibility of reaching an agreement on the exchange of energy with Mexico.

--Continue consultations on petroleum with Venezuela and other Latin American suppliers who proved to be secure and dependable sources of oil during the crisis after World War II.

--Review with producing nations of the Eastern Hemisphere, and our NATO allies and Japan, the findings and recommendations of the Cabinet-level Task Force on Oil Imports.

In line with the President's directives, the Department renewed its efforts to achieve bilateral oil agreements. The following sections outline the situation with several Western Hemisphere countries supplying oil imports. We have also included a section concerning Saudi Arabia, which was one of two Eastern Hemisphere countries to recently propose a bilateral oil agreement with the United States. An Iranian proposal, similar to the Saudi proposal but made several years ago, was not pursued, according to Department of State officials, because it was not feasible at that time in view of existing U.S. import quotas. At the time of our review, newspaper articles indicated that Abu Dhabi was preparing to make a similar offer.

Canada

Canada in early 1973 was providing about 23 percent of U.S. oil imports. Department officials have been striving to come to an equitable agreement for increasing U.S. oil imports from Canada. However, because eastern Canada depends entirely on imported oil, some arrangement is needed which considers the security needs of both countries.

The President, in his energy message of June 4, 1971, referring to the increasing energy trade between the United States and Canada, stated that the time had come to develop further this mutually advantageous relationship. He added that the United States was prepared to move promptly to permit Canadian crude oil to enter the country, free of any quantitative restraints, upon agreement as to measures needed to prevent oil shortages in either country. In early 1973, Canadian and U.S. representatives met to discuss an oil sharing plan for application during supply emergencies. To date no formal agreement has been reached on either, and over 13 years have passed since the United States recognized the need to reach an agreement with Canada. Canada's growing need for its own oil, its spirit of nationalism, the desire to conserve this wasting asset, and its concern about encroachment by foreign capitalists are obstacles to negotiating an arrangement.

In February 1973 the Canadian Government announced that it was imposing controls on oil exports to the United States beginning March 1. According to the Canadian Energy Minister, the U.S. demand for Canadian oil had strained its oil production and transportation system and threatened the continued supply to Canadian refiners dependent on such supplies. The controls were labeled interim, and a long-term policy was to be determined after public hearings and a cabinet study.

We were unable to review this situation in depth because Department officials felt that we should not have access to records dealing with Canada in view of the ongoing discussions.

Venezuela

The United States imported about 62 percent of Venezuela's 1972 oil exports. This accounted for about one-third of all U.S. petroleum imports and 10 percent of U.S. consumption. However, the oil companies have little incentive to invest

the large sums needed to sustain or increase conventional oil outputs because most oil concessions will revert to the host government between 1983 and 1985 under the Petroleum Assets Reversion Law of 1971. Although production has already peaked out, Venezuela is expected to continue to provide an important part of U.S. oil requirements from its conventional sources. No efforts are being made to consummate a government-to-government agreement for a guaranteed supply of conventional petroleum.

A second source of a large supply of petroleum lies in Venezuela's tar sands area. Although it has not been exploited because extraction costs are estimated to be much higher than those for conventional oil, several U.S. oil companies have indicated considerable interest in developing this alternative source.

With the substantial funding and the long leadtimes required to reach full production, oil companies wanted assurances that their investment in tar sands production would not be nationalized in 1983, along with the conventional petroleum concessions, or at some later date. Thus, the United States began discussing with Venezuela a government-to-government treaty for developing the tar sands oil (heavy oil). In return for investment and other assurances, the United States would provide the Venezuelans with preferential treatment in the U.S. market. We were advised by a Department of State official in January 1974 that such a treaty is not imminent under the present conditions.

Other Latin America countries

Although formal oil arrangements have been informally proposed for Colombia and Ecuador, no sustained negotiations have taken place. Ecuador has the second largest oil reserves in South America and it has recently completed a major oil pipeline with a capacity of 250,000 barrels a day. Despite the potential in Ecuador, U.S. officials have stated it is unlikely that Ecuador will respond to a treaty proposal before observing the course followed by Venezuela. The United States has not raised the question of a treaty with either Ecuador or Colombia since the informal proposal in September 1972.

Although Colombia is presently an oil exporter, its proven oil reserves are limited to such a degree that it will become a crude oil importer by 1975 or 1976 and a large-scale importer by 1980, unless large new discoveries are made.

Saudi Arabia

In September 1972 the Saudi Arabian Minister of Petroleum informally suggested a bilateral commercial oil agreement with the United States. The agreement would exempt Saudi oil from U.S. restrictions and duties and encourage the increasing investment of Saudi capital in marketing the oil, thus practically guaranteeing its continuous flow to the United States.

Although no further discussions on the matter have developed, the U.S. Government has considered the proposal but has made no decision to pursue it.

The purpose of the Saudi offer was to gain experience in all aspects of the international oil industry and to associate itself closely with the only country it believes can give it adequate political and military support. The other oil-consumer nations, including those in Western Europe and Japan, are undoubtedly anxious to conclude agreements with Saudi Arabia. Several countries have approached it hoping they would receive similar offers, but Saudi Arabia was primarily interested in the security the United States could provide.

Such an agreement would help the United States overcome major objections to increased imports because:

--The balance-of-payments problems could be met by Saudi investment in the United States.

--The security problem could be at least partially overcome by presumed Saudi reluctance to cut off deliveries to its own partners.

--The United States could secure the necessary energy for the next two decades.

According to U.S. officials, the proposal has hazards. It would be contrary to the General Agreements on Tariffs and Trade; it could start competition among the other consumer

nations; prices could rise drastically; and other oil-producing countries already supplying the United States would seek U.S. trade and aid benefits similar to those given Saudi Arabia.

U.S. officials have indicated that they would welcome Saudi investment in the United States. But awarding Saudi Arabia special preference, according to Department officials, would cause other oil-exporting countries to seek similar preferences, especially Western Hemisphere countries which have enjoyed certain U.S. preferential treatment in the past. It should be noted that the elimination of U.S. oil import quotas met one of the objectives sought by the Saudi Minister of Petroleum in his proposal.

U.S. officials believed that a formal and exclusive agreement could set off a dangerous and cutthroat scramble by other consumer countries for available oil supplies. Therefore, they believed that a specific agreement was not necessary and that the free enterprise system would encourage the development of the proper relationship.

Although U.S. officials are aware that other consumer countries have negotiated agreements with several producing countries, they still believe the major consumer countries must work together to protect themselves and the interests of the underdeveloped non-oil-producing countries.

OTHER COUNTRIES HAVING AGREEMENTS FOR A CONTINUING SUPPLY OF OIL

Although the United States has suggested avoiding formal oil agreements to prevent cutthroat competition, several consumer countries have already negotiated agreements and barter arrangements with oil-exporting countries. This has been done, either directly or through controlled or nationalized companies, to secure at least a portion of their petroleum requirements. For example:

--Iraq has individual oil sales or barter arrangements with France, Italy, the Soviet Union, East Germany, Spain, India, and Brazil.

--The Soviet Union has concluded a technical assistance agreement with Libya. The Soviets will provide petroleum technicians and training personnel and will buy crude oil. Libya has also made a few other small barter arrangements with the Soviet Union.

--Brazil has arrangements with Bolivia, Venezuela, and Iraq for the exploration for or purchase of petroleum and is negotiating with the Soviet Union to secure supply sources.

--Iran has a $200 million barter deal with Czechoslovakia which will involve about 20 million tons of crude oil during this decade.

--Spain and the Soviet Union have agreed to a barter deal including oil.

--Japan has oil arrangements with Kuwait, Indonesia, China, Abu Dhabi, and the Soviet Union.

Now a U.S. oil company is negotiating a special agreement with Iran and, according to Department of State officials, other U.S. firms are seeking similar arrangements in producing countries.

POTENTIAL CUTTHROAT COMPETITION AMONG CONSUMER NATIONS

Many consider petroleum to be the most political of all commodities because the economies of all industralized nations depend to a large degree on it. According to Department officials, with the expected substantial increase in the worldwide use of oil and the declining number of petroleum sources, consumer countries could begin intense competition with each other by bidding for the limited supply of oil and thus drive the price to exorbitant heights.

During hearings held by the Subcommittee on Foreign Economic Policy, House Committee on Foreign Affairs, in September 1972, a Department official testified that:

> "Our oil importing allies are disturbed by the unexpected rate with which our oil imports are increasing; their concern is heightened by the fact that this growth is occurring at a time when there is already considerable concern over the availability of satisfactory supply to meet their own demands of the next decades. They fear our buying power, and suspect that the American companies which dominate the international oil industry will take care of American needs first and at their expense. These are important and sensitive concerns which we must take very seriously into account as we enter into a new era of multipolar diplomacy in which our relationships with our NATO and OECD colleagues will be repeatedly tested. We believe the United States must show leadership in seeking to avoid a situation which could touch off a scramble for energy supplies among the importing nations."

OIL COMPANIES AS BUFFERS BETWEEN PRODUCING AND CONSUMING NATIONS

In addition to supplying the technology and capital necessary to develop overseas oil sources, the oil companies, according to Department officials, have served as buffers between producing and consuming nations. This has helped to keep political ideologies from entering oil contract negotiations. Department officials believe it has kept the

industrialized nations from using their dominant world positions and military strengths to secure the needed oil on their own terms.

With the oil negotiations increasingly favoring the producing countries, the need for further consumer government support or influence in the negotiations becomes more obvious.

POTENTIAL FOR AGREEMENTS WITH CONSUMER COUNTRIES

The U.S. Government does not have any agreements with other major oil consumers, such as Japan, the United Kingdom, France, Germany, and Italy, to promote the closest possible coordination in developing alternative sources of energy or contingency plans in case of supply disruption. However, the United States and several other nations with large oil interests outside their countries have agreed to keep consumer governments informed on international oil developments.

The United States, as a member of the OECD, has used this organization as a forum to discuss the international energy problems. OECD consists of the 24 most industrialized free-world countries--including Germany, the United Kingdom, France, Japan, Canada, and the United States. The energy policies of member countries are reviewed at meetings of the Energy Committee, which attempt to harmonize and balance estimated trends of supply and demand in the energy sectors of member countries. The Oil Committee and its restricted-membership High Level Group have been the focal point for consumer country cooperation and have coordinated emergency measures during past oil crises, such as the Six Day War in 1967. They also review oil policies of member countries to detect any factors in the oil sector likely to affect general economic growth.

The United States has repeatedly outlined to OECD members its growing concern about the increasing reliance on imported oil and the potential effect on national security. The Department of State called for a cooperative rather than a competitive approach in dealing with oil-producing countries, while avoiding direct confrontation with the OPEC countries. But this and the important changes in the relationship between the OPEC countries and oil companies have not yet united the

consumer country governments concerning the producers. Other consumer governments are apparently less interested in supporting the predominately British, Dutch, and U.S. oil companies. As long as supplies do not appear seriously threatened, consumer governments seem to prefer leaving petroleum matters in the hands of the oil companies.

At the time of our review, OECD was striving to develop a scheme for apportioning available oil supplies in an emergency. Department officials have told us that they are currently engaged in a series of negotiations in the OECD which they hope will result in an OECD-wide sharing arrangement, on a basis acceptable to the U.S. Government. No agreement has yet been reached.

When OECD tried to establish an overall plan for joint action, problems arose. Much of the difficulty centered around how the OECD governments might assume a more active role in the oil company/OECD negotiations. One member country had suggested that the OECD countries be prepared to (1) indicate to the oil industry what was, and what was not, acceptable with regard to OPEC, (2) take the risk of a breakdown in oil deliveries, with recourse to the use of stockpiles, and (3) bring this viewpoint to the attention of the OPEC negotiators. Because finding common ground among the members became a problem, no action is expected on this proposal in the near future.

At U.S. urging, OECD agreed in October 1972 to modify its planned 2-year program of energy studies and to proceed on a priority basis with a preliminary assessment of the petroleum problem. This assessment, which was to be submitted by mid-1973 but was delayed until November 1973, would be used to formulate timely recommendations regarding the oil crisis. OECD members were told that the United States was formulating a plan, part of which would be the basis for cooperative action by OECD colleagues.

Although OECD provides member nations the opportunity to consult directly with each other on major issues, it has not yet shown the ability to formulate and execute a consolidated approach to the energy crisis.

CHAPTER 6

EMERGING ISSUES

The United States is expected to experience substantial balance-of-payments deficits as a result of oil imports, and oil-producing countries are expected to accumulate ever-increasing monetary reserves. Increased efforts to expand trade and investment opportunities are needed to overcome the problems which these significant deficits and reserves are expected to create.

ESTIMATED BALANCE-OF-PAYMENTS DEFICIT

Petroleum is already the largest single commodity being imported. According to Department of State officials, by 1985 the projected large increase in oil imports could be contributing about a $35 billion deficit to the annual balance of payments of the United States.

To pay for future oil imports, the United States will need to seek additional export markets for goods and services. Many of the more important oil-producing countries, however, do not have the populations or economic infrastructures to accept increasingly large imports. By 1980 the oil-producing countries in the Near East could be collecting oil revenues at an annual rate of about $63 billion. U.S. officials believe it would not be realistic to expect that an annual outflow of this magnitude would be offset by a corresponding inflow from export sales. One clear possibility is that these countries could become large equity holders in U.S. financial institutions and industrial complexes. The impact on the balance of payments can be measured by the fact that in 1972 the cost of oil imports equaled about 15 percent of our total manufacturing exports which totaled about $29.5 billion.

ACCUMULATION OF MONETARY RESERVES BY OIL-EXPORTING COUNTRIES

The following schedule shows the payments received by some Middle East oil-exporting countries since 1962.

Payments to Producing Countries

Year	Kuwait	Saudi Arabia	Iran	Iraq	Abu Dhabi	Qatar	Libya
	(millions)						
1962	$ 526.3	$ 451.1	$ 333.8	$ 266.6	$ 2.8	$ 55.8	$ 38.5
1963	556.7	502.1	398.1	325.1	6.4	59.5	108.8
1964	655.0	561.0	469.7	353.1	12.4	65.5	197.4
1965	671.1	655.2	522.4	374.9	33.2	68.5	371.0
1966	707.2	776.9	593.4	394.2	99.8	92.1	476.0
1967	717.6	852.1	736.7	361.2	105.0	101.8	631.0
1968	765.6	965.5	817.1	476.2	153.2	109.5	952.0
1969	812.2	1,008.0	937.8	483.5	191.1	115.2	1,132.0
1970	895.1	1,199.7	1,092.7	521.2	233.1	122.0	1,294.8
1971	1,395.3	2,159.6	1,869.6	840.0	430.7	197.8	1,766.0
Total	$7,702.1	$9,131.2	$7,771.3	$4,396.0	$1,267.7	$937.7	$6,967.5

These payments have, in many cases, been so large that the countries have been unable to spend the money earned and they have accumulated large monetary reserves. The chart on page 56 demonstrates how rapidly the monetary reserves of three countries, which have about half of the world's known oil reserves, have risen since 1966. As shown, Saudi Arabia's monetary reserves have quadrupled to approximately $3.15 billion in the last 2-1/2 years. These reserves will continue to increase rapidly unless Saudi Arabia significantly increases its operating budget or investments. The question of Saudi Arabia's investment is crucial because, if it cannot put a major portion of its growing income to a good use, it may well consider holding back on oil production to slow the increase of its monetary reserves and to conserve its oil. Inevitably, this would seriously disrupt the present world supply-and-demand cycle.

The following schedule indicates the importance of the oil-producing countries' monetary reserves by comparing them with those of the United States on a per capita basis.

Per Capita Monetary Reserves of the United States And Selected Oil-Producing Countries, June 1973

Country	Monetary reserves	Population	Per capita monetary reserves
	(millions)		
United States	$14,350	209.6	$ 68
Venezuela	1,865	10.8	173
Iran	1,188	30.7	39
Iraq	1,107	10.0	111
Kuwait	580	.9	644
Saudi Arabia	3,150	5.7	553
Libya	2,717	1.9	1,430
Nigeria	575	56.5	10

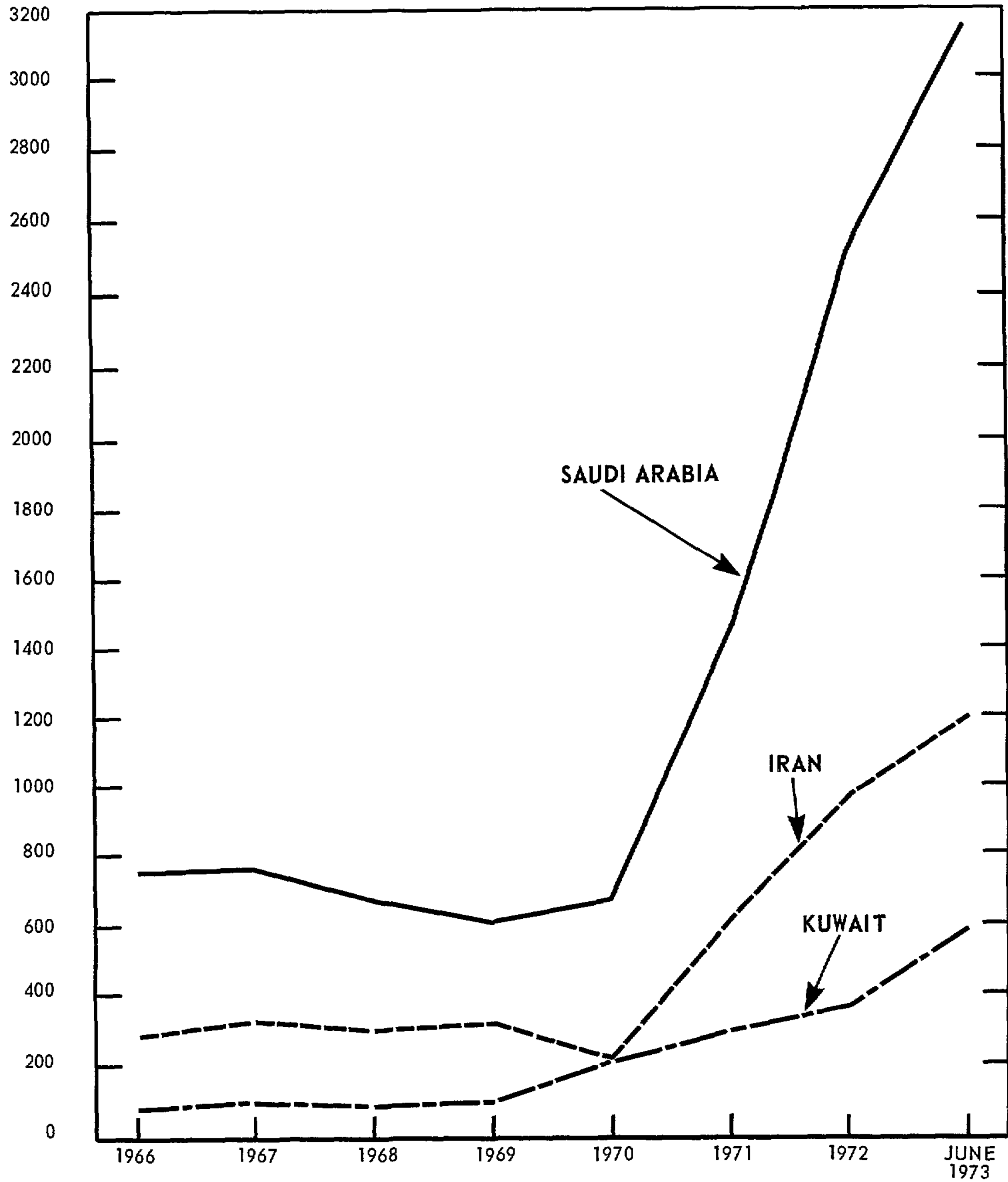
The United States, with a population of over 200 million people, has a per capita monetary reserve of $68, while five of the seven oil-producing countries listed have per capita monetary reserves ranging from 1-1/2 to over 20 times that of the United States. Arab oil-producing countries have 4.4 percent of the world's monetary reserves but have only 1 percent of its population. Knowledgeable authorities have calculated that these countries could control more than half of the world's monetary reserves in the coming decade. These countries have (1) funds available to invest in any conceivable enterprise at home and abroad and (2) the oil which will provide income for future investments. However, if satisfactory investment opportunities are not found, their monetary reserves may serve as a disincentive for increasing production and permit the Arab nations to use petroleum for political purposes.

OPPORTUNITIES FOR IMPROVED TRADE RELATIONS

U.S. efforts to expand trade relations with oil-producing countries have been limited compared with their rapidly increasing monetary reserves. With these potentially disruptive amounts of money and the U.S. balance-of-payments problems, increased trade would be mutually beneficial.

Saudi Arabia already has large monetary reserves and is seeking to convert this money into goods, services, and

FINANCIAL RESERVES OF COUNTRIES WITH ABOUT HALF OF THE WORLD'S OIL



technology. It seems natural that, given our growing need for oil and their increasing desire for goods, services, and technology, arrangements beneficial to both parties could be made. Department officials, however, indicated that the problem was in developing methods to encourage key oil producers, such as Saudi Arabia, to at least maintain, and preferably increase, rates of production in view of their lack of motivation because of U.S. policies concerning Israel, their lack of absorbtive capacity for imports, and the rapid growth in their monetary reserves.

According to Department of Commerce publications, several oil-producing countries, including Iran, Iraq, Kuwait, Libya, Saudi Arabia, and Venezuela, are interested in obtaining U.S. goods and services--such as drugs and pharmaceuticals, factory construction, various metal goods and paper products, heavy-duty construction equipment, and various electronic items. Creation or expansion of foreign market sales will offset some of the projected balance-of-payments deficit. However, increases in sales to oil-exporting countries under free-market conditions are, according to U.S. officials, not expected to significantly offset the projected cost of the growing foreign oil imports.

The U.S. Government, with its various agencies, provides the best means to promote trade agreements for dissimilar goods and services. Other countries, including Italy, Japan, the Soviet Union, and Brazil, have already used their own government institutions as vehicles for negotiating trade and barter arrangements with oil-exporting countries. (See p. 49.) Although trade arrangements may not be the sole answer, they could offset some of the projected U.S. balance-of-payments deficit.

CHAPTER 7

CONCLUSIONS, AGENCY COMMENTS,

AND MATTERS FOR CONSIDERATION BY THE CONGRESS

CONCLUSIONS

Petroleum is vital to our national security and economic growth. There is no adequate substitute to meet short- and intermediate-term needs. The U.S. supply cannot keep up with the rapidly expanding demands. The needs of our allies, as well as of other countries, are also rapidly increasing.

The availability of foreign petroleum products to the United States will, to a great extent, govern the future of industry, transportation, and way of life in the United States. Therefore, it is vitally necessary that national policy on energy be fully coordinated with U.S. foreign policy.

Oil companies, under a free-enterprise system, negotiate the terms of oil agreements with producer countries. The companies, however, have frequently called on the State Department and other U.S. Government officials to use political influence with foreign governments on their behalf. The Department, however, did not become involved in the substance of the oil agreements. It has established only general guidance for, and only broadly defined the responsibilities of, its overseas Missions for advising, assisting, monitoring, or otherwise watching over the practices and activities of U.S. business overseas.

The Department has tried to conclude agreements with Canada and Venezuela and to coordinate its efforts with those of other oil-consuming countries. However, Western Hemisphere countries cannot meet U.S. oil needs, and other major consuming countries have already negotiated agreements with certain Middle East countries for a continuing supply of at least a portion of their petroleum requirements. Department promotion of trade and investment arrangements with Middle East countries has been limited considering the large monetary reserves of these countries.

If future U.S. oil imports are to be insured, workable solutions based on mutual interests are needed for a variety of emerging foreign policy issues relating to oil. The United States must effectively coordinate its foreign policy with its energy policy.

In August 1973 we brought our findings to the attention of both the Department of State and the Office of Management and Budget and asked for their comments. We suggested that the Department of State play a major role in developing national policy on energy. We also made several proposals to the Secretary of State to point out specific areas where the Department's efforts could be strengthened. These proposals included enhancing its capability to analyze economic and security ramifications of oil negotiations; to influence oil negotiations; to lead in identifying potential trade and investment opportunities for dollar-rich oil-exporting countries; and to define responsibilities of overseas Missions for advising, assisting, and monitoring the practices and activities of U.S. business overseas.

DEPARTMENT OF STATE COMMENTS

In a letter dated September 19, 1973, the Department concurred in general with the basic conclusion of our report--the need for the Department to play a larger, and in fact a major, role in the rapidly evolving petroleum situation.

The Department said, in regard to that role, that:

--It has played and continues to play a major role in the development and implementation of national policy on energy imports.

--It led the efforts to alert the administration and the Congress to actions which should be taken if serious future shortages of energy were to be avoided.

--It provided guidance to the U.S. oil companies on U.S. policies on energy imports.

--It had intensive and frequent consultations with the oil companies during their negotiations on the major petroleum agreements.

--It had regular consultations, both bilateral and multilateral, with other concerned governments in producing and consuming countries to develop a climate conducive to successful negotiations between U.S. oil companies and oil-producing countries, while protecting U.S. national interests.

--A more active Department role in the negotiations themselves was inconsistent with traditional Government-business relationships, and it doubted that direct involvement of the U.S. Government in the negotiations would have enhanced the interest of the United States as a whole.

--Each issue and negotiation had a characteristic peculiar to itself and not amenable to other than very broad guidelines.

--It had recently augmented its staff in the Bureau of Intelligence and Research and was seeking a staff increase for the Office of Fuels and Energy in its budget for fiscal year 1975.

The Department said, concerning trade and investment, that:

--It was actively engaged, along with the Departments of the Treasury and Commerce, in developing opportunities for trade and investment outlets for the large monetary reserves now being rapidly accumulated by Middle East oil-producing countries.

--It intended to send teams of financial and trade experts to the major oil-producing countries in the near future to assist them in planning intelligent use of their growing financial resources, while also promoting U.S. investment and trade interests.

--It was substantially increasing its commercial representation in oil-producing areas for the dual purpose of expanding our exports and attracting investment, and it would propose a further expansion in fiscal years 1974 and 1975.

--It planned to create several new staff positions in the Middle East directed exclusively to the development of portfolio and equity investment in the United States.

--It had traditionally followed the practice of attempting to promote an environment conducive to U.S. private investment in foreign countries; but, because of the variety of circumstances in individual countries, it had established only general guidelines on the conduct and behavior of U.S. business abroad.

--General guidance to its Missions abroad concerning their responsibilities to and relations with U.S. commercial interests are contained in the Foreign Affairs Manual, and, when appropriate, specific guidance is provided to its Missions.

--The changing company role and the growth of large, multinational companies require a changing Government role, and this problem, as it relates to the major oil companies, is currently being explored both within the administration and with other concerned oil-consuming governments.

OFFICE OF MANAGEMENT AND BUDGET COMMENTS

On September 13, 1973, the Office of Management and Budget said that:

--The Department of State should, and already does, have a major role in developing national policy on energy imports to deal with the energy crisis.

--The Department should have adequate capability for comprehensive analysis of long-term economic and security ramifications of agreements negotiated between U.S. oil companies and foreign governments. The extent of that capability should be looked at in the context of the capability of other departments, agencies, and offices, including the Energy Policy Office.

--The implication that the Department has the authority to dictate the terms under which private firms dealing with foreign governments shall negotiate should be avoided.

--The Department's leadership in developing opportunities for trade and investment for the Middle East monetary reserves from oil sales should be exercised in conjunction with that of the Departments of Commerce and the Treasury.

--The Department should define the responsibilities of its Missions for advising, assisting, and monitoring the practices and activities of U.S. business overseas, including their role in oil negotiations.

--The balance-of-payments implication of increased oil imports is one of concern but should by no means be regarded as an insoluble problem.

ANALYSIS OF AGENCY COMMENTS

Our report does not deal with or call for direct Government involvement in oil negotiations but, rather, points to areas in which the Department could strengthen its capabilities to deal with the ramifications of the international oil situation. In view of the highly volatile situation which has emerged in the Middle East since the proposals were made, GAO is deferring specific recommendations to the Department at this time.

In the trade and investment area, satisfactory solutions will inevitably involve the U.S. Government, foreign governments, and the private sector, particularly multinational corporations. It is for this reason that we believe the Department should lead and coordinate the U.S. Government efforts. We intend to review separately the U.S. efforts in this area.

MATTERS FOR CONSIDERATION BY THE CONGRESS

During 1973 attention has been increasingly focused on the Nation's energy shortages and increasing need for petroleum imports. In October 1973, with the eruption of hostilities in the Middle East and the Arab curtailment of petroleum exports, the Department was thrown into a critical situation of trying to resolve issues connected with current and future flow of imports from the Middle East. This report discusses the Department's role in this evolving situation before the eruption of hostilities.

The fundamental issues involved in the international petroleum scenario, although altered somewhat by recent events, remain essentially unchanged. These issues involve

--the future availability of petroleum imports,

--agreements with oil-exporting countries,

--agreements with oil-consuming countries,

--outlets, such as increased trade and investment opportunities, for the increasing monetary reserves of oil-exporting countries, and

--the Department's role in negotiations between oil companies and producer countries.

Although the above issues will be influenced by world opinion and the overall Arab-United States-Israeli relationships, the issues, in and of themselves, must ultimately be dealt with. This report contains information on the issues which the Congress should find useful as it considers future energy proposals and programs.

PRINCIPAL OFFICIALS RESPONSIBLE FOR THE ADMINISTRATION OF ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
DEPARTMENT OF STATE		
SECRETARY OF STATE:		
William P. Rogers	Jan. 1969	Sept. 1973
Henry A. Kissinger	Sept. 1973	Present
ASSISTANT SECRETARY OF STATE (BUREAU OF ECONOMIC AND BUSINESS AFFAIRS):		
Julius Katz (acting)	Nov. 1971	Feb. 1972
Willis C. Armstrong	Feb. 1972	Present

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