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National oil companies and international oil companies in the Middle East: Under the shadow of government and the resource nationalism cycle

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1. Introduction

This paper considers the cyclical nature of resource nationalism. As the title suggests, the focus is on the oil production in the Middle East.[1] The reason for the emphasis on the Middle East is obvious. It has always dominated the global oil reserves[2] and has in recent years had more than its fair share of conflict.[3] This issue matters because it determines the ability and willingness of the region to convert its geology into supplies of oil for the global oil market.[4] Fig. 1 illustrates the importance of the Middle East exports in the global energy markets since 1951. The issue also matters because it affects the ability of the region to convert its resources into development meaning growth, employment creation and the alleviation of poverty for its own people.

A key issue concerns how 'resource nationalism' is defined. Given the recent revival of interest, there are a multitude of different definitions and interpretations. The International Energy Forum has recently defined it "nations wanting to make the most of their endowment" (Middle East Economic Survey (MEES), 2006, 49, p 39). Bill Farren-Price of MEES described it as a situation where the "producer countries have moved to maximize revenue from present oil and gas production while altering the terms of investment for future output" (MEES, 2006, 49, p 37). Another version is that it is simply an expression of Ray Vernon's 'obsolescing bargain' (Vernon, 1971) whereby once oil was discovered and the investment sunk in development, relative bargaining power switches in favour of the host government which then tries to increase its fiscal take by changing the terms of the original contract. Yet another alternative view is that it is simply a political antipathy to the USA (and by implications its oil companies) and/or economic globalization.

In this paper, a simple definition is used. 'Resource nationalism' is assumed to have two components – limiting the operations of private international oil companies (IOCs) and asserting a greater national control over natural resource development. This

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[1] Because of the interlinking nature of the region, North Africa is also included in the "Middle East" for analytical purposes.

[2] In 2005, the Middle East accounted for 61.9% of global proven oil reserves, and if North Africa were added the figure rises to 67.1% (BP, 2006).

[3] A rough calculation suggests that of the 12 major wars fought since the end of World War II (excluding civil wars and internal repression), 7 had involved the Middle East.

[4] In 2005, the Middle East and North Africa accounted for 40% of the global oil exports (in 1975, the figure was 61%). The Middle East crude production accounted for 11.5% of the global primary energy consumption (BP, 2006). Oil is a seriously important strategic commodity (Yergin, 1991; Parra, 2004).

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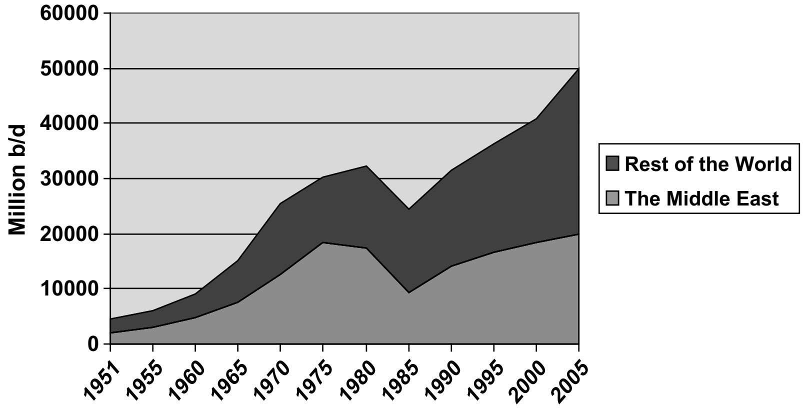

Fig. 1. World oil exports (1951–2005). *Source*: BP (various years).

phenomenon has had a long history and not just in the context of oil or minerals.[5] Furthermore, it is not just a phenomenon associated with 'dodgy' governments in 'dark continents'. Often Canada and Australia are cited in the literature as classic examples of countries where 'resource nationalism' has ruled (Owen, 1988; Uslaner, 1989).

The drivers of 'resource nationalism' are many and are a function of history as much as the current context. It can be driven by a concern that the IOCs are taking too large a share of the cake. By a perception that the resource will be needed for domestic uses[6] or that the potential customers are somehow 'unworthy'.[7] Another driver is the perception amongst ordinary people that they have seen little or no benefit from the extraction of 'their' oil and minerals, despite IOCs paying taxes to their governments. In such circumstances they either revolt as in the Nigerian Delta or elect populist governments as in Venezuela and Bolivia.[8] A variation on this 'exclusion' is the experience in Russia where popular opinion feels that the sell-off of oil resources in the early 1990s was an outrageous give-away that created a bunch of oil oligarchs tainted by corruption.

However, there is also an ideological component to 'resource nationalism' strongly linked to the perceived role of the state in the operation of the national economy, and it is this that contributes a cyclical appearance to the phenomenon. Because of its crucial contribution to the story of 'resource nationalism', this deserves an elaboration.

In terms of the modern history, the 25 or so years after World War II saw very large state involvement in nations' economic systems. There was a widely held view that governments could and should intervene directly to address social and economic problems. Three basic underlying drivers can be identified in the OECD (Organization for Economic

5 For example, there were serious riots in Iran in 1890 over the tobacco monopoly granted to a British citizen by Mozaffar Al-Din Shah.

6 For example, this is becoming a major issue in relation to gas in Iran (ESMAP, 2007).

7 The case of gas exports from Bangladesh to India comes into this category as does the export of Bolivian gas through Chile.

8 Another variation from the mining sector in Peru is that the local community short-circuits the system and appeals directly to the companies for aid and assistance. The problem with this is that in a world of easy information it generates a 'bidding war' in which the last 'donation' acts as the base bid for the next approach. Also it means the company still has to pay taxes to the government thereby potentially undermining the economics of the project.

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Co-operation and Development) countries to justify this government intervention – market failure, the Keynesian legacy and the Soviet example.

There was a general acceptance of the existence of 'market failure' – the existence of imperfect competition arising from the presence of monopoly power and asymmetric information, the presence of ownership externalities and finally the existence of public goods where consumption was non-rival and exclusion from access technically infeasible. Solutions to these problems of market failure lay in government intervention in the form of corrective taxes and subsidies, regulation, price controls, planning and ultimately government ownership. The Keynesian legacy was that the equilibrium level of employment would not necessarily coincide with full employment. The function of government was, through the management of aggregate demand, to force these two to coincide. Finally, Soviet planning was held up by many as the way for the future to mobilize the resources of an economy to promote growth. Even the UK introduced a 'five year plan' in the mid-1960s.

Collectively, these three drivers caused growing government intervention in the economy. In the OECD, this translated among other things into nationalization of public utilities and industries as a part of the development of instruments for economic management. Few voices were raised against such state intervention. The voices that were raised (predominantly the Chicago and Austrian schools) were at best regarded as eccentric and at worst lunatic.

For what was then called the 'Third World', justification for state intervention received additional support. There was a 'structuralist' view of the economy that challenged the assumption that participation in the international market economy would lead to mutual gain. Rather, the 'normal' operation of market forces would aggravate differences between countries and not encourage the convergence assumed by more mainstream economics. Hence, state action was essential if this were to be avoided. In a less extreme vein, there was a view among many economists of the need for a 'big push' to promote development. A concerted effort was needed to focus resources to 'break out' of the vicious circle of poverty of low income leading to low savings, low investment and low output leading back to low income. The underdevelopment of the private sector in these countries meant that only the state could marshal sufficient resources for such a 'break out'.

In a world where government intervention was viewed as necessary and desirable, attention was paid to the strategic sectors – the so-called 'commanding heights' of the economy. For major oil producers this inevitably meant the oil and gas sectors.

These previously unchallenged views of state intervention came under scrutiny during the 1970s. The intellectual underpinnings came under attack from three recently developed areas of economic analysis – the economic theory of politics examining the behaviour of politicians, theories of public choice examining the behaviour of bureaucrats, and principal–agent analysis examining the interaction between politicians and bureaucrats. All these schools identified the fact that government intervention would lead to a misallocation of resources, if government intervened in the economy – the so-called 'government failure'.

These intellectual attacks on government intervention were reinforced in the 1970s because macro-economic management, which had previously delivered economic growth

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and full employment, now failed to produce in a world of economic downturn coupled with extensive factor price instability. Supply-side and 'monetarist' economic analysis attacked the Keynesian macro-economic intervention. The internationalization of macro-economic stabilization after the collapse of Breton Woods also reduced the scope for independent government intervention. In the 'Third World', the obvious failure of many economies to deliver led to the conclusion that the lack of expected convergence was because of government intervention. There was also concern that state intervention in developing countries led to 'crony capitalism' which further undermined the economy's performance.

During the 1980s, these views coalesced into what became (disparagingly) called the 'Washington Consensus'. The prime missionaries of this position – the IMF and the World Bank – because of the debt crisis of the 1980s, found themselves in a uniquely powerful position to impose such views. When the Soviet Union collapsed, the story appeared complete. The result was privatization, deregulation and general liberalization. State-owned enterprises became viewed as dinosaurs requiring a helping hand into extinction. Reducing state intervention was seen as an undisputed requirement.

However, as the twentieth century ended, the 'Washington Consensus' as the dominant ideology began to falter and a number of factors contributed. The Asian financial collapse of 1997–98 and the economic collapse of Russia in the summer of 1998 had a profound impact on thinking within the World Bank. Here were economies that had complied with all the measures required by the 'Washington Consensus', yet they simply collapsed. At the same time, it was clear that while economies grew strongly, in many cases poverty alleviation was struggling. The 'trickle-down' mechanism whereby everyone benefited was not to be working.[9] In energy, many were beginning to question that such a strategic sector could simply be 'left to the market', a view reinforced by growing problems with electric power (most spectacularly in California in 2002–03), the growing concerns over climate change and the need to control greenhouse gas emissions and by rising oil and gas prices. State intervention in energy again started to become respectable for governments although not yet with the same fervour as in the 1950s and the 1960s. This evolving ideological story weaves centrally throughout the story of 'resource nationalism'. It also provides a crucially important context in the story of national oil companies which also plays a key role in the 'resource nationalism' story to be developed below.

Resource nationalism has been characterized by a battle between national interests and foreign influences. As such it has combatants, battlefields and outcomes. In terms of this paper it raises the questions – who fights, for what reason, where do they fight and with what results? There is also a recurrent theme of where 'resource nationalism' fits into this narrative and what role did the national oil companies (NOCs) play in the story.[10] This

[9] For those with a sense of history, it will come as no surprise that exactly the same failure in the 1960s led to the gradual undermining of conventional development economics, and the rise of the 'Basic Needs' development strategy (Hirschman, 1981).

[10] It is important to note that 'resource nationalism' was not the only driver of what happened in the international oil industry. For example, demand factors and their impact on international prices also played an important role. However, this paper focuses on 'resource nationalism'.

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approach gives rise to an historical approach since the answers depend on the time period. This paper is divided into five periods:

— Pre-World War II: Seeding the conflicts
— The 1950s and the 1960s: Golden Years
— The 1970s: Nationalization and closure
— The 1980s: The Washington Consensus and Opening
— The 2000s: Closure again?

A conclusion seeks to draw lessons that may inform the future.

2. Pre-World War II: Seeding the conflicts[11]

The combatants in this period were all foreign; the major powers, specifically Britain, France and the USA and the IOCs.[12] The latter were often fighting not just against themselves but also against small-scale individual prospectors. In the Gulf there were also an extremely lively series of minor skirmishes in Britain between the Foreign Office, the Colonial Office and the India Office. What was being fought over were spheres of political influence in the first place and access to oil reserves in the second place, or in the case of the Anglo-Persian Oil Company, denial of access to others. The horse trading and conniving to secure concessions, especially by the British, was breathtaking in its intensity.[13] The outcome of the fighting was a truce and a victory. The truce was between the IOCs in the 'As Is' agreement of 1928 that carved up the world oil market between them, built upon the Gulf Basing Point pricing system.[14] The victory was that by the end of the 1930s, the spheres of influence had been agreed and the oil concessions allocated accordingly between the various companies. In this period, the Middle East governments were not allowed by their colonial masters to harbour any thoughts of 'resource nationalism' or indeed any form of nationalism, although at times Ibn Saud tended to side step such niceties.

3. The 1950s and the 1960s: Golden years[15]

The main combatants were the IOCs and the producer governments although lurking was always present the potential conflict between the great powers, which now included

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[11] The references for this period include Blair (1976), Kent (1976), Monroe (1981) and Keating (2006).

[12] Often called the 'Seven Sisters' or 'Majors'. To use their modern names these were Exxon Mobil, Chevron, Gulf and Texaco (USA); BP (British); Shell (Anglo-Dutch); and CFP (French). Non-majors in the literature were generally referred to as 'independents'.

[13] Keating tells a wonderful story regarding the meeting organized by the British between King Faisal of Iraq and Ibn Saud of Saudi Arabia. The meeting was to take place on a British warship in the Gulf with only one gangplank to access the deck creating a serious protocol problem. British officials told Faisal that in the Royal Navy the tradition was the senior person went on board first, which he did. They told Ibn Saud the tradition was the senior person went on board last, which he did. Reading such detail leaves little doubt about the old Arab saying that "God gave the British an empire upon which the sun never sets because God could never trust the British in the dark!"

[14] This agreement remained secret until 1952 when its existence emerged during a series of Senate Hearings on the international oil industry.

[15] The references for this period include Mughraby (1966), Penrose (1968), Stocking (1970) and Stevens (1975).

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the Soviet Union. Thus the battle lines of 'resource nationalism' emerged for the first time.

What was being fought over was complex, and the drivers of the battles were multifaceted. This was a post-colonial world where all forms of nationalism were in the ascendancy as newly independent nations of the 'Third World' asserted their sovereignty. This was in a context, as explained in Section 1, where state intervention in the economy was regarded as the norm. For the international oil industry, three other drivers were crucial – the rise of 'permanent sovereignty' over natural resources, dissatisfaction with the concession terms agreed in the previous period and rising oil demand.

First, there was a rise in the concept of 'permanent sovereignty' over natural resources. The United Nations passed its first resolution on this issue in 1952. In 1962, a resolution recognized the rights of a country to dispose off its natural wealth in accordance with its national interests. In 1966, Resolution 2158 was even more explicit and the host countries were advised to secure maximum exploitation of natural resources by the accelerated acquisition of full control over production operations, management and marketing.

The second driver was growing dissatisfaction with the oil concessions signed before World War II, especially in the Middle East and four issues dominated. First was the very long life of the original concessions. In Iran, Iraq, Kuwait and Saudi Arabia the average life was 82 years. Second, the areas covered by the agreements were huge. In all the four countries, on average 88 per cent of the national area was covered including the whole of Iraq and Kuwait. Furthermore there were no relinquishment clauses. The companies could simply sit on acreage, including commercial discoveries and do absolutely nothing. Third, there was growing dissatisfaction with the fiscal terms. This first surfaced in Venezuela in 1948 when the government insisted (successfully) on a profits tax in addition to the lump sum royalty. This idea rapidly spread to the Middle East and by 1952 all the major countries in the region had switched to a system of profit taxes. This created major disputes over the setting of the posted prices used to compute revenue and over what should be included as costs and how they should be treated.[16] The final and the main source of dispute was that the concession gave the companies total managerial freedom within their concession areas. Given the size of these areas, this gave them the power of being a 'state within a state'. They could choose the rate of exploration and development plus the production levels. Government could try and influence these decisions but their power was strictly limited. A good example was how the Iraq Petroleum Company (IPC) treated the government of Iraq. The Majors had to manage the oil supplies from various sources to balance the international market and to protect prices. Because the IPC had the widest ownership outside of Iran, it became the swing producer (Blair, 1976). If the market was over-supplied, then IPC would pick up a fight with the Iraqi government which then 'pressured' the IPC to reduce the output.[17] If the market was under-supplied, then IPC-offered 'concessions' and production increased. Furthermore,

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16 For example, a major dispute was how royalties should be treated (Seymour, 1980).
17 This was confirmed to the author many years ago by an old IPC senior manager.

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there was nothing in the original agreements to allow governments any role in the operating companies.[18]

The third driver of conflict was rapidly increasing demand for oil. The 1960s saw the 'OECD Economic Miracle'. The USA, Western Europe and Japan grew at an unprecedented rate. With an income elasticity of demand for oil of one, this meant very strong demand growth for oil met largely by imports as can be seen in Fig. 1. Between 1958 and 1972, world oil demand (excluding communist areas) grew from 16.5 million b/d to 46.3 million b/d, with an annual average growth rate of 6.3 per cent while between 1965 and 1970, the annual average growth rate was 8.1 per cent (BP, various years). In the same period, non-OPEC production grew at only 6.8 per cent thus greatly increasing OPEC's share of the market and its market power. By 1973, OPEC produced 53 per cent of world production outside of the Soviet Union (ibid). This raised the strategic importance of the Middle East to the West. The region became one of the main battlefields of the Cold War with the USA and the Soviet Union carving up the region to secure their own client states and subverting the client states of the other. It also inevitably increased the bargaining power of producer governments in the Middle East.

The three drivers together all fed the growing 'resource nationalism' which in the region expressed itself most obviously in popular opposition in the 'Arab Street' to the role of the Majors (Hirst, 1966).

With these drivers in place the battles commenced. The first salvo was the Iranian nationalization of 1951, which was quickly undermined by the intervention of the Western powers leading to the overthrow of Prime Minister Mossadegh. These events dampened enthusiasm among other producer governments for the pursuit of the nationalization route to secure greater control.[19]

The next battlefield was among the producer governments seeking to secure greater oil revenues. This led to a two-pronged attack. First was to pressurize the Majors to produce more oil and second to renegotiate the fiscal terms. Furthermore, this was in a world of falling real oil prices. Initially, the Majors tried to maintain the traditional link between US domestic oil prices and the international price. This proved impossible and unilateral cuts to posted prices that reduced producer government revenues led in 1960 to the creation of OPEC. Thereafter, although posted prices of the existing crude were effectively frozen, new crudes were given relatively low posted prices, and the actual realized prices of arms length deals was falling (Adelman, 1972). The governments were successful over improving fiscal terms, not least in reaching an agreement that royalties should be expensed (Seymour, 1980). Such improvements were boosted by the introduction of new contracts such as joint ventures, production sharing agreements and service contracts. These allowed new international oil companies to enter the fray, but as such contracts spread, even the Majors began to accept these terms as the norm. Also, the rising

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18 Some did have clauses allowing the government to purchase shares in the event of any being sold. However, since no equity was ever offered this was totally ineffective (Stevens, 1975).

19 In the aftermath of the coup that overthrew Mossadegh, he was sentenced to death. While the sentence was never carried out, he died shortly after, a broken man. This remained a powerful image for governments which might have contemplated a more aggressive route to control of their oil.

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demand for oil helped absorb some of the pressure for increased production although there was an intense competition between the producer governments trying to secure a greater output. This increased production was particularly important since the success of the Majors in fuelling the 'OECD Economic Miracle' with a relatively cheaper oil meant the Western powers left oil to the oil companies. They were effectively given a free hand to operate.[20]

However, the underlying problem of managerial freedom for the IOCs and the lack of producer government control over operations failed to be addressed. The result was a growing upsurge of 'resource nationalism' aimed at governments taking control of the Majors' operations. To this end, there began the creation of national oil companies (NOCs), which becomes another central part of the 'resource nationalism' story and requires elaboration.[21] The arguments for the creation and nurture of an NOC in the 1960s and the 1970s consisted of political arguments and economic arguments although there is a strong overlap.

Energy was seen as a 'commanding height' of any economy and has been a political issue ever since the first Royal Commission Report on the coal industry in Britain was issued in the middle of the nineteenth century (Grayson, 1981). Add this to the concept of a public corporation as a "... corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise" (President Roosevelt on the Tennessee Valley Authority quoted in UNCRET, 1980, p 35) and this gives one the basis for an NOC.

The political arguments for an NOC can be summarized under several headings. First there are ideological arguments coming from 'socialist' thinking. 'Socialism' controls the commanding heights; hence the oil is a necessary target for state ownership and control. In countries where the oil production dominated the economic scene, the oil sector became a key vehicle for such a process. For example, "Algeria envisages achieving socialism through Sonatrach" (Madelin, 1974, p 128).

Of more interest is the driver of sovereignty and economic nationalism reflecting a collectively bad experience with the IOCs already outlined. Hence the nationalization of OPEC oil (and earlier examples starting with Mexico in 1938) had little in common with the ideological nationalizations of public utilities and some manufacturing in Europe post 1945. "The nationalizations were not because they were privately owned but because they were foreign" (Hartshorn, 1993, p 140). Also the Majors appeared to be backed by governments with a history of imperial domination. Nationalization required an NOC (Olorunfemi, 1991). Hence creating an NOC could be seen as "a national reaction to the undue

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[20] A major reason why the first oil shock of 1973–74 was a 'shock' was because virtually no one in the Western governments – politicians or civil servants – understood the international oil industry. It had been deliberately left to itself. The notable exception was Ambassador James Akins who clearly outlined many of the issues in his 1973 article (Akins, 1973).

[21] What follows are effectively the results of a search on how the academic literature views NOCs. The literature on NOCs tends to be of two types – either fairly general or studies of specific NOCs. A good overview of the debates and issues can be found in the Department of Energy (Canada) (1972), Madelin (1974), Krappels (1977), Noreng (1980), UNCRET (1980), Grayson (1981), Bentham (1988), Robinson (1993), Van der Linde (2000) and Marcel (2006). The specific NOC studies are widely different reflecting the obvious point that the (OPEC) NOCs "are as diverse as the member countries themselves" (Hartshorn, 1993, p 165). For differences in the legal status of NOCs see also Bentham and Smith (1986) and Bentham (1988).

influence held by some large companies as a result of which they may be able to threaten the sovereignty of the country" (Madelin, 1974, p 140). Although this may have been true in many cases, it was not true for all. For example, private Venezuelan interests were also nationalized (Mommer, 1998). Furthermore, OPEC's June 1968 Declaratory Statement of Petroleum Policy in Member Countries which entitled governments to acquire "reasonable participation on the grounds of the principle of changing circumstances" (Seymour, 1980, p 219) specifically excluded national private interests in the sector (Mommer, 1998).

The movement of 'permanent sovereignty over natural resources', already referred to, also provided a rationale for state involvement in the sector (Mughraby, 1966). If permanent sovereignty implies nationalization, some entity must be created by the government to take over the oil operations. This was the obvious imperative behind Pemex, NIOC (National Iranian Oil Company) and a number of other NOCs. An alternative variation from less frantic circumstances is when the creation was viewed as a desire for change (driven by the ideas of sovereignty over resources) for which it was regarded as unsatisfactory to rely on foreign investment. There is evidence (Philip, 1982) that when this strategic purpose was the motive to create the NOC, the company was more successful (at least in the early years) than where the creation was because of a nationalization in response to excessive foreign influence – an explanation being that the NOC forced into creation suffered from a lack of preparation.

In short, the political justification based upon sovereignty and economic nationalism lay in providing "an indispensable tool for mobilizing state policy at both national and international levels ... (to ensure) ... a national mobilization of resources" (Khan, 1987, pp 185–6). Furthermore, "... the corporate purpose is usually tied to the national purpose. The constituent instrument usually expresses this and so all decisions and activities must be done with this larger state purpose in mind" (ibid, p 188). A variant on this theme was that "they are sometimes assigned by their respective governments to fulfil political and social tasks in which a private oil company would not wish to participate" (Ghorban, 1989, p 23).

Although in theory such objectives could have been achieved through regulation rather than an NOC, at the time – the 1950s and the 1960s – regulation was simply not considered a serious option.

There were other political motives to create an NOC. There was a need to feed national pride and a sense of independence. The Canadian debate preceding the creation of Petro-Canada, was when Canada was highly sensitized to the accusation of being the latest State of the USA. National pride was claimed to be on top of the listed reasons for its creation (Department of Energy (Canada), 1972). There was also an element of mimicry. In many countries an NOC became required as a symbol of independence in a post-colonial world. Hence "... The establishment of state petroleum enterprises has become very fashionable these days" (Jaidah, 1980, p 20). People came to expect it and not just in the developing world. As one author remarked the British National Oil Corporation (BNOC) was created "to reassure the public" (Grayson, 1981, p 188). Finally, a less desirable motive, was that the creation of an NOC was part of a programme to assist in the process of political patronage (Auty, 1990).

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The economic justification for the creation of NOCs from the literature can be grouped under market failure arguments that can be considered under the headings of imperfect competition and externalities.

One argument for an NOC concerned market failure associated with information asymmetries between host government and companies – a variant of principal–agent analysis. The state's bargaining strength with companies is inversely proportional to the scale and technological complexity of the industry concerned (Vernon, 1971). Also an oil company's bargaining position depends ultimately on the ability or inability of a producer state to run the industry itself (Nore, 1980). Hence greater control required greater information, and this was seen best supplied through an NOC. For example, explicit in the creation of Statoil was the provision of "better control of the private companies" (Grayson, 1981, p 199). Before 1973, the vast majority of the Majors in the Middle East operated in isolation from the rest of the domestic economy.[22] There was little local labour employed (particularly in high management positions) and domestic firms had either a small presence or none. This "made it impossible for the national governments to gain access to the information they needed" (Van der Linde, 2000, p 98). Furthermore, the companies did not want to share this information since it would impede the achievement of their strategic goals and give a strong bargaining position to the host governments.

However good and professional the tax inspectors and civil servants were it was seen that . . . "there was no substitute for hands-on knowledge of buying and selling oil" (Ross, 1987, p 200). In similar vein, Grayson (1981) pointed out that the problem of the European governments was not so much their ability to get information – easily done through regulation – but their inability to properly analyze the information. Hence their NOCs would provide "a window on the oil industry . . . to establish a yardstick against which they could judge the performance of the oil MNCs in their own country" (ibid, p 10). In any case, even in the presence of regulation, often the information was not forthcoming. Hence organizing the oil resources in an NOC ". . . created a situation in which local knowledge could be increased by learning by doing" (Van der Linde, 2000, p 100).

It was also perceived that to achieve the same result through the local private sector would not work. In many cases the sector was too large a commercial risk for a small private sector. Furthermore, if there were some domestic private sector capability it was believed this would complicate taxation and reduce government income. In any case, as indicated OPEC positively discouraged private sector involvement.

A variant on information asymmetry was that the NOC would act as a channel for technology transfer (Nore, 1980). One version (Philip, 1982) argued that economic power in oil stemmed from control of oil reserves and/or market outlets. Hence, the Majors were willing to contract out other aspects such as the production of technically sophisticated capital goods to competing specialist firms and this technology was available for the NOCs to use. Thus an NOC was seen to afford "a covert form of training for locals, which allows for the assumption of local control . . . and allows the state . . . to move away from

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22 An honourable exception to this was probably Aramco in Saudi Arabia.

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its previous status of a sleeping partner or absentee landlord'' (Khan, 1987, p 188). Furthermore, such a transfer if it were to happen would have wider benefits. Hence ''the technically advanced and complex oil business is an important lever to acquire technical skills needed to build a modern society'' (UNCRET, 1980, p xii).

It was also widely viewed that conventional fiscal instruments such as royalties, income taxes and production sharing contracts were sub-optimal tools for collecting economic rent ''in that they are too rigid to be applied in a dynamic international oil market'' (Kemp, 1992, p 105). Hence an NOC as the sole operator can capture all of the rent. Following the tortuous negotiations during the 1960s between the host governments and the oil companies over various dimensions of fiscal change alluded to earlier, the idea of cutting out the 'middleman' to collect rent must have seemed extremely attractive.

Other options such as resource rent taxes were not in the frame until the later 1970s – the concept was only beginning to be developed among the academics (Dam, 1976). By then most NOCs had already been created. Also during the 1970s, when many NOCs began to play a major role, concerns about NOC efficiency and rent seeking had not yet begun to enter the agenda. Creating an NOC for rent capture by the state seemed to present a win–win picture. This was made stronger in the 1970s when concern about NOCs undermining international crude prices, a major issue during the 1960s, was swept away by the oil shocks of the 1970s.

The externalities argument for an NOC had several strands. The first was that state and private interests in the oil sector differ. The rationale for direct state participation was to secure crucial national interests more efficiently than market forces and private initiative (Noreng, 1997). The first NOC was created in Austria in 1908 when the private producers of crude faced a glut and were unable to agree how to manage it. Emperor Franz Joseph approved the building of a topping plant owned and operated by the government to solve this impasse within the private sector (Heller, 1980). Hence a country with substantial oil reserves had many interests to consider and protect. These might include domestic security of supply, Health and Safety (HSE) regulations, conservation of oil resources, training and employment of local labour, and the generation of 'proper returns' (Grayson, 1981; Bentham, 1988).

There are many examples of this fundamental divergence of public and private interests. For example, Noreng (1980) cites the argument that in the North Sea, the majors were more driven by time targets than cost targets, and the tendency to delegate complex construction tasks to agents and contractors. This led to higher costs. An NOC, he argued, could be more resistant to these pressures not least because access to public capital at lower interest rates reduces the pressure to hurry production.

This public–private interest strand had several variants. The first was the fact that the Majors had international interests that may not have coincided with national interests, whereas the NOC was assumed to put national interests first. For example, Frankel (1980) argued internationally diversified oil companies could not be expected to take fully into account the specific interests of every country in which they operated and would seek global rather than national optimization. A commonly heard argument related to the limited exploration effort of the Majors in many producer countries

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(UNCRET, 1980) and the role of NOCs in rectifying this neglect. This view rejected the conclusions of the very influential Levy Report (Levy, 1960), which concluded that private companies were much better positioned to bear exploration risk than the government. However, it was generally true that in the 1960s the key problem facing the Majors was controlling excess capacity to produce crude rather than searching for more. Therefore, in many cases, exploration interest was minimal.

Another variant in the literature on NOCs was the use of the oil sector as a leading development sector (Hirschman, 1981). To give oil this role requires increasing local linkages with other sectors (Fee, 1988; Auty, 1990). Given the limited role of the private sector, many saw the NOC as the engine to develop fiscal, forward and backward linkages. In similar vein, the NOC could be seen as the chief instrument of capital accumulation. Hence state participation in oil enhanced the role of government from a mere tax collector to also taking part in the accumulation of capital (Noreng, 1997). Another issue concerned depletion policy. In the 1970s, as concerns about 'the oil running out' grew, there was a belief that higher oil prices meant 'oil in the ground was worth more than money in the bank'. The result was a view that governments should have depletion policies. It was argued that left to themselves, private companies had too short a time horizon and would produce the reserves too quickly for society's optimal requirements. Of course, such a policy could be achieved by regulation – the UK in the mid-1970s provided an excellent example of such legislation. However, there was always a fear that such regulation would impose a cost on private companies which may inhibit them from investing. Hence, it was assumed that the NOC, specifically created to protect society's interests, would provide a better basis for a depletion policy.

For all of these reasons, in this period, producer governments created NOCs. Inevitably, this created a political constituency which sought to gain access to upstream operations in their own countries. One obvious option was to take over the existing operations. In the Middle East, most major governments resisted popular pressure for nationalization fearing a Mossadegh-like outcome. However, the aftermath of the Six Day War in June 1967 and the perceived involvement of the USA and Britain in the Arabs' defeat brought this popular pressure to a crescendo. To try and head it off, in 1967, Zaki Yamani, the oil minister of Saudi Arabia introduced the concept of 'Participation' to begin the process of seizing control without provoking a political backlash from the home governments of the Majors. This led to negotiations which in turn led to the October 1972 General Agreement on Participation giving producers an initial 25 per cent equity stake, projected to rise to 51 per cent by 1982.

4. The 1970s: Nationalization and closure

The result of these battles had led to an unprecedented victory for the producing governments. In 1970, following huge pressure from Libya, the Majors accepted producer government involvement in setting posted prices creating a bilateral negotiating process. By October 1973, the governments took over that prerogative and unilaterally announced increases to price which was the first oil shock. In 1972, Algeria and Iraq opted for the

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nationalization route. The lack of a response from the Western powers[23] meant that the Participation Agreement of 1972 was destroyed in a series of renegotiations led by the aggressive stance of the Kuwait National Assembly. By 1976, the old-style concession had been swept away; the producer governments had full control over their oil operations and indeed their oil prices. With the first and second oil shocks, oil revenues reached unprecedented levels.

In this new era, 'resource nationalism' was at a peak and had spread throughout the developing world, and the governments either refused entry to IOCs or did so under the harshest terms. The newly found confidence of producer governments was strongly evident, not least as their NOCs aspired to becoming the major integrated players in the global oil market.[24] This was reinforced because high revenues meant less urgency to expand capacity and production. The major existing producers effectively closed their doors to the IOCs – 'resource nationalism' ruled!

In this context new combatants emerged and battlegrounds shifted. There was still conflict between aspiring producer governments and IOCs for new acreage, but the rules of engagement had been clearly defined by the new contracts and the fighting was relatively half-hearted.[25] In the 1970s, the battle was more an internal one between Organization of the Petroleum Exporting Countries (OPEC) members with very different economic and political drivers. It was almost as though having defeated one 'enemy' – the IOCs – the victors turned upon themselves. For example, those members with high reserves favoured a more conservative price path than those with low reserves for fear of undermining the monetary value of their underground assets. Saudi Arabia also favoured price moderation as the price to be paid for US protection in what was a very dangerous neighbourhood. As OPEC's excess capacity rose during the early 1980s the battle became focussed on OPEC quotas, discipline, indiscipline and cheating which eventually led to the oil price collapse of 1986.

5. The 1980s: The Washington Consensus and Opening

The 1980s brought a new set of conflicts, combatants and battlefields. The common theme was related to competition. There was intense competition between IOCs for

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[23] There is a widely believed view in some quarters that the USA favoured these events because they wanted higher international oil prices. These would damage export competitiveness of their European and Japanese export competitors when the US balance of payments was a cause of concern. It would also give a boost to the flagging US domestic oil industry (Chevalier, 1973).

[24] A good example was the huge number of plans announced in 1974–75 for new export refineries to be built in the Middle East. At a meeting in Damascus organized by Organization of Arab Petroleum Exporting Countries (OAPEC) in October 1975 to compare plans, the implications of adding to global excess refining capacity forced most to postpone their plans. Only Saudi Arabia went ahead with three major export refineries.

[25] IOCs had attempted to protect themselves from the obsolescing bargain by insisting on stabilization clauses and arbitration procedures being written into the contracts. However, at the end of the proverbial day these were just words on a piece of paper which sovereign governments could if they wished ignore. In a world where there was limited interest in attracting FDI this appeared a relatively costless exercise.

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upstream acreage as acreage began to open.[26] There was also competition between IOCs and the NOC of the country where they were trying to enter. The NOC saw the IOC as a threat to the information asymmetry that allowed the NOC to capture rent. Governments of producer countries began to compete to attract IOC investment that many so desperately wanted. Finally, there was a continuation of the competition between OPEC and non-OPEC which emerged in the late 1970s.

A number of drivers fed these conflicts. The key was a clear move away from the ideas outlined earlier that an NOC was a 'good thing'.[27] First, as outlined in Section 1, there was an ideological swing away from government involvement in the economy. This view had two strands – (i) that government intervention in itself was undesirable and (ii) that markets in themselves had good and desirable characteristics which "have no close substitutes" (Robinson,1993, p 150). The result was that "the whole socialist concept of public enterprise is challenged" (an official report debating the role of the state in France – Rapport sur les Entreprise Publique – quoted in Madelin, 1974, p 131). For example, as Tony Crosland, a noted socialist intellectual in the UK commented in 1965 "... public corporations by their nature were 'remote, irresponsible bodies, immune from public scrutiny or democratic control' " (also quoted in Madelin, 1974, p 127). NOCs were by no means excluded from this growing belief in the need for the retreat of the state.

The second political dimension against NOCs was the potential for it to become too powerful in domestic politics. Although the NOC was created to defend government interests, very often, the NOC used government to advance its own interests, especially in a situation where there were few countervailing powers. There was always the danger that the NOC would become a state within a state – the so-called 'Pemex syndrome'. One version expressed the idea in a description of the political system in Latin America as an iron triangle (Szabo, 2000). This consisted of the industrial oligarchies which seek preferential economic treatment, the politicians who give the oligarchies preferential treatment in return for largesse and the labour unions. The problem was there is so much rent in oil, the NOC becomes too powerful in this triumvirate and, backed by the labour unions, effectively takes over the state. Pemex is an example most often quoted and analysed in the literature (Philip, 1982). Pertamina is also often cited (McPherson and MacSearraigh, 2007) and, more recently, PDVSA (Petróleos de Venezuela SA) has been accused of behaving in such a way which in large part lies behind Hugo Chávez's dislike of the company (Randall, 1987; Boue, 1993; Szabo, 2000).

This political 'takeover' provided an intellectual basis from which to attack the concept of the NOC which received practical support from a growing ground swell of popular discontent. Thus "... state companies often work in semi-secrecy which is scarcely likely to gain them favour with the public" (Madelin, 1974, p 122). The ability of the political

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[26] Before the 1950s, competition between the IOCs for acreage was strictly limited by the so-called "Red Line" agreement. Thereafter competition did begin to increase driven in part by the entry of a number of new companies ranging from consumer country NOCs such as ENI and a growing number of American independents. However, competition between the majors for acreage was subdued and could not be described as 'cut throat'.

[27] As will be seen from the references, many of these ideas were developed in the 1970s. However, as often happens with academic work, it takes a long time for it to percolate into the public domain and especially into the area of government policy.

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system to resist is determined by the extent of checks and balances. For example, it was widely believed that Arve Johnsen, the first head of Statoil, "had the intention of running Statoil both as a business and a political instrument" (Grayson, 1981, p 201). However, the government "was all too aware of this" (ibid) and was concerned from the very start to limit Statoil's powers largely by taking the budgetary control. In particular, this allowed the government to scrutinize all capital requirements. However, this in itself created dangers. There exists a fundamental contradiction whereby "excessive government control means the NOC is merely an extension of the civil service" (ibid, p 20) while insufficient control means the NOC might lose interest in non-commercial objectives and become just like any other oil multinational.

Another attack against NOCs was the problem that conflicting objectives imposed on the NOC by government effectively paralysed their operations. For example, when Pemex was created in 1938 its basic directive was to develop the petroleum industry in the interests of the national objectives of the Mexican government – 'al servicio de la patria'. These meant meeting the petroleum needs of the domestic economy (especially domestic industry, reduction of exports to a minimum, and finally improving the working conditions and the welfare of the oil workers. In the event, these goals ". . . turned out to be quite diverse and often conflicting" (El Mallakh *et al*, 1984, p 42).

Hence "the government of the day frequently intervenes in management to impose non-commercial considerations. . . . this . . . appears to be very resistant to change" (Horn, 1995, p 137). While securing returns on investment and providing for social, political and economic services need not conflict, ". . . in practise they often do" (Grayson, 1981, p 14) and "either service or rate of return falls by the wayside" (ibid, p 15).

There was an economic argument challenging the role of the NOC. The first was related to poor efficiency and rent seeking. Part of the intellectual underpinning against state intervention outlined earlier is that bureaucrats will pursue rent for their own purposes. The key relevance of oil is that there is considerable rent in oil from two sources. In a competitive market, those blessed with low-cost geology would earn producers surplus. In addition, supply restraint by OPEC earns super-normal profit. Both are very considerable. Hence NOCs were especially vulnerable to attack on grounds of absorbing rent since there was so much to absorb. Also it becomes a self-feeding process. Gaining rent gives the NOCs resources to pursue further rent-seeking strategies.

A variant was that, as suggested by principal–agent analysis, the management of the NOC in a technically complex industry was able to use information asymmetries to help them capture rent. Hence "the expertise arising from actual experience . . . (a key raison d'etre of the NOC) . . . accrues to the oil company rather than the government itself" (Dam, 1976, p 140). Also, their value as sources of benchmarking came under attack. As one observer argued, if NOCs were to act as benchmarks, they would have to be similar to IOCs in all respects therefore neither receive government assistance nor perform non-commercial services.[28] Since they patently did, they became "inappropriate measuring devices" (Grayson, 1981, p 10). This was aggravated because the NOCs were often

[28] What has become called "the national mission" (Marcel, 2006).

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monopolies operating in a highly protected business environment where they frequently had first choice of permits for acreage, no internal competition and their financial requirements were met on a needs basis. Even where there existed potential competitors, especially in the downstream, the NOC was able to create significant barriers to entry often by manipulating the regulatory environment to their advantage.

The arguments about rent-seeking and information asymmetries gained further momentum as NOCs invested abroad. This was seen as a mechanism to disguise their operations and to put out of reach of the central government their resources. For example, in 1982, PDVSA was ordered to withdraw funds from US banks and bank to the Central Bank, and it was also required to underwrite public debt certificates (Mommer, 1998). The key lesson learnt from this was that it was better that money available should be spent on illiquid assets out of the reach of the government (ibid).

All these arguments from the academic literature gave rise to growing concerns over the efficiency of the NOCs. Hence "the absence of the spur of competition will very likely cause it . . . (the NOC) . . . to drift into complacency and laziness" (Madelin 1974, p 119). Furthermore, "it may even develop aims of its own and forget the purposes for which it was brought into being" (ibid). However, trying to establish the extent of inefficiency was made extremely difficult because of the lack of transparency that characterizes most of the NOCs. However, there is considerable casual empiricism to give support. For example, it was a leaked report by Pricewaterhouse Coopers which suggested that Pertamina had wasted $6.1 billion in two years on corruption and inefficiency (quoted in Van der Linde, 2000, p 30).[29]

Al-Mazeedi (1992) argued that in the NOCs, recruitment policies are influenced "to a great extent by tribal and religious considerations rather than qualifications, performance or personal attributes" (p 988). The result is that "the majority of Gulf NOCs are severely limited in managerial and technological expertise" (ibid). Another managerial problem is that too many NOCs encourage a large gap between the top management and the next generation to protect the existing top management. Governments are less likely to remove senior management if their successors are not ready.

As the 1990s proceeded, other arguments against the NOCs appeared. Because of growing hostility among some quarters they were increasingly unable to undertake their tasks because they were being starved of resources by their governments. Hence they complained that the governments have left them too a little of the revenues for investment to maintain production, let alone increase it (Hartshorn, 1993). Often the NOC was forced to send all its foreign exchange receipts to the central bank thereby restricting its ability to purchase spares and equipment (Randall, 1987; Karshenas, 1990). Also securing additional capital through a government budgetary system is not easy (Van der Linde, 2000). The competing demand for funds from other state companies and government departments is large "especially when the government is running a budget deficit" (ibid, p 107) which tended to be the norm for oil producers in the 1990s. Furthermore, borrowing from private sources normally needs government approval and, in the case of raising

29 See also ESMAP (2007).

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funds internationally, was severely constrained by the existing foreign debt of the government. In many cases, in the downstream, the insistence on subsidized prices means the NOC is cash starved and unable to maintain its assets, often with disastrous results. Many Latin American countries have suffered from this problem (Philips, 1982), and Nigeria provided an extreme example (Khan, 1994), as does Iran (ESMAP, 2007).

The result was that ''management does not have complete freedom to invest and to develop a market strategy, nor is it free to define, let alone change, the efficient boundaries of the firm'' (Holmstrom, 1999, p 95). This problem was not new. For example, YPF of Argentina between 1935 and 1955 was starved of funds and forced into ''a self-feeding downward spiral'' (Philip, 1982, p 492). However, as producer governments faced ever greater financial pressure in the low price world post 1986, the problem became more acute. A final attack on NOCs was that private companies could better serve many NOC objectives in a regulated environment (Robinson, 1993). Hence regulation was seen as a more efficient solution than direct government intervention.

Thus reliance on an NOC for developing national resources began to be questioned in a great many countries. This process was reinforced because the debt crisis in the 1980s gave the IMF (International Monetary Fund) and the World Bank considerable leverage to 'persuade' countries of the need to open their oil sector to private players. Given many of the countries lacked an indigenous capability, this inevitably meant bringing in foreign companies.

Added to this cocktail of growing disillusion with NOCs were three other realties that set the drivers (i) the growing importance in a globalized world of attracting Foreign Direct Investment (FDI) as the basis of development strategy, (ii) a low oil price world following the oil price collapse of 1986 and (iii) the fact that oil appeared to be coming out of more difficult geography and geology. All these helped to open access to acreage and diminish the 'resource nationalism' that dominated the 1970s.

First, many governments under the influence of the 'Washington Consensus' switched their economic policy towards attracting the FDI. In such a world of competing for funds, the obsolescing bargain no longer appeared as a costless option. Unilateral abrogation of contracts would cost the country dear in terms of inhibiting the other FDI inflows.

Second, lower prices after 1986 meant producer governments sought ways to increase production to try and increase oil revenues. Thus many countries that had been off-limits to the IOCs in the region began to open the upstream. With the exception of Saudi Arabia, all countries in the region began this process.[30] The experience ranged from one of success such as Algeria where oil production rose from 1.33 million b/d in 1995 to 2.02 million b/d by 2005 (BP, various years) to failure such as Kuwait with Project Kuwait and Iran with their Buy Back deals where production capacity targets were consistently missed (ESMAP, 2007).[31]

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[30] With the other exception of Mexico, this was also true globally.
[31] In both cases the reason for the failure was that the opening became a domestic political issue which effectively undermined the process.

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Third, increasing difficulty of geology and geography coupled with problems of borrowing to fund the upstream[32] meant governments turned to the IOCs which were seen as sources of technology and capital. This was particularly true when operating in the deeper offshore areas. In the early stages, it was only the Majors who had the technology for deep water and the ability to take the huge risks where an exploratory well could cost up to $1 billion. Subsequently, the technology became more widespread and the service companies began to accumulate the necessary skills to operate in deep water. The IOCs were also needed in some larger producing fields where easy oil was being replaced by harder oil. For example, in Kuwait, if the capacity target of 4 million b/d is to be reached, this will involve handling 20 million b/d of water (ESMAP, 2007) and only the Majors are capable of this.

This desire to employ the IOCs was reinforced as the ideas of principal–agent analysis began to be spread by young nationals returning from abroad where such analysis was central to the economics curriculum in the universities. The analysis argues it is information asymmetry between principal and agent that allows the agent to capture rent. One way to reduce these asymmetries is by benchmarking. Given problems of comparing geologies, it is better if the benchmark is operating in a similar environment to the NOC. Thus encouraging were IOCs to enter provided such a benchmark.[33]

There were a variety of results from these drivers and the consequent battles. There was an increase in the upstream access for IOCs, and the terms became competitive as governments tried to attract IOC investment. It might be argued that these favourable terms were setting the scene for the next round of dissatisfaction with the agreements although the progressive nature of the fiscal systems muted that tendency. There was the growing role of non-OPEC. Between 1985 and 1998, non-OPEC's share of world oil production outside of the former Soviet Union rose from 36.7 per cent to 47.1 per cent (BP, 2006), which left OPEC struggling to defend its price target. It failed in 1986 and again in 1998.

Growing competition amongst IOCs led to greater emphasis on value-based management as a financial strategy. This meant if the company could not do better than the market in terms of its rate of return it must give the money back to the shareholders. This led to two outcomes. First was the mega-mergers triggered in 1998 by BP's takeover of AMOCO (the American Oil Company), which meant that some 45 IOCs before 1998 became only 16 by 2004. Second, it meant investment by IOCs was inadequate in terms of market needs leading to pressures on capacity in the upstream and downstream. It was noticeable that after the price collapse of 1998, exploration expenditure by the IOCs fell dramatically. Thus the nine largest non-Russian integrated multinational oil companies in 1997 spent $14 billion on exploration. This fell steadily, reaching $7.5 billion in 2004 (private source).

[32] Problems for the governments to borrow were not just related to the debt crisis. Upstream oil exploration is highly risky and borrowing to fund such an activity would have been prohibitively expensive. Either the government had to fund from its own resources requiring scarce foreign exchange or it turned to the IOCs.

[33] This was an important driver for the Ministry of Finance behind the attempted opening of the upstream in Saudi Arabia (Robins, 2004).

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This lack of investment by IOCs was mirrored by NOCs which were often starved of investment funds by their finance ministries who believing the principal–agent story feared resources would be diverted through rent seeking. However, this was not true in all cases and a number of NOCs began a process of transformation in this period to make them operate on a much more commercial basis and also to extend their operations abroad (Marcel, 2006).

Thus the outcome of the period was the price collapse in 1998, underinvestment in all stages of the value chain, a growing role for IOCs together with their consolidation, and the NOCs under pressure to change.

6. The 2000s: Closure again?[34]

The combatants were now the IOCs and the producer governments, the IOCs and the NOCs and, in some cases, NOCs competing against other NOCs. The IOCs were under pressure from all sides and forced to consider what their future role could and should be. There was a growing sense that US foreign policy had created a 'them versus us' situation with the rest of the world increasingly being anti-USA.[35] As mentioned in Section 1, in this period this could be construed as part of the general resurgence in 'resource nationalism'.

A number of drivers fuelled these conflicts. As indicated in Section 1 there began a shift in ideology away from the 'Washington Consensus'. Suddenly, government intervention in the energy sector driven by a combination of security of supply and environmental concerns became again respectable. Many governments, including the USA and the UK who had been prominent supporters of the role of market forces, began to consider energy policy options. This disillusion with market forces was also linked into growing anti-globalization, driven in large part by the sense of many in the emerging market economies that they had seen little benefit from the process (Abdela and Segal, 2007).

It was also a world of much higher oil prices. From a low of $12.21 in 1998, Brent rose inexorably to an average of $54.52 in 2005 (BP, 2006) and in November 2007 nearly exceeded $100 per barrel. This trend of rising prices was kick-started by unexpected demand growth in 2004 meeting constrained capacity in the upstream and in refining the upgrading capacity as a result of underinvestment in the previous period. Upgrading capacity constraints in refining gave a large premium to light crudes which are the headline crudes on NYMEX (WTI) and ICE (Brent). Geo-political concerns in the futures markets driven by threats of supply disruption in a world of limited surplus crude producing capacity also helped higher prices.

A key consequence of these high prices was that producer governments looked at the terms offered in the 1990s and in many cases concluded they had been overly generous. The obsolescing bargain was alive and well, and fuelled pressures on the IOCs. Also, it meant that many governments appeared reluctant to pursue capacity expansion plans. For

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34 Unless otherwise cited, much of the factual material in this section is drawn from the excellent Middle East Economic Survey (MEES).

35 Sadly but understandably Britain was lumped into the US camp.

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example, in Algeria where the new Hydrocarbon Law appeared to be aimed at the IOCs, in July 2006, the oil minister announced that the country no longer wanted additional revenue. Algeria's debt had been repaid and there was a fear that more revenues would simply induce an attack of 'resource curse'. In Kuwait, elements in the National Assembly sought to introduce legislation limiting production (Stevens, 2007). Even Qatar announced a moratorium on further gas projects to allow an assessment of the North Field gas reserves.

There were growing concerns about security of supply and demand. Security of supply concerns arose as more geo-political events such as the stand-off over Iran's nuclear programme, the worsening security situation in Nigeria and the generally deteriorating situation in Iraq and the Middle East appeared to threaten oil supplies. In particular, some of the Asian importers appeared to be not willing to just 'go out and buy it' but looked for political influence within the supplying countries. At the very least this presaged an aggressive campaign of seeking acreage but also meant the Chinese especially were seeking to gain political advantage in many of the countries of the Middle East. Security of demand concerns were fuelled by President Bush's State of the Union Address in 2006 and 2007 when his references to the US 'addiction to oil' led him to argue for reduced imports from the 'unstable' Middle East.[36]

The period of rising prices also began to generate fears of 'resource curse' among many producer governments. 'Resource curse' crept back onto the agenda as prices rose, threatening the existing producers and as a number of new producers entered the danger zone (Stevens, 2005; Stevens and Dietsche, 2007). This meant that more producing capacity was not a high priority and plans announced by the OPEC countries for 2005–06 began to slip.[37]

Finally there was a clear resurgence in 'resource nationalism'. As developed in Section 1, this first emerged in Russia and Latin America for rather different reasons. However, it was only a matter of time before contagion led to its appearance in the Middle East where the disgraceful shambles in Iraq and the blatantly obvious double standards applied to Israel had created fertile ground to grow anti-Western (and by implication anti-Western IOCs) sentiment.

As these drivers gained momentum, a number of consequences emerged. Access to acreage in the region that had begun to open in the 1990s appeared to be closing or at least becoming available on much tougher terms. For example, it was significant that in the last two licensing rounds in Libya, very few of the larger IOCs took acreage and the industry gossip was that of 'the winners curse' implying seriously overbidding to secure access. There was insufficient investment from IOCs and NOCs. For the IOCs this was partly because of returning money to the shareholders. In 2005, the six largest IOCs while investing $54 billon returned some $71 billion to their shareholders – $31 billion in the form of higher dividends and $40 billion in the form of share buybacks (private sources). Also the difficulties of getting attractive access to acreage meant fewer opportunities in their investment portfolios, a factor aggravated by the lower exploration

[36] In public, Saudi officials expressed concern about these statements. In private they were absolutely furious!

[37] The IEA in its November 2005 Oil Market Report listed the official plans of OPEC countries for gross additions to crude producing capacity. In the event only Saudi Arabia delivered.

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expenditure already alluded to. This in turn causes low returns for the IOCs potentially leading to even more money being returned to the shareholders. This reluctance to invest was reinforced as major IOCs struggled to mount the management teams following 20 years of shedding labour and as the cost and delays of securing oilfield services rocketed. The latter point is a problem that also affects NOC willingness to expand capacity. As for the NOCs, as already indicated, excepting Saudi Aramco, they were also reducing investments either as part of a deliberate policy to slow down depletion or simply because their governments were denying them access to funds.

All these factors suggested that the continuing capacity constraints that prompted the price rise since 2003 would continue for the foreseeable future. In this context, there was clearly a growing role for the Asian importing NOCs. They began an aggressive campaign, especially in Africa to secure upstream acreage, although the Chinese and the Indians veered between intense competitions with each other to a compact not to compete in certain areas.

From this, a number of potential outcomes begin to appear to set the context for future conflicts over oil in the Middle East. The first is that there is a strong probability of oil prices remaining high for some time. This will encourage further application of the obsolescing bargain, possibly leading to creeping expropriation of the existing IOC operations. Also, it may be that the Asian NOCs will not be immuned from such pressures once their exploration acreage converts into producing fields. It also means while prices remain high, there is much less pressure on producing governments to expand capacity.

Another outcome is that IOCs are beginning to question their role in this new world where 'resource nationalism' is gaining ground rapidly. It has been argued that the IOCs brought access to capital and technology. However, this view can be challenged. In today's high price world, capital access for oil-producing governments is not an issue. Equally, much of the specific technology – 3D and 4D seismic, horizontal drilling, coiled tube drilling, deep-water operations, etc lies in the service companies rather than the IOCs. What the IOCs do remain good at, at least compared to others, is the ability to manage large projects combining the various technologies and managing risk. Another view is that large IOCs have always been at the frontier of discovering and developing 'new' sources of energy. In the 1950s and the 1960s and even before, it was the Majors who found the large fields in the Middle East. In the 1960s and the 1970s, it was the IOCs who developed offshore production. In the early 1990s, it was the large IOCs who had the capital and technology to develop deep-water production. In each case, the competitive edge lasted a relatively short period before others mimicked their behaviour and the 'first mover' advantage was lost. A question worth considering is what is the new 'frontier' to attract the next 'first movers'? Obviously it could be linked into gas or into the heavy oils, tar sands and shale or even the more exotic renewables. Arguably, without such a development, the large IOCs will disappear and there is a commonly held view that the next fall in oil prices when it comes will presage another round of mega-mergers among the IOCs.

A related issue is the relationship between IOCs and NOCs and the relationship between them is ambivalent. On the one hand the IOCs present a model in terms of scope and reach of operations that most if not all of the NOCs would dearly like to emulate. However, the performance of the IOCs potentially challenges that of the NOCs. From

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the IOC point of view it is the NOCs, or at least their governments that control access to the reserves of conventional oil. A variant on this theme is NOC–NOC alliances. In particular, there appears to be a growing scope for the NOCs of producer countries to create joint ventures with the NOCs of importing countries. This appears to be mutually beneficial since it is supposed to provide security of supply for the oil importers and security of demand for the exporters. Also, some of the NOCs who have been relatively successful in terms of commercialization and the development of technology look to be politically more acceptable partners than the IOCs in a world where 'resource nationalism' translates into an anti-Western IOC campaign. For example, Petrobras's command of deepwater technology makes it an attractive option for many producer governments.

More generally, the apparently inadequate levels of investment in all stages of the industry which has arisen because of the context described above is giving rise to genuine concern over adequacy of future supplies. The last time the world experienced very high oil prices in the 1970s, three market feedback loops developed. The high prices generated economic recession reducing oil demand. They also provoked fuel switching away from oil in the static sector and improved appliance efficiency in the transport sector reducing oil demand. The high prices prompted a supply response presaging the non-OPEC production boom, which dominated the 1980s and the 1990s. Falling demand and increased supply inevitably led to lower prices in 1986. However, the significance of 1986 is quite simply that it was 13 years after 1973. Thus the key question is how long will these market feedback loops take this time?[38] Arguably, the greater the conflict in the industry the more limited will be investment on the supply side, and therefore the longer it will take.

Finally, returning to the theme of conflict there is the potential problem of the USA versus China. As already indicated, China will not be content to simply go out and buy its oil supplies. It has for a long time been quite clear that China's obsession with security of supply[39] is encouraging it to secure political influence in the countries where it is seeking to obtain oil supplies either through exploration and production or simple long-term purchase contracts. Given global reserve dispositions, this inevitably leads it into the realm of the Middle East politics. Into this mire for a long time the USA has also been wallowing. In this context, it is quite feasible to imagine a re-run of the Cold War whereby the USA and China both seek to secure client states and to undermine the client states of the other great power.[40] One sad but inevitable consequence which characterized the last Cold War will be that much needed political and economic reforms needed in the Middle East will be slowed and muted as the two powers support their client regimes no matter how objectionable. One consequence is that when the oil price eventually falls in response to the market feedback loops, the consequent economic problems of poverty and unemployment in the region will return on a grand scale leading to considerable

[38] This paper strongly believes that these feedback loops will happen. It is merely a matter of time. Only if the 'peak oil' argument is to be believed could this be challenged. The author rejects the 'peak oil' argument simply on the grounds that it depends upon a definition of 'conventional oil' which is neither helpful nor valid. This is not to deny that liquid fuels may become more difficult to secure.

[39] For further details see Andrews-Speed (2004).

[40] In such a battle today China will have considerable advantages given that it is not tainted with support for Israel or military intervention in the region. Thus it can pursue its own national interests without the baggage which encumbers the USA.

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conflict and upheaval. This is a bad news for those outside of the region depending upon oil for energy to fuel economic growth and development. However, more importantly it is a bad news for the people of the region who frankly deserve better.

7. Conclusions

What emerges from this paper is that 'resource nationalism' is a cyclical phenomenon. The cycle is driven by exogenous and endogenous drivers. The exogenous drivers concern the state of ideology with respect to the state intervention in the economy, the extent of the alienation of the mass of the population in poor developing countries where the resource is located and the level and nature of nationalism and xenophobia more generally. In all the three cases these in turn can be influenced by the behaviour and attitudes of the dominant power(s) in terms of their ability to impose ideologies and in terms of the reactions their policies provoke. The endogenous drivers relate to a number of factors. Of key importance is the state of the 'obsolescing bargain' in terms of its own natural cycle. This tends to be driven by the level of oil prices at the time the agreements were signed, the degree of competition for acreage when the agreements were signed, the sophistication of the negotiators and the current level of oil prices. Thus a period of low prices, easy terms and weak negotiators inevitably sow the seeds for the next round of conflict to unilaterally renegotiate terms. A poor deal today is a renegotiation or unilateral change tomorrow.[41] Another key endogenous factor is how far the owner of the reserves needs the private companies to provide capital, technology and markets? As with the obsolescing bargain this too is highly dependent upon the level of oil prices. High prices mean no shortage of capital and an easy ability to buy the technology. However, it is also a function of the geology. As the geology gets more complex and difficult, there is a need for access to more sophisticated technology – autarchy becomes less of an option.

Because of this pervasive role of oil prices, the 'resource nationalist' cycle is self-feeding. A period of 'resource nationalism' inevitably leads to less investment and a shortage of crude oil. This supports high prices encouraging further 'resource nationalism' as the obsolescing bargain kicks in and the need for capital and technology by the owner of the resources to expand capacity diminishes. Eventually, however, markets work albeit imperfectly. The high price provokes a market response on demand and supply causing prices to fall. As they fall, the imperative of the obsolescing bargain diminishes and the need for access to capital and technology grows. 'Resource nationalism' recedes and the upstream opens. While the state owns the sub-soil minerals which is the case everywhere outside of the USA, this cycle is inevitable.[42] This time round the key question is

[41] In reality, given the developments in upstream oil agreements in the context (for example) of progressive fiscal systems and the growing availability of expertise in drafting and negotiating such agreements there should be no excuse for any "poor deals". Unfortunately, even today many host governments fail to avail themselves of this expertise.

[42] It is legitimate to ask if there are any solutions to this problem. As mentioned, stabilization clauses and arbitration options have been employed in the contracts but have failed to stop the cycle. Various treaty options such as the Energy Charter Treaty have been touted as providing a way out but it is too early to assess the effectiveness of this Treaty and as with other such solutions ultimately they are only pieces of paper. Producer–consumer dialogue has also been suggested as a solution but since this first emerged as the North–South dialogue in the 1970s there is little sign it can solve the underlying problems. However, clearly possible solutions are a rich area for further research.

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how long will the current high prices and rampant 'resource nationalism' last? Last time when 'resource nationalism' dominated in the 1970s the cycle took from the early 1970s to the mid-1980s to begin to work its way through. This time it could take longer given that the exogenous drivers of the cycle are particularly strong, especially the disillusion and despair of the dispossessed in those countries which have the resources.

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