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Abstract

'for the purposes of the case, [the company is] indistinguishable from the government of Great Britain.'[1]

The oil industry has been accused of structuring markets nationally and internationally to exploit consumers in the advanced world. Thus 'transnational firms view individual states as resources to provide conditions amenable to business'.[2] Alternatively the oil majors are presented as a mechanism through which the first world exploits the wealth and resources of the third world. They have been dubbed western governments' willing 'vehicle of the national interest' on the understanding that, in international commercial oil matters, a policy of economic liberalism, i.e. no direct government involvement, would be pursued in return for the companies' active participation in the promotion of their government's international interests.[3]

This paper examines the relationship between the Anglo-Iranian Oil Company, later to become British Petroleum, during the period when these tensions were at their greatest. The period from the end of World War II to the retrieving of AIOC's major oil source, the Iranian oil fields in 1954 provide a clear demonstration of the co-operation and conflict, agreement and tensions between the British Government and the company.

This paper examines the degree to which the oil company was successful in controlling its environment. In particular the paper asks whether the British government was simply a malleable

[1] Explanation given by Judge Kirkland of the U.S. Federal District Court for quashing the subpoena issued against the Anglo Iranian Oil Co., by the U.S. Justice Department during anti-trust investigations. Times, 16 December 1952.
[2] G.P. Nowell, Mercantile States and the World Oil Cartel 1900-39, (New York 1994), p.286.
[3] D.S. Painter, Private Power and Public Policy, (1986), p.208.

institution captured by transnational capital, or, was the Anglo-Iranian Oil Company, AIOC, merely an expendable firm whose disappearance would not have had severe repercussions for the rest of the oil industry? The business government relationship will be shown to have involved both co-operation and conflict, agreement and hostility. Nevertheless it remained strategic for both parties based upon mutuality of interests.

The Anglo-Iranian Oil Company 1945-54: Government Business relationships in conflict?[4]

Industrial structure has been a major pre-occupation amongst those examining economic performance, British relative economic decline or the rise of managerial hierarchies.[5] One of the key areas of debate revolves around the degree to which the visible hand of managerial/ proprietorial decision making has replaced the role of the hidden hand of the market as an effective method of resource allocation.[6] Another focus of attention has been the role of government, or the state, in the process of economic development.[7]

The following paper aims to address some of the concerns raised within these conceptual frameworks through the use of a case study of the Anglo Iranian Oil Company, AIOC.[8] The paper will argue that a central influence upon oligopolistic firms operating within the oil industry was the abandonment of concepts of competition in favour of co-operation and profit maximisation for market control. Firms' intent was to secure stability within markets through the control of changes within markets. Not only did such influences exist but, with the active participation of governments, the major oil companies attempted to determine the parameters within which markets for products could develop. In so doing governments and companies were consciously acting to not only remove the hidden hand of the market but were acting to define the very future development of the market itself. Further the paper argues that the influence of government within the oil industry, after 1945, derives from the attempts to create a post-war settlement in which the political and strategic desires of national ruling classes, particularly the British and American, could be satisfied.

Hence the visible hand should be understood not simply as the emergence of managerial or proprietorial resource allocators within firms but as an attempt to create a planned capitalism in which markets are determined by the visible hands of firms and governments. As a result it is possible to explain the conflict and resolution within the government and industry relationship as the development of a coherent class group whose distinct and mutually agreed goals are altered and redefined.

The paper deals with the high point for such developments in the oil industry, between 1945

[4] This paper has been supported by funding from the Economic and Social Research Council Award No. R00429234227

[5] See A.D. Chandler, Scale and Scope, (Cambridge, Mass 1990) and L. Hannah, The Rise of the Corporate Economy, (London 2nd Ed. 1983) for two classic cases of this.

[6] See and O. Williamson, Markets and Hierarchies, (New York 1975) and alternatively W. Lazonick, Business Organisation and the Myth of the Market Economy, (Cambridge 1991)

[7] See D.C. North, Structure and Change in Economic History, (London 1981)

[8] The Anglo Iranian Oil Company, AIOC, was renamed British Petroleum in 1955. Throughout this paper the term AIOC will be used.

and the mid 1950s, and finishes prior to the crisis of the established system of co-operation and stability. The decades following required new frameworks to re-establish stability, although these new frameworks and the extent to which they did or did not prove successful are not discussed.

The oil industry before 1945

The fact that crude oil provides such uniform products which find such large numbers of users and diverse uses meant that the opportunities for large scale investment and integration, both horizontal and vertical, existed in the oil industry probably more so than in any other industry. Added to these economies of scale was a recognition by governments of the strategic importance of oil. As a result of the economic role of oil and the strategic value governments placed on it government links to the oil industry were unsurprisingly to be close. Oil companies were to hold an 'exceptional' relationship to their primary government and as such foreign policy and competition policy was to reflect not purely the domestic political interests but also the needs of the oil industry itself. In Britain the origins of the Anglo-Iranian Oil Co's 'exceptional' relationship with the government was made clear by the £2m purchase of 51% of the company shares by the Admiralty in 1914.[9]

Prior to 1945 the oil industry had developed into an industry dominated by vertically integrated firms capable of operating on a multinational basis.[10] This structure and scale of operations was necessary in order to compete against the competition which the largest firms would use to drive competitors out of business. Firms had to develop upstream capabilities in the production and transportation of crude oil as well as midstream capabilities in refining and international transportation. Vertical integration also involved downstream capabilities in national distribution and sales networks to gain access to markets for refined products and was also crucial to ensure a balance existed for the companies between supply and demand. A high degree of vertical integration became both a pre-requisite for survival and a significant barrier to entry for competitors. These barriers to entry were of the physical kind based upon high levels of investment rather than ones based upon the cost of information in following learning curves or in any increased transaction costs incurred by trading with third parties. By 1945 seven companies in total had emerged which dominated all aspects of oil production, transport, refining, distribution and sales. Collectively these were known as the 'major' companies or the 'Seven Sisters'.[11]

The major oil companies were concerned that, what they termed, 'cut-throat' competition

[9] See G. Jones, The State and the Emergence of the British Oil Industry, (London 1981) for detailed history of the 'exceptional relationship and R.W. Ferrier, The History of the British Petroleum Co., Vol.1, 1901-32, (Cambridge 1982) for the early history of AIOC

[10] See D.Yergin, The Prize, (London 1991) for a popular account of the development of the oil industry

[11] The Seven Sisters consisted of five American companies, one British and one jointly Dutch/British owned

between the major integrated firms would break out and spill beyond single national boundaries and onto the world markets before 1945. As a result the majors developed new strategies to reduce the pressure of competition. The Achnacarry, or As-Is, Agreement in 1928 and the Red Line Agreement negotiated between 1922-8 are both important examples of this strategy. The aim of 'As-Is' was to ensure that each companies' market share in each national market, outside of the United States, was guaranteed by its' rivals so reducing competition. The importance of the Red Line Agreement was to limit the supply of products to markets and so maintain price levels. The method chosen for this was the setting up of joint companies to carry out the exploration and exploitation of oil across most of the Middle East whose operation were limited by the inclusion of a 'self denial' clause restricting further exploration, (see below).[12]

In the depression of the 1930s neither vertical integration nor cartelization proved capable of preventing either over production or a collapse of prices. From a crude oil price of almost $14 per ton in 1926 prices had fallen to under $8 per ton by 1930 and continued to fall to just over $1 a ton by 1931. The legacy of the 1930s was therefore an industrial structure in which fully integrated oligopolistic companies had emerged who were primarily concerned to prevent a return to conditions of over production and unstable prices, which despite their co-operation they had failed to prevent.

Post war reconstruction and inter-company collaboration.

The difficulties European nations faced during reconstruction with raw material and dollar shortages have been well documented.[13] However in the oil industry the post war challenges were markedly different.

The United States and British governments met with the major oil companies to ensure that the industry was aware of and accepted its role in creating a new era of security. The Governments' view was that a 'greatly increased demand' would develop on a world wide basis. The governments' crucially thought that if a 'collective security' was to be achieved then a ‘ready access to oil to all nations under (conditions of) expansion and abundance' needed to be at the top of their agendas.[14] Thus plentiful oil supplies were central, in U.S. and British government opinion, to the creation of a new post-war settlement.

Such a policy created difficulties for the oil companies themselves who faced, in marked contrast to other raw materials, an initial surplus of supply. Between 1944-46 consumption in the U.K. had fallen 26%. This combined with the proposed tripling of production from Iraq and Iran threatened to weaken oil prices and promote 'a struggle for markets’ and competition which was

[12] See D. Yergin, Ibid, pp.203-6 and pp.260-5 for the detail of the two agreements.

[13] See A. Milward, The Reconstruction of Western Europe 1945-51, (London 1984) and on Britain see A. Cairncross, The Years of Recovery 1945-51, (London 1985)

[14] Public Records Office London (hereafter PRO). POWE 33/1492, Anglo- American Exploratory Discussions on Petroleum, 18 April 1944

'damaging to all'.[15] As a result AIOC and Standard Oil (New Jersey) began to seek collaboration in limiting supplies of oil onto the market. Standard Oil (New Jersey) acknowledged their interest in recreating the conditions of the As-Is agreement stating that 'they wanted no greater percentage of the trade than they had previously enjoyed.'[16] However, Standard Oil (New Jersey) also made clear that they could not formally adhere to any new agreement due to the United States anti-trust laws but that such a problem, as with the original As-Is agreement, would not stop them from tacitly supporting any agreement.

The fact that the expected oil surplus in 1945 turned into an oil shortage by the end of the 1940s did nothing to weaken the oil companies' enthusiasm for collaboration. Rather the expansion in demand for oil allowed the cooperation between oil companies to succeed where as in the 1930s it had failed.

A brief examination of the development of cooperation between AIOC and Shell, the other part British owned major, reveals just how important collaboration was. The two companies association had a long history with the formation of Shell-Mex & B.P. Co. in 1932 to market all Shell and AIOC products in Britain and the Consolidated Petroleum Company and Consolidated Refineries, formed in 1928, for the production and marketing of products across large parts of the globe.[17]

One new arrangement which AIOC and Shell entered into in 1949 covered the sale of aviation spirit. All aviation spirit sales in the Eastern hemisphere, covering Africa, Europe, South East Asia and Australia were to be merged into a single company. Despite the merger the two constituents were to retain their separate brands and to continue to trade separately. The agreement was to ensure a Shell/AIOC split of 50:50 by 1955 from the 72.5:27.5 share that existed in 1949. Such an agreement would have enormous impact on the market for aviation spirit and both sides recognised that 'advantage might indeed be gained by the set-up which in the initial years at least would indicate two independent and competing organisations.'[18] Further it was recognised that at some point an 'overt' act would be required to announce the merger of the operations but both companies had differing views on exactly when this should be. For AIOC it was considered a matter of 'high policy' that the earliest date possible should be chosen whereas for Shell it was to be carried out only 'if it is not to troublesome' and certainly 'after the fruits of the secret and illicit association have been fully harvested.'[19]

Collaboration between AIOC and Shell extended to all areas of operations with the

[15] British Petroleum Archive (hereafter B.P.). 43853, Note of meeting between AIOC and Standard Oil (New Jersey) 18 June 1945

[16] B.P. 43853, op. cit., p.1

[17] See J. Bamberg, The History of the British Petroleum Co., Vol.2, 1928-54, (Cambridge 1994) for creation of the consolidated companies.

[18] B.P.43853, letter from Shell's G. Legh-Jones to AIOC's Sir William Fraser, 19 January 1949

[19] B.P. 80918, Joint AIOC/Shell Aviation Agreement, 15 May 1951

companies directors meeting to examine each others investment plans. These meetings were to ensure that there was no wasteful duplication of resources in investment decisions and that any potential competitive conflicts in geographical areas were anticipated and resolved in advance.[20] The fact that this collaboration had negative effects on company activity can be seen from the fact that AIOC decided that it would not develop capacity for the manufacturing of aviation spirit at its' plant in Aden and so compete with Shell 'unless forced to' by government.[21] Similarly when discussing expansion plans for B.P. Chemicals at the Grangemouth refinery the company explicitly agreed not to manufacture tetra-ethyl lead, the anti-knocking agent in leaded petrol, because this would compete with Shell.[22]

These arrangements were by no means exceptional to AIOC. The dividing up of market share in national markets had a long history which the As-Is agreement had attempted to formalise after 1928. Outside of the United States and Eastern Europe there existed tacit and explicit agreements between the major oil companies, involved in each national market, regulating competition. Further these cooperative agreements were not exclusive to the oil industry but appeared across many if not all industries.

By looking at the growth of consumption of oil products in the United Kingdom after 1945 it is possible to examine the importance of collaboration for company success. The growth in the total size of the U.K. market of petroleum products can be seen from Figure 1. Generally the period after 1945 saw rapid annual growth in consumption for oil based products with total consumption rising from the trough in 1946 of 9.6 million tons to 68.4 million tons by 1966, an increase of 710%. This period saw a rapid rise in the use of fuel oils which were increasingly being used in electrical power generation, heating in industrial furnaces and also in smaller commercial and light industrial industries. Consumption in fuel oils alone accounted for 48% of the total increase in consumption over the two decades, see Figure 2. The second most important single product was motor spirit, or petrol. Before 1940 sales of petrol had accounted for over 50% of total sales of oil based products by either price or quantity. The increase in motor spirit sales accounted for 12% of the total increase in consumption up to 1966. In fuel oils we have an example of how oil companies affected industrial users with motor spirit we have an example of the oil companies impact upon direct retailers and consumers.

Taking the figures for 1953 and 1954 we see that Shell-Mex & B.P. alone were directly responsible for the supply of 77.5% of the total quantity of fuel oil consumed in the U.K in 1953 and 76.1% in 1954. If some of the smaller distribution companies which were supplied by the Shell-Mex & B.P. group are included this total rises to 82.2% and 80.8% respectively. The next largest competitor was Standard Oil New Jersey (Esso) with 15.6% of sales in both years.[23] In other words

[20] B.P. 70322, Central Planning Department meeting with Shell 3rd December 1951

[21] B.P. 70322, Shell Refinery Plans, 14 February 1952

[22] B.P. 25725, British Petroleum Chemicals Forward Programme, p.2, 9th March 1954

[23] B.P.7446, Petroleum Statistics of the U.K., table 2.21

in the single most important market for oil products in Britain AIOC and Shell through their associated company maintained a monopoly of supply in the legal sense and a virtual monopoly in the popular sense.[24]

A similar picture can be described for the market in motor spirit in 1954. Whilst Shell-Mex & B.P. were directly responsible for sales of 'only' 32.6% amongst dealers and 33.1% among commercial consumers the company was, through sales to distributor companies, indirectly responsible for 51.4% of sales among dealers and 51.1% of sales among commercial consumers.[25] Consumer sales of motor spirit in Britain by 1954 were dominated by the creation of larger designated sites with three or more pumps primarily for the sale of petrol. Of the 36,404 sites throughout the British Isles 16,326, or 45%, contained three or more pumps. Shell-Mex & B.P. directly controlled, through tied agents, 7,696, or 47%, of these.[26] The sale of motor spirit was carried out through sites supplied directly by the producers and distributor companies and therefore the supply, distribution and retailing elements of the industry were closely interlinked and created enormous physical barriers to entry for competitors.

The vertically integrated structure of the industry was a central element in providing a balance of supply and demand and in so doing creating the conditions for sustained cooperation between the major oil companies. Such a structure also had the advantage of preventing the entry of less vertically integrated 'independent' firms into the market.[27]

Government cooperation and industry stability

The second element of cooperation which was essential to the emergence of a highly cartelized oligopolistic oil industry was the impact of government support. Each of the major oil companies relied upon their close links to their respective primary government. Government support to the oil industry was not simply passive or restrictive in its role, rather it was both active in the structuring process, promoting certain developmental paths, and enabling in that government provided a safety net for oil companies in times of stress. Governments saw the need for their national oil industry to develop in specific areas and ensured such development took place.

The United States government had been instrumental in pushing the American majors into the Red Line Agreement by demanding an 'open door' policy for exploration across most of the Middle East. The United States was increasingly worried over domestic oil reserves and U.S.

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[24] The legal sense of a monopoly in this period is controlling over 33% of output as defined by the 1948 Monopolies and Restrictive Practices (Inquiry and Control) Act.

[25] B.P. 7446, Ibid, table 2.15

[26] B.P. 7446, Ibid, table 3.10

[27] The 'independents' refers to the name given to the national oil companies and private firms which did not integrate backwards to production and concentrated upon refining, distribution and sales. These emerged from the mid 1950s onwards, threatening the influence of the majors, and was one of the changes which led to the breakdown of the institutional framework discussed in this paper.

government policy was to promote oil exploration outside the U.S. The Petroleum Administration believed that the 'national policy of the United States should aim at securing for American nationals access to the world's oil resources.'[28] Indeed Middle East oil was of such importance that F.D. Roosevelt supported a plan to take on proprietorial and managerial control of the U.S. foreign operating companies.[29] Such a plan, although abandoned went well beyond the financial interest the British government held in AIOC.

Once the Red Line Agreement was signed the 'open door' policy was explicitly abandoned with one of the clauses of the Agreement demanding that no oil company would carry out exploration work without the agreement and participation of the other companies. This 'self-denial' clause whilst safeguarding the U.S. and British interests in the area became a barrier to further exploitation of oil reserves after 1945 and thus threatened U.S. hopes of a collective security based upon an 'expansion and abundance' of oil supplies. As a result one of the key changes in the U.S. government policy after the war in the Anglo-American discussions was for the abandonment of the self-denial clause.[30]

The fact that the self-denial clause was abandoned in 1947 was a victory for the United States government and indicates the degree of influence that the U.S. had in negotiations with both the British government and the oil companies. Despite the British governments' wish to maintain the self-denial clause and reintroduce into the oil industry what one Treasury official described as 'a nicely adjusted balance between competing interests' the British were forced to recognise that in any open competition the Americans would 'hold most of the trump cards'.[31] Thus the British and American governments had differing interests yet it was clear that the British government would be the minor partner in negotiations.[32]

Government influence in structuring the oil industry also influenced company decision making and investment plans. After 1945 governments promoted domestic refining of crude oil. One main reason for this, particularly in Britain, was the fact that importing crude oil as opposed to finished products would aid the balance of payments problem. The degree of importance attached to this by the British government can be gauged from the fact that steel allocations were not only prioritised for the refinery expansion programme but that steel reserves were also to be made available if necessary.[33] The success of the programme can also be gauged from the fact that domestic refining as a proportion of total consumption rose from 17.6% in 1947 to 101% by 1952.[34]

[28] R.H.K. Vietor, Energy Policy in America since 1945, (Cambridge 1984), p.29

[29] R.H.K. Veitor, Ibid., p.29

[30] See PRO POWE 33/1391 for Minutes of proposed Anglo-American Petroleum Commission

[31] PRO. T236/219, Oil Policy Document written by M.T. Flett, 20 June 1944, p.5

[32] See J. Saville, The Politics of Continuity. British foreign policy and the Labour Government 1945-6, (London 1993)

[33] PRO T236/1314 Cabinet Investment Programme, 5th September 1947

[34] B.P. 7446, Petroleum Statistics in the U.K., table 1.10

The oil companies themselves were not entirely willing partners in such an expansion programme, initially preferring to refine products close to production areas and to transport only refined products so saving transportation costs on any unused oil. Nevertheless in the case of AIOC they acquiesced to government demands due to a recognition that transportation costs were falling making such a shift commercially advantageous. The knowledge that a commercially sized plant, of 2 million tons annual throughput, which coincided with the demand in the area and could be expanded at a later date made the expansion in domestic refining a rational decision for AIOC.

Political considerations were also important to AIOC in the change of emphasis in refining as the company considered that its' main refinery at Abadan in Iran represented a 'considerable placing of eggs in one basket'.[35]

The role of government within the oil industry as a safety net for oil companies needs to be understood as part of the reciprocal nature of the government/industry relationship. Government support was crucial for the maintenance of a system of stability within the industry and stability in the industry was crucial for the maintenance of a 'collective security'. Two key areas in which this proved important for AIOC was in the nationalisation crisis in Iran from 1951-54 and during the U.S. anti-trust case in 1952.

AIOC was dependent upon Iranian oil fields and refining facilities for most of its' oil. In 1949 AIOC estimated its future oil production at 41.5 million tons for 1950. Of this production 28.5 million tons, 69%, was to be produced from Iran.[36] AIOC's refining capacity in 1950 was estimated at 30.7 million tons with the main refinery situated at Abadan in Iran having a throughput capacity of 25 million tons per year.[37] In 1951 the entire oil industry within Iran was nationalised and production and refining virtually stopped following the introduction of an international boycott. Only after a military coup in 1954 did AIOC, under new conditions, regain its access to Iranian oil.

Prior to 1951 AIOC had expressly seen itself as independent of the British government and explicitly stated that the link to Iran was far more important than the link to Britain. In the AIOC post war policy document the company explicitly spelt out the centrality of the Iranian link:

> 'From the company's point of view...the position of Iran (is) unique.' 'A clear distinction must always be drawn between those considerations that are paramount and those that are secondary. The position of Iran is obviously paramount and, wherever a conflict of interests arises, must always be given precedence.'[38]

The company made its' attitude to the British government abundantly clear by placing the

[35] B.P.72339, AIOC Policy Document, p.10

[36] B.P. 91002, Forward Programme 8 September 1949, pp.1-2

[37] B.P. 72339, Ibid, p.2 and B.P. 69283, Memorandum to Finance Committee, 8th December 1949, p.1

[38] B.P. 72339, Forward Programme Production Policy 1947, pp.5-9

'requirements of the British Empire' 'secondary'.[39]

If AIOC's policy document had been correct then the company would have had to accept the nationalisation and attempt to work within the new arrangement. However, this would have radically altered the conditions under which the international oil industry ensured control over crude oil supplies. The ability to use vertical integration as a method of control over the industry would have been severely weakened. Also the attempts of the majors to introduce improved royalty agreements with producer nations in return for a continuation of existing agreements, such as the Venezuelan 50/50 agreement, would have immediately looked much less favourable to the producer nations.

The oil companies recognition of the dangers posed by nationalisation can be summed up by the statement of a director from Shell who stated that nationalisation 'would jeopardize the whole structure of international trade and the security of foreign investment'.[40]

When it came to Iranian nationalisation the AIOC's policy aimed at ensuring the company's continued prosperity through maintaining a close relationship to the oil producing nation proved wrong and only the close link to its primary government in Britain prevented a potential collapse.

The anti-trust case initiated by the U.S. Justice Department against AIOC and other majors provides another important example of both the close relationship between oil companies and governments and the necessity for such a link.

In 1952 the U.S. Justice Department issued a subpoena demanding AIOC pass files held in Britain to the U.S. courts for examination. AIOC worked closely with the British government to prevent the disclosure of company material.[41] The Government ordered the company not to disclose any material without first gaining approval.[42] Eventually the Justice Department subpoena of AIOC was quashed on the grounds that 'for the purposes of the case, (the company was) indistinguishable from the government of Great Britain.'[43] In this instance the government/company relationship proved extremely important in preventing any disruption to the industry structure.

The extent of government support to the oil industry can be seen from the fact that the British government not only refused to allow AIOC and Shell (the other part owned British oil company) to pass documents to the Justice Department but it also gave similar instructions to British subsidiaries of United States oil companies including Esso, Vacuum and Regent. Government support went so far as to cover 100% U.S owned subsidiaries, such as Esso, and to subsidiaries which were not even mentioned by the original subpoena. In other words the British Government was in the incredible position of preventing a U.S. parent company from examining its' own

[39] op.cit.

[40] Quoted in D. Yergin, Ibid, p.276

[41] B.P.71283 and B.P. 35984, on cartel allegations

[42] See Appendix I for text of the British Government's letter

[43] Times, 16 December 1952

subsidiaries company files! Not surprisingly the British Government recognised that the instructions 'admittedly has no force of law in an American Court'.[44]

Most importantly, the United States owned firms also gained support from the U.S. State Department with the result that the original anti-trust case was abandoned. The oil companies link to their primary government was essential to preventing any disruption to the industry's structure whether the threat was from an independent nation or from a more domestically influenced section of the government. The second conclusion that should also be drawn is that the British Governments concern did not arise due to a part ownership of the company but from a mutual interest in maintaining the stability of the oil industry's structure. Hence the instructions preventing disclosure could be applied to companies with which the government had no direct link.

Penrose has suggested that the nationalisation in Iran acted as a shock similar to that faced by Standard Oil in 1911 with the anti-trust case.[45] Theoretically one might suggest that the events between 1951-2 provided a series of Olsonian shocks to AIOC.[46] Olson has suggested that economies grow more slowly where narrow distributional coalitions, including cartels, develop over time. In economies undergoing defeat in war, revolution or occupation these distributional coalitions are removed allowing the market to operate more efficiently which in turn leads to more rapid growth. Significantly, the evidence provides conclusions which are the opposite of Olson's theory. AIOC's ability to survive these shocks lay not with the growth induced from the destruction of a distributional coalition, namely the AIOC/Iranian concession agreement, but with the continuation of strong distributional coalitions, namely those involving government and other oil companies. The AIOC/government coalition proved crucial to defeating the anti-trust investigation and the co-operation between the major oil companies and the British and U.S. governments proved crucial to ensuring a successful boycott of Iranian oil between 1951 and 1954. Competitor companies and governments were not prepared to see AIOC destroyed, rather they worked to ensure that no competitor would gain new crude oil supplies following the nationalisation through the enforcement of an oil boycott. Secondly, after the military coup in Iran in 1954 the oil company/government coalition ensured that AIOC not only regained much of the oil production it had lost but also ensured compensation payments from competitors who gained supplies of Iranian oil. To continue with the Olsonian analogy the conclusion to draw would be that the distributional coalition of world oil companies foresaw a threat to their own existence if one member of the coalition was removed and therefore competition and profit maximisation were placed firmly at the bottom of the agenda below the stabilisation of the market and defence of the industry's structure.

The rapid development of the Cold War made the prevention of the growth of Middle East nationalist movements a key policy objective for the Western governments. Thus political issues to safeguard the post-war 'collective security' and the oil industry's role within it ensured that the oil

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[44] PRO. POWE 33/1857, letter from J.H. Brook from the Ministry of Fuel and Power to R.L. Sich, 25th November 1952

[45] E.T. Penrose, The large International Firm in Developing Countries., (London 1968), p.114

[46] See M. Olson, The Rise and Decline of Nations, (New Haven, Conn 1982)

boycott would gain support from competitor companies.

<u>The limits of co-operation and stability</u>

It would be wrong to conclude from the above that the form that cooperation took excluded competition completely. Rather the aim of cooperation was to regulate and define competition within narrowly defined and mutually agreed areas. Equally the cooperation between either companies or between government and companies did not rule out conflict. Rather the development of the industry highlights the difficulties of creating this consensus of cooperation over time.

The meetings between Shell and AIOC show how far competition could be defined within the oligopolistic industry. One of the key differences between the attempts at cooperation before 1940 and the moves after 1945 lies with the use of restrictive covenants or 'marriage letters'. Before 1940 both companies accepted that there would be no interference in the spheres of influence of the rival company. After 1945, however, both companies wished to avoid any 'restrictive covenants' such that participants whilst agreeing to sharing markets and preventing direct competition wished to remain free to flexibly respond to the new conditions. As a result Shell and AIOC agreed to end the 'marriage letters' both had agreed to when setting up the consolidated companies which had restricted the operations of the partner in each company's designated areas.[47] The only exceptions to this were to be the continuation of restrictions safeguarding AIOC operations in Iran and Mesopotamia and Shell's operations in Indonesia and British Borneo.

The need for flexibility between companies can be seen from the history of the 1949 Aviation Agreement, detailed above, which was mutually abandoned in 1952 for two reasons. Following AIOC's loss of the Abadan refinery it could no longer supply Shell with aviation fuel on 'most favoured nation terms' and, according to AIOC records, Shell appears to have been unwilling to concede the market share which AIOC was anticipating resulting in the agreement failing to be 'generally' implemented.[48]

A potential area of conflict which the major oil companies also had to find solutions to was the impact of their oligopoly or monopoly on the emerging independent companies. By the mid 1950s new oil companies were emerging, many set up as national champions by their respective governments including Compaignie Francaise des Petroles,CFP, in France. These companies emphasis upon purchasing crude on the open market as opposed to integrating backwards to production was beginning to threaten the industries stability as crude oil prices fell and surplus crude began to emerge onto the market.

One conflict AIOC had with CFP and the U.S. independent Caltrex which provides insights into the clash between these two forms of company organisation took place in the Australian market in 1955.

[47] B.P.43853, Letter from Sir William Fraser to G. Legh-Jones, 13 January 1949

[48] B.P. 80918, op.cit., p.1-2, 19 May 1954

Commonwealth Oil Refineries, COR, an AIOC/Australian-government owned subsidiary held 43% of the furnace oil market which AIOC considered to be too high.[49] COR also had a contract with the government body the Australian Shipping Board for fuel oil which included a continuation clause virtually guaranteeing its renewal. In the area of motor spirit both AIOC and Shell combined together to fix prices and quality. The Australian market was thus typical of the highly structured and cartelized markets that emerged in this period.

In the areas of fuel oil and motor spirit COR came under pressure from Caltrex and CFP respectively. AIOC were concerned about the 'difficulties through political channels' that could be made by Caltrex if the continuation clause were discovered and were worried that CFP may undermine price and quality agreements in motor spirit.[50] As a result of these fears AIOC took the view, here expressed with reference to CFP's entry into the motor spirit market, that; 'if some general understanding on quality and price could be reached (COR) would maintain our existing sales policy i.e. (COR) would neither facilitate by price cutting markets or take any special steps to impede (CFP's) entry into market in return for which (CFP) would be accepted from the outset as entitled to participate in industry discussions.'[51]

The oligopolistic fully integrated major oil companies, such as AIOC, tended to be against holding monopolistic positions within markets. This was largely because of the political difficulties it could cause. As a result the majors were prepared to concede market share on condition that competitors continued to follow the oilgopolists' 'rules' and did not introduce either lower priced products or better quality products.

This reinforces the conclusion that AIOC and other major oil companies did not act simply as profit maximising organisations. Of equal if not greater importance was ensuring the survival of an international industrial structure whereby large oligopolistic firms were able to sustain stability in consumer markets.

The relationship between governments and companies was also fraught with problems for the maintenance of stability for the oil companies. Most notably in the immediate post war period for AIOC was the continued conflict with the British government over steel allocations.

Steel allocations became the centre for conflict between the British government and AIOC for two reasons. The growth of the oil industry by the end of the 1940s required enormous quantities of steel. The department most favourable to the oil industry, the Ministry of Fuel and Power, calculated that the oil expansion programme of British companies would increase crude oil production from 54 million tons in 1947 to 100 million tons by 1954 requiring 3.8 million tons of steel for production purposes alone. The Treasury who were not hostile to the oil industry nevertheless were forced to consider this as 'quite fantastic' and opposed an expansion on such a

[49] B.P. 65179, 28th December 1955, p.1

[50] B.P. 65179, Letter G.R. Shelbourne to H.G. Cooper, 26th August 1955

[51] B.P. 65179, C.O.R. Melbourne letter to AIOC Head Office, 8th February 1955

large scale.[52] The problems this caused AIOC can be gauged from the comment of G.H. Coxon, the Director of the Central Planning Department for AIOC, who maintained that the efforts to increase refining capacity by 16m tons were being 'nullified by our complete inability to get the necessary permits from government.'

The second problem, however, that AIOC faced was in the use of steel and Coxon went on to say that 'Mr Gaitskell himself has said that he doubts whether the country can afford to export steel at the rate requested by the petroleum industry.'[53] The exporting of steel certainly was considered less favourably than when used domestically given that central to government thinking was the need to increase exports of finished goods and so earn as much foreign currency, especially dollars, as possible. The oil industries steel allocation was reduced to 800,000 tons of which 500,000 tons was to come from United Kingdom sources in September 1947. In October the steel allocator rejected a requested increase to 153,000 tons and instead reduced the allocation of 138,000 tons per quarter to 133,000 tons.[54] The main reason behind this cut was that most steel allocated to the oil industry was being used outside of Britain and as a result the government placed a limit of 100,000 tons per quarter upon the Petroleum Division, excluding the refinery expansion programme.[55]

The steel shortage was the centre of disputes between government and AIOC for some time. The company was not however significantly commercially disadvantaged as a result of the shortages due, in part, to world shortages of steel also affecting potential competitors. Nevertheless the example of this running sore for AIOC highlights the extent to which the attempts at collaboration faced major problems.

<u>How successful was collaboration?</u>

Measuring price data in the oil industry is extremely difficult given that the oil companies themselves kept little comparable information on costs of production. In part this may well have been to prevent information falling into the hands of anti-trust investigators. It also reflects the fact that oil companies remained highly profitable companies and that because of their fully integrated structure they never developed a detailed analysis of value added or costs in each stage of the process from extraction to sales. What costing did take place followed the same form in which prices were quoted - 'net-back'. From the posted free on board (f.o.b) price of crude oil companies subtracted royalties, production costs, depreciation, capital expenditure etc, to arrive at a cost per ton.[56] To arrive at a selling price companies worked forwards from a price (f.o.b) and

[52] PRO. T236/1314, Cabinet Investment Programme, 5th September 1947.

[53] B.P.65179, Note to Chairman from G.H. Coxon 17.11. 1947, p.2

[54] PRO T236/1314, <u>op.cit.</u>

[55] PRO T236/1314, Ibid., 5th September 1947 and 29th October 1947

[56] See D.S. Painter, 'Oil and the Marshall Plan' in <u>Business History Review</u>, Vol.58, 1984 for a discussion on 'net-back'.

added/subtracted freight rates, taxes and production costs.

Nevertheless it appears that the post 1945 period saw success for the cooperative strategy of the oil majors. The price collapses of the 1930s never reoccurred in either the crude oil markets or in product markets (see Figures 3 and 4). Crude oil prices and supply varied only marginally during the events between 1951-4 when Iranian production ceased and then re-entered the market.[57] As Figures 3 and 4 show price changes for either crude oil or petrol prices in Britain show little correlation to the Iranian events.

Most importantly for the oil companies whilst real prices were falling from their 1947 peak over the period they did so in a controlled manner (see Figures 3a and 3b). Hence the cooperation led to a stability in the rate of change of prices (see Figure 3a) and it was this control over the rate of change of prices that was the real success for the cooperative strategy. Such stability also suggests that it was not only prices that were controlled but so was the expansion of crude oil supplies onto the market. Thus the cooperative strategy succeeded in allowing the oil companies to maintain a balance between supply and demand.

The end of an era?

The high point for cartels and controls within the oil industry lasted from the end of the Second World War to the mid 1950s. By the end of the 1950s surplus crude oil was again being sold onto the market at 'depressed prices'. This allowed the independents and national oil companies, such as Italy's AGIP, to challenge the majors over their domination in refining and retailing. As can be seen from Table 1 the prices of fuel oil across European economies began to diverge as governments such as Italy who had previously been reliant upon the major oil companies utilised the world surplus of oil to undermine the position of the majors. Similarly governments which had established oil companies, such as in Britain and France, helped to maintain high domestic product prices.

[57] E.T. Penrose, The Large International Firm in Developing Countries, (London 1968), p.150

Table 1
Estimated Prices for Fuel Oil 1954-61.

	U.K	France	Germany	Italy	Netherlands	Belgium
1954	100	100	100	100	100	100
1955	102	103	105	102	103	105
1956	112	110	109	112	127	114
1957	138	131	114	112	153	133
1958	116	145	82	107	113	110
1959	118	148	77	93	110	105
1960	122	145	77	86	110	110
1961	139	141	77	86	117	105

Source: PRO POWE 61/108 7/02/62, The Coal Reappraisal Group, CRG 4, Derived from Oil and Gas International and Petroleum Times

Even with the inclusion of the independents the oil industry remained a highly vertically integrated industry but the hold of the fully integrated firms was nevertheless weakened. The response of the majors to the challenge posed by surplus oil and the emergence of competition also provided a further nail in the coffin for the immediate post war strategy. In order to compete with the independents the majors cut the posted price of crude oil in 1959 and again in 1960, the price which royalty payments to producer nations were calculated from. As a direct result of this move by the majors the Organisation of Petroleum Exporting Countries was formed in 1960 as an organisation whose aim was to counter the influence of the majors and control the output of supply. The emergence of a new threat to the old industrial structure of the oil industry emerged and with it new sources for instability which the majors and governments were required to find solutions.

This paper has attempted to suggest that oil companies and governments consciously acted to structure markets and define competition. Of particular interest has been the development and extent of the government/industry relationship. The relationship emerged as a conscious act of all parties and was not simply some rent-seeking, profit maximising strategy to capture governing institutions by oligopolistic business. The relationship was mutual and served both groups. Under specific circumstances the relationship could be antagonistic but when the basis for the relationship was threatened the core interests rapidly came to the fore. Essentially the relationship was built upon national class interests rather than narrow monopolistic considerations. The core of the relationship was the maintenance of a set of conditions which allowed firstly, the continuation of the accumulation of wealth by the national ruling classes involved in the relationship and secondly, allowing a maximising of that wealth to the participants within those conditions.

Appendix One

Text of letter from Geoffrey Lloyd, Minister for Fuel and Power to Boards of all U.S. owned oil companies operating in Britain.[58]

4th December 1952

Dear Gentlemen,

Her Majesty's Government understands that in connection with proceedings under the Anti-Trust laws in the United States of America (which raise important questions relating to international comity you have been required by your holding company in pursuance of subpoenas issued to them to produce documents relating to your company's business.

Her Majesty's Government understands that this requirement relates to documents which effect a wide range of your company's activities and Her Majesty's Government consider that the disclosure of some of these documents relating to business outside the United States may prejudice or endanger the economic, strategic and political interests of Her Majesty's Government and Western Powers.

Her Majesty's Government therefore require you not to produce any documents which are not in the United States of America and which do not relate to business in the United States of America without the authority of Her Majesty's Government.

[58] PRO. POWE 33/1857

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