

Empires of Energy: Britain, British Petroleum, Shell and the Remaking of the International Oil Industry, 1957-1979

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Boston College

The Graduate School of Arts and Sciences

Department of History

EMPIRES OF ENERGY:
BRITAIN, BRITISH PETROLEUM, SHELL AND THE REMAKING OF THE
INTERNATIONAL OIL INDUSTRY,
1957-1979

[A dissertation by]

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Empires of Energy: Britain, British Petroleum, Shell and the remaking of the international oil industry, 1957-1979

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Dissertation Abstract

This dissertation examines British oil policy from the aftermath of the Suez Crisis in 1956-1957 until the Iranian Revolution and the electoral victory of Margaret Thatcher's Conservative Party in 1979. It was a period marked by major transitions within Britain's oil policy as well as broader changes within the international oil market. It argues that the story of Britain, and Britain's two domestically-based oil companies, BP and Shell, offers a valuable case study in the development of competing ideas about the reorganization of the international oil industry in the wake of the rise of the Organization of Petroleum Exporting countries and the companies' losing control over the production of oil. The emergence of OPEC, and the political and resource nationalism which provided it with its inspiration, proved to be a challenge for the companies. In their view, this had to be countered commercially through the maintenance of the role of the major oil companies as well as the further internationalization of the oil market; a process which they believed would help de-politicize oil production and distribution. Although the Governments which ruled Britain in this era were initially in favor of this laissez-faire approach, economic and political uncertainty in Britain, coupled with the game-changing potential of Britain's own North Sea oil resources led to a gradual process of state intervention into oil matters, both at home and abroad. Out of this emerged a different philosophy on the part of Cabinet and Whitehall officials, one which saw the future of oil

being in the hands of the state and state-controlled companies. This growing divergence weakened the traditional partnership between BP, Shell and the British Government and limited cooperation until the defeat of the Labour Party in 1979 by Thatcher's Conservatives reversed the trend of growing state involvement. Together these interconnected accounts provide an important counter-point to the idea that the emergence of a fully international oil market was inevitable and reveals that the reformation of the oil market in the post-1973 world was the result of political and as well as market forces.

*Dedicated to my counselor, coach, editor, friend and wife
Amy Kuiken*

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List of Abbreviations

ADMA – Abu Dhabi Marine Areas
AIOC – Anglo-Iranian Oil Company
APOC – Anglo-Persian Oil Company
ARAMCO – Arabian American Oil Company
ARCO – Atlantic-Richfield Company
BGC – British Gas Council
BNOC – British National Oil Company
BP – British Petroleum
CEGB – Central Electricity Generating Board
CFP – *Compagnie Française des Pétroles*
CI – Carried Interest
CPRS – Central Policy Review Staff
DEA – Department of Economic Affairs
DOJ – United States Department of Justice
DTI – Department of Trade and Industry
ECG – Energy Coordinating Group
EEC – European Economic Community
ENI - *Ente Nazionale Idrocarburi*
ERT – Excess Revenue Tax
FCO – Foreign and Commonwealth Office
FMG – Federal Military Government
FO – Foreign Office
GOQ – The Interdepartmental Working Group on International Oil Questions
HMG – Her Majesty’s Government
IEA – International Energy Agency
IEP – International Energy Program
IMEG – International Management and Engineering Group
IMF – International Monetary Fund
INOC – Iraqi National Oil Company
IPC – Iraq Petroleum Company
JIC – Joint Intelligence Committee
KOC – Kuwait Oil Company
LPG – London Policy Group
MEEC – Middle East Emergency Committee
MoP – Ministry of Power
NCB – National Coal Board
NHC – National Hydrocarbons Corporation
NIOC – National Iranian Oil Company

NUM – National Union of Mineworkers
OAPEC – Organization of Arab Petroleum Exporting Countries
OECD – Organization for Economic Cooperation and Development
OEEC – Organization for European Economic Cooperation
OPEC – Organization of Petroleum Exporting Countries
PRT – Petroleum Revenue Tax
RCC – Revolutionary Command Council
SOG – Standing Oil Group
TAP – Trans-Arabian Pipeline

Introduction – Britain and a Changing International Oil Industry

On the evening of 21 October, 1973 an emergency meeting was held at Chequers, the country retreat of Britain's Prime Minister Edward Heath. The two most anticipated guests were the chairman of British Petroleum (BP), Sir Eric Drake, and the chairman of the British unit of Shell, Frank McFadzean. Heath had called the two men to Chequers in the midst of a chaotic scene for the world oil market. Two weeks earlier, a joint Egyptian/Syrian attack on Israel had ignited what would come to be known as the Yom Kippur or October War.¹ Events had developed dramatically following the opening of hostilities, with the nations of the Organization of Petroleum Exporting Countries (OPEC) using the crisis situation to pressure the international oil companies to increase the posted price of oil.² When these companies sought to delay such an increase, the Persian Gulf OPEC states raised the price of oil unilaterally by 70 percent to \$5.11 a barrel on 16 October.³ Just one day later, the Organization of Arab Petroleum Exporting Countries (OAPEC) unleashed the "oil weapon" by announcing a dramatic 5 percent, and later 10 percent, monthly cut-back on oil production until Israel withdrew to its pre-1967 borders.⁴ Several countries, including the United States and the Netherlands, were

¹ This was the fourth Arab/Israeli war since 1948.

² The posted price of oil was, at this time, set by the oil companies and was the price used to calculate the taxes and royalties paid by the companies to the oil-producing states.

³ These states included Saudi Arabia, Kuwait, Iraq, the United Arab Emirates, Qatar and Iran.

⁴ OAPEC at this time consisted of Saudi Arabia, Kuwait, Iraq, Libya, Algeria, Egypt, Syria, Qatar, the United Arab Emirates and Bahrain.

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completely embargoed by OAPEC suppliers for their pro-Israeli stances on 20 October.⁵

The other industrial countries were categorized as either “friendly,” “neutral” or “unfriendly” and would suffer from the cutback more or less depending on where the OAPEC nations felt they stood in relation to the Arab/Israeli conflict.

Britain had been classified as a “friendly” country and was therefore supposed to receive the same amount of oil as they had on average for the first nine months of 1973. But OAPEC’s classification system did not take into account that the international oil companies, such as BP and Shell, were obligated to attempt to meet their contract requirements to the best of their ability. Thus the international oil industry subsequently resorted to a policy of “equal misery,” meaning that the loss in supplies would be spread evenly to all oil importing countries. This loss of oil supplies could not have come at a worse time for the Heath Government, which was locked in a struggle with the National Union of Mineworkers (NUM) and was already suffering from a decreasing supply of coal.⁶ Having already experienced an energy crisis in 1972 during an earlier miners’ strike, Heath could little afford for the lights to go out yet again.⁷

⁵ With the embargo in effect, the cutback was even more pronounced. In Saudi Arabia, for instance, the share of production destined for the United States was cut off on top of the 10 percent reduction of remaining production. This meant that roughly 20 percent of Saudi Arabia’s production was halted by the end of October. See United States. Office of International Energy Affairs, *U.S. Oil Companies and the Arab Oil Embargo : the International Allocation of Constricted Supplies : Prepared for the Use of Subcommittee on Multinational Corporations of the Committee on Foreign Relations, United States Senate* (US Government Print Office, 1975).

⁶ Following a successful industrial action in 1972, the NUM continued to pressure the Government for increased wages for the coal miners. This ran counter to the Heath Government’s inflation reduction plans and was thus refused. As a result, the NUM had instructed its members to work to rule since the mid-summer and was preparing for new negotiations in the autumn.

⁷ For the cultural and political impact of these energy crises, see Andy Beckett, *When the Lights Went Out: Britain in the Seventies* (Faber, 2009); and Dominic Sandbrook, *State of Emergency: The Way We Were : Britain, 1970-1974* (Penguin, 2011).

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It was thus out of desperation that Heath called the oilmen in the hope that the companies they represented, two of the largest oil firms in the world and British-based, would ensure that the United Kingdom's full supply of oil would be provided. In doing so, Heath went against the advice of his own officials. Over the previous two years there had been a great deal of discussion about ways to protect Britain's oil supply in the event of such a crisis. Opinion among civil servants had consistently been against the notion of BP and Shell providing special benefits to Britain for fear of what this would do to the companies' international position.

The companies themselves had warned that even a hint of such an approach would harm any prospect of consumer nation solidarity. In a meeting between officials and Drake and McFadzean held on 4 October, Drake had expressed concern that other large consumers like West Germany, which had no major international oil company of its own, feared that "in the last resort the US and the UK would direct their oil companies to favour the home market."⁸ For this reason, he argued, "it was important that the independence of the oil companies should be made absolutely clear."⁹ This independence would be used to employ the policy of "equal misery" during an oil shortage. Similar strategies were used during the Suez Crisis of 1956-57 and the abortive Arab oil embargo of 1967, to the great benefit of Britain.¹⁰ Whitehall officials agreed

⁸ FCO 55/1060, NA, OPEC Negotiations: Minister for Industry's Meeting with Shell and BP on Thursday 4 October 1973, October, 1973.

⁹ Ibid.

¹⁰ During the Suez Crisis production had been increased in the Western Hemisphere, following the British and French withdrawal from the Canal Zone, and the international oil companies, operating under the aegis of the Organization for European Economic Cooperation's Petroleum Industry Emergency Group had coordinated the even distribution of these extra supplies to make up for the shortfall resulting from the

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with this approach. On 12 October, officials from the Department of Trade and Industry (DTI) reported to the Ministerial Committee on Economic Strategy that a move – such as the one Heath would contemplate a little over a week later – “would certainly undermine” BP and Shell’s “position as international companies, with heavy losses to our balance of payments, and with possible retaliation against our exports in general and against the companies' foreign assets.”¹¹

Despite these warnings, Heath persisted in his belief that BP and Shell would feel a sense of duty and assist the Government in its difficult situation. During the meeting at Chequers, Heath noted to the two chairmen that “The volume of oil handled by Shell and BP was many times greater than total British demand,” and raised the question of whether or not it was “really impossible, when we imported our requirements from a wide range of suppliers and when two major international oil companies were based in Britain, for us to devise arrangements whereby all our reasonable needs would be met?”¹² Heath, in effect, was asking for BP and Shell to give the UK precedence over their other customers and ensure Britain’s supplies came first. Much to Heath’s chagrin, the two oilmen demurred at his proposal and responded that such a request could only be met if the Government took the legal step to invoke *force majeure*, thereby relieving the companies of their contractual obligations to their other customers. A flustered and irate

closure of the Suez Canal and the damage to the Mediterranean pipelines. Similar procedures were used in 1967 to distribute extra American and Iranian supplies during the 1967 Arab embargo against the United States and the United Kingdom.

¹¹ FCO 55/1096, NA, Ministerial Committee on Economic Strategy: Task Force on Oil Supplies - OECD Oil Sharing Arrangements, 12 October, 1973.

¹² PREM 15/1838, NA, Note of a Discussion at Chequers on the Evening of Sunday 21 October, 22 October, 1973.

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Heath declared that he could not pursue such a course, as it would instantly publicize that Britain had placed its own economic needs above the solidarity of the other Western consumer nations.¹³ The meeting went on to discuss other matters, but Heath's proposal, and the companies refusal to agree to it, stood as a symbolic moment in a partnership that had proven mutually beneficial to both sides for many years.

Realized and Unrealized Shifts

The scene described by this anecdote can be interpreted several ways – as an example of the hapless response of Western leaders to the “shock” of the 1973 Oil Crisis, or perhaps as a damning indictment of Heath's short-sightedness – but it also sheds light on a larger picture of tremendous change in the international oil industry and in the global political economy. The incredible redistribution of power and wealth from the industrialized world to the oil-producing states that culminated in the 1973 Oil Crisis has been described as one of the crucial events of the twentieth century.¹⁴ The huge price increases instituted by OPEC are often credited with dealing a death blow to the

¹³ This story has subsequently become a famous example used by historians to show the dramatic changes sweeping over the oil industry and the consumer nations during the 1973 Oil Embargo. In his memoir, Heath criticized Drake and McFadzean by stating that he “was deeply ashamed by the obstinate and unyielding reluctance of these magnates to take any action whatever to help our own country in its time of danger,” a comment that historian Charles More found inexcusable considering the fact that BP did, against its better commercial judgment, make diversions to Britain during the worst of the crisis. More also condemned Heath's position at Chequers as “embodying stupidity, short-sightedness and panicky selfishness in roughly equal measures.” See Edward Heath, *The Course of My Life: My Autobiography* (Hodder & Stoughton, 1998), 503; and Charles More, *Black Gold: Britain and Oil in the Twentieth Century* (Continuum, 2009), 140.

¹⁴ In his memoir, Henry Kissinger described it as “one of the pivotal events in the history of this century.” See Henry Kissinger, *Years of Upheaval* (Little, Brown, 1982), 885.

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economic boom that had lifted Europe and much of the Western world from the ruins of the Second World War, ushering in a new age of economic and political instability.¹⁵

Historians have placed the 1973 Oil Crisis as a pivotal moment in the longer-term evolution of the oil industry from a system wherein a few major oil companies controlled the vast majority of international trade through their possession of large and stable oil concessions (in areas such as the Persian Gulf, Venezuela and Indonesia) to one in which oil production and marketing was more-or-less distinct and conducted through sales on an open internationalized market.¹⁶ The dramatic shift in influence from the consumers of oil to its producers, and the consequent emergence of a more internationalized oil system, should certainly not be minimized, but often overlooked in this story is another struggle – one that would only intensify as a result of the 1973 oil crisis. The events leading to the crisis not only represented the decline of the Western oil companies’ ability to single-handedly control the oil industry but also characterized the battle within the industrialized world over the future shape of the international oil market. With some projecting the seizure of power by OPEC over the pricing and production of oil as the end of the major international oil companies, strong arguments were made in certain corners for the creation of state-run oil companies and a regulated market.¹⁷ Some even envisioned a

¹⁵ Eric Hobsbawm, for instance, wrote that “The history of the twenty years after 1973 is that of a world which has lost its bearings and slid into instability and crisis.” See E. J Hobsbawm, *The Age of Extremes: a History of the World, 1914-1991* (New York: Vintage Books, 1996), 403.

¹⁶ See Steven A. Schneider, *The Oil Price Revolution* (Johns Hopkins University Press, 1983); Cyrus Bina, “Internationalization of the Oil Industry: Simple Oil Shocks or Structural Crisis?,” *Review: A Journal of the Fernand Braudel Center* 11, no. 3 (July 1988): 329–370; Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (Simon and Schuster, 2008).

¹⁷ Turner entitled his final chapter “Will the Oil Companies Survive?” and while he argued that they would, others were more skeptical. See Louis Turner, *Oil Companies in the International System* (Royal Institute

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wholesale reconfiguration of the world economy through a New International Economic Order. This idea, put forward by the United Nations Conference on Trade and Development, would have seen trade and development, particularly of oil, altered to the benefit of developing countries based on a centrally planned, rather than a free market system.¹⁸ But these views conflicted with others which claimed that the international nature of oil production and marketing made it impossible to fragment and regulate. With oil being “one big pool,” the only system which could adequately and fairly distribute this most vital of resources was a liberal market governed more or less by the laws of supply and demand.¹⁹

It is this second vision of oil which ultimately triumphed. It was a system that allowed the major international oil companies not only to survive but to flourish and in doing so helped give it an aura of inevitability. This impression is strengthened by the fact that most studies of the oil industry tend to focus on the United States and American companies where the lure of state intervention was always weakest.²⁰ Traditionally, the story is one which shows the international oil market evolving towards something more akin to a free market for available oil, albeit one still heavily influenced by the whims of OPEC. This process occurred either through the longer term internationalization of the

of International Affairs, 1978). Those that believed change was in the offing held up France, with its semi-state-owned companies CFP and ERAP and its tightly managed oil market, as an example to be emulated. See G. John Ikenberry, “The Irony of State Strength: Comparative Responses to the Oil Shocks in the 1970s,” *International Organization* 40, no. 1 (Winter 1986): 105–137.

¹⁸ For an excellent account of these ideas see Giuliano Garavini, *After Empires: European Integration, Decolonization, and the Challenge from the Global South 1957-1986* (Oxford University Press, 2012).

¹⁹ For a discussion of the theory on the inter-connectivity of oil markets see Robert J. Weiner, “Is the World Oil Market ‘One Great Pool’?,” *The Energy Journal* 12, no. 3 (January 1, 1991): 95–107.

²⁰ Even magnificent and comprehensive histories such as Daniel Yergin’s *The Prize* tend to have an American-centric view of the history of the oil industry.

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oil companies themselves, or through a default position of a consumer bloc and a producer bloc at loggerheads with one another.²¹ Though this was the eventual outcome for most of the industrialized world, it was by no means inevitable.

This narrative ignores the fact that in Europe and Japan the question of the future of the oil industry was much more existential than in the United States.²² With the European Economic Community (EEC) engaged in talks on common energy policy, there existed the very real possibility of the formation of a Europe-wide managed market in oil which could have given preference to private or state-controlled European companies, thus irrevocably altering the international oil market.²³ There was also the prospect that individual countries could seek to insulate themselves through the creation of an even more fragmented system of single-state markets. In any of these alternate systems, the

²¹ The clearest elucidation of this argument can be found in Bina, "Internationalization of the Oil Industry."

²² There were two key differences between the United States and most other consumers. The first was that it imported relatively little in terms of overall percentage from the Middle East due to its large domestic production capacity. The second was that American companies had large stakes in productive concessions in the United States and elsewhere, allowing them to transition more easily into the post-1973 world of state-controlled concessions in the Middle East. Europe's position will be discussed in greater detail but for contemporary views of the Japanese situation see Koji Taira, "Japan After the 'Oil Shock': An International Resource Pauper," *Current History* 68, no. 404 (May 1975): 145–148; and Valerie Yorke, "Oil, the Middle East and Japan's Search for Security," *International Affairs* 57, no. 3 (Summer 1981): 428.

²³ A French-style managed market had long been viewed as an intriguing option by the British Government. Under such a system, market share was allocated to preferred companies and strict qualifications put on any outside firms who wished to operate within the market. These included provisions on everything from refining within the managed market all the way to the necessity of transporting crude into the managed market on tankers flagged to countries within that market. For examples of the debate over Europe's energy future see Henri Simonet, "Energy and the Future of Europe," *Foreign Affairs* 53, no. 3 (April 1975): 450; Peter Stingelin, "Europe and the Oil Crisis," *Current History* 68, no. 403 (April 1975): 97; Judith Gurney, "North Sea Oil and Gas: Implications for Western Europe," *World Today* 31, no. 10 (September 1975): 415–423. For examples or more recent scholarship on the subject see Rüdiger Graf, "Between 'National' and 'Human Security': Energy Security in the United States and Western Europe in the 1970s" *Historical Social Research* 35, no. 4 (134) (January 1, 2010): 329–348.; Aurelie Elisa Gfeller, *Building a European Identity: France, the United States, and the Oil Shock, 1973–1974* (Berghahn Books, 2012); Silvio Labbate, "Italy and the Development of European Energy Policy: From the Dawn of the Integration Process to the 1973 Oil Crisis," *European Review of History* 20, no. 1 (February 2013): 67–93.

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role of the state in the oil market would have been greatly expanded. Answering the question of why these options were abandoned in the post Oil Crisis years is crucial to a fuller understanding of the evolution of the modern international oil market.

The story of Britain during this period offers an exceptional case study to provide such an answer and to see how state intervention grew in attractiveness and why it was ultimately abandoned in favor of a more liberal approach. As the parent government of two of the largest international oil companies, but also the possessor of huge oil resources in the North Sea, Britain occupied the enviable yet uncomfortable position of having the choice of following either route. It had traditionally embraced a liberal oil policy, allowing the international companies to operate freely within its market.²⁴ However, growing concern about the safety and the economic viability of overseas supplies had, as early as 1957, forced some officials within Whitehall to envision a day when the Government would take an active hand in managing oil affairs. Oil was the only form of energy in Britain that was not run by a nationalized industry and therefore stood as an outlier in terms of economic planning.²⁵ Hence the story of the years from 1957-1979, from the Suez Crisis to the victory of Margaret Thatcher, is not just a story of the shift in power from the oil companies such as BP and Shell to OPEC, but also the story of industrialized countries such as Britain wrestling with the question of whether the market or state control was the best way of guaranteeing a stable and profitable supply of oil.

²⁴ This had opened the door to many American companies, chief among them Esso, to establish strong market shares within Britain.

²⁵ The other major energy sources, coal, gas and nuclear, were all controlled by nationalized industries as was the Central Electricity Generating Board.

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For much of the period of study, it seemed to most educated observers that the state would continue to increase its competency in oil matters and would perhaps achieve a type of control over oil matters akin to that exercised over Britain's other energy sources. But this seemingly inexorable increase in State intervention was hampered by political division between and within Britain's major parties, the resistance of entrenched financial and business interests including those of BP and Shell, and ultimately the inability of the State to develop the confidence that it could effectively manage the nation's oil supply on its own. These factors crippled – but did not stop – the drive for State intervention even before the victory of the pro-market Thatcher Government in 1979, which spelled the effective end of the experiment in State control over the oil industry. Thus in the end, Britain, like the United States, embraced a liberal international oil market as their best hope of maintaining a secure and relatively profitable supply of oil. How and why this happened is the subject of this dissertation.

To begin answering these questions, we can turn back to the story of Heath, Drake and McFadzean at Chequers in October, 1973. The incident there reveals three key questions that together help to frame the issue of state intervention by the British State in oil matters for the period of 1957-1979. The first is why a British Prime Minister would expect help from private, international companies. Equally important to this question is why BP and Shell would have taken the risk to meet with Heath given the crisis atmosphere and their own fears of appearing too closely tied to the British Government. The second question feeds off this: why, upon agreeing to meet with Heath, did BP and

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Shell then reject his request for special assistance? The final question is how Whitehall itself functioned regarding oil policy. A key aspect of this story is the fact that Heath was warned by his officials that BP and Shell would not only be unwilling to grant the special assistance he wanted to ask of them but that such a policy would ultimately be detrimental to Britain in the long term, advice that Heath chose to ignore.

These three questions uncover larger issues which will be examined in this dissertation such as the nature of the relationship between the State and BP and Shell, the changes the international oil industry was undergoing, British responses to those changes, and fundamental questions about how oil policy was formed and exercised. Some of these concerns existed since the beginning of the oil industry in the late nineteenth century. A few, however, took on increased importance in the post-Suez world where the forces of Arab nationalism, growing oil demand and declining British power all combined to create a situation where the importance of oil was increasing while Britain's traditional means of protecting and securing that oil were diminishing. In these years of transition, old ideas were challenged, new approaches were attempted, and crises fundamentally altered the relationship between the major international companies and their home states.

A Strategic Partnership

The first question – why Heath would expect help from private oil companies – will be explored in more detail throughout the following chapters, but first requires a

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brief discussion of the historical relationship between the British Government and BP and also with Shell. These associations were never entirely the same for reasons which will be discussed shortly, but both companies did maintain strong connections to Whitehall in what was a strategic partnership rather than a traditional company-state connection.²⁶

Unlike most relationships between a business and a government, Whitehall and the companies received more out of their partnership than simply domestic economic benefit.²⁷

In fact, the true impact of these firms came in their dealings overseas. Economically, the operations of BP and Shell across the globe returned large earnings to Britain's balance of payments, both visible and invisible.²⁸ But less quantifiable was the influence the operations of these firms in the Middle East and elsewhere afforded the Government throughout much of the Twentieth Century. Pre-1957 BP and Shell were both major operators in the Middle East and were, in some places such as Kuwait and Iran, the largest employers as well as owners of the largest capital projects.²⁹ These countries, along with Iraq and the Trucial States, were already within Britain's sphere of

²⁶ Tony Benn, the Secretary of State for Energy from 1975-1979 would later write that "some oil companies are comparable in strength and wealth to national governments" and that "relations between governments and oil companies were rather like treaty negotiations." See Tony Benn, *Conflicts of Interest: Diaries, 1977-80* (Hutchinson, 1990), 3.

²⁷ For example, Britain relied on a liberal oil policy to supply itself, allowing American firms to operate freely in the country and to compete with BP and Shell, who actually marketed their products jointly in the UK through a partnership known as Shell-Mex and BP. Even at its height, Shell-Mex and BP supplied only a little over half of Britain's oil supply needs. While not insignificant, the operations of BP and Shell in the domestic market were not the chief source of importance for the firms to Britain.

²⁸ Both companies' large tanker fleets returned a similar advantage. For a slightly earlier example of the importance of oil transport to the British economy, see Nathan J. Citino, "Defending the 'Postwar Petroleum Order': The US, Britain and the 1954 Saudi-Onassis Tanker Deal," *Diplomacy & Statecraft* 11, no. 2 (July 2000): 137.

²⁹ The crown jewel of these overseas properties was the Abadan Refinery in Iran, the largest refinery in the world throughout much of the 1950's.

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influence, but the operations of BP and Shell served as a powerful force to cement that status. The fact that British ambassadors often functioned as mediators during negotiations between the companies and their host governments only served to enhance the prestige of Britain and its seemingly indispensable role in the region.

The strategic nature of the relationship between the companies and the British Government had been evident for decades. In the case of BP, this fact was even more pronounced. The official connection between the State and BP began in 1914 when the First Lord of the Admiralty, Winston Churchill, moved to secure a long-term supply of fuel oil for the British Navy which was at that time in the process of transitioning from warships powered by coal to oil.³⁰ The opportunity for Churchill to achieve this goal arose when the small Anglo-Persian Oil Company, a forebear of BP which operated a massive concession in Persia, fell into financial difficulties.³¹ Anglo-Persian, which was a subsidiary of what was then the largest British oil company, Burmah Oil, had struck oil in Persia in 1908 but lacked the capital to properly exploit its discovery.³² In exchange for a guaranteed long-term contract for the British Navy, Churchill agreed to purchase 51 percent of Anglo-Persian in 1914.³³

³⁰ Churchill actually sought to find a source of oil that could be actively controlled by the British Government as opposed to entering into a long-term contract with the two oil companies already capable of fulfilling the British Navy's demand, the Standard Oil Company and Royal-Dutch Shell.

³¹ Reza Shah would change the country's name from Persia to Iran in 1935.

³² For the history of the early years of what was known as the D'Arcy Concession, see Hesamedin Navabi, "D'Arcy's Oil Concession of 1901: Oil Independence, Foreign Influence and Characters Involved," *Journal of South Asian & Middle Eastern Studies* 33, no. 2 (Winter 2010): 18–33. For the early history of Burmah and its relationship, see Thomas Anthony Buchanan Corley, *A History of the Burmah Oil Company: 1866-1924* (Heinemann, 1983).

³³ For an excellent analysis of the decision to acquire the 51 percent stake in Anglo-Persian, see Ronald W. Ferrier, *The History of the British Petroleum Company, Vol. 1: The Developing Years, 1901-1932*

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The other stockholders were not certain of this arrangement and thus a Treasury official, Sir John Bradbury, wrote to the Board of Anglo-Persian laying out the explicit terms of the Government-Company relationship. The Bradbury Letter, as it came to be known, would serve as a constitution of sorts for the partnership between Anglo-Persian and its successor companies, and Whitehall.³⁴ It stated that the Government would appoint two directors to the Board who would oversee Britain's investments, but that Whitehall would not interfere in the day-to-day operations of the Company. The Government would hold the ability to veto any decision by the Company if it was determined to be against the interest of Britain, an option that was never exercised.

The infusion of capital from the Government helped Anglo-Persian thrive, soon making it one of the largest and most successful companies in the world. It took concessions in Mesopotamia and elsewhere, quickly becoming one of the most profitable investments of the British Government.³⁵ Following the First World War, during which the allies "floated to victory on a sea of oil" according to British Foreign Secretary Lord Curzon, Anglo-Persian found itself in an even stronger position due to Britain's expanded

(Cambridge University Press, 1982). For a more general account of the British State's role in the early development of Britain's oil industry, see Geoffrey Jones, *The State and the Emergence of the British Oil Industry* (Palgrave Macmillan, 1981).

³⁴ APOC would change its name to the Anglo-Iranian Oil Company in 1935 and to British Petroleum in 1954.

³⁵ These concessions were in the Turkish Petroleum Company, later renamed the Iraq Petroleum Company. For the story of early oil exploration and production in the Middle East, see Anthony Sampson, *The Seven Sisters: The Great Oil Companies and the World They Shaped* (Bantam Books, 1991); Yergin, *The Prize*; Marian Kent, *Moguls and Mandarins: Oil, Imperialism and the Middle East in British Foreign Policy 1900-1940* (Routledge, 1993).

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role in the Middle East.³⁶ This was a mutually beneficial situation as Britain was willing to expend influence to assist the company. It became particularly true in 1932 when Reza Shah of Persia unilaterally attempted to cancel Anglo-Persian's concession after the failure of renegotiations of the terms under which the Company operated.³⁷ The British Government took the case to the Permanent Court of International Justice at The Hague and eventually pressured Reza Shah to agree to new terms in 1933.³⁸ Eight years later, the British along with the Soviets occupied Iran and deposed Reza Shah in favor of his more compliant son, Mohammed Reza.³⁹

But the complications of the BP/State relationship were revealed ten years later when the regime of the nationalist politician Mohammed Mossadegh once more reopened the issue of the concession terms for the company, now named the Anglo-Iranian Oil Company (AIOC).⁴⁰ When negotiations again broke down, mainly due to the obstinacy of AIOC's chairman William Fraser, Mossadegh nationalized AIOC's concession and property within Iran. The Iranian nationalization crisis caused major upheaval in the international oil market but was ultimately overcome through the blacklisting of Iranian

³⁶ By taking control of Iraq as a League of Nations' Mandate, Britain positioned itself to control some of the largest known oil fields in the world. For excellent accounts of oil's role in the First World War and its aftermath, see Sampson, *The Seven Sisters*; Yergin, *The Prize*.

³⁷ For an excellent account of this situation, see Kent, *Moguls and Mandarins*.

³⁸ The 1933 Agreement offered several symbolic concessions to Iran but was widely considered to be a complete victory for Anglo-Persian and the British Government. See Ferrier, *The History of the British Petroleum Company, Vol. 1*.

³⁹ For an account of the deposition of Reza Shah see Shareen Blair Brysac, "A Very British Coup: How Reza Shah Won and Lost His Throne," *World Policy Journal* 24, no. 2 (Summer 2007): 90–103.

⁴⁰ Anglo-Persian was renamed Anglo-Iranian in 1935 to honor Reza Shah's wish for the country to be called Iran.

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oil, as well as the increase in production in other Persian Gulf producers.⁴¹ Negotiations between AIOC and Mossadegh were facilitated by the British Government through its embassy in Tehran. Whitehall was furious with the Company, especially with Fraser, who many within the Foreign Office (FO) considered responsible for the crisis. Despite their sympathies toward the Iranians, the FO realized that caving in to Mossadegh's demands would have radically altered the nature of the international oil industry to the detriment of British interests.⁴²

The successful boycott of Iranian oil crippled Mossadegh's finances and forced him to seek allies on the Iranian Left. This turn towards parties such as Tudeh, a communist group, alarmed the United States. Much more concerned by the possibility that Iran could fall to the communists than that a British company would be deprived of its oil concession, the Central Intelligence Agency worked with the British to engineer the overthrow of Mossadegh. Mohammed Reza Pahlavi was reinstated as the undisputed Shah and leader of Iran in 1953.⁴³ A new deal was hammered out to govern Iranian oil production, which forced AIOC to give up its monopoly. Instead, a new Consortium of

⁴¹ Kuwait where AIOC owned 50 percent of the concession saw its production increased dramatically.

⁴² For an excellent account of relations between the Government and the Company during the Crisis, see J. H Bamberg, *British Petroleum and Global Oil, 1950-1975: The Challenge of Nationalism* (Cambridge University Press, 2000).

⁴³ The historiography on the Iranian Nationalization Crisis is rich and extensive. For representative examples see James A Bill, William Roger Louis, and Center for Middle Eastern Studies, "Musaddiq, Iranian Nationalism, and Oil" (University of Texas Press, 1988); Mostafa Elm, *Oil, Power, and Principle: Iran's Oil Nationalization and Its Aftermath* (Syracuse University Press, 1994); Mary Ann Heiss, *Empire and Nationhood: The United States, Great Britain, and Iranian Oil, 1950-1954* (Columbia University Press, 1997); Steve Marsh, *Anglo-American Relations and Col War Oil: Crisis in Iran* (Palgrave, 2003); Steve Marsh, "Anglo-American Crude Diplomacy: Multinational Oil and the Iranian Oil Crisis, 1951-53.," *Contemporary British History* 21, no. 1 (March 2007): 25-53; Reza Ghasimi, "Iran's Oil Nationalization and Mossadegh's Involvement with the World Bank," *Middle East Journal* 65, no. 3 (Summer 2011): 442-456.

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companies divvied up the valuable concession; these companies agreed to pay AIOC, now renamed British Petroleum, twenty years' compensation for their part in the new grouping.⁴⁴

Among the new Consortium members was Shell. Shell's link to the British Government was not as close as that of BP but for several reasons developed a distinct strength of its own. The "Shell" Transport and Trading Company was a British concern founded in 1897 by the brothers Marcus and Samuel Samuel. The company established itself primarily as a provider of tankers to other companies but soon fell into financial trouble. Looking to shore up their transport capabilities, the Dutch firm Royal Dutch offered a merger plan with Shell in 1907. The "Shell" Transport and Trading Company's increased difficulties during the merger talks resulted in a final agreement that saw the newly created company split 60/40 between Dutch and British stockholders.⁴⁵ This meant that the new Group, as the combined company was known in shorthand, was majority Dutch-owned. There was, however, no distinct management structure uniting the two firms, adding even more confusion to relations with the British Government.⁴⁶

⁴⁴ The new Iranian Consortium saw BP retain a 40% share while the five US majors, Jersey-Standard (later Exxon), Socony-Vacuum (later Mobil), Gulf, Texaco and Standard Oil of California (now Chevron) received 7 percent. Shell received 14 percent and the French firm CFP received 6 percent. The final 5 percent was divided amongst a group of "independent" American firms.

⁴⁵ The early history of the two companies that became Royal-Dutch Shell can be found in Stephen Howarth et al., *The History of Royal Dutch Shell*, vol. 1 (Oxford University Press, 2007).

⁴⁶ For all intents and purposes, Royal Dutch and Shell remained independent companies who were joined together into the larger Royal Dutch Shell Group. Each company had its own board and chairman and each maintained separate subsidiaries. These subsidiaries often worked with one another in a complicated interplay. The Group did have one overarching Managing Director, sometimes called Chairman, but the true power in the firm was in the hands of the boards of Shell and Royal Dutch.

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Because of this lack of clear leadership and given Royal Dutch's strong connections to the Dutch Government, the overall Group was widely considered to be a mainly Dutch company prior to the Second World War. The British section, Shell, maintained a headquarters in London, but even with the lack of a unified management structure the overall Company's decision-making resided in The Hague, in the hands of the Group's domineering Chairman Henri Deterding. But when Deterding was deposed in 1939, the Group took a more pro-British approach. With the outbreak of war in 1939 and the conquest of the Netherlands in 1940 by Germany, the London Headquarters became Royal Dutch Shell's main outpost along with a second headquarters in Curacao. Shell and AIOC worked actively with the British Government in helping to manage oil supplies as part of the Petroleum Advisory Committee seconding staff to Whitehall.⁴⁷

The close working relations established between Shell and the British Government carried over into the post-war period. With the Netherlands devastated and on a long road to economic and fiscal recovery, Shell worried that the Dutch Government would no longer be able to provide the firm with the financial tools it needed in order to rebuild its own international network of holdings.⁴⁸ The Dutch Government's supply of

⁴⁷ This included the future BP chairman Maurice Bridgeman. For a look at the wartime role of the oil companies, see Fiona Venn, "The Wartime 'special Relationship'? From Oil War to Anglo-American Oil Agreement, 1939–1945," *Journal of Transatlantic Studies (Routledge)* 10, no. 2 (June 2012): 119–133.

⁴⁸ One of the first steps in Shell's post-war recovery was streamlining its management structure. The Group reorganized itself by transferring control of most of the Group's assets to Britain where they would be put into a trust jointly managed by Royal Dutch and Shell. In exchange, the overall Group conformed its management structure along the lines of Royal Dutch, with a two-tiered system of managing directors and non-executive officers. The managing directors of both partners in the Group also began to meet informally as an Executive Committee, thus more firmly integrating the firm's overall management. See Stephen Howarth and Joost Jonker, *A History of Royal Dutch Shell*, vol. 2, *Powering the Hydrocarbon*

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dollars, sterling and other international currencies was depleted, and few expected the Company to be able to pay its reconstruction cost with Dutch guilders.⁴⁹

Therefore, in 1946 Shell signed the Shell-Treasury Agreement with the British Government. The Agreement gave Shell access to the British State's foreign exchange capabilities in return for the Company placing its international investment program under the authority of the Treasury. For many years this was a win-win agreement, as Shell's large operations in the Western Hemisphere earned them a healthy supply of dollars which were returned to London, contributing to the strength of sterling as an international currency.⁵⁰ The Agreement also brought the leadership of the firm, both the British and Dutch sides, into closer contact with Whitehall. While Shell continued to maintain close relations with the Dutch Government, on issues of international strategic importance the Company chose to liaise with the British.

Thus by the 1950's Whitehall had formalized relationships with both companies. While the two firms retained complete independence in commercial matters, each still worked in close cooperation with the Government. The State's 51 percent ownership of BP and the Shell-Treasury Agreement supplemented the already natural tendency of the two firms to seek out the support of Whitehall in their international dealings, looking to Britain's diplomatic resources to help open and keep markets, as well as holding out the

Revolution, 1939-1973 (Oxford University Press, 2007), p. 94.; and Tyler Priest, *The offshore imperative: Shell Oil's search for petroleum in postwar America* (Texas A&M University Press, 2007), p. 20

⁴⁹ For the sake of simplicity, from this point on the term Shell will refer to the entire Royal Dutch Shell Group unless specified.

⁵⁰ Howarth and Jonker, *A History of Royal Dutch Shell*, vol. 2, p. 95-97.

implicit threat of British action against any state that interfered with the firms' commercial contracts.

An Industry in Flux

The long history of partnership and decades of cooperation between the State and the companies would continue throughout the period covered by this dissertation; in fact, in 1973 it may have very well seemed plausible to Heath and others that the firms would come to the rescue of the British Government. There was also another very important dynamic that Heath was banking on. With their concessions in the Middle East under threat, Heath believed that BP and Shell would be more willing to cooperate with the British Government who themselves were the masters of several extremely valuable oil fields in the North Sea.⁵¹ Thus it was not just an appeal to the companies' patriotism but also a calculation that the firms would see the writing on the wall and rush to embrace a new model of cooperation between the State and industry. This belief made the companies' rejection of Heath's request even more shocking to the Prime Minister. But his assumption of aid and participation in a "Britain First" policy ignored key changes occurring in the international oil industry throughout the period covered in these chapters.

Over the course of these two decades, two processes had been driving changes in Britain's relationship to the international oil industry. The first is that the ability of Britain to influence events in the oil-producing world weakened at the same time the

⁵¹ Gas had been discovered in the North Sea in 1965, while the first oil strike was made at the Ekofisk Field in Norwegian waters in 1969 and the Forties Field in British waters in 1970.

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companies' ability to do so faltered. At the beginning of this study in 1957, both Britain and companies such as BP and Shell occupied powerful positions in their respective spheres. Britain had strong diplomatic and military relationships with most of the Persian Gulf oil producers and the companies dominated all points of production, transport and sale of oil, through a system that was based on a series of concessions held in those countries. By 1973, and even more so by 1979, these dominant positions had diminished dramatically. Britain's decline as a regional power in the Persian Gulf was hastened by its withdrawal of military forces, announced in 1968 and implemented in 1971. Meanwhile, the rapid increase in demand for oil progressively strengthened the hand of the oil-producing states. As demand equaled and even outstripped supply, each individual oil producer had the power to disrupt the industrialized economies severely – and were therefore capable of pressuring the companies to make major concessions.⁵²

Simultaneous to these transitions, however, was the second process driving change in the international oil industry. This was the increasing globalization of companies such as BP and Shell. Although these firms, especially Shell, had been international since their inception, two factors had increased the companies' tendencies to see themselves not simply as British firms but as truly multi-national entities. The first was that the two companies had pursued a policy of diversification outside of the Middle East since at least the Iranian Nationalization Crisis of 1951. Shell had been far ahead on

⁵² The increasing demand for imported oil in the United States, which accelerated once American oil production from traditional fields peaked in 1968-1969, dramatically tightened international oil markets. From 1960-1970, US oil importation grew at a rate of roughly 6 percent a year. Europe on the other hand saw growth of oil importation of around 11 percent a year. See Schneider, *The Oil Price Revolution*, 522.

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this front, already owning large and productive fields in the United States, Venezuela and Indonesia. BP had concentrated on its Middle Eastern concessions, but made up for lost time by joining with Shell to make a major discovery of oil in Nigeria in the late 1950's. Even more significant was BP's discovery of oil at Prudhoe Bay, Alaska in 1969. These major discoveries were joined by large strikes in the North Sea to give the firms a more global source portfolio. But this process also meant that the companies had major interests beyond the control of the British State and had just as many reasons to please the American and other governments as they had their own.

Concomitant to this expansion of sources of supply was an expansion of markets. Again, Shell had a head-start on BP in this regard as well. It had a strong foothold in the all-important American market from the early twentieth century onward. BP had, on the other hand, to fight tooth and nail to gain entry into the American market, an objective that was only successfully achieved in the late 1960's. But other markets soon grew in importance as well. As the post-war economic boom lifted the European and Japanese economies, the demand for oil products in these places grew simultaneously. BP and Shell were both well-placed to take advantage of this phenomenon. With Britain joining the European Economic Community (EEC) in 1973, the connection to the European markets seemed like it would only grow stronger. But the increasing importance of the Japanese, European and American markets to BP and Shell led to a relative decrease in the importance of the British market. BP and Shell had together through their combined

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subsidiary Shell-Mex and BP cornered only slightly less than half the British market, making it a substantial earner, but by no means a dominant position for either firm.

These two factors – the shifts in regional and oil power in the Persian Gulf combined with the growing internationalization of BP and Shell – did not make the companies scornful of their relationship with Britain, but it did mean that their interests lay in the preservation of a liberal international system and market for oil. It was a position that Heath himself had supported before the crisis and one which would face its greatest challenge when Heath fell in 1974 to the Labour Party. This new government would flirt with the idea of a self-sufficient Britain insulated from the world market to a greater extent than any previous Government and, as a result, would only hasten BP and Shell's transition towards internationalization.

Making Oil Policy

Thus at the time of the Chequers meeting in 1973, Heath and Britain were actually at a crossroads in terms of oil policy, one suspended half-way between an embrace of a truly international market and one which sought state control and advantage. The prospects of North Sea oil made this second option incredibly tempting since it was estimated that by the 1980's Britain would be able to produce much of the oil it required from sources under its own control.⁵³ Given the atmosphere that surrounded

⁵³ Estimates varied tremendously, but the consensus was the between 50 and 60 percent of Britain's domestic needs would be available from the North Sea by 1980. In reality, this estimate was significantly low.

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oil matters following the 1973 Oil Crisis, this was a politically attractive option. Whether it was as attractive to the private firms, including BP and Shell, was another matter.

It was this division – between the politically desirable and the commercially justifiable – that had bedeviled British oil policy for the years leading up to the 1973 crisis and beyond. Britain's oil policy had long had two fairly simple goals: 1) a secure and stable supply of oil and 2) the acquisition of that oil at a rate profitable to Britain. From 1914 until the 1950's, the realization of these goals had been straightforward. Britain had relied upon a liberal oil policy which opened its domestic market to all comers. With its connection to BP securing its military needs, the Government felt little compunction about constructing a managed market for oil. Thus, much of Britain's domestic market was supplied by non-British firms; a situation that officials and ministers believed allowed the forces of competition to keep down domestic fuel prices. Part of Britain's embrace of a liberal oil policy stemmed from the hope that other states would do the same. This would allow BP and Shell to establish their strong markets across Europe and Africa and even in parts of Asia and the Western Hemisphere, offsetting a large portion of the balance of payments costs of Britain's oil imports.

But this hands-off approach was predicated on the ability of the international oil companies to fulfill the two goals of Britain's policy. During moments of crisis such as the Second World War, or when events went awry as in the case of the Iranian Nationalization Crisis, Whitehall had not been shy about stepping in to manage the situation and ensure the two goals were met. Therefore the precedent, and the

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temptation, for the state to intervene in the securing of Britain's oil supplies remained constant.

Two things had traditionally prevented the State from exercising greater control over its oil policy during times of calm. First, the *laissez-faire* system of allowing the private oil companies to manage Britain's oil supply had been remarkably effective for a number of years. When the Government had questions regarding oil, they were able to turn to BP and Shell for figures, explanations and even policy advice. This ability to rely on the companies allowed for and perpetuated the second factor in the State's lax approach to oil policy, which was that in the 1950's and 1960's there was no unified apparatus within Whitehall for managing oil affairs. At the beginning of this dissertation in 1957, little clear delineation of authority existed between the three major Departments which handled oil matters. The Ministry of Power (MoP) was the official sponsoring department of BP and Shell, but as oil still accounted for a rather small proportion of Britain's energy needs in the later 1950's, the contact between the MoP and the companies was not extensive. While the MoP's role would grow along with oil consumption, much more important in these early stages were relations between the firms and the FO.⁵⁴ With the vast majority of BP's holdings in the Middle East and a large portion of Shell's supply also coming from that region, the two companies kept in close touch with the FO, sharing information extensively.⁵⁵ There was also a good deal of

⁵⁴ The Foreign Office would become the Foreign and Commonwealth Office (FCO) in 1967.

⁵⁵ Though only about 12 percent of Shell's total holdings were in the Middle East, they had entered a long-term contract with the Gulf Oil Company to buy all of that firm's oil produced in Kuwait. As Gulf owned

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conversation between the companies and the Treasury. Since the Treasury held the Government's 51 percent of BP, it was actively involved in appointing the two Government directors and in approving the appointment of the Company's chairman. The Treasury also worked with Shell on matters of foreign exchange.

Yet although these three departments had contact with the companies, the diffusion of responsibilities made the formation and implementation of a strong policy of direction for the firms difficult. At first this did not matter, given that the official Government policy was to allow the firms to operate freely. But during moments of crisis, such as the oil shortage due to the closure of the Suez Canal in 1956, this inability of Whitehall to coordinate effectively was revealed as a major shortcoming. To make matters worse, few people in the three departments had any degree of specialization in oil matters; there was a Petroleum Department in the MoP and an Oil Desk in the FO, but these were staffed by relatively mid-level civil servants who themselves often received on the job training as well as copious advice from BP and Shell. Adding to the complication was the fact that the three departments regularly did not see eye-to-eye regarding matters of oil policy. The FO saw the companies as a valuable foreign policy tool and frequently pressured the firms to make small commercial sacrifices for the sake of shoring up allies or tamping down anti-British sentiment in the Middle East. The MoP, on the other hand, were interested mainly in keeping the price of oil low and thus usually supported the companies in their desire to avoid increasing payments to oil producers. The Treasury

50 percent of the Kuwait Oil Company, this meant that Shell was contracted to purchase nearly half of all Kuwaiti production.

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drifted in between these two views, worrying most of all about the value of oil operations to the balance of payments and, just as importantly, about the strain put on foreign exchange by the long-term investments of BP and Shell.

Because of this, officials in Whitehall developed a tendency to turn directly to BP and Shell on all matters of oil rather than trusting in their own ability to decipher the workings of the oil industry. Even those civil servants in the Petroleum Department and the Oil Desk knew enough to know that they knew too little to base major policy decisions on their own opinions. This lack of expertise was exacerbated by a certain ‘brain-drain,’ as well-qualified civil servants often left Whitehall to take up jobs with the companies, BP in particular.⁵⁶ This was especially true of the FO whose foreign policy experience was highly valued by the oil companies.⁵⁷

Perhaps unsurprisingly, the lack of expertise in oil matters was even more pronounced in the Cabinets of the time. Both Anthony Eden, the prime minister during the Suez Crisis, and his Chancellor of the Exchequer, Harold Macmillan, openly admitted to not understanding oil matters, though they adamantly believed in oil’s strategic importance.⁵⁸ This was an important factor in the role ministers played in the shaping of oil policy. As the Suez Crisis subsided in 1957, ministers’ attentions drifted away from oil matters. The day-to-day dealings with oil issues were consistently handled by

⁵⁶ This was a phenomenon that particularly annoyed Harold Wilson’s economic adviser Thomas Balogh. See June Morris, *The Life and Times of Thomas Balogh: A Macaw Among Mandarins* (Sussex Academic Press, 2007), 163.

⁵⁷ Some prime examples of this are Robert Belgrave and A.T. Gregory.

⁵⁸ More, *Black Gold: Britain and Oil in the Twentieth Century*, 97–98.

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officials in Whitehall. It was only during moments of crisis that the Cabinet turned its focus to the oil industry and to BP and Shell.

But over the course of the period covered by this dissertation, these crises grew more frequent and thus so too did ministerial attention to oil policy. The problem for BP and Shell was that the level of knowledge regarding oil only slightly improved from the time of Anthony Eden. If officials grasped that they did not have the capacity to adequately understand the inner workings of the oil industry, such deficiencies were even more pronounced within the Cabinet. An added complication was that unlike officials, the ministers took political concerns into consideration when deciding issues of importation policy, taxation or continued military support in places such as the Persian Gulf. Such politically expedient decisions were often not in harmony with the wishes of BP and Shell. This was more the case with the Governments of the Labour Party, but even during periods of Conservative rule, BP and Shell watched ministerial interference with great trepidation.

Making oil policy within the British Government was thus a complicated endeavor, hampered by a lack of confidence in the ability of both ministers and officials to understand adequately the intricacies of the world oil market and the finer points of oil production. The triangular relationship between ministers, civil servants and oil company representatives meant that decisions were often filtered through several layers of discussion; the result was a strong tendency to embrace the status quo. The close connection between Whitehall and the companies translated into a natural conservatism

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regarding oil matters which consistently pervaded advice passed to the Cabinet. But as the ability of Britain, and of BP and Shell, to influence events in the world of oil and in the oil-producing states continued to decline, the pressure to reorient Britain's policy grew and put a strain on the traditional *laissez-faire* policy. Beginning as early as 1957, officials had begun contemplating the value of greater state oversight or even intervention in oil matters. But to do so the Government would have to improve its competency in oil matters. This necessity became even more apparent when hydrocarbons were discovered beneath the North Sea in 1965.⁵⁹ The realization that large quantities of gas and eventually oil could be found within British territory slowly but definitively altered the calculations of ministers and officials regarding oil policy. For officials, the need to understand oil and gas issues now became imperative. For ministers, North Sea oil and gas was not only a political godsend but also a political football which could be used to build up or tear down the two major parties.

This factor dovetailed nicely with the changing world oil scene to create a situation where politicians, from both the Conservative and Labour parties, began to take a much more active interest in oil matters. Upsetting the cozy cabal of officials and oil company representatives laid the groundwork for conflict and mistrust between all three sides of the triangle of minister, officials and the oil companies. Mistrust, lack of communication and division between political expediency vs. commercial judgment all

⁵⁹ The oil academic Peter Odell was a major proponent of the need for civil servants to improve their knowledge of oil matters so as to avoid being led astray by the companies. See Peter Odell in 'The Development of North Sea Oil and Gas', held 11 December 1999 (Institute of Contemporary British History, 2002, <http://www.icbh.ac.uk/witness/northsea/>), p. 21-25.

contributed to the ensuing alternative visions for the future of British oil policy and, perhaps more importantly, the international oil market.

Historiography

The story of the international oil industry has been told in many ways across several decades. The study of oil seems subject to waves of interest, periodically renewed by oil crises or anniversaries. Much of the best work done on the oil industry and oil diplomacy was written in the 1970's and early 1980's as the world continued to grapple with the changes brought about by the 1973 Oil Crisis and the 1979 Iranian Revolution. A brief burst of attention was once again given to the issue in the aftermath of the Persian Gulf War during the early 1990's. Surprisingly less work was done during the Iraq War, but the pending 40th anniversary of the 1973 Oil Crisis has once again brought the matter into vogue and has carried with it some excellent new work based on archival material not previously available.⁶⁰

The grand sweep of the oil industry's history has received several important treatments. These histories tend to revolve around several major questions. These include the debate over whether the 1973 Oil Crisis marks a definitive turning point in the history of oil or whether it is the continuation of longer-term trends, the issue of the effectiveness of OPEC and its significance in the tremendous power shift in the international oil industry and, finally, the significance of oil and the oil industry in

⁶⁰ Much of the work done around the time of the Iraq War was polemical in nature. See William Engdahl, *A Century of War: Anglo-American Oil Politics and the New World Order* (Pluto Press, 2004).

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international diplomatic decision-making. Attached to these large issues are many smaller ones, but debates on these three questions offer the best insight into the development of the field.

The first question – on the impact of the 1973 Oil Crisis – has seen significant change over the four decades since the actual events. The first works were written in the immediate aftermath and therefore both the shock of the event and its short-term significance influenced the writing on the subject.⁶¹ But even works written one to two decades later have contended that 1973 truly was a “shock” to both the companies and the consuming states.⁶² It was argued that 1973 was thus a decisive shift in the power balance between the companies and the producing states. Later works have begun to push back against the idea of 1973 as being a definitive turning point, choosing to focus instead on the continuities of a gradual power shift over production and prices that occurred from the mid-1960’s onward.⁶³ While not downplaying the importance of 1973, these histories ultimately minimize the extent to which this was a shock to all involved. This dissertation will expand on this trend, showing the long-term build up to 1973, and

⁶¹ Examples of this includes Michael Tanzer, *The Energy Crisis* (Monthly Review Press, 1974); and the Fall 1975 edition of *Daedalus* entitled *The Oil Crisis: In Perspective*, *Daedalus*, vol. 104, no. 4, Fall, 1975.

⁶² Examples of these include Sampson, *The Seven Sisters*; Schneider, *The Oil Price Revolution*; Judith A Rees and Peter R. Odell, *The International Oil Industry: an Interdisciplinary Perspective* (St. Martin’s Press, 1987); Ethan B. Kapstein, *The Insecure Alliance: Energy Crises and Western Politics Since 1944* (Oxford University Press, 1990); Yergin, *The Prize*.

⁶³ This process began with Cyrus Bina but was not followed up on until Fiona Venn explored the idea in the early 2000’s. See Bina, “Internationalization of the Oil Industry.”; Fiona Venn, *The Oil Crisis* (Longman, 2002); Giuliano Garavini, “Completing Decolonization: The 1973 ‘Oil Shock’ and the Struggle for Economic Rights,” *The International History Review* 33, no. 3 (2011): 473–487; Rüdiger Graf, “Making Use of the ‘Oil Weapon’: Western Industrialized Countries and Arab Petropolitics in 1973–1974,” *Diplomatic History* 36, no. 1 (2012): 185–208; Garavini, *After Empires*.

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the full cognizance on the part of the British Government concerning these impending changes.

Closely related to the issue of the deeper roots of the 1973 Oil Crisis are histories that deal with the issue of OPEC.⁶⁴ The major question regarding this institution hinges upon its effectiveness and the associated question of whether the success the oil producers had in securing greater control over oil production occurred because of, or in spite of, OPEC. The high point for this type of inquiry was in the 1980's and the 1990's during a time when OPEC's influence was waning, with the organization itself verging on dissolution. Because of this, the dominant strand of thinking that emerged was a pessimistic view of OPEC which focused on the group's squandering of the opportunity to fundamentally remake the oil market.⁶⁵ Other studies, especially those written by former members of OPEC, have been more forgiving, showing the difficulty of maintaining unity in a group that included countries of such diverse economic and ideological backgrounds.⁶⁶

One of the common threads in the histories of OPEC was the fact that the member states were bound together by the common desire to achieve sovereignty over their natural resources and to redress what they saw as an unfair balance of political and economic power in the world. This leads into a final major historiographical issue for the

⁶⁴ One of the earliest of these is Fuad Rouhani, *A History of O.P.E.C* (New York: Praeger, 1971).

⁶⁵ See Shukri Mohammed Ghanem, *OPEC, the Rise and Fall of an Exclusive Club* (KPI, 1986). Somewhat more forgiving but still critical is Jahangir Amuzegar, *Managing the Oil Wealth: OPEC's Windfalls and Pitfalls* (I. B. Tauris, 2001).

⁶⁶ Al-Chalabi offers one of the most interesting accounts. See Fadhil J Al-Chalabi, *Oil Policies, Oil Myths: Analysis and Memoir of an OPEC Insider* (I. B. Tauris, 2010).

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histories of the oil industry – the interplay of diplomacy and oil. These histories roughly break down into two groups: those that focus on the oil companies' role in international affairs and those that regard oil as a matter of inter-state discourse and activity. This first group saw its peak in the late 1970's and early 1980's, as the public vilification of the oil companies during the 1973 and 1979 oil crises made them a target of much study and discussion.⁶⁷ Further scholarship has been done since then in an attempt to understand the role of oil interests in international politics.⁶⁸ More recent works have sought to follow in Yergin's footsteps and to provide a comprehensive account of oil, mixing the technical and economic aspects of the industry with the diplomacy that undergirded it.⁶⁹

These broad works have been accompanied by important new research on Britain's specific relationship with oil.⁷⁰ Much of this study has concentrated on key events or economic factors, using oil as a way of exploring key strategic and economic

⁶⁷ Two of the best early works that fit this category are Robert Engler, *The Politics of Oil Private Power & Democratic Directions* (University of Chicago Press, 1976); Turner, *Oil Companies in the International System*. Engler looks predominately at the American situation and grants the companies a huge amount of influence over American foreign policy. Turner, on the other hand, tends to argue that the companies were more at the mercy of the states, both consuming and producing, rather than being independent power brokers.

⁶⁸ One of the most important of these works is Fiona Venn's, *Oil Diplomacy in the Twentieth Century* (Macmillan, 1986). Venn's work focuses mainly on the high diplomacy surrounding oil matters, focusing on diplomatic maneuvers on the part of the US and UK Governments. But her work is important in that it shows the delicate balance between strategic and economic interests regarding oil that impacted foreign policy decisions.

⁶⁹ Three interesting examples of this are Francisco Parra, *Oil Politics: A Modern History of Petroleum* (I. B. Tauris, 2004); Leonardo Maugeri, *The Age of Oil: The Mythology, History, and Future of the World's Most Controversial Resource* (Praeger, 2006); Toyin Falola, *The Politics of the Global Oil Industry: An Introduction* (Praeger, 2010). Parra is a former chairman of OPEC whereas Maugeri is a high-ranking official in the Italian oil company Eni.

⁷⁰ The most far-reaching of these is More, *Black Gold: Britain and Oil in the Twentieth Century*. More looks at the history of Britain's relationship with oil from the later 19th until the later 20th centuries.

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decisions made by Britain in the second half of the 20th century.⁷¹ Moments of crisis such as the Six Day War have received a good deal of attention while Britain's role in the 1973 Oil Crisis is beginning to draw more consideration as well.⁷²

Somewhat separate from these is scholarship on North Sea oil and gas. Some of these works were produced in the 1970's and 1980's when they were presented not so much as history but as policy arguments for how North Sea oil and gas should be developed and used.⁷³ Even later works have often focused on the question of how North Sea oil and gas was used and whether the policies employed had been a success or a failure.⁷⁴ The new authority on the subject is, however, Alexander Kemp's *Official*

⁷¹ An excellent example of work on oil as an economic factor can be found in Steven G. Galpern, *Money, Oil, and Empire in the Middle East: Sterling and Postwar Imperialism, 1944-1971* (Cambridge University Press, 2009).

⁷² For works on the Six-Day War, see Moshe Gat, *Britain and the Conflict in the Middle East, 1964-1967: The Coming of the Six-Day War* (Praeger, 2003); Moshe Gat, "Britain and Israel Before and After the Six Day War, June 1967: From Support to Hostility," *Contemporary British History* 18, no. 1 (Spring 2004): 54-77; Gernot Klantschng, "Oil, the Suez Canal, and Sterling Reserves: Economic Factors Determining British Decisionmaking During the 1967 Arab-Israeli Crisis.," *Diplomacy & Statecraft* 14, no. 3 (2003): 131-150; Keir Thorpe, "The Forgotten Shortage: Britain's Handling of the 1967 Oil Embargo.," *Contemporary British History* 21, no. 2 (June 2007): 201-222. For Britain's part in the 1973 Oil Crisis, see Geraint Hughes, "Britain, the Transatlantic Alliance, and the Arab-Israeli War of 1973.," *Journal of Cold War Studies* 10, no. 2 (Spring 2008): 3-40; Muhamad Hasrul Zakariah, "The Euro-Arab Dialogue 1973-1978: Britain Reinsurance Policy In The Middle East Conflict," *European Review of History* 20, no. 1 (February 2013): 95-115.

⁷³ Examples of these include Donald Iain MacKay and George Anthony MacKay, *The Political Economy of North Sea Oil* (Robertson, 1975); Guy Arnold, *Britain's Oil* (H. Hamilton, 1978); and Adrian Hamilton, *North Sea Impact: Off-shore Oil and the British Economy* (International Institute for Economic Research, 1978). Less polemical is Øystein Noreng, *The Oil Industry and Government Strategy in the North Sea* (Croom Helm, 1980).

⁷⁴ See for example Gerry Corti and Frank Frazer, *The Nation's Oil: A Story of Control* (Graham & Trotman, 1983); Christopher Harvie, *Fool's Gold: The Story of North Sea Oil* (Penguin Books USA, 1994); Norman J. Smith, *The Sea of Lost Opportunity: North Sea Oil and Gas, British Industry and the Offshore Supplies Office* (Elsevier, 2011). Corti and Frazer were writing just as the Thatcher Government began privatizing many of Britain's North Sea oil assets. Their work tells the story of how these assets came into the State's possession in the first place and is tinged with regret about the contemporary state of affairs. Harvie argues that the privatization of Britain's North Sea assets by the Thatcher Government compares unfavorably with the Norwegian approach. Smith chooses to focus on how the rapid development of the North Sea in the 1960's and 1970's found a British industry unprepared to take full advantage of the

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History of North Sea Oil and Gas, which delivers an in-depth blow-by-blow account of the development of the resources.⁷⁵ But, being an official history, it is predictably light on analysis.

A common thread through most of these works, both those focusing on Britain and those taking a broader view, is the importance of oil interests to the diplomatic maneuvering of powerful states, such as the United States and the United Kingdom. Nevertheless, very little work has been done on the way the oil companies worked with their Governments and influenced their policies and decisions. This has only been partially remedied by the official company histories, but even these tend to examine issues of marketing strategy and business expansion rather than matters of high politics.⁷⁶

This dissertation therefore offers a different perspective than many of these other works. By directing attention not only to how oil interests influenced foreign and economic policy decisions but to how BP and Shell themselves worked with the Government to help shape those decisions, a much fuller understanding of the interplay between oil and policy-makers can be achieved. Also, by combining into one study the foreign and domestic aspects of oil, including North Sea oil, it is possible to see how often conflicting forces drove British oil policy. This struggle helped push forward the

economic opportunities available, leading to much of the economic benefit of North Sea oil and gas accruing elsewhere.

⁷⁵ Alexander G. Kemp, *The Official History of North Sea Oil and Gas*, 2 vols., Whitehall Histories: Government Official History Series (Routledge, 2012)

⁷⁶ This is especially true of Howarth et al., *The History of Royal Dutch Shell*. Bamberg spends a good deal of time discussing the BP-State relationship but ends his study in 1975. See Bamberg, *British Petroleum and Global Oil, 1950-1975*.

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process of growing state intervention, while also laying the seeds of the policy's destruction.

Sources

To present both the Government and company sides of the oil policy equation, it has been essential to use a wide range of sources on top of this rich historiography. The most important set of sources used in this study are found at the National Archives in Kew. The files there present not just the inter-departmental and inter-Cabinet struggles regarding oil matters but, of equally importance, possess copies of the many reports, letters and meetings held between members of Whitehall and BP and Shell. Because of the significance of the long-term relationship between the oil companies and the mid-level officials of Whitehall, it was essential to move beyond the upper level documents found in the Cabinet and Prime Minister's papers and to dig into the more nuanced and often labyrinthine records left by the Foreign/Foreign and Commonwealth Office, the Treasury and the various iterations of the Ministry of Power.

Even these copious records show only part of the story, however. To get a more accurate representation of the oil company position, non-governmental sources have proven essential. Fortunately, the use of the BP Archive at the University of Warwick is available to researchers. This repository houses a vast amount of Company data there, from marketing strategies to personnel decisions and, most crucially for this study, high-level discussions about relations with the Government in addition to BP's methods of

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influencing their decision-making. A similar archive exists for Royal Dutch Shell, but attempts to gain access to these documents were rejected by the Company. Luckily, many inter-Company records exist in the BP Archive where discussions and letters sent between BP and Shell can be found, giving a behind-the-curtain look at Shell's thinking. Added to this are records housed at the North Sea oil and gas or "Capturing the Energy" Archive at the University of Aberdeen. Some Government files are kept at this location, but most of the records to be found were left by the companies regarding their activities in the North Sea. This proved to be an invaluable resource for illuminating the debates and decisions taken by the many companies working to unlock the vast resources of that area.

To supplement both the Government and Company records, this study uses many memoirs and diaries from the actors involved. Many of the high-ranking Cabinet members left remarkably little behind in their memoirs about oil matters; this is all the more surprising, considering the importance of North Sea oil to the plans and policies of these Governments.⁷⁷ Filling in many of these memoirs' policy holes are the personal accounts of some of the civil servants involved in the same questions. Several of the most important officials, mainly from the FCO, have left behind detailed accounts of their activities relating to the oil companies and the oil-producing states which offer a somewhat less-politicized view of the events. Along these same lines is the Institute of Contemporary British History's Witness Seminar entitled "The Development of North

⁷⁷ This is a fact that perhaps reveals the continued discomfort that politicians had with the intricacies of oil policy. Tony Benn stands as an exception to this trend although even his published diaries contain more in terms of the squabbles of the Labour Party than detailed accounts of oil policy making.

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Sea Oil and Gas.” This one-day seminar brought together a host of business, academic and Government insiders to share their thoughts and reflections on the early days of North Sea oil and gas and its connections to the broader developments in the world of oil.

Organization

To make use of these sources and to give a more complete picture of the development of British oil policy during this crucial period, this dissertation is divided into three chronological sections which are split between chapters that highlight Britain and Britain’s companies’ role in the Middle East and those that focus on oil affairs in Britain and elsewhere. By looking at oil holistically, the dissertation will provide a more comprehensive understanding of how the changes in the international oil industry impacted oil policy specifically in Britain, but with implications for the rest of the industrialized world.

Section 1 (Chapters 1 – 4) examines the period from the aftermath of the Suez Crisis in 1957 until the aftermath of the Six-Day War in 1968. At the beginning of this era, both Britain and its companies stood at or near the pinnacle of their power in the Middle East but had already begun to foresee the changes ahead. Chapter 1 underlines a growing realization in Whitehall that what was commercially justifiable for the oil companies was not always politically advisable in their dealings with the Middle East oil producers. This battle between political and commercial decisions would result in the creation of OPEC and early efforts by the oil producers to organize against the

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monopolistic power of the oil companies in matters of oil production. Chapter 2 shows how these efforts on the part of OPEC and the growth of nationalism which supported those moves caused a fundamental reassessment of Britain's role in the region. With the oil companies becoming a target of nationalist wrath, Britain was eager to avoid providing any further irritants, a fact which helped in the decision to withdraw British forces from the Persian Gulf. But while Britain and BP and Shell struggled to hold the line against the nationalist challenge, the British state also sought to ensure that the profitable return on the activities of the oil companies would continue to benefit Britain's economy. This early expansion of the State's role into oil matters was at first mainly fiscal, a fact that Chapter 3 highlights. But as concern over the long-term safety of Britain's oil supply grew, so too did plans for counteracting that threat. Chapter 4 will show that some of these plans placed enormous trust in the companies, but other, more state-oriented strategies also began to be developed.

Section 2 (Chapters 5 – 7) covers the period from 1968 to 1973. This was a crucial period of transition from oil company to oil producer control. The sweeping changes that occurred during this period have been overshadowed by the 1973 Oil Crisis and thus do not receive the attention they deserve in many histories. Chapter 5 looks at the rise of Muammar Gaddafi in Libya and his ability to destabilize the status quo through his willingness to challenge the oil companies. By dividing and conquering the companies within Libya, Gaddafi set off a period of price leapfrogging which resulted in large price increases negotiated at Tehran and Tripoli in 1971. These dramatic series of

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defeats led to an intense scramble on the part of BP and Shell and the British Government to find a way of protecting Britain from future price and production instability, a process discussed in Chapter 6. The companies advocated an international consumer cooperative agreement, arguing that the dictates of the oil market meant that no single-state solution could hope to be successful. Although agreeing with this assessment, the Government of Edward Heath found itself unable or unwilling to take the steps necessary to create such an agreement. A major factor in this unwillingness was that Britain had a major security guarantee looming just over the horizon – North Sea oil. Chapter 7 analyzes how the prospect of North Sea oil, as well as BP's massive discovery in Alaska and its entry into the American market altered calculations of Britain's approach to oil. BP, Shell and the other oil companies saw these discoveries as a way of gaining leverage in their disputes with OPEC; to the British Government, however, North Sea oil was not only a safety guarantee but a bonanza to be exploited for the benefit of the nation.

This breakdown between the companies and the Government was exacerbated by the 1973 Oil Crisis, the consequences of which are examined in Section Three (Chapters 8 – 9). Chapter 8 examines the crisis and the response of the Government. Faced with simultaneous oil and coal crises, Heath's Government initially attempted to pursue a "Britain First" policy. The failure of this approach brought the Conservatives around to the idea of consumer cooperation, one which had been backed by the companies since before the Crisis. Realizing that the rewards of putting Britain first were outweighed by the damage that could be done to Britain's overseas interests and alliances, the British

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joined with the Americans to push for the creation of the International Energy Agency, which would help coordinate consumer activity in the future. But this path towards cooperation was not a simple return to the traditional liberal approach to oil policy. With the victory of the Labour Party once more in 1974, Britain's oil policy again underwent a shift. Chapter 9 will show how the Government of Harold Wilson, faced with the greatest opportunity yet to expand state control over oil affairs, found itself divided over the proper way forward. The battle over the future of the North Sea was waged within the Cabinet as well as with the companies, as plans for cooperation clashed with the desire to secure North Sea oil for Britain's benefit.

This story culminates in the Conclusion, which examine both the high-water mark of state intervention and its ultimate demise. Despite the setbacks discussed in Chapter 9, the Secretary of State for Energy, Tony Benn, would wage a spirited struggle for state control over the North Sea. The inability of Benn to persuade his colleagues to follow his lead would, however, prevent his vision from being implemented. The division within the Labour Party ultimately crippled it, leaving it vulnerable to defeat by a new force on the scene – Margaret Thatcher. Thatcher's ascendancy set the stage for a more extensive reevaluation of Britain's oil policy and a turn from state control towards privatization.

Together these chapters tell a story that is crucial not just to British history or even that of the international oil industry. The changes which occurred during this period, and Britain's role in them, helped reshape a key element of the international economic order. It was a pivotal part in the end of the first chapter of the post-World

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War II world and set the tone for the next stage of international affairs. It thus reflects not just Britain in transition but an international system evolving into today's interconnected global web.

Section 1: Close but not Identical Interests: 1957-1968

Chapter 1 –

An Indefinite Canute: Upholding the Status Quo in a Changing Persian Gulf¹

In September 1956, British officials and the leading financial officers of the oil companies Shell and British Petroleum (BP) held a dinner in London. The primary topic of conversation was the decision announced by Egyptian President Gamal Abdel Nasser on July 26 to nationalize the Suez Canal. The company representatives expressed their concern over the unsettled state of affairs regarding the future of the Suez Canal, a waterway through which between 55-60 percent of Britain's oil supply flowed.² The oil men proposed a novel solution for the growing crisis to Roger Allen, the top civil servant at the dinner, suggesting that an international consortium be put together to offer a three-step plan to defuse the crisis. First, this group would pay Nasser an upfront capital payment equal to a compound of his expected Canal dues. Second, they would compensate the former Canal owners and, finally, they would purchase strips of land running on either side of the Canal and grant them and the operation of the Canal to an international authority. This plan would have the benefit of not recognizing Nasser's

¹ According to legend, King Canute of England, Denmark and Norway (c. 985-1035), placed his throne upon the sea shore and ordered the onrushing tide to halt before him. Upon being dowsed by the waves, Canute leapt back and declared that the power of kings was nothing compared to the power of God. Debate as to whether this story reveals Canute's arrogance or whether it was an object lesson to his followers continues.

²These figures are derived from J. H Bamberg, *British Petroleum and Global Oil, 1950-1975: The Challenge of Nationalism* (Cambridge University Press, 2000); D.A. Farnie, *East and West of Suez: Suez Canal in History, 1854-1956* (Oxford University Press, 1969). Bamberg claims that Britain prior to Suez, Britain received 75 percent of its oil from the Middle East. Oil not shipped through the Suez Canal was received via the Mediterranean pipelines that originated in Iraq and Saudi Arabia traversing Syria and terminating in Lebanon.

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nationalization while still providing him with a substantial cash windfall to show for his troubles.

Allen dutifully forwarded the idea up the chain of command within the British Government only to have it dismissed as fantasy by other top civil servants and eventually Prime Minister Anthony Eden himself. Writing about the plan, Ivone Kirkpatrick, the permanent under-secretary of the Foreign Office, commented that “the oil men are proceeding on the assumption that Nasser is a rational individual. I personally do not believe that he would sell you the Canal for a thousand million pounds.”³

Instead, the Eden Government, along with their French and Israeli counterparts, concocted a plan to oust Nasser and remove any threat to the free flow of oil and other goods through the Canal. The story of what happened is a familiar one, and one about which historians have spilled much ink.⁴ The ill-fated attack on the Canal Zone failed in its objectives; Nasser remained in power and the Suez Canal was closed as were the Mediterranean oil pipelines, sabotaged in solidarity with the Egyptians by pro-Nasser

³ PREM 11/1117, The National Archives, 21 September 1956.

⁴ A representative sample of the work on this subjects includes: David Carlton, *Britain and the Suez Crisis* (Blackwell Publishers, 1989); Steven Z. Freiburger, *Dawn Over Suez: The Rise of American Power in the Middle East, 1953-1957* (Ivan R. Dee, 2007); Anthony Gorst and Saul Kelly, *Whitehall and the Suez Crisis*, 1st ed. (Routledge, 2000); Diane B. Kunz, *The Economic Diplomacy of the Suez Crisis* (University of North Carolina Press, 2009); William Roger Louis and Roger Owen, *Suez 1956: The Crisis and Its Consequences* (Oxford University Press, 1989); W.Scott Lucas, *Divided We Stand: Britain, the United States and the Suez Crisis* (Hodder & Stoughton, 1991); Jonathan Pearson, *Sir Anthony Eden and the Suez Crisis: Reluctant Gamble* (Palgrave Macmillan, 2002); Simon C. Smith, *Reassessing Suez 1956* (Ashgate, 2008); Barry Turner, *Suez 1956: The Inside Story of the First Oil War* (Hodder Headline, 2007).

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Syrians.⁵ As a result of this, Britain faced a major oil shortage that forced a period of petroleum rationing for domestic consumers.

This chapter begins in the aftermath of this great fiasco. Given the subsequent failure of Britain's plan to deal with the "irrational" Nasser, it is tempting to say that more consideration should have been given to the plan laid out back in September by the oil companies. Whether or not this option was realistic, the exchange of ideas which took place reveals important distinctions between how the government and the companies viewed the nexus of oil and politics in the Persian Gulf.⁶ From the companies' perspective, the crisis over oil transportation, although at root a political one, could be solved through a commercial transaction. To the Government, however, the situation was about much more than simple economics; oil was not just a commodity but rather a strategic chess piece to be used in the realm of geopolitics. This was in part the reason why Nasser's nationalization of the Canal was treated as such an existential threat to Eden and his Chancellor of the Exchequer Harold Macmillan. Even if these two did not fully understand the inner workings of the oil industry, they understood oil to be a vital

⁵ These two pipelines were the Trans-Arabian Pipeline (Tapline) and the Kirkuk-Baniyas pipeline. The Tapline connected the main Saudi Arabian oil fields to the Lebanese port of Sidon. It traversed Jordan and Syria on its route to the Mediterranean. The Kirkuk-Baniyas Pipeline connected the oil fields of northern Iraq to the Syrian port of Baniyas. Both were vulnerable to the unsettled political situation in Syria. It has been argued that American intervention in Syria in 1949 was stimulated by a desire to protect American interests in the Tapline. See Irene Grendzier, "Oil, Politics, and US Intervention," in *A Revolutionary Year: The Middle East in 1958*, eds. Wm. Roger Louis and Roger Owen, 101-142. (I.B. Tauris, 2002).

⁶ Although there has been some debate over the use of the name "Persian Gulf," I have chosen to use it throughout this chapter do to the simple fact that this is the designation used by British officials at the time.

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strategic asset and one they could not afford to lose.⁷ Whether the oil companies' plan might have worked is impossible to say, but the "rational" approach of Eden and Macmillan resulted in Britain's first oil major crisis.⁸

The Suez Crisis was in many ways not a typical matter of oil politics since Nasser himself controlled very little of the actual oil supply. In fact oil was but one factor in the decision to attempt to topple the Egyptian leader. But the failure of Suez, and the oil crisis that accompanied it reinforced a traditional policy that Britain had held with few exceptions since the earliest days of the oil industry. Britain's long-standing approach was a simple one which gave oil companies—British and other—a free hand in producing, transporting, refining and selling oil products with little interference from the Government.⁹ This had long helped to secure the two goals of Britain's oil policy: 1) a stable and secure supply of oil and 2) the acquisition of that oil at a profitable rate for the British economy. The classic concessionary system that had been built during the 1920's and 1930's and only slightly modified since had served to achieve these goals with little effort on the part of the British Government, a situation Whitehall wanted to preserve.¹⁰

⁷ Charles More, among others, has argued that Macmillan in particular had little understanding of the oil industry but allowed his arguments for action to be guided by oil-related doom-mongering none-the-less. See Charles More, *Black Gold: Britain and Oil in the Twentieth Century* (Continuum, 2009).

⁸ There had of course been an oil scare during the 1951 Iranian Nationalization Crisis but this situation was resolved with no shortage in Britain due to increased production in Kuwait.

⁹ British officials often described their oil policy as a "liberal" one in which companies, many of them American, were free to sell and refine products in Britain. Thus BP and Shell, along with other British firms such as Burmah, seldom provided more than 50-60 percent of the total British market at any given time.

¹⁰ There had been several occasions where active involvement had been necessary in the protection of the rights and privileges of British oil companies. The first was in 1932 when Reza Shah of Iran cancelled the concession of the Anglo-Persian Oil Company (later to become BP) after four years of negotiations on improved concessionary terms. The British Government took the case before the Permanent Court of International Justice at The Hague. A mutually agreeable solution to the situation was later agreed between

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The benefit of this policy was that on the surface it kept politics separated from the oil supply. In the immediate aftermath of Suez this approach seemed obvious to both the companies and to Whitehall.

The problem, however, was that over these five years from 1957 to 1962 the political situation in the Middle East, and the political calculus of oil, had changed rather dramatically, increasing concern in Whitehall that the oil companies could no longer serve their traditional buffering role between Britain and the oil producers without active government assistance. This posed a dilemma to both the companies and to the Government. While both sides recognized the benefit of London using its clout to support BP and Shell, the risk of greater involvement by Whitehall in oil affairs was also acknowledged. The disagreement, however, was over where the line stood when Government involvement would go from a benefit to a hindrance. This question dominated the relationship between the Government and the companies from 1957 to 1962 as both sides attempted to recalibrate the role of the other in order to maximize the benefits relationship.

For BP and Shell this meant keeping the Government's footprint in their affairs as light as possible while still making it subtly apparent that the diplomatic, legal, and even

the company and the Shah in 1933. A less successful intervention occurred when the Government of Mexico nationalized the oil industry operating in that country. One impacted company was Anglo-Dutch also known as the Mexican Eagle Petroleum Company. British and American Government attempts to achieve a redress for their firms failed, however and the Mexican oil industry remained nationalized. For more on these early interventions see Ronald W. Ferrier, *The History of the British Petroleum Company, Vol. 1: The Developing Years, 1901-1932* (Cambridge University Press, 1982); Geoffrey Jones, *The State and the Emergence of the British Oil Industry* (University of London, 1981); Marian Kent, *Moguls and Mandarins: Oil, Imperialism and the Middle East in British Foreign Policy 1900-1940*, 1st ed. (Routledge, 1993); Stephen Howarth et al., *The History of Royal Dutch Shell* (Oxford University Press, 2007).

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military, power of Britain was behind their commercial endeavors.¹¹ Keeping oil relations purely commercial with the producing states in the Middle East and in places like Venezuela and Indonesia depended on BP and Shell's ability to keep from appearing to be an extension of the British foreign policy apparatus. The concern was that close cooperation would give "the impression in a hostile questioner's mind that there was some interference with the Company's commercial policy taking place or the right to interfere or a precedent established."¹² The companies were confident that they, along with the other major international oil firms, could moderate any political demands on the part of the oil producing countries. What BP and Shell truly wanted from the Government, therefore, was not so much overt support but rather Whitehall's ability to give their concessionary contracts the implicit force of international law. For as badly as the oil producing governments of the region would want to increase their revenues and prestige, the oil companies knew that these governments realized "that they must take care not to kill the goose that lays the golden egg."¹³

The preservation of these "golden geese" in their present form was in the interest of both the oil companies and the British state. But as a 1959 Government report on oil policy concluded, "an identity of interest is not synonymous with an identity of views."¹⁴ While Whitehall was happy to provide the sort of diplomatic support the firms found so

¹¹ The American firms such as Exxon, Mobil, Chevron, Gulf and Texaco followed a similar strategy which was both eased and complicated by the United States' more ambiguous role in the Middle East in the late 1950's and early 1960's. See Nathan J. Citino, *From Arab Nationalism to OPEC: Eisenhower, King Sa'ūd, and the Making of U.S.-Saudi Relations*, (Indiana University Press, 2002).

¹² BP 129270, BP, Meeting with Lord Mills, 13 August, 1959.

¹³ BP 4807, British Petroleum Archive, Middle East Concession Terms, 23 March 1959.

¹⁴ FO 371/141193, NA, Report Cover Letter, January 1959.

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valuable, the civil servants in the three departments charged with oil matters, the Ministry of Power (MoP), the Treasury and the Foreign Office (FO), were growing increasingly concerned that legal and commercial arguments were not going to hold the line against the growing force of nationalism as represented by leaders such as Nasser.¹⁵ Therefore a growing opinion within Whitehall suggested that a more robust form of diplomatic guidance would be required to prevent the companies from falling victim to nationalist sentiment in the oil producing states, even if this meant encouraging the firms to take actions against their commercial interests. But how to exercise this influence was a matter of debate. Giving off the appearance of close relations between the Government and the companies might only serve to inflame nationalist backlash against BP and Shell even further.

Therefore, in order for the British Government to achieve the correct balance between interference and non-interference, they would have to gain the cooperation of BP and Shell. To do so would require closer contact with the firms and possibly greater coercive control over them. Thus from 1957 to 1962, officials inside the British Government attempted slowly to assert more oversight of the nation's oil policy while continuing to leave the main job of operating the oil production system free from interference. To do so, the FO, MoP and the Treasury sought to build a stronger and more cooperative relationship with BP and Shell. By having greater and timelier access

¹⁵ The Foreign Office would become the Foreign and Commonwealth Office (FCO) in 1967. For the purposes of simplicity and clarity chapters 1-4 will use the abbreviation FO to describe this department while chapters 5-10 will use the designation FCO.

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to BP and Shell's thoughts on oil, the government hoped to stay ahead of any oil-related surprises and to exercise a stronger behind-the-scenes influence on the companies.

But this process did not work in a way that was satisfactory to either the Government or to the companies. Fundamental disagreements over how to handle nationalism in the region made efforts by the two sides contradictory and mutually frustrating. Whitehall, believing that the rise of nationalism was inevitable but controllable through timely concessions and gestures, grew increasingly exasperated with BP and Shell's inflexibility when it came to modification of their concessionary deals.¹⁶ Meanwhile the companies desired greater support from the British Government regarding the securing of new transport routes and eventually in their negotiations with the new, radical republican government of Iraq – support that the Government was hesitant to give for fear of only inciting greater nationalist resentment.

Along the way, the terrain of oil production dramatically shifted. The overthrow of the British-aligned monarch in Iraq coupled with the rise of the Organization of Petroleum Exporting Countries (OPEC) gave rise to new threats to the traditional system of oil production. Nonetheless, Britain's policy did not change. Despite a great deal of discussion, Whitehall stuck with its long-held approach of allowing the companies to

¹⁶ Nationalism in the oil producing world is of course a complex subject and one which should not be oversimplified. Scholars have begun to offer deeper and more nuanced studies of the rich variety of movements, ideologies and beliefs of "nationalists" from across the Arab and non-Arab parts of the Middle East. But it is equally important to note that the views of policy-makers were guided by a somewhat non-sophisticated view of the rise of nationalism, particularly pan-Arab nationalism. The FO, in particular, viewed most nationalist movements throughout the region as being either connected to Nasser's Egypt or in some way inspired by him. This helped encourage the belief that nationalism was a malevolent force that needed to be neutralized or co-opted. For a discussion of recent scholarship on the concept of Arab nationalism see Franck Salameh, "Towards a New Ecology of Middle Eastern Identities," *Middle Eastern Studies* 47, no. 2 (March 2011): 237–253.

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handle their own relations with the states of the region. Thus while Britain's oil policy did not change, the circumstances in which it operated made for an uncertain future for the traditional system of oil production.

Pipelines, Tankers and Treaties: Building a more secure transport system

In the wake of the Suez Crisis, concerns about the future of British oil concessions were far from the minds of British policy-makers and oilmen as the conflict had essentially revolved around issues of oil transportation rather than production. It is not surprising, therefore, that British officials' first concern following Suez was the creation of a more secure transport system for oil from the Middle East to reach Europe. The blocking of the Canal along with the disabling of the Mediterranean pipelines flowing through Syria had resulted in a nearly instant shortage of oil to Britain and Western Europe.¹⁷ These two vital transport links were still in unfriendly hands following the Crisis and therefore could not be relied upon in the event of another emergency.

These transportation issues also loomed large because the actual production of oil seemed relatively secure in 1957. While Nasser and his allies controlled the Suez Canal and the Mediterranean pipelines, the various oil producing states (the most important for

¹⁷ Like Britain, much of Western Europe received roughly 70-75 percent of its oil from the Middle East. The FO estimated that normal European consumption was 142 m. tons of crude oil a year.

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Britain being Iraq, Kuwait and Iran) were all ruled by friendly regimes.¹⁸ According to the British General Headquarters of Middle East Land Forces, “Security of oil supplies is accepted to be the principle object of our Middle East policy... While support of the Baghdad Pact is intended to prevent oil bearing lands being drawn into the Russian orbit it does not cover the problems of ensuring the flow of oil to U.K. and Western Europe.”¹⁹ Because of this it seemed certain that oil for Britain would be pumped to the surface; whether it could get to Britain or not was another question.

Shell and BP felt similarly about the situation. Even before the Suez Crisis the two companies had begun exploring the possibility of building larger “super” tankers that could traverse Africa at a more economical rate. These tankers, or more tankers of the smaller sort, would be required, according to BP, “to ensure that in an emergency Europe’s supplies of oil can still be transported even though both the Suez Canal and Pipelines were closed.”²⁰ Ideally, however, the companies wanted the quicker, and cheaper, route through the Suez Canal and the eastern Mediterranean ports fed by the major pipelines. But even if these routes were politically secure, they were nearing their shipment capacity. With demand for oil growing at a rapid clip in Britain and the rest of

¹⁸ In the 1959 Middle East Oil Report, Whitehall officials calculated the total production for 1957 from Iran to be 34.8 m. tons, Iraq to be 21.6 m. tons and Kuwait to be 56.4 m. tons. See FO 371/141193, NA, Middle East Oil, January 1959.

¹⁹ FO 371/127220, NA, Future Strategy in Middle East, 16 January, 1957.

²⁰ BP 42544, BP, The Cost of Retaining in Operation a Reserve of Tankers Against the Possible Closure of the Suez Canal and the Middle East Pipelines, 1957.

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Western Europe, shipments through the Suez Canal and from the pipelines would no longer be adequate by the mid 1960's.²¹

The international oil companies and concerned governments therefore sought out ways of securing both the safety and the capacity of the transportation system. In this process, BP and Shell negotiated a delicate balancing act with Whitehall, pushing for firmer British political and diplomatic support while simultaneously attempting to keep their distance for fear of contaminating their “purely commercial” image. This early struggle over transportation issues laid the foundation for later attempts by the Government, particularly the FO, to exert greater influence on the decision-making of the companies since all of the options for easing oil transportation carried some political risk.²²

The first option was the expansion of the Suez Canal, a process which would have been costly and might have increased the Canal's capacity marginally. Added to these drawbacks was the fact that the companies, British, American and French, were leery of investing resources and hopes in a project that would have involved close working with the Egyptian Government—a government that still held many of Shell and BP's assets

²¹ Government officials estimated in 1963 that world demand for oil had increased by 7 percent per annum from 1951 to 1961 and was expected to continue to grow at a comparable rate. See POWE 33/2526, NA, Middle East Oil, January, 1963.

²² These options are discussed in BP 42625, BPA, Note on the Future Movement Westward of Middle East Oil, 13 March, 1957.

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hostage following the Suez Crisis.²³ An idea that was floated to build a second Suez Canal had similar shortcomings.

A cheaper and simpler idea was adding another line to the pipeline system running from northern Iraq through Syria. This could be easily accomplished by dismantling an old pipeline that had ended at the Shell-Mex BP refinery in Haifa, Israel, which for political reasons was no longer used by the Arab oil producers.²⁴ The problem, yet again, was the political volatility of Syria. The government in Syria was notoriously unstable and even when in the hands of friendly politicians was not able to guarantee the safety of the pipeline.²⁵ To make matters worse, the Syrian state seemed to be veering inexorably into Nasser's orbit, a process that would culminate in the unification of Syria and Egypt with creation of the United Arab Republic with Nasser as its President in 1958.

With these options for the expansion of transportation looking dubious, the major oil companies sought new solutions. One appealing answer was the creation of a new pipeline system that would run from the Iraq to the Turkish port of Iskanderun.²⁶ This

²³ Shell maintained several small oilfields in Egyptian territory which were sequestered following the British intervention in the Suez Crisis. Their return was not successfully negotiated until 1959. See FO 371/127220, NA, Letter from Richmond to Beith, 14 July, 1959.

²⁴ BP and Shell's dealings with the Haifa refinery were an entirely different political headache for the British Government. A decision taken in 1957 by Shell-Mex BP, the joint marketing company of Shell and BP to close the Haifa refinery was met with stiff diplomatic pressure from the Israelis. While the British Government took the line with the Israelis that it could not interfere with the commercial decisions of its private companies, officials were privately livid that Shell and BP would have taken such a decision without prior consultation with the FO.

²⁵ During the Suez Crisis, pro-Nasser partisans had blown up several pumping stations and knocked out the entire system.

²⁶ This was not an entirely new idea. Even before the Suez Crisis, thoughts of expanding the pipeline system to diversify transport routes had occupied both the British Government and the companies. Anthony Eden grasped onto the plan during the early days of the Suez Crisis and continued to push the idea up to the point of his resignation. See PREM 11/2011, "Letter from Eden to President of the Board of Trade," 3 January, 1957.

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idea had two major benefits. First, the northern Iraqi oil fields were an area ripe for quick expansion as they had been under-utilized for over a year due to the closure of the Syrian pipeline.²⁷ The second benefit was the fact that this system would run entirely through friendly territory. In 1957 and early 1958, both Turkey and Iraq were members of the Baghdad Pact, a defensive alliance linking Britain to several of the key Middle Eastern powers.²⁸ These factors caused the companies to press the idea that it was “essential to build a new Middle East pipeline system from the head of the Persian Gulf to an outlet in the Mediterranean in Turkey.”²⁹

Even with this assurance, the international companies were uncertain about the huge cost of such a project. They wanted to be sure that after laying out the capital required to complete the project they would be able to maintain control and to reap the reward of its completion. The MoP reported that the companies “no longer feel able to safeguard their existing investments without some form of political support to strengthen their position vis-à-vis the transit Governments; and they are even less inclined, without such support to commit themselves to further investment in pipelines.”³⁰ Shell and BP turned to their government for such a guarantee.

But asking for government intervention was a tricky matter. In many ways the companies wanted the best of both worlds: protection from the governments of the oil

²⁷ According to the 1959 Middle East Oil Report the closure of the Kirkuk-Baniyas pipeline caused Iraq’s production to dip by 9.2 m. tons a year.

²⁸ For more on the formation of the Baghdad Pact as it pertained to US-UK relations see, Michael Joseph Cohen, *Strategy and Politics in the Middle East, 1954-1960: Defending the Northern Tier* (Psychology Press, 2005); Magnus Persson, *Great Britain, the United States, and the Security of the Middle East: The Formation of the Baghdad Pact* (Lund University Press, 1998).

²⁹ FO 371/127203, NA, Telegram from Foreign Office to Baghdad, 30 March, 1957.

³⁰ FO 371/127201, NA, Middle East Pipeline Guarantee, 6 March, 1957.

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producing and transporting states and protection from overt interference on the part of Whitehall. This double-agenda was on display at a meeting between two top officials of Shell and BP and representatives from the Foreign Office on December 31, 1956. During the meeting it was “said more than once that the companies, left to themselves, would be able to cope by 1965 with all the issues apart from those of politics.”³¹ One BP official went on to say “that if the Government could assure them that it would be safe to put in more lines across the desert, then the companies could undoubtedly put in ‘dozens of lines’ by 1965.”³²

Yet this statement was somewhat disingenuous. Company leaders did want the government to assist them but only on their terms. To justify the construction of these “dozens of lines,” BP, Shell and the major American and French firms involved required a guarantee that the lines would be free of political interference on the part of the transit states. Therefore the companies pushed the concept of a treaty signed between the oil producing and transporting states with the parent states of the major oil companies. Just what these “umbrella treaties,” as they were called, would govern was a matter of debate. Some oil company officials wanted them to guarantee all oil company investments in the region, thus solidifying their concessionary deals with the backing of international law. John Loudon, the managing director of Shell, for instance, argued that “unless they could have some assurance covering the security of their sources of supply, it would be too risky to invest large sums of money on pipelines which later on might prove impossible

³¹ FO 371/127201, NA, Meeting between J.H. Brook and Jamieson and Thompson, 31 December, 1956.

³² Ibid.

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to use.”³³ The FO was very dubious about the feasibility of this type of treaty. But other proposals were more modest, suggesting that the umbrella treaty regulate the use of the pipelines and provide for legal recourse in the event that the operation of the pipeline was interrupted or in any way disturbed by one of the contracting parties. This type of treaty would also, importantly, leave the control of the pipelines completely in the hands of the oil companies.³⁴

Although more reasonable, FO officials still doubted if the Middle Eastern states would sign on to such a deal which would have effectively guaranteed their lack of authority over the transport of their own oil. Therefore, matters such as the “umbrella treaties” would need to be approached with caution. To find a satisfactory way forward it was decided to bring the problem up with the Americans at the Bermuda Conference between Prime Minister Harold Macmillan and President Dwight Eisenhower scheduled to take place in March, 1957. On the minds of the civil servants in the FO was the possibility of setting up an international authority to govern the pipeline and to mediate disputes. This would disperse the responsibility for the pipelines and would give the entire project less of a neo-colonialist image.³⁵

Word of this proposed idea reached the oil companies before the Bermuda Conference and they were quick to express their displeasure. Shell in particular was

³³ FO 371/127209, NA, Record of Meeting Between Loudon and Shawcross, 20 June, 1957.

³⁴ The oil companies argued that this was only fair considering that they were providing the capital for the pipelines construction. Indeed the entire purpose of the project and the umbrella treaties was to create a system that was within the control of the companies operating in the Middle East.

³⁵ PREM 11/2439, NA, Middle East Pipeline Guarantees: Supporting Brief, 9 March, 1957. A similar argument was put forward for including more oil-consuming countries as a part of the umbrella treaty although this idea was dismissed as impractical.

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“very worried about certain ‘dangerous ideas’ concerning the establishment of a pipeline authority that seemed to be ‘crystalising’ in Whitehall.”³⁶ The Company considered such a scheme “very objectionable,” particularly because Shell and the other companies “believed that once other countries had muscled in on the pipelines, it would not be long before they also muscled in on our oil concessions.”³⁷ Shell need not have worried, however, because the brief discussions held at the Bermuda Conference reached the conclusion that “the creation of a single pipeline authority in the Middle East would tend to strengthen the hand of the producing interests unduly unless consuming interests were also closely associated; and this might well lead to claims for internationalisation of production operations as well.”³⁸

Thus the FO’s fears of upsetting nationalists in the region were subordinated to the desire that nothing threaten the existing production arrangements. But this system of oil concessions, production rights and royalty payments under which the oil industry in the Middle East operated relied on two key elements, both of which could be threatened by nationalist sentiment. The first was the political stability of the regimes friendly to Britain. The second equally important element was the continued acceptance on the part of the oil producers of the terms of agreement known colloquially as the “50/50” principle.³⁹

³⁶ FO 371/127201, NA, Protection of Pipelines, 5 March, 1957.

³⁷ Ibid.

³⁸ PREM 11/2439, NA, Middle East Pipeline Guarantees: Supporting Brief, 9 March, 1957.

³⁹ This referred to the fact that most concessionary agreements dictated the equal splitting of profits made on the sale of crude oil. In actual practice, the system varied from country to country with each arrangement using a different formula to achieve a roughly 50/50 split.

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These two elements were connected as the survival of the 50/50 principle depended on keeping the governments of the region friendly. This was to become a problem since one regime that did take the question of sovereignty very seriously was that of Iraq. The Iraqi Prime Minister, the wily and long-serving Nouri al-Said had been a steadfast ally of British interests in the Middle East and a guarantor of the stability of the oil arrangements between the Iraqi state and the Iraq Petroleum Company (IPC), a consortium of western companies in which both BP and Shell held major stakes.⁴⁰ Nouri recognized that the new pipelines, along with the treaties, ran afoul of the prevailing Arab nationalist sentiment growing throughout the region.⁴¹ Despite the support of Iraq's King Faisal for the new pipelines, Nouri continued to urge caution to his contacts in the British embassy. The treaties would be meaningless, he argued, if the governments which signed them fell to revolutionary forces.

Nouri's worries about the pipeline seemed to be relieved as the scheme soon fell to pieces not because of any grand problem but because it had become increasingly impractical. There was a shortage of steel piping available for the construction of any new pipelines and the reopening of the Suez Canal in April, 1957 decreased the urgency of the situation. But Nouri's fear of nationalist sentiment was to prove prescient.

The Iraqi Revolution, the Kuwait Crisis and the Destabilization

⁴⁰ The make-up of the IPC was as follows: Shell – 23.7 percent, BP – 23.7 percent, Compagnie française des pétroles (CFP) – 23.7 percent, Standard Oil New Jersey (Exxon) – 23.7 percent and Gulbenkian – 5 percent

⁴¹ PREM 11/2439, NA, Telno. 667 From Bagdad to London, 22 May, 1957.

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On July 14, 1958 nationalist politics threw Britain's Middle East strategy, and with it its oil policy, into utter confusion. A coup in Iraq led by a hitherto little-known Brigadier General Abd al-Karim Qasim overthrew and killed King Faisal, the crown prince and Nouri al-Said. In a matter of hours, one of Britain's most important allies was inextricably changed and with it Britain's traditional approach to the region.⁴²

Gone as well was the assuredness that the system of oil production that had seemed so secure even a short while before. General Qasim proclaimed the new Republic's desire to uphold the existing oil concessions and contracts with the IPC, but many within the foreign policy apparatus of the British government suspected the new Iraqi leader of pro-Nasser sympathies.⁴³ At best, the British assumed the new regime would be overtly nationalist making matters of sovereignty over oil much trickier than with the compliant monarchy. It was reported to Harold Macmillan that the goal of the revolution was "continuation of the flow of oil without nationalising the oil industry, though seeking improved terms by negotiation."⁴⁴ Negotiating with the new regime, it would turn out, would also be much more difficult than it had been with the Hashemites.

⁴² For a fresh and detailed look at the 1958 Revolution see: Juan Romero, *The Iraqi Revolution of 1958: A Revolutionary Quest for Unity and Security* (University Press of America, 2010).

⁴³ Three accounts of the 1958 coup and its effects on British foreign policy can be found in William Roger Louis and Roger Owen, *A Revolutionary Year: The Middle East in 1958* (I.B.Tauris, 2002); Richard John Worrall, "'Coping with a Coup d'Etat': British Policy Towards Post-Revolutionary Iraq, 1958-63.," *Contemporary British History* 21, no. 2 (June 2007): 173-199; and Stephen Blackwell, "A Desert Squall: Anglo-American Planning for Military Intervention in Iraq, July 1958-August 1959," *Middle Eastern Studies* 35, no. 3 (July 1, 1999): 1-18. Worrall argues that initial fears of a Nasserite coup in Whitehall led to plans for a military intervention. Once it was determined that Qasim was an Iraqi nationalist, the British Government transitioned to an attempt to normalize relations in order to ease negotiations between the new Iraqi government and Western oil interests.

⁴⁴ PREM 11/2368, NA, The Revolution in Iraq, 19 July, 1958

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The British Government resolved to take a hands-off approach to the IPC negotiations regarding their concessions in Iraq. Given the nationalist nature of the Qasim regime it seemed, early on, better to allow the companies to distance themselves from Whitehall. But negotiations became difficult since Qasim and his chief negotiator Saleh Kubbah were forced to balance his demands delicately in order to play off his various internal opponents and supporters.⁴⁵ In a memo to the Prime Minister the Minister of State for Foreign Affairs, John Profumo laid out the situation as such:

The Company, with all their assets in Iraq, are obviously vulnerable to Iraqi pressure. At the same time they feel they must call a halt to the current process of bazaar bargaining. The Iraqi Government for their part badly need their oil revenues and even the Communists have not suggested the immediate expropriation of the Iraq Petroleum Company.⁴⁶

Despite the mutual need for a solution, the negotiations dragged on. The IPC was hesitant to give too much ground since any agreement with Iraq could lead to forced renegotiations across the Middle East. But Qasim's support came from his ability to proclaim himself the defender of Iraq's national interest. Any deal that appeared too generous to the Western oil firms would have been disastrous. Therefore stalemate ruled and limited any expansion of Iraq's oil production. An internal report written by BP complained "it was impossible to make headway in oil negotiations with the Iraq

⁴⁵ Bamberg, among others, has argued that Qasim's nationalistic positioning made it impossible for him to negotiate in good faith with the IPC because any concession on his part could be construed by his enemies as a surrender to "imperialist" interests. See Bamberg, *British Petroleum and Global Oil, 1950-1975*.

⁴⁶ PREM 11/3451, NA, Iraq Petroleum Company, 15 July, 1959

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Government. Whatever the oil companies might do or not do, Dr. Kubbah, it was believed, would blame them.”⁴⁷

Qasim’s precarious position in Iraq also led him to pursue an increasingly reckless foreign policy which would bring him into near confrontation with the armed forces of Britain. The major point of contention was the fate of Kuwait. In 1959 the ruler of Kuwait Sheikh Abdullah III Al-Salim Al-Sabah requested a change in the formal relationship between his state and the United Kingdom, which still controlled the foreign affairs of the territory.⁴⁸ Kuwait had not been immune to the forces of Arab nationalism sweeping through the Middle East and the ruling family felt it was time to exercise greater sovereignty over its foreign policy. The British were initially hesitant to relinquish what control they did have in Kuwait as the tiny state produced around sixty nine million tons of oil in 1958, or roughly a third of all Middle East production.⁴⁹ On top of this, the Kuwaitis possessed one of the largest reserves of sterling in the world, an amount capable of severely damaging the currency should something go awry.⁵⁰

Yet the FO had for quite some time pursued a policy of attempting to placate the Ruler and his family and therefore allow for the smooth operation of the oil industry in Kuwait. Therefore, despite the misgivings, the FO stated that “it would clearly be politically impossible for us to resist the Ruler's demands indefinitely, since this would

⁴⁷ BP 58685, British Petroleum Archive, Middle East Political Report, 29 January, 1959.

⁴⁸ The relationship had been governed up to that point by an “Exclusive Agreement” signed in 1899 which recognized Kuwait as an independent principality under the protection of the British Empire.

⁴⁹ The British Government estimated all Middle East production in 1958 to total 210.6 million tons. See FO 371/141201, NA, Special Position of Kuwait as a Source of Oil, August, 1959.

⁵⁰ See Galpern for a thorough discussion of the fears related to Kuwait’s sterling reserve. Steven G. Galpern, *Money, Oil, and Empire in the Middle East: Sterling and Postwar Imperialism, 1944-1971* (Cambridge University Press, 2009).

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endanger our relations with him and put our oil interests and the Ruler's continued investment in sterling at risk.”⁵¹ Thus on June 19, 1961 the British Representative in Kuwait, William Luce, signed an Exchange of Letters with the Abdullah III Al-Salim Al-Sabah granting Kuwait its independence. Part of the agreement stipulated that Britain would come to the aid of Kuwait militarily if the former Sheikh, now Emir of Kuwait, requested it.

That request came more quickly than many expected. On June 25, President Qasim launched a blistering attack on the Exchange of Letters. Qasim, like other Iraqi leaders before him, argued that Kuwait had been historically part of the Ottoman province of Basra, now part of Iraq.⁵² This argument had been made before, but previous Iraqi leaders had not been in the position of Qasim who had great need of a major foreign policy triumph to help secure his shaky grip on power.⁵³

Sir Humphrey Trevelyan, the British ambassador in Baghdad gave voice to this concern and linked together Qasim's intransigence towards the IPC with his threats on Kuwait stating, “His delaying tactics with the oil companies may have been due to a plan to put himself in a stronger position by annexing Kuwait before committing himself to an agreement with them.”⁵⁴ Trevelyan also raised concern over a suspected build-up of Iraqi troops in Basra, a mere 40 miles from the Kuwait border. Speculation was rife that

⁵¹ PREM 11/3427, NA, “Jurisdiction in Kuwait,” 30 November, 1959.

⁵² Following the Ottoman defeat in the First World War, Basra had been joined to the new Iraqi state. Therefore, according to Qasim, Kuwait belonged to Iraq.

⁵³ British officials had worried about this possibility since Qasim took power on July 14, 1958. Contingency plans for military intervention had been drawn up and prepared in the event of Iraqi aggression. See Nigel Ashton, “Britain and the Kuwaiti Crisis, 1961,” *Diplomacy & Statecraft* 9, no. 1 (1998): 163, for an excellent description of this process.

⁵⁴ PREM 11/3427, NA, “From Baghdad to Foreign Office: no. 640,” 27 June, 1961.

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Qasim would use the pretext of celebration for the July 14 anniversary of his coup to launch an invasion of Kuwait. Concern was so great within Whitehall that the MoP held meetings with BP and Shell, both members of the Oil Supply Advisory Committee (OSAC) which had been set up during the Suez Crisis, to allow them to begin organizing the supply shifts that would be necessary to make up for a loss of Iraqi, Kuwaiti and perhaps even Iranian oil.⁵⁵

The difficulty for Macmillan and his Cabinet was that all the contingency plans for dealing with an Iraqi invasion required British forces to be in Kuwait before the start of hostilities. British military planners feared that the United Kingdom did not have the military resources in the area to stage a successful landing to retake Kuwait from an occupying Iraqi force. Therefore, there was no time to wait to see if Qasim's threats were serious. Officials also feared the consequences of doing nothing with Philip de Zulueta, Macmillan's Private Secretary putting it to the Prime Minister that, "If we let Kuwait go without a fight, the other oil Sheikdoms (which are getting richer) will not rely on us any longer."⁵⁶

It was therefore imperative for British forces to enter Kuwait to stave off an Iraqi threat. The British received an invitation from the Emir on June 30 and with it Macmillan ordered Operation *Vantage* into effect. By the end of the operation nearly seven thousand British troops had landed in Kuwait. Qasim protested wildly at the

⁵⁵ Conflict between Iraq and Kuwait would almost certainly have disrupted the vital Shat al-Arab waterway through which much of Iranian production flowed. The FO would not, however, allow the MoP to discuss the pending British military action in the region with the companies. See POWE 33/2507, NA, Note of Meeting Held at the Ministry of Power, 1 July, 1961.

⁵⁶ PREM 11/3427, NA, Note Zulueta to Macmillan, 29 June, 1961.

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British action but did nothing about it. The IPC, however, feared what the move might mean for their negotiations with the Iraqi dictator.⁵⁷

The problem however was that not only was the intervention incredibly difficult for the British military, it also provoked more nationalist disapproval of Britain's "neo-colonial" activities in the region. The British force in Kuwait was eventually replaced by an Arab League contingent and the withdrawal of British troops left two questions in the air in Whitehall. The first was if Britain could continue to defend its oil interests in the region militarily. The second was how much longer Britain could stave off threats to the production arrangements that benefitted it so greatly. The Iraqi regime's negotiations with the IPC were an unpleasant foretaste of what the future might hold and the threatened instability in Kuwait highlighted the danger of rising nationalist sentiment in the region. Combined these factors meant that the traditional concessionary system, and the traditional way of defending that system, both faced uncertain futures.

In Defense of 50/50

Whitehall had been apprehensive about this developing threat for some time. Admiral Matthew Slattery, who had been assigned the task of investigating ways to secure reliable forms of transportation of oil from the Middle East completed his task in September 1959, reporting to the PM that "During 1958 it became evident from the

⁵⁷ For an excellent account of the IPC's frustrating negotiations with Qasim see BP 30456, BP, *The Iraq Oil Negotiations*, 1962.

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events in the Middle East (culminating in the Iraq coup of July) that we should concern ourselves more with a production than a transportation crisis."⁵⁸

This concern over production had two aspects. The first was the fear that political instability or malice would prevent oil from being pumped or possibly blocked from being distributed. The second aspect concerned how production would be regulated and operated. The 50/50 principle had proven to be a stable and enduring pattern of production ever since Venezuela negotiated the first such agreement in the late 1940's, and one that left the day to day running of the operations in the hands of the oil companies.⁵⁹ This system guaranteed not only a continuous flow of oil but a reasonably stable level of income to the companies and by extension to the countries where those companies were based.⁶⁰ Because of this, both the companies and officials in Whitehall believed "very strongly... that preservation of 'a 50/50' was of primary importance," because, "once one got away from the general principle of 50/50 one was on a slippery slope."⁶¹

The principle of evenly dividing profits was also hailed by oil company officials as one which showed the producing states' sovereign stake in oil production. A report by the MoP noted "The 50/50 principle, which has the great advantage of simplicity, has

⁵⁸ PREM 11/3451, NA, Oil Transport from the Middle East, 17 September, 1959.

⁵⁹ The 50/50 principle had first been applied in the Middle East by Aramco and Saudi Arabia in 1950. See Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (Simon and Schuster, 2008), 413.

⁶⁰ According to a Treasury report from 1958, it was estimated that the profit arrangements in the Middle East resulted in Britain receiving 70 million tons of oil at a value of £450 million, 20 million tons of which were consumed in the UK with the remainder being shipped elsewhere. This meant that Britain was able to obtain £220 million worth of oil as well as an additional £100 million of foreign investment each year with no cost to Britain's foreign exchange accounts. See T 236/5645, NA, Report from Minister of Power to Prime Minister, 30 July, 1958.

⁶¹ FO 371/141195, NA, Meeting with BP and Shell, 3 March, 1959.

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been regarded by the companies as being a proper basis for the division of the proceeds, founded on principles of equity and fairness which it is doubtful whether any alternative sharing of profits could produce when taking into account the contributions made by the respective parties.”⁶² But fears persisted within the Government that as the balance of power between the companies and the producing states tipped against the oil firms, 50/50 would come under increasing pressure.

This pressure began to mount even before the Iraqi Revolution and came from some unlikely sources. The initial assaults on the concessionary arrangements came from Italian, Japanese and American “independent” firms attempting to break into the Middle Eastern oil production market.⁶³ These firms lacked the fully integrated production, refining and distribution networks of companies such as Exxon, Shell or BP. What they did possess was markets thirsty for stable, cheap supplies of oil.

The Italian firm *Ente Nazionale Idrocarburi* (ENI) had for years been attempting to break into the Middle Eastern market and, under the leadership of the irascible Enrico Mattei, was willing to put aside oil company orthodoxy to do so.⁶⁴ Thus in 1957 ENI signed an agreement with the Shah of Iran to explore new areas of the country for oil and gas. The profit-sharing agreement was the traditional 50/50 split—however the difference was that ENI agreed that the state-run National Iranian Oil Company (NIOC)

⁶² POWE 33/2200, NA, Fifty/Fifty, February 1958.

⁶³ The term “independent” refers to the smaller American firms not traditionally associated with the Seven Sisters. Examples include Getty and Continental.

⁶⁴ Mattei had attempted to get ENI included in the Iranian Consortium during the negotiations over that institution’s formation in 1954 but was rejected ostensibly because adding another firm would have “complicated” the already delicate negotiations. See FO 371/127205, NA, Italian and Other European Interests in Middle East Oil, 6 May, 1957.

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would be equal partners in the venture without having to shoulder any of the capital outlay. This would mean that if oil was found, the Iranians would in effect receive a 75/25 profit split. In the end, not much marketable oil was found in ENI's new concession but this deal, along with an agreement struck between Saudi Arabia and Kuwait with the Japanese firm the Arabian Oil Company which split profits 57/43 and 56/44 respectively, revealed to the oil producing states that perhaps 50/50 was not sacrosanct.

The major integrated oil companies that had up to this point dominated the concessions in the Middle East argued that the reason these firms needed to tender such terms was that they could not offer the states the same level of technical expertise, refining capacity and distribution networks. But behind closed doors there was concern brewing that these moves could presage a stronger push on the part of producing countries to renegotiate the terms of their concessions. Commenting on the ENI-NIOC agreement, Angus Beckett of the MoP noted that "While it is impossible to comment intelligently on the effect which joint ownership might have on the 50/50 principle without seeing the concessionary terms, it would not surprise me if an attempt is made to breach the 50/50."⁶⁵ The British embassy in Tehran was even more pessimistic reporting, "we all know that 50/50 is about as dead as the four minute mile. And as inevitably."⁶⁶

⁶⁵ FO 371/127202, NA, Letter to DT West from JA Beckett, 25 February, 1957.

⁶⁶ Quoted in Yergin, *The Prize*, 487.

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Many within the MoP and FO, not to mention within Shell and BP, were not willing to give up 50/50 without a fight. But how to go about preserving the principle would lead to division between the Whitehall and the companies. This was because the Government's vision for preserving 50/50, which emanated mainly from the FO, depended on playing to the oil producers' nationalist sympathies, while BP and Shell felt that stroking national egos was a poor substitute for rigidly upholding the letter of the contracts they had signed.

During the not-so-secret negotiations between the Shah and Mattei over the ENI-NIOC concession, the FO began to formulate suggestions for a new approach to the oil production issue. Arguing that the real issue was national pride and sovereignty, these officials believed that offering greater participation to the Iranians, and eventually other oil producers in their own industries, would make the companies partners with their hosts rather than outside contractors.⁶⁷ This in turn would help relieve pressure on the companies to compensate the countries financially. Responding to the ENI-NIOC deal, Sam Falle of the FO's Middle East desk suggested that it was, "yet another indication that we are not going to be able to hold the line on 50/50 for ever," and that "it may be necessary to try quietly to educate the companies towards a slightly less rigid attitude."⁶⁸ Along these same lines the British embassy in Tehran argued in an appraisal of the Shah's oil policy that if the companies offered "genuine partnerships which in time

⁶⁷ What was meant by participation was not entirely clear. The FO encouraged the firms to employ more of the local population in non-menial positions paying particular attention to the elites of the oil producing states. Later, the FO would even encourage the firms to allow national oil companies such as NIOC to purchase a share of the operating companies and thereby become true partners of the oil companies.

⁶⁸ FO 371/127202, NA, Middle East Oil: S. Falle's Response. 27 September, 1957.

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enable the oil producing countries to stand on their own feet, we might find a formula which would provide stable arrangements for the next few decades,” adding that “offers of more money alone will not in my view enable us to achieve this: there must also be genuine partnership.”⁶⁹

But this approach did not find universal acclaim within the Government. While the FO was concerned with keeping Britain’s strategically important partners in the Middle East happy, the MoP was much more sympathetic to the views of the companies. Responding to the Tehran embassy’s report, representatives of the MoP claimed that “The impression that we get from these despatches is that our people in Tehran are being over-pessimistic about the chances of current oil agreements surviving in their present form for any length of time.”⁷⁰ Despite this recalcitrance, the MoP was not completely blind to the threat. Instead, the MoP sought to find solutions that would keep control of oil production solely in the hands of the international oil industry.

One such solution appealed to both the MoP and the FO: this was the suggestion that more European and Japanese companies should be admitted to the concessionary agreements, thus diversifying the interests, de-politicizing the arrangements somewhat and giving the entire system a more international air. Plus in the words of the FO’s DR Collard, “if other countries were to enter existing oil groupings in the Middle East, it might stop them from trying to obtain new concessions directly from Middle Eastern

⁶⁹ FO 371/127202, NA, Letter to Selwyn Lloyd from John Russell, 11 October, 1957.

⁷⁰ FO 371/127202, NA, Letter to Ballard from Beckett, 27 October, 1957.

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governments on terms which were an embarrassment to us.”⁷¹ Despite the FO’s dislike of Mattei, the prevailing thought was that he would cause less trouble to 50/50 while inside than he would if he was left out in the cold.⁷²

Ultimately, however, this plan did not come to fruition. The initial target for the Italian, German and Belgium firms to be brought in was the Iranian Consortium. The British, American and French firms already involved in the Middle East did not veto the idea but insisted that a market rate be paid for the stakes, and this proved to be beyond the financial capabilities of the non-major oil firms.

Even so, some within the FO felt that progress was being made in convincing BP and Shell that some compromises would be needed in order to guarantee the long-term viability of the current production arrangements. But the glimmers of hope were short-lived. Sam Falle, a FO official in regular contact with both BP and Shell, recorded a conversation of a meeting he attended of the main integrated companies’ public relations officers. According to these company men, the threat to 50/50 emanated from the young rash nationalist officers who populated many of the Arab capitals. In the words of one Aramco official, Homer Metz, even though the nationalists “were no more capable of governing the Middle East than the remnants of the Red Indians were of governing the United States of America,” they were a “fact of Middle Eastern life with whom the oil

⁷¹ FO 371/127205, NA, Italian and Other European Interests in Middle East Oil, 8 August, 1957.

⁷² A fact that Mattei seemed to confirm in a conversation with British embassy officials in Rome. See FO 371/127205, NA, Record of Conversation between Mr. Hannaford and Signor Mattei, 16 April, 1957

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companies had to deal with as best they could.”⁷³ One Shell official privately conceded to Falle that he had put forward an internal report which stated that the challenge to 50/50 was “a difficulty which would have to be faced reasonably.” He went on to argue that “it would not be possible to do an indefinite Canute on that particular ocean and that it would be necessary to discuss any new Middle East propositions reasonably and employ economic arguments to keep them within bounds.” But unfortunately for Falle and the British Government, the paper was “suppressed within Shell.”⁷⁴

The main difference in approach between the British Government and the major oil companies was at its heart a matter of urgency. As the exchange between Falle and the Shell official shows, the companies were not blind to the fact that pressures on the model of production were going to increase. The difference for the companies was that they felt rushing into any new arrangements could have the potential to further destabilize the situation. There were two main factors that buttressed this view.

The first of these was that the structure of the oil industry in the Middle East was not conducive to rapid adjustments. Decision-making was a two-tiered process due to the fact that most of the operating companies in the Middle East (i.e. IPC, the Kuwait Oil

⁷³ FO 371/127213, NA, Meeting of Oil Company Public Relations Officers, 25 September, 1957. Not everyone interested in oil affairs was so dismissive of the nationalists. Many of the oil industry trade publications offered a more sympathetic portrait of the oil producers desire to exercise greater control over their main natural resource. Chief amongst these was *Petroleum Week* and later *Petroleum Intelligence Weekly*’s Wanda Jablonski. Over her extraordinary career, Jablonski cultivated contacts on both sides of the oil equation serving as a conduit of information. She was among the first to point out the fact that a younger generation of Saudis, Iranians, Kuwaitis and others were returning from Western universities equipped with superb educations and a desire to assert greater sovereignty over oil-related matters in their home countries. See Anna Rubino, *Queen of the Oil Club: The Intrepid Wanda Jablonski and the Power of Information* (Beacon Press, 2008).

⁷⁴ Ibid.

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Company (KOC), the Iranian Consortium, Aramco, etc.) were governed by their shareholders which were, in effect, the seven major British and American firms plus CFP. This meant that any changes negotiated between a Middle Eastern government and an operating company, such as the IPC, would need to be approved by the boards of the major companies that owned shares. To add extra complication to this matter was the issue of transferability in that any agreement struck with one Middle Eastern country would ultimately need to be applied in the other producing states as well.⁷⁵ This convoluted structure made necessary the periodic conferences held by the major oil companies, such as the London Conference of 1957, at which major decisions could be discussed, debated and perhaps decided upon.⁷⁶

This decision-making process was further complicated by the fact that the major oil companies had two different parent countries with sometimes conflicting approaches to the oil industry and to the Middle East. Both the United States and the United Kingdom agreed that the preservation of the traditional concessionary system was in the best interest of their companies, and their economies, but how best to achieve this was another matter. The two states held fairly regular discussions on oil but Whitehall found it difficult to come to definitive collaboration with the Americans due to divisions between their Department of the Interior and State Department.⁷⁷ Also, US anti-trust

⁷⁵ This was not a legal obligation but was for all intents and purposes a practical reality of dealing with the rival Middle Eastern states.

⁷⁶ US anti-trust law limited the topics that could be discussed at gatherings such as these.

⁷⁷ Strong political representation by the many independent oil companies operating in the United States pushed the various Secretaries of the Interior to discourage US assistance to the American oil majors in the Middle East. Thus the US pursued an even more hands-off approach to coordinating the actions of its oil companies in their relations with the oil producing states.

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laws prevented the US oil majors from giving off the appearance of working too closely together, even for strategic purposes. Thus while the State Department was sympathetic to the FO's desire to provide direction to the oil companies in their dealings with the oil producers, it offered little practical support.

The other major factor holding back the companies from following the Government's advice to offer small concessions to the producers was the fact that the period of the late-1950's to early-1960's was a time of over-supply for crude oil. Despite the temporary shortage brought on by the Suez Crisis, oil supplies were by and large ample. New supplies from Nigeria, Algeria, Abu Dhabi and the discovery of deposits in Libya had created the potential for a market glut.⁷⁸ This had the dual effect of convincing the oil companies that they had the leverage to face-down any single oil producer in the knowledge that supplies could be made up elsewhere in the event of a shut-down, while also depressing prices to the point that the companies were loath to do anything which would further limit their profits.

Price Cuts and the Birth of OPEC

⁷⁸ The companies had been seeking to diversify their sources in the Eastern Hemisphere since before the Suez Crisis. Oil was discovered in Nigeria by a joint Shell/BP venture in 1956. Algeria was extensively explored by French companies seeking to find an independent source of oil to help fuel France's autarchic economic approach to resources. Libya, however, was an area where exploration was encouraged and supported by the British and American governments. When oil was discovered in 1959, Libya was under the control of King Idris who was friendly to the West and allowed the maintenance of NATO military bases in Libya. The thinking behind this strategy was that any discoveries made west of the Suez Canal would be exempt from a transportation crisis. While this was true, the fields in Libya and Algeria would come under increasing pan-Arab pressure as the decade progressed.

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One of the byproducts of the over-supply of oil on the market was an increasing downward pressure on the price of oil. The difficulty for the major companies was that there were, in reality, two separate price categories for crude. The first was the posted-price which the companies “paid” for their oil at the source of supply. This price was set by the companies, usually more or less in unison, and was the benchmark used to calculate the royalties paid to the producing states.⁷⁹ The second price category was the actual market price that oil fetched at the point of sale, either as bulk crude or as a refined product.

By 1959 the divergence between these two price categories was growing. The increasing over-supply of oil was depressing the market price while the posted-price was maintained at a constant level. The companies had been willing to tolerate this difference as long as it remained narrow, partly in the interest of peace with the producing countries and partly because the gap could be made up by the increased value of refined goods over the cost paid for the crude. Yet by early 1959 the difference in price meant that instead of a 50/50 profit split, the oil producing states were actually receiving anywhere from 60 to 70 percent of the profit off of the oil being produced.⁸⁰ This situation increased the pressure to do something to rectify the balance and pushed the companies towards making the fateful decision to cut their posted-prices for oil.⁸¹

⁷⁹ There was a finely developed system of grading the quality of oil from various regions and wells. This quality differential determined the final posted price for each wellhead.

⁸⁰ Frank Brenchley, *Britain and the Middle East: Economic History, 1945-87* (I. B. Tauris, 1991), 156–157.

⁸¹ Shell’s official history points out that the resumption of Soviet oil exports in 1959 also played a factor in the depreciation of market prices for petroleum. See Howarth et al., *The History of Royal Dutch Shell*.

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On February 13, 1959 BP—at that point still the largest holder of Middle Eastern reserves—announced cuts to its posted prices for all of the Persian Gulf oil producers. The cuts differed in degree according to oil type and production area but they averaged about ten percent. In a press release, BP stated that the move “reflects the downward trend internationally in the market for Crude Oil under the pressure of very plentiful supplies.”⁸² The other major companies followed suit shortly thereafter.

The cut in posting price met with surprisingly little reaction on the part of the producing states. Posted prices had earlier been cut in the United States and in Venezuela and thus were not entirely unexpected in the Middle East. In Iran, however, the mood was stormier. Since the oil industry in Iran was technically nationalized under the control of the NIOC and was only operated by the Consortium, the Shah’s government felt that it had the right to be notified of any major change in prices.⁸³ Not only was the government angered but, as the British Embassy in Tehran reported, the news was a “shock to the ill-informed public to realize the extent to which Government finances are at the mercy of Oil Company decisions, reached without consultation with Iranians.”⁸⁴

The fallout from the price cut seemed to be fairly contained but officials within Whitehall still felt apprehensive about the manner in which the move was conducted. Their suggestions that in the future BP might well take care at least to inform the

⁸² FO 371/141194, NA, Note for Editor, 12 February, 1959.

⁸³ As part of the settlement of the Iranian Nationalization Crisis of 1951-1954, the nationalization of the Iranian oil industry was technically upheld. NIOC was to be the official owner of all Iranian resources but would lease out control of its concessions to the Iranian Consortium. To assuage any residual anti-BP sentiment in Iran, BP was forced to allow several American firms as well as Shell and CFP into the Consortium. In exchange, BP received an annual payment from these firms that was to last twenty years.

⁸⁴ FO 371/141194, NA, No. 11 Saving, 11 April, 1959.

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producing countries before the newspapers about impending changes to the post-price were not well received. Maurice Bridgeman, soon to be named the Chairman of BP, gruffly rebuked the British Government's entreaties by noting that BP was "in the same position over posted prices as the Bank of England and the Treasury over the Bank rate – the leak of advance information could frustrate the purpose of the operation." Bridgeman went on to complain that the British Embassy in Tehran was coddling the Iranians, arguing to a member of the FO that "The National Iranian Oil Company strutted across the stage as a fully-fledged oil company, but their ignorance of the business was still abysmal."⁸⁵

Attitudes such as this were what continued to divide the British Government from the companies. BP, Shell and the other major companies were wary of operating their businesses as political agents, instead preferring to treat the producing countries as equal business partners. This would help to keep them, in their thinking, as separate from geopolitics as possible. This approach was deeply frustrating to the FO. Officials there understood that Britain's relationships in the Middle East were influenced by the actions of British companies. Whether BP and Shell wanted it to happen or not, their activities were linked to the British state. This linkage was just one of the issues that officials within Whitehall sought to address in their 1959 Report on Middle East Oil, a long-term study which brought together the oil experts from the FO, the MoP and the Treasury. The Report's stated aim was to "consider possible measures for the maintenance of stable relations between the oil companies and the producing countries with a view to

⁸⁵ FO 371/141194, NA, Record of Meeting between Stevens and Bridgeman, 17 April, 1959.

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forestalling eventual pressure for wide-sweeping modifications of existing concessions,”⁸⁶ and contained within it a frank assessment of Britain’s position as an oil trader and consumer. It stated that it was within Britain’s interests to seek to uphold the essence of the current oil production arrangement. The strong position of BP and Shell not only brought the United Kingdom significant financial reward but it helped to secure the stability of supply due to the fact that “world trade in oil is largely concentrated in the hands of a small number of integrated international companies with sources of supply in various parts of the world, and having the incentive and resources to replace quickly any shortfall in supplies from one area with oil from other parts of the world, and to distribute available supplies equitably amongst all consuming countries.”⁸⁷

But the Report also indicated that keeping oil production in the hands of these companies would require compromise. This would not be easy, for despite the agreement between the Government and the companies that the concessionary system as it existed was the ideal, the current status of 50/50 would be unsustainable in the long-run. The report concluded that this difference in views required greater effort on the part of the Government to direct the activities of the companies, stating that “Her Majesty's Government must take a leading part in guiding and co-ordinating policies.” It went on to acknowledge that “Although relations between the industry and the oil companies are, of course, in the first place a matter for the oil companies, the companies' activities and security are affected by political relations between the various oil countries and the

⁸⁶ FO 371/141193, NA, Report on Middle East Oil, January, 1959.

⁸⁷ Ibid.

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West.”⁸⁸ The companies, however, took a different view of this policy objective. An internal BP report noted, “the Companies do not accept the implication that, without outside prompting, they have been slow to see the needs of the situation in the Middle East, nor can they, in present circumstances, accept the recommendation that a leading part in determining future policy and concerting a new approach to the Middle East Governments should devolve on H.M.G. [Her Majesty’s Government].”⁸⁹

Despite these disagreements, both sides believed that more cooperation could be achieved through regular meetings between representatives of the three main oil-related ministries and top officials from BP and Shell. The first of these informal and more importantly, secret, meetings which became known as “tea parties” took place on January 15, 1959, a full month before the decision to cut the posted price. The fact that nothing about the price cut was discussed revealed the limitations of these meetings. The Companies were happy to discuss events in the Middle East in return for privileged information from Whitehall but, being competitors with one another, they were naturally hesitant to delve too deeply into commercial matters.⁹⁰

Notwithstanding this shortcoming, it was felt that there would be adequate time to allow the relationships to develop into a strong working partnership. Any effort by the oil producers to alter the production arrangements radically would require a united front on their part. But it was felt that “such concerted action appears improbable, unless the

⁸⁸ Ibid.

⁸⁹ BP 4807, BP, Note on the Position of the British Oil Companies, 23 March, 1959.

⁹⁰ John Loudon of Shell was particularly fierce in his desire to keep discussions as limited as possible.

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Arab oil countries were either reacting to measures by the West which they regarded as ‘provocative,’ or had become united under the leadership of a single man or group.”⁹¹

Unfortunately for the British Government such a perceived provocation was just around the corner, and one that would lead to the producers becoming united under the leadership of a single group. The incident in question was another cut in the posted price and the result was the formation of the Organization of Petroleum Exporting Countries (OPEC).

Even before the second price cut, the oil-producing states had begun to organize themselves. The calm reaction to the first price cut in 1959 belied a deep concern over the ability of the major oil companies to impact the national budgets of the oil-producing states in such a swift and definitive manner. Thus in April 1959 just two months after the price cuts, the first Arab Oil Conference was held in Cairo. The meeting was also attended, importantly, by observers from non-Arab oil-producing states such as Venezuela and Iran. While the matters discussed in conference were of a technical and prosaic manner, other conversations were being held. Fuad Rouhani who was later to become the chairman of OPEC recorded later that “views were being exchanged in the lobby concerning the possibility of creating an organization in which all producing countries – Arab as well as non-Arab – would participate.”⁹² The conference ended with

⁹¹ FO 371/141193, NA, Report on Middle East Oil, January, 1959.

⁹² Fuad Rouhani, *A History of O.P.E.C* (Praeger, 1971), 76.

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an agreement that further steps would be taken to unify the policies of the producing states to present a united front to the major oil companies.⁹³

Both the British Government and the oil companies showed little concern about these proclamations. The over-supply situation had still not eased and, despite the cut in posted price made at the beginning of 1959, the companies were still being forced to sell their oil at a discount on the new posted price. Rumblings throughout the industry that this situation was untenable first began to be picked up by civil servants in late June of 1960 with the publication of two articles by the oil journalist Wanda Jablonski in *Petroleum Week*. Jablonski indicated that a further price cut was in the offing. It perturbed the FO that despite a year of assiduously cultivated contact with BP and Shell such news came from a trade journal rather than from the companies themselves. The best that Whitehall could get from the companies was that “Everyone was intensely interested in speculating as to who might make the first move.”⁹⁴

In the end it was Standard Oil of New Jersey (later Exxon) that took the first step. On August 9, 1960 the American company announced further reductions in the posted price.⁹⁵ Shell quickly followed and matched Jersey’s cuts. According to conversations between top officials from BP and members of the FO and MoP, BP was angered by these moves for two reasons. The first was that BP felt the move came at a politically delicate time given the ongoing negotiations between the IPC and Iraq over the fate of the

⁹³ This agreement was furthered by a joint declaration made in May 1960 by the Venezuelan Minister for Mines and Hydrocarbons Perez Alfonso and the Saudi oil minister Abdullah Tariki which urged this process along.

⁹⁴ FO 371/150064, NA, Letter Rose to Powell, 3 August, 1960.

⁹⁵ This time the reduction was roughly 7.5 percent.

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Iraqi oil industry. Secondly, BP felt that the cuts in prices were not enough to seriously bridge the gap between the posted price and the market price, thus paying tremendous political capital for a small amount of fiscal gain. Nevertheless, by August 16 BP was forced to follow suit, announcing that the company regretted that “reduction should have been made in posted prices.”⁹⁶ They announced smaller cuts than Jersey and Shell in the hopes that this would curry favor with the producing states.

But BP’s moderation did not win them many plaudits and the anger caused by the second price cut galvanized the producing nations into action. As Rouhani points out, the two cuts had cost Iran nearly 13 percent of their expected oil income upon which much of their budget depended.⁹⁷ As one early oil historian noted, “The attitudes that were finally expressed in the formation of O.P.E.C. had begun to form many years before, too. But it took the price cuts of August, 1960 ... to crystallize them.”⁹⁸ This crystallization of attitudes led to the creation of OPEC on September 14, 1960 with an initial membership of five of the largest oil producers in the world.⁹⁹

The initial response by both the British Government and its oil companies to the creation of OPEC was muted. The stated aims of the organization were moderate and many doubted whether serious cooperation was possible between the different parties involved. Writing in January of 1961, J.E. Lucas, one of the Treasury’s oil specialists,

⁹⁶ FO 371/150064, NA, Foreign Office to Baghdad no. 1185, 15 August, 1960.

⁹⁷ Rouhani, *A History of O.P.E.C.*, 77.

⁹⁸ J. E. Hartshorn, *Politics and World Oil Economics: An Account of the International Oil Industry in Its Political Environment* (Praeger, 1967), 20.

⁹⁹ The original members were Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. Qatar joined the organization in 1961 while Libya and Indonesia joined in 1962.

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commented that "There was no evidence of any general pressure for a change in the basic pattern of concessionary arrangements." He went on to add that "OPEC was concerned mainly with ways and means of keeping up the level of crude oil prices and did not apparently aim at making any radical changes in the existing concessions."¹⁰⁰ Writing again two months later, Lucas spelled out what was to become Britain's policy towards OPEC by stating "The general policy of the oil companies and the Governments of consuming countries should be to refrain from comment and, in particular, not to express any opposition. Equally, there was no reason why any direct encouragement should be given to O.P.E.C."¹⁰¹ Bridgeman, now the chairman of BP, and the managing director of Shell, John Loudon, echoed this sentiment in a meeting with British officials in April.

Bridgeman noted that,

the quieter the oil companies kept about OPEC the better. It was not to be expected that the Organisation would dissolve itself, as too much prestige was involved. Any attempt to co-operate or to come to terms with the Organisation would make it more dangerous. The companies should therefore follow a middle course. There was a reasonable chance that OPEC might become ineffective as a result of internal stresses.¹⁰²

OPEC seemed to oblige the oil companies' lack of concern in the first two years of its existence, choosing to focus on structural and organizational matters prior to engaging in any commercial or political gamesmanship.¹⁰³ Internal divisions between

¹⁰⁰ T 236/6443, NA, Middle East Concessionary Arrangements, 24 January, 1961.

¹⁰¹ T 236/6443, NA, O.P.E.C., 3 March, 1961.

¹⁰² T 236/6443, NA, Organisation of Petroleum Exporting Countries, 5 April, 1961.

¹⁰³ Bamberg argues that it was this initial moderation that actually gave OPEC credibility in the eyes of the British and American Governments. See Bamberg, *British Petroleum and Global Oil, 1950-1975*, 153.

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more moderate and radical states made any grand strategy difficult.¹⁰⁴ The prospective invasion of Kuwait by Iraq even threatened to destroy the organization before it had fully formed. Yet the very existence of OPEC gave the producing states a better negotiating position when it came to discussions of prices, and even more threateningly, the 50/50 principle.

Coordination

This situation unsettled the civil servants of Whitehall. They feared that British assets were not well suited to meet the twin nationalist threats of political instability as manifested by the Kuwait Crisis and conflict over resources represented by the birth of OPEC. While British officials were confident that political situation in the region as well as the position of the oil companies were secure in the short-term, they were growing increasingly concerned by the end of 1961 about the long-term viability of the traditional concessionary system and the massive benefits it brought to Britain's balance of payments.

Although there was better communication between the FO, MoP and Treasury and BP and Shell as a result of the tea parties, officials, particularly in the FO, were frustrated at the lack of influence that the Government wielded over the actions and decisions of the oil companies. In the newly developing reality in the Persian Gulf and

¹⁰⁴ The chief point of disagreement within OPEC was over the policy of? pro-rationing or creating a quota system to control production rates. This would have given the OPEC states some form of control over supply and thus over the price of oil. This position was advanced by Alfonso and Tariki but was strongly opposed by Iran which felt that higher production rates were the way to improved revenues. This disagreement neutralized one of OPEC's most dangerous weapons.

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other oil-producing regions it was deemed imperative that Whitehall cultivate the ability to develop actual sound strategies for the companies to follow and just as importantly to find ways to encourage the firms to actually implement Government suggestions.

It was widely recognized by all the departments that this second aspect would require the support of the United States. BP and Shell often reported to the Government that they were unable to follow the conciliatory approach suggested by the FO because of pushback from the American companies. The American firms, for their part, also complained to both BP and Shell as well as to the British Government about the lack of interest shown in their affairs by the US State Department. In a conversation with British officials, Maurice Bridgeman, the chairman of BP, noted that he thought that “most of the international oil companies including the American ones, had been trying to exert influence on the State Department to take a greater interest in the international oil situation and, in particular, to give political guidance where necessary to the companies in connection with their operations in areas where there was a potential threat to oil production, such as in the Middle East.”¹⁰⁵ The British had attempted to hold substantive and regular talks on oil with the United States each year since the Suez Crisis but often found their American counterparts unprepared or even uninterested.

There had been hope that the new Administration of John F. Kennedy which took office in 1961 would be keener to work closely with the British on these issues. In a note to Denis Greenhill who was stationed at the UK’s Embassy in Washington, P.E.

¹⁰⁵ FO 371/158050, NA, Note of a Meeting between Bridgeman and Ambassador to US, 3 November, 1961.

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Ramsbotham of the FO (and later ambassador to Washington) stated that “our real object is to get the new Administration to accept the proposition that the U.K. and the U.S. have so many common interests in oil matters that close consultation on them is both normal and essential.”¹⁰⁶ But these hopes were frustrated as the US Government continued to reserve its main attention for other oil-related matters such as the idea that the Soviet Union could win influence in the West through the sale of oil. The British viewed this threat as minimal and they were supported in this by the great international oil analyst Walter Levy who in meeting with British Embassy staff in Washington let it be known that “he thought that the oil companies, the U.S. Government and the general public in this country were far too much obsessed with Russian threats generally, with the result that their attention was being diverted from problems that really mattered, namely the effects of nationalistic tendencies in the producing countries and in the newly emerging nations.”¹⁰⁷ While the Americans did begin to come around to the threat posed by OPEC over the course of 1962, it would not be until 1963 that substantive discussions would be held between the two governments.

With closer cooperation with the US not developing as they would have liked, Whitehall turned towards establishing closer coordination between its own departments as a way of strengthening the message being sent to BP and Shell. Despite the tea parties, many top oil officials still believed that the Government was sending mixed messages to the companies and therefore sought ways to harmonize the positions of

¹⁰⁶ FO 371/158048, NA, Ramsbotham to Greenhill, 8 February, 1961.

¹⁰⁷ FO 371/164605, NA, Letter from Rose to Stock, 10 January, 1962.

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Whitehall. But although this idea had unanimous support from the FO, MoP and Treasury, how to go about it was another matter. The FO wanted a formal group, perhaps attached to the Cabinet Office, a suggestion that was resisted by the MoP and Treasury which feared such a powerful group would infringe their ability to influence oil matters. Instead, an informal Standing Oil Group was proposed which would be made up of high-ranking officials from the three interested departments. This group would serve alongside the tea parties as avenues of discussion and would in the words of the MoP's M. Stevenson serve "as the point of contact with senior members of Shell and B.P. for the advanced consultation with the companies on oil problems we are recommending to Ministers."¹⁰⁸ The Standing Oil Group held its first meeting on 20 December, 1962 but was quick to prove that it was not a Government attempt to interfere overmuch into the affairs of the companies. The Standing Oil Group was envisaged as "an approach by Ministers to Shell and B.P. asking them to consult H.M.G. more fully and more promptly so that H.M.G. could consider oil problems before they came to a head, and, if necessary, offer advice."¹⁰⁹

Such an approach was not unwelcomed by BP and Shell. Although still disparaging of OPEC's long-term potential, both firms still recognized the threat of growing nationalism and appreciated the need for closer collaboration with the Government. This was due in large part to the fact that the firms were growing concerned that an ill-informed Whitehall might result in policies or decisions detrimental

¹⁰⁸ FO 371/164604, NA, Letter from Stevenson to Reilly, 22 November, 1962.

¹⁰⁹ FO 371/164604, NA, Standing Oil Group – 1st Meeting, 21 December, 1962.

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to their interests. Therefore, both companies strengthened their government relations apparatus with BP appointing Billy Fraser, the son of its former chairman as its government affairs representative. Thus, by 1962, an unprecedented amount of high-level contact existed between the oil companies and the Government. The sharing of information was regular as were meetings between officials.

Conclusion

The subtle transition in the relationship between the Government and its oil companies which marked the period from 1957 to 1962 was not immediately obvious. On the surface, it appeared that the traditional strategy of the companies handling oil negotiations which had been in operation for decades, with London offering diplomatic support as well as the implicit threat of military intervention, would continue to exist unaltered. But changes on the ground and shifts in attitude within Whitehall had combined to create a very different situation in terms of Britain's oil policy going forward.

While the early days after the Suez Crisis saw both the companies and the Government focus on transportation security, the fall of the Hashemite Monarchy in Iraq and the birth of OPEC had given rise to fears that the traditional concessionary system was now under threat. The natural inclination amongst policy-makers in Whitehall was to attempt to head off this danger through direct intervention with the oil companies, but the very source of this hazard, the rise in nationalism in the Middle East, would have only been inflamed by even the suggestion that the British Government was dictating the

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affairs of its oil companies. On top of this, both the Eisenhower and Kennedy Administrations declined to exert overt pressure on their companies to make the types of concessions recommended in the 1959 Report on Middle East Oil. While recognizing the growing threat, the Americans believed that it was not imminent enough to justify interference in their oil industry. Therefore Whitehall was left in the uncomfortable position of monitoring the oil industry and offering advice and suggestions to BP and Shell through their monthly tea parties and through the activities of the Standing Oil Group.

The natural tendency towards the status quo was also bolstered by the fact that even in 1962 there remained a significant oil surplus as new fields in Libya, Algeria and Nigeria were fully developed and added to the international trade. This seemed to grant the oil industry the cushion it needed to resist demands for major changes to the concessionary system. But on the other side of the equation, the oil surplus exerted further downward pressure on prices which only encouraged greater unity amongst the OPEC states.

The struggle between the desire to uphold the status quo and the unease regarding the future was perfectly captured in a new report on Middle East Oil published in January, 1963. The report was put together over the course of 1962 and acknowledged the changing situation in the Middle East. Despite this, it recommended little change in strategy. Regarding security of supply the report stated, “the substantial excess of crude oil producing capacity in the world today, and the greater diversity of sources of supply

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make an interruption less likely now than was the case in 1959.”¹¹⁰ But this optimism was tempered by the admission that “some loss of control by the oil companies seems to be inevitable sooner or later” as “the tendency for developing countries to seek and win more control of what goes on inside their frontiers is a world-wide one.” The report went on, ominously noting that “We are clearly about to enter a more active phase in relationships between the oil companies and the producing countries and developments of the kind indicated could seriously threaten British interests.” Because of this the civil servants involved in writing the report offered a simple suggestion that “the liaison arrangements between the oil companies and the Governments, which have been strengthened in recent years, should be further improved.”¹¹¹ Just what this improvement would entail would be a matter of debate and disagreement between the companies and the Government in the years to come.

¹¹⁰ POWE 33/2529, NA, Middle East Oil, January, 1963.

¹¹¹ Ibid.

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Cartels and Chaos: Declining State and Company Power, 1962-1968

In the pre-dawn hours of 5 June, 1967, hundreds of Israeli jets streaked into the skies to initiate the conflict that was to become known as the Six-Day War. By 8:00 AM, the air forces of Egypt and Syria had been destroyed and the Arab armies were on their way to defeat. The military might of the Arab states had appeared impressive on paper but proved no match for their Israeli enemies. Even before the conflict, some strategists such as the former Saudi oil minister, Abdullah Tariki, had theorized that the most powerful weapon in the Arab arsenal for the fight against Israel and her allies was not missiles, planes or tanks, but oil. On 6 June, Arab oil ministers issued a call for an oil embargo against Israel's friends in the 'Free World,' chiefly the United States and the United Kingdom.¹ By 8 June, over 60 percent of the oil normally produced by the Arab states had ceased flowing and the Suez Canal was closed to any oil still being produced.

Although this initial use of the Arab "oil weapon" would eventually fail and indeed even humiliate its chief proponent, King Faisal of Saudi Arabia, the events surrounding the Six-Day War and the abortive oil embargo served to highlight just how quickly the international oil situation and the power balance in the Middle East were changing.² From 1962-1968, the power of both the oil companies and Britain to control

¹ For a discussion of the Labour Government's policy towards the lead-up to the Six-Day War, see Moshe Gat, *Britain and the Conflict in the Middle East, 1964-1967: The Coming of the Six-Day War* (Praeger, 2003); and Gernot Klantschng, "Oil, the Suez Canal, and Sterling Reserves: Economic Factors Determining British Decisionmaking During the 1967 Arab-Israeli Crisis," *Diplomacy & Statecraft* 14, no. 3 (2003): 131-150.

² According to Yergin, "The biggest losers turned out to be the countries that instituted the embargoes." Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (Simon and Schuster, 2008), 539.

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and influence events weakened dramatically, straining the traditional approach to oil policy taken by Whitehall. The growing strength of nationalist forces in the Persian Gulf, exemplified by the spontaneous strikes of oil and port workers in places such as Kuwait during the Six-Day War, revealed the limits of Britain's ability to maintain stability in the region through its military and diplomatic presence. Likewise, OPEC's capacity to force the international oil companies to concede several key points on profit-sharing in 1964 and 1965 set the stage for even more difficult negotiations in the years to come.

This changing balance of power necessitated a reworking of the relationship between the companies and Whitehall, which would help them to better coordinate their actions so as to maximize the influence that they retained. Unfortunately this period also marked a down-turn in relations between the companies and the ruling government in London. The victory of the Labour Party in 1964 brought to power Harold Wilson and a Cabinet that was less friendly to the laissez-faire approach to oil policy.³ This tension was managed by the civil service which kept up its strong relationship with company officials but hampered coordination.

The source of the tension was not just Labour's attempts to monitor the activities of the oil industry more closely but also strategic reevaluations that BP and Shell viewed as detrimental to their long-term interests. Chief amongst these was the decision to withdraw British forces from the Persian Gulf made as part of the general decision to pull

³ The General Election of 1964 returned Wilson and the Labour Party to power with a slim majority of just four seats.

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back British troops from their positions East of Suez.⁴ This move was a recognition that British forces were doing little to promote stability in the region or to guarantee Britain's oil interests. To the companies, however, the withdrawal was simply another tool of influence removed from the Government's repertoire at a time when greater support was necessary to forestall major changes to the concessionary system.

Thus by the end of 1968 relations between the two sides were on a downward trajectory. Although continuing the strategy of allowing the companies a free hand in negotiating their relationship with the oil producers, Labour had begun to make preparations for a future in which Britain's domestic supply security would not need to rely on the international oil industry. The companies for their part realized that the increased demand for oil in the industrialized world would continue to undercut their negotiating position. This meant that the diplomatic support of the United States and the United Kingdom would no longer be enough to secure their bargaining positions. With the Organization for Economic Cooperation and Development (OECD) becoming increasingly dependent on oil, the companies would need the support of all oil consumers in order to face down the growing strength of OPEC. The divergence of these two positions would spell difficult days ahead for the Government-company relationship.

Demands and Negotiations

⁴ The term East of Suez is derived from an 1890 poem by Rudyard Kipling entitled *Mandalay* and commonly refers to the British military positions east of the Suez Canal. This included the great military base at Singapore as well as positions in Malaysia and Hong Kong. It also included, crucially, the string of bases that Britain maintained in the Persian Gulf and Aden.

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The shift in the balance of power that was to mark the period of 1962-1968 began with an opening salvo of demands from OPEC regarding the pricing of oil and the sharing of profits. After nearly two years of organizing themselves, OPEC was better prepared to face down the oil companies and win serious concessions for the member states.⁵ In the past these states had seen their progress hampered by divisions between radical states such as Iraq and conservative states such as Kuwait and Saudi Arabia, divisions which led many Western observers to discount the possible effectiveness of the organization.

But at OPEC's fourth conference held in June, 1962, the opposing sides found issues around which to unite. The meeting resulted in the issuing of Resolutions 32, 33 and 34, which sought to redress some of the revenue imbalance brought about by the price cuts of 1959 and 1960. Resolution 32 stated that the oil companies should return posted prices to the pre-1960 cut level. Resolution 33 had more long-term connotations. This one Resolution called for a revamping of the formula used to calculate the payments made to producing countries under the 50/50 system in what was known as "royalty expensing." Up to this point, the 50 percent received by the producing states was technically an amalgamation of two different payments.⁶ Under the concessionary deals signed in the Middle East, the countries were entitled to a royalty payment of 12.5 percent of total profits but this was included as part of the 50 percent received under the

⁵ For an account of the struggles of these first two years of OPEC's existence, see Fuad Rouhani, *A History of O.P.E.C* (Praeger, 1971); Shukri Mohammed Ghanem, *OPEC, the Rise and Fall of an Exclusive Club* (KPI, 1986); and Fadhil J Al-Chalabi, *Oil Policies, Oil Myths: Analysis and Memoir of an OPEC Insider* (I. B. Tauris, 2010).

⁶ 12.5 percent Royalty + 37.5 percent Profit Sharing

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50/50 system. OPEC Resolution 33 stated that the royalty payment should be excluded from the 50 percent formula and paid separately.⁷ OPEC argued that there was “no justification for the fusion of royalty payments into income tax in such manner that royalty becomes entirely unreal, as is the case with the agreements at present in force in the Middle East.”⁸ Just what might happen if the companies refused these requests was not entirely clear although some more radical elements, such as the Iraqis, spoke darkly of expropriation and perhaps even nationalization. To strengthen their position, the leaders of OPEC suggested that negotiations with the oil companies over the three Resolutions should be conducted by the organization itself. The companies realized that negotiating with OPEC would not only strengthen the hand of the producers, it would also grant legitimacy to the organization and therefore refused. The internal unity of OPEC was not strong enough at this time to overcome the companies push to negotiate bilaterally with individual producers.

While some within the industry were still skeptical that OPEC could follow through on the Resolutions, there was enough concern to prompt a new strategy to encourage a split between the moderate and radical members. Such a strategy was discussed with Whitehall during the regular tea party meetings and was actively encouraged by the Foreign Office (FO).⁹ To do this, the companies proposed striking better deals with moderate states to show that cooperation with the oil industry would

⁷ Resolution 34 which sought to eliminate the 1.5 cent marketing allowance granted per barrel to the oil companies was considered less significant by both OPEC and the oil companies.

⁸ Taken from the Explanatory Memorandum attached to Resolution 33 in Rouhani, *A History of O.P.E.C.*, 222.

⁹ The Foreign Office (FO) became the Foreign and Commonwealth Office (FCO) in 1967.

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bring more tangible benefits than taking a radical course. The primary target for these negotiations was Iran.¹⁰ The Iranians had a great many political, religious and economic differences with the other OPEC members and with the Arab producers in particular.¹¹ Added to this was the Shah's stated desire for Iran to retake its position as the world's leading oil producer, a position lost during the nationalization crisis of 1951.¹²

Thus in late October, 1962, Maurice Bridgeman, representing the Iranian Consortium, visited Iran in order to attempt to strike a deal.¹³ Bridgeman had known the Shah for many years and was actually considered a friend by the Iranian ruler. Through talks first with the Iranian Prime Minister Asadollah Alam and then later with the Shah himself, Bridgeman did all he could to guarantee that Iran would receive special treatment by the major oil companies if they led the resistance against the radical elements within OPEC and perhaps even against the Resolutions themselves.¹⁴ Nothing was set in stone, but the vague assurances given by Bridgeman were taken at face value by the Iranians so much so that both Alam and the Shah let it be known over the

¹⁰ See J. H. Bamberg, *British Petroleum and Global Oil, 1950-1975: The Challenge of Nationalism* (Cambridge University Press, 2000). See Chapter 6 for more details about these negotiations.

¹¹ Iran was culturally and linguistically distinct from its fellow Persian Gulf OPEC members. It was also predominantly Shiite while many of the Arab governments were dominated by Sunni Muslims.

¹² Cold War politics added yet another layer to the desire to support the Shah. While the British tended to downplay the threat of internal Communist intrigue in Iran, the Americans were fearful of such an eventuality. Since roughly half of the Consortium was made up of American firms, the State Department's move to shore up the Shah aided in pushing the oil companies into being more generous negotiating partners. For a view of American policy towards Iran during the Kennedy administration, see April R. Summitt, "For a White Revolution: John F. Kennedy and the Shah of Iran," *Middle East Journal* 58, no. 4 (October 1, 2004): 560-575.

¹³ As the largest member of the Iranian Consortium, BP was the natural leader for these negotiations.

¹⁴ The benefits to the Iranians were to be 1) A reduction of the marketing allowance per barrel to 0.5 cents which effectively meant an acceptance of Resolution 34. 2) Protection of Iranian revenues from any future drop in the posted price, 3) An increase in oil production in Iran by 10 percent annually, and 4) The Consortium would assist in funding development projects throughout Iran.

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following months that they were not averse to the idea of Iran leaving OPEC altogether. In a meeting with British government officials, Bridgeman reported that “the Iranians do not want a second ‘Abadan’ and... they believe that they can do better for their country by making arrangements with the Consortium which would be outside the Agreement and outside the OPEC Resolutions.”¹⁵

The FO was alarmed by the idea of Iran withdrawing from OPEC but generally pleased with the brake that it had put on Iran’s willingness to be OPEC’s “spearhead.”¹⁶ The desire for Iran to remain within OPEC and to serve as a moderating force was relayed to the Iranian government through the British Ambassador to Tehran, Sir Geoffrey Harrison.¹⁷ Harrison had played an active role in the entire process of the Consortium’s negotiations and reflected a growing trend whereby working parties within Whitehall were drafting complex sets of instructions to British representatives in the oil-producing world, giving them the data and the knowhow to defend British oil interests from attacks of profiteering and exploitation.¹⁸

The ability to moderate the demands of the Shah was a shining success of the combination of Government influence and commercial acumen on the part of the

¹⁵ FO 371/164604, NA, Record of a Meeting with Shell and B.P. held in the Foreign Office, 13 December, 1962. “Abadan” refers to the Iranian Nationalization Crisis of 1951 in which the Abadan refinery, then BP’s single largest refinery in the world, was nationalized.

¹⁶ Ibid.

¹⁷ Iran’s flirtation with withdrawing from OPEC was accompanied by threats from the other members to expel them. This made operations within OPEC awkward since its first chairman, Fuad Rouhani, was an Iranian. Rouhani was vehemently opposed to even the hint of Iran’s withdrawal and wanted closer OPEC collaboration in order to give the organization the ability to negotiate directly with the companies on a multi-lateral basis.

¹⁸ These instructions were often drawn up with the assistance of BP and Shell and included information shared at the tea parties. Their purpose was to provide the British diplomatic staff in the oil producing states with information which they could use to counter anti-oil company arguments put forward by their host governments.

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companies. It was made all the more important by the fact that negotiations in Iran's neighbor, Iraq, were going very poorly. Just as Iran's successful compromise with the companies lessened the country's desire to push for radical changes through OPEC, so the Iraqi's lack of success furthered their drive to use OPEC as a tool of vengeance against the oil industry.

Since the July Revolution of 1958, the member companies of the Iraq Petroleum Company (IPC) had been engaged in fruitless bargaining with the government of Abd al-Karim Qasim. In these discussions, the IPC shareholders were guided by the fear that any major concession to Qasim would be demanded by the other major oil producers. Thus from 1959 to 1962, the IPC fought bitterly on every negotiating point.¹⁹ Even so, they did agree on key issues such as relinquishment of part of their concession area, haggling over how much would be given up. They also acceded to Qasim's requests, made in 1960 and 1961, to forward payments early in order to help plug gaps in the Iraqi budget.

But each minor concession seemed to only encourage further demands from Qasim. An internal BP report on the talks somberly stated that any surrender on the part of IPC would lead the Iraqis to "immediately pursue some other objective."²⁰ Ultimately negotiations were broken off in December 1962 and the Iraqi parliament passed its Law

¹⁹ For a description of the negotiations from the point of view of the IPC see, BP 59364, Iraq Negotiations, 6 September 1960 – 20 January, 1961 and BP 179282, The Iraqi Oil Talks, 29 September, 1960. See also Bamberg, *British Petroleum and Global Oil, 1950-1975.5*, p. 163-171.

²⁰ BP 59364, BP, Report to Snow on Relinquishment, 6 September, 1960.

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80, stripping IPC of 99.5 percent of its concession area.²¹ Whitehall's 1963 Middle East Oil Report claimed that "Whether at any time in the past 3 years it would have been possible to reach an agreement with Qasim is doubtful. Qasim has proved to be quite unpredictable - to say the least - and he may well never have wanted to reach agreement with the company, for political reasons."²²

Again, throughout these negotiations, the British Ambassador to Baghdad proved instrumental in keeping open the channels of communication. The secure communications between the IPC and its shareholders were sent via the diplomatic wires to the British embassy, and the ambassadors Humphrey Trevelyan and later Sir Roger Allen played crucial roles in easing tensions as well as keeping the IPC abreast of the developing political situation.²³ But this assistance also revealed the limitations of what the Government could do to help the companies. Both Trevelyan and Allen pushed the Iraqis hard for a settlement, but the British Government had little leverage.²⁴

When Qasim was overthrown in a bloody coup in 1963, both Whitehall and the companies breathed a sigh of relief in the hope that the new government under General Abdul Salam Arif would prove more flexible in its negotiations. Unfortunately for IPC

²¹ This was effectively all of the territory held by the company that had not been explored or exploited with fully developed and functioning wells. The United States saw Law 80 as being directed against British influence in the Persian Gulf and not a particular attack on the IPC. Because of this they were cautious in their support of the tough approach being taken by Whitehall. Despite this, the State Department did encourage American companies not involved in the IPC to avoid taking new concessions from the territory acquired under Law 80. See Stephen J. Randall, *United States Foreign Oil Policy Since World War I: For Profits And Security* (McGill-Queen's Press, 2005), 273.

²² FO 371/164605, NA, Middle East Oil, 1962.

²³ Trevelyan served as ambassador from 1958-1961 and Allen from 1961-1965.

²⁴ For a detailed account of Qasim's time in power see Juan Romero, *The Iraqi Revolution of 1958: A Revolutionary Quest for Unity and Security* (University Press of America, 2010).

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this was not the case.²⁵ The new government quickly followed in Qasim's footsteps by passing Law 11, establishing the Iraqi National Oil Company (INOC) which would operate the new concessions parceled out from the 99.5 percent of the IPC concession that had been confiscated.²⁶

The difficulties in negotiating with both the Qasim and the Arif regimes stood in poignant contrast for the companies to the easier dealings with Iran. Although nothing had been set in stone by Bridgeman's conversations with the Shah, there was hope that a final agreement with the Iranians would settle the Resolution 32, 33 and 34 issues in ways that were relatively less painful to the international industry. Therefore the prevailing belief was that the companies should give in to Iran lest they end up with more Iraqs on their hands. Progress consequently quickened in the discussions over the OPEC Resolutions as the companies looked for ways to make their concessions as painless as possible. In these talks and others, the British companies continued to communicate regularly with their government. This period saw a high point in the tea party meetings between representatives of BP, Shell and the three main oil-related departments of the British Government. These meetings regularly discussed the ongoing OPEC negotiations as well as IPC's struggles in Iraq.

²⁵ Arif's position in Iraq was an insecure one. He had come to power with the aid of the Ba'ath Party with which he was forced to share power. Much of his early time in office was taken up with talks conducted with Egypt and Syria to reform an expanded United Arab Republic in 1963. This plan did not come to fruition and Arif spent his remaining years in office attempting to build "Arab Socialism" in Iraq. For the discussions on unification see Elie Podeh, "To Unite or Not to Unite -- That Is Not the Question: The 1963 Tripartite Unity Talks Reassessed," *Middle Eastern Studies* 39, no. 1 (January 2003): 150.

²⁶ Negotiations with the new regime, and its predecessor, were to drag on throughout the decade. An agreement was nearly completed in 1965 only for the government to be overthrown in a Ba'athist coup. The new Ba'ath government insisted on returning to the negotiating table, thereby nullifying the unratified 1965 agreement.

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Along with the tea parties and the obvious diplomatic support offered by the British missions in the OPEC states, Whitehall also actively coordinated and organized a campaign of propaganda meant to bolster the negotiating position of the companies. The suggestion for such an effort actually originated from the US State Department in early 1964 and was taken up by the FO, the Ministry of Power (MoP) and the Treasury as a tangible way that they could both assist the companies and develop a closer working relationship with them. A meeting with BP and Shell in April, 1964 confirmed the two companies' interest in such a program. In fact, as A.T. Lamb who ran the FO's "oil desk" reported, the meeting went, "somewhat wider than had originally been expected in that, at the instance of the oil companies, it also considered whether there was not room for more co-ordination generally of official and company information efforts in the Middle East on certain major themes."²⁷ This agreement resulted in the creation of a company information liaison group that was to meet quarterly in order to coordinate the message being put out on all channels about matters such as the profitability of the oil industry, the dependence of Western Europe on OPEC supplies and the availability of petroleum in non-OPEC areas. All of this was meant to support the companies in their attempt to reach a more moderate deal with countries such as Iran while undercutting the arguments being put forward by Iraq and other radicals, many of whom were journalists not associated with any particular government.²⁸

²⁷ FO 371/178153, NA, OPEC: counter-propaganda, 24 April, 1964.

²⁸ The companies were particularly concerned with the Egyptian publication *Al Ahram* which was widely distributed throughout the Arabic-speaking world.

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There was recognition, however, of the need for this cooperation to be below the surface. Lamb wrote in August that the British diplomatic missions around the Persian Gulf wholeheartedly agreed with the information liaising being conducted but cautioned that “any appearance of collusion between Whitehall and the oil companies must be avoided.” But they added that the “official information services could, however, help the oil companies and could also act by themselves, particularly in combatting anti-oil company propaganda which has an Arab nationalist base.”²⁹

The Whitehall-company liaison group suggested the use of a wide array of British information assets in order to promote stories and commentaries sympathetic to the oil company position. Plans were to use the BBC’s English and Arabic services as well as internationally regarded publications such as *The Economist* to promote stories and information that could be used to combat the aggressive propaganda regarding the excessive profits the oil producers believed the companies to be taking. The effectiveness of this strategy is difficult to tell and is in some ways less important than the fact that the liaison group marked an important point of cooperation between Whitehall and the companies.

But even with the backing of the British and to a lesser extent the American Government, the oil companies were still unable to resist the demands of the OPEC states completely. The combination of refusing to negotiate with OPEC as a block, along with the diplomatic support of Whitehall in places like Iran, had helped moderate the position

²⁹ FO 371/178154, NA, Co-Ordination of the Official and British Oil Company Information Efforts in the Middle East, 11 August, 1964.

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of the oil-producing states but had not shaken them from their determination to gain major concessions from the oil industry. The companies realized this and thus continued to focus their attention first on Iran. The Shah had shown his willingness to cooperate with the Consortium in return for production increases and the hope was that a successful resolution of the demands encapsulated in Resolutions 32, 33 and 34 with the Iranian Government would put pressure on the other OPEC states to accept similar deals.

This was not going to be an easy or simple matter, however. Despite the good relations with the Shah, the Iranians still demanded a fair deal and threatened to act unilaterally against the Consortium's interests should they not negotiate in good faith. Fuad Rouhani, frustrated by the companies' refusal to negotiate with OPEC directly, used his position in the Iranian Government to attempt to push for the best arrangement possible. This growing pressure from the Shah's Government forced the companies to cross the line regarding the 50/50 principle and when negotiations had picked up steam in late 1963, the companies agreed in principle to the concept of royalty expensing with the Iranians, a move that was in keeping with OPEC's Resolution 33. In return, the Consortium convinced the Iranians to give up the idea of Resolution 32, which stipulated that the posted price should return to its pre-1959 level.³⁰ By November 1964, a final

³⁰ The oil companies reasoning was that by protecting the price cuts of 1959 and 1960 which OPEC was trying to undo with Resolution 32, the companies were actually protecting themselves from an even worse deal. With royalty expensing the profit split was expected to be somewhere between 56/44 and 58/42 whereas in 1959, prior to the first price cut, the companies believed the actual profit split had been somewhere between 60/40 to 70/30 in favor of the producing states. The oil producers for their part were willing to give up the price increase due in part to fears of Soviet Oil entering the market in increasing quantities, putting a downward pressure on market prices. The companies tried to put a good face on the situation with one Aramco executive declaring to the US Embassy in Saudi Arabia that, "in 1950 they hoped 50-50 formula would last 'a few years.' Actually its term has exceeded their expectations." Foreign

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agreement was struck with the Iranians regarding royalty expensing which would be introduced gradually but also retroactively to include all of 1964.³¹

As had been hoped, the Iranians encouraged the other moderate OPEC members, Libya, Saudi Arabia, Kuwait, and Qatar, to agree to similar deals as well.³² At OPEC's conference in Jakarta, Indonesia, these moderate states agreed to strike comparable arrangements. Only Iraq continued to resist, although the IPC held out a deal to the Iraqi Government that could be signed as soon as the conflict over Laws 80 and 11 were resolved. The companies came out of the 1962-1965 negotiations feeling that they had made the best of a bad situation. They had cemented a somewhat better agreement than they had in the pre-1959 era of major discrepancies between the posted and market prices of oil but there was also a deep concern that these negotiations marked only the beginning of a new era of OPEC strength. The OPEC states had not received everything they wanted from the negotiations but had won a symbolically important victory in breaching the 50/50 principle.

Relations of the United States, 1964-1968, Volume XXXIV, Energy Diplomacy and Global Issues, Document 178, Telegram from the Embassy in Saudi Arabia to the Department of State, 12 April, 1964. <http://history.state.gov/historicaldocuments/frus1964-68v34/d178>, accessed 11 May, 2013.

³¹ Rouhani had been consistently frustrated in his attempts to wring a better deal out of the companies. Every tactic he tried to pressure the companies was immediately countered, leading the Iranian negotiator/OPEC chairman to suspect that someone was leaking information. Rouhani was convinced that the leak was Wanda Jablonski but it was later revealed that Dr. Reza Fallah, a high-ranking official in the National Iranian Oil Company was conducting regular discussions with BP. Fallah revealed Rouhani's negotiating tactics in return for payments. See Anna Rubino, *Queen of the Oil Club: The Intrepid Wanda Jablonski and the Power of Information* (Beacon Press, 2008), 236.

³² As part of the deal, posted prices were to be "discounted for assessing tax by an average of 8½ percent in 1964, and a percentage point less in, 1965, and again in 1966, after which the possibility of a further cut in the discount would be reviewed in the light of the oil market." See FO 371/183512, NA, O.P.E.C., 15 January, 1965. For an excellent breakdown of the negotiations see FO 371/183512, NA, Shell Paper on O.P.E.C. Negotiations, 26 January, 1965. This success did not end the matter, however, as any OPEC resolutions had to be carried out unanimously.

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There were also immediate consequences of the deal. In return for their role in bringing about the more moderate agreement, Iran “had come to expect some sweetener from the Consortium for the part – a considerable one – they had played in persuading the other countries to settle this O.P.E.C. issue.”³³ Central to those assurances was the promise to increase Iran’s production levels, thereby increasing Iran’s revenues. With the Shah launching his “White Revolution” to modernize Iran in 1963, the demand for higher revenues grew immensely.³⁴ This would have been incredibly problematic, considering that the over-supply of oil continued into the mid-decade. But luckily for the major oil companies, there was slack within the system due to the continued intransigence of Iraq. The inability of IPC and Iraq to come to an agreement over the fate of IPC’s concession meant that since 1959, no work had progressed within the country to expand production capabilities.³⁵ This in turn meant that production increases that should have been parceled to Iraq could be shared out to the other nations of the Persian Gulf.³⁶

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³³ Ibid.

³⁴ For three critical evaluations of the Shah’s White Revolution, see Ali M. Ansari, “The Myth of the White Revolution: Mohammad Reza Shah, ‘Modernization’ and the Consolidation Of....,” *Middle Eastern Studies* 37, no. 3 (July 2001): 1; Nimah Mazaheri, “An ‘Informal’ Revolution: State-Business Conflict and Institutional Change in Iran,” *Middle Eastern Studies* 44, no. 4 (July 2008): 585–602; Summitt, “For a White Revolution.”

³⁵ Iraq’s refusal to back down from its expropriation of 99.5 percent of the IPC’s concession meant in effect that it had been successful in nationalizing a portion of its oil industry. But it paid a huge price in the lack of development of its oil resources and in the IPC’s capping of its production level in 1961. See Frank Brenchley, *Britain and the Middle East: Economic History, 1945-87* (I. B. Tauris, 1991), 158.

³⁶ According to Yergin, Iran’s production from 1957-1970 grew by 387 percent while Saudi Arabia’s grew by 258 percent. See Yergin, *The Prize*, p. 516. As Bamberg points out, the four major American firms involved in the Iranian Consortium were also members of ARAMCO thus inextricably linking increases in Iran to those in Saudi Arabia. See Bamberg, *British Petroleum and Global Oil*, p. 172.

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The ability to boost production due to Iraq's intransigence was a short-term fix, however. By 1964, the signs were pointing to a growing aggressiveness on the part of OPEC. The strength and cohesion of the oil-producers had caused increasing alarm in Whitehall. Immediately after the release of the updated Middle East Oil Report in 1963, further reassessments began about the need to push for more active Government oversight of the ongoing relations between the companies and the OPEC states. The heavy involvement of British ambassadors in the negotiations between the IPC and Iraq and between the Consortium and the Shah only furthered this attitude.

But the efficacy of Whitehall's influence on BP and Shell was a continual worry to officials. The creation of the Standing Oil Group in 1962 and the continued use of the tea parties had improved the channels of communication but officials had the distinct impression that oil information and advice was flowing from the companies to the Government but that the advice and instructions of the FO, MoP and Treasury were having little impact in the boardrooms of BP and Shell. To the FO, the reason for this was clear. Whitehall's message was being diffused by multiple contacts maintained by the companies with different Government departments. And on top of this, while the Government message might have been politically well-informed, the lack of understanding on the part of Whitehall officials of the inner-workings of the oil industry was dampening the interest of the firms in listening to the advice of their Government.

There seemed little that could be done about this, but an opening for real change came with the election of the Labour Party in October, 1964. The new Government of

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Harold Wilson promised to bring about great changes to the operation of governing Britain's economic and foreign policies. The changeover also offered opportunities for a reexamination of the relationship between the companies and the Government at both the political and institutional level. Labour's stated desire to seize control of the economy caused shivers in the boardrooms of BP and Shell and several prominent Labour politicians and advisors such as Wilson's special economic consultants Nicholas Kaldor and Thomas Balogh made it clear that they sided with academics such as Peter Odell of the London School of Economics who criticized the current structure and operation of the international oil industry.³⁷ These thinkers wanted to answer the challenges of a disparate and ill-informed message to the companies pointed out by the FO by using the measures of control available to the Government, such as the maintenance of two Government directors on the Board of BP and the Shell-Treasury Agreement of 1946, to assert greater overt influence on information-sharing and on decision-making where possible.³⁸

The civil service saw these ideas as reckless and did their best to resist them, but Whitehall did use the opportunity provided by the new Government to examine ways to shake up the institutional relationship with BP and Shell. One of the reorganizational goals the Wilson Government had discussed was a plan to roll the MoP into a large department which would be tasked with handling Government relations with and control over heavy industries. The FO, which had long felt that the long-term sustainability of

³⁷ All three argued that the fully integrated structures of the major international oil companies suppressed competition and kept prices artificially inflated.

³⁸ These plans and the attempts by the Labour Party to assert greater control over BP and Shell in the domestic sphere will be analyzed to a further extent in Chapters 3 and 4.

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the international oil industry was being sacrificed for short-term expediency in the eyes of the MoP and Treasury, saw this as an opportunity to stake their claim to greater control over the nation's oil policy. A.T. Lamb wrote to his fellow FO officials that, "We should perhaps now consider, if the Ministry of Power is to evolve into a Ministry of Heavy Industry, whether responsibility in Whitehall for international oil questions should not be more clearly defined. That is, whether it should not be recognised that the protection of our major economic investment abroad, the oil industry, is an element in foreign policy, and not in domestic industrial policy, and as such is a primary responsibility of the Foreign Office."³⁹

To make their case stronger, the FO put into place plans to reorganize its own oil affairs apparatus. Up to this point, responsibility for oil had been handled by several different groups within the FO from the Economic Relations Department (ERD) all the way down to regional desks which dealt with specific local oil issues. Lamb himself manned the "oil desk," but his role was simply to serve as a point person for the other groups within the Department handling different aspects of oil affairs.⁴⁰ The fact that no one group or person in the FO dealt with all oil matters or even specialized in oil was beginning to be seen as a serious liability. The MoP had long maintained a Petroleum Attaché at the British Embassy in Washington and the FO felt that a similarly dedicated official would go a long way in helping to unify the FO's message as well as to sharpen

³⁹ FO 371/178151, NA, The United Kingdom's International Oil Interests and Policy, 19 October, 1964.

⁴⁰ Lamb would later state that the head of the FO at the time "didn't really come into the oily side, he left the oily thing to me." See Lamb, Albert T., Interview, British Diplomatic Oral History Program, Churchill College, Cambridge University, 2000. 18.

<http://www.chu.cam.ac.uk/archives/collections/BDOHP/Lamb.pdf>

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its focus and usefulness to the oil companies. Lamb noted to his colleagues that the new Petroleum Advisor should “Not only... deal with the oil work now handled by E.R.D. but he would also prepare papers on the evolution of the international oil industry, would liaise with H.M. Missions in oil producing countries and would, subject to the agreement of the Ministry of Power, attend international oil, gas and petro-chemical seminars and conferences as the official leader of the British delegation.”⁴¹ Sir Geoffrey Harrison now serving as the Deputy Under-Secretary for Middle Eastern Affairs further developed the argument a few days later by stating that “there is need for more forward thinking about the implications for foreign policy of the problems which are arising as a result of the transitional phase into which the international oil industry is entering than can be provided by our existing staffing arrangements.”⁴²

This idea was met with approval by Foreign Secretary Patrick Gordon Walker who minuted that, “It is very important that our knowledge of our oil interests should become more systematic and concentrated.”⁴³ The other departments were less enthusiastic, however. Both the MoP and the Treasury believed that the FO already had sufficient influence over oil affairs since they provided the chairman for the Standing Oil Group and also hosted and led the tea parties. They were not averse to the reorganization

⁴¹ FO 371/178151, NA, Petroleum Advisor, Memo by AT Lamb, 13 November, 1964.

⁴² FO 371/178151, NA, Petroleum Advisor, Memo by Geoffrey Harrison, 19 November, 1964.

⁴³ FO 371/178151, NA, Petroleum Advisor, Memo by Geoffrey Harrison, 25 November, 1964. Walker would serve as the Foreign Secretary for only a little over two months after being appointed in the odd circumstances following on his defeat in the 1964 General Election. When he was again defeated in the January 1965 bi-election, he was replaced as Foreign Secretary by Michael Stewart.

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of the FO's own oil-related positions but refused to cede any more authority.⁴⁴ This resistance was strengthened by the fact that the MoP was not immediately reorganized by the Labour Government and therefore continued to hold its remit as the parent Department of BP and Shell.⁴⁵

But the FO's moves still reveal a growing desire on the part of Whitehall to deepen its knowledge of oil matters and despite their intransigence, the MoP and the Treasury did follow the lead of the FO in helping to strengthen Whitehall's support of the companies in their continued negotiations with the OPEC states. The signing of deals on royalty expensing in early 1965 had not stopped further demands for production increases, new investment programs and renegotiation of arbitration rights from continuing the near perpetual state of bargaining between the oil-producing states and the international oil industry.

Nowhere was this truer than in Iran. Each year the Iranians requested higher production levels and each year the Consortium struggled to fit those requests into the broader quotas throughout the region. This was especially difficult given the rivalry between the Shah and Saudi Arabia, coupled with increasing Arab nationalist frustration at the moderation of Iran within OPEC. The most problematic point of all for the companies was the fact that they could not justify the increases being negotiated with the Shah from a purely commercial standpoint. The companies therefore had to rely more and more on their parent governments for diplomatic support.

⁴⁴ The FO eventually created an internal Oil Department in July 1965 under the leadership of J.T. Fearnley which assumed the role of coordinated the department's response to international oil matters.

⁴⁵ The MoP would eventually be subsumed into the new Ministry of Technology in 1969.

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This was not a problem for the British. The FO knew that the companies needed political cover for their actions in the region but they were also aware of the fact that the Iranians needed support if they were to continue to hold a moderate course in the halls of OPEC. Kuwait and Qatar were within Britain's sphere of influence and were more susceptible to British pressure. The British had little, if any, sway in Saudi Arabia, however.⁴⁶ Even with the replacement of the radical oil minister Abdullah Tariki with the more moderate Zaki Yamani did little to change Britain's standing.⁴⁷ Thus any pressure brought to bear on Saudi Arabia would have to come from the United States.⁴⁸

The US had for years sought to maintain its distance from the oil business in the Middle East. The major American oil firms had done well enough and any political difficulties usually fell to the British to clear up. BP and Shell had complained on numerous occasions to the FO of the limited interest of the State Department regarding oil-related matters.⁴⁹ But even before the end of the initial OPEC negotiations the

⁴⁶ Relations between the two countries had been strained since the Buraimi incident of the early 1950's.

⁴⁷ Tariki was replaced by Yamani in 1962 after Tariki supported King Saud against Prince Faisal during an internal Saudi power-struggle. See Yergin, *The Prize*, p. 506.

⁴⁸ Randall has argued that the US was hesitant to pressure Saudi Arabia to support Iran's moderate position since Iran was already viewed as pro-US. The State Department felt that undue pressure on Saudi Arabia might provoke a nationalist backlash against the idea. See Randall, *United States Foreign Oil Policy Since World War I*, 273.

⁴⁹ This was due in large part to the strength of the domestic oil industry in the US and had two effects on US involvement in oil matters abroad. The first was that foreign oil was, throughout the 1950's and 1960's, of less strategic importance to the US since domestic production provided most of the consumption needs for the country. The second was that the political power of the independent oil companies inside the US influenced foreign oil policy. It was politically difficult for any US administration to fight publicly for the rights of the US majors abroad while those same companies fought tooth and nail to keep any of the independents out of their Middle East concessions. This political pressure was instrumental in the creation of the quota system in 1955 that restricted foreign oil imports into the United States to 9 percent of the total domestic consumption. This system remained in place for fourteen years. A third somewhat related issue was the problem of US anti-trust law. It was difficult for US companies to work together and with their Anglo and Anglo-Dutch partners without running afoul of anti-trust legislation. It was therefore also

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American Government had begun to express greater concern regarding the unfolding of events. During a meeting between Sir Geoffrey Harrison and representatives of the US Government, John Kelly of the US Department of the Interior conceded that “We can no longer brush OPEC under the rug.”⁵⁰ At the next meeting between British and American officials it was agreed that OPEC had “gained in international status through obtaining objectives on royalty expensing, obtaining recognition by the UN, and in the competence of some of its staff.”⁵¹ Both sides also agreed that OPEC had proven itself as a reasonable group with the United States going so far as to inform the British of their decision to reevaluate the mutually decided position of neutrality towards the organization.

But it was not necessarily OPEC which posed the immediate threat to British and American interests in the region. Instead it was the mixing of oil and nationalism that was causing concern. In 1965, Syria had nationalized several minor US-owned oil operations and while this in itself was relatively minor, there was fear that such trends would continue. These fears were exacerbated by the increasing nationalist rhetoric emanating from places such as Kuwait. British officials chalked this up to the need by

difficult for the State Department to offer diplomatic support to any issue that might have had the appearance of collusion between the major oil companies such as collective negotiations with the OPEC countries. This was not just frustrating to the British firms but to the American firms as well. Gulf Oil complained openly to BP, its partner in the Kuwait Oil Company, of a lack of diplomatic support from the State Department. See BP 58934, BP, Letter to Bridgeman from William K. Whiteford, 25 October, 1961.

⁵⁰ Foreign Relations of the United States, 1964-1968, Volume XXXIV, Energy Diplomacy and Global Issues, Document 176, Memorandum of Conversation, 29 January, 1964.

<http://history.state.gov/historicaldocuments/frus1964-68v34/d176>, accessed on 11 May, 2013.

⁵¹ Foreign Relations of the United States, 1964-1968, Volume XXXIV, Energy Diplomacy and Global Issues, Document 186, Circular Airgram From the Department of State to Certain Posts, 22 December, 1965. <http://history.state.gov/historicaldocuments/frus1964-68v34/d186>, accessed 11 May, 2013.

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the conservative emir to placate nationalist sentiment but it was concerning nonetheless. The US and British officials decided at their meeting to continue the counter-propaganda campaign being spearheaded by the British-company liaison group stating that “what requires countering are the wilder radical Arab views.”⁵²

Allowing Iran to be diplomatically isolated was one such destabilizing contingency and the British government felt that both the Americans and the companies needed to do what they could to support the Shah. The difficulty became that the Shah knew of this concern as well.⁵³ As one historian put it, “By the mid-1960s the Shah of Iran had come to realize that the West was tied to *his* fortunes and the he could pressure the Western oil industry with growing impunity.”⁵⁴ In 1966 the Shah demanded a 17.5 percent increase in production, a level that even in the best of circumstances the Consortium would have difficulty meeting. Dr. Manouchehr Eqbal, one of Iran’s top oil negotiators put it to the FO that “The reason for the Iranian attitude was that Iran's development programme must be maintained at its present level to ensure the degree of economic and social progress necessary to maintain the country's political stability.”⁵⁵ The Consortium once again entered into difficult negotiations with the Shah’s government which continued throughout 1966. BP and Shell eventually got behind a plan which would cut the production increase to 12 percent in exchange for a package of

⁵² Ibid.

⁵³ Summit argues that the Shah intentionally played up the threat of Communism to receive greater military aid from the US which could be used to suppress internal dissent. See Summitt, “For a White Revolution.”

⁵⁴ Louis Turner, *Oil Companies in the International System* (Royal Institute of International Affairs, 1978), 82.

⁵⁵ FO 371/187683, NA, Iran: Consortium/NIOC Talks, 10 October, 1966.

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other benefits to Iran including the sale of oil to NIOC at a 25 percent reduced cost. The American firms in the Consortium resisted such a compromise and BP and Shell were forced to inquire as to whether the British Government could pressure the US Government to twist the arms of the American firms into agreement.⁵⁶

This the Government duly attempted. Numerous meetings with representatives of the American Government were held to express the British view that negotiations with the Shah needed to be completed successfully and quickly in order to avoid a showdown which would only serve to strengthen the hand of OPEC. But these attempts were frustrated by a lack of commitment from the Americans. Derek Eagers, an FO official stationed at the British Embassy in Washington, relayed the results of one such meeting, informing London that Ted Eliot, the State Department's country director for Iran, "kept coming back to the theme that the negotiations in some ways resembled an annual carpet deal, where it was strongly in the interests of both sides that the bargaining should not be broken off." According to Eliot, the State Department felt that "governmental advice should be strictly rationed and given only when we felt it was absolutely necessary and likely to prove effective. Otherwise we risked being used by the Iranians to put pressure on the oil companies every time the negotiations got under way."⁵⁷

The Americans strategy in Iran stemmed in large part from the fact that many of the American firms that were part of the Iranian Consortium were also members of Aramco which operated in Saudi Arabia. The Saudis were displeased that the Iranians

⁵⁶ FO 371/187683, NA, Record of Oil Tea Party 29 November, 5 December 1966.

⁵⁷ FCO 54/17, NA, Iran/Consortium Talks, 7 December, 1967.

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were seemingly receiving preferential treatment and put intense pressure on Aramco to match the production increases that the Shah was receiving. But whatever the divisions between the two allies, the British and Americans were both in agreement that a resolution to the situation which would preserve stability and security was of utmost importance.⁵⁸

Oil Company Interests and the Military Position in the Persian Gulf

This emphasis on stability and security was of especial importance to Britain since British forces in the Persian Gulf were supposedly the guarantor of peace in the region. But the continued negotiations with the OPEC states, combined with the increasing potency of nationalism throughout the Gulf meant that this position was beginning to be reassessed. There were several reasons that British forces were stationed in the region but chief among them was the protection of Britain's oil interests. There were two major rationales of this military deployment in terms of protecting these interests – the counter-chaos argument and the counter-cartel argument. Since oil production began in earnest in the smaller Gulf States following the Second World War, it was believed that British troops were essential in ensuring that internal disorder or external disputes did not disrupt oil production. The fear was that the smaller Gulf States

⁵⁸ This process of the growth of American and decrease of British influence in the Middle East was not a simple one. Previous arguments that Britain's influence precipitously declined following the Suez Crisis have been challenged by arguments which show that the shift from Britain to American supremacy was not a quick nor linear transition. See Ivan L. G Pearson, *In the Name of Oil: Anglo-American Relations in the Middle East, 1950-1958* (Sussex Academic Press, 2010); Simon C. Smith, "'America in Britain's Place?': Anglo-American Relations and the Middle East in the Aftermath of the Suez Crisis," *Journal of Transatlantic Studies* (Routledge) 10, no. 3 (September 2012): 252–270.

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would be amalgamated into their larger neighbors. It was no secret that Iraq had designs upon Kuwait and that Saudi Arabia had previously threatened the Trucial States as well as maintained designs upon Qatar.⁵⁹ Should this occur, oil production would be concentrated in fewer hands giving either Iraq or Saudi Arabia near cartel-like influence.

This was because as large as the fields in Saudi Arabia, Iraq and Iran were, they were equaled or perhaps even surpassed by those held in the smaller Persian Gulf states. Kuwait was by far the cheapest and easiest source of production in the world, and established fields in Qatar and Bahrain added to the region's importance.⁶⁰ Throughout the 1960's the massive resources of Abu Dhabi were more greatly appreciated and had begun to come on line by the mid-decade.⁶¹

All of this should have made civil servants in Whitehall very happy. After all, these territories were under British tutelage or protection and British companies had a share in most of the oil operations taking place there.⁶² The actual problem, however, was twofold. First, the British military presence in the region, which allowed Britain the political influence it used to support its oil companies, was becoming increasingly

⁵⁹ The ongoing dispute over the Buraimi Oasis on the border of Saudi Arabia and Abu Dhabi created a persistent concern in Whitehall over the Saudi's claims on the Trucial States.

⁶⁰ In 1966 the Joint Intelligence Committee estimated that Kuwait produced 114.3 m. tons of oil as compared to 119.4 for Saudi Arabia and 105.9 for Iran. Qatar contributed 13.6 m. tons while Bahrain produced 3.2 m. tons. The relatively inexpensive cost of production in this small Gulf States came from the fact that very little infrastructure was required to pipe the oil to the coast due to their locations directly on the Persian Gulf.

⁶¹ The Abu Dhabi Petroleum Company was a subsidiary of the IPC and as such contained a substantial stake for both BP and Shell. On top of this a joint BP-CFP venture known as the Abu Dhabi Marine Areas had struck oil and gas offshore in the Persian Gulf. By 1966 production from Abu Dhabi had reached 17 m. tons per annum and was set to increase.

⁶² British influence in the region stemmed from a treaty signed with many of the Gulf sheikdoms in 1820. This was further strengthened by an 1853 treaty guaranteeing a "perpetual maritime truce." Those states which adhered to the truce became known as the Trucial States. Kuwait was added to Britain's sphere through the signing of a treaty in 1899.

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expensive and difficult to maintain.⁶³ The Kuwait Crisis of 1961 showed the region that Britain could still flex its muscles if necessary, but even that effort had been extremely difficult for the over-stretched British military to achieve.

The other difficult aspect of Britain's military presence in the Gulf was the fodder it provided for Arab nationalists. The anti-imperialist rhetoric that spewed from nationalist newspapers, journals and radio stations continually linked Britain's military presence to the operations of BP and Shell. For example, at the Fifth Arab Oil Conference held in Cairo in March of 1965, Abdullah Tariki, the ex-oil minister of Saudi Arabia, proclaimed to great applause that "the might of Europe and America depends on Arab oil" and that "their oil companies had, in league with Western imperialism, created Israel."⁶⁴ These companies, the nationalists argued, were the tip of Britain's neo-Imperial spear into the region.

Thus, beginning as early as 1961, some within the foreign policy establishment in London began to reassess the value of maintaining outright British military control of the Gulf States.⁶⁵ In July of 1961, Prime Minister Macmillan wrote to Chancellor Selwyn Lloyd that it would "be optimistic to assume that we should be able to repeat our recent military intervention at any rate in anything like the same way." Therefore, he added that

⁶³ The actual cost of the small British force in the Gulf was minimal with Brenchley estimating the cost to be around £12 m. per annum. But according to Brenchley, the true cost came from that fact that British military planners believed that it would be impossible to guarantee the security of the Gulf without a British aircraft carrier in the Indian Ocean, a fact that significantly increased the cost of the deployment. See Brenchley, *Britain and the Middle East*, 170.

⁶⁴ FO 371/183513, NA, The Fifth Arab Petroleum Congress, 5 April, 1965

⁶⁵ This was part of a broader look at Britain's military commitments. Included in the review were Britain's commitments to South East Asia. See Matthew Jones, "A Decision Delayed: Britain's Withdrawal from South East Asia Reconsidered, 1961-68.," *English Historical Review* 117, no. 472 (June 2002): 569.

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the situation pointed “to the need for an up-to-date assessment of our stake in the Middle East, as a basis for an examination of how far we can, or should, adjust our military strategy for that area in the future.”⁶⁶ The assets that these military forces were meant to protect were in no doubt, but the usefulness of having the British flag flying in such a pronounced manner was. Therefore the question which periodically arose over the next several years became one of how much Britain could afford to scale back its presence in the Persian Gulf without its oil interests suffering any negative consequences.

These reviews took on greater urgency following the change in government after the 1964 election. The Wilson Government had ambitious economic goals yet almost from the start, the Wilson Government was beset with balance of payments problems.⁶⁷ Labour was confident that these problems could be overcome, but savings were sought where possible.⁶⁸

How much saving could be wrung from the defense costs incurred in the Middle East was a difficult question. A report on the issue released one day after Labour took power laid out the situation by saying, “whilst the Middle East oil industry is the United Kingdom's major economic asset abroad, and bestows great economic benefits on the United Kingdom, it is very exposed politically. Apart from the special position we still enjoy in certain shaikdoms of the Persian Gulf and in South Arabia, British company

⁶⁶ PREM 11/3452, NA, Memo Prime Minister to Chancellor, 12 July, 1961.

⁶⁷ Upon entering office in 1964 James Callaghan, the new Chancellor of the Exchequer, was horrified to find that the country was facing a balance of payments deficit of £800 million, much worse than had been expected.

⁶⁸ An example of this was the decision made by the Wilson Government in 1965 to cancel the TSR-2 airplane program which had been meant to upgrade Britain's air strike capabilities.

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participation in the Middle East oil industry is attacked as a major remnant of the imperial position which we once occupied in the Middle East.”⁶⁹

The FO feared that if the British forces evacuated the area in an attempt to calm nationalist sentiment against BP and Shell these same groups would be emboldened by their success in pushing the “imperialist” military out. This was a nightmarish scenario for the Shah, with the FO noting, “The stability of the Gulf is also important for maintaining the confidence of the Shah of Iran in Western support and in keeping his policy aligned with the Western countries. The Shah is extremely sensitive to the danger of the Persian Gulf coming under the control of a power hostile to him.”⁷⁰

These strategic concerns certainly carried enormous weight in the discussions about how to proceed with Britain’s presence in the region. But a host of factors contributed to the continued reexamination of the Persian Gulf role. Among these was turbulence in what is now Yemen, which embroiled Britain’s important military base at Aden. The Aden Emergency, as the conflict became known, was sparked by an assassination attempt against the British High Commissioner in 1963 and threatened the long-term viability of retaining Aden as a base of operations.⁷¹ Another factor that

⁶⁹ FO 371/178149, NA, British oil interests in the Context of Her Majesty’s Policy in the Middle East, 16 October, 1964.

⁷⁰ CAB 148/16, NA, Iraq-Kuwait Defence Agreement Implications, 11 October, 1963. Keeping the Shah in the West’s camp was essential to the long-term stability of the Middle East and the continued access by the West to the oil from that area. Should Britain allow Iran’s Arab neighbors to flood a power vacuum in the Persian Gulf, the Shah threatened to assume a neutralist stance and to cease aiding the West in its attempt to prevent Communist incursion into the region. Few within the FO or the US State Department believed that the Shah would last long without Western support and thus any move towards neutrality by Iran would threaten Communist subversion of the entire country.

⁷¹ For a description of Britain’s struggle to retain control in Aden see Spencer Mawby, *British Policy in Aden and the Protectorates, 1955-1967* (Routledge, 2006).

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militated against the continued status quo was the economic struggles of 1960's Britain. The burden of imperial defense was an increasingly enticing target for those in the British Government looking to cut back on expenditures. These economic concerns, which culminated in the decision to devalue sterling in 1967, have often been cited as the main reason for why the Labour Government decided in January of 1968 to withdraw all British forces from East of Suez by 1971.⁷²

The difficult task of reassessment pitted the departments of the British Government against one another and provoked internal divisions within the departments as well. The FO was, on the whole, in favor of a continued military presence in the Persian Gulf. The strategic threats of instability were of grave concern to the FO. The potential loss of Aden weighed heavily on the departmental discussions in 1964 and 1965 but it was believed that new bases in the Persian Gulf could accommodate a force of sufficient size to serve its purpose. A 1965 FO memorandum claimed "The preservation of the present general political situation around the Gulf makes it possible for the oil companies to conduct their affairs by negotiation with the governments of the oil producing countries, either individually or collectively without being continually exposed to the threats of expropriatory measures of one kind or another," adding later that the "companies cannot of course be safeguarded from steady pressure to change the terms

⁷² Much of the recent historiography on the withdrawal from East of Suez disputes this assertion as simplistic. See Saki Dockrill, *Britain's Retreat from East of Suez: The Choice Between Europe and the World? 1945-1968* (Palgrave Macmillan, 2002); Jeffrey Pickering, "Politics and 'Black Tuesday': Shifting Power in the Cabinet and the Decision to Withdraw from East of Suez, November 1967-January 1968.," *Twentieth Century British History* 13, no. 2 (June 2002): 144-170; David M. McCourt, "What Was Britain's 'East of Suez Role'? Reassessing the Withdrawal, 1964-1968.," *Diplomacy & Statecraft* 20, no. 3 (2009): 453-472.

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of existing concessions, and these seem likely in the future as in the past to be progressively eroded. But the changes which such pressures bring about are slow and gradual, and are such that the companies can adapt themselves to them; where necessary, they can take measures to reduce the worst consequences.”⁷³

Yet this line was not unanimous. Some members of the FO concerned with oil were among those to propose a more thorough study of the impact of a British departure from the Gulf. Their argument was that British forces in the Gulf were too few to provide any real stability and were an irritant to Arab nationalists. This put pressure on the very states which the military was trying to protect. A.T. Lamb argued that explicitly keeping forces in the region for the defense of oil interests would make it more “likely, if and when the policy is changed... that everyone would expect, if not Kuwait's incorporation into one of her larger neighbours, at least the final liquidation of the last remnant of British imperialism in the Middle East, namely the oil companies.”⁷⁴ The feeling amongst the oil-informed civil servants was that the current of opinion in Kuwait would move away from British involvement and would perhaps even lead to the derogation of the Exchange of Letters which pledged Britain to militarily aid the Ruler in case of emergency.⁷⁵ If this were the case, the oil aspect of the British military presence in the Persian Gulf would be severely diminished.

⁷³ CAB 148/52, NA, Middle East Oil and United Kingdom Defence Policy, 31 August, 1965.

⁷⁴ FO 371/178149, NA, Lamb's Response to Letter from Crawford, 19 June, 1964.

⁷⁵ Kuwait's increasing acceptance into international organizations such as the Arab League and the United Nations, which is joined in 1963, decreased existential fears within the country given the legal protection such memberships afforded. The British were also reasonably certain of Kuwait's security due to the fact that the only power truly capable of destabilizing the country internally was Egypt. Egyptian interference

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Another reason that the oil department of the FO was more willing to see a British withdrawal from the Persian Gulf was that they foresaw any threat to British oil interests stemming more from the evolution of concessionary agreements rather than any one single blow, such as the Iranian nationalization of 1951. The prevailing sentiment amongst the oil companies and the oil men at the FO was that no single nation could risk such a confrontation knowing full well that the Western oil majors still had enough clout to blacklist the offender and raise production elsewhere. The FO pointed out that even “Qasim did not attempt to resort to it in Iraq.”⁷⁶

While the oil surplus was tightening, there was still enough slack inside the system that the loss of one or perhaps even two major producers could be absorbed with minor difficulty. The tensions within OPEC, made so apparent during the negotiations of 1962 to 1965, led many Western oil analysts to doubt whether the organization could mount the collaborative action needed to support across the board nationalization of the oil industry. Therefore, the threat of British military action was completely unnecessary to prevent nationalization and was not even likely to slow down the evolution of concessionary agreements towards a system more favorable to the producing countries. At the very least, the oil department of the FO argued that the British military presence in the Gulf should be more firmly aligned with the Central Treaty Organization to remove some of the diplomatic pressure. Lamb argued that such a strategic posture would “be

was unlikely due to the fact that any political changes in Kuwait would most likely benefit Iraq, Egypt’s main Arab rival. See FCO 54/76, NA, Country Notes: Kuwait, 14 August, 1967.

⁷⁶ CAB 148/9, NA, Oil Aspects of Middle East Defence Policy, 7 September, 1964.

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less embarrassing, in my view, for the United Kingdom oil companies than apparently being in the position of operating only under the protection of British bayonets.”⁷⁷

But these views were, at least initially, subordinated to the more general FO view that the British had to maintain a presence in the Persian Gulf in the interest of geo-political stability. These concerns even outweighed opinions emanating from the Treasury and the MoP. Both of these departments questioned the long-term value of British investments in the region as compared with the cost of keeping a military force in the region.⁷⁸ Summing up the disagreement, one report stated simply,

There has been an unresolved difference of opinion between the Foreign Office and the Treasury on the part played by our military forces in the Middle East. The Treasury maintain that a proportion, though unquantifiable, of the defence costs in the area is attributable to defence of oil interests. The Foreign Office view is that our military presence is necessary for other reasons although it also serves to defend oil interests.⁷⁹

Echoing the assessment of Lamb, these two departments argued that BP and Shell would be able to continue operating in the region even without overt Government support. The Treasury, in particular, questioned the long-standing assumption that the companies made most of their profits at the point of production i.e. in the sale of crude. While admitting the difficulty of breaking down the profitability of certain sectors of an integrated company, the Treasury argued that the companies did, or at least could, earn

⁷⁷ FO 371/178149, NA, Response to Memo from Crawford to Lamb, 24 June 1964.

⁷⁸ One internal FO memo complained about the Treasury's views by recording, “Technically it is for the Treasury and other home departments to assess the importance to us of the international oil trade and to indicate to the Foreign Office the degree of importance we must attach in our responsibilities for overseas oil policy. But in fact it is hard to see how the figures can be interpreted without some consideration of foreign policy. They would not be of great value unless they took into account questions of oil security, risk of stoppages etc. on which the Foreign Office is competent to advise.” See FO 371/183505, The Importance of Middle East Oil, 28 June, 1965

⁷⁹ FO 371/183505, NA, The Importance of Middle East Oil, 10 June, 1965.

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more profit from the transportation, refining and ultimate sale of finished product, a fact which would make changes in the concessionary system less important and which therefore militated against paying for British troops to sustain the old system.

Another voice which picked up this argument was Harold Wilson's combative economic adviser, Thomas Balogh. The out-spoken Hungarian-born economist was little-loved in the corridors of Whitehall but carried tremendous weight in No. 10. Balogh took the Treasury argument even further, claiming that Britain would in fact benefit over the long run from the destruction of the traditional concessionary system. Writing to Wilson, Balogh argued, "The loss of the Middle East part of operations would not reduce real profits very much; and the effect of this loss of profits might be offset by the prospect of Britain's being able to buy oil at prices more in line with those now paid by other countries."⁸⁰ Balogh believed that the attempt to placate the oil producing states had made BP, Shell and the other majors complicit in the over-inflation of oil prices.

Balogh's ideas were contested by Whitehall officials who noted that "under the present system the British companies sell abroad five times as much oil as is consumed in this country. It is difficult to see that a radical change would have the advantages for the United Kingdom which are sometimes suggested."⁸¹ Whatever the pros and cons of leaving the Persian Gulf, most within Whitehall did not want to see the destruction of BP and Shell's integrated supply lines or the total revamping of the international oil industry.

⁸⁰ CAB 147/43, NA, Memorandum from Balogh to Wilson, 19 October, 1965.

⁸¹ CAB 148/52, NA, Middle East Oil, 3 August, 1965

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But questions about how Britain could best support this industry were being more freely discussed. The old view that active British involvement in the region with the aim of promoting stability was giving way to a new intellectual paradigm of behind-the-scenes intervention on the part of diplomats and other back-channel means. This was consistent with Britain's wider desire to pull back from its post-Imperial commitments and to take on a more manageable world role. But in the Middle East it was not just about downsizing and finding a cheaper way forward, there was a distinct sense that the writing was on the wall for the international oil industry and that overt political interference by Britain would only hasten along the inevitable rebalancing of power between the industry and the producing countries.

The Six-Day War, Devaluation and the Decision to Withdraw

When the Israelis launched their surprise attack on the Arab forces arrayed against them in those early hours of 5 June, 1967, the forces of Arab nationalism and oil nationalism converged quickly. The ensuing crisis, brought about by the war and the Arab back-lash against Britain and the United States, had the makings of a serious oil emergency, the likes of which members of the Treasury, FO and the MoP had discussed hypothetically throughout the decade.⁸² Within hours of the beginning of fighting, the Suez Canal was closed. This was followed shortly by the closure of the Mediterranean

⁸² See Roy E. Licklider, *Political Power and the Arab Oil Weapon: The Experiences of Five Industrial Nations* (University of California Press, 1988); and Ethan B Kapstein and University Harvard, *The Insecure Alliance: Energy Crises and Western Politics Since 1944* (Oxford University Press, 1990) for a discussion of the development of this crisis.

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pipelines. To this transportation disruption was added the unsheathing of the so-called “oil weapon” which had been discussed in Arab circles for years. On 6 June, Arab oil ministers agreed to call for an embargo against the United States, Britain and West Germany. By 8 June the Arab producers had cut back production by 60 percent.⁸³

This desperate situation caused temporary panic in Whitehall. Preparations for rationing were quickly set into motion and ideas about purchasing oil from Romania or the Soviet Union seriously mooted.⁸⁴ Balogh and others advocated the securing of new supplies through bilateral deals with these Eastern Bloc states or any other oil producer willing to sell directly to the British Government. A near simultaneous outbreak of warfare in Nigeria between the Federal Government and the break-away province of Biafra knocked nearly all Nigerian production off line adding to the oil supply woes.⁸⁵ The Arab ban, although far from watertight, was still stringent enough to cause serious interruptions. Even the moderate Arab states considered “the ban to be the minimum necessary gesture of Arab solidarity as well as a safety valve for popular pressures,” and would not grant much of a reprieve to the British.⁸⁶

⁸³ Yergin also points out that the Arab producers had to deal with public opinion at home which was outraged by the Israeli attack. Numerous strikes by Arab oil workers would have disrupted supply in any case and it was therefore politically expedient to take advantage of the situation. See Yergin, *The Prize*, 537.

⁸⁴ This scenario will be discussed in further detail in Chapter 4. For a description of these preparations, see Keir Thorpe, “The Forgotten Shortage: Britain’s Handling of the 1967 Oil Embargo,” *Contemporary British History* 21, no. 2 (June 2007): 201–222; and Klantsching, “Oil, the Suez Canal, and Sterling Reserves.”

⁸⁵ For a look at the historiography of the Nigerian oil industry and its relation to the Nigerian Civil War see Ann Genova and Toyin Falola, “Oil in Nigeria: A Bibliographical Reconnaissance,” *History in Africa: A Journal of Method* 30 (September 2003): 133–156.

⁸⁶ FCO 54/71, NA, Letter to Garvey from Fearnley, 17 July, 1967.

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But unlike during the Suez Crisis of 1956-1957, Britain did not end up facing oil shortages. Thanks to a combination of increased Iranian, Venezuelan and Indonesian supplies along with the ramping up of US production, Britain and Western Europe were able to escape any serious shortages. The tremendous logistical reorganization that this required was achieved through the cooperation between the major oil companies. The anti-trust implications of this cooperation were overcome by the reinstitution of the same legislation that had governed the post-Suez oil lift of 1957 and required the Organization for Economic Cooperation and Development (OECD) to declare an oil emergency. Once this had been achieved the companies could coordinate the shipment of oil to make up for shortfalls in Europe.⁸⁷

This was seemingly a shining triumph for the oil industry and for Britain's traditional laissez-faire oil policy. The companies certainly seemed to think this; in a post-mortem of the embargo, the Shell Briefing Service wrote confidently that "the fact is that the crisis was overcome by individual oil companies acting independently, reacting flexibly to the new situation, and adjusting their normal marketing mechanisms to meet it."⁸⁸ The report went on to conclude that "If Western Europe's oil supplies had depended upon bilateral deals between governments there would have been no convenient alternatives to turn to," meaning that "A prolonged interruption of supplies, rationing, and widespread industrial dislocation would have been inevitable."⁸⁹

⁸⁷ When the Arab producers came back online Middle Eastern oil which was banned from Europe was shipped elsewhere and was replaced with non-Middle Eastern oil.

⁸⁸ POWE 63/245, National Archives, The Oil Companies and the Crisis, December, 1967.

⁸⁹ Ibid.

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The ability of Britain to weather the storm was also a testament to the relationship that had been built up between Whitehall and the companies. While their political masters might have been sent into a panic by the use of the Arab “oil weapon,” it was a contingency that the FO, MoP and Treasury had been considering for some time. During the run-up to the crisis, members of the FO and the MoP had been in contact with BP and Shell, updating them on the deteriorating situation and determining contingency plans. Both companies responded by “quietly making their own arrangements for maintaining supply” by sending “a number of tankers... on their way via the Cape.”⁹⁰ This move kept the en route supply above normal for the first few weeks of the crisis.

The lack of success of the embargo put stress on the united front of the Arab oil producers. By August, 1967 it was clear that their policy had failed and at a meeting of Arab leaders in Khartoum, Sudan, it was decided to lift the embargo. This decision, coupled with the surge in production elsewhere, actually resulted in an oil glut. Because of this, many assumed that the embargo had not only been survived by the West but had been a victory.

If this was the case, it was a Pyrrhic victory for the British.⁹¹ The Arab embargo coupled with the civil war in Nigeria had knocked out much of the world’s “sterling” oil. The oil brought in from Venezuela and the US to make up for the initial short-fall had to be paid for in dollars, thus limiting the positive foreign exchange and balance of

⁹⁰ CAB 164/542, NA, Arab Oil: Letter from Rogers to the Foreign Secretary, 2 June 1967. Added to this cooperation was the part played by the oil companies in building up reserve stocks in the UK. This will be discussed in greater detail in Chapter 2.

⁹¹ Gat describes the Six-Day War as having “disastrous consequences for Britain.” See Gat, *Britain and the Conflict in the Middle East, 1964-1967*, 241.

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payments benefits of BP and Shell's international operations to the British economy. Even after the embargo was lifted, the Suez Canal remained closed, which meant that Persian Gulf oil had to be transported around the Cape of Good Hope. This was not in and of itself a problem due to the advent of supertankers, but this route was more expensive and again cost the Treasury very valuable balance of payments credits.⁹²

The weakening of oil's benefit to the balance of payments could not have come at a more sensitive time for Britain. Already struggling with a weak economy, the Labour Government had fought hard to nurse the economy back to health. Having struggled throughout its time in power to achieve equilibrium in the balance of payments and to encourage economic growth, the government of Harold Wilson now had to face facts. The oil aspect of this issue was relatively minor but it helped push the Government to its tipping point. On 18 November, 1967, Wilson announced that Britain would devalue the pound sterling in an attempt to ease the pressure on the balance of payments and to boost exports.⁹³

This decision had major implications for BP and Shell. The two firms traded much of their oil in sterling and their investment budgets were also tabulated in the currency. The devaluation meant that the companies had to rework their long-term

⁹² Galpern estimates that Britain was forced to pay 400 percent more in shipping costs due to this shipping pattern. He goes on to state that "the nation's trade account suffered by £90 million in 1967, £45 million in 1968, and £40 million in 1969. See Steven G. Galpern, *Money, Oil, and Empire in the Middle East: Sterling and Postwar Imperialism, 1944-1971* (Cambridge University Press, 2009), 269.

⁹³ There is a rich historiography of the sterling devaluation. For a summary see M. J. Oliver, "The Management of Sterling, 1964-1967," *The English Historical Review* CXXVI, no. 520 (June 1, 2011): 582–613.

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strategies.⁹⁴ As several of the largest holders of sterling, and thus those most affected by the devaluation were the Gulf States. The governments of these states expressed their dissatisfaction with London through increasingly tough demands on the companies to compensate them for their loss. The firms could rightly argue that there was not much they could do and it was hoped that the situation would settle down after the initial shock of the devaluation wore off.

It therefore came as another shock when Wilson announced on 16 January, 1968 that all British forces would be withdrawing from their bases East of Suez by 1971. This policy shift, while not entirely unexpected, was announced with little prior consultation with the Americans, the Arabs and the oil companies. In fact, as late as November 1967, the FO had discussed in preparation for an Oil Tea Party with BP and Shell that “that Her Majesty's Government intended to maintain their presence in the Gulf for as long as was necessary for the peace and stability of the area.”⁹⁵ The oil company response to the announcement was reserved, partly due to the fact that no one knew entirely what the result of the decision would be.

Conclusion

Part of the reason that there was so little consultation with BP and Shell about the ramifications of such a withdrawal was that oil interests played only a part in the broader strategic discussions. The East of Suez decision was just as much about British forces in

⁹⁴ The adjustments that BP and Shell were forced to undergo following devaluation will be discussed in Chapter 4.

⁹⁵ FCO 54/68, NA, Oil Tea Party: Eastern Department Guidance, 18 December, 1967.

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the Far East as it was about the Persian Gulf.⁹⁶ Oil's limited significance in the decision was also made apparent by the fact that the Joint Intelligence Committee's assessment of the threats to Britain's oil interests in the Persian Gulf following withdrawal was only taken up and completed after the decision was announced.⁹⁷

But if policy-makers had had significant fears about the future of Britain's oil interests in the event of a withdrawal, it is difficult to believe that such a decision would have been made. Therefore two conclusions must be drawn from the East of Suez decision. The first was that the long process of evolution in the oil industries' operating pattern in the Middle East—and the ability of the oil companies to adapt to those changing circumstances—eased the concerns of the top decision-makers in Whitehall. Since the late 1950's, the FO and other departments had propounded the idea that the concessionary arrangements of the Middle East were bound to change due to the political and economic pressures brought to bear by nationalism and modernization in the countries of the region. While the conclusions on how to deal with this situation were not always agreed upon by the different departments or by BP and Shell, all these groups eventually came around to the idea that the status quo would not last forever. The small victories of OPEC in the 1962-1965 negotiations had emboldened its member states and the use of the oil weapon following the Six-Day War, although unsuccessful, gave all oil-

⁹⁶ Dockrill argues that the decision to withdraw from the Gulf was made after the decision to withdraw from Hong Kong and Singapore and was therefore tangential rather than central to the East of Suez decision. See Dockrill, *Britain's Retreat from East of Suez*.

⁹⁷ A copy of the report can be found in CAB 164/542, NA, The Consequences for Oil Supplies and British Oil Interests in the Middle East and North Africa of Various Forms of Instability in the Persian Gulf up to 1975, 2 July, 1968.

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watchers a foretaste of the increasing politicization of oil. The fact that Kuwait, which was under the nominal protection of Britain's military forces in the Gulf, quickly threatened and then engaged in the oil embargo against Britain showed that even a continued military presence in the region would not guarantee the continued flow of oil.⁹⁸

The second conclusion stemmed from this unhappy state of affairs. This was the idea that overt British political presence might actually precipitate a faster degradation of the position of BP and Shell than withdrawal would. Whether it liked it or not, Britain was inextricably tied to its imperial past in the region, and its cardinal sin of helping in the creation of the state of Israel. Besides this, the companies had already shown that they could, through stubborn persistence, win breathing room for themselves. The best that could be hoped for was the ability of BP and Shell as well as the other major companies, supported diplomatically by the British and American Governments, to fight a rearguard action against the OPEC states.

Therefore, by 1968, the Government's oil policy was similar to that of 1957 with a rather large caveat. Despite its attempts to improve its influence over the oil industry, the British Government was forced, at least in the Middle East, to rely even more on its companies to manage the rough waters of the changing international oil scene and to serve as its political "buffer". Whereas in 1957, the Government could offer the companies its protection, backed up with the real threat of force, by 1968 it could only

⁹⁸ While Kuwait's decision to participate in the embargo other Gulf States such as Qatar and Abu Dhabi experienced slow-downs in production due to spontaneous strikes on the part of oil workers in support of Egypt and Syria.

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offer moral support and the tools of diplomatic persuasion. The first goal of Britain's oil policy, stability of supply, was therefore firmly planted on very shaky ground.

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Oil for Britain's Benefit: Oil and Britain's Finances, 1957-1968

When the Labour Government of Harold Wilson won the closely fought general election of October, 1964, it promised wholesale changes to the country's economic strategy.¹ After excoriating the listless tenure of the Conservative Alec Douglas-Home as being amateurish and antiquated, Wilson promised a government that would modernize Britain through the “white heat” of a “scientific revolution.”² What this meant for Britain's oil policy was anyone's guess, but one thing was certain - the new Labour Government would undoubtedly be more uncomfortable with such a major fuel source being outside the purview of state control. Even those who understood that state interference in negotiations with the oil-producing states would be counter-productive still believed that there was more room for State management of the domestic sphere of oil.

But even individuals who wanted more overt Government control over the oil industry, such as Wilson's economic advisers Thomas Balogh and Nicholas Kaldor, and academics such as Peter Odell from the London School of Economics, would be left disappointed.³ While Labour did offer up policies and programs that in some ways served to deepen the State's involvement in oil affairs, Wilson's Government actually

¹ Wilson and the Labour Party were surprised by the slimness of their victory. Alec Douglas-Home had put up a surprisingly spirited performance in his final months as prime minister and Labour returned to power with a majority of just five seats.

² These phrases come from a speech delivered by Wilson to the Labour Party Conference on 1 October, 1963.

³ For a description of Balogh's views, and an account of his battles with Whitehall civil servants, see June Morris, *The Life and Times of Thomas Balogh: A Macaw Among Mandarins* (Sussex Academic Press, 2007).

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followed more closely to the policy trajectory set by the Conservatives than many would have deemed likely. Just as in the Middle East, Britain's oil policy at home and in other parts of the world centered on the fundamental balance between a state-dominated and a liberal approach to the oil supply. The twin goals of a financially beneficial and stable supply were as influenced by this tension outside of the Middle East as they had been in the debates over relations with OPEC and the shifting oil production patterns of the region. But unlike in the Middle East, the question at hand in oil production elsewhere was not about the relations between BP and Shell and other governments as much as it was about striking the right balance in the partnership between the two oil companies and the British government itself.

During the negotiations with the oil producers of the Middle East, BP and Shell had been confident that the governments of the region would not push the oil industry too far in fear of killing the goose that laid the golden eggs. The same principle applied in the relationship between Her Majesty's Government and the firms inside Britain. The goals of financial benefit and stability dictated a careful strategy on the part of the civil servants responsible for running Britain's oil policy. Pushing the oil companies too far in terms of financial controls and taxation could end up harming both aspects of the oil policy.

In 1962 the Ministry of Power (MoP) addressed the dilemma of crafting an oil policy that both supported the companies abroad but also brought in sufficient economic

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benefit at home in a long memorandum entitled “Oil in the Nineteen Sixties.” It stated that:

It is not always easy to strike the right balance between our varied interests as an international oil supplier and our, sometimes, conflicting interests as both a supplier and consumer. As a supplier, with our companies operating in practically every country in the Free World, we have a strong incentive to uphold the freedom of the oil industry to conduct its business in what it considers to be its own economic interests. Yet we are unable to disregard the effects that complete freedom of action might have on our own economy either directly, e.g. in relation to the U.K. coal industry or indirectly, e.g. in relation to the political stability of the Middle East. Nor is freedom, in the sense of unbridled competition, necessarily in our best interests as the effects of current world market conditions on the profits of British companies have shown.

The alternative, however, is likely to be governmental intervention of one kind or another. To some extent this is inevitable: governments are unlikely to leave the exploitation and disposal of oil entirely in the hands of private concerns when it is forming an increasingly vital part either of their national revenues or of their energy supplies. To some extent also it may be beneficial, e.g. in limiting the inroads of Russian oil. But undue government intervention can be positively harmful: at the national level it can fragment an industry that can only operate successfully internationally; at the international level it could remove control from the industry entirely.⁴

The report concluded that, “It is unlikely, for these reasons, whether H.M.G. can ever adopt and enforce an oil policy that is consistent in all respects and that will remain valid for a long period.”⁵

This tension over whether Government intervention was fundamentally a good or bad thing was a clear one to the oil companies themselves. The tightening of profit margins brought about by the dual trend of decreasing prices due to oversupply, coupled with increasing demands for greater revenue from the producing states, was not

⁴ POWE 61/271, NA, Oil in the Nineteen Sixties, 14 June, 1962.

⁵ Ibid.

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conducive to any cooperation on the firm's part with the Government's desire to increase its influence over their activities. These diverging views were stressful to the relationship between the firms and the Government, particularly during the governments of the Labour Party. The Treasury made this clear to James Callaghan when he assumed the role of Chancellor of the Exchequer in 1964 with a plan to increase the tax contribution made by BP and Shell. Writing on the relationship between BP and the British State, Treasury officials noted, "In spite of the relatively favourable financial returns shown by B.P. in recent years, the Group (in common with other oil companies) is at present being squeezed from two directions. On the one side the oil producing countries... have been pressing not only for the maintenance of crude oil prices but also for additional revenues... On the other hand many consuming countries are demanding reductions in the price at which crude oil is invoiced and intense competition is forcing down the price of oil products."⁶

But in any relationship as large and complex as that between BP, Shell and the British Government, trends very seldom move in any easily definable and linear fashion. It is thus important to work thematically as well as chronologically to show the evolution of attitudes regarding oil policy during this era. The next two chapters will therefore focus on the steps taken within the domestic oil sphere in order to shore up the two halves of Britain's oil policy.

This chapter will look at the approach taken to render the trade of oil as financially beneficial as possible to the British economy, an endeavor for which the

⁶ T 317/716, NA, British Petroleum Company Limited, 8 December, 1964.

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Government had several formidable tools. With BP, the Government had the advantage of its over 50 percent ownership of the firm. The agreement which had originally created the Government shareholding stipulated the placing of two Government-appointed directors on BP's board as well as an implied power of veto over decisions taken by the board. Whitehall's influence over Shell was not as formal but was still significant. The Shell-Treasury Agreement, signed in 1946, had registered Royal Dutch Shell as a British-based firm for the interest of foreign exchange.⁷ This meant that the Treasury could monitor the incomes and expenses of the entire Shell Group.

These avenues of influence came with drawbacks but formed the foundation of the relationship between the Government and the two firms in the domestic oil sphere. How these tools were used, however, varied from Government to Government. The Conservative Governments of Harold Macmillan and Alec Douglas-Home tread lightly in their attempts to control the activities of BP and Shell in the domestic oil market and in other areas outside the Middle East, but they did exert increasing control over the investment policies of the two companies. While BP and Shell found this annoying, the program of the Labour Party was even more irritating. The Government of Harold Wilson brought with it many ideas about using central planning to reshape the British economy, ideas that the two firms found threatening.⁸ And while the worst of their fears

⁷ For an excellent look at the condition of the Royal-Dutch Shell Group at the end of the Second World War, see volume three of Stephen Howarth et al., *The History of Royal Dutch Shell* (Oxford University Press, 2007).

⁸ For analysis of Wilson's views on planning see James E. Cronin, "Labour's 'National Plan': Inheritances, Practice, Legacies," *European Legacy* 6, no. 2 (April 2001): 215–232; and Noel Thompson, "The Fabian Political Economy of Harold Wilson," in *The Labour Governments: 1964-1970*, ed. Peter Dorey. (Routledge, 2006).

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never came to fruition, relations between the oil industry and the Labour Party degenerated over time.

Thus by the end of this chapter, in 1968, both sides were left looking for ways to remake the relationship of the oil industry and the Government. In an increasingly competitive, dangerous and unstable international oil market, the firms believed that they were beginning to be undercut by their own Government. That Government, however, began to wonder openly whether the traditional structure of the international oil industry was as beneficial to Britain's balance of payments as had long been assumed. These disagreements would pave the way for a worsening of the relationship at precisely the moment when the balance of power in the Middle East began to turn decisively against the interests of the international oil companies, and by extension, their parent governments.

A Repertoire of Influence

Whitehall's ability to expand its financial take from the oil industry stemmed from its repertoire of influence that it maintained in its relationships with BP and Shell. The fundamentals underlying these two relationships were very different, but in practical effect the British Government held a similar amount of sway over the decision-making of the two companies, with the Foreign Office (FO) writing in 1967 that "Her Majesty's Government's relations and contacts, formal and informal, with B.P. are in essence the

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same as those with Shell.”⁹ In both cases, the Government was hesitant to push its rights too far for fear of undermining the two firms as commercial operators.

The formal relationships were, however, still important in that they dictated how far government officials felt entitled to interfere, direct or cajole the companies. The differences were also vital in how the companies were perceived outside of the UK. This was especially true of BP. The British Government had owned around 51 percent of the firm’s stock since Winston Churchill organized the purchase of the shares in 1914 to secure a long-term supply of oil for the British Navy.¹⁰ This original purchase agreement had stipulated the presence of two government-appointed directors on BP’s board who would maintain veto power over any company decision deemed to be against the interest of the British Government.¹¹ This intrusive power had never been exercised but remained a sore point in the relationship between BP and the British Government for decades. The British Government continually asserted that the so-called Bradbury Letter of 1914, which had laid out the terms of the agreement between HMG and BP’s forebear the Anglo-Persian Oil Company, and the Bridges Letter of 1951 which reaffirmed the original terms of that relationship, did not allow the government officials to interfere in

⁹ FCO 54/78, NA, The British Interest in Oil, August, 1967.

¹⁰ These shares were held by the Treasury. Along with purchasing this share, the Government also encouraged the British firm the Burmah Oil Company to purchase a further 25 percent of the company’s stock. For further discussion of this period see Ronald W. Ferrier, *The History of the British Petroleum Company, Vol. 1: The Developing Years, 1901-1932* (Cambridge University Press, 1982); and Geoffrey Jones, *The State and the Emergence of the British Oil Industry* (Macmillan, University of London, 1981).

¹¹ These government-appointed directors were chosen by the Treasury with the FO being given the right of refusal on any nominee.

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the day-to-day operations of BP or to influence any commercial decision-making.¹²

Despite this, numerous BP officials complained that being a semi-publicly owned corporation hurt morale amongst the top executives at the Company who constantly felt under the watchful gaze of the State.¹³

Not everyone within the British Government was happy with this arrangement either. The FO in particular felt that the 51 percent shareholding served no real purpose. The Bradbury and Bridges letters proscribed any active intervention in the affairs of the company and the veto power of the Government directors had never been exercised. Whitehall exercised as much oversight on BP as it did Shell, of which HMG owned nothing, through their regular meetings. On top of this, the FO felt that the Government shareholding actually hurt BP's competitive chances abroad as many countries, most importantly Venezuela, would not allow entities owned by foreign governments to operate inside their borders.¹⁴ The FO also feared that Government shareholding could be used as an excuse for the Middle Eastern states to take an adversarial approach to their relations with BP, pegging the Company as a tool of "imperialism." The Treasury noted these feelings by commenting that the FO "have emphasized in particular the adverse

¹² BP kept a close record of all the instances that the Government made this assertion publicly. They can be seen in BP 27356, BP, British Government Policy of Non-Interference in the Commercial Management of The British Petroleum Company Limited, 1965. The original Bradbury and Bridges letters were circulated continuously during any discussion of the BP-Government relationship; a good example of this can be seen in PREM 13/367, NA, British Petroleum, 11 June, 1965.

¹³ These feelings were especially pronounced during the periods when a new chairman for BP was being selected. The Government expressed reservations about both Maurice Bridgeman in 1960 and Eric Drake in 1968. The Labour Government actually considered outside candidates in 1968 before succumbing to the Ministry of Power's argument that such a move would be devastating to the staff of BP. See FCO 54/80, NA, Memo from Denis Allen, 11 January, 1968.

¹⁴ Other countries such as Pakistan banned operation by government-owned entities in their markets thus excluding BP from sales there.

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effect on B.P.'s operation abroad of the nominal Government control which has resulted in B.P. being regarded as a tool of H.M. Government.” They went on to add that, “Foreign Governments have tended to be suspicious of the activities of a company controlled by the British Government and the company has been widely regarded as a cat's-paw of the Government.”¹⁵

While they acknowledged the FO's concern, the Treasury and particularly the MoP both felt that holding on to the Government's share of BP was in the national interest. The attitude about exactly how large this share should be, and what it meant to the relationship between the Government and BP, however, changed over time with the shift from a Conservative to a Labour Government in 1964. Under the Macmillan Government, the emphasis on non-interference was pushed more strongly. In 1960, brief consideration was even given to selling the Treasury's share completely and allowing BP to become a fully private company. Maurice Bridgeman, the new chairman at the time, welcomed the idea in theory but recognized that “an attempt to sell the whole of the Government shareholding would almost certainly not be practical politics and might lead to a substantial American holding in the Company (which no-one would want to see).”¹⁶ But what was agreed, even by the Treasury, was that the Government could settle for something around 40 percent ownership.¹⁷ This process could be achieved by the Government not fully taking up its rights during stock offerings or during mergers and

¹⁵ T 317/710, NA, B.P. Government Shareholding, 27 July, 1965.

¹⁶ FO 371/150058, NA, BP: Record of Conversation, 4 May, 1960.

¹⁷ Bridgeman also agreed that this would be desirable with the caveat that HMG would give up its veto power.

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acquisitions. This seemed to be close to taking place when, in 1963, BP and Shell briefly sought a joint take-over of the Burmah Oil Company, the oldest but most frail of the British oil companies, in a move that would have reduced the Treasury's stockholding to 46 percent.¹⁸

This plan eventually fell through, however, and as the Conservative Party gave way to Harold Wilson's Labour Party in 1964, the Treasury still owned roughly 51 percent of BP's shares and the official relationship between BP and the British Government continued to be rather ill-defined. This set of circumstances did not suit the Labour Government which was focused on renewing the economy through a greater emphasis on centralized planning. Having a major source of energy under the control of private industry was difficult enough for Labour's planners – even more unpalatable was to have one that technically belonged to the State, but over which the State exercised no control.¹⁹ Upon entering office, the new Foreign Secretary Patrick Gordon Walker, who was soon followed in office by Michael Stewart, sought to clarify the relationship by seeking to strengthen the role of the Government Directors on BP's board.²⁰ To the Labour Party, the old system whereby the Government Directors did not report formally

¹⁸ The potential for this move thrilled the Foreign Office as it would have reduced the perception that HMG was controlling BP's actions while simultaneously putting BP and Shell into a stronger position in both India and Pakistan. See FO 371/172521, NA, Burmah Oil Company, 28 January, 1963. The deal ultimately fell through, however, and Burmah continued to exist as an independent company.

¹⁹ The other main sources of energy in the United Kingdom, coal, gas and nuclear were all nationalized industries.

²⁰ Patrick Gordon Walker was defeated in a surprise result in the 1964 election but was given the post of Foreign Secretary anyway. This position was untenable after he was later defeated in January, 1965 during a bi-election.

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to the Government was utterly useless. Instead, the idea was floated that the Government Directors should become the eyes and ears of HMG in BP's boardroom.

The civil servants in the Treasury, MoP and FO who had developed close ties with BP were horrified at the suggestion. The departments countered the Minister with the argument that "Our contacts with the Government Directors are second in importance to our contacts with the Chairman, the real source of power in the Company," and that "There is a danger that written reports by the Government Directors might tend to undermine our contacts with the Chairman, who might, under the new arrangements, expect us to look to the Government Directors for anything that we wanted to know rather than to him."²¹ Added to this was the sentiment that it would damage morale on the board to know that nothing they spoke about was confidential and that such outright interference would also damage the Company's reputation abroad.

This defense of the oil companies by the career civil servants is not surprising given that the relationships built up between the firms and the mandarins of Whitehall lasted over years and witnessed the comings and goings of many ministers.²² In regards to the role of Government Directors, the civil servants succeeded in dissuading the ministers from making any changes to the arrangements. In fact, the civil servants were successful in many ways in bringing the Labour ministers into line with the institutional relationship long maintained with the oil companies. This in turn opened divisions

²¹ T 317/709, NA, British Petroleum: Written Reports by Government Directors, 11 May, 1965.

²² There was also a certain amount of cross-pollination between the two sides. Several members of the civil service left their posts to take up positions with BP. Chief amongst these were the FO's Robert Belgrave and Sir Denis Greenhill. Sir Maurice Bridgeman himself had served in the civil service during the Second World War.

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between the Cabinet and the more radical members of the Labour Party and created a dynamic tension between the civil service and the political advisers serving the Cabinet such as Thomas Balogh and Michael Posner.²³

Shell's relationship with Whitehall was not quite as angst-filled as that of BP. It was not, however, free of all complications. To begin with, "Shell" was really a term that loosely defined what was a complicated organization of companies and subsidiaries, based in two countries and whose operations spanned the globe.²⁴ The Shell Group was officially known as Royal Dutch-Shell and was 60 percent Dutch-owned and 40 percent British-owned.²⁵ This seems, therefore, to indicate that the Group should have been more greatly influenced by the Dutch government and indeed the Managing Director of Shell, John Loudon was a Dutchman based in The Hague.²⁶ But the relationship between Shell and the British Government was formalized and increased in importance in 1946 by the signing of the Shell-Treasury Agreement. This agreement gave Shell access to the vital foreign exchange that it needed to help rebuild its world-wide production in the wake of the destruction of the Second World War. The Netherlands, itself recovering from conquest and occupation, could not process the large quantities of foreign currency Shell needed to operate around the world. In exchange for access to the Bank of England and

²³ Wilson had made it a major goal of his Government to remake the machinery of Whitehall. This included bringing in outside specialists like Balogh, Kaldor and Posner whose views could shake up the traditional lines taken by the civil service. See Andrew Blick, "Harold Wilson, Labour and the Machinery of Government," *Contemporary British History* 20, no. 3 (September 2006): 343–362.

²⁴ It could even be argued that the Shell Group was based in three countries since Shell Oil, the American subsidiary of the Group, operated semi-independently from within the United States.

²⁵ To complicate matters even more, Royal-Dutch was internationally traded, meaning that many of its shareholders were not Dutch.

²⁶ The rather complex nature of the group is thoroughly examined in volume three of Howarth et al., *The History of Royal Dutch Shell*.

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the Treasury's ability to exchange currencies and process international payments, Shell agreed to base its foreign earnings in the United Kingdom. This benefitted Britain by bringing in important foreign currencies, none more important than US dollars that could be held and used as foreign reserves.²⁷

The balance of benefit to this relationship initially lay with Shell as they desperately required the financial services provided by the Bank of England. Shell acknowledged as much in 1963 in a letter sent to William Armstrong, the Permanent Secretary of the Treasury, which noted that the Agreement had "enabled the Group first to carry out the task of post-war reconstruction, and then to move on to building up the Group to its present position of strength in the international oil business."²⁸ But as the post-war recovery accelerated, the balance quickly shifted. This tension between Shell's benefit versus the detriment of being required to return all foreign earnings to London was a constant force in Shell's relationship with the British Government. The agreement was revised in 1955 to give either side the right to abrogate the contract at six months' notice.

This ability for Shell to end the Treasury Agreement and to remove their massive reserves from London gave the company strong leverage in the relationship with the British State. Added to this was the fact that Shell was not as beholden to Middle East oil as BP and thus not as reliant on British political protection. Shell's primary holdings

²⁷ Shell's official history estimates that during its first seven years the Shell-Treasury Agreement "had cost Britain the equivalent of £487 million in dollars, but had generated £510 million in various currencies, including dollars." See Stephen Howarth and Joost Jonker, *The History of Royal Dutch Shell*, vol. 2, (Oxford University Press, 2007), 96.

²⁸ T 317/372, NA, Letter Raeburn to Armstrong, 18 June, 1963.

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were in Venezuela, Indonesia and the United States, all areas where British political influence was an important but not decisive force. One exception to this was Shell's holdings in Nigeria where the Company did rely on British diplomatic support. But despite this strong position, it was doubtful whether Shell would be willing to end the Agreement since the Netherlands would still be unable to handle the massive currency exchanges required by Shell in the 1960's. Thus British civil servants questioned "whether Shell would wish to terminate the agreement except under very considerable provocation, although they might be ready to put forward the idea of bringing the agreement to an end as a bargaining counter."²⁹

Regardless of the differences between the two relationships, the Whitehall sought to increase its influence over both BP and Shell over the course of the 1960's. The switch to the Labour Government quickened this process and brought the traditional British oil policy of allowing the two oil companies, along with the other internationals, to manage the flow and sale of oil under increasing scrutiny. The Labour Party's emphasis on centralized regulation and planning was in sharp tension with the need to rely on private firms to manage the fastest growing source of fuel and energy for the British economy.³⁰ Because of this, the British State in the mid 1960's wanted to rein in the oil companies and to channel their efforts into areas most beneficial to Britain's economy.

²⁹ T 317/372, NA, Shell/Treasury Agreement, 13 August, 1963.

³⁰ In 1956, coal accounted for 84.9 percent of primary fuel consumption in Britain compared to 14.6 percent for oil. In 1966, however, these numbers were 58.7 percent for coal and 37.5 percent for oil. See FCO 54/66, NA, Fuel Policy, 1967.

Oil for Britain's Benefit

The need to maximize the oil companies' benefit to the British economy in 1964 was not a new phenomenon, however. The Conservative Governments of Harold Macmillan and Alec Douglas-Home also sought to manage the activities of BP and Shell in such a way as to limit any drain and to accentuate the gains brought by the operations of the two firms. Prior to 1965, tax income from the companies was of limited importance due to provisions that allowed the firms to avoid double-taxation.³¹ The true benefit which BP and Shell brought to the economy came in the realm of the balance of payments and in foreign exchange.³² As one historian noted, "Not only did the profits of the companies help increase Britain's invisible earnings, but by virtue of the fact that they were treated as British residents, their operations also protected and bolstered the visible side of the nation's current account, simultaneously saving and earning foreign exchange for Britain's reserves."³³ This was certainly the case in the glory days of the oil industry from the 1920's until the early 1950's, but by the 1960's with the founding of OPEC and

³¹ This meant that the firms could discount the taxes paid on their operations in the Middle East and elsewhere. Since taxes in these regions were higher than those in Britain, this effectively meant that BP and Shell were able to write off their entire UK tax burden.

³² Middleton provides an excellent definition for the concept of "balance of payments," writing that it is "a tabulation of the credit and debit transaction of a country with other countries and international institutions during a specified period, with strict accounting rules the balance on the current account and capital account summing to zero, but in practice requiring a balancing item as balance of payments statistics are notoriously incomplete." See Roger Middleton, *The British Economy Since 1945: Engaging with the Debate* (St. Martin's Press, 2000), 139.

³³ Steven G. Galpern, *Money, Oil, and Empire in the Middle East: Sterling and Postwar Imperialism, 1944-1971* (Cambridge University Press, 2009), 7.

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the breaching of the 50/50 principle, the balance of payments and foreign exchange benefits became more tenuous.

It was generally accepted that having two of the major world oil companies domiciled in the UK was beneficial to the nation's balance of payments. Just how beneficial it was, however, was a subject of debate. There were many ways to calculate oil's impact on Britain's economy. In terms of BP and Shell's operations, there was the simple matter of the oil being brought to the UK and sold there, but a portion of that oil was also re-exported as refined product, offsetting some of the cost. On top of that, as international concerns BP and Shell remitted profits made in other countries back to London, further offsetting the cost of oil. Making the matter even more opaque were the benefits to the balance of payments that accrued from the purchase of equipment and materiel from Britain by BP and Shell's subsidiaries abroad. A complicating factor in all of this was the fact that oil's role in the balance of payments had traditionally been withheld from public knowledge, instead being lumped along with much else in the "Miscellaneous" category of the published balance of payments record. Thus it was possible to come up with a host of different numbers regarding the benefit, or cost, of BP and Shell's operations to the balance of payments.

This was not problematic during the boom times for the oil industry. But as the market suffered a glut beginning around 1958-1959, prices were depressed and profitability declined.

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By the early 1960's, during a time of general balance of payments difficulties, calls for the publication of the true balance of payments figures became louder as concern over the amount of oil investment versus the return gained grew in importance. By 1961, members of Parliament as well as members of the press began to make inquiries into why the Government refused to publish the data. In reality, the reasons were fairly simple. First and foremost, compiling the data into an easily digestible and publishable form was statistically difficult. Secondly, BP and Shell were fearful that the raw numbers would give the impression to the oil-producing states that the companies' oil operations were more profitable than they actually were. Shell wrote with concern that "it seems to us possible that the supplementary information you would now like to publish concerning foreign exchange earnings (as distinct from "profits") may provide our detractors with additional ammunition with which to assault our position."³⁴ But, as one Treasury official noted, there was "a risk that the longer we put off the disclosure of figures the more would be the suspicion that we had something to hide."³⁵

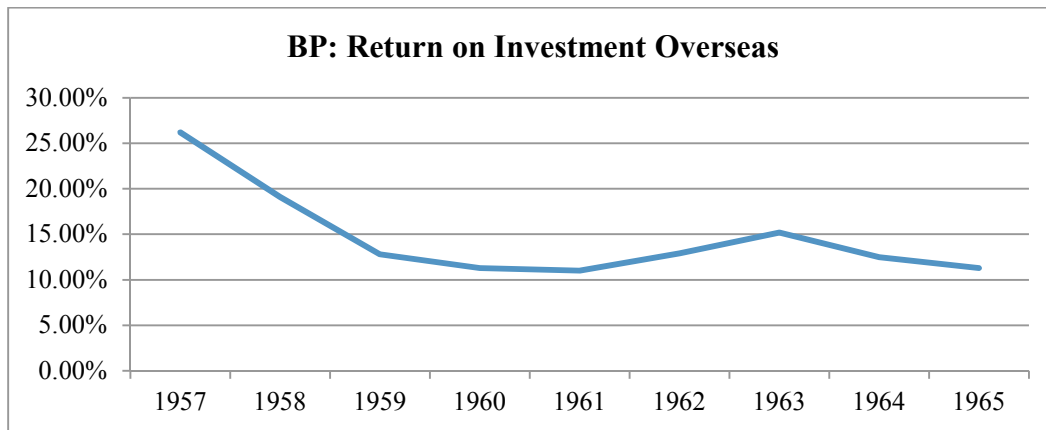
These concerns were suppressed as the Conservative Government listened to BP and Shell's arguments for delaying the release of the oil statistics. Part of the reason for this decision was that government officials had decided to tackle the problem of investment abroad differently, and in a way which was to cause deep unhappiness in the boardrooms of BP and Shell. The policy pursued beginning in 1961 was to request that BP and Shell restrict their foreign investment in order to save foreign exchange and limit

³⁴ T 317/134, NA, Letter from Shell to Treasury, 22 September, 1961.

³⁵ T 317/134, NA, Publication of Oil Statistics, 12 October, 1961.

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the current account deficit for the balance of payments.³⁶ This was obviously a short-term strategy as limiting investment cut into future returns. The Treasury weighed this concern against numbers which indicated that BP and Shell's return on investment was already declining and were thus already accounting for a smaller benefit to the balance of payments. The Treasury therefore argued that its foreign exchange could be put to better use elsewhere. Officials also argued that although inconvenient, this policy would not be too onerous to the companies. This was because officials felt that both companies could offset some of the loss of investment currency by borrowing from international lenders, a move that would have the added benefit of including more parties who would be invested in the long-term success of the British oil industry.



Source: T 317/863, NA, Comments on Past and Future Profitability, 7 September, 1966.

This strategy initially met little resistance from the firms since the oil glut which permeated the market restricted the need to invest heavily in new field development.

They therefore had already planned to decrease their investment programs in 1962. The

³⁶ This was part of a broader policy which placed restrictions on all foreign investment unless it met a "quick return" criteria. The oil companies won an exemption from this plan on the condition that they voluntarily scale back investment where possible.

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Treasury was content with this state of affairs at first, claiming that to force more stringent cuts on the firms would “run the risk of damaging the profitability of the companies' operations in a way which would be harmful to our own balance of payments interests.”³⁷

But as the current accounts deficits in the balance of payments continued to increase in 1962 and 1963, the Treasury was forced to take a more forceful approach with the companies. The Treasury proposed that the voluntary restrictions on oil company investment be replaced with a harder cap whereby 30 percent of outlays be paid for through local borrowing. This proposal elicited a furious response from the companies, Shell in particular. Shell had been a net foreign exchange earner for the Treasury and business had been going well enough that the retained earnings kept by the company with the Treasury as part of the Shell-Treasury Agreement vastly exceeded the £400 million that the Agreement was set up to handle. Of that excess, over £250 million technically belonged to *Bataafse Petroleum Maatschappij*, the Dutch operating aspect of the company. In an aide-memoire to the Treasury, Shell argued that, “Acceptance of the Treasury's proposal would leave the Group with the problem of explaining to the shareholders of Royal Dutch and "Shell" Transport why the investments of some of the Group's most important companies outside the U.K. should be restricted by the need to keep their funds in sterling, at a time when the Group's competitors are free to invest as they like.”³⁸ Shell instead countered that they be allowed to hold much of the surplus

³⁷ T 317/315, NA, Letter Milner-Barry to Rickett, 27 February, 1962.

³⁸ T 317/372, NA, The Treasury Agreement, 18 June, 1963.

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sitting with the Treasury in foreign currency and to use that for investment in lieu of buying official exchange. This proposal was equally unacceptable to the Government because it would have weakened Britain's foreign reserves. Compromise was reached when the Treasury and Bank of England agreed to "authorise the provision of official exchange for financing investment in the non-sterling area by the Shell Group... provided that the amount of official exchange so authorized in any one calendar year shall not exceed the net additions in that year to the balances deposited with Shell Petroleum by *Bataafse* and its subsidiaries."³⁹ In the end, however, even this compromise gave way to a simple continuation of voluntary restrictions on investment, which the companies attempted to fulfill in ways not harmful to the maintenance of their market share.

New Government, New Relations

The continual balance of payments difficulties became a major theme in the run-up to the 1964 election. The Labour Party presented a different vision for the British economy that would focus more on domestic production and exports, which they believed would help to break the "Stop-Go" cycle and end the perennial problems with the balance of payments. Writing in his short work *The new Britain*, Labour Party leader Harold Wilson laid out his vision by stating,

The one lesson of the past few years is that you won't make sterling strong by making the economy weak. We condemn attempts to solve our export-import problem by holding production down below the level of our industrial capacity. The key to a strong pound lies not in Britain's

³⁹ T 317/372, NA, Shell's Overseas Investment, 9 September, 1963.

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finances but in the nation's industry. Finance must be the index not the determinant of economic strength.⁴⁰

To do this, the Labour Government sought to take steps to further limit foreign investment so as to encourage investment in domestic industry. This obviously did not fit well with the priorities of BP and Shell.

This set the two sides on a collision course which was only further exacerbated by a plan by the new Chancellor, James Callaghan, to reform the tax code for corporations. The combined effect of further investment cutbacks along with the new tax frustrated the oil firms and provoked a good deal of pushback against the ideas. First, on foreign investment, both companies argued that cutbacks would hit their independent projects unequally hard. Throughout the Middle East, BP and Shell's concessions were held by joint operating companies (i.e. the Iraq Petroleum Company, the Kuwait Oil Company, the Iranian Consortium, etc). This meant that the investment projects for these companies were decided jointly with the other owners and could therefore not be guaranteed to meet the investment cutbacks demanded by the Treasury. As a result, any cutbacks would impact other areas where BP and Shell acted independently, such as oil concessions in Nigeria or Alaska, but also in refinery construction and upgrades throughout the world.⁴¹ These cutbacks held the potential to damage the firms' market share in important retail areas. BP for one argued to the Treasury that the limits "had forced B.P. to cut out projects which they would otherwise have undertaken and as a

⁴⁰ Harold Wilson, *The New Britain: Labour's Plan: Selected Speeches 1964* / (Penguin Books, 1964). Quoted in Alain Beltran, *A Comparative History of National Oil Companies* (Peter Lang, 2010), 179.

⁴¹ BP in fact cancelled a refinery construction project outside Turin, Italy as a result of this policy.

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result B.P. were in danger of "losing out" to their competitors in many overseas markets."⁴² In 1965 Maurice Bridgeman argued in a letter to George Brown, the minister for the Department of Economic Affairs, "that two of our most significant contributions in the past have arisen from exploration and research, neither of which could be justified in future if quick and substantial returns are to be the only yardstick to be applied."⁴³

The 1965 Finance Act and the new corporation tax that it created had the potential to do similar harm to the companies' investment strategies. This is because the new tax would have allowed both corporations to claim tax relief on taxes paid overseas but crucially would also tax the dividend payments made to shareholders. Such a step would make BP and Shell's shares less attractive to investors and would limit, the companies argued, their ability to raise new capital by rights issues. Should they increase the dividend payments to make up the difference, they would be transferring money from retained earnings which were used for future investment, thereby undercutting future profits.

All of this came at a time when the Government had pressed the firms to meet some of their cash requirements with increased borrowing abroad. Both firms had taken major loans in Switzerland and Germany as well as in the United States at the Treasury's request and were now being expected both to lose access to more of their retained earnings and to pay higher taxes. Bridgeman argued in a letter to the Treasury that "B.P.'s borrowing was now getting unduly high in relation to its capital. The only way in

⁴² T 317/863, NA, Shell and BP Investment Programme, 6 September, 1966.

⁴³ BP 51999, BP, Letter Bridgeman to George Brown, 27 April, 1965.

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which overseas borrowing could be increased would be by short term borrowing at rates which might be prohibitive.” The BP chairman thought “that B.P. was being penalised in 1966 because of an exceptionally good overseas borrowing record in 1965.” He added that “B.P. could not continue to earn large profits overseas if they were not allowed to plough back a large part of such profits.”⁴⁴ Nevertheless, the Government was convinced that BP and Shell could make even more serious contributions towards improving the nation’s balance of payments difficulties. An official paper on this topic stated hopefully that “B.P. and Shell are now very much alive to the significance of their operations to our payments position,” and MoP and Treasury officials pushed even further into the business dealings of the two firms, plus their international counterparts doing business in the UK to encourage them in directions beneficial to Britain.⁴⁵

The combination of tax changes and investment restrictions caused a deterioration of the relationship between the politicians of the Labour Party and BP and Shell. But the fallout from these struggles also reveals an important aspect of the relationship between the two sides. Despite the ideological differences between the Wilson Government and BP and Shell, the Cabinet was still at its heart pragmatic. The complaints of the two companies regarding the corporation tax and the investment limitations were taken seriously, in large part because the companies’ allies in Whitehall continued to present their ministers with the oil industry’s case. In an attempt to address the companies’ concerns, Callaghan even acquiesced to a program of transitional relief for the new

⁴⁴ T 317/710, NA, B.P.: Overseas Investment, 13 October, 1965.

⁴⁵ T 317/1151, NA, Possible Savings on the Oil Balance of Payments, 5 August, 1966.

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corporation tax. This meant that the full impact of the new tax would not be felt by the companies for several years.⁴⁶

This pragmatism is not surprising as Wilson's Government were more preoccupied with the short-term difficulties of staving off balance of payments crises, tamping down inflation and battling to save the pound from devaluation than with any prospective battle for control over the oil industry.⁴⁷ While difficult to quantify, the benefits brought to the balance of payments by the operations of BP and Shell were appreciated as were the investments being made in Britain by other, mainly American oil companies. Therefore whatever their personal feelings about the oil industry, Wilson's Government settled into a policy groove which saw them attempt to increase the state's take slowly without pushing the companies' too far, too fast.

But the Labour Government did not and indeed could not adhere completely to the oil companies' whims. This was because many within the Labour Party wanted to see the companies brought to heel in one way or another. When Bridgeman brought his complaints about the corporation tax to the press in 1965, there were outraged calls from

⁴⁶ The transitional relief was planned to last for three years, from 1966-1968 and would continue at a diminished amount until 1972. As it turned out, the Heath Government extended the transitional relief in 1972 for a further five years. See J. H Bamberg, *British Petroleum and Global Oil, 1950-1975: The Challenge of Nationalism* (Cambridge University Press, 2000), 311.

⁴⁷ Many officials felt that the pound should have been devalued in 1964 when Labour came into office. This would have lessened inflationary pressures and would have allowed the Government to pursue a more robust spending program on the economic and social services on which it had campaigned. But the fear that this would be politically dangerous, as the last devaluation in 1949 had occurred under the previous Labour Government, forced Wilson and his Chancellor, James Callaghan, to hold back. Thomas Balogh, one of Wilson's main economic advisors, feared that devaluation would simply result in increased wage demands and thus spiraling inflation. He wrote, "Devaluation is inevitable in the long run. What I was opposed to was a devaluation (or floating) without some assurance that we would obtain a pledge from the Unions – with due social policy packages, pensions, progressive tax and all – to be restrained in their wage demands to correspond with the increase in production. Quoted in Morris, *The Life and Times of Thomas Balogh*, 107.

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the Labour back bench for the Government to use its position as the chief stockholder of the company to censure the chairman. There was also a strain of anti-oil company thinking present amongst some of the Government's chief economic advisors. Thomas Balogh and Nicholas Kaldor, sometimes known semi-pejoratively as "the Hungarians," both made arguments over the life of the Government that state-to-state transactions could be a beneficial way to break the stranglehold of the companies over the oil industry. They especially felt that the purchase of Soviet oil would have the dual benefit of lessening oil company power and showing the OPEC states that alternate sources existed for the West.⁴⁸ Kaldor was also responsible for the crafting of the 1965 Finance Act, another achievement that did not endear him to the oil companies.

Relations between the civil servants and the companies, however, were better as many top officials defended the interests of the oil industry to their ministers. For instance, Treasury and MoP officials sought to make the process of submitting investment programs less onerous on both companies in order to give them the maximum leeway in how they chose to invest their approved foreign exchange.⁴⁹ Harold Wilson for one noticed this trend, writing in his memoir that he believed there was an "excessively

⁴⁸ Balogh would press this argument especially forcefully during the oil crisis following the Six-Day War in June, 1967. His arguments and the Government's chaotic response to the crisis are laid out very well by Thorpe. See Keir Thorpe, "The Forgotten Shortage: Britain's Handling of the 1967 Oil Embargo," *Contemporary British History* 21, no. 2 (June 2007): 201–222.

⁴⁹ In exchange for regular submissions of annual programs, individual requests for exchange were dispensed with. This agreement was referred to by Shell, BP and the Treasury as the "concordat" in recognition of the fact that it was a major step towards improving relations between the two sides. See T 317/1316, NA, Overseas investment by UK oil companies [British Petroleum and Shell]: future policy on individual exchange control applications, 1 January, 1966 – 31 December, 1969.

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oil-oriented prejudice” in the MoP and that “It had been thus, to my knowledge, for over a quarter of a century.”⁵⁰

Oil vs. Coal

Part of the reason that this rankled the leaders of the Labour Party was the long-term relationship that the Party had with one of its major constituencies, the coal industry. Oil had been a major contributor to the decline of British coal mining. It was actually a coal shortage in the immediate post-World War II years which had allowed oil to gain a foothold in the energy market in Britain and cheap fuel oil had progressively replaced coal in many industries, decreasing demand and thereby pressuring the profitability of marginal coal pits.⁵¹ Furthermore, the oil glut of the late 1950's and early 1960's had lowered the cost of fuel oil further, straining the profitability of the entire nationalized coal industry. This was not just a problem for the Labour Party, however. Even the Conservative Government had sought ways to boost the coal industry in the face of oil's increased prevalence. In 1961 the Macmillan Government had placed a 2d. per gallon tax on imported fuel oil which at the time was calculated to have saved the National Coal Board (NCB) £20 million per year.⁵² On top of this, the Conservative Government had

⁵⁰ Harold Wilson, *The Labour Government, 1964-1970: A Personal Record* (Weidenfeld and Nicolson, 1971), 522.

⁵¹ One report estimated that from 1956 to 1966 the percentage of Britain's energy being provided by coal dropped from 85 to 60 percent. See CAB 168/270, NA, Foreign Office to Washington: Telno 3516, 16 November, 1967.

⁵² The companies were unhappy about this tax. The cost of the tax was to be borne by the consumer but its express purpose was to suppress demand for fuel oil. To add to the problem, the tax was collected as soon as fuel oil was removed from bonded storage. Since it was often several weeks between removal from

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also conducted a review of fuel policy in 1962 which resulted in Government pressure on the Central Electricity Generating Board to increase the amount of coal burned in the nation's power plants as opposed to oil.⁵³ This was partly politics but it was also an attempt to improve the balance of payments. Even with the savings that came from BP and Shell's activities, imported fuel oil still counted against the balance of payments while domestically produced coal did not. BP and Shell were annoyed at these moves which they viewed as a blow to competitiveness and an unnecessary increase in domestic energy prices, but they were placated somewhat by the concomitant decision by the Macmillan Government to ban imports of Soviet fuel oil as well.⁵⁴

But the 1962 fuel policy was a short-term fix. Most long-term forecasts showed a continued decrease in profitability for coal based on assumptions that oil prices would remain low for years to come. Thus when the Wilson Government came into power, it sought to find a solution to the coal problem through another major fuel policy review in 1965. The troubles in the coal industry put Labour in a tough position. While the coal miners were one of the Party's most loyal and important constituencies, the numbers were simply not adding up. Despite the 2d. tax on fuel oil and the ban on Russian oil and American coal, by 1965 the NCB was still operating at a significant loss. Lord Robens, the head of the NCB, pushed the Wilson Government to pledge itself to the production of 200m. tons of coal per year, an amount that would boost the industry and stem the decline

storage until final sale, this meant that the companies had significant resources tied up in the tax payment before they were reimbursed by the final sale of the product.

⁵³ Beltran, *A Comparative History of National Oil Companies*, 191.

⁵⁴ Cheaper American coal was also banned.

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of the mining workforce.⁵⁵ But the MoP and the Treasury were very hesitant to back such a pledge. The MoP estimated that agreeing to such a production level would mean the displacement of 14.5m tons of oil imports and that the balance of payments savings were “not likely to be great,” and “could well be insignificant, and taking into account the effect on foreign investment and indirect consequences, might even turn out to be a loss.”⁵⁶ This estimate did not stop serious discussion from taking place regarding the proposal but when the final fuel policy review was completed, the working party tasked with the project decided that such a guarantee was not in the interests of Britain’s fuel consumers.

Another idea floated by officials concerned with the demise of the coal industry was an increase on the 2d. per gallon fuel oil tax. Their argument was that an increase in this tax would not only help the coal industry but would bring additional funds into the exchequer. The idea was even floated that this extra money could be used to fund the capital restructuring of the coal industry. But once again this idea was rejected, much to the relief of BP and Shell. The final Fuel Policy Review stated that “A significant increase in the duty would reduce the market for fuel oil and imports of crude oil: it would react on plans to increase refinery capacity in this country, and increase the need to

⁵⁵ The 1962 plan had hoped to keep the decline in miners to roughly 30,000 per year, mainly through the attrition of retiring workers. But by 1965 the pace was closer to losing 55,000 miners per year.

⁵⁶ T 317/849, NA, The U.K. Balance of Payments: The implications of maintain coal production in 1970 at 200m. tons a year, 1 March, 1965.

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import expensive refined products: and it would put up the fuel oil costs of industry about which there is already a substantial amount of complaint.”⁵⁷

The 1965 review more or less upheld the status quo with one major exception; it accepted the gradual decline of the coal industry, but attempted to provide the opportunity for the industry to restructure and return to profitability. Nearly £400m. or roughly 40 percent of the NCB’s capital debt was written off and special funds were set up to assist in resettling workers.

While not entirely pleased with the 1965 review, BP and Shell were both satisfied that no major changes were made contrary to their interests. Besides, there was already speculation that another major review would be needed as in August, 1965, just two months before the release of the Fuel Policy Review, BP had struck a major gas field in the North Sea. The prospect of British-produced gas created new fuel possibilities that the Labour Government would have to plan for and which BP, Shell and the other companies exploring the North Sea hoped would benefit them.⁵⁸

The next review was completed in 1967 and once again demonstrated the internal tensions of the Labour Party regarding energy. Despite the new opportunities provided by North Sea gas, the new White Paper did not fundamentally alter the nation’s fuel policy. It spoke vaguely of the transition from two fuels (coal and oil) to four fuels (coal, oil, gas and nuclear) but kept in place the privileged position of the coal industry. The Review tried to put a good spin on embracing the status quo, arguing that coal “must

⁵⁷ T 317/849, NA, Fuel Policy, October, 1965.

⁵⁸ The exploration of the North Sea and the debates over the sale of gas produced there will be discussed in Chapter 4.

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expect to lose markets to the new fuels because of their inherent advantages in ease of handling, cleanliness and price, and even if it were possible to arrest this change in the pattern of fuel supplies, it would be to the disadvantage of the economy if the Government were to attempt to do so.” But the report went on to add that “the economy would also suffer by too abrupt a decline in coal, which would put at risk the success of the industry’s re-organisation and result in needless hardship and waste.”⁵⁹ BP and Shell were, however, unimpressed. M.F. Petheram of BP wrote to his colleagues that the Review was “a repetitive and rambling document in which the exposition of fuel policy is dominated by discussion of the problems of the coal industry.” He added that “The White Paper’s professed objective of a cheap fuel policy is inconsistent with its preoccupation with the need to support the coal industry.”⁶⁰

A Difference of Opinion

The battle over fuel policy revealed the internal tensions of the Labour Government. The Cabinet was attempting to balance several social, economic and political factors in its domestic policies with internal party pressures that were often contrary to the interests of BP and Shell. The battle between pragmatism and ideology often pitted the civil service against Wilson’s own advisers and saw the struggle for the future of Britain’s oil policy being waged through memos and meetings.

⁵⁹ FCO 54/66, NA, Fuel Policy, 1967.

⁶⁰ BP 66519, BP, The White Paper on Fuel Policy – Cmnd 3438, 29 November, 1967.

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A perfect example of the widening divide between the civil service and Wilson's political advisers can be found in the plans put forward at the end of 1966 for encouraging a closer partnership between BP and Shell. The reason such cooperation was attractive was, as an MoP report put it, "Shell is short of cheap crude oil but has very large markets. B.P. has plenty of crude but lacks markets."⁶¹ To rectify this problem, the MoP, Treasury and FO had been working to encourage a long-term oil purchase agreement between Shell and BP. The MoP noted that, "B.P. would clearly be ready to sell large tonnages to Shell in conditions short of partnership. Given Shell's shortage, it is remarkable that no such arrangement has been made hitherto." The note added that "it is hard to believe that terms could not be concluded, especially with a push from H.M.G."⁶²

The most crucial aspect of this plan's potential success, however, was that it was a commercially viable option which would benefit the companies and bring balance of payments benefits to the State. The plan was to approach Shell first so that it could reach out to BP "on his own initiative, as it were, and put to them a purely commercial proposition, without any further action being taken by any Government Department."⁶³

This lack of Government pressure was again highlighted by the meeting between the

⁶¹ T 317/1151, NA, A closer link between BP and Shell, 23 September, 1966. The origins of the idea go back even a few more years when Shell bid for offshore concessions in Iran in 1964. The concession deal was not favorable to Shell and BP had made it known that Shell could have purchased some of their excess Kuwaiti stock for far better terms than they received from the Iranians. To make matters even worse for Shell, no oil was found in their dearly paid-for concession. An MoP official at the time had estimated that had such a deal been consummated by BP and Shell at the time it would have saved the balance of payments at least £21 million from the bonus payment to Iran. This sum was actually borrowed abroad and did not directly cost the balance of payments anything, but the Treasury and MoP argued that it could have been put to use elsewhere which would have necessitated a lighter draw on foreign exchange resources for other projects. Such reasoning was perhaps debatable but it reflects the desire amongst Government officials to save expenses at every possible turn.

⁶² Ibid.

⁶³ T 317/1151, NA, Possibility of B.P. Supplying Crude Oil to Shell, 20 October, 1966.

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MoP official Sir David Pitblado and the Managing Director of Shell, David Barran. Pitblado presented the proposal in such a way as to make “it clear that we had not consulted Ministers and that I was speaking to him first without any prior discussion with B.P.”⁶⁴ This extreme caution to present the civil service’s plan to the oil companies in such a way as to encourage rather than force an action was much appreciated by Barran who subsequently advanced the proposition to BP.

This civil service approach was in sharp contrast to a somewhat similar plan which emanated from the political wing of government. A paper, presented by the oil companies’ *bête noire* Nicholas Kaldor, proposed that tremendous balance of payments savings could be achieved by rationalizing the operations of BP and Shell by way of a merger of the two companies. Kaldor’s suggestion was picked up by Callaghan and presented to the oil companies in separate face-to-face meetings with the respective company heads. The idea was immediately and brusquely rebuffed by Sir Maurice Bridgeman but was more cordially received by David Barran, who coyly suggested that such a merger would be beneficial “in as much as H.M.G. might tend to have a more open-handed approach to investment in such circumstances.”⁶⁵

The accompanying outbreak of the Six-Day War and the interruptions of normal supplies put off any discussion of both plans and the idea eventually faded. The different approaches taken by the bureaucratic and political wing of the British Government

⁶⁴ T 317/1151, NA, Letter Pitblado to Armstrong, 21 October, 1966.

⁶⁵ T 317/1152, NA, Record of a meeting held in the Chancellor of the Exchequer’s Room, H.M. Treasury, at 3.30 P.M. on Friday, 15th September 1967. This positive response was not expected and Kaldor expressed great surprise at Barran’s reaction.

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manifested themselves again during the oil crisis sparked by the Arab-Israeli conflagration, however. Civil service officials worked with BP and Shell along with the other major international oil companies to coordinate an effective response to the shortage. BP and Shell requested, and received, permission to add a surcharge of 2d. to every gallon of oil sold to help offset the increased expense of shipping oil around the Cape of Good Hope.⁶⁶

This measured approach was in contrast to the rather panicked response of the ministers. The closure of the Suez Canal and the resultant rise in the cost of oil came at a terrible time for the Wilson Government which was still trying to tame the recurrent balance of payments problems. The desperation of the ministers brought them so far as to consider Balogh's idea of purchasing Eastern Bloc oil from the Soviet Union or Romania on a state to state contract.⁶⁷ This would have been a radical departure from Britain's traditional oil policy but was ultimately unnecessary because BP, Shell and the American majors were able to adjust shipping routes and minimize any shortages in Western Europe.

Yet the damage to the balance of payments pushed the Wilson Government further down the path towards the devaluation of sterling. Wilson and his chancellor James Callaghan had made it a centerpiece of the Government's economic policy to save

⁶⁶ This so-called "Suez Surcharge" helped the companies significantly but did not completely overcome the losses accrued due to increased shipping costs. From June 1967 to March 1968, BP saw their costs increase by £31.8 million while the Suez Surcharge brought a recovery of £21.6 million. For Shell, who could draw on resources in the Western Hemisphere, the impact was less dramatic with their costs rising £31.4 million while their recoveries reached £28.8 million. See T 317/1464, NA, Surcharge on Oil Prices, 26 April, 1968.

⁶⁷ Thorpe, "The Forgotten Shortage."

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the pound from devaluation, but the myriad economic difficulties buffeting Britain finally brought the Government to the conclusion that the only way to escape the cycles of balance of payments and exchange crises was to devalue the currency from the equivalent of \$2.80 to \$2.40 on 18 November 1967.⁶⁸

While this move took some pressure off the balance of payments, it threw the finances of the oil industry into disarray. With sterling devalued, the costs of oil to the companies increased. But with Harold Wilson promising the British public that the “pound in your pocket” would not be worth any less, the Government was very hesitant to allow the price of oil sold in Britain to increase correspondingly. Balogh for one argued that “The only reason for increasing prices is if otherwise the oil companies stop supplying us.”⁶⁹ Similarly, it was feared that any benefit accruing to the British economy from devaluation could be swallowed up by price increases. The Treasury put voice to this by writing that their “overriding interest here is to keep the increase in oil prices resulting from devaluation—and hence the increase in industrial costs—down to the minimum so that the benefits to our export prices of the recent change in parity are not whittled away.” Of secondary importance was “seeing that B.P. get a reasonably square deal, but the interests of a particular oil company must obviously be secondary to the national interest of keeping industrial costs down.”⁷⁰

⁶⁸ The historiography of the decision to devalue is a rich one. For an excellent summary of these works, see S. Newton, “The Sterling Devaluation of 1967, the International Economy and Post-War Social Democracy,” *The English Historical Review* CXXV, no. 515 (July 2010): 912–945.

⁶⁹ PREM 13/2849, NA, Letter from Balogh to Shore, 30 August, 1967.

⁷⁰ T 317/1464, NA, Oil Prices: devaluation and surcharge, 19 December, 1967.

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But fear that keeping prices lower would make it difficult for the companies to rebuild their stockpiles convinced ministers that a price increase needed to be granted.⁷¹ They devised a politically ingenious approach to this issue, however. The Minister of Power Richard Marsh and his officials suggested that prices be allowed to rise by a 1d. per gallon average on all oil products. This price rise would, however, be offset by a 1d. per gallon average cut in the Suez Surcharge that the oil companies had been allowed to place on their products following the Six-Day War.⁷² The net result of what *The Times* called a “neat solution for petrol prices” would be that oil prices would stay the same for consumers with the burden falling on the oil companies.⁷³

There was much debate within the Wilson Government about how far to push the oil companies. Balogh and another of Wilson’s advisers, Michael Posner, argued that the companies were not only exaggerating their losses but that they could absorb those losses in the interest of the overall British economy. Writing to Robert Marshall of the Treasury, Posner commented that “because the likely result of the crisis will have been a large loss for the U.K. economy and a very marginal loss for the general run of companies, we have established a clear clash of interest between the industry and

⁷¹ While Government officials technically did not control the price of oil, they did exercise tremendous influence. This was because prices were decided jointly by the companies and the Minister of Power. Any disagreement between the two sides was referred to the Prices and Incomes Board which would settle the matter. This was an eventuality that the oil companies were eager to avoid, since the Prices and Incomes Board was unlikely to rule in their favor.

⁷² PREM 13/2849, NA, Oil Prices: Devaluation and Surcharge, 20 December, 1967.

⁷³ *The Times*, “A neat solution for petrol prices,” December 23, 1967.

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ourselves: a crisis like this one costs them very little save some sleepless nights, while it costs us extremely substantially.”⁷⁴

Conclusion

But in some ways the belief that the companies had invincible profit-margins was a mistaken one. The firms had been suffering from a decrease in returns on their capital employed for several years as low oil prices meant that new field development did not return on their investment as quickly as in the past. This fact, coupled with the squeeze on the companies by both the producing states and their own government led some within the companies to believe that their current model of operation was unsustainable. The firms had been watching what they perceived to be the growing interventionism of the State with apprehension, but also with resignation; in an internal BP memo on relations with the British Government, one official noted glumly that “Even though one may, as does the writer, believe that we are today over governed, it seems likely that a mixed economy will develop more and more towards a managed economy, irrespective of the political party in power.”⁷⁵ This meant that “oil seems to be a sector which could increasingly attract Government attention. It is the only major sector of energy production not in public ownership, it is large and capital intensive, its activities impinge

⁷⁴ T 317/1464, NA, Letter from Posner to Marshall, 15 December, 1967.

⁷⁵ BP 66519, BP, Relations with HMG II, 21 November, 1967.

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on foreign policy and defence policy, its prices directly effect [sic] cost of production and cost of living.”⁷⁶

A strain of thinking therefore emerged within BP that if the Government was to continue the type of meddling exemplified by the limiting of their foreign investment, new taxation and attempts to exert greater influence through the Government directors on BP’s board, then at least the Company should receive something out of it. Sir Maurice Bridgeman gave voice to this idea and the frustrations that lay behind it in a document sent to the Chancellor and the Minister of Power. This complaint, which came to be known as the Bridgeman Memorandum, built upon several earlier notes sent by the Company to Whitehall detailing the financial straits that the firm found itself in. Years of heavy borrowing, increased taxation, and now the devaluation of sterling had put the Company’s finances into a precarious position.

The Bridgeman Memorandum argued that several aspects of Britain’s tax system, oil policy and the structure of its domestic oil market worked to the disadvantage of BP. The BP chairman pointed out that “A major consideration in any assessment of the British Oil Industry’s future is the extent to which its competitors are helped by direct support and protection from their parent Governments or can take advantage of more favourable conditions in their home country than are available to BP or other British Companies in the U.K.”⁷⁷ In essence, Bridgeman believed that BP was expected to operate in a liberal home market where it was offered no privileged position and to

⁷⁶ Ibid.

⁷⁷ POWE 63/339, NA, Memorandum by British Petroleum Company Limited, 31 January, 1968.

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compete equally with foreign oil companies such as Esso and Mobil which had the advantage of a protected home market in the United States. This was difficult enough, but Bridgeman went on to complain that the British Government was demanding BP fight on an even playing field while it simultaneously limited BP's investment abroad, tying up its ability to raise new capital through the prospect of the 1965 corporation tax and decreasing the Suez Surcharge at a time when BP had not recovered the excess cost of shipping oil around the Cape of Good Hope. He concluded that "The present trend is for other countries to give increasing support and protection to their own national companies, while the U.K., for at least the last 8 or 10 years, the reverse has been the case."⁷⁸

The document then went on to lay out several ideas which would have reshaped the relationship between Whitehall and BP through the creation of a new system of privileges for the Company. These included the exemption of BP from the corporation tax, the limiting of refinery construction within Britain by non-British companies and the restricting of product importation from the Common Market of the European Economic Community. On top of this, Bridgeman stated that BP and other British firms should be included in the formation of oil policy, stating that "While liberal import and export policies and absence of restrictions have in the past been of great advantage to the Oil Industry, as well as an example to other countries, it is a matter for debate whether this is any longer the case."⁷⁹

⁷⁸ Ibid.

⁷⁹ Ibid.

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The Bridgeman Memorandum poignantly laid out the tensions which had been growing for the better part of a decade regarding the British Government's attempt to extract financial benefit from the operations of the oil industry. In an international world of oil that was growing more hostile to the interests of firms like BP and Shell, these same firms felt that they were not receiving the support from their own Government that they needed. Bridgeman's complaint would, however, spark a major governmental review of oil policy that would consume the better part of 1968 and 1969. The British oil industry's insecurity and financial frailty, whether as dire as Bridgeman believed or not, put BP and, to a lesser extent, Shell into a poor position to resist further impending changes to the concessionary system in the Middle East, helping to usher in a period of mistrust between the firms and the Government at what would prove to be a crucial period in the history of the oil industry.

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Dirigisme: Safeguarding Against Shortage, 1957-1968

On 30 September, 1965 a British Petroleum-owned drilling rig, *Sea Gem*, struck a substantial gas deposit nearly forty miles from the mouth of the Humber River in the North Sea. The gas strike, the first major hydrocarbon discovery in the United Kingdom's section of the North Sea, set off a wave of excitement in the oil industry and throughout the corridors of Whitehall. Geologists had long suspected that the North Sea was a promising area for hydrocarbons and a major discovery near the coast of the Netherlands in 1959 had finally confirmed this.¹ Yet the technical difficulties of offshore drilling, the cost of such an operation in a time of oil surplus, and the fact that there was no treaty clearly delineating the continental shelf boundaries, delayed any real exploration for several years. But the *Sea Gem* strike opened once and for all a new frontier of hydrocarbon production and one which was firmly in Britain's own backyard.

The excitement of the discovery quickly turned to sorrow, however, as a mere two months later the *Sea Gem*, a barge which had been converted into a rig with the addition of ten extendable legs, capsized into the North Sea killing thirteen members of its crew. This tragedy, so quick on the heels of triumph, was a sobering reminder of the difficulties facing Britain in its quest for energy security. This quest would involve both cooperation and conflict between the companies and the Government and would be marked by the

¹ Geologists had discussed the possibility of the North Sea being a potential hydrocarbon province at a conference in Mexico City in 1956. But due to the high costs and technical sophistication necessary for drilling offshore, this estimation was not followed up.

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same challenges that had sprung up in the battle over taxes and finances as highlighted in Chapter 3.

The maintenance of supply was in essence the most important aspect of British oil policy, as no other element of that policy would matter, should the flow of oil be cut off. Because of the elemental nature of this situation it is perhaps unsurprising that it was an area of major cooperation between the firms and the British Government. Both sides worked together to maximize stability through rationing plans, stockpiling and ultimately diversification of supply outside the Middle East. Yet the divergence of opinions between the firms and the Government were also exposed here. The British Government expected the firms to assist financially in any contingency plans for an oil shortage. But their plans for the companies' assistance often went well beyond commercial considerations. This divergence between strategic concerns and commercial justification had affected relations between BP, Shell and the British Government regarding the Middle East, and the same force would contribute to frustration that the firms would eventually develop toward the Government.

But there were moments of cooperation as well. The companies and the Government agreed that one of the best ways of guaranteeing the secure supply of oil was through the diversification of the companies' sources of oil. This led to an extensive program of exploration in areas beyond the Middle East and saw moments of tremendous cooperation between the firms and Whitehall. These triumphs, and the close cooperation that made them possible, show the complicated nature of BP and Shell's relationship with

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the Government during this period. Even while the firms were growing increasingly frustrated by Government decisions, they remained close partners with Whitehall due to their mutual need of one another. The increasingly onerous financial controls placed on the companies combined with the efforts to encourage the firms to do more to guarantee the safety of Britain's supply strained the partnership between BP and Shell and Whitehall, but did not break it.

Ultimately all of these questions of stability and financial benefit came together with the discovery of hydrocarbons in the North Sea. The revelation that a significant reserve of petroleum and gas was within Britain's borders tied together the issues of stability and financial benefit. The question became one of how best to exploit the resource—through private development or through the creation of a state-controlled enterprise.

Stockpiling and International Cooperation

Since the Suez Crisis and the oil shortage that accompanied it, British policy-makers had been dedicated to the idea of building up Britain's ability to resist a cut-off of supply. Plans for a shortage prior to the closure of the Suez Canal in 1956 had relied upon BP, Shell and the other major oil companies which traded in Britain to be able to reroute supplies from the Western Hemisphere, specifically from the United States. Britain had withstood the Iranian Nationalization crisis of the early 1950's with this

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strategy.² But during the Suez Crisis this was impossible due to President Dwight Eisenhower's fury at what he viewed as a duplicitous attack on Egypt and his subsequent refusal to assist Britain and France.³

The long period of rationing that resulted from the failure of this plan pointed to the need for a better strategy and one that did not rely solely upon the oil majors to come to the rescue by rerouting supplies.⁴ Instead, beginning in the late 1950's and continuing throughout the decade, the British government would construct a plan relying on stockpiling, international cooperation and diversification to insulate their home market from interruptions in the oil supply. All of these issues would bring the question of the relationship between the government and BP and Shell to the fore. The balance between seeking voluntary assistance in these programs versus forced compliance was a difficult one for government officials to negotiate.

The process of creating an oil security program was referred to the Oil Transport Committee.⁵ Securing the routes of transport was the highest priority of this committee, but second to it was the creation of a national stockpile.⁶ As part of this, the Ministry of Power (MoP) simultaneously conducted another study on the mass storage of oil in the United Kingdom itself. This group, known as the Oil Storage Committee, was set up in

² Britain had only needed to rely on imports from the Western Hemisphere briefly while production in Kuwait was increased to make up for the shortfall stemming from the loss of Iranian supplies.

³ When Eisenhower relented and allowed cooperation between the American and British firms, BP and Shell were instrumental in organizing the Middle East Emergency Committee which put together the "Oil Lift" of US supplies to Europe. See Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (Simon and Schuster, 2008), 475–476.

⁴ Petrol and fuel oil were rationed in Britain from 17 December, 1956 to 14 May, 1957.

⁵ Further discussion of the Oil Transport Committee can be found in Chapter 1.

⁶ This transport study had concluded that a mixture of more pipelines through stable countries coupled with increased tanker size would be key to surviving any future transportation emergency.

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August, 1958 under the chairmanship of Solly Zuckerman, a long-time government scientific advisor. The Zuckerman Committee set out to “examine the possible methods of storing, primarily as a reserve against interruption of imported supplies in peace, substantial additional stocks of oil in the United Kingdom and to report on the relative advantages, financial and otherwise of the various methods.”⁷ The goal of both committees, and the program in general, was to stockpile enough oil that when combined with a rationing program, Britain would be able to weather an oil shortage brought on by transport or production problems until alternate arrangements could be developed.⁸ Added to this was the benefit that such a stockpile would, in the words of one official, “enable us to face an interruption in Middle East supplies for nearly twice as long as at present without serious dislocation of the economy.”⁹

The question, however, was how best to store the oil, as well who would pay for the creation and maintenance of the stockpile. The Zuckerman Committee already had one solution on the table. Even before the Suez Crisis, some discussion had been undertaken about creating a safer stockpile of oil in Britain in the event of war with the Soviet Union. These initial reports had suggested the use of cavities in the earth left behind by the production of potash brine. These cavities could act as natural storage containers and had the benefit of being airtight, large and invisible from the air.

⁷ POWE 33/2448, The National Archives, Oil Storage Committee, 7 October, 1959.

⁸ Exactly how long this period would last was a matter of some debate. The studies which were conducted used several likely scenarios to judge how much oil would last how long. Most of the studies reasoned that only one major producer would withhold production at a time.

⁹ PREM 11/4389, NA, Oil Supplies, 2 October, 1958

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The only drawback of the potash cavities was the fact that they were not always situated close to oil refineries. Because of this it was suggested by the Committee that the cavities be supplemented by conventional steel tanks built near the refineries so as to allow uninterrupted production in the event of a sudden oil shortage. Other suggestions such as the use of mothballed oil tankers to store the stockpile were considered but were eventually discarded.¹⁰

The question then turned to how much oil should be stored. The Oil Transport Committee advised in October, 1958 that a stockpile of 122 days' worth of normal consumption would suffice to meet the project's requirements.¹¹ A review of the program conducted in 1966 summarized its goals by stating that it "was based on an assessment in 1958 that with it we could in 1965 survive, with a 10% reduction in consumption, the loss of all Arab oil (then Iraq, Kuwait and Arabia) in the Middle East, and of the transit routes, for a year."¹² This suggestion was approved by the Cabinet and was to come into force in 1959.

Of this stockpile, the report suggested that 16 weeks' worth of oil should be stored and paid for by the oil companies operating in Britain, while 10 days' worth would be stored and paid for by the British Government. This arrangement was not felt to be overly burdensome to the oil companies as BP and Shell already maintained a stockpile

¹⁰ The use of tankers was similarly dismissed due to the rapid change in freight rates that ebbed and flowed according to oil demand. It was uncertain for how long the tankers would be mothballed and therefore available as floating storage containers.

¹¹ The actual amount of oil would change from year to year based on rises in consumption. The Oil Transport Committee estimated that it would be required to stockpile 2.5 million tons of crude oil equivalent in 1959 - 1960 to meet the requirement. This would not include the oil already stockpiled by the Government for the armed forces in the event of a conflict.

¹² POWE 63/76, NA, Security of Oil Supplies: UK Stockpiling Policy, 17 May, 1966.

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of roughly 60 days normal supply simply to protect their refinery processes from any unexpected delay in supply. Thus more than half of the demanded stockpile was already necessary for commercial reasons and beyond dispute with the companies. But for the other half, the issue was one of who would pay for the oil and the maintenance of the equipment used to store it.

The main oil firms felt that it was unfair to expect them to bear the full brunt of the cost to produce, ship and then store oil for a purpose which would serve the economic interests of an entire country. To make matters worse, early discussions about the plan, conducted in 1957 before the Zuckerman committee even formed, suggested that not only should the companies be compelled to pay for the oil, but that they should pay rent to the Government for the oil stored in the potash brine cavities for a five-year period. An internal BP memo discussed this strategy by saying, “the rental will be an onerous cost and in guaranteeing five years’ use, we are by implication undertaking a long-term commitment to maintain larger total stocks in this country than we would normally consider necessary for commercial purposes. It seems wrong, therefore, that we should not only do this, but should pay the Government for it.” The report also added that “previously, of course, the Government have purchased outright all the oil stored for reserve purposes.”¹³

This posed a challenge to the MoP, Treasury and the FO, the three main departments represented on the Oil Transport and the Oil Storage committees. Government officials had a choice between seeking to persuade the oil companies to

¹³ BP 63473, BP, Storage of Crude Oil in Cavities, 9 December 1957.

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participate in the program or to enact legislation forcing compliance. The Macmillan Government was, by and large, hesitant to interfere in the commercial operations of the oil companies as their business were seen as an economic and strategic asset which had done a good job keeping Britain supplied in the past. That the Suez debacle, and the subsequent oil shortage, was primarily the result of a bungled Government initiative only added to the desire to seek cooperation from the companies through non-legislative forms.

Initially persuasion seemed to work quite well. By 1959 the oil companies had agreed to voluntarily stockpile of 1 million tons of crude oil while the Government would add 500,000 tons of refined products in 1959 and a further 500,000 tons in 1960. This left roughly 500,000 tons of crude oil equivalent to reach the required stockpile goals.¹⁴ The Treasury concluded that in view of the fact that the oil companies (mainly BP and Shell) had already paid £20 million to bring their stocks up to the level requested by the Government, they would “be reluctant to provide further stocks for the Potash Brine (P.B.) storage as it becomes available, though the Ministry of Power is asking them to do so.”¹⁵

The fact that the Government did not push the companies to provide more to the stockpile left the policy in limbo. There was no real clear directive as to how the stockpile would be kept up to date, given that consumption was growing at a steady rate.

¹⁴ The term “equivalent” is used because some of the stockpile would be held in refined products rather than as crude oil.

¹⁵ FO 371/141205, NA, National Oil Reserve, 26 June, 1959.

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Because of this, almost from the start the stockpile fell short of its goals.¹⁶ Between 1961 and 1966 the highest total stock held in the UK by the companies was 14.8 weeks' worth, still short of the 16 weeks required by the plan. This total was in itself misleading as it represented the peak of what was held just before winter, traditionally the time when stocks were at their highest. The average stock level held by the companies was 12.5 weeks, well below the expected total. A review of the policy in 1966 concluded that,

There are several reasons for failure to reach the objectives. The lesson, as it was interpreted at the time, of the Suez crisis, has less impact with the passage of the years. The political situation in the Middle East may be thought by some to be now more stable; at any rate, the companies have grown used to living with it. The companies have diversified sources of supply; they perhaps judge the chance of all Middle East Arab oil supplies being cut off at once more remote on that account. The established majors now face keener competition, and their margins have been drastically reduced. All companies' financial resources are being squeezed; concessionary Governments are gradually increasing their take, and both the British and U.S. Governments are pressing the companies to reduce their spending overseas.¹⁷

The failure of this policy was not rectified by the Labour Government of Harold Wilson. Despite the fact that the 1965 Department of Economic Affairs' "National Plan" depended heavily on stable and cheap supplies of energy to meet its ambitious targets, it was still felt that legislating compliance with the stockpiling program was not a course worth pursuing.¹⁸ This decision was

¹⁶ The Treasury's frustration with this set of circumstances is highlighted in T 319/200, NA, Maintenance of the National Oil Reserve, 1960-1963.

¹⁷ POWE 63/76, NA, Security of Oil Supplies: UK Stockpiling Policy, 17 May, 1966.

¹⁸ The National Plan was to be the centerpiece of the new Government's economic policy. The Department of Economic Affairs was created in order to oversee it and it was put under the leadership of the talented but mercurial George Brown. For the intellectual roots and the legacy of this program, see James E.

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reached for different reasons. The review of the stockpiling policy concluded that if the stockpile were to reach its full level, “the best method would seem to be by legislation.”¹⁹ But this was not the study’s recommendation. The report had actually shown that it was likely the UK could get by with a smaller stockpile of 80 to 90 days’ worth of consumption, a target that was already reached by the average stockpile of 92 days which had been held since the 1959 plan. This was due in part to the fact that the Labour Government had high hopes for the recent discoveries of hydrocarbons in the North Sea.²⁰ Thus the policy review argued that “So long as we can, by persuasion, maintain the present average oil stock cover of 80/90 days, and since some clearer indication of prospects on the Shelf should be available within at the most five years’ time from now, (by which time licensees must have completed their obligations to drill on the first, major, round of concessions), no new decision is needed nor could one be soundly based.”²¹ Thus the Labour Government chose not to pick a fight with the oil industry since its goals could be met through alternate means.

Another reason for confidence amongst the government officials of Britain was the relative success they had enjoyed in the second part of their oil security program, the building up of an apparatus of international cooperation regarding

Cronin, “Labour’s ‘National Plan’: Inheritances, Practice, Legacies,” *European Legacy* 6, no. 2 (April 2001): 215–232.

¹⁹ Ibid.

²⁰ The belief was that natural gas from the North Sea would be increasingly adopted as an industrial fuel thereby decreasing reliance on imported fuel oil.

²¹ Ibid.

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oil supplies. The Suez Crisis had not only affected Britain but had seriously hampered oil supplies throughout Western Europe. Therefore, while Britain was working on its own national stockpile, it was also helping in the creation of an Oil Committee at the Organization for Economic Cooperation and Development (OECD) in 1961 which would help to organize and manage the industrialized free world's response to an oil shortage.

The Oil Committee lacked any real authority to force action on the member governments, but it did give Britain a forum to push its vision of a stockpile-based oil security program. Britain was in fact given the chair of the committee in recognition of its perceived expertise in oil.²² The United States acquiesced to this in part because it was still able, in the early 1960's, to call upon extra production capacity within its own borders to meet any emergency need.²³ The British also saw the OECD as "the only international body available at which British oil officials can seek to influence officials of major consuming countries in a direction favourable to British oil interests, i.e. B.P. and Shell."²⁴ That direction meant protecting the firms from excessive demands on the part of continental countries. Part of the reason that BP and Shell had been so perturbed about a

²² The British chairmanship was handled by long-time British MoP official Keith Stock. BP and Shell may have disputed this perception of expertise. Foreign Office files suggest that the two companies were less than thrilled with the quality of officials chosen to represent Britain at the OECD and other international oil seminars and meetings. See FO 178152, NA, Continuity of our Official Arrangements for Coping with International Oil Problems, 19-21 October, 1964.

²³ The United States was also unpopular amongst the European oil community for the imposition on mandatory importation controls in 1959 targeted against any Eastern Hemisphere oil. See FO 371/141203 for discussions on the decision by the United States to impose these restrictions.

²⁴ POWE 61/163, NA, Consultation in the O.E.C.D. Oil Committee, 1964.

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potential mandatory British stockpiling plan was that they “were worried by the possibility of having to make comparable provision on the continent of Europe.”²⁵

Thus the OECD Oil Committee set a rather low bar for its recommended range of stockpiling, at anywhere from 60 to 90 days. This met no opposition from BP or Shell as these totals fell within the range of already existing stockpiling legislation in Western Europe.²⁶ As it was, the Europeans had difficulty reaching even these modest goals with the UK regularly maintaining a 15-20 percent higher stockpile than any other European nation.²⁷

These moves within the OECD by Britain were mirrored by efforts within Whitehall to prepare the British oil industry for the country’s eventual entry into the European Economic Community (EEC). The British chairmanship of the OECD Oil Committee was vital in the minds of UK officials in helping to prevent any policy developments among the six nations of the EEC that might endanger the interests of BP or Shell should Britain eventually join the organization. In a report on the OECD Oil Committee, the MoP stated that “we regard it as of first importance to assert this influence on the Six before they form their own firm policies on oil.”²⁸ This planning was for naught in the 1960’s, however, as both

²⁵ FO 371/141205, NA, National Oil Reserve, 24 July, 1959.

²⁶ The European Economic Community (EEC) would, in 1964, pass guidelines for all its member countries requiring an average stockpile of 65 days’ worth of consumption. See POWE 63/76, NA, Stockpiling Legislation in European Countries, January, 1968.

²⁷ For example, Britain regularly maintained an average of 92 days’ supply, while France maintained 77 and Germany 58.

²⁸ POWE 61/163, NA, Consultation in the OECD Oil Committee, 1964.

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of Britain's applications to the EEC were rejected.²⁹ Nevertheless, it did not end the cooperation between the European nations regarding stockpiling.

For all of the European cooperation, both through the OECD and the EEC, the key tool of international cooperation remained shut-in American supplies. Pro-rationing policies in Texas meant that somewhere close to a million barrels a day of extra capacity existed in the United States, a capacity that could be called upon in the event of an emergency.³⁰ That fact would be born out during the Six-Day War and the ensuing abortive Arab oil embargo.³¹

Diversification

Of course such a reliance on the United States did not sit well in Britain. British leaders could not forget how, during the Suez Crisis, American anger at Britain's actions led to their withholding of extra oil production to the detriment of all Western Europe. In fact, all of the international cooperation regimes were final resorts and shaky ones at best. The only surefire way of weathering an oil shortage was to ensure that one never occurred in the first place. This meant that British and other Western companies needed to diversify their sources outside of the Middle East. Luckily for British officials, BP and Shell were in agreement

²⁹ The first application, submitted by the Macmillan Government, was rejected in 1963 while the second, submitted by the Government of Harold Wilson, was rejected in 1967.

³⁰ These pro-rationing policies were coordinated by the Texas Railroad Commission, which governed most oil-production in Texas meant that throughout the 1960's there was a substantial amount of production that was unutilized.

³¹ See Yergin, *The Prize*, 539.

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and had already taken steps towards expanding non-Middle Eastern sources. One British official commented that the “Oil companies will continue to look for oil and to develop it as a matter of business; diversification is as much in their own commercial interests as in our own as consumers.”³²

The fact that both the companies and the Government shared a vision for the diversification of oil supplies did not mean that this process was without complications in the relationship between the two sides. While there was little debate within the Government about active intervention regarding the direction of exploration efforts, there were two areas of direct contact between the interests of the companies and the interests of Whitehall: the firms’ need for diplomatic support as well as a need for foreign currency with which to pay for their exploration. These two points of intersection varied in importance depending on the area of exploration.

One of the most important areas where the oil industry sought to diversify was in Libya. The relationship between the British Government and its companies was not as close to the fore in Libya as in other areas, but the experiences of BP and Shell there show the importance of British diplomatic influence in paving the way for the success of the companies’ diversification plans. BP, Shell and other Western companies were able to take advantage of a favorable situation in Libya due to the initial pro-British and pro-American sentiment of the country’s ruling class. As those feelings ebbed, the situation

³² POWE 63/76, NA, The U.K. and the Security of Oil Supplies, 25 November, 1966.

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became more difficult for BP and Shell, culminating in the downfall of the pro-Western regime and the eventual nationalization of the companies' assets.

In the 1950's, however, such fears were far from the minds of the oilmen. Libya's prospects were initially uncertain but its orientation towards the West and its location made any potential discoveries both commercially and strategically desirable.³³ Both Shell and BP were early entries into the Libyan market.³⁴ Following independence, the new Libyan leader, King Idris, relied on British help to craft the 1955 petroleum laws that would govern the country's oil market.³⁵ Idris had good reason to cooperate with the British firms. Unlike many other Arab states, Libya did not view Britain and the United States as imperialist powers, but rather as liberators.³⁶ Anglo-American forces had been instrumental in ridding Libya of their Italian overlords during the Second World War.³⁷ Even more influence accrued to London by the fact that the Libyan pound, the new nation's currency, was linked to sterling, not only providing Libya with a stable

³³ Although Libya was predominantly Arab and subject to the same forces of pan-Arab nationalism that was causing oil companies headaches elsewhere in the Middle East, it had the important distinction of being west of the Suez Canal.

³⁴ BP and Shell began geological and seismological explorations soon after Libya's independence in 1951.

³⁵ For an excellent description of this process, see Frank C Waddams, *The Libyan Oil Industry* (Johns Hopkins University Press, 1980), 57–70. The law was not beneficial to the companies in the sense that it divided the country into many small concessions rather than the larger ones typical in the Persian Gulf. One big incentive was, however, that the government of Libya would calculate its share of the profits based on the market value of oil rather than the arbitrary "posted price" used in the Persian Gulf. See Yergin, *The Prize*, 509–510.

³⁶ J. H Bamberg, *British Petroleum and Global Oil, 1950-1975: The Challenge of Nationalism* (Cambridge University Press, 2000), 113.

³⁷ By the early 1950's, the subsidies provided by the US and the UK to Libya in exchange for the use of Libyan territory for military bases were the predominant source of income for the desperately poor nation.

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currency but also allowing the easy facilitation of payments to and from the oil companies which could process their transactions through London.³⁸

Yet the good relations between Britain and Libya did not mean that Shell and BP would have a free hand in the country. Concession allotments were distributed in a competitive bidding process and BP lost out on much of the territory it prized. Oil was first discovered in significant quantities by Standard Oil of New Jersey (Exxon) at Zelten. BP was relatively unsuccessful with its own concessions but struck the massive Sarir field in 1961 on a concession owned by Nelson Bunker Hunt, with whom BP had worked out a partnership.

The year 1961 was a good one for BP in Libya, but it also marked the beginning of a transition in a thus-far cordial relationship between the Libyan state and the oil companies operating in the country. The turning point came with the decision by the Libyan government to amend the 1955 petroleum laws to bring the country more into line with the concessionary terms offered by the Organization of Petroleum Exporting Countries (OPEC).³⁹ This was in preparation for Libyan membership in the organization which it achieved in 1962. These amendments were furthered in 1965 which brought Libya's production laws totally into line with the OPEC norms.⁴⁰

³⁸ Waddams, *The Libyan Oil Industry*, 24.

³⁹ Gurney calls the move a "watershed" in the history of Libya's oil industry. See Judith Gurney, *Libya, the Political Economy of Oil*, Political Economy of Oil-exporting Countries 4 (Oxford University Press, 1996), 46.

⁴⁰ These changes did not perturb the major oil companies who were used to negotiating with OPEC members. The myriad independent companies on the other hand, were operating on smaller profit margins and therefore resisted these changes. Esso, Shell and BP made it clear to Libyan authorities that any

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Thus, even in a friendly Arab country, the oil industry confronted a trend towards diminishing control over their concessions. Things could have been worse, however. The push to join OPEC and to wring greater flexibility out of the oil industry was conducted in part because of the pressure placed on King Idris by elements in Libya loyal to the nationalist ideas emanating from Nasserist Egypt. These same forces pushed the King in 1964 to ask Britain and the United States to remove their armed forces from Libyan territory.⁴¹ Yet the good relations between the King and Britain in particular were still an important factor to the success of BP. The US State Department, in a telegram to its embassy in London, remarked that “It may well be that only factor still keeping British in Libya is personal attitude of King, who presumably regards [the] British as his chief protector.”⁴² This special relationship with King Idris helped BP complete its critical pipeline from the massive Sarir field to the coast at Tobruk. The pipeline terminal required the King’s special assent because it would be within sight of his palace. This the King gave with some reluctance.

The second problem was that the pipeline needed to cross the territories of several different tribes in Cyrenaica. A Foreign Office diplomat stationed in Libya at the time, Ivor Lucas, recalled in his memoir a conversation held between the King and the general manager of BP in Libya, John Haines, who was

changes to the petroleum laws would need to be enforced on all operating companies. As a consequence, by 1966 all companies operating in Libya were forced to agree to the amended concessionary terms.

⁴¹ This was a request that cash-strapped Britain was only too happy to oblige.

⁴² Telegram from the Department of State to the Embassy in the United Kingdom, August 26, 1966, *Foreign Relations of the United States, 1964-1968, Volume XXIV: Africa* (GPO, 1995), p. 81

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exasperated by the company's inability to convince the tribal elders to allow the construction of the pipeline. Lucas reports that Haines appealed to the King by saying that, "during the war I spent months in German occupied Tobruk trying to discover ways of getting out. I never dreamed that, years later, I should find it even more difficult and time-consuming trying to get back in."⁴³ This harkening back to Britain's role in liberating Libya from the Italians and Germans seemed to do the trick, because King Idris cut through the red tape and allowed the pipeline to be constructed.

But following the withdrawal of British troops in 1966, the ability of Whitehall to influence events in the country waned. King Idris' friendliness to Britain and the United States won him no support amongst a growing segment of Libya's elite that supported the cause of pan-Arab nationalism as espoused by Egyptian President Gamal Nasser. The companies also saw the writing on the wall, knowing that if and when King Idris' regime collapsed, they would be operating in an openly unfriendly nation. This was indeed the case when in 1969 a small group of officers led by the 27-year-old Colonel Muammar Qaddafi overthrew the royal family and took power in Libya.

This story of declining British diplomatic influence in Libya may have predisposed the companies to look elsewhere for support. But in many other areas Whitehall's influence remained strong and, in fact, essential to the smooth

⁴³ Ivor Lucas, *A Road to Damascus: Mainly Diplomatic Memoirs from the Middle East* (Radclyffe Press, 1997), 71.

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operation of the firms' business. One such area was Nigeria. In many ways, Nigeria was among the easier places for the British firms to operate. Shell and BP had both begun operations in the country even before the Second World War and took full advantage of the fact that it was a part of the British Empire. The two companies formed a joint exploration partnership known originally as Shell/D'Arcy Exploration Parties in 1937, but renamed Shell-BP Petroleum in 1956, and truly began exploring the promising Niger delta after the War.⁴⁴ Oil was originally struck in 1956, before the Suez Crisis, but real production did not begin until 1958.⁴⁵

Yet the striking of oil in Nigeria also set into motion a train of events that would once again reveal the need the companies had for British diplomatic support. The discovery of oil occurred just as the nation was preparing for independence from Britain. In order to promote a strong unified central authority, a British commission helping prepare the transition to independence recommended that income from Nigeria's oil industry would be funneled for disbursement through the central Federal Government. This meant that to control the central authority meant to control the power over Nigeria's oil wealth; the fact

⁴⁴ Although the firm was a 50/50 partnership, most of the management team operating Shell-BP came from Shell.

⁴⁵ By this time other firms had joined the competition for stakes in Nigeria. This was of little concern to the British Government, however, who were more than happy to have a major source of oil located west of the Suez Canal. For a more detailed description of the process of oil exploration in Nigeria, see Bamberg, *British Petroleum and Global Oil, 1950-1975*, 109 – 113. See also, POWE 63/830, NA, History of the Oil Industry in Nigeria, 18 February, 1972. For a discussion of the switch from a bilateral to multinational economic relationship between Nigeria, the UK and the world and its impact on the Nigerian oil industry, see J. K Onoh, *The Nigerian Oil Economy: From Prosperity to Glut* (St. Martin's Press, 1983).

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that most of the country's oil was found in the Eastern Region meant that resentments were never far from the surface.⁴⁶

The situation came to a head following a coup in 1966 which brought a military government to power. The eventual military head of state, Lt. Col. Yakubu Gowon, sought to reorganize the country by subdividing the four regions that made up Nigeria's federal structure into twelve new territories. This move broke the oil-rich Eastern Region into three states with the primary oil regions being divided from the traditional powerbase of the Ibos, the most powerful ethnic group in the former Eastern Region. This blatant attempt to diminish the power of the Ibos led to the secession in May, 1967 of the Eastern Region from Nigeria under the leadership of Col. Odumegwu Ojukwa. The break-away state took the name of the Republic of Biafra and, after the failure of negotiations, a civil war erupted in Nigeria in July, 1967.

The Nigerian-Biafran War was a brutal contest most remembered for the terrible hardships it inflicted upon the civilian population of Biafra.⁴⁷ It was also a conflict with BP and Shell stuck directly in the middle. With two-thirds of Shell-BP's production in Biafra, the company and its parent firms were in an uncomfortable position. The Nigerian Government demanded that Shell-BP pay

⁴⁶ The placing of oil at the heart of the Nigerian Civil War is central to Chibuike Uche's argument that Britain's role in the conflict was dominated by its desire to protect its oil interests. See Chibuike Uche, "Oil, British Interests and the Nigerian Civil War.," *Journal of African History* 49, no. 1 (March 2008): 111–135.

⁴⁷ It is estimated that upwards of three million people lost their lives during the conflict, most from disease or starvation.

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no royalties to Biafra, while the Biafran Government presented an ultimatum that the firms were required to pay at least a significant token payment on the royalties due on oil produced in Biafran territory by July 1, 1967. The Commonwealth Office reported that the demands had placed the companies in an impossible position, noting that the “implication is that if they make payments to one the other side will cut off the oil, i.e. the Federal Government by blockade or Ojukwu by restraint on the companies.”⁴⁸

As the Biafran deadline approached, the parent firms of Shell-BP turned to the government for assistance. The firms’ legal advisors had urged them that international law stipulated that royalty payments should be paid to the de-facto government in power. This would seem to dictate that payment should be submitted to Biafra. The problem for the companies was two-fold, however. First, production was split between territories held by the Federal Military Government (FMG) of Nigeria and Biafra. Thus paying Biafra royalties would most likely result in the nationalization of the other third of Shell-BP’s wells in the still promising Mid-Western Region. The other problem was that the Nigerian navy had by June blockaded Biafra, meaning that any payment to the break-away region could result in a full oil blockade.

Shell-BP therefore decided that its only course was to claim *force majeure* and to pay Biafra a token royalty of £500,000 while placing the remainder in a neutral account. Along with this, the company turned to the British Government

⁴⁸ FCO 54/47, Telegraph No. 1243 Commonwealth Office to Lagos, 29 June, 1967.

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for full diplomatic support. Whitehall was quick to oblige this request, going so far as to send the minister for Commonwealth Affairs, George Thomas, to meet with FMG leaders to plead the case for Shell-BP. Gowon and the FMG were incensed by the payment to Biafra and threatened to seize Shell-BP's assets in Nigeria and blockade all oil shipments. Yet the need to keep Britain from recognizing Biafra, which would have lent it international credibility, meant that Whitehall's diplomatic maneuvering spared Shell-BP the fate of nationalization. In the end, the diplomatic entreaties became a moot point as heavy fighting erupted between the two sides on 6 July, 1967. Many oil installations were damaged in the fighting and no oil was exported from Nigeria for nearly fifteen months. Yet the British Government's influence had made the best out of a bad situation for Shell-BP and helped the company and its parent firms live to fight another day in Nigeria.⁴⁹

A very different example of how the relationship between the British Government and its oil firms played out in the American state of Alaska. Unlike in Libya or Nigeria, the close relationship between the firms, (in this case BP) and the British state served no real benefit in gaining access to the region. Instead, because of American petroleum laws, BP was forced to create an American subsidiary and to go into partnership with an American oil company, Sinclair Oil,

⁴⁹ Following the retaking of the oil producing areas by FMG forces, Shell-BP was one of the first companies to return. Damage to installations was significant but was quickly repaired.

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in 1958 in order to fully participate in prospecting for oil in Alaska.⁵⁰ In the late 1950's and early 1960's Alaska was considered a promising but difficult area to conduct oil operations.⁵¹ A strike in Alaska was especially attractive to BP since it would meet two of its longstanding goals. First, it would do much to help BP diversify from its Middle East holdings and second, it would help the company gain greater access into the lucrative American market.⁵²

But for all of the promise that Alaska held, it also came at a tremendous financial cost. Oil exploration in the remote state with its notoriously harsh climate was much more expensive than oil exploration elsewhere. The most attractive area for BP was the Northern Slope, between the Brooks Range and the Arctic Ocean which also happened to be one of the most inaccessible areas to operate in. This meant that BP Exploration Co. (Alaska) Inc. had to put up a substantial dollar total to meet its share of the financial obligation. To do this, BP as the parent company needed to receive Government authorization to remit funds, in the form of dollars, to its subsidiary. This was no small matter, as the period of exploration from 1962 to 1968 also happened to be a period of intense balance of payments difficulties for the Treasury. The remitting of so many

⁵⁰ This partnership was unique in that the two companies did not combine their operations. This was due to the fact that US federal law limited the leasing of a single maximum of 300,000 acres for exploration. Thus by operating separately but sharing costs and profits, the two firms skirted this limit and were able to lease 600,000 acres for exploration. See Bamberg, *British Petroleum and Global Oil, 1950-1975*, 189.

⁵¹ Alaska's potential was recognized very early. Oil seeps and promising geology led many oilmen to believe that substantial reserves could be found in the northern reaches of the territory. Belief in Alaska's potential was so great that in 1923 President Warren Harding ordered that a large section of Alaska's northern coast be set aside as a naval petroleum reserve.

⁵² Very little of BP's production could be sold to the American market due to the 1959 import restrictions placed upon foreign-produced oil

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dollars in what was, for the short term, an unproductive asset would put strain on the nation's already struggling balance of payments. Yet in 1962 the Treasury reported that its opinion was "that B.P. should not be discouraged from expanding their production in North America and we, therefore, support the Company's application to remit the sum required for their exploration operations in Alaska in 1962."⁵³

The potential rewards of a major Alaska strike were very difficult for the Treasury and the Bank of England (which would be responsible for the foreign exchange element) to resist. The fear that the overall balance of payments benefits that BP brought to the Exchequer could be threatened by a major Middle Eastern disruption meant that the prospect of successful diversification was extremely tempting. Likewise was the thought that BP could access the American market. The British Government had been vociferous in its opposition to the US's import restrictions, and the possibility of BP gaining a stake in such a large market was enticing.⁵⁴

Nevertheless, the Treasury was still cautious about the project. In January, 1963, in response to BP's requests for funding for initial drilling, an internal Treasury memo noted that "There is no hint in the B.P. letters that oil has been found or is likely to be found in the near future in their concession areas in

⁵³ T 317/2379, NA, B.P. Exploration Co. – Alaska, 11 December, 1961.

⁵⁴ The 1959 importation quota meant that BP had effectively been barred from activity in the American market. The Company had bought into the small Kern Oil Field in California in the early 1960's to help with its diversification efforts, but the output from this field was negligible. See Bamberg, *British Petroleum and Global Oil, 1950-1975*, 310.

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Alaska, but presumably B.P. are still reasonably convinced of the possibilities of finding oil in the region.” It went on to state cautiously that “expenditure is now running at a very high level and, while we have agreed that B.P. should attempt to find oil in the Western Hemisphere and thus lessen their dependence on Middle East oil, I think that before approving the 1963 expenditure it would be useful to have the comments of the Ministry of Power about the technical prospects.”⁵⁵

The MoP, however, had no such hesitations about the project, viewing it as crucial to relieve the pressure BP felt from having the vast majority of its holdings in the Middle East. Plus, the technical data shared by BP with the MoP showed that the geology of the North Slope was indeed promising.

But as exploration in the region produced one dry hole after another from 1963 to 1965, the Treasury became increasingly concerned that it was continuing to throw good money after bad. In 1964, BP came to the Exchequer with a request for a further \$6 million to finance a further bid for a territory known as the Prudhoe Bay structure, which BP geologists were convinced would contain a significant reservoir. J.E. Lucas, the Treasury’s most experienced civil servant in the field of oil, wrote nervously that

I am slightly concerned at the amount of money which BP propose to spend in Alaska. Including the amounts at issue the total remittances will be in the region of \$32m. and this is a very great deal to spend without, so far as I am aware, any return or any prospect of return. We shall clearly need the views of the Ministry of Power on the technical prospects. But quite apart from this I should have preferred considerably more information from BP

⁵⁵ T 317/2379, NA, B.P. Exploration in Alaska, 9 January, 1963.

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about the results so far achieved and what they hope to achieve from the expenditure now envisaged.⁵⁶

BP, which had by far the most thorough seismic data of any oil company operating in the area, was able to assuage the MoP and the Treasury for the time being. The bidding, however, did not go exactly according to plan, as the partnership of Richfield/Humble outbid BP for the crest of the structure.⁵⁷

BP did manage, however, to secure concessions along the important flanks of the structure where their geologists were confident that oil would be found. This confidence received a jolt when the more promising Colville structure just a short distance away turned out to be dry. But just as Treasury and MoP officials grew more worried about the potential waste of over \$20 million, the Richfield/Humble partnership (which had since merged and become ARCO) struck oil in the crest of the Prudhoe Bay structure in 1968. Still, the risks taken by the Treasury in funding BP's exploration were to be rewarded just a year later when BP struck massive quantities of oil in 1969 which company geologists estimated at five billion barrels.⁵⁸

Alaska had been a success in the partnership of the British Government and one of its major oil firms, but it also revealed a great deal to both sides. The experience had shown BP how easily the tight restrictions on its use of foreign

⁵⁶ T 317/2379, NA, BP: Alaska, 12 October, 1964.

⁵⁷ The fact that BP's seismic data had pinpointed the exact areas that Richfield/Humble had bid on as the crest raised some suspicion amongst BP's geologists in Alaska that their data had been stolen. See Jack Roderick, *Crude Dreams: a Personal History of Oil & Politics in Alaska* (Epicenter Press, 1997), 187.

⁵⁸ It was estimated that the entire Prudhoe Bay field would be able to produce roughly 2 m. barrels a day. This would make it the third largest producing field in the world behind Saudi Arabia's Ghawar and Kuwait's Burgan fields. See Yergin, *The Prize*, 554.

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exchange could hamper its ability to operate freely around the world. Had the Treasury held back at any point during the 1960's, it would have been entirely possible that the company would have missed out on the Prudhoe Bay find. But the situation also revealed the trust that had grown between BP and the MoP and by extension the Treasury. To these government departments, the experience was a lesson in how conflicting goals of its economy could wreak havoc on smooth relations with the oil industry. It renewed its faith in BP's and in the private oil industry's ability to conduct risky exploration, but also reaffirmed the precarious nature of diversification and the need to find a more secure and controllable source of energy.

A stable and profitable supply: the North Sea

The same tensions between partnership and confrontation that marked the diversification efforts of BP and Shell around the globe were manifested, and amplified, in the oil and gas exploration of the North Sea. The State's growing intervention in both halves of the British oil policy was a symptom of the belief that central planning could successfully promote faster and more stable growth in Britain's economy. The need for oil to be as profitable as possible to the British balance sheet also often conflicted with the need to invest abroad to increase the diversification of Britain's oil supply. The sometimes opposing goals of the political establishment and the upper echelons of BP and Shell caused

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disagreement about how best to achieve the dual goal of profit and stability in the international oil market.

Little did either side know that a potential answer to both halves of this question lay under the subsoil off the coast of Britain itself. The North Sea's hydrocarbon potential had been discussed in the early 1950's, but the technology for drilling at such depths was limited at that time.⁵⁹ True interest did not surface, however, until 1959 when the Groningen natural gas field was discovered in the northern Netherlands. Since the same geological structure that contained the massive Groningen Field extended into the North Sea, geologists quickly speculated that hydrocarbons were likely to be found offshore as well.⁶⁰ The story of the exploration and eventual discovery of gas and later oil under the North Sea is yet another chapter in the story of the growth of Government intervention in the oil industry. The first phase of exploration, which is discussed in this chapter, saw the Government position evolve from one of relative disinterest in the North Sea to a loosely controlled and monitored position under the Conservatives and, finally, to a more thoroughly managed role under Labour.

Early interest in the British sector of the North Sea came from Shell, who approached the British Government in 1959 with proposals to explore a 16,000 square mile sector. No steps could be taken on this application, however, since

⁵⁹ Britain itself contained several very small oil fields. These had been uneconomical in normal times but some, such as the Nottingham Field, had been pressed into service during the Second World War.

⁶⁰ The European Permian Basin actually extends from Northern Poland into the North Sea. But the feature of greatest interest was a layer of Permian Basal rock that stretched from Groningen into the North Sea.

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the proper legislation for the exploitation of the Continental Shelf did not exist. Internal discussions between the Treasury, MoP and the FO revealed confusion about what the rights of the Government were in terms of granting concessions in territory off the coast of Britain.⁶¹ The United Nations Law of the Sea Conference in 1958 had discussed and agreed to conventions regarding the exercising of sovereign rights to resources found on continental shelves but these conventions had not been ratified by the British Government. Ministry of Power officials advised Shell that it would take around two years for the ratification process to proceed through Parliament. This estimate proved optimistic, however, as the agreement was not ratified until 1964.

It may seem surprising that it took the Government nearly five years after the discovery of gas at Groningen to ratify the UN Convention and to pass the coinciding Continental Shelf Act of 1964 which would govern hydrocarbon concessions. There are several reasons, however, that the process extended for such a long period. To begin with, the gas discovery at Groningen, while exciting, was made during a time of massive oversupply of oil and gas internationally. Coupled with this was the fact that the Conservative Government was attempting to manage an orderly transition in the nation's energy supply. The decline of the coal industry, discussed in Chapter 3, was a difficult problem for the Government to manage as it brought with it a host of attendant social and

⁶¹ See POWE 33/2487, Oil Exploration in the North Sea, 19 May, 1959 – 3 July, 1959

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employment issues.⁶² Therefore the prospect of British gas was not as immediately appealing as it would later become.

Another difficulty with getting an immediate jump on offshore exploration was that even with the ratification of the UN Continental Shelf Convention, mutually acceptable borders would have to be agreed upon with the other nations of the North Sea.⁶³ This process in and of itself was not terribly difficult for Britain since many of the disputes centered on the Low Countries and West Germany. There was one area where the UK could have pressed a claim, however. In dividing up the continental shelf with Norway, it was possible for Britain to demand territory up to about 50 miles of Norway's coast. This was because a deep trough, known as the "Norway Deep" in the continental shelf was known to run nearly the entire coastline of Norway. Since the UN Continental Shelf Convention stated that sovereignty over continental shelves could be claimed until the sea reached a depth of greater than 200 meters; it is possible that Britain could have argued that Norway's sovereignty ended at the trough. But this claim was not pursued since there were geological reasons for arguing that the trough was an anomaly and not a delineating line on the continental shelf.

⁶² This was especially a problem for the Labour Party, who had stronger political motivations for managing a graceful decline of the coal industry. This was manifested in the 1967 Fuel Policy Review which sought to promote a strong continuing role for coal in the energy supply of Britain. BP described this report as "a repetitive and rambling document in which the exposition of fuel policy is dominated by discussion of the problems of the coal industry." BP 66519, BP, The White Paper on Fuel Policy, 29 November, 1967.

⁶³ Such an agreement was stipulated by the UN Law of the Sea under Article 6, which stated that sovereignty could be claimed up to a depth of 200 meters. In the case of the North Sea, most of the continental shelf fell within this depth limit. Therefore sovereignty over the shelf was to be divided at a point equidistant from the coastlines of the countries bordering the North Sea.

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There was also the matter of expediency. The FO felt that Norway's claim was very strong and that any such move by Britain would delay the final ratification of the agreement by several years. This meant that all exploration and production would be pushed back while running the strong risk that Britain would ultimately lose. Negotiations eventually worked out an equidistant dividing line between the UK, Norway and the other North Sea states.⁶⁴

The final issue holding up immediate offshore exploration was that the UK needed to construct a regime with which to govern the production of hydrocarbons on the continental shelf. This process began with the passage of the Continental Shelf Act in 1964 which gave the MoP the right to license out parcels of the territory in question and vested all the hydrocarbons that were discovered in the Crown. As J.G. Liverman, a civil servant who helped in the formation of these policies, later wrote, "The Act provided the basic framework: before exploitation of the sea-bed could begin, the Government had to publish designation orders, prepare licensing regulations, and make arrangements for the issue of license."⁶⁵

⁶⁴ This has not stopped some commentators from questioning whether the MoP's decision was the correct one. Had Britain pressed the claim and won, nearly all of the major North Sea oil fields would have fallen within British territory. Frazer and Corti, however, believe the correct choice was made since Norway's claim was geologically sound. See Gerry Corti and Frank Frazer, *The Nation's Oil: A Story of Control* (Graham & Trotman, 1983), 32 – 33. Kemp also includes a thorough analysis of the debate over this issue. See Alexander G Kemp, *The Official History of North Sea Oil and Gas*, vol. 1 (Routledge, 2012), 62–64. Kemp also notes that more the Central Policy Review Staff (CPRS) forwarded several arguments in 1973 that point to a theoretically plausible case for Britain to have won control of the entire shelf up to the Norwegian trough.

⁶⁵ John G. Liverman, "Without Precedent: The Development of North Sea Oil Policy," *Public Administration* 60, no. 4 (Winter, 1982): 453.

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These further regulations were reached with the help of BP and Shell.⁶⁶

The chief question confronting the Conservative Government was how the licenses would be issued. One suggestion favored by the US oil firms was to put the licenses up for auction as was done in the United States. This was certainly an attractive option as it would mean a large and rapid influx of funds into the UK's coffers. But BP and Shell both opposed this option, no doubt in part due to their own lack of success in previous auctions in Libya and Alaska. Shell and BP argued that companies would expend such large quantities of capital to secure the licenses that they would not be able to develop their blocks quickly enough to ensure the rapid development of Britain's offshore resources.

Instead, both BP and Shell pushed for a system where licenses would be awarded at the discretion of the Minister of Power based on an established criteria. The first requirement was that all applicants for offshore prospecting rights had to be incorporated in the UK. This was in essence a tit-for-tat with the United States, which required all companies operating within its borders to incorporate there.⁶⁷ It also made the management of taxation and the payment of royalties easier. The second requirement was more controversial. In meetings with Whitehall officials, BP pushed hard for the MoP to take into consideration the notion of how British oil companies were treated in the home-country of any

⁶⁶ For the records of these conversations see POWE 33/2620, NA, Ratification of the International Convention on the Continental Shelf 1958, Associated Legislation, Discussion with Oil Companies, 9 September, 1963 – 7 May, 1964.

⁶⁷ It would also prevent US companies from unfairly benefitting from the generous US tax policy towards overseas oil operations. See Kemp, *The Official History of North Sea Oil and Gas*, 1:35.

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applicant. The company reminded officials that “BP has been penalized abroad in a number of countries in comparison with competitors by reason of its Government shareholding; it is not unreasonable to seek a corresponding advantage over such competitors in the home field.”⁶⁸

These criteria as well as others were accepted by the Conservative Government of Alec Douglas-Home, as was the overall concept of the discretionary granting of licenses.⁶⁹ With the general election looming towards the end of 1964, the first round of licensing was quickly carried out.⁷⁰ This was much to the consternation of the Labour Party, which felt that such a momentous activity should have waited until after the election to take place, as any new government would be forced to abide by the contracts meted out by its predecessor. The Conservative Party pushed past these objections, however, and issued the first round of licenses for blocks of roughly 100 square miles. Of the 960 blocks offered, 394 received applications with 230 of these blocks receiving two or more applications. The southern area of the North Sea, closest to the Groningen Field, received by far the most interest. The MoP reviewed the applications and offered their provisional approval in August and, as one of the

⁶⁸ BP 99647, BP, North Sea Exploration, 30 December, 1963.

⁶⁹ The other criteria included the ability to judge the financial and technical strength of applicants and an overall assessment of an applicant’s work program and potential contribution to the UK’s fuel sector.

⁷⁰ The Continental Shelf Act received royal assent on 15 April, 1964. An order opening 86,000 square miles to licensing was issued on 12 May. The agreed criteria and licensing regulations were laid before Parliament on 13 May, and an invitation for application was announced on 15 May, 1964.

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last acts of the Conservative Government, formally issued the licenses on 17 September, 1964.

Despite losing out on some of the most promising blocks to US companies, BP and Shell were happy with the results.⁷¹ They had received much of what they wanted from Whitehall regarding the criteria and the regulation of the licensing program. This is not to say that the companies received everything they desired. The Conservatives, despite being more in favor of allowing the oil industry to operate freely, did exert a large degree of state control over the process, often to the annoyance of the oil companies. First, the MoP refused to budge on the issue of taxation which stood at 53.75 percent, as well as on the additional 12.5 percent royalty to be paid on profits. This was despite strong objections from the Foreign Office who feared that any stringent regulations passed by the UK Government would be copied by other producing states, specifically in the Middle East, where British diplomats had been fighting hard against changes in concessionary terms.⁷² Along with this high tax rate, the MoP insisted that the after an initial exploration period, 50 percent of each block would

⁷¹ British companies received 23 percent of the First Round licenses. Despite this small percentage, BP received 22 of the 35 blocks that it had applied for including block 48/6 which it considered to be a prized location. See Bamberg, *British Petroleum and Global Oil, 1950-1975*, 199 – 200.

⁷² Kemp points out that the Guidance Notes sent out by the Foreign Office to foreign representatives prepared a series of arguments to counter any claim that the British Government was seeking better concessionary terms than it was willing to allow other governments to impose on their companies. These arguments included some which have already been referenced in Chapter 1, such as the idea that the 50/50 policy actually worked out to something closer to 57/43 because oil companies paid taxes and royalties on the artificially high posted prices rather than on the market values. Added to this was the fact that oil companies were required to pay bonus payments to their host governments in order to obtain and keep their concessions. Thus the roughly 60/40 split designed into the North Sea concessions was on par with existing contracts. See Kemp, *The Official History of North Sea Oil and Gas*, 1:53.

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need to be relinquished to the State.⁷³ Finally, Section Nine of the Continental Shelf Act, which was passed by the Conservatives, gave the Gas Council a monopoly right to deliver and sell all gas supplies to consumers. Since the Continental Shelf Act also stipulated that all hydrocarbons discovered under the North Sea had to be landed in the UK, this meant that there was effectively only one customer for any gas found.

Even with these disagreeable policies, BP and Shell were happy that the first round of licensing had been completed before the Labour Party could take power. It was believed that this would present Labour with a *fait accompli* regarding the licensing and would allow the oil companies to operate any production fields under the agreement struck with the Conservatives. But this was briefly thrown into doubt when a Labour Party spokesman announced on 19 September, 1964 that, should Labour win the upcoming election, all the awarded licenses would be reviewed. This was a chilling start to Labour's dealings with the oil companies regarding the North Sea. Following the awarding of the licenses, massive quantities of money had been spent to procure drilling rigs and crews.⁷⁴ The thought that the licenses could be taken away by Labour was therefore deeply disturbing. In the final event, the new Government, at the urging of the MoP, quickly decided that a delay in exploration and production would be

⁷³ This policy was meant to encourage prompt exploration of the blocks.

⁷⁴ As Kemp points out, agreed work programs totaled a minimum of £80 m. and orders for five drilling platforms which each cost £2 m. had already been placed with British firms. See Kemp, *The Official History of North Sea Oil and Gas*, 1:60.

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an unnecessary burden on the balance of payments which desperately needed a boost at the end of 1964 and the early part of 1965.⁷⁵

But the Labour Government asserted a new authority over the issue of the North Sea in keeping with its overall desire to manage the economy and jumpstart Britain's industrial power through central planning. Despite keeping the original First Round licenses, the new authorities set about adding new regulations to the prospective Second Round. To increase North Sea hydrocarbons' impact on the renewal of Britain's economy, the Labour ministers added a criterion to the application process that stated that any applicant who agreed to facilitate the participation by any nationalized industry would receive a significant boost.⁷⁶

When the Second Round of licensing was carried out in 1965, both the Gas Council and the NCB found themselves as partners with different oil companies in numerous exploration blocks. Though BP and Shell had pushed for preference for British firms, this was not what they had in mind.

But for BP, Shell and the other participating companies, the most troubling aspect of Labour's attempt to exert influence over the course of North Sea production was in its role negotiating a price to be paid by the Gas Council for the gas from the new discoveries which were being made in 1965-1967. The negotiations started in earnest in 1966 after the commercial viability of the early

⁷⁵ An announcement that the licenses would stand was made in Parliament on 1 December, 1964.

⁷⁶ Both the Gas Council and the National Coal Board (NCB) had been minor participants in the First Round. The new Labour stipulation led to increased participation by these industries. The Gas Council partnered with Amoco, Amerada and Texas Eastern in a 50/50 venture while the NCB joined Gulf and Allied Chemicals.

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strikes in the North Sea was established. During these negotiations, the Gas Council became a tough negotiator over the price that it would pay to the oil companies for North Sea gas. Being a partner with Amoco, the Gas Council had inside knowledge about the true costs of production. Its initial offer, therefore, was for 1.8 old pence per therm, an offer which shocked and dismayed the oil companies.⁷⁷

Not even sympathetic members of the MoP could be much of a help to the firms. Dealing with chronic balance of payments crises, the Labour Government needed not only to keep the cost of its new energy source cheap, but also needed to provide a boost to its policy of state intervention by heightening the status of the nationalized Gas Council.⁷⁸ The MoP argued that setting prices so low would decrease the oil companies' willingness to invest in further exploration or even the development of already discovered sites. But Wilson's special economic advisor Thomas Balogh had a near obsessive concern about the profits from the North Sea accruing to non-British companies.⁷⁹ Since many of the most promising blocks were held by American firms, Balogh argued that higher gas prices would result in more money fleeing back across the Atlantic. As one group of Labour Party analysts concluded "the higher the price and the higher the profits

⁷⁷ By way of comparison, imported Algerian gas had been paid for at a price of 6.25 old pence per therm.

⁷⁸ Corti and Frazer make this argument and point out that more radical elements in the Party's grassroots would have been angered by any perceived surrender to private interests seeking to maximize their own profit at the expense of Britain's overall economy. See Corti and Frazer, *The Nation's Oil*, 44.

⁷⁹ According to June Morris, Balogh was also furious that the MoP simply trusted the companies' reports about the size and scope of their discoveries, believing that the true potential of the gas fields was being underreported. See June Morris, *The Life and Times of Thomas Balogh: A Macaw Among Mandarins* (Sussex Academic Press, 2007), 159.

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made by the oil companies to be remitted back across the exchanges to their parent companies the less will be the benefit to the balance of payments.”⁸⁰ To this end, agreement was eventually struck with the companies for a slightly better offer ranging from 2.83 to 2.90 old pence per therm depending on which field the supplies came from.

This meant that the only way oil companies could increase their profits from North Sea Gas was to increase the supplies provided to the Gas Council. But even this hope was stifled by the fuel policy plans put forward by the Labour Government in 1967. This fuel policy review staked out an important place for coal, which could no longer compete in terms of price with gas or oil. BP complained bitterly that “the need to support coal may well prevent the expansion of natural gas into the substantial bulk markets, such as power stations, which it will need in order to balance demand with the desired growth of supply.”⁸¹ Labour ministers were anxious that gas should not cut even deeper into the viability of coal. The sheer fact that North Sea Gas would be coursing through the gas grid of the UK had already damaged the prospects of coal. The old gas system, whereby so-called “town gas” had been provided from the gas works around the country, was derived from coal mixed with imported Algerian gas. Since North Sea Gas was a different chemical composition than town gas and produced a much higher BTU when burned, the nation’s entire gas

⁸⁰ POWE 63/345, NA, Labour Party North Sea Study Group Report, June, 1967

⁸¹ BP 66519, The White Paper on Fuel Policy, 29 November, 1967.

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infrastructure was reworked by the Gas Council, and therefore the extra demand for coal was made obsolete.⁸²

Conclusion: A National Hydrocarbons Corporation?

During the rancorous negotiations over price, new ideas about the role of government in the hydrocarbon industry began to percolate throughout the Labour Party. Wilson's Government had fought hard since assuming office to bend the oil industry towards its will and had sought to glean the maximum benefit from their activities and put it towards the reinvigoration of Britain's nationalized industries. Yet the debate over the price to be paid for North Sea gas seemed to show yet again how difficult it was to balance the forces of private business and central planning. It was therefore discussed, first in the grass-roots party, whether or not it would be more beneficial to Labour's goals for Britain if a publicly-owned organization should not take over responsibility for exploiting the resources of the continental shelf.⁸³

To examine this issue, the Party created a North Sea Study Group which reported in June, 1967 that the optimal approach to take would be the setting up of a National Hydrocarbons Corporation (NHC). The idea was for the NHC to serve

⁸² This process not only involved making certain upgrades in the pipelines but also replacing many of the stove burners across the country which were configured to burn town gas. New burners were provided by the Gas Council to all customers.

⁸³ This idea was first proposed at the 1966 annual party conference and was accepted as a resolution which called on the Party's leadership to "examine and report on the advisability of public ownership of all operations concerning the production of natural gas and oil in Britain or on the British section of the Continental Shelf." POWE 63/345, NA, Labour Party North Sea Study Group Report, June, 1967

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in a capacity similar to the state-run oil companies on the Continent such as ENI in Italy or ERAP in France. It would achieve this not through nationalization but by taking over the North Sea interests of the NCB and the Gas Council, as well as inheriting the 50 percent of each block which the license holders of all the North Sea blocks would be required to return to the Government by 1970. Ideally, the North Sea Study Group saw the NHC maturing into a full-fledged oil company capable of seeking concessions internationally, thereby balancing its risks. The idea for the NHC was motivated by the philosophy of the Labour Party which put forward that “the public sector should advance where it was most needed—at the growing points of the British economy and in the new industries based on science.”⁸⁴ The North Sea Study Group believed that “the North Sea provides the opportunity for such an advance and for a valuable experiment in a new form of social ownership.”⁸⁵

The Labour leadership was initially cautious about the idea. During the drawing up of the report, Minister of Power Richard Marsh let it be known that while “he naturally favoured an extension of public ownership, they had to take care that this was not simply a political gesture but would stand a good chance of bringing economic benefits.”⁸⁶ The fear of the leadership, seconded by officials at the MoP, was that any announcement of an NHC would have a chilling effect on interest in exploration in the North Sea by the major oil companies. Because

⁸⁴ Ibid.

⁸⁵ Ibid.

⁸⁶ POWE 63/345, NA, Note for the Record, 11 April, 1967.

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of the length of time which would be necessary to staff, train and organize the NHC, this drop in interest would mean a slow-down in exploitation at a time when the balance of payments benefits were sorely needed.

Unsurprisingly, BP and Shell were not supportive of the idea. BP in particular had been pressing the Government to be more sympathetic to its attempts to secure a more substantial presence in the North Sea, and any move towards a NHC was anathema to the company. But requests for assistance from the companies in setting up the NHC were not totally denied. Despite the temptation to in order to “indicate that there is a limit to the acceptable amount of creeping ‘dirigisme,’” BP for one advised in a letter to Shell that they should “aim at some broad level of association but eschew detailed involvement,” in order to keep good relations with the Government.⁸⁷ Both firms saw the move as having to do more with politics than economics. An internal BP memo bitterly complained that “As a purely political gambit the proposal that an NHC should be established seems to me to be a winner. (The fact that I also consider it extremely ill advised is irrelevant). It can be represented as cashing in on the supposed ‘profits’ of North Sea gas production, as keeping these out of the hands of the ‘international oil companies’ (used as a semi pejorative term), and of Labour ‘planning’.”⁸⁸ Shell went further and criticized the financial and technical merits of the idea by attacking the North Sea Study Group’s second report issued on 22

⁸⁷ BP 66528, BP, Letter from DA Lindsell (BP) to D. Hirsch (Shell), 14 May, 1968.

⁸⁸ BP 66519, BP, National Hydrocarbons Corporation and a Ministry for Nationalised Industries, 3 October, 1969.

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August, 1968, stating that “the report is so slipshod—by any standards—that it is difficult to understand how it achieved publication; many of the figures used are wildly inaccurate in that they relate neither to currently available information nor to statements/other sets of figures used in the report.”⁸⁹

As fate would have it, the NHC idea never got off the ground. The preliminary work being done to study the concept was interrupted by the Conservatives’ surprise victory in the 1970 election. Despite this, the NHC stood as the culmination of the evolution in the thought process of the political leadership of Britain regarding the oil industry. The fact that it attempted to hybridize a nationalized industry with a privatized industry reflects the drift in Britain’s oil policy between intervention and non-intervention. Even the most avidly pro-interventionists in the Labour Party still did not believe that the country could do without BP, Shell and the multinational oil industry to fully secure their energy supply.

This did not prevent British oil policy from moving toward greater state intervention, however. The subtle exertion of greater influence over finances, taxation and stockpiling policies all brought BP and Shell closer to Whitehall in ways that often conflicted with the companies’ desire to operate freely. BP officials acknowledged this in an internal memo which stated “irrespective of one’s personal political views – one must accept that intervention by HMG in the

⁸⁹ POWE 63/434, NA, Shell: National Hydrocarbons Corporation: Labour Party Report of 22nd August, 1968, 28 February, 1969.

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affairs of industry has increased, is increasing and will probably continue to increase. Whether such intervention arises from considerations of management of the economy, from ‘the national interest’, from political prejudice, or merely from the increasing complexity and interplay of Government and industry, is irrelevant to our need to ensure that we are in a position to react.”⁹⁰ Yet the experience of the oil companies abroad, even in supposedly secure places outside the Middle East, showed the importance of maintaining strong relations with the British Government. Diplomatic support was still required to keep concessions and to ensure the continued flow of oil, and profits, into the companies’ hands.

⁹⁰ BP 66528, BP, Relations with HMG, 20 February, 1968.

Section 2: Precipitous Decline: 1968-1973

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Participating in Defeat: Shifts in the Balance of Power, 1968-1972

A few weeks following the coup which deposed the Libyan King Idris on 1 September, 1969 and replaced him with a Revolutionary Command Council (RCC), armed men stormed into the local office of Shell in Benghazi. They were not after the staff, nor even after any valuables or intelligence for the new regime. Instead, they were there to tear down all the safety and informational signage throughout the facility that was written in English. One of the early decrees of the new RCC and its de facto leader, Col. Muammar Gaddafi, was that all signage in the new Libyan Arab Republic had to be written in the language of the people, Arabic. This strange form of harassment was noted with concern by the British Embassy as yet another symbol that the new regime was something unlike anything the companies had yet dealt with. The strange symbolic act was shrugged off by Shell and the other companies, but a few years later the firms' would be able to look back and see that this replacement of English with Arabic had a profound, prophetic quality to it.

At the time, however, the oil companies were simply grateful that the new regime had shown restraint when it came to oil matters. According to the British Embassy in Libya, "Operations have continued uninterrupted, although in some cases they have been impeded by administrative difficulties."¹ The RCC had immediately made it clear that they wanted oil production to continue but did note somewhat ominously for the firms that "in future the oil companies would have to pay more attention to the interests of the

¹ FCO 67/256, NA, Oil, 9 October, 1969

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people.” There was one way, in particular, that the new government wanted the companies operating in Libya to “pay more attention” and this was to pay more for Libya’s oil. According to the acting oil minister, one of the top priorities of the RCC would be to achieve a “just agreement with the oil companies for the increase of posted prices.”²

The companies may not have realized it then, but decrees such as this marked the opening of a new stage of the struggle between the oil producing countries and the international oil industry. The Organization of Petroleum Exporting Countries (OPEC) had flexed its muscles throughout the mid-1960’s, winning concessions from the companies on royalty expensing and production levels, but the next battle would be over a much larger price – the setting of the price of oil. Over the previous years, the companies had relied upon tension between the conservative and radical OPEC states to prevent any serious threat to the control of prices, but the loss of Libya to the radical camp threw that balance into question. Not only did Libya add another member to the radicals, but the government of Muammar Gaddafi soon proved itself to be more extreme than most, not only in its demands, but in its willingness to risk blacklisting, or perhaps even a full-fledged shutdown of its industry, in order to get what it wanted.³

This put a powerful weapon into the hands of the oil producers. It was a weapon magnified in significance by the fact that, unlike in the early 1960’s or even in 1967 during the crisis over the Six-Day War, by 1969 and 1970 oil demand had caught up to

² Ibid.

³ Libya’s small population and large currency reserves meant that Gaddafi could, with little exaggeration, claim that Libya could survive a complete shut-down of its industry for months, if not years.

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oil supply and even threatened to exceed it. With the United States operating at near full-production for the first time, there was no longer a cushion of safe oil to be called upon to defend the industrialized nations from the loss of supply from one or more of the major OPEC producers. Because of this change, the balance of power had shifted not just to the radicals in OPEC, but to the oil producers in general.

This chapter will examine how this new reality affected Britain's oil policy during the crucial period from 1968 until 1972. During this period, British Government and company officials began to realize the extent of the shift in power to the producers but found themselves powerless to stop it. Britain, involved in a strategic withdrawal from the Persian Gulf, was particularly eager to avoid instability in the region and was neither willing nor able to offer more than perfunctory support for the companies' efforts to stand firm in negotiations with the producing states. These negotiations were driven by the desire of the OPEC states to increase the posted price of oil and, while the companies' kept symbolic control over this responsibility, by 1971 it was clear that the industry's hold over prices was tenuous at best. This dramatic turn of events and the limited support offered by the Government frustrated BP and Shell immensely since they regarded Whitehall's non-action as a short-sighted attempt at placating opinion in the Persian Gulf to the long-term detriment of the industry's control of oil prices and perhaps even production.

The result of this divergence of opinion was a growing realization on the part of Whitehall that the companies could no longer guarantee the two parts of Britain's oil

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policy – stability and profitability – on their own. Equally apparent, however, was the realization on the part of the companies was the fact that their partnership with the British Government was bringing diminishing returns. Even their hope that the 1970 General Election victory of the Conservatives and their leader, Edward Heath, would presage a return to an active defense of oil company interests proved false. But most crucially for the future relationship between BP and Shell and the Government was the fact that the price increases that would ultimately be conceded to the Middle East producers in 1971 would provoke an increased interest in oil matters by the politicians in Government. Long content to allow the companies and Whitehall officials to make and manage oil policy, the realization that major shifts in the control over oil resources were looming on the horizon suddenly made oil and oil prices an issue for Party leadership on both sides of the aisle and set the stage for growing intervention on the part of ministers into oil affairs.

Coping with Diminishing Influence

The long-term process of change in both the relationship between the companies and the Government as well as within Britain's own oil policy was somewhat obscured by the success of Britain and her allies in overcoming the 1967 oil crisis. But this brief triumph could not hide the fact that Britain's position was changing in the Middle East and, more specifically, in the Persian Gulf. The decision to withdraw British forces from their East of Suez deployments announced by Defence Minister Denis Healey in January,

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1968 was met with shock and dismay by the rulers of the Gulf States and signaled the end of tangible British influence in the region.⁴

Britain's new lame-duck status in the Persian Gulf, combined with lingering resentment on the part of the Arab states regarding Britain's position during the Six Day War, made the period from 1968 to 1971 very trying for British policy-makers and for the oil companies.⁵ This was primarily due to the fact that the British military withdrawal was to leave a tremendous power vacuum. Work was already underway to encourage the formation of a new political unit which would bind together the various Gulf sheikdoms that had been under British protection, but the loss of strategic certainty in the area was inevitable.⁶ Because of the ambiguity surrounding the region's future following the British withdrawal, Whitehall commissioned the Joint Intelligence Committee (JIC) to

⁴ The literature on Britain's withdrawal from the Persian Gulf is expanding with new works due to be released soon. For a representative sample of recent work, see Simon C. Smith, *Britain's Revival and Fall in the Gulf: Kuwait, Bahrain, Qatar, and the Trucial States, 1950-71*, (Routledge Curzon, 2004); W. Taylor Fain, *American Ascendancy and British Retreat in the Persian Gulf Region* (Palgrave Macmillan, 2008); Simon C. Smith, *Ending Empire in the Middle East: Britain, the United States and Post-war Decolonization, 1945-1973* (Routledge, 2012); Helene von Bismarck, *British Policy in the Persian Gulf, 1961-1968: Conceptions of Informal Empire* (Palgrave Macmillan, 2013).

⁵ One example of this can be seen in the negotiations between the Iraq Petroleum Company (IPC) and the Iraqi Government. Negotiations about the fate of IPC's concessions in Iraq had been ongoing since the Iraqi Government promulgated its Law 80 in 1961 which had expropriated 99.5% of the companies' concessionary territory. The Iraqis used Britain's supposed pro-Israeli sentiments to justify the passage of Law 97 in 1967 which further widened the position between the two sides by giving the expropriated territory to the state-run Iraqi National Oil Company (INOC). This move was not surprising and was in some ways welcomed by both the companies and British officials, one of whom noted that "A continuance of the status quo for the next few years would probably be the most desirable outcome." This acceptance was due to a much greater concern regarding the diminishment of Britain's influence with the other Persian Gulf countries. These countries, especially Iran, had demanded increased production levels from the Western companies in order to justify these firms' continued concessionary benefits. A settlement of the Iraq/IPC stalemate would have increased Iraqi oil production and flooded the market to the detriment of other producers. See FCO 67/286, NA, Iraq Oil: Background Note, 1 May, 1969.

⁶ Smith offers an in-depth analysis of the torturous negotiations needed to weld together the Trucial States into the United Arab Emirates. See Smith, *Britain's Revival and Fall in the Gulf*.

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conduct a study on the potential threats to Britain's oil supply as a result of any instability in the Persian Gulf.

The report, finished in July of 1968, was fairly optimistic in its conclusions about the likelihood that Britain's interests would be negatively affected for political reasons, arguing that "Arab and Iranian self-interest and the normal lack of Arab solidarity ought, if these governments always behaved rationally, to be expected to serve Britain's interests both in retaining her investments in Middle East oil and in the flow of oil on reasonable terms."⁷ But, the report cautioned that "emotional and irrational factors are only too liable to play a disproportionately large role."⁸ The real threat in the JIC's view, at least in the short term, were a number of contingencies that could potentially damage oil installations or disrupt the oil transportation networks of any of the Persian Gulf exporters.⁹

Yet another fear for the region was that Britain's withdrawal would allow increased Soviet influence into the Persian Gulf. This was particularly worrisome to the United States, which had responded with outright despair to the British decision to

⁷ CAB 164/564, NA, Joint Intelligence Committee (A): The Implications for Oil Supplies and British Oil Interests in the Middle East and North Africa of Various Forms of Instability in the Persian Gulf up to 1975, 2 July, 1968.

⁸ Ibid.

⁹ These potentialities included an Arab-Iranian conflict possibly caused by Iran asserting claims over some of the Gulf territories such as Bahrain. They also included another attempt by Iraq to conquer and annex Kuwait, the ever-looming threat of another Arab/Israeli conflict and the potential political and strategic chaos that could entail due to the ever present fear of Egyptian saboteurs. BP, in particular, was concerned about the potential for an Arab-Iranian conflict, since such a conflagration would threaten the company's assets on both sides of the Gulf. See BP 66519, BP, H.M.G./Security of Supply Study, 21 February, 1968.

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withdraw.¹⁰ After their initial attempts to pressure Britain into reconsidering its position had failed, the Americans pushed for a continued British presence, at least politically, in the region. This was to some extent achieved by the fact that Britain sought to resolve any outstanding diplomatic issues regarding Bahrain and the other Gulf states.¹¹

But this was not enough of a guarantee for the United States.¹² Instead, the Americans began to formulate what would eventually become known as their “Twin Pillars” policy towards the Gulf in which they attempted to build up both Iran and Saudi Arabia as regional policemen.¹³ The application of this strategy in the Gulf was not necessarily antithetical to Britain’s vision for the region. Indeed it had been anticipated in the Foreign and Commonwealth Office (FCO) that Iran would fill the void left by Britain, hence the efforts by British diplomats to resolve thorny issues such as the status of Bahrain before their withdrawal.¹⁴ But while a rise in Iranian influence was not necessarily a problem strategically, it did demonstrate the difficulties that such a strategic

¹⁰ There is some disagreement among historians as to how surprising the British move was to the Americans. Matthew Jones and Saki Dockrill argue similarly that the United States quickly recognized the necessity of the British decision whereas Simon Smith has countered that claim by arguing that the American’s eleventh-hour attempt to save Sterling from devaluation in 1967 is evidence of a strong desire to stave off any British withdrawal. See Matthew Jones, “A Decision Delayed: Britain’s Withdrawal from South East Asia Reconsidered, 1961-68,” *English Historical Review* 117, no. 472 (June 2002): 569; Saki Dockrill, *Britain’s Retreat from East of Suez: The Choice Between Europe and the World? 1945-1968* (Palgrave Macmillan, 2002); Simon C. Smith, *Britain’s Revival and Fall in the Gul*.

¹¹ These included Iranian claims to Bahrain and several small islands off the coast of the Trucial States.

¹² The Americans themselves resisted pressure from some of the Gulf States to replace a British military presence with US forces. Such a move was simply impossible given the political strains inside the US brought on by the continuing quagmire in Vietnam.

¹³ This policy would come to full fruition under the Nixon administration which came into office early in 1969. The so-called “Nixon Doctrine” demanded that allied countries look after their own defense needs with the knowledge that the United States would support those efforts.

¹⁴ Iran had long claimed sovereignty over Bahrain and had threatened to absorb the island nation at various points over the previous decades.

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shift would entail for Britain's oil supply and for the interests of BP and Shell in particular.

These problems emanated from the fact that the Shah had for several years been pressuring the Consortium operating in Iran to increase its production level in his country. The Shah's "White Revolution," intended to modernize the Iranian economy and society, needed ever-increasing amounts of revenue to fulfill its goals. Prior to this the Consortium had been able to counter the Shah's arguments for expanded production, but the announcement of the British withdrawal from the Gulf was quickly picked up by the Iranians as yet another excuse to demand higher revenues from the oil companies.¹⁵ In August, 1969, the British Embassy in Tehran reported that "The Iranians argue that they deserve better treatment than the Arabs whose backward economies cannot absorb more oil revenues anyway," adding that "they will assume responsibility for the security of the Persian Gulf after our departure in 1971."¹⁶

Participation vs. Nationalization

It was therefore evident to BP and Shell that Britain's decreasing influence in the Persian Gulf would make the maintenance of their positions more problematic. To make matters even worse, they needed Iran's support in the broader struggle within OPEC

¹⁵ The introduction of the Shah's new 5-Year plan which was to run from 1968-1973 demanded an annual production increase of 15%, a number more than twice as high as the 6% that the Consortium believed was possible to dispose of. If such a rise were agreed to, it would mean limiting the increase in production in other Persian Gulf areas to 2.5 percent, a disparity that would not have gone unnoticed in places like Saudi Arabia and Kuwait.

¹⁶ FCO 67/226, NA, Iran/Oil Consortium Relations, 20 August, 1969.

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regarding the future of the oil industry. The shape that this struggle would take was not entirely clear after the failure of the Arab oil embargo of 1967, with some commentators even prognosticating the demise of OPEC following the humiliation of the Arab members.¹⁷

However, the true division within OPEC was not between Arabs and non-Arabs but between conservative and radical members. The so-called “oil rich” states of Saudi Arabia, Kuwait, and Libya under King Idris, and the Gulf States with their small populations and conservative monarchies generally pushed for a more gradual change in the structure of the oil industry. The “oil poor” states of Iraq, Venezuela and Indonesia – with large populations and, in the case of Iraq, a history of poor relations with the oil companies – had a different agenda. These states advocated for a tougher line to be taken with the international oil companies with the goal of eventually assuming greater, if not total, control of the oil industry operating within their borders.¹⁸ Iran traditionally stood between these two groups. In political temperament, the Shah had more in common with the conservative members, but he often toyed with more radical ideas for the oil industry in order to pressure the Consortium during negotiations.¹⁹

¹⁷ Production increases in Iran, Venezuela and Indonesia, all OPEC members, had been partly responsible for the ability of the United States and Western Europe to weather any major disruptions during the abortive embargo.

¹⁸ The replacement of Sukarno by Suharto as president of Indonesia in 1967 significantly improved Indonesian relations with the oil companies. See Nicholas J. White, “Surviving Sukarno: British Business in Post-Colonial Indonesia, 1950–1967,” *Modern Asian Studies* 46, no. 5 (September 2012): 1277–1315.

¹⁹ As was highlighted in Chapter 1, the oil companies and the British Government sought in the past to encourage Iran to disrupt OPEC activities and to serve as a balancing force between the conservative and radical sides. But with Iran in need of greater and greater production levels, it had become more unwilling to play this role.

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Two major outstanding issues provided ground for OPEC to both unite and split over. The first was the generally accepted idea that the posted price of oil was too low and should be raised. On this there was agreement by all the members, but the main issue that divided the conservative and radical sides of OPEC revolved around the question of control over oil production. If the initial stage of OPEC's plan had focused on undoing the price cuts of 1959 and 1960, and second on the percentage of the income received by the producing-states, then this third stage was about taking sovereign control over the oil being produced. This was not a new idea; Mohammed Mosadegh had attempted to nationalize the oil industry of Iran in 1951 and while defeated in practice, Iran's oil was technically the property of the National Iranian Oil Company (NIOC) which contracted out its production to the Consortium of Western oil companies.²⁰ More recently, in 1961 Saudi Arabia's oil minister Abdullah Tariki had pushed for the Middle Eastern producers to nationalize unilaterally all the oil concessions within their boundaries, a position that helped hasten his dismissal.

The conservatives, in the guise of the new Saudi oil minister Zaki Yamani, responded with a less radical plan calling for national companies of the oil-producing states to "participate" in the production of oil.²¹ This would mean that the national oil companies would become partners with the producing companies such as Aramco, IPC,

²⁰ There were two other successful examples of nationalization. The Soviet Union nationalized its oil industry in 1918 and Mexico in 1938. New work is, however, measuring the cost of the Mexican nationalization; see Noel Maurer, "The Empire Struck Back: Sanctions and Compensation in the Mexican Oil Expropriation of 1938," *Journal of Economic History* 71, no. 3 (September 2011): 590–615.

²¹ Ghanem points out that the appointment of Yamani was considered at the time to be a pro-Western gesture. See Shukri Mohammed Ghanem, *OPEC, the Rise and Fall of an Exclusive Club* (KPI, 1986), 108.

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the Kuwait Oil Company, etc. Yamani also hoped that participation would lead to cooperation downstream in the refining and sale of product. He advocated this idea of “participation” in a speech at the American University in Beirut entitled “Participation versus Nationalization a Better Means to Survive.” There Yamani attacked the radical position which advocated outright nationalization of the oil companies’ concessions by pointing out three key factors: the oil surplus made it a buyer’s market, the loss of concessions would remove any impetus from the international companies to maintain oil prices, and such a move would simply result in production competition between the producing states themselves. Speaking for those pushing participation, Yamani pointed out that

For our part, we are not in love with the majors for themselves alone. What matters to us is our own interests. Once these interests coincide with those of other parties, then we have a real mutual interest. We like the consumers because they provide the outlets for our oil. And we like the majors because they provide the buffer element between us and the consumers which is indispensable for the maintenance of world prices.²²

In an attempt to consolidate their position on issues such as participation, the three conservative oil states, Saudi Arabia, Kuwait and Libya, founded OAPEC in 1968.²³ The goal of this organization, according to the staff at the British Embassy in Libya, was “to take the export of oil as far as possible out of the context of Middle East politics.”²⁴ It

²² Zaki Yamani, “Participation Versus Nationalization a Better Means to Survive,” *Middle East Economic Survey* XII, no. 33 (June 13, 1969): 4.

²³ Among the few accounts specifically focused on OAPEC are Abdelkader Maachou, *OAPEC: An International Organization for Economic Cooperation and an Instrument for Regional Integration* (St. Martin’s Press, 1983); and Abdulaziz H. Al-Sowayegh, *Arab Petropolitics* (Palgrave Macmillan, 1984).

²⁴ FCO 67/203, NA, O.A.P.E.C., 26 September, 1969.

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would do this, according to the British Embassy in Kuwait, by strengthening “the hands of the three countries bearing the burden of supporting the economies of the Arab States seriously affected by the war of June, 1967, in resisting further demands.”²⁵

But OAPEC’s role as a stabilizing force was short-lived. In 1969 Algeria joined OPEC, further strengthening the radical position within the larger organization.²⁶ The coup in Libya in 1969 made matters even worse for the conservatives. The new Libyan regime were admirers of President Gamal Nasser of Egypt and adherents to pan-Arab nationalism. This placed them firmly in the radical camp of OPEC and limited the effectiveness of OAPEC as a conservative bloc.²⁷ Speaking with Willie Morris, the British Ambassador to Saudi Arabia, Yamani noted that “He was afraid that through lack of knowledge and experience the new Libyan regime would act emotionally” and that “It was clear that their ultimate intention was nationalisation.”²⁸

A Bit of Soul-Searching

All of these changes seemed to presage difficult days ahead for both the oil industry and for the oil policy-makers in Whitehall. On the surface, the companies did their best to portray an air of confidence. Speaking at a luncheon for the Foreign Press

²⁵ FCO 67/203, NA, O.A.P.E.C., 1 October, 1969.

²⁶ Algeria had taken a hard line with France, the only country producing oil and gas in Algeria, and quickly joined Iraq in calling for a firmer stance on the issue of nationalization.

²⁷ Gaddafi’s coup was a double blow for the oil industry. Not only did it add to the ranks of the radicals in OPEC, but Libya had also been a vital supplier west of the Suez Canal. Libya produced light, sweet crude, a very valuable form of petroleum and its export terminals were the shortest distance from Europe of any producer aside from Algeria. This strategic location had always given Libya an out-sized influence in oil matters, an influence that was now in the hands of a regime that wanted to fundamentally alter the shape of the international oil industry.

²⁸ FCO 67/203, NA, OAPEC After the Libyan Coup, 23 October, 1969.

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Association in London, the Managing Director of Shell, David Barran, concluded a speech with the optimistic idea that

The last ten years have brought many changes: the next will bring many more. But the basic structure, which has worked so well for so long, is not likely to be superseded. Realistic agreements will undoubtedly be worked out that will reflect changing circumstances. But they will continue to be firmly based upon the triple interdependence that exists between the producing countries who have the oil, the consuming countries who need it, and the international companies who provide at one and the same time the link and the buffer between the two.²⁹

But behind the scenes Government officials and members of BP and Shell were equally apprehensive about the future. This concern had grown since the Six Day War and opened some profound questions about the future of Britain's oil policy. In a paper for the Security of Oil Supplies Committee, set up in the wake of the abortive oil embargo, officials made the point clear that it could be "predicted with reasonable confidence, that the terms upon which the U.K. has been able to procure oil hitherto will worsen; and that the dangers of co-ordinated Arab action against the economies of the U.K and the other Western countries will persist so long as there is no durable Arab/Israeli peace."³⁰ This realization led some to question whether Britain's oil policy should anticipate the changes that were coming and to shift away from the old ways of doing things.

No one felt this apprehension more than the outgoing chairman of BP, Maurice Bridgeman. Bridgeman, at the end of his career and in ill health, submitted his gloomy report to the Ministry of Power (MoP) and the Treasury in January, 1968 about the future

²⁹ FCO 67/267, NA, The Middle East and Oil, 19 February, 1969.

³⁰ FCO 54/76, NA, Oil Supplies: A Forward Look at Political Factors, 14 August, 1967

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of BP. The “Bridgeman Memorandum,” as discussed in Chapter 3, argued that Britain’s liberal oil policy, which allowed no protections for BP in its domestic market, was sabotaging the financial strength of the company. He argued that American and French firms had distinct advantages over BP since they were allowed to operate freely in the UK while BP could not do the same in the United States or France.³¹ Bridgeman wanted changes to help make the UK market a safer, more profitable one from which BP, and by extension Shell, could face down pressures from the Middle East.³² He concluded his report with the extraordinary sentiment that “While liberal import and export policies and absence of restrictions have in the past been of great advantage to the Oil Industry, as well as an example to other countries, it is a matter for debate whether this is any longer the case.”³³

This document hit Whitehall at precisely the moment two opposing viewpoints regarding the future of the oil industry were coalescing. The debate was between those supporting a greater state role in the industry in the form of a National Hydrocarbon Corporation (NHC) and those who regarded the independent oil industry as indispensable for the continued stable and cheap flow of oil. BP officials were themselves concerned that their request for more government assistance could fuel the cause of state intervention, noting during a planning meeting that “In seeking Government intervention

³¹ BP’s products were subject to EEC tariffs on the Continent and from import quotas in the United States. Even Shell had the advantage of having one of its parent countries inside the EEC, thus allowing it to circumvent the tariffs. Shell had also been an early entrant into the oil market in the United States and therefore enjoyed a profitable market-share there.

³² Since Shell and BP marketed their oil in the UK together through Shell-Mex and BP, any changes which aided BP would have, by default, assisted Shell as well. These recommendations and the Government response to them are addressed in greater detail in Chapter 4.

³³ POWE 63/339, NA, Memorandum By British Petroleum Company Limited, 31 January, 1968.

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to make our competitive position as comparable as possible with other major companies we should ensure that we do not give a wrong impression about our viability as a private oil company. There were some in Government and Parliament circles who would use such an impression as an argument either for some form of nationalisation of BP or to justify its withdrawal from integrated international operations.”³⁴

BP’s concern was well warranted. Oil policy had long been the domain of relatively medium-level civil servants in the MoP the FCO and the Treasury. Discussions with the oil companies had rarely involved ministers and the Cabinet seldom discussed oil-related issues in non-crisis situations. But this was beginning to change. The “tea parties” at which officials and company leaders exchanged views began to be held with decreased regularity. Even worse, however, was that elements of the Labour Party, chief among them Prime Minister Harold Wilson’s economic adviser Thomas Balogh, sought to bring the actions and activities of the oil companies under greater scrutiny. In this Balogh had many supporters on the Party’s left who viewed BP and Shell with suspicion. These groups had begrudgingly admired the ability of the oil industry to coordinate a response to the 1967 oil embargo, but Balogh refused to concede that Britain was better off due to the activities of BP and Shell.

The swirl of ideas inside the Government and the Labour Party culminated in the Minister of Power, Dick Marsh, calling for a secret review of Britain’s oil policy in

³⁴ BP 66528, BP, Minutes of the 11th Planning Committee Meeting held on 14th April 1969, 21 April, 1969. The arguments for greater state intervention were led by the Labour Party luminary Ian Mikardo backed by the “Hungarians” Thomas Balogh and Nicholas Kaldor, economists who had the ear of Prime Minister Harold Wilson.

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August, 1968. It was hoped that this review could be hidden from the oil industry for as long as possible, although some inside the MoP were “very skeptical whether it will in fact be possible to conceal it.”³⁵ Initially the review was kept closely confined within Whitehall itself, reflecting the unease that many civil servants had about the Labour Party’s politicization of oil policy.³⁶ One memo between members of the FCO described the secrecy as being “done in this way largely to avoid the intervention of Dr. Balogh before the latter moved again to other things.”³⁷ This helped to reinforce the view that Marsh and his department were allies of the oil industry. Richard Crossman noted in his diary that “Dick Marsh was in the hands of his officials,” while Barbara Castle recorded being told by Ian Mikardo that the MoP was “in the pocket of the oil companies.”³⁸

The companies soon caught wind of the exercise and sought to exploit their relationship with the MoP and other departments to protect themselves from any radical re-think of Britain’s oil policy. A meeting of BP’s planning committee reported that “The manner in which the Petroleum Division of the Ministry of Power has been orientating the papers in preparation for the inter-departmental committee is so far basically favourable to BP and our co-operation has proved to be worth while.”³⁹ It is essential to continue to cooperate, “so that we may influence its conclusions affecting our specific interests and so that its representatives may support our views with full

³⁵ FCO 54/81, NA, Note from Killick to Ellingworth, 28 August, 1968.

³⁶ The proposal for the NHC had in fact stemmed from the North Sea Study Group of the Labour Party and not from the Government itself. It was presented at the Labour Party Conference in 1968.

³⁷ FCO 54/81, NA, Memo to JT Fearnley, 12 August, 1968

³⁸ R. H. S Crossman, *The Diaries of a Cabinet Minister*, vol. III, 3 vols. (Hamish Hamilton : Jonathan Cape, 1975) p. 199; Barbara Castle, *The Castle Diaries, 1964-70* (Weidenfeld and Nicolson, 1984) p. 301.

³⁹ BP 66528, BP, Planning Committee: H.M.G. Oil Policy Review, 9 April, 1969.

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understanding when discussion moves into forums where the climate may be less favourable to our interests.”⁴⁰ Despite this, BP and Shell were still very concerned that the oil policy review was simply part of a wider government plot to exert greater control over their activities both at home and abroad. The two companies even considered refusing to cooperate with the review. In a letter from a BP official to his counterpart at Shell, the companies’ strategy was debated. The letter argued that refusing to participate in the review would remove some of the validity of any proposed policies while also avoiding the possibility that their data would be misused or fall into unfriendly hands such as Balogh’s. Furthermore, it would “indicate that there is a limit to the acceptable amount of creeping ‘dirigisme’” that the companies would cooperate with.⁴¹

The companies were right to be concerned since the oil policy review was set to go back to the first principles of the long-standing British oil policy. The initial document laying out the cause for the review put the issue succinctly, stating “The suggestions for change which have been put forward amount broadly to a demand for a more ‘interventionist’ and less ‘liberal’ policy, aimed at giving preferential treatment to British companies and perhaps securing greater direct public involvement in the industry.”⁴² The chairman, J.L. Rampton of the Treasury wrote that

The basic issue on overseas policy is whether our involvement in international oil through B.P., Shell and the smaller British companies on the present scale and pattern still suits our interests. The framework of the industry has been changing and will no doubt continue to evolve whether we like it or not. We need to consider, however, how far we should strive

⁴⁰ Ibid.

⁴¹ BP 66538, BP, Letter from Lindsell to Hirsch, 14 May, 1968

⁴² FCO 54/81, NA, Review of Oil Policy, August, 1968.

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to preserve the present arrangements or whether we should seek to change them in some way, and if so how.⁴³

In order to answer these questions, representatives from the Treasury, MoP and FCO, began to analyze the nation's oil policy thoroughly, both domestic and foreign.⁴⁴ The Inter-departmental Committee on Oil Policy's (IOP) chief concern regarding the future of the international oil industry, and of Britain's oil policy, was the issue of the "dis-integration" of the major oil companies. This was a question simply of whether the producing nations would be successful in claiming participation rights and perhaps even gain control over the production of their own oil. Should dis-integration occur, the business model and the price rationale for the industry, and therefore the policy objectives of the Government, would change.⁴⁵

The theory of dis-integration was propounded most vigorously by Dr. Edith Penrose, an outside academic at the London School of Economics, in her book *The Large International Firm in Developing Countries: The International Petroleum Industry* and was taken up by those in the political establishment who supported greater state participation in oil matters, including Thomas Balogh.⁴⁶ Balogh and others expressed the

⁴³ FCO 67/198, NA, Interdepartmental Working Party on Oil Policy, 11 October, 1968.

⁴⁴ The domestic aspects of this review will be discussed in the Chapter 7.

⁴⁵ Britain had always based its policy on the fact that financially it was more of a "producing" rather than a "consuming" country in the sense that BP and Shell made much of its profit off of the production of crude oil and the sale of refined products outside of the United Kingdom. Because of this, the British government did not share the same fear of higher crude oil prices held by other governments since it meant that BP and Shell's profits, and homeward remittances, would increase. Should the industry disintegrate, Britain would have the double-blow of greater supply insecurity and a loss of the most profitable aspect of the business. On top of this, BP and Shell would be forced to increase their downstream profits which would result in a large rise in petrol and fuel oil prices inside Britain.

⁴⁶ See Edith Tilton Penrose, *The Large International Firm in Developing Countries: The International Petroleum Industry* (Allen & Unwin, 1968).

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view that dis-integration might not necessarily be harmful to Britain's interests. In fact, they argued that direct government-to-government contracts could replace the buffer role of the international oil industry. These outside specialists also helped reinforce the idea that the Labour Government was being ill-served by the civil service. The specialist knowledge required in order to manage and regulate the oil industry was difficult to come by and some within the political establishment felt that the civil service was overly reliant on BP and Shell for help in matters related to oil and gas.

This held true even as the Ministry of Power was absorbed into the Ministry of Technology in October, 1969. The new minister in charge of energy issues was Tony Benn, who had not yet developed into the nemesis of the oil industry he would later become. While the merger was intended to show Labour's commitment to paving the way to a better technological future, it had little practical impact on energy matters.⁴⁷ Through this political transition, the Inter-departmental Committee on Oil Policy performed what Sir Thomas Brimelow, a mandarin in the FCO, had once described as the "brake theory" of the civil service, meaning "that it was the civil servants' function to see that nothing much happened."⁴⁸

The civil service's oil policy review lived up to that expectation by concluding in regards to dis-integration that "Developments of this kind are unquestionably possible but we do not judge them to be very probable during the period under review since it seems

⁴⁷ The BP Economic Relations Department commented on the reorganization by noting that "there will be very little change in day-to-day dealings at official level." See BP 36977, BP, Whitehall Reorganisation, 8 October, 1969.

⁴⁸ Tony Benn, *Office Without Power: Diaries, 1968-72* (Hutchinson, 1988), 208.

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clear that among the parties directly concerned – producing countries, international companies, or consuming countries – few want to move far in this direction.”⁴⁹ This meant that the review recommended little change to the current oil policy. The committee lamely concluded that

Our broad policy objectives have been to obtain adequate supplies of oil for consumption in the U.K., at the minimum risk, at the least cost to the balance of payments and at low pre-tax prices; and to secure the maximum balance of payments benefit from the British companies' overseas operations. These objectives remain valid and relevant. Despite all the uncertainties ahead, we believe that they can best be secured within the present framework of the international oil industry, and that we should seek to maintain the British stake in it, while encouraging competition at home.⁵⁰

A Conservative Approach

Although the IOP's final report ultimately supported BP and Shell, the review process itself marked a new low in relations between the oil companies and the Government. The Labour Party's moves to assert more control over oil policy had alienated BP and Shell and made them concerned about the willingness of the Government to fight for the future of the oil industry. It was therefore not surprising that the firms watched with some hopeful anticipation as the Labour Party's electoral fortunes began to cloud throughout 1969.

Optimistically, BP organized a series of seminars for Members of Parliament to educate themselves on oil and gas matters. What made these meetings unique was that

⁴⁹ POWE 63/655, NA, Oil Policy: Report by a Working Party of Officials, 5 August, 1970.

⁵⁰ POWE 63/655, NA, Oil Policy: Note by the Chairman of the Official Working Party, 6 August, 1970.

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almost everyone invited was a member of the Conservative Party.⁵¹ BP officials justified this by pointing out Labour's low standing at the time and the fact that it looked likely the Conservatives would win the upcoming election. But BP had other reasons for favoring the Conservatives as well. One memo about the seminar recorded the prevailing sentiment that "From oil's point of view the likely Conservative attitude to fuel policy has two promising features: the absence of a sustained pressure group for coal within the Party and an inherent tendency towards support rather than suspicion for the private sector of industry. Moreover, the weight of policy-forming opinion lies in those income levels and geographical areas most aware of the contribution of oil to private amenity and public prosperity."⁵²

Luckily for BP, the Conservatives swept into office just as the oil policy review was being completed. Several of the review's status quo items were contingent on consistency in Britain's strategy overseas. Chief among these was the decision to pull out from East of Suez. Heath's Government quickly put policy-planners at ease by upholding the withdrawal decision and promising to follow through on the final preparations for the British departure.

⁵¹ Out of 20 MP's invited, 19 were Conservatives.

⁵² BP 66528, BP, MP's Seminar Project, 8 May, 1969. Labour's fortunes, however, began to rebound in late 1969 and by early 1970 it appeared that they were set to cruise to another easy election victory. Such was the confidence of several top Labour Party members that when Edward Heath's Conservatives registered a shock victory in June of 1970, they were left with no London accommodations to live in as they had not bothered to secure any.

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The oil companies were optimistic about relations with the new government.⁵³

The IOP's report was given to the new ministers and its conclusions worked well with BP and Shell's vision for the future.⁵⁴ But the Heath Government had no intention of simply returning to the "good old days" of free oil-company reign over the nation's oil policy. Heath came into office committed to pro-market policies but also to creating a leaner and more efficient government. This meant a government that had more technical expertise with which to weigh policy decisions. In October 1970, the Conservatives published a White Paper entitled *The Reorganization of Central Government* in which they laid out their vision for a small but more effective government. This White Paper led to the merger of the Ministry of Technology and the Board of Trade into the Department of Trade and Industry (DTI), a new, larger department that was intended to unify fuel and industrial concerns.⁵⁵

Of equal importance to the future of oil policy was the creation of the Central Policy Review Staff (CPRS). This group was to be based in the Cabinet Office and would advise the prime minister and his cabinet with the goal of enabling them "to take better policy decisions... and to ensure that the underlying implications of alternative

⁵³ The Conservatives election manifesto *A Better Tomorrow* included many policy proposals that were in BP's interest such as entry into the EEC, income-tax reform, and a general pledge to open up the economy to a greater dose of free market principles. The Conservatives had also pledged to go ahead with a plan to run down the coal industry in Britain, a move that would have furthered the move from coal-fired to oil and gas-fired power plants.

⁵⁴ The Conservatives drive for greater reliance on the market in the realm of energy ran counter to the Bridgeman Memorandum's call for a preferred position for BP, but Heath's plans for taxation reform was enough to allow BP to move on from that idea.

⁵⁵ This new department was to be led by John Davies who had, until the election, been the director-general of the Confederation of British Industry.

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courses of action are fully analysed and considered.”⁵⁶ Chosen to head this new enterprise was Lord Victor Rothschild, a scion of the famous banking family but, more importantly for oil policy, a longtime employee of Shell who had recently retired as the vice-director of scientific research.⁵⁷ When Rothschild got the CPRS up and running in February 1971, he requested a member of Shell’s staff to be seconded to him. The choice was Dr. Anthony Fish, who together with Rothschild would give the CPRS, in the words of two former members of the think tank, “an enduring capability on energy matters.”⁵⁸

The two oil companies were confident that these moves by the Heath Government would help to improve relations between the two sides. The resumption in September, 1970 of regular “tea parties,” which had been held with decreasing frequency under the Wilson Government, also added to the sense that relations would recover from the low depths they had reached under the Wilson Government.⁵⁹ But the cozy attitudes did not last long. The Heath Government, and Rothschild’s CPRS in particular, were not about to abdicate responsibility over the nation’s oil policy. Far from simply embracing the oil policy of the early 1960’s, the Conservative Government would attempt to rethink the issue. A series of events that threw the domestic political scene and the international oil

⁵⁶*The Reorganisation of Central Government*, 71 1970, 13–14, House of Commons Parliamentary Papers, http://gateway.proquest.com/openurl?url_ver=Z39.88-2004&res_dat=xri:hcipp-us&rft_dat=xri:hcipp:rec:1970-059695. Date accessed 26 January, 2012.

⁵⁷ When describing the choice of Rothschild in his memoirs, Heath noted that he “wanted someone with a mind of his own, who would stand up not only to me and my colleagues but also to the mandarins in the civil service.” See Edward Heath, *The Course of My Life: My Autobiography* (Hodder & Stoughton, 1998), 316. Heath’s biographer, John Campbell, credits Burke Trend with suggesting Rothschild and called the selection, “one of the best appointments Heath ever made.” See John Campbell, *Edward Heath: A Biography* (Jonathan Cape, 1993), 317.

⁵⁸ Tessa Blackstone and William Plowden, *Inside the Think Tank: Advising the Cabinet 1971-1983* (Mandarin, 1990), 28.

⁵⁹The “tea parties” would even be redubbed “oil lunches” as the civil service expanded the hospitality extended to the visiting oilmen.

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industry into turmoil would turn this inclination into action. If the previous Labour Government had been committed to greater intervention in an attempt to seize the “commanding heights” of the oil industry, the Conservative Government would seek to intervene sparingly and selectively – but intervene decisively nonetheless.

A Radical Triumph

And so the increasing interest in oil by politicians was therefore already beginning by 1970. But in many ways the changes in the British Government, and its concern with oil policy, were the least of BP and Shell’s concerns. After years of enjoying the buffer provided by an oil surplus, the oil market began to tighten in 1969 and 1970.⁶⁰

Unfortunately for the West, OPEC was falling increasingly under the sway of its radical members. In Libya, Gaddafi had solidified his control over the country and turned his attention to the international oil companies operating within Libya. His next moves would expose the divisions within the international oil industry and help to spark a series of events that would culminate in the seizure of control over prices by OPEC by 1973.

One of the major factors that had weakened the ability of the major oil companies to resist the demands of the OPEC countries was the rise of the so-called “independents.” These smaller oil companies, some of them huge corporations in their own right, had

⁶⁰ This was due to several factors, most importantly being the decline in the United States’ productive capabilities which increased demand for imported oil there. The United States had traditionally operated an import quota in order to guarantee a market for domestically produced crude but, with falling production, it was forced to increase this quota. With the United States now importing more of the world supply, and with Alaska and the North Sea still several years from coming online, the new demand could only be met by OPEC.

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fought their way into concessions in the Middle East, often by offering better terms than the established majors.⁶¹ This gradual fragmentation of control over oil production also lessened the ability of the companies to coordinate responses to pressure put on the oil industry by the producing states. This was certainly the case in Libya where the early oil laws, passed under the administration of King Idris, had been crafted to promote competition. Some of the largest producers in Libya were independent oil companies such as Occidental, the Oasis Consortium and Bunker Hunt.⁶² The problem was that many of these companies held very few concessions elsewhere in the Middle East and were therefore dependent on their supplies from Libya to fulfill their contracts in Western Europe.

This weakness opened all the oil firms in Libya to potential conflict with the regime. Gaddafi's regime had actually attempted to start negotiations with the firms in early 1970, asking for a larger increase in the price of Libyan oil that would reflect both its superior quality and its desirable location.⁶³ But these moderate approaches were rebuffed by the companies which feared that relenting would simply set a precedent for the unpredictable regime.

Then in May, 1970, a seemingly innocuous event created the perfect conditions for a revolution in oil prices. Far away from Libya, in southern Syria, a tractor digging a trench to lay a phone line accidentally ruptured the TAP line, a pipeline carrying roughly

⁶¹ Examples include Continental, Atlantic Richfield, Bunker Hunt, Amerada-Hess and Getty.

⁶² The Oasis Consortium was made up of the independents Marathon, Amerada-Hess and Continental backed by Shell. Bunker-Hunt, meanwhile, operated in partnership with BP in Libya.

⁶³ Libyan oil was light and sweet, meaning that it had a low sulfur content and thus a higher percentage of the oil could be refined into lighter, more desirable elements such as gasoline.

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500,000 barrels of Saudi crude to the Mediterranean coast every day.⁶⁴ With the Suez Canal still closed, this was a devastating development for the transportation of crude.⁶⁵ Tanker capacity was already stretched and rates skyrocketed.

For Gaddafi, however, the situation presented the opening he needed to pressure the oil industry into submission. Libyan crude had been supplying 30 percent of Europe's oil even before the accident and the inability to transport Saudi crude to the Mediterranean made Libyan oil that much more valuable. The Libyan regime moved to exploit its advantage and picked the Occidental Oil Company as its target.⁶⁶ Gaddafi's negotiators ordered Occidental to cut back its daily production from 800,000 to 500,000 barrels a day under the threat of nationalization, demanding large price increases from Occidental as well as a new profit-sharing arrangement. Occidental's chairman, Dr. Armand Hammer, frantically tried to build support from the other oil companies to back him in resisting the Libyan demands. But the oil majors were not quick to support a pesky independent oil company that had undercut them in order to gain the Libyan concession in the first place.⁶⁷ This failure to help on the part of the oil majors proved to be a short-sighted move. Eventually, Hammer was forced to relent and sign onto a new

⁶⁴ There was speculation at the time as to whether this pipeline rupture was entirely accidental.

⁶⁵ Nasser had closed the Suez Canal in response to the Six-Day War. The Canal would remain closed until 1975.

⁶⁶ Occidental was the third largest producer in Libya but was by far the most dependent on Libyan oil supplies.

⁶⁷ Jersey Standard also had the very legitimate excuse that providing cost oil to Occidental would have been economically detrimental. Libya's high currency reserves would have meant that they could have sustained Occidental's cutback for a prolonged period; Jersey Standard would be forgoing profit on the cost oil provided to Occidental for an indeterminate period. See Steven A. Schneider, *The Oil Price Revolution* (Johns Hopkins University Press, 1983), 144.

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agreement increasing Libya's profit take from 50 to 58 percent.⁶⁸ The FCO watched these developments with concern, conceding that "With the present tight – and even dangerous – international supply situation, the Libyans hold all the aces."⁶⁹

The Libyans next turned their attention to the Oasis Consortium and attempted to pressure them into the same type of agreement conceded by Occidental. Shell, which was the only major company that belonged to Oasis, attempted to hold firm and buttress its smaller American partners, but they were simply too reliant on Libyan crude to resist and gave in to the Gaddafi regime's demands.⁷⁰ The Oil Department of the FCO wrote gloomily that "Now that company solidarity has been breached by the Libyans as a result of the Occidental agreement and the apparent submission of Shell's Oasis partners, it seems only a matter of time before the rest of the industry fall into line."⁷¹

When the other companies did agree to most of Libya's terms, all within two months of the Occidental agreement, they made sure to declare the new terms unilaterally rather than "agree" with the Libyan Government, so as to avoid recognizing the principle of governments to negotiate over posted prices.⁷² Despite this attempt at message

⁶⁸ For an excellent description of these events, see Anthony Sampson, *The Seven Sisters: The Great Oil Companies and the World They Shaped* (Bantam Books, 1991); and Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (Simon and Schuster, 2008), 556–562.

⁶⁹ FCO 67/446, NA, Libyan Oil, 21 September, 1970.

⁷⁰ Shell had actually been forced to stop production by the Libyans in response to their hard line. Turner points out that Shell was by far the most willing to battle Gaddafi and later the other oil producers. This was due in large part to the fact that their oil holdings were diversified across many states. See Louis Turner, *Oil Companies in the International System* (Royal Institute of International Affairs, 1978), 137.

⁷¹ FCO 67/446, NA, Oil Meeting and Lunch, 23 September, 1970: Steering Brief, 22 September, 1970.

⁷² Ghanem, *OPEC, the Rise and Fall of an Exclusive Club*, 122.

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management, there was no denying that Libya had struck a major blow against the international oil industry.⁷³

Even worse for the companies was the fact that their defeat in Libya increased concern regarding the ability of the international oil industry to continue to supply oil securely and cheaply. This alarm was exacerbated by independent oil analysts such as Walter J. Levy, who pointed out the power-shifts underway and argued for a reconfiguration of the role of consuming-state governments in the management of the world's supply of petroleum products. BP noted with apprehension that in light of Levy's arguments, "European governments will undoubtedly reconsider the extent to which public policy as well as corporate initiative should bear upon the future distribution and security of their oil supplies."⁷⁴ This was due to the fact that the Libyan settlement was an example of an uncomfortable new situation wherein an oil producer had ignored economic arguments in order to pursue what was at its heart a political objective. BP reflected in an internal memo regarding Levy's article that "the issue between the companies and Libya had become less a matter of bargaining over economic terms than a critical matter of maintaining the flow of essential oil supplies," and that "the Libyan settlement thus stands out as a politically-imposed settlement, in large

⁷³ Yergin argues that the Libyan victory "was emboldening; it not only abruptly reversed the decline in the real price of oil, but also reopened the exporters' campaign for sovereignty and control over their oil resources, which had begun a decade earlier with the foundation of OPEC, but then had stalled." Yergin, *The Prize*, 562.

⁷⁴ BP 37002, BP, *Implications of a Libyan Settlement*, October, 1970.

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measure owing to the increasing and by now the very substantial dependence of Europe upon Libyan oil.”⁷⁵

Price Leapfrogging and the Limits of British Influence

Few thought that the Libyan triumph would be the end of the matter. At a meeting between US and UK officials held in December of 1970, the two allies fretted together over the precedent set by the companies’ capitulation in Libya. Blame was cast on the companies for not agreeing to Libya’s initial moderate demands. J.R. Bottomley, the top FCO official at the meeting, even wondered “whether the Libyan surrender was necessarily wise in the long run, even though it was clearly in the short term interest of the U.K. as a consumer and of both the U.K. and U.S. as parent Governments with regard to their relations with the consuming countries of Western Europe.”⁷⁶ But the reality was that neither government had offered much help to the companies involved. Even if the governments had sought to assist the firms in their negotiations, Gaddafi’s antipathy towards the US and UK would have made such support of dubious value.

The concern over the precedent set in Libya was quickly born out as the settlement there soon spread discontent to the other oil producers. Nowhere was this truer than in Iran. The yearly battles between the Shah and the Consortium over production levels was as much about prestige as it was about actual finances and therefore the Shah could not let the Gaddafi regime’s success stand above his own. The

⁷⁵ Ibid

⁷⁶ FCO 67/445, NA, Anglo/American Oil Discussion, 3 December, 1970.

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Shah almost immediately demanded that Iran also receive 55 percent profit share from the Consortium, and OPEC as a whole followed suit with a similar demand in December, 1970. But the oil producers' demands went beyond profit-splitting. Some commentators began to argue that the tightening oil market required an increase in posted prices as well.

To negotiate these demands, the major oil companies proposed a global settlement to bring all oil production under the same rules and taxation levels. The hope of the oil industry was to maintain a united front against OPEC and simultaneously end the process whereby one OPEC nation or group of nations might strike a deal only to be leapfrogged by another OPEC nation. To pursue these goals, fifteen of the major international oil companies met at the suggestion of Shell and formed the London Policy Group (LPG), which was granted special dispensation from the US Department of Justice helping the American firms to circumvent anti-trust laws.⁷⁷

But the Shah would not agree to such a grand bargain and insisted that the companies meet with regional groupings of OPEC members in order to strike deals more suited to the local circumstance. The Shah invited representatives from the oil companies operating in the Persian Gulf to attend a meeting in Tehran. The Iranian ruler argued that this was in the companies' best interest because the Gulf States were much more moderate whereas any negotiation with the whole of OPEC would result in a radical

⁷⁷ Turner, *Oil Companies in the International System*, 137. Included in the LPG were BP, Shell, Exxon, Mobil, Texaco, Gulf, Standard Oil of California (Chevron), CFP, Marathon, Continental, Nelson Bunker Hunt, Occidental, Amerada-Hess, Atlantic Richfield, Grace Petroleum and Gelsenberg. See Francisco Parra, *Oil Politics: A Modern History of Petroleum* (I. B. Tauris, 2004), 128.

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victory for all the producing nations. Negotiations with the Gulf States would, he promised, result in a five-year deal.

The companies felt that such split negotiations would simply result in further leapfrogging. Besides that, they had dealt with the Shah for long enough to be distrustful of his claims of a five year agreement. The LPG therefore decided to hold the line on having a single meeting, stating in January, 1971 in a “Message to OPEC” that “We have concluded that we cannot further negotiate the development of claims by member countries of OPEC on any other basis than one which reaches a settlement simultaneously with all producing governments concerned.”⁷⁸

While the LPG might not have bought the arguments promoted by the Shah for split negotiations, one very important actor – the US Government – did. Meeting with the Shah in January, right around the time the “Message to OPEC” was released and just days before the oil company representatives were to arrive in Tehran to continue to push for an all-encompassing negotiation, Under Secretary of State John Irwin II and American ambassador to Iran Douglas MacArthur II agreed with his proposal for the negotiations.⁷⁹ This move shocked the oil company representatives and undercut their position drastically. The British Government, meanwhile, did little to push back against

⁷⁸ Quoted in Schneider, *The Oil Price Revolution*, 150.

⁷⁹ Schneider argues that the United States’ position reveals that their primary concerns were to avoid a diplomatic disagreement between OPEC and the West. The primary objective of the US policy was to prevent an oil embargo while the oil industry’s main objective was to stop the process of leapfrogging prices. Schneider also argues that the US was not overly concerned about a rise in Middle East oil prices since this would make higher-priced US-produced oil more attractive to domestic consumers and would lessen the demand for oil imports at a time when the US was beginning to suffer from balance of payments difficulties. See *Ibid.*, 155–157. Parra argues that the Irwin mission accomplished little other than informing the OPEC states of the fact that the consumer states would probably force their companies into an agreement so as to avoid a shutdown of their oil supplies. See Parra, *Oil Politics*, 131.

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the American position and in fact agreed with them. With the final touches being put on the British withdrawal from the Gulf, Whitehall could not afford to anger the Shah or the Americans.⁸⁰ In a brief written up for Anglo-American oil talks due to be held in December, 1970, the FCO wrote “We do not want difficulties over oil with Iran, especially while there are other unresolved disputes in the Gulf. To the Iranians we take the line that we do not interfere with the companies' commercial judgement, but we do not, in fact exclude the possibility of putting discreet pressure on them (though there is not in fact much leverage available to us).”⁸¹

The companies were therefore forced to relent on the idea of one all-encompassing negotiation and started out the talks in Tehran on the back foot. The pressure from the Persian Gulf producers did not let up even as negotiations began.⁸² Led by the Shah, they issued a series of demands regarding the increase of posted prices, the abolition of the small marketing allowance granted to the companies in 1965 and a new formula for pricing oil according to its gravity.⁸³ To up the pressure, the producers announced on 3 February, 1971 that if the oil companies did not reach an agreement with them by 15 February, they would unilaterally legislate a new pricing agreement. If any

⁸⁰ The British Government had, however, resisted Iranian attempts to bypass the Consortium and to barter oil directly to Britain in exchange for an order of Chieftain tanks. During the Libyan cutbacks, the Iranians had attempted to fill the void through raising production beyond the capacity of the Consortium to dispose of it. The offer to barter with the British Government, or at least to have the Government pressure the Consortium to take the extra production, was resisted in an attempt to maintain the distance of the British Government from the day-to-day affairs of the oil industry. See FCO 67/445, NA, Outline Brief for Anglo/American Oil Discussions, 27 November, 1970.

⁸¹ Ibid.

⁸² The countries participating in the Tehran talks were Iran, Kuwait, Bahrain, Qatar, Abu Dhabi, Saudi Arabia and Iraq. Saudi Arabia and Iraq would participate in both sets of negotiations since they were Persian Gulf and Mediterranean exporters due to the TAP line and the Kirkuk-Banias pipeline.

⁸³ The gravity of the oil dictated the types of product which could be extracted from it. Lighter oils produced more gasoline and other elements such as naphtha while heavier oils produced more fuel oil.

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company did not accept this legislated price increase, OPEC promised to withhold all supplies until the company complied.⁸⁴

This unity on the part of the oil producers was unprecedented and could not be matched by the oil industry. The LPG, which was chaired by BP during the crisis, did paper over some of the divisions between the companies, but ultimately the risk of confrontation with the producers over 75 percent of Europe's oil proved decisive. The weakness of the companies in this situation was exacerbated by the fact that the US and UK Governments offered little to no diplomatic support for a unified position.⁸⁵ Because of their lack of unity, the oil industry had no choice but to accept the Gulf producers' demands in Tehran. They capitulated on 14 February and signed a deal that became known as the Tehran Agreement on 15 February. The Agreement conceded most of the Persian Gulf producers demands regarding pricing but did grant the crucial concession that there would be no leapfrogging or production restrictions for five years.⁸⁶

This dramatic defeat of the oil industry caught the attention of Britain's political leaders. On 15 February, the day the Tehran Agreement was signed, Edward Heath

⁸⁴ This move played on the distrust that existed between the oil companies who feared that a principled stand against OPEC might result in a competitor stealing their oil and markets.

⁸⁵ British officials later discussed the possibility that the US had welcomed the price increases brought about by the Tehran and Tripoli Agreements. Lord Cromer, the UK ambassador to Washington, noted in a letter to the DTI that "The recent large increases in revenue secured by the O.P.E.C. countries work to the advantage of the U.S. in some ways. They lower the disparity between U.S. and world oil prices, thus relieving the pressure for liberalisation of imports, and their impact will be felt more by competing industrialized nations than by the U.S." See POWE 63/709, NA, Cromer to Bottomley, 18 May, 1971.

⁸⁶ The agreement resulted in the following: an increase of the posted price by \$0.35 per barrel at all Gulf oil terminals, an increase of 2.5 percent in the posted price plus \$0.05 from 1 June, 1971 along with an increase of 2.5 percent plus \$0.05 in 1973, 1974 and 1975, the pricing differential according to the gravity of oil that the OPEC nations wanted and the elimination of the small per barrel marketing allowances that had been granted to the oil companies. It also made the 55 percent government take a uniform principle across OPEC.

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invited Chairman of BP Sir Eric Drake to dine with him at Chequers. The two had a long discussion about the negotiations and the changing situation in the international oil industry. Drake, who had a penchant for dramatic statements, put it to the Prime Minister that “the question of oil supplies and prices for Europe had now become a political problem for Governments, not a commercial problem for companies.”⁸⁷ He argued that “the point had now been reached where Governments had to come to grips with the whole problem, and to consider what political pressures could be applied to ensure energy supplies for Europe,” and that “the oil companies could not see what more they could do.”⁸⁸

Drake was not the only one who realized the game had been irrevocably altered. Writing years later, Fadhil Chalabi, who had attended Tehran as a member of the Iraqi delegation, remembered that “The Tehran outcome empowered OPEC and reversed the dominance of the oil companies.”⁸⁹ This shift in the balance of power was felt almost immediately after the Tehran Agreement was struck. The deal agreed upon with the Persian Gulf producers was only one half of the oil price equation, as negotiations with the Mediterranean producers were still to come. The Libyans opened these negotiations with a list of demands presented on 23 February which would have dramatically increased Libya’s and the other Mediterranean producers’ income per barrel. The Algerians upped the pressure by taking a controlling interest of 51 percent on all French

⁸⁷ CAB 184/10, NA, Note for the Record - Meeting of Drake and Prime Minister, 15 February, 1971.

⁸⁸ Ibid.

⁸⁹ Fadhil J Al-Chalabi, *Oil Policies, Oil Myths: Analysis and Memoir of an OPEC Insider* (I. B. Tauris, 2010), 60.

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oil companies operating within its borders and Libya threatened to follow suit should their demands not be met.⁹⁰

While the Libyan position was not as strong as it had been in 1970 due to the reopening of the TAP line, the companies still had no interest in seeing their concessions nationalized. The Libyans had the wherewithal to wait out any boycott of their oil thanks to their large currency reserves and it was doubtful whether the companies would be backed up by their home governments who were desperate to avoid an oil shortage. The companies therefore once again capitulated and accepted many of the demands presented to them at Tripoli. The Libyans had effectively once more leapfrogged the Persian Gulf producers and had succeeded in cementing their earlier gains on top of receiving all the benefits conceded at Tehran.⁹¹

The Tehran and Tripoli Agreements nearly completed a remarkable reversal in the power relationship between OPEC and the international oil industry. The oil companies had been forced to capitulate on almost every point and were to suffer financially because of it. Their failures would also help to color the relationship between the companies and their host governments, particularly the relationship between BP and Shell and the British Government. One frustrated oil company negotiator summed up the sentiment in the boardrooms of the international oil industry towards the Western governments by saying

⁹⁰ The Algerian move struck a major blow to France's managed oil market and called into question the wisdom of relying on one source for so much of France's oil. The two largest French companies, CFP and ERAP, both attempted to blacklist Algerian oil, but in the tight market, smaller American companies soon rushed in to purchase available supplies. See Turner, *Oil Companies in the International System*, 138. For a description of France's policy and its development, see Douglas Andrew Yates, *The French Oil Industry and the Corps Des Mines in Africa* (Africa World Press, 2009).

⁹¹ The Tripoli Agreement had raised the cost of Libyan oil for the oil companies working there from \$1.40 to \$2.30 a barrel in just six months. See Schneider, *The Oil Price Revolution*, 161.

that “All these governments had no conception of the scale of the disaster to which their lack of initiative and solidarity was exposing them. In this climate, the companies had no sound alternatives; they saw themselves as damned if they did, and damned if they didn’t.”⁹²

Losing Control

Although disappointing to BP and Shell, both they and the Government clung to the hope that the Tehran and Tripoli deals would hold for the specified five year period, thus bringing a modicum of stability back to the oil market. But the silver lining would soon vanish as oil producers continued their pressure on the international industry. The result of this further conflict would be a rapid shift of attitudes in both Whitehall and the boardrooms of BP and Shell about the role the Government needed to play in the future.

The cohesion of the Tehran and Tripoli Agreement first began to give way as the result of a decision that was only tangentially related to oil. Increasing economic problems in the United States pressured the Administration of US President Richard Nixon to decouple the US Dollar from gold in August 1971.⁹³ This shocking move effectively ended the Bretton Woods system, which had governed international finance and trade since the Second World War, and ushered in a period of fluctuating values amongst the major currencies. This in turn led to difficulties in pricing oil. The Tehran

⁹² Sampson, *The Seven Sisters*, 273.

⁹³ Some of these economic problems stemmed from the spending on the Vietnam War and the inflation that came with it, coupled with balance-of-payments difficulties which were exacerbated by the increased price of foreign oil. The decision by the Nixon Administration was made and announced with little warning to Britain and the other Western European allies, a move that did little to help American-European relations.

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and Tripoli Agreements were predicated on a certain idea of the value of the US Dollar; with that value now altered, the OPEC states became concerned that their oil was worth significantly less than they had anticipated. They therefore demanded that prices be increased again to make up for the difference. Shell once more led the opposition to such a concession. Sir David Barran argued to the FCO that he “saw no reason in principle why the OPEC countries should be compensated at all,” commenting that “OPEC had no right now to be given special treatment, compared to others who also lost by currency changes.”⁹⁴

But the by-now dispirited oil companies did not follow Shell’s lead. The issue was resolved in January, 1972 during a meeting in Geneva held between OPEC and the major companies.⁹⁵ Their agreement stipulated that OPEC would be compensated for the losses incurred by the devaluation of the US Dollar with an across-the-board increase of 8.5 percent on posted prices.⁹⁶ While the price issue was resolved easily enough, the negotiations (on the other hand) showed the tenuous nature of the structure of the Tehran and Tripoli Agreements and the ease with which OPEC could force the companies to tweak such an agreement.

This realization resurrected another question which had been discussed a few years previous but had been abandoned as untenable at the time. This was the issue of

⁹⁴ FCO 67/621, NA, Record of a Meeting with the Chairmen of BP and Shell, 9 November, 1971.

⁹⁵ The Smithsonian Agreement of December, 1972 revalued the dollar against gold and revalued the other major currencies against the dollar. This stabilization allowed OPEC and the companies to come to terms more easily although some, such as David Barran of Shell, felt that giving OPEC a price increase was foolish since every other international industry had suffered a similar shift in the values of their contracts without similar readjustments.

⁹⁶ It was also agreed that future prices would be regulated by an index of eleven currencies rather than simply the US dollar.

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participation in – or even nationalization of – oil production. In the minds of the OPEC leaders, issues of participation had nothing to do with the Tehran and Tripoli Agreements, which they argued were only related to the price of oil, and not about who controlled the production of that oil. The companies disputed this belief, arguing that Tehran and Tripoli had covered all aspects of oil production for five years. These protests were shrugged aside, and certain members of OPEC felt that it was an ideal time to renew their claims for participation in oil production within the concessions on their territory.

Yet there were still differences of opinion within OPEC about how best to proceed. Algeria had opened talks with the French on a similar matter in 1969 and by the time talks broke down in 1971, it had nationalized 51 percent of the French concessions within its territory. Venezuela had offered a less confrontational Hydrocarbon Reversion Law stipulating the nationalization of all productive fields in the first few years of the 1980's upon the natural expiration of concessions held by the international companies. The successful passage of these laws inspired the other members of OPEC to pursue a firmer strategy towards participation. But disagreement remained regarding how much participation should be sought. It was generally agreed that the participation shares would require compensatory payments so as to avoid alienating the international oil industry, whose expertise was still required. Therefore the more conservative OPEC states wanted to push for an initial 20 percent participation agreement whereas Libya,

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with its large cash reserves and small population, demanded an immediate 51 percent share.⁹⁷

The oil industry's response to these initiatives was predictably negative, but some companies still met the challenge, albeit with resignation. Even BP and Shell were divided as to how hard to fight the concept. On the matter of price, Shell had been willing to fight to the bitter end, while BP was willing to make concessions; on the matter of participation, however, the opposite was true. BP, with its huge concessionary stakes in the Middle East, was prepared for battle knowing that participation would cost it control over much, if not most of its oil. Shell, on the other hand, felt that a more moderate position would have a greater benefit in the long term. During a meeting with the Prime Minister, Sir David Barran made it clear that he and his firm "saw the OPEC demand for participation as part and parcel of the developments which he had already foreshadowed, as the oil-producing countries became increasingly aware of their bargaining strength."⁹⁸ British officials tended to agree with Shell's assessment. In preparation for a meeting with their American counterparts, a FCO memorandum declared Britain's policy succinctly by stating, "We believe that a growing degree of producer government participation in production is inevitable and are anxious to see the adjustment made as smoothly as possible."⁹⁹

This continued to be the position even as the lines for negotiations were being drawn. While preparing for a meeting with the chairmen of BP and Shell, the Oil

⁹⁷ Whether Libya would agree to any meaningful compensation was another matter.

⁹⁸ PREM 15/595, NA, Record of a Meeting with David Barran, 5 October, 1971.

⁹⁹ FCO 67/570, NA, Anglo-US Oil Talks: 28 and 29 October 1971, October, 1971.

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Department of the FCO wrote that “It is difficult for us to support the companies diplomatically as long as they hold out against the principle of participation,” but added that “we shall support them in every feasible way to obtain the best compensation terms.”¹⁰⁰ Since most accepted that some form of participation was inevitable, the question became how to get the best deal for the industry. Compensation was an important issue but it was also one that was contingent upon the percentage of participation agreed to. Therefore the first issue was how much the countries would get, the second was how much the companies would receive for that percentage and, finally, what would be done with the oil that came from the exporting countries’ share.

But events once again intervened to ratchet up the pressure on the international oil industry. In December, 1971 just before negotiations were due to commence on participation in January, Libya nationalized BP’s 50 percent share of the lucrative Sarir field. The move was made in response to the supposed British acquiescence to the Iranian seizure of three small, uninhabited islands in the Persian Gulf which had been vacated by the British as one of the final steps of their military withdrawal from the Gulf.¹⁰¹ While the nationalization was ostensibly because of this surrender of “Arab” land, to the British ambassador, M.P.V. Hannam, “it seemed...that the impelling motive was the Libyan wish to show suitable revolutionary zeal to other OPEC members on the matter of participation.”¹⁰²

¹⁰⁰ FCO 67/621, NA, Meeting with the Chairmen of BP and Shell, 5 November, 1971.

¹⁰¹ The islands were of no practical value, but the Shah worried that they could be used as a staging area for rebels to launch raids against Iranian shipping.

¹⁰² FCO 67/610, NA, Letter Hannam to Chalmers: Nationalisation of BP, 9 December, 1971.

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The nationalization of BP's stake in Libya coupled with Algeria's earlier nationalization efforts increased the pressure on the more moderate Gulf state producers to achieve a similar triumph through a new participation agreement. When the companies and the Gulf producers eventually began meeting, negotiations were predictably difficult. The producing countries' initial offer was for a 20 percent participation stake that would eventually escalate to 51 percent. This share would be purchased at net book value, which was essentially 20 percent of the overall money invested in the fields to make them operational.¹⁰³ The offer went on to include a provision that this participation oil would be sold back to the companies at a price half-way between the companies' tax-paid costs and market price.¹⁰⁴

None of these aspects of the deal were acceptable to the companies at first, although the industry once again lacked a unified negotiating position. Alec Douglas-Home, the British Foreign Secretary wrote in instructions to Britain's embassies with exasperation that,

While the negotiations are still in these early stages and many further alarms and excursions may be expected, we are worried that the London Policy Group as a whole seem to have no common fall-back position. Some individual companies may have given thought to the matter but even here we are kept in the dark. Other companies, we fear, may merely be sticking their heads in the sand.¹⁰⁵

¹⁰³ The companies demanded to be compensated for the profits they would give up as a result of losing control of the oil still in the ground for the period until their concessions were due to expire.

¹⁰⁴ This met a major company concern: the loss of oil that they had planned on using to fulfill their contracts. The companies wanted to purchase the participation oil at the posted price which was now below market value. The producers countered that allowing this would simply make participation nothing more than a cosmetic change.

¹⁰⁵ CAB 184/57, NA, Telegraph no. 542: Oil: Participation Negotiations, 3 March, 1972.

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This sentiment was seconded by Lord Rothschild who commented that “The negotiating positions of the oil companies appear to be characterised more by their diversity than by cohesive strength, and to have little chance of success.”¹⁰⁶

To combat this lack of unity, the companies agreed after the initial meetings on participation held during the Geneva talks on the revaluation of the dollar to allow the American consortium, Aramco, to negotiate with Saudi Arabia on the London Policy Group’s behalf. The feeling was that the deal struck by Aramco and Zaki Yamani would serve as a template for all other participation deals. Aramco made bold and unyielding statements against the principle of participation, starting out with a firm negotiating position against any concession on the issue. Despite the bravado, Douglas-Home feared that the industry’s lack of a common position would allow Yamani to divide and conquer the oil companies.

In effect, this is exactly what happened. Yamani called together the interested countries to an OPEC conference in March, 1972. Before the meeting even gathered, the wily Saudi oil minister let it be known that “If the negotiations were to fail there would be no alternative but for OPEC members to implement the demand through unilateral legislation.”¹⁰⁷ The pressure was further increased when King Feisal of Saudi Arabia, usually friendlier to the companies than Yamani, declared that there would be no negotiation on the principle of participation. Aramco conceded the concept of 20 percent participation just before the OPEC meeting was due to begin. BP and Shell, who had

¹⁰⁶ CAB 184/57, NA, Letter from Rothschild to Sir Robert Marshall, 16 February, 1972.

¹⁰⁷ FCO 67/744, NA, Letter from Chalmers to Bottomley, 14 March, 1972.

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watched the negotiations from London, bitterly reported to the FCO that they had “been annoyed and frustrated by the hard line that Aramco have hitherto taken in their discussions with Yamani and at the way that Aramco held their cards close to their chest and then when under duress from the King threw in their hand.”¹⁰⁸ Shell in particular felt that if Aramco was going to surrender at the last moment, they would have been better served by agreeing to participation at the very beginning, thereby creating a positive tone for negotiations about the details regarding compensation and buy-backs.

The British Government, on the other hand, was relieved that the principle of participation was finally conceded.¹⁰⁹ But despite this move in the negotiations, the FCO noted that “there is still room for considerable divergence of views over the manner and timing in which it is to be implemented and over the level of compensation.”¹¹⁰

Whitehall continued to hope that the companies would be able to rally together now that participation was on the horizon to win the best deal possible. The FCO in particular hoped that if eventual 51 percent participation “were achieved smoothly and with the payment of satisfactory compensation, there could well be beneficial effects for consumers in the form of a more stable and acceptable relationship between companies and producers.”¹¹¹ In the end, the FCO rosily stated that “It is above all in everybody's

¹⁰⁸ FCO 67/744, NA, Telno 183: OPEC – Participation, 17 March, 1972.

¹⁰⁹ The decision by Britain's coal-miners to go on strike in February, 1972 increased the burden on Britain's oil policy makers to do what they could to encourage complicity on the part of the oil companies. It was felt that during the strike, everything possible needed to be done to avoid a disruption of oil supplies as well.

¹¹⁰ FCO 67/744, NA, Guidance Telegram No. 77, 10 March, 1972.

¹¹¹ Ibid.

interest that the process takes place in an atmosphere of negotiation rather than confrontation.”¹¹²

Under Pressure

Unfortunately, negotiations had gotten to a point where confrontation was all but inevitable. This was due to the fact that another set of talks was occurring simultaneous to the participation meetings. Between January and May the long-running feud between the Iraq Petroleum Company (IPC) and Iraq had once again boiled over. The specific issue was the amount of taxes Iraq was demanding to be paid on its northern oil, which was delivered to the Mediterranean, but the heart of the matter was the long-standing dispute over Iraq's confiscation of the IPC's concession in 1961. The problem for these already complex and tense negotiations was that if Iraq consented to reimburse IPC for their confiscated territory, this would undermine the position of OPEC regarding compensation to be paid for participation. Likewise, if IPC backed down without compensation, this could undercut the companies in their negotiations with OPEC.

After much discussion, negotiations completely broke down; on 1 June, 1972, Iraq took the bold step of nationalizing the Kirkuk oil field, one of the largest in the world. Because of the tense situation between OPEC and the companies at the time, the international industry's response to the nationalization was muted. BP and Shell informed the Government that they intended to “‘play it long’ to avoid on the one hand an open battle which might spread to other Gulf countries, and on the other hand a

¹¹² Ibid.

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weak attitude which would cause the other oil producing countries to step up their demands in the current OPEC negotiations.”¹¹³ While the industry did not blacklist Iraqi oil, they did not go out of their way to buy it. Following the nationalization, Iraq wanted to strike an accommodation with IPC in order to have a new relationship with the company that they still needed to market their oil. But until the other participation negotiations were finished, this was impossible.¹¹⁴

The pressure of the Iraq nationalization left the companies in a difficult position. The more moderate OPEC countries would now feel even more pressure to succeed in achieving their participation demands. To decrease the tension, the members of the Iranian Consortium began separate negotiations with Iran and convinced the Shah to give up the principle of participation in exchange for a guaranteed increase in Iranian production from 4.3 mb/d to 8 mb/d by 1976.¹¹⁵ Several other perks were also granted the Shah and, in exchange, the Consortium solidified its position as the principal producer operating in Iran for fifteen years beyond the expiration of their original agreement in 1979.¹¹⁶ Crucially, however, the Shah refused to allow the agreement to be signed until after the participation negotiations were settled.

¹¹³ CAB 164/1196, NA, Letter from Boardman to Heath, 2 June, 1972.

¹¹⁴ These negotiations are dealt with in detail by Dietrich. See Christopher R. W. Dietrich, “‘Arab Oil Belongs to the Arabs’: Raw Material Sovereignty, Cold War Boundaries, and the Nationalisation of the Iraq Petroleum Company, 1967-1973,” *Diplomacy & Statecraft* 22, no. 3 (September 2011): 450–479.

¹¹⁵ In a way this was an easy decision for the Shah. The symbolism of participation was somewhat meaningless to the Iranian leader due to the fact that the resolution of the 1951 Nationalization Crisis in Iran had left the National Iranian Oil Company as the “owner” of all Iranian oil while the Consortium was merely the “operator” of those fields.

¹¹⁶ These other perks included the provision for a small quantity of oil to the National Iranian Oil Company which it could market downstream on its own.

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This had the perverse and unintentional effect of placing even more pressure on the companies. The move to settle with the Shah angered the other Gulf producers and by not convincing the Shah to sign the deal before the end of the participation negotiations, the industry had created a situation where the Iranian, Iraqi and broader participation negotiations were all linked together. Many within Whitehall viewed this situation with a mix of apprehension and annoyance. Some, even within the normally pro-BP and Shell DTI, even began to question openly whether the companies were pursuing such a reckless strategy because they felt any concessions forced on them by legislation or nationalization would be easier to bring to their shareholders than a voluntary agreement. The DTI civil servants therefore advised their minister, John Davies, that “our interests lie in telling companies that we shall be able to support them only if they adopt a more conciliatory attitude.”¹¹⁷

But as negotiations dragged on through various levels of acrimony it became apparent that the British Government’s traditional hands-off policy paralyzed its ability to inject itself more forcefully into the discussion. The participation issue had again opened up the threat that one element of Britain’s oil policy would have to be sacrificed to spare the other. Should the companies capitulate, it could threaten cheap oil supplies, but if they stood their ground they risked the security of the supply. The FCO worried that if the companies did not pass along the price increases to consumers, “they will lack the capital to invest in the future exploration” that would “be necessary to produce the

¹¹⁷ POWE 63/901, NA, OPEC Negotiations, 16 June, 1972.

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increasing amounts of oil required during the rest of the century.”¹¹⁸ Yet the balance within Whitehall tended to favor security of supply over cheapness. The DTI pointed this out in a guidance memo to Davies saying, “As a parent government we want Shell and BP to obtain the best possible terms in the current participation negotiations. As a consumer government however our main concern is with the security of supply and the latter interest takes precedence over the former.”¹¹⁹

The biggest problem, however, for the British Government was that its already limited influence in the situation extended only to BP and Shell. As BP and Shell were quick to remind Whitehall, the decisions in the participation negotiations were not theirs alone to make, noting that they were “backed in consortia with the American companies and cannot move without them.”¹²⁰ All the Government could do was pledge to push the American State Department to do what it could to influence the American majors.¹²¹ The divergence of opinion within the London Policy Group meant that the de-facto position of the oil companies was resistance to any concessions to the OPEC position beyond the 20 percent participation agreed to by Aramco in March.

But holding out against the producing states only increased the risk of unilateral legislation or nationalization with the accompanying bad will. It was the underlying threat of supply destabilization that most worried British leaders. The companies eventually overcame their differences with great difficulty and hashed out a deal with

¹¹⁸ FCO 67/744, NA, Guidance Telegram No. 77, 10 March, 1972.

¹¹⁹ POWE 63/902, NA, OPEC Strategy: Guidelines for Shell and BP, 14 June, 1972.

¹²⁰ POWE 63/901, NA, UK Strategy towards OPEC, 25 May, 1972.

¹²¹ The fact that relations between the Heath and Nixon governments were not the warmest did not help this situation.

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Yamani under a cloud of threats from the members of OPEC. But when the negotiations reached what should have been their end in October, 1972 with an agreement between Yamani and the companies on a reasonable participation framework, British and other Western leaders were deeply troubled to find that many of the other OPEC states temporarily rejected Yamani's pact.¹²²

Most of the disputes were over small issues that were eventually resolved and when the deals were all signed early in 1973, it became apparent that while the industry had put up a good fight, the results were very near a rout.¹²³ The fact that OPEC was gaining the strength and wherewithal to withhold oil and that they were willing to use that strength to assert their will had created a brave new world for oil negotiations. For the first time it became increasingly apparent that in the future, oil supplies might be neither cheap nor secure.

¹²² Even supposedly moderate states such as Abu Dhabi and Kuwait held out for more and the Shah instantly demanded a renegotiation of his deal in order to make it equitable to what Yamani had wrung out of the industry.

¹²³ The basics of the deal included immediate 25 percent participation that would rise to 51 percent by 1983. The compensation paid to the companies would be calculated using updated book value which was essentially the net book value adjusted for inflation and containing several escalators that would help increase the value of the compensation while not acknowledging the right of the company to receive more. This was better than OPEC's initial offer but still far from what the companies had demanded. The oil that went into OPEC control would be divided into three different categories. The first was oil which was to be sold directly by the national companies of the OPEC states. The second would be sold back to the companies and the third was a "balancing factor" of oil that the governments could market themselves or sell back to the companies. The result of this program was that the companies would lose roughly 50 percent of the profits they would have made upon the buy-back oil, had it stayed in their control. See Schneider, *The Oil Price Revolution*, 181. Valérie Marcel and John V Mitchell, *Oil Titans: National Oil Companies in the Middle East* (Brookings Institution Press, 2006), 28–29.

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Conclusion

In the aftermath of the Tehran and Tripoli agreements, the oil analyst Walter Levy wrote “the winds of change for the oil industry that have been stirring throughout the decades since 1950 have now risen to hurricane proportions.”¹²⁴ It was a fitting metaphor. Most educated observers, including many within the British Government, had foreseen the massive changes that struck from 1968 to 1972 but even so were shocked by the rapidity of their arrival and the triumph they brought to the oil producers. The string of defeats faced by the oil companies, coupled with the concession of participation, radically altered the traditional relationship between the companies and the oil producers. Indeed, the only real power that remained tenuously in the hands of the companies was the ability to set the posted price of oil. Throughout all talks and negotiations, the companies had “voluntarily” agreed with the oil producers to increase the posted prices thus, theoretically, keeping that privilege to themselves.

Despite this fig-leaf, few doubted that the era of complete oil-company control over the oil industry were over. The days where the governments of the Middle East were content to sit back and receive their royalty and tax payments had been replaced by a new era in which the governments would be equals, if not superiors, to the companies. While the exertion of sovereignty was a triumph for the oil producers, however, it was a worrying development for the oil consumers. Just as the OPEC states had previously sat back and watched the oil revenue fill their coffers, so too had the oil consumers been content to allow the oil industry a free hand in producing, transporting, refining and

¹²⁴ Walter J. Levy, “Oil Power,” *Foreign Affairs* 49, no. 4 (July 1971): 652–668.

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distributing supplies throughout the industrialized world. But now the future of that system seemed uncertain.

In Britain, such uncertainty could not have come at a worse time. The Government of Edward Heath had fallen upon hard times. Heath's plans for Britain ran into the realities of economic struggle and his attempts to liberalize the country's economy were abandoned in a humiliating "U-Turn." But the event that dovetailed most with the changes in the oil industry was the 1972 coal miners' strike which began in January and necessitated the declaration of a state of emergency. The strike woke Heath and his ministers to the threat that an energy crisis could pose to Britain and increased alarm regarding the loss of control over the oil industry from the companies to the oil producers.

This growing concern only fueled the process of heightened Government interest in the oil industry. The efforts of both the Wilson and the Heath Governments to expand the competence of the State in regards to oil issues were only encouraged by the seeming inability of the oil industry to stave off the challenge to their position. Even worse were fears put forward by Walter Levy and other academic and journalistic specialists in the oil industry such as Edith Penrose and Anthony Sampson, that the recent changes in the price and tax structure, as well as the acceptance of participation made the future motives of the oil companies suspect.¹²⁵ In effect, these analysts argued that the companies now had a greater community of interest with the producers than with the consumers; Levy

¹²⁵ This argument was made privately by Levy to British officials. Penrose and Sampson made claims such as these in their publications. See Edith Penrose, "The Development Crisis", *Daedalus*, vol 104, no. 4, (1975), pp. 91-112; and Sampson, *The Seven Sisters*.

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himself said in a private meeting with officials that “the oil companies had no choice but to be increasingly subservient to the producing countries since their profits and their corporate property depended on maintaining supplies and good relations with the producer country governments.”¹²⁶ Although these arguments were not generally accepted in Whitehall, they did add to the concern that the traditional oil policy of Britain was collapsing.

This was not an entirely new fear as British officials had, of course, been working towards insulating Britain from the effects of an oil shortage or crisis to a varying extent since the Suez Crisis (as discussed in Chapters 3 and 4), but the dramatic change in the international oil industry that became apparent in the first years of the 1970’s brought the matter more firmly to the attention of ministers. This was due, in large part, to the fact that the defeat of the oil companies had not only thrown into question the issue of the security of supply, but also the price of oil. With inflation beginning to grip Britain and other industrialized countries, the modest price increases imposed by the Tehran and Tripoli agreements as well as at the Geneva meeting were most unwelcomed by the Heath Government. If BP, Shell and the other oil companies could not guarantee either half of the nation’s oil policy, officials were faced with the uncomfortable realization that a better way forward needed to be found.

¹²⁶ PREM 15/1836, NA, Note of the Secretary of State's Dinner Meeting with the American Oil Consultant, Mr Walter Levy - 17 January, 1973, 19 January, 1973.

Chapter 6 – Preparing for the Worst, 1971-1973

When Edward Heath tapped Lord Victor Rothschild to head the Central Policy Review Staff (CPRS), it was done in part to give the Cabinet greater insider knowledge of the oil industry. Rothschild's time as the director of research for Shell was supposed to make him an ideal candidate for interpreting the ins and outs of international oil production for the Prime Minister and his colleagues. But Rothschild had enough experience with oil companies to know that he would require outside assistance in deciphering the intentions and the course of the industry as well as in predicting the best path forward for the British Government. For this, he continually turned to Walter J. Levy. Levy was the world's foremost oil analyst, based in New York, but one with a special connection to Britain. A German Jew, Levy had been welcomed in London after being forced to flee the Nazis in the 1930's. Levy remained grateful for this shelter for the rest of his life and happily worked to advise Rothschild on oil-related issues.

Levy, or "our consultant in New York" as Rothschild referred to him in all but the most secret of correspondence, provided a valuable counter-point to the companies.¹ The Cabinet had long been nearly totally reliant on BP and Shell to provide them with insights into the oil industry and depended on their information to make strategic decisions about oil policy. The fact that Levy and other analysts were increasingly called

¹ Levy did a great deal of sensitive analysis for some of the world's leading oil companies and did not want it to be widely known that he also advised governments, such as Britain's.

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on from the late 1960's and into the 1970's reveals a growing concern that the trust placed in the companies was no longer completely warranted.

This was especially the case after the string of defeats suffered by the companies from 1970-1972. The situation was bluntly assessed by Sir Denis Greenhill, the Permanent Under-secretary of the FCO, who wrote to Rothschild that "It is increasingly evident that the international oil industry, by itself, will be unable in future to withstand the co-ordinated pressures of the oil producer governments," and that "it seems likely to cause a much greater governmental involvement in future dealings on oil matters with the Middle East producer governments."² What exactly this meant was difficult to define. Thus Rothschild turned again to Levy. Levy himself had made it known since the Tehran and Tripoli agreements that the oil consuming states would need to play a more active role in the defense of their oil interests. In December, 1972 he wrote to Rothschild allowing him to see a draft of a major policy speech he was preparing to give in March, 1973. In it, Levy laid out his vision for how the oil-consuming world should respond to the changes which the international oil industry was undergoing. He argued that the growing power and unity of the oil producers needed to be countered to avoid its irresponsible use; the oil consumers could no longer rely on the oil companies to provide that counter since "The companies are mere pawns in this balance (or imbalance) of power."³

² CAB 184/58, NA, Letter from Greenhill to Rothschild, 20 September, 1972.

³ CAB 184/58, NA, Letter from Rothschild to Marshall, 12 December, 1972.

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Instead, Levy argued that the consuming states, led by the United States and the United Kingdom needed to unify their efforts to reduce dependency on oil and to protect themselves from the misuse of oil by the producing states of the Middle East. The Americans, Europeans and Japanese needed to work together to achieve this because none were “of a sufficient size to ‘go it alone.’”⁴ Levy went on to argue that “all this points to the need for an Atlantic/Japan alliance of consumer countries, devoted to working out a coordinated and stable free world energy policy; to subordinating the companies to the collective interests of the consuming countries; to offsetting the potentially disruptive power of the producing countries; and to ensuring as far as possible that the revenues of oil producing countries are channeled into sensible international development projects.”⁵ Just as importantly to Levy, however, was the fact that these proposals needed to be initiated by Britain. In an earlier meeting with members of the CPRS, he had noted that any proposal emanating from the United States “will be regarded with suspicion by other consuming countries (rightly or wrongly).”⁶

Interestingly, these views were not all that surprising to either Rothschild or to other officials within Whitehall. This was because BP and Shell had been making similar arguments as well. The firms had made it clear that the lack of diplomatic support from consuming countries had fatally undermined their ability to coordinate with other firms, allowing competitive distrust to undermine any unified position. This also meant that the diplomatic support had to itself be unified. Support from Britain or the United States

⁴ Ibid.

⁵ Ibid.

⁶ CAB 184/58, NA, Letter from Mayne to Rothschild, 8 December, 1972.

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would be useful, but not enough. Additional support from the EEC and Japan, backed up with a plan for consumer cooperation, however, would be something that the Organization of Petroleum Exporting Countries (OPEC) would have to take seriously. This would also allow the Government a greater role in defending their oil interests while leaving the day-to-day oil matters to the companies.

But the unified advice from Levy, the companies and even the CPRS was not a guarantee that this new approach would be followed. Although most within the Government from Heath downward realized that the old system was no longer tenable, concern and fear about exposing Britain to the wrath of OPEC consistently hampered the ability of ministers and officials to settle on a new strategy. Because of this fear, caution reigned in Whitehall as did a plethora of other ideas about how Britain could adjust to face the new threats to its oil policy. As J.F. Mayne of the CPRS noted to Rothschild, “we should not commit ourselves to any initiatives or firm points of view over the emerging oil sharing arrangements, over our oil policy as a member of the EEC, or over the type of consumer country collective defence agreements we should pursue, until we were much more sure of where our national interest lay.”⁷

This cautious approach dictated the British Government’s attempts to rework its role in oil-matters and ultimately prevented it from implementing the advice of Levy or BP and Shell; the years from 1971 until the Oil Crisis of 1973 were wasted as officials debated the pros and cons of various policies that might bolster the companies or strengthen the security of supply and oil’s benefit to the British economy. This

⁷ Ibid.

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procrastination left Britain and the rest of the oil-consuming world open to the supply and price disaster that would befall them in October, 1973.

Diagnosis

While it had long been expected that the international oil industry would eventually cede greater control over production to the OPEC states, the rapidity of the oil companies' negotiating collapse from 1970-1972 provoked grave doubts in Whitehall. By achieving the price increases of the Tripoli and Teheran Agreements, as well as by gaining their own supplies of tradable oil through participation, the OPEC countries now had the means to cut back production and leverage their position to divide the OECD countries. Unlike in 1967, the oil industry lacked any reserve capacity outside of OPEC to act as a safety valve to any political pressure from the cartel. In Britain, North Sea oil was tantalizingly close, but even so, it was not predicted that the country would ever be able to be self-sufficient.⁸

The question of how to meet the challenges of the newly evolving reality of the international petroleum market had consumed Britain's oil policy apparatus even before the participation negotiations exposed the growing power divide between the companies and the producing countries. These deliberations had led to the questioning of Britain's traditional policy of relying on the private oil industry to insulate its oil market from price and security shocks by the Government but also by the oil companies. But although both

⁸ Early estimates were that Britain would be able to produce 50 percent of its required needs by 1980, subject to restrictions and limitations on exports.

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Whitehall and the Boards of BP and Shell agreed that the Government should increase its capacity to intervene in the negotiations and perhaps even operations of the international oil industry, just what this intervention would look like, and to what ends it would be directed, provoked new disagreements.

To examine these issues, a new working group of officials was created in March, 1971 in the aftermath of the Tehran and Tripoli agreements. During its first meeting, Sir Denis Greenhill declared “that the changes discussed in the oil review for 1970 had occurred far more rapidly than had been then foreseen,” and that “we should consider what action we could take to anticipate future changes rather than allow them to overtake us.”⁹ The Interdepartmental Working Group on International Oil Questions (GOQ), as it became known, began a wide-ranged examination of many aspects of Britain’s dealings with the oil-producing states and with the international oil industry, particularly with BP and Shell. This working group, which included representatives of the DTI, the Treasury, the FCO and the CPRS, set about diagnosing the problem that had created the Tehran situation and which would lead to the continued difficulties of the oil industry.

They did this by first soliciting the opinions of the boards of Shell and BP through a detailed questionnaire. The responses from Shell’s Sir David Barran and BP’s Sir Eric Drake revealed just how difficult any reconfiguration of Britain’s oil policy would be. This was because their two responses showed that the oil companies were themselves divided on the nature of the problem and the solution. Barran responded to the inquiry by

⁹ CAB 184/10, NA, Note of a Meeting Held in Sir Denis Greenhill's Office at 11:15 AM on 26 March 1971 To Discuss the Setting up of a Working Group to Review Certain Aspects of Oil Policy, 26 March, 1971.

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writing, “There has been a radical change in the relationship between producers and consumers, rather than producers and oil companies, brought about by the recognition by producer governments that... they will be able to force up the level of taxation, leaving prices to follow, and that at present consumers have no countervailing powers.”¹⁰ BP, on the other hand, resisted the line that such a radical shift had taken place. Robert Belgrave, a BP official who had previously worked in the old Foreign Office, pushed back during a meeting with Whitehall officials, warning against “any assumption that the ‘traditional’ relationships between producer Governments and the international oil industry were necessarily about to be dramatically changed,” and pointed out “that even the fierce negotiations of the recent months had been concerned almost entirely with matters of price and cost and had not disturbed the ‘political’ relationships of the parties involved.”¹¹

But it was Shell’s answer that the GOQ focused on. The CPRS in particular felt that the shift described by Barran had indeed remade the playing field by pitting the producers directly against the consumers. In particular, it was the struggle over participation that caused the CPRS to begin to question the long-term wisdom of entirely trusting Britain’s oil policy to the companies. Dr. Anthony Fish, the CPRS’s oil specialist, voiced this concern in an exchange with members of the FCO and DTI by writing, “What we should recognise about the position of the majors is the difference between increasing OPEC ‘take’ and OPEC participation demands. Demands along the

¹⁰ POWE 63/709, NA, A Reply to the Questions in the Note Attached to Mr. R.H.W. Bullock's Letter of 6th April, 1971, 26 April, 1971.

¹¹ BP 4812, BP, HMG Working Group on Oil Policy, 20 May, 1971.

former lines leave the majors very much in the same camp as the consumers, but participation would make the majors' position more ambiguous.”¹²

Prescriptions for Change

While the companies would have disputed these assertions, they too recognized that their relations with Whitehall needed to be reconfigured in order to rebalance their position vis-à-vis the producing states. BP and Shell were not in total agreement as to what they would have liked to see happen in the future in terms of the role of the British Government, but there were two main areas that they hoped to see improvement in. First, they expected and wanted greater diplomatic support during their negotiations with OPEC. Immediately following the Tehran and Tripoli Agreements, several Members of the British Parliament suggested a Parliamentary statement to the effect that Britain expected the OPEC states to abide by the agreements. But Foreign Secretary Alec Douglas-Home reported that “Shell/BP think that a communication, in general terms, through diplomatic channels, to the six OPEC governments concerned would be more appropriate than a Parliamentary statement and more likely to be effective in helping to make the agreement stick.”¹³

The second thing the companies demanded was that a privileged financial situation be granted to them by the British Government. Both firms had long argued that the financial restraints put on their investment programs by the Treasury was

¹² CAB 184/10, NA, Letter Fish to Mayne, 4 November, 1971.

¹³ FCO 67/563, NA, Tehran Telegram No 131, 15 February, 1971.

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handicapping them against their American rivals and had weakened their fiscal position. This had, especially in the case of BP, weakened the firms' ability to bargain with OPEC. Near the end of the participation negotiations, Sir Eric Drake sent a note to the DTI and Treasury arguing BP's case for greater Government protection. In the cover letter of the so-called "Drake Memorandum," David Steel, Drake's deputy, argued that BP stood "to reap the benefits of twenty years of deliberate policy aimed at geographical and marketing diversification," but that "on the threshold of these rewards the financial strains of bringing them about are at their greatest, and OPEC demands for 'participation' do not help this."¹⁴ Because of this, BP felt it was the Government's duty to give the Company a favorable position against its rival oil companies by ensuring that BP would have a safe, low-tax, foundational operation in the North Sea. This would give BP the wherewithal to withstand the loss of profits from the Middle East and to put up a stronger fight against OPEC in the future.¹⁵

Other members of BP went even further. During several informal meetings with the CPRS, some top BP officials began to feel out Whitehall regarding an idea that would have been anathema both to the company and to the Government just a few years prior. This proposal called for the construction of a managed market in the UK on the model of the French system, the essential elements of which would be "the control of refinery expansion, the control of product imports and some system for quota allocation of crude imports." Clive Hardcastle of BP argued that since the UK was now poised to join the

¹⁴ POWE 63/829, NA, Letter from Steel to the Chancellor of the Exchequer, 20 October, 1972.

¹⁵ The Drake Memorandum will be discussed in greater detail in Chapter 7.

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EEC, “Britain and Germany should now follow the lead of France and others in establishing a managed oil market, as a step on the road to the eventual formation of a single managed market at the European level” in order to “avoid future decisions in the oil world being taken exclusively by the Americans and the Arabs.”¹⁶

Hardcastle pinned many of BP’s financial troubles on the fact that the company had been unable to adapt to the changing situation seeing as it had traditionally made most of its profits in dealing crude – a strategy called into question by producer participation. He and others at BP recognized that the situation was not tenable and that greater Government help was necessary. But this did not mean allowing BP to become simply a state-run company. Hardcastle stated to Wade-Gerry of the CPRS that “BP recognised that, if the British Government gave them a favoured position by establishing a controlled national market, it would want in return to have a bigger influence on company policy than had been traditional hitherto. BP would accept this, on the basis that such back seat driving was inevitable anyway and would be less damaging if it came as part of a package deal which brought the company major advantages in other ways.”¹⁷

While these ideas excited the CPRS and provoked thoughts that “it might offer a rather better and more constructive basis for a new relationship between BP and the

¹⁶ CAB 184/58, NA, Views of BP, 14 December, 1972. The negotiations regarding Britain’s entry into the EEC had been finalized in 1972 and were to take effect 1 January, 1973. The implications of this will be discussed to a further extent in Chapter 7.

¹⁷ CAB 184/58, NA, Views of BP, 23 November, 1972. Hardcastle went on in claiming that “BP’s long-term aim would be to establish as wide a gulf as possible between their increasingly public-utility role in supplying the British and European markets on the one hand and on the other their more truly entrepreneurial activities in the North Sea, Alaska and the OPEC countries.”

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Government,” the DTI was noticeably less enthralled.¹⁸ Wade-Gerry remarked that the meeting between Hardcastle and the DTI did not go well on the grounds that the plan “would represent a further departure from Minister's philosophy of industrial non-intervention, which would be particularly hard to justify to Government supporters in the case of an apparently highly prosperous industry.”¹⁹ After the numerous U-turns that had marked the Heath Government's economic policies, creating a cozy managed market for BP was simply too much for the Conservatives to bear politically.²⁰

The DTI and the CPRS did agree, however, on the need to prepare the British oil market, and the British companies, for eventual entry into the EEC. Whitehall had several ideas for not only improving BP's bargaining strength against OPEC but also smoothing the transition to the Common Market. These plans revolved around the idea of selling part of the Government's holding in BP to other European governments or of encouraging a greater partnership between BP and continental oil companies. The CPRS floated this idea, which had been around for several years, in 1971 during the problems with Libya and Iraq. In Libya especially, BP's attachment to the British Government was a drawback and the CPRS felt that perhaps “If BP were turned, in fact as well as in name, into the European Petroleum Co Ltd its Britishness in Arab eyes would be reduced and

¹⁸ Ibid.

¹⁹ CAB 184/58, NA, Views of BP, 14 December, 1972.

²⁰ Despite promising to let British industry sink or swim on their own, the Conservative Government was forced to step in to save Rolls Royce in 1971 and later the Upper Clyde Shipbuilders through nationalization. These moves disgusted some members of the Conservative Party, including the Secretary for Education Margaret Thatcher.

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thus its vulnerability when the Arabs are wanting to be nasty to Britain without simultaneously alienating e.g. Germany.”²¹

In 1973 the idea was brought to prominence once again when the great merchant banker Siegmund Warburg brought a proposal straight to Heath himself calling for Burmah Oil's share of BP, roughly 23 percent of the company's stock, to be sold to European, particularly German, concerns.²² Heath was intrigued by the idea given its potential bolster the concept of European energy cooperation, but others in his Government were not as positive. Peter Walker, the new minister for the DTI, wrote to the Prime Minister that the Warburg proposal might mean the board of BP would have to include non-British members. This, according to Walker, might make it “difficult to maintain the same closeness of relationship between BP and the Government and BP's support for our national policies, such as the development of a British capability for North Sea supply.”²³ But Heath was not “not wholly persuaded that it would necessarily be disadvantageous to accept European interests on the Board of B.P.” He added that “Ways could surely be found to maintain the closeness of our relationship with the Company while enlisting European support for its success and understanding of its difficulties.”²⁴

²¹ CAB 184/10, NA, EPC and BP, 28 October, 1971.

²² Burmah's shareholding stemmed back to the creation of the Anglo-Persian Oil Company (APOC) in 1909. When Winston Churchill orchestrated the purchase of 51 percent of APOC by the Treasury in 1914, Burmah was left with a 25 percent shareholding. This had dwindled down to 23 percent due to Burmah's decisions at various points not to participate fully in rights offerings.

²³ PREM 15/1835, NA, Letter from Walker to Prime Minister, 15 February, 1973.

²⁴ PREM 15/1835, NA, Letter from Prime Minister to Walker, 22 February, 1973.

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When the proposal was put forward to BP and Burmah, it fell flat. Eric Drake felt that “it would be very much to our national disadvantage to have European directors on the board of BP because this could mean that any strategies that we were pursuing with BP would quickly be disclosed to European Governments.”²⁵ This refusal showed once again the limit of Government control over “their” oil company and revealed the difficulty of getting private firms to accept politically expedient decisions that might have been contrary to their interests.

These limitations had informed much of the discussion in the GOQ and had encouraged another notion about how best to protect the two pillars of Britain’s oil policy. This was the concept of the British Government engaging more directly in oil matters. There were many opinions on how best to achieve this, but most of these views saw Britain doing more than simply giving the overt diplomatic support which BP and Shell had requested. Instead, these various schemes saw Britain diplomatically engaging OPEC as an organization, participating directly in negotiations regarding prices and perhaps even striking government-to-government deals for oil, bypassing the oil companies altogether.

The first aspect of this rethink, dealing with OPEC as an organization rather than only dealing bilaterally with its members, was arrived at somewhat quickly following the Tehran and Tripoli Agreements.²⁶ Initially, both the DTI and the FCO continued to support the traditional line of not recognizing OPEC. Richard Ellingworth of the DTI’s

²⁵ PREM 15/1835, NA, Letter from Walker to Prime Minister, 21 March, 1973.

²⁶ The United States and the United Kingdom had agreed upon the founding of OPEC in 1960 to withhold recognition of the organization.

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Petroleum Division wrote that “We should prefer a situation in which, the flexibility of the industry having (hopefully) been restored, differences of interest between the various producers became a relevant factor again, OPEC solidarity weakened and negotiations over prices and other matters were resolved bilaterally.”²⁷ But just a few days later, the FCO presented a report to the GOQ entitled “HM Government and OPEC” in which they laid out the pros and cons of officially recognizing OPEC, with their advice tending towards recognition. The paper’s penultimate argument was that “If we have a link with OPEC... then the potential for misunderstanding will be reduced; and the link may prove invaluable indeed if the present system breaks down.”²⁸ A few months later the FCO’s Oil Department argued that “we should recognise that in demanding substantial price increases, they have done no more than follow the laws of supply and demand” and that “We should therefore treat OPEC and its members as responsible parties, vigorously pursuing legitimate commercial interests, rather than as rapacious brigands; we should seek to emphasize a community of interest between them, and ourselves and other consumers, rather than the differences.”²⁹

But the CPRS once again stood apart from the other departments.³⁰ Rothschild and others of his opinion called for a different tact. This included toying with the idea of

²⁷ POWE 63/719, NA, Letter from Ellingworth to Warrington, 4 June, 1971.

²⁸ FCO 67/564, NA, HM Government and OPEC, 14 June, 1971.

²⁹ FCO 67/621, NA, Meeting with the Chairmen of BP and Shell, 5 November, 1971.

³⁰ In a letter to Heath, Lord Rothschild deplored the arguments of the FCO and DTI regarding accommodation with OPEC. Describing their views, Rothschild wrote sarcastically, “we should treat the oil-producing countries as reasonable equals and not as brigands - having a nice cup of tea with them from time to time, if that is the right beverage.” But he added that “While the CPRS fully endorses this public posture, we are far less confident than the committee about the intentions and actions of these countries.” See PREM 15/593, NA, Memo: Lord Rothschild to Prime Minister, 8 December, 1971.

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either direct government-to-government deals for oil, or else allowing other British firms to barter goods and services in exchange for oil. It was thought that this system might particularly appeal to the Iranians, who were desperate to conserve foreign exchange for the purchase of military equipment.³¹ The problem was that these transactions would still require cooperation from the oil companies in order to refine and market the bartered oil. Earlier that year in a letter to Lord Rothschild, David Barran of Shell made it quite clear that his company did not approve of such ideas, writing, “This is a matter upon which we have expressed ourselves very forcibly throughout the years to Governments all over the world, and I would certainly not lower my voice in rejecting such a proposal if it emanated from a British Government.”³²

Slightly more palatable but still worrisome to the companies was the concept of the Government involving itself more directly in the negotiations regarding prices. Rothschild noted to the Prime Minister’s private secretary Robert Armstrong that “sooner or later, we, Western Europe, and the USA will find it impossible entirely to leave negotiations with the oil producing countries to the oil companies.”³³ The idea of Government involvement had several different forms, but most revolved around some sort of negotiated framework between consumers and producers which would dictate acceptable price increases as well as legally guarantee any of the agreements and contracts signed by the companies and the producing countries. Britain would be a signatory of this framework and use its diplomatic resources to ensure it was upheld.

³¹ See POWE 63/709, NA, Letter from Murray to Ellingworth, 26 May, 1971.

³² POWE 63/709, NA, Letter Barran to Rothschild, 11 February, 1971.

³³ PREM 15/595, NA, Minute Rothschild to Armstrong, 1 December, 1971.

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But even this idea was resisted by both the companies and in some corners of Whitehall. In a speech to an industry group, David Barran argued that “If heat is generated in company/government negotiations it is ostensibly commercial heat, a less explosive commodity than the political heat of government-to-government confrontation.”³⁴ Many in the Government agreed with this sentiment, feeling that any move on the part of Britain would be doomed to failure if it was not backed by all the other major consumers. Out of this began to emerge an idea that would eventually be picked up by Walter Levy: the Government could back the companies and ensure the stability and price of their supplies by encouraging the development of a united front of consuming nations able to back the industry against any unreasonable OPEC demands. But this concept had its own difficulties, namely that the two main venues of consumer cooperation, the OECD Oil Committee and oil cooperation through the EEC, were themselves being called into question by both ministers and officials alike.

Two Questions

With all of these ideas floating around and the negotiations over participation in full swing, the debate percolated up the chain of command into the Cabinet. In June, 1972, John Davies wrote to Heath to lay out the situation that Britain, and more specifically Britain’s oil policy establishment, had found itself in.³⁵ The problem

³⁴ PREM 15/595, NA, The Need for a National Fuel Policy?, 1 October, 1971.

³⁵ Part of the reason that both Davies and Heath became more intimately involved in oil policy decisions was the sudden catapulting of energy issues to the forefront of Government concern brought about by the 1972 coal miners’ strike. The strike which lasted from 9 January to 28 February, 1972 had resulted in a

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according to Davies was that oil was “becoming progressively much more expensive and into the field of it becoming in due course scarce to a point of limiting our own economic development.”³⁶ This was due, in Davies’ opinion, to the two roles of the oil companies “in negotiations and in balance of supply decisions” coming into conflict so that “the objectives of maximising profits may be seriously at variance with those of maximising security.”³⁷ Davies then boiled down all of the oil-related issues that the GOQ and other committees had been wrestling with into two major categories. First the minister wanted to examine “Our adherence to the good neighbor principle of pooling resources with other developed countries relying heavily on imported oil supplies, the nature of which undertaking is likely to be substantially re-cast as we develop as an oil producer ourselves and as the USA develops as an oil importer.” The second was even more challenging to the status quo with Davies asking whether Britain’s “acceptance of the principle that our national interests will be best served by allowing the international oil industry to strike the best bargains it can in maintaining supplies to all its markets.”³⁸

In order to conduct the review of these two broad categories, the DTI suggested to Sir Burke Trend, the Cabinet Secretary, that the GOQ be upgraded to a Cabinet committee so that ministers could keep a closer eye on its proceedings. The group was reconstituted as the Committee on Oil Policy, or GEN 123, and was put under the

state of emergency being declared on 9 February and the introduction of a three-day work week on 11 February. For excellent accounts of the political and cultural ramifications of this struggle, see Andy Beckett, *When the Lights Went Out: Britain in the Seventies* (Faber, 2009); and Dominic Sandbrook, *State of Emergency: The Way We Were: Britain, 1970-1974* (Penguin, 2011).

³⁶ CAB 184/58, NA, Letter from Davies to Heath, 19 June, 1972.

³⁷ Ibid.

³⁸ Ibid.

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chairmanship of the DTI's J.G. Liverman. But even before this group was organized, doubts began to emerge about the ability of British policy-makers to reach any definitive conclusions. Rothschild, for instance, somewhat petulantly wrote to Heath that "It is, perhaps, gratifying that the DTI should have started taking an interest in matters that you and I have been discussing for the last six months."³⁹ He went on to say that "It is hard to know whether the DTI at last realizes that the policy of non-intervention between Government and the oil companies (Shell and BP), not intervention between the consumer countries and the oil producers, is now out of date, first because the stakes have become so high, and, secondly, because the interests of the oil companies are not necessarily identical with those of Governments."⁴⁰ The FCO, on the other hand, was wary of any radical re-think of policy during such an unstable time, noting that "In the short term there are real limitations to our ability to introduce major changes in our policies."⁴¹

With these sentiments already prejudicing the proceeding, the committee took shape and began to review papers and proposals on the many ideas that had been bouncing around Whitehall, particularly focusing on Davies' two questions. The question of British participation in the OECD and potential EEC sharing arrangements, as well as the question of continuing to rely on the international oil industry to conduct the negotiations regarding price and supply, were in fact quite interrelated; the papers produced by the various departments for the GEN 123 committee therefore covered

³⁹ CAB 184/58, NA, Letter from Rothschild to Heath, 22 June, 1972.

⁴⁰ Ibid.

⁴¹ PREM 15/1836, NA, Letter from FCO to Lord Bridges, 22 June, 1972.

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elements of both. The discussion centered on three issues: how Britain could best protect itself during an oil shortage, how Britain and other consuming countries could bolster the oil companies during negotiations over prices and participation, or finally whether or not the consuming states should simply bypass the oil industry altogether and seek out state-to-state accommodations with the oil producers.

On the first point, the committee examined the question of the benefits accruing to Britain from remaining in the OECD's sharing arrangements as well as the possibility of joining any new sharing arrangements in the EEC.⁴² Several matters were at issue here. British policymakers were concerned that entry into the EEC and any joint EEC energy policy that might develop could potentially limit Britain's ability to control its North Sea oil. As British law stood at the time of Britain's entry into the EEC, all oil produced in the North Sea had to be landed first in the UK before any exportation.⁴³ This system not only allowed the movement of oil to be counted in Britain's balance of payments but would furthermore give the Government the ability to control the flow of oil in the event of an emergency.⁴⁴

This idea that North Sea oil might be kept in Britain during a crisis also informed views regarding the OECD sharing arrangements. The DTI reported to the committee

⁴² The OECD sharing scheme only applied to the European members of the organization. The United States, Japan and Canada remained outside of the sharing apparatus. It stipulated that all supplies coming into Europe would be divided equally during a shortage. Whether stockpiles were to be added to this system was a matter of some dispute.

⁴³ There were some doubts expressed about the ability of this law to stand up to legal challenges based on the Treaty of Rome.

⁴⁴ There was some debate about whether the Government had the power to do this. Such questions became increasingly important during the 1973 Oil Crisis when ministers decided to invoke a 1939 law which granted the Government the ability to control the export of key commodities such as oil.

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that by 1980, should there be a complete cut-off of OPEC oil, the UK would be able to meet 45 percent of its needs from North Sea oil whereas the sharing arrangements would return only 14 percent.⁴⁵ The question was therefore whether or not the UK should withdraw from all sharing arrangements and go it alone when it came to oil security. But this concept raised a host of new problems. The DTI reported that “withdrawal would probably stir up great resentment (perhaps leading to counteraction elsewhere) and would be very hard to reconcile with membership of the EEC,” since “Withdrawal would also be inconsistent with the spirit and probably the letter of the EEC treaty.”⁴⁶

Perhaps the only step that could have improved the ratio of British oil vs. shared oil was the encouragement of the United States to enter the OECD sharing agreements.⁴⁷ The US also possessed a vast, if diminishing, production capability that would have bolstered the OECD’s non-OPEC supply sources.⁴⁸ US participation would also boost the OECD’s credibility as a potential back-up to the oil companies in their negotiations with OPEC. If the consuming countries had a viable stockpile and sharing plan, it could soften OPEC’s position against the oil industry and perhaps make them more amenable to compromise.

⁴⁵ This was due to the fact that Britain would be the only large scale producer of oil belonging to the OECD sharing arrangement.

⁴⁶ CAB 130/610, NA, The OECD and EEC Sharing Out Arrangements, 25 September, 1972.

⁴⁷ The US had remained aloof because before the 1970’s it was only marginally dependent on oil imports from OPEC nations. But as US oil demand increased, and domestic production decreased, the benefits of belonging to the sharing arrangement increased.

⁴⁸ US production had peaked in 1970 at 3.5 billion barrels a year but was still producing 3.45 billion barrels a year in 1971 and 1972.

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But others in Whitehall felt that the OECD was not an ideal tool for this purpose due to its unwieldiness.⁴⁹ The FCO put forward a proposal for a framework agreement which could be negotiated with OPEC to lay out parameters for regulated increases in price and supply. Such a system could “provide security of oil supplies at reasonable prices for the consumer governments and in return offer a guaranteed and steadily increasing level of oil revenues for the producing governments.”⁵⁰ Nevertheless, the FCO was forced to concede that such a plan would be difficult due to the fact that “consumer governments having been brought into a contractual relationship on oil matters with the producers would give the latter a splendid opportunity to apply political pressures.”⁵¹

The CPRS had perhaps the most visionary approach, arguing for a stronger organization of consumer state and company interests. The plan would “bring importing States and the oil companies together in a single, two-tier organisation (OPIC - the Organisation of Petroleum Importing Countries), for the purpose of coordinating State and company action.”⁵² The CPRS argued that the main flaw with the other proposals was that biggest weakness in the oil companies’ negotiating position was their inability to coordinate more closely with one another on account of US anti-trust laws. By creating an OPIC where the companies and states could unify their negotiation strategies, the

⁴⁹ The OECD Oil Committee was made up of representatives of all the OECD states, many of which had little experience in oil matters. A High Level Group made up of only representatives of key countries did exist but British officials often complained at the slow pace of decision-making in the body.

⁵⁰ CAB 130/610, NA, Proposed Framework Agreement Between the Oil Importing Countries and Oil Exporting Countries, 29 August, 1972.

⁵¹ Ibid.

⁵² CAB 130/610, NA, Collective Defence Against Collective Attack (OPIC), 28 September, 1972.

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CPRS believed that OPEC could be effectively countered. The FCO, however, was not so sure. In a letter to Burke Trend discussing the idea, the FCO's John Hunt commented that "this is an interesting idea but completely unnegotiable."⁵³

Walter Levy in private discussions with Whitehall officials was equally bleak in his assessment of the plan's feasibility, arguing that "these proposals are not based on the realities of the power situation in the oil world at present, and place a naive faith in legal provisions."⁵⁴ Levy believed that the fundamental flaw with the OPIC idea was that it was predicated on the fact that the only thing preventing the companies from continuing their traditional buffer role was the fact that they were not granted the ability to coordinate with one another due to anti-trust concerns. Levy argued, however, that "the oil companies, far from being a centre of power and influence which could offset the enormous bargaining power of the producing countries, are in pawn to the producing countries."⁵⁵ His own idea was for a more robust consumer cooperation group that could negotiate directly with OPEC or at least back up the companies with serious force.

Levy's pessimism about the oil industry suffused the last of the three main categories of study facing the GEN 123 committee. The issue of whether the UK was best served by continuing to allow the oil companies to manage the negotiations with OPEC was an existential question for British oil policy and it was one with which the committee was not willing to come to grips. The pull of the status quo was thus

⁵³ CAB 164/1196, NA, Letter from Hunt to Trend, 19 September, 1972.

⁵⁴ CAB 184/58, NA, Letter from Mayne to Rothschild, 8 December, 1972.

⁵⁵ Ibid.

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irresistible and the bold stroke of the question devolved into discussions about making minor adjustments to the machinery of cooperation with BP and Shell.

The group's interim report in October proclaimed that "No major change of policy is recommended at this stage since it appears to the Committee that the oil companies still largely share the Government objective of stability of supply and the lowest possible level of producer government taxation."⁵⁶ The officials involved in the committee had been conditioned over years to think that the Government had no business directly engaging with OPEC and therefore decided that the Government could do no better in negotiations than the companies. Instead, they recommended that it was essential for Whitehall to devise ways of strengthening BP and Shell's position around the world. The FCO tried to chart a moderate course, arguing that greater Government oversight of negotiations was advisable but that "The degree to which Ministers will wish to go beyond their previous role of interested auditors and influence the negotiating positions of the companies on the other negotiations will vary from country to country."⁵⁷ The committee's final report issued in January, 1973 shed light on this unwillingness to take bold action. The report stated that "While it is easy to visualize general guidance to our companies – e.g. to adopt a more conciliatory approach in certain negotiations – it is a formidable prospect to embark on detailed intervention."⁵⁸

⁵⁶ CAB 130/610, NA, Interim Report of a Cabinet Committee on Oil Policy, October, 1972.

⁵⁷ CAB 130/610, NA, The Ministerial Relationship with the Oil Companies in the Current Negotiations with the OPEC Countries, 12 September, 1972.

⁵⁸ CAB 130/610, NA, Report on Oil Policy by a Group of Officials, 1 January, 1973.

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In the minds of many of the members of the committee, such intervention was beyond the abilities of Whitehall. The CPRS may have been staffed with experts in the oil industry but even that expertise was limited to Lord Rothschild and a few staff seconded from Shell and BP. Therefore the report concluded that “The Government, if wishing to offer detailed guidance on such affairs, would need to equip itself to do so by recruiting highly skilled staff; even then there is no reason to suppose that the Government's judgement of the conduct of negotiations would be any better than if as good as that of the oil companies.”⁵⁹

During a visit to London in June, 1973, Levy met with Douglas-Home and Thomas Boardman, the new Minister for Industry, as well as the Prime Minister to confirm some of the points of the GEN 123 report but also expose its timidity. Levy reaffirmed his belief that the governments of the consuming states could not put as much faith in the oil companies as the British Government planned to continue doing. He argued to the FCO and DTI that “The oil companies had no choice but to be increasingly subservient to the producing countries since their profits and their corporate property depended on maintaining supplies and good relations with the producer country governments.”⁶⁰ In his meeting with Heath, Levy reiterated his view “that the matter was getting too big to be left to the oil companies on their own,” and that “in this situation the

⁵⁹ Ibid.

⁶⁰ PREM 15/1836, NA, Note of the Secretary of State's Dinner Meeting with the American Oil Consultant, Mr Walter Levy - 17 January, 1973, 19 January, 1973.

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consuming countries were short both of bargaining power and of time.”⁶¹ Levy went on to encourage Heath strongly that it was “high time that the governments of consuming countries took a much more active and concerted interest in negotiations with the oil-producing countries.”⁶²

In Levy’s view, it was the British, more so than anyone else, who were best placed to lead this effort. If the Americans were to take the lead, it might be resisted by the other European states whose leaders were increasingly wary of the Nixon Administration’s attempts to exert influence in Europe.⁶³ On the other hand, there was a certain amount of threat that came with being the leader of a push for greater consumer-government cooperation. Levy admitted that “Mr. Yamani had said to him that, if the governments of the consuming countries formed a united organisation to deal with OPEC, that would mean war.” But Levy “judged from that observation that such a development was the one thing which Mr. Yamani feared.”⁶⁴

A Cooperative Failure

Unfortunately for Heath and his ministers, neither the GEN 123 committee nor could Levy give any specific recommendations on how to go about achieving this consumer cooperation. The committee had raked over several ideas but had simply

⁶¹ PREM 15/1837, NA, Note for the Record: Meeting between Walter Levy and Prime Minister, 19 June, 1973.

⁶² Ibid.

⁶³ See Catherine Hynes, *The Year That Never Was: Heath, the Nixon Administration and the Year of Europe* (University College Dublin Press, 2009); Andrew Scott, *Allies Apart: Heath, Nixon and the Anglo-American Relationship* (Palgrave Macmillan, 2011).

⁶⁴ Ibid.

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pointed out the deficiencies and difficulties with each one. But still the official recommendation to Heath was for “some form of organisation to protect Western consumers from the effects of blackmail by the producing countries.”⁶⁵ The goal of this organization would be “both to bring Government pressure to bear on the producers and to prevent ‘mavericks’ among the consumer countries and oil companies from breaking out of line.”⁶⁶

Britain’s entry into the EEC around the same time as the report’s submission presented Britain with a challenge and an opportunity to get a new united consumer group of this nature together. The continental powers of the EEC had long wanted a greater say in international oil matters but a unified EEC oil policy had been consistently frustrated by differences between the *dirigiste* approach of countries like Italy and France and the *laissez-faire* approach of West Germany and the Netherlands. With Britain now a part of the EEC, however, and with the challenge presented by OPEC as a driving catalyst, the hope was that a new common approach to oil and energy could emerge within the Common Market. Heath was especially hopeful that cooperation on energy matters would help cement Britain’s place at the heart of an enlarged Europe, would advance the cause of European integration, and would strengthen the EEC’s ability to act with or without the United States.

But some within Whitehall believed that a common EEC oil policy would only be just one step towards countering OPEC’s power and that a broader consumer union

⁶⁵ CAB 164/1196, NA, Oil Policy: Meeting, 24 January, 1973.

⁶⁶ Ibid.

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would be needed. A more feasible approach would be to resurrect the idea of expanding the OECD sharing arrangements to include the United States and Japan and to strengthen the OECD decision-making machinery. The two ideas did not necessarily conflict, but a difference in opinion did emerge regarding which strategy should be pursued first.

The FCO was a proponent of the second approach, but with some important caveats. They wanted a loose understanding between the OECD members to control their own oil companies rather than any separate entity which would negotiate with OPEC. Rejecting Levy's idea, they argued that "A formal organisation of petroleum importing countries might be provocative to the oil producing countries and lead to Governments supplanting oil companies in negotiations with the producers."⁶⁷ Instead, the FCO suggested that "the Agreement be supported by normal consultative machinery relying as far as possible on existing diplomatic contacts, including EEC and OECD where appropriate."⁶⁸

Heath agreed but came down hard on the side of working in Europe to develop an EEC approach to oil first. In writing to John Davies, Heath commented that "I agree that early action is needed if we are to bring about effective cooperation between the main oil consuming states. Clearly this will require consultation with the Americans and Japanese. But I doubt whether it would be right to begin that process until we have

⁶⁷ CAB 164/1197, NA, Oil Consumer Co-operation, 7 May, 1973.

⁶⁸ Ibid.

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decided at least the outline of our policy, and secured the agreement of our Community partners.”⁶⁹

Heath and his ministers were also driven towards a Europe-first approach due to the desire to work out the future of North Sea oil before it came online in 1975. Securing a European oil policy that advantaged Britain was of prime importance. Writing to Heath, the Cabinet Secretary Burke Trend opined that “we shall need to ensure that the development of a managed market in the Community does not damage the competitive position of Shell and BP *or threaten the independence of our own supplies of North Sea oil* (emphasis original).”⁷⁰ British officials knew that EEC regulations, as they currently stood, might have limited Britain’s ability to control the destination of North Sea oil, especially in an emergency. It was therefore imperative to strike a deal with the Europeans which would either secure full control of North Sea oil for Britain, or would win some return of equal value.⁷¹

Another reason Heath approved of this approach was that he and others in Whitehall feared what would happen if Britain were to be seen leading an effort to organize the consuming countries. Should these efforts fail, it was feared that Britain and British companies would bear the brunt of OPEC’s anger. Heath worried “that the Arab oil producing states would come to learn of the suggestion we have made,” and “that the

⁶⁹ CAB 164/1197, NA, Letter from Prime Minister to Sec. of State for Trade and Industry, 19 April, 1973.

⁷⁰ PREM 15/1837, NA, Oil Supplies: Trend to Heath, 6 July, 1973.

⁷¹ This equitable return might have included giving Britain a preferential position in any common nuclear energy projects or possibly giving BP and Shell a preferred position in any future EEC managed oil market. The part played by North Sea Oil on Britain’s entry into the EEC and its early attempts to integrate its energy policies with the other members of the Common Market are discussed in greater detail in Chapter 7.

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British Government would appear to the Arabs as advocating a hard line in relations with them.”⁷² Therefore, according to Heath, “The ideal situation would be for any emerging proposals to be the product of the Community rather than of the British Government.”⁷³

This Europe-first approach received an unexpected boost from the announcement in late April, 1973 by Henry Kissinger, Nixon’s national security adviser and soon-to-be Secretary of State, of a new diplomatic initiative called the “Year of Europe.”

Kissinger’s attempt to rekindle the trans-Atlantic relationship between the US and Western Europe was met with resistance and helped drive the Europeans more closely together for a short period.⁷⁴ This move on the part of the US to inject itself more forcefully into European affairs also cemented Heath’s view that Europe should get its own energy house in order before attempting to deal with the US on any project to expand the powers of the OECD Oil Committee.

This proved to be easier said than done. The different opinions in Europe over how the EEC could best secure its oil needs were still holding up progress on the issue. A Nixon Administration official, Peter G. Peterson, who was visiting London following a fact-finding mission to the other European states reported that he “had detected very

⁷² CAB 164/1197, NA, Letter from Bridges to Alexander, 10 May, 1973.

⁷³ Ibid.

⁷⁴ For an overview of the “Year of Europe,” see Keith Hamilton, “Britain, France, and America’s Year of Europe, 1973*,” *Diplomacy & Statecraft* 17, no. 4 (December 2006): 871–895; Thomas Robb, “Henry Kissinger, Great Britain and the ‘Year of Europe’: The ‘Tangled Skein’,” *Contemporary British History* 24, no. 3 (2010): 297–318; Matthew Jones, “‘A Man in a Hurry’: Henry Kissinger, Transatlantic Relations, and the British Origins of the Year of Europe Dispute,” *Diplomacy & Statecraft* 24, no. 1 (2013): 77–99. For a more extended analysis of the “Year of Europe” and its impact on the Trans-Atlantic relationship, see Hynes, *The Year That Never Was*; Daniel Möckli, *European Foreign Policy During the Cold War Heath, Brandt, Pompidou and the Dream of Political Unity* (I.B. Tauris, 2009); Aurelie Elisa Gfeller, *Building a European Identity: France, the United States, and the Oil Shock, 1973-1974* (Berghahn Books, 2012).

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different attitudes depending on the way in which oil affairs were organised in each country.”⁷⁵ The French were the main stumbling block as they wanted any common EEC policies to be modeled close to their own managed market system.⁷⁶ This was mainly due to the fear in Paris that the French companies, chiefly CFP and ERAP, would not be able to compete with the British and American firms in a free market. By 1973, however, the British were willing to come a part of the way in meeting the French. BP, for one, reiterated some of the ideas put forward by Hardcastle a year earlier in March 1973. Lord Rothschild discussed this with Robert Armstrong, Heath’s Private Secretary, writing, “BP believes that if Britain adopted some version of these import and refinery controls, Germany and other EEC members would follow suit,” before going on to add that “The national managed markets of the Community could then be merged, whenever the Community so wished, into a single managed market comparable to the managed markets of Japan and the US.”⁷⁷

But even if the spirit of compromise existed, the process was still tortuous. The British, French and the Germans all wanted to avoid involving the EEC Commission and its glacially slow secretariat in the hammering out of a common oil policy, but the parties worried that if they did not use the official machinery some of the smaller states would be angered at their exclusion. There were also concerns, however, that multilateral discussions between all the members could hardly remain secret and might alert OPEC to

⁷⁵ CAB 164/1197, NA, Secretary of State's Meeting with Ambassador Peter G Peterson, 24 February, 1973.

⁷⁶ See Gfeller, *Building a European Identity*.

⁷⁷ CAB 164/1197, NA, Letter from Rothschild to Armstrong, 6 March, 1973

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the EEC's attempt to strengthen itself. Should the efforts fail, this could come to haunt those leading the effort, namely Britain.⁷⁸

The pace of progress in Europe was therefore excruciatingly slow. What efforts there were became further complicated by the fact that the United States was attempting its own moves to secure greater consumer cooperation.⁷⁹ The US saw the OECD route as the only feasible option and after months of frustration with Europe, some within Whitehall agreed. But the United States was not in a good position to influence the Continental Europeans. The unpopularity of Kissinger's "Year of Europe," together with lingering resentment at American actions in the ending of the Bretton Woods system and the ongoing fighting in Vietnam, severely diminished American political capital on the other side of the Atlantic. Sir Denis Greenhill acknowledged this in a meeting regarding consumer cooperation, saying that Britain "had to recognise that the US was in this context a political liability and there was no advantage therefore in an Anglo/US move."⁸⁰

After a summer of fruitless talks and meetings, very little progress had been made. This led an exasperated Sir Robert Marshall of the DTI to write to his civil service colleagues that "much effort has been expended in Whitehall with remarkably little to show for it whether domestically in clarifying the relationship between our oil companies

⁷⁸ For an excellent examination of the relations between France, West Germany and Britain and their collective relationship with the organs of the EEC see Möckli, *European Foreign Policy During the Cold War Heath, Brandt, Pompidou and the Dream of Political Unity*.

⁷⁹ This included continued attempts to making the "Year of Europe" a success. See Robb, "Henry Kissinger, Great Britain and the 'Year of Europe'."

⁸⁰ PREM 15/1837, NA, Record of a Meeting in Sir Denis Greenhill's Office at 4pm on Wednesday 5 September, 5 September, 1973.

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and Government in handling international crises; or in developing consumer co-operation to increase our ability to cope with OPEC threats and actions; or in thinking out and concerting policies aimed at creating some mutuality of interest between consumers and producers and thereby attempting to strike at the root of the trouble.”⁸¹ This, in Marshall’s opinion, was due to “the harsh reality of the disparate situations and interests of the individual EEC countries, the USA, and Japan and the reluctance of any one of us to get out on a limb or sacrifice a possible advantage.”⁸²

At the meeting held to discuss Marshall’s views, the situation was debated thoroughly. The consensus was that “The consumer country which took it upon itself to blow the trumpet for consumer co-operation would do intense harm to its national interests and would fail to secure its objective because the other consumers would not line up behind it.”⁸³ Heath himself made this clear in a letter to Eric Drake, writing “I very much share your views on the need for urgent action by the EEC, the USA and Japan. But we must proceed circumspectly if we are to avoid the risks and consequences of exposing ourselves as the instigators of a common anti-OPEC front, or of moving too far in directions which could jeopardise our control of the North Sea.”⁸⁴ On the other hand, it was feared that the lack of progress on consumer cooperation would simply promote an oil free-for-all of bilateral state-to-state deals that could wreak havoc on prices. John Hunt, who was poised to take over as Cabinet Secretary from Burke Trend,

⁸¹ PREM 15/1837, NA, Letter from Marshall to Greenhill, 31 August, 1973.

⁸² Ibid.

⁸³ PREM 15/1837, NA, Record of a Meeting in Sir Denis Greenhill's Office at 4pm on Wednesday 5 September, September, 1973.

⁸⁴ PREM 15/1837, NA, Letter from Heath to Drake, 10 August, 1973.

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warned that “The worst course of all would be if we were left still preaching consumer co-operation while everyone else had tied up their supplies bilaterally.”⁸⁵

The Gathering Storm

While the fruitless attempts to negotiate a unified consumer agreement either within the EEC or the OECD continued to drag on, experts around the Western world continued to watch the Middle East with apprehension. The continued intractability of the Arab/Israeli conflict gave the radical elements of the region something to use to whip up passions and to inject politics into oil negotiations. Following the 1967 Six Day War, the British along with the French had sought to pursue a neutral, if not slightly pro-Arab, approach to the conflict in an attempt to lower the political temperature.⁸⁶ But the United States had only increased its support of Israel, a policy which exposed US companies, and the partnerships they operated through, to political pressure.

This was made readily apparent in May, when the Gaddafi regime in Libya effectively confiscated the concession of the Bunker Hunt Company, an American independent firm.⁸⁷ The announced reason for the move was that the Libyan regime wanted to show its defiance to the United States for its support of Israel. The international oil industry did what it could to help Bunker Hunt resist in acquiescing to

⁸⁵ PREM 15/1837, NA, Letter from Rothschild to Armstrong, 27 June, 1973.

⁸⁶ The shift in Britain’s policy is highlighted in Moshe Gat, “Britain and Israel Before and After the Six Day War, June 1967: From Support to Hostility,” *Contemporary British History* 18, no. 1 (Spring 2004): 54–77; and Geraint Hughes, “Britain, the Transatlantic Alliance, and the Arab-Israeli War of 1973,” *Journal of Cold War Studies* 10, no. 2 (Spring 2008): 3–40.

⁸⁷ This action was technically not a nationalization of the concession. Libya demanded 100 percent participation in the Bunker Hunt field with the understanding that the oil company would remain as a service contractor with a preferred position to purchase the oil at a market rate.

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the takeover, but demand for oil had grown so precipitously since the Tehran and Tripoli Agreements that it was impossible to prevent the sale of Libyan oil to other independent firms.⁸⁸ The simple fact was that economic growth in the OECD was increasing demand at such a rate that there was no alternative but to buy “hot” oil.⁸⁹ This in turn dramatically weakened the hand of the oil companies since it gave the members of OPEC a way of disposing of its participation oil at prices far in excess of the posted price.

In June, 1973, Heath addressed this issue by writing to Foreign Secretary Douglas-Home that “we have to face the fact that the Arab position has been transformed by their new ability to use their position in the world oil business for political purposes.”⁹⁰ He went on, noting that because of the “energy crisis and the growing effectiveness of OPEC, it is now within the Arab's power to withhold oil supplies from the Americans, and perhaps from Europe as well, unless the United States and others cease to furnish any political or military support to Israel.”⁹¹ A few days later, Heath wrote to President Nixon encouraging the US to do what it could to pressure Israel down the road toward peace.

The views of BP and Shell regarding the looming threat mirrored some of the concerns of the Government but also diverged in important ways. Both companies viewed the Arab/Israeli Conflict as a mere political symbol the producers were using to

⁸⁸ One firm which contracted for oil from the concession in question was the American company Sohio, just purchased by BP, which had not yet received compensation for the nationalization of its Libyan stake in the same field.

⁸⁹ “Hot oil” was the designation given to supplies produced from sources confiscated or expropriated without proper compensation.

⁹⁰ CAB 164/1197, NA, Letter Prime Minister to Foreign Secretary, 4 June, 1973.

⁹¹ Ibid.

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justify their excessive claims. G.A. Wagner, the chief executive of Royal Dutch Shell, went so far to say that he “did not believe that the attitude of the OPEC countries would be any different if there was no Arab/Israeli problem” and that “they would be just as greedy as now.”⁹²

Both companies viewed the game being played by the OPEC and specifically the Arab oil producers as one in which they were using a political cover to mask their attempts to break what remained of the oil companies’ control over prices and production.⁹³ BP in particular feared the movement of “hot” and participation oil. With demand so high, and with the OECD states unable to reach any sort of agreement to discourage bilateral state-to-state deals, BP worried that this oil would prove a temptation impossible to resist for independent companies or even governments desperate to fulfill their oil needs. This would consequently create a rise in prices as a complete sellers’ market would ensue. According to a memorandum sent by Drake to Heath, “this threatens to overturn the recent agreements and by virtue of the higher revenues for smaller volumes, to reduce the incentive to producing governments to permit exports of levels of which they are physically capable.”⁹⁴

Drake proposed that in lieu of an agreement on a strengthened consumer group, at the very least the British Government could spearhead efforts to get the OECD to control

⁹² CAB 164/1197, NA, Note for the Record: Meeting between Wagner and Heath, 5 June, 1973.

⁹³ Garavini has argued that long-term desire to claim sovereignty over their natural resources played just as much, if not more of a role in these issues than did the Arab/Israeli dispute. See Giuliano Garavini, “Completing Decolonization: The 1973 ‘Oil Shock’ and the Struggle for Economic Rights,” *The International History Review* 33, no. 3 (2011): 473–487.

⁹⁴ PREM 15/1837, NA, Letter from Drake to Heath, 4 July, 1973. Walter Levy backed this analysis as well arguing that should prices increase too much, the OPEC nations could cut back production and still receive the same amount of income thereby creating both a supply and price crisis.

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imports of “hot” oil. This would hopefully prevent the breakdown of pricing structures and give the companies slightly more negotiating room. Shell, however, felt that this move would accomplish little other than angering OPEC. Frank McFadzean of Shell “preferred a cooler game while working to change the attitudes of some OPEC countries in the hope of getting them round the table eventually on sensible terms.”⁹⁵ This disagreement was not surprising, given that BP had a massive amount of crude production in the Middle East while Shell was relatively crude short in this area.⁹⁶

One thing the companies could agree on, however, was that the British government’s efforts to provide them with the type of support they needed to face down OPEC were a complete failure. Even BP’s stripped down plan for control of imports got nowhere. This was not entirely the fault of the Heath Government. The differences in opinions between EEC members, not to mention the US and Japan, had made any meaningful agreement next to impossible.

Heath, for his part, made one last attempt to prepare British oil policy for an eventual showdown with OPEC. In June, Heath ordered the creation of a new Oil Supply Task Force that was to be led by the Minister of Defence Lord Carrington. The task force would be of the highest level and included Lord Balniel of the FCO and Lord Rothschild of the CPRS. Its terms of reference were “To keep under review any developments threatening to interrupt supplies of oil” and “to consider measures to be taken to

⁹⁵ PREM 15/1837, NA, Oil Co-Operation, 6 July, 1973.

⁹⁶ This meant that any changes in the ownership and sale of crude would have affected BP disproportionately harder than Shell.

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anticipate, or to deal with, such interruptions.”⁹⁷ Unfortunately for Heath and for Britain, the task force barely had time to organize itself before the serious crisis that had been forecast erupted.

Conclusion

If ministers and officials had hoped that the Tehran and Tripoli agreements would grant them five years in which to reorganize Britain’s oil policy and to prepare for future uncertainty, they were sadly mistaken. The huge growth in demand for oil from 1971 to 1973 had wreaked havoc on the price structure of these two agreements. The spot market for oil, which was used by many independent oil companies as well as majors which needed short-term supplies, began registering prices far in excess of the agreed-to posted prices. OPEC demanded that this situation be rectified, and the major oil companies were called to Vienna for a conference on prices to be held there from 8-10 October, 1973. As they prepared for the conference, company officials knew that a showdown of monumental importance was in the offing. The final card held by the oil industry – the ability to set the posted price – was under threat. With little consumer cooperation achieved, the firms headed toward the negotiations in the same weak position that they had endured during the Tehran and Tripoli negotiations.

The one hopeful sign for the oil company negotiators was that the October meeting in Vienna seemed as though it might be free of political pressure. Earlier fears of conflict between the Arabs and the Israelis appeared to have died down for the

⁹⁷ CAB 164/1197, NA, Letter from Trend to Heath, 6 June, 1973.

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summer, a major relief for both the companies and Whitehall. In August, H.B. Walker of the British Embassy in Jedda, Saudi Arabia had written to his colleagues in the FCO that Britain needed to do everything in its power to prevent a new conflict between Egypt and Israel. He warned that, if fighting did break out, “I have no doubt that in a war situation the Saudis would turn off the tap” and use the oil weapon.⁹⁸ Walker’s sentiments were not dismissed, but few felt that war would occur any time soon. In fact, P.G. Adams of the British Embassy in Cairo reported back to London that in talks with the Egyptian National Security Adviser Hafez Ismail on 2 October, he received the assurance that “he could tell me categorically that no responsible Egyptian and no foreseeable Egyptian regime would be party to turning off the taps.”⁹⁹ It thus came as a shock when on 6 October the Egyptian military struck a surprise blow on Israeli units in the Sinai Peninsula, starting what became known as the Yom Kippur or October War. With the Vienna meeting due to begin two days later, few doubted the likelihood that the two events would come together in a most unpleasant way.

While the timing of the crisis came as a surprise, almost all who had been involved in oil issues over the previous three years readily accepted that the growing strength of OPEC, and the Middle East producers in particular, would eventually result in the confluence of politics and oil which had begun with the first shots of the October War. Unfortunately for Whitehall, the warnings of people like Walter Levy had provoked a great deal of talk, but little progress. While it was widely recognized that the

⁹⁸ FCO 93/297, NA, Letter from Walker to Wright, 23 August, 1973.

⁹⁹ FCO 93/297, NA, Letter from Adams to Craig, 2 October, 1973.

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old system of relying entirely on the oil companies to negotiate directly with OPEC was no longer feasible in an era when oil was no longer a simple commercial matter, no replacement system was readily apparent or politically desirable. Because of this fact, Britain and the other industrialized states headed into the 1973 Oil Crisis with no international apparatus for coordinating their responses or limiting the destructive competition for supplies.

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Partners and Rivals: Battles Abroad, Battles at Home, 1968-1973

The security of Britain's oil supply was an overriding concern for British officials from 1967-1973. From the abortive Arab oil embargo in the wake of the Six Day War through the Tehran and Tripoli agreements until the outbreak of the October War, it had seemed to ministers and officials alike that the oil industry was hurtling inexorably towards uncertainty. The industry itself, on the other hand, had a much more sanguine view of oil security, at least initially. During the 1967 crisis, overcoming the oil embargo had been a matter of logistics for the companies, not a matter of high politics. Indeed, in the wake of that crisis, the oil companies felt more secure than ever in their position as the providers of the world's oil supply after their own resupply efforts had thwarted the use of the "oil weapon" by the Arab states.

What worried the executives of the oil companies and BP in particular was not the security of supply but rather its profitability. In the years leading up to 1967, OPEC's cohesion had resulted in several negotiated settlements that had increased costs for the oil companies.¹ This was coupled with the continued influx of smaller, independent oil companies which had strengthened competition and lowered profit margins.² The closure of the Suez Canal as a result of the Six Day War also greatly increased the costs of transporting Persian Gulf crude to the refineries of Western Europe. Some of these costs

¹ See Chapter 5 for a discussion of these settlements.

² In 1953 the "Seven Sisters" controlled 64 percent of the world's oil concessions; by 1972 they controlled only 24 percent. See Steven A Schneider, *The Oil Price Revolution* (Johns Hopkins University Press, 1983), 114.

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could be passed to the consumers, but lifting prices on products had to be done carefully, since government-imposed price controls were never out of the question.

Added to the increased expenses was the growing cost of exploration in the non-OPEC world, exploration that was actively encouraged by the British and other governments in the name of security through the diversification of supply. Together, these rising costs resulted in a lower rate of return for all of the major oil companies.³ No company was hit harder by this phenomenon than BP. With the vast majority of their supplies coming from the Middle East, BP was particularly susceptible to the growing cost of doing business there. The Company was also leading the charge in developing new fields outside the Middle East, being heavily invested in Alaska and the North Sea. Because of this, BP began noticing a financial pinch.

This was the situation that led Sir Maurice Bridgeman, the outgoing chairman of BP, to submit his memorandum to the Treasury and the Ministry of Power (MoP) in January, 1968. The Bridgeman Memorandum laid out the Company's position and made suggestions for how the Government could improve BP's prospects. At its heart, the document warned that BP felt the State was squeezing its companies too hard in the pursuit of its own oil policy goals of security and financial benefit to the economy. Bridgeman's argument was that BP was suffering as a result of Whitehall's drive for greater security; the Company was being pushed to diversify in expensive locations while also being expected to abide by the taxation policies and exchange controls of the Labour

³ For example, in 1957 BP reported a 17.8 percent return on investment while Shell reported a 15.3 percent return. In contrast, in 1968 BP reported a 8.6 percent return while Shell reported a 10.1 percent return.

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Government of Harold Wilson which, the Memorandum claimed, were all damaging the firm's financial flexibility. To Bridgeman, these combined pressures threatened the very survival of the Company.

The concerns raised by the Bridgeman Memorandum were echoed four years later in 1972 in another document sent to the Government by Bridgeman's successor, Sir Eric Drake, highlighting a problem in Britain's oil policy that would plague relations with the companies for the next decade. Whitehall's continued and growing desire to wring as much benefit from the oil industry for the economy and balance of payments led to a divergence of interests between the two sides. This gave the Bridgeman Memorandum and later the Drake Memorandum particular importance. They served as reminders to Whitehall that the British Government needed to care for their "golden geese." Because of this, the era between the 1967 and 1973 oil crises saw the Government attempt to reformulate its approach to non-Middle Eastern oil policy in order to accentuate its benefits while mitigating the negative impact it had on the interests of BP and Shell. They did this by refusing to make life easier for BP and Shell at home and in the North Sea, but fought hard for the companies in their attempt to win and maintain market share in the safe and profitable markets of the United States and Europe.

This dual-track effort ultimately produced mixed results. The Governments of both Harold Wilson and Edward Heath frustrated BP and Shell with their continued refusal to change Britain's tax law and financial controls to benefit the industry. Against this strategy was measured the firm diplomatic support provided by the State for BP's

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efforts to break into the all-important American market. The Government put in an equal, if ultimately unsuccessful, effort in helping craft a European energy policy that would benefit BP and Shell.

The pressure put on BP and Shell domestically, coupled with the aid given by the Government to their efforts abroad led to a feeling of the companies becoming increasingly international in their outlook and their interests. The limited support that BP and Shell received in the development of the North Sea, coupled with their decreasing market share in Britain, made that market less important to the overall health of the companies' finances and therefore less of a priority to the firms in general. The result was that the close partnership between BP, Shell and the British State which had marked the 1950's and 1960's was about to give way to something different. In its stead a new kind of relationship was developing, still close and important but one in which the companies would begin to view their interests and those of Britain as no longer always synonymous.⁴

A Fight for Preference

This process began with BP's contentious effort to win a preferential position for itself. On the face of it, the Bridgeman Memorandum seemed like a straightforward and

⁴ Aspects of this argument have been touched on by other historians such as More and Kemp. More highlights the work done to enhance British markets abroad while Kemp argues that the development of North Sea oil and gas led to a process of increasing state intervention in the British oil industry. By taking these two processes together, it is possible to see how this strategy ultimately bolstered the companies' market-share abroad while simultaneously making the British market less friendly, a result which had significant ramifications during the 1973 Oil Crisis. See Charles More, *Black Gold: Britain and Oil in the Twentieth Century* (Continuum, 2009); Alexander G Kemp, *The Official History of North Sea Oil and Gas*, vol. 1 (Routledge, 2012).

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reasonable argument. In it Bridgeman pointed out the fact that most other major industrial powers of the Free World supported or protected their oil companies. Whether it was the quota system that protected American producers from cheap imports or the French system of allotting a certain market share to its companies, these systems gave an advantage to domestic operators that assisted them in competing more effectively abroad.⁵ The same could not be said of Britain. BP, Shell and the other smaller British companies such as Burmah competed on a level playing field with foreign competitors. This helped explain the fact that despite being home to two of the largest oil companies in the world, 52 percent of the oil consumed in Britain was provided by foreign companies.⁶

In a meeting with Minister of Power Richard Marsh, Bridgeman also noted that one of Britain's main oil policy objectives "was to reduce the balance of payments costs of oil supplies" but, the BP Chairman argued, "against this was the completely free access by foreign companies to the British market in the form both of the freedom of restrictions on new refineries" and "in the freedom to enter into the market generally." Bridgeman reminded Marsh that "It was all very well to have reasonable freedom of competition," but "the Government did not seem to have a view as to where to stop."⁷

Added to this open competition was the detrimental impact of the 1965 Corporation Tax. The Memorandum argued that the "existing direct tax system imposes

⁵ The American quota system was put into place in 1959 by the Eisenhower Administration as a way of protecting domestic producers from competition from cheap Middle Eastern crude.

⁶ BP and Shell marketed their oil in Britain through a joint subsidiary known as Shell-Mex and BP from 1932 until 1976. The company was run by Shell but was supplied by both BP and Shell. It provided roughly 40 percent of the British market.

⁷ POWE 63/401, NA, British Petroleum Company and Future Oil Policy, 9 February, 1968.

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very severe penalties on those British companies which, owing to the nature of their business, must inevitably have a larger investment abroad than in the UK.”⁸ But recognizing that the entire tax could not be overturned, BP offered several ideas for how their specific situation could be improved. These included removing the provision whereby the profits distributed through dividends were also taxed or, if this was not possible, increasing the rate of corporation tax and reducing the rate of the dividend tax.⁹ Bridgeman’s diagnosis and prescription for improving Britain’s oil policy were eagerly examined by the civil servants in Whitehall and used to launch a thorough policy review.

BP’s pleas for greater assistance from the British Government came at a particularly inopportune time, however. While the Company had good relations with Whitehall officials, the same could not be said of their dealings with the Labour Government. Just prior to the arrival of the Bridgeman Memorandum, the Labour Party’s North Sea Study Group had released its report recommending the creation of a National Hydrocarbons Corporation (NHC), which would partner with private oil companies in the North Sea on its way to becoming a viable company in its own right.¹⁰ This idea was fiercely opposed by the companies but won public support from the major Labour Party

⁸ Ibid.

⁹ Under the 1965 Corporation Tax, companies could claim relief from double taxation on their overseas profits up to the amount they were taxed in the countries in which they were operating. Due to the taxation increases levied by OPEC, this tax rate was higher than the roughly 40 percent tax imposed in Britain. This meant that BP effectively paid no tax in Britain but still held a roughly 15 to 20 percent of additional tax relief that could not be used. Therefore, raising the corporate tax rate in Britain while also lowering the withholding tax would not impact the Company but would offer tax relief to their stockholders.

¹⁰ The idea for an NHC has elicited much comment in the works on Britain’s North Sea oil. See Donald Iain MacKay and George Anthony MacKay, *The Political Economy of North Sea Oil* (Robertson, 1975); Guy Arnold, *Britain’s Oil* (H. Hamilton, 1978); Gerry Corti and Frank Frazer, *The Nation’s Oil: A Story of Control* (Graham & Trotman, 1983); Kemp, *The Official History of North Sea Oil and Gas*.

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leaders, including Marsh and Prime Minister Harold Wilson. Luckily for BP and Shell, that support was not deep, and the plan was felt to be too complex and politically delicate given the struggles the Labour Government was facing to rebalance the economy following the devaluation of sterling in late 1967; it was therefore shelved for further study.¹¹

But the failure of the NHC plan to take outright control over the resources of the North Sea did not stop some of the left-leaning members of Labour's leadership from seeking greater authority over the oil industry.¹² While the Cabinet ministers might have been content to rely on more traditional modes of control over BP, other elements within the Party wanted to push the envelope. Chief amongst these agents of change was Ian Mikardo, who had been the force behind the idea for a NHC. As that plan languished, Mikardo worked to establish more regular Government influence over BP through his capacity as a member of the House of Commons Select Committee on Nationalised Industries. This group provided parliamentary oversight to the various nationalized industries in the British Government's portfolio. He proposed bringing BP into the Committee's purview, claiming that as the major shareholder of BP, the Government had

¹¹ The literature on the devaluation of sterling is well developed. For a recent piece that discusses the historiography, see M. J. Oliver, "The Management of Sterling, 1964-1967," *The English Historical Review* CXXVI, no. 520 (June 2011): 582-613.

¹² Richard Marsh describes BP in his memoir as a "nationalized oil company" but went on to recount that Sir Maurice Bridgeman "left me in no doubt that while a majority of the shares in BP were owned by the Government, he saw himself in the same position as a Chairman of any other oil company and certainly not in a position analogous to that of the other nationalized industries." Richard Marsh, *Off the Rails* (Littlehampton, 1978), 103.

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the right to oversee its investment.¹³ It was also part of Mikardo's plan to use the Committee to examine "the relationship between the N.H.C. and the existing British-based international oil companies, *particularly B.P.* [emphasis original], and the possibilities of an international role for the N.H.C. on the lines of the Italian E.N.I. or the French E.R.A.P."'¹⁴

Fortunately for BP, their allies in the civil servant allies agreed that Mikardo's plan went too far. The Treasury, however, feared that the traditional line against intrusion into BP's commercial affairs would carry little weight in this situation. One Treasury official, P. Mountfield, wrote to his colleagues that "It is perhaps no great defence to say to the Select Committee that the Government does not intend to take a day-to-day interest in B.P's affairs when the real question which the Select Committee wants to ask is 'why should it not do so?'"'¹⁵

BP actually approved of this Treasury assessment and met with Whitehall officials to discuss a more subtle approach to the problem. During these meetings, Drake pushed for the argument to be put forward in a foreign-policy context. He noted that "although he never liked opposing suggestions for enquiries or investigations, since BP had nothing to hide, the inclusion of the Company in the Select Committee's Terms of Reference could do considerable damage to BP's standing abroad," adding that BP already "found it extremely difficult to convince foreign governments that the Company

¹³ The long-standing 51 percent ownership of BP's stock had been allowed to dip to roughly 48 percent when BP acquired Distiller's Chemicals in 1966 without full Government participation in the new rights issue.

¹⁴ T 317/1177, NA, Select Committee on Nationalised Industries - Terms of Reference, 11 January, 1968.

¹⁵ Ibid.

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was not in fact run by the British Government.”¹⁶ This argument reinforced the view of officials who were already concerned about the fact that “Not only would the company not welcome Government interference, but the Government itself would not welcome the responsibility of running an oil business.”¹⁷

Forming a consensus in Whitehall was imperative to warding off the plan since several Cabinet ministers did not have strong opinions regarding the idea and supported it for purely political reasons. One official warned that there was “a number of Ministers who were reluctant to oppose the wishes of the Select Committee on the grounds that this would inevitably lead to a major row in the House of Commons.”¹⁸ The Treasury therefore sent the Cabinet a report arguing “that H.M.G's relations with foreign Governments and B.P's competitive position (and therefore H.M.G's financial interests as a major shareholder) would be materially damaged if the Select Committee's recommendation were accepted.”¹⁹ The Cabinet was swayed by this argument, feeling that angry backbenchers were easier to deal with than OPEC, and Mikardo's plan was rejected.

But this triumph was a small one compared to the hopes that BP had for the resolution of its concerns laid out in the Bridgeman Memorandum. As the debate over the Select Committee was ongoing, so too were discussions within Whitehall regarding

¹⁶ FCO 67/195, NA, Report of the Select Committee on Nationalised Industries, 2 October, 1968.

¹⁷ T 317/1177, NA, Select Committee on Nationalised Industries: Terms of reference: Should B.P. be included?, 4 March, 1968.

¹⁸ FCO 67/195, NA, Letter from Gallagher to Fearnly, 10 October, 1968.

¹⁹ FCO 67/195, NA, Terms of Reference of the Select Committee on Nationalised Industries, October, 1968.

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the Memorandum's ideas and proposals. The process was drawn out as it was swept up in a full-blown oil policy review in 1969. As the evaluation carried on, it became increasingly evident that BP's small successes against Mikardo would be its only victories.

One by one, the proposals and ideas which BP had put forward were discussed and debated by the different departments. Much of what they had argued was true in their small context, but officials often found that larger policies would have to be manipulated in order to secure the goals put forward by the Company. This was particularly true of the suggestions regarding the taxation issue.²⁰

BP's concerns about taxation elicited sympathy without action from some officials. The FCO in particular recognized that BP was operating at some tax disadvantage abroad as compared to their American and Continental competitors. But while the FCO, MoP and the Treasury were willing to concede that BP had a point in their complaint, the Internal Revenue Department was not as generous. Acknowledging that the 1965 Corporation Tax hurt BP financially, Internal Revenue declared that the changes had "brought to an end a privileged form of treatment of companies operating overseas and of their shareholders which was unparalleled abroad."²¹

²⁰ On the refinery issue, BP requested that the government limit the ability of foreign companies to construct new refineries in Britain. While the MoP did not have anything against this idea in principle, they decided that it was practically impossible. First, restricting refinery construction by foreign entities would require new legislation, but even more importantly it was pointed out that "Controls on refinery developments would not on present policies exclude the foreign companies from the market because they could import products." POWE 63/401, NA, The Bridgeman Memorandum: Comments by the Ministry of Power, March, 1968.

²¹ POWE 63/401, NA, Sir Maurice Bridgeman's Memorandum, 22 February, 1968

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Despite this harsh assessment, the other departments of Whitehall were willing to hear BP's detailed arguments. Therefore in March, 1969 they requested that BP present another, more comprehensive memorandum on the taxation issue which would "aim to quantify, in terms of cents per barrel, B.P.'s disadvantage vis-à-vis other international oil companies."²² The Company complied and the debate continued over the strength of BP's case.

After another year of deliberation, and a change of government, a final report on the issue was presented in February, 1970. The gist of the report was summed up by FR Vinter, a MoP official who noted that "In a single phrase – B.P. argued that they were at a very serious disadvantage compared with major U.S. oil companies; by and large we (and the Treasury and F.C.O.) think there was something in their argument but not so much as to call for special measures."²³

Cracking the Largest Market

The conclusion of the report meant that BP would receive no succor from the Government and would need to find alternative ways of increasing its profitability. Whitehall did offer a few suggestions toward this end. Chief among them was a further incentive for the diversification of BP's supply. Diversification had been a staple of the Government's security plan, but the Treasury also pointed out to BP that if it could "diversify its sources of supply," it could "significantly reduce the proportion of world

²² POWE 63/402, NA, Note of a Meeting between BP, Treasury, Ministry of Power and Inland Revenue, 18 March, 1969.

²³ POWE 63/643, NA, The Bridgeman Memorandum, 6 March, 1970.

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profits paid over in tax and thus improve its net of tax cash flow.”²⁴ This was because while the rate of taxation in the Middle East was higher than that of Britain, resulting in tax that could not be credited, there were areas where the reverse was true. Production in an area where the tax rate was lower than Britain’s would help to bring the entire Company’s average overseas taxation closer in line with Britain’s, thereby reducing the amount of un-credited tax paid by the company.

Better still would be if BP could expand its market share in areas where it was underrepresented. Increasing profits on the sale of products overseas could help to offset their weakness in the British market. Besides this, greater market share abroad would give BP more access to different financial services, allowing them to borrow more money which would reduce the strain on Britain’s foreign exchange.²⁵

There was one area in particular where this strategy had the potential to return massive rewards for BP and for the British balance of payments – the United States. The US was the largest single market in terms of oil sales, both of crude and of product.²⁶ It was also a market from which BP was almost completely blocked. The quota system put into place by the Eisenhower Administration in 1959 severely limited the sale of any petroleum not produced in the United States. Since BP had no significant US production,

²⁴ POWE 63/401, NA, Notes on the B.P. Memorandum about the company's tax position, August, 1968

²⁵ Lenders in New York had been hesitant to continue financing BP’s North American operations due to its small American footprint. The company had already borrowed extensively to conduct exploration in Alaska.

²⁶ The US was technically second to the EEC but most statistics reflected rankings on a nation by nation basis.

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this made it impossible for them to sustain a distribution network in the country and therefore excluded them from the lucrative market.²⁷

But the discovery of oil in Alaska dramatically changed this situation. When the Atlantic Richfield Company (ARCO) and its partners struck oil in the Prudhoe Bay area of Alaska in March, 1968, it was a potential game-changer for BP. This was because BP's concession areas abutted ARCO's, leaving BP's geologists feeling that the Company had a "95 per cent chance of discovering oil in commercial quantities" and that "they have at least a one third share of what is likely to prove one of the largest oil fields, even by Middle East standards."²⁸ The Alaska field would provide BP with a US production base and oil that could be sold in the US market.²⁹

BP therefore had to acquire a distribution network in the United States from scratch. This figured to be a very expensive proposition since the market was already saturated with distributors.³⁰ By comparison, Shell had broken into the American market in the 1920's, establishing itself throughout the country early on.³¹ To buy property and build new service stations and refineries would have cost BP more money than it was capable of raising.³² Thus BP had to look for opportunities to buy into the existing American market.

²⁷ BP did own the small Kern field in California but its production and sales were minimal.

²⁸ FCO 67/200, NA, Memo from Hancock, 15 November, 1968.

²⁹ In fact, under US law, the oil produced in Alaska would be required to be sold in the United States.

³⁰ For a detailed description of the growth of integrated refinery structures in the US market, see Kathryn Rudie Harrigan, *Vertical Integration, Outsourcing, and Corporate Strategy* (Beard Books, 2003), 89–93.

³¹ For an account of this process see volume 1 of Stephen Howarth et al., *The History of Royal Dutch Shell* (Oxford University Press, 2007).

³² One estimate showed that achieving even a 10 percent share of just California's market would require an investment of \$2 billion.

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Shortly after ARCO's Alaska discovery, such an opportunity presented itself. ARCO along with another American firm, Sinclair, announced plans to merge in October, 1968. Under the US anti-trust legislation, such a merger was to be scrutinized deeply by the American Department of Justice. To facilitate an easier investigation, ARCO and Sinclair announced that Sinclair would sell off 6,000 of its East Coast service stations as well as one of its major refineries in Pennsylvania and one of ARCO's refineries in Texas. BP jumped at this opportunity and in November, 1968 struck a preliminary deal to purchase all of these assets for \$300 million, all of which would be raised by BP's American subsidiary through loans in the US.³³

But this ideal situation quickly soured as the Department of Justice (DOJ) sued to stop the ARCO-Sinclair merger on anti-trust grounds. Despite the deal with BP, the official line from the DOJ was that the merger would suppress competition. There was some doubt on the part of the companies about the validity of the case. The suit had been brought by President Lyndon Johnson's outgoing Attorney General, Ramsey Clark, and some oil company officials speculated that it had been done merely to cause the new administration of Richard Nixon a headache.

This situation put the British Government in a delicate position. BP was technically not part of the suit and was, in effect, an innocent bystander. Nevertheless it

³³ This was crucial due to the restrictions on foreign exchange placed on both BP and Shell by the Treasury. The odd location of the refineries as compared to the source of supply, Alaska, mean that BP would swap Alaskan crude for crude which could be distributed more easily on the East Coast. Bamberg points out that BP was paying a premium in order to enter the American market. The assets being sold off by ARCO and Sinclair were of a fairly low quality. The refineries were out of date with high operating costs and the service stations were thinly spread with low market share. But BP felt it was worthwhile to gain a foothold in the lucrative American market. See J. H Bamberg, *British Petroleum and Global Oil, 1950-1975: The Challenge of Nationalism* (Cambridge University Press, 2000), 272-275.

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was highly unlikely that BP would find another deal of similar importance or value should the ARCO-Sinclair merger fail. Interfering, or even appearing to interfere diplomatically, in what was essentially a domestic lawsuit could have had negative ramifications for BP's future dealings in the United States. But this did not stop ARCO, hoping to enlist the help of the British Government, from arguing that "the real purpose of the suit is to prevent B.P. from establishing themselves in the United States."³⁴ BP, however, realized the risks and came to the conclusion "that it would be much better to avoid any official intervention from H.M.G. or the British side at the present moment," stating that "the less British official fuss we make the better."³⁵

As the case continued to drag on, however, BP became nervous that many of the service stations they had planned to buy could be sold to other competitors. There were several discussions with Foreign Secretary Michael Stewart about how the British Government could help. Both sides still agreed that an open demarche by the FCO would achieve little, but they did approve back-channel discussions with both the American ambassador in London and between members of the FCO and the American State Department. In February, after the presiding judge in the suit granted the DOJ a delay in order to strengthen their case, the FCO approved plans to express their impatience to a member of President Nixon's entourage during a visit by the US leader to Britain.

BP greatly appreciated these tactful approaches but in the end, they proved to be unnecessary. The DOJ, which had a weak case against the ARCO-Sinclair merger,

³⁴ FCO 67/200, NA, Telegram from Dean to FCO, 15 January, 1969.

³⁵ FCO 67/200, NA, Telegram from Rouse to FCO, 16 January, 1969.

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agreed to allow the deal to go through on the condition that the two firms sell a further block of service stations to BP in the south-eastern states. This made the deal even more attractive to BP, who quickly agreed.³⁶ When the deal became official mid-way through 1969, BP had made the major step of gaining a foothold in the American market.

Yet the Company was not finished. Even with its new outlets on the East Coast, BP still would not be able to process and distribute all of their Alaskan production. Therefore, BP had already begun searching for a partner in another US market even before the ARCO-Sinclair deal went through. They found an ideal candidate in Standard Oil of Ohio (Sohio). Sohio had a strong position in Ohio and a good share of the market in the surrounding states. They were also crude-short, meaning that the prospect of merging with BP was extremely attractive to the American firm as well.

The plan was for BP to take an eventual 54 percent ownership of Sohio over the course of the 1970's. This acquisition would be paid for in Alaskan crude. As the production level of the Prudhoe Bay field rose, so to would BP's share of Sohio.³⁷ This meant that BP would not need to lay out a large amount of cash upfront but it also meant that, for a number of years, BP would not control a large portion of its production from Alaska. The Company was unconcerned by this, and the merger was announced in June, 1969 with BP stating that the plan would allow them to "acquire a major shareholding in an already substantial, well-run, expanding U.S. company."³⁸

³⁶ The total cost of the new deal reached \$400 million.

³⁷ BP would secure 54 percent ownership when Prudhoe Bay reached production of 600,000 barrels a day.

³⁸ FCO 67/271, NA, BP Press Release, 1 June, 1969. Part of the lack of concern on BP's part stemmed from the fact that even with the oil which would be "paid" to Sohio and with the new service stations and

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There was some doubt, however, amongst some British officials about this strategy. Before the merger was announced, JG Owen of the Treasury questioned whether BP was “doing the right thing in going for a marriage of convenience rather than trying to go it alone.”³⁹ He and other officials admitted that “It would, of course, be very nice if they could follow the latter course. Just as it would have been very nice if we could have developed North Sea gas without letting any American companies have a share of the cake.”⁴⁰

Owen concluded that “there is nothing in the proposed deal, as it has been described to us – including the possible charge of an American sell out – which would justify the Government in using the veto – for the first time in history – in order to prevent it.”⁴¹ FH Gallagher of the FCO wrote that while the deal might prove to be a public-relations headache, it would be a tremendous boon to Britain’s oil policy for two key reasons. First, the move would help cement BP’s “place in the American oil lobby and thus enable them to exercise more influence on American oil companies.”⁴² The second was that it would give BP a stake in a major American industry which “would be to some extent the counterpart of American investment in Britain (e.g. in North Sea gas) and would strengthen the commercial relationship between the two countries.”⁴³

refineries on the East Coast, BP would still have left over crude from Alaska that would need to be disposed of through sales to third parties.

³⁹ FCO 67/271, NA, Memo by JG Owen, 29 May, 1969.

⁴⁰ Ibid.

⁴¹ Ibid.

⁴² FCO 67/271, NA, British Petroleum, 30 May, 1969. This was especially useful considering that BP had to negotiate jointly with American companies in the Middle East.

⁴³ Ibid.

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What seemed like a win-win for the two companies, however, once again fell afoul of the anti-trust suspicions of the US DOJ. Almost immediately after the merger was announced, rumors of a suit began swirling. Unlike the ARCO-Sinclair deal, this time BP would be a party to any anti-trust case and therefore, even before a lawsuit was filed, BP began to push the British Government to prepare both preemptive and responsive action. Officials in Whitehall weighed the advantages and disadvantages of intervention. Since BP was to be a major player, it would be much more politically charged. Gallagher of the FCO noted that the Nixon Administration “may not take kindly to an intervention in what are, from one point of view, domestic matters,” adding that “it could be particularly counterproductive if the Americans were to gain the impression that the British Government were intervening because of their shareholding.”⁴⁴ The British Embassy in Washington also reminded the FCO that BP was likely to be heavily involved in the United States for years to come which meant that “If we react every time there is a risk that B.P.'s plans may be impeded we may not get so sympathetic a hearing when we really need it.”⁴⁵ But these concerns were outweighed by the fact that the FCO believed that the deal was “of great importance” because it would “transform the fortunes of BP if it is successful and will also eventually lead to a major contribution to the British balance of payments.”⁴⁶ Because of this, the FCO, with the backing of the MoP and the Treasury, agreed to help present BP’s case.

⁴⁴ FCO 67/271, NA, Letter to John Freeman from FGK Gallagher, 7 July, 1969.

⁴⁵ FCO 67/271, NA, Letter from Freeman to FCO, 10 July, 1969.

⁴⁶ FCO 67/271, NA, Letter to John Freeman from FGK Gallagher, 7 July, 1969.

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The matter was thus one of how best to approach the Americans. BP “regarded the timing of any such approach as very important and thought in particular that it would be undesirable to intervene too early,” and that “any representations should not be too ‘naked.’”⁴⁷ When the case was forwarded to a DOJ lawyer, David Melincoff, to examine the merger’s anti-trust implications, BP worried that the window for British intervention was closing. BP admitted to Whitehall that “It would be fatal to intervene before Melincoff had made his recommendation but, on the other hand, there was practically no hope, once a decision had been taken, of getting it changed.”⁴⁸

It thus fell to officials in Whitehall to approach the Americans in such a way as to win the maximum sympathy for BP. The departments involved concluded that it would be best to avoid making arguments on an anti-trust basis as this would open them to attacks of meddling in domestic matters. Instead, officials sought to “aim to get it across that this was a matter in which H.M.G. had an interest and urge that if there were doubts in the mind of Justice Department on whether it was a proper case in which to institute proceedings, B.P. should be given the benefit of them.”⁴⁹ They would do this at a much higher level than they had with the ARCO-Sinclair situation. Both the Foreign Secretary, Michael Stewart, and the Chancellor of the Exchequer, Roy Jenkins, discussed the situation with their counterparts in the US and conveyed the intense feelings that would arise in both Britain and in Europe if BP were denied the chance to merge with a major American oil company.

⁴⁷ FCO 67/271, NA, BP/Sohio Merger, 4 July, 1969.

⁴⁸ FCO 67/272, NA, BP/Sohio Merger, 4 September, 1969.

⁴⁹ Ibid.

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But these arguments were still not enough as the case seemed to be headed for trial in October, 1969. The Sohio shareholders meeting, scheduled for 9 October, which was to finalize the merger, was postponed and the entire deal fell under an uneasy cloud. BP pressured the British Government to do more to ensure a favorable outcome, asking them to squeeze American firms already operating in Britain as a form of retaliation. This plan was resisted, however, with one official noting, “we depend on American goodwill and co-operation in so many fields that we should weigh very carefully the results and benefits to be expected from any tough stance towards them.”⁵⁰ But while Whitehall refused that tactic, they did subtly encourage the British press to ramp up the pressure on the United States.⁵¹

A series of meetings between the DOJ, BP and Sohio in early and mid-October led to progress. The DOJ promised to drop its case if BP and Sohio agreed to divest some assets in order to increase competition in Ohio and western Pennsylvania. During these negotiations, BP asked the British Government to back off on its pressure, which Whitehall duly did. An agreement was struck in November and the lawsuit was dropped, allowing the merger to go forward.⁵²

BP was extremely grateful to the British Government for its support. How much the British pressure on the US side helped the final decision is impossible to tell, but the

⁵⁰ FCO 67/273, NA, Letter from Brant to McElvie, 30 October, 1969.

⁵¹ One example of this is an early article in *The Times* which noted that “The feeling in Government circles that an unfair discrimination was being threatened against the deal, seem clear enough last night.” A.M. Rendel, “Government May Act with BP on Merger Crisis,” *The Times*, October 7, 1969, The Times Digital Archive 1785-1985.

⁵² The merger came into effect on 1 January, 1970.

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matter did ease some of the frustrated ties between BP and the Government. With the deal, the Company and its partners now held a major share of the market east of the Mississippi River and possessed a formidable outlet for its Alaskan production.⁵³

Keeping the Common Market Open

While BP needed their Government's help to enter the American market, it also required its assistance in keeping their share in Europe. In terms of size, the European market consisting mainly of the six EEC members was actually larger than that of the US. But unlike in America, BP had a long-established presence on the Continent. Together with Shell and Esso, BP was among the largest suppliers of oil products to Europe and made roughly 25 percent of its overall sales there.⁵⁴

It was seemingly a strong and secure position for BP to be in, but a persistent threat continually worried the company. This was the fear that the EEC would create a common energy policy detrimental to BP's interests. The French had long maintained a

⁵³ The matter still remained of getting that production to market. BP, along with the other firms operating in Alaska, had joined together in a pipeline consortium in order to construct a pipeline from Prudhoe Bay across the state to the port of Valdez. The plan was quickly mired in a host of delicate domestic issues that prevented its final approval. Environmental concerns, native land rights and struggles with the Alaskan Government all slowed down the project. In most if not all of these issues, the British Government was unable to help BP. The matter became even more complicated when an alternative route through Canada's McKenzie Valley was proposed. This pipeline would have had the added benefit of linking up with several smaller oil projects in Northern Canada belonging to Burmah Oil's Canadian subsidiary. Even so, the FCO thought it prudent to remain outside the Canadian-American tussle over the pipeline. Because of these delays, the Trans-Alaskan Pipeline System (TAPS) languished and BP could not move forward on its plans in North America until the 1973 Oil Shock encouraged the conflicting parties in Alaska to reconcile their differences. The delay in construction reportedly cost BP around \$1 million a day in equipment and staffing costs.

⁵⁴ In 1968, BP supplied 36 million tons of crude and product to the European Market. Shell sold roughly 51 million tons of crude and product which constituted 20 percent of its worldwide sales. See POWE 63/655, NA, Oil Policy: Report by a Working Party of Officials, 5 August, 1970.

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dirigiste energy policy and they made no secret of their desire to extend such a policy to the Common Market. This plan would give preference to “Community” sources of oil, which in the French scheme included their companies’ concessions in Algeria. This plan would have also allocated market share to “Community companies” and placed limitations on firms from outside the EEC such as BP.

Happily for BP, the French plan had limited appeal to the Netherlands, Belgium and West Germany which all relied on more liberal oil-trading policies. Despite this divergence in opinion, the Commission of the EEC determined that the organization needed to establish a greater competence over oil issues. As early as 1964, the Commission’s Robert Marjolin noted that “the Six were embarrassed by their ignorance of oil matters compared with the British and American Governments.”⁵⁵ Yet progress on such expanded knowledge and control over Europe’s oil affairs did not advance until 1969 with the proposed unification of the three main agencies of the Common Market: Euratom, the European Coal and Steel Community (ECSC), and the EEC. The energy matters dealt with by Euratom and the ECSC were brought under a new committee of the Commission known as the Direction-générale XVII (DG XVII). This group was charged with applying some of the ideas that the EEC had agreed to a year earlier in 1968 in a document on energy known as “Première orientation pour une politique énergétique

⁵⁵ FO 371/178152, NA, Record of a Meeting Held in the Foreign Office: Report on Oil Supply Prospects by the O.E.C.D. Oil Committee, 1 April, 1964.

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communautaire” that called for the principles of the Treaty of Rome to be applied to the realm of oil and gas.⁵⁶

Both BP and the British Government kept a close watch on the activities of this group, fearing that it could encourage policies damaging to BP’s market in Europe. The British had pursued a long-standing policy since the creation of the EEC which was to use whatever influence it had to prevent the formation of a common energy policy inimical to British interests. Whitehall had achieved this primarily through the building up of the Organization for Economic Cooperation and Development’s (OECD) Oil Committee as the most logical place to discuss Europe-wide oil concerns. A report on the matter from 1964 argued that “The O.E.C.D. is the only international body available at which British oil officials can seek to influence officials of major consuming countries in a direction favourable to British oil interests, i.e. B.P. and Shell,” before pointing out that “we regard it as of first importance to assert this influence on the Six before they form their own firm policies on oil.”⁵⁷

This policy had worked for a time, but the oil embargo following the Six-Day War reignited discussion within the EEC regarding oil issues, leading to the creation of the DG XVII. While rapid development was unlikely, in the words of the MoP, “some progress towards common energy policies in the coming period is not to be ruled out; indeed, in the longer run, if the Community is to progress at all, some development of

⁵⁶ This translates to “Initial guidelines for a Community energy policy.”

⁵⁷ POWE 61/163, NA, Consultation in the O.E.C.D. Oil Committee,

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policy in this field is inevitable.”⁵⁸ Along these lines several ideas were being put forward that had some appeal to the Six, all of which centered on ways to improve the competitiveness of “Community companies” either through tax relief, investment grants or tariffs on non-Community companies. Thus while both Whitehall and BP felt confident that progress along these lines would be difficult, the MoP still concluded that “Any development of restrictive Community policies – however slowly they may come – will tend to affect B.P. adversely so long as the U.K. is not a member.”⁵⁹

This last point remained the operative one. BP’s concerns about the development of a common energy policy in the EEC could be instantly relieved through UK membership. If BP could become a “Community company” like Shell, then any policies enacted would benefit them as well. Failed attempts by Britain to enter the Common Market in 1963 and 1967 did not completely diminish the hope that membership could eventually be attained. Indeed in terms of energy, officials began to take a somewhat desperate view of the need for Britain’s entry. The 1969-1970 oil review contained a large section on the EEC and energy, noting darkly that,

If we fail to join the Community we should have to use what little influence we would then have to preserve the position of the British oil companies there and prevent or delay progress towards a restrictive common oil policy. In particular, we should have to watch very closely any special measures to help Community companies compete against the international majors. Though Shell would probably be regarded as a Community company BP would not. This would put BP at a disadvantage but it could also have implications for Shell if “Community company”

⁵⁸ FCO 67/278, NA, The Present and Future Oil Policies of the European Economic Communities, 31 March, 1969

⁵⁹ FCO 67/278, NA, The Present and Future Oil Policies of the European Economic Communities, 31 March, 1969

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were narrowly defined. In that event, to keep its status as a Community company, Shell might be required to move some financial (as well as operational) control to the Hague; this in turn could have repercussions on the company's sterling holdings in London and on the Shell/Treasury agreement, with implications for our reserves.⁶⁰

The review therefore unsurprisingly concluded that “Our oil interests clearly favour joining the E.E.C.” and that “if we do so BP, as well as Shell, would have Community company status... and both companies' interests in this important market would be safeguarded.”⁶¹

BP, Shell and Whitehall did not have long to wait. In October, 1970, the new Conservative Government of Edward Heath re-opened negotiations for Britain's entry into the EEC. The FCO's Oil Department was fully on board with this decision, noting however that “even if we do not join we can rely on Shell to represent our views on oil policy in the Communities, but there would be a greater likelihood of the balance being tipped against a French-inspired restrictionist policy if we (and BP) were also involved in Community decision-making.”⁶² Once it became apparent that this third attempt would be successful, the matter regarding oil policy shifted from one which embraced the status quo to one in which the British Government could take a leading role in formulating an energy policy beneficial to their interests.

BP was excited about Britain's application since the tense negotiations with OPEC producers were once again prompting calls within the EEC for new policies and

⁶⁰ POWE 63/655, NA, Oil Policy: Report by a Working Party of Officials, 5 August, 1970.

⁶¹ Ibid.

⁶² FCO 67/629, NA, Effects on the British Oil Industry of UK Accession to the European Communities, 17 February, 1971.

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tighter control of the oil industry. Among the proposals was the extension of Euratom's "enterprise communes" to the realm of oil and gas. Enterprise communes were essentially partnerships between different Community companies that would receive financial grants and other benefits from the EEC as a way of promoting more indigenous energy development. Along with this suggestion was a proposal for the EEC to develop closer cooperation agreements directly with oil producing states. One FCO official based in Brussels wrote to London that the Commission was beginning to "foresee that relations between consuming and producing countries will in any case become increasingly inter-governmental during the course of the 1970's, rather than remaining so largely in the hands of the major oil companies."⁶³

Such plans drew concern in Whitehall although some officials downplayed the possibility. These civil servants noted that the nationalization of the holdings of French companies in Algeria in 1970 had dampened French enthusiasm regarding cooperation with the oil producers. A note prepared by the FCO's Oil Department laid out the sense of relief brought about by this development, stating "it is likely that after the nationalisation of their Algerian interests," the French would "now be more ready to consider a more liberal policy," which in turn would "lessen the danger of discrimination against BP, whilst we remain outside the Communities."⁶⁴ It was also noted that "it seems doubtful that member states will wish to transfer responsibility for conducting the

⁶³ FCO 67/629, NA, Letter from Christofas to Bottomley, 13 May, 1971. The DG XVII hoped that by trading development aid and expertise, the members of the EEC could spare themselves the oil insecurity that appeared to be a growing threat during the standoffs between the international oil companies and the members of OPEC.

⁶⁴ FCO 67/629, NA, EEC Common Energy Policy, March, 1971

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most crucial part of relations with the oil-producing countries from the major oil companies not to their own governments, but effectively to representatives of the Commission, and this may be yet a further unwillingness to make energy policy a Community subject.”⁶⁵

A more realistic plan was evolving around the enterprise commune concept. A.E. Furness explained that “The main benefits to be conferred on ‘entreprises communes’ would be fiscal, and there would be no rigid formula to be applied in every such case.”⁶⁶ Georges Brondel, the European commissioner for oil, elucidated the idea further, admitting to FCO officials that,

one of the main underlying thoughts behind the Commission's wish to offer European oil companies fiscal or financial benefits was their fear that the fiscal advantages offered to US-based oil companies were so considerable, that not only were they heavily loading the scales in favour of existing US companies, but were also tending to attract to the United States other companies (and he instanced both Shell and BP) which were now based in Europe.⁶⁷

The exact details of the enterprise commune concept were fuzzy, which led both Whitehall and BP to hope that any further plan could be decisively influenced by the British. This optimism was bolstered by the fact that Britain possessed an asset of

⁶⁵ FCO 67/629, NA, Letter from Christofas to Bottomley, 13 May, 1971. The oil companies believed that greater government involvement was inevitable. Their defeat during the Tripoli and Teheran negotiations had left them demoralized and turned their attention to ways in which consumer countries could coordinate their responses to OPEC. Lowell Pumphrey, a representative of Mobil Europe admitted as much to Derek Eagers of the FCO saying “In the long run it was probably inevitable that the oil industry would assume something of the status of a public utility.” BP likewise saw greater government involvement as likely but preferred “a co-ordinated approach of any sort to a situation where the governments of consuming countries had to deal individually with oil producing governments.” FCO 67/629, NA, Possible Future Developments, 4 June, 1971 and FCO 67/629, NA, Letter from Furness to Tunnell, 11 June, 1971.

⁶⁶ FCO 67/629, NA, Letter from Furness to Tunnell: Community Energy Policy, 30 June, 1971.

⁶⁷ FCO 67/629, NA, Letter from Furness to Tunnell: Common Energy Policy, 30 July, 1971

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tremendous value – North Sea oil – to use as a bargaining chip. The limited energy cooperation that did exist within the EEC revolved mainly around stockpiling and agreements which stipulated the sharing of supplies and production during a crisis. This policy would not be favorable to the British as North Sea oil would give them a much larger production level than any other EEC member. It was therefore expected that full cooperation could be bartered for more favorable treatment in other fields. The GEN 123 Committee, which was conducting a wide-ranging oil policy review, argued that because North Sea oil would be a “very considerable asset to the EEC...the UK should try to use it as a bargaining counter in negotiations on a common energy policy” or to gain assistance for “our coal and nuclear industries, or to BP and Shell through the ‘enterprise commune.’”⁶⁸

The failure to make any significant headway on EEC energy issues during Britain’s accession negotiations was unsurprising. The oil analyst Walter Levy noted that “No policy will now be settled before 1973, when Britain joins EEC,” before adding pessimistically that Britain’s entry would “much further delay any comprehensive petroleum policy – and hence any full EEC energy policy – at all.”⁶⁹ But for BP, and to a lesser extent Shell, the chief goal of securing their markets in Europe seemed to be ensured by Britain’s entry into the EEC. No matter what shape future EEC energy policy

⁶⁸ CAB 130/610, NA, The OECD and EEC Sharing Out Arrangements GEN 123(72)9, 25 September, 1972. When the extent of the oil finds in the North Sea continued to grow, members of the Committee later had second thoughts claiming “We should not know the full extent of our North Sea oil resources, and therefore the strength of our bargaining position, until about 1980; and until the shape of our overall energy policy was clearer, it was hard to see how any concessions which might be offered on coal, nuclear power or help to British Petroleum and Shell through the “enterprise commune” could be properly evaluated.” CAB 130/610, NA, Oil Policy: GEN 123(72) 4th Meeting, 11 October, 1972.

⁶⁹ FCO 67/629, NA, First Thoughts on Energy Policy in an Enlarged European Community, June, 1971.

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would take, both firms were guaranteed to be Community companies. This relieved the pressure on the British Government and shifted their attention towards protecting the growing asset they had in North Sea oil. While the possibilities of energy cooperation in the EEC were significant, the risks to Britain's control over North Sea oil provided a powerful incentive for Britain to hold back from making any major concession solely for the sake of a united European oil policy.

A Battle for the Future of the North Sea

As North Sea oil became a greater consideration for the Government in its international dealings, it also became a larger factor in relations between Whitehall and BP and Shell. While BP received the desired results in both the United States and in Europe due to cooperation with British officials, the same could not be said of the policy regarding North Sea oil and gas. Already thwarted in their attempts to receive preference in the British market, BP and Shell would become increasingly exasperated by the British Government's policies for state involvement in the production of North Sea gas and later oil. This frustration was made worse by the fact that the victory of Edward Heath's Conservatives in the 1970 general election inspired hope for better relations, but ended in disappointment as the new Government faced economic and political difficulties which forced it to create oil and gas policies contrary to BP and Shell's interests.

The fact that battles erupted over the North Sea is not surprising due to the amount at stake. Already by 1968 several large gas discoveries had been made in the

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southern basin of the North Sea. The huge Leman Bank natural gas field ranked in the top five in the world and its extent had still not been completely mapped.⁷⁰ Production from the Leman Field had been held up, however, by haggling over the price which would be paid for the natural gas by the Gas Council, the monopoly buyer of all gas produced in the British North Sea. The negotiations over price opened up not only large differences between the oil companies and the Government but also further exposed the fault lines within the Government itself.

The problem lay in the fact that more radical elements of the Labour Party wanted to ensure that the companies did not achieve “excessive profits” on North Sea gas. This, they argued, would have gone against the ethos of the party which saw North Sea gas as a potential bonanza with which to remake Britain’s industry. These thinkers, chief of whom was Harold Wilson’s special economic advisor Thomas Balogh, felt that by driving a very hard bargain with the companies the Government could win the twin benefit of filling the Exchequer’s coffers with royalty and tax money while simultaneously keeping gas prices low for British industry. Balogh was appalled at some of the early negotiating figures regarding the price that the Gas Council would pay to the companies for their gas. Writing to the Prime Minister in late 1967, he argued that “I do not need to emphasize to you the political dangers for us if an arrangement were to be

⁷⁰ The Leman field was joined by others of various sizes such as West Sole, Indefatigable, Hewett and Viking.

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arrived at which is fundamentally so different from the way the Labour Party voted at Conference – for an intensified national exploitation of our natural resources.”⁷¹

The Ministry of Power agreed with Balogh and his compatriots that North Sea gas was a unique resource in its potential to assist the balance of payments. But the civil servants argued that the theoretical benefit that the production and use of North Sea gas could have on Britain’s economy was irrelevant if the gas stayed in the ground. This would happen, they claimed, if the Government insisted on too low of a price, or on a price that could be changed. The capital and expertise required develop these resources had to come from the international oil industry. If the Government struck too hard a bargain, these companies would invest their resources elsewhere.⁷² This disagreement within the Government camp plagued the early negotiations with the oil companies and delayed a final settlement until 1969.⁷³ The final agreement was one with which none of the parties were pleased. Even after the signing of an agreement with the Shell/Esso group that held a large share of the Leman Field, Shell refused to participate in the press

⁷¹ PREM 13/2119, NA, Letter from Balogh to the Secretary of State for Economic Affairs, 7 November, 1967.

⁷² The Minister of Power, Richard Marsh, was a firm advocate of his department’s view. Early in the process of negotiations, Marsh recognized the fact that the civil servants of the MoP were relative novices in the art of oil and gas discussions when compared to the international oil companies. Therefore Marsh contracted Walter J. Levy to conduct a study on the MoP’s pricing methodology. With his department being strapped for cash, Marsh repaid Levy for his services with a dinner at the House of Commons, which according to Marsh was “paid out of my own pocket for the princely sum of about £10 for our dinner that night.” Marsh, *Off the Rails*, 107.

⁷³ Colin Robinson, who worked as a member of Esso’s negotiating team later recalled that “In the case of gas it is a bit of a myth to think that the oil companies negotiated with the Gas Council. Everybody knew that in fact they were negotiating with the government, and it wasn’t even with the Department of Energy in its various incarnations. Hovering in the background always was the Treasury and also the various advisers which the Prime Minister had, in particular Tommy Balogh, who had a very big influence on the negotiations. I think in many ways the Gas Council was a front organisation for what went on.” See Colin Robinson, in ‘The Development of North Sea Oil and Gas’, held 11 December 1999 (Institute of Contemporary British History, 2002, <http://www.icbh.ac.uk/witness/northsea/>), p. 32.

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conference because they were “in profound disagreement with the Government's general policy on North Sea gas prices.”⁷⁴

But the rancor did not finish with gas prices; the division between the Ministry of Power and the left-wing of the Labour Party continued in the closely-connected discussions regarding the potential NHC. The NHC idea resurfaced towards the end of 1968 as the North Sea Study Group prepared to release a second report in time for the Labour Party's annual conference. This second report fleshed out the initial plan for the organization to take over the Gas Council and the National Coal Board's North Sea allotments which had been awarded in the second licensing round.⁷⁵ The plan also called for the NHC to assume the responsibilities of the Gas Council as well as taking control over the surrendered license blocks that were due to be returned to the Government in 1970 and 1971 as part of the first two licensing rounds.⁷⁶ In addition, the North Sea Study Group foresaw the NHC taking over all further exploration and production in the parts of the Continental Shelf not yet awarded, as well as developing regulatory instruments to govern the companies that were operating in British territory.⁷⁷

This was a truly radical program and one which the companies and the MoP vehemently opposed. Officials from the MoP had met with the Labour Party's Study Group before the report's release, questioning some of the figures and estimates in the

⁷⁴ PREM 13/2656, NA, Memo from McIntosh to the Prime Minister: The Price of North Sea Gas, 10 September, 1968.

⁷⁵ These licenses were held in partnership with other oil companies, Amoco with the Gas Council and Conoco with the NCB.

⁷⁶ These initial rounds had contained a provision requiring 50 percent of all the licensed blocks to be returned to the Government by 1970 or 1971.

⁷⁷ Many of these ideas would later be incorporated into the British National Oil Company (BNOC) established in 1974. See Chapter 9.

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proposal as being overoptimistic. These challenges however were ignored which, given the long-running mistrust between the two sides, was predictable. H. Scholes of the MoP noted that “Ministry officials came in for a certain amount of derogatory comment” despite the attempt to keep politics out of the discussion. But, Scholes admitted, “the Study Group could hardly have failed to get the impression that we thought their proposal ill-considered and unsubstantiated.”⁷⁸

There were several reasons for these misgivings. Michael Posner, a pro-Labour economist and on again/off again adviser to Wilson and other Cabinet members described the MoP’s dilemma, stating that “they naturally dislike the N.H.C. on both ideological and practical grounds, and doubt whether at this stage in the North Sea affair a State Corporation can really make any impact, or usefully spend money.”⁷⁹ The first argument made by the MoP to support these doubts was the fact that the Government had in May, 1968 performed a major evaluation of the Gas Council and set out a policy that would make the organization the center piece for marketing natural gas from the North Sea. To go back on that policy so quickly would show a lack of decisiveness and hamper marketing gas to British industry. The new Minister of Power, Roy Mason, made this point in a letter to Harold Wilson, writing, “I have most serious misgivings about the detailed proposals in the present report, mainly because of the effect they would have on our announced plans for the gas industry and the exploitation of natural gas.”⁸⁰

⁷⁸ POWE 63/434, NA, Letter from Scholes to Willmott: National Hydrocarbons Corporation, 27 August, 1968.

⁷⁹ T 319/2316, NA, Letter from Posner to Vinter, 13 August, 1968.

⁸⁰ T 319/2316, NA, Letter from Minister of Power to the Prime Minister, 6 September, 1968.

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To the MoP, the plan for an NHC was powered more than anything by the political ideology of the left-wing of the Labour Party. The desire to create a national oil company that could challenge the likes of BP and Shell overrode any potential challenges and practical realities. This, MoP officials suspected, was behind the renewed plan for the NHC to take over the Gas Council. The Gas Council and its partners Amoco had made a major gas strike and were amongst the groups ready to produce and sell gas at the earliest stage. Thus, if the NHC could inherit the Gas Council's licenses, it would be guaranteed an income right from the beginning. As H. Scholes of the MoP noted sardonically, "Politically the N.H.C. might seem very much less attractive if it had to operate for its first few years at a loss until it could develop profitable production of its own (if it ever did)."⁸¹ The officials of the MoP backed by the Treasury also noted that the Study Group's projections for exploration expenses were extremely optimistic. The report suggested a reasonable success to failure ratio of drilling holes at 1:4 while some within the oil industry suggested that 1:20 or even 1:30 would be a more accurate number. Even these more realistic ratios also assumed that the NHC would be able to acquire the professional staff required to conduct exploration and drilling. Mason summed these arguments up to Wilson by stating, "The Study Group's prospectus is, in my view, over-optimistic and does not pay sufficient regard to the risks associated with a venture of this kind, the heavy calls on capital and the technical problems of entering into

⁸¹ POWE 63/434, NA, Letter from Scholes to Willmott: National Hydrocarbons Corporation, 27 August, 1968.

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this highly specialised field.”⁸² He suggested that the NHC proposal be abandoned and replaced with increased public participation through the agency of a strengthened Gas Council.

The oil companies were similarly savage in their criticism of the plan. Shell, asked by the MoP to provide an assessment, was blunt in its condemnation writing that “the report is so slipshod – by any standards – that it is difficult to understand how it achieved publication.”⁸³ J.E. de Quidt of BP, however, noted the political attractiveness of the idea reporting that “It can be represented as cashing in on the supposed ‘profits’ of North Sea gas production, as keeping these out of the hands of the ‘international oil companies’ (used as a semi pejorative term), and of Labour ‘planning.’”⁸⁴ De Quidt’s concern was not so much that the plan would be a failure but that “there must surely be an obvious temptation to seek a ready made body of experience and expertise to be, in conjunction with some of the Gas Council staff, metamorphosed into an NHC, thus avoiding the effort of building this up from scratch. What better candidate than BP?”⁸⁵

The strong pushback against the NHC by the MoP, the companies, and even several major trade unions gave the Cabinet pause about fully endorsing the Study Group’s plans.⁸⁶ The Labour Party leaders therefore once again praised the proposals at the Party’s conference in 1968 but refused to endorse them. But if the NHC was to be set

⁸² T 319/2316, NA, Letter from Minister of Power to the Prime Minister, 6 September, 1968.

⁸³ POWE 63/434, NA, Shell Appraisal: National Hydrocarbons Corporation: Labour Party Report of 22nd August, 1968, 28 February, 1969.

⁸⁴ BP 66519, BP, National Hydrocarbons Corporation and a Ministry for Nationalised Industries, 3 October, 1969.

⁸⁵ Ibid.

⁸⁶ This included the General and Municipal Workers’ Union and the National and Local Government Officers Association.

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up, the legislation would have to be introduced in 1969 to give the new organization a chance to staff itself and prepare to assume the surrendered North Sea licenses due to be returned to the Government in 1970 and 1971. On top of this was the fact that dithering over the NHC was holding up the possibility of another licensing round being issued for more areas of the North Sea and Irish Sea.⁸⁷

Yet the argument that pushed the Cabinet over the edge against the NHC was the fact that any take-over of exploration by a state company would require massive amounts of capital. Exploration wells each required several million pounds to complete and with Government finances as stretched as they were, the thought of investing that amount was unpalatable. Therefore, in the summer of 1969, a series of meetings were held which confirmed the Cabinet's decision to pass on the idea of an NHC.

But it was politically impossible to completely abandon the idea without some political cover. Thus the Cabinet decided to pursue a strategy of encouraging a long-term partnership between the Gas Council, the National Coal Board and BP to create a British group that could compete for offshore licenses. This would, according the RRD McIntosh of the Treasury, "go a long way to meet the Fuel Study Group's proposal for a National Hydrocarbons Corporation (even though the joint company would probably be

⁸⁷ According to Kemp, the MoP felt that the already discovered gas fields could supply 3.5 billion cubic feet per day (bcf/d) of gas which would fulfill most of the 4 bcf/d expected by the 1967 Fuel Policy Review. But if no further finds were made, Britain's fuel plans would have to be significantly modified. Because of this, the encouragement of further exploration was imperative. See Alexander G. Kemp, *The Official History of North Sea Oil and Gas*, vol. 1 (Routledge, 2012) 120.

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given some other name) and would seem to make good sense technically and commercially as well as on wider grounds of national policy.”⁸⁸

The MoP expressed some doubts about this proposal as did BP and Sir Henry Jones, the head of the Gas Council. The Gas Council, the NCB and BP had all had success independent of one another in the first two licensing rounds. In the case of the Gas Council, they had even established a strong working relationship with another oil company, Amoco. Added to this was the MoP’s fear that should such a British group inherit all the surrendered territory from the first two licensing rounds plus the unallocated areas, the exploration program would prove to be far too expensive. This would force them to return to the Treasury for more funding or to sub-contract blocks to other companies, thereby defeating the process of increasing the British share in the first place.

With the idea of a British group stumbling at the gate, the MoP and the Ministerial Committee dealing with North Sea gas issues pushed for a more workable solution. If a national group were untenable, at the very least it was hoped that licenses could be granted more favorably to British interests. Put simply, the Labour Party wanted “licensing arrangements for the next round that mark a distinct advance on the practice of the two earlier rounds; and, in political terms... arrangements that are consistent with the aims of the North Sea Study Group.”⁸⁹

⁸⁸ PREM 13/3211, NA, Letter to the Prime Minister from McIntosh: Continental Shelf Licensing, 23 June, 1969.

⁸⁹ PREM 13/3211, NA, Letter from the Minister of Power to the Prime Minister: Continental Shelf Licensing, 23 May, 1969. This decision infuriated Balogh who later wrote “I blame myself because I did

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There had been three basic ideas about how to conduct the next round of licensing. The first was to allocate the new blocks to a public entity, but with the NHC torpedoed and the British group idea dead on arrival, this course was a nonstarter. The second idea was to use an American-style auction for the blocks which would bring in a great deal of money to the Exchequer. But this would cost the oil companies more upfront, leaving them less capital to carry out exploration. It also all but ensured that the public sector would have a very small share of the next licensing round. The final option was to continue a form of the discretionary system that had been used in the first two rounds but with even greater emphasis on public sector participation.⁹⁰

It was this final approach that was eventually agreed to and in a speech to Parliament on 23 July, 1969 Roy Mason laid out the rationale by stating that the goals of the licensing round would be “to maintain a continuing and vigorous effort on the U.K. Continental Shelf and to do this in a way which secures the maximum advantage for the economy in terms of the balance of payments and of low energy costs.”⁹¹ According to the Minister of Power, this first goal could only be achieved “by continuing to take advantage of the immense experience and resources of the oil industry.” But to ensure the success of the second goal, it was recognized that “the nationalised industries and

not move earlier and stifle the continuation, dominated by the civil servants, of a Tory policy.” Quoted in June Morris, *The Life and Times of Thomas Balogh: A Macaw Among Mandarins* (Sussex Academic Press, 2007), 161.

⁹⁰ Kemp, *The Official History of North Sea Oil and Gas*, 1:120–121.

⁹¹ PREM 13/3211, NA, Statement to be made by the Minister of Power in the House of Commons - Wednesday, 23rd July - Continental Shelf Licensing, 22 July, 1969.

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British companies should play a larger part in the future.”⁹² This appeared to be a total triumph for the MoP’s position over Labour’s left-wing.⁹³

Applications for the third round began to be accepted in September, 1969 with the announcement that bids which included British public sector involvement would be given preference. Despite this, interest in the round was large, with 157 blocks receiving bids. This was due to the fact that a major discovery of oil was rumored to have occurred in the Norwegian sector of the North Sea in late 1969. The find was confirmed in May, 1970 when the Norwegian Government announced that Phillips had struck oil at what would become the Ekofisk Field. The strike established that commercially recoverable oil existed in the central and northern basins of the North Sea.

The deadline for applications was January, 1970 and by that time, the Paymaster General, Harold Lever, who administered the process reported to Wilson that “Given the essential need to maintain a vigorous and continuing effort on the Continental Shelf and to increase the public stake, I regard the provisional outcome as very satisfactory.”⁹⁴ It took Government officials several months to go through the applications but by May,

⁹² Ibid.

⁹³ In Kemp’s words, it was “the triumph of pragmatism and caution over ideology and radicalism.” See Kemp, *The Official History of North Sea Oil and Gas*, 1:137. Mason was magnanimous in victory by agreeing to pursue a plan to beef up the Gas Council’s ability to conduct exploration on its own, in effect creating a truncated NHC. This was done through the creation of a subsidiary called Hydrocarbons Great Britain which competed in the third licensing round, particularly for areas of the Irish Sea. Also part of the revised plan was a provision for the third round licenses that stipulated that any commercially viable discovery would be opened to public sector participation. The participation rights of such licenses would be purchased for an equal percentage of the exploration costs.

⁹⁴ PREM 13/3211, Letter from Lever to the Prime Minister: Continental Shelf Third Round Licensing, 10 April, 1970. Lever was from the right wing of the Labour Party. Pro-business and himself a millionaire, Lever was considered a useful ally by Wilson in dealing with the companies. As Tony Benn put it, “On every issue Harold Lever always supports the Right, the rich and the powerful against the Labour Party and all it stands for.” See Tony Benn, *The Benn Diaries: 1940-1990* (Random House, 2013), 337.

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Lever again wrote to Wilson proposing, “there are strong practical and economic reasons for moving now on all applications where the issues are clear cut.”⁹⁵

In June, 1970 the licenses were accordingly awarded by the MoP. Ninety-four blocks were licensed to 24 groups. It was happily reported to Wilson that should the Gas Council and the NCB take up all their rights, British participation in the round would reach 49 percent, its highest proportion ever. Most of the new territory was in the southern basin where the main gas fields had been found, but a large portion was also along the median line between the British and Norwegian sectors. The companies involved were betting that Ekofisk was not isolated and that the North Sea was soon to become a major oil province.

Striking Oil

The awarding of the third round licenses on 8 June, 1970 infuriated the opposition Conservatives since a general election was in the offing. The Labour Party ignored the protests, however, just as the Conservatives had during the issuing of the first round licenses in 1964. But the Conservatives would not have to wait long for another chance to influence policy on the North Sea. Just ten days after the third round licenses were announced, Edward Heath and his party won a surprise victory in the general election. There was little the Conservatives could do about the already awarded licenses, but they

⁹⁵ PREM 13/3211, NA, Letter from Lever to the Prime Minister: Continental Shelf Third Round Licensing, 27 May, 1970.

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promised in their election manifesto to “pursue a vigorous competition policy” and it was therefore apparent that future licensing rounds would be handled much differently.⁹⁶

There was little time to waste, as interest in some of the unallocated areas in the central and northern basin dramatically increased once the significance of the Ekofisk find was established. Therefore the Conservative Government immediately launched a review of Britain’s Continental Shelf oil policy. Among the topics discussed were the desirability of continued public sector participation as well as whether an auction system would improve competition.⁹⁷ These proposals were kept behind closed doors at the time and were deliberated thoroughly by the new Department of Trade and Industry (DTI) which in 1970 had subsumed the Ministry of Technology and with it the old MoP. Yet the prospect of change was not welcomed by BP. The preferential system used in the first three rounds had served BP fairly well and the financial strictures described in the Bridgeman Memorandum were starting to bite, leaving the Company with little financial flexibility to compete in open auctions with the likes of the American firms and Shell.

But BP’s fortunes and the fortunes of the entire British Continental Shelf received an astonishing boost in October, 1970 when BP announced a major oil strike in the British sector of the Continental Shelf. The site, which came to be known as the Forties Field, was significant – some early estimates put it near the size of the Prudhoe Bay

⁹⁶ Iain Dale, *Conservative Party General Election Manifestos 1900-1997* (Psychology Press, 2000), 185.

⁹⁷ For a list of the pros and cons of such a system as they related to the North Sea, see Adrian Hamilton, *North Sea Impact: Off-shore Oil and the British Economy* (International Institute for Economic Research, 1978), 106–109.

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Field.⁹⁸ The Forties Field was located in the central basin, an area with a great deal of unallocated territory, increasing the area's appeal and raised the pressure on the Government to issue a fourth licensing round quickly. At the same time, the negotiations leading to the Tehran and Tripoli agreements were exposing the rising power of OPEC, giving even greater urgency to the development of the North Sea.

The process of review was consequently sped up. But if observers expected a sweeping change from the new Conservative Government, they were to be disappointed. Each level of the review returned only cautious suggestions which stuck close to the status quo. This was unsurprising since the officials of the DTI were responsible for the creation of the licensing process that had been used in the first three rounds. The earlier struggle with the Labour Party had been hard fought and any radical changes being pushed by their new political masters were equally opposed. Thus the DTI held the line on increasing license fees and resisted any major moves away from the discretionary licensing system or the assessment criteria used to pick the winners of the various blocks. It was also debated and decided within the DTI that the Gas Council and the NCB could not be excluded from the fourth round.⁹⁹

⁹⁸ It was later concluded that Forties was significantly smaller than Prudhoe Bay.

⁹⁹ This was due to the fact that the Gas Council was intimately involved in the transmission and sale of the gas and that the NCB's partner companies would be left in a lurch just before the new licensing round without time to find new partners. Colin Robinson would later remark on the consistency of the first four licensing rounds, commenting that "It is wrong to think there was very much difference between Labour and Conservative attitudes on the North Sea and that it had much effect. The licensing terms in fact were laid down by a Conservative government originally, and they were followed by Labour governments, and later Conservative governments." See Colin Robinson in 'The Development of North Sea Oil and Gas', held 11 December 1999 (Institute of Contemporary British History, 2002, <http://www.icbh.ac.uk/witness/northsea/>), p. 32.

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There were nevertheless minor concessions to the Conservatives' desire to improve the process. While the Gas Council and the NCB would be allowed to participate in the fourth round, applications would no longer receive preference if they included partnership with public institutions. This meant that the Gas Council and NCB and their partners would be competing on more equal footing. The fourth round would include, however, weighing applications according to the participants' contribution to the British economy, giving BP, the Gas Council and the NCB a natural advantage. Another concession to the Conservative line was the inclusion of a small experimental auction system on 15 of the blocks shown to have the most promise.¹⁰⁰ Finally, the DTI also concluded that this round would be much larger than the third in the hopes of cashing in on the excitement generated by BP's Forties discovery.¹⁰¹ A Treasury official noted the rationale of the DTI plan by stating that "the time is now approaching when we should reappraise the current approach to the development of the North Sea," and that "the results of the present round, and in particular the level of bids for the blocks to be allocated by auction, should give us useful evidence."¹⁰²

The fourth round, which opened on 22 June, 1971 was subject to a huge amount of interest. Of the 421 blocks offered under the discretionary system, 266 received

¹⁰⁰ These were mainly located around the Forties Field.

¹⁰¹ Little did the DTI know that another, even larger strike had been made just weeks before the fourth round was expected to begin. Shell had hit oil in what became the Brent Field, which to date has been the largest discovery in the North Sea. It took Shell over a year to announce the discovery, in large part because they did not want their competitors to create a bidding frenzy for fourth round blocks. See Kemp, *The Official History of North Sea Oil and Gas*, 1:237.

¹⁰² CAB 184/61, NA, Letter from Corti to Wade-Gery, 6 August, 1971

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offers.¹⁰³ Meanwhile the bidding for the 15 auction blocks received 78 bids from 73 different groups and companies. The bids opened before a live audience and the media on 20 August, 1971. The results were shocking, the highest being a cumulative £37 million, with £21 million bid for a single block.¹⁰⁴

The tremendous amounts bid for these blocks were a windfall for the Government, but they also revealed just how valuable the oil companies considered the prime territory in the North Sea. This instantly led to questions about whether or not the Government had been giving the oil companies too good of a deal all along. The DTI's insistence that high license fees and royalties would discourage investment seemed to stand in stark contrast to the massive amounts the companies put up for the auction. Despite the fact that it had been the long-standing rule to give good terms to the companies and groups exploring the North Sea in order to encourage quick development of its resources, the success of the auction turned the attention of the Government, and the press, towards the policy which had been governing the process.¹⁰⁵

A review of the country's North Sea oil policy was therefore launched, to be conducted by the DTI. But even before the work on this review could commence, Heath began to encourage a renewed push to make North Sea oil and gas work for the British economy in ways that were visible. He was particularly interested in having BP's work

¹⁰³ The rush for North Sea territory was inspired in large part by the discovery of the Ekofisk and Forties Fields, but the Tehran and Tripoli agreements also boosted oil prices enough to make investment in the North Sea slightly more attractive.

¹⁰⁴ See John G. Liverman, "Without Precedent: The Development of North Sea Oil Policy," *Public Administration* 60, no. 4 (Winter 1982): 451–469.

¹⁰⁵ Few in the press took notice of the fact that even ten years prior most geologists did not believe that the proper geology existed in the northern North Sea for oil to be found there.

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in the Forties Field lead the way in making North Sea oil production a boon to the wider British economy.¹⁰⁶

Feeling slightly put out by the suggestion that more needed to be done by themselves to help the British economy, BP decided to host several ministers, along with Lord Victor Rothschild of the Central Policy Review Staff (CPRS), for a presentation on their work in the North Sea. Drake felt that there was “an inadequate appreciation in Government circles of the scale of their operations and commitment in this endeavor,”¹⁰⁷ and it was hoped that such a presentation would remedy that situation. But when the meeting was held on 13 December, 1971 quite the opposite happened. During the presentation, Drake made it known that BP was intending to export a major part of its production from the Forties Field. This struck several attendees, Rothschild in particular, as against the national interest. Added to this was Drake’s announcement to the Government that although BP would try to purchase equipment in Britain, much of the underwater pipe and at least two of the four rigs it planned on using would be constructed in Japan and the Continent.

In the margin of the memorandum sent to him about this meeting, Heath scribbled “unacceptable” next to each of the points made by BP about exports and equipment purchases. While officials admitted that the ideas might make commercial sense, it would have been a public relations disaster for the Government. Therefore Heath ordered these questions be added to the policy review in the hope that the

¹⁰⁶ This would eventually lead to the creation of the Offshore Supplies Office in 1973.

¹⁰⁷ PREM 15/1141, NA, Letter from Wright to Gregson, 24 November, 1971

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companies could be encouraged, or forced, to maximize oil's return to the overall British economy. In a letter to the CPRS, Heath's principal private secretary Robert Armstrong laid out the Prime Minister's vision writing, "he would like to see a completely fresh approach to the whole of this problem, in which consideration of British interests should override all other considerations," adding that "it is not unreasonable that [BP] should be expected to work in close consultation with the Government, and in full conformity with Government policy, on this major new development."¹⁰⁸

What particularly exercised Heath and others was the idea that BP would export some of its North Sea production.¹⁰⁹ At a time of rising tensions with OPEC, one of the common themes amongst Government officials was that North Sea oil would help Britain resist any blackmail on the part of the foreign oil producers. Heath was thus incredulous that BP would export oil and eliminate the safety it would have guaranteed.

The DTI, which did not share Heath's concern, duly added the issue of BP's plans to their review of North Sea licensing. But the DTI continued to believe that regulations had to be limited if Britain wanted to exploit its North Sea resources effectively. In a draft of the review, officials noted that BP's export plan was "presumably to the company's technical and commercial advantage" and "to the extent that it involves exports to other countries it is consistent with the UK's traditionally liberal approach to

¹⁰⁸ CAB 184/61, NA, Letter from Armstrong to Wade-Gery, 7 January, 1972.

¹⁰⁹ What neither Heath nor his advisors totally grasped at the time was that the oil produced in the North Sea was of a light, sweet variety. This meant that it would yield a higher quantity of lighter fractions such as gasoline or naphtha and was therefore in high demand in Northern Europe and in the US. It also meant that the yield of heavy fuel oil would be low, ensuring that Britain would have to continue to import heavier crude from the Middle East. Martin Chick, "Property Rights, Economic Rents, BNOC, and the North Sea," in *Reappraising State-Owned Enterprise: A Comparison of the UK and Italy*, ed. Franco Amatori, Robert Millward, and Pier Angelo Toninelli (Routledge, 2012), 149.

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oil questions.”¹¹⁰ This draft also noted that “We have at present no statutory powers to prevent BP's exporting this oil; and to take such powers might invite retaliation from other countries.”¹¹¹ Nevertheless the DTI promised that they would ask BP for a “full statement of their case, so that the national balance of advantage in allowing some exports may be considered.”¹¹²

Meanwhile, the CPRS began a review of their own regarding the Forties Field. Their findings suggested that the British balance of payments would benefit marginally should BP export some of its oil but not nearly as much as if the Company first refined their crude in Britain.¹¹³ Furthermore, the CPRS also concluded that perhaps it was time “to re-examine fundamentally our traditional attitudes to the major oil companies; and perhaps play a more active role than hitherto in influencing their decisions about production, refining, pricing and marketing which affect the U.K. economy.”¹¹⁴

The DTI, however, characteristically disagreed with the CPRS's conclusions and proposals. An Annex to the DTI report suggested that “The apparent national advantage derived from keeping more North Sea oil here would be offset by loss of BP profits (and the foreign exchange which they represent).”¹¹⁵ Going further, Sir Robert Marshall of the DTI responded to Rothschild by writing, “we must bear in mind the pitfalls involved in

¹¹⁰ CAB 184/61, NA, The Possibility of "Reserving" North Sea Oil for the United Kingdom, 10 January, 1972.

¹¹¹ Ibid.

¹¹² CAB 184/61, NA, Letter from Wright to Armstrong, 25 January, 1972

¹¹³ The CPRS also argued that Britain would not benefit at all if the replacement oil were bought from Libya or transported on non-British flag tankers.

¹¹⁴ CAB 184/61, NA, Letter from Rothschild to Marshall, 8 February, 1972.

¹¹⁵ CAB 184/61, NA, Annex C: Disposal of North Sea Oil, 25 February, 1972.

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attempting to question BP's commercial judgment while we stand (as we must) outside the management of the company.”¹¹⁶

The questions regarding North Sea oil policy therefore remained deadlocked. JF Mayne of the CPRS complained that the DTI's plan still assumed “that what is good for BP is by and large good enough for the UK.”¹¹⁷ Rothschild for his part continued to expound the view that “it is legitimate for the UK Government to bring significant influence to bear upon the policies followed by BP as they affect the UK's interest,” adding that “this goes to a considerable extent for Shell as well.”¹¹⁸

The DTI resisted these arguments but were soon buffeted by other forces as well. A series of major rig and pipeline contracts were given to non-British firms by BP and other companies, leading to outrage in the press over what came to be known as the “Great North Sea Give-away.”¹¹⁹ Soon the Public Accounts Committee of Parliament launched their own examination into the fourth round of licensing. These probing criticisms and questions, coupled with “combined assault by the Treasury, Foreign Office

¹¹⁶ CAB 184/61, NA, Letter from Marshall to Rothschild, 29 March, 1972.

¹¹⁷ CAB 184/61, NA, Letter from Mayne to Wade-Gery and Rothschild, 7 April, 1972.

¹¹⁸ CAB 184/61, NA, Letter from Rothschild to Marshall, 10 April, 1972.

¹¹⁹ Liverman, “Without Precedent.” Balogh had for years made the argument that the Government was not doing enough to prepare the British economy for the potential economic boost from North Sea oil and gas, chalking this up to the persistent underreporting of the size of the gas reserves and later the oil fields by the companies who wished to avoid greater Government involvement in the industry. He also pushed his friend, Harold Lever, the head of the Public Accounts Committee, to bring pressure on the Government regarding the North Sea. See Morris, *The Life and Times of Thomas Balogh*, 160, 169. The debate about estimated reserves carried on for years. See for example Peter Odell in ‘The Development of North Sea Oil and Gas’, held 11 December 1999 (Institute of Contemporary British History, 2002, <http://www.icbh.ac.uk/witness/northsea/>), p. 21-25.

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and CPRS” began to push the review towards conclusions that would have increased the return to Britain on North Sea oil operations.¹²⁰

There were two ways to achieve this. The first was to ensure that the companies cease buying their equipment abroad. The second was to find ways of increasing the Government’s actual tax revenue from production in the North Sea. The first set of proposals was relatively uncontroversial. It was, in fact, the chief recommendation of the non-partisan International Management and Engineering Group’s (IMEG) Government-commissioned report entitled “Study of Potential to British industry from offshore oil and gas developments.”¹²¹ IMEG’s proposals ultimately lead to the creation of the Offshore Supplies Office, whose task it was to liaise between companies working in the North Sea and other British industries in order to maximize the potential benefit of North Sea operations to the overall British economy.

The second aspect – increasing the Government’s take – was more controversial. To do this, the CPRS suggested that Britain “might consider taking a few leaves out of OPEC’s book.”¹²² J. Rosenfeld of the CPRS elaborated on this by remarking that Britain’s licensing policy should be based on the concept of “Lure and Fleece.” In his opinion, the initial stages of North Sea development had needed to be fiscally attractive

¹²⁰ CAB 184/61, NA, Letter from Rosenfeld to Rothschild: North Sea Oil EPCO (72)7, 12 April, 1972. Hamilton, writing in 1978, defended the Government from the attacks leveled by the Public Accounts Committee arguing that “the discretionary system adopted by the U.K. did ensure, to a surprising degree, that U.K. interests gained a larger share of reserves by awarding them better blocks than they would have gained under alternative systems or by acreage alone.” See Hamilton, *North Sea Impact*, 111.

¹²¹ International Management and Engineering Group of Britain and Great Britain Dept of Trade and Industry, *Study of Potential Benefits to British Industry from Offshore Oil and Gas Developments* (H.M. Stationery Office, 1972).

¹²² CAB 184/61, NA, Letter from Rosenfeld to Rothschild: North Sea Oil EPCO (72)7, 12 April, 1972.

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in order to “lure” the companies and encourage early development. Now that the North Sea was a proven oil and gas province, the “lure phase” was “now almost over” and the fleecing stage ready to begin.¹²³ For this period, Rosenfeld argued that “the major constraint is that we should not do anything more than what is done by OPEC, for fear of encouraging them to follow our lead.” Therefore “the motto there might be 'anything OPEC do we can do a little bit less.’”¹²⁴

According to the CPRS calculations, even at the highest corporate tax rate, which many of the companies did not pay, Britain’s take on North Sea oil was roughly 40 percent of profits while the OPEC countries were receiving on average 65 percent. Hence a new taxation regime would need to be created in order to balance development and profit.

The Drake Memorandum and the Prices and Incomes Policy

A new tax regime was precisely what the oil companies did not want. But domestic political and economic events were moving against BP and Shell’s interests and would put the Heath Government into a position where leniency would not be possible. This was due to the fact that energy matters were becoming deeply politicized and at the forefront of the public’s attention. The new position of energy in the public’s attention stemmed from the reaction of the coal miners to the Heath Government’s imposition of the Industrial Relations Act of 1971 which sought to impose a common legal process for

¹²³ Ibid.

¹²⁴ Ibid.

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labor negotiations.¹²⁵ This approach was angrily opposed by many unions and this resentment fed into the negotiations being held by the National Union of Mineworkers (NUM) with the NCB regarding a wage increase for Britain's coal miners. On 9 January, 1972 a strike was declared and the nation's coal miners walked off the job. There was widespread support for the miners from other unions; when the strikers began to picket power stations, the labor dispute turned into a full-scale energy crisis for Britain.¹²⁶ Although its proportion of the nation's energy production had fallen, coal still provided roughly 36 percent of Britain's power and the strike, combined with the blockade of the coal-fired power stations, soon cut into the power supply deeply. In response, the Heath Government was forced to declare a three-day work week in an attempt to save on electricity. The crisis profoundly embarrassed Heath and though it was resolved after seven weeks, it revealed for the first time since the Suez Crisis what a true energy emergency looked like.

These events also constrained the ability of the Government to compromise with the oil companies over the North Sea. Having fought tooth and nail with the miners over wage increases and, arguing that the economy could not afford the inflationary pressures such rises would bring, the Government could not be seen to submit easily to the oil

¹²⁵ The proposal for an Industrial Relations Act was a key part of the Conservative Party's 1970 election manifesto. The bill required tighter control over the registration of official unions, the steps required for a legal strike and requirements that workers join a union. It also created a National Industrial Relations Court that had the power to block strikes. The Trade Union Congress and other major labor groups rejected the premise of the bill before it was passed and refused to comply with its ordinances even after it became law.

¹²⁶ For two interesting accounts of the strike see Michael Flinn, *The History of the British Coal Industry*. (Clarendon Press, 1984); Hywel Francis and Dai Smith, *The Fed: A History of the South Wales Miners in the Twentieth Century* (Lawrence and Wishart, 1980).

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companies' desires over taxation. In fact, loud calls echoed from the Conservative Party to consider ramping up the usage of North Sea oil and gas in the process of electricity generation.¹²⁷ This meant that if anything, the Government had to further extend its controls over the industry's activities in the North Sea through the guise of the Gas Council and the Central Electricity Generation Board.

Therefore when Sir Eric Drake felt the need to do the same – just a little over four years after his predecessor, Sir Maurice Bridgeman, issued a memorandum asking for more preferential treatment for BP – his request was planted in particularly infertile soil. The document, which was soon known as the Drake Memorandum, once again laid out BP's concerns that the Government's policies were damaging the Company's business and putting at risk its ability to benefit the British economy and national security. In the new memorandum, BP claimed that "The continued existence of a British international oil company will depend on the maintenance of an environment, particularly a fiscal environment, in which BP does not carry a substantial handicap as against its major competitors and can sustain competition with those who benefit from discrimination in their favour by their home Governments."¹²⁸

The Drake Memorandum went on to lay out the argument that BP had followed Whitehall's directive to diversify their sources of oil – so as to improve oil security – at great cost to the Company. This policy had been tremendously successful with BP making discoveries and developing finds in Alaska, Canada, Nigeria and the North Sea.

¹²⁷ "Parliament, March 10, 1972: Coal Facing Strong Competition: North Sea Oil and Gas Meeting More of Britain's Needs," *The Times*, March 11, 1972.

¹²⁸ POWE 63/829, NA, The British Petroleum Company Limited, 20 October, 1972.

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Added to this was BP's push to acquire a broader market share in the US.

"Furthermore," BP had done all this "in a period of intensive competition when profit margins in the oil industry generally have been falling and, more recently, the situation has been aggravated by the burden of OPEC settlements."¹²⁹

To accomplish this, BP had taken on a tremendous amount of debt, being forced to borrow money to finance these projects rather than drawing on Britain's foreign exchange. This debt was taken in the expectation of large returns once the Alaskan and North Sea fields began to produce, but BP was quick to remind officials that "the main rewards of our diversification are not likely to be reaped before the mid-1970's," meaning "the Company's current overriding problem, therefore, is one of maintaining financial equilibrium whilst the results of the substantial efforts already made begin to pay off."¹³⁰

To do this, BP made several recommendations, many of which were rehashed ideas from the Bridgeman Memorandum. Along with requests to reconsider the 1965 Corporation Tax, BP included the special plea for the Government to recognize that "the most effective help both to BP and the development of the North Sea would be for the Company to know that a stable basis for the calculation of its net after-tax income will be maintained."¹³¹ BP warned that "Any fears that the U.K. Government may change the tax rules against BP at a point when the other strains on the Company are at their greatest

¹²⁹ Ibid.

¹³⁰ Ibid.

¹³¹ Ibid. It should be noted that a new discussion of the 1965 Corporation Tax was warranted by the fact that the "overspill relief" that had been programmed into this tax change which gave temporary relief to the taxation of BP's profits and dividends had been due to extend at the end of 1972. The relief was extended for four years in the 1972 Finance Act.

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can only inhibit our commercial decisions and the maintenance of our position in the world oil industry.”¹³²

But as in 1968, BP did not receive a sympathetic hearing. The battles with the coal miners and the shock of the three-day work week meant that a tough line had to be taken with the oil companies in order to restore the Government’s *bone fides* on energy. A draft of the memorandum was sent to the Treasury where one official, H.S. Lee, gave it the faint praise of being “better than the Bridgeman memorandum in point of clarity and brevity.” But Lee added that “In the Bridgeman memorandum BP set out to demonstrate, in effect, that they were discriminated against, but I do not think that their case was made out, in a quantified manner, and they have not reinforced it (except by repetition) in the present draft.”¹³³ As for BP’s argument that their diversification effort had been conducted at great cost and to the nation’s benefit, Lee wrote dismissively that “they have done it for their own good; it happens to coincide with the public interest; but that is surely no reason why they should be rewarded,” going on to conclude that “they deserve no more than perfunctory congratulation for enlightened self-interest.”¹³⁴

Part of the reason that the Drake Memorandum ran into such difficulties in Whitehall is not that officials were unconcerned about the Company’s plight but that many of them considered it a blatant attempt to influence the two major reviews on the Government’s take from North Sea oil and on the security of oil supplies. Some officials believed that BP was overstating its present and future difficulties in order to shape the

¹³² Ibid.

¹³³ T 317/2004, NA, Letter from Lee to Owen, 11 October, 1972.

¹³⁴ Ibid.

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policy reviews. The Treasury in particular felt that numbers provided by the Company showed “that BP's fears about the effects on them of any likely tax regime were, if not illusory, at any rate exaggerated.”¹³⁵

The new tax plan being considered followed a two-pronged approach to improving the Government's take from oil profits. First, it was proposed to do away with the “artificial loss” system of tax accounting that allowed companies such as BP to use accounting procedures to determine where their profits and losses accrued.¹³⁶ This system had not mattered much while the profits made by the companies in the UK were relatively low, but with North Sea oil coming on stream those profits were due to rise substantially, meaning the tax forfeited by the “artificial loss” system would become much more significant. The elimination of the scheme was thus deemed to be a top priority of the Heath Government, much to the chagrin of BP and Shell.

The second prong of the tax policy under consideration was how best to increase the tax revenue generated by production in the North Sea. Two ideas were put forward, one for an excess revenue tax (ERT) and the other for a commodity tax. The balance of favor fell to the ERT both because it was more efficient and because it would only hit the oil companies, particularly BP, once they began to return a profit on North Sea oil.

¹³⁵ POWE 63/829, NA, Letter from Lee to Watts: British Petroleum: Drake Memorandum, 14 November, 1972.

¹³⁶ For example, BP and Shell operations in the Middle East produced oil and sold it to their subsidiaries according to the posted price of oil in that region, which was substantially higher than commercial prices thereby making a large “profit.” They were therefore taxed at this higher rate by their host countries while their downstream subsidiaries, forced to sell the oil at commercial rates, made substantially lower profits due to this “artificial loss.” This lowered their tax bill in places like the UK against which they could also place their overseas tax credit, effectively diminishing their UK tax bill to zero.

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But the tax issue was not the only worry for BP and also for Shell. A little over two weeks after Drake submitted his memorandum to the Chancellor and the Secretary of Industry, the Government was obligated to institute a new policy that would frustrate the oil companies even more. Unable to control inflation, and faced with increasing unemployment and battles with the coal miners, the Heath Government executed a dramatic shift in economic policy that culminated with the announcement on 6 November, 1972 of a Statutory Prices and Pay Standstill. This measure effectively froze the prices of all goods and services, including oil, for a period of ninety days to be followed, if necessary, by a second phase lasting for sixty days.

This meant, effectively, that the oil companies could not raise their prices in Britain. The policy was announced in the midst of renewed negotiations with the Shah and in the aftermath of the Tehran and Tripoli agreements, the costs of which the companies were hoping gradually to pass on to the consumer. To worsen matters further, a rapid deterioration in the balance of payments had forced the Chancellor, Anthony Barber, to float the pound in June, 1972.¹³⁷ The effect was not immediate, but over the course of the year the pound floated downward, moving from £2.60 to the dollar to around £2.40. This put immense pressure on the profits of the oil companies. As oil was denominated in dollars, the decrease in value of the pound increased the cost of oil for the

¹³⁷ The near-chaotic international currency market, which had been thrown into turmoil by the decision of the Nixon Administration to de-peg the dollar from gold, was temporarily calmed by the Smithsonian Agreement of December, 1971. This agreement realigned exchange rates and placed the pound at \$2.60. See Michael J. Oliver and Arran Hamilton, "Downhill from Devaluation: The Battle for Sterling, 1968–72," *Economic History Review* 60, no. 3 (August 2007): 457–485.

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companies. Without the ability to pass on some of these cost increases to the consumer, the companies' profits began to suffer.

An early request by Shell-Mex and BP, BP and Shell's marketing unit in the UK, to raise prices by 0.35p a gallon was rejected by the Government. In January, 1973 Sir Eric Drake and the chairman of Shell's British unit, Frank McFadzean visited the DTI to complain about this rejection. Drake argued that while he recognized the need to combat inflation, he also thought that the oil companies "were too important to the economy to be allowed to suffer damage."¹³⁸ The concern of the two oilmen was that Britain's refusal to allow the companies to raise prices would be copied by other countries, specifically Japan, where negotiations over price increases were currently underway. Should other countries follow Britain's example, it would "represent a considerable loss to the balance of payments and could affect the security of oil supplies to the UK if companies had to choose between their responsibility to the national interest and their duty to shareholders to sell in the most buoyant markets."¹³⁹ The companies requested that if they were forced to operate below market rates for the first phase of the price freeze, at the very least they be allowed to recoup those losses through a significant price rise in the second phase. On top of this, the companies requested an official statement from the Government acknowledging this policy so that BP and Shell could convince the Japanese and other governments to agree to price increases.

¹³⁸ PREM 15/1845, NA, Note for the Record – Vivian Brown, 30 January, 1973.

¹³⁹ Ibid.

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These proposals were presented to Heath who was “unimpressed by the arguments based on possible damage to B.P.'s and Shell's earnings abroad,” and was “not convinced by the case for giving a statement to the oil companies.”¹⁴⁰ To Heath, the overriding and most imperative goal for his Government was to bring down inflation, even if it cost the oil companies some of their profit. Heath acknowledged as much in a letter to Drake, writing, “while we recognised that the cost of crude oil had risen, we could not, because of its possible effect on our counter-inflationary policy, agree to an oil price increase during the standstill.”¹⁴¹

A meeting was held the day after this letter was sent at which Tom Boardman, the Minister for Industry, explained the Government's rationale for their refusal to allow a price increase for oil products. This incensed the two companies. Frank McFadzean let rip at Heath in a letter with all the frustrations that had been pent up by the companies who had had so much hope for his Government. The Shell chairman wrote with barely concealed rage that “I wish to protest in the strongest terms against this arbitrary and quite unjustified action.”¹⁴² McFadzean went on to lay out the argument that Shell and BP had suffered cost increases due to their negotiations in the Middle East which the Government had approved, since “The officials concerned, quite rightly in our view, stressed that continuity of supply was more important than the financial costs involved.” Thus, “In essence, what I have been told is that H.M.G. agrees with what has been done in the Middle East but is not prepared to face up to the financial consequences; you must

¹⁴⁰ PREM 15/1845, NA, Letter from Heath to Drake, 22 February, 1973.

¹⁴¹ Ibid.

¹⁴² PREM 15/1845, NA, Letter from McFadzean to Heath, 23 February, 1973.

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therefore either run your business at a loss or use such profits as you can earn in other countries to subsidise the United Kingdom.” He added, “It is a humiliating posture for any country to adopt.” McFadzean challenged Heath further by asking “How much loss is an industry supposed to sustain and over what period of time before H.M.G. is prepared to face up to the economic realities?” He concluded that “Unless you are prepared to move from the rigid position you have adopted over oil prices please do not trouble to reply to this letter.”¹⁴³

Conclusion

McFadzean’s letter summed up the frustration that had grown within the relationship between the Government and its two major oil companies. While one of Heath’s secretaries dryly noted that “Mr. McFadzean appears to have written in a fit of temper,”¹⁴⁴ the anger expressed could very well have been about a number of issues on which the two sides clashed. The oil companies had expected difficult relations with the Labour Government, but there had been high hopes that Heath and his Conservative Party would see issues more sympathetically. And while Heath may have been sensitive to the arguments put forward by the oil industry regarding North Sea oil, taxation and price controls, the practical reality of the economic difficulties confronting the Conservatives forced the sacrifice of principle to expediency.

¹⁴³ Ibid.

¹⁴⁴ Ibid.

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Yet there had been some shining successes for the relationship between the Government and the companies as well. Harold Wilson's Government had successfully and subtly used diplomacy to help secure BP's entry into the US market through their acquisition of ARCO and Sinclair's properties, as well as through the merger with Sohio. Likewise, the Heath Government was able to settle the long-standing concern of BP, and Shell regarding the formation of a European energy policy that excluded Britain. Heath's dogged determination to get Britain into the EEC partially solved this dilemma and ensured that BP's markets on the Continent would be safe no matter what the final shape of the prospective common energy policy.

These successes had another effect on the relationship between the British Government and its oil majors, however. By helping secure and increase their markets in the United States and in Europe, the British Government had by extension helped decrease the importance of the British market to both companies. This was not an entirely new phenomenon – at no point was the British market the overwhelming share of either companies' business – but the impact was just as much psychological as it was practical. The difficult dealings with the British Government at home made business abroad seem much more enticing. When Drake had argued that BP and Shell were being forced to “to choose between their responsibility to the national interest and their duty to shareholders to sell in the most buoyant markets,”¹⁴⁵ he was not exaggerating.

When the oil companies were finally able to apply to the Price Commission for a small price increase in August and September, 1973 they had no inkling that events were

¹⁴⁵ PREM 15/1845, NA, Note for the Record – Vivian Brown, 30 January, 1973.

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already underway that would make the price increases of 1971-1973 seem like a pittance. Even as the companies argued about increases measured in pence, Anwar Sadat, the president of Egypt, was shoring up support from the major oil producers of the Arab world for a renewed showdown with Israel. The dislocation and price increases that were to accompany this struggle would fundamentally alter the world of oil and, with it, the relationship between the British Government and its oil companies.

Section 3: Coping with Crisis: 1973-1975

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Grasping for a policy: 1973-1974

On 27 February, 1973 two old friends met and talked about the future of the oil industry. Although the crisis that was to define the era was still months away, a sense of foreboding already permeated the atmosphere in London. Both Government and oil company officials seemed to recognize that a major shift in the oil industry was about to take place and that this swing in the balance of power was simply a matter of time. The two men sharing these thoughts were former colleagues from the Foreign Office. Both been specialists on the Middle East there, and both had helped construct Britain's policy in the region throughout the 1960's. But each had also moved on to new positions that placed them at a unique vantage point to observe the events unfolding in the 1970's as well.

Donald Maitland and Robert Belgrave, though not at the top of their respective organizations, were men whose views carried weight. Maitland had left the Foreign Office to serve in the difficult role as the ambassador to Libya from 1969-1970. After the general election of 1970 he was tapped by Prime Minister Edward Heath to become his press secretary, a position he used to become a trusted adviser to the Conservative leader. Belgrave for his part had left the Oil and Middle East desk at the Foreign Office to become one of the chief policy planning advisers at British Petroleum (BP). During their conversation Belgrave laid out his views on the developing situation in the oil industry. Intrigued, Maitland requested that they be formally written down so that they could be

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passed on in Whitehall. Belgrave complied, on the assurance that the views would not be attributed to him, since he was speaking privately and not as a member of BP.

The document produced is not remarkable in its long-term influence or importance but rather in its prescience about the challenges facing the industrialized nations and their oil companies. Belgrave's six-page report laid out the situation by describing how the trends showed demand for oil outstripping supply by 1977. This fact alone meant that "OPEC therefore has the whip hand."¹ He went on to add that this situation meant that the Organization of Petroleum Exporting Countries (OPEC) could at any time "cut off supplies for political reasons, while the only apparent economic restraint on the prices they charge is represented by the visible prospect that steps are being taken elsewhere to develop non-conventional sources."²

But Belgrave went on to argue that "there need not be a crisis provided governments and industry get together now and behave sensibly."³ Perhaps losing control over production and prices to OPEC was inevitable but this process would be manageable on one condition – that the consuming countries find some way to coordinate their policies so as to prevent a scramble for oil supplies in a tightening oil market. Belgrave believed that it was "obvious that any attempt by any one region, or by any one part of a region, to ensure its own requirements bilaterally and at the expense of other consumers can have only one result, namely to strengthen still further the hand of

¹ FCO 55/1059, NA, Letter from Belgrave to Maitland, 1 March, 1973.

² Ibid.

³ Ibid.

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OPEC.”⁴ His biggest fear was that in the event of OPEC using the “oil weapon” the situation could become dramatically worse if the consuming states of the OECD were to try to outbid each other for the limited supplies. In any such circumstance the nations with healthier balance of payments figures would be able to absorb higher prices with greater ease, thus giving the United States, Japan and West Germany a stronger position. Britain and the rest of Europe would be left struggling with the crippling effect of huge price increases on their already struggling balance of payments. Belgrave noted that “The Americans seem uncertain whether to pursue their suggestion of a consumers' club or to take care of their own needs and devil take the hindmost,” and that the Japanese had already shown their willingness to overpay for oil supplies through their buying into offshore concessions in Abu Dhabi. Therefore, in Belgrave’s eyes, the European response to the looming crisis was “to be of a critical importance comparable to Europe's reaction to the proposal of the Marshall Plan in 1948.”⁵

While Maitland passed along this message to his superiors it failed to make an impact. BP and Shell had been preaching the virtues of consumer cooperation for years but several considerations prevented the Government from pursuing the idea with any vigor. In the immediate post-war years, Winston Churchill had lauded Britain’s essential position in world affairs, describing it as standing at the center of three concentric circles which connected it to the United States, Europe and the Commonwealth. In terms of oil and energy matters, Britain stood in the center of three other circles. But the position in the midst of these intersecting fields of opportunity and responsibility prevented Britain

⁴ Ibid.

⁵ Ibid.

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from following Belgrave's advice by stranding Britain in a policy limbo in terms of energy cooperation. The first was Britain's connection to the United States. In terms of oil, both states had a profound interest in preserving the role of the international oil companies in as close to the present form as possible. This meant preserving the international oil market which gave these companies their essential role.

The second circle was Britain's link to its new EEC partners in Europe. The desire of Heath in particular to strengthen the EEC's role in international affairs meant that cooperation in energy matters would be essential. This kind of cooperation, however, looked like it would need to come through the creation of a managed European market for oil.⁶ Such a move would not have destroyed companies such as BP and Shell but would have dramatically altered their profile as international firms. It would also upset relations with the United States. While a managed European market was not necessarily inimical to American interests, especially if American firms were granted access to the market, it would have been yet another example of Europe turning away from the Atlantic partnership and making itself more insular.

Stranded between these two circles Britain was already in a difficult position. To make matters worse, the third circle would pull them even further from a collaborative approach. This was Britain's own North Sea oil and gas assets. Unlike the rest of its EEC partners, Britain had the real prospect of having much if not most of its energy needs fulfilled by indigenous sources within the next decade. But instead of being a

⁶ The term "managed market" was used by British officials to describe a state organized system of import and export controls combined with state-decided allocation of market share; this was based on numerous factors included a companies' home country and economic benefit to the host country. It also usually implied some form of requirement on refining crude oil within the host country so that all the benefits of the oil's production, transport and sale accrued to the host Government.

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comfort, this fact was a major concern. Until North Sea oil came online in 1975, Britain was just as much at the mercy of the Middle Eastern oil producers as their American, Japanese and European partners. But having North Sea oil looming also made British leaders extremely hesitant to sign onto any form of cooperation that might prejudice their control over this asset.

Thus while British leaders might have agreed with the idea of cooperation in principle, the question of how to achieve this goal proved a more difficult matter. Added to the already intractable problem was the fact that Britain was struggling with high rates of inflation, a slowing economy and a balance of payments deficit. Even more worrisome, Heath's Government was also marshaling its strength for what appeared to be another bout of industrial unrest on the part of the coal miners.⁷

This multitude of problems meant that when the members of the Organization of Arab Petroleum Exporting Countries (OAPEC) announced a series of production cutbacks in support of the Egyptians and Syrians in October, 1973, Britain was placed in a situation that required bold and decisive leadership. What it received, however, was a Government unsure of how best to respond to the crisis.

The tug of the three different circles that made up Britain's awkward energy position contributed to a confused response on the part of the Government. With Britain ultimately classed by the oil producers as a "friendly" nation not supposed to suffer from the OAPEC cutbacks, Heath chose to ignore the prevailing realities of the international

⁷ Having already struggled through one coal miners' strike from January to February 1972, the unions were once again demanding wage increases throughout the summer of 1973.

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oil market and demanded that Britain benefit from this preferred position.⁸ This delusion militated against any early cooperative efforts and pushed the Government to embrace a “Britain first” policy that did little other than create ill-will between the country and its partners. It was only when it became apparent that the true threat of the oil crisis was not a supply shortage but uncontrolled price increases did Heath switch tactics and embrace the concept of cooperation. But this left open the question of whether to build European, trans-Atlantic, or even global cooperation (if one included Japan). Realizing that the problems of the international oil industry could only be met with an international solution, the Government ultimately turned its back on the small, Europe-based solution of a managed market and embraced the American concept of a new consumer group which would support the oil companies and the traditional international oil market.

The response of the Heath Government, although haphazard and panicked, would have two legacies. The first was the Conservative embrace of State intervention during the months of the “Britain first” policy. Although unsuccessful, it left an institutional heritage that the Labour Government of 1974-1979 could easily and willingly take up. But, secondly, the ultimate embrace of an international solution that culminated in the Washington Energy Conference of 1974 and the creation of the International Energy Agency also committed the British Government to the survival of the traditional system wherein the oil industry would function only with the “thin lubricating film” of the oil companies remaining intact.

⁸ Britain would receive this classification after the embargo against the United States and the Netherlands was announced on 20 October.

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The Crisis

When fighting erupted between Egyptian and Israeli forces on 6 October, most oil commentators immediately realized that the hostilities would have a profound effect on the oil negotiations set to take place between the OPEC and the major oil companies two days later. How dangerous this crisis would be to the long-term viability of Britain's traditional oil policy was not immediately apparent. The newly appointed Cabinet Secretary, John Hunt, noted in a minute to ministers that "assuming the fighting does not last more than about 10 days and we take no action to antagonise the Arabs, there should be no serious threat to United Kingdom supplies."⁹ But Hunt also conceded that the use of the "oil weapon" was possible and that the negotiations taking place in Vienna between OPEC and the companies would make it "easier for the Arabs to concert their counsels and bring pressure on the non-Arab members of the Organisation to make such a move effective."¹⁰

When the negotiations in Vienna opened on 8 October, the members of OPEC took advantage of the politically-charged situation and demanded a 100 percent increase in the price of a barrel of oil. This request was far beyond what the negotiating team representing the companies was expecting. They had been authorized to open negotiations with an offer of a \$0.45 or 15 percent increase per barrel, a proposal that was dismissed by OPEC who demanded another offer by 10 October. Any larger increase in the offer would have serious ramifications on the consuming countries and therefore BP and Shell informed the British Government that "in view of the consequences to prices

⁹ FCO 55/1095, NA, Letter from Hunt to Heath, 9 October, 1973.

¹⁰ Ibid.

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and the balance of payments” they could not “alone accept responsibility for agreeing to any terms substantially in excess of the oil companies' initial offer.”¹¹

The British companies pushed the other firms to bring a similar argument to OPEC, thus buying time for the governments of the OECD to build a consensus approach to the negotiations. It would only be through such cooperation that the companies would have a chance to bring about a more reasonable offer from OPEC. It was also essential because BP and Shell had suspicions that the American firms were not as concerned about price increases, since “the bulk of the Middle East oil handled by US companies goes to consumers in Europe and Japan who will have to bear the cost.”¹² There was also the fear that disunity amongst the oil companies, and consuming states, would tempt some states to resort to bilateral deals with individual producing states, which would, according to Sir Eric Drake, “lead to absolute anarchy in the oil market and very steep increases in prices.”¹³

Shell and BP’s concern over consumer and company solidarity proved prophetic. The two firms’ desire for delaying tactics was overruled by Exxon and the other companies who offered OPEC a \$0.60 a barrel increase. This plan was summarily rejected by the OPEC ministers and the meeting adjourned on 10 October under the dark cloud of threatened unilateral legislation. Heath and his ministers quickly realized the danger and, taking Shell and BP’s advice, sprang into action to attempt to forge some form of consumer solidarity before OPEC’s next move. Heath sent letters to the leaders

¹¹ PREM 15/1837, NA, Note from Marshall to Heath: Vienna Negotiations with OPEC on Oil Prices, October, 1973.

¹² Ibid.

¹³ FCO 55/1060, NA, OPEC Negotiations: Minister for Industry’s Meeting with Shell and BP on Thursday 4 October 1973, 4 October, 1973.

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of the OECD nations including President Nixon and Prime Minister Tanaka of Japan writing, “at a time like this, it is vital that the main consuming countries should avoid pursuing competitive national policies which could adversely affect the outcome of the OPEC negotiations and prejudice any approaches that we might agree upon.”¹⁴

But already the doubt and confusion that was to mark the entire British response to the situation was revealing itself. Fearing that attempts to foster cooperation might fail, British officials had begun to explore the very types of policies that Heath was warning against. Three days before Heath’s telegrams were sent out, his Oil Task Force debated numerous options for how Britain could respond to an oil supply crisis should the situation deteriorate any further.¹⁵ The default response to a crisis would be the allocation of supplies through the OECD sharing plan, a strategy that Britain was wary of embracing for fear that it would set a precedent which could be exercised after North Sea oil came online. Other options were therefore examined. These included the types of bilateral deals with oil producers that BP and Shell were decrying as well as the possibility of pressuring the two British companies to continue supplying Britain at the expense of their other customers. There were many drawbacks to this plan, however, with the Task Force noting that “Attempts to use Shell and BP in that way would certainly undermine their position as international companies, with heavy losses to our

¹⁴ PREM 15/1838, NA, Telegram from Heath to Nixon, 15 October, 1973.

¹⁵ This Task Force had been set up under the chairmanship of Lord Peter Carrington in 1972.

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balance of payments, and with possible retaliation against our exports in general and against the companies' foreign assets.”¹⁶

The uncertainty shown by the Task Force was fueled by the deteriorating political situation. Company and Government officials had hoped that the oil negotiations could be kept separate from the ongoing struggle between Israel and Egypt and Syria and that the battle over prices would not turn into a battle over supply. But as the fighting intensified in the Sinai, passions ran high. These political feelings grew even stronger when the United States resupplied Israeli forces on 14 October in response to a similar Soviet move on behalf of Egypt and Syria a few days earlier. While the American Air Force had intended to land its transport planes during the night so as to avoid a show of support for Israel, bad weather had altered the flight plans and forced the landings to occur in broad daylight for the world to see.¹⁷ The open American involvement in the crisis all but doomed the companies' hope of keeping oil and politics separated.¹⁸

Thus when the Gulf States of OPEC, meeting in Kuwait, announced on 16 October a unilateral increase of 70 percent in the posted price of oil to \$5.11 a barrel,

¹⁶ FCO 55/1096, NA, Ministerial Committee on Economic Strategy: Task Force on Oil Supplies - OECD Oil Sharing Arrangements, 12 October, 1973.

¹⁷ Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (Simon and Schuster, 2008), 587.

¹⁸ Whether keeping oil and politics separated was ever a realistic possibility is open to debate. It now appears clear that King Faisal of Saudi Arabia was resolved to use the “oil weapon” to support the Arab cause against Israel even before the outbreak of fighting. A meeting between Sadat and Faisal on 23 August, 1973 seems to confirm this. See *Ibid.*, 579. But as Garavini has shown convincingly, it is important not to view the Arab decision to use the oil weapon simply in the context of the Arab/Israeli struggle. The Arab decision to use the oil weapon was not simply a result of the October War but rather the natural conclusion of the long process of struggle between the oil companies and the oil producers. For a quick summary of this argument see Giuliano Garavini, “Completing Decolonization: The 1973 ‘Oil Shock’ and the Struggle for Economic Rights,” *The International History Review* 33, no. 3 (2011): 473–487. For a more detailed account see Giuliano Garavini, *After Empires: European Integration, Decolonization, and the Challenge from the Global South 1957-1986* (Oxford University Press, 2012).

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many within the Government and the companies were dismayed but not shocked.¹⁹ This was not as much as had been threatened in Vienna by OPEC, but the price increase was dramatic and beyond anything that the OECD economies were prepared to handle.²⁰ As the oil industry absorbed this news, a further blow was delivered the next day when OAPEC announced that production would also be cut back by 5 percent from September's output and that additional 5 percent cuts would occur periodically until the Israeli's withdrew from all the territory they had acquired during the Six-Day War of 1967.²¹

The "oil weapon" had thus been officially unleashed for the second time but it did not have the immediate effect that OAPEC was hoping for. Instead of being cowed, the Nixon Administration announced on 19 October a \$2.2 billion aid package to Israel to help it continue fighting. In response, Libya immediately placed a complete embargo on all oil exports to the United States and was followed by the rest of OAPEC on 20 October.²² Before the Kuwait meeting adjourned, a mechanism for extending the embargo to any "unfriendly" power was adopted as was a list of so-called "friendly"

¹⁹ This included the five Arab Gulf States plus Iran.

²⁰ On 17 October the Secretary of State for Trade and Industry, Peter Walker, announced to Heath that the price increases would add £400 m. to the cost of oil to the balance of payments. See FCO 55/1131, NA, Note of a Meeting Held at No. 10 Downing Street on Wednesday 17th October 1973 at 5.30 p.m, 19 October, 1973.

²¹ This plan was spelled out in the proposed UN Resolution 242. OAPEC at this time consisted of

²² The Netherlands was added to the embargo because it had allowed the Americans to use bases and Dutch airspace in the resupply effort. On 20 October, the same day that the United States was officially embargoed, Nixon had also fired Archibald Cox, the special prosecutor investigating the Watergate Scandal. The firing of Cox, along with the resignation of Attorney General Elliot Richardson and his Deputy Attorney General William French Smith, came to be known as the "Saturday Night Massacre" and greatly exacerbated the political crisis surrounding the US President.

states. Included on the list of friendly states was Britain, but just what being on this register meant was not immediately clear.²³

Contingency Plans

While the British Government had anticipated difficult negotiations, the rapid and dramatic escalation of the conflict caught many ministers and their officials off guard. At a Cabinet meeting held after the announced price increases of 16 October, the possibility of a cut-off of oil supplies was discussed. Given the already existing energy difficulties, such a prospect was dire for the Heath Government. During the discussion it was suggested that “Consideration would need to be given to the possibility of importing coal,” even though it was recognized that “this could have an adverse effect on industrial relations in the coalmining industry.”²⁴ Even with this concern, Heath wanted every option available. He summed up the importance of the coming days to his colleagues by stating “If a serious crisis arose, public opinion would expect the Government to be ready with appropriate measures; and there would be wide-spread criticism if they failed to match the pressure of events.”²⁵

What exactly the “appropriate measures” were was a question that bedeviled Whitehall. To begin with, there was tremendous uncertainty as to how the production

²³ For an excellent analysis of the goals of the Arab Embargo and the question of its success or failure in achieving those goals, see Roy E. Licklider, *Political Power and the Arab Oil Weapon: The Experiences of Five Industrial Nations* (University of California Press, 1988); Rüdiger Graf, “Making Use of the ‘Oil Weapon’: Western Industrialized Countries and Arab Petropolitics in 1973–1974,” *Diplomatic History* 36, no. 1 (2012): 185–208. Licklider presents a somewhat simplistic look at the Arab Embargo, arguing that it was a failure because it did not achieve its goals of forcing Israeli withdrawal or radically altering US foreign policy. Graf offers a more nuanced look by reframing the issue of the true uses of the embargo.

²⁴ FCO 55/1131, NA, Extract from Cabinet Meeting of 16 October, 1973, 17 October, 1973.

²⁵ Ibid.

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cutbacks would impact Britain which had yet to be classified as a “friendly” or “unfriendly” state. As a result, few wanted to embrace full consumer cooperation in the fear that Britain’s “friendliness” could be questioned. At the same time, however, most options for a “Britain first” approach had severe drawbacks. Because of this awkward position, Heath pushed for a strategy that attempted to embrace both cooperation and a “Britain first” policy, and as a result achieved neither. The Government arrived at this divided policy only as it became apparent that there were few good options for dealing with the crisis.

The easiest steps that could be taken were moves to reduce demand for oil products. But even these were fraught with problems. One obvious way to cut back was through rationing of petroleum products. This course had been pursued during the Suez Crisis and had been prepared for in 1967. Heath floated the idea in a meeting with key ministers on 19 October and preparations were put into place.²⁶ But rationing was a drastic measure and one that was bound to be politically unpopular.

The other means of reducing demand were similarly unfeasible. One such idea was for the power stations in Britain to be switched over the coal.²⁷ This would reduce the demand for fuel oil, which while not totally solving the problem would ease the burden on the balance of payments. John Hunt wrote to Heath that “burning more coal in power stations could save up to 6 million tons of oil (6 per cent of our supplies) in six

²⁶ FCO 55/1131, NA, Note of a Meeting Held at No. 10 Downing Street on Wednesday 17th October 1973 at 5.30 p.m., 19 October, 1973.

²⁷ As a result of a 1962 plan by the Conservative Government of Harold Macmillan which was reinforced by the 1965 and 1967 Fuel Policy reviews, many new power stations constructed in the 1960’s were dual-fired, meaning that they could burn either fuel oil or coal.

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months.”²⁸ But he also added a major caveat. Burning more coal would use up much of Britain’s coal stockpile. As Hunt noted to Heath, “this may be cutting things fine if there is a miners strike this winter.”²⁹ This was a very real concern as tensions with the coal miners had continued to mount.

With these means of dramatically reducing demand politically distasteful or impractical, other avenues had to be explored. Perhaps the most obvious route was through the contingency plan that had worked in the past, namely the OECD sharing plan. This effectively meant that supplies would be shared out evenly amongst the European OECD member states, a plan which had worked well during the Suez Crisis seventeen years earlier. There was also the possibility of working out a joint energy plan with Britain’s fellow EEC members. But implementing any sharing agreement would commit Britain to a common fate with its European partners. With uncertainty swirling around how exactly the production cutbacks would affect different parties, Whitehall was hesitant to give up any advantage Britain might be granted by OAPEC. But the Department of Trade and Industry (DTI) did concede that “If the Middle East situation deteriorates to a point where oil supplies are seriously interrupted, it would seem in the interest of the UK to support the implementation of the OECD emergency arrangements which, in practice, might have to be extended to bring in Japan and the USA.”³⁰

Somewhat less drastic were alternative cooperative plans that called for a coordinated effort amongst the OECD and/or the EEC states to bilaterally protest the

²⁸ CAB 164/1198, NA, Oil: Contingency Planning, 16 October, 1973.

²⁹ Ibid.

³⁰ FCO 55/1096, NA, Ministerial Committee on Economic Strategy: Task Force on Oil Supplies - OECD Oil Sharing Arrangements, 12 October, 1973.

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price increases and the production cutbacks to individual OPEC and OAPEC members. The Working Party on Oil Supplies made up of officials from the FCO, DTI and Treasury, wrote that “consumer governments should say something to try to moderate the present edict and future demands.”³¹ The danger, however, was that such a move might suck the consuming states into direct negotiations with the oil producers, a move that many within Whitehall were still not yet willing to accept.

All of these approaches also had the major drawback of requiring collective action by a large group of consuming states that had very different needs, interests and views. British officials acknowledged that even in the best of circumstances, decisions in the OECD or the EEC were not taken quickly. Coordinating any bilateral effort on the part of OECD or EEC ambassadors would be extremely difficult if even possible. In a crisis situation, the long delays and agonizingly slow decision-making were not ideal. Therefore a growing group within the Cabinet and civil service pushed for measures that Britain could adopt on its own to secure its own oil supply.

One advantage that Britain had over its European partners was the fact that it was home to BP and Shell. While both firms were active across the Continent there was hope that their residency in the United Kingdom could be used to encourage them to ensure Britain continued to receive its full supply. The Working Party on Oil Supplies had asked the question “Is it practicable to think that the Government might, for example, lean on BP and Shell to divert to the UK supplies intended for Japan and the Continent?”

³¹ CAB 164/3609, NA, Maintenance of Oil Supplies, 19 October, 1973. The Working Party on Oil Supplies was set up to advise the Oil Supply Task Force, created by Heath in the summer of 1973 and put under the direction of Lord Peter Carrington.

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in a report to the Task Force, but had come away with the feeling that such a move would do more harm than good.³² But the idea stuck with Heath. There was a fear amongst British officials that the American oil companies could re-direct supplies intended for Britain back to the United States or else to other markets. Lord Victor Rothschild, the head of the Central Policy Review Staff (CPRS) reinforced this view to Heath, writing to the Prime Minister at Chequers on 20 October that “Already products of United Kingdom oil refineries are being exported to the USA either direct or via Europe (Rotterdam, Free Spot Market) at an unparalleled rate, so far partly because of the differential between the United Kingdom and Rotterdam or US product prices.”³³

While Heath mulled over the possibility of pushing BP and Shell, he sought alternative routes out of the potential supply crisis as well. One relatively uncontroversial proposal was the idea of speeding up production from the North Sea. Oil had been struck in 1969 but developing the fields already discovered had been a laborious process complicated by delayed equipment and labor unrest.³⁴ Officials in the DTI were quick to warn Heath and the Cabinet that even if these difficulties could be overcome, the target date of North Sea oil coming online would only be advanced by a few months to mid-to-late 1974 and was thus not an immediate solution.

But while Britain could not get its hands on the oil in its own territory there were large quantities of oil available elsewhere. With the advent of participation by the

³² FCO 55/1096, NA, Ministerial Committee on Economic Strategy: Task Force on Oil Supplies - OECD Oil Sharing Arrangements, 12 October, 1973.

³³ CAB 164/1198, NA, Message from No. 10 to Chequers, 20 October, 1973.

³⁴ These difficulties will be discussed in greater detail in Chapter 9.

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national oil companies of the OPEC states, these companies had available oil.³⁵ Given that most of the oil-producing states were already flush with cash and poised to be flooded with even more “petrodollars” following the huge price increases of 16 October, direct purchase of this oil was less attractive to the producers than were bilateral agreements focused on economic and technological development. While there was an inherent bias amongst many civil servants against such deals, Lord Carrington and others in the Cabinet began to view them as a way of supplementing the activities of the international oil industry rather than replacing them.

This was an essential distinction to make, since any bilateral deal struck would require the services of at least one international oil company to transport the oil back to Britain as well as to refine and distribute it. But the danger of simply pooling this oil into the normal supply chain was that it could be re-exported to a market with higher prices, or even more dangerously to an embargoed country.³⁶ Thus any action to bring in extra supplies to Britain, whether through forcing such an action on BP and Shell or through bilateral deals with the producing states, would have to be supplemented by controls on the export of petroleum products. This seemed simple enough, but as the DTI pointed out to the Task Force, “Due to planning on a European basis, we are not self-sufficient in particular products.”³⁷ While Britain had refinery capacity capable of producing 20

³⁵ The participation deals, struck at the end of 1972 and the beginning of 1973, had given the producers control over varying amounts of the oil produced by the great operating companies such as Aramco in Saudi Arabia. This “participation oil” could be disposed of however the producing states wanted.

³⁶ For example the price of fuel oil in Britain was roughly half of its price in France and West Germany.

³⁷ CAB 134/3609, NA, Export Controls on Oil, 19 October, 1973.

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percent more than the country required, these refineries were not calibrated to produce certain products, especially chemical feed stocks needed for industry.

Thus each of the contingency plans open to British officials suffered from problems and limitations. Moreover, the Working Party on Oil Supplies pointed out that “We do not yet know whether supplies will be cut by company, or by destination; nor whether the UK will be ranked as a ‘friendly’ nation, whose supplies are to be safeguarded. No useful representation can be made until the picture is clearer.”³⁸ This fact hampered early decision-making but did not prevent Heath from taking initial steps to examine his options.

Casting over us like a fly

Heath’s dilemma was that by inclination he supported cooperation. His major triumph as Prime Minister was bringing Britain into the EEC and had since worked hard to be a good European. This was in keeping with the more conservative approach to contingency planning that the DTI, FCO and Treasury had embraced. But many of the more effective measures that he could take to spare Britain the worst of a supply crisis, such as squeezing BP and Shell or striking bilateral deals, would have gone against the communitarian ethos of the Common Market. But Heath also recognized that he faced a profound economic and political crisis. From mid-1973 the National Union of Mineworkers (NUM) had encouraged their members to work to rule which had limited

³⁸ CAB 134/3609, NA, Maintenance of Oil Supplies, 19 October, 1973.

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the production of coal significantly.³⁹ Because of this, the Conservative Government simply could not afford even a modest loss of oil supplies, a fact that militated against Heath's cooperationist tendencies.

The tipping point for Heath and his officials came when OAPEC embargoed the "unfriendly" states such as the United States, the Netherlands and Portugal on 20 October. The fact that Britain was not included in this list was taken to mean that it would be considered "friendly" and therefore would not suffer from the cutbacks.⁴⁰ While some of his officials were not certain how the promise of being spared any pain from the cutbacks could be squared with the large reduction in production by the members of OAPEC, Heath clung to the idea and used it to shape his policy going forward. Being listed as "friendly" meant to Heath that Britain was entitled to all the oil it would have otherwise received. This also made the option of cooperation unpalatable, since invoking the OECD sharing plan – which included the Netherlands – might be viewed as an unfriendly act by OAPEC. Because of this fact, Heath refused, along with the French, to endorse the activation of the OECD sharing plan.⁴¹

Unfortunately for Heath most of the American firms did not share his conviction. These companies began to implement a policy of "equal misery" in an attempt to fulfill

³⁹ Heath would later write "militants within the NUM gradually realized that the oil crisis was a chance to win a massive wage settlement and damage the government in the process." Edward Heath, *The Course of My Life: My Autobiography* (Hodder & Stoughton, 1998), 503.

⁴⁰ This was seemingly a vindication of Britain's endeavor to pursue of more pro-Arab policy in the wake of the 1967 Six Day War. See Moshe Gat, "Britain and Israel Before and After the Six Day War, June 1967: From Support to Hostility," *Contemporary British History* 18, no. 1 (Spring 2004): 54–77.

⁴¹ Turner later argued that while on the surface this looked to be an act of cowardice, there were good reasons not to provoke an even more severe cutback by OAPEC, although few Americans were convinced of this rationale. See Louis Turner, *Oil Companies in the International System* (Royal Institute of International Affairs, 1978), 176–177.

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their contracts to the best of their ability. Though such a move was not unexpected, there was little the Heath Government could do about this. But Heath did believe that BP and Shell had the responsibility to continue their full deliveries to the United Kingdom. To ensure the two firms' cooperation, Heath called their chairmen Sir Eric Drake and Frank McFadzean to Chequers on the evening of 21 October.⁴²

The meeting was ultimately very disappointing for Heath. The Prime Minister asked the two oilmen if there was any way that the firms could do more to keep Britain supplied.⁴³ Drake and McFadzean, while sympathetic, made it clear that they were obligated to employ equal misery for all of their customers. Without legislation from the Government which would allow them to claim *force majeure*, the two firms were afraid that any overt assistance to the United Kingdom could result in damage to their operations elsewhere, especially to BP. Heath was unwilling to take such a step as it would definitively close off any option of ultimately cooperating with Britain's European partners.

Despite the setback at Chequers, Heath refused to give up on the idea that BP and Shell could be encouraged, or forced, to ensure that Britain avoided equal misery. His persistence did pay a small dividend a few days later when BP met with officials to discuss ways in which the Company could help the Government while still technically upholding its contracts with non-British customers. An example of this occurred on 25 October when Drake informed officials that he had been able to divert between 800,000 –

⁴² The details of this meeting are discussed to a greater extent in the Introduction.

⁴³ The implication of Heath's request was that the two companies would not simply keep up the same amount that they normally imported into Britain but that they would import extra in order to try to make up for the shortfall caused by the American firms, such as Esso's use of the equal misery policy.

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1 m. tons of crude oil to Britain taking advantage of Kuwait's ban on exports to the Netherlands.⁴⁴ While this oil should have technically been pooled, Drake took the risk to transfer it directly to Britain. Because of the dangerous nature of this move, he "asked that the strictest confidence should be preserved about this diversion which, he claimed, represented a financial loss for BP of some £3m."⁴⁵

But this was not enough for Heath. While he expressed frustration with Frank McFadzean, complaining to Robert Armstrong that "it seems almost impossible to deal in a rational way with the present chairman of Shell," he reserved special ire for Drake and BP.⁴⁶ In a high level meeting with Cabinet members and other top officials held on 29 October, Heath argued that being listed as a "friendly" state by OAPEC meant that Britain should be exempt from equal misery. He raged "that it would be completely unacceptable for BP to defy the intentions of the producer states and cut supplies to the United Kingdom in the interests of their other customers; and this must be brought home to the company, if necessary by requiring the Government's nominated director to intervene."⁴⁷ He went on to add forcefully that "The Government's first duty was to safeguard the essential interests of the United Kingdom, and not to put industrial expansion at risk to satisfy the commercial scruples of BP."⁴⁸

⁴⁴ This amount was estimated to be about three days' worth of oil for Britain.

⁴⁵ CAB 164/1198, NA, Letter from Mumford to Webster - The Oil Crisis, 25 October, 1973.

⁴⁶ PREM 15/1839, NA, Telegram from Prime Minister to Armstrong, 29 October, 1973. This anger was still evident 25 years later when Heath published his memoir in which he wrote "I was deeply ashamed by the obstinate and unyielding reluctance of these magnates to take any action whatever to help our own country in this time of danger." Heath, *The Course of My Life*, 503.

⁴⁷ CAB 164/1198, NA, Note of a Meeting held at 10 Downing Street on Monday 29 October 1973 at 6.30 p.m., 31 October, 1973.

⁴⁸ Ibid.

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Adding to Heath's fury were the repeated assurances from several OAPEC members that Britain was entitled to all the oil that it needed. Early on in the crisis the British ambassador to Saudi Arabia had wired back to London that Prince Fahd, a highly influential member of the royal family, "wished me to convey to my Government a message approved by King Faisal, that, because of the British Government's attitude during the Arab/Israel hostilities and taking into consideration the friendly relations between our two countries, the cut-back in Saudi production would not (repeat not) apply to the UK."⁴⁹ Guarantees such as these continued as British embassies in the region sought to clarify what the exact parameters of the Arab embargo were. These assurances fed into Heath's prevailing obsession that Britain should not experience any shortage. The fact that there was a shortage was a problem that he laid at the door of BP, Shell and the other major firms supplying Britain.

For their part, BP and Shell believed that the Government was being unrealistic. In their numerous meetings with Heath and other top Ministers, Drake and McFadzean had repeatedly made it clear that the best hope for Britain's survival of the crisis with minimal damage was through close cooperation with the other consuming states. On top of this, the two firms pointed out that Britain had by far the lowest prices in Europe, meaning that a good deal of supply that was meant for Britain was being diverted by smaller companies to the more lucrative Continental markets. But with top officials, including Heath, fixated upon the idea that Britain was exempt from the embargo, such

⁴⁹ PREM 15/1839, NA, Telegram from Jeddah No. 231013Z, 23 October, 1973.

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arguments regarding prices were ignored. The companies' support for cooperation was heard with more sympathy, but also with skepticism.

The most obvious vehicle for cooperation was the OECD, but that would involve open collaboration with the United States. The fear of being too closely associated with the Americans had impacted several major decisions during the crisis and as one official warned the Foreign Secretary, Alec Douglas-Home, "If the supply reduction reaches the point where more formal apportionment arrangements appear necessary, it might be better (if only to avoid any risk of Europe and Japan appearing to connive in frustrating the Arab embargo on supplies to the USA) to work for an allocation system operated by the oil companies rather than under the aegis of OECD."⁵⁰ In other words, equal misery might be better than being tied to the United States.

Concern about collaboration with tainted allies also affected plans for coordination within the EEC. Since the Netherlands was on the list of embargoed states, it was feared by the British and other Europeans that pursuing strategies which seemed to help the Dutch might be construed as an unfriendly act towards OAPEC. Therefore, in both the OECD's High Level Group and in meetings in Brussels, British representatives dissembled and attempted to stall any collective action for fear of being added to the embargo. N.M. Fenn of the FCO's Energy Department tried to put a good face on the policy by writing to colleagues that "The current strategy is to put Britain first. We have won for ourselves a privileged position by our... policy during the Middle East war and

⁵⁰ CAB 164/1198, NA, The Oil Situation, 23 October, 1973.

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must not allow this position to be eroded.”⁵¹ This stance, however, brought Britain into conflict with West Germany, Belgium and Luxembourg. These states shared sympathy for the Netherlands but even more importantly each received a significant portion of their oil product supplies from the massive Rotterdam refinery. Fenn nevertheless argued that it would do little to help the rest of Europe “by putting ourselves in the same boat as the Dutch.”⁵²

But Fenn and others in the FCO were also concerned that the lack of solidarity in the EEC would come back to haunt Britain. Unfortunately for the purveyors of this view, those within Whitehall who pushed the policy of “Britain first” had a powerful example to follow and to use to validate their position – France. The French, the supposed champions of Europe, had made no qualms about exerting pressure on the international companies to continue supplying France with its full quota.⁵³ They had pursued an even more pro-Arab foreign policy than Britain and had even befriended the Iraqi regime prior to the Crisis. With their managed oil market, the French had allotted certain percentages to various companies. They threatened both BP and Shell with exclusion from their market should they not deliver their full percentage. BP and Shell reported to the FCO that “The French Government's attitude with them has been that there is no crisis as far as France is concerned. France has political assurances that her supplies will not be cut and it is up to the companies... to see that that oil gets to France.”⁵⁴

⁵¹ CAB 164/1199, NA, UK Oil Supplies: the European Problem, 1 November, 1973.

⁵² Ibid.

⁵³ For a good examination of French thinking during the Crisis, see Aurelie Elisa Gfeller, *Building a European Identity: France, the United States, and the Oil Shock, 1973-1974* (Berghahn Books, 2012).

⁵⁴ PREM 15/1840, NA, FCO Tel no 1534, 9 November, 1973.

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This might have been justification for some, but to many in the FCO this was a short-sighted policy for France and for Britain. Fenn noted Britain's difficult position, writing "If we share our oil, we shall offend the Arabs and lose our favoured position, thus further reducing total Arab oil production and the deliveries to Europe (which would benefit neither us nor our European partners). If we refuse to share oil our partners will resent it. If we obstruct the export of oil products, we shall be in open breach of the Treaty of Rome, and shall have placed at risk our European policies, to say nothing of co-operation between consumers."⁵⁵

It was not just elements of the FCO that found Heath's embrace of "Britain first" and his attempts to direct the activities of BP and Shell to be disconcerting. Both firms, for obvious reasons, felt that the policy was misguided. It was not simply against their own interests, they argued, but a classic example of short-term gain for long-term pain. According to BP, aside from the "disastrous effect on BP's reputation as a politically impartial international trading group," the other danger of government directed discrimination was "the unavoidable risk of this policy spreading, and the consequent total fragmentation of European oil policy."⁵⁶

At a tense meeting between top civil servants and Drake and McFadzean on 7 November, the two oilmen laid out their case. Drake argued that by seeking to preserve itself at the expense of others, Britain was actually playing directly into the hands of OAPC. By allowing the oil weapon to be focused on the United States, the Netherlands and other states, it made the weapon that much more effective. Instead, according to

⁵⁵ CAB 164/1199, NA, UK Oil Supplies: the European Problem, 1 November, 1973.

⁵⁶ CAB 164/1198, NA, BP Group - U.K. and European Supplies, 30 October, 1973.

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Drake, “the only hope was to show the Arabs that their oil weapon was affecting the entire world and was thus counter-productive.”⁵⁷ McFadzean concurred and added that not only was Britain’s policy politically short-sighted but was also economically foolish. The Shell chairman reminded the Whitehall officials that “In an uncontrolled scramble for future oil supplies the Japanese and Americans could afford to offer much higher prices for their oil supplies and Europe would be pushed to the back of the queue,” adding that “the UK would be at the back of the European queue.” Drake noted sadly that the granting of a “friendly” status to Britain and France “had been cast over us like a fly, which we had snapped up and thereby threatened to tear Europe apart.”⁵⁸

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Drake and McFadzean’s warnings did not have the intended effect. While many within Whitehall agreed with the two firms, the escalation of the crisis militated against the long-term view advocated by the companies. With the National Union of Mineworkers declaring a ban on overtime in November of 1973, the sense that the Heath Government was facing an existential threat became more acute.⁵⁹ This situation allowed a strand of thinking to emerge among some in Whitehall and in the Cabinet that sought to fundamentally rethink Britain’s position in the international oil industry. If BP and Shell

⁵⁷ FCO 55/1058, NA, Record of a Meeting Held in the FCO on 7 November, November, 1973.

⁵⁸ Ibid.

⁵⁹ One of the long-standing arguments used against the coal miners and their demands for wage increases was that coal was already too expensive to compete with oil and gas. With the drastic increase in oil prices, coal was now relatively cheap, a fact that the miners used to press their claims for higher wages. See Hywel Francis and Dai Smith, *The Fed: A History of the South Wales Miners in the Twentieth Century* (Lawrence and Wishart, 1980), 477.

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were unwilling to work for Britain's benefit, the question began to be asked whether Britain should concern itself with the fate of BP and Shell.

This view found no argument from Heath. In this he was supported by Lord Rothschild who felt that BP and Shell's concerns regarding the potential backlash for assisting Britain were overblown. Writing to the Prime Minister at the same time that others were urging caution, Rothschild asked "why France can take a tough attitude whereas this seems very difficult for us?"⁶⁰ He went on to muse that "Even if we do not or can not operate in such a dirigiste way as the French, has not the DTI got powers to make life difficult for oil companies which do not toe the line?"

Taking Rothschild's encouragement to heart, Heath toyed with was the idea of making life difficult for BP and Shell in the North Sea. Writing to Heath, John Hunt suggested "The most potent threat is a tougher oil regime combining a higher share of revenue from North Sea Oil with destination controls and possibly moving towards a managed domestic market."⁶¹ The CPRS, perhaps realizing that Rothschild's advice was being taken too much to heart, pushed back hard against this idea with J.R. Guinness writing to Rothschild that "I think we must be very careful to use threats about future North Sea (or rather UK offshore) licensing and taxation to persuade BP & Shell to give us preferred treatment in the short-term," urging the CPRS head to remind that Prime

⁶⁰ PREM 15/1840, NA, Letter from Lord Rothschild to Prime Minister, 13 November, 1973.

⁶¹ PREM 15/1841, NA, Letter from Hunt to Prime Minister: Relations with the International Oil Companies, 20 November, 1973.

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Minister that “It is in our national interest for Shell & BP to get a large share of the licenses in any new licensing round.”⁶²

But what Heath might have lacked in specific means of controlling BP and Shell, he made up for with pure force of argument. The leadership of the two firms was called upon repeatedly to participate in meetings, provide data and offer advice to the numerous groups working out Britain’s short, medium and long-term plans for dealing with the crisis. At the end of one such meeting, an exhausted Eric Drake conceded once again that “he was prepared to do everything he could short of actions that incurred the risk of destroying BP as an international operating company” to help Britain through the supply crunch.⁶³ But, Drake also returned to the domestic price argument. One solution to Britain’s supply problem lay not in squeezing BP and Shell to deliver more but rather in raising prices. Drake insisted that “he was not making his plea on behalf of BP’s revenues, but as a concrete proposal for improving the stock position in this country.”⁶⁴

Heath and his ministers were very hesitant to do this. Increasing the price of oil products during negotiations with the miners could have been disastrous.⁶⁵ But the truth of Drake’s argument was becoming hard to ignore. The disparity between the price of oil in Britain and its price on the market was growing. Places such as Iran and Nigeria, which were not participating in the embargo or cutbacks, had increased their production.

⁶² CAB 164/1199, NA, Letter from Guinness to Rothschild - Relations with the International Oil Companies, 16 November, 1973.

⁶³ CAB 164/1199, NA, Letter to Bridges from Mumford, 13 November, 1973.

⁶⁴ Ibid.

⁶⁵ The miners were already using the international oil price increase as justification for the increased wages they were demanding. Their argument was that coal was now much more competitive with oil and that the wage increase would do little to harm that competitiveness.

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Their state-owned firms thus had large supplies available to be purchased at auction.⁶⁶ In November an auction of Nigerian oil saw the offering bought for \$16 a barrel, well beyond the posted price of \$5.40 a barrel. By mid-December Iranian oil was being sold at auction for \$17 a barrel. The frenzy was topped off by the purchase of a shipment of Nigerian oil for \$22.60 a barrel, or more than four times the posted price, by a Japanese firm seeking to secure the desperately needed supply for the Japanese market.⁶⁷ This frenetic bidding seemed to prove BP and Shell's warnings of the consequences of a scramble. While the oil being produced through the old concessions was not subject to these wildly inflated prices, prices on the spot market were exploding, leading many to believe that it was only a matter of time before OPEC would respond with yet another price increase.

At a meeting held in the midst of this chaotic price increase, Drake once again proclaimed a dire warning to Whitehall. Looking "very tense and edgy" and "inclined to repeat himself," Drake laid out a bleak vision for Britain's oil future if the seller's market continued indefinitely.⁶⁸ He warned that "The effective oil price could easily go to levels which BP could not afford to pay and the burden on the UK balance of payments would become astronomical."⁶⁹ Shell reiterated this sentiment with a document sent to Whitehall entitled "Consequences of Granting Preferential Treatment to the U.K. in the Matter of Oil Supplies," in which they reminded officials that "Japan and West Germany

⁶⁶ Iraq, which had seen its more extreme suggestions for the embargo rejected at the Kuwait meeting in October, had refused to join the embargo and actually increased its production. Altogether the loss of oil due to the embargo and production cutbacks equaled roughly 4.4 million barrels per day or about 9 percent of the total available in the non-Communist world. See Yergin, *The Prize*, 596.

⁶⁷ *Ibid.*, 597.

⁶⁸ CAB 164/1199, NA, Note for the Record, 27 November, 1973.

⁶⁹ *Ibid.*

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have not so far used their full economic power to buy up a larger share of available supplies, but once they see that they are not being treated on a basis of equality, they must be tempted to do so. This could destroy existing participation arrangements which would transfer larger volumes of oil to the producing governments for them to dispose of.”⁷⁰ Writing to Minister of Industry Peter Walker two weeks later and following the Iranian auction, Drake expanded on this warning and once again argued that “even at this late hour, the attempt should be made to halt the scramble.”⁷¹ This could only be accomplished “by consumer Governments' controlling oil imports by setting a ceiling price above which oil will not be admitted, and agreeing jointly at the same time on the allocation between countries of the oil that is available.”⁷²

These dire prognostications and warnings did not go completely unheeded, but once more the new thinking in Whitehall drifted in an anti-oil company trajectory. By the end of November, Whitehall had begun to come to grips with the crisis and had transitioned from planning for immediate shortages towards preparations for a longer-term and more systemic shift in the international oil industry.⁷³ Symbolic of this change was the dissolution of the Task Force on Oil Supplies on 20 November. The Task Force had been a relatively medium-level outfit made up of a few ministers but mainly of officials. Matters of oil planning were now to be referred directly to the Cabinet's

⁷⁰ CAB 184/170, NA, Consequences of Granting Preferential Treatment to the U.K. in the Matter of Oil Supplies, 29 November, 1973.

⁷¹ FCO 55/1060, NA, Letter from Drake to Walker, 12 December, 1973.

⁷² Ibid.

⁷³ This process was aided by the fact that the Arab oil producers meeting in Vienna on 18 November, 1973 resulted in the cancellation of the 5% production cutback in appreciation for the EEC's declaration on 6 November of support for Israeli withdrawal from the territories it occupied in 1967.

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Economic Strategy Committee which was to be advised by the officials of the Working Party on Oil Supplies under the chairmanship of the civil service's foremost specialist on energy matters John Liverman.

By pushing oil decisions to this upper echelon, Heath signaled his willingness to examine the fundamentals of Britain's oil policy, including its traditional reliance on firms like BP and Shell to keep the country supply. The Working Party on Oil Supplies was given the mandate to explore all the options available. As part of this they debated a draft report that they had drawn up in the weeks after the outbreak of the crisis on 27 November entitled "Medium Term Oil Policy" which agreed with many of BP and Shell's warnings but came to a different conclusion about the way forward. While the oil companies sought consumer cooperation to help save as much of the industry's traditional role as possible, the Working Party on Oil Supplies all but gave up the old system for dead. Instead the report concluded that the Arab states would "offer some of their share of oil direct to consumer nations on long-term agreements; and sell some direct on short-term contracts at very high prices which may set the overall prices." The second half of this equation would bode very ill for Britain, therefore the Working Party suggested that the UK needed to "tie-up oil quickly through bilateral deals whatever the source." To do so required "intensive political activity to secure a favoured position with Saudi Arabia, Kuwait or Iraq (and to keep the USA on side as far as possible)."⁷⁴

The report did not completely discount the idea of cooperation with other consumers but highlighted the difficulty of achieving any serious results in a timely

⁷⁴ Ibid.

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manner. And thus while Whitehall was open to the idea of meetings at the OECD, the EEC and with the Americans, they turned more of their attention to the securing of bilateral deals. Officials recognized the danger of these deals to create the scramble that BP and Shell had warned about, but in the deepness of the crisis, it was felt that the positives of such deals outweighed the negatives. With North Sea oil due to come online in 1975, the proponents of bilateral deals felt that the long-term ramifications of the deals would impact Britain less harshly than others.⁷⁵

The primary target for these deals was Saudi Arabia. The Saudis had expressed their continued cooperation with Britain even at the height of the production cutbacks and with the Americans, Saudi Arabia's traditional patron and ally, completely excluded, Heath believed an opportunity existed for Britain to establish a long-term partnership. The Governor of the Bank of England, Gordon Richardson, had journeyed to Saudi Arabia in November to discuss possible investment opportunities for the Saudis in Britain and his visit was quickly followed up by a top-level delegation led by Lord Aldington whose purpose was to propose a long-term deal swapping oil for British goods and technical assistance with the industrialization of Saudi Arabia's economy.⁷⁶ A similar approach was made to the Shah and involved direct negotiations between Heath and the Iranian Government officials.

⁷⁵ There was also the issue of so-called "petrodollars." With the huge increases in oil prices, the OPEC states were accumulating vast amounts of dollars, to the point that fears were mounting over the impact of this imbalance on the international economy. One solution to this was the encouragement of direct investment by the oil-producing states into the developed economies of the OECD. Thus officials argued that striking bilateral deals would help increase Britain's attractiveness for such investment.

⁷⁶ Aldington was a close ally of Heath and a major business figure who had served as the head of several banks as well as the chairman of GEC.

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With these deals seemingly progressing, Heath and the other officials involved began reimagining the involvement of BP and Shell in this process. BP was contacted about the possibility of its ships and refineries being put to use to handle the oil that was coming to Britain because of the bilateral agreements.⁷⁷ While not enthused with the idea, the company responded favorably.⁷⁸ But this was just one part of the developing philosophy inside Whitehall about the future of the oil industry, and in particular the future role of the international oil companies. Just a few days after it debated its Medium Term Oil Policy plan, the Working Party on Oil Supplies debated another paper entitled “The Future of the International Oil Companies.” The report was written mainly by the DTI, traditionally the strongest supporters of the companies within Whitehall, but it showed no sympathy in declaring that “the present crisis has thrown into sharp relief the divergence of interest between the Government and the international oil companies” and that “there are strong pressures among Ministers for a complete reappraisal of this relationship.”⁷⁹

According to the paper’s authors, the two options going forward were “to sustain the present system so far as possible, or actively to seek a greater degree of government control in the operations of the oil companies.” The DTI felt that the first option would not appeal to the Cabinet and that either approach now required the cooperation of the oil producers. Given this fact, the paper concluded that it was more likely that the system would move away from interaction between companies and the producing states to

⁷⁷ BP was approached only after it became apparent that the Government’s initial choice, Burmah Oil, was not up to the challenge of handling as much oil as Whitehall expected to receive from Saudi Arabia.

⁷⁸ BP 114000, BP, U.K. Oil Supplies, 29 November, 1973.

⁷⁹ CAB 134/3702, NA, The Future of the International Oil Companies, 30 November, 1973.

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government-to-government contracts, with a managed domestic market on the model of France becoming the norm. In this situation, the companies would simply serve as middle men, and most likely would be increasingly replaced by state-controlled companies. The DTI noted that “The only oil company which the Government can control is BP; it can only exercise a greater degree of control by interfering with its freedom of operations and hence affecting its international status,” before going on to note that “how far this matters is not clear.”⁸⁰

Word of these discussions reached BP and Shell through their web of contacts within Whitehall and sparked a good deal of concern. In a record of a conversation between Geoffrey Chandler of Shell and A.T. Gregory of BP, the question arose as to whether the Government would “see sense or proceed to disastrous attempts at direction?”⁸¹ Gregory for one thought that the future policy “was still on a knife edge.”⁸² The conversation concluded with Chandler saying that “it would be the greatest assistance if our two companies could keep closely in touch on intelligence of HMG’s thinking and generally” to which Gregory “of course agreed.”⁸³

This rather dramatic vision of a future without the international companies as a central part of the oil industry, and of Britain’s oil policy, did receive some push-back within the Government. During the debate within the Working Party, one unnamed official reminded the other members that “it was essential that the Government's thinking should not be too heavily conditioned by the short-term position resulting from the

⁸⁰ Ibid.

⁸¹ BP 114000, BP, Conversation between Chandler and Gregory, 3 December, 1973.

⁸² Ibid.

⁸³ Ibid.

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existing production cut-backs.”⁸⁴ In this spirit, some officials did try to reassure the companies regarding the future. Just two weeks after the Working Party debated the paper, John Liverman, one of the DTI’s top officials on oil, spoke with three high-ranking members of BP including David Steel. Steel recorded that Liverman had conceded that “he thought the PM was moving more our way in his thinking.”⁸⁵ But Liverman also noted that “the relationship between HMG and BP was obviously a subject for consideration in the changing circumstances,” although “he did not think there was any question of nationalisation.”⁸⁶

Towards Cooperation

Whether Heath was actually moving towards the Company position is unclear. What was apparent, however, was that December saw several events which dramatically changed the calculus for Whitehall and helped move opinion away from the most dramatic elements of the Working Party’s reports. The reasons for this seemingly stark shift revolved around the fact that Heath and the Conservatives were in a perilous political situation both domestically and internationally. Looming industrial action by the coal miners forced Heath to announce on 13 December, 1973 that a three day work week would be imposed on 1 January, 1974 in an effort to save power. The break-down of negotiations with the NUM had led to fear of a coal shortage and the possibility of a miners’ strike. Even with oil supplies looking better than the Government had feared, the

⁸⁴ CAB 134/3702, NA, Working Party on Oil Supplies - Minutes of a Meeting held in Conference Room E, Cabinet Office on Tuesday 4 December 1973 at 11.30 am, 5 December, 1973.

⁸⁵ BP 34741, BP, Walters, Gregory and Steel meet Liverman, 17 December, 1973.

⁸⁶ Ibid.

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shortfall was still significant enough to prevent the boosting of power output from fuel oil.⁸⁷ Matters were almost as bad internationally. Relations with the United States had been at a low ebb for some time.⁸⁸ Tensions over numerous US policies ranging from the war in Vietnam to Nixon's policy of détente with the Soviet Union had strained the trans-Atlantic partnership. The tension had become so noticeable that in April, 1973 Henry Kissinger had declared a new policy initiative known as the "Year of Europe." But instead of receiving heart-felt appreciation from the United States' European partners, Kissinger's proposal was received with annoyance and, in some quarters, even derision.⁸⁹

Things had gone from bad to worse with the outbreak of the October War. Heath infuriated the United States during the crisis by refusing to allow American forces to use British bases or even to overfly British territory on their way to resupply Israel.⁹⁰ To aggravate matters further, Heath had also refused to put forward an American-backed resolution at the United Nations' Security Council.⁹¹ Instead, Heath had tacked towards his European allies who, aside from the Netherlands, had pursued a neutral if not pro-Arab policy during the conflict. On 6 November, the British joined their EEC partners in issuing a common statement in support of UN Resolution 242, a move that greatly

⁸⁷ Shortfalls in November and December had been limited to 10 percent, less than was originally feared. Projected shortfalls for January and February were 7 percent, a dramatic improvement on earlier estimates.

⁸⁸ Heath's insistence that Britain had a "natural" rather than a "special" relationship was a semantic, but also a symbolic difference from the close partnerships enjoyed by previous US presidents and UK prime ministers.

⁸⁹ For a list of excellent works on the Year of Europe, see footnote 74 in Chapter 6.

⁹⁰ Heath justified this by pointing to Britain's neutrality in the conflict. The policy choice was also influenced by fear that approval of the US resupply would be viewed as an unfriendly act by the Arabs. The fact that the Netherlands' acceptance of American over-flights resulted in their being embargoed seemed to reward Britain's caution.

⁹¹ See Geraint Hughes, "Britain, the Transatlantic Alliance, and the Arab-Israeli War of 1973.," *Journal of Cold War Studies* 10, no. 2 (Spring 2008): 3–40.

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annoyed the US President Richard Nixon and his newly appointed Secretary of State Henry Kissinger.⁹²

But the desire to cleave to Europe only extended so far. While Heath and his Foreign Secretary Alec Douglas-Home sought to weather the political winds of the crisis in the Middle East through cooperation with its European partners, the same could not be said of the turbulence in the world of oil. Britain continued to resist calls to implement the OECD sharing plan, which was mainly put forward by West Germany. On top of this, the bilateral deals they negotiated with Saudi Arabia and Iran also angered Britain's partners in Benelux and West Germany. France and Britain became scapegoats in the EEC for their seemingly selfish policies during the crisis.⁹³

This would have been acceptable had the "Britain First" policy brought tangible benefits, but it was beginning to seem that it was doing more harm than good. This was especially apparent from the fact that the price increases had dramatically damaged Britain's balance of payments outlook. Even the most diehard supporters of bilateral deals recognized that such an approach would do little to control prices. The only option with any hope of moderating the skyrocketing prices was consumer cooperation.

Fortunately for Britain this revelation had struck someone else as well – Henry Kissinger. The Americans had already begun making proposals for how to address the

⁹² As a result of this action, OAPEC agreed to forego Europe's share of the production cutbacks scheduled for December. As Gfeller points out, this resolution by the EEC was a triumph of a longer French project of improving their ties with the Arab world and a crucial step in France's view towards the creation of a unified European foreign policy. Henri Simonet of the EEC saw it differently. Writing in 1975 he noted that the declaration "conveyed the implication that when faced with the economic, social and political consequences of a sustained oil embargo the Nine had chosen the path of appeasement at any price." See Gfeller, *Building a European Identity*; and Henri Simonet, "Energy and the Future of Europe," *Foreign Affairs* 53, no. 3 (April 1975): 450.

⁹³ See Gfeller, *Building a European Identity*, 118–119.

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energy crisis in November with Nixon giving a speech on his so-called Project Independence. In this speech Nixon had sketched plans for energy conservation and research into alternative fuels, but these alone would not meet the immediate crisis. Thus, on 12 December, 1973 during a visit to London, Kissinger gave a speech at the Pilgrim's Society in which he laid out a vision for a new level of consumer cooperation that would counteract the ability of OPEC to set prices unilaterally on the international oil market. Kissinger proposed a small group of eminent Americans and Europeans that would work out strategies for consumer cooperation, emergency sharing, and control of prices.⁹⁴ At the heart of Kissinger's concept was the need to support the international oil companies and to allow them to continue their function as the suppliers of the industrialized world.

The timing of Kissinger's speech was not accidental; two days later the leaders of the nine EEC states were due to meet in Copenhagen for a summit.⁹⁵ Although the purpose of the summit was not explicitly to deal with the oil crisis, there was little doubt that discussions regarding energy would dominate the meeting. Drake for one saw the Copenhagen Summit as an opportunity for the EEC to make a strong statement on cooperation to the US and Japan, writing to Walker that "my own view on this is that if

⁹⁴ These proposals were met publicly with great enthusiasm by the leaders of Europe. But privately there was tremendous annoyance that Kissinger had not floated the ideas to them prior to making his public announcement. This smacked of the same lack of consultation that had marred the introduction of the Year of Europe. See Daniel Möckli, *European Foreign Policy During the Cold War Heath, Brandt, Pompidou and the Dream of Political Unity* (I.B. Tauris, 2009), 255.

⁹⁵ There was, in fact, speculation that Kissinger's proposals had the primary purpose of torpedoing the Euro-Arab dialogue that was to be debated at Copenhagen.

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the EEC at Copenhagen agreed even without the French to make the attempt, those two Governments might well be prepared to co-operate.”⁹⁶

Walker was sympathetic to Drake’s arguments, a fact that reveals just how much attitudes had changed within Whitehall in a relatively short amount of time. Even so, he was not ready to embrace wholeheartedly rushing into cooperation. In a letter to Heath, Walker pointed out that “With oil supply for the future below demand, and with producer Governments marketing far more of their oil in bilateral deals, we can expect to see a scramble on both supplies and prices among the consumer nations unless the long-shot of consumer cooperation led by the USA or EEC comes off.”⁹⁷ But Walker also hedged by stating, “If consumer cooperation continues to look unlikely, we must be prepared to secure our own oil supplies through bilateral deals with the producer countries even if the prices demanded mean a heavy burden on import costs.”⁹⁸

Heath carried this fence-sitting approach to the Copenhagen Summit which was held from 14-15 December, 1973. Energy was to be a major topic, although other important structural issues were also to be discussed. The West German Chancellor, Willy Brandt, came to the Summit with a plan for a comprehensive energy sharing policy that would see members of the EEC pool their resources together. The plan was, of course, not palatable to Heath who desperately wanted to protect Britain’s control of North Sea oil. This position, along with Britain and France’s embrace of bilateral deals, won Heath a certain amount of odium and the meeting began to founder. While these

⁹⁶ FCO 55/1060, NA, Letter from Drake to Walker, 12 December, 1973.

⁹⁷ FCO 55/1100, NA, Letter from Walker to Heath, 12 December, 1973.

⁹⁸ Ibid.

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discussions were taking place, the foreign ministers of the Nine EEC states were visited by four uninvited Arab foreign ministers who arrived from the Arab Summit conference being held in Algiers.⁹⁹ As part of a Euro-Arab dialogue, French representatives had been in close touch with Arab leaders regarding the Copenhagen Summit. The representatives applied a carrot and a stick approach to the Nine, praising them for their support of the Arab cause, in particular their 6 November pronouncement. They stated that moves such as these would go a long way towards ending the oil embargo.¹⁰⁰ But along with the pleasantries, the Arab ministers also warned the Nine that if more were not done to pressure the United States and Israel towards a favorable solution to the crisis, they could face the wrath of the Arab oil producers.¹⁰¹

According to *The Times*, the Arab ministers' visit "threw the first day of the EEC summit badly out of gear" and little progress was made on any of the points of discussion.¹⁰² Heath would later describe Copenhagen as the "worst summit that I have ever experienced."¹⁰³ But what was salvaged from the wreckage was an agreement in

⁹⁹ Gfeller argues that the Arab mission to Copenhagen was inspired by French Foreign Minister Michel Jobert and his calls for a Euro-Arab partnership. Despite this, Gfeller goes on to claim that the French were caught off guard by the Arab desire to participate in the Copenhagen Summit. Möckli also notes that wrangling over what to do about the four uninvited guests took up most of the first day of the meeting. See Gfeller, *Building a European Identity*, 99; Möckli, *European Foreign Policy During the Cold War* Heath, Brandt, Pompidou and the Dream of Political Unity, 240–247.

¹⁰⁰ Roger Berthoud, "Arab ministers in Copenhagen hint at terms for lifting oil curbs," *The Times*, 15 December, 1973, 5.

¹⁰¹ Heath would later report that "what the Arab Foreign Ministers had said at Copenhagen in December had shown that they saw their action as a revenge for years of colonial exploitation." PREM 15/2188, NA, Note for the Record, 24 January, 1974. For an analysis of Heath's role in the Euro-Arab dialogue see Muhamad Hasrul Zakariah, "The Euro-Arab Dialogue 1973–1978: Britain Reinsurance Policy In The Middle East Conflict," *European Review of History* 20, no. 1 (February 2013): 95–115.

¹⁰² Roger Berthoud, "Arab ministers in Copenhagen hint at terms for lifting oil curbs," *The Times*, 15 December, 1973, 5.

¹⁰³ Edward Heath, *The Course of My Life: My Autobiography* (Hodder & Stoughton, 1998), 393. Hynes points out that Heath was undercut at Copenhagen by the rapidly deteriorating situation at home as he had announced the three day work week the day before the Summit began. See Catherine Hynes, *The Year*

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principle that the EEC would work together to craft a common energy policy and would no longer seek to overcome the oil crisis individually.¹⁰⁴ In a note sent to President Nixon two weeks after the Summit, Heath wrote that he hoped “the agreement reached in Copenhagen will put an end to the recent differences within the Community about solidarity in the face of the Arab Oil Weapon.”¹⁰⁵ Although subsequent attempts to formulate this common policy would founder on French obduracy, the Copenhagen Summit had two significant outcomes for Britain. The first was that the principle of cooperation had been formally endorsed by the meeting, helping to shift the minds of the ministers and officials in Heath’s cabinet away from the “Britain First” approach they had been exploring. Of equal importance, however, was that the meeting showed Heath just how difficult the construction of a European energy policy would be. The difficulties of dealing with the French made cooperation along the lines suggested by Kissinger a more enticing option. Thus, if cooperation was to be the way forward, it was quite possible it would have to be extra-European.

Securing Britain’s Goals

Any lingering doubts Heath might have had about the need for cooperation were dispelled when the Gulf States met in Teheran from 22-23 December. Recognizing that the posted price of \$5.40 a barrel was lagging far behind prices on the spot market and

That Never Was: Heath, the Nixon Administration and the Year of Europe (University College Dublin Press, 2009), 218–219.

¹⁰⁴ Although, as Möckli points out, the Nine conspicuously did not address the proposals advanced by Kissinger in his Pilgrim’s Society speech. See Möckli, *European Foreign Policy During the Cold War* Heath, Brandt, Pompidou and the Dream of Political Unity, 242.

¹⁰⁵ PREM 15/2178, NA, Message from the Prime Minister to President Nixon, 30 December, 1973.

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especially behind those of the auctions being held for participation oil, the assembled oil producers more than doubled the posted price to \$11.65 a barrel.¹⁰⁶ Douglas-Home informed British diplomatic posts abroad that “Coming on top of the sharp increases in October, this will have very serious consequences for the economies of oil consumers, developed and developing alike, and will threaten the stability of the world economy.”¹⁰⁷ The price increase shocked British officials and quickly focused minds on the need to combat the continued price inflation. Thus when US President Richard Nixon responded in January by elevating Kissinger’s Pilgrim’s Society proposal into an invitation for a full-blown conference of foreign and energy ministers to be held in Washington, Heath and Douglas-Home both agreed that Britain needed to be a part of it.

Nonetheless this course carried its own risks. There was the danger of angering the Arab oil producers by appearing to work too closely with the United States, but there was an equal vulnerability to accusations from France that Britain was the dreaded “Trojan Horse” of American interests in the EEC. Douglas-Home acknowledged this would make matters more difficult since it was “the view of some of our EEC partners (notably the French) that a Community energy policy should be elaborated first.” But the Foreign Secretary also noted that, “In our view, this is neither possible nor necessary.”¹⁰⁸

Agreeing to attend the conference meant that Britain had to consolidate its own oil policy goals, however. Working for cooperation would mean that the Government

¹⁰⁶ There was actually some debate about this price. More radical representatives pushed for a price of \$23 a barrel while the Saudis, concerned about the welfare of the international economy argued for \$8. The Shah came up with the compromise of \$11.65 basing his argument on a study which showed that any price higher than this would make alternative hydrocarbons such as shale oil and coal to liquid technology financially competitive.

¹⁰⁷ PREM 15/2178, NA, Telno 2540: Oil Price and Supply, 31 December, 1973.

¹⁰⁸ Ibid.

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would have to lay off its attempts to force BP and Shell to shortchange other consumers in favor of Britain, but officials were less certain about the mutual exclusivity of cooperation and bilateral deals. Even if Britain were to go along with the American view that consumers should decrease demand through conservation and avoid a market scramble through support of the international oil companies, oil producer participation meant that these companies would be receiving less and less so-called “equity oil” under conditions akin to the old concessionary system. Therefore it was entirely likely, in the minds of the British, that the companies would have to assume a greater middle-man role facilitating the contracts signed by producing and consuming states.

With this view in hand, Whitehall hoped to stake out its argument with the Americans and to convince them that cooperation and bilateralism could coexist. But this effort did not start out on a promising note. During a brief meeting at London Airport on 20 January, Douglas-Home inquired about Kissinger’s views on bilateral deals. The US Secretary of State was unequivocal in declaring “that these could prove suicidal.”¹⁰⁹ Douglas-Home countered that it would be “important to work out arrangements so that bilateral deals would be unnecessary.” He argued that Britain “had not done much ourselves to put up prices” but that he “was not sure about the French.”¹¹⁰

The conversation left open doubts about what the United States wanted out of the consumer meeting and only made Britain’s own confusion that much more dangerous. There was a real fear that if clarity was not brought to the situation, the Washington

¹⁰⁹ PREM 15/2178, NA, Record of Conversation Between the Foreign and Commonwealth Secretary and Dr. Henry Kissinger at London Airport on Sunday 20 January 1974, at 11.40 P.M., January, 1974.

¹¹⁰ Ibid.

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Energy Conference would end up as ineffectual as the Copenhagen Summit or perhaps even worse. Cabinet Secretary John Hunt therefore sought both to focus and solidify Britain's own goals, and to try to bring Kissinger on board with ideas that would achieve those goals. On 21 January, Hunt wrote to Robert Armstrong, Heath's Private Secretary, asking "whether the time is ripe for an unpublicised attempt to smoke out the American intentions about oil supplies and oil prices."¹¹¹ Hunt felt that "It would be helpful to have a clearer indication of American intentions before we conclude some of our own bilateral deals and more particularly before the Secretary of State for Energy has to be briefed for the first meeting of the Energy Action Group."¹¹² Hunt proposed that a secret high level meeting with Kissinger would be invaluable to feel out the Americans and perhaps to sway them in a direction favorable to Britain. Armstrong wrote in the margin of the note that "I think that the idea of an exploratory mission to Henry Kissinger before 11 February has much to commend it; and that John Hunt is probably the man to do it."¹¹³

Kissinger quickly agreed to a meeting with Hunt which was scheduled for 30 January. This presented Britain with a good opportunity to push the conference agenda in a favorable direction. This was all the more likely since, in the words of Anthony Acland of the FCO, "the Americans have not yet thought through their policy over oil."¹¹⁴ Hunt therefore sought first to discern what Britain's objectives should be. In a steering brief sent to Heath, Hunt argued that there were four strands of policy that Britain needed to weave together at the Washington Energy Conference. They were: 1) cooperation with

¹¹¹ PREM 15/2186, NA, Letter from Hunt to Armstrong, 21 January, 1974.

¹¹² Ibid. The Energy Action Group refers to Kissinger's proposal for a small gathering of "wise men" from the OECD nations.

¹¹³ Ibid.

¹¹⁴ PREM 15/2186, NA, Letter Acland to Armstrong, 25 January, 1974.

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the US Government, 2) solidarity with the EEC, 3) Britain's own oil requirements and 4) the safeguarding of North Sea oil.¹¹⁵ Realizing the difficulty in finding a solution that fit with all these goals, Hunt believed that the issue of oil prices could be a unifying factor.

When Hunt met with Kissinger in Washington the next week he and the US Secretary of State held a detailed discussion regarding the upcoming meeting. Hunt mainly asked questions but did push Kissinger for a more focused conference in which the price of oil would be the main consideration. Kissinger agreed that oil prices were the major issue that needed to be tackled, noting that "a situation in which 40 million backward people were able to dictate to 800 million others their style of life, their standards of living and even the relations between them was basically intolerable."¹¹⁶ When pressed on how he envisaged this combatting of price inflation, however, Kissinger stated that he did not think a formal arrangement would work. The interests of the consumers were too disparate for any strict machinery; instead, "It was more likely that Governments would have to work through the oil companies."¹¹⁷ There was even some agreement on the issue of bilateral deals. Kissinger had come to realize that these were inevitable but he wanted to see them regulated, a stance that BP and Shell had also grudgingly adopted.

With these basic agreements outlined, Hunt returned satisfied that the Washington Energy Conference could be an adequate vehicle to cement Britain's oil policy goals. As preparations for the Conference continued, Britain worked with both its American and

¹¹⁵ PREM 15/2178, NA, Steering Brief for the Washington Energy Conference, 28 January, 1974.

¹¹⁶ PREM 15/2178, NA, Record of Conversation between the Secretary of the Cabinet and the American Secretary of State held at the White House on Wednesday 30 January, 1974 at 3.00 pm, 4 February, 1974.

¹¹⁷ PREM 15/2178, NA, Telno 368: Meeting between Hunt and Kissinger, 30 January, 1974

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European partners, a difficult task considering the differing opinions on both sides of the Atlantic. Sir Jack Rampton of the newly created Department of Energy was dispatched to Washington a week before the Conference to work with Kissinger on preparing the structure and the goals of the meeting.¹¹⁸ Meanwhile other officials were meeting with their EEC counterparts to work out a common Community approach. This proved difficult, given the considerable reservoir of mistrust still lingering in Europe toward Kissinger and the Americans. Of particular concern to the French was the idea that the Conference would result in the creation of new machinery for cooperation, a move that they believed could be interpreted as a hostile one against OAPEC. But, despite these concerns, the common thread in all these discussions was the assertion that consumer cooperation had to be the end result. After several months of struggling with various solutions, the Heath Government realized that the only way to stabilize the market was through working with the other major consumers.

The Washington Energy Conference

Thus Alec Douglas-Home and Lord Peter Carrington entered the Washington Energy Conference on 11 February fully committed to the idea of backing the Americans on the need to establish a stronger framework for consumer cooperation.¹¹⁹ How to

¹¹⁸ The Department of Energy was created at the suggestion of the Foreign Secretary Alec Douglas-Home by splitting off the energy related aspects of the DTI.

¹¹⁹ Robb argues that this is proof of Heath's more nuanced approach to foreign policy, proving that he was not as anti-American as he is often portrayed. While this is certainly true, the decision to back the American position over that of the French was more a recognition that oil matters had to be settled globally rather than regionally. See Thomas Robb, "The Power of Oil: Edward Heath, the 'Year of Europe' and the Anglo-American 'Special Relationship'," *Contemporary British History* 26, no. 1 (March 2012): 73–96.

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achieve this goal was another question. Douglas-Home wrote to British diplomatic posts that “Our objective will be to avoid having to choose between US and French positions and to build on the common ground which exists,” but French statements prior to the Conference made that very unlikely.¹²⁰ Michel Jobert, the French foreign minister renowned for his Gaullism, had not even accepted the invitation to the Conference until the eleventh hour and continued to insist that the communiqué of the Copenhagen Summit, as well as the mandate agreed on 5 February by the EEC foreign ministers, both precluded setting up any new machinery to push forward the cause of consumer cooperation.¹²¹

The Conference began with Kissinger giving a passionate speech on the value of cooperation and the American role in leading that movement.¹²² Kissinger warned darkly of the dangers of division and noted that any hope of stability in the international oil market required concerted action. But even on the first day of the Conference, Douglas-Home reported “The Conference has run into the expected difficulty over machinery to coordinate follow-up work, with the Americans pressing for strong decisions, the French seeking to avoid them and the rest of the Community trying to bridge the gap.”¹²³ The Foreign Secretary went on to say that “There is a strong feeling among Community

Similar themes are explored by Rossbach. See Niklas H. Rossbach, *Heath, Nixon and the Rebirth of the Special Relationship: Britain, the US and the EC, 1969-74* (Palgrave Macmillan, 2009).

¹²⁰ PREM 15/2179, NA, Telno 340: Washington Energy Conference, 8 February, 1974.

¹²¹ For an analysis of Jobert’s goals, see Gfeller, *Building a European Identity*.

¹²² The nations participating in the Conference were Belgium, Canada, Denmark, France, the Federal Republic of Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, the United Kingdom, and the United States. The EEC was also represented by the President of the Council, Walter Scheel, and the President of the Commission, Francois-Xavier Ortoli. The Secretary General of the OECD was also in attendance.

¹²³ PREM 15/2179, NA, Telno 540: Washington Energy Conference, 12 February, 1974.

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delegations that the French should not be allowed to get away with it this time. The issues are too big and their procedural objections too petty.”¹²⁴ Because of this, he let it be known that the British and other members of the EEC were prepared to agree with the Americans on the creation of international machinery which would govern consumer cooperation. Douglas-Home insisted that they would do this even against French resistance. He noted that “We shall try to avoid this result, but the issues are so important that we shall have to accept the damages to the Community resulting from French obduracy. Failure to achieve a result acceptable to the Americans, Japanese and the rest would carry dangers to the Community of at least equal gravity.”¹²⁵

In the end, all of the attending nations except for France signed on to the full Conference communiqué. Among the points of agreement were concurrence of “the need for a comprehensive action programme to deal with all facets of the world energy situation by cooperative measures,” and to do so through building “on the work of the OECD.”¹²⁶ Importantly, under this point was also the agreement to “a system of allocating oil supplies in times of emergency and severe shortages.” These agreements were very pleasing to BP and Shell who felt vindicated after years of arguing for a similar system. But less exciting was the fact that the Conference also “agreed to examine in detail the role of international companies.” Leaving discussion of the role companies such as BP and Shell to the new cooperation group was not entirely appealing to the firms. Although France would be sidelined, there were other states that were even less

¹²⁴ Ibid.

¹²⁵ Ibid.

¹²⁶ PREM 15/2179, NA, Text: Communique of 13-Nation Energy Conference, 14 February, 1974.

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favorable to the companies which would have a voice in such hearings. To tackle these questions, the Conference agreed to create a “coordinating group headed by senior officials to direct and to coordinate the development of the actions referred to above.”¹²⁷ This assembly came to be known as the Energy Coordinating Group (ECG) and, as instructed by the Conference, soon began to produce and circulate papers on the various problems highlighted at Washington. With progress on this front it appeared that the Washington Energy Conference was a success, especially for Britain. In drawing up a report on the proceedings, R.A. Sykes, the *chargé d'affaires* of the British Embassy in Washington, presented the question confronting Britain at the conference to be if Europe would “seek to assure its energy supplies on its own account, using such leverage as it possessed with the producer states, or would it act in this international commodity market in concert with North America and Japan?”¹²⁸ Britain’s decision to seek an international approach to the supply and price issue was the correct answer to this question, according to Sykes. He wrote to Douglas-Home that “In drawing up our balance sheet, I hope that your Department will agree with my conclusion that the results were satisfactory for British interests,” adding “the participation of the US is essential for any orderly development of the world's markets.”¹²⁹ Sykes also admitted, though, that many questions were left unanswered by the meeting and that in some ways the hard work of recalibrating oil policy for Britain and its partners remained to be done.

¹²⁷ Ibid.

¹²⁸ FCO 96/86, NA, Report from Sykes to Douglas-Home: The Washington Energy Conference 10-13 February, 27 February, 1974.

¹²⁹ Ibid.

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One such issue was where exactly the international oil companies fit into the new energy reality. The ECG was due to begin meeting within weeks of the Conference and it was not at all certain which direction their recommendations would go. The Conference had not condemned bilateral deals or government-to-government contracts although it did discourage them. The fact of the matter was, however, that the nature of the oil business had changed and was continuing to change. As a result of the participation deals of 1971 and 1972 most of the Persian Gulf producers would see their stake in their oil production rise to 50 percent, but in the wake of the 1973 Oil Crisis, noises were being made about that percentage increasing even more. In places like Kuwait and Saudi Arabia there were even rumors that full nationalization was on its way. If that was the case, then the major international oil companies would lose their equity oil and would be forced to either strike deals with the producers or else to buy oil at market rates. The other option was for the consuming states to lay down ground rules for bilateral deals that would in turn be facilitated by the oil companies. These ground rules would have to be decided at an international level and while the ECG would eventually take up the issue, Heath initially promoted the issue as one around which the EEC could rally and restore some of the unity shaken in Washington as part of a broader common energy policy.

This situation alarmed BP. The British Government had become suspect to the Company in their clashes during the height of the crisis and was no longer to be trusted in defending the interests of the industry, especially against the French with whom Heath now sought to make peace. Writing to Leonard Williams of the Department of Energy,

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P.I. Walters of BP wrote, “we still feel that however desirable a common EEC system might be in theory, the fact is that oil policy in the foreseeable future is going to be basically a national matter, which can, however, only make any sense at all with an agreed international background; there is no half-way house of a distinctly "European" policy to be specially promoted by the Community's organs.”¹³⁰ In a paper attached to the letter, BP stated that if the British Government wanted to pursue a system of government-to-government deals, the international industry would be indispensable to the smooth transfer of the oil contracted. But the paper went on to argue that Walters did not believe that such a system was tenable for two reasons. First, “government to government deals for oil supplies could mean that oil will inevitably be affected by deterioration in the general political relationships with production countries and placed at risk.”¹³¹ This was essentially the argument for the oil industry serving as a buffer, a similar argument that had been used since the Suez Crisis and one perhaps sharpened by the Arab Embargo. The second argument was that the Government and its partner states did not have the technical expertise in pricing various grades of oil. Without the companies, the consumer governments would have to calculate the prices themselves to make sure they weren’t being swindled, a move that “would strain the ability of governments in this field to breaking point.”¹³²

But BP’s report did not stop with the problems of pure government-to-government deals, or the limitations of a purely EEC energy policy. It went on to lay out

¹³⁰ FCO 96/2, NA, Letter from Walters to Williams, 22 February, 1974.

¹³¹ FCO 96/2, NA, An EEC Energy Policy: Oil Issue, 21 February, 1974.

¹³² Ibid.

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a different vision. The paper put forward the idea that “even if consumer and producer governments succeed in agreeing a regulated supply/price system, to underpin a ‘normal’ situation, this may prove fragile.” Therefore, “a defence mechanism is needed.” To BP, this fallback position would be a stand-by allocation system that could kick in should the producers try to spike the price of oil or use oil as a political weapon. This allocation system would be governed by “a small international body (perhaps in the OECD),” and an “international government forum (perhaps the OECD) to decide when action had to be taken.” If the system needed to be employed, BP believed that this new group could use “the established companies in their international capacity as the operating arm of consumer governments in allocating supply.”¹³³ A meeting held in the Department of Energy to discuss the paper “agreed that this was a useful contribution to the discussion and that they would be consulted further as governmental thinking evolved.”¹³⁴

How that thinking would evolve was about to change, dramatically. The meeting at the Department of Energy was being held as the people of Britain were going to the polls. Hamstrung completely by the conflict with the miners, Heath had called a snap election to determine “Who Governs Britain?” The result was not the ringing endorsement that Heath was hoping for. In a closely fought election, Heath was ousted by Harold Wilson and the Labour Party who returned in a minority government. This was mildly concerning to BP and Shell, considering the poor relations they had maintained with the previous Labour Government, but there was also little love lost with Heath’s ill-fated rule. Besides, the institutional relationship with the civil servants in

¹³³ Ibid.

¹³⁴ FCO 96/2, NA, Meeting with the Oil Companies, 28 February, 1974.

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Whitehall remained consistent and attitudes there were turning back towards favoring the oil industry.

Many of these officials were actively involved in formalizing the consumer cooperation agreed at the Washington Energy Conference. But this work, proceeding on two different fronts, was moving slowly. The first front was the ECG and the second was the work being done to create a common EEC energy policy. In both arenas there existed significant anti-oil company sentiment, a mood made worse by the fact that the huge spike in oil prices in late 1973 had actually boosted company profits.¹³⁵ France led the charge in this effort, but even Germany, traditionally friendly to the big oil companies, complained of their oligopolistic tendencies. Britain, however, was unwilling to defend the oil firms too vigorously in the ECG. The EEC was still licking its internal wounds following the French refusal to go along with the decisions of the Washington Energy Conference, and British officials were hesitant to take any positions at the ECG that would exacerbate those differences. But fortunately for BP and Shell, they had a very powerful patron in these discussions in the United States. Unwilling to see a system put into place that would damage the interests of their major companies, the Government of the United States participated in the ECG meetings with the interests of the international companies in mind. At the meeting of the ECG Working Group on the Role of the International Oil Companies, the Americans defended the independence of the oil

¹³⁵ There are many reasons for this, including the ability of the firms to sell oil purchased earlier at a lower price for the much higher post-October price. This also included the boosted value of the companies' non-OPEC oil as well as the ability of the firms to sell some of their supplies on the spot market for dramatically inflated prices. This phenomenon was thoroughly examined by the Church Committee in the United States Senate from 1974-1975.

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industry from an Italian and Danish plan to control and equalize the prices charged by the oil companies. The British representative at the meeting, A. Blackshaw, reported that the Americans were “pouring cold water on the proposals and expressing particular concern about any measures which could lead to price regulation.”¹³⁶ Blackshaw himself, however, “did not take a very active role.”¹³⁷ British officials did keep “Shell and BP informed in detail of the progress in the ECG,” and consulted them “closely on the ongoing work of the *ad hoc* group dealing with the role of the oil companies,” but the British fight lay elsewhere.¹³⁸

With the Americans defending an independent oil industry at the ECG meetings, Britain felt less constrained in arguing for the same position within the context of the EEC. There it was possible to defend the companies without looking too anti-France. There was good reason for British officials to defend the companies at the EEC, as there was “widespread suspicion in other member states of the international oil companies, their profits and the degree to which they work in the national interests of member states.”¹³⁹ Because of this, certain ideas were put forward at the meetings on EEC energy policy held in the wake of the Washington Energy Conference that envisaged a greater role for the Commission in coordinating the activities of the companies. Officials vowed to BP and Shell to “resist the less helpful aspects of the Commission thinking, and

¹³⁶ CAB 164/1252, NA, ECG Working Group on the Role of the International Oil Companies: Meeting of 1 May, 1974, 7 May, 1974.

¹³⁷ Ibid.

¹³⁸ FCO 96/3, NA,

¹³⁹ FCO 96/3, NA, Steering Brief: EEC Energy Policy, 16 May, 1974.

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notably their ideas about Community *control* over oil policy and the activities of the oil companies.”¹⁴⁰

BP and Shell were grateful for Whitehall’s defense of their interests at the EEC but suspicions remained between the two sides. In an attempt to remedy these, a meeting on the model of the old “tea parties” was scheduled for 20 May, 1974. It was the first time since 6 November, 1973, at the height of the crisis, that the chairmen of the two companies had met with top officials. In his opening remarks, the FCO’s J.O. Wright acknowledged the tension that had grown up in the relationship over the course of the crisis by addressing Britain’s role in watching out for the companies at the EEC. He noted somewhat tongue-in-cheek that “the United Kingdom has been cast in what the companies may feel is the rather surprising role of defender of the records of the majors.”¹⁴¹ But the meeting itself went well. BP, represented by Drake, and Shell, represented by McFadzean, discussed a wide range of topics with the Government. McFadzean stuck mainly to technical points but Drake, in top form, gave several impassioned statements about the need for Whitehall to keep up the momentum in the quest for consumer cooperation. He said that “that BP were sad, not to use a stronger word, at the lack of progress in cooperation between consumers” and that despite the agreement at Washington, “oil companies could detect little real will towards

¹⁴⁰ Ibid. The failure to make any real progress on a European energy policy in the aftermath of the Washington Energy conference led many prognosticators to announce the entire crisis as a major defeat for Europe. For an example of this see Walter Laqueur, “The Idea of Europe Runs Out of Gas,” *Atlantic Community Quarterly* 12, no. 1 (January 1974): 64–75; and Karl Kaiser, “Europe and America: A Critical Phase,” *Foreign Affairs* 52, no. 4 (July 1974): 725–741.

¹⁴¹ FCO 96/3, NA, Introductory Speaking Note for Mr J O Wright, 16 May, 1974

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coordination between consumers.”¹⁴² He went on to comment that “there would be no stability in the oil industry until the consumers reached agreement,” and argued strongly that “consumers had the choice of standing firm against OPEC or continuing to ‘run away.’” He and McFadzean both maintained that the companies could continue to serve an important role as a moderating and equitable force in world oil affairs but if the tide of opinion went against them and some sort of state-controlled system were set up, Drake worried that “governments would make a hash of it if they tried to handle energy supplies themselves.”¹⁴³

Conclusion

BP and Shell’s concerns about the slow-pace of work within the ECG were well founded. Deliberations continued throughout the summer with numerous proposals being made and debated. But when a final agreement was struck in November, 1974 for an International Energy Program (IEP) that would result in the creation of an International Energy Agency (IEA), the companies were thrilled. As part of the agreement, the IEA would govern an allocation system to be used in response to future crises. The final agreement was nearly identical to the idea proposed to officials by BP in the waning days of the Heath Government. The IEP document envisioned the IEA working in concert with the international oil industry to regulate the allocation of supply and required the companies to submit regular reports so that the Agency could keep track of price and

¹⁴² FCO 96/3, NA, Record of a Meeting Held at the FCO on 20 May, May, 1974

¹⁴³ Ibid.

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supply trends. It seemed as though the type of consumer cooperation that the firms had been arguing for since the years before the 1973 Oil Crisis had finally arrived.

By placing the oil companies in the important role of facilitators of the IEA sharing plan, the agreement effectively preserved much of the companies' traditional role. Although the foundation of the old integrated system, the long-term concessions in the Middle East, was crumbling, the companies were in a position to readjust their positions to take advantage of the new situation. With their position as the buffer between the consumers and producers intact, the companies could manipulate their business models to move their profits from the point of production and the sale of crude to different points in the supply chain. And as a result, the firms would quickly adjust to life in the new world of oil.

But even at this high point, dark clouds loomed for BP and Shell. The attempt to rebuild relations between the companies and Whitehall following the depth to which they had fallen during the crisis had been somewhat successful, but new challenges swiftly arose. The Labour Government which had come to power in 1974 had cooperated with the United States in the creation of the IEA, winning plaudits from the companies but, at the same time, Wilson and his comrades began a process of intervention into oil matters that would go far beyond anything that had come before. Even while officials worked to secure BP and Shell's role as international companies, Wilson's Cabinet was simultaneously laying plans to take greater control over Britain's North Sea oil resources.

The lurch towards interventionism that marked the Heath Government, especially during the crisis, made this move by the Labour Party that much easier. In many ways,

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Labour's exertion of influence in the North Sea would be a continuation of the policies begun by Heath. The crisis, along with the shortage and price escalation it brought, deeply impressed itself upon Government ministers and the British public. It also helped make the idea of state-control over an indigenous oil source seem not only natural, but preferable. These sentiments would result in the creation of a new rival for BP and Shell – the British National Oil Company and in years of wrangling and debate about the future of the industry and the role of government in this most important of markets

Chapter 9 – Britain's Oil, Britain's Company, 1973-1976

When the Labour Government returned to power in February, 1974 it faced a very inauspicious environment. The quadrupling of oil prices in the previous six months had put Britain's balance of payments into a dangerous deficit. Industrial action by the coal miners had added to the economic woes by crippling industry throughout the country through the forced imposition of a three-day work week. What is more, Labour had “won” the General Election by taking a plurality of seats in Parliament, earning fewer overall votes than Edward Heath's Conservatives and remaining 17 seats short of an overall majority.¹ Even worse, the Party was itself far from unified as the time in opposition had seen two distinct policy visions emerge. From the left was *Labour's Programme 1973* pioneered by the new Minister for Industry Tony Benn, which called for a radical policy of state intervention in industry and the economy of as whole.² From the other side came the “social contract” negotiated between Harold Wilson and the leaders of the trade union movement. This agreement envisioned a corporatist approach to industrial affairs, with the Party working closely with the unions on more moderate economic goals. The Party was, however, able to paper over these differences by

¹ Heath had in fact conceded defeat only after negotiations on a coalition with the Liberal Party failed.

² At the heart of this vision was the creation of a new National Enterprise Board (NEB) which would take a controlling interest in at least 25 of Britain's leading companies through the purchase of shares and would use this power to guide investment. Added to this would be the fact that every major British firm would need to agree to a planning agreement with the Government. These agreements would force firms to create an investment and price policy program for a five-year period. Along with these economic controls, *Labour's Programme 1973* also promised Government controls over prices and an increase in pensions and social services. See James E Cronin, *New Labour's Pasts: The Labour Party and Its Discontents* (Pearson/Longman, 2004), 136–138.

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maintaining vague promises in their Manifesto. By focusing on ideas which united the Party rather than those which divided it, Wilson sought to project an image of dynamism and a promise of an escape from the chaos and confusion of Heath's final days in office.

Near the top of the Manifesto's list of priorities was a new plan for North Sea oil and gas. The new Secretary of Energy, Eric Varley, put it to his fellow ministers that "The Government had promised in their Manifesto to secure the maximum public advantage from the immensely valuable resource of the continental shelf."³ But how exactly to do this was another complicated, and potentially divisive, question. The exploration and development of the North Sea up to that point had been driven by private industry. In spite of attempts by both the 1964-1970 Wilson Governments and the 1970-1974 Heath Government to extend state influence and its "take" from the North Sea, the rate of profit that was expected to accrue to the companies versus that which the State was to receive was much more favorable to industry than nearly anywhere else in the oil-producing world.

To examine this problem and tackle the issue of seeking "maximum public advantage" in the North Sea, Wilson set up a Ministerial Committee on Energy in March, 1974. This group, led by the Prime Minister himself, was meant to cut through the endless debates and discussions that occurred at the official level, and to make bold decisions regarding Britain's energy future. At its second meeting in April, 1974 the Ministerial Committee on Energy sought to establish a vision for North Sea oil and its

³ CAB 134/3746, NA, Ministerial Committee on Energy: Minutes of a Meeting held in the Prime Minister's Room, House of Commons on THURSDAY 4 April, 1974 at 5.00 pm, April, 1974.

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future. Varley, who hailed from the right of the Labour Party, laid out the many interrelated goals of Labour's policy, which were to "ensure that oil would be produced at the best rate for the national interest, to maximise the Government 'take' and benefits to the balance of payments, and to secure effective control over exploration and development programmes, and possibly exports as well."⁴ Beyond these, "they would wish to satisfy the legitimate expectations of Scotland and other parts of the United Kingdom, and ensure that British industry would get the maximum benefit from developments on shore."⁵

To achieve these goals, Varley laid out three broad categories through which the Government could work, categories that would provide the areas of discussion and debate between the State and the international companies for the next two years. These were "taxes, physical controls and ownership of the oil."⁶ Varley submitted to his colleagues that specific proposals should be drawn up "for further discussion which should include provision for a substantial increase in Government take secured by a tax on profits and a scheme for participation in future licenses, inducement through taxation and other measures to persuade the oil companies to accept participation in existing licenses, and any additional physical controls over the oil which might seem expedient."⁷ By fighting for greater control over these three areas, the Labour Government would push forward

⁴ Varley, a former iron worker, served in the leadership of the National Union of Miners before becoming a Member of Parliament in 1964.

⁵ CAB 134/3746, NA, Ministerial Committee on Energy: Minutes of a Meeting held in the Prime Minister's Room, House of Commons on THURSDAY 4 April, 1974 at 5.00 pm, April, 1974.

⁶ Ibid.

⁷ Ibid.

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the project of state intervention in oil affairs to the greatest extent yet seen and lay the groundwork for a further push in the second half of the decade.

Interestingly, these calls were not a radical departure from the efforts which were already underway under the Heath Government. Questions over the ways in which Government take and control could be increased had bedeviled the Conservatives, who wrestled with a conflict between their desire to secure Britain's supply and increase the financial benefit of North Sea oil and their pro-business instincts. Labour would have an easier time with this issue, but other considerations would continue to make the expansion of State control over the North Sea less of a cut-and-dry issue than it might first appear.

Both the Heath and the Wilson Governments had to balance the desire to strengthen North Sea oil's contribution to the British economy and security with the need to continue attracting private investment, lest the exploration and development program required to reach full production fall behind schedule. On top of this were also considerations of international and European law and the need to avoid running afoul of new international cooperation agreements. Finally, there was the difficulty of setting up a Government body to oversee the Government's own interests in the North Sea – the size, shape and scope of which would likely have a profound impact on the future of Britain's most prized resource.

While the tension between these issues tripped up the Conservatives, many assumed Labour would be able to move more decisively. While Labour was in disarray

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in other policy areas, it seemed, on the surface, that their stance on energy issues was well-developed. Their Manifesto commitment was clear and many of the ideas that had emerged in the first Wilson Government regarding a National Hydrocarbon Corporation had been developed in more detail. But what these observers did not realize was that the internal divisions within the Labour Party would manifest themselves in the new Government's decisions regarding the North Sea.⁸ These differences, both ideological and personal, would mean that the Labour Government's actions in the North Sea would be anything but decisive. This disunity at the top allowed for officials and representatives of the oil companies to chip away at the more radical elements of the Government's plans and to moderate the final strategy for the Government's control of and take from the North Sea. Even the penultimate step in the Labour Party's plans to exert control over the natural resources of the North Sea, the creation of the British National Oil Company (BNOC), was beset by disagreements and a lack of clear vision. Thus, even as the State stood at the precipice of complete control over Britain's oil industry, doubts about its competence, its ability to raise capital and its capability of managing oil affairs divided ministers, ultimately preventing transformative change from taking root.

Conservative Control

⁸ For the internal struggles of the Labour Party see David Coates, *Labour in Power?: A Study of the Labour Government 1974-1979* (Longman Group, 1980); Cronin, *New Labour's Past*.

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The process that would eventually culminate in the creation of BNOC and an attempt at unprecedented State involvement in the oil industry saw its genesis during the Conservative Government of Edward Heath. As was highlighted in Chapter 7, the reevaluation of the State's take from the North Sea actually began in earnest in February, 1973. These efforts resulted in the creation of the GEN 182 Committee headed by Heath himself. This committee had considered three main ways of increasing the fiscal benefit of North Sea oil production to the British economy. The first two were different forms of taxes, the Severance or Barrelage Tax and the Excess Revenue Tax (ERT). The Severance Tax was a payment that would be levied on each barrel of oil produced from the North Sea, while the ERT would set an acceptable level of profit which could be derived from a field based on the cost of development, and place a percentage tax on any profits made above that level. The third option was the imposition of Carried Interest (CI) on North Sea oil production. According to a strict definition of the concept, CI would result in the Government taking possession of a percentage of any field proven commercially viable. In exchange, the Government would compensate the company which had explored and developed the field the costs spent on the field.⁹ This option had two sub-categories, however. It was considered fairly simple to include provision for CI in new licenses, but how to incorporate it into already existing licenses without appearing confiscatory was another question, one which the Conservatives had a difficult time answering.

⁹ Taking up to 50 percent was generally considered feasible.

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Throughout the summer of 1973, Heath and his colleagues weighed the options and debated their merits and drawbacks. Little progress was made and several outside consultants, including Walter Levy, were summoned to help clarify the feasibility of the different plans. Levy worked closely with Lord Victor Rothschild of the Central Policy Review Staff (CPRS) and made it clear that “a Barrelage Tax (called Severance Tax) was not on.”¹⁰ His rationale was that adding a tax to every barrel of oil produced would simply appear to be a surreptitious way of increasing the royalty payment and would most likely be struck down in a court.

Then again, the other two options were even trickier. According to Levy it was difficult to “foresee the movement in world oil prices” and therefore, he argued, it would “be very hard to set tax rates at a level that we can be sure will not discourage further investment.”¹¹ In addition, he contended, the ERT “might provoke the OPEC countries (even if they are going to do this in the long run anyway) to make an early move against the very large profits the companies still earn there.” CI on the other hand had several positive attributes, including the fact that it left “the companies' rate of return on commercial fields unchanged,” and increased “the power to influence or control operations.” There was also the fact that some form of it had already been “adopted by most other oil-producing countries,” and that it was “the only practical way of getting a really high share of profits for the Government.”¹²

¹⁰ PREM 15/1467, NA, Meeting, Prime Minister - Lord Rothschild, 24.8.1973, August, 1973.

¹¹ PREM 15/1467, NA, North Sea Oil: Note by Officials, 31 August, 1973.

¹² Ibid.

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But CI carried its own difficulties. Levy and the other consultants believed that CI could be applied to new licenses with little difficulty. Applying it to already established licenses would be more problematic. Unilaterally changing the terms of licenses could be “represented as close to nationalization,” making the British Government look hypocritical for resisting similar moves by OPEC states against BP and Shell’s concessions elsewhere. It would also provoke a severe backlash from the firms. But Levy’s biggest concern with any form of CI was the fact that “he did not believe Whitehall had the expertise to take a serious interest in a major oil operation.”¹³ It also raised the question of whether Britain’s carried interest rights should “be administered by the Government direct, by a new body set up outside the Government, or by a BGC [British Gas Corporation] subsidiary.”¹⁴

As clear as Levy’s analysis of the situation was, it did little to help Heath and his ministers decide which course to take. Rothschild, in a letter to Heath’s Private Secretary Robert Armstrong, described the problem as “intractable” but sought to find a way forward by presenting two plans he called Hybrid I and Hybrid II. The first plan would allow the firms holding North Sea licenses to choose whether to accept ERT or CI, the thought being that some would welcome the ability to recoup part of their investment quickly in the form of the Government’s repayment of their exploration and development costs. But Rothschild suspected that most of the larger companies would opt instead for ERT. Thus in Hybrid II the Government would have discretion in imposing ERT or CI

¹³ PREM 15/1467, NA, Meeting, Prime Minister - Lord Rothschild, 24.8.1973, August, 1973.

¹⁴ PREM 15/1467, NA, North Sea Oil: Note by Officials, 31 August, 1973.

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on a particular license depending on what would most beneficial in any given circumstance. These plans seemed to advance the process, but the report was not presented until 15 October in the midst of a new and more pressing crisis.

Hence North Sea oil policy was no clearer than it had been before the process of reevaluation when the October War of 1973 and the subsequent Oil Crisis changed the tone of the conversation. The production cutbacks by the OAPEC members turned the issue of the North Sea away from one that solely focused on maximizing the Government's financial benefit towards one of the security of Britain's oil supply.

In the short-term, this turned the Government's attention toward ways of expediting production from the North Sea. BP's Forties Field had been undergoing development since its discovery in 1970 and was due to come online in 1975. The question of whether this deadline could be moved forward instantly sprang to mind following OAPEC's announcement on 17 October that it would be cutting back its production. During his meeting with the chairmen of BP and Shell, Sir Eric Drake and Frank McFadzean, at Chequers on 21 October Heath broached the subject. Both the oilmen attempted to pour cold water on the idea, citing numerous problems the companies had encountered in getting the fields in the North Sea to a production stage. These included shortages of steel, difficulty in retaining trained staff such as welders, and labor unrest amongst the crews constructing the production platforms. This discouraging news, along with the firms' refusal to spare Britain from equal misery, frustrated Heath

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but a detailed report on the subject confirmed the oilmen's view and offered little scope to advance production by any significant rate.¹⁵

The crisis had another effect on North Sea issues as well. Chaos in the international oil industry brought about by the OAPEC action along with the simultaneous large rise in prices gave greater impetus to the idea of imposing Carried Interest. The same forces that had compelled Heath to make his request at Chequers and had caused his Government to explore bilateral deals with oil producers also pushed the Conservatives to consider more robust control over the North Sea. The Cabinet Secretary, John Hunt, wrote to Heath that "the last two weeks in the Middle East seem likely to make oil operations in the North Sea more attractive to oil companies, in terms both of price and the stability of the supply."¹⁶ This fact would give the Government more leeway in their attempts to impose a settlement on the North Sea licenses favorable to the State. As Hunt pointed out, not only did CI "offer an earlier return than an excess revenue tax; but it gives the Government a degree of control of the companies' operations under the licence."¹⁷ With this control, the Government could keep its share of North Sea production at home without the need to resort to export controls, thus avoiding potential conflicts with the Treaty of Rome.¹⁸ But even Hunt was still wary of imposing CI directly on the existing licenses. This was a feeling echoed by other members of Heath's

¹⁵ CAB 134/3702, NA, Working Party on Oil Supplies: Possible ways of Speeding up UK Offshore Oil Production, 5 November, 1973.

¹⁶ PREM 15/1467, NA, Letter from Hunt to Heath: North Sea Oil, 23 October, 1973.

¹⁷ Ibid.

¹⁸ The Treaty of Rome, signed in 1957, is the foundational document of the European Economic Community and established the Common Market between all signing states.

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Cabinet who feared that “opinion among the Government's supporters might well consider the preference of CI to ERT as uncharacteristic of a Conservative administration in encouraging interference with the companies' operations.”¹⁹

As the crisis deepened, debate over CI vs. ERT or Hybrid I vs. Hybrid II gave way to more basic decisions over the control of exports –the Government’s ability to suppress the price of North Sea oil and the advisability of such an action. There was also the equally important issue of a common European energy policy and the need to work to extract concessions from the EEC, should North Sea oil be included in any emergency planning. But each of these problems seemed to address only symptoms of the overall issue of the Government’s role in the North Sea and each debate seemed to bring officials and ministers closer to embracing the concept of CI. At the third meeting of the GEN 182 committee, ministers argued that the answer to the problems of price and exports “appeared to lie in imposing a carried interest regime, which would entitle the Government to determine directly the disposal of part of the oil, and to influence the disposal of the rest.”²⁰ With this in mind, there appeared to be general agreement among all Departments involved that “CI should be taken on licenses to be negotiated at the licensee's option, as well as on future licenses, with ERT being waived in both cases.”²¹ But this would only address a small fraction of the licenses and for hardly any of the most promising areas.

¹⁹ CAB 130/698, NA, GEN 182(73) 2nd Meeting: Minutes of a Meeting held at 10 Downing Street on Wednesday 24 October, 1973 at 10.30 am., 25 October, 1973.

²⁰ CAB 130/698, NA, GEN 182(73) 3rd Meeting: Minutes of a Meeting held at 10 Downing Street on Wednesday 5 December, 1973 at 5.15 pm, 7 December, 1973.

²¹ Ibid.

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The fear of imposing CI on existing licenses remained strong and the debate in the committee was intense. Those opposed to CI warned that “A regime of this kind would be a recipe for confusing conflict between the Government and the companies; and any conditions which the Government sought to impose on the companies about the disposal of the oil produced might well be in breach of the Treaty of Rome.”²² In the end, this division resulted in a decision to send the concept back to officials for further discussion. The lack of decisiveness reveals the difficulties the Conservatives felt over taking what could be construed as an anti-business position on the North Sea. Given that the crisis had created an atmosphere in which the British public had expected some important movement on energy issues, any bold step would likely have received public support.

Thus, to those advocating a strong approach, this dithering was infuriating. Among the frustrated was the CPRS for whom the choice was clear. In a letter to fellow CPRS member Dick Ross, J.R. Guinness discussed the shortcomings of all other alternative approaches open to the Government to the control of North Sea oil, from production to distribution. He argued that “I believe that we should continue to support Compulsory CI as the policy likely to achieve our policy objectives to the greatest extent.”²³ Other members of the Cabinet Office were equally frustrated. One internal Cabinet Office report noted with exasperation that “There is in fact a fundamental conflict of policy about the proper way to use North Sea oil, which has not been resolved,

²² Ibid.

²³ CAB 184/171, NA, Letter from Guinness to Ross: North Sea Oil, 2 January, 1974.

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nor even clearly polarised.”²⁴ With the 14-15 December Copenhagen Summit’s declaration of intent on a common European energy policy, the Cabinet Office felt that the decision on ERT versus CI needed to be made in the context of whether Britain sought to use the resource only for their own benefit or if they intended to put it into the service of the EEC as a whole. They encouraged ministers to think of North Sea oil as “a strategic issue,” and to “look at it in a strategic context, and not when they are preoccupied with short-term or tactical considerations.”²⁵

It was these strategic concerns that ate up much of the discussion over the last month of the Heath Government’s existence. Preparations for the Washington Energy Conference put the long-term fate of North Sea oil on the back-burner. In the wake of the Conference, attention shifted to whether the new machinery of consumer cooperation would require Britain to pool some or all of its North Sea oil into the common sharing plan. Thus, by the time the Conservatives were beaten in the General Election on 28 February, 1974, no actual decision regarding ERT or CI had been taken.

Labour Plans

But, crucially, the intellectual foundation of CI had been thoroughly laid and examined by the Conservatives and had come to be embraced by key elements of Whitehall. Once in office, Labour planned to waste little time in pursuing its goals of not only increasing the Government’s take from North Sea oil but in having a strong

²⁴ CAB 184/171, NA, North Sea Oil, 11 January, 1974.

²⁵ Ibid.

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Government presence in the actual production of that oil. In this desire they had allies in the CPRS. Lord Rothschild's group had grown increasingly frustrated by the Conservatives' lack of decisiveness on the subject of the future of the North Sea resources. With oil from several of the earliest discoveries due to come online in the winter of 1975, Rothschild realized that whatever decision was taken regarding taxes, carried interest or some combination of the two, it would have to be made quickly.²⁶

The group's thinking had evolved somewhat in the hectic days of February. The intimations of several OPEC states that they might be upping their participation share in their concessions to 60 percent had changed the game in the North Sea by making the idea of 51 percent CI seem much less onerous by comparison.²⁷ But, as had often been the case with this topic, questions remained. In a report finished just days after Labour's election victory, the CPRS started off by arguing that their goal was some form of Government participation/carried interest as this would "give the Government control over the destination of North Sea oil."²⁸ To the CPRS, such control was "vital if Britain is to be assured of the full economic benefit from North Sea oil."²⁹

But according to the Government's Law Officers, the imposition of CI on existing licenses would be illegal unless the Government "provided prompt, adequate and effective compensation covering both existing capital expenditure, interest and an

²⁶ Chief among these was BP's Forties Field, discovered in 1970.

²⁷ Kuwait had made its intentions of pursuing a higher participation share in the months following the October Crisis. Saudi Arabia had made similar noises and Iraq had actually taken steps to nationalize the remaining concessions in the hands of the Western oil companies in December, 1973.

²⁸ CAB 184/171, NA, North Sea Oil: Note by the Central Policy Review Staff, 4 March, 1974.

²⁹ Ibid.

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allowance for inflation as well as future profitability.” This would, of course, be an extraordinary expense and one which would limit the economic return of CI. But crucially, this new regime could be legally imposed if the companies voluntarily agreed to it. Therefore the first option was that “the Government could follow the example of OPEC, and try to negotiate say 51 per cent Carried Interest initially.”³⁰

At the new Ministerial Committee on Energy’s first meeting on 26 March, 1974, the Secretary of Energy, Eric Varley was given the job of figuring out how to get the companies to agree “voluntarily” to CI. The Department of Energy did this over the next week. The paper presented to Varley’s ministerial colleagues noted that “the subject is extremely complex in itself, and is inextricably interwoven with the problem of super-national corporations in general and oil companies in particular.”³¹ Varley highlighted many of the difficulties that would attend the decision on how to proceed with the new North Sea policy. Chief among these problems was the need to act in a legally defensible way. Work on consumer cooperation under the guise of the International Energy Agency with the United States and Britain’s EEC partners was continuing and it would have been politically difficult for the Government to pursue a policy that could be construed as expropriation.³² Such an action could also have sparked retaliation, especially by the United States, on British interests, such as BP’s stake in the Prudhoe Bay Field in Alaska. But having promised in their Manifesto to take a majority share in the North Sea, the

³⁰ Ibid.

³¹ CAB 134/3746, NA, EN(74) 4: North Sea Oil: Fiscal and Other Controls, 2 April, 1974.

³² Several high-ranking members of the Labour Party had also foresworn nationalization of the North Sea before the election, thus limiting their ability to pursue that option. See Gerry Corti and Frank Frazer, *The Nation’s Oil: A Story of Control* (Graham & Trotman, 1983), 94.

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Labour Ministers knew that they could not simply apply CI to new licenses and ERT to the old. Added to the pressure on Ministers was the emerging necessity of placating Scottish public opinion where there was a growing fear that a great national asset would be frittered away to private oil companies.³³ Therefore Varley suggested an aggressive form of the CPRS's Hybrid plan which would see a large ERT placed on all licensees that refused to accept CI.

This proposal met with little argument. It seemed that among the Ministers on the committee there "was general support for a scheme which would combine tax and ownership." But recognizing this would be difficult to sell to the oil industry, the idea of expanding the competence of the State over oil matters proved a top priority. One minister admitted that "Given the wide extent of the North Sea operation, and the expertise required in dealing with the industry, it would probably be necessary to set up a public corporation to supervise the Government interest in the different consortia, possibly using British Petroleum as an instrument to this end."³⁴

Ministers also recognized that the oil industry would not be the only force to contend with in pushing this plan. During the first Wilson Governments, Labour's plans had constantly been moderated, if not frustrated altogether, by cooperation between the oil companies and the civil service, much to the consternation of Lord Thomas Balogh

³³ Adrian Hamilton, one of the preeminent journalists covering North Sea oil and gas would later right with a touch of sarcasm that "So long as oil is but a gleam in the country's eye, all is incentive and welcome for foreign investment and foreign know-how. Once oil is found, the cries change to resentment, greed, and divisiveness within the host country as the politicians quarrel over how the spoil is to be divided." See Adrian Hamilton, *North Sea Impact: Off-shore Oil and the British Economy* (International Institute for Economic Research, 1978), 102.

³⁴ CAB 134/3746, NA, Ministerial Committee on Energy: Minutes of a Meeting held in the Prime Minister's Room, House of Commons on THURSDAY 4 April, 1974 at 5.00 pm, April, 1974.

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and others.³⁵ Therefore, in this new endeavor it was argued that “the traditional arrangements under which negotiations were begun by officials and handed over to Ministers to ratify was open to the objection that Ministers' theoretical freedom of action was all too often circumscribed in practice by the course of the preliminary discussions.”³⁶ The Ministers represented at the meeting thus discussed the idea that it might be “desirable for these negotiations, which were of outstanding importance on the broadest political and economic grounds, to be conducted from the outset at Ministerial level.”³⁷

How easy this would be, and whether it was even possible given the fact that the negotiations would likely be arduous and extensive, was another question. One official was not particularly impressed with the ministers' abilities or their decisiveness. The Cabinet Secretary, John Hunt, wrote to Wilson a day before the meeting regarding Varley's paper, arguing that it “presents the problem well,” but that “the DTI had reached this point a year ago.”³⁸ He went on to remind Wilson that “It is the next step – the formulation of specific proposals – which has so far always proved elusive,” and added that “it must be pinned down now if we are to settle this question by the autumn.”³⁹ Ministers would have nothing to negotiate with the oil companies if definitive plans were not settled. Thus, somewhat ironically, it was the officials of the Department of Energy

³⁵ Balogh was made a Life Peer by Wilson in 1968.

³⁶ CAB 134/3746, NA, Ministerial Committee on Energy: Minutes of a Meeting held in the Prime Minister's Room, House of Commons on THURSDAY 4 April, 1974 at 5.00 pm, April, 1974.

³⁷ Ibid.

³⁸ PREM 16/244, Letter from Hunt to Wilson: North Sea Oil, 3 April, 1974.

³⁹ Ibid.

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that took up the task of boiling down the Ministerial Committee on Energy Policy's views into a workable policy.

By mid-May a working paper, signed off on by Varley, was prepared which "set out proposals for a profits tax on North Sea production, and recommended that the Government should as a rule seek at least 51 per cent participation in all commercial oil fields under both new and existing licenses in the North Sea."⁴⁰ Initiating Government participation through CI on new licenses was easy enough, but Varley's paper proposed several strategies that Whitehall could employ to convince the companies to agree voluntarily to participation in already existing licenses. The first was the previously discussed idea of putting an ERT on all existing licenses and remitting it to a varying extent on those licenses which agreed to allow at least 51 percent Government participation. Varley suggested that "It would not be necessary at the outset of negotiations to quote a particular rate of tax," with the feeling that the specter of an unknown tax might induce the companies to be more compliant.⁴¹

Should this fail, the Department of Energy paper had several other suggestions. The first was that the Government could use some of the powers already granted them by the existing licenses to pressure the companies. One such power was the required Government approval regarding any company's desire to use prospective oil production

⁴⁰ CAB 134/3748, NA, ENO(74) 5th Meeting: Minutes of a Meeting held in Conference Room C, Cabinet Office on Friday 17 May 1974 at 11.30 am, 17 May, 1974.

⁴¹ CAB 134/3748, NA, ENO (74)10: Official Committee on Energy Policy: North Sea Policy, 14 May, 1974.

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as a security against borrowing.⁴² This was how many of the companies, large and small, were financing the development of their existing fields. Threatening to withhold such permission could have been a powerful negotiating ploy. But Varley also had a carrot to go with the stick. He noted that “We could also hold out the inducement that companies willing to accept participation would be looked on favourably in future licencing rounds.”⁴³ Together, he believed that “by these means we should achieve the re-negotiation of most of the licences covering commercial oilfields.” If this were successful, it was the Department of Energy’s estimation that “51% participation should increase our revenue from the North Sea in 1980 from &1,650 million to &2,490 million (assuming no change in current real prices) and our total share of profits from a field over its life from 51% to 75%.”⁴⁴

This dealt with the issue of the Government’s take, but Varley’s real breakthrough came regarding the Government’s ability to control North Sea oil. One early idea which had been floated was the concept of a State buying agency. This would operate similarly to the monopoly buying position of the BGC in regards to North Sea gas.⁴⁵ The idea had many advantages, but they were outweighed by the fact that it would almost certainly have limited the interest of companies in investing further in the North Sea since a

⁴² For instance, a company could offer its prospective oil production of say 200,000 b/p/d which would be valued at the prevailing oil price as security for any new loan being negotiated with the financial sector. But, since the oil technically belonged to the Crown under the terms of the Continental Shelf Act, the pledging of future oil production as security required the Government’s approval.

⁴³ CAB 134/3748, NA, ENO (74)10: Official Committee on Energy Policy: North Sea Policy, 14 May, 1974.

⁴⁴ Ibid.

⁴⁵ The BGC was formally known as the Gas Council or the Gas Board but was restructured by the Gas Act of 1972.

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monopoly buyer would have total control over the price paid for the oil. While he discounted the idea, though, Varley did suggest that the Government not publically reject it since it could be used as a terrifying threat to the oil companies during participation negotiations.

After this initial false start, the real idea that Varley realized that Government control would come through the administration of its participation in the North Sea. Participation not only meant that Britain would accumulate either oil or cash but also that it would be involved in questions of investment, pipeline construction and production programs. It therefore needed a competent authority to make these decisions. Varley proposed that there were four options for this. The first was to give the BGC the mission. The BGC had a large staff and had experience handling negotiations with the oil companies. Varley believed, however, that “The BGC has enough on its hands with gas.”⁴⁶ The second option was employing the Department of Energy. The major drawback of this was that British participation was not just an administrative but also a commercial endeavor, something that a Government bureaucracy was not well-suited for. The third option, and one that was commercially viable, was to use BP as the Government’s agent. But as Varley pointed out, “It might be difficult to control BP, and the importance of complete Government control is paramount.” Thus, the final choice was the one which Varley and the Department of Energy believed would offer the Government its best option. This was a plan to create a new body “perhaps to be called

⁴⁶ CAB 134/3748, NA, ENO (74)10: Official Committee on Energy Policy: North Sea Policy, 14 May, 1974.

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the British National Oil Corporation (BNOC) - whose functions and constitution we can tailor to meet our needs.”⁴⁷ With the BNOC and 51 percent participation Britain would control roughly 57 percent of the oil produced in the North Sea.⁴⁸ As for controlling the rest, Varley’s paper suggested that “Our best course, if we wish to avoid a confrontation as far as possible, is to set up a system which would enable us to control supplies without doing so explicitly or in explicit breach” of the Treaty of Rome.⁴⁹

The White Paper

With this new vision for the State’s role in the North Sea laid out, Varley and his officials argued that there was little time to waste. Legislation encapsulating these plans would take some time and Varley suggested that negotiations should begin with the companies as soon as possible to avoid a united company front against the plan. To break the unity of the firms, Varley suggested focusing on the companies “most vulnerable to pressure – for example, those most dependent on an assured supply of North Sea crude oil.”⁵⁰

The process of turning the paper into policy, and then law, began quickly. The document was brought first to the Official Committee on Energy Policy which approved it and began disseminating it to other Departments and eventually to ministers. Despite

⁴⁷ Ibid.

⁴⁸ They would achieve this due to the 51 percent of oil produced accruing to the Government through participation and the 6 percent which would be a result of the Government’s 12.5 percent royalty being applied to the 49 percent of production remaining in the companies’ control.

⁴⁹ CAB 134/3748, NA, ENO (74)10: Official Committee on Energy Policy: North Sea Policy, 14 May, 1974.

⁵⁰ Ibid.

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some griping from the FCO and the Law Officers that they were not consulted more, there was general approval of the plan. Some fear lingered that there were dangers “in starting the negotiations before having a clear idea of what terms we might wish to achieve,” so the plan was pushed to the top of the agenda for the next Ministerial Meeting on Energy scheduled for 23 May but ultimately deferred until 5 June.⁵¹ This meeting saw some debate over the wisdom of using the threat of ERT to get companies to agree to participation. Some ministers felt that this approach could be challenged in court. However, wide support for the idea of a BNOC remained. Varley’s additional idea that BNOC should be headquartered in Scotland was also approved.⁵² The discussion resolved with the endorsement of Varley’s plans in principle. But the ministers also rejected early negotiations with the companies until the relationship between taxation and participation was fully developed. This was a task which Wilson gave to a small group of ministers with the urging that it be completed within two weeks.

In spite of this slight hedging, the 5 June meeting was still a tremendous step in defining the State’s role in the North Sea. Lord Rothschild, who was nearing the end of his term as the head of the CPRS, was ecstatic with the outcome. He wrote to Wilson the next day that “To me, the meeting was a triumph in that after endless efforts and discussion, a decision has been taken to go for Participation which is synonymous with

⁵¹ PREM 16/244, NA, Letter from Hamilton to Wilson: North Sea Oil, 22 May, 1974. This committee was made up of top members of the Cabinet including Varley, the Minister for Industry Tony Benn, the Chancellor of the Exchequer Denis Healey and the Foreign Secretary James Callaghan. The group was chaired by the Prime Minister himself.

⁵² BNOC’s headquarters was eventually established in Glasgow.

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Carried Interest.”⁵³ But the head of the CPRS’s excitement was tempered by the realization that the oil industry would be very displeased by the plan. He urged Wilson to consider how best to deal with the oil companies, warning the Prime Minister that “if the oil companies wish to turn nasty, there are some things they could do. For example they could appeal to the World Bank (International Centre for the Settlement of International Disputes); to the Court of the Common Market; and to the International Court. They might find reasons for refusing to refine crude oil within the United Kingdom; they might try, or even be able to create a lack of confidence in the UK’s credit-worthiness (as a combined international oil company operation).”⁵⁴

Rothschild was right to be concerned, because the small group that had been charged with the task of hammering out the final details on taxation and participation was drawing nearer to a plan that would go against the oil companies’ interests in multiple ways. On 19 June, Edmund Dell, the Paymaster General, revealed to Wilson that the small group had decided on three major tax elements that would apply to the North Sea. These changes would apply to the standing Corporation Tax and were separate from the ERT. The group decided to “ring fence” North Sea oil production “so that corporation tax on North Sea oil profits will not be reduced by losses and allowances arising out of other activities” by the companies operating there.⁵⁵ Secondly, the group picked up on an idea that had been debated by the Heath Government regarding the ending of the practice of “artificial loss” in which the large companies such as BP and Shell would use

⁵³ PREM 16/244, NA, Letter from Rothschild to Wilson, 6 June, 1974.

⁵⁴ Ibid.

⁵⁵ PREM 16/245, NA, Letter from Dell to Wilson: Taxation of Oil Companies, 19 June, 1974.

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transactions between their different subsidiaries to ensure that some would make most of the profit and others would take most of the losses, depending on the most propitious tax situation.⁵⁶ Dell proposed tightening restrictions on transfer prices between subsidiaries as a way of eliminating, or at least diminishing, this practice. But he and his colleagues also proposed going a step further than the Conservatives in cancelling the ability to use past “artificial losses” against future tax payments. Dell pointed out that British oil companies had racked up £1,600 m. in artificial losses up to December, 1972 and that these losses would only be allowed to be used against tax payments up to some point, perhaps a year, after the legislation was passed. This final point would only apply to British companies, and therefore threatened BP and Shell with a major unexpected tax liability.

This matter came up when the plan was presented as part of the finalized White Paper draft by Varley to the Ministerial Committee on Energy on 27 June. During the discussion of the draft, one participant argued that “In present circumstances it might be of crucial importance for the Government's longer term policies to ensure that the oil companies were given no pretext to decry the measures now proposed, or threaten their

⁵⁶ Simply put, artificial loss was a process by which the companies could manage their tax bill by using their subsidiaries to spread their profits and losses. For instance, the profits made on the production of oil in the Middle East were taxed based on the posted prices of oil, now set by OPEC. Since the tax rate in these countries was higher than Britain, these profits were essentially untaxed by Britain since the companies could claim relief from double taxation. But the companies took advantage of this situation by having their production subsidiaries sell the crude oil to their refining and distributing subsidiaries at the posted price rather than the market price. This meant that when the oil products were sold in their final markets, the prices realized were actually lower than the value paid for the crude. Thus the subsidiaries operating in places like Britain operated at a loss on paper, thus making their operations tax free as well. This resulted in the companies paying very little if any tax to the British Exchequer. See Charles More, *Black Gold: Britain and Oil in the Twentieth Century* (Continuum, 2009), 170.

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withdrawal from the North Sea; and international opinion must be assured that the Government would give effect to its policies equitably and seek participation by consent.”⁵⁷ While this objection was noted, the White Paper draft as a whole was accepted, with Wilson praising Varley, whom he felt “had produced a clear, concise and authoritative statement which admirably expressed the Government's policy in this complex field.”⁵⁸

Rothschild was very concerned that the tough approach to the oil companies might result in some political blowback, particularly as it appeared likely that a new election would be held in the autumn. He wrote to Hunt that he was worried “the oil companies will pull out all the stops before the Election and, for example, threaten to leave the North Sea in order to influence the Electorate to vote Conservative in the hope that the Conservative Government, in exchange for this support will concentrate on ERT and give up Participation.”⁵⁹ He added the same cautionary note he had sent to Wilson several weeks prior by reminding the Cabinet Secretary that “if one goes too far in “punishing” the oil companies, they will start becoming difficult.”⁶⁰ Hunt himself had some apprehension about the plan. He was afraid that the ministers were pushing forward too fast without having all the details nailed down. This could, he worried, result in the new policy sowing confusion. He was especially concerned about the loose ideas regarding BNOC. Writing to Wilson he said, “There is a deep cleavage between the

⁵⁷ CAB 134/3746, NA, EN(74) 8th Meeting, Item 2 Thursday 27 June, 1974 at 5.00 pm, 28 June, 1974.

⁵⁸ Ibid.

⁵⁹ PREM 16/245, NA, Letter from Rothschild to Hunt, 28 June, 1974.

⁶⁰ Ibid.

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functions which the BNOC will undertake to control the industry and those in which it will compete with the industry. But it will be important to avoid institutional schizophrenia.”⁶¹ He asked Wilson, “Is it to be commercially orientated (with the risk of becoming too independent as a result)? or to look on itself primarily as an arm of Government?”⁶²

These concerns aside, Wilson and Varley were content with the paper. The final version was divided into three sections: Government participation and take, Corporation Tax changes, and measures to help Scotland and other development areas. Under the first section, the Government proposed five major changes. First was placing greater tax on profits. Second was the introduction of CI to all future licenses. Third was that the Government would seek majority participation in all commercially viable North Sea fields. Fourth was the announcement of the creation of the BNOC. Lastly, the paper called for new powers for the control of production, the rate of depletion and the laying of new submarine pipelines. Under the changes to Corporation Tax, Varley announced the closure of the various loopholes that Dell had discussed earlier with the Prime Minister. The last section announced the creation of a Scottish Development Authority that would be funded by the Exchequer, presumably from funds accrued from North Sea revenues.

The paper, presented by Varley to Parliament on 11 July, was met with great acclaim by the Labour Party. Wilson was pleased with the announcement and the plan in

⁶¹ PREM 16/245, NA, Letter from Hunt to Wilson, 2 July, 1974.

⁶² Ibid.

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general. On the heels of the Parliamentary Statement introducing the White Paper, entitled “United Kingdom Offshore Oil and Gas Policy,” Wilson sent Varley a note congratulating the Secretary for Energy and encouraged him that “whatever the press reaction, or the political vituperation which may follow the announcement, you have carried through a remarkable achievement.”⁶³ The oil companies, BP and Shell chief among them, begged to differ.

(Re)negotiations

The White Paper and the policies it espoused were bad news for the major oil companies. They had anticipated some uncomfortable changes, but were still shocked by the range and extent of the Government control and taxation being proposed. How to respond, though, was a delicate matter. Robert Belgrave of BP warned his colleagues that, “We need to be clear in our own minds, before we say anything in public, as to what we think about a British National Oil Company, which the Government has announced... their intention of establishing and with which we are invited to co-operate.”⁶⁴ This did not prevent some oil officials from speaking out, however. One Shell spokesman was quoted by the *Financial Times* as stating, “We do not believe State participation would improve either the technical or administrative efficiency of the development

⁶³ PREM 16/245, NA, Letter from Wilson to Varley, 11 July, 1974.

⁶⁴ BP 113110, NA, BNOC Note by R. Belgrave, 16 July, 1974.

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programmes,” and that “participation in existing licences and paying a share of development costs is likely to take a great deal of public money.”⁶⁵

It was these two points that the industry would emphasize over and over again during the coming months. They attempted to build a narrative which would show the Labour Government’s plans for the North Sea being built on ideology rather than practicality. By working to show that Labour’s plans were unnecessary, expensive and perhaps even confiscatory, the firms hoped to undercut support for the plan, or at least to put enough pressure on the Government’s negotiators that they would be more amenable to compromise.

In a memo to his colleagues, Belgrave addressed these points, writing first about the lack of necessity of participation, saying “the Government can secure a proper share of profits by tax arrangements, and can control the development of Shelf resources by its existing powers and by the additional powers it now proposes in any case to take.”⁶⁶ He then turned his attention to arguments that could be made about cost, writing that “there is of course the fundamental question of the cost to the Government of acquiring participation; a cost, incidentally, which seems bound to involve, directly or indirectly, an enormous outgoing of foreign exchange at a critical period for our balance of payments, in respect of the concessions held by foreign based companies.”⁶⁷

But with it seeming likely that the Government would not back down over participation, Belgrave and others planned a different approach. BNOC was still only

⁶⁵ Dafter, Ray, *Financial Times*, 13 July, 1974. Quoted in Corti and Frazer, *The Nation’s Oil*, 99.

⁶⁶ BP 113110, BP, Background Note North Sea Oil Policy, 19 July, 1974.

⁶⁷ Ibid.

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loosely formulated and it was hoped that by presenting arguments about the lack of desirability of true participation, the companies could convince the Government to make BNOC a “brass plate company” i.e. an organization that existed solely to collect the revenues and to sell the bulk crude accumulating to it from the Government’s 51 percent share in the fields. This went against the Labour Party’s thinking, however, which saw BNOC emerging as a fully-fledged oil company in its own right. BP’s A.F. Down sought to address this by writing to Douglas Wass of the Treasury that the firm accepted the idea of taxation in principle, but “the White Paper goes far beyond the North Sea in its fiscal proposals.” He went further to claim that the creation of BNOC and the imposition of Government participation pushed the matter “into what will in effect constitute a blow at BP’s position as an international trading company.”⁶⁸

The Parliamentary recess allowed both sides time to hone their arguments in preparation for negotiations which were due to begin in the autumn. The Government moved forward with ideas on the structure and level of the new tax that would be placed on North Sea profits which came to be known as the Petroleum Revenue Tax (PRT).⁶⁹ The plan was, however, to keep the specifics of the PRT from the companies until negotiations were underway. The same was true of the Government’s oil depletion policy which would regulate the later stages of North Sea production in the 1990’s and beyond.

⁶⁸ BP 10483, BP, Letter from AF Down to DWG Wass, Permanent Secretary, the Treasury, 22 July, 1974.

⁶⁹ For a detailed analysis of the development of the PRT see Alexander G Kemp, *The Official History of North Sea Oil and Gas*, vol. 1 (Routledge, 2012), 297–340.

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But the real focus of ministers and officials during the summer and early autumn was the preparation of a strategy for negotiations with the companies. Varley knew that he needed to be wary of the narrative being promoted by the oil companies. Labour's negotiating strategy needed to be tough but also politically savvy and one that would show the Government to be reasonable partners rather than confiscatory adversaries. Even so, this did not mean that Varley planned to go soft on the companies. One early key decision made by Varley was that the Government would negotiate with the firms individually rather than collectively.⁷⁰ This strategy would allow ministers to "concentrate on those licensees most likely to concede participation because, for example, they are most dependent on North Sea oil, or feel that they are very dependent on favours from the Government."⁷¹ By dividing the companies, Varley was hoping to build momentum that would pressure those firms in a stronger negotiating position to relent before major concessions needed to be granted. Varley knew that the companies would resist participation but would also expect some benefit if they relented. He therefore planned to "ensure that those licensees who accept participation are at least no worse off than those who refuse."⁷² This phrase, "no worse off," was uttered by Varley in several speeches but would come to have even greater significance in the upcoming negotiations. The companies would latch on to the concept to an extent that Varley never intended and would make it a centerpiece of all conversations going forward.

⁷⁰ The companies had organized in 1964 a loose association known as the United Kingdom Offshore Operators Association to coordinate the needs and interests of all the firms working the Continental Shelf. See Guy Arnold, *Britain's Oil* (H. Hamilton, 1978), 77.

⁷¹ CAB 134/3747, NA, EN(74) 49: Re-negotiation of North Sea Licenses, 10 September, 1974.

⁷² Ibid.

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The preparations for these negotiations were briefly delayed, however, by Wilson's announcement, made in September, that a second General Election would be held on 10 October, 1974. After governing with a hung Parliament since February, Wilson believed he had the chance to strengthen his position. But the prospect of the election also hung over the approaching North Sea negotiations. Wilson and the ministers involved in the preparation of the PRT, the depletion policy and the negotiating strategy all agreed to hold their plans close to their vest to prevent any information about Labour's vision from being used as election fodder. If Labour lost, its plans would effectively be neutralized, but if the election returned a similar result, the companies could find themselves in a stronger position to resist some of the more onerous demands of Varley and his negotiators. An outright Labour victory, however, would mean that there would be little to stop Labour from pushing for as much as they wanted.

There was little doubt which outcome the companies preferred. Certainly there was little love lost between the firms and Edward Heath, but his Conservative Party was their only chance of escaping participation. The Conservative Manifesto embraced many of the arguments being put forward by the oil companies such as the rejection of 51 percent carried interest/participation as too expensive. It also argued that increased Government take and control could be achieved through taxation and regulation. It was a plan described by Varley as "a continuation of the dismal failures of the previous administration which handed over this new and vast national resource to mainly foreign

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companies for uncontrolled exploitation and profit making.”⁷³ Unfortunately for the companies, the vote resulted not in a Conservative victory but in a very modest victory for Labour who returned with a tiny three seat majority.⁷⁴

With the matter decided, both sides prepared to head to the negotiating table. While Varley remained in charge of the Government’s negotiating strategy, it was decided that he should not lead the actual negotiations. As Secretary for Energy, Varley was supposed to be seen as the steward of all Britain’s energy sources and tying him too closely to the North Sea was seen as potentially damaging to relations with the coal industry. Therefore the actual negotiations were to be led by Harold Lever, the Chancellor of the Duchy of Lancaster, assisted by officials from the Department of Energy, the Paymaster General Edmund Dell who would handle negotiations over PRT, and the Minister of State for Energy Lord Thomas Balogh.⁷⁵ This team had agreed that negotiations needed to start with the so-called “Big Three” – BP, Shell and Esso – even though the Government knew that these companies would be difficult to persuade. It was feared that “to start elsewhere would look strange and might antagonize these three,” and

⁷³ PREM 16/607, North Sea Oil and the Election, 24 September, 1974. See also Corti and Frazer, *The Nation’s Oil*, 97.

⁷⁴ Labour received a little over 39 percent of the overall vote.

⁷⁵ Teaming Lever with Balogh was a calculated move by Wilson whose top priority in the negotiations, as in almost every move he made, was to maintain the unity of the Labour Party above all else. By choosing Lever, who hailed from the extreme right of the Party to lead the negotiations, Wilson had given the companies someone they felt comfortable working with. But putting Balogh into the discussions as well, Wilson ensured that the Party’s left would feel that their interests were being defended. Balogh had used the period that Labour was in opposition to publish a series of articles which condemned Britain’s oil policy and laid out a vision for a greater return for Britain from North Sea oil. The two were actually old friends and both hoped their partnership would bring great benefit to Britain. See June Morris, *The Life and Times of Thomas Balogh: A Macaw Among Mandarins* (Sussex Academic Press, 2007), 168–169.

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would expose their strategy of dividing and conquering thus setting discussion off on the wrong foot.⁷⁶

Preliminary talks began in November, 1974. BP was the first company approached by the negotiating team and the initial talks revolved mainly around what the Government envisioned for the future of North Sea oil production. Lever started off the meeting by insisting that “this was not a ‘marauding venture’” but that “they hoped and intended to settle the future structure of British Oil production in partnership with the Companies.”⁷⁷ He went on to state that the guiding principle to achieve this partnership would be “(i) that the oil companies ought not to be out of pocket but (ii) that equally there was no reason why HMG should fortuitously add to their profits because of its wish to participate in this way.”⁷⁸ In discussions with Esso the next day, Lever made it clear that participation was not up for negotiation, stating that “it was a political objective determined by the Cabinet and his remit was to negotiate accordingly.”⁷⁹ Sir Eric Drake, leading the negotiations for BP, responded to this opening debate by agreeing that the companies could not object to participation in principle since it was within the rights of the Government, but that such action would be impractical and damaging to the long-term development of the North Sea and to BP’s prospects in particular. Drake alluded somewhat threateningly that “he was concerned at approaches made to him by American

⁷⁶ CAB 197/68, NA, NSRC(74) 1: Participation Negotiations, 28 October, 1974.

⁷⁷ BP 113110, BP, HMG Participation in U.K. Continental Shelf Oil Fields: Meeting at Cabinet Office – 28th November 1974, 29 November, 1974.

⁷⁸ Ibid.

⁷⁹ CAB 197/68, NA, Participation Negotiations: Note of a meeting between the Chancellor of the Duchy of Lancaster and Esso - 3.00 PM on Friday, 29 November, 1974, 2 December, 1974

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Oil Companies who had doubts as to the confidence they should have in the British Government,” and expressed fears that Government involvement in operational decisions under the aegis of BNOC would slow down development.⁸⁰

Similar concerns were expressed by the other major firms but by and large this first round of negotiations was friendly and clearly delineated the opposing views regarding participation. Simultaneous discussions regarding the PRT were showing similar divisions between the Government and the companies but also reflected some positive movement. The firms did not, by and large, reject either participation or the PRT in principle, but it was the combination of the two that caused the most unease. Drake pointed out to Lever that should the Government proceed as planned, it would take 75 percent of the profits from the North Sea. Little did Drake imagine his estimate, meant to show how ridiculous he thought the Government’s proposals were, was actually short of the mark. Varley and others thought that an 80 percent take was an appropriate number to aim for. This division would make for rough negotiations in the new year.

Internal Divisions

Another thing that Drake did not realize was that he had a sympathetic ear on the Government’s side who shared his view that the Government’s demands for both

⁸⁰ BP 113110, BP, HMG Participation in U.K. Continental Shelf Oil Fields: Meeting at Cabinet Office – 28th November 1974, 29 November, 1974. Drake also expressed concern about the safety of BP’s assets in Alaska from American retaliation. But most importantly Drake made it clear that BP could not lead the way in negotiations with the British Government due to the special nature of their relationship and the fact that BP should not be seen to be “a leader in making a deal which might be read as representing Government pressure on the foreign companies.”

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participation and the PRT were excessive. This figure was not to be found amongst the companies' traditional allies in the civil service but in the person of Harold Lever himself. The Chancellor of the Duchy of Lancaster, the head of the Government's negotiating team, was privately very sympathetic to the oil companies' position. In an extraordinary move, Lever invited Drake to visit him at his private residence to discuss the course of the negotiations.⁸¹ There he told the BP Chairman that "he regarded participation as doctrinal nonsense," and that "he accepted totally that it was likely to be damaging both to the interests of the country and, in his view, to the financial yield to the State."⁸² Because of this fact, Lever suggested that he and Drake work out a framework agreement that would satisfy Labour's political need for participation, but one that would not damage the fiscal standing of the companies involved. Q. Morris, who recorded the meeting for BP, noted that Lever "was at pains to say that he rejected the theology of his colleagues over participation but on the other hand he had no intention of being soft in financial terms of Government take."⁸³

This was extremely good news to BP and by extension the other oil companies, but how far Lever's views counted was another matter. Lever was on the right of the Labour Party and was viewed with distrust by those on the left. As a multi-millionaire investor who lived in a 22-room flat on Eaton Square, Lever was not a typical Labour leader. Interestingly, however, the man most suspicious of Lever's intentions was not a left-winger like Tony Benn or Michael Foot but the moderate Secretary for Energy, Eric

⁸¹ Lever would subsequently invite the heads of other companies to meet with him privately as well.

⁸² BP 113110, BP, Record Note – Meeting between Harold Lever and Drake, 18 December, 1974.

⁸³ Ibid.

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Varley. In January, Varley wrote to Wilson regarding concern on his part that Lever had been sending signals through the press that the Government would ensure that companies which accepted participation would suffer no financial loss. Varley argued to the Prime Minister, “it is true that we have offered terms to the companies along these lines,” but the immediate result of Lever’s words was “to arouse the suspicions of our supporters that we were selling the pass.”⁸⁴ He went on to add that one company had concluded from Lever’s comments that there would be no adverse impact on them should they refuse participation. To Varley, this meant “of course throwing away one of the best cards in our hand.” He continued, “if it becomes public people will wonder whether we really want participation at all.”⁸⁵

Lever defended himself by arguing that it would be imprudent to argue one thing in private with the companies and another thing in public.⁸⁶ But his sympathies towards the company position did not diminish. These sympathies were appreciated by BP for, during the course of negotiations, their position vis-à-vis the Government would take a rather dramatic turn. At the end of December, the Treasury received a rather urgent entreaty from the board of the Burmah Oil Company. This firm, long a distant third in terms of size and importance for the British oil industry, had run into serious financial difficulties and was at risk of defaulting on a major loan granted to it by a group of

⁸⁴ PREM 16/607, NA, Letter from Varley to Wilson, 24 January, 1975.

⁸⁵ Ibid.

⁸⁶ This was a somewhat ironic argument, considering the opinions expressed in his private meetings with BP.

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American and other foreign banks.⁸⁷ Officials pointed out that aside from the embarrassment of having a major British company collapse, Burmah's default and liquidation could have major consequences for the Government. First, the fact that the loan was in US dollars meant that if the Government took no action, "this would seriously undermine international confidence in sterling."⁸⁸ Secondly, Burmah was a major participant in two North Sea fields; if it collapsed just at the point of North Sea oil coming online, there "could be a serious risk of delaying North Sea oil production and to the confidence of investors in it."⁸⁹

Rescuing Burmah would be a costly endeavor but luckily for the Government, the firm had two very large assets. First, Burmah was a major stakeholder in the Ninian Field in the North Sea, the largest field to date after the Forties Field. They also had holdings in the smaller Thistle Field. The second asset was equally important; since 1914, Burmah had held between 20-25 percent of BP's stock, with current holdings hovering around 20.5 percent, making it the largest stockholder of BP after the Government.⁹⁰ On top of this, the Company owned a small percentage of Shell's stock as well. These assets made Burmah an intriguing problem. There were three possible approaches: they could break up Burmah and sell its pieces to pay back the creditors, they

⁸⁷ The two largest lenders were Orion Bank and Chase Bank which were together owed roughly \$420 m.

⁸⁸ PREM 16/474, Letter from Rampton to Armstrong: Burmah Oil, 30 December, 1974.

⁸⁹ Ibid.

⁹⁰ The Anglo-Persian Oil Company, BP's forebear had actually at one time been a subsidiary of Burmah, but most of Burmah's shareholding in that company was sold to the Treasury as part of the 1914 deal. Burmah's remaining shareholding had fluctuated due to their decisions to take up or not take up various rights issues offered by BP.

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could encourage BP to acquire Burmah and thus consolidate the British oil industry, or the Government itself could rescue the company.

The Government initially wanted to avoid the final option. In a meeting between the Governor of the Bank of England and the Chancellor of the Exchequer, Dennis Healey, Healey suggested that they to encourage a takeover by BP or perhaps even Shell of Burmah.⁹¹ Healey, on the right of the Labour Party, wanted to avoid any further temptation for interference in the affairs of BP. But others in the Government saw this as an opportunity to strengthen the State's position in the industry in general and in the participation negotiations in particular.

When urgent discussions with Shell and BP revealed that neither company had the wherewithal to rescue or buyout Burmah, the Government option gained momentum. By the end of December, Healey, Varley and Wilson had agreed to a plan wherein the Bank of England would guarantee Burmah's loans in exchange for two major concessions. First, Burmah's 20.5 percent holding in BP would be transferred to the Bank of England as security and second, Burmah would agree immediately to 51 percent participation in both its Ninian and Thistle Fields. This plan was accepted by Burmah but brought a furious reaction from the company's other creditors who believed that by taking BP and Shell stock as their own security, the Government had weakened the security of those who were still owed money. In response to this, the Government altered the plan slightly in January, 1975, but in a way that would have even more consequences. Instead of

⁹¹ Having Shell involved was, on reflection, undesirable since it would have given Shell a 21 percent interest in its rival, BP. See PREM 16/474, NA, Burmah Oil, 24 December, 1974.

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using the BP and Shell stock as security, the Government decided that the Bank of England would buy the stock outright and thus provide Burmah with a cash infusion that could be used to satisfy their creditors, should their loans be called in.⁹² This plan was accepted by all sides, with the caveat that the Bank had decided against the purchase of the small amount of Shell stock, instead focusing entirely on that of BP.

The Government was to acquire this stock for a good deal. Shares of BP had fallen precipitously since the October War in 1973 from around £6 a share to £2.30 a share. The price had fluctuated since details of the Government's rescue had emerged at Christmas and ministers decided to pay an average of the stock's price over the previous month in order to more fairly represent its true value. But at least one member of the Cabinet believed that this was not good enough. Harold Lever wrote to Wilson that he believed "this price is unrealistically low and represents unfairly harsh treatment of Burmah."⁹³

Lever's concerns marked a by now all-too-familiar split within the Cabinet and the Party. When the sale of the shares went through, attention then turned to the question of what to do with them. Radical elements saw the possession of 48 percent of BP's stock by the Treasury and 20.5 percent by the Bank of England as a golden opportunity to strike a blow for socialism by nationalizing BP and all of its assets. This plan had few if any backers in the Cabinet; even Tony Benn, then the Minister of Industry who was

⁹² The Bank purchased 77,817,507 ordinary shares of the British Petroleum Company Limited.

⁹³ PREM 16/474, NA, Letter from Lever to Wilson, 22 January, 1975.

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known to favor greater state intervention and control in the economy, did not back such a plan in early 1975.

But slightly less radical visions also persisted. One such idea was for the Treasury to buy the Bank's shares and therefore hold nearly 70 percent of BP. The rationale was that this would allow for the Government to control BP in the event of another oil crisis in the Middle East and would fulfill Heath's ambition of having BP provide Britain with preferential treatment. This idea was disputed by those who argued even a 70 percent ownership of BP would not guarantee that the board of the Company would cooperate, not to mention the fact that by signing onto the International Energy Program and being a member of the International Energy Agency meant such preferential treatment would be impossible anyway.⁹⁴

On the other side were those led by the Chancellor of the Exchequer Dennis Healey who felt that the stock should be disposed of as soon as it was feasible. Healey believed that "if HMG owned 70% of BP, the effects would all be disadvantageous."⁹⁵ Healey was supported in this view by Eric Varley, but with one major caveat. Varley believed that the potential of a massive Government shareholding in BP would be a powerful lever in negotiations with the Company. Writing to Healey, Varley argued, "I feel bound to tell you that I think the potential influence that our control of this shareholding provides in the context of participation negotiations is, at present, a vital

⁹⁴ See Richard Scott, *IEA the First 20 Years*, vol. 1 (OECD/IEA, 1994).

⁹⁵ PREM 16/474, NA, Letter from Healey to Varley, 14 February, 1975.

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and overriding consideration which precludes early disposal of the shares.”⁹⁶ This argument was supported by Lever and the Foreign Secretary James Callaghan, who both believed that the shares should ultimately be disposed of but not until BP agreed to participation.

This was exactly the course that the Government chose to pursue. In discussions held on 25 April, between Varley and Sir Eric Drake, the Secretary of State for Energy used this negotiating ploy to great effect. Warning Drake that “he was under increasing pressure in the Parliamentary Labour Party (and even more so in the Party at large) to use the Government's majority holding (including the ex-Burmah shares) to enforce participation,” Varley pressured Drake to agree in principle to the idea of participation.⁹⁷ According to Drake, Varley “said that he was being very much pressurized by his left-wingers (my Marxists, he said) over the BP/Burmah stockholding and hinted indirectly that unless I could collaborate by giving him an indication that we were discussing the subject of participation together, we might as well say goodbye to the BP/Burmah stock, as the left-wing wanted the Government to take them over.”⁹⁸ When Drake hesitated, “the Secretary of State rejoined that it was politically impossible for him in present circumstances to agree to the disposal of the ex-Burmah shares” and added that “it would be difficult in any circumstances for him to go below a 51% holding in BP, and quite impossible if participation in BP's operations on the Continental Shelf was not

⁹⁶ PREM 16/474, NA, Letter from Varley to Healey, 18 February, 1975.

⁹⁷ T 319/2911, NA, British Petroleum: Participation, Petroleum Bill, Ex-Burmah Shares Etc: Discussion with Sir Eric Drake on 25 April 1975, 25 April, 1975.

⁹⁸ BP 113109, BP, Record Note of Meeting with the Rt. Hon. Eric Varley on Friday, 25th April, 1975, 13 May, 1975.

achieved.”⁹⁹ Given this choice, Drake agreed to let the Government announce that its negotiations with BP had moved on from matters of principle and onto terms.

At nearly the same time, the Government’s North Sea policy experienced another major triumph. The Petroleum and Submarine Pipelines Bill was published for debate in April, 1975 and formalized the creation of the BNOC as well as laying out numerous powers for the Government over safety, regulation and depletion policies.¹⁰⁰ This, together with the Oil Taxation Bill and the announcement of the terms of PRT which had been made in February, the Petroleum and Submarine Pipelines Bill legalized the Government’s increased take and increased control over its North Sea assets, creating a framework for the use of these powers. But to fill in this framework, individual participation deals still needed to be struck with the firms operating in the North Sea. With Burmah agreed and BP moving towards agreement it seemed that Labour had finally overcome the major obstacles to the achievement of its Manifesto commitments.

Bête(s) Noire(s)

But as the negotiations dragged on, another problem emerged for the Labour Party. Another crucial aspect of the Party’s Manifesto from the October, 1974 election was a plan to hold a referendum on Britain’s continued membership in the EEC.

⁹⁹ Ibid.

¹⁰⁰ The debate over this bill was contentious. Corti and Frazer describe how both sides were being fed information, with the Government from its officials and the Conservative Opposition by the oil companies. Patrick Jenkin, the Shadow Energy Secretary even took a fact-finding trip to the United States during the course of the debate, paid for by contributions from the oil industry. See Corti and Frazer, *The Nation’s Oil*, 108–119. By the time the Bill was enacted in November, 1975, 71 amendments had been tabled. See Kemp, *The Official History of North Sea Oil and Gas*, 1, 381.

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Although a supporter of British membership, Wilson himself had argued that Britain had not gotten a fair deal under Heath, and the Labour Party in general felt that EEC membership should have been voted upon by the British public.¹⁰¹ After renegotiating the terms of Britain's membership, Wilson prepared to bring the question to the public.

This was all well and good except for the fact that as in many other areas, the Labour Party, and the Labour Cabinet in particular, were deeply divided over the issue of Britain's continued membership. The pro-membership faction was led by the Home Secretary Roy Jenkins who had the tacit support of Wilson, while the anti-membership faction was championed by the Minister for Industry, Tony Benn. A referendum was announced in April and the vote scheduled for 5 June. The debate divided the Cabinet and ate up much of the useful time for the weeks leading up to the vote, during which time Wilson took the hitherto unprecedented step of suspending collective Cabinet responsibility, allowing his Ministers to campaign freely and vote their conscience. The spirited campaign was fierce and frayed relationships within the Party, particularly between Benn and Wilson. The final result returned a 67 percent majority for the pro-EEC position, leaving Wilson triumphant but Benn unrepentant.

The defeat of the anti-EEC movement was dispiriting for Labour's left-wing and this situation grew even worse when only a few days after the referendum Wilson announced a Cabinet reshuffle. The Prime Minister had been mostly magnanimous in victory but he took the opportunity to remove Benn from his politically important post at

¹⁰¹ In fact, the Foreign Secretary James Callaghan had renegotiated some of the terms of Britain's membership in early 1975 which were only accepted by Parliament through the strong support of the pro-EEC Conservatives. See Coates, *Labour in Power?*, 231.

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the Ministry of Industry. But Benn was still a vital figure on the left and Wilson could not summarily dispatch him, so he therefore offered to swap Varley to Industry and give Benn the Department of Energy. Benn was, by all accounts, very displeased by this turn of events but decided to take the post.¹⁰² Although this move was widely viewed as a demotion for Benn, it changed the dynamics of the North Sea negotiations by taking the right-leaning Varley out and replacing him with a left-wing firebrand. Benn would soon carve out an important niche for himself at the Department of Energy and seek to place his stamp on the ongoing participation negotiations.

Benn's appointment caused a stir in the oil industry and worried many oil company officials. This was despite the fact that No. 10 combined the announcement of Benn's new position with reassurance that Lever would remain in charge of participation negotiations. BP in particular feared what having Benn at the Department of Energy would mean for them. Writing in an internal memo to his colleagues, Robert Belgrave stated that "More than most leading politicians, Mr. Benn's style and political philosophy is distinctive."¹⁰³ This distinctive style would probably translate into some serious challenges for BP. Belgrave noted that Benn's new position could result in a renewed push to speed up the creation of BNOC and a definite move to create a downstream presence for the new national company. Benn's position also meant that North Sea policy would now take a decidedly Britain-centric turn as depletion policy, equipment purchasing policies and prices would be shaped towards Britain's specific needs rather

¹⁰² Benn's own account of the turn of events makes for entertaining reading. See Tony Benn, *Against the Tide: Diaries, 1973-77* (Hutchinson, 1989).

¹⁰³ BP 113114, BP, Mr. Benn: Some Policy Issues for BP, 26 June, 1975.

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than a broader European approach. This was not to mention the probability of Benn pushing for full unionization of oil rig workers. Finally, Belgrave worried that the deal with the Government regarding the former Burmah share of BP's stock might be threatened. He noted that "the disposition of the Burmah shareholding is strictly a Treasury matter and one which, like participation, will in the end be decided by the Cabinet, but it is inevitable that Benn will have some influence in these decisions."¹⁰⁴

Belgrave's offered two stark options as to how to face this new situation. Benn's primary goal would be to create a real and vibrant BNOC, and BP could either seek to cooperate fully with this endeavor in the hopes of neutralizing the worst effects of BNOC's rise or at least finding some way of profiting from it – or BP could take the riskier approach of rejecting all cooperation with BNOC in the hopes that it would struggle to achieve Benn's goals for it and therefore become a political liability for the Labour Government.

Belgrave was correct to be worried about BNOC. Since the larger participation negotiations were in the hands of Harold Lever with the strong backing of the Treasury, Benn would have limited influence over the course of those talks. But the creation of BNOC gave him the opportunity to exert influence over the situation, especially over BP. The details of BNOC had been kept purposely vague as the Government itself was unsure exactly what it wanted out of the national company. What was certain is that it would inherit the interests of the National Coal Board and the BGC which included some

¹⁰⁴ Ibid.

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promising production areas.¹⁰⁵ With the publication of the Petroleum and Submarine Pipelines Bill in April and the subsequent debates over it, BNOC came closer to reality. By the time Benn came into the Department of Energy in June, discussions were already underway about staffing the new organization. Benn knew that the most important staffing choice would be for the position of chairman; BNOC needed a strong personality who could drive the disputing ministers towards a resolution on BNOC's future. But he also realized that this individual would need to be someone who commanded respect within both Government and business circles. Luckily for Benn, he already had just the man in mind. Lord Frank Kearton was preparing to retire as the head of the British manufacturer Courtaulds in mid-July, 1975. Unlike most other major business leaders, Kearton maintained a good relationship with Benn and respected the Secretary of State for Energy.¹⁰⁶ On the day before he was due to retire, 21 July, Benn lunched with Kearton and discussed the possibility of him taking on the chairmanship of BNOC. A few days later, on 30 July, Kearton was announced as the chairman-designate. Kearton shared Benn's conviction that BNOC held the key to the Government's role in the North Sea and perhaps to its overall oil future.

This was an important alliance because opinion in other parts of the Labour Party was becoming more moderate. Lever was continuing to push along negotiations over participation in a way that would satisfy the bare minimum of what could be considered a fair reading of the Government's Manifesto pledge. Lever, backed up by Edmund Dell

¹⁰⁵ This decision was later altered to keep an independent interest for the BGC.

¹⁰⁶ The two had frequently interacted when Benn served as the Minister for Technology in the 1960's and later as the Minister for Industry from 1974-1975.

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and Dennis Healey, had grown very skeptical of the original plan for the Government to buy in to the licenses and assume a full 51 percent ownership of the production fields. This course, while politically desirable, would have entailed a massive payout to the oil companies as compensation. Added to this was the fact that over 60 percent of the North Sea licenses were held by foreign firms, meaning that the majority of this large payment would be remitted overseas – a potentially crippling blow to the balance of payments. Lever and those who supported him therefore sought a way to fulfill the principle of participation without involving the actual buying in to the licenses. In this they were aided by BP. Meetings had been held with BP in May and early June which saw the two sides swap proposals for participation. BP's proposal intrigued Government officials in that it offered a plan wherein the Government would receive a 51 percent title to the oil in the license together with a seat on, and a vote in, the operating committee for the license.¹⁰⁷ This would mean that the Government would not “own” 51 percent of the license, but rather that it would have the right to purchase 51 percent of the oil produced from the license. There were some financial sweeteners that BP demanded as part of this, as well as the right for the Company to buy-back all of the participation oil for a number

¹⁰⁷ Gulf and Conoco put forward a similar proposal although with a smaller loan request than BP. But the Gulf/Conoco negotiations were slightly different than those with other companies because the companies shared in several licenses with the National Coal Board. Early on in discussions, Lever and Dell had agreed with other Ministers that the NCB's interests would be immediately assumed as part of the Government's participation share. Therefore to reach the full goal of 51 percent participation in the Gulf/Conoco concession would require the companies to cede only 16-17 percent of their interests.

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of years, but the framework of the plan served as a jumping-off point for further discussions.¹⁰⁸

The main concern of officials was whether such a plan would provide enough political cover to the Cabinet. BP thus wanted to move discussions along before Benn could organize an effective resistance to their moderate compromise. In a meeting with Dennis Healey in July, Drake conceded that “B.P. considered that it was in their interests to sign an agreement on participation on the basis, which had been stated by Ministers, that participation would involve no commercial loss to the companies concerned.”¹⁰⁹ Drake nevertheless pressed Healey to “get the Participation matter moving through his own channels (Dell and Lever),” in the hopes of avoiding Benn. But “the Chancellor was obviously sensitive to the question of poaching at this stage on Benn’s territory.”¹¹⁰ As a favor to Healey, Drake did, however, make it clear in an interview with various newspaper outlets that BP accepted the concept of participation in principle. Although he had made statements over the past several months that the Company was open to discussing the idea, this was the first clear signal that a major company would accept a deal with the Government.

This seemed to bode well for talks between BP and the Government.

Negotiations were handed over to officials with the hope that the final details could be

¹⁰⁸ The summary of the proposal submitted by BP read as: “BNOC is given title to 51% of the oil (and of the assets if required) in each of BP’s fields on the U.K. Continental Shelf. BNOC agrees to sell this oil back to BP, within the PRT ring-fence for each field. BNOC agrees to lend to BP money equal to 51% of the development expenditure for each field, on which BP will pay a “banker’s” return. BP continues to bear the full financial risk associated with the development of each field.” BP 113109, BP, BP Participation Scheme – Financial Framework, 11 June, 1975.

¹⁰⁹ T 319/2912, NA, Record of a Lunch held on Friday 4th July, 1975, 4 July, 1975.

¹¹⁰ BP 113109, BP, Record Note of Lunch with Chancellor, 9 July, 1975.

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worked out quickly. Drake, who was in a hurry to strike a deal before he retired in the autumn and before Benn could marshal his forces to press for a harsher settlement, was willing to compromise on almost every element except for one: some form of reimbursement for past costs. BP's main North Sea asset, the Forties Field, was nearly three-quarters developed by the summer of 1975 and Drake argued that it would be unfair for BNOC to gain full participation in the Field without some form of payment for the development costs, including unsuccessful drilling in the licensed area. The Government refused to budge on this idea, however, arguing understandably that setting such a precedent would make participation in all the North Sea fields too cost prohibitive. Thus, as the summer wore on, the negotiations reached a stalemate.

A National Oil Company?

The hiccup in talks with BP allowed room for Benn and Kearton to develop a new approach to Government participation that would mark the pinnacle of the Government's attempts to interject itself into the oil industry. Given that both Benn and Kearton believed Government participation would be meaningless if BNOC was purely a symbolic entity, the two looked for ways to enhance BNOC's capabilities quickly and to make it into a legitimate partner for major oil companies such as BP and Shell. This was a difficult prospect, however, since BNOC was being crafted from scratch by Kearton. Well-trained and experienced staff were incredibly difficult to come by, especially since BNOC could not offer the same level of pay that other oil companies could. With no

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participation deals yet officially struck, there was also the threat of BNOC coming into existence with very little oil to handle.

Kearton saw a way to deal with both problems in one fell swoop. The plan was daring and politically dangerous, but offered perhaps the best chance for BNOC and by extension the Government to have a real role in the North Sea. In a meeting with BP's Monty Pennell in early September Kearton put forward an idea that he and his staff had been developing. He suggested that "BNOC and BP should agree to form a joint 'national' oil company for the UK."¹¹¹ This partnership would be a 51/49 split in favor of BNOC but would "rely on BP expertise to conduct its operations and that all existing links with the BP Group would be maintained."¹¹² The company would take over all of BP's UK assets including oil fields, pipelines, refineries and distribution networks.¹¹³ The suggestion shocked Pennell, but Kearton assured him that there would be a significant reward for BP. The BNOC Chairman proposed that although there would be no cash payment, "there would be a compensating fall in Government ownership of BP in respect of the rest of the world other than the UK from the present 48%," along with a dispersal of the share owned by the Bank of England.¹¹⁴ This effectively was an offer for BP to sacrifice its British holdings in order to become a truly independent international company.

¹¹¹ BP 113109, BP, BNOC, 9 September, 1975.

¹¹² Ibid.

¹¹³ These assets were held by the recently created BP Oil (UK) subsidiary.

¹¹⁴ Ibid.

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The proposal, which had yet to be put to Ministers, prompted a flurry of opinions within BP. There were obvious disadvantages to the idea but, given the uncertainty about where Government policy was headed in the North Sea, there was a certain security that it offered as well. BP officials debated the merits of the plan over the next several weeks. Some such as I.R. Walker came down against the idea stating “Unless, therefore, the arguments in favour of BP agreeing to such a merger are strong enough, or alternatively the risk of political blackmail by the use of the Bank of England shares to take away BP’s present commercial freedom is too great, BNOC should probably be left to sink or swim depending upon the lameness of the duck and the will of its political master.”¹¹⁵ Despite the fact many in the Company shared this feeling, top officials decided to pour cold water on the proposal but not to dismiss it outright.

Meanwhile, however, Kearton’s own thinking was evolving. When he presented his ideas to Government officials ten days after broaching the subject with BP, he argued that the combined BP/BNOC group would be 100 percent Government-owned. Benn was of course very supportive of the idea. In a conversation with the Prime Minister, Benn “pointed out the dangers, both political and economic, of allowing BNOC to take a long time to develop and said that Lord Kearton’s proposals were attractive in that they gave credibility and substance to the BNOC enterprise at an early date.”¹¹⁶ Wilson was initially non-committal, telling Benn that he wanted officials to review the idea while Ministers were at the Labour Party Conference. Other members of the Cabinet were not

¹¹⁵ BP 113109, BP, BNOC/BP Oil – Record Note of a Meeting to discuss our response to Lord Kearton’s proposals, 17 September, 1975.

¹¹⁶ T 370/58, NA, BNOC, 24 September, 1975.

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so calm about the idea. Edmund Dell wrote to Healey that “I hope you will succeed in persuading colleagues that BP's activities in the North Sea constitute one British operation which is going reasonably well;” arguing that “contrary to Kearton/Benn, that fact does not provide a sufficient reason for mucking it around in this way.”¹¹⁷

The officials attempted to analyze the idea but soon ran into an elemental problem. When meeting with representatives of BP in early October, Treasury officials discovered that BP had not been told of Kearton's switch to the concept of 100 percent Government ownership of the new BP/BNOC entity. The record of the meeting records Monty Pennell's response as being that “Lord Kearton would be ‘positively misleading’ BP if his real intention were the ‘dreadful’ course of wholesale takeover of the company's UK operations.”¹¹⁸ He added later in the meeting that Kearton's plan “would amount to a ‘disembowelling’ of the company.”¹¹⁹

Officials involved from the various departments tended to agree. Even Benn's own Department of Energy was tepid toward the idea, reflecting the strained relationship in that department between the traditionally pro-oil company officials and their Secretary of State.¹²⁰ The report produced for ministers was unequivocal in its argument that the Government would be wise to avoid pursuing the matter.

¹¹⁷ T 370/58, NA, Letter from Dell to Healey, 26 September, 1975.

¹¹⁸ T 370/58, NA, BNOC and BP: Note of a meeting held at 4 45pm on Monday 6 October, 7 October, 1975.

¹¹⁹ Ibid.

¹²⁰ Benn famously did not get along with his Private Secretary Ronny Custis, even working to have him removed. He wrote in his diaries that “I felt I couldn't speak to my own Private Secretary, and if the situation wasn't changed, I would do things privately from now on.” See Benn, *Against the Tide*, 451.

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Benn naturally did not agree with this assessment, nor did Kearton. Prior to the meeting of the Ministerial Group set up to consider Kearton's proposal, the BNOC head confided in Benn that "the oil companies were insisting that BNOC was a dead duck, that we'd never get it off the ground, and that we might as well pack it in."¹²¹ At a meeting, Benn stood against his colleagues and demanded the right to produce a new paper that would respond to the officials' report. But the other ministers, led by Lever and Dell, argued that "to proceed on the basis of any proposal of the kind Lord Kearton had put forward would mean building up BNOC only by doing great damage to BP, one of Britain's most successful companies and a substantial contributor to the balance of payments."¹²² Wilson was, yet again, non-committal and farmed out the problem to another committee of Ministers and Officials, effectively killing the idea. Benn fumed in his diaries that "Here we have a company where the Government holds 68 per cent of the shares and still they refuse to cooperate with us. A public ownership majority does not even give us the capacity to get them to agree to sit down with us and work out how we are going to solve the problem of BNOC. It is an absolute disgrace."¹²³

Conclusion

The defeat of Benn and Kearton's plans meant that Government participation would continue to be painstakingly negotiated with the companies, a process that would

¹²¹ Ibid., 448.

¹²² CAB 130/831, NA, Ministerial Group on Lord Kearton's Proposals for BNOC: Minutes of a Meeting held at 10 Downing Street on Thursday 23 October 1975 at 4.30 pm., 24 October, 1975.

¹²³ Benn, *Against the Tide*, 449.

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take a further year and a half to complete. Kearton was so dispirited by the rejection of his plan that he offered Benn his resignation in early December, 1975. This was refused, with Benn arguing that the fight was far from over. The Secretary of State for Energy would indeed continue the fight and be the bane of BP and the other companies' existence until the fall of the Labour Government in 1979.

Even Benn and Kearton had to admit that a golden opportunity had been lost – not just in the BNOC/BP plan but, in the first two years of Labour's Government. Although BNOC officially came into existence in January, 1976 it was a toothless entity at first, struggling to hire staff and lacking in solid participation deals to truly get off the ground. The process that had started with so much promise at the beginning of 1974 now seemed like it would end in a watered-down compromise that left much of the power over the North Sea in the hands of the companies.

As had so often been the case in Britain's oil relations, the belief that the Government could control events clashed once again with the reality of the oil industry's complicated nature and its intricate connections to the world of international finance and trade. Those who saw North Sea oil as the ticket to a "millennium of socialism" in Britain were sorely frustrated by the entrenched influence of the oil companies over officials but, just as importantly, over elements of the Cabinet. The Labour Government came into power at a moment in history where sweeping change to the oil industry was perhaps most possible. But in the end the very things that made this change conceivable were what provided ammunition to those clinging to the status quo. The insecurity and

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rapid price increases brought about by the 1973 Oil Crisis caused public opinion to warm to the idea of stronger Government involvement in the North Sea, but these same concerns made the more cautious Cabinet members and officials loathe to do anything that might prejudice the speedy development of Britain's offshore bounty.

Thus, in the end, Varley and Lever's policy of dividing and conquering that had been meant to be used against the united will of the oil companies was in fact employed against the Government with the effect of delaying any major move in the North Sea until the moment of opportunity had passed. While Benn would continue the struggle and while Kearton, through his own herculean will, would turn BNOC into a legitimate force, economic and political turmoil in Britain finally ensured that no major move towards firmer national control in the North Sea could be seriously attempted again.

Conclusion – Two Revolutions

In 1978, the Cabinet of Prime Minister James Callaghan approved the creation of a new Ministerial Committee. Dubbed GEN 150, or the Ministerial Group on Relations with BP, the new committee was tasked with the job of finding ways to improve the Government's standing with "the biggest industrial concern in the UK."¹ A great deal had changed since Lord Kearton's proposal to take control of BP's UK holdings in 1974, but the split within the Labour Party over the future of Britain's oil policy had not mended. During the first meeting of the GEN 150 committee, two proposals for improving relations with BP were presented, one by the Chancellor of the Exchequer Denis Healey and another by the Secretary for Energy Tony Benn.

Healey highlighted just how much the partnership between BP and the Government had deteriorated since the halcyon days of the 1950's. Whereas in the past the special relationship between BP, Shell and the British Government had given both sides access to privileged information, Healey complained that in the present atmosphere, "BP were more guarded in their dealings with the Government than were other oil companies, slower to consult and quicker to adopt the posture of adversary." Healey and others in the Cabinet who agreed with him believed that the main issue in the breakdown in this relationship was the Labour Government's constant flirtation with ideas of expanding their control over BP, either directly or through enhancing the abilities of the British National Oil Company (BNOC). That said, they did not advocate a complete

¹ CAB 130/1061, NA, GEN 150(78) 1st meeting, 4 December, 1978.

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separation of the State from the Company. Instead, Healey proposed “that the Government should act to improve two-way communication with BP,” which he hoped “would increase the Government’s influence over BP’s activities in both the short and the long term.” They could do this, he argued, by beefing up the role of the two State-appointed directors on the board, an idea that the Labour Party had toyed with since the 1960’s. Healey also wanted to appoint two Government directors to the board of BP Oil Ltd., BP’s UK subsidiary that controlled its operations in the North Sea. This would give a stronger Government voice in the Company’s decision-making while not infringing on its commercial independence. In Healey’s words, it “should increase the Government’s influence, but in a way that would be compatible with the Bradbury/Bridges letters.”²

Benn had an entirely different set of ideas. While agreeing with Healey’s suggestion that the Government appoint directors to BP Oil, Benn wanted to go much further. He believed that “the Government’s relationship with BP required a framework within which the Government could be sure that BP’s activities would be fully consistent with the national interest.” He had three specific proposals on how to achieve this. First, he wanted the Government’s shareholding in BP to be transferred from the Treasury to the Department of Energy where it would be under his control. Second, Benn proposed that “the Secretary of State for Energy should appoint at least half the BP Board, including all executive directors.” Finally, he wanted the Bradbury and Bridges letters to

² Ibid. The Bradbury and Bridges letters were sent by Treasury officials to the Board of BP in 1914 and 1951 respectively. They laid out the parameters of the relationship between the company and its largest shareholder.

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be amended to “bring it up to date,” with one possibility being the creation of a “planning agreement negotiated with BP and regularly reviewed.”³

Benn’s colleagues balked at his suggestions, arguing that his views “envisaged a fundamental change in the Government’s relationship with BP.”⁴ But Benn’s plans for a more robust intervention on the part of the Government represented a natural culmination of the struggle for state influence in oil matters which had been slowly growing and maturing since the Suez Crisis. The longstanding fear that Britain’s two oil policy goals, stability and profitability, could no longer be adequately protected by the private oil industry had motivated British officials to search for ways to bolster the nation’s position vis-à-vis oil matters for over two decades. But Healey’s position also represented a natural evolution of attitudes. The countervailing opinion that had battled with the desire for state control had held that the Government could do no better than the oil companies at securing Britain’s interests and in fact might result in more harm than good.

This same *mélange* of opinions had played out abroad and at home. The temptation to negotiate directly with OPEC had been balanced by the fear of injecting international politics into oil matters. Any desire to secure a healthy take for the State from operations in the North Sea had been challenged by the need for the technical and fiscal resources of the international industry. But the debates in 1978 were also the outcome of specific events that had occurred in the post-1973 world and were in fact,

³ Ibid.

⁴ Ibid.

only a prelude to an even bigger dual revolution – one would settle the issue of State intervention in Britain’s oil industry once and for all.

Stability Abroad

One of the most important aspects of this post-1973 reality in oil was the fact that many doomsday predictions about price hikes or stability of supply failed to materialize. The countries which made up the Organization of Petroleum Exporting Countries (OPEC) had received a windfall of unimaginable proportions as a result of the price increases of late 1973, with the incomes of oil exporters jumping from \$23 billion in 1972 to \$140 billion by 1977.⁵ But crucially, these countries had not used their newfound position of power to destabilize the world economy or even to continue to push reckless demands onto the oil companies. In fact, most of the OPEC countries quickly recirculated their vast earnings back into the international economy through development projects, luxury imports and the purchase of military equipment.⁶

OPEC was similarly prudent in its hesitancy to continue the drive for higher oil prices. The 1973 Oil Crisis had proven to be a powerful catalyst for OPEC unity, and the countries, Arab and non-Arab had used the situation produced by the Organization of Arab Exporting Countries’ (OAPEC) embargo and production cutback to push for price

⁵ Daniel Yergin, *The Prize: The Epic Quest for Oil, Money & Power* (Simon and Schuster, 2008), 616.

⁶ OPEC was particularly concerned about the impact of oil price increases on Developing Countries and thus sought to construct lending and investment programs which would benefit the Global South. The success of these ventures was less than stellar, however. See Giuliano Garavini, *After Empires: European Integration, Decolonization, and the Challenge from the Global South 1957-1986* (Oxford University Press, 2012).

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increases unimaginable even a few years previous. But the tremendous success also opened up the Organization to differences of opinion. As Yergin points out, OPEC was not so much a cartel as a “somewhat unruly oligopoly,” and several fissures quickly appeared in the formerly united front of oil producers.⁷ Chief amongst these was the divergence between Saudi Arabia and several other states, most notably Iran, over the issue of continued price increases.⁸ The Saudis had felt that quadrupling prices, realized from October to December 1973, had been too much too fast and risked destabilizing the world economy to the detriment of the oil producers. The Iranians, on the other hand, saw the massive surge in prices as vindication of their long struggle with the Consortium over funding for Iran’s development projects. The Shah saw the new income as his chance to fulfill his ambitions of making Iran a regional and global power and believed that the West could pay even more to make those dreams come true.⁹

The Saudis, however, held a trump card. Most other producers were operating at or near capacity while the Saudis had significant reserves. With this being the case, Saudi Arabia could increase production whenever pressure on prices grew too much, easing the tension between supply and demand. Thus, even when OPEC was at its zenith, internal strains prevented the Organization and the states that made it up from

⁷ Yergin, *The Prize*, 618. Ghanem points out that during its moment of supreme ascendancy, OPEC ceased to function as a unified whole. See Shukri Mohammed Ghanem, *OPEC, the Rise and Fall of an Exclusive Club* (KPI, 1986), 161.

⁸ The long-standing rivalry between the Saudis and Iranians gave the United States in particular the opportunity to sow disunity within OPEC. For an interesting take on this process, see Andrew Scott Cooper, *The Oil Kings: How the U.S., Iran, and Saudi Arabia Changed the Balance of Power in the Middle East* (Simon & Schuster, 2012).

⁹ See Andrew Scott Cooper, “Showdown at Doha: The Secret Oil Deal That Helped Sink the Shah of Iran,” *Middle East Journal* 62, no. 4 (September 2008): 567–591.

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wreaking the kind of havoc upon the Organization for Economic Cooperation and Development (OECD) countries which was initially feared. This view would be reinforced by OPEC's inability to maintain unity and a common policy during the second oil shock in 1979.

A similar sense of having averted disaster existed regarding the fate of the international oil companies. In the uncertainty of the months after the 1973 oil crisis, some expected the oil companies to struggle in adjusting to the new shape of the international industry. While losing control over prices to OPEC was a dramatic blow, the continued drive for greater participation in the Middle East concessions was even more dangerous. Kuwait had used the crisis as an opportunity to push their participation in the Kuwait Oil Company to 60 percent and openly talked about taking 100 percent control, a position they achieved in 1975. Similar pressure existed elsewhere. Iraq had nationalized the main element of the Iraq Petroleum Company and the Kirkuk oil fields in 1972 and took control of most remaining areas in private hands when it nationalized the Basrah Petroleum Company in 1975. Saudi Arabia had also entered into conversations with Aramco about reaching 100 percent participation, although these negotiations proceeded at a slower pace.

Despite this loss of control over the actual point of production, the companies remained in a more powerful position than some commentators had anticipated. Recognizing that 100 percent participation was inevitable, the firms focused their attention on compensation and winning favorable purchasing positions in their former

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concessions.¹⁰ These discounts were usually small, sometimes only a few cents on a barrel. But with purchase contracts that ranged in the tens of millions of barrels per year, even a small advantage could accumulate into large overall savings. This continued to give the major internationals such as BP and Exxon a leg up on their smaller independent rivals who bought participation oil at full market rate.¹¹ But even so, the profitability of oil production declined mightily for the companies. Even the new sources of supply which they still owned, such as Alaska and the North Sea, were extremely expensive to produce from; this contributed to a shift in the oil industry in the direction of boosting profits which could be made from transporting, refining and selling product rather than crude. From 1974-1976 the companies did such a good job of it that Zaki Yamani, the Saudi oil minister, complained to Benn that companies' profits were making both the producing and the consuming governments look bad. An example of the shift in importance from crude production to marketing refined product can be seen in the fact that in 1975, BP and Shell ended their decades-long marketing collaboration with the dissolution of Shell-Mex and BP. The subsidiary had been the two firms' main distributor in Britain and throughout much of Africa but would be replaced by independent marketing by BP and Shell.

¹⁰ In the words of Parra, "the battle is lost, forget confrontation and get on with the job as best you can." Francisco Parra, *Oil Politics: A Modern History of Petroleum* (I. B. Tauris, 2004), 211.

¹¹¹¹ Shell was in an interesting position in this regard. Of the major companies, Shell had long been considered to be the most crude-short, meaning that it did not have enough production under its control to meet its marketing requirements. Thus the company had for years contracted large quantities of oil from other firms such as Gulf. While somewhat disadvantageous in the new system, it also meant that Shell was more experienced in buying on the spot market than other firms.

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Moves such as these showed the industry's resilience. The project of diversification had provided the firms with new sources of supply, but in the end it was their ability to adjust their business strategies which allowed them to continue earning major profits. Of course this meant that both BP and Shell were even less interested in any type of Government control over their operations in Britain. With distribution of refined products an increasingly important part of their business, these firms, especially BP, needed more than ever to expand their footprint in markets such as the United States and the European Continent. Any decision by Benn and the Labour Government able to be construed as protectionist or even dirigiste could have the potential to seriously damage the companies' standing abroad. For BP, an added fear was the fact that the Government refused to dispose of the ex-Burmah shares of BP's stock; this continued to hang over the fortunes of the company, bringing it extra scrutiny in the United States which had within its power the ability to break apart BP's merged partnerships with Sinclair and Sohio, moves which would cost BP its Prudhoe Bay concession.¹²

Instability at home

Thus the fortunes of BP's international status were tied to the decisions of the Labour Government. If OPEC and the international oil industry had reached a *modus vivendi* abroad that allowed for the turbulence of 1973 to subside, the same could not be

¹² This was of particular concern given the activities of the Church Committee in the Senate of the United States which had been set up in 1975. This Senate Committee spent months digging into the activities of the international oil companies in an attempt to understand the events of the 1973 Oil Crisis and the relationship of these firms to them.

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said for Britain's domestic economic scene. The British economy had been in a low-level crisis since the Labour Party regained power in late February, 1974. Already in a balance-of-payments crunch before the 1973 Oil Crisis, the rapid escalation of oil prices and the inflationary shock in other commodities that accompanied it had laid the foundation for a full-blown economic crisis. Wilson had tried to overcome these difficulties through economic stimulation during his truncated two years in office before resigning in 1976.¹³ In terms of oil, it was hoped that the coming online of North Sea oil would help alleviate the trade balance and perhaps buy some time for the economy to grow its way out of the dilemma.

But by 1975 it had become apparent that events would not wait for this strategy to develop. Furtive talks within the Cabinet began over the necessity of cutting public expenditure in order to stave off the collapse of confidence in the pound. Opinion broke down into the obvious groupings: James Callaghan and Denis Healey led the call for cuts while Tony Benn refused to give up the plans for increased expenditure on Britain's industrial development which had been at the heart of the 1974 Manifestos. But the more economic data that came in throughout the year on the performance of the British economy, the more it became apparent that not only would public expenditure need to be cut, but that Britain would need outside assistance to shore up confidence in the pound as well. This would most likely take the form of a loan from the International Monetary

¹³ Much of this deficit spending was financed by loans to Britain from Saudi Arabia and Iran, effectively recycling the petro-dollars spent by Britain in purchasing their oil. See Denis Healey, *The Time of My Life* (Politico's, 2006), 423.

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Fund (IMF).¹⁴ Initial talks with the IMF were not promising, though, as cuts of between £9 and £12 billion were demanded from the Government in exchange for support.¹⁵ The IMF's main concern was for the Government to reduce its Public Sector Borrowing Requirement (PSBR).¹⁶ One way to do this without cutting spending was to sell off assets and use the proceeds to pay down the debt. Conveniently, one massive and politically problematic asset held by the Government was the shares of BP that the Bank of England had bought from Burmah. In February, 1976, the Chancellor of the Duchy of Lancaster Harold Lever noted to his colleagues that the Bank of England and the Treasury were both "keen to dispose of the whole of the former Burmah shares as soon as possible in the next financial year," so that "the proceeds could help to reduce the public sector borrowing requirement."¹⁷

But the loss of ex-Burmah shares would also reduce the pressure on BP to cooperate with plans that Tony Benn had for the growth of BNOC. Therefore, when the idea was discussed, Benn put up a spirited defense against the idea of selling all the ex-Burmah shares. Benn and others argued that enough of the Bank of England's shares of BP should be kept to keep the Government's overall ownership of the Company at 51 percent.¹⁸ This would entail giving up some of the revenue that could be used to pay

¹⁴ The authoritative study of the 1976 IMF remains Kathleen Burk and Alec Cairncross, *Good-bye, Great Britain: The 1976 IMF Crisis* (Yale University Press, 1992). For a different look at the crisis see Kevin Hickson, *The IMF Crisis of 1976 and British Politics: Keynesian Social Democracy, Monetarism and Economic Liberalism* (I.B.Tauris, 2005).

¹⁵ Bernard Donoughue, *The Heat of the Kitchen: An Autobiography* (Politico's, 2003), 245.

¹⁶ Simply put, the PSBR was the deficit between income and expenditure in the Budget.

¹⁷ CAB 130/905, NA, MISC 103(76) 1st Meeting, 23 February, 1976.

¹⁸ Benn would continue to fight for this idea against all challengers. In November, 1976 he wrote in his diary that "Without our policy on participation, and our own BNOC, a state-owned oil company like BP is

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down the PSBR, but “this figure was of some political significance, and there would be a great deal of criticism if the Government neglected to take the opportunity which the Burmah purchase presented.”¹⁹ This argument carried the day and plans were undertaken to devise a means of selling the shares without diminishing their value too rapidly.²⁰ The decision frustrated those like Lever who wanted to completely free BP from the symbolic burden of Government ownership controlling a stake in the Company. But, the decision was a victory of sorts for those in the Cabinet who wished to preserve the oil companies’ independence as it seemingly removed the threat of outright nationalization.

Chastened

The decision to sell the ex-Burmah shares was withheld from BP, perpetuating a strategy used since 1974 to pressure the Company into finishing participation negotiations with the Government. These negotiations were ultimately completed in June, 1976 with the Government foregoing an actual partnership in the operation of BP’s North Sea fields; it instead favored an option to buy 57.1 percent of the oil produced in the fields for BNOC along with several other agreements regarding refining and

very important to us. I said that we had pledged in the Social Contract to stick at 51 per cent ownership of the shares. Churchill had bought them and I never thought I would have to quote a Churchill speech to a Labour Cabinet committee, that even in the darkest days of the war he would never sell them. In fact, in Scotland, where the Forties field is regarded as Scottish oil, there would be a tremendous row, if an English government – as they saw it – sold off their assets.” See Tony Benn, *Against the Tide: Diaries, 1973-77* (Hutchinson, 1989), 647.

¹⁹ CAB 130/905, NA, MISC 103(76) 1st Meeting, 23 February, 1976.

²⁰ The sale was temporarily thrown into doubt by a lawsuit brought by Burmah against the Bank of England. Burmah claimed that the initial purchase of its shares of BP was illegal as it was conducted under duress and during a time when the shares were selling much below their average value. Since the sale of the Bank’s shares could not take place with the law-suit outstanding, it was decided to sell the requisite number of Treasury shares, about 15 percent of BP’s total stock. The plan was for the Treasury then to purchase all 20.5 percent of BP held by the Bank to bring its total shareholding back up to 51 percent.

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distribution.²¹ This option did carry with it the right of BNOC to vote on production decisions, thus fulfilling the original 1974 Manifesto commitment of the Labour Party. But despite the Cabinet's decision to agree to the sale of the ex-Burmah shares upon BP's acceptance of the participation deal, Benn could not help but tweak the Company in the final negotiations. When BP asked for an official commitment to sell the shares, Benn "made clear that in all these circumstances it would be inappropriate to link these shares in any way to the completion of a participation agreement of a kind that HMG would be expecting to conclude with all other companies with major interests in the Continental Shelf."²²

The Government did not have much time to relish the victory. The economic problems that had necessitated the discussions with the IMF had only soured further. Shortly after the participation agreement was struck with BP, serious negotiations started with the IMF. Currency speculations were putting increasing pressure on the pound as fears emerged that the Government of the newly appointed Prime Minister James Callaghan would be forced to devalue. Callaghan requested a major loan of £2.3 billion to help prop up the struggling currency. The IMF and their American backers agreed to

²¹ 57.1 percent was derived from a simple option to buy 51 percent of the oil thus achieving the initial goal of participation. Added to this was a royalty of 12.5 percent which would be paid in kind on BP's remaining 49 percent thus resulting in an additional 6.1 percent of the total oil produced accruing to BNOC.

²² T 364/131, NA, Annexed Extract from the Record of the Meeting: Bank of England Shares in BP, 28 June, 1976. The actual agreement would not be signed for another year. Upon its signing in June, 1977, Benn wrote in his diaries that "I have the gravest doubts whether it has any real meaning, but it is a start and it is the best deal I can get; the fact that the oil companies, even BP, have gone along with it convinces me that it doesn't mean very much. But it has given birth to a national oil corporation which in time could be used in substantial ways." See Tony Benn, *Conflicts of Interest: Diaries, 1977-80* (Hutchinson, 1990), 158.

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the rescue package but exacted a heavy price.²³ Spending would have to be slashed, spelling the end to many of Labour's grand visions of industrial redevelopment, not to mention the expectations for future increased wages brought about by the Government's earlier settlements with workers such as the coal miners.

The agreement was struck in December, 1976 – a time considered by many observers to mark the end of the Labour Government's ability to pursue the agenda which brought it to power in the first place.²⁴ Some have even argued that it marked the end of Keynesianism and a turn towards the Monetarism that would characterize the era of Margaret Thatcher.²⁵ But while this might have been true in other areas of the economy, Tony Benn still ruled the Department of Energy and had not given up the hope that the Government would be able to construct an oil regime that could provide salvation for the left wing's vision of industrial investment and economic modernization.²⁶

Benn was not alone in this view. Even his opponents in the Cabinet clung to the hope that an influx of money from the North Sea would make their humiliation at the hands of the IMF a short one. But the members of the Cabinet also knew that to make the

²³ For a look at the American role in this process, see Mark D. Harmon, "The 1976 UK-IMF Crisis: The Markets, the Americans, and the IMF," *Contemporary British History* 11, no. 3 (September 1997): 1–17.

²⁴ The deal even provoked a brief split in the Labour Party. A March, 1977 vote on the White Paper outlining the details of the deal saw Callaghan defeated when a group of left-wing Labour MP's cast votes against him. Callaghan was forced to strike a deal with the Liberal Party in order to survive a vote of confidence. The Lib-Lab Pact further limited the ability of Labour to strongly follow through on its priorities.

²⁵ Cronin writes that "The process was painful politically... and is likely to have weakened the overall legitimacy of Labour's claim to govern." He also notes that together with Callaghan's speech about the inability of the Government to spend itself out of recession, delivered just months earlier, the IMF deal "appeared to argue the end of Keynesian policy-making." See James E Cronin, *New Labour's Pasts: The Labour Party and Its Discontents* (Pearson/Longman, 2004), 184.

²⁶ A fascinating account of the entire IMF Crisis has been published by Douglas Wass who was himself a top Treasury official during the process. See Douglas Wass, *Decline to Fall: The Making of British Macroeconomic Policy and the 1976 IMF Crisis* (Oxford University Press, 2008).

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most of the opportunity provided by North Sea oil, a plan would have to be prepared for the responsible use of the wealth which they hoped would soon be pouring into the Government's coffers. To that end, Callaghan commissioned the drafting of a White Paper on the benefits of North Sea oil and gas. In a speech given at Aberystwith, Callaghan laid out the question on the minds of the Cabinet and indeed much of the nation when he said, "How are we to use this new oil wealth of ours? How are we to ensure that 1977 really *is* a watershed (emphasis original)? It must not be frittered away."²⁷

But plans for how to not "fritter away" the opportunity were wide-ranging. Some advocated using the revenue to decrease personal and business taxation. Others wanted to increase investment in social programs. Still others called for the money to be put into modernizing British industry. There were even appeals for the surplus to be put into loans to developing countries that would then be indexed and tied to the purchase of British goods. Some advocated all of the above.

The problem, however, was that the massive external debt which the IMF package had helped temporarily alleviate still loomed over the future of North Sea oil revenues. Some within Whitehall argued that the new wealth should be used first and foremost to pay down the old debt. But Benn argued that this would be not only a political disaster – as there were great expectations amongst the party faithful that North Sea oil would be transformative – it would also be too backward looking. In a note to Callaghan, he argued that "so long as the balance of payments current account is not in large deficit the

²⁷ CAB 184/340, NA, Letter from Hunt to Callaghan, 26 July, 1977.

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debt which will fall due should be easy to refinance.”²⁸ He felt similarly about another argument put forth by Whitehall officials – that Britain should not only repay its external debts but should build up its exchange reserves which could then be invested in high-yielding projects around the world, similar to what the OPEC states were doing. To Benn it was “essential that North Sea revenues should be spent in the UK and that full advantage is taken of the multiplier effects on output, employment, investment and productivity which could not occur if North Sea revenues are invested overseas.”²⁹

The disagreements within the Cabinet and within Whitehall over the best way to use North Sea revenues were reflected in the many drafts of the White Paper that were circulated. Kenneth Berrill, the head of the Central Policy Review Staff (CPRS), noted to Sir John Hunt, the Cabinet Secretary, that the report “seems to have the flavor of having been baked for much too long.”³⁰ Berrill warned that one of the roots of the problem was the exaggerated belief in the size of the benefit that North Sea oil and gas would bring to the economy. He noted to Hunt that the best estimate had North Sea activities and revenues bringing only a 5 percent bump to the GNP by 1985, stating that this increase “can be described as being equivalent either to two years normal growth of GNP or as getting back what OPEC took away from us in 1973.”³¹

Recognizing the problems facing the White Paper, Healey and Benn met personally to attempt to hammer out their differences and produce a document that could

²⁸ CAB 184/340, NA, Letter from Benn to Callaghan, 29 July, 1977.

²⁹ Ibid.

³⁰ CAB 184/340, NA, Letter from Berrill to Hunt, 2 November, 1977.

³¹ Ibid.

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account for part, if not all, of both their visions. While Benn did not get everything he wanted, the compromise solution was closer to his vision than expected. The joint paper was brought before the Ministerial Committee on Economic Strategy in January, 1978 and approved for publication. The final White Paper was announced on 21 March, 1978 by Callaghan who proposed that the benefits of North Sea oil would be focused onto four areas: investing in industry, improving industrial performance, investing in energy and increasing essential services.

Nevertheless, Benn and his supporters were still not totally satisfied. They had bent the White Paper in their direction but Benn had also been forced to concede that the benefits of North Sea oil and gas would not be as large or as transformative as originally hoped by the Labour left. A large part of the reason for this, in Benn's estimation, was that the private oil companies were still receiving too much of the profit from operations in the North Sea. Given the lack of stomach for any radical move towards nationalization by his Cabinet colleagues, he had no choice but to accept the types of deals modeled on the agreement struck with BP in June, 1976. But this did not mean Benn would remain idle; if there was one company that could still be put to use by the Government to push development in ways favorable to the State's interest, it was BP. Even as the details of the sale of the ex-Burmah shares were worked out over 1977, the Government's plans to retain enough of those shares to increase the permanent Government holding to 51 percent of the company had been solidified. To other members of the Cabinet this was

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purely symbolic, but to Benn it was an opportunity to force BP to behave as the Government wanted it to.

It might not have seemed like the Government was in much of a position to do this. The 1976 IMF crisis had embarrassed the Labour Party and limited its fiscal flexibility. BP and the other companies, on the other hand, had restored much of their profits through shrewd bargaining with OPEC and the coming online of Alaska and the North Sea.³² But fortunately for Benn, 1977-1978 saw a scandal erupt around BP and Shell that damaged the two firms' public image and left them exposed to uncomfortable scrutiny.³³

The issue at the heart of the scandal was the allegation that firms linked to BP and Shell were conducting an illicit oil trade with the government of Rhodesia. Rhodesia had been put under sanctions following the Unilateral Declaration of Independence by the white-minority regime in 1965 but had long been able to skirt these restrictions through friendly relations with South Africa.³⁴ Shell and BP operated jointly in many African countries on the model of Shell-Mex and BP in Britain. Their subsidiaries in Mozambique and South Africa had gotten involved in the Rhodesia trade in the mid to

³² In the wake of the 1973 Oil Crisis, authorization for the Trans-Alaska Pipeline was rushed through Congress and signed into law in late November, 1973. Construction began in March, 1974 and was completed by the summer of 1977.

³³ This came on top of an earlier scandal in 1976 where BP was accused of bribing Italian politicians.

³⁴ Some research has been done on the early years of the sanctions. See Richard Coggins, "Wilson and Rhodesia: UDI and British Policy Towards Africa.," *Contemporary British History* 20, no. 3 (2006): 363–381; A. S. Mlambo, "'We Have Blood Relations over the Border': South Africa and Rhodesian Sanctions, 1965-1975.," *African Historical Review* 40, no. 1 (January 2008): 1–29; Andrew Cohen, "Lonrho and Oil Sanctions Against Rhodesia in the 1960s," *Journal of Southern African Studies* 37, no. 4 (December 2011): 715–730; Christopher R. W. Dietrich, "'The Sustenance of Salisbury' in the Era of Decolonization: The Portuguese Politics of Neutrality and the Rhodesian Oil Embargo, 1965–7," *International History Review* 35, no. 2 (April 2013): 235–255.

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late 1960's without the knowledge of their home offices in London. When this came to light, Shell, BP and the British Government moved to quash the illicit trade. But since South African law did not allow restrictions on particular customers, including those that the Shell and BP subsidiaries knew were on-selling to Rhodesia, it was difficult for these firms to stay completely aloof. The story of this ongoing sanctions-busting first emerged in 1976 but burst out into the press in 1977, leading to a major Parliamentary Inquiry ordered by the Foreign Secretary David Owen and led by the lawyer Thomas Bingham. Although the Bingham Inquiry found no wrong-doing on the part of BP and Shell's Board of Directors, the fact that their subsidiaries had been helping the Rhodesian regime was a severe black eye.

The State and BP

It was also all the proof that Benn needed to make a further claim for the Government's need to exert greater control over the oil industry and BP in particular. Many within the Cabinet found it embarrassing that they knew so little about the companies' overseas activities, especially those of BP.³⁵ In February, 1978 Benn wrote to Callaghan regarding the oil matters where he believed the Government had "made great strides in the last few years in developing our national oil policies, the success of which is so important to our economy and social future."³⁶ But Benn argued that much

³⁵ This also had repercussions on British relations with many other African countries, most importantly Nigeria. See Ann Weymouth Genova, *Oil and Nationalism in Nigeria, 1970--1980* (ProQuest, 2007), 108--109.

³⁶ PREM 16/1992, NA, Letter from Benn to Callaghan: BP Shareholding, 7 February, 1978.

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work remained to be done if Britain wanted to maximize the contribution that the oil industry, and North Sea oil, could make to the British economy. He noted to the Prime Minister that “in all this our on-going relationships with Esso, Shell and BP will be of special importance and the relationship with BP most important of all.” Benn felt the Government was not getting all it could from its relationship with BP and he thought that the only way for the Government to receive adequate support from the firm was if “one Department is clearly in the lead on all matters involving BP’s commercial policies and strategic planning.” That department would, of course, be the Department of Energy. Such a move, he believed would make it possible to “improve greatly the whole coordination of Government relations with BP in the development of our oil strategy,” and would “do much to reduce the opportunities which the company has had and often used to try and play off one Department against another.”³⁷

Callaghan acknowledged Benn’s views but little was done over the next several months. Realizing that there would be limited support for any radical change in the Government’s relationship with BP and with North Sea oil in general, Benn decided that he would need to apply pressure on his colleagues. He would do this by bringing his views directly to the Labour Party Conference in October, 1978. Benn prepared a major speech to be given at the Conference in which he would lay out his vision for state control of BP and eventual state ownership of all North Sea oil. He refused to allow even his own Department of Energy officials to see a draft of the paper, although rumors of its contents did begin to emerge. Perhaps as a sign of how radical Benn’s proposals were,

³⁷ Ibid.

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one Department of Energy official wrote his colleagues that “I understand Lord Balogh has been seeking to dissuade him [Benn] from the radical proposals he had in mind.”³⁸ That same official believed that if even Lord Thomas Balogh, the oil companies’ old nemesis, was trying to change Benn’s mind then it might be prudent to warn BP that “all the signs are that some sort of critical statement about BP will be made.”³⁹

Benn’s speech, delivered on 5 October, was a smashing success.⁴⁰ He was loudly applauded by the rank and file of the Labour Party and by the unions especially. Conference motions backing State ownership of the rights to all North Sea oil as well as State control of BP were passed to loud acclaim. The next day’s papers screamed headlines such as “Oil takeover demanded” in the *Morning Star*, “Benn backs aim to nationalize North Sea oil” in the *Guardian*, “Benn backs BP takeover” in the *Financial Times*, and more pugnaciously, “A bloody nerve” in the *Sun*.⁴¹

Benn’s rousing performance received the attention, and the annoyance, of his Cabinet colleagues. In response to Benn’s actions, Callaghan sanctioned the creation of the GEN 150 committee, highlighted earlier, which was meant to sort out the issue of the Government’s relationship with BP. In the committee, Healey once again went to battle with Benn regarding the future of BP and the British effort in the North Sea. As has

³⁸ EG 13/69, NA, Lunch with BP on 3 October, 2 October, 1978.

³⁹ Ibid.

⁴⁰ The significance of the speech was somewhat overshadowed by the fact that ongoing disputes over wage restraint between the Callaghan Government and the unions had spilled over into the Conference itself. The same day as Benn’s speech, an official strike was declared by autoworkers for the Ford Motor Company in opposition to a wage increase offer that stayed within the Callaghan Government’s official 5 percent wage increase limit. See David Coates, *Labour in Power?: A Study of the Labour Government 1974-1979* (Longman Group, 1980), 78–79.

⁴¹ EG 13/69, NA, Newspaper clippings, 6 October, 1978.

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already been noted, the GEN 150 committee heard Benn's arguments but generally rejected them. Reporting on the committee's activities, Healey wrote to Callaghan that "our majority conclusion was against going along with Tony Benn's proposal to reword the Bradbury and Bridges letters. Although we all accepted the need to ensure that BP would consult the Government in advance on major issues, it was represented to us that the existing letters were probably as tough as they could be and that to redraft them might in fact lead to a weakening of the Government's position."⁴² Benn's suggestion that control over the Government's shares in BP be transferred to the Department of Energy was similarly dismissed.

The GEN 150's conclusions were not a total defeat for Benn, however. His proposals for the Government Directors to be appointed to the board of BP Oil, and his suggestion to that the Government conduct planning operations with BP, on a voluntary basis, were both accepted. But by the time GEN 150 had concluded its study and recommendations, the small battles over the future of BP and even the shape and structure of the North Sea oil fields took a backseat to another crisis on the horizon.

Two Revolutions

If the disagreement between Healey and Benn had been the source of instability in Britain's oil policy, much of the post-1973 stabilization in the international oil market was due to the dynamic tension between the Saudis and the Iranians. Both were interested in keeping oil flowing, if for somewhat different reasons, and each was

⁴² PREM 16/1992, NA, Letter from Healey to Callaghan, 27 March, 1979.

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governed by pro-Western monarchies. The Shah, in particular, had benefited from the period of stable and high prices from 1974-1978.⁴³ But as more money had flowed into Iran, expectations had grown commensurately. When the development plans in the country did not pan out as the Shah had hoped, he faced a crisis; he had alienated many of the conservative forces in the country with his Westernizing policies and he had promised too much to the growing population of educated liberal Iranians. Demonstrations against his rule began in earnest in 1977, causing British officials to assess their position in the region.

A report written on the subject by Ivor Lucas of the FCO in July, 1978 reported that the situation was growing dangerous but was not yet critical. Lucas informed his colleagues that “despite recent developments, an upset of the Shah’s regime remains on any rational calculation unlikely.”⁴⁴ Because of this position, Lucas suggested that “by far the best policy is the one which we are at present pursuing – ie support of the Shah ‘warts and all’ (while occasionally offering treatment for the warts).”⁴⁵ But this approach soon proved untenable as the situation in Iran deteriorated rapidly. The Shah, already suffering from the cancer which would take his life, experienced a series of breakdowns throughout the autumn driving him to seek asylum abroad. On 16 January, the Shah and his family fled the country, effectively marking the end of the Pahlavi Dynasty.

⁴³ The Shah’s reliance on these high oil prices laid the seeds of his downfall. For a look at how oil prices were linked to the decline of the Shah’s regime, see Cooper, “Showdown at Doha.”

⁴⁴ FCO 8/3194, NA, Iran, 6 July, 1978.

⁴⁵ Ibid. Lucas would later write a fascinating assessment of the fall of the Shah. See Ivor Lucas, “Revisiting the Decline and Fall of the Shah of Iran,” *Asian Affairs* 40, no. 3 (November 2009): 418–424.

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Uncertainty reigned for the next few months but the political instability almost immediately affected the oil market. Iranian production had dropped even before the departure of the Shah, in large part because oil workers were participating in the upheaval. As early as November, 1978, production and exports had fallen precipitously and this only worsened in the political vacuum.⁴⁶ The jittery spot market soon recorded huge increases in prices for oil. BNOC exacerbated this trend by increasing the price of North Sea oil by 11 percent in December, 1978 to bring posted prices more in line with the spot market. This removed all restraint from OPEC and soon led to an unorganized increase of prices across the board.⁴⁷ The so-called Second Oil Shock would eventually send prices from around \$13 to \$34 a barrel.

But more importantly, the crisis caused by the Iranian Revolution would give the *coup de grâce* to lingering elements of the old order of the international oil industry. The great upheaval of the 1973 Oil Crisis had severed the companies control over the productive concessions in the Middle East and elsewhere, but participation negotiations with the OPEC states had resulted in what were in effect long-term contracts to purchase similar amounts of oil. Thus, while the relationship with the point of production had changed, the traditional sources of supply for the companies' integrated systems remained relatively unaltered. The Iranian Revolution, however, had unceremoniously disrupted even this compromise solution. The contracts signed under the Shah became null and void, not so much through decree or decision but through the *fait accompli* of the

⁴⁶ Yergin notes that exports dropped from 4.5 million bpd to less than 1 million bpd by November. See Yergin, *The Prize*, 660.

⁴⁷ See Parra, *Oil Politics*, 221.

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massive oil industry strike which had been a part of the demonstrations against the Pahlavi Dynasty. This meant that firms reliant on Iranian oil, such as BP and to a lesser extent Shell, no longer had access to oil they had been counting on to fulfill their contracts. Thus, for the first time, BP, Shell and other firms such as Exxon became major buyers on the spot market. This market had long been the territory of small producers and refiners with the occasional purchase by an oil major needing to plug a hole caused by a new contract or a transportation delay. But with the breakdown of the contractual system as a result of the Iranian Revolution, purchasing oil on the open market became the norm for most major companies.⁴⁸

Yet throwing the companies onto the mercy of the open market also meant that OPEC had less control over prices. This became readily apparent when rates spun out of control despite OPEC's efforts. Less than five years after winning control over prices, OPEC now seemed on the verge of losing it. These increases also had the perverse side-effect of incredibly boosting oil company profits once again. With huge amounts of crude already in their systems, the companies could sell oil bought at the much lower prices of late 1978 for the much higher prices being demanded in 1979. Despite all the setbacks they had suffered, the international companies demonstrated once again that their huge networks of supply and distribution made them an essential player in the maintenance of the world's oil supply.⁴⁹

⁴⁸ See *Ibid.*, 215.

⁴⁹ It was OPEC's outrage at these huge profits that ultimately helped bring the crisis to an end. By driving prices up still further in an uncoordinated manner, the OPEC states created what seemed to be a new and unimaginably high level of oil prices. To take advantage of these high prices, OPEC producers ramped up

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There was, of course, at least one dissenter from this opinion. Tony Benn watched the tightening of the world oil market and the rapid increase in prices and saw in it evidence of the need for Britain to isolate itself from the international oil market through greater control of North Sea oil by the State. As the crisis deepened, Benn urged his colleagues to approve his plans for BNOC to have its royalties paid in oil, as well as taking up its rights to purchase 51 percent of the oil produced in the North Sea. This, he argued, would give BNOC, and thus the British State, the ability to keep that oil in Britain, and to suppress its price to the benefit of British manufacturers. This would, he believed, be the breakthrough that could help Britain realize his dream of creating a state-run market for oil, supplied by a national company, to the benefit of Britain and British industry.

Yet there was one minor problem with Benn's plan; a general election was scheduled for May, 1979. Just as Edward Heath's Government had been crippled and ultimately brought down by the combination of an oil crisis and labor militancy, so too was the Government of James Callaghan. The so-called "Winter of Discontent" had seen unions strike against attempts by the Callaghan Government to cap wages. The devastating series of strikes, combined with the oil shortage, revived in Britain many memories of the 1973 Crisis and all but sealed the fate of the Labour Government.

The general election saw the Conservative Party returned to power under the leadership of Margaret Thatcher. Unlike previous elections which had brought minor

production which, by 1980, had created an oil glut leading to the decline of prices throughout the rest of the decade.

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changes to Britain's oil policy, the 1979 election witnessed a fairly dramatic shift. Thatcher and her cohort had a very different outlook than most members of the Labour Party and were in many ways the polar opposite of Tony Benn. On the first document on energy issues sent to her by Sir John Hunt, Thatcher underlined several times Hunt's recommendation that a thorough review of BNOC and its activities be conducted for the new Government.⁵⁰ This review was set in hand within days and was due to be finished by June, 1979. In the meantime, Thatcher made her own views crystal clear to the new Secretary for Energy, David Howell. During their first meeting following the election, Thatcher informed Howell that she saw no value in BNOC. She recognized that for various contractual reasons she could not abolish the organization outright, but she also "saw no advantage of introducing a private equity interest to BNOC, making it more like BP, and would prefer to dismember it."⁵¹

The process of "dismembering" BNOC would need a new leader, however, as Lord Kerton made it clear soon after the election that he would step down from his position as the head of organization. Kerton, having expended so much effort in getting BNOC up and running, was not about to oversee its destruction. Thatcher believed that she had just the man for the job – who better to dismantle a state-run oil company than a man who had just retired as the head of one of Britain's major private oil companies? Sir Frank McFadzean, the recently retired chairman of Shell, caught the attention of the

⁵⁰ PREM 19/42, NA, Letter from Hunt to Thatcher: Energy Issues, 4 May, 1979.

⁵¹ PREM 19/42, NA, Principle points made by the Prime Minister on her visit to the Department of Energy: 18 May 1979, 31 May, 1979.

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Prime Minister who surmised that he “would be an excellent choice,” and that “he would have no objection to presiding over the running down of BNOC.”⁵²

But unfortunately for Thatcher, McFadzean turned down the offer. Heading BNOC would have meant that McFadzean would be required to resign from his lucrative position as an honorary director of Shell. He likewise denied Thatcher’s request to head the CPRS, although he did agree to advise her on an informal basis regarding oil and other economic matters. Regardless of this setback, Thatcher plowed ahead with her plans to remake the British oil industry. One symbolic step was brought to her attention by Geoffrey Howe, the Chancellor of the Exchequer. As part of Labour’s 1978 White Paper, the Government was obligated to report to the British public how the proceeds of North Sea oil were being used to promote British industry and the economy. Howe believed that to follow this advice would be a mistake, arguing that “unlike our predecessors, we do not accept that it is a proper function of Government to attempt to define a set of objectives towards which our North Sea resources should be directed.”⁵³

Thus Tony Benn’s dreams of the State controlling North Sea oil seemed to be at an end. His hopes for State control over BP were similarly doomed. Another of Thatcher’s first acts was the decision to sell off 5 percent of BP’s stock, bringing the Government’s holdings down to 46 percent. While still significant, the new level of holding was below the symbolically important threshold of 51 percent. BP felt that such a move should be accompanied by an announcement of a loosening of the ties between

⁵² PREM 19/42, NA, Meeting between Howell and Thatcher: Note for the Record, 6 June, 1979.

⁵³ PREM 19/42, NA, Letter from Howe to Thatcher, 8 June, 1979.

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the Government and BP, since “with the reduction in size of the Government shareholding the public would *expect* something different to be said about the terms of the relationship (emphasis original).”⁵⁴

While the Government refused to put anything in writing, they did actively look to transform the relationship with BP in particular and the oil industry in general. One way to do that was to dismantle BNOC. The Thatcher Government had pledged to raise £1 billion in 1979 through the sale of Government assets. Parts of BNOC were to comprise a good portion of that. But rather than fritter away BNOC’s assets, another plan emerged which would strengthen the private industry’s control of North Sea oil while simultaneously benefiting the Government. During a meeting with BP’s chairman, Sir David Steel, Thatcher proposed the sale of all BNOC’s assets directly to BP. Although interested, Steel was concerned about the political optics of such a deal. He worried that it “might lead to demands that the Government should have a closer control over BP’s activities.”⁵⁵ In fact, Steel felt that the continuation of a rump BNOC would give both the Government and BP the cover they needed to privatize more of the North Sea. Therefore Steel proposed two steps. First, he believed that the Government should create a subsidiary of BNOC which would hold all of BNOC’s productive assets, such as the fields they inherited from the National Coal Board in 1974. BP could then buy up shares of this subsidiary and effectively take control of BNOC’s physical assets without actually buying out BNOC itself. Secondly, Steel recommended keeping BNOC in

⁵⁴ T 364/230, NA, Visit by Sir David Steel (BP): Note for the Record, 21 June, 1979.

⁵⁵ T 264/230, NA, Future of BNOC, 16 July, 1979.

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existence as an oil trading entity. This would allow the organization to trade the royalty and participation oil and establish a distribution pattern favorable to British interests.

Thatcher's Cabinet colleagues agreed. While BNOC, in their view, did not need to own its own concessions or have its own productive capacity, the retention of the participation rights and royalty oil was important politically, especially during a time of supply crisis. Therefore, while relatively little was done to BNOC in the first years of the Thatcher Government, its fate was effectively sealed within months of the election.

BP's fate was also sealed as the sale of the five percent of its Government-owned stock went ahead in September, 1979.⁵⁶ Sir David Steel's advice was heeded, with BNOC's business assets being split off into the newly created Britoil in 1982. This new entity was privatized in two stages in 1982 and 1985 as shares were sold directly to the public. One of the biggest purchasers of Britoil stock was BP, who bought out most of the remaining shareholders in 1988, completing a total acquisition of the company. The rump of BNOC continued on in its oil-trading capacity until it was abolished in Thatcher's second term in 1985.

The death of BNOC and the transfer of its valuable assets to BP brought Government oil policy full circle. The process had strengthened BP by giving it very large holdings in two non-OPEC fields, Alaska and the North Sea, allowing it the financial flexibility to compete in the open market for OPEC supplies as well as in the distribution market. In 1987, the Conservative Government put the remaining shares of

⁵⁶ This represented about 80 million shares.

BP held by the State onto the market and ended the formal relationship with the company that had begun in 1914.

The Rise and Fall of State Intervention

From 1957-1979, the rise in state intervention in the operations of the British oil industry had been gradual but seemingly inexorable. Beginning at the time of the Suez Crisis until the twin revolutions in Iran and Britain, the Government had slowly expanded its control and competency in oil matters. The traditional system wherein the Government left the planning, supplying, refining and distributing of oil to the firms seemed like a relic of the past, akin to the operations of the East India Company. But the very things that had always made the industry, and BP and Shell in particular, a valuable ally to the State were what saved the companies from being controlled by the British Government. These were the ability of the companies to raise capital for new projects, their integrated, worldwide networks of supply and distribution, and their essential role as the “thin lubricating film” which buffered the interactions of consumers and producers.

It was ultimately the adaptability of the industry that allowed it to keep these advantages. They had fought tenaciously at every step of the transition from the old concessionary system of the 1940's and 1950's to the new world of a mixture between classic concessions and open markets for the world's supply of oil, yet at each stage they had been able to change their operations to take advantage of the new situation. The ability of the companies to pass on most of their costs to the consumer had been limited

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at points by the British and other Governments, but there had been enough opportunities along the supply chain to boost profits, cut costs and generally shore up the finances of the companies involved in the production, movement and sale of oil products.

This adaptability was similarly demonstrated in the industry's ability to coordinate the movement of supply during times of crisis. During the Suez Crisis, the abortive Arab embargo in 1967, the 1973 Oil Crisis and finally the 1979 Oil Crisis, cooperation between the major oil companies had proven far more effective in redistributing supplies than any Government action likely could have. Even the setting up of the International Energy Agency did little to bolster the efforts of Governments to construct an adequate system of supply distribution. A large part of this was due to the necessities of short-term political expediency. The politicians running the industrialized world were willing to take the easy, short-term solution such as hoarding supply or demanding special treatment, but the desire for profit on the part of the companies forced them to think both short and long term. If protecting their long-term interests required short-term pain, even for their parent government, the companies were willing to take that risk. This ultimately made them far superior crisis managers than their political counterparts.

Ironically, this ruthless pursuit of profit also made the companies a form of honest broker between the consumers and the producers. Although eventually not entirely trusted by either side, the companies were able to serve an important function as a buffer. Even when they themselves were the object of wrath by either the producer or the

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consumer states, that wrath was tempered by the fact that the firms were essential to the smooth flow of oil. This made things uncomfortable for the companies at times, but ultimately helped keep them in their place of prominence.

The adaptability and chameleon-like nature of the oil companies could not be matched by Government officials or ministers. Oil had always been a bit of a mystery to Whitehall. Its strategic and economic importance was understood by all, but the ins and outs of the industry – the technicalities of oil grading, the complicated factors which increased or decreased costs and even the mundane calculations of supply and demand – required expert skill and a trained staff. This was not even to mention the need for knowledge of geology, drilling and reserve calculation in order to explore successfully for oil. This vast business and technical knowledge amassed over decades by the companies proved to be beyond the grasp of most civil servants and helped add to the opacity of the industry as a whole.

But this did not prevent successive Governments from urging the increased competency of both ministers and officials regarding oil matters – even if officials could not master the technicalities of oil drilling, they could still grasp the fiscal aspects of the industry and more fully understand the type of deal the Government was receiving from these most lucrative of subjects. But even the creation of BNOC did not completely remedy the inability of the Government to understand all aspects of these sprawling business interests. Even at the peak of state intervention in the oil industry, officials and

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ministers were still forced to speak to the chairmen of BP and Shell as equals or perhaps even as supplicants.

The eventual triumph of the international oil industry, however, over the concept of managed, state-run oil companies and markets was by no means inevitable. The drastic realignment of wealth and power after the 1973 Oil Crisis, although anticipated by many Government observers, caught the public unawares. This created a sense of chaos that could have been exploited to reshape radically the way the oil industry within Britain functioned. The chaos in 1979, and the companies' ability to benefit from it, only reinforced the view that the international oil companies were not out for the best interests of the public, but rather for their shareholders.

This sense of public outrage was felt on both sides of the Atlantic, but in the United States the idea of the Government taking a direct hand in the production and distribution of oil was never seriously considered. The same cannot be said of Britain. Not only was such an option desirable to a large portion of the population, but much of the infrastructure to take such a step was already in place. Britain's flirtation with a state-run oil industry, or even a managed market on the model of the French, did have profound consequences and could have had even more if even a modified form of Tony Benn's vision had been implemented. With France and Britain both advocating managed markets, there was a very strong possibility that the EEC would go the route of a protected market for oil, perhaps with the sort of special bilateral deals with OPEC member states that had been advocated by Britain and France during the 1973 Oil Crisis.

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Had this happened, the oil markets of today might look very different and the international oil companies as they are currently constituted might not exist.

But counterfactuals aside, the British example and the ultimate failure of state intervention reveals not only the factors already cited such as the firms' adaptability, their buffering role and the failure of the State to fully develop a competence in oil, but also the enduring power of capital. Many of the British Government's attempts to control or even influence the operations of the industry within its borders were limited by the fact that without the companies' ability to attract capital, the projects desired by the State could not come to fruition. From the earliest days of North Sea oil, the Government's program was dictated by the need to attract private capital. This held true up until the great debates and battles between Denis Healey and Tony Benn. The officials in Whitehall had long appreciated this necessity, thus binding them closely to the interests of the companies from an early date. The companies' ties to the web of international finance provided the financial muscle required to develop the resources desperately needed by the industrialized economies.

This remained true even in the post-Oil Shock world and continues in some form to this very day; in the end, the strategic partnership which was so important for both sides in 1957 never truly disappeared. Despite all of the change the international oil industry had experienced, BP, Shell and the British State continued to benefit one another. With the victory of Thatcher and the privatization of the North Sea, it was the

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companies who received what they had always wanted – a free hand to operate abroad powered by a secure base of supply and a secure market at home.

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