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OPEC as a Legal Entity

Laurence Stoehr*

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Abstract

Evaluates the legal organization and past operations of OPEC in order to understand it and anticipate in what direction this new economic power is headed.

OPEC AS A LEGAL ENTITY

INTRODUCTION

In 1960, responding to a fall in petroleum prices, representatives from five oil producing states¹ met in Baghdad to discuss their common plight. The result of this conference was the founding of the Organization of Petroleum Exporting Countries (OPEC). From a cautious beginning, OPEC survived a decade of muddling and, in early 1971, firmly established itself as a major force in the petroleum industry.² Currently, the thirteen member³ organization is considered to be an important factor in, perhaps even a threat to, the world's economy.⁴ OPEC has outlived the many predictions of its downfall, and a major reason for this success has been its effective organization.⁵ Accordingly, in order to understand OPEC and to anticipate in what direction this new economic power is headed, one must evaluate its legal organization and its past operations.

Defining OPEC is perhaps the most difficult but most important step in understanding its organization. OPEC is usually described as a cartel, and, to some extent, it fits that description in practice;⁶ yet OPEC is more than a mere cartel, and this fact might partially explain its remarkable success.⁷ The thirteen mem-

1. Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela are the Founding Members of OPEC. Z. MIKDASHI, *THE INTERNATIONAL POLITICS OF NATURAL RESOURCES* 52 (1976) [hereinafter cited as *INTERNATIONAL POLITICS*].

2. In 1971, OPEC threatened to embargo the oil supplies of any oil company that failed to accept a 55% tax rate on oil imposed in late 1970 by the OPEC Members. See OPEC, Res. XXI.120 for the procedural authority supporting such action.

3. Qatar, Libya, Indonesia, United Arab Emirates (Abu Dhabi), Algeria, Nigeria, Ecuador, and Gabon are all Full Members, in addition to the five Founding Members. *INTERNATIONAL POLITICS*, *supra* note 1, at 52.

4. From the standpoint of the average American, OPEC's power can be seen in the dramatic increase in the price of gasoline and the gasoline shortages in the summer of 1979.

5. D. RUSTOW & J. MUNGO, *OPEC: SUCCESS AND PROSPECTS* 94 (1976) [hereinafter cited as *RUSTOW*].

6. The purpose of the cartel is to artificially affect supply and demand curves. See W. OUALID, *INTERNATIONAL RAW MATERIALS CARTELS* 16 (1938). See also Z. MIKDASHI, *THE COMMUNITY OF OIL EXPORTING COUNTRIES: A STUDY IN GOVERNMENTAL COOPERATION* 96 (1972) [hereinafter cited as *COMMUNITY*].

7. While OPEC is a cartel by definition, it has shown that solid organization, represented by the ability to quell internal conflicts between Members' individual

ber organization has been recognized by one Western state as a juridical person;⁸ giving the organization, through its Secretariat, certain legal and diplomatic advantages.⁹ Perhaps the simplest and most accurate definition has been given by Jahangir Amuzegar: "OPEC is what OPEC does."¹⁰ By themselves, these words are insufficient, but they suggest an approach towards defining OPEC—namely, why does OPEC exist, how does it operate, and most importantly, what has it done. Each of these questions suggests a different perspective from which an understanding of OPEC can be gained.¹¹

I. HISTORICAL BACKGROUND: WHY OPEC?

The Baghdad Conference (September, 1960) was called by the Republic of Iraq to examine the state of the petroleum industry at that time.¹² The environment created by the international oil industry had three major characteristics: a highly-concentrated structure, vertical integration of the oil companies, and the oil concession system.¹³ As a result of these features, the seven major oil companies¹⁴ were able to decide the crucial policies of production

goals in order to present a general framework for individual policies, can stand up to the natural effects of supply and demand. In addition, the growing demand for oil has aided OPEC's power and cohesion. *See* notes 96-103 *infra* and accompanying text.

8. OPEC, Headquarters Agreement between the Republic of Austria and OPEC (1965).

9. *See, e.g., id.* art. 3 (the recognition of OPEC's extraterritoriality, *i.e.*, that OPEC operations are separate from the domain of Austria); art. 4 (the capacity of OPEC to make contracts, the capacity to acquire and dispose of property, and the capacity to sue); art. 6-9 (grants of immunity to OPEC from legal proceedings, state action, and taxation).

10. Amuzegar, *The Oil Story: Facts, Fiction and Fair Play*, 51 FOREIGN AFF. 684 (1973).

11. Unlike other articles dealing with OPEC, this Note will avoid analyzing OPEC from an economic standpoint. It is intended to aid in understanding OPEC as a legal entity, thereby enabling the reader to anticipate OPEC's future effects on the world economy.

12. There had been previous discussions by the oil-producing states, but those discussions never amounted to any action. *See generally* RUSTOW, *supra* note 5, for a brief history of these pre-OPEC groups.

13. COMMUNITY, *supra* note 6, at 35. These characteristics can be defined as follows: "highly-concentrated structure" refers to the almost oligarchic control of oil production, first by the seven major oil companies, later by OPEC members; "vertical integration" describes the control of all phases of oil production from exploration and drilling to refining; "oil concession system" is the leasing of oil fields by an oil exporting state to a company in return for royalties on production. *Id.*

14. Exxon, British Petroleum, Shell, Standard California, Mobil, Gulf, and Texaco. *See* RUSTOW, *supra* note 5, at 3.

and pricing, whereby the oil-producing states would receive only a limited share of the production revenues.¹⁵ Whenever individual states took action against the abuses of the system, as did Iran in 1951, they would meet with failure.¹⁶

OPEC was the product of a common emotion against this exploitation by the oil-consumer states.¹⁷ The Founding Members¹⁸ recognized that their economies depended, to a large extent, upon petroleum income and that this source of revenue was a "wasting asset."¹⁹ Realizing they could meet the inequities caused by the three features of the oil industry only through concerted action, the states at the Baghdad Conference created OPEC.²⁰ OPEC was formed, therefore, to correct the abuses of the then-existing petroleum industry and to protect the revenues of those states that relied on oil exports as the cornerstone of their economies through the unification of petroleum policies,²¹ through the prevention of competitive quarrels,²² and by taking concerted action towards common interests.²³

II. THE INTERNAL STRUCTURE OF OPEC

A. Membership

Membership in OPEC is divided into Full and Associate Members and is open to any state that satisfies the membership test.²⁴ The criteria for joining OPEC, as set out by the Baghdad Conference, are twofold. First, the state seeking membership must

15. See *id.* at 2-4.

16. Jensen, *International Oil-Shortage, Cartel or Emerging Resource Monopoly*, 7 VAND. J. TRANSNAT'L L. 335, 345-48 (1974). Since OPEC has been formed, Libya successfully raised its petroleum tax in 1970; however, due to a pipeline cut in Syria, there was a shortage of Saudi Arabian oil in the Western European market, the main consumer of Libyan oil. Thus, Libya could act without fear of being undersold by other oil producers. *Id.* at 346.

17. See generally RUSTOW, *supra* note 5, at 95.

18. See note 1 *supra*.

19. OPEC, Introduction to the Conference (1960). In other words, oil was a depleting, non-replenishable resource.

20. OPEC Res. I.1 (1960); OPEC, Introduction to the Conference (1960). For the convenience of the reader, the Roman numeral refers to the Conference meeting at which the resolution was passed, and the Arabic numeral places the resolution in the historical order of Conference action.

21. Azzam, *The Organization of Petroleum Exporting Countries (OPEC)*, 57 AM. J. INT'L L. 112, 112 (1963).

22. *Id.*

23. *Id.*

24. See OPEC Res. I.2 (1960).

have a substantial net export of crude oil, and second, the state must be accepted by three-quarters of the Full Members with a concurrence of all five Founding Members.²⁵ Since most highly industrialized states consume far more oil than they produce, the first membership requirement seems by definition to exclude them automatically from membership consideration. Furthermore, acceptance by all five Founding Members appears in practice to safeguard the homogeneity of the organization. Because these two criteria are likely to insure that common interests, both economic and social,²⁶ will be maintained within the organization, OPEC has the potential to be a cohesive and decisive group.²⁷

B. *The Resolution Procedure*

Resolutions are OPEC's only expression of policy.²⁸ While they represent the legal effect of OPEC, the resolutions, and especially the procedure under which they are formulated,²⁹ clearly illustrate the most divisive element within OPEC: the state sovereignty principle.

Because of the respect for state sovereignty, Member states are required only to follow the decrees of the organization with an obligation of good faith.³⁰ OPEC has no legal sanctions against errant or contrary practices by any individual state.³¹ Rather than force individual Members to follow an undesirable resolution, OPEC passes a resolution only upon the unanimous vote of all the

25. OPEC Res. VIII. 56, art. 7C (1965), reprinted in 4 INT'L LEGAL MATERIALS 1175 (1965) [hereinafter cited as Statute]. See note 38 *infra* and accompanying text.

26. The producing states have economies somewhat dependent upon petroleum and would not naturally align themselves with the consumer states. Thus, England, assuming the North Sea Oil field allows exportation, would probably never pass the membership test. It is questionable whether Mexico, because of its ties with the United States, would be accepted.

27. See generally INTERNATIONAL POLITICS, *supra* note 1, at 54.

28. See Statute, *supra* note 25, art. 15(1), art. 11C. These sections state the power of the Conference to make policy and describe the procedure through which this power is used—*i.e.*, resolutions, although the term "resolution" is only used in actual practice and is not used in the Statute.

29. The procedure is found in the Statute, *supra* note 25, art. 11.

30. *Id.* art. 3.

31. The Enforcement Department of the Secretariat is charged only with monitoring the implementation of resolutions by Members. See Statute, *supra* note 25, art. 36. Nobody other than the Conference can act against a Member, and since such action requires a unanimous vote by the Conference, see note 32 *infra*, it is unlikely any action would ever be taken.

delegates to the Conference,³² a practice which hopes to promote faithful observance through the removal of controversial policies. Although the resolutions are passed under conditions of unanimity, they do not impose automatic acceptance upon the Members;³³ thus, resolutions are accepted only when they are compatible with the interests of the individual state.³⁴ Furthermore, the typical terminology of the resolutions implies that there is no obligation to accept them.³⁵

Resolutions are considered to have the same juridical character as a treaty and are intended by OPEC to be followed as such.³⁶ Once a resolution is accepted, therefore, it becomes a part of the Member's municipal laws.³⁷ The importance of this assimilation is that in a concession dispute, it seems the municipal laws of the source state should apply.³⁸

By couching its resolutions in advisory rather than in assertive language, OPEC appears to be trying to project an image of

32. Statute, *supra* note 25, art. 11C. Substantive issues require unanimity of all Full Members. *Id.*

33. See Statute, *supra* note 25, art. 3. The Statute only speaks of a good faith obligation to follow resolutions. *Id.*

34. M. EL-SAYED, L'ORGANIZATION DES PAYS EXPORTATEURS DE PETROLE 200 (1967).

35. *Id.* at 197. Typical language is "resolves," or "recommends."

36. *Id.* at 136. The juridical character of treaties is that treaties impose binding obligations on party-states. This obligation rests partly upon the principle of *pacta sunt servanda*—following in good faith what one agrees to do. J. STARKE, INTRODUCTION TO INTERNATIONAL LAW 459 (8th ed. 1977) [hereinafter cited as STARKE].

37. The force of treaties internally depends upon the individual state's constitutional treatment of the treaties. See STARKE, *supra* note 36 at 481-82. A survey of the constitutions of the Member states show that each accepts treaties made by representatives of the government as a part of the municipal law of the state. The relevant sections of the respective constitutions are: Iran art. 24; Iraq art. 45; Kuwait art. 70; Saudi Arabia art. 18; Venezuela art. 128; Libya art. 23; Indonesia arts. 5(1), 11, 20; Algeria, no provision on point, *but see* art. 28; Nigeria art. 74; Ecuador arts. 184(3), 132; Gabon and Abu Dhabi apparently have no written constitutions; *reprinted and edited in* A. PEASLEE, CONSTITUTIONS OF NATIONS (3d ed. 1965).

38. The precedent for such application may be found in the 1951 decision of the International Court of Justice concerning the nationalization of the Anglo-Iranian Oil Co. *United Kingdom v. Iran*, [1951] I.C.J. 89. The Court held that the nationalization of the company by Iran was valid since Iranian law, not British law, would apply. Of course, the Court's decisions have no precedential value and can serve only as a guideline. Mirvahabi, *Claims to the Oil Resources in the Persian Gulf: Will the World Economy Be Controlled by the Gulf in the Future?*, 11 TEX. INT'L L. J. 95, 96 (1976) [hereinafter cited as Mirvahabi]. See also G. Kozanec, *Problems Juridiques Internationaux des Concessions Petrolures*, 36 Y.A.A.A. HAGUE ACAD. INT'L L. 48 (1966).

unity.³⁹ The practical effect, however, is that a Member can vote in favor of an advisory resolution and then disregard it without fear of reprisal. The same practical effect holds true even when the resolutions are framed as assertive mandates.⁴⁰ While the resolutions have a legal importance, the state sovereignty principles inherent in the resolution procedure seem to undercut any autonomous power that may have been conferred upon the organization, thus stripping OPEC of its potentially dynamic role as a leader of the oil exporters.

C. OPEC's Government

One of OPEC's strongest features is its governmental organization.⁴¹ Although the governing body originally was created at the Second Conference in 1961,⁴² its present form was established by the Statute of the Organization of the Petroleum Exporting Countries, which was drafted at the Eighth Conference in 1965.⁴³ The Statute seems to outline fully the tripartite government of the organization, clearly delineating the powers and functions of each branch—the Conference, the Board of Governors, and the Secretariat.⁴⁴

i. The Conference

The Conference has been designated as the supreme authority of the organization⁴⁵ and is composed of delegations from each of the Member states. A quorum of three-quarters of the delegations needs to be present to hold the Conference.⁴⁶ For the purpose of voting, the Conference distinguishes between Full and Associate Members. While all Members are expected to participate in Conference meetings, only Full Members may vote.⁴⁷ Although the delegation may have more than one representative, each delegation is limited to one vote.⁴⁸

39. See INTERNATIONAL POLITICS, *supra* note 1, at 59-60.

40. See note 101 *infra* and accompanying text.

41. See INTERNATIONAL POLITICS, *supra* note 1, at 76.

42. OPEC Res. II.6 (1961).

43. Statute, *supra* note 25.

44. *Id.* art. 9.

45. *Id.* art. 10.

46. *Id.* art. 116.

47. *Id.* arts. 7E, 11C; INTERNATIONAL POLITICS, *supra* note 1, at 54 gives the distinctions between Full and Associate Members.

48. Statute, *supra* note 25, arts. 11A, 11C. Full Members may cast one vote per delegation; Associate Members do not vote in the Conference, but participate in the

The primary functions of the Conference are to formulate the general policy of OPEC and to determine the appropriate implementation thereof.⁴⁹ Other duties, mostly procedural in nature, give the Conference control over the finances of the organization and the other branches of the government.⁵⁰ Usually, the Conference will meet twice a year,⁵¹ however, an extraordinary meeting may be called,⁵² as was done during the oil negotiations in 1971.⁵³

ii. *The Board of Governors*

The managerial branch of OPEC is the Board of Governors.⁵⁴ The Board is composed of one governor from each member state, each with one vote.⁵⁵ Two-thirds of the governors need to be present for a quorum,⁵⁶ and a simple majority of those present is necessary to carry a motion.⁵⁷ Unlike the Conference, which is essentially an ad hoc body, the Board is permanent and meets "at suitable intervals in the year," as determined by the Chairman of the Board.⁵⁸ A governor serves a term of two years,⁵⁹ but may be removed from the Board by a two-thirds majority vote of the entire Board if that governor is found to be acting contrary to the interests of the organization.⁶⁰ In conjunction with a duty to obey the orders of the Conference, the Board has two main functions: to manage the affairs of the organization through the implementation of Conference resolutions, and to prepare recommendations for Conference action.⁶¹

Conference debates prior to voting. *Id.* art. 7E. See note 47 *supra*, and accompanying text.

49. Statute, *supra* note 25, art. 15(1).

50. See *id.* art. 15.

51. *Id.* art. 12.

52. *Id.* The Secretary-General also is authorized to call an extraordinary meeting. *Id.* art. 18.

53. The 1971 Tehran meeting was set up by Conference vote at the Twenty-first Conference in December, 1970. See note 96 *infra*.

54. Statute, *supra* note 25, art. 20.

55. *Id.* art. 17D. All Members nominate and are represented by a Governor, who must be confirmed by the Conference. If a Governor is absent, the Member state may replace him with an ad hoc Governor for that meeting without confirmation from the conference. *Id.* art. 17C.

56. *Id.* art. 17B.

57. *Id.* art. 17D.

58. *Id.* art. 18. The Chairman should consult with the Secretary-General before calling the meeting. Extraordinary meetings may be called by the Chairman, the Secretary-General, or by two-thirds of the Governors. *Id.*

59. *Id.* art. 17E.

60. *Id.* art. 23.

61. *Id.* art. 20.

iii. *The Secretariat*

The Secretariat was not originally a separate entity within OPEC; instead, its duties came under the control of the Board of Governors, and the Chairman of the Board had a secondary duty as Secretary-General.⁶² As OPEC began to grow during the early 1960's, the position of Secretary-General became too burdensome to be a secondary function. The 1965 Statute, therefore, created the Secretariat as a separate branch to carry out the executive functions of the organization.⁶³

Originally, the Secretary-General was appointed by the Conference to serve a term of one year.⁶⁴ The Secretary-General was required to be a national of one of the Member states and needed the unanimous support of the Conference.⁶⁵ Appointments were made on a rotational basis—each Founding Member would have one of its nationals serve as Secretary-General, then the appointments would rotate around the Full Members according to seniority of membership.⁶⁶ The Conference decided that after 1970 the position of Secretary-General would be more effective if the term of service were longer and if the qualifications for appointment were more stringent.⁶⁷ The term of service was extended to three years and was made renewable.⁶⁸ The rotational system of nomination was discarded;⁶⁹ however, if no nominees met the new qualifications, appointments were to be made on a two-year term rotational basis.⁷⁰ Although the new selection process seemed to be aimed at reducing problems arising from the state sovereignty principles, the Conference has been unable to agree upon any nominee under

62. When the Statute was originally conceived, OPEC Res. II.6 (1961), the organization was composed of the Conference and Board of Governors. *Id.* § 2. The Chairman of the Board carried the duty of Secretary-General. *Id.* § 4.8.

63. The Secretariat is the research unit, the administrative body, and the legal representative of OPEC. Statute, *supra* note 25, arts. 27A, 29. See INTERNATIONAL POLITICS, *supra* note 1, at 55.

64. Statute, *supra* note 25, art. 28.

65. *Id.* arts. 28A, 15(10), 11C.

66. *Id.*

67. See OPEC Res. XX.117 (1970). The minimum qualifications are: (1) nominee must be 35 years of age, (2) he must have a university degree in Law, Economics, Science, Engineering, or Business Administration, and (3) he must have 15 years of relevant experience. *Id.*

68. INTERNATIONAL POLITICS, *supra* note 1, at 56.

69. See *id.*

70. The rotational system is substantially similar to the system found in the Statute, *supra* note 25, art. 28.

the new system. Appointments, therefore, have been made on the rotational basis.⁷¹

The duties of the Secretariat are to prepare studies for the Conference and to serve as an information center both for the benefit of the Members and for public relations with non-Members.⁷² Although the Secretary-General is charged with performing these duties, he may delegate his authority to the five departments of the Secretariat.⁷³ The employees of the Secretariat are considered to be international employees, owing no allegiance to any one Member.⁷⁴ This feature seems to strengthen the concept of OPEC as an autonomous organization.

While the powers of the Secretariat, as described within the Statute, appear to make this branch a strong instrument of the organization, it has never been given sufficient Member support to fulfill its potential.⁷⁵ The failure of the Secretariat to become a strong force within OPEC again seems to indicate the corrosive effect of state sovereignty principles upon the power of OPEC as a supergovernmental organization.

III. OPEC IN OPERATION

As Amuzegar's description of OPEC implies,⁷⁶ the only effective way to understand the mechanization of OPEC is to see it in action. The acts of OPEC clearly show the limits of its purposes.⁷⁷

71. See INTERNATIONAL POLITICS, *supra* note 1, at 56.

72. See Statute, *supra* note 25, arts. 29-39.

73. *Id.* art. 33. Performing these duties are five departments: the Administration Department; the Economics Department, which studies the petroleum market for the informational benefit of OPEC Members; the Enforcement Department, which reviews the legal aspects of the petroleum industry, as well as following the development of resolution implementation; the Public Relations Department; and the Technical Department, which studies technical improvements in the industry. See *id.* arts. 34-38. In 1977, the Secretariat was restructured to meet an increasing work load. See OPEC ANN. REP. 58-59 (1977).

74. Statute, *supra* note 25, art. 32.

75. See COMMUNITY, *supra* note 6, at 56. Rather than making the Secretariat a strong, independent entity that could exert some control over the Members—in other words, a leader of the oil-exporting interests—the 1977 restructuring turned the Secretariat primarily into a research organization. OPEC ANN. REP. 59 (1977).

76. See note 10 *supra* and accompanying text.

77. "OPEC is a limited-purpose alliance of governments bent on maximizing their medium-term monetary returns from oil." RUSTOW, *supra* note 5, at 90-91. This quote points to two factors in OPEC's operations: its limited economic purpose and its deference to state sovereignty. A third factor is the metamorphosis of OPEC from a defensive group to a dynamic economic power. OPEC ANN. REP. 58 (1977).

OPEC has not integrated its Members' economies, but has coordinated their policies concerning oil production.⁷⁸ Since the Third Conference in 1961, OPEC has sought to develop a uniform production policy;⁷⁹ however, in 1971, the Twenty-third Conference finally resolved to hold back a joint production program.⁸⁰ While the OPEC Economic Commission⁸¹ acknowledges that the failure to unite the Members' various petroleum policies is a threat to OPEC's existence, the Conference has resisted imposing any formal plan of production control.⁸² The absence of a system of uniform production may lead to future trouble if oil consumption drops,⁸³ because a decrease in demand may result in price reductions.⁸⁴

Although no formal production policy has ever been implemented, OPEC has created informal production controls through the principle of supply and demand.⁸⁵ OPEC's most visible function is to set price guidelines.⁸⁶ While OPEC does not force its Members to observe these suggested prices, the five states—Venezuela and the four major Persian Gulf producers—who control 72 percent of the total OPEC production have maintained

78. COMMUNITY, *supra* note 6, at 69. Integration is almost impossible when one considers the social, geographical, and economic differences among the Members, e.g., a populous, tropical state such as Indonesia and a sparsely populated, desert state such as Saudi Arabia.

79. OPEC Res. III.26 (1961).

80. OPEC Res. XXIII.133 (1971).

81. The Economic Commission is a separate research body within OPEC, working in conjunction with the Economics Department. INTERNATIONAL POLITICS, *supra* note 1, at 55.

82. Cf. F. WYANT, THE UNITED STATES, OPEC, AND MULTINATIONAL OIL 95 (1977) (use of pricing policy as an alternative to formal production controls) [hereinafter cited as WYANT].

83. Comment, *Cartel Pricing in the International Energy Market: OPEC in Perspective*, 54 ORE. L. REV. 643, 663-64 (1975).

84. See Levy, *World Oil Cooperation of International Chaos*, 52 FOREIGN AFF. 690, 710 (1974). But see generally WYANT, *supra* note 82, at 112-21 for an economic analysis that may counter this position.

85. See RUSTOW, *supra* note 5, at 99; INTERNATIONAL POLITICS, *supra* note 1, at 60-61 for examples of this informal production control.

86. There are three types of pricing: (1) posted price—a legal fiction used by exporters to calculate royalties and tax forms from companies who produce and keep the oil, (2) buyback price—applied to oil produced by the companies, but owned by exporters through participation agreements, then bought by the companies, and (3) open-market price—applied to participation oil not bought back or to oil sold on the open market. See Loumiet, *Toward an International Commodity Agreement on Petroleum*, 5 DEN. J. INT'L L. & POL'Y 513 (1975).

close adherence to OPEC's price policy.⁸⁷ The other Member states must bring their prices in line with the five major producers in order to remain competitive, and in the past higher prices have been driven back into conformity with OPEC guidelines by this process.⁸⁸ It follows that over-production by one state can be curtailed if the major producers slightly increase their production while maintaining lower prices: the smaller state would be faced with an economically destructive surplus.⁸⁹ It seems that as long as these five states dominate production and remain moderate with respect to following OPEC price guidelines,⁹⁰ OPEC can continue to present a consistent production policy to the consumer states, assuring them of a supply of oil at a "fair" price.⁹¹

OPEC has made substantial external gains in the international petroleum industry.⁹² The industry is based upon the concession system,⁹³ which has influenced OPEC's actions. In its first ten years, major successes were accomplished in two pricing areas.⁹⁴ First, a new method of royalty payments was established in 1963 called "expensing royalties," which changed royalty payments from a credit to an expense for the purposes of taxes.⁹⁵ Second, the 55

87. RUSTOW, *supra* note 5, at 99.

88. *Id.*

89. WYANT, *supra* note 82, at 95. *See id.* at 95-112 for a discussion of the economic interrelationship of the OPEC states with respect to oil production.

90. Of course, Iran, traditionally a moderate on oil policies because of ties with the United States, is now a question mark both for its production ability and for its policies, since the Shah has been deposed.

91. "Fair" is a relative term. OPEC's conception of a fair price might be substantially different than that of the consumer states.

92. INTERNATIONAL POLITICS, *supra* note 1, at 81; *See* RUSTOW, *supra* note 5, at 32.

93. Mirvahabi, *supra* note 38, at 94. *See* note 13 *supra*, for a definition of the concession system.

94. *See* notes 95-96 *infra* for the events surrounding "expensing royalties" and the "55% minimum tax rate." The significance of these two items is that the charges revolutionized revenue sharing. The pre-OPEC system allowed royalties to be credited towards any taxes paid on oil profits to the source state. The effect of credit royalties was that a 12½% royalty would cancel any tax liability. By turning these royalty payments to an expense, OPEC separated royalties from tax payments, which could increase revenues to the source state to a reasonable level. OPEC, Background Information: Explanatory Memoranda on Resolutions IV. 32, IV. 33, and IV. 34, at 13-14 (1962). The 55% minimum tax, which was coupled with premium payments for freight advantage and other miscellaneous items, also represented a significant increase in revenues to the source states. The true importance was that OPEC was, for the first time, able to influence oil prices to a significant degree. *See* OPEC, RECORD AND REVIEW, 7-8 (1971).

95. The Conference, in 1962, passed three resolutions in order to meet a con-

percent tax rate on net income of oil company operations within Member states was established in 1971.⁹⁶ The net effect of these changes has been a substantial increase in revenues to the Members as compared to revenues derived from the old system of credit royalties and "50-50 revenue sharing."⁹⁷

These two gains in the pricing area seem to indicate the power of OPEC when it does act as a unified body. OPEC's power is based upon its ability to retaliate against or to reward the conduct of its consumers, both governments and private companies.⁹⁸ Re-

tinued drop in petroleum prices. OPEC Res. IV. 32, IV. 33, IV. 34 (1962). OPEC had not tested its strength as an organization until this time, but resistance from the oil companies to individual state action caused OPEC to try its power of collective action against the companies. OPEC, however, did not act as an autonomous body, calling instead for joint action among its Members. *Id.* By the Fifth Conference, when a three-member committee was authorized by OPEC to continue negotiations with the oil companies, sufficient progress had been made so that the measures called for in Resolution IV.32 would not be necessary. OPEC Res. V.40 (1962). Nonetheless, further resistance by the companies to "expensing royalties" caused OPEC to call for a boycott on granting new oil rights until the companies acceded to the new pricing system in all member states. OPEC Res. X.63 (1965), OPEC Res. XI.72, Res. XI.73 (1965). The expensing royalty negotiations were carried out for the most part by individual states; however, it seems that the success of these negotiations was due to the potential power that collective bargaining could bring. It was the first victory for OPEC, which discovered that the mere threat of retribution could shatter the once immovable company resistance. See Vafai, *Conflict Resolution in the International Petroleum Industry*, 5 J. WORLD TRADE L. 427, 434 (1971) [hereinafter cited as Vafai].

96. While the pricing negotiations of 1962-1965 were the first sign of OPEC's strength, the negotiations leading to the Tehran Agreement in early 1971 marked OPEC's emergence as a direct influence over the world petroleum market. Vafai, *supra* note 95, at 428-29. See OPEC Res. XXI. 120 (1971); OPEC, RECORD AND REVIEW, 7-8 (1971) for details of the proposals and the agreement, as well as its companion agreements negotiated later in 1971. OPEC presented general price guidelines which formed the framework of the negotiations, appointed a three-member Ministerial Committee—Iran, Iraq, and Saudi Arabia—to negotiate on behalf of the Members concerned, and threatened price legislation within the Member states if the negotiating parties could not come to an agreement. Vafai *supra* note 95, at 429. The Tehran Agreement was the product of careful planning by the Conference, which formulated its strategy in December, 1970. The Conference was careful to recognize the international legal principles of contracts, choosing the path of negotiations over unilateral change. Devaux-Charbonnel, *Les Accords de Teheran et de Tripoli*, [1971] ANNUAIRE FRANÇAIS DE DROIT INTERNATIONAL 137 (Centre National de la Recherche Scientifique). The time for negotiations was ripe, however, for the worldwide energy market had changed such that demand exceeded supply to a critical point. Consumers, *i.e.*, the companies, had little choice other than to agree to OPEC's demands. *Id.* at 135.

97. Vafai, *supra* note 95, at 435.

98. Amuzegar, *OPEC in the Context of the Global Power Equation*, 4 DEN. J. INT' L. & POL'Y 221, 227 (1974) [hereinafter cited as *OPEC as a Global Power*].

taliatory measures include embargoes, regulation of operations, controlling foreign investments of oil proceeds, discriminatory price-fixing, and altering politico-military alliances.⁹⁹ Rewards, on the other hand, include special concessions and cooperations in investments.¹⁰⁰ These tactics have been utilized successfully in the past, although they have greater power when used merely as a deterrence or an inducement.¹⁰¹ Of course, these weapons are effective only in a market situation in which demand exceeds supply,¹⁰² and only if the Members act as a unified body.¹⁰³

Solidarity seems to be the main problem within OPEC. The organization has been inconsistent in its support of individual Members at various times, partly due to socio-political differences.¹⁰⁴ These differences have led to the formation of a coalition within OPEC—the Organization of Arab Petroleum Exporting Countries (OAPEC), which was responsible for the oil embargoes of 1967 and 1973.¹⁰⁵ OPEC has been careful in treating the OAPEC problem, but has noted its detrimental effect on production and on the interests of OPEC as a whole.¹⁰⁶

The limitations of OPEC as an organization can be illustrated by three failures. First, OPEC has been unable to create an effective aid program for Third World states.¹⁰⁷ Second, OPEC has been unable to draft a “Uniform Petroleum Code” or to establish

99. *Id.*

100. *Id.* at 228.

101. *Id.* An example of the use of embargo as a deterrent can be seen in both the expensing royalty negotiations, *see* note 95 *supra*, and the Tehran Agreement negotiations, *see* note 96 *supra*.

102. *See* RUSTOW, *supra* note 5, at 106.

103. INTERNATIONAL POLITICS, *supra* note 1, at 57.

104. COMMUNITY, *supra* note 6, at 78. Some examples are the political alignments of Libya and Saudi Arabia, the border disputes between Iraq and Iran and between Saudi Arabia and Kuwait, and the geographical differences between the desert states and the other members. *Id.*

105. *Id.* at 82-83. OAPEC called the boycotts because of the conflict between Egypt and Israel. Egypt was a member of OAPEC at the time. During these embargoes, the non-Arab Members of OPEC continued to supply oil, but could not make up the shortages resulting from the embargoes. *Id.*

106. *See* OPEC, RECORD AND REVIEW 4 (1973).

107. *See* Williams, *The Aid Programs of OPEC Countries*, 54 FOREIGN AFF. 308, 315-16 (1976). Although OPEC recognizes that higher oil prices have an even greater detrimental effect on less-developed countries, any politically conscious attempts to alleviate the burden of higher oil prices with increased aid have never been fully implemented, such that OPEC members lag far behind the United States in foreign aid. As a result, OPEC has not been able to achieve leadership of the Third World states. *Id.*

an inter-OPEC High Court "for the settlement of all disputes and differences relating to petroleum matters."¹⁰⁸ Finally, resolutions passed by the Conference have been disregarded when not in Member's interests.¹⁰⁹ These failures all seem to revolve around the conflict between having a strong and independent OPEC as a vanguard for the oil exporters and protecting the sovereignty of each Member state. It seems the basis for OPEC's failures and problems is that the Members will act according to their own interests and will not subordinate those interests to the interests of OPEC as a whole unit.

OPEC's failures, nonetheless, seem to have been overshadowed by its success. This success has hinged upon the replacement of coal by oil as the main fuel of the industrialized states.¹¹⁰ Furthermore, the location of Member states in economically and militarily strategic areas has discouraged criticism from the governments of the oil consumers.¹¹¹

The only major external threat to OPEC's existence appears to be either a large discovery of oil in a non-OPEC area, thus ending OPEC domination of the market,¹¹² or a reduction in oil's importance in the world energy market.¹¹³ Internal threats of price-cutting are unlikely so long as the control of a major portion of production is concentrated in Member states whose income absorptive capacity is relatively small, such as Saudi Arabia.¹¹⁴ It seems OPEC will exist so long as its economic benefits have a greater priority among the Members' individual interests over any divisive feelings of state sovereignty.

108. See OPEC, Res. V.41 (1962). OPEC believed that it would be in the best interests of the Members if their disparate laws concerning petroleum were unified, and that a special international court be set up to mediate any disputes within OPEC that would hinder productivity. It is difficult to say what happened to these concepts, since there is no subsequent record of action on either. Most likely, they were abandoned during discussions.

109. E.g., OPEC Res. XVII.94 (1969) asked Members not to grant new oil rights to companies from highly industrialized states. Shortly thereafter, Qatar and Abu Dhabi each granted oil rights to a Japanese company. See COMMUNITY, *supra* note 6, at 80.

110. RUSTOW, *supra* note 5, at 118.

111. OPEC as *Global Power*, *supra* note 98, at 223-24.

112. Akins, *The Oil Crisis: This Time the Wolf is Here*, 51 FOREIGN AFF. 462, 485 (1973).

113. *Id.*

114. Income absorptive capacity is the ability of a state to utilize income. The significance is that such a state can afford to cut back production without fear of economic depression.

CONCLUSION

OPEC was created as a challenge to the abuses of the international petroleum industry, and it has proven to be an effective force in the world's economy.¹¹⁵ Although its legal system was intended to establish OPEC as a strong leader of oil exporting interests, the refusal to subordinate individual state interests to the interests of OPEC as a whole has made OPEC merely a forum for its Members' own self interests. The Members seem to be relying on the continued importance of oil as a world energy source,¹¹⁶ but the current demand for petroleum may abate in the future. The importance of having OPEC in the role of a strong, united, autonomous leader of the oil exporters seems to be inversely proportional to the demand for oil. If its Members are to be protected from the same type of competitive quarrels that brought about the need for OPEC or from a strong reaction from the highly industrialized states, OPEC will need to be strengthened as an organization. OPEC will need to be restructured, removing the divisive elements of state sovereignty from the organization, before it can guarantee to its Members that it will protect their petroleum assets.

Laurence Stoehr

115. See, e.g., notes 95-96, *supra*.

116. WYANT, *supra* note 82, at 121.

