DEVELOPMENT OF CAPITALISM AND LAND TENURE:
THE EXAMPLE OF PETROLEUM

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PREFACE

Capitalism emerged from political regimes characterised by land ownership in the hands of a dominant landlord class. The new regime, in contrast, was characterised by the ownership of capital in the hands of a new dominant class, the capitalist class. Hence, in the transition from one regime to the other, the latter had to subordinate the former, economically, politically, socially and ideologically.

Ideologically, this subordination was reflected in the evolution of modern economic thinking, which originated in the sphere of production, rather than the sphere of commerce as had previously been the case. This evolution can be summarized in the successive appearance of three schools of thought in a mere 150 years.

The first of these schools was the French *Physiocracy*. Its most important representative was François Quesnay, author of the *Tableau Économique* (1758). For the Physiocrats, economic activities were based on two factors of production*, labour and land*. Physiocracy was followed by the British school of *Classical Political Economy*, whose most important representative was Adam Smith, author of *An Enquiry into the Nature and Causes of the Wealth of Nations* (1776). For this school of economic thought, there were three factors of production: *labour, capital and land*. Capital had already made its presence felt, acquiring an importance in the sphere of production impossible to ignore. The Classical school was then replaced by a third school, also British, which came to constitute *Economics* as it is known today. The term *Political Economy*, which had been the hallmark of the Classical School, was stripped of the adjective *Political*, a change in vocabulary reflecting the transformation of Great Britain from feudalism to capitalism. One representative of importance of this school was Alfred Marshall, author of *Principles of Economics* (1890). This third school of thought reduced the number of factors of production again to two, but now they were *labour and capital.*

This brief sketch of the evolution of economic thought highlights the disappearance of *land* as a factor of production between 1758 and 1890. During this period, land was absorbed into the concept of capital, an outcome mirroring the actual transformation of the British economy. It has been estimated that, in 1688, ground rents represented 47% of the National Income of England; by 1900, their share was only 12%.[1] This development reflected a profound social transformation of traditional landlords becoming private landed property owners, and of a traditional peasantry being converted into a free working class. Thus, wherever landed property continued to generate ground rents, such rents were now dressed up as profits. Indeed, with the development of a market for landed properties, landlords were able to benefit from the option of converting themselves into capitalists, and vice versa, capitalists into landlords. Thus, from the point of view of a buyer or seller of land (either real or hypothetical), land took the form of a 'natural' capital, but 'capital' nevertheless. And it could not be otherwise once the capitalist class had taken over the political power. It was this

[1] Asdrúbal Baptista: *Bases cuantitativas de la economía venezolana: 1830-2008*, 4ª ed., Caracas 2011, p.201.

political power that allowed that class to create a new conceptual framework, not only ideologically, but also socially, economically, legally, and institutionally.

Ground rent was now relegated to the past as a fundamentally illegitimate source of income, given the former land-owning class had spent it unproductively, and on luxury consumption. The decline of ground rent gave impetus to the drivers of capitalist development, labour and capital, and ultimately of the development of productivity. But it was not only about labour and capital benefitting from the demise of ground rent; most importantly, it was also about breaking up traditional forms of land ownership which were obstructing the development of productivity. Thus, for example, the form and size of landholdings were compelled to adapt to progressive mechanisation, and mining rights were compelled to adjust to the characteristics of deposits.

In Great Britain, these changes were brought about through an evolutionary process, but in France, it came through revolutionary violence. Nevertheless, for capitalism, as a dynamic mode of production, the reassignment of property rights over natural resources always remains a possibility. Although the assignment of such property rights may have been consistent with the development of productivity at a specific moment in time, such arrangements could become obsolete in later stages of development. Ultimately, property rights on natural resources will always continue to be subject to the historic mission of capitalism: the development of productivity.

NATIONAL DEVELOPMENT

For practical reasons, capitalism organised itself historically in national States, more precisely, *territorial* States. In other words, the subordination of land tenure to capitalism took the form of eminent domain by the state over natural resources. Above all, this was about subjecting land tenure nation-wide to capitalist competition.

But it was also about subjecting land tenure to a fiscal regime targeting ground rents, favouring salaries and profits through lower levels of taxation. From a microeconomic viewpoint, the consumer would certainly pay implicitly a price covering extraordinary economic surpluses; but from a macroeconomic viewpoint, consumers would end up paying only production costs, the usual profit included.

INTERNATIONALIZATION

However, the developed countries also turned to land available in the rest of the world for their supply of foodstuff and raw materials in order to circumvent national limitations. Consequently, one group of countries emerged as exporters of industrial products, while another group of countries emerged as exporters of primary products. This latter group consisted principally of countries that would later be known as the Third World.

These countries' nascent development of capitalism initially received a strong boost from the investment necessary to become a significant exporter of primary products. Generally, this investment came directly from the interested developed capitalist countries. However, once

they were established as exporters of primary products, these countries would follow the same principles regarding the fiscal regime as the developed countries: they would concentrate on the extraordinary surplus that would appear in the exporting primary sector.

Yet as far as the domestic market was concerned, this taxation policy involved the *national* distribution of income; in contrast, as far as the international market was concerned, this policy involved its *international* distribution. Consequently, to the extent to which the state in the exporting countries would be able to collect the extraordinary surpluses generated by the export of raw materials, these countries would be the beneficiaries of *international ground rents*. Thus, *Landlord States* emerged claiming their right to collect such ground rents as a *sovereign right*.

Therefore, the group of the importing States – in the first place, the developed capitalist countries, the promotors of the internationalization of capital – turning to international trade in its endeavour to subject land to capital, would end up confronting the exporting States of primary products, questioning in one way or another their *territorial* sovereignty. Nationally, the development of capitalism went hand in hand with the development of private property, sacrosanct and inviolable, but with the caveat of natural resources ultimately being subject to the eminent domain of the State. Internationally, however, the development of capitalism also went hand in hand with the emergence of sovereign national States; but the importing countries would consistently question the legitimacy, if not legality, of the eminent domain of the State over natural resources in the exporting countries of primary products, to be a sovereign right to collect an international ground rent.

The most important example of this confrontation between the two groups concerning the scope of the concept of sovereignty was, and still is, petroleum. In its first phase, the petroleum exporting countries were most successful in their handling of the then prevailing *concessionary regime*, imposing gradually their concept of territorial sovereignty. Moreover, in 1960, they concluded an international treaty, the Organization of the Petroleum Exporting Countries (OPEC). Finally, the concessionary regime came to an end in the 1970s with the nationalization of the concessionaires: the international oil companies.

GLOBALIZATION

Following World War I, the world entered a general period of decolonisation, which ultimately culminated after World War II in the nationalisations mentioned above. There is no doubt that the developed capitalist countries had suffered a major setback in their endeavour to subject land tenure internationally to their design. But further, there cannot be any doubt that these countries would never abandon this endeavour, being one of the most fundamental characteristics of capitalism. Their response would be to close ranks, and to move forward from the process of internationalization of capital to its globalization.

What followed was a critical and systematic evaluation of the complete arsenal, which had been used so far successfully to subject land tenure to capital nationally, with a view to defining the changes, adjustments and actions necessary to create a new, *globally* successful

one. The leadership in economic thinking once again fell to Great Britain, and the new global regime was to be implemented first in the British part of the North Sea, the most important of the new oil-producing regions.

Politically, *national property* over the reservoirs as a natural resource would and could not be questioned, but it would be subject to a fiscal regime converting it, *economically*, into a *global property*. In other words, it was about subjecting the national property to a fiscal regime which would collect the extraordinary surplus, both nationally and internationally, to the benefit of global consumers. This was to be achieved by the national government collecting them, but only as a *contingent debt in favour of the very same oil companies*. Thus, once rising production costs due to the progressive exhaustion of the reservoir would no longer allow even normal profits to be made, the government would start to pay its debt in instalments necessary to guarantee such profit to the companies. Thus, they would only abandon a reservoir once they recovered their credits with the government.

Considering the full period of its exploitation, the companies would make their normal profit, and the extraordinary surplus would be zero. The global consumer, both domestic and foreign, would benefit through lower prices, thanks to the additional supply. Definitively, the recovery factor of the reservoirs would be maximized, as they would only be abandoned once the *average* cost of production would be equal to the prevailing market price.

PERSPECTIVES

Until the nationalization of the foreign concessionaires in the petroleum *exporting* countries, the fiscal regimes in all petroleum *producing* countries attempted to collect the extraordinary surplus, both national and international, to be distributed nationally, benefiting the collective owners of the natural resource. These regimes may best be defined as *national fiscal regimes*. In the case of the exporting countries, those extraordinary surpluses in exports were thus transformed into international ground rents.

The new *global* fiscal regime was designed to collect the extraordinary surplus, but it did so only as a *contingent debt*, to be re-invested in production by the very same companies. The resulting additional production would then benefit consumers globally. Moreover, the global fiscal regime could be applied in all oil producing countries, whether exporters or not, as it was conceived to maximize production and, ultimately, the recovery factor of the reservoirs. It would thereby also promote an accelerated development of global capitalism. The importing countries would thus be favoured from all viewpoints.

But under a global fiscal regime, the exporting countries would necessarily give up their claim to an international ground rent, much to the benefit of the importing countries. However, the former might also benefit from speeding up the development of global capitalism. Hence, in the exporting countries, there is a political divide. The importing countries – at present as in the past still under the leadership of the USA – may take advantage of this divide, ultimately *imposing* a global fiscal regime.

In this essay, we will analyse the development of land tenure and the corresponding fiscal regimes from the perspective of the developed capitalist countries. The same development, but from the perspective of the oil exporting countries, will be the subject of another, forthcoming essay.

PART ONE
NATIONAL DEVELOPMENT AND LAND TENURE

Modern economic thought was essentially *national* in nature, focusing on the development of national economies in Europe during the eighteenth and nineteenth centuries, specifically on the French (Physiocracy) and British economies (Classical Political Economy and modern Economics).

I.1. PHYSIOCRACY

In Physiocratic thinking, only labour in the primary sector (farming and mining) generated surplus value, or an *economic surplus,* over and above the cost of wages, due to the productivity of the land. Labour in the secondary sector (industry) and in the tertiary sector (services), on the other hand, was considered unproductive because it was limited to transforming one set of goods into others or to putting them into circulation, without increasing total production and consequently, its *value*. Land was the only source of economic surplus and landowners, as the agents of its exploitation, were considered the legitimate beneficiaries.

Nevertheless, the Physiocrats were in fact the pioneers of capitalism, something which was manifest in their proposals about taxation: because only the land could generate surplus value, the Physiocrats maintained that taxes should mainly be imposed on landowners and not on labour, a term which still included the nascent entrepreneurial class.

I.2. CLASSICAL POLITICAL ECONOMY

Classical Political Economy, on the other hand, had already accepted the fact that capital intervened as tenants (*lessees*) between the landlords (*lessors*) and the peasantry. Tenants became the new agents of production, whereas landlords, the traditional agents of production, were now relegated to the status of rentiers, as their income was only derived from their monopoly over the landed property as such.

Thus, labour emerged as the sole source of value, and thereby the sole source of surplus value. In principle, the latter was to accrue to the capitalist entrepreneur – in the primary sector, the capitalist tenant – as the new agent of production, in the form of profit, which was still understood as a supplementary wage justified by the special skills of entrepreneurship. In contrast, the traditional landlords now appeared as parasites who were obstructing productive activities, subjecting access to land to onerous negotiations of leases. Worse still, landlords were criticized because they dedicated their ground rents to luxury consumption and not to investment. Hence, *ground rents were deprived of legitimacy because they were spent on consumption and not on investment.*

I.2.1. ADAM SMITH

Nevertheless, land and capital as factors of production were forced to coexist in the primary sector, sharing the monopoly of property over the means of production, with the economic

surplus being divided between them. In other words, the surplus had to be divided between the tenants' profits and the landlords’ ground rents.

By far the most important part of ground rents originated in agriculture. Moreover, based upon his empirical observations, Adam Smith maintained that in Great Britain the landlords' monopoly over landed property was sufficiently strong, at least with respect to the production of corn, to allow them to impose a monopoly price above its value, a surcharge independent of the value of the corn. This was of major importance because corn was the principal ingredient to the work force's diet and, therefore, a very important element of salary. Hence, this surcharge affected not only labour and capital in agriculture but also in industry and commerce. All labour and capital had to pay the bill through lower real wages and profit rates. Thus, there was definitively *one* labour class and *one* capitalist class, united economically and politically in their endeavour to minimize ground rents.

The fact that private landed property was obstructing the development of capitalism, inasmuch as it hampered the free flow of investment, was even more obvious in the mining industry. In agriculture, the typical rent was measured in acreage, without any reference to volumes that might be produced. But the typical mining rent was a payment per unit produced, a *royalty*; for example, a few pence per ton of coal.

The virtue of royalties, from the viewpoint of the landlord, is that they vary with the intensity of the exploitation of the exhaustible reservoir. But, as Smith pointed out, they make economically impossible the exploitation of reservoirs of low natural productivity, which would command an acceptable profit if not for royalties.

I.2.2. COMTE DE MIRABEAU

Only thirteen years after the publication of Adam Smith’s *The Wealth of Nations*, the French Revolution of 1789 put an end to the landlords' monopoly of landed property in that country. *The land to the tiller* was the slogan that established the revolutionary criterion to be followed, reforming land tenure. Thus, in 1791, the National Assembly granted private property rights to those who worked the surface. It thereby created a structure of small properties, fully exposed to market competition.

But at the same time it also sanctioned *public* mineral ownership. Its principal spokesman in the National Assembly was the Comte de Mirabeau.[2] The debate focused exclusively on private mineral property obstructing the efficient working of underground mineral resources, without even mentioning ground rent. Indeed, projecting the boundaries of private landed surface property beneath the ground would obstruct the rational working of the mines, even more so as minerals were found at greater depths. The subdivision of landholdings on the surface of the land then corresponds less and less to the divisions appropriate for efficient mining. Moreover, there would also be an increase in capital requirements and it could not

[2] Honoré-Gabriel Victor de Riqueti, Comte de Mirabeau: *Collection complète des travaux de M. Mirabeau l'aîné, à l'assemblée nationale*, 1792 ; vol.5, pp.424-93.

be assumed that the surface owners would be able to meet such requirements.

The National Assembly finally sanctioned public mineral ownership whenever the minerals were to be found at greater depths. The rights to work them would be granted through concessions, with areas defined independently from the boundaries of private surface properties. In other words, the mining industry would be able to operate under the ground without concern to the landed property boundaries that existed at the surface, and the mining industry would benefit from the eminent domain rights of the State.[3] Under eminent domain, surface property owners could not deny the right to access their lands to the concessionaire in order to access the mines; nor could they claim compensation beyond the actual damage that might be caused. In the words of Mirabeau: "There is no other purpose or motive for eminent domain rights to prevail but the working of the minerals".[4] By the same token, the State was not to be considered the proprietor or owner of the mineral resources but only their administrator. Therefore, Mirabeau proposed that:

> The national assembly decrees, *as a constitutional article*, that metallic and non-metallic minerals, as well as different kinds of bitumen, coal, and pyrite, belong to the nation <u>but only in the sense that they cannot be worked without her consent</u>.[5]

In other words, in the case of certain minerals, private property rights on the surface had to be restricted to prevent them from becoming an obstacle to mineral production. "The nation has the right to the minerals being exploited. Hence, if they are not, the nation has to provoke their exploitation".[6] However, regarding other minerals, public ownership was not justified: "Society has the right to their being exploited, and only to that. Hence, society should not intervene whenever their exploitation is sufficiently granted".[7] In other words, if market mechanisms failed to guarantee the efficient assignment of property rights over mineral resources, the State had to intervene. As a matter of principle, all natural resources, the surface as well as the subsoil, were to be considered free gifts of nature. Public or private ownership were only different ways to implement this principle, as summarized in the slogan *the land to the tiller*.

Historically, there had been always a distinction between the activities on the surface and related surface based rights, and the rights over the minerals in the subsoil. The appropriation of underground mineral resources by the owners of the surface was a relatively recent, circumstantial and exceptional development. Public ownership outside the Anglo-Saxon world had always been the predominant rule. The 1791 Mining Law, the basis of French legislation on mineral ownership to this day, only confirmed that distinction.

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[3] In French law this is done by declaring mining activities to be of "*utilité publique*".
[4] Mirabeau, op. cit., p.441.
[5] Op. cit., p.491; Italics in the original; underlined ours.
[6] Op. cit., p.483.
[7] Op. cit., p.489.

I.2.3. DAVID RICARDO

AGRICULTURAL RENT

Forty years after Smith, David Ricardo, in his work *On the Principles of Political Economy and Taxation* (1817), maintained that in an agricultural sector subject to market competition, landlords wouldn't have the power to impose a surcharge on the rest of society, directly contradicting Smith's position. In order to make his case, Ricardo did not rely on empirical observation, as Smith had done, but rather on a *model.*

Ricardo's model can be summarized as follows: Under normal conditions of capitalist free market competition applying to industrial activity, capital attaining the highest levels of productivity is able to ultimately impose the market price. In contrast, nature imposes limits on competition in agricultural activities, giving rise to different levels of economic performance between the worst and the best land. Consequently, in agriculture, it is actually the *least* productive capital, amongst the most efficient ones, that determines the ruling price in the marketplace. This is due to the scarcity of better lands.

Under his assumptions, free competition in the countryside would not be able to eliminate lasting extraordinary surpluses on better lands. Of course, what are worse and better land, over the long term is still subject to technological progress, including the development of communications. But meanwhile, free competition will lead potential tenants to offer landlords ground rents which correspond to the level of the extraordinary surpluses, and the landlords to accept them. In other words, competition converts the extraordinary surpluses into ground rent, and not into profit, and tenants are forced to accept the usual rate of profit as defined by the national economy in general.

This same principle – still according to Ricardo – would apply to each and every individual landholding, considering successive investments. These investments would have decreasing returns for natural reasons, and free competition would generate extraordinary surpluses, even on the worst land.

The central assumption of the Ricardian model of agricultural rent was that the *marginal* product, using a term from modern Economics, would not pay any rent whatsoever. This assumption, however, depended on the *form* in which such rent was typically paid in Great Britain: yearly, per acre, and without any reference to volumes that might be produced. In other words, rents were paid as *annuities*. Thus, according to Ricardo, the tenants were free to invest and produce additional amounts over and above that which was necessary to merely pay the rent. The tenant would make a profit or break even as long as the cost of this additional production was less than or equal to the available market prices. In other words, Ricardo's model assumed that there was always some marginal production paying no rent whatsoever, but still determining the market price.

Thus, for Ricardo, competition ensured that all ground rent would be *differential rent*, which was supposed to be a consequence of a defect in economic practice, given that the market

value of agricultural products would be determined by the costly marginal production paying no ground rent.

In conclusion, according to Ricardo's model, free competition nullifies economically private landed property as such, which, in his opinion, would only be manifest in a monopoly rent. The presence of differential rents is therefore not a substantive or real expression of private landed property but rather only an indication that social arrangements at the margin of history had not yet reached their ideal state of affairs.

At first sight, it would appear as if Ricardo was defending landlords because he was absolving them of responsibility for the high price of corn. As all ground rent was supposed to be differential rent, it would only have a bearing on the *individual* relationship between landlords and tenants, without consequence to the working and capitalist classes generally. However, this appearance was misleading, because *Ricardo also maintained that the State should intervene to socialise these differential rents*. His contention was that the State should, by way of taxation, collect the better part of ground rents, a policy which, according to his model, would not impact the supply of land. Landlords would have no alternative other than to lease their lands at a rent determined by the market. The State would then be able to reduce the tax burden to which wages and profits were subject. The tenure of natural resources would thus approach the capitalist ideal of *natural resources as free gifts of nature*, <u>without even formally questioning private landed property</u>.

Ricardo was satisfied with insisting on free competition, which in turn led him also to advocate for free trade. Thus, international competition from all over the world would impose lower agricultural prices and reduce the margin for differential rents.

Interestingly and importantly, Ricardo never questioned why, if it was necessary to sign a lease to obtain access to land, such a lease was not evidence of a hurdle to the free flow of capital? Moreover, wouldn't the typical lease term of one year constitute an obstacle to long-term investments, which might bring about lower costs of production? Obviously enough, the very concept of private property prevented the free flow of capital, entailing higher production costs and, ultimately, higher prices, even if the marginal ground rent were zero. Nevertheless, Ricardo's model was formally consistent; but whether the model corresponded to reality or not could only be confirmed through empirical research, something which neither Ricardo nor his followers ever intended.

MINERAL RENT

Most importantly, however, Ricardo's model applied only to agriculture, and was not applicable to mining. The typical mineral rent was a royalty to be paid for each unit of production, from the first to the last. Hence, marginal mineral ground rent was definitively not zero.

Ricardo therefore resorted to conveniently *re-defining* the concept of 'ground rent', no longer as that part of the produce of the earth paid to the landlord, but as "that portion of the

produce of the earth, which is paid to the landlord for *the use of the original and indestructible powers of the soil*".[8] Thus for Ricardo, a royalty was not a ground rent at all and, instead, was justified as the price paid for a "valuable commodity"[9] taken from the bowels of the earth. But the undeniable fact is that royalty was paid to the landlord, as the *owner* of the mineral resource and, in consequence, the tenant had to get by on the basis of the market price *minus* the agreed royalty.

Ricardo insisted on denying the existence of a monopoly rent despite the overwhelming empirical evidence to the contrary in the mining industry. He thus insisted in denying that the origin of ground rent, whether in mining or agriculture, was to be found in the *institution* of private landed property.

Furthermore, leases in the mining industry were not limited to one year. Even the minimum investment necessary to access minerals underground required that the terms of leases be longer, apart from the necessity of a continuous flow of investment and expenditure to maintain mining operations, which clashed fundamentally with reversion. For these reasons, private landed property obviously obstructed the development of productivity in the mining industry, even if marginal ground rent would have been zero.

I.2.4. KARL MARX

Karl Marx' works, of course, were also based on the theory of labour value, but contrary to Smith and Ricardo, he did not directly identify values and prices. The latter would be the outcome of a complex process of transformation, from feudalism to capitalism, and of capitalist market mechanisms. This process also explained the existence of monopoly rents under certain circumstances, on top of differential rents, as observed by Smith in the case of corn. Marx agreed with the practical observation of Smith; and he named that monopoly rent, an *absolute rent*. Of course, Marx radically opposed private landed property as such:

> From the standpoint of a higher economic form of society, private ownership of the globe by single individuals will appear quite as absurd as private ownership of one man by another. Even a whole society, a nation, or even all simultaneously existing societies taken together, are not the owners of the globe. They are only its possessors, its usufructuaries, and, like *boni patres familias*, they must hand it down to succeeding generations in an improved condition.[10]

He always stigmatized private landed property as an obstacle to the development of productivity, not only in mining but also in agriculture; and he always emphasized the development of productivity to be the historic mission of capitalism. Nevertheless, this did not prevent him from pointing out that private capitalist ownership of the means of production was also only a historic category, which would disappear, sooner rather than later, with the socialist revolution.

[8] David Ricardo: *On the Principles of Political Economy and Taxation*, 1817; chap.2; italics ours.
[9] Ricardo, op. cit.
[10] Karl Marx, *Capital*, volume III, Chapter 46. Published posthumous by Friedrich Engels in 1894.

I.2.5. CONCLUSIONS

Adam Smith’s work was based on the labour theory of value, assuming that goods would be sold at their value, on average and leaving aside market fluctuations. Nevertheless, based on empirical observations, Smith maintained that corn, due to the monopoly power of the landlords in Britain, was being sold at a price above its value and that, in consequence, other products taken together would in general be sold at prices below their value.

The French Revolution, on the other hand, destroyed the monopoly of large estates of feudal origin, and imposed instead small properties owned by those who worked the surface, fully exposed to market competition. However, regarding mines, Mirabeau considered private landed surface property to be a serious hurdle to their development and therefore advocated in favour of public mineral ownership, which was codified in the Mining Law of 1791.

David Ricardo's works were also based on the labour theory of value and the identity of value and prices, but being consistent, he rejected Smith’s practical observations. Further, he denied that private landed property, subject to market competition, could possibly have an impact on prices as an obstacle to the free flow of investment. Although Ricardo was writing after the French Revolution, he never referred to it, nor to public mineral ownership. However, public mineral ownership prevailed across Continental Europe. To mention this fact would have entailed, necessarily, a discussion of the convenience or inconvenience of private landed property, a discussion Ricardo wanted to avoid at all costs. The French Revolution acted as a deterrent to where the discussion of private landed property could lead to, and Ricardo went on up to the extreme to deny that a royalty – the mineral ground rent *par excellence* – would constitute a ground rent at all.

Finally, Karl Marx's works were certainly based on the labour theory of value, but he also insisted that there was a complex process transforming values in prices. Furthermore, he agreed with Smith's practical observations on the existence of a monopoly rent imposed by the class of landlords in the production of corn, on top of differential rents. His analysis concentrated, above all, on private landed property as an obstacle to the development of productivity, and he considered private landed property to be as unacceptable as slavery. However, he also extended his criticism to all private ownership on the means of production. Classical Political Economy came thus to an end, following Economic Science as it is still known at present.

I.3. ECONOMIC SCIENCE

By the end of the 19th century, capitalism had firmly taken root, and *Political Economy* had been replaced by *Economics*. Land disappeared as a factor of production. This evolution was premised on the *theory of prices*, based on *marginal costs of production*, and no longer on the theory of labour value. Yet natural resources as such do not have a cost of production, but labour and capital do. The number of factors of production was consequently reduced to two, *labour and capital*.

Certainly, as far as capital is concerned, it is assumed that it has an ‘opportunity cost’. The opportunity cost is defined as the return the capital could potentially achieve, being mobile, in alternative uses, which is definitively *not* zero. In contrast, the opportunity cost of land, which is not mobile, is reduced to a limited set of options. For example, land could be used to sow corn or to raise cattle, depending on which option would maximise ground rent. Thus, its opportunity cost would be referred to the differential rent to be paid under the best of circumstances, and which, according to Ricardo, would not affect prices. Hence, the opportunity cost of land is supposed to be zero.

The Ricardian theory of rent became an essential, unquestioned and unquestionable component of modern Economics and, in honour of Ricardo, differential rents became known as *Ricardian rents*. For modern economists, the crucial point was that Ricardo was supposed to have demonstrated that, under conditions which today would be called ‘perfect competition’, private landed property would not impinge on prices. It was then but a short step to postulate that the same principle would apply to capital, but incorporating as a cost, *its 'opportunity cost'.* Thus, private property in general would only affect prices under conditions of ‘imperfect competition’, found in circumstances where cartels, oligopolies or 'monopolies' exist: monopolies now understood as being based on identifiable *individual* interests, and no longer as monopolies of social classes.

In the following, with respect to the term monopoly, we shall align ourselves with the established lexicon of Economics. What Smith called ‘monopoly rent’, and Marx called ‘absolute rent’, referring to the monopoly exercised by the *landlord class*, we shall call *proprietorial rent* because its origin is to be found in the *institution of private property*, enjoyed by a specific social group. In this sense, the ‘opportunity cost’ of capital referred to above represents a *proprietorial profit*.

I.3.1. PROPRIETORIAL MINERAL RENT

Ricardian rent theory, which became an integral part of Economics, was essentially a theory of *agricultural* rent. Of course, Ricardo acknowledged that there were differential rents in mining, for example, due to differences in natural productivity and the location of the deposits. However, with respect to the typical mining rent, royalty, Ricardo simply denied that this was a ground rent at all. Instead, he suggested that royalty should be considered as the price of a valuable ‘commodity’.

In what follows, we will revise the contortions of Economics on mineral royalties as they attempt to deny the obvious: that competition did not reduce marginal mineral rents to zero; and how they deal with private mineral ownership as an obstacle to the development of productivity. To illustrate these developments, we shall rely on the most important historical examples of extractive industries: British coal and United States oil. Both industries developed on the basis of private landed property and in both cases proprietorial rents emerged in the form of *customary rates of royalties*. Likewise, both the Americans and the British were forced to deal with serious issues in the development of productivity.

British Coal

Towards the end of the 19th century, the customary royalty in British coal varied, depending on the quality of coal, between five and seven pennies per ton. Hence, Marshall recognised that the marginal cost of production included a royalty. Nevertheless, he insisted on following Ricardo's view that "a royalty is *not* a rent", and ought "to be regarded, in part at least, as the price got by the sale of stored-up goods". His understanding was that mineral deposits were 'natural capital' which, like all capital, depreciates over time. Hence, a royalty would partly represent compensation for the eventual exhaustion of a mine. Obviously, these goods were "stored-up by nature indeed", but now they were to be "treated as <u>private property</u>". He thus concluded that "the marginal supply price of minerals includes a royalty in addition to the marginal expenses of working the mine".[11] This is not the vision of a pre-capitalist landlord, but of a bourgeois landed property owner. For the bourgeois, land is bought and sold like any other good and therefore represents an investment with the right, like all investments, to make a profit. Marshall therefore had no problem in attributing royalties to the institution of private property; whereas for Ricardo, it was, on the contrary, about denying that private landed property had any bearing on prices.

United States Oil

In the US oil industry, there were two customary rates of royalty, one eighth and one sixth, depending on the region. US economists also recognised the existence of these royalty rates, but always resorted to subterfuge in order to avoid the conclusion that they were actually in the presence of proprietorial rent. For example, under the assumption that the royalty rate was one eighth, Paul Davidson stated that:

> If marginal royalty and marginal operating costs were the only marginal costs, and since short-run profit maximization would require the firm to equate the sum of these marginal costs to price, then the short-run supply function for the firm would be obtained by elevating the marginal operating cost curve by 1/7, or 14 2/7 per cent, so as to include marginal royalty costs in the supply price.[12]

But before arriving at this conclusion, he had already stated in a footnote that:

> Royalties are an important component of the short-run supply function. Nevertheless, since royalties provisions are fixed at the outset and depend upon expectations of the future income stream from the well, royalties are, in the long run, price-determined rather than price-determining.[13]

However, future prices would still have to cover the cost of customary royalties. But in the face of all empirical evidence, Davidson denied the very existence of proprietorial rent. In his

[11] Alfred Marshall: *Principles of Economics*, 1890; p.483. Italics in the original; underlined ours.
[12] Paul Davidson: "Public Policy Problems of the Domestic Crude Oil Industry", *The American Economic Review*, vol.53, March 1963, p.91.
[13] Davidson, op. cit., p.90.

mind, there was no doubt that "royalty payments are ... Ricardian rent payments",[14] and that "oil lands are obviously analogous to the Ricardian case of agricultural lands of differing fertilities".[15]

Moreover, lessees pay acreage-related rents, designed to prevent land from being kept idle. Thus, a ground rent must be paid even for exploration, and its usual level is a component of the proprietorial rent. Nevertheless, for our purposes, it is sufficient to consider only the customary royalty, the mineral rent *par excellence,* with a direct and transparent impact on prices. Finally, differential rent manifests itself in higher-than-usual rents and royalties, and especially in bonus payments.

I.3.2. PRIVATE VS PUBLIC MINERAL OWNERSHIP

The entire debate about royalties – about whether or not it is a ground rent; about the analogy between a mineral deposit and a natural store of goods; about royalties as the present value of future streams of differential rents; or about minerals having an 'intrinsic value', etc. – doesn't amount to anything more than circumstantial arguments whose first and foremost goal is to exclude from Economics any critical discussion about private landed property and, ultimately, about private property in general. Criticism of the former could all too easily lead to criticism of the latter.

But one should not be mistaken. Certainly, once capital has consolidated its power, it will deal with the issue of private landed property, and particularly of private mineral property, with extreme caution, in order to not give rise to a critical and potentially revolutionary discourse on private property in general; however, this does not change its very essence and willingness to subordinate land tenure to its design. Whatever the arrangement, it is always a circumstantial *arrangement*, a compromise considered both politically expedient and economically tolerable, justified by the most convenient arguments available at the time. Nevertheless, capital might still question and modify any such arrangement, much to the detriment of private landed property in general, and to private mineral property in particular, even to the extreme of putting an end to it. The principal reason why this happens is that proprietorial rents do not reflect the costs that private landed property may cause as an obstacle to the development of productivity. Even though proprietorial rents may remain relatively stable, such costs could reach critical levels, for example, with the increasing depths of the mines.

BRITISH COAL AND THE 'NATIONALISATION OF ROYALTIES'[16]

In British coal, following centuries of mining at ever greater depths, the irrationality of private mineral ownership made itself increasingly felt. Certainly, lease terms became longer as mines went deeper: the typical term of a tenancy passed from a few years in past centuries,

[14] Paul Davidson: "Public Policy Problems of the Domestic Crude Oil Industry: A Reply", *The American Economic Review*, vol.54, April 1963; p.126.
[15] Davidson, op. cit., vol.53, p.104.
[16] Bernard Mommer: *Global Oil and the Nation State*, 2002; chap.2.1.

to 21, 42 and even to 63 years during the 19th century, as was required by the technical structure of investment and its depreciation. Nevertheless, reversion remained a major hurdle to the continuous flow of investment, due to the inherent confrontation between landlords and tenants. The former would always aspire to appropriate the capital invested by the latter during the preceding lease term, in order to immediately increase subsequent rents and royalties, based on the interest on the capital which had already been invested.

Moreover, in the 19th century, as mines became deeper and deeper, the landlords – who had originally been the agents of mineral exploitation, as it was in agriculture and breeding – definitively became rentiers as the mining industry became more technically challenging and capital intensive.

However, beyond whatever could be achieved by the market, the political power of the English landlord class made it impossible to reform private mineral ownership. For example, it was impossible to legally oblige neighbouring landlords to collaborate and to promote cooperation between their respective tenants exploiting the same deposits. Finally, after 1880, the productivity of British coal mining started to decline, and after 1913, so did total production.

Now, in 1919, the *Liberal* government, frustrated by the lack of reforms and the disappointing performance of the coal industry during World War I, announced its decision to "nationalize royalties" in order to promote the regional merging of mining companies. In 1938, the *Conservative* government brought this project to a conclusion, referring to it more tactfully as "the unification of royalties". The word *expropriation* was carefully avoided. Landlords were not compensated for deposits which were not being exploited; however, they were fully compensated for their loss of rents and royalties. The benefit of nationalisation, it was claimed, would be an increase in productivity, once private mineral ownership had been brought to an end.

In 1946, the *Labour* Government moved on from the nationalisation of the natural resource to the nationalisation of the industry. Decades later, in 1994, a *Conservative* government returned the coal industry to private hands. However, neither the Conservative Party, nor the Labour Party, nor the Liberal Party, ever reconsidered the nationalization of the natural resource. Public mineral ownership was definitive, irreversible and unquestioned. But caution dictated that it was best not to draw attention to the fact that public ownership in this case had unquestionably turned out to be superior to private ownership.

UNITED STATES OIL: A CONSERVATIONIST POLICY[17]

In the United States, cradle of the world oil industry, the first petroleum leases were signed in the 1860s. The term of these leases was generally limited to twenty years. To be sure, there were private landed property owners in the United States, but they did not constitute a class as such. Political power was firmly in the hands of capital. Thus, the development of legislation

[17] Op. cit., chap.2.2.

was, in principle, favourable to the lessees. Moreover, in the case of disputes, the courts tended to favour the lessees against the lessors.

For example, when the first cases of reversion occurred in the 1880s, the tribunals backed the right of lessees to freely dispose of their capital and denied the lessors the right to appropriate it through contractual stipulations (as was the case in the British coal industry). Thus, upon the reversion of a lease, lessees would only hand over scrap and, even worse, reservoirs in ruins. Therefore, towards the end of the 19th century, the lease terms were extended, once and for all, until the ultimate exhaustion of the reservoirs. Reversion disappeared, allowing a continuous flow of investment as required by the development of productivity.

Then, during the 20th century, the rights of landowners to interfere with production were systematically restricted. For example, regulations relating to the location of oil wells were introduced, without consideration of the boundaries of surface properties. Of course, this development was facilitated by the fact that the irrational distribution of oil wells, corresponding to property boundaries and not to technical criteria, was visible on the surface (whereas, the irrational design of British coal mines could not be observed on the surface).

Moreover, from 1929 onwards, the most important oil producing States, having to contend with recurrent crises of collapsing prices, created regulatory bodies to control production with a view to stabilising prices as part of a *conservationist* policy. Maximum efficient rates were established for each oil well, taking into account the content of associated gas and the structure of the reservoirs, in order to increase its recovery factor. Indeed, these rates would prevent the interruption of the flow of oil to the wells due to producing at too high a rate, thus leaving behind pockets of oil which would be lost forever.

In 1935, these bodies formed the *Interstate Oil Compact Commission* with the support of the government in Washington, which enacted legislation making it a Federal offence for oil produced illegally in one State to be transported to another; and the Supreme Court sanctioned this regulatory structure because it was essentially focused on the conservation of a natural resource, and not on monopolistic practices of producers imposing higher prices.

Regarding public lands, throughout the 19th century, they had been subject to a process of private appropriation through colonisation. However, from the beginning of the 20th century, the privatization of public lands was increasingly limited to the surface, safeguarding public mineral ownership of petroleum reservoirs. Moreover, by granting leases, the states and the Federal government essentially adopted the same patterns already defined by the private sector. (Of course, the same apply to public waters, i.e. lakes, rivers, and the seas, all of major importance in oil production).

Nevertheless, even if public and private mineral property coexist, and even if the State formally appears as the lessor of public mineral properties, the State will always consider related rents and royalties simply as *taxes*. Hence, mineral deposits in the public domain constitutes a free gift of nature to the nation. Regarding private landed property, the rest of the nation is forced to pay, indeed, a ground rent. Certainly – micro-economically speaking –

from the perspective of the lessees who have to pay rents and royalties, it makes no difference if the minerals constitute private or public properties. But macro-economically speaking, the decisive fact is the ownership of the mineral resource. In other words, where private mineral property prevails, what is legally a royalty, is economically a ground rent; however, where public mineral ownership prevails, royalty is no different from a consumption or a value added tax.

In any event, all oil producing States besides California levy a 'severance tax' (in Alaska called 'production tax'), economically equivalent to a royalty, imposed on both private *and* public mineral properties without any distinction. For example, in Texas this tax has traditionally been 4,6%; in Alaska, in the 1970s, it was set at 12,5%.

INCOME TAX AND ROYALTIES

Despite the aversion of US economists to attribute an 'intrinsic value' to mineral resources, the idea that mineral deposits should be seen as 'goods stored-up by nature', or 'natural capital', was, and still is, very popular. In line with this perception, such 'natural capital' would depreciate as production depletes the deposit. Hence, the lessors' ground rent would reflect, at least partially, the depreciation of their natural capital. This analogy became of great practical importance at the beginning of the 20th century with the introduction of an income tax, because such tax would only apply to *net* income, *after the deduction of depreciation*.

As a matter of principle, the 'depletion allowance' was to benefit the natural resource owners, *prima facie* the landlords. But oil was a liquid, able to flow underground from one property to another. Hence, properly speaking, the landlords were not the proprietors; they only had the right to appropriate the oil underground according to the 'rule of capture'. On the other hand, the reservoirs were originally discovered by the oil companies, and their tenancy covered the right to exploit them until these reservoirs were fully depleted. Thus, the companies could argue that they were, in fact, their co-owners, at least to a proportion defined by the rate of royalty. This rate would thus define the proportion of the 'natural capital' to be accorded to the landowner, with the remainder – in general 7/8 or 5/6 – being accorded to the tenants. After World War I, this view point was incorporated into the Income Tax Law, initially only for oil, though later extending to all other minerals. Finally, in 1932, the depletion allowance was defined as a percentage of the market price of the mineral, as compensation for their 'intrinsic value'. This percentage varied between 27.5% for oil and 5% for sand and gravel.[18] As a result, private mineral ownership not only brought in a proprietorial rent, but also a privileged tax treatment of that rent.

[18] John Lichtblau and Dillard P. Spriggs: *The Oil Depletion Issue*, New York, 1952. After 1969, se applicable percentage to oil was reduced and subject to a series of limiting conditions.

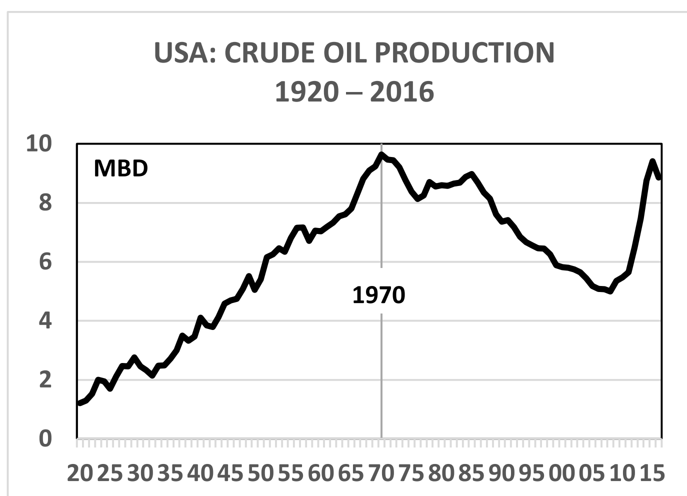
PEAK PRODUCTION

Historically, the United States has been by far the most important oil producer in the world. But as oil is definitively an exhaustible and non-renewable natural resource, production had to reach its peak at some point. This tipping point happened in 1970, when the United States was producing 9.4 million barrels per day (MBD) of crude oil. Thereafter, even important new discoveries, most notably in Alaska, barely slowed the decline. Only recently, a new technology – *fracking* – has managed to reverse this trend and restore growth at a spectacular rate.

Contrary to what happened in British coal, peak production in US oil did not give rise to any questioning of private mineral ownership. This can be explained by the fact that, although the private mineral property owners certainly collect rents and royalties, due to the conservationist policy discussed above, these payments do not otherwise represent a substantial obstacle to the development of productivity. The fortunate land owners collect rents and royalties until the final exhaustion of the reservoirs, but that is it. Questioning existing private mineral property rights under these conditions, be it in oil or minerals in general, is simply not an option in a country with the ideological complexity of the United States.

I.4. CONCLUSIONS

The subordination of natural resources to capital undoubtedly resulted in a very significant reduction of the share of ground rent in national income, although the existence of proprietorial rent was denied, both theoretically and ideologically. All ground rent was supposed to be differential rent. Regarding the typical form of mineral rent, royalty, a proprietorial rent *par excellence*, it was even interpreted as the present value of future differential rent; or, alternatively, it was simply denied that royalty was a ground rent at all, to be attributed to the mineral deposits, understood as 'goods stored-up by nature' or 'natural capital'.



With the transformation of a regime dominated by the landlord class to one dominated by the capitalist class, landlords were offered the opportunity to convert themselves into capitalists, and capitalists into landed property owners. This is of great importance to the proper understanding of the disappearance of land as a factor of production in modern Economics. The traditional rights of the landlords over natural resources were converted into private property rights while at the same time, the serfs were

massively ejected from their lands, casting them into the marketplace as free labour. The buying and selling of land then gradually blurred the historical demarcation between the landlord and capitalist classes and, consequently, the distinction between the concepts of ground rent and profit. For the purchaser of land, his income – whether an agricultural, urban or mineral ground rent – is simply justified as a return on his 'investment'.

Ricardo's proposal that ground rent should be socialised by means of taxation was thus enshrouded in an opaque cloud of smoke. Taxation to this end became increasingly circumstantial and erratic, just like the interpretations of ground rent itself. In the mining industry of the United States, a capitalist country *par excellence*, both lessees and lessors even benefitted from a reduction in income taxes. Nevertheless, the capitalist regime always continues to be willing to confront private landed property through reforms and, if necessary, by resorting to nationalization whenever it becomes a significant obstacle to the development of productivity.

Land was subject, definitively, to the hegemony of capital and, even more, to its exclusive ideological dominance.

SECOND PART
INTERNATIONALIZATION OF CAPITAL AND LAND TENURE: *THE EXAMPLE OF PETROLEUM*

In the previous part, we concluded that it is essential for the development of capitalism to subordinate land to capital, economically, politically, socially and ideologically. In practice, this implied a reduction of ground rent to 'tolerable' levels, and dressed up as capitalist profit. Moreover, this subordination was about preventing private landed property from seriously obstructing the development of productivity.

In this endeavour, the development of capitalism in Great Britain led to a policy of free trade, with international competition resulting in lower prices for agricultural products. The economic space for extraordinary surpluses, ultimately the space for ground rents, was thereby reduced. Competition from countries exporting primary products – including minerals – essentially countries from what later would be named the 'Third World', would weaken the monopoly power of the British landowners, and eventually of European landowners in general.[19]

It was of major importance to the international development of capitalism that these countries would continue to supply cheap raw materials. However, with free trade, the problem of subordinating land to the development of capitalism was becoming more and more international in nature. Indeed, exporting and importing countries represented different jurisdictions and, in international trade, natural resources, converted into raw material or semi-finished goods, would play a central role for exporting countries. In certain cases, therefore, important extraordinary international economic surpluses could arise which, driven by market competition, would accrue within the jurisdiction of the exporting countries, rather than importing countries. Hence, these surpluses could be converted into *international ground rents*.

In other words, the solutions conceived and developed at a national level to subordinate land to capital were not applicable internationally. The practical solution at the national level assumed that the State would appropriate any extraordinary surpluses, as far as possible, while reducing the level of taxation for the rest of the economy accordingly. On the other hand, the State would promote international competition in order to weaken the monopoly power of the national landlord class, resulting, ultimately, in lower prices. When it came to exports, however, the extraordinary international surpluses appropriated and distributed nationally by the exporting countries effectively had to be paid by the importing countries. The taxpayers of the exporting country would therefore benefit, as common owners of the natural resource, of an international ground rent; consequently, they would benefit from export prices being higher, not lower.

These developments had no effect on the exploitation of natural resources for the domestic

[19] Karl Kautsky: *Die Agrarfrage*, 1899.

market. For this part of the produce, the analysis of the First Part of this essay continues to be valid. The same cannot be said, however, for any produce being destined for the export market. Thus, there is a *qualitative* difference between importing and exporting countries. Importing countries, with the internationalisation of capitalism, continue to be fully identified with the very essence of capitalism, i.e., to subordinate land to capital. In contrast, the exporting countries find themselves beneficiaries of an international ground rent. Importing countries collide with the division of the globe into *territorial* nation states, while the exporting countries benefit from this division.

In the following, we will focus on the case of petroleum. As a source of an international ground rent, petroleum far exceeds the importance of all other natural resources combined. The history of oil, in its first phase, constitutes the example *par excellence* of the internationalisation of capital and its effort to subordinate natural resources to its design. From the beginning of the 20th century until the 1970s, the importing countries were essentially developed capitalist economies, and the exporting countries were essentially pre-capitalist Third World countries. The USA played the leading role in the development of this first phase, not only because of the extraordinary importance of its domestic oil industry, but also because of its rise as a superpower following World War I. In the second and current phase of this history, the phase of globalisation of capital, Great Britain would play a central role, both because of its historic importance as a colonial power in the Middle East and because Great Britain became the most important oil producer in the North Sea, the new oil province coming to prominence in the 1970s.

II.1. FEDERAL PETROLEUM REGIME: THE USA

In the First Part of this essay, it sufficed to insist on the compromise between lessees and lessors in the petroleum sector as it developed historically during the 19th century in the USA, prevailing private mineral ownership under the hegemony of capital. This compromise had to unfold within the complex federal structure of the USA, and Indian reservations operating under the auspices of the Department of Interior in Washington. Thus, there was a very complex set of institutional structures governing land tenure, coexisting private landed property with public, federal, state and tribal ownership. The following is a summary of the problems of land tenure in inter-state and inter-regional trade.

With the expansion of the US oil industry during the 20th century, oil became a significant source of an inter-regional ground rent in some states and indigenous communities. For example, this was the case in Texas, Alaska, and the Native American reservation of the Osage Indians.[20] Even though these political entities were vested with different levels of sovereignty, at the economic level, capital was hegemonic. At the political level, on the other hand, the interests of the importing states predominated by virtue of the structure of the

[20] Regarding the Osage, see David Grann: *Killers of the Flower Moon: Oil, Money, Murder and the Birth of the FBI*, Great Britain, 1917.

Union. Thus, the compromise arrived at by the private sector during the 19th century continued during the 20th and into the 21st century, extending to both public and tribal lands. The private interests of lessees and lessors limited the public interest to the imposition of severance or production taxes by the ultimate resource owners, the respective states. Moreover, from the perspective of the importing states, public or private ownership in the exporting regions made no difference. If rents and royalties paid implicitly with the price of petroleum would end up in the pockets of private lessors, or in the budget of the exporting regions, all the same: the consumers in the importing regions had to pay them without benefiting from their subsequent distribution, which would happen only in the exporting states.

Nevertheless, the petroleum policy of the United States was, at all times, designed to serve the interests of the national petroleum industry and its *internationalisation*. Under the hegemony of capital, the petroleum regime continued to modernise according to the development of geology and to the technical imperatives of increasing well depths. By the same token, the exporting states were allowed to unite, with the blessing of the government in Washington, with the goal of stabilising prices as part of a conservationist policy. For each well, a maximum efficient rate of production was established that could not be exceeded. The effective rate of production, however, could still be restricted by the authorities. But marginal wells were exempt from these restrictions, as otherwise they would have to shut down, with the remaining reserves lost, probably forever. Hence, the domestic price of oil in the United States was based on the cost of production of marginal wells, plus the customary proprietorial rent.

Concurrently, and in parallel with the creation of the Interstate Oil Compact Commission in the 1930s, the seven largest oil companies in the world, five of which were US companies, formed the International Petroleum Cartel.[21] This Cartel was to regulate the international market based on its control, through concessions, of the richest oil lands known at the time, located in Venezuela and the Middle East. Cooperating informally with the US government, it would bring international prices in line with domestic oil prices in the United States.

However, on the one hand, the United States became definitively a net petroleum importer in 1947; on the other hand, the International Petroleum Cartel began to weaken after World War II. By 1959, this Cartel was no longer able to maintain international prices at the high US level. In response, the US government intervened, imposing a system of import quotas in order to protect a host of high-cost marginal wells.

International prices started to fall, and continued to do so until 1970. This was the immediate reason for the most important oil-exporting countries, in 1960, to create the *Organization of the Petroleum Exporting Countries* (OPEC), formalized as an international treaty. Starting in

[21] The five US companies were SONJ, Socony, Stancal, Gulf and Texaco. At present, SONJ and Socony conform ExxonMobil; and Stancal, Gulf and Texaco conform Chevron. The other two members were Anglo-Persian Oil Company, APOC (later Anglo-Iranian Oil Company, AIOC; today British Petroleum, BP) and Royal Dutch Shell.

1970, with the end of the recession in the world petroleum market, OPEC would take advantage of the following boom, pushing international oil prices to much higher levels than those prevailing in the US domestic market. Finally, in 1973, the USA put an end to its system of import quotas and control of production. From now on, the United States would produce at maximum efficient rates.

II.2. CONCESSIONARY REGIME, INTERNATIONAL OIL COMPANIES AND TERRITORIAL STATES[22]

Outside the United States, from the turn of the 20th century through the 1970s, the international petroleum industry developed on the basis of concessions. A freak of nature, the richest oilfields in the world were found in Third World countries: countries with pre-capitalist economies, weak, dependent, or even subject to semi-colonial or colonial regimes. Oil exports from these countries would generate very significant extraordinary international surpluses, not only compared with the investments in production, but also compared with the size of their national economies.

The hegemony of international oil companies over the concessionary regime was based on the international power structure of the advanced capitalist countries. Regarding land tenure, these companies had to deal with private ownership of the natural resource only in Mexico, where it had developed following the example of neighbouring Unites States. This eventually led to a counter-revolutionary alliance between Mexico's property owners of oil-bearing lands and the international oil companies, both British and US-American, which, as well as being tenants, had also acquired landed property rights. Banded together, they opposed the revolutionary Constitution of 1917, which re-established public ownership over hydrocarbon resources. This counter-revolutionary alliance continued for more than twenty years, until 1938, when the government of General Lázaro Cárdenas put an end to it by nationalising those international oil companies that refused to formally recognise the sovereign jurisdiction of the country.[23] In response and unsurprisingly, the United States and Britain imposed an embargo on Mexican oil. However, while Mexico had been the world's most important oil-exporting country by the end of World War I, its exports had dwindled and by 1938, were already insignificant.

Venezuela, in contrast, always maintained public ownership over the natural resource, just as the oil-exporting countries of the Middle East. But there were fundamental differences between Mexico and Venezuela, on one side, and the Middle East exporting countries, on the other. The Latin American countries had generally liberated themselves from Spanish imperial rule during the early decades of the 19th century, while the struggle for independence in the Middle East took place in the 20th century; first against Turkish, German and British imperialism and then, after World War I and the rout of the Turkish Empire, against British, French and United States imperialism. In the Middle East, therefore, the power structure was

[22] Mommer, op. cit.
[23] Specifically, for refusing to recognise a decision of the Supreme Court in relation to a labour dispute.

still essentially colonial or semi-colonial, and the international oil companies acquired their huge concessions based on this structure.

II.2.1. VENEZUELA: EXCLUSIVE NATIONAL JURISDICTION AND SOVEREIGN TAXATION[24]

Venezuela had been subject to the Mining Ordinances for New Spain since 1784, which reserved mineral resources, including "bituminous or juices of the earth",[25] to the Crown. The existence of hydrocarbons in Venezuela was well-known at the time, in both the West due to of surface seepages around Lake Maracaibo, and in the East because of Lake Guanoco, a lake of asphalt. On the basis of these Ordinances, mining concessions were granted, subject to certain tributes. Following Venezuela's independence, the Liberator Simon Bolivar validated these Ordinances by decree in 1829, but, of course, substituting the word 'Republic' for the 'Crown'. Subsequently, the Republic developed its own Mining Codes and Laws which, by end of the 19th century, followed largely the most modern legislation of the time, that of France.

The first four concessions of future importance to Venezuela as an oil-exporting country were granted in 1907, based on the Mining Law of 1905. Accordingly, they were subject to exclusive national jurisdiction: "in no case nor for any reason they may give rise to a diplomatic action or international claims".[26] *Mining taxes* defined by the Law and in the title deeds were considered acquired rights but, of course, the concessions were still subject to *general taxation*. At the time, this meant import tariffs. However, the Executive was authorized to grant exemptions at its discretion, but only if the imports in question were related directly to the purpose of the concession.

The initial areas conceded for exploration were vast, but the duration of the exploration period was limited to a few years. Thereafter, the concessionaires were required to choose plots for production, of 200 hectares each, subject to a rental payment of two bolivars (0.38 US$) per hectare and an exploitation tax of four bolivars per ton (about 0,11 US$/b).[27] The rental payment guaranteed that at the end of the exploration period, the concessionaire would surrender any area they were not seriously interested in. The maximum total term of these concessions was fifty years.

WAIVING SOVEREIGN TAXATION

These concessions were granted by the government of General Cipriano Castro. He was toppled by General Juan Vicente Gómez in December 1908, with the explicit support of the United States. The following year, Gómez passed a new Mining Code, establishing that "all mineral title deeds are contracts concluded between the National Government and the concessionaire, regarding the rights and obligations established in this Code, <u>including</u>

[24] Irama Mommer and Carlos Luis García: "Las fuentes del tesoro y tesoro de las fuentes: arqueo de las fuentes *primarias* para la política petrolera del período concesionario", forthcoming. All the documents quoted in this chapter are to be found in its digital appendix.
[25] Rufino González Miranda: *Estudios acerca del Régimen Legal del Petróleo en Venezuela*, Caracas 1958; p.33.
[26] 1905 Ley de Minas, art.6.
[27] The exchange rate was 5.20 Bs/US$ (gold).

taxes".[28] Moreover, according to the Statement of Reasons, the concessionaires would pay taxes just like all other economic entities, and mining taxes were the equivalent in this specific case. In other words, *concessionaires would not have to pay for the natural resource.*

Hence, the concessionaires were exempt from import tariffs; moreover, mining taxes were reduced in half. The 1910 Mining Code, much in the same spirit as the 1909 Code, offered previously existing concessionaires the option to convert their title to the new Law, and so they did. These concessions ended up in the hands of Royal Dutch Shell. Venezuela became an oil exporter in 1917. Henceforth, oil became *objectively* a source of an international ground rent.

FROM THE FRENCH TO THE UNITED STATES REFERENCE

With World War I still underway, and the United States having become – temporarily, as it turned out – a net oil importer, US oil companies became interested in Venezuela. In order to compete with established British and Dutch interests, they offered rents and royalties higher than the taxes imposed by the 1910 Mining Code. The government immediately dropped the French reference and took on the US reference, with its roots in private mineral property. Oil, therefore, became *subjectively* a source of an international ground rent, as manifest in the development of a specific legislation for hydrocarbons.

The first Hydrocarbons Law was enacted in 1920. This law established rents and royalties similar to the customary rates applying to leases on public lands in the United States, even though the Law continued to refer to them as surface and exploitation *taxes*. This Law lasted only nine months, being replaced by the 1921 Hydrocarbons Law, which, in turn, was replaced by the 1922 Hydrocarbons Law. The latter again offered existing concession holders the option to convert their titles to the new Law, thereby reducing rents and royalties to about half of those stipulated by the 1920 Law. All concessionaires holding title deeds obtained since 1918 made use of this option.

Until the death of General Juan Vicente Gómez in 1935, subsequent hydrocarbons laws experienced only minor modifications, and *all these Hydrocarbons Laws waived sovereign taxation for the complete term of the concessions.* Hence, we may limit ourselves to a brief summary of the 1922 Hydrocarbons Law. The concession term was forty years, and the area was limited to a maximum of ten thousand hectares. At the end of the exploration period of three years, the area had to be reduced by half, and divided into plots of 200 hectares, subject to a rental of one to two bolivars (0,06 US$) per hectare. The exploitation tax (royalty) was 10% onshore, but only 7.5% offshore, because production offshore was deemed more costly at the time.[29] The areas surrendered at the end of the exploration period would subsequently be put back out to tender, possibly fetching even higher rents and royalties. As a matter of fact, the highest rate ever achieved would be 15%.

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[28] 1909 Código de Minas, art.23. Underlined ours.

[29] In any event, production taxes had guaranteed minimums 2.00 or 1.50 bolivars per ton (0.06 or 0.04 US$/b), respectively. These minima became effective in several occasions between 1931 and 1933.

Most of the concessions granted after 1918 ended up in the hands of Standard Oil of New Jersey (today ExxonMobil) and Gulf Oil (today Chevron). In 1928, Venezuela became the world's largest oil exporter, a position which the country maintained until 1970.

1943 PETROLEUM REFORM

When General Juan Vicente Gómez came to power in 1908, Venezuela was one of the poorest countries in Latin America. When he died in December 1935, Venezuela had already become a prosperous oil country. The first modern political parties would be founded the following year.

Regarding the governance of oil, vocal opposition to the general exemption from import tariffs enjoyed by the concessionaires was immediately gaining strength. But when the government attempted to address the issue, the international oil companies turned to the Supreme Court of Justice, where they prevailed with their arguments in defence of what they considered 'acquired rights'. Nevertheless, the international oil companies were subject to sovereign taxation in their home countries – in the United States, Britain and The Netherlands – even on *their profits arising in Venezuela*. This situation was unacceptable to the Venezuelan government. Its oil policy was summarised by the Minister of Development, at the time responsible for oil, in these words: "the action of the Authorities should aim at the realization of the *right* of the State to the greatest possible participation in the riches of the subsoil".[30]

Faced with the defeat in the Court, the government suspended the granting of new concessions. Moreover, it commissioned a study of the legal shortcomings that could affect some of the important concessions; between 1907 and 1938 about eight thousand concessions had been granted. Finally, in 1942, in the middle of World War II, President Isaías Medina Angarita announced that his government would thoroughly reform the existing governance structure in oil. Although Standard Oil of New Jersey initially refused to renegotiate its concessions, it finally gave in on orders from Washington. In the middle of World War II, the United States government could not risk a debacle in Venezuela[31] such as the one they experienced in Mexico just four years earlier.[32] The United States government also sent two of its experts to assist the Venezuelan government.

Rents and Royalties

The Petroleum Reform of 1943 consisted, firstly, of a new Hydrocarbons Law, which followed best practices on federal lands in the United States. The usual royalty rate was set at one sixth,[33] and the rental at five bolivars (1.62 US$)[34] per hectare.

Concession holders were offered the option to renew their titles under the new Law for

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[30] Manuel R. Egaña: *Memoria del Ministerio de Fomento*, 1939, p. XI. Italics in the original.

[31] In 1942, German submarines sank some shiploads of Venezuelan oil and bombarded the refinery of Curaçao.

[32] In 1941, the USA had already reached an agreement with the Mexican government regarding the nationalizations of 1938.

[33] The Law also defined minimum prices to be applied to the payment of royalties, equivalent to the average market prices observed during the years immediately before World War II.

[34] The exchange rate, after the devolution of the dollar in 1934, was now 3.09 Bs/US$ (gold).

another forty-year term, cleansing them once and for all of their legal shortcomings. As previously agreed, all of them did so. They thereby accepted an immediate increase in mineral taxes. For example, the production tax rose to 16.67% in 1943; in 1942, the average had only been 9.3%.

Sovereign Taxation
The 1943 Hydrocarbons Law reaffirmed the validity of *mineral taxes* for the full term of the concessions. But regarding general taxation, particularly import tariffs, the Executive was again empowered, as it had been under the Mining Law of 1905, to grant exemptions to concessionaires at its sole discretion, if the imports involved were directly related to developing the concessions.[35]

However, the Law declared categorically that "*concessionaires shall pay all general taxes, of whatever kind, and shall also pay the legal charges, contributions and dues for services that may be rendered to them*".[36] Consequently, the concession holders became subject to a brand new Income Tax Law, becoming effective on January 1st, 1943. The rate applying to the oil sector was set at 12%. Given the legislation on preventing double taxation, the net result was going to be that US oil companies would cease to pay the corresponding amounts in the United States.

Yet the international oil companies insisted until the last moment that the lines quoted above should be followed by the tag line: "that will equally affect all companies".[37] In other words, they pretended to limit sovereign taxation to the level corresponding to the non-oil sector, but to no avail.

INDUSTRIALISATION OF PETROLEUM

Between 1918 and 1932, Royal Dutch-Shell and Standard Oil of New Jersey built large refineries on the Dutch islands of Curaçao and Aruba, located off the coast of Venezuela, to refine their Venezuelan production. For the promotors of the 1943 Petroleum Reform, this was unacceptable. They required the two companies to construct large refineries in Venezuela within five years following the end of World War II, and to desist from expanding or modernizing the capacity of their already existing refineries. This issue was extremely controversial, and was the last one over which agreement could be reached, only after the Venezuelan government threatened to suspend negotiations and take unilateral action.

New Licensing Rounds
The international oil companies made use of the renewal of their concessions to reorganise themselves. Standard Oil of New Jersey brought all its concessions together under the umbrella of 'Creole', Royal Dutch Shell created Shell de Venezuela, while Gulf was already

[35] 1943 Hydrocarbons Law, op. cit., art.58.
[36] Op.cit., art.46.
[37] "Informe que presenta al Señor General Isaías Medina A., Presidente de la República, los Dres. Manuel R. Egaña y Rafael Pizani, acerca del Proyecto de Ley de Petróleos", Caracas, 6 January 1943; italics ours. Personal papers of Manuel R. Egaña.

organised as ‘Mene Grande’. In 1943, these three big companies controlled, respectively, 56.7%, 28.8% and 8.7% of Venezuelan production; in total 95.2%. Moreover, in 1936 and 1937, Standard Oil of New Jersey and Shell had each acquired a 25% share in Mene Grande, which served as their centre of coordination in Venezuela. This arrangement was part of the setting up of the International Petroleum Cartel. However, the government of Medina Angarita considered the cartelisation of concessionaires contrary to the national interest, as competition between the oil companies in bidding for concessions was essential to getting ground rents which would truly reflect market conditions.

The 1943 Hydrocarbons Law declared the pipelines to be common carriers, in order to guarantee smaller companies' access to the market, and in the licencing rounds following the Reform, the government encouraged the participation of competing companies. In the licencing rounds of 1944/45, royalty rates of up to one third were offered, with bonuses over 180 million bolivars (58.3 million US$).

In 1942, the concessions covered an area of 7.1 million hectares, which was reduced to 5.5 million hectares in 1943, due to the economic pressure of the new Hydrocarbons Law. In 1944/45, 6.3 million hectares were granted, and the total now reached 11.7 million hectares. However, in 1955, according to legislation and given the economic pressure of rental payments, the total had come down to 5.9 million hectares. Moreover, the participation of the big three oil companies in the production of the country had been reduced to 88.4%.

One of the conditions applying to the new licensing rounds required that if production reached significant levels, refining had to take place in Venezuela or in distant important countries, but not in the neighbouring countries. This met with objections from the ambassadors of the United States, Britain and Holland, who considered this to be an attack on the freedom of commerce. President Medina responded by immediately suspending the licensing rounds already underway, only reactivating them once the ambassadors in question had withdrawn their protest.

The last licensing rounds took place in 1956/57 under the government of General Marcos Pérez Jiménez, where a total of 821,000 hectares were granted to the highest bidder, achieving royalty rates up to 25.5% and bonuses totalling 2.2 billion bolivars (708 million US$). The participation of the big three in production continued to decline, from 88% in 1955 to 80% by 1970. In this opportunity, some of the newcomers were committed to the development of a national petrochemical industry.

NATIONAL *TERRITORIAL* SOVEREIGNTY

As a result of the 1943 Petroleum Reform, the concessionaires in Venezuela would pay the same rents, royalties, and income taxes as they would have if they had been in the United States; and concessions were granted through licensing rounds following the same criteria as in the United States. However, the petroleum regime in the United States had developed under the hegemony of capital and on the background of private landed property. In Venezuela, in contrast, the petroleum regime had been imposed by the nation state, a

territorial state, being *the one and only sovereign landlord*.

The idea of a sovereign landlord state was, of course, unacceptable to both the US government and the international oil companies. Indeed, the two US government advisors, in a memorandum to the Venezuelan government, categorically declared that:

> …a one sixth royalty for the proprietor of the reservoirs represents very closely 50% of the net benefits derived from their exploitation. It cannot be expected that any proprietor would ask for more, and certainly no company would be disposed to concede more than this equal participation. [38]

Yet in the middle of World War II, they had no alternative but to accept the new law. For the time being, all they could achieve was the inclusion of the following lines in the Statement of Reasons of the 1943 Hydrocarbons Law:

> According to numerous and careful calculations this percentage of 16 2/3 of the production, together with the other taxes, is the equivalent in our country, approximately, of an average of 50% of the benefits of the extractive industry of oil.

This was an isolated paragraph without any connection with the effective text of the law.

World War II had hardly ended when a civic-military coup toppled the government of General Medina Angarita. In 1946, the newly elected Constituent Assembly increased the highest income tax rate from 12% to 28.5%. Nevertheless, the total government take – the sum of rents, royalties, and income taxes – of the two biggest concessionaires with the best lands, Creole and Shell, fell slightly below 50%, due to the increase of production, and continued to fall in 1947 because of increasing prices. Thus, in 1948, the government now asked Congress to again reform the Income Tax Law, creating an Additional Tax of 50%, so that the total government take would be equal to the net profit of the companies.[39] *Moreover, Creole and Shell voluntarily agreed to pay this Additional Tax retroactively for the years 1946 and 1947, and this to comply with what had allegedly been the very essence of the Petroleum Reform from 1943.*[40]

There is no doubt that a fifty-fifty split of the economic surplus had a certain ideological and political appeal, suggesting an inherently just distribution. But in fact, it lacked any economic basis. Economically, the decisive criterion is the rate of return of the investment, after the payment of rents, royalties and income taxes. Due to the existence of income tax, the Venezuelan government had at its disposal all information necessary to estimate oil company profit rates with a high level of accuracy. In 1957, the returns averaged 32% on net investment, in production, refining, transport and distribution. In Ricardian terms, therefore, ground rent in Venezuela was low given that 20% is the rate of return considered adequate

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[38] Arthur A. Curtice and Herbert Hoover Jr.: *Memorándum*, January 2, 1943. Personal papers of Manuel R. Egaña.

[39] 1948 Income Tax Law, Art. 31. However, the Additional Tax of 50% would only apply if profits were higher than 15% of the companies' patrimony.

[40] See *Fortune*, February 1949: "Creole Petroleum: Business Embassy". – Quantitatively the Additional Tax was insignificant. The total government take for the years 1946 y 1947 amounted to 383 million US$, but the sum of the retroactive payments from Creole and Shell only amounted to 6.2 million US$. Vallenilla, op. cit., p.200.

to attract foreign investment into the oil sector of the exporting countries. Since January 1958, the country was again under control of a civic-military Junta. Confronted with a severe fiscal crisis the Junta resorted, in December 1958, to its special powers to reform the income tax law by decree. Taking the entire country by surprise, the applicable maximum income tax rate increased from 28.5% to 47.5%. The government take would now always be above 60%.

In a letter addressed to the Minister of Mines and Hydrocarbons (this Ministry was created in 1950), the President of Creole expressed his dismay, demanding that the government reconsider the reform, threatening reprisals. The Minister replied immediately, stating that the initiative was an "act of sovereignty" taken "after long and careful study", and that it would be maintained in its integrity.[41] However, the President of Creole insisted in declarations to the press that:

> ... Venezuela ... completely disregarded acquired rights and ignored the moral if not legal obligation to negotiate this change between the interested parties ...[42]

The Minister replied publicly the same day:

> With regard to the statements made this morning ... by ... [the] President of Creole ..., I consider that the enacted tax ... does not injure any acquired right nor does it modify any existing agreement with the oil companies since the so-called 50:50 system emanates from the law itself and not from any formalized agreement.[43]

As a matter of fact, until 1958, income tax levels in the Venezuelan oil sector had still been below the US levels prevailing in upstream oil. In other words, the US companies also benefited internationally from the depletion allowance in their home country. For example, by 1958, the highest corporation income tax rate applying generally was 52%, but only 37.7% for upstream oil. Now it was significantly higher in Venezuela, being 47.5%. The Venezuelan government had decided to move beyond the US reference, exercising its sovereign rights.

II.2.2. MIDDLE EAST: INTERNATIONAL ARBITRATION AND THE GENERAL LEGAL PRINCIPLES OF THE CIVILIZED NATIONS

IRAN (UNTIL 1931)

The oldest of the important concessions in the Middle East was granted in 1901 by Persia (later Iran) to a British citizen. At the time, Iran was divided into two zones of influence: Russia in the north and Britain in the south. The concession was granted for sixty years and covered all of southern Iran, some 1.3 million km^2, and included a transport monopoly of hydrocarbons.

Apart from an initial bonus payment of twenty thousand pounds sterling (97 thousand US$) and a shareholding in the company exploiting the concession, also worth twenty thousand

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[41] Letter of Minister Julio Diez to H.W.Haight, President of Creole, 23 December 1958.
[42] H.W.Haight in *World Petroleum*, Vol. 30, No. 1, January 1959, p.16.
[43] Ministerio de Minas e Hidrocarburos: Introducción a la Memoria del Ministerio de Minas e Hidrocarburos presentada al Congreso Nacional en sus sesiones ordinarias de 1958, pp. VII-VIII. Parentheses ours.

pounds sterling, the only other significant payment was a 16% share in profits. Moreover, *the concessionaire was granted fiscal stability for the whole duration of the concession.* The legal basis of the concession was limited to the title,[44] and *any dispute would be subject to international arbitration based on the principles of law common to both parties and on the "general legal principles of the civilised nations*".[45]

The first significant discovery was made in 1908, which led to the foundation of the Anglo-Persian Oil Company, APOC (later Anglo-Iranian Oil Company, AIOC, and finally British Petroleum, BP). In 1914, on the eve of World War I, the British government acquired a majority shareholding of the company.[46] The importance of oil for modern industry, and especially for the British Navy, was already evident.

IRAQ (UNTIL 1932)

In early 1914, German, British and Dutch interests agreed to jointly apply for concessions in the Turkish Empire, and not to compete amongst themselves. To this end, they set up the Turkish Petroleum Company, TPC (later Iraq Petroleum Company, IPC). In mid-1914, the Turkish government promised TPC a concession in Iraqi territory. After the collapse of the Turkish Empire, the TPC sustained that this promise still remained binding on Iraq, now under British mandate, with German interests being transferred to the French. Yet the United States, being one of the victorious powers of World War I, now also claimed a participation in TPC for its international oil companies.

The European parties had originally offered a 20% shareholding to the Iraqi government, but the US parties suggested instead a one eighth royalty. The end result was a royalty of four shillings (gold) per tonne (about 0.13 US$/b), supposedly equivalent to one eighth at the then prevailing prices. With a fixed rent per tonne, oil companies would only have to inform the Iraqi government of production volumes, but not of their prices; and from the viewpoint of the oil companies, the less informed the owner of the natural resource, the better. Definitively, the international oil companies rejected the concept of an Iraqi government shareholding.

The concession was finally granted in 1925. However, regarding general taxation, it is a most noteworthy fact that the concession title established that TPC would have to pay taxes just like all other economic undertakings:

> No other or higher taxes, impositions, duties, fees or charges, whether Government or municipal or port, shall be imposed upon the Company, or upon its property or privileges or employees within Iraq, than those ordinarily imposed from time to time upon other industrial undertakings, or upon their property or privileges or

[44] The first mining law in Iran – and in the Middle East generally – was enacted only in 1957.
[45] Henry Cattan: *The Law of Oil Concession in the Middle East and North Africa*, 1967; *passim*.
[46] In Venezuela – like everywhere else in Latin America – foreign state-owned companies were not allowed to acquire concessions.

employees.[47]

This arrangement was not to the liking of the companies. The existence of such a clause was to be explained by the complex and tortuous negotiations around the granting of the concession: not only were the international oil companies involved, in competition with each other, but also the British, French and United States governments. It actually took until 1928 to reach a definitive agreement on the shareholdings in IPC: 23.75% each for BP, Royal Dutch Shell and the Compagnie Française des Pétroles (CFP, then a state company, today Total, a private company); 11.875% each for Standard Oil of New Jersey and Standard Oil of New York; and the remaining 5% for an intermediary who would not have voting rights. But once IPC had achieved firm control over the concession, it insisted on renegotiating this clause subjecting the company to the same general taxes levied on the non-oil sector. *Finally, the Iraqi government guaranteed, in 1931, fiscal stability over the remaining 69 years of the concession in return for an additional payment of about four pence per ton*. Moreover, a yearly delay rental of 400 thousand pounds sterling (gold) (1.9 million US$) was agreed, a minimum to be paid until production would reach significant levels. The following year Britain granted independence to Iraq, and exports began in 1935.

The legal basis of the concession was limited to the title, and any dispute would be subject to international arbitration based on the principles of law common to both parties and on the 'general legal principles of the civilised nations'.

IRAN (1931-1933)

Meanwhile, Iran continued under the predominance of Britain, with one single, enormous concession in the hands of the British state company. Iran was still the only petroleum producing country in the Middle East. The fiscal take agreed on at the beginning of the century was very modest compared with that which had just been agreed for neighbouring Iraq.

Worse still, in 1931 the AIOC (BP) produced 5.73 tons (about 115 thousand barrels daily), but, in the midst of a world petroleum market suffering a sharp recession, Iran's fiscal revenues only amounted to 310 thousand pounds sterling (1.5 million US$). In neighbouring Iraq, in the very same year, IPC paid a delay rental of 400 thousand pounds sterling (1.9 million US$), without so much as a drop of oil having been produced. In the face of this, the Iranian government cancelled the concession granted in 1901 for 60 years, and in the middle of a major international confrontation, renegotiated and renewed the concession in 1933, again for 60 years, though the area of the concession was reduced to 260 thousand square kilometres.

In this renegotiation, the Iraqi concession played, of course, a major role as a reference. Regarding the outcome, suffice it to point to the royalty rate of four shillings (gold) per ton. At the time the concession was reissued, however, the pound sterling had just devalued by 29%. As a result, Iraq and Saudi Arabia would charge, in nominal terms, no longer 4 shillings

[47] Quoted in George W. Stocking: *Middle East Oil*, 1971; p.132.

but 5 shillings and 8 pence, whereas Iran was stuck with its 4 shillings. Thus, even though the Iranian government achieved some significant improvements through renegotiation, the new agreement still fell short as, once again, imperial Britain was able to impose itself. Moreover, as part of the agreement, the AIOC (BP) purchased the shares that had been given to the Iranian government when the company was founded in 1908.

BAHREIN, SAUDI ARABIA, KUWAIT AND QATAR (1930-1935)

The ink had barely dried on the 1928 agreement covering the shareholdings of Royal Dutch Shell, BP and Standard Oil of New Jersey in IPC, when these companies – the three largest oil companies in the world – founded the International Petroleum Cartel. They agreed not to compete with each other in acquiring new concessions within the territory of the former Turkish Empire, just as the original participants in IPC had agreed in 1914.[48] Later, Gulf and Standard Oil of California (today merged into Chevron) and Standard Oil of New York (today part of ExxonMobil) joined the Cartel.

Between 1930 and 1935, four other important concessions were granted which yielded significant discoveries before World War II. In 1930 Bahrein granted a 55-year concession to Standard Oil of California; in 1934 Kuwait granted a 75-year concession to be held in equal parts by BP and Gulf; and in 1935 Qatar granted a 75-year concession to a subsidiary of the IPC.

These three small Emirates in the Persian Gulf were British protectorates at the time, and these concessions covered the entirety of their national territory, at a ground rent of about 4 shillings and 6 pence per ton. However, the currency used in these concessions was the Indian rupee, which was not backed by gold. This meant that the value of the ground rent agreed would devalue with the rupee.

Saudi Arabia granted its historic concession in early 1933 to Standard Oil of California for 60 years, over an area of about 1.3 million square kilometres, and ground rent was four shillings (gold) per ton, agreed *before* the devaluation of the British Pound. To obtain such a favourable result, Saudi Arabia benefitted from competition between Standard Oil of California, which had not yet joined the Cartel, and IPC. Eventually, the concession would be worked by the Arabian American Oil Company (Aramco), in which Standard Oil of California, Texaco and Standard Oil of New Jersey each had a 30% stake, and Standard Oil of New York 10%. In the Middle East, Saudi Arabia was going to be the only oil country in which all the concessionaires were US oil companies.

All these concessions guaranteed fiscal stability for the entirety of their term. The legal basis of a concession was limited to their titles, and any dispute would be subject to international arbitration based on the principles of law common to both parties and on the 'general legal principles of the civilised nations'.

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[48] U.S. Senate, Select Committee on Small Business: *The International Petroleum Cartel*, Staff Report to the Federal Trade Commission, 1952.

II.2.3. FROM BRITISH COLONIAL REFERENCE TO UNITED STATES REFERENCE

Before the US government and oil companies arrived in the region after World War I, the only reference in the Middle East was the British concession in Iran, of colonial characteristics.

The United States introduced a new common element in troubled development of the concessionary regime in the Middle East: all the important concessions referred to a ground rent of four shillings per ton, even though the real value of these four shillings varied considerably. Nevertheless, this fact revealed that it was not sufficient to restrict competition between the concessionaires; it had also to be taken into account that each government in the Middle East would compare their own concessions with those of the other governments, aspiring to equalize, in one way or the other, the best terms achieved, or, at the very least, keeping up appearances.

SAUDI ARABIA (1948–1950)

A fixed rent per ton implied that the Saudi government would not benefit from increasing prices following World War II. But in 1948 Aramco accepted that the 4 shillings (gold) would be valued according to the price of gold in Saudi Arabia, significantly higher than in the USA. Consequently, the rent per barrel increased from 0.21 US$ to 0.32 US$. Nevertheless, even though Aramco paid, in 1949, 32 million US$ in rents and royalties to the Saudi government, the company also paid 43 million US$ in income taxes in the United States on profits made in Saudi Arabia.

Finally, with the help of US experts, the Saudi government passed an income tax law with a rate of 20%, plus an Additional Tax of 50%, resulting in a 50:50 split of the benefits between the Saudi Government and Aramco.[49] *All of this would become an integral part of the contractual framework of the concession*.

This arrangement came into force in 1950. The overall result was that the Saudi Arabian fiscal take per barrel increased from 0.21 US$ in 1945 to 0.68 US$ in 1950. At the same time, Aramco stopped paying income taxes in the United States on its Saudi earnings.

IRAN (1948–1954)

In Iran, the situation ran in parallel with what was happening in Saudi Arabia, but with the aggravating circumstance of a significantly lower royalty. Moreover, Iran was aware of how Venezuela's petroleum regime had been developing, something reflected in its 1949 proposal to the AIOC (BP), which followed the Venezuelan reference of a 50:50 split of the benefits. But the AIOC (BP), confident in British colonial power, pushed a proposal equivalent to a 30:70 split of the benefits in favour of AIOC (BP) and the British government. Though the Iranian government finally relented by accepting the deal, it still required its ratification by the Iranian parliament.

[49] Abdullah H. Tariki: "Arab-Latin American Cooperation in the Energy Field", in Fehmy Saddy (ed.), *Arab-Latin American relations: energy, trade, and investment*, 1983.

In December 1950, the Iranian parliament rejected the British proposal, and when news arrived, in January 1951, that Aramco had accepted a fifty-fifty arrangement with Saudi Arabia, the government of Muhammad Mossadegh nationalised the AIOC. Henceforth, the National Iranian Oil Company (NIOC) would take charge of the former concession.

What followed was the full programme of an international embargo against Iran, with the participation of the United States, France and Holland; Britain alone no longer had the requisite power. Finally, a coup promoted by the secret services of the United States and Britain overthrew the Mossadegh government in 1953. Formally, the nationalisation of AIOC was maintained; however, in 1954 an International Consortium was formed which ended the predominance of Britain in Iran. BP retained a 40% shareholding, the same percentage granted to the US companies, with Royal Dutch Shell receiving 14% of the shares and CFP 6%. NIOC then contracted this consortium as operator of the former AIOC concession for a period of 25 years, renewable for a further 15 years. The Consortium would be subject to a fifty-fifty arrangement, following the model established by Aramco in Saudi Arabia.

II.2.4. MYTHOLOGY OF FIFTY-FIFTY

In the Middle East, Saudi Arabia was the first petroleum exporting country benefiting from the fifty-fifty sharing of benefits, and Iran was the last. In its conception, the fifty-fifty compromise was essentially tailor-made for the US companies.

The United States emerged from World War II as the world's dominant economic power, while Great Britain came out of the War in precarious economic conditions, and with a colonial empire in decline. The United States and its international oil companies were in a position to concede relatively generous arrangements to the petroleum exporting countries: they would pay rents and royalties as usual in the United States and, moreover, the United States government would give up any pretension to subject their profits in these countries to US income taxation. In contrast, the British government, with a struggling economy, was dependent on the Iranian concession as the principle source of foreign exchange, but was no longer able to exert control over Iran on its own.

To stabilise the *fifty-fifty* arrangement, it was necessary to dress it up both ideologically and politically, and to wrap it up in its own mythology. In the words of the President of Standard Oil of New Jersey, it was an inherently just arrangement:

> Fifty-fifty relieves the country of any financial risk, and places that risk upon the company which is in a position to evaluate it and spread the risks of the search for oil over many areas. Any basis other than 50:50 could create an imbalance of interests which would reduce the attractiveness of the venture for one or the other of the parties. The 50:50 represents a tested principle for maintaining an equality of interest through all the aspects of an inevitably complex relationship intended to endure for many years.[50]

[50] M.J.Rathbone in *The Financial Times*, London, 6 March 1958.

According to another Director of Standard Oil of New Jersey, the historic roots of the fifty-fifty in the Middle East supposedly went back to the very first concession in Iraq:

> ... in the Middle East pre-war … 4 s. gold … plus other payments to the governments came to an average of nearly 50% of the profit…

However:

> After the War, with … the rapid increase of crude prices, higher United States and United Kingdom corporate income taxes…, the oil companies operating in the Middle East recognized that the fixed royalty payment no longer gave the equitable division originally intended, and that additional royalty payments were neither economically practical nor a permanent method of maintaining equity between the parties. …50:50 was the result of this recognition of the need to restore the equity which had been frustrated by drastically changed conditions, beyond the control of either party and unforeseen at the time the agreements were negotiated."[51]

Of course, neither the negotiations over the concession in Iraq, nor those over the Saudi concession, made any reference to a fifty-fifty split of benefits. Nevertheless, the objective was clear: on the one hand, to situate the antecedents of fifty-fifty as far back in time as possible and, on the other hand, to sustain the appearance of sacrosanctity of contracts. Allegedly, the renegotiation of the contracts had only been accepted in order to restore the equity originally intended by the two parties, which had been frustrated by drastic and unforeseen changes in circumstances.

Economically, between 1952 and 1961, the fifty-fifty split of benefits resulted in a net average rate of return for Aramco of 58%; for IPC, between 1952 and 1963, it was 57%; for the International Consortium, between 1955 and 1964, it was 69%; and for KOC, between 1956 and 1960, it exceeded 150%.[52]

The international oil companies controlled the most prolific oil-bearing lands in the world, paying essentially the same rents, royalties and general taxes as would apply to marginal land in the United States, and it was that marginal land that determined the international price of oil. But with the introduction of income taxation in the oil-exporting countries, there was no way of concealing the high rates of return being achieved. These high rates were also revealed by competition. The new concessions granted after World War II were much more advantageous for the State than the old ones with their fifty-fifty arrangement.

DECLINE OF FIFTY-FIFTY

In spite of the systematic effort by the International Petroleum Cartel to control all oil-bearing lands in Venezuela and the Middle East, as well as to shut out potential competitors, enough free territory outside its control remained open to competitors.

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[51] H.W. Page: "Profit Sharing between Producing Countries and Oil Companies in the Middle East: A Reply", in Edith T. Penrose: *The Growth of Firms, Middle East Oil and other Essays*, London, 1971; p.168.

[52] Zuhayr Mikdashi: *A Financial Analysis of Middle Eastern Oil Concessions: 1901-1965*, New York, 1966; pp.181, 221; and by the same author: *The Community of Oil Exporting Countries*, London, 1972, p.141.

In the Middle East, but not in Venezuela, the participation of exporting countries as shareholders was a feature which had always been present. After 1914, the presence of state companies from European *importing* countries also became the norm. It was against this backdrop that European powers originally offered a 20% shareholding in TPC to the government of Iraq. For the time being, however, this proposal was neutralised by the intervention of the US interests.

Nevertheless, after World War II, new concessions usually included some ownership by the oil-exporting countries, apart from and on top of fifty-fifty. As a matter of fact, in 1957 the Ente Nazionale de Idrocarburi (ENI), the Italian state oil company, provocatively challenged the existing fifty-fifty agreements by consenting to a *double fifty-fifty* with Iran, offering a 50% shareholding to the NIOC on top of 50% of benefits. Under this concession, the distribution of the economic surplus was to be 75:25 in favour of Iran. The US ambassador intervened personally with the Shah in an effort to ensure the arrangement would not see the light of day, but in vain. In 1958, Iran granted two additional concessions under the same terms, one to a US company and the other to a Canadian.

On the other hand, the most important oil-exporting countries were in direct contact with each other ever since a Venezuelan delegation had visited the Middle East in 1949. Next, in 1951, delegations from Iran, Saudi Arabia and the Arab League attended as observers the First National Petroleum Congress in Caracas. Then, in April of 1959, just four months after Venezuela had put an end to fifty-fifty, delegations from Venezuela and Iran attended as observers the First Arab Petroleum Congress in Cairo. On the fringes of this Congress, the highest-ranking officials from oil-exporting countries met in secret and signed a 'Gentlemen's Agreement':

> On the occasion of the First Arab Petroleum Congress, informal talks were held between Dr. Pérez Alfonzo of Venezuela and Messrs. Farmayan of Iran, S. Nassim of the United Arab Republic, Tariki of Saudi Arabia, A. Omar of Kuwait and M. Salman of the Arab League. In view of the evident usefulness of these informal talks ... the abovementioned agreed to take back to their respective governments the idea of setting up as soon as possible a *Consultative Petroleum Commission* by means of which common problems could be discussed so that common solutions might be reached. ... The problems that were discussed and about which there was general agreement were as follows:
>
> 1. An improvement in the shares of the oil producing countries on a reasonable and equitable basis. The consensus of opinion was that the governments in question should be guided by a 60:40 formula as a minimum to bring themselves into line with the recent position assumed by Venezuela and evidenced as a tendency in new contracts made in other countries. …[53]

The days of fifty-fifty were definitely numbered.

[53] Eduardo H. Acosta Hermoso: *Análisis histórico de la OPEP,* vol.1, p.17s., Mérida (Venezuela), 1969.

II.2.4 CONTROL OF PRODUCTION

In the short term, however, a new concern arose as the number one priority for the petroleum exporting countries. The post-war boom in the world petroleum market came to an end. Production from the new concessions granted to oil companies not part of the International Petroleum Cartel, in both Venezuela and the Middle East, had resulted in an excess supply, putting pressure on the domestic market of the USA. In March 1959, this led the US government to impose a system of import quotas, to be distributed between refineries, and the refineries would in turn buy the cheapest oil on the world market (or else sell their rights to other refineries) and then sell the corresponding oil products at domestic prices.

As a matter of principle, this measure taken by the US government should not have affected Venezuela, as the two countries had signed a Reciprocal Trade Treaty in 1952, exempting Venezuelan oil from import quotas. Furthermore, Venezuela had been an observer to the *Interstate Oil Compact Commission* since 1953, and its production was generally considered to be well controlled. Nevertheless, Venezuela lost its preferential access to the US market in 1959 as a reprisal for ending the *fifty-fifty* arrangement. Venezuela was no longer deemed trustworthy.

Of course, the fall in international prices affected all oil-exporting countries. In turn, lower prices directly benefitted the consumers of oil-importing countries (except in the United States, where lower prices benefited directly the refineries). Indeed, the petroleum-exporting countries had something serious to worry about: if the cost of production of marginal wells in the United States, the corresponding proprietorial rent included, was no longer to be the determinant of international prices, what would be the floor for these prices? This concern found an immediate reflection in the Gentlemen's Agreement in Cairo:

> … The general opinion was that an attempt ought to be made to maintain the price structure since of necessity the prices affect the level of participation of the oil producing countries as regards oil profits. Consequently, it was also recommended that any change should first be discussed and approved by all the interested parties.

In Venezuela, the average realised price for hydrocarbon exports and their derivatives peaked in 1958 at 2.48 US$/b. In 1959, it fell to 2.19 US$/b, and dropped further, to 2.08 US$/b, in 1960; and fiscal revenue dropped accordingly.

In the Middle East, in contrast, fiscal participation was calculated on the basis of the *prices posted by the companies*, and *not on realised prices*. The posted price for the Arabian Light of 34 ^{o}API – the Saudi marker crude – was in 1958 at its maximum historical level of 2.08 US$/b. In February 1959, Aramco reduced its price to 1.90 US$/b, and to 1.80 US$/b in August 1960. Now the reaction of the affected countries was immediate.

ORGANISATION OF THE PETROLEUM EXPORTING COUNTRIES

Upon an initiative from Abdullah Tariki, the official responsible for oil in the Saudi Arabian

Ministry of Finance,[54] a meeting was convened in Bagdad on the 14th of September, 1960, with representatives from Saudi Arabia, Iran, Iraq, Kuwait and Venezuela in attendance. This meeting resulted in the founding of OPEC. Its first Resolution stated:

> That Members shall demand that Oil Companies maintain their prices steady and free from all unnecessary fluctuations; that Members shall endeavour, by all means available to them, to restore present prices to the levels prevailing before the reductions…
>
> The Members shall study and formulate a system to ensure the stabilization of prices by, among other means, the regulation of production…[55]

Regarding the second point, the international oil companies replied with a most emphatic "*no".* The last thing they would concede to the Landlord States was their voice and vote in the control of production. In the words of an ex-Secretary General of OPEC:

> The majors' ability to manipulate production in the Middle East has been, and still is, a potent weapon which they have used and will no doubt continue to use to very good effect against individual countries in the area. Agreement on their part to operate in accordance with an OPEC Joint Production Program would effectively entail a relinquishment of the weapon that has enabled them to surmount many a storm in the past for the production program is in essence an instrument whereby OPEC itself, rather than the oil companies, can assume the responsibility for deciding on the production level from the OPEC area as a whole, as well as the output from each member country.[56]

Regarding the first point, the companies were not willing to revoke the August 1960 reduction in posted prices. Nevertheless, OPEC enjoyed a notable success: the oil companies were forced to freeze their posted prices throughout the 1960s, even though market prices – realized prices – continued to decline. Posted prices were thus transformed into *Fiscal Reference Prices.* At the same time, OPEC continued to insist that the fiscal regime should be changed from 50:50 to 60:40, as stated in the Gentlemen's Agreement, *to be calculated on the basis of fiscal reference prices.*

The result speaks for itself. In August 1960, the posted price of Arabian Light crude was 1.80 US$/b, reflecting market conditions. With an estimated cost of production of 0.20 US$/b, the government take of Saudi Arabia and the net profits of the concessionaire were both 0.80 US$/b. At the beginning of the 1970s, this posted price continued to serve as the fiscal reference price despite the fact that the market price had fallen to 1.25 US$/b, and the fiscal take of Saudi Arabia had increased to 0.85 US$/b. With the cost of production down to 0.12 US$/b, the net profits of the companies had fallen to 0.28 US$/b, and the split of benefits between the government and the companies was now 75:25 in favour of the former. In

[54] Arabia Saudita creó el Ministerio de Petróleo y Minería apenas en diciembre de 1960.
[55] OPEP, Resolución I.1.
[56] Ashraf Lutfi: *OPEC Oil*, Beirut, 1968; p.68.

Venezuela the situation evolved accordingly; but in the Middle East this outcome had been *negotiated*, while in Venezuela, it had been *legislated*.

In retrospect, the oil-producing countries managed, in the context of rising prices, to move from a fixed ground rent per barrel to a percentage based rent. In the context of falling prices, however, they managed to take a ground rent per barrel to be calculated on the basis of a fixed fiscal reference price.

CRUDE OIL PRODUCTION 1920-1973

Year	EUA (%)	OPEP* (%)	Others (%)	Total (MBD)
1920	64.3	4.4	31.3	1,882.2
1940	62.9	15.8	21.3	5,873.8
1950	51.9	32.3	15.8	10,419.2
1960	33.6	41.5	24.9	20,920.1
1970	21.1	51.0	27.9	45,653.5
1973	16.5	55.7	27.8	55,656.5

* As of 1970: Saudi Arabia, Algeria, United Arab Emirates, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar and Venezuela.

II.2.5. DEMISE OF THE UNITED STATES REFERENCE

Between 1920 and 1973, world oil production grew at an average of 6.6% per year. Until the beginning of World War II, US production represented about two-thirds of global production. Following World War II, it rapidly lost importance. By 1970, US production was a mere 20% of the world's total. In 1970, with the US still the world's largest crude oil producer, its production reached its peak, with 9.6 million barrels daily (MBD). By 1973, US production had fallen to 9.2 MBD, then equivalent to a sixth of world production.

After more than a century of intensive exploitation, US oilfields were nearing depletion. Because demand in the domestic market continued to expand, net imports of both crude oil and products grew rapidly. Between 1947 and 1970, net imports had grown from zero to 2.8 MBD, and by 1973, they had already reached 5.7 MBD. In contrast, oil production in the eleven oil-exporting countries, members of OPEC, began to assume an ever-larger share of the world oil market, from a modest 4.4% in 1920 to 51% in 1970 and 55.7% in 1973. This occurred in parallel with an intense political process of decolonisation involving ten of the eleven OPEC member countries. The eleventh member was Venezuela, the example *par excellence* of a sovereign oil country.

Venezuelan production also peaked in 1970, after having been the top exporting country for 42 years, averaging 3.7 MBD. By 1973, production was down to 3.4 MBD. This trend strengthened the other ten members of OPEC, eager to close the political and institutional gap with Venezuela.

It was also in 1970 that the world petroleum market turned from recession to boom, and international prices began to move upwards. The oil exporting countries were now negotiating, both individually and collectively, fiscal reference prices and changes in the fiscal regimes that would guarantee increases in extraordinary surpluses translating into fiscal revenues.

For example, the fiscal reference price of Arabian Light Crude of 34 ºAPI was 1.80 US$/b until August 1970. Thereafter, it rose steadily to 3.01 US$/b by October 1973. At the same time, the fiscal regime was being modified in favour of the landlord state. Consequently, market prices also increased in parallel with tax reference prices. It is worth reiterating that all this was a result of *negotiations,* while in Venezuela it was the subject of sovereign *legislation*.

The United States government still sought to subject the increases of market prices to its own domestic prices by freezing them at the beginning of 1973. In the past (for example, during World War II and the Korean War), such a measure would ensure a freeze in international oil prices as well, but this time around the major oil companies making up the International Petroleum Cartel had already lost the power to contain the price increases.

YOM KIPPUR WAR

Just as the upswing in the international market was reaching previously unknown extremes, the Yom Kippur War broke out, culminating, after the armistice at the end of October, in a petroleum boycott against the United States and the Netherlands by the Organisation of Arab Petroleum Exporting Countries (OAPEC) because of their support for Israel.[57] OPEC member countries, in turn, seized the opportunity to put an end to negotiations and to declare that fiscal reference prices and the fiscal regime, from now on, would be determined sovereignly.

The fiscal reference price for Arabian Light Crude of 34 ºAPI on January 1, 1974, rose to 11.25 US$/b. The boycott was lifted in the middle of 1974, and even though fiscal reference prices remained constant, the fiscal take continued to increase because of changes in the fiscal regime. Saudi Arabia imposed a royalty of 20% and income tax of 85%, together amounting to 9.30 US$ per barrel. Considering Saudi Arabia's 60% share in Aramco (which will be discussed below), ground rent per barrel reached ten dollars at the end of 1974.

By 1974, all spare capacity in the United States had disappeared. The government suspended the system of import quotas and the control of production; everybody was allowed to produce at maximum efficient rates. US domestic prices would no longer determine or limit international prices. On the contrary, the latter would now determine the former.

LANDLORD STATES ENTERING PRODUCTION

The signatories to the Gentlemen's Agreement also agreed to the "Establishment of National Oil Companies which would work side-by-side with existing companies".[58] And so they did. Obviously enough, without state intervention the petroleum exporting countries would never develop a proper national oil industry.

Since 1968, the Middle East OPEC member countries had also been claiming a participation in the capital of the older concessionaires, acquired before World War II. The principal advocate for this policy was the Saudi Petroleum Minister, Ahmed Zaki Yamani, who argued

[57] Iraq did not take part in the embargo. This country opted for the immediate nationalization of all US and Dutch shareholdings in IPC.
[58] Acosta Hermoso, op.cit.

in favour of a policy of *participation* and against a policy of *nationalisation*. He argued that through such participation, the problem of control over production could be resolved: with their share of production, the petroleum exporting countries would be able to balance the market themselves. It should be noted that, for the oil exporting countries of the Middle East, a growing participation in the capital of their concessionaires did in fact represent an evolutionary path towards sovereignty.

At the beginning of the 1970s, against the backdrop of a booming world petroleum market, Yamani negotiated a 25% capital participation for all the Arab countries bordering the Persian Gulf, effective January 1, 1973. This participation would increase over time, to 51% in 1981. However, in the heat of the booming oil market of 1973, other member countries, as well as Iraq and Kuwait, demanded and obtained larger percentages. With the outbreak of the Yom Kippur War in October 1973 and the subsequent Arab oil embargo, events accelerated. Now Saudi Arabia negotiated a 60% participation, retroactively applicable to January 1, 1974.

Venezuela went its own way. In 1960, the country created its national oil company, the *Corporación Venezolana del Petróleo*, which was preparing itself for the reversion of the most important concessions expected to happen between 1983 and 1984.

II.2.6. CONCLUSIONS

In 1970, OPEC member countries benefited from an international ground rent of 7.6 billion US$; in 1974, it was 91.8 billion US$. Even adjusting for the loss of the international purchasing power of the US$ in those years, between 1970 and 1974 OPEC's ground rent had still increased, in real terms, eightfold.

Internationally, the concessionary regime in oil had failed in terms of its original purpose of minimising, and socialising, ground rent, which would have converted natural resources into a free gift of nature. The Ricardian recipe, minimising the space for extraordinary surplus through market competition amongst producers, was certainly valid; but market competition between the tenants would favour landlords. The balance, in the global petroleum market, was definitively favourable to the landlords. Even worse, state intervention to collect extraordinary surpluses favouring their non-oil sector backfired, because the exporting and importing countries represented different national jurisdictions. Thus, public ownership of oil in the exporting countries gave rise to sovereign Landlord States.

For the very same reasons, US oil policy also failed in its attempt to impose internationally the same compromise between capital and landed property which had developed nationally, under the hegemony of capital.

From the turn of the century through 1973, the major international oil companies undertook the management of the concessionary regime from the perspective of the developed capitalist countries. As part of the internationalisation of capital, their objective role was to contain the aspirations of the exporting countries to garner international ground rents and, ultimately, to keep oil prices down. And last but not least, they were supposed to guarantee

security of supply to the petroleum importing countries. Nevertheless, the Arab oil embargo of 1974 revealed, quite obviously, that the international oil companies were no longer able to deliver that security of supply. Indeed, the oil companies had no other option but to comply with the boycott of the United States and the Netherlands, despite the fact that five of the seven majors were from the United States, and a sixth was Anglo-Dutch.

The moment had arrived for the petroleum importing countries *par excellence*, the developed capitalist countries, to intervene directly in order to create a new, truly *global*, oil regime. Although the Arab embargo had delivered a major and spectacular defeat, forcing the developed importing countries and their international oil companies to withdraw, they would return to the offensive with *a new global regime*, in accordance with the very essence of capitalism: to subordinate land tenure to the hegemony of capital, both nationally and internationally.

THIRD PART
GLOBALIZATION OF CAPITALISM AND LAND TENURE: *THE EXAMPLE OF PETROLEUM*

The dramatic rise in oil prices in the 1970s was of great significance, not just because it caused a slow-down in the growth of demand, but also because it resulted in a slow-down in the growth of the world economy. The rise in prices between 1973 and 1974, and again between 1978 and 1980 due to the Iranian Revolution and the ensuing Iran-Iraq War, cost the member countries of the Organisation for Economic Cooperation and Development (OECD)[59] the equivalent of 2.6% and 3.7% of their Gross Domestic Product (GDP), respectively. To contain the advance of the oil-exporting countries, the OECD countries would have to make large investments in costly domestic oil and gas production, as well as in alternative sources of energy. And last but not least, they were confronted with a severe problem of security of supply.

III.1. INTERNATIONAL ENERGY AGENCY

In 1974, the United States government reacted to the Arab oil embargo with the creation of the International Energy Agency, whose membership would be limited to OECD countries. From the outset, the IEA adopted an ‘International Energy Programme’, with the status of an international treaty, to collectively prepare for future emergencies. Under this programme, each member country would put sufficient oil into storage to cover up to ninety days of consumption, thus creating a Shared Emergency System.

I.1.1. PRIVATE INTERNATIONAL OIL COMPANIES

The first reaction of some OECD member countries, relatively well-endowed with the natural resource, was to confront the petroleum crisis nationally, creating new state oil companies. For example, in 1975, Great Britain created the British National Oil Company to manage its part of North Sea oil; and Canada created Petro-Canada to manage its immense reserves of natural bitumen in Alberta. However, these countries, along with all the other OECD countries, would soon come to accept that state companies no longer made any sense, neither in Europe, where they had emerged in the context of the development of the concessionary regime in the Middle East, nor in the oil-importing countries of Latin America, where they were established in the context of import substitution policies. There would be no space for any of them within a capitalist world economy undergoing a rapid process of globalisation. The new petroleum regime would no longer be national, but *global.* The Shared Emergency System would operate under close collaboration between *private* international oil companies.

In 1979, Great Britain took the lead in privatising its national oil companies, BP as well as the British National Oil Company. Twenty-five years later, all the national companies in the OECD countries had been privatised, with one important exception: Norway. In 1972, the

[59] Basically the developed capitalist countries.

government created Statoil, a national oil company designed to play a central role in its oil policy. The discoveries in the Norwegian part of the North Sea had already revealed that this country would definitively become an oilexporter. Hence, although Norway was a member of the OECD, this country only subscribed to a conditional membership in the IEA.

I.1.2. NON-PROPRIETORIAL FISCAL REGIME

Confronted with another dramatic increase of oil prices towards the end of the 1970s, the IEA urged its member countries to do whatever was economically feasible "to minimise declines in their own indigenous oil production" and to revise the procedure of granting licences or concessions, as well as the fiscal regimes "so as to encourage timely development of the reservoirs".[60] Specifically, the IEA recommended eliminating licensing bonuses, along with any rents and royalties negatively affecting the viability of an investment project. This was about non-proprietorial fiscal regimes, strictly targeting potential Ricardian rents.

The intention was to maximize production of petroleum outside the OPEC area, with a marginal production cost equal to the market price, as the marginal fiscal take would be zero. This proposition was met with structural resistance in the most important of all IEA member countries: the USA. It was difficult, if not impossible, for the US government to even question private mineral property, deeply rooted in that country. By the same token, it was not possible just to scrap bidding bonuses in the leasing of public lands. All the federal government could do was to put regularly on the market, starting in 1981, *all* available areas, with the result of significantly lower bonus payments. Similarly, in 1995, the US government authorised the Minerals Management Service to grant a limited royalty holiday in *federal* leases, but only in deep water off-shore.[61]

I.1.3. GLOBAL FISCAL REGIME

But even with a non-proprietorial fiscal regime, the exploitation of a reservoir is abandoned as soon as the increase in production cost, with its progressive exhaustion, surpasses the level of market prices. Until that point, the *average* cost of production has been lower than that price and, as a result, there has been extraordinary surpluses. If these Ricardian rents had been collected by the state and distributed nationally, or, if these would have been simply appropriated by the companies themselves as extraordinary profits, the result would be the same: definitively, the companies would give up the exploitation of the reservoir. Why would they continue exploiting it if they were no longer able even to make a usual profit?

However, assuming that the state would collect these extraordinary surpluses but only as a *contingent debt* in favour of the producing companies, to be paid back gradually, after production costs surpass the market price, up to the amount necessary for the completion of a usual profit, the companies would continue to exploit the reservoir until they had recovered all the contingent debt. In other words, the first phase, during which the state would collect

[60] Richard Scott: *IEA – The First Twenty Years*; Vol. II: *Major Policies and Actions*, 1995; p.169.
[61] Juan Carlos Boué: *A Question of Rigs, of Rules, ¿or of Rigging the Rules? Upstream Profits and Taxes in US Gulf Offshore Oil and Gas*, with the assistance of Edgar Jones, 2007.

the extraordinary surpluses, would naturally be followed by a second phase, where the extraordinary surpluses would be re-invested in the very same reservoir to compensate for production costs increasing beyond the market price. In the final analysis, considering the two phases together, *average* production costs would necessarily equal the market price.

Under a non-proprietorial fiscal regime, the national consumer pays, micro-economically speaking, a price equal to the *marginal* production cost of the reservoirs. But macro-economically speaking, if the state collects the extraordinary surpluses and distributes them nationally, the consumer ultimately pays only the *average* cost of production, always lower than market prices. In contrast, under a global fiscal regime, national consumers pay, both micro and macro-economically, only the average costs of production, but with the benefit of additional volume. The recovery factor of a reservoir, under a global fiscal regime, is necessarily higher; and the additional production, without any doubt, translates into lower prices.

As a matter of fact, *all* consumers, both national and foreign, would benefit from the increase in supply. Even if a country with a global fiscal regime happens to be a petroleum exporting country, the importing countries would benefit from the barrels in question at a price without any international extraordinary surplus and, ultimately, any international ground rent. The exporting country would benefit from the development of its national oil industry, but not from the natural resource as a national property. The natural resource would definitively be a free gift of nature to consumers.

III.2. THE NORTH SEA: A NEW PETROLEUM PROVINCE

Towards the end of the 1960s, thanks to technological development allowing exploration and production at greater water depths and under exceptionally adverse climatic conditions, oil was discovered in the North Sea. This would become the most important new oil province of the second half of the 20th century, giving rise to two new important petroleum producing countries, Great Britain and Norway.

III.2.1. GREAT BRITAIN: GLOBAL PETROLEUM REGIME

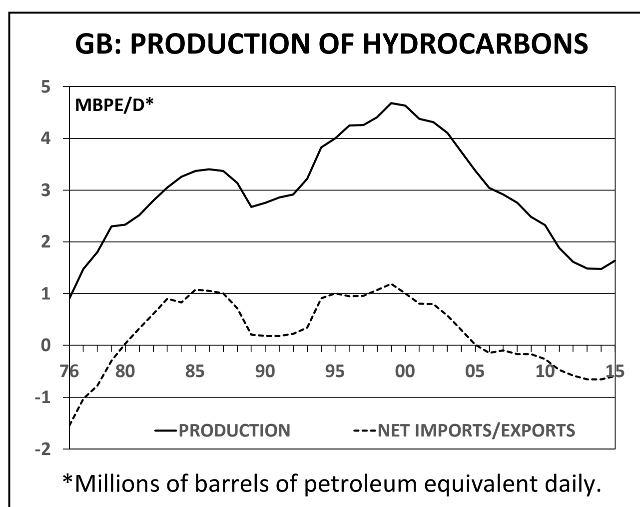
Great Britain became a petroleum producing country in the mid-1970s and a net exporter between 1980 and 2005. However, Britain had historical experience of dealing with the petroleum exporting countries of the Middle East, relying on two large companies, in their origin both *international* and *colonial*: BP and Royal Dutch Shell.[62]

Great Britain had always maintained its reservations about the US Reference. Nevertheless, the US Reference ended up dominating the scene historically. But now, it had collapsed, and Great Britain re-entered the scene. Moreover, as the natural resource was publicly owned, Great Britain was in an ideal position to create the new reference – the UK Reference – for a global petroleum regime.

[62] BP originated in Iran, then a British half-colony. Royal Dutch Shell originated in Indonesia, then a Dutch colony. Royal Dutch Shell is 60% Dutch and 40% British.

Fiscal Regime[63]

The first licences[64] were granted towards the end of the 1960s, with a term of forty years. They were awarded through negotiations, requiring the companies to comply with an established investment programme. According to the law, the usual royalty rate was one eighth. But no higher royalty rates or bonus payments were used in the negotiations, though bonuses were sometimes used as 'tie-breakers'. The whole procedure was based on the argument that it was about attracting investment to a region still considered high risk.



*Millions of barrels of petroleum equivalent daily.

This situation changed in the 1970s, following the first important discoveries in the British North Sea, along with the sustained increase of international oil prices. Now the British government started to reform the fiscal petroleum regime. First, bonuses disappeared completely. Yet given the dramatic increases of the international prices by the end of the decade, the government imposed a severance tax of 20% for the fiscal years 1981 and 1982.[65] Thereafter the process of eliminating the one eighth royalty began. The royalty disappeared completely in the early 2000s, when the old licences were to be renewed. Moreover, as a matter of course, they were renewed without claiming any bonuses or additional payments whatsoever. At that point, no traces remained of a proprietorial fiscal regime.

Global petroleum regime: First phase

On the other hand, the British government created a *Petroleum Revenue Tax* (PRT) in 1975, a levy on the extraordinary surpluses in oil conceived as a *contingent debt of the government in favour of the very same companies*. PRT would apply annually to accumulated cash flow, without distinction between operating costs and investments. This flow would be adjusted for corresponding hypothetical usual profits, for interest, and for inflation. PRT would only be paid once this cash flow turned positive, but only if the internal rate of return was higher than 15%. Definitively, PRT would not have any influence on the production cost of the marginal barrel.

PRT was to apply individually to each 'ring-fenced' reservoir. The 'ring-fence' was designed to prevent the extraordinary surpluses from being minimized through the transfer of costs from transport, refining and distribution of hydrocarbons to the upstream; and, the other way

[63] Mommer, op. cit., chap.7; and Juan Carlos Boué: "Reflections on the Revolution in Britain (and on the Proceedings in certain Countries relative to that Event): The Governance of Upstream Petroleum in the UK North Sea", forthcoming.

[64] Great Britain uses the word 'license' in lieu of 'concession'.

[65] The fiscal year in Great Britain starts on April 6.

round, to prevent the extraordinary surpluses from being transferred to downstream activities with lower levels of taxation.

PRT would be collected annually. However, if the accumulated cash flow would decrease for any reason, a company would get back the 'excess' it might have paid in the past.[66]

The initial rate of PRT was set at 45%. But when prices started to increase at the end of the 1970s, the rate was raised, up to 75% by the fiscal year 1983. As prices began to decrease, so did the rate of PRT. The rate for already established fields was reduced to 50% in 1993, and was completely abolished for fields developed thereafter, with the argument that such fields could be deemed as marginal anyway. Thus, new fields would only pay usual, non-oil sector taxes.

Finally, from 1999 onwards, the British production of hydrocarbons began to decline, despite the following period of very high prices. In order to contain the decline, significant amounts of additional investment would be required, and its profitability could only be guaranteed by resorting to the contingent debt.

Global petroleum regime: Second phase

Since 1998, the British government had been in talks with the industry about how to manage the final stages of the exploitation of North Sea hydrocarbons. The response was, first of all, to stop focusing on each individual reservoir, as had been the case so far. To pay the contingent debt on that basis would certainly have optimized the recovery factor of the individual reservoir, but not for the whole area. What was now required was a high level of cooperation between all interests involved. For example, the greater part of the infrastructure had been built in connection with large fields entering the production phase more than thirty years prior. That infrastructure was now obsolete and renewing it was never going to be a viable option, at least without taking into account the large number of small fields that depended on it, which had never paid PRT. But now, the creditors of a contingent debt were given access to that debt, including for use in new investment outside the specific reservoir.

In 2016, the government created the Oil and Gas Agency (OGA) with the status of a 'Government Company', endowed with wide powers to promote and impose the required level of cooperation, but also to commit itself with the industry. Of course, any cooperation with private entities would always be based on them realizing an acceptable rate of profit. The rate of PRT was now fixed at *zero*, effective January, 2016. Moreover, the government was stripped of its discretionary power to manage PRT. From that point on, any change in PRT required parliamentary approval, adding to its stability. Thus, the phase of paying back PRT to the companies, the creditors of this contingent debt, had begun; and this was not just about raising the rate of recovery for particular fields, but of the whole area. For the fiscal

[66] As a consequence of the catastrophe of the *Piper Alpha* platform in 1988, where 167 people lost their lives, the companies concerned benefitted for several years from a negative PRT, because of the losses. Moreover, all the companies had to comply with new, and costly, safety requirements. As a result, PRT turned *negative* for the fiscal year 1990, in the amount of 216 MUK£.

year 2015, the government paid for this concept 562 million UK£.

In 1999, production of hydrocarbons had reached 4.7 million barrels of petroleum equivalent daily (MBPE/D); by 2015, it was down to 1.6 million. According to government studies, 42 billion barrels of petroleum equivalent had been produced to date, with remaining reserves estimated at between 12 and 24 billion barrels. Without the presence of the OGA, only around 12 billion barrels would be recovered, but with the OGA, it is hoped that something closer to the 24 billion barrels could be recovered over the next three decades. This was the very purpose of the contingent debt of 133 billion UK£ (2015) incurred by the government with the oil companies between 1979 and 2015.

Income Tax

For the purposes of Corporation Income Tax, royalty payments and PRT are treated as deductible expenses. A ring-fence is also applied to income tax, not at field level, but at the level of the entire continental shelf. As noted above, with respect to PRT, this treatment prevents the profits liable to Corporation Income Tax being diluted by transferring costs from, or transferring profits to, businesses outside the area.

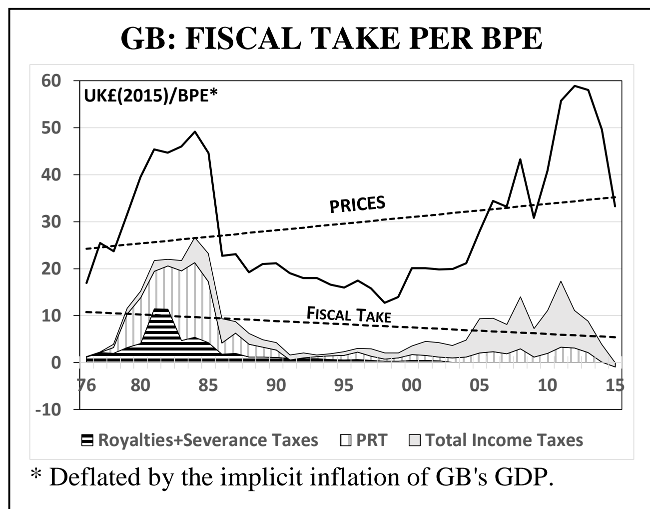
Until fiscal year 1983, the Corporation Income Tax was set at 52%, in conformity with the US Reference at the time. Subsequently, and mirroring its evolution in the United States, it was reduced, reaching 20% in 2016. However, when the one-eighth royalty was abolished in 2002, a Supplementary Charge in the form of an additional income tax was introduced, applicable only to the petroleum sector. Its rate was initially set at 10%, increasing as prices rose, to 20% in fiscal year 2006 and to 32% in fiscal year 2011, and back to 10% in fiscal year 2016. With the creation of the Oil and Gas Agency as a Government Company, any change would now require an Act of Parliament.

In fiscal year 2015, revenue from Corporation Income Tax on the oil and gas sector was 538 million UK£. However, the payment of the contingent debt amounted to 562 million UK£; the total fiscal contribution of the British oil industry to the national budget thus became negative for the first time in history.

Conclusions

The petroleum fiscal regime of the UK is a *global* one. In its first phase it was designed to maximise both production and rate of recovery, without differentiating between national and international consumers: all would benefit from lower prices as a result of an increase in supply. This would be achieved, in principle, through collecting PRT on the extraordinary surpluses during the first period of production, with high natural productivity of the reservoirs, to be paid back during the second period, when natural productivity was declining. Thus, over the lifetime of a reservoir, the companies would make a reasonable profit, whereas all extraordinary surpluses would disappear, at least theoretically. However, in its second period, the global regime was redesigned, in order to maximize the recovery factor for the whole area as such, and not only of specific reservoirs.

In practice, PRT was designed with great care to ensure that it would never affect investment. Indeed, the British regime has always allowed the petroleum companies operating in the North Sea to appropriate a significant portion of the extraordinary surpluses. Over the period under consideration, fiscal revenues per barrel of petroleum equivalent decreased at the average rate of 2% annually, while oil prices increased on average at 1%. For the government, this would be because the marginal costs of production were growing at a faster rate than prices, but unquestionably it also reflected a growing tolerance of extraordinary profits.

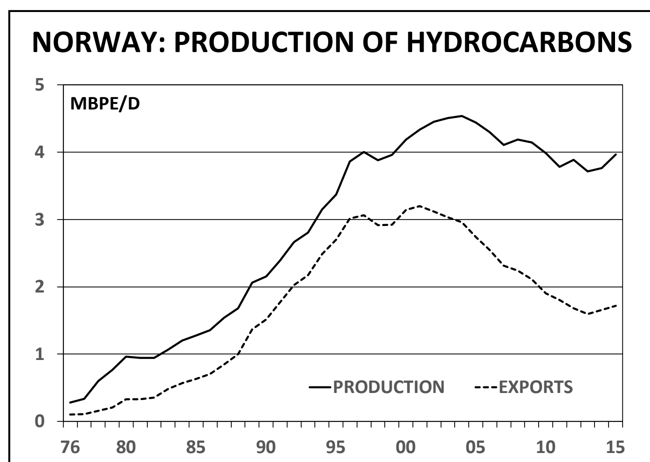


* Deflated by the implicit inflation of GB's GDP.

II.2.2. NORWAY: A NON-PROPRIETORIAL REGIME[67]

Norway granted its first licences in the second half of the 1960s. They had a term of 46 years and extensions of 500 km^2, but half of this area would revert to the state after nine years. The first discoveries left no doubt that this country was going to be a petroleum-exporting country for the foreseeable future.

Norway, like Great Britain, was already a developed country, but differed from Great Britain in that it had no oil industry at all. Therefore, in 1972, the Norwegian government created Statoil, a state-owned company to promote the development of a proper national oil industry, beyond its role in collecting international extraordinary surpluses. Statoil would have a majority shareholding in all new licences, but by the mid-1980s, as exports grew and prices increased, it had become clear that the Norwegian oil regime had a problem: the national company was accruing too much power, at all levels, due to its control over an immense cash flow.



The role of Statoil was therefore reduced to that of an *operating* company, with only a *minority* shareholding in the associations, being obliged to reach agreement with its private associates. However, this reduction in the shareholding of Statoil was made in favour of a new *State Direct Financial Interest* (SDFI), so that the major part of the flow of income, previously

[67] Farouk Al-Kasim: *Managing Petroleum Resources: The 'Norwegian Model' in a Broad Perspective*, Oxford Institute for Energy Studies, 2006.

going to Statoil, now went directly into State coffers. Moreover, even though Statoil would retain responsibility for operations, voting rights would be exercised by the *Norwegian Petroleum Directorate*. With these votes plus ultimate control over Statoil, the Norwegian government would be able to impose majority decisions should this prove necessary. The Norwegian Petroleum Directorate would also assume the role of regulator over both technical matters and prices, which had to be market prices. This left the Ministry of Petroleum with responsibility for relevant legislation, defining oil policy, planning and organising licensing rounds.

At the same time, Norway followed the example of Great Britain in eliminating royalties. However, simultaneously, an adjustment was made to the State Direct Financial Interest in such a way that the State would continue to enjoy the same gross income even though it had now to cover the respective production costs.

Each license holder was required to pay its income taxes individually, but those license holders who participated in more than one association would be considered as one single company for income tax purposes. These companies were ring-fenced, but not on the basis of each reservoir, as was the case in Great Britain, but from a national viewpoint. Hence, when Statoil started to operate internationally in the 1990s, the State obligated Statoil to do so with a rigorous separation of accounts, one national, and the other international. Norway would not allow Statoil to dilute the extraordinary surpluses in Norwegian oil through a system of global accounting.

Statoil was partially privatised in 2001 in order to obligate the company to compete on the basis of the efficiency criteria used by the private sector. The State would retain, however, a 67% stake in the company. At the same time, the administration of the State Direct Financial Interest became fully independent from Statoil through the creation of Petoro, which would hold the titles of the licences corresponding to the SDFI in all associations.

Moreover, Norway consistently maintained high levels of income taxes. Although it followed the example of Great Britain – and ultimately of the United States – in lowering the general level of income taxes, the government increased the levels of an additional income tax that applied specifically only to the petroleum sector. The total income tax level in oil was thus around 65%.

Finally, Norway also followed in the footsteps of Great Britain regarding the renewal of licences. Taken as a whole, the Norwegian petroleum regime has to be qualified as a *non-proprietorial* one, but not as a *global* one. The extraordinary surpluses which were garnered by the Norwegian State annually – conceived as differential rents – were not converted into a contingent debt as was the case in Great Britain. During the period under consideration, fiscal revenues – excluding the contingent debt – in Great Britain amounted to just 17.5% of the gross value of the oil and gas sector's production, while in Norway the percentage was 51.2%. At a micro-economic level, Norwegian and British consumers had to pay the same international oil prices paid by consumers throughout the world. But at a macro-economic

level, the Norwegian tax-payer benefited from having 51.2% of that oil price as a contribution to the country's national budget, whereas the British taxpayer only benefited from 17.5% of the oil price. And PRT was definitively not a tax but a contingent debt.

CONCLUSIONS

In 1990, Norway established a *Heritage Fund*, nourished by a significant part of the international ground rent in oil. At present, the estimated value of this fund is 900 billion US$(2015), or – with a population of only 5.2 million – 175,000 US$ per capita. In contrast, during the same period, Great Britain accumulated a contingent debt of 203 billion US$(2015), or – with a population of only 65.1 million – 3,100 US$ per capita. These figures reflect the essence of the difference between a *national* petroleum regime, albeit non-proprietorial, and a truly *global* petroleum regime.

III.3. PERSPECTIVES

The petroleum regime in Great Britain was conceived as *global,* with the pretension to become the new international reference, replacing the US Reference. However, the UK Reference was only fully implemented by Denmark, a petroleum producing country of little consequence and, like Great Britain, only a temporary exporter. It reached its peak production in 2004, at 389 thousand barrels daily, and since then, its production has been in decline, as in Great Britain. Now, in both Great Britain and Denmark, the petroleum companies could reasonably expect to recover these contingent debts. This seemed guaranteed by their relative importance – for example, to the GDP of these countries – and the structure of the economic and political power. But no other country has involved itself in accounts that have to be carried for decades, or committed itself to an unpredictable contingent debt.

But how to convince the petroleum-exporting countries generally to implement a global fiscal regime? How to convince them to minimize, by design, their international ground rents?

Norway, the only developed oil country, simply refuses such an arrangement, and the country leaves no doubt that it is not willing to give up its sovereign management over its natural riches. This position rests on four pillars: one, the existence of an income tax at a relatively high rate; two, its effective involvement in all licences through Statoil, regarding oil as an industry; three, the Direct Financial Interest of the State takes care of petroleum as a source of an international ground rent; and – last but not least – the successful management of its Heritage Fund.

In contrast, in the petroleum-exporting countries of the Third World, the state-owned oil companies were created by the nationalisation of their concessionaires. Their personnel had been trained over decades by the international oil companies, ideologically and politically. To nationalise and to incorporate them into the *national* political structures was in itself a major challenge, for which these countries were not prepared. These companies – now *national* companies – would confront the Landlord States regarding their traditional petroleum policy of focusing on the value of the natural resource. Their arguments would be the same as those

put forward by the international oil companies in the past, but now they were put forward by the highest level of *national* executives of the *national* oil company. Norway, by contrast, created its own national oil company *ex novo*.

On the other hand, Norway was a developed capitalist country before it became an oil country. Thus, the phenomenon of an international ground rent was perfectly understandable. In contrast, in the oil counties of the Third World, this phenomenon became confused with the development of capitalism in the form of a *rent capitalism*, in itself of a very peculiar political and ideological complexity.[68] Their economic performance was exposed to fierce criticism from the globalizing forces, amongst them the national oil companies, given that their failure to perform would be the most powerful argument to de-legitimize the international ground rent. However, this general subject matter is beyond the limits of this essay.

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[68] See Asdrúbal Baptista and Bernard Mommer: *El petróleo en el pensamiento económico venezolano*, Caracas 1987; and Asdrúbal Baptista: *Teoría económica del capitalismo rentístico*, 2ª ed., Caracas 2011.