# Iran's Oil, the Theory of Rent, and the Long Shadow of History: A Caveat on Oil Contracts in the Islamic Republic

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# Iran's Oil, the Theory of Rent, and the Long Shadow of History: A Caveat on Oil Contracts in the Islamic Republic

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**ABSTRACT**

The modern oil industry is an outcome of a three-stage change in which the largest cartel in recent memory emerged secretly, thrived visibly, and collapsed onto itself just before the 1973-74 oil crisis. Iran was the first country in the Middle East where a colonial oil concession (D'Arcy, 1901) for the exploration and production of oil was signed. This paper focuses on Iran to unveil the toehold of the International Petroleum Cartel (1928-72) in economic/political terms, before theorizing the history of decartelization, oil rents, and the competitive globalization of the petroleum sector following the crisis of the early 1970s. This paper validates that, regardless of the ownership of deposits, the lessor is entitled to a differential oil rent and the lessee merely to a competitive profit, both of which are the effect of the globalization of oil. Oil contracts in the Islamic Republic are no exception.

## Introduction

The socioeconomic evolution and political economy of petroleum in Iran (and similarly in the Middle East, North Africa and Latin America) can be divided into three stages of development: (1) the colonial oil concessions of 1901-50, (2) the transitional period of 1950-72, and (3) the globalization (and decartelization) of oil since 1974. Today, contrary to orthodoxy and its manifold popular representation in the media, there is no longer a "cartel" or a "monopoly" in the readily globalized (crude) oil industry. The Islamic Republic emerged in 1979, nearly half a dozen years after the worldwide restructuration of the oil industry in the early 1970s. The new regime inherited a severe disruption and deterioration in the production of oil, while at the same time initiating a populist policy of self-reliance, including lessening the economy's dependence on the production and export of oil. Yet, the Islamic Republic has always remained in desperate need of further revenue from this very vital source.

The motivation of this paper is threefold: (1) presenting a theoretical framework for *oil rent* and its distinction from that of *profit* of enterprise, a missing link in mainstream (neoclassical) economic theory, (2) showing that, since the globalization of oil, the public ownership of the subsoil has not impeded competitive profits, and (3) positing that it falls upon the sovereign state to safeguard the control of such ownership. This has profound implications for oil contracts between the Iranian government and foreign oil companies in the post-nuclear deal.

In other words, these contracts must be written in such a way that they do not replicate the awful pattern of capitulation reminiscent of the pre- and post-Mossadegh eras. The decartelization and globalization of oil, and universal oil rents are contrary to the captive oil concessions of yesteryears. Thus, long-term contracts with private concerns which either tacitly or explicitly leave the control of oil and gas deposits at the disposal of these companies must be avoided. By recognizing the delicate link between *rent* and *profit* of enterprise, the state (*i.e.* the holder of public ownership) must be cognizant of its fiduciary responsibility toward the public. And such entrusted responsibility should be taken seriously not only with regard to the present generations, but also to those yet to be born.

The Iranian economy (and polity and society) today, under the Islamic Republic, is the consequence of cumulative evolution, contradictory disposition, and the outcome of social and political forces that have emerged since the Constitutional Revolution (1906-11). The massive urban movement that swept throughout Iran (formerly Persia) in search of two simple but unmistakenly *intertwined* objectives: (1) freedom from the autocracy of the Qajar dynasty and (2) freedom from the tutelage of imperial powers. And since the turn of the twentieth century, and indeed during the nationalization of oil under the brief premiership of Mohammad Mossadegh (1951-53), these two aims were an important gauge to know why Iranians behaved the way they did politically. Oil, therefore, cannot be considered as an isolated entity but as a genuine social and political relation, particularly in the Mossadegh era, during which the denationalization and re-cartelization of oil was shoved down Iran's throat through the 1953 CIA-orchestrated coup under the Eisenhower administration. The popular sentiments in Iran, therefore, cannot remain immune to either such predisposed history or the pre-given social relation under the Islamic Republic.

This article argues that private concerns, like Shell, BP, Chevron, Total, etc., should not exercise any degree of ownership over Iran's oil and gas deposits (oil and gas in place consists of both recoverable and non-recoverable deposits), nor should there be any long-term contracts (perhaps beyond five years or so) between the Iranian government and any of these private petroleum concerns. A longstanding demarcation is perhaps the practice of competitive bidding by private oil concerns on US public lands managed by the Department of the Interior. However, so far, other than prototypes of contracts (*i.e.* fictional), Hasan Rouhani's government has neither provided any pertinent information concerning the actual oil contracts to the Energy Committee of Islamic Majles, nor informed the public at large in Iran.[1]

1 The following are two examples of criticism of the Rouhani administration's secrecy, and perhaps the compromising terms and context of oil contracts with transnational oil companies.
http://www.gharardad.org/tag/%D9%82%D8%B1%D8%A7%D8%B1%D8%AF%D8%A7%D8%AF-ipc/
https://youtu.be/J62TjCEKccs (January 2017). [Persian]

## 1. Power Politics and a Brief History of Petroleum in Iran

### 1.1. D'Arcy's Oil Concession

The history of oil in Iran can be divided into three development stages: (1) the epoch of colonial oil concessions, (2) the transitional period of 1950-72, and (3) the era of globalization since the mid-1970s (Bina, 1985). Two parallel phenomena have fused the destiny of Iran's economy with oil: (1) a geological accident and (2) the emergence of twentieth-century hydrocarbon capitalism. The first oil concession in Iran (known as Persia prior to 1935) was signed between Mozaffar al-Din Shah (Qājār) and William Knox D'Arcy, in 1901 (Ferrier, 1982; Mikdashi, 1966). Oil was struck on May 26, 1908 in Masjed-e Suleiman, a tiny village in southwest Persia. This concession comprised the entire country, except for five northern provinces (Āzerbāijān, Gilān, Māzandarān, Astarābād, and Khorāsān), and was under D'Arcy's complete control for exploration, production, gathering and storage, and transportation of oil exclusively for a period of 60 years. The term included £20,000 advance cash; and upon exploration, £20,000 in shares of the company to be formed, and 16% of annual net profits as royalties. On April 19, 1909, the Anglo-Persian Oil Company (APOC) was formed, and eventually in 1913 it produced oil in commercial quantities, including the construction of pipelines, storage facilities and what is known as the Ābādān refinery. Meanwhile, the British Navy decided to switch from coal to oil and had an eye on Persian oil.

In 1914, the British government obtained about 53% of APOC's stocks and installed two representatives on the company's board of directors. This was a preamble to secretly supplying the British Admiralty with heavily discounted oil, which in turn led to a substantial reduction in the company's net profits, at the expense of the Persian government. During the First World War (as acknowledged by Lord Curzon), Britain "floated to victory on a sea of [Persian] oil" (Ford, 1954). APOC evaded the payment of royalties to the Persian government in a variety of ways, including, but not limited to, "maximizing" stockholders' returns (the British government being the majority stockholder), paying an "excess profit tax" to the same government, and secretly granting deep discounts to the British Navy (an incredible triple-dipping in the profits); plus, engaging in illicit accounting practices through vertical integration, special marketing arrangements, and simply fictitious bookkeeping to hide profits and to reduce the magnitude of the oil royalties.

APOC consistently refused to allow the Persian government to participate in management in accordance with the equity stipulated in the concession.

From 1915 onward, APOC refused to pay royalties outright either partially (offsetting the presumed bribes given to Bakhtiari tribesmen), and by doing so the company in effect not only suspended the payment of royalties to the Persian government, but also refused to accede to the latter's request to arbitrate the dispute according to the expressed provision of Article 17 of the concession –egregious breach of contract. Similarly, with the British government's backing, APOC also refused to calculate royalties based on the net profit of its consolidated (worldwide) operations, including upstream and downstream activities– understood according to D'Arcy's original (1901) concession. APOC was a party to the *Armitage-Smith* "interpretive" agreement, which was a *de facto* dialogue between the company and Britain's emissary, and which was never ratified by the Persian Majles. In 1920, this original agreement "justified" *ex post* the non-payment of royalties based upon the calculation of the net profits of APOC's consolidated (worldwide) operations. In Winston Churchill's own words, "Fortune [*i.e*. Persian oil] brought us [*i.e*. Britain] a *prize* from fairyland far beyond our brightest hopes" –the author of *The Prize* (see Yergin, 1991) was equally an aficionado of such obviating sentimentalities. For the 1914-24 decade, the non-consolidated net profits of the company were £28.5 million, of which £9.5 million (33%) were distributed as dividends and £3.9 million (13.7%) were paid to the Persian government. Thus, aside from the aforementioned incongruities, the dividends reported on APOC's non-consolidated books alone amounted to nearly 244% of the royalties (Mikdashi, 1966).

The royalties, which were at the mercy of deliberate APOC bookkeeping, due to the company's arbitrary price fluctuation and its effect on the net profits, did not remain steady. On September 17, 1928, APOC (a crude-long company) joined with two remaining major oil companies, namely the Standard Oil of New Jersey (Exxon) and Royal Dutch Shell, to form a worldwide cartel at Achnacarry Castle (Scotland). This was the beginning of an International Petroleum Cartel (IPC) that controlled the exploration, development, refining, transportation, marketing and retailing of oil worldwide (Blair 1976). This aggressive act added to APOC's posture and worsened the situation between Persia and APOC by the end of the 1920s. Oil royalties then declined, from £1.288 million in 1930, to £307,000 in 1931 (for 5.7 million tons of crude oil) –a drop of more than 75%. By contrast, APOC's corresponding net profit dropped less than 37% over the same period (Mikdashi 1966). To make matters worse, on September 21, 1931, Britain went off the gold standard, thus causing the depreciation of Persia's sterling balances in London.

To be sure, the D'Arcy contract had already been breached by APOC a number of times since 1913, the dawning of commercialization. Yet APOC (and the British government) did not wish to cancel it for fear of losing it to rivals. There were dilemmas on both sides: APOC's dilemma was to have the concession and breach it too; the Persian government, however, knew that, lawfully, the original D'Arcy concession had given them the advantage of owning sizeable shares and 16% of consolidated net profits (upstream and downstream) of APOC worldwide. It is true that the continuous lack of payment of royalties meant the *de facto* unilateral cancellation of the concession; but any such cancellation *prima facie* needed the express consent of both parties to effectively be *de jure*.

### 1.2. The 1933 Oil Concession

APOC's intransigence in addressing the issues surrounding the payment of royalties deteriorated further until November 27, 1932, when the Government of Persia informed the company of the cancellation of the concession. This act alone brought British warships to the Persian Gulf, and soon the British government also took the dispute to the Council of the League of Nations and also submitted the case (a dispute between a sovereign state and a private company) to the Permanent Court of International Justice at The Hague. This, of course, resembled the very same spectacle that would be displayed two decades later, during the 1951-53 nationalization of oil under the premiership of M. Mossadegh. Yet, the injudicious cancellation of the D'Arcy concession by Reza Shah Pahlavi (and the acceptance of a much inferior concession) was neither wise, nor farsighted, nor beneficial for Persia. Article 10 of the 1933 oil concession settled on 4 shillings (gold) per ton of oil as royalties, and minor financial provisions which in due course would prove to be either trivial or practically inapt (Ford, 1954). However, the size of the concession was reduced to 100,000 square miles (Millspaugh, 1933; Beck, 1974). Yet, given the more than three decades of exploration in nearly 80% of the country, APOC had an accurate picture of where oil deposits were located at the time. APOC's major gains were extending the concession by some 30 years (until 1993) and divesting the government of its stock ownership in all operations and subsidiaries of APOC outside Persia.[2]

During the 1931-50 period, the Anglo-Iranian Oil Company (AIOC, following the change of Persia to Iran in 1935) continued to increase its dividends, from 5% in the depth of the Great Depression to 20% in 1936-38. Dividends rose to 30% in 1946-50 –a maximum rate allowed by Britain's new policy at the time. Despite the nationalization of Iranian oil in March 1951 and the significant deterioration of its revenue, AIOC kept on rewarding its stockholders (the British government being the majority holder) to the tune of 30% in 1951, 35% in 1952, over 42% in 1953, and 15% plus a 400% scrip bonus in 1954. This generous practice reflected the existence of huge financial reserves hitherto accumulated by AIOC from its extraordinary profits in past operations, which also additionally allowed it to finance its massive internal expansion. Indeed, an AIOC spokesman boasted that "the whole of the capital investment during the years between 1930 and 1952 was financed by retained profits and without recourse to outside borrowing of any importance." Between 1935 and 1950, Iran's official (under)estimate of crude oil reserves by AIOC increased from 2.2 billion barrels to 7 billion barrels (an increase of more than 300%), with a negligible fraction of retained earnings as investments (Elm, 1992).

### 1.3. Mossadegh, Oil and the Nationalization

In 1947, Majles passed a law that expressed dissatisfaction about the 1933 concession and its unremitting violation by AIOC, and, in the subsequent year, a memorandum (containing a 25-point contention) was duly sent to the company for negotiation. The gist of this memorandum reflected the longstanding evasion of royalties through a variety of means, including the triple dipping that was selling discounted oil to the British Navy, paying taxes

2 The reader should be able to compare Reza Shah Pahlavi's (1925-41) political stance and that of Mossadegh (1951-53) in dealing with colonial powers, particularly when Reza Shah was involved personally in the acceptance of the 1933 colonial oil concession. He forced his reluctant subordinate, Hassan Taqizadeh, the principal negotiator on the Iranian side, to sign this half-baked agreement. This capitulation in due time led to AIOC's further power grab and plunder which left no middle ground and eventually led to the nationalization of oil by Dr. Mossadegh on March 20, 1951.

on Iran's oil to the British government, and distributing handsome dividends to the shareholders (the British government being the majority), besides the arbitrary calculation of financial reserves. This memorandum also *inter alia* focused on the deplorable conditions of Iranian workers in the oil fields and in Abādān. This prompted the company to present a very superficial rejoinder, known as the Gass-Golshaian Supplemental Agreement, which was rejected by the Majles outright on March 20, 1951 in favor of nationalization (Elwell-Sutton, 1955; Elm, 1992; Bina, 2005).

The nationalization of oil in Iran was a significant event within the transitional period of 1950-72 toward decartelization and the globalization of oil. It had roots in the two entwined objectives of Iran's Constitutional Revolution (1906-11), namely, the opposition to autocracy and foreign domination. Hence, democracy and independence were the twin motivating forces behind the nationalization of oil in Iran. According to the recommendation made by the special oil committee of the Majles, chaired by Dr. Mossadegh, the nationalization of oil was the only choice. At the time, Iranians knew that AIOC had a *de facto* control over scores of politicians in the Majles, in the executive branch, and tucked away in the imperial court (Elwell-Sutton, 1955; Bina, 2005).

AIOC's reactions and Britain's concerted efforts were predictable if somewhat anachronistic. It was a *déjà vu* of nearly two decades earlier. British warships were dispatched to the Persian Gulf; the case was taken to the International Court of Justice at The Hague, and a complaint was filed with the UN Security Council, all in sequence (Walden, 1962). Also, the 1928 Achnacarry Agreement that had led to the International Petroleum Cartel was peaking. Oil purchased from Iran by independent oil companies was labeled "stolen property" and oil exported by Iran was blocked and embargoed without impunity. This time, neither the British Navy, nor the International Court of Justice (ICJ), or even the UN Security Council (UNSC) could legitimately and lawfully reverse the nationalization of oil in Iran. The ICJ found no jurisdiction to rule, the UNSC no real cause to act, and the British Navy matched the formidable mass mobilization of Iranians in Abādān (International Court of Justice, 1952).

In the interim, five different contracts (including a plan under supervision of the World Bank) were proposed to Mossadegh, none of which recognized the reality of nationalization. In August 19, 1953, Prime Minister Mossadegh was overthrown by the CIA. The coup restored the Shah (Mohammed Reza Pahlavi), and soon the new concession was signed by the beneficiaries of the coup and a *consortium* composed of major oil companies, including AIOC (now BP) with 40% of shares. Royal Dutch Shell was given 14% and Jersey, Texas, SoCal, Gulf, and Socony acquired 7% each, while the French CFP obtained 6%, and the remaining 5% went to several US oil independents (Blair 1976, Elm 1992). Iran's oil –according to the IPC's diktat– was once again *denationalized*. The *consortium* (the IPC's shadow) estimated Iran's share (in a continued concession) based on 50-50 profit-sharing which lasted until the oil crisis of the 1970s.

### 1.4. Decartelization, Increased Oil Revenues, and the Aftermath

Early in the 1970s, Iran's oil revenues from oil exports had increased from $3.6 billion (1972) to nearly $21 billion (1974). Oil revenues declined slightly in 1975, and then increased to $22.9 billion and $23.6 billion, respectively, in 1976 and 1977, before declining again to $21.7 billion and $19.2 billion, in 1978 and 1979, when the Iranian Revolution was in full swing. The impact of labor strikes in the oil fields and of the disruption of production, however, was revealed belatedly in 1980 and 1981, as oil revenues declined precipitously to $11.7 billion and $10 billion, respectively. The level of Iran's oil production nearly mimicked the pattern of oil revenues (Bina, 1992b). In 1974, oil production peaked at just above 6 million b/d. Such a level, however, could not be sustained for long (notwithstanding secondary and tertiary recovery costs) without long-term investment in additional capacity. Hence, a steady decline in production –combined with the disruptive impact of the revolutionary surge– diminished the production just below 1.3 million b/d in 1981. In 1981, oil exports were much lower –at 55% of production. The country's proven oil reserves were estimated at 57 billion barrels (13% and 8% of the corresponding estimations for OPEC and the world) in 1981 (OPEC Statistical Bulletin, various years). The proven natural gas reserves at this time were estimated at 14.1 trillion cubic meters, second only to Russia's –standing at 44% and 16% of the corresponding estimations for OPEC and the world. The estimated proven oil reserves, however, were upgraded to about

93 billion barrels for the 1986-99 period; these reserves were estimated just below 100 billion barrels in 2000 and 2001, before being revised again to 131 billion barrels, in 2002, and 136.3 billion barrels, in 2005, nearly 12% of the world's reserves (for some of the petroleum statistics in this section, see Bina 2008a, 2008b, 2008c, 2008d). The median figures for Iran's proven natural gas reserves for the 1980s, 1990s, and the 2000-2005 period are respectively 14, 20.7, and 26.7 cubic meters –second largest, only to Russia's, and, according to 2005 estimates, about 16% of the world's proven natural gas reserves. The comparative levels of such estimations have been more or less stable since the mid-2000s (The Government of Iran, various years; World Bank, 2007.)

Since 1995, the ironic timing of the US sanctions against the oil industry, Iran has found several sizable (even giant) oil fields, by using either its own technical expertise or the technical know-how of a number of non-American oil exploration and development companies *via* joint operations. One of these operations was the Dārkhovin oil field near the major refining city of Ābādān at the mouth of the Persian Gulf. And a deal of $1 billion in 5½-year buyback for its development was signed with Italian company ENI in 2001. This field (3 to 5 billion barrels) had already started producing 50,000 b/d in July 2005 and was expected to reach 160,000 b/d a few years thereafter. There were other new development fields of minor size, such as five Henjām fields, in the Hormuz region; and some ten additional fields whose enhancement was planned in the southern provinces and which were in need of nearly $7 billion investment for extension and development in the late 2000s. Also, the largest oil discovery in 30 years was made onshore in southwestern Iran, the Āzdegān oil field, in 1999. This field was estimated to have a potential production of 300,000 to 400,000 b/d for 20 years. Meanwhile, in 2001, Iran made another significant oil discovery, named Dasht-e Ābādān in the vicinity of Ābādān. This oil find is reportedly comparable in size to that of Āzdegān. There are also recent smaller discoveries, such as the Anārān oil field in Khuzestan, by Norsk Hydro. This field contains estimated reserves of 2 billion barrels and was to produce 100,000 b/d by 2010 (Economist.com, various years; World Bank, 2006). There were about three dozen significant buyback agreements with respect to the development of the South Fārs field (in total 28 phases) or other fields with various European, South Korean, and Chinese companies.

Iran's proven natural gas reserves were estimated at 27.58 trillion cubic meters (974 trillion cubic feet [tcf]) in 2005, nearly 65% of which are located in non-associated fields and have not yet been completely developed. Major natural gas fields include South Pārs (280-500 tcf), North Pārs (50 tcf), and Kangān-Nār (24 tcf) –all in the southern part of the country. Natural gas treatment and processing plants include Kangān-Nār, Aghar-Dālān, Ahwāz, Marun-4, Bid-Boland, and Asaluyeh. Natural gas accounts for nearly half of Iran's domestic energy consumption, and the government has subsidized it in order to reduce and finally replace fuel oil, kerosene, and LPG consumption. However, the government's primary objective is to develop these vast natural gas reserves for export. The exploration and development of natural gas from the offshore Persian Gulf continental shelf is not without border disputes or over-drilling and/or horizontal drilling in joint reservoirs. An example of the former is the dispute between Iran, on the one hand, and Saudi Arabia and Kuwait, on the other, over the Dorra natural gas field. This field was unilaterally claimed by Saudi Arabia and Kuwait in a bilateral agreement between the two countries in July 2000. An example of the second case is Qatar's exploitation of its North Field and Iran's South Pārs natural gas field in 1991, while the latter started much later and worried about the rapid dissipation of the reservoir, including the possible impact of over-drilling and horizontal drilling.

The Islamic Republic Government (IRG) in Iran had initially enunciated a policy of self-reliance and reversal of the economy's dependence on oil and oil exports. Yet, during eight excruciating years of war with Iraq, the IRG was in desperate need of further income (Bina, 1992b). Thus, neither a diversification of foreign exchange earnings, nor a genuine conservation of natural resources, nor a diversification of the economy seemed feasible. The oil production, while recovering initially, nevertheless hovered around 2.26 million b/d in the 1981-89 period –at 40% of the production peak in the 1970s (World Bank, 2007; US Energy Information Administration, 2007). Oil exports, recovering from 715 thousand b/d, in 1981, averaged around 1.6 million b/d over the same period. Oil revenues (all in nominal dollars) in the 1980s recovered from $10 billion in 1981, peaked at $20.3 billion in 1983, and then sharply declined to $5.9 billion in 1986, before a slight recovery to an average of $9.7 billion at the end of the decade (The Government of Iran, various years).

Finally, the value of petroleum exports represented nearly 25% of the GDP and 50% of the government budget in 2005. During the 1970-78 period, the ratio of oil exports to oil production was 85% to 90%, whereas, for example, in the 1982-2005 period, the same ratio fluctuated between 59% and 76% –without any appreciable difference during the eight-year war. As a consequence, there has been well over a 20% proportionate decline in the utilization of oil as a prime source of foreign-exchange earnings in this period. The picture appears gloomier today in this regard since the mid-2000s, given the immediate as well as long-term impacts of the international sanctions and their aftermath (Bina, 2009).

## 2. Decartelized Oil, Global Competition, and the Theory of Oil Rent

### 2.1. The Epoch of Cartelization

The transformation of Iranian oil and its evolutionary change into a modern industry is not separate from its Middle Eastern or, in epochal measure, its counterpart on the American continent, as all cartelized oil eventually went through three distinct historical stages: (1) the era of worldwide cartelization, 1901-50, (2) the modification in the 1950-72 period; and (3) the epoch of decartelization and competitive globalization since the mid-1970s. Given its earlier discovery, oil in the continental United States went through a slightly different evolution, namely, (1) the era of classical cartels and trusts in 1870-1910, (2) the period of regulated neo-cartelization in 1911-50, (3) rudimentary competition in 1950-72, and (4) the era of decartelization and competitive globalization since the mid-1970s.[3] This is the story of one of the most integrated sectors of the economy in which capitalist production was transformed from a powerfully hands-on international cartel to a competitively globalized crude oil industry (Bina, 1989b; Bina, 2006). This indicates that when capital (as a social relation) is weak and in the early stages of its development, it needs crutches –such

3 The Oil Crisis of 1973-74 was precisely a crisis of transformation and globalization of the oil industry. The so-called "OPEC offensive" was indeed a catalyst for the de-cartelization and globalization of oil. The globalization of oil, in turn, changed the nature of OPEC from a sort of countervailing power vis-à-vis the "Seven Sisters" to a rent-collecting entity within the competitive (*i.e.* spot and futures markets) structure of global oil pricing (Bina, 1985).

as a cartelized structure– to lean on and to limp along. As soon as social relations (of capital) become strong, as the transformation of the oil sector has shown, the crutches must be thrown aside to walk on one's own.

A careful examination of a century of worldwide oil production, between 1870 and 1970, brings to light the predominance of *administered prices* and cartelized practices, which ruled oil across the world. Clifton (1983) excludes sui generis cartels and restricts the application of "administered prices" to other concentrated companies; thus, at best, it is an incomplete theory. I employ this notion to decidedly validate that the cartelization of oil led to a colossal monopoly, yet as soon as the latter collapsed through competitive forces in the globalization crisis in the 1970s, all administered prices (*i.e.* posted prices in the Persian Gulf and wellhead prices in the Gulf of Mexico) went by the wayside.[4] These practices were often supported, if not instigated, by colonial powers in the hinterlands and to some extent by the governments of major industrial countries in the heartlands of capitalism. Yet, there was a great deal of resistance on the part of the masses against monopolies in the United States, particularly against John D. Rockefeller's oil empire. Public pressure in the United States resulted in the passage of the Sherman Antitrust Act of 1890, which then led to the breakdown of Rockefeller's Standard Oil Trust in 1911. Nonetheless, in due time, some of the separate fragments of the "empire" –such as Standard Oil of New Jersey, Standard Oil of New York, Standard Oil of California, or Standard Oil of Ohio– had become so huge, so vertically- and horizontally-integrated, and so syndicate-like that they predictably renewed their worldwide reunion at Achnacarry Castle, Scotland, and formed the International Petroleum Cartel in 1928 (Blair, 1976; Bina, 2012a). This grand consolidation is particularly important for the fact that, according to the As Is Agreement –*i.e.* the infamous seven-point stipulation–, the wellhead cost of US oil (in the Gulf of Mexico) had to be the primary basing point in the calculation of the administered prices of oil across the

4 While I have much sympathy for what Clifton (1983) offers, it obscures the feature of entities similar to the International Petroleum Cartel (1928-72) when they engaged in administered pricing, while being in total control and owning the whole market, so to speak. In other words, by virtue of their institutional setup, they were monopolies.

all-inclusive network of the cartel.[5] Later, when the production of oil from the Persian Gulf became significant, this singular (universal) mechanism was modified to include a separate basing point with much lower "posted prices" for the Persian Gulf oil region.

The administered pricing of oil under cartelized oil was an accounting scheme that should not be confused with market prices in an ordinary economic sense. These arbitrary prices had nothing to do with ordinary price theory in neoclassical economics or classical theory according to Marx. Yet, even in the absence of a cartel, the neoclassical orthodoxy (and a number of heterodox schools, including Monopoly Capital) treat concentration and centralization (*i.e.* accumulation) of capital as non-competitive, thus as a monopoly. Such a treatment is especially widespread in the petroleum industry. The neoclassical economic methodology (and mainstream economics as a whole) gives the impression that the *fiction* of "perfect competition" can be a suitable substitute for *real competition*. This shows the uselessness of axiomatic (fictional) theories –theories that are devoid of a real subject and short of a definite history. The International Petroleum Cartel (IPC), on the other hand, was the market onto itself across the board and the only game in town; it was the very essence of administered pricing head-on and without mediating institutions (Mikdashi, 1966). The IPC literally owned the international oil market and completely forecast all demand and controlled all supply according to the principles of the Achnacarry agreement (Blair, 1976). And despite the façade of multiple accounting schemes at the basing points of the Gulf of Mexico and the Persian Gulf, this artifice could not even follow a systematic framework to present a unifying method for the reasonable allocation of royalties across the regions and captive subsidiaries.

5 The wellhead price of oil in the Gulf of Mexico was an administered price based on the highest cost of oil in the world. This price was not a price in the commonplace meaning of market, but a "price" based on accounting calculations by the cartel. This price then functioned as the basis –thus the connotation, basing point– for oil from the various geographical locations in the world, plus the transportation cost from the Gulf of Mexico to any delivery point on the planet. It is interesting to note that even if the delivery point was adjacent to, say, oil from the Persian Gulf, the cost of transportation from the Gulf of Mexico was used in the calculation of such a delivery. This manner of calculation with respect to the cost of transportation is known as the phantom freight price in the literature.

### 2.2. The Transitional Period

The second stage in the development of Middle Eastern oil is the transition to the competitive globalization of oil (1950-72). During this stage, there was a transitory coexistence of the declining cartelized institutions and the proliferation of market relations, leading to competitive global pricing. The basic identifying features of this period are: (1) the dominance of long-term oil contracts (the colonial concession system)[6], (2) the establishment of "basing-point" oil pricing in the Persian Gulf parallel (with lower magnitude) to the basing point in the Gulf of Mexico, (3) the utilization of "posted prices"[7] to calculate the oil royalties (*i.e.* embryonic oil rents) to host countries, and (4) the formation of OPEC.[8] During this period, given the desire for *stabilizing* "basing-point" oil in the Gulf of Mexico, US domestic oil was the subject of the IPC's control with further scrutiny in the absence of competition (Keysen, 1949; Machlup, 1949; Blair, 1976).

Given the new and bountiful discoveries of cheaper oil in the Persian Gulf, oil from the Middle East gradually displaced US oil in regional markets close to the Western Hemisphere.[9] This prompted the IPC to cut Persian Gulf posted prices in order to control the interregional flow of oil vis-à-vis the US oil region. The rationale: the Persian Gulf "posted price," used as a mechanism for the internal transfer of oil within the cartel's network, was cut to reduce the supply of oil from this region to Western markets.[10] This

6 An oil concession is essentially a colonial contract similar to the arrangements by the East India Company.

7 The "posted price" was the price according to which the transfer of crude oil within the worldwide network of the "Seven Sisters" was accounted for.

8 The Organization of Petroleum Exporting Countries (OPEC) was formed in 1960. The original founders were Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela (Bina, 1990).

9 From the standpoint of historical evolution and the emergence of oil prices based on value-theoretic foundations, "cheap oil," both actually and figuratively, was a metaphor for oil prior to the valorization of landed property by capital in the oil sector. And this irony should not be lost on the issues surrounding US foreign policy and colonial-minded authors, such as Daniel Yergin, author of the Pulitzer-Prize-winning *The Prize* (1991) and also *The Quest* (2011).

10 The so-called posted price was an artificial method through which the IPC disbursed (transferred, swapped, etc.) oil from the the Persian Gulf basing point within its international network. The posting of the so-called price was also used to determine the percentage of royalties due to be paid to the oil exporting countries. The same scheme was utilized for Venezuela and, much later, North Africa.

was done according to the tenet of the As Is Agreement which forbade the movement of oil from one area of production to another, just like the apple and Adam's fall from grace in paradise (Blair, 1976; Engler, 1977). Yet, the very fact that the cartel was able to do just that proves how huge the profits from IPC's Middle East oil operations must have been. It also shows that, in the absence of valorized oil and a fully-developed global oil market, how the cartel had a tight grip over the control of both US domestic oil and international oil. This transitional period also saw the formation of OPEC, which personified the major rent-collecting oil producers and thus potentially revealed the tip of *oil rents* as a price-determined economic category in the modern oil industry (Bina, 1989a, 1990, 1992a; Bina and Vo, 2007). As a result, the struggle over the magnitude of "posted prices" became the focal point of contention between the IPC and members of OPEC for the years to come.

Here, parenthetically, it should be pointed out that *rent* (and thus rent seeking) in the orthodox economics literature is a corollary of the lack of competition. This indeed shows the flimsiness of an analysis based on illusory "perfect competition" and its equally deceptive corollary: "imperfect competition." Departing from perfectly competitive markets violates the rules of the game, mainstream economic theory tells us, and unlocks the gate for all kinds of "imperfect behaviors" such as "rent seeking." Hence, the mainstream view of "rent seeking" is nothing more than a tautology. There is also the notion of "rentier" in the lexicon of those who were mystified by the coincidence of the bonanza of oil revenues and dictatorships in the Middle East and elsewhere. It was said that since many of these dictators, such as the Shah of Iran or Col. Qaddafi, absolutely controlled oil revenues, and thus did not need money from domestic taxation, there was something wrong with oil and the oil revenues which kept them in power. The protagonists even borrowed a popular adage from American colonist Patrick Henry: "no taxation without representation" (Mahdavy, 1970; Beblavi, 1987; Beblavi and Luciani, 1987). This outlook on "rent" simply scratches the surface by focusing on the sphere of circulation rather than production, and by ignoring the fact that the effect of such windfalls (in revenue terms) is not the cause of dictatorships; indeed, rent (as an effect of landed property in the sense of classical political economy) has nothing to do with the cause of modern authoritarianism. Two transparent examples might suffice to prove this point: (1) the overthrow of the Shah of Iran, following the skyrocketing upsurge of oil revenues (the lion's share of which was oil rent) in the 1970s, is a prime example of more oil revenues, and thus more polarization which, among others, paved the way for the 1979 insurrection; and (2) the Arab Spring in Libya and the massive street demonstrations against Col. Muammar Qaddafi –the man who controlled Libya's oil revenues for long and for every kind of payoff and buyoff; he apparently had no need for tax collection but, as we have seen, dictatorship did not prove handy. And despite the ample and enthusiastic literature on the "rentier state," oil rents are neither full-proof catalysts nor guarantors of such dictatorships (see Hendey, 2011 for further reflection).

From the 1950s through the end of the 1960s, three major developments emerged, which forcefully undermined the cartelized character of the industry and prepared the way to the unification of the oil sector across the world. First, there was sweeping socioeconomic change in the Middle East, Latin America and Africa, and thus in OPEC's relationship with the IPC;[11] this had to do with the further integration of these oil-exporting countries into the world economy (Bina, 1990; Bina, 2012d). Second, there was a steady stream of burgeoning "independent" oil companies entering this embryonic international petroleum market. These companies were either previously barred from the IPC's network or newly formed to partake in the incipient market that was evolving, and slowly was removing the arena from under the tutelage of cartel. This was a grand experiment on so-called barriers to entry –a proposition in many mainstream economics textbooks today. This should be the Achilles heel of any colonial cartel that tends to be successful in an atmosphere conducive to the development of modern capitalist social relations. And clearly, the eventual collapse of the IPC, in 1972, should be seen in this light. To identify some of these "independents," companies like Ashland Oil, Atlantic-Richfield, Occidental Petroleum, Amerada Hess, Marathon Oil, Continental Oil, City Service, Sun Oil, Union Oil, Philips Petroleum and Getty Oil come to mind (Federal Trade Commission, 1952; Blair, 1976; Bina 2012a). It should be pointed out in passing that during the nationalization of oil in Iran, in 1951, some of these very companies were either strong-armed by the IPC or quietly muted

11 Sometimes, reference to the IPC is made by identifying the cartel as the Transnational Oil Companies (TNCs); this is also interchangeably labeled, in popular jargon, as "Seven Sisters."

by Secretary of State John Foster Dulles in order to block Mossadegh from bypassing the barricades of cartelized oil worldwide, thus delivering a blow to a thriving, tangible, and promising democracy in Iran. And once such political shenanigans (and other destabilization tactics) proved ineffective, the Eisenhower administration authorized the CIA (Allen Dulles) to deliver the mortal blow to a democratically-elected government against internal law and contrary to the tenets of all international norms (National Security Archive, 2000, 2013).

Third, there was a considerable increase in the exploration and development costs of US (lower 48 states) oil –relatively the highest-cost deposits in the world. This was partly the consequence of highly fragmented US oil-lease contracts and partly of the very high (and increasing) cost of further investments by the IPC in nearly-exhausted, aging US oil fields (Bina, 1985; Bina, 1988).

### 2.3. Competition and the Arrival of Spot/Futures Markets

Today, contrary to the preceding historical stages, the pricing of oil is an outcome of the competition between all the oil regions in the world. Given that these oil regions are diverse in terms of their quality, productivity, and cost structure, and that they also compete with one another across the divide, the regulating capital on the least productive region (in this case, the continental United States) obtains a competitive rate of profit, whereas the owners of the more productive (*i.e.* less costly) deposits capture the difference between their own (individual) cost of production and the benchmarked cost of production in the lower 48 states of the US, as differential oil rents. The magnitude of such a differentiation of course depends on the prevailing differential productivity across all oil regions worldwide. In this manner, low-cost oil regions, in addition to a competitive profit rate, obtain additional profits commensurate with their own differential cost advantage. This excess profit (*i.e.* differential oil rent) has nothing to do with "profit of enterprise," but constitutes rent. And in a competitive system, such "excess profits" belong to the owner of oil in place. Hence, from the standpoint of the political economy of petroleum, excess profits which turn into differential oil rents are *not* price-determining but price-determined.[12] This rule also applies universally to OPEC and non-OPEC producers equally when it comes to oil rents. This should indicate the reason why OPEC prices could no longer remain insulated from the determining (and oftentimes, undermining) impact of spot (and futures) prices across the worldwide oil market.

This theoretical point should speak loud and clear to the cause of Iran's oil nationalization, and prove rather theoretically why M. Mossadegh was justified in fighting head-on against Britain's all-inclusive oil monopoly and the tentacles of the IPC in Iran. Indeed, Mossadegh was a pioneering statesman who was cogently explicit on the cause of the nationalization of oil in Iran; he and his close associates were crystal clear on the competitive nature of nationalization, and they were steadfast on neocolonial outfits such as the IPC. The irreconcilable differences between Iran and the United States (and Mossadegh's overthrow by the CIA) speak volumes on the rhetoric of the "free market," the obstinate support of cartelized oil by the Eisenhower administration, a trait that marked US foreign policy long after the breakdown of the IPC, and the closure of the postwar Pax Americana in the 1970s (Bina 1997, 2006, 2012a, 2012c, 2013).

The development of global spot (and futures) markets is not the cause but rather the consequence of: (1) the extent of the globalization of the oil industry and the deep integration of oil-producing nation-states within the global economy, (2) the critical importance of the US oil cost structure in the valorization and magnitude of value worldwide, (3) the competition of

12 Differential oil rent is not the same as "monopoly" rent. It is rather a measure of comparative productivity of the various oil fields in competition. As for the Marxian concept of "absolute rent" and its presumable relevance to the oil industry, I wish to make two points. First, from the standpoint of the dynamics of accumulation, absolute rent belongs to a rent-collecting sector (*i.e.* an industry entangled in "landed property"), whose "organic composition of capital" is below "average." Second, the effect of "landed property" upon the investment of capital, via the appropriation of a portion of surplus value, potentially leads to keeping the "composition of capital" below average. Here, "landed property" creates the category of "absolute rent," regardless of the existing qualities of the land. In this connection and in Marxian terms, the cost price remains below the magnitude of value (or *production price* is below *value*). Therefore, according to Marx, the development of capitalism and the historical limitation of landed property may lead to the increasing "composition of capital" in agriculture beyond "average," thus removing the material basis of "absolute rent" (Marx Engels, 1989).

oil regions across the world, (4) the replacement of cartelized arrangements and arbitrary prices by uncertain and turbulent market forces across the globe, and (5) the restoration of OPEC as an agency of rent collectors and without control over the magnitude of oil rents. (Bina, 1990; Bina and Vo, 2007; Bina, 2012d).

The onset of these post-monopoly adaptations found its *creative* feat in the wholesale *destruction* of the IPC through the most profound crisis of restructuration which this industry ever underwent. This was the crisis of the valorization of oil beyond a single oil region, including US oil, which was identified as the globalization and valorization of oil deposits across the geography of production--a valorization which, to put it in Marx's precise terms, accomplished an organic union between global capital and landed property across the board (Marx, 1973a, 1973b, 1991).[13] And like any other valorization in capitalism, this valorization too has not been without contradictory and conflictual restructuring.

### 2.4. Globalization, Regulating Capital, and Oil Rents

One of the significant corollaries of the 1973-74 oil crisis was the broad but gradual nationalization of oil. This task was accomplished either *de facto* or by intent across the entire geography of oil under the IPC's concession system. These post-crisis oil nationalizations were carried out by countries which held unfavorable views of US foreign policy in the region, as well as by those which thrived on such policies. For instance, Saudi Arabia first hesitated and thus opted for "equity participation," before recognizing that these *de facto* nationalizations were in-built mechanisms prior to entering the era of the globalization of oil. The process started piecemeal in Iraq (1972-75), Libya (1971-74), Kuwait (1976), Saudi Arabia (1976), Venezuela (1976), and Iran (1979) –the latter by default when the Shah was overthrown. The concession system of the colonial legacy was finally buried along with the IPC by the mid-1970s. Of course, the succession and frequency of these nationalizations will not be lost to the attentive reader who grasps the very fact that globalization

13 This point is drawn from the very meaning of *modern* landed property, *i.e.* landed property valorized by capital. It is only in this context that it is possible to speak of rent in its *modern* connotation. This elementary point is lost on many scholars who have ventured to write about this subject. Aside from David Harvey (2003, 2010), Dick Bryan (1990) also should be implicated for such oversight.

is not incompatible with the nationalization of oil (subsurface deposits), as the two are embodied within the synthesis of capital accumulation and the subsoil property in competition (Bina, 2012b; Bina, 2013).

Thus, the recognition of the periodization of oil in definite historical stages is a precondition to have a viable theory for the oil sector across the globe. As pointed out earlier, the globalization of oil led to the aggregation and unification of nearly all producing oil fields (with diverse cost structures) under a single value and pricing system in competition. To further elucidate this process: (1) the regulating capital in highest cost (least productive) oil regions governs the limit of the price of production; (2) the least costly (most bountiful) oil regions may collect a differential rent calibrated by the differential productivity of oil fields located within their geographical boundaries; (3) every oil region in the world should exhibit a universal tendency to receive a competitive rate of profit (the same as the regulating capital in the least productive regions) in the long run; and (4) in step with the globalization of oil, OPEC producers too should take their cue from the competitive global oil market –just as non-OPEC producers– and collect differential oil rents commensurate with the productivity of oil fields within their own borders (Bina, 1985; Bina, 2013).

I have mentioned *regulating capital* in the classical tradition and particularly in Marx (1991) –as opposed to marginal capital in neoclassical economics. Regulating capital in the oil sector is essentially entwined with the least bountiful oil fields. These oil fields might be the least productive originally or may have become less productive by the successive application of capital. Therefore, in addition to natural fertility, the question of capital deepening and its relationship to productivity is both theoretically and empirically important to locate the regulating capital in the oil industry (Bina, 1985; Bina, 1989a; Bina 2012a).

Costly oil fields though are the ones upon which the *regulating capital* of the entire industry operates; these are regulating oil fields which, by virtue of their valorization through regulating capital, set the *magnitude of value* for the entire global oil sector. To put it differently, given worldwide (effective) demand, capital investments on the least bountiful US oil fields –*i.e.* an expanse of overlapping, interlaced, older deposits of oil and gas in the lower

48 states– represent the site of regulating capital for the entire industry, a material link to *profit of enterprise*. In addition to profit of enterprise, more bountiful oil fields in the world should also generate differential oil rents (Bina, 1985; Bina, 2012a; Bina, 2013).

## Conclusion

The two entwined strands of history and theory presented above are necessary for informed practice across petroleum industries in Iran and elsewhere. First, the identification of oil rent, as a *sui generis* category, and of its theoretical and practical status vis-à-vis the profit of enterprise has been the primary objective of this paper. The theoretical import of this should be obvious in practice and in the process of negotiations between lessors and the lessees over oil and gas contracts across the globe, and particularly for Iran. There is a difference between the ownership of the produced oil and the ownership of an oil field. The former normally involves a specified period of time in the contract and can be carried off by the capitalist investor, while the latter belongs to the rentier. In the case of public ownership of deposits, the oil field belongs to the public, while its temporary lease may be owned by a private concern. That is why the duration of contracts in such matters is of paramount consequence. Second, contrary to mainstream (neoclassical) economic theory, oil rents are neither a monopoly nor an absolute toll (absolute rent) against capital investment as defined by Marx in undeveloped agriculture in the classical tradition. Rent in oil is a differential rent, a return on the differential productivity of the oil fields in competition. Hence, differential oil rents are neither arbitrary, nor are they there by the grace of bargaining. Third, the fact that the ownership of underground petroleum deposits is either public or private has nothing to do with the profit of enterprise. Capital investments may earn competitive profit either way. Fourth, the globalization of oil is the negation of cartelized oil, and OPEC is not a cartel but a rent-collecting association. OPEC also has the spot market for the crude oil sold by its constituents, while it takes its cue from spot and future markets across the globe, namely, the Brent (London) and Nymex (New York).

The stage theory of oil provided above offers a historical and conceptual context for the evolution of petroleum, from colonial concessions to decartelization and the eventual globalization of oil. Iran's oil has been no exception. The early 1970s were the moment of grand disruption and restructuration in the oil sector across the board. The 1973-74 crisis was the equivalent of the Big Bang in the modern political economy of oil. The quadrupling of (nominal) "posted prices" in the Persian Gulf, North Africa, and Venezuela was the consequence of formidable forces that gathered strength during the 1950-72 transitional period, and moved the tectonic plates of upheaval (Bina, 1985, 1990; Terzian, 1985). OPEC played a part as a catalyst in all this, and anytime it moved in an arbitrary direction, it was forced to calibrate its course according to overpowering global market forces. This could be seen from the events of the mid-1970s to the early 1980s when OPEC functioned based on little trial and more error. Yet, it has gradually become somewhat responsive to the objective vicissitudes of the rentier and the capitalist investor in the production of oil globally. The oil crisis had multiple global effects, namely, (1) a single global price of production for both high- and low-cost oil, (2) the *de facto* nationalization of oil in the concessionary oil regions and the transnationalization of oil production across the board, (3) the universal decartelization of oil, (4) the competitive formation of differential oil rents for the OPEC and non-OPEC production alike, and (5) the abolition of "posted prices" in the late 1970s in favor of global spot markets and spot oil prices.

Finally, after nearly four decades of turbulent political upheaval, revolutionary and counter-revolutionary struggles, Iran is now grappling with refurbishing (*via* foreign investment and operation) its oil industry and thus invoking the collective memories of the past, along with the subtleties of the globalized petroleum sector today. Yet, the government of the Islamic Republic, according to newspaper articles and public reports since the resolution of the nuclear issue (July 2015 in Geneva), does not appear to take heed from Iran's past experience, nor is its Oil Ministry able to appreciate the difference between the colonial (and cartelized) concessions of the past –*i.e.* concerning the *control* and *length* of contracts– and a post-globalized modern contract in which private oil companies are universally and merely entitled to competitive profits across the board.

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