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DOLLAR SHORTAGE AND OIL SURPLUS IN 1949-1950

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The present essay is the eleventh in the series ESSAYS IN INTERNATIONAL FINANCE *published by the International Finance Section of the Department of Economics and Social Institutions in Princeton University. The author, Dr. Horst Mendershausen, has been associated with the National Bureau of Economic Research, Bennington College, and the United States Military Government for Germany. He is now an economist with the Federal Reserve Bank of New York. Nothing in this study should be considered an expression of the views of that institution.*

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BY HORST MENDERSHAUSEN*

I. SURVEY OF ISSUES

RECOVERY from the effects of World War II led the Western European countries on to a broad issue: Should they seek economic viability in a progressive integration of the non-Soviet world or in narrower frameworks implying some discrimination against United States commerce? Since their dollar needs showed a persistent tendency to exceed dollar availabilities during the recovery period and their dollar reserves proved either too small or too volatile, many countries, in particular Britain, found it necessary to make preparations for the latter alternative. During the postwar years, the United States exerted its influence in the direction of closer economic interdependence of countries throughout the world and effectively supported its persuasive efforts by grants and loans, particularly under the European Recovery Program (ERP). But, while relieving the foreign dollar needs inherent in the progress toward more effective cooperation with poorer nations, the United States was not able to still the fears abroad that within a few years—the year 1952 used to be considered as the critical break—the supply of American dollars might decline greatly and that such a decline might worsen the prospects of economic improvement and political stability in many parts of the world. Since 1941, Lend Lease, relief and recovery programs—amounting to forms of international redistribution—had given essential support to the livelihood of associated nations and strengthened the economic and political bonds between them. But the scope of redistributive measures seemed destined to shrink, perhaps excessively and prematurely in view of the world political situation. Market processes alone offered a frail substitute for the cumbersome yet resilient dual system of international economics that had developed since the war: foreign trade plus foreign aid. These fears encouraged discrimination against the United States trade in the name of dollar saving.

The economic developments of 1949, in particular during the first three quarters of the year, seemed to confirm the apprehensions. The dollar supply to the outside world declined as a result of a business

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recession in this country and other factors, and the British dollar position deteriorated rapidly. No major new foreign financing program from the United States was indicated, and the prospective decline of the existing ones was reaffirmed time and again. This hastened general provisions for restrictions of dollar expenditures over an indefinite period of time, in particular the British program of curtailing the dollar outlays of the entire sterling area by 25 per cent. It also led to specific measures against sales by American oil companies abroad. These sales cause foreign dollar expenditures although they come mostly from oil fields and refineries located outside the United States and do not constitute United States exports.

The foreign activities of American oil companies offered an obvious target for dollar saving efforts. Sales of American oil companies abroad constitute a major dollar expenditure to many countries. In 1949, the British Government estimated that more than half of the sterling area's current dollar deficit for fiscal 1950 would arise through the deficit on oil transactions. Transactions with American oil companies alone would account for more than a quarter of the deficit. Eleven per cent of the value of all Economic Cooperation Administration (ECA) shipments to participating countries up to the middle of 1950 consisted of oil.

During the ERP period, Britain, France and other countries felt it necessary to prepare for a lessening of their dollar outlays on oil. These preparations followed different lines: expansion of facilities to produce crude oil, refined oil, and oil industry equipment; limitation of civilian demand for oil products; and, finally, the restriction of oil purchases from American companies. Since no foreign country could afford an actual lessening of its oil consumption under the conditions of 1949, the last mentioned course was open only to those who had access to rapidly available supplies. Only Britain was in that position. Toward the end of 1949, Britain's major oil companies, which have been sharing the markets outside the United States with the American companies on a roughly half-and-half basis, became able to supply some additional oil in substitution for American company oil. Britain, therefore, took the lead in imposing discriminatory measures against the so-called dollar oil.

The measures taken by the British Government will be discussed below. Together they seem to have restricted the sale of refined oil products by American-controlled companies in the sterling area and elsewhere by about 6.75 million tons or 9 per cent of the overseas production of American companies.[1] (At least this may be said to have been

[1] Testimony of Assistant Secretary of State Willard L. Thorp before the House Inter-State and Foreign Commerce Sub-Committee on Petroleum, April 5, 1950, reprinted in *Effects of Foreign Oil Imports on Independent Domestic Producers*, Report

their potential effect by mid-1950; they never became fully effective in reality.) Further limitations on the sales of American oil companies abroad for dollars had to be expected in the course of time as new facilities were completed in the Middle East and Europe. France for instance has been aiming at eliminating all dollar expenditures on oil imports by 1952 and at relying thereafter on sterling and franc oil, chiefly crude oil from Iraq. But in 1949 more than half of France's oil imports were paid for in dollars, with the help of ECA, and no practical alternative was available.

Britain's measures took the form of stipulations in bilateral trade agreements with countries outside the sterling area (Egypt, Sweden, Brazil, Argentina, and others) providing for larger shipments of sterling oil to them, restrictions on the use of sterling owned by other countries for payments to American accounts, including those of the oil companies, and, finally, the partial substitution of sterling for dollar oil in the markets of the sterling area.[2]

The British measures were received with sharp opposition by the American oil companies and the State Department and led to protracted negotiations that seemed deadlocked up to the early summer of 1950. Then several compromise arrangements were made between the British government and individual American companies which reduced the effects of the restriction measures considerably and practically left not much more of them than the "whereases." These compromises were facilitated by the relative improvement of the dollar position of the sterling area following the devaluation of sterling as well as the renewed expansion of the American domestic market for oil following the general upswing of business in the early half of 1950. The outbreak of hostilities in Korea did not bring about the compromises, but it signaled the beginning of a new great economic effort in the western world that could not fail to increase greatly the effective demand for petroleum products and other fuels, and, more generally, signified a renewal and intensification of the community of interests. It is not likely that the positive restrictions against dollar oil will be tightened again unless general demand and dollar supply prospects take another turn for the worse.

of the Sub-Committee on Oil Imports to the Select Committee on Small Business, 81st Congress, 2nd Session, House Report No. 2344, Washington, D.C., 1950, p. 100. This committee report is henceforth referred to as: *Effects of Foreign Oil Imports.*

[2] The terms dollar oil and sterling oil mean different things to different people. The British government has used the word sterling oil to describe the oil offered by "British-controlled companies," and dollar oil that offered by "American-controlled companies." American oil men have stressed that dollar oil is oil that has to be produced at dollar cost, that most oil in the world has some dollar production cost, and that the distinction therefore is one of degree. In this study the British definition will be adhered to since it became operative in the British government's measures.

At home there developed simultaneously a conflict over imports of crude and fuel oil. While oil imports into the United States had been growing rapidly since the war, it happened only in 1949 that their growth was accompanied by a curtailment of domestic production—by about 8 per cent as compared with 1948—and the formation of a developed reserve capacity of about 50 million tons of crude oil per year—about 18 per cent of 1949 domestic production—that could be exploited in keeping with "sound conservation practices." The growth of the demand for oil had fallen behind the development of domestic production facilities. Strong efforts were exerted by oil and coal interests to restrict oil imports.

In the market, both of these phenomena—restrictions on dollar oil abroad and on production at home—appeared as expressions of an oil surplus.[3] It is the purpose of this essay to examine the causes of this apparent oil surplus of 1949, and the involvement of the domestic oil industry with its assets of $18 billion, the American oil industry abroad (assets over $3 billion) and the multi-billion dollar British oil enterprises. We shall also consider the involvement of certain countries of Latin America and the Middle East whose economic development depends so heavily on the operations of the British and American oil companies.

Part II of the essay is focused on the British-American conflict, part III on the controversy over oil imports into the United States and national oil policy. The fourth part of the study deals with the way in which the conflicts were resolved and aims to show how the troubles of this dynamic international industry reflected the difficulties of moving toward a more effective economic integration of the United States, Western Europe, and the areas of new development.

II. DOLLAR OIL ABROAD

1. Pattern of International Oil Industry

The larger part of the world oil market, 62 per cent in 1948, is in the United States. About 90 per cent of it is supplied from the domestic production of a variety of American oil companies including the Shell Oil Company, a subsidiary of the Royal Dutch Shell group.[4] The remainder is imported by the Standard Oil Company (N.J.), the Gulf

[3] Both were anticipated at the time of the conclusion of the as yet unratified Anglo-American petroleum agreement of 1945. See Herbert Feis, *Seen from E.A.*, New York, 1947, p. 181.

[4] Sixty-five per cent of the common stock of the Shell Oil Company, a Delaware corporation, is owned by Shell Caribbean, a New Jersey corporation, which in turn is owned 100 per cent by Batavian Oil Company, a Dutch corporation. The British/Dutch Shell group is referred to as British in this paper.

Oil Corporation, Socony-Vacuum, and about eight other large companies including the two British-controlled organizations, Shell Oil and Shell Caribbean.

Outside North America and Eastern Europe the oil industry is shared fairly evenly by a few large American and British company groups, with third groups holding a minor, although now increasing, share. The American share is somewhat greater in crude oil reserves and production, the British in refined products. (See Table 1.) The chief source of crude oil produced by American companies abroad is in Venezuela—where the American share is about twice as large as the British—followed by Saudi Arabia and other Middle East areas, where output has risen rapidly since the war. The British companies have their main sources of crude in the Middle East (particularly Iran) and the East Indies, where their share is greater than the American, and in the Caribbean area. (See Table 2.)

British and American oil interests throughout the world are interwoven in a very intricate manner. The major international company groups in the United States, in particular Standard of New Jersey, Caltex, Socony-Vacuum, Gulf, and the two British groups, Shell and Anglo-

TABLE 1

BRITISH AND AMERICAN COMPANY SHARE IN WORLD RESERVES AND AVAILABLE SUPPLIES OUTSIDE NORTH AMERICA AND EASTERN EUROPE

	Total (million metric tons)[a]	*American companies*	*British companies*	*Others*	*Total*
		(Percentage Shares)			
Proven crude oil reserves, January 1, 1950	6,236	50	46	4	100
Crude oil available, 1948, annual rate[b]	150	53	44	3	100
Refined products available, 1948, annual rate[b]	123	43	49	8	100

[a] Throughout this study the following conversion factors have been used: 1 metric ton = 7.3 barrels. 1 metric ton per year = 50 barrels per day.

[b] Including supplies obtained from North America. The difference between the availabilities of crude and refined oil is largely due to gross exports to North America and Eastern Europe and stock changes.

Sources: ECA, *Statistical Summary of Individual Plans for the Development of World Oil Production, Refining and Trade (Excluding North America and Eastern Europe), 1948 to 1953*, Washington, D.C., September 12, 1949, Tables 8 and 9. ECA, *Congressional Presentation Material*, March 10, 1950; published in *Petroleum Study*, Hearings before a subcommittee of the House Committee on Interstate and Foreign Commerce, February to May 1950, Washington, D.C., 1950, p. 118. These hearings are subsequently referred to as: *Petroleum Study*.

Iranian, are linked together by jointly held concessions, by joint ownership of wells, refineries, pipe lines and other facilities, and by the sharing of output and inter-company purchase agreements.[5] In the disposal of products, certain standard percentage shares of the companies have evolved in some markets and assumed a measure of stability; e.g., 28 1/2 and 7 per cent, respectively, for the shares of Jersey Standard and Caltex affiliates in the United Kingdom gasoline market. Market sharing has been encouraged by governments of importing countries through the allotment of import quotas to major suppliers.

Interlacement of production and market sharing seems to have superseded generally the acute struggle for supremacy between the British and American companies that was so pronounced in the 1920's and 1930's, although the emergence of Caltex as a major factor has invigorated competition. Such competition as does exist is often more pronounced between American companies than between the American and British companies as groups, largely as a consequence of exchange controls. On the whole, the two groups at present seem content to proceed with the orderly sharing of major existing markets and to limit their competition to marginal areas.[6] While the British restrictions of dollar oil sales have been explained by some domestic oil men as part of a major drive to conquer the international oil market for the British companies, neither the stated intentions of the British Government nor the timing of the restrictions, nor finally the nature of the settlements gives support to this explanation.[7] The preference of the British

[5] For example, Standard (N.J.) and Socony own the Iraq Petroleum Company jointly with Shell, Anglo-Iranian and a French government company, and share output in the same proportions as their capital. Gulf shares the Kuwait concession with Anglo-Iranian, is bound by contract not to sell in any marketing areas served by Anglo-Iranian, and regularly sells most of its crude oil from this source to Shell. Standard (N.J.) and Socony have a 20-year agreement with Anglo-Iranian for large purchases of Iranian oil. Standard (N.J.), Socony-Vacuum, and Anglo-Iranian jointly own the Middle East Pipeline Company. (Raymond F. Mikesell and Hollis B. Chenery, *Arabian Oil*, Chapel Hill, 1949.) Other joint Anglo-American oil ventures can be found in Canada, Germany, Austria, the East Indies and South America.

[6] In 1948, American companies had 39 per cent of the total refinery throughput of the world excluding North America and Eastern Europe, British companies 52 per cent, others 9 per cent. On the basis of independent company estimates for 1953, the share of American companies in that year has been put at 37 per cent, that of the British at 47 per cent, and that of others at 16 per cent. The ratio of American to British throughput volume remained constant at 1 to 1.3. Source: ECA, Petroleum Branch, *Statistical Summary of Individual Plans for the Development of World Oil Production, Refining and Trade, 1948 to 1953*, Washington, D.C., September 12, 1949 (mimeo.), Table 2.

[7] Herbert Feis, economic advisor of the State Department during the last war, judged similarly the view expressed by American oil companies in 1943 that the British were exerting themselves to oust or injure their American rivals in the Middle East. "They were imprints left by the earlier struggle to gain admission into a secluded and guarded area. Diligent questioning revealed little more than a state of mind." *Op. cit.*, p. 110.

government for a stable sharing of international oil markets appeared as no less definite than that of the American companies as a group. The intricate connection between government and oil companies in Britain, including the controlling share of the British government in the Anglo-Iranian group, is of course well known; but it is of no greater significance for Britain's conduct in the recent oil conflict than is the close cooperation existing on many issues between the major American oil companies and the United States Government.

In both countries, international oil matters are recognized as being of greatest importance to foreign commercial, political and strategic relations. Since World War I, both the British and American governments have frequently lent active support to the expansion of their nationals' interests in oil abroad;[8] and American and British commercial and political interests have clashed repeatedly in the process. But in the setting of 1949 that historic conflict hardly offered a satisfactory explanation of Anglo-American disagreement over oil. In both countries, companies and governments were drawn into a dispute over oil markets by tensions in broad demand and balance-of-payments developments that arose in the joint pursuit of greater over-all interdependence. These tensions produced the general problem of sterling inconvertibility as well as the particular and confusing division between dollar oil and sterling oil. To ascribe them primarily to a commercial or political imperialism was temptingly easy but deceptive.

2. *Dollar Cost of Oil*

Dollar outlays related to oil may appear in the purchase of oil products, or in their production, processing, transportation and distribution. Oil bought from American companies normally leads to a dollar claim on the foreign exchange supply of the buyer's country. American oil companies operating abroad, like domestic concerns, seek dollar earnings from their sales not only to remit profits and to amortize invested capital, but usually also to pay dollar salaries and buy dollar input supplies. The production and handling of oil costs dollars wherever royalties or taxes to concession-granting governments must be paid in dollars or some equivalent (e.g. gold) and whenever drilling, piping or refinery equipment must be bought from American firms, "dollar tankers" must be employed, or American patents or other services must be paid for. As far as the trade in oil is concerned, only American companies necessarily have to claim conversion of their earnings into dollars, at least

[8] For an account of policy developments, see *Hearings*, Special Senate Committee Investigating Petroleum Resources, *American Petroleum Interests in Foreign Countries*, Washington, D.C., 1946, *passim*; and Willard L. Thorp, *Effects of Foreign Oil Imports, op. cit.*, p. 95.

in part, while in production, refining, transportation and marketing an oil company controlled by nationals from any country may have to make dollar expenditures. When the impact of the oil trade on a country's balance of payments is to be established, dollar outlays on oil purchases and on oil production, etc., have to be considered.

Until 1949/1950, American international oil companies could be considered as dealing almost completely in dollar oil in both the trade and production sense. They claimed full payment in dollars for oil sold; they paid most of their royalties and taxes, e.g., to the Venezuelan and Saudi-Arabian governments, in dollars or instruments bought with dollars (gold sovereigns); they bought the bulk of their material, equipment, and commissary supplies from the United States and hired their non-native personnel there.

The British companies on the other hand were only partially engaged in dollar trade. A large part of production expenses in Iraq, Indonesia and other Eastern Hemisphere areas could be paid in sterling and related currencies. But in Venezuela, Shell had to pay royalties and taxes—recently upward of 50 per cent of profits—with dollars and, like American companies, buy all local currency needed with dollars—at a special and unfavorable exchange rate. Except for the profits remitted to owners in Britain, Holland, etc., and some salary payments, practically all the outlay of Venezuelan Shell took the form of dollars. Also, in Iran the British government had to convert a sizeable part of Anglo-Iranian royalty payments to the Shah's government into dollars to satisfy its requirements for imports from the United States. Much of the oil equipment needed for expansion and maintenance of facilities anywhere in the world had to be bought in the United States in the early postwar years, and American or Panamanian tankers had to be chartered. On the other hand, income from the oil sold by British companies in the sterling area and many other countries came in sterling form. Only in the United States, Canada and some Latin countries did they sell for dollars and, in the case of Shell, earn dollar profits through the domestic operations of American subsidiaries. These dollars had, of course, to be turned over to the British Government's dollar pool, which in turn provided the dollars for the companies' expenditure.

This difference between British and American-controlled companies with regard to dollar costs probably increased in 1949. Growing supplies of oil, transportation equipment, materials and shipping services became available outside the United States, particularly in Britain, and were sought by or allotted to British companies under their government's, if not ECA's, admonitions to save dollars. The British oil equipment industry more than doubled its export deliveries from 1946 to mid-1950

and broke the near-monopoly of the American industry that existed before the war. Since the fall of 1949, Iran's conversions of royalty earnings into dollars have probably declined, owing to the opening up of non-dollar sources of goods.[9] Thus, the British companies lowered the dollar component in the cost of their oil. This probably was not the case with the American companies operating in Latin America, the Middle East and Far East, partly owing to a lack of the pressures to which the British companies were subject, partly owing to British policies aimed at preventing the intrusion of American companies into the flow of sterling within the sterling area and between Britain and her trade agreement partners. This policy made it difficult for certain American companies to carry out a program of gradual shifts of input purchases from dollar to non-dollar sources that was conceived in the later part of 1949. Some American companies even shifted purchases from British and other foreign to United States sources in 1949 as the recession eased supplies and prices in this country.

Thus it came about that at the end of 1949 the dollar cost of British and American company oil to Britain differed very greatly. In an important memorandum issued in February 1950 to the American oil companies via the State Department, the British government provided data that made it possible to estimate the difference.[10] For 1950, Britain expected to pay about $535 million in dollars in connection with the production, marketing, etc., of 80 million tons of crude oil and oil products by British-controlled oil companies inside the sterling area and elsewhere.[11] She expected the operations of American companies in the sterling area to lead to dollar claims amounting to about $350 million (plus $12 million in other currencies) in return for about 13 million tons of oil. The *dollar* cost of oil operations of the British companies appears as $6.69 per ton (gross) or about 92 cents per barrel, that of the American-company oil sold in the entire sterling areas as $27.00 per ton—on the assumption of full conversion of sterling earnings into dollars—or about $3.69 per barrel, i.e. four times as much.[12]

These estimates refer to extremely complex commercial, financial and possibly transport transactions. Since their basis has not been published it is impossible to check their comparability in terms of inclusive-

[9] The monthly average of British exports to Iran in the first five months of 1950 was 5 per cent above, that of United States exports 48 per cent below, the 1949 average.

[10] This memorandum was published in the *Journal of Commerce* on February 14, 1950. It is henceforth called the *February Memorandum.*

[11] Thirty million tons in the United Kingdom and the sterling area, 50 million tons elsewhere.

[12] On the other hand, the British companies expected to earn $260 million in dollars through their trade with North America. The net dollar cost of their operations to Britain thus appeared as $3.44 per ton of oil handled.

ness, product composition, etc. The British data have been criticized as inconsistent and misleading by American oil men, but no alternative over-all computations have been published.

According to another estimate, reported by ECA to Congress in February 1950, the British Government placed the dollar cost of producing oil by British companies at 20 per cent of total f.o.b. value in the Middle East and 60 per cent in Venezuela.[13] Since, in 1949, 61 per cent of the oil supply of British companies came from the low-dollar-cost facilities of the Eastern Hemisphere and only 39 per cent from the Caribbean area, the weighted average of the two percentages would probably have to be near 35 per cent. This would be somewhat higher than the figures presented above, which showed the British companies' dollar component as one-fourth of that of the American companies trading with the sterling area. Still another statement that has a bearing on the matter has been made in connection with the agreement between Caltex and the British Government of July 18, 1950. The American company was reported to have undertaken to reduce its dollar cost component to "close to 30 per cent"[14] to meet the gross dollar component of British company oil. One may suppose that the average gross dollar component in the f.o.b. value of all British company oil in 1949/50 was somewhere between 35 and 25 per cent, probably moving from the upper toward the lower part of the range.

The difference between the dollar components of American and British company oil as estimated in early 1950—as far as outlays by Britain are concerned—must not be considered as permanent. It was very large at that time and the American companies were considering ways of reducing it, gradually and piecemeal. The British government apparently sought to give momentum to the change and decreed a curtailment of the markets for American company produced oil. This brought about the conflict.

It is hard to believe that the British government expected the American companies and the United States Government to accept quietly the market restrictions; but it is possible that such an illusion arose in the later part of 1949 at least in some branch of the British government, and that the Treasury, the driving force in dollar saving, forced the issue over the warnings of others. Following devaluation in September, British officials explained the impending substitution program in Washington and allegedly received "nothing beyond expressions of regret" from the American side.[15] But the State Department quickly expressed

[13] ECA added: "The American companies question this estimate." Senate Foreign Relations Committee, *Extension of European Recovery—1950*, Washington, D.C., February-March 1950, p. 57.

[14] *Journal of Commerce*, July 19, 1950.

[15] See the letter of the British Colonial Secretary to the Kenya government published in the *New York Times*, January 1, 1950.

its "emphatic concern" when the program was announced, and a British embassy spokesman in Washington subsequently explained the quoted phrase as an "example of excessive British understatement."

3. *Demand and Supply Developments*

The conditions of late 1949 were favorable to a move by the British Government aimed at a lowering of the dollar claims of the American companies and a raising of their sterling expenditures while maintaining their share in the markets outside the United States. They were unfavorable to an attempt to lower their market share drastically.

After World War II, production of petroleum rose considerably in the United States and the world as a whole. The rise was accelerated by the heavy pressure of demand in 1947/48 and the undertaking of large expansion projects all over the world. But in 1949, this general upward trend was broken by the decline of production in the United States caused by a stagnation of demand in the face of rising imports. Production of American companies in the Caribbean declined likewise, by about 7 per cent. In the Middle East and the East Indies, by contrast, the production of both the American and British companies advanced considerably, by 39 and 21 per cent, from 1948 to 1949, respectively (see Table 2). Production in Canada, Egypt and Europe also continued to grow.

Domestic demand for oil and oil products was expanding in Western Europe. Oil consumption in Europe (excluding the U.S.S.R.) had risen by 15 per cent from 1948 to 1949 (6 per cent from 1947 to 1948) and in the entire world outside the United States, by 11 per cent, while consumption in the United States remained about the same.[16]

The American companies as a group were therefore anxious to maintain their share in foreign markets. It seemed most unlikely that they would acquiesce in a systematic lowering of that share at a time when the domestic market appeared unable to absorb increasing supplies from domestic and foreign sources and when a considerable expansion of American production facilities outside the United States was under way. In 1947, 1948 and 1949, the 30 leading American oil companies spent a total of about $1 billion on the expansion of their production, refining and distribution facilities abroad ($6 billion on their facilities at home),[17] most of this in the field of crude oil production. In Saudi Arabia, Bahrein and Kuwait, established American companies were increasing the exploitation of their rich concessions, while newcomers, such as the American Independent Oil Company,[18] paid high "entrance fees" to gain new

[16] *World Oil,* July 15, 1950, p. 40. The rise of demand in South America slowed down considerably in 1949.

[17] J. E. Pogue and F. G. Coqueron, *Financial Analysis of Thirty Oil Companies,* Chase National Bank, New York, annual volumes.

[18] This joint enterprise of nine American firms, with Phillips in the leading role, obtained concessions in the neutral zone between Kuwait and Saudi Arabia.

TABLE 2

Crude Oil Production: World Summary[a]

(In thousands of tons)

	1948				*1949*			
	American Companies	*British Companies*	*Others*	*Total*	*American Companies*	*British Companies*	*Others*	*Total*
Major Exporting Areas								
Venezuela, Colombia Peru	50,900	28,000	100	79,000	47,450	28,000	100	75,550
Middle East	23,600	31,400	900	55,900	32,950	37,800	950	71,700
East Indies	2,100	5,000	—	7,100	2,900	6,400	—	9,300
Total	76,600	64,400	1,000	142,000	83,300	72,200	1,050	156,550
Importing Areas								
OEEC Countries	450	500	800	1,750	450	550	1,200	2,200
Others[b]	1,400	1,150	11,100	13,650	2,450	1,200	11,650	15,300
Total	1,850	1,650	11,900	15,400	2,900	1,750	12,850	17,500
Sub Total	78,450	66,050	12,900	157,400	86,200	73,950	13,900	174,050
Per cent of subtotal	*49.8*	*42.0*	*8.2*	*100.0*	*49.5*	*42.5*	*8.0*	*100.0*
United States[c]	276,000	—	—	276,000	252,100	—	—	252,100
Eastern Europe[d]	—	—	36,700	36,700	—	—	38,400	38,400
WORLD TOTAL	354,450	66,050	49,600	470,100	338,300	73,950	52,300	464,550
Per cent of world total	*75.4*	*14.1*	*10.5*	*100.0*	*72.8*	*15.9*	*11.3*	*100.0*

[a] Partly estimated.
[b] Canada, Mexico, Other Latin America, Other Asia, Africa.
[c] Includes American subsidiary of British Shell group.
[d] Includes that portion of Austrian production which has been or is likely to be unavailable to the Austrian economy.

Source: ECA, *Congressional Presentation Material on Crude Oil and Petroleum Products and Petroleum Equipment*, March 10, 1950; *Petroleum Study*, Washington, D.C., 1950, p. 117.

concessions in Arabia. American companies also shared to a little less than one-third in the extensive program of refinery expansion in the ECA countries (see Table 3). They could not reasonably be expected to withdraw or turn gradually into sales agents for British company oil.

British and other companies were of course similarly expanding, the former allotting the equivalent of about $438 million annually to new oil equipment,[19] mostly overseas, and additional sums to plant expansion. In 1949, the total fixed investments of the British companies may have corresponded to about 10 per cent of aggregate fixed capital formation in the United Kingdom. The expansion of the foreign companies probably was somewhat held in check by ECA's reluctance to provide dollars for European refinery expansion projects that might duplicate American-owned facilities abroad. Total ECA funds hitherto approved for European refinery expansion amount to $24 million—a small amount compared with the $971 million of ECA procurement authorizations for dollar oil imports into the participating countries through June, 1950. ECA financing is scheduled to cover 15 per cent of the cost of refinery projects having a capacity of 5,725,000 tons per year, which amounts to less than 5 per cent of the expansion projects of non-American companies in participating countries to be completed by 1953. ECA made no commitments for the bulk of British company projects within the ERP area (see Table 3) and none for those outside that area. For every ECA dollar allotted to the petroleum equipment purchases of British companies, Britain has been spending $19 of her "free" dollars on such purchases in fiscal 1950, and planned to spend $30 in fiscal 1951.[20] Britain obviously is straining her resources to maintain the relative position of her companies in this politically and economically vital field.

A systematic growth of the market share of the British at the expense of the American companies may or may not have been in prospect. In any case the British companies had some leeway for tactical maneuvering. If the expansion of oil demand in the sterling area could be held in check through rationing, high oil prices and other means, the British companies apparently expected to be able to replace about 4 million tons of dollar oil supplies with their oil, the new supplies coming in part from their large crude reserves and expanded refining facilities and in part from a cessation of the practice in Iranian oil fields of pumping fuel oil back into the ground to increase oil pressure. This capacity, chiefly in fuel oil, together with control over demand, was the basis for the British "substitution" thrust in the late days of 1949. It was question-

[19] Including $83 million in United States dollars. Planned expenditures as reported in ECA, *Congressional Presentation Material,* March 10, 1950; *Petroleum Study,* Washington, D.C., 1950, p. 111.

[20] *Ibid.*, p. 104.

TABLE 3

REFINERY-EXPANSION PROGRAMS IN ECA-PARTICIPATING COUNTRIES BY COMPANY NATIONALITY AND TYPE OF FINANCING

(*Thousand metric tons per year of crude oil intake*)

	Ownership			
	American	*British*	*Other*	*Total*
1. Capacity, refineries existing at end of 1948	5,800	11,050	7,400	24,250
2. Expansion projects completed or under construction, Total	9,350	14,005	4,480	27,835
(A) ECA financed	0[a]	4,435	1,290	5,725
(B) Not requiring ECA financing	8,700	2,215	1,970	12,885
(C) Financing undecided	650	7,355	1,220	9,225
3. Capacity, fiscal 1953 with present projects completed	15,150	25,055	11,880	52,085
4. Additional expansion proposals in OEEC long-term program (adjusted)[b]	4,945	3,420	5,300	13,665
5. Capacity, fiscal 1953, assuming execution of all projects proposed in OEEC programs	20,095	28,475	17,180	65,750

[a] Two American-owned refinery projects in France that benefit from ECA financing to the extent of $2.3 million will increase lubricants and cracking capacity, but not total crude runs.

[b] Includes changes reported subsequent to OEEC long-range report.

Source: ECA, Petroleum Branch, *Congressional Presentation Material*, March 10, 1950; *Petroleum Study*, p. 106.

able, however, whether British companies actually could muster a surplus of 4 million tons in 1950.

At that time, then, it was doubtful whether the British companies would be able to challenge the relative market position of the American companies in the long run; but since they were able to do so in the short run, the British government apparently sought to use this short-term advantage to improve the prospects of its long-run dollar balance and to reap some fiscal advantages on the side.

4. *The Conflict*

Two important British Government measures of 1949 brought the sterling-dollar oil conflict to a head. By arrangement with the British

Exchange Control Board, American oil companies had been selling oil to the sterling area for convertible sterling. At the end of June 1949, however, the Exchange Control Board began to curtail import licenses for such oil; the American companies were not permitted to accept nonconvertible sterling in payment for oil on the same basis as British-controlled companies. The British Treasury also declared itself unwilling to transfer sterling credits of other countries to American oil companies for their general (uncontrolled) use.[21] Britain undertook to substitute sterling oil for the 42 per cent of Argentina's crude and fuel oil imports that had previously come from American companies. As a result, outlets for dollar oil were greatly reduced, in Argentina (by 2 million tons), in Denmark (by 30 per cent of her oil imports), etc.

In December 1949, the British Ministry of Fuel and Power announced that beginning January 1, 1950, British-controlled companies would be able to supply an additional 4 million tons of refined oil to the sterling area. The Ministry directed importers in the sterling area to cut back their purchases of dollar oil products as sterling products became available.[22] For the United Kingdom, the Ministry proposed to eliminate in 1950 all dollar fuel-oil imports and one third of the dollar gasoline imports. Sales of dollar crude oil to the sterling area or to British-controlled companies, expected to cost $100 million, were left un-

[21] Developments in Japan illustrate the ensuing situation. Since the summer of 1949, Japanese refineries twice received permission from SCAP to invite offers of crude oil, to be paid for in sterling from Japanese sterling accounts, one purpose being to save GARIOA expenditures on oil. In both cases sterling-company tenders were rejected, dollar-company tenders accepted. American companies proposed to buy Japanese textiles for sterling, presumably to sell them in the United States. (*The Economist*, January 7, 1950.)

But the British-Japanese trade pact signed in 1949 required all invitations to tender in sterling to contain the phrase "Bids must have the approval of the appropriate sterling exchange control." In January 1950, a British Trade Mission advised SCAP that American oil companies might sell oil in Japan for sterling only if they: (1) supplied oil from sterling sources, (2) used sterling proceeds to buy Japanese goods (i.e. did not seek to convert the sterling into dollars or British goods), (3) shipped those products to the sterling area, and (4) took the proceeds in nonconvertible sterling. (*New York Times*, January 13, 1950.) American companies thereupon complained of British discrimination against them.

The London *Times* of December 30, 1949, criticized discrimination in favor of American oil against cheaper British oil in Japan on alleged technical grounds. After the British Trade Mission had made its statement, the *Times* reported, the sterling tenders awarded to American oil were canceled, and the oil was delivered by American companies on government account.

On February 15, the *Journal of Commerce* reported that some contracts for sterling oil sales to Japan had been concluded, amounting, however, only to one quarter of the volume agreed to in the British-Japanese trade agreement for 1949/50.

[22] The Indian Government and the colonial government of Kenya at once notified American oil companies of the prospective elimination of dollar fuel-oil imports in 1950. (The recent Indian intake of dollar fuel oil was at an annual rate of about 180,000 tons.)

curtailed, although the British companies had supplies available for substitution. As a result of substitution, the market share of the United States companies in total oil imports of the sterling area, estimated at 29.5 per cent for fiscal 1950, was expected to decline to 22.0 per cent by fiscal 1952. Previously it had been expected to rise to 30.2 per cent by that time. And the rise of total oil imports into the United Kingdom and the other sterling area countries during the interval was to be slower than previously expected.[23]

In late 1949, two major American companies made proposals to the British government aiming at a reduction of British dollar outlays on American oil through "sterlingization."

The Caltex group proposed to sell oil for sterling to the extent that it could replace dollar purchases of goods and services by purchases from sterling sources and could use sterling for crude oil purchases from Arabia, for the operations and the expansion of its refineries in Europe and the Middle East, and for purchases of assorted goods that might be sold for dollars subsequently. Besides drawing on the 60 per cent share of its parent companies in ARAMCO, an exclusively American enterprise in Saudi Arabia, Caltex's subsidiary, the Bahrein Petroleum Company, operates oil fields and a refinery in Bahrein, which is in the sterling area and defrays its local expenditures and royalties there in rupees. Its operations resembled those of British-controlled companies in so far as Caltex turned its dollar earnings (e.g. from Bahrein sales to the United States Navy) into the British Treasury and received a dollar allotment from it for its dollar expenditures to ARAMCO and on Bahrein operations. Still under the British formula, all of its oil was to be treated as dollar oil.

The Standard Oil Company of New Jersey proposed to set up a new subsidiary under British law; sell to it Venezuelan, Iraqui and Arabian crude oil for sterling at special prices; and convert into dollars 50 per cent of its gross sales proceeds after taxes.[24] This powerful company which, beside its large market share, plays an outstanding role in Britain's refinery expansion program (its subsidiary, Anglo-American, is expanding the capacity of the Fawley refinery from 1 million tons per year to 5 1/2 million tons) found itself in a less favorable position in the dollar oil conflict than Caltex, since most of its foreign supplies consisted of dollar expensive oil from Venezuela. Gulf was in the most favored position of all American companies. The bulk of its crude oil

[23] Derived from ECA estimates presented to Senate Foreign Relations Committee: *Extension of European Recovery—1950*, Washington, D.C., 1950, p. 61.

[24] Neither the Caltex nor the Standard proposal has been published in sufficient detail to permit a satisfactory judgment of their provisions and implications. For a summary of the Standard proposal, see *Journal of Commerce*, February 2, 1950.

output in Kuwait, and a large part in Venezuela, is sold to Shell for dollars under a long-term contract, and this contract was left intact under the British measures. The company played no active role in the dollar oil conflict.

The British Government did not accept either of the two sterlingization proposals for dollar oil as a basis for reconsidering the substitution order. It only postponed the effective date of the order to February 15, 1950. In the February Memorandum, the British declared their opposition to any:

(a) accumulation of blocked sterling by American companies—because "there is, naturally, continuous pressure for conversion, direct or indirect, and the existence of additional balances of this kind, even when effectively blocked, impairs the strength of sterling";

(b) use of sterling earnings for investment purposes in the sterling area—because "they involve us in a recurring dollar liability in respect of profits and dividends, and ultimately, in some cases, for the repatriation of capital";

(c) use of earnings for purchases of an uncontrolled variety of sterling-area goods:

(i) for consumption in the sterling area—because "United States companies operating there are, like British companies, expected in any case to switch their procurement from dollar to non-dollar sources whenever possible"; or

(ii) for export—because Britain does not want to encourage United States companies "to go in for merchanting to U.S.A. sterling area goods which can be sold there anyway."

Britain offered, however, an "*incentive program*" to the American companies to recoup their market shares lost through substitution without earning additional dollars. The companies might sell more oil for dollars, i.e. for sterling acceptable for conversion into dollars, if they bought with dollars certain sterling area products for their own current use, the list of purchases to be determined by negotiation. While assuring the American companies of "the same access to materials, equipment, etc., and the same priorities as the British companies," the British government insisted that the purchases must be "additional" according to some formula to be found by negotiation. Britain also offered "*British company treatment*" to American companies (1) operating mainly in the sterling area, (2) resident, registered and taxable in the United Kingdom, that would (3) lower substantially the overall dollar cost of their operations to Britain. This "treatment" meant non-discrimination inside and outside the sterling area. In a later memorandum, June 1950, the British government specified that exemption from substitution could be

obtained for American oil with a dollar content not exceeding the *gross* over-all dollar component of British oil (30 per cent), and "*British company treatment*" could be granted to American companies meeting the *net* average dollar component of British oil (15 per cent).

The British government offered to avoid additional restrictions on imports of dollar oil products into the sterling area—beyond those referred to above—until 1952, and it did not put in question the full convertibility of earnings arising from sales within the set limits; but it indicated that as supplies became available the substitution might be shifted increasingly from fuel oil into the more profitable gasoline trade.

Regarding the attempts of American companies to sell oil for sterling outside the sterling area, the British government stated that the difficulties experienced by the American companies there were solely due to the dollar shortage, for which "the United Kingdom is not responsible," and which it could not be expected to alleviate.

The reaction of the affected American companies to the British offensive was, first, to contest the validity of the motive to save dollars and, second, to offer various counterproposals. The companies held that the saving of $50 millions of dollar outlays per year which the British hoped to achieve through substitution could be made without curtailing their market shares. American oil from the Middle East could be supplied at a dollar cost far below that of the British companies in Venezuela, if Britain only permitted the use of sterling by the Americans for royalty and other payments. They argued that the marginal dollar cost of the sterling oil to be used by Britain for the substitution should not be compared with the average dollar cost of dollar oil, but with the dollar cost of the marginal quantity that they would be ready to supply if substitution were rescinded. Standard (N.J.) and Caltex made proposals to Britain, never fully presented in public, that provided for the sale of the marginal quantities to their British subsidiaries for sterling, on the condition that only part of the earnings of the subsidiary would be claimed in dollars. For the British "*incentive program*," the American companies had no use at all since they did not wish to spend dollars to buy sterling goods.

The State Department actively supported the protests of the American companies and suggested to the British that "American companies be permitted to compete to sell oil for sterling in the sterling area and in third markets to the extent that their own oil has been displaced. . . . For such sales, they would receive in dollars the average dollar cost of producing an equivalent amount of sterling oil, and the remaining sterling would have to be used for certain types of expenditures in the sterling area. It could not be accumulated in burdensome amounts."[25]

[25] Testimony of Willard L. Thorp, Assistant Secretary of State, April 5, 1950, *Effects of Foreign Oil Imports*, p. 100.

This suggestion meant "*British company treatment*" for 30 per cent dollar oil.

Meanwhile, Britain's measures came in for sharp criticism in Congress. In January 1950, Senator Tom Connally of Texas, chairman of the Senate Foreign Relations Committee, called them "a British act of hostility directed at our economy," and advocated the withholding of ECA allocations to Britain until she ceased to discriminate against dollar oil. Criticism of Britain's oil policy became part of a wave of discontent with British economic policies and political developments that swept over the United States political stage in 1949 and early 1950. "It's ideology, not economics, that guides British oil policy," exclaimed an editorial in a New York financial newspaper.

ECA did indeed suspend assistance to expansion projects of the British oil industry, but no rash measures were taken to withhold allocations to Britain in general. Such action might have led to a further cut in British dollar oil purchases besides straining insufferably the relations with our main ally abroad. Moreover, the British effort of dollar saving deserved sympathetic consideration since it had been advocated in a general and emphatic manner by the United States government itself. Even if that purpose could not be found to validate the British oil policy in a short-run sense—and that was the contention of the American companies—it might justify it in a long-run sense. British companies undoubtedly have greater potentialities of dollar saving in the long run. A drastic curtailment of the dollar-expensive operations of Shell in Venezuela, informally suggested by the American companies, would not necessarily be a sensible long-run alternative to Britain since output from that source is largely sold in dollar markets and probably produces net dollar earnings for Britain. These earnings could be raised further by increased sales in North America on the one hand and by a conversion of dollar into sterling outlays in Venezuela on the other, provided the Venezuelan government agreed to it, that is to say, were ready to shift some of its imports from the United States to Britain.[26]

It is noteworthy that the conflict over the markets for dollar oil did not lead to any price war between the American and British companies. The supply and demand situation in 1949 for crude oil seemed to call for a lowering of the price; but the strategic United States price remained at the level reached during the shortage period at the end of 1947, 126 per cent above the 1945 average, and the price of crude in

[26] Actually Shell's output in Venezuela, like that of American companies, was somewhat less in 1949 than in 1948 and was reduced further in February 1950, as a reaction to the threat of import restrictions in the United States. But total Shell imports into the United States rose substantially throughout 1949 and 1950, in fact at a higher percentage rate than the imports of American companies. (*Effects of Foreign Oil Imports*, p. 27.)

Europe was lowered only slightly, by about 13 per cent from mid-1948 to September 1949, as a result of shifts of the "price equator" of Caribbean and Persian Gulf crude oil westward across the Atlantic toward the Eastern seaboard of the United States.[27] Product prices weakened, however, particularly for fuel oil.

The devaluation of sterling in September 1949 was not used by the British companies to attempt an underselling of their American competitors, nor was it used by the latter to keep the British from raising their profits on sterling oil. Dollar prices remained unchanged and sterling prices were raised to maintain price equality. After devaluation, from August to November 1949, the domestic price of fuel oil in the United Kingdom and the Netherlands rose by 34 per cent, in Belgium by 6 per cent.[28] In India and other devaluing countries the price of imported oil, sterling and dollar, apparently rose by 44 per cent. It seems that neither side expected to gain markets by unilateral price concessions. Both maintained price discipline despite the sharp conflict between them. Thus the world "oil surplus" of 1949 was accompanied by rising oil prices in many foreign markets and constant crude oil prices in the United States. Net earnings of leading oil companies fell, in this country and in Britain, without however lowering dividends, and investment outlays were curtailed by the American companies, but not by the British.

III. OIL AND ECONOMIC POLICY AT HOME

We shall now turn to the conflict over oil imports into the United States that developed in 1949. Imports of crude oil continued their rise throughout the year and into 1950 despite the stagnation of the domestic market. From 1948 to 1949 they increased by 3 1/2 million tons, or 20 per cent, and onward to the first five months of 1950 by a total of 5.4 million tons (annual rate), or 30 per cent above 1948.[29] Imports of residual fuel oil (heavy heating) increased from 1948 to 1949 by 2.9 million tons (40 per cent), and to early 1950 by a total of 8.7 million tons, or 119 per cent above 1948. Almost all United States oil imports presently come under these two categories.

Simultaneously, the domestic production of crude oil was curtailed by 23 million tons from 1948 to 1949, or by 8 per cent; to early 1950, by

[27] The "price equator" is the geographic line at which delivered prices from the two sources are equal. For refined products, the equator still seems to rest somewhere in the Mediterranean. Source: *Effects of Foreign Oil Imports on Independent Domestic Producers; Hearings*, House Select Committee on Small Business, 81st Congress, 1st Session, part 2. Washington, D.C., 1950, p. 539 and *passim.*

[28] United Nations, *Economic Bulletin for Europe*, Third Quarter 1949, vol. 1, no. 3, p. 9. In France, no price change was registered.

[29] American Petroleum Institute, *Statistical Bulletin*, June 19, 1950, and later reports.

9 per cent. This curtailment was administered by the State conservation authorities, in particular the Texas Railroad Commission, through a lowering of "allowable production" and prorating.[30] It affected all oil companies operating in the United States, including the domestic elements of the large American companies operating abroad and importing.[31] While the domestic output losses of the importers were cushioned by growing imports, the exclusively domestic concerns, the so-called Independents, felt the full weight of output restrictions. From their ranks sprang a movement to restrict imports, sponsored by senators and representatives from several oil states.

1. Controversy over Oil Imports

In May 1949, General Ernest O. Thompson, chairman of the Texas Railroad Commission, proposed that a quota be imposed to keep imports of crude oil and refined products from exceeding 5 per cent of the domestic market demand that obtained in the same quarter the year before.[32] The Thompson quota appeared in proposals to amend the Reciprocal Trade Agreements Act and the Tariff Act, sponsored by Senator Elmer Thomas of Oklahoma. Simultaneously, several bills were introduced in the House designed to raise the excise taxes on imported oil; e.g., one by Representative Gossett of Texas aimed at a tax of 2 1/2 cents per gallon for crude and fuel oil.[33] Representative Patman and Speaker Rayburn, both of Texas, urged President Truman to invoke the escape clause in reciprocal trade agreements with Venezuela and Mexico to make higher excise rates on imported oil possible.

Extensive hearings held by the Subcommittee on Oil Imports of the House Select Committee on Small Business brought to light that many

[30] The overt purpose of this output control is to serve "the best principles of conservation." Effects on supply and price are of course unavoidable, even if they are not intended.

[31] The domestic elements of these companies typically are much bigger than the foreign, and they also form an important part of total domestic crude oil production. In 1938, the ten major importers owned one-third of domestic crude production. TNEC, Monograph No. 39, *Control of the Petroleum Industry by Major Oil Companies.*

[32] If this quota had been in effect in the first quarter of 1950, imports would have been about one-third of what they actually were.

[33] Import prices for crude recently were at 4 1/2 to 5 cents per gallon, for residual fuel at 3 1/2 cents per gallon.

Oil imports are not subject to customs duties, but since 1932 imported oil has been charged an excise tax. The original rates of that tax were lowered through international agreements in 1942 and 1947 to 1/4 cent per gallon for crude oil and heavy fuel oil, 1 1/4 cents per gallon for gasoline, and 2 cents per gallon for lubricating oil; these are the rates now in force. The rate on crude and fuel oil imports that exceed 5 per cent of United States refinery consumption during the preceding year will double automatically when the present trade agreement with Mexico expires at the end of 1950, unless some new trade agreement restores the situation.

"independent" producers wanted import restrictions to gain relief from restrictions on their crude oil output. They were supported by the governors of the oil states. The National Petroleum Council, an advisory body of the industry with the Department of the Interior, issued an ambiguous statement in early 1949—"imports should supplement, not supplant domestic production"—but later in the year, a committee of the Council declared that the "sharp increase in imports has hurt the domestic industry." The major importers, however, denied that imports were "supplanting" domestic production—except for two, Cities Service and Standard of Indiana, who do not produce oil abroad. The majors claimed that imports were "supplementary," reasonable, and subject to long-range plans that could not be changed to fit temporary market situations. They recalled the active support of the United States Government to their oil development projects in the Middle East and noted that the markets for this oil in the Eastern Hemisphere were now endangered by the dollar shortage and the British measures. While some of the major companies announced downward revisions of their import plans, nearly all of them continued to raise their imports in 1949 and early 1950, chiefly from Western Hemisphere sources.[34] In 1949, the tonnage of import increases over 1948 had been less than one-third of the curtailment of domestic crude output. But from 1949 to the first 5 months of 1950, total oil imports rose by nearly twice the tonnage of the additional curtailment of domestic crude.

The importing companies found strong support in the State Department. Pointing to the involvement of important American oil concessions abroad and to the vital importance of Venezuelan dollar earnings from oil for American exports to Venezuela and for the economy of that country in general, the Department opposed the demands for import restriction.[35] The Department of the Interior and the Defense Department gave less emphatic support (see below). Consumer interests were not aroused by the threat of import restrictions on crude oil since the importing companies did not hold out promises of lower prices through imports, and other business interests showed rather little concern about the crude oil situation.

The case of fuel oil aroused stronger reactions in the business community. On the one hand, fuel oil distributors felt dependent on larger imports because of the tendency of the domestic industry to turn out as little heavy fuel as possible and to produce instead greater proportions of the more profitable lighter products, gasoline, etc., through more

[34] *Effects of Foreign Oil Imports*, p. 27.

[35] Of late, 90 per cent of Venezuela's foreign exchange and more than two-thirds of her government's receipts were derived from oil operations. In 1949, Venezuela was our fourth largest market for commodity exports in general.

elaborate refining. With domestic consumption of residual fuel oil holding up well in the latter part of 1949, stocks declining, and imports making up as much as one-third of the total supply on the Eastern seaboard, the distributors expected prices to rise considerably if the inflow of fuel oil from abroad were to be curtailed. They sided with the importing companies.

On the other side, in early 1950 the Independents suddenly found new allies in the coal industry. The national coal strike of September 1949 had accelerated the conversion of railroads to diesel traction and, together with other factors, stimulated a considerable expansion of oil and gas home heating, partly at the expense of coal heat. Coal companies, coal carrying railroads, John L. Lewis's Mine Workers and some railroad unions joined hands and attacked the "dumping of foreign oil." "Every barrel of foreign oil brought into this country means one less barrel of oil that can be produced in this country," said one of the Oklahoma Oil Independents. "A million barrels of dumped foreign residual oil would displace 250,000 tons of coal and 250 mine workers," said the National Coal Association.[36] Senator Matthew Neely of West Virginia opened hearings aiming to protect the coal market by making fuel oil scarcer. There the attacks of the coal interests on the import and price policies of the large oil companies clashed with statements by the latter that fuel oil had not displaced coal in 1949, but that both coal and fuel oil had been displaced by natural gas in homes and utilities and by domestic diesel oil in railroads. Indeed, the advance of natural gas pipelines to the East coast threatened the outlook for fuel oil, held its price down and possibly foreshadowed some limitation of the imports of residual fuel in the future. But coal state senators felt that oil should take the loss now, and one suggested that fuel oil imports be taxed at a higher rate than imports of crude.

2. *Facets of National Oil Policy*

The struggle over oil imports, paralleled by the conflict with the British, was conducive to statements of national oil policy. Such statements came forth from the Departments of Defense, Interior, and State, ECA and other agencies. None of the agencies was prepared to favor either domestic or foreign (although American-produced) oil supplies under conditions of a stagnant domestic market. Statements of preferences were conditional, and some statements implied the hope that no choice would have to be made at all. This optimism was justified by the later developments of 1950.

[36] *Effects of Foreign Oil Imports*, pp. 47 and 49.

The Defense Department indicated that it gave highest priority to oil development in the continental United States, second to the Western Hemisphere, and third to other world areas.[37] Assuming a long period of relative peace, it would favor maximal shut-in reserves in the United States and the current use of supplies from distant areas. This might mean relatively low crude production but continued exploration at home (which would not harmonize easily) and sizable imports. But preparedness for an early conflict, in the Department's view, would require a high level of developed production in the several areas, in accordance with their priority rating (that is, preferably at home) and a level of imports that would not endanger that objective. Taking the short-term outlook at the time, the Defense Department favored a "reasonable balance for the Western Hemisphere between imports and exports," that is, between imports from the Near and Far East and exports to the Eastern Hemisphere. Curtailment of imports from the Eastern Hemisphere into the United States was not opposed; but a reduction of imports from the Western Hemisphere sources was held dangerous.[38]

The Department of the Interior felt "that it is possible to import too little as well as too much," and that there was at that time "no evidence to indicate that we are importing too much." It suggested that the high rate of drilling activity in the United States showed the health of the industry. Indeed, drilling and completion of new wells remained at record levels in 1949, despite output restriction. But there could be some doubt whether this reflected the health of the oil industry or the income tax rules applying to it. In computing taxable income, oil producers may deduct 27 1/2 per cent of their gross income as an allowance for depletion, plus the amount of their expenses on new drilling.[39] Moreover, new wells come under prorating rules only after about one year of operation. These are powerful incentives to new oil development, even in times of a slack market, at least as long as prorating prevents a lowering of crude oil prices.

The State Department held that the domestic oil industry had not been seriously injured by imports in 1949/50, and the Department of Commerce added that the leveling off of domestic demand, the decline of exports, and the transition from stock building to withdrawals from stock were more important factors. Finally, ECA revealed its difficult position as an agency aiming simultaneously at a greater independence

[37] Testimony of Rear Admiral Burton B. Biggs, June 15, 1949. *Effects of Foreign Oil Imports*, pp. 93-94.

[38] See in this connection Bernard Brodie, *Foreign Oil and American Security*, Yale Institute of International Studies, New Haven, September 15, 1947.

[39] The Administration's request to lower the oil depletion allowance to 15 per cent of gross income *after* deduction of development expenditures was not heeded by the Congress in 1950.

of Europe from dollar oil supplies and at the maintenance of market outlets for American-owned oil. The latter seemed very difficult in the long run under a persisting dollar shortage, although the oil companies conceivably might be able to deflect the effects of the dollar shortage from themselves to other American exporters. The agency explained that it was trying "to follow a balanced approach" and argued convincingly that, in the absence of its aid, the foreign markets for dollar oil abroad would have shrunk much faster.[40]

The problems of formulating an American oil policy thus appeared in their full complexity—or almost so: little attention was given to the oil price and to the issue of cheapening oil for American consumption by relying on low cost sources. This consideration would strongly favor greater imports from the Middle East, where oil still is produced at so much lower cost than in the Western Hemisphere that it could overcome the disadvantage in transportation.[41] (In the Eastern Hemisphere, likewise, the cost advantages of Middle East oil probably could be translated into greater price reductions than made hitherto; and ECA has pressed for action in this direction.) It appeared that the relevant area to which policy is to be applied is in flux, with the continental United States, Canada (rapidly increasing her oil output), the Caribbean area, and, finally, the Middle East attracting varying emphasis on the supply side; the United States and Western Europe on the demand side. The total national fuel situation is in flux, with natural gas pressing on oil and coal, and with synthetic liquid fuel from shale, if not from coal, gradually becoming competitive.[42] The structure of the oil industry is in flux, in terms of refining policy, regional specialization, etc. All these problems were raised simultaneously by the joint crisis of dollar oil abroad and oil imports. The material gathered by the Congressional hearings on these issues gave a broad view.

The issues were not resolved by drastic decisions. By the time they had been clarified they had lost their urgency. Oil demand in the United States resumed its increase, Britain's dollar position improved, and the beginning of a rearmament economy in the later part of 1950 even eased the position of the domestic coal industry. We must now turn to the resolution of the conflicts.

[40] See also Walter J. Levy, "Foreign Oil Development and the World Dollar Shortage," address to the American Institute of Mining and Metallurgical Engineers, February 13, 1950.

[41] It is interesting to note that Canadian imports of crude oil from the United States and Venezuela declined by almost 1 million tons from 1948 to 1949 while those from the Middle East rose by 700,000 tons. This suggests some substitution.

[42] According to the Bureau of Mines, (July 4, 1950), the production cost of a gallon of oil from coal is 10.8¢, from shale 7.3¢, which is said to be close to the price based on crude oil.

IV. RESOLUTION OF CONFLICTS

1. Bogus Oil Surplus

In more than one way, the oil surplus of 1949/50 seemed absurd. The formation of a 50 million ton shut-in production reserve in this country was not unreasonable; in some respects it was desirable. The expansion of sterling oil production that made the displacement of dollar oil possible abroad was desirable in itself and expected, although the displacement was not. To interpret the difficulties of selling dollar oil abroad and their reflection in this country as signs of an oil surplus seemed fantastic indeed at a time when the rest of the world was consuming oil at a rate of 197 Kwh. per capita per year to the United States' 4,832 Kwh.;[43] when the per capita oil consumption of the United Kingdom was less than one fourth of ours, that of ERP Europe as a whole less than one tenth, that of India little more than one two-hundredth; when strict import quotas and gasoline rationing were in force in many countries; and when high oil prices—even before taxation—were holding demand in check in the United States and abroad. To prepare for a long-run reduction of oil production in this country, Venezuela, or the Middle East or to stop the expansion of either the American or the foreign companies seemed a desperate course of action—real failure of economic statesmanship.

We came rather close to such a failure. The loss of expansive impetus in the world economy in 1949, particularly in the United States, the lag of an aggressive approach to economic development in Asia, Africa, and elsewhere, and the pressure for dollar saving provoked by the prospect of declining foreign financing from the United States did create an unfavorable climate for the oil industry. Output was restricted in Venezuela and Arabia, foreign investment of American oil companies was curtailed—although the decline was cushioned by long range commitments—while the domestic price of crude oil was kept at the shortage level of 1948, that of gasoline above it, and foreign oil prices were raised in the process of devaluation. Vast demand potentials in many countries remained locked up. Both the international and domestic conflicts arose over shares in restricted markets, but the forces that had caused the restrictions received less attention than the possible advantages that competitors might find under the restrictions. There was danger then that the prospects of economic improvement would be lost in mutual recrimination and that political instability would be increased in the Caribbean and the Middle East areas.

[43] *World Petroleum,* February 1950, p. 29. Figures are for 1948. For energy derived from coal the inequality is considerable too but not quite as great as for oil, i.e. 6,205 Kwh. per capita for the United States, 742 Kwh. for the rest of the world.

2. Demand Improves—Import Problem Solves Itself

During the winter of 1949/50, it had become obvious that the contraction of the domestic refiners' margin would either make necessary a lowering of the price of crude oil or a raising of the price of gasoline. In April 1950, the major companies raised the gasoline price. Growing numbers of cars on the road and in production promised greater consumption. Likewise, rapidly growing sales of domestic oil heating equipment and railroad diesel engines in early 1950 promised a faster growth of distillate fuel oil sales. Official and private estimates of the rate of increase of domestic oil consumption for the year were boosted by more than 50 per cent within a few months. The Texas Railroad Commission increased the monthly allowable production of crude oil steadily, from a low of 1.9 million barrels per day in March to 2.8 million in September 1950, and the market took rising quantities of crude at the stable price, in the form of higher-priced refined products. By June 1950, the Eastern refiners' margin had risen by 50 per cent above the January level, i.e., to 86¢ out of an average price of $3.48 per barrel for the major refined products; and the quarterly earnings of 30 leading companies were 15 per cent higher than a year before, after having been 16 per cent below that standard in the first quarter of 1950. Thus the renewed updrift in the national economy found its reflection in the oil industry.

At the time of the Korean invasion the problem of oil imports was about to solve itself. It was buried by the new events. At once demand rose sharply on the West Coast and heavy fuel oil prices went up; within a few weeks the Texas Independents publicly withdrew their opposition to oil imports. Since, at the same time, the demand for coal increased spectacularly, the anti-import campaign lost all support. The votes of House and Senate committees turning down proposals to increase taxes on oil imports in June and July, came as an anticlimax. In its July report on the investigation of the import problem, which drew wide praise, the Keogh Committee wisely counselled against rash restrictive measures. Of course, the development encouraged oil production in Venezuela.

But in the midst of the disintegration of the protectionist movement, a boon fell to its protagonists. On the day before the Korean invasion, the State Department cancelled the trade agreement with Mexico and thereby invalidated its tariff-lowering provisions, which affected imports from all sources through the most-favored-nation clause. The reasons for the Department's actions were far removed from oil protectionism. They lay outside the field of oil entirely. But unless new measures are taken, 64 per cent of United States oil imports will pay a tax of 21¢ per barrel beginning January 1, 1951, instead of 10.5 cents. Ironically, this bit of protectionism will come into effect at a time when

we may be closer to an oil shortage than to a surplus. For as early as August 1950, the domestic crude oil output broke previous records and refineries approached capacity operations, while ahead there loomed further demand increases as well as the possibility of a slowing down of the gas pipeline building program. Import restriction failed, but an additional cost factor slipped into the oil price structure.

3. Compromises on Dollar Oil Abroad

In early June, *The Economist* commented: "Where trade expands, interests can be reconciled." The reconciliation of American and British oil interests began in May 1950. It proceeded piecemeal, company by company, in relation to various occasions and markets and on different terms. A general settlement on matters of principle was not reached; and the conflict may flare up again at some future time.

The summary table of agreements (Table 4) may help to put the development into perspective. The series opened with the Stanvac agreement, which conceded sterling oil treatment inside, but not outside, the sterling area to the American company for its production in the East Indies, and wide freedom in the use of its sterling earnings. Part of these earnings will accrue to the Indonesian government. The agreement remained notable for the low dollar conversion allowance set as the target. In past years, Britain used to convert 50 per cent of the company's sterling earnings into dollars. While this agreement broke the ice, it could not be regarded of major importance, since the company always enjoyed a relatively favorable position with Britain, owing in part to its marketing of Anglo-Iranian oil.

The derationing of gasoline in Britain brought an altogether new element into the picture. Following by a few days upon the defeat of a motion by the opposition to increase the gasoline ration, the abolition of rationing opened the way to an increase of consumption. Sharing of the two important American gasoline suppliers in the increase was both a prerequisite for the move—British companies did not have enough gasoline to spare—and an opportunity to break the deadlock in the Anglo-American negotiations. The agreement was advantageous to Britain in so far as it did not involve any dollar outlay whatever on the additional supplies from American companies—the corresponding additional supplies from British companies did—and required direct spending of the companies' sterling in Britain. Nor did the agreement affect the substitution program, except in so far as it lowered further British company supplies available for substitution. New Zealand and India (urban areas) were soon to follow Britain's example. Estimates of the consumption of ration-free gasoline at higher prices naturally were tentative.

With the third agreement, on oil drawn from Iraq, the meeting of minds entered the critical Middle East area. This agreement gave the British subsidiaries of the two affected United States concerns *"British company treatment" inside* the sterling area and conceded the conversion into dollars of their net earnings after taxation. Selling Iraq oil *outside* the sterling area, the two American companies can earn as much sterling as they can pass on to the Iraq Petroleum Company in payment for crude oil, the sterling share in such purchases not to exceed 75 per cent. The Iraq Petroleum Company's dollar earnings benefit the dollar pool of the sterling area. This has been the only agreement lifting the ban on sterling earnings by American companies outside the sterling area. It was the first to bring a tax advantage to the British government, for it placed the entire profit element in the internal price structure of the companies —as far as sterling area sales are concerned—within the reach of the British income tax.

The fourth agreement was of critical importance. It permitted the major American producer in the Middle East to dispose of sterling and thus opened the way for its four parent companies to utilize sterling in large amounts. Aramco is entitled to pay in sterling up to 25 per cent of its royalties to the Saudi Arabian government, now estimated at about 22¢ per barrel. Its concession contract allows for sterling payment; but the sterling equivalent of the "gold shilling" is not fixed and will have to be bargained out, as the dollar equivalent had previously. Agreement was also reached on the purchase of various sterling goods for the company's operations.

On the basis of this compact, two of Aramco's parents, organized in Caltex, concluded the fifth agreement. It is patterned on *"British company treatment."* The mixture of Bahrein and Arabian oil produced by the company in Bahrein can be sold inside the sterling area through a new operating subsidiary of Caltex in Britain. Caltex (U.K.) Ltd. will acquire supplies from the parent partly for dollars, partly for sterling. Dollar claims on the United Kingdom arising from the subsidiary's oil purchases and from the transfer of its profits after taxation are to be reduced to about 30 per cent of the value of the products by 1952. Tankers are now being built in Britain for the Bahrein trade, and their utilization is expected to sterlingize the freight charges in a few years' time. Other sterling income is to be used in Bahrein, or passed on to Aramco, or spent elsewhere on sterling goods. The agreement seems quite favorable to the operation of the American concern in the sterling area but makes no provision for sales outside the area for sterling.

These agreements reduced the disabilities placed on American company oil abroad and restored an estimated 1.5 million tons of the loss suffered through substitution. Also, in the spring, Standard (N.J.),

TABLE 4

BRITISH-AMERICAN OIL AGREEMENTS, SUMMER 1950

U.S. Companies Affected	*Date of Announcement*	*Affected*			*Estimated Quantity Covered, Tons Per Year*	*Provisions*
		Source of Oil	*Type of Oil*	*Market for Oil*		
1. Standard-Vacuum	May 23	Indonesia	Any	Sterling area East of Suez	About 2,500,000 from Indonesia, including 500,000 affected by substitution; plus marketing of Iranian oil.	About 85 per cent of company's marketing, customarily sold in the sterling area for sterling, to be treated as "sterling oil." Percentage of Stanvac's conversion of sterling earnings into dollars to decline from 40 to 15 per cent in 2 to 3 years.
2. Standard N.J. and Caltex (Derationing of gasoline in Britain)	May 26	Any	Gasoline	United Kingdom. Addition to previous import quota.	400,000-500,000 rising to perhaps 700,000 as other sterling area countries deration.	Sale for sterling, earnings to be spent on tanker construction, sterling area goods, refinery construction in Britain. No conversion into dollars allowed. Other sterling area countries permitted to make similar arrangements.
3. Standard N.J. and Socony-Vacuum	June 9	Companies' 23.75 per cent share in I.P.C.	Crude and products	Inside and outside sterling area	Companies' total share in Iraq crude: about 1,500,000. Uncertain how much of this involved.	Sales within sterling area to be handled by British subsidiaries, buying parents' share in Iraq crude at cost price for sterling, sell-

						ing for sterling and converting full profit after taxation into dollars. Sales outside sterling area permitted for sterling to extent of 75 per cent of the crude cost price paid to I.P.C., a British concern. Remainder of cost to be paid in dollars.
4. Aramco	July 7	Saudi Arabia	Crude and products	Parent companies	Unlimited (Total 1950 production may be 24,000,000)	Up to 25 per cent of royalties may now be paid in sterling, to be obtained from parent companies under agreement (5), possibly (2), and future agreements. Sterling commodity purchases planned.
5. Caltex	July 18	Bahrein (2/5), and Saudi Arabia (3/5) from 60 per cent share in Aramco.	Products refined in Bahrein	Sterling Area	3,500,000, including about 1,000,000 affected by substitution	"British company treatment" inside sterling area. British Caltex subsidiary to sell for sterling, buy Bahrein and Arabian oil for sterling and dollars, with dollar share to decline to about 30 per cent. Percentage includes conversion of subsidiary's profit after taxation. Equipment, tankers ordered in Britain.

Texas and Socony recovered part of the Argentine market in a setting marked by difficult Anglo-Argentine trade talks and the provision of a $125 million Export-Import Bank loan to Argentina. The substitution provisions for Standard (N.J.)'s Arabian and Venezuelan oil in the sterling area remained in force. But with the improvement of the world oil market in 1950 this limitation was less painful to the company and probably also largely ineffective.

To Britain, the agreements brought increased opportunities for shipbuilding and other production for export markets, fiscal gains, and a program of gradual reduction of dollar outlays on at least part of the American companies' oil sold in the sterling area. The bulk of American company sales, not affected by substitution, continue to require full dollar payment. Her shipyards were set to build several tankers for American companies while the last tanker under construction in the United States was approaching completion. (Some dollar savings and trade advantages also fell to France and Italy when some American companies agreed to accept more francs and lire for local purchases.) It is next to impossible to determine whether Britain saved/earned any dollars during the foreshortened period of restriction, compared with other courses of action that she might have taken; but under the conditions developing in 1950 the agreements proved quite advantageous. They made some American oil supplies available to Britain that she would have had to buy anyway, at a reduced cost in dollars. Of course, to the extent that Britain succeeded in raising claims on her exports, through the sterlingization of American company spending, the intervening change to boom and rearmament conditions may sour the fruits of victory. Export outlets are likely to lose priority to some extent as Britain's rearmament gets under way, and even dollar saving and earning may for a while become less urgent concerns.

To the oil producing countries of the Middle East, in which American companies hold concessions, the developments brought a renewed expansion of output and of the income derived therefrom. Like the concessionaires themselves, they were now to affect some shift of imports to European sources. Employment of American personnel declined.

Although the principles of dollar oil treatment as announced in the "February Memorandum" were compromised in the agreements and modified in a later British Memorandum to the State Department,[44] they were not abandoned in favor of a broad agreement on non-discrimination in the oil trade. This is a fact of long-run significance.

4. *Renewed Expansion into Uncertain Future*

The progressive improvement of the oil market and the easing of the tensions discussed above stimulated further expansion in various sec-

[44] See *Journal of Commerce*, June 23, 1950.

tions of the oil industry abroad. Pipe line projects in the Middle East and refinery construction in Europe are being speeded along. Expectations of high demands in the near future are leading the American companies to increase their stake in production outside the United States. A return of the slack market does not seem imminent; but it may happen again. The experience of the recent conflicts points to some of the problems that may be anticipated for such a time.

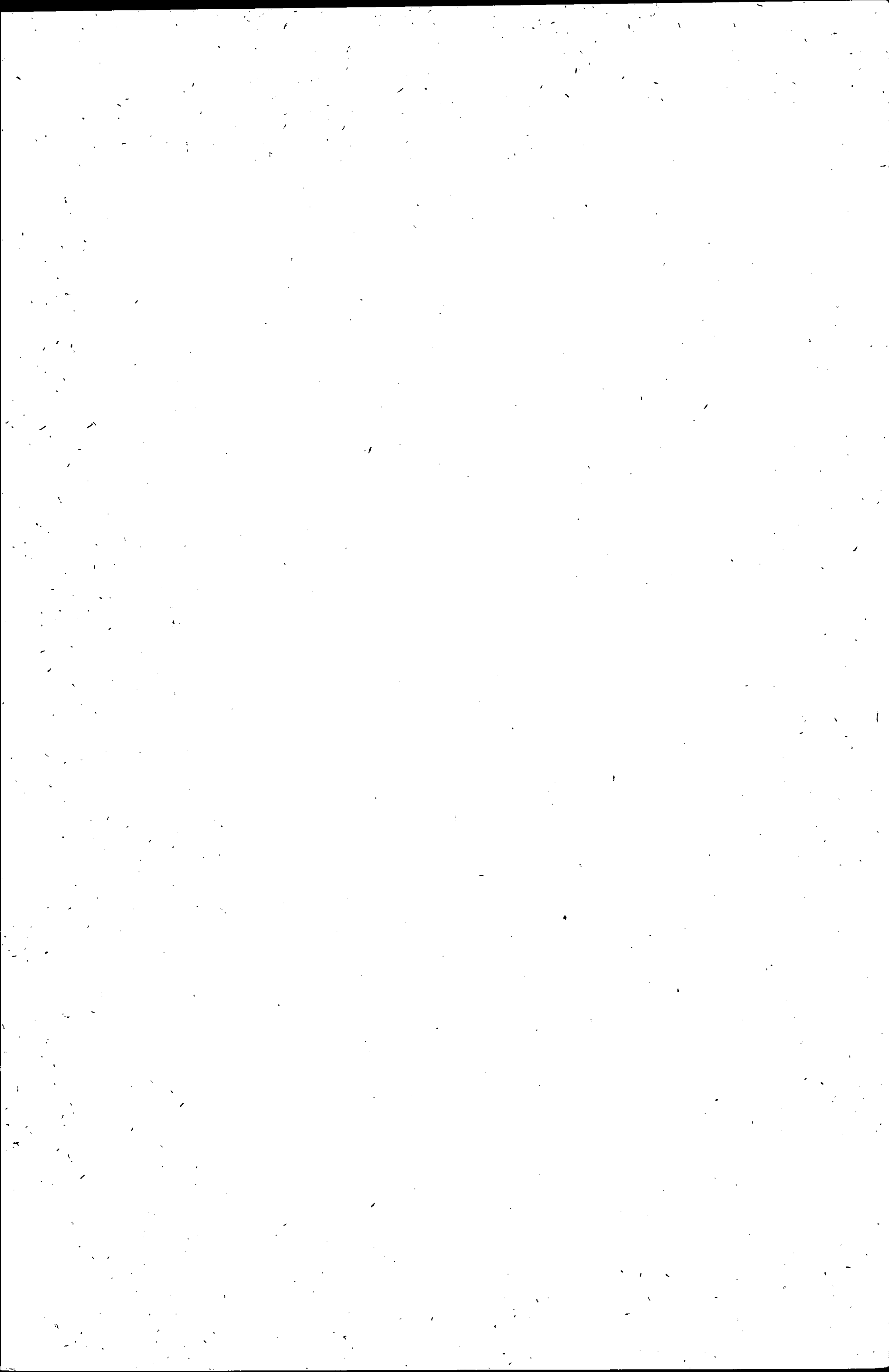
There is no indication that Britain will forsake reliance on her powerful oil industry to bolster her foreign trade and exchange position. Should this position weaken again in relation to the dollar area, Britain is likely to apply her control over the financial and commercial policies of the areas politically and economically affiliated with her to restrict operations of American oil companies that cause dollar outlays to her. Since in the long run British companies have greater possibilities to free themselves of dollar expenditures, and since the affected trade is a very sizable one, the American companies run the risk of losing market outlets, or at least the profitability of the markets in dollar terms, and of finding their foreign investments in jeopardy, particularly in crude production. There is also the danger that such difficulties abroad may coincide with a slack oil market at home and a renewed resistance to the importation of oil from their foreign properties.

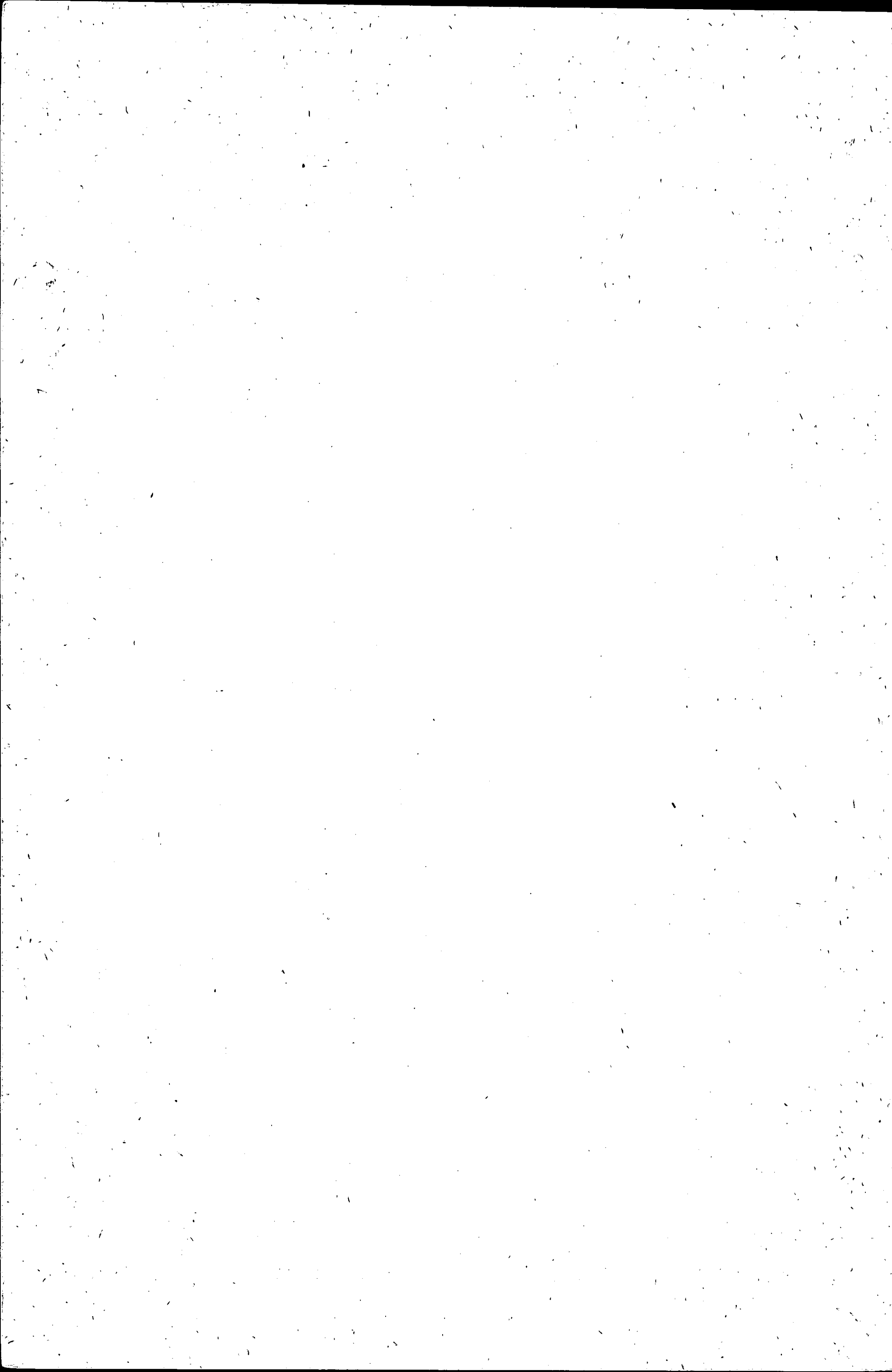
In maintaining and increasing their foreign operations, the United States companies are relying on a long-run development toward a freer convertibility of European currencies and dollars, in so far as they are not counting on the increasing absorption of their foreign output in the domestic market. Such a development seems likely only under a continuing and ever closer economic cooperation between the United States and the European countries and a relatively ample and predictable dollar supply to the outside world. Whether this supply will be provided by our foreign commerce and lending or by arrangements of international redistribution of dollar purchasing power does not matter here. The international oil companies cannot expect to maintain their position abroad over a period of systematic restriction of foreign dollar resources and dollar spending. As sellers of a dollar commodity and ultimately even as holders of dollar investments abroad, their position would prove vulnerable.

This suggests a rationale for the recent Anglo-American disagreement on oil. The American companies had reason to be disturbed over the British tendency to tighten rather than loosen the controls dividing sterling from dollar oil, particularly at the time of a slack domestic market for oil; the British in turn had reason to be disturbed over the possibility of a failure to exploit their long-run international advantage in this field, which is needed to offset their disadvantageous position in

food and other fields. It was the renewed expansion of world demand for oil and of general economic activity, chiefly in the United States, that made it possible for the British to realize their advantage without causing a net loss of markets to the American companies. Without the intervention of those events, both parties might have lost and their conflict might have become even more disturbing.

The problem of dollar oil abroad is partly a problem of economic integration in the Atlantic community and of a productive contribution of that community to economic development in other parts, partly a problem of steady growth in the United States economy. When progress in these directions seemed to slacken in 1949, the foreign operations of the American oil companies were immediately endangered. When dollar supply and world demand improved in 1950, the international surplus of dollar oil came to a rapid end. Fresh evidence of this country's intent to lead in the defense and the economic development of the community of free nations made it less likely that crises of that sort would recur in the near future.





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