The Power of the Weak and the Weakness of the Strong: Explaining Corporate Behavior in Middle Eastern Oil after the Second World War

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The importance of the Middle East in the international petroleum industry changed decisively in the fifteen years following the Second World War. Before 1939 its output was marginal compared to other world regions; twenty years later the Middle East was the largest source of crude oil outside the United States. Before 1939 a single company, British Petroleum (BP), dominated oil production in the region; after the war five American multinationals broke BP's hold. Bringing these two patterns together, we can say that the postwar growth of Middle Eastern output and its integration into the world oil trade was accomplished largely under American corporate leadership.

A key episode in the rise of this American ascendancy was what the editors of *Fortune* called "The Great Oil Deals" of 1947. This dramatic label designated principally the entry of Exxon and Mobil into Arabian-American Oil Company (Aramco), which was Chevron and Texaco's joint venture in Saudi Arabia. Exxon and Mobil's purchase of 40 percent of Aramco provided the capital to develop Aramco's rich fields and construct a big pipeline to the Mediterranean. Output could readily be expanded because Aramco's crude would now be directed into the extensive marketing networks of the new partners. As for Exxon and Mobil, they obtained access to huge new crude reserves

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outside the western hemisphere without having to bore a single test well.

In 1947 only one thing stood in the way of the Aramco deal: the Red Line regime. This curious term denotes the contractual obligations and business practices through which four oil multinationals -- BP, Shell, Exxon, and Mobil -- plus a small parastatal French company, Compagnie Française des Pétroles (CFP, today Total), attempted to monopolize the development of Middle Eastern oil. During the 1920s these companies put together a consortium called Iraq Petroleum Company (IPC) which they structured to operate as a producers' cartel [Wilkins, 1974, pp. 118-19; Yergin, 1992, pp. 194-206].[2] By terms of a "Group Agreement" signed in 1928, the member firms undertook not to compete with each other throughout most of the Middle East. (This extensive region was informally called the "Red Line area" on account of the red line delimiting it on a map annexed to that contract -- hence the nicknames "Red Line agreement" and "Red Line regime.") This arrangement stood in the way of the Aramco deal because clause 10 of the Group Agreement legally obligated all members of the cartel to offer pro-rated shares of any new acquisition to their consortium partners -- something which the American firms had no intention of doing. Thus the Red Line regime had to go for the all-American Aramco deal to succeed.

In the fall of 1946 Exxon and Mobil mounted a full-scale attack on the Red Line regime. Exxon's Orville Harden and Mobil's Harold Sheets travelled to London and presented their consortium partners with two arguments: First, during the war CFP had been subject to Britain's Trading With the Enemy Act because it was legally domiciled in occupied France. The application of the Act, they claimed, had nullified the Group Agreement, for any contract with an "enemy enterprise" was deemed to have lost all force in English commercial law. Second, the U.S. government, they averred, was now taking a more vigorous

[2] The American group originally included three other companies, but they quickly sold out to Exxon and Mobil. The consortium also had a fifth member, C.S. Gulbenkian, an Armenian promoter whose association with IPC's corporate forerunner gave him a claim to a five-percent share in the cartel. Gulbenkian proved to be pest during the Aramco affair, and up to November 1948 he employed legal stratagems to obstruct the agreement reached by the majors. Constraints of space make it impossible to discuss his role here.

approach to antitrust investigations and would likely find the consortium's Group Agreement in violation of the Sherman Act [Larson et al, 1973, pp. 736-37; Wilkins, 1974, p. 319]. To avoid prosecution Exxon and Mobil needed to break free from the Red Line regime. Harden and Sheets added that they would be willing to negotiate a replacement for the legally "dead" Group Agreement, but only on condition that any new version would exclude all restrictions on the activity of individual firms within the Red Line area.

The American view of the nullity of the Group Agreement was known to all consortium partners before the end of September 1946. They initially expressed reservations of various degrees, but nevertheless deliberated the American position in a succession of meetings in London. While these talks were proceeding, Exxon and Mobil finalized the terms of the Aramco deal with Chevron and Texaco. Of course this aspect of the American attack on the Red Line was still unknown to the other members of the consortium. Whatever suspicions they might have entertained, they knew nothing for certain about the real reason why the American companies were insisting the Red Line agreement was no longer valid.

Then on December 12, 1946, the London *Daily Telegraph* carried a brief item, "Saudi Arabian Oil Deal Plan," which revealed the negotiations with Chevron and Texaco. That got the cat well and truly out of the bag. At a glacial meeting of the consortium a week later, the French exposed the link between "nullification" and the Aramco deal by sardonically proposing that all IPC partners be invited to share in the Aramco purchase. To their astonishment, neither BP nor Shell went along with them. Unlike CFP, these big-league players had the muscle to go head-to-head with the Americans over the Red Line and Aramco questions; unaccountably they now refused to help the French company block the Americans' plans. So the outcome was ironic: the weakest firm in the cartel, CFP, was the only member to react strongly by challenging the projected new petroleum order in the Middle East. Within a week the French company launched a political, legal, and diplomatic campaign against Exxon and Mobil, demanding the maintenance of the Red Line regime and a pro-rated share of Aramco.

This unexpected pattern of corporate behavior calls out for explanation. Why did powerful Shell and BP accept the breakup of the Red Line regime without demur? Why did weak CFP tackle the Americans head on? By tracing the development of this episode, this paper tries to account for these reactions. But it also addresses a broader question: When the threads of explanation are drawn together, do they reveal a more general lesson which can be drawn from the paradox that is central to this episode?

The Feistiness of the Weak

After getting the bad news about the Red Line on September 21, CFP's president, Victor de Metz, held further talks with Harold Sheets and Mobil's legal counsel Austin Foster in both London and Paris. These talks prove that the French did not start from a position of root-and-branch hostility to the American position on the nullity of the Red Line regime [U.S. Congress, 1975, p. 125]. In fact de Metz asked Sheets, Exxon's Orville Harden, and the State Department's John Loftus to hold back on formal renunciation of the Group Agreement so that a constructive solution could be worked out behind the scenes [CFP, file 81.1/80, 10/13/46; FRUS 1946, pp. 38-40]. Then on October 17 de Metz sent Exxon and Mobil counter-proposals asking for assurances of CFP's existing share of Iraqi crude liftings plus guarantees of rapid postwar development of Iraqi output even if the other consortium partners did not want this to happen [CFP, file 81.1/80, 10/17/46].

Initially, therefore, the French appear to have accepted the idea of a revision of the Group Agreement provided two aims were met: protection of CFP's existing position as a small player in the Middle East, and promises of substantially increased crude liftings from Iraq. Indeed, in November CFP's legal staff actually sent three new versions of clause 10 to a New York law firm for an opinion as to whether these draft revisions would be deemed lawful under the Sherman Act. Thus an accommodation seemed to be in the making. On November 22 Loftus confidently told British officials in London that the French would probably agree to a revised Group Agreement without the restrictive clause, provided that the consortium's existing concessions were protected and "provision was made for any member group to obtain

additional oil" by increasing IPC production [PRO, file FO 371/62390/UE 393]. But then CFP's position hardened. A top company executive was sent to New York to say that CFP would allow the Americans to purchase crude from non-cartel sources within the Red-Line area, but nothing more. That was the only modification of the Group Agreement CFP was willing to countenance [U.S. Congress, 1975, pp. 125-26].

Why did the French suddenly switch to a hard line? CFP had received encouraging legal opinions on the "nullification" issue from its London solicitors, and that may have played a part. But the decisive factor was probably a report from the company's troubleshooter in the Middle East, Jean Rondot. On November 17 Rondot told de Metz about rumors of "a State Department scheme" to procure more oilfields in the Middle East for American companies [Catta, 1990, p. 84]. De Metz no doubt concluded that the assault on the Red Line regime was part of this secret project. By holding out against Exxon and Mobil's attack on the Group Agreement, CFP could perhaps force the American companies to give it a share in the new fields they and the State Department were allegedly seeking. When the announcement of the Aramco deal appeared to confirm this line of thinking, de Metz convinced the board of directors to go ahead with a full-scale legal and diplomatic offensive to back up CFP's claim to a share of the spoils.

The Circumspection of the Strong

At this point we need to shift the focus back to the reaction of BP and Shell to the American attack on the Red Line regime. Unlike small CFP, these multinational oil companies steered clear of a fight over Aramco. Part of the explanation for their circumspection (but not all of it) can be found in a simple fact: they were bought off.

A week after press reports had made the Aramco talks public, Exxon signed an agreement which Orville Harden had quietly been negotiating with BP's chairman, Sir William Fraser. Since 1943 Fraser had been preoccupied with his company's need to find markets for the larger volumes of oil which, he anticipated, would result from increased postwar production in Iraq and Kuwait. BP's problem was straightforward. As a bulk producer of crude the British company was

a giant of the international oil industry; but it remained something of a dwarf when it came to outlets for refined products. In 1944 BP tried to remedy this downstream deficiency by proposing extensive marketing links with Royal Dutch/Shell; but Shell turned down Fraser's offer in the summer of 1945 [Bamberg, 1994, pp. 278-81]. Thus Exxon's timing was perfect. Its offer of a big crude sales contract -- 1.2 bn bbls (133 mn tons) over the next two decades -- held out the prospect of immediate relief for BP, providing a breathing space during which the British company could develop its own downstream outlets. Moreover, Exxon also proposed to pay for half of a new, high-capacity pipeline from the Persian Gulf to the Mediterranean [FTC, 1952, p. 147; U.S. Congress, 1975, pp. 119-21].[3]

These long-term crude sales furnished an assured revenue stream on which BP could draw to finance the development of Kuwait's Burgan field, where the British company held a joint concession with Gulf Oil Corporation. By providing a future market at a known, if discounted, selling price, the agreement in effect allowed BP to finance its investment in Kuwait at Exxon's expense. But far more importantly, the contract guaranteed that BP's existing output from Iran would not want for postwar markets, for the deal allowed BP to supply Exxon's offtakes from either Kuwait or Iran. Thus the British company could adjust the composition of its deliveries to sustain Iranian production levels. This aspect of the agreement was important because all industry analysts expected the Aramco deal would lead to a marked expansion of Arabian output. Both Fraser and Basil Jackson, BP's chief representative in the US, were concerned about the effect this surge could have on Iran's position as the region's leading producer -- something that would surely have ramifications for the security of BP's concession there. In this context the benefits of assured crude sales to Exxon were even more

[3] These proportions were subsequently modified. At Exxon's urging, Mobil signed on for a fifth of the crude purchases and 10 percent of the pipeline financing. In March 1948 the three partners finalized the pipeline arrangements, with financing percentages distributed as follows: BP, 60.9; Exxon, 24.7; Mobil, 14.4. In the same month Mobil also negotiated an additional 40 mn tons of offtakes from BP. (The pipeline, by the way, was never built; it become blocked by Middle Eastern politics and had to be abandoned.)

attractive to BP than the purely commercial aspects of Harden's proposal [Bamberg, 1994, p. 304].

In sum, in the matchlessly cautious prose of Exxon's official historians, "[BP's] apprehension [at the Aramco deal] was to some extent lessened by the prospect of [guaranteed] sales" to the American companies [Larson et al, 1971, p. 738]. In fact BP's "apprehension" disappeared, for the crude sales contract meant the problems of market adjustment to increased Arabian output would fall largely on the shoulders of the American companies.[4] But for Exxon the deal possessed clear advantages as well. First and foremost, it constituted the requisite inducement to persuade BP not to block the Aramco deal by invoking clause 10 of the Group Agreement. Second, it supplied Exxon with a source of sterling-denominated oil at a time when currency inconvertibility left the American company stuck with sterling balances which might otherwise remain sterilized in London. Third, the deal provided Exxon with a way to manage the potential threat posed by Kuwait's reserves, which were then estimated to be twelve times the size of the famous East Texas field [Moran, 1987, p. 584]. By earmarking a big part of that new output for its own marketing network, Exxon could hope to defuse the disruptive potential which Kuwaiti production posed to the continued operation of the majors' "As Is" market-sharing accord. In short, just as BP received a guarantee against the disruptive effects of a flood of Arabian crude, this long-term contract gave Exxon the means to absorb the anticipated surge in Kuwaiti output.

This sweetheart deal accounts for BP's acquiesence. But what about Royal Dutch/Shell? When Exxon's accord with BP was announced, Shell was busy negotiating a similar long-term agreement with Gulf, BP's partner in Kuwait. It is quite possible that BP played a brokerage role in getting these talks started, for the two British majors possessed many common links. Together they built and operated Consolidated Refineries Ltd at Haifa, where they refined their offtakes

[4] This was emphasized in the fine print. Exxon and Mobil could take delivery of only 5 percent of BP's crude sales at Abadan for disposal in east-of-Suez markets. Almost all of the crude offtakes were intended for sale in the Americans' distribution networks in Europe and the Mediterranean [Bamberg, 1994, pp. 305-06; Adelman, 1972, p. 92; Blair, 1976, p. 43].

of the consortium's crude deliveries from Iraq. Another joint venture, Consolidated Petroleum Company Ltd, provided both firms with a common distribution network for the Middle East, Ceylon, and Africa; and local markets there and in India were served by fourteen joint-marketing companies [listed in FTC, 1952, p. 142]. The two companies exchanged data on sales and supply projections, and in 1944 they entered into negotiations for an even wider-ranging 50:50 marketing accord [Bamberg, 1994, pp. 279-81]. Given such collaboration, it would have been natural for BP to have suggested an arrangement with its partner in Kuwait. This would not have been difficult, for Gulf was already selling Kuwaiti crude to Asiatic Petroleum, one of the main companies in the Shell Group [FTC, 1952, p. 134].

In any case, negotiations for a longer-term arrangement proceeded from this beginning, for the needs of the two multinationals were strikingly complimentary. Shell was caught in a crude-short position: its properties in Rumania had been seized by the communists, and its extensive holdings in the Dutch East Indies had been devastated by the Japanese. In contrast, Gulf was crude-long: estimates of its Kuwaiti reserves ranged to over 5 bn bbls, five times the size of its U.S. reserves [Greene, 1985, p. 103]. But Gulf's existing distribution network could not assimilate new output on this scale. The company estimated that an investment of $300-$350 mn in new refineries and marketing arrangements would be required in order to absorb Kuwaiti crude [FRUS 1947, p. 638]. Moreover, were it to take that initiative, Gulf could well wind up in court. Its joint-venture agreement with BP included an undertaking by both companies not to sell output from Kuwait in such a way as to "upset or injure" their respective "trade or marketing position directly or indirectly at any time or place" [FTC, 1952, p. 131]. This clause gave BP legal grounds to obstruct any Gulf plan to market Kuwaiti crude in the eastern hemisphere.

In short, Shell needed oil and Gulf needed markets. The concordance of interests led to a long-term arrangement signed on May 28, 1947. Shell undertook to purchase about 1.25 bn bbls of crude from Gulf from 1947 through 1969. Gulf thus got a secure outlet for at least a quarter of its proved reserves in Kuwait without being obliged to create a distribution network east of Suez and thereby risking legal retribution from BP. Shell got guaranteed access to Gulf's underground

assets in Kuwait and thus greatly increased the size of "its" reserves in the Middle East. But Shell also managed to protect its existing position in eastern markets. This was done by linking the revenue Gulf would derive from these sales to the level of Shell's profits on the eventual disposition of Gulf's crude deliveries. If Gulf ever tried to use its uncommitted portion of Kuwait oil to carve out a bigger market position east of Suez, the volume and value of Gulf's deliveries to Shell would automatically be cut back [Moran, 1987, pp. 587-88; FTC, 1952, pp. 139-41]. Sitting squarely in the driver's seat, Shell found in this advantageous deal a good reason not to contest the new American arrangements in Saudi Arabia.

The Stubbornness of Facts

We can now return to where we left off and pick up the story of the Aramco deal from the French company's hostile viewpoint. In the corporate struggle it had decided to precipitate, CFP disposed of three weapons. First, it brandished a "dirty linen" menace. By filing suit in London, the French had initiated a procedure which, if carried through to a trial, would make public all of the restrictive practices followed by the Red Line cartel since 1928. Because of the political storm these revelations would supposedly generate in the United States, CFP reckoned that Exxon and Mobil would agree to anything in order to keep the Group Agreement secret.

Second, the company secured diplomatic backing from the Quai d'Orsay. The French ambassador in Washington, Henri Bonnet, delivered two vigorous notes of protest to the State Department on January 6 and 13 [FRUS 1947, pp. 627-33]. At the same time René Massagli, the French ambassador to London, sought to enlist support from the British government. Of course the French Foreign Ministry was normally helpful to parastatal CFP, but in this case the diplomats had a special reason to come on side. They feared the combination of the Aramco deal with the repudiation of the Red Line regime would pose a grave danger to France's tenuous foothold in Middle Eastern oil. If the Group Agreement was abrogated, BP, Exxon, and Mobil would be free to neglect Iraq and develop their concessions in Iran, Kuwait, and now Saudi Arabia -- concessions in which the French had no part.

That would threaten the volume of CFP's crude deliveries to France at a time when the war-devastated country needed all the imports it could get. Moreover, it held out an additional menace. Exasperated by static levels of production, Baghdad might retaliate, as it had threatened to do in the past, by revoking the consortium's concessions in Iraq. And that would leave CFP without a single producing field in the Middle East [MAE, AEF-AT, box 80, file IPC, 1/7/47]. So the Foreign Ministry initially gave strong diplomatic support to CFP's campaign to save the Red Line.

Third, the French company could count on official pressure on the Americans' established interests in France. Pierre Guillaumat, the country's ardently nationalist fuel supremo (and later CEO of Elf Aquitaine), presented this "power-of-weakness" tactic in a brief prepared for his minister. Though foreign subsidiaries held an important place in the domestic oil market, "our weakness on this front has given us valuable hostages" -- namely Exxon and Mobil's refining and distribution networks in France. By threatening to punish these subsidiaries, the government could pressure the Americans into a settlement.

The fuel department of the Ministry of Production and Industry applied this stratagem by warning Exxon's and Mobil's subsidiaries of potential repercussions; and the Planning Ministry's fuel commission specifically threatened to limit Exxon's refining activities in France. The message certainly got through to Robert André, an executive of Standard Française des Pétroles, who warned Orville Harden about "arbitrary measures" which the government might take against Exxon's interests in France [FTC, 1952, p. 106]. Guillaumat claimed that this tactic was paying off: the warnings "seem to have generated a strong reaction in New York" where Exxon's board was said to be "expressing its desire to come to an understanding with us" [MAE, AEF-AT, box 80, file IPC, 2/28/47; MAE: DE-CE 1945-60, file 165, 2/28/47]. (As we shall see, though, this was to overrate the effect and mistake the cause of the Americans' "desire" for a settlement.)

But as the struggle unfolded in the spring of 1947, the weapons in CFP's arsenal proved less potent than the company had initially expected. First, the "dirty linen" gambit turned out to be a two-edged sword. The core of the French threat was that its lawsuit would expose

the collusive character of the consortium. It is true that the Americans had not expected CFP would carry out this menace [U.S. Congress, 1975, pp. 118-19]. But they quickly grasped that CFP's "exposé" could actually help their attack on the restrictive Red Line. The American firms could now stand up in court as model corporate citizens and reply: "Exactly -- that's why we want to put an end to the Red Line regime." Thus Exxon and Mobil were not intimidated by CFP's legal moves, and their solicitors matched the French claim for claim in London's high court.

Second, diplomatic support from Paris was offset by stronger backing from Washington. This was something the American firms had been careful to cultivate from the start. Exxon and Mobil had consulted government officials about the Red Line problem well before the Aramco plan had been set in motion, and their confidence was buoyed by the knowledge that the State Department agreed that the Red Line had to go [FRUS 1946, pp. 31-34, 44-45; Miller, 1980, p. 153; U.S. Congress, 1975, pp. 94-95, 124]. When they finalized the terms of the Aramco deal with Chevron and Texaco, the companies made sure the Departments of State, Justice, War, and Interior were kept in the picture [Anderson, 1981, p. 153; Painter, 1986, pp. 106-7]. Thus informed, the American government extended the umbrella of diplomatic support to include the Aramco buy-in as well. So in the same week when the French ambassador presented his government's notes of protest to Washington, the State Department officials who had been following the affair told the American oilmen to reject any new restrictive agreement, keep the French out of Aramco, and go ahead with their merger [FRUS 1947, pp. 629-31; Painter, 1986, p. 108; U.S. Congress, pp. 124-26, 160-61].

Why was Washington so supportive of the Aramco deal? In the past four years different agencies of the federal bureaucracy had addressed the question of postwar petroleum supply, giving particular attention to the Middle East, especially Saudi Arabia. The various approaches elaborated by the rival bureaucracies are dealt with in detail by an excellent monographic literature [Anderson, 1981; Mejcher, 1990; Miller, 1980; Painter, 1986; Stoff, 1980]. The pertinent point is that all government plans to create a workable framework for a postwar foreign

oil policy had miscarried; and American oil interests in Arabia were no more secure in 1946 than they had been in 1939.

Against that background the news of the Aramco deal struck Washington as great good news. Exxon and Mobil were going to create through private initiative what government policy had singularly failed to produce: a credible framework for the protection and development of Arabian oil reserves under American control [Vietor, 1984, p. 30]. The subtitle of *Fortune's* article on the Aramco deal -- "U.S Business, Doing Business, Does What the Government Cannot Do" -- might sound like free-enterprise cheerleading, but in this case it was literally true. Thus it is hardly surprising that American diplomatic support for the deal was full and firm.[5]

A further diplomatic reason created an insurmountable barrier to French entry into Aramco. The ultimate owner of all Arabian oil, King Abd al-Aziz ibn Saud, adamantly opposed any non-American participation in "his" Aramco. When informed of the impending merger, the king's first question was: "Are Exxon and Mobil British firms?" Assured that they were not, he gave his approval to the deal. Subsequently learning of CFP's demand for a share in the purchase, King Abd al-Aziz had his ambassador in Washington declare that "the development of Arabian oil resources must remain exclusively in American hands... [and] if the proposed new partners in Aramco [Exxon and Mobil] could not disassociate themselves from previous commitments [i.e. the Red Line regime], they would not be permitted to buy into the Arabian concession" [FRUS 1947, pp. 634-35; Kennedy, 1979, p. 77]. Thus even if Exxon or Mobil had wanted to accommodate CFP, the royal veto put French participation out of the question.

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[5] This statement requires two qualifications. First, the State Department did suggest an alternative strategy for dealing with the French: Mobil could buy Exxon out of the Red Line consortium, leaving Exxon legally free to enter Aramco alone. Exxon's Orville Harden quickly scotched this idea (which the companies had in fact already considered). Second, the foreign service officers who backed this strategy, Paul Nitze and Robert Eakens, also questioned the concentration of ownership of Middle Eastern oil in the hands of the majors. They suggested bringing a number of small American oil companies into the region as an alternative [FRUS 1947, pp. 646-54]. Although this option was not put forward very convincingly, it can be regarded as the origin of official support for the Aminoil consortium which Ralph Davies put together in 1947.

A fourth and final reason ruled out French entry into Aramco: the financial weakness of CFP. Indeed, CFP's demand for a share in Aramco seemed irrational to the Americans; for the State Department and the American oil companies understood that CFP just did not have the horses to convert its Middle Eastern desires into real investment.

The financial details of the Aramco deal were intricate, but for Exxon and Mobil the total cost over the life of the contract was $469.2 mn (equivalent to more than $3.3 bn today). For our purposes we can stick with just the front-end loading, which amounted to $152 mn. Suppose for a moment that CFP actually succeeded in forcing Exxon and Mobil to abandon their attack on the Red Line and give in to the French company's demand for a pro-rated share of Aramco. The price of this counterfactual victory would have been $36.1 mn, which CFP would have had to pay Chevron and Texaco in 1947. (On the alternative assumption of a buy-in by equal thirds, CFP would have been on the hook for $50.7 mn in that year.)

What did a sum of this magnitude mean to CFP? The French company was already under financial strain to pay off wartime losses and rebuild its damaged refineries. Even more burdensome were new capital call-ups (plus normal operating costs) by the Red Line consortium: CFP's share amounted to £2,235,419 up to January 1947, with an additional £4,322,500 forecast for 1948. Throughout 1946-47 the meetings of CFP's board reveal a palpable sense of financial tension [CFP, Board of Directors, minutes]. In this difficult context, to have added a further outlay of $36.1 mn -- a sum 72 percent greater than the company's total capitalization at the end of 1946 -- was arguably outside the realm of reality. But even if the French company managed to raise the money, payment had to be made in dollars, not francs. France's transactions with dollar-zone countries in 1946 had generated a current account deficit of $1.48 bn. In those pre-Marshall Plan days of generalized dollar shortage, $36 mn (much less $50 mn!) represented a tremendous -- and highly doubtful -- allocation of precious hard currency.

The French have a saying, *"les faits sont têtus"* -- "facts are stubborn." This particular set of facts evidently sobered up the oil patriots at the Quai d'Orsay and Ministry of Finance. The diplomatic record shows that the French government did not follow up its initial

moves in support of CFP's claims to a stake in Aramco; indeed, after January 1947 the French embassy in Washington did not receive further instructions from Paris about the question. In London the Foreign Office made it clear to the French embassy that the best hope for a satisfactory solution lay in the inter-company talks which Sir William Fraser had initiated on January 9 [PRO, file FO 371/67695A/Z640]. Informed by CFP of the progress of these talks, the Quai d'Orsay evidently accepted Whitehall's view. Paris drew back from its initial pressuring and left the French company to work out a settlement with Exxon and Mobil.

The Basis for an Arrangement

On January 8, right at the start of its legal and diplomatic offensive, CFP's London solicitors had given Exxon and Mobil the French company's terms for accepting a very limited revision of the Group Agreement: namely, rapid development of the oilfields in Iraq, a new IPC pipeline to the Mediterranean, and a share of Aramco. We might guess that this was a high-ball negotiating position, not a realistic basis for an entente; and that guess would be right. The confidential record of a telephone briefing which CFP's head office gave its representative in New York on January 17 proves that, no matter what its executives were saying to the French government or its consortium partners, CFP had already given up on saving the Red Line and securing entry into Aramco. The French company was ready to come to the table if Exxon and Mobil would guarantee that the Aramco deal "would not prompt them to hold back through any means, active or passive, the consortium's development." Specifically, CFP wanted an undertaking that the American firms would support expanding the consortium's Iraqi output to the same production levels as those attained by companies with "outside" (i.e. non-consortium) concessions in the Middle East, meaning the American firms and BP [CFP, file 81.1/82].

Exxon and Mobil were not privy to CFP's thinking, but they did know that the French company had been pressing for rapid expansion of Iraqi production since the 1930s. This, after all, was the quid pro quo CFP had initially put forward in October 1946 as its price for cooperation over the Red Line issue. Acting on this knowledge (and

with considerable tactical help from Shell), Exxon and Mobil proposed in mid-February to increase IPC's total production *and* to allow CFP to acquire more of this expanded output than its share in the consortium entitled it to [U.S. Congress, 1975, pp. 151-53]. In that way France would get crude deliveries for postwar reconstruction and CFP would obtain secure access to an enlarged stream of Middle Eastern oil -- though not, of course, in Arabia [FRUS 1947, pp. 651-53]. To this carrot the Americans shrewdly added a bit of stick. New York cabled its negotiators to warn CFP that if it refused to compromise on the basis of extra deliveries of Iraqi oil, the only alternative would be to break up the consortium and divide its assets among the partners [CFP, file 81.1/82, 2/26/47]. The prospect of being left to its own devices in the Middle East would, they wagered, be bleak enough to coax the French into compliance.

This looks to have been a good guess. Faced with the choice between a dubious legal battle or an enhanced position in Iraq, CFP decided to abandon its Arabian ambitions and take the bird in the hand. The French reaction to the American proposals was sufficiently encouraging for Exxon and Mobil's vice-presidents to return to London. High-level talks resumed in early April on the basis of what the French saw as "the general principle of putting at our disposal the amounts of oil we deem necessary for the development of our economy" [MAE, AEF-AT, box 80, file IPC]. Progress was rapid, even though de Metz held out for a large-capacity IPC pipeline to handle CFP's anticipated "overliftings" in Iraq [Catta, 1990, pp. 87-88]. The Americans agreed, probably because they grasped that the postwar scarcity of rolled steel plus controls on U.S. steel exports would oblige IPC to shelve this scheme until Aramco's own Tapline was completed. A provisional accord was reached on April 11, and this evolved into a final settlement which the American negotiators cabled to New York for approval on May 14 [CFP, file 81.1/82]. Three weeks later the consortium's four major groups formally signed their new "Heads of Agreement" which incorporated the compromise with CFP. The Red Line regime was history, the Aramco deal was in the bag, and the way was clear for the rise of American paramountcy in Middle Eastern oil.

Weakness of the Strong, Strength of the Weak

This paper began with the assertion of a paradox: that the dissolution of the Red Line regime was contested not by the strong consortium members that had the power to fight Exxon and Mobil, but by weak CFP, who did not. Now that we have traced the ups and downs of the French company's struggle, it is time to ask if the specific elements in the story add up to a more general lesson.

As a starting point we can say that no matter what their individual positions on the utility of the Red Line restrictions, all of the *international* oil companies in this story had a stake in the success of the Aramco deal. Aramco's joint owners, Chevron and Texaco, stood near the bottom of the international league tables: together they accounted for only 5 percent of world crude oil sales in 1946 [Moran, 1987, p. 585]. But these firms also held enormous reserves in Arabia, where wellhead costs were the lowest in the world [Fortune, 1947, p. 180]. It was therefore very likely that Chevron and Texaco would try to increase their share of international markets by selling Aramco's growing output through Caltex (their joint distribution subsidiary) at low prices; for low production costs gave them much more room to compress margins and still turn a profit. The desire of King Abd al Aziz for greater royalty payments also meant pressure for a big expansion of Arabian production -- a fact which the companies and the State Department recognized. In short, the majors could see a price war in the offing if Aramco's Arabian output was brought to market in this fashion.

As a matter of fact, the international oil companies had perceived the problem of Middle Eastern output years before the rise of the Aramco "threat"; and it is, I submit, very instructive to see how they tackled the problem at that time. In 1938-39, Royal Dutch/Shell contracted with Caltex to buy offtakes of fuel oil and kerosene from Chevron's new refinery in Bahrain. In making this arrangement, Shell was acting not only for itself but also as an agent for BP, Exxon, and Mobil. (The deal, by the way, violated the Red Line agreement, so the consortium partners drew up a special "agency agreement" in an attempt to legalize their improper action.) The four multinationals paid Caltex high prices for these offtakes, close to the level of wholesale prices prevailing in the Far Eastern markets where the shipments were destined

to be sold. This of course left very little room for the majors to make a profit on those sales. Why then did they bother to make this arrangement? Because, as Mobil's Dick Sellers explained, the purchases were "of a purely protective nature." Or in the more candid words of Shell's Joseph Boyle, the majors had bought these Caltex products so as "to reduce the amount which might be dumped on an unsound market" [Shell Group Archives, file ME 102 (1), R.W. Sellers to L.B. Levi (Mobil), May 24, 1939; file ME 104 (2), J. W. Boyle to J.E. Taylor (BP), January 23, 1946].

In other words, even before the war the majors had faced up to the need to work together in order to prevent market disruption by Middle Eastern oil produced by "outsiders" like Chevron and Texaco. Now what they needed -- albeit on a much greater scale -- was a way to "discipline" Aramco so that the anticipated surge in crude output would not push down prices or precipitate disruptive struggles for market share. The Aramco deal supplied that discipline. As part of the deal, the non-consortium members, Chevron and Texaco, signed an eighteen-year offtake schedule to supply Exxon and Mobil with a large portion of Aramco's future output at prices set by Aramco's board, on which Exxon and Mobil would now have directors [Off-Take Agreement, 1947]. This schedule obliged Chevron and Texaco to accept a modest rate of growth for Aramco's output after 1947 -- just 3 percent per year. The offtake arrangement thus accomplished two things: it obviated the feared postwar "flood" of Arabian crude and at the same time made sure Aramco's more modest production would be channelled into *existing* distribution networks. And because the buy-in agreement specified that a two-thirds majority was required for new board decisions, Exxon and Mobil (now holding 40 percent of Aramco's equity) had the votes to stop output increases if Chevron and Texaco ever tried to push for more rapid rates of growth. (A complex penalty clause was also included to discourage any three-against-one alliances to increase output levels.) [Off-Take Agreement, 1947, p. 8; Moran, 1987, p. 589].

Shell and BP derived no direct gain from these arrangements; but as international companies concerned with the stability of markets and prices, they benefited indirectly from the discipline which the Aramco deal imposed on the marketing of Arabian crude. We have already seen

this same pattern at work in regard to the commercialization of Kuwaiti output, but it is worthwhile to remind ourselves of it here. Recall Shell's 1947 sales contract with Gulf. BP could have blocked that deal by invoking clause 7 of its 1933 agreement with Gulf. Since BP competed with Shell in Asian markets, it had an apparent motive to obstruct Shell's access to this new supply of crude. Why didn't BP do so? Because the British company understood that, somehow, somewhere, Gulf *had* to find a market for its share of Kuwaiti output. By channelling that oil into Shell's existing distribution system, Gulf would get its market. But just as important, Gulf's crude would wind up safely in the hands of one of the industry's big three -- that is, in the hands of a prudent rival whom BP could trust to act "responsibly" with that oil.

Here, then, is my point: In 1946 Exxon, BP, and Shell accounted for 71 percent of the international oil market [Moran, 1987, p. 585]. Their dominant position fostered in these companies a system-wide perspective and a proclivity to take the long view of profit maximization. Indeed, the famous "As Is" marketing agreements stand as a monument to their statesmanlike outlook [U.S. Congress, 1975, pp. 30-34]. A key component of that outlook was safeguarding the petroleum trade against conditions of oversupply. That is why the big three had bought Caltex offtakes before the war; that is why they were now acutely aware of the need to manage the impending surge in both Kuwaiti and Arabian output. Because they all shared this concern, BP could trust Shell to absorb Gulf's deliveries without disrupting the "As Is" division of eastern markets. Or as the Federal Trade Commission put it, the Gulf deal "merely transfer[ed] to Shell the ultimate responsibility of controlling the distribution of Gulf's share of Kuwait production so as to protect the [existing] trading position of both Shell and [BP]" [FTC, 1952, p. 144]. Similarly, the Aramco deal gave Exxon and Mobil the responsibility for integrating Arabian output into world oil supply "safely." That is why the Aramco deal suited the objective interests of BP and Shell as well.

However, the system-wide focus and logic of common interest shared by the major players found no echo in Paris. Unlike its Red Line partners, CFP was an international company in name only. Its share in the consortium constituted the totality of its upstream assets; and the "international" aspect of its operations was limited to shipping Iraqi

crude from Tripoli to Marseille. CFP's minor-league status caused it to perceive the Americans' plans in a completely different light from BP or Shell. The French company's own resources were too slim to enable it to compete successfully in wide-open contests for concessionary rights. Conscious of this weakness, CFP set high value on the Red Line regime, for only through its continued operation could CFP hope for access to new concessions in the Middle East. Because company executives understood this, they had always been the foremost proponents of the Group Agreement's collusive elements [Fitzgerald, 1991]. In short, the French firm's motivation to fight was more pressing because it had the most to lose from the breakup of the Red Line regime.

Thus we wind up with the paradox that CFP's "strong" reaction to the American attack stemmed from self-consciousness of how weak it really was. But there is a second paradox as well. In the struggle over the Red Line, CFP's greatest asset was its status as a weak company in a world run by the strong. That sounds perverse, but it is not just playing with words. The individual corporate interests of the oil majors were refracted through a common prism of concern with oversupply. But this preoccupation with preserving the conditions for systemic stability undercut the leverage they could bring to bear on CFP. "Orderly marketing" was a matter of first necessity for the big players; but a small parastatal company with assured domestic sales did not have to give a tinker's damn about international price wars or struggles for market share east of Suez. In that sense CFP's minor-league status became a source of strength, for it rendered the French company impervious to the logic of collective interest which the majors had no choice but to heed.

Yet being odd man out can take a firm only so far. The "power" involved here is in effect a situational strength, the temporary by-product of the big players' concern for the big picture. It acted as a permissive factor, allowing the small French firm to mount the sort of challenge which Shell or BP necessarily rejected as counter-productive. Thus the power CFP obtained in this particular situation was a function of the danger which its tactics of non-compliance posed to the maintenance of systemic stability -- that is to say, its threat to the timely

implementation of the majors' arrangements to manage the coming surge in Middle Eastern output.

But to make such a challenge convincing, a small player needs to be something more than just a loose cannon; it must deploy threats which opponents find credible. In the conflict over the Red Line and the Aramco deal, CFP's position rested too much on bluff -- a fact which Exxon and Mobil were astute enough to see. Above all, CFP's inadequate financial resources bestowed a wholly implausible character on its demand for a slice of Aramco. In its struggle with Exxon and Mobil, CFP's position as a weak company in the world of the strong conferred on the French a certain paradoxical advantage. But CFP relied on this situational strength beyond the point that its recalcitrant stance could reasonably be believed. At the end of the day, then, it was the balance of real corporate power that set the limits to what the French firm could achieve in the Middle East in the years after the Second World War.

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