Reasons of State

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The Limits of International Cooperation

In the short term, it is possible to conceive any number of bilateral deals that can be made between major consuming countries and major producing countries. In the short term, it is possible to see how particular producing countries can enrich themselves by an unrestrained use of their temporary strong bargaining position. But in the long term, it is bound to lead to disaster for everybody. It is particularly a case where the common interest is also everybody’s selfish interest.

Secretary of State Kissinger, January 3, 1974

The first line of action for American executive officials in the wake of the oil price shocks of 1973–74 was diplomatic. Led by the State Department, administration officials sought to draw together the industrial consuming nations in order to confront OPEC and negotiate the rollback or stabilization of oil prices. Despite the persistence of American efforts, these cooperative schemes did not succeed. The International Energy Agency (IEA), an international organization of modest scope, was created, and it provided stand-by arrangements for emergency oil sharing. But it was unable to play the role American officials had envisaged for it. Programmatic cooperative agreements also failed to take hold during the second oil shock. Government leaders did make pledges in 1979 to reduce oil import levels, but these collective statements of intention largely proved unavailing.

Despite the magnitude of energy adjustment problems, and despite what appeared to be a basic mutuality of interests among the industrial consuming nations, policy coordination remained elusive. This chapter seeks to account for the persistence of American efforts to achieve a common solution to those problems and for the failure of those efforts.

In Chapter 2, I argued that international cooperative agreements
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(international offensive and defensive adjustment) are part of a larger set of adjustment strategies and that the attractiveness of each option is related to the state’s domestic capacities for adjustment and the goals that arise from the state’s international position. Applied to the case at hand, these considerations suggest that U.S. officials favored the cooperative adjustment strategy for two sorts of reasons. First, government leaders were constrained in their ability to impose the costs of adjustment on the economy, primarily by domestic price controls on petroleum. These controls, enacted prior to 1973–74, shielded consumers from the full force of external price increases and gave price windfalls to some segments of the petroleum industry. In response to these interests, Congress preserved and extended price and allocation controls in the years that followed. Swift market-driven adjustment to escalating petroleum prices remained beyond the reach of executive officials.

Second, the privileged international position of the United States uniquely favored international strategies of adjustment. Several features of the American international position were important. By virtue of its large absolute share of international oil imports, which satisfied a small relative share of domestic energy consumption, the United States was favorably positioned to lead Western importing nations in a response to OPEC. Its dominant international political position also gave the United States a broad set of objectives in the oil price revolution. Accepting higher petroleum prices in the West meant accepting slower growth, greater export competition, and bilateralism, and encouraging demands by developing countries for a New International Economic Order—all of which ran counter to American postwar ideals. The United States, in sum, was interested not only in how it adjusted domestically but in how other advanced industrial states adjusted as well. Together, domestic constraints on energy adjustment and a commanding international position led to an initial American emphasis on international strategies of adjustment.

The failure of U.S. cooperative proposals was rooted in the differences among importing nations in the costs and objectives that attended energy adjustment. Whereas the United States found it particularly difficult to pass higher oil prices through its domestic economy, other industrial states accepted those higher costs. Consequently, the United States put the pricing issue at the top of its foreign policy agenda, whereas its industrial partners were more concerned with access to supply and favorable diplomatic relations with the Arab states. By adjusting to higher prices and pursuing a different set of objectives, these countries in effect exited from multilateral adjust-
ment schemes, and what followed was the failure of the American grand design.

**Opportunities for Cooperation**

Prior to the 1973–74 oil embargo, the industrial nations had not attempted formally to coordinate energy policies. The oil crisis of 1956–57, for example, had been met by unilateral American action. In response to conflict with Britain, France, and the United States, Egypt nationalized the Suez Canal in July 1956. This action led to an international crisis that culminated in the invasion of Egypt by Israeli, French, and British forces. Although the invasion was cut short by U.S. pressure, the Suez Canal was blocked, cutting the major transportation route of oil from the Persian Gulf to Europe. The American government, although faced with initial resistance from the Texas Railroad Commission, was able to increase domestic production and, with cooperation from the international oil companies, ease European shortages during the winter of 1956–57. Because the United States had access to large, readily available domestic reserves, it could compensate for international dislocations and stabilize supplies.\(^1\) By the early 1970s, however, the American position in the world petroleum market had changed. Domestic production had peaked, and the United States had begun to import larger amounts of foreign oil. In 1973 the U.S. government was unable to match the shortfall in OPEC production with expansion of its own.

The absence of a power capable of countering OPEC restrictions made cooperation among oil-consuming nations more vital if Western governments were to control supplies and prices of international petroleum. A variety of opportunities for cooperation existed to lower or redistribute the costs of oil shortages and higher prices. Both petroleum crises in the 1970s began with the curtailment of a portion of OPEC production. In 1973–74 the attempt by Arab OPEC member countries to embargo the United States created a shortfall of about 9.8 percent of available world supplies.\(^2\) The scramble for crude oil by consuming nations, each concerned to maintain its access to imported oil, pushed prices on the spot market dramatically higher and gave

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\(^2\)Noncommunist production fell from 47.8 billion barrels a day to 43.2 million barrels a day between September and November 1973. Philip K. Verleger, Jr., *Oil Markets in Turmoil: An Economic Analysis* (Cambridge, Mass.: Ballinger, 1982), p. 33.
OPEC additional opportunities to raise its prices. In 1979 the tightening of the world oil market started when Iran curtailed oil production in the wake of its revolution. The shortfall in late 1978 was approximately 6.3 percent of world supply. This tightening of supply was, as in the first crisis, followed by the bidding up of prices on the spot market and a rise in official OPEC prices. Competitive bidding by consumer nations on the spot market was even more consequential for OPEC pricing in the second crisis, because by the late 1970s more international petroleum transactions were being conducted through the market and less through long-term contract. In both cases the supply shortfall was small, but the competitive actions it unleashed and the pricing actions it allowed disadvantaged all consuming nations. These supply and pricing problems thus provided substantial opportunities for mutual gains through cooperation.

The most immediate form of cooperation would have entailed agreement by the consumer nations to restrain import demand. By abstaining from unilateral efforts to increase supplies, or by going further and actually reducing current import levels, consumers could reduce pressures on already limited world supplies. In the absence of such an agreement, and with each nation pursuing its own short-term objective of gaining access to existing supplies, prices would rise higher than when nations agreed to moderate demand.

Cooperation could also take the form of longer-term efforts by consumer nations to conserve energy and generate alternative sources of supply. Such efforts would also alter the supply and demand pattern and, by so doing, undercut the pricing power of the cartel. Whereas the cooperative actions noted above involve immediate steps to limit oil imports, the plan here involves more gradual efforts to address the underlying structure of demand and supply. Collective agreement would increase the efficacy of individual actions by governments.

In both cases—whether demand restraint or conservation and production initiatives—consuming nations could pursue actions individually. Yet unilateral actions would have less overall impact on prices and supplies. Indeed, without agreement each government was likely to pursue separate policies of national gain even as those actions left all nations worse off than they would have been if a collective agreement had been achieved. In this sense the problems of agree-

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3Between October and November noncommunist world production fell from 62.9 million barrels a day to 58.9 million barrels a day. Ibid., p. 33.

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ment by consuming nations over energy adjustment were driven by the dilemma of collective action.5

These forms of cooperation can be characterized as international offensive strategies of adjustment. The objective is to engage in cooperative actions that serve to counter or mitigate unwanted international economic change by going to the source of that change. In this case, the strategies involved joint actions by consuming nations to roll back or moderate oil price increases or to engage in indirect bargains (between consuming nations and between those nations and OPEC) to stabilize oil prices and supply. Consuming nations could also take internationally defensive cooperative actions: emergency oil-sharing agreements that spread the burden of reduced oil supplies among industrial importing nations, and international financial agreements that cushion balance of payments problems generated by the higher costs of petroleum imports.6 Such actions do not go to the source of the international economic disturbance; they aim, rather, at collectively equipping the consumer nations with a means to cope with the most onerous consequences of the disturbance.

The United States advanced cooperative proposals along both international offensive and defensive lines after 1973. Not only did other consuming nations have strategies that addressed more immediate political and security objectives, however, but the United States itself was unable to generate the domestic changes necessary to make the multilateral cooperative strategy successful.

AMERICAN INTERNATIONAL ENERGY STRATEGY

The U.S. government was the most persistent and forceful advocate of a cooperative response by industrial consumer nations to rising oil prices in the early 1970s. This strategy, articulated by the State Department and Secretary of State Henry Kissinger, initially sought to salvage the world petroleum order by confronting OPEC directly.


6For a discussion of the full range of cooperative issues as noted by an observer at the time, see Walter L. Levy, “World Oil Cooperation or International Chaos,” *Foreign Affairs* 52 (July 1974), 690–713.
American efforts to counter OPEC directly were blunted by resistance from allies and intractable political constraints at home. Government officials sought to adapt their international strategy after its initial failure, but in due course they grudgingly abandoned it in favor of a sequence of domestic adjustment strategies.

American officials showed an interest in an international solution to energy shortages before October 1973. Urging a united front against OPEC, one State Department official wrote in early 1973 that the Western importing nations should create an “international authority” that would “avoid cutthroat competition” for available energy supplies. He argued that “such competition could drive prices far higher than we can presently imagine.” In April 1973 the State Department disclosed an ongoing planning effort to establish an international organization of oil-importing countries whose primary purposes would be to allocate petroleum supplies in times of shortage and to develop practices to avoid an “international price war.” Although State Department officials differed about the possibilities for a “buyers’ cartel,” most agreed that cooperative measures would improve the joint bargaining position of industrial nations with OPEC.

In responding to the proposal, the French and Japanese governments foreshadowed the positions they would take in the months ahead. France acknowledged the need in principle for some cooperation but argued that European cooperation should come first. The Japanese insisted that producers not be provoked unnecessarily.

The logic of the American position on the unfolding energy problem was revealed in comments by the State Department’s undersecretary for economic affairs, William J. Casey. In a discussion of the energy predicament in June 1973, Casey acknowledged that rising American consumption of imported oil was aggravating the situation by increasing world demand for Middle Eastern oil and thereby putting upward pressure on prices. But the U.S. government, he maintained, favored international responses to the problem and, therefore, urged consultation and cooperation in areas such as energy conservation, production, and technology. In effect, Casey argued that although the United States was contributing to the problem, the

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7 James E. Akins, “The Oil Crisis: This Time the Wolf Is Here,” *Foreign Affairs* 51 (April 1973), 486.
solution would need to be arrived at jointly among industrial consuming nations. 10

Confronted by the October embargo, American officials redoubled their efforts to fashion a united response to OPEC. They emphasized the virtues of multilateral rather than bilateral or regional responses to problems of oil supply and pricing, and they did so for both political and economic reasons. Politically, the movement toward deals by individual countries with oil-producing nations, according to State Department officials, threatened to fragment the liberal, multilateral trading system into rival blocks. Addressing his remarks to Europeans, Kissinger argued in December 1973 that unless cooperative measures were taken to alleviate the crisis, the industrial world would be faced “with a vicious cycle of competition, autarchy, rivalry and depression as led to the collapse of the world order in the thirties.” 11

The United States, therefore, found itself opposing actions by other governments, particularly the French and the Japanese, to forge bilateral deals with OPEC producers. Bilateral oil trading relationships threatened the postwar norms of nondiscriminatory trade and open markets.

The United States agreed, moreover, that the prevailing higher oil prices were neither inevitable or necessary. If consumer nations cooperated to limit import demand and stimulate their own production, they could undercut OPEC pricing, and more moderate prices would prevail. This remained the core of American international energy policy throughout the Kissinger period. The American objective, as a senior State Department official noted in congressional testimony, was to “bring about a basic shift in the supply/demand balance in the world oil market. This will reduce our vulnerability to foreign supply disruptions, reduce the ability of a small group of countries to manipulate world oil prices arbitrarily and enable prices to approach their long-term equilibrium level.” 12 Only through collective action by consumer countries could competitive bidding be avoided and oil prices be moderated or reduced.

The American opposition to a fragmented consumer response to

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OPEC, exemplified in the pursuit of bilateral negotiations, was thus both political and economic. The connection between these arguments was articulated by the American secretary of state in February 1974: “What we believe is going to be disastrous for the world economy is if bilateral deals are made unconstrained by any general rules of conduct, because we believe that this will either stabilize prices at too high a level or bid prices up even higher and in general create a relationship among the major consuming nations of economic warfare—which inevitably will affect, in time, their political relationship.”

Maintaining the integrity of a multilateral approach to international economic problems, preserving political relations among Western industrial nations, and developing a coordinated program to counter OPEC went hand-in-hand.

The most public call by the United States for a united, multilateral response came in December 1973 with Secretary of State Kissinger’s speech to the Pilgrims of Great Britain in London. Kissinger argued that the crisis of supply was a long-term problem that would require collaborative programs by consuming nations to develop new methods of conservation and sources of supply. The secretary of state called for the formation of an Energy Action Group, composed of leading public officials and other representatives from Europe, the United States, and Japan. This group’s mandate would be to “define broad principles of cooperation, and it would initiate action in specific areas” such as stimulating conservation and production of energy and joint programs in research and development.

Kissinger’s declaration made the goal of consumer unity a central element of American foreign policy.

The Washington Energy Conference

To put the American international plan into action, the Nixon administration in January 1974 called for a conference of the industrial consuming nations to meet in Washington the following month. Again Secretary Kissinger, in making the announcement, put forward the arguments for cooperation. Importing nations, he argued, had a common interest in restraining competition for supplies, in collaborating to generate additional sources of energy, and in bargaining with the producing nations not only on price but also on the


trade and monetary distortions that price increases were creating. In the absence of such cooperation, Kissinger warned of a severe world depression. Such an “economic disaster” would, he argued, be driven by unrestrained competition over limited supplies, the result of industrial nations attempting to solve their problems individually.\textsuperscript{15}

The central challenge Kissinger and other administrative officials confronted in early 1974 was the movement by other importing nations toward individual deals with producing nations to protect their supplies of oil. American efforts to forestall these developments were renewed after the French government announced it had completed the first phase of a bilateral deal with Saudi Arabia for long-term oil supply. While not directly criticizing that deal, Secretary Kissinger emphasized the American view that “unrestricted bilateral competition”, would be “ruinous for all countries concerned.” He also introduced an implicit warning of retaliation, noting that the United States might seek its own arrangements to protect energy supplies. It was an option, he emphasized, the United States wanted to resist taking.\textsuperscript{16}

The Europeans and Japanese were not eager to endorse the American plan of action if consumer cooperation was to serve as a “counter-cartel” and thus antagonize the OPEC countries. The French objected most vigorously to the proposed Washington Energy Conference, choosing to pursue instead its own strategy of a European-Arab dialogue. Japan and most European governments maintained a middle position between France and the United States. Before the Washington conference the foreign ministers of the European Community adopted a joint position. Following the French lead, they held that the Washington conference was not to be used to confront the oil-producing countries, that no new consumer nation organization should be established, that European nations must remain free to establish direct relationships with OPEC producers, and that a formal dialogue between developed and developing countries should be pushed forward.\textsuperscript{17}

Government representatives at the Washington Energy Conference were able to agree upon a modest, collective course of action, its centerpiece an emergency oil-sharing plan. But agreement, modest as


\textsuperscript{17}See Robert Lieber, \textit{Oil and the Middle East War}, Harvard Studies in International Affairs no. 35 (1976), p. 21.
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it was, was achieved only with substantial American concessions. The United States conceded, for the first time, that its domestic oil supplies would be included in the emergency sharing plan.18 American officials also agreed to delete references to the prohibition of direct deals between consuming and producing nations from the final resolution. The U.S. delegation had proposed a code of conduct to govern bilateral agreements with OPEC producers, but this proposal was eventually dropped.19 Most important, the United States abandoned its original view that an organization of consumer nations could be formed to articulate a common bargaining position and, by so doing, undercut the oil cartel.

To get even this limited agreement the Nixon administration was forced to pressure the European governments to eschew the French approach. American officials warned that if the conference failed to reach agreement, U.S. markets and the security commitment to Europe could not be assured. Addressing the Washington conference, President Richard Nixon argued that “security and economic considerations are inevitably linked and energy cannot be separated from either.” Secretary of State Kissinger told German foreign minister Walter Scheel that the United States would reconsider its troop commitment to the Federal Republic unless the Europeans supported the establishment of an Energy Coordinating Group and rejected the French position.20

The Washington conference produced agreements in four areas. First, the countries agreed on joint action to allocate oil in times of emergency and to pursue energy conservation and R & D. Second, financial and monetary measures were to be developed to avoid competitive currency depreciation and to strengthen international credit facilities. Third, an Energy Coordinating Group was established to implement the agreement. Finally, the countries agreed to engage in a dialogue with the oil-producing nations. In November 1974 the sixteen-member International Energy Agency was established.

Outwardly the Washington conference appeared to be a victory for the American multilateral strategy, yet the success was more one of form than of substance. The French refused to participate in the Energy Coordinating Group and did not join the IEA. Nor did the February conference diminish the movement toward bilateral and regional agreements between European and producing countries. In-

18See discussion in Rustow and Mugno, OPEC: Success and Prospects, p. 59.
19Schneider, Oil Price Revolution, p. 260.
20Nixon is quoted in New York Times, February 15, 1974, p. 43; for Kissinger see Lieber, Oil and the Middle East War, p. 49.
The following month the EEC Council of Ministers agreed to a program of economic, technical, and cultural cooperation with twenty Arab countries. The French strategy of a broad European-Arab accord still had support within the European Community. The governments of Europe, particularly the British and the Germans, continued to pursue a middle course. They were unwilling to risk a breakdown of relations with the United States and therefore agreed to participate in the limited American program of multilateral cooperation. But they were also unwilling to abandon the opportunities for bilateral and regional agreements with Arab oil producers led by the French. The result was a failure of the American strategy for a unified response by consumer countries to OPEC actions on supply and pricing. The French continued to insist on both the need for a dialogue with the producing nations and the legitimacy of separate oil agreements. The United States, though moderating its objectives to gain agreement on the IEA, continued through 1974 to search for a unified way to challenge OPEC.

The central threat to Kissinger’s multilateral strategy was that industrial consuming nations might pursue bilateral deals with OPEC producers, thereby undercutting cooperative efforts at demand restraint and collective negotiations over price stability. As importing nations scrambled for separate deals with producing nations, they competed for unilateral advantage, strengthening the position of producers and leaving the consuming nations as a whole less well off.

Although the pursuit of national advantage was implicit in the French bilateral initiatives, Paris based its opposition to the American multilateral proposals on broader considerations, including a difference in view concerning the nature of the international petroleum problem. Whereas the United States thought world prices could be lowered, France believed that oil prices were likely to continue to rise and therefore sought to contract for supplies at prevailing prices. Moreover, the French government attempted to strengthen its position throughout the developing world by its conciliatory policy toward OPEC. French president Georges Pompidou was also able to strength-
en his domestic political position by pursuing an antagonistic policy toward the United States.

Beyond these broader political considerations which informed the French position, bilateral deals were attractive to consuming nations because they secured sources of supply and, when part of a larger trade package, helped pay for the imports. In the immediate aftermath of the October embargo, for example, the French negotiated a three-year contract with the Saudi Arabian government at a price below the official OPEC price. At the same time the French government began negotiations with the Saudis for a twenty-year contract that would guarantee access to enough oil to cover roughly a quarter of French consumption. Through its state-owned company, Elf-Erap, the French also negotiated deals with Libya and Iran.24

Japan also pursued bilateral deals, seeking not only to gain secure sources of supply but also to promote larger economic projects with oil-producing nations. In early 1974 the Japanese agreed to lend Iraq one billion dollars and to initiate refining, petrochemical, and other industrial projects in exchange for a ten-year contract for crude oil and petroleum products. The Japanese, with an export economy dependent on the maintenance of an open, multilateral system, were more hesitant than the French to compete for bilateral deals with Middle Eastern oil producers. Also, their oil supplies from the Persian Gulf were protected by the United States. Consequently, Japanese policy preserved bilateral access to oil producers but also moderated competition with other industrial countries for specific deals. Britain and West Germany also negotiated projects that exchanged participation in technical and economic development for oil contracts.25

The major challenge, however, was from France. The French were pursuing both a national strategy, government-to-government deals for secure supplies of oil, and a European strategy, fostering a dialogue between the EEC and Arab countries. The Euro-Arab strategy did not make much headway. Although the EEC Council of Ministers approved a wide-ranging program of economic and technical cooperation in March 1974, the British vetoed a proposal for EEC negotiations with the Arab countries. Several meetings were held in an effort to institute a Euro-Arab dialogue, but they yielded no substantive agreements.26

As oil supplies became more available and prices stabilized in

24Lieber, Oil and the Middle East War, p. 30; Schneider, Oil Price Revolution, p. 255.
26Lieber, Oil and the Middle East War.
mid-1974, the rush to secure direct contracts with producers slowed. Even the French, by the end of the year, were not eager for additional bilateral contracts, which had become in many instances more costly than oil purchased through the multinational oil companies. Bilateral agreements increasingly became a means to address balance of payments problems, with consuming nations looking for opportunities to market their goods among OPEC producers. In June 1974, for example, the French signed a ten-year, $4 billion agreement (later increased to $7 billion) with Iran for a package of economic and petroleum development projects. Oil was not directly involved in this deal.27

Although the threat of bilateralism was declining, U.S. executive officials continued to seek to put pressure on OPEC in order to moderate oil prices. Some success was achieved, not by collective restraint on the part of the consumer countries but through direct American pressure on Saudi Arabia. By September of 1974, however, Saudi efforts to continue a price moratorium had collapsed, and surpluses were countered not by a reduction of prices but by a lowering of production. At this juncture the United States again sought to bring consumer pressure on OPEC to moderate oil prices.

As before, the only leverage American officials were able to exert was the threat of collaborative actions by consumer nations to alter market forces through conservation and the development of alternative sources. In November 1974 Kissinger proposed new measures for cooperation among consumer nations. The first element of Kissinger’s proposal was a set of safeguard measures to protect consumer nations from financial adjustment problems as well as to provide stand-by emergency oil-sharing arrangements. These measures were incorporated into the IEA. Second, Kissinger proposed a new set of conservation goals for the consuming nations. He proposed that the industrial nations take steps to reduce consumption of imported petroleum by 20 percent. Indicating that the United States was still intent on undercutting the pricing power of OPEC, Kissinger noted that his proposals could provide the conditions in two or three years that would make it “increasingly difficult for the cartel to operate.”28

A year after his original London speech, then, Kissinger was still pursuing an international strategy that sought to unite the consumer nations. The original American position had envisaged immediate

steps to confront OPEC and hinged on consumer nations not negotiating bilateral agreements with oil producers. The new American position was directed at a longer-term effort to alter the underlying patterns of production and consumption. This shift in emphasis led State Department officials to accept a broader dialogue between producers and consumers over the stabilization of prices.

**Broadening the Dialogue**

American officials now emphasized the need for an agreement between consuming nations and oil producers on a long-range floor price or minimum selling price (MSP). The price of oil would come down, these officials now argued, only with long-term efforts in conservation and the development of alternatives to oil. Efforts of this sort would require massive investments by the industrial countries. Such investments, however, could be jeopardized if OPEC manipulated prices: oil prices could be brought just below the level necessary to encourage the production of alternatives. To take the extraordinary investment measures needed to shift production and consumption patterns, therefore, the industrial nations needed to agree among themselves, and with OPEC, to stabilize prices.29

The United States would facilitate a dialogue between consuming and producing nations in order to establish stable international oil prices. To protect Western investments in energy development, Kissinger proposed a common floor price for oil. “Paradoxically,” Kissinger argued, “in order to protect the major investments in the industrialized countries that are needed to bring the international oil prices down, we must ensure that the price of oil on the domestic market does not fall below a certain price.” He also proposed an international consortium, to pool capital for energy investment as well as to conduct joint research and development. With these agreements among consuming nations, Kissinger envisaged more constructive negotiations with OPEC on prices, stable markets, and petrodollar recycling. The bargain Kissinger sought to strike with OPEC turned on this logic: OPEC should “accept a significant price reduction now in return for

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29See discussion of this policy shift in Rustow and Mugno, *OPEC: Success and Prospects*, pp. 56–57. The scheme was championed by the State Department’s assistant secretary, Thomas O. Enders, and presented by Enders at a meeting of OECD representatives in April 1975. Its rationale is presented in Enders, “OPEC and the Industrial Countries: The Next Ten Years,” *Foreign Affairs* 53 (July 1975), 625–37.
stability over a longer period, or they can run the risk of a dramatic break in prices when the program of alternative energy sources begins to pay off."³⁰

American officials began to campaign for a floor price on oil, but the proposal met with protracted debate in the IEA. Europe (except the United Kingdom) and Japan worried that an effective minimum selling price would thwart any long-term erosion in oil prices. They also feared that OPEC might construe such a proposal as political confrontation. With this consideration in mind, for instance, the Japanese foreign minister claimed that the price plan was “beyond the bounds of reason.”³¹

Disagreements also broke out over what the floor price would accomplish. Behind the guarantee of a minimum selling price for oil, governments were to proceed to develop major new sources of energy. Yet the sources of energy to be developed and the effectiveness of the investment programs remained uncertain. Most important, conflict over the MSP hinged on the divergent gains that would accrue to energy-rich and energy-poor countries within the IEA. In effect, the MSP was a potential transfer of income to the energy-rich in return for the expectation of diffuse collective benefits: a better energy balance with OPEC. This conflict became more pronounced with the refusal of the United Kingdom and Norway to offer pledges of good faith concerning access by others to their domestic oil resources in return for agreement on the MSP.³² Meanwhile, the credibility of the U.S. bargaining position was undercut by the continuing presence of American price controls on domestic oil.

The IEA eventually hammered out agreement on an MSP in September 1976. The agreement, however, was largely devoid of significance. The floor price for oil was set at $7 a barrel, far below prevailing world market levels. While proponents of the MSP could claim victory, few countries believed that prices would ever fall to such a low level, and though the agreement contained provisions for review of the program’s implementation, such reviews have not taken place. Nor have there been efforts to move the price floor upward to reflect

current costs of production. An agreement may have been reached, but it could not mask basic disagreements among IEA members over the proper course of energy adjustment.

As the IEA continued to search for a meaningful agreement on a floor price plan, American officials shifted their strategy yet again. In May 1975 Kissinger placed oil price and supply issues on the agenda of the proposed dialogue between developed and developing nations. Since the earliest moments of the October embargo, American executive officials had resisted efforts to place energy issues within a larger set of global economic negotiations. U.S. officials, while agreeing in principle to France's call for a dialogue with the oil-producing nations, argued that prior cooperation by consuming nations was necessary. In the wake of OPEC's success, however, government representatives from developing nations had begun to articulate an agenda for negotiations that would include other raw materials and broader international economic issues. Consequently, when the State Department's floor price initiative failed to attract support among consuming nations, the United States became interested in using the evolving North-South dialogue as a device for engaging OPEC on issues of price and supply.

The American floor price proposal gave legitimacy to the demands of other commodity producers for cartel pricing agreements. In announcing the shift in American position in May 1975, Kissinger acknowledged that international agreements covering other raw materials would be considered on a "case-by-case basis." In this regard the American secretary of state proposed the creation of three separate commissions to cover energy, nonenergy raw materials, and economic development aid. This proposal met with resistance from OPEC governments; later in the year Kissinger, in a major UN address, proposed an elaborate set of global economic initiatives ranging from financial aid programs and commodity agreements to a new, special $10 billion IMF lending facility to stabilize the export earnings of

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developing countries. These various programs were to be financed jointly by OPEC and the industrial countries. Talks got under way in Paris as representatives of developed and developing countries met at the Conference on International Economic Cooperation (CIEC). 36

These efforts to manage commodity markets internationally did not, however, provide any headway on the American effort to induce OPEC to moderate or reduce oil prices. The United States opposed commodity schemes involving the maintenance of prices at levels necessary to achieve significant transfers of wealth. Nor would the consumer nations accept OPEC's proposal for the indexation of oil prices to the price of producer goods. The demise of the U.S. international adjustment strategy came in November 1976. On the eve of a meeting of the CIEC, Kissinger sent word to the representatives of other industrialized countries conceding that “there is no negotiable package which the industrialized countries could accept and which would also present sufficient inducement to OPEC to refrain from a substantial oil price increase over several years, given the lack of leverage by consumers over oil prices.” 37 American efforts to orchestrate a united response to OPEC by consumer countries, which had evolved over the preceding three years but had constantly sought the moderation or rollback of cartel prices, were at an end.

THE IEA AND THE SECOND OIL CRISIS

In the three years following the October 1973 embargo American administration officials pursued an international offensive strategy that sought to unite the consumer nations and, by so doing, develop the economic and political leverage to return oil prices to more moderate and stable levels. At the center of consumer unity was to be the International Energy Agency. The IEA, however, did not play the role that American officials had envisaged. Governments in Europe and Japan resisted efforts to use it as a vehicle to confront OPEC. The IEA did manage to develop a more modest mission that revolved around agreements on emergency oil sharing and energy information sharing. In effect, the agency came to represent consumer country efforts to develop international defensive measures to guard

against future emergencies. Yet as we shall see, in 1979 cooperation between the consuming nations remained, for the most part, elusive.

A central mission of the IEA was the development of an emergency oil-sharing agreement. The task was to develop an agreed set of procedures between the major international oil companies, the IEA, and member-governments for the sharing and management of oil supplies at moments of extreme shortage. The IEA also began to develop the organizational capacity to monitor international oil markets and to set aggregate oil-import targets for member-countries as a whole.38

The stand-by agreements and monitoring activities of the IEA did not significantly moderate the scramble for supplies in the midst of the 1979 oil crisis. This crisis, triggered by the cutback of Iranian production, resulted in a reduction of about 2 million barrels per day on international oil markets in late 1978. Although the aggregate loss of production was modest, approximately 6.3 percent of the noncommunist world total, the rush by governments and companies to secure supplies was even more intense than in 1973–74. International oil companies, independent refiners, and governments all acted to increase their stocks. In the face of uncertainty, demand for oil on the spot market rose quickly, pushing prices to extraordinary levels, far out of proportion to actual shortages.39

As in the earlier oil crisis, prices were driven by short-term, competitive responses to very small shortfalls in production. The Iranian cutback, which caused prices to climb on the spot market, was followed in January 1979 by the announcement that Saudi Arabia would reduce production to meet a ceiling set by the government. Production dropped only slightly (by approximately 500,000 barrels a day for several weeks in February) and was restored in March, but the effect on prices was dramatic. The spot price for Saudi Arabian crude rose 64.5 percent, from $19.09 to $31.40 a barrel, during February and dropped back to $25.04 a barrel in late March40 (see Table 4).


40Verleger, Oil Markets in Turmoil, pp. 34–35.
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Table 4. Spot market and official oil prices, January 1978–April 1980 (cost per barrel in U.S. dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Month</th>
<th>Spot Market Value</th>
<th>Official Contract Price</th>
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<tr>
<td>1978</td>
<td>Jan.</td>
<td>$13.71</td>
<td>$14.20</td>
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<td></td>
<td>April</td>
<td>14.13</td>
<td>13.95</td>
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<td>1979</td>
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Although supply-side changes were small, they triggered demand-side actions that were large and consequential. The uncertainty created by the suddenness of the cutbacks and the relatively low inventories that oil users possessed at the moment of the disruptions encouraged competitive bidding for supplies. At the moment that supplies were tightening up, short-term demand for those supplies increased.

Efforts by individual buyers to increase inventories escalated prices out of line with the loss of production. Indeed, the shortfall in production was very brief. By the third quarter of 1979 world oil production was actually higher than it had been the previous year, and consumption was only marginally higher. Iranian production did decline in late 1978 and in 1979, but other Middle Eastern oil producers, particularly Saudi Arabia (in the third and fourth quarter of 1979) and Iraq, raised production over the previous year’s level.41

Efforts by the IEA and its member-governments to address the collective dilemma of competitive bidding were unavailing.42 The IEA urged in March 1979 that consumer countries cut their imports by 2 million barrels a day. Yet individual governments were not held to specific targets, and the incentives for demand restraint were not

42Indeed, many actions by governments tended to increase market pressures. The United States, in May 1979, imposed a $5 per barrel subsidy for distillate imports. This subsidy, imposed without warning, was roundly criticized by IEA member-countries and immediately drove up prices on the spot market. At the same time, oil stocks under the control of the governments of the consuming nations could have been released on to commercial markets, mitigating the competitive scramble for supplies. See Badger, “Anatomy of a Minor Crisis.”
strengthened. Imports by IEA countries in fact increased in 1979, by about 1 percent over 1978 levels. Nor was the IEA’s emergency sharing agreement of use. That agreement, to redistribute oil supplies to IEA members with more than a 7 percent shortfall of supply, was designed to protect countries from selective embargoes. In 1979 shortfalls for individual countries hinged on such circumstances as the existence of price controls and stockpile arrangements. The sharing of oil would at least partially have rewarded countries with less efficient import policies.43

The consuming nations also used the occasion of their annual economic summit meeting, held in Tokyo in June 1979, to agree to country targets for oil imports. Prior to the summit the French government, in contrast to its actions in 1974, called for quantitative limits on oil imports, coordination of emergency stockpiling programs, and joint control of prices on the spot market. At a meeting of the European Council, however, government representatives could agree only on the monitoring of the spot market and refused to commit themselves to national import targets. During the Tokyo summit and in later negotiations, Japan and West Germany forcefully opposed controls on spot market purchases and national import levels. Japan was eager to avoid international obligations that might prevent it from finding new supply contracts, which it needed as contracts with the major oil companies terminated. West Germany was suspicious of controls on the market and was convinced that the inevitable cheating on any agreement would be sufficient to drive prices up anyway.44

Agreement at the Tokyo summit on national targets to limit oil imports was possible only when pledges gave governments large margin for discretion. A compromise was eventually concluded: the United States, Canada, and Japan agreed to national ceilings, and the European governments agreed to reach individual national targets later. Following the summit the United States continued its attempt to persuade other consuming nations to share the burden of supply reductions.45 Yet the United States itself was having difficulty reducing imports, and the target agreements were of limited effectiveness in coping with the immediate problems of OPEC supply reductions.

43See Keohane, After Hegemony, pp. 228–29.
44Cowhey, Problems of Plenty, p. 274.
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The IEA and member-governments were ill-equipped to deal with the problem of collective action. As a result governments, oil companies, and marketers followed the incentives of the moment. Short-term demand had the effect of doubling oil prices. The OPEC cartel followed the spot market, moving official prices higher as well. After the disruption ended and supplies had been stabilized, the price of oil remained at the higher level.46

CONCLUSION

The rise in oil prices in 1973–74 and in 1979 began with the curtailment of a portion of OPEC production. The manner in which consumer nations responded to these disruptions in supply had a decisive impact on the magnitude of the price increases. The scramble by state officials and oil companies to ensure supplies pushed prices higher and reinforced the market position of the oil cartel. Opportunities for cooperation existed at both moments of crisis, but cooperation remained elusive.

The interests of states in a multilateral strategy to cope with oil shortages diverged, and these divergences were related to differences in the capacities of those governments to pursue other strategies. The interest in and fate of international strategies of adjustment can be understood when those strategies are juxtaposed with the other opportunities states had for action. In the American case, other opportunities were not immediately available. Price controls constrained the ability of American executive officials to impose higher costs of imported oil on the domestic economy. Moreover, foreign policy officials could conduct an international strategy of adjustment without getting immediately involved in the larger and unwieldy decision-making process. At the same time the international position of the United States provided opportunities to seek international adjustment solutions—solutions that accorded with a broader set of hegemonic political objectives. Other consuming nations, however, were able to pass

46A third oil supply disruption, precipitated in 1980 by the Iran-Iraq war, did not have the same effects on prices as the two previous disruptions even though the fall in the world production involved was actually greater than the production losses of 1979. Over a two-month period, world oil production fell by 3.6 million barrels a day from 59.5 to 55.9 million barrels a day. Yet oil prices did not increase as in the earlier crises. Although an increase in Saudi production was important in offsetting these losses, Verleger argues that the most important factor was the high level of consumer stocks. “Stocks were high in the fall of 1980, and oil companies probably welcomed the opportunity to work them off.” Oil Markets in Turmoil, p. 38.
prices through their economies and were better equipped to pursue separate deals with oil producers. The construction of multilateral schemes to share the costs of adjustment and to moderate price increases, at least in the 1973–74 crisis, was less pressing than other objectives: access to supply and favorable diplomatic relations with Arab states. Moreover, while U.S. officials had stronger incentives and a favorable international position from which to pursue an international offensive strategy, their inability to adjust to higher prices domestically prevented them from satisfying their international obligations. The persistence of price controls indirectly encouraged the growth of oil imports. Even if other nations had agreed to a collaborative program of import restraint, the United States could not have lived up to its part of the bargain.

This argument is not a complete theory of the determinants of international collaboration. The industrial importing nations confronted divergent international and domestic constraints and opportunities, which in turn influenced national preferences for specific forms of international agreements. But states with different international and domestic capacities may still participate in multilateral cooperative schemes. The French, for example, were much more interested in coordinating national oil-import levels during the second oil crisis than during the first. Moreover, some of the conflicts between the industrial nations over energy adjustment were rooted in differences only indirectly related to state capacity. Lines of conflict over the MSP, for instance, were primarily drawn between countries with and those without significant indigenous sources of energy. I focus here, that is to say, on a particular set of constraints and opportunities—variables that cannot explain the entire course of cooperation and noncooperation in energy adjustment during the 1970s. These variables are helpful, however, in explaining important elements of the international struggle over energy adjustment: the initial interest of American officials in an international solution to OPEC petroleum pricing; the opportunities for other industrial nations, particularly France, to “exit” from these multilateral schemes; and the inability of the United States to fulfill its leadership role by controlling domestic imports of petroleum.

It is difficult to disentangle the conflicts over energy among industrial nations in the 1970s from larger foreign policy and economic circumstances. American international strategy sought to advance goals beyond the immediate problem of energy adjustment. French opposition to that strategy was also wrapped up in a larger and well-established objection to American leadership. Differences among
states concerning the nature of relationships with the countries of the Middle East served to widen the breach between Washington and other Western capitals.

The international strategies that American officials articulated and reformulated between 1973 and 1976 were only a subset of a larger variety of strategies available to states. U.S. officials were drawn to the multilateral approach because, if successful, it would have the virtue of lowering and distributing the costs of adjustment across the industrial world—an option all the more attractive for executive officials ill-equipped to impose costs on their own economy. At the same time Secretary Kissinger was intent on removing OPEC from a position of prominence in the international system. OPEC had challenged the West with higher oil prices. With higher energy costs came slower growth, export competition, greater bilateralism, and unprecedented demands by developing countries for fundamental reform of international economic relations—all events that ran afoul of the principles upon which American postwar leadership was based.

The failure of the international collaborative proposals advanced by the State Department during the 1973–74 crisis was rooted in the “exit” by the Japanese and the Europeans, particularly the French, from those agreements. French opposition to the American strategy was informed by a variety of factors. The larger issues of political leadership within the Western alliance, divergent foreign policy positions on the Middle East conflict, and European regional goals all formed part of the backdrop for French intransigence in the face of American multilateral initiatives.47 Beneath these political considerations were divergent national economic and political capabilities. While imports in the United States continued to rise, the French government in 1975 moved to limit annual oil imports to about 10 percent below the level of the previous year.48 The Ford administration, in the same year, sought to limit oil imports by use of a tax; this import fee was an attempt to pressure Congress into decontrolling oil prices, but the effort did not succeed and imports continued to rise. The French were also well-equipped to negotiate bilaterally with oil producers. Through state-owned oil companies the French government could negotiate secure contracts of oil directly, even in the face of overall shortages and dislocations in world markets. Because of

48Rustow and Mugno, OPEC: Success and Prospects, p. 55.
these and similar differences in political objectives and national capabilities, the Europeans and the Japanese did not find compelling the multilateral schemes pursued by the United States during the 1973–74 oil crisis.

Finally, the United States itself was not able to develop the domestic responses that would have given its international strategies more credibility.49 In particular, the United States was not able to curb its own consumption of imported oil.50 European demand for oil dropped from an average of 15.4 million barrels a day in 1973 to roughly 13 million barrels a day in 1978, the year preceding the second oil shock. During the same period Japanese consumption of imported oil also fell, if slightly less. U.S. oil consumption, however, rose substantially: oil imports went from an average 6.3 million barrels a day in 1973 to 8.2 million in 1978 (and rose again in 1979).51

American executive officials attempted to redress the nation’s problems of adjustment by confronting OPEC directly over the pricing issue. Other industrial importing countries, with different capabilities and policy objectives, found alternative responses, and in the end the United States was also forced to look for other responses. When the oil shortages and dislocations of 1973–74 receded, the price consequences remained, and the United States found itself looking for domestic (as well as international) means to adjust to the new reality.

49Kissinger noted this failure. “When I was in office, we helped develop the International Energy Agency, which was supposed to bring together the industrial democracies in a program of conservation, alternative supplies and emergencies against embargoes. [He went on to argue that] I think it is safe to say that this agency has not been able to achieve the goals set for it, largely because the United States did not carry out its share of the necessary conservation.” U.S. Senate, Committee on Energy and Natural Resources, Subcommittee on Energy and Regulation, “Status of Federal Energy Conservation,” Hearings, April 4, 1977, 95th Cong., 1st sess., p. 5.

50An analyst writing in 1976 noted the influence of domestic constraints on the waning vigor of American energy diplomacy. The retreat of U.S. international efforts “lies in the relatively weak position of the United States regarding the development of its domestic energy policy. Domestic linkages, the political constraint which stops governments from pursuing a policy of restraint through pricing, have been particularly apparent in the United States.” Walton, “Atlantic Bargaining over Energy,” p. 195.