King 'Abd al-'Aziz' Negotiations with Concessionaire Oil Companies in Saudi Arabia

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Executive Summary

King ‘Abd al-‘Aziz bin ‘Abd al-Rahman Al Sa‘ud, founder of the Kingdom of Saudi Arabia, initially granted a concession for oil exploration in the Kingdom to the British Eastern General Syndicate, but he withdrew that concession when it failed to find oil in the Eastern Province. Because British companies already controlled oil concessions in Iran and Iraq, the King opened the door for companies of other nationalities, ultimately turning to the major American oil companies with their wide international marketing outlets and, in many cases, their independence of the “red line” agreements made by the British with companies operating elsewhere in the Gulf.

He thus achieved a strategic balance to British hegemony in the Gulf region, and created the basis for future relations with the United States. When, at the end of the Second World war, French, Dutch and other countries sought to participate in concessions in the Kingdom, the King turned them down.

This monograph traces the development of the concessionary agreements during King ‘Abd al-‘Aziz’ reign.

The Author

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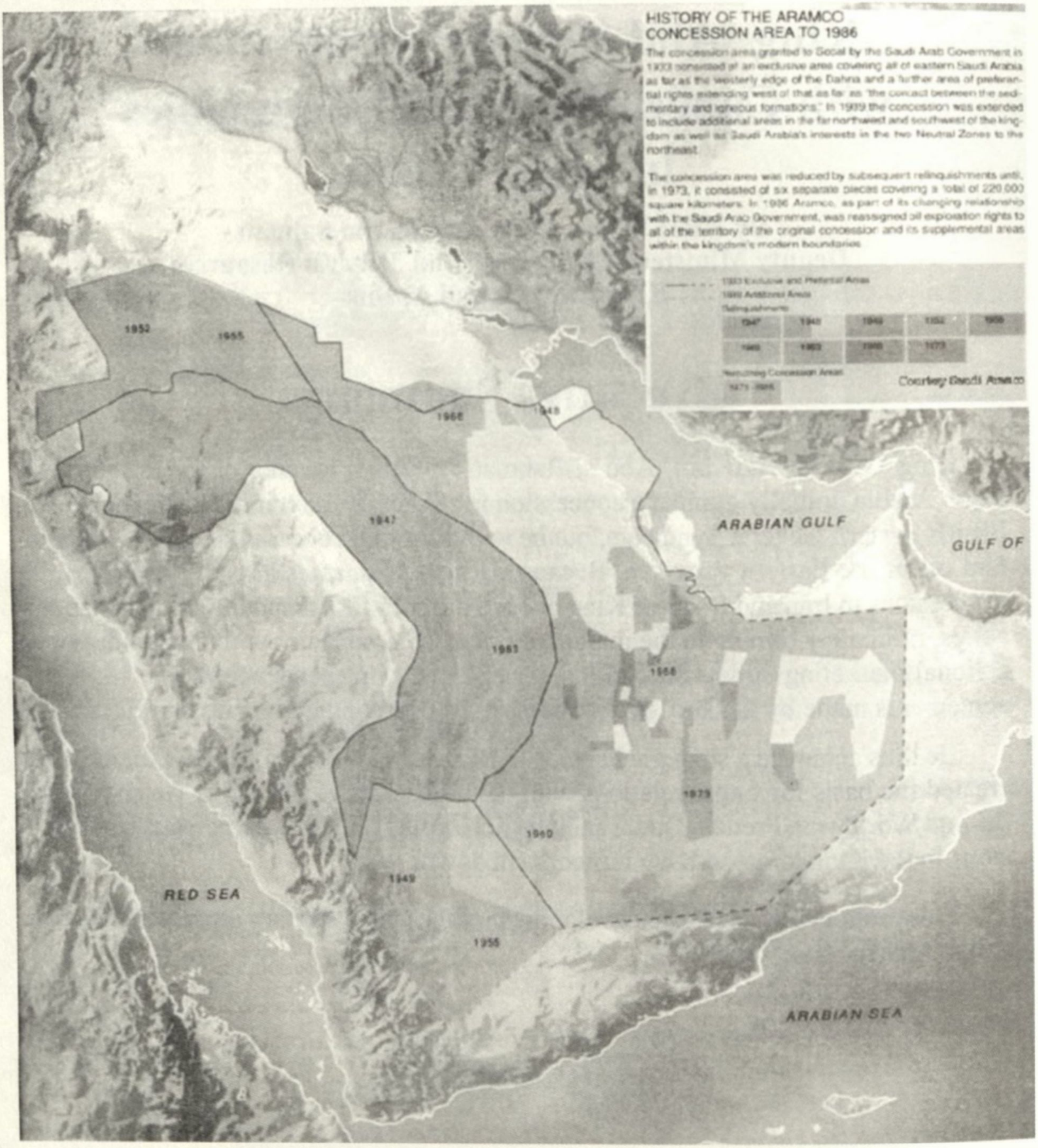

Map of Saudi Oil Concessions (courtesy Saudi Aramco).

"It is He Who hath made the earth subservient unto you, so traverse ye through its tracts and enjoy the sustenance which He furnishes: but unto Him is the Resurrection."

***(Holy Qur'an,* Sura LVII *Al-Mulk*, verse 15)**

Historians agree that one of the most distinct features of the modern Arab renaissance in general was the emergence of the first Saudi state between the end of the 18th century AD and the end of the 19th century AD, and the proclamation of its reformist principles of true Islamic faith. King 'Abd al-'Aziz resuscitated the country at the beginning of the 20th century AD. He took his first step in the holy war for unity and restoration of the Saudi Kingdom when he conquered Riyadh on 5 Shawwal 1319 AH (15 January 1902 AD). King 'Abd al-'Aziz thus began the reunification of the Kingdom at a time when most Arab countries were languishing under the oppression of foreign occupation. This reunification was accompanied by an Islamic cultural renaissance whose influence spread to most Arab and Islamic countries.

After King 'Abd al-'Aziz extended his full sway over Najd, following ferocious compaigns and battles, he continued his efforts to restore authority by turning his attention to recovering al-Hasa, which he conquered on 5 Jumada I 1331 AH (12 April 1913 AD). This area was to be of major economic importance, since it was the part of the Kingdom that was destined to witness the largest oil discoveries in the world, thanks to the founder of the Kingdom, King 'Abd al-'Aziz. Three years after the conquest of al-Hasa, the British government through its High Commissioner in Iraq, Sir Percy Cox, recognized the sovereignty of the Saudi Government over al-Hasa, al-Qatif and Najd and their dependencies, as well as recognizing King 'Abd al-'Aziz as the independent ruler of these provinces. This recognition was formalized in a treaty between the two sides signed on 18 Safar 1334 AH (26 December 1915 AD) in the port of 'Uqair, known as the First Treaty of 'Uqair.[1]

In 1340 (1921-1922), border disputes broke out between Saudi Arabia and both Iraq and Kuwait, and in the wake of these disputes two conferences were held between the Saudi government and representatives of the British government and of King Faisal of Iraq. The first of these was the Muhammara conference on 5 Ramadan 1340 (5 May 1922), which was attended by delegates from the two sides, and produced a preliminary draft agreement which King 'Abd al-'Aziz did not ratify. A follow-up to the Muhammara conference, the second 'Uqair conference, was then held, attended by King 'Abd al-'Aziz personally, Sir Percy Cox, and the personal representative of King Faisal of Iraq. As a result of this conference an agreement on the border with Iraq was signed on 12 Rabi'a II 1341 AH (2 December 1922 AD). The next day, another agreement was signed with Kuwait defining the border of the Neutral Zone between the Kingdom and Kuwait.[2]

The significance of these conferences and agreements went beyond the official recognition of the Saudi state and its borders by Britain, which at that time controlled the countries next door to the Kingdom. The second 'Uqair conference had witnessed the emergence of the first oil concession granted by King 'Abd al-'Aziz to a foreign company.

Present during the border negotiations at 'Uqair was a New Zealander, Major Frank Holmes, representing a British oil company called Eastern and General Syndicate (EGS), which was seeking from the King an oil concession in the Eastern Province and the Saudi-Kuwait Neutral Zone.

Sir Percy Cox, the British delegate to the 'Uqair conference, learned of Major Holmes' request and tried to persuade King 'Abd al-'Aziz to turn it down, with the aim of leaving the field open for entry by the Anglo-Persian Oil Company (APOC: after 1935 it became the Anglo-Iranian Oil company, AIOC) in Iran, in which the British government held a 70% share, and the Iraq Petroleum Company (IPC). Ironically, Cox advised Major Holmes not to be over-hasty in pursuing a concession, despite the fact that he represented a British oil company (but one in which the British government had no stake). King 'Abd al-'Aziz considered this an unacceptable interference by the British in matters which did not concern them, with the aim of paving the way for APOC to obtain a concession in the Kingdom. For the King, his state was sovereign and had the right to grant oil concessions to whichever companies it wished. He had given no commitment to Britain or anyone else that oil concessions would be restricted to citizens of one state or another, as was the case in Kuwait and Bahrain. So, some months after the signature of the 'Uqair agreement, he granted a concession to EGS in al-Hasa and the Kingdom's share of the Neutral Zone.[3] This concession agreement included the following conditions, *inter alia:*

1) The area of the concession was 36,000 square miles extending from the north of the Neutral Zone to Harad in the south.
2) The concession covered the right to explore for and produce oil and other minerals and to exploit them and export them.
3) The duration of the concession was 75 years.
4) The company undertook to begin drilling and exploration within nine months of the signature of the agreement.

5) The company had no right to intervene in the political affairs of the country.

6) The company was obliged to employ Saudi workers in areas for which they were qualified, to pay them good wages, and to provide them with free medical services.

7) The state undertook to assist and protect the company.

8) The company had the right to terminate the concession after 35 years from the date of signature if it so wished. At that time it had the right to take the tools and machinery which it was using.

9) The state had the right to buy 20% of the shares in any company established by the concessionaire to exploit the concession. The state had the right to accept or reject this offer within 60 days.

10) The state had the right to nominate one of six members of the company's board of directors.

11) The company undertook to pay an annual rent of 2,000 gold pounds for the concession, each year in advance. [4]

The company began to drill for oil immediately, using a geologist of Swiss extraction. However, while it continued to meet its obligations by paying the rent for 1923 and 1924 AD (1342 and 1343 AH), it failed to find any oil deposits, and its expenditures on the project had drained all the funds available to it. Consequently, it then tried to bring in major oil companies such as Shell, APOC, Standard Oil of New Jersey, and Gulf as partners. These companies did not respond, principally because the Red Line agreement, which they had already signed as a condition of membership in the Iraq Petroleum Company (IPC) agreement, had prohibited any individual company from entering into oil activities in a certain specified area, which included Saudi Arabia. Since the company failed to maintain its exploration and drilling activities in the two subsequent years, and also failed to pay the rent due for 1925 and 1926 AD (1344 and 1345 AH), King 'Abd al-'Aziz decided to withdraw the company's concession in 1928 AD (1347 AH) citing the company's blatant violation of the terms of the concession.

Thus ended the first chapter of King 'Abd al-'Aziz's efforts to develop the Kingdom's oil. As soon as he established his control and sovereignty over the major part of the Kingdom, he spared no effort in seeking new sources of income for the young state and in developing its economy, guided by a firm belief in the existence of oil and mineral resources inside his territories.[5]

Major Power Disputes Over Oil Concessions In the Middle East: Historic Rivalries

Before proceeding to review the late King 'Abd al-'Aziz's policies towards granting oil concessions to the major American oil companies, it is necessary to present a picture of the circumstances prevailing in the neighboring areas and their effect on oil developments in the Kingdom.

The first European country to obtain an oil concession in the region was Britain. A British company obtained an oil concession in Iran in 1872, but Russia, which enjoyed powerful influence in Iran, opposed the project and the Shah annulled the concession. However, the British government rejected this decision, and the Shah renewed the concession for the same company (De Reuter) in 1889. When it failed to find oil, the Iranian government annulled this concession in 1899. Another British national, named D'Arcy, then approached the Iranian government in 1901, seeking a new concession. He subsequently obtained from the government a concession to exploit oil resources for a period of 60 years. The northern areas were excluded from this concession. When, after three years of expenditures, the company failed to find oil in commercial quantities, the British government feared that the concession would fall into the hands of the Dutch or the Americans, and it asked Burmah Oil, which was British-owned and produced oil in Burma, to come to the assistance of D'Arcy's company, and the two companies were merged under the name Anglo-Persian (later Anglo-Iranian). As a result, the British government became the majority shareholder in the concessionm, with a stake of 87.5%. Oil was discovered in Iran in 1909. In 1933, in the time of Shah Reza Pahlavi, the Iranian government contested the terms of the agreement, and at Britain's request the dispute was referred to the League of Nations. Subsequently a new concession agreement was signed with the company, which contained terms more favorable to the government.[6]

As for Iraq, it was a dependency of the Ottoman state, and the Ottoman government was aware that there was oil in the northern areas around Kirkuk, since quantities of it leaked to the surface. The Ottoman Sultan 'Abd al-Hamid decided to give himself the concession to explore for oil there and issued a decree (firman) to this effect covering the provinces of Mosul and Baghdad in 1888. In 1904, an agreement was concluded with a German company, the Anatolian Railroad Company, to explore and drill for oil in Iraq on behalf of Sultan 'Abd al-Hamid, but this agreement was annulled two years later in 1906. Negotiations were then entered into with the D'Arcy company, the same company that had obtained a concession in Iran. However, in 1908, power in Turkey had passed into the hands of the Committee for Union and Progress (the "Young Turks") and the new government inherited the Sultan's oil concession in Iraq. In 1912, the German government approached the Turkish government to obtain a concession in Iraq through Deutsche Bank. At the same time approaches were also made both by a consortium of D'Arcy Oil and Royal Dutch/Shell, and the American Chester group. The three European companies agreed among themselves to exclude the American group, and formed a company known as the Turkish Petroleum Company (TPC) in which D'Arcy Oil held a 50% share and the other two companies 25% each. This company opened negotiations with the Turkish government with a view to obtaining an oil concession in Iraq, and Turkish Prime Minister Sa'id Halim agreed in June 1914 to lease the requested areas in Iraq to the company, while reserving the Turkish government's right to participate and laying down the relevant conditions. However, the outbreak of the First World War blocked the company's activities.[7]

After the war and Turkey's defeat, Britain and France divided up the territory of the Arab countries east of the Mediterranean, and in accordance with the Sykes-Picot agreement of 1916 (made public in 1917), Iraq and Palestine became Britain's share, and Syria and Lebanon became France's share. From that point on, the two countries began to take an interest in Iraq's oil affairs at the government level. The two governments in 1918 entered into negotiations in Paris which culminated in an agreement specifying that in the event that Britain obtained an oil concession in Iraq through TPC, France would obtain a 20% share against a 70% share for Britain, with the remaining 10% to be held by the anticipated Iraqi state. In the wake of the San Remo peace conference with Turkey in 1920, the French and British mandates over the Arab east were confirmed. Britain then proceeded to give France a 25% share in TPC, replacing the German share in the company, which was forfeited as a result of Germany's defeat in the war.

Britain retained a 50% share and the Dutch a 25% share. One factor that motivated the British government to give France its 25% share was the realization that any oil discovered in north Iraq would have to be transported by pipeline across Syria and Lebanon in order to be exported to world markets, and since these two countries were under French control, Britain sought to mollify France with this share, so as to ensure that the French would agree to the oil transiting Syria and Lebanon.

This agreement angered the American government, since it excluded its nationals from investing in the region's oil wealth, and gave rise to a dispute between the US and the British and French governments. France and Britain's reason for excluding the Americans was that the US had not declared war on Turkey, and therefore had no right to share in the spoils of war in former Ottoman territory. The Americans argued that they had a right to share in the spoils from the defeated Turkish state, since they had made a major contribution towards helping Britain and France defeat Germany and its Turkish ally, and that the open door policy applied in this respect. They also argued that they had supplied the allies with the oil products required to fuel the military equipment and machines used in that war from domestic sources in the US, and should therefore be compensated, particularly since US oil reserves had started to decline as a result. Meanwhile, seven US oil companies headed by Standard Oil of New Jersey, Socony Vacuum (later Mobil) and Gulf had opened negotiations to obtain a share in TPC but were refused entry on the advice of the British government. In the meantime the Iraqi government granted an oil concession to TPC on 24 March 1925 giving the company the right to drill for and exploit oil in all regions of Iraq except Basra and Mosul for a period of 75 years. The American companies were excluded from this concession.[8]

However, the Americans did not give up as a result, and continued to negotiate with TPC, and in 1927 an agreement was finally concluded under which the American group entered TPC with a share of 23.75%.

Similar shares were held by the British D'Arcy group (through its wholly-owned subsidiary Anglo-Persian), Royal Dutch/Shell, and the Compagnie Française des Pétroles, while a 5% share was given to the Armenian businessman Nubar Gulbenkian, in recognition of his efforts in originally organizing the Turkish Petroleum Company, and the negotiations he carried out for obtaining a concession in Mesopotamia from the Turkish government. As a price for joining TPC, the American group accepted the self-imposed ban agreed by all the partners, precluding them from seeking any other oil concession individually in an area defined by a red line on a map. This area included the entire Arabian peninsula, with the exception of Kuwait, and the adjoining territorial waters and continental shelf, including Bahrain. It also covered the countries of the Levant and Turkey and their corresponding offshore areas. This agreement came to be widely known as the Red Line agreement. The name of the new company was changed to the Iraq Petroleum Company (IPC) and it obtained a new oil concession on 24 March 1924.

As far as Kuwait is concerned, the British government had been aware of the existence of oil there since 1913. The British government had signed an agreement with the Amir of Kuwait in 1899, making Kuwait a British protectorate. In the expectation that oil existed, since traces in the form of bitumen appeared on the surface of the Burgan field, the Amir in 1913 made an obligation to the British in an official letter affirming that in the event of the existence of oil in his country, he would not grant an oil concession to any party except that which had been designated by the British government. In view of this situation and seeking to monopolize Kuwait's resources, the British government used its influence to exclude its territory from the Red Line agreement. In 1920, the New Zealander Frank Holmes approached the Amir on behalf of the British company Eastern and General Syndicate (EGS) to obtain an oil concession. He obtained the concession, but instead of proceeding directly to carry out drilling he offered to sell the concession to APOC, and when APOC declined this offer, he offered to sell it to Gulf Oil of the US. At that point the British government objected to the inclusion of Gulf Oil on the basis of the undertaking given by the Amir in 1913, restricting oil concessions to British companies alone. In 1932, the American government intervened and protested officially to the British government about this obstruction and procrastination.[9]

Shortly thereafter the British government claimed that APOC had already obtained an oil concession from the Amir of Kuwait before Major Holmes and therefore had priority in this respect. As a result, talks were broken off and the dispute between the two companies lingered. Finally, on 14 December 1933, they agreed to divide the concession equally between them and jointly formed the Kuwait Oil Company (KOC). Nearly a year later, in 1934, KOC obtained from the government of Kuwait an oil concession covering the entire area of Kuwait for a period of 75 years.

In Bahrain it was the same story as in Kuwait with Major Holmes and EGS. As in Kuwait, at the request of the British government, the Amir of Bahrain gave an undertaking to the British in May 1914 that he would not grant an oil concession to any party without the approval of the British government and would consult with the British political agent in Bahrain. In December 1925 Major Holmes and his company were awarded a concession covering 100,000 acres on condition that exploration and drilling should take place within four years. Holmes tried to sell the concession to British companies without success, so he then offered it to Gulf of the US in 1927, and reached agreement to sell it to Gulf in 1929. Since Gulf was one of the partners in TPC and its concession in Iraq, and had signed the Red Line agreement forbidding the individual acquisition of oil concessions in the areas within the line, and since Bahrain lay within the Red Line area, Gulf's partners in TPC objected to its entry into Bahrain. Gulf then transferred its concession rights in Bahrain to another American company, Standard Oil of California, in exchange for $50,000. This company was not subject to the restrictions imposed by the Red Line agreement since it was not a partner in TPC. However, it only obtained the concession legally in June 1930, after winning the consent of the British government, following the intervention of the American government and on condition that it be registered as a British company. It discovered oil in Bahrain in May 1932, and about a year later this was the company which obtained an oil concession in the Saudi Kingdom.[10]

The Second Oil Concession

King 'Abd al-'Aziz had continued his campaign to expand and unite the territories of the Kingdom and to establish his authority over it, and once he had done so his thoughts turned to developing the Kingdom's economy. As the Kingdom's territory had expanded, its cities and population had grown in number, as had been the case when the King conquered the Eastern Province. Recognition of the Kingdom within its new frontiers was forthcoming from the major countries, and this recognition reinforced the country's political stability and security, an essential pre-requisite for encouraging the inflow of foreign capital to the country.

The first visitor to the Kingdom at the invitation of King 'Abd al-'Aziz, in February 1931, as part of the campaign to develop the country's economy was Charles Crane, an American citizen well known for his friendship towards the Arabs. The discussion which ensued centered on the Kingdom's development potential and the possibility of finding water, minerals and oil. As a result, it was decided that the prime need was for geological survey of the Kingdom, to establish its potential. Crane commissioned a geological engineer, Karl Twitchell, to carry out the survey and submit a report. Mr. Twitchell arrived in the Kingdom in April 1931, and carried out a geological survey across the country from west to east and from north to south.

Twitchell's studies resulted in the development of water resources in the western region and the supply of drinking water to Jiddah, as well as the rediscovery of the Mahd Al-Dhahab gold mine.[11] He also expressed the belief that there was a high probability that there was oil in the Eastern Province, particularly after the discovery of oil in Bahrain. On that basis, King 'Abd al-'Aziz commissioned him officially to seek out American oil companies that wanted to invest in exploration for and the development of oil in the Kingdom, particularly in the Eastern Province. He also assigned him the task of bringing in companies to exploit the Kingdom's mineral wealth, since the political stability and security enjoyed by the Kingdom in the era of King 'Abd al-'Aziz formed an excellent basis on which to attract foreign capital. Twitchell initiated contacts with a number of American companies, including Texas Oil, Gulf, and others, but these companies were uninterested, particularly since Gulf was anxious to obtain an oil concession in Kuwait. Standard of California, for its part, showed great interest, particularly since it had obtained a concession in Bahrain with similar geological formations in which it had discovered commercial quantities of oil. In mid-February 1933, Socal sent Lloyd Hamilton to Jiddah as its representative, along with Twitchell in his capacity as an adviser to the company, to negotiate with the Kingdom with a view to obtaining an oil concession in the Eastern Province. As mentioned previously, Socal was exempt from the restrictions imposed by the Red Line agreement, and there was no objection to it taking a concession in the Kingdom.[12]

Socal's initial offer was for a 60-year concession in the Eastern Province, with the necessary geological work to start within three months from the date of signature and a commitment to begin exploiting oil within four years. The company also undertook to pay a royalty of four English gold shillings per ton of oil produced and to make an initial payment of 50,000 English gold pounds, 30,000 upon signature and the remaining 20,000 in the second year, with the proviso that the government would cover this sum from the royalties due to it after production.[13] King 'Abd al-'Aziz was not opposed in principle to giving the American company a concession in the Kingdom, since that would open the way to strong economic ties with the US, which would counterbalance the growing influence of Britain and its oil companies, which enjoyed hegemony over Iran, Iraq, and Kuwait. However, he at first rejected these conditions, which he considered unfair, particularly the cash payments. Socal was not the only company in the arena, since IPC, which was 47% owned by the British, sent its representative, Stephen Longrigg, to negotiate with the Saudi government with a view to obtaining a similar concession. Also in attendance at the same time was Major Holmes, the holder of the original, nullified concession, who was seeking to obtain the concession once again. These attempts only reinforced King 'Abd al-'Aziz's belief that there were large quantities of oil in the Eastern Province, which strengthened his bargaining position. He gave instructions to his aides to make a counter-offer to Socal which contained a demand for a signature payment of 100,000 gold pounds, an annual rent of 30,000 gold pounds and a floor of 200,000 pounds annually for royalties, the aim of which was to oblige the company to produce large volumes of oil and to discourage any attempt at delaying exploitation and implementation of the agreement.[14] The company would also be required to hire Saudi employees and workers.

The company was slow to respond to these demands, and it appeared that the economic depression, whose effects had by then spread throughout the world, including the US, had affected its financial position, particularly since the US had passed a law forbidding the export of gold. King 'Abd al-'Aziz stuck to his conditions, and negotiations dragged on for several months. The King excluded IPC, because it had enough oil of its own in Iraq, and if it obtained a concession in the Kingdom it would regard it as secondary and delay its development in order to protect its oil resources in Iraq from competition. He similarly excluded Major Holmes and refused to meet with him, since he had been given the opportunity some years ago and had failed to meet his obligations in regard to his agreement with the state. Finally, the agreement with Socal was signed and King 'Abd al-'Aziz issued Royal Decree 1135 of 14 Rabi'a I 1352 AH (7 July 1933 AD), licensing the company and ratifying the agreement. Despite the fact that the agreement called for an initial payment to the government of 50,000 gold pounds, because of the firm position regarding Saudi demands adopted by King 'Abd al-'Aziz during the negotiations, a condition was inserted obliging the company to pay 100,000 gold pounds to the state upon the discovery of oil in commercial quantities, to compensate for the original government demands, which the company was unable to meet at the time. In addition, the company undertook to pay an annual rent of 5,000 gold pounds until the discovery of oil in commercial quantities. The agreement further specified that the company would pay a royalty of four English gold shillings per ton of oil produced, and the company undertook to build a refinery after the discovery of oil in commercial quantities and subsequently to supply the government at no cost with 200,000 US gallons of gasoline and 100,000 gallons of kerosene, which quantities were needed to meet local consumption at the time.[15]

The Mining Agreement

Once again, King 'Abd al-'Aziz commissioned Karl Twitchell to bring in US and other international mining companies to invest in the Kingdom's mineral wealth. On the basis of the information provided by Twitchell's geological and mineral survey of the Kingdom, a number of American and British mining companies formed a group in May 1935 known as the Saudi Arabian Mining Syndicate and applied to King 'Abd al-'Aziz for a mineral concession in the Hijaz. The King granted the concession and on 24 December 1934 an agreement was signed in Jiddah which contained the following conditions:

A. The area of the concession was some 110,000 square miles, covering most of the Hijaz.

B. The company was granted a period of two years to study the area and choose the sites it wanted.

C. In return for the right to exploit mineral resources, the state received 15% of the company's shares.

D. 5% of the value of minerals produced was to be paid to the state as a royalty.

E. The Saudi government and Saudi individuals had the right to buy 10% of the company's shares if they so wished (an option which was exercised by Saudi nationals).

The company worked the Mahd gold mine, which had been previously rediscovered by Twitchell, and between 1945 and 1954 total production of gold was some 9,030,800 ounces worth around $31.6 mn. Thereafter the Directorate of Oil and Mineral Affairs at the Ministry of Finance was entrusted with the direct supervision of the mine and other mineral resources.[16]

THE DISCOVERY OF OIL IN COMMERCIAL QUANTITIES

The major event that ensued was the discovery of oil in commercial quantities in well number 7 in the Dammam field on 22 Sha'ban 1357 AH (16 October 1938 AD), five years after the concession was awarded. The reason for the delay in discovering oil was technical.

Drilling for oil began on 30 April 1935, but to a depth of 3,200 feet, the same depth as the wells in Bahrain. After six wells were drilled to this depth without finding oil in commercial quantities, the company decided in the first instance to increase the depth of well number 7 to 3,600 feet in October 1937, without finding any oil. Following a dispute between the company's management in San Francisco and the management in Dhahran, consultations were held with the noted geologist Max Steineke, and he recommended drilling deeper to a level known as the Arab formation. When the well was drilled to 4,584 feet abundant quantities of oil were found, 900 tons a day, on 12 March 1938, paving the way for the official announcement of the discovery of oil in commercial quantities.[17] With the drilling of additional wells the company was able to raise its production to more than 2,000 tons a day. "Commercial quantities" of oil were defined as production from one or several wells of 2,000 tons a day for a period of 30 consecutive days.

Once this had taken place, the government and the company signed what was called the Supplementary Agreement[18] under which the company undertook to pay 140,000 English gold pounds as a signature bonus, more than the 100,000 gold pounds over two years specified in the original agreement, in return for the government granting an additional concession extending the original concession area to the borders of al-Dahna in the west, as well as including the Saudi-Kuwaiti Neutral Zone. The company also increased its annual rent from 5,000 gold pounds to 20,000. This Supplementary Agreement was signed on 12 Rabi'a II 1358 AH (31 May 1939 AD), and its terms reflected the improvement in the Kingdom's bargaining position after the discovery of oil in commercial quantities. Now that it was known that large quantities of oil were to be found, the Kingdom was able to improve the terms of the concession on the orders of King 'Abd al-'Aziz. For example, in the seven months following the signature of the Supplementary Agreement the Kingdom's production reached some 65,618 tons, and then it began to increase by leaps and bounds year after year. Despite the bottlenecks in international trade created by the Second World War, in 1945, the last year of the war, production reached some 2,825,990 tons, or 59,000 barrels a day. After the war came to an end, the Kingdom's production rose sharply, bearing out King 'Abd al-'Aziz's expectations when he decided to grant the concession to companies new to the region that could compete with the companies in Iran and Iraq.

In 1950 AD production reached 26.2 mn tons, or 547,000 b/d, and in the period 1938-1950 AD the company discovered a number of giant fields such as Abu Hadriyah (1358 AH, 1940 AD), Abqaiq (1358 AH, 1940 AD), Qatif (1364 AH, 1945 AD), Ghawar (1367 AH, 1948 AD) and Fadhili (1368 AH, 1949 AD). As a result of rising production and exports, the Kingdom's income from oil, for which it received a royalty of four gold shillings a ton, rose from \$860,000 in 1939 to \$56 million in 1949. As for what followed, that is another story.

These major discoveries also increased the size of the Kingdom's reserves. The well-known American geologist DeGolyer appraised the Kingdom's reserves in 1943 and placed proved reserves at 2 billion barrels, probable reserves at some 5 billion barrels and possible reserves at 20 billion barrels.[19] In order to enable the company to fulfill its obligation under the agreement to supply the Kingdom with gasoline and kerosene to meet its domestic requirements, it built a 3,000 b/d refinery at Ras Tanura in early 1941. In 1945 it decided to build an additional unit with a capacity of 50,000 b/d.

The Offshore Agreement

These major oil discoveries confirmed King 'Abd al-'Aziz's belief in the huge size of the Kingdom's oil resources compared to those available in other countries and convinced him of the need to improve the terms on which this oil was to be exploited in support of the Kingdom's interest. The impact of these discoveries on the oil companies appeared to have motivated them to expand the area of their concession once again with the aim of making further discoveries. The discoveries also led to the expansion of the reserve base of the Aramco owners (on Aramco, see below), which heightened the importance of Saudi Arabia as a principal source of future world supply. They asked the Kingdom to give them another concession comprising the offshore area parallel to the Saudi east coast in the Arab Gulf. King 'Abd al-'Aziz agreed to add the Kingdom's rights in the offshore area to Aramco's original concession for the same period as the original concession, but on new terms that reflected the improvement in the Kingdom's bargaining position. An agreement was accordingly signed for that purpose on 7 Dhu'l Hijja 1367 AH (10 October 1948 AD). The conditions of the new agreement included the payment of a royalty to the state of 5 cents a barrel higher than the royalty paid on offshore production. The original royalty was four gold shillings a ton, or some 22 cents/barrel.

The royalty now became 27 cents/barrel under the new agreement. The state also stipulated that the annual floor for royalties would be \$2 million paid in advance at the beginning of each Gregorian year starting from the date of signature, and that the company would guarantee this floor payment for four years even if it relinquished the territory of this concession. The government further stipulated that the company should proceed to explore and drill in the area speedily, diligently, and vigorously, and should employ the best technical means available to the industry internationally. Under the agreement the company relinquished the concession previously granted to it in the Saudi Kuwaiti Neutral Zone.

Getty Oil and the Neutral Zone Concession

Aramco preferred to obtain an additonal concession in the Saudi offshore area and in exchange relinquished its concession in the Saudi share of the Saudi-Kuwaiti Neutral Zone. After the relinquishment on 7 Dhu'l Hijja 1367 AH (10 October 1948 AD), the Neutral Zone became an open area, clearing the way to giving a new concession for its exploitation to another company. The relinquishment also gave the impression to the major oil companies, including the four owners of Aramco, that the oil prospects of the area were poor. Accordingly, other major oil companies did not seek an oil concession in it. King 'Abd al-'Aziz, however, held an opposite position, and if the major companies did not want that concession, there were always the independent companies.

For if the majors had sufficient oil reserves, the independents needed more if they were to realize their ambitions to expand. Three independent, medium-sized American companies, Philips, Ashland and Sinclair, had formed a consortium named Aminoil which the year before the Aramco's relinquishment (i.e., 1947) had obtained from the Amir of Kuwait a concession to exploit Kuwait's half-interest in Neutral Zone oil. In 1949 Paul Getty, the owner of an independent US oil company called Pacific Western Oil, submitted to King 'Abd al-'Aziz a request for an oil concession for the Saudi half-interest in the zone's undivided oil resources. His representative in the Kingdom was a company geologist, Paul Walton, who was allowed to visit the Neutral Zone and study its geological formation from a roving aeroplane. Walton advised that the formation indicated a possibility of oil in the area. The Saudi government was not unaware of this information. In due course, King 'Abd al-'Aziz agreed to grant Getty an oil concession for its undivided interest in the area, but on terms that secured better returns for the Kingdom that reflected the true economic value of the major oil resources in the ground. King 'Abd al-'Aziz entrusted the then Minister of Finance, 'Abd Allah Sulaiman al-Hamdan, with the task of negotiating with the company representative, but on terms laid down by the King, the most important being that the company would pay a signature bonus of $9.5 million and that the annual floor for the royalty against production would be $1 million.[20] King 'Abd al-'Aziz demanded that the royalty paid by Getty be considerably higher than that paid by Aramco and other companies in the region, including Aminoil, which had been granted a concession for Kuwait's share in the Neutral Zone a year earlier and had paid to the Kuwaiti government a bonus of $7.5 million. Aminoil also agreed to pay a royalty of 34 US cents a ton, whereas the companies in Iraq and Iran paid the Iraqi and Iranian governments a royalty of 16.5 cents a barrel, KOC paid the Kuwaiti government a royalty of 15 cents a barrel and Aramco paid some 22 cents a ton. Faced with this, King 'Abd al-'Aziz demanded that Getty should pay a royalty of 55 cents a barrel, the highest royalty paid by any company to any state in the region. The company agreed to the conditions laid down by King 'Abd al-'Aziz. Consequently, the King delegated Minister of Finance 'Abd Allah Sulaiman al-Hamdan to sign the agreement on his behalf, which he did on 23 Rabi'a II 1368 AH (20 February 1949 AD). The company also agreed to pay to the government 25% of its net profits after the recovery of all its costs, including capital costs, and it undertook upon itself to build a 12,000 b/d refinery when production reached 75,000 b/d for a period of 90 days.

After the completion of the refinery, the company agreed to deliver to the government without charge 100,000 gallons of gasoline and 50,000 gallons of kerosene. It undertook to employ Saudi nationals alongside its foreign employees and to provide medical and educational services for its staff and to train them for its technical work and give them scholarship grants. The duration of the concession was specified in the agreement to be sixty Gregorian years. After taking up the concession, the company entered into an agreement with Aminoil on a joint drilling program and the two companies spent a total of $30 million on a number of dry wells. Oil was finally discovered in March 1953, and production began in 1954, followed by exports in 1955. Although the company had undertaken to build a 12,000 b/d refinery, in fact it constructed a larger one with a capacity of 36,000 b/d.[21] Production from the Saudi share reached some 2,983,052 barrels in 1954, earning for the state royalties worth $1,640,679, an amount higher than the floor level called for in the agreement. By March 1975 total cumulative production from the Saudi share reached some 500 million barrels, with annual production in subsequent years varying from 29.5 million barrels to 32 million barrels, or 80-90,000 b/d.[22]

If these figures prove anything, it is that Aramco undervalued the Neutral Zone, and a small, independent oil company came in and developed the oil fields there, realizing King 'Abd al-'Aziz's ambition to build and develop the area.

The Tapline Agreement

In December 1936, Socal, the holder of the concession in the Eastern Province, obtained King 'Abd al-'Aziz's consent to bring in the Texas Oil Corporation (Texaco) of the US as a 50% partner. Like Socal, Texaco was not a signatory of the Red Line agreement, and it therefore met with no resistance from any other company when it became a partner in the Saudi concession.[23] This agreement created wider possibilities for the development of the Kingdom's oil fields and the marketing of its oil, in view of Texaco's marketing network in Asia.

After some ten years, Standard Oil of New Jersey and Socony Vacuum applied to buy a share of the concessionary company. These two companies jointly held a 23.75% share in IPC, and they wanted to expand their activities and acquire more crude oil reserves. They also had large marketing networks in Europe, the US and elsewhere. When the other parties to the Red Line agreement (CFP and Gulbenkian) learned of the news, they objected and threatened to take legal action against the two companies unless, like them, they acquired an interest in the Saudi concession. When the other European companies went to King 'Abd al-'Aziz seeking his approval for their entry in the Saudi concession, the King announced his absolute refusal to allow any other non-American company to participate in the concession, and insisted that the concession should be restricted to American companies alone.[24] In the end, Standard and Socony were compelled to compensate CFP and Gulbenkian by giving them a greater share of IPC production in exchange for their relinquishing their rights under the Red Line agreement. Thus the Red Line agreement finally came to an end. King 'Abd al-'Aziz agreed to the entry of the two US companies into the Saudi concession in accordance with paragraph 32 of the original concession agreement, on the grounds that it would benefit the development of the Kingdom's fields and the marketing of their output. The process was completed in December 1946, with Socony (subsequently Mobil) taking a share of 10%, and the other three companies holding 30% each. The new company was named Aramco.

The four partners agreed to expand export facilities of Saudi crude, now available in large quantities. They applied to King 'Abd al 'Aziz for his permission to construct a pipeline stretching in Saudi territory from Abu Hadriya to the Saudi-Jordanian border near Turaif and then extending across Jordan, Syria and Lebanon to an export terminal at Zahrani near Sidon. For this purpose the four partners formed a company known as Tapline in which they held the same shares as in Aramco. The project involved laying 854.4 miles of 30-31 inch pipeline in Saudi territory with four pumping stations at Na'riya, Qaisuma, Rafha and Badana.[25] The export capacity of the line was 310,000 b/d. King 'Abd al-'Aziz entrusted Finance Minister Hamdan with the task of negotiating with the companies, and an agreement was signed with them on 22 Sha'ban 1366 AH (11 July 1947 AD).

Under its terms, the company was obliged to transport large volumes of Saudi oil produced by Aramco to world markets, thus paving the way for an increase in Saudi production and the development of new fields, particularly since the entry of new companies into the concession provided a new and greater source of well-needed capital investments available within their huge financial empire. The company was also obliged to build and maintain a road running the length of the pipeline at its own expense, to construct schools to teach the children of its Saudi employees, to build hospitals to treat its employees and their families, as well as people living near the pumping stations, and to drill water wells. The company further undertook to pay to the Kingdom a transit fee equal to that paid to any neighboring state. King 'Abd al-'Aziz was well aware that opening the way to exports of Saudi oil from the east coast of the Mediterranean would increase the competitiveness of Saudi oil against oil exports made through the other oil pipeline owned by IPC, which extended across Syria and Lebanon to Tripoli. In addition, there were other domestic benefits deriving from the four pumping stations to be built by Tapline. They in fact formed a nucleus for the development of the surrounding areas and the growth of new population centers in the north of the Kingdom. In view of these benefits, King 'Abd al-'Aziz issued the Royal Decree of 2 Muharram 1369 AH (23 October 1949 AD) ratifying the agreement. The construction of the pipeline cost some $240 million, and shipments of Saudi oil through the line began in September 1950 (Dhu al-Qa'da 1370), with the first tanker loaded with Saudi crude at Sidon on 2 December 1950 AD (21 Safar 1370 AH). The pipeline operation had brought about an immediate rise in Saudi oil output. In 1950 the Kingdom's production reached 26.2 million tons. In 1951, after the pipeline had been in operation for only one year, output rose to 36.3 million tons, an increase of 10.1 million tons or 39.8%. In that year the line's throughput was 14.3 million tons of Saudi oil, and increases in production continued in the following years.

The Profit Sharing Agreement of 20 Rabi'a I 1370 (30 December 1950)

In 1367 (1948) the Saudi government was able to increase the royalty it received from Aramco from 22 cents a barrel to 33 cents a barrel as a result of a new agreement with Aramco designed to amend the exchange rate of the four gold shillings paid on each ton of oil produced as a royalty. The new basis of calculation asserted that the gold pound was worth $12 instead of the previous $8.[26] The year 1948 had marked the beginning of a succession of a series of important events. In that year work began on the Tapline project aimed at increasing the production and marketability of Saudi oil. In the following year 1368 AH (1949 AD), the Kingdom signed a concession agreement with Getty Oil for the exploitation of the Neutral Zone on terms which were more favorable than those in the Aramco agreement.

Meanwhile, oil production by Aramco had begun to increase rapidly, reaching

18.7 million tons in 1948 and 22.8 million tons in 1949, an increase of 22%. Aramco's production costs were no more than 20 cents a barrel including amortization, while the posted price of oil in 1948 was $2.03/barrel and in 1949 $1.80/barrel. Since the state received a royalty of 33 cents/barrel, there was left for the company a profit a $1.27-1.50/barrel after the deduction of costs, or a profit 2 to 3 times greater than the share of the state.[27] So while Aramco in 1949 paid the state an amount of $56 million, in the same year it realized net profits of $115.1 million (according to the annual reports of the parent companies), at a time when production costs in Venezuela were 50 cents/barrel and in the US $1.10/barrel. In March 1943, Venezuela was able to sign an agreement with the international oil companies operating there, including the Aramco partner Standard of New Jersey, which amended the terms of the previous agreement that limited the state's income to royalties only. The new agreement provided the government and the companies an equal share in the profits from oil, as a result of implementing an income tax on the companies promulgated by the Venezuelan government for achieving that objective.

King 'Abd al-'Aziz realized the importance of Saudi oil for world markets. Most countries, and particularly Western Europe and Japan, had come to depend on oil from the Arab Gulf as a main source of energy required to fuel their economic expansion following the Second World War. The Tapline project and Getty's willingness to pay a royalty of 55 cents/barrel as against the 33 cents/barrel paid by Aramco have brought into sharp focus the indispensability of Gulf crudes for meeting rising world demand for oil. His Majesty also recognized that the high profitability of the concessionaire companies from selling Saudi crude is to a great extent a function of the low cost of production of Saudi oil. As a result, Aramco realized profits that exceeded the government's receipts by three to four times.

In view of all these factors, the King presented Aramco with a demand for the modification of the original concession agreement. Article 21 of this agreement exempted the company from paying direct or indirect taxes on its profits, but circumstances had now changed, particularly after the end of the war. In view of the tax changes and the new royalty payments in the region and in other producing countries such as Venezuela, it was only fair that this agreement should be rectified and that the state should receive a greater share of the profits from its oil, particularly since the profitability of this oil derived more from its abundance and low production cost than from the company's marketing abilities. As a result, King 'Abd al-'Aziz issued two royal decrees — number 3321/28/2/17 of 21 Muharram 1370 AH and number 7634/28/2/17 of 16 Rabi'a I 1370 AH (26 December 1950 AD) — approving the imposition of an additional income tax on the companies operating in the production of oil and other hydrocarbons at a rate of 50% of the companies' net operating profits.

Aramco bowed to this modification of the income tax and an agreement was signed with the government introducing the new tax changes on 20 Rabi'a I 1370 AH (30 December 1950 AD). Although the agreement was signed at the end of 1950 AD, the tax was retroactive to the beginning of that year and amounted to some $112 million on a production of 26,196,852 tons, i.e. an average of $4.3/ton compared to the previous 33 cents/barrel, or some $2.4/ton. Company payments to the government in the next two years reached $155 million and $212 million consecutively as the Kingdom's production rose by 39% and 8.3% respectively. As for the royalty, it was considered to be a payment on account of income tax and continued to be applicable as a floor. The agreement further obliged the company to give the government 2,650,000 gallons of gasoline and 200,000 gallons of kerosene free of charge, as well as 7,500 tons of asphalt. This agreement became a model which was emulated by other producing countries in the region such as Iraq, Kuwait and Iran, who in subsequent years put forward demands for the same terms from the oil companies.[28]

CONCLUSION

King 'Abd al-'Aziz withdrew Eastern General Syndicate's concession rights in 1928 (1347 AH) following Major Holmes' failure to find oil in the Eastern Province and his subsequent violations of the terms of the concession. From that time on, King 'Abd al-'Aziz began to think about opening the door for companies of other nationalities. British companies controlled the oil concessions in Iran and Iraq and had the largest share in them. If they were awarded oil concessions in the Kingdom, it could not be expected that they would invest in oil resources there with the same energy and determination they displayed in Iran and Iraq, because their needs for oil were more than satisfied from those areas.

King 'Abd al-'Aziz then turned to the major American oil companies endowed with wide international marketing outlets and awarded them oil concessions in both the Eastern Province and the Neutral Zone. In doing so, he achieved a strategic balance to British hegemony in the region. He also created a firmly-anchored basis for important future economic relations with the US, which he rightly expected to be victorious over the Axis countries in the Second World War and to emerge thereafter as a world economic superpower.

When the French and Dutch oil companies and others tried to participate in the Saudi oil concessions after the end of the Second World War in the footsteps of Standard of New Jersey and Mobil, invoking the terms of the Red Line agreement, King 'Abd al-'Aziz turned them down and insisted that only the two American companies would be admitted. This resulted in the collapse of the Red Line agreement and the emergence of the Kingdom as a major oil exporter and the owner of the largest oil reserves in the world. It also resulted in a major boost in economic relations between the Kingdom and the US to new, higher levels which have continued up to the present time.

ENDNOTES

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