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USSR EXTENDS PERMANENT FOOTHOLD IN MIDDLE EAST

Political developments in the Middle East continue to be the main event in the world political arena. For the moment the heat is off the Arab-Israel dispute and instead is on intra-Arab feuds as well as the local manifestations of the East-West struggle. The future course of events can, of course, only be sketched in the roughest terms, in view of all the imponderables and unknowable factors entering the situation. However, this much is sure: the USSR is now firmly established in the Middle East and will remain a major factor in all Middle East affairs from here on in. At the same time it has become clear that Arab unity is not nearly as cohesive a factor in the Middle East as it appeared when Israel seemed the only source of trouble in the area. Nevertheless, unity is genuinely desired by all Arab nations and in the absence of countervailing forces can be expected to play an important part in Arab policy-making.

Both these factors have a direct bearing on the Middle East oil situation. Since the USSR's exceptional effort to gain a foothold in the Middle East is not caused by any Soviet need for Middle East oil or by any other special economic or strategic considerations, it seems clear that the Kremlin is out to gain control over the Middle East oil producing and transporting countries for the purpose of gaining an economic stranglehold on non-communist Europe.

Since there is no doubt that the USSR is now fully entrenched in Syria and fairly strongly in Egypt, this means that it already sits astride all existing oil transportation routes between the Middle East and Europe, with the exception of the Cape of Good Hope route. This does not permit the USSR to turn the flow of Middle East oil on and off at will from now on. But in any future crisis - and there will undoubtedly be some - the presence of direct Soviet influence in both Syria and Egypt must be taken into account.

Of course, there is always the possibility of a change in government in either or both these countries. But barring such an eventuality, Soviet influence in both countries will continue to grow, as their trade, aid and foreign investment becomes increasingly Soviet-oriented. This is particularly true of Syria which, being a small and poor country, can easily be totally supplied by the USSR, which can also take most of its exports. According to all reports from Syria, this is exactly what is happening. If this trend continues, the country should be economically completely inside the Soviet orbit within the next couple of years.

A preliminary indication of the strength of this trend was given last spring when the Czech firm Technoexport was awarded the contract to build the country's first refinery, at a cost of \$29 million. The award was so obviously based on political rather than technical or economic considerations that it briefly became a rallying point for all anti-government forces who pointed, in vain, to the fact that the American firm Procon, Inc., had submitted a bid which, at an only slightly higher cost, would have given Syria a far superior refinery, including Procon's high-octane process.

But the "neutralist" countries are not the only ones in the Middle East affected by Soviet economic infiltration tactics. Even such pro-western countries as Lebanon, Iran and the Sudan are reporting very sharp increases in trade with the Soviet bloc. At the moment there are no political strings attached to these deals. But since they are all much more important and advantageous to the Middle East countries concerned than to the Soviet bloc, which has no real need for any of the Middle East's export commodities, it is obvious that USSR's real interest in all this is to extend its political influence in the world's richest oil area.

PROTECTING EUROPE AGAINST A NEW MIDDLE EAST OIL CRISIS

For Western Europe all this means that some 70 percent of its oil needs come from an area whose existing political instability has now been compounded by the successful entry of the West's official enemy No. 1 on the scene. How to protect itself against the obvious dangers of this situation is something that concerns not only the countries dependent on Middle East oil but also the companies which produce, ship and market it. For they can contribute greatly in providing the degree of flexibility which would immunize Western Europe from the immediate consequences of another Middle East oil shut-down.

To a considerable extent this is already being done. The exploration of new concession areas in Venezuela (which during the last crisis had little spare capacity) and the opening-up of the Sahara and of new deposits in Sicily and France are all designed to accomplish this. For, were it not for the political risks in the Middle East, there would be much less motivation to find new oil supply sources for Western Europe, in view of the vast and growing reserves in the Middle East.

The high level of super tanker construction activity, in the face of the sustained current slump in world tanker trade, is another way to create additional flexibility. For it means that in case any or all of the existing shipping routes from the Middle East become suddenly closed, alternative ones can be used. Of course, not all the 34 million dw tons of existing firm tanker orders are meant to carry Middle East oil to Europe. But since the world tanker fleet is expected to increase at an annual rate of 16 - 17 percent while the annual increase in world oil consumption may not even reach the generally quoted figure of 6-7 percent in the next few years, there will certainly be a lot more excess carrying capacity available in the next 3-5 years than we had in any previous post war year.

BUILDING ADDITIONAL STOCK CAPACITY

Some additional stock capacity in Europe, as a buffer against any sudden emergency, would also be part of the overall effort to increase flexibility vis-a-vis the Middle East. Very little has been done on this particular aspect of it, largely because of the exceedingly large amount of unproductive capital that would have to be tied up in order to maintain enough oil stocks to supply all of Europe for any significant period of time.

Determining the level of such emergency stocks is, of course, an extremely difficult and delicate procedure, since it has to be based largely on hypothetical assumptions, regarding the type and length of future emergencies. The only thing that can be said from recently gained experience is that if the emergency were limited to the Middle East, and not part of a general international conflagration, Western Europe could certainly temporarily get along on 75 to 80 percent of its normal needs. Furthermore, it could count on receiving a combined 50 to 60 percent of its reduced oil requirements from the Western hemisphere together with its own domestic production. Additional coal shipments from the U. S. would also help to reduce the oil deficit.

This means that, at the most, emergency stocks would have to fill a gap equivalent to only about 1/3 of Europe's normal oil requirements. At the present rate of consumption for Western Europe and adjacent areas this would mean approximately 1 million b/d, disregarding seasonal fluctuations. However, since it would take three to four weeks to call forth the required additional quantity of oil from the Western hemisphere and to complete the necessary tanker transfers, an additional 750,000 - 850,000 b/d would have to be stocked up for this initial period.

These figures assume a type of emergency which would cut off all Middle East oil shipments to West of Suez but not to East of Suez. Of course, this precise situation may never occur. Furthermore, the length of such an emergency can not even be guessed at.

The big question in all this is not so much the principle that Europe needs some stocks to safeguard it against the repercussions of another Middle East crisis but the level to which such stocks should be built up. This, in turn, depends not only on the assumed duration and intensity of the crisis but also on availability and allocation of capital. For, from a certain point on, the building up of more oil stocks would have to be weighed against the construction of fewer tankers or a reduction in exploration activities, given the existing limitations in oil industry capital. Future policy in this regard may well be influenced by the views of the OEEC whose Oil Committee is now studying the whole problem of stock level and will then issue a report on the subject.

LACK OF PUBLIC RECOGNITION OF OIL COMPANIES' JOB

The general problem which the oil companies face in connection with the creation of all such safeguards against future political or military emergencies is that though the companies must bear the entire cost of the program, its main justification is to provide additional national security rather than to create additional profits. Unfortunately for the public relations of the major oil companies, this is very little understood outside the oil industry itself.

A PIRINC staff member who has just returned from an information trip to Europe, has found almost universal sharp criticism of current oil prices among non-industry circles. Everywhere the question was asked why Middle East oil prices had to be raised, following the Middle East crisis, and why the raise had to be permanent. No one among the government officials, politicians, journalists and just plain people with whom the question was discussed had considered the fact that, as a result of the Suez crisis, certain

policy changes of a very expensive nature had, or will still have to be made in the world oil industry in order to assure Europe's future oil supply even under adverse circumstances. That some of the cost of this policy should be borne by the people who will be its most direct beneficiaries had not occurred to any of these critics.

But even in European oil circles (outside of the majors) there is the feeling that the Middle East price increase was just an "unfair way of burdening" all oil importing countries with the cost of protecting the U.S. domestic oil producers against lower-priced foreign oil.

THE MIDDLE EAST PIPELINE PROJECT

One plan to insulate Middle East oil transportation from the vagaries of the area's political changes seems likely to be dropped, or at least indefinitely postponed. This is the huge pipeline project from Kuwait and Iraq to Iskanderun, Turkey, which was conceived in the immediate aftermath of last spring's pipeline sabotage.

According to press reports, the reason for the postponement is a feeling in oil company circles that the constantly moving political scene in the Middle East makes super tankers a more reliable means of transportation than the \$1 billion pipeline with its eventual capacity of about 1.4 million b/d. This feeling has, reportedly, been greatly strengthened by the recent Syrian-Turkish charges and counter-charges of planned military aggression against each other. These show that Turkey is not nearly as insulated from the Middle East political turmoil as had been assumed in the past. In this connection, the apparent Soviet-Syrian military cooperation is also significant, particularly since its center seems to be the Syrian port of Latakia which is quite close to the planned Turkish pipeline terminal of Iskenderun (Alexandretta) which until 1938 belonged to Syria and is still claimed by that country.

IRAQ'S DILEMMA

Another factor which seems to speak against the project is Arab unity, despite the fact that it is currently at an all-time low. Nevertheless, very strong pressure is being put on Iraq to prevent a non-Arab country from becoming the major oil outlet for Arab oil. Already before the outbreak of hostilities in the Middle East last fall, the Lebanese Minister Saeb Salem stated that the Lebanese Government had been formally notified by the Iraq government that Iraq would not "under any circumstances or conditions" permit construction of a new pipeline which would by-pass Syria and Lebanon. When Syria subsequently destroyed all pumping stations of the Iraqi pipelines on its soil it was assumed that Iraq had revised its stand against a Turkish pipeline project, since the Syrian action had hurt its economy severely (and probably intentionally).

However, the psychological mass appeal of Arab unity continues to be of considerable importance in the Middle East. Therefore, a gesture of open defiance against it, which could not be undone at a later stage (since a pipeline is a permanent installation), might well prove politically dangerous for Iraq, as it would be likely to offend Arab public opinion throughout the Middle East. This would be all the more so since the Turks have traditionally never been popular among the Middle East Arabs.

Under these circumstances, it was not surprising that a report from Damascus in September stated that Syrian President Kuwatly received the Iraqi ambassador for a discussion of "current Arab affairs" during which the Iraqi diplomat informed the Syrian chief of state of the rejection by the Iraqi government of the projected pipeline from Kirkuk to Iskenderun. The Damascus report was neither confirmed nor denied in Baghdad but the Iraqi minister of economics Dr. Nadim Pachachi has publicly expressed his own dislike of the project, following his recent return from London, where he had had discussions with I.P.C. officials. He has also declared it to be "the Iraq government's policy to induce the oil companies operating in our country to maintain the present Arab oil routes."

Thus, though no responsible Iraqi official has categorically rejected the Turkish pipeline project, quite a few of them have been outspoken in their opposition to it. No doubt this is largely due to the government's fear that the project would isolate Iraq still further from Egypt, Syria and Yemen than the country's membership in the Baghdad Pact has already done. Furthermore, according to the reports from the Arab Oil Conference in Beirut, Saudi Arabia too, seems dead-set against the Turkish pipeline project, though it would not even be directly affected by it.

It is interesting to recall in this connection that Iraq has already once before interfered with an I.P.C. pipeline project in the name of Arab unity. That was in 1948 when it forbade any oil to flow to Israel through I.P.C.'s two southern pipelines, thus preferring to lose several hundred million dollars in royalties to being considered a traitor by the Arab League. Naturally, Arab emotional resentment against the Turkish pipeline project is not nearly as strong as against Israel. But it is present, nevertheless.

This does not mean that Iraq is at all satisfied with its present rate of oil production which averages now less than 500,000 b/d, compared to nearly 750,000 b/d last fall, making Iraq by far the smallest producer among the Middle East's big four, and giving it only \$90 million in total royalties for the first nine months of this year, compared to \$155 million for the same period of 1956. Furthermore, unless new outlets are constructed, Iraq is likely to remain in this position even after the pumping stations in Syria have been fully repaired, since Iran is already now producing at a higher rate than Iraq did just before its pipelines were damaged.

The suggestions put forth by the Iraqi government to remedy this situation for its northern fields are (1) the transfer of the unused southern pipelines with its capacity of 140,000 b/d to a Lebanese port, (2) the re-activation of the project to build a new pipeline from Homs to either Tripoli or Baniyas, and (3) a pipeline running south from Kirkuk to the Persian Gulf, where it would connect by submarine line to a floating island, capable of accommodating large tankers. I.P.C. has not officially announced which of these projects it will carry out. But, according to all reports, it will definitely take some step to raise Iraq's oil output.

As far as Iraq's southern fields of Rumailia and Zubair are concerned, it had been hoped to build a pipeline to Kuwait's large tanker terminal.

This relatively simple and inexpensive project might have doubled the present 170,000 b/d output of these fields. However, for reasons of politics and oil rivalry, this project is unlikely to come off in the near future. Instead, there is now a strong probability that I.P.C. will build the projected tanker terminal in the Persian Gulf and connect it with the southern fields, too, thus doubling their output.

THE IRANIAN PIPELINE PROJECT

The Persian Gulf - Iraq - Iskenderun project is not the only pipeline planned across Turkey. There is also the project from Qum, Iran, to Iskenderun. It was only recently announced by the Shah as part of the plan to exploit the Qum deposits as "a pure Iranian reservat". An agreement for the construction of the pipeline has already been signed with Turkey. Financing of the project is supposed to come from an American investment company, according to the Shah, which will form a joint venture with the National Iranian Oil Company (NIOC) on a 50/50 basis. However, 50 percent of the joint venture's total net profits will go to the Iranian government in form of taxes. The Shah gave the total cost of the entire project at \$500 million. He did not identify the American investment firm but, according to confirmed press reports, Allen & Company of New York will give its financial backing. The pipeline construction firm of Williams Brothers of Tulsa, Oklahoma, may be selected to do the job.

The length of the Qum-Iskenderun pipeline would be about 1,000 miles, approximately the same as the Kuwait-Iraq-Iskenderun project whose total cost the oil companies have estimated at over \$850 million. The lower cost of the Iranian project could be explained by the fact that it would consist of only one single 38 inch pipeline, while the Kuwait-Iraq project would have two parallel 38-40 inch lines. Furthermore, the projected capacity of the Iranian pipeline would be only about 500,000 b/d compared with 1,400,000 b/d for the pipeline from Kuwait. This means that it would need considerably fewer pumping stations than the 10 to 12 units which the Kuwait line would require.

On the other hand, the Qum pipeline is a much more difficult undertaking since it has to cross the 10,000 ft high Zagros mountains over a distance of hundreds of miles, whereas the line from Kuwait would run along the Tigris valley for most of its length. Thus, the cost of transporting the construction materials to the Iranian mountain sites, where there are no railroads, would be considerably more expensive than for the Iraq line which is accessible by railway, river and sea transport for most of the way.

Whether the total effect of these divergent factors would make the Iranian project 40 percent cheaper than the one across Iraq remains to be seen. The Shah's estimate of \$500 million was given before any detailed survey was made of the terrain which the pipeline would have to cross. It is therefore subject to a good deal of change. Of course, the whole project depends on whether enough oil will be found at Qum to make an investment of this size worth while. The determination of this elementary factor is expected to take 18-24 months.

THE ITALIAN ENTRY INTO IRAN

Meanwhile, Iran is looking for other ways of increasing her oil revenue. It has just opened up large parts of the country, outside the Consortium area, to foreign exploration, either on an exclusive basis or in 30 - 49 percent partnership or a 50 or more percent joint venture with the NIOC. Already before that, the NIOC had formed the much discussed joint venture with the Italian government oil agency AGIP Mineraria under the name of SIRIP, for the purpose of exploration and exploitation. SIRIP has already started operations with an Italian exploration crew and is awaiting its first off-shore drilling platform, now being built in Italy.

The SIRIP venture is often referred to as a 75-25 sharing of oil profits, and thus a basic change from the existing 50/50 arrangements between producing countries and oil companies in the Middle East. This, however, is not quite correct since the NIOC will have to pay its half share of all expenditures and capital needs from the moment commercial oil production has been discovered by SIRIP. Until that point, exploration expenses have to be borne by AGIP alone.

However, Iran does make its contribution by waving all demands for cash bonuses and rentals. Thus, if no oil is found, AGIP will have to bear the loss of all exploration expenditures while Iran will forfeit the cash bonuses and rentals which it would have collected had it assigned the concessions to a foreign concern without forming a joint venture with it.

It is difficult to say which of the two would be the net loser if the venture should fail. AGIP's stake is \$22 million which it is committed to spend on explorations over the next twelve years. How much Iran would have asked in cash bonus and rentals is, of course, not known. But there are a number of instances on record where an international oil company has paid that much and more for the acquisition of a particularly desirable concession area. Since one of the three concession areas of SIRIP is only some 30 miles north-east of Agha Jari, Iran's most prolific field, and another is an off-shore concession at the top of the Persian Gulf, just opposite Kuwait, it seems likely that Iran could have collected quite a bit of cash, had it stuck to the old-fashioned method of awarding concession contracts to the highest bidder.

Since Iran is presently very much strapped for capital - it had to borrow \$75 million early this year from the International Bank to finance current development expenditures in anticipation of future oil revenues and its Plan Organization will have to look for outside financing for many of its development projects - the question arises whether SIRIP was really the most advantageous deal Iran could have got for itself.

If oil is found, the Iranian state's total share of the profits will, of course, amount to 75 percent. But this does not disturb the existing 50/50 agreements in the Middle East, since Iran's half-share in any income of SIRIP, after SIRIP has paid its regular 50 percent profit tax to Iran, derives only from the fact that the state-owned NIOC will contribute half of SIRIP's capital and share in half of its risks and profits, once a commercial oil discovery has been made.

It may thus be compared to a partnership formed, let us say, by B.P. or a state-owned French oil concern with a private oil company. In this case, too, the British or French state would collect its share of the partnership's profits twice, once as a tax collector and once as a business partner. But this would no more alter the existing tax structure in those countries than the NIOC-AGIP arrangement should cause activation of the regional "most-favored-nation" clause regarding oil profits, contained in the Iraq-I.P.C. agreement*

Once commercial production starts, SIRIP must reimburse AGIP for half the initial exploration expenditures and must pay an equal amount to NIOC, presumably in lieu of rental. These payments must be made as soon as possible and must amount to no less than the equivalent of 10 U. S. cents for each barrel of exported crude oil. Thus, AGIP must bear the whole exploration cost and NIOC must forfeit all rental payments only if their joint venture fails.

However, even after commercial production has started, there is no guarantee that Iran will really get total cash payments equal to 75 percent of net profits before taxes and royalties. For whenever SIRIP decides to reinvest part of the profits-after-taxes in the business, the take-home pay of both its partners will be equally reduced.

Yet, while the SIRIP arrangement may not have been the most favorable deal from the point of view of cash-hungry Iran, it is probably quite advantageous for AGIP. Though AGIP is a large concern, it is not so well endowed that it could easily have paid a lump-sum multi-million dollar cash bonus plus a large rental to Iran, for the privilege of looking for oil on its territory. Furthermore, as a state organization such bonus payments would undoubtedly have been sharply questioned by public opinion and its political representatives, especially since Italy itself is badly in need of development capital. However, the agreed average amount of \$1.5 million annually for exploration expenditures over the first four years can easily be fitted by AGIP into its normal operating budget, particularly since it does not represent a non-productive payment to a foreign country but a regular outlay for exploration carried on by its own personnel.

Of course, if no oil is found within a reasonable number of years, voices may well be heard in the Italian parliament, asking whether it would not be better for AGIP to spend more of its money exploring the Italian home soil for hydrocarbons, instead of "wasting it on futile foreign ventures." In fact, the Italian Association of Industries is already asking this question. However, since AGIP is a profit-making organization (last year's net profit after taxes amounted to \$6.5 million) the usual argument against any government expenditure, namely that the taxpayer is

* However, another Middle East concession agreement currently under discussion would deviate from the 50/50 principle. This is Saudi Arabia's offer to give the Japan Export Petroleum Company on oil concession in the Neutral Zone based on a 56:44 split of all profits, in favor of Saudi Arabia. The Japanese concern has been trying to hold out for the usual 50/50 agreement but has now been strongly urged by the Japanese Minister of Commerce to accept the Saudi Arabian terms. The concern's president, Taro Yamashita, is now in Saudi Arabia carrying on negotiations with local authorities.

unwilling to underwrite it, would not apply in this case.

Furthermore, AGIP's president Enrico Mattei, has emerged from the Iranian negotiations (in which he had the direct support of Italian State president Gronchi) as a minor national hero. This he has managed to do largely at the expense of the major foreign oil companies whom he has sharply criticised for allegedly not letting him join the Iranian consortium in 1954.

Whatever the truth of these charges, it has made Mattei the "little fellow" who fights a heroic battle against "the sinister machinations of the international oil interests".

This impression has only been strengthened by a special article on the subject which appeared recently in The New York Times and was given wide publicity in Italy. The article implied that the established Middle East oil companies might retaliate against the AGIP-NIOC deal by refusing to supply Italian refineries.

Since Mattei has the use of one of Milano's largest daily newspapers, which AGIP controls, to propagate his "fight", he can count on the support of the millions of Italian gasoline consumers who have been told (and believe) that Middle East oil prices are too high (though the major reason for the high gas price in Italy are, of course, gasoline taxes which were raised still further during the Suez crisis). They are apt to take Mattei's statement that "for the first time there will be some real competition in the production of Middle East oil" quite literally and see a future ahead in which their country will be a major producer of low-cost Middle East oil.

Italian oil circles outside of AGIP do not fully share this enthusiasm. But they do feel, in the words of one major independent oil dealer, that "the major foreign concerns are making a mistake in under-estimating Mattei". They also feel that when the Iranian development has reached the point where large sums are needed to develop commercial production, build pipelines, harbors, etc., the Italian public will be eager to contribute the necessary sums by buying the "people's shares" which Mattei has said he would issue. Furthermore, they believe that once oil has been found, SIRIP will have no trouble in attracting foreign funds for development purposes.

What the net effect of the AGIP-NIOC deal will be on the Middle East is not quite clear yet. As we have said, it has not violated the existing 50/50 principle. On the other hand, it has certainly introduced a potential new element into the region's country-company relations. This may be of particular importance to the smaller oil companies trying to get a foothold in the Middle East. They may well see in the SIRIP scheme a way of getting a Middle East concession without having to lay out huge amounts of cash merely for the privilege of looking the place over, geologically speaking. Thus, it is likely that SIRIP will not remain the only partnership arrangement in the Middle East between a foreign oil concern and a local government company.

CONSORTIUM DEVELOPMENT PLANS

As far as Iran is concerned, it can well afford to gamble on the SIRIP deal. It can be sure that its total oil income will continue to increase regardless, thanks to the planned activities of the international Consortium, operating in Southern Iran. The Consortium has announced that it will undertake a \$140 million development program in 1958. More than one third of the budget will be spent on the relatively new Gachsaran field which is already the third-largest in the Consortium area. Also of significance is the fact that a new terminal at the Persian Gulf is planned, equipped to handle "upward of 100,000 ton" tankers. It will probably be an off-shore terminal. Since the giant Agha Jari field, which provides the bulk of Iran's oil output, is also scheduled for a "substantial" increase, according to the Consortium, it seems that Iran will maintain its new position as the Middle East's third largest oil producer, even after the Iraqi pipelines have been fully repaired.

TRENDS IN MIDDLE EAST OIL PRODUCTION

Exactly what will happen to Middle East oil production after Iraq's pre-Suez capacity has been restored (probably by next January) is not yet clear. In the first and second quarter of 1957, total Middle East oil production was 24 percent and 6 percent respectively below the same periods of last year, due to the Suez affair. During both these quarters Iran was the only country whose output continued to increase steadily over the corresponding months of 1956, even surpassing the Consortium's contractual quantity obligations.

Thus, Iran, whose production increased by 35 percent over the first half of 1956, was the only Middle East oil country totally unaffected by the crisis. To a large extent this was made possible by the fact that Iran temporarily took over from Saudi Arabia the job of supplying the 200,000 b/d Bahrain refinery after Saudi Arabia decided to boycott it.

Since June 1st, when -except for Iraq - complete normalcy returned to Middle East oil production, Iran has continued to outpace all other Middle East countries in production gains, as is shown by the following tables on Middle East oil production for the four-months period from June to September.

CRUDE OIL PRODUCTION

June 1st - Sept. 30th, 1957, 1956, 1955

(in thousands of b/d)

	<u>Iraq</u>	<u>Kuwait</u>	<u>Saudi Arabia</u>	<u>Iran</u>	<u>Quatar</u>	<u>Total 5 Countries</u>
1957	494	1327	1186	769	148	3924
1956	749	1205	1026	580	123	3683
1955	691	1085	924	365	113	3178

ANNUAL PERCENTAGE CHANGE

Period: June 1st - Sept. 30th

	<u>Iraq</u>	<u>Kuwait</u>	<u>Saudi Arabia</u>	<u>Iran</u>	<u>Quatar</u>	<u>Total 5 Countries</u>
1956-1957	-34.0%	10.1%	15.7%	32.8%	19.7%	6.6%
1955-1956	8.4	11.1	11.1	58.0	9.2	15.8

Since June 1st, Iran's growth has been made possible largely by the loss of Iraqi production. However, the other oil countries also seemed to have benefited by Iraq's loss. For, though total Middle East oil production for the four-months period is only 6.6 percent above the corresponding 1956 period, each country, with the exception of Iraq, shows a much larger gain. Thus, while the Iraqi production remains throttled back, the four other countries will probably continue to show a sizeable production increase over last year.

However, the area's total increase over June-September, 1956 is less than half of the previous year's rise. This sharp decline in the rate of increase is, of course, not due to the lower Iraqi production which could be more than made up by any of the four other countries. Its reason lies in the lower oil demand in Europe (examples: U.K. crude imports for 3rd quarter slightly below same period of 1956; French August-September gasoline consumption 8.5% below last year) plus the reduced imports into the United States.

Unless this situation improves by next January (and most economic indicators suggest clearly that it will not) the full return of Iraq's productive capacity is likely to mean a reduction in the output of the other countries which have so far escaped the decelerating effect of the current declining rate of growth of world oil demand.

EGYPT

THE OIL SITUATION

The oil supply situation in Egypt seems to be considerably - if not decisively - eased by the discovery in 1956 of the Balaim-Abu Rudais structure a few miles south of Wadi Feiran, on the Western coast of the Sinai peninsula. Though the structure of the deposits, which extends offshore into the Gulf of Suez, has not yet been fully evaluated, reserves proved so far are estimated at 500 million barrels. The Chairman of the Egyptian Petroleum Authority informed the government last summer that the Balaim-Abu Rudais discoveries are the richest so far discovered in Egypt. He said production from this field would exceed local requirements so that Egypt would become an oil exporting country within about a year. Italian oil men, in charge of the technical aspects of exploiting the structure, are speaking, even more optimistically, of an annual production of 2 million tons (40,000 b/d) next year and 10 million tons (200,000 b/d) within three or four years. Present production amounts to 25,000 b/d, or 100,000 tons per month, from 20 producing wells.

The discovery of the Belaim-Abu Rudais field was originally made in 1955 by the International Egyptian Oil Company in which the Italian government oil concern AGIP has the controlling interest and the Belgian firm Petrofina holds most of the remaining shares. At the beginning of 1957, International Egyptian became part of a new company, Eastern Petroleum Company, in which it owned 51 percent of the stock and Egyptian interests held the remainder. In September, a further change took place with the transfer of all assets, liabilities, rights and obligations of Eastern Petroleum to the newly-found Oriental Petroleum Company of Egypt. The following are the shareholders of Oriental Petroleum:

General Petroleum Authority	7,000	shares
Cooperative Petroleum Society.....	4,750	"
Mahmoud Younes	250	"
Fathy Rizk Ahmed	250	"
International Egyptian Oil Company	12,720	"
	<u>24,970</u>	

The foreign-owned International Egyptian continues to hold the majority interests (51%) in the new company exploiting the new Sinai discoveries. AGIP - International Egyptian's major shareholder - has therefore the controlling shares in it. However, under Egyptian law, the "Economic Organization", established in January as a central holding, investment and management trust for all enterprises under government control,

appoints the top executive in any organization in which it owns at least 25 percent of the capital. Since the General Petroleum Authority, which owns over 28 percent of Oriental Petroleum's capital, is one of the new government agencies affiliated with the Economic Organization, its chief Mahmoud Younes has been appointed president of Oriental Petroleum, despite the company's foreign majority ownership.

The role of the Italians, in addition to running the actual operations, will be to dispose of the Sinai peninsula's export crude. At present this consists of half of field's total production. However, once all local Egyptian oil requirements have been filled, AGIP and Petrofina have the right to export all of Oriental Petroleum's surplus crude. Since Petrofina also has its own refinery in Italy and is about to build a 40,000 b/d plant near Rome in partnership with AGIP, it seems likely that the bulk of Egypt's oil exports will continue to go to Italy.

The importance of the new discoveries for Egypt has to be measured against the fact that Egyptian oil production has been steadily declining since 1950, as follows: (in millions of metric tons)

1950	.....	2.60
1951	.....	2.32
1952	.....	2.38
1953	.....	2.27
1954	.....	1.97
1955	.....	1.81
1956	.....	1.73

Actually, production began to pick up in 1956 when the annual rate during the first ten months amounted to over 2 million tons. The year's drop was thus due entirely to the Israeli invasion of the Sinai peninsula.

The consequence of Egypt's declining oil production was a corresponding increase in oil imports from an average annual level of 1.2 million tons (24,000 b/d) in 1952-53 to 2.2 million tons (44,000 b/d) in 1955. In 1956, imports were again down to 1.2 million tons, due partly to the increase in domestic production and partly to the cessation of all shipping to and from Egypt in the last two months of 1956.

In the two years prior to 1956, oil imports had reached a value of nearly \$50 million, representing 10 percent of total Egyptian imports. Thus, the net surplus in crude oil expected in the very near future would mean a fundamental improvement of the country's foreign exchange position. Instead of having to pay out some \$50 million per year in imports, Egypt would actually earn quite a few million dollars on oil exports. Such exports are already amounting to about 50,000 tons per month (12,000 b/d), all of it going to Italy. By 1958 they should amount to as much as 20,000 b/d, or a million tons annually, according to Enrico Mattei, head of AGIP.

Of course, even after the country attains crude oil self-sufficiency it will have to continue to import some products, particularly fuel oil, since its own refining capacity is not yet sufficient to supply Egypt's total need of 95,000 - 100,000 b/d, including considerable quantities of heavy fuel oil for Suez Canal bunkering stations. Current refinery production amounts to only 3.7 million tons (74,000 b/d), including the recently inaugurated 4,000 b/d refinery at Alexandria. However, this refinery is to be enlarged to a capacity of 14,000 b/d while construction of a fourth refinery with a capacity of 20,000 b/d is planned in Cairo. If and when all these expansion plans are completed, Egypt should be completely independent of foreign crude oil and products.

OIL AND SOVIET BLOC TRADE

This, in turn, could be of major significance to Egypt's general foreign trade pattern, particularly its increasing trade with the Soviet bloc. This trade accounts now for nearly 50 percent of Egypt's exports but less than one third of its imports. This imbalance indicates that while the Soviet bloc is willing and able to take most of Egypt's cotton exports, thereby becoming the country's major foreign customer, it is not in a position to fill the role of becoming Egypt's major supplier of civilian goods. Thus, Egypt has accumulated large trade surpluses with Soviet bloc countries - Czechoslovakia alone run up nearly \$50 million in one year - which it finds difficult to reduce, in view of the limited availability in the Soviet bloc of the types of goods Egypt has traditionally imported from the West.

Crude oil and fuel oil are an important exception to this. Egypt has been buying increasingly large quantities of oil from the USSR and Romania while at the same time reducing its oil purchases from Saudi Arabia. If the need for these purchases should cease it would become even more difficult to achieve a balance in Egyptian-Soviet bloc trade, unless Egypt is willing to take its surplus out in the form of Soviet bloc arms.

EGYPT'S ECONOMY

However, this does not mean that Egypt is headed for an early economic crisis, unless it can quickly re-establish its trade ties with the West. Increased trade with the West is certainly a desideratum for Egypt (though it will not stop the growth of Soviet economic influence which makes itself felt increasingly in the long-term industrial development projects). Yet, contrary to expectations, the Egyptian economy has weathered the Suez storm quite well and is not at all on or near the point of collapse.

Egypt did have to make a sharp reduction in its import trade as a result of the Suez Canal closure and the blocking of its foreign sterling and dollar assets in London and Washington. But it managed to avoid an inflation and maintained a budget surplus. Since the end of May, its foreign exchange receipts from Suez Canal operations have been more than equal, on an annual basis, to the 10-15 million pound sterling which it could normally have drawn each year from its sterling funds with the Bank of England. Thus, the unblocking of its foreign funds are no longer a vital to Egypt as appeared to be the case last spring.

Furthermore, the sequestration of all British and French banks, insurance companies and industrial concerns in Egypt has stopped the transfer

of these companies' profits to their foreign owners, thus plugging an important pre-Suez foreign exchange outflow.

Since Egypt has, so far, not paid a penny to the foreign owners for the sequestered companies (the largest of which is Shell's Anglo-Egyptian Oilfields, Ltd.), the operating profits accumulated by these companies are a net gain for the Egyptian economy. It is therefore understandable that Egypt has made counter-claims in the recently tabled negotiations with British and French representatives regarding the final disposition of these concerns, which are obviously unacceptable. For it is quite clear that Britain and France are not willing to pay Egypt \$93 million in war reparations, including \$54 million for loss of transit tolls.

THE SUEZ CANAL TODAY

Compensation payments to the Suez Canal Company have not even reached the discussion stage. However, there are now signs that Egypt is ready to heed the World Bank's advice to start direct talks with the company's representatives, particularly since the Bank's attitude on financing Nasser's pet project, the High Aswan Dam, may well depend on the successful outcome of these talks. Meanwhile, with no transfer payments having to be made for profits, dividends or compensation, the Suez Canal is now Egypt's most important foreign exchange earning source.

The Canal's draft is still only 33 ft, compared to 35 ft. before November 1956, which means that total tonnage is probably 10 percent lower than it was in the last months of the Canal's foreign ownership, since no ship over 36,000 dwt can currently go through fully loaded. (Official Egyptian statistics on number of ships going through the Canal have little meaning since they indicate neither the total tonnage nor whether all ships or only those from a certain size on up - as was the old Company's practice - are included in the total).

Egypt's future plans for the Canal are not clear beyond its attempt to dredge it back to its 35 ft. pre-demolition draft by next January. Under the Suez Canal Company's eighth improvement program, which was halted when the Canal was nationalized, the depth by next January would have been 36 ft.

What will happen to the unfinished part of the eighth improvement program and to the planned ninth improvement program which was to have deepened the Canal's draft to 40 ft. (permitting an average daily traffic of 83 ships) is, of course, of great interest to the world tanker owners and charterers. So far, Egypt has announced nothing on the subject beyond its general willingness to set 25 percent of the receipts aside for expansion and maintenance purposes.

According to press reports, Egypt is seriously considering the possibility of a pipeline running parallel to the Suez Canal. It is possible that it is keeping its canal expansion plans (if it has any) in abeyance pending a decision on that project.

Meanwhile, the continuous, frictionless flow of Canal traffic is a reminder to the world that Egypt has successfully and permanently expropriated one of the West's largest enterprises in the Middle East, has managed to operate it nearly as efficiently as its former owner and has retained everyone of its customers.

The effect of this feat on the peoples of the Middle East may, in the long run, be the most important consequence of the Suez Canal affair.