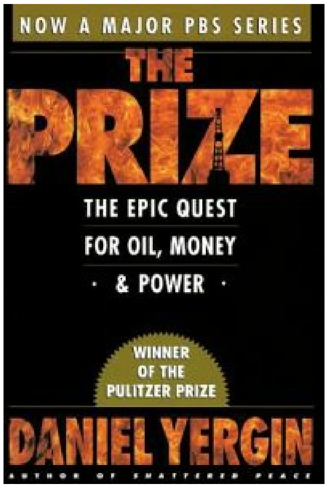

Book The Prize

The Epic Quest for Oil, Money & Power

Daniel Yergin
Free Press, 1993
First Edition:1991

Recommendation

This significant tome is Daniel Yergin's fascinating, 1992 Pulitzer prize-winning account of the personalities, politics, adventures and misadventures behind the evolution of the ruthless global oil business. This authoritative, intelligent and highly entertaining book reports on the past, present and future of the commodity that shapes the world power struggle. Yergin delves knowledgeably into fulcrum events. For example, shortly before World War I, Winston Churchill made the fateful decision to convert British navy's fuel from coal to Iranian oil. This decision set off the modern Western quest for Middle Eastern oil. The world is still feeling its wrenching impact, and Yergin shows how and why. *BooksInShort* finds that this book provides an essential context for understanding today's international conflicts.

Take-Aways

- Oil is the world's largest business. Modern society is based on hydrocarbons.
- Standard Oil was the world's first and largest multinational corporation. Its founder, John D. Rockefeller, was "the single most important figure in shaping the oil industry."
- By 1879, Rockefeller's Standard Oil controlled 90% of U.S. refining capacity.
- The invention of the electric light bulb in 1882 made kerosene obsolete, but the popularity of the automobile made gasoline the most important oil by-product.
- Churchill shaped energy's history by powering England's WWI navy with Iranian oil.
- The Nobel and Rothschild families developed oil fields in Russia's Baku region to sell oil to Europe and Asia.
- European and U.S. oil companies later focused on Mexico and then on the Persian Gulf.
- Andrew Mellon actively lobbied for Gulf Oil as U.S. ambassador to Great Britain.
- In 1960, oil-rich nations formed OPEC, the Organization of Oil Producing and Exporting Countries, to balance the pricing and production power of the oil companies.
- Muammar al-Qaddafi's Libyan coup in 1969 forever shifted power from the oil companies to the oil countries.

Summary

Inside Oil

Three overarching themes emerge from the history of the oil business:

1. **Oil is intertwined with capitalism and modern corporations** – Oil is the world's largest business. It powers the industry that developed modern pricing, marketing, corporate strategy and technology, both in the U.S. and internationally. Yet despite these deliberate efforts, luck, fate, risk and reward also have shaped the industry. It is so profitable that seven of the top 20 *Fortune* 500 firms are oil companies.
2. **Oil is intrinsic to international politics and economics** – World War I helped define oil's geographical boundaries as replacement for the horse and the coal-fired engine. In World War II, Japan, Germany and the Allies all coveted oil. Japan attacked Pearl Harbor to gain access to oil in the East Indies, while the Nazis sought control of the oil fields in Russia's Caucasus Mountains. After WWII, oil was the prize at stake in the 1956 Suez Crisis, which marked the end of European colonial power. Since the 1970s, oil has played a large role in the Iraq wars. It drove U.S. misadventures in Mexico, Russia and Iran.

3. **Hydrocarbons impelled the modernization of society** – The advent of kerosene light started a fundamental societal shift when it illuminated the night and allowed people to work longer. Its popularity and functionality made John D. Rockefeller the richest man in America. Gasoline, originally a useless kerosene by-product, sold for two cents a gallon or just got dumped into rivers. But the invention of the light bulb and then the internal combustion engine meant the end of kerosene and the beginning of a gas-based society.

> "At the beginning of the 1990s – almost 80 years after Churchill made the commitment to petroleum, after two World Wars and a long Cold War, and in what was supposed to be...a new, more peaceful era – oil once again became the focus of global conflict."

Today, oil has helped create suburbia, modern agriculture, the chemical industry and worldwide transportation, all accompanied by political instability, scarcity and environmental degradation. These forces will continue to clash in the face of population expansion, economic development and the constant need for more oil-based energy products.

"Rock Oil"

Entrepreneur George Bissell drilled the U.S.'s first oil wells in Titusville, PA, in 1859. The area was renowned for surface oil that bubbled up through crevices. People mopped it up with blankets or collected it in buckets for use in medicines. Bissell and his partners, including foreman Edwin Drake, tried adapting rock-salt drilling methods to extract oil they could sell as fuel for kerosene lights. Their venture proceeded under tough circumstances until they hit oil 69 feet underground that August, just days before the deadline set by their frustrated investors.

> "Virtually from the very beginning, petroleum was an international business."

Oil was discovered and pumped under the "rule of capture," a part of English common law that originally applied to hunting. It said drillers could pump as much oil as possible even if some of it came from under adjacent land owned by other parties. Since determining where the oil resided was impossible, all landowners had the right to drill for oil on their own property and to pump as much out as possible. Thus, an oil discovery on one lot spawned more wells on all the adjacent properties. Those who drilled fastest won. This created wild swings in prices and population as people dashed to areas where oil was found. However, installing too many wells dissipated a field's internal pressure, preventing more oil from flowing to the surface. Given the primitive state of pumping technology, this made more oil unrecoverable, hastening further exploration.

> "The enthusiasm for oil seemed to know no limits, and it became not only a source of illumination and lubrication, but also part of popular culture."

The oil industry attracted many talented, energetic individuals, including John D. Rockefeller, 26, who became the majority owner of a successful refinery in 1865 when he bought out his fellow senior partner, Maurice Clark, for $72,500 and began building his oil monolith. In 1870, Rockefeller and his new partner, Henry Flagler, raised capital to form Standard Oil. Soon after, oversupply plagued the industry; a barrel of oil sold for 48 cents, three cents less than a barrel of drinking water. Refineries were underpriced during this surplus, so Rockefeller began buying his competitors, seizing the opportunity to "consolidate the industry in his own grasp." By 1879, he controlled 90% of United States' refining capacity.

> "A central theme underlay Rockefeller's management; he believed in oil, and his faith never wavered."

Rockefeller became "the single most important figure in shaping the oil industry," and his company became one of the first and largest global businesses. He started with refineries and soon began exporting kerosene. Linking supply and distribution, he manufactured his own barrels, opened warehouses, and bought oil-transport ships and train cars. He hoarded cash, so he would not be dependent on bankers when business conditions worsened.

> "The Great War had made abundantly clear that petroleum had become an essential element of nations."

Step by step, he created the first vertically integrated oil company, from mining to shipping to refining, garnering charges of monopolistic, unethical practices along the way. Standard's competitors fought back and circumvented its shipping monopoly by creating a 110-mile pipeline from the Pennsylvania oil fields to the Reading Railroad, an engineering feat comparable to building the Brooklyn Bridge.

Going International

In 1861, the first shipment of American kerosene journeyed on specially designed ships from Philadelphia to London, opening the way for international oil shipments. Europe was especially receptive to buying kerosene from the world's largest refiner, Standard Oil. That changed in the 1870s, when Ludwig Nobel developed a closer source in the Russian province of Baku. Nobel, whose brothers built fortunes in dynamite and armaments, worked on a Rockefeller-sized scale. He developed the first oil tanker ships and built scientifically advanced refineries.

> "The politicians and bureaucrats...would now rush headlong into the center of the struggle, drawn into the competition by a common perception – that the postwar world would acquire ever-greater quantities of oil for economic prosperity and national power."

But the Nobels soon found themselves competing with the Rothschilds, refinery and railroad owners who also pursued new kerosene supplies from Baku. Russian oil production soon rivaled that of the U.S., as the Nobels and Rothschilds opened marketing operations in Great Britain to compete with Standard Oil. The Rothschilds soon looked to Asia for a new market for kerosene, their "illuminating oil." To expand, the Rothschilds partnered with Marcus Samuel, the future founder of Shell Oil, who had good business contacts in the Far East.

> "In 1940, the area including Iran, Iraq, and the entire Arabian Peninsula produced less than 5% of world oil, compared to 63% for the United States."

Around this time, Aeilko Jans Zijlker, a Dutchman managing a tobacco farm in Sumatra, noticed that the natives' torches produced oddly bright flames. He learned that they dipped their torches into a waxy mineral they took from small natural ponds. That "muddy substance" turned out to be about 60% kerosene. By 1895, an oil company named Royal Dutch was drilling successful wells in East Sumatra. The company's quick, though not easy, success and marketing prowess soon beckoned

Standard Oil, which tried to buy a controlling interest. The Dutch refused the offer.

Cars, Gasoline and Fuel Oil

By 1882, Thomas Edison paired one of his inventions, the incandescent light bulb, with an electric illumination system, and lit American homes and businesses. This innovation signaled the demise of kerosene as the world's lamp fuel. To develop a new market, refining companies turned to the horseless carriage. Henry Ford, chief engineer at the Edison Illuminating Company in Detroit, quit his job to produce cars. By 1905, gasoline-powered cars had won out over those powered by electricity and steam. This created a new demand for gasoline (which sold for two cents a gallon in 1892), as well as for fuel oil to power boilers in factories, ships and trains.

> "Total world energy consumption more than tripled between 1949 and 1972."

Also in 1892, in Texas, one-armed mechanic Patillo Higgins took his Sunday school class on a hike to Spindletop, a sand hill in Beaumont. Higgins noticed gas escaping from the sand. Suspecting oil, he formed a drilling company, but found nothing. Persisting in his quest, he enlisted a partner and then some wildcatters who discovered the nation's first oil gusher in 1901, a well that produced 75,000 barrels a day. This started the Texas oil boom, which moved oil production from Pennsylvania to the Southwest, and eventually to Louisiana and Oklahoma. This discovery also attracted the attention of Shell Oil's Samuels, who wanted an alternative to his fields at Baku. Texas crude oil had another benefit; it was well suited for being made into fuel oil, allowing the oil conversion of existing coal boilers. Texas attracted other families who founded oil companies: the Mellons of Gulf Oil, the Pews of Sun Oil and the Cullinans of Texaco.

Oil and Power

Oil was also discovered in Mexico, which was shipping it worldwide by 1913. Mexico played a chief role in WWI and was a major international oil producer by 1921. However, dating from its new constitution in 1917, controversy erupted over who owned Mexico's oil and mineral rights. The country asserted that it owned its subsoil, no matter who drilled it. Reluctant to commit to ventures they could not control, the oil companies pressed for a change. Royal Dutch/Shell owned Mexican Eagle, a British firm that handled some 65% of Mexico's production; a Standard Oil-led trio of U.S. firms managed the rest. These companies slowed production amid political uncertainty. In 1938, Mexico nationalized the oil business, particularly hurting Mexican Eagle. England broke relations, but new customers stepped in: Nazi Germany, fascist Italy and Japan.

> "While privately owned oil companies will still have great impact because of their sheer size and wealth, they have lost their once unique strength."

Oil ventures then focused on Venezuela, ruled by General Juan Vicente Gómez, a tyrant. In 1922, British and U.S. companies already were drilling profitably in the Maracaibo Basin on leases owned by Gomez, but concerns over his regime's future political stability forced the oil companies to build refineries on two nearby Dutch islands, Aruba and Curaçao.

> "Whatever the evolution of this new international order, oil will remain the strategic commodity, critical to national strategies and international politics."

The end of WWI initiated intense competition among England, France and the U.S. for access to oil. The struggle started in British-controlled Mesopotamia, which had been carved out of the Ottoman Empire and included Iraq. Each country wanted an aligned oil company in place to secure its national position, profits and security. The companies wanted autonomy and access to top prices. Finding an ally in the Sharif of Mecca, in 1921, Britain made his third son, Faisal, the king of Iraq. His brother, Abdullah, became king of "the vacant lot which the British christened the Amirate of Transjordan." In 1928, the competing nations signed the Red Line Agreement, dividing up the oil fields inside the old Ottoman Empire, except those located within Persia and Kuwait.

> "Of course, the 'free market' approach rested upon a contradiction: After all, a cartel, OPEC, was preventing a big fall in the price of oil, this providing the incentives for conservation and energy development in the United States and elsewhere."

In the late 1920s, itinerant American mining engineer Major Frank Holmes was working to exploit his oil concessions in Bahrain, Kuwait and today's Saudi Arabia. The British barred outsiders, including Holmes' group, from drilling in the Gulf, but the Arabs still see Holmes as the "Father of Oil." In the early '30s, Saudi Arabia's ruler, Ibn Saud, needed cash. Though he wanted to preserve his traditional relationships, including that with Sunni Islam's Wahabi branch, he gave foreigners exploration rights. This led to the development of modern Saudi Arabia.

> "Over almost a century and a half, oil has brought out both the best and the worst of our civilization."

Western oil activity in the area also turned to Kuwait, whose economy rested on natural pearls. When Japanese noodle vendor Kokichi Mikimoto developed a way to make cultured pearls artificially, Kuwait's pearl business evaporated. This forced its ruler, Sheikh Ahmad, to seek oil developers. He invited British and U.S. oil companies to bid on his concession, even though that angered Britain, which supported Kuwait militarily against Saudi Arabia, Iraq and Iran. This rivalry between Britain and the U.S. reached the cabinet level. Under pressure, England allowed U.S. companies to compete in Kuwait. Andrew Mellon, U.S. ambassador to Great Britain, was a major force behind this decision. A former U.S. Treasury Secretary and scion of the Gulf Oil family, he lobbied the British on Gulf's behalf. Bidding for Kuwait drilling came down to Gulf and Britain's Anglo-Persian oil company, which formed a 50-50 joint venture under British control in 1934. The sheikh gave the new Kuwait Oil Company a 75-year concession.

Modern Oil and OPEC

In 1960, Standard Oil of New Jersey and other companies cut their price on Mid-East crude, reducing the revenues of major oil-producing countries. This unilateral cut generated a sharp reaction from the Mid East and Venezuela. In 1960, they created the Organization of Oil Producing and Exporting Countries (OPEC) to counterbalance the oil companies' pricing and production power. Initially, OPEC made only a slight impact. After the 1967 Six-Day War, the 20-year surplus of abundant, cheap oil showed no signs of declining.

But things were changing. Britain and the U.S. were losing influence. In 1968, Britain ended its Persian Gulf military presence, though the Arab sheikhs wanted it to stay. Instead, with President Richard Nixon's assent, the Shah of Iran filled the gap. By the 1970s, global demand for oil skyrocketed. But as the search for more oil began, the environmental movement gained strength. Then, in 1969, Muammar al-Qaddafi's Libyan coup shut down Western military bases. He ordered the 21 oil companies in Libya to pay him more or face nationalization. After tense negotiations, the Libyans won. Power shifted from the oil companies to the oil countries, changing the oil business forever and launching the nationalism that dominates it today.

About the Author

Daniel Yergin heads an international energy consulting firm. A former lecturer at the Harvard Business School and at Harvard's John F. Kennedy School, he co-authored the bestseller *Energy Future*. His book *Shattered Peace* is a classic history on the origins of the Cold War.