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Warfare over oil prices

Unless demand increases, reports Judith Wyer, the 'glut' can mean triage of refineries and some producers.

Speaking before a closed-door seminar last week at Harvard University, Saudi Arabian Oil Minister Ahmed Zaki Yamani forcefully reiterated the message he came to the United States to deliver: world oil prices must come down. Yamani told a select audience of bankers and oil company executives in no uncertain terms that Saudi Arabia intends to revive world consumption of oil by forcing down oil prices.

A source present at the meeting reported that Yamani insisted that Saudi Arabia intended to use its massive oil producing capacity to pressure OPEC to lower contract price of crude from as high as $40 a barrel to Saudi Arabia's $32 a barrel price. "Yamani wasn't kidding around," observed the source. "What he is asking OPEC to do, it has never done before; we've seen some shaving of surcharges, that is going on now. But never has the cartel actually lowered contract prices. Yamani thoroughly believes he can stimulate world demand of oil by this maneuver."

The response from Wall Street to Yamani's bid to stimulate an industrial recovery was not the enthusiasm one would expect. Within 48 hours of Yamani's speech, a number of New York oil analysts were retailing the evaluation that Riyadh's bid to stimulate world oil demand by lowering prices had little chance of success.

This was underscored by a move by several large banks to raise interest rates again.

It is no coincidence that right at the point when oil prices began their descent, Federal Reserve Chairman Paul Volcker, in tandem with the largest American banks, decided to take the lid off interest rates. The renewed climb of interest rates will act to dampen any prospects for stepped-up oil demand, by preventing badly needed capital formation for expanded industrial and agricultural output.

The interest-rate boost is aimed at steering Saudi Arabia's policy of record high production in a direction diametrically opposed to stated Saudi objectives. Volcker's action is motivated by a policy articulated by the New York Council on Foreign Relations *Project 1980s* studies, which calls for a "certain amount of controlled disintegration" of the world economy—studies Volcker helped to coordinate. The CFR report is a blueprint for a postindustrial society. Volcker and his allies in the boardrooms of the multinational oil companies plan to rationalize vast sections of both the oil-producing sector and sections of the so-called downstream oil process business. This plan is based on keeping world oil consumption depressed while Saudi Arabia continues to export record high levels to expand the glutted oil market. Under these circumstances, massive rationalization can take place.

The element of risk

According to the strategy spelled out by Yamani, Saudi Arabia will maintain its record level of oil exports, now at about 10.3 million barrels a day, in order to flood an already glutted world oil market. With current demand continuing to slide, Riyadh calculates that it can force its fellow OPEC producers to cut prices, if they want to continue to sell crude.

But if oil demand does not take a substantial upturn, Saudi Arabia could be in trouble. A source at a Solomon Brothers investment bank observed, "There is an element of risk in what Saudi Arabia is trying to do. If it continues to pump out all that oil into a gluted market, and demand stays flat, then a number of OPEC countries that can't afford to drop oil income will be hurting. They are going to resent what Saudi Arabia is doing. They could get behind Libya and make trouble for Saudi Arabia. The whole thing could get very messy. Countries like Indonesia, Nigeria, and Algeria with large populations and ambitious development plans would be in big trouble."

A number of influential New York bankers echoed this bloodcurdling scenario. Circles close to the U.S. Federal Reserve predict that Indonesia, Nigeria, Ecuador and Algeria would be eliminated as oil exporters. This idea coheres with the policies of the Global 2000 study originated by the Carter administration and now supported by Secretary of State Alexander Haig and Volcker, policies that aim to eliminate 2 billion people from "the overcrowded earth" by the year 2000. Indonesia and Nigeria, which jointly have a population of well over 200 million people, are special targets of this brutal genocidal policy. They are also critical catalysts

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for the development of Southeast Asia and black Africa.

The World Bank has already begun to pressure Indonesia to make painful cuts, including eliminating all fuel subsidies in order to "prepare for the future loss of its oil markets."

Both countries are engaged in massive natural gas projects to supplement future income as oil revenues wane. But a source with the Maryland-based Energy Futures Group was pessimistic that they would meet their expected income from natural gas, since it is expected that fairly soon there will also be an oversupply of natural gas, which could leave these countries with large debt service to pay on projects which will not pay for themselves.

A New York oil analyst warned that "if trends in the market continue along the same course, this could spark the breakup of OPEC. . . . I don't mean that in the way it is normally referred to in the *New York Times,* I mean that certain OPEC countries who aren't as rich as Saudi Arabia will simply break up under the pressure of diminishing oil income."

Rationalizing refineries

Within the oil industry in the industrial sector, the same process of junking "unneeded" refinery and transportation capacity is occurring. This rationalization process is particularly striking within the United States which has had the greatest drop in oil consumption of any advanced country. The current mothballing of refineries is putting the U.S. economy into a mode which is aimed at ensuring that it remains in a virtual zero-growth state.

Over the last three years U.S. oil imports have dropped from 6.6 million barrels a day to the six-year low of 3.8 million barrels a day. Even discounting a small jump in domestic crude output and a modest conversion to coal and gas for power generation, the picture of U.S. energy consumption is dismal. In the last year and half U.S. gasoline consumption has dropped by 11 percent.

As a result of the depressed market for petroleum products, in the last 12 months the American oil industry has seen a spate of refinery shutdowns. As of April, 336,000 barrels per day of refining capacity was on the auction block. Though this is still a small percentage of the total of 18.5 million barrels a day of U.S. refining capacity, the closures are expected to continue.

The London-based *Petroleum Economist* last month estimated that as many as 50 American refineries could permanently close because of the depressed state of American oil consumption. The total number of American refineries is just over 300. The bulk of the closings are expected to occur in the Gulf of Mexico area, since these refineries were built before the Nixon administration lifted the oil import quotas in 1971, and were geared to take high-quality Texas light crude.

The American Petroleum Refiners Association reports that 10 of its 60 members have shut down their refineries. Whether the closures are permanent is not yet certain. Clearly American refineries need a rebound in oil demand as badly as does Saudi Arabia.

Now that the Reagan administration has decontrolled all domestically produced crude prices, and removed all subsidies to independent refineries, they can no longer realize a profit. With petroleum product inventories brimming and nobody buying, they had no choice but to close up shop. Last month U.S. refinery utilization had dipped to a record low of 67 percent.

Unlike the small refineries, the major oil companies have the profit margin to rationalize some of their own refinery capacity and convert much of the remaining capacity to distill low grades of crude, known as heavy oil.

A number of major oil companies have registered either substantial declines in profitability for their refining and transportation operations or even a loss for the first quarter of 1981. Most dramatic was Standard Oil of Indiana, which showed a loss of $208 million in its downstream division. But what the headlines failed to report was that after declining profits or losses in this area of the total operations, profits otherwise continued to climb. The major oil companies can in fact write off their losses against other more profitable ventures in their integrated systems.

Up to $60 billion will be invested by the majors in retooling their refineries to take heavy oil. Gulf Oil recently announced that it would put up $500 million for such reconversion while it is also studying the option of mothballing more refineries. In recent months Gulf has shut down two refineries in Toledo, Ohio and Venice, Louisianna. Chevron Oil is now studying the prospects for rationalizing some of its refining capacity, and like Gulf, has already invested hundreds of millions for conversion of California refineries to distill heavy oil. Atlantic Richfield recently shut down four refineries, and Sun Oil just put two of its Texas refineries up for sale.

The multis' rationalization policy is coherent with Federal Reserve Chairman Paul Volcker's program to force consumption cuts. By moving aggressively into heavy oil, the major oil companies are adopting a policy just as wasteful as the fanciful flight into exorbitant synthetic fuels. Not only is it a needless expense to reconvert refineries to take this sludge, but the refining cost is also much higher than refining crudes within the medium and light range of viscosity.

The smaller refiners cannot afford this expensive conversion process. They, like the rest of the American economy, could only benefit from the pledge Sheikh Yamani made last week.