EIR Economics

Oil-price plunge will ravage Third World producers

by Richard Freeman

World oil production levels, which in the non-communist world exceeded 50 million barrels per day two years ago, may now fall to 40 million barrels per day or below. OPEC oil production, which averaged about 32 million barrels per day for several years, may drop to half that figure. And the price of a barrel of crude oil which last year reached as high as $40 and is currently $34, may hit a floor of $15 per barrel by mid-summer. These are the set of predictions released March 8 by Texaco Oil Company, British Petroleum, the Hudson Institute, and others, including the newspapers *Le Figaro* in Paris, and the *Financial Times* of London.

The predictions of lower oil prices should not be taken as a sign that the world will return to the good old days of cheap energy. Certain of the multinational oil companies, and the Anglo-Dutch oligarchies standing behind them, are after all the same people who forced on the world a 13-fold increase in the price of oil following the 1973-74 Middle East war, and the 1978-79 Iran "revolution." Their game is not to return the world to prosperity through cheaper oil prices. Rather, they intend to use a price drop to fracture OPEC into a thousand pieces, by sending prices crashing. Leaving nothing to chance, the oil multis are dumping oil stocks onto a glutted world oil market. Oil consumption has dropped, because a world plunged into the depression that Federal Reserve Board Chairman Paul Volcker's high interest rates have created has far less need for oil. According to a statement by Kuwaiti Oil Minister Sheik Khalifia Al-Sabah March 9, certain multinational oil companies are dumping 4.5 million barrels of oil per day onto the market in an attempt to force the price down.

This will create an oil shock in reverse. The purpose of the shock is to destroy the ambitious development programs of some of the most advanced and more populous Third World nations, led by Mexico, Indonesia, and Nigeria, which depend on oil revenues to finance their programs.

"The world oil markets will become a dog-eat-dog situation," stated Mr. Lippey, the chief economist of British Petroleum, March 9. "The fall in the oil prices could lead to instability. I wouldn't be surprised to see a coup d'état in Indonesia; the coup attempt in Nigeria was just the beginning, and a coup in Saudi Arabia cannot be excluded."

The oil price strategy reflects the 1975-79 "Project 1980s" perspective of the New York-based Council on Foreign Relations. According to the CFR study, the

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developing sector should be forcibly "delinked" from the advanced sector, thus condemned to underdevelopment. At the same time, the Project 1980s projected a collapse of world trade and a "controlled disintegration of the world economy."

Trigger for lower prices

The world depression caused by Fed Chairman Volcker's interest rates has reduced oil imports and oil consumption dramatically. In 1979, for example, the United States imported 6.51 million barrels of oil per day. By February 1982, this was down to below 3 million barrels. A marginal amount of the drop is due to energy efficiencies or switching to alternative systems, but most of it results from the decline in industrial use of oil. In Germany, between 1980 and 1981 that nation's use of oil dropped 16.7 percent. Overall, world consumption of oil shrank by 11 percent between January 1981 and January 1982.

This sent world oil stockpiles held by companies, nations, OPEC producers, etc. to 110 days' worth of supply, when 80 to 90 days is considered normal. Since a day's worth of stocks is roughly equal to a day's worth of production—currently 45 million barrels per day—the excess 20 to 30 days worth of stocks means that an extra 900 to 1,350 million barrels exist out there to be dumped.

This "oversupply" set up the conditions for an interesting set of maneuvers. According to one well-placed oil analyst, President Reagan and the leaders of Saudi Arabia conspired to use the glut of world oil production to begin a controlled lowering of world oil production and thus freeze Libya and Iran out of world oil production. This would be a political move that would change the face of Middle East politics.

Whether by getting wind of this, or simply deciding that the time was propitious for a bear raid, the British-Venetian forces responded to the over-stocked world oil situation with a dumping spree and threats to bust OPEC. Thus, the week of Feb. 15, the British National Oil Company cut the price of North Sea light crude, which competes with North African light crude, by $4 to the price of $32 per barrel. Britain has used the price cut to undercut Nigeria, and has actually replaced Nigeria as the second largest seller of oil to the United States. If the price falls as low as $25 to $28 per barrel, not to speak of $15, it will wreak havoc with developing sector producers. And three of those producers, with some of the most ambitious development programs, largest populations, and highest import demand from the West are in special jeopardy: Mexico, Nigeria, and Indonesia. Among them these nations have more than a quarter of a billion people.

The best way to evaluate the situation is to see how vital oil is to a nation's development programs. In the case of Mexico, it was projecting for 1982 oil exports of 1.5 m

light and heavy oil of $30 per barrel. This would yield $16.5 billion worth of export earnings, or more than 75 percent of Mexico's expected $19 to $20 billion of total merchandise export earnings for this year. But what happens if Mexico's production for export is lowered to 1.1 million barrels per day, as it has been, and the price of Mexican crude is cut by an average of $4 per barrel? Mexico's expected export earnings from oil would plunge to $10.5 billion, or a cut of Mexico's total projected export earnings of one-fifth. This slashes Mexico's ability to carry on its internal development programs: not only do oil exports provide foreign exchange with which to buy high-technology goods, but oil production also provides more than a quarter of tax revenues.

Last month, Swiss and British banks forced Mexico's currency, the peso, to undergo a 40 percent devaluation. A top think-tanker connected with the Council on Foreign Relations stated March 9, "The estimates I have from knowledgeable sources is that Mexico needs $30 billion in gross financing, $20 billion in net, this year. They simply won't get it. Mexicans think they can carry on, but the 3 percent budget cutback they've announced doesn't mean anything. . . . They will have to cut capital investment in long-term projects, the petrochemical industry . . . steel . . . maintenance on roads and railroads . . . [and] slow the ports projects. . . ."

Nigeria, with 80 million people—more than one-fifth the population of the continent of Africa—is struggling to bring its population into the 21st century. Oil revenues provide more than 90 percent of its export earnings and almost the entirety of its budget revenues. In February, British-controlled forces ran an assassination attempt on the President of Nigeria, Shehu Shagari. And at the end of February, British Petroleum and Phillips Petroleum pulled out of a natural-gas liquefaction project in Nigeria that all but killed the project. Now London bankers predict that Saudi Arabia will have to bail out Nigeria financially, which will run a payments deficit even if it cuts back its development projects.

Indonesia, another major oil producer, has 110 million people. Though for the last few year it has run balance of payments surpluses, a fall in the price of light crude to $28 per barrel would wreck its development programs. The country is still a net importer of rice; its development programs never reached the level of producing enough food for its people.

Banking collapse

The lowering of oil prices occurs against a background of tremendous financial upheaval. The high

interest rates in the United States continue to drain capital from Europe, causing extreme currrency exchange-rate instability. If OPEC moved into deficit, and withdrew funds from the Eurodollar market, the basis for international debt rollover would shrink drastically. OPEC has $125 to $150 billion in Eurodollar deposits, about half the core deposit base of the Eurodollar banks. Upon this base, with a multiplier of from 4 to 6, the banks have lent out $1.2 to $1.6 trillion to each other, and more importantly to third world nations which need the funds for debt roll-over.

The OPEC surplus in 1981 was $66 billion. For 1982 Chemical Bank estimates that OPEC's expenditures for imports, transfer of resources, and charges for insurance and shipping come to $220 billion. Then, at an oil price of $28 per barrel and an OPEC production level of 18 million barrels per day, OPEC will run an approximate $50 billion current-account deficit, even if it cuts back on development projects. Were the price of oil to fall as low as $15 per barrel, and the OPEC production level to 16.5 million barrels per day, OPEC would run a deficit of between $100 and $125 billion.

While Saudi Arabia and Kuwait may achieve a surplus this year, even if the price of oil falls, other OPEC nations, including Algeria, Iran, and Ecuador, as well as Nigeria and Indonesia, will probably run deficits. In the event that the Saudis lend them money, that would amount to the same drain on the Eurodollar deposit base as a direct withdrawal of their own funds. OPEC already drew approximately $15 billion from its Eurodollar deposits in 1981; if members go into deficit, the rate would be at least doubled.

As an economist for Texaco Oil in London commented March 9, "I could see a few large banks going bankrupt if OPEC withdraws deposits. This would mean that international lending would be curtailed."

The consequences for the Third World, which has $100 billion in balance of payments and current account financing for 1982, according to the IMF, are obvious.

The world is not completely helpless in the face of such a "reverse oil shock" threat. Under the conditions of collapsing oil prices, notably Japan and Germany, but also the Uniied States, would realize a sharp improvement in their terms of trade. If the Germans and Japanese were to make the increase in their current account surpluses the basis for credit expansion geared toward increasing world trade, their economies could survive the shock, and begin to put the Third World on its feet.

In order to make such potential practical, Germany and Japan, in tandem with Saudi Arabia, would have to peg the deutschemark and the yen to give gold backing to this long-term trade credit. The Eurodollar market would then cease to be the central source of international liquidity.

Documentation

'Multis are dumping, social chaos will follow'

From a March 9 interview by EIR *Wiesbaden correspondent Mark Burdman with Herr Lönncke, a Hamburg oil analyst:*

Burdman: How do you see the OPEC situation?

Lönncke: We don't know yet what OPEC will do exactly, but I can say that prices are certainly falling. Even if OPEC goes below 18 million barrels a day, it doesn't make an impression on the buyers. After all, interest rates are too high for the companies to maintain stocks, so they will try to sell off surplus reserves in response to the rather depressed level of activity now prevailing; so the companies are drawing down stocks.

The lower prices and production are rather difficult for Nigeria. Their planned liquefied natural-gas project has effectively been killed. The Nigerian national oil company was going to put in 60 percent of the cost, but Phillips and BP [British Petroleum] dropped out, and the project is dead. Nobody is going to take their place.

There will be problems for Algeria and Libya too, more so Algeria. Algeria is certainly in bad shape. Algeria priced itself out of the market, especially in respect to gas sales. Their crude is too high. They're losing volume every day, and they have no reserves to speak of financially.

Burdman: What does the situation you are describing mean for German exports to OPEC countries?

Lönncke: It will certainly mean that our exports to that part of the world will decline in the second half of the year and through 1983. There will be no reversal in the decline of income in the OPEC countries for at least a couple of years. They will have to get along with a much lower level of income. This will certainly hamper them in ordering new technology imports. We in Germany will be hit by this, there is no doubt about it. To calculate exactly how much would be very difficult. . . .

Burdman: What effect will the situation have on OPEC lending?

Lönncke: The Arabs with money will now only lend to their close circle of friends. The rest of the community needing money will be squeezed out. I am thinking of India, Bangladesh, and South American countries. There will not be much left after lending goes to Iran, Iraq, Algeria, and Nigeria, the OPEC countries in deficit. And

even this income may become scarce if the Saudis go down to 6 million barrels a day. Such a level is clearly possible; there is a lot of pressure. This would be sufficient for their budget, and would allow others to produce more. There is pressure along such lines, also from Kuwait and the Emirates.

From a March 9 interview with Mr. Maynard of Texaco Economics in London:

Burdman: Can you comment on talk of a $15-per-barrel OPEC price?
Maynard: The $15 figure was based on a report I can send you. It was speculation on a pretty extreme case. We think that things could fall quite precipitously before resistance is mounted effectively enough. Such a level would have catastrophic consequences for OPEC. There would be amazing political problems, many countries [in OPEC] wouldn't be able to run any more, pure and simple. This is true particularly for the countries with high populations, like Indonesia, Nigeria, and Ecuador. These places have clearly balanced budgets which they have to maintain.

What you have now in the oil markets is a ratchet down; every time there is a fall, another level of drop is necessitated, and so on. Twenty-eight dollars a barrel may be an adequate price, but production of 18.5 million barrels a day is too high. It has to go down to at least 16.5 to 17 million to be at all effective. This is mostly going to have to come from the Saudis. There is no alternative. . . .

Burdman: Do you think the Saudis could go to 6 million?
Maynard: I don't see why not. They could balance their budget at that level. For a short period of time they could go to that level.

Burdman: What effects are likely on the international credit and recycling situation?
Maynard: There is a danger of a bank crash if the reserves are pulled out by OPEC countries. The question I ask is how quickly they could pull reserves out. The problem is that the money has not been kept as cash in the banks but has been loaned out. Look at how much money is going into Poland! It would be very dangerous if any revenue-hungry country tried to pull out their reserves. I'm thinking primarily of Iran, although someone like Iraq is a possibility too. Look at the Iranians, they are selling as much gold as they can. This is an extreme case, admittedly, that such a crash would occur: The OPEC countries would try to pull their money out, find it already loaned, and the crash would be on. . . .

From a March 8 interview with Parviz Mina, former head of the Iranian state oil company:

Burdman: What is your judgment of OPEC's future output?
Mina: It's very difficult to protect the market price of oil through cutting production, since many OPEC countries are in great need of money at this point. I'm thinking of Nigeria, Libya, Algeria, and others. . . . Nigeria would be happy at the 18.5 [million barrel per day total OPEC output] figure, if it didn't have to reduce prices. But the recent moves by the British oil companies put Nigeria under great pressure. If there is a cutback in Nigeria and elsewhere, there will be considerable budget deficits.

Burdman: What is your information on oil-company drawdowns of stocks?
Mina: I think the level of these drawdowns is 1.5 million barrels per day, not 3-4 million as is sometimes mentioned. The companies still have excess, with the estimates being that there are 103 days' overall inventory still existing. The companies will draw down more in the coming months, because prices will drop further, and the companies want to beat the price drop by selling as much as they can now.

Because of the high interest rates, it is no longer logical for the companies to keep stocks. . . . With interest rates high, the oil companies have the incentive to make quick cash, when money is worth 14-17 percent on the international markets. Their idea is to sell their stocks and make as much cash as possible.

From a March 8 interview with Mr. Bretherton of the International Energy Agency in Paris:

Burdman: What do you consider the most important factors facing OPEC?
Bretherton: Two factors are defining the situation. First, demand figures are absolutely horrific; January consumption figures show that the trend for demand was down 11 percent in comparison with the previous January. There's a 2 million-plus volume drawdown in the OECD countries, and maybe as high as 4 million for the whole world. Eleven percent is a hell of a lot of drop.

Second, 1981 ended with pretty high stocks for the companies, and the industry is now trying to run the stocks down. By our estimation, there's a 4 million barrel a day drawdown of stocks now taking place. With OPEC producing at 20 million, this makes for quite a glut. . . .

Burdman: Could prices go as low as the $15 per barrel figure cited by Texaco?
Bretherton: It's conceivable, purely by the market, if demand is weak, and stays that way, and there is a stock overhang, prices will continue to fall. Then you have North Sea and Mexico coming into the market, which means it will be harder for Iran, Iraq, Libya, Nigeria, and so forth to maintain their market share. A country

like Nigeria, which is now producing 1.4 million barrels a day, is moving slower than events, and the markets are moving against them. Nigeria will have to scale down their expectations of income, at the same time they are committed to high levels of spending.

Our view is that now demand will slow down in 1982. The previous expectation of an upswing in demand is now disappearing. Demand in 1982 will be far weaker than expected. The demand decline, in our view, could accelerate.

From a March 8 interview with Mr. Lippey, economist at British Petroleum's London headquarters:

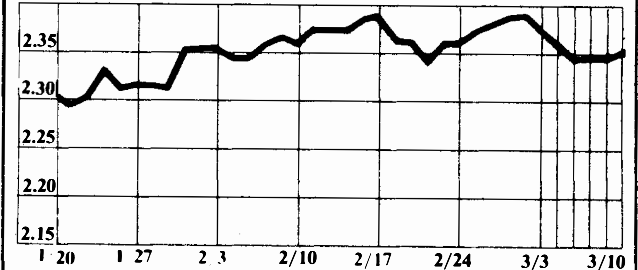
Burdman: What is your estimated range of drawing down of stocks by the companies at this point?
Lippey: It's within the range of 1.5-4, it's uncertain exactly how much, but it's within that range. It *ought* to be near the higher end, that is traditionally what happens at this time of year, but I don't think it's being drawn down at such a high rate, since the demand is just not there for so much oil, and oil is being pumped out now as fast as the demand is there. There are 103 days of reserves now, significantly above the 90-day figure under the IEA [International Energy Agency] statutes, but demand is very low; my information is that Japanese and U.S. demand has fallen more than expected in comparison with European demand. . . .

Burdman: What effect would a war in the Mideast have on the price and production?
Lippey: A war would mean a giant yawn. If Iraq blows up, it makes no difference at all. It wouldn't matter if this happened anywhere, except for the Saudis. . . . the drop in production would be made up by the North African producers. . . . It's a dog-eat-dog picture in OPEC. There would simply not be enough money to go around if oil sold at $28 a barrel at 18.5 mbd. If the Saudis can't go down in production, the other OPEC countries are in trouble. There are discreet discounts now being offered here, there, and everywhere. The BNOC [British National Oil Company] price cut has put the cat among the pigeons. . . . The action of non-OPEC producers—the U.S., Mexico, Britain, Egypt—has jumped the gun on OPEC. OPEC has lost its markets.

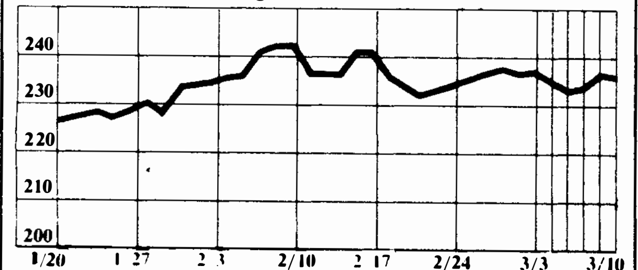
Burdman: What does this mean for the political stability of these countries?
Lippey: I wouldn't call them stable entities in the first place, would you? What keeps Saudi Arabia from going under?. . . Any of these regimes might just keel over. . . . The fall in the oil price could lead to instability. I wouldn't be surprised to see a coup d'état in Indonesia; the coup attempt in Nigeria was just the beginning, and a coup in Saudi Arabia cannot be excluded.

Currency Rates

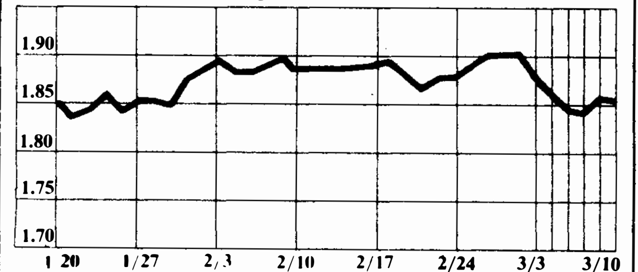
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing