Click here for Full Issue of EIR Volume 10, Number 9, March 8, 1983

EIR Economics

The oil-price drop: how far, how fast?

by Judith Wyer

After over a week of intensive consultations with both OPEC and non-OPEC oil exporters, Saudi Oil Minister Zaki Yamani on Feb. 23 declared that he thought it "doubtful" that OPEC as a whole would arrive at an oil pricing and production agreement. Days before, Yamani and five other OPEC oil ministers had parleyed in Riyadh, Saudi Arabia. After the meeting Yamani announced that they had reached an agreement on a cut in the price of oil, but Yamani refused to reveal that cut until the other seven OPEC producers were consulted.

But leaks from two participating countries, the United Arab Emirates and Qatar, indicated that Riyadh and its allies were ready to drop the OPEC marker price from $34 a barrel to $27, undercutting both the British National Oil Corporation and Nigeria, which the week before had lowered their price to about $30 a barrel.

In the midst of an unprecedented density of contacts among oil producers since the Feb. 18 British price drop, Yamani and the oil ministers of the Gulf allied to Saudi Arabia have issued repeated warnings that if OPEC could not reach an agreement, they were prepared to take matters into their own hands.

As *EIR* reported last week, Saudi Arabia has a contingency plan to drastically increase its production and lower its oil price perhaps to as little as $20 a barrel in order to regain control of the oil markets. A drop to $27 may only be a brief moment in a rapid downturn in crude prices.

On Feb. 21, George Bradley, the Assistant Deputy Secretary of Energy, told the U.S. Senate Banking Committee that the United States could manage an oil price drop to $20 a barrel. It was the first public acknowledgement by an administration official that a decline in world oil prices by up to 40 percent was possible. The next day the *New York Times,* a daily notorious for its allegiance to the British oligarchy, reported that oil traders in London saw the oil price bottoming out at $25 a barrel, while New York traders expected it to slide to $20 a barrel. These are reflections of what is thought to be some differences between Washington and London on just where the "safety net" under the price of oil is.

While London continues to caution against too drastic a drop, Washington is lauding the oil price cut as a welcome sign. Bradley affirmed that the $20 price would quicken President Reagan's long-awaited economic recovery.

The British position

British Prime Minister Margaret Thatcher, in a speech of Feb. 23, warned of the impact of a dramatic oil price drop on the world financial situation. Even though Britain started the latest round of price cuts, its policy has been that the oil price should drop slowly in small increments, to no lower than the $23 per barrel mark.

In fact, the 1983 budget written by British Chancellor of the Exchequer Geoffrey Howe, during November 1982, accounts for an oil price drop to as low as $25 a barrel. The British Treasury brings in substantial tax earnings from North Sea oil, this year estimated to yield over 7 billion pounds sterling. But because that oil is sold in high-valued dollars as opposed to the very weak British pound, the City of London makes a handsome premium on oil sales once those dollars

© 1983 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

are reconverted into pounds.

The real danger to London of a large price drop and concomitant production increase led by Saudi Arabia is not so much that of a threat to the British economy, which is only 4 to 5 percent dependent upon North Sea oil, but undercutting British North Sea oil's growing share of the world market. Since Britain initiated its policy of taking small oil price cuts in 1982, the United Kingdom has carved out a growing market share providing sufficient marginal market leverage to determine the trend in oil prices internationally. At present the British North Sea is producing at a record high of 2.3 million barrels a day (mbd), and exporting upwards of 1.4 mbd. This has occurred while OPEC's total production has slid from a 1979 high of just about 32 mbd to the present nadir of under 14 mbd.

Britain, in fact, remains a net importer of up to 800,000 b/d, more than half its total estimated 1.5 mbd oil consumption. London's policy is to export as much of the high quality North Sea oil as it can, in order to increase its market leverage. From the standpoint of the City of London, British oil exports function as a weapon against the moderate bloc of Saudi-led OPEC producers, which are allied to the United States. It is little surprise to hear OPEC members, Algeria and Venezuela, harshly attack London following its mid-February price drop for dominating the oil markets.

The reason for the precipitous decline in OPEC's output is the effective boycott of those 13 producers by the multinational oil companies. Since the late-January meeting of OPEC, the cartel's total output has slid by nearly 5 mbd. The major oil companies are consuming crude from their massive oil stockpiles at a rate ranging from 3 to 6 mbd instead of buying from the OPEC exporters. The majors can argue that unloading expensive oil is necessary in anticipation of a ratchet downward of crude prices, in order to balance their books.

But the question becomes: Why are the companies only boycotting the OPEC producers? This boycott is meant to pressure the cartel to make a cut in oil prices. Because of depressed world oil demand, refineries lose money on crude oil priced higher than $29 to $30 a barrel. But the question remains an open one regarding differing objectives between the United States and the British on where the cutting should stop. As a source from Chase Manhattan Bank admitted, the multinational oil companies could halt their massive destocking overnight and if not reverse, certainly slow the downturn in oil prices, by resuming purchases of oil from OPEC.

OPEC's next move

Saudi Arabia has announced that there will probably be a full oil ministers' meeting of OPEC during the week of Feb. 28 in Geneva. It is expected that the 13 ministers will reach a consensus on price cut by $4 a barrel, lowering the OPEC marker to $30. But there is every likelihood that the agreement will not last, since hungry OPEC countries like Nigeria and Algeria will probably shave oil prices again to earn badly needed revenues. Already, the major oil companies which buy British oil are pressuring London for another price cut, in response to the anticipated OPEC cut next week.

Should the OPEC agreement collapse, then Saudi Arabia and its allies will be wont to cut another $3 to $27 a barrel as agreed upon during meetings in Riyadh. But Nigeria has already stated that it will enact another price cut in response to an OPEC cut.

On Feb. 22 British Foreign Minister Francis Pym met with Mexico's energy minister, Francisco Labastida. London has viewed the non-OPEC producers like Mexico as potential allies in its effort to leverage world oil markets at the expense of OPEC. But Mexico appears to have gone the other way, having signed an accord with OPEC member Venezuela that same week pledging not to undercut the cartel. In view of the assault that developing countries like Mexico are now undergoing by the London-New York banks and the IMF on renegotiating Mexico's debt, Mexico's move appears to signal its pursuit of solidarity with fellow developing nations. Mexico was expected to follow London's lead and drop its price by $4 a barrel Feb. 26, but at the last minute reversed that decision.

Instead, on Feb. 24 Labastida made the first trip by a Mexican oil minister to Saudi Arabia, for consultations. This move might portend the long-mooted prospect of Mexico joining OPEC, something Saudi Arabia has for some time supported, but London has opposed.

Stretching out the price drop

London has already put out the word that another oil price cut by BNOC may come as soon as March 1. According to the *Financial Times* of Feb. 25, Gulf Oil Corporation, one of the largest purchasers of British North Sea crude, has notified BNOC that it will not fulfill its purchase requirement of 100,000 barrels per day in March unless there is another BNOC price reduction. Since December, Gulf has been the leader of the group of mostly U.S. majors which have called upon BNOC to lower its price.

Given Gulf's longstanding marketing links to the British group of companies, primarily east of Suez and in the Far East, Gulf's demands are very likely coordinated with BNOC. Not only was Gulf behind the move to get the Feb. 18 three-dollar price-cut by BNOC, it was a dominant force in pressuring Nigeria to lower its price by $5.50 a barrel to the same $30.00 level, a move which occurred within 48 hours of the BNOC cut.

More than any other U.S. multinational, Gulf has been a vocal supporter of London's policy of restructuring world oil trade. This goes back to Gulf chairman James Lee's public endorsement of the British scheme to create a North-South agreement to raise oil prices in "little steps" in 1980; it is most recently reflected in Lee's Feb. 2 statement to New

York oil analysts that Gulf was all but pulling out of Nigeria in order to retrench in Western Hemispheric oil projects in the Arctic.

A drawn-out period of price decline, even to a temporary level of below $20 a barrel, is seen as the means by which to undermine the developing-sector oil producers' control of their oil. This need not come in the immediate form of denationalization.

The case of Nigeria illustrates the point. Following the near-zero level of Nigerian oil sales in the days prior to its price cut, the Nigerian government acceded to demands by the major oil companies which market its oil to allow the majors a greater profit on their take of Nigerian crude. The initial concession by the Lagos government gave the equity-owning multinationals an additional $.60 profit per barrel of crude.

Though this might appear an insignificant concession, it conforms to what *EIR* has documented as the objective of the major companies during the 1980s: to force oil producers in the developing sector to give multinational oil concerns contracts which increasingly favor the company and in the long term reflect the process of the return to a colonial system.

Controlling the market

Throughout the 1970s, the multis surrendered control over the wellheads in developing countries. And most insiders in New York and London concur that the increasing leverage the oil companies have over the oil exporters of the South comes as a result of the majors' control of marketing outlets.

According to numerous studies by City of London think tanks like the influential Petroleum Economics, Ltd., the oil market over the course of the '80s will no longer be based on long-term contracts between producer and consumer, an arrangement which has provided stability; rather, oil will become a commodity subject to speculation like any other raw material, and futures markets will become the chief means of trading oil.

In this light, the oil companies become purely trading concerns, not engaged in any aspect of energy production, and secure ultimate leverage over oil prices and availability. The growth of futures markets has been highly controversial within the oil industry, especially in the United States. Gulf's James Lee has been one of the few to acknowledge this trend and admit that Gulf is preparing to take up the role as oil trader.

London was the site of the first such futures market three years ago. At that time, only British Petroleum was an overt supporter of the London gas-oil futures market. Since then, these markets have proliferated to U.S. shores, and the first crude oil futures market will be inaugurated soon in New York.

Though the majors gave Third World oil producers a certain amount of control of their oil at the wellhead throughout the course of the 1970s, the producers were forbidden from acquiring independent marketing capabilities in the advanced sector. This was most glaringly demonstrated when Secretary of State Henry Kissinger intervened in the mid-1970s to prevent the National Iranian Oil Company, then the ninth largest oil company in the world, from buying a chain of U.S. gasoline stations owned by Ashland Oil.

Similarly the wealthiest Third World oil exporters, the Arabian Gulf exporters, have voiced their complaints about the difficulty of purchasing tankers to build up their own exporting capability outside the framework of the majors.

As long as the state oil companies of developing countries are kept from a marketing capability internationally, they will be subject to the kind of bullying which Nigeria experienced when the majors boycotted it prior to its price cut. The slow price-drop scenario, perhaps extending over the next 6 to 12 months, will provide an environment in which producing states, desperate for exports, will make more and more concessions to the multis.

The effects on the North

There is already talk in Europe and in the United States that whatever economic relief may come from an oil-price drop, it will not be passed onto the consumer. France and Italy as well as the U.K. are already considering a tax hike on gasoline to offset the anticipated drop in prices.

And a drop in gasoline prices will invite cash-strapped state governments in the United States to impose similar taxes. Plans are already afoot in certain states for such taxes. From Washington's point of view, this would take pressure off the White House to impose further federal taxes on gasoline, a move risky to Reagan, who hopes to increase his popularity as a result of an economic upturn resulting from the price drop. The federal government is already imposing an increase in the federal gasoline tax of $.05 a gallon in April.

Low oil prices are also expected to spark a wave of bankruptcies among small independent oil producers and banks, primarily in the so-called sun belt. States like Oklahoma and Texas will be hardest hit. Small oil producers, which took out large loans to explore for oil when the oil price skyrocketed to near $40 a barrel in the aftermath of the Khomeini takeover in Iran, can't meet payments as the oil price falls. In the state of Oklahoma alone, according to the Governor's office, there are 25 Oklahoma banks on the verge of going under due to collapsing oil prices. In Oklahoma the price of gasoline is now under $.90 a gallon. Expensive drilling rigs which three years ago were in short demand are now being sold for 30 percent of their previous value.

Moreover, oil industry analysts are already talking about the coming "third oil shock" hitting sometime in 1985, probably sparked by a new Middle East crisis, making the favorable effects of the current price drop at best a very short-term phenomenon.