Moscow replies to Saudi oil price war

by William Engdahl

Moscow has given its response to the current collapse in the world oil price: a combination of carrot-and-stick moves directed at isolating Saudi Arabia and intimidating Saudi ally Kuwait. Khomeini's Iran and Qaddafi's Libya have played out the threat on Moscow's behalf, including a renewed Iranian war offensive up to the borders of Kuwait; the Soviet Union has taken the diplomatic role of courting Kuwait with offers of major technology deals.

The oil price collapse was triggered by a process begun last September, when Saudi Arabia began increasing its production and marketing its oil in medium-term "netback" contracts to Western oil companies.

Then on Feb. 9, the Iranian army launched a major new offensive in the six-year old Iran-Iraq war, aiming directly at positions threatening neighboring Kuwait for the first time (see article, page 38). Iran's military move came only hours after Iranian Speaker of Parliament Hashemi Rafsanjani threatened to "take action" against continued Saudi and Kuwaiti oil production increases.

Iran's offensive must be viewed against the background of the re-establishment of "full relations" between Iran and the Soviet Union 10 days earlier, when Soviet Deputy Foreign Minister G. M. Kornienko was in Teheran meeting with Rafsanjani and other top Iranian officials. The full agenda of those talks was not made public, but the overwhelming evidence is that Iran's advance nearly to the Kuwaiti border at Umm Qasr was taken with at least the encouragement of Moscow.

Moscow is simultaneously pursuing a persuasion strategy aimed at splitting Kuwait from its adherence to Saudi price strategy. Kuwaiti officials recently warned of oil prices falling below $10/barrel if non-OPEC producers, especially Great Britain, refuse to agree on production limits. Kuwait, which has upped its output to 1.3 million barrels/day, has been the main backer of Saudi price war strategy in OPEC.

In a surprise move, Kuwait Oil Minister Sheikh Ali Khalifa Al Sabah flew to Moscow for talks with Soviet Prime Minister Nikolai Ryzhkov early in February. Soviet observers expressed surprise at the priority accorded the Kuwaiti minister, including page one coverage in *Izvestia* on Feb. 9, hours before Iran's military offensive threatened Kuwait's borders. Kuwait and the Soviet Union have signed a protocol for sharing of oil technology.

While it is not clear that Kuwait has agreed to pull back from its support of Saudi Arabia in return, Soviet displeasure over the Saudi/Kuwaiti price war offensive is clear. *Izvestia* on Feb. 10 accused "Western governments and companies" of encouraging the price fall, warning that it could lead to a "bigger crisis than 1973 or 1979," the two major oil price increases. The official Russian government paper criticized "some OPEC members" who wanted to force the price down and aggravate the debt problems of such oil-producing countries as Mexico and Nigeria—a veiled attack on Saudi Arabia and Kuwait, at the time of the Kuwaiti-Soviet talks in Moscow.

Effect on the Soviet economy

The Saudi oil price offensive is clearly creating significant financial problems in the Soviet economic gameplan. "The Russians are in a terrible squeeze with the present oil price collapse," a petroleum expert based in Geneva told *EIR*. In addition to physical production problems and engineering difficulties in their own major producing fields, which have decreased production for the first time in recent history, the Russians have not been able to sell any of their oil on Western markets since at least December, when the current price collapse began.

The reason is believed to be the specific form of Saudi and other OPEC "netback" contracts with the major Western buyers of oil. Under these special new contracts, automatically renewed every six months, Saudi Arabia guarantees to sell its oil to the majors—Exxon, BP, Shell, SoCal—at a guaranteed profit margin to the refinery of $1.50/barrel at the specific refinery, for example Rotterdam. This guarantee is one major reason the major oil companies have been conspicuously silent over the price collapse. They had already significantly shifted their operations downstream, from producing oil to controlling its transport, refining, and distribution. But the "netback" terms directly break the Soviet pricing strategy of calculated underselling of OPEC in order to increase their share in Western markets without seriously damaging price stability. With prices falling through the $16 level and no bottom yet in sight, Moscow has not sold a single barrel of oil. One Rotterdam trader reported a recent Russian offer of crude for $22, against a counteroffer of $19.50. The Russians withdrew
evidently preferring to stockpile—at least for the moment.

Oil is a major prop of Russian hard currency export earnings. In 1985, at least 60% of total hard currency revenues were from sales of oil and gas in the West. Under the high prices of recent years, Soviet crude sales via Swiss, London, and other trading markets have dumped an added 2 million barrels/day, according to best available estimates. If prices stay at present levels, Soviet export earnings could drop $5 billion this year. Already in 1985, energy revenues were down an estimated 23% to $18 billion.

Will Moscow risk a U.S.-Soviet confrontation in the Gulf to reverse the oil collapse? Evidence to that effect is accumulating.