Energy Insider by William Engdahl

OPEC surprise accord buys time

Some endangered banks are the beneficiaries of the Geneva deal, but how long will it last?

The surprise agreement by the 13 members of the Organization of Petroleum Exporting Countries (OPEC), announced on Aug. 5 following a marathon ten-day Geneva meeting, has produced some of the most dramatic price fluctuations on international commodity trading markets since the 1979 Khomeini coup helped trigger price panic and $40 per barrel oil. What was actually agreed in Geneva and how will it impact the dramatic collapse in oil prices since the first of this year?

Twelve of the 13 OPEC members agreed essentially on a desperation stabilization measure to bring prices back up from levels well below $10 per barrel. Indeed, the week before the OPEC meeting, Saudi Arabia, according to the authoritative *Middle East Economic Survey (MEES)*, had contracted to sell crude at $7.40 per barrel.

Within hours of the reports of an imminent agreement to cut some 4 million barrels/day from the cartel's 20.5 million barrels/day July levels, the major speculative oil commodity markets—NYMEX in New York and the International Petroleum Exchange in London—went wild. One trader in Geneva rushed to the phone and told a caller, "This is a historic day."

Prices for North Sea Brent rocketed from a low of $9.60 Monday morning (September delivery) to $14.50. Market insiders at Petroleum Argus and elsewhere in Europe reported a scramble of speculators to cover exposures based on assuming little or no OPEC cuts. Until Monday, no one was predicting 4 million barrel cuts. By Wednesday, fed by negative rumors, prices dropped back slightly to $13.00.

"We will not be able to say how real this agreement is until end of August, early September," a spokesman for *Middle East Economic Survey* told *EIR*. "By then it will be clear from lifting levels who is doing what." Under terms of the Geneva agreement, the 13 OPEC producers agree, beginning September through the end of October, to hold output to 16 million barrels/day. The figure is somewhat misleading because it includes 1.2 million for Iraq.

But, under the complicated compromise, Iran agreed to drop demands for Iraqi cuts in return for getting agreement that would increase its oil revenues. Iran is reportedly cash desperate. Oil revenues for the first six months of 1985 have plunged to an estimated $3.5 billion according to *MEES*. Their yearly budget requires $4.2 billion. Only one year earlier they had twice the income from oil sales to finance their war in the Gulf as well as extensive international terror operations.

Iran has emerged with almost no production reductions—from present 2.4 million bpd to 2.3 million bpd—in return for its deadlock-breaking concession. This means that if prices rise to levels of $15 or more now, Iran's oil cash flow will dramatically improve. Iraq essentially refused to lower its present 1.9 million-barrel output. So Iran had nothing to lose and everything to gain by the tactic.

In a sense, this trade-off, bred in desperation of the recent months' plunge in price, fed the OPEC agreement. "The agreement will stick, at least for a while because people in OPEC are scared," one British-based OPEC consultant told *EIR*. Already observers are doubting whether every signer will hold to their deal. Venezuela, Nigeria, and United Arab Emirates are considered questionable. Even before the ink dried at Geneva, Kuwaiti Oil Minister Ali Khalifa al-Sabah threatened to abrogate the agreement and return to full production if any OPEC member "exceeded its quota by a single barrel."

Saudi Arabia is believed to echo the same threat. This is the major reason for the short term of the truce. "We all felt the price war strategy was taking oil prices toward $5 dollars per barrel, which is simply unbelievable," Iran Oil Minister Gholamreza Agazadeh stated at Geneva. "That became the greatest single element that mattered most in pulling us together on this agreement."

According to *MEES*, reported to be a reliable source for official Saudi thinking on oil issues, Saudi Arabia, which is still the single most powerful force on today's fragile petroleum market with existing production capacities of at least 10-12 million barrels/day, wants the price of oil to stabilize at $17-18 dollars for the next year or so.

That will depend on many things, not the least of which will be the real economic growth of the United States economy over coming months. Latest economic reports from Washington indicate a major shock to the fragile OPEC stabilization move could be hitting just in the fall months, as the two-month accord comes up for renewed negotiation.

For the moment, anyway, bankers in New York and Texas are breathing a bit easier.