Energy Insider by William Engdahl

Saudi shakeup rocks the oil markets

If anything, with the seasoned Yamani gone, the chances will increase for all-out price wars among OPEC members.

The surprise dumping of the man most associated with the Organization of Petroleum Exporting Countries, (ex)-Sheikh Yaki Yamani, on Oct. 30, can only be a desperate move by a Saudi Royal House intent on changing policy without having the means to accomplish it. Within hours, acting Petroleum Minister Hisham Nazer's call for a meeting of the OPEC Price Committee to work out an accord to bring world prices back up to the $18-20 per barrel level, sparked euphoric speculation on oil futures markets and drove prices of North Sea Brent from sagging levels of $13.50 to above $14.50.

A week later, no firm date for Nazer's emergency meeting had been set, and traders have decided to hold back from any speculative binge pending concrete action from OPEC.

Within hours of the last OPEC ministers' meeting in Geneva, which ended on Oct. 22 with a pledge to an even larger output of oil, prices began a steady fall. Clearly, the reality of depression in the world's largest industrial economy, the United States, combined with devastated economies in most of the developing world, including once-prosperous OPEC lands, has brought no "upswing" in demand for oil. Monetarist dogma breaks down in a real depression, and "demand" does not grow out of the "magic of the marketplace." This lesson has yet to be digested by the Saudi Royal House. With or without Yamani, who by all accounts was the convenient "fall guy," the strategy has been contradictory and inept.

A spokesman for the Cyprus-based *Middle East Economic Survey* said that the Saudi's declared strategy following Yamani's ouster "won't work, it is absolutely contradictory. They are calling for $18 oil and at the same time a greater share of the total market." Saudi production for the last months has run 4.3-6 million barrels per day. The sales have been secured on the cutthroat basis of so-called "netback" contracts. These guarantee to the major oil multinationals such as Exxon, Mobil, BP, and Shell, "irresistible" terms giving the buyer a fixed profit at the refinery point, regardless of market fluctuations. The Saudis resorted to this desperate means to increase their market share late last year. Saudi output had fallen to 1-2 million barrels per day by summer 1985 according to industry sources, when the Saudis decided to try to regain market share by scaring the rest of OPEC, as well as a lot of non-OPEC, into obeying production share agreements.

According to European industry sources close to Mideast oil politics, the Saudis were shocked at how far world prices dropped as a result of their strategy. In November 1985, North Sea Brent sold for almost $30 per barrel, with Mideast crudes a few dollars lower. By last summer, prices for certain Saudi cargos were reliably reported as low as $7 per barrel on netback, with further giveaway incentives up to $1.50 per barrel. Oil industry and banking studies indicate that a sustained price well below $15 will lead to massive bank insolvencies and industrial collapse in big parts of the U.S. oil industry. As well, the $100 billion Mexico debt bomb is tied to its oil export earnings.

It now seems that Yamani was dumped in a desperate bid to "talk" oil up by signaling a bold shift in strategy. Yamani, a Harvard trained Texas oil-patch roustabout, who had been Saudi oil minister since the birth of OPEC in 1962, even reportedly lost his honorary title of Sheikh in the ouster. More interesting is what OPEC and the Saudis can do now to deliver on the intent. One London brokerage source says the Saudis have privately determined to resort, if needed, to their earlier role as "swing producer" if the Dec. 11 OPEC ministers' meeting fails to gain agreement to further reduce output. Most Rotterdam and London industry sources predict such OPEC consensus is impossible under strains of crises in every OPEC economy.

One possible gimmick is that the Saudis plan to cancel existing netback contracts retroactive to Oct. 1. If so, given the six-week lead of such contracts, the markets could expect some sign of such a move by mid-November.

Diplomatic and Saudi-linked sources are circulating the rumor that the Saudi Royal House acted under pressure from Washington, as well as OPEC desperation. Certainly George Shultz and Donald Regan exert enormous influence on certain Saudi circles. Regan's associate at Merrill Lynch, David Mulford, now assistant treasury secretary for international affairs, was the liaison to the Saudi Arabian Monetary Agency for 10 years before coming to Treasury in 1983.

The growing world economic depression means no oil minister can increase both price and market share over a longer term. If anything, with the seasoned Yamani gone, pressures to market anarchy will increase the chances for all-out price wars among OPEC members.