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EIR Economics

World oil prices and the spring collapse

by David Goldman

The shape of the next four months—which may well determine the nature of the world economy for the remainder of this century—is discernible in two leading developments: the marginal drop in spot oil prices following the well-staged breakup of the OPEC ministers' meeting Jan. 24, and the warnings by Paul Volcker Jan. 18 and Donald Regan Jan. 26 that further money-supply expansion would lead to higher interest rates.

Although the present drop in oil prices will not, by itself, be of sufficient magnitude to break the external finances of Mexico and other big debtor nations who pay their bills with oil, British oil industry sources plan a "free fall" of the oil price by March or April, following the end of the winter peak demand for oil—with the disastrous consequences for the world banking system that some world leaders and international press headlines have already indicated. Combined with a rising American interest level (in the context of a still-contracting economy), the stage will be set for a deflationary blowout of the world banking system just in advance of the Williamsburg Summit May 28.

In the interim, the marginal $2 to $3 per barrel reduction in oil prices will, according to sources close to Secretary of State George Shultz, considerably weaken the bargaining position of leading participants in the Mar. 7 meeting of the heads of state of the non-aligned nations. Specifically, the State Department believes that even a marginal oil price reduction will force Mexico to renegotiate its current agreement with the International Monetary Fund on terms even more onerous than the present ones, force Venezuela into an IMF ageement as well, and neutralize Nigeria and Indonesia. After the flattening of the Non-Aligned summit—the last effective date by which a group of developing nations might mount effective opposition to the IMF in the form of a unified debt-negotiation front—Shultz's State Department will turn matters over to the worst international monetary crisis in the past century.

'Waiting for Henry'

Henry Kissinger's appearance at the White House days of briefings immediately before President Reagan's State of the Union address—supposedly on the subject of his world economic scheme published in *Newsweek*—indicates what is at work beneath the surface of events. As *EIR* reported, Kissinger chaired a secret meeting of the "International Counsellors" of Georgetown University's Center for Strategic and International Studies in early December, which heard proposals for a vast expansion of the International Monetary Fund's powers to the point of dictatorial control over world credit. Chief in the formulation of these plans were the Center's chief of financial studies, Genevan aristocrat Thibaut de St. Phalle, and IMF Executive Director Jacques J. Polak, the IMF's house lobbyist for the conversion of the IMF into a world central bank.

In dilute form, Kissinger's Jan. 24 *Newsweek* spread

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reported on the results of these and related secret discussions: Kissinger summarized the nature of the world crisis, concluding, "A blowup is certain sooner or later if debtor countries are asked to accept prolonged austerity simply to protect the balance sheets of foreign banks . . . if pushed too far it risks provoking radicalism that will rally public opinion (and perhaps other debtors) by defying foreign creditors." His proposals together form a plan to put control of the world economy on a supranational footing:

1) "deprive the debtors of the weapon of default" by creating a "global safety net," i.e., vastly expanded IMF resources;

2) "an overhaul of the international monetary system" including "a realistic range for permissible exchange-rate fluctuations," which implies "the coordination of fiscal and monetary policies," and "unprecedented coordination of [leading nations'] national economic policies." At the secret CSIS meeting which spawned the document, this meant IMF authority to dictate budgetary policy to the leading industrial nations, above all, to the United States.

Very quietly, a task force under George Shultz is preparing "options" on the proposed expanded powers of the IMF, while Shultz's close friend, Undersecretary of State for Economic Affairs Allen Wallis, has quietly taken charge of preparations for the Williamsburg summit. Even the internal bureaucratic side of this is nebulous; a senior Wallis aide responsible for summit preparations says, "Shultz is the biggest internationalist in the administration, and we are very open to proposals. But Washington is a bazaar, with everyone hawking his own plan. There are ten different proposals running around." Although the Cabinet economic crisis-management committee, the Senior International Group/International Economic Policy, is assimilating various proposals through Treasury Assistant Secretary Mark Leland, no official reports or discussion minutes are yet in the pipeline on such matters as Kissinger has raised.

Bank of England officials worry that the biggest obstacle to Shultzian "internationalism" inside the Administration is the President himself. In a recent background discussion, a ranking source from the "Old Lady of Threadneedle Street" argued, "Since the Mexico crisis, matters in the United States have been going substantially the way we would like. President Reagan did indeed give the International Monetary Fund a nod of approval during his State of the Union address. But we still have some trepidation about the Administration. The crisis is not yet deep enough such that Shultz, Regan, and Volcker could go to the President and insist that he take action, and spend his scant remaining political capital on behalf of a monetary reorganization. Reagan's political advisors are still able to tell him that ad hoc procedures are enough. However, when it becomes evident that Brazil cannot fulfill the IMF conditions, we will enter Phase Two."

The administration's present efforts are, instead, concentrated on selling the Congress on the proposed $10 billion American contribution to a total $50 billion increase in the resources of the International Monetary Fund. This is the "bailout for the banks" that, as Kissinger himself suggests, cannot work. The banks are warning Congress that a monetary crash will certainly take place if they do not support the bailout; British and Swiss financial sources are just as emphatic that the banking system will crash nonetheless, with the added proviso that an American commitment to defend the indefensible will ruin the Treasury's finances as well.

The oil crash

However, the drop in oil prices rigged by London has brought the Anglo-Swiss scenario a notch closer to reality. French Foreign Minister Claude Cheysson warned in a statement yesterday that the drop in oil prices would lead to "withdrawals of deposits from the international banks by OPEC nations, and could lead to a chain reaction." A senior Federal Reserve economist commented, "Oil prices are at the top of the list of things that could go wrong with the banking system."

Mexico, whose debt crisis nearly brought the banks down in September, loses $500 million per year in revenue for every $1 drop in the oil price, and Mexico's oil price has already fallen about $2 per barrel. A fall in the oil price from the present $34 in the Persian Gulf to the $20 to $25 range predicted by top British banks, would blow up Mexico's delicate negotiations with the bankers for a debt rollover, bringing down Venezuela, Indonesia, and Nigeria as well. Together, these four countries alone owe over $200 billion to the international banks.

In addition, a further drop in price and quantity of OPEC oil production would force even the super-rich Saudis to withdraw funds from the banks, squeezing the base of funds in the world banking system at the same time that major borrowers began to default.

Inside the OPEC meeting

The most likely scenario is a $2 a barrel drop by Saudi Arabia. Then the pressure would ruin the shaky African producers. Ironically, the African producers were credited with blowing the meeting of OPEC apart yesterday. According to inside sources, when OPEC ministers came to the subject of oil pricing differentials between the Saudi benchmark crude and the North Africans, all hell broke loose. According to the traditional arrangement, the North Africans *should* charge about $2.00 more than the Saudis because their crude is very high quality (i.e. much less expensive to refine) and it is closer to markets (reducing shipping costs), therefore equalizing the price. But the North African producers have been desperate for markets and, of course, they have been underselling Saudi Arabia so that the differential is about $4.00 a barrel.

At this critical point, the British National Oil Corporation (BNOC) put out the word that London will lower its price by

as much as $2.00 to $3.00 a barrel. This sent the North African countries into a spin, since their oil is sold in competition with North Sea crude; another British price drop would completely undersell them. Pinned down by the British, the African producers refused to accept export quotas, the setting of which was to have been the subject of the emergency ministries' meeting in the first place.

Saudi Arabia, oil industry insiders say, will now have to lower its price about $2 per barrel in order to match the British price change. But the African producers will immediately lose a disastrously large portion of their market share. Nigeria's economic development program is premised on oil exports of 2 million barrels per day; even with price-shaving, Nigeria has been able to sell no more than 900,000 barrels per day in the last two months. The inevitable fall in Nigerian output will produce chaos in that country and most of West Africa.

In the case of Mexico, State Department sources close to Secretary Shultz report, a drop in the oil price will push Mexico into a renegotiation of their recent deal with the International Monetary Fund—a deal which has already thrown that country into an economic disaster. With Mexico weakened even further, State Department officials hope, the IMF will be in the position to gain even greater control over the internal Mexican economy, especially over the Federal budget.

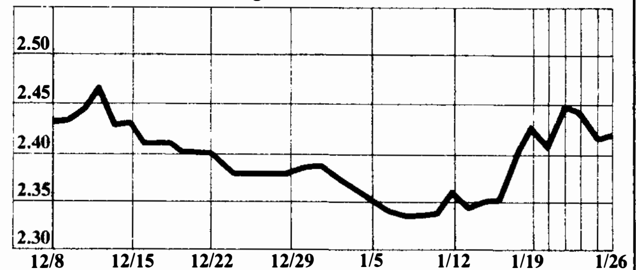
Saudia Arabia's Sheikh Zaki Yamani thinks that he has thrown the smaller OPEC producers to the wolves in order to hold the cartel together, with a marginal drop in the oil price. However, London and New York oil analysts insist, this "deal"—brutal as it is—cannot hold past the beginning of March, when production will take another major turn for the worse. OPEC combined output is barely 16 million barrels a day, only half of the group's combined oil production in 1979, before the world depression began. The effect of the spring slump in oil demand will be to throw the oil price into a free fall, and the banking system into an uncontrollable crash.

According to a senior London investment banker, Saudi production is now only 3.5 million barrels per day, a level so low that the Saudis would have to withdraw deposits from the banking system or liquidate Treasury securities in order to meet their import needs, i.e. spend their capital. However, the London banker commented, "There is no technical reason why the price of oil should bottom out after the $2 to $3 drop we expect during the next few days. It is possible that the price will be $15 per barrel. That makes international repudiation of debt very, very likely."

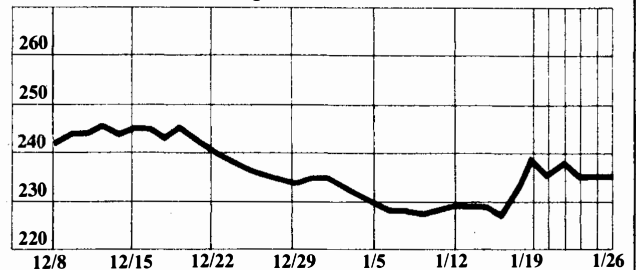
At this point, whatever the heads of state imagine they will be able to do at Williamsburg will be pre-empted by a crisis that shakes the foundations of their governments. If it reaches that point, they are expected to sign whatever paper is presented to them by IMF Managing Director Jacques de Larosière.

Currency Rates

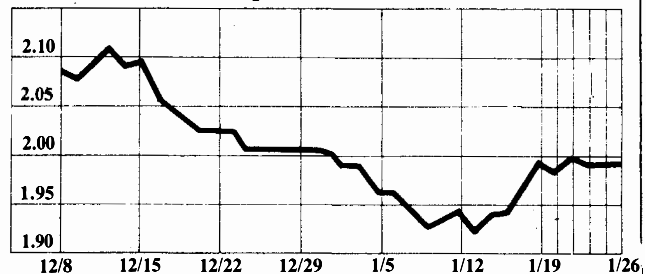
The dollar in deutschemarks
New York late afternoon fixing



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