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Turmoil follows Yamani ouster

by Chris White

It is some measure of the underlying weakness of the world economy and financial system that the firing of an oil minister, even an oil minister like Saudi Arabia's Sheik Yamani, could unleash a wave of panic and turmoil around the world, bringing market activity to a halt in Tokyo and London, amid fears that the price of oil was on the edge of a bottomless drop.

Nerves are indeed jittery these days.

Yamani, Saudi oil minister for the last 24 years, and perhaps the single individual most closely associated with the identity of the oil producers' cartel, OPEC, was abruptly fired, by royal decree of Saudi monarch King Fahd. The signal nature of the act, for some marking the end of an era for both OPEC and Saudi Arabia, sent shock waves of panic through world markets.

The panic subsided as Yamani's appointed successor, Saudi Planning Minister Hisham Nazer, announced that the Kingdom was convening a meeting of OPEC's pricing committee, in an effort to bring the world price for oil back up to the range of $18-20 a barrel. That created as much enthusiasm in some quarters as the firing of Yamani had created panic in others. In New York the price of the U.S. benchmark crude shot back up $1.50 to go above the $15 a barrel range for the first time in weeks.

What does it all mean? Three different kinds of options are being discussed, but all share a common fallacy of assumption, that questions of oil pricing and production can somehow be separated out from the fundamental reality that the world economy as a whole is plunging into depression, and, that commodity prices, such as the oil price, no matter how they bounce around in the short-term, are in an aggravated secular decline, otherwise known as a deflationary collapse. That is so because the industrial markets for primary products such as oil are in collapse.

The three options include: the continuation of the price-cutting production war, or production cutting as the basis to increase prices, and that latter combined with political agreements with Iran, presumably to target competitors' oil production for shut down. The latter is pushed by the friends of Henry Kissinger, namely James Schlesinger and William Quandt, who have dreamt of cataclysm in the Gulf for at least the last 15 years.

Thus, speculation about what the Saudi Arabian monarchy intends to do now is generally made worthless by the assumption that the Saudi royal family is as stupid as those shapers of both markets, and opinion, who do such speculating. For example, it is assumed that the prime Saudi concern, over the past months, has been the price of oil. Whether in busting the price, from the beginning of the year, or in stabilizing the price from August, it is assumed that there is some equation between pricing and volume of output, which will provide the Saudis, and maybe other producers, with levels of income desired.

In this view, income can either be maintained by cutting back production to below levels of demand, to force a higher price, or, by flooding the market with production and maintaining income from increased sales of cheaper product. Production can always be increased, if the price is low enough, or reduced, if the price is high enough.

The Saudi government for its part insists that its policy, meanwhile, has not changed. But what was the Saudi policy?

Saudis: changing policies and institutions

We argued from the beginning of the year, when the Saudi price war strategy went into effect, that the price cutting had nothing to do with oil as such. We argued that the Saudis had launched a war against those London and Swiss-centred financial interests which rig the terms under which oil is produced and marketed worldwide. We said that the Saudis were seeking to change the policies and institutions

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which had forced the world economy into a new depression.

This is what is overlooked by those who insist that all the Saudis are concerned about, like other producers of raw materials, is the price received per unit volume of their product relative to anticipated or required levels of income. Since they cannot conceive that there is anything wrong with the political monetary arrangements which determine pricing and production policy, they cannot conceive that something other could be going on.

For example, it is widely assumed that the present U.S. administration actually believes its own propaganda about the depth, strength, vigor, and so forth of the longest expansionary cycle in the economy since World War II, which is otherwise called the recovery. But the same U.S. administration has been working overtime for months to try to patch together crisis situations, financially and economically, in efforts to prevent blow out disasters before the November elections, and, if possible, postpone such erupting dangers into next spring. Prominently on this agenda, in late July and early August, was the question of the oil price collapse.

In some cases this has simply involved issuing fraudulent economic indicators to the press, which no one in the press corps calls disinformation, but actually is. In others, like the hokum around Gramm-Rudman deficit reduction targets, it involves forgetting about $70-80 billion dollars worth of the more than $220 billion deficit. It involves organizing a lockout of steelworkers to reduce output to prevent chain reaction bankruptcy in the industry after the July failure of LTV. It involves arrangements with Germany and Japan, and investors in the United States, to keep the flow of funds coming.

U.S. policy towards the oil producing Saudi kingdom has been approached from this standpoint since George Bush's trip there in July. At that time, Saudi Arabia agreed to modify the strategy it had adopted earlier in the year, at least until the U.S. elections. The arrangements were then concluded which pushed the price of oil back up to the $13-15 per barrel range, from the $7-9 dollar range which had been hit in the summer.

Since then, it is freely admitted, in London and New York, the price of oil has been kept up, and the international financial institutions supported, by oil consumers' swallowing into storage 2 million barrels a day more than the world is consuming. Much of that has come from Saudi Arabia and other Gulf nations, through the so-called 'net-back' arrangements pioneered by Yamani. The oil thus produced surplus to market requirements has been poured into holes in the ground, known as strategic reserves, kept afloat stored in tankers on the high seas, and so on.

Energy Secretary John Herrington has been one of the proponents of this effort. On Oct. 24, he called on the Western nations to build up oil stockpiles to prevent a return to dependency on OPEC. He also said that the United States was studying ways of bypassing the Strait of Hormuz, given the Iran-Iraq war. He called OPEC's role "unhealthy and unacceptable." The United States now has reserves of 560 million barrels, and will increase this to 750 million, he said. His anti-OPEC rhetoric is belied by what he is actually doing.

Price rise only temporary

Through these kinds of practices, a temporary fix was thus achieved, at the cost of accumulating the potential for a much bigger price break in the oil markets, and thus much greater turmoil in financial markets, at the point that the temporary fix was ended, or comes unstuck. It must be presumed that the Saudis know this as well as anybody else. And that they thus also know that the price of oil will not automatically go back up to $18-20 per barrel even if they do say that that is where it should be. It must also be presumed that they are therefore now preparing for what will happen now that the U.S. election season is coming to an end, as the deals and arrangments which kept everything together are either renegotiated, or fall apart.

Producers inside the United States, as the case of Texas shows, were not included in this international agreement. There the effect of the earlier collapse in oil prices has been compounded by the corollary collapse of production itself. According to Texas state Comptroller Bob Bullock, "The drop in production was worth $772.1 million at current market prices. So much attention on declining oil prices may have masked the fact that production in Texas has slipped by more than 140,000 barrels a day." Tax records of Texas producers show the output decline from 1985 to 1986 to be more than 12%. The number of active rotary rigs functioning in the state has fallen by 60%, the number of drilling permits issued has fallen by more than 60%.

Jack Copeland, of the investment bankers Copeland, Wickersham, Wiley, reported what kind of crisis had thus been papered over through the course of the summer. He proposed that the government establish a $10 billion fund to buy bad energy loans from troubled banks, and prevent a banking collapse. "It's a scary problem," Copeland told the Independent Petroleum Association of America. "If oil stays at $14 a barrel, I'm convinced the U.S. banking system cannot survive and we may be looking at a 1929 scenario. At $15 per barrel, we calculate that only $3 billion (of Texas banks $9 billion in energy loans) are payable. There has been some interest among cabinet members. Our biggest problem is Don Regan, who made his money on Wall Street and does not understand the problems of the oil industry." Copeland estimates that the oil price drop had cost non-OPEC nations $150 billion in oil production cash flow which would have been available for investment in new drilling. The U.S. share would have been 20% of the total.

Copeland's concerns may well turn out to be what the Saudis are talking about when they say their policies have not been changed. In the next weeks and months, the question of the continued viability of the bankrupt international banking and monetary system is going to come right back to the fore. Perhaps the shift in Saudi Arabia is part of the preparation for that.