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Credit and synthetic fuels

At senior levels of the Brookings Institution, Hudson Institute, and the Wharton School, it is generally admitted that the so-called synthetic fuels approach to "energy independence" is totally impossible without a total, top-down reorganization of the U.S. credit system.

Legislative proposals for synthetic fuels propose funding of between $40 and $200 billion, with the understanding that the upper range of such figures barely begins to reach the level at which synthetic oil and gas production could, presumably, make a dent in the American supply situation. Most of the proposals would create a Reconstruction Finance Corporation type of authority to issue Federally-backed bonds in that amount. In other words, it is proposed to double the current level of federal off-budget financing, at a point where the credit powers of the Federal government both at home and abroad are at an extreme ebb.

Plainly, this will not work under current criteria. The Hudson Institute's current draft, under the Institute's consulting contract to the Department of Energy, proposes to make the new Federally-backed bonds "indexed" according to the cost of living or some other measure. That borrowing from the financing methods of the Brazilian government implies—for obvious reasons—the indexation of the entire American economy. Since the price of synthetic fuels obtained under methods now proposed, e.g. hydrogenation, is above the $25 per barrel equivalent oil price, the inflationary effects of such a policy would push the economy and credit system in that direction in any case.

Speaking in general terms, the cost of the synthetic fuels program would be so large as to displace the entire current profile of federal off-budget financing, almost all of which funds construction and real estate activity, through such agencies as the Federal Home Loan Board, the GNMA, the FNMA, and so forth. Construction is the single largest sector of the U.S. economy and the most supported, in both the primary and secondary markets for new structures, by federal discount facilities for the insurance companies and savings banks who provide the bulk of construction finance.

On the part of the insurance companies, according to interviews with company officials, there is little objection to the switchover to a form of RFC paper, especially if the change includes the availability of indexed as opposed to fixed-income paper, again for obvious reasons. However, the transformations that would have to occur in the American economy to correspond to this "financial" change are staggering.

First, the entire present structure of consumer credit, which has been sustained at middle-income levels through mortgage financing, would cease to exist. Secondly, the construction industry, whose gross revenues are barely double the level of construction-related off-budget financing, would have to transfer its activities to the construction of coal mines, slurry pipelines, synthetic fuels plants, and so forth.

The entire exercise would remove a large portion of the productive part of the economy, and replace it with an "energy" industry which produces less than the same volume of fuels consumed by the economy from existing sources at much greater cost. The Hudson Institute is not incorrect to assume that inflationary implications would be so staggering as to make indexation not only desirable but indispensable.

When Nazi finance minister Hjalmar Schacht developed an identical policy to produce synthetic fuels and armaments, centering on the off-budget financing powers of the *Metallforschungsinstitut* (*Mefo-Institut*), he had two "advantages" which his present imitators do not have. First, the German economy had gone through two thoroughgoing bankruptcies in the previous ten years, namely the inflation of 1923, and the Reichsmark and banking collapse of 1931. Those sectors of the economy that, in the present-day parallel, compete for available credit and resources, had already been bankrupted, under conditions in which unemployment exceeded 30 percent.

Second, and equally important, Schacht was in a position, due to help from the Bank of England, to make the Reichsmark inconvertible and run Germany as an autarky, subsidized by looting rights against the economies of Eastern Europe. Schacht did not have to deal with the implications of a reserve currency, investments in which would fast become worthless due to vast amounts of unproductive spending in that currency.

Currently, one of the determining questions concerning the health of the American government's credit is the foreign standing of the dollar as a reserve instrument, since holdings of dollar reserves are mostly invested in American Treasury paper. The present collapse of the dollar makes the remainder of the year's federal financing requirements considerably more uncertain. The uncertainty has a great deal to do with the fact that some $800 billion in deposits are located offshore, and are the most volatile, short-maturity section of the entire dollar credit sector.

In formulating plans for synthetic fuels. the State Department has taken this into account by proposing an international authority whereby foreign governments would invest a portion of their reserves directly into American coal-related synthetic fuels projects. This proposal fell flat at the Tokyo Summit. Related efforts by Washington to get such discussion into the Executive Board of

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the International Monetary Fund in preparation for next September's Fund-World Bank Annual Meeting have also fallen flat, due to opposition principally from the French and Germans. In other words, the foreign exchange side of the problem, which Schacht covered so effectively in the 1930s, in hopelessly uncovered now.

Unless the advocates of synthetic fuels under hydrogenation technology propose to address these questions in a format that promises to reinstate the full array of Schachtian preconditions for their policy—rather than burying the implications in obscure reports—all their statements on the subjects must be viewed as mostly bluff.

—*David Goldman*

BRITAIN

British oil customers get the shaft in the aftermath of Tokyo

Upon her return from the Tokyo summit, British Prime Minister Margaret Thatcher blithely declared that the decision to set national oil import quotas for EEC countries would have "no effect" on the U.K., which is in any case aiming for zero net oil imports between 1980-85. North Sea oil production is expected to make Britain energy self-sufficient by 1981.

However, unless new fields are found, supplies will reportedly start to dwindle in little more than five years, leaving Britain again dependent upon foreign supplies. And, as recent government action indicates, even Britain's current domestic energy needs cannot be met unless supplies are diverted from foreign customers of the state-owned British National Oil Company (BNOC), which controls North Sea oil production and distribution.

BNOC is one of the biggest crude oil trading companies in the United Kingdom sector of the North Sea, thanks to the 51 percent stake in virtually every company operating offshore which it gained from the state participation deals brought in by the Labour Government. Despite rising production, Britain remains about 6 percent short of oil overall—worse off than some non-oil-producing countries within the EEC. The U.K., with no "downstream" or refining operations of its own, keeps only 45 percent of its production for the home market, exports the remainder and makes up the difference from the Middle East.

To ensure supplies for Britain, the government has told BNOC to revise the terms of its supply contracts with the 20 or so small American and European companies who buy 75 percent of BNOC's oil. These mostly American companies, who export North Sea crude without refining it in Britain, will be ordered to export up to 50 percent less to make their own customers and divert supplies to the British market instead.

According to the *Economist*, BNOC appears to be making progress with its demands—even though none of it is in writing. Smaller American oil firms are playing ball for fear of having their export licenses revoked, though they may have to buy at $35 a barrel on the spot market (instead of $21 from BNOC) to supply their customers back home, and will be forced to pass along the higher cost.

The British government will also exercise its option to have its North Sea royalties (12.5 percent) in oil rather than cash, putting a further squeeze on oil supplies which would ordinarily be shipped abroad.

The second part of the Government's strategy is to extend the oil-producing life of the North Sea in order to make Britain self-sufficient well into the 1990s, if not beyond. This will mean a crash effort to discover more oil in the North Sea and the Tories are even prepared to drop the requirement, established by the Labour Government, that all oil companies must give the state corporation a 51 percent partnership before being allowed to look for new fields.

In line with the Tories' new "free enterprise" theme, the British National Oil Company is expected to undergo a major face lift. The most likely possibility is that BNOC's equity assets will be sold off to private companies such as British Petroleum, Rio Tinto Zinc and ICI (Imperial Chemical Industries). North Sea oil assets would then be under the direct control of the British oligarchy. Thatcher's husband Dennis, former Burmah Oil executive, could end up with the chairmanship of the truncated BNOC, according to rumors in the British press.

—*Marla Minnicino*