Energy Insider by William Engdahl

Who shot J.R.'s oil boom?

The bottom has fallen out of drilling in the United States, thanks to Federal Reserve Chairman Paul Volcker.

The shock waves set off by the failure of the Oklahoma City oil bank, Penn Square, will prove as profound in its effect on the collapsing domestic oil industry as on the world of international finance. As we said as early as June 1981, the boom in domestic oil and gas drilling could not remain immune from the overall economic collapse ravaging the economy.

As recently as last December, the number of active oil drilling rigs domestically broke all records, topping 4,530. Industry associations and trade journals extrapolated from the previous 30 months of uninterrupted increase in activity to project the same into the future.

Then the crash hit. The price of OPEC crude took a decided drop due to North Sea-London manipulations and sagging demand. This produced a drop in average domestic oil from about $35 per barrel in March 1981 to just over $29 today, compared with the OPEC marker price of $35. In addition to removing about $15 billion from the annual cash flow of the domestic oil industry, the price drop sent a wave of panic through the industry, a panic which has deepened with the Penn Square affair. Then, with industry shutting down across the country, natural-gas demand began collapsing. In recent weeks, contracts for deep gas in the Anadarko Basin of Oklahoma—which is precisely where Penn Square operated—have fallen from a high of $10/mcf down to $5-$6/mcf. Deep gas, currently unregulated, absorbed 40 percent of total industry costs last year.

Under Jimmy Carter, the Trilateral Commission effort to phase out the industrial economy of the United States centered around use of energy and interest rates. At the Department of Energy, RAND's James Schlesinger and Trilateralist John Sawhill were content to allow an episodic short-term flow of funds into oil investment while they secured the more important gain of higher domestic prices. President Reagan accelerated this process in February 1981 when he lifted the remaining price controls. As the economy sunk under the stranglehold of Paul Volcker's interest rates, oil (and real estate) became "the only game in town," as one speculator termed it.

Well, boys, it's over. The July 6 Hughes Tool count found 2,816 oil or gas drilling rigs active in the United States. This represents almost a 40 percent drop since December, the sharpest collapse ever.

I just completed a survey of industry and investment sources, and the most striking thing I found is that nobody knows how serious things are. The Independent Petroleum Association of America, chief lobbyist for some 12,000 independent oil companies, cautiously predicts revival of drilling by the year end. One driller from Mississippi, W. E. Craft, calls the shakeout a good thing because it will weed out the fly-by-night hustlers. He says that during the euphoria of 1980-81, "at least 40 percent of wells drilled were useless and without merit." He correctly claims many companies were formed "simply to promote money from the public." But there is a deeper reality which nobody, especially the "J. R. Ewing types," wants to face. There will be no recovery in oil before there is a fundamental growth of the real economy.

Not only drilling companies, but the $70 billion oilfield supply, service and equipment industry, and in crisis. Hughes Tool spokesman Frank Potter has characterized the overall situation as "catastrophic." Last month, one of the three largest builders in the world, Dreco Energy of Houston, filed for Chapter 11 bankruptcy. Five of 17 rig manufacturers are trying to sell out their companies. An estimated 25,000 rig hands are now unemployed, and thousands more are about to be laid off by service companies as order books shrivel. Expanding capacity to produce oil pipe and related goods represented the only area of steel growth over the past two years; companies such as Armco gambled hundreds of millions on adding new capacity. One Chicago-area steel tubing plant saw its production drop 90 percent since December, and no new business is coming in.

More solid companies feel insulated at the moment, but they are not immune from the growing Volcker-induced depression. The only upturn will come when the independents realize they are in fact "dependent" on the same economic reality as housing, steel, agriculture, and other industries.

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