# The financial stakes in the drive to push down oil prices

by Renée Sigerson and Kathy Burdman

Any forecast suggesting that the current downturn of world oil prices will serve to encourage a world economic recovery is patently incompetent, if not a deliberate fraud. Prior to 1982, a downturn of world oil prices, in conjunction with other, indispensable political policies might have helped prevent world depression. The final cutoff point for such a simple connection was the global debt crisis of 1982.

When the British National Oil Corporation (and the British crown behind it) announced during OPEC's mid-January meeting that the oil price must fall below $34 a barrel, they did so for the purpose of putting an end to the current world monetary system, and triggering the creation in its place of Britain's planned "new Bretton Woods." The plan is, by breaking OPEC, Mexico, and other oil producers, to totally break the political power of the Third World going into the March Non-Aligned Nations Conference, and to "shock" the West into re-chartering the International Monetary Fund as a new world central bank.

Regarding the Third World nations, the purpose of the oil-price collapse is to show their powerlessness and dependence on the creditors' cartel of British and U.S. banks which runs the world banking system, a Morgan Guaranty source said this week. "The first oil shock showed Mexico that they must depend on the banks," he said. "The second shock will force them to even greater dependence on the International Monetary Fund." Mexico, which stands to lose some $600 million for each dollar drop in the oil price, will be forced to renegotiate its IMF loan to give the IMF greater power, State Department sources said.

The Third World is to go into the Non-Aligned meeting a mass of squabbling bankrupts, with oil consumers, such as Brazil, and oil producers at each others' throats, unable to cooperate to form a "debtors' cartel" which could confront this creditors' cartel. Indeed, the very collapse of OPEC is meant to show that no Third World cartel can succeed against the powerful banks and the IMF.

Regarding the United States and other industrial nations, not only is the oil price drop of little benefit, since energy demand is already so low, but the shock is meant to force them to also agree to a re-chartering of the IMF as a "world central bank" which would have dictatorial powers over the North as well. "The effect of the second oil shock," said the Morgan official, "is to prove to all of the Third World, and to the United States alike, that the world has been and will be subjected to too many shocks to go on any longer without stronger international institutions."

The oil price drops and other financial and economic shocks will continue, he said, until the U.S. Congress and Third World alike are ready to re-write the IMF charter to give it dictatorial power over the world economy. "There must be a total re-think of the role of the IMF, including expansion of its charter."

## Draining the credit pool

The high price of oil since 1973 has been a perverse tax on the world economy. Detracting from immediate investment and consumption, high oil prices have created a pool of "forced savings" which have been "recycled" back into massive lending to the Third World.

Not only much of the $700 billion in Third World and East European debts, but also some $100-200 billion in U.S., European, and other governments debts and stock markets alike are supported by the OPEC pool. The total amassed OPEC surplus since 1973 exceeds $400 billion.

The oil-producing countries never unilaterally "controlled" their oil revenues. More than 50 percent of what they earned on sale of their oil was "recycled" back into the international banking system, forming the largest single pool of liquid deposits on the $1.8 trillion Euromarkets.

Well over $1 trillion in world debt is directly supported by this mainstay. This includes not merely the $700 billion in debt owed by developing countries to international banks, but, additionally, hundreds of billions of dollars in debt issued by Western governments, foremost among them, the United States.

This system of "recycling," whereby oil producer deposits were reissued as credits by international banks, has been for the last decade the primary source of financing for international trade. How this worked in its entirety is usefully illustrated by a brief comparison of the present world oil market with 1978, the only other year before now when the oil-producer surplus was near zero. The comparison pinpoints more precisely why the current oil price downturn serves as a trigger for a breakup of the world monetary system.

In 1978, the OPEC surplus was only $5 billion, in contrast to its $45 billion average for the previous three years, and its 1980 high-point of $115 billion. The 1978 absorption of the surplus had two causes. Noticeable conservation measures in oil-consuming countries had lowered demand for oil. At the same time the oil-producers were heavily increasing imports of capital goods for domestic economic development programs. These capital goods imports benefited export industries in the United States and throughout Western Europe. Simultaneously, the payments surplus in the advanced sector was partly used to finance debt as well as capital goods exports from the advanced sector into the developing countries.

Thus, in 1978, the tailspin of the world economy into depression was still not yet an "irreversible" process.

Leading British financial sources have argued publicly (privately, they admit the argument to be ridiculous), that something similar to 1978 will happen again. The lowering of oil prices, the *Financial Times* printed this month, will produce a 1.5 percent rise in Gross National Product in major consuming nations, having a "stimulatory" effect on world economic activity.

Whether the effects of an oil-price decline are evaluated globally or on a country-by-country basis, there is not a single part of the world economy where the current oil price decline will have a "stimulatory" effect.

In 1982, OPEC as a whole suffered a price and markets collapse which lead to a roughly zero-balance in its current account for the first time in a decade (see **Figures 1** and **2**). Now, the British banks, Morgan, and the IMF say that the oil price will have to collapse far enough to totally destabilize these markets.

The British plan is supposed to proceed in phased "shocks," as a Bank of England official also told *EIR* this month. The first shock, the lowering of the effective take-in price of OPEC by 12 percent from $34 to $30 a barrel, has already taken place on the spot markets and is expected to be forced upon producers themselves by the first quarter of this year. Assuming an OPEC production for export rate of about 14.5 million barrels a day holds, this alone would create an OPEC deficit this year of $40 billion.

The Arab states could either cut their huge development budgets and foreign aid by this amount (at the risk of political upheaval!) or liquidate some investments. But if they do not pull enough credit out of the world banking system and government debt markets to "shock" the United States into agreeing to a new Bretton Woods system, the British will proceed.

Under Phase I and Phase II of the scheme, the oil price will fall further until Saudi Arabia and the richest Arab governments themselves are forced into major liquidations of their U.S. Treasury, European, and other Western government debt holdings, causing market panics throughout the world. At a $25 per barrel oil price, the OPEC deficit would reach $73 billion in 1983, and the Saudi deficit alone would be $22 billion.

In the midst of such scenarios, it must be emphasized that there is no reason to believe a controlled price ratchet would actually occur. There is a high likelihood of an uncontrolled price collapse fueled by cutthroat marketing efforts.

The financial planners who are reckoning on the basis of a controlled price decline have acknowledged that possibility. James Lee, Chairman of Gulf Oil, said on Feb. 1 that the "real fear" is that OPEC will not impose production limits to reduce excess supply which might lead to a "downward price spiral" of more than $4 a barrel. In Japan, Secretary of State George Shultz cautioned that oil traders and multinational oil companies might begin dumping oil stocks onto the spot market at a rate that could unleash an uncontrolled downturn in prices.

## The liquidation potential

It is at the point that the price reached $25 per barrel that the OPEC nations would be unable to finance the resultant deficits simply by reducing imports, and cutting back devel-

**Figure 1**

### OPEC total

| | 1981 | 1982 (est.) | 1983 Current | Phase I | Phase II |
|---|---|---|---|---|---|
| Oil production (mbd) | 22.5 | 18.5 | 16.5 | 16 | 16 |
| Oil exports (mbd) | 20.5 | 16.5 | 14.5 | 14 | 14 |
| Oil price (average dollars per barrel) | $ 34 | $ 33.5 | $ 30 | $ 28 | $ 25 |
| Oil revenues (billions of dollars) | $255 | $200 | $160 | $143 | $127 |
| Other exports* | $ 30 | $ 30 | $ 30 | $ 30 | $ 30 |
| Interest income* | $ 17 | $ 15 | $ 15 | $ 15 | $ 15 |
| Imports | $234 | $245 | $245 | $245 | $245 |
| Current account* (billions of dollars) | +$68 | 0 | −$40 | −$57 | −$73 |

*Assumes imports, investment income, and non-oil exports all hold steady. The deficit can be made up by cutting imports or by liquidating investments abroad.

**Figure 2**
## Saudi Arabia

| | 1981 | 1982 (est.) | 1983 Current | Phase I | Phase II |
|---|---|---|---|---|---|
| Oil exports (mbd)........ | 9.5 | 5.5 | 4.5 | 4.5 | 4.5 |
| Oil price (average dollars per barrel) ........... | $ 34 | $ 33.5 | $ 30 | $ 28 | $ 25 |
| Oil revenues (billions of dollars).... | $118 | $ 68 | $ 49 | $ 46 | $ 41 |
| Other revenues and imports .............. | | Held steady at 1982 levels | | | |
| Current account* (billions of dollars).... | +$43 | +$5 | −$14 | −$17 | −$22 |

*Assumes imports, investment income, and non-oil exports all hold steady. The deficit can be made up by cutting imports or by liquidating investments abroad.

If the oil price collapses to $25 a barrel, both Saudi Arabia and OPEC as a whole will go into major deficits, assuming they refuse to cut their imports, development programs, and military aid. Most observers estimate that Saudi Arabia cannot keep its production levels below 4.5 mbd for any extensive period, or it will lose the associated gas which it needs for its domestic economy. On similar lines, OPEC production as a whole is highly unlikely to fall below 15 mbd.
In this case, once the oil price falls below $25 a barrel, Saudi Arabian oil revenues will drop by $22 billion, causing a current account deficit of some $24 billion. OPEC as a whole similarly will lose $66 billion in oil revenues, or a $66 billion deficit—assuming they do not cut their imports or aid to other Third World countries from 1982 levels. That is, the losses in oil revenues will have to be made up either by import and development cuts, or liquidation of overseas investments.

opment programs. At $25, the OPEC nations would have to begin to liquidate some portion of their more than $300 billion in outstanding, previously deployed funds in the world financial system.

The consequences of OPEC undertaking such liquidations of financial investments in the world financial system are the following:

1) A crisis in the United States' ability to finance its $300 billion 1983 deficit.

As shown by the statistics in **Figure 4**, such a crisis in financing the U.S. deficit is already in the making, even without oil-country liquidations of U.S. Treasury holdings. Nevertheless, the implications for all international investors of Saudi Arabia liquidating its holdings of U.S.

**Figure 3**
## OPEC deployment of foreign assets
(Total outstanding estimated foreign assets: $410 billion)

| OPEC investment into: | 1980 | 1981 | 1982 I | 1982 II | 1982 III |
|---|---|---|---|---|---|
| Britain: | | | | | |
| Government debt.................. | 1.9 | 1.0 | 0.1 | 0.2 | −0.3 |
| Eurocurrency bank deposits ....... | 14.9 | 7.9 | −0.9 | −5.5 | +1.3 |
| Total*............................. | 17.6 | 9.0 | −0.5 | −5.1 | +1.0 |
| United States | | | | | |
| Government debt.................. | 9.6 | 10.3 | 3.4 | 1.2 | 2.5 |
| Bank deposits..................... | −1.1 | −2.1 | 1.5 | 5.2 | −1.0 |
| Total*............................. | 14.1 | 16.1 | 5.2 | 7.2 | 1.6 |
| Europe, Japan | | | | | |
| Bank deposits..................... | 26.2 | −2.6 | −2.0 | −5.9 | n.a. |
| Stocks, bonds..................... | 17.0 | 21.7 | 1.0 | 1.4 | n.a. |
| Total*............................. | 43.2 | 19.1 | −1.0 | −4.5 | n.a. |
| Total identified cash deployed ....... | 86.5 | 53.9 | 5.5 | −1.9 | n.a. |
| Total current-account surplus ........ | 113.0 | 65.0 | 9.0 | −1.0 | n.a. |

*Totals do not add because not all components are given.

Treasury debt cannot be underestimated. Of the $146 billion in U.S. government debt held by foreigners, $70 billion of that is held by Saudi Arabia. During 1981, although the Saudi surplus was already dwindling to zero, Saudi Arabia preferred to draw down its holdings of all other OECD country debt, while it increased its purchases of U.S. government debt (see **Figure 3**). Saudi investments in U.S. Treasuries are the leading edge for all foreign investments in this area.

Informed banking sources estimate that the Saudis will liquidate their holdings of U.S. Treasury paper by $10 billion this year—a net reversal of $20 billion compared to 1981. There is no other major foreign source to replace this funding. As documented in the profile here, moreover, exceptional sources of U.S. internal financing of the deficit which were geared up during 1982 cannot be extended at the same, unprecedented level during 1983. Taking these combined factors into account, the United States will be short $104 billion—a sum equal to the debt of Brazil or Mexico—in financing during 1983.

2) Withdrawals of funds from the world banking system. As shown in **Figure 3,** such withdrawals were already under way in Europe and Japan during 1982. Naive economists assert that when the OPEC producers liquidate bank deposits in one section of the system, to finance imports, these funds "reappear" in the banking system in the form of import financing. "If an oil producer withdraws $1 million from Chase in London," one New York bank economist asserted, "and redeposits it in Germany to pay for imports, Chase-London can always pay the German bank to borrow those funds back." Such arguments assume the world economy still looks like it did in 1978.

During 1982, world trade declined by approximately 15 percent, hitting major exporting countries such as Japan and Germany with export declines from 2 to 10 percent during the year. Privately, a leading oil company executive reported to a select meeting of Wall Street investors on Jan. 3 that "for every dollar West Germany will now save on reduced oil payments, it will *lose $2 in export orders.*"

It is entirely reasonable to assume that Saudi Arabia or another major oil producer will liquidate short-term deposits to finance imports in coming months; however, it is virtually certain that this would occur sometime *after* import programs overall will have been cut back. For this not to be the case would mean that Saudi Arabia et al. would have to be prepared to withdraw many tens of billions of dollars from the banking system within a short period of time, to maintain constant import levels. Were this latter—highly unlikely—development to occur, the world banking system would break apart, virtually overnight, and the mechanisms for financing world trade would have been eliminated in any case.

3) Leading developing countries will be seriously hit.

Mexico, Indonesia and Venezeula are the major Third World oil producers whose debt problems are immediately worsened by the decline in oil prices. For every $1 decline in the price of oil, Mexico faces a $600 million decline in its export receipts. The $28 price of the coming weeks means a $4 billion rise in Mexico's already unfinanceable deficit.

In 1982, Indonesia's oil revenues were $11 billion; in 1983, they will decline to, at least $7.7 billion. However, it is not just the oil-producing countries in the Third World which are affected by the oil-price decline.

In the second half of 1982, commercial bank loans to the developing sector fell 50 percent compared to 1981. A draw-

**Figure 4**
## Sources and uses of Treasury funds

| | 3RD Quarter 1982* | 1983 (est.) |
|---|---|---|
| **Borrowing** | $288.7 bn. | $325 bn.** |
| **Funding Sources** | | |
| Private non-financial | $146.3 | $140 |
| Federal Reserve | 35.4 | 20 |
| State and local government | 36.7 | 15 |
| Commercial banks | 10.9 | 20 |
| Households | 34.8 | 35 |
| Foreign | 8.0 | 12 |
| Corporations | 7.0 | 3 |
| **Borrowing gap** | $ 0.0 | $104.3 |

*Latest complete data from Federal Reserve Flow of Funds tables.

**$325 billion includes $69 billion of "indirect," i.e., sponsored or guaranteed agency borrowing, continuing the rate for the third quarter; this is probably an underestimate, since total indirect borrowing in fiscal year 1982 was above $80 billion. It also assumes that the administration's $224 billion deficit projection is too low, given the 3 percent GNP growth assumption; for purposes of calculation, it assumes that GNP will not grow, and applies the Congressional Budget Office formula that each point of GNP growth equals $10 billion in federal revenues.

Under reasonable assumptions, the federal government of the United States will be unable to find the resources to finance $104 billion of its total requirements during the present calendar year. As the above table shows, the majority of the $288.7 billion per year deficit registered during the third quarter was financed through traditional savings sources, i.e., financial corporations and households; the projection for 1983 assumes that these remain stable. However, special factors were present to make funds available that cannot continue. First, the Federal Reserve bought government securities at a staggering $35 billion annual rate, bringing on the now notorious "money supply explosion"; this cannot possibly continue, as Fed Chairman Volcker insisted in recent congressional testimony; even the $20 billion figure for Fed purchases of government securities in the projection would represent an all-time record. The shift in the Saudi surplus to deficit implies a $20 billion net swing away from foreign purchases of U.S. Treasury securities, as shown. The enormous purchases by state and local governments reflects short-term arbitrage factors which market analysts agree cannot possibly continue. The added deficit plus reduced special factors bring the "borrowing gap" up to $104 billion, implying a fiscal catastrophe for the United States this year.

down of OPEC deposits in the world banking system encourages continuation of that reduction at an accelerating pace. Additionally, if OPEC must borrow $10-$30 billion in 1983 from international banks, this will withdraw funds available to the developing countries. Most European countries have already become heavy borrowers on the private international markets due to their serious internal deficits, and are already taking such funding sources away from the Third World.

### The shrinkage of the world economy

As the 1982 decline in world trade forewarned, the world economy is shrinking—despite the fact that the real development needs of nations for expanding production of capital goods and manufactures have never been greater.

The collapse of world trade helped pave the way for the City of London to trigger the oil price decline in January. Constant British efforts to rig the price downward over the last two years had been successfully thwarted by Saudi Arabia. It became impossible for Saudi Arabia to hold the cartel together behind a constant price at the point that the demand for OPEC oil began collapsing precipitously.

The depression-induced scaling down of world economic activity has cut into world energy and oil production. During 1982, U.S. consumption of energy fell 10.8 percent compared to 1981. The United States is importing half the petroleum it imported in 1979. West German imports of crude oil fell 9.1 percent last year; Japanese imports fell 10.4 percent.

When economies go into depression, they lose, at rapidly accelerating rates, their ability to absorb energy. Thus, even though the price of oil is declining, consumption of energy sources will continue to decline during 1983 because there will be less economic activity. In eliminating the OPEC surplus, the City of London has successfully undertaken to cut the world banking system "down to the size" defined by the world depression. Rather than being "recycled," the displaced funds previously identifiable as the OPEC surplus are now being "vacuumed" up by the world's debt.

# A dramatic shift in world oil trade

by William Engdahl

The backdrop to the unfolding drama of future world petroleum prices is a profound if little-discussed strategic shift over the 1979-82 period in global oil power. The best way to dramatize the situation in which Saudi Arabia has retreated and Britain, the Soviet Union, and Mexico have emerged as power brokers is to examine the following facts:

- Total world production of crude oil has plummeted from an average of almost 63 million barrels per day (bpd) in 1979, the year Iran's 5 million barrels a day were forced out of the picture and Federal Reserve Chairman Paul Volcker began his usury policy against industrial production. World output averaged 53 million bpd in 1982. This is more than a 15 percent market shrinkage, or almost 10 million barrels daily.
- Total U.S. demand for petroleum for the same 1979-82 period shrank some 4 million bpd from 18.9 million to 14.8 million at the end of 1982. This is almost a 22 percent decline in consumption. The United States is the world's biggest single market.
- U.S. imports of crude and petroleum products for the 1979-82 period have been halved from 8.6 million bpd in December 1979 to 4.4 million bpd in December 1982. This means a drop of 4.2 million barrels daily in consumption of imports.

Now, in this context of overall shrinkage of world oil consumption, a much less noticed structural shift in trade flows of world oil has occurred. Within its greatly reduced import regime, the United States has lowered its imports of Saudi Arabian oil, in fact of *all* Arab OPEC oil, since 1979. As recently as 1981, Saudi Arabia was the largest single supplier to the United States, with 1.1 million bpd. By September 1982, this had dwindled to less than half that volume, 546,000 bpd, and by the end of last year, Mexico and Nigeria had both surpassed the once-influential Saudis as the number-one and number-two suppliers, respectively, to the U.S. market. Mexico today is officially sending 852,000 barrels of crude north to the United States each day, double the volume of a year earlier. With a sizeable chunk of those imports soon due to be dumped into the salt domes of the U.S. Strategic Petroleum Reserve, this means that Mexico has become dependent on the United States, a dependence linked to attempts by Armand Hammer and others to grab ultimate control of the most precious oil reserves in the known world outside of Saudi Arabia.

Currently, of the top seven suppliers to the United States, Saudi Arabia, the number-three supplier, is the only Arab OPEC member. This shift is coherent with the British "New Yalta" plan of pushing the United States out of the strategic Middle East. In fact, at present, the United States imports approximately the same amount from Great Britain as from Saudi Arabia.

### The Soviet role

With the shrinkage of total Saudi production in only the past 13 months from slightly over 10 million bpd to an estimated 4.2 million bpd at present, the role of Soviet oil in the world market has for the first time become substantial. Moscow has moved dramatically in the past year to maximize its influence in the world oil market. It was unprecedented when on Feb. 1 Moscow announced that it was cutting the posted price of its Urals blend by $2.15 down to $28.50 a barrel; London had been hoping for this move, so that the onus for breaking the price structure would not fall on the British.

More important is the fact that for almost the last year,