

which forced its dollar parity down by two cents had ended in a strengthening of the other "lower-tier" currencies as well as a slight further appreciation of the mark and yen, instead of dragging down the French franc, lira, Belgian franc, and Swedish and Danish crowns. One Chase Manhattan scenario for wrecking the European snake centers around a series of devaluations of the three last-mentioned currencies before the mark is forced to officially revalue; otherwise, explained Chase, the West Germans would carry the weaker currencies upward, too, an effect incompatible with the bank's austerity policies for Sweden, Denmark, and Belgium.

At this point, no fundamental realignments of market rates can be expected without an explicit policy shift on the part of the U.S. or the key European countries. Whether the Bundesbank buys dollars, as it did on Feb. 14 in the modest amount of 30 million, to hold the mark down, or sells dollars to support the "lower-tier" snake partners and the French franc, in the absence of a generalized crisis of confidence in the dollar, the effect will be comparable to the strengthening pound's favorable reverberations for the dollar last month: a marginal increase in dollar trading on not unfavorable terms, and, more importantly, an interim invulnerability of the snake to speculative attack.

The 500 million pound British trade deficit in January following a December surplus, and the large Italian trade deficit in one of its crucial sectors, chemicals, exemplify the Europeans' grounds for concern about U.S. official policies that would further weaken essential trading partners.

An obvious case in point is Italy, whose importers this fall and winter have been operating on large short-term suppliers' credits bypassing the foreign exchange tax, which come due this month, with potential danger for the lira. The U.S. Treasury Department, however, sees no reverse flow of short-term capital occurring, and concludes that rollovers are taking place; the financing source is probably direct Arab credits for oil purchases or an equivalent Italian bank borrowings of petrodollars

from French and other European sources. This expedient, and not the interest-rate arbitrage, is keeping the lira intact for the time being.

Policy Options

Debate over longer-term restructuring on the continent and in Britain took an increasingly open form this week, centering around the subject of gold's status as an international payments medium and the gold-backed transferable ruble offered as a trade instrument by the central bank of the Eastern European CMEA. The new Common Market commission headed by Roy Jenkins is studying the possibilities of using gold reserves as a means for settling payments balances, reports last weekend's issue of the London Economist, while also looking toward an expansion of the "snake." West Germany is only half-plausibly said to oppose both moves, which would constitute major steps toward forming the kind of gold-based European monetary union advocated by various Gaullists and Italian leaders.

The Lombard Odier bank in Geneva has issued a report predicting that central banks will buy gold heavily, since gold has proven its usefulness as a reserve asset; other Swiss bankers said privately this week that, although dollars still have confidence at the moment, when this situation reverses, gold will return to the center of the monetary system, as de Gaulle advocated. If the USSR backs the transferable ruble with gold, they added, it would be a much more attractive holding than "the inconvertible dollar." Significantly, the Lombard Odier report was featured in the Feb. 15 Frankfurter Allgemeine Zeitung, outlet of the West German financiers and industrialists who earned their past reputation as anti-gold holdouts during the dollar crises of the 1960s and 1970s. West Germany, with 70 per cent of its official reserves held in dollars, would face drastic adjustments under a gold-based European system, but its businessmen are aware of the broader advantages of expanded exports opened by an altered international monetary system.

Oil Market War On The Horizon

SPECIAL REPORT

Exxon is preparing to recoup the serious losses it suffered on European refining and marketing operations last year by taking over a bigger share of the U.S. market. A number of industry analysts reckon that Exxon is in a good position to do this. With an additional 250,000 BPD of domestic refining capacity scheduled to come on stream in 1977, Exxon is well-positioned to take advantage of its preferential access to lower-tier Saudi crude — if the company can circumvent Saudi and U.S. government monitoring measures designed to keep Exxon and the other Aramco partners from reaping a

competitive advantage over oil companies that must pay the higher OPEC price.

Exxon's determination to expand its domestic market share necessarily means market warfare. What happens in the oil industry in 1977 will be determined primarily by the Administration's energy policy. So far Carter and Energy Czar James Schlesinger have made it clear that they want strict conservation and some form of energy tax to help cut down on what they call waste. From the industry side, this means a shrinking market.

The features of the Carter energy program — high prices, conservation, an increasingly monopolistic market — are, in fact, the embodiment of the energy policy pursued by Exxon and the other Rockefeller-controlled oil companies for decades. *The Control of Oil*, a new book by former Senate Anti-trust and Monopoly Subcommittee economist John Blair, documents in graphic

detail how the consistent strategy of the Rockefeller-dominated majors was to maintain control of the international energy market and keep prices up by recklessly running independents out of the market and restricting production worldwide.

Exxon: European Losses

Exxon's present intentions to grab a bigger share of the U.S. market are being determined by the disappearance of its European profit margins. The company's 1976 annual report will reveal actual losses on 1976 refining and marketing operations in Europe. Exxon's refineries in Europe — in France, Italy, West Germany, and the United Kingdom — were operating with about 25 percent spare capacity throughout 1975 and 1976, resulting in sharply higher per unit operating costs. Company spokesmen cite the problems of the European economies, which have undoubtedly been a factor in the reduced operating rates. The profitability of refining and marketing operations has been hurt even more by European price controls. The company complains about having to submit all requests for price increases on refined products to the governments in the countries where they operate and waiting months for a response. As a result, the higher per-unit operating costs cannot be passed on to the consumer.

The strict price controls throughout Europe are politically motivated and part of a concerted effort by the European governments to favor their own national oil companies. According to Exxon, the governments are also making life difficult by more strictly controlling their investments and other phases of their operations. Exxon is looking to the U.S. market for future expansion.

Since the 1973 price explosion, downstream margins — margins on refining and marketing operations — have become all important. Historically the major integrated oil companies derived the bulk of their profits from upstream operations — crude oil production. As Blair recounts, prior to 1973 the Aramco partners (Exxon, Mobil, Texaco, and SoCal) and the other international oil companies operated as concessionaries in the Middle East, sharing the total "take" with the producing countries, usually on a 50-50 basis. The enormous profitability of upstream operations derived from the fact that payments to the host countries were made in the form of taxes, which were used as dollar-for-dollar credits against taxes of other foreign incomes — the famous foreign tax credit advantage.

After 1973, the major oil companies shifted their profit centers downstream. As a result of nationalization moves by the oil-producing countries, (1) the government "take" increased sharply, and (2) the oil companies were now *purchasing* the oil back from the producing countries, not paying them taxes. The combined impact of the higher government "take," the loss of the foreign tax credit, and certain tax changes in 1975 (such as the elimination of the oil depletion allowance for the major integrated companies) would have been a disaster for profit margins — had the majors not been able to *more than pass on* the sharply higher world prices for crude oil in refined product prices. Statistics cited by Blair show that even using very conservative assump-

tions, the profit margin on a typical refinery jumped from about \$3.00 a barrel in July 1969 to around \$8.00 a barrel in December.

Given this overall shift in emphasis from up to downstream operations, Exxon's recent losses in Europe are particularly worrisome for the company. Partially because of losses in Europe and partially because of increased product sales in the U.S., growing portion of Exxon's net income came from U.S. sources throughout 1976. In the third quarter, 56 percent of net income was of U.S. origin, compared with 49 percent in the same quarter of 1975. Exxon expects this trend to continue in 1977.

Some industry analysts think that Exxon and the other Aramco partners are in a position to increase their domestic refining margins and market share on the basis of their access to lower-tier Saudi and the United Arab Emirates crude oil. Fifty percent of Exxon's imported oil comes from Saudi Arabia and the Emirates, compared to 19.3 percent of Atlantic Richfield's imports, for example. Combined with its added refinery capacity, the differential between the lower-tier and upper-tier OPEC crude could give Exxon a slight but significant competitive advantage over the integrated companies which must pay approximately 50 cents a barrel *more* for their feedstock.

FEA To Step In

The Federal Energy Agency is naturally under enormous pressure to nullify the Aramco partners' cost advantage of extending the present entitlements system to equalize the cost of imported crudes among refiners. Presently the entitlements system equalizes the crude oil costs of refiners with access to "old" domestic crude (price controlled at about \$5.50 a barrel) and those dependent on "new" domestic crude and \$13 a barrel plus imported crude. Designed as a subsidy to independent refiners who were dependent on high-priced OPEC oil purchased via Aramco, the entitlements system has worked to the benefit of Exxon, Mobil, Texaco, and SoCal, too, and against companies like Gulf with large supplies of domestic crude and more limited access to OPEC oil.

In addition to extending the entitlements system to deal with the two-tiered OPEC pricing systems, the FEA says it also will begin closely monitoring imports to determine country of origin. The aim is to stop Aramco from charging the higher price for Saudi imports and exploiting the two-tier system for its own benefit. The Saudis have also indicated they will be guarding against such profiteering by Aramco.

How either the U.S. government or the Saudis will actually be able to carry out such a monitoring procedure is another story. As every one in the oil business knows, when a tanker arrives at a Texas port, it is close to impossible to know for sure where its cargo came from. Judging from past experience, the Aramco companies are certainly going to try to get around the regulatory measures.

The other Aramco companies are also becoming increasingly dependent on their domestic refining and marketing operations for profit margins. In the first nine months of 1976, Mobil's earnings from its U.S. petroleum operations increased by 51.5 percent, while oil and gas profits outside the U.S. declined by 21.6 percent. In 1975 (the first nine months) 31 percent of SoCal's profits were

derived from domestic sources, compared to 54 percent in 1976. Domestic operations are expected to contribute to the bulk of its 1977 earnings. SoCal, some analysts reason, stands to benefit from the Saudi price decision even more than Exxon, since 53.2 percent of SoCal's imports come from Saudi Arabia and the Emirate. And SoCal has just completed a major, 500,000 BPD expansion of domestic refining capacity designed to process an increasing volume of Arab light and other Saudi crudes.

Companies like Gulf, which have concentrated efforts on developing their domestic production are clearly at a disadvantage. Gulf's earnings in the U.S. in 1976 declined \$95 million, reflecting sharply higher exploration ex-

penses and higher U.S. income taxes. The decline was partially offset by gains in Gulf's downstream operations. However, enormous exploration costs and the loss of the oil depletion allowance tax advantage decisively undercut Gulf's earnings.

The spectacular four-fold rise in exploration and developments costs since 1971 — a charge that has fallen predominantly on Gulf and other U.S.-centered producers — has been determined primarily by the Exxon-Chase Manhattan perspective of "resource depletion" and escalating energy costs. This perspective and not price controls on domestic oil per se guarantees that companies committed to energy development will have little economic incentive to do so.