EIR Economics

Saudis abdicate oil-market control: Moscow in the wings

by David Goldman

Responding to reporters' questions about Saudi Arabia's decision to effectively abandon its official oil price, U.S. Energy Secretary John Herrington cautioned on Sept. 19, "There's still a lot we don't know." As a First Boston analyst commented to wire services Sept. 17, an era has indeed passed: Saudi Arabia, whose ability to increase or withhold oil supplies to the market was the backbone of the Organization of Petroleum Exporting Countries, has abdicated its leading position, in favor of that mysterious power, the "spot market."

The spot market is less than mysterious: As *EIR* has reported for three years, the Soviet Union plays a marginal, but decisive role in world oil markets through deliveries to the spot market. In previous periods of apparent oil scarcity (i.e., OPEC's ability to limit supplies to the market), the spot market was an insignificant factor, absorbing the odd shipment outside of normal contracts. Now, with a world depression and world oil glut, it has become the decisive factor in world oil markets.

The power shift in the world oil markets opens the prospect of an oil price crash, but by no means ensures it. The successful Iranian air strike against an Iraqi oil installation 245 kilometers inside Iraqi territory on Sept. 13 underscores, once again, the way in which the present oil glut could turn into a shortage overnight. Despite the Saudis' decision to bring an additional 1 million barrels per day onto the market (they were recently producing barely half of their 4.5 million bpd OPEC quota) through contracts linked to the spot price, the oil market failed to collapse between Sept. 15, when the news leaked out, and *EIR*'s deadline of Sept. 18.

Each of the price tremors in the world oil market since 1983 can be traced to Soviet activity in the spot market. Although Soviet oil exports are dwarfed by those of OPEC, and the spot market's size (usually less than 10% of world oil trade) is relatively tiny, the Soviets' margin of power has increased out of bounds with the deterioration of the world economy, and the increasing glut of supply. Most Western analysts wonder why the Soviets, who depend upon oil exports for 60% of their total (reported) foreign-exchange earnings, would sacrifice their own short-term interests by pushing the price down. But the issue for the Soviets (and all other major exporters) is not short-term cash flow, but ultimate strategic control of the market.

The question that must be asked is why Saudi Arabia, whose cash position is far from desperate, is willing to abandon its "swing" role in world oil markets, and allow the price at which it sells oil to be determined by marginal supplies coming onto the spot market. The answer is suggested by the following chronology:

Sept. 3: The Syrian oil minister flies to Moscow.

Sept. 5: Gorbachov visits the Tyumen oil-producing region.

Sept. 9: Gorbachov declares the Soviets' military interest in expanding oil production.

Sept. 9: The London *Times* warns of Soviet pressure on Norway's Spitzbergen Island.

Sept. 10: OPEC calls an emergency ministers' meeting, to take place Oct. 3 in Vienna.

Sept. 10: *Petroleum Intelligence Weekly,* the leading London-based industry publication, warns that the Saudis are likely to offer discount deals for oil, unless the other OPEC members pledge to stop cheating and keep their production within OPEC quotas.

Sept. 10: Reuters reports rumors of the (subsequently confirmed) Saudi deals with Western oil companies fixed to spot-market prices.

Sept. 10: Wire services carry rumors that Sheikh Yamani has been assassinated.

Sept. 11: Wire services report rumors of political unrest in Saudi Arabia, denied by diplomatic and oil-company sources.

Sept. 11: Wire services carry reports of a shooting incident involving Sheikh Yamani.

Sept. 13: Irani warplanes attack an Iraqi oil installation 245 kilomters inside Iraq.

Sept. 13: Iraqi warplanes drop 8 tons of explosives on Iran's principal oil-loading station, Khargh Island.

Sept. 14: Reuters reports rumors that Sheikh Yamani had predicted that oil prices would fall to $18 per barrel, as well as denials by OPEC spokesmen.

Sept. 15: Sheikh Yamani attends a private meeting of oil ministers and oil-company officials at St. Anthony's College, Oxford, England, at which the spot-market deals are confirmed.

Sept. 16: The *Wall Street Journal*, citing sources at the Oxford meeting, retreads the rumor that Sheikh Yamani has predicted an $18 per barrel oil price, warning of world financial disaster.

Sept. 16: Sheikh Yamani denies to wire service reporters the $18 per barrel prediction, but does not deny the spot-market deals.In short, Saudi Arabia's oil minister, Sheikh Yamani, spent the first two weeks of September denying that he was dead, and Soviet party chief Gorbachov spent the same period visiting the Western Siberian oil fields, proclaiming his government's intention to throw enormous amounts of resources into new oil exploration and development, and reverse the two-year decline in Soviet oil output.

It is also of the greatest significance that on Sept. 3, the Syrian oil minister, Ghazi al-Durubi, arrived in Moscow on what was described as a "working visit to further cooperation." The Syrians are the Soviets' most important diplomatic surrogate in the Mideast.

Gorbachov visited the Tyumen fields Sept. 5, flanked by several deputy prime ministers, including those responsible for heavy industry, electrical equipment, oil and gas, as well as Gosplan chief Baibakov. He continued his tour through the Soviets' oil-producing regions, concluding in Kazakhstan, where he proclaimed that oil and grain were the key to national prosperity, as well as the country's economic and military power.

Gorbachov's extraordinary emphasis upon oil production has, of course, something to do with the Soviets' failure to keep up oil exploration during the past decade. During the first quarter of 1985, Soviet oil production was at 147 million tons, against 153 million tons in the same months of 1984.

But the broader message from the Soviet leader is that the Soviet Union, still the world's largest oil producer by far, intends to do everything necessary to maintain its power in world oil markets, as a military-strategic consideration. This involves more than the Soviets' internal production; as the London *Times* reported Sept. 9 while Gorbachov was on tour, the Soviets are also putting renewed pressure on Norway over alleged Soviet oil rights in the Arctic Sea island of Spitzbergen, where Soviet asset Armand Hammer's Occidental Petroleum (among others) is now exploring for oil.

Saudi Arabia's exalted status in the world economy has been, since the Second World War, a matter of American sponsorship and suffrance. It is not credible that the Saudis would have walked away from their central role in determining the oil price, whatever the Soviet pressure, unless certain American channels sent them the same message.

It was, after all, Exxon which signed the first spot-market-priced deal with the Saudis (the other companies reportedly involved are Mobil and Texaco). From what standpoint would Exxon's board, and such individuals as Trilateral Commission founder David Rockefeller, view the oil market situation?

Apart from strategic concessions to the Soviets, the threat of a reduction in the oil price is a weapon in David Rockefeller's hands: As the chief of the Mexican oil company PEMEX, Mario Ramón Beteta, warned the same Oxford meeting Sept. 15, any rapid drop in oil prices would threaten the world financial system. Most of all, as the *Wall Street Journal* insisted in its Sept. 16 report of the Oxford meeting, it would destroy the financial position of Mexico, not to mention Nigeria and other oil-exporting debtors. These estimates are accurate as far as they go (compared to Energy Secretary Herrington's insipid statement Sept. 19 that the lower oil price would aid the mythical "recovery").

The question, however, is on whose terms the financial crisis will break.

From the standpoint of David Rockefeller, and such of his old collaborators as Secretary of State George Shultz, the most pressing danger is not a financial crisis—this they consider inevitable in any event—but, rather, the prospect that the debtors will unite around the Peruvian example. The Peruvian government's action against Occidental must have worried them, and even more so the $600 million trade deal Brazil signed with Peru on Sept. 12. Brazil will send food and manufactures to Peru, in return for Peruvian oil.

With a continental debtors' cartel in serious preparation for the first time, the oil price is a central issue. Since the oil crisis and the debt crisis broke out in 1979-80, the banks have sought to divide the debtors along exporting and importing lines. Brazil, the largest debtor, derives enormous short-term benefits from a lower oil price, while Mexico, the second-largest debtor, derives enormous short-term losses. Moreover, Brazil is vulnerable to blackmail over its oil supplies: The threat of an oil cut-off, delivered to Brazil by the U.S. Treasury in June 1983, forced that country to accept the IMF's terms, and broke the back of the debtors' resistance at the time.

Now that the situation is much further advanced, both politically and in terms of the financial crisis itself, Rockefeller et al. will use every means at their disposal to divide the debtors.