



## Are oil prices out of control?

### *How the multinationals made their record profits in driving the independents out*

The multinational oil companies this week posted profits for the third Quarter that are so high that oil analysts in Wall Street investment houses are terming them "shocking and embarrassing." Exxon reported a 118 percent profit increase for the third quarter, Continental posted a jump of 134 percent, and Standard of Ohio 190 percent!

Such record profits are directly related to the dramatic climb in oil prices over the course of this year, particularly during the early summer oil shortage hoax. The price hike is due to the increasing rate of speculative oil trading on international spot markets where the largest integrated oil companies have made a killing. The oil producing countries, Europe and Japan have all condemned the oil majors for their increased profiteering and market manipulation.

Over the last three weeks the price of spot purchases of crude have reached as high as \$40 a barrel with no relief in sight. The *Journal of Commerce* reported on Oct. 15 that if prices exceed this level, OPEC is sure to enact a new price rise at its mid-December price-setting parley.

In the United States last week, Saudi Oil Minister Yamani stated that the markets were going out of control as a result of the spot market momentum. The Indonesian Oil Minister Adimir Adin is quoted in the *Journal of Commerce* saying that OPEC will not raise its prices but will allow "market forces"—the spot market—to set pricing trends.

#### **A Catch-22**

The administration and the media are responding to the announcements from the major oil companies with a more vigorous campaign for a windfall profits tax on oil company profits. Such a demand is misplaced since the profits of the multinationals are primarily from foreign

business; the windfall profits tax only hits profits made from domestic oil production. Curiously, not a word from Washington or the press has appeared on foreign tax credits which enables the multinationals to engage in international oil production and trade virtually tax free.

As experts in the oil industry are well aware, the windfall profits tax will not hurt the multinationals, but will destroy the smaller independent producers, historically the ones who explore for 80 to 90 percent of the U.S. produced crude.

#### **Behind the spot market bubble**

According to a former employee of Exxon, as early as 1974, the Seven Sisters cartel of multinationals was distributing written secret documents elaborating policies which this year have been enacted to break up the "integrated" nature of their elaborate marketing system. This entails primarily the process of severing third party contracts of oil sales between companies to "balance the market."

Such a move throws the world markets into instability, the result of which is that the multinationals bid against one another for oil purchases in greater and greater volumes on the spot market. The Council on Foreign Relations, a prestigious policy making body in New York City which is known to represent the corporate boardrooms of the Seven Sisters, produced a series of studies called the 1980s Project on world politics and economics. In their volume on oil politics, written in 1976, is a description in great detail of the current chaotic market situation. The study terms it "the second oil regime" whereby the "integrated structure" of the oil industry is severed and the cost of energy soars.

The key to realizing this plan was the shutdown of Iranian exports earlier this year. As a result, British Petroleum initiated the move to break third party

agreements, followed by Exxon, Gulf, Mobil, and Royal Dutch Shell, which reverberated throughout the oil industry. The net result was to force companies with refineries and petrochemical installations onto the spot market for competitive bidding against one another for precious cargos of crude at increasingly higher and higher prices. The spot market in normal times only accounts for about 5 percent of total world trade and is used by companies to make across the counter transactions of crude not covered by long-term contract.

According to a New York analyst, well over a million barrels a day of crude have been added to the total volume traded on spot terms because third party contracts were severed. The *Washington Star* reported on Oct. 16 that as high as 24 percent of the total volume of crude sold on world markets now goes on spot.

Throughout the course of this year, average spot transactions for crude oil have never dropped below \$30 a barrel compared with OPEC's average \$20.48 price.

#### **A new reality**

In a series of articles printed in the *Petroleum Economist*

earlier this year, Joe Roeber reported on the growing importance of the spot markets in world trade, particularly the European spot trading center associated with the Amsterdam-Rotterdam-Antwerp importing and refining center. Roeber noted that a new reality is presently impinging upon oil markets in which the major oil companies are taking a more dominant position in trade. As a result, many smaller independent companies which have traditionally gained the necessary margins of crude to feed their refineries off spot trade are finding themselves threatened by powerful, newly established trading subsidiaries of the multis.

An aide to a top international oil consultant last week commented that the expanding rate of spot trade and the commensurate reduction of third party sales represents a "revolution" in world oil. The *Petroleum Intelligence Weekly* reported on Oct. 8 that as early as August of this year Royal Dutch Shell initiated a move to impose hefty surcharges on those third party contracts which have survived. The weekly notes that certain unnamed multis have since then attached premiums on third party sales of up to \$8 a barrel. *Le Monde* on Oct. 9 cites Exxon, Gulf, and Shell as having

## New reality in world oil

### **Multis consolidate spot market control**

*Following are excerpts of an article that was part of a three-part series in the Petroleum Economist. Authored by Joe Roeber and titled "Dynamics of the Rotterdam Market," this installment appeared in the February issue. The series discussed international spot trade centered in the controversial Rotterdam spot market.*

...The policies of the refiners toward the market have adapted to the new realities. Having allowed independents to perform a function that logically belonged within their own systems, they have reclaimed large parts of it, by tightening up their own trading activities and even setting up trading subsidiaries (Shell with Petra, BP with Anro, and Exxon with Impco). They learned to adopt more conscious and controlled policies towards the spot market, selling as little and buying as much as economics and opportunities dictated in order to avoid swamping it with surpluses. With unused capacity to play with, they could tune refinery runs more closely to demand and store their own surpluses.

The result for traders has been to shake out the

weaker ones, consolidating and concentrating the relatively few strong traders—particularly those with access to funds from a strong parent company. Leading traders without such strong integrated corporate financial backing are a rarity, Bulk Oil, and Vitol being the most obvious examples. Traders with U.S. links are important, with Coastal States leading a field that has such names as Petrosun (Sun Oil), Derby (Englehard), Northeast Allied (Hess), Anschutz and Tampinex (Ingram). This was the trend last year, and it probably remains the underlying trend.

### **Independents to be bought up**

*H. Andrew Thornburg, senior vice-president of Security National Bank, this month delivered his assessment of financial requirements for energy companies, given higher exploration and producing costs and a recessionary economic environment. Mr. Thornburg, speaking before the Pacific Energy Association at San Diego, paints a grim picture for smaller oil producers in the U.S. Below are excerpts of reportage from the Oct. 15 issue of the Oil and Gas Journal's coverage of the speech.*

willingly accepted offers of spot sales from Iran at over \$36 a barrel, a sop to the Iranian price hawks who have admitted selling 15 percent of their exports at spot prices up to \$40 a barrel.

### **The spot market and decontrol**

A New York-based international oil consultant has stated that the effect of removing government controls on the price of U.S. produced oil will amount to transforming the U.S. oil market into one giant spot market. To date, 20 percent of the 8 to 9 million barrels a day of U.S. produced oil is fetching an average of \$30 a barrel with the short-term trend in the upward direction.

Over the next 20 months, barring a reversal by the next administration of President Carter's decision to let price control measures lapse, all U.S. oil prices will rise in accordance with the prices resulting from oil company competitive bidding. A similar trend, says a former top government energy official, will occur after 1980 with respect to natural gas.

The recommendations taken by the influential Senate Finance Committee over the past weeks with respect

to Carter's energy program and, in particular, the windfall profits tax on oil company profits reveals the complicity of such figures as Senator Russell Long (D-La.) with the multinationals. The Finance Committee under Long's leadership has formulated a series of exemptions from the tax (which is slated to capture windfall profits following price decontrol) which only benefits Big Oil.

Moreover, the actions of the Committee, known to be weighted with pro-oil industry senators, adds incentive to the trend toward higher prices. First, all new oil found since 1973 is exempt. Expensive-to-extract oil which the multinationals are presently exploring for will be given the financial backing of the government. Across the board, the multinationals claim that it will require at least a \$30 a barrel market price to make this new category of crude "economical."

Second, the Committee has approved numerous measures to foster conservation which, in effect justify the trend toward higher oil costs.

Third, the committee has only exempted the first 1,000 barrels of stripper crude (oil from wells which produce less than 10 barrels a day) from the windfall

Although inflation is "out of control," interest rates are high, and productivity has declined, Thornburg said that "even with these concerns it is easy to affirm that adequate financing will be available for the industry as a whole, but it won't necessarily, be equally available to all segments of the industry.

The most efficient use of funds by the petroleum industry, he said, will be development of conventional sources of oil and gas, even though the discovery rate has been declining.

Decontrol of oil and gas prices and reasonable tax legislation are required, however, for such development to occur.

Thornburg predicted hard times ahead for independent producers, although they should find adequate financing at least during the early 1980s by using their own cash flow or by borrowing against reserves.

"Ultimately, as the cost of drilling increases and discovery rates fall, more and more of the independent companies will leave the industry," he said.

"Today, independents with proved reserves, especially those who lack the capital to develop existing properties, are prime targets for acquisition."

Independent marketers and refiners also may have problems.

Thornburg said, "they must face the fact that higher prices are going to discourage the use of petroleum products. And this calls into question the advisability of investing in additional refining capacity."

### **New York banker sees tight credit squeeze on independents**

*An investment analyst with Manufacturers Hanover sees the impact of the recent increase in interest rates as forcing the independent oil producers out of business. We quote:*

At a 15 percent prime lending rate and with the soaring cost of materials not to mention spiralling taxes, the smaller oil producers just can't do it. Many of them, even if they are exempted from windfall profits, won't be able to make it—not in this environment. They were already being forced to sell out long before the advent of the 15 percent rate.

Now, the government is looking to enhance the industry's search for domestic oil, but finding and pumping remaining reserves here is so damned expensive no little guy could hope to get into this ball game. The current trend in the oil leans toward the bigger companies with the profit margins to lease land and invest in expensive exploration. I wouldn't be surprised to see buy ups of smaller companies by the majors as time goes by, particularly if current economic conditions persist.

profits tax, which means all middle-sized independents running larger, more productive wells will be taxed out of existence, leaving only the "little guys and big oil."

#### **Multinational corporate consolidation**

A grim assessment for the independents was given this month by a California investment banker to the Pacific Energy Association. He predicted that severe recessionary economic conditions, fostered by Federal Reserve Chairman Volcker's recent moves, coupled with massive increases in production costs would force many of the smaller U.S. independent oil companies out of business.

Under these circumstances, he anticipated that many valuable independent oil producers would be ripe for

"acquisitions." The recent buy up of the tiny California company Belridge Oil by Shell for a whopping \$3.6 billion is just the first. Belridge reportedly controls reserves of California heavy crude to the tune of 360 million barrels. The purchase occurred just weeks after the administration decontrolled the price of heavy crude.

The only difference in the long term between future acquisitions of independents by the multis and the Belridge purchase is that as credit tightens further and inflation worsens, the purchase price of such acquisitions will go down markedly as the multis' profits and oil prices climb higher.

—Judith Wyrer

### **Spot oil prices reach \$50 a barrel**

*The following are excerpts of an account of growing chaos on the international spot markets which appeared in the Wall Street Journal, October 26.*

The oil market is near chaos following the collapse of price stabilizing efforts by the Organization of Petroleum Exporting Countries.

"It is a complete shambles," a crude oil trader with a major oil company said...

So far this month, five of OPEC's 13 member states have increased official crude oil quotes in what appears to be a new round of price leapfrogging in the producers group. But until this week, only Libya had broken the \$23.50-a-barrel "ceiling" established by OPEC last June in an effort to stabilize runaway oil prices for the second half...

Oil buyers had been hoping, however, that others in OPEC would continue to honor the ceiling. That hope vanished Wednesday when Algeria announced that the price for its key grade would be increased to

\$26.27 a barrel to match the top price set by Libya...

The African producers often move in tandem in pricing petroleum, and representatives of the three met recently in London to discuss fourth quarter prices. Sources said that Nigeria had agreed to hold prices where they were if Algeria would do the same...

Nigeria notified contract buyers of its crude oil early this month that prices for the fourth quarter would be the same as in the third quarter...

How much longer this restraint will hold in view of the Algeria action isn't known. Meanwhile Nigerian and other African crudes are being sold on the spot market at prices of about \$40 a barrel. So are the Iranian crudes...

Published reports in Iran yesterday said that a cargo of Iranian crude had been sold at \$45 a barrel. Some U.S. crude-oil trading sources said they understood the Iranians were asking \$46 to \$48 a barrel currently, and one source said he has heard the price is as high as \$50 a barrel...

Trading sources said they expect a continued spiraling of prices on other crudes, too.