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## EIR Feature

# Oil price crash: the demise of the Lone Star State

by David Goldman and EIR's Houston Bureau

Texas is celebrating the 150th anniversary of its independence from Mexico with a general bankruptcy of state and public finances. The state's economic crisis began in 1985 with the end of the oil exploration boom, turned into a disaster with the first signs of oil price decline last December, and threatens to dwarf the worst 1930s experiences of any state, now that crude oil is trading at less than $10 per barrel.

Without emergency measures, which must begin with a protective tariff against cheap imported oil, Texas stands to lose 9 out of 10 of its top banks, 20% of its workforce, and the already-thin structure of essential government services. Not Mexico or Brazil, but America's boom economy of 1981, will be the trigger for a crash of the American financial system and the American economy.

At risk are:
- Texas's 7 million jobs;
- $172 billion of Texas banks' assets;
- $22 billion of federal income tax collections;
- 29% of U.S. oil production;
- 36% of U.S. natural gas production; and
- 31% of America's farm acreage.

Just under 10% of Texas jobs are directly related to extraction, refining, and servicing of oil and gas. But a vast financial structure has been built upon oilfield revenues, which is now in the middle of a crash. One of the state's 10 largest banks, BancTexas, is in immediate danger of failure at *EIR*'s deadline, and 8 of the others are in no position to survive an oil price of $13-15 per barrel—much less today's oil price of less than $10. Statewide, 81 insurance companies failed last year, largely as a result of the property market crash, and more are expected to this year.

Below, we present the anatomy of a state in deep depression, recalling that the data we present reflect merely the first stage of the oil price crash. The impact of oil priced in single digits will be much, much worse.



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*The collapse of Houston: the real-estate market is plummeting, while unemployment soars.*

## No more oil in Texas?

In early March, the Texas Interstate Compact Commission produced estimates of the effect of different price levels on "stripper," or marginal, oil production. The results are remarkable: at $10 per barrel, the state will lose 210,000 barrels per day of "stripper" oil production, or roughly 10% of its total oil production. That does not count other expensive forms of recovery, including the "secondary" and "tertiary" methods which bring costs to well over $15 per barrel. The stripper well data are shown in **Table 1.**

A sustained price level in the range of $15 per barrel would wipe out a minimum of an additional 10% of Texas oil production, according to independent petroleum company sources. A $10 per-barrel price would shut in more like 20%, bringing the total loss of production to 30% or more of Texas output.

"Offshore drillers have never faced conditions as devastating as those today," said Michael Simmons, drilling editor for Offshore Data Services, which reported a 7-point drop in the offshore rig-utilization rate in the past week to 43.9%. Of the 248 mobile rigs in the Gulf of Mexico, 109 are working and 139 are idle. "For the first time ever, more than 100 jackups are idle," he said. "The number working is almost half that of a year ago." Worldwide, the offshore rig utilization rate dropped 2.5 points, to 68.8%, with 233 rigs idle out of a fleet of 746.

Meanwhile, Hughes Tool Company reports that the domestic onshore rig-utilization rate was at its lowest point since May 21, 1973, with only 1,063 rotary rigs working in the United States in the last week of March 1986. That compares to 1,137 the previous week, and 1,939 for the same period in 1985. The breakdown is shown in **Table 2.**

Table 1
### Stripper well data
(indicated units)

| Price/bbl | No. wells closed | Bbl/day loss | $ loss (mn) | Reserves lost (mn bbl) |
|---|---|---|---|---|
| $10 | 51,465 | 210,343 | 767.7 | 860.7 |
| $15 | 28,433 | 91,347 | 500.1 | 241.9 |
| $20 | 12,658 | 35,138 | 256.5 | 30.6 |

Table 2
### Rotary rig utilization

| State | 3/31 | 3/24 | 1985 |
|---|---|---|---|
| Texas | 358 | 386 | 714 |
| Louisiana | 161 | 185 | 280 |
| New Mexico | 34 | 36 | 63 |
| Oklahoma | 166 | 159 | 259 |

Meanwhile, the elimination of oil-field investment would wipe out the state's—and the country's—capacity to produce petroleum by early in the 1990s.

## Texas stops working

February unemployment figures showed that 161,000 Texans lost their jobs in one month alone: the official unem-

ployment rate went from 6.9% to 8.8%, according to the *Houston Post*.

The Houston unemployment rate jumped from 7.4% in January 1986, to 9.6% in February 1986, as shown in **Table 3**, an astounding 2.2% jump in one month. However, the unemployment rate in the McAllen-Edinburg-Mission area, an agricultural area sensitive to problems in Mexico, jumped from 18.5% to 22.7% during the same period, a 4.2% jump.

The total labor force in the Greater Houston decreased from 1.5 million in March 1982, to 1.4 million in January 1986. By major sector, the casualties include the following:

- In the oil tool business, peak employment in March 1982 was 51,700, compared to 20,900 in January 1986.
- In oil-field services, 54,500 in March 1982, and 37,800 in January 1986.
- In oil drilling, the peak was 60,400 in June 1982, compared to 51,500 in January 1986. Thus, according to Bureau of Labor Force statistics, there were 59,300 fewer oil and gas jobs in Houston in January 1986, than in spring 1982. In the 1982-83 oil and gas tailspin, about 150,000 local jobs disappeared; about 70,000 of those jobs came back after the "recession."

*These data do not reflect the wave of oil-related layoffs that is now sweeping Houston*, following the last month's events on the oil market.

- **Baker International** is laying off between 800 and 1,000 workers at its seven Houston operating companies, which represent 15-30% of its local employees; by the end of

## The urgent need for an 'oil parity tariff'

On Jan. 29, 1986, presidential candidate Lyndon H. LaRouche, Jr., proposed an oil-import tariff to keep domestic petroleum prices at a level high enough to allow domestic production and investment to continue, for obvious national security reasons. The point of such a tariff would not be to raise revenues, but to protect our internal oil industry, which otherwise faces disaster. Even if we did not face a massive reduction of current oil production, we would feel the effect of lowered exploration within about five years, as old fields run dry. Without continued, aggressive development of new sources, the United States will be on the way out of the oil business by the early 1990s.

On April 1, the National Democratic Policy Committee announced its support for the implementation of the emergency oil tax package, as one step in a program to stop a financial blowout in 1986.

At the center of the package is an "oil parity tariff," which would establish a parity price for oil, and impose a revenue tariff on imported oil when oil was below that price. The parity concept is the same as that in farming. It sets a commodity price which takes into account the cost of maintaining current production, and of investing for future production, thus allowing the producer the equivalent of a "living wage," and society the provision of needed resources. The federal government is responsible for guaranteeing parity prices.

The current parity price is minimally $20 a barrel. But the market price is now hovering around $10 a barrel. That is why oil producers in the United States cannot cover their costs of production, and are beginning to fold up their operations. Thus, Alaska and Texas, two of the largest oil producers in the United States, depend for solvency on an oil price of over $13 to $15 a barrel. If the current collapse in the price continues, as seems likely, at least 5% of U.S. GNP can be expected to be wiped out in the near term.

Oil production will not be the only casualty, however. As the case of Texas shows, the oil price drop way below parity will trigger a deflationary collapse in real estate, and could pull the entire rotten banking system down with it.

The only way to avoid this disastrous result is for Congress to break from the illusion that the "free market" will save us, and impose an oil parity tariff. Under the tariff, the difference between the current price, and the $20 a barrel parity price, will be taken as revenue by the federal government. The maintenance of the $20 price will at the same time protect our oil production and exploration, which are, in fact, vital for national security.

Such a protective tariff, in defense of the national oil supply and the nation's financial health, is one of an array of measures outlined needed to prevent a financial collapse in 1986. It follows in the tradition of Alexander Hamilton, Abraham Lincoln, and the school of American System economists, who built our nation on a program which united workers and industrialists in pursuit of progress, and used governmental powers to implement it.

Opposition to such a program is not only financial lunacy, but in the tradition of those "free traders" who opposed the formation of the United States as a republic, and the preservation of the United States by President Abraham Lincoln.

Table 3
### Texas unemployment statistics
(percent)

| Area | Feb. 1986 | Jan. 1986 |
|---|---|---|
| Abilene | 7.7 | 5.6 |
| Amarillo | 7.3 | 5.9 |
| Austin | 5.4 | 4.4 |
| Beaumont/Port Arthur | 15.7 | 12.6 |
| Brazoria | 11.1 | 8.9 |
| Brownsville/Harlingen | 18.7 | 13.7 |
| Bryan/College Station | 6.2 | 4.7 |
| Corpus Christi | 11.6 | 9.4 |
| Dallas | 5.8 | 4.7 |
| El Paso | 12.0 | 9.3 |
| Fort Worth/Arlington | 6.3 | 4.9 |
| Galveston/Texas City | 12.4 | 9.8 |
| Houston | 9.6 | 7.4 |
| McAllen/Edinburg/Mission | 22.7 | 18.5 |

Source: Texas Employment Commission

the year, Baker expects to have only half of the 33,000 people it employed during peak year 1982.

- **Texas Oil & Gas,** the Dallas-based subsidiary of U.S. Steel, has announced company-wide layoffs of 15%. Another U.S. Steel subsidiary, Marathon, is cutting back its capital spending by one-half for the next fiscal year, and cutting the remainder in half the year after.
- **Dresser** Industries' Dresser Atlas unit laid off 100 workers in Houston.
- **Damson Oil** laid off 8% of its Houston workforce.
- **Diamond Shamrock** announced layoffs.
- **Chevron** plans to reduce its worldwide work force by 10 to 15% this year, plus cut other expenses by 30%.
- **Exxon** has announced spending cuts of 26% worldwide and 36% in the United States.
- **Lone Star Steel** has announced plans to lay off over half of its 4,100 employees; all but about 90 of the company's employees work at its major manufacturing facility at Lone Star, Texas (population 2,036). The layoffs are expected to be complete by the end of March, and will be across the board, including management, salaried employees, and production workers. In 1982, Lone Star employed 6,000 and had a booming market for its oil field pipe. Lone Star, Texas is in Morris County, which, according to Texas Employment Commission figures, saw its unemployment rate skyrocket in 1982, from 4.6% to 43.8% in less than a year, when Lone Star laid off 4,000 and virtually shut down operations; over 1,500 workers left the county and the tax base dwindled from $1.7 billion to $1 billion.

General Motors Acceptance Corporation, Chrysler Credit Corporation, and the other major auto finance companies hold weekly auctions in Houston, and every other major city in the United States. Houston auctions normally brought about 150 cars to market, sold to local used-car dealers. During the past two months, however, dealers from around the country began flying into Houston, as up to 1,000 cars, predominantly one- and two-year-old vehicles, turned up at the auctions. These included not only cars repossessed from private individuals, but company fleets dumped into the dealer auctions as well. Dealers report that a one-year-old car that sold for $12,000 new can be had for $6,000 or less.

The affluent population of Texas is going bankrupt, at a rate that escapes the already-alarming unemployment and other data. The real-estate market in Texas, especially in Houston, continues to collapse, as indicated by the foreclosure rate on homes. At one point last year, Houston alone had more home foreclosures than any *state* apart from Texas; as **Table 4** shows, the foreclosure rate is rapidly accelerating.

Houston's foreclosure total for 1985 of over 17,000 compares with only 9,000 in 1984. At least 47,000 homes are now on the market in Houston, and the figure is rising. This flood of homes has helped drive down home prices considerably, and many homes have lost 25% of their market value over the last year. A growing number of homeowners, seeing that their homes are not worth what is owed on their mortgages, are simply walking away from their homes.

Government lending agencies, including the Federal Home & Loan Mortgage Corp. (Freddie Mac), and the Veterans Administration, have resorted to auctioning houses to offset losses from foreclosure. At one Veterans Administration auction in March, several bidders needed only Visa cards to buy three bedroom houses for less than $5,000, and one four bedroom house equipped with fire place, sun deck, and Jacuzzi sold for less than $10,000.

Texans have a different view of their beleaguered commercial banks than they did of the Alamo. Their directors are bailing out before the bailiffs move in. *EIR*'s previous issue examined Texas banks' balance sheets, and concluded that the combination of an energy and real-estate collapse would wipe out 9 of the 10 biggest Texas banks.

The boardroom of BancTexas, whose fate may be decided while this issue of *EIR* goes to print, is virtually deserted. Nine directors have resigned in the past six months, leaving the bank with just six directors, four of whom work for the bank. The $1.8 billion, 12-bank holding company, 10th largest in Texas, lost $24 million in the fourth quarter of 1985, leaving it with a 5.4% primary capital ratio (primary capital to liabilities), less than the federally required 5.5%. BancTexas has been under a "supervisory agreement" with the Fed since 1984, and currently 5.01% of its assets are listed as non-performing.

Four directors of Texas Commerce Bancshares, the fourth-largest bank company in Texas, have resigned, due to their problems in repaying commercial loans to TCB's Houston

Table 5

### Top 10 Texas banks' non-performing assets December 1985

($)

| Bank | Non-performing | % non-performing |
|---|---|---|
| RepublicBank, Dallas | 18,603,700 | 3.54 |
| InterFirst, Dallas | 18,959,000 | 4.87 |
| MCorp, Dallas | 18,184,000 | 3.49 |
| Texas Commerce, Houston | 16,985,000 | 4.90 |
| First City, Houston | 14,620,700 | 4.95 |
| Allied, Houston | 8,972,200 | 4.60 |
| Texas American, Fort Worth | 5,380,800 | 3.48 |
| Cullen/Frost, San Antonio | 2,943,800 | 3.51 |
| National, San Antonio | 2,417,900 | 2.46 |
| BancTexas, Dallas* | 1,548,600 | 5.01 |

* As of Sept. 30, 1985

bank, the holding company's flagship. Henry F. LeMieux, chairman of Raymond Holdings, stepped down last June, although his resignation was first announced in March. Raymond Holdings owed TCB $30 million, of which $18 million has been written off. Robert R. Shelton resigned in August, due to problems with $37 million in loans to his Shelton Ranch Corp. Resigning last month was oil-and-lumberman Thomas L. Carter, who has about $6.3 million in problem loans. Carter has been on the board of TCB since 1971, when the holding company was founded; Shelton joined in 1973 and LeMieux in 1977. Another director, Pat Rutherford, resigned last year over bad loans.

According to the Federal Deposit Insurance Corporation's March 24 statement, 563 U.S. banks have lent a collective $60 billion to more than 600 independent energy producers who stand to be ruined by the collapse in oil prices. This $60 billion amounts to 25% of the aggregate capital of these banks. However, $57 billion of these loans were held by large regional banks with assets of more than $1 billion each. The regional banks which hold the overwhelming majority of energy exposure are concentrated in Arkansas, Louisiana, New Mexico, Oklahoma, and Texas.

Federal bank examiners are now treating Texas as a potential disaster area, and the imminent failure of several major banks, including First City National Bank and BancTexas of Houston, has been the subject of widespread speculation.

The Federal Home Loan Board Bank (FHLBB) of Dallas, the Texas agency of the nation's savings-and-loan regulator, has more than doubled the size of its examining staff, bringing in 250 savings and loan examiners from around the country, to supplement its staff of 180 examiners. On top of that, the FHLBB hired Arthur Young & Co., Peat Marwick Mitchell, and Deloitte, Haskins and Sells, in preparation for an "intensive look" at 200 of the region's 488 thrifts. As of Sept.

Table 6

### Survey of Houston construction based on value of building permits issued

(million $)

| Category | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| Residential | 665 | 576 | 586 | 343 | 101 |
| Office/bank/prof. | 1,225 | 1,040 | 273 | 284 | 153 |
| Industrial | 146 | 121 | 23 | 30 | 17 |
| Public works/utilities | 38 | 26 | 164 | 25 | 61 |
| Stores/mercantile | 46 | 88 | 154 | 167 | 114 |
| Total construction | 3,056 | 2,886 | 1,979 | 1,614 | |

Source: Kirksey-Meyers architects, Houston

30, 1985, there were enough troubled S&Ls in Texas alone to drain the Federal Savings and Loan Insurance Corporation (FSLIC), the national insurance agency for S&Ls, of its entire $3.8 billion in uncommitted funds. The Dallas bank handles a region including Texas, Arkansas, Mississippi, Louisiana, and New Mexico; Texas has 269 of the 488 thrifts.

Paul Horvitz, a director of the Dallas FHLBB, said some insolvent S&Ls will remain open while they try to heal their wounds. "We're forced to do this by necessity," he said. "The FSLIC doesn't have the resources or the people to liquidate all the problems."

Even while oil prices remained at $28 per barrel, the major Texas banks listed a total of problem loans approaching their shareholders' capital. Oil at $10 will multiply that total by a factor of three or four. A bank may have non-performing loans in the range of its shareholders capital, but write them off over several years—providing that there is a future stream of profit. With collapsing revenues, the Texas banks' volume of problem loans prior to the oil price collapse represent an inoperable cancer (see **Table 5**):

But Texas banks have only 11% of their assets in energy, compared to 36% in real estate. In a market where *current* vacancy rates for prime commercial real estate are in the range of 40% *before* the effects of the oil price collapse are fully registered, the real-estate bombshell could take down virtually all of the major Texas banks, producing a situation much worse than that of the 1930s.

In fact, Texas banks reduced their total energy loans from $13.766 billion in 1982 to $12.075 billion in 1985. But they drastically increased their exposure in the real-estate sector. Most real-estate ventures involve a limited cash flow ultimately related to oil income, leveraged with a great deal of outside financing. Oil is the small wheel that turns the big wheel of real-estate speculation; when Texas was afloat in cash following the 1979 price increases, the generous write-offs for real-estate investment of the 1981 tax code drew oil money into real estate, typically with a 1 to 4 gearing ratio.

Although the Texas banks have acted prudently in writing off energy loans, they have hardly begun to write off their

real-estate loans. We calculate a 20% loan-delinquency rate on commercial real-estate loans nationally on the basis of hard data reported by the Federal Home Loan Bank Board; numerous interviews in the banking and real-estate industry confirm that this figure is, if anything, an underestimate. We calculate a minimum 30% loan-delinquency figure for Texas, based on the higher (40%) Texas vacancy rate for commercial properties. Assuming that the overall Texas rate for real-estate loan delinquencies, including residential properties, is half of the commercial rate, or 15%, writing off bad real-estate loans would cost the banks 5.25% of their total assets, and virtually their entire shareholders' capital. Energy and Third World loans will cost them at least as much, bankrupting all the banks
at least twice over.

New construction spending in Houston has decreased by 60% since 1981, according to a Kirksey-Meyers architects survey of building permits issued by the city:

- $3.056 billion of construction contracts were issued in 1981, compared to $1.163 billion in 1985.
- Housing starts in 1985 were only 17% of 1983 levels, by dollar volume.
- Office construction peaked at $1.225 billion in 1981, and plunged to $153 million in 1985.
- Retail permits dropped from $167 million in 1984 to $114 million in 1985.
- Industrial permits fell from $146 million in 1981, to $17 million in 1985.
- Public-works and utility construction more than doubled over 1984, but at $61 million, fell way short of the peak of $164 million in 1983, as shown in **Table 6.**

Even at the height of the oil boom, social services in major Texas cities provided threadbare protection for indigents and other severely impoverished sections of the population. Tax and service levels were both low, in keeping with the state's free-enterprising self-image.

Now, the implications for local government finances are devastating. The Texas budget is based on $20.08 oil for FY1986 and $15.18 for 1987, while West Texas Intermediate Crude is now hovering around $10.

Only a fraction of the state's 200 agencies have responded to Gov. Mark White's call for 13% spending cuts. The oil price drop has forced a $1.3 billion budget cut on the state; thus far, 11 agencies have proposed cuts totaling a mere $75 million. The state Department of Human Services, one of the larger state agencies, said it would be unable to make the 13% cuts. "There's no way we can find that kind of money without cutting services," said Brian Packard, the agency's associate commissioner for budget issues. "And the governor doesn't want us to cut services. If we come up with half of that, I think we'll be doing good. But I don't know if we can come up with half."

Early in March, Texas senators, in a rare off-year caucus, were told by State Treasurer Ann Richards that Texas may be forced to write "hot checks" to make it through the year. "Right now, the money is going out faster than it is coming in. By mid-December, we will have paid out almost $2 billion more than the state's general revenue fund has in the Treasury. This puts the state in a serious financial crunch," Richards said. "Should these measures fail to cover the state's obligations, the Treasury would have to enter into some variation on an old-style arrangement used in the past, which calls for the state's banks to honor 'hot' warrants. I don't like hot checks, I don't write them. I don't want the state of Texas to write them." If oil prices stabilize at $15 a barrel, she said, the state might be able to "squeak by" through year's end without writing hot checks.

Richards' warning provoked a black comedy in the Senate. Texas State Sen. John Trager (D-Segiun), after a briefing on state finances by treasurer Richards, called for a special legislative session to raise the state's sales tax from 4.125% to 5%. "If the legislature would get up and come down here in June and pass enough taxes—that's heresy, I realize—raise the sales tax to 5%, catastrophe, total catastrophe could be averted. That's the only way it can." A sales tax increase "is as painless, as fair, and as quick a solution as you can find. To hell with politics." Trager, who is retiring, is not up for re-election this year.

Treasurer Richards responded: "In my candid opinion, I don't think it would do you any good," she told the senators. "I think elected officials would be distracted by the fact that they are facing elections back home. . . . On top of that, it's too expensive to call a special session and you don't have the money to pay for it."

Houston Mayor Kathy Whitmire, who campaigned last fall on a platform of "recovery," now admits that the city's revenue will fall $72 million short in FY 1987, and is planning to cut city services accordingly.

Social service agencies in Houston are straining to keep up with the demand for assistance caused by the collapsing economy. United Way, the umbrella agency for 80 area services, reports an 84% increase in demand since 1981; United Way served 35,094 people in 1985, up 6% from 1984. However, requests in February 1986 exceeded those of February 1985 by 28%. Since 1981, there has been a 1,159% increase in requests for utility-bill assistance, a 214% increase in food requests, and a 93% increase in requests for general financial assistance.

The Texas Crop and Livestock Reporting Service surveyed 3,700 farmers in the Panhandle and Gulf Coast areas, and more than one out of six said this was their last year in business. In the Panhandle, 23% said they would quit, with 87% citing financial reasons. Along the Gulf Coast, 19% will quit. Overall, 68% cited financial reasons as their primary reason for leaving. Texas has about 184,000 farmers and ranchers. The Texas Department of Agriculture said that the Texas percentages are about double the level of Iowa farmers experiencing economic problems, according to a similar survey, and suggest the worst of the farm depression is moving into the Sun Belt.