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Re-run of 1979 'oil shock' ahead?

by William Engdahl

Since the first week of July, according to reliable West European oil trading sources, Mideast OPEC producers have increased their sales of oil by at least 2 million barrels/day to the major oil multinational companies and others. Despite this apparent "oversupply" given present world demand, the market price of crude has steadily risen by slightly more than $2/barrel. With the July 31 Iranian riots in the Saudi holy city of Mecca, world oil traders rapidly bid the price up an additional $1/bbl to the highest level in 18 months, $21, for North Sea Brent, September delivery.

Within hours of the Mecca riots, Japanese trading companies began predicting a possible return to the 1980 levels of $40/bbl should the crisis escalate to threatened Iranian sinking of tankers attempting to pass through the narrow Strait of Hormuz. World press has been featuring various diagrams showing why tankers needed to briefly enter Iranian territorial waters before leaving the vulnerable Arabian Gulf for open waters of the Gulf of Oman. By week's end, prices had sunk again to the $20 level just prior to the Mecca riots. The critical question being analyzed around the world, is the extent to which world oil price markets are vulnerable to threatened supply disruption, as in 1979.

Supply situation has changed

Many important factors have changed since the Khomeini coup of 1979. According to trading sources in Switzerland and Britain, between 6.5 and 7.5 million barrels/day of crude oil are delivered out of the Strait of Hormuz. This represents some 15% of the present non-communist world daily consumption of 45 million barrels per day, enough to trigger the automatic 19-nation International Energy Agency emergency rationing and reserve-sharing agreements, which go into effect at 7%. On the surface, it would seem serious grounds for alarm and price rises.

But this does not account for a number of developments. Most important perhaps is the fact that Saudi Arabia, the largest potential oil producer, with estimated capacities to pump from 10.4 to even 11 million bpd, has immense underutilized reserve pipeline capacity running to the western Red Sea. Best estimates are that Saudi pipeline output, combined with a new .5 million bpd Iraq-Turkey pipeline which began operation in late July, could quickly replace almost 50% of any Gulf losses, or 3.5 million bpd. In addition, traders report a substantial Saudi "floating reserve" as well as tanker terminal storage in the region around Yanbu on the Red Sea—how big, is classified information.

Estimates range into the millions of barrels for this reserve stock. The major Western oil companies, for the past month, are reported to have significantly increased their purchases from the Gulf OPEC producers. One report is that the Saudi government has in effect given long-time Aramco partner Texaco a de facto "letter of credit" to make large purchases of Saudi crude at bargain contract prices during the recent market rise. This has allowed the U.S. major to buy the bargain oil despite its current bankruptcy imbroglio with Pennzoil.

"There's a lot of oil floating on the high seas right now," one well-informed Swiss trader confirmed to *EIR*. "The major companies have plenty of oil in the pipes. World stocks are estimated at higher than a 100-day supply right now." In addition, a "worst-case scenario" of prolonged Persian Gulf disruption, would increase supply from a variety of other regions.

Instead of supply disruption, we may see unprecedented price disruption. Many traders peg a relative price jump level of at least $30/bbl. Some, like the Japanese traders, calculate a return to the all-time high of $40. Why?

'The Wall Street refiners'

"The difference today from 1979 is the complete change in form of world oil trade," one leading trader emphasized. "In 1979, all but about 3% of world oil trade was done in fixed long-term contracts between largely the major companies and suppliers like Saudi Arabia or Iran. Today, more than 70% of all oil is traded on speculative spot or futures markets. These markets do not deal in physical cargoes of crude, but in hedges and speculation about future market price conditions. This situation allows huge speculators to move the price market. The NYMEX pulls today's price of oil," he stressed.

A spokesman for the authoritative *Petroleum Argus,* a London-based trading monitor, predicted that in event of any supply disruption, "the market would simply go wild. There will be hoarding, companies will sit on stocks in anticipation of selling at far higher prices. The new danger, is the percentage of oil now traded on spot and commodity futures markets is far higher than in 1979. No one can predict how these new markets will react to a supply disruption. This is the million dollar question."

The price is falling again because, "so far nothing has concretely yet happened to disrupt oil supplies," as one London broker put it. As soon as it does, it could rise far more than any temporary supply disruption would warrant. This would mean a brief windfall for Chase Manhattan, Citibank, and a few others. But the ability to sustain such price levels is even far less than the brief 18 months or so of 1979-80, when "oil was king."

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