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DRILLING AHEAD

Will high oil prices be sustained?

Mike Killalea, Editor & Publisher

WITH OIL PRICES soaring to $23 in early September, the E&P industry is finally allowing itself to anticipate better times after a sudden and disastrous crash earlier this year. Nonetheless, the eminent oil politician and veteran analyst **Ahmed Zaki Yamani** doubts high prices are sustainable for long. Dashing cold water on warming expectations, the celebrated former Saudi Oil Minister even suggests that high oil prices may not be OPEC's best long-term strategy.

Mr Yamani said the drive to increase oil prices stems from "OPEC's misguided mindset".

"Who needs higher oil prices?" he asked. "There's nothing wrong with stabilizing oil prices within a band. The problem is the band that was chosen.

"In my opinion $18-$21 is too high."

Mr Yamani spoke at a conference co-sponsored by the London-based **Center for Global Energy Studies** and ***Oil & Gas Journal***. Mr Yamani is chairman and founder of CGES, which he established in 1990.

A CALL FOR HIGHER QUOTAS

"The oil industry still faces serious challenges, notwithstanding the high oil prices we are seeing at present," Mr Yamani remarked. "OPEC's actions have not really solved any of the deep-seated and longstanding problems that plague the industry. Indeed, I would argue that the OPEC-engineered oil-price rises of 1999 have *added* to the industry's catalogue of worries.... OPEC has hardly achieved a resounding success. It has merely averted disaster."

Mr Yamani recomended that OPEC announce at its next meeting that production will increase in March. This, he said, would cool "overheated" prices.

Further, he says the cartel should develop a long-term strategy for stability. He did not propose a price level or range.

EXCESS CAPACITY AT 10%

Mr Yamani said that the 43% increase in oil price achieved by OPEC quotas was reached by shutting in nearly 4 MM bbl/day of oil production since April. "Its excess capacity right now is no less than 7.5 MM bbl/day, representing 10% of world consumption," Mr Yamani said. "Such a massive amount of oil—ready to be produced at almost a moment's notice—will keep on hanging like Damocles' sword over the oil market, with one country in particular seemingly carrying the whole burden."

That country, of course, is Saudi Arabia, home to 43% of the excess. Mr Yamani attributed another 40% to Iran, Kuwait, UAE and Venezuela.

Mr Yamani observed that the market has not seen excess capacity above 9% since 1988.

WILL OPEC BOOST CAPACITY?

While the OPEC of late has exhibited refreshing discipline, Mr Yamani predicts that the temptation to cheat will prove irresistable as prices rise.

"There is little doubt that higher oil prices encourage increased output," he said. Mr Yamani pointed to the cycle of the late '70s through '86, when high prices resulted in increased output worldwide, ultimately leading to a catastrophic price crash.

"History has shown that OPEC disregards this at its peril," he said.

Nonetheless, OPEC is already preparing to increase capacity, Mr Yamani warned. Several OPEC nations have invited foreign firms to assist. Iran, the UAE and Kuwait, for instance, are working toward capacity increases of 2 MM bbl/day. Iraq, he said, should realize production increases of 3 MM bbl/day within 3 years of sanctions being lifted. Saudi Arabia also seeks to increase capacity.

NON-OPEC SUPPLY

As E&P folks in the non-OPEC world hope, higher prices will also coax increased production and capital investment outside the sphere of the cartel, Mr Yamani confirmed.

"Already, Canadian upstreamers are revving up their capex in the second half of '99, having slashed expenditures by around 20% last year," he said. In Canada, the heavy-oil producers are leading the pack in increased spending.

As in '97 and early '98, higher prices will

inevitably increase US and North Sea production, he said.

From OPEC's standpoint, though, encouraging production outside the cartel diverts market share. This is not obviously in OPEC's best interest.

THE COST OF RESTRAINT

Further, maintaining idle capacity is costly, Mr Yamani said. CGES estimates the price tag to Saudi Arabia at $500 million annually. This increases their per-barrel production cost by 17 cents. In Venezuela, the cost is some $240 million per year, or 24 cents/bbl of production.

"Restraining output obviously pushes prices up and improves the OPEC countries' financial situation in the short term, but it comes with some heavy baggage, too," Mr Yamani said. "There are no free lunches when it comes to idle capacity."

DAMPENING DEMAND

Mr Yamani also argues that higher oil prices will dampen demand. He noted that the full stop in Far Eastern oil demand late last year was a principal culprit in the recent price crash. Now those economies are recovering, and so is the Far Eastern appetite for oil.

But, Mr Yamani cautioned, "The doubling of crude prices since February is hardly likely to help oil demand growth in that region."

AND IF THAT'S NOT ENOUGH...

If that's not worriesome enough, Mr Yamani gloomily ticked off specters even more ominous. Chief among them is the 1997 Kyoto Protocol, which seeks to limit hydrocarbon consumption, especially among developed nations.

"The Kyoto Protocol requires a substantial worldwide cut in hydrocarbon consumption simply through government fiat," he said. The upshot will be higher taxes and regulations designed to discourage oil consumption.

Further out on the horizon, Mr Yamani worried over technical developments with the potential to shoulder oil aside. He cited the evolution of gas-to-liquid technology and fuel cells. Fuel cells, more efficient than conventional internal-combustion engines, run on hydrogen created by breaking down methane. Some automobile and oil companies are reportedly collaborating to develop fuel-cell engines for vehicles. While these advances should not sadden gas producers, they hardly spell out a bright future for oil-dominated basins.

If these dark premonitions come to pass, oil, having fueled the 20th Century, could in the next millennium be as dead as the ancient algae that formed it. It's an unlikely immediate scenario, but down the road, who can say? ■

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CAPITAL WIRELINES

WTO: Free trade urged for energy services

Brian T Petty, Senior Vice President-Government Affairs

WTO Energy Services (Geneva)—IADC and 30 other energy companies and groups have urged the US Trade Representative to embrace global free trade for energy services, including drilling. A letter urging that commitment to USTR Ambassador **Barshefsky** from the Energy Services Coalition comes in advance of the launch of the General Agreement on Trade in Services 2000 negotiations during the upcoming World Trade Organization ministerial meeting in Seattle, which takes place this 30 Nov-3 Dec. The GATS negotiations have been organized under the auspices of the 135-member nations of the WTO. The GATS will be the first multilateral agreement to provide legally enforceable rights to trade in all services, according to the WTO. It will then provide a built-in opportunity for additional liberalization through periodic negotiations.

The ESC letter stated "Our group of energy companies, associations and organizations would recommend a strong United States position on liberalizing non-tariff barriers to energy services. As state-owned vertically integrated energy companies around the world become disaggregated and privatized and regulations liberalized, economic activities which we consider services will be developed and supplied by independent operators under competitive conditions. These should now be included in multilateral trade negotiations." Ambassador Barshefsky has replied that she agrees that energy services should be a high priority for the Seattle meeting.

In the pursuit of garnering support from US trading partners for this initiative, IADC has appealed to the International Association of Oil and Gas Producers to prompt parallel support within the European Union, which would strengthen USTR's position in advocating ESC's case in Seattle. Additionally, the ESC is attempting to enlist the support of the state-owned oil and gas companies of major energy-producing countries, including Brazil, Mexico, Norway and Venezuela. Arguments for oil and gas operators worldwide include:

• "Energy services" encompass a very broad range of contractors, suppliers and transporters for the oil and gas industry;

• Major oil and gas producers need to select the services necessary to support E&P programs as they deem best, especially to safely develop hydrocarbon resources around the world;

• In many places in the world, oil companies are required to source energy services "locally" without regard to their efficiency or reliability, but as required to serve the political interests of the licensing authority;

• In pursuing a "sectoral" approach to liberalize and make transparent the procurement of energy services in this next round of the WTO, there is an opportunity to enable the global oil and gas producing industry to select services and contractors who demonstrate best practices in ensuring personnel and environmental safety;

• Reducing trade barriers to energy services around the world would also reduce the cost of recovery for major oil and gas companies operating in, especially, developing countries.

IADC Senior Vice President-Government Affairs Brian Petty serves on the Executive Committee of the ESC, and has been designated as an industry representative to the WTO meeting in Seattle by the USTR. ■

NOBLE SETS DEEPWATER RECORD

A ROUND OF applause is due **Noble Drilling** for setting a world record for deepwater drilling. Noble announced that its EVA-4000 semisubmersible Paul Wolff drilled a well in 8,017 ft of water for **Petrobras**. The Paul Wolff, designed for water depths to 8,900 ft, is working for Petrobras under an initial 6-year contract that began in May. ■