Challenges and opportunities facing the international oil industry

by

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Introduction

Ladies and gentlemen,

Even though we are now well into the 1990s, the outlook for the international oil industry up to the year 2000 is by no means clear and requires our constant attention. Conferences such as this have an inestimable value, in that they enable us to set aside our day-to-day activities for a short while and take a closer look at our industry; in this way, we are able to identify future trends and, where possible, influence them to the common good. It is with this in mind, therefore, that I wish to thank the organizers of the Spring International Conference for inviting me to deliver this speech.

I have divided this address into two sections. In the first, I discuss the broad range of challenges facing the industry as we move towards the 21st century. Here, I identify four broad areas, entitled the quantity of oil supply, its quality, oil’s image and the industry’s broader responsibilities. The second section looks at the opportunities we have to meet these challenges; they include making the best use of the new world economic and political order, deriving the maximum benefit from a more unified international oil industry, and participating in full in environmental and other fora aimed at realigning the global energy mix.

If some of the categories in this address appear contrived, then it is because it is difficult to treat separately issues which, by their very nature, are interlinked. Challenges incorporate opportunities and opportunities lead to challenges; it is difficult to know where to draw the line. What is important is to cover the main issues.

Challenges

1. Quantity of supply

The principal challenge facing any commodity sector is to ensure the satisfaction of basic market forces, in other words, that supply meets demand. Linking these two elements is the issue of price.

At the present time, the market is relatively stable, with prices of the major international light crudes hovering around the $16–20 per barrel mark and displaying a gradual upward trend. OPEC’s price marker ‘basket’ of seven crudes averages out at just below $18 per barrel. While this is below our reference level of $21 per barrel, it nevertheless represents an encouraging rise from the average of $16.74 for the weak first quarter of the year. In short, the oil market represents a mixed blessing for us at the present time — relatively weak, but relatively stable, with output slightly above OPEC’s designated ceiling of 22.982 million barrels per day.
Potentially, the biggest market challenge facing us in the short-to-medium term is the effect of the lifting of United Nations sanctions on Iraqi oil exports, when this materializes. Will the market be able to absorb what may transpire to be a sudden surge of supply on the world market, without too big an impact on prices? In this respect, it is important to note that the mere decision to lift sanctions — even before the actual release of the first drop of Iraqi oil — may lose a dollar or two from the price of a barrel, in this sensitive international commodity sector. At the present time, Kuwaiti oil exports are expanding on the world market, but this is at a more orderly pace and thus can be more easily accommodated.

A big question mark hangs over the supply situation from the former Soviet Union. While production has fallen dramatically in this region since the mid-1980s, so has domestic consumption, thus reducing the potential impact on exports. Nevertheless, there has been a significant net loss in exports to the world market. How and when the situation revives in the former Soviet Union is anyone’s guess; the issues at stake extend beyond the indigenous energy sector and general economic considerations, and impact upon matters of national politics and sovereignty.

Looking to the longer term, there is little doubt that there will be a continued absolute rise in world demand for oil throughout this decade and into the 21st century. The big question is, however, by how much? There is also an important supplementary question: what about demand for oil relative to demand for energy generally? The consensus of present projections indicates a decline.

OPEC’s projections show that, for the 1990s, world gross domestic product, outside the former centrally planned economies, will grow at an average annual rate of 2.7 per cent, world energy demand at 1.9 per cent and world oil demand at 1.1 per cent. This assumes a real price of $21 per barrel for OPEC’s basket of seven crudes throughout this period. The pace-setting group, in terms of expansion rates, will be the newly industrializing countries, especially from the Asia-Pacific region, as has been the case for the past few years. In absolute terms, however, the OECD nations will continue to dominate world demand. In the year 2000, they will account for 70 per cent of the projected world energy demand of 131 million barrels of oil equivalent per day and 67 per cent of world oil demand of 58 million barrels per day.

World oil demand, excluding the former CPEs, is projected to be 5.9 million barrels per day higher in the year 2000 than in 1990. Moreover, during the decade, with non-OPEC production already on the decline, there is expected to be an increased call on OPEC oil of 7.1 million barrels per day by the end of the century, compared with the Organization’s existing production levels. Does OPEC have the potential to meet this?

In terms of reserve strength, yes. At present production rates, our reserves are forecast to last for another 91 years, whereas those for the rest of the world, excluding the former CPEs, have a life expectancy of only 19 years. This great discrepancy between OPEC and non-OPEC exists because of a longstanding phenomenon in the international oil market, whereby OPEC possesses 84 per cent of world reserves, yet accounts for only 51 per cent of its production. To add to this, I must also point out that the OPEC area, especially the Middle East, has been less intensively explored than most other oil-producing regions in the world, so that the
reserves-to-production imbalance may turn out to be even greater than the above figures suggest.

While OPEC has the reserve strength to meet this anticipated high level of demand, its present sustainable production capacity is well short of the forecast supply requirement of 31.4 million barrels a day for the Organization’s oil in the year 2000. Therefore there is a need to expand capacity substantially and this will involve heavy investment in what has traditionally been a capital-intensive industry.

In the upstream sector of the oil industry, there are two aspects to investment. One is to maintain production from existing oil fields, while the other is to develop additional reserves from new fields. It has been estimated that up to $80 billion needs to be invested in OPEC countries during the next five years to enable them to meet world demand — and this excludes the damage caused to the Iraqi and Kuwaiti oil facilities in the recent Gulf War. The investment requirement for non-OPEC countries has been estimated at about $170 billion, making a worldwide total of about $250 billion.

This is, needless to say, a very large sum of money. Much of it will have to come from outside the oil industry. The industry must therefore present a compelling case to potential investors, who may otherwise be inclined to commit their funds to competitive sectors elsewhere in the world economy. The accent must be placed on guaranteeing secure, worthwhile returns for those with the faith to invest in the future of our industry.

2. Quality of supply

So far, in this address, we have concerned ourselves with the quantitative aspect of oil supply to the international oil market. But the challenge facing producers in the 1990s extends beyond this. There is now a greater accent, than in the past, on quality — both of the product itself and of the supporting infrastructure.

Naturally, there are sound economic reasons for this; this has always been the case. But, what is new, from a qualitative point of view, is the far-reaching impact of the environmental debate. This has added a new dimension to the future development of the energy industry as a whole, pervading every aspect of it, from the overall energy mix to the finest details of industrial activity. This raises a host of fundamental issues, only a handful of which can be tackled here.

There is no questioning the wisdom and the correctness of seeking a cleaner, less wasteful, more efficient energy industry, as an end in its own right. At the same time as being beneficial to the environment, this will also help conserve the world’s finite energy resources, most notably fossil fuels. But we must retain a sense of proportion. Environmental harmony is but one of a range of elements which constitute life as it we know it today. We must also remember other equally noble causes, such as the vast gulf between rich and poor nations, the ensuing poverty trap, the need to accommodate a rapidly expanding world population in an orderly manner and the necessity for the rational exploitation and utilization of the world’s finite energy sources. The entire package of issues presents the true challenge, not just the environment, important though it is.
What concerns us at OPEC is the substance and validity of many of the items at issue in the energy/environment debate. Last month, we held a two-and-a-half day seminar on the environment in Vienna, with participants coming from many parts of the world, including the United States. The presentations were varied and illuminating, and they left one with a deep-seated feeling of uncertainty about the nature of the environmental problems purportedly associated with the energy industry.

We heard how tenuous is the entire debate on global warming; there is no unimpeachable evidence of the existence of this phenomenon; what is more, the evidence that is on offer is riddled with political undertones. If global warming does in fact exist, there is widespread disagreement among scientists about its real significance. Some claim there may even be a net beneficial effect on the world's life systems. We were also reminded that, less than a decade ago, there was widespread concern about a possible early return to an ice age. This all served to emphasize the dangers of adopting precipitate, so-called remedial measures before it can be irrefutably established that there is today a real problem in the first place.

What lies beyond any shadow of a doubt is that the imposition of environmental measures will not be cheap, in whatever shape or form they occur and at whichever part of the upstream/downstream spectrum. Extensive research must be undertaken; new technologies developed; existing plant and machinery dismantled or upgraded before the end of their natural life; new equipment purchased and installed; long-established trading routes and practices revised; and so forth. In many refining and petrochemical activities, the output per barrel of crude will be reduced. In listing such probabilities, please do not misinterpret my intentions; I am not making a value judgement about the intrinsic worth of such actions. All I am saying is that there will be a cost and it is very likely that this will be a high cost.

This cost will be enhanced by the proposed imposition of a carbon tax, which we in OPEC view as injudicious and unjust. Oil is taxed heavily enough as it is; in many industrialized countries, well over half the revenue from a barrel of gasoline goes to the government in the form of taxation — this began years ago, long before the subject of the environment achieved its present status on the international political agenda. Additional taxes, even in the name of the environment, will only lead to a worsening of the present imbalance in the world's usage of its natural resources. We also deplore the way in which some countries have subsidized some of their other energy resources, at the same time as penalizing oil, for reasons which are more political than economic or environmental. In the long run, we cannot help feeling that such discriminatory actions will only prove counter-productive, in that future generations will have to pay for them in the form of higher prices and increased market instability.

3. Oil's image

It was made abundantly clear at the OPEC seminar last month that the international oil industry could find itself the target of much unwarranted criticism at the United Nations Conference on Environment and Development in Brazil in June.
On the evidence of past experience, the essence of this criticism would be more political than scientific. We must prepare ourselves to counter such criticism.

This opens up the whole issue of the image of the international oil industry. This has always been a problem, from the earliest days of the industry in the 19th century and well before the establishment of OPEC in 1960. In much of the industrialized world, oil has been envisaged traditionally as cheap and abundant. As a result, when prices rise, for whatever reason, oil producers are hastily — and unjustly — accused of being ‘on the make’, reaping super profits, holding consumers to ransom, and so on.

The harshest criticism is usually reserved for OPEC. All our Member Countries come from the traditionally poorer parts of the world and, as our detractors see it, should not have access to such ‘easy’ wealth. Other producers from the Third World suffer similarly, although their not belonging to a formal Organization weakens the case against them.

The effectiveness of responsible actions by the industry is often compromised by this tarnished image. We must set about the difficult task of repairing this image during the 1990s, if we want wholehearted credibility to be given to our involvement in the environmental and other fora.

Perhaps our biggest image problem revolves around the issue of security of oil supply. To OPEC, this has always appeared surprising because people tend to forget that security of supply is as much in OPEC’s interests as in consumers’. In nearly all our Member Countries, the vast majority of our export revenues come from sales of oil. For the Organization as a whole, we are talking about a figure of four-fifths. There is an acute need for these revenues, to enable our Members to develop their backward economies.

Therefore, we cannot afford to malign the delicate market mechanisms for purposes of pure self-interest, through fear of triggering a backlash that will eventually, and perhaps permanently, reduce these revenues. Students of the industry will see, from their researches, that our Organization’s actions have been consistent with this view over the years. Our market-stabilizing actions, at the outbreak of the Gulf hostilities in August 1990, are but a recent example. On the other hand, what we desire in OPEC is the guarantee of secure markets for our oil, instead of being left with the impression that we are merely suppliers of the last resort.

4. Broader responsibilities

Oil, with its unique blend of attributes, is the pace-setting source in the global energy mix. No other energy source performs such a universal role as oil in today’s industrialized society. Oil is easily transportable and is the most internationally traded energy source.

This prominent bearing on the world energy map assigns the oil industry a special responsibility in international energy affairs. It also draws the industry into a broader global equation. For we do not believe that energy issues can be — or should be — seen as existing in a vacuum. They are all part of a diversity of international economic ingredients which constitute the 20th century way of life —
others include economic development and environmental harmony. They are all interconnected. Some nations are more fortunate than others in having a greater abundance of such ingredients. But this should not disassociate them from the responsibility of concerning themselves with the plight of the less privileged. Oil’s special role in the global energy mix provides us with the opportunity to do this, and we should see it as constituting a very important challenge for all of us.

This can best be put into practice by doing all we can to ensure a stable, orderly oil sector, with a sound eye for the future and equitable returns for all. Oil is too important a commodity to be treated irresponsibly. We must never forget that, however spurious individual claims may be about the life of oil reserves, there is no doubting the fact that such reserves are finite. In other words, they will run out some day. By and large, the world’s more accessible reserves have already been exploited. The process is already becoming more difficult and the costs higher.

Opportunities

Ladies and gentlemen,

We have now identified some of the important challenges facing the oil industry during the 1990s. They can be summarized as supplying the quantity and the quality of the oil demanded, improving the industry’s image and meeting our responsibilities to the world at large. Let us now look at the opportunities we have to meet these challenges.

1. A new global order

Politically and economically speaking, we are witnessing the biggest change in the world’s established order since the Second World War. Even now, it is difficult to predict the eventual outcome. The most significant development has been the dissolution of the Soviet Union, leaving a vacuum in the world political order. This has, for the time being, at least, boosted the international standing of the United States. At the same time, Europe is reorganizing itself economically, creating the biggest consumer market in the world. The Asia-Pacific region has witnessed the most rapid rates of economic growth, a trend which appears likely to continue well into the 1990s. Change elsewhere in the world must not be overlooked — the Middle East, Latin America — although its impact may not be so dramatic on the world order at the present time.

Nevertheless, there is a strong sense of out with the old and in with the new. It is a situation which we, in the oil industry, should be ready to make the best use of, from both the supply and the demand points of view.

From the perspective of supply, the oil-producing areas of the former Soviet Union offer many possibilities, particularly in the medium and long terms, as attempts are made to resurrect the region’s oil industry from the disarray into which it has fallen. Such a prospect would have been considered inconceivable even five
years ago, when this region's oil industry functioned separately to that of the rest of the world.

What must not be overlooked, however, is the fact that many of the established producing countries in the former non-CPE world also offer excellent prospects for investment, with some of them currently producing below capacity at the present time and well below their reserve potential. Most OPEC Member Countries are included in this category.

Turning to the other side of the coin, demand, we can identify the need for a fundamental realignment occurring here. The United States itself is relying increasingly on imports to meet its expanding oil requirement; output from the traditional producing areas is falling and can no longer be compensated for by developments in Alaska. Rapidly growing oil demand from the Asia-Pacific region is similarly beyond the local supply potential, and these countries are looking elsewhere increasingly for their supply. The dissolution of the Soviet Union and COMECOM has destroyed an entire trading system that lasted four decades, and the establishment of new oil supply arrangements is but one of many economic problems facing around 20 countries.

2. Greater industrial unity

The opportunities for taking effective action within the industry have been enhanced in recent years by greater unity. This has been in both a structural sense and a behavioural one.

By structural, I am referring to the trend in the 1980s towards vertical integration, with the national oil companies expanding downstream and the multinational ones upstream. The benefits were numerous and included the diversification of the revenue base, a smoother upstream/downstream flow and better security of demand and supply. Generally, they resulted in a blurring of the divisions between producer and consumer.

This was accompanied by a significant behavioural development within the industry, which began with OPEC and non-OPEC producers sitting round the table together to discuss matters of common interest, most notably the means of bringing order and stability to the international oil market. Eventually, the dialogue included consumers, culminating in the first consumer-producer ministerial seminar in Paris last July. The central focus is no longer confined to the oil market itself, as witnessed by the OPEC-IPEC Ministerial Meeting on the Environment, held in Vienna a fortnight ago.

It cannot be stated too strongly that this more cooperative stance of participants within the industry can only result in good for the industry. It is particularly important in tackling such issues as raising sufficient funds for investment in future production capacity, exploiting technological advances to the full and meeting the stringent demands of the environmental lobby. It is still early days, but we must seize the opportunity to build upon the progress made so far. Consumers have shied away from discussions involving pricing and production levels, on the grounds that market forces should be allowed a free rein. But no market is absolutely free in this far from
perfect world, and we believe that greater flexibility is warranted in this respect, if the market is to prosper in the 1990s.

3. Environmental and other fora

I have included this as a separate category, because of the importance of constructive debate on the future of the industry, in particular in the context of the environmental demands being made upon it. We cannot move in the oil industry, unless the environmental credentials are accommodated simultaneously. Seminars and conferences enable us to put the case for oil and ensure that our industry's interests are properly represented in the evolving global energy mix. They also enable us to take a close look at the industry and see it in its broader global context. If we come well equipped to them, we shall be realizing a valuable opportunity to consolidate oil's position on the global energy agenda.

When participating in such fora, we should embrace the following principles:

— With the expertise, funds and managerial talent available, the oil industry should take the lead in the environmental debate.

— Oil should not be discriminated against, and should be treated fairly, along with the other energy sources.

— The oil, gas, coal and nuclear industries should cooperate with each other, since no single energy type can satisfy the projected increase in energy demand.

— Environmental policy should not be formulated in such a way as to retard economic advancement in the developing world.

Conclusion

Ladies and gentlemen,

I should like to close by saying that you have called upon me to tackle a very big subject in the limited time available. I have sought to isolate what I believe are the important areas in which we should all be heading, in order to provide a sound future for our industry. Let us now seek to exploit these opportunities and meet the many challenges facing us in the oil industry in the 1990s.

Thank you.