Opec production doubling in the next 20 years: is it feasible? Is it desirable?

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Mr Chairman, Excellencies, Ladies and Gentlemen,

Let me first thank the organizers of the seminar for giving me an opportunity to participate in this Opec gathering for first time in ten years. I kept, of course, good souvenirs and friends from my experience with this organization. I would also like to take this occasion to congratulate the present animators of Opec who have succeeded in achieving what we dreamed of during the eighties & nineties : to set a mechanism for stabilizing oil price at a reasonable level by managing production among members countries, a mechanism apparently accepted by other parties of oil industry. Those who are familiar with the complexity of the negotiations for distribution of quotas inside Opec can appreciate the work done and the progress made. I wish long life to this mechanism for the benefit of Opec member countries and the stability of the world oil market and I hope it will survive to the risk of disturbances in economic and geopolitic fronts generated by the tragedy of September 11 in Manhattan.

When I was asked to participate to this seminar, I proposed to participate in the discussion on production capacity. The future of Opec capacity interests not only Opec peoples but also the rest of the world.

For common sense, Opec possesses huge reserves and there is no problem, if we need them it will be enough to call on them.

Opec sustainable production capacity is estimated to be around 32. Some 40% of oil world demand. If we take, for instance, forecasts of institutions such US.DOE, IEA, EU, Opec or IEPE model, although different assumptions and methodologies, we notice that all of them indicate a call for Opec oil between 55 to 60 mbd for the horizon of 2020. The conclusions of these studies are nearly the same : Opec production should increase drastically in order to ensure the global energy balance.

When we remember that since 1980, Opec capacity has stagnated around 30 mbd, what happened in oil industry perceptions to authorize to project such development which was not thinkable in the past twenty years ?

Are only imperatives of global energy balance which make necessary this doubling of Opec production?

Is that level of production easily feasible ? Is the international framework favorable ?

Is it in the interest of Opec countries to increase their production so quickly at this high level? Are there contreparts for Opec?
Answers are not be obvious. My opinion is that such trend should not be considered as granted.

I am not an expert on geology or a reservoir engineer nor a specialized economist on oil production capacity, so I will not approach technical aspects but let me recall some of the challenging issues:

Will the world energy continue to grow enough to make the call for Opec oil necessary?

How Opec countries take advantage of their reserves and low costs to maintain their position in oil supply?

How to reduce fear and risks for importing countries?

What about price’s effects on these forecasts?

Is the opening of the upstream of Opec oil a necessity? What will be the role played by international oil companies and importing countries’ governments?

Will Opec keep the same statut in the future world economy?

If from the ressources point of view, those scenarios are conceivable, what kind of economic and political conditions are necessary to allow a smooth process in that direction. Drawing lessons from the past, leaves us to think that those conditions will involve not only an adaptation of international economic relations but also deep structural reforms in producing countries.

**Oil resources are sufficient, there is no risk of scarcity:**

By 2020, if the world economy grows as we expect and wish, oil demand will reach some 100 to 110 mbd. At this horizon, despite the reluctance of some experts, there is a consensus, for that horizon, about the absence of global resource constraint. However, as I mentioned before, all the scenarios predict the need of a substantial expansion of, nearly a doubling of present Opec capacity. The main reasons are known: Opec countries hold at least 2/3 of the world reserves and cost for finding and producing a barrel of oil are the lowest.

The behaviour of Opec countries will be affected by the way they will solve the equation between long term and short term considerations. Increasing production capacity quickly (without concertation) on the one hand, and maintaining spare capacities with difficulties to defend prices on the other hand. Opec should, therefore, be aware to not increase too much its capacities quicker than oil demand. If spare capacities are too big, competition between producers will be strong and finally negative for prices.
We know that while it is only a technical and economic question to develop oil production capacity in the rest of the world, it is unfortunately still a mix of geopolitical and economic questions when Opec countries are involved.

This mistrust of the so-called risk of dependency could become an obstacle for Opec production expansion.

**Mutual dependency and « security risk » : no discrimination against Opec**

Effectively, we still find as a permanent term of reference of energy policies in western countries, the target of reducing their dependency on oil. Actually we should understand by that Opec or Arab oil. They fear to be « too » dependent on Opec countries. So, for some parties, we can say that it is not desirable to see Opec reaching this level of production.

After a small step back in the nineties with the sentiment that best protections against this risk are: expansion of the market rules, globalisation and interdependency of world economy, the concern for security of supply resurfaced with the renewal of international tensions.

Some analysts consider as a common sense evidence that if Opec production reaches for instance 50% of world oil production, the risk of disruption or scarcity will be considerable. Such a position is not necessarily reasonable:

- First, what level of oil dependency from Opec is considered as « too high »; 25%, 50% or more? There will be always a share for Opec countries and its lack will have an impact on market balance.

- Opec countries are dependent themselves for outlets and oil export revenues, for their strategic and vital imports including food.

Furthermore, one of the consequences of big mergers of some international oil companies we noticed recently will give them 1) a larger financial surface (turn over of one single of the five big new super majors is equal to the total oil revenues of all Opec members ) and 2) more diversification of reserves and sources of production. Such a position will therefore strengthen their bargaining power vis à vis producing countries. From this point of view this merger process will alleviate the risk of dependency.

There is no reason to fear Opec oil dependency. Definitely, oil suppliers will lose more by disruption than buyers. If importing countries wish to get the needed oil quantities from Opec at appropriate timing, they should try to send different messages, more centred on cooperation.

**Oil prices should be incentive**
The future of oil prices and Opec production capacity are interconnected. Change of one of them affects the development of the other. Too high prices reduce the Opec share, and in long term low prices will affect negatively the feasibility of expected production capacity not only in Opec but also for the rest of the world.

To develop progressively and without chock production capacity, Opec countries and oil actors need good signals from prices level. It is difficult to imagine substantial increase of capacity.

**Will Opec keep its present statut during the next decades?**

How to minimize price fluctuations?

Opec faced tough experiences in this field and learned some lessons:

- Too high prices reduce Opec share and finally have a negative impact on the revenues of member countries.

- The consequences of low prices are terrible in social, economic and political aspects.

- Administering the market by fixing an official price is impossible.

- However Opec, with the support of other exporters, can influence, more or less, movements towards a desirable range of fluctuations.

Opec’s role will be decisive in reducing price fluctuations. However to increase its production, Opec needs to cooperate with other actors in the oil industry.

**Mutual benefit in cooperation between IOC’s and NOC’s**

The call and the come back of international oil companies in Opec countries has not the same meaning than before nationalizations. The difference is fundamental: Opec countries have now solved the issue of the sovereignty on their oil resources.

In contrary of opening their upstream, Opec countries are expecting finance and technology from that cooperation. However I would like to draw your attention on another effect: implication of IOC’s will give more confidence to importers and will contribute to reduce therefore the sentiment of risk.

On the other hand, we should be aware that there is also a risk to Opec in having IOC’s participating substantially in their production. Their presence on a
large scale could be in contradiction with the role of regulator for Opec world oil supply.

Effectively, how to solve the conflict between the demand of IOC’s who want to profit quickly from the development of the new oil project on the one hand, and the obligation of Opec members to reduce their production level (even for a short period) in case of Opec decisions. If, for instance, reduction is minor, equally distributed between IOC’s and National oil companies, NOC’s and for a short period, IOC’s could live with it. But what will be their reaction in case of longer period with spare capacities? This issue is in fact the next big challenge for Opec: management of production should necessarily be coupled with coordination in future capacity development.

I believe that one of the conditions of the ability for Opec to continue to play its responsibility in oil market will depend on the solution to this challenge.

I think also that one of the desirable continuations for the ongoing process of opening upstream in Opec countries is to improve market access in OECD countries and to allow more substantially the involvement of producing countries and their NOC’s in the downstream of importing countries. Such behaviour will certainly be considered as positive answer to the opening of Opec upstream. This presents a real opportunity for Opec countries to also benefit from the whole chain of value of their crude oil by establishing fair relations based on crossed interests between IOC’s and NOC’s. This will be in the interests of market stability and mutual security. It will imply removal of various obstacles, including political and legal ones.

**Financing oil and gas development: Opec countries should avoid the trap of external debt.**

Huge financing is needed to develop the projected production capacity. Who is going to support such effort? Is it once again, as in the past two decades, the producing countries themselves, who will increase their external debt in this way?

Through the trap of external debt, they devoted directly or indirectly a large share of their oil revenue to finance oil and gas projects to supply international markets. Some can say: (OK) but it was done in their interest because they make profit by selling hydrocarbons with a good rent. But we also know that it was not completely true. Low prices from the middle of eighties till the end of the nineties coupled with high costs of external debt reduce considerably the real profit of these investments.

The result, as everybody knows, is the increase of their fragility and their weakness through the «vicious circle» of external debt and their dependency.
on oil revenues making them prisoners of that exclusive and finally negative specialisation.

Present financial constraints and experience should lead them to avoid such an approach. Opening the upstream to IOC’s is the beginning of the answer. However, I think that international financial institutions and OECD countries should also contribute by having a more positive position vis a vis the issue of the debt burden of exporting countries.

The danger for Opec countries is in keeping or increasing their already high dependency on volatile oil revenues. If they take a risk by developing their hydrocarbon resources too quickly, wisdom should lead them to keep a watch on the financial needs and try to size them commensurately with their real capacity to use oil revenues efficiently.

Now that their sovereignty is admitted and definitely not contested, Opec countries can gain money through fair taxation of IOC’s activities and also the profits of the NOC’s. And that increased revenue should be directed towards diversifying their economies.

If used correctly, oil revenues could be very profitable for accelerating economic development.

**The need for democracy in producing countries**

If we assume that most of the development of capacity will be financed by outside sources in contrepart of fair taxes, Opec members must devote their revenues to others uses for diversification. But how to ensure that expenses will be more efficient than in the past?

Standard economists propose only one solution: leave market forces to play and you will be guaranteed global economic efficiency.

I think they are right, but only partially. All experiences of economically advanced countries show that, directly or not, government and state intervene in the economic process, not only during crisis or for regulation purposes.

Opec countries are still considered as developing countries or emerging countries. States should continue to act at the economic level, at least to help acceleration and adaptation of their economies through reforms. NOC’s have a strategic role yet to play in developing oil resources in the interests of all the population and the country. Some will object that the reason for the failure in the past was: massive involvement of state controlled companies in all sectors. I will once again follow this though, governments should not be main actors, but state owned companies managed following market rules - why not, if it is the only way to make available some strategic goods or services.
Democratic control is the answer for good and efficient use of oil revenues. The economic standards reached in developed countries are not only the result of market forces but they are also due to the process of control which obliges leaders and managers to be accountable to the community.

The genuine solution is the election of governments and alternance when the majority decides so. Actually, we know that the real development is based not only on economic factors but also on social and political ones.

In my opinion, all the conditions I mentioned before are actually heavily dependent of the achievement of the last one, i.e democracy as the best tool for sustainable development and peace.

Going progressively in that direction would certainly be the right option for oil exporting countries.

Thank you for your attention.