

Comments Prepared for the 3 June 2004 Press Conference

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Russia

Oil production in Russia averaged a bit more than 9 million b/d during the month of May, meaning that its output had roughly matched that of Saudi Arabia. I would guess that for the year 2004 as a whole Russian oil production should average around 9.1 million b/d.

Demand for oil in Russia has been holding roughly constant for the past handful of years, at around 2.5 million b/d. Demand growth in 2003 was less than 1 percent, and there should be little change this year.

Meaning that most of the incremental barrels become available for export. Production should rise by some 700,000 b/d this year, supporting an export volume of around 6.5 million b/d of crude and product.

How does Russia feel about current high prices? Might it take steps to add to supply, in concert with OPEC?

Production growth will be maintained during the year, not in support of OPEC and not out of concern for the consumer.

Rather, whatever growth is achieved should be regarded as supporting the national strategy. As Finance Minister Alexei has stated: "Annually we increase production by 5% to 10%. We are going to maintain this momentum. ... The growth in oil production is planned regardless of prices. Our strategy does not specify that a reduction in prices should influence production. We are going to

increase production in accordance with our strategy.”

In other words, a substantial price drop on the world oil market would not lead to a drop in Russian oil export levels. No particular surprise, as the former Soviet Union had taken the approach. Continue to expand, and sell, whatever the price.

The question now arises: can the growth trend in Russian oil production and exports be maintained? There are conflicting signals coming out of Moscow, and we can find official statements to support whatever answer we choose for that question.

The Russian oil sector has been living off its inheritance, that is, what it inherited from the former Soviet Union in terms of producing oil fields, pipelines, and refineries. Has it been careful with this inheritance, spending it wisely, so to speak, or is it being depleted so as to take advantage of high oil prices?

Let me offer two Russian opinions that foresee limited growth:

The country's energy regulator, that is, the agency monitoring energy producers, has said: “Growth in oil output is to stop in 2005 as some fields are depleted.”

Lukoil is on record as noting that annual production in Russia is to peak at between 9.6 and 10.3 million b/d as early as 2007, then stabilize.

The question comes down to this: where will the new oil come from? East Siberia? Offshore? The Russian sector of the Caspian Sea? The potential is there. All it takes is time and money. A good portion of the money may have to come from the pockets of international oil companies. As time passes, current fields decline, and much of the new oil will have to go to offset these declines.

Iraq

What other country might challenge Saudi Arabia as an oil producer and exporter?

In the minds of the Iraqi opposition that I worked with prior to the war, only Iraq

has that potential. Iraq is second only to Saudi Arabia in terms of proven oil reserves, a number of oil fields have been discovered over the years, but not yet developed, and much of the country remains untouched by the drill bit.

The Iraqi opposition, although not all, thought that a production goal of 6 million b/d by the year 2010 was feasible, with a longer range potential of 12 million b/d.

A few others, not so optimistic, were thinking in the 4 to 4.5 million b/d range for the year 2010. Keep in mind that Iraq has never produced more than 3.5 million b/d, and that level was reached some 25 years ago. Moreover, any industry, neglected and underfunded for more than 20 years, bearing the impact of wars and 12 years of UN sanctions, would suffer greatly, and the Iraqi oil sector is no exception.

But the Iraqi oil sector continues to struggle in its effort to return at least to prewar production and export levels. It is getting close, but then falls back as pipelines are taken out of operation, either by sabotage or because of equipment failures. With pipelines down, exports are constrained and so then is production.

Iraq hit its postwar peak of some 2.3 million b/d in April, with exports around 1.9 million b/d. I would not anticipate much expansion beyond these levels during 2004 and even into 2005.

Time and money again come to the fore. Foreign investment will be essential if the oil sector is to move forward. Iraqi oil is good quality, production costs are low, and there is ready access to ports of export. All conditions attractive to the potential investor. But Iraq is well aware of this attraction and the investment terms will not be easy.

When will a popularly elected, internationally recognized government be in place, ready to negotiate long term oil investment contracts, and will contract terms as well as general conditions in the country be acceptable to the potential investor? Only then will the investor be prepared to come to the negotiating table.

Iraqi oil today is one of promises unfulfilled, of the optimism held early last year

now having been replaced by a strong dose of reality.

Final Comment

Saudi Arabia has something that no other country has, not Russia today, and not Iraq of the future. And that is substantial spare producing capacity, to be used in support of its national interests.

We have searched long and far, seeking a substitute for Persian Gulf oil. The continuing centerpiece of our energy policy has been to encourage US oil companies to explore for oil outside the United States but away from the Persian Gulf. This effort has been encouraging. Caspian oil, West African oil, Russian oil—all are helpful to the importer as he seeks security of supply through diversity of supply.

But production follows reserves, and where are the bulk of oil reserves? In the Gulf. There is no substitute for Saudi oil, not yesterday, not today, not tomorrow.

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