



Bill Jamieson

Doomsters are wrong - there's plenty of oil

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IN A terror-prone world, apprehension is the new fever and the state we're in. It feeds on any new information, no matter that it may be contrary to yesterday's alarm and panic.

Financial markets are now in the grip of Apprehension Fever. Not long ago, the great fear was global deflation. Now, stock markets are in retreat on worries that inflation is back. Only months ago we fretted over America's jobless recovery. Now investors fret over employment numbers that look too buoyant.

Last month, the big worry was China's booming economy driving up commodity prices. Now, we fear a China slump. Interest rates? Yesterday they were too low. Today, the prospect of rising rates has sent fixed-interest markets into a spin.

Among environmental doomsters, the default worry has been the fast rate of energy depletion and low prices for fossil fuels. These have stunted the growth of alternative energy sources, and threatened energy scarcity unless we cover the land with wind farms. Yesterday, the new panic in the markets was of oil prices surging back towards the record highs seen earlier this week.

In the US, there is talk of oil scarcity as the so-called "motoring season" gets under way. And pressure is growing on the Organisation of Petroleum Exporting Countries to relieve supply shortages by stepping up output when it next meets in Beirut on 3 June. Both the Prime Minister and the Chancellor have been pleading for higher output quotas.

At times like these, it pays to sort out real causes for apprehension from the fakes.

Yes, there is an inflation risk. Yes, both Britain and the US are in rate-raising mode. And yes, there are anxieties over terrorist attacks on oil installations. But the world is not running out of oil.

There may be many fears spooking the world's oil markets. But there is no oil "shortage", just as there was no oil "shortage" in the early 1970s or the early 1990s. There are our own apprehensions. And then there are the facts of the matter.

According to a paper in the latest edition of Science magazine, proven world oil reserves exceed one trillion barrels. Overall, the paper reckons that the world retains more than three trillion barrels of recoverable oil resources.

Far from oil "running out" as some might have it, the big story of the oil industry over the past 50 years has been the way in which technological change has continuously worked, not only to yield up new discoveries but also to upgrade the size and extent of existing fields.

The paper, *Never Cry Wolf - Why the Petroleum Age is Far from Over*, cites the example of the Kern River field in California, first discovered in 1899. Calculations in 1942 suggested that 54 million barrels remained. In fact, over the next 44 years the field produced 736 million barrels and in 1986 was reckoned to have another 970 million barrels remaining.

From 1981 to 1996, the estimated volume of oil in 186 well-known giant fields across the world discovered before 1981 rose from 617 to 777 billion barrels - and this without new discoveries.

This trend, the paper argues, is likely to continue. For example, the Kashagan field in Kazakhstan was deemed in the second half of the 1990s to hold between two and four billion barrels. In 2002, after completion of only two exploration and two appraisal wells, estimates were officially raised to between seven and nine billion barrels. In February this year, after four more exploration wells in the area, they were raised again to 13 billion barrels.

Recovery rates from fields worldwide have also increased, from about 22 per cent in 1980 to 35 per cent today.

So why the panic? The real issue, says the article, is that neither major producing countries nor the big oil companies have been keen to invest money in substantial exploration campaigns. One reason has been the fear of creating permanent excess capacity such as in the mid-1980s, when the

oil price tumbled to just \$10 a barrel.

Another is inaccessibility to foreign investment of the largest and cheapest reserves. Yet another is the pressure on publicly-quoted oil companies to concentrate on short-term performance.

So why has the price risen so sharply over the past year? The key reason has been the world economic boom and in particular the emergence of China as a huge oil guzzler. Add to this in recent months the OPEC output cutbacks and fears of terrorist disruption to supplies as the US-led mission in Iraq has backfired spectacularly.

The fear in the markets this week is that if oil stays at or close to \$40 a barrel it will work to shift consumer expectations and trigger an economic slowdown. The oil companies see it another way: the more it looks as if \$40 a barrel is here to stay, the more attractive it is to push ahead with field development.

Much has been made of the headline return of oil prices to "the crisis levels of the early 1970s". These were indeed dark times. And a steep rise in oil prices could fuel inflation and encourage consumers to spend less on other items: the dreaded "stagflation" double-punch.

But we are not back to a 1970s crisis. After adjusting for US inflation, oil needs to rise to about \$80 a barrel to be as high in real terms today as it was back then. And after adjusting for UK inflation, the price would have to be nearer to \$120.

Two other factors should help cool our apprehension on oil. The first is that the price is denominated in dollars, and on currency markets over the past 18 months there has been a sharp fall in the dollar. Thus, in dollar terms, Brent crude may have risen by 30 per cent over the past year. But in sterling terms, the increase has been about 20 per cent. In addition, the world economy overall is much less energy-intensive than it was 30 years ago.

None of this means that we will escape pain if prices do stay high. And poor or vulnerable economies (Africa, southern Asia) stand to be hit the hardest. George Magnus, global economy watcher at UBS, predicts that global output will be 0.1 per cent lower this year and 0.4 per cent lower next were oil prices to end the year above \$32.

What is helping to keep the price up is a push in the US to replenish strategic oil stockpiles. While inventories are rising, they are still 4 per cent

lower than a year ago. That may not seem much. But overall demand is running some 3 per cent higher year on year.

Hence the pressure piling on OPEC to announce a rise in output quotas of 1.5 million barrels a day when it meets next month. The cartel counter-argues that this will make little difference to prices. It is already pumping out two million barrels a day in excess of the official 23.5 million barrels per day limit.

But while the physical impact of a lift in output may be small, the psychological effect could be considerable, taking the speculative froth out of the futures market. Indeed, anything that helps counteract the perception of oil supply vulnerability would help. And as we know only too well, in the Age of Apprehension, small gestures can have big effects.

We have a political problem, and a security problem. But we are most definitely not running out of oil.

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