Can U.S. Petroleum Companies Compete With National Oil Companies?

By Professor James M. Day

THE WORLD IS FACING RECORD HIGH OIL prices. Supply cannot keep up with the demand for crude oil. The Paris-based International Energy Agency (IEA) forecasted an increased world demand of 2.1% in 2005 to 84.3 million barrels per day (b/d) that will reach 120 million (b/d) by 2025. Since 1985 more oil has been produced than discovered and the world is running out of places to look for new sources. As a result, every developed nation has an energy program except the U.S.

Our Presidents and Congress have debated energy policy ad nauseam since the early 1970s. They implemented energy conservation and efficiency programs, developed alternate fuel sources, and improved technology, which helped. But their efforts are already factored into the IEA's estimates, which indicate that the U.S. energy supply has lost ground to demand. The U.S. offers few areas to drill for oil that are not considered environmentally off-limits and which will remain politically inviolate until the price of oil or our national security and economy reach unacceptable levels, which might be too late.

America consumes 25% of the world's oil production, but has only two percent of the world's reserves. The U.S. imports 60% of its petroleum needs, and the nation's crude oil production is declining. Those espousing America's "energy independence" in the near future are dreaming. We must open drilling in conceived environmentally sensitive areas under strict safeguards, conserve oil and *obtain reliable sources of imports.*

Political promises to shift our reliance from the Middle East and the Organization of Petroleum Exporting Countries (OPEC) are a fantasy. The Middle East has 57% of the world's crude oil reserves and OPEC has 72%. America's five major sources of imports are Canada, Mexico and OPEC members Saudi Arabia, Venezuela and Nigeria. All OPEC members, except Saudi Arabia, are currently producing at or near capacity. The only nations with the potential to increase production significantly are Russia, with its own self-serving political agenda; OPEC member Iraq, which is currently unable to produce its potential because of terrorism; OPEC member Iran, which is subject to U.S. sanctions; West Africa and the Caspian and Caucasus nations, which at best might add four million b/d. How the world will increase production by 42% over the next twenty years to produce 120 million b/d is an enigma.

The governments of every major nation, except the U.S., are scrambling to obtain oil supplies as an integral part of their economic and foreign policies. All hold the advantage of owning their minerals and have established national oil companies (NOCs) to develop their resources. NOCs are also responsible for assuring their nations have sufficient oil imports. This includes not merely purchased oil, but cheaper "equity" or "profit" oil from operations that reduce their nations' balance of payments.

In the U.S., minerals are privately owned except on state and federal lands and the outer continental shelf. The government depends on private companies to develop reserves and supply the nation with oil at a profit. The government, however, does little to support them compared to other nations. U.S. oil companies' only edge is their superior technology. NOCs are not constrained by having to earn profits and are backed by

their respective governments, both financially and politically. And, in the quest for oil, government politics and support are crucial in *obtaining or losing* imported oil. A snapshot of U.S. competition is enlightening.

Venezuela via its NOC, Petróleos de Venezuela SA (PdVSA), export 1.5 million b/d to the U.S. They own or have interests in eight U.S. refineries, and market gasoline at 1,400 U.S. Citgo stations. Its left-wing President, Hugo Chávez, has

called for developing nations to unite against U.S. political and economic policies on al-Jazeera and throughout Latin America. President Chávez has also announced plans to sell Citgo's assets and stop exporting oil to the U.S. Strikes at the once-efficient PdVSA resulted in Chávez firing 18,000 employees and lowering PdVSA's oil production. Chávez claims its production is 3.1 million b/d, but the IEA reports that it is only 2.6 million b/d.

Chávez promised to attract private investment, but his raising of royalties, and restricting foreign companies to minority interests, reviewing all thirty-two 1990's private production contracts, ordering their tax returns audited, and raising investment taxes say otherwise. He prefers dealing with governments. Chávez recently visited Iran to discuss cooperative oil and gas ventures. He also signed an agreement with India to finance and develop Venezuelan oil fields to supply India.

China agreed to develop 15 Venezuelan oil fields by offering the incentives to build a railroad in Venezuela and spend $40 million to boost Venezuelan agriculture. Chávez plans to build a 625-mile pipeline to Colombia's Pacific Coast to lower the tanker costs to China. And, if that doesn't come to fruition, he is negotiating with Panama to reverse its 800,000 b/d oil pipeline from the Pacific to the Atlantic that now carries oil Pacific oil to the Texas Gulf coast refineries.

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To win friends, Chávez assured Cuba, Paraguay, Uruguay, Jamaica, and Costa Rica oil at preferential prices. As evidence he uses oil as a political carrot and stick, he renewed an oil agreement with the Dominican Republic after suspending it because of political differences. Agreements on ways to cooperate in energy ventures with Argentina and Brazil were also inked. Chavez's proclamation that "oil is a political weapon" is manifested by his attempt to create Petrosur, a multistate oil company to include all Latin American NOCs.[1]

China was an oil exporter a decade ago. It now imports 2.5 million b/d and the IEA projects its imports will reach 6 million b/d by 2015. With the world's fastest growing economy, its demand for oil is a major cause of price increases. Its NOC, the Chinese National Petroleum Co. (CNPC), has the ability to obtain government loans at little or no interest. Last year, China's President, Hu Jintao, committed to invest $100 billion in Brazil and Argentina in the next ten years tied to oil development agreements. The CNPC and its affiliates have agreements with nine OPEC members and twenty-four other nations, several of whom were blessed with multi-billion dollar loans from Beijing, including Sudan, which is under U.S. sanctions. Nigeria, a major U.S. exporter, has recently offered China exploration agreements.

The CNPC has also set up an office in Canada, which sends 95% of its oil exports to the U.S. (over 2 million b/d). Canada recently raised its estimated conventional oil reserves from 4.8 to 178.8 billion barrels with the addition of tar sands, which are now economically viable due to the current high oil prices. Since the January 2005, China-Canada energy cooperation pact, Chinese companies have purchased interests in three Canadian tar sands companies. In April 2005 CNPC signed an agreement to construct an 800-mile 400,000-b/d pipeline from Alberta's tar-sands region to the Pacific to export one-half of its capacity to China.

China also holds interests in Russian oil companies and is negotiating to build a pipeline from Russia to China to thwart a proposed pipeline to Russia's Pacific Coast as a source of Russian exports to the U.S. and Japan. In March 2005 construction started on a 1,900-mile pipeline from Kazakhstan to China.

India, like China, is one of the world's fastest growing economies. A U.S. competitor for oil not shackled by U.S. sanctions, India is exempt from the Kyoto Treaty. Indian NOCs purchase Iranian oil and have recently signed a government-backed $40 billion agreement to import liquefied natural gas (LNG) and to build a $4 billion pipeline from Iran to either India or the Arabian Sea oil terminals.

India's NOC, Indian Oil Co. (IOC), is on a global hunt to supply India with oil, 70% of which must be imported. The IOC has development contracts with Russia, Venezuela, Egypt, Qatar, Vietnam and Sudan (the latter under U.S. sanctions). In April 2005, India began talks to build a refinery in Saudi Arabia, a major crude exporter, to India to lock up a long-term refined products supply.

Japan, in response to the poor performance of its bureaucratic state-owned Japan National Oil Corp. (JNOC) and Chinese competition, has disbanded the JNOC and anointed Ipex Corp. its "flag oil company." Ipex is 38% government-owned and produces oil in the United Arab Emirates, Australia, Azerbaijan and Russia.

Japan's Iranian oil imports and its agreement to develop Iran's vast Azadegan oil and gas field raised feeble protests from the U.S., which calls for sanctions against Iran. U.S. sanctions

prohibit U.S. companies from investing in Iran, which has the world's second largest natural gas reserves after Russia and the second largest conventional oil reserves after Saudi Arabia.Italy's NOC, ENI Spa, is 30% government-owned and has production in Egypt, Libya, Algeria, Russia and Iran. ENI rattled the oil majors by outmaneuvering ExxonMobil and Shell to became the operator of Kazakhstan's 16.7 Kashagan billion-barrel oil field, the largest oil discovery since Alaska's North Slope 1967 bonanza. ENI funded the building of Kazakhstan's national library and contributed to the building of the prime minister's residence.

Russia's natural gas octopus, Gazprom, was 39% owned by the Kremlin. During the Kremlin's shady takeover of Yukos, Russia's largest and privately-owned crude producer, for tax evasion, it jailed Yokus's billionair chief executive Mikhail Khordorkovsky. The Kremlin-owned Rosneft oil company bought Yukos's crude producing subsidiary at a government auction for $9.4 billion, well below the Russian Justice Ministry's evaluation of $15.7 to $18.3 billion. Rosneft, came up with the cash after China's CNPC prepaid $6 billion for 35 million barrels to be shipped to China through 2010. Gazprom then attempted to grab Rosneft, but failed because of Rosneft's superior Kremlin connections. Russian news reports claim the CNPC will purchase a major interest in Rosneft from the Kremlin for *$7.5* billion, which it will use to purchase Gazprom stock and increase the Kremlin's ownership to over 50%.

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Gazprom holds one-fifth of the world's gas reserves. Its chief executive, Alexei Miller, told Gazprom shareholders in June 2004 that Gazprom would not be just a significant player in the energy market, but it would set the rules of the game. In a press interview, Miller was asked if Gazprom was a tool of Kremlin energy policy. He replied, "What do you think? Of course it is."[2]

The IEA has warned the European Union that it was becoming too reliant on Russian gas, which supplies Western Europe with one-third of its gas needs, including several nations that are 100% dependent. European officials are concerned with the expensive monopoly pricing that allows Russia to subsidize its low domestic gas prices. They also worry about the possibility of their gas being shut off for political reasons under the guise that they fell behind in their payments. This tactic has been used in Armenia, Belarus, Georgia and the Ukraine. Germany, however, may not have reason to be concerned. German Chancellor Gerhard Schroder tries to maintain a relationship with Russian President Vladimir Putin, because Germany relies on Gazprom for 40% of its gas. Also Germany's Ruhrgas AG is the only Western firm to own a major stock interest in Gazprom.

Gazprom's and Russian Lukoil's tentacles have spread to the petroleum producing nations of the Former Soviet Union (FSU) that are plagued by instability and corruption. With the advantage of political influence and pipeline monopolies to Russia built during the FSU, many are captive, such as Moldova, Turkrnenistan and Uzbekistan. Similarly, Georgia, Kyrgyzstan and Tajikistan cannot stray far from Mother Russia's grasping arms. Even Azerbaijan and Kazakhstan, who invited Western oil companies to share in their Caspian Basin riches, cannot fully evade Gazprom's control of the region's pipelines. The Ukraine borrowed $2.9 billion from the Deutsche Bank (Gazprom's Western bank) for oil and gas ventures primarily with Gazprom. Ostensibly to avoid being tied exclusively to Gazprom, the Ukraine invited Germany's Ruhrgas AG (a major Gazprom shareholder) to join the consortium.

Russian politics, varying between hardball and promises to discuss, have been the norm between Presidents Bush and Putin as late as their recent so-called constructive and friendly discussions. Putin talked about increasing trade and investment, but new rules do not match his words. Russia now requires 51% Russian ownership in the development of its oil and gas fields; it cancelled of ExxonMobil's and ChevronTexaco's Sakhalin auction awards; and its export taxes reached $102.60 per metric ton ($14.00 a barrel) on April 1, 2005. The planned pipeline to transport crude and LNG to Russia's Pacific Coast for tanker delivery to the U.S. West Coast and another pipeline to Murmansk to ship crude to the U.S. East Coast are now on the unlit back burner.

Russia passed Saudi Arabia as the world's largest crude producer in 2004– 8,950 million b/d to 8,750 million b/d, notwithstanding Saudi Arabia's estimated crude reserves of 259.4 billion barrels far exceed Russia's 60 billion barrels. (The U.S. ranked third in crude production at 5,400 million b/d, but only has 22.9 billion barrels in reserves.) Russia exported 6,675 million b/d of crude (72% of its production) in 2004, but continues to seek more outside oil for export.

Russian eyes are on Iraq, struggling to pump 2 million b/d with its antiquated production infrastructure and terrorism, but with a reserve capability to produce 6 million b/d. Prior to the U.S. invasion, Russian and U.S major oil companies, accompanied by Commerce Secretary Donald Evans and Energy Secretary Spencer Abraham, met in Houston to divide the Iraq's oil largess. Little came of the meeting except to temper Putin's objections to U.S. military action. Russia, China, France, Italy, Japan and India, to name a few, claim their contracts to develop Iraqi oil fields made during Saddam Hussein's regime and U.N. sanctions are still valid, with Russia holding 40% of the estimated potential new crude production. Out of the billions

U.S. taxpayers contributed to reconstruct Iraq's infrastructure, $3 billion was allocated for the rehabilitation and modernizing of Iraq's oil downstream oil industry. But nothing was spent on the upstream development of the oil fields.

Whether the U.S. government can or will assure that U.S. companies obtain a share of the Iraqi oil is an unanswered question, notwithstanding that many believe we invaded Iraq for its oil. Will U.S. companies have to gamble, like ConocoPhillips by its purchase of 7.59% of Russia's Lukoil for $2 billion with the right to purchase up to 20%? ConocoPhillips hopes to obtain a share of Iraq's 4.9 billion-barrel West Qurna oil field that Lukoil claims it was awarded under Saddam Hussein in 1997.

Calouste Gulbenkian, "Mr. Five Percent" of Mid East oil until the nationalization of Western oil companies in the 1970s, said, "oil friendships are greasy."[3] They can be changed by politics, terrorism or the greasing of palms. During the oil crisis of 1975, the U.N. General Assembly voted 72 to 35 (35 abstentions) in favor of a resolution proclaiming: "Zionism is a form of racism and discrimination,"[4] under the veiled threat of an oil embargo. Every developed nation is making deals and allegiances for its oil security. The European Union is pressing the Gulf oil states of Saudi Arabia, Kuwait, Oman, Qatar, Bahrain and the United Arab Emirates to guarantee an oil supply.

Foreign nations must first protect their economies and national security; thus America cannot depend on foreign nations to supply it with oil. The NOCs have the advantages of not having to earn a profit, and the ability to overspend to secure contracts, particularly China which has a record of failure in honoring its contractual commitments.

The President and the Congress must agree on a viable oil and gas policy that includes government support to U.S. oil companies' efforts to obtain secure petroleum contracts. The Energy bill passed by Congress in August 2005 fostered no meaningful additions to the nation's energy supply, according to the Oil & Gas Journal (August 1, 2005). The only recent energy-related Congressional action was to discourage China's government-controlled and financed China National Offshore Oil Corporation from concluding its $18.5 billion bid for the Unocal Corporation, American's seventh largest company in oil and gas reserves.

The Department of Energy is virtually without power regarding the nation's petroleum needs. The powerless Secretary of Energy and other administration officials must be given the power to assist U.S. petroleum companies and influence the State Department's foreign policy in connection with aid, trade and relations. Sanctions that prevent U.S. companies from investing, while allowing other nations access to the oil, must be removed.

Efforts to support oil companies should not involve giving U.S. petroleum companies tax breaks, grants or incentives, but rather should provide them a level playing field when competing with the Russian Bear, the Chinese Dragon and the multitude of NOCs. Oil and gas reserves are not like turning on a water spigot, they take years to develop. And the time to act is swiftly passing by. BLB

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ENDNOTES: *Professor James M. Day*

1 Hugo Chávez , Council of Hemispheric Affairs, March 28, 2005.

2 Gregory L. White, *Latest Move Seals Gazprom's Role as Energy Giant*, WALL ST. J., Dec. 24, 2004, at A1.

3 JAMES M. DAY, OILMEN AND OTHER SCOUNDRELS 281 (Barricade Books 2004).

4 G.A. Res. 3379, U.N. GAOR, 30th Sess., Agenda Item 68, U.N. Doc. A/RES/3379 (1975).