The coming oil 'shokku'

For more than a decade the world has ignored the infrastructure of its most important primary energy.

Most people still recall the collapse of world oil prices in 1986, which drove Texas and Oklahoma into deep depression. This has lulled many into illusions that the world won't see any new shocks, or as the Japanese called it during the turbulent 1970s, "Oil Shokku," for the foreseeable future.

This is a dangerous folly.

According to confidential industry estimates circulating in the North Sea petroleum sector, within the next three to five years, the price of North Sea Brent oil, the most widely traded "benchmark" oil, will rise steadily to the range of $35 a barrel. This is an increase of 75% in the cost of the world's most important primary energy source, sharply increasing costs in every area of economic life—transportation, electricity, fertilizer. How have we gone from feast to famine so rapidly?

In the matter of a few short years, the United States, the world's largest oil consuming economy, has let itself become import-dependent on foreign oil. January was the first month since 1977 that U.S. oil imports went over 9 million barrels. More alarming, imports are running at 50% of total oil use. Add a dramatic fall in domestic oil production and we have part of the recipe for a new "Oil Shokku." Since the end of 1985 domestic U.S. oil production has plunged by more than 1.3 million barrels per day, most from elimination of a large share of domestic medium-sized independent producers. Washington under George "Big Oil" Bush has let the multis grab "market share" at the expense of domestic interests and national energy security.

So, U.S. oil imports have soared from 3.2 million barrels per day (bpd) in 1985 to 9 million this January. The two major sources are Saudi Arabia and Iraq, together some 1.75 million bpd. Since the Tax Reform Act of 1986, traditional oil drilling tax incentives have been slashed, further cutting new exploration and investment. According to the American Petroleum Institute, U.S. domestic oil output last year suffered its biggest one-year decline ever, and produced the lowest volume in 26 years!

The world's other largest oil producer, the Soviet Union, is in the throes of devastating economic troubles which have spilled over into its vital oil and gas industry. Exact data is hard to obtain; best Western estimates are that already in 1989, Soviet crude oil output slipped markedly, the first time since the oil investment boom of the 1970s. Soviet oil exports are dropping. According to estimates of London oil analyst Mehdi Varzi, this January the Soviets were forced to cut hard currency-earning oil exports to the West by 250,000 bpd. The overall cuts were larger, but pushed onto East European economies where Moscow gets goods instead of hard currency. There cuts ran some 500,000. Since Poland, Czechoslovakia, and the other economies need energy to survive, this Soviet surprise cut has forced them onto the world market, scrambling for OPEC oil.

The Soviets' 750,000 bpd shortfall intersects U.S. production cuts. After the price collapse in the mid-1980s, worldwide investment in costly exploration for large new fields has severely dropped. Last year, North Sea oil production was down sharply, if temporarily. Output for the U.K. sector in 1989 was 30% below the peak 1985 year, to 1.8 million barrels a day.

Now, in this situation, we have the world's largest known concentration of cheap, readily accessible petroleum reserves, the Arabian Gulf. The region is just climbing out of the ashes of one of the most senseless wars in recent history. Oil infrastructure in Iran and Iraq has been ruined. The economies of the other large producers, notably Saudi Arabia, are only beginning to recover from the 1986-88 revenue collapse. This translates into lack of significant investment in new oil production and refining capacity.

A recent estimate by the Paris *Petrostrategies* shows that, whereas OPEC cartel producers got a total "petrodollar" income of $290 billion in the peak year 1980, by 1989 that had fallen to only $111 billion, a drop of 62%. And that amount bought far less new equipment, owing to inflation. Last month, OPEC Secretary General Subroto warned that a growing worldwide energy crisis by the mid-1990s could be averted only if some $60 billion in investment into expanding OPEC production and refining infrastructure were made. He said the sum was far beyond OPEC's internal capacities. In short, OPEC is now running some 23 million bpd, which is more or less the limits of its present capacities.

All in all, the world energy picture is becoming tighter than that proverbial tick on the hound dog's back. It is an ominous setting where someone might be tempted to try to trigger a new oil shock. Keep a close eye on Anglo-Saxon antics.