



THE JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY
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SAUDI ARABIA AND THE INTERNATIONAL OIL MARKET

A TRANSCRIPT OF
THE SPECIAL PRESENTATION BY

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Foreign Minister Prince Saud Al Faisal Address to the Baker Institute

Address by HRH Minister of Foreign Affairs Prince Saud Al Faisal to the Baker Institute for Public Policy, Rice University in Houston, Texas, September 21, 2005. Topic: Saudi Arabia and the International Oil Market.

Ladies and Gentlemen: Allow me to convey my heartfelt condolences to the people of the United States for the suffering, death and destruction brought about by Hurricane Katrina. At the same time allow me to praise this great city of Houston for the noble generosity of its people in offering a very needed assistance in sheltering those who suffered most. Houston has always been a great city and I am very pleased to be here.

Many years ago, when I started my government career in the Ministry of Petroleum, one of your fellow Houstonians gave me advice about traveling in the oil-producing countries of the world. He was what is known in the oil industry as an “old redneck.”

We were sitting in my office in Riyadh on a very hot summer day when he volunteered this unsolicited advice: “When you get to one of them countries,” he said, “the first thing you do is to go to the nearest shop, buy some durable candy, stock up on candles, go to your hotel room, fill the bathtub with water, and wait for the revolution.” I am sure I don’t need to do that in this oil city, I hope.

Before I proceed further, I must apologize to my friend and colleague His Excellency Mr. Al-Naimi, the Minister of Petroleum and Mineral Resources of Saudi Arabia, for delving into his turf. He has my wholehearted blessing to discuss matters relating to our foreign policy any time he wishes.

My topic today is of vital importance to both my country and yours – namely the structural flow in the oil industry. The severe increase in oil prices which we have experienced over the past several years is only a phase of a cumulative process that has been going on for some time.

The developments in the oil industry are important and warrant our full attention. High energy costs can create long term repercussions to the economies of the world that will affect all of us – consumers as well as producers, both in the industrialized and the emerging economies of the world.

It is important, therefore, that our two countries, the largest consumer and the largest producer, make the time available to assess the situation. We must define the issues and review our options

to resolve them before they become too severe to manage. This becomes a matter of urgency and priority for all of us, especially when Saudi-bashing has become fashionable, and allocating blame has become an end in itself.

Crude oil has doubled in price to over \$65 per barrel since 2002. Escalating energy prices have already had some indication of a depressing effect on the global economy.

The risks are too great to leave the solution to market forces alone. Because of global interdependence, depressions create social and political instability which cannot be confined to one region of the world. If not dealt with promptly and reasonably, such instability will spread regardless of the political and economic soundness of any individual nation.

What then is going on in the oil industry?

There are three sets of variables that need to be examined: Production, consumption, and political-psychological variables.

On the crude supply side, there is currently no shortage of oil. However, and for the first time in decades, there is no sizable excess production capacity. This has understandably caused some heated debates about the long-term supply of oil.

Some pessimists, mostly geologists, contrary to their customary nature, are predicting dire shortages in the future, while some optimists, mainly economists, also contrary to their nature, are predicting higher prices would eventually reduce the growth rate of consumption while increasing the growth rate of production. However, all these predictions are at best educated guesses based on uncertain assumptions.

What is indisputable is the finite depletable nature of oil. However global proven oil reserves have increased from 550 billion barrels in 1970 to 1.2 trillion today, and there is no reason why this trend should not continue.

In addressing these uncertainties, I must emphasize Saudi Arabia's proven record of meeting its production commitments irrespective of international crises and political turmoil or even wars. Yes, we have kept our commitment even when wars were being fought in our region, when oil tankers were being set ablaze in the Gulf and when our cities and oil facilities were being attacked by Scud missiles.

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Saudi Arabia has made up for shortfalls in oil production levels by maintaining between 1.5 and 2 million barrels per day of excess capacity at great cost to our industry and economy for the last 20 years.

Saudi Arabia's year-to-date production in 2005 has increased by 700,000 barrels per day from last year. This accounted for more than half of the increase in global demand for that period.

The Kingdom of Saudi Arabia has declared its plan to increase its production capacity by 2.4 million barrels per day by 2009. This represents a net capacity increment of 1.5 million barrels per day while the rest will augment existing capacity. Barring any outside impediments that are beyond our control, we see no problem in achieving this ambitious target.

We have signed drilling contracts, selected project management teams, allocated funds and put the initial engineering plans on the drawing boards. And unless the international companies use up the equipment we have on order and divert contractors from our oil fields to other projects, we see no problem in achieving our objectives.

It is estimated that the total investment needed to increase OPEC production to meet demand by 2025 ranges between U.S. \$258 and 382 billion. The difference of U.S. \$124 billion is due to different estimates in demand projections based on different economic growth assumptions. This gives you an idea of the difficulty of planning investments by producing countries.

Yet, with an attitude of "damned if you do and damned if you don't," we are now – in spite of what we have done and are doing – accused, of all things, of a lack of transparency.

This truly puzzles me. How can we lack transparency when we have published our production capacity, our oil and gas reserves, and our current and future production plans? And we have done so in a manner totally consistent with international norms and standards. In fact, our known practice is to err on the side of underestimating our reserves and potential production.

Let us face it, providing additional data will not stop endless questions and challenges raised by those who get publicity and consulting fees for questioning everything we do. No amount of data and analysis can convince a truly dedicated conspiracy theorist.

The focus on tarnishing proven Saudi performance is largely a distraction from the fact that the key price and supply issues affecting you are not about volumes of production, but rather about gasoline formulations, limited refinery capacities, lack of storage capacity, and the various other restrictions that have paralyzed the energy industry in the Western hemisphere.

Without minimizing the importance of the environmental issues, a balance must be reached between the need for further oil exploration and development and the preservation of the environment. In that respect, Saudi Arabia calls for increased research in this field.

We are ready to join others in developing uniform regulations that are environmentally responsive and sustainable while offering the most effective energy utilization.

In fact, the real energy issues that we need to address today have little to do with Saudi Arabia. Consider the situation with regards to some of the major oil companies.

In recent years, we have witnessed unprecedented mergers and acquisitions on both sides of the Atlantic. Tremendous resources and capabilities have been concentrated within the hands of a few corporations. All of them have the resources and experience to invest in and manage the entire value chain of the oil industry.

The collective expectations were that the oil and gas industry would experience a tremendous revival as a result of such restructuring and integration. But this did not materialize.

It seems that over-regulation made it easy to avoid investing in the needed downstream operations, which are of marginal returns, by tempting investors to seek higher returns and safe investments. The result was a break in the value chain of investments in the industry.

At the risk of angering some of my good friends in the audience, oil companies may have forgotten that calculated risk-taking is the means to higher profit making. They may have opted for the ease of the cautious advice of corporate accountants instead of the spirit of adventure that has characterized the oil industry from its inception.

A critical shortfall in the industry's refining sector has been created, which is totally beyond the control of oil exporters. This in turn has led to a gap between the oil production of crude oil and consumption of refined products.

The consumers are clamoring for more fuels which cannot be supplied due to the lack of refining capacity. This gap traditionally has been bridged by the integrated operations of the oil companies.

To be fair to the oil companies, the main reason for the refinery shortages is the environmental and land use restrictions that limit the construction of domestic refineries. Refinery projects which already require years to construct have to wait for additional years for site approvals, if

such approvals are forthcoming at all. In fact, notwithstanding certain modifications and expansions in existing facilities, not a single refinery was built in the United States during the last three decades.

According to the Energy Information Administration, global refining capacity has only increased by 1.3 million barrels per day over the past five years. Meanwhile, oil demand has increased by over 7 million barrels per day. Today, global refinery capacities stand at 82.7 million barrels per day, over one million barrels short of global demand.

Yet in spite of these refinery bottlenecks, Saudi Arabia is called upon to increase its oil production on a daily basis. Clearly, additional oil production will do little to meet the fuel requirements of the world refined products. We, however, began adding to our refinery capacity in Yanbu and Jubail, our two industrial cities which are the major hubs for our petrochemical and refinery industries, and there is room for more expansion. Today, I heard that we are opening, or are in the process of establishing two refineries with a capacity of 800,000 barrels per day in Saudi Arabia. We therefore invite all investors to join with us to build additional refineries and to expand existing ones, to alleviate the refined products bottlenecks.

This invitation does not require any delays in implementation that would create added cost to the consumers. All it needs is the will to contribute to relieve the pressure that is building. At the same time, we are ready to join any efforts in building facilities in the U.S.

Over-regulation does much to limit supply and raise prices. Gasoline specifications often vary on a state by state basis. Applying standardization would increase the efficiency in managing refineries and allow better utilization of fuel products storage capacities.

The imposition of boutique fuel specifications on a state by state and country by country basis only confounds efforts to formulate global solutions for overall fuel shortages.

The reality is that as oil supplies from the North Sea, Alaska and continental U.S. lag behind demand, heavier crudes with higher sulfur contents will be increasingly needed to meet increased demand. Therefore fuel specifications must be standardized in order to modify refinery processes on a timely basis. This is something which we must resolve urgently if we are to ensure fuel specifications and optimum refinery efficiencies over the next decade.

The question of stability in the Middle East is a major concern in this regard. Conflicts in the region that contains over 65% of the world's oil reserves and 45 % of its gas reserves have been allowed to spiral out of control.

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Regional turmoil and military confrontations have created a volatile atmosphere that undermines investment in the region's oil industry.

This volatility has in turn become a fertile ground for oil price speculation. Every tragic incident in the Middle East has become a green light for oil traders to set higher premiums on oil supplies.

The need to putting a just and equitable end to the Arab-Israeli conflict is a matter of extreme urgency. This would not only end decades of human suffering, but in the process rid us from the unhealthy speculations that have been so damaging to the oil markets.

I have taken a lot of time to cover these matters because they are of vital importance and yet have no simple resolution. Identifying the problems is always easier than seeking their effective solutions.

What is certain, however, is that we need to move away from the blame game, and to recognize the simple truth that the desired solutions can only be arrived at through collective cooperation.

Facing these challenges require a joint effort by oil producers, oil consumers and the oil companies. To institutionalize a fruitful dialogue among all concerned, King Abdullah bin Abdulaziz, the Custodian of The Two Holy Mosques, took the initiative in setting up a Secretariat for the International Energy Forum in Riyadh.

One of its primary functions has been to facilitate data exchange and transparency through the administration of the Joint Data Initiative, which involves monthly submissions from producing and consuming countries. A few months ago, while in Dallas, he called for the convening of a conference under the auspices of this International Forum.

We look forward to increased cooperative effort and stand ready to work with the United States to do our part in addressing these challenges.

Let me conclude by quoting an old Chinese proverb: "It's better to light a candle than curse the darkness."

Thank you.

Question and Answer Session with Foreign Minister Prince Saud Al Faisal

Moderated by Ambassador Edward P. Djerejian, director of the Baker Institute, HRH Minister of Foreign Affairs Prince Saud Al Faisal answered written questions that were taken from the audience.

Djerejian: Thank you very much Your Royal Highness. We have many, many questions. I think you've answered in your remarks many questions based upon what will make oil prices come down, extra refining capacity, extra production capacity, fuel standardization, and I believe that you've addressed these issues, unless there's something more you want to say on that. But I think your remarks basically addressed all three.

One question is: Can you comment on Saudi plans to monetize its natural gas reserves? Will it be done indirectly by enhancing oil recovery or directly through LNG or GTL?

HRH: Well, I was in the Ministry of Petroleum but I can't say I am an expert at oil and gas issues. I don't want to hedge the question but the strategy of Saudi Arabia and the development of its gas resources is to use these gas resources. There are two kinds of gas resources. One is the associated gas and that has a special use, but the natural gas that we find is not going to be used for export but for industrialization inside Saudi Arabia. This is a difference between us and some of the Gulf countries of the region.

Djerejian: In general, where do you see the balance between government-led and private sector-led investment in the downstream sector?

HRH: In the downstream we are willing as I said to invest. Aramco is willing to build refineries. We have a refinery here that, by the way, is helping in the recovery effort for Louisiana. This is one of the advantages of being in the United States. So we are willing to invest in downstream operations in the country and as well as building refineries in Saudi Arabia. As a matter of fact, this is a necessity. The private sector in Saudi Arabia is also beginning to enter into the field of downstream investments. There are some companies that are pretty substantial now and that have the resources and manpower and finances to enter as partners with either Saudi government projects or foreign government projects. With our entry into the WTO, of course, we will follow the rules of the WTO so investors in Saudi Arabia will be able to own the refinery completely, and own land, and so forth.

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Djerejian: Has Saudi Arabia considered the means to diversify its economy in the eventuality that oil is displaced by substitutes in the long term?

HRH: Well, I may have a different opinion than the general opinion in my country. I don't see what's wrong with basing your economy on oil to want to diversify. What better resource can we find to base our industrial development on than oil? And diversification -- I don't know how to find a resource that we can diversify that is more than the oil that Saudi Arabia owns. So it is true, it is not good to depend on one resource, but if you have oil as that one resource, you're not in a bad position.

Djerejian: You are in Houston, Your Royal Highness, and this question always comes up, because one of our citizens Matt Simmons has written about Saudi Arabia's reserves and so we have several questions. Just one is: will you comment on the conclusions of Matt Simmons on the quantity of Saudi Arabian oil reserves?

HRH: Well, it's been announced how much the reserves are [pause] 261 billion barrels. That's not bad.

Djerejian: The tanks are not empty.

On foreign policy issues, Your Royal Highness, there are quite a few questions on Iraq. Could you comment on the recent events in Basra? How concerned are you about the sectarian strife that seems to be emerging in Iraq between Sunnis and Shia? And about Iran's influence in Iraq.

HRH: Yesterday I made some comments in New York, and I was taken to task by everybody for what I told them. I hope I won't be taken to task here for what I am going to say, but I am going to repeat what I said there. Unfortunately, Iraq has every sign of moving towards disintegration. The Kurds have always had a special relationship to the majority of the Arabs that make up the population of Iraq. So that is no problem whether they get a separate entity in the north of Iraq. But the real danger is in the division that is being projected between the Arabs of Iraq, dividing them into Shias and Sunnis, especially a separate entity for both. If this happens, that means Iraq will be divided into at least three portions. This is the right recipe for bringing the countries around Iraq into conflict themselves. You have Iran on one side which will come in with the Shias. We have the Turks on the other side which will come in to fight with the Kurds, and the Arabs who will definitely be dragged into the fight on the part of the Sunnis. The road to take is to get the Arabs together, the Sunnis and the Shi'ites, in order to maintain the Arabic character of

the state, which has been there for thousands of years, not just hundreds. Iraq is one of the oldest countries in the region. It has been there for 8,000 years. It is not a new country that can be played with or toyed with.

The danger that exists now is that the enemy is presumably now the Sunni Arabs, that they are the ones fighting the resistance fight, they have become the enemy. The South has been stabilized to a great extent by the presence of the British and the American troops. The Constitution has given the right to the governments of Iraq to have an independent constitution and almost self-rule. With the quiet and the peace that has been established in the South, the Iranians have moved into all these governments with money, with people, and even with religious scholars and are settling themselves in these governments, mind you under the protection of the military forces of the United States and Britain. Several years ago, we fought a war with the United States and Saudi Arabia in order to save Iraq from the occupation of Iran. Now it seems that Iran is being handed over Iraq on a golden platter. So this is something that the United States must think about.

Unless the Sunnis and Shias are brought together in a majority government to hold the country together, it will disintegrate into civil war. And then, the whole region will also disintegrate and conflicts that we have not dreamt of in the past will be facing the international community. And that is something that nobody wishes to do.

Djerejian: That is a very sobering analysis.

Going to an equally difficult issue in the region: the Arab-Israeli conflict and prospects for peace in the wake of the Israeli withdrawal from Gaza. What is your assessment of the next steps and will Saudi Arabia continue to play its role in [facilitating] the comprehensive peace struck at Madrid?

HRH: Well at least we have a move from Mr. Sharon for withdrawal. That is in the right direction. But withdrawing from Gaza alone, if it is the end of his movement towards peace, will be a meaningless gesture. Gaza in any case is the most populated piece of land in the whole world. The number of per capita people per square mile is the largest in the world. So giving it up is no great sacrifice on the part of Mr. Sharon.

But in any case it is a positive sign. It allows the national authority for the Palestinians to exercise its role as a government in a Palestinian territory. But he has to follow that with other

steps. I don't know if Mr. Sharon with his history and he's now how old – I think 75 – whether at this age he can turn into a peacemaker; it's something that he has to prove. But before Mr. Rabin, who also had what he called an iron-fisted policy towards the Palestinians, turned into a peacemaker, and he was killed for it. So miracles do happen, even in Israel. And if this miracle happens and Mr. Sharon turns into a peacemaker, then he has a certain road to travel. He has the Roadmap, which is there, and he can pursue, and he has also the proposal by King Fahd, by King Abdullah, the peace proposal that was accepted in the Arab League, unanimously, for establishing normal relations with Israel immediately with all the Arab countries. The Arabs have made no secret of what they propose or where the maximum and minimum compromises that they are willing to make are. And it is time for the Israelis to put their cards on the table. If there is a proper response for the Roadmap and for the peace proposal established by the Arab countries and Mr. Sharon is willing to move to negotiate in those areas, then there is a prospect for peace.

Everybody knows what the peace should be. I was quoting an Israeli author Amos Oz, who said, and I don't remember exactly the words, "Everybody knows what the peace will look like." Every Israeli on the street knows what kind of peace will be possible with the Palestinians. Every Palestinian knows. It will be somewhere along the border of the war of 1967 with some adjustments to what has happened since 1967, the reality of the situation. Villages have been built here and there. Some adjustments have to be made. But generally, that line is going to be the peace line between Israel and the Arab world.

And so the continuation of the conflict seems a stupid thing to me to continue, a silly thing. It generates hate; it kills people, innocent people. We have seen on the television screen Israeli youth being plucked out of their homes and being driven out after years of struggling to build their homes in the Palestinian territories. And we saw the shock on the faces of the Palestinians themselves at seeing Israelis being taken this way by the Israeli Army. These youths have been manipulated by their government as pawns in the negotiations, by telling them they can build settlements in the Palestinian territory, only to be negotiated away. So they are the real victims: the Israeli youth and the Palestinian youth. The people must make their voices heard. When he made his proposal, King Abdullah spoke directly to the Israeli people, for they are the ones that must make the peace. I was using the simile that Clemenceau used, "Peace is too important to be left for the politicians." The people must make the peace. They are the ones that are suffering. They are the ones who are dying. The Middle East is no longer a place where you can play games with the lives of people, or use them as pawns in a negotiating process. You must come to terms with the issue of peace. You must come to terms with the lives of people and allow them to

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live with each other. Nobody can live in an area in spite of the people of the area. Israelis cannot live in the Arab world in spite of the Arabs. They have to live with them. And we have to live with the Israelis, and we are ready. And I hope that the Israeli government is ready to move as quickly as we are willing to move.

Djerejian: Thank you very much Your Royal Highness.