



**ROUND TABLES – RT 7**

**WORLD ENERGY MARKET CHALLENGES**

**Primary Energy Price Volatility: A Challenge for Long-Term Planning?**

**Questions & Answers**

Well thank you Excellency. During the session you've had to option to write down a number of questions and I think I actually have 12 or 13 questions here. We have about 20 minutes and we'll try to get through most of those questions and I'll try and address them to the person who they have been written for. I think some of them have been covered so I'll ask for some other comments.

**The first question I'd like to put to Your Excellency Mr. Khelil is actually three questions, all of which relate to the oil price, which won't come to you as a great surprise probably. The first question is: the 22 to 28 dollar price ban seems to be too high in the current economic environment. It incentives non-OPEC high cost production and will also have an impact in the recovery of economy. Both effects are against OPEC in the long run. High prices have also proven to be an enemy of price stability. The question is: has OPEC thought of lowering the price ban to a more reasonable level? And there is a second question which actually is very similar: What is the minimum oil price to make most OPEC countries budgets worth?**

**Mr. Khelil**

First of all I'd like to say that it's not the day that OPEC was formed that prices were in a way stabilized by operators, so it was nothing new when OPEC was constituted, the tradition of regulated prices was already in place. That's the first comment I'd like to make. The second comment is that if the ban is not valid when prices go down, why isn't the question raised when prices were at 33-35 dollars? I think I'd like to ask that question. And then if we do a change, on what basis do we do the change? I'd like to make some comments on so-called high prices. I think the 73 crisis of course created high prices but I think it has had a very beneficial effect on energy efficiency. If you look at energy efficiency between 73 and now, in terms of energy use per unit of GDP, that energy efficiency has decreased by 50%. And I think this was due thanks to OPEC's decision in 1973 and I think that's a very positive impact. The 25 dollars per barrel, which is the average between 22 and 28, it is true it's going to help develop new production. I think that's good for competition and I think it's good also because it's going to help substitution of oil by new energy sources, and I think we should be working for that, all of us and I think lots of oil companies are already working towards that. Shell, its objective now is to move to solar in the medium term. So I think that if that's the price that's going to help substitution.

it's good. The issue is spare capacity with the new production. Who is going to be in charge of the spare capacity, who is going to be in charge of the cost of spare capacity? Up to now it's only OPEC.

Now, in terms of economic downturn, we all agree there is a recession. Most economists say that it's going to be V-shaped, which means very short duration, but experience shows that recession has lasted between 6 and 24 months. But we all know also that world growth has been an average of about 3% a year. Of course there has been ups and downs, so we should be counting in the long term about 3% of energy growth. But I think what affects economic growth is really fiscal and monetary policy, not oil price. If we take the Central European Bank policy, whose target is really to fight inflation not to help growth. Is it the right policy to stimulate economic growth? Also the taxation on consumers. 80% taxation on petroleum products bring revenues of a thousand billion dollars to governments in industrialized countries compared to 250 billion dollars to OPEC countries. One to four. So a 10% decrease in taxes will bring into the pockets of consumers 100 billion dollars which could help tremendously the economies of the industrialized countries because it goes directly into the pockets of consumers. And as you industrialized countries' economies rely on consumer spending. Now, volatility I think is a concern to all of us. It is a concern to producers, to consumers. It is a concern to producers because we are charged risk premiums for financing that is awarded to us, you know, for our projects. If people know that we are going to get 10 dollars one time and 30 dollars next time, they are going to charge us risk premiums and we don't like that because it's costly for us. So we are for stability, just like consumers, I think they are for stability because if prices go down they need to find some resources for their budget because they get huge resources from taxation of petroleum products. At the same time your prices go high, you have political problems. By the way, I'd like to say that the transportation problems they had in U.K. didn't have much to do with high prices. They had lots to do with the rate of exchange, variations of the Euro to the dollar. In terms of the minimum price for OPEC, I think it's a very difficult question because OPEC countries are all different. There are huge countries, like Indonesia, there are small countries like Libya. They are all different culturally, socially, economically. We think that the 25-dollar target is acceptable, I think to both producers and consumers and we are working to stabilize it at that level. Thank you.

Thank you, Excellency.

**The second question was to Mr. Priddle and as it is in French and his French is better than mine, I'll ask him to ask the question and give the answer.**

**Mr. Priddle**

Thank you very much. The question if I may translate it, says and it actually anticipates part of the answer: you have shown the revenues that go to OPEC countries; first, what are the corresponding revenues that go to consuming countries from taxation and what is the relation between price volatility and taxation. Well, first, price of course is made up of the crude oil cost, the transport, the processing and distribution cost and tax. The tax element is

extremely varied, in the countries which I represent. On gasoline, for example, in the USA it's relatively low, but it's up to 80% in the highest taxing European country. So there is no consistent pattern in the taxation across consuming countries. What relationship does this have with price volatility?

Well, it actually diminishes the high level of tax, actually diminishes price volatility to the final consumer because some tax is proportionate to the crude oil price, but other taxation is not, it's a fixed element, so the final price does not rise proportionately as high as a proportionate increase in the crude oil price. Indeed, in the year 2000, although there was a great deal of focus on the tax element of the price, the tax component, the proportionate component of tax in final prices actually fell as the crude oil price rose. The very fact of such varied tax rates across countries means that there is very little direct relationship between taxation in consuming countries and volatility of price. There simply is no consistent element there to have some effect. Of course, there is some effect of taxation through the pressing demand on the long-run price of oil but actually oil is very insensitive to price changes. The underlying point here, I think, is a certain resentment on the part of oil producers, that some consuming governments do take such high proportion of tax revenues from oil products. I understand that, but it is important to understand that tax on an oil product is a transaction within a country, it is a transfer of wealth between citizens in that country. Well, the change in the crude oil price is a transfer of wealth across national boundaries. And that's why that rise in the crude oil price is a much more controversial matter. The tax component, a government is accountable to its own citizens for a change in its tax, as we saw last year in Europe and this year in Australia. But there is a tension between countries when it involves a transfer of wealth across national frontiers.

Thank you Mr. Priddle.

**The next question is to Mr. Dispenza.**

**Would you propose the creation of an organization of gas-producing countries to manage a price ban for gas?**

**Mr. Dispenza**

When we speak of cartel, we could have a different option, a different attitude. The main difference is if you are out part of the cartel or you are out of the cartel. We are out of the cartel, so probably what I am going to say is that I prefer the market works by itself.

Thank you. There are quite a few questions here. The next one is to Mr. Perez.

**Could you explain a little bit more about the impact of 11 September attack on the Philippine energy policy in particular with respect to the idea of strategic stock power build up program?**

**Mr. Perez**

I'm afraid I cannot discuss that in public but those are some of the policy options that we discussed but that one is as we call it an operation of security detail. Thank you.

Thank you. **The next question is actually to Mr. Dispenza, but it's been covered to some degree by Mr. Kempff Bruno and it is: Do you think there will be a spot market for LNG and what is your prognosis about the levels of price in terms of dollars per million BTUs. I think you already suggested there would be a spot LNG market maybe Mr. Dispenza would comment about that and then maybe the two of you could discuss what sort of price. As a participant of the North West shelf project I will be very interested in your answer.**

**Mr. Dispenza:** Up to now, we have a feeling that LNG spot market is developing only when some capacity is not to be used or because the sign was given a larger output in respect, or because some customers do not take all the quantities. And it's worked quite well. We've seen in the last months, in the last years, a small quota of LNG traded with a price that followed on dead on lines. I think in the future LNG will continue to be traded mainly with long-term contracts, some spot LNG trade could appear but this will remain limited. Anyhow, I could be in favor of this spot LNG because this could give indication of the prevailing price.

**Mr. Perez:** We agree completely. Most of the LNG projects of course have several years in order to be implemented so price fixing at that specific moment when the feasibility studies are being done they can be done only with long-term contracts. But in the future, if we look at, if we have of course the vision that gas is going to be one of the most important energy producers in the future, then we are going to have more and more LNG plans and in that specific moment spot markets are going to be important and that is going to cause a deepness in the market that is going to be good for everybody because we are going to have much more competition, prices are going to reflect direct competition by several LNG plans and this is going to reflect also a different perspective for future LNG plans, let's say in the year 2010 up front. Thank you.

Thank you.

Can I add a comment of my point of view . I think we've seen a change as a supply to the Japanese market. We've come away from the time of having negotiations between a consortium of eight buyers to now having individual buyers and I think there's no doubt that LNG suppliers in the future will not be able to underline their plant expansions with 100% contracts. There will be a degree of spot market which all these suppliers will have to be addressing.

**The next question will be to Dr. Khelil and is a little bit different from the ones we've had today. It has been proposed that Algeria export electricity as well as gas to Europe. Would you like to comment?**

**Dr. Khelil**

Yes, Algeria is already interconnected with Morocco and Tunisia and actually trades electricity with these countries and you know that Morocco is interconnected through the Strait of Gibraltar with Spain, so there's a scope for small trade of electricity. But apart from this interconnection, which is going to extend actually to Egypt, to Libya, as part of the ring around the Mediterranean basin, this is going to be a long-term project, we have an agreement with the Spanish and the Italian government to initiate studies on a cable, a direct cable link between Algeria and Spain and we have already initiated the studies with Red Eléctrica, which is the electrical operator in Spain, in association with companies in Algeria, Sonalgas, which is the electricity company and the new company that we have formed between Sonatrach the national oil company and Sonalgas electricity company which is called the Algerian energy company. These three countries are doing the feasibility studies for the electrical cable between Algeria and Spain. It will have a capacity of 2,000 megawatts and it will allow the trade of 1200 megawatts from a plant for which we have requested bids, for which we already have five technical bids. We'll be opening the commercial bids within the next three months. So once that plant is made, we'll be able to trade 1200 megawatts plus the possibility of exporting an additional 800 or importing 800 megawatts to Spain. We have just returned from Italy also, from an official visit, and we have agreements to initiate studies of a cable, electrical cable with the GRTN, which is the operator of the electrical system in Italy, to Sardinia, with extension to the mainland. This is on-going and we are hoping that once it's finished we'll be able to build these two projects which are very important to provide flexibility to the electrical market. We feel these are geo-strategic projects for Europe, because they will give Europe another way of introducing competition in the electricity market. Thank you.

Thank you Excellency. **The next question is to Mr. Priddle. If less volatility is in the interest of producers and consumers, why is volatility increasing? Is this because there is the power of the traders greater than that of the power of governments?**

**Mr. Priddle**

Thank you. I tried to give in my presentation a number of reasons why volatility appears to be increasing. They are political, they are market factors, they are failures of government, in some cases. They are poor designs of competitive systems which have constraints built into them, which cause these fluctuations. So I think it's a complicated question. Governments have some responsibility. Traders are interested in volatility. They don't mind whether the price is high or low, they like changing prices, so certainly traders have an interest in volatility. Governments have an interest generally in stability but governments don't have all the levers.

Thank you.

**There are questions, one of which is addressed to the whole panel and one which possibly Mr. Kempff Bruno could probably handle and all these questions relate to the linkage between gas and electricity. The first question: Is it desirable to clearly unbundle any interlinkage between oil and gas prices, and particularly when it comes to electricity should there**

**be more and more linkage of gas process and how should this be used to have more predictable prices for gas and electricity? Really, it's overall the same question because in some industries or uses it's a substitute, is this important in looking at stability of industry overall by having more linkage by gas and electricity process?**

**Mr. Perez**

In the case of Bolivia and also our neighbor Brazil, one of the most important markets for gas is gas that is going to the electricity market, and using gas of course as a sort of energy and invested in gas thermal plants in Brazil and in Bolivia. For the crises that has been going through in Brazil, the commission that is analyzing the energy crisis in Brazil is planning to invest 55 geo-thermal plants in Brazil. So in that sense, gas is going to be one of the most important sources of energy in the future, at least in the Southern Cone. In the other sense, gas is also as very important source of productivity increases in the industry, not only used as energy but also for boilers and other types of processes. So gas, indeed is going to be one of the major products to be supplied to the industry and also to the producers of energy.

**Mr. Khelil**

I'd like to make a comment on gas and electricity prices. We all know that gas cost is a major component in electricity prices. Electricity prices are not determined necessarily by gas costs, they are determined by the market. In the electricity market you have other sources of electricity power, like hydropower. And like lots of operators in the electricity market you don't like to move into the hydrocarbon because you feel you are a really special industry. The issue of dispatching is a very important issue because you dispatch electricity on different rules, depending on the different countries. So while gas is very important, I think the structure of the electricity market in the different countries is very important, and you may end up having maybe a problem with gas prices if you have a highly competitive electricity market and you have a very high cost, so you really have to look at the whole issue of not only gas cost but also the dispatching rules and competition from other fuels and from other users of energy. Thank you.

**Mr. Philip Aiken**

Ladies and gentlemen, we are coming to the end of the session now. I was supposed to take 10 minutes to sum up but in the light of all the questions that have been asked I thought it would be of more value to the audience if we actually handled the questions instead of me trying to make a long sum-up. I think today you've heard from five very learned speakers a number of issues and we've had the views from His Excellency Mr. Khelil talking about the OPEC view and the objectives of OPEC. I think Mr. Priddle gave us a good view from the oil consumers' viewpoint and again much, I think, much about the nature of users and consumers to make sure they understand what the issues are together. Mr. Dispenza and then Mr. Kempff Bruno I think talked very much about the importance of gas and we are all aware what a major role gas is

going to play in the next few decades, when it comes to the energy situation overall. I think Mr. Perez gave us a good insight into the issues that a government such as the Philippines experiences when there are shocks like we've had recently like the 11 September. But really I suppose in summing up all of the speakers today have spoken very clearly about the nature of stability and the fact that volatility overall doesn't do any good to anybody, whether you are a producer, a consumer, a government or whatever. And therefore I think today you've had a good view of the various issues which I think face this topic that we've had today. So, ladies and gentlemen I now would like to invite you to join me in thanking our panel. H. E. Dr Khelil, Mr. Priddle, Mr. Dispenza, H.E. Mr. Pérez and H.E. Mr. Kempff Bruno. I certainly would like to thank them for their efforts today. This concludes the round table and would you please now join me in thanking our panelists for what I think has been a most interesting and enlightening session.