

Ten Years Hence Lecture Series

Oil and Peace

Ross J. Pillari

President, BP America

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Mendoza College of Business
University of Notre Dame
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Good morning. I'm very pleased to be able to join you this morning and it is a privilege to be invited to speak here for the first time.

The "Ten Years Hence" lecture series is a powerful way to think about factors impacting our future and in my case the role that oil might play in influencing that future.

Will it be a driver of stability and peace or will the issues related to its production and demand patterns create tension between nations over the next ten years.

Interestingly in our industry 10 years is also about how long it takes for a new discovery to reach market and begin paying back its investment.

And while there is always some uncertainty around the decision to spend hundreds of millions of dollars on a new oil well, the science of geology and engineering is much more predictable than the art of politics and power.

Yet we know they are linked and the consequences of securing oil resources can often impact on the political and economic stability of a nation or region.

Today I can only comment on the next decade from the perspective of someone who has spent over 33 years in the oil industry. This undoubtedly influences my view of the factors and challenges ahead.

And even that experience has not kept me from being surprised.

Ten years ago we would not have expected BP to be the 5th largest company in the world and the largest single international investor in Russia through TNK/BP.

We would not have expected that Amoco and ARCO would no longer exist as great oil companies, and that oil would be above \$35 a barrel for much of 2004.

So we know that taking a view of the future is always challenging. In fact, it may surprise you to know that BP does not even try to forecast the price of oil and gas.

The complexity of the global markets and the factors impacting them are impossible to predict.

All you can do is look at the fundamentals and then be prepared for anything to happen – positive or negative, and develop the options to fit the context as it evolves.

We know we will be faced with unexpected events and we develop plans that can meet the challenges we expect, and the challenges yet to be understood.

There is always something new to consider.

It is this notion of meeting new challenges that frames how we might contemplate and speculate about the role oil will play as we seek peace and international stability in the decade between now and 2015.

It may be a role where the worlds demand for oil can encourage mutually beneficial progress between supplier and consumer nations, and create economic growth that is the foundation of a sustainable peace in the world.

Or... as history demonstrates, it is sometimes a contributing factor in decisions and actions that can create tensions leading to uneven economic growth, social inequity, and even conflict.

The question is which scenario will it be? And, how can we influence the outcome?

Today I want to focus on how the inter-dependencies between the producing and consuming nations of the world can be a factor and even a driver of a stable and peaceful future.

Not only in the way we supply oil and meet market demand, but also in the way we in this industry conduct our business and relate to the countries and society we serve.

However, no single factor, including oil, will be the determining factor.

We know from the past that the multidimensional and complex interplay of social, cultural, economic and political drivers will create an environment where even relatively small but important influencing factors can make the difference between peace and tension in the world.

One of these factors is clearly the role that energy, and oil in particular, will play in shaping the next decade. We may not know exactly what that role will be, but our history and certainly the activities of the last few years suggest it will be an important role.

One possibility is a role that is the result of well thought out policies and strategies. One that is driven by resource owners... "governments"; and resource developers... the "oil companies" working together to overcome obstacles and achieve mutual advantage.

Or, it could be a role where the dynamics of the supply and demand for oil could be driven more by unrelated events such as political instability, economies in transition, social imbalances, or even the unintended consequences of globalization.

Either of these scenarios is possible. And while the outcome is uncertain, I do believe that it can be influenced and that there will be choices to be made.

And with these choices there will be risks to be managed.

But despite all this complexity and uncertainty it is clear that under any scenario for the future, oil and gas... hydrocarbons...will be a factor in whether the next ten years are peaceful, or marred by instability.

How could it not be?

Now, and for the foreseeable future, energy in the form of oil and gas will be the basis for economic growth, and a significant driver of the world's economy.

The energy provided by hydrocarbons will be crucial to providing heat, light and mobility to the world's population.

A population that is growing by more than 250,000 a day, and a population that is driving world economic growth by over 4% in 2004, a thirty year high.

Consequently demand is set to increase. According to the International Energy Agency world oil demand will grow by 32% by 2020 and world gas demand by a remarkable 48% in the same period.

Obviously when we set the context for demand, we do have to consider the reality of the recent increases in the price of oil.

We've now lived with oil prices above \$ 35 a barrel for almost a full year. That represents a significant change from the average of the 1990s which was around \$ 18 to \$ 20 a barrel.

It's also a change from the period between April 2000 and the beginning of last year when OPEC reasserted its discipline in terms of production, and prices increased to around \$ 25 a barrel.

Why has that shift occurred?

There has been no physical shortage of oil at any time over the last year.

Despite continuing conflict in Iraq, global production has been sustained.

The reason for the price increase is the growth in demand, particularly in China, but also here in the USA. The Chinese oil demand has risen by around 1.6 million barrels of oil per day in the last two years, with almost 90% of that increase coming from imports.

Demand pressure reduced the normal cushion of surplus capacity from an average of around 3 million barrels a day to around 1 million barrels a day at some points last year.

At one million barrels a day, the surplus is less than the production from a number of countries such as Iraq and Nigeria where, for different reasons, the stability of output was at risk.

So demand has been the reason for the upwards shift in oil prices.

On the supply side, we will continue to work on an array of alternatives such as solar, hydrogen and other renewable forms of energy to meet this demand, but the reality is that the world will continue to be greatly dependent on oil and gas for decades to come.

Renewables and alternative sources of energy will supply an increasing proportion of the total – but the figures are small.

Last year solar, wind and all the other alternatives (excluding hydro) provided just 1.1 percent of America's energy needs, with biomass contributing another 2.5 per cent.

By 2020 the contribution from these sources will rise but biomass and all the alternatives together will still produce only 3.8 per cent.

Nuclear power will continue to supply a proportion of the world's energy needs but there are still questions over the public confidence, commerciality and waste disposal issues.

So, the question is... how will the world respond to these increasing demands?

What can governments, consumers and institutions do to create the circumstances where oil resources, markets and patterns of supply support sustainable economic growth and stability...the foundation of peace.

Importantly, how can we create an inter-dependency between nations, that reduces tensions, and encourages mutual advantage?

What do we have to do to create the environment where, during the next decade, peace is more likely than conflict?

An environment where the supply and demand for oil results in increased cooperation and mutual advantage among nations.

Of course we know from history that there are many challenges to achieving this objective.

For a considerable period beginning at the end of the 19th century and the beginning of the 20th the world was generally at peace and enjoying economic growth driven by oil and the new combustion engine.

Open markets flourished and there were clear links between economic growth, oil, trade and peace.

Still, the almost simultaneous arrival of the oil century, the automobile era and age of flight began significantly affecting how nations regarded their own security and how they related to each other.

Just as Billy Mitchell foresaw the importance of air power to a nation's military capabilities, Churchill realized the significance of oil and sought an alliance with Persia...now Iran.

Concurrently, Germany sought to use military might to reach the Caspian to secure oil, and the US embargo against oil exports to Japan emboldened that nation to attack Pearl Harbor.

These are two examples of how oil has shaped the world.

One where oil provided growth, stimulated by trade and peace, and one where oil was a critical factor in war and the drive for power...political and economic.

But, what about today?

What are the influencing factors in a world that is experiencing more globalization and changing patterns of trade?

Is this a positive development for the role that oil can play in supporting global stability and peace, or does it create new tensions?

I believe it is a positive factor but there are counterbalancing forces also shaping our future.

Unfortunately, much of the environment we see today is a result of 9/11 and the consequential actions by markets, nations and institutions.

Since this event, we have seen significant change in our international institutions and their ability to resolve problems.

We have seen nations testing the depth of their longstanding relationships as a result of differing views on how to react and counter terrorism.

We now have to deal with a faceless enemy and terrorism where individuals, not nation states, require new tactics and create new fears.

We have seen a crisis and another war in Iraq, and an environment of mistrust and uncertainty in a part of the world that is a key strategic source of oil supply.

Now, the backdrop of world tension and political instability has again made energy growth an issue of national security as well as economic volatility.

With these tensions as background, the availability of energy, its recent increase in price, and the nature of the supply infrastructure and its control become another source of tension between the "haves" and the "have-nots".

Those that have access to oil resources and the ability to use these resources to further their own objectives, whatever they may be; and those that are dependent on these same resources for their own objectives and success.

In considering these patterns of trade we find the US, Europe and now China are all reliant on imported oil. In every case that reliance will increase in volume terms over the next decade.

On the other side of the equation the supplies of oil and gas available for export are concentrated in just three main regions – West Africa, Russia and of course the middle east, and in particular the Gulf States.

Within the next decade those three areas will be supplying four barrels in every five of traded oil.

An unresolved question is whether those areas can provide the energy security the world needs.

The fundamentals affecting Trade are clear but the events affecting it can be a source of insecurity, mostly for the consuming nations of the world.

At times of global instability, there is a tendency for net importers to worry.

They worry about whether they will continue to have access to the energy required to maintain or increase their economic growth.

And they worry about whether supplies or prices will be determined by market-based volatility, or will they be manipulated for political reasons?

All of these reactions are prevalent in our country and the source of media and government attention on an almost daily basis.

In a world beset by such tensions, oil and gas tend to take on significance beyond just their use in the supply of energy. The nature of how we supply our energy is now a geo-political bargaining chip, an instrument of foreign policy as well as a driver of economic policy.

These “political” interventions can disrupt the natural workings of the marketplace and create imbalances, resulting in unwanted tensions in the world and a clear threat to peace.

It would be naïve to think these interventions will not be present over the next ten years.

In fact as more countries face transitions, whether it be societal, political or economic, we should expect more non-market based pressures on the supply and demand for oil.

We cannot predict them and we cannot manage them but there are things we can do to increase the likelihood of international stability.

We know the global market can resolve most demand/supply imbalance issues, albeit with price as one of the tools.

In fact, not only are the net importers, such as the United States, concerned about security of supply; but also net exporters seek its counterpart – security of demand.

This is the natural role of the marketplace and it is also an encouraging environment for peace.

It creates inter-dependencies that require mutual advantage between suppliers and consumers, and establishes a platform for energy security and economic growth

So using the United States as the example, what would increased inter-dependencies between nations mean for our countries energy policy?

Is it consistent with our desire for energy independence?

I think the answer is yes, but only if we redefine what we mean by energy independence.

For me, true energy independence means the ability to enjoy secure and sustainable access to energy supplies on world markets that are robust enough to withstand political manipulation and disruption — even by terrorists..

True energy independence means we are “independent” from single-source or single-region suppliers, and secure in our broad-based supply options.

It is clear that this access will be at price levels and price volatility determined by the interplay of market forces, which include cartels, such as OPEC, and other non-market based influences including the forward markets.

But robust markets built on many sources of supply are more likely to provide the balance required to minimize these non-market factors and establish a secure energy infrastructure for the nations of the world, including our own.

And such markets based on supply flexibility and mutual advantage also create mutual risk that bolsters the prospects for enduring peace.

That is very different from geographical self-sufficiency most commonly mentioned in the media.

I do not believe geographical self-sufficiency is at all realistic for the US in the long term, and probably not even a realistic short-term option.

A serious attempt to achieve geographical self-sufficiency would likely result in higher economic penalties related to inefficient distortions of supply and logistics; price volatility that could be greater than we see now, and possibly unacceptable environmental consequences.

It could also lead to unintentional and unwelcome economic penalties for consumers.

Rather than strength through participation in a global market we could be subject to the consequences of limited access to those markets.

Nations have historically gained by trading and I believe this mutual advantage increases the likelihood of sharing peace. The consuming nations need supply and the producing nations need markets.

This is just as true for oil or gas as it is for other products. And, given the importance of energy in driving overall economic growth the security of this mutual dependency is a key issue in the role that oil will play in supporting peace in the next decade.

In fact, the international market has demonstrated an understanding of this mutual dependency in the way it has responded to both the fundamental shifts in supply/demand patterns and recent non-market related events.

In recent years we have seen disruptions affecting the oil producing region and global oil markets, including the tragedy of September 11th, and military action in Afghanistan.

These events could have resulted in significant supply disruptions to our countries energy needs and added to the already high level of tensions in the world.

But instead, the mutual advantages of economic inter-dependencies between producing and consuming nations resulted in a sustained and secure flow of oil to the global markets and the USA in particular.

Yes, we did see some price volatility but supplies were plentiful.

And then consider the more recent behavior of the global markets.

The war in Iraq has proved less disruptive to world oil markets than many had feared. The global marketplace, particularly Saudi Arabia and non-OPEC suppliers, demonstrated the world's ability to use global spare capacity to compensate for the loss of Iraqi production.

And while we must never be complacent and always expect the unexpected, it is also worth noting that since the major oil shock of 1973, the OPEC countries have not used their power against the west.

In fact, during the war in Iraq, they used their power to keep oil flowing.

They did this because we have developed an economic co-dependency between the health of our economy and theirs. We must not forget that large scale and reliable “demand” is just as valuable as supply.

We now see large production volumes from non-OPEC countries such as Angola, Azerbaijan, Canada, Brazil, and most of all from Russia...a once sleeping but now waking giant ... where production halved in the 1990s, but has risen again in recent years.

And, in even this most difficult situation, the global market system was also able to compensate for last years strike in Venezuela and violence in Nigeria.

OPEC turned on its tap a little more, and the emergency stocks held in consuming countries, including America's Strategic Petroleum Reserve, were appropriately left intact.

Despite tension in the world and the significant disagreements between producing and consuming nations the interdependencies of the oil markets have probably been a modifying factor in an extremely volatile situation.

Obviously we in the US should support expansion and development of our domestic supplies, particularly natural gas.

It's very important that we optimize our domestic capabilities if we are to effectively compete in the global market.

But we should do it as part of a broader strategy of energy security through expanded options, not reduced options.

A strategy of interdependence that will bring supplier and consuming nations together

And these expanded options are available and attractive to energy companies, which with confidence in a dynamic marketplace will make the required investments

To this end, for example, BP is spending more than \$15 billion dollars on exploration in the Gulf of Mexico to find more oil and natural gas. We are participating in the proposed natural gas pipeline from Alaska to the lower 48, LNG projects on the East and Gulf coasts, and in expanded production of gas from the Rockies.

Other companies are, and will be willing to invest in similar projects to enhance our domestic supply capability and increase our ability to have "real" energy security through participation in both the domestic and world markets.

The combination of a strong domestic capability, continued development of alternate sources of energy, and the development of interdependencies with producing nations is an important element in ensuring that oil and peace are linked together for the future decade and beyond.

It would be dangerous to simply allow a situation to develop in which the importing countries are only dependent on, and indeed begin to compete for supplies from a very limited number of places.

Precautionary action to avert that risk is necessary and possible.

So, along with the development of the inter-dependencies I have been describing, I believe there are a number of practical steps which can be taken.

Each is necessary, but it is the combination of each of these steps working together which would restore genuine long term energy security and a positive role for oil in the next decade.

The first practical step is to diversify the sources of supply available to the world market to the maximum extent.

The private sector of the industry is already doing a great deal.

The industry has invested almost \$ 100 bn in new sources of supply in the last four years alone. For the top three companies in the industry alone the investment rate in exploration and development activity is running at more than \$ 30 bn each year.

That investment is bringing on-stream oil and gas from the Caspian, West Africa, Latin America, North Africa, Indonesia and Russia.

The private sector is also building infrastructure – pipelines and terminals – for oil and for gas, including of course the receiving facilities here in the US and in other importing countries. That infrastructure is crucial for energy security.

But we need to sustain and extend that process and we can only do so if we can invest freely and with confidence in the countries where the resources are available.

Many of those countries are in transition – from autarky and central control, and from civil war and conflict. The successful completion of that transition is important if the resources are to be developed successfully.

The process of transition is most likely to be successful when the countries concerned have the human capacity and the quality of governance to manage the wealth which resources can bring.

Business has a great role to play in that. As a 2nd step we can support education and training and the development of individuals.

This includes providing a lead in terms of the way we work, and the best example of that is transparency.

We believe that transparency is the best way in which to conduct business, because it is the only possible basis for the development of long term mutual advantage.

That's why we publish what we pay.

It's why we have strict rules against bribery and facilitation payments. We have every interest in eradicating corruption because corruption is a business cost and a threat to peace.

We will continue to publish what we pay and, wherever possible, we will do so on a disaggregated basis.

But transparency on one side isn't enough. We need to ensure that "publish what you pay" is matched with the publication of what is spent.

And just as here and in Europe, transparency and good standards of reporting have built the trust which underpins economic success so now we need to ensure that those standards are applied throughout the world.

Without that, private companies will not be able to invest sufficiently in areas where resources exist, and energy security and peace will be put in jeopardy.

Supporting the process of transition is a matter both for companies and for Governments working together.

The third strand is about taking precautionary action to avert the environmental risks and the subsequent economic costs associated with growing energy consumption. This is about beginning to take action now, the benefits of which will come in the medium to long term.

A great deal is already being done. People are reducing waste and improving energy efficiency. We've seen over the last decade that you can, for instance, eliminate the flaring of the natural gas which is produced in association with oil. That reduces emissions and allows you to make good use of the gas.

You can shift the energy mix – substituting gas for coal for instance in the generation of electricity.

And you can use advances in refining technology to improve the quality of energy products such as gasoline and diesel.

All those things are already happening, but the pace of change, where it is taking place and the differential impact between growing and mature economies could be a source of tension in the coming decade.

The recent differing views on the Kyoto treaty have highlighted how the desire for sustainable development can be contentious.

So, we need a comprehensive approach if we are to ensure that the sustainable improvement of the environment is shared by all nations and not a source of differential political and economic tension. .

The fourth strand is about going beyond what appears possible today, in order to achieve a more sustainable long term outcome.

At many different points in history, people have looked ahead and believed that the pattern of development was unsustainable.

The status quo projected forward is often unsustainable, but what the predictions of gloom ignore is human ingenuity – the capacity to find a different way forward and to go beyond the status quo.

And that's what I believe will happen in this case. I don't believe the world will allow itself to become dependent on a tiny number of suppliers for products and services which are vital to the economic activity of every nation state.

I don't believe the world will just tolerate the risks associated with global warming, and I don't believe the interdependencies between nations can be ignored.

I'm not a practicing economist, and so I can only bring this back to commerce, and the fundamental purpose of business which is to supply the goods and services which people want, at a price they can afford, and in a manner which is mutually advantageous to everyone involved.

I don't think we'd be fulfilling our purpose if we just allowed a pattern of dependence and therefore of insecurity to develop.

It is clear we have a role to play in both what we do and how we do it.

This doesn't mean the world will smoothly and quickly move to a balanced approach to energy supplies leading to a constant state of interdependence and ideal relationships.

There will still be other factors to be considered

But it does suggest that through these interdependencies combined with the other conditions I mentioned, we are more likely to establish a mutually dependent basis for dialog and cooperation.

It does mean that oil as a source of economic growth and the actions of the industry can be a building block for sustaining historic relationships and building new ones.

And, importantly, it does mean that economic growth, political stability and social progress are inextricably linked to oil and the quality of life it provides for societies around the globe.

Many factors determine the choices we make between instability and peace. But we can work hard to make oil a positive factor in these choices.

While we cannot be certain what the next ten years will bring, we can work now to create the conditions where oil as a key contributor to peace is the likely consequence of our actions.

Thank you and I look forward to your questions.