

Distortion, Illusion and Confusion: How to Improve Global Oil Market Data

*By Paul Tempest**

“The mind which has feasted on the luxurious wonders of fiction has no taste for the insipidity of truth.”
- Dr Samuel Johnson, 1709-1784

A Hall of Mirrors

Understanding the oil market is like walking into a hall of mirrors. From outside, all may seem in good order: the prices of transactions flash abundantly, instantaneously and reliably to and from all parts of the world. It is just another marvel of modern electronics. Yet as soon as we step inside and ask the what, and how and when and why concerning the vital information which affects those prices – details of production, sales, stocks, industry investment schedules, we see through a glass darkly, rarely face-to-face. Distortion may be often deliberate or it simply arises from the multiplicity of estimates filling the many gaps in the highly deficient statistics available to the market.

Illusions are caused by misplaced assumptions. The general public is mystified by the volatility of the market; it has difficulty in understanding how, over the past two years, the price has been allowed to swing violently between the two levels of US\$10 and US\$30 which the U.S. administration has defined as “dangerous” for the global economy – why it was necessary to send the U.S. Secretary of Energy on bended knee to the Saudis to beg for, first, a major cut in Saudi production and then, later, for a major expansion. Nor can the public comprehend how, within a matter of weeks, the three supermajors and other large oil companies can move from draconian cost-cutting and threatened bankruptcy to multi-billion dollar profits. If public opinion is suspicious of the motivation of the oil companies, it remains doubly suspicious of what a cartel such as OPEC is up to, even when such actions can sometimes be demonstrated to be of considerable benefit in restoring stability and harmony to the market.

The public assumes that OPEC bases its decisions regarding production quotas on the known daily facts

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of current production, tanker loadings, pipeline usage and market demand patterns. Nothing could be further from the truth. On a day-to-day basis much of this data is not available and is only made available after considerable delay. So OPEC and the market, for the most part, relies on estimates and guesses, almost all of which are later proved wrong and become subject to revisions on a truly massive scale.

The International Energy Agency

Among the many providers of the up-to-date assessment of oil supply, demand and the level of stocks, the International Energy Agency in Paris stands in pole position. Its professionalism and dedication are highly regarded and its estimates carry considerable weight. But these are little more than intelligent guesses based on what governments tell the IEA. And governments are slow, clumsy, inaccurate and sometimes secretive and devious. So the numbers have to be continually massaged by reference to secondary sources. Even then, in 1999, the IEA was having to revise its OPEC numbers by up to 3mbd and make other corrections of the order of 7-20%.

We do not, of course, live in a perfect statistical world. We can say that the telecommunications revolution has brought many more players and data into the public domain. Things are certainly getting better and faster. But when it is noticed that an IEA global demand or supply estimate in 1999 was so far out that a fall should have been a rise and a rise should have been a fall, then confusion reigns. Indeed the question then raised is whether the price panics of 1999 were partly caused by the IEA when the market was already moving independently on a different track.

This point requires a little explanation for those less familiar with the workings of the oil market and the practices of the industry. Most oil production and sales contracts include formula calculations linking them to movements in the Brent, West Texas Intermediate and other marker crudes as reported each day, so that they never step out of line with developments in the market. Many developing countries set their crude and product selling prices by reference to *Platts* daily prices and that obligation and practice is enshrined in law. Now when a false signal from the IEA indicates imminent shortage, the price moves up sharply. Automatically, all production, development and financing contracts are affected. The upward movement of the price feeds on itself, generating its own momentum. Deals are struck all over the world at the new price level. The IEA picks up the new signals from the market and revises its own forecasts. The process is reiterated and reiterated and the price continues to rise until new evidence comes to the market that the IEA may have been quite wrong in the first place. By this time, it is too late. Governments, companies and traders are well into well-rehearsed contingency plans to

minimise risk and optimise opportunity and profit.

All the key market players have positions to defend and wish to exploit competitive advantage in knowing more about the market than the rest of the players, so a fundamental interest in market transparency is a low priority, particularly when the market is in turmoil. For the traders, oil price volatility means a vast increase in turnover and, whether up or down, they can reap huge profits. The last thing a trader wants is a stable, steady market.

What is the Risk ?

How much of all this shinnanikin is avoidable ?

Oil price volatility is nothing new. The history of the oil industry is one of feast and famine. At each period, it has been found necessary to impose order whether by condoning market dominance by Rockefeller or later by the Seven Sisters or, in the seventies, by OPEC. The lesson of history is that oil price volatility has to be contained. Equally history demonstrates all too clearly the danger of unfettered power concentrated in too few hands in what appears to be a free market.

We cannot afford another grotesque waste of human resources on the scale of the global economic slowdown, inflation and structural damage to the global financing and banking infrastructure which followed the two OPEC price-hikes of 1973-74 and 1979-80. Equally, as demonstrated in the 1990 invasion of Kuwait by Iraq, military intervention on behalf of the global consumer remains necessary whenever global supplies of oil are placed in jeopardy.

The greatest risk to the interests of every one of the four billion or so consumers of oil and natural gas (the other two billion on this planet derive nil or negligible benefit from petroleum) is complacency. Oil and natural gas are no longer at the top of geo-political problems and priorities. Yet their availability in ample and increasing volumes remains essential to underpin continuing global economic growth –at least over the next twenty to thirty years. Adequate supply of this petroleum can only be ensured by an ample flow of investment, a healthy profitable industry, the expansion of world trade and inter-dependency and an ability to surmount any obstacles, bottlenecks and pressures of a geo-political nature.

We also have to take a much longer view of mankind's chances for survival and prosperity. Only by maintaining a momentum of accelerating technological advance can we hope to absorb an increasing global population with, worldwide, an enhanced expectation of increasing affluence, mobility and diversity of activity. Even so the two billion without petroleum will quickly become three and four billion and it is these people who are deeply involved in and by the stripping of the rainforests and the desertification of marginal agriculture. Our hopes must lie in the environmentally benign transition from coal and petroleum to hydrogen

power, to solar applications and to those nuclear options where concerns for safety, concern for the environment and the risks of proliferation for military purposes can be satisfied. Continuing global growth fuelled by increasing supply of petroleum is the only viable route to this transition.

In this time-scale, the bulk of incremental energy demand will be absorbed in the developing and transition economies. Consequently the leadership role of the United States, whose population currently constitutes less than 3% of the global total and which consumes one-quarter of global energy will be gradually diminished while its role as principal innovator of new technology of all kinds and as custodian of global peace and the freedom of international trade is likely to persist.

What Can be Done ?

Against these long-term prospects, the current failings of the oil-market are a flea-bite. The interests of the principal players are so entrenched that they will not easily give up their secrecy and caution in releasing statistics. In the absence of overt transparency, increasing telecommunications and media coverage, the quality of overall market intelligence will gradually improve. There is no point in shooting the messengers such as the IEA, who, within their very narrow tunnel-vision mandate, have done a good job.

Nonetheless, we are almost certainly bound to have further oil and gas supply crises in the years to come. They will concentrate the public mind on the current weaknesses and dangers of the market infrastructure. Meanwhile, it is time to put a better footing under the oil market. The rest of this presentation summarises my suggestions.

The world must have a clear factual basis of what energy is being produced and consumed day-by-day. Everyone will have their own estimate and forecast for the path forward, but at least everyone should start from the same well-informed factual base. Each global consumer has a right to this information: he or she at least deserves to know the current ingredients of the sauce they are going to be cooked in.

I, therefore, propose a UN-backed initiative to provide a set of guidelines for all countries to supply instantaneously by electronic means details of the volume of energy production, imports and exports on a weekly basis to a new UN-backed international and global agency.

This new global energy agency should be built on the foundation of the International Energy Agency, but it needs a completely new global mandate. The IEA was founded in 1974 to represent and protect industrialised country interests in the oil market then dominated by the leading OPEC producers. It has since broadened its interest but remains a sub-agency of the OECD and is thus still tied to the interests of the industrialised world. This is not an acceptable way forward for the rest of the world.

The new Agency would need ample resources to collect and collate the improved statistics and to begin to underpin the oil market with some form of agreed