

Lecture Meeting

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World Oil Market-The Current State and The Role of Middle East Oil

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I would like first to thank Mr. Sakamoto and Mr. Toichi for inviting me to speak at this seminar. The first time I was in this room was in 1975, 27 years ago, where there was a seminar organized by IBJ (The International Bank of Japan) and Harvard University. So I think this is the 17th time I have come to Japan. And I'm always very pleased to be here.

I want to talk first very briefly about the current state of the oil market. Then we want to look a bit ahead and see what could happen in the next few months, perhaps next year. Then I want to think a bit about the long-term consequences on the Middle East and the Middle East oil of the current political situation, and finally to speak a little bit about the role of Middle East oil in the long term.

The current state of the oil market. First, there is no doubt that we have not had this year much growth in demand for oil for consumption. And this is because of the economic situation in the world, which has recently been deteriorating very rapidly.

On the other hand, there has been some additional demand in the United States for the Strategic Petroleum Reserve. And although the quantity which is added to the Reserve is small, perhaps 120,000 to 140,000 barrels a day, most of this volume is coming from the Brent market. It's coming from the North Sea, through contracts with Shell and other companies.

The result is that, although it is a small amount, but it has a big impact, because it is drying up the supply of the North Sea market. It's causing a shortage of liquidity.

On the supply side, there are 3 important factors. One is that Iraq in recent months has been exporting much less than in 2001. The average Iraqi exports to the world in 2001 were 1.7 or 1.75 million barrels a day.

This was an average for the year. The peak exports reached 2 million barrels a day, even 2.1 million barrels a day in certain months.

Against that, the average supplies in July, August, and September have been much lower, some months perhaps 1 or 1.1 million barrels a day, and more recently not more than 700,000 barrels a day. And some weeks it was even much

lower than that, at about 375,000 or 400,000 barrels a day.

So there is a very significant reduction in supplies from Iraq.

This has two impacts. The first one is that total supply has to be compensated for because of this reduction. But the second is when an important source of oil exports is disrupted, even if you can get the same volume of oil from somewhere else, you have what we call friction in the system. In other words, it takes time to change supply sources. It takes time to get the right type of quality. And during this time you have a price impact, despite the fact the overall balance might be in equilibrium.

The other phenomenon of the supply side is that OPEC countries are producing more than the quotas upon which they had agreed six months ago. And this extra production, which some people say is 1.5 million barrels a day (I believe it is closer to 1 million than 1.5; perhaps it is 1.1 or 1.2; it's very difficult to know), but more or less it is matching the Iraqi shortfall.

So there is no doubt that the quota levels upon which OPEC agreed last time were more or less the correct levels if we don't take Iraq into account.

But, given that Iraq did not export as much as before, that increase in production above the quotas is compensating for the Iraqi shortfall.

The third point is that there has been an increase in non-OPEC supplies, supplies from non-OPEC countries but it is not, in my mind, very large yet, at least not this year.

The interesting phenomenon in the current situation is that the inventory levels of crude oil and oil products in the United States have been falling. They have been declining. Of course, we get data every week from the American Petroleum Institute (API). And some weeks you will find that it is going up, and some weeks the levels are coming down. But in the past a few weeks or in the past 2-3 months the general tendency has been one of a decline.

And the commercial stocks are certainly lower than they were on the same dates in 2001 at the same period.

You have a very interesting phenomenon when it comes to the formation of prices in the world market, that the futures market (NYMEX and IPE in London) are very sensitive to the changes in stock levels in the United States.

Theoretically, they should be very sensitive to the changes in stock levels in the world at large. But we do not have global statistics of stocks that come out every week for the world. The only data that come out every once a week from the API and from the Energy Information Administration of the United States come only about U.S. stocks.

And the people who trade in the market have a very simple interpretation: If the stocks are down, if the inventory levels are falling, it means that there is a shortage of supply. If the inventory levels are going up, it

means that there is too much supply.

By the way, this is too simple an interpretation. It is not always the correct interpretation, because when you have a change in stock levels, you have to ask two questions. Because you have the suppliers, who are selling oil. But you have the people who buy the oil and decided whether put it into stocks or not to put it into stocks.

As we say, it takes two to tango. You cannot dance on your own. So to always interpret a change in the stocks level in terms of the behavior of the producer may be true in certain situations, and may not be true in other situations, because you could have a situation where companies, because of cash flow, because of optimization of their inventory levels for whatever reason, prefer not to buy oil to put into stocks, and they might even prefer to reduce their stocks instead of buying oil.

So it could be that when stocks are coming down it is not always a symptom of a shortage. The cause could be behavior of the buyers to optimize their cash flows.

So stocks are down. And as a result of the stocks' coming down, we can predict almost automatically that the WTI price on the NYMEX will go up.

On top of that, we have had a big disruption in the Brent market. As you know, there are three crude oils whose prices are used as references prices for exporting oil to the world. There is the WTI, which is the futures price in NYMEX. There is the Brent price, which is the futures price in IPE in London, the International Petroleum Exchange. And there is the Dubai-Oman price, which is used for pricing oil that is exported to Asia.

The Brent market has been suffering very seriously from very low production volume of the Brent blend up to the point that recently there was no trade whatsoever of any cargo of Brent.

As I said earlier, this has been exaggerated by the fact that the SPR is being supplied from that market.

So you don't have trade in Brent. But at the same time you need the Brent price for two reasons, because the futures market, which buys and sells futures contracts in Brent, needs to know what the physical Brent price is. They have to know the spot price of Brent. Otherwise, the futures price is going to be disconnected from the physical market situation.

Second, which is quite important, if the futures market does not have a relationship with the physical market, and then we are going to use the futures price as a reference price in the formula--at which Saudi Arabia, Iran, Algeria, and everybody sells to Europe, for example--then you have a serious problem, that your futures price, which is your reference price, is totally disconnected from the state of the market.

So there is now a proposal, which is beginning to be implemented in the Brent market, that instead of selling Brent those who sell oil in the Brent market they will have the option to deliver either Brent or Forties or Oseberg. Forties is another big field in the North Sea. Oseberg is a Norwegian field in the North Sea.

Now they are experimenting with this formula. There is a problem there, because if I'm a buyer and I go and buy what theoretically is Brent, but then two weeks later, when the seller has to supply, he can supply me with Oseberg or Forties or Brent. So I don't know what I'm going to get. And that is causing a bit of nervousness in the spot and forward market.

My view is that, although there is no global shortage of oil today in the market, the fact that we have this Iraqi disruption (which causes friction), the fact that we have the demand of the SPR (which is completely localized in the North Sea, and because commercial stocks in America are coming down (even though it's possible that commercial stocks in Europe and Japan and other places are going up, but the market doesn't know that--all it knows is what is happening in the United States), and because of the disruption in the Brent market, there are a number of causes which explain why the price is going up or has been up or has been for a long time until last week very firm (around 25-27 for WTI and Brent), this means that even if there is a war premium in the price it is really difficult to estimate how much this war premium is.

In other words, yes, uncertainty about war is adding to the price. There is no doubt about it. But whether it has added \$1 or \$5 or \$10 is very difficult to know. But we should not forget that in that price there are reasons for it to be high irrespective of the war premium.

In other words, even if we didn't have the war premium, we would have had a price which is higher than what people would expect in a market which is more or less in global balance.

The final feature about the current situation is the OPEC decision in Osaka on the 19th, the agreement of OPEC not to change the quotas.

There are a number of reasons for that decision. There is a tactical reason. The tactical reason is if they decided to increase the production, they would have to change the whole distribution of the quotas among members. And that requires long negotiation and disagreements, which would upset the market. So they decided it was better to leave things as they are.

The second tactical reason is that OPEC has not forgotten the Jakarta meeting of November 1997, when they decided on an increase of 10% on the quotas, which resulted in a greater increase in actual production, because people started producing this extra 10% if they had capacity, and other people did not. And that unsettled the market and was the trigger that caused the fall in prices

in 1998.

So the OPEC ministers have not forgotten that if you increase quotas without very good reasons, and without doing it in a very careful manner, you might cause a price collapse.

These are a fear of tactical reasons, a fear of showing disagreements, and fear of unwittingly causing a price collapse.

The argument that they put forward was not that. They didn't tell the world, "We are afraid to show that we are in disagreement." They don't do that.

The reasons they said is first, "This recession is getting deeper." The recession, especially in the United States, is getting deeper and deeper. So the demand for oil is going to decline.

On the other hand, in the winter the demand for oil is higher. So on the one hand it might fall because of the recession, but on the other hand it might go up a bit for seasonal reasons.

Iraq probably immediately soon will increase its exports, because it has renounced the idea of asking companies to pay a surcharge.

And there is a lot of uncertainty, both economic and political. So the wise thing to do is to leave the situation as it is and to review it later in December.

So they decided to have another meeting on December 12 in Vienna to review the situation. And if extra supply is needed, then they will decide to increase the quotas. If less is needed, they will reduce them.

But you have to interpret the OPEC decision correctly. It was a presented as a decision not to change the quotas. But we know that the OPEC countries are producing 1.5 million barrels a day more than the quotas.

So in fact the decision is not to change the actual production levels. So it status quo on the production levels, not really on the quotas. So that's my first point.

If you look ahead at the next few months, what is going to happen? I'm personally convinced that there will be a war on Iraq--very soon (by very soon I mean in the next 1-4 months), unless before the war starts, for some reason, Saddam Hussein either is removed by a military coup within Iraq, or he dies of natural death, or something happens to him that removes the regime.

There is no doubt if you listen carefully to all the statements and speeches that are coming out from U.S. administration--and from Britain, unfortunately. I think Mr. Blair should join the cabinet of Mr. Bush and leave Britain alone. But he won't do that. He could be Secretary of Defense or Secretary of State.

But if you analyze carefully, or just listen to the speeches, it is very clear. And they said it very clearly. Cheney said it very clearly and Bush said it

very clearly that their intention is to change the regime.

All these stories about weapons of mass destruction are not even a pretext. It is a way to tell the world, "Look, this regime is dangerous."

There is no doubt in my mind that the regime is very dangerous for the Iraqi people. It is not dangerous for anybody else.

And if the new international policy is to remove every government in the world which is not doing a good job for their people, we can compile together a very long list of governments that should be removed, even some democratic governments.

So if the intention is to remove the regime, to send inspectors or not to send inspectors, whether Saddam Hussein has nuclear or doesn't have nuclear (I'm sure he doesn't have nuclear, by the way), and when they are saying, "Look. But if he gets fissible material he may be able to make a bomb within six months or a year or two years," it's exactly the same as if I said if I win the lottery I will be able to buy a Rolls-Royce in three days time.

So the argument doesn't make sense. It's if he can buy that. You cannot buy fissible materials in a supermarket or at a bazaar. So there will be a war.

My view about the war is that the military side of the war will win very quickly. I don't think that the Iraqi army is able to fight against a very heavy bombardment of all their facilities, mainly communications. You cannot move an army if orders cannot reach the troops.

And the U.S. technological superiority search that they will succeed in dislocating the communication system very quickly.

People say, "Yes, but perhaps there will be urban guerrilla warfare, that Saddam Hussein's men will fight in the streets of Baghdad, etc. It's possible. But also possible that it won't happen, because I don't think there are many people in Iraq who want to fight for him and to fight for that cause.

So my optimistic scenario is that the military side of the war will not last very long.

Where there will be a problem is after the war, after the military intervention is finished. And the problem is how you manage the policy situation in Iraq after the military intervention.

Officially, the American administration and Mr. Rumsfeld are talking about installing a democratic government in Iraq. You don't have to know very much about Iraq's history and Iraq's current situation to see that to suddenly install a democratic government is not possible.

Iraq is divided on ethnic grounds, on religious grounds. But many countries are divided on ethnic grounds and religious grounds. But in Iraq these various groups have been fighting each other. The Kurds are fighting the non-Kurds. And they themselves are divided into two groups.

The Arab Moslem Sunni minority has been dominating Iraq for hundreds of years, since the Ottoman Turks.

When Saddam's regime falls, they will find that the balance of power has changed, that the Kurds have a say, that the Shi'ites in the south have a say, and they have become a true minority. They will want to fight to preserve their dominance.

Plus you have political differences. The Baath Party is not going to disappear. You have Communists in Iraq. You have Islamic fundamentalists. You have Baathists. You have Arab Nationalists.

How are you very quickly going to create a consensus among them, a social contract that enables democracy to work?

So I don't think there will be a democratic government. What there probably will be is another military dictatorship, supported by the American army.

But a new dictator will not be able to be as oppressive, will not be as harsh and hard on the population as Saddam was. So it will be a weak dictatorship.

I predict a very unsettled, unstable situation in Iraq after the military intervention.

What are the consequences for oil? Of course, as soon as the war starts the Iraqi oil exports will stop. If the war starts tomorrow, the world will be losing only 700,000 barrels at day. If the war starts two months from now, the world may be losing 1.5 million barrels at day, because Iraq may increase its exports.

You have heard Mr. Priddle say that the IEA will do nothing at the beginning. This is perfectly consistent with what the IEA has been doing since it was created, because in 1979, during the Iranian revolution, they did absolutely nothing.

And the reason then was that the agreement among the members of the IEA was that we trigger the emergency plan if there is a reduction of 7% in world supply. So they met several times, and they said, "No, it's not 7%. It's still 6.5," or whatever. And they did nothing.

The same in 1990, where the emergency plan consisted of sending one cargo to Turkey. It arrived late, and it was too expensive. So the Turks refused to take it.

And now it's the same. A million barrels is not a big disruption. But 2 million barrels a day at the margin can raise the price of oil by 10%.

People do not understand that in a market a small change at the margin can have a very big price effect. It's not a matter of a million or 2 million.

So there is no doubt that pressure will be put on Saudi Arabia to

produce the extra million or 2 million barrels a day. And the Saudi minister in Osaka said two days ago, "We shall not allow the market to be overheated by the political situation."

So it's possible that Saudi Arabia will compensate for the loss of Iraqi crude. But it is also possible that there will be a difference of opinion among the leaders of Saudi Arabia, resulting in their hesitating to show to their population that they are helping the Americans and the world at a time when there is strong frustration and strong unhappiness among their people.

So we shall see.

It is possible also if there is a big war premium in the price today (I don't know if there is, but suppose there is), it is possible that the moment that air force starts attacking Iraq you have what happened on January 17, 1991, when the price of oil overnight (between midnight and 6 a.m.) fell from thirty-something dollars to \$22. When the war started, the price fell. It did not go up.

So you could have the same phenomenon if there is a big war premium in the oil price, because people will say, "The war has happened. Fine. The uncertainty is gone. We don't need that premium." It could happen.

What are the long-term consequences of U.S. intervention in Iraq? Here, we have to look at two problems. All the focus now is on the U.S. intervention in Iraq. But for the Arab societies, and the Muslim societies, the first problem and the longest problem and the oldest problem and the most-used problem is the Palestine problem.

And because all the attention is focused on Iraq, people are not paying enough attention to what is happening in Palestine.

So we have on the one hand the suicide bombers. We have on the other hand the very strong and harsh retaliation by the Israeli government, which nobody seems to be able to stop.

And yesterday there was a U.N. Security Council recommendation that Israel should stop. And the immediate response of Israeli was, "Thank you, gentlemen. We will do nothing," which is very interesting, because in the American submission to the Security Council about Iraq, they said that Iraq had violated or ignored 12 Security Council resolutions. We counted the other day that since the beginning Israel has ignored 28 Security Council resolutions. And yesterday one more. So that's 29.

And this has a very bad effect on public opinion in the Arab and Muslim world, because they feel that there are two standards, two criteria, two sets of international law: one for the Arabs and one for Israel.

The next thing is suppose the U.S. goes to Iraq and changes the regime there. Will they stop with Iraq? Will that be the end of the story? Will they be

tempted to put pressure on Iran? Will they be tempted to put pressure on Jordan, on Syria, on Saudi Arabia? How? In what way? What are they going to do next? Will it be the end of the story or the beginning of the story?

Long-term consequences in the Middle East? Very simple. Do not expect revolutions, changes of regimes, happening in the weeks or months even two or three years following intervention in Iraq.

I heard an American commentator say, "Everybody talks about the Arab street. Where is the Arab street?" I would say it's a pity that the Arab street does not express its feelings, because if they expressed their feelings in the street at least the steam would be out.

Because they cannot express their feelings in the street, the steam is inside. And when there is too much steam in a boiler, it looks stable and nice, and then one day it explodes when you expect it least.

So what will be the long-term consequences? Very simple. More fundamentalism, more extremism, and eventually more terrorism.

And we will find a change in political regimes slowly happening--within a regime sometimes--toward much more extreme policies, much more fundamentalist policies.

This will not cause an interruption of oil supply. There will be no use of the oil weapon. Forget about the oil weapon. And that's why all this hysteria in the OECD about energy security, in my mind, is not very convincing, not very justified.

There will be no oil weapon. But what you will have is governments that are less capable of investing, of bringing in investors, of operating their national companies in a way that can ensure long-term supplies.

The question everybody asks is "What will happen to Saudi Arabia?" Saudi Arabia is very unsettled by the criticism they are getting, mainly in the United States, extremely unsettled.

And they believe that there is a danger that the United States wants to intervene in Saudi Arabia sooner or later by operating some division in the country.

Perhaps this is paranoia. I don't know. But they read stories like that in the press. And they worry about it.

The Saudi government is worried and is unsettled. And the Saudi population is upset, because they feel that they are the target of criticism because some Saudi citizens were involved in the hijacking of the plane and World Trade Center.

I think this in the long run could destabilize Saudi Arabia, because they will attempt certain policies in one direction and other policies in other directions. And that will create quite a lot of confusion, and more seriously,

could create a split within the ruling family between those who want to advocate one policy and those who want to advocate the opposite policy.

My view is that any change in Saudi Arabia would be for the worse, not for the better. We can have whatever view we want about the current regime in Saudi Arabia. Even if we consider it to be very bad, what would come after would be worse, not better. And that's very important to remember.

A final point: We hear a lot about the Middle East's not being important in the long run. We hear that in American lobbies. Mr. Priddle said the opposite. He said the reliance on the Middle East in the long run will increase.

But we have heard that Russia is the new Middle East. Some people say, "No. no. Not only Russia and the Caspian, but West Africa," because there is a lot of oil deep offshore. Nigeria is a lovely country. If they would only leave OPEC everything would be fine.

In my humble view, all that is total nonsense. Yes, Russian production will increase. Russian oil production has been increasing. It has been increasing by 400,000 barrels a day every year. It will continue at that rate until 2005 or 2006. And after that, it will flatten.

But Russia will never be the swing supplier. It might be an growing, expanding supplier, but not a swing supplier. For swing supply, there is only Saudi Arabia today and in the foreseeable future the only one who can play this role.

To believe that Nigeria and Angola will be more secure and stable suppliers in the future than Saudi Arabia is a bit of a stretch.

And to believe that if Nigeria leaves OPEC they will produce much, much more oil again is also a bit of a stretch, because if Nigeria is not producing more today it is not because they want to respect the quotas. Nobody respects the quotas. Everybody supplies demand as it comes.

Nigeria cannot expand, because they have internal problems, because the system there is not geared toward that expansion.

So what I predict to conclude is yes, OPEC will have problems managing the oil price for 5-6 years after all this trouble with Iraq, because a lot of non-OPEC oil will come then onto the market, from Russia, from the Caspian, from other parts of the world.

During that time we will perhaps have a long recession, and world demand will not be going.

But if you go forward to 2010 or 2012, then demand will start going again, because the developing world is growing. Demand will start growing again.

And these new sources of supply will have peaked. They will not continue to grow forever. You will have falls in supply from other places.

And then unless we have a huge investment in nonconventional oil, in Venezuela, Canada, and places like that, then the reliance on Middle East oil will increase, and not diminish, until such time as we have a technological revolution which make everybody instead of driving cars drive hydrogen bicycles or something. Then the situation will change.

So we are going to face a big cycle, with very difficult times for the producers, followed by another period when the markets will be favorable to them until such point where we have oil being displaced more and more by technological advances in the transport sector.

Thank you, Mr. chairman.

Q: Those were very good insights. My question is "Why do you think the United States is insisting on launching a war against Iraq?" Is it for oil-related reasons?

Thank you.

A: No, I don't think so. Oil is an aspect of the story, but it is not the fundamental aspect. My view is that the long-term strategic aim of the United States is to have a dominant position in the Middle East from which they can exercise pressure on the neighbors of Iraq, and in the long term to have a position in area where there might be competition against the United States from Russia or China.

That's the geopolitics of it. But you cannot say that now. Mr. Bush cannot say, "I want to go there, because I don't like the Chinese, I don't like the Russian. And they can cause problems in the area in the future." He has to say, "I have to go there, because this is a terrorist regime and a very bad regime," which is true. It's bad regime.

I don't think it's a terrorist regime, because they are too scared to be involved in an act of terror, which would bring retaliation.

But it's a bad regime. As I said, we can list a lot about it. But the theory that it's all because of oil, and it's because the United States wants the Iraqi oil, etc., of course it's one of the by-products. It's one of the benefits if everything works well. But I don't think it's the prime motivation.

Q: If the United States stays in Iraq, will Iran and Libya will try to compete with the U.S. using oil as a weapon?

A: Are you asking about whether the United States will continue sanctions? If they are in Iraq, they don't need to have sanctions on Iraq. So that will stop.

But the United States is sanction-prone. They impose sanctions every time they are unhappy with somebody. So they will maintain the sanctions on Iran. I think they will maintain the sanctions on Libya also, because Congress wants them. Even if the administration doesn't, it's difficult to sell the idea to Congress, unless there is a very big settlement over the Lockerbie issue. It's progressing, but it's not there.

I think there will be political resistance to removing the sanctions on Libya. But we shall see.

Q: After the U.S. attacks Iraq, what will be the reaction from Libya and Iran? That was my question.

A: Colonel Qaddafi is very good at making statements, so he will make some statements after the attack. But there is nothing much he will do. What can he do?

What about Iran? I don't know, but people say Iran doesn't like Saddam Hussein because of the war, which is true. There was an 8-year war. A lot of Iranians died. It cost Iran a lot of destruction. Of course, they don't like Saddam Hussein.

But I don't think they would like to have the United States on their border. Mr. Churchill and Mr. Roosevelt didn't like Stalin. But they didn't like Hitler to be on their border, either. So they allied themselves with Stalin.

My view is that if I were Iranian I would say, "I don't like Saddam Hussein. But I don't like the U.S. intervention, because they come to close to me. So I will forget about Saddam Hussein for the moment and protest against the U.S. intervention."

But again, you know, you can protest--everybody protests--but it has no effect. So they are in a dilemma. And what can they do? There is not much they can do.

Libya will be unhappy. Iran will be unhappy. But 62% of the British people are unhappy, and 75% of the Germans are unhappy. Probably the same proportion in France is unhappy. Who is happy about this type of policy? It's going to destroy Iraq. Okay. Fine. We can forget about that for the sake of the discussion.

But it's going to destroy the whole basis on which international relations have based since World War II. And you have a group of fundamentalists in the United States, because Rumsfeld and Powell and Wolfowitz and all these people are fundamentalists, basically, who got their election by 12 votes, which were even contested, and who are holding the world for ransom and are going to really destroy the basis on which international relations have been based.

So everybody is unhappy, but nobody can do anything. Russia will sign. China will sign. France will sign. Japan will help. The Arab world will say nothing but allow the planes to fly. How can you stop them from flying?

And that's a very sad situation.

Q: I know you are a mastermind of oil markets, especially pricing mechanisms. Given that Brent is now losing the basis as market crude, and WTI could be manipulated fairly easily, and Dubai is losing ground. So given these situations about market crudes, would you suggest nominating just one crude as the market

crude to be applied all over the world, like asking Saudi Arabia to release a million barrels a day of Arabian light to spot markets and make it the common market crude?

In an ideal world, what would be your proposal for a new world pricing system?

A: There is no doubt that if Arabian light, the Saudi crude, were the reference crude it would have more relevance than do Brent or Dubai or WTI, because it's a very broadly internationally traded crude, because the supply is very big, 5 million barrels a day, not 400,000, etc.

But suppose Saudi Arabia said, "Okay. Let's have a market in which our crude can be sold." Who is going to trade against a single supplier? People liked the Brent initially, because Brent was produced by 5 or 6 companies. They didn't want Forties, because Forties was produced by one company.

How can you trade against Saudi Arabia? That's one point. Second, the Saudis would lose control, and they don't want to lose control.

There is no reference crude that is eligible. The ideal solution is to do with the oil price what the Bank of England does with the rate of interest or what Mr. Greenspan with the rate of interest. It's to have a set of principles defined by OPEC saying, "Look. We have to look at our revenue needs up to a point. We have to look at the state of the world economy up to a point. We have to look to see if there are sudden reductions in demand because of recession or increase in demand. I have a committee of OPEC experts plus three or four neutral people, with a good set of guidelines," and to fix the price once a month within a certain range.

But if you say that, I can say this here, because I say it everywhere, because I'm so old now that I don't mind being insulted. People say, "He's a dinosaur. He wants to go back to the bad world of fixed prices." If you don't like volatility, you have to fix the price. If you don't fix the price you are going to have volatility. And I don't care-- whatever you want to have.

But you cannot escape that logic. What you have to avoid in a fixed-price system is sudden shocks. But the problem is that the oil market is managed in a very primitive and unsophisticated way.

Q: Noe Van Hilst, from the Netherlands. Mr. Mabro, I very much enjoyed your speech. I have one question on Iraq. But setting aside the interesting political issue, on the oil side of it, there is also a theory that whatever happens, if a new regime in Iraq would be able to restore the capacity of oil production in Iraq that then they have so much potential that they could really act in the medium term as a new swing supplier in the oil market. What do you think about that theory?

A: If you give me 5 years of political stability in Iraq after the intervention,

complete political stability (otherwise the oil companies are not going to put billions of dollars into a country that is in turmoil), and if after this 5 years you increase Iraqi production from today's capacity of 2.8 million barrels a day by another 2 million barrels a day, how are you going to replace 8 million barrels a day of Saudi oil, 2 million from Abu Dhabi, 2 million from Kuwait (12 million in total) by an increase of 2 million in Iraq, or even 3 million in Iraq?

Second, the Iraqis are sophisticated people. Don't underestimate them. And they have big experience in oil. What will happen in Iraq if there is a new government is that at the beginning they will want to do like any newcomer does. They will want to have more volume. No doubt about it.

And Iraq will be new, in a sense. They will first want more volume, to increase their share. So okay, they will have their 2 million more. If by the time they have this 2 million more they find that the price of oil is collapsing in the world they will be the first to lead OPEC into doing something to restore the price of oil.

And don't forget that governments do not live from production volume. They live from revenue, from cash.

The Kuwaiti minister said the other day, "There is one lesson we learned in 1999. It is that by reducing our production by 10% our revenues multiplied 2.5 times."

This simple fact, which is ignored by all commentators, by all industry, by all the consultants, is not ignored by the producing countries, and especially by their ministers of finance. They understand that point.

So the idea that Iraq in the long run is just going to flood the world with oil even if the price has fallen down to \$7-10 is totally ignoring very fundamental facts. Governments need cash. They don't need ballots. They need cash.

But you will have trouble before, right? We have crisis like 1998. It takes a year or two to sort out the problem. But in the end you go back to the fundamental: "I want cash!"

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