Statement Of David L. Bole
Vice President, Corporate Research and Development
Randall & Dewey, Inc.

Subcommittee on Energy and Power
Committee on Commerce
U.S. House of Representatives

March 26, 1999

Mr. Chairman, my name is David Bole. I am Vice President of Corporate Research and Development for Randall & Dewey, Inc., a Houston-based company that facilitates transactions in the upstream part of the petroleum industry for all segments of the industry – major companies, large and small independents, both public and private. In this business, we have seen the disruptive effects of the current price crisis not only on the stability of this critical portion of the industry but in the direct loss of producers' equity value. Today, I am representing the Independent Petroleum Association of America. IPAA submits that the current problems facing domestic producers, and potentially significant future problems, are related in large part to the abuse of the UN "oil for food" sanctions program by Saddam Hussein.

The industry has faced a low oil price crisis for more than a year, but today's problems are very different. Just over a year ago, the price crisis was started by a combination of events – the collapse of Asian economies, a warmer than normal winter in the Northern Hemisphere, and OPEC's decision to increase production quotas. The production most at risk was marginal oil wells in the United States – wells that produce about 20 percent of America's domestic production, an amount equivalent to our imports from Saudi Arabia.

However, as 1998 progressed, key OPEC countries and other significant non-OPEC countries curtailed production to try to diminish surplus inventories around the world and stabilize oil prices at levels that permit profitable operation. As other countries cut production, the UN sanctions program created an opportunity for Iraq's leaders to influence the price of oil in ways that no one would have expected. The UN sanctions structure was changed in two significant ways in early 1998. First, the "oil-for-food" program has always been based on a dollar amount rather than a volume allowance. The dollar amount was increased to $5.265 billion per six months – an amount at current prices that effectively allows Iraq to pump unlimited volumes. Second, $300 million every six months was allocated to improve Iraq's oil production capacity. Thus, as other countries were making the economic decisions to reduce production as prices fell, Iraq was given a perverse incentive to increase production.

And, increase it did. At the beginning of 1998 Iraq was exporting approximately 700,000 barrels of oil per day. *By the beginning of 1999 it was exporting as much as 2.5 million barrels per day.* In 1998 Iraq was the only country to increase its production of oil. This increase has allowed Iraq to become the world's swing producer – the producer that sells the last barrels into the market and thereby defines the price for the entire market.

Let me explain what allows Iraq to become the swing producer. Currently, many industry analysts estimate that worldwide oil productive capacity, that is production that could quickly be added to the world market, exceeds demand by only about 4 percent. As demand increases at a rate of 1.5 to 2 percent per year, this excess capacity is rapidly *disappearing*. Current low oil prices have decimated upstream capital development budgets by an estimated 40 percent. Simply put, without the expenditure of enormous development funds current capacity will not be expanded to keep pace with increasing demand. This is the situation we now face. As a result any country with exports matching the excess productive capacity, has the ability to be the world's swing producer. Iraq now has about three percent of the world's demand and has the ability to dramatically influence prices by either cutting or increasing its production. As demand increases and excess capacity drops, the export volume needed to drive prices will decrease. In the not too distant future – if not already – Saddam Hussein will be in the position to drive prices upward and punish consuming countries – perhaps when sanctions are lifted and all the money from Iraqi oil sales goes to him.

We submit that Iraq is using this position for its leader's own political purposes. Saddam's objectives differ from other oil producers. He wanted higher oil prices when he invaded Kuwait – money he needed to build his military forces. Now, he can't spend money to buy arms. But, he can – by keeping oil prices low – punish his enemies, first by reducing the income to Saudi Arabia, Kuwait, UAE, Iran, and all the exporting countries; second, to increase market share by driving down prices and causing critical U.S. production to be shutdown and plugged forever. Thus, while condemning the UN sanctions and thwarting efforts to deliver to his people the humanitarian aid the sanctions purchase, Saddam is effectively manipulating the world oil markets for his own political purposes. This is where we stand today. And that is why we are here.

At issue then is what will happen next. Last week, the Secretary of Energy argued that "Iraq's ability to increase its production is limited and is not expected to go up measurably this year. As a result, EIA believes that whatever effect Iraqi production has had on prices has already occurred, because Iraq cannot increase oil production much more over the next year or two." While we agree Iraqi production has impacted prices, the statement that Iraq cannot increase production is a costly assumption that must be proven. Given that the current sanctions program continues to fund additional improvements to the oil export capabilities of Iraq, there is no certainty that exports will not increase further. In the middle of 1998 most experts believed that Iraq could not reach the export levels it is currently sustaining. Clearly, today's crude market is forcing other major oil exporting nations to develop elaborate plans to manage their production, the success of these efforts is limited by the ability of Iraq to add more oil to the market. If the current "oil-for-food" program results in further Iraqi oil production increases, it will allow Iraq to continue to hurt the other oil producing countries – Saudi Arabia, Kuwait, Venezuela, Russia, Indonesia, Mexico, and the strategically essential domestic production of the United States. If it does, the UN sanctions will continue to be fatally flawed at two levels. First, they will have failed in its primary mission to provide humanitarian aid to the Iraqi people. Second, they will have handed Saddam Hussein the victory he lost in the Gulf War.

For the United States these options reflect policies we must change. They make no sense. The world fought a war to prevent Saddam Hussein from controlling world oil prices. Now, we have – however inadvertently – handed him this ability. And, we are handing him control of the future of our domestic resources – an unbelievable policy choice. Current national policy on Iraq is faulty. Today, domestic production is at risk, while tomorrow the U.S. consumer may soon feel the shock of higher energy prices brought on by the actions of a rogue nation – a policy that hurts producers and consumers alike.

Our domestic oil production resource is our true national strategic petroleum reserve. We must value that resource. IPAA has presented an array of options for Congress to address *in response* to the current price crisis. With respect to Iraq we must recognize that its role in oil pricing may not have been planned, but it is now significant and it is not benign. If we fail to act in the short term, precious domestic resources will be lost forever. Then, in the longer term when Saddam shuts in production, we will not have the production needed to respond. In the past year we have lost nearly 600,000 barrels per day of domestic production, which has *reduced* the U.S. crude production to a level that has not been seen since 1950. Since 1986, when the last price crisis crippled the industry, domestic oil production has dropped by 2 million barrels per day. We need to act now to prevent a similar consequence from the current price crisis.