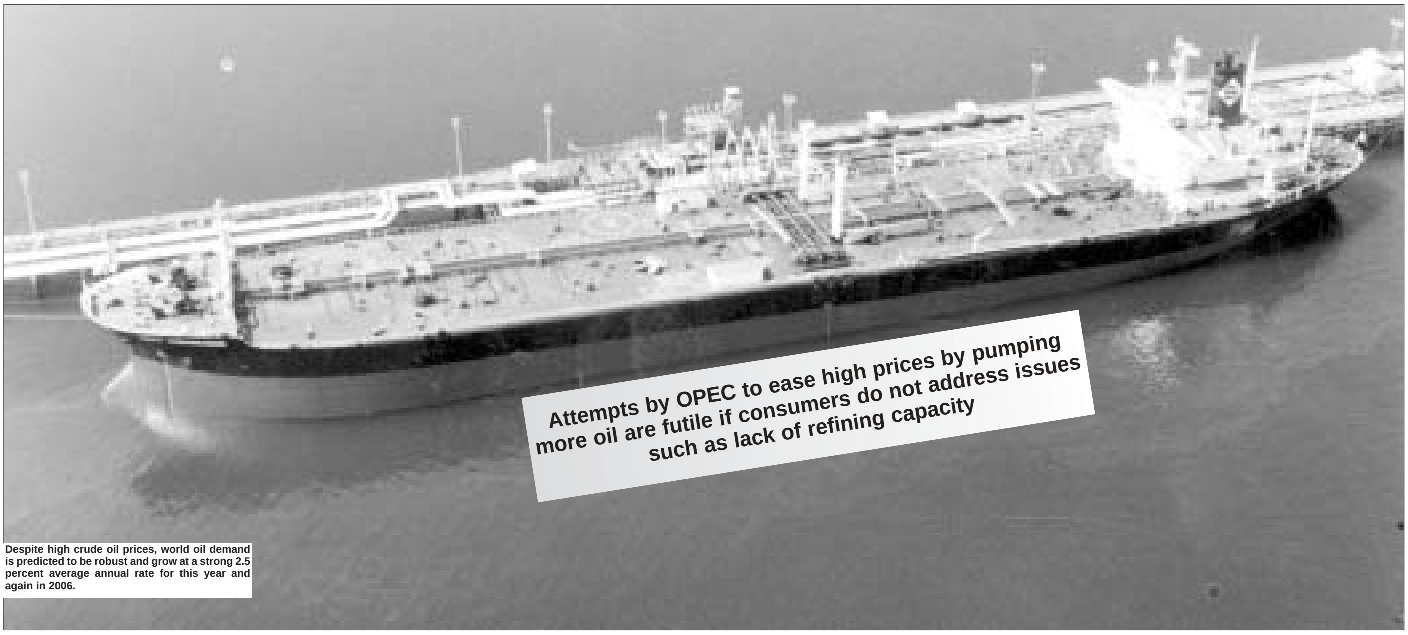
Oil Prices to Stay High



Despite high crude oil prices, world oil demand is predicted to be robust and grow at a strong 2.5 percent average annual rate for this year and again in 2006.

Hossein Kazempour-Ardebili, Iran's representative in the Organization of Petroleum Exporting Countries (OPEC), blamed concerns regarding continuing US hegemony over oil-producing countries and unilateral sanctions against some of them for the soaring oil prices.

He believes the upward trend of prices will continue in the next few years.

"Reduced production level of non-OPEC countries is also a contributing factor, in addition to low refining capacities mainly due to low technology. This has prevented producers from refining low-quality heavy and sour crude. Coupled with political tensions, especially in the Middle East where the world's largest oilfields are situated, the threat of terrorism also restricts output," he said.

The Iranian official says the recession looming over the global economy and low interest rates often cause an massive influx of idle capital toward the oil market and push the prices higher.

World demand for crude is estimated at 84.9 million barrels a day in the third quarter

Status Quo

In the meantime, crude futures have jumped, approaching $61 a barrel mark.

The US Energy Information Department also raised its demand estimates for the second half of 2005 ahead of its petroleum data release.

World demand for crude is estimated at 84.9 million barrels a day in the third quarter, 400,000 barrels a day higher than the June forecast. Meanwhile, fourth-quarter demand is estimated at 87.2 million barrels a day, up 500,000 barrels a day.

Oil prices are nearly 55 percent higher than a year ago, but would still need to cross $90 per barrel to match the all-time inflation-adjusted high set in 1980.

Kazempour-Ardebili says Iran has a 14.6-percent share of OPEC's quota, with a daily quota of 3.96 million barrels.

"The country's production capacity is 4.25 million barrels," he said.

According to Oil Minister Bijan Namdar Zanganeh, Iran's new quota as of July is 4.11 million bpd, but some analysts believe Tehran's capacity is constrained at 4 million bpd, about 200,000 bpd lower.

He plays down the concerns of the Group of Eight leading nations that current high oil prices will have a major impact on the global economy.

"Studies have shown that with oil at $50 a barrel, this has a 0.3-percent downward revision on world economic growth," he said.

He, however, says if prices continue to rise toward $70 per barrel, this could start to have a serious impact on global economic growth.

"If prices go higher, obviously the downward revision on economic growth would become bigger."

OPEC cranked out an additional 80,000 barrels per day of crude in June to push average production up to 30.1 million bpd.

The Iranian official pointed out that India and China have decided to create strategic oil reserves, that too in the face of supply shortage and high prices, and this will have a long-term effect on the market and keep the current high prices up for the next two or three years.

OPEC Inability

The inability of OPEC to produce more is obvious in the small net increase of 80,000 bpd. A great deal will depend on whether Saudi Arabia, the only member of OPEC with a significant spare capacity, will be willing to produce additional oil, even though much of its 1.5 million bpd of surplus capacity is made up of heavy oil for which there is no demand.

Kazempour-Ardebili says attempts by OPEC to ease high prices by pumping more oil are futile, if consumer countries do not address issues such as a lack of oil refining capacity.

He also says prevailing geopolitical tensions, concerns over terrorist attacks and market speculators continue to keep prices high.

Persistent supply concerns are also pushing prices higher.

"Consuming countries will continue building reserves, particularly while geopolitical concerns remain paramount...and that will naturally have a bearing on prices," he said.

Kazempour-Ardebili maintained that growth is expected to remain robust but challenges remain, especially persistent global imbalances and high, volatile oil prices.

If prices continue to rise toward $70 per barrel, the downward revision of growth rates would become bigger

Iran has a 14.6-percent share of OPEC's quota and produces 3.96 million barrels of oil a day.

Robust Demand

Despite high crude oil prices, world oil demand is predicted to be robust and grow at a strong 2.5 percent average annual rate for this year and again in 2006.

For 2006, experts expect oil demand to also be 300,000 barrels per day higher than previously forecast and average 87 million barrels per day.

Still, oil demand growth for this year and next will be lower than the 3.4 percent seen in 2004. Global oil use averaged 82.8 million barrels per day last year, an increase of 300,000 barrels per day in a revision issued by the IEA in its monthly report.

Rising Chinese oil demand will particularly contribute to overall world growth in petroleum use over the next two years.

To help meet demand, OPEC will have to supply more crude because the supply from non-OPEC oil producers is not expected to accommodate incremental worldwide demand growth. The IEA expects Saudi Arabia, OPEC's biggest producer, to "steeply discount their heavy oil in order to market it effectively".

For the US market, the agency said it expects oil demand in the upcoming third and fourth quarters to be 210,000 barrels per day and 240,000 barrels per day higher than previously forecast.

High crude oil costs will help keep the quarterly average price for retail gasoline above $2.20 a gallon through 2006. The average price for gasoline this summer, which runs from April through September, should average $2.25 a gallon, up 8 cents from earlier projections last month.

Kazempour-Ardebili, like many oil analysts, believes high oil prices are here to stay in a world of geopolitical uncertainty.

Reducing Monopoly

The first step to enhance productivity in any economic sector is to encourage free competition

Low productivity rate is the result of government monopoly rather than the form of ownership (state-run or privatized).

In an effort to boost competition in the international markets, Chinese industries boosted their productivity levels and trimmed down production costs. In this respect, instead of concentrating on the time-consuming process of privatization, they focused on the ownership and legal terms and introduced a competitive market. Their immediate success proved that inefficiency is more a matter of government monopoly rather than legal issues.

Therefore, the first step to enhance productivity in any economic sector is to encourage market competition. In a monopoly where government controls almost everything and there is virtually no competition, it is very difficult – if not impossible--to assess government performance, reports Eqtesad-e Energy.

One of the biggest challenges for the Iranian economy is low productivity. In order to enhance it there is no other option but to provide a competitive market and introduce anti-monopoly policies through privatization schemes. Government monopoly of the energy sector and its affiliated bodies such as oil and gas industries is complete with virtually no competition.

But how long can monopoly continue in the energy sector? There might be some doubts over private sector trust or the capability of the government to supervise and control its performance. In addition, the private sector might not have the necessary capacity and the means to perform efficiently in the energy sector. To sort this out, the government could offer financial resources and invite large companies to invest in the sector in a bid to break the monopolistic hold.

Within the next few years the energy sector will have to generate thousands of MW electricity requiring huge investments. The Ministry of Energy has shown some interest to allow the private sector or foreign companies to be part of the process, but in practice this has never been the case. For certain reasons the government is of the opinion that the energy sector has to be under its complete control.

It is important to take effective measures immediately to trim down the scale and scope of government influence in the economy

Europe has several gas and electricity companies and people are free to choose any of them to supply their gas and electricity needs. Iran's electricity network is just one big unit without separate branches, which makes it unattractive for investment. However, as per the law, the national network is bound to connect producers to consumers.

The European Union is planning to spread competition in favor of consumers throughout Western Europe. This will make it possible for citizens to choose any electricity and gas supplier from anywhere in Europe. The unified network will be obliged to connect people to producers regardless of the country of origin.

Fundamental measures need to be taken in Iran to break the monopoly and downsize the government. This will help include the private energy sector and boost competition in the market. A better option is to set up semi-government agencies with rules and regulations in place. They could have equal access to the energy network and be able to compete as independent entities with the government.

In view of globalization it is important to take effective measures immediately to trim down the scope of government monopoly. All economic agencies in the private sector need to be competitive in the domestic market; otherwise they will have no place or future in the complex and competitive global market.