

PETROLEUM FOR SUSTAINABLE DEVELOPMENT

In the last few years, the world seems to have become accustomed to the notion that sustainable development relies exclusively on the development of green energy, and can be achieved independently from what happens in the oil sector.

However, energy markets don't work like that. What affects oil also affects other energy sources. Oil must be at the centre of any concept of sustainable development.

Low oil prices, for example, are the worst enemies of research in alternative energy sources, as well as the strongest enablers of unacceptable energy consumption habits.

Instability and volatility, meanwhile, are bad news for both long-term oil prices and for the development of alternative energy. After all, it isn't easy to invest in any energy source when one doesn't know – from one day to the next – whether oil will rise to \$100 or fall to \$30.

This deep uncertainty could well determine a sort of “energy paralysis”, where investments are scaled back across the board.

And this, as Saudi oil minister Ali Naimi has pointed out, could bring about a “nightmare scenario” where traditional energy suppliers reduce investments because they expect

declining demand for their products, while alternative energy supplies fail to meet overly optimistic expectations.

As a result, energy of every kind could be in short supply, triggering a new cycle of skyrocketing prices and lower economic growth.

Oil market stability at a reasonable price is therefore essential for sustainable development. But unfortunately, there are two daunting obstacles to achieving stability in our market:

Firstly, we must determine what a “reasonable” price for oil might be. And secondly, we need to find ways to stabilise the oil market at this reasonable price.

Let's start with the first issue. What should the oil price be?

Forget for a moment the basic economic assumption that the long-term price of a good depends exclusively on the laws of demand and supply.

Because of the special nature of this non-replaceable resource and its impact on the global economy, the development of other energy sources, and the well-being of people around the world, the ideal price of oil should take into account six different issues.

- 1. First, the oil price should be high enough to ensure adequate returns on investments for producers.**

Of course, this calculation depends on what we think the marginal cost of the barrel is. The most expensive projects worldwide – technologically ambitious and in daunting areas – may cost as much as \$80 per barrel. But the market doesn't necessarily need these. In my view, even factoring in a decline in upstream costs from their recent highs, the right number to make investments stack up is **no lower than \$60 a barrel.**

2. Second, the oil price should be low enough not to hurt economic growth.

Evidence suggests that this time around, oil started affecting the economy somewhere around \$70-\$80 a barrel. Coincidentally, in real terms this is in line with the peak average price of \$34 per barrel we saw in 1980, at the height of the second oil shock.

Of course, every economic cycle is different. But these indicators suggest that, to preserve economic growth, the oil price should rise **no higher than \$75 a barrel.**

3. Third, the oil price should be high enough to encourage a rational and efficient use of energy.

Decades of low oil prices have made consumers, and particularly consumers in the US, believe that cheap oil is a divine right. As a result, wasteful habits are ingrained in everyday life, and hard to get rid of.

If we use the U.S. as a paradigm for our evaluations, the critical oil price that spurs conservation is certainly **no lower than \$ 70 a barrel, and possibly even higher.**

4. Fourth, prices should be low enough that bio-fuel production doesn't displace agricultural activity.

This is an issue that is commonly underestimated. But in the last few years we have witnessed a massive movement towards using arable land to produce biofuels, which contributed to the food crisis of 2007-2008.

In order to avoid farmers switching to producing biofuels instead of food, and therefore harming the world's poorest, oil prices should rise **no higher than \$70 a barrel.**

5. Fifth, prices ought to high enough to encourage investment in alternative energy sources.

When speaking about sustainable development, we cannot but consider that it is essential for mankind to eventually develop effective and efficient renewable energy sources.

To make research and development of renewables possible, however, it's necessary for the oil price to fall **no lower than \$60 a barrel.**

6. Sixth, oil prices should be high enough to encourage investments in new technologies both to extract more oil and to contain the

In this case, my personal evaluation is that – to make a long term commitment to investing in advanced technology possible - the oil price should fall no lower than **\$60 a barrel**.

To sum up, calculating a “reasonable” oil price is a balancing act.

Go too low – say below \$60 a barrel - and what you get is declining investments – in oil, in renewables and in new technologies – plus a lot of waste. Go too high – say above \$75 dollars a barrel – and what you get is contracting economies and a massive displacement of agriculture in favour of biofuels.

Taking all of this into account, the best number is probably somewhere in the region **of \$60-\$70 a barrel**. Not the perfect number, but a good compromise between the different interests involved.

Of course, all these considerations must take into account that we are passing through a severe global recession that is feeding the destruction of oil demand even at prices that are considerably lower than which are needed to ensure sustainable oil production. Extraordinary moments require extraordinary behaviour. And that means we must consider that – for 2009 at least – any move to substantially increase the oil price could accelerate demand destruction.

This means that the oil industry needs to take the long view, rather than getting bogged down by short-term considerations.

But now that we have identified a reasonable long-term price, is there any way to stabilise the market around this level?

The hard part here is not deciding **what** needs to be done. Indeed, it is clear that if we want price stability we need to encourage a constant flow of investments for petroleum development, and the creation of sufficient spare capacity.

The difficulty is finding the best way to do it.

One idea might be to use long term contracts obliging sellers to provide, and buyers to purchase, predetermined quantities of oil at agreed prices, as is the case with the *Take-or-Pay* contracts in the natural gas sector.

Another idea could be to establish a sort of *Global Stabilization Fund* or an *International Capacity Market*, whose main task would be to remunerate spare productive capacity in the world petroleum market. This fund could be fed by a sort of excise tax on oil products, and would be managed by an independent body.

These ideas could also be combined to create a new framework for oil price stabilisation.

Of course, these are just the first, bare bones of a possible solution. At Eni, we have recently launched a working group which will try to flesh them out.

But this is not the sort of project that can be brought to fruition in the closed confines of a meeting room. For any new contractual framework to be really effective, it would need to be endorsed by a significant number of the world's most important producers and consumers.

And that is why we hope that other market operators will participate actively in the discussion to create a truly viable new model which would benefit our industry, producing countries, consuming countries, and contribute to the sustainable development of the world.

Thank you for your attention.