Business & Finance

Going Global

The Future of Kuwaiti Oil

Interview with Nawaf S. Al-Sabah

Nawaf Al-Sabah is Manager of Kuwait Petroleum Corporation USA.

GJIA: How does the development of the northern oilfields through Project Kuwait fit into Kuwait Petroleum Company's (KPC) overall global strategy?

AL-SABAH: KPC's overall global strategy is to diversify its sources of income beyond simply selling crude oil. To that end, we have, over the past couple of decades, increased our refining capacities and, more recently, ventured into petrochemicals. As we look into the future, we recognize that the global oil demand will be increasing and that much of this demand will be on Gulf crude from Kuwait, Saudi Arabia, and the United Arab Emirates. We are aiming to fulfill our responsibility of being a stable and reliable provider of energy to the world by increasing our own production capacity from our current rate of about 2.4 million barrels a day to 3 million in the next few years and then 4 million a decade thereafter.

The key to this production boost will be Project Kuwait. When the project was conceived, we were producing 450,000 barrels of oil per day from those fields in the northern half of Kuwait; we want to double it to 900,000 barrels per day. We realize that in order to increase the capacity of those fields we need addi tional technology: a water flood and gas-lift system to increase the recovery rates from the wells. Also, as these fields mature, the water cut will be increasing in such a way that, while we currently produce less than a barrel of water for every barrel of oil, in the future we may have up to five barrels of water for every one of oil. What do we do with that water? How do we treat it? What corrosive effect does that water have on the equipment? All of these issues present technical challenges that KPC has not yet overcome. To try a water-flood or a gas lift system on our large reservoirs is relatively dangerous, so we are looking for help from our partners in international oil companies that have experience with this kind of project.

GJIA: Will this new international presence and foreign investment in northern Kuwait affect trade preferences or international relations, and what economic or political benefits might it bring?

AL-SABAH: Thus far in Project Kuwait, we have qualified a number of companies as operators and non-operators, we have invited consortia to be formed, and companies have formed three consortia of international character. Each of these consortia has at least one American company and one international company; the consortia are very well mixed and the companies are of the highest caliber.

As for the geopolitics of the region, the project was designed on a strictly techni cal basis, but it is no secret that, by our asking for international consortia, we want as much international participation as possible and a stake in the economy and security of Kuwait. Until recently, Kuwait had an extremely aggressive northern neighbor, and we are still very mindful of our future security. Although this project is not designed to address that specifically, it does have security benefits insofar as it gives the leading nations of the world an economic inerest in the future well-being of Kuwait.

GJIA: How does KPC view the burgeon ing energy market in East and South Asia, particularly China? How does your company plan to position itself in the region as energy demand increases exponentially over the coming decades?

AL-SABAH: The East has long been our natural market, as Asia has traditionally provided the greatest net revenue back to Kuwait. We have very strong markets in Japan and Korea, and we are now looking at expanding to China and India where we see huge opportunities. A crucial develop ment will be how China industrializes in the transportation sector. Will it go from bicycles to motorcycles to cars, which is the conventional method, or will it jump from bicycles straight to cars or, perhaps, to alternative fuel vehicles?

We are also focusing heavily on establishing markets for Kuwaiti crude in South Asia. We have been looking into various privatizations of marketing companies by the governments in India and Pakistan. Besides two projects in India, we are one of the lead bidders in the privatization of PSO (Pakistan State Oil), which controls 65 percent of the oil market in Pakistan. These ventures are the most ambitious, but we should not discount our strong foothold in Thailand as well. We are going out, looking for market shares, and trying to tie them into our global strategy.

GJIA: What impact did the 2003 war in Iraq have on KPC and the Kuwaiti economy? What role and/or prospects of contracts does your company have in the rebuilding of Iraq?

AL-SABAH: The war in Iraq had an extremely positive effect on KPC and the Kuwaiti economy. From the point of view of our security, the removal of Saddam Hussein was perhaps the best thing we could have asked for.

Before the war, a few hundred thousand American and British troops were staged in Kuwait. Their logistic supply needs essentially cleaned out the Kuwaiti market of cars, refrigerators, air conditioning units, and all kinds of consumer supplies. The consumer market in Kuwait was extremely happy and just could not import products and equip ment fast enough.

During the war, Kuwait contributed 25,000 barrels of oil per day to Jordan, free of charge, as Jordan was heavily dependent on Iraqi supply. This continued for three months and then was renewed for a successive period.

When the allied forces liberated Iraq, Kuwaiti investors immediately found this to be our natural market. We have the closest port facilities to Iraq, highways that are already built, and a general infrastructure that is designed to supply Iraq—which is what we did before the Iraqi invasion of Kuwait in 1990. Our ports have been quite active and we are considering expanding or rebuilding them. Business confidence is high. Just recently, for example, Kuwait's two mobile telecom companies were granted contracts in Iraq. Also, at the recent Madrid Donors' Conference, our government announced Kuwait's commit ment $500 million of aid to Iraq in addition to the $1 billion already contributed. That amounts to over $1,700 of aid per Kuwaiti—the highest per capita contribution to Iraq in the world. We hope that our support for Operation Iraqi Freedom and the freedom of the Iraqi people will be rewarded in the future. We took the stand against Saddam's regime out of our own conviction; even so, businessmen in Kuwait are quite hopeful.

KPC is waiting to see what Iraq has in store for its own oil industry before we determine our role. An Iraqi oil minister was named only several months ago, and we have talked to him about how we can be helpful. Recently, we have helped by meeting the emergency supply needs of Iraq. In terms of exploration, production, and the future, I think that when the Iraqis themselves have a better idea of what kind of pictures they would like to draw, we would be happy to be involved in future plans.

GJIA: What challenges does Kuwait face as a small country, territorially speaking, within the Organization of Petroleum Exporting Countries (OPEC)? How does your country respond to these challenges?

AL-SABAH: OPEC operates based upon the sizes of a country's reserves and spare capacities, rather than upon the size of a country. Our reserves are third or fourth highest in the world, we have about 10 per cent of the world's reserves of oil, and our production capacity is 2.4 million barrels per day. So, when we sit at an OPEC meeting, we do not sit as a small country the size of New Jersey, but as a country with 400,000 barrels of spare capacity—and that gives Kuwait a lot of weight.

OPEC, however, is an organization led by Saudi Arabia because of the size of its reserves, the size of its production, and, most importantly, the size of its spare capacity. Our interests are relatively closely tied to those of Saudi Arabia and the United Arab Emirates because we have large reserves and are interested in the long run. We are, essentially, long on oil in that we would like to see a maximization of the long-term interests of Kuwait through the oil industry. However, the smaller reserve countries may have more interest in short-term revenue maximization. This presents somewhat of a challenge within OPEC because, while we are interested in increasing our market share over the long term and can handle blips along the way, other countries are not able to do that, so there is some tension between the two.

For a number of years, OPEC has been trying to find a fair balance between the interests of oil-producing countries and oil-consuming countries because fluctuations in price have a negative effect on both types of economies. OPEC has been quite cohesive. The countries involved have been trying to find a production level that will sustain a fair price so as to allow the economies of producing countries to develop without inhibiting the economic development of consuming countries. We can argue as to what is fair—OPEC has tried to set $25 per barrel as its target and sees that as a fair price that would benefit all the economies. Some producers argue that something closer to $20 per barrel is a better target. A number between these may be accurate as well.

GJIA: What is the Future Generations Fund, and how does this fund relate to the future of your company?

AL-SABAH: The Future Generations Fund was established in 1976 in preparation for the day when oil would not be the dominant source of income in Kuwait. 10 percent of the government's revenue—93 percent of which comes from oil sales—goes straight into the fund. Originally, the fund was not meant to be touched until the year 2000, but we had to dip into it in 1990–1991 to pay for the war and reconstruction. Most estimates were that, before the invasion, the fund stood at around $100 billion invested around the world. It was generating returns that exceeded the oil sales of Kuwait, and these returns were directly reinvested into the fund. We had to use about $60 billion to pay for the war and the reconstruction. That money was essentially taken out as a loan from the fund, which the government is still repaying. Between repayments by the government and investment returns, the fund now stands at some place in the $60 billion range—so we have recuperated about $20 billion. There is not a direct correlation between the fund and KPC because the fund was designed to provide investment returns that would replace oil sales at some time in the future when the oil either runs out or is no longer marketable. We don't see either scenario happening in the immediate future, so we're operating as commercially as possible to generate large returns for the government.

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GJIA: How serious a threat is the recent decision by the EU to take Kuwait off its list of preferential trading partners? Will the exception for the United Kingdom make up for lost business on the continent, particularly regarding your export of jet fuel to this region?

AL-SABAH: The decision was a product of straight numbers; as we understand it, no value judgment was made. The tax affects only finished petroleum products, which, in our case, is mainly jet fuel. We export about 2.5 million metric tons of jet fuel per year to EU, which is about 15 percent of the EU's total consumption of jet fuel and about 40 percent of our total jet fuel exports. So there is a significant mutual dependency between Kuwait and the EU. Beginning in January, the tax rate will be 4.7 percent, which will add about $1.50 per metric ton to the cost of fuel, and the burden of this tax will be on the buyer in Europe. It will only be for one year, at which time Kuwait's trading status will be re-examined.

However, there is an exception for sales to certain European airports, such as those in the United Kingdom, or jet fuel sales to international airlines. One option for us is to avoid EU taxes by focusing on these other opportunities. However, it is very early on in the process for us, and our experts have yet to deter mine whether trading through the UK would make economic sense. We could also try to sell the jet fuel as feedstock in the petrochemical industry, as that would not be subject to the 4.7 percent tax. Yet another solution is to try to expedite the free trade agreement discussions between the Gulf Cooperation Council (GCC), of which Kuwait is a member, and the EU. Those discussions have been going on for a number of years, so, while this would not be an immediate solution, it could be helpful in the long term.

GJIA: How has KPC positioned itself regarding climate change and other environmental issues relative to its regional and global rivals? Given the inevitable depletion of the world's oil reserves, what is KPC doing to ensure a smooth transition to alternative sources of energy?

AL-SABAH: We are looking at the various actions of the international community to address global climate change. One of these efforts is essentially to tax hydrocar bon use; however, as a former chief econ omist at Amoco once said, "taxes empty pockets and don't clean the air." This is especially true for those governments that, for domestic political reasons, subsidize coal use, which is far dirtier than hydrocarbon use. We want to work through the Kyoto principles to try to address the climate change aspects, but we do not think that taxation is the proper method. We are still somewhat skeptical as to the direct effects of hydrocarbon use on climate change, as suggested in some of the Kyoto principles.

We are also actively looking to alternative sources of energy. We have noticed, with great interest, the Bush administration's hydrogen fuel cell initiative; in fact, we might eventually like to be an investor in that type of technology. In the meantime, the depletion of the world's oil reserves has been greatly exaggerated. Since the 1970s, people have been saying that we have maybe ten or twenty years of petroleum left. Right now the world's known reserves of petroleum are greater than those of the 1970s, even considering the past thirty years of consumption. There will not be an immediate shortage of oil—this is a long-term hydrocarbon age. Somewhere along the tail end of it, of course, we have to address these issues of change, but they are not immediate short–term concerns. Kuwait will prepare itself for that later time through the Future Generations Fund and our efforts to diversify away from the oil sector as the principal source of income for Kuwait.

GJIA: Kuwait has been a leader in the Gulf in diversifying its economy through investment in non-oil-related industry. How will these plans progress further, and how important are they?

AL-SABAH: We recognize that we have a very small population, a very small industrial base, and very few raw materials other than oil. We do not even have natural gas in quantities sufficient to be a feedstock for chemicals or to provide fuel for power generation. Nevertheless, the government is constitutionally required to provide jobs for Kuwaitis. As a result, about 90 percent of the Kuwaiti work force is employed by the government—myself included. The private sector employs about 80 percent of the non-Kuwaiti work force. Recently, however, the government implemented a law that created incentives for the private sector to hire Kuwaitis. This law incorporates matching social security contributions, providing greater job security for Kuwaitis as they move into the private sector, and allocat ing grants to private sector companies who employ more Kuwaitis.

We are struggling to create jobs that would allow the diversification of the economy. At KPC, we recognize that 76 percent of our 14,000 employees are Kuwaiti. However, we have contractors that operate with us, and they in turn employ 17,000 employees, very few of whom are Kuwaiti. We are trying to institute a requirement that at least 25 percent of the employees who work on contracts for KPC must be Kuwaiti. We will probably incur some cost in this initiative, but we are trying to move beyond that so that once Kuwaitis are involved in skilled labor for contractors, the contractors will then recognize that employing Kuwaitis creates a huge savings for them, and will pass those savings back to KPC in due course.

GJIA: In Saudi Arabia, per capita GDP has dramatically decreased over the past decades due to its quickly increasing population compared to its relatively stable rate of oil production. Is a similar phenomenon occurring in Kuwait? How will this affect Kuwait's public sector and oil production?

AL-SABAH: The population boom is not confined to Saudi Arabia. Since Kuwait's population is so small, however, it does not register as dramatically as it does in Saudi Arabia. Thus far the government has been able to meet the challenge of employing Kuwaitis, although, frankly, it does not always meet that challenge with meaningful jobs. There is a bloated bureaucracy designed just to employ and hire more Kuwaitis, so our challenge is to create *significant* and *productive* jobs in Kuwait.

This will affect the oil sector because, so long as Kuwait remains almost exclusively reliant on oil sales for its income, the government will look to KPC to alleviate its financial burdens. In the end, this does not impact our production as much as our revenues, and whatever increases the revenues of the government will be best for KPC and Kuwait. If that requires tweaking production, as OPEC has recently done, then so be it.

GJIA: Does KPC have an internal system for monitoring its greenhouse gas emissions? If not, how does it monitor the environmental effects of its business?

AL-SABAH: We do not yet have that system, but we just recently commissioned DuPont to help us elevate our Health, Safety, and Environment (HSE) stan dards. We work through our own domestic environmental protection criteria, which we have tightened to essentially the same level as the standards of the U.S. Environmental Protection Agency; we hope that in the future these measures will be strictly enforced. We had a policy of flaring the associated gas that comes up with the production of oil, and, in the past, we have flared at a level higher than what is considered either environmentally safe or an industry standard. We now plan to capture that natural gas and reduce flaring to 1 percent by 2006; in fact, our goal is to flare zero percent because we need the gas for our own power generation and as a feedstock.

GJIA: What implications would the emer gence of low-cost, reliable fuel cells have on oil demand and KPC's export market?

AL-SABAH: We are very interested in how fuel cells will progress. The Bush administration's goal is that a child born today will drive, as his first car, a fuel cell car—so we think it will be at least sixteen or eighteen years before this technology has a broad market. That may sound like a far off time, but for us it is really around the corner. What implication will that have on our demand? A lot of the demand for oil is focused on transportation fuels. Therefore, we see alternative sources of fuel for transportation as a threat to our natural markets. However, we see markets expanding so fast—especially those emerging in China, India, and the East—that we do not anticipate much reduced demand for hydrocarbons in the future, even with the advent of fuel cells (unless, as I men tioned before, industrialization in those countries skips a developmental stage and advances directly to fuel cells).

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GJIA: How did the proposed Qatar-Kuwaiti gas pipeline come about, and how will it affect regional security?

AL-SABAH: Demand for natural gas is increasing in Kuwait because of population growth and increased consumption of electricity per person. Unfortunately, supply is limited in Kuwait. We foresee an increase in supply of associated gas with our increase in oil production, but we also expect that much of that gas will be needed for reinjection to maintain the pressure in the reservoirs. Qatar, on the other hand, needs to dispose of the dry gas, which is all that is left after stripping the profitable liquids from the gas to sell internationally. The only way to ship this dry gas is by pipeline, and an easy way to do this is to build a sub-sea pipeline from Qatar to Kuwait—about 600 km—and send the gas up. Kuwait needs the gas and Qatar needs to dispose of it, so it made a lot of sense for Qatar and Kuwait to pursue this project. We are in the process of negotiating the final sale and purchase agreement, but there are still some political issues, such as transit rights, to sort out. We have agreed to buy gas from Qatar at the beach head in Kuwait; how it gets there is essentially Qatar's responsibility.

The regional implications of the pipeline are immense because of what it promises for the future. For the past twenty years, the GCC (of which both Kuwait and Qatar are members) has had a goal of creating a GCC-wide gas distribution network that would ultimately lead to an electricity network between all the GCC states. This would be the very first step towards that goal. At this point we are not envisioning the pipeline to have branches going off to other countries, but it would demonstrate cooperation between these countries that could lead to the establishment of such a GCC-wide network.

GJIA: What will KPC look like in the year 2015?

AL-SABAH: We would like to be a global petrochemical player. Within the next thirteen years we hope to be generating three times our current profit. We also envision that we will be a leader in health, safety, and environmental standards; we are very committed to that because we do not want a repetition of the accidents that we have had over the past few years. We also see ourselves, at least in 2015, as having strategic alliances with key players in every activity in the oil sector. Whether on the upstream side, through ventures like Project Kuwait, or on the petrochemical side, through our alliance with DOW, we see ourselves acting in concert with partners from international oil companies and international leaders in the field. I think it was Jack Welch who said that if his company could not be at the top of a specific industry, then it should get out. We are striving to get to the top of the various oil sub-industries by partnering with international companies.

Finally, in the year 2015, we plan to continue meeting our responsibility to the Kuwaiti society by being responsible producers and responsible corporate citizens, and by assisting the government in meeting its employment requirements. On the upstream side, in Project Kuwait, we would like to see Kuwaitis going back and forth—working for international oil companies and working for KPC—and sharing the technologies and knowledge that they gain.