

Challenges to U.S. Access to Saudi Energy Investment

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Brief Analysis

The U.S. Department of Commerce must rule by August 9 on whether a suit can proceed against Saudi Arabia, Mexico, Venezuela, and Iraq, accusing them of selling oil in the U.S. market at an unfairly low price. The suit was filed with little fanfare in early July by a consortium of small to mid-sized U.S. oil companies that calls itself Save Domestic Oil (SDO). The SDO coalition claims to represent 25 percent of the eastern regional producers (incorporating all states east of the Rocky Mountains) and that 50 percent of all producers within the eastern regional producing area will be prepared to support the petition, thereby meeting the U.S. legal requirement before the claim can proceed. The coalition seeks retaliatory duties of up to 177 percent on oil imports from the four countries listed in the lawsuit. In the Saudi case, it is seeking duties to be imposed at 84.4 percent.

Although most U.S. oil observers assure the case will not proceed -- and nearly all economists find the allegation of dumping to be ridiculous--the case has gotten much attention in the target countries. Mexico and Venezuela, for example, have threatened retaliation by reducing U.S. access to investing in their oil industry. This could not have come at a worse time for the major American producers--Exxon-Mobil, Texaco, and Chevron--whose energy investment proposals are currently being evaluated by the Saudis. This explains why all the larger U.S. oil companies have asked for the dismissal of the case, and why Energy Secretary Bill Richardson has intervened to attempt to settle the dispute as soon as possible.

Access to Saudi Arabia's enormous reserves of oil and natural gas (through both "upstream" exploration and production and "downstream" refining ventures) is the biggest treasure in the world energy market. The major international oil companies (IOCs) have been courting the kingdom since September 1998, when the possibility of their reentry to the sector was first broached by Crown Prince Abdullah in a visit to Washington. In fact, as of July 1999, nearly all the IOCs had submitted investment proposals for projects in the kingdom.

Owing to a history of strong U.S.-Saudi relations--culminating in close cooperation during the Gulf War crisis -- U.S. oil companies have a certain advantage over their foreign counterparts when it comes to gaining entry into the Saudi market. For instance, Crown Prince Abdullah invited U.S. oil companies to submit their proposals for energy investments before asking the Europeans for theirs. Yet, the acceptance of American companies' proposals is not at all guaranteed, for the competition is intense. In fact, the main European firms and Japan's National Oil Company (JNOC) are all strong competitors.


The case of the Neutral Zone concession, with 520,000 barrels per day (bpd) in production, provides an excellent example of how fierce the fight is to maintain a presence in the Saudi oil sector. The zone, between Kuwait and Saudi Arabia, is the one area where the Saudis and Kuwaitis now permit foreign investment in oil production. The concession is divided into four slots -- two off-shore and two on-shore (in each case, one Saudi and one Kuwaiti). The two off-shore fields, which produce a combined 280,000 bpd, are the most lucrative. Japan has had a exclusive forty-year contract through the Arabian Oil Company (AOC) to extract oil from these fields, but the contract is set to expire in February 2000 on the Saudi side, and in 2003 on the Kuwaiti side. The two on-shore fields produce a combined 240,000 bpd. On the Saudi side, the field is managed and operated by Texaco, while on the Kuwaiti side, it is run by

the Kuwait Petroleum Corporation (KPC). The Japanese government has made it a matter of national security to have the Saudis renew Japanese rights to the concession, in light of Kuwaiti declarations saying that Kuwait will follow whatever example the Saudis set. In mid-July, Japan's powerful minister of international trade and industry, Kaoru Yosano, took a two-day visit to Jeddah to jump-start the negotiations with the kingdom's petroleum "A" team -- Prince Saud Al Faisal, the foreign minister, Ali Al Naimi, the oil minister, and Prince Abdelaziz bin Salman, the deputy oil minister for petroleum policy.

Although the Japanese were not prepared to meet the kingdom's initial demands (including the financing of a railroad), they have put on the table substantial new investment offers in the downstream oil sector and upstream and downstream natural gas sectors. In some cases, these proposals are larger than those put forth by the American majors. Moreover, the Japanese have also guaranteed that their imports of Saudi oil would jump from 1.1 million barrels per day (mbd) to approximately 1.7-1.9 mbd by the middle of next year. This deal will look all the more appealing if the United States decreases its imports of Saudi crude, something that the dumping case would ensure if not dismissed promptly.

The Japanese are not the only potential competitors for investment in Saudi Arabia. The Europeans have also been waiting on the sidelines. Until now, European oil firms have generally been most active in former colonies, such as Italian firms in Libya and French firms in Algeria. But this does not mean that they have no interest in the Saudi oil fields. In fact, all but one (BP-Amoco-Arco), submitted extensive proposals to the Saudis -- the last was delivered in an unpublicized visit to Jeddah by the chief executive officer of Italy's national oil company, ENI, last Sunday. To add extra intrigue to this situation, in a surprise preemptive move, France's Total-Fina submitted early this week a proposal to develop and manage the long-sought-after off-shore Neutral Zone concession. For perspective on the size of investments at stake in the Saudi energy market, consider that Europe's Royal Dutch-Shell has \$8.5 billion invested in the Saudi downstream petrochemical industry, while America's Exxon-Mobil has a \$9 billion to \$10 billion current presence. This demonstrates how large is the prize at stake in the U.S.-European competition for the Saudi energy openings in the next few years.

Thus, any American advantage is tenuous, despite the close strategic relationship. Already, Mexico and Venezuela have threatened retaliatory measures, in the event that the U.S. government does not dismiss the dumping case. Should antidumping measures be implemented, Saudi Arabia may follow the lead of its fellow oil exporters. In that case, the chances of American companies entering Saudi Arabia's energy sector will be significantly reduced. Such an outcome, after so many years of carefully cultivating that "special" relationship that the two countries share, would be an unfortunate loss.

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