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Slippery Slope
By David Strahan
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More and more oil executives maintain that there are just a few years left before production reaches its peak, and that we are sleepwalking into economic catastrophe. David Strahan reports on dwindling global reserves.

The Irish chapter of the Association for the Study of Peak Oil (Aspo) could hardly have wished for better. Last week, on the first day of Aspo's recent conference in Cork, the oil price obliged by striking a new all-time high. And in the following days it struck three more in a row.

This was no mere serendipity. The price has since drifted a little, but at the time of going to press remains around $8o a barrel. That is an eightfold increase in less than a decade, and several analysts now forecast $100 oil by the end of next year. All of which reflects not only the usual short-term vicissitudes of the oil market - hurricanes, Iran, trouble in the Niger Delta - but also the gnawing realisation that global oil production is approaching some fundamental geological limits.

For many years, the idea that global oil production will soon start to fall, with potentially catastrophic economic consequences, has languished on the fringes of the environmental debate, with nothing like the recognition of climate change, and shunned by the industry itself. But when the history is written, 2007 is likely to go down as the year the issue of peak oil production went mainstream. In Cork, the former US energy secretary, James Schlesinger, used his keynote speech to tell delegates that they were no longer a tiny minority crying in the wilderness: "You can declare victory . . . and prepare to take yes for an answer."

It was a bold claim, but true. Although most senior oil executives continue to deny publicly what is becoming more obvious by the month, the industry-wide "omerta" is beginning to crack. Thierry Desmarest, chairman of Total, declared last year that production would peak in 2020, and urged governments to suppress demand to delay the witching hour. In Cork, the former Shell chairman, Lord Oxburgh, told me he expects demand to outstrip supply within 20 years, and that the oil price may well hit $150. He warned: "We may be sleepwalking into a problem that is actually going to be very serious, and it may be too late to do anything about it by the time we are fully aware."

It is no surprise that most senior oil executives still refuse to accept their business may soon start to contract, but the evidence is becoming increasingly hard to ignore, as companies struggle to maintain production or adequately replace the oil they do produce with fresh reserves.

A recent study by analysts John S Herold showed that the world's 230 biggest oil companies raised their upstream spending by 45% to more than $400bn in 2006, but that oil and gas reserves inched up by just 2%. There would have been no oil reserve growth at all without the inclusion of hard-to-produce bitumen deposits in Canada. The report concluded that peak oil has become part of the industry's long-term planning, and this would force oil companies to choose from four options: "Try to become a dominant participant, find a niche operational talent, harvest assets, or liquidate quickly."

No Surprise

The international oil companies' difficulties should come as no surprise since they are largely excluded from the areas with the greatest remaining potential, such as the Middle East, and predominantly confined to the most mature regions, such as the North Sea, where British production peaked in 1999 and has already plunged by well over 40%. Organisation for Economic Cooperation and Development oil production has been falling since 1997, and it is now widely agreed that output in the world, outside the Organisation of Petroleum Exporting Countries (Opec), will peak by about 2010. This much is accepted even by those who reject the idea of an impending global peak, such as ExxonMobil's chief executive, Rex Tillerson, who told me recently that he expected no further output growth from non-Opec production beyond the end of the decade.

This matters because there are severe doubts about the size of Opec's reserves, buttressed last year by the leak of internal documents from the Kuwait Oil Company (KOC). The paperwork revealed that although Kuwait has for two decades been telling the world it has about 100bn barrels of proved reserves, KOC's internal assessment was just 24bn, apparently confirming the widely held suspicion that the reserves of many Opec countries were inflated in the early 1980s, when members were vying for larger shares in the new quota system. In 2005, the consultancy PFC Energy briefed US vice-president Dick Cheney that, on a more realistic reading of Opec's reserves, its production could peak in 2015.

Opec recently announced a production hike of 500,000 barrels a day, but some analysts doubt that the cartel has the capacity to deliver even this modest increase. With the International Energy Agency (IEA) forecasting demand to rise by 2m barrels a day to almost 88m barrels a day by the end of this year, the most important question in the oil market is whether Opec's current production ceiling is entirely voluntary. Even if Opec can raise its production, oil consumption in member countries, particularly Iran and Saudi Arabia, is growing so fast that exports may soon start to fall in any case.

The one Opec member with the capacity to raise its oil production dramatically - in theory at least - is Iraq, where for many years production was held below its natural potential by war with Iran and UN sanctions. The country's pivotal importance was recently recognised by IEA's chief economist, Fatih Birol, who warned: "If by 2015 Iraqi production does not increase exponentially, we have a very big problem, even if Saudi Arabia fulfils its promises. The figures are very simple, there's no need to be an expert."

The war it seems was not just "largely about oil" as even Alan Greenspan, former head of the US Federal Reserve, now concedes, but all about deferring peak oil. But if so, the strategy has failed miserably. With almost daily attacks on Iraqi oil pipelines, output languishes at about the pre-invasion level, and chances of a significant increase in the foreseeable future are close to zero - with or without the introduction of the long-disputed oil law.

Territorial Claims

Opponents of the idea claim that peak oil is not imminent because there remains lots of oil to be discovered in areas such as West Africa or the Arctic, where Russia, Canada, Denmark and Norway are now scrambling to establish territorial claims. These views are often justified by reference to a study of the world's potential oil resources produced by US Geological Survey (USGS) in 2000, which concluded that the industry could discover another 650bn barrels of oil by 2025. Since the amount of oil discovered each year has been falling since the mid-1960s, and amounts to just 9bn barrels a year, less than a third of annual consumption, this forecast has long been regarded as wildly optimistic by peak oil forecasters.

But in another sign of how quickly the debate is moving, the USGS figure has also been discredited by oil industry experts at a private enclave held in Colorado last November - the Hedberg research conference on understanding world oil resources. It was organised by the American Association of Petroleum Geologists to try to resolve the wide range of estimates of future oil availability, and it was a closed-door affair, attended by technical experts from all the super-majors - ExxonMobil, Shell, BP, Total and Chevron - along with some of the biggest state-owned oil companies, such as Saudi Aramco.

According to Ray Leonard, a senior executive with Kuwait Energy Company, the experts challenged the USGS's optimistic assessments on the basis of their companies' more detailed proprietary data. Leonard says the majority opinion at the conference was that future oil discovery will total 250bn barrels - little more than a third of the USGS number.

On the basis of that rough consensus, Leonard concludes that global oil production will peak and then plateau at between 95m and 100m barrels a day - bringing soaring oil prices - in around five years' time. He says: "If there's a world recession, it could be a little longer. If the US invades another oil producing country, it may happen a lot sooner. But it's going to happen in around five years, so we need to make some preparations." Leonard's forecast matches that of the IEA, which predicts a "supply crunch" in 2012.

But we may have left it too late for planning, since a number of oil chiefs - such as James Buckee, chief executive of the Canadian independent Talisman - are convinced we have already reached the peak. And with some reason: total liquid fuels production is lower today than it was a year ago. Yet still the British government continues studiously to ignore the issue - at least in public. My own view is that we have a few more years, but with demand forecast to keep rising strongly, we will soon find out. It could be that 2007 is the year peak oil goes mainstream because this is the year it arrives. David Strahan is the author of The Last Oil Shock: A Survival Guide to the Imminent Extinction of Petroleum Man, published by John Murray (£12.99). To order a copy for £11.99 with free UK p&p go to guardian.co.uk/bookshop or call 0870 836 0875.

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