

Why oil could hit \$180 a barrel

Just when crude is becoming more costly to extract and process, producers in three key countries are short of cash. And without that money, recent finds won't do much good.

By [Jim Jubak](#)

Yikes! Oil at \$117 a barrel. It has to go down from here, right?

Wrong. In the short term -- say, the next two years or so -- we're looking at bad news about global oil supply that could take the price of a barrel of crude to \$180. Needless to say, today's \$3.50-a-gallon gasoline would look cheap if oil prices hit \$180 a barrel. At that price for a barrel of oil, gasoline would cost somewhere north of \$5.50 a gallon. The good news is that's about the price, experts now say, that would send global consumption tumbling and oil prices into retreat, as drivers scrambled to find ways to conserve. Of course, experts once thought \$3-a-gallon gasoline would lead to a drop in consumption. The latest [forecast from the International Energy Agency](#) calls for global oil demand of 87.2 million barrels a day this year. That would be an increase in consumption of 1.3 million barrels a day from 2007 -- despite a U.S. economic slowdown and soaring oil prices.

So why do I think oil prices will keep climbing for two more years at least?

A terrible coincidence of geology and geopolitics. Just when oil is getting more expensive to produce, the oil industries in three key countries -- Mexico, Russia and Nigeria -- find themselves short of cash. And without that cash, oil production in these countries, and global oil production in general, is headed into a decline. The Russian oil industry, for example, announced that production had fallen 1% in the first quarter of 2008. According to the Russian energy ministry, oil production for the full year could be lower than in 2007.

Any decline would mark a huge turnaround. Russian production has grown steadily over the past 10 years, and in its supply-and-demand projections the International Energy Agency has been counting on growth in Russian production of 5% by 2012 to offset big declines in older fields in the North Sea and Mexico.

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The International Energy Agency now estimates that worldwide production from older existing fields is now falling each year by about 4.5 million barrels a day. To stay even -- let alone to meet rising demand from the new automobile drivers of Moscow, Shanghai and Tehran -- the world has to increase annual production by 4.5 million barrels a day.

You'd think that would be easy when oil is selling for more than \$115 a barrel. But it's not. What's the problem? Geology and money. But mostly money.

Government is in the way

Russia's older west Siberian fields are in decline, following the path of such fields as the North Sea. Russia has promising fields in eastern Siberia, but developing those is expensive. The fields are hundreds of miles from anywhere, making it costly to get workers and equipment to the fields and then support them in one of the world's more hostile climates. And then there's the additional cost of getting the oil and natural gas from remote wellheads to market.

How expensive is expensive? Leonid Fedun, the vice president of **Lukoil**, Russia's largest independent oil company, recently estimated that Russia needs to invest \$1 trillion over the next 20 years to keep production in the range of 8.5 million to 9 million barrels a day.

The Saudis say their oil production will rise to 12.5 million barrels a day by 2009 but that they see no reason to invest billions to go beyond that, notes MSN Money's Jim Jubak. Is it because the Saudis don't want to increase production -- or can't? And why should we care?

It's never easy to find \$1 trillion in investment capital, but the Russian government has made it hard for its oil industry to attract even a small part of

that capital. The Kremlin has structured taxes so that most of the extraordinary rise in oil prices flows into government coffers, not oil-company profits.

When oil rises above \$27 a barrel, the Russian government takes 80% of any additional revenue in taxes. That means at \$67 a barrel, an oil company gets just \$8 more a barrel in revenue than at \$27. If the price climbs to \$107 a barrel, the oil company's revenue increases by just \$16 a barrel from what it was at \$27 a barrel. That may delight U.S. consumers who believe oil companies are making obscene windfall profits from soaring oil prices, but it hasn't made companies eager to sink their money into developing new oil in Russia. The production decline in Russia would be serious enough if it were an isolated problem. But it's not. The same conjunction of geology and geopolitics is crimping production in Nigeria and Mexico, for example.

Paying less than what's fair

In Nigeria, a third of the country's oil output by 2015 is at risk, energy advisers to Nigerian President Umaru Yar'Adua have warned, because the government hasn't been paying its share of the costs of joint ventures -- about \$3 billion to date -- with **Royal Dutch Shell ExxonMobil**, and **Chevron**. If the government's failure to pay jeopardizes the joint ventures, Nigeria can kiss plans to double its production goodbye. Instead, total oil and gas production will fall 30% by 2015.

Where has the money gone that was supposed to go into the joint ventures? It's in the pockets of just about any Nigerian government official with any clout.

Mexico faces a similar shortfall in investment capital. The country's massive Cantarell oil field in the Gulf of Mexico is dying. Production fell 12% in 2006 and 18% more in 2007, according to data from the national Energy Ministry.