

ENERGY & GEOPOLITICAL RISK

Volume 3, No. 9 October 2012

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The Arab Spring: Flounder, Or, A New Middle East?

MAP OF EASTERN TURKEY IN ASIA, SYRIA AND WESTERN PERSIA



Egyptian Revolution Hits Energy Sector

European Banking Union Heads The Regulatory Agenda

Pricing/Profitability Of Iraq's Southern Gas Deal

Iraq's New Exploration Rounds



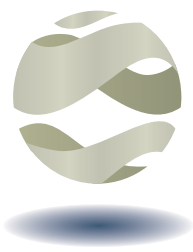


ثِقْ بِهَا، اِعْتَمِدْهَا.



مَصْرَفُ لُبْنَانَ





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COMMENT

The Arab Spring was a surprise as youth in several countries demonstrated and succeeded in bringing to an end decades of dictatorial regimes. The “Spring” remains an enigma, as Islamists are voted to power and assume leadership. However, the fatal attack on the US Consulate in Benghazi in mid-September and other US missions across the Arab world, writes Mr. Gerald Butt “shifted briefly the main news focus away from the fighting and political chaos in Syria. This lull in the blanket coverage of Syria revealed the extent to which the Arab awakening had shaken the foundations of the region as a whole...as result, predicting the path of the floundering Middle East in the months ahead has become even more difficult than before.”

Mr. David Hirst offers one possible futuristic scenario: The possible break-up of the modern Middle East, i.e. the redrawing of the regional map sketched by the Sykes-Picot agreement following World War One, through the break-up of the current states into smaller political entities-based on religious and/or ethnic identities. Such a “dismemberment”, if it materializes in Syria, the “hub” of the Arab world, would “imperil the political and territorial integrity of the regional states, not just the immediate neighbors such as Iraq and Lebanon, but even to the Gulf and the Arabian Peninsula, which fell outside the Sykes-Picot carve-up, but are far from lacking fault-lines of their own.”

The revolutionary instability of the Arab Spring in Egypt has manifested itself on all aspects of Egyptian society and economy, not least of which is the energy sector. However, Mr. James Cockayne argues that the energy industry has the potential to be part of the solution to the country’s economic woes, as well as being part of the problem. The challenges are many: shortage of hard currency reserves; difficulty to meet contractual obligations with the operating IOCs; urgency to reform domestic energy subsidy programs; and competition with neighboring countries to attract IOCs investments in the offshore.

For two years, European bank regulators have been working their way through a well-recognized agenda of issues, driven largely by the international response to the 2007 global financial crisis of 2007-2009 and, to a smaller extent by a need to respond to issues that resonate particularly loudly in Europe, such as short-selling and bankers' pay, writes Andrew Cunningham, adding that "in late May, the priorities changed : banking union jumped to the front of the queue." Mr. Cunningham suggests that the urgency for banking union "arises primarily from the euro zone's need to be able to recapitalize banks- as opposed to governments- directly. Assistance package for ailing sovereigns such as Ireland have included funds to strengthen the financial sector, and those that did not routinely included conditions related to financial structure restructuring, such as requirements to close or recapitalize insolvent banks. But there has been no way of enforcing financial sector conditionality, other than halting disbursement of funds under the package as a whole; and that is a big problem if you believe that weak banks are one of the main causes of Europe's economic and fiscal problems."

Iraq has had to deal with several challenges as it opens its oil industry to the IOCs. One of the most controversial issues has been the bilateral agreement negotiated between the Ministry of Oil with a Shell and Mitsubishi consortium to capture and use flared associated gas in the southern fields. Dr. Ali Merza provides a price/profitability sensitivity analysis of the agreement, concluding that "on balance, it is an economically reasonable deal for Iraq."

In light of the discouraging response of the international bidders for exploration round 4 in the auction held at the Iraqi Ministry of Oil last May, because of unfavorable contractual terms, vague field development of discovered hydrocarbons and, in the case of some of the blocks, security concerns, plans are underway for rounds 5 and 6. Dr. Thamir Uqaili reviews the exploration options available to the Ministry of Oil in preparation for the coming rounds.

*Map Source: http://upload.wikimedia.org/wikipedia/commons/f/f9/MPK1-426_Sykes_Picot_Agreement_Map_signed_8_May_1916.jpg

MENA Flounders On Shifting Foundations

Gerald Butt*



The attacks on US diplomatic missions in the Middle East and North Africa (MENA) in mid-September shifted briefly the main news focus away from the fighting and political chaos in Syria. This lull in the blanket coverage of Syria revealed the extent to which the Arab awakening had shaken the foundations of the region as a whole. The changes over the past two years make necessary a re-examination of the crises afflicting the region, including the Arab-Israeli conflict. As a result, predicting the path of the floundering Middle East in the months ahead has become even more difficult than before.

The first effect of the killing of US diplomats in Benghazi and the mob attacks on embassies elsewhere was to make the West rethink its underlying assumptions about the changes brought about by the popular revolutions. Despite explicit warnings to the contrary, the prevalent view among Western governments was that democracy would gradually see the countries of the Middle East and North Africa adopt the comfortable and tested templates of Europe and elsewhere. The unequivocal success of the Muslim Brotherhood in Tunisia and Egypt dampened that euphoria. Then, the sight of Salafists inciting and leading deadly attacks on US and other targets in major Arab cities has made Western governments gasp in disbelief. For opening up the political process has also unleashed forces that the previous autocratic regimes kept in check, as much for Western interests as their own.

But if the West reacted with horror, the effect on the new post-revolutionary governments in Tunisia and Egypt was hardly less traumatic. At first, these administrations seemed content to view the unrest as the natural extension of the controversial film made in the US denigrating Islam. The first reaction from the Libyan authorities in the aftermath of the Benghazi attack was to condemn the film, rather the killings. It was only later that the President of Libya's ruling General National Congress, Muhammad al-Megaryef

* *Mr. Gerald Butt is former Editor-in-Chief of MEES.*



offered an apology “to the American people and to the government” for the attack on the US diplomatic mission, describing it as an “act of cowardice”.

After attempts by angry crowds to storm the US Embassy in Cairo, President Muhammad Mursi denounced the film first and the violence after that: “I condemn and oppose all who... insult our Prophet. [But] it is our duty to protect our guests and visitors from abroad. I call on everyone to take that into consideration, to not violate Egyptian law... to not assault embassies.”

Salafist Threat To Regimes

The Muslim Brotherhood-led Tunisian and Egyptian authorities seemed to realize finally in the aftermath of the violence two uncomfortable facts: that the Salafists were successfully exploiting the genuine public revulsion felt towards the film to present themselves as the true guardians of Islam against perceived Western provocation; and that the Salafists represent as great a threat to the post-revolutionary world as the supporters of the former regimes and the military that backed them.

Furthermore, the Tunisian and Egyptian governments are new in the job and are hampered by reliance on police and security services that themselves have been enfeebled by the events of the past few years. Tunisian political analyst Munthir Thabit was asked by al-Arabiya TV if he thought the Tunisian government would take a firm position against the Salafists. He replied: “This is a real challenge, especially since the security apparatus is these days witnessing major revisions and purges. There is no experience in managing such crises.” So the Tunisian and Egyptian governments face the difficult choice of either attempting to subdue the Salafists, or of bringing them (and secular groups) into an inclusive political system.

Ignoring these challenges is not an option. The worry of human rights groups is that assertive moves by Salafists or other challengers will be met with repression of the kind that was widespread during the Ben Ali and Mubarak eras. Indeed an Egyptian social scientist in Cairo, who asked not to be identified, said in mid-September that “the system in Egypt is as despotic and corrupt as ever, but with an Islamic veil.”

But if some aspects of Egyptian domestic life appear not to have not changed – or have not yet changed – the direction of the country’s foreign policy most certainly has. President Muhammad Mursi has slipped seamlessly into the role of an Arab statesman, seeking to broaden his countries international alliances away from an exclusive one with the US. So, he raised eyebrows in the West by deciding to attend the Non-Aligned Summit in Tehran, amid rumours that Egypt might be about to restore diplomatic ties with Iran. But instead, to the shock of his pro-Syrian Iranian hosts, he used the occasion to call for regime change in Damascus. Shortly afterwards, addressing the Arab League in Cairo he promised to put his country “back in the heart of the Arab world.”

Mursi Flexes Diplomatic Muscles

The prospect of Egypt playing the pivotal regional role that it did during the era of Gamal ‘Abd al-Nasir is probably still a distant one, given the slew of political, economic and social problems facing President Mursi and his team. But even the very idea of Egypt pulling its weight once more has been sufficient to cause unease in various corners of the region. Saudi Arabia, for one, was happier with Egypt the way it was in the Mubarak era, a quiet, dependable and unchallenging ally. Turkey’s President Recep Tayyip Erdogan envisaged a political and economic partnership with post-revolutionary Egypt, but one in which Cairo would play the junior role. Israel, too, is unnerved and not a little alarmed by the change of regime in Egypt and the sight of President Mursi flexing his diplomatic muscles and seeking to improve ties with Iran.

Israel is listening carefully, too, for any hint that the new regime in Cairo might be seeking to renegotiate, if not scrap, the peace treaty between the two states. But Israel’s disquiet about Egypt is overshadowed by its concern over Iran’s nuclear policies. Prime Minister Benjamin Netanyahu’s rhetoric, which matches in tone that emerging from Tehran, has evoked fears that he might be planning a unilateral attack on Iran.

But some Israeli analysts dismiss the idea of such a military venture. Instead, they believe that Mr. Netanyahu’s outbursts are motivated by other concerns. These centre on his country’s growing isolation in the region (a question mark hangs over relations with Egypt, ties with Turkey are on ice and Jordan is paralysed by political crises). There are fears that the US is shifting its attention away from the Middle East and towards the Far East, thus leaving the region open to competing powers (Egypt, Iran, Saudi Arabia and Turkey) that are all, to some extent, hostile to Israel.

So by continually raising the spectre of a nuclear-armed Iran, Mr. Netanyahu is hoping to ensure that the US keeps its forces in the Gulf and thus keeps a reassuring presence in the region. Ultimately Israel will be happy only with regime change in Iran. For the existence of an intensely hostile Iran (even without nuclear weapons) seeking to extend its influence in the Middle East further restricts Israel’s ambitions to extend its own hegemony over the region.

Palestinian Crisis On Backburner

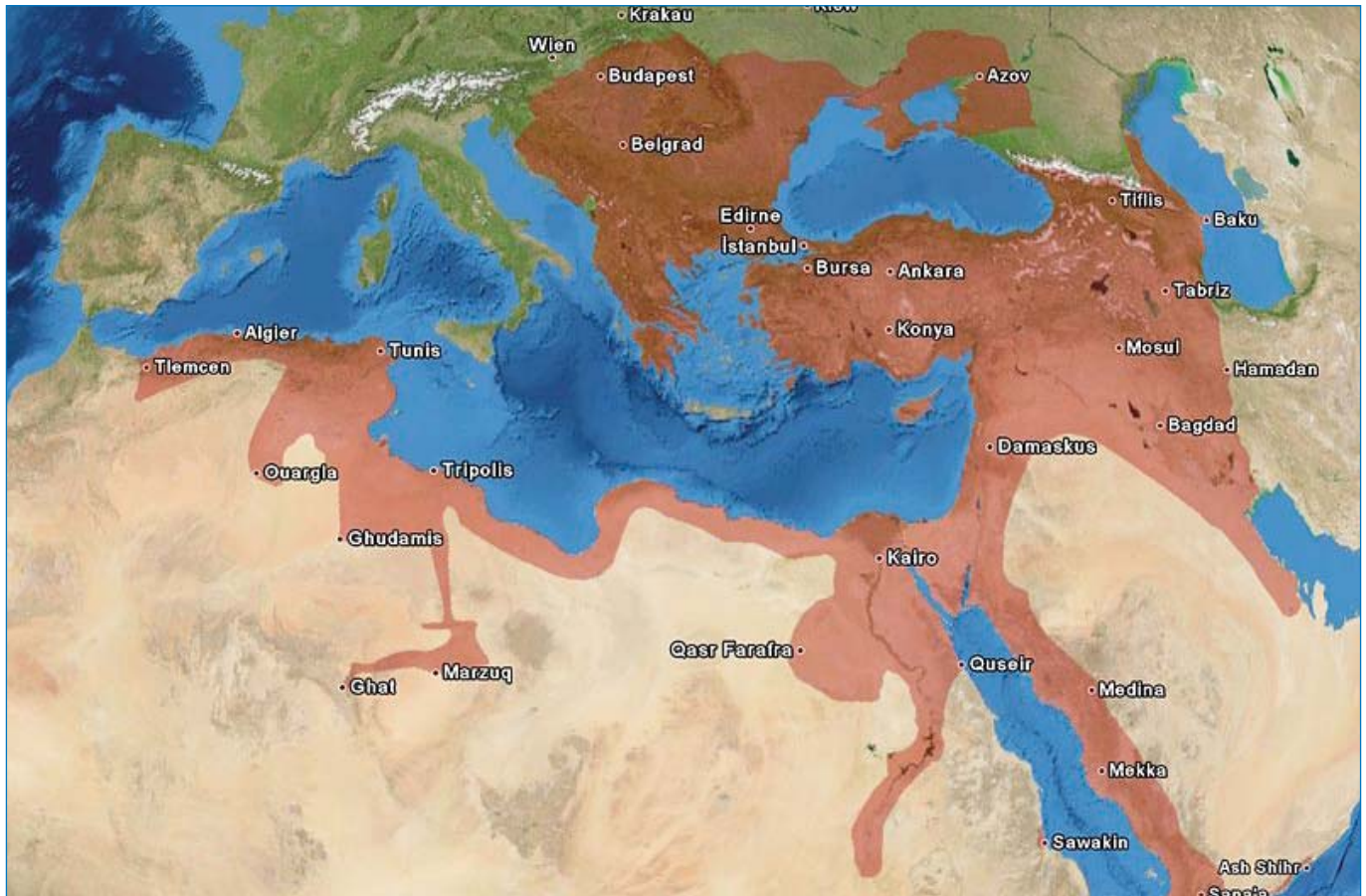
But the Iran crisis and the turmoil stemming from the Arab awakening have produced one benefit for the Israeli government: the Palestinian issue has been largely forgotten by the international community. During Mr. Netanyahu’s recent visit to Washington the Israel-Palestinian dispute, remarkably, was never mentioned – a fact that won the prime minister plaudits even from his opponents when he returned home. “By forcing the Iran crisis onto the headlines,” a Western diplomat in Tel Aviv said, “Netanyahu has shifted the whole Palestinian question onto the backburner, thus relieving the constant pressure from Washington and elsewhere on this and giving his right-wing coalition partners a free hand in the occupied territories. The far right are a lot more keen to keep the territories than strike Iran.”

The Arab world itself is as much to blame as the international community for ignoring Palestine. As Asharq al-Awsat columnist Samir Attallah pointed out recently, Arab armies are busy turning their guns on their own people, in Syria, in the Egyptian Sinai and in Yemen, and calls for the liberation of Palestine have evaporated: “If the Arab revolutions of the last century touted Palestine as the central theme of their slogans, the word ‘Palestine’ has not been cited in any of the recent Arab revolutions, not even as an essential part of revolutionary discourse.”

So the radical changes in the Middle East and North Africa over the past two years go much further than the mere dismissal of long-serving dictators and the holding of free elections – or even the turmoil in Syria. Fundamental shifts are occurring in the foundations of the region as a whole. Equally radical changes will be needed to the perceptions and expectations of Arabs, Israelis and the West if they are to understand their implications for the future.

The Break-Up Of The Modern Middle East?

David Hirst*



In 1958, Syria merged with Egypt to form the United Arab Republic. Quickly followed by other inter-Arab unionist experiments, it seemed so momentous an event at the time that, in his book *Arab Unity*, Palestinian political thinker Fayez Sayegh wrote: 'for the first time in centuries, the Arabs have now emerged as the makers of their own history, their leadership asserted itself as the principal actor on the stage of Arab life, no longer content with reciting a script written by someone else.' There had been nothing like it, he said, since the 'cataclysm' of the First World War and the fall of the Ottoman Empire.

It was out of that cataclysm that the modern Middle East, and the states of which it is still composed, arose. But the Arabs themselves had not shaped it. They had entered the war on Britain's side on the strength of its pledge that, after their liberation from the Turks, it would support a free, independent and potentially united Arab state encompassing all, or the vast bulk of, the territories they claimed as their own. Britain – betraying that pledge – and France were the 'someone else' who wrote the script. In accordance with the Sykes-Picot agreement of 1916, they divided up what, under the Ottomans, had been a more or less single political unit into a crazy patchwork of artificial polities, a full ten of them at one point, directly or indirectly ruled by themselves. With the 1917 Balfour Declaration, Britain went further, laying the basis for an alien state destined not merely to rule over a former Ottoman province, Palestine, but to dispossess its people in favor of another, the Jews. The historic Arab capital, Damascus, lay at the heart of the political and military processes by which the two imperial powers, competing even as they collaborated with each other, imposed this deeply resented new order.

* David Hirst, author, free-lance journalist, and former Middle East correspondent of *The Guardian*.

Only after the Second World War, with Europe in retreat from empire, could the Arabs set about undoing its imperial legacy. Pan-Arab union, via the dismantling of Sykes-Picot, became a supreme goal, to be striven for, wrote Sayegh, 'as the feeble long for strength, the sick for health, the maimed for wholeness.' It was also seen as vital for the prosecution of what, with Israel's creation, had now become that even more sacred cause: restoring Palestine to the Palestinians. Nowhere was the unionist impulse stronger than in Syria, at once the most 'Arab' of Arab countries and the most cruelly dismembered. And no-one exemplified it like the Syrian Baath party. Unity – along with Freedom and Socialism – was the foremost of its three famous slogans, which President Nasser, the great Arab champion of the time, adopted in his turn. It was the Baath, not yet in power, who chiefly engineered the Syrian-Egyptian union.

Those were stirring times, full of revolutionary ferment and surging expectations, inducing even a judicious scholar like Sayegh to read so much into what he saw as a great leap forward in the renaissance of the 'Arab nation.'

But it was a false dawn. The union collapsed in 1962. Seizing power soon thereafter, the Baathists not only failed to join Syria with anyone else, even their fellow-Baathists in Iraq, they became, in their own country, the embodiment of what their secular-nationalist credo officially abhorred; via their military wing, they surreptitiously built and perpetuated their nearly fifty-year rule around the tribalistic solidarity of a small sectarian minority, the Alawites, further fracturing a state and society that was already the fragment of a larger whole. As for Freedom, they betrayed that with a despotism only rivaled in its brutality by their Iraqi counterparts; their Socialism, with its vast corruption, bore ever more heavily down on the 'toiling masses' to whom they had originally pitched their revolutionary appeal. As for Palestine, its 'liberation' was massively set back by Israel's smashing victory in the Six-Day war of 1967.

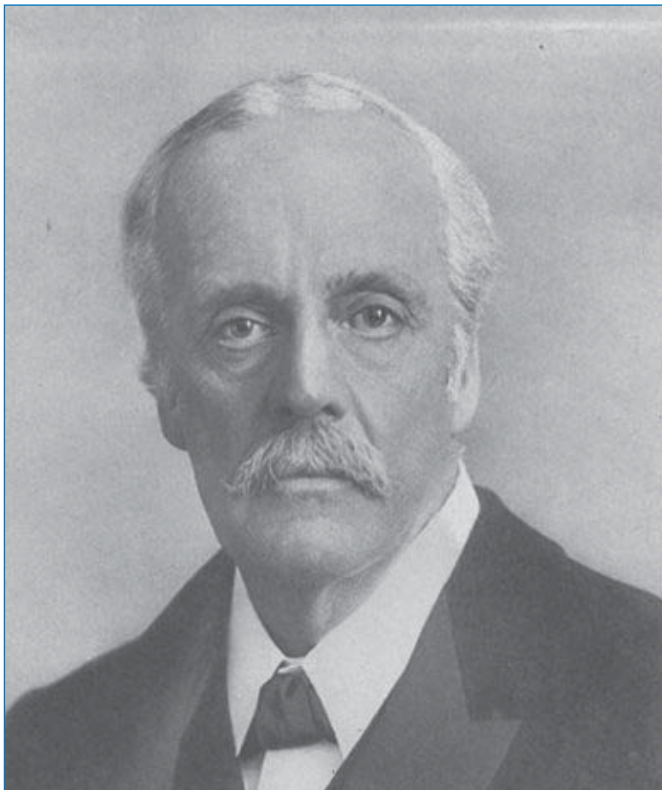
Sayegh would have had to wait another 53 years for a drama which, this time, could truly be likened, in its vast and tumultuous scale, to those birth pangs of the modern Middle East, wherein the Arabs truly became 'the makers of their own history' and the people, as opposed to their leaders, truly 'wrote the script.' For such, in its great initial thrust at least, was the Arab Spring. Yet he would in due course have grown more and more disappointed with this too, the clearer it became that the script it followed was written not just in Arabic, but in 'Islamic', Kurdish, and even – given Iran's deep involvement in Arab affairs – Farsi as well.

To be sure, the Arab Spring instantaneously established itself as a pan-Arab phenomenon, in itself an impressive measure of at least the moral or affective oneness of Arab world. But in contrast with the Maghreb – and its historically homogenous nation-states like Tunisia and Egypt – where it began, in the *Mashrek* it became anything but a politically unifying one. There, Sykes-Picot may indeed be falling apart, but replacing it is not union, it is even greater disunion. 'Here we now are,' wrote Talal Salman, editor of Beirut's nationalist-minded *al-Safir*, 'with our highest ambition just to salvage those very entities, spawned by imperialism, which our forebears struggled, and died, to prevent.'

And Syria's uprising did begin, like elsewhere, as a peaceful popular protest. But thanks, ultimately, to the artificiality of the Syrian state, the divisiveness of its society and the nature of its regime, it steadily degenerated into an outright civil war in which the primary struggle, for democracy, was overridden by the secondary ones it had also engendered. These, mainly ethnic and sectarian, not merely threaten to tear Syria itself apart, they are crossing – in effect erasing – its colonially created borders to nourish and be nourished by their counterparts elsewhere.

So, like nearly a century ago, Syria is cataclysm's hub once more, and central battleground of forces of disintegration which imperil the political and territorial integrity of states wherever they spread; and spread they might, not just to immediate neighbors such as Iraq and Lebanon, but even to areas, the Gulf and the Arabian Peninsula, which fell outside the original Sykes-Picot carve-up, but are far from lacking fault-lines of their own.

Actually, it was not Syria, but Iraq, where, well before the Arab Spring, it all really began. There, after the US-led invasion of 2003, a sectarian tyranny, Saddam Hussein's and his Sunni minority, was replaced by a kind of ethno-sectarian democracy, under which the three distinct components of Iraqi society, Shiites, Sunnis and Kurds, were supposed to get their fair and representative share of authority. But it just has not worked. The coalition government to which, with immense difficulty, it gave birth lurches from crisis to ever greater internal crisis. Kurds and Sunnis tax Prime Minister Nuri al-Maliki with steadily amassing Saddam-like dictatorial powers through, and on behalf of, the Shiite majority he heads. Inter-communal tensions – and horrendous terror exploits – are on the increase again. In growing dispute over various issues with the central government, Kurdish leader Masoud Barazani recently threatened full and formal secession, while some Sunnis agitate for greater self-rule. The spectre of renewed civil war looms – or outright, three-way partition.



Foreign Office,
November 2nd, 1917.

Dear Lord Rothschild,

I have much pleasure in conveying to you, on behalf of His Majesty's Government, the following declaration of sympathy with Jewish Zionist aspirations which has been submitted to, and approved by, the Cabinet

'His Majesty's Government view with favour the establishment in Palestine of a national home for the Jewish people, and will use their best endeavours to facilitate the achievement of this object. It being clearly understood that nothing shall be done which may prejudice the civil and religious rights of existing non-Jewish communities in Palestine, or the rights and political status enjoyed by Jews in any other country'

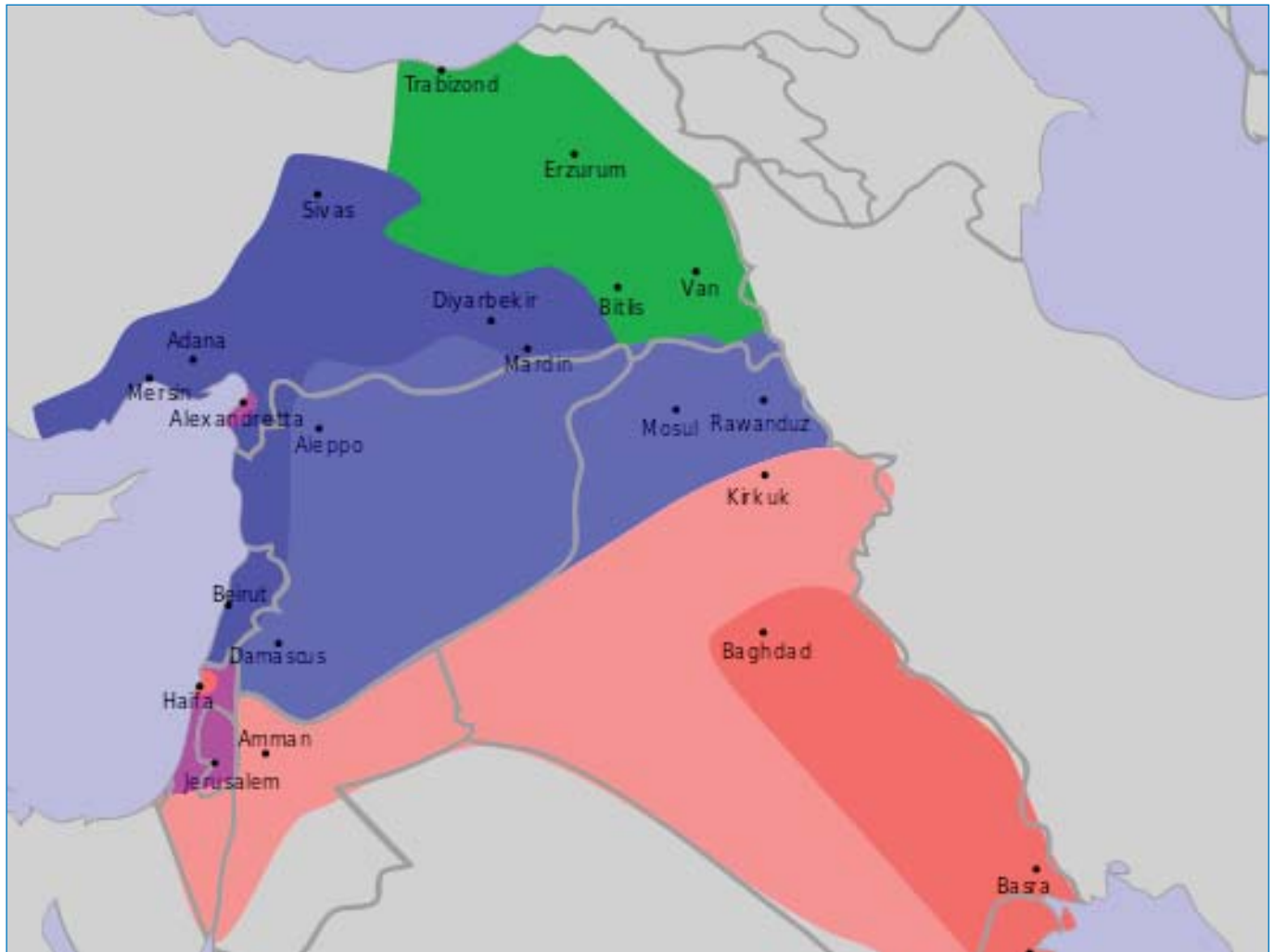
I should be grateful if you would bring this declaration to the knowledge of the Zionist Federation.

Y. King

Nothing would encourage that like the disintegration of Syria. Trans-frontier convergence is now clearest-cut in the case of the Kurds. Those of north Iraq moved swiftly to support their Syrian brethren when, last month, these suddenly found themselves before an historic opportunity to achieve at least the same kind of quasi-independence within Syria as they themselves have long enjoyed in Iraq. Any amalgamation of these two 'Arab' portions of a 'Greater Kurdistan' couldn't but revive pan-Kurdish ambitions for the eventual adhesion of its 'Turkish' and 'Iranian' portions too – and the formation of that independent Kurdish state which Sykes-Picot had originally promised, but failed to deliver.

That is an ethnic affair. But, if less clear-cut, of greater moment in the long run is the sectarian one: the conflict that now pits Sunni against Shia Islam throughout the Middle East. This is the regional context in which the Sunnis of Iraq and Syria now increasingly converge at the expense of the always fragile national identity and cohesion of both. A majority in Syria, they are the mainspring of the armed uprising, bent not only on democracy but on restoring the political dominance they lost to the Alawites fifty years ago. A minority in Iraq, not merely do they stand no chance of regaining *their* lost dominance, they cannot secure even that much diminished fraction of power to which, post-Saddam, they are constitutionally entitled. They make common cause against two regimes, Assad's and Maliki's, which, for them, are but two arms of the common, Iranian-backed, Shiite adversary. They aid and abet each other, with fighters and weapons, across an increasingly porous border. Herein lie the makings of one of those new polities which, as old ones splinter, could arise in their place, with the disempowered Sunnis of Iraq finding salvation in the embrace of the re-empowered ones of Syria – the country of which, but for a last-minute, Lloyd-George/Clemenceau tweak to Sykes-Picot, many of them would have been citizens anyway.

With the Iraqi Kurds going their own way too, all that would then be left of British-created Iraq would be a Shiite rump – and outright Iranian satellite which that would inevitably become. But might that vestigial entity even have its counterpart in Syria too, in an echo of the separate statehood which the Alawites once enjoyed under the French? There is no evidence that the Baathists ever actually planned for such a contingency, just a widespread expectation, and a concrete indication or two, that they might, in extremis, resort to it. In the now paranoid Alawite mind, all boils down to a matter of survival, not merely for the regime, but for a whole community which has so closely identified with it, so extensively participated in both its long misrule and – through the *Shabiha* militias – the ever-growing brutality of its repressive war. There could indeed be terrible retribution should the regime collapse. And collapse, if it continues on its current course, it very well might. Vastly superior though its military resources might be, they are, after all, finite, and they are gradually eroding in the face of a nation-wide resistance that seems to grow inexorably in scale, intensity and resolve. A time might very well come when it feels it has to make a fateful choice: between continuing to squander them on an ultimately unsustainable struggle to re-assert its



mastery over the whole country, or withdrawing and concentrating them within a last redoubt and more readily defensible segment of it, the ancestral Alawite highlands in the coastal region between Lebanon and southern Turkey.

Any such Alawite fiefdom would seek alliances among other minorities which, whatever they felt about Baathist rule, also worry about the rise of an overwhelmingly Sunni, very possibly Islamist, one in its place. And it would encourage any separatist tendencies akin to its own; it was after all Assad himself who, in a sudden, astonishing reversal of decades-long Baathist hostility to any kind of non-Arab minority rights, voluntarily ceded control over the Syrian Kurds, a tactic designed to wean them away from the rest of the Syrian opposition, thereby strengthening his own hand against it.

It would also seek alliances in neighboring Lebanon, that haven and archipelago of minorities that was once an integral part of Syria itself. Some observers discern a pattern to massacres and population displacements in and around the central town of Homs; they are intended, they suspect, to create a Sunni-free corridor between the Alawite heartlands and those, running from the northern Beqaa valley to the deep south, of Lebanon's largest and most powerful community, the Shiites, who, under Iran-backed *Hezbollah's* auspices, are already staunch Assad allies anyway.

Far-reaching though they already are, the geopolitical ramifications of what began in *Dera'a* eighteen months ago have still far from run their course; their ultimate implications for the tottering edifice of Sykes-Picot are still only to be guessed at. And so they are for that other, everlasting, ever toxic legacy of European rule, the Palestine problem – though here, perhaps, two fairly concrete prognostications can safely be made. One is that the greater the disintegration of states, the greater will be the growth of non-state actors to be added to the already existing ones, *Hizbollah*, *Hamas*, Islamic *Jihad* – or something called 'the Soldiers of Jerusalem' [*my translation of Ansar Beit al-Maqdis*] that has just cropped up in the lawless wastes of Sinai. The other is that if and when, out of the raging matrix, a stable new order does eventually emerge, the regimes that compose it, likely - like Egypt and Tunisia's - to be Islamist-led, will be no less hostile to Israel than any Baathist or Nasserite was at the height of the nationalist era.

MEES

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Since its establishment in 1957, the Middle East Economic Survey (MEES) has come to be recognized as the world's foremost authority on oil and gas in the Middle East and North Africa.

MEES, over the past Fifty years, has provided credible and dependable weekly analysis on regional energy, finance and politics, becoming an invaluable asset to global decision makers in over 55 countries.

Revolutionary Instability Hits Egyptian Energy Sector

James Cockayne*



Egypt's new Muslim Brotherhood-led government, which entered power in July, is faced with severe economic challenges – many of which are the direct result of the February 2011 Revolution. The energy sector is part of the problem but also has the potential to be part of the solution, writes MEES North Africa Editor James Cockayne.*

Egypt's budget deficit is likely to hit E£135bn (\$22.2bn) for the July 2012-June 2013 financial year, according to the country's new Finance Minister Mumtaz Sa'id. The country's foreign exchange reserves have meanwhile fallen to only \$15.5bn, equivalent to three months of imports. This has thrown stark attention on Egypt's need to rein in energy subsidies – if not the – key reason for the hole in government finances. Meanwhile, international oil companies (IOCs) active in Egypt are threatening to scale back their exploration efforts if chronic payments backlogs are not resolved.

Egypt's foreign currency reserves have fallen by more than 60% since the start of 2010. Even before last year's instability they were hit hard by the global financial downturn and the contraction on international credit markets since 2008-09. The Eurozone's intensified woes and renewed recessions in 2011-12 have come as an additional blow – contractions in key export markets (not to mention source of remittances and tourists), would have been testing even without Egypt's own political upheavals.

Soaring Subsidies

Energy subsidies have ballooned in line with soaring international oil prices. The bill hit E£68bn (\$12.3bn) for the 2009-10 financial year, up from E£40bn (\$6.9bn) for 2005-06. The new government led by President Muhammad Mursi and his Oil Minister Usama Kamal has indicated in its 2012-13 budget that it will cut subsidies to E£70bn (\$11.5bn), down from earlier estimates of \$15bn were subsidy-cutting measures not to be implemented.

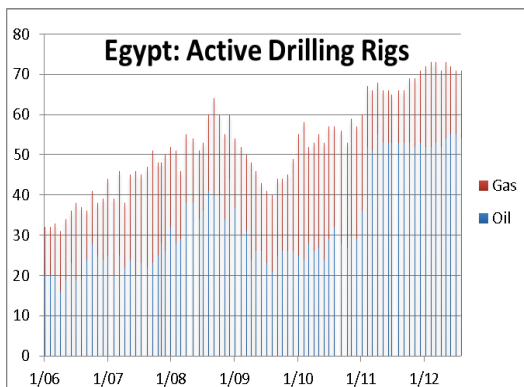
*Mr. Cockayne is MEES North Africa Editor.



But the measures to achieve subsidy cuts remain on the drawing board, with the ultimate amount to be cut from the subsidy bill up in the air. The authorities have mooted various ideas for restructuring subsidies to targets those most in need. Speaking on state TV on 19 September Mr. Kamal stressed that rather than being cut per se subsidies to petroleum products would be better “targeted... to ensure that subsidies be to deserving recipients”. He added that only 20% of petroleum subsidies go to people in the bottom 80% of incomes. Mr. Kamal again mooted using ‘smart cards’ to distribute the subsidies, adding that subsidized gasoline may only be available to drivers of 1600cc cars or less.

Oil Industry Impact

The oil ministry has been left with the responsibility of funding the subsidy bill – this has left it with little option but to ‘raise’ the cash by withholding payments to the country’s foreign operators. Whilst on paper Egypt’s commercial terms remain attractive to foreign independent oil firms, in practice delays: to the approval of development and other permits, to the award of blocks, and most crucially to payments for their share of production are putting off many potential investors, and are giving some firms active in the country second thoughts.



Whilst the biggest operators, such as BP, Shell and Eni have been prepared (at least in public) to put up with delays in the hope of reaping the future upside, some smaller operators have had no choice but to cut exploration spending in response. Yet other firms have quietly decided to invest elsewhere. Exploration activity has begun to fall having hit record levels in late 2011 and early 2012 (see graph). Unless the situation is rapidly reversed, it is likely only a matter of time before production also falls.

Source: Baker Hughes, MEES

No Money, No Drilling

Many firms have clocked up payment arrears of more than six months running into the tens, or in some instances hundreds, of millions of dollars. Coming on top on reduced access to international credit markets this has forced many firms to cut back on capital expenditure – “calibrating expenditure to receivables,” as the firms themselves typically put it.

Even the majors have not been immune. BP has seen start up at its flagship 1bn cu ft/day West Nile Delta (WND) project continuously put back. Start-up of the deepwater gas project is now slated for the fourth quarter of 2016 – the project has been delayed by two years in the two years since it was approved. Pre-revolution BP had been hoping for first gas in 2014 but this target last year slid to 2015 as the start of construction of the onshore gas treatment plant – which had been slated to begin in 2011 – was delayed as residents in the coastal town of Idku protested the plant’s proposed location. Construction is only now starting to move ahead. The latest delays are down to glacial processing of permit approvals.

Even after holding back foreign operators’ payments, state oil firm EGPC has been left with a cash shortage and was forced to borrow \$600mn from the country’s finance ministry for July and August to cover the cost of supplying fuel for electricity generation. This raises the total amount of loans extended to EGPC since 2010-11 to \$5.75bn. EGPC is seeking to borrow a further \$600mn from Arab lending organizations to ease its liquidity crisis.

International Finance

Soaring subsidies have left Egypt reliant on securing international finance to bridge its budget deficit. Mr Sa’id says that external sources will be needed to cover a whopping 44% of the country’s deficit for the current financial year, that is to say \$9.8bn.

Egypt has had some luck tapping international finance. The countries that supported the 2011’s Revolution, are generally the most willing to dip into their pockets. Key loans have come from Qatar, and Saudi Arabia, as well as international institutions such as the African Development Bank, the Islamic Development Bank and the European Bank of Reconstruction and Development – which in mid-September made its first foray into North Africa. For energy in particular the World Bank’s International Finance Corporation has also expressed its willingness to support cash-strapped independent oil firms active in the country

However Egypt is still awaiting the finalization of the ‘big one’, a long-mooted \$4.8bn IMF standby facility (the new government has raised the requested amount from \$3.2bn). This has been under discussion for over a year and still appears some distance from resolution. The IMF has made subsidy reform and reduction of the budget deficit prerequisites for the facility being granted. IMF External Relations Director Gerry Rice, speaking in mid-September, played down the chances of an early resolution. He repeated that the IMF first wants Egypt to come up with a “home-grown program in Egypt that addresses the economic and the social challenges that Egypt is facing.” The IMF will only then begin discussions with Cairo on the “conditions or measures of a possible program.” Prime Minister Hisham Kandil says he hopes to finalize the loan agreement in November or December.

Falling Revenue, Increased Expenditure

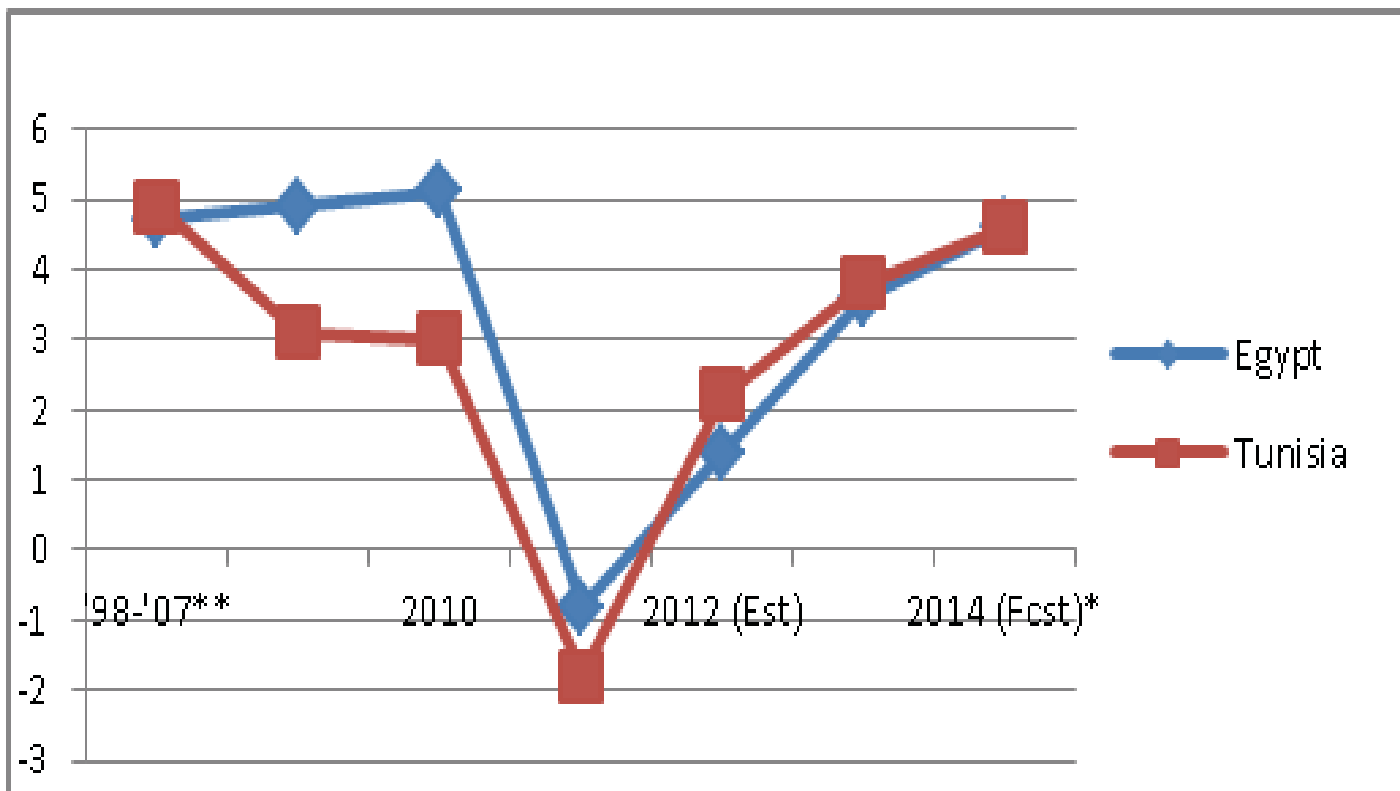
Whilst expenditure of subsidies has risen, tax revenue has fallen as a result of declining economic activity. Tourism income has nosedived, whilst Egypt has also been hit by contraction in the Eurozone, one of the country’s key export markets and the largest source of tourists. One bright spot has been Suez Canal Revenues which at \$5.22bn for 2011, were only just down on 2008’s all-time record.

Tourism saw a 30% contraction during 2011, knocking 1.8% (\$4bn) off GDP, according to UN World Tourism Organization figures. Foreign direct investment (FDI) had also fallen sharply, due to the global economic downturn even before 2011’s Revolution (from \$11bn for 2001 to \$6bn for 2010, according to the UN’s International Investment Report). For 2011 the situation was even worse, a development not unrelated to the fall in tourism as the sector has traditionally been a key destination of FDI inflows.

The World Bank, in its latest *Global Economic Prospects*, predicts that Egyptian growth – as well as that of low ‘revolutionary economy’ Tunisia – will move into positive territory of 1.4% this year, compared to -0.8% for 2011, though this is below population growth of 1.6%, and way below the growth rates of 4-5% a year thought necessary to generate sufficient employment for young people entering the labor force.

The World Bank predicts a sharp rebound in Egyptian GDP to 3.6 for 2013 and 4.6% for 2014 “in line with ... underlying potential” (see graph). But this may prove optimistic given that it is predicated on a pick-up in the Eurozone economy from the second half of 2012. The World Bank predicts that the international environment will gradually become more benign over the next two years and will thus play a role in “stabilizing... external receipts and to a degree, domestic finances.”

GDP Growth (%/Year)



* Forecast “should domestic reforms proceed as planned”.

**Annual average.

Source: Data from World Bank, 2012.

But there remain major downside economic risks for Egypt, the World Bank warns. Should domestic stability and/or European recovery fail to materialize, Egypt’s current difficulties in financing its fiscal and current account deficits could get worse. “Should these difficulties become acute, the country could be forced to cut rapidly into government spending and/or imports,” the World Bank says.

Energy Can Be Part Of The Solution

Oil Minister Kamal realizes that the energy sector has the potential to be part of the solution to Egypt’s economic woes as well as part of the problem. He recently called a meeting with the country’s key foreign operators where he impressed on them to “develop and increase their investment and accelerate development of gas discoveries, especially in the deepwater offshore Mediterranean”.

Compared to nearby Libya and Algeria the Egyptian upstream remains popular, especially among smaller independent firms, but this should not be taken for granted - Tunisia, Morocco and even offshore Cyprus and Lebanon are attracting more attention from independent firms.

Companies tend to keep a close eye on their bottom line. Egypt is unlikely to see an upturn in energy investment until it starts paying them promptly – and ultimately this will require reining in energy subsidies. The country’s two ongoing bid rounds are set to provide a litmus test of the strength of foreign interest in the Egyptian upstream.... if indeed the country’s energy bureaucracy manages to award them in a timely fashion.

Banking Union Moves To The Top Of The Regulatory Agenda

Andrew Cunningham*



For two years – until this summer – European bank regulators had been working their way through a well-recognised agenda of issues, driven largely by the international response to the global financial crisis of 2007-2009 and, to a smaller extent, by a need to respond to issues that resonate particularly loudly in Europe, such as short-selling and bankers' pay.

But in late May, the priorities changed: "banking union" jumped to the front of the queue.

The President of the European Commission, José Barroso, spoke in favor of a banking union at the informal European Council meeting held on 23 May; and the formal Council meeting on 28-29 June endorsed a report by its President, Herman Van Rompuy, and others proposing further integration of the European financial sector, fiscal matters and economic policy, including a single bank supervisor.

On 12 September, the European Commission published its proposals for a Single Supervisory Mechanism (SSM), under which the European Central Bank (ECB) will assume responsibility for supervising all banks in the Eurozone by the end of 2013. The Commission also proposed to strengthen the powers of the European Banking Authority (EBA) – which regulates banks (as opposed to supervising them).

For a good summary of the background to the Commission's proposals, take a look at its Memo/12/656, issued on 10 September: <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/656&format=HTML&aged=0&language=EN&guiLanguage=en>

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European Central Bank To Start Supervising Banks From 1 January 2013

Under the Commission's proposals, the ECB will be able to choose to assume supervisory authority over any credit institution from 1 January 2013. All Eurozone banks of "major systemic importance" will automatically fall under ECB supervision from 1 July 2013 and all Eurozone banks will fall under the ECB from 1 January 2014.

As supervisor, the ECB will be responsible for licensing banks and monitoring their compliance with capital, leverage and liquidity requirements. More significantly, it will be empowered to carry out "early intervention measures" when a bank breaches or risks breaching regulatory capital requirements.

In simple terms, if the ECB thinks a bank looks weak, it can impose remedial actions, and if the bank does not comply, the ECB can withdraw its license.

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The Commission is asking the European Council to adopt its proposals on the SSM by the end of 2012, in addition to proposals on the other three components of the banking union: CRD4/CRR ("Basel 3 in Europe"), a harmonised deposit protection scheme, and a single European deposit insurance scheme.

You don't have to be a dyed-in-the-wool British Euro sceptic to think that such a timeframe is over-ambitious.

What Is Behind The Urgency For Banking Union?

The urgency arises primarily from the Euro zone's need to be able to recapitalise banks – as opposed to governments – directly. Assistance packages for ailing sovereigns such as Ireland have included funds to strengthen the financial sector, and those that did not routinely included conditions related to financial sector restructuring, such as requirements to close or recapitalise insolvent banks. But there has been no way of enforcing financial sector conditionality, other than by halting disbursement of funds under the package as a whole; and that is a big problem if you believe that weak banks are one of the main causes of Europe's economic and fiscal problems.

Spain's long-awaited request for financial aid -- on 5 June it asked for €100bn -- brought all the issues into sharp focus. The Spanish government made clear that the money was needed solely for bank restructuring, and not for budgetary support. Furthermore, it said that it did not want to act as a conduit through which money would pass to the banks – if it did, Spain's sovereign debt burden would increase; markets would deem the government's financial condition to have deteriorated; and the government's cost of borrowing would increase. The problem was that the mechanisms created to provide financial aid to troubled economies and, in this case, specifically the European Financial Stability Facility (EFSF) may only lend to governments.

The European Stability Mechanism Will Lend Directly To Banks

The EFSF was created as a temporary body. Its successor, the European Stability Mechanism (ESM) has been waiting in the wings for some time. The ESM will be a permanent organisation, established by an amendment to the Lisbon Treaty. The original vision for the ESM was that it would maintain its predecessor's policy of lending only to sovereigns. That changed on 29 June 2012, when the leaders of the Eurozone countries agreed that once an SSM was in place, the ESM would be allowed to lend directly to banks. In other words, once the Eurozone countries had a way of enforcing conditionality for funds disbursed to banks (through the SSM), and a way to anticipate and attempt to prevent bank problems arising in future (ditto), then they were willing to allow support funds to flow directly to banks.

For the supporters of a single Eurozone supervisor, the Spanish bailout demonstrates not only the need for a mechanism to disburse money directly to banks, but also the need for on-going supervision of banks. The Spanish government's request for €100bn came just a few days after Bankia, the country's third largest bank, had asked the government for €19bn. The fact that Bankia was itself a conglomerate created in 2010 from the rubble of seven regional savings banks, and that as recently as February 2012 the government had announced a bank recapitalisation programme totalling only €50bn, strengthened the belief in Frankfurt and Brussels that national governments and supervisors cannot be trusted to address domestic banking problems in a timely and robust manner. As a result, some people say, the cost of bail-outs – a cost that is now being born largely by the Eurozone taxpayer – becomes greater than it needs to be.

Banking Union: The Devils Are In The Details

However logical the arguments for banking union may be, many challenges – both political and practical – will need to be addressed before its implementation.

Even before the Commission published its proposals, the German government made clear its belief that the new single supervisor should have jurisdiction only over large banks. Writing in the Financial Times on 30 August, German Finance Minister Wolfgang Schäuble argued that the supervisor should have direct oversight only over banks that pose a risk at a European level. "This is not just in line with the tested principle of subsidiarity," he explained. "It is also common sense; we cannot expect a European watchdog to supervise directly all of the region's lenders...effectively."

In contrast, the French authorities favor oversight of all Eurozone banks, citing the fact that many of those that have caused problems in the Eurozone have been mid-sized (such as the Spanish savings banks, Anglo-Irish and Northern Rock) rather than the region's giants.

It is easy to discern national interests at stake in this debate: Germany has many medium sized banks that it sees as central to the industrial fabric of the country. German politicians do not want to lose control over those banks. The French financial system is dominated by five large institutions.

Deutsche Bank may be the biggest in the world (assets of €2,162bn at the end of 2011), but the combined assets of the next four biggest German banks are less than those of BNP Paribas (€1,963bn).

Another difficult issue will be the division of functions between the new Eurozone supervisor and the national supervisors. The formal position will be that national supervisors will be responsible for all tasks not explicitly conferred on the ECB, but since, according to the Commission, all key tasks related to financial stability will be conferred on the ECB, it is hard to see much of significance being left at the national level.

Take the following example: CRD4/CRR gives national supervisors the ability (but not the obligation) to quench dangerous asset growth through temporary higher capital requirements -- the "Counter Cyclical Buffer" (CCB). What will happen if the European supervisor believes that the CCB should be deployed in a country, but the national supervisor does not?

Then there is the issue of the ten non-Eurozone countries whose banks will not fall under the new Single Supervisory Mechanism. The Commission's proposals provide for such countries to enter into "close cooperation" arrangements with the supervisor but such cooperation is entirely voluntary. In practical terms, the E.U.'s biggest banking system -- that of the United Kingdom -- will remain outside. British Banks account for 25% of the E.U.'s €44,818 bn in assets (see tables below).

The European Banking Authority will be setting regulations for the E.U. 27, but supervision will be enforced by the SSM in the Eurozone and by ten different supervisors outside it.

New Liquidity Rules: Anti European?!

Jamie Dimon, the chief executive of JPMorgan Chase, famously described Basel 3 as "anti-American." European bankers have not been so blunt, but their objections to Basel's proposed new liquidity ratios -- the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) -- are just as strongly held.

French bankers are particularly concerned with the effects that the new liquidity requirements will have on their overseas business -- three of the big five banks that dominate French banking have significant overseas operations (BNP Paribas, Credit Agricole and Société. Générale). Overseas clients typically need medium/long term dollar funding, but with U.S. money market funds and others withdrawing from Europe, raising long-term dollars is increasingly difficult.

In a presentation to industry experts in Paris in May, BNP Paribas' head of corporate and investment banking, Alain Papiasse, said that the "buy-to-hold" model, which still dominates European finance, is under threat from the new liquidity rules. The French authorities are arguing that any instrument that can be discounted with a local central bank should be deemed "liquid" under the new rules.

The requirement for banks to hold more liquidity could hardly come at a worse time for European banks. The ECB has become the "liquidity provider of last resort" -- its Long-Term Refinancing Operations have injected €1,018.5 bn in cheap medium-term funds into the European banking system -- most of which the banks have hoarded on their own balance sheets rather than lending out to customers.

First Set Of Tables

Share of bank assets in the E.U. (27) (Total assets = €44,818 bn, end 2011)	
U.K.	24.9%
Germany	17.8%
France	14.9%
Spain	8.7%
Netherlands	6.3%
Italy	6.2%
20 other countries	21.2%
Spain 8.7%, Netherlands 6.3%, Luxembourg 6.2%	
Source: European Central Bank	

Share of bank assets in the Eurozone (17) (Total assets = €30,389.7bn)	
Germany	26.3%
France	22.0%
Spain	12.9%
Netherlands	9.3%
Italy	9.2%
12 other countries	20.3%
Source: European Central Bank	

Second Table

Share of bank assets in E.U. (27) (Total assets = €44,818 bn)	
Large domestic banks	60%
Medium sized domestic banks	18%
Small domestic banks	2%
Foreign banks	20%
1. Total number of credit institutions: 4,713, of which 3,691 are domestic and 1,022 are foreign controlled subsidiaries and branches.	
2. Large domestic banks have more than €214.4bn in assets; medium sized banks have between €214.4bn and €2.1bn; and small banks have less than €2.1bn.	
Source: European Central Bank	

Pricing & Profitability In the Gas Deal Of Southern Iraq: Preliminary Evaluation

Ali Merza*



Introduction

After long years of waste, there is now an agreement/deal that could transform mostly zero-value southern Iraqi natural gas into positive domestic benefits and export profits. It was signed in November 2011, between the Iraqi South Gas Company, SGC, and an alliance of subsidiaries of Shell and Mitsubishi, and, subsequently, approved by the Iraqi cabinet. In the light of analyses, figures, and indicators in this article, and given the urgency to utilize a largely wasted resource, we think, on balance, it is an economically reasonable deal for Iraq. Furthermore, besides analyzing pricing, profitability, and other issues, exposition in this article also points at possible improvements on the terms of the deal (through sensitivity analysis).

This could enhance benefits to Iraq (SGC and Ministry of Finance MoF) subject to insuring acceptable rate of return to the foreign partners. However, without looking into the detailed feasibility study, upon which the deal was concluded, analyses and conclusions in this article remain preliminary. In the following, I will refer mainly to a published draft of the deal (through the 'contract').¹ Reference to the so-called Heads of Agreement, HOA (of 2008), and other sources, will also be made.

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¹ On September 29, 2011, Iraq Oil Report, a specialized website on Iraqi oil, reported the following:

'Iraq Oil Report has obtained a copy of the draft contract. In service of transparency and an accurate dialogue, we now publish both the Basrah Gas Development Agreement and the Basrah Gas Company Shareholder's Agreement in full'. The two copies were downloaded by the author from the said website as follows:

Volume 1: Basrah Development Agreement Among South Oil Company and Shell Gas Iraq BV and Diamond Iraq BV, Initialing Draft, 12 July 2011 (238 pages),

Volume 2: Basrah Gas Company: Shareholder Agreement Between South Oil Company and Shell Gas Iraq BV and Diamond Iraq BV, Initialing Draft, 12 July 2011 (143 pages), <http://www.iraqoilreport.com/energy/natural-gas/exclusive-the-shell-gas-deal-contract-6267/>, Accessed 16 January 2012.

The joint venture

The agreement under consideration is a production-sharing-type deal that lasts for 25 years (extendable). According to the agreement, a Basrah Gas Company, BGC, is to be set up whereby SGC owns 51% and foreign partners 49% (Shell 44% and Mitsubishi 5%). The partners' share profits and contribute to capital and other costs, according to their shareholdings.

Total capital cost of the project is estimated at \$17.2 Billion, \$4.4 Billion of which is to set up an LNG plant for exports. SGC pays 51% (\$8.77 Billion), which includes \$1.52 Billion of existing installations. The foreign partners pay 49% (\$8.43 Billion) \$1.46 Billion, of which is expended in the first three years; the remainder over the next seven years.² Apart from the existing installations, SGC spends the rest of its investment starting from the fourth year onward; \$3.71 Billion of which to be financed from the central budget and the remainder from its revenues from the project. It could also use a loan of \$1 Billion, from the foreign partners. Therefore, even after deducting the value of existing installations, the required spending in foreign exchange is large. Besides needed expertise in gas technology, high foreign exchange costs could explain the need for foreign partners.

Production capacity and required raw gas

The 2008 Heads of Agreement HOA has proposed to offer the project, i.e. BGC, a monopoly (rather a monopsony; single buyer) over the utilization of all associated and non-associated gas, produced in Basrah governorate (and other 'agreed areas'), which has raised many objections since. As a consequence, the new deal limits the access of BGC to associated gas from three ('dedicated') super giant fields; Rumaila, Zubair and West Qurna 1.

Production capacity of the new project is 2 Billion cubic feet daily. Current daily production from the three fields in 2012 (first five months) is about half the proposed capacity. For the project to operate at full capacity, crude oil production in these three fields, therefore, needs to increase from its present level of about 1.72 million barrels daily (mn b/d) to a minimum of 3.64 -3.78 mn b/d during the period 2014-2038; i.e. about 57-59% of their combined Plateau Production Targets of 6.4 mn b/d (according to the oil deals of 2009). The figures are indicated in table (T-1).³

Table (T-1) Production of associated-gas from Rumaila, Zubair, and West Qurna 1

	Oil Production <i>Thousand Barrels Daily</i>	Net available gas: Production minus 10% shrinkage & losses <i>Million Cubic Feet (MM scf)/Day</i>
Actual		
2009	1,418	817
2010	1,439	850
2011	1,633	955
January-May 2012	1,718	1,011
Projections		
2014-2017	2,168 - 2550	1,192 – 1,403
2018-2021	3,637	2,000
2022-2038	3,761	2,069

Source: actual figures from Ministry of Oil, <http://www.oil.gov.iq/>.

² At the end of the 25-year period, the foreign partners will be paid \$1.5 Billion for the remaining value of its assets. In the light of the fact that all capital outlays would have been recovered long before the 25th year, this payment is a double compensation.

³ Tables with (T-number) are placed within the text. Single-numbered tables are placed at the end of the article, before the Appendix.



Realizing the required gas from the three fields is, therefore, possible. However, if oil production from other fields, included in the oil licensing rounds, were added the scale of total oil production in the south becomes so high that pro rata reductions might become a possibility. To safeguard against possible shortages in raw gas supplies from the three fields, the deal stipulates that the balance to be provided from other sources.⁴

Taxation

Benefits from PSA-type deals usually divide into two streams of returns for the host country; first, profits accruing to the national partner. The second accrues to the treasury (MoF) in the form of taxes, royalties, fees, bonuses etc. The present deal mentions only income tax, at 35%.⁵ It does not mention royalty, bonuses, and other taxes. Imposing royalty is a recognized prerogative of the state, and has been part of non-service oil agreements in the Middle East, North Africa, and other parts of the world.

The pricing scheme

According to the agreement, SGC supplies raw gas to BGC and buy back processed gas consumed domestically (dry gas, LPG, and condensates). LNG and exportable LPG and condensates are not sold to SGC; rather to the State Oil Marketing Organization, SOMO, which handles exports. However, unlike the HOA, another reference mentions that domestic users of dry gas (power stations, and industries,) will continue to pay a price of about \$1.0/mn Btu whatever the price of dry gas paid by SGC to BGC.⁶ Domestic consumers of LPG, presumably, also continue to pay official prices. According to the same reference, SGC will subsidize the difference between the price it pays to BGC and what it gets from domestic users. Accordingly, the pricing, as formulated in the contract, and described below, does not affect prices to domestic users. It only pertains to the distribution of costs, taxes, and profits among the shareholders in BGC. On the other hand, without the LNG plant, the paying back of costs (including investments) largely depends on domestic resources. Only when LNG exports commence, then foreign markets will contribute tangibly to the payback.

⁴ Paragraph (5.2.1), Volume 1, P. 29.

⁵ In addition to income tax, the deal also includes a moderate amount of 'fees' for SOMO. Export tax of 1% is also reported in "Dow Jones Deutschland", 15 November 2011.

⁶ This is mentioned in a document, in Arabic, circulated online, through the Internet, in August 2011, titled 'Basrah Gas Company, BGC', 5 pages. It bears no author name or date.

While largely related to world prices, the pricing of raw gas, dry gas, LPG, and condensates, is formulated in the contract, in elaborate set of definitions, rules, formulae, time intervals, and price quotation sources. LNG, by contrast, which is wholly geared to foreign markets, is directly related to world prices.

According to Exhibit 5, Volume 1, of the contract, during the lifespan of the project, and except for LNG, two periods are distinguished in pricing; an interim and subsequent periods. The interim is defined as number of years/quarters during which the foreign partners spend in 'capitalizable' expenditures a sum equivalent to 96% of the 'initial' value of the existing installations in the dedicated fields (\$1.52 Billion). The subsequent period starts at the date when such equality materializes, which is assumed in this article to be the beginning of 2016 (see table 1).

'Contract' price of each of raw gas, dry gas, LPG and condensates in the interim period, is calculated as a weighted average of 'initial' price and 'reference' price. In the subsequent period the contract price is equal to the reference price only. The initial price itself increases, annually, in the interim by an 'inflation' rate of 2%. The initial price of raw gas is specified at \$1695/mn scf, of dry gas at \$1.04/mn Btu, of LPG at \$85/Ton, and of condensates at \$6.74/Barrel. The reference price of dry gas is equal to 33.6% of the world price of equivalent BTUs of high sulfur fuel oil (HSFO). The reference price of LPG is a weighted average of world prices of propane and butane. The reference price of condensate is equal to the price of Dubai crude oil. World prices in the Asian/Gulf region.

The reference price of raw gas is determined in more elaborate way which, it seems, intended to tie the cost of raw gas to the value of final sales. The reference price formula is composed of two weighted terms divided by the quantity of supplied raw gas. The first term is equal to the sum of domestic sales, non-income taxes, fees, and other related domestic receipts. This term is weighted (i.e. multiplied) by a parameter/fraction, X (initially specified at 0.1). The second term is called 'windfall adjustment', which is related to a difference between world price of HSFO and baseline value of Brent crude'. The second term is weighted by the difference between one and the parameter/fraction. Furthermore, through escalation clauses, the price of raw gas is also influenced by investment expenditures and total sales (domestic and exports). With such set of determining/influencing variables, therefore, variation and even fluctuation in the price of raw gas can exceed those of outputs. As a matter of fact, fluctuation in the price of raw gas occurs even if the prices of outputs remain constant; see note 2 of table (1). It is worth noting that if SGC uses the option of borrowing from the foreign partners (\$1 Billion), then from year 2020 onward the initial value of X falls from 0.1 to 0.02 (Volume 2, P. 23). We assume that SGC will not use this option. However, its consequences are touched upon in the last section.

According to Exhibit 14, Volume 1 (P. 225), LNG price is 'to be based on market prices', FOB loading terminal. As LNG output is planned to come online during the 'subsequent' period (assumed 2018 in this article), only a 'reference' price is used. We will take it to equal LNG price in Japan, netted back to the loading terminal at the Gulf. See the Appendix for precise formulation of the price formulae.

Escalation clauses

The parameter/fraction (X), in the reference price equation of raw gas, is initially specified at (0.1). However, it is made to vary according to escalation clauses set in the contract (pages 129-131, Volume 1). For each year, the after-tax internal rate of return (AIRR) of the project (BGC), up to the previous year, is calculated (starting from year 0; taken to be 2013 in this article). If it turns out that AIRR is less than 17.5%, then the fraction stays as it is. If AIRR is more than 27.5% then the fraction becomes (0.6). If AIRR is between 17.5 and 27.5% then the fraction (0.1) is increased by the difference times a factor of 5. For instance, if AIRR is 20.5%, then the difference is 3%, which is multiplied by 5 and added to 0.1. The fraction becomes 0.25, $(0.1 + 5 \times 0.03)$. That is to say the reference price of raw gas becomes 0.25 times the first term plus 0.75 times, the second term (both terms divided by the quantity of supplied raw gas), as described in the previous section. See equations (6) in the Appendix and table (1).

In a production sharing agreement, like BGC, the escalation scheme could have been applied to such other parameters as the income tax rate and SGC shareholding in BGC. However, keeping the escalation scheme as it is, we will explore, inter alia, through sensitivity analysis below, consequences of possible changes in some of these parameters on net income distribution between Iraq (SGC and MoF) and foreign partners. It suffices to say here that variations in the tax rate and production sharing affect net income distribution between Iraq and the foreign partners, whereas changes in



world prices affect the level of net income and its distribution. Furthermore, because of the entanglement of the influencing factors on the price of raw gas, the consequences could be disproportionate among the partners. For instance, a rise in tax rate leads to lower AIRRs for BGC, SGC, and foreign partners. However, unlike the foreign partners, the consequences for SGC are twofold. First, its income falls by the additional tax. Secondly, lower AIRR for BGC could lead to lower escalation parameter (X) and possibly lower price for raw gas, hence reducing the net income of SGC further.

World price of natural gas

As evident from the above, the price of the main output of the project, dry gas, is tied to the world price of fuel oil, that of condensates to the price of Dubai crude. LNG and LPG prices are related to their world prices. The assumed association between crude oil/fuel oil and gas prices raises three questions. First, the accuracy of this association. Second, if accurate, what is the future prospect of crude oil prices? Third, if not, what is the future prospect of gas prices? In this article we are mainly concerned with the first question.⁷

Association between gas and oil prices was quite strong before 2005 in all regions of the world. Gas pricing was tied in long-term contracts to crude oil or oil products. Since then, the relationship has undergone varying transformations in the different regions. In the USA, spot pricing together with increasing shale gas supplies have led to wide divergence. In 2003 the prices of WTI crude and natural gas were almost the same (at \$5.4/mn BTU). In the first half of 2012, natural gas price (\$2.4/mn BTU) was only 14% of that of WTI; graph 1 below. In Europe, oil-based pricing in long-term contracts is still widespread, but clauses have been introduced to limit the variation of gas prices in response to changes in oil prices (S-curve arrangement).⁸ Furthermore, spot pricing in north Europe is widening. That is why divergence is increasing in this region too. In 2001 prices of Brent crude and natural gas were very close at \$4.1/mn BTU. In the first half of 2012 price of natural gas (\$11.5/mn BTU) was 59% of that of Brent; graph 2. In Asia, oil-related pricing of gas is still prevailing but S-curve arrangement is also applied and spot pricing of LNG is increasing. However, although 'Japan/Korea is the largest and most concentrated spot market for LNG in

⁷ In spite of their recent decline, long-term crude oil prices, in many available projections, are expected to exceed \$100/Barrel in nominal and real terms. See the following projections:

OPEC (2011) *World Oil Outlook 2011*, November.

International Energy Agency (2011) *World Energy Outlook 2011, Executive Summary*, November.

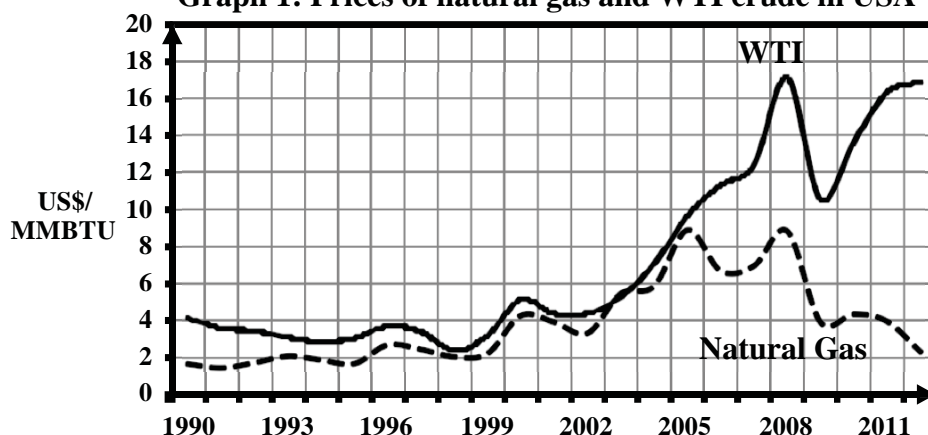
Energy Information Agency, EIA (2012), *Annual Energy Outlook 2012, with Projections to 2035*, 25 June.

For instance, in reference case scenario, EIA estimates that natural gas price in USA (Henry Hub spot) will increase from \$4.4/MMBTU in 2010 gradually to \$7.7 in 2035. As for WTI crude, price will rise from \$79/Barrel in 2010 to \$145 in 2035 (all in 2010 Dollar).

⁸ In S-curve arrangement, a floor and a ceiling for oil price are established within which the slope of the relationship between gas and oil prices is adjusted.

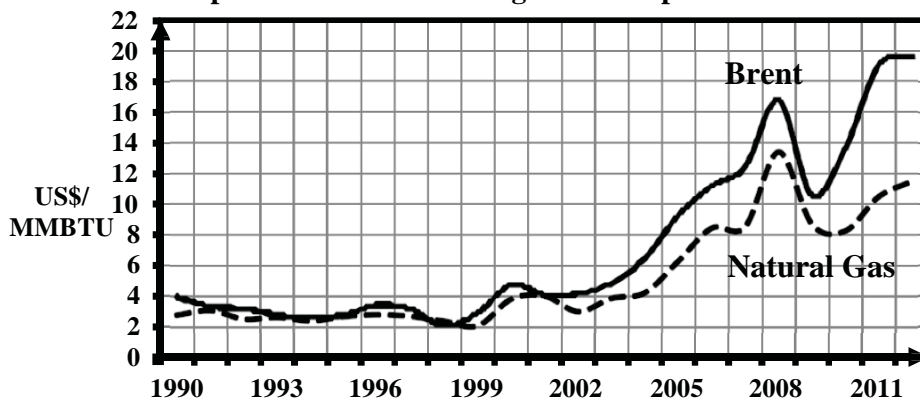
the world', according to Platts,⁹ the relationship between LNG and crude oil pricing is still strong. Before 2004, LNG price exceeded that of Dubai crude. In the first half of 2012, it averaged about 87% of the price of that crude; graph 3.¹⁰

Graph 1: Prices of natural gas and WTI crude in USA



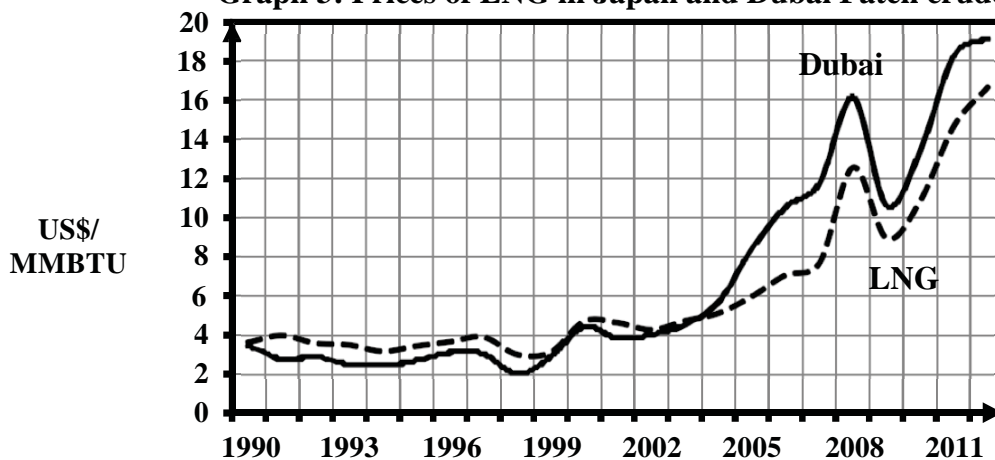
Note: natural gas spot price at Henry Hub, Louisiana.

Graph 2: Prices of natural gas in Europe and Brent crude



Note: natural gas average import border price, including UK. As of April 2010 includes a spot price component.

Graph 3: Prices of LNG in Japan and Dubai Fateh crude



Note: LNG import price, cif.

⁹ Platts (2011) 'Platts Daily Spot LNG Price Assessments', <http://www.platts.com/IM.Platts.Content/downloads/faqs/lngfaq.pdf>.

¹⁰ In drawing the three graphs, for the period 1990-June 2012, data are obtained from: World Bank (2012) Commodity Price Data (Pink Sheet), 5 July. <http://go.worldbank.org/4ROCCIEQ50>.

The association between the prices of gas and crude oil in the Asian market, although weakened in the last eight years, is still stronger than in other regions. Whether this continues into the future is an open question. Let us, however, test further the accuracy of the association by calculating the 'world' price of dry gas on the basis of equivalent BTUs of fuel oil and compare it to actual world prices during the last four years, in table (T-2).

Table (T-2) Calculated and actual world price of gas

	Price of Fuel Oil (180 cst 2% S) Singapore		Actual World Price \$/MMBTU		
			USA	Europe	Japan
	\$/Ton	Fuel-oil-based 'world' price of dry gas \$/MMBTU	Natural Gas	Natural Gas	LNG
	(1)	(2) =(1)/37.661	(3)	(4)	(5)
2009	377	10.0	4.0	8.7	8.9
2010	484	12.9	4.4	8.3	10.9
2011	677	18.0	4.0	10.5	14.7
January - June 2012	726	19.3	2.4	11.5	16.6

Sources: Fuel oil (180 cst 2.0% S) Singapore: OPEC: *Monthly Oil Market Reports*: March 2009 – July 2012. In this source prices are quoted in \$/Barrel. They are multiplied by 6.6 to convert them into \$/Ton.

Actual gas prices: World Bank (2012) World Bank *Commodity Price Data* (Pink Sheet), 5 July, <http://go.worldbank.org/4ROCCIEQ50>.

Hence, fuel-oil-based prices for gas in column 2 are much higher than actual prices in USA, higher than those in Europe, and higher but closer to those in Japan. The conclusion is that in light of the levels of actual gas prices in the last four years, using fuel oil price to determine 'world' price for dry gas overstates the latter. Nevertheless, in the absence of a 'world' price for dry gas in the Gulf, using fuel oil as a yardstick to derive its value could be justifiable.¹¹ For such exports from the project as LNG, LPG, and condensates, however, the possibility of lower world (i.e. Asian) gas prices, should be taken into consideration as one scenario in calculating future profits for the Basrah Gas Company, BGC (see last section below).

World Prices, Domestic Subsidy, And World Trade Organization

There are two kinds of outputs in this agreement, dry gas and liquids. They are separately used, the first is exclusively for the domestic market while the second, mainly LNG, is exclusively for exports. Whereas it is practical to relate the pricing of LNG, LPG, and condensates, to world prices, such association for dry gas could raise objections in WTO negotiations for Iraq's membership. The consent of the WTO, in 2005, for Saudi Arabia to subsidize domestic consumption of dry gas, hinged on the argument that dry gas had no world market price in the Gulf.¹² Stipulating that price of dry gas sold to SGC to be 33.6% of the world price of equivalent heating value of fuel oil could be used to make the case for domestic subsidy hard to defend. The Saudi precedent, however, could still be applied to the Iraqi case. First, all dry gas from the project is consumed domestically. Second, the fuel oil-based pricing of dry gas is an accounting price; it is not a quotation of actual dry gas price in the Gulf. Thus, the argument that dry gas has no world market price in the Gulf is also valid for the Iraqi case.

¹¹ As mentioned in the previous section, the reference price of dry gas in Iraq's gas deal is 33.6% of fuel-oil-based dry gas price.

¹² '[T]he representative of Saudi Arabia [in WTO negotiations] noted that pricing of natural gas (including methane and ethane) was quite different from the pricing of natural gas liquids (butane, propane, and natural gasoline). Natural [i.e. dry] gas was not sold for export due to the high costs of liquefying, transporting and re-gasifying such gas, and therefore had no international reference price in the Gulf region', WTO (2005), *Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization*, Document WT/ACC/SAU/61, 1 November, Paragraphs 29, 30.

Appraising Project's Profitability: Simulation

In the absence of the detailed feasibility study of the project, we need to construct an approximate system of evaluation that preserves the pricing scheme and other relevant features of the contract. Such system needs to analyze profitability by performing the following tasks:

Task I: determine the profitability of the project and its distribution between the stakeholders (SGC, foreign partners, and MoF).

Task II: test the sensitivity of the project to possible changes in such indicators as world prices, tax rate, and shareholding in BGC.

Task III: consider a possible service contract arrangement.

Accordingly, we have constructed an evaluation system through hypothetical cash-flows for the 25-year period (2013-2038) of the project, based on terms, pricing formulae, and other stipulations included in the contract (Volumes 1 and 2). Some general notes on price subsidy, presented in a previously cited reference, are also taken into consideration. Secondary information and assumptions are used whenever primary information is missing. The exercise is described in tables (1) and (2), below. In these tables, we assume that BGC processes a feedstock of raw gas that rises, gradually, from 757 mn scf /day in 2014 to 1,400 in 2017. In 2018, LNG starts production, using additional 600 mn scf /day. From 2018 onward, therefore, processed raw gas totals 2,000 mn scf/day. We assume further that 2011's world prices to prevail during the projection period. Price formulae of the Appendix are calculated accordingly.¹³

Needless to say that this is a hypothetical exercise which leads to results and conclusions that could change when more accurate information in the unpublished feasibility study of the project is made available.

Let us now perform the above mentioned tasks, noting that task I can be read directly from tables (1) and (2). Tasks II and III are performed through a set of sensitivity analyses on these tables, but the numerical details are not shown in this article. Task I will be referred to, below, as the reference case. The following is a summary:

I. Profitability: The Reference Case

After-tax IRR, AIRR, of the project (BGC) is 22% and that of foreign partners 23%. The after-tax, after-subsidy IRR of SGC is 14%. Note that the AIRR of BGC does not average the shareholders' rates. The reason is that SGC's rate is calculated after including the raw gas value as inflows, and subsidies as outflows. These flows do not enter, as such, in the calculation of BGC's AIRR.¹⁴ If these two flows are excluded, SGC's AIRR becomes 21%. The distribution of total net income throughout the project life (2014-2038) divides as follows: Iraq 69.4% (SGC 31.9%, and income taxes 37.5%) and foreign partners 30.6%.

II. Sensitivity Analysis

From the following cases it is clear that foreign partners' AIRR, remains high (i.e. equals or higher than 15%) even if the following values of tax rate, SGC shareholding, or world price decline rate materialize (one at a time and in comparison with the reference case). Note that in the first two cases BGC's AIRR does not change.

- If income tax rate increases from 35 to 50%, then foreign partners' AIRR falls from 23 (in the reference case) to 20% and that of SGC from 15 to 7%. Iraq's (SGC & MoF) share of total net income increases from 69 to 77%.
- If the share of SGC in BGC increases from 51% to 65%, then foreign partners' AIRR falls from 23 to 21%. That of SGC increases from 14 to 16%. Iraq's share of total net income increases to 78%.
- If SGC elects to borrow from the foreign partners, then, through lower initial value of the fraction (X) from 2020 onward, lower raw gas costs lead to slightly higher AIRRs for the project (BGC) and for the foreign partners. SGC's, however, undergoes small decline. The fall in SGC's raw gas receipts is not compensated for by the rise in its net income and fall in its share of raw gas cost. Compared to the reference case, Iraq's

¹³ According to the contract, prices of outputs (including LNG) are to be calculated quarterly, using data from the previous quarter. But as we are dealing with the future we calculate prices annually for raw gas and outputs.

¹⁴ Raw gas value enters as outflow in BGC's and proportionally in SGC's and foreign partners' calculation of AIRRs. In addition, however, SGC receives all the value of raw gas as inflow.

share of total net income remains at 69%.

- If world prices decline by 17%, then BGC's AIRR falls from 22% (in the reference case) to 15% and the foreign partners' AIRR from 23 to 15%. In this case, SGC's AIRR increases slightly from 14% to 15%. That is because the fall in subsidies outweighs, slightly, the fall in raw gas receipts to SGC. Iraq's share of total net income increases slightly from 69 to 70%.

III. Service contract

Now let us use tables (1) and (2), to consider the case of assuming a service contract, instead of production-sharing agreement, by posing the following question: what is the gross (before-tax) fee per MMscf of processed raw gas that insures an AIRR between 15 and 25% for the foreign partner? Before answering, let us assume that the foreign partner agrees to lend the project \$8.43 Billion (49% of \$17.2 Billion) in instalments equal to the foreign partners' annual capital outlays shown in Table (2). We assume further that these instalments are repaid back at the end of each year starting from an accumulation at the third year of production. Moreover, the tax rate is 35%. Then our background calculations show that the foreign partner would realize an AIRR between 15 and 25% only if it is offered a gross (before tax) fee much higher than those offered (for an equivalent barrel of crude oil) in the oil deals in the first and second rounds (2009/2010).



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Table (1) Iraq's Southern Gas Agreement: Production and Revenues

	Oil Production from Rumaila, Zubair, W. Qurna I		Raw Gas: Million Cubic Feet/Day		Cash Inflow (Sales), \$Million												Total Sales \$Million			
	Thousand Barrel/Day	Total Production	Utilized		Dry gas			LPG			Condensates			Sales of Dry Gas, LPG, and Cond.				Value \$Million		
			GI	G2	Quantity Million MMBtu/Year	Price \$/MMBtu	Value \$Million	Quantity Thousand Ton/Year	Price \$/Ton	Value \$Million	Quantity Thousand Barrel/Year	Price \$/Barrel	Value \$Million	Quantity Million MMBtu/Year	Price \$/MMBtu	Value \$Million				
2010	1,439	850																		
2011	1,633	955																		
Jan-May 2012	1,718	1,011																		
2013																				
2014	2,168	1,214	757	0	234	2.7	621	197	302	39	92	0	13.3	0	911	0	13.3	0	911	
2015	2,295	1,262	1,029	0	318	4.3	1,354	461	518	70	228	0	13.3	0	2,043	0	13.3	0	2,043	
2016	2,423	1,332	1,201	0	371	5.8	2,169	760	733	102	386	0	13.3	0	3,315	0	13.3	0	3,315	
2017	2,550	1,403	1,400	0	432	6.0	2,613	918	760	106	467	0	13.3	0	3,998	0	13.3	0	3,998	
2018	3,637	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2019	3,637	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2020	3,637	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2021	3,637	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2022	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2023	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2024	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2025	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2026	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2027	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2028	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2029	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2030	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2031	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2032	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2033	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2034	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2035	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2036	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2037	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
2038	3,761	2,000	1,400	600	432	6.0	2,613	1,233	760	106	667	191	13.3	2,546	4,513	191	13.3	2,546	7,059	
Total																				
IRR																				158,514

Sources: Actual figures 2009-2012 : Ministry of Oil, <http://www.oil.gov.iq>.

Projections 2013-2038: pricing, production, capital expenditures, taxation, domestic consumption, exports, escalation scheme, matching level, etc, are based on articles of the 'contract' of the gas deal. Prices for the projection period are calculated on the basis of price formulae in the contract (see Appendix of this article), using world prices of 2011. Other figures and coefficients for the projection period include explanations in Doc 1 and Doc 2, other secondary information and technical coefficients, and assumptions. See footnote 1, page 1, for the cited sources.

Notes:

- (1) Operating costs (apart from raw gas) make 19% of total revenues.
- (2) Fluctuations in the price of raw gas. Between 2014 and 2017, in this table, raw gas price increases due to increasing domestic sales and related receipts. In 2018 it falls sharply because of addition of the quantity of LNG's feedstock of raw gas to the denominator (equation 5 in Appendix) without adding returns from LNG sales to the numerator. Between 2019 and 2026, it falls slightly because of growth, by 2 percent annually, of the so-called windfall adjustment (equation, 5) at the time when output prices remain constant. After 2026, raw gas price increases continually because the effect of escalation scheme outweighs growth in windfall adjustment.
- (3) Raw Gas Composition by volume : output from raw gas, earmarked mainly to domestic consumption, is divided as follows: 82.5% dry gas, 12.5% LPG, and 5% condensates. Output from raw gas, earmarked to the LNG plant, is divided as follows: 85% LNG, 10% LPG and, 5% condensates.

Table, Continued

Continued, Table (1) Iraq's Southern Gas Agreement: Costs, Escalation Parameter, and Profitability Indicators

	Total Cash Inflow (Sales), \$Million	Cash Outflow, \$Million					Net Revenues minus Costs, \$Million			Matching Level	Income Tax 35%	After-Tax Internal Rate of Return AIRR	Escalation Parameter	
		Raw Gas Cost		Operating Costs	Capital Costs		Total Costs	Before Income Tax	After Income Tax					
		Quantity Thousand MMsfc V (G1+G2)×0.36525	Price \$/MMsfc CP _{RG}		Value \$Million	Capital Cost by SGC								Capital Cost by Shell/M
2010														
2011														
Jan-May 2012														
2013														
2014	911	277	1,616	447	173	1,524	488	488	2,012	-2,012	-2,012	0	0%	0.10
2015	2,043	376	2,320	873	388		488	488	1,108	-197	-197	0	0%	0.10
2016	3,315	438	3,804	1,668	630	1,035	995	995	1,749	294	191	103	0%	0.10
2017	3,998	511	4,036	2,064	760	1,035	995	995	4,328	-1,013	-1,013	0	0%	0.10
2018	7,059	731	2,892	2,113	1,341	1,035	995	995	4,853	-855	-855	0	0%	0.10
2019	7,059	731	2,889	2,110	1,341	1,035	995	995	5,484	1,575	1,024	551	0%	0.10
2020	7,059	731	2,886	2,108	1,341	1,035	995	995	5,482	1,577	1,025	552	0%	0.10
2021	7,059	731	2,882	2,106	1,341	1,035	995	995	5,480	1,580	1,027	553	0%	0.10
2022	7,059	731	2,879	2,103	1,341	1,035	995	995	5,477	1,582	1,029	554	1%	0.10
2023	7,059	731	2,875	2,100	1,341	1,035	995	995	5,475	1,585	1,030	555	5%	0.10
2024	7,059	731	2,872	2,098	1,341	1,035	995	995	3,442	3,618	2,351	1,266	11%	0.10
2025	7,059	731	2,868	2,095	1,341	1,035	995	995	3,439	3,620	2,353	1,267	14%	0.10
2026	7,059	731	2,865	2,093	1,341	1,035	995	995	3,437	3,623	2,355	1,268	16%	0.10
2027	7,059	731	2,938	2,146	1,341	1,035	995	995	3,434	3,626	2,357	1,269	18%	0.12
2028	7,059	731	3,130	2,286	1,341	1,035	995	995	3,487	3,572	2,322	1,250	19%	0.17
2029	7,059	731	3,265	2,385	1,341	1,035	995	995	3,627	3,432	2,231	1,201	20%	0.21
2030	7,059	731	3,364	2,457	1,341	1,035	995	995	3,726	3,333	2,166	1,167	20%	0.24
2031	7,059	731	3,437	2,511	1,341	1,035	995	995	3,798	3,261	2,120	1,141	21%	0.26
2032	7,059	731	3,492	2,551	1,341	1,035	995	995	3,852	3,207	2,085	1,123	21%	0.28
2033	7,059	731	3,534	2,581	1,341	1,035	995	995	3,892	3,167	2,059	1,109	21%	0.29
2034	7,059	731	3,566	2,605	1,341	1,035	995	995	3,923	3,137	2,039	1,098	21%	0.30
2035	7,059	731	3,590	2,623	1,341	1,035	995	995	3,946	3,113	2,024	1,090	22%	0.30
2036	7,059	731	3,609	2,636	1,341	1,035	995	995	3,964	3,096	2,012	1,083	22%	0.31
2037	7,059	731	3,623	2,646	1,341	1,035	995	995	3,977	3,082	2,003	1,079	22%	0.32
2038	7,059	731	3,633	2,654	1,341	1,035	995	995	3,988	3,072	1,997	1,075	22%	0.32
Total				54,058		30,118	17,200		101,376	57,138	35,713	21,426		
IRR										28%				

Continued, Notes

(4) Contract Prices: 'initial' and 'reference' prices for the projection period:

Dry Gas	\$/MMBtu	Initial price	Reference Price
LPG	\$/Ton	1.04	6.0
Condensates	\$/Barrel	85.0	760
Raw Gas	\$/MMsfc	6.7	106
LNG	\$/MMBtu	1,695	14.7

Refer to formulae in the Appendix and world prices for 2011 in point (5), on the right

(5) World Prices in 2011 (Asian Market):

P _D : Fuel Oil 180 HSFO	\$/Ton	677
LPG	\$/Ton	833
Freight from Japan to Arab Gulf	\$/Ton	73
Dubai Crude	\$/Barrel	106
LNG	\$/MMBtu	14.7

(6) Conversion Factors:

MMsfc =	18.91	Ton Liquids,
MMsfc =	1025	MMBtu,
MMsfc =	172.3	Barrels of crude oil equivalent (condensates),
Ton of LNG =	55.25	MMBtu
Ton of Fuel Oil =	37.66	MMBtu
MMsfc: one million cubic feet.		

Table (2) Iraq's Southern Gas Agreement: Partners' Cash Flows and Profitability, US\$ Million
Iraq's South Gas Company, SGC

	Foreign Partners										Iraq's South Gas Company, SGC													
	Outflow					Inflow					Net after Tax					Income Tax 35.0%								
	Capital Costs		Raw Gas & Operating Costs			Sales Revenues			Capital Costs		Raw Gas & Operating Costs			Subsidy on Domestic Sales		Revenues from Sales of Outputs		Net Before tax		Income Tax 35.0%		Net after Tax		
	Initial & Central Budget	Costs Paid for by Sales Revenues	Initial & Central Budget	Capital Costs	Operating Costs	Raw Gas	Operating Costs	Dry Gas	LPG	Revenues from sales of Raw Gas	Revenues from Sales of Outputs	Capital Costs	Costs Paid for by Sales Revenues	Operating Costs	Raw Gas	Operating Costs	Dry Gas	LPG	Revenues from sales of Raw Gas	Revenues from Sales of Outputs	Net Before tax	Income Tax 35.0%	Net after Tax	
2010																								
2011																								
2012																								
2013	488																							
2014	488	304																						
2015	488	618																						
2016	995	1,126																						
2017	995	1,383																						
2018	995	1,692																						
2019	995	1,691																						
2020	995	1,690																						
2021	995	1,689																						
2022	995	1,688																						
2023		1,686																						
2024		1,685																						
2025		1,684																						
2026		1,683																						
2027		1,709																						
2028		1,777																						
2029		1,826																						
2030		1,861																						
2031		1,887																						
2032		1,907																						
2033		1,922																						
2034		1,934																						
2035		1,942																						
2036		1,949																						
2037		1,954																						
2038		1,958																						
Total	8,428	41,246																						
IRR																								

Sources and Notes: same as those of Table (1).

Notes on subsidy calculations:

- Subsidies on domestic sales of dry gas and LPG, in this table, are calculated as the difference between Contract Price and official domestic price multiplied by SGC's domestic sales of the respective product.
- Official domestic price of dry gas is \$1.04/MMBtu. Therefore, the subsidy on dry gas is equal to price paid by SGC to BGC, as shown in Table (1), minus official domestic price times domestic delivery of dry gas.
- In the beginning of 2012, production capacity of LPG stood at 1.75 Million tons. According to the 'Oil Products Distribution Company', Iraq (excluding Kurdistan) consumed about 1.6 Million tons in 2011. Proportionately, if Kurdistan is taken into consideration, Iraq would have consumed 1.85 Million tons in 2011. To meet total Iraq's need of LPG and a percentage for contingency, from 2014 onward, we assume that 1.2 times the growing consumption of LPG will be met by BGC. In 2011, official domestic price for LPG was ID5,000/cylinder, equivalent to \$356/Ton. The difference between Contract Price of LPG (Table 1) and official price constitutes subsidy. Multiplying this price difference by the 'additional' consumption (background calculations) makes up total subsidy on the 'additional' domestic consumption. Quoted figures for capacity (2012) and consumption (2011) of LPG are from the following, respectively: Mubashir (2012) "Reaching Complete Coverage of Domestic Consumption of Gas", 19 February.

Appendix Simplified Price Formulae

Each of the prices of raw gas, dry gas, LPG, and condensates is described in Exhibit 5, Volume 1, of the contract, by a set of equations. We have carried out substitutions in each set to reduce it to one equation for each price; which is reported in this appendix. The resulting price from each single equation coincides with that determined by the corresponding set of equations. In Exhibit 14, Volume 1, it is stipulated that LNG price 'to be based on market prices', FOB loading terminal. We, therefore, take it to equal LNG price in Japan, netted back to the loading terminal in the Gulf.

Contract price of dry gas

$$(1) CP_{DG} = (1-ML) \times 1.04 \times 1.02^n + ML \times 0.00892P_D,$$

Where,

CP_{DG} : Contract price of dry gas, US\$/MMBTU.

1.02^n : inflation factor, $n=0$ in the first year of implementation, taken to be 2013 in this article.

P_D : \$/Ton, price of high sulfur fuel oil (HSFO) 180 FOB Arab Gulf, quoted under the heading *Asia Products* in the *Asia Pacific/Arab Gulf Market Scan* (Platts).

ML : Matching Level, which is a situation (date) when cumulative expenses by foreign partners become equivalent to (96%) the value of initial (and additional) installations transferred from SGC to BGC. It is defined as follows:

$$(2) ML = \begin{cases} \frac{A}{1,463} & \text{If } \frac{A}{1,463} \leq 1, \\ 1, & \text{If } \frac{A}{1,463} > 1. \end{cases}$$

Where:

A : sum of capitalisable cost incurred and cash calls paid by foreign partners up to the calculation date in US\$.

$\$1,463$ million: 96% of the value of initial (and additional) installations transferred from SGC to BGC.

If investment starts in 2013 the matching date is taken in this article to be beginning of 2016.

Contract price of LPG

$$(3) CP_{LPG} = (1-ML) \times 85 \times 1.02^n + ML [s_1P_{propane} + s_2P_{butane}] - B_{LPG}$$

Where,

CP_{LPG} : Contract price of LPG, US\$/Ton.

s_1, s_2 : respectively, shares of propane and butane, by weight, in LPG.

$P_{propane}$, P_{butane} : respectively, averages of daily quotations (\$/Ton) for propane and butane under the heading “Asia Far East Index” under “Asia Pacific Refrigerated Cargos” as published in *Argus International*.

B_{LPG} : average of the Baltic Exchange titled “LPG freight rate one” [used in netting-back prices of propane and butane to Arab Gulf].

Contract price of condensates

$$(4) CP_{cond} = (1-ML) \times 6.74 \times 1.02^n + ML \times P_{Dubai}$$

Where,

CP_{cond} : Contract price of condensates, US\$/Barrel.

P_{Dubai} : the average (in \$/barrel) of the high and low quotations of Dubai crude price at the close of Singapore trading (as published by Platts).

Contract price of raw gas

$$(5) CP_{RG} = (1-ML)1.02^n 1695 + ML \frac{X R + (1-X) ML 0.00669 DV \{P_D - 1.02^n 0.82BB + 6\}}{V}$$

$$(6) X = \begin{cases} 0.1 & \text{If after-tax-IRR (AIRR)} \leq 0.175, \\ 0.1 + 5 (AIRR - 0.175) & \text{if } 0.175 < AIRR \leq 0.275, \\ 0.6 & \text{If } AIRR > 0.275. \end{cases}$$

Where,

CP_{RG} : Contract price of raw gas, \$/MMscf.

R : sales from dry gas, LPG, condensates, non-income taxes, fees, and other related domestic receipts (excluding LNG sales), in \$Million.

DV : volume of dry gas, in million MMBtu.

V : volume supplied of raw gas, in million MMscf.

BB : a ‘constant with value (50) reflecting baseline value of Brent crude’.

X : parameter/fraction through which the escalation scheme is applied.

After year 2015, ML becomes equal to one. Therefore, after year 2015 the price of raw gas equation simplifies to:

$$(5') CP_{RG} = \frac{X R + (1-X) 0.00669 DV \{P_D - 1.02^n 0.82BB + 6\}}{V}$$

IN PREPARATION FOR IRAQ'S NEW EXPLORATION BID ROUNDS

Thamir Uqaili*



The response of the international bidders for exploration round 4 in the auction held at the Iraqi Ministry of Oil (MoO) on 30-31 May this year was discouraging for reasons that included unfavorable contractual terms, vague field development of discovered hydrocarbons and, in the case of some of the blocks, security concerns. At the end of May auction, Iraq's oil minister announced that there will be further exploration rounds, including rounds 5 and 6.

A detailed exploration study is being prepared by the author to assist potential international bidders in defining their bidding priorities for the coming rounds. However, this article reviews the exploration options available to the Oil Ministry in preparation for the coming rounds.

The Original 65 Exploration Blocks (Source Map)

The attached map (Fig 1B) shows the locations of 65 blocks identified by Iraq's Oil Exploration Company (OEC) before the fall of Baghdad in April 2003. This map was the basis for defining the Western Desert blocks (1-12A) that were negotiated with several international oil companies (IOCs) during the years 1997-2001. The same map was a source for the selection of the 12 blocks of Bid Round 4 (Figure 1A), but with changes in the size and boundaries of those 12 blocks when compared to the original Western Desert

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blocks. Furthermore, the choice of many potential blocks in Kurdistan by the Kurdish Regional Government (KRG) was made by reference to the Source Map.

The definition of the exploration blocks of the next rounds, or at least of round 5, is expected to be based on the Source Map plus a seismic map generated by OEC as result of 2D covering many parts of the country. The latter has not been published.

A close look at the relevant maps identifies the following areas:

- 1- Area 1: Western Desert Area containing blocks 3,4,5,6,11 and 12 of Figure 1A and blocks 1-12A in Figure 1B.
- 2- Area 2: Upper Furat Area containing blocks 7, 10 and 9 of Figure 1A and blocks 19-39 of Figure 1B. It is doubtful if block 18 of Figure 1B will be offered in the coming rounds.
- 3- Area 3: East Central Area containing block 8 of Figure 1A and blocks 40-49 (and 51) of Figure 1B.
- 4- Area 4: Jezira Area containing blocks 1 and 2 of figure 1A and blocks 17-18, 64 and 65 of Figure 1B.
- 5- Area 5: North and North eastern Area containing blocks 50, 52 and 63 of Figure 1B. It is to be noted that blocks 53-62 have not been included in this area as they are mostly in Kurdistan and nearby. These blocks contain concessions awarded by the KRG, an act considered illegal by the federal government.

Results of Bid Round 4

The following Blocks have been awarded, while the rest of the 12 Blocks of Figure 1A are still open for bidding.

Contract Area	Companies/Consortia	RF \$/B
Block 8	Pakistan Petroleum	\$5.38
Block 9 (ex-19)	Kuwait Energy (Operator)/TPAO/Dragon Oil	\$6.24
Block 10	Lukoil (Operator) / Inpex Corporation	\$5.99
Block 12	Bashneft	\$5.00

The Remuneration Fee (RF) bid for each contract area is as agreed by the winner, provided that this is less than or equal to the pre-defined Maximum Remuneration Fee.

Options for coming rounds

The choice of the blocks for the next round(s) may include candidates from areas 1 to 4, avoiding area 5, which contains many blocks already awarded by the KRG to IOCs. These blocks should be assessed on the basis of the following:

- Seismic leads identified through past seismic data acquisition and other sources.
- The regional geology and stratigraphy of Iraq, including surface features, identifying reservoirs and source rocks in the geological columns.
- Results of exploration wells drilled in and around the blocks.

The following guidelines shed light on the prospects of the blocks that may be announced by the Oil Ministry for the coming bid rounds:

- 1- Area 1 (West Desert) still offers the best choice for exploration, as it contains many geophysical leads identified by 2D seismic prospecting. Extra information from deep water wells and magnetic and gravity surveys are available too.

The main expectations are discoveries of light oil, gas and gas condensate.

2- Area 2 (Middle Furat) contains:

- a. Several discovered fields on the eastern side.
- b. A few small discoveries ranging from semi-commercial to marginal on the western side.
- c. A few seismic anomalies.
- d. Blocks 9 and 10 that were awarded in Round 4.

Prospective formations are oil from medium-heavy to medium and possibly gas and gas condensate from depths of 4500 ms plus.

3- East Central Area containing:

- a- Block 8 which was awarded in Round 3.
- b- Several fields and discoveries surrounding the areas.
- c- A few seismic leads within and nearby.

Prospective formations are mostly Jurassic and Cretaceous with gas and light oil.

Block 51, in a known hydrocarbon province, may be included in a forthcoming round. Prospects are heavy and medium API crude oil.

4- Area 4 (Jezira)

This area contains blocks 1 and 2 of round 4, which are still open for bidding:

Block 2 has one well with a semi-discovery in the Ordovician Khabour Sandstone.

The area has several seismic leads and several discoveries that are not properly appraised and should be included in the coming rounds.

The few oil and gas fields in the Syrian side of the border add some exploration bias to the area.

The Kurra Chine and Khabour Formations are the two main targets for medium-light oil, gas and gas condensate.

5- Area 5 (North eastern)

The area has high potential, being surrounded by and containing oil and gas discoveries. It includes blocks already awarded by the KRG to IOCs, though mostly in the "Disputed Areas."

Preparations For Future Rounds

Preparations for the coming bidding should include:

1- A revision of contractual terms.

2- An increase in the seismic data acquisition capacity of the Oil Exploration Company of the Oil Ministry to include:

- a. Adding three 2D crews and at least two 3D crews to carry out an intensive seismic surveying program.
- b. Improved processing and interpretation capabilities.
- c. The signature of joint venture agreements with one or two seismic companies following Pre-Q campaign and transparent well advertised bidding.

3- A specialised conference for Pre-Q bidders to be introduced to prospective exploration blocks and small and semi-commercial Iraqi discoveries. The participation of experienced ex-Iraqi experts is a must.

Sweetening Of The Contractual Terms

For successful bid rounds, lessons from Bid Round 4 should be taken into serious consideration by the Oil Ministry. Exploration, as opposed to contracting for discovered fields as in Bid Rounds 1,2 and 3, requires sweetened contracting terms covering:

- a- Linkage of the RF with the rate of production in case of a discovery by assigning inversely proportional RF values to expected production potential.
- b- Higher RFs for less secured sites.
- c- Incentives in case of discovery.
- d- Clear terms for the utilisation/ export of discovered oil and gas in a manner that enables the awarded side to carry out the timely development of the discovery.
- e- In case no discovery is made, priority should be given to the unsuccessful awardee to enter into negotiations to sign for a reasonably sized discovery that has not been included in the current development plans of the Ministry of Oil.

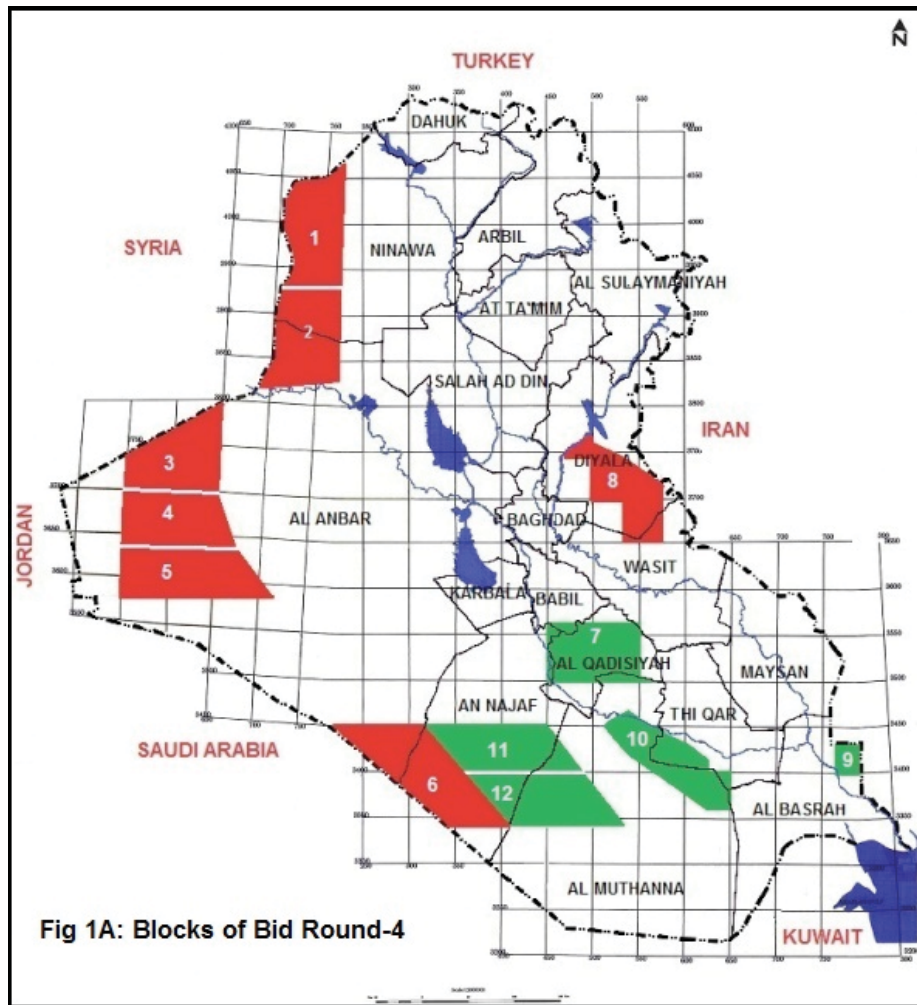
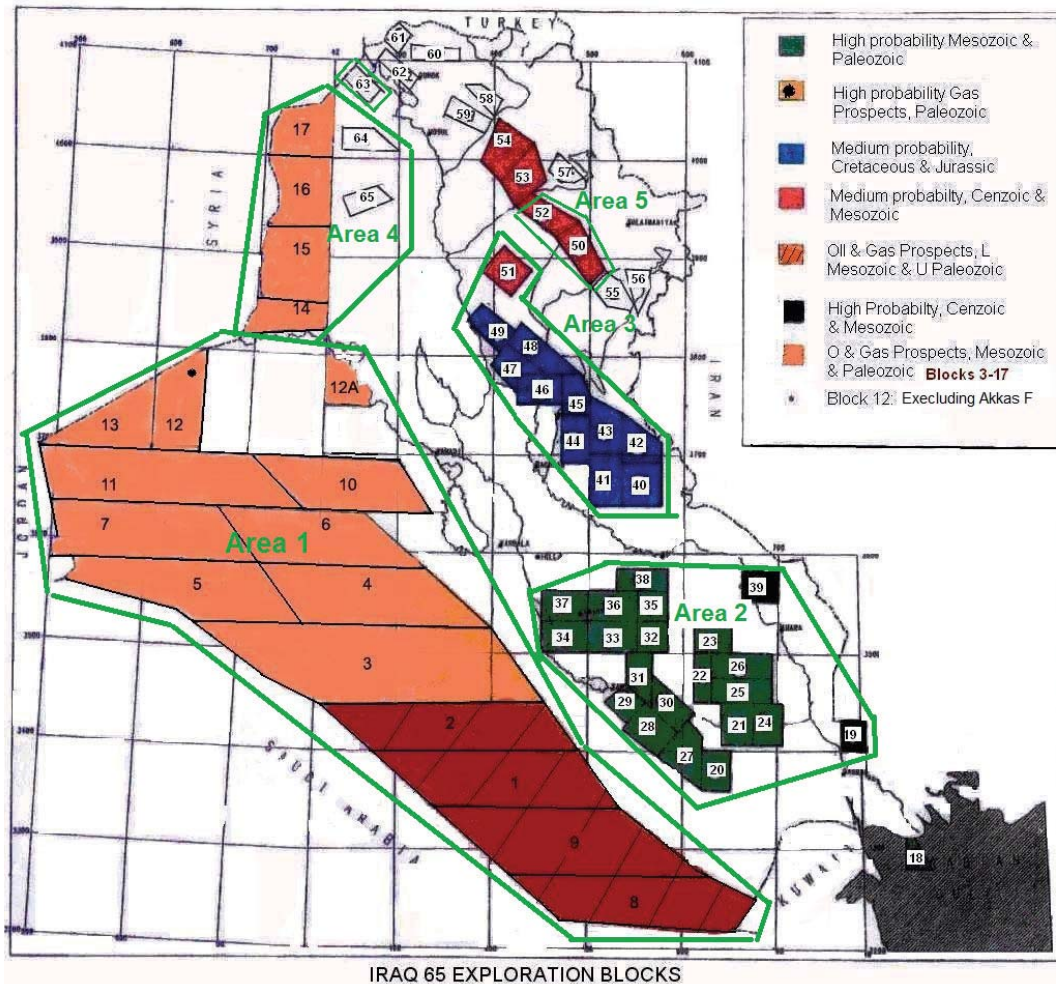


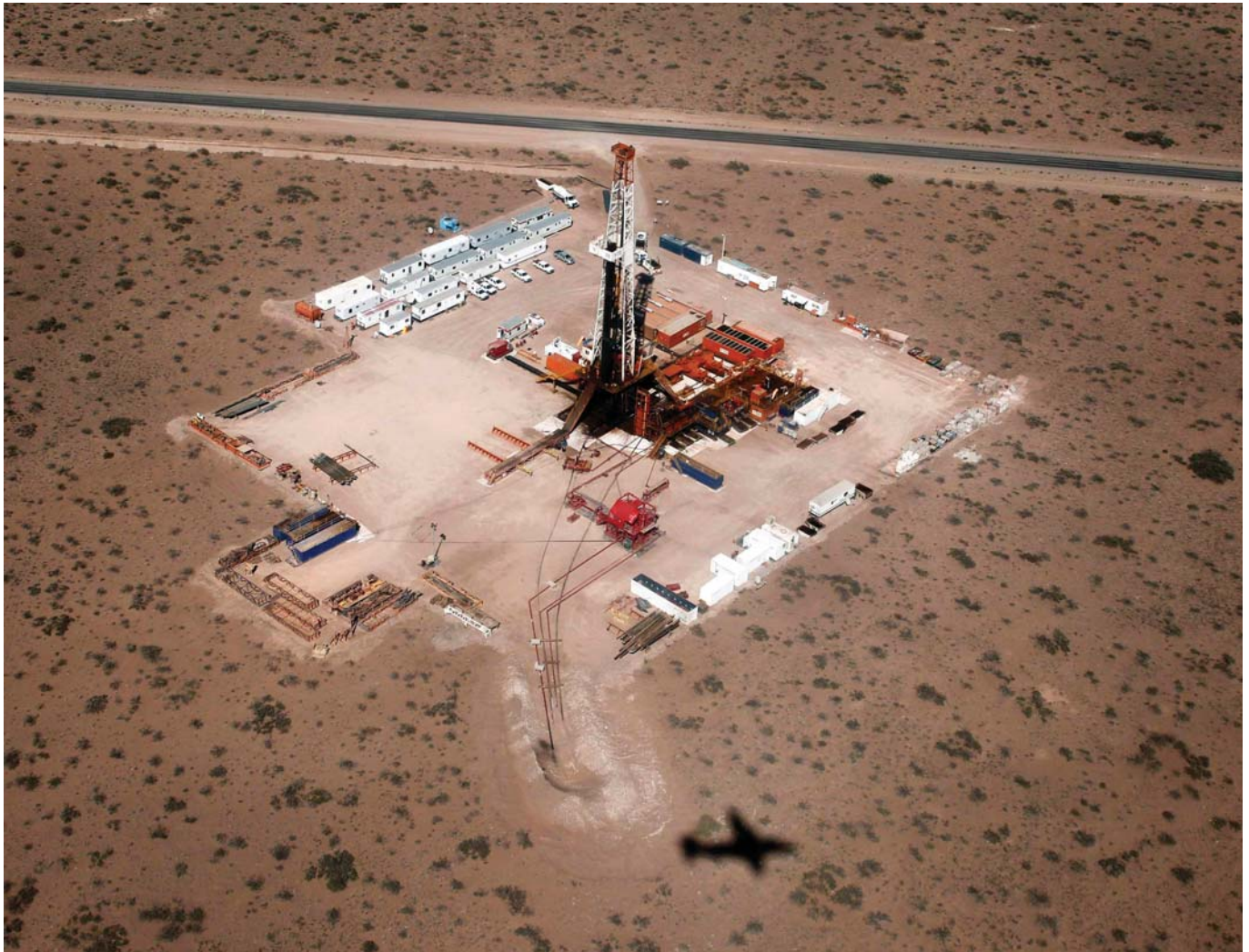
Figure 1B: IRAQ 65 Exploration Blocks



Re-visiting The Myths Of Oil Policies

A Book Review “Oil Policies, Oil Myths” (Fadhil Chalabi, 2010)

Luay J. Al Khatteeb*



Not since Jahangir Amuzegar's study *Managing the Oil Wealth: OPEC Windfalls and Pitfalls* (2001) has there been an authoritative study of OPEC. This time Dr. Chalabi's study, from inside the organization, provides an opportunity to have authoritative information about the workings of OPEC as he sets about chronicling its history. From its beginning in 1960, OPEC's role has been one of exaggeration. Seen by some western economies, especially the USA, as the priors of economic recessions with oil price shocks that have been quickly followed by economic downturns. The western media, governments and the international oil companies IOCs have been quick to blame OPEC for the high pump prices. However, Dr. Fadhil Chalabi, Iraq's representative, who spent many years holding the most senior posts at the organization, identifies and dispels the myths and invites the reader to discover the realities, environment and evolution of policies that have shaped OPEC and the oil industry.

Initially, OPEC faced open hostility from the oil majors that controlled global oil supplies. However, the Seven Sisters were quick to find alternative supplies in their attempt to curtail the potential power of OPEC.

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Oil commentators saw Libya's Qadhafi as a hero pointing out that he was the first Arab leader to stand up to the oil companies and won a better deal for his country. All what happened took place in OPEC. Colonel Qadhafi started the whole process of change. He took on Occidental, gained a higher price for his oil and greater share of the oil revenue. This event started a domino effect across the MENA region. Dr. Chalabi agrees that "Libya's bold demands under Qadhafi heralded the new winds of change that were blowing through OPEC." (p53). However, he points out that while Qadhafi did gain a higher price, it was a small price increase that hardly reflected the true difference in the quality of sweeter Libyan oil had over the more heavy oil from the Middle East and that Qadhafi went on to only serve his own interests rather his peoples or that of OPEC.(p65)

Nevertheless, the stranglehold of the oil majors was broken and OPEC gained for the first time a degree of power which came to the fore in 1973 when the Arab embargo, designed to punish the USA for its support of Israel, punished the world as oil prices quadrupled leading to unprecedented inflation rates in the developed economies. However, Dr. Chalabi argues that the 1973 events might have increased oil revenues by some 400%, but only served to increase the demand for the dollar, strengthening both the currency and USA's position as the world's number one economy when these petrodollars were spent on American goods. A fact, that Henry Kissinger welcomed according to the author. Furthermore, he points out that the events of 1973 brought about high prices and high profits for the IOCs and the financial institutions associated with the industry at the expense of businesses and drivers the world over. (p248).

Dr. Chalabi showed how ironic it was that the IOCs invested heavily in non-OPEC countries to replace the reserves lost by them due to nationalization, just at the height of OPEC's power. Moreover, the consumer countries pursued energy efficiency policies, as well as self-sufficient energy programs, led by the US,

In essence, the IOCs only cooperated with OPEC for a short period of time, until they could marginalize OPEC's power by seeking other sources of supply and regain the market power that the Seven Sisters had enjoyed for many years. 1973 marked the end of the cheap oil era as the USA and the IOCs pursued a high cost high price strategy with OPEC's compliance. OPEC became a follower of policy rather than a decision-maker. New high cost offshore oil discoveries in both Europe and the USA meant that high oil prices were desirable to all. Dr. Chalabi in many ways basically confirms the famous U.S. State Department quote that "American oil operations are, for all practical purposes, instruments of our foreign policy toward these countries."

The 1973 events tarred OPEC's image as a self-interest cartel, hungry for oil revenues, and penalizing the West with high oil prices. This image serves only to deflect criticism from the IOCs and their profits. Meanwhile, world demand increased by some 50% while OPEC output increased by only 26%, thereby highlighting the decline of OPEC influence upon the market. Dr. Chalabi's advice during the 1980s was the necessity of more upstream investment to expand output to regain OPEC's market share, rather than attempt price fixing. This advice fell on deaf ears in the Middle East. Dr. Chalabi also points out that the rapid growth of OPEC member-states' population from some 100million in 1960 to over 400million today has taken an ever increasing share of the oil produced for their domestic markets. Furthermore, the author demonstrates that the cartel has not been a price fixer but a price taker as its market share and power have declined. OPEC has only recently been able to influence price when Saudi Arabia has played the role of swing producer because of its spare capacity.

Like most cartels, OPEC members appear to have a common aim, but national self-interests surface quite often. Dr. Chalabi gives a running commentary on how many national oil companies NOCs are increasingly preoccupied with optimizing the development of their own resources and supporting their own attempts to promote a degree of diversification in their own economies rather than to support the common objectives of OPEC. Meanwhile, other members have squandered the opportunities made available to them by OPEC policies.

Although OPEC has been labeled a cartel by western commentators, as Dr. Chalabi points out, it has failed to act as one. (Chapter 14) It has failed to maintain its market share allowing self-defeating pricing and production policies to reduce its influence in the market. It has allowed the price to rise at the behest of high cost non OPEC oil producers, such as the development of expensive offshore oil fields in the Gulf of Mexico, as well as the development of the North Sea. Even expensive and environmentally sensitive fields such as in Alaska have become potentially viable under such policies. Expensive development of tar sands oil and shale oil have attracted more investments than low cost Middle Eastern fields as high prices and increasing revenues from current capital investment have been sufficient to satisfy OPEC governments and their fiscal budgets, though most have failed to reach their economic potential.



OPEC members have failed to plan for long-term demand trends, as the member states accumulate high revenue surpluses, and political sensitivities have encouraged a high price strategy. The author emphasizes that OPEC members have until recently failed to take seriously long term investment to increase production capacity, maximizing instead short term revenue from existing capacity, especially as OPEC members have many different goals and interests at stake. Disparate goals have usually made negotiation of any agreement extraordinarily complicated and often adversarial, leading to the maintaining of a status quo rather than looking for solutions to the instability of the market by expanding investment in capacity building. Dr. Chalabi is critical of this development, arguing that “with the exception of Saudi Arabia, OPEC has done nothing to reinvest its colossal oil revenues in drilling activities, which have remained stagnant, if not in perpetual decline, ever since OPEC first took over the industry from the oil companies in 1973.” (p244)

The book highlights the diplomatic skills that Dr. Chalabi and other OPEC officials needed to keep this disparate group of countries united over more than fifty years. You have to ask: How and why did countries with such major divergences in size, population, resources, economic structures, governmental systems, culture and ethnicity all follow the same path to political and economic development for so many years? The book sheds some light on this.

How did OPEC members benefit from their petro-dollar windfall? Where did all that money go? Why the deficits, debts, and economic backwardness for many OPEC members? The book deals with these questions, showing that the countries often suffered from poor leadership with egotistical and megalomaniac leaders bent on developing their own personal agendas. The book reads like a political drama, as characters and geopolitical events conjure up conspiracy theories and intrigue, that seemingly belong to a TV documentary or even a Hollywood film.

Nonetheless, the true economics of the oil market are laid bare as Dr. Chalabi argues that OPEC had very little market power except in periods of rapid world economic growth, when demand got ahead of supply and that the power of the cartel was undoubtedly a myth portrayed by consumer states who themselves were often dictating policy to OPEC as they were often in favor of high prices to maintain their own oil profits. The evidence is clear as OPEC's failure to stabilize price and the ensuing price fluctuations only served to damage the development of most OPEC members. The folly of peak oil theorists is exposed (Chapter 12) as is the role of the speculators who only served to drive up prices to the advantage of the IOCs and high cost producers. Meanwhile, the \$100 price fluctuations of 2008/9 caused fiscal chaos for most OPEC members as fiscal surpluses turned into deficits.

Reading through each chapter it soon becomes apparent that the economic failures of the OPEC members are often the result of the geopolitics of the MENA region. It is a story of one step forward two steps back. Religious and political rivalry allied to poor leadership often prevents the development needed to exploit the hydrocarbon wealth. It is, as if we are often just at the tipping point of development, only for political or religious chaos to ensue, and turn economic development back to economic fantasy.

At times, the reader may be forgiven for believing that this Chalabi's autobiography. Dr. Chalabi was one of Carlos the Jackal's OPEC hostages in 1975 and the chapter detailing the events makes fascinating reading. Furthermore, the fact that he played such a significant and often pivotal role in the politics and leadership of OPEC becomes clearly apparent. The book gives his personal account of how the oil policies of the past fifty or so years have touched all of us and one is left feeling that if only producer and consumer states had seen their common interests and not foregone the missed opportunities, the world and especially the Middle East would be a better place today.





ENERGY & GEOPOLITICAL RISK



Since the later part of the 19th century oil and gas have dominated the lifestyle and welfare of the human species. The pursuit of oil and gas has brought about technological innovations that have produced both beneficial and harmful consequences for the development of human welfare. On one hand they have helped to improve the quality of human life and contributed to the reduction of disease, illiteracy, poverty and insecurity. On the other hand no other source of energy has created such devastating and unabated political instability among nations. The ensuing geopolitical risk identification, management and mitigation with respect to energy sources constitutes a central factor in the modern international relations. Their ramifications cross all boundaries among the mutually dependent economic, political, social and environmental factors that shape the plans and aspirations of nations.

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Cross-border behavior is to varying degrees attributable to the uneven distribution of energy resources, which is a significant factor in assessing the ensuing risk profiles of sovereign nations. The security of global supply and demand of energy significantly determines the flow of energy resources and their derivatives to their intended destinations within a stable price régime. This position is further enhanced as the world is increasingly interconnected and characterized by irreversible dynamic interdependence.

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