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Challenges in Financing Energy and Oil & Gas Projects in Iraq.

By Dr. Ihsan Al-Attar *

Type of Projects

Oil and Gas projects as part of the energy projects in Iraq fall within the three standard categories generally known in the international oil industry as upstream, midstream and downstream type of projects. These include but are not limited to:

- Drilling oil and gas wells
- Laying flow lines trunk lines and distribution lines;
- Building degassing stations facilities.
- Building tank farms and storage depots.
- Constructing refineries and gas plants
- Building onshore and offshore loading platforms.
- Building all infrastructure needed for such projects.

The Iraqi Ministry of Oil is the central government entity entrusted with the total implementation of such projects, and two modes (Insourcing & Outsourcing) of implementation were normally employed which were largely dependent on allocations specified in the “Annual National Budget” based on pre-determined cost estimates by the Ministry’s specialized offices as follows:

- Insourcing: Using the Ministry’s own resources through direct execution.
- Outsourcing: Awarding to local and international contractors and suppliers.

Resources Required for the Proper Execution of Projects.

Modern project management methodology requires the application of at least (5) five main types of resources (money, manpower, materials, machinery, and management) for the proper and successful implementation of large projects such as those in the energy, oil & gas sector whereby success is realized when the Project is completed as per specifications, according to schedule and within cost. This requires that management had to impose all the way, a high degree of control so as to keep the Project execution process within the safe limits of (3) three variable project parameters of scope, schedule and cost or what is generally known in project management terms as the “**Project Control Triangle**” shown below.

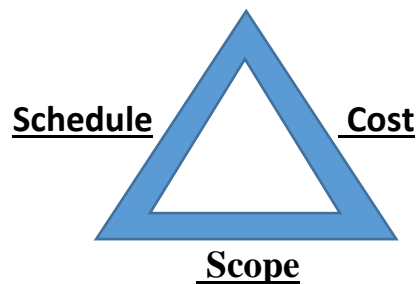


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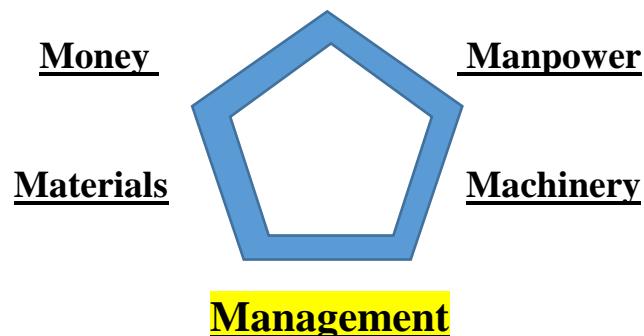
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All the (5) five types of resources required to achieve the objective of successful project implementation start with the letter (M) and they are depicted in what forms the sides of the "Project Resources Pentagon" shown below.



By far **Management** is considered the most important of all the five resource since there are countless examples of project failures in Iraq and elsewhere in the world where in spite of the comfortable availability of all the four resources, projects failed due to the unfortunate absence of the fifth, which is proper **Management**.

This paper deals with the first type of resources required for projects implementation which is "Money" or in other words "Financing."

What Caused the Need for Foreign Financing

Financing in general is the process of providing the Financial Resources needed to bridge the gap between what is available in the budget and what is actually required.

Two major overlapping events raised the need for foreign financing:



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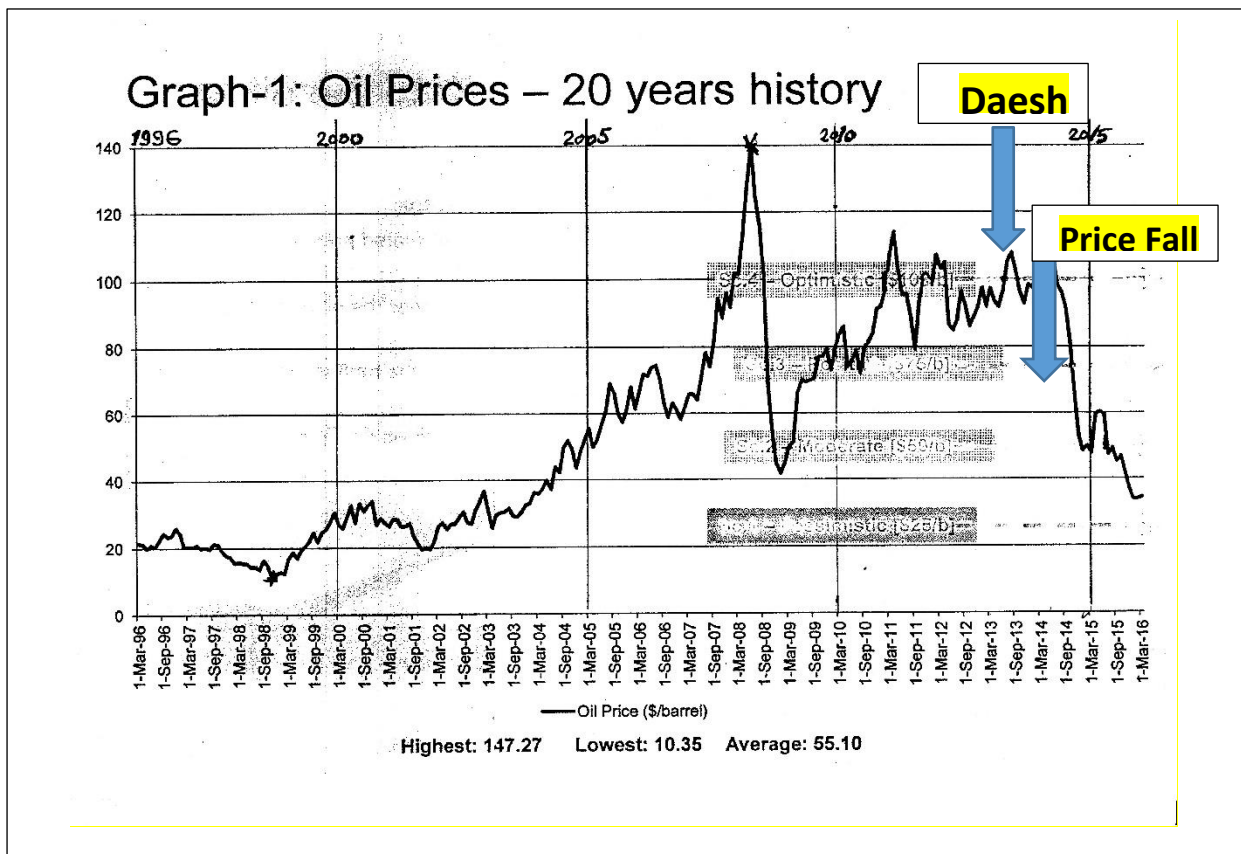
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First: The drastic fall in oil prices on international markets causing a major drop in revenues feeding Iraq's Annual National Budget which itself is heavily dependent on oil revenues at a high rate of (86%) at present (2017) resulting in a deficit of 21 trillion dinars or 17 billion dollars

Second: The ongoing war on Daesh in the Mosul province which started June 2014 draining an appreciable amount of the total financial resources of the country as well as the ailing “National Budget” for providing the urgent military needs of this war

Graph (1) below shows 20 years of historical fluctuation of oil prices on the international market and the effect that the two above said overlapping events had on imposing more pressure on the Iraqi “National Budget” and eventually raising the need for additional financing. Furthermore it shows the two historically overlapping events that caused the need for additional financing in Iraq. (The war on Daesh and the Drastic Fall in Oil Prices)





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Present Requirement for Financing are Needed:

- To complete delayed projects already under construction
- To start initial phases of new projects.
- To start strategic projects already planned.

However, in response to calls for financing, the following (4) four types of offers were received from various banks and financial institutions. Such offers can be categorised as follows:

1. Finance Against Supply of Crude Oil

The financier provides the money needed against payment in crude oil at a later date (with or without grace period), usually with a certain discount of the price per barrel in the international market.

2. Finance on Deferred Payment Bases

The financier provides the money needed to be paid back at a later date (with a grace period) plus a certain interest rate to be agreed upon between the two sides.

3. Finance on Joint Venture Bases

The financier is willing to enter into a joint venture agreement with the Ministry of Oil where he would provide the finance needed to execute the project in return for receiving back his debts from the proceeds of the project after completion, such as selling refinery or gas plant products of a jointly executed project.

4. Finance on Investment (BOO, BOT, BOOT) Bases

The investor executes the project on Build, Operate Own (BOO) or Build, Operate, Transfer (BOT), or Build, Operate, Own, Transfer (BOOT) bases

Under these types of agreements, the Ministry (provides crude oil at a discounted price in the case of refineries) and the financier is free to sell the products at commercial prices inside or outside the country for an agreed number of years to cover the cost of the installations, whereby such installations would be returned to the Ministry after the elapse of the agreed period.

Challenges Facing the Finance Process

Financing oil and gas projects did not go without facing some major challenges which can be summarised as follows:

1. Inadequate Legislations



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Project financing is relatively a new venture for the Iraqi Administration and there are no integrated rules to regulate the complex contractual relationships of the parties in a “Project Finance Agreement”. Some legislations have been issued such as the (Implementing Strategic Projects on Deferred Payment Guidelines), also the Public Private Partnership (PPP) guideline is under preparation.

2. Inadequate Expertise.

Again being a new venture, there are not enough "Expert Personnel in Foreign Finance" within its organisation. Steps are already underway to sign an agreement with a “Leading International Finance Consultant”.

3. Long Chain of Bureaucratic Decision Making Steps

Offers from Investors on (BOO, BOT, and BOOT) bases must go through a long chain of decision making process involving several entities, making the process lengthy, cumbersome and discouraging to said investors.

4. Absence of Sovereign Guarantees

Most offers on differed payment insisted on a precondition that they should have a sovereign guarantee for the amount being provided. So far the Ministry of Finance has not agreed to such a condition.

5. Inadequate Crude Oil

Finance offers against payment in crude oil faced difficulties in finding adequate quantities of surplus oil left to cover payments, since an appreciable amount of the produced oil is already committed to be lifted by the (IOCs) in return for Petroleum Costs of the Service Contracts which counts for some (15 - 20) % of the “Annual Budget”. Such offers posed an additional hidden risk to the Ministry in case that lower oil prices raise the number of barrels to be lifted thus imposing more pressure on the production limit imposed by OPEC.

6. Absence or Low Credit Rating

Low credit rating can have a vital effect on a country's ability to borrow money from finance offerers. Of the three international rating agencies only Fitch rates Iraq but with a low (B) grade. While Moody's and Standard & Poor's display a rating of “Undefined” in their list of country rates.

7. Unfavourable Security and Social Environment.

This is mostly related to project land and right of way acquisition required in investment projects where the investor fined himself confronted by members of the local community



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demanding assumed property rights and employment opportunity during the construction phase of the project.

8. Relatively High Cost of Mediators.

It has become clear that most finance offering entities are mediators and not original accredited **Finance Institutions**. Dealing with mediators is not only unsafe but can raise the total cost of the finance offered and make it unnecessarily higher to the Ministry.

Conclusions

In drawing up the conclusions, the following economic, social, political, and environmental parameters must be considered:

1. The prevailing low price of oil in the international market and the unexpected high rise of price in the near future.
2. The unilateral dependence of the economy on oil revenues
3. The relatively high rate of population growth (3%) at present
4. The inefficiency of utilizing agriculture to generate additional revenues where only (6%) of the arable land is utilized at present
5. The inefficiency of utilizing the industrial sector to generate additional revenues where there are (113) idle or semi idle loss making state owned factories employing hundreds of thousands of workers and employees.
6. The continuing war on Daesh at present.
7. The cost of depreciation of the existing energy, oil and gas installations and infrastructure which is estimated at a moderate rate of (5%) per annum
8. Uncontrolled corruption of the political machinery manifested by attacks and counterattacks among rival parties in parliament and wide spread mass media reports of politicians engaging in various sectors of private businesses.

Consideration of all the above parameters will only sum up to the unfortunate conclusion that Iraq will definitely have to resort - at least in the short term future - to foreign financing in order to bridge the gap between the National Budget and what is actually required to implement its urgently needed energy, oil, & gas projects.

Recommendations:

The Iraqi Administration represented and its legislative and executive entities together with parliament should endeavour to undertake the following immediate steps and seek foreign finance only for feasible projects with high probability of revenue generating results:



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1. Expedite formulating and approving required legislations on finance issues with the aim of raising the **Credit Rating** of Iraq by the **international rating agencies**.
2. Train more people to become experts in foreign finance matters or seek the help of specialised consultants.
3. Resolve the issue of **Sovereign Guarantee** required by finance providers to raise confidence and build up mutual trust.
4. Take necessary steps to simplify procedures and shorten the long chain of **Bureaucratic Decision Making Path**
5. Improve social and security environment by promoting a **Foreign Investment Friendly Culture**.
6. Return back to the more viable alternative revenue generating means in Iraq, **Agriculture and Industry** which have been unfortunately neglected for decades due to political and economic mismanagement, and **keep foreign finance to the absolute feasible minimum and save Iraq and its people from sinking into long term, unnecessary heavy debts**.

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