Guns and Barrels: Risks and Rewards in Iraqi Oil and Gas

https://marketpublishers.com/r/GCE807643BCEN.html
Date: August 2010
Pages: 13
Price: US$ 490.00 (Single User License)
ID: GCE807643BCEN

Abstracts

The oil sector contracts signed between Iraq and international energy companies in 2009 reflect the first stirrings of what the oil and gas industry hopes will be the reestablishment of a strong working relationship. Following years of underinvestment as a result of the economic sanctions imposed on Iraq following the 1991 Gulf War, Iraq is hoping to tap the expertise and capital of international oil companies (IOCs), their state-run national oil company (NOC) competitors and service companies in order to boost the technical capabilities of its infrastructure as well as the production and export capacities of the country's crude oil, natural gas and refined products.

Owing to the 1991 Gulf War and subsequent UN sanctions Iraqi production suffered during the 1990s. The country was granted an exemption from OPEC production quotas while it operated under the auspices of the UN Oil-for-Food programme, which allowed Iraq to export limited amounts of crude oil in exchange for the purchase of food and essential medical supplies.

Although the Oil-for-Food programme was disbanded after 2003, Iraq still benefits from the OPEC quota exemption. BMI forecasts Iraq's 2010 production at 2.47mn b/d, of which 1.62mn b/d will be exported, and the government plans to boost production to 12mn b/d by 2020–a production increase of 485% over the 10-year period. BMI sees this target as ambitious, forecasting 2020 output of 4.5mn b/d, but our projections still see 82% growth over the period.

While our outlook is sanguine, there are manifold risks to investment in the Iraqi oil and gas industry. In the long term, crude production growth will mean that Iraq will come under increasing pressure to rejoin the OPEC quota regime, presenting a potential cap on further output gains. In the short and medium term, Iraq's large investment needs,

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political instability and security risks will all contribute negatively to the country's energy sector aims. Furthermore, the role of 'resource nationalism,' particularly in a country with an insecure polity wary of foreign intervention, cannot be discounted in the upstream segment.

This can be discerned from the development contracts signed between Iraq and the various international companies jostling for position in the country's energy investment plans. The final awardees originate from a broad spectrum of European and Asian countries, and only two US companies–ExxonMobil and Occidental Petroleum–were awarded contracts. Furthermore, the Iraqi government was keen to be seen as negotiating hard to obtain the best possible terms for the state, and the government has shown no hesitation in changing deal terms for its financial benefit. Earlier changes to contractual structures included a 5% decline rate provision for output above the applicable production targets, as well as changes in ownership structures to the benefit of the IOCs.

Nonetheless, BMI believes that Iraq's ambitious plans for its oil and gas sector present significant investment opportunities for foreign companies. Specifically, we have identified the country's oil services sector, refining segment and natural gas industry as particularly attractive opportunities. We have highlighted below not only the nature of these opportunities, but the three most important risks that foreign investors will face in the Iraqi energy sector in the coming years.

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