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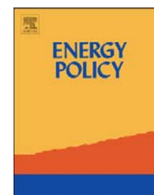

North African oil and foreign investment in changing market conditions

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ABSTRACT

Since the 1960s, the experiences of the North African oil producers of Libya, Algeria, Egypt and Sudan within the oil industry have followed separate paths, which have led them into different relations with foreign oil companies. While reflecting broader trends of "resource nationalism", these relations have also been affected by a number of factors specific to these countries. In tracing the evolution of the oil investment frameworks of these countries, as well as their concomitant relations with IOCs, this paper probes the roles played by these factors and argues that the type and size of remaining reserves as well as the capability of NOCs are likely to determine the most future developments in the region's oil industry.

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1. Introduction

The oil sectors in the North African countries of Algeria, Libya, Egypt and Sudan have witnessed major transformations in the last decades. In Algeria, government reforms introduced in the mid-1980s opened the door to a wide range of foreign oil companies in an oil sector previously dominated by the state-owned oil company Sonatrach. In Libya, the lifting of US-imposed sanctions and the opening of the oil sector to foreign investment through a series of licensing rounds created a new dynamism not seen since the mid-1950s when the country's oil industry kicked off. Egypt's oil policy of building partnerships with foreign oil companies makes it one of the most attractive countries for foreign investment despite its mature oil fields. In Sudan, Asian national oil companies have transformed the prospects of the country's oil sector. Since 1999, Sudan's oil production has been rising steadily enabling the country to join the club of oil exporters.

The focus on this sub-region of Africa is important for a number of reasons. First, oil production in these countries reached more than 5 million barrels per day (mb/d) in 2008 accounting for almost half of Africa's oil production as shown in Fig. 1. More important is these countries' pattern of production growth in the last few years. With the exception of Egypt where output has been in decline since 1993, Algeria, Libya and Sudan have achieved on average positive output growth in the last decade. During the period 1998–2008, these three countries increased their production by 1.36 mb/d as shown in Table 1. This increase in capacity proved vital at times when oil market conditions were getting tighter.

Second, the proven oil reserves of these four countries were estimated at around 67 billion barrels in 2008 constituting more than half of Africa's total oil proven reserves (BP, 2009). More important is the large increase in the size of estimated proven reserves over the last two decades as shown in Table 2. In Libya, the size of proven oil reserves almost doubled rising from 22.8 billion barrels in 1986 to 43.7 billion barrels in 2008. In Algeria, the increase in the size of proven reserves was more modest but still significant, rising from 9.2 in 1986 to 12.2 billion barrels in 2008. In 1986, Sudan's proven oil reserves stood at 300 million barrels while in 2008 proven oil reserve were estimated at 6.4 billion barrels. Due to the long civil war in Sudan and the sanctions in Libya, exploration activity in these countries was kept at a minimum. In view of the region's relatively under-explored overall potential, the volume of proven reserves in these two countries is likely to increase as exploration intensifies.

Third, North Africa is one of the few regions in the developing world where oil companies have full access to reserves and/or access to reserves with the participation of the state-owned company. As will be discussed below, international oil companies (IOCs) have always formed an important part of the North African oil industry. This was reinforced in the last decade during which their share of output continued to rise.

Fourth, the region provides a rich framework for comparative analysis regarding the evolution of the relationship between foreign oil companies and the national governments. The relationship has been affected by many country-specific factors, including

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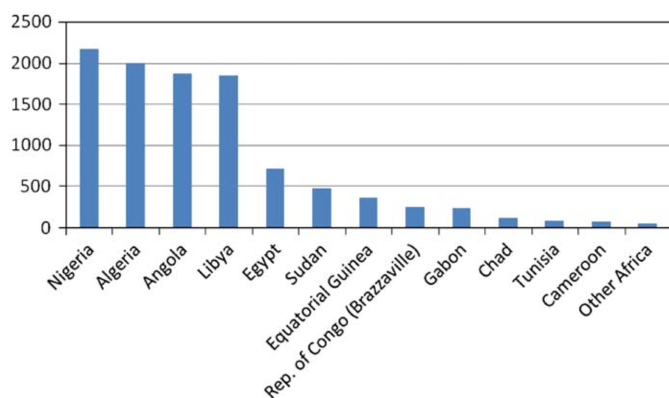

Fig. 1. Oil production in Africa in 2008 (thousand barrels per day).
Source: BP (2009).

Table 1
Year on year change in oil production (thousand barrels per day).

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Algeria	55	63	−16	118	172	94	69	−11	12	−23
Egypt	−29	−46	−23	−7	−2	−28	−25	1	13	12
Libya	−55	50	−48	−52	110	139	127	83	13	−2
Sudan	51	111	43	24	24	36	4	26	137	12

Source: BP (2009).

the competence of the national oil company (NOC), the country's hydrocarbon potential, as well as its domestic stability and international standing. Focusing on North Africa is also interesting since for most of their modern history, economies such as those of Egypt, Libya or Algeria have been heavily dominated by their states and state actors (Richards and Waterbury, 1996). Thus, allowing private investors – not to mention foreign private investors – into this strategic sector is considered an exception to the prevailing political-economy doctrine. In some countries such as Egypt, this relationship has survived extreme market conditions: the slack market and low oil price environment of the 1980s and the 1990s and the tight market conditions and high oil price environment of the past few years. This begs important questions: what have been the underlying bases of this relationship? Can this framework be generalized onto different contexts?

Finally, the region provides a rich framework to compare fiscal regimes both across countries and over time. The oil contracts and fiscal terms vary considerably across the North African producers. The production sharing agreement (PSA) remains among the most common types of contractual formula used in North Africa and elsewhere in the world.[1] These agreements, however, take different forms and the way the state participates in joint companies varies considerably across countries.[2] The government take of oil revenue also varies widely across North African

Table 2
Proven oil reserves in billion of barrels.

Country	At end 1988	At end 1998	At end 2008	Change over 20 Years
Algeria	9.2	11.3	12.2	3.0
Egypt	4.3	3.8	4.3	0.1
Libya	22.8	29.5	43.7	20.9
Sudan	0.3	0.3	6.7	6.4

Source: BP (2009).

producers where Libya's fiscal terms are considered one of the harshest in the world, while those of Sudan and Egypt are seen as relatively attractive. In addition to cross-country differences, regulatory frameworks and fiscal terms have evolved differently. While in Egypt and Sudan the hydrocarbon law and fiscal terms remained highly stable, in Algeria and Libya these were adjusted regularly to reflect changing market conditions and, sometimes, shifting domestic power constellations. The tight oil market conditions during the period 2002–2007 have resulted in major changes to fiscal terms in Algeria and Libya.

This paper traces the evolution of these regimes since the early 1960s, taking into account market cyclicality and country-specific factors. It argues that, besides reflecting general trends of resource nationalism that can be observed in other oil-producing regions and countries, the relationships between North African exporters and foreign investors have been noticeably affected by other issues such as the abundance and type of hydrocarbon resources, national government policy orientation, the capabilities of NOCs, and international sanctions. The paper analyses the role played by each of these factors in the evolution of investment frameworks in North Africa, with a view to identifying the outlook of these factors in defining the future of the oil industry in the region. This paper is divided into seven sections. Section 2 provides a theoretical framework for analysing the evolution of oil investment frameworks. Sections 3–6 provide a brief description of the evolution of foreign companies' involvement in each of these countries' oil sectors and the fiscal regime in use. Section 7 identifies and analyses some general and country-specific factors that explain the evolution of the fiscal regime. Section 8 concludes.

2. The evolution of North African oil investment frameworks: between market cyclicality and region-specific factors

The attitudes of oil producers towards the involvement of IOCs in the exploitation of their hydrocarbon resources are often dealt within the relevant literature under the banner of 'resource nationalism'. Ever since the 'politicisation of oil markets' in the 1970s, observers have attempted to explain and often predict the behaviour of oil producers, particularly members of OPEC, with reference to the 'petro-political cycle' (Wilson III, 1987). The assumption is that high oil prices endow governments in oil-exporting countries with additional leverage in their relations with consumer countries and foreign, often western-based, oil companies, allowing them to more easily alter the local terms of investment with a view to maximizing control and revenue. Conversely, on the downside of the market cycle, lower oil prices and reduced oil rents lead producers to seek greater foreign investment to boost output and reduce budgetary deficits. This results in the relaxation of regulatory regimes, which, nonetheless, in downswing circumstances are not always conducive to increased foreign investor interest. A variation of this assumption is the 'obsolescing bargain' model, which posits a diametrically opposed relationship between project investment risk and

[1] In a production sharing agreement, the oil company bears the exploration risk. If no oil is found, the field is relinquished with no compensation. If oil is found in commercial quantities, the field is developed by the foreign investor. When the fields begin production, the contractor recovers his cost (capital and operational costs) from oil output. The portion of oil used to cover costs is referred to as cost oil. The remaining output called profit oil is split between the government and the oil company on some agreed basis. For details see Bindemann (1999).

[2] In Algeria, the state retains 51% share of the joint venture. In Libya, there is no such requirement but the national oil company usually retains a high share of the venture. In Egypt, a foreign oil company is obliged to form an Egyptian based stock joint company with each of the partners holding 50% of the newly created entity. In Sudan, the state participates in some but not all projects, and its share is often low not exceeding 10% of the venture.

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