
IRAQ NEEDS OIL COMPANIES TO DRILL MORE, BUT CAN IT PAY?

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The Iraqi government is asking international oil companies operating in the country to continue to produce oil, but to get used to lower oil prices.

Iraq's oil minister Jabbar al-Luaibi sent a letter to several foreign oil companies, asking them not to rein in their ambitions on producing oil. "In light of the current environment of the oil price and its forecast in the next year[s], we [the Ministry of Oil and contractors] should be prepared to live with the prevailing circumstances," the letter said, according to S&P Global Platts. The minister wants them to "modify and adjust, accordingly, the field enhanced redevelopment plans/final development plans."

But the problem is that the oil contracts in Iraq are structured in such a way that oil companies are paid/reimbursed by the government to produce oil. That means that they need to be assured they receive payment before they go and spend large sums of money. Last year, the Iraqi oil ministry sent requests to oil companies to lower their spending budgets because the government was unable to pay for them.

Now, the oil ministry is effectively asking the companies to drill and produce aggressively, but suggested that it cannot guarantee proper payment. The letter apparently argues that Iraq would have more financial resources with which to pay the companies if the companies produce more oil.

However, the companies involved likely view the issue differently. "We're not a bank," an unnamed official from one company operating in Iraq said, according to S&P Global Platts.

Separately, Iraq recently announced that it would increase oil exports by 150,000 barrels per day after resolving an issue with three oilfields in and around Kirkuk. The stepped up exports will allow Iraq to restore some output, a factor that helped put a temporary halt to the oil price rally earlier this week. Iraq is the second largest oil producer in OPEC, producing 4.78 million barrels per day in July, which is up sharply from a few years ago.

And Iraq is not giving up hopes on higher output. The Iraqi Prime Minister said this week that Iraq has not yet reached its full oil market share, dampening hopes around a potential OPEC deal in Algeria in September. "And the capping, we are not open to that because Iraq is still below what it should produce," Prime Minister Haider al-Abadi told reporters, according to Reuters. That stance echoes Iran's position on the freeze deal. Oil prices did rally on Tuesday following reports that Iran had agreed to attend the meeting, but both countries' hitherto reluctance to sign on to any freeze deal creates a major obstruction to an agreement from the OPEC meeting.

While short-term oil price dynamics often revolve around the ability of OPEC members to cooperate, or by changing levels of oil production in the U.S. and the extent to which shale can or cannot weather the oil price downturn, over the longer-term Iraq will be a key factor in global oil supplies. For years, the IEA has put Iraq at the top of the list in terms of potential oil supply growth. Long-term projections about the ability of oil producers to meet demand depend very heavily on Iraq's success in boosting production. □ Iraq will be much more important in terms of supply growth than U.S. shale, and even other OPEC producers.

Nevertheless, Iraq will struggle to continue to post impressive production gains without heavy investment from foreign oil companies. Several years ago, Iraq had hoped to dramatically ramp up oil production to 12 mb/d by 2020, a ridiculously ambitious target. Even the revised 6 mb/d target by the end of the decade looks out of reach, especially if the government cannot offer the necessary payments to companies in order to achieve that goal. The Iraqi government has been hit hard by the collapse of oil prices and the ongoing fight with the Islamic State, major problems that have now stretched into a third year.

Kaynak/Source: