Kuwait Project

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Strategy to boost crude oil production capacity

Project Kuwait: A short-term solution to a complex issue

By Bassam Fattouh

KUWAIT: Project Kuwait, a $7 billion project initiated in 1997 by the Supreme Petroleum Council (SPC) of the Kuwait petroleum Corporation (KPC), is a part of a general strategy aimed at increasing Kuwait's crude oil production capacity to 4 million bpd by 2020 from the current level of around 2.5 million bpd. The project would allow international oil companies to invest in upstream production in five northern oil fields (Abdali, Bahra, Ratqa, Randhatain and Sabirya) near the border of Iraq to increase their production from the current level of 650,000 barrels per day to 900,000 barrel per day within a three-year period.

Almost a decade has passed and Project Kuwait has not taken off. The project has been delayed repeatedly by members of the National Assembly who have resisted the idea of foreign investment in the country's oil sector. The case against foreign investment is based on the Constitution, which states in Article 25 that "no concession for exploitation of either a natural resource or a public service may be granted except by a law and for a limited period." To avoid any constitutional breach, the KPC has called for the agreements with international oil companies to be structured on "incentivised buy-back contracts" (IBBC).

Based on this type of contract, international oil companies will not own oil reserves and hence will not be able to book reserves. Instead oil companies would be paid a fee per barrel, incentive fee for increasing reserves along with allowances for their capital investment. This structure allows the government to retain full control of its oil policy. Stalled for over a decade by a power struggle between the National Assembly and the government, the Project Kuwait bill was finally approved by a parliamentary committee in June this year but with amendments limiting its scope to four fields (the Bahra field was excluded). The committee also ruled out any role for local agents or brokers in the project.

Although this represents a step forward, the implementation of Project Kuwait may still have to wait. First, the bill has to get approved by the National Assembly, where at the moment it is still facing opposition. Second, the KPC should complete its negotiations and conclude the legal and financial terms of the contracts with the international oil companies. This is not a straightforward process given the complexity of the IBBCs. Assuming that things run smoothly, Project Kuwait can be in position to start no sooner than mid-2006. Although Project Kuwait was officially announced in 1997, the origin of the idea can be traced back to 1992. International oil companies' involvement in the northern oil fields was seen as part of a strategy to create a security zone or buffer against any potential Iraqi invasion.

Although the initiation of Project Kuwait was politically motivated, the KPC seized the opportunity and promoted the project as its own. The KPC claimed that foreign oil companies will bring the much needed capital and technology to enhance production. Nader Sultan, the previous CEO of KPC, identifies the following main objectives of Project Kuwait: "reach a production level within an agreed time frame, increase the reserve base and recovery factors, reduce the potential increase in production costs, allow for transfer of technology and develop the technical abilities of the national workforce."

But some doubt whether Kuwait really needs more production capacity. When Project Kuwait was announced in 1997, prices were not particularly high and Kuwait was trimming its production along with other OPEC members. By the time the new planned investment is translated into higher oil output, the added capacity may not be needed. Some argue that the capital outlays for such investments are not prohibitive and can be met by the Kuwaiti government or by borrowing.

Others say that if it is a matter of technology, it can be purchased or transferred through service contracts. But this last argument misses an important point. Obtaining technology is not the real problem per se. It is rather the expertise and skills to manage these new technologies and the complexities of the new reservoirs that are lacking within the national oil company. Such management expertise unfortunately cannot be bought off the shelves. But this raises a fundamental question: Why has the KPC not managed to acquire the highly needed skills and expertise? Why has it not established the mechanisms and structures to deal with the daunting technological challenges?

In my view, the saga of Project Kuwait highlights some important aspects of the complex relationship between the state and national oil company. The roots of the problem are due to the inefficient links between the KPC, the Energy Ministry and the Supreme petroleum Council, and the bureaucratic impediments that such a relationship entail for the decision making process. In fact, many press reports have indicated that the former Oil Minister Adel Al-Subaih, who resigned after the Al-Rawdatain explosion, complained about political interference and pressures that contributed to negligence and mismanagement of the oil sector. One could only expect non-commercial pressures and political interferences to be more intense on the KPC board. Bringing foreign companies will do nothing to address this complex problem. If the foreign investment is successful, it can only help improve efficiency at the project or field level. Those who hope that the efficiencies and expertise brought in by foreign companies will spread to the national oil company in the current context are likely to be disappointed. Project Kuwait is not the solution to the problem, it is rather the symptom.