

Lecture 6: Resource Nationalism and Market Power (II) – Iran, Iraq, and the Future of Hydrocarbon Production in the Persian Gulf

Iran and its move towards globalization

- Iran is going to have to get quite a bit of foreign investment if they want to achieve their goal of doubling their output
 - Decade and a half – need to bring in \$150 Billion dollars to meet their stated goals
- Oil industry was nationalized in the 1950s
- Islamic Republic constitution says that oil company cannot grant concessions
 - Instead it can do these things called “Buy-backs”
 - International oil companies hate this system
 - Contracts are of relatively short duration
 - ~5-7 years
 - skews operational decision-making
 - Rate of return is relatively low
 - Because it is structured as a service contract, the foreign investor in most 3rd party systems cannot use the oil as booked reserves
 - There are foreign investors that have done this buy-back system
 - The region is of a very high strategic significance
 - None are American companies
 - Clinton banned US companies
 - US policy deters lots of other international companies from investing as well

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What if there was a US-Iranian breakthrough?

- US companies would be all over Iran if they had the chance (US sanctions lifted)

If not...

- Two options
 - No war
 - Unproductive diplomatic interaction that will last years
 - Chinese, French, Indonesian need to figure out how to get into Iran successfully
 - Iran will have to figure out how to modify buy-back system
 - US and Iran go to war
 - This would really stimulate the Iranians to make some aggressive revisions to the buy-back system

The biggest question marks about future production in the Middle East are fundamentally ***political***.

Iraq

- Relatively low production rates given the resource base
- Lousy security system
 - No one can keep people on the ground in the oil fields in the south

- Can keep people in the north
- Lot of political uncertainty for the terms for investing
- Kurds have been really trying hard to find investors
- Kurdish regional government has hydrocarbons
- Estimate from Leverett that there will be a national hydrocarbon law in Iraq in the next few months
- There will probably be several oil sectors in Iraq
 - North with the Kurds
 - South where all the big fields are will have a Shi'a dominated regional government controlling the deals for those oil fields
 - You will have a tremendous amount of uncertainty for the next several years

If you look over the next two to three years there is enough reserve and investment in OPEC that non-OPEC production in the aggregate will probably grow at a nice rate

- After about 2011, that won't hold up
- Beyond that (5-10 years) you really start to wonder if you will be headed towards a real supply crunch