

The Energy Sector in North Africa

Speakers

- Khaled Abubakr, Vice Chairman and Managing Director, Gas & Energy Co. (Genco Group)
- Reema Ali, Managing Partner, Ali & Partners (Libya office Legwell, Ali & Partners)
- Thomas E. Thomason, Vice President, Globeleq, Inc.

Moderator

- John Brodman, Deputy Assistant Secretary for International Energy Policy, U.S. Department of Energy

Co-sponsor

- American Chamber of Commerce in Egypt

On March 8, 2005, the United States Egypt Friendship Society (USEF) hosted a panel discussion on the state of the energy sector in North Africa. While the Middle East is known as a major repository for oil and gas resources, two countries offer important new opportunities for the oil and gas sector, although for very different reasons. Libya's very well-established energy sector, long closed to U.S. investment for policy reasons, has now reopened as the Government moves to rejoin the global economy. Egypt, historically a minor player in energy production, is emerging as an important new source of natural gas resources as new finds are made in the Delta and Middle Egypt. What are the implications of these changes for the global energy sector, for U.S. investors and importers, and for the countries themselves? How do these changes fit into the broader perspective of economic reform and resource development in North Africa and the Middle East? How will energy development interact with other regional policy issues, both economic and political?

Mr. John Brodman introduced the topic for discussion and the panelists. The energy sector in North Africa has been undergoing important changes in the last few years. As demand has risen, there have been new private and public efforts to expand production of oil and natural gas. The United States is the largest energy market and the largest single source of foreign investment for the region.

Mr. Khaled Abubakr began the panel discussion by providing an overview of the natural gas industry in Egypt. Egypt's Petroleum Ministry is organized into four public entities, the Egyptian General Petroleum Corporation (EGPC), the Egyptian Natural Gas Holding Company (EGAS), the Egyptian Petrochemicals Holding Company (ECHEM), and the Ganoub El Wadi Petroleum Holding Company (GANOPE). Together, these state-owned companies coordinate all of the various aspects of the petroleum industry in Egypt, including financing, exploration, production, and strategic planning.

USEF EXPERT PANEL DISCUSSION NOTES

February 16, 2005

Although the first discovery of natural gas in Egypt took place in 1967, it has only been in recent years that the industry has seen significant expansion, owing to changes in concession agreements in the early 1990s. In 1991, proven reserves stood at 14 trillion cubic feet (TCF). In December 2002, proven reserves had reached nearly 60 TCF, with estimates of probable reserves at 120 TCF. Since 1994, natural gas consumption in Egypt has grown by 171%, and between 1997 and 2004, consumption of natural gas has increased as a percentage of primary energy consumption from 30% to 48%.

Deregulation of the Egyptian gas industry began in 1997 with the introduction of the franchise system. This phase of development has greatly increased the efficiency of the sector by incorporating private companies and contractors in marketing and distribution. The change from a state-owned monopoly to eight private local distribution companies (LDCs) has resulted in the addition of 400,000 customers, attracted increased foreign investment, saved the Egyptian government \$400 million per year in subsidies, introduced better technology, and enhanced health and safety for the Egyptian people.

Egypt has also led the region in promoting compressed natural gas (CNG) as a transportation fuel. Since the first pilot project in 1992, 88 CNG stations have been created to service 55,000 vehicles, with an additional 75 stations projected for the next five years. Through a partnership with USAID, the industry's annual growth rate is 13%. However, CNG development faces the challenges of high capital investment requirements and the high costs of imported conversion kits.

The Egyptian government is currently undertaking a number of projects to harness new sources of energy. The Arab gas pipeline stretching from Al Aqabah to Damascus, Syria is projected to be completed in the next 13 to 14 months. Ultimately, the pipeline will reach as far as Tripoli. The Ministry of Electricity & Energy hopes to expand the production of wind power from 145 MW to 650 MW by 2010. The US Department of Energy, the American Chamber of Commerce in Egypt, and the Egyptian private sector also recently sponsored a workshop to promote hydrogen (H₂) as another viable source of energy.

Ms. Reema Ali provided an analysis of the political and economic changes taking place in Libya. She began with a short overview of the evolution of Libya's governance and economic structures. Since 1970, in theory Libya's political structure has been a tiered system of "conferences," with political participation open to all citizens over the age of 18. Representatives from some four hundred district conferences participate in twenty-six municipal conferences, which in turn send representatives to the General People's Conference, a body analogous to a national parliament. From this body is chosen the General People's Committee, which is analogous to a cabinet. The role of the General People's Committee is to make recommendations to the General People's Conference. Gaddafi is invited to the conference as an adviser, the "conscience of the revolution."

The basis for the economic structure associated with this system of government is rooted, in theory, in the concept of *shura*. The first tenet of this system is that the labor-

USEF EXPERT PANEL DISCUSSION NOTES

February 16, 2005

employer relationship is a kind of slavery. Therefore, laborers should be full partners in business concerns, an idea reflected in Libya's labor laws. The second tenet is that free trade creates injustices. Consequently, the state took control of all productive property except for small family-owned businesses.

While most Libyans do not expect any changes to the political system, the process of instituting reforms to the economic system has created significant confusion and anxiety in Libyan society. The difficulty in transforming the economic system to one that incorporates private ownership of capital lies in overcoming fears among the Libyan populace and the international community that private property will not be nationalized again. Libyans and foreign investors are looking to the other for signs of confidence in the system. The instability of laws and regulations affecting businesses presents another challenge—labor and commercial laws can be altered swiftly in response to comments by Gaddafi. Yet another challenge is reconciling the four different calendar systems in use in Libya.

The oil industry in Libya has fared better than other sectors of the economy over the last 50 years. In the 1970s, the government nationalized the oil industry and put an end to the system of concession and regulation. Thenceforth, the National Oil Corporation (NOC) would be a full partner in oil production. However, Libya has continued to modify the public-private structure of its oil industry through 2000, updating its Exploration and Production Sharing Agreements (EPSA). With the recent lifting of economic sanctions, Libya is trying to determine the best formula to exercise its sovereign rights while taking full advantage of its resources.

Ali concluded that while the political risks to doing business in Libya have subsided substantially, there is still uncertainty in the economic. Nevertheless, the environment presents abundant investment opportunities for Libyans and foreign investors.

Mr. Tom Thomason described the state of the energy sector across the entire North Africa region. The growth of the energy sector in North Africa is driven by the region's high population growth rate, where 30 – 35% of the population is under the age of 19. Energy demand in Egypt, for example, is expected to rise from 16,454 megawatts (MW) in 2005 to 31,122 MW in 2015. These demand forecasts have put pressure on governments to build the necessary infrastructure to accommodate growth. To accomplish this objective, governments have reorganized and corporatized their electricity sectors and some have looked to increasing the role of the private sector in power generation.

In Egypt, as in several other countries in the region, for the private power projects to be able to secure project financing the power purchase contracts were dollar denominated. When a dollar shortage arose in a flat economy and the Egyptian pound was devalued, energy purchased in US dollars and provided to citizens at subsidized rates paid in Egyptian pounds put the Egyptian government in a difficult circumstance. It faced a fiscal drain but was unable to revise the subsidies to charge for electricity at its actual production costs.

USEF EXPERT PANEL DISCUSSION NOTES

February 16, 2005

In recent years, Egypt has had access to cheap financing from regional and international development banks. This has presented the Egyptian government with a choice between using cheap financing to develop a national energy sector or promoting privatization of the energy industry, which is another important national goal. Since 1998, Egypt has postponed its plan to actively engage the private sector in expansion of the energy sector.

Over the last fifteen years, the proportion of public sector contribution to Egypt's GDP has been reduced from 70% to 30%. This general trend toward private sector participation in the economy is reflected across the region. Independent power projects (IPPs) are currently operating in Egypt, Tunisia and Morocco, with projects in various stages of planning, commissioning, or creation across the region. The proposed MedRing Interconnection project, which would integrate the energy grids of the region, would reduce national reserve requirements, improve reliability, and increase efficiency in power generation.

Private power in North Africa is challenging because power is heavily subsidized for social/political reasons. It is difficult to reduce or remove the subsidies to bring costs and revenues into balance. As the governments maintain the subsidies, they face difficulties in making the required investments in infrastructure to meet the growing demand for electricity. In this circumstance, government policy to increase private sector participation/investment in the economy will drive private power rather than the economics.

Q&A Highlights

Q. What are the prospects for reducing consumer subsidies in Egypt?

Abubakr: The Egyptian government is committed to increasing transparency and fighting corruption. Subsidies are as high as 400% in some areas. The government is currently in a process of identifying the magnitude and depth of subsidies and considering what other nations have done to reduce them—what strategies have worked and what have not.

Thomason: From discussions with the Prime Minister, it is apparent that reducing subsidies is a high priority for him. The important issue facing Egypt is how to end subsidies for those who don't need them.

Q. Could you explain the issue of assets denominated as USD?

Ali: There has been some discussion of moving from the US dollar to a basket of currency, but the Libyan financial sector is being completely refurbished—including the privatization of banks and reforms for the central bank—so there are many other issues of convertibility involved.

Thomason: Despite the current strength of the Euro, the US dollar remains the standard for contracts in Egypt. Nevertheless, it's something the US should bear in mind.

Q. How serious are Egypt and Libya about privatizing refineries and plants?

USEF EXPERT PANEL DISCUSSION NOTES

February 16, 2005

Ali: From conversations with officials, it is clear that there is an intention to move in that direction. However, Libya must balance its external relations with continuity of its current system, its goals, and its need for new revenue sources. Among other concerns, Libya faces a paucity of technically skilled laborers.

Abubakr: Privatization is ongoing. Deregulation is needed to restore the fundamentals of the industry.

Q. What are the prospects for legal reform in Libya? What steps will Libya take to allay the concerns of domestic and foreign investors?

Ali: Libya is considering legal reforms, but to proceed, the government will have to develop a formula. While the people's concerns are legitimate, there is also some exaggeration of claims in an effort to speed reforms and increase concessions. For reforms to be successful, the General People's Committee must revisit the issue of confiscation and recalculate compensation at fair market value. This is necessary to create confidence in the system. Another important issue is the need to register and enforce clear property ownership. The Libyan government must develop a formula that will deal with these competing claims and issues fairly.