Uncertainty Amid Egypt's Mounting Debt to IOCs

By Maya Moseley

Since the toppling of Mubarak, Egypt's energy sector has been in a perpetual state of disarray. The sector has suffered from declining production, pipeline attacks, an unsustainable subsidy system, and mounting debt. The current transitional government faces the daunting task of restoring the sector. One of the biggest hurdles is the government's USD 6.2 billion debt to IOCs. Company executives have repeatedly echoed their concerns to *Egypt Oil & Gas* over delayed payments. In this article experts and academics give their insight and opinions on the significance and impact of the arrears.

Source of Debt

The current debt to IOCs is tied to much deeper inadequacies within the Egyptian economy. As Dalibor Rohac of the CATO Institute explained, "[The debt to IOCs] is just one part of the broader fiscal problems in the country, driven by unsustainable public spending. The subsidy system is making that problem worse by encouraging overconsumption, emergence of black markets in fuels and the like, and finally exacerbating the government's fiscal position."

The long-standing subsidy system requires that the government operates on a deficit. For decades that deficit was offset by foreign revenue sources, notably tourism and taxes from the Suez Canal. The Egyptian economy has been a rental system for decades but recent unrest exacerbated faults in the system. Oxford University Energy Expert, Justin Dargin explained, "This large-scale subsidization program which placed an enormous burden on the governmental budget even in the best of times, became a daunting burden during the political crises that occurred with the downfall of President Mubarak. The political transition caused Egypt's foreign revenue to decline, led to a mass exodus of foreign direct investment from the country, and a precipitous drop in tourism revenue. At the same time, Egypt had to deal with rising food import costs for its eighty-five million citizens."

Lacking the income to cover the costs of subsidies, the government's debt has flourished since the removal of Mubarak. Under production sharing agreements, the government is entitled around 59 percent and the remainder goes to the oil and gas companies[i]. However, the government's portion is still not enough to meet domestic demands, thus it either purchases the rest from IOCs in Egypt or imports it from abroad. The exact details of the debt remain murky, as Trinity University Professor James Stocker pointed out, "because of a lack of transparency in budgeting and contracts regarding oil and natural gas, it is difficult for the public to know exactly how and to whom Egypt accumulated its debt."

The government provides petroleum products and energy to citizens at a subsidized rate, costing the government an estimated USD 17.4 billion over the past year. Thus the government is purchasing fuel on credit from IOCs and selling it significantly below market price without a source of revenue to cover the difference. This system is inherently flawed, as Dargin explained, "Overall, Egypt owes approximately USD 6.2 billion to foreign oil companies such as BP, BG Group, Dana Gas, PJSC and Apache, and is struggling to meet its rising domestic energy demand at the same time."

The Impact

In terms of investment and the economy, the arrears are worrisome. "Most importantly, it is a sign of things to come, namely of the inability of the Egyptian government to honor its debt obligations," stated Rohac, noting, "Obviously, in the short run this also erodes investor confidence and will worse the terms under which the government can borrow. There is therefore the prospect of a fully-fledged fiscal crisis emerging as a self-fulfilling prophecy as a result of seemingly small failures of the Egyptian government to honor its obligations."

"In the short term, there have yet to be major negative impacts," asserted Stocker, noting, "There have been a few delays in future investment projects but these may not be due to the debt issue alone. BG Group, for instance, decided to delay its West Delta Deep Marine project, but it is unclear whether this is due to concerns about debt or due to the security situation." Additionally, BG Group publicly expressed uncertainty over future investments in the country as the availability of LNG exports declines amid higher volumes of gas being diverted to the domestic market.[ii] Dargin explained, "As a result of the debt crisis, many companies have delayed investment in Egyptian oil and gas fields and this has hardened energy production. Furthermore, it occurred precisely at the moment when Egypt needs to increase energy production to meet its rising domestic consumption needs."

Despite the uncertainty, Dargin asserted, "the sheer potential of the Egyptian energy sector has also encouraged companies to make a long-term bet on its continued viability…Companies that have the ability to absorb the higher debt levels still made future investment plans for the country. Smaller oil and gas companies are the ones that had to delay investment, as they could not carry the debt burden for the midterm."

Petroleum Aid

Following the ouster of Mohamed Morsi, Saudi Arabia, the United Arab Emirates and Kuwait poured aid into Egypt. The Gulf countries pledged USD 12 billion in the form of cash aid and fuel products. The aid has certainly kept the transitional government afloat. As Dargin aptly put it, the Gulf assistance "is a life saver for the Egyptian economy." On the other hand, it is simply a temporary Band-Aid to the country's economic woes. As one Western source told Reuters, Egypt cannot go on spending USD 1.5 billion a month, otherwise it will exhaust the funds within one year.[iii] Similarly, Rohac noted, "The aid has removed some of the immediate pressure but does not represent a solution (not even a part of the solution) unless the Gulf countries are willing to send big checks on a permanent basis."

The aid in petroleum products eased the summer shortages but inadvertently added to EGPC's debt. The country is now experiencing glut due to the gasoil gifts. "Egypt has given priority to aid cargos from the Gulf counties and as a result, cargos that were ordered on the open market are incurring substantial penalty fees. Egypt's oil import terminals are facing such a backlog that many tankers have been waiting at Suez or by Alexandria for nearly two months," Dargin informed. According to Dargin, "Several oil firms have canceled contracted gasoil deliveries to Egypt because of this port confusion and since EGPC has no interest in finalizing payment before unloading."

Thus the fuel aid has been somewhat of a mixed blessing. As Dargin explained, "The penalty fees are adding to Cairo's overall debt problem and will have an impact in the long-term as it struggles to comprehensively restructure state debt. However, the Gulf energy aid has been so substantial that Egypt does not need to import anymore gasoil in the short-term. While the Gulf aid has temporarily alleviated Egypt's gasoil deficit in the short-term, it is not a long-term solution and is merely delaying the need to grapple with its energy subsidization problem. And while Egypt, thanks to shipments of gasoil from the Gulf, now has a sufficient supply, there are still shortages of gasoline, propane and butane, which Egypt still needs to import. The disruptions at the port facilities are not making the management of these other shortages any easier."

Government Response to Debt

According to the Minister of Petroleum and Mineral Resources Sherif Ismail, Egypt's debt to IOCs was USD 6.2 billion in September. Since taking control, the current administration has repeatedly stressed its efforts to create a timetable to repay its arrears. According to Dargin, "EGPC finalized an agreement with foreign oil companies to reschedule its debt. Approximately USD 1.5 billion will be paid by December 2013. Therefore, according to EGPC's budget, approximately USD 508 million will be paid as interest charges incurred during the 2013/2014 fiscal year, out of which approximately USD 232 million will go to foreign companies and USD 276 million will remain locally."

"As a result of the debt rescheduling agreement, the foreign oil companies agreed to invest about USD 1.5 billion in the Egyptian oil sector which is in dire need of both exploration and production and will help in reducing Egyptian import of crude," Dargin informed, noting, "This debt restructuring has reassured many foreign investors and as a result, will likely stimulate new investment if Egypt remains able to show good faith in paying off its debt in a timely manner."

The transitional government has staved off implementing austerity measures. Dargin believes, "The main issue is that the government will likely not tinker with the status quo until elections take place and a modicum of stability returns. Any transformation of the status quo would cause more social unrest at this tenuous time." Instead the transitional government opted for a USD 3.2 billion stimulus package, with plans to increase funds next year. Unfortunately, a stimulus package can only do so much in such a deeply impaired system.

Sustainable Solutions

"There is no single or simple remedy to this problem," asserted Stocker. Stocker suggested, "Two obvious solutions are allowing more production and cutting subsidies to consumers. Neither of these alone can solve the problem, but increases in production and reducing subsidies in some manner will likely have to be part of any lasting, long-term solution."

According to Rohac, "a successful reform will have to come as a part of a broader package of structural reforms. Egypt's energy markets are marked by heavy government involvement and lack of competition."[iv] Rohac explained, "Erosion of investor confidence will certainly drive investment away from Egypt unless there is a credible shift of government policy… The durable solution involves getting Egyptian public finances on a sustainable trajectory. I would argue that eliminating subsides and replacing them with a more efficient form of social assistance is a necessary part of the solution. So are cuts in other areas of public spending, especially government employment. Unless we see deep, serious fiscal reforms, Egypt will only be living from one fiscal crisis to another."

While Gulf countries are willing to provide economic aid in exchange for marginalizing the Muslim Brotherhood, that aid will only last for so long. Even if the government is able to settle its debt to IOCs and rebuild investor confidence, without a steady revenue source to compensate for the energy subsidy deficit it could easily fall back into debt. Thus, it is time that Egypt musters up political will to carry out massive economic restructuring or else it runs the risk of falling back into fiscal crisis.

i Reuters, Egypt Looking at Energy Subsidies to Cut Deficit. March 7, 2013.
ii Reuters, BG Flags Egypt Investment Concerns. July 26, 2013.

iii Reuters, West Warned Egypt's Sisi to the End: Don't Do it. August 14, 2013.

iv Rohac, Dalibor. Egypt's Subsidy Nightmare. November 6, 2013.