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Nigeria's Ascendant Oil Industry Faces Host of Pitfalls

By Spencer Swartz in London and Will Connors in Lagos

Nigeria has decisively reclaimed the mantle of Africa's top oil producer, with rising output and crude prices spurring growth in the continent's most populous country. But the same industry driving the economy—oil—faces a host of challenges.



Reuters

Smoke rises from an illegal crude-oil refinery in Nigeria's Niger Delta last month. Theft and sabotage are among risks to the country's oil industry.

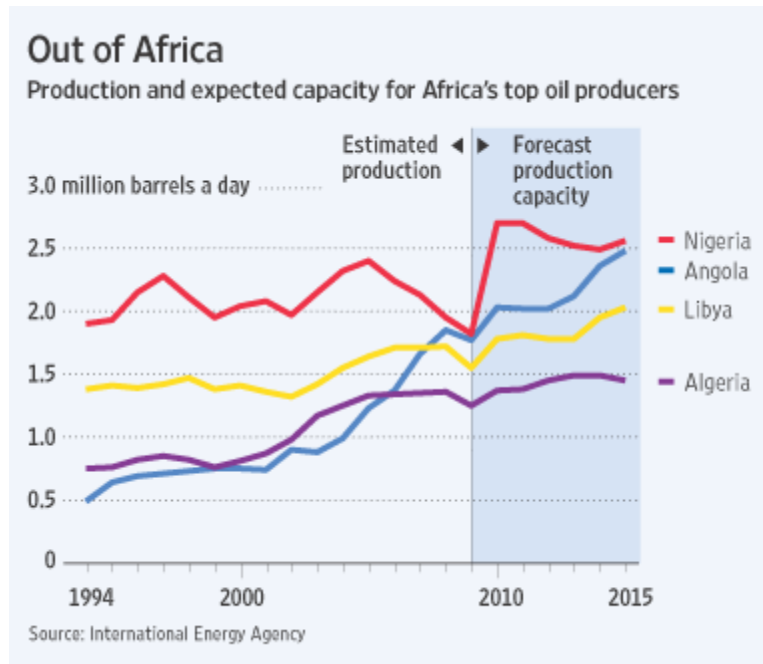
In the next month, Nigeria's national assembly is expected to approve energy legislation that U.S. and European oil executives warn could curtail investment. The presidential election early next year may reignite fresh violence in the Niger Delta, the West African country's main oil region, where Royal Dutch Shell says its pipeline was attacked recently.

The sabotage reflects longstanding discontent among the poor in the area. Some attacks are conducted by oil thieves who set up illegal refineries.

Nigeria—which holds the world's ninth-biggest proven oil reserves—produced almost 2.2 million barrels a day in July, its highest average since November 2007, according to analysts and traders.

The upswing stems largely from a lull in militant violence against Niger Delta oil pipelines and is linked to a government amnesty deal for militants who had been on a bombing spree against oil-industry infrastructure.

Thanks to the relative peace, idle oil fields are pumping again, allowing Nigeria this year to consistently produce more crude than Angola, Africa's second-biggest producer.



Output has also increased amid the rise in fuel prices this year. Benchmark U.S. crude prices are expected to average \$78 a barrel in 2010, up from \$62 last year. That could push Nigeria's economy to expand by about 7% this year, some analysts say, putting it among the fastest growing in Africa. But the rising crude output masks weaknesses in the industry.

An ominous sign for Nigeria's production is slumping international investment. Foreign direct investment, mostly in the petroleum sector, sank to \$5.85 billion last year from \$13.96 billion in 2006, according to a recent United Nations report.

One reason for shrinking foreign-capital flows, analysts say, is the state's failure to spend enough on joint projects with companies. Many foreign companies have, as a result, cut spending on such projects, which in turn is likely to crimp oil output.

In a foreshadowing of that scenario, the International Energy Agency in July projected Nigeria's effective oil-production capacity would fall 5% by 2015 from this year's levels. The same report forecast Angola's capacity would grow 22% by 2015. Angola's proven oil reserves are one-third the size of Nigeria's.

Nigeria's Petroleum Industry Bill, which the government expects to be approved, also has alarmed investors. Among other changes, the bill would raise the government's share of the profits to about 70% from 45% from offshore oil projects—the source of most of the growth in Nigeria's production capacity.

"The PIB is a disincentive for offshore investments," said Sebastian Spio-Garbrah, managing director at DaMina Advisors, a U.S.-based consulting firm.

The government says new royalty taxes and other measures are needed to make offshore contracts signed back in the 1990s more equitable to Nigeria.

The move comes as Nigeria's government is trying to attract Chinese and other non-Western firms to supplement the U.S. and European companies that have played a central role in the oil sector for decades. But company warnings that the legislation will hurt investment may turn out to be unfounded. Nigeria holds big proven oil reserves and drilling access elsewhere in the world is limited.

Officials say the new terms to be imposed on foreign oil companies in Nigeria compare favorably with those in other big oil-producing states such as Iraq. **"What [foreign companies] perceive to be harsh terms are not," Emmanuel Egbogah, a Nigerian presidential adviser on petroleum issues, said in an interview. "The terms are extremely good," he said.**

New legislation is only part of the risk of pouring more capital into Nigeria.

President Goodluck Jonathan, a Niger Delta native, hasn't declared his intention to run for election in January. But a presidential aide said if Mr. Jonathan doesn't seek the presidency, or lost in the election, social unrest and violence against oil infrastructure in the Delta could erupt, as has happened in recent elections.

Nigeria also remains a tough place to operate. After suspected sabotage to some facilities last weekend, Royal Dutch Shell said it won't be able to meet contractual obligations to customers for exports of Nigerian Bonny light crude, a type of oil, for the rest of August and into September.

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