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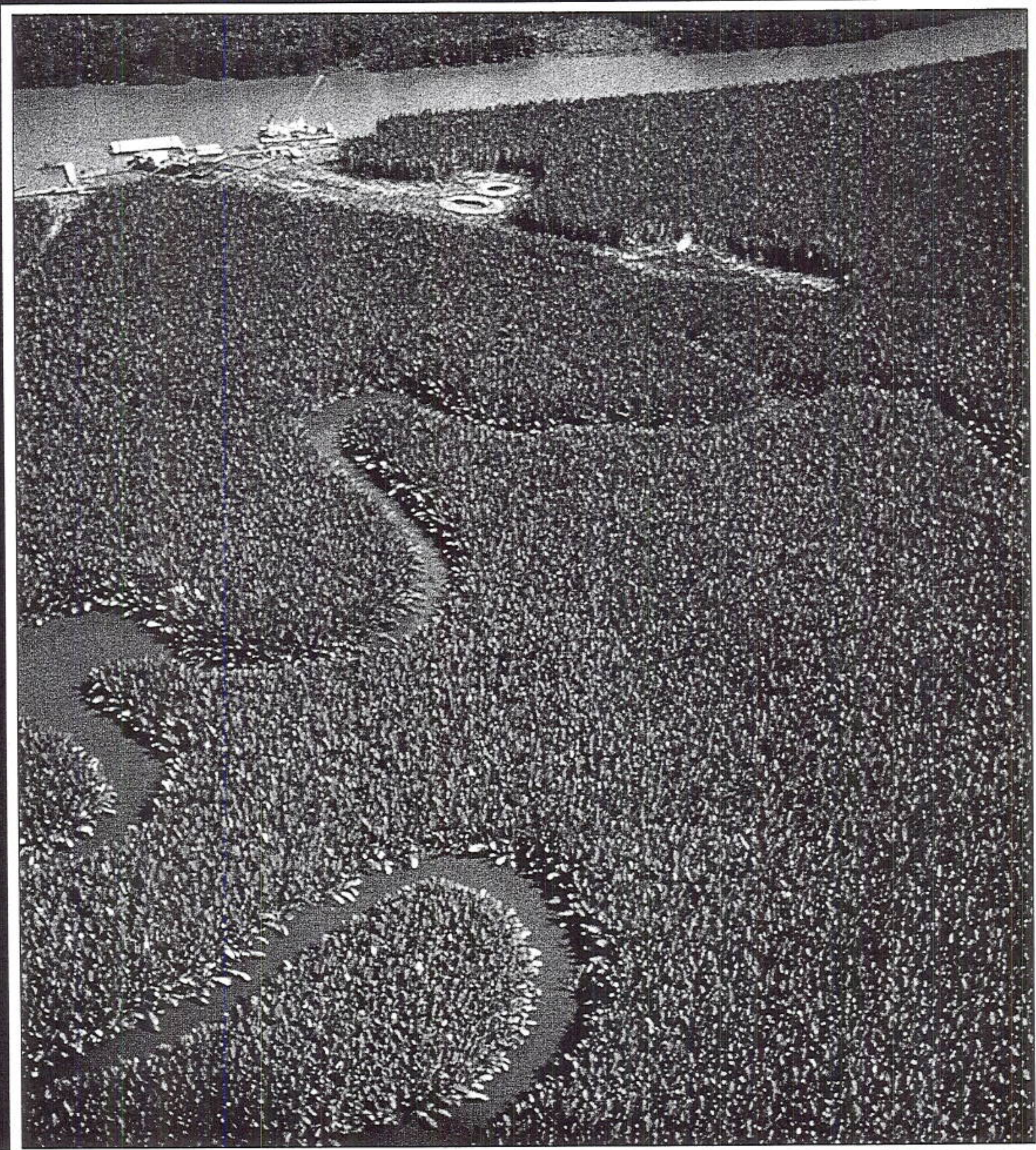

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COMMENT

Russia aims for favorable climate for joint ventures

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Unofficial estimates place potential investment by foreign firms in the Russian oil industry at $60-70 billion.

Taking this into account, Russia must present a clear, long term strategy to potential investors. It must persuade them that the rather risky economic and political environment is at an end.

World markets have been very competitive in recent years in seeking foreign investors. That is why creation of a favorable climate for investors—domestic and foreign—is a vital issue for all host countries looking for foreign capital.

The Russian government intends to develop relations with all countries based on principles declared in the European Energy Charter and its legally binding documents. Under those documents, common energy and economic frameworks are to be established in the industrial world.

A set of nondiscrimination rules will assure equal access to energy resources, export markets, transportation, and technologies, as well as capital markets. That will promote a balance of interests between host countries and prospective investors in investment protection and in trade related and political issues.

From this point of view major improvements need to be made in Russian oil tax laws. Today's tax system is rather restrictive and indifferent to market fluctuations. That is because the current tax system relies too much on taxes on revenue, not profits.

Russia's current tax system is rather complex. Different calculations place the total number of taxes, tariffs, and duties at the federal, regional, and local levels at 39-42. Each one may not be very high, but their combined effect is considered by producers to be too high in international practice.

High taxes penalize operations with higher production costs, increase producer risks, and thus discourage new developments.

World Bank data show elsewhere in the world total government take of profits amounts to 40-80% at the margin, depending on profitability of the project. Taxes and price controls in Russia now appropriate as much as 100% or more of producer profits.

Export tariff

The major negative effect on profits of foreign investors is the "export tariff" imposed last Jan. 1 with a flat rate equal to 26 European currency units/ton of crude. More than a dozen oil industry joint ventures have asked the Ministry of Fuel and Energy for exemptions from the tariff in order to maintain the economics of their production.

The dollar value of the tariff—$35/metric ton, or $5/bbl—is equal to about 30% of the world oil price.

The tariff was established to balance the difference between international and domestic oil prices for production units that had been exporting part of their oil and for intermediary or broker firms that were buying domestically priced oil for resale on the world market.

The tariff hit the economics of joint ventures hard because they were making their investment decisions based on world market prices.

There have been rather sharp discussions in the government between supporters and opponents of the tariff.

Among those that supported the tariff, even for joint ventures established before last Jan. 1, were "fiscal" ministries that helped create it: the Ministry of Finance, Ministry of Foreign Economic Relations, and Customs Committee.

Among those that opposed tariff imposition on joint ventures registered before Jan. 1 were ministries responsible for long term economic development—the Ministry for Fuel and Energy, Committee for Foreign Investments, and Ministry of Economics—even though Russian foreign investment law provides no grandfather clause.

Western Siberia's shut-in wells*

Producing enterprise	Percent of wells shut in
Nizhnevartovsk	21.7
Yugansk	23.6
Noyabrsk	36.8
Variegan	36.5
Kogalim	42.7
All of western Siberia	25.3

*As of Mar. 1, 1992.

As a result of these discussions, two joint ventures that were the first to address the Ministry for Fuel and Energy and Committee for Foreign Investments with their export tariff problems early in June won exemptions for their payback period.

Deputy Prime Minister E. Gaidar has signed the exemption decrees for the Komiarcticoil joint venture established by Gulf Canada, British Gas, and Russian Komineft Production Unit and the Polar Lights joint venture formed by Conoco and Russian Arkhangelskgeologia Production Unit.

The Ministry for Fuels and Energy and Committee for Foreign Investments are preparing a more general exemption decree to free from the export tariff—presumably for the payback period—all energy producing joint ventures established in Russia before last Jan. 1.

Let us hope this is only the start of rationalization of the Russian oil tax system.

Short term priority

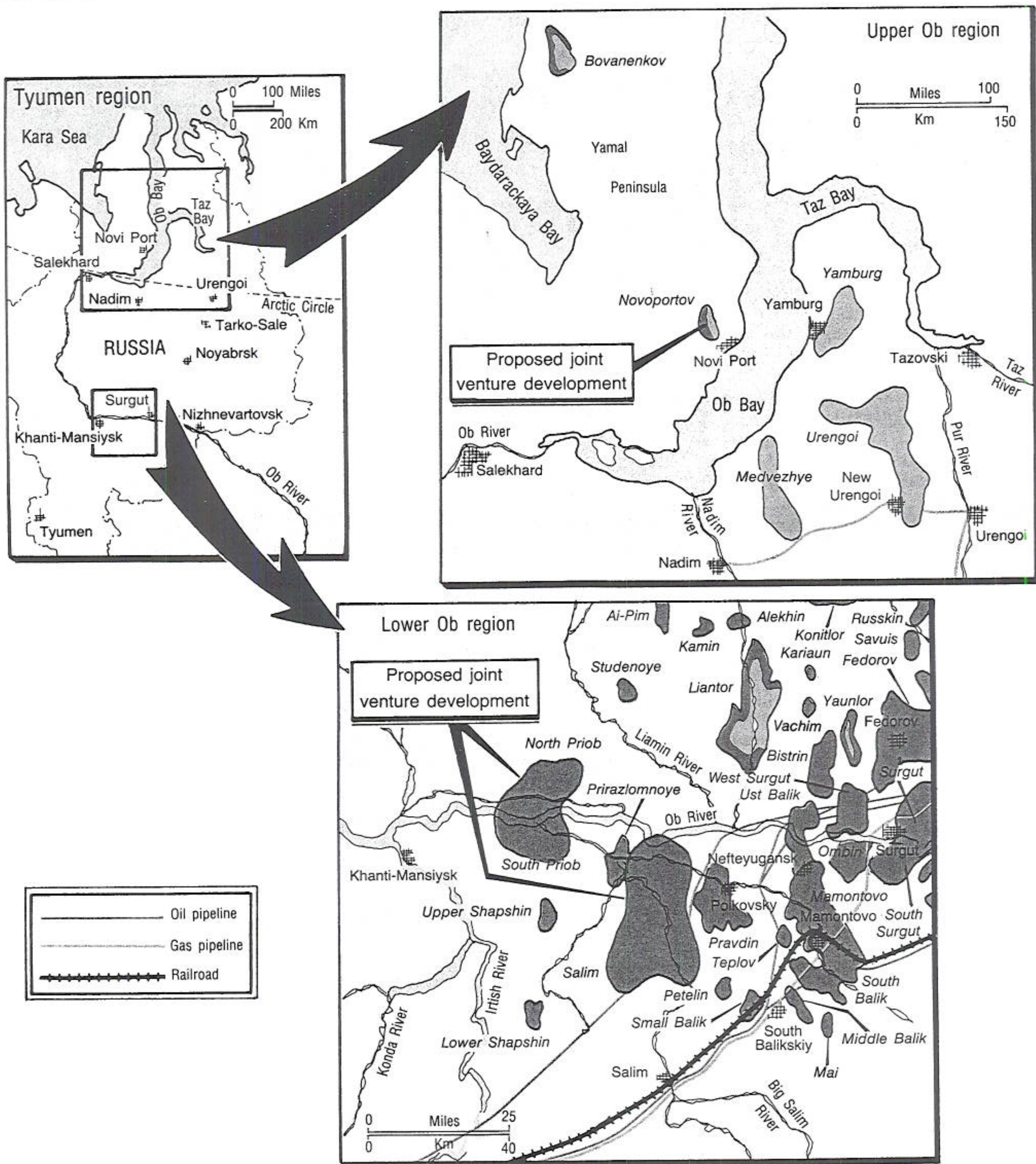
Russia's No. 1 short term problem is trying to halt production declines in today's oil fields. It believes the quickest return on investment can come from restoration of idle oil wells.

Well shut-ins have grown in recent years for lack of equipment and technical resources. Last Mar. 1 Russia's number of idle wells exceeded 25,000.

The number of shut-in wells rose rapidly during the past 3 years, increasing by 2,100 in 1989, 6,700 in 1990, and 5,900 in 1991 by 5,900. The first 2 months of 1992 saw another by 1,600 wells idled.

Most of the shut-ins are in western Siberia. Last Mar. 1 they numbered 17,900, or 25.3% of western Siberia's total. Producing enterprises estimated their average lost oil production at 8

WHERE RUSSIA SEEKS JOINT VENTURE PARTNERS FOR FIELD DEVELOPMENT



metric tons/day/well (58.4 b/d/well).

The average loss of oil production throughout Russia because of well shut-ins is about 30 million metric tons (219 million bbl)/year with an estimated export value of $3.6 billion.

Western firms can make their investments in well restoration programs under service contract arrangements in which Russian producers receive western credits to buy equipment, then repay the credits with a portion of oil produced by repaired wells.

This potential credit line has been rather well prepared by the Russian side. A lot of contracts for equipment purchases have been negotiated and many of them were signed.

But as a result of the U.S.S.R. Vnesheconombank bankruptcy in December 1991 all hard currency accounts of oil producing enterprises were frozen, and they cannot pay for their contracts. One needs to understand that new credit lines will be used as typical bridge financing for highly reliable, technically developed projects that well suit small and medium firms.

Support for this type of projects was proposed by the World Bank and European Bank for Reconstruction and Development (EBRD).

World Bank has been preparing a special petroleum credit line for Russia worth as much as $1 billion and is

expected to increase this sum by millions of dollars through the energy portion of an urgent rehabilitation credit.

EBRD intends to provide the Russian oil economy about $500 million in addition to World Bank's oil loans. Three fifths of the EBRD sum will be proposed to five or six production enterprises for restoration of idle oil wells and purchases of imported production equipment.

In the medium term—3-5 years—it is possible to prevent an oil production decline through massive development of proved fields that are shut in for lack of money for domestic development.

Foreign companies are to be involved in this activity on a tender basis. The return on their investment will come in the form of guarantees for export of their portion of oil produced.

The companies will be given opportunities to invest their profits in stocks of established joint companies and privatized oil enterprises.

Foreign firms will receive access not only to marginal fields, as it was in the past, but to fields with favorable parameters—rather big with high productivity, for example.

To solve complex procedural problems, the Investment Tender Commission (ITC) was established under the auspices of the Committee for Foreign Investments attached to the Ministry of Finance. Head of the ITC is Leonid Grigoriev, who also heads the Committee for Foreign Investments. ▪

Russia to seek foreign partners in three fields

Russia plans in coming months to call for international tenders covering joint venture development of two oil fields and one oil and gas/condensate field in western Siberia (see map at left).

None has seen extensive drilling.

Here are details on the fields:

North Priob

North Priob field is in the Khanti-Mansi autonomous district of the Tyumen region, one of the most industrially developed oil producing areas of western Siberia.

The field is 65 km east of the city of Khanti-Mansiysk and 100 km west of the city of Nefteyugansk. It is 125 km from the nearest railway station, Salim, and 80 km from the the nearest crude oil main line, Kholmogori-Klin.

Among the nearest major producing fields are Salim, 20 km to the east, and Pravdin, 57 km to the southeast. The Ob River divides Priob field into northern and southern parts.

Oil pays are concentrated in Cretaceous and Jurassic zones at 2,200-3,100 m. Porosity is as much as 19%, permeability 40 md. Pay thickness ranges to as much as 11 m. Oil has a low viscosity—1.4 cp in situ.

Proved and probable reserves as of last Jan. 1 were estimated at 1.7 billion metric tons of oil in the northern part of the field. An increase is believed possible if development moves toward Studenoye field.

Salim

Salim field also is in the Khanti-Mansi autonomous district of the Tyumen region. About 70% of the field lies in the Nefteyugansk subdistrict, while the remainder is in the Surgut and Khanti-Mansi subdistricts.

The field is 95 km southwest of Surgut, 90 km east of Khanti-Mansiysk, and 69 km southwest of Nefteyugansk.

The Urengoi-Novopolock gas pipeline and Ust-Balik-Omsk oil pipeline run south of the field. A 40 km crude oil line ties Salim field into the Ust-Balik-Omsk pipeline.

Oil reservoirs are in the Cretaceous and Jurassic Bazhenovskaya suite at 2,200-3,100 m. Cretaceous reservoirs, as thick as 6 m, have as much as 18% porosity and 65 md permeability.

Average well gauge is 6 metric tons/day (44 b/d), but some wells have yielded as much as 1,000 metric tons/day (7,300 b/d). Oil viscosity is as much as 1.3 cp, sulfur content 0.8%, and paraffin content 4.2%.

A Russian estimate places proved, probable, and possible reserves at 1.9 billion metric tons, including 1 billion metric tons probable, as of last Jan. 1.

Limited production has taken place since 1974. With 40 wells drilled, cumulative production is 2.8 million metric tons.

Novoportov

Novoportov field lies in the Yamalo-Nenecki autonomous district of the Tyumen region in the southeast part of the Yamal Peninsula. On the left bank of Ob Bay, the field is 15 km northeast of the Novi Port settlement and 300 km northeast of the city of Salekhard.

About 300 km northeast of Novoportov field lies giant Bovanenkov gas/condensate field, while Yamburg gas field and a railroad are 120 km east of Novoportov.

Novoportov is an oil and gas/condensate field with Cretaceous and Jurassic pay zones at 1,800-2,000 m. Pay thicknesses are as much as 20 m.

Porosity ranges to 22%, permeability 77 md. Oil viscosity ranges to 9 cp, sulfur content 0.1%, and paraffin 3.5%.

Russian data peg proved, probable, and possible oil reserves at 760 million metric tons, including 690 million metric tons probable. Proved and probable gas reserves are listed at 211 billion cu m. Proved and probable condensate reserves are 16 million metric tons.

Winner of the Novoportov tender will have an opportunity to take part in other future tenders for exploration, development, and production on the Yamal Peninsula and in adjoining areas of the Kara Sea. ▪

Shell Canada chops 11% from budget

Shell Canada Ltd. is cutting its 1992 budget by $90 million, or 11%, because of "brutal" business conditions.

The company reported a loss of $7 million in first half 1992, compared with a loss of $95 million for the same period in 1991. It reported a $12 million loss for the second quarter of this year.

Retail gasoline competition and low natural gas and sulfur prices were blamed for the loss.

Shell said the budget cut to $745 million from $835 million is the first move in efforts to improving cost management, revenue enhancement, and capital asset management.

The company said staff levels will be reviewed but it too soon to say there will be major staff cuts or how many workers will be affected. Shell has already cut staff and launched a reorganization program for its downstream operations.

Shell spokesman Gary Sherkey said business conditions are "just brutal" upstream and downstream.

He said the budget cut will be shared between oil field development and downstream operations. Drilling activity will be focused on prospects that will yield early returns. ▪