

RUSSIAN PETROLEUM INTELLIGENCE

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Concessions Will Have to Wait

By Deputy Minister Andrei Konoplyanik

The present wave of interest among foreign companies eager to invest in Russia is the third one in our nation's history. The first wave occurred during the Industrial Revolution. The second occurred during the period of Lenin's New Economic Policy (1921-1928). During both of these periods, Russia's energy industry was the focal point of foreign investors, but no significant investments were made in the country's oil and gas sector at either time.

Similarly, the current wave has not resulted in any major inflow of foreign capital in the Russian energy industry to date. The several oil and gas joint ventures which are operating in Russia are too small to make an impact on the industry, and some are barely surviving.

Taxes: Not an Excuse

High taxes are often cited as one of the reasons explaining the lack of foreign investment in Russia's oil industry. But if one studies international experience, it

quickly becomes apparent that our system of taxation for energy ventures is considerably more favorable than the practices existing in most Western countries. For example, according to present joint-venture legislation, the maximum corporate income tax rate for enterprises with foreign participation — including those in the oil industry — is 25%.

This figure is in the lower range of the tax rates used throughout the world (the rates range anywhere from 0% to 70%). According to our studies, the average maximum rate of taxation in oil-producing countries in 1985 was 48.15%. If we use the weighted-average figure taking into account each country's oil output, the average maximum rate of taxation increases to 57.77%.

In my opinion, the main reason for the absence of any serious investment in Russia's energy industry is our inflexible legal structure, which ignores more than 90 years of international experience and cooperation between foreign oil companies and host countries. Until last month, for example, even such a universally accepted form of cooperation as production-sharing had not been legalized in Russia. As a result, many companies held back, not wanting to entangle themselves in the inflexible structure of a joint venture.

Hopefully, the passage of the Law on Mineral Resources, which permits the practice of production-sharing, will remove one of the major hurdles on the way to increased investment by major Western oil companies in Russia. The fact that we have seen Mobil and Elf Aquitaine

sign production-sharing agreements in the last several weeks — even before the law was passed — also gives us cause for optimism.

Concessions Unlikely

While many Western companies have greeted the Law on Mineral Resources with great enthusiasm and may finally be willing to make a major investment in the Russian oil industry, there are others who will continue to wait until Russia begins permitting concessions. Since concessions are by far less attractive for our country than production-sharing arrangements, such an action on behalf of our government is unlikely in the near future. There are two reasons for this.

First, international practice of concessions calls for the host country to collect income taxes and other forms of payment from a foreign oil company in the form of local currency. Since our currency is non-convertible, such payments are clearly less desirable than the oil we would receive under a production-sharing arrangement.

Second, and more important, is the fact that when concessions are made, the host country is usually detached from the production process. As our oil-extraction industry is so far behind that of the West, it would be suicidal for us to remain on the sidelines while Western oil companies exploit our resources without sharing their technology and know-how.

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Quick Buck

The unattractiveness of the concession approach to our country was one of the major reasons why a law on concessions — two versions of which were developed in the All-Union parliament prior to the August 1991 coup — was never passed. The problem with both of those versions, as well as with Article 40 of the Russian Federation Foreign In-

vestment Law on concession agreements, was that they failed to consider alternative forms of cooperation in the energy field, such as production-sharing. Yet production-sharing, from our perspective, is by far the more effective and attractive approach for working with foreign energy companies.

Having said this, we should nevertheless acknowledge that we must do everything within our power to make the investment climate in our energy indus-

try as favorable as possible. While the current legal environment may allow us to attract the smaller, more entrepreneurial and flexible firms, major oil companies will only work with us under the traditional arrangements with which they are comfortable. If we do not introduce these arrangements, we will have to accept as partners companies which are either too weak to compete in their home markets or opportunists looking for a quick buck. It is clear that both of these options lead to a dead end. **RPA**

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can firm in true contention, we have to be pristine pure and not show any favoritism. When there is only one American firm in actual contention — if for instance you have the Tengiz field, and you have Chevron and twenty one-man independent operators, we would say there's only one true contender — then you can certainly support that concern.

RPI: What type of assistance can you provide to Chevron or another major oil company?

G.H.: We can provide help in a case where two negotiating parties are at loggerheads. We can do it as a government because the former Soviets believe that the US government is not as "devious" as these private capitalists whom they don't understand at all. Because they do understand governments, we can come in and say something and be accepted, or we can just answer questions. If the Russian partner asks "Is this a fair deal or is this an unfair deal?" — we can come back and say "This is a fair deal."

Because the government provides, or is seen to be providing, so much that the Russians or former Soviets might want, the very fact that we say we are interested in an American company doing this or that could in fact pave the way to a transaction. That is the way Elf Aquitaine got their deal — the French government said, "We want them to get this deal," and it happened.

RPI: Do you think that American companies are disadvantaged on these larger deals in Russia because they are not national oil concerns, like Elf Aquitaine?

G.H.: The answer to that would be obviously yes. But to leave it at that would be a very misleading statement. If there was only one nationalized oil company in the United States, then we could weigh in heavily any time that this American company came in — in fact it would be our job to do so — and we could threaten to withhold everything unless you give it to our oil company. But that's not how we run our country. I think the

cost to our country would be so great that it would far offset anything we might gain in this small arena. **RPA**

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