

Examine the move towards royalty schemes in Russia

**Dr.A.Konoplyanik
Deputy Secretary General
The Energy Charter Secretariat**

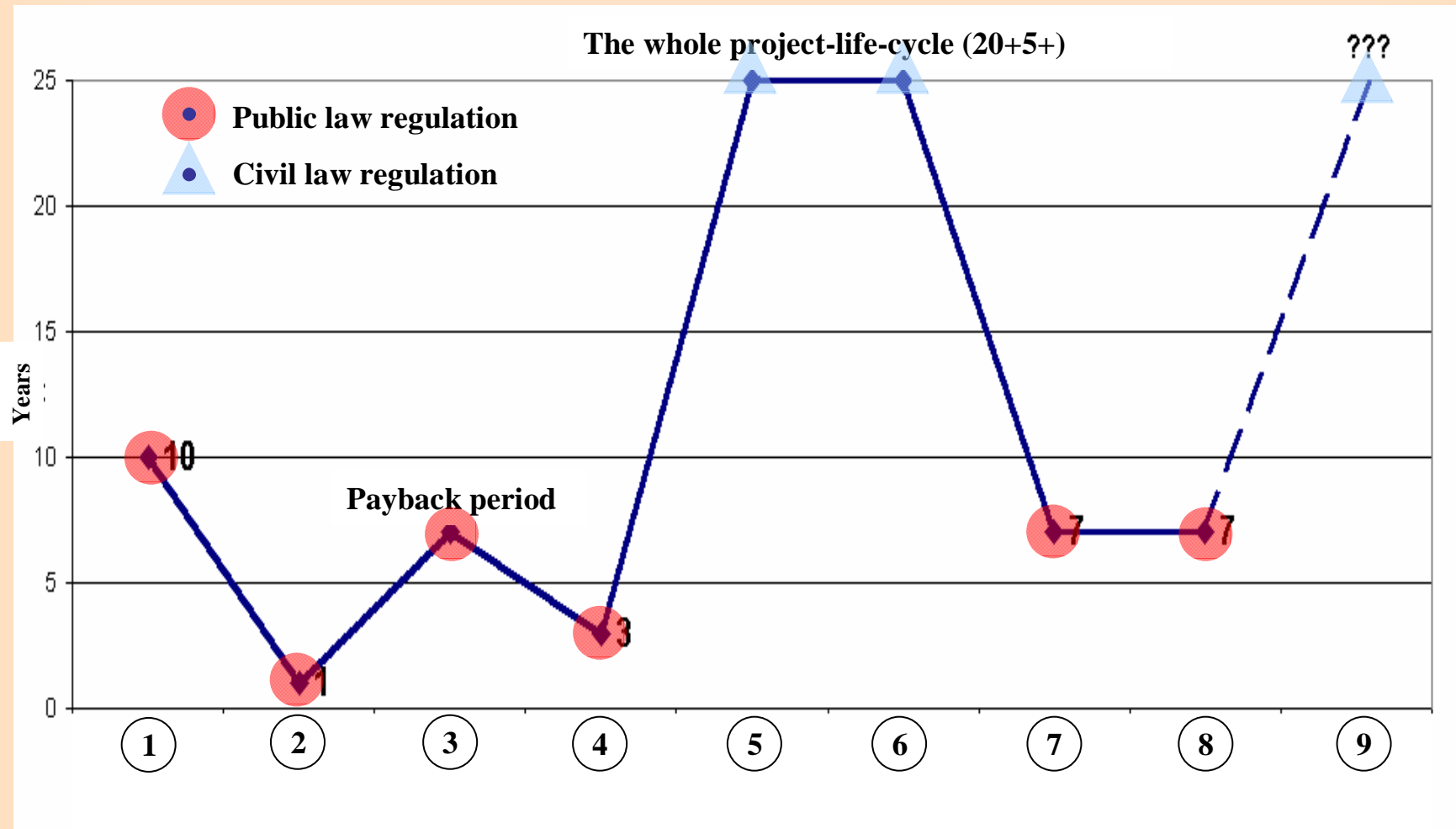
**Conference on “How to Manage the Evolving Relationships Between NOCs and IOCs
Through Effective Production Sharing Agreements”
29-30 January 2004, London**

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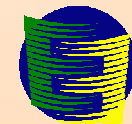
- 1. Licensing regime of the 90's**
- 2. Licensing tax regime reform of 2002**
- 3. 10 years of PSA history: up and down**
- 4. Oil taxation: what will go further?**

1. Licensing regime of the 90's

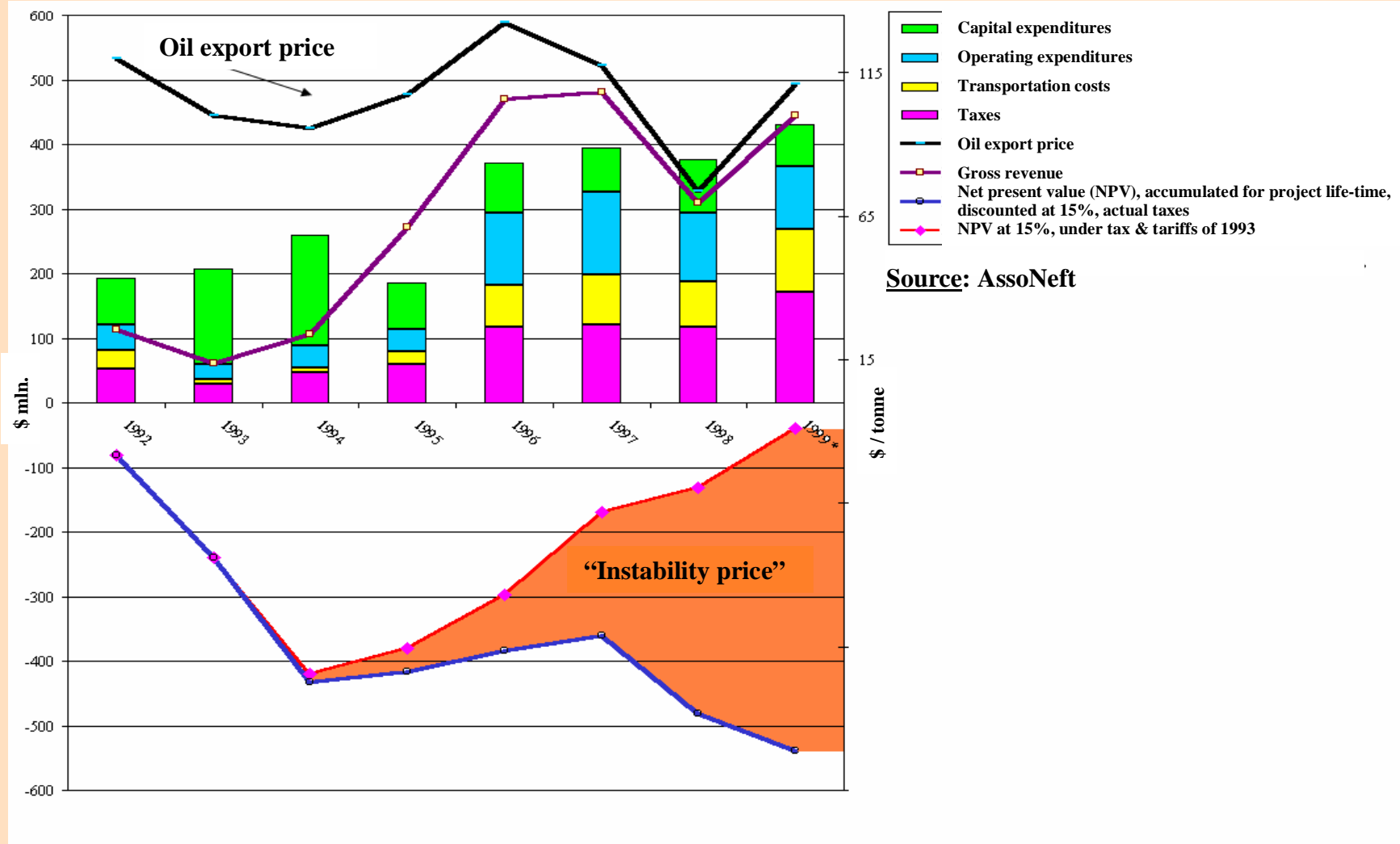
DURATION OF THE “GRANDFATHER’S CLAUSE” IN RUSSIAN INVESTEMENT RELATED LEGISLATION



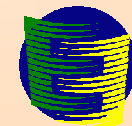
3. Decision of the Government of RF №1375 (July 1992)
4. Decree of the President of RF №1466 (September 1993)
5. Decree of the President of RF №2285 (December 1993)
6. Law “On Product Sharing Agreements”(December 1995)
7. Law “On Investment Activities in RF, realised in a form of capital investments” (February 1999)
8. Law “On Foreign Investments in RF” (July 1999)
9. Draft Law “On Concessions” (2003+?)



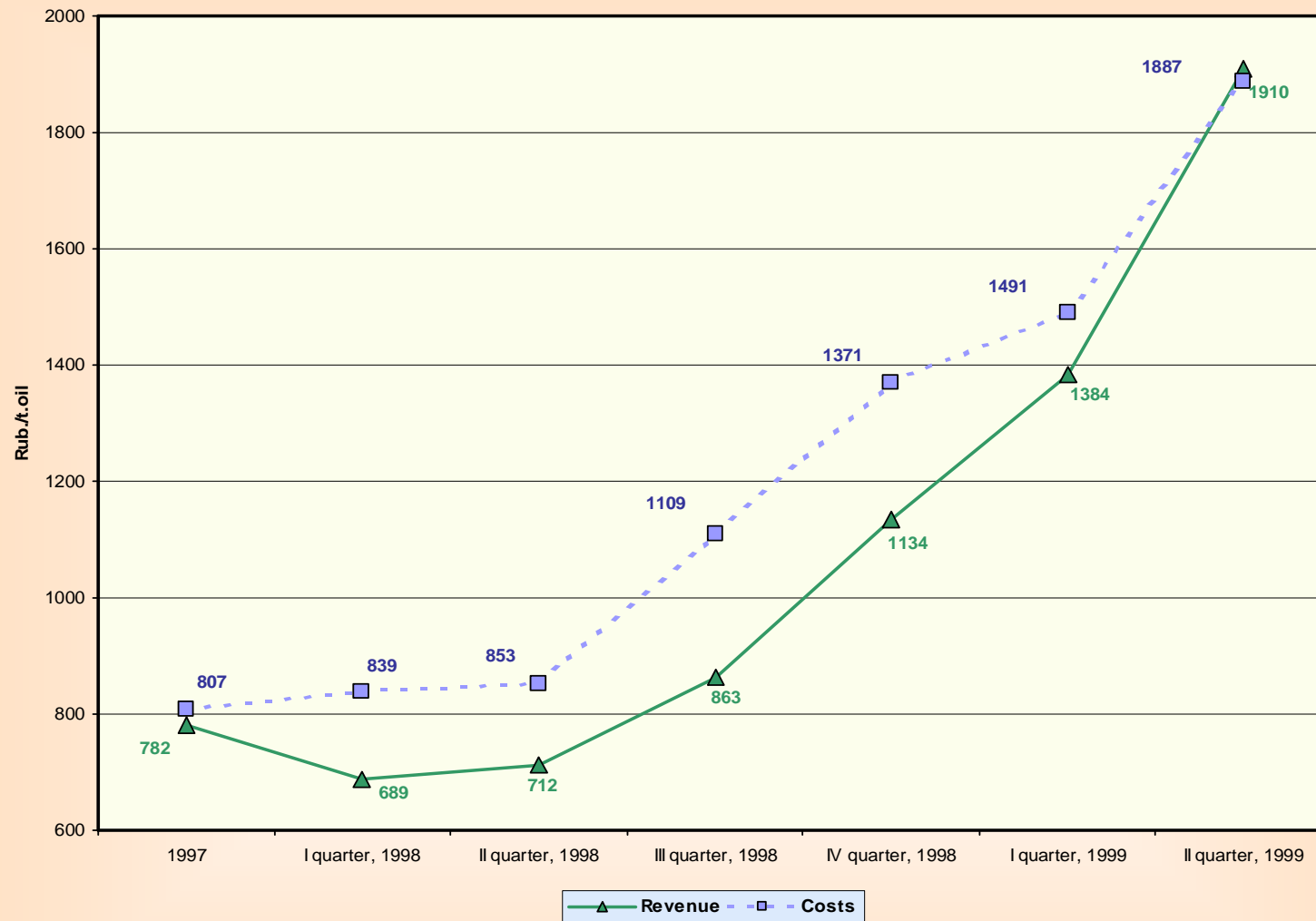
“INSTABILITY PRICE” OF THE RUSSIAN TAX LEGISLATION (for a group of non-integrated oil companies)



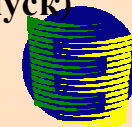
Source: AssoNefit



GROSS REVENUE AND FULL PRODUCTION COSTS OF RUSSIAN OIL INDUSTRY



Source: Основные концептуальные положения развития нефтегазового комплекса России.
 – М., Минтопэнерго, 2000 («Нефтегазовая Вертикаль», 2000, №1, спецвыпуск)

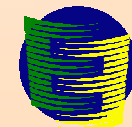


2. Licensing tax regime reform of 2002

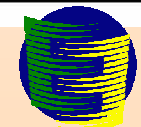
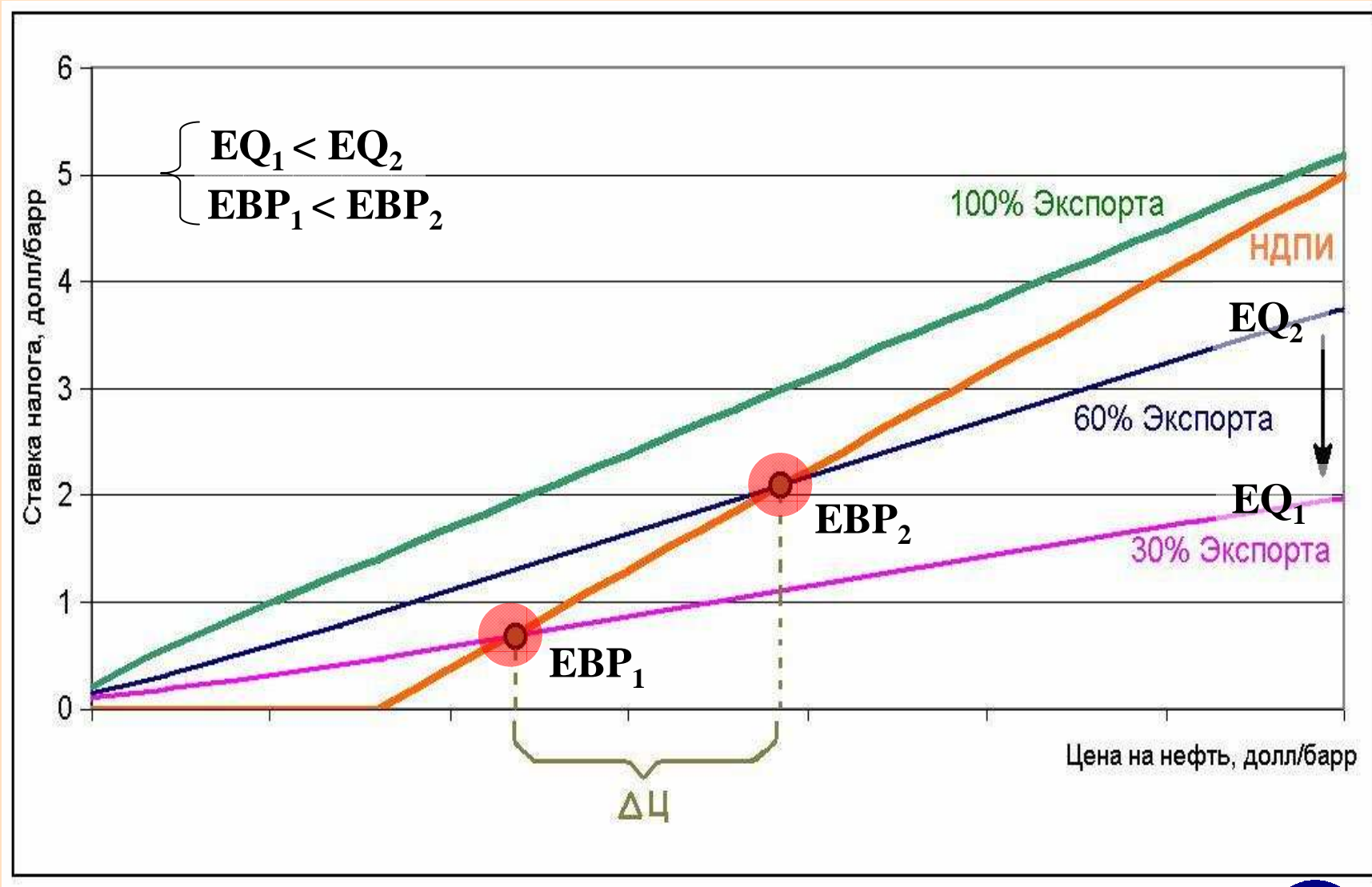
EVOLUTION OF THE TAX REGIME FOR SUBSOIL USE LICENSING SYSTEM

BEFORE 2002:	AFTER 2002:	AFTER 2004:
1. Profit tax	1. Profit tax (Tax Code, Chapter 25)	
2. Royalty 3. “Geology”(*tax 4. Excise tax	2. Mineral Resources Production Tax (flat rate) (Tax Code, Chapter 26)	<div style="border: 1px dashed black; padding: 5px;"> <p style="text-align: center;">MRPT (differentiated)</p> <p style="text-align: center;">Tax on Incremental Revenues (R-factor)</p> <p style="text-align: center;">Tax on Right of Subsoil Use (tax on reserves)</p> </div>

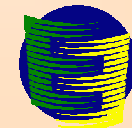
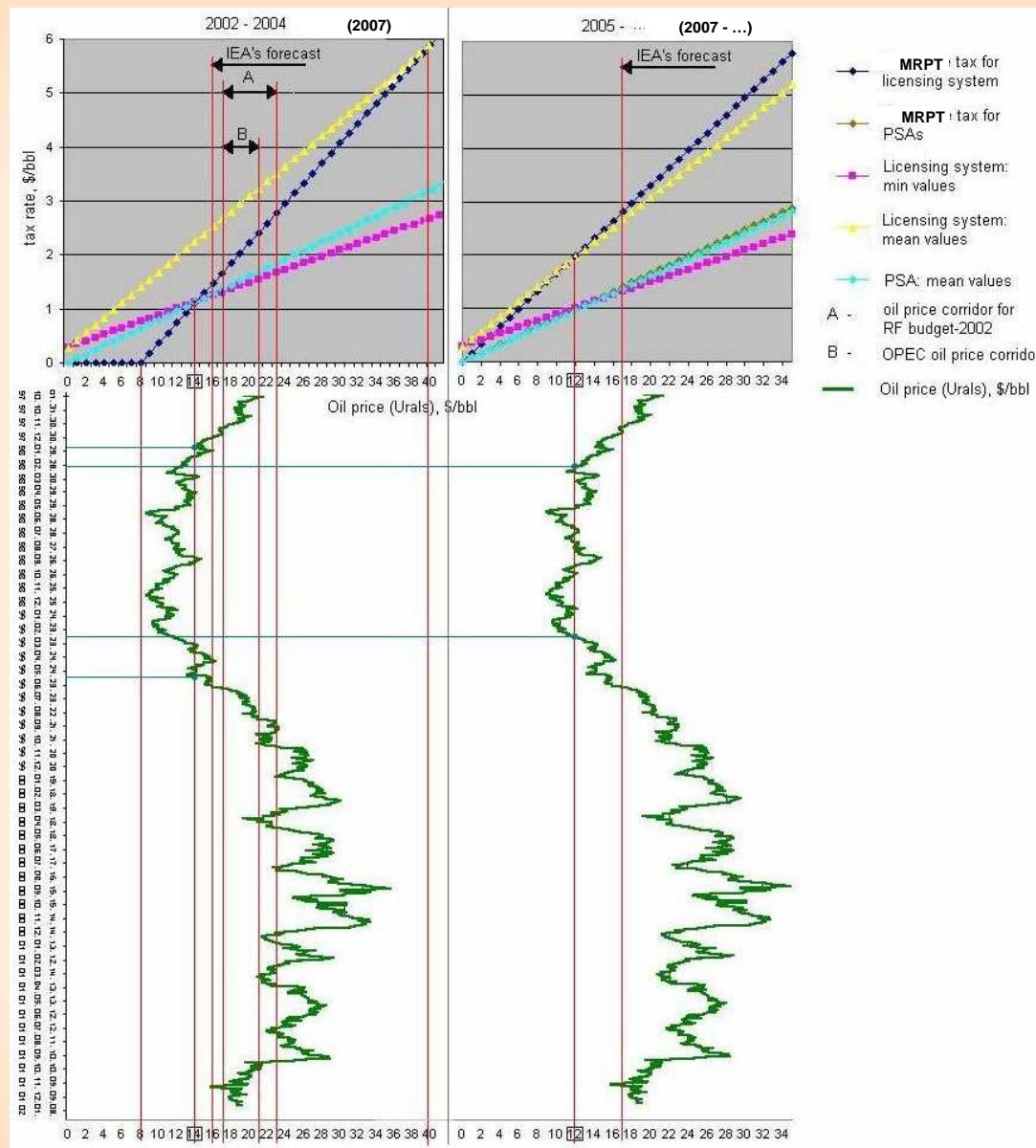
(* - Duty for reproduction of mineral resource base



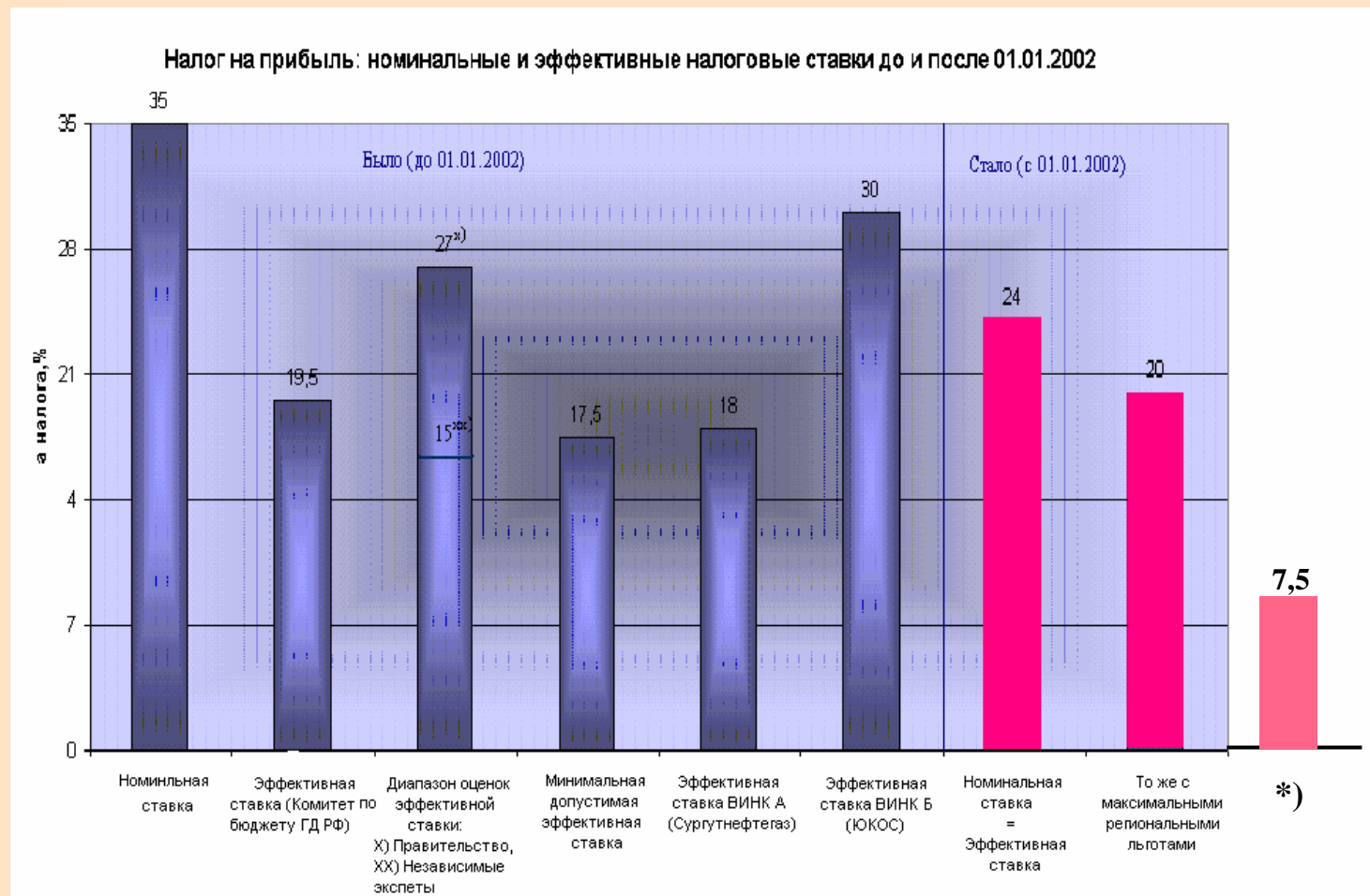
THE SMALLER IS EXPORT QUOTE (EQ) - THE LOWER IS EQUAL BENEFITS PRICE (EBP)



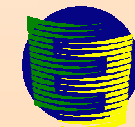
COMPARATIVE ANALYSIS: MRPT VS. PAYMENTS REPLACED WITH IT



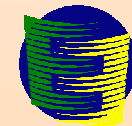
PROFIT TAX: NOMINAL AND EFFECTIVE TAX RATES BEFORE AND AFTER 1 JANUARY 2002



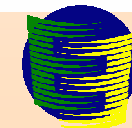
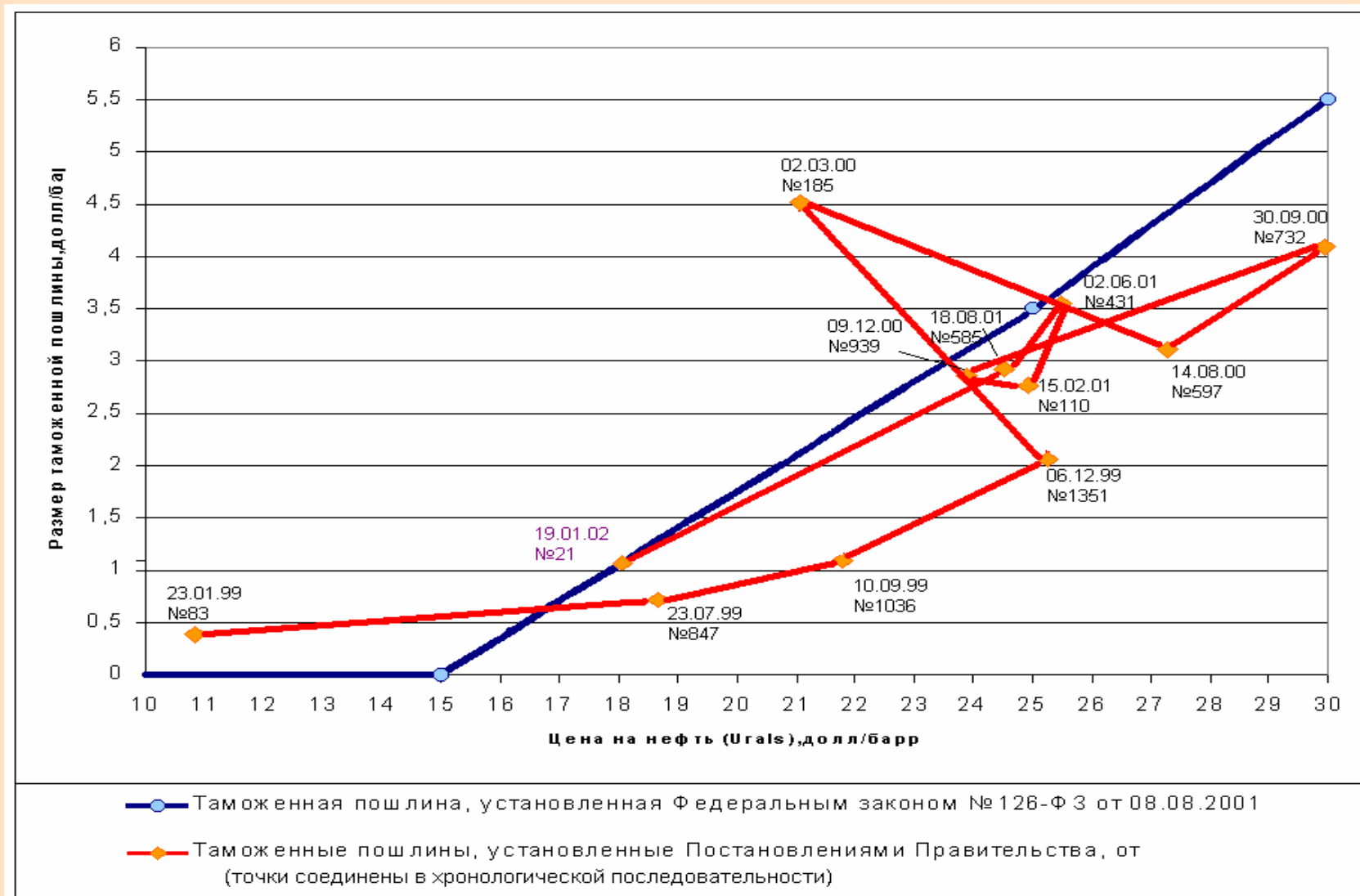
*) if “investment agreements” were signed by oil companies with regional authorities prior to 2001 (Mordovia, Chukotka, Kalmykia – internal domestic offshores)



EFFECTIVE PROFIT TAX RATE OF RUSSIAN OIL MAJORS

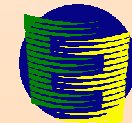
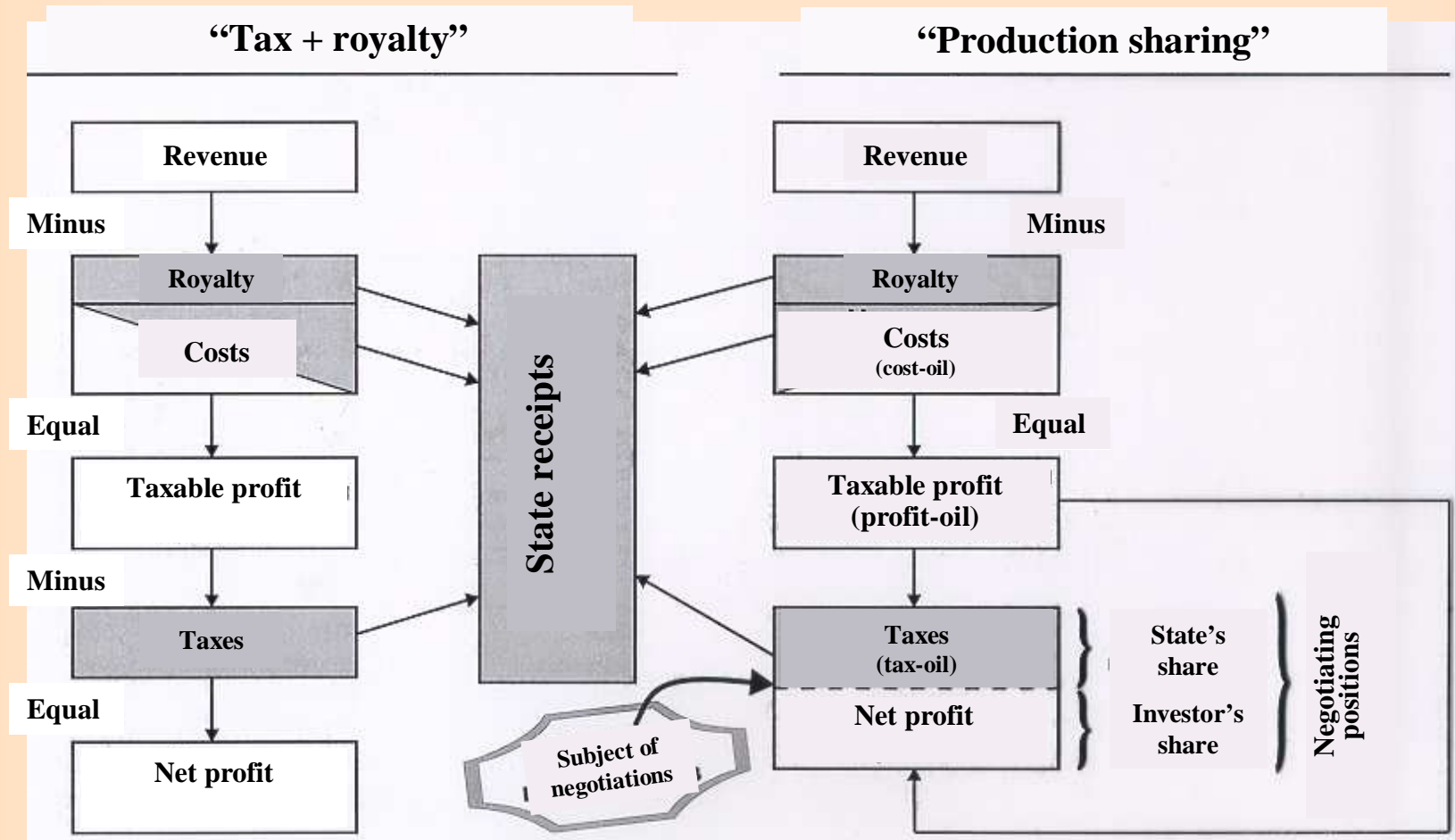


CUSTOMS DUTY – CHRONOLOGICAL DYNAMICS PRIOR TO 2002

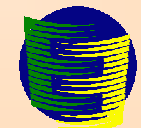
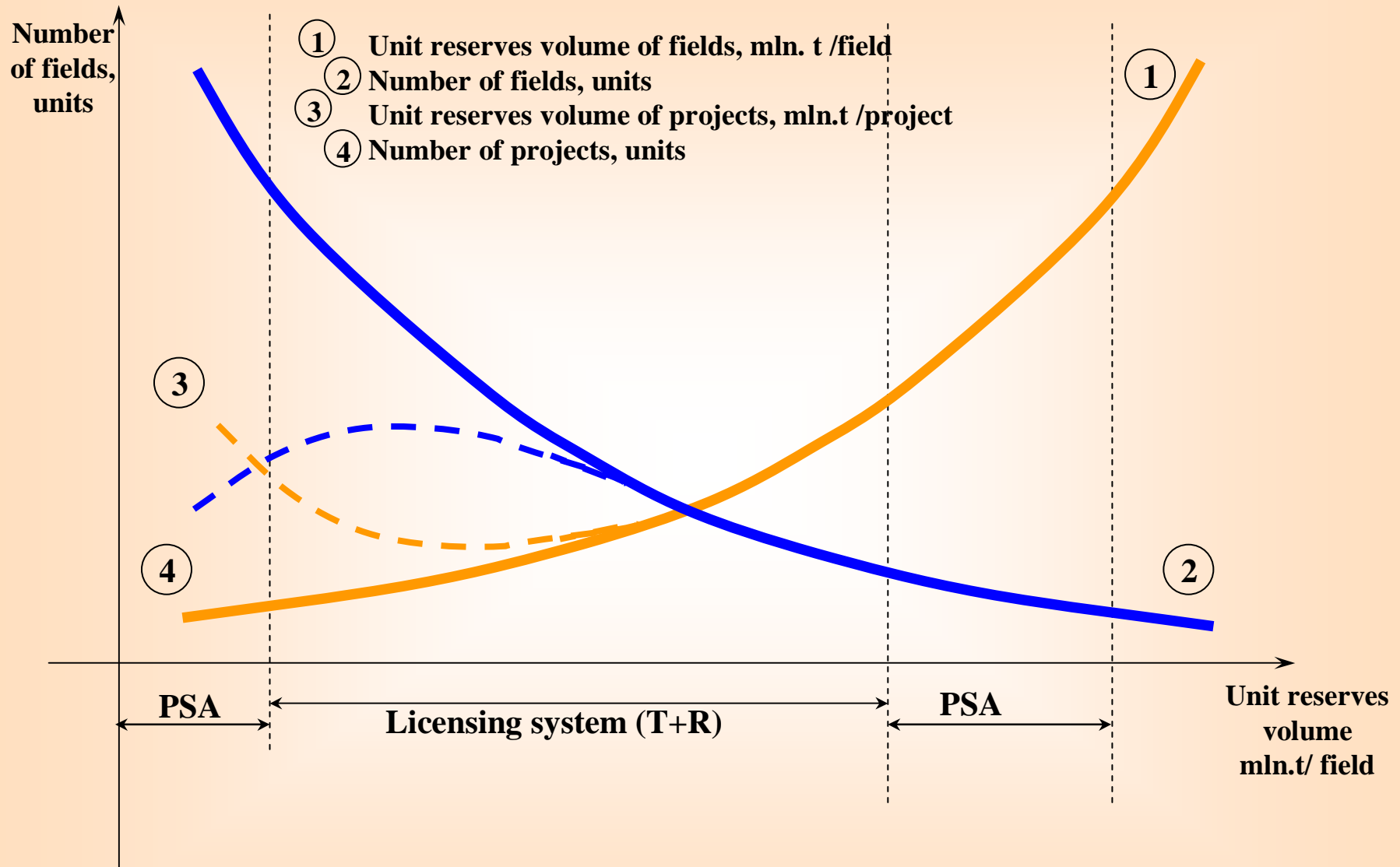


3. 10 years of PSA history: up and down

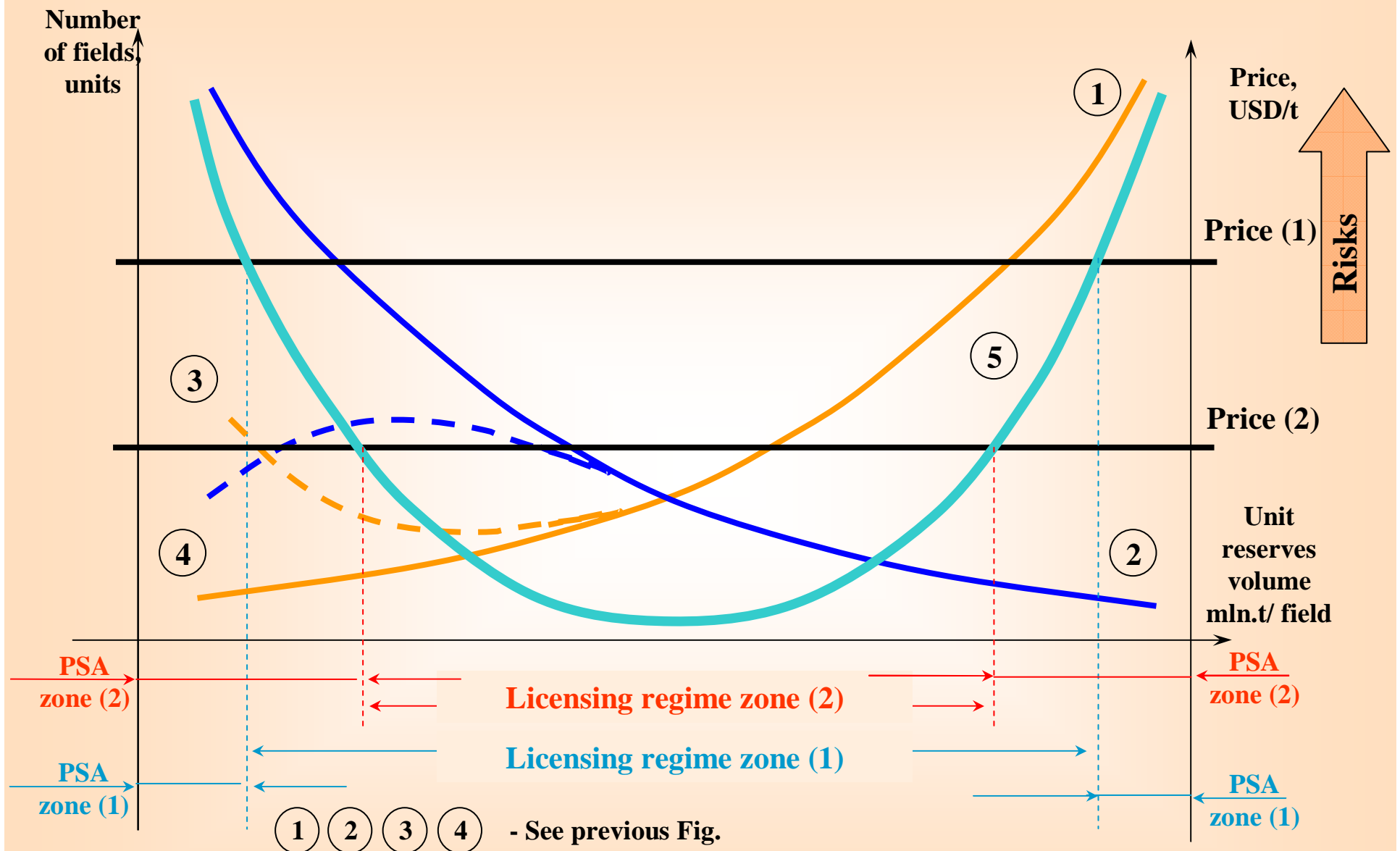
GOVERNMENT TAKE MECHANISMS UNDER THE LICENSING “TAX PLUS ROYALTY” AND “PRODUCTION SHARING” SYSTEMS



PSA /T+R PREFERENTIAL APPLICATION ZONES



CHANGING RANGE OF PSA / T+R ZONES WITH OIL PRICE FLUCTUATIONS



⑤ - Overall risk of financing oil and gas projects dependent on resource range zone

FLAT-RATE TAX SYSTEM, PSA AND TRANSFER FROM MRPT TO PSA

Figure 1: Flat-rate tax system

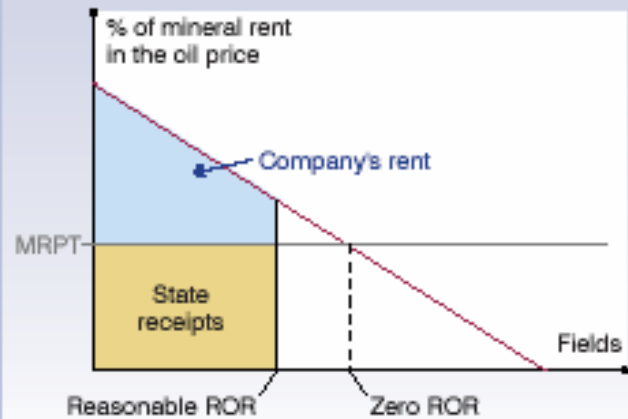


Figure 2: PSA

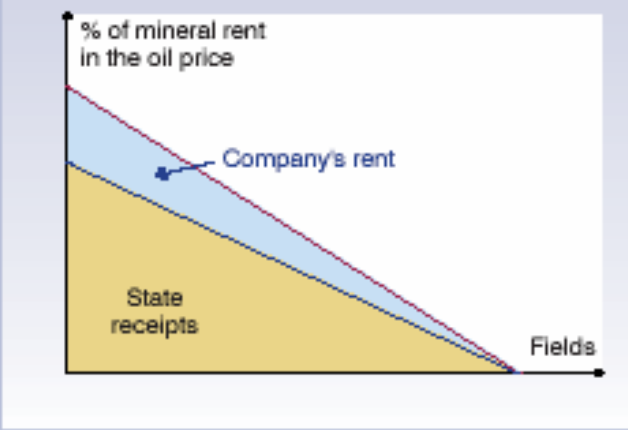
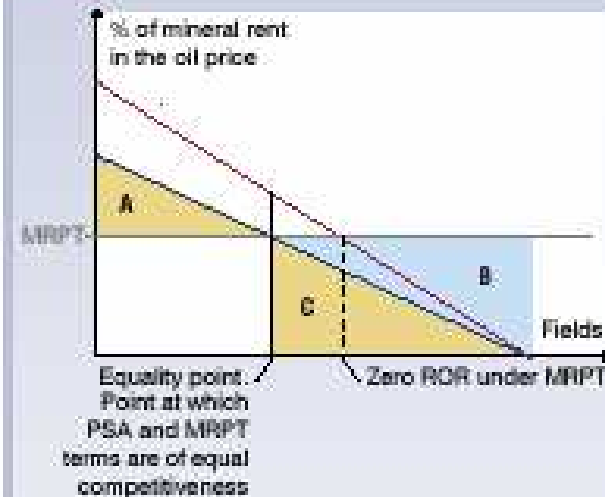
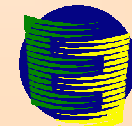


Figure 3: Transfer from MRPT to PSA

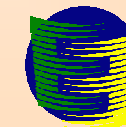
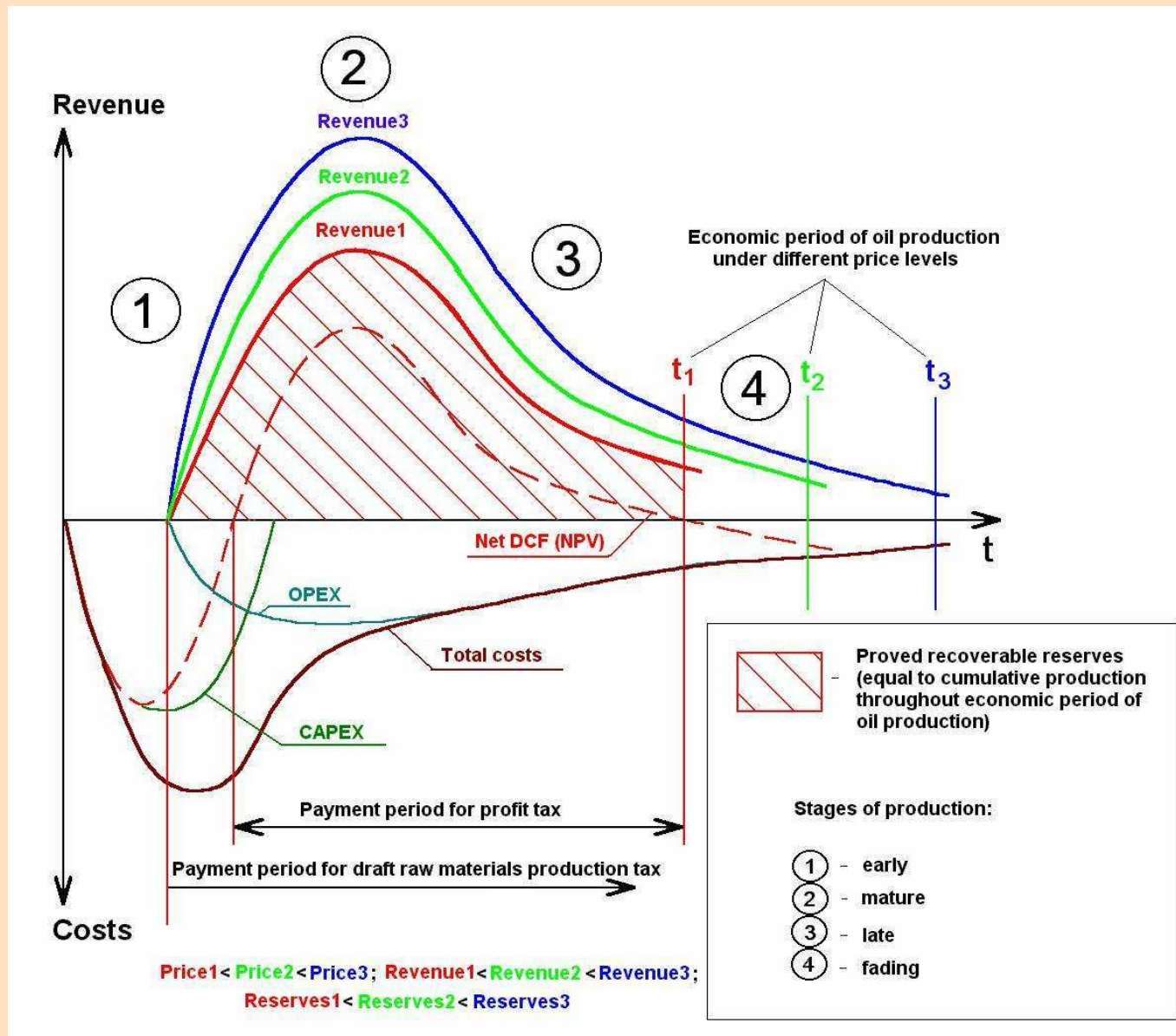


- A: Companies' incremental rent-type earnings under MRPT, which transferred into state take under PSAs
- B: Revenues that the opponents of PSAs wrongly claim are lost to the state under transition to PSAs
- C: Incremental state earnings under PSAs through development of non-profitable fields under MRPT with flat rate



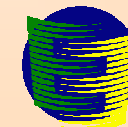
4. Oil taxation: what will go further?

FINANCIAL FLOWS DURING OIL-FIELD INVESTMENT CYCLE



INVESTMENT-RELATED STIMULI IN UPSTREAM OIL TAXATION IN RUSSIA: RECENT TRENDS

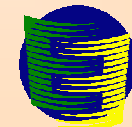
Stages of oil field development	Pro-investment stimuli in oil producers' taxation under the concept of its efficient (non-fiscal) formation	Presence of pro-investment stimuli in taxation of oil producers:	
		In pre-2002 Russian tax legislation	In post-2002 Russian tax legislation
Early	Diminishing of tax burden, especially of revenue-based taxes, shift of tax burden from early to mature stage: tax holidays, tax credits & tax-related uplift at oil field investment stages	Partly existed (investment-related concession on profit tax up to 50% of the tax-base of the latter)	No
Mature	Sliding scale (project-to-project differentiation) of taxation linked to the factors of mineral rent formation	Partly existed in indirect form through negotiable character of establishing royalty value in licensing agreement	Basically no, except one factor (reflecting changes in world oil prices, i.e. Brent spot dated) which does not consider stages of field development, different oil qualities, domestic price changes, real export quotas, etc.
Late	Reserves depletion allowance, dependent on system of factors	Basically no. Few regions (i.e. Tatarstan) has been using it for marginal wells/fields via mechanism of diminishing a regional portion of the profit tax	No
Fading	Reserves depletion allowance, dependent on system of factors, up to zero rate of special oil taxes		No



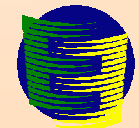
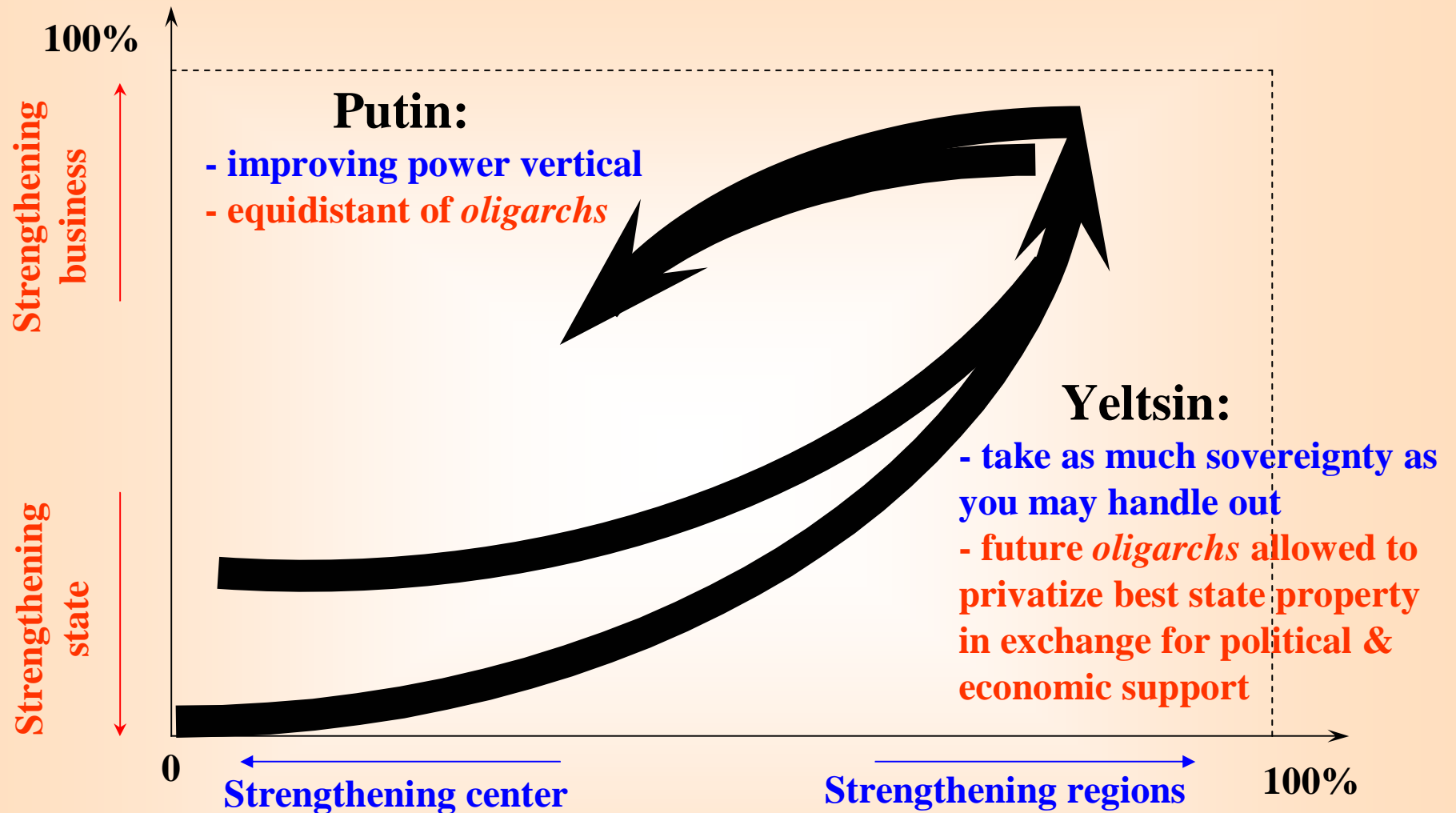
POSSIBLE COMPOSITION OF INVESTMENT REGIMES IN RUSSIAN SUBSOIL USE

		Legal system	
		Administrative	Civil
Tax treatment	General (common)	Licenses	Concessions
	Special (incl. individualized)	Licenses with allowances	PSAs

There is no must to have only one legal regime for subsoil use in Russia, especially taking into consideration huge geographical dimensions and geological complexities in different areas of the country. Russia is among a dozen of oil-producing countries worldwide that has more than one legal regime for subsoil.



EVOLUTION OF STATE ECONOMIC POLICY IN MODERN RUSSIA



INCREMENTAL RUSSIAN “OIL RENT” ASSESMENTS, USD bln. / year

G.Gref (Ministry of Economic Development and Trade)	} 1,5-2
V.Milov (Institute of Energy Policy)	
E.Yasin (High Economics School)	2-3
V.Putin (Russia’s President)	3
E.Gaidar (Institute of Economies in Transition)	3-4
M.Zadornov (State Duma)	3-5
I.Nikolaev (Financial & Business Consultants)	5
V.Orlov (Council of Federation)	5-10 ?
S.Stepashin (Audit Chamber)	8
A.Zhukov (State Duma)	10 (max.)
S.Glaziev (“Rodina”)	17 (8 – no damage)
V.Klepach (Development Center)	20-25
E.Gourvich (Economic Expert Group)	30
Communist Party of Russian Federation	40
Acad. D.Lvov (all natural resources)	52-56
Maximum assessments	up to 80

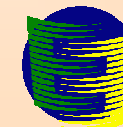
Note: (1) E.Gaidar: +3-4 bln USD – no harm for investments and production growth

+5-6 bln USD – no production growth

+30 bln USD - oil industry collapse

(2) 3 bln. USD = dividends of Russian oil majors in 2002

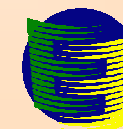
Source: compiled on different Russian media sources



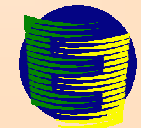
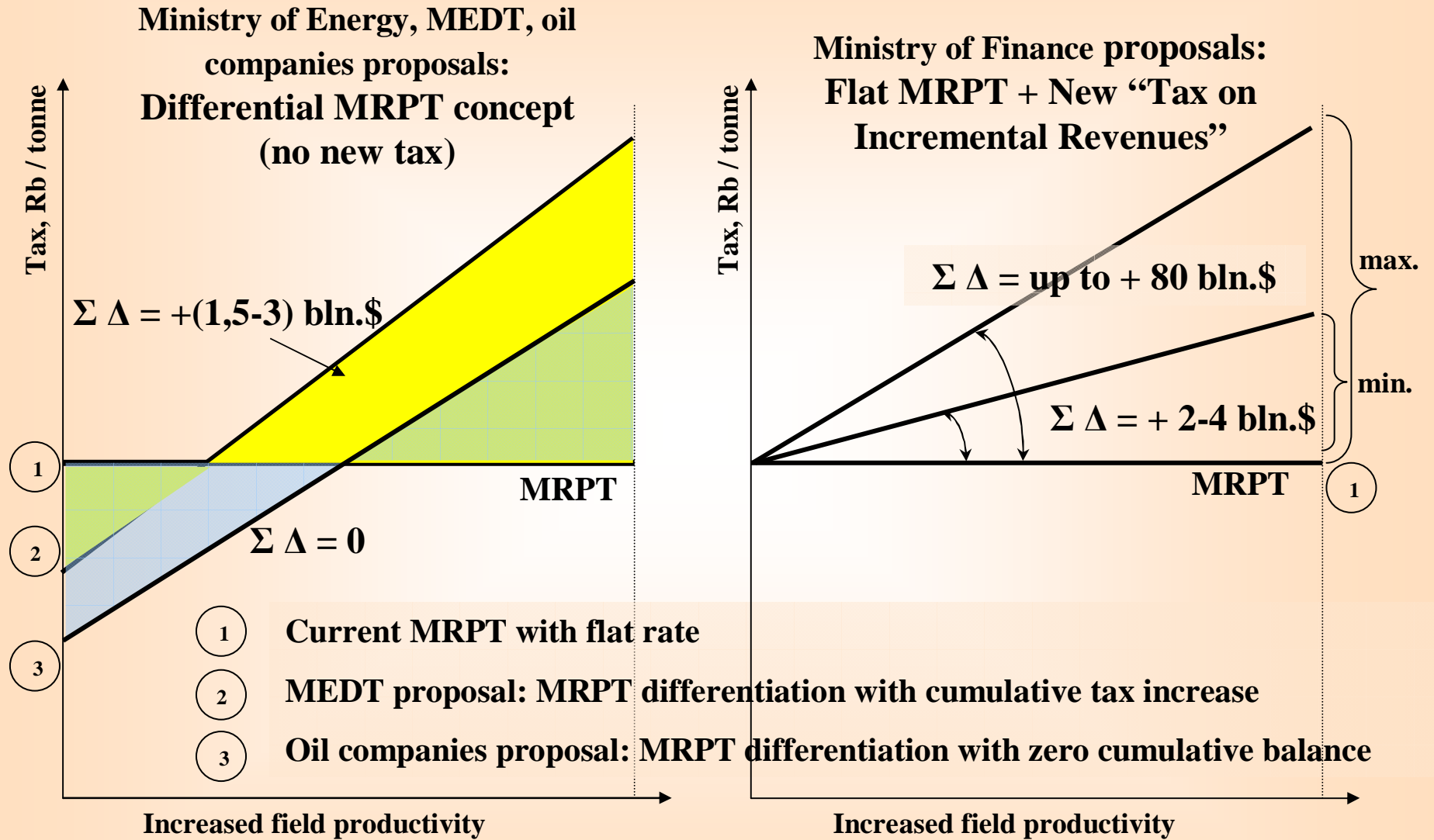
OIL PRODUCED FROM THE HIGHLY DEPLETED FIELDS AS % OF TOTAL PRODUCTION OF THE COMPANY, % *

Oil produced from the highly depleted fields as % of total production of the company, % *			
Company	Fields depleted at:		
	80% and more	70-80%	less than 70%
Tatneft	66,4	13,7	19,9
Bashneft	53,4	9,7	36,9
Slavneft	25	16,4	58,6
Rosneft	18,8	6	75,2
LUKOIL	18,2	12,1	69,7
Sibneft	13,3	2	86,5
YUKOS	8,7	17	74,3
Sidanko	5,3	4	90,7
Surgutneftegaz	2,3	8	89,7
TNK	1,9	6,2	91,9
* Calculated on the Ministry of energy of RF data on oil production in 2001			

Source: Oil & Capital, 2003, № 9



NEW RUSSIAN OIL TAXATION PROPOSALS: A FIGHT FOR “OIL RENT”



A.KONOPLYANIK'S MOST RECENT BOOKS ON THE TOPICS OF TODAY'S PRESENTATION



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