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Russian Oil Industry and Foreign Investments: Legal Aspects and the Problem of Business Risk

By A Konoplyanik*

The Russian energy sector and, in particular, the oil industry have been passing through hard times. The decline in energy production continues. The total volume of primary energy production decreased in 1992 by 104.5 million (m) tonnes of coal equivalent (mtce), or by 6 per cent, as compared to 1991. Based on that figure, primary energy consumption in the country dropped by 47.8 mtce, or by 3.8 per cent, and energy supplies to the countries of the former Soviet Union (FSU) were diminished by 23 per cent. The oil industry faces a very difficult situation. Oil and gas are among Russia's principal sources of wealth. Its potential reserves of hydrocarbons constitute over one-third of world reserves, and may serve as a source of the country's future economic prosperity and meet a considerable portion of the world's demand for oil and gas.

Over the past few decades Russia's energy industry developed at a rapid rate, providing the raw material requirements of the FSU and yielding a large part of hard currency earnings through the export of oil and gas. During the past few years the gas sector has developed relatively rapidly, but there has been a substantial decline in oil production. Thus, during 1986–1991, production fell by more than 20 per cent. Oil production in 1992 was 62.3 m tonnes lower than in 1991. Compared to 1988, which was a record high in oil production, the 1992 level is 170 m tonnes lower. That is equivalent to \$20–22 billion (bn) of annual export losses. That, in turn, is equivalent to half of Russia's 1993 foreign debt repayment obligations (\$41.8 bn according to the Ministry of Foreign Economic Relations) if existing restructuring deferrals were not taken into account. (I would like to remind you that in 1992, Russian export earnings were equal to \$44 bn, but the country was only able to pay lenders \$2.5 bn out of \$75.8 bn total foreign debt of the FSU). That is why the problems of the oil industry have directly affected the macroeconomic situation in Russia including its foreign economic aspects.

In 1993 the situation in the oil industry has remained difficult. Oil and condensate production are anticipated at 350.6 m tonnes, which is 48.2 m

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tonnes, or 12.1 per cent, lower than in 1992. The total export volume is expected to be 38.3 m tonnes in 1993, or 27 per cent lower than in 1992.

Causes of the crisis in oil production and refining

The major high-yield deposits of the exploitable fund which form the basis of available resources have been depleted to a large extent. The depletion of those deposits reached 60–90 per cent. Accordingly the extraction of oil dropped significantly. The fact that the depletion of the deposits occurred at an inadmissibly rapid rate (6–12 per cent of the initial reserves) also contributed to the fall in extraction levels. As a result of the intensive and by no means efficient application of secondary recovery methods the water cut of produced liquids went up sharply. This led to a large number of deposits being taken out of use and to an increase in the proportion of marginal reserves. In turn, the deterioration in the quality of the current “residual” reserves means that much more financial, material and technical resources will have to be used to develop them.

The quality of new discoveries has also sharply deteriorated. No high-productive deposit has been recently opened. The average daily production of new wells in the Tyumen Region (Russia’s main oil province) fell from 138 tonnes per well in 1975 to 12–13 tonnes in 1992. Thus the financial, material and technical costs of producing 1 tonne per day from new wells has risen 10 times in 17 years.

There has also been a drop in the financing of exploration. This fact and the reduction in the quality of new reserves (here the “knock-on effect” comes into play) have resulted in a progressive reduction in the absolute growth of oil reserves. Thus, from 1989 onwards financing for geological work dropped by 30 per cent, and volumes of exploratory drilling were reduced by the same amount in Western Siberia, where the level of development of forecasted resources is around 35 per cent. As a result, the growth in commercial reserves of that region fell one and a half times. At the same time there are considerable potential oil resources in Russia — at present no more than 40 per cent of forecasted reserves have been drilled and sufficient supplies will be available for over 46 years.

The sector is in dire need of high-productivity technology and extraction and drilling equipment. Depreciation of most of the technical resources is at over 50 per cent, only 14 per cent of machines and equipment meet world standards, 70 per cent of the assets of drilling installations are outdated and in need of replacement, and a third of well repair units were taken out of production five to seven years ago. At the same time the domestic industry satisfies only 40–80 per cent of the sector’s requirements for the principal types of material and technical goods. After the collapse of the USSR the situation with respect to supplies of oil field equipment from CIS republics deteriorated: being monopoly producers of many types of goods (Azerbaijan alone currently owns around 37 per cent of material and technical goods produced for the oil industry), factories in the republics are inflating prices and cutting supplies of equipment to Russia.

Low domestic oil prices have made it impossible for oil production enterprises to finance themselves (this situation remains the same despite a series of increases in oil prices). At the same time a high rate of reserve depletion has created the need for an accelerated rate of compensation for the withdrawal of extraction capacities. This resulted in a sharp deterioration

in the availability of material, technical, financial, and hard currency resources to the sector. In 1992 alone the total volume of investment in the oil industry fell by 25–30 per cent (in comparison with 1991). At the same time the volume of budget appropriations (previously the main source of financing) fell by over 40 per cent. The sharp reduction in governmental investment, the shortage of hard currency resources available to enterprises and the severed economic relations with some republics of the FSU have led to a sharp decrease in supplies of oil field and drilling materials and equipment and to a reduction in the volume of drilling. Thus, in order to maintain Russia's current level of oil production, new facilities must be installed providing for the extraction of 118 million tonnes a year. This will require the drilling of 62 million metres of borehole for development wells. In 1991 only 27.6 million metres were drilled, ie 2.2 times less, and only 20.3 m metres, ie 3.1 times less, were drilled in 1992.

During the last few years oil and gas production enterprises have been consistently subject to shortages in supply of material and technical resources needed to keep the wells producing. Moreover, equipment supplied by domestic factories is of a low quality, leading to an unjustified increase in the volume of repair work. The number of idle wells has therefore increased sharply: as of 1 March, 1992 the number of idle wells was over 25,000 (17.3 per cent of the total wells available), of which 12,400 were above the technically justifiable norm. At the beginning of 1993 the corresponding figures were significantly higher: 31.9 thousand (21.7 per cent) and 12.8 thousand. The average daily productive rate for idle wells is about 8 tonnes of oil, according to a minimum estimate. For that reason alone at least 30 million tonnes annually remain unextracted.

Owing to the shortage of efficient and environmentally safe equipment the problem of pollution in the sector has become particularly serious; this means that considerable material and financial resources are diverted to resolving problems which do not lead directly to an increase in oil production. The intensive increase in the extraction and refining of oil without an accompanying increase in the efficiency of raw material use resulted in the fact that upgrading has not changed substantially since the seventies and stands at present at around 65 per cent.

In oil refining, a significant depreciation of equipment (up to 70 per cent) and low technical standards have led to high energy consumption, an irrational production structure and low quality oil products. Unleaded gasolines and low-sulfur diesel fuels constitute about half of production, and the proportion of high-index lubricants is even smaller. The haphazard deployment of refineries and a high average unit capacity of oil refineries has caused a surplus of refining capacity in some regions and a complete lack of it in others, leading to considerable pressure on cargo traffic and to a disrupted supply of oil products to consumers.

Demand-side approach to solving the problems

In the long term it is impossible to solve the problems of the fuel and energy complex without restructuring the whole system of energy utilisation and introducing a wider range of energy-saving technologies. At the end of the 80s the energy intensity of the USSR/Russian GNP was two times higher than in major West European countries and 1.5 times higher than in the USA. During 1990–92 the level of economic activity in Russia declined b

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18–20 per cent but energy consumption stayed almost constant. That is why the energy intensity increased by another 16–18 per cent and significantly exceeded its all-time maximum of 1975. In 1992 the GNP energy intensity was 34 per cent higher than in 1988 — the year of maximum energy production.

It is estimated that 35–40 per cent of Russian energy production is excessive. The production of these excessive amounts of energy costs Russian taxpayers approximately 1 trillion rubles annually. So, this money might be either saved or the excess energy might be exported, bringing badly needed hard currency to the country's budget (where it is needed, for instance, for repaying foreign debt). It is well known that investments in energy conservation are two to three times more effective (from the macroeconomic point of view) than respective additional investments into energy production in terms of subsequent cost reduction for the consumer. That is why the maximum improvement of energy-use efficiency is FSU's strategy. But any major results of energy-conscious policies (from the technological and structural energy savings) will not appear until later — in some five to seven years time, and during the first two years the initial investment requirements of energy conservation programmes may be as high as or even higher than annual costs of normal energy expansion.

At present the primary short-term objective is to stabilise Russia's energy production and, first of all, to halt any further runaway slide of its oil production. If all of the above-mentioned trends persists, and given the current domestic demand for crude and refined products, the country may find itself having to import crude and/or refined products within the next few years.

Foreign participation: demands for external financing

Today, foreign investment in the Russian oil industry may effectively contribute to the stabilisation of the oil industry. Taking into consideration the specific importance of this sector for the entire Russian economy, the government adopted decrees NN 368, 369, and 372 on 1 June 1992 which specify short and medium-term (until 1997) requirements for external financing of oil production and refining which amount to \$30 billion. That is only 1.4–1.5 times higher than the export price of the annual volume of Russian "lost" oil production as compared to the year of the maximum production.

Only one source of external financing existed for the USSR/Russian economy in the recent past. The source was foreign, almost completely governmental, loans secured by sovereign (governmental) guarantees. These loans were then distributed by authorised governmental agencies among enterprises at "no cost" to them.

Currently, as Russia has been transforming to a market-oriented system of business management, the economic independence of the enterprises has increased significantly, and the national oil supply can hardly meet the demand, the monopolistic form of providing external financing is no longer appropriate. The required amount of external financing (\$30 billion) cannot be provided exclusively in the form of debt. To do so would mean that more than 50 m tonnes of additional oil export would be required each year in 1993–1998. But taking into account the current situation in the industry, such an increase is impossible, even theoretically.

Table I

Obstacles and barriers for foreign investors in the Russian petroleum industry (opinion of Canadian experts)

- (1) High political instability.
 - (2) High (prohibitive) level of taxation.
 - (3) Export tariffs (1/3 of world market prices).
 - (4) Legal environment:
 - (a) Delays with issuing the Law "On Oil and Gas".
 - (b) The Law "On Subsurface" requires revisions:
 - Direct negotiations are needed in addition to bids and auctions.
 - Settlement of disputes by international arbitration rather than exclusively by competent Russian authorities.
 - (5) The negotiation process on new oil projects with participation of foreign capital is riddled with red tape.
 - (6) No distinct division of authority among federal, regional, and local governments, and the management of oil producing enterprises and associations.
 - (7) The issues pertaining to the operation of oil and gas transportation systems need to be settled on the intergovernmental level.
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Therefore it is necessary to look for new approaches other than debt financing to attract foreign financial and industrial capital, with emphasis on direct foreign investments. Moreover, FSU needs to pay attention not only to state financing, but also to private investment, since at least 80 per cent of international financial flows comes from non-governmental sources. So the necessary change is quite clear from governmental loans to direct private investment.

Unofficial expert assessments indicate that foreign investors are ready to invest as much as \$60–70 bn into the Russian oil industry. That is even higher than the short-term external financing requirements of this country. Of course, it is not expected that these investments will flow into the Russian economy immediately. At present there is a high demand for investments in international financial markets. Therefore, many firms and financial institutions which are interested in a stable business environment for their activities, prefer to keep investing in traditional oil-producing countries with stable legal and economic environments (ie the Middle East, South East Asia, or America) rather than entering the new and risky Russian oil market, previously closed to most foreign investors.

However, this market does possess a tremendous appeal for potential investors. There is a large resource base of mineral industries, production costs which compare favorably with many other countries, highly skilled workers and rather low wages in comparison with world standards, conversion potential of the former defence industries to produce oil and gas equipment, etc. However, no major rechanelling of cash flows in favour of Russia can be expected until the country creates an investment climate which would be at least as favourable as that in the traditional oil and gas producing areas.

Western analysts believe, however, that for the time being many obstacles and uncertainties exist for investments into the Russian oil and gas industry. Tables I and II summarise the respective opinions of US and Canadian analysts. These opinions can be accepted or questioned (particularly, with respect to the inconsistency of the decisions of the Russian Government or

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Table II

Outstanding issues for US business with respect to potential investments in the Russian oil and gas industry (opinion of the US oil and gas business)

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- (1) The existing Russian laws and regulations applicable to foreign investments are not sufficiently developed yet:
 - (a) Many issues associated with division of authority between federal and local governments remain uncertain.
 - (b) No accurate information is available on who is authorised to execute contracts.
 - (c) Although in general the Law "On Subsurface" and the Procedure for Licensing the Use of Natural Resources refer to concessions, production sharing contracts, and other generally accepted international contracts, they fail to define their terms and conditions, including execution.
 - (2) Legal and financial guarantees (this issue is particularly important, owing to a long-term nature of investments in the development of oil and gas fields):
 - (a) The membership of Russia in the Multilateral Investment Guarantee Agency is yet to be approved by the Supreme Soviet.
 - (b) Russia is not a member of the International Financial Corporation.
 - (3) Investment climate in general:
 - (a) Uncertain and unstable:
 - Taxation system.
 - Foreign trade environment.
 - Currency controls.
 - (b) Export tariff:
 - Its unexpected introduction in January 1992 led several US-Russian JVs to the verge of bankruptcy.
 - The Executive Order, passed by the Government in July granted exemption from the tariffs to JVs registered before 1 January 1992, is not enforced, creating an uncertainty about companies' futures.
 - (4) The activity of US companies is affected by the following recent governmental acts which contained "serious violations of the Russian laws":
 - (a) Decrees of the Government of the Russian Federation:
 - #90 dated 12/30/91 "On Export and Import Licenses: Quotas on Goods (work and services) in the Territory of the Russian Federation in 1992" (as amended).
 - #91 dated 12/31/91 "On the Introduction of an Export Tariff on Specific Goods Exported from the Russian Federation" (increased export tariffs for the enterprises with foreign investments).
 - (b) Decrees of the President of the Russian Federation:
 - #629 dated 06/14/92 "On Partial Revisions to the Procedure for Mandatory Sale of Hard Currency Proceeds and the Collection on Export Duties" (contained violations of the current RF Law: "On Foreign Investments").
 - Dated 11/25/92 "On Measures to Expedite the Development of Oil and Gas Fields on the Continental Shelf of the Russian Federation" (contained violations of the current RF Law: "On Foreign Investments" and "On the Subsurface").

its President with Russian Laws as observed by US analysts), but at least they represent a certain system of concepts that are entertained by (some of) the North American oil business community. But if we are to promote a practical and mutually beneficial interaction with western industrial groups and financial institutions, we should learn to live with these opinions and,

consequently, take into consideration what we perceive as uncomplimentary and/or erroneous pronouncements.

Investment climate: recent past

Even a few years ago none of the above problems in the relationship with foreign investors existed. Until very recently, notably while the USSR was still a union with its mighty institutions of central government, federal agencies were in charge of any contacts with foreign companies. Such agencies naturally preferred to go to a handful of major companies for investment. The orientation towards foreign companies located at the top tier of the industrial and financial hierarchy and possessing a formidable economic capability narrowed such cooperation down to a small number of multi-billion dollar "superprojects" and an equally small number of credit lines obtained from the governments of their home countries. That made it possible to keep such projects under constant control of federal agencies. Also, such projects required, as a rule, appropriate governmental guarantees, which could only be obtained through governmental authorisations for particular investment projects, credit lines, and commercial deals.

Therefore, alongside the widely used intergovernmental financial agreements, virtually the only other type of interaction with foreign companies was the so-called "diagonal" deals, whereby a contract is executed between the government of the host country and the foreign company in question, rather than between two companies, ie between economic entities of the same level. Under such circumstances any developed and ramified legislation regulating investment, trade and political issues became redundant, because cooperation with a small number of large companies could do without such laws and rely on government resolutions adopted on a case-by-case basis. Besides, no one generally questioned the legitimacy of direct contacts between the supreme governmental agencies of the USSR as the host country and major foreign monopolies with annual sales equivalent to the GNP of small countries.

As governmental agencies become de-centralised, as an increasing number of enterprises and associations enter into direct relationships with foreign companies, and the scope of cooperation with potential foreign investors grows as a result of the enlistment of small and medium sized businesses from both sides, the old scheme of things, known as the "system of individual legal restrictions" simply cease to work — because the number of entities involved is too great. In this situation the only legal regulatory medium for the relations between the host country, which owns the subsurface, and the prospective investors is a ramified system of economic laws. Such a system is only emerging in Russia, and according to V Shumeiko, First Vice-Premier of the Russian Government, the country will have to draft and enact at least 100 laws for such a system to fully emerge. Yu Shafranik, Russian Minister for Fuel and Energy believes that at least 50 laws will be required for normal privatisation alone.

The existing laws and regulations do not include many general and specific laws and regulations to govern the activities of the energy sector and specifically, the oil industry, in a market-oriented economy or in the process of transition thereto. For this reason we attach much importance to creating the necessary business and legal environment in the energy sector, particu-

larly in the mining industries, which suffer from the largest number of legislative "white spots".

Current legislative activities

At present our internal legislation already includes some fundamentals of a legal base, which regulate relations between the owner of the subsurface and the investor, as well as other aspects of the use of the subsurface. In June and September 1992 the Supreme Soviet of Russia adopted the Law "On the Subsurface" and "The Procedure for Licensing the Use of Natural Resources", respectively. In October 1992 the Government of Russia approved the Regulation "On the Procedure and Conditions for the Right to Use the Subsurface, Water Areas and Sections of the Seabed". In November, pursuant to the October Decree by President Yeltsyn "On the Introduction of an Excise Tax on the Users of Underground Resources in the Territory of the Russian Federation", the Russian Government adopted the Resolution "On an Excise Tax on Oil Produced in the Territory of the Russian Federation". In February 1993 the Supreme Soviet of the Russian Federation approved the Regulation "On the Off-Budget Fund for the Replenishment of Known Mineral Resources". The Russian Government adopted the resolution "On Price Control in the Oil Industry".

The Russian Ministry of Fuel and Energy, the Russian Ministry of Science, and other agencies developed a Concept for Russia's new energy policy, which was reviewed and approved by the Russian Government in September 1992. The Concept contemplates the drafting of a package of priority laws to regulate operations of the energy sector. The procedure for the development of said legislation, and the time-frame for the submittal thereof have been agreed upon by the leadership of the Supreme Soviet of the Russian Federation (Table III). For the energy sector as a whole the most important bill is "On the Fundamental Energy Policy of the Russian Federation", the first version of which should be ready in the near future.

Table III

Package of priority laws associated with activities of Russia's fuel and energy sector (drafted and/or scheduled to be drawn up)

Special ("internal") energy laws:

(a) "Horizontal" laws (applicable to several sectors):

- (1) On the fundamental energy policy of the Russian Federation.
- (2) On safety and environmental properties of facilities of the fuel and energy complex.
- (3) On the integrated power system of Russia.
- (4) On the integrated gas-supply of Russia.

(b) "Vertical" laws (governing a specific sector):

- (5) On energy saving.
- (6) On oil and gas.
- (7) On power industry.
- (8) On the use of nuclear power.
- (9) On the use of unconventional renewable energy sources.

Laws constituting a part of legislation external with respect to the energy sector:

- (10) On amendments to the fiscal system of the Russian Federation with respect to the use of energy resources and the operation of energy facilities.
- (11) On concessions and production sharing agreements.

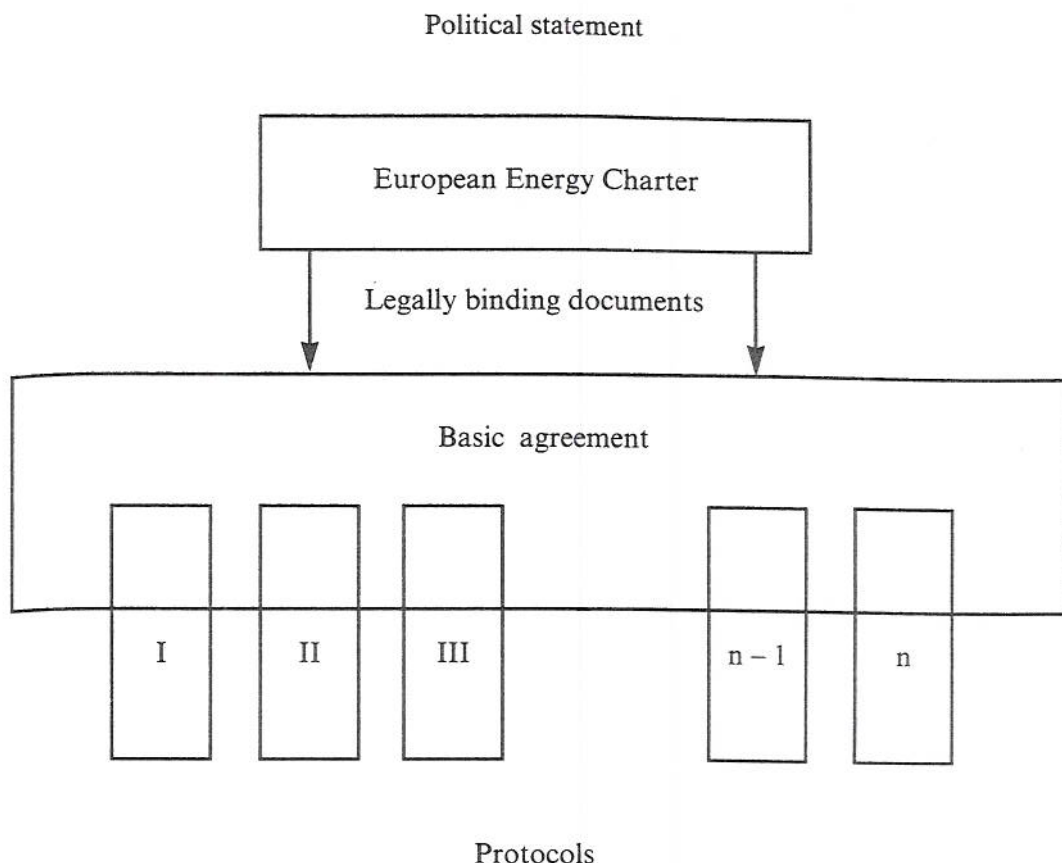
To coordinate the drafting of the legislation outlined in Table III, the Government of the Russian Federation, in concurrence with the Supreme Soviet of the Russian Federation set up an Interdepartmental Coordinating Group headed by A Samusev, Deputy Minister for Fuel and Energy of Russia. Working groups to prepare each of the other draft bills have been set up. Work is underway to draft the laws "On Oil and Gas", "On Concessions and Production Sharing Agreements", "On Amendments to the Fiscal System of the Russian Federation with Respect to the Use of Energy Resources and the Operation of the Energy Facilities". All of the above are priority bills for the oil industry.

Oil and gas law

Soon the draft Law "On Oil and Gas", the main "dedicated" law for oil and gas industries, will be completed. When working on this draft law the special inter-departmental commission managed to avoid some errors made during the preparation of the Law "On the Subsurface", such as submission to the RF Supreme Soviet of two "conflicting" versions prepared by the Russian Committee for Geology and the Ministry for Fuel and Energy, respectively. The attempts to agree upon these versions were made at the early stage of discussions in the RF Supreme Soviet and resulted in confrontation over the two versions, which were mutually exclusive in some aspects, rather than an effort to find a mutually acceptable wording of certain articles.

There seems to be no such confrontation this time despite the fact that three versions of the draft Law "On Oil and Gas" initially existed as compared to the Law "On the Subsurface", which only had two. The first version of the Law "On Oil and Gas" was prepared by the VNIIOENG Institute. It is called the "Tishchenko version", by the name of the Study Group manager and Institute director. The second version called the "gas version" was prepared by the Ministry of Gas Industry experts who proposed separate laws for oil and gas. The third version called the "Gazeev-Hardy version" was the result of a joint effort of the group that included Russian experts headed by M Gazeev, a department manager of the VNIKTEP Institute, and the World Bank experts headed by J Hardy-III, a Professor of Law of the University of Houston (USA).

The above versions were discussed and reviewed by the Ministry of Fuel and Energy and other interested governmental organisations, by Russian and foreign experts and organisations, and "independent experts", at conferences and workshops including international forums, as well as by the RF Supreme Soviet Commission headed by G Kalistratov, Deputy Chairman of the RF Supreme Soviet Committee for Industry and Power Engineering. Based on the experience of passing the draft Law "On the Subsurface" through the RF Supreme Soviet, it was understood that a uniform "trade-off" version of the draft law "On Oil and Gas" should be prepared for submission to the Supreme Soviet. To this end, a Commission headed by the above mentioned A Samusev was created together with a special Subcommission — a Working Group of experts headed by A Perchik, a Professor of Law at the State Academy of Oil and Gas. The "trade-off" version of the law known as the "Perchik version" is now under independent expert examination and review in order to prepare it for submission to the RF Supreme Soviet.



- I — Energy efficiency including environmental requirements
- II — Hydrocarbons
- III — Nuclear power including nuclear safety

Figure 1. The schedule of the European Energy Charter.

European Energy Charter

In December 1991, Russia, among 48 other nations and two inter-governmental organisations of three continents, signed the European Energy Charter which became the first international agreement signed by the republics of the former USSR as independent sovereign states. Currently, active negotiations are underway on a package of binding legal documents supplementary to the European Energy Charter: the Basic Agreement which, as opposed to the Charter *per se*, a purely political declaration by the signatories, will be a multilateral "horizontal" commercial, political, investment, economic and legal agreement; and "vertical" Protocols on cooperation in selected energy sectors, among which the Protocol on Hydrocarbons (Fig 1) is the most significant one.

In our law-making activities we assume that relations with all states and companies should be built on principles stated in the European Energy Charter and the supplementary binding documents. Pursuant to these documents, a common energy, economic, and legal space for the whole industrially developed part of the world will be created: 50 European, North American, Pacific Rim and CIS states are negotiating the document package. Here uniform conditions will be created for all participants, with respect to

access to energy resources, markets, transportation facilities including transit privileges, technologies, capital markets, etc. Such a system would provide a balance of interests for the host countries and potential investors in terms of both investment regimes as well as commercial and political issues. (Problems related to the European Energy Charter and its significance for the economics of Russia, other CIS countries and Western nations are considered in detail in the special issue of the *Finvest* (Financial Newsletter) published to mark the first anniversary of the Charter¹).

We believe that the development of our internal "energy" legislation is closely linked to the negotiations in Brussels since in our opinion the problem of creating the necessary economic/legal environment in the Russian energy sector includes three distinct aspects each of which should complement each other:

- (1) Creation in the domestic legislation of a series of special "energy" laws reflecting the distinctive features of the energy sector including its mining industries as an object of legal regulation (some of such legislative acts were mentioned above; currently a package of 11 basic legislative acts related to activities in the energy sector is under development, of which nine are designed for "internal" use in the power industry — see Table III).
- (2) Development of diversified general legislation, with the energy industry as one of its objects (eg tax and concession laws — see Table III)
- (3) Development of a system of bilateral and multilateral international contractual and legal acts facilitating integration of our national economy into the world economy and into the system of international economic relations (eg international agreements on mutual protection of investments, on avoidance of double taxation, etc. The package of legally binding documents supplementing the European Energy Charter also belongs here — see Fig 1). In our view, development of an efficient and balanced package of legally binding documents as a supplement to the European Energy Charter and the ratification by the Parliaments of the negotiating parties will undoubtedly help stabilise the business environment in the energy industry of Russia and make it less hazardous.

Investment risks: current situation

According to both western and domestic experts the current environment is still characterised by a high risk for potential investors. We have already analysed western estimates of risk for foreign investment in USSR/Russia/CIS countries². These estimates dictate that minimal rates of return which would satisfy the US investor should be 25 to 40 per cent higher in Russia than in Western Europe and from 66 to 75 per cent higher than in the USA, thus reflecting the perception by some US companies of the relative risk of investment in the above three regions (Fig 2).

A similar picture with respect to risks typical for the business climate

¹ European Energy Charter: First Anniversary of Signature ("Finvest" [Financial Newsletter], #51, 1992).

² A Konoplyanik: Foreign Investments: Risk Ranges ("Finvest" [Financial Newsletter] 1991, p 12). A Konoplyanik: *The Less Risk, the Better* (Energy: Economics, Technology, Ecology, #3, 1992, pp 23–26).

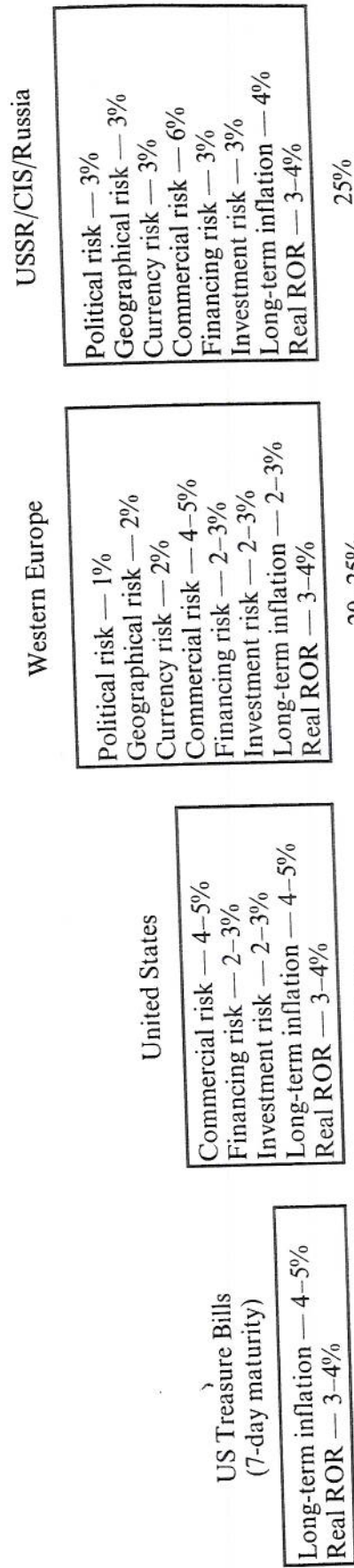


Figure 2. Minimum rates of return acceptable to US investors (as measured by some American companies).

Table IV

Business climate in Russia: estimated risks (rated from "best" [1] to "worst" [10])

Risks in 1992 and 1993	20 July	20 October	20 January
Social and political	6.485	6.57	6.74
Domestic economic	6.70	6.85	6.65
Foreign economic	4.125	5.20	5.45
Weighted average	5.812	6.21	6.28

Source: "UNIVERS" Independent Information Agency ("Izvestiya", 16 January 1993, p 1, 4; 30 January 1993, p 1, 4).

Russia is presented by "UNIVERS", an independent Russian information agency. According to their data, quantitative estimates of risk lie in the range between its mean and worst possible values for each of the three assessed risk categories (socio-political, internal economic, and foreign economic). Developments that occurred in the second half of last year and in the beginning of the current year caused an insignificant increase (4 per cent) in socio-political risks and a noticeable (33 per cent) increase in foreign economic risks. As a result, the weighted average estimate of risk involved in the Russian business climate has gone up 8 per cent over 6 months (Table IV).

Nevertheless, despite repeated statements to the effect that oil business in Russia is highly risky, many foreign companies spare no effort to secure, in one form or another, a place on the Russian oil market. In a manner speaking they are trying to establish a sort of stepping stone for the future large-scale expansion of their businesses in the country in case its legal and economic environment evolves in the investor-friendly direction. Hence about four dozen joint ventures that are operating or are being established in the Russian oil industry seem to be forward-based emissaries of western investors on the Russian oil market. The objective of this task force is to

Table V

Planned foreign involvement in the development of Russian oil fields, 1992-2000

	Number of fields	Proved recoverable reserves (A/B/C ₁), million tonnes
Total number of fields put into production in 1992-2000:		
● Russia's total	551	5132
● Including the Tyumen Region (% of Russia's total)	183 (33%)	4061 (79%)
Fields put into production with foreign participation:		
● Russia's total (% of the total number)	143 (26%)	1205 (23%)
● Including the Tyumen Region (% of the total number in Tyumen) (Percentage of Russia's total)	70 (38%)	739 (18%)
	48%	61%

Source: "State Programme of Russia to Stabilise Operations of the Oil and Gas Industry in 1992-1995 and Through 2000" (part 1), Ministry of Fuel and Energy of the Russian Federation, Moscow, May 1992, Annex #10.

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formulate rules of the game and "show the flag" in the Russian oil business and also to "track from the inside" changes which are taking place in the Russian economic balance of forces.

Direct investments made by foreign companies into the development of Russian oil fields are insignificant and only slightly exceed \$150 million, according to the estimates of the Main Administration on Coordination of Foreign Economic Activities of the Fuel and Energy Complex under the Ministry of Fuel and Energy. These investments, however, are very noticeable, particularly in Western Siberia. Data presented in Table V confirms the fact by showing that one quarter of the Russian oil fields and 40 per cent of the Tyumen oil fields will be matured to the production stage in 1992-2000 by participating foreign companies. Western companies participate in the activities associated with the development of the proved recoverable oil reserves (categories A + B + C₁), which amount to one fourth of the Russian fields and about one fifth of the Tyumen fields to be developed by the end of the century. More than a half of the Russian fields to be put into production in 1992-2000 with assistance of foreign companies, and 60 per cent of oil reserves are located in the Tyumen Region.

So, this is not a matter of involving more foreign companies in the Russian oil business (their number is high enough, as shown in Table V), but rather of creating a better environment for the existing interaction between Russian oil producers and foreign companies, and of deriving more benefits for Russia from the foreign capital in the petroleum sector.