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STATE CONTROL, TAX COOL RUSSIAN OIL INVESTMENT CLIMATE: IEA

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The Kremlin appears to be re-asserting state control over national resources, and taxation favours the export of oil products over production: these two factors have blown a chill wind over oil investment in Russia, the IEA reported on Thursday.

The International Energy Agency summarised in its August report the "impressions" to emerge from a recent visit by its officials to Moscow to meet representatives of the government, oil companies and analysts.

One piece of information to emerge was that "up to 380,000 (oil) wells are idle in Russia". One of the causes was said to be "an insensitive tax regime".

The IEA reported: "After the laissez-faire period of the past decade and the rise of the oligarchs, the Kremlin is seen as re-establishing state control over national resources. This covers all phases from licensing terms through production to exports.

"Control over domestic and near-abroad energy infrastructure is seen as a key national interest.

"Consequently, new foreign investment in Russian oil could be limited to a small number of larger operators willing to take minority stakes in large projects."

The IEA revised downwards its estimate for Russian oil production this year by 35,000 brrels per day to an average of 9.5 million barrels per day.

This lower base, together with potential weakness of investment in developing oil resources by key producers, would also undermine output in 2006.

The IEA said: "Projected 2006 supply is cut by 135,000 barrels per day to 9.8 million barrels per day. Russian oil production will grow much more slowly than in 200-2004." But it would increase by two-three percent in 2005-2006.

Growth of oil production on a 12-month comparison had slumped from a peak of one million barrels per day or 12.0 percent in July 2003 to about 175,000 barrels a day or about 1.5 percent in July 2005. This was considered to be a result of manoeuvering by "key domestic operators intent on buying up the assets of companies wielding less influence with government".

The IEA warned: "This reduces focus on organic growth and could impede production for the next one to two years at least".

It commented: "While the stars of Gazprom, Rosneft, Lukoil and BP-TNK may be rising, prospects for other producers are less certain."

Debt and legal issues confronting Gazprom and Rosneft "could further divert attention from production growth". The report added: "Many of those questioned see consolidation ultimately leaving Russian production controlled by three to four main players."

A proposed "subsoil" law would restrict the participation of foreign companies in "as-yet undefined strategic fields" to 49 percent. The law might not take effect until the end of 2006 or 2007 and was not see as a substantial "impediment" to investment.

However, action by the Natural Resources Ministry to enforce existing field licences "could cut both ways for short-term production".

Strict enforcement of existing production licences "framed before the application of modern reservoir management techniques, could curb production substantially". But this might be balanced if the authorities re-allocated licences for production assets which were currently idle.

The export tax system favoured product exports over crude oil. "Crude exports by expensive rail and river routes have taken a hit, having earlier been a key outlet for rapidly rising production." Since the duty on exported crude oil was 140 dollars per tonne contrasted to 60 dollars per tonne for products, "one consequence may be the long-overdue upgrading of hitherto unsophisticated Russian refineries."

Small, non-integrated operators were lobbying hard for the tax system to differentiate on account of mature and small-scale fields. "Up to 380,000 wells are idle in Russia, seen in part due to an insensitive tax regime". But time would be needed to draft a new law.

The IEA reported a perception that high prices for oil were shielding the government from "the imperative of fiscal and regulatory reform". But there were positive signs after a "lost year" in 2004. The government estimated that investment in the oil sector had grown by 13.0 percent in the first quarter of 2005 and would grow by 20 percent in the whole of this year.

The IEA, quoting a reference by British World War II leader Winston Churchill to Russian policy in 1939, said that it had come away from its talks in Moscow with the impression that the complexity of the issues facing Russia is: "A riddle wrapped in a mystery inside an enigma -- but perhaps there is a key: That key is the Rusian national interest."

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