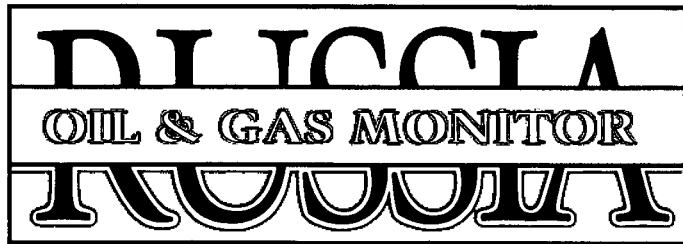




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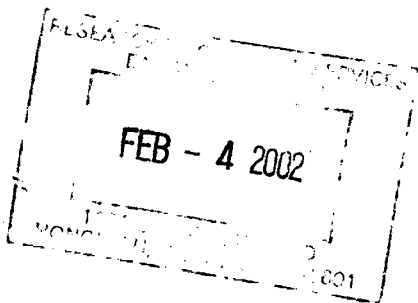
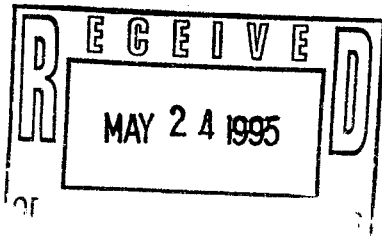
PROGRAM ON RESOURCES:  
ENERGY AND MINERALS



A Quarterly Analysis of  
Oil and Gas Developments in Russia

Prepared by the  
Russia Energy Project

Volume 1, Issue 2, 1995



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## **EAST-WEST CENTER**

The U.S. Congress established the East-West Center in 1960 to foster mutual understanding and cooperation among the governments and peoples of the Asia-Pacific region, including the United States. Officially known as the Center for Cultural and Technical Interchange Between East and West, it is a public, non-profit institution with an international board of governors. Principal funding for the Center comes from the U.S. government, with additional support provided by private agencies, individuals and corporations and more than 20 Asian and Pacific governments.

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The Project publishes much of its study findings in articles, books and energy advisory reports, as well as in the quarterly *Russia Oil & Gas Monitor*.

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**RUSSIAN OIL AND GAS DEVELOPMENTS: FIRST QUARTER OF 1995**


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## **RUSSIAN OIL AND GAS DEVELOPMENTS: FIRST QUARTER OF 1995**

### **1. General Overview**

The first quarter of the year (1Q95) was characterized by some reassuring changes in the performance of Russia's oil industry which, if not handicapped by destructive regulations, may mark the beginning of the long-awaited stabilization of the country's oil sector.

In 1Q95, national oil production equalled 1Q94 output and was 1% above its 4Q94 level. It is noteworthy that such a year-over-year increase has occurred for the first time after the persistent production declines observed since the end of 1980s.

In turn, refinery throughput, which has been rising since last September, was almost 7% lower in 1Q95 than in the same period of 1994. Refinery intake accounted for 56% of the country's oil production, as against 60% a year ago.

Domestic crude oil prices, driven by continually rising production costs, temporary oil shortages, and oil export liberalization, more than doubled within the first three months of this year.

Crude oil exports in 1Q95 grew by more than 13% over 1Q94. The cash-generating exports outside the FSU grew faster, with their 1Q95 level exceeding that of 1Q94 by nearly one-fourth. Overall, exports amounted to almost 37% of national oil production, up from 32% in the preceding quarter.

At the same time, Russia's oil export regulations were dramatically liberalized and "democratized". Cancellation of individual export privileges has also contributed to the further marketization of the Russian oil industry.

The decontrol of the country's oil exports, and of domestic oil prices, provided additional incentives to national oil producers and facilitated further contractions in inland oil demand. This may result in another oversupply crisis, the first signs of which (all-time low refinery intake) surfaced in March.

Fewer changes were observed in Russia's gas industry in 1Q95. Production of natural gas continued its moderate downward trend, with 1Q95 output being 1% less than it was in 1Q94. Concurrently, Gazprom's restrictive supply measures, aimed at collecting the debts from Russia's industrial consumers led to a reduction in domestic gas consumption, and made more gas available for exports. Consequently, gas exports grew in 1Q95 by 15% compared to 1Q94. As a result, exports accounted for almost 34% of the country's gas output, as against 29% a year ago.

The war in Chechnya significantly impacted Russia's hydrocarbon industry, both directly and indirectly. First, the military activity severely damaged production, transportation and refining facilities, completely paralyzing oil and gas operations in this autonomous republic [1]. The restoration of Chechnya's oil and gas industry is estimated to cost around Rbl 1.3 trillion (US\$270 million). Second, the war has added to the country's political instability and reduced the already low international rating of Russia's investment

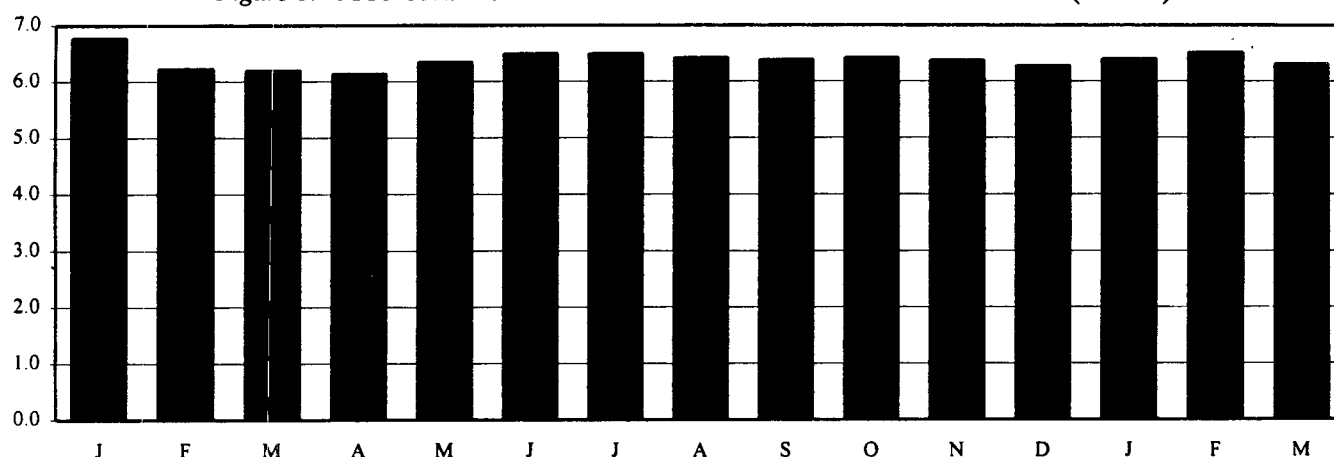
climate. Third, substantial war-related budget expenditures contributed to higher inflation and made tax cuts less likely.

## 2. Production

### 2.1. Crude Oil and Condensate

In the first quarter of 1995 (1Q95) Russia produced 6.41 million barrels per day (mmb/d) or 78.8 million tonnes (mmt) of oil (crude and condensate), nearly equal to 1Q94 output and almost 1% more than in 4Q94 (see *Table 1*) [2]. Monthly fluctuations were within  $\pm 2\%$  of the daily average for the quarter, with the highest level of output (6.51 mmb/d) being recorded in February, and the lowest (6.35 mmb/d) in March (see *Figure 1*).

Figure 1: MONTHLY OIL PRODUCTION IN RUSSIA: Jan '94-Mar '95 (mmb/d)



Oil production in **European Russia** declined insignificantly to 1.80 mmb/d, or by less than 1% compared to 1Q94. Its share of Russia's total output remained virtually unchanged at 28%. At the same time, the regional breakdown of the area's production underwent tangible changes.

In particular, the Volga/Urals region yielded 8.5% more than in 1Q94, reaching 1.65 mmb/d and raising its share of European Russia's output to almost 92% (by comparison, a year ago the region accounted for less than 84%). This was mainly caused by over-producing fairly depleted and highly watered oil fields in the independence-minded Tatarstan, which launched a crash development program to meet its political and economic ambitions at the end of 1994 (see *Section 6.4*). Not surprisingly, last March the republican oil company, Tatneft, announced a forthcoming reduction in its production, by nearly one-third, in order to prevent damage to its oil fields and to dispose of excessively produced heavy and high-sulfur crudes.

In contrast, oil production in the North/Northwest and North Caucasus regions in 1Q95 declined from 1Q94 levels by 46% and 52% respectively. Another spill from Kombineft's pipeline, occurring in January 1995, forced further reductions in oil output in the North/Northwest region. As a result, the region's share of European Russia's total shrank to 6%, down 4 percentage points compared to 1Q94. The drop in the

Table 1: OIL (CRUDE AND CONDENSATE) PRODUCTION IN RUSSIA: 1993-1Q95 ('000 tonnes)

	1993	1994	1Q95	Δ, %	
				1Q94	4Q94
<b>Total</b>	<b>354,874.9</b>	<b>318,041.1</b>	<b>78,616.6</b>	<b>-0.1</b>	<b>-1.5</b>
in '000 b/d	7,117.1	6,378.3	6,398.3	-0.1	0.7
<b>By Region:</b>					
<b>European Russia</b>	<b>103,598.6</b>	<b>90,925.2</b>	<b>22,165.5</b>	<b>-0.7</b>	<b>-2.8</b>
<i>North and Northwest</i>	<i>10,583.3</i>	<i>8,048.8</i>	<i>1,236.1</i>	<i>-46.4</i>	<i>-27.9</i>
<i>Volga/Urals</i>	<i>87,184.5</i>	<i>78,932.8</i>	<i>20,303.6</i>	<i>8.5</i>	<i>-0.9</i>
<i>North Caucasus</i>	<i>5,830.8</i>	<i>3,943.6</i>	<i>625.8</i>	<i>-51.9</i>	<i>5.3</i>
<b>Asian Russia</b>	<b>236,288.6</b>	<b>209,548.3</b>	<b>51,363.5</b>	<b>-2.0</b>	<b>-1.6</b>
<i>Western Siberia</i>	<i>234,573.9</i>	<i>207,842.5</i>	<i>50,863.7</i>	<i>-2.2</i>	<i>-1.7</i>
<i>Eastern Siberia</i>	<i>34.3</i>	<i>30.5</i>	<i>63.2</i>	<i>479.8</i>	<i>643.5</i>
<i>Far East</i>	<i>1,680.4</i>	<i>1,675.3</i>	<i>436.6</i>	<i>5.5</i>	<i>2.3</i>
<b>Other [1]</b>	<b>14,987.7</b>	<b>17,567.6</b>	<b>5,087.6</b>	<b>28.7</b>	<b>5.1</b>
<b>By Institution:</b>					
<b>State Enterprises</b>	<b>96,667.6</b>	<b>84,419.4</b>	<b>20,103.9</b>	<b>-7.0</b>	<b>-0.6</b>
<i>Oil Enterprises (Rosneft)</i>	<i>94,032.2</i>	<i>81,451.3</i>	<i>19,649.9</i>	<i>-6.4</i>	<i>1.0</i>
<i>Gas Enterprises [2]</i>	<i>153.9</i>	<i>158.4</i>	<i>55.5</i>	<i>-5.1</i>	<i>23.1</i>
<i>Geological Enterprises [3]</i>	<i>2,481.5</i>	<i>2,809.7</i>	<i>398.5</i>	<i>-31.2</i>	<i>-44.8</i>
<b>State-Controlled Companies</b>	<b>245,661.4</b>	<b>218,825.7</b>	<b>53,811.3</b>	<b>0.2</b>	<b>-3.0</b>
<i>Oil Companies</i>	<i>235,808.6</i>	<i>210,301.6</i>	<i>51,384.4</i>	<i>0.2</i>	<i>-3.3</i>
<i>Bashneft [4]</i>	<i>21,550.1</i>	<i>18,805.1</i>	<i>4,569.9</i>	<i>1.1</i>	<i>-4.1</i>
<i>KomiTEK</i>	<i>9,353.0</i>	<i>6,939.8</i>	<i>961.8</i>	<i>-52.2</i>	<i>-33.2</i>
<i>LUKoil</i>	<i>48,900.4</i>	<i>43,710.0</i>	<i>10,907.1</i>	<i>4.8</i>	<i>-3.4</i>
<i>ONAKO</i>	<i>7,258.9</i>	<i>7,426.9</i>	<i>1,835.8</i>	<i>3.5</i>	<i>-4.7</i>
<i>Sibur</i>	<i>293.5</i>	<i>295.1</i>	<i>58.4</i>	<i>-14.4</i>	<i>-13.5</i>
<i>Sidanco</i>	<i>28,700.3</i>	<i>25,277.1</i>	<i>5,513.6</i>	<i>-16.1</i>	<i>-6.7</i>
<i>Slavneft</i>	<i>13,221.7</i>	<i>12,875.9</i>	<i>3,424.1</i>	<i>14.5</i>	<i>3.5</i>
<i>Surgutneftegaz</i>	<i>38,135.8</i>	<i>34,245.5</i>	<i>8,346.0</i>	<i>-3.3</i>	<i>-1.6</i>
<i>Tatneft</i>	<i>25,228.0</i>	<i>23,107.7</i>	<i>6,118.1</i>	<i>22.8</i>	<i>-4.6</i>
<i>VNK (East Oil Company)</i>	<i>11,010.8</i>	<i>10,290.4</i>	<i>2,765.6</i>	<i>7.9</i>	<i>6.6</i>
<i>VSNK</i>	—	—	<i>55.1</i>	<i>n/a</i>	<i>n/a</i>
<i>YUKOS</i>	<i>32,156.1</i>	<i>27,216.3</i>	<i>6,801.6</i>	<i>1.1</i>	<i>-1.5</i>
<i>RMNTK Nefteotdacha</i>	—	<i>111.8</i>	<i>27.3</i>	<i>-2.2</i>	<i>-2.8</i>
<i>Gas Companies (Gazprom)</i>	<i>9,173.0</i>	<i>7,859.4</i>	<i>2,283.5</i>	<i>0.8</i>	<i>4.6</i>
<i>Russian Fuel Company (Rostoprom)</i>	<i>679.8</i>	<i>664.7</i>	<i>143.4</i>	<i>-1.8</i>	<i>-1.4</i>
<b>Non-State-Controlled Entities [5]</b>	<b>12,545.9</b>	<b>14,796.0</b>	<b>4,701.4</b>	<b>39.1</b>	<b>13.9</b>
<b>By Product:</b>					
<b>Crude Oil</b>	<b>346,017.4</b>	<b>310,136.2</b>	<b>76,359.3</b>	<b>-0.1</b>	<b>-1.7</b>
<b>Gas Condensate</b>	<b>8,857.5</b>	<b>7,904.9</b>	<b>2,257.3</b>	<b>1.2</b>	<b>4.0</b>

[1] Geographically unspecified; includes Non-State-Controlled Entities and Roskomnedra. [2] Comprised of Norisilkgazprom and Yakutgazprom. [3] Comprised of Roskomnedra and Arktikmorneftegazrazvedka. [4] Includes Ishimbayneft. [5] Comprised of Private and Closed-Type Joint Stock Companies, and Municipal/Public Entities.

North Caucasus production is explained by the military conflict in Chechnya, which led to a complete closure of oil-producing facilities in the republic during 1Q95.

Oil production in **Asian Russia** declined by 2% from 1Q94 to 4.17 mmb/d, with its share of the total decreasing to 65%, down 2 percentage points compared to 1Q94. All of the decline is attributed to Western Siberia, which produced 4.14 mmb/d, 0.1 mmb/d less than in 1Q94. Meanwhile, Far East oil output, at 35,000 b/d, showed a buoyant increase of 6% above 1Q94.

**State enterprises** produced 1.63 mmb/d in 1Q95, equalling approximately 26% of the total output, with their share fluctuating from 25% in the preceding quarter and 27% a year ago [3]. State-run oil enterprises (mainly those managed by Rosneft) produced 1.60 mmb/d, up 3% compared to 4Q94, with the remaining lower output of 0.05 mmb/d being provided by geological enterprises (not annexed by integrated oil companies) and gas companies (descended from Gazprom). While the gas companies managed to tangibly raise their oil production over the preceding quarter, the state geological enterprises suffered drastic drop in output, which is explained by a sharp contraction in state funds and the abolition of foreign-trade privileges that allowed geologists to export all their oil output duty-free during the whole of 1994 (see *Section 6.2*).

In turn, **state-controlled companies** yielded 4.37 mmb/d, accounting for more than 68% of Russia's 1Q95 total, with both their output and share virtually unchanged over the first and fourth quarters of 1994. All the "independent" oil companies, taken together, provided 4.17 mmb/d, by 1% lower than in the preceding quarter. However, four of them managed to increase their production above that recorded in 4Q94: VNK (by 9% to 0.22 mmb/d), Slavneft (by 5% to 0.28 mmb/d), Surgutneftegaz (by 1% to 0.68 mmb/d), and YUKOS (by 1% to 0.55 mmb/d). In the meantime, some other major oil producers experienced marginal declines: LUKoil (by 1% to 0.89 mmb/d), Tatneft (by 2% to 0.50 mmb/d), Bashneft (by 2% to 0.37 mmb/d), ONAKO (by 3% to 0.15 mmb/d), Sidanco (by 5% to 0.45 mmb/d). Due to the January pipeline accident, KomiTEK's output in 1Q95 dropped by 32% from 4Q94 to 0.08 mmb/d. As for the non-oil producers, Gazprom increased its oil production by nearly 7% over 4Q94 to 0.19 mmb/d, while oil output of JSC Russian Fuel Company (Rostopprom) remained virtually unchanged at 12,000 b/d.

Oil production of **non-state-controlled entities** grew to 0.38 mmb/d, approximately 21% higher than the preceding quarter and almost 45% more than a year ago. As a result, their share of total national output exceeded 6%, compared to 5% in 4Q94 and 4% in 1Q94. Joint ventures produced 0.26 mmb/d of their "own" crude, down almost 4% against 4Q94 but up more than 19% over 1Q94. Meanwhile, oil output by other "commercial" entities soared to 0.12 mmb/d or to nearly twice as high as in the preceding quarter. This is explained by the new export regime which incites oil-trading companies to get directly involved in oil production or, at least, to prove their oil-producing status (see *Section 6.2*).

Taken separately, **crude oil** output increased in 1Q95 to 6.21 mmb/d, up 0.2% against 1Q94 and 0.9% over 4Q94, while field production of **gas condensate** amounted to 0.21 mmb/d, down 0.6% against 1Q94 and 4.4% above 4Q94 (which closely mirrored dynamics of the country's output of natural gas).

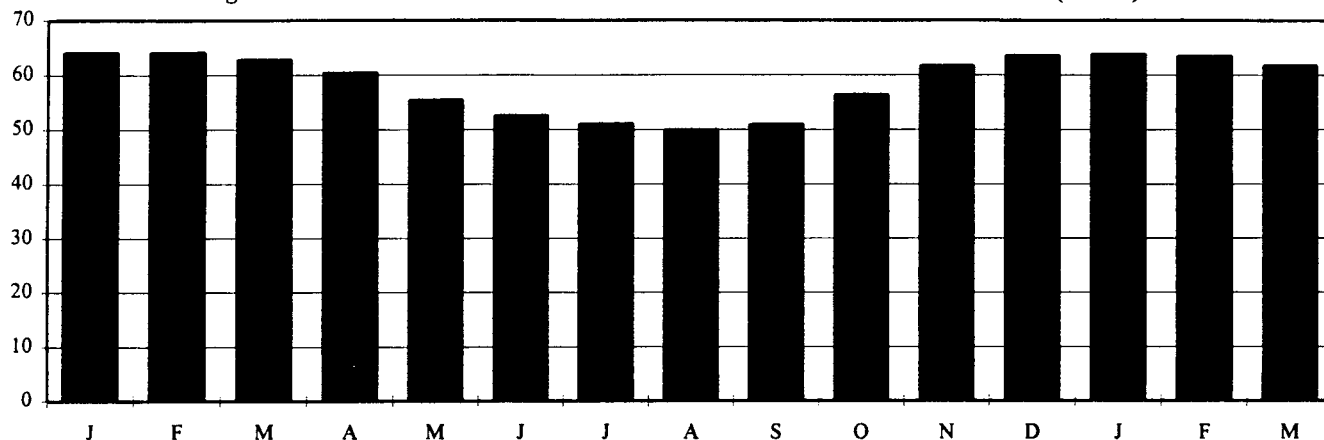
## 2.2. Natural Gas

In 1Q95, Russia's production of natural gas totalled 63.00 billion standard cubic feet per day (bscf/d) or 163.5 billion cubic meters (bcm), 1% less than in 1Q94 (see *Table 2*). Due to seasonality of gas consumption, its monthly output slid down to 61.78 bscf/d in March from 63.81 bscf/d in January, which in turn, showed the highest level of monthly production for the previous 11 months (see *Figure 2*).



**European Russia** produced 4.71 bscf/d, about 6% lower less than in 1Q94. The area provided some 7% of Russia's total output. The Volga/Urals region accounted for 85% of the area's production (3.99 bscf/d), while North/Northwest and North Caucasus produced 0.37 bscf/d and 0.36 bscf/d respectively, or nearly 8% of the European Russia's output each.

Figure 2: MONTHLY GAS PRODUCTION IN RUSSIA: Jan '94-Mar '95 (bscf/d)



Production in **Asian Russia** amounted to 58.23 bscf/d and contributed about 92% of Russia's total. The bulk of it came from Western Siberia, which yielded 57.30 bscf/d, down 0.7% from 1Q94. The largest of Gazprom's subsidiaries, Urengoygazprom and Yamburggazdobysha, which accounted for nearly 79% of the region's production, fared in opposite directions. While the former reduced its output by more than 2%, the latter raised it by nearly 3%. Gas production in Eastern Siberia, at 0.52 bscf/d, was down by almost 8% from 1Q94. At the same time, the Far East was the only Russian region that increased its output above 1Q94, to 0.41 bscf/d or by nearly 4%. The rise was entirely due to the better performance of Sakhalin-morneftegaz.

**State enterprises'** production declined to 1.87 bscf/d, over 9% down from 1Q94. The fall in gas output by state-run oil entities (12%) was more tangible than that of gas enterprises (5%). The group's share of total 1Q95 production was about 3%, virtually the same as a year ago. **State-controlled companies** produced 61.06 bscf/d, down 0.8% from 1Q94. More than 97% of this group's output was provided by Gazprom which decreased its production by 0.7% to 59.28 bscf/d. Gas output by "independent" oil companies, at 1.77 bscf/d, fell by more than 2% compared to 1Q94. At the same time, **non-state-controlled entities**, which produce small amounts of oil-well (associated) gas, managed to increase their output by a hefty 26% — almost in line with their gain in oil production.

More than 96% of the total 1Q95 production was represented by **free** gas output, which amounted to 60.52 bscf/d (0.9% down from 1Q94), with the remaining 2.49 bscf/d coming from **associated** gas, whose production declined by more than 4%, reflecting a 6% decrease in gas output by Russian oil producers.

Table 2: NATURAL GAS PRODUCTION IN RUSSIA: 1993-1Q95 (million cubic meters) [1]

	1993	1994	1Q95	$\Delta$ , %	
				1Q94	4Q94
<b>Total</b>	<b>618,173.8</b>	<b>607,369.9</b>	<b>163,474.5</b>	<b>-1.0</b>	<b>1.8</b>
in mmscf/d [2]	58.7	57.7	63.0	-1.0	4.1
<b>By Region:</b>					
<b>European Russia</b>	<b>52,335.7</b>	<b>48,916.1</b>	<b>12,222.4</b>	<b>-5.7</b>	<b>-2.1</b>
<i>North and Northwest</i>	4,855.0	3,793.9	953.4	-13.0	4.2
<i>Volga/Urals</i>	42,794.0	41,112.3	10,347.5	-2.9	-2.4
<i>North Caucasus</i>	4,686.7	4,009.9	921.5	-23.5	-5.1
<b>Asian Russia</b>	<b>565,354.8</b>	<b>557,853.4</b>	<b>151,077.3</b>	<b>-0.7</b>	<b>2.1</b>
<i>Western Siberia</i>	557,387.2	549,958.7	148,669.2	-0.6	2.1
<i>Eastern Siberia</i>	4,763.0	4,782.3	1,355.1	-7.6	4.1
<i>Far East</i>	3,204.6	3,112.4	1,053.0	3.6	10.8
<b>By Institution:</b>					
<b>State Enterprises</b>	<b>19,871.2</b>	<b>18,192.6</b>	<b>4,862.8</b>	<b>-9.4</b>	<b>1.3</b>
<i>Oil Enterprises (Rosneft)</i>	13,522.2	11,776.3	2,898.7	-12.1	-1.6
<i>Gas Enterprises [3]</i>	6,349.0	6,416.3	1,964.1	-5.2	5.9
<b>State-Controlled Companies</b>	<b>597,819.3</b>	<b>588,576.9</b>	<b>158,436.9</b>	<b>-0.8</b>	<b>1.8</b>
<i>Gas Companies (Gazprom)</i>	577,670.0	570,634.7	153,804.4	-0.7	2.0
<i>Oil Companies</i>	19,989.5	17,806.0	4,587.5	-2.1	-3.8
Bashneft [4]	657.5	575.0	143.1	-9.4	-6.3
KomiTEK	629.1	384.9	84.6	-23.6	-9.6
LUKoil	2,225.7	1,819.5	488.4	-0.8	-7.4
ONAKO	1,250.7	1,465.6	388.4	16.3	-2.3
Sidanco	3,381.0	2,385.9	582.1	-15.1	-10.9
Slavneft	768.1	744.4	188.9	13.4	-3.7
Surgutneftegaz	8,530.8	8,100.6	2,120.8	-1.6	-0.1
Tatneft	923.1	862.2	215.7	7.6	-6.3
VNK (East Oil Company)	238.6	288.6	89.8	12.8	5.4
YUKOS	1,384.9	1,179.3	285.7	-6.5	-7.5
<i>Russian Fuel Company (Rostoprom)</i>	159.8	136.2	45.0	-15.1	11.1
<b>Non-State-Controlled Entities [5]</b>	<b>483.3</b>	<b>600.4</b>	<b>174.8</b>	<b>25.7</b>	<b>8.0</b>
<b>By Product:</b>					
<b>Free Gas</b>	<b>589,783.7</b>	<b>581,978.0</b>	<b>157,026.3</b>	<b>-0.9</b>	<b>2.0</b>
<b>Associated Gas</b>	<b>28,390.1</b>	<b>25,391.9</b>	<b>6,448.2</b>	<b>-4.4</b>	<b>-3.4</b>

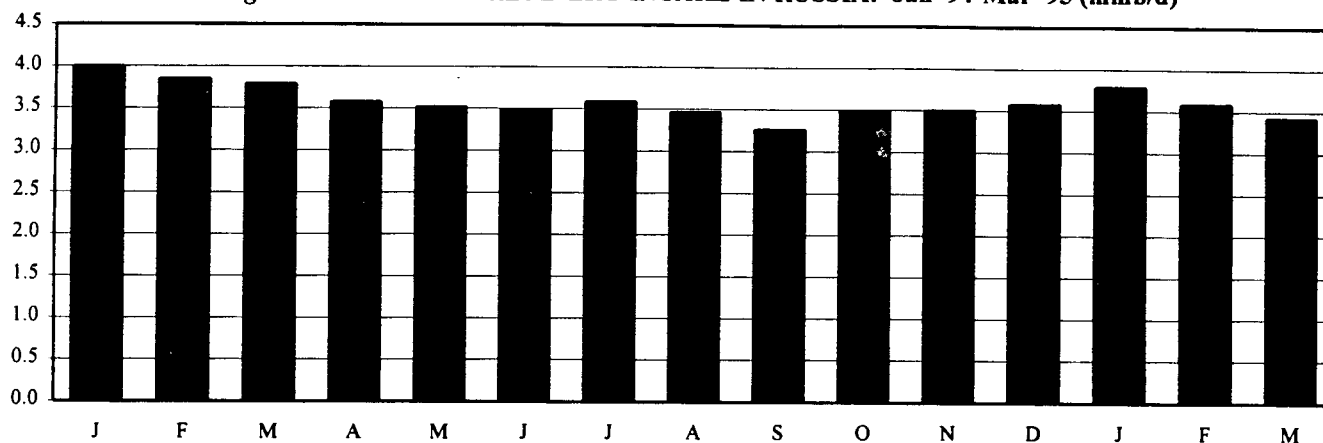
[1] Under the Russian standard conditions (20° C and 760 mm Hg). [2] Under the U.S. standard conditions (60° F and 30 in. Hg). [3] See Footnote 2 in Table 1. [4] Includes Ishimbayneft. [5] See Footnote 5 in Table 1.

### 3. Refining

In 1Q95, total Russian refinery throughput amounted to 3.60 mmb/d (44.3 mmt), 7% less than in 1Q94 (see Table 3). This level was, however, over 2% higher than in 4Q94. Utilization of available refinery capacity, at 59%, has not changed noticeably from the preceding quarter but was palpably less than nearly 63% recorded a year ago. On a monthly basis, total refinery runs showed quite a rapid decline from 3.79 mmb/d in January to 3.43 mmb/d in March from 3.79 mmb/d in January, which represented a peak of the

cyclical development observed in the national refining sector since last October. In turn, the depressed March intake almost hit the all-time low level recorded in September 1994 (see *Figure 3*).

*Figure 3: MONTHLY REFINERY INTAKE IN RUSSIA: Jan '94-Mar '95 (mmb/d)*



The cyclical patterns were essentially determined by refining developments in **European Russia**, which processed 2.69 mmb/d of oil in 1Q95, 9% less than in 1Q94 and 4% more than in 4Q94. The area accounted for nearly 75% of the total Russia refinery runs in 1Q95, as against over 76% a year ago. Refinery throughput in the Volga/Urals region was 1.79 mmb/d in 1Q95, and the region's share of European Russia's refinery runs exceeded 66%. Refineries in the Central region processed 0.58 mmb/d of oil, contributing 21% of European Russia intake. The North/Northwest region refined 0.27 mmb/d (10% of the area total), with capacity utilization at a low 53%. It is worth to note that in February several refineries in the North/Northwest and Central regions had to cut their crude inputs significantly due to extremely high refinery stocks of straight-run furnace fuel oil (*mazut*) which reached up to one-third of its monthly production. The observed build-up in *mazut* stocks was mainly caused by a ban on exports of furnace fuel oil introduced by the Russian government from December 1, 1994, until April 1, 1995. Relatively warm weather conditions and high product prices compounded the problem by restraining inland use of the overabundant *mazut*. In turn, refining activity in the North Caucasus region was adversely affected by the ongoing military conflict in Chechnya that put the republic's refining facilities out of operation. As a result, only 0.05 mmb/d of oil, or less than 2% of European Russia total, was processed in this region in 1Q95, down 57% down from a year ago.

In contrast, refineries in **Asian Russia** decreased their crude intake by less than 1% and managed to process 0.90 mmb/d. This raised the area's share of the total 1Q95 refinery runs to over 25% compared to less than 24% in 1Q94. Capacity utilization, at 60%, was higher here than in Russia as a whole and, unlike in the European part of the country, the March level of refinery throughput was 4% higher than in January. West Siberian refineries accounted for about 41% of the area's total and processed 0.37 mmb/d of oil, down 3% from 4Q94. East Siberia refined 0.45 mmb/d, 3% more than a year ago, and increased its share of the area's total to 50%. The better-than-elsewhere results were affirmed by the highest rate of capacity utilization in the region (75%). However, the observed recovery in Asian refining was inhibited by poor performance of Far Eastern refineries, which processed only 0.08 mmb/d of oil, more than 26% down from 4Q94. The two obsolete and worn-out processing facilities at the region's two refineries were utilized at a low 34%. As a result, its share of Asian Russia throughput dropped in 1Q95 to less than 9% from 15% in 1Q94.

Table 3: REFINERY INTAKE IN RUSSIA: 1993-1Q95 ('000 tonnes)

	1993	1994	1Q95	Δ, %	
				1Q94	4Q94
<b>Total</b>	<b>217,710.1</b>	<b>179,077.1</b>	<b>44,265.3</b>	<b>-7.1</b>	<b>0.0</b>
in '000 b/d	4,366.3	3,591.4	3,602.6	-7.1	2.3
<b>By Region:</b>					
<b>European Russia</b>	<b>165,507.8</b>	<b>133,994.4</b>	<b>33,152.1</b>	<b>-9.1</b>	<b>1.8</b>
North and Northwest	18,615.3	14,432.6	3,374.5	-12.6	-12.3
Central	34,696.3	27,440.8	7,061.9	-6.2	2.3
Volga/Urals	104,522.6	88,390.9	22,090.5	-6.4	4.3
North Caucasus	7,673.6	3,730.1	625.2	-57.3	-1.0
<b>Asian Russia</b>	<b>52,202.3</b>	<b>45,082.7</b>	<b>11,113.2</b>	<b>-0.8</b>	<b>-4.9</b>
Western Siberia	21,128.5	17,857.0	4,583.1	8.4	-4.9
Eastern Siberia	23,227.5	22,067.4	5,538.4	3.6	1.0
Far East	7,846.3	5,158.3	991.7	-39.0	-28.2
<b>By Institution:</b>					
<b>State Enterprises</b>	<b>114,704.8</b>	<b>91,357.7</b>	<b>21,979.4</b>	<b>-12.3</b>	<b>-1.0</b>
Oil Enterprises	110,729.0	88,456.2	20,679.0	-13.6	-4.5
Bashneftkhimzavody	22,021.3	20,595.3	4,720.7	-9.0	-2.0
Rosneft	88,707.7	67,860.9	15,958.3	-14.9	-5.2
Gas Enterprises [1]	107.8	104.0	35.6	20.7	11.9
Petrochemical Enterprises (Roskhimneft)	3,868.0	2,797.5	1,264.8	16.4	138.1
<b>State-Controlled Companies</b>	<b>102,969.4</b>	<b>87,378.2</b>	<b>22,163.9</b>	<b>-1.6</b>	<b>0.9</b>
Oil Companies	100,125.8	84,325.3	21,112.7	-2.9	0.0
KomiTEK	3,573.7	2,964.4	750.0	-2.6	-4.6
LUKoil	18,752.5	17,103.8	4,640.8	11.5	-0.6
ONAKO	4,766.1	4,340.1	1,037.6	3.5	-12.9
Salavatnefteorgsintez	8,167.5	6,078.1	1,884.2	-0.9	37.8
Sidanco	23,081.4	19,401.1	4,524.9	-2.1	-5.0
Surgutneftegaz	15,041.6	11,468.2	2,624.5	-15.1	-14.3
VNK (East Oil Company)	5,711.5	5,034.9	1,408.8	11.0	9.9
YUKOS	21,031.5	17,934.7	4,241.9	-13.9	6.5
Gas Companies (Gazprom)	2,723.6	2,910.5	1,018.0	35.4	23.4
Russian Fuel Company (Rostoprom)	120.0	142.4	33.2	11.8	-12.9
<b>Non-State-Controlled Entities [2]</b>	<b>35.9</b>	<b>341.2</b>	<b>122.0</b>	<b>44.2</b>	<b>50.2</b>

[1] See Footnote 2 in Table 1. [2] See Footnote 5 in Table 1.

**State enterprises** were responsible for almost all of the decline in refining activity in 1Q95. They processed 1.78 mmb/d of oil, over 12% less than in 1Q94. Consequently, their share of Russia's total refinery intake dropped below 50% from over 52% a year ago. Rosneft-controlled refineries cracked 1.30 mmb/d, utilizing 57% of available capacity and covering 81% of oil output by Rosneft oil producers. Three major state-run refineries, comprising the Bashneftkhimzavody association of Bashkortostan, processed 0.38 mmb/d of oil, corresponding to 103% of the republic's oil production. However, they utilized only 44% of their capacity, considerably lower than Russia's average (59%).

At the same time, the contraction in the refining activity of **state-controlled companies** was rather insignificant. In 1Q95 they processed 1.80 mmb/d of oil, down less than 2% from 1Q94. As a result, their

share of total refinery intake increased from less than 48% to about 50%. The seven integrated companies with oil-processing facilities in Russia refined 1.57 mmb/d, equalling 52% of their oil production. Their refineries' utilization varied mainly between 54% and 58%, with the two remarkable exceptions: LUKoil and VNK, which operated at 81% and 85% of available capacity respectively. This is explained by technological advantages of their more sophisticated refineries, as well as by their more efficient management. Not surprisingly, in 1Q95 these two companies increased their refinery intake by 12% compared to 1Q94, while refinery runs of all other integrated companies declined over the same period by 13%. In turn, Gazprom processed about 83,000 b/d of crude and condensate, a surge of 35% over 1Q94.

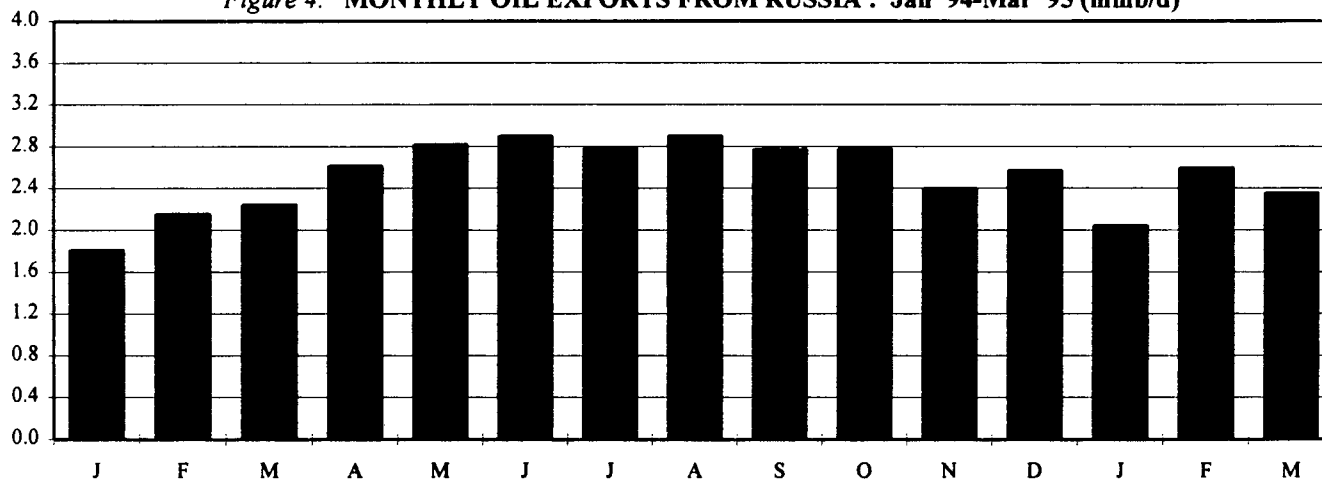
An even larger relative gain was achieved by the **non-state-controlled entities**, which refined in 1Q95 44% more oil than a year ago (though still a mere 9,900 b/d).

## 4. Exports

### 4.1. Crude Oil

In 1Q95 total crude oil exports from Russia amounted to 2.32 mmb/d (28.6 mmt), up 12% over 1Q94 (see Table 4). At the same time, monthly quantities of Russian oil exports showed sharp swings: it surged from 2.04 mmb/d in January to 2.60 mmb/d in February, and slid down to 2.36 mmb/d in March (see Figure 4).

Figure 4: MONTHLY OIL EXPORTS FROM RUSSIA : Jan '94-Mar '95 (mmb/d)



Russia's crude oil exports **inside the FSU** declined to 0.53 mmb/d, by 13% compared to 1Q94. Consequently, the FSU's share of overall Russian exports fell to 23% from 29% a year ago. The lowest (and all-time low) level of exports to the "near abroad", at 0.37 mmb/d, was recorded in January, which reflected Russia's reluctance to deliver crude to its indebted neighbors, and in particular Ukraine [4]. Export deliveries to the ex-Soviet neighbors progressively increased in February and March, due to higher duty-free exports to Belarus and Kazakhstan, members of the newly established trilateral customs union (see Section 6.2).

Russian exports **outside the FSU** rose in 1Q95 to 1.80 mmb/d, up nearly 23% over 1Q94. The "far abroad" received 77% of Russia's total exports, against 71% a year ago. January and March levels were virtually equal, remaining at a fairly low 1.67 mmb/d, while in February exports reached 2.07 mmb/d.

Table 4: CRUDE OIL EXPORTS FROM RUSSIA AND OTHER FSU COUNTRIES: 1993-1Q95 ('000 tonnes) [1]

	1993	1994	1Q95	$\Delta$ , %	
				1Q94	4Q94
<b>Total</b>	<b>134,059.9</b>	<b>132,918.8</b>	<b>29,663.6</b>	<b>11.4</b>	<b>-12.2</b>
in '000 b/d	2,681.2	2,658.4	2,406.0	11.4	-10.3
<b>By Source:</b>					
From Russia	127,419.1	128,521.6	28,637.7	12.5	-12.9
– inside FSU	47,707.3	37,630.2	6,489.9	-12.8	-34.9
– outside FSU	79,711.8	90,891.4	22,147.8	22.9	-3.4
Other FSU Countries [2], [3]	6,640.8	4,397.2	1,025.9	-12.3	13.3
<b>By Destination:</b>					
Inside FSU [4]	47,707.3	37,630.2	6,489.9	-12.8	-34.9
Outside FSU	86,352.6	95,288.5	23,173.7	20.7	-2.7
<b>By Means of Transportation:</b>					
Pipeline	85,004.8	79,046.9	17,048.6	-0.9	-18.4
– inside FSU [5]	47,707.3	37,630.2	6,489.9	-12.8	-34.9
– outside FSU [6]	38,512.0	41,416.7	10,558.7	8.2	-3.2
Sea [3]	47,840.6	53,871.9	12,615.0	33.6	-2.3

[1] Excluding exports that by-pass Transneft's pipeline system (1Q95 exports by-passing Transneft included 120,100 tonnes to non-FSU countries and 37,800 tonnes to Lithuania); including export deliveries designated for processing deals. [2] In transit through Russia, and from countries west of Russia. [3] Outside FSU only. [4] From Russia only. [5] Including minute quantities exported by rail and sea. [6] Including 137,600 tonnes exported to North Korea in 1993.

Export operations during January were adversely affected by two factors. First, poor implementation of new export rules (see *Section 6.2*) seriously restricted the actual export possibilities of joint-ventures. In January they managed to export a miserable 0.04 mmb/d, almost three times less than a year ago. Second, Ukraine's branch of the Druzhba oil pipeline (which is used to export Russian crude to Hungary, Slovakia and the Czech Republic) was closed during the first third of January due to Russia's resistance to a four-fold increase in pipeline transit charges, which was arbitrarily introduced by Ukraine, effective January 1, 1995. Export deliveries resumed on January 12, when a smaller increase in the transit tariff (from US\$1.30/t to US\$4.53/t) was agreed upon in bilateral negotiations. In turn, the March decline in exports was partially caused by delays in reallocating export pipeline space after the government issued Decree No.209 of February 28 (see *Section 6.2*), which eliminated the priority of exports for federal needs over ordinary export supplies. Besides, March exports were restrained by the start of repairs to a pipeline that feeds Russia's main oil terminal at the seaport of Novorossiysk. Furthermore, oil traders reported more red-tape delays in obtaining contract approvals and customs permits. Finally, owing to ample deliveries via the Druzhba pipeline in February, most East European buyers of Russian crude, having fully replenished their oil stocks, began to restrict further receipts scheduled for March. For all these reasons, actual March exports were almost 0.3 mmb/d lower than what was originally allocated for shipments via Transneft network to outside the FSU.

All in all, exports to the "far abroad" through Transneft's oil transportation system totalled 1.88 mmb/d in 1Q95, with Russian exporters accounting for 96% and the other FSU suppliers (almost exclusively Kazakhstan) providing the remaining 0.08 mmb/d (a 13% drop from 1Q94). Almost 46% of the total (0.86 mmb/d) was exported via the Druzhba pipeline, whose capacity (estimated at 1.0 mmb/d) was almost fully

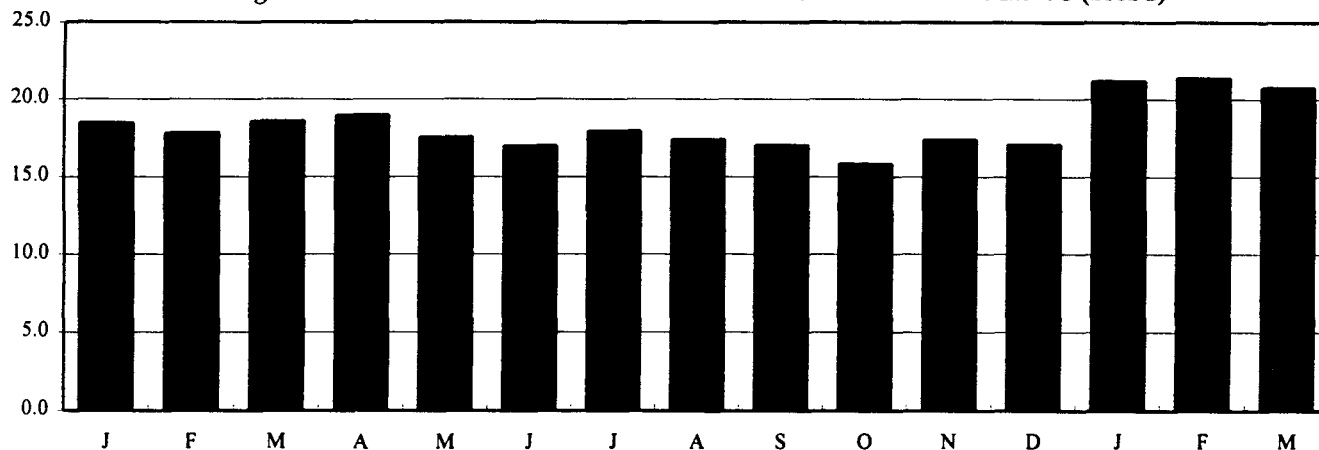
utilized in February when pipeline deliveries rose to 0.98 mmb/d. Seaborne exports amounted to 1.02 mmb/d and exceeded the 1Q94 level by more than one-third.

Besides, some amount of Russian crude exports originated from oil fields that have independent export outlets (Sakhalin Island, the Kaliningrad enclave and the Arctic seas) and by-passed Transneft's transportation system. In 1Q95, almost 10,000 b/d of such exports were destined for the "far abroad" and about 3,100 b/d for Lithuania.

#### 4.2. Natural Gas

In 1Q95 Russian export supplies increased to 21.10 bscf/d (54.75 bcm), a surge of more than 15% compared to 1Q94 (see *Table 5*). Monthly fluctuations were less than 3% of the quarterly average, with a peak of 21.38 bscf/d falling in February (see *Figure 5*).

Figure 5: MONTHLY GAS EXPORTS FROM RUSSIA: Jan '94-Mar '95 (bscf/d)



Some 60% of the quarterly increase over 1Q94 was due to larger exports **inside the FSU**. Deliveries to the "near abroad" amounted to 9.60 bscf/d, up 21% from 1Q94. As a result, the FSU countries received 45% of total Russian exports, as against 43% a year ago. Moreover, when compared with 4Q94, FSU exports grew by nearly 56%, which cannot be completely explained by the seasonal growth in gas consumption for space heating. The "near abroad" deliveries were boosted by breakthroughs in Gazprom's negotiations with some of its main FSU customers on recovering their debts for past deliveries. In particular, some of Gazprom's debtors have agreed to exchange their arrears for Gazprom's equity participation in gas transportation and storage facilities in their territories. By now, such preliminary property-for-debt deals have been concluded with Moldova (which owes \$275 million for Russian gas) and Belarus (whose gas debt is \$655 million). Belarus has agreed to host a section of a new transcontinental gas trunkline Yamal — West Europe, which will be owned jointly with Gazprom. As for Ukraine, which enjoyed a 78% increase in Russian gas imports over 4Q94, it has managed to reschedule its US\$2.2 billion debt to Gazprom by spreading its overdue payments over a 12-year period.

Exports **outside the FSU** reached 11.50 bscf/d, up nearly 11% compared to 1Q94 and accounted for 55% of total Russian supplies, up 2 percentage points over the preceding quarter. The biggest relative increase (by 18%) occurred in exports to East European countries, and was due to the improved performance of

Table 5: NATURAL GAS EXPORTS FROM RUSSIA: 1993-1Q95 (million cubic meters) [1]

	1993	1994	1Q95	Δ, %	
				1Q94	4Q94
<b>Total [2]</b>	<b>179.65</b>	<b>184.90</b>	<b>54.75</b>	<b>15.3</b>	<b>23.4</b>
<b>in bscf/d [3]</b>	<b>17.07</b>	<b>17.57</b>	<b>21.10</b>	<b>15.3</b>	<b>26.1</b>
<b>Inside FSU</b>	<b>78.75</b>	<b>79.14</b>	<b>24.90</b>	<b>21.5</b>	<b>52.3</b>
<i>Belarus</i>	<i>16.45</i>	<i>14.30</i>	<i>4.30</i>	<i>-4.4</i>	<i>17.8</i>
<i>Kazakhstan</i>	<i>1.15</i>	<i>0.56</i>	<i>—</i>	<i>-100.0</i>	<i>-100.0</i>
<i>Moldova</i>	<i>3.09</i>	<i>2.98</i>	<i>1.10</i>	<i>10.0</i>	<i>22.2</i>
<i>Ukraine</i>	<i>54.84</i>	<i>57.07</i>	<i>17.60</i>	<i>32.3</i>	<i>74.3</i>
<i>Latvia</i>	<i>1.00</i>	<i>1.08</i>	<i>0.60</i>	<i>50.0</i>	<i>100.0</i>
<i>Lithuania</i>	<i>1.82</i>	<i>2.02</i>	<i>1.00</i>	<i>42.9</i>	<i>19.0</i>
<i>Estonia</i>	<i>0.41</i>	<i>0.77</i>	<i>0.30</i>	<i>0.0</i>	<i>25.0</i>
<i>Georgia</i>	<i>—</i>	<i>0.36</i>	<i>—</i>	<i>0.0</i>	<i>-100.0</i>
<b>Outside FSU</b>	<b>100.91</b>	<b>105.76</b>	<b>29.85</b>	<b>10.6</b>	<b>6.5</b>
<i>Czech Republic &amp; Slovakia</i>	<i>13.23</i>	<i>14.00</i>	<i>3.65</i>	<i>5.2</i>	<i>2.8</i>
<i>Austria</i>	<i>5.33</i>	<i>4.67</i>	<i>1.36</i>	<i>2.3</i>	<i>-5.6</i>
<i>Italy</i>	<i>13.77</i>	<i>13.73</i>	<i>4.29</i>	<i>10.0</i>	<i>9.2</i>
<i>France</i>	<i>11.58</i>	<i>12.20</i>	<i>3.07</i>	<i>5.9</i>	<i>-1.0</i>
<i>Germany</i>	<i>25.68</i>	<i>29.54</i>	<i>7.75</i>	<i>9.2</i>	<i>2.1</i>
<i>Switzerland</i>	<i>0.38</i>	<i>0.60</i>	<i>0.09</i>	<i>-75.0</i>	<i>50.0</i>
<i>Yugoslavia</i>	<i>1.74</i>	<i>2.19</i>	<i>0.60</i>	<i>0.0</i>	<i>-3.2</i>
<i>Hungary</i>	<i>5.79</i>	<i>5.27</i>	<i>1.54</i>	<i>28.3</i>	<i>18.5</i>
<i>Poland</i>	<i>5.84</i>	<i>6.01</i>	<i>1.80</i>	<i>26.8</i>	<i>15.4</i>
<i>Bulgaria</i>	<i>4.81</i>	<i>4.65</i>	<i>1.56</i>	<i>20.0</i>	<i>27.9</i>
<i>Romania</i>	<i>4.61</i>	<i>4.47</i>	<i>1.77</i>	<i>36.2</i>	<i>16.4</i>
<i>Turkey</i>	<i>5.03</i>	<i>5.02</i>	<i>1.35</i>	<i>10.7</i>	<i>9.8</i>
<i>Finland</i>	<i>3.11</i>	<i>3.41</i>	<i>1.02</i>	<i>13.3</i>	<i>13.3</i>

[1] Under the Russian standard conditions (20° C and 760 mm Hg). [2] Including Turkmen gas in transit. [3] Under the U.S. standard conditions (60° F and 30 in. Hg).

their economies. Gas deliveries to Germany were jacked up, by 9% over 1Q94, owing to successful operation of Gazprom/Wintershall joint-venture. In turn, higher exports to Italy (up 10% over 1Q94) reflected the start of compensation for modernizing Russia's gas network, rendered to Gazprom by SNAM/Nuovo Pignone.

## 5. Prices

### 5.1. Crude Oil

In 1Q95, domestic prices for crude oil experienced a dramatic upsurge caused by accumulated cost inflation, temporary shortages in domestic oil supplies and the liberalization of Russian oil exports (see Section 6.2).



By the end of 1Q95, the average monthly level of **contract prices** rose by 86% over December 1994, which was considerably higher, than the 1Q95 growth of wholesale price index (WPI), at 58%, and an observed increase in the rouble-dollar exchange rate, at 40%. On a monthly basis, crude oil prices in January averaged Rbl 135,000 per tonne (up 35%), in February Rbl 159,000/t (up 18%) and in March Rbl 186,000/t (up 17%). [Note: Domestic oil prices are presented on a wellhead basis and are exclusive of value-added tax (VAT) and special tax (ST)]. Over the same period, monthly growth rates of WPI were 22%, 17% and 11% respectively. Consequently, in real terms contract prices grew by 10.4% in January, by 0.7% in February and by 5.4% in March. It is noteworthy that the January and March price hikes reflected (with a typical one-month lag) oil shortages that occurred in December 1994 and February 1995 when the gap between the domestically available crude oil (calculated as the difference between oil production and exports) and refinery intake narrowed to a mere 0.1 and 0.3 mmb/d respectively compared to the usual 0.6 mmb/d. In dollar terms, the average contract price reached in March US\$5.35/b, up 33% compared to December 1994.

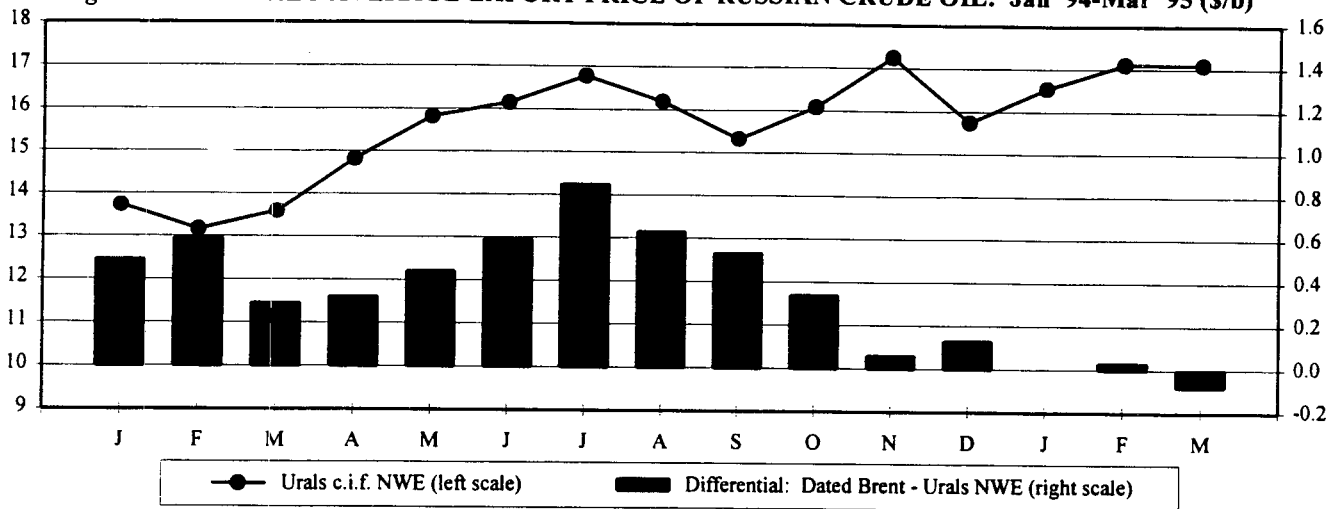
Exchange transactions, which define the levels of **spot prices**, were extremely rare and small-scale in 1Q95. As a matter of fact, given ample supplies of oil available directly from producers, "wet barrel" trade at Russian commodity exchanges proved too troublesome, inefficient and redundant, while "paper barrel" (futures) trade has not developed yet due to a lack of the necessary market infrastructure. The only physical transaction with 30,000 tonnes (about 220,000 barrels) of crude sold through the Moscow Oil Exchange in January depicted the price level of Rbl 212,000/t.

In March, the last pillar of the state regulation of crude oil prices — the 50% profit-to-cost cap on prices (see *ROGM*, 1995, Issue 1, Section 5.1) was demolished. On March 7, 1995, the government issued a decree (No.239) On Measures of Putting in Order the State Regulation of Prices (Tariffs) which elaborated a related presidential edict of the same name (No.221 of February 28) and freed domestic prices for crude oil from any kind price control both on federal and local levels, retroactive from March 1, 1995.

Still, **export prices** for Russian crude remained under partial state control — in the case of exports destined for member countries of the Commonwealth of Independent States (CIS) which unites all the ex-Soviet republics except the three Baltic states. Effective from April 1, 1995, a permissible minimum for export (border) prices of crude oil (including condensate) delivered to the CIS was fixed for the next three months at \$112/t (inclusive of all due Russian charges), as against \$110/t "prescribed" as a floor for the CIS exports during the first three months of 1995. The minimum prices, used to prevent dumping, are evaluated in roubles or (acceptable) local currencies at exchange rates set by the RF Central Bank on the 15th of the month preceding the delivery. The price floor, which is determined in cooperation between the Russian ministries of economy and of fuel and energy, does not apply to CIS exports under intergovernmental agreements. For instance, under the latest trade protocol between Russia and Ukraine, the latter is to pay world prices with the exception of heavy, high-sulfur crudes from Tatarstan which are purchased at a 20% discount.

As for exports to the "far abroad", they were mainly priced in relation to Dated Brent, though at smaller and even positive differentials. The strong fuel oil markets and lack of sour, heavy crudes in Western Europe narrowed the traditionally negative differential between the spot prices of Urals blend c.i.f. NWE and Dated Brent, from minus an average \$0.15/b last December to zero in January and turned it over to an average premium of \$0.08/b in March (see *Figure 6*).

Figure 6: MONTHLY AVERAGE EXPORT PRICE OF RUSSIAN CRUDE OIL: Jan '94-Mar '95 (\$/b)



Source: Bloomberg LP Database

## 5.2. Natural Gas

The above-mentioned government decree has not changed the existing order of the state control of domestic prices for natural gas which remains among a few goods and services subject to direct price regulation by the State.

During the first two months of 1995, wholesale prices for the **industry** were tied to overall inflation rates and, as such, increased from Rbl 73,773/1,000 cm last December [5] to Rbl 82,626/1,000 cm in January and to Rbl 92,541/1,000 cm in February (exclusive of VAT, ST and distribution surcharge). In March, the base gas price was revised upward to Rbl 124,015/1,000 cm in connection with the escalation of related excise tax (see *Section 6.3*). Also, the gas distribution surcharge was raised to Rbl 13,794/1,000 cm, which made final sale price for industrial consumers equal to Rbl 137,809/1,000 cm. These new price levels, effective March 1, 1995, were set by Government Decree No.296 of March 27, 1995, On Price of Natural Gas, and were, as usual, indexed to monthly inflation. However, on April 17, the RF Government issued another decree (No.355) which shifted the initial date of the new base price introduction to March 27. As a result, average wholesale price for industrial gas in March was lower than it was envisaged — at an estimated Rbl 111,600/1,000 cm. In real terms, the WPI-deflated price was by about 5% lower in March compared to last December. However, in dollar terms, the price increased to US\$0.68/1,000 scf, or by 8% over December 1994.

Final sale prices for **households** remained at a flat, low level of Rbl 2,460/1,000 cm (including VAT and ST) during the first two months of 1995. Then, in compliance with the government Decree No.208 of February 28, 1995, On the State Regulation of Price for Natural Gas, the price was raised to Rbl 20,000/1,000 cm, effective from March 1. In dollar terms, the price rose to US\$0.12/1,000 scf, or by 5.8 times compared to December 1994, while if adjusted by the Consumer Price Index, it increased by 5.7 times over the same period. Furthermore, in line with a subsequent government decree of March 27 (No.297), a new wholesale industry price of natural gas destined for households was fixed at Rbl 7,000/1,000 cm (exclusive of VAT and ST), thus leaving Rbl 13,000/1,000 cm as a gross surcharge for gas distributors (resellers).

## 6. Other Developments

### 6.1. Legislation

On January 1, 1995, the new RF **Civil Code** was put into force. With regard to upstream oil and gas legislation, the Code lists plots of subsoil as real estate for the first time (prior to that, subsoil was not the subject of civil legislation). Thus, all activities involving subsoil use will be subject to civil laws rather than to administrative acts. However, the Code stipulates that specific laws (such as the Law on the Subsoil) may restrict free civil circulation of the subsoil and land plots.

On January 16, 1995, the **Draft Law on Oil and Gas** was rejected by the State Duma (lower chamber of the Russian parliament) on the grounds that many of its provisions virtually repeat and, in some cases, conflict with the new edition of the Law on the Subsoil which was being reworked at that time (see below). Any further discussion of this bill, containing provisions on the ownership of hydrocarbon resources and open access to pipelines, was indefinitely postponed.

On February 24, 1995, the long-awaited **Draft Law on Production Sharing Agreements (PSAs)** was passed by the Duma in the first reading [6]. The adopted version of the law explicitly states that its provisions are universally applicable, even if they contradict other laws (including those on the subsoil use and on foreign investments). It stipulates that PSAs can be concluded both with foreign and Russian investors for a maximum of 25 years, and considerably simplifies the tax regime: investors are requested to pay royalty, profit tax, value-added tax (VAT) and special tax (ST). Both VAT and ST are fully refundable in case of export, while all other (numerous) fiscal charges (including federal, regional and local taxes and duties) are not payable at all as they are accounted for in the agreed split of profit output. Besides, the bill provides immunity to unfavorable changes in legislation and taxation (godfather clause), and protects investors' rights, spelled out in PSAs, from being restricted by subsequent federal, regional and local laws. In turn, investors may assign their exploration and production rights to third parties after notifying the government.

In some cases, the draft law on PSAs is at odds with the recently adopted new edition of the law on the Subsoil (see below). In particular, it specifies that exploration and production licenses can be obtained not only through tenders and auctions, but also on the order of the federal government or regional/local administrations. Moreover, licenses are to be issued after concluding the PSA, and that they should be re-issued each time the PSA is prolonged.

Also on February 24, the Duma rejected the **Draft Law on Concession Agreements**, stating that all the principal issues of licensed subsoil use are already regulated by the Law on the Subsoil, which does not list concession as a possible form of subsoil use.

On March 3, 1995, President Yeltsin enacted the **Law on Amending and Supplementing the Law on the Subsoil** (No.27-FZ). It was reworked by the Duma's experts to comply with objections and suggestions of the President, who vetoed an earlier draft two months ago (see *ROGM*, 1995, Issue 1, Section 6.1). In contrast to its previous version, the new law makes a strict distinction between the license and the license

agreement. While the former is now understood as the State's permission to use the subsoil (and is to be normally issued immediately to the declared winner(s) of a tender or an auction), the latter is the contract between the State and the licensee and is therefore fully negotiable after the issuance of the license.

Drafts of the **Law on Amending and Supplementing the Law on Foreign Investments** may be presented for their first reading in the Duma in April. The new law is aimed at replacing a number of the President's and government's acts on foreign investments and is to settle the following matters which are of vital importance to foreign investors in Russia's oil and gas industry: the definition of priority industries and territories to which preferential treatment of foreign investments would be provided; the introduction of a grandfather clause; the development of a mechanism of granting export duty exemptions and privileges.

## **6.2. Export Control**

From the beginning of the year, new export-control regulations were mainly directed at clarifying and implementing the Government Decree of December 31, 1994, on Exports of Crude Oil and Oil Products Outside the Customs Territory of the Russian Federation (see *ROGM*, 1995, Issue 1, Section 6.2), in line with the general move towards liberalization of foreign trade — the move which encountered resistance of some executive and legislative authorities.

On January 18, 1995, the RF Ministry of Fuel and Energy issued a directive (No.YuSh-8) **On Providing Access to Trunk Pipelines for the Purpose of Exporting Oil to Enterprises That Are Not Subsoil Users**. It stipulates that companies not holding oil production licenses (*e.g.*, service joint ventures) should obtain the producer's (license-holder's) agreement to assign a part of its own export pipeline space as payment for their services. Since this procedure involves a number of complicated formalities, only 21 out of some 30 regularly exporting joint ventures were listed in the January export schedule. This number grew to 27 JVs in February and to 30 JVs in March.

On January 28, 1995, a trilateral **customs union** was officially set up between Russia, Belarus and Kazakhstan to provide for the tariff-free trade of goods (including energy resources) among its participants, with effect from January 1, 1995.

On January 30, 1995, the RF Government issued a decree (No.94) **On the Interdepartmental Commission on Regulations of Issues Related to the Use of the System of Trunk Crude Oil Pipelines, Oil-Product Pipelines, and Seaport Terminals for Exporting Crude Oil and Oil Products Outside the Customs Territory of the Russian Federation**. According to this decree, the function of this commission was to finalize the quarterly oil export schedules developed by the RF Ministry of Fuel and Energy. In doing so, the commission was to give priority to oil exports for federal needs and ensure sufficient oil supplies to the domestic market. Besides, it must appoint the executors of inter-governmental oil export arrangements and develop the procedures of transferring rights of pipeline access to third parties.

At the first meeting of the interdepartmental commission, held on February 20, 1995, it was decided that **joint ventures** could export 100% of their own oil production outside the FSU. Prior to this decision, it was expected that enterprises with foreign investments (likewise any other Russian exporters) were to sell

the bulk of oil produced on the internal and FSU markets, since scheduled exports were allowed only after the fulfillment of "recommended" domestic supply commitments.

Furthermore, the commission determined that permissible deliveries of crude oil designated for **processing deals** (so-called "temporary exports") should be generally destined for the FSU states only (apparently due to the difficulties in controlling and ensuring the return to Russia of oil products manufactured at Western refineries).

On February 28, 1995, the RF Government issued a decree (No.209) **On Regulating Access to the System of Trunk Crude Oil Pipelines, Oil-Product Pipelines, and Seaport Terminals for Exporting Crude Oil and Oil Products Outside the Customs Territory of the Russian Federation**. It drastically alters the earlier adopted oil export regime: severs the link between domestic and export supplies; eliminates priority export supplies for federal needs; establishes priority pipeline access to meet the Russia's international obligations; gives priority pipeline access to joint ventures that were granted export tariff privileges to allow them to recoup project investments carried out before 1995; guarantees full acceptance of producers' applications for export pipeline space (provided sufficient space is available); allocates deficient pipeline space in proportion to an applicant's oil production in a previous quarter; provides for the unrestricted transfer and sale of pipeline space (the right of pipeline access) from producers to third parties. The issue of access to available export facilities was further clarified in an instructive letter by the RF State Customs Committee (GTK) of March 21 (No.01-13/3896), which explains that the exclusive (but transferrable) right of exporting crude oil and oil products given to their producers does apply to only pipelines and seaport terminals — in case of using other means of transport (rail, road, river, etc.) oil exports may be carried out by any legal or natural persons.

Also on the same day, President Yeltsin issued an edict (No.220) **On Certain Measures of State Regulation of Natural Monopolies in the Russian Federation**. It provides for the establishment of the Federal Service on Regulating Natural Monopolies in the RF Fuel and Energy Complex (such as transportation of crude oil, oil products and natural gas by pipelines and through seaport terminals). It is assumed that, when officially established, the Service will probably replace the above-mentioned interdepartmental commission on the use of oil export facilities.

On March 6, 1995, the President signed another important edict (No.245) **On the Basic Principles of Carrying Out Foreign Trade Activity in the Russian Federation**. Effective from March 25, it abolishes the previously required registration of vital commodity exporters at the RF Ministry of Foreign Economic Relations (MVES) and consequently abrogates the institution of "special exporters"; forbids export restrictions in the form of obligatory domestic supplies; and restricts the introduction of export quotas and exports for federal needs to the cases when required to meet the RF international obligations. On March 30, however, the State Customs Committee (GTK) issued a directive extending the licenses of special exporters for three months (until June 25). Although the directive could not prohibit "independent" exports, it implies that during the specified period special exporters would be free from a number of time-consuming export formalities (such as signing an obligation to repatriate export revenues, certifying it at the Ministry of Foreign Economic Relations, removing all related accounts into one of authorized banks, etc.).

On March 13, 1995, the **Federal Law On Some Issues of Granting Privileges to the Participants in Foreign Economic Activity** (No.31-FZ) was enacted with the signature of the RF President. Effective from March 15, it cancels all forms of previously granted export privileges, with the exception of those given in accordance with RF Laws On the Customs Tariff, On the Value-Added Tax, On Excise Duties, and the RF Customs Code. However, since the Law on the Customs Tariff specifies that the Government can define specific conditions under which foreign trade privileges are granted, the oil-producing JVs that received exemptions from export duties (see *Section 6.3*) under the requirements of the RF Government Decree of May 19, 1994, On Tariff Privileges for Oil Exports of Joint Ventures' Own Production (see *ROGM*, 1995, Issue 1, Section 6.3), were not adversely affected by the new law.

At the same time, it appeared as if the legislature tried to counteract the presidential edicts and governmental decrees aimed at liberalizing the country's foreign trade regime. Thus, last February the State Duma passed through its first reading the **Draft Law On the Foreign Economic Activity**. The draft permits the use of non-tariff restrictions on foreign trade such as the rejectable registration of vital commodity exporters, export quotas, and state monopoly over exports of some (unspecified) goods. Additionally, according to the draft law, the Duma intends to empower itself with the right to determine export duty rates — a power that is now wielded by the government.

### 6.3. Taxation

On February 28, 1995, the RF Government exempted seven more joint ventures from the export (Decree No.282-r). In most cases, the exemptions were granted for the whole year, retroactive from January 1, 1995 (see also *Section 6.5*).

Effective from March 1, 1995, by virtue of Government Decree No.208 of February 28, 1995, On the State Regulation of Natural Gas Price, the **excise duty** on the production of natural gas was increased from 15% to 25% of its wholesale industry price (excluding value-added tax and special tax but including the excise duty itself). Consequently, new base prices of natural gas for domestic consumers were calculated and introduced (see *Section 5.2*). In addition, in accordance with a government decree of March 29 On Export and Excise Duties on Crude Oil Produced on the Territory of the Russian Federation (No.304), beginning from April 1, the average excise duty rate levied on the production of crude oil was set at Rbl 39,200/t (US\$8.00/t). To allow for the depreciation of the rouble, the duty rate will be regularly (monthly) adjusted in line with Rbl/US\$ exchange rate. Further, the decree requests the application of varying duty rates for individual oil-producing companies. However, the differentiated rates have not yet been developed. In 1Q95, the weighted average excise duty on Russian oil amounted to Rbl 21,600/t (US\$5.05/t).

Moreover, the above decree has set up a mechanism linking export and excise duties rates. For every 1.00 ECU/t cut in the export duty the weighted average excise duty is to be raised by Rbl 3,400/t (US\$0.70/t as of April 1). Therefore, accounting for the current production-export patterns of Russian oil sector, a further 10% decrease in the present export duty rate would actually mean an almost 2% rise in the total amount of export and excise duties, that Russian oil producers will have to pay.

Effective April 1, 1995, the **export duty** on crude oil was reduced from 23.00 to 20.00 ECU/t [7]. It is noteworthy that the reduction has decreased the duty rate to a level below what had been earlier agreed

upon between the Russian government and the International Monetary Fund. The RF-IMF schedule was to lower the duty to 21 ECU/t for 2Q95, and then to 19.0 ECU/t for 3Q95 and 17.6 ECU/t for 4Q95.

Also effective from April 1, in compliance with a federal law of February 23, 1995 (No.25-FZ), the **special tax** rate was reduced from 3% to 1.5% of gross sales proceeds. Furthermore, the law stipulates that this tax must be completely abolished by the beginning of 1996.

On April 25, 1995, the **Law on Amending and Supplementing the RF Law on the Tax on Profit of Enterprises and Organizations** was put into force. It specifies a lower ceiling for the "regional" part of the **profit tax** — 22% instead of 25% before. The new tax cap is effective from January 1, 1995.

Meanwhile, legislators of some oil-producing regions, aiming to attract foreign investments, have been independently reshaping their local fiscal regimes. For example, in January 1995, the **Sakhalin** Region reduced its portion of the profit tax from 25% to 22% for companies participating in Sakhalin oil and gas development projects. In February 1995, the autonomous **Komi** Republic adopted a law providing new foreign-backed projects with 50-percent reduction in the republic's profit tax. The tax allowance may be used until payback is reached but, generally, no longer than for 3 years after the beginning of a project (unless the latter is given a special republican status which can extend the preferential tax regime to 10 years). The above tax initiatives followed similar move made last October by the **Tatarstan** Republic which granted to JVs (with no less than 30% foreign participation) a 3-year tax holiday on its portion of the profit tax.

#### 6.4. Management

By the start of 1995, the persistent attempts by federal authorities to seize control of the Tatarstan oil industry proved futile, and the republican oil-producing enterprise **Tatneft** was officially recognized as an independent regional oil company [8]. The company is regarded as the core of the republic's oil-related conglomerate, **Tatneftekhiminvest Holding**, which was set up by Tatarstan's President in November 1993. This holding group includes, among others, the Nizhnekamskneftekhim petrochemical complex (also known as Roskhimneft), the Tatnefteprodukt distribution company, and the North-Western Oil Trunkline association. Furthermore, in December 1994, the Presidents of Tatarstan and Ukraine signed decrees providing for the establishment of a transnational, closed-type joint-stock company **Ukrtatnafta**, combining Tatneft, Ukraine's refinery in Kremenchug (JSC Kremenchugnefteorgsintez) and some other Tatar and Ukrainian firms (Tatneftekhiminvest, Tatnefteprom, Suvar, Kremenchugnefteprodukt, etc.). Ukraine and Tatarstan will each own 50% of the new company. The size of each party's contribution to the statutory capital is being negotiated. However, it is expected that the latter would be mainly formed of Ukraine's state stake in the Kremenchug refinery and of Tatarstan's stake in two of Tatneft divisions (NGDUs) which produce high-sulfur crudes.

A similar reorganization took place in another autonomous republic, Bashkortostan. In mid-January, **Bashneft**, an oil enterprise operating across this autonomous republic, was registered as a joint-stock company under the republic's privatization laws. Bashkortostan will exercise control over the company through owning 63% of its shares. Furthermore, the related resolution of the republican Committee on the State Property expanded Bashneft's structure by including the JSC Ishimbayneft, which was formerly regarded as a subsidiary of the Moscow-based RMNTK Nefteotdacha (see *ROGM*, 1995, Issue 1,

Appendix B) [9]. In turn, Bashneft is expected to join an emerging integrated oil company, **Bashneftekhim**, which is conceived as an open-type joint-stock holding that would combine all oil-related enterprises of Bashkortostan. As soon as the privatization of these enterprises is completed, Bashneftekhim (or Bashkirskaya Neftekhimicheskaya Kompaniya) will probably also include the republic's refineries (still state-run Bashneftekhimzavody and JSC Salavatnefteorgsintez), oil product distributor (Bashnefteprodukt), petrochemical plants, and related service companies.

On January 24, 1995, the RF Government issued a directive (No.112-r) withdrawing state-owned shares of the JSC **Purneftegaz** from the integrated oil company Sidanco, and transferring them back to the state enterprise Rosneft.

At the beginning of February, for the first time the State exercised its shareholding control over formally independent oil companies. Concerned about non-payment crisis, the state representatives on YUKOS board of directors demanded that all questions relating to crude and products trade be handled by the holding company rather than by its subsidiaries.

Also at the start of February, the **Russian Union of Oil Exporters (SONEK)** inaugurated itself in two subsequent presentations in Moscow and London. The union, immediately dubbed Ropec, was officially registered as a public association last November. Initially, it included LUKoil, Komineft, Nafta-Moskva, MES, CONEX, Rosnefteimpex, Alfa-Eco, and Balkar Trading. In March, it was joined by three new members: Roskontrakt, Neftekhimexport and VSNK (East Siberian Oil Co.). The Foreign Economic Relations Minister Oleg Davydov was appointed chairman of the Union which is co-chaired by the First Deputy Minister for Fuel and Energy, Anatoly Fomin. The Union's official goal is to coordinate and to improve the efficiency of Russian oil exports. To this end, it intends to certify domestic oil-exporting companies which would mean unofficial lobbying of their elite's interests and eventual cartelization of the Russian export market by the Union members.

On March 7, 1995, **Sibirsko-Uralskaya Neftegazokhimicheskaya Kompaniya** (Siberian-Urals Oil and Gas Chemical Co.) was established by Government Decree No.214. The company, also called Sibur, has combined the JSC Sibneftegazpererabotka, which specializes in processing of oil-well petroleum gases, and the Perm gas-processing plant. State-owned shares of both the enterprises (38% interest) will be transferred to the statutory capital of the new company, 51% of whose shares will be held as federal property for 3 years.

On March 21, 1995, in accordance with Government Decree No.275, the state enterprise Kalmneft, which produces oil in the territory of the autonomous Republic of Kalmykia, was transferred from federal control to the republic.

On March 22, 1995, the RF Government took another unprecedented regulatory measure which was formalized in a special decree (No.269) **On Measures for State Support to the Open-Type Joint-Stock Society "Oil Company "LUKoil" and Its Subsidiaries**. It allows pledging part of the state-owned company's shares (11% of the company's common stock) as a security for LUKoil's bonds issue in Western stock markets. The bonds would be exchanged for the pledged shares in April 1996, when the three-year period of the federal title to 45% of LUKoil's shares comes to an end.



On April 1, 1995, President Yeltsin signed a long-awaited (and now rather diluted) edict (No.327) **On Immediate Measures to Improve Activity of Oil Companies**. Instead of establishing the Russian National Oil Company (see *ROGM*, 1995, Issue 1, Section 6.4), it transformed the state enterprise (SE) Rosneft into an open-type joint-stock company (JSC) **Rosneft**, but reserved 51% of its shares as federal property for 3 years. The state-owned shares of most privatized oil-producing, refining and distribution companies, which were managed by the SE Rosneft, are to be transferred into the statutory capital of the JSC Rosneft (detailed listing of such subsidiaries is to be defined by a forthcoming government decree). The company did not gain considerable advantages over other oil companies, as it was expected and specified in the draft edict. However, it was assigned three specific functions: managing state-owned shares of those joint-stock companies which have not joined any of the established oil holding companies; ordering R&D work needed to fulfil national oil-related programs; and selling the State's share of oil and gas output obtained under production-sharing agreements.

In addition, the edict requests that the government complete the structural changes in the oil industry by mid-1995. This may result in the founding of a new oil company — Tyumenskaya Neftyanaya Kompaniya (Tyumen Oil Company), incorporating two major oil producers — Nizhnevartovskneftegaz and Tyumenneftegaz, as well as the Ryazan refinery. At the same time, it is expected that more oil producers (presumably, Permneft, Nizhnevolskneft and Kaliningradmorneftegaz) will join LUKoil and that YUKOS will annex Samaraneftegaz.

Also, the edict is aimed at consolidating the existing oil companies. It allows oil holdings to issue additional shares to be exchanged for privately owned shares of their subsidiaries. This would allow holding companies to obtain full (100%) control over their subsidiaries (a plan most actively advocated by LUKoil).

### **6.5. Foreign Participation**

In the first quarter of this year, Russian **joint ventures** with foreign partners increased their "own" oil production to 0.26 mmb/d (3.23 mmt), up 19% over 1Q94. As for their crude oil exports outside the FSU, it amounted to 0.21 mmb/d (2.52 mmt), up 34% compared to the same period of last year. This means that JVs' exports accounted for about 78% of their oil production in 1Q95, as against 69% a year ago. While the bulk of these 1Q95 exports were made by 20 oil-producing ventures, almost 41% of the total was exported by 10 service JVs that obtained crude oil (and appropriate space in export pipeline) from Russian oil producers as compensation for their services.

Nevertheless, foreign partners of some Russian oil-producing joint-ventures, tired of waiting for the repeatedly promised preferential treatment, announced reduction in their activities in Russia.

On February 20, 1995, Occidental Petroleum of the CIS notified the State Duma that its joint-ventures, Vanyoganneft and Parmaneft, suspended their operations due to insufficient cashflow and were facing possible bankruptcy due to unbearable fiscal burdens. The company requested that these JVs be exempt from export and excise duties on produced hydrocarbons and from VAT on imported equipment, on the grounds that these charges were not accounted for in the projects' feasibility studies or listed in JVs' statutory documents. Oxy's appeal to the Russian parliament may be regarded as an act of desperation,

following its failure to reach compromise with the RF Government, which is fully responsible for considering such requests.

In mid-March 1995, Gulf Canada Resources abandoned its joint-venture KomiArcticOil, having sold its 25% stake to another co-founder — British Gas. The venture, whose Russian partners are Komineft (40%) and Ukhtaneftegazgeologiya (10%), develops and exploits the Vozeyskoye and Verkhne-Vozeyskoye oil fields in the Timan-Pechora basin of the Komi Republic. The withdrawal of the Canadian partner, which had invested \$21 million in the project, followed the purchase of 25% of Gulf's shares by Houston-based Torch Energy Advisors which undertook management shake-up and cost-cutting program.

At the same time, Pennzoil was reportedly seeking buyers for its 50% stake in the Siberian-American Oil Co. (SANK), set up to develop an estimated 50 million bbl of oil in the Mogutlorskoye and Zapadno-Mogutlorskoye fields in the Tyumen Region, West Siberia. Over the past three years, Pennzoil has invested \$33 million in this joint venture with a US company, O'Connor & Young Drilling, and a local Agansk geological enterprise. The decision may be a part of Pennzoil's efforts to concentrate its E&P activity in the FSU on its participation in the major oil project offshore Azerbaijan.

Worried of a massive foreign capital outflow, at the end of February, the government exempted seven joint-ventures (Tatoilgas, Tatex, Tatoilpetro, Geoilbelt, Nobel Oil, Komi Quest, and Mekamineft) from export duties for one year, from January 1, 1995, with the exception of Mekamineft, which was granted this concession for the first half of 1995 only. The new exemptions were given in addition to similar privileges granted last September to six JVs (AmKomi, Polar Lights, SANK, Chernogorskoye, White Nights, and KomiArcticOil) which were exempted for three years or until full payback of their capital expenditures, retroactive from January 1, 1994.

As for major **production sharing** projects, they were involved in array of ongoing negotiations, which got a boost from the first legislative breakthrough on PSAs (see *Section 6.1*) and moved ahead with rather different speeds and diverse results.

At the start of this year, Shell Neft submitted to the RF Government a long-awaited draft PSA on its Salym project. The project envisages the development, in partnership with a Russian company Evikhon, of three West Siberian fields (Zapadno-Salymskoye, Verkhne-Salymskoye and Vadelypskoye) which were won through bids in September 1993 and which contain, according to Shell, about 5 billion bbl of oil-in-place and up to 730 million bbl of recoverable oil reserves. Despite having submitted the draft agreement (which was found too general and does not commit the foreign investor), Shell has expressed no intention to proceed with large-scale investment in the project until the Russian PSA legislation is in force.

At the same time, Russian representatives and the Timan-Pechora Company (TPC) nearly achieved an agreement on the principal clauses of a production-sharing contract. However, two major obstacles still remained: the lack of production-sharing legislation, and the tough position of local geological enterprise, Arkhangelskgeologiya (AG), which requested 50% stake in the project without investing the required \$2.2 billion. In mid-February, the Russian side suggested that its stake, shared between Rosneft and AG, be 20%. Although, TPC rejected the proposal in mid-March, the issue of the Russian stake remains on the agenda. Moreover, it is expected that LUKoil and YUKOS may also join the project. TPC representatives

and a government delegation, headed by Deputy Minister for Fuel and Energy Vadim Dvurechensky, are to resume negotiations in mid-April.

The above government delegation, set up in March as a special bargaining task force, is also to start negotiations with Amoco on the terms of production-sharing contract for the development, in partnership with YUKOS, of more than 5 billion bbl of recoverable crude reserves in the giant Priobskoye oil field, in Western Siberia. The first official meeting of the delegation with Amoco representatives is scheduled for mid-May 1995.

By the beginning of April, Exxon and the recently established Sakhalin Oil and Gas Development Co. [10] completed negotiations with federal and local authorities on the terms of production-sharing agreement for the Sakhalin-1 project. The scheme would involve total investments in order of US\$15 billion. The recoverable reserves of the allocated offshore fields (Chayvo, Odoptu and Arkutun-Dagi) are estimated at some 2.5 billion bbl of oil and 15 trillion scf of natural gas. Exxon and SODECO would each have a 30% stake in the project, while Rosneft and Sakhalinmorneftegaz would share the remaining 40%. The agreed terms of the Sakhalin-1 contract must be officially approved by the RF Government and the Sakhalin Region administration. Nevertheless, it is likely that the foreign partners will wait until enactment of the production-sharing law before starting the planned investments — just as it is currently the case with the Sakhalin-2 project (see *ROGM*, 1995, Issue 1, Section 6.5).

In February, the deadline to bid for the Sakhalin-4 project was postponed from April 14 to June 21, 1995, at the request of the interested foreign companies, to allow them additional time to analyze geological information. Meanwhile, the Mobil/Texaco consortium and Exxon were studying the feasibility of, and drafting production-sharing agreements on the exploration and development of the Kirinsky and Ayashsky blocks, as well as the East Odoptu field, which are included in the Sakhalin-3 project.

A long-awaited breakthrough was finally achieved by members of the Caspian Pipeline Consortium (CPC). On January 11, 1995, the partners in the consortium, established by the governments of Russia and Kazakhstan, and Oman Oil Company (OOC), signed a memorandum commencing the first phase of a large-scale project aimed at the construction of the Tengiz—Black Sea pipeline. So far, the project is fully financed by OOC, which had to assume all financial obligations after Chevron Corp. refused to join it, being dissatisfied with the financial and management terms. The total cost of the project is estimated at US\$1.8 billion. This includes some \$400 million for its first phase, which involves the construction of a new seaport terminal to the north of Novorossiysk with transshipment capacity of 15 mmt/y, and a 250-km 40-inch pipeline to the terminal from the town of Kropotkin (the Krasnodar Region). The new branch line will be fed by the existing pipeline Tikhoretsk—Kropotkin, and will facilitate additional exports of Urals blend, which is currently pumped through the Samara—Lisichansk—Tikhoretsk—Novorossiysk trunkline. Construction is to begin in January 1996, with completion of the first phase planned for January 1997.

## 7. General Outlook

The observed and above-described developments affirm our previous prediction about the turning-point changes in the country's hydrocarbon industry which became particularly evident in the performance of its

oil sector. This allows us to update and amend our tentative projections for 1995, which remain generally unchanged.

### **7.1. Oil Sector**

Before proceeding to the yearly outlook, it is interesting to consider a forecast of Russia's crude oil balance for the **second quarter of 1995**, which was prepared last March by the RF Ministry of Fuel & Energy. According to the ministry's projections, in 2Q95 national production of crude and condensate will amount to 77.7 mmt (6.25 mmb/d), about 1.7 mmt (0.14 mmb/d) of oil will be imported from Kazakhstan, and around 45.0 mmt (3.62 mmb/d) will be processed within the country. Accounting for other domestic requirements for crude oil (direct use and losses), which are predicted at 2.2 mmt (0.18 mmb/d), it will leave some 32.2 mmt (2.59 mmb/d) of crude for net exports from Russia: 23.0 mmt (1.85 mmb/d) to the non-FSU countries and 9.2 mmt (0.74 mmb/d) to the ex-Soviet republics. Actually, gross exports of Russian crude to the "near abroad" will include swap deliveries to Kazakhstan and will amount to 10.9 mmt (0.88 mmb/d), with 2.0 mmt (0.16 mmb/d) out of the total FSU exports being designated for processing deals with refiners in Belarus, Lithuania, and Ukraine. Additionally, Transneft will transport about 1.5 mmt (0.12 mmb/d) of Kazakh crude destined for Ukraine (0.5 mmt) and for the "far abroad" (1.0 mmt). The forecast looks fairly realistic and may materialize, provided that domestic refineries and East European buyers of Russian crude are willing to acquire all the projected supplies.

As for the **whole of 1995**, we predict that Russia will produce between 6.1 and 6.4 mmb/d (305-320 mmt) of crude and condensate which, on the average, is about 2% lower than in 1994 (see *Appendix C*). Refineries are likely to take in between 3.2 and 3.6 mmb/d (160-180 mmt), down an average of 5% from 1994. Other domestic requirements (*i.e.*, own and direct use, field and transportation losses, and stock changes) will, as usual, consume between 0.2 and 0.3 mmb/d (10-15 mmt), with the remaining supplies being shared between crude oil exports to the "far abroad" and the FSU. Due to the existing export-capacity restraints, the non-FSU exports will not likely exceed 2.0 mmb/d (100 mmt) and, most probably, will be somewhat higher than 1.9 mmb/d (95 mmt). Thus, taking account of small oil imports through swap arrangements with Kazakhstan, available gross exports to the "near abroad" are projected to be the residual of 0.7 to 0.8 mmb/d (35-42 mmt).

### **7.2. Gas Sector**

In line with the updated forecast, the Russian gas industry is expected to slow its production slide — from about 2% over 1993 to around 1% over the last year — and will likely yield between 55.6 and 58.4 bscf/d (585-615 bcm) of marketable natural gas (see *Appendix D*). A slight increase (of up to 4%) should mark Russia's gas exports to the "far abroad", which will likely receive between 10.0 bscf/d and 10.5 bscf/d (105-110 bcm). With the final domestic consumption now predicted to be in the range of 33.0 to 34.7 bscf/d (347-365 bcm), the resulting exportable surplus available for the gas buyers in the other FSU countries is still foreseen at 6.2 to 6.8 bscf/d (65-72 bcm). However, bearing in mind the resumption of Turkmen gas imports (which are to pay for Russian military supplies and assistance to Turkmenistan's hydrocarbon industry), gross exports to the ex-Soviet republics should noticeably increase to between 7.9 and 8.7 bscf/d (83-92 bcm).

**Footnotes:**

- [1] Before the separatist government of General Dudayev came to the power in the autumn of 1991, the then Chechen-Ingush Republic used to produce more than 80,000 barrels of oil, about 140 million cubic feet of gas, and over 280,000 barrel of oil products per day.
- [2] Unlike in the accompanying tables, throughout the text flow data are compared on a average *daily* basis.
- [3] Institutional groupings are based on the current (and ever changing) management structure of Russia's oil industry. Thus, the present figures do not match those used in the previous issue of *ROGM* (see *Section 6.4* for details).
- [4] Ukrainian imports of Russian oil would have completely dried up in 1Q95, if Ukraine's Kremenchug refinery had not be the only one in the FSU which can process the high-sulfur heavy crudes produced in Tatarstan.
- [5] *Correction and update:* The data on gas prices for the industry in Section 5.2 of the previous issue of *ROGM* related to *wholesale industry* prices, which actually rose to Rbl 73,773/1,000 cm.
- [6] To enter in force, a Russian federal law should pass three readings in the lower chamber of parliament and one reading in its upper chamber (Council of Federation) and should be then signed by the RF President.
- [7] At the beginning of April, 1 ECU was equal to \$1.30. *Correction:* The last line on page 18 of the previous issue of *ROGM* should read: "At the start of 1995, 1 ECU was approximately equal to \$1.22".
- [8] The former production association Tatneft was converted to a joint-stock company in November 1993 by a related decision of the State Property Management Committee of Tatarstan which gave the republic 40% control of Tatneft assets.
- [9] It should be noted that, despite a related RF government's decree (of July 6, 1994), Ishimbayneft's state-owned shares, fully controlled by Bashkortostan, were not transferred into the statutory fund of RMNTK Nefteotdacha, which has now been formally deprived of its main oil-producing unit (see *Appendix B* for details).
- [10] The new company was set up last March on the basis of SODECO after this Japanese-led group was left by Chevron and joined by Teikoku Oil and Indonesia Petroleum.

## Main Fiscal Charges in the Russian Oil and Gas Industry (1)

Type of Charge	Rate of Charge	Base of Rate	Allowances
<b>Export Duty</b>	<i>Oil (2): 20.00 ECUs per 1 tonne</i>  <i>Gas: 1.74 ECUs per 1,000 cubic meters</i>	Oil and gas exports outside the Russian Federation	Exemptions may be granted to JVs with no less than 30% foreign participation (during the payout period but for no more than 3 years)
<b>Value-Added Tax (VAT)</b>	20%	Gross sales proceeds	Waived for exports
<b>Special Tax (ST)</b>	1.5%	As above	As above
<b>Excise Duty</b>	<i>Oil (2): US\$8.00 per 1 tonne (3)</i>  <i>Gas: 25%</i>	<i>Oil (2): Gross production</i>  <i>Gas: Wholesale industry price, excluding VAT and ST (but incl. excise duty itself)</i>	<i>Oil (2): Some companies enjoy lower than general rates and some are fully exempt</i>
<b>Royalty</b>	6 to 16%	Producer (wholesale enterprise) price or (in the case of exports) calculated field-gate price ( <i>export price - export duty - excise duty - inland transportation costs</i> )	Resource depletion discounts may be granted (in cases of depleted or hard-to-access reserves)
<b>Contributions for Mineral Reserves Replacement</b>	10%	As above	Reduced by an amount spent by the subsoil user on agreed exploratory works
<b>Property (Assets) Tax</b>	Up to 2%	Annual average value of the enterprise's fixed (incl. intangible) assets and inventories	Reduced by depreciation
<b>Road-Use Tax</b>	0.4% (federal) (4)	Sales proceeds (excluding VAT, ST, and excise duties)	—
<b>Land Tax</b>	Usually from US\$2 to \$10 per 1 hectare	Area of used land surface	—

<b>Profit Tax (Tax on Profit)</b>	Up to 38% (13% federal + up to 25% regional) (5)	"Balance" (operating) profit (excluding production costs, rent charges, excise duties, interest and other non-operating income)	Reinvestment and other tax deductions up to 50% of the taxable profit before deductions  Federal tax is reduced to zero for the first two years after JV's registration and is levied at 3.25% for the 3rd year and at 6.5% for the 4th year (6)
<b>Withholding Tax</b>	15%	Distributed dividends and share income (originated in Russia)	Reduced by some tax treaties (with Austria, Great Britain, Cyprus, Finland and many ex-socialist countries) to zero

(1) As of April 1, 1995; as applied to foreign investors in the upstream sector. Excluding federal taxes related to income and salaries (income tax, excess wage tax, transportation tax), and some local taxes. (2) Crude oil, including gas condensate. (3) General rate (not differentiated yet). (4) Regional authorities may set higher rates. (5) A new ceiling for the "regional" part of the tax at 22% was introduced on April 25, retroactive from January 1, 1995. (6) Applies to joint ventures registered after 1/1/94, with more than US\$ 10 million of foreign investment constituting more than 30% of the statutory capital.

## Structure of Independent, State-Controlled Joint-Stock Oil Companies (1)

Holding Company	State Stake (%)	Date of Establishment	Subsidiary Companies (2)		
			Exploration & Production	Refining/Processing	Distribution
NK LUKoil	45.0	April 15, 1993	<ul style="list-style-type: none"> <li>• Langepasneftegaz</li> <li>• Urayneftegaz</li> <li>• Kogalymneftegaz</li> </ul>	<ul style="list-style-type: none"> <li>• Volgogradneftepererabotka (Volgograd refinery)</li> <li>• Permnefteorgsintez (Perm refinery)</li> </ul>	<ul style="list-style-type: none"> <li>• Adygeyanefteprodukt</li> <li>• Abadzekhsknefteprodukt</li> <li>• Vologdanefteprodukt</li> <li>• Volgogradnefteprodukt</li> <li>• Permnefteprodukt</li> <li>• Chelyabinsknefteprodukt</li> <li>• Kirovnefteprodukt</li> </ul>
NK YUKOS	45.0	April 15, 1993	<ul style="list-style-type: none"> <li>• Yuganskneftegaz</li> </ul>	<ul style="list-style-type: none"> <li>• Kuybyshevnefteorgsintez (incl. Kuybyshev and Syzran refineries)</li> <li>• Novokuibyshevsky NPZ (Novokuibyshevsk refinery)</li> </ul>	<ul style="list-style-type: none"> <li>• Samarnefteprodukt</li> <li>• Bryansknefteprodukt</li> <li>• Lipetsknefteprodukt</li> <li>• Orelnefteprodukt</li> <li>• Penzanefteprodukt</li> <li>• Tambovnefteprodukt</li> <li>• Ulyanovsknefteprodukt</li> <li>• Voronezhnefteprodukt</li> </ul>
NK Surgutneftegaz (SNG)	45.0	March 19, 1993	<ul style="list-style-type: none"> <li>• Surgutneftegaz</li> </ul>	<ul style="list-style-type: none"> <li>• Kirishinefteorgsintez (Kirishi refinery)</li> </ul>	<ul style="list-style-type: none"> <li>• Karelnefteprodukt</li> <li>• Novgorodnefteprodukt</li> <li>• Pskovnefteprodukt</li> <li>• Tvernefteprodukt</li> <li>• Kaliningradnefteprodukt</li> <li>• Peterburgneftesnab</li> </ul>
NK Tatneft	40.0(3)	November 16, 1993	<ul style="list-style-type: none"> <li>• Almetyevneft (4)</li> <li>• Aznakaevneft (4)</li> <li>• Aktyubaneft (4)</li> <li>• Bavlyneft (4)</li> <li>• Dzhaililneft (4)</li> <li>• Yelkhovneft (4)</li> <li>• Irkeneft (4)</li> <li>• Leninogorskneft (4)</li> </ul>	--	--



Holding Company	State Stake (%)	Date of Establishment	Subsidiary Companies (2)		
			Exploration & Production	Refining/Processing	Distribution
NGK Slavneft	45.0	April 8, 1994	<ul style="list-style-type: none"> <li>• Megionneftegaz</li> <li>• Megionneftegazgeologiya</li> </ul>	<ul style="list-style-type: none"> <li>• Mozyrsky NPZ (Mozyr refinery in Belarus)</li> </ul>	--
Vostochno-Sibirskaya Neftegazovaya Kompaniya (Vostsibneftegaz or VSNK) [East-Siberian Oil and Gas Co.]	51.0	April 8, 1994	<ul style="list-style-type: none"> <li>• Yeniseyneftegazgeologiya</li> <li>• Yeniseygeofizika</li> </ul>	--	--
Sibirsko-Dalnevostochnaya Neftyanaya Kompaniya (Sidanco) [Siberian and Far East Oil Co.]	51.0	May 6, 1994	<ul style="list-style-type: none"> <li>• Varyeganneftegaz</li> <li>• Kondpetroleum</li> <li>• Chernogorneft</li> <li>• Udmurtneft</li> </ul>	<ul style="list-style-type: none"> <li>• Angarskaya Neftekhimicheskaya Kompaniya [Angarsk Petrochemical Co.] (Angarsk refinery)</li> <li>• Saratovsky NPZ (Saratov refinery)</li> </ul>	• Sakhalinnefteprodukt
Vostochnaya Neftyanaya Kompaniya (VNK) [East Oil Co.]	51.0	May 20, 1994	<ul style="list-style-type: none"> <li>• Tomskneft</li> <li>• Tomskneftegazgeologiya</li> </ul>	<ul style="list-style-type: none"> <li>• Achinsky NPZ (Achinsk refinery)</li> <li>• Tomsky Neftekhimichesky Kombinat [Tomsk Petrochemical Combine] (Tomsk refinery)</li> </ul>	<ul style="list-style-type: none"> <li>• Krasnoyarsknefteprodukt</li> <li>• Tomsknefteprodukt</li> <li>• Khakasnefteprodukt</li> <li>• Tuvanefteprodukt</li> </ul>
Orenburgskaya Neftyanaya Aktsionernaya Kompaniya (ONAKO) [Orenburg Oil Co.]	51.0	June 19, 1994	<ul style="list-style-type: none"> <li>• Orenburgneft</li> </ul>	<ul style="list-style-type: none"> <li>• Orsknefteorgsintez (Orsk refinery)</li> </ul>	• Orenburgnefteprodukt
NK KomiTEK Holding	51.0(5)	June 30, 1994	<ul style="list-style-type: none"> <li>• Komineft</li> </ul>	<ul style="list-style-type: none"> <li>• Ukhtinsky NPZ (Ukhta refinery)</li> </ul>	• Kominefteprodukt
RMNTK Nefteotdacha	38.0	July 6, 1994	<ul style="list-style-type: none"> <li>• Ulyanovsknefteotdacha (6)</li> </ul>	--	--

Holding Company	State Stake (%)	Date of Establishment	Subsidiary Companies (2)		
			Exploration & Production	Refining/Processing	Distribution
NK Bashneft	63.0(7)	January 13, 1995	<ul style="list-style-type: none"> <li>• Ishimbayneft</li> <li>• Maksimovskoye</li> <li>• Chekmagushskoye</li> <li>• Tuymazyneft (4)</li> <li>• Aksakovneft (4)</li> <li>• Arlannneft (4)</li> <li>• Yuzharlannneft (4)</li> <li>• Ufanefit (4)</li> <li>• Krasnokholmneft (4)</li> </ul>	--	--
Sibirsko-Uralskaya Neftegazokhimicheskaya Kompaniya (Sibur) [Siberian-Urals Oil and Gas Chemical Co.]	51.0	March 7, 1995	• Sibneftegazpererabotka	<ul style="list-style-type: none"> <li>• Sibneftegazpererabotka</li> <li>• Permsky GPZ (Perm gas-processing plant)</li> </ul>	--

(1) As of April 1, 1995. (2) Business co-founders only. Excluding non-founding subsidiaries and supporting businesses (R&D, engineering, etc.). (3) All state shares are held by the Republic of Tatarstan. (4) Oil and gas producing divisions (NGDUs). (5) Including 29.7% held by the Komi Republic and 21.3% of federal stake. (6) Besides, RMNTK Nefteodacha has a stake in several enhanced-oil-recovery enterprises which (unlike Ulyanovsknefteodacha that was given a status of an oil producer) are formally defined as EOR service enterprises (Kominnefteodacha, Kubannefteodacha, Nizhnevarovsknefteodacha, Purnefteodacha, Tatnefteodacha and Surgutnefteodacha). (7) All state shares are held by the Republic of Bashkortostan.

*Note:* GPZ - gas-processing plant, NGK - oil and gas company, NK - oil company, NPZ - refinery, RMNTK - Russian Inter-Branch Scientific-Technical Complex.

## Russia's Crude Oil Balance - 1992-95

	1992(1)		1993(1)		1994(2)		1995(3)	
	mmt	mmb/d	mmt	mmb/d	mmt	mmb/d	mmt	mmb/d
<b>Gross Oil Production</b>	<b>400.8</b>	<b>8.02</b>	<b>354.9</b>	<b>7.12</b>	<b>318.0</b>	<b>6.38</b>	<b>305-320</b>	<b>6.1-6.4</b>
Crude Oil	390.9	7.79	346.0	6.91	310.1	6.19	298-312	5.9-6.2
Gas Condensate	9.9	0.23	8.9	0.21	7.9	0.18	7-8	0.2
<b>Refinery Intake (4)</b>	<b>254.9</b>	<b>5.10</b>	<b>217.7</b>	<b>4.37</b>	<b>179.1</b>	<b>3.59</b>	<b>160-180</b>	<b>3.2-3.6</b>
<b>Other Domestic Requirements (5)</b>	<b>18.6</b>	<b>0.38</b>	<b>19.7</b>	<b>0.39</b>	<b>11.0</b>	<b>0.23</b>	<b>10-15</b>	<b>0.2-0.3</b>
<b>Gross Crude Oil Exports (6)(7)</b>	<b>141.7</b>	<b>2.83</b>	<b>127.8</b>	<b>2.56</b>	<b>132.4</b>	<b>2.65</b>	<b>130-142</b>	<b>2.6-2.8</b>
Inside FSU	75.5	1.51	47.7	0.95	41.0	0.82	35-42	0.7-0.8
Outside FSU	66.2	1.32	80.1	1.60	91.4	1.83	95-100	1.9-2.0
<b>Gross Crude Oil Imports (6)</b>	<b>14.4(8)</b>	<b>0.29(8)</b>	<b>10.3</b>	<b>0.21</b>	<b>4.5</b>	<b>0.09</b>	<b>5-7</b>	<b>0.1</b>
<b>Net Crude Oil Exports (7)</b>	<b>127.3</b>	<b>2.54</b>	<b>117.5</b>	<b>2.35</b>	<b>127.9</b>	<b>2.56</b>	<b>125-135</b>	<b>2.5-2.7</b>
Inside FSU	61.1	1.22	37.4	0.75	36.5	0.73	30-35	0.6-0.7
Outside FSU	66.2	1.32	80.1	1.60	91.4	1.83	95-100	1.9-2.0

(1) Based on Gapmer data. (2) Revised and partly estimated. (3) Updated forecast. (4) Including processing of crude and condensate at gas-processing plants. (5) Own and direct use, field and transportation losses, and changes in stock of crude and condensate. (6) Without account of re-exports. (7) Including deliveries designated for processing deals. (8) Including withdrawals of Russian crude deposited in other FSU countries (3.2 mmt or 0.06 mmb/d).

*Note : Totals may not add due to independent rounding*

## Russia's Natural Gas Balance - 1992-95

	1992(1)		1993(1)		1994(2)		1995(3)	
	bcm <sup>4</sup>	bscf/d <sup>5</sup>	bcm <sup>4</sup>	bscf/d <sup>5</sup>	bcm <sup>4</sup>	bscf/d <sup>5</sup>	bcm <sup>4</sup>	bscf/d <sup>5</sup>
<b>Marketable Gas Production</b>	<b>640</b>	<b>60.7</b>	<b>617</b>	<b>58.7</b>	<b>607</b>	<b>57.7</b>	<b>585-615</b>	<b>55.6-58.4</b>
Free Gas	608	57.7	589	56.0	582	55.3	562-590	53.4-56.1
Associated Gas	32	3.0	28	2.7	25	2.4	23-25	2.2-2.4
<b>Other Gas Sources (6)</b>	<b>2</b>	<b>0.2</b>	<b>2</b>	<b>0.2</b>	<b>2</b>	<b>0.2</b>	<b>2</b>	<b>0.2</b>
<b>Final Domestic Consumption</b>	<b>396</b>	<b>37.5</b>	<b>382</b>	<b>36.3</b>	<b>353</b>	<b>33.6</b>	<b>347-365</b>	<b>33.0-34.7</b>
<b>Other Domestic Requirements (7)</b>	<b>61</b>	<b>5.8</b>	<b>73</b>	<b>6.9</b>	<b>74</b>	<b>7.0</b>	<b>65-75</b>	<b>6.2-7.1</b>
<b>Gross Gas Exports (8)</b>	<b>194</b>	<b>18.4</b>	<b>172</b>	<b>16.3</b>	<b>185</b>	<b>17.6</b>	<b>190-200</b>	<b>18.1-19.0</b>
Inside FSU	106	10.0	79	7.5	79	7.5	83-92	7.9-8.7
Outside FSU	88	8.3	93	8.8	106	10.1	105-110	10.0-10.5
<b>Gross Gas Imports (8)</b>	<b>8</b>	<b>0.8</b>	<b>7</b>	<b>0.6</b>	<b>3</b>	<b>0.3</b>	<b>18-20</b>	<b>1.7-1.9</b>
<b>Net Gas Exports</b>	<b>186</b>	<b>17.6</b>	<b>165</b>	<b>15.7</b>	<b>182</b>	<b>17.3</b>	<b>172-180</b>	<b>16.4-17.1</b>
Inside FSU	98	9.3	72	6.9	76	7.2	65-72	6.2-6.8
Outside FSU	88	8.3	93	8.8	106	10.1	105-110	10.0-10.5

(1) Based on Gazprom data. (2) Revised and partly estimated. (3) Updated forecast. (4) Measured at the Russian standard conditions (20°C and 760 mmHg). (5) Measured at the U.S. standard conditions (60°F and 14.73 psi). (6) Condensate stabilization and deethanization gases. (7) Pipeline fill, fuel gas, transportation losses and stocks change. (8) Excluding re-exports of Turkmen gas.

*Note: Totals may not add due to independent rounding*

### **RUSSIA ENERGY PROJECT**

The *Russia Energy Project* analyzes and forecasts developments in the Russian energy sector and their impacts on national economic growth, trade, and foreign investments as well as on the international energy markets. There are two main areas of research — (1) oil and gas and (2) coal and electricity — with the former given deserved priority. Mineral-resource and energy-related legislation, policies and regulations, and especially those governing foreign investments, are also key study areas of the project. The scope of the research includes analyses and forecasts of nationwide and regional energy balances (supply, consumption, and net trade), interregional energy flows and logistics, market situation and prices, and development of energy-related infrastructure. Due to a fairly high interdependence of energy sectors in all the former Soviet republics, the Russian energy developments are analyzed and projected in connection with and in relation to those in other countries of the FSU. Special emphasis is put on the Russian Far East and its interaction with the Asia-Pacific energy markets.

In addition to the *Russia Oil & Gas Monitor*, the *Russia Energy Project* also publishes much of its study findings in articles, books and energy advisory reports.

The *Russia Energy Project* is headed by **Dr. Eugene (Yevgeny) Khartukov** and is actively supported by the Moscow-based World Energy Analysis & Forecasting Group (GAPMER) and other Russian researchers. All research activities of the Program on Resources: Energy and Minerals are supervised by the PREM director, **Dr. Fereidun Fesharaki**, who is also involved in the project's studies.

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