

The Russian oil industry between public and private governance: obstacles to international oil companies' investment strategies

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Abstract

The low level of involvement by international oil companies in Russia seems difficult to explain given what development of its resources and production has to offer. There are still many restrictions and contradictions, born of the particular institutional and political environment of the Russian oil industry at the end of 15 years of transition, that act as a bar to international integration. Three factors currently define the establishment of relations with foreign investors. First, because of the many different levels of negotiation with Russian companies, the State and the Regions, the decisions are based on complex relations between the various forces. Second, the reforms, and especially privatisation and the allocation of rights of ownership to deposits, are considered by sizeable sections of public opinion and many political classes to be illegitimate, thus making the issue of international investment and foreign presence still more complicated. Finally, the State's wish to take back the oil industry in order to use it to fulfil its economic and foreign policies is creating further uncertainty. These three elements seriously restrict the entry of international oil companies to the Russian market.

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1. Introduction

The low level of involvement by international oil companies in Russia seems difficult to explain given what development of its resources and production has to offer. Since 1985, first under Mikhail Gorbachëv and then under Boris Yeltsin, the recourse to foreign investment is seen as one of the best means of financing a sector with considerable investment needs. Russia's aim of integrating itself into the world market also argues in favour of significant involvement by international oil companies in that country. Meanwhile, Russia has become a principal actor on the international oil market, with production levels of 8 million barrels per

day (mbd) in 2003. As such, it has now become very important for the international oil companies, as access to resources in the major oil-producing countries of the Middle East remains closed. That, however, is as far as the consistency of interests goes; there are still many restrictions and contradictions, born of the particular institutional and political environment of the Russian oil industry at the end of 15 years of transition, that act as a bar to international integration.

Reforms and privatisation programmes implemented have allowed new actors, largely independent of the State and its overall political objectives, to emerge. The industry has mainly restructured itself around these actors, who are national private firms tied into a complex network of domination and subordination with the Federal State and the Regions. These firms are not a homogeneous group, given the wide variety of their assets and the differing strategies arising in consequence. The Federal State and its government

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and administrative authorities do not have a united vision of the policy to be pursued and the type of control to be developed in relation to oil companies involved at national level. The Regions, faced with a weakened Federal State, are also interfering in the sharing of the hydrocarbon rent.

In this destabilised institutional environment, three factors currently define the establishment of relations with foreign investors. First, because of the many different levels of negotiation with Russian companies, the State and the Regions, the decisions are based on complex relations between the various forces. Second, the reforms, and especially privatisation and allocation of rights of ownership to deposits, are considered by sizeable sections of public opinion and many political classes to be illegitimate, thus making the issue of international investment and foreign presence still more complicated. Finally, the State's wish to take back the oil industry in order to use it to fulfil its economic and foreign policies is creating further uncertainty. These three elements reduce the number of institutional and legal organisations likely to secure international investments, and seriously restrict the entry of international oil companies to the Russian market. It is in the context of this "hybrid" governance, both public and private, affecting the industry, that international oil companies' strategies need to be determined as far as Russia is concerned.

First, we will define the game being played between Russian companies and the State, marked by a new affirmation of public coordination. Second, we will analyse its effects on the non-completion of the reorganisation process and the stabilisation of the new institutions. From that, we will deduce what possibilities there are for international companies to enter that game and involve themselves in it.

2. Investment stakes for the Russian oil industry

To continue the long-term rise in Russian oil production requires considerable investment. The elements that triggered its growth in the early 2000s are now beginning to flag, and the renewal of mature deposits is suggesting that further exploratory efforts will be made in consequence. From this point of view, the "economic transition" has led to a significant drop in investment in exploration. This drop is one of the striking characteristics of the new Russian oil companies' strategies.

The structure of the industry has radically altered in comparison with the centralised, hierarchical and tightly controlled system administered by the Soviet Oil Ministry, but has not yet stabilised. As part of the "liberal" approach to the transition, developed by the

Washington Consensus,¹ the aim of oil industry reform was to produce a new organisational model based on various private enterprises. What was needed was to redefine the rights of ownership through huge privatisation programmes and to develop competition by breaking up the old hierarchies. The transposition of the industrial organisational model of the market economy oil industry has, however, been only partial. Because the oil rent has been controlled in order to supply the public budget while relying on income from exports, the Russian State has maintained control of the transport networks. In contrast to the Western companies, transportation has not been integrated into the vertical production and refining companies because of the wish to control export income.²

From the beginning of the 2000s, most of the rise in Russian production has been attributable to investment in boosting production from existing fields.³ The investment strategies developed in the 1990s allowed productivity to be increased, especially through using enhanced oil recovery techniques. Now, the future of Russian oil production depends mostly on large-scale recovery of the investments made in exploration. The AIE has assessed the total investment needed to be made in the oil industry at \$328 billion for the period 2001–2030.⁴

Exploration and renewal of reserves, which determine long-term developments in the field of production, have, however, been largely ignored until now. For example, investment in exploration dropped by some 60% between 1988 and 1994. This trend occurred again in 2001–2003, with a 30% drop in 2002 compared with 2001. Russian reserves are very significant,⁵ but low exploration investment levels are leading some experts to voice serious misgivings. At the current pace of production, unless massive investment is made in exploration the total of proven reserves will be halved in the next 10 years (Konoplyanik, 2000). From this

¹According to G. Roland, the transition envisaged by the Washington Consensus is based on a combination of neo-classical price theory, standard macroeconomic theory and the experience of stabilisation policies. It is opposed to the more institutionalist view of the transition. For a presentation of the two views of the transition, the reader is referred in particular to Roland (2000), Andreff (2003).

²Because of the magnitude of the investments to be made and the specific nature of the assets, this is traditionally included in the production and refining industry.

³More than half of the rise in production is attributable to three oil companies, namely Yukos, Sibneft and Surgutneftegaz. The first two companies have made huge investments in enhanced oil recovery techniques (hydrofracture, horizontal drilling, etc) AIE-OCDE (2003).

⁴In the document published in 2003 by the Russian Government on the Russian Energy Strategy, the required investment is totalled at \$230–240 billion for the period 2000–2020 (AIE-OCDE, 2003).

⁵They are, however, the subject of numerous disputes. According to BP, Russia's oil reserves total in the region of 60 billion barrels, while the USGS evaluation gives a figure of 207 billion barrels (Petroleum Intelligence Weekly, 8 September 2003a).

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