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TRENDS AND OUTLOOKS
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The review provides a detailed analysis of main trends in Russia's economy in 2014. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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4.5. Oil and Gas Sector in Russia in 2014

Oil and gas industry remains the basic sector of Russian economy playing the key role in shaping revenues of the state budget and the country's trade balance. In 2014 the national crude oil output reached its maximum over the period since 1990. In the second half of the year the sector's performance felt a negative impact of the lowering world prices for oil and the financial and technological sanctions introduced against Russia. Legislative acts providing for tax incentives in order to encourage the development of hard-to-recover oil reserves and for the differentiated taxation of natural gas production have come into effect and the principal decisions regarding restructuring of the system of oil sector's taxation have been taken.

4.5.1. Dynamics of the World Oil and Gas Prices

In the first half of 2014 the situation on the global oil market was characterized by the persistence of high world prices for oil observed all through the recent years (*Table 15, Fig. 37*). The basic factors shaping such prices were a noticeable strengthening of demand for oil due to the world economic growth (first of all, in China and other Asian countries) and the conservative policy of OPEC as regards the increase of oil production by countries – members of the organization. However, in the second half of the year the situation changed dramatically: the continuing growth of global oil production combined with relatively weak demand led to the remarkable drop of the world prices for oil. In 2014 the global oil output was up 2.1% primarily due to the growing production in the US that was conditioned by the development of shale oil deposits. Meantime, the increase of the global demand for oil was as small as 0.7% (*Table 16*). As a result of the notable excess of oil supply over demand the price for Brent crude oil fell from \$111.9 per barrel in June 2014 down to \$62.2 per barrel in December. However, OPEC did not take any steps to reduce production of oil in order to balance the global oil market: it chose to leave unchanged the earlier established output quota thus prioritizing the preservation of its market share. As a result in 2014 the price for Russian Urals crude oil on the world (European) market averaged \$97.7 per barrel, or fell by 9.3% as compared with the previous year. It hit the bottom in December when the price for Russian oil dropped down to \$61.1 per barrel.

Table 15

**World prices for oil in 2000–2014,
\$/barrel**

| | 2000 | 2005 | 2010 | 2011 | 2012 | 2013 |
|--|------|------|------|-------|-------|-------|
| Price for Brent crude oil, Great Britain | 28.5 | 54.4 | 79.6 | 111.0 | 112.0 | 108.8 |
| Price for Urals crude oil, Russia | 26.6 | 50.8 | 78.3 | 109.1 | 110.3 | 107.7 |

Table 15 (continued)

| | 2014 IQ | 2014 IIQ | 2014 IIIQ | 2014 IVQ | 2014 |
|--|------------|-------------|--------------|-------------|------|
| Price for Brent crude oil, Great Britain | 107.9 | 109.8 | 102.1 | 76.0 | 98.9 |
| Price for Urals crude oil, Russia | 106.5 | 107.7 | 101.2 | 75.3 | 97.7 |

Source: IMF, OECD/IEA.

Table 16

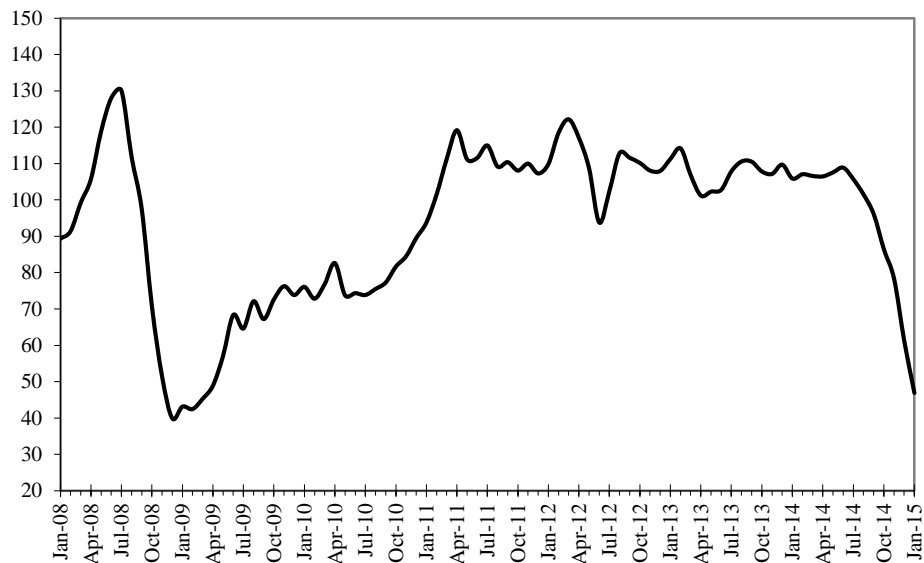
World demand for oil in 2010–2014, as % of the previous year

| | 2010 | 2011 | 2012 | 2013 | 2014 |
|--------------------|------|------|------|------|------|
| World, total | 3.1 | 0.9 | 1.2 | 1.4 | 0.7 |
| OECD countries | 1.3 | -0.8 | -1.1 | 0.4 | -1.1 |
| including: | | | | | |
| North America | 2.0 | -0.3 | -1.7 | 2.1 | 0.0 |
| Europe | -0.3 | -2.3 | -3.2 | -0.9 | -1.9 |
| Non-OECD countries | 5.2 | 3.0 | 3.6 | 2.4 | 2.4 |
| including: | | | | | |
| | 7.9 | 3.2 | 4.0 | 2.5 | 2.5 |

| | | | | | |
|--|--|--|--|--|--|
| Asia (except for countries of the Middle East and former USSR) | | | | | |
|--|--|--|--|--|--|

Source: OECD/IEA.

The price for Russian natural gas on the European market also displayed a downward trend. The prices for gas supplied under long-term contracts are usually tied to prices for petroleum products and with a certain lag follow the world prices for oil (*Table 17*). Moreover, in recent years prices for Russian gas were also pulled down by the changing situation on the European gas market, i.e. the growing competitive supply from other gas producing countries and lower spot prices for gas as compared with prices under long-term contracts. All this has forced “Gazprom” to bring down its sale prices for gas on the European market.



Source: Ministry of Economic Development of the Russian Federation.

Fig. 37. Price for Urals crude oil in 2008–2014, \$/barrel

Table 17

World prices for oil and natural gas in 2005–2014

| | 2005 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|-------|-------|-------|-------|-------|-------|
| Average world price for oil, \$/barrel | 53.4 | 79.0 | 104.0 | 105.0 | 104.1 | 96.2 |
| Price for Russian gas on the European market, \$/1,000 m ³ | 212.9 | 296.0 | 381.5 | 431.3 | 402.0 | 376.0 |

Source: IMF, Rosstat.

4.5.2. Dynamics and Structure of Production in the Oil and Gas Sector

In 2014 the output of oil in Russia reached 526.7 million tons which is the maximum level over the period since 1990 (*Table 18*). A positive effect on the dynamics of oil recovery was produced by the recent putting in operation of several large new fields in Eastern Siberia and the changes in taxation system that stimulate the development of new production regions and better oil recovery at the functioning fields. At the same time the growth rates of oil production in recent years have been notably falling (*Table 19*) primarily due to the worsening of recovery conditions. A great share of operating fields have entered the stage of declining output while new fields in most cases have worse mining, geological and geographic parameters and their development requires higher capital, operational and transport expenditures. At the moment Russian oil industry has approached the ceiling of its production capacities. To make up for the declining production of oil at the

operating fields, one has to develop both new fields in regions with poorly developed or lacking infrastructure and idle reserves of lower quality oil in the developed regions.

Table 18

Oil production and processing in the Russian Federation in 2000–2014

| | 2000 | 2005 | 2010 | 2011 | 2012 | 2013 | 2014 |
|--|-------|-------|-------|-------|-------|-------|-------|
| Production of crude oil including gas condensate, million tons | 323.2 | 470.0 | 505.1 | 511.4 | 518.0 | 523.3 | 526.7 |
| Primary oil refining, million tons | 173.0 | 208.0 | 249.3 | 258.0 | 270.0 | 278.0 | 294.4 |
| Ratio of oil refining to crude oil production, % | 53.5 | 44.3 | 49.4 | 50.4 | 52.1 | 53.1 | 55.9 |
| Crude oil conversion rate, % | 71.0 | 71.6 | 71.1 | 70.8 | 71.5 | 71.7 | 72.4 |

Source: Federal Service of State Statistics, Ministry of Energy of the Russian Federation.

Table 19

Production of crude oil, petroleum products and natural gas in 2000–2014, as % of the previous year

| | 2000 | 2005 | 2010 | 2011 | 2012 | 2013 | 2014 |
|------------------------------------|-------|-------|-------|-------|-------|-------|-------|
| Crude oil including gas condensate | 106.0 | 102.2 | 102.1 | 100.8 | 101.3 | 100.9 | 100.7 |
| Primary oil refining | 102.7 | 106.2 | 105.5 | 103.3 | 104.9 | 102.7 | 104.9 |
| Gasoline | 103.6 | 104.8 | 100.5 | 102.0 | 104.3 | 101.3 | 98.8 |
| Diesel fuel | 104.9 | 108.5 | 104.2 | 100.3 | 98.7 | 103.1 | 107.4 |
| Heating oil | 98.3 | 105.8 | 108.5 | 104.6 | 101.6 | 103.3 | 102.0 |
| Natural gas | 98.5 | 100.5 | 111.4 | 102.9 | 97.7 | 102.1 | 95.7 |

Source: Federal Service of State Statistics, Ministry of Energy of the Russian Federation.

At the same time in 2014 growth rates of oil processing remained higher than those of oil production primarily due to faster growth of petroleum products' export that was stimulated by lower export duties on these items as compared with export duties on crude oil. As a result of higher growth rates in primary oil refining, its ratio to crude oil production increased from 42.5% in 2004 to 55.9% in 2014. However, the crude oil conversion rate over this period actually did not improve and in 2014 was as low as 72.4% which is far below the level of developed countries where this indicator reaches 90-95%. The technological upgrading of oil processing industry remains one of the most critical tasks for the development of Russia's oil sector.

The largest producers of oil in 2014 were "Rosneft", "LUKOIL", "Surgutneftegaz" and "Gazprom". The share of these four companies amounted to 73.8% of the total oil production in the country. Medium-size companies ("Tatneft", "Bashneft", "Slavneft" and "RussNeft") accounted for 13.1% of the total oil output. The share of other producers (over 100 smaller oil-producing entities) was as small as 9.5% (Table 20).

Table 20

Share of selected companies in the total Russian output of crude oil in 2010–2014

| | Total oil output in 2010, million tons | Share in the total output, % | Total oil output in 2012, million tons | Share in the total output, % | Total oil output in 2013, million tons | Share in the total output, % | Total oil output in 2014, million tons | Share in the total output, % |
|--------------------------------|--|------------------------------|--|------------------------------|--|------------------------------|--|------------------------------|
| Russia, total | 505.1 | 100.0 | 518.0 | 100.0 | 523.3 | 100.0 | 526.7 | 100.0 |
| Rosneft | 112.4 | 22.3 | 117.5 | 22.7 | 192.6 | 36.8 | 190.9 | 36.2 |
| LUKOIL | 90.1 | 17.8 | 84.6 | 16.3 | 86.7 | 16.6 | 86.6 | 16.4 |
| TNK-BP | 71.7 | 14.2 | 72.5 | 14.0 | – | – | – | – |
| Surgutneftegaz | 59.5 | 11.8 | 61.4 | 11.9 | 61.5 | 11.8 | 61.4 | 11.7 |
| Gazprom including Gazprom neft | 43.3 | 8.6 | 46.1 | 8.9 | 48.5 | 9.3 | 49.8 | 9.5 |
| including: Gazprom | 13.5 | 2.7 | 14.5 | 2.8 | 16.3 | 3.1 | 16.2 | 3.1 |
| Gazprom neft | 29.8 | 5.9 | 31.6 | 6.1 | 32.2 | 6.2 | 33.6 | 6.4 |
| Tatneft | 26.1 | 5.2 | 26.3 | 5.1 | 26.4 | 5.0 | 26.5 | 5.0 |
| Bashneft | 14.1 | 2.8 | 15.4 | 3.0 | 16.1 | 3.1 | 17.9 | 3.4 |
| Slavneft | 18.4 | 3.6 | 17.9 | 3.5 | 16.8 | 3.2 | 16.2 | 3.1 |
| RussNeft | 13.0 | 2.6 | 13.9 | 2.7 | 8.8 | 1.7 | 8.6 | 1.6 |
| NOVATEK | 3.8 | 0.8 | 4.2 | 0.8 | 4.3 | 0.8 | 4.3 | 0.8 |
| Operators of PSA | 14.4 | 2.9 | 14.1 | 2.7 | 14.0 | 2.7 | 14.4 | 2.7 |
| Other producers | 38.2 | 7.6 | 44.1 | 8.5 | 47.6 | 9.1 | 50.1 | 9.5 |

Source: Ministry of Energy of the Russian Federation, author's calculations.

In recent years, the share of public sector in the Russian oil industry has notably expanded. In 2013, the state-owned company "Rosneft" took over "TNK-BP" that inclusive of its share in "Slavneft" produced 15.7% of the total domestic output of oil. In 2014 the ownership title to "Bashneft" accounting for 3.4% of the Russia's total oil output returned to the state. As a result in 2014 the share of state-owned companies in the national oil production reached 58.6% (our own estimates, *Table 21*). Meantime, the respective share of "Rosneft" taking into account its part in other entities was as high as 38.1%.

Table 21

Share of state-owned companies in the Russian crude oil production in 2014

| | Total oil output, million tons | Share in the total oil output, % |
|--|--------------------------------|----------------------------------|
| Rosneft including its share in the output of other entities | 200.5 | 38.1 |
| Gazprom including Gazprom neft including their share in the output of other entities | 60.6 | 11.5 |
| Tatneft | 26.5 | 5.0 |
| Bashneft | 17.9 | 3.4 |
| Zarubezhneft (production on the territory of Russia) | 3.2 | 0.6 |
| State-owned companies, total | 308.7 | 58.6 |

Source: Ministry of Energy of the Russian Federation, author's calculations.

"Gazprom" preserves its dominant positions in the Russian gas sector. However, in recent years its share in the total domestic output of natural gas notably reduced: from 83.2% in 2008 down to 68.1% in 2014 (*Table 22*). At the same time the contribution of other producers (oil companies, "NOVATEK", operators of PSA, etc.) increased. Altogether, the share of independent producers in 2014 gas output reached 31.9% including 8.2% provided by the largest independent producer of gas - "NOVATEK" company.

Table 22

Share of selected companies in the total Russian output of natural gas in 2010–2014

| | Total gas output in 2010, billion m ³ | Share in the total output, % | Total gas output in 2012, billion m ³ | Share in the total output, % | Total gas output in 2013, billion m ³ | Share in the total output, % | Total gas output in 2014, billion m ³ | Share in the total output, % |
|--------------------------------|--|------------------------------|--|------------------------------|--|------------------------------|--|------------------------------|
| Russia, total | 665.5 | 100.0 | 671.5 | 100.0 | 684.0 | 100.0 | 654.2 | 100.0 |
| Gasprom including Gasprom neft | 513.9 | 77.2 | 489.4 | 72.9 | 489.1 | 71.5 | 445.5 | 68.1 |
| including: Gasprom | 509.0 | 76.5 | 478.5 | 71.3 | 476.3 | 69.6 | 432.1 | 66.1 |
| Oil companies | 66.6 | 10.0 | 71.1 | 10.6 | 76.8 | 11.2 | 78.1 | 11.9 |
| NOVATEK | 37.8 | 5.7 | 51.3 | 7.6 | 53.0 | 7.7 | 53.7 | 8.2 |
| Operators of PSA | 23.3 | 3.5 | 26.8 | 4.0 | 27.8 | 4.1 | 28.0 | 4.3 |
| Other producers | 23.9 | 3.6 | 32.9 | 4.9 | 37.3 | 5.5 | 48.9 | 7.5 |

Source: Ministry of Energy of the Russian Federation, author's calculations.

A new factor able to affect further development of the national oil and gas sector are economic sanctions against Russia introduced in 2014 by the US, the EU and some other countries in response to the Ukrainian developments. In addition to financial sanctions limiting access to external financing for Russian companies, in the second half of 2014 a number of developed countries introduced a ban on the supply to Russia of equipment and technologies for the development of three categories of fields: deposits in the Arctic shelf area, deepwater deposits and shale oil deposits. All the three categories of projects are critically dependent on foreign technologies. At the same time the investment cycle of projects for the development of Arctic shelf and deepwater fields is rather protracted and from the oil production point of view the negative effect of blocking such projects may show up only in the long term. Besides, in case prices for oil remain low the implementation of many projects of the kind will be suspended due to their economic inefficiency.

The situation with technologies for the development of shale oil deposits is more difficult. According to estimates of US EIA, Russia ranks first in the world by technically recoverable resources of shale oil. In case of applying modern technologies the development of these deposits is more cost-effective than the development of offshore fields. Meantime, the time needed for the development of these resources is much shorter. Under the conditions of sanctions Russia won't be able to develop its resources of shale oil and thus offset the decline of production at dwindling operating fields.

It should also be taken into account that technologies used for the development of shale oil deposits (horizontal drilling, hydraulic fracturing) are applied as well for the development of traditional oil deposits, first of all the ones with high level of resource depletion, in order to provide better oil extraction. Therefore, the ban on supply of equipment for horizontal drilling and hydraulic fracturing may also lead to the premature closing of operating fields due to the impossibility of their enhanced recovery.

Under the conditions of technological sanctions deeper recovery of traditional fields assumes crucial importance for the sustaining of oil production and export. In this regard both more active use of respective foreign technologies not included in the sanction list and the development of own technologies for enhancing oil recovery are necessary.

4.5.3. Dynamics and Structure of Oil and Gas Exports

In the situation of slowing growth of oil production, one can observe stabilization of petroleum exports (*Tables 23 and 24*). In 2014 the total exports of crude oil and petroleum products amounted to 388.2 million tons or were only 0.05% above the level of the previous year. Exports of petroleum products continued growing (up 8.7% as compared with 2013) while exports of crude oil shrank (by 5.6%). In 2014 the ratio of oil exports to oil output fell down to 42.4%. At the same time the ratio of exports to the output of heating oil exceeded 90%, the ratio for diesel fuel reached 61.6%. The ratio of gasoline exports to the output of this product was 10.9% (for reference: in 2005, it amounted to 18.5%, in 2010 – to 8.2%, in 2013 – to 11.2%).

Exports of natural gas in 2014 notably fell (by 12.1% as compared with the previous year). In recent years, the basic factor of gas exports' decline was the shrinking of supplies to the European market where the share of other gas producing countries has greatly increased. As a result, exports of Russian gas to the non-CIS countries in 2014 fell by 23% as compared with 2006 when the volumes of gas supplies from Russia to Europe reached their maximum. The ratio of net exports to the output of gas dropped from 31.4% in 2005 to 25.3% in 2014.

Table 23

Proportions between production, consumption and exports of oil and natural gas in 2000–2014

| | 2000 | 2005 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|-------|-------|-------|-------|-------|-------|-------|
| Oil, million tons | | | | | | | |
| Production | 323.2 | 470.0 | 505.1 | 511.4 | 518.0 | 523.3 | 526.7 |
| Exports, total | 144.5 | 252.5 | 250.4 | 244.6 | 239.9 | 236.6 | 223.4 |
| Exports to non-CIS countries | 127.6 | 214.4 | 223.9 | 214.4 | 211.6 | 208.0 | 199.3 |
| Exports to CIS countries | 16.9 | 38.0 | 26.5 | 30.2 | 28.4 | 28.7 | 24.1 |
| Net exports | 138.7 | 250.1 | 249.3 | 243.5 | 239.1 | 235.8 | 222.6 |
| Domestic consumption | 123.0 | 123.1 | 125.9 | 140.7 | 142.1 | 137.5 | 141.3 |
| Net exports as % of production | 42.9 | 53.2 | 49.4 | 47.6 | 46.2 | 45.1 | 42.3 |
| Petroleum products, million tons | | | | | | | |
| Exports, total | 61.9 | 97.0 | 132.2 | 130.6 | 138.1 | 151.4 | 164.8 |
| Exports to non-CIS countries | 58.4 | 93.1 | 126.6 | 120.0 | 121.2 | 141.1 | 155.2 |
| Exports to CIS countries | 3.5 | 3.9 | 5.6 | 10.6 | 16.9 | 10.3 | 9.6 |
| Net exports | 61.5 | 96.8 | 129.9 | 127.2 | 136.8 | 150.0 | 162.8 |
| Oil and petroleum products, million tons | | | | | | | |

| | 2000 | 2005 | 2010 | 2011 | 2012 | 2013 | 2014 |
|--|-------|-------|-------|-------|-------|-------|-------|
| Net exports of oil and petroleum products | 200.2 | 346.9 | 379.2 | 370.7 | 375.9 | 385.8 | 385.4 |
| Net exports of oil and petroleum products as % of oil production | 61.9 | 73.8 | 75.1 | 72.5 | 72.6 | 73.7 | 73.2 |
| Natural gas, billion m³ | | | | | | | |
| Production | 584.2 | 636.0 | 665.5 | 687.5 | 671.5 | 684.0 | 654.2 |
| Exports, total | 193.8 | 207.3 | 177.8 | 184.9 | 178.7 | 196.4 | 172.6 |
| Exports to non-CIS countries | 133.8 | 159.8 | 107.4 | 117.0 | 112.6 | 138.0 | 124.6 |
| Exports to CIS countries | 60.0 | 47.5 | 70.4 | 67.9 | 66.0 | 58.4 | 48.0 |
| Net exports | 189.7 | 199.6 | 173.5 | 179.2 | 171.6 | 189.3 | 165.5 |
| Domestic consumption | 394.5 | 436.4 | 492.0 | 508.3 | 499.9 | 494.7 | 488.7 |
| Net exports as % of production | 32.5 | 31.4 | 26.1 | 26.1 | 25.6 | 27.7 | 25.3 |

Source: Federal Service of State Statistics, Ministry of Energy of the Russian Federation, Federal Customs Service, author's calculations.

Table 24

Dynamics of Russian exports of oil, petroleum products and natural gas in 2005–2014, as % of the previous year

| | 2005 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---------------------------------|-------|-------|-------|-------|-------|-------|
| Oil, total | 98.4 | 101.2 | 97.6 | 98.2 | 98.6 | 94.4 |
| including: non-CIS countries | 99.1 | 106.1 | 95.7 | 98.7 | 98.3 | 95.8 |
| Petroleum products, total | 117.9 | 106.2 | 98.5 | 104.4 | 109.6 | 108.7 |
| including: non-CIS countries | 119.1 | 109.6 | 94.6 | 100.8 | 116.4 | 109.8 |
| Gas, total | 103.7 | 105.6 | 104.0 | 96.6 | 109.9 | 87.9 |

Source: Federal Service of State Statistics.

The analysis of dynamics of Russian oil exports over a long term reveals a notable strengthening of oil sector's export orientation as compared with the pre-reform period. The ratio of net exports of oil and petroleum products to the output of oil increased from 47.7% in 1990 to 73.2% in 2014. However, one should keep in mind that this is due not only to the increase of absolute export volumes but also to the remarkable drop of domestic oil consumption following market transformation of the Russian economy, improvement of oil utilization efficiency and replacement of heating oil by natural gas. It's noteworthy that the share of petroleum products in the total petroleum exports increased from 18.2% in 1990 to 42.2% in 2014 (Table 25). Still, one should take into account that due to the low oil refining depth the major part of Russian exports of petroleum products consists of heating oil that in Europe is used as an input for further processing and production of light oil products. In 2014 the share of heating oil in the total exports of petroleum products amounted to 53%.

Table 25

Net exports of petroleum products in 2005–2014

| | 2005 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|------|-------|-------|-------|-------|-------|
| Net exports of petroleum products, million tons | 96.8 | 129.9 | 127.2 | 136.8 | 150.0 | 162.8 |
| Share of petroleum products in the net exports of oil and petroleum products, % | 27.9 | 34.3 | 34.3 | 36.4 | 38.9 | 42.2 |

Source: Federal Service of State Statistics, Federal Customs Service, author's calculations.

The lowering of world prices for oil and gas and the reduction of physical volumes of gas export resulted in the shrinking of fuel and energy items' share in the Russian exports down to 69.5% in 2014, with the share of crude oil amounting to 31.0% and the share of natural gas – to 11.0% (Table 26).

**Cost and relative importance of fuel and energy exports
in 2005–2014**

| | 2005 | | 2010 | | 2013 | | 2014 | |
|------------------------------|------------|------|------------|------|------------|------|------------|------|
| | Billion \$ | %* | Billion \$ | %* | Billion \$ | %* | Billion \$ | %* |
| Fuel and energy items, total | 154.7 | 64.1 | 267.7 | 67.5 | 371.8 | 70.6 | 345.4 | 69.5 |
| including: | | | | | | | | |
| oil | 83.8 | 34.7 | 134.6 | 34.0 | 173.7 | 33.0 | 153.9 | 31.0 |
| natural gas | 31.4 | 13.0 | 47.6 | 12.0 | 67.2 | 12.8 | 54.7 | 11.0 |

* as % of the total Russian exports.

Source: Federal Service of State Statistics.

**4.5.4. Dynamics of Prices for Energy Products
on the Domestic Market**

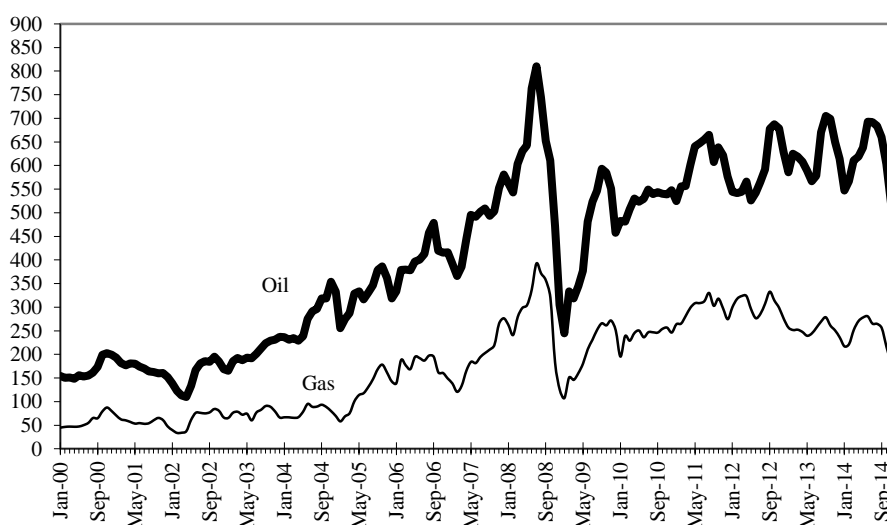
Prices for oil and petroleum products on the domestic Russian market are basically determined by the corresponding world prices so that to provide equal profitability of supplies to foreign and home market, i.e. are net back prices equaling the world price minus export customs duty and export shipment costs. In recent years the growth of world prices for oil and petroleum products drove the rise of prices on the domestic market. But in the second half of 2014 lower world prices and ruble exchange rate resulted in a notable decline of domestic prices in dollar terms (*Table 27, Fig. 38 and 39*). It's noteworthy that due to the high export duties there still remains a great gap between the world and domestic prices. In 2014 the domestic price for oil (producer price) averaged only \$41.1 per barrel, or 42.1% of the world price (price for Urals oil on the European market).

Table 27

**Domestic prices for oil, petroleum products and natural gas in dollar terms
in 2000-2014 (average producer prices, \$/ton)**

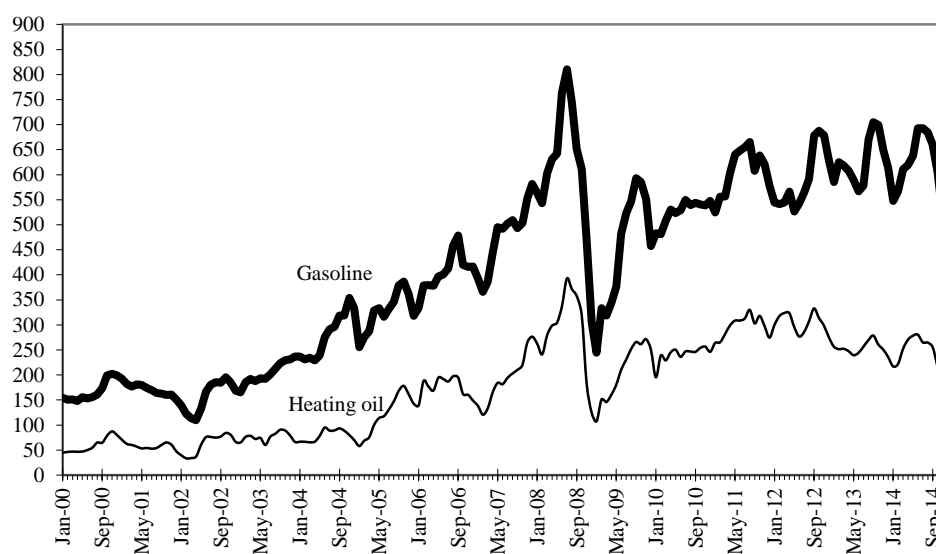
| | 2000 Dec. | 2005 Dec. | 2010 Dec. | 2011 Dec. | 2012 Dec. | 2013 Dec. | 2014 June | 2014 Dec. |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Oil | 54.9 | 167.2 | 248.2 | 303.3 | 341.1 | 346.1 | 364.6 | 178.9 |
| Gasoline | 199.3 | 318.2 | 547.9 | 576.9 | 628.7 | 614.4 | 692.7 | 372.3 |
| Diesel fuel | 185.0 | 417.0 | 536.1 | 644.9 | 774.2 | 698.0 | 677.2 | 419.3 |
| Heating oil | 79.7 | 142.7 | 246.3 | 274.6 | 275.3 | 235.8 | 280.6 | 128.7 |
| Gas, \$/1,000m ³ | 3.1 | 11.5 | 20.5 | 21.3 | 40.3 | 39.8 | 42.4 | 29.1 |

Source: calculated using data of the Federal Service of State Statistics.



Source: calculated using data of the Federal Service of State Statistics.

Fig. 38. Average producer prices for oil and gas in dollar terms in 2000–2014 (oil - \$/ton, gas - \$/1,000m³, right axis)



Source: calculated using data of the Federal Service of State Statistics.

Fig. 39. Average producer prices for gasoline and heating oil in dollar terms in 2000–2014 (\$/ton)

Domestic prices for gas remain the subject of state regulation. In order to ensure the competitiveness of national economy the government supported far lower level of the domestic gas prices as compared with that of the world market. In 2014 the domestic price for gas (the price paid by industrial consumers less indirect taxes) averaged only 26.4% of the price for Russian gas on the European market.

4.5.5. Tax Regulation of the Oil and Gas Sector

In the beginning of 2014, new statutes of tax regulation aimed to encourage the development of hard-to-recover oil reserves came into force. These provisions were enacted by Federal Law No. 213-FZ of July 23, 2013 “On introducing amendments to Chapters 25 and 26 of Part II of Tax Code of the Russian Federation and Clause 3.1 of the Law of the Russian Federation “On customs tariff””. This Law establishes differential rates of mineral extraction tax (MET) depending on the reservoir permeability, size of the oil-bearing formation and the degree of deposit depletion. The Law establishes application of a special MET degression coefficient K_{∂} [Kd] reflecting the difficulty of oil recovery. Depending on the parameters of a specific field (hydrocarbon reservoir) the K_{∂} value may be 0.8, 0.4, 0.2 and 0. A special coefficient – $K_{\partial\beta}$ [Kdv] – is introduced for reflecting the depletion of a specific hydrocarbon reservoir. In case of high depletion (over 80%) the coefficient is degressive and its value is determined using a special formula.

So, five coefficients reflecting major rent-shaping factors are currently applied to MET: coefficient $K_{\mathcal{U}}$ [Cts] reflecting the dynamics of world prices for oil; coefficient K_{β} [Kv] reflecting the degree of depletion of a specific subsoil area; coefficient $K_{\mathcal{Z}}$ [Kz] reflecting the size of reserves in a particular field; coefficient K_{∂} [Kd] reflecting the difficulty of oil recovery and coefficient $K_{\partial\beta}$ [Kdv] reflecting the depletion of a specific hydrocarbon reservoir.

The application of price coefficient ($K_{\mathcal{U}}$) for the purposes of taxation permits making allowances for the world prices for oil that shape producers’ gross income. This coefficient is applied for all deposits. Meantime, other coefficients are designed to alleviate tax burden for fields

with increased development costs (depleted fields, small deposits, hard-to-recover reserves). Higher costs associated with the development of such deposits are taken into account by applying lower tax rates.

In 2014 amendments to Law No. 5003-1 “On customs tariffs” adopted by Federal Law No. 213-FZ came into effect. According to them oil recovered in the fields where the share of initial recoverable oil reserves qualified as productive sediments of Tyumen suite in the total initial recoverable oil reserves in the deposit is not less than 0.8, is included in the list of oil types for which special formulas of calculating export duty rates are established. These formulas envisage lower export duty rates for oil from such deposits.

Special formulas for calculating export duty rates are also applied for high viscosity oil and oil developed in fields located in Eastern Siberia (within the borders of the Sakha (Yakutia) Republic, the Irkutsk Region and Krasnoyarsk Territory), the Nenets Autonomous District, the Yamalo-Nenets Autonomous District to the north from 65 degrees north latitude as well as in Caspian sea and on continental shelf.

The system of taxation in gas sector was also notably revised in 2014. On July 1, 2014 a new procedure for determining MET rates for producers of natural gas and gas condensate came into effect. It is based on applying special formulas and coefficients that take into account various factors shaping profitability of gas and gas condensate production and marketing. This procedure was adopted by Federal Law No. 263-FZ of September 30, 2013 “On introducing amendments to Chapter 26 of Part II of Tax Code of the Russian Federation and Clause 3.1 of the Law of the Russian Federation “On customs tariff””.

The new procedure provides for considering a number of important rent-shaping factors when establishing MET rates: the price for gas on foreign and domestic markets, the price for gas condensate, the price for Urals oil, the rate of export duty on oil, the exchange rate of US dollar relative to ruble, the share of recovered gas in the total amount of crude hydrocarbons recovered from a particular field, the difficulty of recovering gas and gas condensate, the degree of depletion of a specific subsoil area, the geographic location of a field, the depth of hydrocarbon reservoir, the specifics of developing particular fields.

The introduced procedure of establishing MET rate for natural gas allows taking into account basic factors that determine profitability of gas production and marketing and provides for the necessary differentiation of tax burden depending on the specific conditions of fields’ development.

Besides, in 2014 came into effect a special soft tax regime for the development of new offshore fields. It was adopted by Federal Law No. 268-FZ of September 30, 2013 “On introducing amendments to Parts I and II of Tax Code of the Russian Federation and relevant legislative acts of the Russian Federation in connection with implementing measures for tax and customs tariff stimulation of crude hydrocarbons production on the continental shelf of the Russian Federation”. This regime is based on lower ad-valorem MET rate differentiated by shelf zones and the standard profit tax. Export duty and property tax are not levied in case of offshore projects.

Principal decisions on restructuring the system of oil sector’s taxation were taken in 2014. Federal Law No. 366-FZ of November 24, 2014 “On introducing amendments to Part II of Tax Code of the Russian Federation and relevant legislative acts of the Russian Federation” envisages a notable lowering of export duties on oil and petroleum products and the compensatory raising of MET base rate. According to the taken decisions the base rate of MET for oil producers is to be raised step by step from Rb 493 per ton in 2014 up to Rb 919 per ton in 2017. At the same time the marginal rate of export duty on oil (coefficient in the formula for calculating the marginal rate) is reduced from 59% in 2014 down to 30% in 2017 (*Table 28*). Simultaneously, export duties on “dark” petroleum products relative to the export duty on crude oil are raised (up to 100% thereof in 2017) while those for “light” petroleum products are reduced.

Table 28

Rates of MET and export duties on oil and petroleum products in 2014–2017

| | 2014 | 2015 | 2016 | 2017 |
|--|------|------|------|------|
| Basic rate of MET for oil production, rubles per ton | 493 | 766 | 857 | 919 |
| Export duty on crude oil: coefficient in the formula for calculating the rate of export duty | 0.59 | 0.42 | 0.36 | 0.30 |
| Export duties on petroleum products: coefficients relative to the export duty on oil | | | | |
| Gasoline | 0.90 | 0.78 | 0.61 | 0.30 |
| Diesel fuel | 0.65 | 0.48 | 0.40 | 0.30 |
| Heating oil | 0.66 | 0.76 | 0.82 | 1.00 |

Source: Tax Code of the Russian Federation, Federal Law No. 366-FZ of November 24, 2014.

The implementation of these measures that have been called “a tax maneuver” will result in a remarkable redistribution of tax burden: the share of MET in rent taxes imposed on the oil sector will grow sizably while that of export duties will notably reduce. So, MET will become the principal rent tax and will perform the basic functions of tax regulation in the sector.

To our mind, such changes are economically indispensable and correspond to the principles of rent taxation and international practices. MET should play the key role in the oil sector’s taxation system while the role of export duties should be seriously diminished (up to their total cancellation in the future). At present, it is the export duty that actually serves as the basic tax in the oil sector. In 2014, the share of export duty in the structure of price for exported oil (given standard tax rates) amounted to nearly 50% and was almost twice higher than that of MET.

The high level of export duty on oil makes it necessary to regulate the effective rate of this tax (set lower duty rates and the term of their application for selected fields) in order to bring the tax burden in compliance with the actual conditions of oil recovery, i.e. to assign export duty the functions that should be performed by MET. Meantime, MET cannot fully perform its regulating function due to the high export duty.

The lowering of export duties on oil and petroleum products will have a number of positive effects. First of all, it will reduce the ongoing subsidizing of oil processing sector and thus will create real stimulus for its modernization and deepening of oil refining. Besides, it will greatly decrease the subsidizing of other Customs Union members by Russia that occurs owing to duty-free supplies of Russian oil and petroleum products. At the same time the growth of domestic prices for oil and petroleum products with their approaching to the world level as a result of export duties’ lowering will create correct price guides for market operators and will strengthen incentives for the improvement of energy efficiency that in its turn will foster the decrease of Russian economy’s energy intensity.