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The Oil and Gas Sector

The world market in 2012 was characterized by the persistence of high global oil and natural gas prices. The average price of Russian Urals crude oil on the European market, according to preliminary estimates, amounted to \$ 110.3 per barrel, and that of Russian natural gas – to \$ 418,2 per 1,000 m³, which translated into high profits of Russian oil and gas companies and considerable revenues of the state budget. Oil production in Russia in 2012 will amount to approximately 516m tons, which is the historic high of the last twenty-two years. Some additional tax measures designed to stimulate the development of new hydrocarbon deposits have been introduced.

In 2012, the situation on the global oil market was characterized by the stubborn persistence of high oil prices. The average price of Russian Urals crude oil in 2012, according to preliminary estimates, was \$ 110.3 per barrel, which exceeded last year's average (*Table 1*). The main factors responsible for the persistence of high global oil prices were the rising demand for oil caused by world economic growth, led by the economies of China, India and other Asian countries; the sufficiently conservative policy of the OPEC; and also the geopolitical risks hanging over the oil market. In the European market, prices for Russian natural gas were also impressively high, well in excess of their last year's level. At the same time, they experienced a downward influence of the changing situation in the European natural gas market, caused by a considerable increase in natural gas supplies from other producers and a lower level of natural gas spot prices in comparison with the prices for long-term contracts with *Gazprom*. This urged *Gazprom* to notably reduce its sale price on the European market.

Table 1

International Prices of Oil and Natural Gas in 2008–2012

	2008	2009	2010	2011	2012 Q1	2012 Q2	2012 Q3	2012 Q4*
Price of Brent (UK), USD/barrel	97.7	61.9	79.6	111.0	118.5	108.9	110.0	110.1
Price of Urals (Russia), USD/barrel	94.5	61.0	78.3	109.1	116.9	106.5	109.0	108.8
Price of Russian gas on the European market, USD/1,000 m ³	473.0	318.8	296.0	381.5	444.7	452.4	409.9	418.2

* Preliminary estimate.

Source: IMF, OECD/IEA.

In 2012, the volume of oil production in Russia, according to preliminary estimates, will amount to approximately 516m tons, thus hitting its twenty-two year record high (*Table 2*). Among other things, crude oil output was pushed up by the beginning of exploitation of several major new oil fields in the north of European Russia and in eastern Siberia, as well as by a number of changes in taxation, designed to reduce the tax burden on the oil sector, to stimulate the efficiency of oil production at Russia's traditional oil fields and to give impetus to the development of new oil areas. At the same time, the volume of oil refining continued to grow at a faster rate than that of oil extraction, mainly due to a rise in RF petroleum product exports.

Russia's oil refining efficiency remains at a low level: in January–November 2012 it amounted to 71.6% (vs. 70.8% in January–November 2011).

Table 2

Production of Oil, Petroleum Products and Natural Gas in 2005–2012, as a Percentage of the Previous Year

	2005	2006	2007	2008	2009	2010	2011	2012 January– November*
Oil, including natural gas condensate	102.2	102.1	102.1	99.3	101.2	102.1	100.8	100.9
Primary crude oil distillation	106.2	105.7	103.8	103.2	99.6	105.5	103.3	104.6
Motor gasoline	104.8	107.4	102.1	101.8	100.5	100.5	102.0	104.1
Diesel fuel	108.5	107.0	103.4	104.1	97.7	104.2	100.3	97.8
Furnace fuel oil	105.8	104.5	105.2	101.9	100.8	108.5	104.6	101.6
Natural gas	100.5	102.4	99.2	101.7	87.9	111.4	102.9	96.8

* As % of January–November 2011.

Source: RF Federal State Statistics Service.

The year 2012 saw, alongside a slight decline in crude oil exports, a continuing rise in petroleum product exports: in January–September they grew by 5.4% on the corresponding period of 2011 (Table 3). As previously, the largest share of petroleum product exports consisted of fuel oil, which is used in Europe as a raw material for further reprocessing into diesel fuel. In January–September 2012, the share of exports in the total volumes of diesel fuel amounted to 59.1%, that in the volume of motor gasoline - to 8.5%. At the same time, petroleum product imports and their share in the coverage of domestic demand significantly declined. In January–September 2012, motor gasoline imports dropped threefold, thus reducing their share in the total volume of motor gasoline resources to a mere 0.7%.

Table 3

Export of Oil, Petroleum Products and Natural Gas in 2005–2012, as a Percentage of the Previous Year

	2005	2006	2007	2008	2009	2010	2011	2012 January– September*
Oil, total	98.4	98.0	104.0	94.0	101.8	101.2	97.6	99.2
including: exports to non-CIS countries	99.1	98.0	104.8	92.6	102.9	106.1	95.7	99.9
Petroleum products, total	117.9	106.3	108.0	105.0	105.3	106.2	98.5	105.4
including: exports to non-CIS countries	119.1	104.5	107.6	102.0	107.1	109.6	94.6	99.2
Gas, total	103.7	97.6	94.6	101.8	86.2	105.6	104.0	95.5

* As % of January–September 2011.

Source: RF Federal State Statistics Service.

Against the background of high global oil and natural gas prices, in January–October 2012 the share of fuel and energy products in Russian exports amounted to 70.6%, including crude oil exports – to 34.7% (Table 4).

Table 4

Value of Petroleum Product Exports and Their Share in the Total Volume of Russian Exports in 2005-2012

	2005		2010		2011		2012 January–October	
	bn USD	%*	bn USD	%*	bn USD	%*	bn USD	%*
Fuel and energy products, total	154.7	64.1	267.7	67.5	357.2	69.2	304.8	70.6
including:								
crude oil	83.8	34.7	134.6	34.0	179.1	34.7	149.9	34.7
natural gas	31.4	13.0	47.6	12.0	63.8	12.4	50.9	11.8

* As % of the total volume of Russian exports.

Source: RF Federal State Statistics Service.

As the prices of crude oil and petroleum products in Russia are set as netback prices, equal to the international price of a product less the amount of export customs duty and export freight costs, the behavior of producer prices for crude oil and petroleum products reflects the behavior of their international prices (Table 5). The domestic natural gas prices, which are still subject to state regulation, over the course of the current year significantly increased in response to their latest adjustments within the framework of price indexation designed to eventually equalize the profitability of Russian natural gas sales on the domestic and foreign markets.

Table 5

Domestic Prices of Oil, Petroleum Products and Natural Gas Expressed in USD in 2005 – 2012 (Average Producer Prices, USD/ton)

	2005 December	2006 December	2007 December	2008 December	2009 December
Oil	167.2	168.4	288.2	114.9	219.3
Motor gasoline	318.2	416.5	581.2	305.1	457.4
Diesel fuel	417.0	426.1	692.5	346.5	394.8
Furnace fuel oil	142.7	148.8	276.5	125.0	250.8
Natural gas, USD/1,000 m ³	11.5	14.4	17.6	18.1	16.9

	2010 December	2011 December	2012 January	2012 июнь	2012 September	2012 November
Oil	248.2	303.3	319.3	281.8	410.3	340.5
Motor gasoline	547.9	576.9	544.4	542.3	678.2	678.9
Diesel fuel	536.1	644.9	674.9	597.1	725.3	735.7
Furnace fuel oil	246.3	274.6	300.2	276.8	333.0	298.8
Natural gas, USD/1,000 m ³	20.5	21.3	28.5	28.8	35.2	35.1

Source: based on data published by the RF Federal State Statistics Service.

A positive influence on Russia's oil sector was also produced by a number of alterations in the system of taxation. In recent years, in order to stimulate the development of untapped basin provinces with no adequate infrastructure, Russia established tax holidays with regard to Mineral Resources Extraction Tax (MRET). From the beginning of 2012 onwards, the MRET tax holidays regime is also established for the new oil fields situated in Yamalo-Nenets Autonomous Okrug north of 65°N and for the oil fields in the Back Sea and the Sea of Okhotsk. In order to create incentives for developing small oil fields with initial producible oil reserves of up to 5m tons, Russia's fiscal authorities have introduced a downward coefficient to be applied

to the rate of MRET levied on oil extraction, which specifies the size of oil reserves in a given oil field.

In 2012, Russia adopted some additional measures designed to stimulate oil production. For the new oil fields in eastern Siberia, the MRET tax holidays is extended from 2017 to 2022. Besides, the mechanism for applying reduced rates of export duty on crude oil from new oil fields in eastern Siberia, Yamalo-Nenets Autonomous Okrug and Nenets Autonomous Okrug was legislatively established. Previously, this approach had already been tried in actual practice: reduced rates of export duty on oil were applied to oil fields in eastern Siberia and the Caspian Sea, to Prirazlomnoe oil field on the Arctic Ocean shelf and to extra-heavy oil fields (*Table 6*). However, the mechanism itself for applying such rates had not been legislatively approved.

Table 6

Rates of Export Duties on Oil and Petroleum Products in December 2012, USD/ton

	2012 December
Export duty on oil	396.5
Export duty on oil for oil fields in eastern Siberia, Caspian Sea, and from Prirazlomnoe oil field	193.3
Export duty on extra-heavy oil	39.6
Export duty on gasolines	356.8
Export duty on other petroleum products	261.7

Source: RF Government's Decree of 22 November 2012, No 1201.

At the same time, the tax burden on the gas sector was increased. In November, it was legislatively established that the rate of MRET on natural gas production was to be raised to Rb 788 per m³ in 2015. (Table 7). In conditions of rising domestic natural gas prices, such an increase in the MRET rate should enhance the capture of natural gas rent and thus substantially augment the revenues of the state budget.

Table 7

MRET Rate for Natural Gas in 2010–2015

	2010	2011	2012	2013 1 st half-year	2013 2 nd half-year	2014	2015
MRET rate, Rb/1,000 m ³	147	237	509	582	622	700	788

Source: RF Tax Code (2010–2012 wording); Federal Law of 29 November 2012, No 204-FZ.

The continental shelf of the Russian Federation contains considerable untapped resources of oil and natural gas. However, the development of shelf oil and natural gas fields is associated with very high capital expenditures and operating expenses, and so it is not going to be cost-effective in the framework of the existing general tax system. In December 2012, the RF Ministry of Finance, the RF Ministry of Energy and the RF Ministry of Economic Development agreed upon a coordinated concept of levying taxes on hydrocarbon extraction on the continental shelf, which envisages a special preferential tax regime to be applied to offshore oil and natural gas production.

This tax regime will be based on two pillars: a reduced ad valorem rate of MRET, which is to be differentiated depending on different categories of project complexity, and tax on profit. All shelf development projects are subdivided into four complexity categories. The rate of MRET is to be established, depending on the category of complexity assigned to each project, in the amount of 30, 15, 10 or 5% of the sale price for the extracted hydrocarbons. It is not intended to levy any export duty on the products exported in the framework of the continental shelf development projects.

Thus tax regime is expected to create the necessary economic conditions for the development of new oil and natural gas fields on the continental shelf.