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The Oil and Gas Sector

Since the beginning of 2012, the situation in the oil and gas sector has been characterized by the persistence of high global oil and natural gas prices. According to preliminary estimates, the average price of Brent crude oil in January-September 2012 amounted to \$ 112.4 per barrel, which translated into high profits of Russian oil and gas companies and considerable revenues of the state budget. Oil production and petroleum products exports have significantly increased. Russia's authorities are planning to introduce additional tax measures designed to stimulate the development of new oil fields. At the same time, the tax burden on the gas sector is expected to be increased in order to enhance the capture of natural gas rent and to augment the revenues of the state budget.

In 2012, the situation on the global oil market so far has been characterized by the persistence of high oil prices. According to preliminary estimates, the average price of Brent crude oil in January-September 2012 amounted to \$ 112.4 per barrel, which exceeded last year's average (Table 1, Fig. 1).

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 prices for long-term contracts where the price of natural gas is pegged to petroleum product prices.

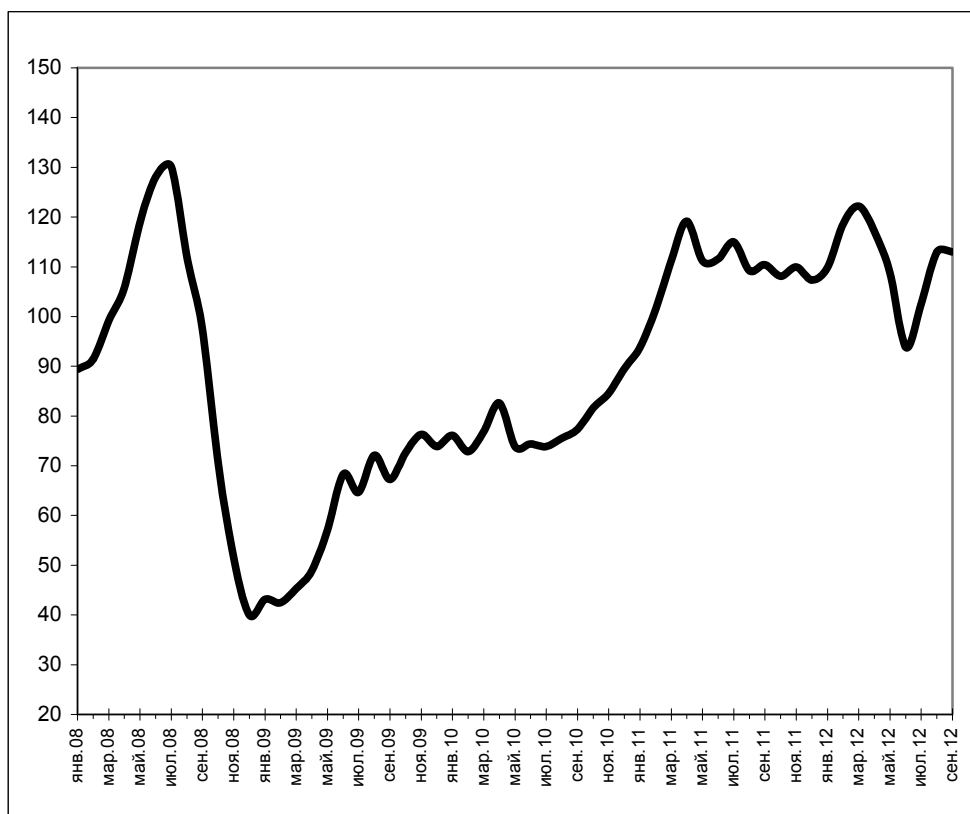
Table 1

International Prices of Oil and Natural Gas in 2008–2012

	2008	2009	2010	2011	2012 I кв.	2012 II кв.	2012 July	2012 August	2012 September*
Price of Brent (UK), USD/barrel	97.7	61.9	79.6	111.0	118.5	108.9	103.1	113.3	113.1
Price of Urals (Russia), USD/barrel	94.5	61.0	78.3	109.1	116.9	106.5	102.5	112.9	112.0
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	409.7	410.4	н/д

* Preliminary estimate.

Source: IMF, OECD/IEA.



Jan 08	Mar 08	May 08	Jul 08	Sep 08	Nov 08	Jan 09	Mar 09	May 09	Jul 09	Sep 09	Nov 09	Jan 10	Mar 10	May 10	Jul 10	Sep 10	Nov 10	Jan 11	Mar 11
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Jan 12 Mar 12 May 12 Jul 12 Sep 12

Source: OECD/IEA.

Fig.1. Price of Urals Crude Oil in 2008–2012, USD/barrel.

Against this background, oil production continued its upward trend. In January-August 2012, oil production rose by 1.0% on the corresponding period of 2011 (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 and 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 the depleted resource base of 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 substantial rise in RF petroleum product exports. In January-August 2012, Russia’s oil refining efficiency amounted to 71.6% (vs. 71.0% in January-August 2011). Thus, in this respect Russia significantly lags behind the leading industrially developed countries, where oil refining efficiency amounts to 90-95%.

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– August*
Oil, including natural gas condensate	102.2	102.1	102.1	99.3	101.2	102.1	100.8	101.0
Primary crude oil distillation	106.2	105.7	103.8	103.2	99.6	105.5	103.3	104.1
Motor gasoline	104.8	107.4	102.1	101.8	100.5	100.5	102.0	103.4
Diesel fuel	108.5	107.0	103.4	104.1	97.7	104.2	100.3	96.3
Furnace fuel oil	105.8	104.5	105.2	101.9	100.8	108.5	104.6	101.5
Natural gas	100.5	102.4	99.2	101.7	87.9	111.4	102.9	96.4

* As % of January–August 2011.

Source: RF Federal State Statistics Service.

The year 2012 saw a considerable rise in petroleum product exports: in January-June they grew by 8.5% 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-July 2012, the share of exports in the total volumes of fuel oil and motor gasoline resources amounted to 59% and 8.6% respectively (in 2011, the share of exports in motor gasoline output was 10.6%). At the same time, petroleum product imports and their share in the coverage of domestic demand significantly declined. In January-July 2012, motor gasoline imports dropped more than twofold, thus reducing their share in the total volume of motor gasoline resources to a mere 0.9%.

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– June*
Oil, total	98.4	98.0	104.0	94.0	101.8	101.2	97.6	97.5
including:								
exports to non-CIS countries	99.1	98.0	104.8	92.6	102.9	106.1	95.7	97.2
Petroleum products, total	117.9	106.3	108.0	105.0	105.3	106.2	98.5	108.5

including:								
exports to non-CIS countries	119.1	104.5	107.6	102.0	107.1	109.6	94.6	101.9
Gas, total	103.7	97.6	94.6	101.8	86.2	105.6	104.0	90.4

* As % of January–June 2011.

Source: RF Federal State Statistics Service.

Against the background of high global oil and natural gas prices, in January–July 2012 the share of fuel and energy products in Russian exports amounted to 71.0%, including crude oil exports – to 35% (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–July	
	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	214.6	71.0
including:								
crude oil	83.8	34.7	134.6	34.0	179.1	34.7	105.8	35.0
natural gas	31.4	13.0	47.6	12.0	63.8	12.4	36.9	12.2

* As % of the total volume of Russian exports.

Source: RF Federal State Statistics Service.

In Russia, the domestic pricing of crude oil and petroleum products is directly linked to their international prices in accordance with the equal profitability principle for their sales on the domestic and foreign markets. This means that the prices of crude oil and petroleum products are set as netback prices, equal to the international price of a product less the amount of export customs duty and export freight costs. In this connection, the behavior of producer prices for crude oil and petroleum products reflects the behavior of their international prices (Table 5, Fig. 2). As regards Russian domestic natural gas prices, they are still subject to state regulation. Over the course of the current year, domestic natural gas prices have 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

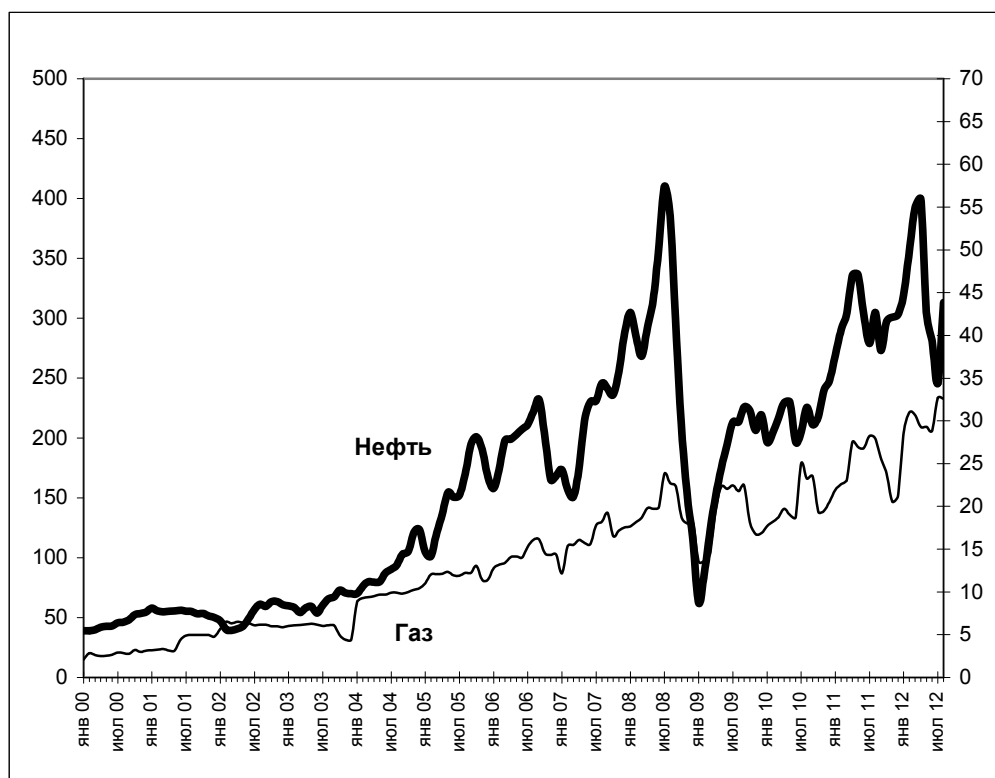
Domestic Prices of Oil, Petroleum Products and Natural Gas Expressed in USD in 2005 – 2012 (Average Producer Prices, USD/ton)

	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 June	2012 July	2012 August
Oil	248.2	303.3	319.3	281.8	245.9	313.1
Motor gasoline	547.9	576.9	544.4	542.3	565.0	591.8
Diesel fuel	536.1	644.9	674.9	597.1	625.9	674.2
Furnace fuel oil	246.3	274.6	300.2	276.8	286.0	307.6
Natural gas, USD/1,000 m ³	20.5	21.3	28.5	28.8	32.7	32.6

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



Oil

Natural Gas

Jan 00 Jul 00 Jan 01 Jul 01 Jan 02 Jul 02 Jan 03 Jul 03 Jan 04 Jul 04 Jan 05 Jul 05 Jan 06 Jul 06
 Jan 07 Jul 07 Jan 08 Jul 08 Jan 09 Jul 09 Jan 10 Jul 10 Jan 11 Jul 11 Jan 12 Jul 12

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

Fig. 2. Mean Producer Prices of Oil and Natural Gas, Expressed in US Dollars, in 2000 – 2012, in USD per Ton and USD per Thousand Cubic Meters

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, Russia established tax holidays with regard to Mineral Resources Extraction Tax (MRET). From the beginning of 2012 onwards, the MRET tax holidays regime is established for the new oil fields situated in Yamalo-Nenets Autonomous Okrug north of 65°N and for the oil fields in the Barents 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 the nearest future, Russia is expected to adopt the following additional measures designed to stimulate oil production: to extend the MRET tax holidays for new oil fields in eastern Siberia from 2017 to 2022; to reduce the rate of export duty on oil from new oil field in eastern Siberia, Yamalo-Nenets AO and Nenets AO; and to introduce reduced MRET rates for 'hard to recover' fields.

At the same time, Russia is planning to increase the tax burden on the gas sector by raising the rate of MRET on natural gas. The proposals to that effect prepared in September 2012 by the RF Ministry of Finance are presented in Table 6. According to the proposals, independent natural gas producers should be entitled to the following downward coefficients to the MRET rate on natural gas production: 0.646 in 2013; 0.673 in 2014; and 0.701 from 2015 onwards.

Table 6

MRET Rate for Natural Gas in 2010 – 2015, Rb/1,000 m³

	2010	2011	2012	2013	2014	2015
MRET established rate for natural gas extraction	147	237	509	582	622	
Rate suggested by RF Ministry of Finance, September 2012				602	700	788

Source: RF Tax Code (2010–2012 wording); RF Ministry of Finance.

In conditions of the expected rise in domestic natural gas prices, such an increase in the MRET rate should enhance the capture of natural gas rent and to substantially augment the revenues of the state budget.