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News Analysis: Low Investment Hampers Oil

By The Moscow Times

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Russia, the world's largest crude producer, is unlikely to make substantial production increases in coming years to capitalize on tight markets or even keep pace with demand due to a lack of investment and a heavy tax burden.

Lack of new projects in the pipeline, while existing fields mature, is a worry for the country, which is hoping to at least sustain crude production above 500 million tons (10 million barrels per day) over the next 10 years.

Russia increased its oil output by 1.2 percent in the first half of 2011 thanks to newly launched deposits. That was a notch above the 1.1 percent forecast in a Reuters poll for full-year 2011, which was compiled early this year when oil was about $85 per barrel.

Since that forecast, prices have jumped above $100, boosted by unrest in the Middle East and a nuclear disaster in Japan, and Russian oil producers have increased their rate of pumping crude.

But analysts say the increase is still small as companies strive to make up for a continued decline in production from their existing fields.

"Certainly, Russia's production growth is not catching up with the world's growing demand. Russia's mature fields base is so large that it needs a lot of new projects just to offset that decline," Julius Walker, senior oil market analyst at the International Energy Agency, told Reuters.

"So any changes to the tax regime would have to be ones that encourage significant new fields startups — and/or investments needed into fields with declining production."

Prime Minister Vladimir Putin has said the country will need more than 8.6 trillion rubles ($308.7 billion) to keep pumping oil at current levels until 2020, while the Energy Ministry has warned that output could fall 20 percent without substantial financing.

According to leading forecasters, global oil demand will rise 1.4 to 1.6 percent this year.

The country produced 10.195 million bpd — 2 percent of the world total — in June, according to government data. That is down 0.6 percent from a post-Soviet high of 10.26 million bpd reached in May and compares to its all-time peak of 11.41 million bpd in 1988, when it was still part of the Soviet Union.

The IEA forecasts that Russia's oil and condensate production is set to peak at 10.57 million bpd next year and then start declining. The IEA's definition of production is slightly broader than that used by Russian officials.

It also forecasts that the rate of increase is set to slow this year.

"Year on year, in 2011 I see it up 90,000 bpd, compared with a 240,000 bpd rise in 2010, as growth from new fields slows," IEA's Walker said.

Government taxation policy has not been helpful for companies that are tapping hydrocarbon reserves in the country, and analysts do not see a light at the end of the tunnel.

Domestic oil and gas companies pay higher tax rates than other industries, with taxes taking 78 percent of total oil company profits and 56 percent of gas company profits.

Proposals to make taxation more diverse and profit-based have long been mired in discussions, while the government is looking to increase the tax burden to compensate for more spending ahead of parliamentary and presidential elections.

Russia canceled preferential export duties for Rosneft's Vankor oil field — a new field launched in 2010 that has become a major driver of overall output growth — as well as for TNK-BP's Verkhnechonskoye and Surgutneftegaz's Talakan, starting from May.

"The key to the answer of whether Russia will increase its production is Vankor. If Rosneft achieves the target of 25 million tons of oil production there in 2013, this will be a decisive factor," said Valery Nesterov from Troika Dialog brokerage.

The country's greenfields such as Vankor together account for only some 15 percent of total oil output.

According to Nesterov, green-field production grew over 13 percent in the second quarter, while output from mature fields declined by 0.2 percent.

"The output growth in Russia is hardly sustainable due to a heavy tax burden and unclear regulation rules. There are simply no drivers for further growth there," Nesterov said.

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