



Russia's energy resources could attract U.S. investors

But a number of obstacles still need to be overcome, energy experts say

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The potential for U.S. companies to invest in Russia's energy industry and for Russia to export more oil and gas to the U.S. is great, but so is the amount of effort that is needed to overcome obstacles to capitalizing on that potential, according to experts at a two-day seminar organized by Rice University's Baker Institute for Public Policy and the Carnegie Endowment for International Peace.

A summary of the U.S.-Russian Energy Summit Executive Seminar, held June 17-18 at the Carnegie Moscow Center, was published this week by the Baker Institute and the Carnegie Endowment for International Peace. Sponsored by the Petroleum Energy Center of Japan, Renaissance Capital, Baker Botts L.L.P. and Lehman Brothers, the seminar convened senior Russian and U.S. government officials, energy industry leaders from both countries, and scholars and other experts to discuss the strategic and geopolitical implications of the Russian energy supply, security and pricing.

Officials at the seminar noted that the U.S. is the world's largest energy consumer and that it needs to diversify its supply sources; they noted also that Russia houses some of the world's largest deposits of oil and gas and has an economic need to develop and market those resources. During the seminar, a number of factors were cited as obstacles to pursuing these seemingly mutual interests:

* The production-sharing-agreement tax amendments that the Russian Parliament passed in May did not go far enough to inspire international confidence in the stability of Russia's investment climate.

* Also deterring major long-term investments is the lack of clearly defined legal regulations and business structures to encourage private-sector initiatives and to promote cooperation between the private sector and state entities, especially in the area of pipeline development.

* Modernization of Russian refineries to minimize the amount of fuel oil produced and maximize the production of more desirable products like diesel fuel and gasoline will require an investment of approximately \$10 billion over the next 10 years.

* Construction of a new infrastructure by private oil companies, which would allow greater and more rapid development of existing oil resources than relying on state monopolies, has been hindered by the Kremlin's reluctance to give up the financial benefits and political influence inherent in controlling Russia's geopolitically important export flows.

* Technical, economic and bureaucratic hurdles are hindering future resource development of remote areas of Russia, such as East Siberia and the north Caspian Sea. For example, there is disagreement about the best routing strategy for exporting oil from East Siberia eastward. And the question of who will pay for and manage such projects is unresolved.

Amy Myers Jaffe, the Wallace Wilson Fellow for Energy Studies at the Baker Institute, noted that most seminar participants seemed convinced that despite progress in reforming the Russian energy sector and encouraging foreign involvement, Russia's investment climate and reliable access to needed export infrastructure remain uncertain.

"Low hanging fruit has borne strong returns to the Russian industry in recent years, but a stable investment environment that gives an incentive to major long-term investment in new, large greenfield projects is sorely needed if Russia is to become the global energy power it has the natural endowment to be," Jaffe said. This applies not just to American investment in Russia, but also to Russian businesses. "Russia's private firms will be equally tempted to invest elsewhere if Russia's investment climate does not offer stable returns," Jaffe said.

Virtually all seminar participants agreed that improved cooperation on energy issues is in both U.S. and Russian interests, but differences must still be bridged for a sustained partnership to develop.

Edward Morse, executive adviser for Hetco, states in the conclusion of the report that "the U.S.-Russian relationship on the energy side went from a period of hype and grand promises to a period of strain." He criticized analysts who argue that U.S. and Russian interests diverge in regard to oil.

"Objectively, I think there is much scope for a special U.S.-Russian tie," Morse said. "However, the question to me is whether either or both governments have the vision that's required to implement such a strategic partnership."

The full report is posted on the Baker Institute Web site, <http://bakerinstitute.org>.

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