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Weekly analysis

RUSSIAN OIL INDUSTRY ON THE VERGE OF DECLINE

According to the Society of Petroleum Engineers, Russia owns the eight largest oil fields in the world possessing around 5% of the global proven reserves of oil and gas condensate (80 billion barrels). Currently, Russia accounts for 14% of the global oil production with 11 million barrels per day, which is a record high level for Russia making it one of the leading oil producing countries. The projected average level of oil production by the Russian Ministry of Energy for 2018 is 11.2 million barrels per day, whereas the International Energy Agency forecasts 11.4 million barrels per day by 2020.

On the other hand, a recent report by the Ministry of Natural Resources and Ecology of the Russian Federation revealed a number of striking facts: during 2016-2017, not a single new gas field was commissioned in the country, not a single large oil field was discovered, and drilling works on the Arctic shelf were suspended for an undetermined period of time. Interestingly, none of the above-mentioned facts would have been foreseen before 2014. There are several factors indicating that currently Russia is at the peak of its oil production, which is about to start declining irreversibly in the mid-term perspective.

Firstly, despite enormous amounts of proven oil reserves, there are certain circumstances and fundamental geological restrictions that make it costly to continuously increase oil production in Russia with the same capital and technologies that is available today. About 60% of all oil produced in Russia nowadays is extracted from the oil fields of Western Siberia, primarily concentrated in the Yamalo-Nenets Autonomous Okrug. The rest of the production is scattered across many other oilfields predominantly concentrated in the neighboring Volga-Ural region, other parts of Siberia and the Arctic shelf. Many of the existing large oil fields that are currently operated are in fact substantially depleted.

Thus, according to a recent report by Russia's VYGON Consulting company, the production of oil in Western Siberia has reduced by 10% within the latest decade and the average well productivity dropped by 36%. Without significant technological upgrades, the production would fall by more than 2% yearly, and by 2024 the total production in Western Siberia would reduce by 17%. The primary reason for the decline in the production is the rising water content of the oil deposits that result from water injection into the wells. According to the Russian Ministry of Natural Resources and Ecology, the current degree of depletion of the West Siberian oil and gas basin is above 50%. The depletion of the Volga-Ural oil and gas basin is approaching 70%.

Even though it becomes more and more costly to increase the production through exploiting the existing oil fields, there are still significant amounts of oil reserves in other parts of the country that could potentially sustain the current volume of oil production or even increase it. However, this option has become difficult to accomplish since recently as the Russian economy and its oil and gas industry, in particular, bear the burden of the sanctions imposed by the United States, the European Union (EU) and some other countries that will lead to severe negative consequences over the long term. On August 1, 2014, the EU imposed sectoral sanctions that among many other things include a ban on the provision of innovative technologies to the Russian oil industry. In September 2014, another package of sanctions was introduced by the United States and the EU restricting the access of the largest Russian oil and gas companies to capital markets. Any cooperation with the Russian Federation related to services for deep-water mining and oil production was also restricted to a great extent.

The Western sanctions have already resulted in some tangible adverse effects for Russia's oil and gas sector, which relies heavily on importing foreign drilling and refinery equipment, as well as on international financing. For example, limited cooperation and restrictions of access to new oil production technologies have led to the cancellation of nine major joint projects between the largest Russian oil company Rosneft and ExxonMobil, which means the loss of investments for ExxonMobil and the need to start searching for new partners and investors for Rosneft. According to the recent research by the Russian AKRA credit rating agency, negative effects of the cancelation of these projects will materialize by 2020 in the form of curtailed production at the major oil fields and unfeasibility of production at new oil fields with higher costs of oil extraction. During the past two years, Rosneft has also suspended its projects in the Russky, South Prinovozemelsky, Pomorsky, North Pomorsky-1, North Pomorsky-2 and East Siberian license areas located on the Arctic shelf that are believed to be highly promising.

The direct consequence of the Western sanctions and restricted cooperation in the oil and gas sector is the deficit of equipment, which is necessary for launching new oil wells and extracting oil in the sea shelf. According to the Russian Ministry of Energy, about 68% of the previously imported equipment for the oil and gas industry such as offshore oil platforms, drilling equipment, electric pumps and related software is now included in the sanctions list. In fact, the sanctions also negatively affect other extractive industries of Russia that are essentially important for its economy.

It is well known that the Russian economy is highly dependent on oil and gas exports. Despite numerous initiatives and state programs aimed at the diversification of the economy, the continuous increase of oil and gas production and exports since 2014 has led to a further strengthening of the dominance of the hydrocarbon industry in the Russian economy. It has been estimated that, at the current oil prices, a continuation of the Western sanctions would lead to $3-4 billion annual losses of direct revenues from Russian oil exports. By 2025, this figure would reach $25-30 billion per year. In 2017, the share of the revenues from the oil and gas sector in the federal budget of Russia amounted to 39.58%. In this light, it becomes clear that the prolongation, let alone the tightening, of the current sanctions regime would make oil production in Russia to contract gradually, causing negative economic consequences.

Written by Kanat Makhanov
Eurasian Research Institute, Kazakhstan

Politics, Foreign Affairs, and Security

- The CIS leaders summarized the year's results at their informal summit held in St. Petersburg. Among other things, the summit participants discussed prospects of further integration within the framework of the CIS and exchanged views on socioeconomic and security issues.
- The 25th OSCE Ministerial Council with participation of foreign ministers of the OSCE member states was held in Milan. The meeting participants reviewed Italy's activities as the OSCE 2018 chair and agreed decisions on the OSCE's politico-military, economic and environmental, and human dimensions, as well as on cross-dimensional issues.
- The ministers of foreign affairs of the CSTO member states adopted a joint statement in support of the Treaty on the Elimination of Intermediate-Range and Shorter-Range Missiles. Prior to that, U.S. Secretary of State Mike Pompeo said that Russia had 60 days to comply with its treaty obligations, or the United States would withdraw from the accord.
- The first high-level Eastern Partnership annual conference was held in Vienna under the theme "A Stronger Economy for Stronger Societies – Investing in People for Sustainable Growth". The event that brought together stakeholders from the EU and six partner countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine) focused on the economic and investment climate, labor market challenges, and youth issues.
- Ukraine's Verkhovna Rada voted to discontinue the Agreement on Friendship, Cooperation, and Partnership with the Russian Federation starting April 1, 2019, the expiry date of the document. 277 parliament members voted in favor of the relevant edict of President Poroshenko signed in September 2018.
- The Constitutional Court of the Russian Federation approved the controversial border agreement between Ingushetia and Chechnya, thus overruling the previous decision of the Constitutional Court of Ingushetia that had found the deal to be illegitimate. The leaders of the two republics, Yunus-Bek Yevkurov and Ramzan Kadyrov, supported the ruling of the federal court.
- The parliament of Turkmenistan ratified the Convention on the Legal Status of the Caspian Sea. In addition, the Turkmen parliamentarians approved the ratification of the agreements between the Caspian states on the prevention of incidents in the Caspian Sea, on trade and economic cooperation, and on cooperation in the field of transport.

Economy, Finance, and Energy

- The heads of the EEU member states attended the meeting of the Supreme Eurasian Economic Council held in St. Petersburg. The participants reviewed the results of Russia's 2018 chairmanship in the EEU, discussed organizational aspects of the union's activities, and outlined the key directions for deepening Eurasian integration.
- During the 5th OPEC+ Ministerial Meeting held in Vienna, the participating states agreed to cut oil production by 1.2 million barrels per day (bpd) from January to June 2019. Of this volume, the OPEC member states will contribute 0.8 million bpd, while the non-OPEC countries will account for 0.4 million bpd.
- According to the Chinese Embassy in Tashkent, over 60 projects that use Chinese government and commercial loans are implemented in Uzbekistan. The projects cover such fields as electric power engineering, coal mining, hydropower, chemical industry, air communication, and railway transport.
- According to Kazakhstan's Ministry of Agriculture, in the first nine months of 2018, the country's agricultural exports to China increased by 42%. Currently, 153 Kazakh enterprises have the right to export agricultural products to China.
- According to the Kazakh Invest national company, Kazakhstan is involved in investment negotiations with about 20 leading Turkish holdings. Proposed projects include the construction of solar power plants, the opening of a modern clinic, the production of canned vegetables, paint and varnish products, sandwich panels, yarn and home textiles, and processed meat products, as well as projects in the logistics, chemical, mining, and metallurgical industries.
- The Turkmen company Gundogar Akymy, which constructs two sunflower oil plants in Turkmenistan, signed a contract for the supply of sunflower seeds with the Swiss Syngenta Agro AG. In addition, the Turkmen company Agzybir Ojak signed contracts with the Turkish companies Erensoy and Ektam Makine for the purchase of equipment to manufacture bottled products and refined oil packaging.
- The Asian Development Bank updated the 2019–2021 country program for Tajikistan to focus on supporting private sector, road and energy development, education and healthcare improvement, food security, and municipal infrastructure. The indicative financial assistance in the form of grants for the three-year program exceeds $300 million, but will depend on the country's performance and availability of funds.

Society and Culture

- The international conference on statelessness in the CIS region organized by the UN High Commissioner for Refugees Representation in Belarus, the Belarusian Ministry of the Interior and the CIS Executive Committee was held in Minsk. The event was aimed at sharing best practices and developing appropriate approaches and strategies in the field of identification, prevention and reduction of statelessness.
- The Forum of CIS Youth Organizations held in Moscow brought together young leaders and officials responsible for implementing youth policies in the CIS countries. The forum focused on discussing the participation of youth in addressing global issues and promoting opportunities for youth development.
- The Turkish Airlines announced its plan to increase the number of flights to Tashkent and Samarkand. The airline is also interested in opening flights to Bukhara. It was noted that the company's pricing policy regarding Uzbekistan could be modified to offer significant discounts.
- Turkmenistan will revise its National Strategy on Climate Change to make it relevant with the country's international commitments under the UN Framework Convention on Climate Change and the Paris Agreement, as well as in the context of the UN Sustainable Development Goals. The State Committee for Environmental Protection and Land Resources will coordinate this work, supported by the UNDP and the German Society for International Cooperation.
- The Green Climate Fund will provide a $10 million grant for climate change adaptation measures in Kyrgyzstan. The UN World Food Program and the Kyrgyz State Agency for Environmental Protection and Forestry plan to spend the funds on joint projects aimed at improving food security and nutrition.
- The Uzbek government opened 18 water reservoirs for the development of ecotourism. The decision will allow business entities and investors to develop recreation opportunities in the Andijan, Jizzakh, Kashkadarya, Namangan, Samarkand, Surkhandarya, Tashkent and Fergana regions.
- Almaty hosted the Central Asia Documentary Film Festival. 18 short and full-length films out of more than 60 applications were selected for the competition. The main topics were environment, labor migration, human rights, and the search for identity. Zaheed Mawani's documentary Harvest Moon won the festival's grand prix.

EURASIAN RESEARCH INSTITUTE
Mametova 48, Almali, 050004,
Almaty / KAZAKHSTAN

Office: +7 (727) 279 97 94 Fax: +7 (727) 279 24 26
ayu.edu.tr • eurasian-research.org
info@eurasian-research.org

Prepared by
Dauren Aben and Kanat Makhanov