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USSR OIL CONCESSION POLICY ALTERNATIVES:  
THE LESSONS FROM DOMESTIC HISTORY  
AND MODERN WESTERN PRACTICE

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To carry out "perestroika" in the economic sphere, the USSR needs to make a breakthrough in its productive forces development. There are no positive prospects to solve this problem without active involvement of Soviet economy into international division of labour. If we stay on the ground of "economic independence" as we did during a lot of previous years the USSR will be solving this problem across long-long decades and God knows whether we'll solve it at last or not.

Modern international technologies and managerial skills are of vital importance for the USSR today. The most effective form of their win over and utilization are the joint ventures (JV). So the need in JV is a call of time. But we have a need in them not only lacking progressive materials and equipment. From my point of view, we vitally need them mainly because of their ability to act as some sort of "inoculation" of industrial culture which principally differs from its level reached today in Soviet country.

This inoculation to be most effective, we need to determine correctly all the parameters of the "injection": size, place, time, etc. In other words we do need not an injection as it is trying to create without a system the more of JV - the better. We do need a substantiated program of their development. To materialize this program all the positive experience need to be involved: either from modern Western, or from our domestic historical practice.

Up to September 2 of this year 1790 JV has been registered in the USSR (Fig.1).

FIGURE 1

Only some 500 of this amount are actually functioning. Foreign investments totals only some \$1.6 billion. JV's input to Soviet national income, according to some estimates, accounted for only 0.02% in 1989.

Recent Soviet developments in JV legislation are summarized in Fig.2.

FIGURE 2

Fig.3 shows the mechanism of JV profit-sharing according to current Soviet legislation.

FIGURE 3

The structure of JV by industries and origin is presented in Fig. 4 - 7.

FIGURE 4

FIGURE 5

FIGURE 6

FIGURE 7

Some experts considered that the Government has not yet worked out nor the concept, nor the strategy of joint venturing in the USSR. The industries where JV may be of major importance has not been marked out yet. And in the process of JV creation this country has been usually the passive partner.



From my point of view, September '89's decision of Soviet Government to create first three specialized free economic zones (in Viborg, Nakhodka and Novgorod) must be considered only as a particular case but not the part of a long-term program.

But in our history we can see at least two periods of active involvement of foreign capital into economic development of this country.

One is the period of the first Russian industrial revolution in the end of the XIX - beginning of the XX century. The other is the period of the "New Economic Policy" (NEP) of 1920s in the post-revolutionary Russia/USSR.

So our recent activities in JV sphere is the third wave (rather weak yet) of foreign investments in Russia. And it will be useful to summarize in brief some positive experience of the two previous periods and to compare these results with current JV state of development.

### PRE-REVOLUTIONARY EXPERIENCE

Russia was "opened" to foreign industrial capital 135 years ago: the first Western firm - "German Continental Gas Company" - was permitted to act in this country in 1855. And it is symbolic that foreign industrial capital has began its operations in the Russian market through one of the energy branches - the sphere of final energy consumption.

The cumulative total of foreign investments in Russian industry up to 1913 (excl. investments in credit institutions, municipal services and trade) is estimated with different variations to mean Rb1300 mln that is equal to some 1/3 of grand total of industrial investments.

Only a little more than 40% of foreign investments were spent on formation of their own companies. The rest of the capital was invested in the shares of Russian companies.

More than 70% of foreign industrial investments were directed in heavy industries. Such a strong inflow of foreign capital with such priorities speeded up over and over the process of the first Russian industrialization. It allowed this country to fall through the "cotton period" of evolution without undue delay and to enter the "iron age" of its economic development.

Foreign capital acted as a locomotive of industrial development creating new businesses. And then it often let growing in force Russian businessmen have these businesses. Such a scheme was rather typical in those years.

Most of the experts suppose that Russian oil industry was also created mainly by foreign capital. 54% of total foreign industrial investments in pre-revolutionary Russia (up to 1917) were invested in mining and the major part of English industrial investments was put directly in petroleum production.

95% of Russian oil came from Baku. The rapid growth of this region began when productive technology was changed: from digging draw-wells to drilling wells. The news about "oil Eldorado" in Baku gave rise to strong inflow of foreign capital in the Russian petroleum industry.

The total fixed capital of petroleum companies in Baku in 1915 was estimated in Rb487.4 mln and Rb130 mln of this or 27% has been controlled by "Brothers Nobel Company". Another major company was "Caspian-Black Sea's Oil Production and Trade Company" of Rothschilds. And maybe the only representative of Russian oil business of that size was Mantashev's company but it is difficult to say for sure how pure (without foreign capital) was its genesis.



In 1890 these three companies accounted for 80% of total Baku oil export. Specialists suppose that this figure can be taken as an indicator of their role in total petroleum industry.

There is a lot of countries which economic development with the help of foreign capital was based only on export of some few raw materials, needed in financial mother-country, and on import from the latter the broad range of processed goods.

Economic history of pre-revolutionary Russia does not provide apprehensions of that kind. Such a suspicion can appear first of all in connection with mining companies's activities, but they accounted only for 1/3 of all foreign investments in Russia's economy. So, with the help of foreign capital the Tsars Russia did not become "banana republic" or, more accurate, "banana empire".

Export of capital in Russia was not usually aimed on mining industries development in order to supply states-investors with raw materials. Thus, oil production in Russia was adjusted by Nobel and Rotshild. To the beginning of the XX century this country won the first place in world petroleum production: 9.6 mln tonnes was produced in Baku in 1900 or 50:6% of world total. But crude petroleum practically was not exported from this country. Almost all its volume, produced in Baku, was refined on local plants and only less than 5% was transported from Baku to Empire in the form of crude. Mainly products of "deep" refining, (from those time point of view) were sent for export. The main export item was kerosene (80%), lubricants accounted for some 15% and not more than 5% was the portion of other products.

Need to be indicated that only excessive part of production was exported, i.e. that could not be sold on domestic market. At the beginning of the XX century such portion of production in Russia accounted for 12-14% (for comparison: in America at that time such a portion nearly reached 50%).

And the last for this topic. Foreign companies were not in a hurry to transfer their profits back in Europe. Intensive industrial development of this country and high profitability of foreign enterprises (average rate of return on foreign investments for the period 1887-1913 was equal 12.9%) made it preferable to reinvest the profits back in Russia.

#### POST-REVOLUTIONARY EXPERIENCE ("NEW ECONOMIC POLICY")

Just at the beginning of 1918 during the talk with American representative in Russia Colonel Robins, V.I. Lenin offered concessions to foreign capital. First formal proposals of concessions were made on May 14, 1918 to the USA and on May 15, 1918 to Germany.

On November 23, 1920 Russian Government approved Resolution N 138 on general economic and legal conditions of concessions ("Decree on Concessions"). To concessions were offered: extensive and rich forest areas in Western Siberia and in the north of the European part of Russia; coal and iron ore deposits of Siberia; areas for tractor ploughing (food-concessions) in the south-east of Republic (Fig. 8 - 10).

FIGURE 8

FIGURE 9

FIGURE 10

The practical forms of foreign capital involvement in the USSR economy were of 3 traditional types:

- (1) concessions (so-called "pure" concessions),
- (2) joint companies,
- (3) purchasing by foreigners the shares of Soviet enterprises.



The first two of them were the most widely distributed. That was the principal difference from the pre-revolutionary period when the third form was of the most prevalence. The main cause of that difference consisted in the foreign businessmen's disbelief in the efficiency of the socialist principles of management. They were trying to stay in the distance from being involved in it in any form. That is why the most popular form of capital investing among foreign businessmen during the NEP-period was a "pure" concession.

Among potentially concession objects the energy sphere was of prior attention. Thus, very few people do really know that out of Rb17 bln of investments envisaged in the GOELRO-plan (that was the plan of Russia's electrification and its productive forces development) Rb6 bln or 35% of the total was projected to mobilize abroad in the form of long-term credits and concessions.

Concessions were the form of direct investments that allowed foreign firms to stay mostly independent in their current activities and routine operations. But while striking a concession agreement the Government kept for himself the possibilities to influence on decisions in the strategic sphere of economic policy of concession enterprises or long-term activities.

Concession agreement in Soviet Russia was a leasing-type treaty. A foreigner-concessionaire could lease some state property (parcels, roads, mines, fields, buildings, equipment, etc.) to organize at his own cost production of some goods. When the period of agreement ends all the fixed capital of concession had to be transferred without any repayments to the Government.

To the Soviet country the pure concession form of foreign investments possessed some additional advantages over two other forms:

For one thing, pure concession of Russian-type, unlike joint companies, did not create for foreigners the right of ownership since a concession enterprise considered to be state property granted on lease.

Secondly, concession form needed no spending of the very scanty then state capital to pay for the Soviet part of Joint company. That allowed the Government to invest the capital, saved by the use of concessions instead of JV, in the creation of such priority productions, in which foreign capital was not allowed or was not interested to participate.

The form of joint companies gave no additional privileges to the Government nor in the form of réglementation of foreign participant's activities, nor in the form of increasing State's portion in profit-sharing comparing with pure concession.

When I analyzed the terms of concessions offered by the Government of Soviet Russia (and after 1922 - by the Government of the USSR) to foreign capital, from the one hand, with the recent types of working agreements between foreign companies and host countries, from the other hand (see Fig.11), I came to the conclusion that those types of agreements that were striking by the Soviet country in the 1920's from their inner sense were not the concessions at all.

#### FIGURE 11

This term - "concession" - characterizing the practice of treaty relations with the foreign firms in Soviet Russia during NEP-period, has a little in common with the types of agreements that were widely adopted in international practice in those days and that were named "concessions" just as those used in our country. Russian concession of the 1920's is not a traditional, nor a modernized concession in their international meaning



(Fig.11). Moreover, it was not a concession, but a pure

contractual agreement, because it had no major distinctive feature of concession-type agreements - it did not transfer the right of ownership on developed natural resources to concessionaire. That is why Soviet "concession" of NEP-period is not more than the settled term formed in the time when any other forms of agreements had not been existed.

So let us bear in mind this fact while speaking about the second wave of foreign investments in Russia and "concession policy" of the 1920's.

In that period oil concessions were also of particular attention. The Governmental Resolution from the February 1, 1921 approved the distribution of concessions in Baku and Grozni. To create the mechanisms of those agreements all the best was chosen from the legislation of the main oil-producing countries and regions: Romania, California and pre-revolutionary Russia itself.

Russian oil concession of the 1920's has some distinctive features of the production-sharing contract (PSC) which is the type of petroleum agreement that considered to appear at first in Indonesia some 45 years later. From my point of view, the variety of that Russian agreement of NEP-period corresponds to the nowadays model of PSC with the one-step production-sharing used widely for instance in Libya (see Fig.12).

#### FIGURE 12

According to V.I.Lenin, the policy of concessions was not the question about the forms of exploitation of Soviet natural resources. It was the question about the means of mutually profitable involvement of foreign capital for the sake of development of all the productive forces of the country on the base of territorial/industrial principles. In the 1920's Soviet Russia possessed a colonial export structure. That is why it began with the offer of forest, mining, food and road concessions with posterior involvement of plants and factories in concession practice.

Concessions were given mainly in the outlying districts (Fig.8-10), their places were chosen by the State. By such approach the tasks of territories' development were solved. Concession terms were individual in every region and they took into consideration the positive - from those times point of view - foreign experience.

It is generally accepted that the first concession in the world was granted in 1901 (D'Arcoi concession). 20 years later so-called "concessions" appeared in Russia (which were not concessions by the essence of the matter - but rather PSC as we saw earlier) and after that only some 27 years later the first modernization of then existed "traditional concessions" came - Venezuela inserted in concession terms the 50/50 split of foreign companies profits (or the 50% tax on the profits of the concessionaire).

But as we can see it is the Soviet Russia who was the first to modernize the only type of then existed concession agreements. Moreover, unlike Venezuela, Soviet Russia did not improve the terms of existing type of agreement but shifted, by the essence of the matter, to the new type of agreements - based on leasing and having distinctive features of PSC.

So we can say that in those days Soviet Russia was for a half of a century in front of the rest of the world in creating progressive - from that time point of view - mechanism of host country's relations with foreign capital in mining and petroleum sphere in particular.



To take practical steps in "concession policy" of the country after proclaiming the USSR formation in 1922, the Central Concession Committee (CCC) was organized attached to the Government. The CCC existed from 1923 till 1937 and had a rather ramified hierarchy structure (see Fig.13).

#### FIGURE 13

The heightened attention payed by Soviet Government to concession questions in the period of preparation for, discussion and establishing of NEP and mutually profitable principles put in the base of concession policy (the major principle: from convertible goods - raw materials and other resources - to manufactures - plants and factories) resulted in sharp increase of their quantity.

The total number of concession offers, being received in the period till October 1, 1929 exceeded 2200. But they included only the offers transferred to the CCC. In practice the number of such offers was greater but the major portion of them was eliminated by different causes on the stage of foreign concession commissions (see Fig.13). Thus, from 1922 till April 1, 1924 foreign concession commission in Berlin had received 1533 offers, from which only 331 or 1/5 of total was chosen and transferred to CCC for further discussion.

The major part of offers was received from Germany, followed by UK, USA, France, etc. (see Fig.14).

#### FIGURE 14

The main number of concession agreements was signed with the companies from nine countries (see Fig.15). The minor part in concession activities also took the firms from Norway, Denmark, Latvia, Finland, Netherlands, Turkey, etc.

#### FIGURE 15

The major part of the competitors for concessions represented small and medium-size business. They were mainly interested in manufacturing activities, first of all in light and food industries, because of rather low minimum capital permissible to invest in those manufactures and its fast turnover in that branches, which was of special importance in conditions of strong deficit of goods in the USSR in the 1920's. That is why foreign capital was invested strongly also in trade (see Fig.16).

#### FIGURE 16

Attractiveness of mining and forest industries as well as agriculture (food concessions) can be explained by the fact that production of that enterprises (gold, manganese, non-ferrous metals, petroleum, coal, wood, food, etc.) could be easily and rather profitably sold in world markets during those first post-war years.

The Government gave the incentive to foreign investments in mining and forest industries because of their capital-intensive character, non-currency scheme of profit-repatriation and because of great domestic demand in raw materials which were to be supplied as a percentage of concessionaire's production.

Concessions in engineering industries were of minor attractiveness for foreign companies. Those manufactures were rather capital-intensive. The USSR lacked indispensable quantities of qualified labor force and materials. There were strong difficulties with their components's supplies. There were serious problems with their marketing: domestic market for engineering goods was rather tight and in the world market production of those concession engineering enterprises wood withstood strong competition from capitalist countries.

Out of the offers, chosen by the foreign concession commissions and other agencies (where the rate of elimination was near 80%) and permitted to CCC (total number 2211 for the period



till October 1, 1927) only 7-7.5% were accepted (total number 163 for the same period) - see Fig.16. Thus only 1.5% from the offers for concessions made by foreigners were accepted for contracting by the CCC agencies:

That testifies to the high attractiveness of Russian concessions and to the well thought-out concession policy of the Soviet Russia during the NEP-period. It is also witness a prudent, weighted approach to the contracting of concession agreements because a great number of competitors lacked necessary economic reliability.

Up to October 1, 1928 only 68 agreements were actually functioning. That was because of lack of capital. The third part of them was in manufacturing. Another one-third totalled for mining and forest industries (see Fig.17).

#### FIGURE 17

1/5 of all actually functioning concessions were of German origin. USA, UK and Japan originated some 10% each. But the UK stood in the first place by the volume of capital, invested in concessions (40%), following by Sweden, Germany and Japan (nearly 15% each) - see Fig.17.

Out of Rb48 mln invested in concessions more than one-half (Rb25 mln) accounted for mining and one-third (Rb15.4 mln) - for manufacturing. Turnover of mining concessions in 1927/28 was equal Rb33.3 mln in mining, incl. Rb19 mln for export, and Rb63. mln - in manufacturing.

That means that the average unit capital of concession enterprise in mining (Rb1.8 mln) was three times as high as in manufacturing (Rb0.6 mln). But their average turnovers were almost equal: Rb2.4 mln in mining and Rb2.5 mln in manufacturing.

Governmental profits from concessions were equal to Rb9 mln in 1927/28. Taking into account excise- and customs-duties this sum increases to Rb14.9 mln.

In the following 5-year period Soviet Government had an intention to place in the country some \$0.75-1.0 billion of foreign investments on highly profitable conditions for the concessionaires. In 1928 the Government adopted special Resolution about activization of concession policy which determined approximate plan of their offers. This plan included almost 100 objects in metallurgy, fuel and chemical industries, machine-building, transport, agriculture and municipal economy.

But with the curtailment of NEP the tendency appeared for abolition of concessions. The last of them was cancelled in 1937.

During the following years the system of agreements between foreign capital and host countries has been developing in the West all this time and uninterruptedly modernizing.

So when the USSR Council of Ministers approved on January 13, 1987 Resolution N 49 ("About the order of creation and activities in the USSR joint ventures with the participation of Soviet organizations and firms from capitalist and developing countries") this country was in the prospect to make up for lost half-a-century time. By the way, that perspective had its own advantages because there was a possibility not to repeat somebody else's mistakes and once more, as it was 100 and 70 years ago, to choose for domestic application all the positive experience filtrated during the century of those agreements's existence.

#### RECENT PETROLEUM ACTIVITIES

Nowadays the major part of JV has been organized in manufacturing, trade and non-financial services (see Fig.4). One of the main obstacles for JV creation in those branches is the



problem of profit-repatriation caused by the non-convertibility

of the rouble. But until now the only Soviet "convertible" goods in the world markets are our commodities - raw materials, first of all fuels, mainly crude petroleum. But at the same moment until recently no JV has been created in mining and in petroleum industry in particular. The first systematic moves in that direction we can see in fact only in the latest period.

JV involving oil production appear to have priority with the Soviet bodies because of their (JV's) ability to generate hard currency that can be used to repatriate Western investments and profits.

On March 27, 1990 in Houston and on April 3, 1990 in London USSR Ministry of Oil and Gas Industry and Professional Geophysics Inc. (PGI) offered information packages (costing \$20,000-50,000) containing seismic data, geology, well logs, cross sections, production history, and reservoir data for the five available areas: four tracts of 175-1500 sq miles in Western Siberia and one 2000 sq miles tract in the Volga-Urals region (see Fig.18).

#### FIGURE 18

These parcels are set aside for exploitation and represent the first Ministry's offering of definite areas for oil and gas development by Western companies. In these areas Soviet oilmen has some problems in drilling and production due to the lack of instrumentation, technology and capital which Western JV would be asked to solve. Some of exploitation areas also contain exploration opportunities though the only Western Siberian areas hold some 1.8 billion tonnes of oil reserves (13 bln bbls). Several other areas may be offered until the end of 1990.

The Ministry of Oil and Gas mandates in this country petroleum rights only in producing areas. In all the other regions these rights are controlled by the Ministry of Geology. So that is why it was this Ministry who relayed through the Jebco Seismic Ltd data packages containing proprietary geophysical and geological information on the six areas for potential joint venturing (see Fig.19).

#### FIGURE 19

Two of these areas, designated N1 and N2, are in the Timan-Pechora basin. It is supposed that JV in area 1 will produce oil for domestic market and in area 5 - for export through a new terminal to be built on the coast of the Barents Sea which is relatively ice-free year-round and affords access to Western markets.

Exploration areas N2 and N6 are in the pre-Caspian depression. Formations in the areas are overpressured, the crude is high-sulphured which cause intensive corrosion problems.

Areas N3 and N4 are in the Eastern Siberia (see Fig.19).

Up to the middle of June at least 18 companies, working alone or in groups, have bought data from Jebco, Another 12-20 have expressed high interest.

Companies will have to provide their own infrastructure possibly as part of large consortiums that could also develop other mineral resources, become involved in related activities and generate general improvement to the local economy.

The first example of such type we can see in the case of general trade agreement signed March 30, 1989 in Moscow by American Trade Consortium (ATC) with the Soviet Foreign Economic Consortium (SFEC). Chevron Corp. is a key foreign participant of this consortium aimed formerly at development of Korolevskoye field in Western Kazakhstan, but taking into account the results of the latest Bush-Gorbachev's summit, Chevron may probably receive super-giant Tengiz field in the same region (see Fig.20).

#### FIGURE 20

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The breakthrough came on May 23, 1990 when France's Societe Nationale Elf Aquitaine won the sole right to search for crude on a 13,500 sq miles onshore tract on the edge of a salt basin in Kazakhetan, just north of the Caspian Sea. That is in area N2 of the Ministry of Geology (see Fig.19). The company will retain control of all exploration, investment and production and split any oil it finds with the host country on a yet-to-be-announced basis.

The next was the recent agreement with Texaco for the tract in the area N1 (see Fig.19). At the first stage the company will search the possibilities of commercial production in this area. At the second stage it is supposed to create JV for oil production and marketing in the domestic and World markets.

Some other companies are pursuing Soviet JV.

So we can conclude that during the 1987-1990 period the positive experience of our domestic economic history and current international practice was mainly ignored. It resulted in a rather minor JV positions in the Soviet markets. Only in the latest period we can see a slow (maybe too slow) progress in this field. Let us hope that its speed will only fasten.