

The Russian oil industry restructuring : Towards the emergence of western type enterprises ?

C. Locatelli, January 1999

The Russian oil industry has undergone fundamental changes since the collapse of the Soviet Empire and its bureaucratic administrative structure, dominated by its various Branch Ministries. The monopoly in the Soviet oil industry has now been replaced by a number of «oil companies», some of which are very powerful, the best known of them being Lukoil. These «joint stock companies» are the product of a reform aimed essentially at implanting, out of all the numerous organisational arrangements developed in the West, the model of the vertically integrated private firm.

Beyond the legal reforms in the Russian oil industry sector, however, the nature of the organisational model that has actually emerged in Russia begs several questions. Many entities, which are complex and highly diversified, are involved in this industry. There are, of course, the many privatised structures in which the banks sometimes carry a considerable amount of weight. There are also some vertically integrated organisations, but the degree of integration is variable and their method of centralisation is based on a specific form of economic logic. It should not be considered, however, that these «actors» are similar to capitalist-type private enterprises, whose behaviour is regulated by the demands of international competition. Reform of property rights has not been sufficient to create true private enterprise in Russia.

This assertion is borne out by several elements, including the Russian economic situation itself. Financial-industrial groups in the oil industry have, first and foremost, to organise and adapt themselves to deal with the essentially non-monetary relationships such as barter, interenterprise credit and non-payment, which are becoming more and more dominant in the Russian economy today, as the recent financial crisis shows. Thus, beyond the change in formal organisation that the various methods of privatisation show, the way in which the industry behaves is still regulated to a significant extent by planned economic relationships and not by efficiency and profitability strategies based on reducing costs. On the other hand, the «survival» strategies are based on the willingness to maximise exports, this being based on a «quantitative production development» logic. They are written into the particular kind of compromise arrived at between the State, the banks, the regions, the workers and the oil joint stock companies, which could be summarised in the following equation: foreign currency in exchange for non-payments and for preserving jobs in the oil industry's holding companies.

The financial crisis in Russia has clearly shown how fragile this system is, and has to some extent shattered the compromise already weakened by developments in international markets. The decrease in foreign currency revenue, brought about by the fall in international oil prices, has clearly shown the structural weaknesses in an oil industry that is still conspicuously beset by heavy production costs, costs that are proving a serious hindrance to its competitiveness. The future of the industry must be in serious doubt if, despite the reforms introduced, it does not continue along the path of major restructuring.

I — THE EMERGENCE OF FINANCIAL-INDUSTRIAL GROUPS IN THE RUSSIAN OIL INDUSTRY

The structure of the Russian oil industry, which is dominated by powerful financial-industrial groups, is the product of several stages of reform that combine the privatisation and restructuring of the industry with the creation of joint stock companies. This reform has favoured the advent of economic role-players whose most noticeable characteristic is the weight of the banks in their capital structure. However, the situation is far from stable, as some of these role-players appear to be having difficulty in staying viable in their current state.

1.1. The industrial structure of the Russian oil industry

The current structure of the Russian oil industry is the result of a restructuring movement aimed both at oil production and at refining. The reorganisation of these two sectors of the industry, each of which was headed by a minister under the Soviet system, gave rise to fourteen financial holding companies organised on the principle of vertical integration, from production through refining down to distribution. The enterprises we are looking at here are Lukoil, Surgutneftegaz, Yukos, Slavneft, Sidanko, the Eastern Oil Company, Onako (Orenburg Oil Company), the Tyumen Oil Company, Sibneft, Rosneft, Tatneft, Bashneftekhim, Komitek and Yunko (see Annex 1). This oligopoly market is dominated by the influential roles played by Lukoil, Yukos, Surgutneftegaz, Tyumen Oil Company and Sidanko (see Table 1).

Table 1: The Russian oil production from 1994 to 1996 according the various «types» of producer, in millions of tonnes

	1994	1995	1996
-Rosneft	73,2	12,7	13,0
- Lukoil	45,1	53,4	51,0
- Yukos	28,6	35,8	35,0
- SIBNEFT (Siberian Oil Company)	-	20,4	18,5
- Surgutneftegaz (SNG)	34,3	33,3	33,3
- Sidanko ((Siberian & Far East Oil)	32,6	22,9	21,0
- Slavneft	13,2	13,2	13,0
- ONAKO (Orenburg Oil Company)	7,4	7,7	8,0
- Eastern Oil Company (VNK)	11,2	11,2	11,5
- Tyumen Oil Company (TNK)	-	22,7	22,0
- Bachneftekhim	18,0	17,7	16,5
- Tatneft	23,6	25,0	25,0
- KomiTEK	5,1	4,4	3,5
* Enterprises of gas industry	8,0	n a (1)	8,8
* Joint ventures	10,1	14,9	15,5
* Others producers	6,8	11,5 (2)	7,0
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.Source : Ministry for Fuel and Energy of the Russian Federation, Moscow, several years

In addition to these holding companies there exists a group of role-players of uncertain status, which principally includes Norski Oil, the Central Oil Company, Vossibneftegaz and Yashar. These organisations appear to be poorly integrated structures, little more than groups of legal entities the links between which are difficult to define. Norski Oil and the Central Oil Company consist only of refineries and distribution companies. Vossibneftegaz, meanwhile, is founded wholly on production associations (see Annex 1).

1.2. The method by which Russian oil holding companies are constituted

In principal, the main aim of reforming the oil industry was to create private enterprises. There was a need to move away from the hierarchical organisation of the planned economy into a clear definition of the boundaries of the various enterprises. The first step in that direction was a reorganisation aimed at fragmenting the old organisational hierarchy in such a way as to set up a level of competition and therefore efficiency in the industry as a whole. This reorganisation then showed itself in a privatisation movement that passed through several stages. The aim was to define «new» property rights (implicitly private) and supposedly to bring about a «structure of incentives» that allowed the development of behaviour aimed at achieving economic efficiency, according to the teachings of the classic works on property rights¹.

• The organisational model used: the joint stock company

The organisational model used in the oil industry is based predominantly on a principle of vertical integration, from production down to distribution. The aim of this vertical integration is to preserve the principal economic relations established in the industry and to prevent serious problems of efficiency by destroying the essential economic relations forged by the «branch ministry» type of organisation².

This model was set up in several stages. The first major stage was allowing a definition of the production companies to be produced. The decree of 27 November 1992 set in motion the process of transforming the production, refining and distribution associations of the oil industry into stock companies. Initially, the share allocation scheme conferred 38% of the shares on the production associations, 38% on the refining associations and 24% on distribution, in a single State holding company known as Rosneft. The second stage consisted of horizontal fragmentation of the industry under the single leadership of Rosneft, in order to bring in a bare minimum of competition at that level. Each of the fourteen holding companies actually in existence was created by transfer of shares in Rosneft to the holding companies. In the production companies, the rest of the shares were divided between the workers (35%, of which 25% were preferential shares distributed free of charge to staff), the directors (5% of ordinary shares), local authorities (5%) and finally the general public (17% of shares were to be exchanged for privatisation certificates using the «voucher» technique). The privatisation movement begun in the associations worked through all the holding companies, using an allocation under which 45% were transferred to the State, 40% to private investors and 15% to the general public³.

¹Property right theory places the stress on relations between property rights and economic decisions. The way in which the firm behaves is therefore very much dependent upon the «structure of incitement » set up, which in turn is largely determined by existing property rights. For these questions, a particularly useful text is Pejovich (S.), *The Economics of Property Rights: Towards a Comparative System*, Kluwer Academic Publishers, Dordrecht, Berlin, 1990, p. 54.

² Joskow P., Schmalensee R. «Privatization in Russia: « What Should be a Firm» in Menard (C.) *Transaction Cost Economy*, Edward Elgar, 1997, p. 101.

³For a more detailed analysis, read C. Locatelli, *Energie et transition en Russie : les nouveaux acteurs industriels*, L'Harmattan, Paris, 1998, 275p.

Finally, the third major stage followed the initial direction of the reorganisation by reinforcing the integration, in very different ways depending on the joint stock company concerned, and following the privatisation process through very heavy involvement by the banks in the oil holding companies' capital.

• **The birth of the financial-industrial groups in the Russian oil industry**

The vertical integration process and the creation of new oil joint stock companies was accompanied by a modification of the capital structure, which was aimed at completely privatising the oil groups. Two principal legal strategies were used during this move: the principle of «loans for shares», launched by the Government, and permission for the oil industry to be opened to international capital.

Loans for shares

Even though its prime objective (for the Government) was finding a means of financing its huge budget deficit, the «loans for share sales» operation, which began late in 1995, was an integral part of the restructuring process in the Russian oil industry. This operation allowed the privatisation of some of the oil joint stock companies to be completed, and significantly altered the structure of the industry by favouring the emergence of financial-industrial groups.

The decree of September 1995 gave the banks and financial institutions temporary control (for three years) over a portion of the shares held by the State in the principal oil holding companies, in return for the opening of credit facilities for the Government. The principal joint stock companies involved in this process were Yukos, Lukoil, Surgutneftegaz and Sidanko (cf. Box 1). On the previously arranged date, the State disposed of its right to repurchase the shares in return for repayment of the loans. Otherwise, the shares were the subject of a definitive transfer made at the end of a process of tender offer.

The purchase of State shares by the banks

To complete the movement, a number of bids have been made since 1996 with the intention of definitively buying back some of these shares. This movement was mainly of benefit to the Russian banks and financial institutions, because some of them have since then been majority holders of the capital in the major oil holding companies.

This was the case with Yukos (currently 85%-held by the bank Menatep), and Sidanko (85%-held by Interros, a subsidiary of Oneximbank), while 51% of the capital of Sibneft was acquired by Finansovaya Neftyanaya Kompaniya and the very powerful B. Berezovskii (cf. Box 1). This restructuring movement is far from finished. At least until the advent of the recent financial crisis, Russian banking sector is pursuing its policy of controlling the oil holding companies. The Menatep Bank appears to be the most ambitious in this field, showing on several occasions a desire to take control of the oil holding company Vostochnaya Neftyanaya Kompaniya, in which it already held 45% of the shares. Following the same logic, it also wished to acquire a portion of the shares in Slavneft and Onako.

These cross-acquisitions are leading progressively to an oil industry that is dominated by a few groups of companies controlled to a significant extent by powerful banks, particularly Menatep and Oneximbank. A level of uncertainty has, however, been triggered by the

August 1998 financial crisis. The effect of the crisis will be to restrict the strategy to some extent, and this event will have the effect of showing the fragility of the Russian banks, with possible devastating consequences.

Box 1 : Capital structure of the main Russian oil joint stock companies (january 1998) %	
* Lukoil :	
• Shares hold by the State	: 11,57
• Shares hold by the State Property fund	: 16,5
• Shares hold by Lukoil	: 32,1
- <i>shares hold by mperial Bank (1) in guarantee of loans to the State and give to investment reserve of Lukoil</i>	: 5,0
- <i>shares hold by the pension fund of Lukoil</i>	: 10,9
- <i>shares hold by Nikoil, investment fund of Lukoil</i>	: 16,2
• Shares hold by linternational investors	: 20,38
- <i>Arco</i>	: 7,99
• Russian investors	: 15,38
* Sibneft :	
• Shares hold by the State	: 1
• Shares hold (2) by the Petroleum Finance Cy, and bought in 1997 by Finantsovaya Neftyanaya Kompanya (3)	: 51
• Shares hold by SINS (llinked to Stolichny Bank Sberezhennii/Agro)	: 19
• Shares hold by REFINEOIL	: 15
* Sidanko :	
• Shares of the State hold by INTERROS, subsidiary of UNEXIMBANK	: 85
- <i>in guarantee of loans to the State and bought in 1997</i>	:51
- <i>bought in 1996</i>	: 34
• Shares hold by MENATEP	: 4
• Others investors	: 11
* Slavneft :	
• Shares hold by the Russian State (4)	: 65
• Shares hold by the Belarus State	: 11
• Actions détenues par un fonds de réserve des employés	: 10,2
• Shares hold by the Mozyr refinery	: 6
• Others investors(5)	: 7,8
* Surgutneftegaz :	
• Shares of the State hold by the pension fund of Surgutneftegaz in guarantee of loans to the State (6)	: 40
• Shares hold by the State	: 1
• Shares hold by employees	: 1
• Shares hold by institutionnal investors	: 3
• Shares hold by Neft-Invest (7)	: 40
• Others	: 15
* Tyumen Oil Company :	

• Shares hold by the State (8)	: 51
• Shares hold by Alfa Groupe (9)	: 40
• Shares hold by the investor CADET	: 9
* Yukos :	
• Shares hold by Menatep	: 85
- <i>Shares of the State hold by Menatep in guarantee of loans to the State</i>	: 45
• Shares hold by employees	: 7
• Shares hold by Yukos	: 7
• Others investors	: 1
* Onako :	
• Shares hold by the State	: 51
• Shares hold by the Russian investors	: 44
• Shares hold by the international investors	: 5
* Eastern Oil Company (10):	
• Shares hold by the State	: 85
- <i>State Committee for State Property (GKI)</i>	: 51
- <i>State Property fund</i>	: 34
• Shares hold by private investors	: 15
* Rosneft :	
• Shares hold by the State	: 100
<i>Regional joint stock companies</i>	
* Komitek :	
• Shares hold by the State Committee for State Property	: 21
• Shares hold by Yevroseverneft (with the guarantee of the National Reserve Bank (BNR)) (11)	: 38
• Shares hold by SB TRUST (with the guarantee of the BNR) (11)	: 29,3
• Shares hold by MENATEP	: 3,9
• Others	: 7,8
* Yunko :	
• Shares hold by the local authorities	: 100
* Tatneft :	
• Shares hold by the Tatarstan authorities	: 46,6
• Shares hold by employees of Tatneft	: 41,3
• Shares hold by private investors	: 12,1

Notes (1) : Lukoil is one of the shareholders of this bank ; (2) : In guarantee of the loans to the State ; (3) : Under the control of Berezoski and Logovaz ; (4) : 20% of the shares should be offered to Russian and international investors ; (5) : People have bought some shares at preferential prices ; (6) : In 1997, the investment fund of the group would have buy 40,12% of the shares sold by the pension fund ; (7) : Under the control of Surguneftegaz ; (8) : The State would sell 48,6% of its shares ; (9) : Shares bought by tender offer in june 1997 ; (10) : At the end of 1997, Menatep would buy 45% of the Eastern Oil Company shares ; (11) : Gazprom is the main shareholder of the NRB bank.

Sources : Marjanovic (M.).- *Les groupes pétroliers intégrés de la Fédération de Russie.*- Les notes des postes d'expansion économique, Direction des Relations Economiques extérieures, Moscow, september 1997, 110 p. and *Petroleum intelligence weekly*.

Opening to international capital

The last major change in this restructuring of capital relates to the participation of foreign capital in the privatisation of the Russian oil industry. Until 1997, this participation was very much restricted, since only 15% of the holding companies' capital was legally open to foreign investors during privatisation. The decree of 4 November 1997, however, abolished all the restrictions on levels of participation, opening a new phase that could be of key importance in the restructuring of the Russian oil industry. In fact, the sale of shares to foreign investors is a privileged means of access to new financial resources, which was not the case at the time of the various privatisation movements that were distinct in their method of completion (free distribution of shares to employees, the general public, etc). The attempted privatisation of Rosneft, in 1998, showed not only the international oil companies' interest in the Russian oil industry⁴ but also the limitations of the undertaking. In fact, at a time when the organisational weaknesses were becoming apparent against the uncertain background of falls in price, the «Rosneft share» appeared to be over-evaluated against the unwieldy, unclear internal organisation of the holding company. Some of its production companies were made autonomous⁵ or, as in the case of Purneftegaz⁶, sold separately under conditions that were not made clear, which made Rosneft almost into an empty shell. First the international, and then the national, investors progressively withdrew, and the result was that this privatisation, which had already been rejected three times, failed. This episode is a testimony to the legal muddle that has characterised the process of privatisation in the oil industry as a whole.

II — AN INDUSTRY PRIVATISED BUT NOT PRIVATE?

In spite of all the reforms, one question still remains largely unanswered: who really controls the Russian oil industry today? Is it the State, or private capital? Is it the workers (who hold significant portions of the capital in the holding companies), the managers, or the banks? The question will of course bring different responses, depending on the context, because the economic role-players involved are of different economic types. It can however

⁴The following alliances were originally in competition: Gazprom-Lukoil-Shell on one side and Sidanko-BP on the other.

⁵Some of the most promising production companies controlled by Rosneft chose to become autonomous and come under the control of others joint stock companies before the attempt at privatising Rosneft was made. The association Arkhangelsk-Geoldobycha, in the heart of Timan Pechora, one of Russia's richest oil-bearing regions, is today more than 70% held by Lukoil. Even more radically, the production company Dagneft (Dagestan) has purely and simply split from Rosneft.

«Russia's New Yuski Spars With Lukoil In Takeover War».- *PIW*, 26 January 1998; «It can be a good thing, if it's not too big».- *Petroleum Economist*, June 1998.

⁶In this case the 38% held by Rosneft in the largest of them, Purneftegaz, (production 8 millions de tonnes in comparison with the 13 produced by Rosneft) would have been sold to Dialog Optim Bank. This sale is currently being challenged by the Russian Government. See «Privatisation - Braderie à la russe», *Le Monde*, 13 October 1998.

be said that the industry is predominantly «dual»⁷ in nature, and as such is neither wholly private because the incidence of bankruptcy is very low (although it is privatised, with private ownership rights), nor wholly public, although it remains under heavy State control because of the regulation of exports by the State.

2.1. The diversity of the economic role-players

Beyond the common reorganisation and reform policy, the oil industry is first and foremost characterised by the diversity of the types of ownership and economic entities involved. The three distinctions between the various role-players are the varying levels of vertical integration of the joint stock companies, the involvement of regional interests, and the structuring of the capital (particularly the level of involvement by the banking sector), all of which most clearly differentiates the economic nature of the oil holding companies.

• Varying levels of vertical integration

Despite the Russian reformers' willingness to structure the oil industry around vertically integrated joint stock companies, this model of organisation has only partly developed from the point of view of the share distribution structures in the companies making up the holding companies. It should be remembered that the scheme initially set up only gave 38% of the shares in each of the production and refining companies to the oil holding companies. Some of these companies, the more powerful ones, carried on and indeed completed the integration process by purchasing the shares in the companies of which they consisted. This situation, however, is far from being the case in general. Although Lukoil, Surgutneftegaz and even Sibneft (which is trying to increase its control over its production company⁸), seem today to be the most highly consolidated groups, this is not the case for other major holding companies such as Yukos, Sidanko et Slavneft. Although these companies possess «trump cards» (in terms of production and reserves), which make them into powerful actors, they appear relatively weak because of their lower level of integration. The consequences of this have been manifold, with conflicts in relationships between production and holding companies, trouble in controlling movements within the holding companies, and so on. In many cases, therefore, the vertical integration of the holding companies is more the result of the incapability of the companies making them up to show even the smallest degree of profitability (this incapability being largely «organised» by the holding companies through fixing of internal transfer prices) than the result of integration by capital through cross-participation⁹.

• Federal reform versus regional reform

Alongside the holding companies, which are the fruit of a reform initiated by the Federal State, a series of entities linked to the regions, and therefore having a much less clear-cut

⁷Kryukov V. «Russian Oil Companies», *Oil & Gas Law and Taxation Review*, Vol 13, No 8, August 1995, p. 393.

⁸Sibneft held about 78% of its production company Noyabrskneftegaz and 78% of its exploration company Noyabrskneftegaz-Geofizika.

⁹There is no case in which the production or refining companies are actors likely to develop a full measure of independence.

status, has appeared. These entities are nevertheless of considerable importance and sometimes of major importance because of their geographical location in areas rich in hydrocarbons. This is the case for the holding companies Tatneft, Bashneftekhim, Komitek, and Yunko. They are the result of more or less spontaneous reorganisations that were the outworking of a regional policy aimed at achieving a greater measure of independence from the Central State in Moscow by taking for themselves the profits realised through exploiting their deposits of hydrocarbons.

It is in fact with regard to the question of ownership of natural resources and their use that the arguments in favour of independence for the regions, and the conflict between central and regional government that arose as a result, have been most clearly put forward. The creation of «regional» holding companies is in this context one manifestation of the essentially economic nature of the Russian regionalisation process¹⁰. The companies recently created in some areas have a status that is even more uncertain than that of the earlier companies. Rossiya Petroleum and Vossibneftegaz, both created in Eastern Siberia, as well as the company Yashar in the autonomous Nenets territory, appear to be poorly integrated structures with economic relations of a very artificial nature between their component entities. They are however of considerable importance because they hold exploration licences for some very promising deposits (cf. Annex 1), but their economic viability is still very much an unanswered question and they will be compelled to restructure themselves sooner or later. A similar process has already begun for the Central Oil Company, 26% of whose shares are now in the hands of Lukoil (13%) and Tatneft (13%); this guarantees the company access to crude oil that it never enjoyed before¹¹.

• Different strategies according bank's involvement

The other main aspect of sharing in holding companies is connected with their respective capital structures. The involvement of the banks is of particular concern to Sibneft, Sidanko and Yukos, and particularly to the Tyumen Oil Company, which are really under their control. For the other companies, either the banks are involved to a very limited extent, as is the case with Slavneft and Onako for example, or the banks and financial institutions concerned are owned by the holding company itself, which radically alters the effect of their participation. In some cases, the banks that participated in the privatisation of the companies are themselves held by those companies. It is therefore quite common for the interaction of banking and oil-industry activity to become an essential aspect of the privatisation of the Russian oil industry, as has occurred with Surguneftegaz and Sibneft¹².

The most typical example of this last case, however, is that of Lukoil. Its strategy has been marked by a willingness to restrict the influence of the banks in its shareholdings from the

¹⁰Todres, V. «Régionalismes» p. 79-91 in Mendras (M.) éd.- *Un Etat pour le Russie*.- Paris, Editions Complexes, 1992, 145p.

¹¹Negotiations have also started with BP, which could become the purchaser of 24% of its shares less one.

¹² Surguneftegaz is therefore a major shareholder in Oneximbank, which brought in its guarantee at the «loans for shares» stage which saw the Surguneftegaz pension fund acquire 40.12% of the shares in the holding company. Kryukov V. & Moe A., *The changing role of banks in the Russian oil sector*, The Royal Institute of International Affairs, 1998, p. 35.

beginning, by offering only 5% of its shares to the «loans for shares» scheme. Most notably, a significant portion of its shares was transferred to financial or banking subsidiaries under the control of Lukoil, particularly to Nikoil (its investment company), and its pension funds or banks (particularly the Imperial Bank) in which the holding company had a major interest (cf. Box 1). Another important aspect of the structure of its shareholdings, not found in the main Russian oil holding companies, was that Lukoil chose to open its shareholding to foreign capital. Today, 20.4% of Lukoil's shares are in the hands of international investors, almost 8% of them being held by Arco.

2.2 The originality of the types of ownership in the Russian oil industry

Beyond the demarcation between public and private ownership, Russian privatisation has led to some highly original combinations of forms of ownership. These forms are the result of the complex structure of the shareholding. The reforms in property rights has produced some remarkably original combinations named “the recombinant property”¹³ which has found its most original expression in the Russian oil industry. Apart from the widespread dispersion of capital that has become apparent, the most striking feature of the «recombinant property” has been the economic diversity of the owners within the same organisation : employees, managers and individuals, but also the banks, the State, several different regions and in some cases even foreign investors. All these elements mean that the process of discovering where the Russian oil industry's centres of decision-making and economic power actually lie can be a very difficult one. In spite of the definition of new property rights, the reform has done next to nothing to clarify the precise location of the economic centres, while privatisation has given but few rights to the numerous entities that hold the capital, with the evident exception of the managers.

• Dispersion of capital

The difficulty of finding the location of the economic decision-making centres in the Russian oil industry has arisen first and foremost because of the very widely scattered nature of the ownership. The Russian oil holding companies, except for those dominated by the banks, have too fragmented a shareholding to establish a dominant group of shareholders that could bring in a form of external control along German or Japanese lines. Besides that, the financial markets are too narrow for any real control to be exerted along Anglo-Saxon lines, by a financial discipline characterised by the risks to a tender offer. In addition to these aspects, the free distribution of vouchers leaves a high degree of uncertainty as to the value of the holding companies. The valuation is made all the more difficult because the financial information is collected for tax purposes rather than for financial analysis purposes.

¹³The “recombinant property” have three principal aspects, which are: «a multiplicity of different kinds of owners, a blurred distinction between private and public forms, and mixed relations of ownership which imply participation by the banks», three ownerships that are absolutely typical of the Russian oil holding companies of today.

Chavance B., Magnin E. « L'émergence des économies mixtes”dépendantes du chemin” dans l'Europe centrale post-socialiste» in Delorme R. — *A l'Est du nouveau : Ichangeement institutionnel et transformations économiques* Paris: L'Harmattan, collection pays d el'Est 1996, p. 126.

• **Ill-defined property rights: a consequence of the “recombinant property”**

The reform has not created the clearly defined system of property rights that was its initial objective. The first stage of privatisation (1993-4) was characterised by two specific aspects. The first model of privatisation brought in, first and foremost, an internal control system that allowed the managers to assert their economic power over the holding companies with a minority of shares. In addition, while the state remained a dominant, sometimes even a majority, shareholder, it exercised its power as a shareholder in the holding companies to a very limited extent and continued to play only a «passive» role.

The banks' involvement in the holding companies' capital has opened a new phase in Russian privatisation, but brings with it a number of specific uncertainties. First of all, the «loans for shares» stage has increased the problems linked with control by the insiders, because of the cross shareholdings between banks and holding oil companies in the companies' ownership structures¹⁴. In addition, this stage has made the dividing line between private and public capital particularly difficult to identify. Firstly, the shares were only the subject of a temporary transfer to the banks and financial institutions. At the end of the period, some of the banks definitively repurchased the shares for some of the holding companies. This however was not the case for all the oil groups, and there is therefore a degree of uncertainty as to who actually owns the shares and what rights the shares confer. Can these shares be considered neither truly private nor truly public? Could they be considered to belong to the financial institutions? One could thus ask the question: how much economic power do they confer on the banks, who merely hold them for a limited period? The overall effect is to reinforce the duality of ownership in the oil industry.

III — THE JOINT STOCK COMPANY: AN ANSWER TO THE UNCERTAINTY OF THE POST-COMMUNIST ENVIRONMENT

The oil joint stock companies are steadily becoming the only real pillars around which the Russian oil industry can build itself, and sometimes they are very powerful. However, the suggestion that a change of depth is becoming apparent in this field should be qualified in several ways. Certainly the forms of ownership have changed, and a significant number of entities are now actively involved. However, the economic behaviour apparent today is not greatly consistent with the new institutional arrangements and rules of competition that define the kind of framework in which the economic actors will act.

The low level of competition amongst actors who tend to set up in «regional monopolies», the absence of bankruptcy in spite of some companies' lack of profitability, the slowness of the restructuring procedure (particularly in the field of employment), and the development of strategies involving the use of barter, non-payment and interenterprise credit, are all bars to financial profitability. They are the product of a non-monetarisation of the economy, a kind of behavioural inertia that is typical of the «Russian economic transition», and they show very clearly how difficult it is to change such informal institutions as custom, tradition etc. However the changes in these informal institutions are an essential element in transforming the Russian economic system. The performance of the economic organisations

¹⁴V. Kryukov & A. Moe, op. cit., p. 43.

is dependent on informal and formal institutions¹⁵. The true economic nature of these holding companies and their various component companies clearly reflects the persistence of administrative mechanisms and behaviour patterns that are rooted in a planned economy logic.

3.1 Questioning the economic viability of the holding companies in the light of non-monetarisation of exchanges

The future of the Russian oil industry, and the hypothesis about how it will emerge from the crisis, are determined by two factors: the restructuring and modernisation policies adopted, and the investment strategies developed. These two factors are influenced by the economic environment in which the holding companies are developing now, but also by their ownership structures and the organisational models that have emerged during the transition period.

• The constraints posed by holding companies' economic environment: problems of taxation and price

If the tax system is unsuitable or too heavy, the profitability of the key role-players in the oil industry will be seriously affected (cf. Box 2). Although the tax system has been criticised on many occasions, particularly by the holding companies, its importance nevertheless remains a very controversial issue and needs to be qualified and put into perspective. The problem is that the system taxes revenue and production rather than profits. However, oil revenue in Russia is relatively low in comparison with the other principal oil-producing countries, largely because of tax arrears. If these arrears were not included, the oil revenue of the Russian industry would be comparable to that of the other major producers (but only very slightly higher)¹⁶.

The problem of the joint stock companies' profitability is also directly linked to development in the prices of crude oil and oil products in Russia. Despite considerable easing of restrictions on crude oil prices since 1993, which should have triggered a rise in prices in order to reflect real costs, what we have seen is actually a fall in real prices (sometimes to a level lower than that of the Soviet administered-price era), a phenomenon that has also called the viability of the principal oil industry role-players into question. This fall in prices is primarily a reflection of the poor degree of adaptation of the industry and the idiosyncrasies of the Russian economic system.

What they reflect is the over-capacity resulting from a long-term pronounced decrease in domestic consumption. The international markets are not merely a solution to be taken when domestic consumption falls, as exports are largely dictated by the extent to which the

¹⁵We need to know if informal institutions in a specific institutional environment are working for or against the formal institutions. A theory of the nature of relations between formal and informal standards is therefore needed. Nee, V. «Norms and networks in economic and organizational performance».- *The American Economic Review*, vol 88, n° 2, May 1998, p. 85-89.

¹⁶Gray D., *Evaluation of Taxes and Revenues from the Energy Sector in the Baltics, Russia, and Other former Soviet Union Countries*.- IMF Working Paper, 98/34, mars 1998, p. 14.

existing transport network is saturated with supplies. This has led Transneft¹⁷ to introduce a policy of allocating insufficient export capacities together with a increased rates of transport fees (part of which is payable in foreign currency)¹⁸. In addition, the disastrous state of Russian oil refining, and its poor degree of adaptation to the changes in the internal demand system, have been a key factor in the fall in crude oil prices¹⁹. It is in fact becoming more and more difficult to enhance the value of heavy oil products coming from the Russian refineries.

Box 2: The Russian oil industry taxation system

Taxes on crude oil can be divided into various federal, regional and local taxes. Five main types of taxation can be distinguished (apart from VAT).

1. Excise duty, based on wellhead production

This is a specific tax payable on each tonne produced, and varies between production companies, according to geological conditions and other cost-related factors. The rates at which the tax is levied vary widely.

- From 1996:

At the beginning of 1996, the tax totalled, on average, R55,000 per tonne (\$11.2 per tonne). Because of the devaluation of the rouble and the rate of inflation, it reached R56,500 per tonne in June and R70,000 per tonne in August 1996 (\$14 per tonne), particularly to compensate for the abolition of export tax in August 1996. The Duma brought it back down to R55,000 per tonne in August 1997. In the early summer of 1998, the Duma's decision to reduce the tax to R25,000 per tonne was overturned by Boris Yeltsin.

2. Geology fund, introduced in February 1993.

A tax paid by crude oil producers and used to finance research costs incurred by the State Geological Committee from State budgetary contributions. The rate was fixed at 10% of gross income. On average, per tonne, this has represented 8% of the gross crude oil price since 1993.

3. Royalties, introduced in October 1992.

Royalties are levied on hydrocarbons produced and exported. They are based on the gross price (price to the producer) net of excise. A function of the production costs for each deposit, they vary between 6% and 16% according to the negotiation or «bidding» process for new deposits. On average, however, the tax totalled about 8% between 1992 and 1994, 9% in 1995 and 10% in 1996.

4. Oil industry investment fund contributions, abolished in 1995.

These payments were introduced to supply an investment fund aimed at redistributing finance amongst producers in the oil industry. The method by which the funds were redistributed amongst the producers is largely unknown. The average rate was 28% of the gross profit.

5. Profits tax

Initially 32%. From the beginning of 1994: 38% maximum, 13% for the federal budget and up to 25% for regional and local budgets.

6. Export duty

Until 1996, crude oil exports were subject to a tax that varied between R51,650 per tonne (\$9.9 per tonne) and R82,540 per tonne (\$15.9 per tonne). It was progressively reduced pending its complete abolition.

¹⁷The company that holds the monopoly on crude oil transportation, particularly along export pipelines.

¹⁸For a more detailed analysis, the reader is referred to C. Locatelli, C, 1998, op. cit., p

¹⁹«Low oil prices, economic woes threaten Russian oil exports»- *Oil and Gas Journal*, 8 June 1998, p. 26.

A tax was reintroduced at the beginning of 1999. It will be in the region of 2.5 Euros per tonne for a barrel of \$9.5-12 and \$5 for a barrel above this level.

• **The logic of non-payment**

The problem of the economic viability of the role-players in the oil industry is, however, linked to the progressive demonetisation of exchanges in Russia, a phenomenon which has brought about economic relations such as unpaid transactions, barter and interentreprise credit. These relations, which are original forms of transaction²⁰, are the product of pronounced behavioural inertia, barter and the essentially bilateral relations²¹ which are important mechanisms of co-ordination in a planned economy. The consequence of non-payment is considerable in the oil industry, totalling (apart from the refining industry) 14.284 billion roubles at the end of 1996²². These include non-payments to suppliers of inputs (totalling 7.073 billion roubles²³), the State budget (in terms of non-payment of taxes) and of course delays in payment of salaries. Only 10-20% of domestic sales are paid for in cash, the rest consisting either or barter or of non-payment. More significantly, cash payments are often the subject of negotiations that lead to reductions in price, sometimes as much as 50%²⁴.

The role played by non-payments in the downhill slide of the Russian oil industry needs however to be defined further. Of course it is damaging for the holding companies' financial situation, given their degree of involvement in the non-monetary transactions. But in a context of non-monetary exchanges, what state would the industry be in were economic relations of this type not present? Relations of this kind are an essential means of co-ordinating the system that maintains a minimum of inter-industrial relations and exchanges. By keeping up the demand, non-payment allows a sharper drop in prices to be avoided at the same time. The Russian «oil crisis» would be considerably more serious than in the current situation, in which the economic role-players are continuing to produce while anticipating a level of non-monetary demand. Where monetary mechanisms of co-ordination are absent, these non-trading transactions tend to become established as a «normal means of operation»²⁵ in the industry. In this context, the organisational model of the financial holding company has been the response to this economic logic.

²⁰Zlotowski, Y, *La crise des paiements en Russie, expression d'un consensus social ?*- CERI Studies, No 43, August 1998, p. 2.

²¹It is evident, however, that complex forms of barter, based on mulilateral exchange relationships, are emerging in Russia.

²²Bobylev Y., *The State of Major Branches of Russian Economy*.- The Institute of the Economy in Transition, Moscow, 1997.

²³Y. Bobylev, March 1997, op. cit., p. 9.

²⁴«Low oil prices: economic woes threaten Russian oil exports», *Oil and Gas Journal*, 8 June 1998, p. 25-30.

²⁵Y. Zlotowski, op. cit., p. 8.

3.2 The organisational model of the holding company: a management of non-monetary relationships

The industrial-financial oil groups represent centralised systems, despite the application of Western schemes that should have introduced a degree of independence (if only a limited one) at various levels in the oil industry and “ of Western organisational models (and therefore of market-economy forms of institution) the underlying practices are completely different. The logic of integration, therefore, rests essentially on internal systems of co-ordination (particularly internal transfer prices) aimed at producing profitability at the single financial holding company level. In this plan, the production companies are confined to the simple role of production, as in the past, and cannot therefore be profit making.

The logic of organisation in the Russian oil holding companies is also a substitute for the development of monetary and market relations. In fact, the logic of the vertical producer-refiner-distributor integration of the single entity, a logic that is completed by the participation of the banks, makes non-monetary relations between these four types of role-player viable. The existence of networks between structured units in and around the holding company allows more or less generalised barter-based relationships to develop. All through the oil industry network, the co-ordination mechanisms specific to the Russian economy — barter and interenterprise credit — have moulded themselves into the organisational form represented by the holding company, which in its turn tends to perpetuate the mechanisms.

These relationships both create and exacerbate the problem of financing the new investments required for ensuring the restructuring and renewal of equipment in the industry, in the face of the problems of liquidity currently being encountered in the oil industry. In this way, although the logic of organisation allows survival strategies to be implemented, these strategies are compromising the future of the Russian oil industry because a set number of investments cannot be guaranteed.

With the exception of a few holding companies, including Lukoil, scarcely any long-term investment strategies can be seen developing, at a time when they alone can ensure the renewal of reserves and the restructuring of the industry. The significant drop in annual investments devoted to the oil industry since 1988 (62% between 1988 and 1994) begs several questions with regard to the future of the industry. But how could it be otherwise? Against this background of increased uncertainty, short-term strategies aimed at providing an immediate valuation and financing of assets, are being demanded when there is a need for long-term restructuring strategies.

• Control rights in the hands of the «insiders» : a limit to the restructuring strategies

The implications of altering property rights on the oil groups' performance levels are very uncertain. To be sure, the rights of ownership theory puts forward that the definition of private ownership is supposed to encourage the development of a system that is likely to bring about effective economic performance on the basis of maximising resource values²⁶. However, the presence of a sizeable shareholding of workers, coupled with a shareholding of managers in the production and refining companies, has brought about a type of internal

²⁶Pejovich S., *The Economics of property rights: towards a theory of comparative systems*. Boston, London: Kluwer Academic, 1990, p. 54.

control²⁷ based on a logic that limits the restructuring and modernisation strategy, and therefore the effectiveness, of the holding companies²⁸. These objectives are more generally linked with external control structures by a dominant group of external shareholders or by the finance markets. It is in fact unlikely that the managers will launch into major restructuring policies when a sizeable portion of their shareholders is also their employees. It is therefore significant that a drop in Russian oil production of about 50% is not accompanied by restructuring and reductions in the work force. The adjusting process is slow and is not linked in any way to the sharp fall in production. Over-manning is still apparent everywhere, hampering productivity with stifling force everywhere in the industry. Moreover, despite the steep drop in credit-worthy demand for oil products, and the impossibility of increasing exports because of the saturation of the transportation networks, crude oil continues to be produced beyond solvent needs.

• **The role of the banks, or the development of financial strategies**

The entry of the finance and banking sector into the holding companies' capital is reinforcing these tendencies. The banks' entry into the holding companies' capital, therefore, has hardly provided any encouragement to implement restructuring policies, at a time when developments of that kind might have been expected because of the holding companies' requirement to fulfil the financial criteria laid down by the banks.

On the contrary, in fact, the banks' entry into the oil holding companies' capital has allowed an absence of adaptation and restructuring, insofar as their presence constitutes a means of easy and almost free access to bank credit, widely used to pay employees and to ensure that the holding companies can carry on their operations. The alliance with the banking sector has thus allowed survival without restructuring²⁹, in spite of the generalisation of the non-paiement. By doing this, the financial institutions are now no longer in a position to encourage the enterprises to achieve efficiency of management by laying down strict rules for access to bank credit facilities. In addition, one of the main driving forces behind the banks' participation in the oil industry was to have a clientele whose activity was geared towards exports, that is, towards activities that carry a low degree of risk and are highly profitable because of the nature of oil (a commodity whose value can be increased significantly on the Western markets)³⁰. The banks therefore had no interest in becoming involved in industrial strategies, which are by their very nature risky and presuppose long-term loans, when the export-based strategy was likely to bring an increase in value to their assets right away. (Most credit facilities granted by the banking sector therefore relate to

²⁷Andreff W., «Le contrôle des entreprises privatisées dans les économies en transition : une approche théorique». *Revue Economique*, No 3, May 1995, p. 764.

²⁸The survival aim can be linked to the internal control coalitions (managers/personnel) in relation to the efficiency objective linked to the external control by coalitions of outsiders. W. Andreff, op. cit., p. 764.

²⁹Dolgopyatova, T : «The behaviour of Russian Industrial Enterprises under Transformation».- *Communist Economies and Economic Transformation*, Vol 7, n° 3, 1995, p. 319-331.

³⁰V. Kryukov & A. Moe, op. cit., p. 3.

short-term credit³¹). The more finance-orientated strategies progressively replace long-term industrial strategies, a phenomenon that has compromised the future of the Russian oil industry.

3.3 Exports, the keystone to the viability of the holding companies

Export strategies are therefore the priority. Totalling about 126 million tonnes, exports are the means by which the internal financial constraints arising from a domestic market that is becoming less and less solvent can be compensated, if only to a limited extent. Despite the falls in international prices, which have weakened the profitability of Russian oil exports (according to available estimates³²), the holding companies have been strongly encouraged to export their crude oil onto the international market, because exports are their principal source of liquidity.

These exports are the subject of a tight negotiation between the State, the oil-producing regions, for which the revenue derived from hydrocarbon exports is an essential ingredient of their budget, and the “oil groups”. The centralised exportation plan, run according to the quota regime, has been abolished in Russia. The State, however, is continuing to regulate exports according to quantities (instead of providing monetary incentives) by using two major means of control. The «exports for federal programmes» regime³³, based on the former «state needs» category, was the heaviest restriction on the freeing up of oil exports. Through this channel, the State had controlled almost one quarter of all export capacity (and indeed much more at times). The second means is controlling the access to the transportation network.

In view of the limited transport facilities available, the order of priority drawn up between the holding companies with regard to access to the transport network is a matter of prime importance in the relations between the State, represented by Transneft (and its monopoly on transport) and the holding companies³⁴. The unwritten rule is that the priority is given to the holding companies that are most powerful in terms of reserves, production and work force, and this is the reason for not dismissing workers and maintaining the work force in

³¹V. Kryukov, A. Moe, op. cit., p. 20.

³²These costs may even exceed \$11 per barrel, depending on the deposit in question. Voisin, C. «La nécessaire adaptation des compagnies pétrolières russes face à la baisse des prix du brut ».- *Énergies et Matières Premières — Hydrocarbons Supplement*, 4th quarter 1998.

³³Abolished at the end of 1997, this system consisted of the State financing specific programmes on the basis of oil exports by working on the differences between domestic and international prices. It therefore had a right to purchase oil at the domestic price and resell it at international prices, the difference being used to finance the programmes. Against a background of limited transport facilities, this kind of provision can seriously restrict access to the transport network by introducing discrimination between holding companies. For further details, cf. C. Locatelli, 1998, op. cit., p. 56-59.

³⁴The State, on some occasions, has looked to use its power of allocation as a means of exerting pressure. Some holding companies have been refused access to Transneft’s transport network in order to compel them to pay tax arrears.

place. In this way, the principal holding companies have obtained rights of access to the export network for between 25 and 35% of their oil production, while the others have benefited from much lower allocations³⁵. Size becomes an important factor because it has to be «big» in terms of production and reserves (but not necessarily profitable) in order to be able to enter into favourable negotiations with the State on exports, which are the only real source of liquidity. In consequence, the concentration of the oil industry, of which the planned merger between Yukos and Sidanko in 1997 (which was never realised) is a prime example, is of key importance for the holding companies.

• **Non-payment versus employment**

As in the past, Russian enterprise continues to fulfil social functions that are largely outside the scope of the traditional economic aims of a market economy. A number of them, organised on a regional scale, are in the position of being the only, or almost the only, employer in an «oil» region or «oil» town, which makes the policy of restructuring, which would first show itself in job losses, more complicated than usual. What we are seeing, therefore, is a kind of social compromise, aimed at maintaining staff numbers in the enterprise and continuing to make deliveries even though they may not be paid for. In exchange for «jobs» (or more accurately, maintaining staff numbers in the enterprise), the number of unpaid employees (delay in payment of salaries can be considerable) and the level of non-payment of taxes (at both regional and federal level) is increasing. The oil holding companies, the regions, for which maintenance of social consensus is essential for their stability, the banks involved in the holding companies' strategies, and the employees themselves, all have a part to play in this compromise, which at the end of the day preserves the basic interests of everyone involved in the face of the uncertainty of the Russian economic environment.

IV — HOW WILL THE RUSSIAN OIL INDUSTRY DEVELOP?

Whatever developments may occur in the future, the Russian oil industry must now take into account criterion of profitability, and must therefore undergo major reforms. The fall in international oil prices has only accentuated, or shown more clearly, the need for the Russian role-players to reduce their costs. It is unlikely that the industry will be able to maintain a structure based on such a large number of holding companies, and it should therefore be supposed that there will be a major restructuring in the future, with concentration of resources but also bankruptcies.

4.1 Some of the effects of the 1998 financial crisis on the financial-industrial oil groups

The collapse of the Russian banking system, and the 90-day moratorium decreed by Russia for paying off its debt, has affected the Russian oil industry in different ways. As the oil holding companies are unable to pay off their loans, the Western banks' confidence in the Russian role-players has been seriously undermined and their long-term situation weakened. A number of these joint stock companies, in fact, were engaged in long-term pre-finance

³⁵C. Locatelli, 1998, op. cit., p. 56.

projects for their production, generally based on exports³⁶. In addition, it is likely that the crisis will exacerbate the problem of making a link between financial strategy and long-term industrial strategy. It is too early to determine all the implications, but some information can already be determined and the short-term and long-term implications worked out.

Some positive short-term effects

Initially, it could be considered that the financial crisis in Russia has had some good effects, mostly in connection with the devaluation of the rouble. The gains in foreign currency automatically increase when evaluated in national currency, and the financial constraints on the holding companies are slightly lessened; their level of liquidity, and therefore their ability to pay taxes, salaries and so on, increases. In addition, crude oil and oil product exports, expressed in dollars, become more competitive and internal costs, evaluated in roubles, are reduced. These, however, are only short-term benefits, and as such are liable to be lost.

Incentives to increase exports

This crisis will have the effect to reinforce the strategy of maximising the level of exports which, in the light of the difficulties in the banking sector, are becoming in ever-increasing measure the only source of income for the role-players in the oil industry. In addition, relations between the holding companies and the State may change as the State could be tempted to increase its level of control over the foreign currency coming from exports and therefore revert to a greater degree of centralisation. The oil companies are already being compelled to change 75% of their income into roubles, compared with 50%³⁷ previously. The viability of the holding companies is therefore becoming more and more dependent on their ability to access the transport network. Of course this increased level of competition will produce winners, although the winners will not necessarily be the most profitable holding companies, but those whose capacity for negotiating with the State is most favourable now. At the same time, employment will continue to be an important deciding factor in the process.

However, the financial crisis has to some extent revealed the instability of the compromise reached earlier with the State. Faced with an huge budget deficit, the State is in fact becoming less and less inclined to tolerate non-payment of taxes, even though the holdings, on the other hand, have sometimes tolerated considerable levels of non-payment. This development, coupled with the fall in international oil prices, is making the need to restructure all the more pressing, and could open the way to more structure-orientated changes in the Russian oil industry.

³⁶Only Lukoil, Tyumen Oil Company, Yukos and Eastern Oil Company chose to fulfil their financial obligation, in direct opposition to the Russian government. «Turmoil in Russia: low prices force pace of change», *Petroleum Economist*, September 1998, p. 6.

³⁷«Russie : une réforme fiscale s'impose face au déclin de la production pétrolière». *Pétrostratégies*, 2 November 1998, p. 2.

4.2. Incentives to concentrate the Russian oil industry

On a more structural level, the industrial-financial groups have been weakened by this crisis insofar as it has directly undermined the viability of the banks, which are key shareholders in the oil industry. It is, at the present time, very difficult to assess how the banks will react to this crisis and what, at the end of the day, the implications will be for the oil industry. Some groups are already in a precarious situation. Faced with the consequences of the crisis, some banks heavily involved in the oil industry have decided to merge, which no doubt will have implications for the holding companies that they control³⁸.

This concentration is becoming more apparent amongst the oil groups themselves, without the thinking behind it always being clear³⁹. Is it part of the restructuring movement aimed at reducing production costs and introducing efficiency factors to the Russian oil holding companies? Or are we seeing a reversion to the traditional image of the Soviet «giant» and is it merely a reconfirmation that size is essential for survival in the Russian environment and for obtaining favourable relations with the State and with regional authorities? No doubt there is no single answer to these questions. Some holdings, following the example of Lukoil, are more eager than others to reduce their production costs, no doubt because of the importance of the role played by foreign investors in the structure of their capital. They are getting there partly by diversifying their deposit portfolios (to the detriment of the Russian deposits) on the basis of internationalisation, particularly in the Caspian region⁴⁰.

* * *

The oil industry is only at the beginning of a long process of development which could see the advent of an industry reduced to just a few powerful financial-industrial groups. The reforming of the centrally planned economy has given rise to a model of organisation that appears to be a novel combination of new institutional structures (private property rights) on one side, and behaviour and co-ordination patterns that appear to be a legacy of the old system on the other. These models are not however only «hybrid» forms, halfway between the plan and the market. They have a logic all their own, which is exerting an influence on the key variable factors in the future of the Russian oil industry. Whatever developments may be taking place now, the long-term durability of the oil industry is inextricably linked with, and determined by, the investment strategies (or non-strategies) currently being developed in the very short term. Although the industrial-financial groups in the oil industry are allowing the obstacles and uncertainty of the post-Communist environment to be managed effectively, their

³⁸«Battered economy leaves Russia's oil sector reeling».- *PIW*, 31 August 1998, p. 5-6.

³⁹Lukoil is interested in Slavneft and Onaco, Yukos by Onaco and Rosneft, and Tyumen Oil Company in Slavneft. At the same time, there is a plan to merge Rosneft, Onaco et Slavneft. «In Russia merger talk firms go for size not for economics».- *PIW*, 21 December 1998.

⁴⁰Lukoil is without doubt the greatest exponent of this strategy. During the first half of 1998 Lukoil's production outside of Russia more than doubled, principally in Azerbaijan and Kazakhstan where the holding company consisted of a portfolio of major assets. «Lukoil reports drop in profits».- *PIW*, October 1998, p. 39.

particular kind of rationale has raised major questions on how the future should be managed.

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Annex1 : Composition of the main russian integrated oil company (except distribution(1))

LUKOIL (created in 1993) Production associations : Langepasneftegaz, Permneft, Arkhangelskgeodobycha (2) Refineries : Volgogradneftepererabotka, Permnefteorgsyntez, Mazheikai (Lituania)
SURGUTNEFTEGAZ (1993) Production association : Surgutneftegaz Refinery : Kirishinefteorgsyntez
YUKOS (1993) Production associations : Yuganskneftegaz, Samaraneftegaz Refineries : Kuybyshevnefteorgsintez, Novokuybyshevsk, Syzran
SLAVNEFT (1994) Production association : Megionneftegaz Refineries : Mozyr (Belarus), Yaroslavl Mendeleyev, Yaroslavnefteorgsyntez
SIBNEFT (1995) Production association : Noyabrskneftegaz Refinery : Omsk
SIDANKO (1994) Production associations : Varyeganneftega, Kondpetroleum, Udmurtneft, Saratovneftegaz Refineries : Angarsk, Saratov, Khabarovsk
EASTERN OIL COMPANY (VNK (3), 1994) Production association : Tomskneft Refinery : Achinsk
ORENBURG OIL COMPANY (ONACO, 1994) Production association : Orenburgneftegaz Refinery : Orsknefteorgsyntez
TYUMEN OIL COMPANY (1995) Production associations : Nizhnevartovskneftegaz, Tyumenneftegaz Refinery : Ryazan
ROSNEFT Production associations : Purneftegaz, Krasnodarneftegaz, Sakhalinmorneftegaz, Arkhangelskgeodobycha (5) Refineries : Komsomolsk, Krasnodarnefteorgsyntez, Tuapse <i>Regional Joint stock companies</i>
KOMITEK (Republic of Komi, 1994) Production association : Kombineft Refinery : Ukhta
TATNEFT (Republic. of Tatarstan, 1994) Production association : Tatneft Refinery : Nijnekamsk
BACHNEFTEKHIM (Republic of Bashkortostan, 1995) Production association : Bachneft Refineries : Oufa, Novo Oufa, Oufimsk, Salavat
YUNKO (Republic of Chechnya) Association de production : Grozneft Raffineries : Groznyi (former Lenin), Groznyi-Sheripov, Novo-Groznyi <i>Others types of organization (6)</i>
NORSI OIL (1995) Without produceur (7) Refinery : Norsi-Nizhniy Novgorod
CENTRAL FUEL COMPANY (1997) Without produceur (8) Refinery : Moscou
Rusiya Petroleum : hold licences to develop some fields in the Irkutsk oblast and the big field of Kovyktinskoye (9) Yashar (National oil company of the Nenets district (10) VOSSIBNEFTEGAZ (Eastern siberia oil company) : hold licences to develop Yurubchen and Sosnovaya fields in the Krasnoyarsk region(11)

Notes (1) : For simplification, the associations of distribution are not included ; (2) : This association of exploration holds licences of some important fields in the Timan Pechora region and Archangel province.

Lukoil owns 75% of its shares ; (3) : VNK for Vostochnaya Neftianaya Kompaniya ; (4) : Purneftegaz would be sold alone in September 1998 ; (5) : Rosneft owns 25% of this association of production ; (6) : These organizations will be restructured in the future ; (7) : Norski Oil is supplied by Lukoil and Tatneft ; (8) : Created in 1997, it is the last joint stock company created by the programme on the oil industry restructuring ; (9) : It would be a regional independent oil company ; (10) : The structure of this company is not clear. One of the shareholders is the association of exploration Arkhangel'skgeodobycha in the Nenets district ; (11) : Vostneftegaz is structured around two companies, Eniseyeftegazgeologiya and Yeniseygeofizika.