ICR Review

Operations Evaluation Department

Report Number : ICRR10740

1. Project Data:		Date Posted :	08/21/2000	
PROJ ID:	P008809		Appraisal	Actual
Project Name :	Oil Rehabilitation	Project Costs (US$M)	1035.0	n.a.
Country:	Russian Federation	Loan/Credit (US$M)	610.0	414.0
Sector(s):	Oil & Gas Exploration & Development	Cofinancing (US$M)	256.0	n.a.
L/C Number:	L3623; LP190			
		Board Approval (FY)		93
Partners involved :	EBRD, Netherlands	Closing Date	12/31/1995	12/31/1999
Prepared by :	Reviewed by :	Group Manager :	Group:	

2. Project Objectives and Components

a. Objectives

(i) slow the rate of decline of oil production and export in the near term;
(ii) strengthen the managerial, technical and financial capabilities of selected oil enterprises;
(iii) catalyze the mobilization of financing (incl. foreign investment) in the sector; and
(iv) support Russia' policy reforms aiming at fostering large-scale private sector investment in the upstream oil sector through legal, tax, price and institutional reforms.

b. Components

Project included TA for the Ministry of Fuel and Energy ($10 million), incl. for drafting new petroleum legislation and assistance (via on-lending of Bank funds) to three Western Siberian Oil Production Associations (OPA): KNG, PNG and VNG (respectively $272 , $158, and $170 million). The latter consisted of:
(i) workover, recompletion and rehabilitation of about 1,300 wells;
(ii) drilling of about 84 infill wells;
(iii) replacement of over 1,000 km of worn out production flow lines; a small topping plant (2,000 BPD) and an NGL extraction unit (875 TPD);
(iv) seismic data processing facilities, reservoir studies and related training; and
(v) assistance in piloting an acreage tendering program.
In spite of the stated reform objectives of the project, no specific policy conditionality was provided for, other than in the form of a Letter of Intent in which the government agreed, inter alia, to consult with the Bank on an appropriate path for increases in domestic oil prices and stated its policy to shift oil taxation from a revenue-based system to a profit-based one.

c. Comments on Project Cost, Financing and Dates

As a result of changes in taxation introduced by the Government in 1995 which made many oilfield rehabilitation projects financially unviable, two OPAs decided to severely curtail the scope of their Bank-supported investments: KNG canceled $140m million of its sub-loan (i.e. 50%) and PNG $39 million (23%). Only VNG decided to fully utilize Bank funds. The scaled-down project was completed four years behind schedule --mostly due to delays in the implementation of the TA component (of which only half was ultimately disbursed).

3. Achievement of Relevant Objectives:

In spite of the sharp reduction in their scope and of significant implementation delays, the physical investments supported under the project successfully stopped the decline in oil production in all three OPAs. The ex-post ERRs for the three OPAs' overall investment programs, although lower than expected at appraisal, are still high (ranging from 18% to 81%), which is not surprising given the nature of these quick-return rehabilitation investments. However, the *financial* returns to the OPAs so far have been substantially less because of the impact of new taxes and of the 1998 fall in international oil prices. These factors were compounded by the stripping of some of the companies' liquid assets (through transfer pricing) by the new private owners, following their privatization under less-than-transparent circumstances (the "loans for shares" program). As a result, all three OPAs have suffered from severe cash-flow shortages (limiting their ability to implement the project) and two have even gone into bankruptcy proceedings.
Financial constraints have also resulted in the OPAs' ignoring their commitments on environmental aspects .

Policy objectives were, for the most part, not achieved. Progress made in the early years on domestic oil pricing (via market liberalization) was partly reversed in the aftermath of the 1998 economic crisis; the petroleum tax system remains grossly inefficient; access to oil transport capacity (incl. for export) remains discriminatory; and the limited progress made on legislative reform --including the recent enacting of the production-sharing agreement (PSA) law--has not been enough to induce a significant influx of foreign investment.

4. Significant Outcomes/Impacts:

Besides the (partial) achievement of physical objectives, the project appears to have contributed to the strengthening of the OPAs' technical and managerial capacities, through their access to international technical advisors, the use of ICB and the introduction of basic concepts of financial management and investment planning Also, the initial liberalization of domestic and export oil prices (started during project preparation) was a noteworthy achievement but its benefits were largely offset by remaining distortions in the petroleum tax and export regime. Finally, the 1999 passing of the PSA law promoted under SAL3 was a major step forward by its impact hinges on yet-to-be enacted regulations.

5. Significant Shortcomings (including non-compliance with safeguard policies):

See section 3 above. Particularly noteworthy was the lack of agreement until 1998 between the Bank and the IMF on petroleum tax reform (from a revenue-based to a profit-based system), which ultimately contributed to the halting of project implementation (see section 2c above). In addition, no full accounting of total project costs (incl. local costs) was available at the time of the ICR mission, pointing to severe deficiencies in the project's (and companies') monitoring and evaluation systems.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Unsatisfactory	Unsatisfactory	
Institutional Dev .:	Modest	Modest	
Sustainability:	Unlikely	Unlikely	
Bank Performance:	Satisfactory	Unsatisfactory	The project's quality at entry was generally satisfactory: the unusually high risks were recognized and judged appropriate given the extremely high potential rewards, both in physical and policy terms. But Bank supervision suffered from excessive staff turnover and focused too narrowly on physical and procurement aspects to the detriment of financial, environmental and policy issues, during a critical period of the project's implementation. Particularly troublesome is the apparent lack of financial due diligence on the Bank's part on the occasion of the 1995 privatization of two OPAs under highly suspicious circumstances. Admittedly, Bank supervision after 1998 filled these gaps and was more proactive (particularly on the policy front in parallel with the preparation of SAL3). However, overall Bank performance is rated unsatisfactory because the unwillingness on the part of Bank management to act forcefully in the previous period had long-lasting negative consequences for project implementation and sector policy dialogue.
Borrower Perf .:	Unsatisfactory	Unsatisfactory	
Quality of ICR:		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

(i) sector expertise in resource development and management is essential in evaluating the medium term impact of specific tax policies, and in Bank discussions with the IMF on such matters; (ii) close coordination with the IMF on fiscal policy aspects is critical to ensure that its fiscal policy conditionality does not work at cross-purposes with Bank-supported sectoral policy objectives; (iii) when project justification hinges on high expectations for sector reform, key sector performance indicators should be agreed to avoid confusion as to the project's real objectives and their achievement; and (iv) when privatization of borrowers or implementing agencies is envisaged during the life of a project, specific provisions should be incorporated in the loan documents to provide for the Bank's reevaluation of the project's likely achievement of its development objectives under the new ownership arrangements .

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR' quality is satisfactory, considering the lack of detailed information made available by the OPAs, including on project costs. However it should have elaborated further on the circumstances (incl. the Bank's internal decision-making process regarding the possible use of remedies) which surrounded the highly non-transparent privatization of two of the project's implementing agencies and the resulting nefarious impact on project implementation (see above comment on Bank performance).