

Extracting Oil, Gas and Public Money in the Arctic: Case studies from Russia and Canada

Ivetta Gerasimchuk, Senior Researcher, IISD

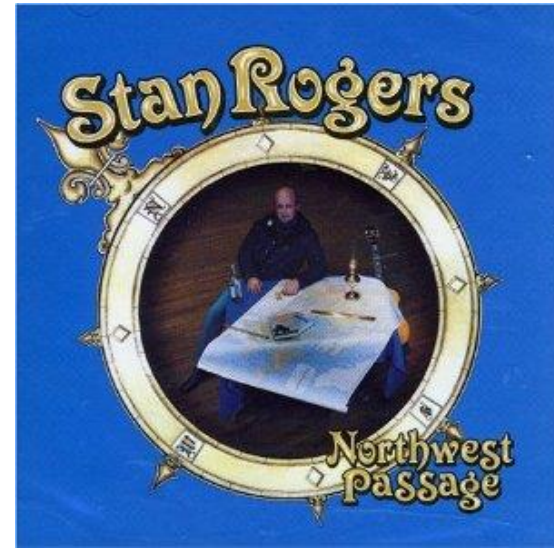
Arctic Futures Symposium, Brussels, 14 – 15 October 2014

The Arctic: Attitudes & emotions



*If it is needed, consider it's done:
We will have gardens even here.
Let the snowstorm rage,
If needed, we will melt the ice.*

From the Soviet song "Guys from 70° Latitude N" (1968)



*Westward from the Davis Strait
'tis there 'twas said to lie,
A sea route to the orient, for which so many died,
Seeking gold and glory,
leaving weathered broken bones,
And a long forgotten lonely cairn of stones.*

From the Canadian song "Northwest Passage" (1981)

The Arctic: Root causes of change

Q1. Are extractive industries in the Arctic market-driven? Or pushed by governments?

Q2. Can a “concerned citizen” make sense of it all based on public info?

**ANTHROPOGENIC
CLIMATE CHANGE**

we will melt the ice.

**DEMAND FOR
RESOURCES**

Seeking gold and glory

BLACK

**GOVERNMENT
POLICY?**

From the Soviet song “Guys from 70° Latitude N” (1968)

From the Canadian song “Northwest Passage” (1981)

Global Subsidies Initiative (GSI):




Inventories of producer support

Roughly same method as OECD's



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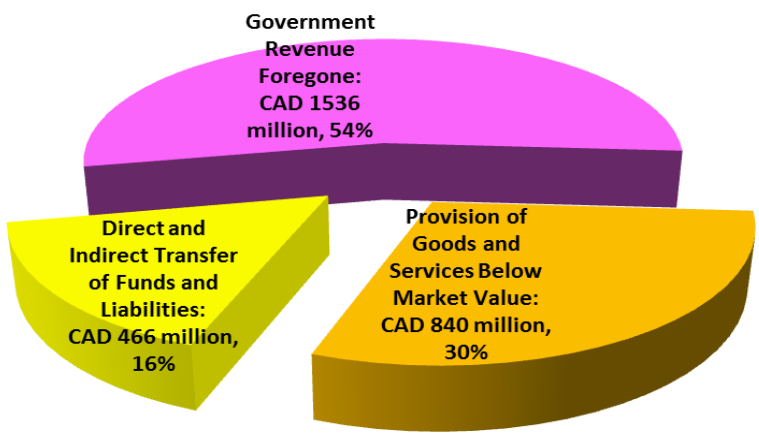
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Country	Scope	Subsidies Identified	Value of Subsidies	Data year
	Upstream oil activities, 3 Provinces	63	\$2.8 billion	2008
	Upstream oil & gas	9	\$4 billion	2009
	Upstream oil & gas, Federal subsidies	30	\$14.4 billion	2010
More at: http://www.iisd.org/gsi/fossil-fuel-subsidies/fossil-fuels-what-cost				

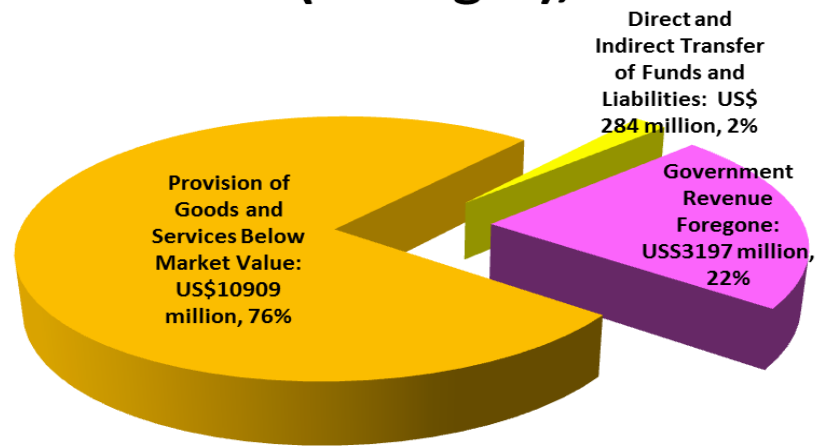
Structure of government support

Direct comparisons IMPOSSIBLE
due to differences in benchmarks and scopes

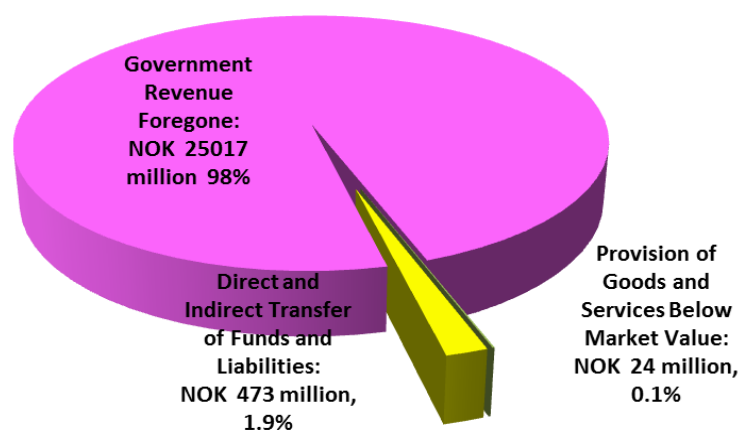
Canada (oil only), 2009



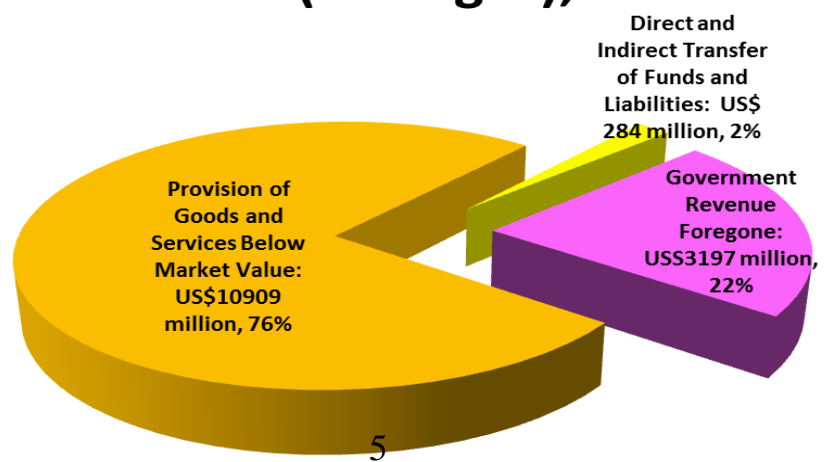
Russia (oil & gas), 2010



Norway (oil & gas), 2009



Russia (oil & gas), 2010



Government Support to Extractives:

Criteria for case study selection

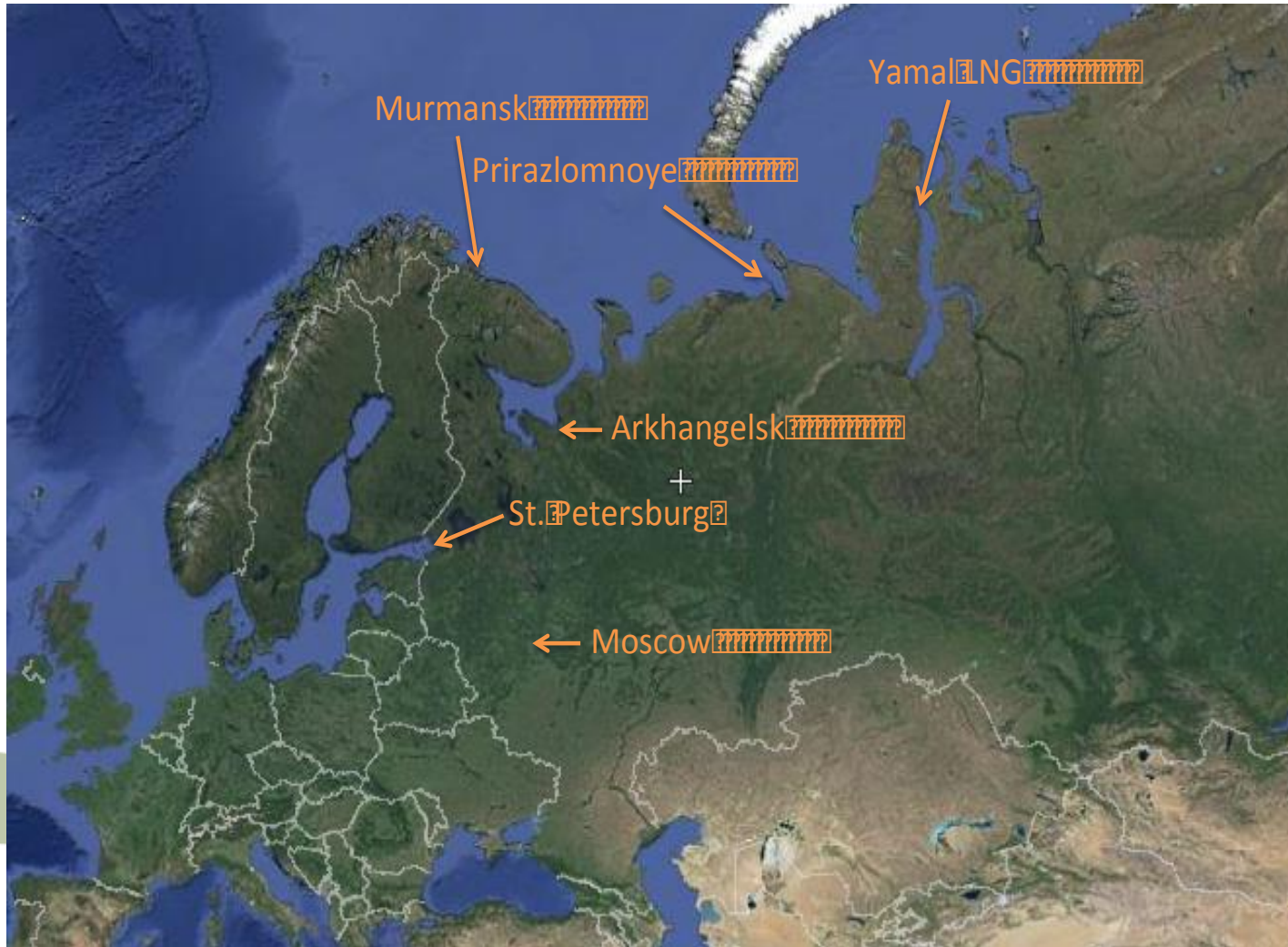
- Our analysis can be useful to Arctic actors who lack such insights now
- Development has advanced (not a paper project)
- There is enough corporate and media reporting specific to projects
 - Prirazlomnoe (offshore oil), Yamal LNG (onshore gas) in Russia
 - Meadowbank mine (gold) in Canada

Yamal LNG & Prirazlomnoe study in partnership with WWF Russia Commissioned to Sigra Group (Norway)

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Yamal LNG (onshore gas)

- ✓ Discovered in 1974, production to start in 2017
- ✓ Capacity at 16.5 mln. tonnes of LNG (27 bln. cubic meter of gas) per year
- ✓ Corporate capital cost USD 26.9 bln., total cost at USD 33 billion
- ✓ 93% of gas already sold in future contracts
- ✓ Main market is Asia
- ✓ Owners: NOVATEK (60 %), Total (20 %) & CNPC (20 %). NOVATEK to sell 9 %

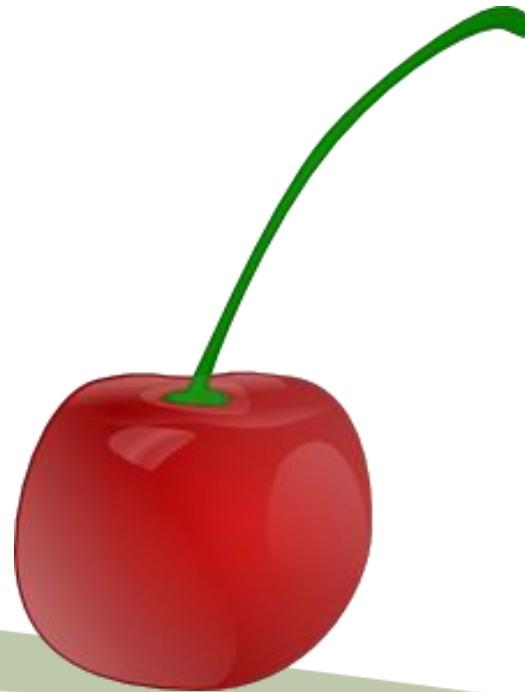


Source: Yamal LNG

Yamal LNG:

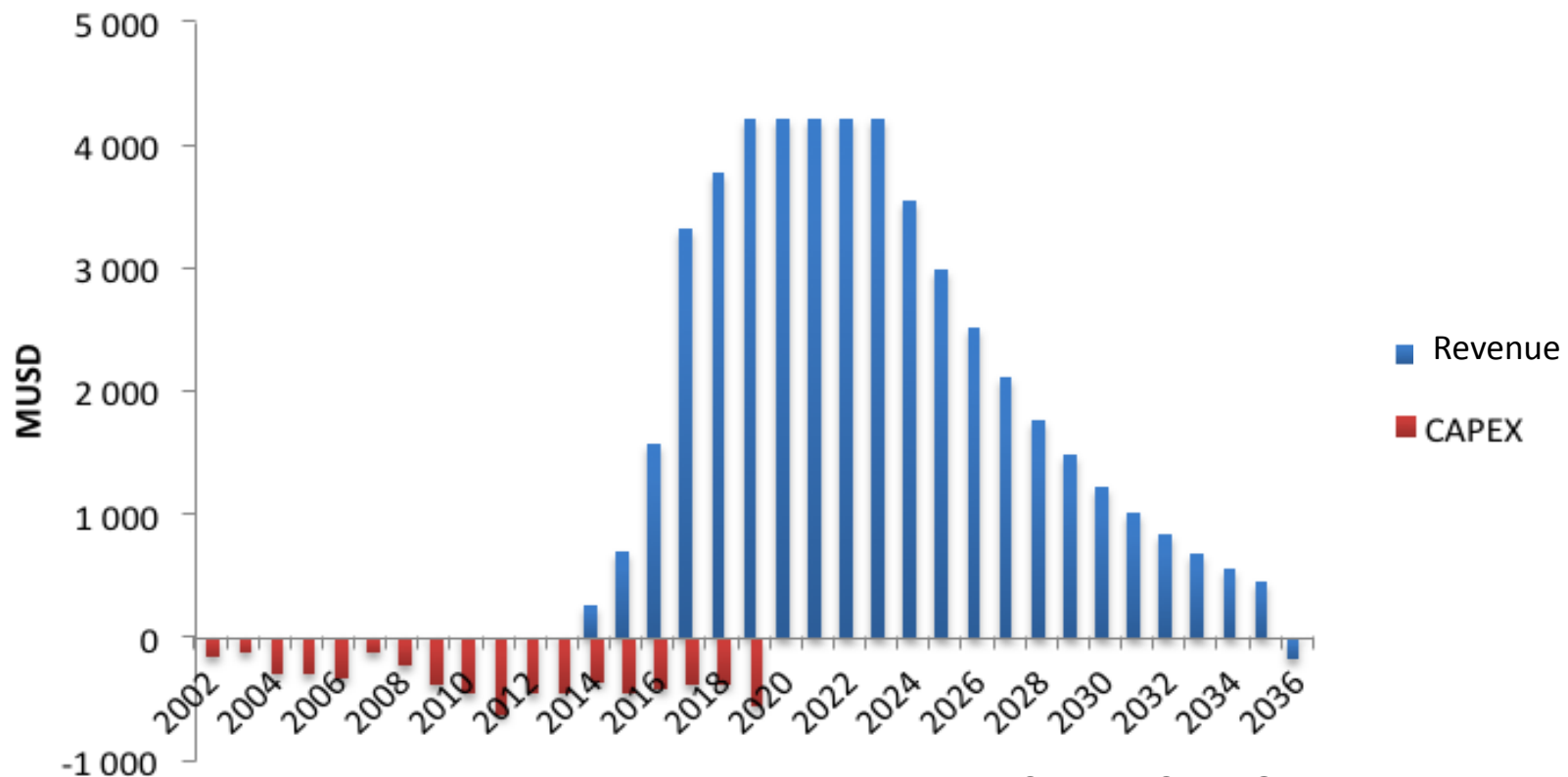
very significant government support

- ✓ Icebreaker fleet
- ✓ LNG tankers
- ✓ Airport in Sabetta
- ✓ Sea port in Sabetta
- ✓ Dredging in the Bay of Ob
- ✓ Tax and royalty breaks



Prirazlomnoe (offshore oil)

- ✓ Discovered in 1989
- ✓ Development started in 1995
- ✓ Production started in 2013
- ✓ Most tax breaks granted in 2013
- ✓ 120 thousand tonnes of oil per day
- ✓ Capital cost USD 5.7 bln.
- ✓ Since 2006 100 % owned by Gazprom



Source: Sibra Group

Tax & Royalty Breaks

	Taxes (incl. royalty types)	Granted exemptions
YAMAL LNG	Mineral extraction tax	Exemption for 250 bln. cubic meters of gas and 20 million tonnes of condensate during the first 12 years from the start of production
	Export tax	Exemption for LNG and stable gas condensate from the project
	Property tax	Exemption for 250 bln. cubic meters of gas and 20 million tonnes of condensate during the first 12 years from the start of production
	Profit tax	Reduction from 18% to 13.5% for 250 bln. cubic meters of gas during the first 12 years from the start of production
PRIRAZLOMNOE (most tax breaks granted in 2013)	Mineral extraction tax	Exemption for 35 mln. tonnes of oil for 7 years starting from 1 January 2015
	Export tax	Reduced rate, roughly 50% of the benchmark
	Property tax	Full exemption

Sources: based on Federal Law №268-FZ, Tax Code of the Russian Federation (Articles 258-259.3), Government regulation № 1029 of 18 November 2013, government regulations on export duty rates, regional law №151-ZAO

Yamal LNG Analysis

Project economics including government investment into infrastructure

	Net Present Value @ 12 % discount rate	Internal Rate of Return
Before taxes	1 813	13,0 %
After taxes, excluding tax breaks	- 10 962	4,4 %
After taxes, including tax breaks	- 585	11,6%

Project economics excluding government investment into infrastructure (theoretical situation)

Before taxes	- 3 825	10,1 %
After taxes, excluding tax breaks	- 16 312	2,1 %
After taxes, including tax breaks	- 5 811	8,9 %

Prirazlomnoe Analysis

Project economics, 2002 base year

Net Present Value @ 12 %

Internal Rate of Return

Before taxes	2 766	19,3 %
After taxes, excluding tax breaks	-1 345	4,5 %
After taxes, including tax breaks	656	14,4 %

Project economics, 2013 base year

Before taxes	16 265	105,8 %
After taxes, excluding tax breaks	1 903	27,8 %
After taxes, including tax breaks	8 863	79,6 %

Government Revenue

From Yamal LNG and Prirazlomnoe

Expected government revenues from taxing Yamal LNG

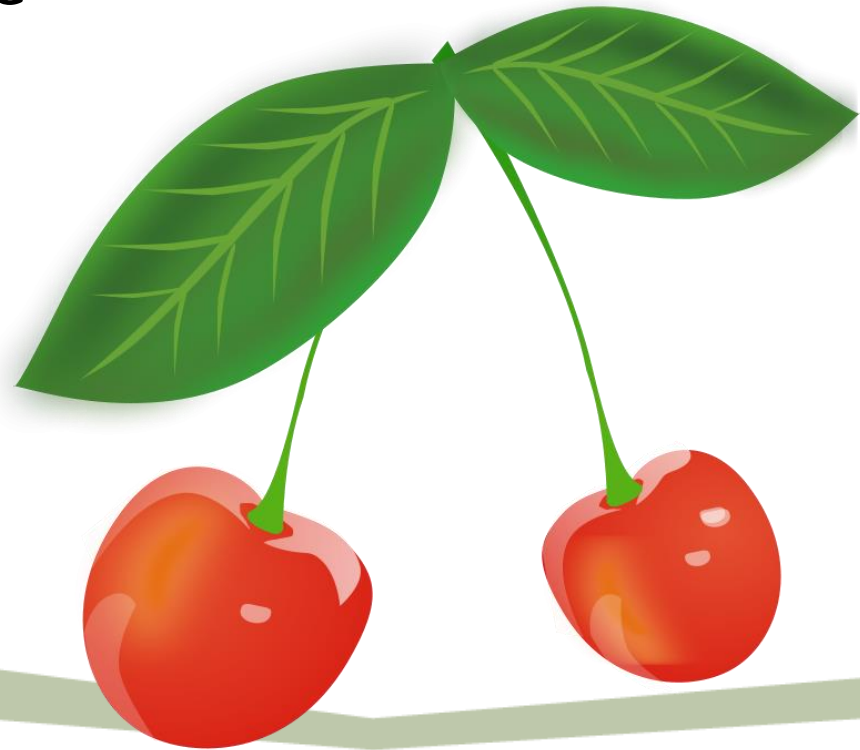
	Government take	Government revenues from taxes	NPV of government revenues @ 8 % discount rate	Gross Tax Share
Excluding tax breaks	77 %	51 648	19 224	92 %
Including tax breaks	24 %	15 852	4 351	27 %

Expected government revenues from Prirazlomnoe

Excluding tax breaks	92 %	38 920	8 269	97 %
Including tax breaks	53 %	22 339	4 419	77 %

Why “Cherry-Picked” by Government?

- ✓ Strategic importance of both projects (remember glory?)
- ✓ Support to military yards through Prirazlomnoe in 1990ies
- ✓ Private interests in case of Yamal LNG
- ✓ Jobs and expected multiplier effects
- ✓ Community investments
- ✓ Environmental impacts



Conclusions for Russia

- ✓ The tax breaks granted to both projects seek to correct the shortcomings of the existing system of oil & gas taxation in Russia. *However...*
- ✓ Yamal LNG is not viable without massive government support into infrastructure development
- ✓ All costs are sunk costs, no point in granting tax breaks to Prirazlomnoe in 2013 and 2014
- ✓ The “manual control” approach creates further distortions and results in inefficient use of resources as well as underdevelopment of inherently viable fields that have not received such massive government support.

Meadowbank gold mine


Nunavut, Canada



- ✓ Discovered in 1987
- ✓ Development started in 2007
- ✓ Production started in 2010
- ✓ Peak production in 2012-2015 expected at 358,000 ounces per annum
- ✓ Mine life until 2020
- ✓ Capital cost CAD 1.5 bln.
- ✓ 100% owned by Agnico Eagle Mines Limited

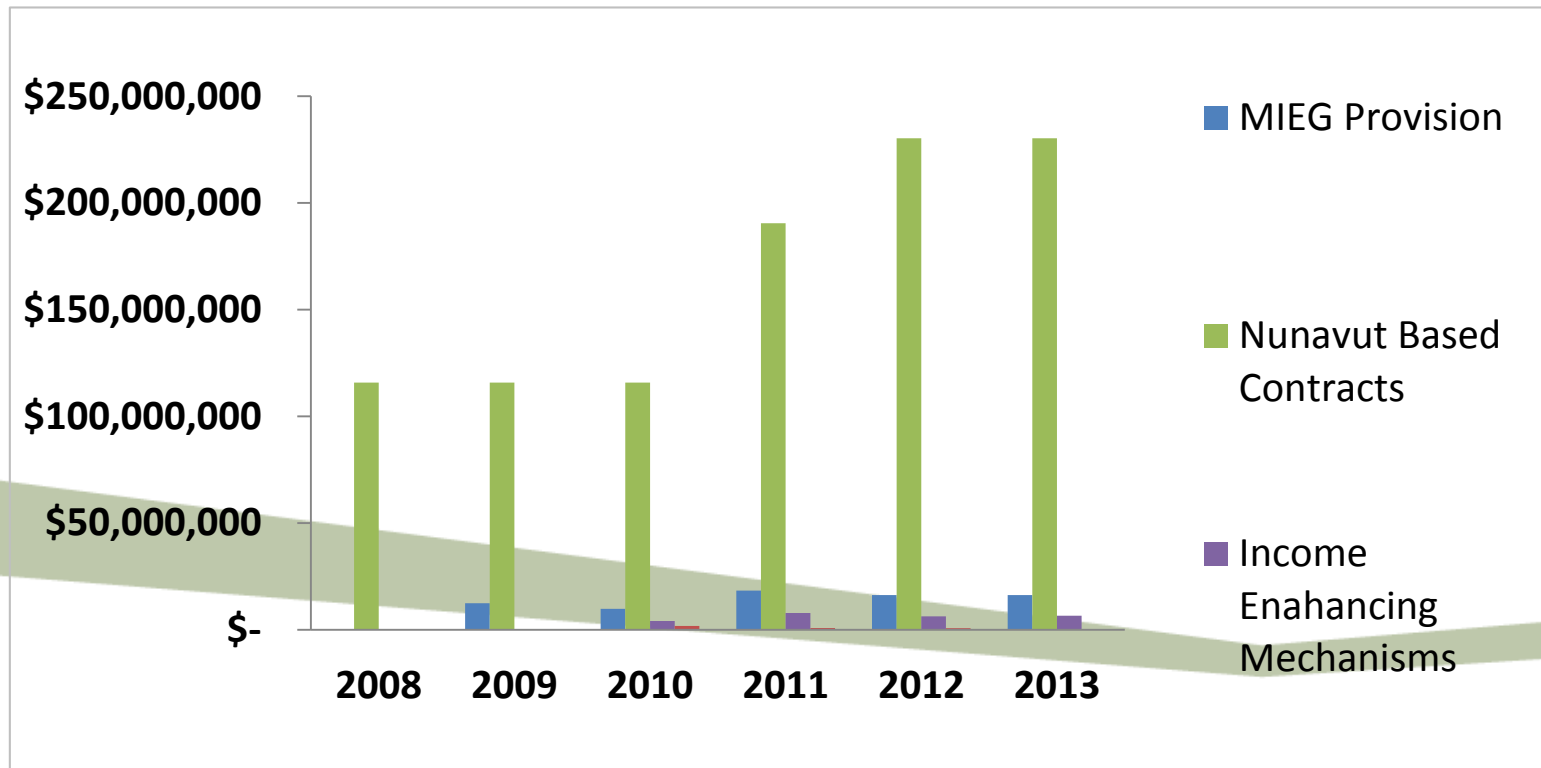
Meadowbank gold mine:

Fiscal treatment

- ✓ Complicated system of federal and regional taxes and their redistribution, for example, corporate income tax
 - ✓ Royalties based on profit and not physical output
 - ✓ Federal programs to support exploration
 - ✓ Federal programs to support skill development of the local labour force
 - ✓ Federal Contaminated Sites Action Plan
 - ✓ Flow-through share deductions
 - ✓ Accelerated depreciation & related
 - ✓ Nunavut fuel tax rebate
- 

Meadowbank gold mine: Benefits to Nunavut

- ✓ Rapidly growing and young population in Nunavut needs jobs, currently largely depends on federal subsidies
- ✓ Impact & Benefit Agreement (IBA= concluded with the Kivalliq Inuit Association
- ✓ IBA includes provisions on the Minimum Inuit Employment Goal (MIEG), contracts and Income Enhancing Mechanisms (taxes, royalties and land lease fees to Nunavut), and community investments



Q1. Are extractive industries in the Arctic market-driven? Or pushed by governments?

A1. Some projects are market-driven. For others, government support can be very significant.

Q2. Can a “concerned citizen” make sense of it all based on public info?

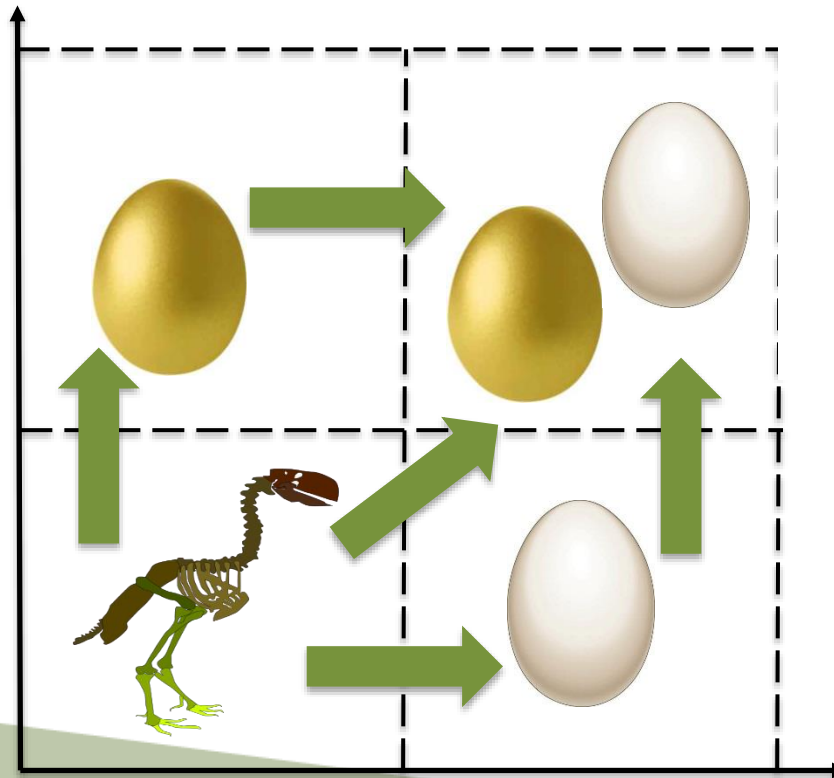
A2. No unless they have a model.



IISD's Arctic Initiative:

Looking at root causes beyond emotions

Tax revenues
(«golden
eggs»)



**What government
policies can help
extractive projects
deliver both tax
revenues and direct
benefits to the
society?**

Direct benefits to the society:
jobs, contacts, other («simple
eggs»)

- IISD's headquarters are in Canada, the current chair of the Arctic Council (offices in Winnipeg, Ottawa, New York, Geneva, Beijing)
- IISD's Arctic Initiative has four areas of focus:
 - Climate change adaptation & food security
 - Extractive industries' costs & benefits
 - Infrastructure development (incl. renewables)
 - Transformative knowledge – IISD-IASS breakout Session on 1 November at the Arctic Circle in Reykjavik

Thank you for your attention!

Ivetta Gerasimchuk

Senior Researcher

igerasimchuk@iisd.org

www.iisd.org

IISD's Arctic Initiative: Looking into the future



*Those who did not believe mean prophecies
And did not lie down in the snow to get a break
Will be rewarded for their solitude
By meeting their soul mates.*

From the song "White Silence" by V. Vysotsky (1972)