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Soviet Oil Production and Obstacles to

U.S. Trade and Investment

Statement of
Allan I. Mendelowitz, Director
International Trade, Energy, and Finance Issues
National Security and International Affairs Division

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Committee on Foreign Relations
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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to testify about our report on issues regarding Soviet oil production and obstacles to U.S. trade and investment in Soviet oil exploration and production.

Our report, which was issued on May 24[1], was prepared at the request of Senator Claiborne Pell, the Chairman of the Senate Committee on Foreign Relations. For the report, we obtained information on (1) the recent decline in Soviet oil production and the reasons for the decline and (2) the principal obstacles to U.S. trade and investment in Soviet oil exploration and production.

DECLINE IN SOVIET OIL PRODUCTION

Despite the fact that the Soviet Union has the sixth highest oil reserves in the world, Soviet oil production has been declining. In 1988 production was about 12.5 million barrels per day; in 1990 it was about 11.4 million barrels per day, a decrease of about 9 percent. Production is expected to continue to decline, to 9.1 million barrels per day by 1994. Soviet oil exports have also decreased. In 1988 exports were 4.1 million barrels per day; in 1990 they were 3.5 million barrels per day, a decrease of 15 percent. Oil exports are also expected to continue to decline.

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[1]Soviet Energy: U.S. Attempts to Aid Oil Production Are Hindered by Many Obstacles (GAO/NSIAD-91-214, May 24, 1991).

Energy exports are important to the Soviet Union as a major source of hard currency earnings. For example, total energy exports during the first 9 months of 1990 represented about 46 percent of total hard currency earnings, or $14.6 billion. Petroleum exports accounted for the major portion of these energy earnings, representing 33 percent of total hard currency earnings, or $10.6 billion. Falling petroleum exports will limit the ability of the Soviet Union to purchase goods and services in the West which are important for economic restructuring.

Soviet oil production is declining for several reasons. First, the Soviets lack sufficient capital to finance oil exploration and production activities and maintain older equipment. This lack of capital results from cutbacks in government funding, uneconomical pricing of oil products, and escalating exploration and production costs. Second, the Soviet Union is using outdated and inefficient production practices. For example, the technique used to drill about two-thirds of new Soviet wells requires frequent changes of drilling bits, which results in lower productivity.

In attempting to reverse the decline in oil production, the Soviet Union has been actively seeking joint ventures with western companies to obtain capital and technology needed for oil production. In 1987 it issued investment decrees permitting the formation of joint ventures with foreign companies. According to the U.S. Department of Commerce, as of March 1991 between 10 and 20 western companies were discussing potential exploration and production joint ventures with Soviet officials. Several U.S. companies have already signed joint venture agreements.

PRINCIPAL OBSTACLES TO U.S. TRADE AND INVESTMENT IN SOVIET OIL EXPLORATION AND PRODUCTION

Let me now focus on the various problems that impede U.S. trade and investment in Soviet oil exploration and production.

Two 1974 congressional restrictions limit the ability of U.S. oil companies and petroleum equipment suppliers to sell their goods and services in the Soviet Union or invest in Soviet oil exploration and production. Although the President in December 1990 waived the Jackson-Vanik amendment, which had limited general trade with the Soviet Union, the Byrd amendment to the Trade Act of 1974, as amended, and the Stevenson amendment to the Export-Import Bank Act of 1945, as amended, continue to specifically limit U.S. Export-Import Bank financing for energy related activities involving the Soviet Union. These amendments were enacted during the Cold War when the Congress was concerned about aiding the Soviet economy.

These legislative restrictions (1) prohibit U.S. Export-Import Bank loans and financial guarantees for the purchase, lease, or procurement of any product or service that is used to produce fossil fuel energy resources in the Soviet Union; (2) limit to $40 million government export credit guarantees and insurance for energy research and exploration projects in the Soviet Union; and (3) set an overall ceiling of $300 million on the amount of financing that the U.S. Export-Import Bank can support with credit guarantees and insurance for operations in the Soviet Union.

Conditions in the Soviet Union at this time also impede U.S. investment. Political conflicts in the Soviet Union among the central, republic, and local governments over who owns the oil resources and uncertainty about the legality of existing agreements and contracts between Soviet and western companies are major impediments to doing business in the Soviet Union. One way that some U.S. companies are trying to protect their investment projects in the face of this uncertainty is by simultaneously signing agreements with the central, republic, and local governments.

Another major impediment to trade and investment is the Soviet unfamiliarity with basic western business practices. In addition, investments are hindered because the existing U.S.-Soviet bilateral tax treaty lacks provisions that would allow U.S. companies to repatriate joint venture profits without double taxation.

Progress is being made in overcoming some of the obstacles. For example, some training programs in western business practices have already been developed in cooperation with the U.S. government, private companies, and universities. In addition, the Department of the Treasury is currently negotiating a new bilateral tax treaty with the Soviet Union that is designed to address the tax issues.

In light of the changes in the Soviet Union since 1974, when the Stevenson and Byrd amendments were adopted, the Congress may wish to reconsider the continued need for these amendments. A decision to remove the legislative restrictions would not necessarily mean immediate U.S. loans and guarantees to the Soviet energy sector. The U.S. Export-Import Bank would, of course, still be expected to apply its standard procedures for assessing the risk of nonrepayment of loans, including country risk analysis, in determining whether loans and guarantees should be extended to the Soviet Union.

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Mr. Chairman and members of the Subcommittee, this concludes my prepared statement. I will be happy to try to answer any questions the Subcommittee may have.