ICR Review
Operations Evaluation Department

Report Number : ICRR10742

1. Project Data:		Date Posted : 08/21/2000		
PROJ ID :	P008805		Appraisal	Actual
Project Name :	Second Oil Rehabilitation Project	Project Costs (US$M)	678.0	n.a.
Country:	Russian Federation	Loan/Credit (US$M)	500.0	346.5
Sector(s):	Oil & Gas Exploration & Development	Cofinancing (US$M)	0	0.3
L/C Number:	L3768			
		Board Approval (FY)		94
Partners involved :	CIDA	Closing Date	06/30/1997	06/30/2000
Prepared by :	Reviewed by :	Group Manager :	Group:	

2. Project Objectives and Components

a. Objectives

This second project's objectives were similar to the first one's, i .e.:
(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) continue to 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 and investments for three more Western Siberian Oil Production Associations (OPA): MNG, TN and YNG (respectively $150, $160, and $190 million). The latter consisted of:
(i) modernization of about 1,200 wells;
(ii) reconstruction of associated surface facilities
(iii) drilling of 127 infill wells;
(iv) comprehensive fiel optimization study for one field in each OPA;
(v) enhanced environmental protection activities and equipment and design of a program to protect national minorities in or near project areas.
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 continue to consult with the Bank on sector policy issues.

c. Comments on Project Cost, Financing and Dates

As a result of the OPAs' failure in early1999 to repay their sub-loans to the Government, the latter requested cancellation of undisbursed loan amounts, i .e. $95.3 for MNG (70% of its sub-loan), $44 million for TN (26%) and $13.2 million for YNG (7%). Loan was closed three years behind schedule .

3. Achievement of Relevant Objectives:

In spite of the partial loan cancellations and of 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 are quite high (ranging from 108% to 244%), 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 repay their subloans) 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 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 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). 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).