

Russia's Latest Oil Gusher

Cash and expats could hurt Sakhalin Island as much as help it

BY DAVID WOLMAN

IT'S AMAZING WHO YOU meet on the flight to the oil-boom island of Sakhalin. Sakhalin Airlines is packed with opportunity hunters like Jeetendra Khemlani of Mumbai, future manager of the island's first Indian restaurant, the Taj Mahal, due to open this month. "Our clientele will mainly be ex-pats of course," says Khemlani, 30. "But as the restaurant becomes better known and Yuzhno grows, we should get more and more Russian customers." And if they don't, who cares? Besides Moscow and St. Petersburg, Yuzhno-Sakhalinsk, the island's capital, now has the highest concentration of non-Russians in Russia: one for every 18 locals.

Until recently Sakhalin Island was perhaps best known for the Anton Chekhov book of the same name. Now the 569-mile-long isle is the center of one of the most concentrated oil and natural-gas booms in decades, as well as a heated Russian debate over who will get the spoils: locals or multinationals. Off the island's blustery eastern shores lie oil and gas fields that, based on rough new estimates, could prove to be among the richest in the world; oil giants including ExxonMobil and Shell plan to spend \$10 billion over the next decade and as much as \$50 billion over the next 30 years. "For a while, the talk was all about the Caspian," says David Victor of Stanford University's program on energy and sustainable development. "Now Sakhalin is the big play."

Oil money is transforming the island of 600,000 people in one of Russia's most backward regions. Sakhalin's governor, Igor Farkhutdinov, says foreign dollars are expected to double to \$1.3 billion this year. You can hear the sound of money in the laughter of drunk expats gathered at the bar of the downtown Sakhalin Sapporo



BOOMTOWN: Breaking ground on 100 new employee housing units

Hotel—in the enthusiasm of a 22-year-old Russian translator working at the site of a new Exxon rig, in the voices of foreigners paying up to \$6,000 a month for modestly refurbished apartments in downtown Yuzhno-Sakhalinsk.

But others don't hear the money. "I don't see much benefit to Sakhalin and the community, at this point or later," says Tai Mak, an engineer from California working on an airport, apartments and other projects for ExxonMobil. Mak's own apartment rents for \$3,500. "But the maids or receptionists in the hotels? The vendors in town? I don't see their salaries going up."

The Russians first discovered Sakhalin oil in the mid-19th century, but it was so remote that no one exploited it with much gusto. The area got hot only after the fall of

the Soviet Union and the arrival of Western firms. This spring ExxonMobil signed a \$12 billion deal that set a record for the biggest foreign investment in Russian history. Already, tax revenues are rising, allowing the government to improve services. "The last 10 years were very difficult in Sakhalin. Many people had no electricity or water," says Natalya Gorbunova, 47, who just started work as a manager for ExxonMobil. "Most everyone I know in Yuzhno-Sakhalinsk now has electricity and water. And the drilling projects bring jobs."

Yuzhno-Sakhalinsk shows both progress and pain. In 2002 the Sakhalin Oblast region attracted \$680 million in foreign direct investment. But while builders expand downtown offices for big oil companies, the rest of the city is still shadowed by dilapidated Soviet block apartments. To house expat employees, the group led by Shell built a new California-style suburb with tennis courts, indoor swimming pool and streets with names like Blackcherry Court and Blue Spruce Drive. The ultimate result could be further distortion of Sakhalin's economy. Jeffery Valkar of the American Business Center in Yuzhno-Sakhalinsk figures the boom is likely to rate poorly for balanced development.

The most controversial aspect of the boom is the profit-sharing agreements between Russia and foreign oil giants. Russia signed these in the early and mid-1990s, when it was much less stable and needed to offer sweet deals to lure investors. Now, Russian officials think they gave away too much, and are considering whether to renegotiate. Particularly frustrating is a clause that allows oil companies to deduct many of their costs from the profits. The complaint is that by the time the multinationals are reimbursed for building new roads and the airport, and subsidizing overpriced apartments for their own employees, there won't be much profit left to share. ExxonMobil's answer is, in essence, that it still needs some assurance of stability to work in a backwater like Sakhalin. ■

Will locals, multinationals or Moscow get the spoils?