

RUSSIA'S ROLE AS MAJOR SUPPLIER: RELIABLE PRODUCER OR DANGEROUS MONOPOLIST?

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Overview

Europe's demand for natural gas is continuing to increase, whilst sources of the blue fuel are becoming less available. With diminishing indigenous supply, and over a quarter of the gas coming from Russia, policy makers have become increasingly aware of the security of supply concerns arising out of a growing dependence on Russian gas.

Nevertheless, in the short to medium term, Russia is the only country with the ability to meet the mounting demand on the European continent. Nevertheless, Russian domestic and foreign policies have cast doubt on whether Gazprom can remain as a reliable supplier of gas. This paper examines the Kremlin policy implications on the Russian gas sector, the physical flow of gas and the lessons for the European consumer.

The paper is organised into four main sections. The first 3 sections analyse the various dimensions of the gas sector from a Russian perspective, whilst the fourth section looks at the implications for consuming countries and makes recommendations for both parties. The fifth section concludes.

Methods

a) Physical availability

- Proved reserves and market share
- Consumption patterns – domestic and export
- Export channels, planned capacity / new routes,
- Fields in plateau, oil production down, supply crunch expected by 2020. Needs investment and technology transfer. FDI to be affected by nationalism, lack of transparency?

b) Resource Nationalism

- Recent world trends towards NOCs
- Gas most protected industry in Russia
- Affecting FDI in Russia – cases such as Sakhalin, Kovykta, Shtokman, Imperial Energy, Rusneft.
- Access to reserves hindered by Subsoil Law, Tax code, Strategic fields order.

c) Policy driving development

- Domestic policy promotes demand growth – inefficient use, subsidised prices, gasification rate, economic growth.
- Deregulation would bring added benefits, but is premature
- Role of independents and central asian suppliers.
- National champions control the sector, under patronage of political camps, Gazprom has strong hold over the gas sector – but control beginning to wane?
- Foreign policy concentrates on security of demand, via downstream integration (subs, asset-for-price swaps etc).
- Gas wars with Ukraine, Nabucco / Southstream wrestle.
- Asian routes, LNG participation, 3 tier pricing and gas cartel activities.

d) The road ahead and lessons for Europe

- Major policy issues to be addressed
- Difficult road ahead – current economic climate means demand destruction and price decreases.
- Requires secured property rights, functioning financial markets, tax incentives and fiscal and regulatory stability. New subsoil law needed.
- Needs investment into gas storage, additional infrastructure, bilateral investment contracts, commitment to demand, competition exemption to major infrastructure projects. Role of LNG and diversification?

Results

Various policy recommendations.

Conclusions

There are a number of policy issues that must be tackled. Domestically, in order to increase production output, various efforts must be made to attract FDI and foreign technology. This includes secure property rights, fiscal and legal stability - new subsoil law, amendments to the tax code, amongst other things. There needs to be greater access to foreign capital through a better functioning financial market. Foreign policy must coordinate downstream diversification with the European Union and allow for bilateral exchange of assets. Shift from the Licensing System to the new IAPN format will help to bring foreign partners.

Domestic consumption must be decreased by encouraging efficient use and increasing the current domestic price cap. Independents should have access to the domestic market without barriers to entry. Already some anti-competitive decisions have been taken against Gazprom. Nevertheless, substantial investment is needed into the infrastructure to bring the fuel to the consumption centres. Reliance on transit states gives rise to problems such as those encountered with the Ukraine. The Nord Stream Project will do well to diversify from this risk, however the South Stream project may fall susceptible to the Obsolescing Bargain.

The consumers must view the Russian position from a point of Security of Demand. Any major initiatives to reduce consumption from Russia via diversification through LNG imports will increase the price to the final consumer, but also incentivise Russia to look for other export route options, namely the Asian markets. But a supply crunch may occur as soon as 2020 unless major capacity is brought online, and in light of this fact, LNG import terminals must be a priority strategy for Europe in the long term. In the short to medium term, additional resources must be committed to gas storage facilities as well as the major pipeline projects. The EU acceleration directive is one such document.

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