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GAZPROM: CHALLENGES AT HOME AND ABROAD

- ANALYSIS
  Gazprom: From Monopoly to Oligopoly on the Russian Gas Market 2
  By Kateryna Boguslavska, Zurich
- ANALYSIS
  Gazprom in the Post-Soviet Region: Shrinking Markets, Politicised Relations 5
  By Ingerid M. Opdahl, Oslo
- ANALYSIS
  EC's Anti-Trust Inquiry into Gazprom's Practices: Its Significance and Meaning for Gazprom's Role in the EU Market 9
  By Elena Kropatcheva, Hamburg
- ANALYSIS
  Gazprom-Rosneft Competition for Asian Gas Markets: Opportunities and Challenges 13
  By Andrei V. Belyi, Tartu
- STATISTICS
  Production Figures and Pipelines 17

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ANALYSIS

Gazprom: From Monopoly to Oligopoly on the Russian Gas Market

By Kateryna Boguslavska, Zurich

Abstract

This article analyzes the current position of Gazprom on the Russian domestic gas market, in terms of recent changes in the legislative framework governing the market, the increasing competition it faces from independent gas producers and its future prospects. Special attention is paid to the authorities' introduction of economic incentives to promote liberalization of the market. It is concluded that such liberalization of the gas market is limited and controlled by the government, while expectations that Gazprom may completely lose its monopoly are overestimated.

Current Position of Gazprom on the Russian Domestic Gas Market

The Russian gas market is traditionally seen as overwhelmingly dominated by a state gas monopoly, Gazprom. Since the 2000s, Gazprom has been seen as a gigantic state corporation, symbolizing the political, economic, and even—to a certain extent—geopolitical power of the Kremlin. However, since 2010 Gazprom has sustained considerable losses with regard to its position of influence over the Russian gas market. The company's capitalization declined from $367bn in May 2008 to $51bn in 2014, an 86% drop[1]. The company has lost control of several extraction fields, closed a number of investment projects and its financial and business situation has deteriorated. Moreover, the volume of gas that it produces declined and it is facing increased competition from independent gas producers on the domestic market.

While there is a lot of attention on its role in foreign gas markets, it should be noted that the domestic gas market remains the largest and one of the most attractive markets for Gazprom. According to available records, Gazprom sells more than half of its gas on the domestic market. The gas is delivered to the following consumption groups: power generation sector (27%), population (27%), cement industry (3%), metallurgy (4%), agrochemical producers (8%), communal services (15%), and other sectors (22%). These numbers show that Gazprom remains the main gas supplier for the Russian population and the communal services sector[2]. At the same time, in recent years Gazprom has been facing increased competition in the domestic gas market, mainly in terms of gas supply to industry in regions close to extraction fields. As will be demonstrated below, this is happening due to the lower logistic and transportation costs of supplying customers in close proximity to extraction fields and preferential taxation arrangements for independent gas producers.

Indeed, the monopolistic position of Gazprom is being challenged due to the decrease in volumes of gas extraction and increased competition from independent gas producers. Data demonstrates that in 2014 Gazprom reduced its gas production by 9% to 443.9 billion cubic meters, compared to 2013. This is the lowest level of production in its history[3]. This negative trend has continued during the first quarter of 2015[4]. The decrease in Gazprom's extraction volumes contrast with the increased role of "independent" gas suppliers, which are regarded to be companies in which Gazprom has less than a 50% stake in their shareholder structure. From 2005 to 2015, the volume of gas produced by independent suppliers increased to 100 billion cubic meters of natural gas. Overall, in 2014 almost 20% of the gas carried through Russian gas transport system was extracted by independent gas producers.

Apart from Gazprom, the other main players on the Russian gas market are Novatek and Rosneft. In 2014, Novatek increased its gas extraction by 1.5%, while Rosneft increased its gas production by 35%[5]. A fourth potential player on the domestic gas market is Lukoil, which is currently not attempting to play an independent role *vis-a-vis* Gazprom and continues to sell its extracted gas to Gazprom for further transportation and delivery[6].

1 *Russia: Gazprom, a Behemoth No More, 2015*. Eurasianet. August <http://www.eurasianet.org/node/74501>

2 *Vnutrennii Rynok Gaza: Kak Vyiti is Bermudskogo Treugolnika*, 2015. National Energy Security Fund, May, Moskva. <http://www.pro-gas.ru/images/data/gallery/0_4997__rinok_2015.pdf>

3 *Russia: Gazprom, a Behemoth No More, 2015*. Eurasianet. August <http://www.eurasianet.org/node/74501>

4 *Vnutrennii Rynok Gaza: Kak Vyiti is Bermudskogo Treugolnika*, 2015. National Energy Security Fund, May, Moskva. <http://www.pro-gas.ru/images/data/gallery/0_4997__rinok_2015.pdf>

5 Kudiyarov Sergei, 2015. *Bolshye Problemy Bolshoi Companii*. Expert Online <http://expert.ru/expert/2015/39/bolshie-problemyi-bolshoj-kompanii/>

6 Raamat Mart, Bryza Matthew. 2015 *Developments in the Russian Internal Gas Sector: Cosmetic Changes or Concrete Reforms*? International Center for Defense and Security, Estonia. <http://www.icds.ee/fileadmin/media/icds.ee/failid/Developments_in_the_Russian_Internal_Gas_Sector_Cosmetic_Changes_or_Concrete_Reforms.pdf>

The decline in gas production is partially explained by the limited potential of the old gas fields owned and used by Gazprom. That is why the issue of acquiring and developing new fields is regarded as being of crucial importance for maintaining Gazprom's dominant position on the domestic market. However, due to the on-going Western sanctions on Russia, there is both a limited availability of credit and a decrease in demand for gas. Therefore, Gazprom has drastically reduced its investment in the exploration and development of new gas fields in Russia. In 2012, Gazprom refused to develop the Stokmanovskoe gas field[7]. In August 2015, the United States imposed sanctions that affected the development of the Yugo-Kirinskoe gas field, which was originally planned to be used for the construction of an LNG plant[8].

Additionally, some public authorities do not facilitate Gazprom gaining access to other new fields. The Ministry of Ecology postponed a decision on providing access to the development of the Murmansk gas field[9]. This decision appears to have been taken in order to facilitate Lukoil's intention to take over the field. Both Rosneft and Gazprom, which collectively control 80% of gas fields in Russia, criticized the Ministry's delay[10]. It could be argued that the current shift to a more conservative strategy on the development of new gas fields will further increase the role of the independent suppliers. Thus, Gazprom's decision not to invest in new projects challenges not merely the company's market position, but also its political influence.

Unlike any time previously, Gazprom is also facing a number of disputes with state authorities. Such tensions are likely to be controlled and managed by public authorities in a manner that demonstrates their determination to pursue the current official agenda of gas market liberalization. For instance, during 2013–2015 Gazprom faced several disputes with public authorities, including the Antimonopoly Committee. In December 2013, the Federal Antimonopoly Committee accused the Gazprom group of companies of abusing their monopoly position by procuring electric large-diameter pipes through non-market mechanisms[11]. The court proceeding lasted from 2013 until June 2015. Eventually, the Antimonopoly Committee lost the case. In August 2015, the Antimonopoly Committee filed a new case against the company, alleging that Gazprom violated market rules and that there was a lack of competiveness in the procurement of pipes[12]. Other disputes between Gazprom and the Antimonopoly Committee were connected with the issue of selling gas on the newly established gas stock market. However, those tensions were resolved without resorting to any court procedures. Overall, the disputes demonstrated the steady increase in public tensions between Gazprom and the Antimonopoly Committee, none of which have yet resulted in decisions against Gazprom.

It should be pointed out that traditionally Gazprom has performed not only business functions, but also informally contributed to state social expenditures through its programs of support and donations. Moreover, corporate social responsibility is often seen as part of the companies' obligations to the Russian authorities in exchange for its political capital. Five years ago, Gazprom was regarded as the main company providing the largest corporate social responsibility programs. The media frequently reported on Gazprom's financial support of the Sochi Olympic projects or its financial assistance in developing Russian sports teams[13]. However, Gazprom's leadership in these spheres has also become contested by other actors active in the gas market. In 2013, Rosneft became the leading spender on corporate social responsibility among Russia's biggest state corporations[14]. In 2014, Rosneft came third, while Gazprom only came eighth in these ranking[15]. This signals that the Russian government has moved to broaden the base of corporate social responsibility to a wider range of actors on the energy market.

7 Topalov Aleksei, 2013. *Gazprom Otkladyvaet Razrabotku «Stokmana» dlya Budishchikh Pokoleniy* <http://www.gazeta.ru/business/2013/05/31/5364169.shtml>

8 *Staty Vveli Sanktsii Protiv Odnogo is Krupneishikh Mestoroghdenii Gazproma*, 2015. Ukrainskaya Pravda, 07 August <http://www.eurointegration.com.ua/rus/news/2015/08/7/7036759/>

9 *Minprirody RF Predloghilo Vremenno Ogranichit Dostup Gazproma I Rosnefti k shelfu*, 2015. <http://abnews.ru/2015/07/03/minprirody-rf-predlozhilo-vremenno-ogranichit-dostup-gazproma-i-rosnefti-k-shelfu/>

10 *U Rosnefti Sdayut Nedra. Goskompania Protiv Dostupa k nim Konkurentov, 2015*. Kommersant, 23 April <http://www.kommersant.ru/doc/2714671>

11 *FAS Priznala Gruppu Gasprom Vinovnoi v Zluopotreblenii Dominiruyushchim Pologheniem*, 2013 <http://www.fas.gov.ru/fas-news/fas-news_35078.html>

12 *FAS Poghalovalos Putinu na Gazprom na Zakupku Trub*, 2015. Interfax, 15 September. http://www.interfax.ru/business/466780

13 *How Russian Energy Gigant Lost USD 30 bn*, 2015. <http://www.theguardian.com/world/2015/aug/07/gazprom-oil-company-share-price-collapse>

14 *Rosneft Vosglavila Reiting Korporativnoi Sotsialnoi Otvetstvennosti Krupneishikh Rossiiskikh Companiy*, 2014. <http://www.rosneft.ru/news/news_in_press/22012014.html>

15 *«Alrosa», «RusGidro», «Rosneft» – Flagmany Korporativnoi Sotsialnoi Otvetsvennosti*, 2014 <http://www.infox.ru/business/company/2014/10/29/__Alrosa____RusGidro.phtml>

Economic Incentives for Market Liberalization

The current efforts of the Russian government to liberalize the domestic gas market might be explained by economic incentives. Independent producers are encouraged and supported by a special taxation regime in which they pay fewer taxes for gas extraction relative to Gazprom. At the same time, independent producers are required to pay higher tariffs for transportation of gas through the pipeline system. As a result, independent gas producers prefer to compete for clients situated close to the places from where they extract gas, selling their gas to the Western Siberian regions, while Gazprom is left to supply, the unattractive in terms of transport costs, marginal western and southern regions[16].

Tariffs for transporting gas through the Russian gas pipeline system are now one of the key points of dispute between Gazprom, independent producers and federal agencies. In order to maintain market competitiveness, Gazprom, exercising its influence over regulatory bodies, seeks to instigate increases in tariffs on gas transportation for independent producers. For instance, in 2015 the tariffs set by the State Committee on Tariff Regulation were increased by 2% for independent gas producers[17].

The lower taxation regime on gas extraction for independents not only encourages large independent suppliers to increase their level of gas extraction, but it also influences Gazprom's business strategy. For instance, according to media reports, there have been several cases in which Gazprom has formally decreased its stake in joint gas extraction companies to 49% so that these companies could obtain the status of being "independent" producers and thus pay lower taxes on extraction. At the same time, Gazprom's *de facto* control over these "independent" companies has reportedly been preserved[18]. Thus, it could be argued that current efforts to liberalize the domestic gas market are being driven not only by the independent producers, but also partially by a government strategy of controlled liberalization.

Nonetheless, as well as the above mentioned changes to tax regimes, the state authorities have taken a number of other decisions in the name of liberalizing the Russian gas market. For instance, starting from 2012 Gazprom was required to grant access to the Gas Transport System (GTS) to independent gas producers. Such access was actually set at a rather limited level (only in cases of spare capacity and certain gas qualities), but did create more room for independent companies to act on the market. As a result, 25 independent gas companies have gained access to gas transportation services through the GTS for the Russian domestic market[19].

Moreover, the liberalization of the gas market is also listed as a main priority in the State Energy Strategy 2030, which stipulates the main priorities for the development of the domestic energy market in Russia. The strategy examines the current problems facing the market, especially the continuation of regulated prices on the domestic market and the lack of market liberalization. It outlines that the gradual liberalization of the main energy source markets (gas, electricity etc.) is the primary goal. It sets a target whereby in 2030 more than 25% of the total volume of gas extraction will be provided by independent gas producers[20]. Interestingly, this level was already reached in 2014–2015.

This gas market reform agenda presupposes a start of "controlled liberalization" of prices for gas and electricity on the domestic market. It is expected that the federal government will keep its monopoly in regulating tariffs on the transfer of gas and electricity. Full liberalization of the market is planned to be conducted by 2030, however, it is not clear what measures will be taken to complete this reform[21].

What is the Future of Gazprom on the Russian Market?

Many analysts have suggested that it would be beneficial for Gazprom to separate its pipeline business from the production and sale of gas. The Economist argues that such an approach would ensure "that economically senseless pipeline projects are not subsidized by exports. Beyond that, Gazprom would probably benefit from being split into a handful of separate gas producers which would then compete to extract and market smaller "corridor" gas fields close to existing ones or pipelines"[22]. However, in the current political circumstances, this scenario does not appear to be the most likely one.

In June 2015, Rosneft suggested Amendments to the current Concept of the Gas Market in Russia, asking the

16 Mastepanov Aleksei, 2015. *Chetvertyi Etap Liberalizatsii Rynka Golubogo Topliva* <http://www.ng.ru/energy/2015-09-08/12_4etap.html>

17 Gazprom Prosit Spasti ego ot *Prozrachnosti*, 2015. Izvestia, 21 August. <http://izvestia.ru/news/590237>

18 *Monopolia Poteryala Yuridichesii Control nad SP* <http://www.kommersant.ru/doc/2075997>

19 Raamat Mart, Bryza Matthew. 2015 *Developments in the Russian Internal Gas Sector: Cosmetic Changes or Concrete Reforms*? International Center for Defense and Security, Estonia.

20 *Energy Strategy of Russia fort he periof up to 2030* <http://www.energystrategy.ru/projects/docs/ES-2030_(Eng).pdf>

21 *Energy Strategy of Russia fort he periof up to 2030* <http://www.energystrategy.ru/projects/docs/ES-2030_(Eng).pdf>

22 *Russia's Wounded Gigant*, 2013. <http://www.economist.com/news/business/21573975-worlds-biggest-gas-producer-ailing-it-should-be-broken-up-russias-wounded-giant>

Russian government to allow it to export gas through pipelines abroad, putting an end to the export monopoly held by Gazprom[23]. In a letter sent to the Energy Ministry, Rosneft has also asked that Gazprom be split into separate producing and transportation companies. Rosneft argues that this is necessary to avoid a conflict of interest. A company spokesman said that "[t]he conflict of interests within Gazprom, which is a monopoly in transportation services on one hand and which is the largest gas supplier on the other hand, should be eliminated". Gazprom has strongly resisted such a division[24].

In October 2015, the government plans to collect all the suggested amendments to the Concept and examine them. As of the time of writing, there is no official answer on whether the suggestions from Rosneft will be taken into account by the government. It is difficult to predict the possible outcomes. However, it can be expected that Rosneft's radical suggestions will not be taken on board. Kremlin economic adviser Andrei Belousov has said that Gazprom would retain the exclusive rights for selling gas abroad via pipelines[25]. However, the latest position of the Federal Antimonopoly Committee on the necessity to establish an independent Gas Transport Company and provide equal access to all gas producers should be also taken into account[26]. It can be expected that the government is likely to give some indications that it will sustain its efforts for further controlled liberalization of the gas market.

The current context of increased competition on the Russian domestic gas market should be seen not as a short term development, but rather as a sustainable trend. However, the current public steps towards liberalization of the gas market and improving the position of independent producers suggest that it does not signal the development of real market competition, but rather demonstrates that the Kremlin will not block the development of an oligopoly. However, the limits on the roles of actors other than Gazprom are likely to be tested in practice.

About the Author

Kateryna Boguslavska works at the Center for Security Studies, ETH Zurich. She holds a PhD from the National Academy of Sciences, Kiev, Ukraine and is currently a student of the Master program in Comparative and International Studies at ETH Zurich.

23 *Rosneft Khochet Rasdelit Gazprom i Polnostiyu Lishit ego Eksportnoi Monopolii*, 2015 <http://www.vedomosti.ru/business/articles/2015/07/23/601845-rosneft-hochet-razdelit-gazprom-i-polnostyu-lishit-ego-eksportnoi-monopolii>

24 *Rosneft Asks Russian for an End to the Gazprom's Export Monopoly*, 2015 <http://www.oilandgas360.com/rosneft-asks-russia-for-an-end-to-gazproms-export-monopoly/>

25 *Gazprom Monopoly on Pipelines is Unshakeable*, 2014 <http://www.reuters.com/article/2014/07/23/russia-gazprom-monopoly-idUSL6N0PY4CG20140723>

26 *FAS Predlozhil Pravitelstvu Rasdelit Gazprom*, 2015 <http://www.dp.ru/a/2015/09/28/FAS_predlozhila_pravitels/>

ANALYSIS

Gazprom in the Post-Soviet Region: Shrinking Markets, Politicised Relations

By Ingerid M. Opdahl, Oslo

Abstract

Gazprom's position in post-Soviet gas markets has changed from secure to ambiguous over the last five years. Ukraine has reduced its takings of Russian gas considerably, while Moldova and Lithuania have established links with alternative suppliers that could potentially weaken Gazprom's export position. Meanwhile, two post-Soviet states with a foreign policy line much closer to Russia's, Belarus and Armenia, pay a lower price, but will likely remain stable markets for Gazprom in the years ahead.

Following the financial crisis of 2008–9, Gazprom's position has changed considerably in its three main markets: Russia, Europe, and the post-Soviet region. Demand has stagnated or decreased in all markets. Gazprom's supply capacity now exceeds demand. Gas sales to the post-Soviet region were reduced from 70.2 billion cubic metres (bcm) in 2010, to 48.1 bcm in 2014.[1] The increasing role of exports to China of Central Asian gas, beginning in 2009, has deprived Gazprom of influence on the development of gas production there. Is Gazprom's dominance in post-Soviet gas markets now less secure?

The Reduced Demand for Russian Gas in the Post-Soviet Region is Mainly a Ukrainian Affair

The post-Soviet region is Gazprom's smallest pipeline gas market by volume, as well as by income. Within the last 15 years, Gazprom's position in post-Soviet markets appears to have come full circle. In 2001–03, the post-Soviet region represented eight to nine percent of the gas volume sold by Gazprom, around 40 bcm. When Gazprom's overall sales volume peaked in 2006, at 578.8 bcm, the post-Soviet share of sales had increased to 17.4 percent of the total. This was also the year when Gazprom's deliveries to the post-Soviet region peaked in absolute terms, at 101 bcm. Following the 2008–9 financial crisis, post-Soviet gas consumers reduced their gas demand. In 2014, the region took 10.9 percent, or 48.1 bcm, of Gazprom's sales.[2]

Gazprom's weakening post-Soviet position in the last few years is mainly a result of Ukraine's reduced demand. Ukraine has traditionally been the largest post-Soviet market, taking between 50 and 60 percent of all gas supplied by Gazprom to the region. In the peak year of 2006, Ukraine acquired 59 bcm. By 2010, this was reduced to 36.5 bcm, in 2013 to 25.8, and in 2014 it only took 14.5 bcm.

Ukraine has steadily reduced the share of gas in its total primary energy supply, from 43 percent in 2007 to 33 percent in 2013, and which now may have dropped further below 30 percent.[3] Overall gas consumption in 2014 stood at 42.6 bcm, compared to 75 bcm a decade earlier.[4]

When Gazprom continued to increase the gas price to Ukraine from 2009, Ukraine's price concerns grew, and it accelerated a downwards trend in import reliance for gas. Import reliance has declined over the last two decades, to 60 percent in 2012 and 46 percent in 2014.[5]

Domestic gas production has increased slightly over the last decade, to 20–21 bcm annually.

In 2014, Russia's annexation of Crimea and support for the separatists in Donetsk and Lugansk prompted Ukraine to access supply from Slovakia, Poland and Hungary. These gas flows, essentially reverse flows of Russian gas, delivered around 5 bcm in 2014. Significantly, Russian gas from Europe in reverse flow could compete on price with gas purchased directly from Gazprom, exposing how Gazprom had inflated the price (in early 2015, 330 US$ per thousand cubic metres (mcm)).[6] Gazprom has now reduced its price to Ukraine.[7] While Gazprom initially reacted to the reverse flow by restricting gas flows to European customers, this was costly in the context of a stagnant European market, and therefore this strategy was abandoned.

Ukraine's reduced demand for gas from Gazprom in the space of only a few years represents a considerable reversal of its position in the post-Soviet region, a position that a decade ago seemed solid. Gazprom has lost positions not only due to its sometimes politicised role in regard to Russian foreign policy, but also because it priced itself out of the Ukrainian market. It is less likely, however, that Gazprom's supply to the Ukrainian market will be further reduced in the immediate future, not least due to the technical limitations of supply by reverse flow.

Gas Transit through Ukraine

Gas transit remains important in Gazprom's relations with Ukraine. In 2014, Ukraine transited around 62 bcm. Over the last two decades, Gazprom has pursued a transit avoidance strategy with regards to Ukraine.

As of today, the bypass pipelines to Europe and Turkey provide around 100 bcm transit capacity in excess of Gazprom's needs. South Stream, a transit avoidance project under the Black Sea from Russia to Bulgaria, was shelved in late 2014, following European Commission pressure on EU transit states. In Gazprom's strategy, South Stream has now been replaced by Turkish Stream, the prospects for which currently have an uncertain outlook. However, the planned construction of Nord Stream II will reduce transit through Ukraine. A binding agreement with shareholders BASF, E.ON, Engie, OMV and Shell came into place in early September.

1 Gazprom. 2015. Gazprom in Figures 2010–2014. p. 83. Available from <http://www.gazprom.com/f/posts/29/761233/gazprom-in-figures-2010-2014-en.pdf>
2 Gazprom. 2015. p. 83
3 International Energy Agency. 2015. «Online Data Services». Available from <http://www.iea.org/statistics/>
4 Naftogaz Ukrainy. 2015. «Types of Activities». Available from <http://www.naftogaz.com/www/3/nakweben.nsf/0/74B2346ABA0CBC69C22570D80031A365?OpenDocument>
5 Naftogaz Ukrainy. 2015.
6 Neftegazovaya vertikal'. 2015. Solo "Gazproma" na eksportnoi trube [Gazprom's solo performance in the export pipe]. No. 13–14, p. 85.
7 J. Henderson and T. Mitrova. 2015. The Political and Commercial Dynamics of Russia's Gas Export Strategy. Oxford Energy Paper. Oxford: Oxford Institute for Energy Studies. p. 50. Available from <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/09/NG-102.pdf>

Nord Stream II will add a third and fourth leg to the Nord Stream pipeline, with a combined annual capacity of 55 bcm, bringing total capacity on this route up to 110 bcm. When the third leg comes into operation, annual transit to Ukraine will most likely be reduced to around 30 bcm. The fourth leg will make Ukraine's transit pipelines superfluous in theory. However, specific contractual arrangements with Gazprom's European customers may prolong the demand for Ukraine as a transit state. In light of Europe's stagnating demand, Gazprom will most likely continue to under-utilise almost all its available transit routes to Europe.

Other Post-Soviet States Still Rely on Gazprom

Gazprom's deliveries to post-Soviet states other than Ukraine have been relatively stable over the last five years, at around 33 bcm. Belarus takes around 20 bcm annually, and is now Gazprom's largest post-Soviet customer. Kazakhstan has increased its purchases of gas from Gazprom recently and took around 5 bcm in 2014. Among the smaller markets (up to 3 bcm annually), the Baltic states, Armenia, Georgia and Moldova are 100 percent dependent on gas imports for their consumption, with gas covering from 10 percent (Estonia) to around two thirds (Armenia and Moldova) of their total primary energy supply.

This reflects an inherited dependence on Russian, and therefore Gazprom's, gas, which Gazprom has used to its business advantage. It has increased its overall presence in the post-Soviet energy sector, mostly through equity deals, which have placed it in control of pipeline systems in several post-Soviet states. This secures both stable deliveries and demand for Russian gas in the post-Soviet region. In the still unlikely event that other Russian gas producers would be allowed direct access to Russia's Single Export Channel for gas, post-Soviet markets would most likely remain dependent on Gazprom. As Gazprom's supply capacity currently far exceeds demand, it can also, if need be, undercut the price offered by any potential alternative supplier.

Politicised Gas Relations

In regards to its smaller post-Soviet customers, like the Baltic states, Moldova, Armenia and eventually Belarus, Gazprom early on recovered old gas debts by taking stakes in gas networks. In business terms, this was a sound strategy. Where gas had not been paid for, and it was difficult to recover debts in cash or barter goods, equity in gas infrastructure was the second-best option. With regards to transit states, this also minimised the risk of transit interruptions. But in bilateral relations, Gazprom's stakes in post-Soviet energy sectors could be, and have been, used for political ends. Above all, gas stakes have been used to coerce states into a foreign policy line closer to Russia's. In turn, several post-Soviet states have undertaken, or intensified, efforts to reduce or mitigate their dependence on Gazprom for gas. In this way, what was for a long time a favourable business position for Gazprom, where it reached a captive and stable post-Soviet gas market, has turned into a more ambiguous outlook and a shrinking market. Several customers now have access to alternative supply that puts pressure on its price and therefore profits. The others have remained closer to Russia in their foreign policies, and also pay a lower price for gas.

Belarus is a stable Gazprom customer and a transit state with the Yamal pipeline (owned by Gazprom). When Gazprom, from 2002, tried to recover Belarus's gas debts by acquiring equity in the gas network Beltransgaz, Belarus responded with patient negotiation. Only with the relaunching of the Nord Stream pipeline in 2005 did Belarus's position weaken. In 2006, Belarus and Gazprom finalised the Beltransgaz deal, on terms quite favourable to Belarus. The deal itself was completed in stages between 2007 and 2011. Gazprom all in all paid 5 billion US$ for Beltransgaz, while Belarus secured Russian loans for a new nuclear power station, and a temporary gas price discount. Belarus is supplied on a long-term contract, currently paying 139 US$/mcm.[8]

In Moldova, Gazprom holds a 50 percent stake in the gas network company Moldovagaz, and manages a 13.44 percent stake for the separatist authorities in Transnistria. Transnistria has generally not paid for its gas supplies. Beginning in 2004, Gazprom held Moldovagaz responsible for Transnistria's gas debts. The ever-accumulating gas debts by September 2012 stood at around 4 billion US$ (5.2 billion US$ by 2015). At that point, Russia and Gazprom offered Moldova a price discount in return for not implementing the EU's Third Energy Package, to which Moldova had signed up in October 2011. The Russian side also demanded that the Moldovan government assume full responsibility for Transnistria's debts. Moldova then obtained a four-year delay (to 2020) from the EU in implementing the Third Energy Package, in return for a one-year gas price discount. Following this, the Moldovan government proceeded with a new 1.5 bcm export-import pipeline leg (Ungheni–Iasi) to connect to the Romanian pipeline network, in an effort to access alternative gas supply and improve its negotiating position with Gazprom. Romania has supplied small volumes of gas from March 2015. Possible greater volumes depend on the further devel-

8 Neftegazovaya vertikal'. 2015. p. 85.

opment of the Romanian gas sector, especially in the Black Sea. Reduced Russian transit through Ukraine will affect Moldova's gas supply from Gazprom.

In the Baltic states, Lithuania has reduced its purchases of Gazprom's gas after the opening of the floating regasification terminal for liquefied natural gas (LNG) in late 2014. Initially, the main effect of the terminal, given Gazprom's dominance of the gas sector in the Baltic states, has been as pressure on Gazprom's position in price negotiations. The Baltic states, in early 2015, paid a relatively high price level, at 326 US$/mcm.[9] Within a few years, as long-term contracts expire, the LNG terminal may cover as much as 90 percent of gas demand in the Baltic states.

In Armenia, Gazprom also owns the gas network, Armrosgazprom. Its original stake, 45 percent, was acquired against Armenia's gas debts in 1997. Armenia in 2004 expanded energy cooperation with Iran, centred around an exchange of Iranian gas for Armenian electricity. Following pressure from Gazprom to minimise this cooperation, Armenia in 2005 denied Iran gas transit from Georgia and Ukraine to Iran, and also reduced the diameter in a new domestic pipeline leg essential to gas trade with Iran. Over the period 2006 to 2013, Gazprom came to control the rest of Armrosgazprom, with shares sold gradually by the Armenian government in return for temporary price freezes and delayed implementation of Gazprom's general price hikes. Gazprom and Armrosgazprom also assumed control of the pipeline to Iran. Overall, Russian dominance of Armenia's gas, electricity and nuclear power sectors, combined with Armenia's isolated position in the region, were important in Armenia's abrupt reversal of the process that would have seen it enter into an Association Agreement with the EU in 2013, in favour of joining the Eurasian Economic Union. The outlook for Gazprom in the Armenian market is now stable. Armenia, like Belarus, currently pays a price that reflects its political closeness to Russia, at 165 US$/mcm.

Georgia has relied on gas from Azerbaijan since the opening of the Baku–Tbilisi–Ceyhan pipeline in 2006. Azerbaijan itself recently agreed to purchase some gas from Gazprom, to cover the domestic market while keeping its export commitments.

Is Gazprom's Previous Dominance in the Post-Soviet Region Up for Change?

The potential for competition to Gazprom from other Russian suppliers remains very limited in the post-Soviet region. Gazprom's main problem is therefore not competition from alternative Russian suppliers, but post-Soviet gas customers' search for and expansion of alternative supplies through Europe, which may even come at a lower price than Gazprom's. To the extent that such supplies—already established in the Baltic states, Ukraine and Moldova—weaken both Gazprom's overall market position and expose it to price competition, profits from post-Soviet markets will continue to fall.

About the Author
Ingerid M. Opdahl is Assistant Professor at the Norwegian Institute for Defence Studies/Norwegian Defence University College.

9 Neftegazovaya vertikal'. 2015. p. 85.

ANALYSIS

EC's Anti-Trust Inquiry into Gazprom's Practices: Its Significance and Meaning for Gazprom's Role in the EU Market[1]

By Elena Kropatcheva, Hamburg

Abstract

Through a focus on the EC's anti-trust inquiry into Gazprom's practices, this article analyses Gazprom's role in the EU energy market and the challenges it faces. The anti-trust enquiry is in line with the increasing pressure exerted by the EU on Gazprom in pursuit of its strategy of market liberalization, demonopolization and energy diversification. Together with changes in the EU market and the current context of a negative international political situation and worsening economic conditions in Russia, the EC anti-trust enquiry is putting more pressure on Gazprom to change its practices than ever before. However, under the conditions of mutual interdependence between the EU and Russia in terms of energy, even a negative EC decision will have only a limited effect.

Gazprom is the main exporter of natural gas (NG) to the EU. In 2013, 30% of the EU's NG supplies came from Russia. The share of the EU market in Russia's total NG exports is about 70%. Despite this high level of cooperation and interdependence, Gazprom finds itself increasingly under pressure in the EU market. The European Commission's (EC) anti-trust inquiry into Gazprom's activities is an important indication of this, with the EC delivering a Statement of Objections to Gazprom in April 2015. This article analyses what this inquiry tells us about Gazprom's role in Europe and its consequences for future Gazprom–EU relations.

The EC's Anti-Trust Inquiry into Gazprom's Activities

The EC's—Directorate-General for Competition (DG Comp)—investigation into Gazprom started in 2011, with raids on Gazprom's offices in EU countries. Officially, the anti-trust proceedings started in 2012 as a response to Lithuania's complaints about Gazprom's practices there. In April 2015, the EC sent a Statement of Objections to Gazprom for alleged abuse of its dominant market position in Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia. These countries depend on Russia for 75–100% of their NG supplies. The EC is, thereby, acting in accordance with Article 102 of the Treaty on the Functioning of the EU, which prohibits the abuse of dominant market positions.

Violations by Gazprom were found in three areas. First, that Gazprom is allegedly hindering cross-border gas sales within the EU by including export ban, destination clauses and other restrictive measures in its contracts with its EU customers, which hinder the re-export of Russian NG. However, in practice Gazprom has not used these clauses and has agreed not to include them in any future contracts, because since the early 2000s the EC had argued that they violate the EU's provision of free movement of goods.

Second, Gazprom is accused of setting unfair prices in Bulgaria, Estonia, Latvia, Lithuania and Poland. Security of supply implies not only availability of resources, but also fair prices. Nonetheless, it is often difficult to define what a fair price is? Agreements between Gazprom and its customers are confidential and different factors can play a role in price calculations (pricing formulae, distance, different energy mixes and availability of alternatives). However, there have been many examples of the Russian state using Gazprom and low or high energy prices to reward its "friends" and punish its "enemies".

Third, Gazprom has allegedly made gas supplies conditional on obtaining infrastructure-related commitments in Poland, related to the Yamal-Pipeline, and in Bulgaria, related to the South-Stream pipeline. Gazprom's strategy has been to acquire control over pipelines, gas storage and other facilities and to reserve their capacities, denying third-party access.

The disputes in these three areas have generated problems in EU–Russia relations, especially in the context of the EU's Third Energy Package (2009), which is aimed at increasing competition and liberalisation in the EU market and breaking the monopolies of energy companies that control energy production, sale and distribution. The novel dimension is that the EU is not only expressing its mistrust of Gazprom, which it has done at different levels in the past, but that it is actually accusing Gazprom on the basis of an investigation.

Are Politics Behind This Case?

The Gazprom case is not unique, however. For example, a week before sending the Statement of Objections to

1 I would like to thank Lisa Pregitzer for her assistance in research.

Gazprom, the EC also sent such a statement to *Google* in relation to another anti-trust enquiry. In the case of Gazprom, the EC's accusations deal with commercial practices. Nonetheless, there are strong political aspects to this matter.

Gazprom as a Political Instrument of Russian Foreign Policy

Gazprom is a state-owned enterprise with more than 50% of its shares belonging to the Russian state. Even though Gazprom's activities depend on market developments, there have been many notorious examples when it has acted against its business interests, as a foreign policy tool of the Russian state, especially in Central and Eastern Europe. Thereby, the EU's message is not only being sent to a large Russian-based company, but also to the Russian state.

The EU's Attempts at Energy Emancipation from Russia

The EC's anti-trust investigation should be seen in the context of its attempts at greater emancipation from Russia in the energy sector. Particularly since Russia's recurrent "gas wars" with Ukraine from the mid-2000s onwards, the EU has started to define its energy security as centred on reducing its dependence on Russia.

The EC has become increasingly active in promoting a more united EU-wide energy policy and in introducing legislative changes related to the EU energy market (e.g. the Third Energy Package (2009), an information exchange mechanism on intergovernmental agreements (2012), a document on Energy Union (2015)). Because the EC insisted that intergovernmental agreements between individual EU countries and Russia about the South Stream pipeline project did not comply with the EU's overarching legislative framework for energy, Gazprom gave up on this pipeline project. And, in 2014, Gazprom proposed the alternative Turkish Stream project, which would not be subject to the EU's legislation framework, as the EU would buy Russian NG at the EU's borders.

Another step in the direction of reducing dependence on Gazprom has been the EU's strategy of diversifying both the sources of energy used to meet demand for energy in the EU (e.g. renewable energy and NG alternatives; prospects of producing its own shale energy[2]) and the suppliers and transport routes delivering energy to the EU market (e.g. the Trans-Adriatic Pipeline (TAP) and Trans-Anatolian gas Pipeline (TANAP), which will deliver NG from Azerbaijan). Changes in the global and EU energy market have helped the EU in these diversification efforts. The US "shale revolution" led to an increase in US coal, and of liquefied natural gas (LNG) from different countries, entering the EU energy market. EU states, especially those most dependent on Russia, have also started to build their own LNG terminals. After Lithuania launched an LNG Terminal in Klaipeda (2015), Gazprom reduced the price for its NG deliveries to this country.

Owing to the EU's energy diversification, as well as negative economic trends for energy supplier to Europe due to the 2008–2009 economic crisis and a series of warmer winters, Gazprom's sales to the EU market have declined. European companies, facing an oversupply of Russian NG under these conditions, took Gazprom to arbitration over pricing, volumes of purchased gas and other conditions of contracts and won their cases. Gazprom has been compelled to allow price cuts, adapt the "take or pay" principle (even to the minimum level) and introduce spot market price elements in its contracts. Because of the low global oil price (cf. \$108/barrel in March 2014 with \$48/barrel in January 2015), Gazprom's oil-indexed price in long-term contracts became more equal to spot prices. In September 2015, Gazprom sold 1.23bln cubic meters of gas at its first export auction in Europe—at a higher price than in its long-term contracts. Next year it plans to sell 10% of its export volumes to the EU at auctions.

All in all, because of these changes in the EU market and the EU's diversification strategies in particular, Gazprom—although unwillingly and preferring the status quo of long-term contracts—has started to adapt. Its behaviour and its contracts have become more flexible. The EC's anti-trust inquiry is consistent with the EU's political strategy of market liberalization and emancipation from Russia and illustrates the EU's determination to put pressure on Gazprom to adapt its behaviour.

Diplomatic and Political Environment in the Context of the Ukrainian Crisis

It is impossible to decouple the discussion about Gazprom's position in the European energy market from the current diplomatic and political context of EU–Russian relations, which has been shaped by the developments in Ukraine since 2013, especially Russia's annexation of Crimea in 2014 and the grand crisis in Russian–Western relations.

The EC's anti-trust charges against Gazprom had already been completed by the end of 2013, but the EC postponed the announcement of its conclusions because of the Ukrainian crisis, so as not to aggravate relations with Moscow in the hope of finding a political solution. The fact that the Statement of Objections was, nonethe-

2 Only France and the Netherlands have so far forbidden its extraction.

less, later released—amidst the continuing deterioration of EU-Russia relations and the sanctions and counter-sanctions "war"—is one more way to put pressure on Russia, especially since EU sanctions in the energy sector have not been very strong. EU sanctions prohibit the export of technology and technical assistance to the energy sector in Crimea and in the area of deep water, Arctic and shale oil exploration/production. Furthermore, Gazprom, whose revenues have been falling (by the end of 2014, its net profit fell about 85%) because of the low global oil price, currency devaluation in Russia as well as lower demand for its NG in Europe and the post-Soviet space, is not be able to get international credits to finance its expensive new projects. While these sanctions are serious and will have an impact on Gazprom's activities, some scholars have argued that the EU's sanctions on the energy trade with Gazprom (the EU's temporary ban on energy imports from Russia) would have been most painful and effective in trying to change Russia's conduct in/towards Ukraine. However, the mutual interdependence between Russia and the EU in terms of energy, which was intended to hinder conflicts between them, has turned out to be a hindrance in the EU's attempts to put pressure on Russia. As a result, money which Gazprom earns in Europe was used to annex Crimea, as well as in other Russia's foreign policy escapades.

Thus, the Statement of Objections is political in terms of its timing, as it has been delivered to Gazprom at a moment in which it finds itself in a much weaker position vis-a-vis the EU than previously. It also shows that the EU is ready to apply more pressure on Gazprom and, thereby, on the Russian state in the energy sector.

Gazprom's Reaction to the EC's Anti-Trust Inquiry and the Consequences for Future Relations

Gazprom and Russia's official reaction to the EC Statement of Objections was quite calm, yet nonetheless, characterizing the EC's accusations as unfounded and political in nature. Gazprom underestimated the EC and had hoped for a quick settlement. It made several quick preliminary proposals to Brussels while the EC was in the process of conducting its investigation, but the EC was not satisfied by any of these proposals. On 21 September 2015 Gazprom sent a new set of proposals to the EC as a response to the Statement of Objections. At the time of writing, the EC is studying these proposals before making a final decision.

If an agreement is not reached, Gazprom will have to pay fines and change its practices in and towards the EU energy market. The fines could reach 10% of its total sales, but most likely will not be so high, because, as mentioned above, some of the provisions in Gazprom's contracts have already become irrelevant as it has made concessions on price and in the form of other adjustments to its practices. As Gazprom's long-term contracts agreed years before expire, it will have to apply new EU rules more and more. Some internal liberalization in the Russian NG market is also on the way, with other Russian companies (such as Rosneft or Novatek) getting more opportunities. To position Russia as more in line with EU legislation, these other Russian energy companies could be given a bigger role in supplying the EU market in the future.

Should the EC's final decision be strict and punitive, its negative effects on Gazprom would nonetheless be limited. Despite Gazprom's negative image as a political tool of Kremlin, and even in the current difficult political environment of EU–Russian relations, it keeps selling its energy to the EU states. In September 2015, several agreements on asset swaps, as well as on "Nord Stream-2", were signed between Gazprom and major European companies, despite the fact that some of them had been cancelled earlier due to the negative political context, which has not changed in the meantime. The asset swaps would allow Gazprom to control some strategic energy infrastructures in the EU states. The extension of the Nord Stream pipeline, the economic rationale of which could be questioned, would additionally help Gazprom limit Ukraine's role as a transit state, making it more vulnerable to Russia's political demands. These deals bring more discord into the EU as a unified energy actor, with different states either supporting these initiatives or criticizing them. Nonetheless, the EC has the capacity to block some initiatives that are seen as contradicting a EU unified position on energy security and good market practice, as was the case with South Stream.

Despite these difficulties, energy cooperation between the EU and Russia will continue. The EU needs Gazprom to satisfy its demand for gas, despite its efforts towards strategic diversification. While Gazprom also needs the EU to sell its gas to. It has an overproduction of NG with not enough markets to which it can sell it. Even though Gazprom has signed important agreements with China on the construction of the Power of Siberia pipeline—which became possible due to the crisis in relations with the West—and another two pipelines are being discussed, there is doubt about their implementation, sufficient demand in China and, especially, their profitability for Gazprom. Besides, Gazprom will need the expertise, technologies, and funding available in the EU for its new energy exploration projects. All in all, the EC's anti-trust enquiry into

Gazprom in combination with recent changes in the EU market, low oil prices, the financial/economic crisis in Russia, and the negative political climate in EU–Russia relations, is putting more pressure on Gazprom to change its practices in and towards the EU energy market than ever before. Yet, under the conditions of mutual interdependence in energy terms between the EU and Russia, even a negative EC decision will have only a limited effect.

Conclusions

The EC's anti-trust investigation into Gazprom is a case in which economics, politics, geopolitics and even war (in Ukraine) became interlinked. While the literature on EU–Russia energy relations usually presents Gazprom as a mighty instrument of the Russian state, a closer analysis shows that its power to dictate terms has been gradually declining. The recent changes in the EU and global energy markets show that the Russian state, which is using Gazprom as a political tool, is not aiming at power maximization, but at sustaining its current position in the EU energy market and preventing further losses.

Gazprom is also struggling to maintain the status quo in its relations to the EU. In previous years, it acted self-confidently, trying to bring about changes in the EU market according to its own rules. With the current pressure on it increasing, Gazprom is no longer able to take such a stance, and currently does not know what to do and is trying out different tactics. These include adjusting its behaviour to EU rules, making concessions, becoming more flexible and proposing new models of supply, as was with Turkish Stream. But other cases ("Nord Stream-2" and asset swaps) are a continuation of its old practices, acting against EU rules of liberalization.

Gazprom lacks a long-term strategic vision for its role in the EU energy market, despite its clear preference for long-term contracts, leaving it unable to foresee important energy market developments, such as shale revolution and LNG. Gazprom's ambivalent strategy is partly the result of the EU's still-incoherent energy policy vis-a-vis the company. Even during a negative political climate, Gazprom still finds partners in the EU who are willing to do business as usual. This sends mixed messages to Gazprom and makes the EU's position weaker. The EC has to remain strict and consequential in putting pressure on Gazprom and European energy companies. Gazprom's short-sightedness is also, however, a result of its political instrumentalization by the Russian state. Russian energy policy is very unstable due to the geopolitical escapades of the Russian state, which are weakening Gazprom's position in the EU market. To be more effective and to produce more revenues, Gazprom needs to become more of a commercial and market-oriented actor and less of a (geo)political tool of the Russian state.

About the Author
Dr. Elena Kropatcheva is a Researcher at the Center for OSCE Research (CORE)/Institute for Peace Research and Security Policy(IFSH) at the University of Hamburg.

Further Reading

Kropatcheva, Elena (2014) 'He who has the pipeline calls the tune? Russia's energy power against the background of the shale "revolutions"', *Energy policy* 66 (March): 1–10. DOI: doi:10.1016/j.enpol.2013.10.058.

ANALYSIS

Gazprom-Rosneft Competition for Asian Gas Markets: Opportunities and Challenges

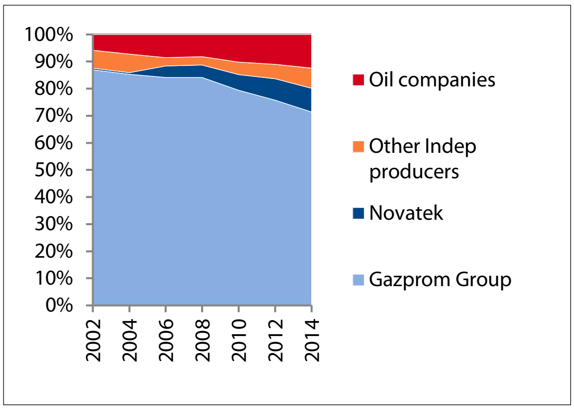
By Andrei V. Belyi, Tartu

Abstract
This article examines the competition between and challenges faced by Gazprom and Rosneft in exporting to Asian gas markets. It outlines how Rosneft is attempting to breakthrough Gazprom's monopoly in exporting gas to China, as well as seeking to enter the LNG markets in Japan and South Korea. It concludes that both the current low oil price and financial difficulties in Russia mean that Rosneft it unlikely to be able to displace Gazprom as Russia's major player in Asian gas markets in the near future.

Background of Russia's Oil and Gas Companies

Russia's hydrocarbon sectors are characterized by tight competition between two state-owned companies, namely Gazprom and Rosneft. Hence, in analyzing this subject it is necessary to remember their different histories[1]. Throughout 1990s, the state-owned Rosneft played only a marginal role, as it was surrounded by privatized oil firms. Only since the Yukos take-over in 2004, and furthermore after the asset swaps with Anglo–Russian TNK-BP in 2012, has Rosneft emerged as the largest oil company in the country.[2] In the meanwhile, the gas sector remained under Gazprom's vertically integrated structure, reinforced by a gas export monopoly.[3] However, in recent years Gazprom's positions have been rather shaken at the level of gas production, whereas independent private producers have increased their stakes since the early 2000s (Fig. 1). Among them, Novatek has augmented its production rates during the last decade. While the newly grown Rosneft has also unveiled its eager interest in gas markets and pursued an acquisition strategy by purchasing an independent gas company Itera. Consequently, together with Novatek, Rosneft has commenced competition with Gazprom in the latter's traditional field of dominance.

Figure 1: Structure and Dynamics of Russia's Gas Production



Sources: TEK, Russia's Gas Statistics, 2014

Political Shifts and Challenges for Gazprom

Due to their competing business interests with regard to Gazprom, Rosneft and Novatek have intensified their political leverage over Russia's energy strategies as well. In turn, Gazprom has often appeared to be taking a rather defensive position. However, an incremental political shift has been observed first on the domestic market. Over the past years, independent Russian gas producers have often gained access to networks without losing ownership over the commodity they were shipping into the grid[4]. Gazprom attempted to protect its priority rights to access the pipelines mostly because of its fear in losing the most attractive segments in the power generation market. Up to now, Gazprom has acquired about 16% of generation capacity in the country to secure a basis for its long term supplies. Nonetheless, competition with Novatek is becoming particularly fierce, since the latter has been able to conclude a number of advantageous commercial agreements[5].

1 T. Gustafson, Wheel of Fortune: The Battle for Oil and Power in Russia (Harvard: Harvard University Press, 2012)

2 For the Rosneft deals with TNK-BP, see BP Press Release, available at URL: <http://www.bp.com/en/global/corporate/press/press-releases/rosneft-and-bp-complete-tnk-bp-sale-and-purchase-transaction.html>

3 T. Mitrova, "The Political and Economic Importance of Gas in Russia" in J. Henderson and S. Pirani, The Russian Gas Matrix: How Markets are Driving Change, Oxford: University Press, 2014, pp. 6–38

4 Decree on non discriminatory Access was adoped in 1997, for details on Gazprom regulation see J. Stern, Future of Russian Gas and Gazprom, Oxford: University Press, 2004; a more active implementation of the rules increased with a naid of Federal Anti-Monopoly Service, Cf. A. Bely and C. Locatelli, "State and Markets in Russia's Hydrocarbon Sectors: Domestic Specificities and Interrelations with the West" in A. Belyi and K. Talus, States and Markets in Hydrocarbon Sectors, Palgrave Macmillan, 2015, pp. 103–121.

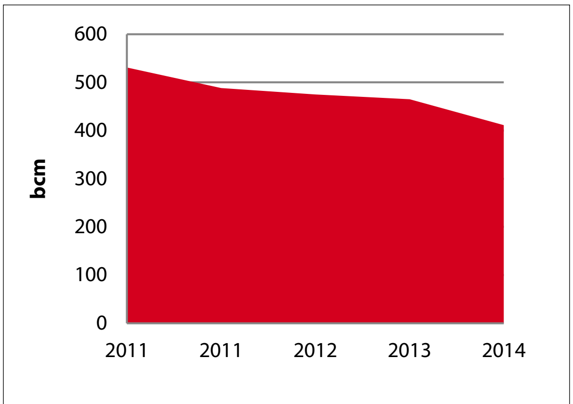
5 J Henderson, 'Evolution in the Russian Gas Market—The Competition for Customers', (Oxford Institute for Energy Stud-

Both Novatek and Rosneft subsequently lobbied for Gazprom's export monopoly at least in liquefied natural gas (LNG) to be repealed, an effort that resulted in a law in December 2013[6]. Since then, significant pressure on Gazprom's pipeline-based exports monopoly has also been orchestrated. Quite interestingly, Novatek managed to conclude a 10-year contract of 2 bcm of annual gas deliveries to a German consumer.[7] Precisely because this export contract overcomes Russia's Gas Export Law of 2006, Novatek's move rather confirms that Russia's gas giant is about to lose is overly dominant position in power relations in the gas export market. Following a similar logic, Rosneft representatives have recently argued for Gazprom's export unbundling. Hence, the gas monopolist might face further challenges in the mid-term future.

Declining European Demand and Competition for Asia

Although European markets remain the most profitable on Gazprom's export agenda, gas demand in Europe has been declining steadily throughout recent years. By 2014, demand volumes fell under 400 bcm, although the figure was still above 530 in 2010 (Fig. 2). In the context of a continuously shrinking European market, Asian markets have become an increasingly attractive from a long-term perspective for Russian companies.

Figure 2: Gas Demand in Europe, 2012–2014, in bcm



Source: Eurogas, 2014

Most of the long term incremental growth in world gas demand is projected to be in China, while Japan and South Korea already comprise the world's largest LNG markets.[8] In this context, Russian companies have been eager to augment their stakes in East Asia. Gazprom has been negotiating various export deals with China for a number of years already.[9] In 2014, two strategic agreements between Russia and China were crafted, allowing Gazprom to open pipeline exports towards the largest country in East Asia. Up to now, the Russian gas giant has secured only one deal of 32 bcm of annual exports from 2018 onwards. Although the details have remained confidential, Gazprom allegedly attempted to get a higher price, while China refused to pay more elevated amounts. Moreover, Gazprom and China have still yet to agree on loan conditions and the pipeline project seems to have been postponed. In the context of severe financial shortcomings engendered by low oil prices, Russia has not secured a second deal with Bejing on the so-called "western route". Indeed, one could mention that currently it is rather an unfavorable context for new capital intensive projects.

In fact, Gazprom faces both international and domestic challenges related to increased competition. Being an attractive prospective market, China has indirectly gained leverage in relations with energy suppliers. Prior to the aforementioned talks with Russia, in April 2014, Beijing reached an agreement with Ashgabat to import up to 60 bcm per annum from Turkmenistan. Already with smaller export volumes than Turkmenistan, Gazprom faces higher production and transportation costs than this competing supplier.[10] In addition, there is an interesting twist, as China's state-owned hydrocarbon giant CNPC has acquired a 20% stake in Rosneft's subsidiary company that is in charge of developing the Vankorskoe gas field, which offers China an opportunity to import gas from Gazprom's most powerful domestic competitor. On these grounds, one could hypothesize a possible demonopolization in gas exports to China, opening this export market to Rosneft as well as Gazprom.

Moreover, in aftermath of the demonopolization of LNG exports, Rosneft also competes with Gazprom for the Japanese and Korean LNG markets. The two state-owned companies entered into a legal dispute in

ies 2013) http://www.oxfordenergy.org/wpcms/wp-content/uploads/2013/01/NG_73.pdf (last accessed on 5 February 2015)

6 Ria Business, 02.12.2013, URL: <http://en.ria.ru/business/20131202/185208315/Law-Ending-Gazproms-Gas-Export-Monopoly-Enters-Into-Force.html>

7 Bloomberg, Nov 2012, available on URL <http://www.bloomberg.com/news/2012-08-15/novatek-s-german-contract-price-seen-at-18-above-spot-at-alfa.html> (last accessed on 4 February 2015)

8 See for background P-L. Lam, "The growth of Japan's LNG industry: lessons for China and Hong Kong", Energy Policy, n 28, 2000, pp. 327–333

9 L. Eder, P. Andrews-Speed, A. Kozhubaev, "Russia's evolving energy policy for its eastern regions, and implications for oil and gas cooperation between Russia and China", Journal of World Energy Law and Business, 2011, Volume 2, Issue 3, pp. 219–242.

10 M Krutikhin, RusEnergy Consult. See, M Krutikhin, 'Arithmetic, an Enemy of Gazprom' Natural Gas Europe, 11 June 2014 available on URL: <http://www.naturalgaseurope.com/china-russia-gas-deal-arithmetic> (last accessed 10 December 2014).

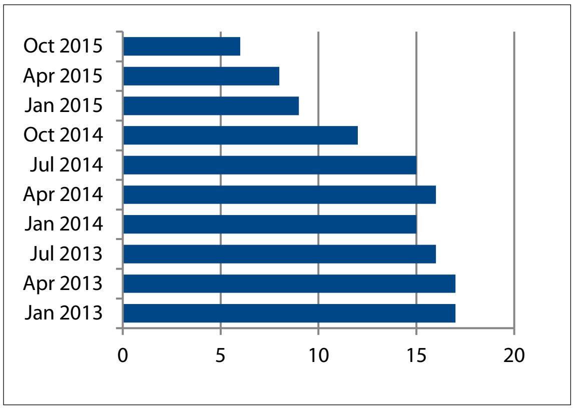
Sakhalin, where Gazprom has an LNG export terminal with 10 mln tons of export capacity and Rosneft plans to build its own 5 mln tons of capacity. In partnership with the US giant Exxon Mobile, Rosneft plans to expand exports to Japan and South Korea. In turn, Gazprom plans to increase its existing export capacities by another 5 mln tons and hence further augment its export volumes.

Yet, domestic trunk pipelines, including the ones in Sakhalin, remains under Gazprom ownership. Accordingly, Rosneft requested access to Gazprom's pipelines to connect its planned LNG facility. Following an expected refusal by Gazprom's to provide access to these pipeline networks, Rosneft compiled a complaint to the Federal Antimonopoly Service. The latter made Gazprom comply with provisions on non-discriminatory access to its pipelines, control over which Gazprom wants to defend in front of courts[11]. The ongoing dispute has only been attenuated by a delay in Rosneft's LNG plans caused by an unfavorable market price.

International Challenges for Asia's Attractiveness

These controversies surrounding access to Asian markets may still be relativized by both price and demand downwards trends. In fact, the three most prominent markets of China, Korea and Japan maintain oil indexation of the LNG price[12], hence during the previous oil price boom, the price for LNG oftentimes peaked at $16 per MBTU in 2013–14 (Fig. 3). Moreover, in the aftermath of the Fukushima accident in Japan, there was a hike in spot gas prices up to $20 MBTU. While remaining attractive, the focus on Asian markets has stimulated LNG export deals involving Australian, Malaysian, African and even North American exporters. Thus far, such growing competition between both suppliers as well as markets in the region has made it more difficult position for suppliers who are attempting to gain access to the market. Rosneft had assumed that the Sakhalin project would be profitable with a price of $11 per MBTU in the Japan-Korean Marker. However, the global oil price together with the oil-indexed and spot LNG prices has tended to fall since Autumn 2014. As a result, the current price level of about $6 per MBTU clearly hinders Rosneft's business plan for entering these markets.

Figure 3: LNG Price Dynamic in Japan-Korea Marker in $ per MBTU

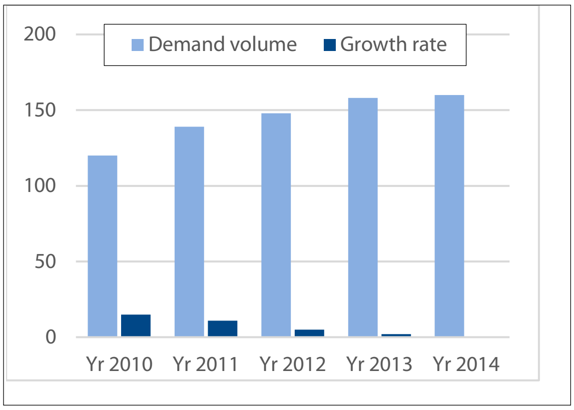


Source: ICIS, LNG Spot Markets Analysis Webinar, 2015

In addition, LNG demand growth rates in South Korea and Japan have slowed down in recent years (Fig. 4). It can be noticed that South Korea's civil nuclear plans and Japan's saturation of gas demand in the utility sector contributed to the trend. Consequently, in terms of both volumes and prices, LNG prospects might become less optimistic in the mid-term.

A cheaper oil-indexed gas price and a boosting of LNG supply projects have contributed to China's reluctance

Figure 4: Cumulative Gas Demand in Japan, Taiwan and S. Korea in Mln tons and Annual Growth Rate



Source: ICIS, LNG Spot Markets Analysis Webinar, 2015

to commit to pipeline gas imports from Russia. Practically, this competition from cheaper LNG might become a serious challenge for both Gazprom and Rosneft ambitions in the region.

11 I. Kustova, "Turf Wars, Gas Market Transformations and Sanctions—Implications for Liberalization Trends in the Russian Gas Sector", Natural Gas Europe, 4 November 2010, available at URL: <http://www.naturalgaseurope.com/liberalization-trends-russian-gas-sector> (last accessed 10 October 2015)

12 Japan-Korea LNG imports (named Japan KoreaMarker) are linked to Japan's Customs cleared crude with a gradient of 0.14.85+0.5 $, with three months time lag, hence if the average price of crude during 3 months is $ 100 per barrel, Japan's LNG is $15.4 per MBTU, see Platts Natural Gas JKM™ Price Assessment Methodology, available on <http://www.platts.com/price-assessments/natural-gas/jkm-japan-korea-marker> (last accessed 23 February 2015)

Conclusion

Tight competition between Russia's energy companies, mostly between the state-owned players Gazprom and Rosneft, has accelerated in recent times at both domestic and international levels. For both, Asia represents the most prominent new market opportunity due to its forecasted long-term incremental growth, at least in comparison with the European markets. In this context, China, Japan and South Korea have increased market leverage vis-à-vis Russian export companies. Therefore, the Russian state and Russian companies are having to adapt to these new realities. Russia has already demonopolized its LNG exports, and might further accept a certain degree of competition over the export of pipeline gas to China in the future, and even intends to introduce a liberal fiscal regime by exempting upstream projects from royalties. However, during the current low oil price period and Russia's subsequent financial difficulties, there are continuous delays in pipeline projects from Siberia to China, creating barriers for exporters' expectations.

Furthermore, gas price decline in Japan and South Korea is also undermining LNG projects in Sakhalin. Although Gazprom is encountering barriers in advancing new export projects to China, it continues to enjoy profits from its existing export projects to Europe. By contrast, the stalling Sakhalin project signifies a temporary renunciation of gas export ambitions by Rosneft. In addition, an over-saturated market in Japan and South Korea contributes to the long term unpredictability for newcomers in LNG supplies to these markets. Thus, it still seems that a major increase in demand and price boost would be needed for Rosneft to challenge Gazprom's position in supplying the Asian market.

About the Author

Andrei V. Belyi is affiliated to the Centre for Climate Change, Energy and Environmental Law at University of Eastern Finland, and is a Global Faculty member at the Centre for Energy, Petroleum, Mineral Law and Policy, University of Dundee, UK. He was previously a Senior Researcher at the Centre for the EU-Russia Studies, University of Tartu, Estonia, where he co-directed a Jean Monet Module on Energy and Environment. He has also spent several years at the National Research University—Higher School of Economics in Moscow (Russia), has completed an assignment for the Energy Charter Secretariat (Brussels, Belgium) and has conducted free-lance consultancy for MVV Consulting GmbH. He holds a PhD from Free University of Brussels (ULB) and specializes on gas markets and policies.

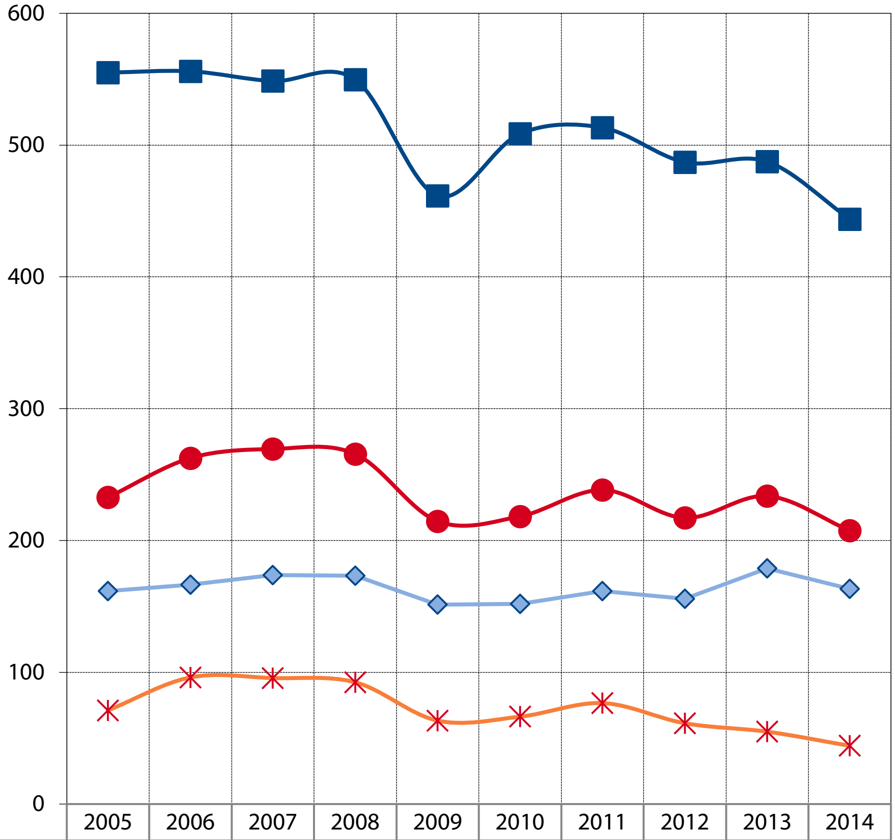
Further Reading

- Andrei V. Belyi, *Transnational Gas Markets and Euro-Russian Energy Relations* (Palgrave Macmillan, 2015)
- Andrei V. Belyi & Kim Talusa (eds), *States and Markets in Hydrocarbon Sectors* (Palgrave Macmillan, 2015)
- Andrei V. Belyi, "Russia's gas export reorientation from West to East: economic and political considerations", *Journal of World Energy Law and Business*, Winter 2015.

STATISTICS

Production Figures and Pipelines

Figure 1: Gazprom's Natural Gas Production and Exports, in bcm



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Production	555	556	548.6	549.7	461.5	508.6	513.2	487	487.4	443.9
Total exports	232.7	262.5	269.4	265.6	214.6	218.3	238.3	217.1	233.7	207.5
Former Soviet Union*	71.1	96.1	95.6	92.4	63.3	66.3	76.6	61.3	54.9	44.2
Europe and Turkey	161.6	166.4	173.8	173.2	151.3	152	161.7	155.8	178.8	163.3

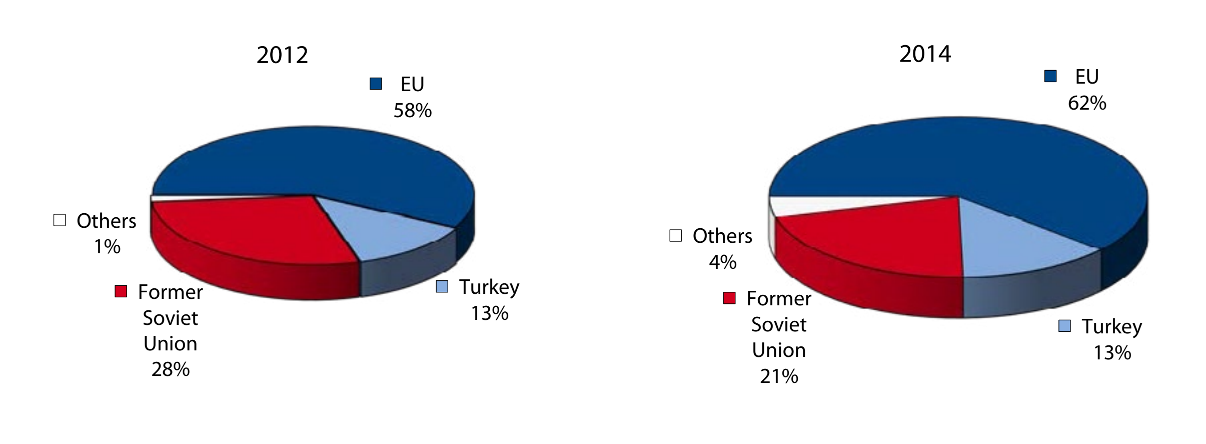
** Contrary to Gazprom's practice, the Baltic states are included with Europe and not with the Former Soviet Union.*
Source: Gazprom data; calculations by the Research Centre for East European Studies at the University of Bremen.

Table 1: Russia's Gas Export Pipelines (pipeline capacity in bcm per annum)

Pipeline	Route	Capacity 2015	Capacity 2020 (planned)
Bratstvo (Soviet pipeline system)	Russia – Ukraine – Central Europe	100	100
Northern Lights (Soviet pipeline system)	Russia – Belarus – Ukraine – Central Europe	55	55
Trans-Balkan (Soviet pipeline system)	Russia – Ukraine – Balkans – Turkey	28	28
Finland Connector (Soviet pipeline system, expanded in 1999)	Russia – Finland	20	20
Yamal-Europe (commissioned in 1999)	Russia – Belarus – Poland – Western Europe	34	34
Blue Stream (commissioned in 2005)	Russia – Black Sea – Turkey	16	19
Nord Stream (commissioned in 2011)	Russia – Baltic Sea – Germany	55	110
Power of Siberia (commissioning planned for 2018)	Russia – China	—	38
Altai Pipeline (commissioning planned for 2020)	Russia – China	—	30
Turk Stream (commissioning planned for 2016)	Russia – Black Sea – Turkey	—	31.5
Total capacity		***308***	***465.5***

Source: Heinrich, Andreas: Introduction: Export pipelines in Eurasia, in Heinrich, Andreas/ Pleines, Heiko (eds) Export pipelines from the CIS region: Geopolitics, securitization, and political decision-making. Stuttgart: ibidem, 2014, 1–73, compilation by the Research Centre for East European Studies at the University of Bremen.

Figure 2: Gazproms Natural Gas Exports by Regions 2012 and 2014



Source: Gazprom data; calculations by the Research Centre for East European Studies at the University of Bremen.

ABOUT THE RUSSIAN ANALYTICAL DIGEST

Editors: Stephen Aris, Matthias Neumann, Robert Orttung, Jeronim Perović, Heiko Pleines, Hans-Henning Schröder, Aglaya Snetkov

The Russian Analytical Digest is a bi-weekly internet publication jointly produced by the Research Centre for East European Studies [Forschungsstelle Osteuropa] at the University of Bremen (<www.forschungsstelle.uni-bremen.de>), the Center for Security Studies (CSS) at the Swiss Federal Institute of Technology Zurich (ETH Zurich), the Resource Security Institute, the Institute of History at the University of Zurich (<http://www.hist.uzh.ch/>), the Institute for European, Russian and Eurasian Studies at The George Washington University, and the German Association for East European Studies (DGO). The Digest draws on contributions to the German-language Russland-Analysen (<www.laender-analysen.de/russland>), the CSS analytical network on Russia and Eurasia (<www.css.ethz.ch/publications/RAD_EN>), and the Russian Regional Report. The Russian Analytical Digest covers political, economic, and social developments in Russia and its regions, and looks at Russia's role in international relations.

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Research Centre for East European Studies • Publications Department • Klagenfurter Str. 3 • 28359 Bremen •Germany
Phone: +49 421-218-69600 • Telefax: +49 421-218-69607 • e-mail: fsopr@uni-bremen.de • Internet: <www.css.ethz.ch/publications/RAD_EN>