



Changes in Gazprom (and Russia): is it possible?...

Vladimir Milov

Democratic Choice / Institute of Energy Policy

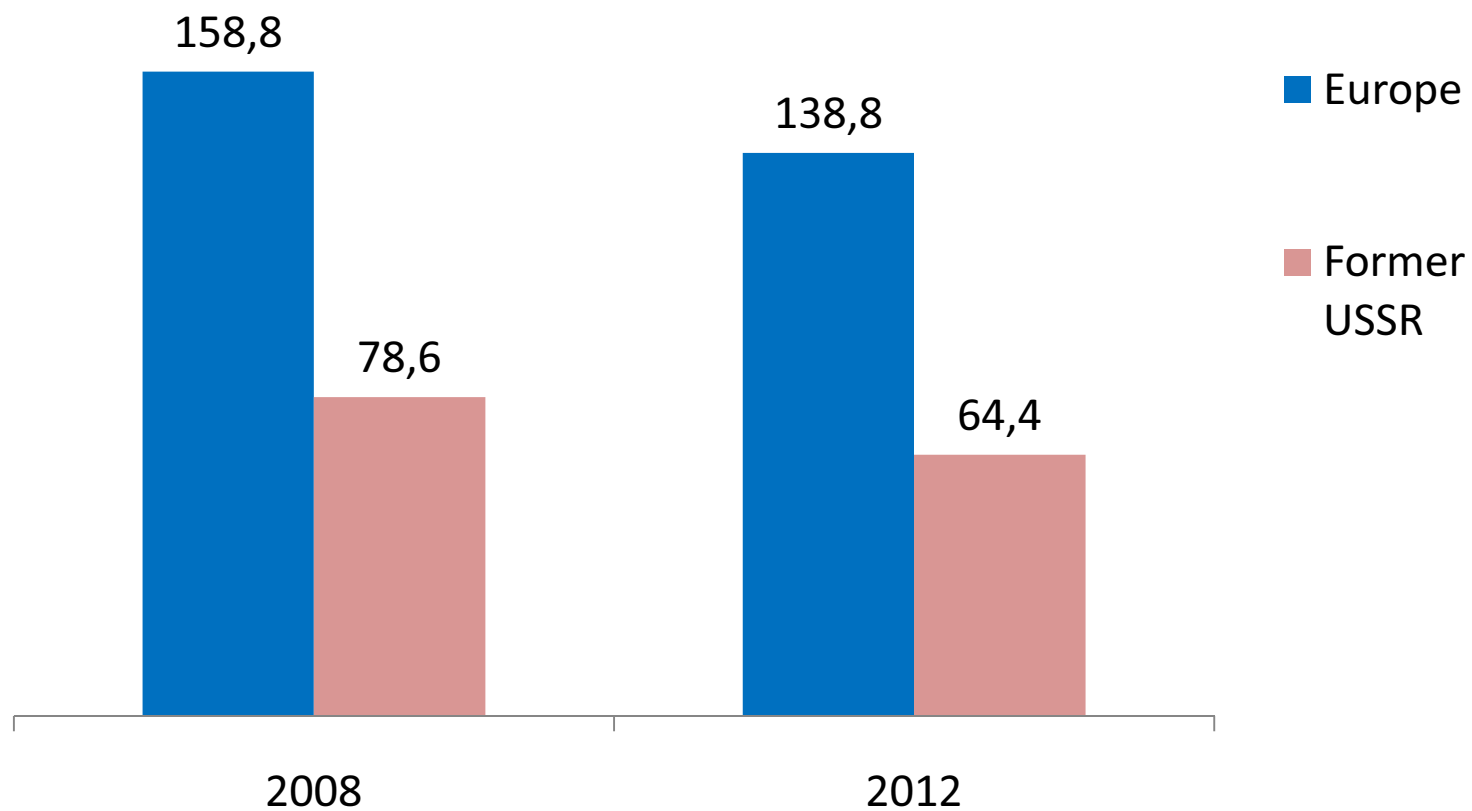
Palanga, September 26th, 2013

Gazprom: remember 2008...

- In 2008, Gazprom had hit record highs in gas exports to Europe – supplies had exceeded 150 bcm per year
- Forecasts were that Gazprom would soon supply 200-220 bcm to Europe, and then – only sky is the limit

But something went wrong

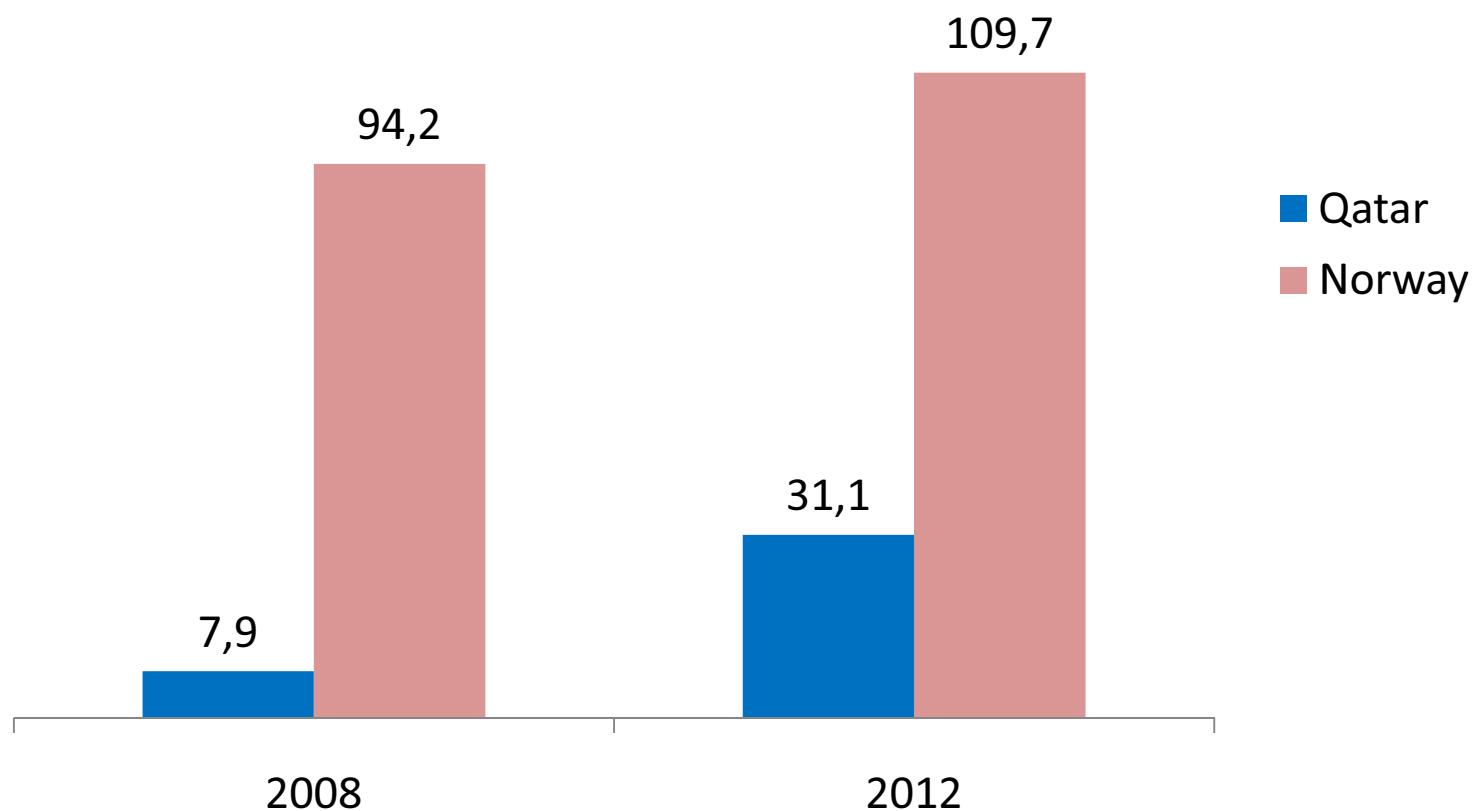
Supplies of Russian pipeline gas to Europe and former USSR, bcm



Source: Gazprom quarterly FSFR reports

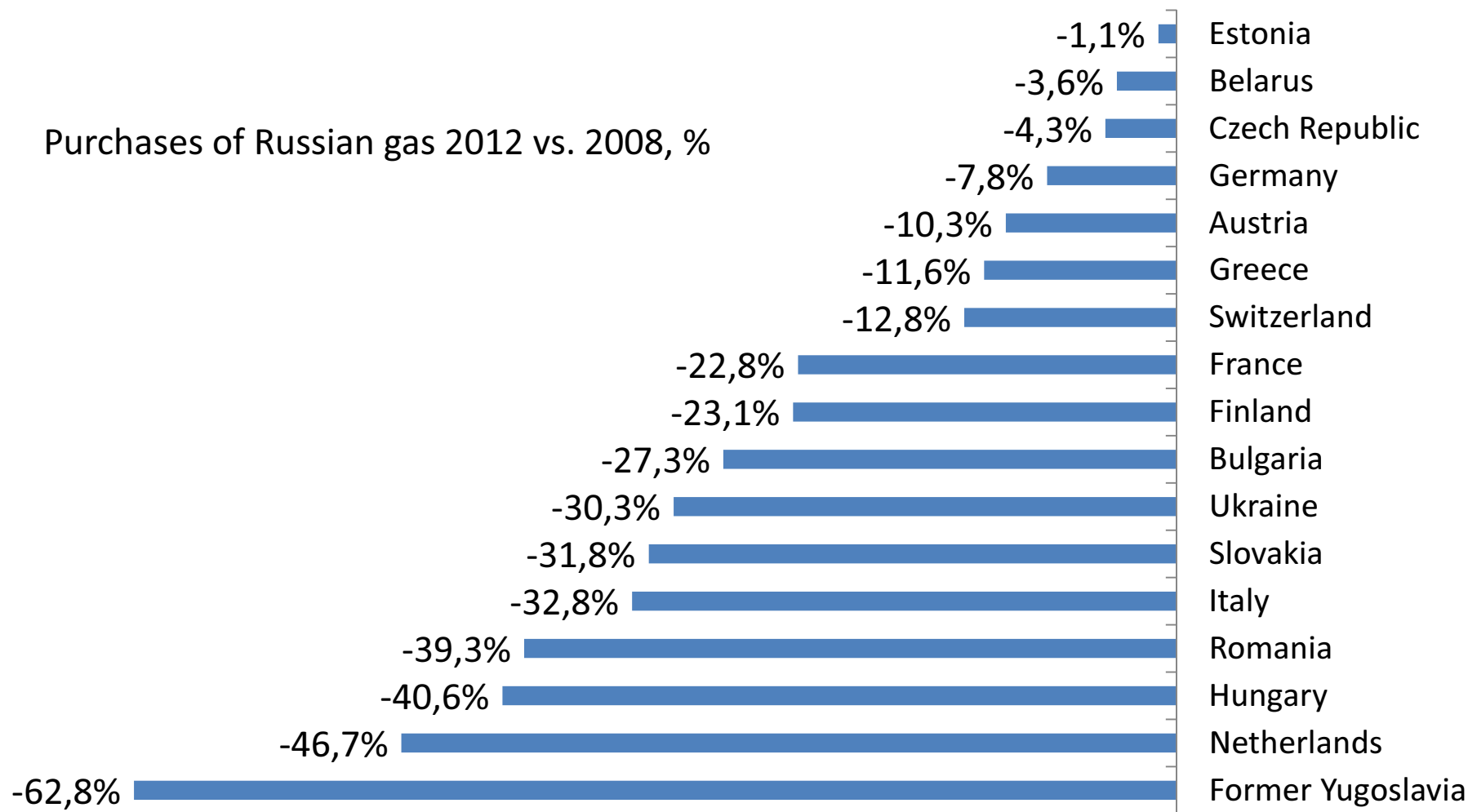
Don't blame it on the crisis: at the same time, Russia's competitors have gained

Supplies of gas from Qatar and Norway to Europe (including Turkey), bcm



Source: BP Statistical Review of World Energy

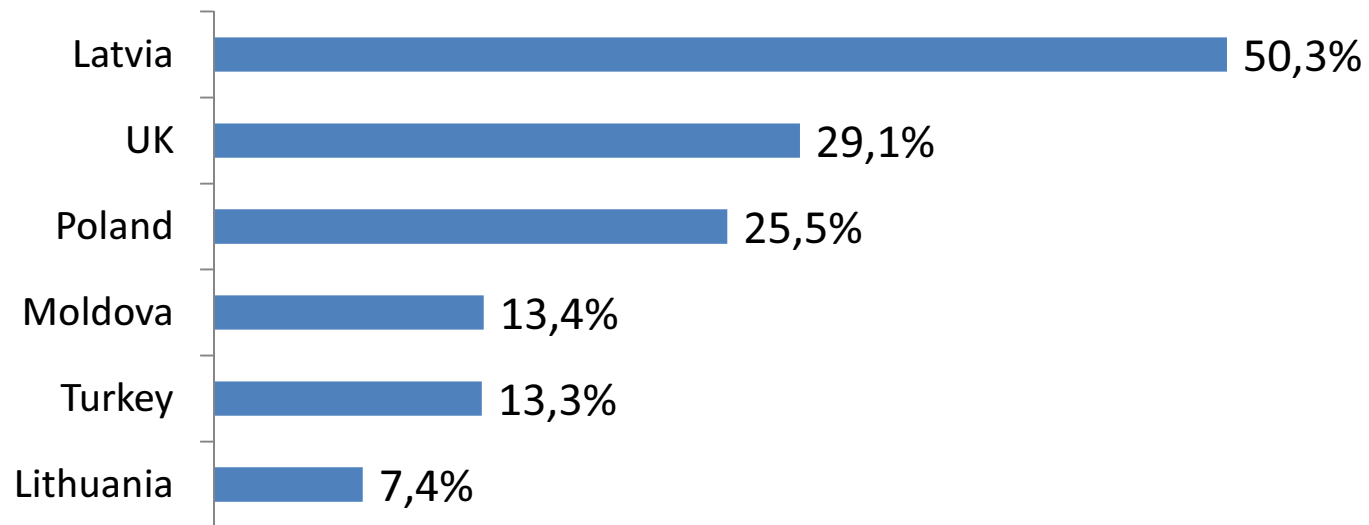
Most countries had reduced purchases of Russian gas



Source: Gazprom quarterly FSFR reports

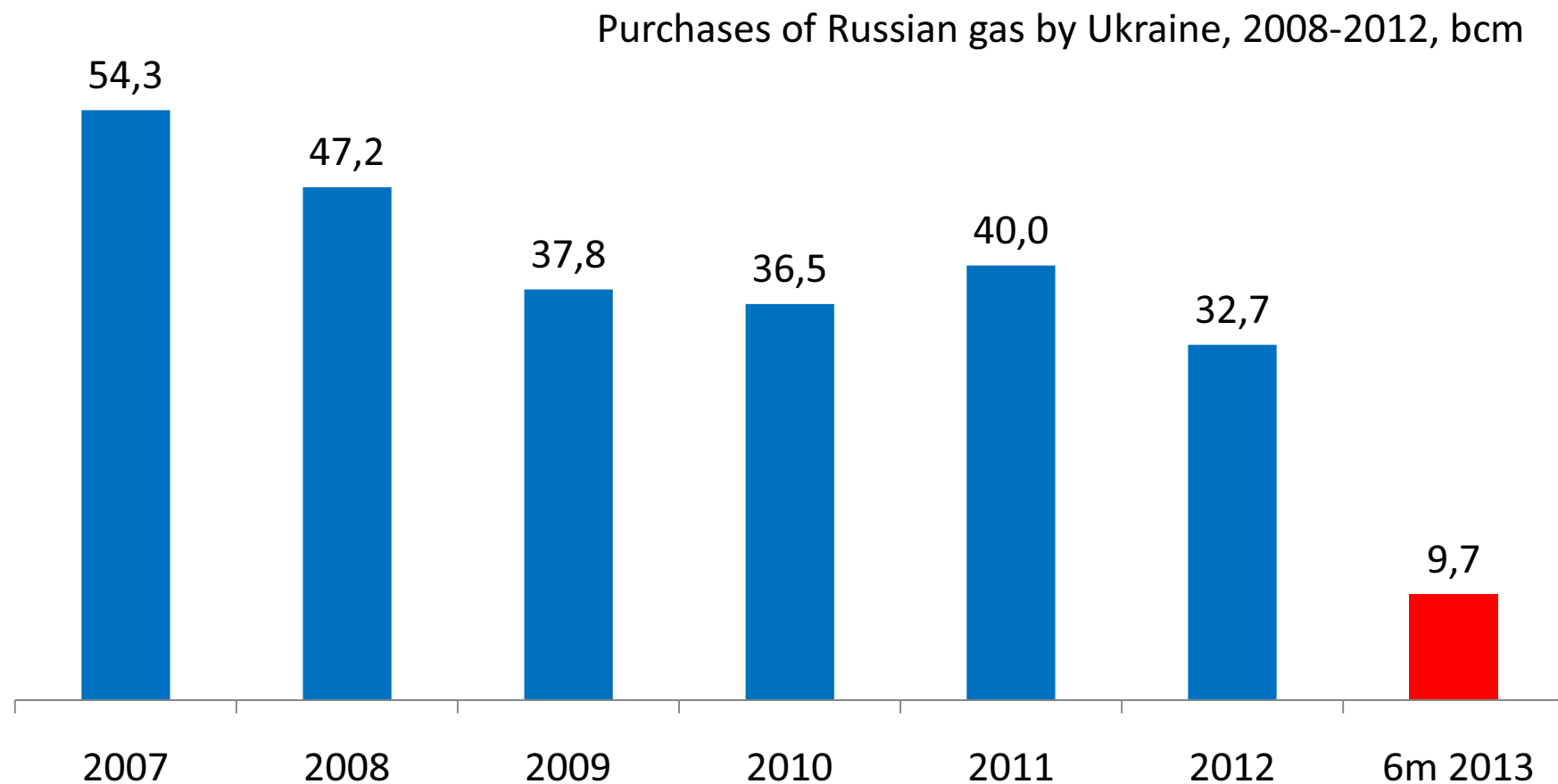
...with just a few exceptions, which do not change the overall picture

Purchases of Russian gas 2012 vs. 2008, %



Source: Gazprom quarterly FSFR reports

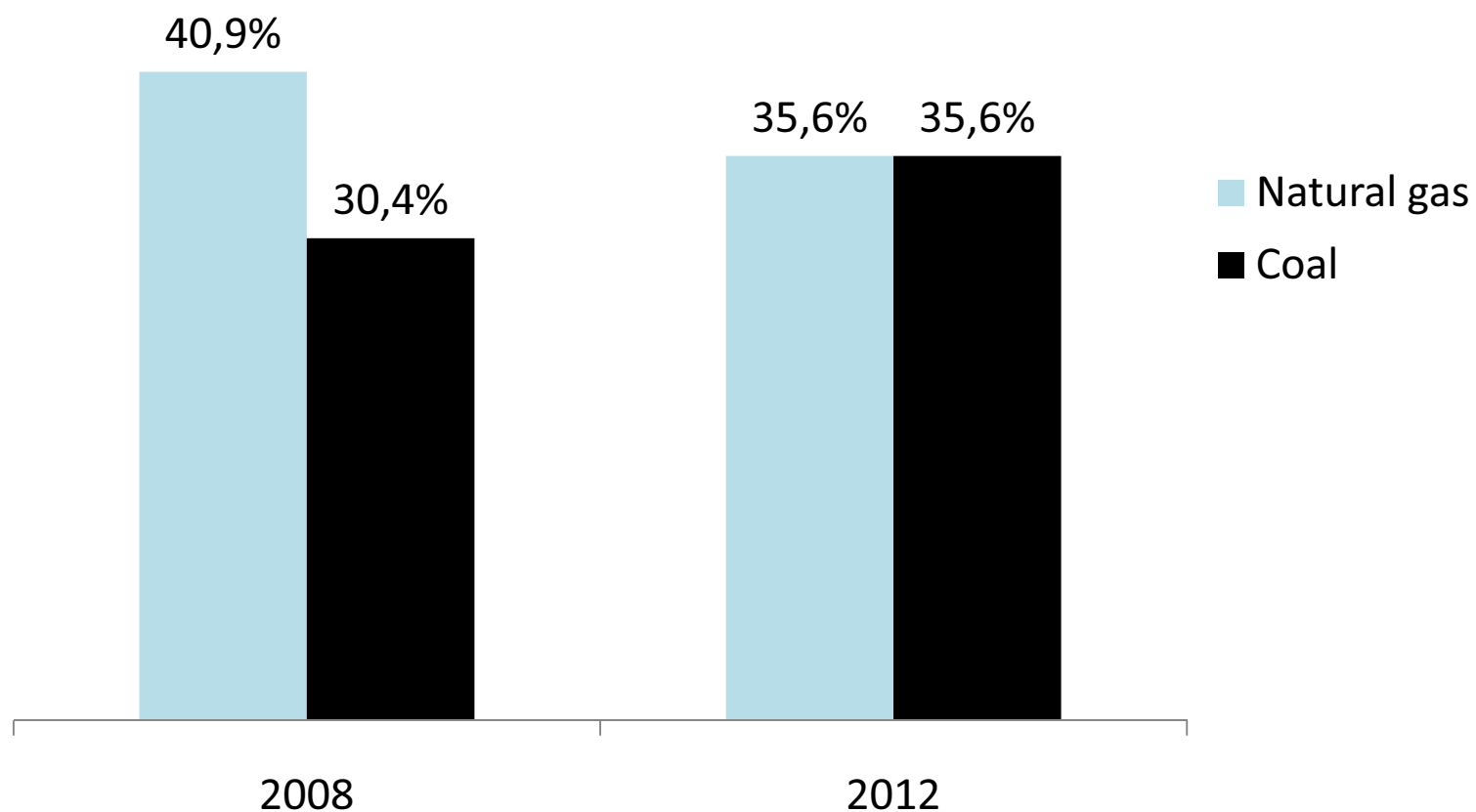
Ukraine: the biggest market, the most catastrophic market loss



Source: Gazprom quarterly FSFR reports

How diversification works: Ukrainian case

Shares of natural gas and coal in Ukrainian primary energy mix 2008-2012, %



Source: BP Statistical Review of World Energy

Why?...

- Holding on to outdated long-term contract system and pricing formulas in rapidly changing competitive environment proved to be a grave mistake
- In case of Ukraine, price wars waged in 2006 and 2009 and the subsequent price hikes have paid back

Who had overslept this and why?

- At Gazprom, decision making is dominated by inertia:
 - Inertia inherited by this never reformed company from the Soviet centralized system (it's basically a former Soviet Ministry)
 - Additional inertia brought in by Putin's "vertical strengthening" (meaning – further monopolization) policies
- That's why Gazprom had been fiercely defending the outdated contract and pricing system in changing competitive conditions, despite severe loss of market...
- ...inertia continues to be at work

China?

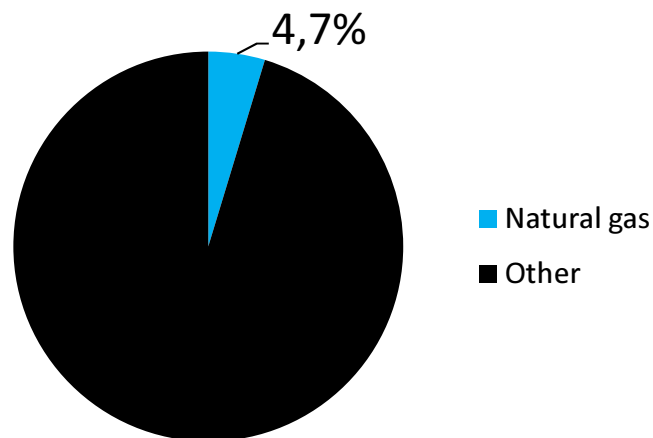


- In March 2006, agreements were signed in Beijing on massive supplies of Russian gas to China
- Almost eight years down the road, Western corridor project (Altai) is dead, there are price disagreements which prevent contracts re. Eastern corridor from being signed
- Meanwhile, gas pipeline from Turkmenistan to China is up and running since 2009

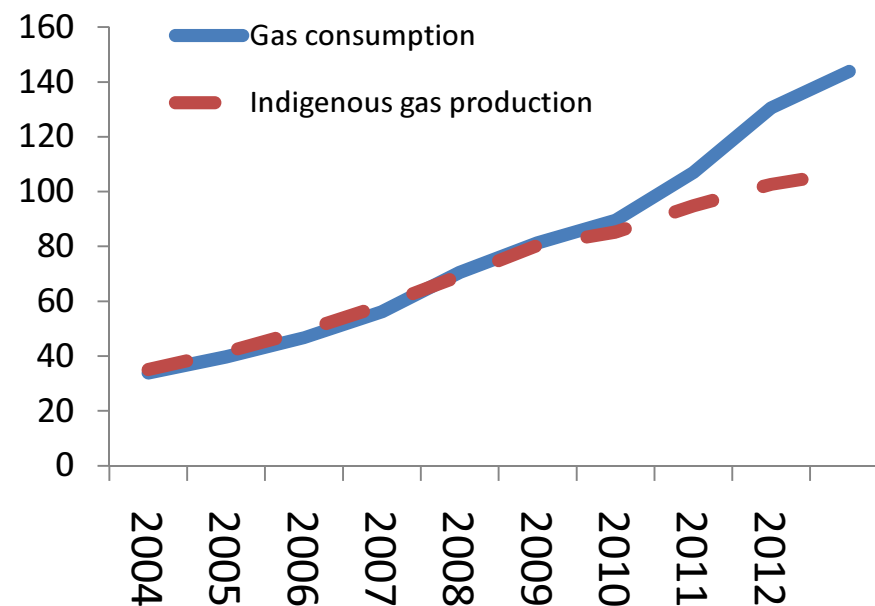
Too early to drink champagne just yet.

Why China so tough on gas import prices?

Chinese primary energy mix, %



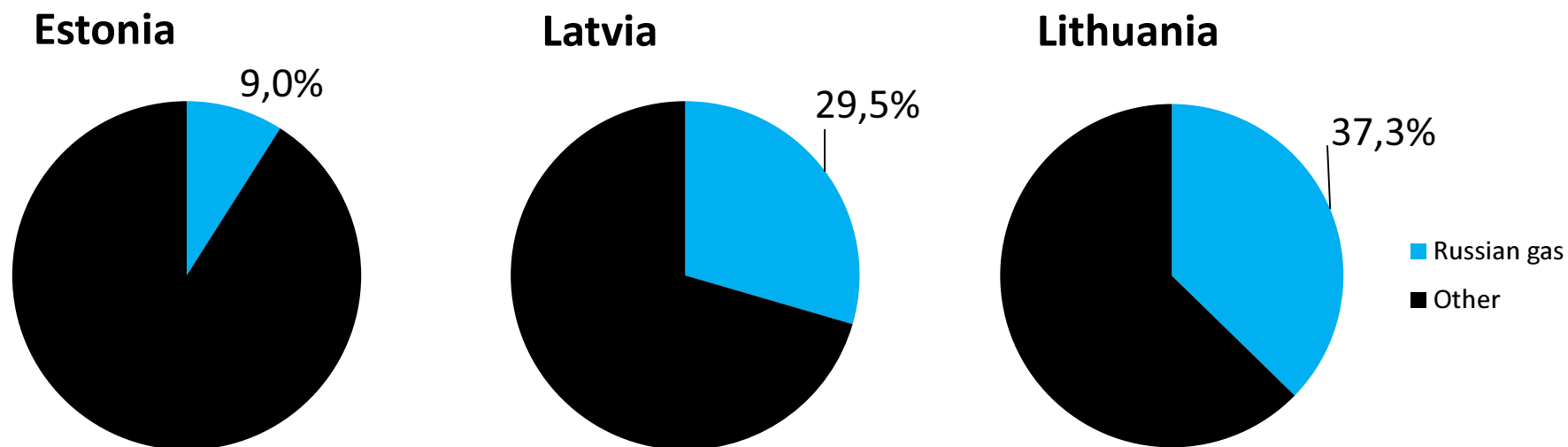
Chinese gas production and consumption, bcm



China is not strongly dependent on imported gas.

What conclusions for Baltic states?

Russian gas in Baltic countries total primary energy supply, % (source: IEA)



Learn from countries who diversify energy imports. Encourage competition.

Gazprom competitive reform: potentially a “win-win-win” case

Russian economy wins

- Russian economy becomes more competitive through containing growth of domestic gas prices
- Ineffective investment and corruption greatly reduced

Russian gas industry wins

- Russia stops losing international market after shrugging off Gazprom’s outdated pricing and contract policies

Europe wins

- Europe receives competitive gas supplies from the East under fair prices without further political and monopoly pressure

Can Gazprom be changed?

- Reforming Gazprom into open and competitive gas industry was key element of economic reform plan back in 2000
- However, Putin had toughly opposed that
- Gazprom was a central element to Putin's philosophy of monopolization and centralization
- As long as Putin stays in power, Gazprom will most likely not be reformed