Russia's Gas and Oil Policy: the Emerging Organizational and Institutional Framework for Regulating Access to Hydrocarbon Resources

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This article examines recent changes in the institutional and organizational arrangements defined by Russia's federal authorities to provide a framework for access to the country's hydrocarbon resources. In the case of oil resources, the dilemma that appears to govern the current changes concerns the necessity for the state to create an institutional framework that will stimulate exploration of new oil fields while at the same time ensuring that revenues from this oil boost state coffers. In the case of gas, the question of the modalities of access to the country's resources cannot be separated from Gazprom's strategy of downstream integration in the gas chain in the EU countries. "Reciprocity" in the exchange of assets now seems to be the prism of Russia's gas policy. While the country's oil and gas policies differ with respect to certain specific details and issues, we present a combined analysis of the Russian model for hydrocarbon access. In the first part of our paper we look at how the model has changed, identifying the main points regarding access to hydrocarbon resources. In the second part of the paper we discuss the contradictions of the Russian model in relation to the standards and rules promoted by the EU in the Energy Charter treaty. This logically opens the debate on alternatives ways to the Charter of managing the energy interdependence between Russia and the EU.

Changes in the Russian Hydrocarbon Model

The reorganization of the hydrocarbon sector that has been underway since the start of the 2000s is aimed at defining a new organizational model. This model must comply with and take into account the main characteristics of an oil and gas policy designed explicitly to ensure economic growth and reconstruction (Heinrich, 2008). Two factors in particular characterize the changes now taking place in comparison with the model of the 1990s, described by Aslund as a "liberal model" (Aslund 2006). First, state-controlled companies appear as the key players in the new institutional arrangements for the hydrocarbon industry. Rosneft, GazpromNeft, Tatneft and Slavneft (50%) in 2008 accounted for 39.7% of Russia's oil production (see Table 1). Gazprom, with 83% of gas output, holds a monopoly over transmission and exports.

Second, the increasing share of state-owned companies in oil production has been accompanied by tougher conditions for access to the country's hydrocarbon resources, or at the very least by tight control over access to resources by the authorities. These tougher conditions for access firstly affected the regions. The various amendments to the subsoil law put an end to the principle of joint allocation by state and regions of exploration and development licences, with the state taking full control (LeBoeuf, Lamb, Greene, MacRae, 2005)[1]. Foreign investors were also affected. First, a list of strategic fields was established. These fields are not subject to the principle of tendering required by law (gas law of 2006)[2]; instead the state reserves the right to select the companies to be granted exploration and development licences. Second, the law on foreign investment in strategic companies, adopted in May 2008, limits private foreign investment in a Russian hydrocarbon company to 10%, and to 5% in the case of investment by a foreign state-owned company. Any investment beyond these thresholds requires special authorization by a commission headed by the prime minister[3]. And third, under amendments to the Subsoil Law passed in 2008, licences to develop the (major) deposits in offshore fields will go exclusively to state companies (currently Rosneft and Gazprom).

	2003	**2008**
Private companies, %	72.6	43.9
State companies, %	4.8	39.7
Regional companies and others, %	22.6 (1)	17.4 (1)
Total output	8.4 mbd	9.82 mbd

Note: (1) Output from regional companies, that is to say companies in which the regions have majority holdings, could possibly be included in state company output, but we feel that these companies differ sufficiently from state-controlled firms for them to be treated as a separate category.

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Table 1: Output of Russian Oil Companies According to Ownership Type

Where do Foreign Investors Stand?

Russia subscribes to the principle of the new "oil nationalism" (Stevens, 2008). Conditions for access to hydrocarbon resources are in fact becoming increasingly restrictive for international investors. However, the Russian territory

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See footnotes at end of text.

is not completely closed. The way we see it, this tightening of control over access to foreign investors is not simply due to the fact that they are "foreign". This movement is taking place in the broader context of the federal authorities' response to the problems encountered by the liberal model. Two problems have been particularly acute: first, the lack of investment in Russia's frontier areas, which has damaged the country's capacity to renew its resources (Kryukov & Moe, 2007), and second, the difficulties encountered by the state in securing oil revenues (Vygon, 2009). The point of the changes currently taking place would seem to be to create a stable legal and fiscal framework, and in particular one that is seen as credible by investors, in order to encourage greater investment in the exploration of Russia's frontier areas. In fact, the transposition of the standards and rules from developed market economies that characterized the first transition phase did not lead to such stabilization. From this point of view, it might be considered that the 2008 law on the strategic sectors clarifies and stabilizes the legal framework for foreign investors (OECD, 2008). It might, therefore, be possible that the presence of state companies in oil contracts will add credibility to the contractual commitments entered into with international oil companies. From the point of view of the State, the involvement of state companies might help reduce information asymmetry and ensure that a fair share of oil revenues is secured. Thus the only viable way for international oil companies to invest in Russian hydrocarbons would seem to be through partnerships with the big state-controlled companies (OECD, 2008), at least where development of major fields is concerned.

In this respect, the framework defined to develop the Shtokman gas field could serve as a model not only for gas reserves but also for oil field development. This framework in fact adopted a new approach that differs from the classic framework of production sharing agreements. Development of the Shtokman deposit is to be led by a consortium named SDC (Shtokman Development Company), formed by Gazprom (51%), Total (25%) and Statoil (24%). While the term "Shtokman model" is not used, the agreement signed in 2007, nevertheless, reflects certain specific features. It does not call into question Gazprom's export monopoly. Gas produced by the consortium will be sold to Gazprom at prices calculated on the basis of gas prices in Russia. The different members of the consortium will, however, be guaranteed a profit on export sales[4]. Finally, it is Gazprom alone that owns the gas resources on Russian territory. The question remains entirely open as to whether the foreign partners will be able to book some of the reserves in proportion to their financial commitment; according to the consortium partners this question has been subject to contradictory statements[5].

Energy Charter versus "Assets for Assets": Two Contradictory Approaches

Russia's hydrocarbon policy is today based essentially on bilateral international relations. This has strong implications for Russia's integration in the hydrocarbon markets, whether in terms of its relations with its main customers (more specifically for natural gas) or in terms of giving international investors access to its territory. This approach has had a considerable impact on its relations with the EU.

The bilateral approach developed by Russia contrasts sharply with the multilateralism that the EU intends to promote essentially through the Energy Charter treaty. The EU's ambition is in fact to establish a single regulatory space (standards, rules, etc.) with its suppliers (Belyi, 2009; European Council, 2006). This could be a prelude to integration of the EU and Russian energy markets (Haghighi, 2007). In this approach, extending the Rule of Law is seen as a mechanism for dealing with the issue of energy security and one that would lead to the creation of a single energy market (Correljé, Van der Linde, 2006). This approach has led to a certain rationale which today conflicts with the principal characteristics of Russia's oil and gas policy[6]. Two aspects are particularly problematic and are at the heart of relations between the EU and Russia.

Access to Hydrocarbon Resources

The aim of the Energy Charter is to ensure that international oil companies can obtain access to the hydrocarbon resources of the producing countries through a multilateral investment framework. This goal does not undermine the principle of state sovereignty over natural resources but such sovereignty must not conflict with the obligations laid down in the principal frameworks for international investment (Haghighi, 2007). Thus, the Energy Charter sets forth rules intended to protect international investment and ensure non-discriminatory conditions for foreign investors (taking up certain WTO clauses).

The Russian government's preferred strategy of exchanging assets with consumer countries conflicts with the rationale of the Energy Charter. Russia seems to be increasingly intent on making access to its hydrocarbon resources conditional on its being granted access to assets in the downstream sector of the importing countries. Thus, the notion of reciprocity (Belyi, 2009) and the bilateral relations that it requires are at the heart of Russia's hydrocarbons strategy. It is also being confirmed as a key element in

Russia's relations with the EU.

The agreement concluded between Gazprom and BASF in 2009 reflects this intention since it concerns the entire gas chain (see. Box 1). But, this agreement could pose problems for de-integration of the gas industry operators (and for ownership unbundling) promoted by the EU gas directives and the 2008 Energy-Climate package. Similarly, in June 2009, Total bought a 49% stake in a Novatek-owned unit in charge of developing a gas field in Yamal province. In exchange, the French company sold a large stake in a Dutch refinery to the Russian oil company Lukoil.

Box 1: Gazprom-BASF agreement of 2009

This agreement covers exploration and production activities (in Russia), and transmission and distribution activities (in Germany and certain European countries). Under the contract Wintershall (a subsidiary of BASF) receives a stake of 25% less one share in the Russian company Severneftegazprom which is developing the Yuzhno-Russkoye gas field[7]. In exchange, Gazprom is to increase its holding in Wingas from 35 to 50% less one share. Furthermore, the agreement also provides for the creation of a 50/50 joint venture between Gazprom and BASF, known as Wingas Europe, to market the gas in Europe.

The Question of Transit

The second stumbling block concerns transit (A. Konoplyanik, T. Wälde, 2006). In the Energy Charter transit protocol it is implicitly assumed that gas suppliers will provide third party access (TPA) to the gas pipeline networks. What Europe wants in particular is to see Gazprom open up its pipelines to outside suppliers. This would make it possible for gas from Central Asia (Kazakhstan, Turkmenistan) to be delivered to Europe and would enable the number of suppliers serving the European market to be increased. As things stand today, this is in total contradiction with Russian government policy. The state has reinforced Gazprom's monopoly over gas production and export with the purpose of preventing greater competition in the gas market in Europe.

One of the key challenges of the reorganization of the Russian hydrocarbon sector is to define economic incentives that will stimulate new investment strategies. One question remains unanswered for the moment: Will this new institutional framework, characterized by tighter state control, be seen as sufficiently reassuring and stabilized to promote long-term investment or will it be a major factor of uncertainty for economic actors, in particular foreign investors and private national companies?

Footnotes

[1] The regions still have a presence on the boards that decide on licence allocation, but their role is now only advisory.

[2] It is on the basis of this principle that Gazprom was given the licence to develop the Chayandinskoye natural gas field, which is listed as a strategic reserve. The reserves of this field in the Sakha (Yakutia) Republic in eastern Siberia are estimated at 1260 bcm "Gazprom given licence to drill".- FSU Energy, Petroleum Argus, Vol XIII, 15, 18 April 2008.

[3] "Russia: Duma passes law limiting foreign investment in strategic enterprises".- BOFIT Weekly, 13. 28.03.2008

[4] "US demand doubts threaten development".- Argus FSU Energy, 26 February 2010.

[5] "Statoil fits the bill for Shtokman".- Petroleum Intelligence Weekly, 5 November 2007.

[6] Remember that Russia signed but did not ratify the Energy Charter treaty. Furthermore, in October 2009 D. Medvedev announced that Russia was withdrawing consent to provisional application of the Charter. Note also that a recent decision from an arbitration hearing in the Yukos affair seems to suggest that Russia will remain legally bound by the provisions of the Charter, under the terms of this provisional application, as far as all investments made before October 2009 are concerned. Clearly there are doubts surrounding the enforcement of this ruling in Russia (Riley, 2009)

[7] Wintershall is also involved in the development of a gas field near Urengoy in Eastern Siberia as part of a joint venture with Gazprom Achimgaz.

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Footnotes

[1] http://money.cnn.com/magazines/fortune/global500/2009/

[2] http://www.forbes.com/lists/2007/18/biz_07forbes2000_The-Global-2000-Russia_10Rank.html

[3] Expert-400 rating in the Russian weekly Expert Magazine no. 38(675) 2009.

[4] Speech by Vice-Premier Igor Setchin, as documented in Energetitseskaja Politika 4/2009.

[5] EU energy and transport in figures. Statistical pocketbook 2009. EU Commission, 2009.

[6] From the end of 2006 limited volumes of gas have been sold at deregulated prices at gas exchange auctions. The prices on the exchange have been ca 35% higher than the regulated tariffs for industrial users (Mezhregiongaz, 2008).

[7] Strategy approved by the Russian government at 13.11.2009, http://www.energystrategy.ru/

[8] A possible point of comparison is Zapolyarnoye, the latest large gas field taken into production. The field reached full production capacity only in 2005, over ten years after the project was launched.

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