

Yuli Grigoryev

DEREGULATION OF THE RUSSIAN GAS SECTOR: THE ARGUMENTS FOR AND AGAINST

Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee
Nethergate, Dundee DD1 4HN, Scotland, UK
E-mail: y.grigoryev@dundee.ac.uk

Overview

The Russian natural gas sector suffers from underinvestment. The only major producer and exporter of natural gas is OAO Gazprom, a state owned and regulated entity, has called for a deregulation of the market. The paper discusses the current situation and reviews the advantages and disadvantages from deregulating the domestic gas market. The paper also discusses the likely outcome if the consumer price per thousand cubic metres of gas was increased above the long run marginal cost to about \$50, both for the residential, commercial and industrial sectors. The paper concludes with an explanation why the market should be deregulated, and makes recommendations about the method for deregulation.

Methods

The first section will describe the current climate surrounding the Russian gas market, explaining the role of Gazprom and the current pricing mechanism employed by them and enforced by the government through the Federal Energy Commission (the regulator).

The second section will look at how the market should be regulated, in respect to pricing, competition and the two tier market and whether it should be regulated at all. The latter section will evaluate the question from both a qualitative and quantitative point of view.

Results

The overall results are presented in the conclusion of the paper.

Conclusions

Given the analysis, it is clear that some reform must take place. Before any price deregulation can take place, meters and valves must be installed at all consumer locations. Thereafter, the domestic price must be deregulated to encompass a new LRMC + price, at around \$50 per TCM. However, this price should, initially, apply only to the industrial sector. With the residential sector, a pricing plan should be published for the consumers, and a gradual increase to prices should be administered. The industrial sector should doubtlessly have a higher price per unit of energy than the domestic sector, but the proportion will need careful economic analysis. By the time the desirable level is reached in the domestic sector, the state of the competition needs to be analysed, to determine its readiness to enter into direct competition with Gazprom's domestic supplies. Some consumers will not be able to pay for the new gas price, but they will need to be subsidized out of the increased revenue generated by the higher prices. Furthermore, no business is safe from bad debts, and so Gazprom, as well as new entrants will have to absorb this risk.

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