Russian Gas Industry:
2004 and new horizons

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First of all, I have to note that official Russian gas statistics for the year 2004 has not been formed yet and the numbers below are of preliminary nature. Nevertheless, there is no doubt, that the development of Russian gas industry in 2004 was quite successful.

Gas production rose in comparison with the year 2003 by 12,6 BCM and reached the level of 632,8 BCM. Gazprom increased its gas production by 4,9 BCM - up to 545,1 BCM; independent producers – by 7,8 BCM - up to 87,8 BCM. For the sake of fair comparison it should be noted that a year before the increase in Gazprom's gas production was 18,3 BCM. As a result, the share of the independents in Russian gas production rose from 12,9% in 2003 to 13,9% now.

Gas demand kept on growing despite the significant 20% rise in gas prices on the internal market. Gas consumption in 2004 was at the level of 379,4 BCM, i.e. by 3,9 BCM higher than a year before.

The rate of growth of gas exports was impressive: in 2004 the overall exports reached 192,3 BCM (plus 8,4 BCM to 2003 level). Export supplies rose both to the CIS and Baltic states – by 0,8 BCM, and to most attractive Central and West European markets – by 7,6 BCM, to the level of 140,5 BCM.

The income from the gas exports to the European countries, due to growth in gas volumes supplied and, of course, extremely favorable prices conjuncture, exceeded $19 bln, (an increase by 2,5 bln to the level of 2003). It is expected that Gazprom, on the basis on its world-largest portfolio of long-term supply contracts amounting to 2 TCM with estimated value around $270 bln (in current prices), is going to keep on raising the level of its annual gas export supplies.

Within the next five years exports to Europe may reach 180 BCM, first of all, because of an increase up to the project level in the capacity of the new main pipelines: Yamal-Europe and Blue Stream, and the construction of the new trunkline Borodtchany-Uzgorod in the framework of the International Consortium to control and develope the Ukrainian Gas Transportation System. These prospects are also associated with such large scale gas production and gas transportation projects as the development of the main fields in Yamal peninsula; the construction of the new pipeline system for Yamal gas transportation to the Russian consumers and abroad; the development of the Shtokman field and the

fields in the region of Ob's and Taz's inlets. The North-European pipeline which is of great interest for the West will contribute to the diversification of the Russian gas deliveries routes. To ensure the declared levels of exports it will be necessary to implement these new infrastructural projects as well as to carry out fundamental reconstruction of existing trunkline systems.

The next major stage in the development of Russian gas industry is the creation of an integrated system of gas production, transportation and distribution in Eastern Siberia and the Far East with a possibility of exporting gas to China, Korea, Japan and other Asian countries (of Asian – Pacific Region).

We are sure that there are at least three basic conditions which are of crucial importance for the dynamic increase of Russian gas exports. These are:

- legitimacy of long-term "take or pay" supply contracts,
- development of short term and spot sales,
- strict adherance to the national policy of Single export channel.

Because of the fact that the main export markets are far away from Russian gas production fields we attach extreme importance to security of transit. It would sound strange, but some risks for such security may be associated, perhaps despite the authors' best intentions, with the new EU Gas Directive which determines the concrete forms, scales and rates of the gas markets liberalization in the EU member states. Referring to this document, the European Commission representatives are set to provide equal treatment to transit gas flows and internal gas transportation, which, in line with the concept of Regional Economic Organization, is supposed to include all kind of movement of natural gas within EU territory. In case of congestion of transportation facilities, which is quite probable, it may lead to the risks of denial of access for the supplier carrying out its long term export contractual obligations, which will not only cause damage to gas consumers, but jeopardize the very security of European gas supply.

Participating as members of the Russian delegation in the negotiations on Energy Charter Transit Protocol, Gazprom's representatives have been persistently persuading other delegations to agree with the clauses which are aimed at strengthening security of supply. Alas, up to now all these efforts have been in vain.

In particular, the EU representatives declare that our proposals are, in their view, in contradiction with such basic EU principle as the freedom of competition. But, to begin with, their arguments do not seem to be reasonable enough and we remain convinced that in fact there is no contradiction. And besides, if one has to choose between such priorities as security and competition, it seems to me, that security should be

preferred, since competition is just a way to improve the quality of life, whereas ensuring security is a matter of survival.

We do not lose optimism as far as these negotiations are concerned keeping in mind that the European Commission representatives have already admitted at least one mistake, when they recognized as important long term gas supply contracts and gave up their attempts to prohibit them.

No doubt, the EU Gas Directives will be gradually improved. Anyway, it is amazing, that under the regulatory terms in force the potential investors link the possibility to realize and even to finance large scale gas projects with the exemption from some regulatory conditions which are aimed at the strengthening of competition. It seems obvious, that the projects requiring multibillion dollar investments will be initiated only with sufficient confidence in investments return. And without such projects the risks of gas deficiency in Europe will be much greater.

Another direction of international economic activity that is supported by Gazprom is the creation of the Single Economic Area (SEA) for such states as Byelorussia, Kazakhstan, Russia and Ukraine. We have to harmonize and then to unify the legislation systems of these states keeping in mind the goal of creating a common gas market. We are just stepping on the path the longer part of which has been already covered by the EU member states. Of course we will try to take into account all their achievements as well as the difficulties they had to overcome and deadlocks on this way. This work will go in parallel with the liberalization of internal gas market in every SEA country, in particular, with the expansion of the market sector in which gas prices are not regulated. It is clear for everyone that market reforms in gas industry will be possible only when gas prices cover costs, and moreover, ensure investment attractiveness of the gas industry.

We are often asked about the access of independent gas producers to Gazprom's gas transportation facilities. It should be clear for any unprejudiced professional that third parties may be provided with *unlimited* access only if there are excessive capacities. At present Gazprom provides the independents with access to its free capacities on the obvious conditions imposed on gas quality and security of connection. At the same time, it seems unreasonable to demand that Gazprom in the case of deficit of transportation facilities should provide a third party with access to capacities that are occupied by its own gas, which will result in the failure of fulfilling its own obligations under supply contracts.

On the other hand, we believe that the independent producers' request to extend gas transportation facilities for their gas should be addressed provided they guarantee that new facilities will be used and paid for at adequate tariffs.