

Gazprom: Board of Directors

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Gazprom: Board of Directors

Dear Delegates,

It is my distinct pleasure to welcome you to the Gazprom. The fact that you are reading this means that you are one of the privileged few to be attending this committee.

Though I have lived in Lahore, Islamabad, Mississauga, Toronto and Dubai in the past, and currently reside in Montreal; the beautiful, coastal mega-city of Karachi, Pakistan is where I call home. I am a fourth year student at McGill, studying Mathematics and Economics. Outside of debates, I have a strong affinity for art, be it performance art, fine art, literature or music as well as watches (which really are a form of art). While many eat to live, I live to eat and find no greater happiness than eating great food.

I have been heavily involved in and winning at debates and Model United Nations for about five years, so you will all be in the most capable of hands for this conference. I started participating in Model United Nations during High School in Pakistan, and have continued participating on the McGill's Model United Nations team on the collegiate circuit. This will, likely, be my last Model UN experience, so I hope it turns out well.

I expect all of you to be well read, going beyond just the background guide and consistently doing your best. This committee will no doubt be competitive but at the same time a great learning experience. You will leave this committee as better delegates than when you entered and will hopefully have learnt a great deal.

Looking forward to meeting all of you and please don't hesitate to contact me at ali.aasim@mail.mcgill.ca.

Ali Aasim
Chair,
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Secondary Schools United Nations Symposium 2015



Topic 1: The 2008 Financial Crisis

Introduction

In the years leading up to 2007 and 2008, world oil prices rose dramatically, peaking in July of 2008 at the price of 132.55 USD per barrel.¹ These prices were very welcome to nations such as Russia that depend heavily on oil exports for the health of their economy. Gazprom, as the state oil exporter of Russia, saw enormous growth in these years and expanded its operations. In 2008, however, Gazprom and Russia were hit with a financial crisis along with the rest of the world. Gazprom faced the rising costs of extracting oil in increasingly difficult environmental locations, coupled with sharply declining oil prices, production shortages, complicated political goals, and a global recession. This guide will explore the financial recession and its effect on Russia, as well as Gazprom's actions and role leading up to and during the crisis, and additional challenges that complicate addressing the crisis.

Context: 2008 financial crisis

The 2008 financial crisis was a multi-stage recession that is still affecting the world today. A number of events and circumstances had led to what would become the worst global recession in 80 years.²

There are a number of complicated and interconnected causes to the financial crisis. American financiers and the US housing market played a major role, as did housing bubbles in other countries to a lesser extent. Irresponsible mortgage lending practices in the United States such as loans to subprime borrowers (individuals with poor credit standing) made seemingly 'secure' investments insecure.³ Initially this did not seem like an issue, but the 2006 housing price downturn triggered further defaults on even bigger loans. Many large and mid-sized financial institutions and investors were encouraged to find riskier assets with higher returns and, amassed enormous concentrations of high-risk securities. However, the firms did not hold enough capital and instead relied on short-term debt, putting them in danger if these assets were to begin defaulting.⁴ Combined with a savings glut in emerging economies, especially in China, and regulators' failure to keep America's deficit in check against excess Asian savings, this proliferation of high-risk investment and lack of capital is said to have led to the financial crisis.⁵

¹ "Crude Oil Monthly Price," IndexMundi.

² "Economist Crash Course: The Origins of the Financial Crisis," *Economist*, September 7, 2013,

³ *Ibid.*

⁴ Bill Thomas et al., "What Caused the Financial Crisis?" *The Wall Street Journal*, January 27, 2011,

⁵ "The Origins of the Financial Crisis," *Economist*.

Russia's Economic Performance in 2008 and 2009

Percentage Changes Year over Year, by Year and Quarter

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009
GDP	8.5	8.0	7.3	5.6	-9.8	-10.9
Industrial Output	7.0	5.4	5.4	2.1	-14.3	-14.2
Fixed Investment	16.9	13.1	13.1	9.1	-15.0	-18.2
Unemployment	6.4	6.2	5.3	7.7	10.0	8.3
Inflation	15.1	14.7	14.2	13.3	14.0	11.9

Sources: Federal State Statistics Service, statistics, as reported in *Vedomosti*, various issues, 2008–2009, and Bank of Finland, Institute for Economies in Transition, “BOFIT Russia Statistics,” at http://www.bofit.fi/bofit_en/seuranta/venajatilastot/index.htm (August 20, 2009).

Table 4 • B 2333 heritage.org

Figure 1 Source: Heritige.org

bankruptcy.⁶ This results in a seizure in the global banking system, and trust between banks begins to dissolve as they question each other's viability.⁷ By 2008, the US economy was in recession and the financial crisis came to a head when Lehman Brothers went bankrupt.⁸ At this point, the US government's decision to allow Lehman Brothers' bankruptcy multiplied panic in markets and results in a spending freeze.⁹ In October, everything “[fell] off a cliff” and companies and banks all over the world requested bailouts and filed for bankruptcy.¹⁰

The global impact of the 2008 financial crisis cannot be underestimated. First of all, the banking crisis spread into the rest of the global economy and resulted in the Great Recession, the biggest recession since the Great Depression in the 1930s.¹¹ This translates into slowed economic growth and downgraded predictions for future growth, high unemployment, and increased financial uncertainty.¹² The impact on growth is particularly dramatic: the IMF predicted the lowest growth rate since World War II in 2009 at 0.5%.¹³ The recession was predicted to cause global power shifts and changes in the distribution and availability of critical resources including oil, and we have already seen trends towards increased nationalization of industries.¹⁴ There is no reason for economists and policymakers to believe that the recession will pass quickly, and the global nature of the crisis will result in a shifting of economic ‘winners’ and ‘losers’ as well as deeper social inequality.¹⁵

⁶ Larry Elliot, “Global financial crisis: five key stages 2007–2011,” *The Guardian*, August 7, 2011,

⁷ “The Origins of the Financial Crisis,” *Economist*.

⁸ “Timeline: Key events in financial crisis,” *USA Today*, September 9, 2013,

⁹ “The Origins of the Financial Crisis,” *Economist*.

¹⁰ Nick Mathiason, “Three weeks that changed the world,” *The Guardian*, December 28, 2008,

¹¹ Andy Kilmister, “The Economic Crisis and its Effects,” *Viewpoint*, 4 (2008),

¹² *Ibid.*

¹³ Bulent Gokay, “The 2008 World Economic Crisis: Global Shifts and Faultlines,” *Global Research*, February 15, 2009,

¹⁴ *Ibid.*

¹⁵ *Ibid.*



The Effect of the 2008 crisis on Russia

When the 2008 financial crisis hit, Russia as a whole was at a point of high confidence due to the dramatic rise in oil prices in the prior years that had resulted in strong economic growth.¹⁶ Russia was convinced that the amassed oil wealth and its considerable foreign exchange reserves made it less vulnerable than other nations – this turned out not to be true in the least.¹⁷ 2008 brought a major economic meltdown in the Russian economy, and by the fall, financial resources had dwindled and hard currency reserves had fallen from \$600 to \$400 billion.¹⁸ By November, the stock market was down 70% just from the spring of 2008.¹⁹ As one leading Russian banker said in anonymity, it was clear that “Russia will be much worse affected by the crisis than other major economies and will be affected for much longer,” a dramatic change from the estimates early in the crisis of minimal damage.²⁰

Indeed, the effects of the 2008 financial crisis and subsequent global recession were dramatic. The nation experienced a perfect storm of declining export earnings from energy and metals, bailout appeals from corporations, a credit crunch and banking failures, a real-estate bubble and mortgage defaults, intense capital flight, and pressures for currency devaluation.²¹ As a result, GDP growth fell from 8.1% in 2007 to a mere 1.1% in 2008 and the number of people in Russia living below the poverty line jumped from 1 million at the beginning of 2008 to almost 5 million in 2009.²² Rising unemployment, government spending cuts, and exacerbated social tension put increased pressure on the government.²³ The 2008 financial crisis hit Russia just as hard – if not harder – than the rest of the world.

The Russian government plays a major role in the governing of Gazprom through both nationalization and corruption. Due to this, and Gazprom’s role as a primary Russian corporation, the recovery of the company is of great importance to the overall economic health of Russia and the level of influence the Kremlin is able to exert abroad.

Gazprom and the Crisis

Part of the reason the 2008 financial crisis hit Russia so hard was the accompanying drop in oil prices. Russia relies quite heavily on energy exports, which made up 66% of the Russian economy in 2008 and for years have been the driving force behind Russian economic growth.²⁴ Russia is considered a ‘petrostate,’ a state with a

¹⁶ Stephen Sestanovich, “Russia and the Global Economic Crisis,” *Council on Foreign Relations*, November 25, 2008,

¹⁷ Michael Stott, “Russia acknowledges financial crisis has hit hard,” *Reuters*, November 21, 2008,

¹⁸ Ariel Cohen and Richard Ericson, “Russia’s Economic Crisis and U.S.-Russia Relations: Troubled Times Ahead,” *The Heritage Foundation*, November 2, 2009,

¹⁹ Sestanovich, “Russia and the Global Economic Crisis.”

²⁰ Stott, “Russia acknowledges financial crisis has hit hard.”

²¹ Sestanovich, “Russia and the Global Economic Crisis.”

²² Cohen and Ericson, “Russia’s Economic Crisis and U.S.-Russia Relations.”

²³ Ibid.

²⁴ Cohen and Ericson, “Russia’s Economic Crisis and U.S.-Russia Relations.”

vitality important energy sector.²⁵ The government's budget swings heavily on the price of oil per barrel at any particular point, and the popularity of leaders such as Putin is directly connected to the benefits the Kremlin reaps from rising oil prices and economic growth.²⁶ The importance of energy and oil to Russia results in the corresponding importance of Gazprom, as it has a near monopoly of the Russian energy sector, and has only increased since 2003, when the government began to renationalize natural resources and government ministers took direct management roles in Gazprom.²⁷

Prior to 2008, the close relationship between Gazprom and the Russian government benefited everyone involved. This was intrinsically connected to the dramatic rise in oil prices from 2002 to August of 2008, where the nominal oil price rose from 19.70 to 133.40 USD per barrel, resulting in a dramatic increase in oil revenues for exporting nations.²⁸ As energy prices rose, Gazprom aspired to become the largest corporation in the world, surpassing Exxon Mobil as the world's largest publicly traded country by 2014.²⁹ The third largest corporation in the world by the beginning of 2008, Gazprom was planning extensive expansion, including two undersea pipelines to reduce reliance on Ukraine as a transport country, new Arctic oil fields to increase production,

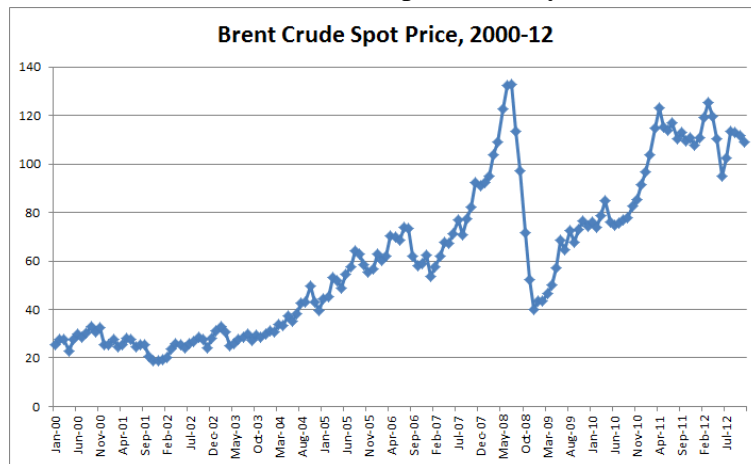


Figure 2 Source: Forbes

and an increase in exports to Asia.³⁰ Gazprom's success was backed by the Kremlin, which intended to use Gazprom as a way of increasing its geopolitical clout.³¹ As James R. Fenker, chief strategist at a Russian-oriented investment firm, said, "they were...inebriated with their success."³²

Unfortunately for Gazprom and Russia, the 2008 financial crisis hit very hard, and along with it came

a much greater collapse in energy export prices than was expected.³³ By December 2008, the horizon was far from bright. Unlike its western competitors, Gazprom was deeply in debt – \$49.5 billion– and was attempting to negotiate a bailout from the government that already owned more than half of the company while its share prices fell and investors dropped its stock.³⁴ The total value of the company fell 76% in 2008 and the country fell

²⁵ Ibid.

²⁶ Sestanovich, "Russia and the Global Economic Crisis."

²⁷ Cohen and Ericson, "Russia's Economic Crisis and U.S.-Russia Relations."

²⁸ Lucas Chancel, "Oil's role in the global economic crisis," *Oil Price*, May 27, 2012,

²⁹ Andrew E. Kramer, "As Gazprom Goes, so goes Russia," *New York Times*, May 11, 2008,

³⁰ Andrew E. Kramer, "Gazprom, Once Mighty, Is Reeling," *New York Times*, December 29, 2008,

³¹ Kramer, "As Gazprom Goes, so goes Russia."

³² Kramer, "Gazprom, Once Mighty, Is Reeling."

³³ Stott, "Russia acknowledges financial crisis has hit hard."

³⁴ Kramer, "Gazprom, Once Mighty, Is Reeling."

from the third to thirty-fifth largest company in the world.³⁵ This dramatic downturn presents not only a challenge to the board of directors, who must develop a way to salvage the company, but to Russia itself, due to Gazprom's prominence in the nation's economy.

Challenges for the Future

The financial crisis came at a bad time for Gazprom, as it not only faces the falling price of oil but challenges in production, expansion, and its business model. These challenges were both exposed and exacerbated by the 2008 crisis and recession and must be considered as the board develops a plan to save the company from the challenges it faces.

Gazprom's traditional business model was based on piping oil from fields Western Siberia to the rest of Europe, and these gas fields, first tapped in the 1970s, are now in decline.³⁶ However, Gazprom is still contractually bound to export energy to European nations for many years in the future, meaning that any shortages in production will result in gas shortages and rising prices for Russians to make up the export gap.³⁷



Figure 3 Source: Nature.com

Prior to the 2008 crisis, Gazprom had planned to triple their capital expenditures in their core businesses of exploring, extracting, and transporting gas through two new pipelines and expansion into Arctic oilfields.³⁸ This expansion is necessary just to maintain current production levels to satisfy export and domestic demands. At the price of oil as it peaked in August of 2008, the Arctic expansion would have cost \$75 billion: it is technologically challenging and dangerous to expand into the Arctic.³⁹ As gas and oil prices collapse and other nation's liquefied natural gas and shale gas compete with Russia's natural gas exports, this Arctic expansion and the construction of new pipelines are becoming unfeasible.⁴⁰ However, Gazprom is bound to European markets not only through long-term contracts but because infrastructure and environment does not allow Russia to export gas easily anywhere except Europe, which reduces its overall flexibility when responding to the various challenges it faces.⁴¹

³⁵ Ibid.

³⁶ Anders Aslund, "Gazprom: Challenged Giant in Need of Reform," *Peterson Institute for International Economics*, 151.

³⁷ Kramer, "As Gazprom Goes, so goes Russia."

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ Anders Aslund, "Gazprom: Challenged Giant in Need of Reform," 152.

⁴¹ Ibid.



Gazprom

Gazprom faces challenges not only in production and expansion, but in its business model. The increasingly nationalized company faces the difficulties of state capitalism – waste and inefficiency – and its reliance on a Soviet economic model of gigantism, faith in monopolies, and economies of scale makes it less and less able to compete in today's markets.⁴² The company emphasizes massive resource endowment, extreme monopoly, and favorable government policies, but the 2008 crisis has revealed structural weaknesses and the business strategy faces serious challenges.⁴³ Although painful, the crisis will force a reform in Gazprom's organization structure and business model that may eventually be a positive occurrence – if it is properly and decisively addressed.

Conclusion

The 2008 financial crisis and subsequent global recession have not been easy for any nation or company to weather. However, the dramatic crash in oil prices has had a particularly negative impact on Gazprom and its future prospects due to its status as an energy exporting company. The importance of Gazprom to the Russian economy gives the issue of the company's recovery a sense of urgency, but recovery will not be easy as Gazprom is simultaneously facing a multitude of other challenges, including declining production, the need to expand into technologically challenging and expensive environments, and a fundamentally flawed business model. Reform and quick action are required, but even with swift and effective action, lowered demand, lowered prices, lowered production, and the need for extensive capital investment may result in Gazprom being a smaller, less profitable, and ultimately less powerful company.

Questions to consider

1. Should Gazprom address its structural, production, and expansion challenges, or should they be put to the side until the company is able to move substantially forward in its financial recovery?
2. Should Gazprom attempt to move towards or away from further nationalization?
3. What lessons can Gazprom learn from the 2008 financial crisis and recession that will allow it to better survive any future financial meltdowns of a similar magnitude?
4. Does recovery from the 2008 financial crisis require corporate restructuring?

⁴² Kramer, "As Gazprom Goes, so goes Russia."

⁴³ Aslund, "Gazprom: Challenged Giant in Need of Reform," 157.



Topic 2: Responses to Western Sanctions

Introduction

In response to Russia's actions in Ukraine and the subsequent annexation of Crimea, the European Union and the United States have imposed sanctions against key Russian figures and companies, restricting Gazprom's access to Western capital and advanced technology. Such restrictions have depleted the company's ability to deal with plummeting revenue due to collapsing gas and oil prices and its core market, Europe, becoming more independent of Russian energy. With export incomes allowing the company to provide below-market price gas for Russian citizens, Gazprom must look to new ways to mitigate the effects of Western sanctions in the foreseeable future.

Sanctions Overview

The sanctions imposed on the Russian Federation were a consequence of its actions taken in Ukraine, specifically Crimea. The initial operation in Crimea began on February 27, 2014, and within a month, the area was annexed by Russia.⁴⁴ Responses from the EU and the United States came shortly after the initial assault. On March 3 2014, the Council officially condemned the actions taken and on 6 March, the EU issued a threat to the Russian Federation, urging for de-escalatory steps.⁴⁵ On that same day, President Barack Obama of the United States signed an executive order issuing sanctions against individuals involved in the crisis.⁴⁶ In the absence of positive negotiation on the side of the Russian Federation, the EU and United States introduced the first sanctions on the state in the form of travel bans and asset freezes on March 17, 2014.⁴⁷ Within weeks, countries including Australia, Albania, Iceland, and Montenegro followed suit in declaring similar sanctions.⁴⁸ Economic restrictions were placed on three major Russia energy companies and prevented the exportation of certain energy-related equipment, including products utilized for deep water oil exploration and productions, arctic oil exploration and production, and shale oil projects.⁴⁹

A second round of sanctions were introduced in late April by the United States and the EU.⁵⁰ The new restrictions targeted individuals and companies linked with Russian President Vladimir Putin. Among the new additions were Transoil, a major

⁴⁴ Amanda Macias, "A detailed look at how Russia annexed Crimea," *Business Insider*, March 24, 2015.

⁴⁵ "EU sanctions against Russia over Ukraine crisis," European Union Newsroom, last updated May 29, 2015.

⁴⁶ Steve Holland and Jeff Mason, "UPDATE 4- Obama warns on Crimea, orders sanctions over Russian moves in Ukraine," *Reuters*, March 6, 2014.

⁴⁷ Ibid.

⁴⁸ "Declaration by the High Representative on behalf of the European Union on the alignment of certain third countries with the Council Decision 2014/145/CFSP concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine," *Official Journal of the European Union* L 78 (March 17, 2014): 16

⁴⁹ "EU sanctions against Russia over Ukraine crisis,"

⁵⁰ "U.S. levels new sanctions against Russian officials, companies," *Haaretz*, April 28 2014.

transporter of oil and oil products in Russia, and Igor Sechin, a close ally of Putin and president of Rosneft, a major state owned oil conglomerate.⁵¹



Figure 1: Russian Companies and Individuals under Sanction¹¹

It was in the third round of sanctions that Gazprom specific sanctions were imposed. The first came against Gazprombank, a financial institution established by Gazprom to provide banking services for gas enterprises. Equity provision and debt financing were both restricted, with the maturity period for new debt reduced from 90 days to 30 days.⁵² Gazprombank is also banned from raising capital on the EU's capital markets.⁵³ While the company released a statement dismissing concerns of clients and investors, stating that the bank will operate as before, Bloomberg reported in December 2014 that the bank's bonds were approaching "distressed levels", forcing the government to inject substantial quantities of capital.⁵⁵ Soon thereafter, Gazprom and Gazprom Neft, a subsidiary company specializing in oil production, were added to the list of energy companies facing prohibitions from obtaining technology for deep water, the Arctic, and shale projects.⁵⁶ Furthermore, the debt maturity period restrictions were also extended to the latter.⁵⁷

⁵¹ Ibid.

⁵² Andrew E. Kramer, "Gazprom Faces Effects of Politics on Its Bottom Line," *The New York Times*, April 22, 2015. http://www.nytimes.com/2015/04/23/business/international/gazprom-faces-effects-of-politics-on-its-bottom-line.html?_r=0

⁵³ Ibid.

⁵⁴ "Ukraine Crisis: Russia and sanctions," *BBC News*, December 19, 2014. <http://www.bbc.co.uk/news/world-europe-26672800>.

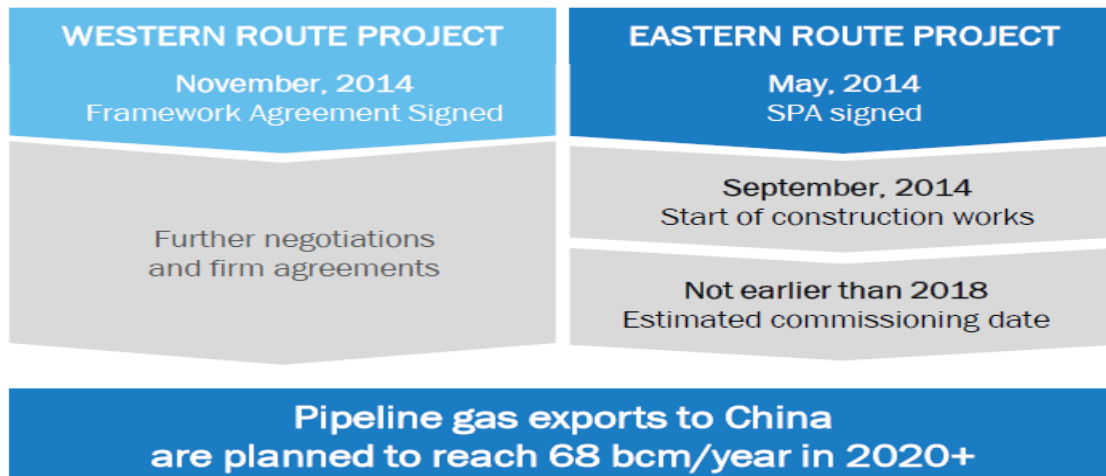
⁵⁵ Natasha Doff, "Gazprombank Bonds Plunge Toward Distressed Levels Amid Sanctions," *BloombergBusiness*, December 5, 2014. <http://www.bloomberg.com/news/articles/2014-12-05/gazprombank-bonds-near-distress-as-sanctions-hurt-russia-lenders>

⁵⁶ Arshad Mohammed and Bill Trott, "U.S. intensifies sanctions on Russia over Ukraine," *Reuters*, September 12, 2014. <http://www.reuters.com/article/2014/09/12/us-ukraine-crisis-usa-sanctions-idUSKBN0H71N320140912>

⁵⁷ Doff, "Gazprombank Bonds Plunge Toward Distressed Levels Amid Sanctions."

Impact of the Sanctions

While it is difficult to ascertain the isolated impact of the sanctions on Gazprom since they were introduced, it is reasonable to conclude that the company has entered more difficult times. Matthew Rojansky, director of the Wilson Center's Kennan Institute for Russian studies, states in a New York Time's articles that, "The biggest problem for Gazprom is its weakness across the board."⁵⁸ He goes on to say, "The difference between Gazprom today and Gazprom five years ago is its ability to think in terms of poker, to simply intimidate other people off the table with sheer resources, is gone."⁵⁹ With more competition also entering the market, the company is facing more and more debt with fewer options for financing due to the restrictions. A \$6 billion dollar debt owed by Gazprom this year has proven to be problematic.⁶⁰ The limitations on Gazprombank has forced the company to be able to only seek short-term loans in the market.⁶¹ Alongside Europe becoming increasingly independent on Russian energy and a crumbling Russian economy, inability to re-finance bonds and loans has proven to be a major roadblock in the development and growth of Gazprom.⁶² Beyond re-financing complications, the company also faces the risk of failing to adapt and grow in terms of its ventures. The restrictions placed on technology allowing Gazprom to explore and produce in the Arctic, deep waters, and shale fields present a shackle to expansion, an area the company had



been aiming to pursue as the sanctions were issued.⁶³ The company had been hoping to following in the footsteps of other Russian energy companies, including Rosneft that had signed oil exploration agreements with company such as Exxon and BP which are now

⁵⁸ Kramer, "Gazprom Faces Effects of Politics on Its Bottom Line,"

⁵⁹ Kramer, "Gazprom Faces Effects of Politics on Its Bottom Line."

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² John Ficenec, "MH17: Russian companies face \$112bn wall of debt," *The Telegraph*, July 23, 2014. <http://www.telegraph.co.uk/finance/globalbusiness/10986772/MH17-Russian-companies-face-112bn-wall-of-debt.html>

⁶³ Mohammed and Trott, "U.S. intensifies sanctions on Russia over Ukraine."



uncertain under the sanctions.⁶⁴ Without such technologies, it will be increasingly difficult to obtain greater productions and assets, which will ultimately compound the debt issue currently facing Gazprom.

Alternative Being Explored

Gazprom's largest market outside of Russia is continental Europe. In 2013, the company supplied 30% of Europe's gas, the most ever in company history.⁶⁶ More importantly, the European market provides Gazprom with more than half of its revenue.⁶⁷ With major countries within this market introducing sanctions on the company, there is a clear risk to being over reliant on a single consumer base. As such, Gazprom has begun to explore new markets in other parts of the world, specifically Asia.

Gazprom has been seeking to enter the Chinese market through the construction of a pipeline through Siberia.⁶⁸ The estimated cost of the project is said to be between \$40 – 65 billion.⁶⁹ In a presentation on Investor Day 2015 in Hong Kong, Gazprom announced the finalization of a long term SPA with SNPC for supplying natural gas to China.⁷⁰ The presentation outlined a general timeline stating the beginning of construction in September of 2014 and an estimated commissioning date of no earlier than 2018; the ultimate goal is to reach 68 bcm/year of gas exported to China by 2020.⁷¹ Gazprom further stressed the aim to expand LNG deliveries to Asia, with the hope of becoming a key player in the Asian market.⁷² However, the success of the venture is uncertain. China is already importing cheap gas from Turkmenistan and its large deposits of shale gas means the probability of the country becoming near self-sufficient by the time the pipeline is complete is a possibility.⁷³ Despite this possibility, Gazprom still view the Chinese market as an important step in future ventures. The Siberian pipeline marks the beginning of closer ties with the world's second largest economy. With the United States leading the way in placing economic sanctions and restricting Gazprom's access to important capital, a positive relationship with China can provide an alternative source for the company's financial needs.

⁶⁴ Ibid.

⁶⁵ Alexander Medvedev, "Gazprom Investor Day: Export," (presentation, Investor Day 2015, Hong Kong, February 3, 2009).

⁶⁶ Isabel Gorst, "European Commission accuses Russia's Gazprom of unfair practices," *LA Times*, April 22, 2015. <http://www.latimes.com/world/europe/la-fg-russia-gazprom-european-union-competition-20150422-story.html>

⁶⁷ "Europe," 2014-2015, <http://www.gazprom.com/about/marketing/europe/>

⁶⁸ Leon Aron, "The political economy of Russian oil and gas," *American Enterprise Institute*, May 29, 2013. <http://www.aei.org/publication/the-political-economy-of-russian-oil-and-gas/>

⁶⁹ Ibid.

⁷⁰ Medvedev, "Gazprom Investor Day: Export."

⁷¹ Ibid.

⁷² Ibid.

⁷³ Aron, "The political economy of Russian oil and gas."



Conclusion

Since the crisis in Ukraine, sanctions have been placed on Russian banks and energy companies including Gazprom and its subsidiaries Gazprom Neft and Gazprombank. These new restrictions have limited the ability of the company to operate on top of their diminishing revenues. With the company's substantial debt, lack of access to western capital prevents them from refinancing through long term loans and bonds, and it has forced the company to seek alternative markets. Compounding the problem are the bans placed on technology enabling Gazprom to explore and produce in new territories. Although these problems can be alleviated if the sanctions placed by the European Union and the United States are lifted, the current ordeal sheds light on the need for Gazprom to seek alternative routes to continue to turn a profit. Gazprom has already taken positive steps in sealing a mega deal with China to build a pipeline and becoming a major natural gas supplier to the latter. Expanding ventures into areas outside of Europe can alleviate the company's over reliance on the European market, as well as open doors to new avenues of capital, helping to mitigate the impact of Western sanctions to a degree.

Questions to consider

1. Should Gazprom veer away from its long-term commitment to oil as its principle asset or build upon its experience in oil exploration and production?
2. Do new alternatives repudiate Gazprom's uncompromising role in subsidizing fuel to its domestic market at below market-level prices?
3. What are the roles of the rivals, such as those from Gulf States, in Gazprom's efforts to enter new markets?
4. Given the limited access to crucial key technologies, can Gazprom move forward in building a long term solution without a short term cushion?
5. Where can Gazprom look to for new sources of capital?



Topic 3: Russian Countermeasures

Introduction

The twenty-first century marked a substantial change in the future of Russian gas supply and demand. Gazprom now holds an important role in world energy and is a major corporate player. However, Russia's national oil company is now facing an immense struggle for power. With ruble/fuel prices collapsing and Western Europe starting to move away from Russian gas, Gazprom must now look for ways to combat these damaging effects.

Russian Countermeasures Overview

Russia holds a dominant position as a supplier of natural gas and also acts as a middleman in gas exports to Europe from post-Soviet Central Asia. The EU countries most reliant on Gazprom for gas can be seen in the following graph. However, one of Gazprom's biggest issues at this moment is the conflict in Ukraine. Gazprom saw its profits fall 86% from last year, with the net income plummeting to 159 billion rubles (\$3 billion) from 1.1 trillion rubles (\$20 billion)⁷⁴. Oil fell from \$100 a barrel last summer to \$50 in just six months.⁷⁵ But however another attack from the EU was unfair pricing. As seen to in graph to the left⁷⁶, Macedonia pays more than three times as much as Belarus for each thousand cubic meters of natural gas. The EU has found that Gazprom "significantly hindered competition in central and eastern European gas markets".⁷⁷ With Russia abusing its dominant market position in Europe, retaliation from the EU and other countries seems inevitable.

The United States of America

Petro politics have been a part of a large war between the US and Russia. As for Russia, the energy sector comprises up of "more than 10 percent of Russia's GDP and provided about 40 percent of its earnings to the federal budget (Gazprom 2009s)".⁷⁸ The mentality of the cold war has actually never died. In the eyes of Russia, the United States never put down their arms and continued their fight. As if the dissolution of the Soviet

⁷⁴Ivana Kottasova. "Russia's Gazprom Sees Profits Collapse on Low Oil and Weak Ruble." CNNMoney. April 29, 2015. Accessed June 14, 2015. <http://money.cnn.com/2015/04/29/news/companies/gazprom-oil-results/>.

⁷⁵

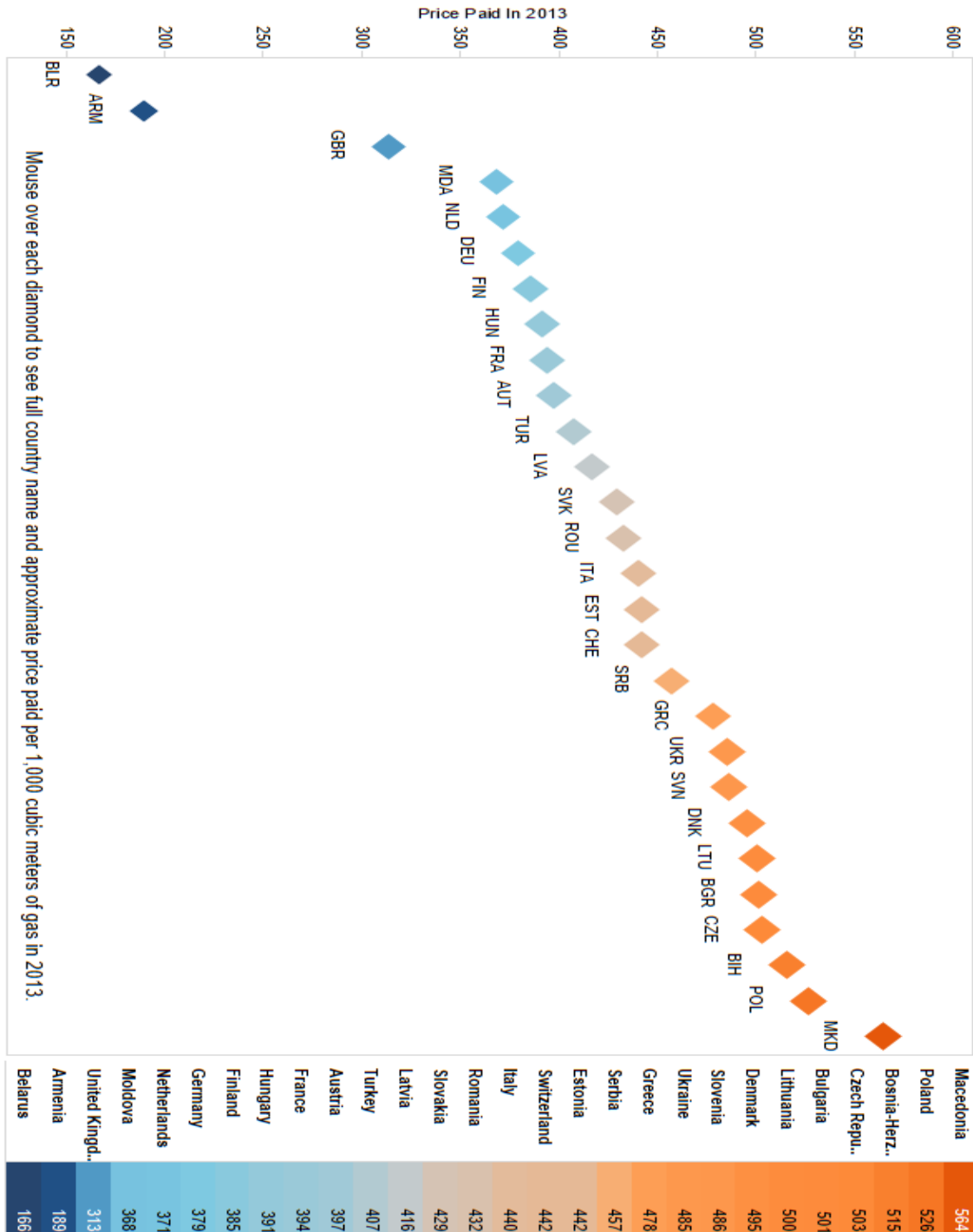
⁷⁶ Li Luo. "Gazprom's Grip: Russia's Leverage Over Europe." RadioFreeEurope/RadioLiberty. Accessed June 14, 2015. <http://www.rferl.org/content/infographics/gazprom-russia-gas-leverage-europe/25441983.html>.

⁷⁷ France-Presse, Agence. "EU Fires Warning Shot at Gazprom with Market Abuse Charge." Theguardian.com. April 22, 2015. Accessed June 14, 2015.

⁷⁸ David R. Hults, Mark C. Thurber, and David G. Victor. *Oil and Governance: State-owned Enterprises and the World Energy Supply*. Cambridge, UK: Cambridge University Press, 2012

Gazprom

Figure 1. Major Consumers of Gas in 2013



Union wasn't enough, they believe the US wants to convert Russia to their customs and beliefs.⁷⁹ The US Secretary of the Treasury Daniel Glaser even admitted that "the objectives of the US economic sanctions strategy against the Russian Federation was not only to damage the trade ties and business between Russia and the EU, but to also bring about economic instability in Russia and to create currency instability and inflation."⁸⁰ This means that the US government was targeting the Russian ruble for devaluation and for the economy for inflation. According to the Kremlin, they understand what the US is trying to do as they are attempting "to manipulate the Kremlin into spending Russian resources and fiscal reserves to fight the inflation that of the Russian ruble that Washington has engineered."⁸¹ However, what Russia is trying to do is to "strategically invest in Russia's human capital"⁸². Therefore, the wages of teachers in schools, cultural institution employees, doctors, paramedics and nurses have all been raised. These are all the most important sectors for developing Russia's human capital and capacity.

The European Union

The Russian economy is highly dependent on the international oil and gas markets. As mentioned previously, the EU is trying to move away from their reliance on



gas delivered to Western Europe was about three times more higher than the gas price sold to the Former Soviet Union (FSU)⁸³. Russia needs to fix the above problems in order to gain trust with the EU. As seen on the graph on the following page, is the reliance of EU countries towards Gazprom.

⁷⁹ Mahdi Darius Nazemroaya. "From Energy War to Currency War: America's Attack on the Russian Ruble." Global Research. December 26, 2014. Accessed June 14, 2015. <http://www.globalresearch.ca/from-energy-war-to-currency-war-americas-attack-on-the-russian-ruble/5421554>.

⁸⁰ Ibid.

⁸¹ Ibid.

⁸² Ibid.

⁸³ David R. Hulst, Mark C. Thurber, and David G. Victor. Oil and Governance: State-owned Enterprises and the World Energy Supply. Cambridge, UK: Cambridge University Press, 2012.

However, Russia has chosen to counteract this situation by threatening to “turn off the taps in retaliation: in parts of southeastern Europe, the dependence on Gazprom is almost 100 per cent.”⁸⁴ As well, in an attempt to combat the decrease in the Ruble, Gazprom has set their attention to the low gas prices they are forced to set on the domestic market⁸⁵. Another issue is that Norway, which as of the end of May overtook Russia as Western Europe’s top gas supplier.⁸⁶ The sharp drop in oil prices has allowed Norway to offer more flexible pricing. Adding onto Gazprom’s stress, Ukraine has been seeking to use more reverse flow supply from the EU and consume less Russian gas. In general, the European Union has been trying to reduce its dependence on Russian imports and is rather looking to buy from Norway and other gas producers. However, Greece’s current economic condition makes it vulnerable to eastern influence. Although Greece claims that it belongs to the west, due to their bankruptcy, the Kremlin is willing to lend money to them.⁸⁷ Greece will continue to play a key role in the growing tension between the East and West, but however with having Russia as a creditor, their future on either side of the conflict is almost unsure.

The People’s Republic of China

As Russia and China are looking forward to move away from the Western influence, they hope to move away from the US dollar currency. Last year in late June, Gazprom’s CFO announced that they were allowed to settle Chinese contracts in Yuan or Rubles.⁸⁸ By moving away from a US Dollar reserve currency, the two nations are attempting to move towards a petrodollar free world thereby meaning a more western free world. Such an effort is attractive to other countries looking to decrease dependency on the West. After the Sino-Russian mega natural gas deal, this move was to establish a “long-term Russian strategy that seeks an increase in trade and ties with East Asia.”⁸⁹ By expanding to China, payment conditions for industrial users in Russia will likely relax (presuming that this will stimulate domestic demand).⁹⁰

⁸⁴ Alex Barker, Christian Oliver, and Jack Farchy. "Gazprom: Keeping the Taps Open - FT.com." Financial Times. March 15, 2015. Accessed June 14, 2015. <http://www.ft.com/cms/s/0/b57ef62e-c979-11e4-a2d9-00144feab7de.html>.

⁸⁵ "Russia's Gazprom Wants to Raise Domestic Gas Prices as Ruble Plunge Hits Margins | Business." The Moscow Times. December 11, 2014. Accessed June 14, 2015. <http://www.themoscowtimes.com/business/article/russias-gazprom-wants-to-raise-domestic-gas-prices-as-ruble-plunge-hits-margins/513181.html>.

⁸⁶ Barbara Lewis, and Nerijus Adomaitis. "Norway Overtakes Russia as Western Europe's Top Gas Supplier." Reuters. May 22, 2015. Accessed June 14, 2015. <http://www.reuters.com/article/2015/05/22/eu-gas-russia-idUSL5N0YD3FQ20150522>.

⁸⁷ Sam Garin. "Gazprom and the Grexit: A Growing Headache for Europe - Harvard Political Review." Harvard Political Review. April 16, 2015. Accessed June 14, 2015. <http://harvardpolitics.com/world/gazprom-grexit-growing-headache-europe/>.

⁸⁸ Tyler Durden. "The Nail In The Petrodollar Coffin: Gazprom Begins Accepting Payment For Oil In Ruble, Yuan." The Nail In The Petrodollar Coffin: Gazprom Begins Accepting Payment For Oil In Ruble, Yuan. August 27, 2014. Accessed June 14, 2015. <http://www.zerohedge.com/news/2014-08-27/gazprom-begins-accepting-payment-oil-ruble-yuan>.

⁸⁹ Mahdi Darius Nazemroaya. "From Energy War to Currency War: America's Attack on the Russian Ruble." Global Research. December 26, 2014. Accessed June 14, 2015. <http://www.globalresearch.ca/from-energy-war-to-currency-war-americas-attack-on-the-russian-ruble/5421554>.

⁹⁰ David R. Hults, Mark C. Thurber, and David G. Victor. Oil and Governance: State-owned Enterprises and the World Energy Supply. Cambridge, UK: Cambridge University Press, 2012.



Conclusion

Ultimately, Gazprom is hoping to “increase its stock price and market capitalization, which, in turn, could allow the company to raise funds for new capital projects.”⁹¹ But despite these numerous obstacles, Gazprom would have to do anything possible to be able to get through them in order to ensure continuous and stable growth. In the end, Russia’s fundamental goal is to diminish Western influence by tackling the financial world.

Questions to consider

1. Should Gazprom continue to surrender their demands for EU customers?
2. What are the possible future outcomes from Russia’s conflict with Ukraine?
3. Is it possible for Russia to gain trust with the EU?
4. How powerful is Russia’s leverage over Western Europe after Finland becoming a new contender?
5. Can Russia sustain a permanent or temporary business relationship with China, as they both attempt to move away from Western influence?

⁹¹ Ibid.



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