

Gazprom

Gazprom

An Energy Giant and Its Challenges in Europe

Edited by

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*To my wife, Mariana, my daughter, Goya,
and my son, Dante*

A.V.

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Preface and Acknowledgments

It is no exaggeration to say that the Russian gas monopoly, Gazprom, is one of the symbols of Russia as a nation with huge energy resources. Unfortunately, this company has become world famous largely as a result of a steady flow of critical articles and commentaries in the mass media on its activities. In the early years of this century, journalists often portrayed Gazprom as an energy monster stretching out its long tentacles to energy assets and markets in European countries. Now they write about “the wounded giant,” but the general attitude toward Gazprom has not improved. This attitude reflects traditionally negative views in the West of Russian foreign policy, for which Gazprom has often served as an instrument. Increasingly, such negative images are symptomatic of serious problems in national energy policies, in energy trade, and in international energy security. These problems have become especially acute in the case of gas trade between Europe and Russia. The parties often comport themselves like fierce opponents in hot energy disputes rather than as rational participants in a sensible and necessary energy dialogue. Gazprom has often been a lightning rod for these disputes.

The goal of this book is to shed light on the nature of conflicting interests in Europe’s and Russia’s energy relations; to explain the motivation behind Gazprom’s policies, strategies, and tactics; and to examine the challenges the company has been facing in the European gas markets and at home. Understanding the interests and motives of the parties is a precondition for resolving conflicts and improving international energy relations. Here readers will learn how Gazprom has to adapt to rapidly changing market structures and to the new regulatory environment emerging from the ongoing gas market reforms in Europe. A sure grasp of these issues is needed by those who seek a path to reform the Russian gas giant so as to ensure its survival in the competitive market and its evolution from a state monopoly to an efficient, market-oriented commercial entity well suited to process and distribute Russia’s gas riches domestically and internationally.

A benevolent political will is crucial for choosing such a path. This volume emphasizes the role of politics in Russia’s gas trade and in strategic and investment decision-making in Russian gas production. We base our analysis on a broad view that goes beyond the scope of a textbook on energy economics that typically merely covers efficient extraction paths

and regimes of rational usage of energy resources. One has to admit that this area of research—international energy relations—if it has any practical meaning, cannot be isolated from the study of political issues that often play a decisive role in the energy sector's development.

The idea of publishing a comprehensive work on Gazprom originated many years ago, with my personal experience of dealing and working with this company. First, as the first deputy finance minister of Russia in the 1990s, I had to deal with the company in the course of Russia's market transition. Gazprom was (and still is) the main revenue source for Russia's budget, and the centrality of its fiscal contributions sometimes led to hard negotiations with its top officials. Later, for a short period soon after the Russian public debt default in 1998, I worked as a top manager in Gazprom. In this role, I was engaged in financial engineering to arrange management of Gazprom's assets and liabilities, something the company badly needed in the situation of overall financial collapse. In fulfilling that charge, I obtained additional evidence of bureaucratic routines, non-transparency, and rigidity that are typical of the management of a giant state-owned company. The persistence of Soviet bureaucratic traditions in Gazprom's corporate governance was at that time the main obstacle to its reformation. Surprising to me was the way the company's activities combined managerial inefficiency with a strong push toward expansion.

The research on Gazprom presented in this book was stimulated by my collaboration with the Economics Department of Pennsylvania State University as a visiting professor, lecturing on energy economics. I also had the opportunity to collaborate with American colleagues at the Center for Research in Financial and Energy Security (CRIFES) established by Penn State's Economics Department together with the Moscow Institute for Financial Studies in 2008. Our joint research profited greatly from fruitful workshops and seminars where we discussed financial mechanisms for managing risk in the context of investing in the energy sector. Initially these studies were based on formal theoretical models—which, however, ignored important practical aspects intrinsic to this sector. For instance, the models could not capture the anomalies in managerial practices and political factors, which are essential factors in the case of Gazprom. That is why I suggested conducting a case study of Gazprom. It resulted in the material presented in this volume.

My colleagues and I share a firm belief in the practical relevance of this study. Previous studies of Gazprom include basically analytical and working papers, and also numerous newspaper articles and commentaries. An earlier, fundamental contribution to this research was provided by Jonathan Stern's 2005 monograph, *The Future of Russian*

Gas and Gazprom, which offered a comprehensive picture of the Russian gas industry and detailed analysis of many important technical issues. *Gazprom: An Energy Giant and Its Challenges in Europe* devotes more attention to political and historical background. History comes into play for a subject of research with a dynamic nature. Changes in the gas industry occur very rapidly, and even a couple of years after the publication of a monograph on this subject may be quite a long time period. There is a risk that any volume on Gazprom will become obsolete very soon after its publication. This is just an unavoidable risk that comes with the territory.

This volume is primarily intended for specialists in the fields of international energy relations and energy economics, political science, and the economic history of Russia, the former Soviet countries, and the European Union. It may also be of value to a wide audience interested in the activities of Gazprom and other state-owned companies, in perspectives on the development of the Russian energy sector, and in the issues of energy security, gas-market reforms, and energy policies in Russia, the EU, Ukraine, Turkey, and other related countries. For students of economics and political science at the undergraduate level, the book will augment and complement the core materials in their courses on energy economics and geopolitics.

It is a pleasure for me and my coauthors, who are the researchers associated with the Institute for Financial Studies in Moscow, to thank the many individuals who have helped us in our work on this book. We are very grateful to Barry Ickes, the director of CRIFES, for providing good ideas on Gazprom as well as for providing organizational support, and to Clifford Gaddy, a CRIFES scientific advisor and senior fellow at the Brookings Institution, for helpful ideas and advice. We greatly appreciate the many fruitful discussions with Alexey Pomansky and his assistance in the effective organization of our work. We also thank Mikhail Alexeev, Richard Ericson, and Anastasia Shcherbakova for careful reading of the first draft and for the many critical comments and suggestions. We are glad to thank the participants of the workshop on Gazprom, held at Penn State in May 2012, where we presented the first version of the manuscript. Special thanks to Katherine Scott for thorough and highly professional editing of the manuscript that resulted in great improvement of the English and contributed to the clarity and readability of the text. We are sincerely grateful to Katherine for her numerous remarks and queries on substantive issues, which stimulated our intensive work in the manuscript's final stages.

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Andrey Vavilov joined the Russian Ministry of Finance in 1992 and resigned in 1997 as a First Deputy Minister of Finance. From 2002 to 2010, he served as a member of the Council of the Russian Federation. He is a visiting senior scholar at Penn State University and a

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