Anti-Russia economic sanctions’2014: consequences for Russian TEK & its participants

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Presentation at the Energy Committee meeting of the Association of European Businesses in Russia, Moscow, 28 November 2014

Chez Freeman on sanctions

- “Sanctions always serves as the first resort for political buffoons. Sanctions turn out to be useless…
- Sanctions, of course, is convenient mean for politicians to show their indignation, to create a vision of some actions & to escape talks on their personal responsibility for what has happened. This impose costs, incurred by incompetent foreign policy, on enterprises, companies, workers & consumers both in the state, which introduce sanctions, and in the state, against which they are imposed.
- In current global economy most of sanctions can be by-passed. Free departure of a country from profitable foreign market opens new possibilities for businesses of another state. Thus, sanctions are destructive, though politically predictable, respond to unwelcome events”.

(Chez Freeman is President of Council of Middle East Policy (Wash. DC), worked in US State Dep’t & Pentagon, etc. Source: Чез Фримен. «Мир непредвиденных сложностей». – «Россия в глобальной политике», том 12, №3, май-июнь 2014, с.35 (translated back to English)

Sanctions: principle & history

- **Milosh Zeman**, President Checz Republic: "**Sanctions are a loss-loss strategy**" (interview to RUS 1TV channel, "Results of the week" programme, 16.11.2014)
- [Only?] ***one*** positive example of sanctions – US against its allies (UK, France & Israel) in 1956 Suez crisis:
  - When three powers concerted to invade Egypt in response to its nationalization of Suez Chanel, US President D.Eisenhower not only warned them to retreat, but he began a massive sell-off of British pounds and embargoed U.S. oil shipments to the three nations. For one of the few times in history, sanctions stopped a military invasion in its tracks.
- Reigan's sanctions on USSR against its 1979 invasion into Afghanistan => USSR-EU "gas-to-pipe deal" (US lost, EU won) => EU as energy & financial alternative to US banking & supplies of pipes & equipment (compressors, etc.):
  - Finance: Deutsche Bank
  - Manufacturing: Mannesmann, Nuovo Pignone, etc.

Evolution of anti-Russia sanctions 2014

- From *as if* "anti-Putin" personified sanctions (1st stage) to sanctions against key industries (3rd stage),
- With double negative effect of traditional link "finance & technology", the aim is:
  - Innovative high-tech branches of O&G sector: O&G as key budgetary donor => to prevent substitution of oil production decline with new green-fields
  - Financial sector: the "blood system" of economy => to prevent raising finance for CAPEX into key industries

Sanctions light (1st level): as if "anti-Putin"

USA	EU	Consequences for O&G
04.03.-17.03: Travel bans for some individuals (to be considered as part of "inner Putin's circle") . Investment & military cooperation with Russia is cancelled.	17 .03.-25.03: Travel bans for some individuals (to be considered as part of "inner Putin's circle"). Suspension of talks regarding to military matters, space, investment, and visa requirements	These sanctions has a preventive (warning) character. No serious business damage/effect (*but*: OPAL decision postponed on 10.03 as if due to "technical reasons" can be already considered as sanctions of 3rd level = "trade war").

Expansion of sanctions' list (2nd level)

USA	EU	Consequences for O&G
20.03.-21.06: Further travel bans for some Russian officials & businessmen (incl. I.Sechin), freeze of their assets, ban on business transactions of 17 Russian companies. Cancellation of supplies of dual purposes products.	28.04.-26.07: Further travel bans for some Russian officials.	Pressure on the sector increases, reputational costs began to appear since high management representatives included in sanctions lists (like Rosneft President)

EU: "Sanctions are not punitive, but designed to bring about a change in policy or activity by the target country, entities or individuals. Measures are therefore always targeted at such policies or activities, the means to conduct them and those responsible for them. At the same time, the EU makes every effort to minimize adverse consequences for the civilian population or for legitimate activities" ("EU restrictive measures". Council of the European Union. 29 April 2014)

Sectorial sanctions: USA (3rd level)

- 16.07-12.09: imposed sanctions against specific Russian economic sectors:
- Energy (technologies):
  - Prohibition of supply to Russia of high-tech equipment for oil production in the Arctic, deep offshore (exceeding 152 meters water depth), shale oil development, like: drilling platforms, equipment for horizontal drilling, subsea & Arctic equipment, software for hydraulic fracturing, remote operated subsea vehicles, high-pressure pumps
  - Covers Gazprom, Lukoil, Transneft, Gazprom neft, SNG, Novatek, Rosneft. Measures aimed to prevent supplies of such technologies & equipment even through intermediaries
  - Sanction on oil companies seek to ban co-operation with Russian oil firms on energy technology and services by international majors
- Energy (finance):
  - extention of transactions ban first to two major Russian energy firms, Rosneft & Novatek, for loans/placements at US debt market with maturity above 90 days; then the same ban for Gazprom neft & Transneft. Then tightening loans/placement conditions for Novaten & Rosneft – US citizens & companies are forbidden to provide loans to these companies and/or to buy their bonds with maturity above 30 days ,
- Banking:
  - extention of transactions ban first to Gazprombank & Vnesheconombank, then to Sberbank (to limit ability to access US debt markets)
- Defense:
  - Major arms maker Rostech (to limit ability to access US debt markets)

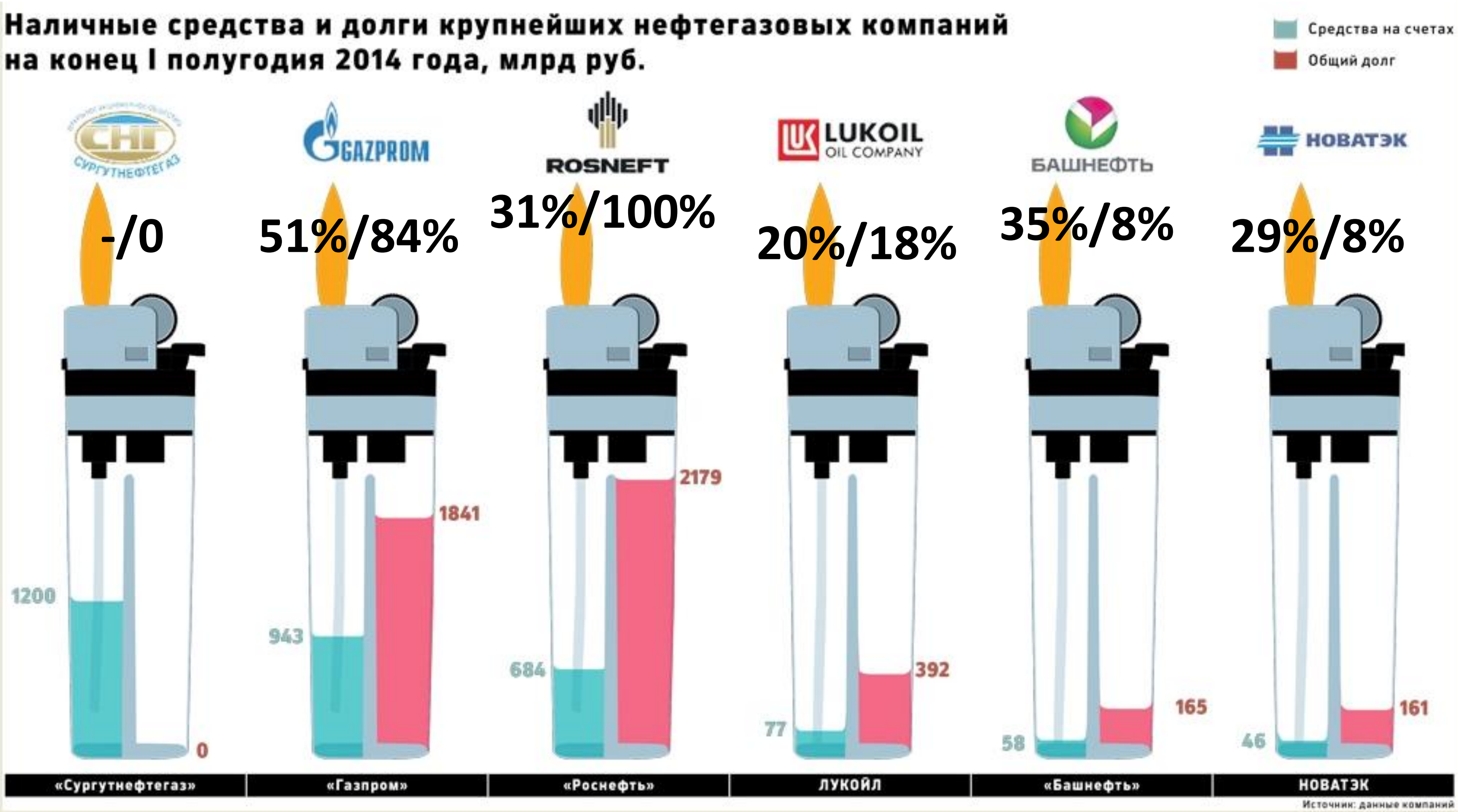
Sectorial sanctions: EU (3rd level)

- 30.07-12.09: Imposed sanctions against certain sectors of Russia's economy, incl.:
  - Financial sector:
    - all majority government-owned Russian banks,
    - ban on debt financing for three Russian energy companies: Rosneft, Transneft, Gazprom neft. Trade in their bonds with maturity over 30 days is prohibited as well as their issue.
  - Energy:
    - prohibition of supply to Russia of high-tech equipment for oil production in the Arctic, deep offshore, shale oil
  - Defense:
    - prohibition of exports of dual purposes & military goods
  - Sanctions on additional individuals & entities designated under EU *asset freezing* provisions
  - Sanctions did *not* cover natural gas production.

Sectorial sanctions: consequences for O&G (3^{rd} level)

- It is this stage of sanctions which is the most serious since it covers most important instruments for O&G development in severe (to become "normal, standard") wild nature environment, incl. Arctic offshore: debt (project) financing & advanced E&P technologies.
- Ban on debt (project) financing prevents to service existing debt of major O&G companies & to finance new Greenfields development.
  - Most frequent Q: How to compensate lost access to traditional financial markets?
  - Most frequent draft A: Anglo-Saxon for China/Asian financial markets. Are they adequate?
- It is considered that Russian companies lack adequate technologies for offshore development which do possess US & EU companies, which either have already left Russian market due to sanctions and/or examine opportunities to stay in Russia but outside sanctions action zone and without being punished.
  - Most frequent Q: How to compensate lost access to technologies with established partners?
  - Most frequent draft A: Anglo-Saxon for China technologies? Are they adequate?

Available cash on the balance & overall debt of major Russian O&G companies (end-Q2/2014)



Note: Numerator = cash vs debt ratio (%), denominator = debt as %% of Rosneft debt - as indicators of absolute & comparative sensitivity for financial sanctions

Source (of original picture): Т.Дзядко. «Газпрому» санкции не помеха. – «РБК-daily», 15.10.2014, http://rbcdaily.ru/industry/562949992650092

Siluanov: Russia looses from sanctions $40 bln annually

- Russia's Minister of Finance A.Siluanov:
  - "Around $40 bln annually we looses from geopolitical sanctions. And about $90-100 bln annually we looses taking into account 30% drop in oil price".
  - "If geopolitics is taken into account, inflow of capital has diminished. Loans, investment resources… How much does it cost? About $40 bln annually".
  - "Capital outflow from Russia in 2014 will equal to $130 bln. Though most of capital outflow is due to conversion of the savings of the people and of economic agents from Rouble into foreign currency in the period of volatile Rouble exchange rate.

Source: http://www.msn.com/ru-ru/money/news/%d1%81%d0%b8%d0%bb%d1%83%d0%b0%d0%bd%d0%be%d0%b2-%d1%80%d0%be%d1%81%d1%81%d0%b8%d1%8f-%d1%82%d0%b5%d1%80%d1%8f%d0%b5%d1%82-%d0%b8%d0%b7-%d0%b7%d0%b0-%d1%81%d0%b0%d0%bd%d0%ba%d1%86%d0%b8%d0%b9-dollar40-%d0%bc%d0%bb%d1%80%d0%b4-%d0%b2-%d0%b3%d0%be%d0%b4/ar-BBfymVR?ocid=iehp

Sanctions on technical cooperation

- Today’s technologies:
  - Import existing Western technologies to develop shallow offshore in “mild” Arctic (cost reduction due to “learning curve” only)
  - Sanctions on (existing) transfer of technologies positive for environment
- Future technologies:
  - No technologies available worldwide for Arctic deep offshore today => joint Russia-Western development of new technologies postponed (cost reduction due to technological breakthroughs)
- Challenge: either “to speed up costly production + continue with inefficient use”, or “to slow down costly production + improve efficiency through all steps of energy value chain”?

Sanctions as a new choice/point of no return

- Choice: to overcome/bypass restrictions imposed by sanctions (based on existing vision/perceptions) ***OR*** new vision based on new assessments (matrix effect)
- Analogy: evolution of Russian attitude towards EU Third Energy Package (TEP):
  - Sept'2007/Sept'2009 onwards (dominant view): only as a risk/threat to existing contractual structure & pricing mechanism of Russian gas supplies to EU,
  - Alternative view (expanding, since early 2010): also new challenges & new opportunities for Russian gas supplies to EU within new EU gas market architecture, ***but only if***:
    - Contractual structures & pricing mechanisms adapted accordingly (RUS side),
    - TEP-based Regulation takes into consideration objective concerns of ALL players (not EU consumers only) within EU-destined gas value chains of "Broader Energy Europe" (EU side)

Sanctions as natural challenge for rethinking Russian energy strategy?

- From attempts to preserve by import substitution pre-sanctions volumes and growth rates of energy production
  - Q: What is the [affordable] price of import substitution within closed Anglo-Saxon capital markets & fiscal-oriented domestic investment climate?
- To more modest volumes & growth rates of energy production due to:
  - [Long-needed] shift to energy efficiency measures (these segments are not under sanctions => new areas for cooperation with EU companies, though different ones => EU is the global pioneer/leader in energy efficiency => FDI shift to energy efficiency)
  - from “Russia as Energy Super-Power” - to finding its competitive niche in global energy
  - From FDI in upstream (under sanctions, more costly) - to FDI in end-use & mid-stream (not under sanctions, less costly, not the same players)
  - Slowdown in volumes/growth rates of upstream => decrease in CAPEX demand => diminished demand for debt financing within restricted financial markets

Domino effects: sanctions vs Arctic offshore

- Anglo-Saxon financial markets have closed for Russian players => to substitute these markets - with the aim to stay with existing investment plans - by (volumes/costs/possibilities):
  - China/Asian financial markets?
  - BRICS Development Bank, etc.?
  - RUS Sovereign & other Funds (National Welfare Fund)?
- Prospects of Russian Arctic offshore development:
  - 51% state owned companies only (Rosneft & Gazprom), 80% prospective areas already licensed to them, obligations under licensing agreements, strong environmental concerns
- Q: Whether under current financial & technological sanctions Rosneft & Gazprom can stay with 51% stake in timely implementation of existing licensing agreements?
  - If implementation postponed (to stay with 51%): more safe for environment, new (though at later stage) opportunities for EU business?
  - If implementation not postponed:
    - To change the law "On Continental shelf" (from 51% to 25%+1)?
    - To return undeveloped licensed areas to State => new licensing rounds => who win? New opportunities?
- Sanctions as the trigger for reassessment of particularities of Russian Arctic offshore policy ?
  - analogy: US shale gas revolution role for EU oversupply & thus for the need for Gazprom to adapt its contractual & pricing policy in EU

Some Worldwide Central Bank Rates

- Anglo-Saxon & related:
  - Eurozone: **0.05%** (Key Interest Rate, 04.09.2014)
  - United Kingdom: **0.50%** (Bank Rate, 05.03.2009)
  - USA: **0-0.25%** (Funds Rate, 16.12.2008)
  - Switzerland: **0-0.25%** (SNB-Target Range, 03.08.2011)
- Asia (except China):
  - Japan: **0-0.10%** (Call Rate, 05.10.2010)
  - South Korea: **2.0%** (Base Rate, 15.10.2014)
  - Hong Kong: **0.50%** (Base Rate, 17.12.2008)
- BRICS:
  - Brazil: **11.25%** (Selic rate, 29.10.2014)
  - Russia: **9.5%** (Key Rate, 31.10.2014)
  - India: **8.0%** (Policy Repo Rate, 28.01.2014)
  - China: **6.0%** (Lending Rate, 05.07.2012)
  - South Africa: **5.75%** (Repurchase Rate, 17.07.2014)

Much costlier in comparative values

Source: http://www.cbrates.com/ (as of 09 Nov 2014)

Anti-Russian or anti-EU sanctions?(1)

- Who is the real aim of the sanctions?
  - **Cold:** "…the actions and policies of the Government of the Russian Federation, including its purported annexation of Crimea and its use of force in Ukraine, continue to undermine democratic processes and institutions in Ukraine; threaten its peace, security, stability, sovereignty, and territorial integrity; and contribute to the misappropriation of its assets, and thereby constitute an unusual and extraordinary threat to the national security and foreign policy of the United States." (*US President Executive Order "Blocking Property of Additional Persons Contributing to the Situation in Ukraine", March 20, 2014; http://www.whitehouse.gov/the-press-office/2014/03/20/executive-order-blocking-property-additional-persons-contributing-situat)*
  - **Warm:** "…artificially constructed crisis which was aimed to prevent Russia and EU to become closer to each other & to create another competitive center in Eurasia (from Lisbon to Vladivostok) => threat to US hegemony/unipolar world" (*O.Noreng, FEEM, 21.11.2014 https://www.youtube.com/playlist?list=PLvQAHMYcNTwecmWuB5Xz2i_ONqLWB9Sfj)*

Anti-Russian or anti-EU sanctions?(2)

- Who is the real aim of the sanctions?
  - **Hot** (?): "artificially constructed crisis" which was used by US to impose Euro-Atlantic (Anglo-Saxon) sanctions on Russia using Ukraine's claims on Russia as if a visible purpose, but factually aimed at EU:
    - EU as real economic target ("To kill a competitor". Nothing personal. Only business)
    - To ease economic recovery for US in a more difficult & competitive global environment :
      - Russia is not a competitor for US (yet)
      - In the past: 3 global competitors = US, EU (6/9/12/15), Japan
      - Now: 3+ global competitors = US, EU (25/28), Japan + China, SEA…
    - Two ways to ease own recovery for US:
      - To improve its own competitive advantages within more tight competitive environment
      - "To kill a competitor" (EU as the weakest link)=> to link together Russia & EU by costly sanctions for both, plus additional costs on EU to deviate from Russian gas => to create competitive disadvantages for EU in global competition

Conclusions

- To concentrate joint efforts of Russian and EU businesses aimed at lifting anti-Russian EU sanctions (to result in win-win situation for Russia & EU) rather than to continue with/under the sanctions and:
  – For EU businesses: to loose Russian market & face more difficulties (competitive disadvantages) in global competition
  – For Russian business: to search for (costlier) by-passes of anti-Russian financial & technological sanctions

Thank you for your attention!

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