

# ***STRATEGIC ANALYSIS OF COMPETITION AMONG RUSSIAN GAS PRODUCING COMPANIES: IMPLICATIONS FOR DOMESTIC AND INTERNATIONAL GAS MARKETS***

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## **Overview**

Competition landscape in the Russian natural gas industry is dramatically changing. Two large independent producers – Novatek and Rosneft appeared in the domestic market, while the state-owned monopoly company - Gazprom lost almost half of it. With high prices in the European market, Gazprom paid little attention to shrinking domestic share, stayed more focused on risks of Third Energy Package (TEP) that came into force in 2011 to strategically diversify gas import. The situation changed after 2014 with oil price meltdown triggered lagging oil-linked long-term (LT) gas export contracts. The emergence of shale producers resulted in new competing LNG export projects in the USA and set the basis for arbitrage in regional gas markets.

Losing competitiveness in both traditional markets, Gazprom renewed its interest in domestic gas market reforms towards price deregulation. In 2016 the Federal Antimonopoly Service of Russia (FAS) proposed first stage liberalization of the local market, declaring the increasing competition and consumer surplus as the primary goals. Gazprom in its turn actively supported this initiative and increases traded volumes on a captive gas exchange - SPIMEX establishing a new pricing benchmark. At the same time, efforts to repeal the price floor in three key Russian regions showing an intense clash of interests in the multi-stage game for higher profits.

The natural gas pipeline system in Russia is inherited from the USSR and was built as one connected network from the main resource base of West Siberia, Nenets Autonomous Region, and Yamal to the prime European markets. Discussions about the reorganization of energy markets including the gas have started since the countries became independent, recognizing the inefficiency of the old system.

## **Methods**

Author's contribution to this article includes a comprehensive analysis of the FAS proposed reforms in the internal gas market declaring the competition enforcement as one of the prior goals of the reform. The position of the Gazprom and other producers was already investigated by (Lunden et al. 2013) using the qualitative descriptive method. However, since 2013, significant changes happened which again actualized this problem. Namely, two ways to enforce the competition in the domestic market were proposed: to abolish the lower regulated gas price for Gazprom and to develop the gas exchange so that its price could be used as a new benchmark instead of the regulated ones. The first reform proposed is analyzed by (Talipova 2018) using microeconomic modeling. The same qualitative descriptive method is used by (Henderson et al. 2018) to examine the current state and evolution of the Russian gas exchange. To the contrary, we discuss the metrics of gas exchange using econometric tools as VaR, in addition to counting the concentration index (HHI).

## **Results**

In this paper, two components of the proposed reform on deregulation of the domestic gas market in Russia, scheduled for July 1, 2019, were examined. The following results were drawn from the analysis:

1. Any reform of the deregulation of a monopoly, by granting a dominant company greater freedom to establish a price in the market, contradicts the theory of economics as such, when the market power of a monopoly is precisely regulated by price caps on the part of the state, and also can not have a positive effect in the conditions preservation of the company's monopoly structure;
2. The introduction of a stock price indicator as a market indicator of the formation of the latter cannot be considered useful either in the conditions of maintaining a monopoly position, since already on the stock exchange there is a situation where, in fact, the monopolist sells and buys himself. It is not yet possible to call this process exchange trading;
3. The proposed reforms give a serious advantage if they fully implement the FAS monopoly and create severe risks for independent producers. The proposed reform mechanisms allow the monopolist to set a low price both on the exchange and on the over-the-counter market. In an optimistic scenario, this will lead to a serious decline in

financial results, as shown in Part 2, if pessimistic - may lead to the replacement of independent producers so that it is more profitable for them to sell gas at the well.

To solve this problem, it is necessary to analyze the domestic gas market in Russia thoroughly, to understand its key influencing characteristics, and already on this basis to develop benchmarks.

4. Monopolist can easily manipulate the price in the gas exchange in the current regulation position which is identifiable by VAR model.

## **Conclusions**

In this article, we provide a quantitative assessment of proposed deregulation, gas pricing model and state of competition in the industry. We make an assumption the competition in Russian gas industry at the moment can be described by Bertrand–Edgeworth model in assessing the expected profit and losses for producers. Also, we qualitatively compare reforms of Russian and mature markets of the USA, the UK, and EU. This paper clarifies controversy over proposed measures to stimulate competition among gas producers in Russia and highlights risks for independent producers.

To solve these problems, it is necessary to analyze the domestic gas market in Russia thoroughly, to understand its key influencing characteristics, and already on this basis to develop benchmarks.