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Impact of Sanctions of European Union and Unites States of America on the Development of Russian Oil and Gaz Complex

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ABSTRACT

The present article analyzes the impact of the restrictive measures adopted by the European Union and the United States of America against Russian Federation. In particular, the item aims to analyze the sectoral sanctions in oil and gas industry. Sanctions in oil and gas sector are extended to the supply of equipment particularly to the technologies for development of the Arctic shelf. The article proposes and analyzes scenarios of Russian oil and gas complex in the conditions of restrictive measures from the part of Western countries. As for equipment authors offer two options: The importation of equipment through third countries or copying it from Western equipment. In the area of finance they offer attracting Asian credits and the use of the National Welfare Fund of Russian Federation.

Keywords: Oil, Gas, Sanctions, Arctic, Offshore
JEL Classification: F510

1. INTRODUCTION

Today's global political situation has led to an aggravation of the conflict in Ukraine. As a consequence the European Union (EU) and the United States adopted sanctions against Russian Federation.

It is interesting to notice that last decades Western sanctions have the pointed character. They are called "sectorial" sanctions. They do not affect the country in total but they touch a branch, company or even an individual person. Such change in the nature of the application of sanctions can be explained due to the fact that almost all countries are integrated now into the world of economic relations. The introduction of full vacuum around one country will lead to serious economic consequences for many partners.

Generally, the use of sanctions against third countries is provided by Common Foreign and Security Policy (CFSP) of the EU (CFSP of the EU, 2016; Consolidated version of Agreement about EU and Agreement about Functioning of EU, 2016) and International Emergency Economic Powers Act of the United States (United States Code Annotated, 2016).

Russian oil and gas revenues are the basis of its economic development and stability. They make up about 40% of the consolidated budget of the country. Restrictive measures of the US and EU affect the Russian oil and gas companies, which are largely focused on the oil sector. Moreover, exactly oil projects in deep Arctic shelf could be potentially developed by state companies (GAZPROM, ROSNEFT).

The choice of oil companies is due to the EU's heavy dependence on Russian gas.

The chronology of sanctions shows that the initiative comes from United States of America and then EU has to follow the same way.

The sanctions that restrict the development of projects on the Arctic shelf are divides in two branches: A ban on the supply of equipment and the prohibition of financial transactions.

2. SANCTIONS ON THE OIL AND GAS EQUIPMENT

Restrictions on the supply of equipment for the deep shelf and for the development of hard recoverable oil reserves were introduced in the summer of 2014.

It should be marked that the Russian Arctic shelf projects are unique in natural, climatic, technical conditions. They require the involvement not only in foreign capital but also in foreign technology.

In the Table 1 you can see the import of technologies in oil and gas as well as plans to reduce it in 2020.

In addition to that, global market of equipment for oil and gas is presented by a few companies (Figure 1).

Thus, EU sanctions against Russia restricted mainly state-owned oil company. These companies are going to develop hard recoverable oil reserves, including the Arctic shelf. According to the Russian legislation foreign companies do not have access to Russian Arctic oil and gas.

Sanctions affected Russian gas sector to a much lesser degree since European countries still largely depend on the export of Russian gas. On the Figure 2 we can see that the volume of Russian gas in the EU reached 30% in 2013 (European Market of Gazprom, 2016).

Sanctions limit access to financial resources for both branches: Oil and gas. As well as for equipment which is very often the same for this two branches.

There are two possibilities to provide equipment for Russian companies in terms of sanctions: To copy existing Western technologies or purchase equipment by the "gray schemes" through third countries (Tulupov, 2016).

The scheme with third countries had taken place in the history when the USSR bought icebreakers for Arctic research in Finland. The Finnish company purchased components from Norwegian producers. However, in modern conditions of open borders foreign producers cannot afford such risks. By the way, the sanctions require a ban sales of equipment if it is known that the end user will be from Russia.

Violators of sanctions will be prosecuted and fined. For example, the biggest oilfield service company Schlumberger after a 6-year investigation had to pay about $ 232.7 million for violating US sanctions against Iran and Sudan. Despite the US ban the company illegally carried out work for the oil companies of Iran and Sudan in the years 2004-2010.

As for method of technology copying, it also can be prosecuted. In addition to that, the both methods do not enable for the development of Russian technology.

3. FINANCIAL SANCTIONS

The restrictions provided by the EU Regulations No. 833/2014 (Order EU No. 833, 2014) have affected the financial sector. It prohibits any operations lasting more than 90 days for the banks with more than 50% of the state capital. A list of certain banks indicated in the Regulations: Sberbank, VTB, Gazprombank, Vnesheconombank, Rosselkhoz Bank. This action is explained by the fact that state-owned banks borrow from Western banks whose interest rate is much lower than in Asian banks. Such banks could also finance the development of gas fields and oil projects. Therefore, this action also affects the hydrocarbon industrial sector.

The next wave of sanctions is presented by EU Regulations No. 960/2014 of 8 September 2014 (Order EU No. 960, 2014). It modifies the previous Regulation No. 833/2014. The ban is imposed on any transactions lasting more than 30 days with Russian companies with the state's share more than 50%, an asset

Table 1: Share of import (Konoplianik, 2015)

Technological direction (number of items)	Share of import 2014	Share of import Maximum planned in 2020
Well operation, enhanced oil recovery (5)	67-95	50-80
Drilling of inclined, horizontal and multilateral wells (2)	60-83	45-60
The liquefaction of natural gas (9)	50-100	40-80
Hydrocarbon processing (4)	40-80	30-60
The implementation of offshore projects (5)	80-90	60-70
Oil and gas transportation (9)	30-80	20-65
Exploration (3)	40-85	30-70

Figure 1: Global market of oil and gas equipment (Konoplianik, 2015)

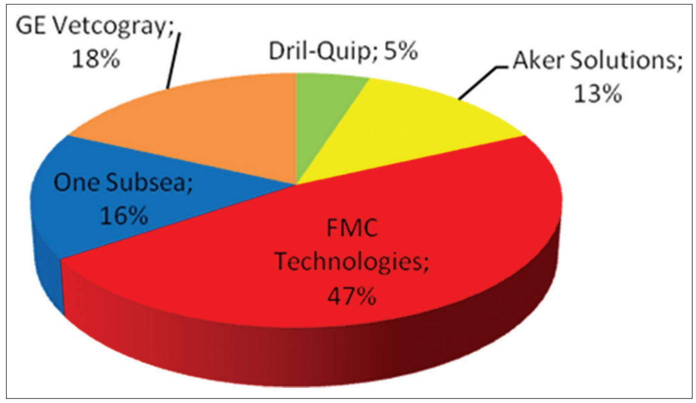
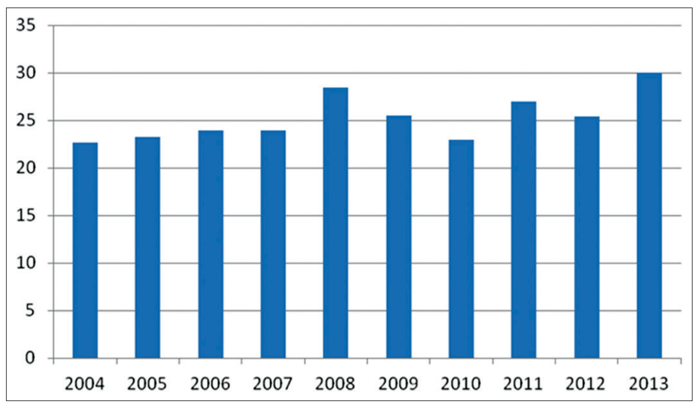


Figure 2: Share of the "Gazprom" in gas import to Western Europe, %



is more than 100 billion rubles, and the share of profit from oil or petroleum products is more than 50%. A list of such companies: Rosneft, Transneft, Gazpromneft.

According to some experts, Russian oil companies mostly affected by financial sanctions (Figure 3).

Regarding the financial sector, Russian companies have two scenarios to raise funds: In Asian financial institutions or in the National Welfare Fund (NWF) (Konoplianik, 2016).

The first option involves virtually unlimited financial resources, but at an interest rate, which will be much higher than the cost of Western loans (Figure 4).

In addition, for example, China, knowing that Russia has a lower bargaining power due to the imposition of Western sanctions, often offers related loans (purchase of Chinese equipment, the provision of jobs to Chinese experts), which are not always advantageous to the Russian side (Figure 5).

Concessional loans are loans which offered for developing countries at subsidised interest rates, and are usually tied to Chinese exports. In other words, they are contingent on a certain percentage of Chinese goods and services being procured with that loan. This methodology is similar to the concessionary finance provided by traditional donors, and it allows Chinese companies to gain an advantageous entry point to new markets. The loan can be used to purchase equipment, technologies, materials and/or services. However, at least 50% have to come from China (Export finance activities by the Chinese Government, 2011).

The second option - the use of the NWF - limited in terms of investment (Well Fare National Fund of Russian Federation, 2016). The Fund is distributed very strict, and most applications from oil and gas companies were refused. The example of the positive solution is the request from the company Novatek for the project "Yamal LNG."

The possible strategies for working under sanctions as well as their critic are presented in Table 2.

Figure 3: Field development schedule (Fjaertoft and Overland, 2015)

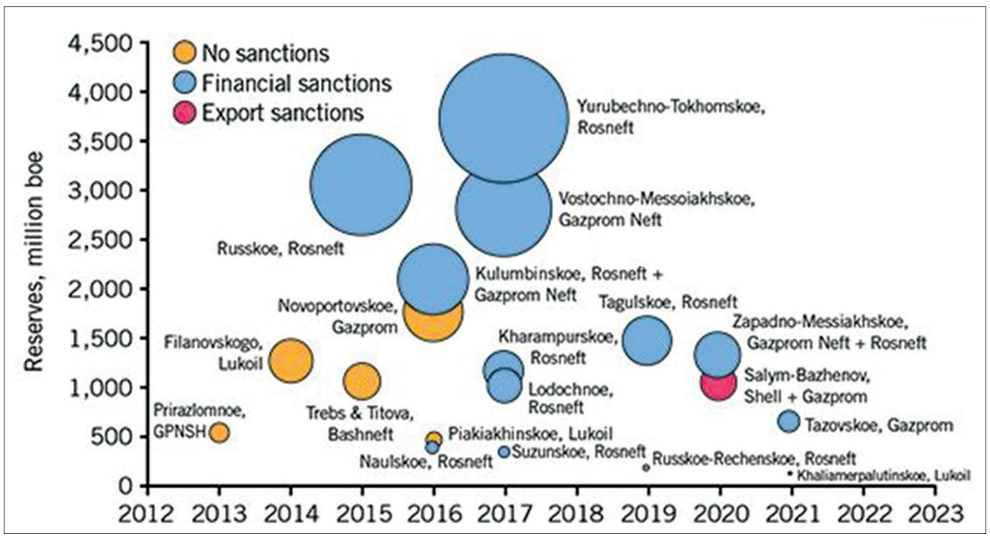


Figure 4: Interest rate of central banks (Central Bank Rates, 2016)

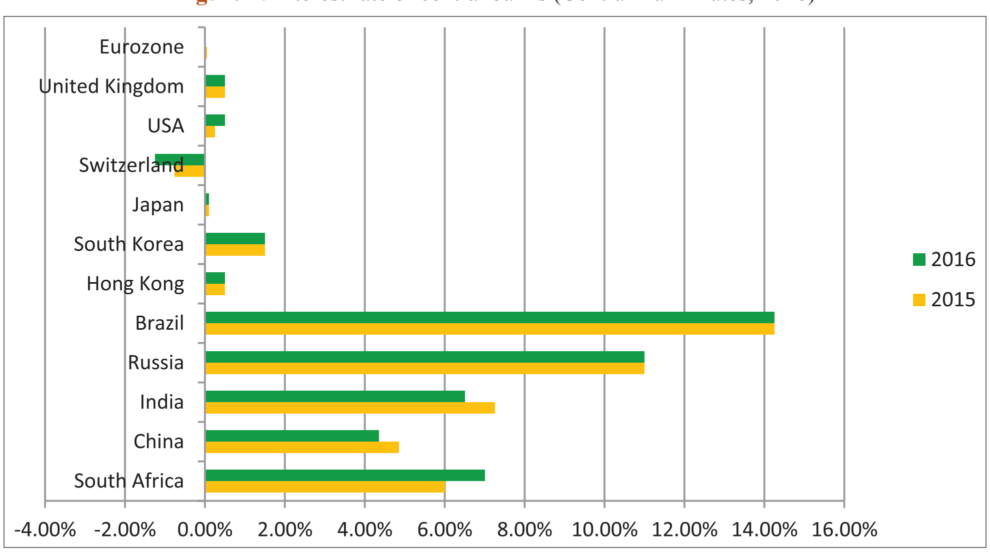


Figure 5: Structure of a Chinese concessional loan

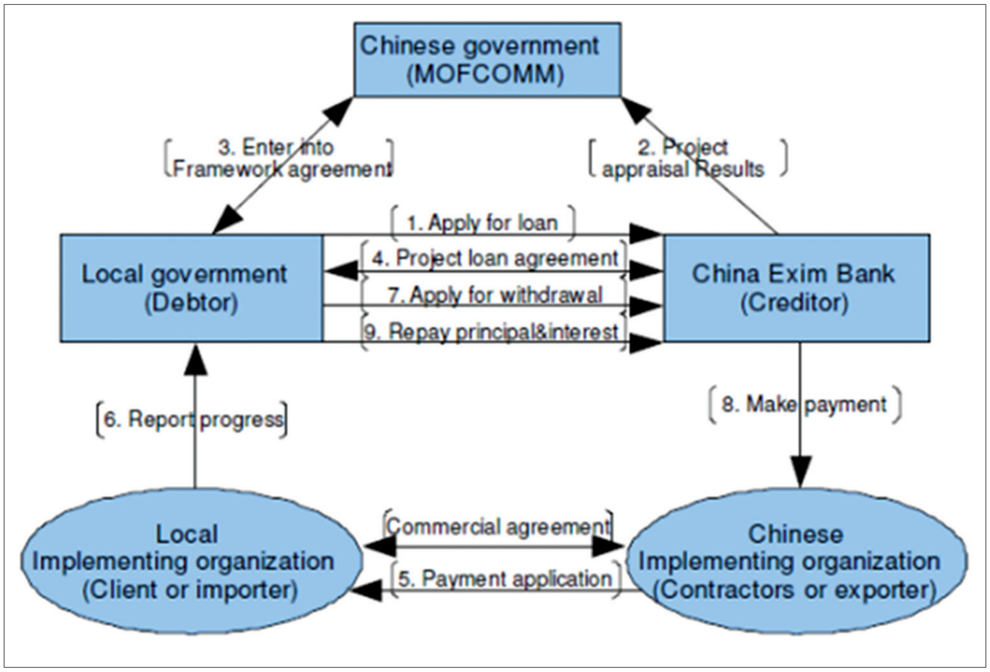


Table 2: Scenarios of oil and gas projects under sanctions

Sanctions	Scenario	Critics
Equipement	Import by third countries (Kazakhstan)	In terms of open borders, it is impossible to hide the way of import. Suppliers do not take the risk because fines are huge
	Copying	Does not let to develop own production. Always a step lag Can cause prosecution
Finance	Asian investments	The interest rate up to 15 times higher than in Western banks. Often offered loans associated with the purchase of equipment and the provision of jobs
	National Welfare Fund	Limited on resources

4. CONCLUSION

Summing up the results of this work we can say that the EU's and US's sanctions affected to a great degree of oil and gas on the Arctic shelf. Due to the tightening of the Russian legislation foreign companies do not have direct access to the Russian Arctic. Only Rosneft and Gazpromneft can develop offshore projects in Arctic zone. As for the Russian gas sector, it suffered much less. Sanctions have negative influence at both sides. There are some possibilities to cooperate but big companies cannot afford such risks. As the term of sanctions is not clear Russian and foreign companies should negotiate while this period.

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