

THE SPEECH OF I.I. SECHIN
AT THE XI EURASIAN FORUM IN VERONA
ECONOMY OF TRUST AND ENERGY SECURITY OF
GREATER EURASIA

October 25, 2018

Dear participants and guests of the Forum!

I'm glad to welcome you at the XI Eurasian Economic Forum. Among the participants today are executives of the biggest companies and prominent politicians, who play the most important roles in economies and energy industries of their countries, in the development of specific regions and of the whole world. This fact demonstrates high importance and relevance of the questions discussed at the Forum, the need for such framework for discussion of the pressing issues of Eurasian energy security.

I am grateful to the organizers of the Forum for choosing the topic of the “economy of trust” as a core motif for today’s discussion. Nevertheless, I cannot but point out how drastically, how deeply differ the productive work of building the “economy of trust” in the common interests and today’s political realities of the economic policies. In a few months we will witness the fifth anniversary of illegal from the perspective of the international law sanctions against the Russian Federation. In 10 days, we will see in action the sanctions against Iran, although, judging by the dynamics of the oil market, I can’t rule out that the administering of the sanctions will include a large number of exceptions for individual partners of the USA.

We have become witnesses of the historic time for the global energy industry. That is why we are grateful to our colleagues, the participants of today’s panel, and to the esteemed auditory for their attention to the Forum and willingness to discuss sensitive issues.

I must note the limitation of liability, since my speech contains evaluative and prognosticative judgements.

1. Trade restrictions and sanctions became a tool in the fight for the market share

In the past year quality changes happened at the energy markets and around them. Concerning the overall pricing environment the situation is somewhat better, but, as we have repeatedly pointed out, the task of creating the instruments of steady functioning and development of energy markets hasn't been completed yet. I'll start with the most pressing issue – the sanctions.

The modern phenomenon of “sanctions” is yet to be closely studied. As of today, they vary so much and so fast that they become something else. It seems, we are dealing with the emergence and development of measures of non-economic, illegal (from the perspective of contravention of the principles of international law), trans-boundary impact on arbitrarily selected countries or companies with the aim of changing their positions at the market for the benefit of the initiators of such measures, achieving changes of political and/or behavioural nature and other benefits.

The proof of that is the choice of industries hit by sanctions – energy, metal manufacture and military and technical cooperation, banking sphere. These are the main industries in which Russia and the USA are direct competitors at a number of key regional markets.

The analysis of reasons for introducing sanctions allows us to conclude that, in fact, their use is rather **a tool for putting pressure on certain countries** in order to make them change their internal or foreign policies in unilateral interests, **than a measure of responsibility under international law against economic entities.** The American regulator clearly notes (decree of the President of the USA No. 13660), that the

restrictions being introduced **are not a punishment of the companies, participants of the market, for specific actions**, but a way to put pressure and increase costs of Russia, until it diverts from its current course.

A spectacular example is the decision of the European Court dated September 13, 2018, in the case of disputing the introduced sanctions by Rosneft, in which the Court admitted the prevalence of political environment above the international principle of the supremacy of law. In its decision, the Court confirmed the justified introduction of sanctions with the aim of, quote, “Impacting the interests in (budget revenue generating) oil industry to reduce Russia’s ability to threaten the countries, dependent on it from the perspective of energy supplies”. **Sanctions must refer to specific facts, violations by the entity being hit by the restrictions. But there is nothing like that, yet the restrictions on the Company’s operations grow constantly.**

In my opinion, what we see is not sanctions, but “trade wars” with intentionally blurred, often ambiguous phrasing. Their arbitrary use has become apparent to everyone. **The concept, techniques and unproductiveness of this approach for the global economy have been known for a long time** – I can refer you to a book by Juan Zarate, Treasury’s War: The Unleashing of a New Era of Financial Warfare. As a high-ranking official of the US Administration, he witnessed how the policy of financial bleeding of the opponents of American interests was conducted, **but today this policy is being used not as an instrument of fight against terrorism, but as a tool for competitive struggle.** Unilateral restrictions have already been introduced against about a third of the world’s oil reserves and a fifth of global output! **That is a definite anti-record.**

Sanctions without the necessary decisions of the UN Security Council have turned into a mundane tool effectively lying in the hands of a single country, not the global community. Certain market participants and whole countries are de facto “hostages” of the situation. In such circumstances there is no place for equal dialogue, and the only advice

that I can give to our partners is **be ready for the dictate, the result of the policy of unilateral sanctions will be the loss of sovereignty and control of economic and energy policy by many market participants.**

This conclusion is evident both after analysing the “cost” of sanctions and their beneficiaries. For instance, only 0.6% of losses caused by the sanctions against Russia falls on the USA, while Germany accounts for as much as 40%. What’s more, I point out that in some spheres – shale output, weapons exports – American economy has rather pragmatically gained benefit from sanctions, introduced against other countries. **One could wonder whether it was simply a way of support for the local producers at the expense of the global community.**

Earlier we have already noted the fact of Total’s withdrawal with significant losses from one of the largest gas projects in the world, the South Pars-11, while the effect of refusal of all European companies to work with Iranian partners, including a possible complete ban on imports of Iranian oil after the 5th of November, 2018, that is being discussed at the moment, may have the most serious consequences for the European economy.

The sanctions rhetoric negatively affects financial markets as well, impeding capital flow and increasing the cost of attracting investment. That could have been one of the reasons behind the replacement of a long-awaited IPO of Saudi Aramco for a deal to acquire the Saudi petrochemical company SABIC. We still believe in the success of the deal to put the company on the public markets, planned by Saudi Arabian government.

2. The US actions led to destabilization of the oil market

According to the existing estimates, current demand and supply of liquid hydrocarbons at the global market are roughly balanced at the level of

about 100 million barrels per day. However, one cannot call sustaining stability and balance a long-term trend, as there has not yet been created a tool for ensuring such stability at the oil market.

In short term already, the US “trade wars” may entail a significant unbalancing of the oil market. Now add to that the instability in Libya caused by the US Administration, sanctions-related drop in Venezuela’s production, the uncertainty about the Iran market. According to the latest estimates, the oil supply may have decreased by up to 2 million bpd in Q4 2018. Today, there comes the news on an unprecedented amount of oil that Iran intends to supply to port Dalian in China. The information indicates a true armada of tankers to carry over 20 million barrels in October-November 2018, while the monthly standard is 1 to 3 million barrels.

This situation roots in a lack of awareness on the global oil market mechanisms and a lack of desire of the world’s leading economy to consider interests of the oil consumer countries.

Apparently, the United States has its own vision of its role in this process, and is pleased to grow into the role of regulator of the world oil market in accordance with methods of work quite far from market practices and with its own interests that are pretty far from being altruistic.

OPEC has, in turn, reduced its share of the global oil market in favour of the American shale industry. As a result, OPEC+ production has decreased by about 2 million barrels per day by April 2017, while US shale projects production (with appropriating changes in the financial well-being of most shale producers) increased by 2.2 million barrels per day. **Moreover, the United States intend to become a major oil exporter. In fact, we can talk now about the US-OPEC structure introduction,** especially with, in the light of recent events, the depth of the relationship between the US and Saudi Arabia that cannot be overestimated. Donald Trump’s visit to Saudi Arabia in May last year resulted in signing of energy and military cooperation contracts and

agreements worth over \$300 billion, along with the assurances of thousands of jobs creation in the United States. It can be assumed that an extremely pragmatic agenda will continue being the engine of this relationship in the future.

It is not surprising that even experienced experts are beginning to appeal to the unreasonable hopes for that the new capacities deployment will not be affected by the sanctions, in spite of a clear example of Total exit from projects in Iran, which we have already mentioned, as well as US sanctions against Venezuela, instability in Libya, Syria and other regions impeding the developing of new projects. **A large role is also played by the numerous financial constraints imposed to the new industry projects financing.**

In this regard, I cannot agree with the opinion of analysts of the American Goldman Sachs bank, who believe that the sanctions rhetoric will not lead to an increase in oil prices, since OPEC and Russia, as well as shale producers in the United States, will be able to introduce new production capacities. I suppose that such an assessment is only an excuse for investment policy of this bank made by its analysts.

According to the latest data from the Energy Information Agency of the US Department of Energy, the amount of spare production capacity in OPEC countries does not exceed 1.4 million barrels per day, with nearly all of this volume, about 1.3 million bpd, concentrated in Saudi Arabia.

The current amount of spare capacity has reached the decade's minimum, and there is a direct threat that it will not be able to compensate for the production capacity eliminated mainly due to the fault of the US administration. We have already witnessed a sharp rise in oil prices largely driven by the fears of such course of events. Any additional external negative event (and the history of the industry shows that we cannot exclude its possibility) can lead to a new sharp rise in oil prices, which will increase risks to the world economy and put an end to the current decade's cycle of economic growth. Neither consumers nor producers are interested in this. Everybody will lose in

this case, and particularly China and India, as well as the poorest consumer countries, **though American and European consumers will also pay for this in the long run.**

3. Tariff policy and sanction instruments form barriers to global growth.

Historically, all the participants of the world economic system, until recently, more or less benefited from implementation of the so-called win-win growth strategy of mutually beneficial global cooperation. The barrier-free world trade volumes have increased by 65 per cent from \$11.1 to \$18.3 trillion over the past 30 years, contributing to sustainable global economic growth.

Now the actions of the USA manifest a drastically different strategy - win-lose, where the protectionism presents its own, temporary and exclusively one-sided advantages. We see them drawing a clear line aimed at sustaining their market share. With reference to shale production, the high leverage of production enterprises was offset by the elimination of competitors through sanctions and oil price boost.

There is a certain clash of interests, when the USA, having been a market economy devotee for decades, begin to mix their self-appointed role of a regulator with own trade, economic and political interests.

However, we learn from history that such a policy has its dark side. For instance, the era of the national protectionism at the end of the 19th century and the beginning of the 20th century entailed a significant monopolisation of the economies, which suffered both end consumers, made pay a higher price, and the countries themselves that, with the limited competition, lost an important driver of the business process and innovation.

At the moment, a range of international enterprises estimates the increase in end-consumer costs from trade wars of 10% to 15%.

Moreover, leading experts in economics believe that trade wars will cost the global GDP 0.5%-0.8%, that is about \$400-700 billion a year.

In fact, we can state that the same country, which was the driver of the world economy, has become its drag.

The USA's application of the strategy has already backfired: China has introduced its import tariffs for a range of American products, including LNG, in response to America's certain import tariffs for Chinese goods. At the moment, the United States are building LNG plants of the total capacity of 60 mmtoe per year, most of which they intended to supply to the growing market of the People's Republic of China. A switching of these volumes to other markets will lead not only to the stronger competition, but also to the increased costs for American producers.

Thus, we see an effect of the Ouroboros. Most likely, the return impact on the US economy of the measures being taken by the Donald Trump Administration worldwide will, in medium term, end with a halt in the rapid growth of the US economy and with a finish of the current economy cycle.

The USA significantly depend on other countries' readiness to fund the US enormous budget deficit, despite their marginally low dependence on foreign trade (the export share of the GDP is under 15%, while the global level is 26%). For instance, now about a quarter of the US external debt is to countries that had already been subjected to a range of trade and sanction restrictions, which can limit its further growth. This ratio reaches 50% with reference to the European Union, since the US Administration presents claims to their European partners as well.

I am convinced that the mutually beneficial win-win ties will continue to develop; while any further escalation of sanctions will ironically set limits for the USA themselves. They will become less reliable and equality-oriented partner and thus lose the trust of other countries, given their one-sided refusal to comply with the international legal standards, their unwillingness to comply with rulings of international institutions, their defiant withdrawal from agreements if not revised to their benefit

otherwise. **The loss of trust in the USA is another sign that the rest of the world, that is over 95% of people, is looking for a replacement of the established model. I believe that we need a system of a mutual discussion based upon trust and respect.**

4. Underinvested oil industry means unfulfilled demand in the future

Speaking on the current oil price rate, I can note that it is comfortable for us and largely represents the existing balance of supply and demand.

With regard to long-term development prospects for the world energy industry, I would like to cover a matter of frequent speculations in international media, that is how soon the oil price is going to drop.

Almost all the forecasts indicate some growth of the oil demand in 2030-2040 in comparison with the current level. However, it is necessary to separate the short-term and long-term impacts on demand.

Industry experts expect that oil demand in 2040 will be higher than consumption level in 2016-2017, with petrochemistry becoming the key driver of global oil demand growth.

We also see an expansion of oil demand in developing countries as their prosperity grows and car fleet increase.

In this regard, I consider it my duty to again warn from over-optimism regarding prospects of electric cars. Although we can only welcome environmentally friendly transport development, it should be noted that energy infrastructure and electric transport operating costs are still highly dependent on government subsidies. It must also be considered that electricity output requires resources and if the widely used source for it will be coal, than all the positive environmental effect of electric cars will be lost.

Furthermore, modern electric cars manufacturers create advertising with social media buzz. In particular, U.S. Securities and Exchange Commission recently declared the head of TESLA Elon Musk guilty of corporate fraud and deceit of shareholders. As a result, the company's capitalization consistently decreases. It is unlikely that company's shareholders want to ensure its business development at the cost of reducing their income.

However, in the longer term, there are concerns that climate change policies, that limit fossil fuels burning or any significant progress in the field of batteries, can significantly accelerate the peak of oil demand. However, even according to the forecast of the International Energy Agency (IEA) the share of renewable energy sources in global energy demand in 20140 won't exceed 20 per cent, having increased by only 6 percentage points compared to the level of 2016, and in general fossil fuels will have to provide more than three quarters of energy consumed.

Therefore, in respect to the oil market, the main challenge for the coming decades is not the hypothetical peak of demand, but the guarantees of available volumes of liquid hydrocarbons in the medium- and long-term. Attention should also be paid to coming years need to compensate for ageing oil-producing assets with new resources – up to 40 million barrels per day by 2040, which will require a stable, significant inflow of investments in the sector. Oil and gas will remain the core of global energy and economy in the foreseeable future.

This opinion is shared by OPEC Secretary General Mohammed Barkindo, who called the problem of underinvestment one of the largest and most pressing in the oil industry at the present time.

Investments reduction in the industry due to oil prices fall in 2014-17 will have serious consequences. The world's leading oil and gas companies (“majors”) investments dynamics show that **in 2017 they almost halved their exploration and production investments compared to 2014, from 145 to 75 billion dollars.** The reductions were made mainly for long-term investment projects that cannot provide quick

returns at low prices. Hence, companies have reoriented themselves to projects with a short investment cycle, which make it possible to ensure production “here and now”, but not always guarantee future production sustainability. **With reference to this, I believe it to be ill-advised to rely on shale projects as a remedy to the production decline in other regions.** As we have noted repeatedly, any further growth of the shale production will involve engineering and technological challenges and will not manage to offset the natural decline of traditional production (estimated at 5%-7% per year). Disestablishment and delay of projects outside the US caused insufficient investments and entailed serious doubts of consumers about the future stability of the oil supply. This is a tremendous risk for the market prospects in the coming years.

For example, according to industry experts, implementation of ExxonMobil growth strategy will soon require to sacrifice its financial efficiency for investment increase. It will take at least five years for the results of intensive development to have a positive impact on financial indicators.

Despite the growth of upstream investment noted in 2018 due to growth of oil prices, it is still not sufficient to provide its sustainable long-term growth.

That is the difference of Russia and Rosneft from the world trend. In 2014-2017, Rosneft continued to invest actively in upstream owing to a resource base with competitive costs. We actually had a 50% growth in dollar terms - from \$9.2 billion in 2014 to \$13.7 billion in 2017. As a result, in the coming 18 months we are launching over 7 new world-class greenfield projects proving once again our compliance to sustainable supplying of the world market.

5. Sustainable development means not more than development of renewable energy

In this context, I would also like to underline that, with reference to ecology problems and climate changes; **we must not forget that the main goal is not to increase the proportion of renewable energy sources in the energy mix at any cost, but to reduce the emissions of harmful substances.**

Excessive incentives and subsidies for renewable energy sources might cause underinvestment both in oil and gas upstream and in research development and implementation of emission reduction technologies in power generation, transport and many other areas.

Therefore, we are risking facing not only an energy shortage but also a decrease in efficiency of the greenhouse gases emission reduction.

This might sound like a relatively new strategy point for Rosneft, **but I would like to reliably claim at this reputable forum that we are determined to take the world industry lead in environmental friendliness of our business.** Our key priorities include minimizing of negative impact on the environment. Today, as a result of our work, Rosneft already differs from its competitors by low greenhouse gases unit emissions (during last three years this indicator decreased by 8% to 36.2 tonnes per a thousand barrel of oil equivalent). According to Bloomberg analytics, this indicator is bigger in many major companies - Total, Chevron and Petrobras. We are going to keep reducing unit emissions of greenhouse gases.

For reference: Unit indicators of greenhouse gases emissions (according to data of Bloomberg analytics), tonnes per a million barrels oil equivalent

Company	2015	2016	2017
Equinor	23.1	21.7	20.7
Rosneft	39.4	39.1	36.2
BP	46.7	46.9	43.4
Total	63.0	61.3	57.7
Chevron	64.8	67.4	60.3
Petrobras	76.4	65.1	66.3

Our strategic goal is to reach the first quartile of international companies comparable in unit emissions of greenhouse gases by 2022.

Every year Rosneft invests significantly to priorities - drawdown of emissions at all stages of production, particularly of greenhouse gases. It is not that simple because every year we put into operation new large facilities of oil and gas production, which are usually located in remote areas with poor infrastructure.

I need to note that these problems are also acute for the intensively developing USA shale industry and are only partly addressed at the regional level; meanwhile, stricter environmental standards in Bakken made production to stagnate.

Global environmental protection and sustainable human development are a good example of our common goal everyone can benefit from. Unfortunately, even here we don't meet understanding of problems from some countries of North America.

6. Prospects of the Russian oil industry

I would like to comment on my vision of the Russian oil industry development prospects separately. Russia and Rosneft, as the Russian largest oil industry company, have a unique resource base of high efficiency. Our unit operating costs and greenfield investments are ones of the world's lowest and comparable to those of Saudi Arabia.

However, a number of analytics in international comparisons put Russian projects and companies in a significantly worse position on a costs scale than it really is. As far as I can see, the cause is in incorrect and even non-objective consideration of tax factors including recent fiscal changes introduced by Russian Government to stimulate oil

upstream and to improve effectiveness of exploration of traditional regions and development of the new ones.

I will say it again that in terms of direct operating and capital costs our resource base and projects are among the world best and significantly exceed indicators of USA oil industry. Misunderstanding of these facts led to recent statements of some of my colleagues about Russian perspectives even down to saying that Russia will exit from the global oil arena in the next 10-15 years.

Of course, nothing like this is going to happen.

According to our evaluations, three of today major players will lead the world in such perspective - Saudi Arabia, Russia and USA - countries with very different industry organization, different resource base and different growth drivers.

7. Rosneft strengthens trust and develops partnerships

Our joint projects involve the huge resource potential, large-scale investments, and sophisticated technology; and it is of no doubt that our partners highly appreciate the environment of trust and respect for mutual interests, which Rosneft creates. We discuss the matters of project implementation as equals with all our partners. Since 2014, the hydrocarbon reserves of the joint projects with our foreign partners have tripled.

Our joint projects are energy bridges across countries, over to the future. Those are of integral nature, including production, transportation, refining and supplies to promising markets; and they operate for the benefit of every country and every member.

Rosneft maintains its position of a development driver for the pan-Eurasian partnerships despite the market volatility and restrictions including sanctions, while actually implementing the vision of the

“economy of trust”, which the Verona Forum is dedicated to this year. We are certain that this is the only proper way, beneficial both for Rosneft and our partners.

I would like to note that Rosneft has changed drastically in just one year. Qatar Investment Authority was welcomed as our new shareholder with 18.93% of Rosneft shares. In total, our strategic partners, including BP and Glencore, hold almost 40% of the Company’s shares, while the biggest shareholder is the state still. We have also adopted a new Rosneft-2022 strategy, which is focused at increasing the profitability and efficiency of existing assets and improving of technology effectiveness of the business. The company's capitalization exceeded \$76 billion, increasing by one quarter.

Along with success on its key market in Russia, Rosneft has shown advanced results on a number of overseas projects. **A good example is our joint Zohr project with ENI and BP, which has produced its first commercial natural gas recently.** Partners of the project from Italy, Russia, and Great Britain made it possible for Egypt to achieve self-sufficiency in gas supplies, turning the country into a net exporter of gas and sparing Cairo from buying expensive liquefied gas from other regions.

In this regard, we also see great prospects in the development of our joint projects with Exxon Mobil on the shelf of Mozambique.

In the conditions of not the most favourable external environment and ongoing volatility in the world markets, we behave responsibly by keeping on developing the cooperation.

The economy of trust and business diplomacy are the keys to the success of all our projects. This is the choice made by Rosneft and our partners.

Over the past few years, we have significantly expanded the range of our joint projects, including the establishment of partnerships in the onshore

and offshore exploration and production in Russia, on foreign projects of oil refining and petrochemistry, development of gas resources of the Mediterranean Sea, and other strategic areas. **Rosneft is actively developing partnerships with leading oil and gas and investment companies in the «Greater Eurasia», where the strategy of mutually beneficial cooperation («win-win») continues to prevail.**

We also continue to actively encourage international companies to cooperate in Russia.

Our major shareholder and long-term business partner BP is participating directly in several Rosneft projects (Taas-Yuryakh, Yermak) and is considering the possibility of entering into a number of new projects. We also participate together in the Zohr project.

Norwegian Equinor is working with Rosneft on the inspection of hydrocarbon reserves of Domanic deposits in Samara Region. Together with this company, we are developing the North Komsomolskoye field, two offshore projects in the Western Arctic and the Sea of Okhotsk, and the shelf license area in Norway.

Our Chinese partners also successfully cooperate with Rosneft. Udmurzneft is an example of Russian-Chinese JV with Sinopec in Russia's oil and gas industry. Beijing Gas participates in development of Verkhnechonskoye oil and gas condensate field, and at the moment an area of mutual interest is being shaped regarding license acreage adjacent to this field.

Furthermore, together with Sinopec we are preparing the development of North-Veninskoye gas condensate field (project Sakhalin-3).

Indian ONGC works with us within the framework of Sakhalin-1 project, a consortium of Indian companies has acquired a share in the equity capital of Vankor field and Taas-Yuryakh, furthermore the possibility of further expansion of this cooperation is being considered. In addition, Rosneft and PetroVietnam participate in a gas and condensate production project in Vietnam.

The opportunities present in the downstream sector are no less abundant. For instance, Rosneft is the third refiner in Germany by scale with a total refining capacity of 12.5 mln tonnes per year, which is more than 12 per cent of all refining capacity in the country. One of the factors of success in the Company's operations at the German market is the use of the largest oil pipeline system in the world, Druzhba, which has been transporting Russian oil to Europe without disruptions for more than 50 years irrespective of political climate.

The scale of the market and the need for significant capital investment stipulate the necessity for international cooperation in refining and marketing. A good example is the mutually beneficial cooperation between Russia and India in this sphere. The acquisition of a stake in the biggest highly sophisticated refinery in India by Rosneft allowed to implement the synergetic effect of India's fast-growing market and Russia's resource potential.

As is evident, we have a lot of opportunities for mutually beneficial cooperation. In this regard, the St. Petersburg International Economic Forum is a useful platform for developing mutually beneficial cooperation. I'd like to use this opportunity to invite you, dear colleagues and friends, to take part in this event in June next year.

We are ready to further expand our partnership in all spheres of operations and, as before, will seek new sources of synergy to benefit both the end consumer and the producers themselves.

Thank you for your attention! I wish you fruitful work at the Forum!