A MOMENTUM FOR UKRAINIAN STRIKES AGAINST THE RUSSIAN OIL INDUSTRY HAS ARRIVED

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In February 2022, the outbreak of the Russian-Ukrainian war upset the balance of the world, particularly where energy was concerned. Since then, the Western world has gradually moved away from its dependence on Russian oil and gas. Europe, once a major consumer of gas coming from the East by pipeline, imports virtually none today: from 1500 TWh per year[1] before the war, consumption has fallen to less than 250 TWh today.[2] Russian gas has largely been replaced by liquefied gas imports, mainly from the U.S. After being abandoned by Europe, Russia has now found new markets for its oil products, namely China and India.

While the outcome of the war remains uncertain from a military standpoint, it has already produced winners and losers in the energy sector. Europe is now on the losing side. Its withdrawal from Russian gas has cost Europe dearly. From 2022 to the beginning of 2023, it was forced to pay a staggering price for its gas, which even exceeded €200/MWh. Admittedly, the current price seems to be stabilising at around €30/MWh. But it is still twice as expensive as it was before the war in Ukraine. And that is three-times more than the prevailing price in the U.S.[3] This, of course, is having a major negative impact on European industry.

Conversely, the U.S. is on the winning side, across the board. They owe this in particular to fifteen years of investment in hydraulic fracturing and an extremely efficient and innovative gas industry, which has allowed it to exploit immense shale gas resources. Consequently, the U.S. has acquired virtual energy sovereignty, while at the same time driving down the price of domestically produced gas,[4] which in turn favours its industry. In the aftermath, President Joe Biden offered tax breaks to energy-intensive industries, particularly in Europe, tempting them to relocate their production to American soil to benefit from this energy windfall. The U.S. also took advantage of the new geopolitical situation to become the world's leading exporter of liquefied natural gas (LNG) in 2023, now ahead of Qatar and Australia, with

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1 https://www.lemonde.fr/economie/article/2023/09/11/malgre-la-guerre-en-ukraine-l-europe-a-augmente-ses-importations-de-gaz-russe-par-la-mer_6188799_3234.html#:~:text=En%202021%2C%20les%20pays%20de,cubes%2C%20selon%20de%20premiers%20recoupements.

2 https://www.naturalgasworld.com/2023-a-year-of-records-in-energy-108992

3 https://www.ice.com/products/27996665/Dutch-TTF-Natural-Gas-Futures/data?marketId=5714606&span=3

4 https://ycharts.com/indicators/henry_hub_natural_gas_spot_price

an exported volume of 1400 TWh.[5] This is all the more remarkable since the U.S. only started exporting LNG in 2016!

Initially, the war in Ukraine has paradoxically benefited the Russian energy sector, from 2022 to the first months of 2023. Russia was then able to sell its gas at an extremely high price, which more than compensated for a loss of revenue from the drop in sales to the West. But in 2024, this is unlikely to still be the case. The price of gas has fallen significantly, and Russia has only been able to find alternative markets for a small volume of the gas it usually sends to Europe, due to a lack of adequate transport infrastructure. Thus, Russian gas exports fell by 65% overall in 2023 when compared to 2022.

On the other hand, for Russian oil, Western sanctions have been only moderately effective. While using a fleet of old tankers to circumvent sanctions, Russia has found other, only slightly less profitable markets to sell the oil that the West no longer wants. But in the long run, Russia will also find itself on the "losing side". By leveraging a form of energy blackmail on Europe at the beginning of the war with Ukraine — which it will not forget in a hurry — it has in fact inflicted a heavy economic handicap on itself, and for a long time to come. The future is uncertain: Russian oil and gas revenues fell by 24% in 2023, which equates to a loss of US$100 billion (€92 billion) compared to the previous year.[6]

Yet, despite these economic and geostrategic upheavals, to date Russia's energy infrastructure — especially its oil industry — has rarely been attacked by the Ukrainians. One may wonder why. Such attacks could indeed impoverish Russia and thus its ability to finance the war. This industry covers a huge area, which makes it vulnerable. Ukraine has highly effective combat drones that have allowed it, for example, to take control of the Black Sea away from the Russians. Also, it could relatively easily attack the Russian port of Novorossiysk, located in the northeastern part of the Black Sea. It is home to the Sheskharis oil terminal, which allows Russia to export 1.5 million barrels of oil per day,[7] which could not find a market without this port. Rendering this terminal inoperative would result in a financial loss to Russia that would amount to tens of billions of euros per year.

Until recently, the Ukrainians' restraint could be explained by the fear of its Western allies, especially the U.S., of a significant rise in oil prices, which would inevitably damage the American president's popularity, especially during a presidential election year. Two years ago, such a strike on Russia's energy infrastructure would likely have resulted in a significant rise in the price of a barrel of crude oil. But times have changed. Today, the oil industry has an estimated production reserve of four million barrels per day available in a matter of weeks. Therefore, the loss of Russian oil from the Black Sea would have little effect on the global price of a barrel. Few people realise that we will probably experience a situation where there is even a fossil fuel glut in the coming decades. This is due to the sharp increase in oil production, particularly in the Americas (Canada, Brazil, the U.S., etc.), which is gradually becoming an oil superpower.

Worse still for Russia, a modest increase in the price of a barrel of crude oil would even be advantageous for the U.S.! Their oil industry, the world's largest with 14 million barrels produced per day,[8] is already marginally on the wane due to prices that are a little too low to allow for growth in the shale oil extraction industry. It should be noted that shale oil is more costly to extract than Saudi or Russian oil. This slowdown in the growth of the U.S. oil industry is reflected in a slight decrease in the number of active U.S. drilling rigs in the Permian Basin of Texas, the world's largest shale oil producing region. In this

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[5] https://twitter.com/SStapczynski/status/1742353001388585141?t=uWBLRGWePynwYWDeLrMh5g&s=19

[6] https://trends.levif.be/a-la-une/les-recettes-fiscales-russes-liees-au-petrole-et-au-gaz-en-chute-de-25-en-2023/

[7] https://incorrys.com/energy/energy-infrastructure/shipping-russian-oil/

[8] https://www.geo.fr/geopolitique/energie-production-petrole-americaine-depasse-les-previsions-des-analystes-et-embete-opep-arabie-saoudite-russie-217990#:~:text=En%20effet%2C%20rappelle%20l'agence,millions%20de%20barils%20par%20jour.

context, eliminating a competitor such as Russia in oil production would promote U.S. energy independence while only marginally penalizing the American consumer, and voter.

Many other oil-producing countries may also wonder if the Russia-Ukraine war might not be an opportunity to eliminate Russia as a competitor in an oil market with a current excess of capacity. Additionally, several members of the OPEC+ organization, to which Russia belongs, would no doubt be relieved to no longer have production limits imposed on them by this organization whose only effect so far has been to painfully keep the price of a barrel of crude oil above US$70 (€64.00)!

If the U.S. initially had good reasons to rein in Ukraine's plausible desire to attack Russia's oil industry, the situation may have been reversed. A window seems to have opened. The momentum is there. And we are already seeing this with this attack on the weekend of January 20, 2024 by Ukrainian drones on a Novatek terminal in the port of Ust-Luga, near St. Petersburg, which exports petroleum products. It is also troubling, for example, to see the U.S. buying oil in early January 2024 to replenish its strategic reserve, while China has increased oil import quotas for its refineries by about 60%.[9] This is precisely what major powers preparing for a possible disruption, even partial, of Russian oil supplies would do: increase their available reserves almost immediately, to allow them to ensure that prices do not soar during the few weeks it would take for global production reserve capacity to be activated.

Of course, this is just one of many scenarios. The evolution of the war in Ukraine, just like the energy sector itself, depends on a multitude of parameters. Nevertheless, it is a healthy perspective to consider.

Russia's foreign policy is heavily dependent on the revenues generated by the exploitation of its energy resources. Hence the irony of the late U.S. Senator John McCain's famous words: "Russia is a gas station masquerading as a country." And when oil is too cheap, the future prospects of our huge neighbour collapse. If Boris Yelstin did not succeed in the country's democratic and economic transition after the fall of the USSR, it was mainly due to a lack of means to finance it. At that time, the price of crude oil per barrel was extremely low. During that decade, for the majority of the time it sold at well under US$40 (€37) a barrel. On the contrary, Vladimir Putin came to power at a time when prices were soaring, which gave him the means to implement his policies.[10]

Russia now finds itself in a very unfavourable energy context, driven by an overabundance of fossil fuels. At the same time, the war in Ukraine has cut the country off from Western markets and the risk of attacks on its energy industry is now a greater threat. This could undermine Russia's financial revenues, which are essential to its war economy and its economy in general.

But whether Ukraine benefits from this momentum or not, it would be a bold move for the West to wholeheartedly rejoice in the deepening crisis in Russia. Major geopolitical upheavals, even those that seem desirable, often have later surprises in store.

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[9] https://www.hydrocarbonprocessing.com/news/2024/01/china-gives-most-refiners-full-crude-import-quotas-for-2024/#:~:text=(Reuters)%20%2D%20China%20has%20released,trade%20sources%20said%20on%20Tuesday.

[10] D. Helm, Burn out. The endgame for fossil fuels, Yale University Press, 2017, pp.130-132