NEW STRATEGY CENTER

A TREASURY BUILT UPON (BLACK) GOLD: RUSSIA'S PETROLEUM DILEMMA AMID SANCTIONS

by Horia Ciurtin, Expert, New Strategy Center

"Oil creates the illusion of a completely changed life, life without work, life for free. Oil is a resource that anaesthetises thought, blurs vision, corrupts."

Ryszard Kapuściński

A Treasury Built Upon (Black) Gold: Russia's Petroleum Dilemma amid Sanctions
October 2022
Author: Horia CIURTIN, Expert, New Strategy Center

About the New Strategy Center
New Strategy Center is a Romanian think tank specializing in foreign, defence and security policy, a non-partisan, non-governmental organisation. New Strategy Center operates at three main levels: providing analytical inputs and expert advice to decision-makers; holding regular debates, both in-house and public, on subjects of topical interest; expanding external outreach through partnerships with similar institutions or organisations all over the world, joint policy papers and international conferences. The Balkans and the Black Sea space are priority areas of interest for New Strategy Center.

New Strategy Center
Jiului Street, no 133, Sector 1 Bucharest, Romania

Follow us on social media:
Twitter: @NSC_Romania
Facebook: @newstrategycenter
Email: office@newstrategycenter.ro
Website: www.newstrategycenter.ro

A Treasury Built Upon (Black) Gold: Russia's Petroleum Dilemma amid Sanctions

Horia Ciurtin, Expert, *New Strategy Center*

"Oil creates the illusion of a completely changed life, life without work, life for free. Oil is a resource that anaesthetises thought, blurs vision, corrupts."
Ryszard Kapuściński[1]

Executive Summary

When Russia's fossil fuel exports are the object of debate, gas usually gets the front spot. Nonetheless, despite a higher level of geopolitical instrumentalisation, it is structurally surpassed by petroleum in all that pertains to harnessing a steady flow of hard currency towards Kremlin's treasury. Oil – crude and refined – represents the veritable backbone of Russia's federal budget. Seaborne and pipeline-transported, it flows both west and east, in a never-ending quest to satisfy difficult customers on a global market that proves more competitive – and challenging – than the overly inertial gas trading patterns.

And this precarious equilibrium in petroleum sales was fundamentally upended by Russia's decision to invade Ukraine in February 2022. Rounds after rounds of sanctions hit, specifically targeting the aggressor state's capacity to export its most valuable commodity. Some were successful, some could not predict the upward evolution of prices and some only collaterally chipped away from Moscow's oil markets. Nonetheless, trading routes were altered, volumes declined dramatically in one direction, only to rise spectacularly in another. And a price cap looms on the horizon.

[1] Ryszard Kapuściński, *Shah of Shahs*, Harcourt Brace Jovanovich, 1985, p. 35.

1. Overture: Russia's Energy Social Compact

A treasury built upon fossil fuels exports is – sometimes – a convenient path for a state to tread upon. Especially in an economy recovering from structural crises, one after another. In such a scenario, equilibrium appears as a desirable objective, although always beyond the (fiscal year) horizon, as overreliance on sales of mineral resources instills, providing a confortable anchor within a volatile global system. The state budget may be subject to a variation in oil and gas prices – beyond any government's control – but it ensures a steady flow of cash.

And Russia is a prime example of this pattern. With more than 45% of the federal budget built upon oil/gas[2] and around 40% of its total exports that stem from such sales[3], Moscow remains an anomaly within the ranks of the world's largest actors, lingering in an 'archaic structure of the economy'.[4] Oil and gas companies are considered fundamental elements of the country's international position, both economic and geopolitical, receiving a special – and continuous – attention directly from the highest echelons in Kremlin.

For this reason, Gazprom, Rosneft, Lukoil, Surgutneftegas and – the somehow independent – Novatek dominate Russia's economic landscape, beyond levels commonly observed in major global powers. The financial wellbeing of such undertakings is equivalent with Moscow's own budgetary viability, with the country's stability and the regime's medium-term firmness. In essence, oil and gas represent the key for Kremlin's capability in preserving the established social compact.

While international attention mainly concentrates upon Russia's delivery of natural gas, petroleum is often left aside from the analytic framework. At a first glance this might appear understandable, given that gas presents a more rigid market in terms of possible supply via pipeline, being more regional and creating longer term interdependences between suppliers and customers.

On the other hand, in the overall picture of Russian exports, oil occupies a much larger share. As a matter of value, in 2020, Moscow exported a total of 330 billion USD in products, out of which 74.4 billion was correlated to crude petroleum, 48 billion to refined petroleum and 19.7 billion to gas.[5] Thus, petroleum (crude and refined) represented 37% of its total exports, while gas merely rose to 5%.

[2] See the IEA factsheet, 'Energy Fact Sheet: Why does Russian oil and gas matter?', IEA, 21 March 2022, available at https://www.iea.org/articles/energy-fact-sheet-why-does-russian-oil-and-gas-matter (consulted on 26 September 2022). Also see Martin A. Sullivan, 'Russia's Revenue Roller Coaster', *Tax Notes*, 25 July 2022, available at https://www.taxnotes.com/featured-analysis/russias-revenue-roller-coaster/2022/07/22/7dqb6 (consulted on 26 September 2022) – at another level, these sums raise to around 20% of the consolidated government tax revenue.

[3] Based on UN Comtrade data, 2020.

[4] Evgeny Gontmakher, 'Russian Exports in Focus', GIS Reports, 25 May 2021, available at https://www.gisreportsonline.com/r/russian-exports-2020/ (consulted on 27 September 2022).

[5] UN Comtrade data compiled by the OEC, see https://oec.world/en/profile/country/rus.

In this sense, the story of the Russian treasury is more of a tale based on oil than gas, although geopolitically the Kremlin uses the latter with greater success in building leverage and constraining its international partners. But for harnessing its monetary resources and building the federal budget, oil remains the key element. Only by relying on petroleum revenues can Moscow maintain its social compact and ensure the stability of the regime. Black as it may be, this irreplaceable postmodern 'gold' is the cornerstone of Russia's assertive international position. A commodity that floats directly into its treasury of welfare disbursements and war-driven expenditure.

2. Before 2022: Weathering the (Political) Storm

(Post-2014) Sanctions? Comfortably Numb.

With proven oil reserves ranging between 80 and 110 billion barrels[6], Russia always played in the grand league of the global petroleum industry. While a relative decline had been witnessed in the years following the disintegration of the Soviet Union, production managed to revert to previous levels after 2000 (see Figure 1 below). And Vladimir Putin transformed this energy 'renaissance' in a personal political brand, allowing him not only to reconfigure the federal budget, but also the manner in which power is held, exercised and maintained in Moscow. Allowing both citizens and (comfortably loyal) oligarchs to benefit from increased hydrocarbons revenues, he wrote a new chapter in the turbulent Russian social contract.

[6] See 'Worldwide Look at Reserves and Production', *Oil & Gas Journal*, 7 December 2020, p. 16. Also see BP, *Statistical Review of World Energy 2021*, 70th edition, online at https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2021-full-report.pdf.

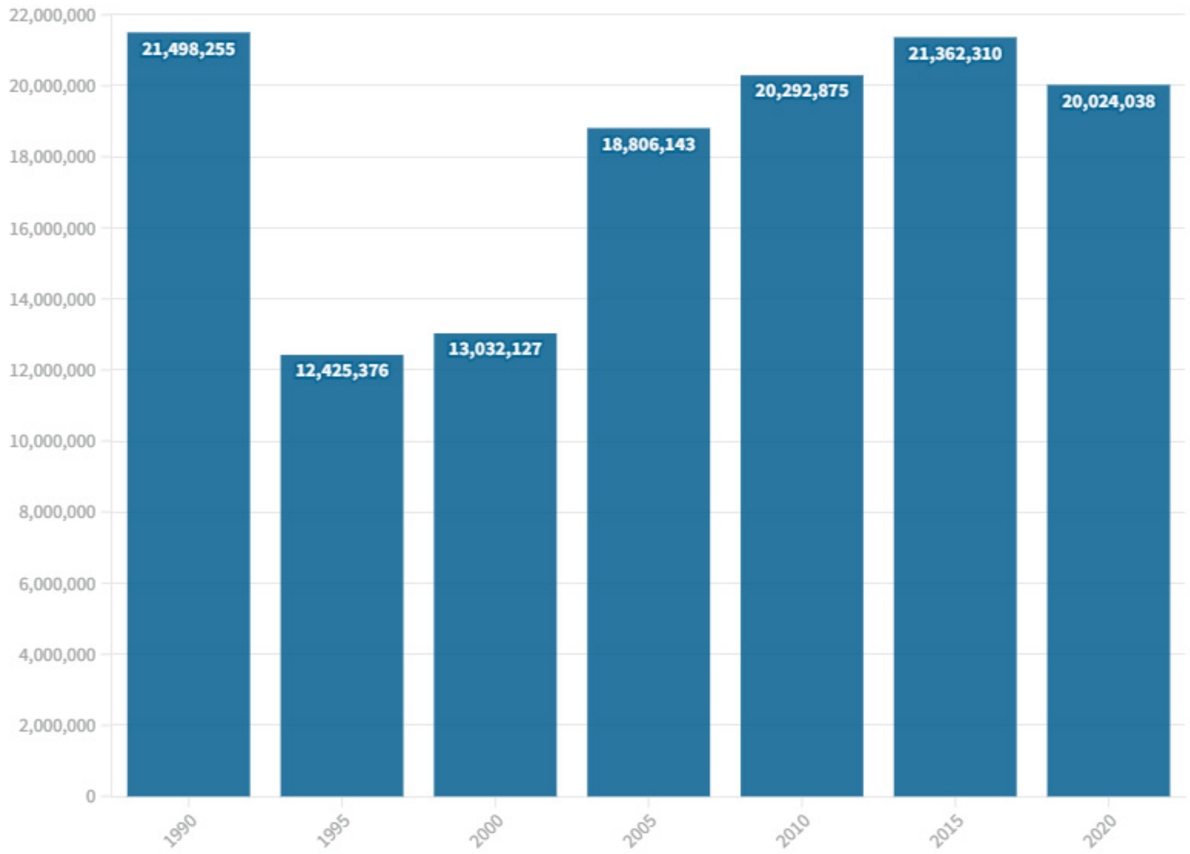

Figure 1 - Russia Oil Production, 1990-2020 (TJ) [Data source: IEA]

Things went on smoothly with exporting the crude and refined oil products. At least, they did so until 2014 when Russia annexed Crimea and began a war against Ukraine in Donbas. However, despite all-out condemnation and some punitive measures for such actions[7], sales of fossil fuels continued undisturbed towards Europe and North America, while also increasing in volume in regard to Asian markets. Indeed, a drop in revenues was registered immediately after 2014 (see Figure 2 below), but this rather reflected market conditions, as the price of oil steeply decreased due to increased

[7] For US sanctions, see Dianne E. Rennack, Cory Welt, 'U.S. Sanctions on Russia: An Overview', Congressional Research Service, IF10779, updated 29 August 2019, available at https://crsreports.congress.gov/product/pdf/IF/IF10779/7 (consulted on 30 September 2022). Initially adopted in 2014, they were enhanced in 2017. For corresponding EU sanctions, see Council Decision 2014/145/CFSP, 17 March 2014; Council Decision 2014/512/CFSP, 31 July 2014; Council Decision 2014/386/CFSP, 23 June 2014. These initial sanctions have been closely followed by those imposed by Australia, Canada, Japan, Iceland, Albania, Montenegro, Norway and Switzerland. In a certain manner, such sanctions were intended to curtail Russia's future production capacities, by (partially) blocking technology transfers and the involvement of Western companies in additional exploration/exploitation projects, but they largely focused on targeting specific individuals and decision makers that were deemed responsible for the illegal acts against Ukraine.

OPEC production and a surge in North American supplies.[8] Nonetheless, actual exported volumes flowing from Russia increased after 2014, from around 4.5 million barrels of crude oil per day to over 5 million.[9]

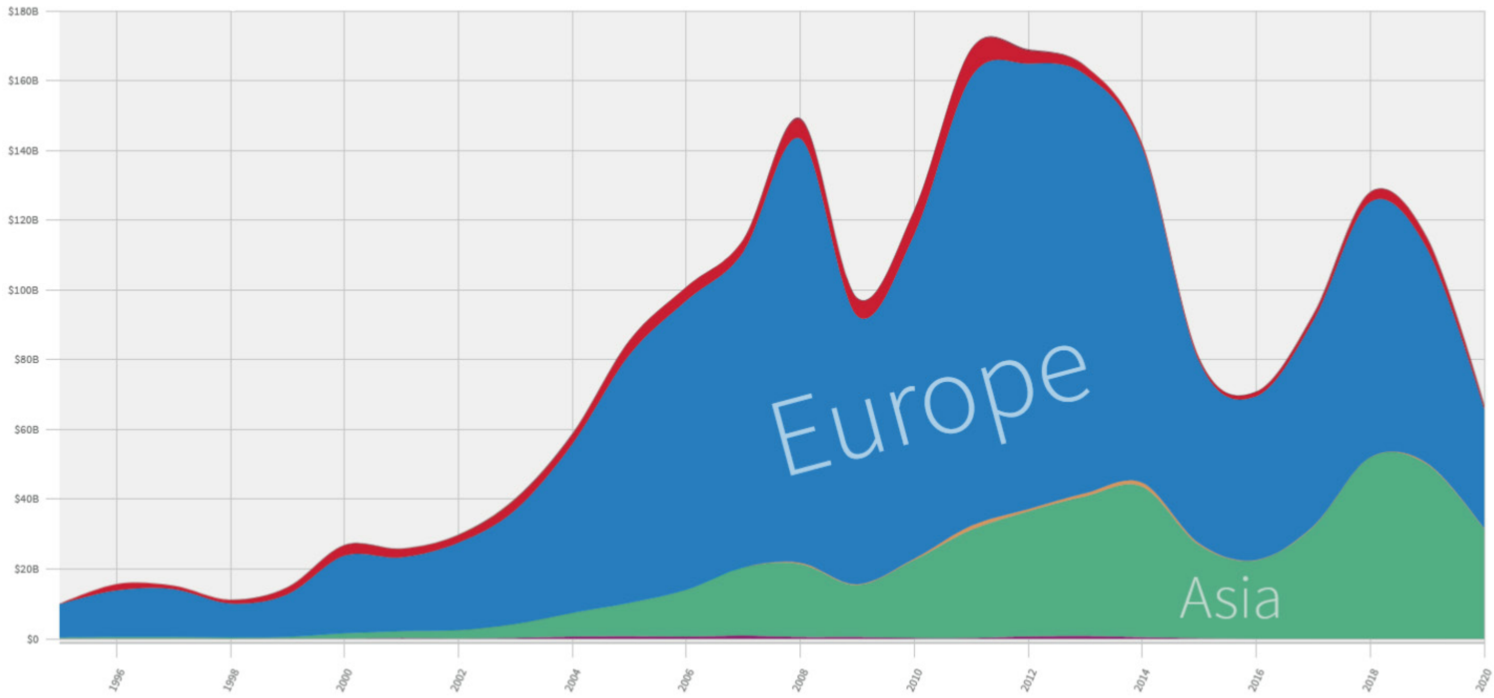

Figure 2 - Russia Export of Crude Oil, 1995-2020 (billion USD)
[Source: Atlas of Economic Complexity, UN Comtrade data]

Also playing its relatively volatile hand and coordinating with OPEC, Moscow agreed upon (further) increasing the cartelization of the oil market along with Saudi Arabia and, in 2016, a first cut in petroleum output took shape, allowing major producers to benefit from higher prices and revenues. For the Kremlin, the move was not merely financial in nature, but had a political underpinning, considering such international cooperation and energy 'great games' as a "symbolic and practical countermeasure against the attempt by Western states to isolate Russia through sanctions".[10]

[8] Dave Mead and Porscha Stiger, 'The 2014 plunge in import petroleum prices: What happened?', U.S. Bureau of Labor and Statistics, Beyond the Numbers, May 2015 - Vol. 4 / No. 9, available at https://www.bls.gov/opub/btn/volume-4/pdf/the-2014-plunge-in-import-petroleum-prices-what-happened.pdf (consulted on 29 September 2022).

[9] OPEC data as compiled by CEIC, available at https://www.ceicdata.com/en/indicator/russia/crude-oil-exports (consulted on 29 September 2022).

[10] See Mikhail Krutikhin and Indra Overland, 'OPEC and Russia: A Happy Pro Forma Marriage', in Dag Harald Claes and Giuliano Garavini (eds.), *Handbook of OPEC and the Global Energy Order Past, Present and Future Challenges*, Routledge, 2020, p. 244.

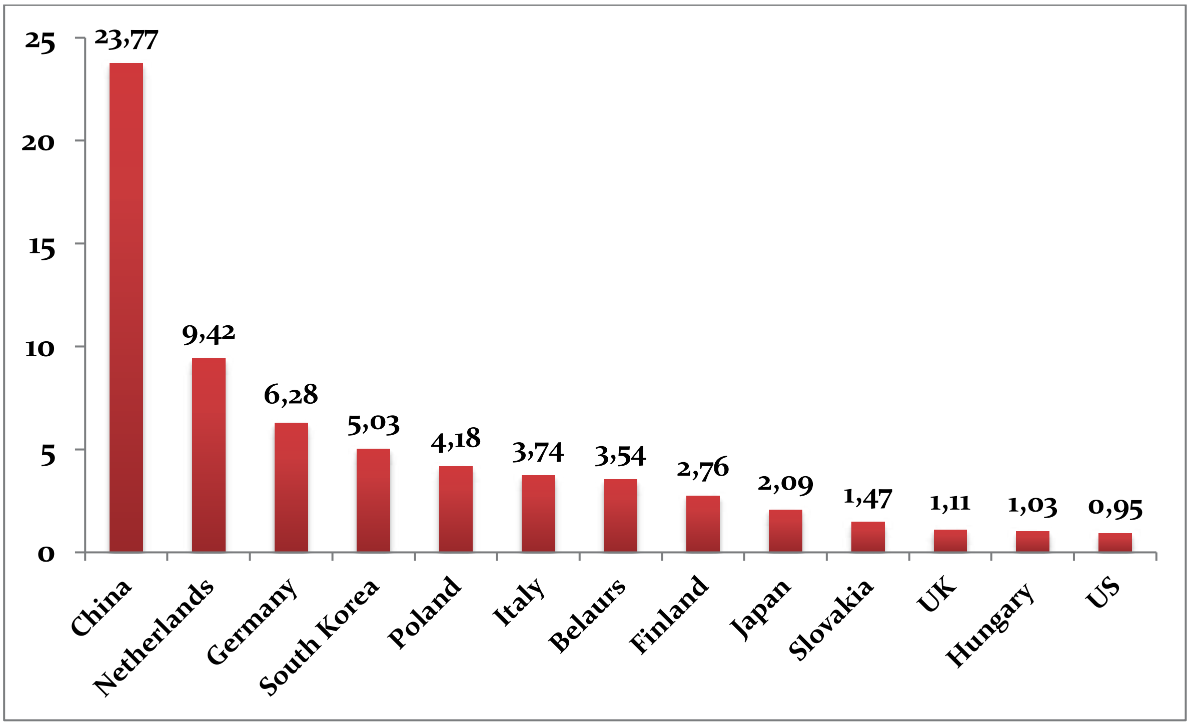

Figure 3 - Russia Top Export Destinations for Crude Oil, 2020 (billion USD)
[Data source: UN Comtrade]

And, thus, in 2021, Russia still exported an average of 4.7 million barrels of crude oil per day, at a higher value than in the immediate post-2014 period. Its top – collective – destination was Europe, followed by Asia and North America.[11] The geographic dispersion of exports remained fairly stable (see Figure 3 above), despite initial EU and US sanctions, allowing Moscow to fill its treasury with funds flowing from Western countries which maintained their energy dependence upon its energy products. As the conflict appeared rather frozen in the Donbas, no further punitive action was taken and business continued as usual.

Market Structure, Export Patterns

As a matter of internal market structure, domestic companies held a quasi-absolute monopoly on the exploitation of energy resources (despite circumstantial partnerships with Western undertakings on certain projects). In 2020, this situation

[11] IEA factsheet, 'Energy Fact Sheet: Why does Russian oil and gas matter?', IEA, 21 March 2022, available at https://www.iea.org/articles/energy-fact-sheet-why-does-russian-oil-and-gas-matter (consulted on 26 September 2022).

reflected in having over 80% of Russia's crude oil production stemming from a number of merely five actors: Rosneft, Lukoil, Surgutneftegas, Gazprom and Tatneft.[12]

For delivering its crude to the largest customers – Europe (EU-UK) and China – Moscow relies on two possible paths: via pipelines or seaborne shipping. Flowing westwards, the (main) Druzhba pipeline and the Baltic Pipeline System (I and II) ensure a steady supply to its Western partners. In the opposite direction, the East Siberia-Pacific Ocean and the Atasu-Alashankou (via Kazakhstan) pipelines allow petroleum to reach the Chinese market. Traditionally, supply through this type of fixed infrastructure provided roughly 50% of the Russian exported oil.[13] However, in the case of Europe, the percentage was considerably different, corresponding only to 15-30% of the received quantities.[14]

Port	Exports (1000 barrels/day)
Primorsk	**616**
Nakhodka	**611**
Novorossiysk	**459**
Ust-Luga	**437**
Murmansk	**271**
Sokol Sakhalin	**265**
Varandey	**221**
Others	**127**

Table 1 - Russia Exports of Crude Oil, Seaborne, 2020 (1000 barrels/day) [Source: U.S. IEA]

The other option is by using tankers to ship oil. And this represented an ever increasing part of Russia's export patter, even before the war. It presents flexibility, better apportioning of resources and does not present the same high investment requirements as building (or expanding) a pipeline. In 2020, Moscow largely relied on 7 major ports for loading its oil cargoes (see Table 1 above). From these, Primorsk, Novorossiysk[15], Ust-Luga and Murmansk are – largely – dedicated to Western

[12] Rystad data compiled by the U.S. Energy Information Administration, Country Analysis: Russia, update of 13 December 2021, available at https://www.eia.gov/international/content/analysis/countries_long/Russia/russia.pdf (consulted on 29 September 2022).

[13] Carol Zu, 'Russia crude oil pipeline capabilities to mainland China—The ESPO crude oil pipeline', IHS Markit – S&P Global, 1 April 2022, available at https://ihsmarkit.com/research-analysis/espo-crude-oil-pipeline.html (consulted on 30 September 2022).

[14] 'How Russian oil flows to Europe', Transport and Environment, Briefing, 7 March 2022, available at https://www.transportenvironment.org/wp-content/uploads/2022/03/20220303_russian_oil_in_the_EU.pdf (consulted on 1 October 2022).

[15] Partially supplied via the Caspian Pipeline Consortium with oil from Kazakhstan (ensuring the loading of almost 80% of Kazakh petroleum).

customers[16], being the largest ones, while the remaining three serve other parts of the world, mainly China.

In this context, with fully functional (productive) oil fields and transport capacity, the (collective) West remained Russia's largest petroleum consumer, despite diplomatic hiccups and targeted sanctions. As far as 2021, it still was the privileged destination of nearly 70% of Moscow's oil exports. While prices might have dropped globally, Russia still managed to raise (consistent) profits, given its breakeven costs of around 30-40 USD/barrel[17], allowing it to successfully weather the political storm and the associated punitive measures. With revenues not as high as it would have desired, but nonetheless satisfactory, the Kremlin took its Western markets for granted and prepared for its next strategic move, wagering that business will continue as usual. No matter what.

3. Game-changer 2022: When Sanctions Alter Geography

However, February 2022 proved to be a reality check for all the parties involved. For Russia itself and for its complacent customers overseas. The full-scale invasion changed the fundamentals of the game in ways unfathomable before. As the whole international community witnessed an event no one was prepared for, the energy markets responded immediately, transforming the entrenched transactional approach into a bet of 'who-blinks-first'. Militarily, politically and financially. It was no longer a question of geopolitical 'hiccups', but of a rupture in terms of confidence and willingness to continue partnering even in pragmatic sectorial matters.

A Western (Energy) Closure: Sanctions, Prices and Profits

As a matter of international pricing, Brent crude oil prices jumped from around 85 USD/barrel before the invasion to a peak of 123 USD/barrel in early March. Steadily, the prices stabilized – downwards – for nearly six months at an average of 100 USD/barrel. The markets quickly anticipated the incoming Western sanctions, raising the demand for oil from other sources. However, with Iran and Venezuela still offline in terms of consistent deliveries, the array of choices remained limited, increasing the pressure on prices and maintaining them at a (highly) profitable level for the Russian producers (see Figure 4 below).

[16] Also see, in this regard, data collected by the Brugel team in the data set 'Russian crude oil tracker', available at https://www.bruegel.org/dataset/russian-crude-oil-tracker (consulted on 1 October 2022).

[17] See Aaron Brady, 'Global crude oil cost curve shows 90% of projects through 2040 breaking even below $50/bbl', IHS Markit – S&P Global, 10 September 2022, available at https://ihsmarkit.com/research-analysis/global-crude-oil-curve-shows-projects-break-even-through-2040.html (consulted on 1 October 2022).

While the effect was rather limited for the United States, it presented serious challenges for the European Union which relied on Moscow for almost 30% of its crude oil imports and a relevant share of refined products (diesel and naphtha).[18] Nonetheless, both Western actors decided to take decisive measures against Russia's petroleum industry, curtailing its capacity to reach their lucrative energy markets.

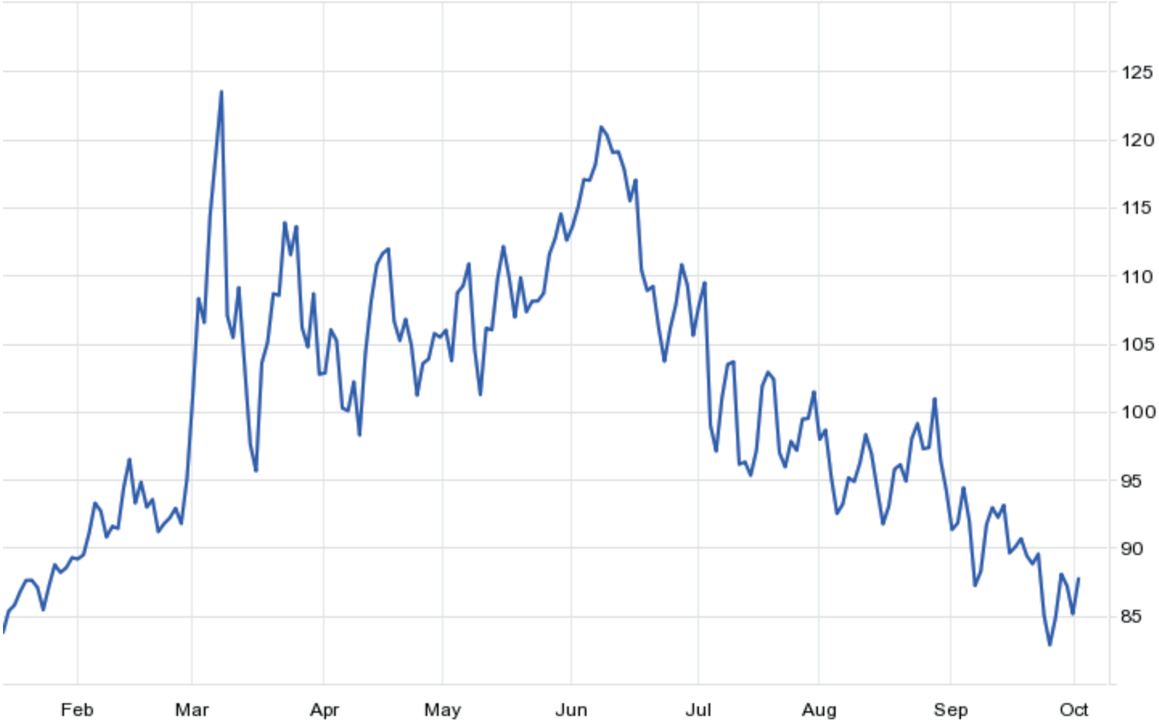

Figure 4 - Crude Oil Prices (Brent), February-October 2022 (USD/bbl)
[Source: Trading Economics]

In essence, the United States adopted a package of measures that initially targeted central elements of Russia's industry and financial structure, explicitly providing caveats for energy dealings. However, as the military situation escalated and Moscow showed no signs of backing down, such sanctions gradually increased in scope and depth, allowing the United States to instill a ban on Russian petroleum imports and

[18] See Bassam Fattouh, 'Russia's Invasion of Ukraine: New Oil Order?', The Oxford Institute for Energy Studies, 2 May 2022, available at https://www.oxfordenergy.org/wpcms/wp-content/uploads/2022/05/Russias-Invasion-of-Ukraine-New-Oil-Order.pdf (consulted on 3 October 2022).

restrict the use of the international payment systems for such transactions.[19] Along with direct prohibitions on technology transfers and sales, specific sanctions upon relevant companies, persons and decision-makers within political and economic circles, such measures paved the way for a metamorphosis of the global petroleum flows.

This US comprehensive punitive package was closely mirrored by EU actions. While slower in terms of implementation and narrower in their scope, given the increased interdependence, European sanctions provided another blow to Moscow's international portfolio of customers. More precisely, in June 2022, the bloc adopted its 6th package of measures[20], effectively phasing out the *seaborne* import of Russian crude petroleum within a transitory period of 6 months. Refined products benefit from a longer (8 months) permissible timeframe.

Certain exemptions have been granted to a number of over-reliant member states, while imports via pipeline remain allowed. In addition, although often seen as a minor issue, EU operators are banned 'from insuring and financing the transport, in particular through maritime routes, of Russian oil to third countries', increasing the logistical challenges (and cost structure) for Russian seaborne exports in a global transport market dominated by Western actors.

Although concerns had been raised regarding the viability of such measures and their indirect effect upon (already impoverished) third parties[21], they were implemented rigorously even by actors who were not (yet) compelled legally to do so. Private companies all over the world were indirectly dissuaded to provide assets, know-how and

---

[19] In this regards, see Executive Order 14066 of March 8, 2022, 'Prohibiting Certain Imports and New Investments With Respect to Continued Russian Federation Efforts To Undermine the Sovereignty and Territorial Integrity of Ukraine', Federal Register, Vol. 87, No. 47, Thursday, March 10, 2022, available at https://home.treasury.gov/system/files/126/eo_14066.pdf (consulted on 3 October 2022). For a comprehensive image of the whole array of sanctions, see Cory Welt, 'Russia's Invasion of Ukraine: Overview of U.S. Sanctions and Other Responses', CRS Insight IN11869, 6 July 2022 update, available at https://crsreports.congress.gov/product/pdf/IN/IN11869 (consulted on 3 October 2022).

[20] The legal instruments for the sanctions are the following: Council Implementing Regulation (EU) 2022/878 of 3 June 2022 implementing Regulation (EU) No 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine, OJ L 153, 3.6.2022, p. 15; Council Regulation (EU) 2022/879 of 3 June 2022 amending Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilizing the situation in Ukraine, OJ L 153, 3.6.2022, p. 53; Council Decision (CFSP) 2022/883 of 3 June 2022 amending Decision 2014/145/CFSP concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine, OJ L 153, 3.6.2022, p. 92; Council Decision (CFSP) 2022/884 of 3 June 2022 amending Decision 2014/512/CFSP concerning restrictive measures in view of Russia's actions destabilizing the situation in Ukraine, OJ L 153, 3.6.2022, p. 128.

[21] See the account of Filip Medunic, 'The EU's sixth sanctions package: A battle of narratives', ECFR, 17 June 2022, available at https://ecfr.eu/article/the-eus-sixth-sanctions-package-a-battle-of-narratives/ (consulted on 3 October 2022).

services to Russian oil producers and exporters long before any mandatory transition period had passed, in a prudent act of 'self-sanctioning'.[22]

Even more, some operators from countries that did not fall under Western legal obligations – many from Moscow-friendly countries – also refrained from getting involved any further in such an uncertain landscape, preferring to preserve their good business relations with the EU and US markets, rather than undertaking a long-term entrenchment in privileged dealings on the sidelines of the international markets.[23]

Rerouting the Flows: One Step Further (East), Three Steps Back (West)

Nonetheless, Russia proved successful – at least for a period – in rerouting its petroleum flows towards other areas of the world, increasing its market-share for traditional customers (such as China, India or Turkey) and gaining new (minor) clients in the interim (such as Egypt and the UAE). With higher volumes (see Figure 5 below) and increased prices in the first six months, the actual revenues proved a bonus for Moscow, as the EU sanctions had not yet the occasion to produce effects upon the export patterns.

[22] Bassam Fattouh and Andreas Economou, 'Russia's Invasion of Ukraine and Oil Market Dynamics', The Oxford Institute for Energy Studies, 8 June 2022, available at https://www.oxfordenergy.org/wpcms/wp-content/uploads/2022/06/Russias-Invasion-of-Ukraine-and-Oil-Market-Dynamics.pdf (consulted on 4 October 2022).

[23] Even for Chinese companies – the greatest beneficiaries of cheap Russian oil – there have been signs of reluctance in stepping up upfront involvement. They are making short-term deals, honoring existing contracts, but are extremely attentive to future US and EU sanctions. See, in this sense, 'China's State Banks Restrict Financing for Russian Commodities', Bloomberg News, 25 February 2022, available at https://www.bloomberg.com/news/articles/2022-02-25/chinese-state-banks-restrict-financing-for-russian-commodities (consulted on 4 October 2022); Erica Downs, 'A Friend in Need is a Friend Indeed? China-Russia Energy Relations in the Wake of the War in Ukraine', Columbia | SIPA, 15 September 2022, available at https://jia.sipa.columbia.edu/online-articles/friend-need-friend-indeed-china-russia-energy-relations-wake-war-ukraine (consulted on 4 October 2022).

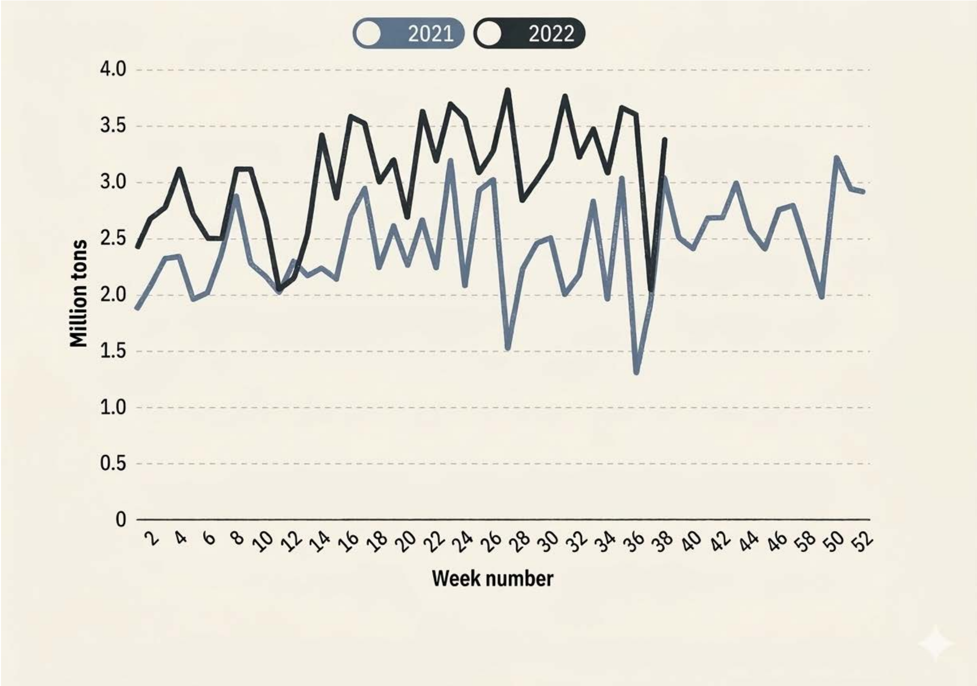

Figure 5 - Russia Crude Oil Exports, 2021 vs. 2022 (million tons) [Source: Using data collected from Bruegel, graph generated by Gemini at the request of New Startegy Center]

Thus, since the beginning of the invasion, Russia cashed in around 115 billion EUR from petroleum exports, with 52 billion (still) coming from the European Union, as a main customer. However, volumes for Europe dropped when compared to the previous year, especially after the announcement of the 6th sanctions package, supporting the conclusion of a market share increase elsewhere. The 'beneficiaries' of this new geoeconomic disruption within the global petroleum landscape? Apparently, first and foremost, China, followed by India and Turkey.

Being capable of offering substantial price discounts for the Urals crude as compared with the Brent variety, ranging from 30-40$ per barrel (initially) to 18-25$ (later on)[24], Moscow managed to prepare for a partial decoupling from European customers. A reconfiguring of transport routes and export destinations (in terms of usually traded volumes) had taken effect, although not as significant as it would have been expected.

[24] Francesco Sassi, 'Russia's Energy Game in Asia', The Diplomat, 27 September 2022, available at https://thediplomat.com/2022/06/asia-cant-save-russias-energy-sector/ (consulted on 10 October 2022).

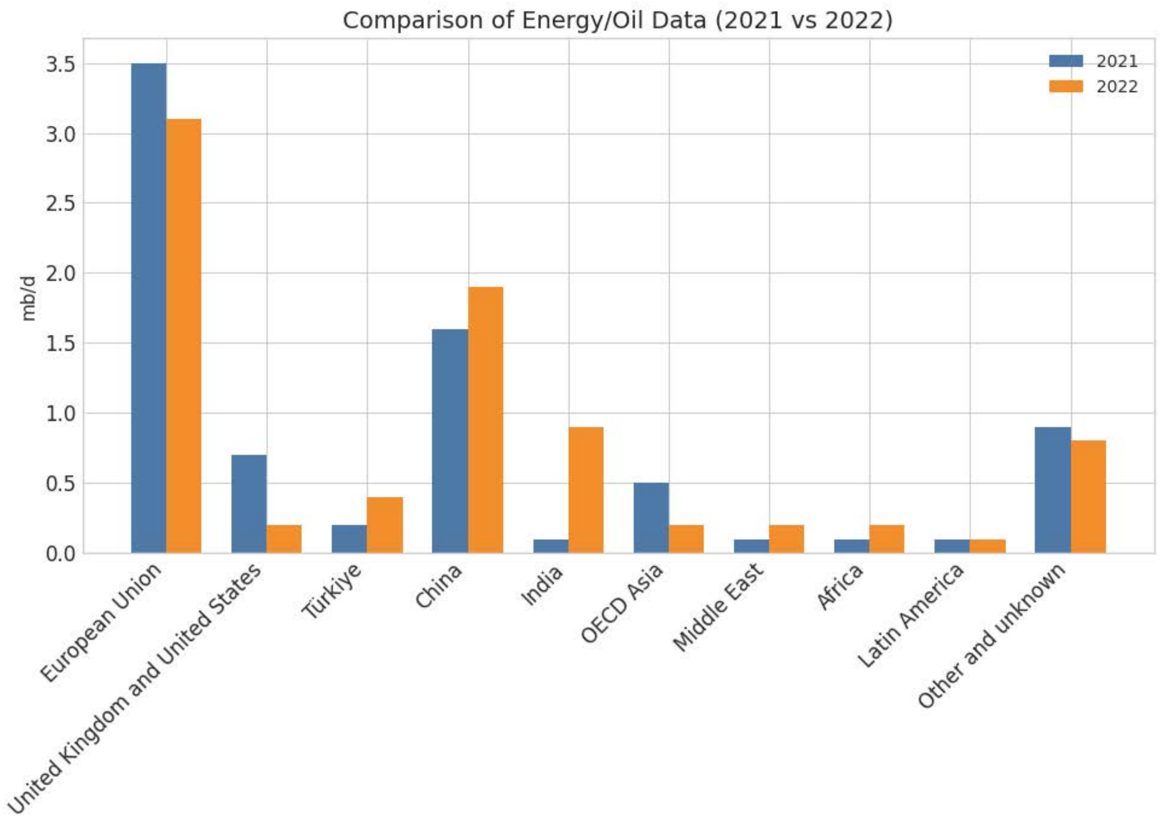

Figure 6 - Russia Crude Oil Export Destinations, 2021-2022 (total landings)

More precisely, Chinese imports of Russian crude nearly doubled in this period, while Indian acquisitions increased more than tenfold, allowing Moscow to become one of the top suppliers, up from a quite marginal position in its portfolio.[25] For both actors, the Russian offer proved to be one they could not refuse, arriving with substantial price discounts, unrivalled by other suppliers so far. Turkey also followed this trend and doubled the purchased quantities[26] stemming from its Pontic neighbour, as the NATO member took a distinct line and refrained from imposing sanctions of its own.

At the same time, Egypt and the UAE emerged as significant importers, using (some of) the petroleum for their needs, but also 'whitewashing' it and providing an

[25] See Nicholas Trickett, 'Asia Can't Save Russia's Energy Sector', The Diplomat, 28 June 2022, available at https://thediplomat.com/2022/06/asia-cant-save-russias-energy-sector/ (consulted on 10 October 2022); 'China's Spending on Russian Energy Jumps to $6.4 Billion in June', Bloomberg , 20 July 2022, available at https://www.bloomberg.com/news/articles/2022-07-20/china-s-spending-on-russian-energy-jumps-to-6-4-billion-in-june (consulted 10 October 2022); 'Ukraine crisis: Russian oil and gas turn to Asia', BBC, 30 September 2022, available at https://www.bbc.com/news/world-asia-india-60783874 (consulted on 10 October 2022).

[26] 'Turkey doubles Russian oil imports, filling EU void', Reuters, 22 August 2022, available at https://www.reuters.com/business/energy/turkey-doubles-russian-oil-imports-filling-eu-void-2022-08-22/ (consulted on 10 October 2022).

outlet for re-export to third countries.[27] Thus, as newcomers to a significant quantity of Russian oil – from a virtually low-profile trading position – the two countries allowed the Kremlin to keep playing in the 'grand league', despite the foreclosure of some traditional markets and to tap into (previously) underdeveloped supply relationships.

However, despite this circumstantial increase in exports to Asia and a total halt of any sales to the US and UK, the European Union still remains Russia's largest petroleum customer. And such an aporetic energy position raises structural challenges for a successful decoupling until December, if the Kremlin intends on maintaining a comparable level of revenues. Dealings with OPEC might bring along a short-term respite from a price drop, but Gulf producers are not eager to see their own market shares plunge in Asia on the long run, as Moscow increases sales in that part of the world to their detriment.

Thus, as a game of variable volumes and prices, Russia's export patterns (and revenue flows) remains seated on unstable ground, witnessing an increased volatility and being pressured for rebates, situation which makes it unlikely to conserve its capability to extract the same inflows of hard currency into its treasury. This 'gold' might be black and liquid, but its exploitation is not – for evident political reasons – certain in terms of profitability. The ability to simply produce it does not automatically translate in a possibility to sell it as nothing significant would have happened in the interim.

4. Aftermath: A Matter of Value(s)

In these circumstances, as early as July 2022, a contraction in output was registered. While still mitigated by high prices until the end of August, the story started to develop differently starting with September. Initially, the first six months of the invasion turned out to be quite profitable for the dwindling Russian oil industry, as high prices coupled with steady volumes maintained a steady flow of revenues for Kremlin 'fossil' treasury.

[27] See the report 'Financing Putin's war: Fossil fuel exports from Russia in the first six months of the invasion of Ukraine', CREA, September 2022, available at https://energyandcleanair.org/publication/financing-putins-war-fossil-fuel-exports-from-russia-in-the-first-six-months-of-the-invasion-of-ukraine/ (consulted on 10 October 2022).

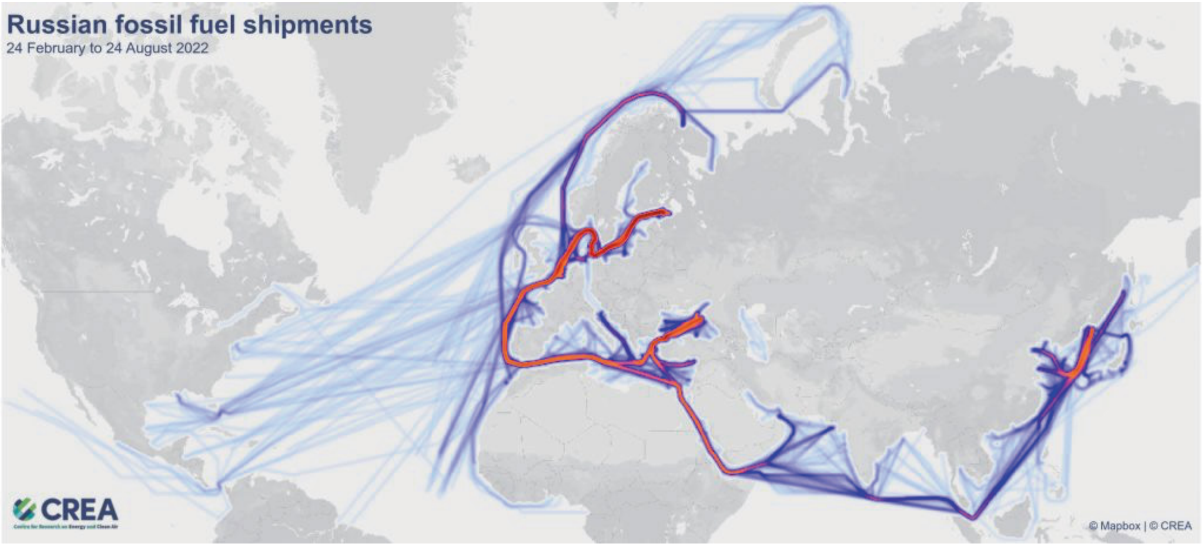

Figure 7 - Centre for Research on Energy and Clean Air (CREA), Weekly snapshot: Russian fossil fuel exports, 21–27 November 2022, , energyandcleanair.org.

But, then, sanctions started to bite in. A European ban in December, an upcoming price cap and the disappearance of several trade partners took their toll. Doubled by a drop in global oil demand[28], such measures affected Russia's stream of revenues from this particular lucrative source. Even in the July-August period, EU petroleum imports dropped around 17% when compared with the existing level at the commencement of the invasion, while September compounded the decrease globally. The demand of China and India registered a decline, unable to be mitigated by episodic surging exports to Malaysia.

Over the map, Russia increasingly appeared as scrambling for new customers, for increasing market shares in areas where it only played a marginal role before, offering (price) incentives meant to compensate for Western opprobrium. But to no significant avail. And with no long-term viable plan to replace its most profitable business venue in Europe.

At face value, while Russia's export plunge has – so far – only manifested in the range of 200000-500000 barrels per day[29], it is estimated that it will gradually reach levels as high as 1.2-1.9 million per day at the beginning of the next year, once the

[28] In this sense, see the CREA September update, 'September update on Russian fossil fuels: EU imports cross EUR 100 billion since the beginning of the invasion', CREA, 4 October 2022, available at https://energyandcleanair.org/september-2022-update-on-russian-fossil-fuels (consulted on 11 October 2022).

[29] When compared on a weekly basis, such figures also rise as high as 900000 barrels per day – see Julian Lee, 'Russian Oil Flows Dive, Hurting Putin's War Chest', Bloomberg, 20 September 2022, available at https://www.bloomberg.com/news/articles/2022-09-20/russian-oil-flows-dive-hurting-putin-s-war-chest (consulted on 12 October 2022).

sanctions shall be enforced.[30] Details regarding the implementation of a G7 price cap[31] are still under discussion, but they are designed to apply to all of Russia's seaborne sales around the globe, as far as they shall prove enforceable against a sufficient number of third parties.

Such price-limiting measures aim to limit Russia's oil export profitability, by trimming down the sky-high margins generated by a crisis of its own making. In practically implementing such a price cap, some have considered a *financial* orientation, in the range of 50-60 USD/barrel, just above production costs, while others have offered a *historical* benchmark, around 70 USD/barrel, as it was in the first half of 2021, before any Russian sign of aggression loomed on the horizon.[32]

So far, the European Union created the conditions for imposing such a price cap by adopting its 8th sanctions package. In addition to measures pertaining to financing and insuring the shipment of Russian oil (agreed in the 6th package), this set will directly interfere with the transport activity itself, making it impossible for European operators to ship such products if their final price at a non-EU destination does not comply with the price cap.[33] This is extremely relevant for Moscow's trading pattern, as most of its fossil fuel shipments either use European vessels or are insured by companies registered in the Union.[34]

Trying to prepare for such a dim financial scenario, the Kremlin played one of its final cards, proposing (and obtaining) an OPEC+ quota reduction. In this sense, both Russia and Saudi Arabia agreed upon voluntary cutbacks in production of around 500000 barrels per day for each of them, while the overall group-quota would drop with 2 million barrels starting in November.[35] However, the self-imposed limits do not seem

---

[30] In this sense, consult the IEA monthly report, 'Oil Market Report - September 2022', IEA, September 2022, available at https://www.iea.org/reports/oil-market-report-september-2022 (consulted on 12 October 2022). Also see, 'OIES Oil Monthly – Issue 17', The Oxford Institute for Energy Studies, September 2022, available at https://www.oxfordenergy.org/publications/oies-oil-monthly-issue-17/ (consulted on 10 October 2022).

[31] See 'G7 Finance Ministers' Statement on the united response to Russia's war of aggression against Ukraine', 2 September 2022, available at https://www.bundesfinanzministerium.de/Content/EN/Downloads/G7-G20/2022-09-02-g7-ministers-statement.pdf?__blob=publicationFile&v=9 (consulted on 12 October 2022).

[32] Lauri Myllyvirta, 'The Economics of Price Caps', CREA, 4 October 2022, available at https://energyandcleanair.org/the-economics-of-price-caps/ (consulted on 12 October 2022).

[33] See the press release, European Commission, 'Ukraine: EU agrees on eighth package of sanctions against Russia', 6 October 2022, available at https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5989 (consulted on 12 October 2022).

[34] Lauri Myllyvirta, 'How Europe can slash the Kremlin's fossil fuel revenue with price caps', CREA, 4 October 2022, available at https://energyandcleanair.org/how-europe-can-slash-kremlins-fossil-fuel-revenue-with-price-caps (consulted on 12 October 2022).

[35] Trent Jacobs, 'Citing Market Uncertainty, OPEC+ Shaves Quota by 2 Million B/D', Journal of Petroleum Technology, 5 October 2022, available at https://jpt.spe.org/citing-market-uncertainty-opec-shaves-quota-by-2-million-b-d (consulted on 12 October 2022).

to be capable of producing the desired effects, given that many of the OPEC+ members already failed to meet their previous quotas.[36] Even more, such an envisioned cutback on behalf of Russia – 500000 bbl/day – merely seems to formalize the demise of a quantity which it already proved unable to place on the market.

At the same time, while the Gulf countries' *energy joy ride* with Russia might be profitable at the moment, their approach is fundamentally transactional and commercially opportunistic.[37] It does not express a geopolitical commitment. Not even a slight preference or a partnership for the long run. Quite the contrary, Saudi Arabia (and the others) might be content with the high prices for the time being, but a question of market share looms on the horizon.

As India and China increase their imports from Russia, Gulf countries lose volumes. And the situation is even more troubling for Iran, a close ally of Moscow, but which is over-reliant on Asian markets. In order to compete with the (cheaper) flow of Urals discounted oil, Teheran saw itself forced to lower the price even further for maintaining its position.[38] Thus, on the medium and long-term, both OPEC and non-OPEC large producers might find that Russia's overtures are not beneficial – after all – for sustaining their own trading positions globally.

In the meantime, the (sanctions) clock is ticking. For easing the initial shocks, the US and the EU hold additional instruments, besides the 'stick' approach. A veritable geopolitical 'carrot' can be wielded, conditionally allowing Iran and Venezuela to return to the global market, mitigating the disappearance of Russian volumes and helping to 'tame' prices at a palatable level. On the other hand, Moscow maintains only one last shot in the energy war. Completely refusing to sell its products and – thus – temporarily creating panic and chaos on the markets. Quasi-suicidal economically, such a move is all that remains possible to significantly alter the path laid forth through sanctions.

Following the same slippery road to uncertainty, Russia's projects for a long-term increase of petroleum sales to China and India remain punctured by logistic challenges. And time-constrained. New pipelines and the development of a seafaring fleet of the

---

[36] 'OPEC+ Actual Oil Output Fall To Be Lower Than Production Quota Cuts', Fitch Ratings, 10 October 2022, available at https://www.fitchratings.com/research/corporate-finance/opec-actual-oil-output-fall-to-be-lower-than-production-quota-cuts-10-10-2022 (consulted on 12 October 2022).

[37] Andrew S. Weiss, Jasmine Alexander-Greene, 'What's Driving Russia's Opportunistic Inroads With Saudi

Arabia and the Gulf Arabs', Carnegie Endowment for International Peace, 5 October 2022, available at https://carnegieendowment.org/2022/10/05/what-s-driving-russia-s-opportunistic-inroads-with-saudi-arabia-and-gulf-arabs-pub-88099 (consulted on 13 October 2022).

[38] Bozorgmehr Sharafedin, Florence Tan, Chen Aizhu, 'More Russian oil going east squeezes Iranian crude sales to China', Reuters, 19 May 2022, available at https://www.reuters.com/business/energy/more-russian-oil-going-east-squeezes-iranian-crude-sales-china-2022-05-19/ (consulted on 13 October 2022); 'Iran Slashes Cost of Its Oil to Compete With Russia in China', Bloomberg, 3 July 2022, available at https://www.bloomberg.com/news/articles/2022-07-03/iran-slashes-the-cost-of-its-oil-to-compete-with-russia-in-china (consulted on 13 October 2022).

size necessary to compensate for the refusal of Western transporters to ship Moscow's oil require a substantial amount of investment and advanced technology. And the Kremlin is short on both.

Other major players – including China and India – might be willing to purchase (heavily) discounted goods, but they do not appear eager to embark on durable projects alongside Russia which might come under the sanctions-oriented scrutiny of the EU and the US, threatening to 'contaminate' their own critical energy companies. Deals on the sidelines of the global markets, discrete ship-to-ship transfers[39], 'whitewashing' of Russian oil might represent an opportunity for the moment, but nothing more at the cost of their own strategic industrial champions.

Moreover, given the West's dominance in shipping, the situation looks dire for exporting a commodity whose main transport method is by loading it onto vessels. For instance, since 24 February, it appears that almost 50% of the Russian seaborne oil used Greek ships to arrive at its destination, with an additional 10% for other European (UK, German and Monegasque) naval players. For comparison, Russian ships only accounted for 4%, Chinese ones for almost 10%, UAE for 14% and Turkish ones for 5%.[40]

The discrepancy is obvious and presents an insurmountable dilemma for both Moscow and its (still lucrative) customers. Replacing such a high number of maritime services providers or developing pipeline alternatives is not a task easily performed even in times of peace. All the more, if such a Sisyphean effort could somehow secure the necessary funding, technology and specialized workforce, the time factor is not working in Kremlin's favor. No breakthrough out of the West's sanctions' isolation can be viably performed in 2023 or even 2024. And Russia's coffers will be slowly and irremediably emptying, month after month.

Despite working gradually and – perhaps – slower than expected, global sanctions are nonetheless efficient at eroding the Kremlin's economic capacity. With added layers of measures, they shall only increase the pressure and restrict Moscow's space for maneuver. Moreover, if additional rounds of generalized sanctions will be designed to become applicable to third parties, in the sense of denying access to US and European finances, ports, business opportunities and services for non-compliant companies, Russia's isolation will be almost complete, putting it in the uncomfortable situation of a near-rogue state.

[39] Nonetheless, many such transfers also take part on EU coasts or by using EU-owned assets – see 'Russian Oil Continues To Flow To Europe As Vessels Use Ship-To-Ship Transfers Off The Greek Coast Since The War In Ukraine', Marine Insight, 9 September 2022, available at https://www.marineinsight.com/shipping-news/russian-oil-continues-to-flow-to-europe-as-vessels-use-ship-to-ship-transfers-off-the-greek-coast-since-the-war-in-ukraine/ (consulted on 18 October 2022).

[40] In this regard, see the calculations made for the EUObserver investigation, 'The European shipping giants plying Putin's fossil-fuels trade', 29 September 2022, available at https://euobserver.com/ukraine/156153 (consulted on 20 October 2022).

Given this bleak financial and logistic horizon, the costs of waging war shall increase the burden upon the budget, requiring a reduction in other public expenses and altering the social compact with its population. Because a treasury built upon oil is one with liquid foundations, structurally exposed to geopolitical tempests. Especially to those of one's own making.

* * *

About the Author

Horia Ciurtin is an Expert at the New Strategy Center (Bucharest, Romania), a Research Fellow for the European Federation for Investment Law and Arbitration (Brussels, Belgium), and an External PhD Researcher at the Amsterdam Center for International Law (Amsterdam, Netherlands). He also serves as an independent consultant in the field of international investment law & political risk throughout the Balkans and CEE.

NEW STRATEGY CENTER

www.newstrategycenter.ro