

Moves to Enhance Energy Embargo on Russia and Their Impacts

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The Group of Seven industrial democracies and the European Union on April 7 announced tougher Russia sanctions including an embargo on Russian coal, as discussed in *A Japanese Perspective on the International Energy Landscape (579)*. The tougher sanctions came after the unacceptable mass killing of civilians by Russian forces was found in suburbs of the Ukrainian capital of Kyiv and triggered harsh international criticism against Russia.

Since the outbreak of the Ukraine crisis, Western countries have enhanced economic sanctions on Russia. Western countries have increasingly recognized that a major problem with sanctions on Russia would be the exception of the energy sector that is extremely important for the Russian economy. They have also acknowledged that buying Russian energy sources would bring about income for Russia, amounting to financial support for Russia's continuation of its military invasion into Ukraine.

However, energy exports that are extremely important for the Russian economy are extremely significant for countries that purchase and consume Russian energy imports. Russia is a key international energy market player, commanding 11% of the international oil market, 25% of the gas and LNG market and 18% of the coal market. Particularly in Europe, G7 members Germany and Italy, as well as central and eastern European countries, depend heavily on Russia. Russia has been a vitally important energy source for the whole of Europe. As Russia and Europe are closely interdependent in energy trade, sanctions on the Russian energy sector have been viewed as painful not only for Russia but also for Europe. Earlier, therefore, countries imposing an energy embargo on Russia had been limited to the United States, Canada and the United Kingdom that import little energy from Russia.

In this sense, the G7 and EU decisions on April 7 mean that Europe and Japan took major steps forward from their earlier posture even at the risk of backlash. They also indicate that the mass killing of civilians by Russia has had great impacts. From the viewpoint of realism, however, coal was subjected to the embargo first because it was relatively easy for the G7 and EU to reach an agreement on the coal embargo. They might have concluded that they could make do even without Russian coal. European countries that depend on Russian coal may try to import coal from alternative supply sources including Colombia, the United States and South Africa. Japan may explore various options in addition to its current major coal supply sources Australia and Indonesia. This means that there are options to explore. In reality, however, efforts to secure alternative supply sources may push up international coal prices and tighten the supply-demand balance. Any easy solution cannot be expected for Europe or Japan.

Meanwhile, recent developments indicate that energy sources subject to the embargo on Russia may not necessarily be limited to coal. Developments in the past week demonstrate that calls have grown in Europe for imposing an embargo on Russian oil that had been dominantly viewed as extremely difficult. As a matter of course, an embargo on Russian oil may be a serious energy security

issue for countries that depend heavily on Russian oil. It may be natural for these countries such as Germany and Hungary to be conscious of a potential serious backlash and cautious of supporting any Russian oil embargo.

In the face of the Ukraine crisis that is growing even more serious, however, calls are growing in Europe for making further steps forward in Russia sanctions. It may be important that European countries have recognized that there are alternative oil supply sources. An oil reserve release under coordination by the International Energy Agency, which has been implemented twice, may be an effective measure along with energy-saving efforts in an emergency. The largest alternative supply source may be surplus oil production capacity in Saudi Arabia and other Middle Eastern oil-producing countries. They intentionally have such surplus capacity based on their strategic decisions. Therefore, they can make decisions to use surplus capacity for additional supply. Saudi Arabia and other Middle Eastern oil-producing countries still remain cautious about expanding planned production growth despite crude oil price hikes. In an emergency, however, their decisions will hold the key. Toward the end of this year, conceivable supply expansion options may include Iran's comeback to the international oil market and a further increase in U.S. oil production.

Given hopes placed on these oil supply expansion options, calls for subjecting oil to an embargo on Russia may grow further, depending on developments regarding the Ukraine crisis. While Western countries other than the United States, Canada and the United Kingdom have yet to ban Russian oil imports, Russian oil supply is forecast by some analysts to decrease by nearly 3 million barrels per day under the tendency to refrain from buying Russian oil. If the tendency is coupled with moves to subject Russian oil to an embargo, crude oil prices may come under upward pressure again. They could rise towards the highs recorded on March 7. Then, moves to explore alternative oil supply sources may become a focus of attention on the market.

Natural gas and LNG are known as the most difficult to subject to a Russian embargo among energy sources. Unlike oil, surplus production capacity for gas does not exist in gas-producing countries. While hopes are placed on LNG as an alternative supply source in an emergency, each LNG production facility is operating at almost full capacity. Additional LNG supply is difficult to secure immediately. Given the characteristics of LNG, LNG inventories in gas-consuming countries are limited. These factors have made it difficult to subject gas and LNG to a Russian embargo. If Russian gas and LNG supply decreases under an embargo, global supply will decline proportionately, leading gas-consuming countries to race to make up for their respective supply drops. Although the EU has indicated a plan to use LNG to reduce dependence on Russian gas, additional "new LNG supply" may not be available for Europe. The EU may have to get existing LNG supply by changing LNG supply destinations by paying higher prices. In such case, European gas prices and Asian LNG spot prices may rise beyond the record highs reached in March if and when there is significant supply disruption. Particularly in Europe, electricity prices may also shoot up, exerting great adverse impacts on the local economy. Political or strategic decisions may be required on whether to subject gas and LNG to a Russian embargo even at the risk of such possibility.

However, there is another issue to consider regarding any energy embargo. An energy embargo may distort the market and produce various problems unless loopholes are closed globally. As an embargo is imposed on any good, international prices for the good may shoot up. As far as loopholes are left regarding an embargo, a country subject to the embargo may be able to sell the good in question through loopholes. For any country subjected to an embargo, the problem may be not export volume but export value. If price hikes are combined with loophole exports to prevent any major export volume decline, export value may remain unchanged or increase further. Those that buy

goods through such loopholes may pay less than market prices, gaining an advantage over buyers in the market in a manner to distort the market. Any energy embargo may thus never be easy. International cooperation may be indispensable for increasing the effectiveness of any energy embargo.

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