Russia and the Oil Market (Or Duel of the Oil Titans)

By Seyed GholamHosein Hassantash

Seyed GholamHosein Hassantash has held various positions in the National Iranian Oil Company (NIOC) including, Director General of the Ministerial Office of the Oil Ministry, NIOC board member and Manager of the Administrative Affairs Department and Advisor to the Oil Minister on Economic Affairs. He was President of the Institute for International Energy Studies from 1997 to 2002.

Russia is amongst the world's top three producers of oil (crude oil and condensate), the U.S. and Saudi Arabia are the other two. Russia is also the world's second largest producer of natural gas after the U.S, but is the number one exporter. In crude oil, Russia is the world's second largest exporter, following Saudi Arabia.

In 2013 and before the global collapse of crude oil prices, 50% of Russia's Federal budget and about 68% of its export revenues came from oil and gas exports. Now, with the current price of crude oil and the fact that the natural gas price is derived from that of crude oil, Russia's economy is, at least in the short term, being hurt and must be under enormous pressure. Ironically, Russia has so far shown no effort to reverse the decreasing trend of oil prices and displays no willingness to cooperate for that purpose.

In the quartet meeting of Russia, Saudi Arabia, Qatar and Venezuela, held in February in Doha, (which was convened chiefly due to the tireless efforts and struggles of Venezuela), Russia stood beside Saudi Arabia in only accepting to stabilize their crude oil outputs at the levels they were at the end of January 2016. This hardly made any difference to the market, and at least in the case of Russia it was perceived as more of a joke, since most of the earlier estimates showed that Russia has basically no capacity to further raise it oil production anyway.

Such inaction by Russia to control the price of oil has to be scrutinized and requires further study of the long term economic and energy policies of that country. Here, I will attempt to raise a few points in the hope of paving the way for further discussions by experts in the field.

In recent months, Russia's total crude and condensate production has been some 10.7-10.8 million barrels per day (mbpd). Given that Russia's domestic oil consumption is just under 3.5 mbpd, a little more than 7 mbpd of crude oil and condensate are exported. In recent months, the global oil market supply has been exceeding the demand by about 1.5 mbpd, which is the main cause of the fall in its price.

Let's assume that Russia alone cuts its oil output and exports by 2 mbpd, which will no doubt raise the oil price by about $ 15 per barrel. If Russia's oil is taken to be priced around $ 35 per barrel, she will lose $ 70 million per day because of that 2 million barrel cut in output. But if the remaining 5 million barrels are sold by only $ 14 per barrel more, then that loss of $ 70 million is already compensated for in full. That way, Russia can preserve oil by cutting back its exports while earning the same revenue. Besides, once crude oil prices rise, natural gas prices will follow suit and thus Russia, the world's largest exporter of natural gas, can benefit greatly from this as well.

Perhaps Russia need not even really have to bear the burden of the cut alone. Al-Naimi, the oil minister of Saudi Arabia, as the pivotal member of OPEC, has at times said that if non-OPEC producers were ready to cooperate in reducing their outputs proportionately, OPEC and his country would reciprocate in kind. Therefore, if Russia is prepared to cut back on its oil production by just 1 mbpd, OPEC and Saudi Arabia will be deprived of any excuse not to lower their output as well. Then, if OPEC yields to this pressure and agrees to cut back another 1 mbpd, Russia will benefit hugely from its oil and gas exports at relatively much lower costs.

But the problem is not that simple. The main excess supply of oil in the market that has in recent years caused the fall of the oil price comes largely from the unconventional shale oil of the United States, which is the source of the rise in the country's oil production.

Since 2004, production of shale oil has become technically possible, all needed infrastructures have been developed and the conditions under which its production would make economic sense have gradually become clear. Hence, it is now clear at what oil price production from shale field would make economic sense and profit. Besides, all drilling and other facilities are in place and as soon as production from a shale field becomes viable, its production can quickly be pumped into the market. There are many drilled but incomplete fields in various zones ready to be swiftly completed and equipped to boost oil output of the U.S.

The U.S. has, therefore, emerged now as a serious competitor to both Russia and Saudi Arabia, and this competition gets intense at higher levels of the price of oil. Rivalry between Russia and America doesn't end with just oil. The U.S. is becoming a gas exporting country through the export ofsee that the press in the U.S. too is sometimes playing the tune of 'the beginning of crumbling of an outdated Oligarchic system that supports Al Qaeda and ISIS, at least ideologically'. Even the U.S. Presidential candidate Donald Trump of the Republican Party (which has traditionally closer ties with the Saudi family) is at a dilemma to determine whether he likes Saudi Arabia or wants it destroyed!

Maybe the Russians too have felt that Saudi Arabia is off track? If a coup de grace knocks out the Saudi government before it hits the Russian economy, then the problem is already fixed for Russia. As a result, the exit of the Saudi oil, or at least a significant portion of it, from the global market will not only push its price up, but will create such a shortage in the global energy market that even the rise in the production of shale oil will not be able to compensate for, and will provide a huge opportunity for the Russians.

But this opportunity will turn into a threat if Putin, or his replacement, fails to use appropriate mechanisms to stop the resources curse from reappearing. liquefied natural gas (LNG). The potential for producing gas from its shale gas fields is even greater than that of shale oil. Further development of shale gas fields in the U.S. is contingent upon the global price of oil, because, as cited earlier, the price of gas is derived from that of oil. In fact, the price of oil is the criterion for economic justification of all types of energy production.

Export of energy, particularly natural gas, is not just an economic issue for Russia. As the largest supplier of natural gas to Europe, Russia perceives Europe's dependence on its gas as leverage in its foreign policy, is extremely determined to maintain it, and tolerates no competition in this regard. The U.S. has been against Europe's dependence on Russian gas right from the beginning (in the 80s and before the collapse of the Soviet Union).

Americans believe that expansion of facilities in Europe for the import of LNG is the best way to secure their gas needs. Meanwhile the U.S. is trying to become a major exporter of LNG and Europe happens to be its best market. The first LNG cargo of the U.S. is expected to be marketed next year. Although the drop in the global price of oil has for now delayed many LNG projects in the U.S., once the oil price regains strength, work on those projects will be resumed and the Russians will find maintaining that leverage quite hard.

In light of above facts, it is likely that Russia and Saudi Arabia have come to an explicit and written or an implicit and unwritten agreement on what the Saudis call protecting their 'market share'. If such an agreement does in fact exist, it raises the question as to how long it can actually last. The prevailing conditions in the oil market will not last forever, and the supply of oil and gas will not always remain more than the demand. In the midterm, an economic development, especially in resolving economic crises of the industrial countries, and the right move in emerging economies, will boost the growth rate of their economies, raise global energy demand which will in turn increase the price of oil.

Or, lack of adequate investment in the production of oil, gas and other energy carriers (because of low prices and hence uneconomical projects) will lead to a shortage and push prices up . How long can Russia and Saudi Arabia actually put up with the market share challenge? More importantly, how long can the two rivals withstand the losses caused by the low price of oil and the resulting economic pressures? Perhaps this is the clue to the secret in Russia's hindsight planning in that agreement; who will yield to the pressures first? Russia or Saudi Arabia?

The actual dependence of the Saudi economy on oil is more than that of Russia on oil and gas. Some 85% of Saudi's export revenues come from oil exports. However, the potential dependence of Saudi Arabia on oil is far more than that of Russia. The Russian Federation is the main body of what has remained from the Soviet period, especially in the fields of industry and technology. Prior to the downfall of the Soviet Union and the ensuing Mafia style looting that climaxed in Yeltsin's era, some huge industries were active in that country.

There is just no comparison between Russia and Saudi Arabia in technical, industrial and scientific bases needed for economic development and freeing the country from dependency on a single commodity. It must be noted, however, that the high prices of oil and revenues generated by export of oil and gas in the post-Soviet era were in fact poisonous for the Russian economy because they simply intensified its dependence on a single commodity and the resulting ailments. Americans must have hoped that the sleeping White Bear would never again awaken to regain its previous superpower status and that the Russian economy would be plagued by the single commodity phenomenon and the inauspicious resources curse. In that sense, and if Russia intends to be saved from such a predicament, a low oil price could be an opportunity (a blessing in disguise) for that country. Perhaps that is why Vladimir Putin has recently issued some executive orders to rid Russia's economy of dependence on oil and gas export revenues.

On the other side, Saudi Arabia has stepped into an era of serious challenges. Following the demise of King Abdullah, the balance of power in the kingdom has undergone radical changes and the internal power struggle in the House of Saud has intensified. At the regional level too, the Saudis have been dragged into a costly, far-reaching and seemingly unending war in Yemen. Besides, the U.S. has visibly turned away from its former allay. The story has long been forgotten that back in 1945 President Franklin Roosevelt met with King Abdul-Aziz Bin Saud on the deck of a U.S. warship in the Suez Canal and offered him America's support for Saud's family in return for a guarantee of oil for the the U.S. The United States of America is no longer in need of the Saudi's oil. One can also see that the press in the U.S too is sometimes playing the tune of 'the beginning of crumbling of an outdated Oligarchic system that supports Al Qaeda and ISIS, at least ideologically'. Even the U.S Presidential candidate Donald Trump of the Republican Party (which has traditionally closer ties with the Saudi family) is at a dilemma to determine whether he likes Saudi Arabia or wants it destroyed!

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Al Troner

Al was a unique character. I met Al in the mid-1980s when he worked at Dow Jones/Telerate's regional energy services. We became friends and he told me of his desire to get out of the daily reporting, do a higher degree, and expand his horizons. I offered him a scholarship to do a graduate degree and work with my team in Hawaii. He spent a couple of years with our group before he joined PIW's Asia-Pacific bureau. Over the years, we met and often exchanged stories, participated in conferences together, and co-chaired a condensate conference. I was touched when he kept telling people, "Once you work for Fereidun, you always work for him no matter where you are." He was always full of stories and loved focusing on topics and areas that only a few cared about! Then he learned so much about the topic, he became the subject expert. He loved complicated condensate streams, high acid crude streams, and difficult small streams that most had not even heard of. He understood the economics, chemistry, and logistics. His history of journalism in Italy added a flare to his stories and approach to the problems that was unique. He touched the heart of many people and developed disciples all over the world. I will miss him deeply. He will be missed by so many in his extended family of friends and colleagues.

Fereidun Fesharaki