The Geo-Economic Aspect of Russia's Policy Towards OPEC and the 2020 Oil Price Crisis

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Abstract

This paper aims, through the descriptive analytical method, to clarify the role that Russia's geo-economic considerations had in aggravating the 2020 oil price crisis, by exploring their effect on its policy towards OPEC. First, the paper examines Russia's employment of its energy export to Europe via Ukraine as a geo-economic instrument, in which two policies are to be distinguished, namely, pricing policies and supplies suspension, in addition to the growing threat that the American shale boom holds towards Russia, and the opportunities it represents to Europe and the US. Secondly, it discusses the changes that the Russian and OPEC oil policies have undergone since 2014, and how the geo-economics of Russian energy exports interacts with OPEC's policy shift, and how has all of this affected the 2020 oil price crises. The paper concludes that the geo-economic aspect of Russia's policy towards OPEC led to an oil price war in 2020 and had an aggravating effect on the sharp drop in oil prices.

Keywords: Russia- oil- OPEC.

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الملخّص

تسعى هذه الورقة من خلال اعتمادها المنهج الوصفي التحليلي إلى توضيح الدور الذي لعبته اعتبارات روسيا الجيو–اقتصادية في مفاقمة أزمة أسعار نفط عام 2020، من خلال بيان أثر تلك الاعتبارات على سياسة روسيا تجاه أوبك. أولاً، توضح الورقة كيفية توظيف روسيا لإمداداتها الطاقية إلى أوروبا عن طريق أوكرانيا كأداة جيو–اقتصادية، ويتم التمييز ما بين سياستين هما السياسات السعرية وقطع إمدادات الطاقة، بالإضافة إلى أنها توضح التهديد المتنامي الذي تحمله طفرة إنتاج النفط الصخري الأمريكي تجاه روسيا من جهة، والفرص التي تمثلها لمصلحة أوروبا والولايات المتحدة الأمريكية من جهة أخرى. ثانياً، تناقش هذه الورقة التغيرات التي شهدتها السياسات النفطية لكل من أوبك وروسيا منذ عام 2014، والكيفية التي تتفاعل بها الجوانب الجيو–اقتصادية لصادرات الطاقة الروسية مع التحول الحاصل في سياسة أوبك منذ ذلك العام، وكيفية تأثير كل ذلك على أزمة أسعار نفط عام 2020. تخلص الورقة إلى أن البعد الجيو–اقتصادي لسياسة روسيا تجاه أوبك قد أدى إلى حرب أسعار نفط في عام 2020، وهو ما كان له أثر مفاقم على الهبوط الحاد في أسعار النفط.

الكلمات المفتاحية: روسيا- النفط- أوبك.

Introduction

OPEC's primary objective has in recent decades become to stabilize oil prices during adverse events. Indeed, during the first half of 2020, when the oil price crisis reached its peak due to the spread of the COVID-19 pandemic, it attempted in early March to reach an output restraint deal with Russia and other non-member oil producing countries, collectively known as OPEC+. Nonetheless, these efforts were undermined with the announcement of an oil price war between Saudi Arabia and Russia, which further aggravated the sharp drop in oil prices at the time. This seemingly obvious fact instead stems from less obvious geo-economic considerations in Russia's policy towards OPEC that date back to 2014, in regard to the United States' consistently growing energy exports in general and towards Europe in particular, which tend to compromise the effectiveness of Russia's "energy weapon" in enhancing its regional influence and foreign policy. Therefore, this paper argues that since 2014 Russia's concerns over losing its energy market share in Europe have had a constraining impact on OPEC's ability to act in line with its objectives during price crises, especially when met by an OPEC policy shift towards maintaining market share and refusal of restraining output without Russian contribution, which in turn impacts prices negatively, as evidenced by the 2020 oil price war and crisis.

1. Russia's "Energy Weapon" and the Shale Revolution

Geo-economics is defined as "the use of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results; and the effects of other nations' economic actions on a country's geopolitical goals."[1] States hold various geo-economic instruments at their disposal, most of which do not fall within the scope of this paper. Instead, Russia's geo-economic behaviour is primarily based on the employment of its energy supplies to achieve geopolitical results in, but not limited to, its "near-abroad" and Europe.

1.1. Pricing Policies

Europe heavily relies on energy imports from Russia, which are primarily transited through Ukraine. Of the total value in trade of extra EU imports of natural gas in 2020, Russia was the largest single supplier with a share of 43.9%, the same applies to petroleum oil imports, in which Russia had a share of 25.5%.[2] In addition, EIA estimates that Russia supplies European markets as a whole with 2.9 tcf to 3.3 tcf of natural gas per year *through* Ukraine,[3] less than it did so prior to the completion of the Nord Stream pipeline. These statistics demonstrate Russia's ability to act geo-economically in order to influence the behaviour of European countries and Ukraine of its "near-abroad." In this pursuit, Russia has been following a "divide and rule" policy in terms of natural gas prices paid by European countries, which are pre-set in bilateral contracts agreed upon with Gazprom, and which vary greatly from country to country in a way that cannot be explained through economic sense, e.g., in 2013 Poland, a country of several disputes with Russia, paid $525.5[4] for every 1,000 cubic meters of natural gas, while Germany paid only $379.3,[5] despite being further away in distance. These lower energy prices serve as incentives to Germany to provide Russia-favourable stances towards efforts seeking to integrate European energy markets and policies, e.g., Germany's efforts to block regulations aimed at addressing Gazprom's dominance in the EU energy market by

[1] Robert D. Blackwill and Jennifer M. Harris, "**War by Other Means Geoeconomics and Statecraft**", Massachusetts, Harvard University Press, 2016, p. 20.

[2] "**EU imports of energy products – recent developments**", European Commission website, 3 January 2022, ec.europa.eu/eurostat/statistics-explained/index.php?title=EU_imports_of_energy_products_-_recent_developments.

[3] "**UKRAINE**", U.S. EIA, eia.gov/international/analysis/country/UKR.

[4] Antto Vihma and Umut Turksen, "**The Geoeconomics of the South Stream Pipeline Project"**, Journal of International Affairs website, 1 January 2016, jia.sipa.columbia.edu/geoeconomics-south-stream-pipeline-project.

[5] Antto Vihma and Umut Turksen, "**The Geoeconomics of the South Stream Pipeline Project"**, op.cit., jia.sipa.columbia.edu/geoeconomics-south-stream-pipeline-project.

limiting foreign companies' ability to buy European energy utilities. While on the contrary, Poland has pushed towards "energy solidarity."[6]

Similar policies towards Ukraine can be noticed in 2010, when Viktor Yanukovych, a close ally of Russia, was declared president-elect in February, which gained Ukraine a 30%[7] gas price cut from Russia, and rewarded the latter with a renewed 30-year term contract for Sevastopol,[8] a strategically critical port for its Black Sea naval fleet and its only access to warm waters, a geopolitical constraint that has burdened Russia for decades.

1.2. Supplies Suspension

Pricing policies tell only half the story. The second half lies within halting gas supplies on the grounds of unsettled debts and contract disputes, and in the face of growing US influence and an expanding NATO towards Russia's southern and western borders. This policy has been followed on many occasions, such as the Ukraine-Russia conflict of 2014 and Moscow's military involvement in Crimea, and the economic and political tensions between Russia and the EU that followed, leading to a gas suspension to Ukraine and several parts of Europe in June.[9] Similarly, in 2021, re-established Russian military build-up near Ukraine's eastern borders,[10] renewed Ukraine-US talks concerning Ukraine's membership in NATO[11] and the backdrop of ongoing deliberation about the controversial Nord Stream 2 pipeline have all led to increasing tensions between Russia on one hand, and the US and its allies on the other, to which Russia responded by gradually reducing supplies through the Yamal pipeline starting August, only for these supplies to fall to zero by November.[12]

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[6] Ibid.

[7] Antto Vihma and Umut Turksen, "**The Geoeconomics of Russian-EU Gas Trade: Drawing Lessons from the South Stream Pipeline Project**", MIT Center for Energy and Environmental Policy Research, 2015, p. 7.

[8] Ibid.

[9] Pasquale DE MICCO, "**A Cold Winter to Come? The EU seeks alternatives to Russian gas**", The Directorate -General for External Policies of the Union – Policy Department, 2014, pp. 4-7.

[10] Warren Strobel and Michael Gordon, "**Russia's Military Buildup Near Ukraine Is an Open Secret**", the Wall Street Journal, 4 January 2022, wsj.com/articles/russias-military-buildup-near-ukraine-is-an-open-secret-11641292202.

[11] Matthias Williams and Natalia Zinets, "**Biden assures Zelenskiy that NATO membership in Ukraine's Hands, Kyiv Says**", Reuters, 10 December 2021, reuters.com/world/europe/ukrainian-president-zelenskiy-holding-talks-with-biden-adviser-says-2021-12-09.

[12] Neil Hunter, "**Europe's energy crisis deepens as Russia cuts gas exports**", S&P Global Platts, 1 November 2021, spglobal.com/platts/en/market-insights/latest-news/natural-gas/110121-europes-energy-crisis-deepens-as-russia-slashes-gas-exports.

1.3. The American Shale Revolution: A Dualism of Opportunity and Threat

For the past decade, the energy landscape has been changing, brought about by energy innovation in North America, which has made vast amounts of shale reserves commercially viable through a process called "fracking," turning the US from an energy importer to the largest oil and natural gas producer in the world, surpassing even Russia in 2013 and thereon.[13] This development, as is any other event, is both a threat and an opportunity. It is a threat in the sense that increasing US production would, and indeed it has done so, drive down world energy prices, thereby damaging Russia's oil dependent economy and, indirectly, defence spending. It is also a threat in the sense that lower US natural gas prices that are determined in the spot market provide cheaper alternatives to European countries, enabling them to negotiate better terms in their contracts with Gazprom and causing financial costs to the latter, as it did in 2012 when renegotiations resulted in reduced pre-tax earnings of $4.2 billion.[14] Moreover, natural gas imports from Russia can be substituted with imports from the US, provided that there exists a proper legal and infrastructure environment, which has been rapidly developing over the past six years. In this context, it is worth to highlight the increasing share of US LNG in total EU LNG imports from 4% and 6% in 2017 and 2018, respectively, to 16%[15] in 2019 following the Trump-Junker agreement of 2018. Similar indicators can also be noticed once in Q2 of 2020, when the EU imported 1.3 bcm more LNG from the US than from Russia,[16] and again towards the end of 2021 when reduced Russian supplies and soaring demand in Europe placed upward pressures on prices, leading to about 50% of total US LNG exports being imported by Europe in December, up from 37% earlier in the year.[17] The American shale boom and decreasing European dependence on Russian energy have represented a major threat to Russia's capacity to employ its energy exports as a geo-economic instrument. On the contrary, it has presented the EU with an opportunity to

[13] Robert D. Blackwill and Jennifer M. Harris, "**War by Other Means Geoeconomics and Statecraft**", op. cit., pp. 205, 206.

[14] Kristīne Bērziņa, "**U.S. Shale Gas: What does it mean for Europe and Russia?**", Latvian Institute of International Affairs website, 14 July 2013, liia.lv/en/opinions/u-s-shale-gas-what-does-it-mean-for-europe-and-russia-297.

[15] "**EU-U.S. LNG TRADE**", European Commission website, 8 January 2020, ec.europa.eu/energy/sites/ener/files/eu-us_lng_trade_folder.pdf.

[16] Market Observatory for Energy of the European Commission, "**Quarterly Report on European Gas Markets**", Volume. 13, No. 2, Q2 2020, p. 19.

[17] Marcy De Luna and Nina Chestney, "**Gas gap in Europe drives U.S. LNG exports to record high**", Reuters website, 6 January 2022, reuters.com/markets/commodities/gas-gap-europe-drives-us-lng-exports-record-high-2022-01-06.

diversify its energy imports, further integrate its energy market and policies, and enhance its energy security in the face of Russia's "energy weapon," ultimately pushing forward its alliance with the US and, most assuredly, their capacity to jointly act on security matters in Russia's "near-abroad."

2. OPEC+ and the 2020 Oil Price Crisis: Between Geo-Economics and Price Stabilizing

Prior to the birth of the OPEC+ agreement in 2016, world oil prices started decreasing significantly since late 2014. Increasing American shale oil production, slower economic growth rates in China and Europe, rising US Dollar value, improving global energy consumption efficiency and OPEC's policy shift- under Saudi influence- towards maintaining market share in the face of America's shale boom were all factors that led to a general glut of crude oil, which made prices fall for about 59,2% between 20/6/2014 and 28/1/2015.[18]

2.1. Changing Saudi and Russian Oil Policies Post-2014

The shift in Saudi Arabia's policy towards preserving its market share was not just in response to the shale boom, it also marked Saudi Arabia's abandonment of its traditional role as a "swing producer," which is based on utilizing spare production capacity to stabilize prices, sounding alarms that price stabilization is not a responsibility specific to OPEC. Russia's response, however, was to continue in its traditional policy of "free ride," i.e., letting OPEC solely handle price stabilization while maintaining its own current production level.[19] The reasoning for this policy at the time was: An economy heavily dependent on oil-albeit presently to a less extent- and, most fundamentally, Russia's concerns over the potential that US energy exports have in impeding its regional geo-economic behaviour, since natural gas is commonly an oil by-product, and curbing crude oil production for prolonged periods as the continuous shale boom necessitates would reduce its natural gas production and market share in the long run, let alone the fact that any reduction in Russian oil production that contributes to price stabilization serves in itself as an incentive for American shale production to rise, which would naturally include increased natural gas production. This resulted in neither party reducing its oil output and the oil price crisis persisting under a price war. Nevertheless, Russia and Saudi Arabia had one interest in common: driving US energy companies out of business, as

[18] Dave Mead and Porscha Stiger, "**The 2014 plunge in import petroleum prices: What happened?**", Beyond the Numbers: Global Economy, No. 9, 2015, pp. 3, 4, 5.

[19] Abdullaziz Al-Dawsari, "**Why Does Russia Cooperate with OPEC?**", Bahrain Center for Strategic, International and Energy Studies, 2019, p. 12.

unconventional oil production is relatively more expensive and cannot be sustained at low price levels. Unfortunate for both, the US energy industry proved resilient.

Early 2016 marked the shift in Russia's policy towards OPEC. Under the pressure of severe economic damage due to low oil prices and economic sanctions imposed by the EU and the US in regard to the Russia-Ukraine conflict of 2014, Russia had no choice but to open up to cooperating with OPEC in order to push up world oil prices, which eventually led to the birth of the OPEC+ agreement in late 2016, under which members collectively restricted their crude oil output,[20] thereby providing American shale production the opportunity to prosper and leading to two additional cuts in 2017 and 2019

2.2. Russia's Geo-Economic Considerations and the 2020 Oil Price War

Since late 2019 and until this day the COVID-19 pandemic has been shaking the world, not only health wise but in all aspects of modern life. It has forced entire countries to shut down, in an effort to contain the spread of the novel Corona virus, which decreased world oil demand as transportation and economic activity fell to unprecedented levels. Coinciding market glut and reduced demand led excess world crude oil supplies to reach 7.3 mb/d in Q1 and 9 mb/d in Q2,[21] leading to one of the most controversial oil price crises in history.

OPEC's first and foremost attempt to stabilize prices was in 6/3/2020, when it sought to reach an output restraint deal with Russia. Failure to conclude a deal, however, marked the beginning of yet another price war.[22] Both countries at the time made clear their intents to increase output and provide discounts to major customers in Europe and Asia, when Saudi Arabia's energy minister famously said "I will keep you wondering" in regard to the possibility of increasing Saudi oil output.[23] Russia's refusal to curb its production on top of the 2019 agreed cut primarily reflected *geo-economic* considerations, not economic ones. Undoubtedly, oil and natural gas revenues are crucial to Russia's economy, as they represent its major source of income and economic growth, which generally contribute to its power level. However, its quest for regional influence through geo-economic behaviour is a consideration of greater importance when facing an

[20] Abdullaziz Al-Dawsari, "**Why Does Russia Cooperate with OPEC?**", op. cit., pp. 4, 5, 6.

[21] "**Market Indicators as at End: December-2020**", OPEC website, January 2021, opec.org/opec_web/static_files_project/media/downloads/publications/MI122020.pdf.

[22] Pippa Stevens, "**Oil plunges 24% for worst day since 1991, hits multi-year low after OPEC deal failure sparks price war**", CNBC website, 8 March 2020, cnbc.com/2020/03/08/oil-plummets-30percent-as-opec-deal-failure-sparks-price-war-fears.html.

[23] "**Saudi energy minister says he will 'keep you wondering' on oil output**", Reuters website, 6 March 2020, reuters.com/article/us-opec-meeting-saudi-idUKKBN20T2CT.

expanding NATO that threatens its national security and an increasing American share in Europe's energy imports that compromises its ability to alter the behaviour of key European countries. Since these transformations might prove more difficult to reverse in the longer run when compared to economic damage, they consequently play a more determinantal role in Russia's policy towards OPEC. Therefore, starting 2014, the intersection of Saudi Arabia's refusal to singlehandedly stabilize prices on one hand and Russia's concerns over the declining effectiveness of its geo-economic instruments on the other has indeed been the factor with the most impact on OPEC's ability act in line with its objectives during oil price crises, by preventing it from reaching a deal with Russia *to begin with*, and will continue to be so for years to come. This nonetheless does not by any means imply that there are no other factors in play.

During pre-2014/2015 oil price crises, many factors internal to OPEC typically arose before or after a production cut has been agreed. Economic differences among its members, and many other factors that are discussed by economic theories of cartels have typically led to a behaviour that ranges from under-committing to production cuts or quotas to noncompliance at best by a few members with relatively less market impact than Saudi Arabia and other key Gulf members whose behaviour matters more. Such obstacles were typically addressed by Saudi Arabia through increasing its own production in order to place downward pressures on prices. This forces the under-committing countries to comply to their quotas, since the alternative would be enduring lower oil prices for prolonged periods under limited financial cushions, as happened in 1984/1985.[24] The same policy, however, might not prove as effective towards a more financially capable Russia that was equipped with $577.8[25] billion in international reserves towards 6/3/2020, the date of the OPEC+ deal conclusion failure. Those reserves had the potential to make Russia more capable of living with low prices and offsetting lower oil revenues for longer periods than the developing OPEC countries, so long as economic damage, among other things, does not force it to switch its policy towards cooperating.

Albeit important, this paper does not aim to evaluate the effectiveness of OPEC's policies, but is rather concerned with examining what *external factor prevents* OPEC from responding to negative shocks in the first place, that is, the geo-economic considerations

[24] Christiane Baumeister and Lutz Killian, "**Forty Years of Oil Price Fluctuations: Why the Price of Oil May Still Surprise Us**", Journal of Economic Perspectives, No. 1, 2016, pp. 145, 146.

[25] "**International Reserves of the Russia Federation (End of period)**", Bank of Russia website, cbr.ru/eng/hd_base/mrrf/mrrf_7d.

of Russia's policy towards OPEC, embedded in its concerns over the undesired potential geopolitical results of rising US energy exports.

2.3. The Effect of the 2020 Oil Price War on Oil Prices

The oil price war of 2020 had a profound effect on oil prices. OPEC's failure to reach a deal with Russia created a widespread panic in financial markets and a selloff of oil futures, contrary to late February and early March when optimism over additional production cuts persisted, which caused prices to stabilize around $50[26] a barrel of Brent crude. The selloff resulted in a massive drop in oil prices of about 40% by the end of March, reaching $20.09 for WTI (West Texas Intermediate) contracts on NYMEX and $22.74 for Brent contracts on ICE (Intercontinental Exchange).[27] Additionally, by 30/3/2020, a wide contango occurred with a price differential of $7.02 between Brent contracts due for delivery on July and contracts due on May, the widest since 2004, while the contango for March as a whole was $2.90 for Brent crude and $2.37 for WTI crude.[28] This made oil storage profitable and induced inventory demand now on the hope of selling later for a profit, thereby increasing oil production and placing further downward pressures on prices. Inventory demand only started falling back with the conclusion of a historical OPEC+ deal on the 12th of April,[29] and the flattening of the contango curve,[30] not to mention the fact that inventory utilization capacity was gradually peaking, which lifted storage costs high in a way that made inventory demand unprofitable. The deal came after US president Donald Trump intervened between the two groups, over fears of the potential damage low prices had on the fracking industry in general and in states focal to the coming elections in particular. It contained an unprecedented production cut of 9.7 mb/d starting 1/5/2020 for a period of two months, to which the US would contribute by an estimated 300.000 b/d.[31]

[26] International Energy Agency, "**Oil Market Report – April 2020**", 2020, p. 50.
[27] Ibid.
[28] Ibid., p. 51.
[29] Javier Blas and Bloomberg, "**Trump's oil deal: The inside story of how the Saudi-Russia price war ended**", Fortune Magazine website, 14 April 2020, fortune.com/2020/04/14/trump-oil-deal-inside-story-saudi-arabia-russia-price-war-ended.
[30] International Energy Agency, "**Oil Market Report – April 2020**", op. cit., p. 15.
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Conclusion

It is concluded that Russia's geo-economic concerns over the US shale boom has become a major determinant of its policy towards OPEC. The result is that so long as OPEC's policy remains tightly focused on maintaining its market share, those geo-economic considerations of Russia will tend to limit its ability to function in line with its objectives as and when needed during price fluctuations, since it will not be able to conclude an OPEC+ deal instantly. This inability to reach a deal would lead to either price wars or unchanged output levels, thereby placing further downward pressures on prices as it did in 2020, i.e., having an aggravating effect that would always bring about a worse initial impact on prices than would reaching a deal with some noncompliant states, which would under any circumstances take some barrels off the market.

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