Istituto Affari Internazionali

The De-Globalisation of Oil: Risks and Implications from the Politicisation of Energy Markets

by Rafael Ramírez

The EU's announced ban on Russian oil imports is a strong political measure that will heavily impact international energy markets, restricting the supply of 4.1 million barrels per day (mbd) of oil and derivates to a market which is a net importer of 10.72 mbd.[1]

The EU's ban, which is due to fully come into effect between December 2022 and February 2023, combined with the US's previous ban of 600 thousand barrels a day (tbd), means that 4.7 mbd of Russian oil and derivatives are being removed from these high oil consuming markets (35.9 mbd in total). If we add the 1.3 mbd of oil that Iran has stopped producing due to US sanctions reintroduced in 2018, we reach a volume of 6 mbd of oil that is restricted or out of the market due to political decisions.

The Russian invasion of Ukraine and the unprecedented sanctions and oil ban imposed on Moscow, combined with the previous oil sanctions against Iran, are fast advancing a new geopolitical reality: the de-globalisation of the international oil market.

These bans on huge volumes of oil and the restrictions imposed on free trade in energy represent a new disturbing factor of instability and fragmentation in the market. As recently noted by the Nobel Prize winning economist, Joseph E. Stiglitz, in his article "Getting Deglobalisation Right", these new policy proposals imply "that longstanding rules of the international trading system will be bent or broken. Unable to reconcile friend-shoring with the principle of free and non-discriminatory trade."[2]

[1] Organization of the Petroleum Exporting Countries (OPEC), *Monthly Oil Market Report June 2022*, 14 June 2022, https://www.opec.org/opec_web/en/publications/338.htm.

[2] Joseph E. Stiglitz, "Getting Deglobalization Right", in *Project Syndicate*, 31 May 2022, https://prosyn.org/babbKda.

Rafael Ramírez is former Venezuelan Foreign Affairs Minister and UN Ambassador (2014–2017); Venezuelan Oil Minister and CEO of PDVSA (2002–2014).

IAI COMMENTARIES 22 | 33 - JULY 2022
ISSN 2532-6570
© 2022 IAI

© 2022 IAI
ISSN 2532-6570
IAI COMMENTARIES 22 | 33 - JULY 2022

The process of de-globalisation of oil stands in contrast to the development and expansion of the capitalist economy, especially since the Davos Forum of 1987 and the deregulation processes that followed in its wake. Contradictorily, in the oil market, major consumers have permanently advocated free and unlimited access to oil and have insisted that the interests of producing countries cannot restrict access to oil or the volumes available in the market. This has been a historical factor of conflict with the oil-producing countries, particularly those grouped in OPEC.

Among the proposed responses to this new situation are efforts to "re-shore" or "friend-shore" the market. Yet, such efforts are impossible when it comes to fossil fuels, given that we are talking about natural resources located in a specific territory rather than commodities or industrial processes that can be re-located. In this regard, the de-globalisation of oil does not appear to be a passing phenomenon. Rather it will likely become a lasting, structural novelty in the world economy.

This new situation has led to skyrocketing oil prices (115–120 dollars per barrel for first half of June), while other energy prices, most notably gas, have also increased, mainly due to supply uncertainties. Combined with inflation, as well as ongoing Covid-19 related disruptions, such developments carry clear economic implications. In early June, the World Bank revised its global growth prospects downwards by 1.2 points, forecasting 2.9 per cent growth in 2022.[3]

The effects of the oil ban are different in Russia and Europe, but both are adverse. On the one hand, Russia must now look for new, more distant markets with rising logistics costs, while offering 30 per cent discounts for its oil in an effort to attract buyers and circumvent sanctions. On the other, Europe is facing extraordinary energy costs, a key component explaining the current inflation rate of 8.1 per cent in the Euro area;[4] as well as the urgent need to look for new oil and gas suppliers, a complex task in a global market where extra supply is limited. From an economic perspective, both sides are losing.

In a matter of months, the existing trading network for the oil and gas market in Europe has been forced to adjust to this de-globalisation process, a direct consequence of the implosion of the geopolitical equilibrium in Europe after the Russian invasion of Ukraine.

Great powers and blocs of countries such as the EU, are now responding to this new geopolitical reality, scrambling to guarantee their energy supplies. This is restructuring the oil market in a way that will reinforce increasingly antagonistic and probably confrontational blocs: Russia–China (a Eurasian bloc) and the North Atlantic, as we already know it, but where Europe will be more dependent on the US, in both energy and security terms.

[3] World Bank, *Global Economic Prospects June 2022*, June 2022, http://hdl.handle.net/10986/37224.

[4] Eurostat, "Euro Area Annual Inflation Up to 8.1%", in *Euro Indicators*, No. 61/2022 (31 May 2022), https://europa.eu/!NcVq3v.

© 2022 IAI

ISSN 2532-6570

IAI COMMENTARIES 22 | 33 - JULY 2022

This costly and dangerous competition for secure and reliable energy supplies will be particularly hard felt in disputed areas such as the South China Sea, Eastern Europe, the Baltics, the Arctic, the Middle East and North Africa (MENA) as well as the African continent, where larges reservoirs of natural resources or corridors for fossil fuels supply are present and highly volatile.

At the same time, the high demand and cost of energy, as well as food inflation and supply chain disruptions, can be expected to provoke significant instability across the Global South.

Precarious balance in the oil market

The oil market had stabilised in the last quarter of 2021, as the fundamentals were progressively restored after OPEC+ agreed to cut of 9.7 mbd of oil due to collapsing demand (-10 mbd) in 2020.[5] By 2022, global oil demand had recovered the shortfall and was projected to reach 100 mbd for the year, the first time world output would have reached that level.[6]

The full recovery of oil demand indicated that the world's post-pandemic growth of +6.1 per cent in 2021 was based on fossil fuels (oil, gas and even coal). The rise in oil prices above $80 a barrel and natural gas by more than 500 per cent in Europe during 2021 are clear indicators that existing demand is unsatisfied by tight supply.

By June 2022, world oil production stood at 98.8 mbd,[7] with a demand still projected to rise to 100.3 mbd by the year's end. Yet, inventories in OECD countries and the US are below their average levels of the last 5 years,[8] all of which is keeping oil prices in tension. Since the Russian invasion, the price topped 100 dollars a barrel, with consumers paying an estimated additional 30 dollars a barrel known as a "war premium" on oil.

There are two existing factors that explain the current tight supply: first, many oil-producing countries and companies have faced a drop in production levels,[9] mostly due to the economic downturn of 2020–2021 (mainly impacting African producers); the lack of economic incentives due to low oil prices; as well as ongoing political instability in countries such as Libya and Venezuela.

Secondly, oil-producing countries and companies are comfortable with current prices, using this income to stabilise their economies, recover loses and pay debts. In the first quarter of 2022, major oil companies made 99.3 billion US dollars in profits[10] while

[5] OPEC, *The 10th (Extraordinary) OPEC and non-OPEC Ministerial Meeting Concludes*, 12 April 2020, https://www.opec.org/opec_web/en/press_room/5891.htm.

[6] OPEC, *Monthly Oil Market Report March 2022*, https://www.opec.org/opec_web/en/publications/338.htm.

[7] OPEC, *Monthly Oil Market Report June 2022*, cit.

[8] US Energy Information Administration (EIA), *Short-Term Energy Outlook Data Browser: OECD Petroleum Production*, https://www.eia.gov/outlooks/steo/data/browser/#/?v=6&f=A&s=0&maptype=0&ctype=linechart.

[9] Rafael Ramírez, *Boletín Petrolero*, No. 55 (4 June 2022), https://www.rafaelramirez.net/?p=8333.

[10] Oliver Milman, "Largest Oil and Gas

IAI COMMENTARIES 22 | 33 - JULY 2022 ISSN 2532-6570 © 2022 IAI

oil exporters in the Persian Gulf are forecast to grow by 5.9 per cent in 2022.[11] For these reasons there are few incentives to increase production and deflate prices.

From the end of the 2021, OPEC+ has consistently refused calls by the US, EU and other consumers to increase production. Meanwhile, US producers also witnessed a slowdown in production and investments, while re-paying debts and dividends, despite the incentives and direct calls from President Biden to increase production and cut prices. This is the main reason why the US and other states, including China, introduced a massive release of strategic oil reserves of at least 273 mbd in 2022.[12]

Risks and costs of the de-globalisation of oil

After the economic and oil market collapse of 2020–2021 and the current energy crisis caused by the Russian invasion, two elements require careful consideration by decision makers.

The first revolves around an acknowledgement that hydrocarbons are still irreplaceable to drive global economic growth in the short and medium term. The green energy transition still has a long way to go. This implies that while efforts should seek to increase renewable energy capacity, a parallel effort needs to be directed at the optimisation of oil consumption and an accelerated transition from coal to gas, as coal still represents 26 per cent of world energy consumption.[13]

The second consideration implies an acknowledgement that, in the short term, there are no readily available surplus volumes of oil to replace Russia's total production of 10 mbd, nor is there enough gas to substitute Russian supplies to Europe (153 billion cubic metres a year in 2021). Simply put, there is not enough spare capacity in the market.

For the last 9 months, OPEC+ countries have been below their production quotas by 1 mbd,[14] and for the first time since the war, according to OPEC data, Russia's oil production fell by 800 tbd by May 2022.

Few producing countries have increased their oil production this year. The United States has increased production by 600 tbd in 2022,[15] but

Producers Made Close to $100bn in First Quarter of 2022", in *The Guardian*, 13 May 2022, https://www.theguardian.com/p/ydpmh.

[11] World Bank, "Middle East and North Africa Regional Highlights", in *Global Economic Prospects June 2022*, https://thedocs.worldbank.org/en/doc/18ad707266f7740bced755498ae0307a-0350012022/related/Global-Economic-Prospects-June-2022-Regional-Highlights-MENA.pdf.

[12] US Department of Energy (DOE), *DOE Announces Second Emergency Notice of Sale of Crude Oil From The Strategic Petroleum Reserve to Address Putin's Energy Price Hike*, 1 April 2022, https://www.energy.gov/node/4818652.

[13] International Energy Agency (IEA), *World Energy Outlook 2021*, October 2021, https://www.iea.org/reports/world-energy-outlook-2021.

[14] Rafael Ramírez, *Boletín Petrolero*, No. 55 (4 June 2022), cit.

[15] EIA, "EIA Forecasts non-OPEC Countries Other than the United States and Russia to Add 0.9 Million b/d of Liquid Fuels Supply in 2022 and 0.8 Million b/d in 2023", in *This Week in Petroleum*, 8 June 2022, https://www.eia.gov/petroleum/weekly/archive/2022/220608/includes/analysis_print.php.

© 2022 IAI ISSN 2532-6570 IAI COMMENTARIES 22 | 33 - JULY 2022

this is still 900 tbd below its 12.8 mbd production in 2020. Saudi Arabia has increased production by 370 tbd while the United Arab Emirates has increased by 120 tbd. Added together, these producers have increased by just 1.09 mbd this year, obviously insufficient to replace the volume of Russian oil production.

Much of the same applies to gas. Qatar's Minister of Energy Saad Sherida Al-Kaabi, confirmed there are not enough LNG volumes available to replace Russian gas supplies to Europe.[16] At the same time, European countries like Spain and Italy are both looking to obtain more volumes of gas via pipeline from Algeria. Others, like Germany and Italy, must increase their capacity and infrastructure to receive LNG cargos, but that will require time and investments.

Meanwhile, the US–EU energy agreement of mid-March promises to increase LNG supply to Europe from the US up to 98 bcm per year, an extraordinary increase of 104 per cent from the 48 bcm forecast for the whole of 2022.[17] The announcement comes with a lot of uncertainties. Even in the event of this goal being achieved, it would equal only 65 per cent of the 153 bcm of gas per year that Russia supplies to Europe.

The Russian government is exploiting these developments, utilising the energy crisis to undermine European political cohesion. As Europe scrambles to diversify its energy supply, policymakers need to reflect on the meaning and scope of "European energy independence". In this respect, an oil and gas embargo on Russia would not change Europe's dependency on fossil fuels. In the short and medium term there is simply not enough renewable energy capacity to substitute hydrocarbons and support the European economy.

The EU is now racing against time to find new energy sources capable of replacing Russian supplies. These new suppliers: the US, MENA or African countries, are not only insufficient but more expensive, both because of high market prices, as well as transportation costs and – in the case of LNG – the development of new infrastructure.

Another by-product of the de-globalisation of oil, is that large consumers who are not self-sufficient in energy, such as Europe, China, the rest of Asia and India are now locked in a frantic and costly competition to guarantee oil and natural gas supplies. This competition over limited supply, while paying more for energy and displacing resources destined to other countries, is already creating geopolitical tensions between blocs and within more struggling countries.

This new situation is a dangerous one because no country or bloc can remain without sources of energy. Without supply, the loss of competitiveness or collapse of the industrialised

[16] "Qatar: No One Can Replace Russia Gas Supply to Europe Quickly", in *Middle East Monitor*, 23 February 2022, https://www.middleeastmonitor.com/?p=537906.

[17] European Commission and US, *Joint Statement between the European Commission and the United States on European Energy Security*, 25 March 2022, https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_2041.

economies will be a matter of time. The dispute over energy is therefore a matter of survival.

Policymakers, especially across Europe, should approach energy security as a matter of collective security. The EU still faces a high dependency on fossil fuels, a different situation compared to the US, the UK and Canada. If geopolitical tensions continue to deteriorate and energy markets become a key arena of competition, the European economy will suffer more compared to its oil producing allies.

No country or group of countries in Europe will remain immune from the implications of this de-globalisation of oil. In this regard, policymakers must prepare to handle the repercussions, including possible political destabilisation driven by inflation, rising energy costs and the more general slowdown of the economy.

Some public policies should be designed to provide relief, including the possible rationing of energy for industry and the need for public subsidies to shield the economy and populations from the rising cost of energy. They moreover should redouble efforts to maximise available energy resources, speed up the diversification of supply, limit waste and continue to promote the energy transition.

The politicisation of energy and the tensions resulting from the war will produce an escalation of measures and countermeasures between blocs. Such a spiral of escalation has already undermined the precarious equilibrium in the energy market, with unpredictable results and permanent changes in the geopolitics of oil and gas.

Implications will be far reaching, but ultimately the permanence of this de-globalisation process in energy markets will depend exclusively on political, not economic factors. For this reason, carefully considering the short, medium and long-term implications stemming from a more fragmented and confrontational international energy market should top the agendas of decision makers across the world, beginning from Europe which has returned to become the eye of the storm in terms of overlapping political, socio-economic and security challenges that are not set to be resolved anytime soon.

13 July 2022

IAI COMMENTARIES 22 | 33 - JULY 2022 ISSN 2532-6570 © 2022 IAI

IAI COMMENTARIES 22 | 33 - JULY 2022 ISSN 2532-6570 © 2022 IAI

Istituto Affari Internazionali (IAI)
The Istituto Affari Internazionali (IAI) is a private, independent non-profit think tank, founded in 1965 on the initiative of Altiero Spinelli. IAI seeks to promote awareness of international politics and to contribute to the advancement of European integration and multilateral cooperation. Its focus embraces topics of strategic relevance such as European integration, security and defence, international economics and global governance, energy, climate and Italian foreign policy; as well as the dynamics of cooperation and conflict in key geographical regions such as the Mediterranean and Middle East, Asia, Eurasia, Africa and the Americas. IAI publishes an English-language quarterly (*The International Spectator*), an online webzine (*Affarinternazionali*), three book series (*Global Politics and Security*, *Quaderni IAI* and *IAI Research Studies*) and some papers' series related to IAI research projects (*Documenti IAI*, *IAI Papers*, etc.).

Via dei Montecatini, 17
I-00186 Rome, Italy
Tel. +39 066976831
iai@iai.it
www.iai.it

Latest IAI COMMENTARIES

Director: Andrea Dessì (a.dessi@iai.it)

- 22 | 33 Rafael Ramírez, *The De-Globalisation of Oil: Risks and Implications from the Politicisation of Energy Markets*
- 22 | 32 Alessandro Azzoni, *European Defence: Time to Act*
- 22 | 31 Daniel Gros and Nathalie Tocci, *Sense and Nonsense behind Energy Price Caps*
- 22 | 30 Alessandro Marrone, *NATO's New Strategic Concept: Novelties and Priorities*
- 22 | 29 Lorenzo Mariani and Leonardo Bruni, *North Korea's Covid-19 Outbreak: An Opening for Engagement?*
- 22 | 28 Gabriele Abbondanza, *The Foreign Policy Challenges of Australia's New Labor Government*
- 22 | 27 Ludovica Castelli, *Italy and the Nuclear Ban Treaty: A Hesitant Opening?*
- 22 | 26 Pier Paolo Raimondi and Margherita Bianchi, *Reconciling EU Energy Security with Climate Policies: Rethinking European Gas Markets*
- 22 | 25 Riccardo Alcaro and Nona Mikhelidze, *Not Yet Time for Diplomacy. Lessons from Italy's Ill-Conceived Peace Plan for Ukraine*
- 22 | 24 Akram Ezzamouri, *The Nile River Dispute: Fostering a Human Security Approach*