Arguments for priority sanctions on Russia

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ENERGY

Embargo on Russian oil is possible. Cumulative economic effect will be less costly for partner than any relief packages during Covid or the financial crisis of 2008-09.

Full scale embargo of Russian oil can be implemented immediately without significant effects on the market with OPEC and OECD releasing their reserves and OPEC utilizing spare capacities and the market can adjust within a year. Introducing the full oil embargo requires **joint actions and joint communication** from oil importers with oil exporting countries with spare capacities to mitigate the effect on oil prices. Altogether, the utilization of 2 mln barrels per day spare capacities from OPEC countries, 1 mln barrels per day the US shale, and 2-2.5 min barrel per day from lifting sanctions on Iran and Venezuela (up to Ukraine and the USA diplomatic position) will enable the elimination of Russian oil import to OECD countries responsible for more than 70% of it.

An import tariff on Russian oil exports is essential to stop financing the war against Ukraine.At current oil price of about US$100 per barrel, Russian budget gets US$70 in taxes. That's almost two times more per barrel than in 2021, when the oil price hovered around US$60-70 per barrel (see the last IMF Article IV report). Even if the demand for Russian oil falls by a third in 2022 as a result of "self-sanctioning", as IEA projects in its recent Oil Report, the price increase would more than offset the fall in volume. At the same time, if Russia faces an oil price of US$15-20 per barrel, virtually nothing would go to Russian budget, but it would still make economic sense for Russian oil companies to sell (as such price covers operational expenses and other costs such as debt servicing) – again the case for a punitive tariff.

In addition, the International Energy Agency Member Countries should commit to release e.g. 15% or of their emergency oil reserves which is equivalent of supply of additional 0.9 mln barrels per day to the market to ensure the stability of oil supply after the embargo on Russian crude is imposed.

Germany, who is the largest importer, depends only on ~35% Russia` crude oil. According to business and household survey data energy spending in advanced economies is only 2-4 percent of GDP making the effect on Germany/EU not that significant. Current tightness at the European, and specifically German, oil market is artificial and will be eliminated by oil products supply from other regions due to very high oil products premiums in Europe.

Introducing full-scale embargo requires:

- Communication of the possibility of market restructuring (with diversifying from Russian oil) without too high price increase and deficit.
- Saudi Arabia and the UEA should be persuaded to pump 2.0 and 1.1 million barrels a day respectively more oil to offset the reduction of Russian oil supply to the market (likely exchange that they require –support in resolving Yemen conflict and guarantee Saudi Arabia security which is very concerned with Iran nuclear program). The joint efforts of the US, France and the UK are more likely to convince Saudis to produce oil at available capacity
- OECD countries should reduce oil consumption by 2.7 barrels per day – following the 10-point plan proposed by the IEA
- Other countries may follow the OECD efforts to cut their oil demand

As preliminary steps:

1. push for oil products embargo clogging up Russian ports and potentially slowing refineries and choking back production;
2. persuade largest oil traders to ban Russia (Trafigura, Vitol etc);
3. push for punitive tariff of Russian energy supplies of up to 90% of the price. This would lead to a government deficit of around 8-10 percent of GDP – enough to deplete the oil fund within a year.
4. push for the EU commitment to set a sunset date on European purchases of Russian natural gas, for example, in 3 years. As a result, multiple market players will start diversifying from Russia.
5. ban purchases from Yamal and Nord Stream. This would create more leverage for Ukraine GTS and Turkstream.
6. pressure the last oil major who didn't withdraw from Russia, Total France - to do so. Their withdrawal may kill Arctic LNG, the big project with Novatek, which is currently investing in a second phase, since the Russians lack LNG technology.

7. pressure the oil field service companies to withdraw. Withdrawal of Schlumberger, Baker Hughes and Halliburton (all US affiliated) would be a further meaningful blow to the Russian oil sector since they provide access to expertise and technology not available locally – in progress.
8. Ban the cracking catalysts supply to Russia. The ban would stop the work of Russian refineries in several months after the use of available stocks. The measure may be easily implemented since cracking catalysts are produced only by the German and the US chemical giants BASF and Grace at manufacturing facilities located in the US and in Europe.

request from correspondent banks that transact oils contracts with Russia - to direct payments to Russian accounts in frozen banks (proposal of Russian economists pushing against the regime from abroad)

Read Further ….. on Importance of crude oil sales for Russia

Reduction of Europe` dependence on Russian natural gas by a third - to a half - within one year is possible. The International Energy Agency 10-point plan lays this out.

Detailed analysis

ENERGY

1. Importance of crude oil sales for Russia

The average daily value of purchases of Russian energy by the European Union, the United Kingdom, and the United States[1] is $500 million (before self-sanctioning). Russia received $104 billion from oil exports to Europe and the UK last year[2]. Russia`s imports to USA is ~ 3-4% of their overall exports of crude oil. It will reduce in several months following USA embargo.

Europe is a way more important market than the USA - in November 2021 OECD Europe imported a total of 4.5 million barrels per day (mb/d) of oil from Russia (34% of its total imports), of which 3.1 mb/d was crude oil and feedstocks and 1.3 mb/d oil products. Another 20% of Russian oil exports goes to China. OECD Asia Oceania and OECD America imported 440 thousands barrels per day (kb/d) (5% of total imports) and 625 kb/d (17% of total imports) respectively in November 2021. OECD countries are responsible for 5.5 mb/d or 70% of Russian oil exports and a full embargo imposed by democratic countries will have a devastating effect on the Russian economy.[3]

Europe is dependent on Russian oil for over 1/4 of its crude oil. While some European countries like Slovakia are dependent on Russia for over 90% of their oil, the continent's dependence as a whole is not so crucial, while significant.

Most oil imports into the bloc are via oil tankers and ports which makes it easier to diversify. Between just 4% and 8% of Europe's oil supplies come via Russian pipelines – up to 30% of total Russian oil exports to Europe – meaning sourcing oil elsewhere in the short term is feasible.

Germany is the largest importer of crude oil with ~35% crude oil coming from Russia[4] [5].

2. Possibility of complete oil products embargo

If a crude oil ban is off the table for Europe at the moment because of German reluctance, Ukraine could push hard for an oil product ban as a first step. The disruption for oil consumers is more manageable while the disruption for the Russian oil system is potentially greater than for crude, since they will struggle to clear the relatively small volume of banned products such as LPG - it won't be economic to ship to Asia - clogging up Russian ports and potentially slowing refineries and choking back production.

Current turbulence at the European oil products market is mainly stemmed from fear of supply shortage rather than systemic problems of supply in case of imposing full embargo on Russian oil products to the EU. First, higher prices today than near term futures provide an incentive for refineries to increase supply to Europe until fears about supply are eroded. Second, the premium for the US, Middle East or Indian refineries for producing more products for Europe is so high, that they will choose to redirect their products to Europe to replace Russian oil products exports to this market. Third, the current artificial tightness at the market stemmed from lowering supply by oil giants like Shell or BP which stopped offering diesel cargos for sale at the European markets for last several weeks will be eroded as companies realize that the fear of supply shortage has no ground and prices are likely to go down in the near future.

Alternatively - go after the big oil trading companies which buy the crude in Russia and have not yet - unlike e.g. BP, Shell - committed to not buying Russian crude e.g. Trafigura, Vitol. If you can ban them from buying Russian crude, so only companies outside Europe can buy, that will further disrupt sales and increase the discount on Russian crude.

3. Possibility for full-scale embargo

According to business and household survey data[6] energy spending in advanced economies is 2-4 percent of GDP. Even large energy price increases in these countries would be less costly than any relief packages during Covid or the financial crisis of 2008-09.

Russian oil in Europe can be replaced with some reduction in demand and if agreement with OPEC is made. OPEC now has a spare capacity of about 5mbd, including Iran and Venezuela, and about 3.5mbd without them. But OPEC still needs to be persuaded to increase output (as if the UAE agreed yesterday). The UAE's strategic reserves will last for almost two years if 2mbd is released. The United States seems to be able to increase production by 0.7-

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[1] Helda.helsinki.fi

[2] Gas revenues ($43.4 billion).

[3] IEA (2022), *Russian supplies to global energy markets*, IEA, Paris https://www.iea.org/reports/russian-supplies-to-global-energy-markets

[4] https://www.transportenvironment.org/discover/europes-dependence-on-russian-oil-puts-285m-a-day-in-putins-pocket/

[5] Germany`s consumption of Russian oil (~0.5 mmbd) comes ~0.4 mmbd via Russian Druzhba pipeline. Key refineries relying on Druzhba oil: Schwedt Refinery (~0.2 mmbd, PCK, Rossneft minority stake 37.5%) and Leuna Refinery (~0.2, Total). Replacing Russian oil might require reducing utilization of Druzhba refineries as seaborne options can be limited due to alternative logistics bottle-necks (mainly increasing utilization of Rostock-Schwedt-Leuna pipeline and railway).

[6] Information from the international analysts

0.8mbd in six months. Demand is the big elephant in the room. Short-term elasticity of demand is small but non-zero. Only 3% of electricity is produced from oil, so switching to other sources will not help. Although it can help in case of gas - it produces 24% of electricity.

IEA Member Countries already demonstrated a unified support for Ukraine by committing to release 61.7 million barrels from emergency reserves to send the signal to the global oil market that there will be no shortfall of oil supply as a result of Russian invasion of Ukraine. IEA Member Countries hold 1.5 billion barrels in public reserves and about 575 million barrels under obligations with industry. Therefore, this initial response of 61.7 million barrels represents just 3% of total emergency reserves and democratic countries still have substantial reserves to release to mitigate the effect of possible embargo of Russian oil export. It will take only days or several weeks for oil to come into market depending on individual country oil emergency reserves regulation. The release of 10-15% of emergency reserves by the IEA countries will send another strong signal to the market that there will be no shortage of supply in case of elimination of Russian oil imports by democratic countries. The International Energy Agency is working on the 10-step plan to substantially reduce oil imports from Russia by OECD countries similar to the already released plan on elimination of EU's dependence on natural gas.

On increasing production, OPEC seems very reluctant to increase production any faster than the agreed 400k per month increase currently scheduled. This partly reflects a political shift: the two OPEC members with the largest spare capacity - UAE and Saudi - are much closer to Russia and much less close to the US than in past conflicts - when the Saudis often helped curb the price of oil by increasing supply during conflicts. Basically, the Saudis are able to increase supply but have not been willing to do it, partly since MBS was close to Trump and has been sharply criticized by Biden. Perhaps the US can still persuade them to do some more. Moreover, very high prices provide a strong incentive to UAE and Saudis to boost production and capture large profits. Otherwise, they will face a risk of losing market share to the US shale oil producers and other OPEC and non-OPEC producers in the medium-term. Moreover, sustained high prices for oil products will speed up the green transition in Europe, e.g. increasing energy efficiency and switching to low carbon fuels and consequently lower demand for OPEC oil and oil products in the foreseeable future.

Other sources of increased supply are a) US Shale - where production is ramping up and will help but the response has been slower, partly given the impact from the collapse in the oil price in the pandemic; b) Iran and Venezuela, where sanctions look set to be eased. If OPEC quotas increase by 2 mn and US shale adds 1 mn and Veni and Iran add 2 min this would create room this year to take most of Russian barrels out of the market without pushing the oil price higher. The most important single step here is a deal with Iran which might increase crude supply by 1.5 mn barrels overnight.

4. IEA 10-Point Plan to Cut Oil Use – which can support embargo

The 10 steps plan proposes the 10 demand restraint measures to compensate the reduction of Russian oil supply to the world market. The full implementation of these measures in OECD countries alone can cut oil demand by 2.7 million barrels a day within the next four months, relative to current levels.

1. Mandatory reduction of speed limits on highways by at least 10 km/h will result in cumulative reduction of oil demand by 430 thousands barrels a day (kb/d).
2. Work from home up to three days a week where possible. One day of working from home can avoid around 170 kb/d of oil use. Three days of working from home avoids around 500 kb/d in the short term.
3. Car-free Sundays in cities would avoid around 380 kb/d of oil use.
4. The cheaper public transport and incentives for micromobility, walking and cycling can avoid 330 kb/d of oil use.
5. Alternate private car access to roads in large cities will reduce the oil demand by 210 kb/d.
6. An Increase of car sharing and adoption of practices to reduce fuel use will be able to save about 470 kb/d of oil
7. The promotion of efficient driving for freight trucks and delivery of goods will enable advanced economies to reduce the demand for oil by 320 kb/d.
8. Using high-speed and night trains instead of planes where possible avoids about 40 kb/d of oil use.
9. The avoidance of business air travel where alternative options exist would lower 260 kb/d oil use by 260 kb/d
10. Reinforcement the adoption of electric and more efficient vehicles will enable advanced economies to lower oil demand by additional 100 kb/d.

5. On structural deficit of crude oil and oils products in Europe

It is widely reported, that there is tightness in the German/European market for oil products, reflecting in high and volatile prices and a lack of available supply, and perhaps some shortages, For instance, the German price for oil

products such as diesel is above the ARA (Amsterdam-Rotterdam-Antwerp) benchmark price and the price is higher in the East of Germany than the West,

The causes of this:
Russia risk. Russia supplies 50% of Europe's diesel demand, and there is reluctance to buy/uncertainty about whether Russian product will be sanctioned in future and not available to buy;
High prices. European refineries are minimising runs given higher prices of natural gas and product/crude feedstocks
Storage. Inventories of heating oil etc are low at the end of the winter
The lack of product and the high prices are now, and may well last for several weeks. However, we see two reasons why these higher prices are unlikely to last an extended period

First, pricing. Prices are in backwardation, ie higher today than in the future, which should support near term supply - especially once fears about supply have been eroded, and we exit the heating season.

Second, market/volume adjustment. It takes some time for US, Middle East and Indian refineries to adjust to provide more diesel for Europe, and for eg Indian buyers to be attracted to discounted Russian diesel and. But the premium for producing more product for Europe is now so high that these refineries have the incentive to] respond, and thereby provide the product to replace Russian supplies in Europe.

6. On possibility of a crisis in the crude oil sector

The embargo on Russian oil supply will not result in oil price hikes because of the two major reasons:

1. Urals crude is being offered at record discounts, with limited uptake so far. Some Asian oil importers have already shown interest in the much cheaper oil supply. If Russian oil cannot find its buyers in Europe, the discounts will sustain at current level or even go further down, so the Asian suppliers switch from the Middle East, Latin America and Africa for the large part of their purchases to Russian oil, freeing up the sources of the sources of their traditional supply to Europe.
2. Surging commodity prices, Covid contagion in China and international sanctions levied against Russia following its invasion of Ukraine are expected to appreciably depress global economic growth. As a result, the IEA has already has revised down its forecast for world oil demand by 1.3 million barrels mb/d for 2Q22-4Q22 on March 16. The demand can be hit even harder if all factors above persist till the end of 2022 as well as governments and consumers can take to cut short-term demand for oil more rapidly to ease the strains

Altogether, the combinations of these supply and demand effects enable us to project the return and stabilise of the Brent oil price at $90/bbl recorded in early February. Thus, Ukraine has to demand more action from Europe in terms of credible and early commitments to end purchases of Russian oil.

7. Possibility to introduce a punitive 90% tariff

A more economically-feasible alternative to a full oil and gas embargo could be a punitive tariff on Russian energy exports[7]. Such tariff is now possible as Russia is being stripped of its Most Favored Nation status by G7. At the same time, most of this tariff would likely be paid by Russia, as its energy exports are highly inelastic. Various estimates put the operational cost of oil production in Russia at just US$4-7 per barrel, so even a 90 percent tariff at current prices would not deter Russia from selling it oil, and for logistical reasons it would not be able to quickly reorient its exports to non-complying countries such as China. A recent scandal with Shell buying Russian oil demonstrates that Russia is already willing to sell at US$20-30 per barrel, a US$70-80 difference with current market prices. Instead of handing this difference to buyers with low ethical standards, the tariff would effectively transfer it to the government coffers in G7, where the money can be used to mitigate energy price increases to poor households, and finance humanitarian and military aid to Ukraine. For Russian economy a 90 percent tariff would be a powerful blow. The exports would plunge by about a half leading to a 10 percent current account deficit. Government oil and gas revenue (6-9 percent of GDP) would be essentially wiped out, as the tariff would absorb all operational profits in the energy sector. The revenue from punitive tariff on Russian energy exports is proposed to accumulate on a special account in the EU to finance the EU's expenses on Ukrainian refugees and recovery of destroyed by Russia Ukrainian economy.

This would lead to a government deficit of around 8-10 percent of GDP – enough to deplete the oil fund within a year (rough calculations based on the latest IMF Article IV report, Tables 3-4, pp.32-33).

[7] as argued in this piece by Ricardo Hausmann

8. Possibility to reduce EU` reliance on Russian natural gas by a third - to a half - within one year

It is feasible for the EU to reduce its natural gas imports from Russia by at least a third within one year without energy supply disruptions. The steps include tapping alternative sources (Central Asia suppliers, LNG), energy efficiency measures, maximizing electricity generation from nuclear and coal-fired power plants, replacement of gas boilers by heat pumps and scaling up renewable energy projects.The EU has the capacity to boost its LNG imports further to substitute another 20 percentage points of Russian gas imports, but this could make LNG market fairly tight. (But again what is the price to avert the WWIII?) The Russian gas imports could be reduced further by temporarily increasing coal energy production (25% of natural gas is used to produce electricity, so it is in principle substitutable by other sources), and temporarily allowing larger drawdowns from European gas storages, which now stand at about 25% of total capacity (Source: Gas Infrastructure Europe, Bloomberg). Reducing EU natural gas imports from Russia by half would cut its exports by about US$20bln per year[8]

9. Effect of setting up a Sunset date on European purchases of Russian natural gas.

Setting an end date for European purchases of Russian natural gas would be helpful - perhaps e.g. 3 years in the future, which is probably about the time needed to put alternative sources of supply in place, with commitments to reduce purchases eg by 50% this year, by 70% in 2023, by 90% in 2024 and 100% in 2025. A credible commitment to end European purchases by a future date, backed by laws and policies to replace Russian gas, would have a major impact, and is something gas importers like Germany will be more likely to agree.

10. Ban purchases from Yamal and Nord Stream

Ban buying Russian gas which is exported directly from the aggressor counties (Russia and Belarus) - i.e. ban purchases from Yamal-Europe and Nord Stream pipelines and leave just Ukraine GTS and TurkStream in play as export routes for Russian gas. This gives the key transit counties - Ukraine and Turkey - more leverage, damages Russia by reducing exports and destroying the geopolitical value of Yamal and Nord Stream, while mitigating the economic hit to the sanctioning countries.

Ukraine has 284 billion cubic meters per year (bcm/y) of entry capacity from Russia and Belarus, which has been used historically both to import Russian gas for use in Ukraine and for its transit to Europe and an exit capacity of 146 bcm/y towards the European Union and Moldova. The TurkStream pipelines has a total capacity of 31.5 bcm/y - two pipelines with 15.75 bcm/y of capacity each, half of each is designated for Turkish customers and the second for gas transit to Europe via Bulgarial. In 2021 the European Union imported around 140 bcm of Rus[9]sian gas by pipelines for the year as a whole. Thus, Ukrainian GTS and TurkStream are able to ensure all Russian pipeline gas supply to Europe. Moreover, they will have a substantial spare capacity given the EU plans to gradually cut Russian gas imports after the Russian unprovoked invasion to Ukraine and as was explained above the EU can cut it at least by third in 2022.

[8] source IMF, Statista

[9] Around 15 bcm was delivered in the form LNG