

# SYNERGY

Bilkent Energy Policy Research Center Newsletter



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## Projecting 2020



2019 is coming to an end. It was an interesting year with geopolitical events, economic growth concerns, OPEC meetings, climate change discussions, and renewable momentum. When it comes to 2020, we have to think about which ones of these will continue their gradual change and which ones have the risk of disrupting the system.

For one thing, climate change discussions will continue their gradual increase. If the past is a prologue, then the only major inhibitor can be an economic slowdown. On the EU side, we may further move for a green development agenda. The critical points will be the definitions and trade relations. With border adjustment tax, the EU is also signaling its way of protectionist measures. It will be an interesting development to watch.

The economic growth for China, India, and Germany will be critical. Apart from India, the other economies are having a better time than in 2019. What will be the significant impact of an Indian slowdown? It is a critical question. The early signs show a less than moderate effect on the world. China, on the other hand, can speed up its economic engine, but with more challenges, there will be more questions on the sustainability of economic growth.

US elections and its results may do what OPEC failed to do. A democratic

candidate with a significant climate change agenda may affect the shale gas development in the US. The markets will probably price the elections result before the election day. There are two credible scenarios. Either the de-regulation policies continue, or heavy-handed regulations returns. The most significant risk is for consumers around the world. But risk also brings its bounties. In the case of a moratorium on new shale developments, major oil producers will profit handsomely. The climate taxes will be just a peanut. Therefore for "big oil," a moratorium may do what OPEC failed to achieve. It will be disruptive.

Specifically, about climate change, we will see more publicity but less action probably because there are more far far away targets but less medium-term checkpoints. So there will be less motivation to act now. But there will be more efforts to put substance to climate discussions. If economies are in good shape, this substance may scale up the efforts. There will be more tenders, record low prices, and the early signs of industrial transformation. However, the reverse may happen. Still, there will be an opportunity window to do a Keynesian Green Deal.

Oil prices are a hot topic for 2020. The best guess for oil prices is the "status quo." That is to stay that oil prices will continue their pattern just like in 2019. Oil prices respond to trade

wars more than the stock levels nowadays. OPEC+ observe the US elections, and until November, they may not break current consensus. Most of the OPEC+ members value this agreement, and there are reasons to expect the continuation.

The only enemy of the gas is the warm weather. In 2020, the warm weather may sustain the gas prices at their current levels. Just like in 2019, the polar vortex affecting both China and Europe can affect prices. But for the rest of the year, with more LNG coming, the prices will probably average more or less 2019. The US elections may distort this equation. The developments in the Australian energy and climate discussions are also worth a look.

The disruptive changes are hard to guess. As always, a major problem in the Middle East is the biggest concern. Another one is an increasing discontent in Asia. There may be a significant cyber attack since their intensity is increasing every year. Volcano eruptions are my favorite unforecastable events.

Nevertheless, the world is moving into a new protectionist and nationalistic plane. Energy policies may not have too much space for romanticism. The realities may sink in. The most significant fact will be the cost of the transformation.

## Oil and Authoritarianism



The oil and gas riches of the Middle East have, for long, making it a hotspot in international energy dialogues. The implications of its vast have been different regarding each state in the region. The domination of fossil fuel production in the export structure of these nations has created significant results over the decades, which are becoming more and more visible by the day for the general public. These negative consequences have also led to the creation of the term 'resource curse,' which implies the overreliance on the hydrocarbons for fueling the national budgets and the harmful effects it brings upon. Before explaining the geopolitical dynamics of the host nations, the focus should be placed initially on how the additional revenue gathered from the sale of hydrocarbons has created different governing structures and the domestic balancing effects these nations have utilized as a result.

A prime reason for why these authoritarian regimes within these states have managed to survive for decades is because they have not required their citizens tax-money to provide them with services. Instead, the oil and gas revenues have been used to substitute for the taxes, and also to win the approval of the general population, numerous subsidies have been granted. The form of subsidies differs from state to state. Still, the general perception that the Middle East North African (MENA) oil is so cheap to extract has led to states lowering the price of gasoline and natural to gas to levels even below that of the cost of extraction. Other forms have been reduced the cost of food imports, an industry which these nations lack progression in due to their geographical location, or even the free usage of simple utilities such as water and electricity. The granting of these aids to the citizens in the region have been going on for decades. Housing some of the easiest to extract reserves in the world; these states, for most of the time, did not experience many problems keeping up with their programs.

However, the state intervention to the free market supply and demand balances has given rise to a problem that has crept up over the years to resurface as a catalyst for budget balance and political instability problems. Owing to the heavily subsidized price of fossil fuels, the domestic con-

sumption of these materials has risen incrementally over the years. To make up for the amount lost in funding the commodity, the host nations and indirectly the NOC's have increased their production rates for export markets. But overgoing the simple fact of the oil field that wells and other equipment need frequent maintenance and significant upgrades from time to time, the production zones of these states have become significantly inefficient compared to their previous conditions' decades ago.

The case for North African states is open to more possibilities and solutions when compared to those situated in the Arabian Peninsula. Diversifying the gas suppliers of Europe, the African countries serve as valuable partners for ensuring the energy security of Europe. The Trans-Mediterranean pipeline connecting Algerian gas through Tunisia to Italy and the Greenstream pipeline connecting West Libyan gas directly to Italy act as points of contact and exchange between Europe and North Africa. The increasing global gas trade and the decreasing oil volume in tankers that are observed at the regional chokepoints such as the Suez Canal indicate a possible point of growth for these nations. Taking advantage of their relatively underdeveloped gas fields, many of these states possess the capacity to be an integral part of the new global energy mix.

The fragile political and economic balances these MENA petro-states hold could have negative implications for the global arena when it comes to maintaining geopolitical stability. The low-employment and low per-capita GDP growth economic models that they retain, in the short-run, cannot be changed. Suiting to the needs of the new global energy order, these states have the option to integrate into the new distributed production model in a more planned manner. The increasing worldwide gas and LNG demand could aid the revenue creation struggle many of these states are facing. Besides, the inclusion of

human rights and freedom inducing points into the loan covenants/terms of sale contracts signed between Europe and MENA could help alleviate the domestic political pressure these states are facing, making changing the subsidization programs much more viable and likely without causing retribution from the citizens.

While the United States is out to grab as much market share as possible for its unconventional oil and gas producers, the MENA states should not worry about losing their shares or of an upcoming prolonged supply glut in the markets causing a sharp drop in prices. The reason is simple. While the U.S. is aiming to be energy independent, its shale wildcatters are fueled by debt and not equity. Already utilizing high-cost technology, the U.S. producers are highly sensitive to the price of oil and gas, and 52% of the shale debt and interest is calculated to be paid within the next seven years. The breakeven point is estimated to be around \$50 bbl. Given this market pressure on the U.S. producers, they cannot be indeed energy independent by following a supply-side push trying to squeeze other cheaper conventional producers out of the market.

Another significant development for these MENA players is the growing new trends within the financial markets. Having financially strained their NOC's, the international public financial markets are out of feasible reach for most of these states for healthy fundraising. But the new growth in the private equity markets has opened new venues to raise funds for these players. Only between 2014-2016 the private equity firms in North America raised \$132 billion for energy investments. The direct and efficiency-focused nature of this financial market can very well be utilized for the greater growth of the fields in MENA.

Given the high-quality low-sulfur sweet crude being prominent in the MENA region, the refinery potential of the area is quite high. According

## 31 December 2019: What Happens If the Gas Stop Flowing?



to S&P Global Platts estimates, the global petrochemical demand is expected to grow above the global GDP growth rate by a few percentile points and multiples of the global demand for transportation fuels. The development of emerging economies will primarily be driving this push, especially for plastics, and it presents a significant opportunity for these petrostates to make up for the lost demand for oil and balance their national budgets.

The same case also applies to the developed nations when it comes to phasing oil out from greater circulation driven by greater employment of renewables and natural gas. The United Kingdom is seeking to revamp its offshore oil and gas service companies by establishing the world's largest offshore wind farms, which share a portion of its supply chain with the offshore oil and gas sector. The lost production volume from North Sea fields is a prime reason behind this push. On the U.S. side, the announced chemical industry investment value is around \$204 billion as of May 2019 according to the American Chemistry Council and the recent campaign for wind turbines in the northern hemisphere, which sources a lot of its large components and materials from petrochemicals products, is not without its reasons. The case can again be connected to the new developing energy mix that focuses more on downstream, variety, and efficiency.

Just as how this new transformation is creating new realities for MENA states, it is also doing so for the developed nations as well. Perhaps for an updated and more niche version of the articles, the developments in wind turbines and the global petrochemical demand can also be taken into consideration as the energy industry is moving faster than ever due to pressing and concerning environmental reasons and the inner dynamics/economics of the energy sector.

Alpcan Efe Gencer

Ukraine has counted on Russia for decades. The year 2014 marks the drastic change in relations between these two states. Russia's struggle to keep Ukraine alienated and US's low priced liquified natural gas (LNG) remains as two fixed variables that affect the mood of the region. US has become highly competitive about its LNG as opposed to Russian gas. As of 2020 US boosted its export capacity to Europe to 112 bcm/y, more than doubling capacity in 18 months. According to the International Energy Agency, Europe has saved \$8 billion due to US LNG import. The imports of LNG are expected to increase gradually.

Russia claims that the process for liquefaction is costly and not sustainable. Russian strategy of having a long-term contract for pipeline gas is in a state of total disorder as importers seek LNG. The expiration date of the 10-year-long agreement between Ukraine and Russia is getting closer, and there are doubts if the Nord Stream 2 and Turkish Stream can replace Ukraine transit. Nord Stream 2 will not be complete until 2020, even if it is operational Ukraine transit would be needed. This expiration date marked the day as "the day gas will stop flowing." In other words, a remake of the 2009 winter crisis when reportedly 11 people died. In the absence of an agreement, on January 1st, gas will stop flowing to Europe. Europe has reported that their gas storages are full, and the consequence would not be as heavy as 2009, but still could be crucial. Depending on the length of disruption, European demand for LNG could

peak.

To be prepared, Ukraine does not rely on only one option. From the Soviet era, Ukraine inherited huge underground gas storages (UGS), which is the largest in Europe, and it is located close to Poland, Slovakia, Hungary, and Romania. These UGS, has the capacity of 31 bcm, can store gas from the Baltic Pipe and LNG terminal in Poland. Ten bcm of these storage units are not utilized due to hampers created by Russian owned Gazprom. Putting them into utilization makes extra 10 bcm storages available. Ukraine is planning to accumulate gas when the prices are low and sell it to EU importers during prices are increased. The role of Ukrainian UGSs gets crucial as LNG is getting more and more popular in Europe. Not only for European clients, but also Ukrainian UGSs can hold gas for distant clients as well as there is a great profitable market in Asia.

Despite the tense relations between Russia and Ukraine after 2014, Ukraine remains a vital transit route for Russia. The gas transit contract between Gazprom and Naftogaz expires on December 31st, 2019. Still, it is expected a five-year extension contract on the same conditions as the current energy minister Orzhel suggests. The deal is expected to be signed by the end of 2019.

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BRENT OIL

66.17 \$/BL

GASOLINE

6.94 ₺/LT

USD/TRY

5.94

DIESEL

6.58 ₺/LT

EUR/TRY

6.59

FUEL OIL

4.54 ₺

## Stucked Between the Giants: Central Asia's Dependence on Russian and Chinese Gas Demands



In this short article, I will discuss the potential Sino-Russian energy rivalry in Central Asia and the region's economic dependence on Russia and China in light of Morena Skalamera's remarks.

The efforts to build a gas pipeline connecting the Central Asian producers to the European markets have not yielded fruit thus far. At the end of the day, Central Asia has become dependent on exports to either Russian or Chinese markets. Moreover, the US, who helped the Central Asian countries balancing the Russian influence geopolitically since the collapse of the Soviet Union, now starts to drift away from the region, due in part to Trump's "America First" policy.

For two decades from the collapse of the Soviet Union to the early 2010s, Russian Gazprom was purchasing landlocked Central Asian gas in an orderly fashion. Gazprom then would sell the same gas purchased at a low price to the European customers for higher prices. It was one of the salient methods serving the Russian gas monopoly in Eurasia. However, starting with the Great Recession in 2007, the European demand plummeted and Russia felt no need to purchase the Central Asian gas. In 2009, a suspicious explosion took place in the main Russia-Turkmeni-

stan gas pipeline, which led Russia to reduce the annual gas inflow from 50 bcm to 10 bcm. Despite the lack of evidence, most commenters believe that it was a Russian plot in order to suspend the gas imports fixed in the long-term contract. Meanwhile, a new gas pipeline starting from Turkmenistan to China through Uzbekistan and Kazakhstan began operating in 2009. This new pipeline, which carries 55 bcm per year (its capacity has gradually increased), elevated China's position to the largest energy customer of Central Asia. As a result of China's involvement in the game, Uzbekistan's exports to Russia fell from 15.4 bcm in 2009 to 1 bcm in 2015. By 2016, Turkmenistan completely cut its gas exports to Russia. Although it seems that the Central Asian republics have kissed off their Russian bully in terms of economic dependency, they now have become dependent on Chinese gas demand.

Over the past decade, the Central Asian states tried to gain satisfactory flexibility and bargaining power in triangulating relations with Russia, China, and the US. While the EU appears as an important investor and a potential market, it is far from balancing the other two, three geopolitically. When we look at the picture of Central Asia today, the countries in the region seem to have been

stucked between the two giants.

Overall, it seems that China's growing economic presence in Central Asia comes at Russia's expense. Except for Kazakhstan, China is the largest trading partner of each Central Asian country. While Russia still being a vital trading partner, investor, and provider of employment to millions of expatriate Central Asian workers, it has been losing its economic weight in the region. In terms of security issues, however, China falls short to challenge Russia in Central Asia. Moreover, when it comes to soft power, Russia clearly outweighs China. Russian political and cultural influence in the region still remains dominant.

Hikmet Can Çakan

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