DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST

"HOW THE UKRAINE WAR IS AFFECTING OIL AND GAS MARKETS"

Washington, D.C.
Monday, April 4, 2022

Guest:

SAMANTHA GROSS
Director, Energy Security and Climate Initiative
Fellow, Foreign Policy
The Brookings Institution

Host:

DAVID DOLLAR
Senior Fellow, Foreign Policy, Global Economy and Development, and the John L. Thornton China Center
The Brookings Institution

Episode Summary:

Samantha Gross, director of the Energy Security and Climate Initiative at Brookings, talks with host David Dollar about the Ukraine war's impact on energy prices. Gross explains the impact Russia's war on Ukraine is having on natural gas supplies and prices, oil markets, and whether the U.S. should increase natural gas exports to Europe.

DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast Dollar and Sense. Today we're going to talk about energy markets and how the Ukraine war is affecting them. My guest is Samantha Gross, director of the Energy Security and Climate Initiative at Brookings.

But before we hear from Samantha, I want to mention that the Brookings Podcast Network has a new show that you might like called Vying for Talent, about the U.S.-China competition for human talent.

[music]

RYAN HASS: Hi, I'm Ryan Hass with the Brookings Institution.

JUDE BLANCHETTE: And I'm Jude Blanchette with the Center for Strategic and International Studies. We're the co-hosts of "Vying for Talent," a podcast examining the role that human talent plays in competition between the United States and China.

HASS: Both the United States and China are vying to demonstrate which governance and economic system is best able to deliver results in the 21st century. Much of this competition hinges on economic performance, which is driven by innovation, which is being pushed forward by talented individuals in both countries.

BLANCHETTE: "Vying for Talent," puts faces and stories to the sprawling competition underway between the United States and China. Through this podcast series, we're using stories to shine a light on what more the United States can do to improve its edge for the future.

HASS: "Vying for Talent" is produced by The Brookings Podcast Network and distributed by both Brookings and the Center for Strategic and International Studies. 3 You can download and listen to it on Apple, Spotify, or wherever you like to get your podcasts. Learn more at Brookings dot Edu slash Vying For Talent.

DOLLAR: So welcome to the show, Samantha.

GROSS: Thank you. Always a pleasure.

DOLLAR: So, the West has imposed these unprecedented sanctions against Russia. How does it affect oil and gas? And what's actually happening? Russia's obviously a major exporter of oil and gas. So what's actually happening with their exports and what's happening to prices? Let's just start with that kind of general overview.

GROSS: Absolutely. So the West is really throwing the kitchen sink of sanctions at Russia. But for the most part, Russia's oil and gas exports are actually not sanctioned, apart from the fact that the U.S. is now not buying any Russian energy products. But what's happening right now is that consumers are moving away from buying these fuels. You're definitely seeing that in terms of Russian crudes being priced at a great discount to similar crudes from elsewhere. And so Russian oil in particular is getting out.

But there are concerns about the supply in the future, there are concerns that the sanctions will get more strict. There's also Russia now coming out with a countermeasure and asking unfriendly countries to pay for its oil and gas in rubles. And so this story is not over.

In terms of prices, they're down a bit off their highest level. They really peaked right at the invasion, no one was quite sure what was going to happen. Peaked at about $120 a barrel. But everything from Biden's announcement a few days ago that he would release from the Strategic Petroleum Reserve, concerns about COVID in China and everything else, crude has come down a bit. It's about $103 as we record this. But this story is definitely not over yet. It's just getting started.

DOLLAR: Right. But that hundred and three dollars is up quite a bit from pre-Ukraine war.

GROSS: Yes, it is. And it's and it's because Russian exports have decreased significantly. Consumers just don't want them. They don't want the stigma associated with them. And they also don't want to necessarily deal with the banking sanctions involved with paying for that oil.

DOLLAR: So if some of the Russian oil has been taken off the market, is there anyone who can make up for that? Can Saudi Arabia or any of the other producers in the Middle East or elsewhere step in and really make a big contribution to try to stabilize the market and bring down the price a little bit

GROSS: To some extent, yes. It depends on how much Russian oil stays off the market. Oil is definitely a fungible commodity, and so you can move it around easily and producers have the opportunity to take up the slack. Likely more is getting to market now. Buyers are still working out the kinks and figuring out how to pay for it. But Russia generally exports about five million barrels a day. If all five million barrels per day would come off the market in a 100 million barrel a day market, that is not replaceable. Whereas if only a smaller percentage of Russian oil is staying off the market, yes, others can make up for that. So it just depends on how bad the disruption gets. Natural gas is a whole 'nother story that we should talk about later in our talk.

DOLLAR: Well, no, why don't you jump in natural gas right now?

GROSS: Sure. Well, the difference with natural gas is that much of Russian natural gas supply goes through pipelines, and those pipelines generally go in one of two directions. There's pipelines going east that go towards China. And then there's a larger pipeline system that goes west towards Europe. That gas is not as fungible as oil, because most of that goes through tankers and it could go anywhere, but those two Russian gas systems don't connect in the middle. So it's not like Russia can divert that gas that's intended to go to Europe and send it to China. So we talk about Europe being in trouble because of its dependance on Russian gas. But Russia also depends on Europe for that market because there's nowhere else for that gas to go.

DOLLAR: So, we'll come back to Europe and gas a little bit later, but you mentioned China. China says it's going to continue normal trade with both Russia and Ukraine, but on the energy side we're really just talking about Russia. Do we have a sense of what's actually happening with China's import of oil, natural gas? I think they import a little bit of coal from

Russia as well. And to the extent we know what's happening, is it violating any sanctions or is it outside of the sanctions regime?

GROSS: No, it's really outside of the sanctions regime. China is definitely still importing oil. In fact, they're enjoying the fact that because fewer buyers want Russian oil, it's selling at a discount. And so the only problem that they've had there is actually finding cargo ships that are willing to carry it because again, it's carrying a stigma right now. You're also seeing India buying a lot of Russian crude. And so these additional prices are lessening the effects of sanctions, but they're also lessening the effect on oil price. And so it's mixed.

DOLLAR: Yeah, it really strikes me, as an economist this is really interesting sanctions example, because as you were at least intimating, we don't really want Russia's exports to immediately go to zero because that would be a big shock for the world market. On the other hand, we don't want it to stay the same because then that would mean, you know, whatever sanctions are there are completely failing. So I think when the dust settles, if, you know, Russia's exports are down, I'm just pulling a number out of my head now, if they're down 30 percent or 40 percent, that's probably severe penalty for the Russian economy, which is the objective of the sanctions. And yet some disruption, but hopefully not total disruption for U.S. energy markets. Is that about right?

GROSS: Well, and for global energy markets, yeah, we're definitely walking a fine line between wanting to punish Russia for its actions, but not wanting high energy prices to to really mess up or even cause a recession in the global economy. And so I think that balance may change over time, depending on additional oil and gas coming onto the market and changes in Russian behavior. But that's where we're at right now.

DOLLAR: Yeah, I mean, these higher prices are definitely going to have some negative effect. I've seen the forecast for Germany's economy this year's already been cut in half. You know, China may be getting some of its energy from Russia, but prices are high in China now, and that's a shock for the Chinese economy. It's going to make it hard for them to grow. So, so everybody's feeling some pain.

So let's talk a little bit about Europe and its situation with gas. Europe wants to wean itself off Russian gas as soon as possible, and I think doing it immediately is not realistic as I understand the numbers. But how can Europe wean itself off Russian gas? Where are the important policy measures that would bring that along? And how quickly can that be done?

GROSS: Yeah, Europe's in a bit of a pickle with respect to its gas. Russia supplies about 40 percent of Europe's total gas consumption. And I mean, eventually, yes, they want to wean themselves off of gas not just for geopolitical reasons with Russia, but also as part of their energy transition. But right now, they don't need less gas, they need more to make up for a Russian supply.

And so the short term is really hard, and the degree of difficulty depends on how that gas is used. And it varies somewhat across countries. In areas where it's used primarily in industry and in power generation, particularly in power, that's not easy to replace, but it's doable. I think you'll see some coal plants running more than they were planned or some that were meant to be retired not retired as we make this adjustment, which is unfortunate for the climate, but it's important to keep the lights on.

But where it really gets hard is a lot of gas, particularly in northern Europe, goes into home heating. So instead of just replacing a smaller number of large power plants, you're looking at replacing the heating system in millions and millions of homes. And that is going to take a mighty long time. So for right now, Europe is focused on bringing in LNG, or liquefied natural gas, from everywhere it can possibly find it, but there's not going to be enough to replace all of that Russian supply.

Just for some numbers for fun, last year, Europe imported 140 billion cubic meters during the year of natural gas. And President Biden a few days ago made a big announcement that he was going to send an additional 15 billion cubic meters this year to Europe. And so that's, you know, just over 10 percent of the total Russian supply. And frankly, I don't even know where that amount of gas is going to come from. So, eliminating Russian gas is very hard.

DOLLAR: Part of Europe's dependance on gas in general and especially Russian gas, relates to its phasing out of nuclear, at least in quite a few countries. Is there any talk about changing that policy, bringing some of the nuclear plants online or keeping them online?

GROSS: You know, it depends on where you are. I actually talked to a German official about this several days ago, and he said "No." Germany is the country in Europe that is most opposed to nuclear power and has its last two plants that are slated to shut down at the end of this year. And I think right now there's there's intense German opposition to nuclear power in the government and among the people. And so I don't think they're looking at that. Whereas in other countries, the opposite is kind of France, and France is saying that they want to build more new nuclear. So it depends on where you are. But in the places where nuclear is on the decline, it's generally on the decline for strong political and public opinion reasons.

DOLLAR: Right, I mean, you couldn't build a new nuclear power plant in time to make a difference. So the only question would be is if there's some phase outs that could be slowed down.

GROSS: Yeah, and Germany seems like the place for that. But at least among the people I've talked to, it's not somewhere they want to go.

DOLLAR: So let's talk a little bit about some of the policies the U.S. is implementing in response to both the domestic energy prices and this global energy crisis. You already referred to President Biden trying to direct some natural gas to Europe. The U.S. is a pretty major exporter of natural gas. But some members of Congress are advocating that the U.S. essentially ban these exports in order to keep the price of natural gas low in the United States. So favor American consumers, not very friendly for our European allies or for the world. So you you had a blog about this recently, Samantha. So can you just run us through your thinking on this issue? Should, you know, should we be banning the export of natural gas?

GROSS: In a word, No! In two words, Absolutely not! I wrote that blog in response to a letter that came out before Russia's invasion of Ukraine. But you're still hearing grumbles on Capitol Hill that they'd like to reduce or eliminate natural gas exports. But there's so many good reasons not to do this. To start, U.S. natural gas prices are generally a lot lower than those in Europe. But in recent months they've been a ton lower as Europe prices have gone up. Russia was messing with European gas supply long before it invaded Ukraine. And they've had prices as high as six times ours. And so we complain about high gas prices, high natural gas prices here, but we haven't seen anything, frankly.

Another thing is that I see helping the European Union with gas is actually part of the U.S. contribution to the war effort. We want to punish Russia for its behavior, and one way to do that is for Europe to send them less money by buying natural gas. And so I think we should think of this not as raising prices for American consumers, but as a reasonable contribution to a very important geopolitical goal.

And the final thing I'll say about this is that high prices for LNG that we're exporting abroad encourage development here. I think there is this idea that if we kept that gas within the United States, all other things would remain equal and our prices would be a lot lower. But all other things are never equal, and we might just produce less gas and have less impact on prices. So absolutely not. We need to keep sending that gas to Europe for so many good reasons.

DOLLAR: Another measure taken by the U.S. administration is releasing some petroleum from our Strategic Petroleum Reserve, and I believe this was in concert with some of our allies. So is this an important measure or is this going to make a significant difference for prices at the pump?

GROSS: Yes, and yes. I think it's a great idea. This is honestly exactly what the U.S. Strategic Petroleum Reserve and reserves in other countries were designed for, either long-term geopolitical interruptions or short-term emergencies. But this is what that reserve is for. The U.S. has said that on its own, it will release or sell about a million barrels per day of crude oil over time. If you'll remember, Russia exports about five million barrels a day of crude oil. So this is a serious dent in a disruption caused by eliminating Russian oil, and we're not the only country considering releasing. And the thing is, we can afford to do this for a while. There's a, I believe, 600 million or more barrels in our strategic reserves, so it's not like we're running down that reserve quickly. We're selling the oil, we're getting the revenue, and we can afford to do this for a while. It's totally what those reserves are for.

DOLLAR: Right, when you have reserves like this, ideally what you want to do is fill them up when prices are low and then sell some of the reserve when prices are high. And if you run it properly, you actually make money. You know—

GROSS: —exactly—

DOLLAR: —it basically pays for itself. So that's good that we were smart enough to build up some reserves and this is this is definitely a good moment to use it. Yeah. What about temporary cuts in gas taxes? We now see U.S. states, a number of states have actually implemented this already. Other states, New York, I think, is talking about it, thinking of putting it in their budget. Price of gas is not particularly high in the United States compared to much of the world, but I think the typical state has maybe 30 cents of tax for each gallon of gas. So, you know, some kind of holiday could potentially make a significant difference. Do you have a view about this?

GROSS: Yeah, I really do. I find this problematic for a few different reasons. One of them is if you were to eliminate state gas taxes or I know there's been discussion about doing at the federal level as well, you want to make sure that that price difference actually gets passed through to consumers. It might not. Other entities in the value chain, the oil companies, distributors, the gas stations themselves could take some of that back. And so it would be difficult to make sure that the consumers actually got all of that lost revenue.

And if we were to make this a temporary holiday, good luck getting those taxes back. You know how Americans feel and cheap gas is our birthright. And it might be really difficult to get those taxes re-implemented. And they pay for really important things, everything from roads and highways to public transportation. And so that money is important.

A few other things. Eliminating those taxes is somewhat regressive. Wealthy people tend to drive bigger cars and drive more, not always, but the tendency. And so I think more of that share than is fair would go to people who don't need it anyway.

I think a better option would be to send some sort of rebate or bonus for low-income car owners. That way, you could keep the price up to encourage people to conserve. But you could also make whole people who are really hurting from high gasoline prices and try to really focus this help on people who really need it to keep the costs down.

DOLLAR: Yeah, I think that's a really good point, Samantha. You know, if you have a temporary lull in that tax, maybe for the rest of the year, you know, you've got a pretty big fiscal shortfall. You're basically, you're using fiscal resources and you're just distributing them pretty randomly, essentially based on how many miles people drive. And as you say, we could help the poorer elements of society who are having trouble paying extra gas prices for a fraction of the cost. And then we economists like, you know, keeping the price that people face nice and high because we do want to continue to discourage excessive use of carbon. So, so I think that makes sense.

GROSS: Yeah, you want consumers to see that real price so they can make good decisions and just help the people who really need it.

DOLLAR: So last question for you, Samantha, I want to hear you speculate a little bit about whether this energy crisis accelerates the transition to a reduced carbon and eventually zero carbon economy, or does it somehow set us back? Or is it just unrelated?

GROSS: You know, it really depends on how it plays out politically. And there's also a timeframe aspect to this. In the near term, I think we may see global emissions go up, particularly in Europe and in Asia, where natural gas has gotten really expensive and they may be turning back to coal for power generation to keep the lights on. So, in the near term, that's not great. But we have to understand that we have to feed the energy system that we have today to keep the lights on, people warm and moving, and the economy running. And so we're kind of stuck with that now.

But over the longer term, I think this really demonstrates one of the benefits of a decarbonized, less fossil fuel dependent economy. Russia doesn't have the ability to mess with wind or solar supplies, to sort of state the obvious. And so I hope that over the longer term, this adds some political will for the energy transition. I think that energy security has been kind of a sleeping giant in the climate debate, and we remember energy security now all of a sudden, and it's also a good argument for changing our energy system.

DOLLAR: Yeah, I mean, wind and solar definitely insulate you from some of these global shocks.

GROSS: Yeah. And wind and solar don't replace everything. I mean, we'll need electric vehicles before wind and solar can be used in the transportation sector. But you know, the idea is that we'll get there. And we might have some different geopolitical shocks, but they won't be quite as large.

DOLLAR: And it's not just Russia. I mean, there are some other unsavory countries. I'm not going to mention names, but the—

GROSS: —yes—

DOLLAR: —the major exporters of petroleum, you know, there are some unsavory countries. And so by being addicted to oil, we're basically funding these different authoritarian governments around the world.

GROSS: Yeah, I mean, we use oil because it's useful stuff, but we're definitely getting a taste of the downsides of our dependance on oil. But now we have the technology to do something different.

DOLLAR: I guess, Samantha, if you had to speculate, you know, ahead the next few months, do you think Russia, do you think Russian exports will be going down? Or do you think they'll find workarounds and they'll start coming back up assuming this war continues?

GROSS: You know, I think Russia and under the current sanctions can definitely find workarounds. My question is will be if the sanctions get more strict and if the U.S. starts to apply secondary sanctions on top of those to penalize consumers of Russian oil. That's when things start getting hairy.

DOLLAR: I'm David Dollar, and I've been talking to my colleague, Samantha Gross, about the energy situation, it's very complicated and actually quite interesting for economists. We're trying to get Russia to cut back its exports as a way of penalizing them, but we actually don't want that to go to zero immediately. That's going to be a big shock to the world economy.

So I think we can assume there's going to be a lot of uncertainty in energy markets for the next year, perhaps longer. So, thank you to Samantha for walking us through this and helping us understand what's happening in global energy markets.

Thank you all for listening. We release new episodes of Dollar and Sense every other week. So if you haven't already, follow us wherever you get your podcasts and stay tuned. It's made possible by support from producer Fred Dews, audio engineer Colin Cruickshank and other Brookings colleagues. If you have questions about the show or episode suggestions, you can email us at podcasts@Brookings.edu.

Dollar and Sense is part of the Brookings Podcast Network. Find more Brookings podcasts on our website Brookings Dot Edu Slash podcasts and follow us on Twitter at Policy Podcasts.

Until next time, I'm David Dollar and this has been Dollar and Sense.