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Why Russia Isn't Afraid of U.S. Gas Exports

By Chris Weafer

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During his recent speech in Brussels, U.S. President Barack Obama said the U.S. could soon become a major supplier of gas to Europe and allow countries that are currently "hostage" to gas imports from Russia to have an alternative supply source at a cheaper price. We heard the same sentiment from the chairman of the U.S. House Foreign Affairs Committee, Ed Royce, during his March 26 address at a committee hearing on "The Geopolitical Potential of the U.S. Energy Boom." While Obama placed his comments in the context of energy supply security, Royce was much more explicit about the real objective of an energy dump into Europe. "America's newly developing energy supplies could make a difference," he said. "They could sap Putin's strength, while bolstering Ukraine's and that of other European countries."

We have heard similar comments from many politicians in Europe as well as the U.S., and from executives in companies operating in the shale gas industry. We also heard similar comments from many others promoting the idea that the U.S. Energy Department might release oil from the Strategic Oil Reserve to increase global supply and depress the world price of crude. The basic line has been to send cheap U.S. gas or oil to Europe to kill off demand for Russian exports and to debilitate the Russian economy. Some have also emphasized the benefits, as they see it, to the European economy from cheaper energy and to the U.S. economy because of higher export volumes. But the key objective, the argument goes, is causing collateral damage to the Russian economy.

You can see where they are coming from. The widely held perception among those who only superficially look at the structure of Russia's budget and economy is that it is a hydrocarbon--dependent country and even a slight twitch in the price of export oil or gas would destabilize the country. That certainly was the case in the late 1980s, in the late 1990s and again in late 2008. But much has changed even since 2008. and the continuing legacy of various wars across North Africa and in the Middle East means there is little threat to the price of crude oil. Brent crude has been more or less stable just under $110 per barrel for more than three years, and looming problems in Venezuela and reports of increasing violence in Nigeria offer little medium-term comfort for oil bears.

But it is Russia's gas position that has attracted most attention since the Crimea referendum. And it is against the backdrop of political emotionalism that basic fact-checking has been ignored. Here are some important facts. Gas production has certainly grown very rapidly in the U.S. since the middle of the last decade. According to BP's most recent Statistical Review of World Energy, the U.S. has increased annual gas production from 550 billion cubic meters in 2007 to more than 750 bcm last year, overtaking Russian production of about 600 bcm. But according to the BP report, the U.S. currently consumes almost all of the gas it produces. It exports almost no gas.

To be sure, if the U.S. can sustain the rapid pace of production growth seen since 2007, it will eventually become a large exporter of gas via LNG tankers. But this will be possible only if it adds a significant amount of export infrastructure, namely LNG loading terminals. The first of these, at Sabine Pass in Louisiana, is not due online until late next year or early 2016, while some others are bogged down in environmental disputes and are not expected until 2019 or 2020. But even then, U.S. gas producers, which have been booking export contracts far in advance, are all planning to send their LNG volumes to Asia. The price of gas is much higher in Asia than Gazprom charges its European customers. It is difficult to see why a U.S. LNG tanker would sail to Europe just to make a political point rather than to the far more profitable markets in Asia.

In addition, the price of gas sold domestically in the U.S. is extremely inexpensive compared to world prices. This is regularly cited by economists — and lauded by politicians — as an important factor behind the revival in the U.S. economy. It is no surprise that U.S. gas executives are pushing for approvals for more export facilities. The Russia angle is purely convenient for a profit-orientated industry keen to sell to the highest bidder and to break free from the depressed local market. One wonders what the attitude of lawmakers will be when the price of domestic gas eventually starts to rise because of competition from the export market.

That is not to say that Russia can be in any way complacent about economic vulnerability to energy exports. By the time LNG volumes are sailing in large volumes into European ports, overall demand will be much higher, and Russia will be a major player in the global LNG business. Novatek's Yamal-based LNG terminal is expected online by 2017, and more than 70 percent of the planned production is already sold to Asian customers. The plant will double in capacity between 2015 and 2020. By 2018, the LNG plant currently under construction in Sakhalin, which is jointly owned by ExxonMobil, Rosneft, ONGC of India and Japanese investors, will also be online. Russia's first LNG plant came online in March 2009 as part of the Gazprom-Shell Sakhalin-2 project, and another bigger Gazprom foray into LNG production cannot be far off. By the start of the next decade, Russia is likely to be a much larger exporter of LNG than the U.S. Exports from both countries will sail to Asia rather than to Europe

What about Europe's ability to produce more of its own gas? Europe is much more sensitive to environment risk than is the U.S. Germany has decided to cut nuclear power, and most countries are dragging their feet when it comes to alternative energy projects, such as wind farms, because of the aesthetic and other environment damage. It is therefore naive to assume that Europe will embrace the shale gas revolution in the same way as the U.S. has. The first television images of homeowners in Britain, France or Germany setting light to gas coming out of their water faucets, a very familiar sight in many parts of the U.S., will send the environmentalists to court for injunctions faster than politicians will deny they ever supported the project.

Russia's current share of the European gas market share is about 30 percent. For Gazprom to maintain that market share as overall gas demand rises on the continent, it must complete the South Stream pipeline across the Black Sea despite objections from Brussels. Customer countries, such as Bulgaria, are in favor of South Stream because it bypasses the troublesome transit route through Ukraine. For the same reason, Germany wanted the twin-pipe Nord Steam connection which delivers 55 bcm of Russian gas directly into its industrial heartland.

U.S. and European Union officials are, of course, quite correct to emphasize long-term energy security. The long-term alternatives — that is, from Iran, Central Asia or Africa — hardly offer more assurance. And we already know that price differential between Europe and Asia means that U.S. LNG tankers will not be in any hurry to supply the market when they eventually do set sail.

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