

RUSSIAN GAS CUT-OFF; A CRISIS IN MAKING

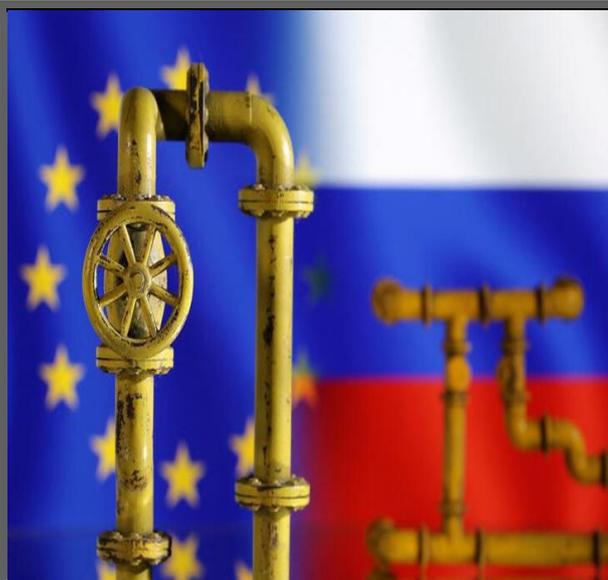
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(Views expressed in the brief are those of the author, and do not represent those of ISSI)



On September 26, 2022, Denmark and Norway reported undersea gas leakages in Nord Stream 1 and 2 pipelines.¹ Although the Western alliance did not overtly blame Russia, Ursula von der Leyen, head of the European Commission, stated that the pipelines may be sabotaged. In response, Russia has blatantly denied responsibility for the pipeline damage.

Since August 31, Russia indefinitely halted all gas exports via its Nord Stream 1 pipeline.² Although Russia cited maintenance work, we have observed partial closure of the pipeline in June (75%) and July (84%) too. As a countermeasure to economic sanctions, foreign policy experts opined, Russia is using Gas as a political weapon to inflict economic pain in the region. Moreover, a reduction in Russian gas and oil supply has soared energy prices in the international market, consequently increasing Russian revenue from energy trade to towering 400 billion euros in the current fiscal year.³

After the Russian-sponsored referendum in four Ukrainian regions (which the international community has shunned as sham), the European Union with the support of G7 states imposed new

¹ "Nord Stream 1: How Russia is cutting gas supplies to Europe", BBC News, published on October 1, 2022. <https://www.bbc.com/news/world-europe-60131520>

² Sam Meredith, "Russia has cut off gas supplies to Europe indefinitely. Here's what you need to know", CNBC, published on September 6, 2022. <https://www.cnbc.com/2022/09/06/energy-crisis-why-has-russia-cut-off-gas-supplies-to-europe.html>

³ "Russia sanctions: How can the world cope without its oil and gas?", BBC News, published on October 1, 2022. <https://www.bbc.com/news/58888451>

rounds of sanctions against Russia. In addition to banning Russian individuals, entities and energy commodities (oil and gas), the EU now aims to cap energy prices.⁴

Bloomberg reported that a full halt of Russian gas could reduce European Union GDP by 1.5%.⁵ In a world still recovering from the drastic economic impacts of Covid, uncertainty in energy supply can put Europe into recession.

Previously in July, Russia reduced the Nord Stream 1 gas flow to 20% of its capacity. Before that, Russia conditioned its European buyers to pay in Roubles instead of Euros, which is against the terms of existing contracts.⁶ This conditioning is Putin's rebuttal to SWIFT sanctions which restricts Russia's access to its \$640 Billion in foreign reserves.

Russia is capitalising on European excessive dependence on Russian gas and oil, consequently creating the worst energy crisis in the continent's history. The International Monetary Fund (IMF) reports that Russian natural gas accounts for 42% of European gas imports and in 8 European countries, it is more than 50%.⁷

To date, 80% of the European storage has been filled. However, even 100% fill will not be sufficient to meet energy demand in winter.⁸ Gas rationing and an industrial shutdown would be required to provide households with energy.

Alex Munton, an expert on the global gas market observed that "This is the most extreme energy crisis that has ever occurred in Europe. Europe [is] looking at the very real prospect of not having sufficient gas when it's most needed, which is during the coldest part of the year."⁹

4 Jorge Liboreiro, "Ukraine war: EU countries agree new sanctions on Russia that includes a price cap on Russian oil", Euronews, published on October 5, 2022. <https://www.euronews.com/my-europe/2022/10/05/ukraine-war-eu-countries-agree-new-sanctions-on-russia-that-includes-a-price-cap-on-russia>

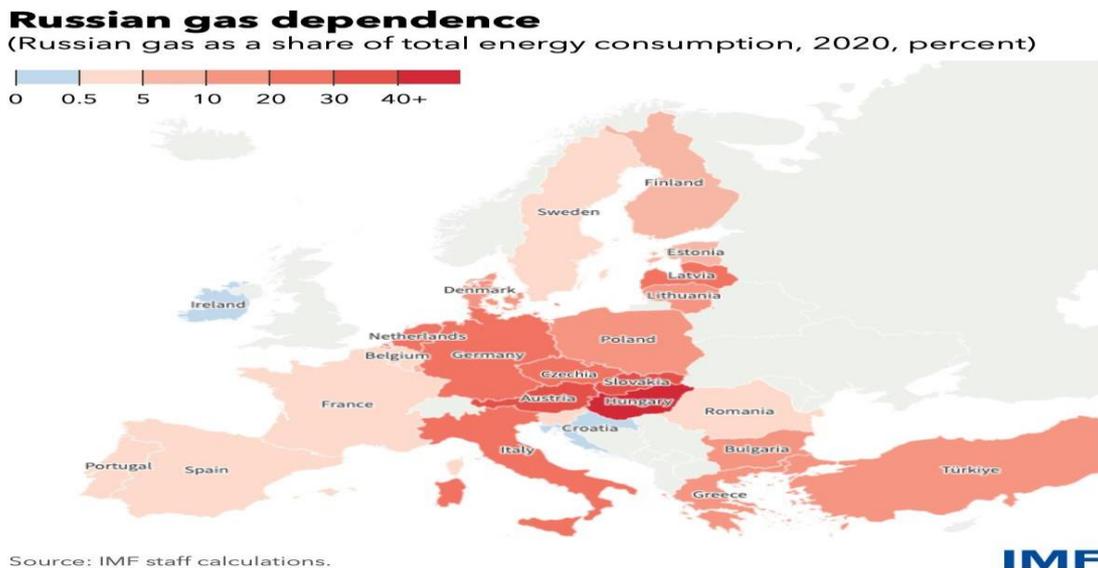
5 EwaKrukowska, "Russian Gas Supply Halt Risks 1.5% Cut to EU's GDP in Worst Case Scenario", Bloomberg, published on July 18, 2022. <https://www.bloomberg.com/news/articles/2022-07-18/russian-gas-supply-halt-risks-1-5-cut-to-eu-s-gdp-in-worst-case>

6 Swasti Rao, "Natural gas is Europe's Achilles heel. Russia to Germany—everyone's desperate to diversify", The Point, published on July 29, 2022. <https://theprint.in/opinion/natural-gas-is-europes-achilles-heel-russia-to-germany-everyones-desperate-to-diversify/1060241/>

7 Chris Giles, "IMF warns of sharp European economic hit from Russian gas embargo", Financial Times, published on July 19, 2022. <https://www.ft.com/content/bd0336e7-1346-4491-a9d5-cc3f9fd0014f>

8 Joseph Majkut, Leslie Palti-Guzman, Max Bergmann, Colin Wall, "Security Implications of Nord Stream Sabotage", published on September 29, 2022. <https://www.csis.org/analysis/security-implications-nord-stream-sabotage#:~:text=Beyond%20pipeline%20explosions%2C%20vulnerability%20to,buying%20across%20the%20East%20Coast.>

European Union member states are not evenly dependent on Russia for their energy imports. Some countries are more dependent than others, hence their likeliness to ease out recent sanctions against Russia is more, the scenario European leaders are seriously considering now. Europe needs a comprehensive continent-wide strategy to provide more Russian gas-dependent member states with their energy needs, especially in winters.



To develop a permanent alternative to Russian energy, Europe requires new energy sources, a comprehensive infrastructure to process, and more renewable green energy projects, which can't be achieved in a fortnight. Therefore, European leaders are considering alternative plans to supply households in Europe with gas in the coming winters.

The measures include:¹⁰

- 1) Plants in Norway, Netherlands, and UAE to operate at full capacity
- 2) Additional LNG imports from the USA
- 3) Withdrawals from Gas reservoirs
- 4) Measures to limit demand-side (Industrial Shutdown)
- 5) Reoperating Nuclear and Coal power plants (Germany)

⁹ Christina Lu, "Europe's Worst Energy Nightmare Is Becoming Reality", Foreign Policy, published on July 11, 2022.

<https://foreignpolicy.com/2022/07/11/europe-energy-crisis-natural-gas-russia-nord-stream-1/>

¹⁰ Niclas Poitiers, Simone Tagliapietra, Guntram B. Wolff, and Georg Zachmann, "The Kremlin's Gas Wars", Foreign Affairs, published on February 27, 2022.

<https://www.foreignaffairs.com/articles/slovenia/2022-02-27/kremlins-gas-wars>

The economic impacts of the Russian gas cut-off could be severe for the Euro region. Fuelled by rising energy prices in July, Europe has observed record inflation of 8.9%.¹¹ Recent supply disruptions made the situation worse. Following the complete shutdown of the Russian gas supply, experts opine that gas rationing could be observed continent-wide. Energy-intensive industries would have to reduce output, lowering eurozone GDP by 1.7% below the benchmark case (assuming no inflow constraints), eventually leading to higher unemployment.¹²

Moreover, if Europe fails to maintain an alternative energy supply in the winter, negative economic impacts would be even more significant. The IMF reported that countries of central and eastern Europe, Hungary, the Slovak Republic, and the Czech Republic, can observe a 40% reduction in gas consumption, shrinking their GDP by up to 6%.¹³

Additionally, the contemporary crisis can severely impact millions of low-income households across Europe, potentially raising the cost of living by 7% in the current fiscal year, IMF reports.¹⁴

Providing financial support to the most vulnerable via targeted relief policies is needed. The German government has announced a \$65 Billion plan to assist individuals and businesses amid soaring gas prices.¹⁵ IMF observed that it would take governments only 0.9% of their respective GDP to fully compensate the bottom 40%.

Conclusion

European nations' resilience in the face of a drastic economic hit by Russia demonstrates their resolve to curtail Russian aggression in Ukraine. The complete shutdown of gas can severely impact the economic growth of the Euro region for the year 2023, especially Germany, Italy, and states of central and eastern Europe. Europe needs to demonstrate unity, now more than ever, and integrate

¹¹ Giulia Carbonaro & Natalie Huet, "Energy bills are soaring in Europe. This is what countries are doing to help you pay them", Euronews, published on September 05, 2022.

<https://www.euronews.com/next/2022/09/05/energy-bills-are-soaring-in-europe-what-are-countries-doing-to-help-you-pay-them>

¹² Mark Flanagan, Alfred Kammer, Andrea Pescatori, and Martin Stuermer, "How a Russian Natural Gas Cutoff Could Weigh on Europe's Economies", IMF, published on July 19, 2022.

<https://blogs.imf.org/2022/07/19/how-a-russian-natural-gas-cutoff-could-weigh-on-europes-economies/#ibid>

¹³ ibid

¹⁴ Oya Celasun, Dora Iakova and Ian Parry, "How Europe Can Protect the Poor from Surging Energy Prices", IMF, published on September 3, 2022.

<https://blogs.imf.org/2022/08/03/how-europe-can-protect-the-poor-from-surging-energy-prices/>

¹⁵ "Germany announces \$65bn plan to combat rising energy prices", Aljazeera, published on September 4, 2022.

<https://www.aljazeera.com/news/2022/9/4/germany-agrees-on-65bn-plan-to-combat-rising-energy-prices>

its market into the world's liquefied natural gas (LNG) supply. An integrated global LNG market can play a crucial role in the face of a historic energy crisis.