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COMMENT

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Russian Arctic sanctioned > Western measures against Arctic oil projects do not signify the geoeconomic importance of the region

The West has imposed sanctions on Russian Arctic oil projects. The sanctions are a reminder to Russia that it will need international cooperation in order to fulfil its economic ambitions. The fact that the sanctions hit the Arctic projects does not imply that the region is geoeconomically important, or that it ever will be.

The crisis in Ukraine has spilled over to the Arctic. The gradually tightened sanctions imposed on Russian Arctic off-shore oil projects have been one of the primary Western tools to counter Russia's actions in Ukraine. The West has decided to prohibit the exportation of Western goods, services and technology for the development of Russian Arctic offshore oil prospects, and has restricted the access of the highly expensive Arctic megaprojects to Western capital.

But what does this reveal about the geoeconomic importance of the Arctic? In essence, the situation can be interpreted in two partially contradictory ways.

According to one interpretation, the Arctic is highly relevant in strategic terms. Hydrocarbon export is essential for Russia, making up 50 per cent of the country's budget revenues. Crucially, Russia needs to develop its frontier regions, such as the Arctic, as well as its unconventional hydrocarbon prospects in order to compensate for the steadily decreasing production in its conventional hydrocarbon basins. Russia has emphasized the Arctic as a strategic resource reserve that is important for the future Russian economy.

Russia is, however, heavily dependent on Western know-how

in its Arctic off-shore hydrocarbon projects. As such, Western actions have been directly targeted against the future prospects of the Russian economy. This can be read as tangible proof of the growing geoeconomic importance of the Arctic region.

The fact that the sanctions are targeting Arctic projects and unconventional energy sources, such as shale oil, is also open to another interpretation. In effect, they are targeting something that does not really exist as yet.

Crucially, the EU and US sanctions don't apply to Russia's existing conventional oil or natural gas projects. As such, Western sanctions will not have a direct and near-term impact on the Russian energy supply to Europe, or on Russian hydrocarbon export revenues. Of course, they may have indirect implications for European energy security through Russian counteractions, such as the recent perceived decrease in Russian pipeline gas flow to Poland.

In the Arctic, the development of off-shore hydrocarbon resources has been slower than expected. Even today, the only operational Russian off-shore installation is the Prirazlomnoye oil rig, which started to produce oil in December 2013.

It is essential to highlight that, in global economic terms, the Arctic potential may or may not be realized in the future. Even if all other factors, including the oil price, were optimal, it would take more than 20 years for the off-shore projects to start producing in high volumes. This is due to the long lead times of the Arctic off-shore projects.

The cooperation between Exxon-Mobil and Rosneft is a case in point. According to the 2011 Strategic Cooperation Agreement between the two companies, they will work jointly on several projects, including Arctic off-shore energy, shale oil and LNG development. The agreement also includes technology-sharing between the two.

The Arctic off-shore joint venture in the Kara Sea includes 14 exploration wells scheduled to be drilled over the next 10 years. The drilling of the first exploration well started in August this year, but according to ExxonMobil, this now has to be halted 'as safely and expeditiously as possible' due to a third round of sanctions. After the 10-year exploration period, the project will include several years of production planning and another several years of infrastructure building before the actual production phase. It could take more than 20 years for the

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production to start – providing that it gets underway at all.

In actual fact, a delay of one or two years in exploration drilling is unlikely to jeopardize the project. In order to have a major impact on Russia's hydrocarbon prospects, the sanctions would need to be in force for several years.

What might jeopardize the Arctic off-shore development is the lack of economic rationale. For example, the cost of the first exploration well in the Kara Sea project is \$700 million, which highlights the extent of the potential capital loss if the actual findings cannot meet expectations. In fact, it may happen that the shale-oil development in Western Siberia turns out to be the more attractive energy option in economic terms, given the existing infrastructure and easier operational environment.

One could argue that – in addition to the lack of capital for future investments and increased country risk for international investors – it is the shale-oil sanctions which could potentially be more detrimental to Russia's hydrocarbon future, not the sanctions against Arctic off-shore projects.

The Arctic economic boom is still something of a myth today, characterized by overhyped expectations and insufficient understanding

of the potential pitfalls of Arctic economic exploitation. As the Arctic development has more potentiality than actuality, Western sanctions against the region's oil projects are a politically and economically safe tool. They are designed to exert pressure on Russia without seriously damaging the Russian economy and European energy interests, or putting the stability of the global oil market and economy in jeopardy. Even ongoing Arctic projects may survive short-term sanctions. In short, imposing sanctions on Russia in the Arctic is intended to send a message, without allowing the crisis to escalate to the point of no return.

As such, Arctic sanctions can be seen as a low-risk reminder to Russia, designed to highlight that in an interdependent world Russia will need to cooperate with the West in order to fulfil its own ambitions. The fact that the sanctions have hit the Arctic projects does not imply that the region is geoeconomically important at present, or even that it will be in the future.

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