

Maritime Summary Note n°218 - March 2020

« The Maritime Dimensions of Russia »

Imperial Russia, Soviet Russia, New Russia. Regimes change, but the destiny of the largest country on the planet remains politically and economically complex for the rest of the world. Thirty years after the fall of the USSR, and having been under the authority of Vladimir Putin for twenty years, Russia has carved out a dominant position for itself on the global chessboard. The United States in its approach to the world, alongside Europe and China in their relations of proximity and economic interest, each envision different modes of cohabitation with Russia. The focus here is not on politics (Syria, Crimea), but on economics, particularly in its maritime dimension. The country cannot be considered a mere emerging market or a petro-regime; it remains an anomaly, much like China and India. Like most of the former USSR, it is an energy giant with industrial and agricultural assets. In this context, the sea and ports are fundamental, with a new dimension now opening up in the Arctic.

The strength of energy exports

• Oil

The world features a few oil giants: Saudi Arabia, the United States, and Russia. The latter, with approximately 550 Mt extracted annually, accounts for 13% of global production. In terms of exports, according to BP's 2019 Annual Survey, the figure stood at 267 Mt in 2019, representing 12% of the global market, compared to 16% for Saudi Arabia.

A portion of these exports is carried via pipelines (Continental Europe, Finland, China), amounting to about 60 Mt. The remainder, roughly 200 to 210 Mt, transits through Russian ports as well as the small Lithuanian port of Būtingė. The latter, along with the ports of Primorsk and Ust-Luga, accounts for nearly 100 Mt of crude oil in the Baltic Sea. The Black Sea is almost entirely the domain of Novorossiysk (30 Mt), which also handles Kazakh oil. The Barents Sea accounts for around 20 Mt (Murmansk, Varandey). Gazprom has a new site near Yamal in Novy Port. The Far East includes the minor production of Sakhalin (10 Mt) and Kozmino/Nakhodka, the port terminal of the Eastern Siberia–Pacific Ocean (ESPO) oil pipeline (30 Mt).

In terms of destinations, 56% of Russian crude shipped by sea or pipeline goes to European refineries. Thus, for shipping, one out of every two cargoes makes a short voyage to a European port. From Europe's perspective, the dependency on Russian crude¹ stands at 30%. China accounts for a quarter of Russian crude oil exports through a pipeline and the Kozmino terminal in Siberia, but predominantly from ports in European Russia. Chinese dependency on Russian oil is only 15%, as Beijing ensures the diversification of its supply sources.

• Refined products

Russian refining is as old as the Russian oil industry itself. Like many sectors of the former USSR, the new political and economic era initially triggered a drop in refining capacity (-25% during the 1990s). Nevertheless, over the past twenty years, it has risen back to a level that, while not identical, closely approaches the past. This provides Russia with another major economic activity centered around energy.

¹ Inherited from the Soviet era and state-owned in essence, SCF Group (Sovcomflot) handles a large share of oil and LNG flows.

In 2019, maritime exports of Russian petroleum products amounted to 150 Mt. According to figures provided by BP, Russia accounts for 14% of the global market for refined products, and two-thirds of Russian exports are destined for Europe, totaling 112 Mt. In the opposite direction, 50% of European imports originate from Russia.

• LNG

Russia is a gas giant, accounting for 17% of global production. By comparison, the United States accounts for 21% and Qatar for 4.5%. According to BP, 37% of Russian production was exported in 2018. Pipeline exports represented 167 Mt, while LNG exports amounted to 19 Mt. Due to the existence of pipelines built since the Soviet era, 86% of pipeline exports are destined for Europe². In comparison, only 28% of LNG goes to Europe (5 Mt). In total, 40% of the gas imported into Europe is Russian, ahead of Norway and Algeria. LNG flows to Asia amount to 12 Mt, representing 70% of Russian LNG exports. Taking all gas exports into account, 80% of Russian exports go to Europe by land or sea.

Russian LNG originates from two regions: the North, in the Arctic zone of the Yamal Peninsula, and the East, from Sakhalin Island in the Sea of Okhotsk in the Far East. The Yamal field began operations in 2017. The port of Sabetta exported 7.3 Mt in 2018; with three liquefaction trains, exports were brought to 16.5 Mt in 2019. A fourth train is scheduled for delivery in 2020.

The private Russian company Novatek is also the operator of the "Arctic LNG 2" project on the Gydan Peninsula, whose final capacity in 2026 will consist of three liquefaction trains producing 20 Mt, bringing the total for the region to 40 Mt.

The two Sakhalin trains produce 10.8 Mt per year, which are mainly exported to nearby Japan, where several companies are partners in the production unit. The Far East, at the tip of the Kamchatka Peninsula, will also host an intermediate terminal partnering Novatek with Japanese firms, serving as a hub to transfer cargo between ice-class LNG carriers (Arc7) and conventional LNG vessels.

• Coal

Russia is the fifth-largest coal producer in the world, accounting for 5.5% of total extractions. The Russian government's objective is to increase annual production from 440 Mt to 550 Mt by 2035. The country's main coal-producing region is the Kuzbass in southeastern Siberia, which accounts for 60% of production and 75% of exports. Over twenty years, Russian exports have increased fivefold, reaching around 140 Mt in 2019 (120 Mt of thermal coal and 20 Mt of coking coal).

Production from Eastern Siberia complements loadings at Far Eastern ports (Vanino, Nakhodka, Vostochny) destined for China, South Korea, and Japan (overall representing 50% of Russian exports). Sustained demand in Asia, particularly in India, justifies ongoing investments in coal terminals.

The other 50% is destined for Europe, which depends on Russian imports for 44% of its coal needs. In addition to production from the Kuzbass, there is production located closer to the southwest of Moscow. The primary ports involved are notably Ust-Luga and Murmansk, although coal can be found in most regional ports, including Riga in Latvia.

It goes without saying that the Russian-European neighborhood is an interdependent economic framework. Russia's contribution to European supplies is major. Generally speaking, Russia participates in flows of relative proximity and North Atlantic routes. This marks a difference with China, whose supplies are highly oceanic.

Russia itself finds nearby customers, which is convenient, but it also creates a level of dependency with Europeans. The latter have grown accustomed to living with this complicated neighbor, which is ultimately economically "attached" as well.

The diversification of Russian exports

Despite its significant deficiencies, the USSR possessed an enormous industrial capacity. The chaotic privatizations and resource grabs of the Boris Yeltsine era eventually led to a new fabric of reorganized large corporations (sometimes through the Kremlin's interventionism). The industrial sectors involved notably include steelmaking, aluminum production, and fertilizers.

² Operated by Gazprom, the Nord Stream undersea gas pipeline connects Russia to Germany, bypassing Poland. A second planned pipeline is currently experiencing US-Russian political difficulties.

Russia has maintained a large steel industry, which places it on par with South Korea and secures its position on the global market. In 2019, Russian ports shipped 27 Mt of metallurgical products, accounting for 7% of maritime trade in this sector. Russia thus adds value to its mineral wealth, as it is a minor exporter of raw ores, with only 9 Mt shipped in 2019. The Soviet industrial tradition is thus perpetuated; the country exports 5 Mt of aluminum per year, notably produced by Rusal, and 120,000 tonnes of nickel by Norilsk Nickel in Siberia through the port of Dudinka.

Less known is Russia's importance in the fertilizer market. Productivist agriculture, particularly in Europe, cannot exist without massive inputs of fertilizers. In 2019, Russia exported 19 Mt of fertilizers, accounting for approximately 10% of the global maritime market. According to the European fertilizer lobby, Russia supplies 45% of the fertilizing minerals imported into the EU by value.

In 2019, Russia exported 39 Mt of wheat and corn, in addition to 4 Mt of barley and 1 Mt of soybeans. The volume contracted slightly last year compared to 2018 (which saw a record 50 Mt), but this occurred within the context of a grain production sector that has now become highly efficient.

The annexation of Crimea and the conflict in eastern Ukraine triggered, among other things, a Moscow embargo on European and American agricultural imports (renewed in June 2019). This resulted in both a qualitative and quantitative leap in Russian agricultural production. As Ukraine follows a similar trajectory, the Black Sea is becoming one of the major hubs for grain exports, accounting for 27% of the global market in 2019, with Russia alone representing 15% (up from 8% in 2012).

Russia and Ukraine can supply the market in competition with Europe, North America, Australia, and Argentina. Among those most threatened are Europeans, and more specifically the French. The Russians can deliver the volumes and qualities demanded by client countries, but at highly competitive labor costs. Only inland logistics remain largely improvable. The Black Sea and Sea of Azov ports, including Taman, Novorossiysk, and Tuapse, meet the Panamax specifications required by the large state-owned importers of certain countries, such as Egypt.

The global market is vast, and Russia is gaining market share, creating competition with France within the European periphery (e.g., Algeria). On this aspect, it is clear how the link between Europe and Russia is a matter of competition. Politics have caused a productive leap for Russian agriculture, while also reducing dependency on imports, notably from Europe.

Russian imports

Russia has a population of 147 million inhabitants, which is ultimately small given its geographic size, and it faces a declining demographic trend. The country's revenues depend heavily on raw materials, particularly oil.

Like all major black-gold producers, Russia benefited from high oil prices starting in the mid-2000s. Globalization and emerging economies generate wealth for producers, leading in turn to prosperity and growth in consumer spending. Containerized and automotive imports act as a mirror to the prosperity of this petro-economy.

The 2013 Russo-Ukrainian crisis and subsequent Western sanctions had already pushed down the ruble against major currencies. Most importantly, the collapse of oil prices in 2014 further weakened the Russian economy and the country's purchasing power. Even in 2018, when crude oil regained some value, the ruble remained low due to ongoing tensions with the Americans, which is unfavorable for anyone trading with Russia.

Russia is both a manufacturer and an importer of cars. In recent years, the number of imported vehicles has dropped due to the Russian economic context and the new factories set up by global automakers. European exports (185,000 units in 2018) and Japanese exports (166,000 units) have fallen by half in just a few years.

Russian container traffic consists essentially of imports and is therefore dependent on the state of the economy. As with new vehicles, the purchasing power of the Russian population previously appeared as a fallback market compared to European slowdowns. Unfortunately, container volumes in Russian ports entered into resonance with the decline in Russian GDP after 2013.

Russian containerization remains dominated by St. Petersburg in the Baltic, which serves European Russia. Nevertheless, the Baltic's market share has shifted in a decade from one-third to half of the total flows. The Black Sea share remains identical, meaning that the Far East is progressing (from 25% to 36%). Around one million TEUs transit via the Trans-Siberian Railway from eastern ports in both

directions—far more than the China-Europe rail link. The Russian ports of Vladivostok and Vostochny are particularly attractive for Japanese and Korean cargo flows.

Container handling involves both Russian and foreign players. The Delo Group, owned by a businessman from the New Russia era, controls one of the terminals in Novorossiysk (NUTEP) and holds 30.75% of Global Ports, matching Maersk's stake. This company owns terminals in St. Petersburg, Ust-Luga, and Vostochny, as well as in Kotka and Helsinki in Finland.

The national shipping line FESCO (with around fifteen container ships) owns the Vladivostok terminal. In early 2020, the press reported DP World's intention to acquire a 49% stake in FESCO. This is part of its maritime diversification strategy, combined with a return to Russia after abandoning a minor port position in the Far East a few years ago.

The Arctic, a new port frontier

Maritime passage via the Northeast Passage frequently makes the headlines: Russia's determination to turn it into an intercontinental transit route, the various Chinese transits (22 since 2003)³, and container shipping lines announcing they will not use it for environmental reasons. This is one of the hot topics in the maritime world, often expanding into geopolitical analysis.

The primary fact is that the use of the Northern Sea Route as a transit axis remains extremely minor, almost marginal, with 27 vessels and 0.7 Mt in 2019. The North Siberian transit, which was already viewed with caution (risks, costs) by the international shipping industry, has become an opportunity for "green marketing." Conversely, there is little doubt that the Chinese approach could be more political, with an "Arctic Silk Road" fitting into the complex relations between Russia and China.

The Russian administration recorded 30 Mt in 2019 in the Arctic (compared to 3.9 Mt in 2003). This is due to northern gas and oil production, but also to the construction requirements of new productive port sites in the Yamal region.

Thus, rather than a mere international transit route, the Arctic region could transform into a new and massive maritime gateway for the Urals and Siberia. This immense continental space possesses rich underground resources, and new lands are set to open up for cultivation due to climate change. Arctic ports offer exit windows for Siberia. This is undoubtedly the best way to perceive the Russian Arctic and the 120 to 160 Mt promised toward 2035 by various official Russian voices. In March 2020, Russia is scheduled to outline once again its highly ambitious public policy for its vast land and maritime North.

New railway links are under construction or have been announced (Yamal region, Ob and Lena river corridors) to connect them to historical East-West axes. Inland waterways will also be adapted, and the modernization of small Arctic ports is on the agenda. To this end, in late 2019, DP World signed a "strategic partnership" (without extensive details) with Norilsk Nickel and Rosatom.

Rosatom, the state-owned nuclear energy corporation, became by state decree in December 2018 the entity in charge of the Northern Sea Route infrastructure, replacing the Ministry of Transport. It controls the entire icebreaker fleet. It will have to manage port development, administration, and transit security using both land and maritime resources. While future nuclear-powered icebreakers frequently make the headlines, Rosatom's acquisition of a 30% stake in the Delo port group is another indicator of the scale the corporation intends to achieve.

Russia, like Brazil, India, and China, remains a complex entity both politically and economically. Its current role is to supply raw materials and industrial goods to Europe and the Asia-Pacific region. The growth in gas and grain sectors is remarkable and influences global markets in its own right. Conversely, the country remains a significant consumption hub for containerization. For all its maritime trade, it relies on its small port coastlines (not to mention the issue of maritime straits). A new frontier is emerging in the North, which will primarily turn the Arctic route into a domestic Russian gateway to the outside world. No matter how martial its approach may appear, Russia remains one of the pillars of globalization.

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³ COSCO, the Silk Road Fund, Sovcomflot, and Novatek have announced the creation of an LNG carrier fleet dedicated to the Northern Sea Route.