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The Energy Side of North Korean Sanctions

Kim Jong-Un-Tenable

Yesterday, the UN Security Council (UNSC) passed a new sanctions regimen against North Korea in response to the hermit kingdom's latest nuclear test and ICBM launch. The test almost certainly appears to have been an underground detonation of a much larger hydrogen bomb; the launch a fly over of Japanese territory.

These latest events have rattled the cages of both Western opposition and those holding out for a more conciliatory approach (read China and Russia here). After a bit of watering down, a US-sponsored resolution received the unanimous approval of all 15 Council members, including Moscow and Beijing.

Sources confirmed that Washington had been lobbying for an absolute boycott of all crude oil and oil product exports to Pyongyang. However, China demurred and Russia remained intent on playing the mediator without bringing the North Korean economy to its knees in short order.

The country has no domestic crude oil or natural gas reserves of consequence. It does have more abundant coal. And that serves as the national energy source and as the leading generator of export revenue (with most of that exported coal going to neighboring regions of China).

Even the US was not about to put a coal blockade on the table, acknowledging it would be rejected outright by China and Russia. As permanent members of the UNSC, a no vote from either would have constituted a veto and the defeat of any new sanctions.

In such a situation, you take what you can get.

Nonetheless, yesterday's moves – the ninth sanctions resolution passed by the UNSC against North Korea – still have some teeth in them, clearly telegraphing the global community's disdain for Pyongyang's actions.

Cotton To These New Sanctions

The resolution does prohibit exports to North Korea of gas condensate and natural gas liquids, limits at 2 million barrels the volume of refined oil products sent annually, and further caps crude oil deliveries at present levels. My sources suggest that the current annual "official" manifest amounts of oil products at about 4.2 million barrels and crude oil at 4 million barrels. China provides the vast majority of both.

Of course, my folks have been tracking “off manifest” shipments globally for some time. When it comes to North Korea, the best estimates presently available suggest surreptitious volume may add some 20% to the total. Such shadow transactions remain expensive and cumbersome, especially when it comes to how North Korea can pay for the transactions.

Most of this is unquestionably done in kind. Yet, aside from coal to China that could serve such a purpose, the country has very little to barter for fuel. That brings in the second part of yesterday’s sanctions.

The resolution bars imports of North Koran textiles. As a separate category, this comprises the second largest source of North Korean export revenues accounting for about $800 million a year.

It also puts a major impediment in the way of circumventing oil and oil product bans by bartering exported goods.

Who Runs Bartertown?

All of these actions – the bans/restrictions on condensate, natural gas liquids, oil, oil products, and the trade in textiles – put the focus squarely on China. China supplies most of North Korea's crude and oil products while accepting at least 80% of its textiles.

Beijing has signed on to the sanctions. But given its pivotal position in North Korean trade going in both directions, it remains central.

The North Korean military hordes at least a third of all oil/oil product imports. To the extent that the new sanctions hold, they may well have a debilitating effect on any sustained North Korean military move.

It is too early to assess what ad hoc moves Pyongyang can make to evade the sanctions and access oil. These would almost certainly issue from the penumbral areas surrounding the Singapore market. Oversight here is limited and the island-state provides ready ability for Chinese interests to facilitate trade.

But unlike Singapore-based actions taken to finance Iranian oil sales at the height of that country’s sanctions, North Korea simply does not have the collateral or the external assets to make such moves palatable. It has little leverage.

As such, its ability to secure additional fuel beyond the levels allowed by the UNSC sanctions seems largely dependent upon the willingness of the Chinese and Russian governments to authorize policies at variance to their own votes on the sanctions themselves.

Both Beijing and Moscow are not averse to creating problems for Washington in the United States' resistance to North Korean nuclear ambitions. Yet China and Russia hardly want a nuclear-armed Kim Jong-un either.

That means any move by Pyongyang to circumvent oil sanctions will have to involve two principal elements.

First, the North Koreans will have to rely upon very expensive and quite inefficient methods involving a long line of shady dealers. Second, it will need to rely almost entirely on third-party access to refined product globally. This is the most crucial factor—the country has a very limited and unreliable refinery infrastructure.

Normally, one may expect some type of tolling in such circumstances. Since crude is easier to come by in shadow markets than large amounts of oil product, this would involve exchanging crude oil volume for processing elsewhere and then importing back of finished product.

However, in this case, one nation would have to provide the initial crude under a contract actually controlled by North Korea, a second would have to agree to process, and then an intermediary (or "third") entity would need to send it back to the "hermit kingdom."

A tortuous path to say the least, although there are some parties that might see a political or (more likely) financial incentive in facilitating it.

In any event, such moves are trackable. If there are any, my network will be provided with an early indication of the players.

About the Author

Dr. Kent Moors is an internationally recognized expert in oil and natural gas policy, risk management, emerging market economic development, and market risk assessment.

He serves as an advisor to the highest levels of 27 countries, including the U.S., Russian, Kazakh, Chinese, Iraqi, and Kurdish governments, to the governors of several U.S. states, and to the premiers of two Canadian provinces. He's served as a consultant to private companies, financial institutions and law firms in 29 countries, and has appeared more than 2,300 times as a featured radio-and-television commentator. He appears regularly on ABC, BBC, Bloomberg TV, CBS, CNBC, CNN, NBC, Russian RTV, and the Fox Business Network.

A prolific writer and lecturer, his six books, more than 2,700 professional and market publications, and over 650 private/public sector presentations and workshops have appeared in 47 countries.

ENERGY CAPITAL RESEARCH GROUP

Energy Capital Research Group,
16 W. Madison Street, Baltimore, MD 21201
Phone: 844.242.5850 or 410.878.3382