

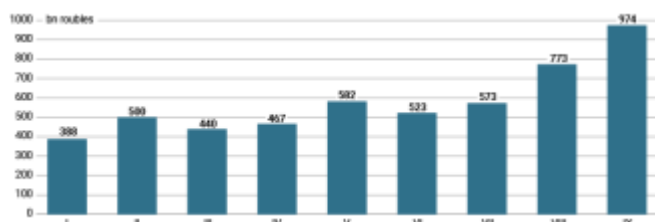
The West needs to re-examine the Russian oil sanctions

Filip Rudnik

Although the West introduced sanctions on seaborne imports of Russian oil in December 2022, Russian budget revenues from oil exports have soared in the second half of this year. This suggests that the price cap has been largely ineffective. Under this sanctions mechanism, Russia can send its oil to third countries using the services provided by Western companies (transport, insurance, technical and financial assistance) only if it is sold at no more than \$60 per barrel. In July, the average price of Russia's Urals oil exceeded this ceiling.

This price dynamic has boosted Russia's budget revenues as the higher price for crude means that the government collects more tax. According to data from the International Energy Agency (IEA), Russian revenues from exports of oil and petroleum products totalled \$18.8 billion in September; this was the highest such figure since June 2022, before the West imposed its restrictions. The higher budget revenues from this source are also reflected in statistics from the Russian finance ministry, which in September recorded the highest level of revenue from the oil extraction tax and oil export duty this year.

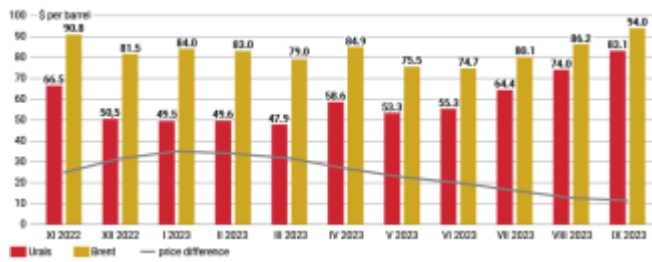
Chart 1. Monthly budget revenue from the oil extraction tax and export duty between January and September 2023



Source: the Ministry of Finance of the Russian Federation.

At the same time, the gap between the price of Urals oil and the Brent reference price has recently narrowed to the lowest point since Russia began its full-scale invasion of Ukraine. In September, the difference was less than \$11, while in January, a month after the EU's embargo and price cap were introduced, it averaged more than \$30.

Chart 2. Average price of Russia's Urals oil and the West's benchmark Brent between November 2022 and September 2023



Source: the Ministry of Finance of the Russian Federation.

Commentary

- The main reason for Russia's soaring revenues from its oil exports is the upward trend in global prices, which has been caused by a (previously anticipated) shortage of crude at a time of growing demand. The IEA has projected that global oil demand will reach an all-time high of more than 102 million barrels per day (bbl/d) this year, partly due to the activity of non-European economies. Russia has also succeeded in its attempt to push up prices within the OPEC+ cartel. Saudi Arabia's consistent policy of keeping production in check in order to maintain a satisfactory crude price was supported by Russian decision-makers, who also slashed the country's production. Last summer, Saudi Arabia cut production by 1 million bbl/d, initially for a month (see '[The OPEC+ summit: an increase in Russian oil exports at the expense of other producers](#)'), and then extended this reduction until the end of the year. This was followed by a similar statement from Russia, which announced that it will prolong the 500,000 bbl/d production cut it introduced in February. This move sent the price of Russian oil soaring by around 50% in the June-September period.
- Even though the price of Urals oil has exceeded the \$60 per barrel cap, exports from Russia have failed to shrink, and have indeed even registered an increase. This calls into question the effectiveness of the price cap mechanism, especially in the current circumstances of the global crude deficit. According to the IEA's figures, Russia's sales of oil and petroleum products to foreign countries stood at 7.3 million bbl/d in July, and even inched up to 7.6 million bbl/d in September. So far, the US administration has confined itself to asserting that the restrictions are effective, and opted not to make any changes to the mechanism. Instead, it has taken several steps to lower the price of crude by increasing supply: it has informally eased the regime of sanctions on Iranian exports, which has allowed the Islamic Republic to increase them substantially; it has also suspended its restrictions on oil from Venezuela as part of a deal with its government. These measures have forced Russia to cut the price of its own crude.
- The intended effectiveness of the price cap was based on the threat to cut off Russian exports from Western capital, which would have made it impossible for Russia to sell a large part of its oil. Until now, the price cap has worked well as a bargaining argument to drive down the price of oil from Russia, but in fact it has only proven effective during periods of oversupply. Since 2022, Russia has been consistently expanding its export mechanisms which exclude operators from G7 countries: it has launched its own insurance system and employed a 'shadow fleet' (tankers with an unclear ownership

structure) to transport its crude. According to the Kyiv School of Economics Institute, the share of Western insurance in Russia's seaborne oil exports has fallen from nearly 80% in April 2022 to 31% in August this year. This drop is a major obstacle to the implementation of the price cap. Nevertheless, Western entities are still involved in transporting this crude, even when its price exceeds the cap. This underscores the need for both US and EU authorities to enforce legal consequences on carriers, and to thoroughly verify the documentation which certifies that the oil has been purchased at a specific price. To date, the US has imposed penalties on only two operators who have been found to have breached the price cap.

- EU shipowners have also enabled the expansion of Russia's 'shadow fleet' by selling their old tankers to companies that transport Russian oil. These shipments are often insured by non-Western operators, while the ships used for this purpose are more than ten years old. This creates a serious environmental risk, including to the Baltic Sea, through which Russia exports up to half of its seaborne oil. The risk of a spill should be a serious incentive for Western decision-makers to require shipowners to insure their shipments with Western insurance companies, as that would increase the chances of enforcing the price cap. The fact that oil-carrying ships have to pass through the Straits of Denmark can be used as an instrument of pressure. In addition, it is worth considering measures to make it more difficult for Russian carriers to buy old tankers from operators based in Western countries as a way to slow down the expansion of this 'shadow fleet'.