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CAPPING THE PRICE OF RUSSIAN OIL:
WILL IT HAPPEN? WILL IT SUCCEED?

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PROCEEDINGS

MS. AARONSON: Good afternoon and welcome virtually to Brookings. I'm Stephanie Aaronson, vice president and director of the Economic Studies program here at Brookings. We're happy to welcome you to this event: "Capping the Price of Russian Oil," organized by our Hutchins Center for Fiscal and Monetary Policy. For months, the U.S. Treasury has been proposing a cap on the price of Russian oil. Last week, countries in the G7, which are among the world's largest and wealthiest, issued a statement announcing just such a cap. The proposed cap is designed to balance two objectives; reducing Russia's oil revenues while at the same time keeping oil flowing to fuel the world economy.

The questions on the table include: is the cap going to be implemented and will it work as intended? To begin to answer these questions we are very honored to have with us Wally Adeyemo, the deputy secretary of the Treasury. Wally is playing a key role recruiting countries in Asia and Africa to the cause of a Russian oil price cap with the particular hope that India and China, two other large economies, will sign on. Today, he will share with us some details on how the U.S. intends to implement this novel plan. Following Wally's remarks we will have a panel of experts discussing the proposed policy, which David Wessel, director of the Hutchins Center, will introduce later.

Now, before I turn the screen over to Wally, let me remind everyone joining us that if you have questions, you can share them on Twitter or on Slido using the code #oilpricecap; and now, Wally; over to you.

MR. ADEYEMO: Thank you so much for joining us today, everyone; and to David and Stephanie and Brookings, thank you for hosting me. It's been a little more than six months since Russia began its brutal and unprovoked invasion of Ukraine; the most significant threat in a generation to the post-World War II international border. Over those six months we have worked with our allies and partners to mount an unprecedented global response to help end Russia's unjustified aggression. As part of our overarching strategy to end Russia's invasion we have deployed sanctions with two primary objectives in mind; to deny proving revenue to pursue this war of choice and to erode Russia's ability to wage war going forward by disrupting the critical supply chains feeding Russia's military industrialized complex.

According to independent academic analysis at Yale, Russia's imports have collapsed by as much as half. Domestic production has been hammered due to shortages of key imports and foreign companies accounting for over 40 percent of Russia's GDP have left the country. Moreover, our sanctions and export controls targeting their military industrialized complex have denied Russia access to critical equipment and imports, degrading their military's capabilities in ways we're already seeing on the battlefield with Russia increasingly reliant on out-of-date Soviet-era weapons without access to chips needed to replenish their stocks of loitering munitions.

However, there's one part of Russia's economy that we must admit is doing even better than when the war began: their oil industry. This summer Russia received prices 60 percent higher than last year for its energy exports, more than offsetting the decline in export volumes. This situation is unacceptable to us, to our allies and to the people of Ukraine. But this situation is also complicated. Consumers and business in the U.S. and around the world are already facing elevated energy prices. Simply banning or sanctioning purchases of Russian oil might deny Russia some revenue but would have the perverse effect in sharply increasing global consumer's cost of living and increasing the risk of a global recession.

It's important to remember that the United States and a number of our G7 allies have already banned the import of Russian oil into our countries. The impact of further actions to prevent the export of Russian oil to other countries would disproportionately fall on the low- and middle-income countries still buying it. These countries are already facing high energy and food prices due to Russia's unprovoked invasion of Ukraine. We know that economic instability in lower income countries often leads to political instability and the last thing we want is for additional countries to be destabilized by Russia's actions; and more broadly, we know that ensuring the continued flow of as much oil as possible onto the global market is critical to reducing prices in our country and around the world. That is why last Friday the G7 finance ministers agreed to finalize and implement an innovative policy that puts downward pressure on global energy costs by allowing Russian oil to continue to flow onto the global market while reducing Russia's revenue: a price cap on Russia's oil.

Today I'd like to share why we think the price cap is so critical, explain how it will work, and dispel a few myths we've heard along the way. Let's start with how it will work. In June, the EU agreed to a 6th package of sanctions that will ban not only the import of seaborne Russian oil into the EU, but as of December 5th will also ban the provision of associated maritime services like insurance, trade finance, banking, brokering and navigation service by companies in the EU to those associated with Russia seaborne export of crude oil, regardless of where those shipments are headed. These maritime services are often essential; in many cases, seaborne oil shipments cannot be made without them. Critically, the provider of some of these services are heavily concentrated in the EU and G7 countries. For example, the EU and G7 provide 90 percent of global shipping insurance and they provide the majority of financing and payment services for the oil trade. One potential byproduct of this package could be a substantial shut-in of Russian production of oil and refined products and associated elevated prices, which could limit or reverse the intention of the action. This price increase would undermine the well-intentioned goal of limiting Russia's revenues for oil sales while imposing an additional and unintentional burden on global consumers of oil.

The price cap is designed to address this outcome by creating a carve out for services related to seaborne transport of Russian oil to be sold at or below the cap level; Keeping this oil on the market and flowing to consumers who need it, but still restricting Russia's revenues. Countries outside the G7 can keep buying Russian oil and companies in the G7 can continue to offer services to support those sales, as long as the oil the services support is purchased at or below a certain price; and in particular, some of the most vulnerable countries in the world –- low- and middle-income oil importers –- will benefit most from access to this low-priced oil.

When it comes to implementation, two critical pieces are compliance and enforcement. Our market participants know oil is coming from Russia and therefore needs to be priced below the cap in how we deter and punish the invasion and knowing violations. On compliance, we're working with the G7 to develop a robust but simple documentation and attestation system that can give service providers comfort if they are complying appropriately. On enforcement, those that evade the price cap by falsifying documentation or otherwise hiding the true origin or price of the oil would face consequences under the domestic law of the jurisdictions implementing price caps.

Our truest implementation is guided by the principle that Russian oil should continue to reach the global market, provided purchasers and service providers abide by the price cap in good faith. That is why today, to offer greater clarity to the market and help accomplish this objective, I'm announcing the Treasury's Office of Foreign Asset Control is issuing preliminary guidance on how this compliance system will work. OFAC will follow up with additional formal guidance in the coming weeks to help ensure these compliance expectations are sufficiently clear to facilitate the flow of Russian oil. This action helps formulize the United States commitment to implementing the price cap.

Finally, from a technical perspective, one of the questions I've heard most often is how the price will be set; and this relates closely to a common objection I've heard that Russia will not sell oil at or below the cap and instead will simply refuse to export. The way the cap is set is the reason we think that won't happen. Russia may bluster and say they won't sell below the cap price, but the economics of holding back oil just don't make sense. The price cap creates a clear economic incentive to sell under the cap. We intent to set the price cap above Russia's marginal cost of production at a level consistent with prices they have historically accepted. Russia doesn't have much storage capacity for oil and many of its wells and equipment are far from state of the art, which makes it hard for them to stop and later restart production without incurring significant costs; and that problem is only going to get worse as our sanctions continue to deny them access to critical software and drilling equipment. As a result, Russia will be forced to continue selling or risk long-term degradation of its capacity to produce. That leaves quite a bit of room below both prevailing market prices and the price Russia is receiving today. It means we have an opportunity to deny Russia the revenues to pursue its unconscionable war while lowering some of the economic pressure countries around the world are feeling. Russia knows that and it's why they are already responding to those clear economic incentives.

They are already offering long-term contracts to potential buyers at steep discounts of 30 percent or more far in advance of the price cap's implementation. The fact that they are doing this reveals how worried they are and shows how the price cap is already working to drive down Russia's revenues. We view this as one of the policy's key features and it can achieve its objective, even if some buyers choose not to formally join, because they also want to pay lower prices for Russian oil; the price cap gives them greater price transparency and leverage when they negotiate with Russia. So, even if Russia tries to get around the cap with buyers outside our coalition, their revenue will still be driven down as we're already seeing.

We're clear-eyed that Russia can go find service providers outside the G7 and the other members of our coalition to replace the maritime service blocked by the EU ban, but these alternative services will be expensive and less reliable than the services provided by the G7 firms. There's a reason the world relies on the EU and G7 firms for the vast majority of these services. Building up a service's ecosystem outside the coalition will cost Russia more money, which will help reduce the Kremlin's revenues even more.

Let me conclude by taking a step back from the details. We're moving forward with this extraordinary proposal because it is essential to the global community to take steps to deny the Kremlin the revenues it is using to prop up its economy and fight its unjustifiable war in Ukraine. The price cap seeks to create incentives that reduce Russia's revenues while its oil continues to flow. The bottom line is that everyone wins, but the Kremlin loses with this proposal. This is not an academic conversation for us. We face the largest ground invasion in Europe since the end of World War II; one being perpetrated by regime that will not easily be deterred. It is critical that we take this step to deny Russia the revenues they are using to pursue this brutal invasion while continuing our efforts to disrupt their critical supply chains and degrade their military industrialized complex. We look forward to your advice on implementation as we move forward with this policy. Thank you again for being here and I'll turn it back over to David and introduce a panel where you'll hear more on this from my colleague, Ben Harris.

MR. WESSEL: Thank you very much, Wally; appreciate your time today. So, we have a particularly good panel to discuss this unusual proposal that I think when I first heard about it, it sounded like something that someone thought up in a Kennedy School study group that might actually just be fun to think about into something which seems to me to be coming close to reality. The panel we have today starts with Craig Kennedy who is now associated with the Davis Center for Russian and Eurasian Studies. Craig is writing a book on the history of Russia's oil industry since 1860 and how it has affected the emergence of civil society. He told me earlier that he's now up to the 1940's, so you won't be able to read it terribly soon, but you have the benefit of his wisdom today. Among other things, Craig has been a trustee of Pushkin House, a London think tank that focuses on Russia, and actually chaired its board from 2016 to 2021. Craig has a Ph.D. in history and Middle Eastern studies.

Ed Morse is global head of commodity research at Citigroup, where he's worked for more than a decade, and he worked for similar firms before that. Early in his career he taught International Relations at Princeton and worked in the auto industry. Ed has a Ph.D. in political economy.

Helima Croft is global head of commodity strategy at RCB Capital Markets, where she's been for eight years; several other Wall Street firms before that. She did spend –- from looking her up on LinkedIn –- three years in the early 2000's as the senior economic analyst for the CIA, and she too has a Ph.D.; hers is in economic history.

Ben Harris is the assistant treasury secretary for economic policy who's been actively involved in crafting and defending this plan with his colleagues at the Treasury, the State Department, and the White House. Ben is a Ph.D. in economics.

So, Craig; I'd like to start with you. You have the big picture here. Does this proposal make sense? Does it seem to have the necessary incentives for Russia and the buyers of energy to cooperate to achieve the goals that Wally setout, which are two-fold; to reduce Russia's revenue, but keep the oil flowing from Russia's wells to the world economy?

MR. KENNEDY: I think to answer that question you need to understand the amount of real leverage that the G7 and the EU actually have over Russia and the decisions –- or the choice –- that they put before Putin. Ultimately, whether this works or not will be a decision made by the Russians as to whether they want a shut-in or keep selling and earning some revenues, even if it's at a depressed price; but I think one of the misconceptions that's very widespread in the market is that if the Russians won't keep exporting at a price above the cap price that there will be enough capacity in the global system to allow them to do that, even if they aren't able to make use of Western maritime services; and I think that's an assumption that is -– when you look at the numbers –- actually a very questionable one.

Let's just start with how Russia gets its oil out. Right now Russia has to use maritime services for almost 80 percent of its oil. Under sanctions that will go up to 85 percent, so most of its oils actually have to reach their buyers by tanker services; and Russia itself has a very small fleet relative to its need, it can provide about 15 percent of the tankerage that it needs to get its oil to market. At present, two-thirds of tankers loading at Russian ports are actually owned by companies domiciled in G7 or EU countries. All of those tankers –- or most of those tankers -– will stop showing up at Russian ports come

December 5th; in many cases it will be as early as the end of October, depending on the length of the voyage goal; and this is going to leave a real problem for the Russians because they won't have access to sufficient tanker capacity to maintain their current levels of exports.

Now, some people would say "Hang on a second, why is that so? There's a large shadow fleet out there that's been helping the Iranians out for a number of years and that should be sufficient", but I think what people haven't done is they haven't looked at the vast difference in the scale of exports that Russia has compared to Iran and the need for capacity. The voyages from Russia will almost all need to come from European ports; they will be several times longer than what's required out of Iran and the absolute amounts of oil are multiple of what Iran needs, and Iran relies primarily on its own fleet; which by the way, has a greater capacity than Russia's does.

So, Russia's in a real bind. Moscow's been looking at this issue since April, Putin assigned a task force of senior representatives to try and figure out solutions, and they've been looking at everything from switching insurance to buying tanker capacity to trying to establish long-term charters with a number of companies that fall outside of the G7-EU sanctions envelope; and I'm sure they will be partially successful across all of those areas, but the scale simply won't be what it needs to be as quickly as it needs to be and by a long shot. My numbers show that Russia probably has certainty of export for about 30 percent of its current exports come December. The rest of it will depend on how effective they are at negotiating long-term time charters with tanker owners around the world; and I think under a best-case scenario they might be able to get to 50 percent certainty, but that means a lot of oil that they either will have to shut in or they'll have to sell at a capped price.

So, if I'm –- say -– a negotiator from India or Indonesia and I'm being approached today by a Russian looking to negotiate a long-term contract, my question to them is going to be "Show me the boats. I want to see a list of time charters, I want to have it as an appendix to our contract, and I want to make certain that you're going to dedicate that fleet just to servicing me; otherwise, I'm going to demand that you sell me oil at the capped price, otherwise I have no assurance that you'll be able to deliver on your contract". This doesn't hold true so much for China, which gets a lot of its oil overseas –- rather by pipe -– or for somebody like Turkey, that's a relatively short distance; but if you're looking at the longer haul -- buyers of Russian oil –- the certainty of supply is very much at risk under the sanctioned proposal.

MR. WESSEL: Craig, if I may; do you think that the European's will stick to these sanctions given what Putin is doing to cutting off the supply of gas as we go into the winter and interfering with the deal to export grain? Why should we expect Putin to say "Okay, it was a good game, I lost this one and I'm going to sell it to cap" when he has shown no signs of relenting on his war on Ukraine?

MR. KENNEDY: I actually agree with you; I don't think that he's going to be relenting anytime soon. I think his team has figured out now that the insurance swap isn't going to work. He's not going to be able to acquire enough tanker capacity at the scale he needs and that his best chance at this point to avoid a very difficult decision come December is to break the resolve of the Western alliance; and the way that he's doing this is to try to precipitate an energy crisis. He's starting with gas, but I wouldn't be at all surprised if in the coming weeks we start to see him winding down oil production as well to try and create more price tension in the oil market and frighten the West into rethinking sanctions and perhaps postponing it; and he certainly is not going to say publicly that he will sell into the price cap program, that would undermine his position; but I think the longer things go on, the more pressure on him, not simply because of what's happening with the fields themselves, but more importantly the denial of revenues to Russian state coffers is going to push him to reconsider whether he wants to sell at the price cap.

MR. WESSEL: I see, thank you. So, Helima and Ed; I invited you both because you know this market well and I want to know from you, is this actually workable, can it work the way the Treasury and the G7 hope, or do they just not understand how the market really works? So, let me start with you, Helima.

MS. CROFT: I think one of the confusing areas before this was unveiled was first, there was a view that Europe just wouldn't go along with these sanctions. I mean, I can't tell you how many market participants, whether it be hedge fund traders, macro traders, but really even CEOs of major European energy companies basically said, "Come December 5, that once the Europeans realize how much pain they're going to be in if they move forward with the EU embargo, they're just not going to be able to stomach the cost of this." They were saying this actually –- even like -– days before the G7 announcement. You also had a view that the price cap plan is too confusing, who's going to enforce it, China and India are never going to buy in, it's never going to work; so, a lot of the market sentiment was EU would pull out of those sanctions and you also would have no price caps because it would just be too confusing.

I think one of the things that I think Treasury has done a good job of is basically highlighting the fact that you don't really need China and India to buy in at the macro level. (inaudible) has to come out and say, "I support price caps". It's really a question of World Reliance Industries -- and Reliance has been essentially backing up the truck and taking discounted Russian barrels. World Reliance Industries A, privately attests that they are paying below the cap or even if they don't want to attest to that, will they use a price cap to essentially increase their bargaining leverage? I think all of that could essentially happen. So, I do think that that is something that does potentially mean that this could work if your goal is to essentially try to continue to reduce the revenue that Putin gets from oil.

I also think that the question really will be, is there any material disruption come December 5, will this seamlessly allow barrels that were going into Europe to move into third markets, or will there be some confusion about how this is all going to work? I can see a scenario where you can have Russian volumes remain largely on the market and you could see Russia having to accept lower prices for those barrels, but the wild card factor to me is what the Russians do because the Russians have made this abundantly clear, that they do not want to play along with price caps; and so, I think they have every incentive –- as Craig said –- to create a view in the market that they are going to make this as painful and awful as possible. They will say essentially "You give us a cap, we give you a floor"; and so, they may have no choice multi-months into this but to essentially say "We will have to play along because revenue needs demand that we do", but I think in the coming months we should prepare ourselves at least for the Russians to strongly signal that they are going to continue, certainly to cut off the gas, but that they may withhold oil as well; and so, again, we may say months into this that they have no choice but to continue supply, but they certainly are not going to want market participants to believe that this is going to be easy for the West. So, I think we could have some potential volatility right around the implementation day and immediately afterwards.

MR. WESSEL: What about the practical thing of how's this going to work? Do you think that we can actually know that some tanker gets some piece of paper from somebody saying "This is Russian oil and I bought it at this price" or "No, this is Saudi oil and it doesn't count" or -- can we do this?

MS. CROFT: I think there's some confusion about some mechanisms around ATAD stations, but I think if we just take a step back and say "What is the" –- we look at the fundamental goal –- I think is to ensure that we don't have millions of barrels of Russian oil off the market because if this EU package of sanctions is fully enforced and there is no mechanism to easily move those barrels or to allow those barrels to move to Asian markets, I think that would be very-very disruptive and you'd see a significantly higher price; and so, the question is -- I think we should judge it by is -– will Russian barrels continue to flow to third countries and will potentially the bargaining power at least of these measures mean that Russia continues to take significantly below market prices for those barrels.

So, I think we sometimes get caught up in the whole mechanics of who's going to certify –- I understand that there's a lot of confusion about that -– but ultimately, I think that's how it's going to be judged; are Russian barrels flowing and is Putin taking less revenue. I can see a case for this working –- again -– my biggest concern is I think Putin's going to make it very-very painful on the way to December 5; and I wouldn't just say the threat is that they shut-in their own production, they also have assets in other producing countries -- whether it be Libya, whether it be Iraq –- they have an ability to cause some problems in other producer states.

MR. WESSEL: Thanks. So, Ed Morse; can this work or not? I think you're on mute, Ed.

MR. MORSE: I think it possibly could work, but I think the uncertainties are overwhelming -- particularly on timing –- but I think it is a poor judgment call to do this at this particular moment in time; and let me be a little bit specific about that. We know that the winter is going to be the worst winter imaginable in Europe in terms of power generation; there are going to be a lot of unhappy people. Already governments –- the UK Government being the most noteworthy – in the wrong camp on this has put in a guarantee that electricity prices for businesses will remain constant for six months and households for two years. That's going to encourage rather than discourage consumption and it's going to mean in that market that people are going to have blackouts because the supply can't materialize from nowhere; where in a world of supply and demand balances the price mechanism needs to be worked.

I think the danger is –- and I'll be very specific about it in a second –- on the timing side; to do an experiment -- an experiment that's never been done in world history –- so, we are in an era of fighting world wars through new instruments -- through economic instruments -- at a scale that may have been like this in World War II, but where the elements involved were not as critical to the economies of the world as they are now. We're doing this at a moment, not only of experimentation, but we ought to be thinking about; what are the limits of the use of economic instruments for foreign policy purposes, and to do what traditionally has been done since the time of (inaudible), to look at things strategically; what is the balance between ends and means, what is the balance between risks and stakes, how much is it going to cost you versus how much you are going to accomplish –- and as Helima said -– how do you calculate the strategy of the action and reaction of nations?

Now, let me be more specific. As I indicated, the uncertainties around this winter are enormous and here is where I worry significantly about timing and implementation. We are dealing with a dislocation in the market of the world that the world has never seen. We have a country that's been exporting over 7 million barrels a day net, it's been exporting 2.7 million barrels a day to Europe alone -- or to Europe and America alone -– and the remainder to other places in the world. The world has reduced that 2.7 million barrels a day by roughly half, let's say 1.3-1.4 million barrels a day; how did we get through that process? We got through that process by bidding up the price of oil in the Atlantic basin to replace the oil lost from Russia; Russian oil sells at a discount, but Atlantic basin oil sells at a premium. So, one of the things we're doing by having another dislocation at the time we're going into winter is jeopardizing –- triggering -– significantly higher prices when we have this competition for American oil basically; and let me be more specific about that.

In January and February the U.S., as a gross exporter, was exporting 7 million barrels a day of crude oil and product; 2 million barrels a day of crude, 5 million barrels a day of product. We had weeks through the month of August in which the U.S. was exporting 10 to 11 million barrels a day. We had weeks in which the U.S. was exporting 5 million barrels a day of crude oil alone. Now, our production may be up a million from where it was in January and February, but that incremental difference between 2 million a day of exports and 5 million has come at the expense of inventories which are unbelievably low in the United States. So, we're now triggering absolutely predictably -– and I don't understand why nobody's calculated it –- that the demand for American oil in the global markets is going to go up and it's going to go up at a time when we have significant hurricane risks in the flow of oil out of the U.S. to begin with.

So, I think that if we look at what should be done in terms of assessing the practicality of imposing additional instruments of economics to achieve political objectives, we ought to be more careful about what the costs are going to be because the costs –- in my judgment –- could really be horrendous and the probability of them being horrendous is not negligible.

MR. WESSEL: I'm trying to understand what you're arguing against. It sounds like you're arguing against the European 6th sanction package because all the things that you said would happen are the result of that; and as I understand the price cap, it's a way to sort of put a little bit of a relief valve in this otherwise devastating sanction.

MR. MORSE: I actually think it risks there being lower liquidity in the global market; that is to say, lower flows coming out of Russia and the price cap itself -- as I understand it from the briefings I've listened to from conversations with the people who are on this call -– is that the price cap is kind of a made-up number. If we look at the economics of the cost of production in Russia the ruble happens to vary with the price of oil and that's why the Russian Central Bank has historically intervened in the market by buying rubles or selling rubles depending on how the cost of ruble exists in the marketplace. If this is going to drive down the price of the ruble, it's going to dramatically drop the cost of production in Russia and it's going to make it easier to deal with –- what I consider -– with great respect for Craig -– some exaggerated common carry-on Russian oil and what the costs are being felt by the industry itself. I have no doubt that Craig is right that if we look at this from the perspective of 2026 or 7, the Russian's will be not be able to produce anywhere near the level that they're producing with the assistance of Western Capital Technology, but I have really significant doubts –- and they're shared by a lot of people -– about what the Russians can do on their production side -- particularly if they have a ruble that goes down -- to maintain production at the current level, and then we have to think about what they can do globally to evade it if the price in ruble terms is going to be really cheap and if the costs of imposition of the price cap just means that the price is going to be lower, but the price is going to be lower and the cost of production is going to be lower within Russia.

So, we're not going to –- on the one hand –- worry about Russian production, but it's not going to punish them as much as we might otherwise think; and yes, I hear the numbers on tankers and I hear the theories on insurance and the cost of mobilizing other tankers, but all that will come out if things be left to themselves in the amount of revenue that Russia gets. So, we're in a pretty good position by looking at what has already been done and I think the added impact of what is being imposed right now is riskier business than what we already have.

MR. WESSEL: So, you would prefer that the sanctions go into effect that ban them from using U.K. and European insurance without a price cap than with this Treasury proposal?

MR. MORSE: I think without a price cap –- I think in effect the price cap -– I think that the insurance is going to be there one way or another, even if it's not going to be considered as complete mis-valuable, so that people who are lifting Russian crude err more significant expenses, including insurance risks, and that means that already you're driving the price down. So, I think the price cap itself puts in place a costly set of administrative requirements that are absolutely not necessary and may be highly costly.

MR. WESSEL: So, then I have a couple of specific questions in view of the audience, but let me give you a chance to respond to what, particularly Ed, but also Craig and Helima have said.

MR. HARRIS: So, let me just slightly correct two things -– and first, there's an enormous amount of wisdom about these markets on this call between the three other panelists –- really just thrilled to be here. The first is, on the price cap; I wouldn't characterize it as a made up number, it's a yet to be determined number and we've been explicit about this that the price cap -– there's actually three separate price caps –- one on crude, one on high value refined product and one on low value refined product –- will be the result of consultation with members of the coalition and the coalition isn't built yet, so of course we can't yet determine what that number will be. It's a slightly -– I think -– nuance relatively calling it a made-up number.

The second is the 6th sanctions package -– I know that the panelists know this -– but it's not just about insurance. It's about all of the services that go into trading oil, it's not just insurance. We haven't yet defined the complete scope of those services, but it will be a broad scope of services. So, just to slightly clarify those two points.

Three other questions I'm going to sort of ask myself and then answer. The first is, the question "will it work" is a nonspecific question because you have to A: define "it" and you have to define "work." So, what do you mean by "it"; are you talking about the combination of the 6th sanctions package and the price cap or are you talking about the price cap conditional on the 6th sanctions package already being in effect? When we've gone out and talked with people in the industry about this and talked with economists and talked with traders about this, there's been a lot of confusion because people have their own assumptions about what the world looks like on December 5th after the 6th sanctions package has been put in place; and by our own assessment, the 6th sanctions package is a very well-intentioned noble bold package, but it would likely lead to substantial shut-in of Russian oil and refined product in already tight markets.

So, it really matters whether or not you're defining –- we are asking someone to assess –- the impact of the 6thh sanctions package in isolation or the price cap conditional on this post December 6th world which likely has substantial shut-in. Some people sort of wave their hands and say "Look, Russia will find a way to get this product on the market. I just don't buy it, I don't think that's plausible, and I think it disregards a lot of frictions in the market and the reach of the G7".

Second is, what do you mean by "work"? We have dual goals and I think the three panelists articulated as well, but one goal is to preserve the gap between Urals and Brent; and whether that happens by selling under the price cap at a prescribed level or whether that happens through increased leverage by consumers of oil really is fine either way; but by preserving this wide gap we're reducing Russian revenue while keeping oil on the market, and that's how we want this to work. The fact that Russia –- and the dep sec mentioned this in his comments –- the fact that Russia is already sort of desperately going around the globe and trying to lock-in long-term deals at previously unheard-of spreads –- 30 percent or more -– gives us confidence that it's already working.

MR. WESSEL: Let me interrupt you because I just want to make sure people understand. When you're talking about the gap between Brent and Ural, you mean there's a world price for oil -– that's the Brent price -– and Russia -- because it can't sell to just anybody -- is having to sell its oil at a discount from that and that's the Ural price; and your goal is to maintain that. You want Russia to sell the oil, but you want them to have to sell it below the world price.

MR. MORSE: Even though the widening between the two crudes means that WTI and Brent are in premium. So, the mirror image of Russia selling oil at a discount is the fact that there is a premium place on oil that the rest of the world has to buy.

MR. WESSEL: Right, thanks. Okay, I'm sorry to interrupt, Ben; I just wanted to make sure people understood.

MR. HARRIS: The second question that people ask is, will Europe blink? Europe has reached –- the EUC reached an agreement -– a unanimous agreement -– between 27 different countries –- this is law –- this is going into effect –- to reverse the 6th sanctions package practically means that Europe loses all its resolve –- which has been incredibly strong since the invasion of Ukraine -– and somehow finds unanimous consent to reverse the 6th sanctions package; I'm very skeptical this will happen.

The third question is, will Russia play ball? I don't want to come in with a ton of –- I don't have a crystal ball –- I don't know exactly what Putin and Russia will do here –- there are a lot of different options –- I'm troubled by people taking the signals out of Russia as being gospel. Russia also said they weren't going to invade Ukraine in February of this year, so let's just discount their signals; but Russia's not playing from a position of strength right here. This is an economy in rapid decline; this is an economy that's seen just an incredibly swift exit of Western companies -- the DEP SEC cited the work by Jeff Sonnenfeld and others at Yale -– over 1,000 companies have left Russia, reversing three decades of foreign direct investment, inflation is through the roof; this is not an economy necessarily bargaining from a position of strength.

The other point which we've made, and this is up for discussion, is, the extent to which long-term shut-in of Russian production over a substantial share of their production will eventually lead towards diminished capacity to produce. So, if they want to go and shut-in 3 or 4 million barrels a day for a prolonged period, this would have a material impact on their production capacity. So, it's not just about taking revenue out of their coffers today, it's about foregoing revenue in the future; again, for an economy in rapid decline. Also, it's not like Russia has a ton of storage capacity right now; it's not like they can go ahead and stockpile all of this oil and then sell it down the road. There is very limited storage capacity; this is a very different market than with gas. You can't just turn on and turn off most of these wells, some of them you can, but many of them you can't; so, this is not really a position of strength for Putin.

Again, we don't know exactly how they'll react, but relative to the 6th sanctions package that we felt like there would definitely be some shut-in; the price cap provides an opportunity for a bit of a release valve and the hope that these Russian barrels will find the market, but at a reduced price.

MR. WESSEL: Thanks. Helima, when you look at the oil market today, Brent is under $90.00 and Chris Condon from Bloomberg said, "If so much Russian oil will be shut-in, wouldn't you see oil futures for delivery in 2023 higher?" So, does the oil market think somehow this is going to work, that Europe will relent, or Russia will continue to pump the oil even with a price cap? How do we read the market?

MS. CROFT: I think many market participants believe that Europe will relent. I've been sort of stunned by -– I would have conversations with Ben and other European officials and I would say that market participants know that the sanctions of the EU are locked and loaded and they're going to launch; because do you think that Latvia or Poland or Lithuania is going to allow this to be walked back and the view really was of many market participants was there's not possible way that Europe could go forward with this sanctions package; that European leaders were focused on gas, they weren't focused on oil, and when they would realize that this was going to be coming and there could be a major disruption they would relent. So, I think that has been a prevailing view in the market. There's no possible way Europe could go forward with these sanctions; and there was some watering down of sanctions over the summer and people would point to that and say "See, Europe just cannot do this"; so, I think that is part of the reason.

People have also looked at how Russian production has held up. Remember the early days of self-sanctioning and we had all that oil sort of in limbo? People now look at these figures and they say "Well, Russia has been able to find markets. They've been able to basically surge their barrels into India" and they think that that's going to continue; and I think with the price cap, there is just so much confusion about who's going to be administering it, is it actually going to work, are we really going to go forward with this, is this going to breakdown? Again, I was shocked -– I was just at ONS in Norway –- how many company executives were saying "This cannot work, it will not go forward" and so I do think that part of the reason it doesn't seem to be priced-in is there still is not -– I think -– full buy-in that this is going to go forward.

MR. WESSEL: Ed, do you see the market the same way?

MR. MORSE: I do. So, I have no real further comment on that. I do have a comment on the unity of Europe. We've just seen -– as I noted earlier –- the nothing short of nutty price cap that the U.K. Government has put on what (inaudible). We have a set of elections coming up; there's an election coming up in Italy not so long from now. I think the results of that are a risk in terms of how major European countries confront this because there are domestic political issues at stake in a lot of countries that are worrisome.

MR. WESSEL: I just want you to explain why you think what the U.K. did was nutty. What the U.K. did is; instead of saying we're going to give people a check to cover your energy costs, they're going to keep the price down which then will encourage people to keep consuming energy; and that's why you think it's nutty, is that correct?

MR. MORSE: Yes, because they have a shortage of supply which is why the price has gone up and there is no conceivable mechanism at work whereby the availability of natural gas in the U.K. -- among other fuels -- is going to be adequate to meet normal winter demand, let alone a bad winter demand. So, people are happy in the streets –- literally –- over the fact that they can look forward to spending a lot of money on electricity knowing that it's not going to be above a certain level with a disincentive to conserve at a time when conserving is critical.

MR. WESSEL: Craig, I wonder if you can talk a little about –- Ed basically -– one of his remarks earlier –- raised questions about the wisdom of economic sanctions to pursue a foreign policy goal; and of course, this is a longstanding debate. On one hand, you could say it's better that we're sanctioning Russian oil than having a nuclear war with Russia, it seems to me that's obvious; but on the other hand, these things tend to have unintended consequences and I just want to know how you think about this in that context?

MR. KENNEDY: Well, of course they do have unintended consequences and I can only agree with Ed the timing here is very difficult; it is going to be a harsh winter no matter how you cut it. On the other hand, the timing is really dictated by the needs of the war and the fact that every month Russia is generating a half a billion plus in income from their oil sales to the West; and this is only prolonging the war itself. Russia at this point is running short of military recruits, they're needing to use very high special contracts in order to enlist people into the Army, and that's all being financed the huge surpluses we're seeing on the oil side; so, there is a moral argument for imposing this.

Sanctions have been around -– economic sanctions –- since ancient times.

Sometimes they work effectively, sometimes they backfire; it really just depends. My big concern at this point has to do with the transition process because even if everything were already clarified in terms of how the price cap is going to work and even if the Russians said "We're in"; actually getting all of the paperwork, all of the administrative work in place and having a seamless transition between now and December, and making certain that all the compliance lawyers, and all of the tanker firms, and all of the banks, and all of the insurance companies were happy that they hadn't tripped over a sanction issue of some sort, it wouldn't go seamlessly.

The best example of that is what happened in early March when the West had bent over backwards to say, "We are not going to sanction Russian oil exports"; nonetheless, the compliance lawyers all sat down and said, "We need to study the new sanctions for a couple of weeks". There was a momentary lapse in loadings at Russian ports and it caused a tremor throughout the Russian oil industry, and they had to shut-in a million barrels a day because they were getting backflow into the refinery system and they simply had no place to store it. Even if things go really smoothly over the next few months –- undoubtedly they won't because the Russians won't want it –- we're still going to see a lot of friction in the transition process; and it is going to cause stress on the market.

I eventually come down to this question of how strong is global demand going to be and if we do see 1, 2, 3 million barrels coming out -– both because of friction, but also because the Russians want to really put pressure on the situation –- what's it going to do to global prices; and I would defer to my colleagues, Helima and Ed, for a view on that; but ultimately, I come back to the same point again and again and again. The export capacity is not a highly liquid commodity that can be treated easily. Export capacity is more like infrastructure. It takes years to build, it's very capital intensive and you can't restructure it overnight; and Russia -– while it may own the pipelines to the port –- it is completely at the West's mercy when it comes to what happens beyond the port; and this has to do with historical reasons and it takes a long time to rewire that. I promise you, they've been hard at work trying to find new sources of insurance and tankerage as well and they're struggling, and I don't think that's going to change between now and December; so, they are going to be stuck. They either go along eventually with the price cap or they have to shut-in large amounts.

Ed, we can talk about what the price of production in Russia is going to be depending on where the ruble is, etcetera; anything below 35-40 bucks, Russia can produce and still generate a profit, regardless if the ruble is at 50 or the ruble's at 100 to the dollar. That's not the issue here. The issue is, will they be able to continue generating large amounts of export revenue that they need to make the system work? Export revenues from energy are the cohesive glue that keeps the Russian regime –- the Putin regime -– vital and once that begins to decline –- as it will if they're shutting-in 3 or 4 million barrels a day -– that's going to really put pressure on the Putin regime. It will take time, it's not going to happen overnight, but it will; and by the way, it will be immensely unpopular within the Russian Heartland, the hundreds of thousands of people who have worked tirelessly over the last 30 years to undo the destruction of the Russian oil industry in the late Soviet times, to actually see all of that being thrown out the window and millions of barrels being shut back in again and with the damage being done. It will make Putin even more unpopular in oil circles than he is today.

MR. WESSEL: Well, there's an upside to that. Ben, a couple of people have asked online for some practical questions. So, first; as I understand it, at some point the G7 and whoever signs on will agree on a cap price, right. When does that happen?

MR. HARRIS: Okay. So, let me sort of address a point made by all three panelists in their own way, which was private industry is confused by this and this is new and novel, and it'll be difficult to implement; and I think the point is well-taken, but let me just respond by saying A: We built this with the input of private industry. We went to the P&I Clubs and said, "How can we build this in a way that will enable you to participate without too much of a compliance burden"? We went to the traders and we said, "How can this work"? So, we've built this in a way -– because we absolutely need the cooperation of the private sector in order to facilitate this trade –- so, this was built with them in mind.

The second point is we haven't even finished building this yet. We haven't finished messaging yet. The whole point of what the dep sec was saying was OFAC is coming out with an advisory in the next few days, so maybe let's just let this come out, give us a chance to explain it before we say it's confusing yet; we really haven't had a chance to roll this out.

To the specific question, David; around when will the G7 rollout the first of the price caps -– again -– there is three price caps, not just one –- so, we want to do this in enough time that private industry can plan and respond. Again, we see them as a partner in this, not as an adversary. We want to facilitate to trade Russian oil; this is not your standard embargo, in fact, it's the exact opposite. So, it will come out in enough time –- after we've consulted with the coalition -– I can't give you an exact date –- but we're not going to roll out the price cap on December 4th -– the day before this all comes into effect -– the idea is to give enough warning for the private sector and all the lawyers that Craig just mentioned to comply. So, I don't have an exact date, but sooner rather than later.

MR. WESSEL: So, we're at attestation. So, I'm a Greek oil tanker owner. What is that you're asking me to do to make sure that I'm not violating this thing?

MR. HARRIS: So, here's the idea, which is there's a whole bunch of different services involved in any given trade. And some of these services, like trade finance, happen to know the price of the oil –- and this isn't rocket science, we're talking about one price, this isn't like a complicated algorithm, it's a number somewhere between—lately—80 and 100 –- but some of these services naturally know the number of the course of business and some, like the insurers, don't. If you don't know the number, it's on you to call the purchaser of the oil or to some other way throughout the supply chain to call up the trade finance provider or someone who does know the number and receive some sort of documentation stating the number, and then what you have to do is put it in a file cabinet and hold onto it in case the regulator in the home country comes asking for it. That's really it. It's basically just asking the parties that know the number to document the number and then holding onto it for a period of time.

MR. WESSEL: Someone asked, do we anticipate using secondary extraterritorial sanctions to enforce the cap against non-U.S. parties?

MR. HARRIS: As designed, those aren't necessary. As designed, they're not part of the conversation. I don't want to take anything off the table — it's a good question — but the way we've designed this — again, okay, just to also sort of make another more macro question, all the incentives are aligned for everyone here, except for Russia, right? So, for the consumers and the purchasers of oil the idea is "Look, be part of this because you get cheaper oil" and we have had very receptive conversations with non-G7 oil importers. For the service providers, they want to participate in this trade; many of them has de-risk, as many have pointed out, they want to come back into this trade provided it's done in the right context. So, the incentive's there for the private sector as well.

So, the incentives are all aligned for everyone, except for Russia, and that's the reason I think we're particularly optimistic this could work, provided Russia does not deliberately shut-in production; and that's an option which could manifest.

MR. WESSEL: In order to work, does this require China to cooperate? I hear that question a lot.

MR. HARRIS: Yeah, China's import of Russian oil has not increased that much. India's of course has gone through the roof, but it's an open question; how much more India could take in? I think people have been too quick to write off participation by these countries for two reasons -– or really even three. The first is that -– again -– you don't necessarily have to buy under the price cap for this to be successful. If China goes ahead and negotiates a 30, 35, 40 percent discount; look, we consider that a win. Now, of course, we welcome broad participation; but there's a lot of ways to get to a win.

Second, in our conversations with a lot of these importing countries they have valued Western services; so, they don't see a U.K. provided insurance company the same as Russian provided insurance; these are not the same service. They put a lot of value in these Western-provided services, and I think all else equal, they'd like to continue operating with those as well. And also, cheap oil's really appealing and if they can get cheaper oil under the price cap than they can elsewhere, I think it's a good chance they'll play ball.

The last point I'll make is, it's not binary. You could imagine if particular firms in certain countries agree to buy under the price cap without necessarily having a national policy that all firms must. So, there's a lot of ways of getting to yes; but to answer specifically, the reach of the G7 is sufficiently broad and we think we'll find success without India and China, although this will probably work better with their participation.

MR. WESSEL: So, I wonder if I could ask –- I'm not sure, Craig or Helima or Ed, who wants to take this; how do I think about OPEC and the Saudis in this, where are their incentives; Helima?

MS. CROFT: I think that a key law of cargo obviously would be OPEC. I think that the Saudi's and the rest of OPEC have made it absolutely clear that Russia is going to remain at the head of the OPEC plus partnership; they are not looking to in any way have a major breach with Russia at this stage. I do think -- going to the point that Ed made and that Craig made as well –- I do think there is some growing concern amongst producer states about the use of sanctions in combination -– I would say -– with the SPR. So, essentially saying –- like –- "Okay, now it's Russia" and I think they're concerned about the service providers –- like – "Wait a second, you are essentially making the service providers we use to have to like now on Russia enforce a price cap. Well, what if we fall afoul at some point and this is turned on us? Should we think about ways of basically working with other service providers? Do we need to lessen our dependence on those service providers because at some point is this going to reverberate back on us? At the same time, when we talk about potentially additional SPR relations, is that potentially going after us as well"? So, I do think that there is some growing unease that you hear about this policy -– and that doesn't mean that from Ben Harris' standpoint, we shouldn't proceed with the policy – but that just is something I am starting to hear.

MR. WESSEL: Could they undermine this? It doesn't bother me that the producers of oil -– the cartel -– is a little nervous, I think we've been trying to do that for the last 50 years.

MS. CROFT: The question is, do you think that OPEC is going to –- they've already had a micro-cut this week -– I think that they will be looking at a variety of factors when they proceed with their monthly meetings in terms of production. I don't think they're going to do Russia's bidding though; I don't think they're essentially going to be using OPEC policy to bailout Russia, but they will be making their own considerations about how they act based on market dynamics.

MR. WESSEL: Ed?

MR. MORSE: I was going to say that they have a capacity for leakage to a certain degree; we don't know what that degree will be, but already both Saudi Arabia and the UAE are importing product from Russia and they're using that product in the domestic economy; in the case of Fujairah, maybe globally because it's high sulfur fuel oil and for noncompliant countries –- that is countries that don't agree to the IMO gas oil requirements, they can be running something that's more polluting; we don't know where this goes. What it does certainly mean is that for every single barrel of oil coming from a Russian supplier they have more oil to release to other places. So, there is leakage, and the question is how much will it be, will it go beyond fuel oil, would it include diesel, will it include crude that can then be refined in a Middle Eastern refinery and the product going into Europe, which would be evasive of the entire price cap mechanism? So, I think it's there, but we just don't know what's going to happen with it.

MR. WESSEL: Craig, last word; so, how do you look at the OPEC, Saudi, and any last thoughts?

MR. KENNEDY: I wanted to address this question about India and China, and do they need to participate; maybe touch briefly on OPEC too. I think the way it's going to work going forward is that certain buyers –- notably Turkey and China -– will be covered under resources that Russia already has. The trip across the Black Sea or around through the Dardanelles is relatively short to deliver oil to Turkey; imports have been going up and Russia will use its limited own fleet to supply those short-haul clients. Pipelines will supply part of Chinese need over land and I think the Chinese will probably use their own fleet -– a small portion of it –- to bring the seaborne exports from Kozmino in the Pacific into Shandong.

So, I think from the point of view of having to participate in the price cap in order to be able to access Russian oil, that will be an issue for places that are relatively near like China and Turkey. The problem is if you're further away. If you're in India –-

MR. WESSEL: Oh, wait, I'm going to stop you there; because of this will they be able to get cheaper oil from Russia?

MR. KENNEDY: Absolutely.

MR. WESSEL: So, that's the point, right?

MR. KENNEDY: They will be in an immensely strong negotiating position and the Russians are already dreading negotiating with the Chinese once this comes into play. Senior executives have rolled their eyes and said, "This is going to be a nightmare." The big question comes if you're India. Russia simply won't have the boats unless they are selling at the cap in order to continue delivering to India. So, for India it's not going to be a question of "Do I buy above the price cap or do I buy at the price cap"; it's "Do I buy at the price cap or not buy Russian oil at all because Russia won't be able to get it to me?" That's where things get interesting and I don't think that many people in the marketplace have taken that onboard fully, but that is the reality that we'll be looking at. Fujairah is very interesting too. That's a relatively long haul for Russia because the unloading times are quite long and if you look at the shipments that have been going out of the Black Sea to

Fujairah, Russia has been using that as a new hub -– a place to put oil that it can't sell itself.

MR. WESSEL: Where is Fujairah?

MR. KENNEDY: It's the expanding -– it's one of the Emirates -– and it's one of the expanding hubs in the Middle East in the UAE. So, it's right on the Horn -- it's relatively accessible from the Black Sea –- but nonetheless, it's further away and unless Russia's able to secure a lot of third party-tanker capacity, they will need to cut its deliveries to the UAE.

MR. WESSEL: Thanks. Ben, I'll give you 30 seconds for your last word.

MR. HARRIS: I'll just say we're still rolling this out and so we've had a pretty terrific reception -- I think –- given its novelty. I'd just ask for the skeptics to just wait for all of the information and perhaps hold your fire before you conclude that this will be too challenging to implement. We're still building this thing and we're working with our allies; and give us a few weeks to get all of the information out there.

MR. WESSEL: Okay; no more than a few weeks though, Ben; then we're going to fire.

MR. HARRIS: Fair enough.

MR. WESSEL: Thank you, Helima, Craig and Ed; for making this such a lively conversation; and Ben and your colleagues at Treasury for helping making it happen; and also, to my colleagues at Brookings who squeezed this in on a very busy day here at Brookings. So, thank you all and have a good weekend.

MS. CROFT: Thank you.

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