WELCOME

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PANEL

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HARRIS: Good afternoon, everyone, and welcome to Brookings. I'm Ben Harris, the vice president and director of the Economics Studies program. I'm delighted to be here with you today discussing the critical issue of the price cap on Russian oil.

Roughly one year ago today, The Hutchins Center hosted an event which I joined as a panelist representing the U.S. Treasury Department as assistant secretary for economic policy. The title of that event, Capping the Price of Russian oil. Will it happen? Will it succeed? Appropriately reflected the uncertainty over over whether the G-7, Europe and Australia would successfully unite to implement a new sanctions regime. At that time, no one could have reasonably imagined a variety of outcomes. One could have reasonably imagined a variety of outcomes, ranging from no cap on Russian crude or Russian refined product to a cap on only Russian crude to a cap on some combination of refined products only. But fortunately, the coalition succeeded in implementing a series of comprehensive caps, one on crude, one on high value refined product, and one on low value refined products. They covered the vast majority of Russian oil exports. Indeed, one year after that initial Hutchins event, we have a definitive affirmative answer to the question posed one year ago.

The second question regarding will it succeed remains open to debate and is why I believe we've gathered energy and sanctions experts here today. My own view is that the price cap succeeded with flying colors over the first six months after its adoption. The cap pushed down the sales price of Russian oil and sharply raised costs for Russian exporters ultimately lowering the revenue received by the Kremlin all while maintaining global flows of oil. However, Russia, as expected, has taken countermeasures to trade around the cap, including amassing a fleet of aging ships to carry its oil and offering questionable insurance on those tankers. Those countermeasures have precipitated the need for an implementation and enforcement phase of the price cap. Some are referring this to as phase two. The enforcement measures announced last week by the Treasury Department and the G-7 coalition are a strong first step towards an effective second phase and have reinforced my optimism that the price cap will continue to achieve state of objectives. Let me offer one final concluding thought before we kick off the panel. As experts have debated various facets of the price cap, an oft overlooked, overlooked point has been the power of unity demonstrated by the cap. The price caps implementation required unanimous agreement across global coalitions of nations, each with its own security and each with its own energy concerns. A no vote from any single nation would have broken the coalition and diffuse the price cap on the spot. And yet, despite Russia's best efforts, the coalition remains unified and committed towards thwarting Russian aggression in Ukraine. So the price cap is not just a novel new strategy to impose sanctions, but also a remarkable diplomatic achievement.

With that being said, let's get to the main events. Our panel today includes experts from both the public and private sectors, ensuring that today's discussion is comprehensive and represents various economic interests. With that, I'd like to turn over things to David Wessel, the director of the Hutchins Center on Fiscal and Monetary Policy, who formally introduced today's panelists. Once again, thank you for joining us. I look forward to the discussion.

WESSEL: Thank you, Ben. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy. I want to welcome all our viewers. And if you have a question, please put it in the you can put it on Twitter at hash tag oil price cap, or you can email it to events at Brookings dot edu. We're going to talk today about oil prices and tankers and sanctions and dollars and cents and rubles. But I want to be clear that the ultimate goal here is to stop the Russian brutal invasion of Ukraine and the devastation it has brought to the Ukrainian people. Now, Ukraine has been pushed off the front pages by bloodshed in Israel and Gaza. And although they aren't the focus of our conversation today, I just think it's important to note that we see the suffering of the people of Israel in Gaza and hope that conflict comes to a speedy end.

Just to put a little bit of meat on the bones that Ben laid out in June 2022, the European Union adopted a sanctions package that, among other things, forbid British and European companies from providing insurance and other services to all Russia's seaborne exports. And in December 2020 to the G7, the EU and Australia said that that ban would not apply if oil was sold
below $60 a barrel. And it really had two goals because all confused at the beginning, the public didn't seem to get it. We wanted to keep the Russian oil flowing because the world needs it, but we wanted to reduce Russia's revenues below what they'd otherwise be. And as Ben said, it worked better than a lot of people thought it would, creating a wedge between the world price of oil and the price that Russia can get. Just want to share briefly a slide from a Ukraine index that my colleagues at Brookings and I have put together. And you can see that initially you see the slide but. Initially, the price of oil was trading below $60 a cap for quite a while, but it has since risen above that level as oil prices have gone up and the wedge between the price of Brant, the world price of oil and the European and the Russian price of oil has narrowed. So I think that the Treasury says that the Russian oil that it's working, that the Russian oil tax revenue is down 45% January to August 20, 23 versus 2022. But everybody acknowledges that its effectiveness has been eroded for at least two factors. One is Russia has built a fleet of ships, mostly older ships, that are carrying crude, that don't have Russia, don't have to deal with our sanctions, U.S. sanctions. The Financial Times estimates that three quarters of all seaborne Russian crude flows traveled without Western insurance in August. And then there's been explicit cheating people who say that oil is less than $60 a barrel, but it isn't really. And the Treasury and its allies have cracked down on that.

So today we're going to start with some comments by the successor at the Treasury, Erik Van Nostrand, but joined the Treasury in August 2022 to advise on Russia and Ukraine as the acting assistant secretary for economic policy. He previously spent six and a half years at BlackRock and spent some time on the staff of the Council of Economic Advisors. Even though he's a lawyer, he masquerades as an economist. But as a former journalist I do the same. I'm also pleased that two of the panelists from our September 2022 event, Ed Morse, who's global head of commodity research at Citigroup, where he's worked for more than a decade, and Craig Kennedy now at the Harvard Davis Center for Russian Eurasian Studies, who spent 20 years in investment banking, and Morgan Stanley and Bank of America merrill Lynch, where he was, did a lot of transaction experience in Russia when such things were possible. He writes a substack on Russian oil called Navigating Russia and is working on the history of the Russian oil industry and its impact on civil society. In September, we were joined by Halima Croft from RBC, who unfortunately couldn't make it today. But I really want to appreciate Clay SIEGEL, who has stepped in. He's been following the oil industry for the last quarter century in various capacities, is currently director of global oil services at Rapidan Energy out of Houston. So with that, I want to give Eric a chance to tell us how well things are working, and then we'll criticize everything you say in the following minutes.

VAN NOSTRAND: Appreciate that, David. Thanks very much. I should note upfront that my partner tells me I'm an economist who's masquerading as a lawyer, so it's nice to hear it. It's nice to hear you characterize it the other way. But let me let me make it clear that it's a pleasure to join this conversation. The Brookings Institution deserves special thanks for its engagement generally on our efforts to address barbaric work, but especially on specific policy we're going to discuss today. I'm also especially grateful to Ben Harris's leadership during his time in public service as an important architect of this policy and grateful for the private sector engagement we've had over the course of the past year, including with a lot of the firms and institutions represented on the panel today. So thank you all very much for that very much. Looking forward to speaking with you all about the ongoing impact of the price cap. And to share the latest on our work to maintain its effectiveness as the policy enters its second phase.

I'm going to make three key points to leave you with. The first is a reminder of the goals of price cap, because this is a little nuanced and sometimes it gets lost in the conversation. Our goals are to keep Russian oil on the market for the emerging market countries that need it, while at the same time limiting Putin's profits by reducing its revenue and increasing its costs. Second key point, and I should note my second and third key points mirror closely the two observations that David made up right up front regarding trading outside the G-7 nexus and our focus on enforcement. Second point is that we recognize that more oil in recent months, as David pointed out, is being sold outside the G-7 indexes. That's a trend that we expect a year into this policy, and it reflects our goal of increasing Putin's costs and that oil is only being traded outside the G-7 next
because of an enormous investment the Kremlin made in building up this G-7 infrastructure that otherwise would be spent on the battlefield. Third key point, it's important to remember that despite that increase in trade outside the G-7, a significant share of the Russian oil trade still operates with G-7 services. And in that domain, enforcement is key. And that's why we announced last Thursday a set of actions focused on enforcing the price cap for G7 service providers. So to note for background press copies bought out in response to Russia's brutal invasion of Ukraine. And we believe it's worked over the past year because the coalition controls over 90% of the maritime services and insurance industry needed to move Russian oil at the time of the price caps launch. And because the attempts that we knew Putin would make to build an alternative ecosystem outside the G7's reach are very cost. But today, global markets have remained well-supplied with oil. And Russia must still choose between accepting a steep discount if they sell oil with G7 service providers under the cap or incurring tremendous costs to build the new eco system that operates without G7 services. Our approach was precisely designed to force Russia to make those hard choices. Again, they could either abide by this cap that we set and sell energy at a considerable discount, or they could invest massively in a shadow fleet to move it outside the G7 reach. Such investments contribute to Russia's growing fiscal deficit. And buying tankers makes it considerably harder for the Kremlin to buy tanks. And that's a desirable goal of the appeal of the strategy.

Ten months after implementation of the price cap, we can see that the first phase of our approach has been successful as we've avoided the disruptive energy supply impacts that many analysts forecast. If its David noted, we were to ban all trade of Russian oil, all servicing trade, Russian oil. Rather than implementing this price cap and at the same time that we've avoided that disruptive price spike. We've also seen Russian revenue declined sharply, as David stated upfront over the first eight months, a year of the Kremlin's oil revenue, its key source of revenue for funding the war was down 45% from the year prior, prompting public alarm from economic officials. And importantly, that figure doesn't account for the large expense Russia has incurred trying to construct this alternative ecosystem of ships and services. So the real economic toll for the Kremlin isn't just about the lost revenues, it's about VAT and the increased cost. Now, today we see that Russia has made a decision to spend huge amounts of money on this alternative ecosystem. And it's clear that he's selling a larger share of his oil outside the cap. But the costs associated with that of avoidance keep stacking up. Putin has bought hundreds of new oil tankers and he faces elevated cost of insurance, longer transport times, elevated capital expenditures and reinvestments that service non G7 providers. In response to Russia's two seven decision to build up its own ecosystem for the transportation of oil at a significant cost to the Kremlin, we're now launching the second phase of our effort, which will constrain Russia's profits by increasing the costs associated with using 97 services. Last week, the U.S. Treasury sanctioned two entities and identified as blocked property to vessels that use coalition service providers while carrying Russian crude oil above the coalition price cap. This comes alongside other actions which underscore our resolve to force into these difficult choices and increase the costs of illegal war. These actions send a clear message that Russia will be continued to force. Will we continue to be forced to face two costly options selling under the cap or spending more to operate outside the G7 nexus, and that attempts to evade those two choices will face a decisive and unified response from the US and our allies. Our goal of promoting stable global energy markets remains unchanged, and Russia can continue to export energy products through either channel. But because of the actions we announced last week and actions will continue to enforce the coming weeks and months, the costs the Kremlin faces will continue to rise, and Russia's ability to sustain its barbaric war will continue to be kept on pause. They're very much looking forward to the conversation.

**WESSEL:** Thank you. Ed Morse, maybe I can start with you. I looked at the transcript, our event back in September, and I think you were quite skeptical about whether this would work at all. And I wonder how it's evolved relative to your expectations and what you think we've learned, if anything, over the past several months.

**MORSE:** Sure, and I'll try to be as crisp and short as I can be, recognizing that there are all kinds of ways of looking at the same set of numbers. So I was a skeptic about it. I was a skeptic coming out of my own days in government and in particular being present, representing the United States at the International Energy Agency when the very first effort to put a cap on prices was
being made under U.S. initiative after the outbreak of the Iran Iraq war in September of 1980. And and it was a it was an utter failure, even though the number of countries involved that needed to coordinate was tighter, smaller, the escape mechanisms outside that group of companies was was tinier. So I was a skeptic about trying to control markets. One of the factors that I was skeptical about was that there’s a chance for people to make money, that includes government officials, that doesn't necessarily include the fiscal regime as a whole, they will find a way to do it. And one of the more stunning articles that has come out recently during all of this discussion of a price cap is a Bloomberg story that that that hit the press on October 14th. And the title is The Trading Tycoon Staring Russia's Global Oil Business. So the incredible part about that story is that the the bulk of the evasion is being orchestrated by colleagues of the CEO of Rosneft and people who have a history of being in the business in the same way that people like Marc Rich got into this business in a big way after October 19, September and October 1980. So where there's a temptation to enrich oneself, there will be evasion. And I think that is one of the aspects of it. The second aspect of it, and I can't try to track the numbers in terms of the price cap and the actual discount of Urals to other crudes, noting that we had very steep discounts a rising before the G-7 decision, and that was because this was a massive disruption in and shipping channels and supply lines. And once you get people saying, I'm not going to buy your crude, you have to find ways to sell it. So we had a distortion in the market of monumental proportions, which had as part of it the steep discounts to to Russian crude.

I’d also note with no disagreement about what what we've heard from Ben and Eric, that there are other things that were at work. And one of them, in my judgment, was that the Russian government actually tried to find a way to get more money for oil and actions taken over the past summer to cut production was certainly a test of the price cap. That was one of its clear objectives, I believe, and it was an objective that, in my judgment, succeeded to a significant degree, and it did so because of market dynamics that are complicated. I'll try to keep them simple. We had cuts, a lot of cuts coming out of out of OPEC+ countries and extra ones made by Saudi Arabia and Russia. And these cuts took place in the summertime when the crude streams that are needed for use within Middle East countries. But Saudi Arabia in particular are crude streams that have a lower they're using at home crude streams that have a lower yield, natural yields of middle distillates and a higher yield of associated natural gas that's needed for summer burn. Now, one of the intriguing things that's happened is that the level of discount which basically disappeared almost at one point paralleled the rise of similar crudes to Urals in the global market, in their relationship to Brant and other light crudes. And as the summer has gone by, we've seen the discounts two of those crudes to two brant. Widening again. And I think once Russia tries to get all of the oil back in the market, we'll see that the distortions are still there, even without all of the efforts made and the costs associated with them of the new sanctions that were recently introduced.

WESSEL: So I guess, can I ask you to boil down here? So relative to what you were you thought back in September 2022, has it worked better than worse than or about the same as you expected? If the goal was to keep Russian oil flowing and deny revenues to Russia?

MORSE: Well, I so I never sided with the people who fought in some official lands that Russian production was going to go down significantly. I was with you know, I was with everybody on. This was a mechanism to keep Russian oil flowing until they decided to stop it from flowing. I think the market dynamics themselves, compared to the costs of implementing sanctions, was something that I still hold by that. It is the relationship of crude value to crude value of Urals, to more bad times to Dubai and Oman, crude that counts more than I sanctions themselves.

WESSEL: I see. I think, Craig, I know you have a number of suggestions for how to make the price cap work better, and I wonder if you could set those aside just for a moment and give us your view on is this thing working at all? Is it accomplishing its aims or is it, as Ed said, just some kind of icing on what the market would have done anyways?

KENNEDY: I think this is one of those half empty, half full discussions there. Clearly some areas for improvement for the price cap. There clearly some things that some steps need be taken.
But I would echo the earlier sentiments that the price cap or I should say more broadly, the package of sanctions on which the price cap is an integral and essential part. I’ve worked beyond most people’s expectations, including my own, and that's just a fact of numbers. If you look at the impact that sanctions have had on revenues going to the Kremlin, we're looking at some somewhere on the order of 40 to $50 billion of lost tax revenues that they would have been expected to have gotten otherwise.

Now, I would agree with Ed that much of this has to do with the discount itself rather than the price cap. Most of the time, Urals has been trading well below the price cap and it's largely due to these market distortions that Ed was talking about. But I think there's a very important aspect of the market need to bear in mind. So the sanctions were incredibly ambitious. They took 4 to 6 billion, a million barrels a day of crude and products, much of which historically gone to Europe and banned them from 50% of the world's markets. Suddenly, Russian crude. The pipelines, the ports, the refineries of which have all been configured and built to export to Europe, had to move this crude much further away. You've obviously got higher freight costs and greater dependency in shipping for this. But I think what many people have missed is that you're moving a huge amount of crude into a much smaller market in a market that is much more highly concentrated. And if you listen to the discussions that are going on in Russia, what has happened is Russia lost bargaining power. These are either by its near being forced to make massive discounts, 25, 30, $35 to the benchmarks because of the superior pricing negotiating power that their counterparties had. I mean, the Chinese and the Indians and others who are by the side of the India actually, many people think that China has been a big net buyer of Russian oil. In fact, that has been the case. Almost all of the crude that's been diverted to new markets has been coming out of western ports, the blacks in the Baltic and almost all of that or a large portion of the crude has gone to India. Very little of that has actually made it to China. But the Indians have had a field day when it comes to negotiating great discounts. So Modi really owes it to Putin in this case because it's helped bring down energy prices in India.

Now, if we look at what happened this summer, it was talking about a cut in exports. What did the Russians focus on? They took half a million barrels a day of crude out, mostly going to India. What they were attempting to do was to tighten up that market, to regain negotiating power, and they succeeded to a certain extent. We can see that in the narrowing of the discount and I share as view. It'll be interesting to see as Russia tries to backfill some of that reduced export back into the marketplace, what will happen with the discount? That's something for us to watch. So with respect to the price cap, I think a very important point that I want to make is the following. If you want to know whether the price cap is working, you cannot get the answer merely by looking at the market price. The price cap was not intended as a ceiling on the market price. The price cap was intended to do something very different. Look at it from the perspective of a Russian export. You've got two ways to get your oil out and you can put it on a shadow chip, negotiate a market price. And that's generally going to be the price today that you see on the street. The assessed price from August or from Platts. What you're not able to get out from through the the shadow fleet channel you have to send out through the client channel. And there if compliance is working as it should be and there is evidence to suggest it is working much better today than it was six or seven months ago. You're going to see a carbon price, a contract price closer to the price cap, if not below it. So we have perfect knowledge of all the contracts. What you should be able to see right now is a two-tiered pricing system. A lot of the shadow fleet prices around what would a screen price that we see today. But then there's all this other stuff that's going on that is control. Now, a screen price cannot show you this two-tiered system, but there is data out there that can and it's some of the customs data that we're seeing is the same data that showed us there was a problem with compliance at the beginning of the year. But more recently, it looks as though we're getting exactly the sort of a two-tiered system that you'd expect with some. Market prices and then some lower discounted prices around the price cap. And that represents stuff that has to go out on the farm, the compliant fleet.

So the big question going forward, and I think this speaks to the phase two enforcement phase that our colleagues from Treasury have been talking about, is can we find a way to slow arrest, possibly even reverse the expansion of the shadow fleet channel and divert more oil back
into the compliant fleet channel and make certain that channel as well policed? We can talk about how that might happen, but I think there are some very interesting points were raised in last week’s advisory, particularly regarding capital adequacy of insurance, which if the states which have put this advisory out, actually follow through on their own advice, you could potentially see limits, quite significant limits placed on the ability of Russia to continue using the shadow fleet for its exports.

WESSEL: So Clay, unfortunately for me, I don't know what you were saying in September of 2022, so I can't throw that at you. I did read something you wrote at the beginning of February, just before the Russian invasion that suggested that geopolitics could drive the price of oil up. You said even maybe even over $100 a barrel. So I'm wondering how you think How would you answer the question? How well is the oil price cap working, given its objectives?

SEIGLE: Well, thanks, David, and thanks. Thanks to Brookings for hosting this discussion and inviting us to wrap it and to contribute. Yeah, I'll take credit for the triple digit call back in February, But you know, in more recent months, our assessment has been that in kind of a two track approach, that the the keeping the oil flowing part has really been the emphasis, the must have priority and reducing revenues is also important. But when when if they do come into conflict or if there are conflicts between them, a little bit of a secondary priority. Now, how has the market been interpreting it and not to who we report to our clients? The market certainly sees the price cap as working as intended insofar as keeping the Russian oil flowing. And I'll just briefly build on on some of the flow analysis that that Craig had alluded to. If we can just go back to the big question that the market was facing last year was would all of these Russian barrels just be redistributed and reshuffled around the world or would they actually be removed from the marketplace? And clearly, the answer has been the former. We I mean, we look at the numbers pretty carefully since the EU import bans for crude and refined products, which I think were last December and February respectively. I mean, the volume of Russian oil exports onto the seaborne markets has been virtually unchanged compared to the prior period. That's the case for crude oil, about 3.3 million barrels per day. But before and since, it's the case for refined products close to two and a half approximately before and since, and for the cut of that, that's diesel, one of our important seaborne exports for oil markets, you know, 500 or 600,000 barrels per day. But it's important to remember how we got there because the import bans and the price cap together informed this reshuffle. And even though the results are kind of similar across the barrel, the the story lines, the narrative between where the crude went and the refined products is completely different. And so in the case of crude oil, it's well understood that that the two east of Suez crude importing powerhouses, India and China, stepped up and made this happen because they wanted big quantities of discounted crude. And. Craig Exactly right. I mean, India came out of nowhere as an importer of Russian crude oil, 20,000 barrels a day on average before the war and before all this to an average, sometimes higher. But a recent average of 1.2 million barrels per day, 20000 to 1.2. And China has even though less, taken some of that incremental supply as well since the invasion. But those guys, they didn't really need more refined products after the EU banned those barrels there. They're good on refine. So the the way the market reshuffle for refined products has gone along is a couple of different tracks. In some cases, all new markets had to discover the economic benefits of importing Russian like quite a few of the countries of North Africa like Brazil in Latin America in. Other cases, third party countries, not the end users, but some third countries that manufacture refined products themselves are stepped up their purchases of Russian refined products while at the same time we observed are increasing their their export flows to of their their sort of their homegrown refined products manufactured at home to the sanctioning coalition markets in the EU. You could call that a swap all legal according to the letter of the law, which as we've stated, was designed to keep barrels flowing. So I think in both cases, a huge reason the price cap has worked is because Moscow has been incentivized to continue exports rather than withhold that. That was that was a big question mark at the beginning.

WESSEL: Right.

SEIGLE: And to be sure, the you know, the general need for state revenues at the time of a very expensive land war. Augments and strengthens also the need for for oil revenues and $60 for crude provided enough revenue to make maintaining this pre war flows worthwhile. So I think we
can all agree that if the sanctioning coalition had set, let's say for crude materially lower than $60, the Kremlin may have made a different decision and may have cut back exports and even crude production if necessary in order to ramp up their revenues the other way, which is by inflating all global prices in response to a supply shortage. But we have a different path. And let me stop here for now.

**WESSEL:** So Ed, I noticed that the Russians said they're suspending exports of diesel. Is that has something to do with all this or is this has something to do with the domestic Russian economy? And what does it make?

**MORSE:** I think clearly the main driver was the Russian economy. They had a complicated, very complicated system to subsidize at home, which was costly. They facilitated or the system facilitated people in Russia to buy discounted crude in the domestic market and sell it abroad. And they needed to stop that, particularly for two reasons. One, their own domestic demand for diesel went up significantly with the war against Ukraine. And secondly, they their inventories were running at a very low level. So that, you know, they had to rethink the price, the pricing of the crude and the mechanisms for keeping it at home. And they've gotten to the point where they've come to what I think is a fairly satisfactory halfway house in a way. They they stopped allowing non refineries with pipeline access to ports. They they denied others from buying the product and selling it on their own or selling it in some manner other than through a port which can be, you know, better monitored. And they relatively quickly replaced their lost inventory at home to enable them to go back into the market and to export it again. So the world lost that supply for a shorter period of time and to a lesser extent than had been feared at the beginning.

**WESSEL:** Hmm. So, Craig, Eric, I won't leave you out. I promise to get back to you. Craig, what would you. You've written some good pieces on what you think ought to be done to tighten the. Effectiveness of the sanctions, some of which I think the Treasury has done now. I'm just interested, what would you do? What you what have they done that really you think is important? And more importantly, what would you do that they have yet to do?

**KENNEDY:** Well, first of all, I just want to pick up on a point Ed was making a moment ago about the situation with diesel domestically. The other event that really helped cause this crisis, it was a domestic crisis. And Russian September was the fact that they were slashing the subsidies for products at home. And they're doing that again because of pressure on the budget, the slashing the subsidies on refined product at home, which are heavily subsidized by export earnings. You're doing the same thing now for natural gas as well. So these are just indicators of the stress on the budget that's caused because of steps that are being taken externally on their energy trade. And this will start flowing through more broadly to the economy. In terms of suggestions, one thing obviously is lower the price cap. I know that's a it's a complicated discussion, but nonetheless, the price cap does seem to be getting some traction now. So there's no reason why we can't start to ratchet that down in a controlled fashion. Another thing, of course, is to make certain that compliance with the price cap remains robust. And we've talked about measures. Clearly, Treasury has been working on this because it appears the compliance is going up. But one thing would be to try and get some of these friends of section out of trading and get some of the international traders back into the Russia trade and require them to be a counterparty to any transaction where Western shipping or Western insurance shipping is being used because that way we know there's somebody in the trade who knows that the underlying contractual terms are and can vouch for that, and they have real consequences if they don't provide truthful information. So that's that's what we call whitelisted traders.

But I think the most interesting thing in many ways is perhaps the least obvious, and it's this situation around insurance. So I think most people will be aware that all tankers in the world are obligated to carry spill liability insurance. And a lot of it so much so that the regular commercial insurance markets aren't willing to cover it. But a very capable system has been put in place by the shipowners themselves. That covers 95% of the global fleet with sufficient insurance. There is transparency around it, good credit ratings. And, you know, if there's a spill by one of these tankers, God forbid it will be adequately funded up to $1,000,000,000 per incident by this insurance
scheme. And that's an international obligation. The shuttle fleet does not provide anything like the degree of transparency or certainty that the insurance that they claim to have actually even exist, much less is adequately capitalized. And what we know about the business model of the shuttle fleet is they cut corners aggressively and they use opacity and lack of transparency as a way of making money. So one of the questions I would pose is why would any coastal state today in Europe, in the Baltic, in the Aegean, elsewhere allow a Russian shadow tanker that doesn't have proper insurance to cross its territorial waters? Coastal states do have rights in maritime law to protect their marine environment from possible threats from oil spills, as we saw happen with Turkey last summer, last December. They have exercised those rights now. They have said we will not allow tankers to pass through the Turkish straits that are not properly insured and they stop traffic and require verification. I'm hoping very much that the the G-7, EU countries to put this advisory forward will do much the same thing required that any tanker that's going through territorial waters of an EU member state has to verify its insurance to show that it's current, properly capitalized. Now, the good news is you can do that in 10 seconds online for 95% of the world's oil tanker fleet. There's full transparency. Investment grade credit ratings. The shadow fleet, however, is then getting a free pass. And it's time for people to step up and say if you're not going to insure your tanker properly, it may not pass.

WESSEL: So, Eric, one of the listeners asked, didn't you anticipate that they'd build this this huge shadow fleet? And why didn't you do more to stop it? And then can you respond to Craig's last suggestion.

VAN NOSTRAND: Sure. And I'd make a couple of points connecting the great points that Clay, Ed, and Craig have all made. First, this is an important point on the, you know, the increase in the shadow fleet we've seen. It's a very common aspect of sanctions regimes generally and especially of new creative sanctions, regimes like this that the sanctioned party invests in getting around it. And if you if you look at the way we talked about this, this question of the shadow fleet last year, you'll see that even before implementation, we recognized that the Kremlin was likely to have an incentive to find other ways to operate outside the G-7 nexus. Now, you know, it's it's because that's such a common element of the sanctions regime. One thing we spend time on as measured out. All right. What's it going to cost the Kremlin to build that? And we do have an important focus on, you know, not just the revenues were limiting via the price cap directly, but also boosting the Kremlin's costs, forcing him to buy these boats, you know, forcing them to set up these longer transit regimes. Those are that's money that would otherwise go toward funding the war itself. So we are glad to see those costs rise, you know. But at the same time, we also care a lot about ensuring the broad stability of the oil trade generally and ensuring the maritime safety. And that's why, as Craig both pointed out, part of the actions we've announced in Phase two are focused on working with, you know, compliance related parties and others in the maritime services industry to ensure that that it's safe.

But importantly, and I want to I want to connect that to plays point and then I'll directly speak to Ahmet, speak to correct suggestions is one thing I want to want to ensure that we all are clear about is that from the perspective of the price cap coalition, the U.S. government, its allies, we really do view those two goals keeping oil on the market and limiting Russian revenue, as Perrie puts it. We have we have not emphasized one goal or the other because we think what we're trying to do with the price cap in a novel way is is reject this historical idea that if you want to sanction someone's exports, you have to deal with their lost supply. The novel ideal and the price cap is that if we're reducing the Kremlin's profits, if we're reducing their revenue, you can do that by reducing price or quantity revenues price times quantity. Normal sanctions reduce the quantity. The price cap is an effort to use the West's influence over the Maritime Services trade to squeeze this trade out through a price control and reduce revenue by lowering price without getting the disruptive loss of supply. So those two things happening together is very much our goal. But obviously, as the as the trade evolves, we're going to focus on specific ways to do that. Our great suggestions, you know, I'm not going to comment specifically on new things we haven't talked about, but I'll make a general point and very much appreciate the sorts of ideas and engagements that Prague and others have brought forward on this is that our focus in the second phase of enforcing the price cap is is really two pronged. Its first to find, you know, when there when we see
evidence of abject evasion of Western services moving oil over the price cap, we're going to enforce that and use our sanctions tools to address it. But also importantly, we're looking at many different ways to increase the costs that the shadow fleet would face, both to disincentivize its further expansion and when the Kremlin decides to invest more in it to keep draining money from its war coffers. So we view those as two essential efforts, elements of the effort going forward.

**WESSEL:** So Clay, I mean, do you think it's possible to lower the cap and have it work? I mean, oil is even euros oil with Craig's point taking about what turns up on the screen is about 60. Do you think changing the cap is a good idea makes sense, could work? Or is that just wishful thinking?

**SEIGLE:** Well, I mean, the. The skull. All the talk has been about potentially increasing that, but not bringing it down, which would obviously probably placate the the Russia hawks and, you know, confrontation stance and stuff like that. But I'm not we're not really contemplating that as a as a potential market outcome. I think that the key question really that that Craig brought to the fore is are regulators going to step up enforcement enough to deter a critical mass of tanker capacity that reduces the flows? And if you really require those more stringent, let's say, insurance requirements for guys coming through, Yeah, the Danish Straits and the Gulf of Finland, that's you're talking about a material portion of those Russian export volumes. And so that would be of acute interest. But I think the question to ask here is right, are no G7 compliant ships needed any more because the dark gray boats and its capacity are so plentiful. And we think that the stress test, the proof is liable to be in some period of months when when opec+, including Russia, start to roll back their supply curtailments. And then we're going to find out if there's enough capacity to to get Russia back to to where it was before. Although I said that the aggregate flows on average have been about the same before and after. Of course, we all know that Russia is curtailing exports to the tune of what's been pledged, 300,000 barrels per day. So that's that's the increment that needs to come up with the supply cuts eventually going away.

**WESSEL:** And what's the argument for raising the price cap? The market price has gone up so much.

**SEIGLE:** Yes, the the argument would be to maintain alignment between between market prices and the cap. But I want to be clear, rapid and we're not arguing for that. We're not suggesting we're just evaluating what participants are saying and thinking about how that might affect the the matrix here.

**WESSEL:** So, Ed, given that you think that that given your experience, if you were in Eric shoes, what are one or two things you would do to make the cap work better and amplify the market dynamics that you described earlier?

**MORSE:** Yeah. So I think the, the big loophole is the trading relationship that Russia has with. Some significant countries in the Middle East where, you know, there's a lot of product and crude shipped and and then it's used in those countries and allows them to ship other things out.

**WESSEL:** And it's kind of like laundered in the Middle East. Is that basically what you're saying?

**MORSE:** I didn't use the word, but, you know, countries that are free to, you know, do that. Yes. I also think there's another aspect of it that requires further study and that has to do historically with the relationship between the ruble and revenue that is earned on a nonrenewable basis. You know, we've had usually when prices go up, the ruble goes up with it. We've had pressures working in the other direction. When those pressures work in the other direction, actually, the cost structure to the industry in Russia goes down. It doesn't go up. So I think there's a subtlety in terms of, you know, using a $50 billion number.

**WESSEL:** Wait, explain that a minute. So usually when oil prices go up, the foreign exchange value of the ruble goes up.
MORSE: Yes.

WESSEL: That hasn't happened now.

MORSE: And and the cost structure of the industry goes up right now.

WESSEL: And what and then the contrast with now is the value of the ruble is gone down.

MORSE: The ruble is under pressure for no other reason than.

WESSEL: Right. But how does that happen?

MORSE: Well, it allows them to do things that they otherwise might not do. So one one example which has to do with, you know, reaffirming public statements made by Novak, one of which has been we're going to keep our production even, but we're planning to raise it by the time we get down the road. And he's used the word two years from now down the road. One of the aspects of what's happened with a cheaper ruble is that drilling activity has increased. And we saw drilling activity in 2022 versus 2021 in terms of number of wells drilled grow by 8%. And then in the first six months of 2023 versus 2022, that number grew by 9%. And, you know, we know that Russia is in the process of building a new Arctic port with capacity to export a million barrels a day. I just I think when we think about sanctions, we ought to think about other longer term consequences of what is underway and wonder, you know, what would happen if we weren't so obsessed with the price cap itself. And the cost actually of of implementing it, which when it comes to friendly countries is not zero.

WESSEL: Exactly. No, I take that. Craig, I wonder if you could we could close this out on a bigger question here. So I get the point that the price cap was to keep oil flowing and reduce Russia's revenues otherwise. B But of course the objective was to squeeze Putin into pulling back on his invasion of Ukraine. And yet I'm a casual observer here, but I haven't seen any sign that it's having that effect. So we've made it more costly for him to do this, but heavily influenced his behavior in Ukraine. Is that even possible?

KENNEDY: Well, there are several questions there. First of all, there's a presupposition that somehow putting in place a price cap is going to end the war. And that was never the case. Was all about raising costs. Right. You know, is that when you have a major long term war going on, that often it's a question of the economies of two competing entities being matched against each other. And the bet here is that the economies of and coordination of Ukraine and its coalition allies can outlast that of Russia when it comes to a war of attrition. That all remains to be seen, the loss of politics. But clearly, energy revenues are an important part. I think there's a deeper ethical question as well. Europe was absolutely scandalized, not scandalized, but it was horrified by the massacres that saw it butcher. It was the primary buyer of both Russian gas and Russian oil. They decided we would no longer take Russian oil. And then Vladimir Putin turned gassed, hands off as well, trying to go it. So there's a broader ethical question. Should we be continuing to to buy that? That's perhaps beyond the scope of our current discussion. But the question of can this have a tangible impact on the Russian economy and its war fighting capabilities? Absolutely. We know that the first Crimean War back in the 1850s was a battle between industrialized Europe and Russia. Russia lost. And they know exactly what they lost. They said so at the time. The same happened again and again and again throughout history with a series of Russia's losses all the way through Afghanistan and others. And it had to do with their own capacity to sustain a long term war. I just want to put my comments with a quick comment about the shuttle fleet itself, because there are a lot of numbers that float around out there. But Russia has an immensely poor shouldn't capacity to keep Russia's exports ticking over at normal levels. You need in excess of 600 Aframax is dedicated 24 seven 365 just to the Russian oil trade. Right now the amount of shadow fleet capacity that they have is perhaps approaching 40% of what they need. They're able to get over 50% of oil going out on these ships because they cherry pick short routes as a way of trying to get more out of fewer ships. But they have a very long way to go. It's a slow build. And so there is still
a great deal of leverage that we have through our control of this Western shipping nexus. So there's a lot to play for. I agree. We need to think about the longer term consequences as well. But when it comes to your sections, plans of the Arctic, I'm not going to lose sleep over that as something that's going to cause a new fresh stream of revenue in the next two or three years in the Russian. I thought you'd also suggested that the EU and the G7 make it harder for them to buy these old used tankers as part of the tightening sanctions. Yes, most so over 80% of the shadow fleet today active in the Russian trade has been purchased in the used market since the outbreak or the expanded invasion of of Ukraine by Russia. And that's being bought largely from Western sellers. Now, there may be cut outs in between, but technically speaking, if you're selling a used oil tanker today, you're not supposed to sell it to Russia. I think that's one area where we could certainly put more pressure. And there are plenty of brokers who stepped away from that trade in order to set that through other European brokers is still facilitating it. So that's a larger question, I think, for Europe. But I think the real question that coastal states need to ask themselves, say in the Baltic, if there's a spill tomorrow by a shadow tanker and they haven't actually stepped, they haven't been exercising their authorities to prevent those tankers from coming through tankers that are under maintained and under-insured, the public will question Why did we not exercise?

VAN NOSTRAND: Thanks, David. I'll make one closing following the economics and then one closing thought on the diplomatic implications as we work through this. First, I thought it was very useful that had opened up with with highlighting that anecdote about the checkered legacy of things style price caps in the past. And I think one one important lesson from this conversation, I think, for all of us is that it's important to remember that what we're doing here is it's not a kind of government by fiat just saying this is the ceiling that we imposed. It works because of the unique structure of the Russian oil market where the West has this influence over the services industry that allows us to exercise this leverage. And that's what makes it different from the kind of economics 1 to 1 Price caps don't work narrative. It's really something that works in a nuanced and structured way given how the oil market is set up. But importantly, as we look forward to the second phase of this, I want to emphasize that it's really been you know, it's it's wrong to think of this as an effort of the U.S. government by itself. This is very much been a collaborative effort with our European allies, with the rest of the G-7, with Australia, who brought this coalition together, and to do to impose a novel policy like this that has these, you know, two seemingly contradictory goals of limiting Russia's profits while keeping oil on the market is really as much a diplomatic achievement as an economic one. And the fact that that coalition is still bound together working on these priorities now gives me a lot of optimism for our ability to continue enforcing it through this second phase and to continue to find new ways of increasing the costs on the Kremlin of fighting this war so that we can get to the outcome for the Ukrainians, for our allies abroad that we're all working toward.

WESSEL: I think that's a very good point. I read some of the stuff that was said at the time and that people some people said the Europeans will flinch at the last minute and they'll never stick to these sanctions, though. It's a very good point for that. Eric, I want to thank you for your time, Clay and Craig, I very much appreciate your thoughts and I hope that we don't have to do this again a year from now. But we will certainly be learning lessons about this episode for a long time, and we appreciate your help in drawing them. So with that signing off, then, thank you all for listening. There are clear. Thanks. That was good. Covered a lot of ground. Appreciate it.