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BULLETIN

Sanctions on Russian Oil Exports Require Further Refining

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Western and other states' restriction of imports of Russian oil and sanctions on its oil trade had little impact on Russia's budget revenues in 2022. This was because Russia found new customers for its crude, mainly in Asia. The effects of the restrictions only started to become apparent from the beginning of this year, but without a further, significant reduction in this source of income, Russia's ability to fund its aggression against Ukraine will not be weakened. The best way to increase the effectiveness of the sanctions would be to further reduce the price ceiling on Russian oil and take steps to increase the oil supply on the global market from alternative sources.

Part of the response of the coalition of countries, including the EU and the U.S., to Russia's aggression in Ukraine was the adoption of sanctions on Russian oil exports. In June 2022, the EU decided to ban the purchase, import, or transfer of oil (effective from 5 December last year) and certain petroleum products (effective from 5 February this year) from Russia to Member States, with the exception of supplies to Bulgaria and Croatia and crude transported by pipeline. The EU, G7, and Australia allowed exemptions from the ban on the transport of oil and petroleum products to third countries under *price caps,* below which these activities are allowed ($60 for a barrel of oil, $100 for, among others, diesel and gasoline, and $45 for, among others, fuel oil and naphtha), which are intended to limit Russia's revenues while maintaining a stable supply on the global market.

The Impact of Sanctions on the Russian Oil Trade. According to data from the Central Bank of Russia, in 2021, Russian oil exports were worth $110.2 billion and other petroleum products exports were worth $68.7 billion, together accounting for about 37% of the total value of domestic exports. Together with natural gas exports worth $61.8 billion, this provided 36% of Russia's budget revenues. The European members of the OECD (with Germany at the top) took in around 60% of Russia's 214 million tonnes of oil exports, followed by China at around 20%.

Although the EU countries began to reduce imports from Russia before sanctions were implemented, oil export volumes increased by around 7.5% between the start of the war and December 2022 as Russia used this time to redirect them. International Energy Agency (IEA) data shows that China remained an important importer of Russian oil, receiving an average of 1.9 million barrels per day (b/d) in 2022, while Turkey doubled its imports year on year to around 400,000 b/d. India became a crucial new customer by importing an average of 0.9 million b/d in 2022. In February 2023, India purchased a record 1.8 million b/d from Russia, becoming the largest buyer of Russian oil and increasing its share in domestic imports from less than 1% in 2021 to 39%. As recently as January this year, the EU received 600,000 b/d from Russia (down from an average of 1.8 million b/d in 2022), two-thirds of which came via the Druzhba pipeline. Compared to the high market prices for the reference Brent crude, Russian Urals crude sold at a discount of more than $30 per barrel, which still guaranteed revenue for Russia. According to IEA estimates, Russia's average revenue from oil exports increased from $16.4 billion per month in 2021 to $18.1 billion in 2022.

Only the recent entry into force of sanctions and price caps has changed the situation. With the average Urals price in January this year still below the cap ($49.50), Russia's oil trade revenues were 36% lower, year on year, in January, according to IEA estimates. The European Commission suggests that the restrictions are costing Russia around $174 million per day. In response and because of the reduced predictability of the oil market situation, Russia

announced a cut in oil production of 500,000 b/d from March this year.

Doubts about Secondary Sanctions. Russia's veto on the UN Security Council rules out the possibility of universal sanctions on it. In order to tighten existing restrictions, the only option would be for the coalition of states to impose secondary sanctions to threaten third-country companies buying Russian oil with repercussions. This solution has proven effective in the case of the U.S. sanctions on Iran since 2018 by limiting that country's oil export revenues. In the case of Russia, however, this solution will not work.

The reasons are, first, because their introduction and enforcement would be politically difficult and costly. Countries importing Russian oil could be uncooperative in their implementation due to the potential for economic gains and would accuse the West of acting unilaterally. For example, India, which imports about 84% of its raw materials, will not stop buying cheap oil regardless of external pressure and or threat of sanctions. The increased pressure would only lead to a deterioration of relations with the U.S. and the EU and halt cooperation in other areas.

Second, a reduction in the supply of Russian oil without the provision of alternative sources would adversely affect the international market for energy carriers and hit importers of raw materials, including the EU. It would lead to anti-Western sentiment in the Global South and a slowdown in the world economy.

Third, secondary sanctions have traditionally been criticised by the EU. A change of position would undermine credibility and trust in the Union among its partners. Therefore, possible new solutions must focus not only on sanctions but also on incentives for importers to switch to alternative suppliers to Russia.

Possible Solutions. The simplest way to reduce Russia's oil trade revenues would be a gradual, further reduction of the price ceiling to the break-even point for production (around $25-30 per barrel). However, achieving the political consensus for such a steep reduction seems unlikely for economic reasons (including the economic consequences for developing countries), and any reduction in the threshold must be accompanied by other undertakings.

Steps must be taken to increase the global oil supply from other sources to maintain price stability and gradually push Russia out of the market. Non-OPEC+ countries such as the U.S., Canada, and Norway have already increased production and seen record exports, but their capacity is limited. The IEA expects global supply growth of 1.9 million b/d in 2023 (driven mainly by the U.S., as well as by Canada, Brazil, and Guyana) to be constrained by a decline in OPEC+ production (in the order of 870,000 b/d) due to sanctions on Russia and the desire to maintain high crude prices.

It is important to harness the production potential of other oil cartel countries, including Saudi Arabia, which is currently limiting output to less than 10 million b/d and theoretically has a sizable margin of up to more than 2 million b/d, and Iraq, which is increasing production from around 2.5 million b/d in 2022 to more than 4 million b/d by March this year). Although the Gulf countries have so far rejected pressure from the West, perhaps concerted action by a broader coalition of importers (U.S., EU, China, India) would bring a change in OPEC policy.

Another option would be for countries sanctioned by the West to increase their oil exports. Iran exported 2.8 million b/d before 2018 and was the third-largest supplier to India (which imported 0.5 million b/d of Iranian oil). Allowing India to import oil from the geographically closer Iran would be economically attractive and would deprive Russia of a major new market. To this end, the U.S. may consider introducing specific exceptions for Iranian exports to selected importers (e.g. India, China, Japan), as it did in 2018. This solution seems unlikely at the moment, however, in the context of the Iranian authorities' violent crackdown on public protests and regime-sponsored repression in 2022, as well as Iran's arms sales to Russia. However, talks on the terms of granting an exception could allow for an improvement in the West's relations with Iran, weaken its cooperation with Russia and lead to unblocking the nuclear deal talks. It would be easier to reduce sanctions on oil exports from Venezuela, with which there is a slow thawing of relations, but its impact would be less significant given the limited production capacity of its oil sector, neglected for years.

Conclusions and Recommendations. The slow implementation of sanctions on Russian oil imports in 2022 has allowed Russia to find alternative markets in Asia where there will still be increased demand for cheap crude for years to come. The Western response to make sanctions more effective should focus on further lowering the price ceiling on Russian oil and on diplomatic pressure on importers to reduce their purchases from Russia. Also, pressure should be put on exporters to increase the supply of crude in global markets, promoting price stability. It is also necessary to rigorously enforce other restrictions, such as sanctions on the sale of oil extraction technologies, and to increase market transparency, for example limiting the possibility to circumvent sanctions for the so-called shadow fleet, that is, vessels acquired by Russia to transport its crude. While some solutions, such as limiting sanctions on Iran, may be politically costly, without reducing Russia's oil export revenues, it will not be possible to exert enough pressure on the already destabilised Russian economy to reduce funding for aggression against Ukraine.

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