U.S. DEPARTMENT OF THE TREASURY

Remarks by Assistant Secretary for Economic Policy Ben Harris on the Russian Energy Price Cap at the American Enterprise Institute

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ASSESSING THE TWIN GOALS OF THE PRICE CAP

A year ago, Russia illegally invaded Ukraine and roiled energy markets. With higher energy prices, Russia was profiting from and funding its own war of choice. This situation was unacceptable.

This situation left the West with a historic economic policy challenge: we needed to stop Russia from profiting on its war, but also needed to keep global energy markets well-supplied and stable. In a basic Economics 101 framework, those two goals are in direct tension. But in consultation with our allies, we devised the price cap policy to meet those two seemingly conflicting goals. If Russian shut in a large fraction of its oil, as markets expected would happen under the EU's 6th sanctions package, emerging market countries would be susceptible to shocks in the market. And, again, the remaining Russian exports would be sold at higher prices, allowing them to maintain a high level of revenues.

How were we able to design a policy that keeps that supplied product on the market while denying revenue to its supplier? The bottom line is that our Coalition dominated the market for services that support the Russian oil trade. The key to understanding how and why the price cap policy works is to recognize that our Coalition is one of service providing countries, not importing countries. In fact, Coalition countries have largely banned the import of Russian oil into our own countries. Instead, we are conditioning the provision of services vital to the shipping of oil – such as insurance, reinsurance, and trade financing – on the price of oil. Historically, the vast majority of this trade relied on Coalition services. So, if Russian exporters or Asian importers want to use best-in-class G7 companies to help facilitate trade, they have to agree to the price cap. This is different than our other sanctions regimes. Normally, we impose prohibitions on certain transactions or activities involving particular people, entities, goods, or countries. But here, with the price cap, we do not want to prohibit transactions on Russian oil. Just the opposite, we want to ensure it stays on the market—but with a capped price to prevent Russia from earning windfall profits. When we socialized this plan last summer with industry and in Europe, people told us we were misguided and that we could only accomplish one goal: either shut in Russian oil to attempt to reduce Russian revenues or let the trade continue unrestricted. Now, many market participants acknowledge that it's working.

A few months into implementation, we are optimistic about the progress we have made in achieving both of our goals, according to international and industry partners. First, it is undeniable that Russian oil revenues have fallen precipitously. Senior Russian economic officials, including the Finance Minister and central bank, have openly acknowledged the price cap is hurting their ability to fund their war. According to the Russian Ministry of Finance, federal government oil revenues in January 2023 were nearly 60 percent lower than March 2022. Second, we have institutionalized a discount on Russian oil. Before Coalition sanctions, Russian oil traded as a global commodity. Now, Russian oil sells at a discount of around $30 from the global benchmark Brent price. We have institutionalized this discount to the extent that Russia changed its tax scheme such that it now assesses the taxable price of oil as a set discount from Brent rather than the market price of Russian Urals. In addition, a discount exists for trades outside the cap – those that do not use any Western services – because we have provided strong leverage to importers to negotiate discounts.

While reducing Russian revenues, our price cap policy has also maintained market stability. The policy and cap levels are designed to keep an economic incentive for Russia to keep selling its oil. Russian exports have been consistent at around 3 million barrels per day and global markets have been steady. This is in stark contrast to market expectations last summer. Many outside analysts feared that in the absence of a price cap on crude oil, we could see prices spike to over $150 per barrel, more than twice the current price. And again, our price cap has left Russia with no good options. It is incentivized to sell into the price cap, but at a discounted price. So even as Russia announced a modest crude oil production cut, global energy markets have remained stable, as markets have largely anticipated the cut and attributed it to Russia's inability to find buyers.

ASSESSING IMPLEMENTATION

Given this progress on both goals, we believe the price cap has been successfully implemented to date. Further, we believe that speculation around potential evasion is unsupported.

To understand how the price cap is working, it's important to parse through the three types of transactions that can occur.

First, using one public report as a benchmark, about 75 percent of the trade of Russian seaborne oil occurs outside of the price cap. That means no Western services are involved in the transaction and, therefore, these trades do not violate or evade sanctions. The Coalition's actions have given importers significant leverage to negotiate discounts on these trades, so we are still denting Russian revenues even though these trades occur outside the price cap.

Within the remaining estimated 25 percent of transactions that use Western services and are under the price cap, there are two types of trades. One type of transaction involves only Western services providers, so, for example a Greek ship and British insurers and banks. A second type of transaction could involve a mix of Coalition services providers and non-Coalition service providers.

There has been speculation in the press that transactions under the price cap with Russian ships may be violating the price cap. The theory is that Russian shipowners are capturing elevated freight rates and, in turn, kicking back some of that money to the Kremlin. None of this public speculation has provided hard evidence of price cap violations. We have seen no evidence of this occurring, and, with our Coalition, we are monitoring compliance and potential evasion.

And to be clear, what we do know is that price cap trades with potentially Russian-affiliated shipping companies only represent a small fraction of total trades of Russian oil. Consequently, we believe it’s an unsubstantiated claim that the price cap has not been successful just because there is unsubstantiated speculation regarding a small fraction of trades. What we know and what is indisputable is that through our actions, we have dented Russian oil revenues and that there have been no shocks to global energy markets.

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