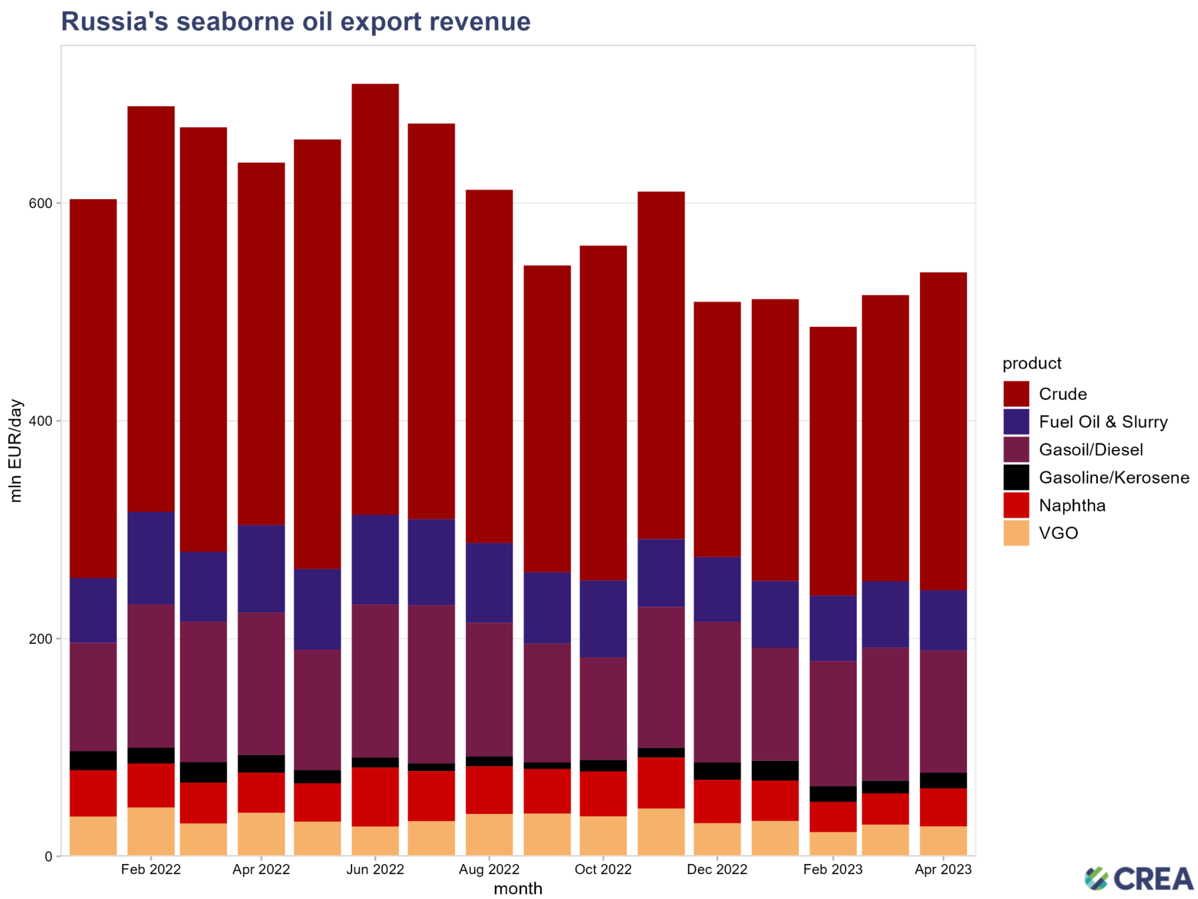
Russia's oil revenue rebounds in March–April as price cap enforcement and review are failing

Key findings

- Russia's oil export revenue rebounded in March–April from levels reached in January–February 2023, rising to the highest level since November. Export earnings fell substantially in the first months since the EU's crude oil import ban took effect in early December.
- The rebound was driven by an increase in export prices, enabled by the failure of the U.S., EU and other price cap coalition countries to lower the level of the caps, contrary to the policy, and due to failures in enforcing the crude oil price cap.
- Reported prices for Urals crude rose above the price cap in April, but European-owned and insured tankers continued to lift Russian oil, indicating that enforcement is not working. It has been apparent for months that enforcement of the price cap doesn't work in the Pacific trade from Russia's Far Eastern ports to China.
- The price cap coalition holds every advantage, as Russia continues to rely on European-owned and insured tankers for most of its oil exports. The share of tankers covered by the price cap in crude oil shipments out of Russia stayed around 54% in April. For oil products & chemicals, the coverage of the price cap coalition is above 60% which shows the strong leverage the policy has if price levels are lowered and enforced properly to reduce Russia's export earnings.
- Russia has made an estimated EUR 58 bln in export revenue on seaborne oil since the EU import bans and the price caps entered into force, with the majority of this oil carried on European-insured or owned tankers. Russian revenues could have been slashed by EUR 22 bln (37%) by setting the price cap for crude oil at USD 30 per barrel and revising the caps for oil products accordingly.

- Unless the price cap coalition takes action, changes to Russia's oil taxation structure will force the price of Russian crude oil closer to international benchmarks, leading to further recovery of Russia's oil revenue, which would damage the impact and credibility of the sanctions.
- Strengthened enforcement of the price caps and lower price cap levels are needed if the architects of the oil price cap policy want it to function as a credible policy and to lower Russia's oil export revenues. Lowering the price cap would reduce inflationary pressure on oil prices, a key objective for policy makers, as well as limit Putin's ability to fund the war.



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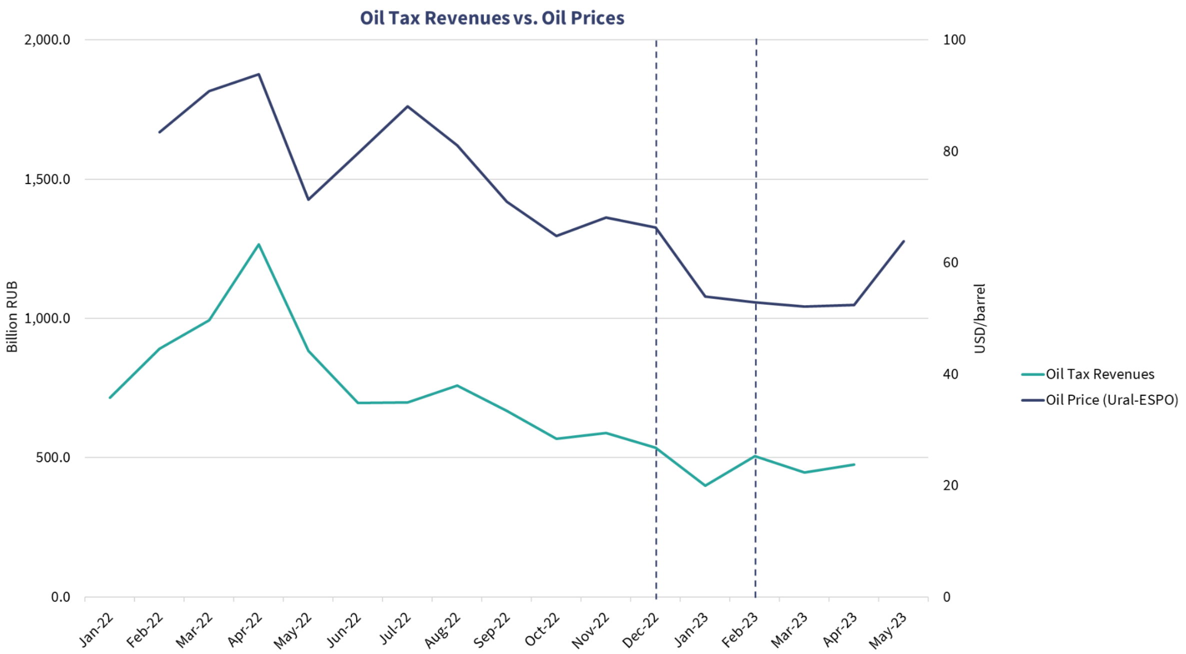
Russia’s oil export revenue climbed 14% from February to April

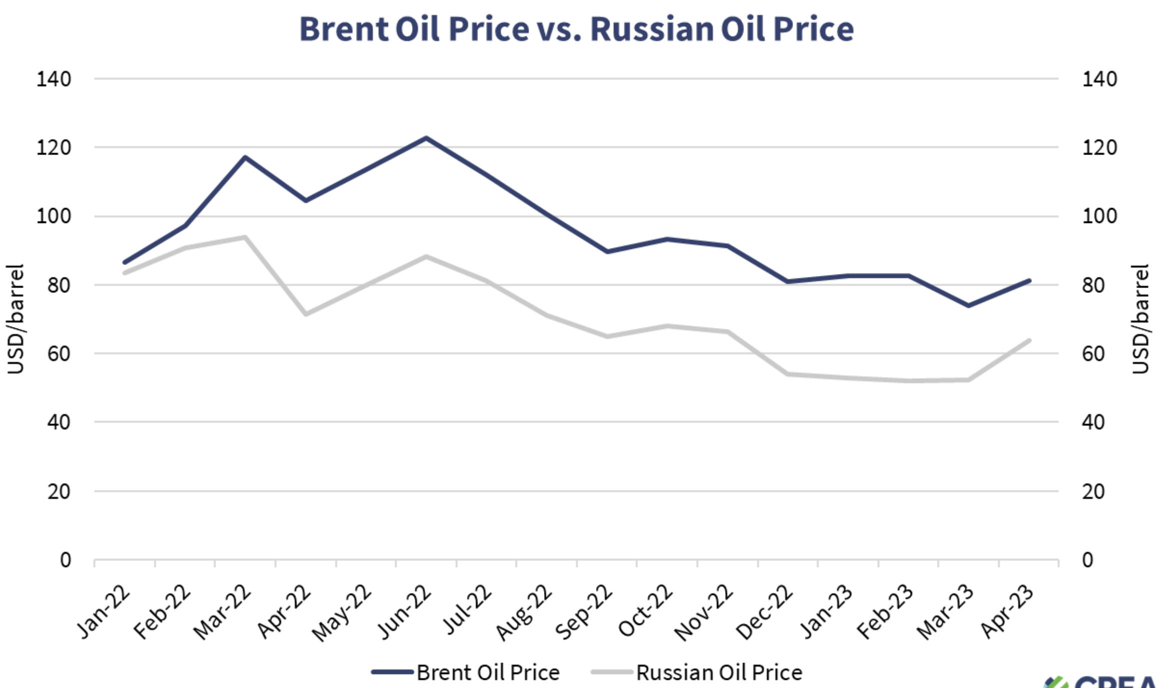
Russia’s oil export revenue rebounded in March–April from levels reached in January–February 2023, rising to the highest level since November. Export earnings fell substantially in the first months since the EU’s crude oil import ban took effect in early December, compared with the preceding months.

The rebound was due to an increase in export prices, enabled by the failure of the U.S., EU and other price cap coalition countries to review the level of the caps, and due to failures in enforcing the crude oil price cap. The failure to lower the crude oil price cap is in express violation of the EU price cap regulation. Russia’s oil tax revenue rose 6% month-on-month in April, due to the increase in export revenue in March, but remained significantly below the same month of 2022 when oil prices spiked following Russia’s invasion of Ukraine.

Oil tax revenues proxied by the combined mineral extract tax (MET) and export duty (ED), representing the vast majority of oil and gas tax revenues, declined by 26% month-on-month in January 2023 and by 44% against the same month of 2022. The introduction of the oil price cap in December 2022 led to a widening of the Urals price discount reflected in lower tax collected from oil sales in the following months at roughly similar monthly volumes. However, oil tax revenues bottomed out in January and recovered from that level in the following months on the back of higher monthly sales volumes in January and March 2023. The tax receipts from oil sales reported monthly cover the volume sold for the previous month. Furthermore, the Russian state is adapting to the current oil price caps by changing the tax regime to diminish the impact of the price caps: the new tax regime limits the discount at which it can sell oil starting with April 2023. The oil and oil tax revenues in April 2023 are 6% higher than those of March 2023 and 19% higher than those of January 2023. Absent a lower price cap, we can expect Russia to successfully claw back revenue this year given the changes in the tax code and higher taxes applied to oil producers. This would provide the Kremlin with additional funding for its war against Ukraine and risk prolonging the war.



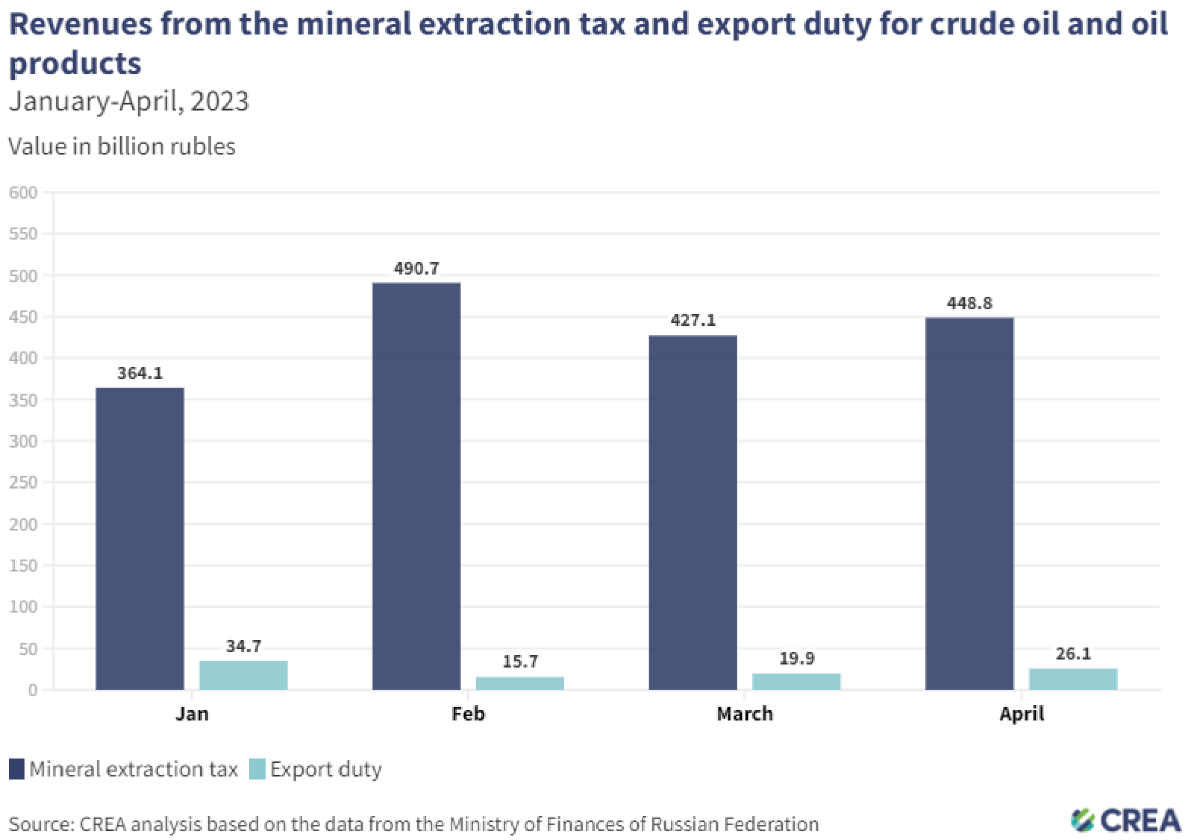
Source: CREA analysis, Russian Ministry of Finance data.
The dotted lines represent the introduction of the oil price cap (December 5th, 2022) and oil products price cap (February 5th, 2023). Oil tax revenues combine the revenues from the mineral extraction tax (MET) and the export duty (ED). OIl price is the weighted average price of Urals and ESPO blends and is forwarded one month.



Source: Bloomberg Data, CREA Analysis

The Kremlin's tax revenue has closely followed prices for Russian crude oil which outlines the importance of the oil price cap: it could and should work effectively to lower the price of Urals and widen the discount between Russian oil and the global benchmark oil price.

The revenue collected from the mineral extraction tax (only crude oil) in January-April 2023 was RBs 1730.7 bln or 50% less than during the same period in 2022 when RBs 3474.7 bln was collected. However, according to the latest data from the Ministry of Finance, the mineral extraction tax on crude oil, recorded a 5% rebound in April compared to March, rising from RBs 427.1 bln to RBs 448.8 bln.



In the first four months of this year, Russia collected RBs 96.4 bln from export duties for crude oil and oil products. April recorded a 31% increase in export duties compared to March. Overall, growth in export duty is recorded for the first time since the beginning of

February, highlighting the need for sanction imposing countries to implement measures that will prevent Russian tax revenues from climbing further.

Jump in oil prices exposed gaps in the enforcement of price caps

The price cap policy had a good start but has since lost traction, integrity and credibility: the price cap level has not been revised down, breaking the EU commitment to review the price cap every two months and to set the it at a level that is "5% below the average market price for Russian oil and petroleum products". In addition, reported prices for Urals crude rose above the price cap in April, but European-owned and insured tankers continued to lift Russian oil, indicating that enforcement is not working.

It has been apparent for months that enforcement of the price cap doesn't work in the Pacific trade from Russia's Far Eastern ports to China. Analysis from Global Witness shows that ESPO prices were above the set oil price cap level of USD 60 per barrel for crude oil during December and January (ESPO priced at USD 76 per barrel) while vessels owned or attaining their maritime insurance within the price cap coalition countries were showing up at Russian ports to transport Russian oil. Global Witness' findings outline that the opaque design of the oil price cap allows companies in sanction imposing countries to continue enabling the transport of Russian crude oil above the set price cap level with little concern of penalties associated with violating sanctions.

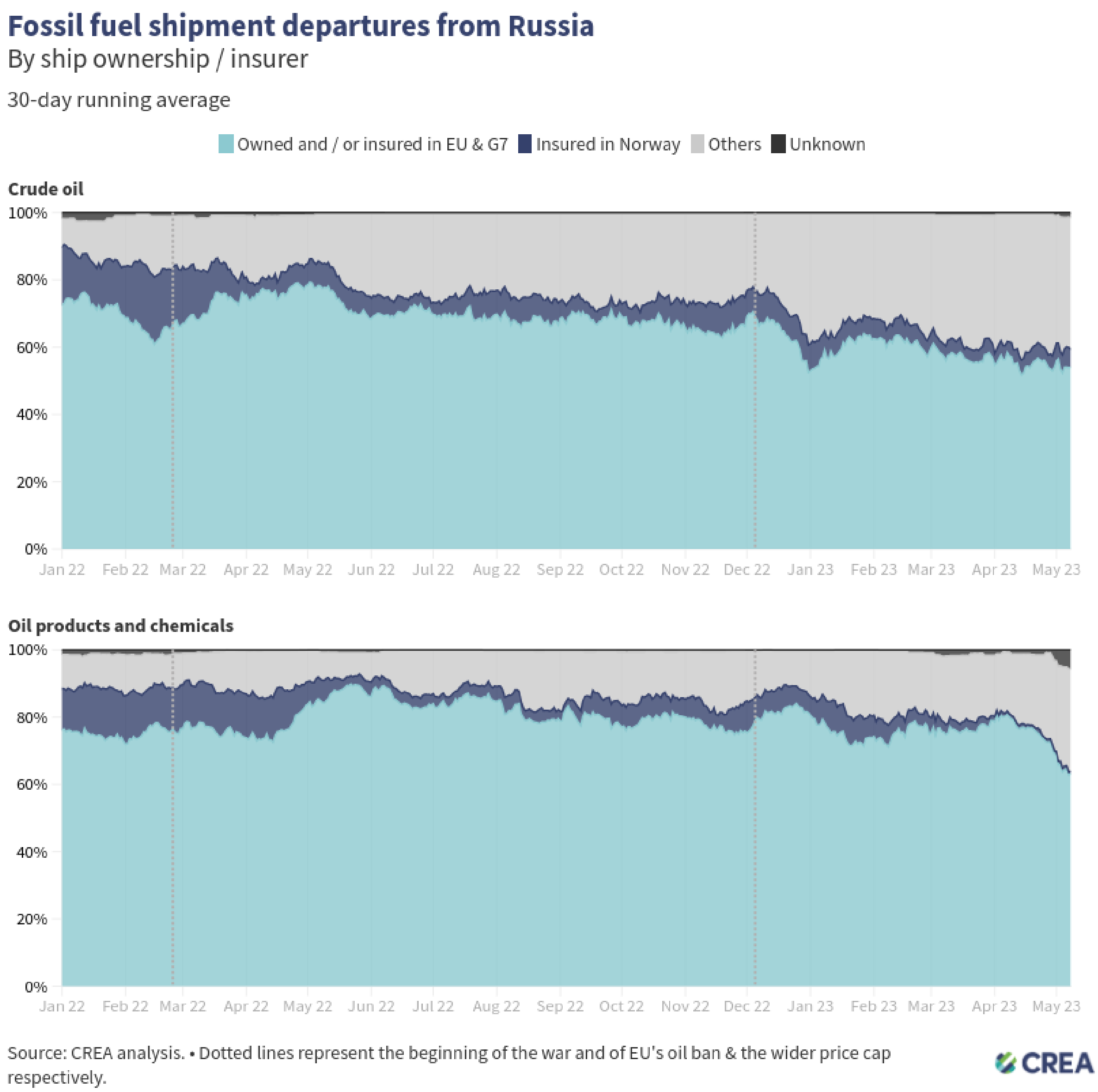
There is considerable uncertainty over the average price at which Russian oil is sold and the spread of transaction prices around the average. Prices have been gauged through surveys of involved traders, but in the new situation, the price surveys have become harder or impossible to carry out with good coverage. However, Russia's tax revenue has followed the reported prices closely. Customs data from India and China indicates that buyers are paying prices well above the Urals benchmark, although still at a discount to Brent crude. Traders and exporters have every incentive to minimize selling prices, in order to reduce tax burden and feign compliance with the price cap, and it's hard to conceive of any reason to over-report. For all these reasons, there is no reason to assume that actual prices are lower than the reported benchmarks.

Urals crude oil spot price

USD / bbl

Source: CREA analysis. • Dotted gray lines represent the beginning of the war and of EU's oil ban & the wider price cap respectively. The dotted red line represents the price cap at 60 USD per barrel.

The price cap coalition holds every advantage, as Russia continues to rely on European-owned and insured tankers for most of its oil exports. The share of tankers covered by the price cap in crude oil shipments out of Russia stayed around 54% in April. For oil products & chemicals, the coverage of the price cap coalition is above 60%.

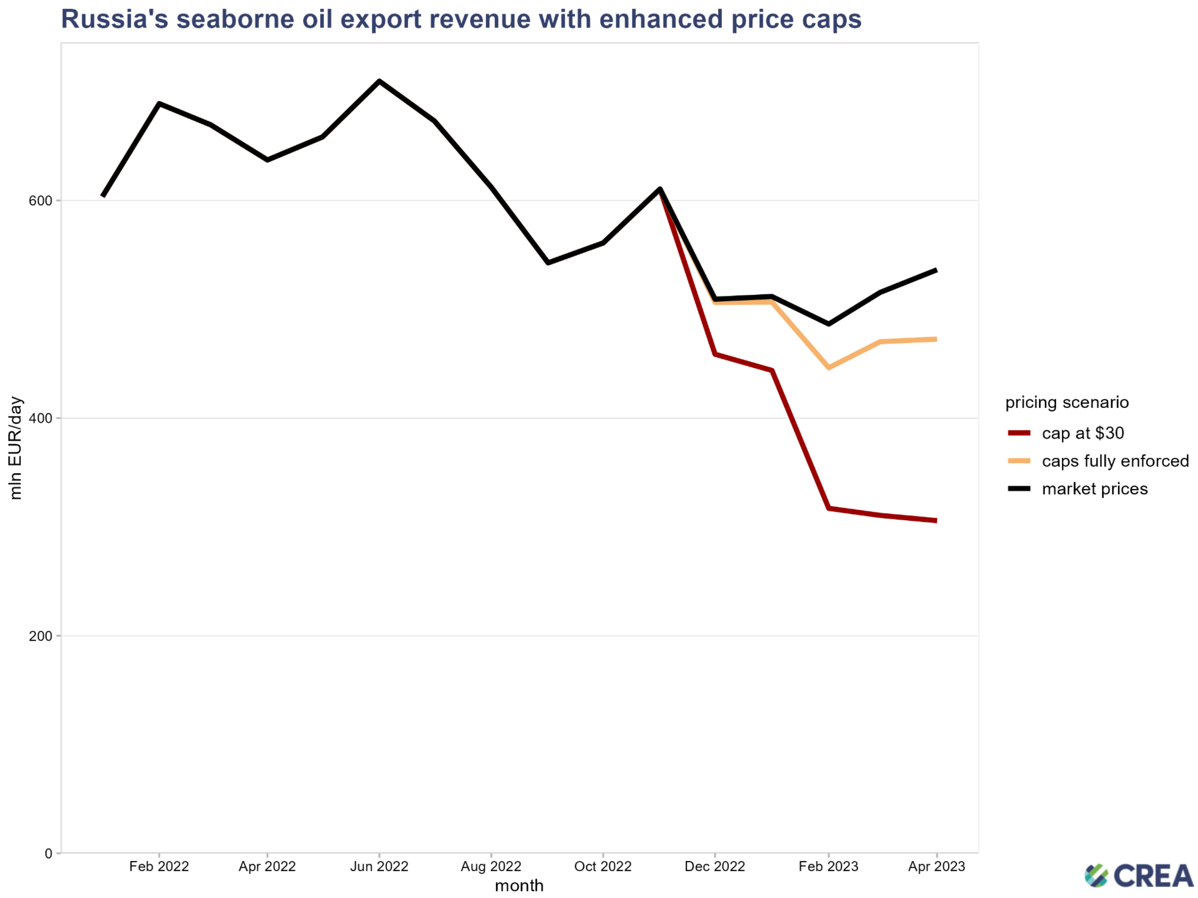


Russia has made an estimated EUR 58 bln in export revenue on seaborne oil since the EU import bans and the price caps entered into force[1], with the majority of this oil carried on European-insured or owned tankers.

The price cap coalition countries need to get a grip on their own policy to avoid losing the initiative in the sanctions game of whack-a-mole to Putin permanently. Without an effective price cap policy being enforced and adhered to, the price cap will be unsuccessful in its aim of lowering Putin's revenues to fuel the war against Ukraine. It would also

[1] This refers to exports of crude oil since Dec 5, 2022 and exports of oil products since Feb 5, 2023.

demonstrate to Putin that he has the initiative and the price cap coalition does not adhere to their own policy commitments.



As seen in the chart above, full enforcement of the price caps would have cut Russia's oil export revenue by approximately EUR 2 billion, or 12%, in April alone. More importantly, the failure in enforcement was an open invitation for Russia and OPEC+ to continue to manipulate the market with supply cuts. If the price cap for crude oil had been fully enforced and revised to USD 30 and for oil products to USD 25–35, Russia's seaborne oil export revenue could have been slashed by 43% (EUR 230 million per day) in April, given the share of the price cap coalition in tanker shipments out of Russia. USD 30 is a level closer to Russia's production costs, which average USD 15/barrel, while still comfortably above those costs, incentivising continued production.

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Putin's plan to bust the price caps: new oil tax

From April, Russia will implement its altered tax structure which overhauls the basis for its oil export taxation. Until April 2023, oil was taxed based on actual selling prices of Russian crude oil during each month. This meant that when Russian oil was selling at a discount from the Brent and other international oil benchmarks, the tax level would be set lower to allow oil producers to maintain profitability.

The new system specifies a maximum discount from the Brent oil price, starting at USD 34 in April and falling to USD 25 in July. This means that if the discount for Russian oil rises significantly higher than the Kremlin has stipulated, tax rates on oil production in Russia will rise to levels that make production unprofitable. This is Putin's attempt to reclaim control over Russia's selling prices for oil.

In early April, OPEC+ flexed its short term pricing power by cutting supply to target an oil price level above USD 80 per barrel which in the absence of a lowered price cap is going to boost oil tax revenues, due to higher overall oil price, that Russia uses to finance their invasion of Ukraine. The Russian Federation has taken notice of the increased discount for its oil following the oil price cap and tries to limit the losses due to the widening discount at which its oil is sold.

Unless the price cap coalition takes action to lower the price cap level and plug the enforcement gaps, changes to Russia's oil taxation structure will force the price of Russian crude oil closer to international benchmarks, leading to further recovery of Russia's oil revenue and wholesale failure of the price cap system.

On the other hand, the past months have demonstrated that lower selling prices for Russian oil led to higher export volumes, if anything. Due to the low production costs and tax revenue targets, oil supply from Russia is highly price inelastic or can even increase when prices fall as the government seeks to meet revenue targets. Lowering the price cap would therefore reduce inflationary pressure on oil prices, a key objective for policy makers, as well as limit Putin's ability to fund the war.

Policy recommendations

Strengthened enforcement of the price caps and lower price cap levels are needed if the oil price cap policy is to regain its credibility and continue to lower Russia's oil export revenues.

Coalition countries need to get a grip of the oil price cap policy. The policy's enforcement and bite need urgent fixing:

- permanently ban tankers that violate the price caps from entering EU and G7 ports or territorial waters.
- instead of relying on attestations, require copies of the underlying sales contracts. Alternatively, require either that payments be processed through an authorized intermediary, or that attestations can be allowed only from trading and financial entities on a pre-approved list established by the G7/EU sanction authorities to reduce the risk of fraudulent documentation.
- establish a dedicated Russian oil sanctions monitoring and enforcement authority that conducts regular monthly and extraordinary audits on the required paperwork.

The coalition should take back initiative from Putin and lower the cap closer to Russia's production costs which are estimated at around USD 15 per barrel. The above steps would demonstrate that the European and price cap coalition policy makers are interested in the dynamic improvement of sanctions rather than giving the initiative to the Kremlin.

If these approaches to improve the functioning, monitoring and enforcement of the oil price cap policy fail to gain approval within the price cap coalition, the EU should draw conclusions and withdraw from the price cap, replacing it with a full services ban so that European owned/insured ships can no longer lift Russian crude at any price.

About the data

To carry out the research, CREA researchers used Kpler data on the movements of thousands of cargo ships carrying fossil fuels and other cargo from Russian ports to the rest of the world, to track shipment destinations and volumes on a day-to-day basis. The tracking covers ship-to-ship transfers to the extent possible. The research also incorporates real-time data on gas flows to Europe via pipelines, and estimates other flows using historical monthly trade data and news reporting. To estimate the value of the imports, CREA developed pricing models that estimate the average value of Russian exports based on current spot market prices. For seaborne crude oil, reported Urals and ESPO price benchmarks are applied directly to exports out of Russia's oil ports in Western Russia and East Siberia, respectively. We also analyze data from the Ministry of Finances of the Russian Federation to produce summary figures and monitor changes in Federal tax earnings.

About CREA

Centre for Research on Energy and Clean Air (CREA) is an independent research organisation focused on revealing the trends, causes, and health impacts, as well as the solutions to air pollution. CREA uses scientific data, research, and evidence to support the efforts of governments, companies, and campaigning organisations worldwide in their efforts to move towards clean energy and clean air, believing that effective research and communication are the key to successful policies, investment decisions, and advocacy efforts. CREA was founded in December 2019 in Helsinki and has staff in several Asian and European countries. Our work is funded through philanthropic grants and revenue from commissioned research. In our statement of support for Ukraine, CREA absolutely condemns the Russian military's unprovoked and unjustified attack against another sovereign nation, Ukraine. The assault goes against the fundamental values of human well-being, safety, and dignity that our organisation seeks to advance. We urgently call for an end to the assault and stand in solidarity with the Ukrainian and Russian people calling for a just peace.