It’s not going to be easy for the G7 to cap the price of Russian oil

Legitimizing cheap Russian crude could boost sales and muddle the message on Ukraine

Western sanctions already had the perverse effect of increasing the energy profits financing Russia’s war in Ukraine — and the G7’s new plan to fix that by capping prices on Russian oil could also backfire.

On Tuesday leaders of the world’s advanced democracies put forward an idea that looks good on paper: Convince countries which so far haven’t been willing to boycott Russian oil to at least gang up and agree to only buy it at rock-bottom prices.

Moscow gets less cash, willing buyers still get cheap crude, and the overall global oil supply doesn’t shrink, meaning energy prices don’t spike.
G7 heads insist the price cap will punish Russia for invading its neighbor.

“We are working to make sure Russia does not exploit its position as an energy producer to profit from its aggression at the expense of vulnerable countries,” the G7 statement reads.

But such a scheme would be complicated to set up and onerous to enforce.

The idea is to allow Russia to earn enough to continue exporting, but too little to fund its war machine. Price cap proposals range from a few dollars above the so-called “break-even price” it costs Russia to produce a barrel of oil — which averages around $42, but for certain oil fields is as low as $10 — to using an average of last year’s global oil price of around $70 per barrel.

For comparison, the global benchmark Brent crude is currently around $112 per barrel, while Russian Urals crude trades at a $35 discount.

Making the cap work isn’t as simple as setting a price — it would involve dealing with insurance markets, oil distribution chains and a hefty dose of diplomacy with big buyers like India and China.

There’s also the risk of unintended consequences. Over the past four months, Western leaders have discovered that declaring Russian barrels off-limits — or just threatening to do so — has caused crude prices to skyrocket in anticipation of reduced global supply, leading to economic pain for countries respecting the ban.

Meanwhile, less-scrupulous buyers — notably India and China— have gotten the benefit of a discount on the shunned Russian barrels, while Moscow raked in record profits by selling less oil but at a higher overall price.

A cap could even make authorized cheap Russian oil a more highly sought-after commodity, which runs counter to the idea of shunning Moscow until it pulls out of Ukraine.

“Once you put a cap on Russian oil then you’re actually saying it’s not illicit, it’s legal, there’s no consequences for buying Russian,” said Brenda Shaffer, senior fellow at the Atlantic Council’s Global Energy Center and energy professor at the U.S. Naval Postgraduate School. “And if the price is lower, it’s the most attractive in the market and suddenly Russia is the darling of the ball everyone wants to dance with.”

Targeting tankers

It wouldn’t be enough to require open energy exchanges to sell Russian crude at the mandated price, because buyers and sellers could simply transact for Russian crude privately via confidential contracts.

That’s why G7 leaders are focusing on a “comprehensive prohibition of all services, which enable transportation of Russian seaborne crude oil and petroleum products globally, unless the oil is purchased at or below a price to be agreed in consultation with international partners,” the statement reads.

A senior EU official said the measure would target the finance, insurance and transportation of oil.

That would mean forbidding shipping insurers, the vast majority of which are in the EU and U.K., from extending protection to Russian oil cargoes.

“The way these crude purchases are transacted is that typically, a buyer doesn’t shell out $100 million for a cargo purchase — they put down a bit of a deposit themselves but the rest is provided by a bank in the form of a credit note,” said

Ajay Parmar, senior oil market analyst with ICIS.

Banks won't issue that credit note if the cargo isn't fully insured.

"And if you go to London for insurance and they say, 'Oh it's Russian crude, I can only insure it by X amount,' a buyer is not going to be willing to pay above the price per barrel that it can get insurance on because otherwise it is at massive financial risk," Parmar added.

Simone Tagliapietra, senior fellow at the Bruegel think tank in Brussels, warned of the possibility of a black insurance market, where the insurer "gets a piece of paper corresponding to the cap, but in reality the buyer pays the Russians into a separate bank account somewhere to get the oil."

Market meddling

But even if all goes well, there's still the matter of allocating the heavily discounted oil.

"Let's say there's this price cap of X, and it actually works — which buyers get access to this cheap Russian crude and which buyers have to go off and still pay the market price? How does that get decided?" asked Laurent Ruseckas, executive director at S&P Global Global Commodity Insights. "Or, if you're selling this capped crude oil at the price that's still being set by the market, that's a huge margin and a lot of money. Who's going to make a lot of money? I just think it doesn't fit easily with normal market principles."

There has been talk of using such profits to set up an aid fund for Ukraine — but a major obstacle to the price cap's success will be getting buyers of Russian crude — notably India and China— to participate in the scheme.

The senior EU official acknowledged the price cap only "works under certain conditions: if it's applied globally, if it's comprehensive, if you have those who control the markets [on board] … China is quite an important actor."

Parmar said India appears more willing to play along, but China "has not been willing to engage so far, and is obviously pretty unlikely to be joining in on any agreement with the West."

That would lead to a three-tier marketplace, according to the Atlantic Council's Shaffer. Buyers would choose between the normal global benchmark price, a low

authorized Russian crude price, and what Shaffer called a "gray market" price for illicit Russian barrels at an intermediate price, delivered and paid for using subterfuge tactics perfected by Iran and Venezuela to obscure the origin of the oil.

David Herszenhorn and Victor Jack contributed reporting.

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