

Price cap on Russian oil: EU eases sanctions on Russia

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On 2 December, the EU countries agreed to set a price cap of US\$60 per barrel on Russian oil as of 5 December (a price cap on petroleum products will be set later). The decision was adopted after agreement among the G7 countries, which – along with Australia – joined the mechanism.

The new ceiling changes the principles of the sixth package of EU sanctions against Russia adopted in June 2022, which in part concerns trade in oil and petroleum products. This package included an embargo on imports of crude oil exported by sea to EU member states (which came into force on 5 December 2022) and a ban on imports of petroleum products (which will take effect from 5 February 2023). In addition, the provision of maritime transport services, technical assistance, brokering services, financing or financial assistance related to the maritime transport of Russian oil and petroleum products to third countries was prohibited.

According to the decision taken on 2 December, if Russian oil is sold at a fixed price (or below it), it will be exempted from part of the above-mentioned third-country restrictions. The EU has also decided to undertake regular reviews of the price ceiling mechanism. This will be conducted by the Council, which should take into account the evolution of the situation on the energy markets (including in the EU itself), as well as what impact the mechanism has on reducing Russia's revenues from oil sales. It is assumed that the price cap should be at least 5% lower than the market prices for Russian oil and petroleum products (the average is to be calculated on the basis of data provided by the International Energy Agency). The first review is to take place by mid-January 2023, with subsequent reviews every two months.

The EU also agreed to introduce transitional periods in applying the price cap. Firstly, a period of 45 days has been established for vessels transporting oil originating from Russia which was purchased and loaded before 5 December 2022 and which arrived at its port of destination before 19 January 2023. Secondly, any oil transports carried out after a change to the price ceiling will be covered by a 90-day transition period.

The EU decision as published does not contain all the details concerning how the new mechanism will be applied. For instance, it does not indicate whether the price determined will include transportation costs, insurance, or possibly other elements making up the market value of the product. According to media reports, the European Commission is expected to provide more precise guidelines on how the new restrictions are to be applied in the coming days.

Commentary

- The EU's decision to introduce the price cap in fact represents a relaxation of previously adopted EU sanctions. This step was preceded by many months of negotiations, which revealed internal divisions on what form the restrictions should take. Some member states (including Poland and the Baltics) demanded that the price cap be set at a low level (US\$30 per barrel), while others (including Greece, Cyprus and Malta) lobbied for a price no lower than US\$70 per barrel. The more liberal stance was dictated by fears of negative consequences for the transport sector in these countries, as their fleets are used to a considerable extent in the export of Russian oil and petroleum products. Furthermore, it appears from the content of the adopted documents that the price limitations will only cover oil sold and exported via sea channels, that is, not to oil supplied via Russian pipelines (the Druzhba to Europe and the ESPO to China). According to media reports, the US government was particularly interested in introducing a high price cap. It feared the destabilisation of the global oil market, by moves including Russia withholding some of its oil exports; that could lead to a significant increase in oil prices, which in turn would aggravate the economic situation in Western countries.
- The price cap set by the EU countries does not seem to contribute to the key objective of reducing Russia's oil revenues. For one thing, it is currently higher than the price of Russian Urals oil sold at European ports. According to data published by Argus, Russian oil cost US\$48 per barrel at the port of Primorsk on 30 November; just under US\$53 at the port of Rotterdam, and just under US\$58 at the port of Augusta. However, the price cap is lower than the amount for which Russian-brand crude is sold in the Far East: there ESPO costs US\$73 per barrel, and oil extracted in Sakhalin goes for US\$68–70. Moreover, according to industry analyses, Russian oil exports will remain profitable even if the price of crude fluctuates between US\$25 and US\$30.
- It is unclear how non-EU and G7 countries will react to the new restrictions. In particular, the attitudes of China, India and Turkey will be significant, as they have become the main customers receiving the large quantities of oil which Russia used to sell on the EU market. For example, India has increased its purchases of Russian Urals from 1.5 million tonnes from January to October 2021 to almost 20 million tonnes in the same period this year. Turkey, in turn, has increased its imports from 2.9 million to 9.2 million tonnes over the same period. It is possible that these countries may be forced to some extent to adjust (at least partially) to the new mechanism due to the restrictions on the provision of EU transport, financial and insurance services to third-country counterparties. Insurance services are particularly sensitive to this, as 80–90% of their transactions are provided by entities registered in G7 countries.
- There is also some uncertainty as to Russia's potential ability to circumvent the price cap restrictions using a so-called shadow fleet (also referred to as a 'grey' or 'dark' fleet in some sources). Although Russia has already begun to develop this fleet – including with the use of vessels which had previously been used to transport sanctioned Iranian or Venezuelan oil – industry sources indicate that the scale of Russian demand exceeds supply in this area. Citing data from the Rystad agency, the *Financial Times* reported that Russia acquired 103 tankers during 2022: so if the remainder of the fleet remaining at Moscow's disposal is taken into account, Russian exporters will need an additional 60 to

70 tankers just to keep their exports at close to the current levels. Furthermore, it remains unclear whether the importers who do not join the price cap mechanism will be ready to import oil supplied by the so-called shadow fleet.

- Although the price cap as ultimately adopted in this form will not have a significant negative influence on Russia's financial and economic situation, it is very likely that Moscow will use it as a pretext for taking retaliatory steps, perhaps including restricting or cutting off oil supplies to those contracting parties which apply the price cap mechanism. Announcements of this nature were made by President Vladimir Putin in October 2022, and have been repeated several times by Deputy Prime Minister Aleksandr Novak and Kremlin spokesman Dmitry Peskov (5 December). Moscow could also resort to suspending exports of Russian oil via the Druzhba oil pipeline (which have formally been excluded from the EU embargo on oil imports, and thus from the price ceiling mechanism). Although that would incur further financial and reputational costs for Russia (as in the case of limiting gas supplies), it seems to be ready for this. The Kremlin's calculations may be based on the fact that a drop in supplies of Russian oil could lead to a drastic jump in oil prices and deepen the energy crisis in Europe, which would force Western countries to revise their sanctions policy towards Russia in the longer term.