

# The Russian oil price cap and its implications for India

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Russian aggression in Ukraine has unsettled the global energy system in a measure that countries that had set their respective net-zero targets in Glasgow to embrace cleaner fuels, have suddenly found themselves scrambling for both oil and gas supplies. Nations in Asia and Europe have accelerated their fossil fuel imports from Russia since the commencement of the conflict in Ukraine, with different long-term goals altogether. India and China have aimed to strengthen their partnership with Russia, while countries, particularly in the Group of Seven (G-7), seek to punish Russia for its war against Ukraine, either through an oil embargo or capping Russian crude oil prices.

Oil imports by India from Russia increased from almost nil in January and February 2022, to around 950 million barrels per day (mb/d) by June 2022<sup>1</sup>. Post oil price cap, which came

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1 Nidhi Verma, "Russia's share of India's June oil imports surges to record", *Reuters*, July 11, 2022, [https://www.reuters.com/business/energy/russias-share-indias-june-oil-imports-surges-record-2022-07-11/#:~:text=NEW%20DELHI%2C%20July%2011%20\(Reuters,provided%20by%20trade%20sources%20showed.](https://www.reuters.com/business/energy/russias-share-indias-june-oil-imports-surges-record-2022-07-11/#:~:text=NEW%20DELHI%2C%20July%2011%20(Reuters,provided%20by%20trade%20sources%20showed.)

into effect from December 5, 2022, India's imports from Russia continued to rise, registering 1.19 mb/d<sup>2</sup> and 1.27 mb/d<sup>3</sup> in December 2022 and January 2023, respectively. China, too, remained the top importer of Russian crude, surpassing its imports from Saudi Arabia, both in consecutive months of May and June 2022<sup>4</sup>. Its imports rose to 11.42 mb/d in November 2022, and fell slightly to 11.37 mb/d in December 2022.<sup>5</sup> Similarly, Europe, which aimed to import the maximum quantity of Russian oil before the European Union-wide embargo on Russian crude, which also came into effect on December 5, 2022, was importing over 1 mb/d of Russian oil.<sup>6</sup>

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- 2 "India's Russian oil imports top 1 million barrels a day in December," *Livemint*, January 15 2023, <https://www.livemint.com/industry/energy/indias-russian-oil-imports-top-1-million-barrels-a-day-in-december-11673762196458.html>.
  - 3 "India's import of Russian crude oil at record high in January", *Zee Business*, February 6, 2023, <https://www.zeebiz.com/markets/commodities/news-in-dias-import-of-russian-crude-oil-at-record-high-in-january-220750>.
  - 4 Chen Aizhu and Muyu Xu, "China extends record imports of Russian oil into June, cuts Saudi supply – trade", *Reuters*, July 6, 2022, <https://www.reuters.com/business/energy/china-extends-record-imports-russian-oil-into-june-cuts-saudi-supply-trade-2022-07-06/>.
  - 5 Russell, Clyde. "Column: Asia's crude oil imports hit record high, but it's not China", *Reuters*, February 2, 2023, <https://www.reuters.com/business/energy/asias-crude-oil-imports-hit-record-high-its-not-china-russell-2023-02-02/>.
  - 6 Irina Slav, "Europe Is Buying All The Russian Oil It Can Before Banning It", *Oil Price*, September 7, 2022, <https://oilprice.com/Energy/Energy-General/Europe-Is-Buying-All-The-Russian-Oil-It-Can-Before-Banning-It.html>.

## The Russian oil price cap and its implications for India

Figure 1: Russian oil Bought by India (mb/d)



Source: Vortexa Ltd.

On the other hand, the US, a net oil exporter, announced a ban not only on imports of crude oil and petroleum, but also coal and natural gas, from Russia, signaling a lesser dependency on imports of these fuels. Total US crude and petroleum product imports from Russia in 2000-2021 stood at 3 per cent and 20 per cent, respectively.<sup>7</sup> However, the post-pandemic growth and subsequently Russia's Ukraine invasion of February 24, 2020, did not spare the US and, indeed, put it in a rather tight spot. US recorded a sharp increase in its pump prices, which rose to an all-time high of USD5 a gallon<sup>8</sup> during the summer of 2022. The invasion also resulted in a sharp rise in Brent Crude, which soared to a 14-year high of USD139.13/

7 "The United States imports more petroleum products than crude oil from Russia", *U.S. Energy Information Administration*, March 22, 2022, <https://www.eia.gov/todayinenergy/detail.php?id=51738>.

8 Vandana Hari, "China and India should reject West's Russia oil-price cap plan", *Nikkei Asian Review*, August 1, 2022, <https://asia.nikkei.com/Opinion/China-and-India-should-reject-West-s-Russia-oil-price-cap-plan>.

barrel (bbl), and the West Texas Intermediate (WTI), which hit USD130.50/bbl in March 2022, before falling to USD85/bbl and USD80/bbl, respectively, on December 30, 2022.<sup>9</sup> Thanks to a surge in COVID cases and resultant recessionary fear, due to easing of China's zero-covid policy.<sup>10</sup>

Earlier, while the US, UK, and Canada announced a ban on Russian oil and the EU on sea-borne Russian crude by December 5, 2022, and petroleum products by February 5, 2023, the Biden Administration proposed a price cap on Russian crude imports. This, according to Treasury Secretary Janet Yellen<sup>11</sup>, "would enhance and strengthen recent and proposed energy restrictions imposed by the US, UK, Canada, and Europe, to limit Russian oil revenue, thereby weakening its economy and war efforts in Ukraine". This would also help control oil prices in a certain price range, benefitting all the oil-importing countries, while allowing Russia to still make some profits, and prompting it to produce oil without shutting its aging oil fields.

On September 2, 2022, G-7 countries vowed to urgently move towards a price cap on Russian crude imports, to which Russia retaliated by halting its gas supplies to Europe. Kremlin spokesman Dmitry Peskov announced, "Russian natural gas supply via the Nord Stream pipeline to Germany will remain

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9 "Crude oil prices increased in first-half 2022 and declined in second-half 2022", *U.S. Energy Information Administration*, January 4, 2023, <https://www.eia.gov/todayinenergy/detail.php?id=55079#>

10 "Payback time for zero-Covid: Why China's problems with the virus could be due to its hard approach to the pandemic", *The Indian Express*, December 25, 2022, <https://indianexpress.com/article/explained/explained-global/zero-covid-china-pandemic-rising-cases-8334223/>.

11 Christopher Condon and Danielle Bochove, "Yellen Says 'Stay Tuned' for Word on Russian Oil Price-Cap Plan", *Bloomberg*, June 21, 2022, <https://www.bloomberg.com/news/articles/2022-06-20/yellen-says-stay-tuned-for-word-on-russian-oil-price-cap-plan>.

## The Russian oil price cap and its implications for India

shut until the Western sanctions that impede gas turbine repairs are lifted.”<sup>12</sup>

At this stage, the Organization of the Petroleum Exporting Countries (OPEC) took a call on their oil production cuts every month, depending on the evolving market conditions. The main objective behind these exercises was, largely, to stabilize oil prices and prevent inflation from shooting up. However, due to the prevailing oil price levels, which went below USD80/bbl,<sup>13</sup> primarily due to recessionary fears, OPEC was not encouraged to increase oil production.<sup>14</sup> Recessionary fears, largely emanating from China’s zero-COVID policy and later, the easing of the COVID related restrictions, coupled with an economic slowdown in Europe and interest rates hikes to fight inflation in the U.S., created contradictory uncertainties in the oil market.

On December 3, 2022, the G-7 nations reached a consensus to limit Russia’s imports of oil priced over USD 60/bbl<sup>15</sup>, with the objective of reducing Russia’s oil earnings, while also being mindful of the possibility of increasing inflation. This, they believed, would force Moscow to reach a ‘culminating point’, where Russian troops run high and dry. Later, in order

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12 Max Seddon, David Sheppard and Henry Foy, “Russia switches off Europe’s main gas pipeline until sanctions are lifted”, *Financial Times*, September 5, 2022.

13 Charles Kennedy, “Oil Falls Below \$80 As Powell Warns A Recession May Be Looming”, *Oil Price*, September 23, 2022, <https://oilprice.com/Energy/Crude-Oil/Oil-Falls-Below-80-As-Powell-Warns-A-Recession-May-Be-Looming.html>.

14 Tsvetana Paraskova, “Further OPEC+ Production Cuts Could Be Looming”, *Oil Price*, September 6, 2022, <https://oilprice.com/Energy/Crude-Oil/Further-OPEC-Production-Cuts-Could-Be-Looming.html>.

15 Olof Konig, et, al., “G7 Sets Price Cap for Russian Oil at USD 60 Per Barrel”, *Baker McKenzie*, December 9, 2022, <https://sanctionsnews.bakermckenzie.com/g7-sets-price-cap-for-russian-oil-at-usd-60-per-barrel/>.

to assess the oil market conditions better, the group also agreed to review the oil price cap in March 2023.<sup>16</sup>

Given these developments around the Russia-Ukraine war, this paper investigates the G-7 proposal on Russian oil price cap restrictions more deeply, to assess its impact on the global oil market. It also examines the implications for India's future energy relationship with Russia.

### THE WAR AND THE PROPOSAL

The Russia-Ukraine war approaches a full year at the time of writing, and there seems no honest effort from either side, including Kiev's NATO supporters, to end the war. According to a joint assessment by the Government of Ukraine, the European Commission, and the World Bank, Ukraine's recovery and reconstruction need as of June 1, are estimated at USD349 billion<sup>17</sup> (Figure 2). On October 24, the World Bank declared an additional USD500 million to aid Ukraine in fulfilling its urgent expenditure necessities, which have arisen due to the Russian invasion.<sup>18</sup> So far, the World Bank has provided Ukraine with emergency funds totaling USD13 billion, including commitments, of which USD11.4 billion has already been disbursed.<sup>19</sup> According to this assessment, the Russian invasion has caused civilian casualties and infrastructural damage, displacing over 5.35 million Ukrainians by January 2023.<sup>20</sup>

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16 Timothy Gardner and Kanishka Singh. "G7 agrees to review level of price cap on Russian oil in March -US Treasury", *Reuters*, January 21, 2023, <https://www.reuters.com/business/energy/g7-agrees-review-level-price-cap-russian-oil-march-us-treasury-2023-01-20/>.

17 World Bank, Government of Ukraine and European Commission, "Ukraine: Rapid Damage and Needs Assessment", August 2022, p. 12.

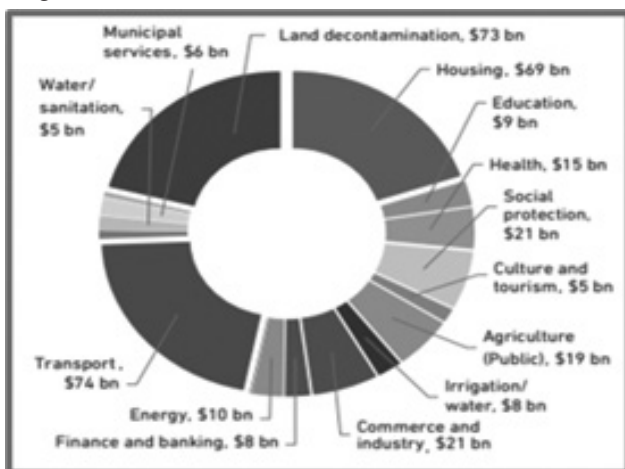
18 The World Bank, "World Bank Disburses Additional \$500 Million, the Latest Tranche of \$11.4 Billion Provided to Ukraine", October 25, 2022.

19 Ibid.

20 "Ukraine — Internal Displacement Report — General Population Survey Round 12, January 16-23, 2023," *Displacement Tracking Matrix, Global*

## The Russian oil price cap and its implications for India

Figure 2: Total needs as of June 1, 2022 USD349 billion



Source: The World Bank, Government of Ukraine, and EU

With the series of offensives<sup>21</sup> and counter-offensive<sup>22</sup> from both sides and neither side willing to blink first, the resultant impact has been felt across the energy markets and the global economy. President Biden's unexpected trip to Kyiv<sup>23</sup> to announce a fresh package of additional US weapons supplies worth USD500 million to counter Russian aggression has the potential to provoke Russia further. His visit could have the unintended consequence of a prolonged conflict as well,

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*Data Institute*, <https://dtm.iom.int/reports/ukraine-internal-displacement-report-general-population-survey-round-12-16-23-january-2023>.

21 "Russia Says Delivering 'Massive' Strikes On Ukraine Frontlines", *Livemint*, September 13, 2022, <https://www.livemint.com/news/world/russia-says-delivering-massive-strikes-on-ukraine-front-lines-11663064049124.html>.

22 "Ukraine retook 6,000 sq km from Russia in September: Zelensky", *India Today*, September 13, 2022, <https://www.indiatoday.in/world/russia-ukraine-war/story/ukraine-reclaims-territory-capturing-many-russian-pow-1999552-2022-09-13>.

23 Peter Beaumont Isobel Koshiv and Luke Harding. "Joe Biden visits Kyiv in major show of support for Ukraine", *The Guardian*, February 20, 2023, <https://www.theguardian.com/world/2023/feb/20/joe-biden-visits-ukraine-kyiv>.

causing more deaths, displacement, and economic and political instability in the region, with possible wider global security implications. These developments eliminate the possibility of Putin considering a ceasefire with Kyiv and, instead, escalate tensions to the point where the world is pushed towards the brink of a global conflict.

The G-7 proposals for an oil price cap were more flexible than Europe's Russian oil embargo that also came into force on December 5, 2022, as part of the EU's sixth sanctions package.<sup>24</sup> Under this proposal, insurance of Russian oil shipments would be permitted if the oil price does not exceed the cap.<sup>25</sup> In other words, the price cap calls for participating countries to deny insurance, finance, brokering, and other services to oil cargoes priced above the USD60 bbl price cap on crude, set by the EU Council on December 3, 2022.<sup>26</sup>

At the Group of 20 finance ministers and central bank governors meeting, which assembled in Bali, Indonesia, in July 2022, US Treasury Secretary Janet Yellen had declared, "Inflation is 'unacceptably high' – and a price cap on Russian oil is one of our most powerful tools to address the pain that Americans and families across the world are feeling at the gas pump and the grocery store right now."<sup>27</sup> She added, further,

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24 Sergey Vaculenko, "The Flaw in the Plan to Cap Russian Oil Prices", *Carnegie Endowment for International Peace*, September 8, 2022, <https://carnegieendowment.org/politika/87873>.

25 Ibid.

26 "EU agrees on level of price caps for Russian petroleum products", Council of the EU, 4 February 4, 2023, <https://www.consilium.europa.eu/en/press/press-releases/2023/02/04/eu-agrees-on-level-of-price-caps-for-russian-petroleum-products/#:~:text=On%20December%202022%2C%20the,oil%20at%20%2460%20per%20barrel>.

27 Rob Garver, "Yellen Pushes Plan to Cap Price of Russian Oil on Global Markets", *VOA*, July 15, 2022, <https://www.voanews.com/a/yellen-pushes-plan-to-cap-price-of-russian-oil-on-global-markets-/6659366.html>.



## The Russian oil price cap and its implications for India

that limiting the profits of Russian crude sales, “would deny [Russian President Vladimir] Putin the revenue his war machine needs... It will also aid in maintaining the global supply of oil, helping put downward pressure on prices for consumers in America and globally at a time when energy prices are spiking.”<sup>28</sup>

According to Charles Michel, President of the European Council, “We want to make sure the goal is to target Russia and not to make our life more difficult and more complex.”<sup>29</sup> His statement makes sense because strong economic recovery post covid and low investment in oil production have pushed oil prices up. The Russian invasion of Ukraine has only exacerbated the global oil market condition further. All these have sent the oil price to stratospheric levels, and which is now been passed over to consumers at the pump, across several countries, including the US. Despite the shale boom, the U.S. cannot be said to be as energy independent as it also gets impacted by the global energy market as any other country.<sup>30</sup> The US too repeatedly requests OPEC to adjust its oil production to keep the global oil prices stable, while also seeking G-7 support for the Russian oil price cap.

The oil price cap on Russian crude is believed to be effective only if China and India are taken on board. Instead, India and China have increased their Russian crude imports at

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28 Tsvetana Paraskova, “Is This The Only Way To Curb Russian Oil Revenues?”, *Oil Price*, July 16, 2022, <https://oilprice.com/Energy/Crude-Oil/Is-This-The-Only-Way-To-Curb-Russian-Oil-Revenues.html>.

29 Guy Chazan, Sam Fleming and David Sheppard. “G7 aims to hurt Russia with price cap on oil exports”, *Financial Times*, June 26, 2022, <https://www.ft.com/content/ee090a48-5407-496f-b0e4-1fe78f37495d>.

30 Colin Jerolmack and Amy Westervelt. “The Enduring Myth of America’s “Molecules of Freedom”, *Slate*, April 11, 2022, <https://slate.com/news-and-politics/2022/04/ukraine-war-american-fracking-natural-gas-exports-russia.html>.

steep discounts, signaling no support for this move of the G-7 grouping. Moreover, China's aggressive response to Pelosi's visit to Taiwan<sup>31</sup> with its unprecedented range of actions has closed all the doors for any negotiation with the US on the oil price cap.

### **RUSSIA'S OIL MATTERS**

Russia being the major player in the global energy market is the world's third-largest producer of petroleum and other liquids (after the United States and Saudi Arabia). Russia is the world's largest exporter of oil to global markets and the second-largest crude oil exporter behind Saudi Arabia. India imports a mix of crude grades from Russia, like the Urals, Siberian Light, CPC Blend, and East Siberia-Pacific Ocean (ESPO). However, India is buying more Urals crude as it suits most of its refineries. Urals Oil is a reference oil brand used as a basis for the pricing of the Russian export oil mixture. It is a mix of heavy sour oil from the Urals and the Volga region, with light oil from Western Siberia.<sup>32</sup> Urals considers the blend prices in the Baltic and Black Sea, including the cost of insurance and freight.

Russia's total crude oil reserves stood at 107.8 thousand million barrels (Figure 3). Russia had an annual average of 10.5 million barrels per day (mb/d) in total liquid fuel production in 2020. However, in January 2022, Russia's total oil production was 11.3 mb/d, of which 10 mb/d was crude oil, 960 thousand barrels per day (kb/d) of condensates, and 340 kb/d of Natural

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31 Jenni Marsh and Cindy Wang. "Here Are All the Ways China's Hitting Back Against Pelosi's Trip", *Bloomberg*, August 3, 2022, <https://www.bloomberg.com/news/articles/2022-08-03/here-are-all-the-ways-china-s-hitting-back-against-pelosi-s-trip#xj4y7vzkg>.

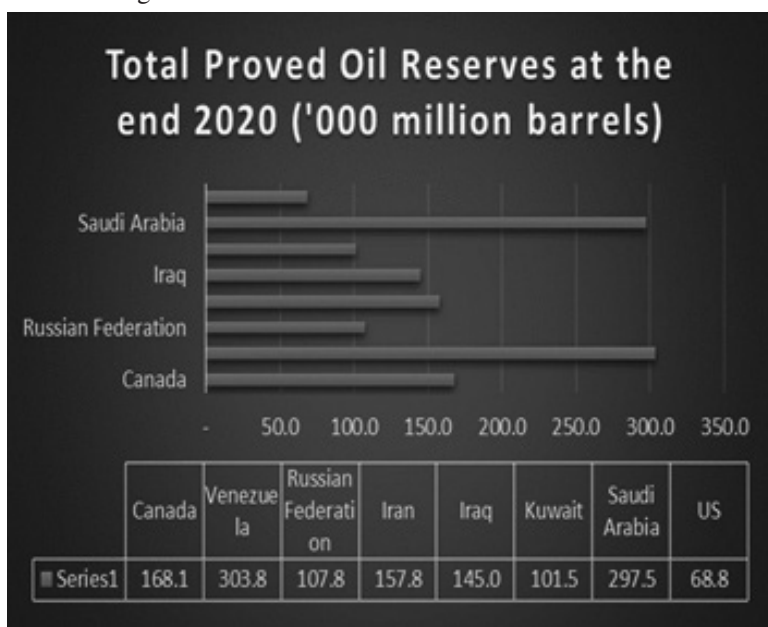
32 Trading economics. "Urals Oil". <https://tradingeconomics.com/commodity/urals-oil>.

## The Russian oil price cap and its implications for India

Gas Liquids (NGLs). Compared to this, US total oil production was 17.6 mb/d while Saudi Arabia produced 12 mb/d.

Russia relies heavily on revenues from oil and natural gas, which in 2021 made up 45 per cent of Russia's federal budget. In 2021, Russia exported an estimated 4.7 mb/d of crude, to countries around the world.<sup>33</sup> The crude imported to China, being the largest importer of Russian crude, accounted for 1.6 mb/d, while in Europe it was 2.4 mb/d.<sup>34</sup>

Figure 3: Total Proved oil Reserves at the end 2020



Source: BP Statistical Review of World Energy, June 2022

Russia's extensive crude export pipeline capacity allows the shipping of large volumes of crude directly to Europe

33 "Energy Fact Sheet: Why does Russian oil and gas matter?", *International Energy Agency*, March 21, 2022, <https://www.iea.org/articles/energy-fact-sheet-why-does-russian-oil-and-gas-matter>.

34 Ibid.

as well as Asia. According to US Energy Information Administration's (EIA) 2021 data, Russia exports around 5 mb/d of crude oil and 2.85 mb/d of other oil products, of which 671,000 barrels per day (bpd) or 13 per cent are received by the US and the remainder by Europe and Asia.<sup>35</sup> The roughly 5,500 km Druzhba pipeline system is the largest crude oil pipeline in the world which transports 750,000 bpd of crude directly to refiners in east and central Europe. Oil shipments via this pipeline are expected to be spared from the ban as Hungary along with other landlocked countries are not prepared for an oil embargo for the next couple of years.

Since 2014, sanctions<sup>36</sup> have been imposed by both the US and EU on Russia for its actions and policies in Ukraine, (On February 24, 2022, Russia launched an undeclared war against Ukraine, a country Russia first invaded and partially occupied in 2014) which has mainly affected Russian energy companies access to US capital markets and goods, services, and technology in support of deepwater exploration and field development.

However, since 2020, Russia has been actively coordinating with the OPEC+ countries and has signed an agreement to curb crude oil production in response to rapidly declining demand resulting from the COVID-19 pandemic.<sup>37</sup> On July 18, 2021,

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35 Mathew Smith, "Why Easing Sanctions Against Venezuela Would Be A Bad Move For The U.S.," *Oil Price*, March 8, 2022, <https://oilprice.com/Geopolitics/South-America/Why-Easing-Sanctions-Against-Venezuela-Would-Be-A-Bad-Move-For-The-US.html>.

36 CRS, "Russia's 2022 Invasion of Ukraine: Overview of U.S. Sanctions and Other Responses", *Congressional Research Service – Insights*, July 6, 2022, <https://crsreports.congress.gov/product/pdf/IN/IN11869>.

37 Eric Han and Candace Dunn, "OPEC+ agreement to reduce production contributes to global oil market rebalancing," *U.S. Energy Information Administration*, September 23, 2020, <https://www.eia.gov/todayinenergy/detail.php?id=45236>.

## The Russian oil price cap and its implications for India

OPEC+ agreed to begin increasing production quotas for the participating countries and to extend the duration of the OPEC+ agreement through the end of 2022. This resulted in an increase in Russia's production baseline from 11.0 mb/d to 11.5 mb/d starting in May 2022. This also allowed Russia's production quota to increase by 100,000 b/d per month beginning in August 2021.<sup>38</sup>

### RUSSIAN REVENUES UP DESPITE SANCTIONS

Russian budget is generally based on low oil prices as has been the case in 2021, with the Russian Finance Ministry projecting an oil price of USD45/bbl, compared to the average price of USD69/bbl.<sup>39</sup> Consequently, oil and gas revenues exceeded the initial expectations by over 51 per cent registering USD119 billion. Even for the 2022 budget, oil prices projected were USD44.20/bbl, with Russia's Ural recorded at USD72.78/bbl, indicating a high potential for increased production.<sup>40</sup>

However, after Moscow started, what it calls 'special military operations' in Ukraine on February 24, it planned to reinstate its budget rule to divert excess oil revenues into its rainy-day fund. Under this new rule, the Russian Finance Ministry proposed a crude oil price of USD60 per barrel

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38 Jon Gambrell, "OPEC, allies raise limits for 5 countries to end oil dispute", *Associated Press News*, July 18, 2021, <https://apnews.com/article/middle-east-business-health-coronavirus-pandemic-opecf3bed082ce6cb9353701bab9dc01429f>.

39 "Factbox: Russia's oil and gas revenue windfall", *Reuters*, January 21, 2021, [https://www.reuters.com/markets/europe/russias-oil-gas-revenue-windfall-2022-01-21/#:~:text=MOSCOW%2C%20Jan%2021%20\(Reuters\),of%20the%20country's%20total%20budget](https://www.reuters.com/markets/europe/russias-oil-gas-revenue-windfall-2022-01-21/#:~:text=MOSCOW%2C%20Jan%2021%20(Reuters),of%20the%20country's%20total%20budget).

40 Rosemary Griffin, "Commodities 2022: Russian crude oil output expected to rise despite demand concerns", *S&P Global*, December 22, 2021, <https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/oil/122221-commodities-2022-russian-crude-oil-output-expected-to-rise-despite-demand-concerns>.

and a daily oil output of 9.5 million barrels.<sup>41</sup> According to International Energy Agency (IEA), Russian oil revenues increased by USD700 million in June 2022 to USD20.4 billion on a month-on-month basis, which was 40 per cent above the last year's average.<sup>42</sup>

Notably, in the first 100 days of the Russia-Ukraine war, Moscow collected around USD100 billion from its energy export proceeds on global markets, 60 per cent of which came from the sale of crude oil and petroleum products. Also, in the first six months since the war started, Russian oil and gas revenues amounted to USD106 billion, compared to its planned budget of USD157 billion.<sup>43</sup> With a daily oil revenue of USD600 million, Russia was expected to make another USD140 billion by the end of 2022, as estimated by TS Lombard. However, in 2022, Russian oil revenues grew by 20 per cent to USD218 billion, as per the estimates from the Russian government and IEA.<sup>44</sup>

This has gone a long way in stabilizing Russia's economy despite a series of sanctions. While across the world nations were struggling to cope with high inflations, oil prices averaging over USD100/bbl (Figure 4) has helped Russia to sit on its sizeable cash reserves. This has helped the Russian government

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41 "Russia considers new budget rule, investment options, sources say", *Reuters*, July 19, 2022, <https://www.reuters.com/business/energy/russia-introduce-new-budget-rule-60-per-barrel-oil-vedomosti-2022-07-19/>.

42 "Oil Market Report – July 2022", International Energy Agency, July 2022, <https://www.iea.org/reports/oil-market-report-july-2022>.

43 Ekaterina Mereminskaya, "The bid to cap Russian oil prices The U.S. and its allies want to limit the price of Russian oil to hinder Moscow's ability to fund the war. Would that work?", *Meduza*, August 10, 2022, <https://meduza.io/en/feature/2022/08/10/the-bid-to-cap-russian-oil-prices>.

44 "How Russia is surviving the tightening grip on its oil revenue", *The Indian Express*, February 8, 2023, <https://indianexpress.com/article/world/russia-survive-tightening-grip-oil-revenue-8430866/>.

## The Russian oil price cap and its implications for India

to add USD9.5 billion to its emergency reserve fund to be used as a stimulus package to protect its economy from the impacts of Western sanctions and its military operations in Ukraine.<sup>45</sup> Thus, Russia has generated more money from oil than it did before the invasion of Ukraine mainly due to higher oil prices.

Figure 4: Road to USD100 per barrel



Source: The Times of India

Knowing that ports and shipping lanes would go off-limits and its exports to face logistical delays, to lock its future revenues, Russia is luring non-participating countries with long-term and fixed price contracts at deep discounts. For instance, Russia has offered India a Ural grade crude oil at a discount of USD35/bbl, given the lower appetite for oil elsewhere.<sup>46</sup> In this

45 “Russia adds \$9.5 bln to emergency reserve fund”, *Reuters*, June 9, 2022, [https://www.reuters.com/markets/europe/russia-adds-95-bln-emergency-reserve-fund-2022-06-09/#:~:text=June%20%20\(Reuters\)%20%2D%20The,and%20its%20actions%20in%20Ukraine](https://www.reuters.com/markets/europe/russia-adds-95-bln-emergency-reserve-fund-2022-06-09/#:~:text=June%20%20(Reuters)%20%2D%20The,and%20its%20actions%20in%20Ukraine).

46 “Russia offers oil to India at \$35/bbl discount from pre-war price”, *Live Mint*, April 2, 2022, <https://www.livemint.com/news/india/russia-offers-oil-to-india-at-35-bbl-discount-from-pre-war-price-11648704105136.html>.

regard Russia wanted India to take contracted volumes of 15 mb/d for 2022 itself.

However, to ramp up its oil war with Russia, the EU has imposed ban on Russian oil product exports with effect from February 5, 2023, just a couple of months after an oil price cap. The oil price caps set for discounted petroleum products is USD45/bbl and premium petroleum products is USD100/bbl.<sup>47</sup> So far, these cumulative sanctions by the EU have done little to significantly curb Russia's oil and gas production, as any loss of exports to the EU has almost been compensated by a ramping up of Russian oil exports to India, China and Turkey.<sup>48</sup>

As a result, according to the IEA, Russia's net oil production in January 2023 decreased by a mere 160,000 bbl/day compared to pre-war levels, and Russia managed to ship 8.2 million barrels of oil to markets across the globe.<sup>49</sup>

However, India would go back to its old sources of oil imports in the Middle East and Africa once shipping rates from Russia go up, shrinking discounts Russian crude further.

## **HOW WILL G7 PRE-MECHANISM WORK**

In a joint statement in early September 2022, finance ministers from the Group of 7 said the "initial" price cap would be based on a range of 'technical inputs and factors', agreed upon by countries that join the agreement by consensus. The coalition would be headed by a rotating coordinator from among

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47 Sam Meredith, "Europe is set to ramp up its oil war against Russia — and markets are bracing for more disruption", *CNBC*, February 3, 2023, <https://www.cnbc.com/2023/02/03/europe-is-set-to-ramp-up-its-oil-war-against-russia-with-products-ban.html>.

48 Elliot Smith, "Sanctions on Russian oil are having the 'intended effect' IEA says", *CNBC*, February 16, 2023, <https://www.cnbc.com/2023/02/16/sanctions-on-russian-oil-are-having-the-intended-effect-iaa-says.html>.

49 Ibid.



## The Russian oil price cap and its implications for India

the countries.<sup>50</sup> According to The Treasury Department's Office of Foreign Assets Control, as and when more countries would join the coalition, the price cap would be reset, constituting the next phase of the agreement.<sup>51</sup> According to this department, the cap would be a fixed price to facilitate frequent reviews, depending on the market volatility.<sup>52</sup> This would continue till the time Russia stops its aggression in Ukraine. The G7 price cap mechanism, which is set at USD60/bbl currently, is on these lines, which allowed a transition period of 45 days for vessels carrying Russian crude loaded before December 5 and unloaded at the final port of destination by January 19, 2023.<sup>53</sup> It has been agreed to review the price cap in March 2023 and thereafter, periodically, to adapt to market conditions, with a transition period of 90 days after each of those reviews.<sup>54</sup>

The stated goal of the price-mechanism continues to be to compel Russia to cease its aggression against Ukraine by targeting its oil industry in a manner that does not affect global oil supplies, while also maintaining Russia's oil revenues at a moderate level to incentivize continued oil production.

The price-cap would limit the availability of shipping and insurance services that facilitates the worldwide transport of Russian oil and the same would be mandated to only those importing countries that observe the above price ceiling of USD60/bbl.

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50 Alan Rappeport, "What Price Is Right? Why Capping Russian Oil Is Complicated", *The New York Times*, September 16, 2022, <https://www.nytimes.com/2022/09/16/business/russian-oil-price-cap.html>.

51 Ibid.

52 Ibid.

53 Olof Konig, et, al., op. cit.

54 CSIS. "Progress Report on EU Embargo and Russian Oil Price Cap", Centre for Strategic and International Studies, January 10, 2020, <https://www.csis.org/analysis/progress-report-eu-embargo-and-russian-oil-price-cap>.

Urals is priced at a discount to the international Brent benchmark and the G7 wants to keep that spread wide, to keep down Russian oil revenue. The price of Russia's Urals oil blends fell to an average of \$57.49/bbl<sup>55</sup> between November 15 and December 14, which is below G7's oil price cap of \$60/bbl. In mid-December, Urals crude hit a new low for the year 2022, trading at around \$53/barrel and at a discount of over \$25/barrel to Brent, mainly due to rising freight costs for tankers carrying Russian oil, as several shipowners refused to handle Russian oil due to the price cap implemented on December 5, 2022.

Russia would be pushed out of more than 90 per cent of the global oil shipment insurance market as most of the ports do not allow tankers to dock unless they have full insurance coverage. This includes insurance from the UK-based International Group of P&I Clubs, which handles 95 per cent of the global tanker insurance market consisting mostly of UK, US, and European insurers.<sup>56</sup>

Holding oil prices at a level closer to the cost of production and much below the current high market price would certainly impact Russia's finances while relieving inflationary pressure on several countries. However, the risk is that oil prices could shoot up very sharply as no other oil exporting countries would be able to fill this void as both Iran and Venezuela are yet to come out of their sanctions, particularly after China's coming out of tough COVID conditions.

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55 "Russia's Urals oil averaged \$57.49/bbl in past month, below price cap", *Reuters*, December 16, 2023, <https://www.reuters.com/business/energy/russias-urals-oil-averaged-5749bbl-past-month-below-price-cap-2022-12-16/>.

56 Tsvetana Paraskova, "Why The U.S. Is Desperate For A Russian Oil Price Cap", *Oil Price*, July 28, 2022, <https://oilprice.com/Energy/Energy-General/Why-The-US-Is-Desperate-For-A-Russian-Oil-Price-Cap.html>.

## The Russian oil price cap and its implications for India

In this regard, the IEA cautioned that the market would have to prepare itself for a loss of 2.4 mb/d. This would include 1.4 mb/d of oil and 1 mb/d of petroleum products off the market.<sup>57</sup> Moreover, the implementation of the price cap would need both India and China's consent to it, otherwise, the very purpose of containing Russia's aggression in Ukraine would be defeated.

### CHALLENGES IN OIL PRICE CAP

#### India's acceptance of the oil price cap

One of the biggest challenges that G-7 countries would face is to convince both India and China and make them to accept the Russian oil price cap. This is particularly the case with India as has been noticed in the Security Council voting, wherein most of the time India has abstained from voting and only once it voted against Russia that too on procedural issue, without compromising its neutral stand at the council.<sup>58</sup> All the G-7 countries appreciate the historic and time-tested relationship between India and Russia, which goes beyond just defence ties, to include, political, security, energy, trade and economy, science and technology, and culture.<sup>59</sup>

Given India's oil demand to increase in the future as well, it wants to have long-term arrangements and agreements with Russia to enhance its energy cooperation, including in the oil

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57 Charles Kennedy, "IEA: Russian Crude Ban Will Take 2.4 Million Bpd Off The Market", *Oil Price*, September 14, 2022, <https://oilprice.com/Energy-General/IEA-Russian-Crude-Ban-Will-Take-24-Million-Bpd-Off-The-Market.html>.

58 Palki Sharma, "India votes against Russia at UN Security Council", *Gravitas, Wion*, August 26, 2022, [https://www.youtube.com/watch?v=p-xpvq0\\_SQs](https://www.youtube.com/watch?v=p-xpvq0_SQs).

59 "India-Russia Relations", Ministry of External Affairs, Government of India, January 2022, <https://www.mea.gov.in/Portal/ForeignRelation/India-Russia-Relation-2022.pdf>.

sector. India's oil imports from Russia increased by ten times as later met India's around 10 per cent of total imported oil consumption. Both countries are set to strengthen their energy ties further with Russian companies planning to invest in India's renewables<sup>60</sup> and coal sector<sup>61</sup>.

Further, despite the Western sanctions on Russia, both countries are also gearing up to enhance trade by reinforcing of International North-South Transport Corridor<sup>62</sup> (INSTC) and paying Russian goods in Indian rupees<sup>63</sup>, given the extremely volatile Rouble.

Therefore, it is highly unlikely that India would concede to the demands of G-7 countries to put an oil price cap on Russian crude additionally, as India is already contributing to this cap, priced at a discount to the international Brent benchmark, though not in the range planned by the group. The G7 wants only wants to keep this cap spread wide, to keep down Russian oil revenue.

India is rather concerned about oil supplies in the market, largely due to supply constraints emanating from OPEC's frequent oil production cuts, non-supply of Iranian and Venezuelan crude and overall upstream under-investments in

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60 Sanjeev Choudhary, "Russia's rosatom to bet on Indian renewables markets", *The Economic Times*, September 14, 2022, [https://m.economictimes.com/industry/energy/russias-rosatom-to-bet-on-indian-renewables-markets/amp\\_articleshow/94185138.cms](https://m.economictimes.com/industry/energy/russias-rosatom-to-bet-on-indian-renewables-markets/amp_articleshow/94185138.cms).

61 Dipanjan Roy Chaudhury, "Russia's largest coal company in talks to set up India office", *The Economic Times*, September 11, 2022, <https://economictimes.indiatimes.com/industry/indl-goods/svs/metals-mining/russias-largest-coal-company-in-talks-to-set-up-india-office/articleshow/94125409.cms>.

62 Angelo Mathai, "India ramps up Russian trade volumes via north-south corridor", *The Loadstar*, August 23, 2022, <https://theloadstar.com/india-ramps-up-russian-trade-volumes-via-north-south-corridor/>.

63 Manoj Kumar and Nidhi Verma. "India's trade with Russia in rupees to start soon - trade body", *Reuters*, September 14, 2022, <https://www.reuters.com/markets/us/indias-trade-with-russia-rupees-start-soon-trade-body-2022-09-14/>.

the oil and gas sector. Moreover, the U.S. has warned Europe that its shale producers cannot bail out them by ramping up production of oil and gas during winters. These factors have further pushed India towards heavily discounted Russian crude to secure its growing oil needs.

### **Can Iran and Venezuela fill the void?**

Notably, when the Trump administration had asked India to cut down its heavily discounted crude imports to zero, India agreed to in return for costlier US crude oil to respect its relationship with the US. This time around with no surety of sanctions to be removed from Iran and Venezuela so soon, India has now looked around its old friend Russia to capitalise on the cheap crude on the offer.

In March, 2022, Iranian Ambassador to India Ali Chegeni offered to relaunch the rupee-rial trade mechanism to export oil and gas to India. The bilateral trade under this mechanism may help cross USD30 billion. However, the US sanctions resulted in a fall in India-Iran trade from USD17 billion in FY19 to less than USD2 billion in April-January in FY22.<sup>64</sup>

However, the new nuclear deal with Iran seems to be stuck for several reasons: Washington has kept the deal on the backburner, particularly after mass protest in Iran after the death of a 22-year-old woman, followed by renewed sanctions by the US.<sup>65</sup> Iran on the other hand, blamed the US for this unrest. Moreover, multiple rounds of new sanctions were also

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64 “After Russia, Iran offers oil to India, proposes revival of rupee-rial barter”, *ET Now*, March 19, 2022, <https://www.timesnownews.com/business-economy/economy/after-russia-iran-offers-oil-to-india-proposes-revival-of-rupee-rial-barter-article-90324533#:~:text=Iranian%20ambassador%20to%20India%20Ali,revive%20the%20rupee%2Drial%20trade>.

65 Maziar Motamedi, “Where does the Iran nuclear deal stand right now?”, *Al Jazeera*, February 20, 2023, <https://www.aljazeera.com/news/2023/2/20/what-exactly-happened-to-the-iran-nuclear-deal>.

imposed on Iran by the West for supplying drones to Russia for the war in Ukraine.<sup>66</sup> Besides, International Atomic Energy Agency said that they are “not in a position to assure that Iran’s nuclear program is exclusively peaceful”, as they didn’t find credible answers from Iran about the presence of nuclear material at three undeclared sites.<sup>67</sup>

On the other hand, the case for removing sanctions from Venezuela is even more complicated. Vladimir Putin received strong support from Venezuela’s President Nicolas Maduro<sup>68</sup>, who, while condemning destabilising actions of the US and NATO on the Ukraine issue, spoke out openly against a Western campaign of “lies and disinformation”.

During the period when Caracas was grappling with civil unrest and widespread corruption coupled with its economic collapse<sup>69</sup> resulting from a prolonged oil price slump, it was Russia<sup>70</sup> that came to the rescue of Venezuela, once the richest and most stable democracy<sup>71</sup> in Latin America. Venezuela

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66 Ibid.

67 “IAEA ‘cannot assure’ peaceful nature of Iran nuclear programme”, *Al Jazeera*, September 7, 2022, <https://www.aljazeera.com/news/2022/9/7/iaea-cannot-assure-peaceful-nature-of-iran-nuclear-programme>.

68 “Russia receives Venezuela’s ‘strong support’”, *France 24*, March 1, 2022, <https://www.france24.com/en/live-news/20220301-russia-receives-venezuela-s-strong-support>.

69 Dany Bahar and Meagan Dooley. “Venezuela refugee crisis to become the largest and most underfunded in modern history”, *Brookings*, December 9, 2019, <https://www.brookings.edu/blog/up-front/2019/12/09/venezuela-refugee-crisis-to-become-the-largest-and-most-underfunded-in-modern-history/>.

70 Mathew Smith, “Venezuela’s Oil Riches Are Quietly Falling Under Russian Control”, *Oil Price*, July 7, 2022, <https://oilprice.com/Energy/Crude-Oil/Venezuelas-Oil-Riches-Are-Quietly-Falling-Under-Russian-Control.html>.

71 Jason Margolis, “Venezuela was once the richest, most stable, democracy in Latin America. What happened?”, *The World*, February 7, 2019, <https://theworld.org/stories/2019-02-07/venezuela-was-once-richest-most-stable-democracy-latin-america-what-happened>.

## The Russian oil price cap and its implications for India

has the largest oil reserves with 304 billion barrels of crude oil. It has the potential to significantly lift ailing petroleum production, provided an estimated investment of USD175 billion<sup>72</sup> is made, to help Venezuela to restore its production to pre-crisis level.

Thus, these apprehensions surrounding Venezuela and the chances of removal of sanctions becoming remote, Venezuela would not contribute in any way towards recovery of the market any time soon.

### **Structural Flaw in oil price cap proposal**

The most important question that needed to be asked before the implementation of the Russian oil price cap rule is whether it would be practically possible to implement it effectively and if all the importers of Russian crude will be made to unite and agree on the stated price level. Some of the structural flaws in the oil price cap are as under.

1. Russia may counter cap price with floor price: At the time when G-7 agreed to put an oil price cap on Russian crude, they assumed that Russia will not retaliate, because the price that would be set will be as close to Russia's marginal cost of production of USD44/bbl, just to ensure that it is not profiteering. Russia in that way would be incentivised to keep producing oil, which otherwise would be a costly affair if it shut-in of production at home, while also losing other strategic markets elsewhere.

However, for the year 2022, Russian Finance Ministry had proposed a crude oil price of USD60/bbl.<sup>73</sup> Keeping the

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72 Mathew Smith, op. cit.

73 "Russia considers new budget rule, investment options, sources say", *Reuters*, July 19, 2022, <https://www.reuters.com/business/energy/russia-introduce-new-budget-rule-60-per-barrel-oil-vedomosti-2022-07-19/>.

price cap at or around the same price levels as estimated by G-7 countries is not acceptable to Russia, prompting them to halt their oil supplies. Russia has already announced that they would not resume gas supplies from Nord Stream pipeline until sanctions are removed completely, forging troubled winters for EU consumers.<sup>74</sup>

Russia has already banned oil supplies to countries and companies which have complied with the oil price cap.<sup>75</sup> In its response to the cap, Kremlin could set a floor price for its oil exports, triggering the oil price to move up sharply. Consequently, the buyer's cartel<sup>76</sup> would be prompted to knock on doors for Russian oil supplies. According to J.P. Morgan, if Russia slashes oil production by 5 mb/d to retaliate against the oil price cap, Brent prices could soar to a stratospheric \$380/bbl in the most extreme scenario.<sup>77</sup> Russia has already announced a cut of 500,000 barrels per day from March 2023 onwards, prompting Brent oil to shoot up immediately by 2.5 per cent at USD86.6 bbl/d.<sup>78</sup>

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74 Tsvetana Paraskova, "Russia Won't Restart Nord Stream Pipeline Until Sanctions Are Lifted", *Oil Price*, September 5, 2022, <https://oilprice.com/Energy/Energy-General/Russia-Wont-Restart-Nord-Stream-Pipeline-Until-Sanctions-Are-Lifted.html>.

75 Alexander Marrow and Vladimir Soldatkin. "Putin bans Russian oil exports to countries that implement price cap", *Reuters*, December 28, 2022, <https://www.reuters.com/business/energy/putin-bans-russian-oil-exports-countries-that-imposed-price-cap-decree-2022-12-27/>.

76 Sergey Vakulenko, "How Russia Could Thwart an Oil Price Cap", Carnegie Endowment for International Peace, July 5, 2022, <https://carnegieendowment.org/politika/87437>.

77 Joe Carroll, "J P Morgan Sees 'Stratospheric' \$380 Oil on Worst-Case Russian Cut", *Bloomberg*, July 2, 2022, <https://www.bloomberg.com/news/articles/2022-07-01/jpmorgan-sees-stratospheric-380-oil-on-worst-case-russian-cut#xj4y7vzkg?leadSource=verify%20wall>.

78 Vladimir Soldatkin and Olesya Astakhova. "Russia to cut oil output by 500,000 bpd in March", *Reuters*, February 10, 2023, <https://www.>