

The Russian Oil Price Cap Won't Work

Europe will inflict more damage on its own economy than Russia's

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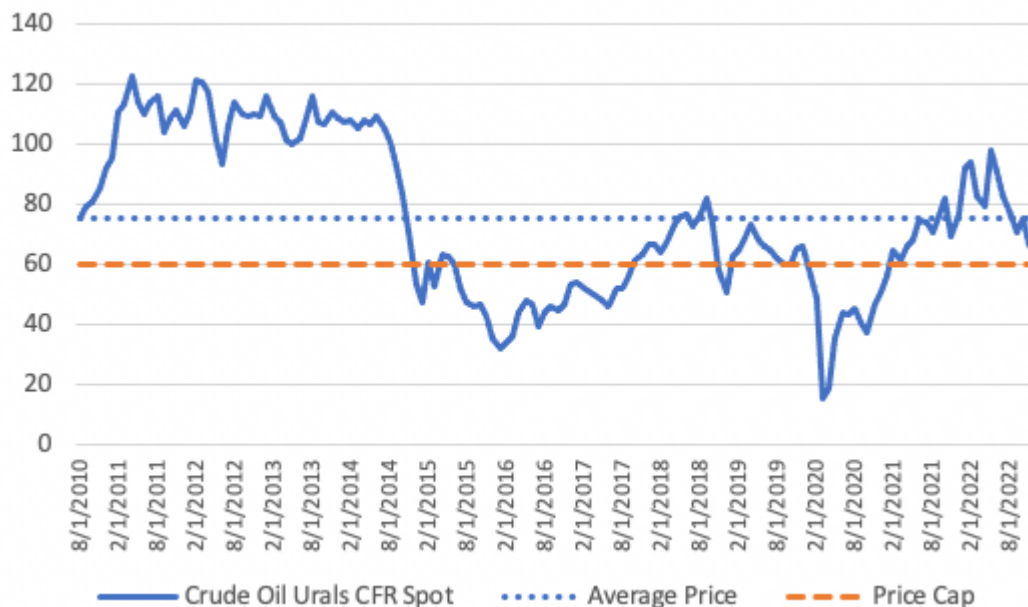
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Over the weekend, amid a major energy crisis which is [decimating](#) European industry, Western countries [announced](#) a price cap that they intend to impose on Russian oil. The idea is that these countries will get together and refuse to pay any more than their stated price for Russian oil - in this case \$60 per barrel. The cap will be imposed by making it illegal for Western insurance companies to insure tankers of Russian oil that sell that oil for more than \$60.

Russia has, unsurprisingly, not reacted well. It has stated in no uncertain terms that it will not sell oil to customers who demand to pay below the market price. Countries outside of the Western sphere have not even responded to the price cap announcement. They may need to work out alternative insurance arrangements, but this will only further undermine Western financial soft power in the global maritime industry.

So, what will the price cap look like in action? To understand this, we should look at the long-term price trends of Russian oil. In the chart below we see the price for Russian oil since 2010 together with the average price between 2010-22 and the \$60 price cap that our leaders have set.



The first thing that stands out is that the price cap we have set is far below the \$75 average price for Russian oil in this period. So, we are demanding to pay \$15 less than the average price for Russian oil. The second point to note is that prices for Russian oil have only been below the price cap level twice in recent history.

The first time was after the sharp decline in the price of oil that took place in 2014-15. This was caused by two dynamics coming into play at once. Firstly, the US massively increased its output of shale oil and, secondly, the Saudis increased production into a market awash with this new shale oil. With the Saudis backing the Russian position at OPEC+ meetings and US shale oil already baked into the market price, neither of these dynamics is likely in the future. The second time the Russian oil price fell below \$60 was during the lockdown.

Throughout the whole period, Russian oil has only fallen below \$60 around 31% of the time. The remaining 69% of the time, the price has been above \$60. Based on these probabilities, it seems that in the coming months the market price will typically be above \$60. When this happens, we will demand to pay less than the market price and Russia will refuse to sell us oil.

In the best-case scenario this will mean we will have to source our oil from elsewhere, likely at a substantially higher price. In the worst-case scenario, we will suffer from serious oil shortages as we find ourselves unable to make up for the Russian supplies that we have lost. This means a lot more inflationary pressure and a lot more potential for shortages. Most of our supply chains, for example, rely on diesel fuel to function. In the case of oil shortages, expect these to translate into shortages of basic goods in your local shop.

History will surely look back on the great European energy crisis of 2022-23 as one of the strangest historical phenomena on record. The Europeans have voluntarily destroyed their economies to impose sanctions on Russia that are having no real impact on their target. As the winter cold sets in, we would be well-advised to change course.

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