Dr. Tatiana Mitrova’s report, *Shifting Political Economy of Russian Oil and Gas*, highlights the serious dilemma faced by Russia and its policymakers. On the one hand, Russia is the world’s largest energy exporter, endowed with abundant resources and enjoying high production rates in oil and gas. On the other hand, it is faced with challenges, some of which are of its own making, others of which are outside of its control. These challenges are eerily reminiscent of the end of the Soviet Union in the 1980s.

After more than a decade of rising prices, a sharp cyclical decline in oil and accompanying natural gas prices uncovered the defects of a defunct economic model. The Russian economy was already stagnant by 2012. The previous boom years saw the stifling of planned reforms to modernize the economy and to diversify it away from overreliance on oil and gas, which represented half of Russian government revenue and 70 percent of export income. Instead, political leaders used the temporary windfall to maintain control and centralize power. Foreign military adventure led to the imposition of international sanctions that further weakened the economy and antagonized foreign partners.

The 70-percent drop in oil prices in the past 20 months should remind Russian leaders that the country is a price taker in the global energy market, not a price setter. Its distant and mostly landlocked producing fields make Russia a regional energy player, locked into fixed export markets, despite the pretension to being an energy superpower. It cannot play the role of Saudi Arabia in the world oil market, or of Qatar in the world gas market, regardless of its high production and export volumes. Expensive new oil and gas transportation infrastructure, mainly pipelines, for diversifying export markets and routes becomes less affordable at a time of low prices. Frightening Europeans does not make Russia a more attractive place for Asians to do business, but it does raise investment hurdles.

Today’s oil price around $40 per barrel is actually above its historical average of $35 in real terms. Therefore, it should not be considered low. In hindsight, $100 oil may well have been an anomaly unlikely to be repeated soon—or even in the longer term—with technological improvement and climate change policy limiting the demand growth for oil and gas. A prudent producing country government would need to reformulate its policies both within the oil and gas sector and in its overall economy if previous policies assumed much higher prices. This is the situation that Russia faces.

What policies Russia actually pursues is more a question of politics than economics. The economic options are relatively clear and are described in this new CSIS report and include establishing a stable, transparent regulatory environment and taxation system that encourage market efficiency, investment, and innovation rather than favoring politically connected companies with state financing and other support, which leads to market concentration and economic inefficiency. The temptation to use oil and gas as a political and foreign policy tool can no longer be indulged at a time of much lower prices without significant economic costs.

Vladimir Putin benefitted from rising oil prices during his first two terms as president of Russia from 2000 to 2008. This enabled many of his improvised policies, absent a long-term strategy to remedy Russia’s structural economic weaknesses. His current term expires in 2018. Whether he will receive a second six-year term after this, and whether his long rule will be judged ultimately as a success in Russian history, will depend on how he navigates the current much more challenging environment, and whether he implements policies that help rather than hinder the creation of a modern Russian economy that can withstand the vicissitudes of the oil and gas market.
Oil and gas can no longer be relied upon as the engine of Russian economic growth. Fortunately, given the human and other natural resources that Russia possesses, this is not an insurmountable problem. However, solutions can only come with reform in governance that removes corruption and promotes economic efficiency.

Given the landmass that Russia occupies, its position as a nuclear power, and its contribution to global oil and gas supply, the rest of the world will also benefit if Russian reform succeeds. Its potential failure would have serious ramifications for the world oil and gas market and much beyond. Dr. Mitova’s report contributes to our understanding of the challenges involved.

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