The Past Is a Sobering Prologue for Russian Economic Policy
By Olga Oliker
March 23, 2016

There’s a lot of talk in the world’s capitals about the Russian economy, Russian energy, and what the two together mean for Russian foreign policy. Though there is no doubt that the price of oil was a critical component of Russian economic growth a decade ago, and is no less important to its economic troubles today, this basic knowledge is where much of the discussion stops. But Russian energy, and Russia’s economy, are a bit more complicated than many commentators acknowledge, and anyone who hopes to understand how gas and oil markets might affect Russia and its neighbors going forward must delve into some of these complexities.

As it happens, CSIS has just published an assessment of the state of the Russian oil and gas sector and its implications for Russia’s economy: *Shifting Political Economy of Russian Oil and Gas*. In that study, Tatiana Mitrova paints a picture of an unreformed sector that faces an uncertain future, but which has nonetheless shown substantial resilience—rather like the Russian economy as a whole. With oil prices up ever so slightly in early March, there is probably some optimism in Russia. Mitrova’s analysis, however, indicates that both optimism and pessimism should be tempered.

Russia failed to act during the boom years to carry out the reforms that would have made its oil and gas industry (and its economy as a whole) more sustainable in the face of shocks. Nonetheless, some smart long-term policies, such as growing and husbanding a healthy reserve fund, combined with a rational immediate response to crisis, which included floating the ruble exchange rate, has helped Russia manage its way through. While the economy is in poor shape, Russia is far from economic collapse. In the longer term, however, Russia is unquestionably in trouble, and it is in trouble even if the price of oil goes up and sanctions come off.

There are several reasons for this. One is the crisis’ encouragement of investor skittishness, which will be lasting. Mitrova outlines the impact of financial and technological sanctions on Russia’s economy. But even if the sanctions were lifted tomorrow, firms and individuals will remain hesitant to invest in Russia going forward. The impact of sanctions and low oil prices have made Russia more volatile for investors than it was before. If past investors were concerned about the insufficiencies of Russia’s legal infrastructure and overall business climate to protect them and their money, now they are also afraid that the Kremlin’s foreign policy actions may bring on new sanctions, further threatening their investments. Better to find safer places for their money, not a few will conclude, with concomitant implications for the oil and gas sector.

Another challenge Russia faces is the continuing shrinkage of markets for its oil and gas. Europeans, frightened of the risks they now see in energy dependence on Russia, continue to find ways to mitigate those risks. China, whatever the hype, simply cannot make up for the European market. Nor can Russia’s domestic customer base. Whatever the price of oil, Russia needs buyers. And new pipelines need markets—or they simply won’t be built.

Russia’s capacity to withstand adversity is a tremendous asset. So are the sharp minds making at least some of its fiscal decisions. But an economy that just barely manages to survive is a long way short of one that thrives. And Russia’s global and domestic agenda would suggest a need for a thriving economy, not a surviving one. Russia’s new National Security Strategy outlines substantial ambitions. They include sustained defense modernization, as well as increased investment in health care, education, and science
and technology. All of these cost money. If Russia were to undertake the reforms it needs, then in time, it would face fewer trade-offs among its many goals. Real reforms that help alleviate the problems that already existed before the crisis, could mitigate new dangers.

But if the past is any precedent, Russia is more likely to try to muddle through. Given its inaction when the economy was growing, Moscow seems unlikely to undertake difficult changes now, when economic conditions are precarious. More likely, Russians will continue to tighten their belts and hope that the price of oil will go up again, with only a few recognizing that this will not be enough. Even worse, Russia may look for sources of funds that rob it of its future: One dangerous option is increased taxes on the oil and gas sector, which may bring more into government coffers immediately, but will further hurt that sector’s capacity to rebound. The bottom line is that if economic mismanagement continues, and is paired with irresponsible foreign policy choices, the doomsday predictions that have proven premature today will yet have their moment.

Olga Oliker is a senior adviser and director of the Russia and Eurasia Program at the Center for Strategic and International Studies in Washington, D.C.

Commentary is produced by the Center for Strategic and International Studies (CSIS), a private, tax-exempt institution focusing on international public policy issues. Its research is nonpartisan and nonproprietary. CSIS does not take specific policy positions. Accordingly, all views, positions, and conclusions expressed in this publication should be understood to be solely those of the author(s).

© 2016 by the Center for Strategic and International Studies. All rights reserved.