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It's déjà vu all over again: Coronavirus, the global energy market, and the Russian economy

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Abstract

Key words: Russia, oil, Covid-19, budget, support, prospects

Introduction

The impact of the coronavirus pandemic on the global economy has already been catastrophic. Whether it will become even more severe is unclear at this point. However, most forecasts indicate that the global economy will experience the deepest recession in recorded history (IMF, 2020; OECD, 2020). The severity of the contraction in economic activity has been especially evident in global energy markets. Demand for oil and gas plummeted at a rate never previously observed (IEA, 2020). Electricity consumption also declined sharply. All of which presents unprecedented challenges for important energy producers. Russia is one such country. It is one of the three largest producers of oil, the second largest net exporter of oil, and the largest exporter of gas. As a result, coronavirus and the global response to it can be expected to exert a profoundly negative influence over the Russian economy.

In this article we present a simple argument. The coronavirus-induced collapse in oil prices has once again exposed Russia's long-standing vulnerability to fluctuations in the value of its oil and gas exports. This should not have come as a surprise to Russia's leadership. Structural changes in global energy markets – including the rapid growth of renewable forms of energy and the rapid expansion of oil and gas production in North America – had already threatened to impose limits on oil and gas revenues before the onset of the coronavirus pandemic. Yet Russia's leaders had failed to take the threat posed by the emergence of a 'new energy order' seriously (Bradshaw et al. 2019). Instead, Russia, was, at the beginning of 2020, becoming more dependent on oil and gas sales. As a result, the collapse in oil prices that began in March 2020 has triggered another severe recession. While Russia appears relatively well placed to avoid a worst-case outcome of a fiscal crisis, the options available to the leadership for dealing with the recession are limited. In the medium-term, the need to reduce Russia's energy dependency has once again become more urgent. However, substantive diversification was not part of the government's revealed economic strategy before the pandemic struck. Whether the destruction of oil demand caused by the pandemic will prompt the leadership to change course remains to be seen.

To make this argument, the article is organised as follows. In the first section, we outline the changes underway in the global energy market before coronavirus that were already laying the foundations for a 'new energy order'. The immediate impact of the pandemic on global energy demand suggests that the journey towards this new energy order may have been hastened. In the second section, we show how dependent Russia's economy is on the export of oil and gas, and how the Russian leadership's economic strategy had not revealed any serious intent to reduce this dependence, leaving it exposed to the collapse in oil prices that took place in March. In the final section, we examine the immediate impact of the global recession on Russia.

The emergence of a new energy order

Even before the price war in March, it was evident that the oil and gas industry faced a new energy order (Van de Graff and Bradshaw 2018). This is the result of two developments that have gathered pace in recent years.

First, the 'shale revolution' in North America has created a more flexible source of oil and gas, undermining The Organization of the Petroleum Exporting Countries (OPEC) and their ability to manage production. In 2014-15, Saudi Arabia tried to damage the shale industry in the United States (US) by increasing production and driving down the oil price. But this strategy ultimately failed as the shale industry reduced its costs and was able to recover and secure the finance needed to expand production. In September 2016, Russia and Saudi Arabia reached the so-called OPEC+ agreement, involving 24 oil-producing countries, to manage oil production to support the price of oil. This worked, but it also incentivised the US shale industry to increase production. Output surged, reaching record levels in early 2020. The emergence of the US as a major exporter of liquefied natural gas (LNG) has had an equally destabilising impact on global gas markets (Bradshaw and Boresma 2020).

Second, following the Paris Agreement in 2015, there has been an increased determination to address climate change and accelerate the decarbonisation of the global energy system, alongside a desire to reduce urban air pollution. This has been aided by the rapid fall in the cost of renewable power generation and a growing acceptance of the need to reduce fossil fuel consumption sooner rather than later. In this context, the coronavirus pandemic and resulting unprecedented fall in oil and gas demand preview an inevitable, more definitive shift that presents an existential threat to so-called 'Producer Economies' like Russia (IEA 2018, Mitrova et al. 2020).

On the eve of what the IMF (2020) has called the 'Great Lockdown', Russia refused to accept a request from Saudi Arabia to introduce further production cuts to those implemented since the end of 2016. This was surprising given that Russia's participation in the OPEC+ agreement had never actually reduced its oil production to any great extent (Krutikhin and Overland, 2020). The real reason for Russia's reluctance to reduce output was revealed by Igor Sechin, the CEO of state-owned oil giant, Rosneft (Lisitsnya, 2020). In an interview just after the collapse of the OPEC+ agreement in mid-March, Sechin stated that the only beneficiaries of such cuts would

be US producers. The immediate result was a sharp fall in global oil prices as Saudi Arabia flooded the market in an effort to increase market share and force Russia back to the negotiating table. At the same time, the full extent of the impact of the pandemic on oil demand became clear. Russia and other members of OPEC+ returned to the negotiating table, in part as a result of the intervention of President Trump. In early April even more sizeable production cuts were agreed and a subsequent G20 meeting resulted in other producing states, including the US, agreeing to cut production further. But it all mattered for nought as in April global oil demand fell by 30 per cent and for a brief period of time US oil prices were negative.

What happens next is anybody's guess. There is various talk of a short-sharp 'V'-shaped recovery, a 'U'-shaped recovery with a prolonged period of recession, or even an 'L' shaped depression. One thing is clear, just as in 2008-9, there will be significant national variance and, just as in 2008-9, Russia is likely to be hit harder than the global average, though less hard than a number of leading Western countries. The reason is its reliance on the oil and gas sector. Current views on what happens next in the global energy industry seem to be divided into two camps (Mitrova 2020). First, there is the oil industry view that the economic recovery will be quick and that prices will rebound as demand recovers, albeit delayed due to the large amounts of oil and gas currently in storage. Then in a few years' time, as a result of the substantial cuts in investment now, supply will be unable to keep up with demand and prices will spike and all will be good again. However, for financial reasons, there is likely to be a permanent reduction in US shale production, delivering market share to OPEC+ (Bordorff 2020). Second, there is the view of environmental groups, many governments, international organisations, and even some oil companies, that calls for a 'Green Recovery' with stimulus packages with conditions attached to improve energy efficiency and accelerate decarbonisation. This, together with permanent changes in consumer behaviour, will constrain the recovery of oil demand resulting in an earlier peak in global oil demand.

The reality is likely to be a mixture of both of the above: demand will recover, but later than expected, and future growth will be constrained more than might otherwise have been the case. As a result, prices may indeed spike, but high prices will then accelerate further fossil fuel demand destruction. This outcome suggests that there may be one further business cycle of high rents left for the producer economies before the energy transition results in permanent and accelerating demand destruction and the prospect of 'lower forever' oil prices that only favour low-cost producers. Where future Russian production sits on the cost curve is uncertain, many existing fields are in decline, and this may be accelerated by the need to cut production, and greenfield developments are likely to be in more costly remote regions and offshore in the Arctic (Makarov et al. 2019). In 2017, Russia's Energy Minister, Alexander Novak estimated production cost for Arctic offshore in the range of \$70-\$100 a barrel, describing them as Russia's "backup stock" (Mazneva and Khrennikova 2017).

Oil and gas exports and the Russian economy

As the world's second largest net exporter of oil and the largest exporter of natural gas, the structural changes in global energy markets described above have potentially profound implications for Russia. This is because the value of oil and gas sales, more than anything else, shapes the fortunes of the Russian economy. If, as proponents of the new energy order thesis suggest, the price of oil and gas is likely to be lower in the near future than it has been over the past two decades, Russia will need to look for new sources of economic growth. For the Russian leadership, a new energy order would represent a severe shock: not only has Russia's position as an energy 'superpower' served as the primary driver of economic growth at home, but it has also been the source of influence and prestige abroad.

The importance of oil and gas exports to the Russian economy

The value of Russian oil and gas exports fluctuated significantly over the past two decades (Figure 1). On average, crude oil tends to account for around half of all oil and gas exports, with oil products accounting for a further quarter. Natural gas exports through pipelines leading to Europe and Turkey account for most of the remainder. The share of liquified natural gas (LNG) has risen over the past decade and is projected to grow further as more LNG is exported from the giant Yamal LNG facility in the Arctic.

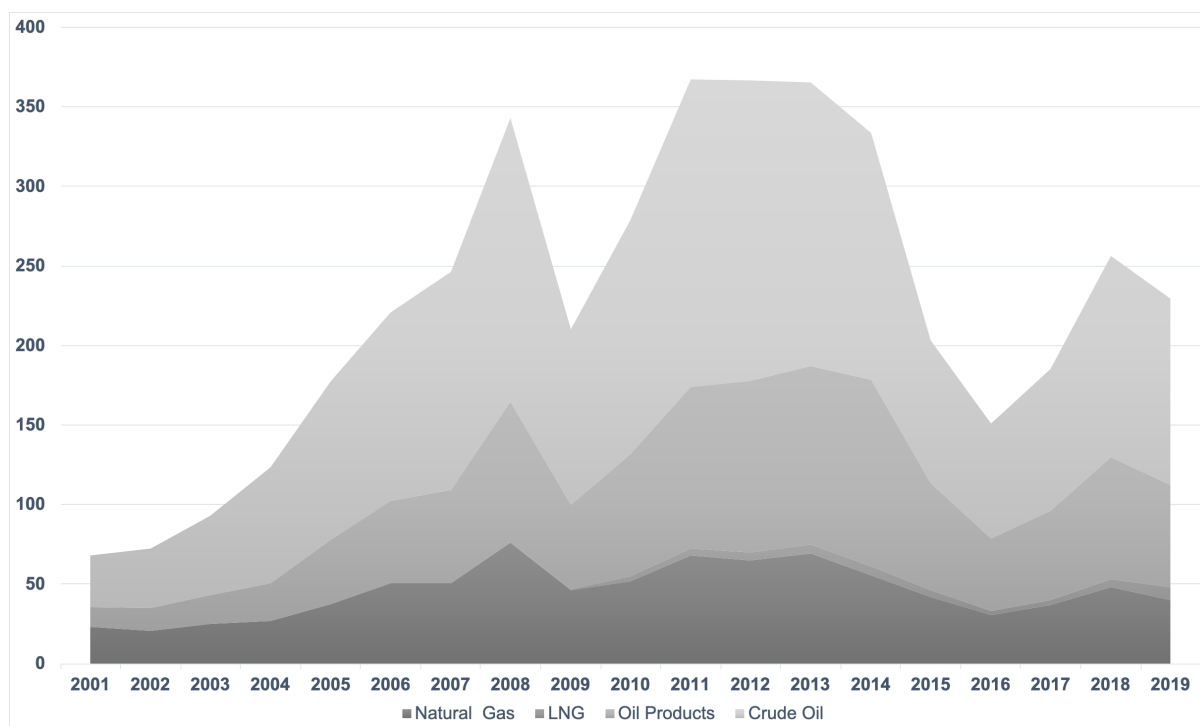


Figure 1. Oil and gas export revenues, 2001-2019 (constant 2015 USD, billion).
Source: Bank of Russia (2020); authors' calculations.

Fluctuations in the value of oil and gas exports affect economic activity in Russia in two main ways.

First, oil and gas exports furnish the Russian state with the bulk of its revenues. Depending on the total value of oil and gas revenues in a given year, federal government income derived from the taxation of the extraction and export of oil and gas accounts for between one-third and half of Russia's federal budget receipts (Ministry of Finance of the Russian Federation, 2020a). As a result, an increase in oil and gas revenues tended to be accompanied by an improvement in the federal government's budget balance, and vice versa. To weaken the vulnerability of the fiscal position to fluctuations in the price of oil, policymakers put in place a 'fiscal rule' designed to ensure that tax revenue from oil at prices above \$40 per barrel was not available for budget expenditure (see Hanson, 2019, p.4).

Movements in the value of oil and gas revenues were also closely correlated with the value of the rouble (Pearson's $r = 0.76$), exerting a strong influence over Russia's terms of trade (Figure 2). When oil and gas prices rose, Russian citizens and businesses were able to buy more goods and services from abroad. But when prices declined, Russian imports declined with them.

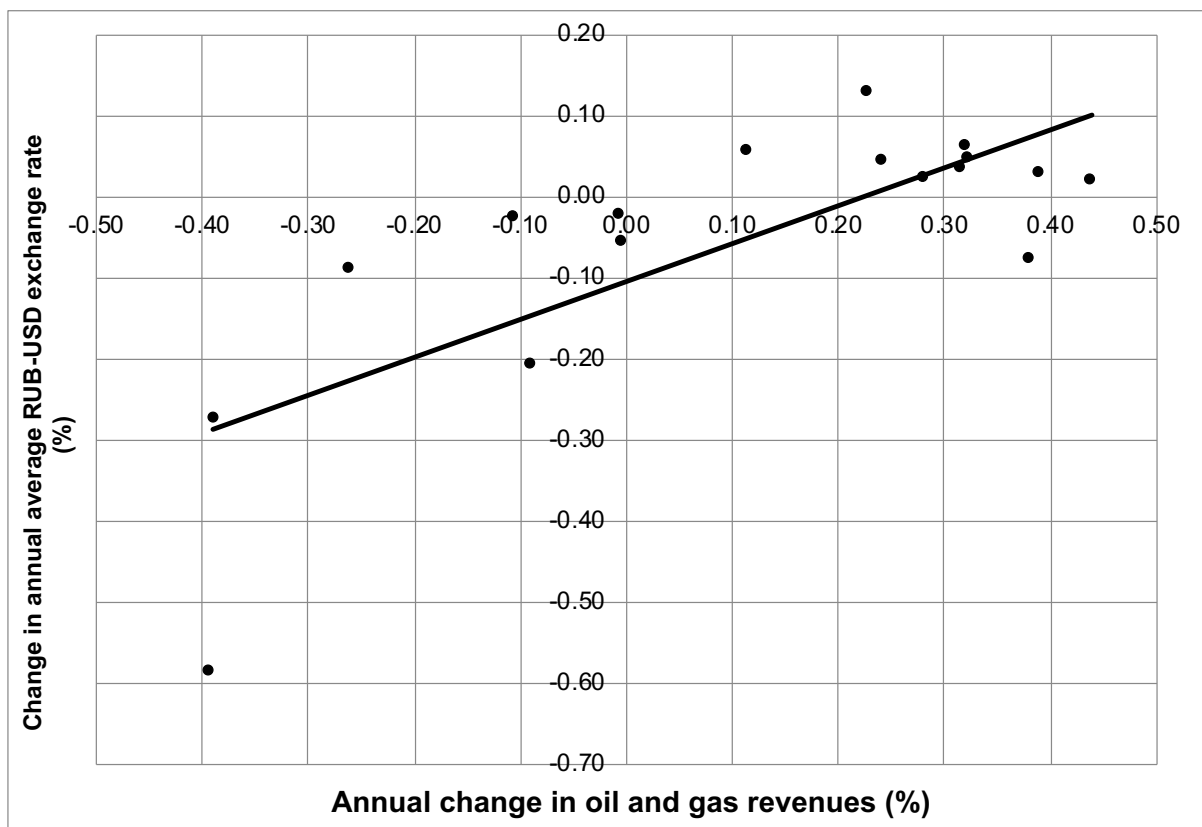


Figure 2. Change in value of annual oil and gas export revenues and average annual rouble-dollar exchange rate, 2003-2019 (per cent).

Source: Bank of Russia (2020); authors' calculations.

Second, oil and gas revenues also influence Russian economic performance through more indirect means. As described by Gaddy and Ickes (e.g. 2005, 2009, 2013) in their schematic account of the relationship between oil and gas revenues and economic performance, oil and gas revenues are shared throughout the Russian economy via informal revenue sharing mechanisms. These include a mix of direct and indirect transfers of oil and gas revenues to other parts of the Russian economy. Direct transfers can take the form of, for example, the taxation of oil and gas enterprises and then using those revenues to fund military expenditure or social welfare programs. Indirect transfers of oil and gas revenues might instead involve oil and gas companies supplying inputs to other Russian enterprises at below market price (e.g. supplying gas to a power generation firm or households), or by providing demand for goods and services produced in the country's large manufacturing sector.

The links – both formal and informal -- between the oil and gas sector, on the one hand, and the rest of the economy, on the other, mean that Russia differs from more conventional 'petrostates' because of the presence of a large non-hydrocarbon sector.¹ The problem for Russian policymakers is that while the country maintains a large manufacturing sector, a large proportion of it is uncompetitive on global markets (hence the low share in Russia's export basket; see Cooper, 2006; Connolly, 2008, 2012). This forces firms from within the manufacturing sector to rely on domestic demand, which in turn is driven by oil and gas export receipts.

The close relationship between the oil and gas industry and the rest of the economy is evident when we examine the correlation between movements in the annual value of oil and gas exports and other key economic variables. Between 2001 and 2019, the statistical correlation between annual movements in the value of oil and gas exports, and with GDP (Pearson's $r = 0.77$), fixed investment ($r = 0.75$), and retail sales ($r = 0.77$) was extremely strong (Figure 3).

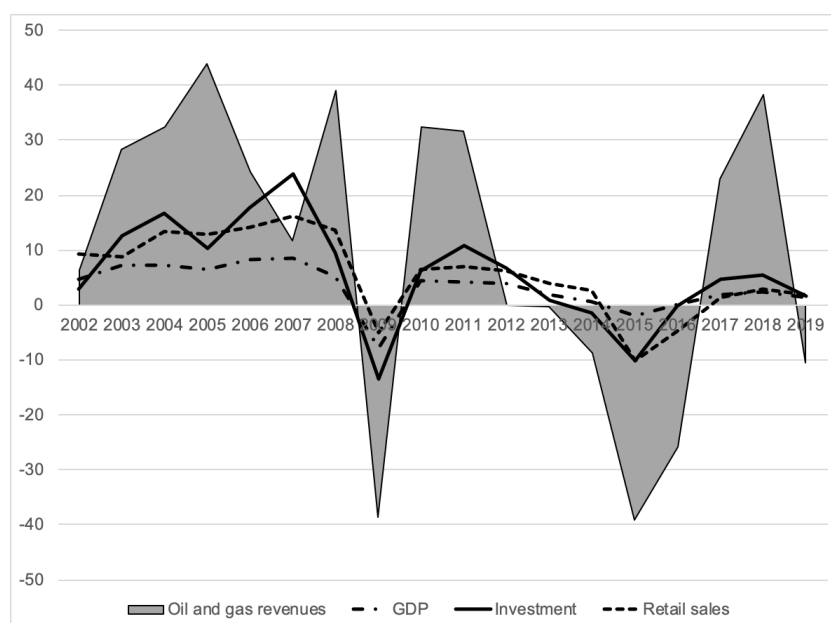


Figure 3. Annual changes in oil and gas revenues and selected indicators of Russian economic performance, 2001-2019 (per cent).

Source: Bank of Russia (2020); Federal State Statistics Service (2020); authors' calculations.

Because the wider economy is so dependent on the redistribution of oil and gas revenues, Russia has proven susceptible to any significant fluctuations in the price of oil (Connolly, 2018). It is instructive that the last three recessions in Russia—1998, 2008-2009, and 2014-2015—were all triggered by sharp declines in the price of oil. As shown in Figure 4, annual changes in oil and gas revenues have served as an excellent predictor of Russian economic performance.

However, this relationship has weakened somewhat in recent years due to the Central Bank's shift towards an inflation targeting strategy at the end of 2014. As shown in the top right quadrant, annual growth in oil and gas revenues of 39 per cent caused GDP to grow by 5.2 per cent; by 2018, the same oil and gas export growth was accompanied by much weaker growth of 2.5 per cent. But this weakening of the relationship works both ways. As shown in the bottom left quadrant, the 2009 collapse in oil and gas revenues (a decline of 39 per cent) caused GDP to decline by 7.8 per cent. But in 2015 a same proportionate reduction in oil and gas revenues was accompanied by a much shallower recession. Nevertheless, while the strength of the relationship has weakened over time, it remains the case that oil and gas exports revenues are the single most important predictor of economic performance in Russia.

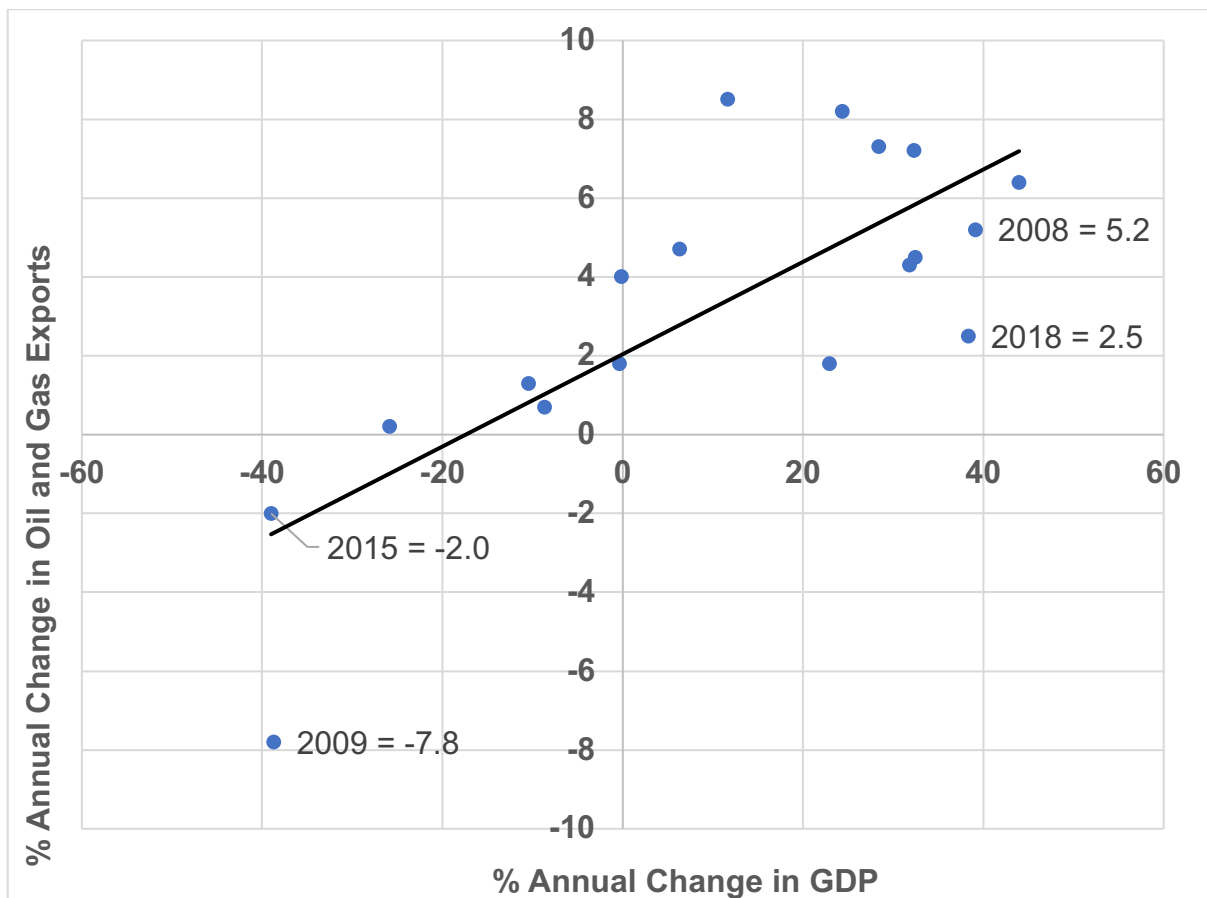


Figure 4. Annual changes in oil and gas revenues and GDP, 2001-2019 (per cent).

Source: Bank of Russia (2020); Federal State Statistics Service (2020); authors' calculations.

Industrial policies to foster diversification: plus ça change

Policymakers in Russia have not been oblivious to the need to generate new economic capabilities outside the oil and gas sector. Since 2000, several government initiatives have attempted to nurture sectors of the economy located outside the oil and gas industry (e.g. Ministry of Economic Development, 2012; Connolly, 2013; President of Russia, 2018)).² However, these policies have met with only modest success, largely because those initiatives were either not afforded sufficient financial or institutional support to make a real difference, or because the prevailing system of political economy prevented the emergence of new economic actors (Connolly, 2013; Kuznetsov and Simachev, 2014).

To the extent that industrial policies have been implemented with any consistency, they have tended to perpetuate the existing production structure. Since 2014, officials have, for example, extolled the virtues of Russia's import substitution (*importozameshchenie*) programme. This was designed to expand investment and production in areas of Russian manufacturing (Connolly and Hanson, 2016). However, the rate of annual investment in the Russian hydrocarbons industry rose faster than aggregate investment in all but one year since 2014 (Figure 5). All things being equal, this should perpetuate, not weaken, the role played by the oil and gas industry in Russia's economy in the future.

This should not have been a source of surprise to observers. Statements from Russian officials consistently signalled the desire to expand production of oil and gas. New deals to export oil and gas to China and Turkey were finalised. Russia's draft energy strategy, written in 2014 and, after some amendments, approved in April 2020, stressed the need to expand the export of hydrocarbons to rapidly-growing markets outside Europe, with the aim of maintaining Russia's position as one of the world's top-three hydrocarbon exporting countries (Ministry of Energy of the Russian Federation, 2020, p.4).

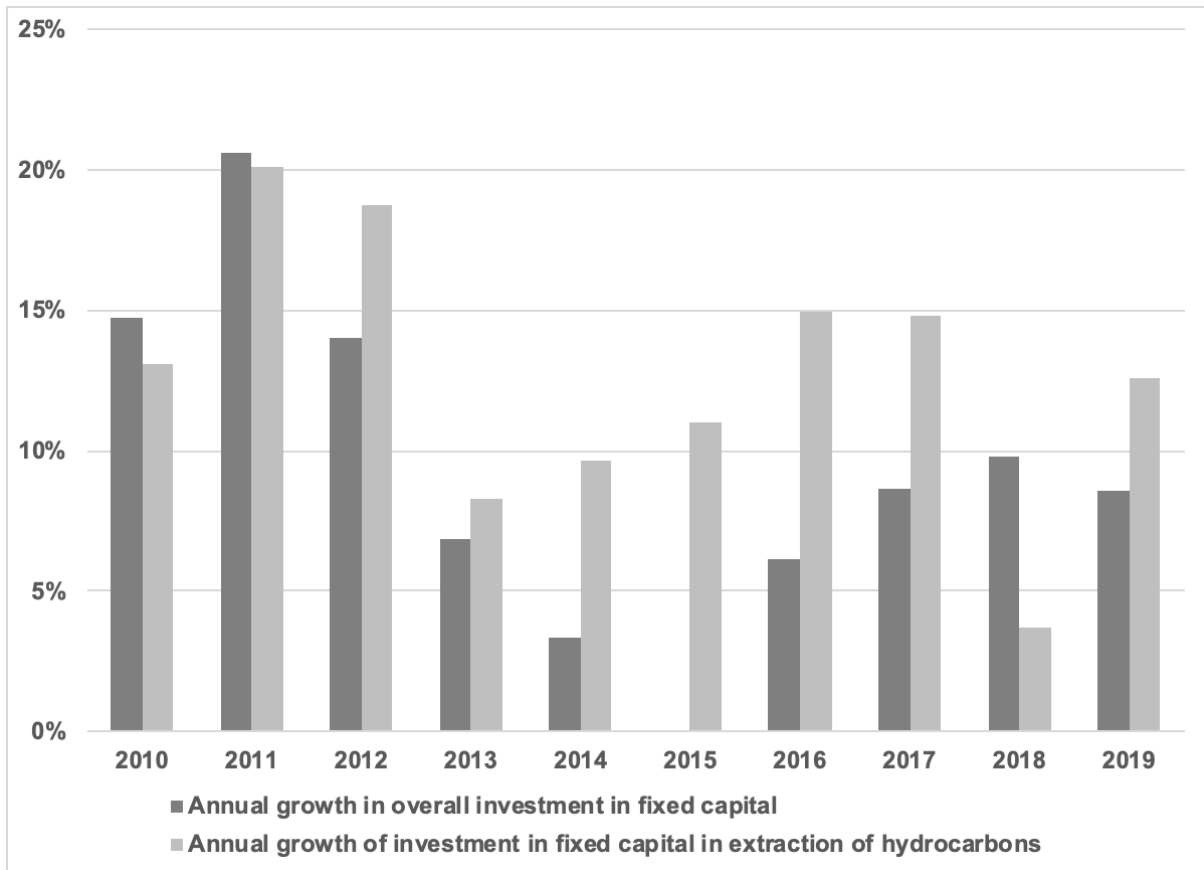


Figure 5. Annual rate of growth in fixed investment in the Russian hydrocarbons sector, 2010-2019 (per cent annual change in value of investment).

Source: Federal State Statistics Service (2020); authors' calculations.

Moreover, even those policies designed to foster manufacturing capabilities outside the oil and gas industry remain dependent on the existence of a thriving hydrocarbons sector. For instance, twelve of the nineteen non-military areas of the economy identified by the government's import substitution strategy of 2015 were located in the oil and gas extraction equipment industry. Elsewhere, policies to support the development of a large new ship-building facility at the Zvezda complex in Russia's Far East, are based on supplying ships and marine equipment to facilitate off-shore oil and gas extraction in the Arctic.³ Put simply, Russia's industrial policies seem designed to strengthen the role played by the oil and gas sector rather than weaken it.

An energy strategy for the future (or the past)?

Despite persistent official rhetoric about the desirability of diversification and modernisation, it is clear that only modest progress was made in developing new industries. With the exception of the sustained growth in agricultural production and exports, Russia's production looked much like it did in 2000 (Wegren, 2020). Meanwhile, as the leaders of other hydrocarbon-exporting countries like Saudi Arabia and the United Arab Emirates at least acknowledged the importance of preparing for

a post-hydrocarbon future, official Russian energy strategies continued to emphasise the importance of increasing production and export of oil and gas (Ministry of Energy, 2020).

The Energy Strategy to 2035, approved in April 2020, provides a clear insight into the role Russian officials envisage that Russia will play in global energy markets in the future (Ministry of Energy, 2020).⁴ The document reveals that the Russian leadership is aiming to “strengthen and maintain” the country’s position as one of the leading energy powers in the world (ibid. p.6). This, it is stated, will enhance Russia’s economic security, promote socio-economic development, and strengthen the country’s position on the international stage (ibid. p. 12).

To be sure, there is an acknowledgment that the global energy environment is shifting. The challenge of climate change and the growth of renewable forms of energy are both cited as important “challenges and threats” to Russia’s energy strategy (ibid. pp.12-13). As is the growth of oil and gas production in North America, which it is acknowledged, may result in a lower price for hydrocarbons in the future (ibid. p.13). Due to the document only recently being approved, it even mentions the “coronavirus pandemic” as a threat (ibid. p.28). However, rather than suggest that these trends might obviate the need for Russia to produce and export large volumes of oil and gas, the document lays out a vision of Russia bolstering its position in precisely those product markets.

In the oil industry, the strategy forecasts a gradual reduction in the global demand. This, however, is seen to take place alongside a tightening of global supply, especially as the most readily accessible reserves are exhausted (ibid. p.28). Growth in China and India is viewed as likely to see demand for certain sub-types of oil rise. As a result, a “new price growth cycle” is envisaged (ibid). Robust global growth in demand for gas is also forecast, largely due to the need for countries to shift away from coal-based power generation to reduce carbon emissions (ibid. p.29). But coal consumption, it is suggested, will not disappear; instead, it will remain the primary source of energy in the “developing countries” of the Asia-Pacific and Africa.

Perhaps the key point in the document is the view that any significant switch towards renewables is only likely to take place in high-income OECD countries. By contrast, the consumption of large volumes of coal, alongside growth in demand for oil, is seen as likely to continue in the Asia-Pacific region and to grow in Africa. Russia, it is stated, should aim to exploit these sources of demand growth. As a result, an ambitious target of ensuring that energy exports to Asia will form at least half of all Russian energy exports by 2035 is set (ibid. p.72). It is also argued that Russia should not simply provide energy: it should also seek to supply technologies to facilitate energy extraction in Russia and abroad (ibid. pp.61-64).

Even a cursory examination of the strategy reveals that Russia’s leadership has made a very clear bet that hydrocarbons will continue to play the most important role in global energy markets for years to come. The shift towards greater use of renewables and other low-carbon sources of energy will, it is suggested, be largely confined to high-income OECD economies. But robust growth in demand for hydrocarbons will

continue to take place in the majority of low- and middle-income countries outside North America and Europe. The strategy is designed to help Russia to meet this demand.

The stakes in such a gambit were always high. If the forecast contained in the strategy were to prove accurate, Russia would be well-placed to occupy a strong position in the supply of strategically-important energy to the rapidly-growing markets of what Oliver Stunkel (2016) refers to as the ‘non-West’. While this might confound mainstream Western opinion, it would enable Russia’s leadership to maintain the existing system of political economy – based as it is on the state-directed redistribution of oil and gas revenues – largely in its current form.

However, by elevating the role that hydrocarbon export play in the economy even further, there always remained a high probability that Russia’s well-established ‘addiction’ and concomitant vulnerability to fluctuations in oil prices would be exposed again in the future. This vulnerability was, in rather predictable fashion, exposed once again even before the ink was dry on the president’s signature that approved the Energy Strategy to 2035.

Coronavirus and the Russian economy

A rapidly changing situation

The coronavirus pandemic and the oil-price crash upset plans around the world. The plans of the Russian leadership suffered along with others. The federal budget plan approved in October 2019 was based on what seemed at the time a plausible set of baseline assumptions about oil prices and the rouble-dollar exchange rate in 2020-22, together with a rather less plausible projection of accelerating GDP growth.

Table 1. Baseline assumptions for the Russian federal budget plan, 2020-22, annual averages and year-on-year % change

Year	Urals oil price (\$/b)	Rouble/dollar exchange rate	GDP % change Year on Year
2020	57	65.7	1.7
2021	56	66.1	3.1
2022	55	66.5	3.2

Source: Ministry of Finance of the Russian Federation. (Minfin 2020c)r

Oil and gas revenues for the federal budget were planned at about R7.5trn, equivalent to 6.6% of GDP (*ibid.*) and to \$113.7bn at the projected exchange rate. The break-even oil price for the 2020 budget was \$42.45 p/b.

As the oil price and the rouble fell, analysts and policymakers struggled to keep up. On March 12 Audit Chamber head Aleksey Kudrin was quoted as saying that if the average oil price in 2020 was \$35/b and the rouble averaged 72 to the dollar, the loss of oil and gas revenue to the budget would be R3trn. There would be a federal-

budget deficit of 2% of GDP and the economy would flatline (Kudrin 2020) Six days later the Brent oil price fell to just under \$25/b. (Business Insider 2020)

By mid-April a group of liberal Russian economists put forward three scenarios for 2020.

- Optimistic: average Urals oil price \$40/b, GDP change -3.7%
- Moderate: average Urals oil price \$31/b, GDP change -5.7%
- Pessimistic: average Urals oil price \$24/b. GDP change -7.9%

In each scenario the fall in GDP was steeper for Russia than for the world as a whole. (Liberal'naya missiya 2020)

At the end of April, the business newspaper *RBK* offered an estimate of the fall in GDP in 2020 caused by the pandemic and the oil-price crash: 7%. This was associated with a loss to the federal budget of 6.5% of GDP, made up of the stimulus package, put at 2.8% of GDP by Siluanov, and revenue losses of 3.7% of GDP (*RBK* 2020b).

The Central Bank of Russia published in April a baseline scenario for 2020-22 that showed how far some official thinking had moved.

Table 2. Central Bank of Russia baseline scenario for 2020-22, average Urals oil price (\$/b) and GDP (% change Year on Year)

Year	Oil price	GDP
2020	27	-4 to -6
2021	35	2.8 to 4.8
2022	45	1.5 to 3.5

Source: Central Bank of Russia (Bank of Russia 2020b)

This forecast is based on a fundamental assumption that might be said to be optimistic. It is one that most policymakers around the world are currently making: that the pandemic recedes in the latter part of 2020 and recovery follows. More specific to Russian circumstances is the wide range of the CBR's future GDP estimates. This, we suggest, reflects political sensitivity. The upper end of the range for 2021 and 2022 is a bow to Putin's ambitions. The lower end dispenses with those ambitions.

The Ministry of Finance (MinFin) early May assessment of the new budgetary situation in 2020 was that the Urals oil price would average \$30/b; the federal budget would be R1.5trn down on oil-and-gas revenues and R2trn down on non-oil-and-gas revenues (reflecting the general decline in global demand and pandemic-constrained supply); and a budget deficit of 4% of GDP would be covered by transfers from the National Welfare Fund and borrowing. (The Bell 2020)

The policy response

How have the Russian authorities tried to tackle the economic crisis so far? Two elements in the response stand out. The state resources committed to stimulating the economy have been relatively small; and Putin has not taken the lead in setting out measures to counter the pandemic.

Finance Minister Siluanov in late April said the support package amounted to 2.8% of GDP. This the *RBK* newspaper reckoned was about R2.9trn. (RBK 2020) The addition of a third package of measures in early May brought the total to R3.7trn and 3.3% of GDP. (Third Package 2020) As a percentage of GDP this is still modest by the standards of most OECD countries. How much of it is a direct call on the federal and regional budgets is not clear. There are quite a lot of state loan guarantees and tax deferrals in the mix of measures, and it is far from clear how these have been quantified. Another part of the package consists of measures to soften regulations affecting business, including the inspections regime and the terms and conditions of state purchase contracts, (Government of the Russian Federation 2020) These do not directly involve expenditure but are probably of real assistance to business.

The IMF provides a summary of national anti-crisis measures but does not attempt to quantify them (IMF 2020). Russian *Forbes* has a useful summary of the ingredients of the second package of measures, which stresses that much more in this package is going to big business than to small and medium-sized enterprises (SMEs), but the second package is of course only part of the picture. (Milyukova and Petukhova 2020). There is however a Russian government posting that purports to be comprehensive.

Table 3. Selected components of the Russian government anti-crisis support package as of April 20, 2020

	Value (R bn)
Credit subsidies, general	330
Support for SMEs	488 (includes tax postponements, social insurance cut, credit subsidies)
Support for tourism, hotels, airlines	37
Pharma, medical supplies	15
System-forming enterprises	Not quantified
Loan support for regions	270
Support for personal incomes	164 (includes enhanced payments to veterans, maternal capital, not including wage subsidies to companies)
Total	1304

Source: Plan for overcoming the economic consequences of COVID-19 (Government of the Russian Federation 2020)

If the total package at the time was, as *RBK* guesstimated, about R2.9trn, the larger part of the package is not quantified in the 'Plan' document. The overall position can however be assessed in broad terms from government statements and public commentary: the support package is modest; its burden on the federal budget is

even more modest; support is concentrated on big business in the form of an expanding contingent of 1000+ 'system-forming enterprises', in which state firms and large private firms with strong political connections are the main beneficiaries; but SMEs are perhaps not as neglected as some commentary would have it. Support for personal incomes is predominantly indirect: subsidies to companies that are conditional on very low redundancies. In addition, private firms are under pressure, in the Russian manner, to contribute to local social provision.

Russian policy in the current crisis is constrained by the leadership's preoccupation with economic security. Government borrowing on any substantial scale would entail borrowing from abroad. On the face of it, in light of Russia's low ratio of debt to GDP, this should not be a problem. But it is judged by Russian policymakers not to be possible because of sanctions. Even if it were possible, it would not in their view be desirable. It would open Moscow to leverage from a hostile outside world. Therefore, the support package has to be modest.

There may be additional, more narrowly economic, considerations. Vladimir Mau argues that Western countries at present are not vulnerable to inflation. Accordingly, in a low-interest environment they can ramp up borrowing without fear of the crisis leading to stagflation. Russia is not so fortunate: stagflation remains, for Moscow, a threat (presumably because rouble devaluation, linked to a falling oil price, puts up domestic prices and because inflation expectations are volatile). For this reason, Russian macro-economic policy has to stay cautious; no helicopter money for Moscow (Butrin, 2020). Whatever the merits of this argument, the preoccupation with security is a sufficient explanation of the small size of the support package.

Policymaking in the crisis

As long as the current elite perception of economic security dominates policy, it will dictate a financially cautious approach. That approach is associated with Finance Minister Siluanov and Central Bank governor Nabiullina – though their espousal of financial prudence no doubt has its basis in economic orthodoxy as well as security concerns. A modest – perhaps dangerously over-modest – stimulus package looks to be firmly in place.

For the time being, at least, Russian finances are strong. At \$567bn on May 1 (33% of 2019 GDP), its international reserves comfortably exceed gross external debt (Bank of Russia, 2020). The National Welfare Fund (NWF), now in use as a budgetary reserve fund, totalled \$165bn, equivalent to 11.3% of GDP, on April 1, 2020 (Ministry of Finance of the Russian Federation, 2020b). Most of the NWF is available to finance a federal-budget deficit. Four years, approximately, of budget deficits at 2% of GDP could be financed in this way alone, without any recourse to borrowing. Hence the official confidence that Moscow can cope with even a long-drawn-out crisis.

In other respects, Moscow's handling of the pandemic and the oil-market crash was confused. The decision to abandon the first OPEC+ agreement in early March appeared rash at the time and even more so in retrospect. As noted earlier, it was reported that the driving force behind the decision was the CEO of state-owned Rosneft, Igor Sechin (Lisitsnya, 2020). However, Russia was forced back to the

negotiating table within a matter of weeks after prices collapsed even more precipitously than its leadership presumably expected. This volte face hinted at a deeper incoherence in the policy process and the absence of a clear strategy.

Since then, Putin has made several public addresses on the crisis but has not taken a lead in handling the pandemic. The Mayor of Moscow, Sergei Sobianin, led the campaign for self-isolation and business shutdowns (Galeotti, 2020). By and large, Putin has left the management of the pandemic to regional leaders like Sobianin. Meanwhile he has rejected calls from conservatives to declare a state of emergency, Siluanov, Nabiullina and Sobianin belong to that segment of the Russian elite that Tatiana Stanovaya (2020) classifies as 'political technocrats'. These are influential people on whom Putin relies for running the country. Stanovaya sees a tendency towards conflict between technocrats and conservatives. Like several other commentators, she also sees growing problems in the management of the current crisis. 'In the long run, a lack of effective governance at a time of national peril could hasten the gradual formation of an elite not beholden to Putin'.

The duration of the coronavirus pandemic is unknown. If the pandemic does not recede in the latter part of 2020, or if it recedes but the retreat is followed by a second peak, Russian society and the Russian economy will be in deep trouble. But so will the rest of the world.

The future evolution of global demand for oil and gas is open to a wide range of predictions. None of them is encouraging for Moscow in the long term. If Russian policy-makers are using the crisis to prepare for a new energy order, they are not telling anyone about it. Official projections assume that oil and gas will continue to be central to the country's fortunes.

Conclusion

In just a few months, the coronavirus pandemic disrupted large swathes of the global economy. It is highly likely that further disruption lies ahead. This has already threatened the growth models of major oil and gas producer countries, like Russia. As we have argued, the collapse in oil prices triggered by the coronavirus pandemic once again exposed Russia's enduring susceptibility to sharp falls in oil and gas prices. Tectonic shifts in global energy markets – including the rapid growth of renewable forms of energy and the rapid expansion of oil and gas production in North America – which had already threatened to reduce the value of future oil and gas revenues. These tendencies were accelerated by the collapse in demand caused by the pandemic.

Once again, Russia was hit hard by a fall in oil prices. Its leadership had failed to take the threat posed by the emergence of a new energy order seriously. Instead of diversifying its production and export structure to insulate the economy from fluctuations in commodity prices, Russia remained, at the beginning of 2020, highly dependent on oil and gas sales as the primary source of economic growth. To be sure, the measures undertaken since 2014 to reduce the government's fiscal dependence on high oil prices will help Russia avoid a worst-case outcome of a fiscal or financial crisis. However, the dependence of other sectors on the energy sector remained high.

This left Russia set once again to experience a deeper recession than that forecast for other energy exporting economies.

Predicting the precise impact that this latest slump in oil prices will have on Russia is, of course, impossible. Nevertheless, it is possible to highlight several dynamics that might be disrupted by the sharp reduction in oil and gas revenues that have accompanied the pandemic.

First, a decline in the volume of financial resources available to sustain Russia's revenue distribution system could expose fissures within the ruling elite. Years of relatively high oil prices caused the number of claimants on the revenue flows that sustain Russia's rent sharing system to rise. If, as is likely, resources become scarcer, it is possible that intra-elite conflict will rise as different constituencies fight to preserve their access to resource revenue flows.

Second, there is the effect on relations between the centre and the regions. In the course of the crisis, as noted above, much of the responsibility for handling the pandemic has been devolved *de facto* to the regions. This has exacerbated the old problem of unfunded mandates at regional level: the lack of resources at the disposal of most regional authorities to fulfil the tasks assigned to them. As available resources shrink and the support package remains modest, most Russian regions will be even more short of funds than usual. Inequalities among regions are likely to worsen.

The devolution of decision-making on lockdowns has two kinds of logic: it reflects the vast diversity of Russia's regions, and it may perhaps allow Putin to evade blame for mistakes. The first of these has some force. The second is a gamble that may not pay off.

Third, any prolonged slump in oil and gas revenues could threaten the social contract that has served as the foundation of Vladimir Putin's power since he came to power in 1999. While much attention is paid to the distribution of resource rents amongst elite constituencies, it is also the case that many ordinary Russians have benefited from the rent distribution system in the form of employment, social benefits, and rising living standards (Miller, 2018). If this latest slump reduces the prospect of living standards rising in the future, the sustainability of the prevailing system of political economy might be compromised.

The options available to the leadership for igniting a diversification programme are likely to be limited. However, failure to take serious action could be disastrous. The former prime minister and architect of economic reform in Russia in the 1990s, Yegor Gaidar, wrote in 2006 about the dangers of overdependence on natural resource revenues (Gaidar, 2006). Seeking to explain the sudden, and, for most, unexpected collapse of the Soviet Union, Gaidar highlighted how a growing dependence on oil and gas exports in the 1970s and early 1980s led to the Soviet Union developing an "ineffective but stable" political and economic system (*ibid.* p.131). This stability, however, proved illusory as a slump in oil and gas exports exposed the weaknesses of the system and ultimately led to its collapse. Many observers today might apply the

epithet of “ineffective but stable” to Russia’s political economy today. A failure to adjust to the emergence of the new energy order, hastened by the coronavirus pandemic, could expose Russia to similarly tumultuous consequences.

Footnotes

¹ For more on the relationship between oil prices and growth, see Tabata (2006).

² The latter are discussed in Hanson (2019).

³ The Zvezda complex is discussed in Connolly (2018, pp.98-100).

⁴ The document is discussed in detail in Mitrova and Yermakov (2019).

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