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Will oil decide the fate of the Russia-Ukraine War?

A collapse in global oil prices could pose a significant risk to Putin's war machine

Saudi Arabia's decision to increase oil supply at a time of falling global demand could jeopardise the Russian war effort. With Russia already selling its oil at discounted rates and with higher production costs, a low-price environment in oil markets may impact its ability to finance its aggression in Ukraine.

Russia and Saudi Arabia have previously clashed in oil markets. For a brief one-month period at the outset of the Covid-19 pandemic, Russia launched a foolish price war, increasing production as the world moved into lockdown. Once Saudi Arabia responded in kind, the oil price went into freefall. In an illustration of how geopolitics 'overdetermines' oil markets, the trigger for the negotiations that brought the crisis to an end was allegedly US President Donald Trump's threat to withdraw American military assistance from Saudi Arabia. Under this geopolitical pressure and collapsing market demand, making a price war potentially ruinous for all parties, Russia and Saudi Arabia stepped back, agreeing to the supply cuts required to stabilise world prices.

As recounted in Cambridge professor Helen Thompson's *Disorder: Hard Times in the 21st Century,* the oil supply glut in 2014 – 2016 was also shaped by the competitive postures of the United States, Russia and Saudi Arabia. Then as now, Saudi Arabia increased the supply of oil into the world market at a time of falling demand with the economic aim of disincentivising American investment in shale oil and the geopolitical aim of pressuring Russia and Iran to retreat from their support for the Assad regime in Syria. That Russia was able to weather the financial crisis produced by the combination of Western sanctions and the Saudi expansion in oil supply, emerging with the Assad regime intact and Russia's hold on occupied southern and eastern Ukraine stable, provides a salutary warning for the hope that the present conjuncture may prove problematic for Putin's regime. But with Russia facing both much more radical external sanctions – in effect its near-removal from the Western

trade and financial order altogether – and fighting an enormously costly all-out war against Ukraine, the conjuncture of late 2024 poses a far more serious challenge.

The limits of military Keynesianism

Trends in the global oil market bear down heavily on Russia's strategic choices. By 2030, the International Energy Agency anticipates that global supply capacity will outstrip demand by some 8 million barrels per day, a situation they describe as 'staggering' and 'unprecedented' (outside of the Covid-19 pandemic). As Iran and the Gulf States have oil wells close to the surface, making them cost-efficient to extract from, these states are in a much more commercially advantageous position to cope with falling oil prices. Their breakeven price for new drilling projects is also far lower than that of their international competitors, including Russia and the United States.

By moving towards a more competitive posture, Saudi Arabia is challenging America's more expensive production but also tacitly acknowledging that the OPEC+ group has a diminished price-setting power. For Russia, this is the worst of both worlds. Unlike the United States, it has an oil-dependent economy, which benefits from the cartel power of OPEC+. Yet, unlike Saudi Arabia, its oil is not cheap to extract, making it poorly equipped to deal with low-price conditions. This drives a short-term escalatory logic for Russia's war on Ukraine, requiring rapid battlefield successes prior to the emergence of low-price oil market conditions.

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Russia's successful adaption of its domestic economy to the war effort has been an important story of the full-scale invasion to date. The Russian state has utilised a suite of policies that Volodymyr Ishchenko, Ilya Matveev and Oleg Zhuravlev identify as 'military Keynesianism', with war-related spending stimulating demand in the economy. They note, in particular, the important distributional effects of this in terms of wage growth and industrial expansion, how this may have impacted support for the war effort among the Russian working classes and the internal limits that these policies have encountered in the form of acute labour shortages constraining economic output.

Putting the Russian war economy in a global context that recognises its oil dependency can help us build a fuller picture of its vulnerabilities. While sanctions have ruptured Russia's relationship to Western markets, this does not make its war economy autarchic. On the contrary, revenues from oil exports are critical. As the Oxford Institute for Energy Studies has argued, the Russian economy is dualistic in the sense that it may be divided between revenue-generating sectors (of which the most important is oil) and revenue-dependent sectors that are sustained through the distribution of rents. With oil accounting for between 30-50 per cent of annual state budget revenues since 2014, Russia is, fundamentally, a petrostate. The Putin regime manages these rents and has drawn on them to fund military aggression in Ukraine.

While Russia has not been publishing trade data since the full-scale invasion, estimates from Bruegel suggest that, despite its successful application of military Keynesian instruments, it continues to fund its trade deficit in non-fossil fuel goods through the sale of fossil fuels (delivering an overall surplus). As these imports are necessary to meet the needs of the Russian populace and the state's war effort, maintaining the flow of oil rents is critical.

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Russia's oil is therefore both a source of power that has funded its war of aggression and a potential vulnerability, due to its sensitivity to movements in the global market price. The full-scale invasion has led to sanctions increasing the regime's production costs, a collapse in Western demand with the move to alternative suppliers and a price cap on oil sales. So, Russia has faced rising costs while selling to markets at a discounted rate (advantaging non-Western buyers in general and India and China in particular). The country has been able to adapt to these changes but was not yet forced to face a situation of global oil supply running in excess of demand.

A peculiarity of a state's uneven and combined development lies in the role that 'far away' events may play in shaping its geopolitical and economic trajectory. This can be seen in the series of contingencies involving multiple actors and theatres of conflict that will likely determine whether Russia will continue to sell oil at the price needed to fund its war effort: the scale of demand for oil given the green transition, especially in China that in 2023 accounted for four-fifths of global demand growth; how aggressively Saudi Arabia seeks to expand the global

supply to seize market share from their rivals; and whether Israel and Iran step back from the brink of all-out war, which, in one scenario, could see the Strait of Hormuz, 'the world's most important oil chokepoint', become a site of conflict. If these factors evolve in such a way as to produce an oil price collapse that is equivalent in scale to 2014 – 2016, the Russian regime may encounter difficulties financing its war economy, at least in the distributionally 'progressive' form *vis-à-vis* its workers.



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