BOFIT blog

War's price tag for Russia will be high

Russian economy | 18 October 2022 | Heli Simola

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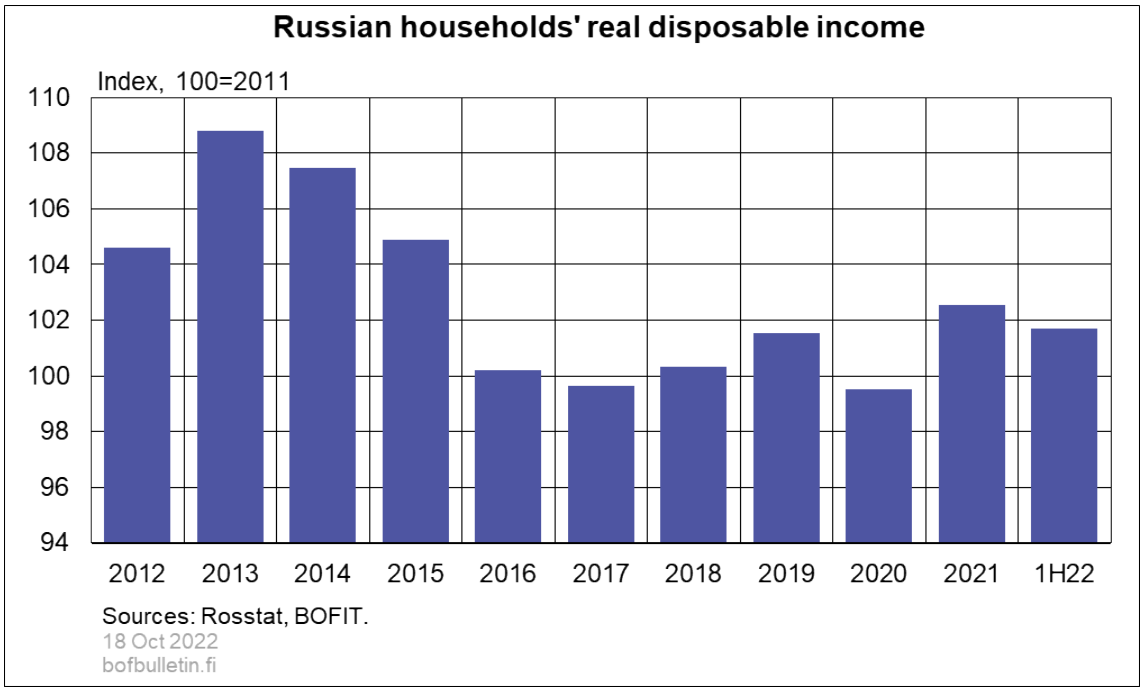
Russia's war in Ukraine is, above all, a massive human tragedy and an assault on Ukraine's economy and society. But Russia, too, will end up paying a high price for its cruel decision to wage war. The war's price tag for Russia is, of course, impossible to estimate with any accuracy. But we can examine various indicators to illustrate the magnitude of the costs.

At the start of this year, Russia's gross domestic product (GDP) was still projected to grow by a total of about 5% in 2022–2023 (Chart 1). As a result of the war, confidence on Russian economy has collapsed. The economic sanctions imposed on Russia due to the war have isolated it from international financial markets, restricted the availability of technology products in Russia and cut the demand for Russian goods in foreign markets. The latest forecasts show that Russia's GDP is expected to shrink by a total of 8% – 10% in the years 2022–2023. Without the war, Russia's GDP could therefore have been as much as 15% higher in 2023. At the average 2021 exchange rate, this means a GDP loss of approximately USD 270 billion in 2023 alone.

Chart 1.



A further perspective on the war's costs can be gained by examining Russia's public sector expenditure. There is, of course, considerable uncertainty built into these calculations as well. War-related expenditure largely falls under the category of defence spending in Russia's federal budget. Defence spending in 2022 will be up by at least RUB 1,200 billion compared with the pre-war budgeted total. According to Russia's provisional 2023–2025 budget, its defence spending for that period is being raised by a total of RUB 2,600 billion above the previously budgeted figure. So, since the start of the war, the country's defence spending is being increased by at least RUB 3,700 billion (approx. USD 53 billion at this year's official average exchange rate).

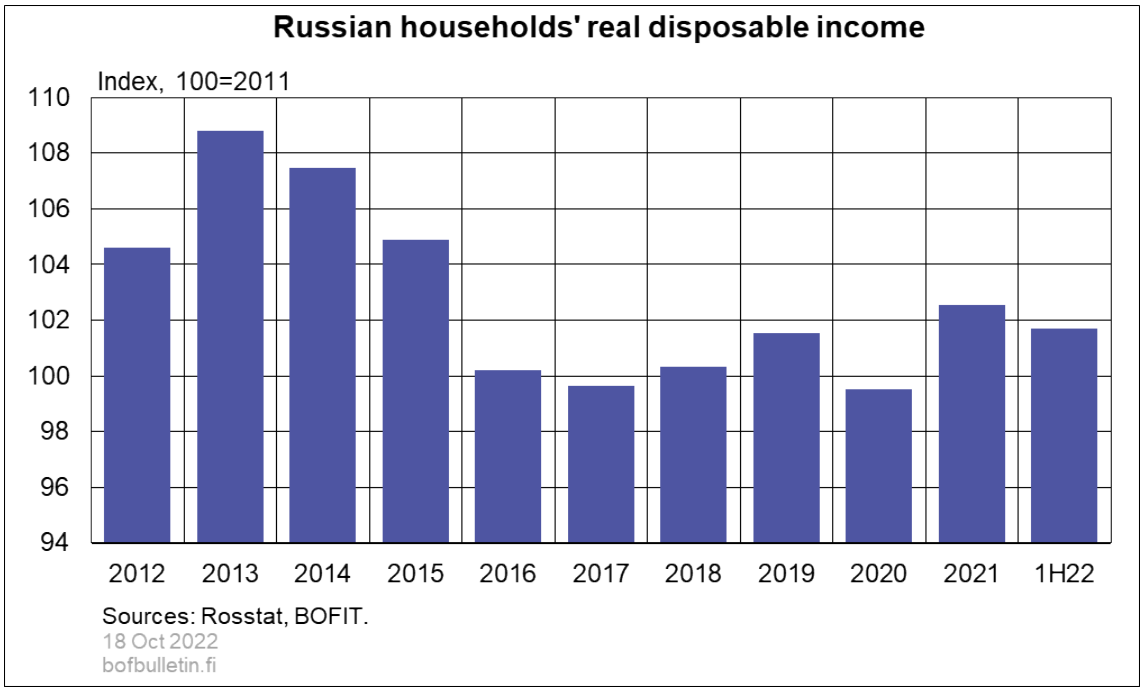
War-related expediture may also be included under the category of national security spending. Such spending is also being boosted in 2022–2025 by an overall figure of about RUB 3,700 billion above the previously budgeted level. In other words, current plans show that the war is increasing budget expenditure on defence and national security in 2022–2025 by altogether RUB 7,400 billion (USD 110 billion, or almost 6% of the 2021 GDP total). The expenditure total may even be greater than this, as not all budget spending is itemised. It is also possible that the level of spending might be raised further beyond the budgeted figure. Without the war, the Russian state could have used these funds for advancing the wellbeing of its citizens. Instead, to fund its war, the Russian state will have to cut expenditure on more beneficial matters such as road construction and science promotion. Additional defence spending may boost output in the military industry, but it will not enhance the wellbeing of the country's citizens.

The Ukraine war is reducing the growth prospects for the Russian economy in the longer term as well. The war and the consequent economic sanctions imposed on Russia have added enormously to uncertainty in the Russian economy. For a long time to come it will be very difficult for Russia to obtain finance from international markets and especially to attract foreign investment. The economic sanctions imposed on Russia by many countries place powerful restrictions on the opportunities for it to access high technology and also many other key imported goods. The war is expanding the role of the state in Russia's economy. Productivity is diminishing. As a consequence of the war, hundreds of thousands of citizens have already fled Russia. This could mean that the more highly educated section of the workforce, in particular, will also shrink in the longer run.

Most assessments show that, before the war, Russia's long-term growth potential was about 1.5% per annum. Preliminary estimates indicate that the war and the sanctions could curtail Russia's long-term annual growth rate by 0.5 – 1 percentage points. At this pace, Russia's GDP will not return to its pre-war level even by 2030.

The purchasing power of Russians will also fall sharply, although it has developed weakly for the past decade already. In January–June 2022, the average disposable income of Russian households was lower in real terms (i.e. taking inflation into account) than in 2012 (Chart 2). The drop in incomes is expected to gather pace in the second half of this year. With import opportunities reduced, the range of products available to Russians will shrink. Russian substitute products often are of inferior quality and more expensive, as was seen with many food products after Russia's import restrictions in 2014. The scope for Russians to travel abroad has narrowed considerably. The short-sighted decision to start a war taken by the Russian government will have far-reaching economic implications for all Russians.

Chart 2.



Keywords

BOFIT, economy, Russia, sanctions, Ukraine