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Russia's GDP growth reflects military spending, not economic strength

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Although Russia's output growth has slowed in recent months, the official preliminary estimate puts third-quarter on-year GDP growth at 3 %. We should not put too much emphasis on the exact number due the heightened uncertainty of Russian statistics since the invasion of Ukraine. But as we lack compelling evidence of systematic or large-scale manipulation of Russian economic statistics [1], it is prudent to assume that Russia's official GDP figure is in the ballpark.

Does this mean that Russia is enjoying a growth boom?

No. It means the Russian government is pouring money into the economy, particularly industries that support the war effort. Russia's Ministry of Finance estimates that fiscal support alone amounted to 11 % of GDP in 2022–2024, representing a sharp break from earlier budget policy. In 2018–2019, the government set the equivalent of 4 % of GDP *aside* in the National Wealth Fund. This strategy is unsustainable over the longer term, even if Russia so far faces no serious financing challenges thanks to tax hikes, increased domestic borrowing and draining the national savings. And the imbalances are mounting all the time.

Does it mean that sanctions imposed on Russia have had no effect?

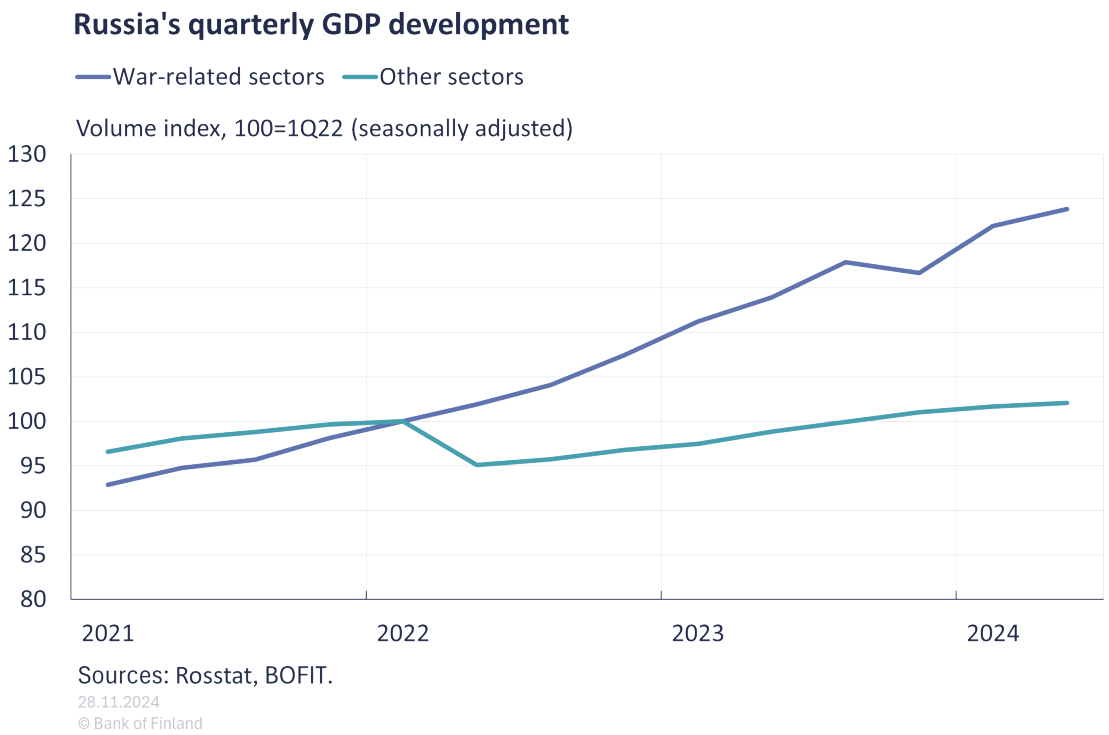
No. Sanctions have substantially reduced Russia's access to foreign funds. Foreign investment flows to Russia have dried up and availability of foreign borrowing is severely restricted. Sanctions have cut Russia's export revenues. The International Energy Agency (IEA) estimates that the

export price of Russian crude in 2023-2024 has averaged $15 a barrel below the price of peer grades, implying a loss of roughly $75 million a day in export revenues. Sanctions have restricted Russia's access to foreign inputs and technologies and increased their prices for Russians and force the country to constantly increase public spending and public debt. Without sanctions, it would be much easier and cheaper for Russia to wage its war of aggression in Ukraine.

Does it mean that the war imposes no costs for the Russian economy and population?

No. The current strong boost from public spending on war-related branches masks the longer-term negative consequences of the war and Russia's policies. Russian economic growth is largely confined to war-related activities (Figure 1). For the rest of the economy, development has been modest. Notably, some of the output and investment growth associated with war effort is rapidly destroyed on the battlefield – it does little to improve the welfare of Russian society. Russian GDP figures depict a shift to military-industrial activity and cannibalization of longer-term consumer welfare and social safety nets.

Chart 1.



Note: War-related sectors refer to manufacturing of fabricated metals, computers & electronics, transport equipment other than automobiles, as well as public administration and defence services.

Russia's long-term structural economic problems are aggravated by war and sanctions. The labour

force decline has been accelerated by mobilization, war casualties and migration. Financial resources for productive investment are scarce as domestic investment is directed to war-related sectors. Foreign investment has collapsed. Productivity gains are ever more difficult due to pervasive state involvement and severely restricted access to international cutting-edge technologies and scientific cooperation. Lack of foreign competition also reduces the incentive for firms to improve their productivity.

Does it mean that Russia can still continue the war?

Yes. Russia's robust output numbers mean that Russia can and will continue its war of aggression in Ukraine. Even with slowing GDP growth, Russia can sustain the current level of output in its war-related sectors. War, after all, is Russia's top policy priority, which means the country will direct all resources needed to support the war effort no matter the harms or long-term costs incurred by other parts of the economy. Eventually it will become economically unsustainable for Russia to continue the war, but policymakers today cannot take a wait-and-see approach and hope for an early end to the conflict. Ukraine needs support now – tightened sanctions, more financial resources and increased military support – to defend itself and Europe from Russia's aggression. That is for the benefit of the whole Europe [2].

Keywords

Russia, sanctions, Ukraine, war economy