BOFIT blog

War has degraded Russia's long-term economic outlook and business environment

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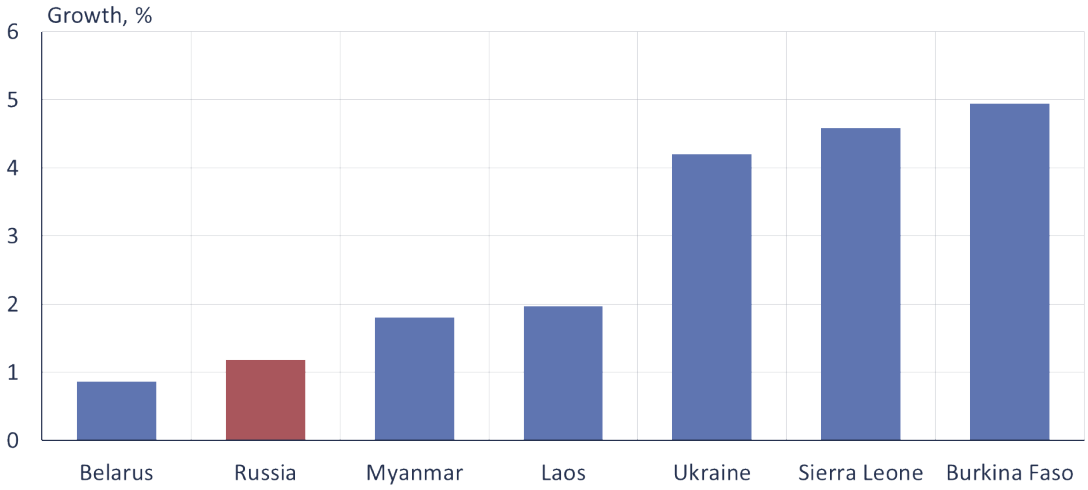
Russia's decision to start a war in Ukraine has eroded its economic growth potential and deteriorated its business environment. These problems will remain long after sanctions are lifted.

Russia currently has one of the lowest projected long-term growth rates and one of the highest levels of country risk in the world. Indeed, only Belarus offers an equally lousy combination of growth and risk (Fig. 1). The situation would improve, of course, with an end to the war in Ukraine and a lifting of sanctions, but such improvement would only be modest without massive changes in Russia's policy framework.

Chart 1.

Long-term GDP growth in countries with similar assessments of country and business environment risk



Note: Long-term growth is the 2028–2030 average estimated by the IMF. Based on the Coface risk assessment indicators, all these countries score assessments of "D" (very high risk) for both country risk and business environment risk.
Sources: IMF WEO April 2025, Coface.
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Russia's recent growth has been mainly based on massive increases in government spending and other government support measures to boost production for the war effort.[1] Such policies are unsustainable, and indeed, Russian growth has already begun to slow amidst accelerating inflation. If the war would end, that would likely mean an end to the growth in the very government spending that has sustained economic growth.

Russia's longer term growth prospects have been weak for years. During 2015–2019, Russia's GDP growth averaged just 1 % a year and its long-term growth potential was generally considered to be somewhere around 1.5 % a year.[2] The Russian economy faces a number of structural challenges, including unfavourable demographics, lack of investment and poor productivity growth. The war and resulting sanctions on the Russian economy have exacerbated these problems and further eroded Russia's growth potential.[3]

The decline of the Russian labour force began already in 2006. Today, the unemployment rate stands at a historical low of about 2 %. Surveys show that Russian companies currently suffer from a severe lack of workers, and that the war has made things worse. Estimates compiled by the *Economist* suggest that about 200,000 Russian soldiers have already been killed in the battlefield. When wounded and injured are taken into account, the total number of casualties rises to 700,000–800,000.[4] In addition, hundreds of thousands of Russians have emigrated from the

country to avoid the war.

Russia's low level of investment presents another long-term economic problem. Since the invasion of Ukraine, there has been a notable acceleration in fixed investment growth. Much of that investment, however, has been directed at the war effort. Some investment has even gone to renovation of Soviet military equipment that has been subsequently destroyed at the battlefield. Such investment hardly supports the future growth potential of the economy at large. Russia has a poor track record in exploiting military production advances in civilian applications.

Russia has consistently performed poorly in international productivity comparisons for many decades. The output per hour worked (PPP-adjusted) in Russia is still only about half that of the US or euro area. Rosstat figures also show that labour productivity declined between 2021 and 2023. Increased government spending and excessive focus on war-related industries have expanded the Russian state's footprint in the economy both directly and indirectly. In the Russian context, such heavy-handed intervention has historically made the economy less efficient and more susceptible to corruption. Moreover, political suppression of foreign competition reduces the motivation of Russian companies seek productivity gains.

Risks related to Russia's business environment will remain high even after the war. Many of the changes to the Russian economy caused by war are lasting,[5] because economic policies are now completely subordinate to political objectives. If Russia is allowed to achieve its goals in Ukraine, it will likely use similar strategy again irrespective of the economic consequences.[6] In the business sphere, survival through displays of loyalty to the leadership has become more important than economic considerations. Expropriation and redistribution of assets has increased.

Russia's political priorities make also the business environment ever more unpredictable. The government has arbitrarily introduced regulations complicating business operations such as additional capital controls with little blowback. The country, of course, will eventually have to pay the costs arising from the war. The private sector will likely be called upon to bear share some of the burden in the form of additional taxes or something else. Russia's policymakers have already declared their intention to favour domestic companies and even begun to specify conditions under which foreign companies might be allowed to return to the Russian market.

Russia's decision to start a war in Ukraine has eroded its economic growth potential and deteriorated its business environment. These problems will remain long after sanctions are lifted.

Keywords

business environment, growth, Russia, sanctions