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Surprisingly resilient

Western sanctions and military defeats could've destroyed Russia's economy. But not only has it emerged unscathed, it's actually on the path to growth

Ever since Russia first attacked Ukraine in 2022, there has been talk of the invading country's economy collapsing. German Foreign Minister Annalena Baerbock predicted the sanctions would ruin Russia. And there were indeed many signs to suggest this in the first few months of the war: from the large number of Western companies that pulled out of the Russian market, to the automotive industry running out of parts due to supply chains being interrupted, which saw factories grind to a halt or close down completely. The Russian economy was in freefall, while the West thought its own economy was on the up.

But not only has the Russian economy come out unscathed, it is actually on the path to growth. To counter the economic crisis brought on by the sanctions and the military defeats in Ukraine in the summer of 2022, the Russian government changed tack by engaging in Military Keynesianism. At its core, this describes a state-driven macroeconomic policy that aims to boost aggregate demand through higher military spending. Russia has tripled its military spending since the invasion of Ukraine. Its defence budget alone accounts for 40 per cent of government spending, up from between 14 and 16 per cent prior to 2022. Rising industrial production is driving the Russian economy out of years of stagnation. In 2023, GDP rose by 3.6 per cent, with growth of 2.5 to 3 per cent expected for this year.

A long-term strategy

The country's demand-oriented economic policy primarily benefits companies in the defence sector, but also supports suppliers in industries such as mechanical engineering and steel. These have long called for a more protectionist economic policy, as their Western – and increasingly Chinese – competition dominates global markets. Workers in the manufacturing sectors are also reaping the rewards, having been among those to lose out the most in Russia's transition to capitalism.

While social hardship and unstable employment conditions have dominated these people's day-to-day lives over the past 30 years, they have seen their material situation significantly improve since the war began. Real incomes rose by 5.8 per cent in 2023 according to the state-run Russian statistics office Rosstat. Despite some significant regional differences, wages in manufacturing have more than tripled, in some cases even increasing fivefold. In December 2021, weavers received about $250 to $350 per month, but can now expect wages of up to $1 300.

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Military Keynesianism should not be seen as restricted to times of war, though. Rather, it is part of a long-term policy strategy championed in particular by national conservative factions in the Russian elite, seeking to reduce the country's heavy dependence on raw materials exports and, in turn, to strengthen Russia's influence on the emerging multipolar world order. Since invading Ukraine, the Russian government has partially abandoned its traditionally monetarist fiscal policy. Neoliberals such as the head of the central bank, Elvira Nabiullina, have heavily criticised introducing capital controls, higher taxation on company profits and replacing the flat tax rate with a progressive system, but have failed to prevent these. Instead, national conservatives have been further bolstered by the appointment of Defence Minister Andrey Belousov.

The changes afoot in Russia's economy are also becoming increasingly apparent in foreign trade. Many companies are now focusing more on BRICS and the Global South than 10 years ago as a result of Western sanctions and domestic support for industry. As the US and the EU push to distance themselves from China, Russia is forging closer technological cooperation beyond defence with its southern neighbour. Even before the invasion, the Carnegie Institute found that Russia had been quietly pursuing a technological *Pax Sinica*. Trade with Eurasian Economic Union (EAEU) member states, as well as with India, Iran and Africa, is also gaining ground. It is striking that Russia is not only supplying raw materials to these countries, but also that efforts are being stepped up to open up new markets for the agro-industrial complex, the IT sector and mechanical engineering, as well as the traditionally global defence industry.

Downsides of this new strategy

Economic relations with China, however, reveal how dependent Russia is on high-tech goods, which was also the case during trade with Western European countries, especially Germany. While Russia mainly exports raw materials, especially fossil-fuel energy, it imports machinery, equipment and consumer goods in return. But there's one key difference: China buys large quantities of arms and technology from Russia to build nuclear power plants. Yet, that dependency on innovative technology and consumer goods is why there are such strong reservations in Russia about a close alliance with China.

Another downside of Military Keynesianism is the growing regional differences: while industrialised western Russia and the Ural region benefit from government demand for arms, the economically isolated regions of the North Caucasus and the Arctic North are falling further behind. On top of these regional gaps, social inequalities are also deepening. Precarious employment and low wages are particularly widespread in the services sector, as demonstrated by the wave of strikes by the courier drivers' union. What's more, the number of families whose relatives have been lost in the war or who have left the country as a result and often live in vulnerable conditions abroad is rising.

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It's abundantly clear: Russia's Military Keynesianism has its people's support. Company managers and employees – especially skilled workers – from the manufacturing sectors support the policy, as it serves their interests in a targeted way. This doesn't necessarily mean that employees approve of the war against Ukraine. But the significant material improvements to their lives have earned support for the government, especially in the echelons of society that were particularly affected by the ongoing economic crisis and the dismantling of the welfare state (not least the pension reform).

This is reminiscent of the economic boom Russia enjoyed during the first two Putin administrations from 2000 to 2008. But there are big differences. Driven by rising commodity prices, the rapid economic growth at the time was primarily based on increased oil and gas exports, which two groups more than anyone else benefited from: owners of raw material companies and the urban middle classes, especially those employed in the trade, financial and property sectors. As the largest

purchaser of Russian energy resources, those social groups had a huge interest in maintaining close economic and political relations with the West.

Yet, Military Keynesianism only works under the condition of economic isolation from the West and goes hand in hand with Russia's economic and political stance toward Asia. This creates a dangerous internal political fabric in which certain social strata have an interest in pursuing conflict with the West (and Ukraine) or at the very least in continuing the Military Keynesianism that they benefit from, whether materially or politically. This makes it difficult not only to find a solution for peace in Ukraine, but to then also bring about a rapprochement between Russia and the West and rebuild trust.



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