



Russia's Economy Behind the Curtain

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You may have seen videos of Russian President Vladimir Putin boasting that the Russian economy grew more rapidly (reportedly up 3%) than the rest of the world (notably most European countries and the U.S.) over the course of 2023. The country has been living under significant economic sanctions since the invasion of Ukraine, so this wasn't exactly what most economists had been predicting.

What happened?

Several articles have delved more deeply into the state of the Russian economy during this alleged growth spurt, and their conclusions are somewhat less optimistic than the Russian leader's. They note that Russia has increased its military spending dramatically, now accounting for an astonishing 39% of the Kremlin's total budget. That figure includes the income of soldiers and pensions for the widows of more than 300,000 soldiers killed at the Ukrainian front lines—and, of course, weapons, tanks, and military aircraft. As a result, deficit spending is running at 6% of the total economy, and interest rates are standing at 16% from the Russian banks that are able to lend.

If you take away the robust growth in military spending, the economic picture isn't so pretty. More than a thousand companies have fled Russia since the start of the war, along with at least a million highly skilled workers who were not excited about being drafted into the front lines. Combine the two, and Russia's tech and oil exploration sectors are dramatically depleted, which will show up on future economic balance sheets should Putin allow it.

At the same time, 33% of the country's millionaires have fled abroad, taking with them an estimated \$253 billion in private capital. Direct foreign investment, once running at \$100 billion a year, has completely ceased since February of 2022, Russia is cut off from the Western banking system, and the Russian ruble is no longer a convertible and exchangeable currency on foreign markets. The value of some state-owned enterprises has dropped 75% since the invasion.

But the question remains: how is Russia able to manage to pay its military budget at all, under the severe sanction regime? The short answer is that China and India have remained eager customers of Russian oil and gas, and Europe is still a buyer, albeit at lower levels than before. Countries like Turkey and Kazakhstan have helped Russia circumvent the sanctions, in part, by taking orders from Moscow, buying on the global markets, and then quietly shipping whatever is requested back north across the forbidden border.

These are euphemistically called ‘parallel imports.’ Observers have noted that since the start of the war, there has been a \$10 billion annual increase in imports from other nations into Kazakhstan and another \$10 billion in exports on the balance sheet. The two are strangely coincidental and actually technically legal since the contracts are made with Russian companies that are not on the sanctions list. The contracts might be written for women’s wigs or canned goods, but, since there are no customs posts at the Russia/Kazakh border, the trucks that cross over might actually be loaded with drones or microchips.

And that doesn’t count the fact that the Kazakh government is not very strict about restricting smuggling activities. Reports indicate that unrecorded trade is equal to or exceeds official trade figures, and the way that Russia is taking over the banking system in Kazakhstan as a backdoor way to convert worthless rubles into valuable dollars makes for interesting reading.

When your entire economic growth story is government spending on something unproductive (like a war), your country’s long-term prospects are not ideal. The Russian President might brag today, but eventually, probably sooner than later, he’ll be a lot quieter about the Russian economy.

Sources:

<https://moneyweek.com/economy/global-economy/why-russias-economy-is-doing-better-than-predicted>

<https://thediplomat.com/2023/10/how-kazakhstan-helps-russia-bypass-western-sanctions/>

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