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Sergey Afontsev: “Russia’s Economy Model Changed Due To Sanctions”

The Russian economy keeps on growing higher than forecasted, despite the 14 sanctions packages, imposed on the country.

At the Eastern Economic Forum (EEF-2024) Russian President Vladimir Putin reported that the increase in the GDP over 12 months may exceed the last year’s number of 3,6%. However, the Central Bank keeps pointing at overheating of the Russian economy. Who is right and which areas could bring unpleasant surprises, the BM asked Sergey Afontsev, Deputy Director for Scientific Work of the Institute of World Economy and International Relations of the Russian Academy of Sciences (IMEMO), who answered these questions in his interview.

The authorities are gradually adjusting their forecasts for Russia’s development rates till the end of the year, and these are positive adjustments. If previously the GDP growth rate for the first six monhts exceeded expectations (the figure for the six months was 4,7%), and the growth was forecasted to slow down by December, then now even

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the President at the EEF -2024 pointed out that the economic growth in 2024 could climb higher than last year. Is this view justified?

All forecasts have variable nature. In Russia forecasts are regularly issued both by the authorities and by independent analytical organizations, this is why the issue of which forecasts would be more accurate, merits a separate discussion. Nevertheless, almost everyone is positive that we are headed for a certain slowdown by December 2024.

Russia entered Q1 with a strong development impetus, which was its legacy from 2023. But it would be too optimistic to expect these dynamics to continue for all of the 12 months.

How tangible will the slowdown of the economic growth will be for the country, its industries and people?

Overall dynamic development will continue, there just will be lower growth rates in comparison to Q1 2024. In 2023 Russia's growth rates for the first time in many years surpassed the global economy. We have great chances to observe a similar story this year as well.

In July the International Monetary Fund (IMF) forecasted that the global GDP in 2024 will grow by 3,2%, when for the Russian economy, as per the most realistic estimates, the GDP growth will be in the range of 3,6-4,0%. And this is a very good result.

Despite all the imposed sanctions, our country will be growing by about 2 times faster than the developed countries of the world, and 4 times faster than the Eurozone countries, which have become the primary losing side of the sanctions standoff.

Which sectors or industries will cause slower development?

By the end of the year foreign trade activity rates will be slowing down. Both the price factor and the destructive policy of our geopolitical adversaries, continuing to put pressure and sometimes just intimidating those countries that would like to develop their cooperation with Russia, will play their roles.

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We have already achieved the key benefits, related to pivoting our foreign trade “from the West to the East”. Further expansion of exports to those developing countries of the world, that are willing to cooperate, will require significant efforts.

At the same time the conditions for access to foreign technologies and goods, required for development of the Russian economy, are deteriorating. Though in this instance the situation is far from hopeless, which is directly recognized by our opponents.

What do you mean by that?

Over the first half of 2024 the Russian imports of sanctioned high-tech goods were only a little below the figure, registered at the start of 2019, when there had not been any strict sanctions in place. This is confirmed by the data, published this September by BRUEGEL think-tank, based in Brussels, which could hardly be suspected of any sympathy towards the Russian Federation. More new restrictions are imposed on us, but we keep finding new mechanisms to adapt to these.

Not Just Arms Industry Alone

Western analysts believe that the growing Russian GDP is boosted by rapid growth of the military industrial complex (MIC). Is this accurate?

This is a popular fallacy in their circles. The key error in this case is their lack of any attempts to analyze Russian statistics, and they make their assumptions based exclusively on ideological stereotypes and their fantasies.

Indeed, many foreign analysts directly tie the growth of our GDP to increased MIC expenditures. Others, more cautious, prefer speaking of the leading role of the total government expenditures on the whole. Both viewpoints are incorrect. To prove them wrong, it is enough to have a look at the numbers. How much did the federal budget expenditures rise in 2023 versus 2022? By ₽1,23 trillion. Consider this — these are aggregate expenditures, and not just the MIC expenditures!

And how much did the GDP of Russia grow by in 2023? By ₽16,96 trillion. This is 13,7 times higher than the increase in the

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expenditures.

Show me an expert, who would in his right mind state, that 1 extra rouble in government expenditures could raise the GDP by almost 14 roubles! This would be just dumb. Yes, government expenditures indeed contribute to expansion of the domestic demand, but they are not the key driver of growth.

Essentially, the primary reason for the Russian GDP growth over the latest years are the changes in the economic development model.

For two decades key financial resources of our country moved inside the “commodity income – state-owned banks – investment mega-projects” circuit. At the same time a significant part of commodity export income was “siphoned off” abroad. Things are totally different now.

Finally, the money in the country went into the domestic market, and not into foreign investments, not into government mega-projects. And this is fueling growth of a broad spectrum of the national economy industries, including those focused on civilian production.

Is the MIC related to furniture manufacturing in any way? No relation whatsoever. And the production volume in the industry over the first six months of this year grew by 14,5% in real terms.

The output of the food product industry rose by 6,9%, in the textile industry — by 8,4%. These are tangible results of the pivot of the economy to the domestic market.

So, it turns out that the rapid increase of the MIC’s rates has not led to any imbalances in the economy, and it is developing for different reasons?

This is correct. The current focus on the MIC output is not an “imbalance” but a reaction to the geopilitical circumstances, where these products are in high demand. If external threats are eliminated, then output ratios will change in line with demand structure. We will manufacture fewer tanks but build more bridges. This will not have any negative effect on economy growth rates.

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Blessing In Disguise

Despite the 14 sanction packages, imposed on Russia, the economy continues growing. Why is this happening?

The restrictions, by all means, have cost our country dearly. Nevertheless, first, the country has managed to address their consequences. Second, as I have already said, our economic model has changed under the impact of the sanctions.

We have been saying for many years that the Russian economic model is very inertial and cannot support high growth rates.

It's a paradox, but a fact: our geopolitical adversaries aimed at destroying the Russian economy, but killed the economic model which had prevented Russia from developing. Now a new economic model is being established.

What happened in 2022? We managed to rebuild our foreign economic ties. And in 2023 we managed to find sources for domestic demand.

What should happen in 2024 and further on? We must develop an investment basis for economic growth. And things are going rather well for now. Over the first six months of 2024 the investments in fixed capital rose by 10,9%. It is crucial to maintain momentum in this sphere.

Why can't the Russian authorities still curb the inflation? In September the Bank of Russia hiked the key rate up to 19%, and might raise it again before the year is out. Why do prices keep on rising?

The Central Bank, when making its decisions to raise the key rate and take other anti-inflationary measures, is primarily guided by the consumer sector pricing dynamics. And on the whole we have to admit that it is successful in curbing their growth.

Let's look at the numbers once again: in the first half of the year the consumer prices grew by 7,9%, and, for instance, the overall level of manufacturer prices rose by 17,7%. But for the Central Bank policy, the consumer inflation would have been

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even higher, which means lower real incomes of the population.

In the first half of the year, despite the inflation, these incomes went up by 7,4%. And just recently their dynamics were negative (it was last registered in QIII 2022). On the whole, a 6-10% inflation corridor for a sanctioned country, which has to expend large resources to resolve geopolitical issues, I believe, is quite acceptable.

And how can you explain the tangible growth of population incomes in the first six months of 2024? The Bank of Russia regularly mentions that the wages of Russians are increasing disproportionately to workforce productivity. Is this true?

Increasing incomes are a natural phenomenon under a changing economic development model and relevant re-organization of cash flows, and also growing demand on the domestic market. This is supported by high employment levels and growing wages. As for the correlation between wage growth rates and workforce productivity, in this instance there are more myths than common sense.

First, if workforce productivity is calculated not per one worker, but per one hour of worktime, then its dynamics would look significantly better. Second, from the viewpoint of the economic science there is no functional connection whatsoever between wages and average workforce productivity. The level of wages is determined by the amount which an employer is ready to offer to an extra worker he would like to hire. Therefore, it is determined by the productivity of this very extra worker, and not anyone else’s. This means, that in those industries, which see growing demand, there is developing production, employers raise wages to get new workers.

Less fortunate industries that cannot raise their wages, in this instance face either an outflow of personnel or are forced to invest into improving production efficiency. This is one of the standard sources for structural changes in an economy. There is nothing wrong with this; on the contrary, an economy would only win from this.

Thorny Path To Leadership

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What does the biggest success of the Russian economy over the three quarters look like? And what is its most palpable risk?

— The greatest success of our country is the start of launching the mechanisms, which are jointly called the “supply-side economy”. These enable expansion of product output at this level of demand: this is an investment mechanism and manufacturer government support mechanisms, and mechanisms for adaptation to external foreign trade and technology restrictions. This is exactly what the key risk for the Russian economy is related to: our geopolitical adversaries continue making up new obstacles, trying to influence our partners, making them act against their own best interests.

Over the latest months there have even been issues with the cooperation with China and some CIS countries. These issues for Russia are a real restriction of its development.

How much will the economy of our country grow by results of this year?

I assume that the economic growth this year will go over 3,8%. The growth of real incomes of the population will continue, but could it be kept at the level of over 7% is a question of the anti-infaltionary policy efficiency.

The key growth drivers will be the industries, focused on domestic demand, primarily the industries of the civilian sector of the economy.

In October Kazan will host a BRICS summit. How could partnership with the BRICS countries help Russia develop faster?

The main practical task, currently faced by the BRICS is minimization of risks, related to the meddling in their foreign economic cooperation by the USA and other unfriendly countries. The key prority is to create payment mechanisms, excluding uses of the dollar and other currencies of the developed countries, which have become toxic. There is a number of constructive propositions, which, as I hope, will be integrated into resolutions of the BRICS Summit and will facilitate easing of the external restrictions for the economic growth in the Russian Federation.

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Anna SOLNTSEVA

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