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Kontakt/Contact

ZBW – Leibniz-Informationszentrum Wirtschaft/Leibniz Information Centre for Economics
Düsternbrooker Weg 120
24105 Kiel (Germany)
E-Mail: [rights\[at\]zbw.eu](mailto:rights[at]zbw.eu)
<https://www.zbw.eu/econis-archiv/>

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27th Global Economy Lecture

Sergei Guriev on “The political economy of Putin’s war in Ukraine”

Compiled by Maria Silgoner¹

On January 11, 2023, the Oesterreichische Nationalbank (OeNB) and The Vienna Institute for International Economic Studies (wiiw) hosted the 27th Global Economy Lecture², which was delivered by *Sergei Guriev*, Professor of Economics and Provost at Sciences Po in Paris and former chief economist of the European Bank for Reconstruction and Development (EBRD). From 2004 to 2013, Guriev was rector of the New Economic School in Moscow. He has published numerous articles on contract theory, corporate governance, political economics and labor mobility. Together with Daniel Treisman, he recently published the book “*Spin Dictators*” (Princeton University Press, 2022).

In his introductory remarks, OeNB Governor *Robert Holzmann* praised Sergei Guriev as one of the most renowned experts on the Russian economy. Being a Russian, Guriev was able to observe and analyze his native country from the inside until he had to emigrate in 2013. He is a critical and committed scientist, deciphering the complex developments in Russia and other authoritarian political regimes. Governor Holzmann emphasized the tremendous dimension of suffering and destruction the war in Ukraine has brought about but also raised the question of the war’s global impact and the risk that the war and the related sanctions might result in a bipolar world.

Professor Guriev started his lecture by pointing out that modern autocrats want to be popular. Instead of scaring people into obedience, these autocrats – for whom Guriev coined the term “spin dictators” – manipulate information to project an image of competent leadership. A leader’s popularity, in turn, is highly correlated with economic performance. Turning to Russia, Guriev explained that President Putin enjoyed a decade of approval rates of about 80% (based on data provided by the *Levada Center*) before Russia’s GDP growth started to decline in 2010/11, causing Putin’s popularity to wane. This decline in popularity, in turn, prepared the ground for Russia’s invasion of Crimea, which can be seen as Putin’s attempt to regain popularity. Indeed, Putin’s approval rates recovered thereafter but decreased again when he decided to raise the retirement age in Russia and had to face adverse media campaigns. Russia’s invasion of Ukraine must thus also be seen against the background of Putin’s historically low popularity.

Guriev then elaborated in more detail on pre-war economic conditions in Russia. The Russian economy had faced years of slow and below-potential economic growth, falling household incomes, large capital outflows, and low and stagnating investment ratios. The Russian growth model was based on widespread corruption that led the country into a middle-income trap, causing it to lag behind the other BRICS countries. At the same time, robust macroeconomic fundamentals – a balanced budget, low sovereign debt (20% of GDP), large currency reserves (40% of GDP), a sovereign wealth fund of 12% of GDP and a sound monetary framework

¹ Oesterreichische Nationalbank, International Economics Section, maria.silgoner@oenb.at.

² The Global Economy Lecture is an annual event organized jointly by the OeNB and The Vienna Institute for International Economic Studies (wiiw).

characterized by a move toward flexible exchange rates and inflation targeting – gave Putin a false sense of security. In response to the COVID-19 pandemic, he opted for fiscal austerity rather than economic stimulus in order to remain independent of financial markets. As his approval rates plummeted, Putin responded by media repression, leaving the “spin dictator” track.

As Guriev put it, Putin’s major mistake ahead of the invasion of Ukraine was to overestimate Russia’s own financial and military strength while underestimating the courage of Ukraine, the unity of the Western world and the power of sanctions. Several studies have found that the sanctions adopted after the invasion of Crimea had only a minor impact on trade or GDP. By contrast, the sanctions adopted in response to the war against Ukraine went much farther, comprising the switching-off of SWIFT, the freezing of currency reserves, comprehensive export controls (also for central items such as microchips, aircraft and software) and – starting from December 2022 – oil sanctions. These steps were reinforced by a voluntary trade boycott by more than 1,200 Western and several non-Western companies.

As a result, Russia’s trade with the US and the EU declined by at least one-third. Russian GDP, which – before the invasion – was forecast to grow by at least 3% in 2022, declined by 3%. This recession was much milder than what had been forecast for the entire year in mid-2022 (–8%). However, in times of war, GDP is not a good measure of economic activity as it includes the production of ammunition. Other indicators suggest that Russia’s economic performance is much worse: The country’s retail turnover is 10% lower than one year ago, household incomes declined by 10%, and non-oil taxes are 9% lower than in the previous year.

That the economic slump did not get any worse than that is the merit of a very competent central bank. Still, the Russian ruble is much weaker than could have been expected on the basis of current oil prices. Although additional revenues from high oil prices compensated some of the losses from frozen reserves, Russia’s fiscal accounts turned from a surplus into an annualized deficit of about 2.5% of GDP by the end of 2022. This forced Putin to take unpopular decisions, such as cutting pension spending or declaring a partial mobilization instead of relying on mercenary soldiers. However, it has required huge repression efforts to hold back protests.

Over the next few months, Russia will experience a continued recession, fiscal fallout and ongoing capital flight and brain drain, all with a major adverse growth impact in the long term. According to estimates by the International Monetary Fund (IMF), Russia will see a permanent growth loss of 10 percentage points by 2026 compared to the pre-war potential. Sanctions constrain Putin’s military spending and access to technology. But all these restrictions, according to Guriev, will not be enough to stop him right away. Instead, he will complete the shift from spin dictatorship to fear dictatorship, tightening censorship and repression and cleansing Russia of “national traitors.”

Coming back to the question Governor Holzmann raised about the war’s impact on the global economy, Professor Guriev pointed to global growth damage, the current gas shortages (reminding the audience that large quantities of gas reserves, which currently are at comfortable levels, are still of Russian origin) and the war’s contribution to prevailing inflation trends. In his opinion, whether the war will result in a bipolar world will ultimately depend on Putin’s success in convincing the global South that the West is a threat.

The Global Economy Lecture was followed by a vivid discussion, with contributions from both the in-person and online audience (more than 300 persons in total). The debate revolved, inter alia, around China's pivotal role as an important buyer of Russian oil. On the other hand, China has so far refrained from supplying military equipment to Russia. The war hurts China as the country's growth and employment depend on the global economy. Whether the likelihood of a Chinese invasion of Taiwan might be influenced by the outcome of this war is unclear. Regarding the reliability of popularity data, Professor Guriev said that polls on political approval do not have a huge bias even in totalitarian regimes but are unreliable in times of repression, when survey participants fear being wiretapped by national security.

When asked how long he thought Russia's war against Ukraine would go on, Sergey Guriev emphasized that a war like this may continue forever, as we can see in Korea, where no peace agreement has ever been reached. Sanctions, the supply of military equipment and financial support certainly tilt the balance of power in favor of Ukraine. But Ukraine will not accept anything less than getting back all its territory plus financial reparations, while Putin would not risk a huge popularity damage by losing this war. Whatever the outcome will be, we should not expect Putin to go back to spin dictatorship anytime soon. Instead, Professor Guriev explained, he will keep repression at high levels.