

Russia: the social consequences of the sanctions

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I have collected some thoughts on the immediate impact of sanctions on the Russian economy: basically, 30 years of economic development is to be thrown into the bin.

An obvious starting point: Russia is highly integrated into the global economy. Its share of imports to GDP (20,5%) is the highest in the BRIC group (19% in India, 16% in China, 15,5% in Brazil).

By targeting Russia's reserves denominated in euros and dollars and blocking access to paper currency, the West severely restricted Russia's ability to import goods from the EU and the US.

The EU is Russia's biggest trading partner, accounting for 36,5% of its imports. Another 5,4% come from the US. Russia can still pay for its imports with currency that comes from current exports, however, this currency is also needed to stop the freefall of the ruble.

Overall, financial sanctions dramatically limit Russia's capacity to import goods. Furthermore, exports are bound to fall too. The US has already stopped importing Russian oil. The EU is still buying oil and gas from Russia, but for how long and at what volumes?

Sanctions by logistical companies such as Maersk, excluding Russian banks from SWIFT and cutting other options for international financial transactions further restrict imports. Finally, many Western companies simply stopped exporting goods and services to Russia.

The Russian economy is no different from any other modern economy in a sense that it is integrated in complex global supply chains. Logistics works on the just-in-time principle (so the stockpiles of foreign-produced components are very limited).

Restrictions on imports will destroy Russian productive capacity in most spheres. Many factories (even those that are Russian-owned) stopped production because they lack foreign components.

They might retain the workforce, waiting for the renewal of imports, but if this doesn't happen in a few weeks or months, dramatic spike in unemployment is guaranteed. In addition, some of Russia's productive capacity is directly organized by foreign capital.

The number of employees in foreign and mixed-ownership firms in Russia is 5 million (some 10% of the workforce in formal employment). Many of these companies are currently suspending activities or leaving Russia altogether, leading to the severe crisis of unemployment.

Of course, because of economic linkages, unemployment will be cascading further and further.

All in all, no other economy in the world has experienced anything like this - extreme de-globalization in a matter of days.

It is impossible to adapt to this situation. Nationalizations of Western companies, even if they happen, do not guarantee that the new managers would be able to resume production.

Trade with China and other countries cannot replace trade with the West: 1) The volume is simply too high; 2) The quality of Chinese goods and components is uneven and unreliable; 3) Knowing that it can hold Russia hostage, China will offer highly unfavorable trade terms.

This is worse than [the sanctions regime imposed against] Iran and Cuba (for the simple reason that Russia is a bigger economy and de-globalization happened at a much more globalized stage of its development).

The damage that is already done is extreme, but if the situation goes on for, say, a year, I predict 30% drop in GDP, 20-30% drop in employment and the elimination of at least half of the middle class.

Hunger might be avoided by controlling prices on essential food items, but overall, this is misery and destitution that rivals and surpasses the early 1990s.

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