Problems mount in Russian economy as government tries to finance war machine

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The Russian government is facing mounting economic and social problems as a consequence of shifting the country onto a war footing. Last year, the state raised military and security expenditures to an unprecedented 40 percent of the federal budget for 2024. The Kremlin made various “guns and butter” promises, claiming that it would finance both the military and social programs. This is failing and inequality is mounting in Russia, in the face of an unsustainable budget that cannot survive the breakdown of the world order.

The Kremlin is currently attempting to paint a rosy picture of the Russian economy. On June 28, President Putin announced that the country’s GDP is expected to grow by 5 percent this year. Real wages are also reportedly up, as is consumer spending. Official unemployment is just 2.6 percent. Thus far, as Moscow regularly notes, NATO has failed in its aim to destroy Russia’s economy through massive sanctions, asset freezes, and the ejection of the country from key global markets.

However, the Kremlin’s ability to maneuver in the context of the rapidly escalating world war is highly tenuous. Above all, it is predicated on a) making the Russian working class pay for the oligarchy’s struggle to survive and b) containing and suppressing mass opposition to the fratricidal war unleashed not just by NATO, but by the restoration of capitalism in the USSR by Stalinist bureaucrats, to which Putin is an heir.

The current driver of Russian economic growth is massive state investments in war-related industries, which, while funneling profits to big business and a narrow layer of the population, are draining Russia’s coffers. Government spending in 2024 is now expected to significantly exceed what was previously approved, even as income from the energy sector is predicted to drop by 768 billion rubles this year. Meanwhile, the liquid assets of the country’s National Welfare Fund, an emergency financial reserve, fell by 44 percent between January 2022 and December 2023. Between $300 and $350 billion of Russian government assets are frozen in foreign accounts.

In response, the Duma is approving increases to deficit spending, with the legislature authorizing a boost in borrowing for 2024 of nearly 33 percent, up to 2.12 trillion rubles from the estimated 1.595 trillion rubles in the original budget. The Kremlin is simultaneously making changes to the tax structure, shifting the country from a flat-tax system to a progressive one, whereby as a person’s income increases, so does their tax burden.

This is expected to bring in an additional 2.5 to 2.7 trillion rubles ($28 to $35 billion at current exchange rates). The tax hikes for upper earners and corporations are being presented to the population as a sign that the government is committed to making the rich pay for the war and limited, although costly in budgetary terms, increases to pensions and welfare benefits authorized over the last year. The foreign press is also highlighting Putin’s alleged “assault on the wealthy.”

The reality is different. First of all, broad layers of the population, which are so poor that they fall in the bottom tax bracket, will see no relief from the reform. They will continue to be taxed at the extremely high rate of 13 percent. To the extent that wages are rising for some in Russia, as the lowest earners get a little bit more, they will move into a higher bracket and pay for their gains. Furthermore, the profit tax, which is levied on personal income derived from things like dividends, savings, and investment—assets held only by the well-to-do—will remain unchanged.

While corporate profits will be taxed at 25 percent, up from the 20 percent previously, Russian businesses reportedly lobbied in support of the reform because they see it as a way to evade one-time “windfall” taxes that the Kremlin imposed previously to fill the breach in the federal budget.

The social programs that the Kremlin says it will finance with the additional revenue—pensions indexed to inflation, payments to injured veterans, benefits for large families—even if they actually materialize, will not fundamentally change the social position of tens of millions of Russian workers whose living standards have been falling for years and whose salaries are being eaten up by inflation.

While the government and economists are highlighting the fact that, according to the official statistical agency Rosstat, as of March of this year real wages rose by 12.9 percent compared to the same time in 2023, this improvement is overwhelmingly concentrated in a handful of economic sectors—banking, oil, gas, and war-related industries. Furthermore, It does not make up for 10 years of falling real incomes in the country. In March, economist Yevgeny Suvorov at Centro Credit Bank described the period from 2014-2023 as “a lost decade” for the majority of Russian households.

Inflation, which the government claims it is getting under control, is currently running at about 7 percent. However, the everyday life of working class Russians is shaped overwhelmingly by the costs of essential products, not average inflation across the whole economy. According to a June 29 article in *Novyie Izvestiia*, in the last six months, the price of beets has risen by 95 percent, potatoes by 80 percent, carrots by 63 percent, onions by 32 percent, and apples by 29 percent. While costs for vegetables and fruit usually fall during the summer growing season, the current pattern is bucking this historical trend.

On July 1, utility rates went up across Russia. Households in the overwhelming majority of regions in the country will have bills that are 9 to 14 percent more than previously. The hike, approved by the federal government, will be in place for "three years," states the official declaration. No sane person anticipates it will decrease afterwards.

To finance its spending on war and national security, the Russian government cut expenditures on healthcare and medicine in both relative and real terms in 2024. The cost of attending many of the country's most competitive universities and higher education programs is now on the rise, with some institutions jacking up fees by as much as 20 percent, reports the newspaper *Vedomosti*.

Efforts to substitute Russian-made products for cheaper foreign-produced goods that sanctions prevent from being sold in Russia is also placing many products outside of the reach of ordinary people. With great fanfare, the country's auto industry released a number of new models in March. The cost of the Lada Iskra, presented as a triumph of domestic industry, far exceeds the average annual income in Russia.

Domestic gasoline prices are also now going up, as the government ended limits on overseas exports of refined oil. While this has resulted in increased profits for the energy sector, which prefers to direct its product to foreign buyers who pay more, it is driving up costs on the Russian market.

A February study commissioned by the Russian central bank found that 28 percent of people report either not having enough money for food or can buy food but not clothes and shoes.

Late last year, Chairman of the Russian Constitutional Court Valeri Zorkin reported that the decile wage ratio—the gap between the top 10 percent and bottom 10 percent of earners—has grown substantially and is nearly 17:1. This official figure significantly understates the reality, he noted. According to TASS, he described inequality as "the main source of tension in Russian society at the present stage." Earlier this year, Rosstat reported that the country's Gini coefficient, a measure of income inequality, grew to .403 from .395 over the course of 2022-2023.

Over half of respondents to a survey just conducted by the sociological research firms CSP Platforma and OnIn insisted that inequality has risen in Russia in the last five years. Thirty seven percent said that it was worse than at any other time in the country's history—including the 18th and 19th centuries, when the vast majority of the population were enserfed peasants living in conditions of near slavery.

Fifty seven percent of those surveyed, overwhelmingly people from the working class, said they regard the very existence of inequality as wrong. "Sociologists note that the proportion of those who strive for complete equality is especially high among poorly educated people with low incomes," reports RBC in a June 25 article about the survey's results.

The squeeze of the Russian working class will only intensify, as the country's ruling elite faces an increasingly precarious situation. Many signs indicate this is happening.

Over the course of June, news leaked that Chinese banks—the Bank of China, ICBC, China CITIC Bank, and most other financial institutions in the country—are now refusing to process yuan payments through their Russian affiliates. How trade between the two states can be sustained in this new context is unclear.

Vladimir Chistyukhin, the first deputy chairman of the Bank of Russia, said his "export-dependent and import-dependent country" faces "ruination," unless it can find a solution. "Everything needs to be tried," he said, according to press outlet RBC. Raising the prospect of turning to credit swaps and crypto currency, he declared that Russia had to do what "seemed unpopular to us yesterday."

China is Russia's largest trading partner and the leading buyer of Russian energy resources. While Moscow regularly portrays Beijing as an economic ally, the relationship between the two countries is more of dependency and constant strain. China is currently demanding that it be able to purchase future gas deliveries through the planned "Power of Siberia 2" pipeline at heavily subsidized domestic rates. Beijing will also not give guarantees as to the amount it will buy.

Russia's dependence on oil and gas, as well as China, continues, however, as Moscow's non-resource-related exports are falling. The recent strengthening of the ruble, which means that goods that Russia sells overseas are less competitive and bring in fewer rubles, is creating additional complications. Economists are also now warning of a banking and debt crisis.

In its attempt to survive the United States' and NATO efforts to devour Russia, the country's ruling class must put the squeeze on workers. Labor is the source of all wealth, and they will have to extract it, in one form or another, from those below. The war machine being built in Russia, however, is not going to save the masses from the mad efforts of imperialism to break up and dominate the country. It will be built at workers' expense with the aiming of saving the Russian bourgeoisie's right to exploit them. A mass international movement against capitalism and against war is the only way forward.