ANALYSIS

Felix Jaitner
December 2025

Objective: decoupling

The reorientation of the Russian economy and its impact on relations with the West

Friedrich Ebert Stiftung

Imprint

Published by
Friedrich-Ebert-Stiftung e.V.
Godesberger Allee 149
53175 Bonn
Germany
https://www.russia.fes.de
info.russia@fes.de

Editing Department
International Cooperation Department,
Russia Program of the FES

Responsibility for content and editing
Alexey Yusupov

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Cover: Illustrations Freepik.com

November 2025

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Contents

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Introduction

There have been repeated predictions of Russia's economic collapse since the beginning of the full-scale invasion of Ukraine. Indeed, many signs seemed to support this assumption. In the first months of the war, the Russian auto industry ran out of parts, causing factories to close or shut down, while Russia's ability to export oil and gas was threatened by Western sanctions. At the same time, a large number of Western companies left the Russian market.

Nevertheless, the Russian economy has survived – and is even on a growth trajectory. In order to stabilise economic development, but also in response to the military defeats in Ukraine by the summer of 2022, the Russian government implemented a change in strategy known as "Military" or "War Keynesianism". At its core, War Keynesianism describes a state-led macroeconomic policy that aims to boost aggregate demand by increasing military spending (Ishchenko/Matveev/Zhuravlev 2023). The state's demand for military equipment is an effective economic stimulus programme. According to Russian Finance Minister Anton Siluanov the demand stimulus will amount to 10 per cent of the annual GDP between 2022 and 2024. This ensures high growth rates: Russia's GDP rose by 3.6 per cent in 2023 and by 4.1 per cent last year.

The state demand for military equipment is causing a massive increase in industrial production, primarily in weapons production, but also in relevant suppliers. The main beneficiaries of the state´s new macroeconomic policy are the traditionally industrialised regions in western Russia and the Urals. Since the Russian invasion of Ukraine, there has been a significant surge in employment, with the creation of two million new jobs. The majority of these are in the arms industry, supplier industries and the army. The current unemployment rate is at a historic low of 2.4 per cent, and there is an acute shortage of labour.

But military Keynesianism cannot be reduced to state demand policy alone. Since the invasion, the Russian government has been gradually moving away from its traditional monetarist fiscal policy. This is reflected in the introduction of capital controls and the recent tax reform that came into force in January 2025: the previous standard tax rate (flat tax) has been replaced by a progressive system that imposes higher taxes on higher incomes (22 per cent instead of 13 per cent). At the same time, the increasing conflict with the EU and the USA is forcing Russia to pivot to Asia, especially the Eurasian Economic Union, the BRICS and Africa. This has long-term geopolitical and geoeconomic implications.

The change of course in economic, financial and foreign policy must be seen in the context of a long-term political strategy, which is put forward in particular by national-conservative factions in the Russian elite and ties in with existing strategies, such as import substitution (Jaitner 2023). The targeted development of industrial capacities in Russia is intended to initiate a new cycle of technological innovation and reduce the country's dependence on international trade conflicts. According to national-conservative strategists, this will increase Russia's influence in the emerging multipolar world order. The government's measures to promote productive sectors are strengthening the position of domestic capital on the domestic market. These factions have criticised Russia's dependence on the export of raw materials, particularly oil and gas, for decades and have called for the targeted promotion of domestic industry through an active state demand policy.

However, the national-conservative programme has not met with unmitigated approval in all sectors of the Russian economy. As a major global supplier of raw materials, Russia's economy is heavily dependent on free trade. But following the invasion of Ukraine, exports to the European Union – the most important sales market for oil and gas – have fallen sharply and companies such as Gazprom have incurred substantial revenue losses. Consequently, the sanctions have become a contentious issue. The longer they remain in force, the more likely the Russian leadership is to persist with its new course. National-conservative factions therefore have an interest in maintaining the conflict, as economic decoupling from the West aligns with their strategic economic and foreign policy goals.

This study analyses Russia's development since the full-scale invasion of Ukraine in light of contested economic strategies. Russian economic policy often plays a subordinate role in the analysis of state and government policy. Instead, most studies focus on the person of Vladimir Putin and his closest circle of ministers and advisors. Analysing the conflicts between national-conservative and neoliberal factions close to the commodity sector makes it possible to focus on long-term economic dynamics, which have exerted a decisive influence on government action prior to and during the war.

Russia – a global raw materials supplier

The dissolution of the Soviet Union and subsequent capitalist transformation have had a profound impact on the Russian economy. Under President Boris Yeltsin, the government relied on neoliberal "shock therapy", characterised by deregulating financial markets and rapidly dismantling tariff barriers. The result was a rapid deindustrialisation. Using 1990 as the starting point (with an index value of 100), industrial production fell to 45.8 per cent by 1998. Meanwhile, the raw materials sector, non-ferrous metallurgy, and the iron, steel, chemical and petrochemical industries developed into the most important economic sectors.

This policy resulted in an unprecedented economic decline. According to US economist Joseph Stiglitz (2002), Russia's economic losses in terms of GDP were greater than during the Second World War. While broad sections of society became impoverished, a Russian oligarchy emerged that made its fortune through dubious privatisation processes and highly speculative business practices. This oligarchy was closely linked to the political leadership.

During Vladimir Putin's first two terms in office (2000–2008), the country became even more dependent on the raw materials sector. Oil and gas alone accounted for an average of 60 per cent of total exports. Taking into account the share of agricultural products and other raw materials, the extractive sector accounts for almost 80 per cent of all Russian exports. In contrast, the proportion of high-tech goods in total exports has been declining continuously. With the exception of the defence and nuclear industries, Russian companies have been losing their international competitiveness in productive sectors continuously since the 1990s.

The national-conservative modernisation programme

The national-conservative camp in Russia has no direct political party basis. Instead, it is an overarching term for a loose coalition of politicians, academic and media intellectuals, and leading members of religious communities, such as the Orthodox Church. They are united by an anti-liberal stance, a commitment to Great Russian nationalism, and a demand for an industrial modernisation programme.

The starting point for national-conservative thinking is the traumatic experience of shock therapy in the 1990s, resulting in mass poverty, the collapse of state order and Russia's diminished international influence. According to Sergei Glazyev, an economist and one of the leading thinkers in the national-conservative camp, the country's international influence is further weakened by its economic dependence on the raw materials sector. Given the intensifying geopolitical competition, this poses a risk to national security.

In response, Glazyev is calling for a debt financed economic stimulus programme to strengthen the manufacturing sector. A return to state industrial policy requires a break with the neoliberal economic and financial policies of most previous Russian governments. A prerequisite for this is political control over the central bank, a bastion of the neoliberal faction, and the enforcement of capital controls. Glazyev claims that the uncontrolled outflow of money exacerbated the economic crises of 1998, 2008 and 2014. According to him, Japan, South Korea and China, with their state capitalist development model, serve as role models for a successful Russian industrial policy.

Andrei Belousov is set to play a key role here. Appointed defence minister in May 2024, he represents the state managers promoted under Putin: a hand-picked group of loyal top politicians and bureaucrats who have been appointed to management positions in an increasing number of state-owned companies. Belousov began his political career in 2006 under neoliberal economy minister German Gref, before joining the national-conservative camp. This represents an ideological shift in values among a growing part of the Russian elite. As an experienced manager, Belousov must organise defence production more efficiently. State support for the industry is intended to promote technological innovation and modernise the entire economy.

The national-conservative camp is demanding a stronger domestic orientation of the economy as part of an import substitution programme, as well as the development of new political alliances to actively shape the emerging multipolar order. This alliance policy focuses particularly on China, the post-Soviet region and the Middle East. This pivot to Asia is also driven by economic considerations. After all, promoting an export-oriented manufacturing industry improves its international competitiveness. Belousov believes this is urgently needed: "Today, our goods are not in China, India or Vietnam." Russia must therefore exert pressure to achieve this, creating competitive advantages for its producers (Kommersant 2023).

The modernisation of Russia's resource economy

As an alternative to Keynesianism, the neoliberal-oriented commodity camp is calling for the modernisation of the extractive economic model. Economist Vladimir Mau (2016: 2) recognised a "structural crisis" in the Russian economy as early as 2016. Like the national conservatives, Mau identifies the main issue as the heterogeneity of the Russian economy, specifically the coexistence of an internationalised, export-oriented raw materials sector and a domestically oriented industry. However, Mau turns the argument around. He identifies transnational raw materials capital as a growth driver, whereas he considers the non-competitive industrial structure to be an obstacle to economic development (Mau 2016: 5).

Consequently, the focus on exporting raw materials should be maintained but adapted to meet the demands of green capitalism. According to this idea, Russia could become one of the largest producers of hydrogen by developing new sources of raw materials, increasing technological innovation and using the existing pipeline networks to export to Europe. The modernised raw materials strategy focuses on the Arctic, whose extensive mineral resources are becoming more accessible due to climate change.

Russia also has many raw materials that are in demand in green capitalist industry. So far, the EU has refrained from imposing sanctions on the world's largest nickel producer Norilsk Nickel, and its primary owner and Putin confidant Vladimir Potanin. Nickel is an important component in battery production. With a 40 per cent market share, the group is also one of the most important producers of palladium, a material used in catalytic converters and semiconductors. The idea is that Russian raw materials companies could fulfil the needs of European industrial companies. Developing new transnational supply chains in line with the requirements of a decarbonised economy could modernise the domestic economy.

Disputes among the Russian elite on economic policy are directly linked to the future of the war in Ukraine and the continuation of sanctions. Unlike the national-conservatives, the commodities camp favours close economic relations with the EU and the USA. These are not only the most important economic markets, but also the most competitive. According to Mau, deeper integration of the post-Soviet region within the framework of the Eurasian Union would reduce the competitiveness of Russian companies. Oligarchs involved in the raw materials business also hope that the EU and the USA may lift their sanctions in the event of a peace agreement. Aluminium magnate Oleg Deripaska, for example, described the war in Ukraine as "insane" in an interview with the Japanese newspaper Nikkei Asia in August 2024, calling for an "immediate, unconditional ceasefire" (Reuters 2024).

New social alliances: the conflict with the West is becoming permanent

Although Putin has repeatedly criticised Russia's dependence on the export of raw materials since the 2000s, this has not been followed by any serious steps to strengthen the manufacturing sector for a long time. However, this changed following the imposition of Western sanctions after the first war in Ukraine in 2014, when the Russian government established an import substitution commission. According to the liberal business newspaper Kommersant, this commission has powers over the corporate sector that "neither the Ministry of Economy, the Ministry of Industry, nor other ministries" have had since 1993–94 (Kommersant 2015). The establishment of such influential commissions will anchor the transition to industrial policy within the state and government in the long term. This shifts the balance of power within the Russian elite in favour of domestically oriented companies and the national-conservative forces associated with them.

Employees in industry are also among the beneficiaries of War Keynesianism. Having suffered greatly from deindustrialisation, they were the big losers of the capitalist transformation of the 1990s. Nevertheless, average salaries in these sectors increased by 19 per cent in 2024 compared with the previous year. Wages in the defence industry and its supply chain have increased even more. These increases are boosting consumption and thus contributing to the economic upturn. This improved socio-economic situation has significantly increased these social classes' approval of the government's political course, which is an important reason why protests against the war have not yet gained widespread support. This seems to allow the Putin administration to expand its power base over the elite and sections of the urban middle class.

At the same time, a new, influential cross-class coalition is emerging amid the changes in economic policy. The management and workforce of manufacturing industry share the same interests as national-conservative forces. Both support a permanent conflict with the West (and Ukraine), or at least the continuation of Keynesian war economics, from which one benefits materially and the other politically. Former Russian Industry Minister Denis Manturov supports this view, stating: "We are very interested in extending the sanctions against Russia" (Innosmi 2017). This is because maintaining the sanctions – and the associated economic decoupling of Russia from the West – promotes the development of domestic industrial production. This increases pressure on the government to maintain an anti-liberal stance and pursue a foreign policy based on dominance in the post-Soviet space.

However, the protectionist, demand-oriented economic policy of War Keynesianism serves not only the interests of the manufacturing sector, but also those of the oligarchy. Despite Western sanctions, the number of Russian billionaires has continued to rise, reaching a provisional peak in 2024. The majority of these individuals still originate from the commodities industry, particularly the oil and gas sector. A key reason for this is that Russia has been able to offset the decline in commodity exports to Europe by increasing demand from Asia, particularly from China, India and Turkey. This development will likely further accelerate Russia's efforts to turn to Asia.

The defence industry as a locomotive of economic development? The Russian paradox

There is much to suggest that the transition to War Keynesianism marks a permanent change in direction for the Russian government. Even in the event of a peace agreement, diplomatic relations with the EU and Ukraine are unlikely to improve significantly. In fact, both sides regard the other as the greatest threat to national security, using this perception to justify their military armament programmes. Furthermore, US President Donald Trump's economic policy is accelerating existing deglobalisation processes. According to the US government, its industrial policy is a necessary response to the emerging multipolar world order and the associated challenges to national security, and the arguments in favour of this policy are similar to those of the Putin administration.

However, it is doubtful that the Russian government will succeed in using War Keynesianism to trigger a sustained economic upturn with a broad impact beyond the defence sector and unleash innovation potential. On one hand, the lack of diversification in Russian industry suggests this is unlikely. Furthermore, there are no foreseeable strategies that could utilise potential technological innovations from the defence sector to sustainably develop the weak consumer goods sector.

In fact, neither War Keynesianism nor a modernised but still commodity export-oriented economic model are suitable for overcoming the many challenges facing Russian society. On the contrary, both models would only exacerbate existing contradictions. Evidence of this can be seen in the growing wage gap. In the service sector, precarious employment and low wages are particularly prevalent. Organised strikes, such as those by the courier drivers' union in 2023, highlight this issue. Additionally, the number of families who have lost relatives in the war or who have fled the country as a result is growing, and many of these war refugees are living in precarious conditions abroad. Moreover, uneven development on a regional level is increasing. While industrial centres in the Urals and western Russia are benefiting from state demand for military equipment, the North Caucasus and the Arctic North are falling further behind.

The limits of the national-conservative modernisation strategy can also be observed in foreign trade. Russian companies are focusing much more on the BRICS countries and the global South than they did ten years ago. While the USA and the EU are pushing for a decoupling from China, Russia and China are deepening their technological cooperation beyond the defence sector. Even before the Russian invasion, the Carnegie Institute stated that Russia was quietly integrating itself into a technological "Pax Sinica" (Carnegie Institute 2021). Trade with the member states of the Eurasian Economic Union (EEU) as well as India, Iran and Africa is also gaining in importance. It is striking that Russia is not only supplying raw materials to these countries, but that, in addition to the traditionally internationalised defence industry, the agro-industrial complex, the IT sector and mechanical engineering are also increasingly trying to open up new markets.

However, Russia's economic relations with China illustrate its dependence on the high-tech goods sector, a pattern also evident in trade with Western European countries, particularly Germany. The Russian Federation exports mainly raw materials, such as fossil fuels, while importing machinery, equipment and consumer goods. One important difference, though, is that China still buys large quantities of defence equipment from Russia.

Scenarios for Russia's future development

Russia's future development, including its economy, is closely linked to the further course of the war. Three possible scenarios are discussed here.

(i) Fast-track peace agreement

If a peace agreement is reached by the end of the year, it will probably be at Ukraine's expense, as the country will probably have to accept significant territorial losses and other conditions. However, this scenario should not obscure the fact that the costs to Russia could be higher than they initially appear. First, rebuilding war-torn territories will require considerable financial investment, diverting scarce resources away from economic diversification and investment. The limited financial resources cannot be offset by savings in defence spending. As already mentioned, the defence budget is likely to remain at a high level, even after the war.

In addition, there is likely to be very little international support for territorial annexations. This will make it difficult for Russia to diversify its foreign policy relations with Asian and African countries. This is particularly true of the post-Soviet states, who are watching Russia's attempts at dominance with great concern. Failure to increase integration within the framework of the Eurasian Economic Union would hinder the national-conservative modernisation project.

A quick peace agreement would also have domestic political consequences. The influence of national-conservative forces is likely to increase, as would the cross-class alliance between management and employees in industrial sectors. This would make adherence to the national-conservative modernisation project more likely, but would make future rapprochement with the West more difficult.

(ii) Continuation of hostilities

If hostilities continue, the pressure on the government to maintain its high defence spending will increase. Up to now, the Russian government has relied on its considerable foreign currency reserves for financing. However, these funds are dwindling. As the Russian foreign currency assets deposited in the West have been frozen, the Putin administration now only has access to funds from the National Wealth Fund. However, its liquid reserves have melted from 117 billion US dollars to 31 billion (November 2024).

In addition, the threat is growing that economic development will weaken. The Russian central bank is forecasting growth to decline to 2.5 per cent in 2025. Meanwhile, inflation remains high, reaching 10.3 per cent in March 2025 – the highest level since Russia's invasion of Ukraine in February 2022. While wage increases in manufacturing are offsetting the rise in the cost of living and improving employees' situation, this does not apply to the service sector, where real incomes are falling significantly.

Despite these negative developments, it is quite likely that Russia will be able to maintain its high level of spending for two to three years. However, social tensions, especially regarding social and regional inequality, threaten to intensify.

(iii) Russian state bankruptcy

There is increasing speculation about Russian state bankruptcy due to the high financing costs of war Keynesian. While it is true that the Russian state's debt ratio is relatively low, it is also true that a large proportion of war costs are financed through extra-budgetary expenditure. Added to this is the high level of private-sector debt.

Russia's off-budget war debt is increasing systemic credit risk in both the short and medium term. High interest rates are fuelling corporate distress and raising fears of widespread insolvency. In his analysis Russia's Hidden War Debt, economist Craig Kennedy (2025) concludes that the Russian government is facing a dilemma: if no drastic cuts are made to war spending, there is either an increased risk of bad loans and the danger of a financial crisis, or a drastic increase in the budget deficit.

Clearly, the Russian government is not interested in an endless war. After all, the longer the war continues, the greater the risk of loan defaults due to the high cost of financing it. Furthermore, there is a strong interest in easing sanctions in order to facilitate debt restructuring and rearmament after the war. Alongside the lifting of sanctions in the financial sector, easing oil sanctions and resuming gas supplies to Europe via pipelines would improve the Russian state's refinancing options.

Despite deteriorating financing conditions, a sovereign default by the Russian state is not immediately foreseeable. However, this does provide an incentive for the upcoming negotiation processes, and, when combined with a reduction in sanctions, could contribute to finding a diplomatic solution to the war in Ukraine.

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The Russian government changed its economic policy in the wake of military defeats in the summer and autumn of 2022, as well as Western sanctions.

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Not only is War Keynesianism an effective economic stimulus programme, but it strengthens the influence of national-conservative forces within the state and wider society. These forces are interested in decoupling from the West in terms of economic policy and are therefore pushing ahead with the war in Ukraine. The management and workforce of manufacturing industry also benefit from War Keynesianism.

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Alongside national-conservative forces, they are putting pressure on the Russian government to continue reorienting economic policy, making a diplomatic solution to the war in Ukraine and rapprochement with the West increasingly difficult in the long term.

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