

Is Russia Becoming a Second North Korea?

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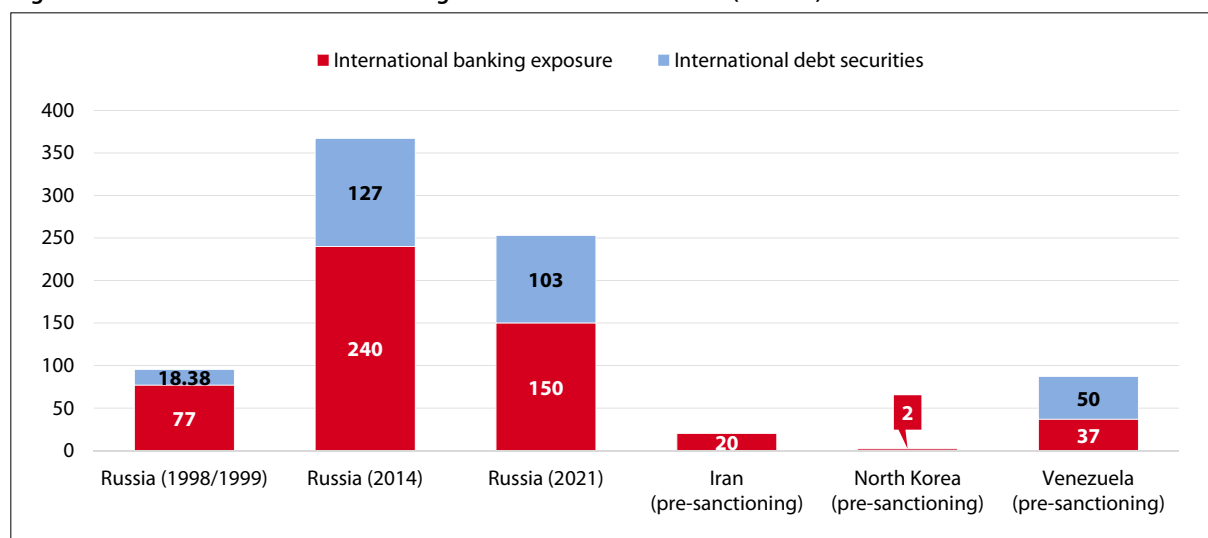
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Figure 5: International Financial Linkages to Sanctioned Countries (USD bn)

* Consolidated banking statistics (Claims plus other potential exposures) & International debt securities statistics (resident issuers); for Iran and North Korea no int. debt securities data available/no int. debt outstanding

Source: BIS, RBI/Raiffeisen Research

ANALYSIS

Is Russia Becoming a Second North Korea?

By Michael Rochlitz (University of Bremen)

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On 24 February 2022, Russian president Vladimir Putin ordered a full-scale military invasion of Ukraine. The decision was based on a series of fatally flawed situational assessments, including an overestimation of the fighting abilities of the Russian army, an underestimation of the determination of the Ukrainian army and people, and a faulty evaluation of the West's willingness to impose serious economic sanctions.

The massive sanctions that have since been imposed on Russia's economy have led to a freeze on half of the central bank's reserves, a fall of more than 40 percent in the value of the ruble, and an exodus of most Western companies from Russia. Increasing political repression and a fear of border closures have caused several hundred thousand Russians—a significant part of the country's intellectual elite—to flee abroad.

The economic consequences of these developments will be disastrous. At the moment, neither the Russian government nor most Russian people seem to realize the extent of the economic catastrophe that is sure

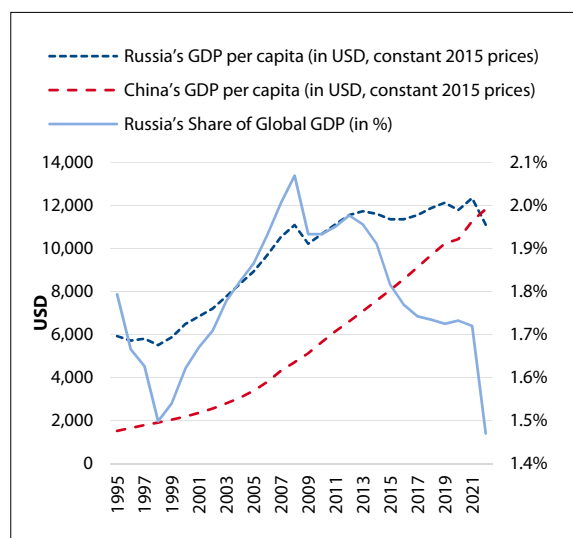
to happen. In the best-case scenario, Russia's economy will shrink by 10 to 20 percent this year, a somewhat worse decline than during the 2008 financial crisis. As a consequence, Russia's relative economic importance in the world—as measured by its share of global GDP—will reach its lowest point in recent history, and Russia's GDP per capita will be overtaken for the first time in several centuries by the GDP per capita of China (see Figure 1). But if the war continues, and new war crimes lead to additional sanctions, the economic disaster might be even worse than that occasioned by the collapse of the Soviet Union in the early 1990s, causing the country to be left even further behind.

Hitting an Already Weak Economy

The economic fallout of the war will hit an already stagnating economy. Russia's GDP per capita in early 2022 was only slightly higher than before the onset of the financial crisis in 2008. Since 2009, Russia's economy has grown at an average rate of less than 1 per-

cent per year, a growth rate far too low for a country of Russia's economic potential.

Figure 1: Russia's Economic Development Compared



Data for 1995 – 2020: World Bank; from 2021: projections, based on GDP growth of 4.7% in 2021 and –10% in 2022 in Russia (see also Table 1 on p. 13).

Russia has a well-educated population, still relatively low salaries, an excellent strategic position between China and Europe—soon to be the world's two largest economies—and abundant natural resources. Yet since Putin came to power 22 years ago, and in particular since his return to the presidency in 2012, the Russian government has lacked a strategy to diversify its economy and make it independent from oil and gas (Yakovlev 2021). While other authoritarian oil-producing countries, such as the United Arab Emirates and Saudi Arabia, have long been preparing for a future without natural resources by investing in science, technology or tourism, Russia has instead focused on an increasingly aggressive foreign policy agenda.

The negative economic consequences of this confrontational agenda have been amplified by increasingly neo-feudalist institutions, with an array of different security services harassing entrepreneurs and investors in the country. Putin's control over domestic politics is more and more based on a quid pro quo between him and the security services, with the latter suppressing protests and guaranteeing Putin's hold on power in exchange for the ability to expropriate successful businesses and plunder the country's economy (Rochlitz 2014, Kazun 2020).

Yet despite all these difficulties, Russia in early 2022 was still a middle-income country well integrated into the global economy. A large part of its population was better off than ever before and able to enjoy a living standard comparable to that of some European states. Russians could choose from a similar range of consumer

goods as people elsewhere in the world, occasionally travel abroad for a holiday, and expect to lead a relatively stable and peaceful life.

A Self-Inflicted Catastrophe

Within less than a month, and as a result of the delusional ideas of a single person, all this has changed. Today, Russia has become an almost completely isolated pariah state. Belarus, Eritrea, North Korea, and Syria were the only countries that voted against a UN resolution condemning the Russian war in Ukraine. According to a list compiled by researchers at Yale University, by 20 March over 400 foreign companies had ceased or curtailed their operations in Russia, with only 37 overseas firms continuing to operate normally. As both Airbus and Boeing are no longer servicing Russian planes, Russia's airlines have been forced to stop international flights and might soon be compelled to stop domestic flights as well. Travel within the country will be pushed back to where it was in the early twentieth century.

It is unlikely that any of these companies will return to Russia if the current situation continues or deteriorates. As a consequence, the country will be deprived of many of the high-technology and consumer goods it has been importing. As Russia produces very few hi-tech goods, this will seriously affect the Russian economy, disrupting supply chains and making the country's situation similar to that of Iran during the last 30 years.

A similarly heavy blow will be the brain drain caused by the recent wave of repression. Most of the hundreds of thousands of people who have fled Russia in recent weeks are highly qualified specialists and researchers who are difficult to replace. The remaining scientists in Russia will be cut off from international networks, as academic institutions around the world have cut all ties with Russian universities. The consequences for science, research, and innovation in Russia will be devastating.

An additional tragedy is that, because of the government's control over the media and its ensuing monopoly over information, most Russians are not yet aware of what is happening to them. Yet as the economist Maxim Mironov has outlined in a recent post (Mironov 2022), both white- and blue-collar workers in Russia will suffer substantially as a result of current developments. The exodus of international financial, consulting, and accounting firms will force tens of thousands of accountants to seek employment in other, less well-paid professions. However, because of the overall contraction of the economy and their narrow specialization, they will encounter major difficulties in finding alternative employment. Entrepreneurs who had built their business models on digital platforms such as Instagram or Facebook, which have recently been banned by the Russian government, will be similarly affected.

Blue-collar workers will also be hit hard. Both Russia's automobile and aviation industries rely on foreign supplies and have already been forced to shut down production. It is only a question of time until they will be forced to lay off workers on a large scale. Several hundred thousand employees in the restaurant business will also be threatened by unemployment, both because many foreign chains have left the country and because remaining restaurants will be hit hard by the crisis, as a much smaller percentage of Russians will be able to afford to eat out. By comparison, state employees—the so-called *biudzhetniki*—will suffer relatively less. Their incomes might decrease in relative terms as a consequence of the fall of the ruble, but they will most likely keep their jobs. The only group that are likely to profit from the current crisis will be people working in the security services and for state media corporations, as they are necessary for the survival of the regime. To ensure their loyalty to the state, their salaries will likely be indexed to the dollar, and might even increase in relative terms.

Dysfunctional Institutions

Few, if any, politicians in recent history have inflicted such massive harm on their own country in such a short period of time as Putin has done during the last month. How could one person cause such a disaster? The answer lies—most probably—in the increasing concentration of power around Putin and the deterioration of Russia's political institutions.

Since 2012, a number of influential heavyweights within Russia's security services have been purged and replaced by less influential technocrats, who are arguably much less able to keep their leader from making dangerous decisions (Petrov and Rochlitz 2019). This problem has also affected other branches of the Russian government, with more and more positions being occupied by loyal but not necessarily competent officials, a problem faced by many authoritarian regimes (Egorov and Sonin 2011). As the threat of being arrested now looms over most Russian government officials (see, e.g., Buckley et al. 2021 on the arrests of Russian mayors), they are unlikely to take responsibility and pass unfa-

vorable news on to higher levels of the government and to the head of state.

As almost all opposition media have been shut down, this contributes to an informational dilemma where key decision-makers in the country no longer have any reliable information upon which to act. As a result, they might find themselves in a parallel reality without much connection to what is actually happening in their country and the world. Although we do not know for sure, this could be a reasonable explanation for why the decision to invade Ukraine was made by Putin, as well as for the dismal performance of the Russian armed forces since then and the deterioration of Russian governance institutions more generally.

Dark Prospects for the Future

How are things going to evolve from here? Even in the best possible scenario of immediate peace, it would take several years to repair the damage already caused. Such a scenario would probably require the fall of the Putin regime, and a new government that ends the war and takes responsibility for Russia's actions, to open up the possibility of returning the country to the international community. Even in this highly unlikely scenario, however, Russia's population will have suffered substantial economic harm, and the horrors already committed in Ukraine will leave deep scars for Ukrainians and Russians alike.

In what is unfortunately a more likely scenario, the war will drag on for a considerable time, potentially leading to a complete end of Western oil and gas imports from Russia. Although China might be willing to jump in, Russia will not be able to significantly increase its oil and gas exports in the near future, as the existing infrastructure in the Far East is already operating at full capacity. Moscow will thus have to rely on Chinese loans to import Chinese consumer goods. As a result, Russia might turn into a large-scale version of North Korea: economically dependent on China and with a government that through tight control of travel and information will try to prevent its population from finding out the true reasons for the disaster that has befallen it.

About the Author

Michael Rochlitz is Professor of Institutional Economics at the University of Bremen. His research focuses on the political economy of Russia and China, as well as on the impact of authoritarian political institutions on economic development and innovation.

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Table 1: Russia’s Economic Development Compared

	1995	1996	1997	1998	1999	2000	2001	2002
Russia’s Share of Global GDP (in %)	1.8	1.7	1.6	1.5	1.5	1.6	1.7	1.7
Russia’s GDP per capita (in USD, constant 2015 prices)	5,928.96	5,714.63	5,804.21	5,505.70	5,876.20	6,491.07	6,851.11	7,206.19
China’s GDP per capita (in USD, constant 2015 prices)	1,520.03	1,653.43	1,787.76	1,909.62	2,038.20	2,193.89	2,359.57	2,557.89
	2003	2004	2005	2006	2007	2008	2009	2010
Russia’s Share of Global GDP (in %)	1.8	1.8	1.9	1.9	2.0	2.1	1.9	1.9
Russia’s GDP per capita (in USD, constant 2015 prices)	7,767.41	8,360.25	8,929.30	9,693.20	10,535.13	11,087.82	10,219.89	10,675.00
China’s GDP per capita (in USD, constant 2015 prices)	2,797.17	3,061.83	3,390.71	3,800.76	4,319.02	4,711.64	5,128.90	5,647.06
	2011	2012	2013	2014	2015	2016	2017	2018
Russia’s Share of Global GDP (in %)	2.0	2.0	2.0	1.9	1.8	1.8	1.7	1.7
Russia’s GDP per capita (in USD, constant 2015 prices)	11,125.34	11,553.58	11,731.38	11,608.76	11,355.24	11,356.40	11,550.53	11,875.73
China’s GDP per capita (in USD, constant 2015 prices)	6,156.83	6,608.71	7,086.87	7,574.68	8,066.94	8,572.88	9,117.34	9,688.47
	2019	2020	2021	2022				
Russia’s Share of Global GDP (in %)	1.7	1.7	1.7	1.5				
Russia’s GDP per capita (in USD, constant 2015 prices)	12,122.61	11,786.62	12,340.00	11,106.00				
China’s GDP per capita (in USD, constant 2015 prices)	10,228.29	10,430.73	11,264.00	11,827.00				

Data for 1995 – 2020: World Bank; from 2021: projections, based on a GDP growth of 4.7% in 2021 and –10% in 2022 in Russia.