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ZOiS REPORT

PERMANENT CRISIS MODE: WHY RUSSIA'S ECONOMY HAS BEEN SO RESILIENT AGAINST SANCTIONS

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Content

Summary

In the aftermath of Russia's full-scale invasion of Ukraine in February 2022, a coalition of Western nations imposed a comprehensive set of sanctions on Russia, encompassing over 13,000 individual restrictions—surpassing the cumulative constraints applied to Cuba, Iran, and North Korea. Remarkably, Russia's economy has exhibited notable resilience in the face of these punitive measures. In 2022, the country's gross domestic product (GDP) experienced a mere 2.1 per cent contraction, and in 2023 GDP growth is expected to exceed 2 per cent.

This report seeks to contribute to understanding this paradoxical result by analysing the key factors of Russia's economic resilience. There is a misconception in public debates that this resilience is due mainly to oil revenues. Yet, an explanation based on this reason alone would be an oversimplification. The Russian authorities have generally seemed prepared for large-scale sanctions. However, this preparedness derives mostly from a mix of the large profits that the Russian government received in the first half of 2022 and a special type of economic management.

This report focuses on the period from 2008 to 2023 and is based on an analysis of Russia's financial management policies, drawing on data provided by the Russian Federal State Statistics Service (Rosstat), the Bank of Russia, media sources, and interviews with financial sector leaders.

Over the past 15 years, Russia has faced a series of significant crises, including the 2008 global financial crisis, the 2014–2015 decline in commodity prices, the 2020–2023 COVID-19 pandemic, and the repercussions of the ongoing war against Ukraine. These frequent shocks within a relatively short time frame have placed the Russian economy under sustained stress. Notably, the same leadership in Russia's central bank and finance ministry has been at the helm of the country's economic policies throughout this period.

Russian top bureaucrats have drawn valuable lessons from managing these crises. They have adopted an ultra-conservative macroeconomic policy marked by cautious reserve spending, an accelerated accumulation of reserves between crises, increased reserve requirements within the financial system, reduced competition in the banking sector for easier management, and strict monetary and fiscal policies. These impact of these policies on the Russian economy has been average GDP growth during this period of close to 1 per cent.

The succession of crises has instilled a particular mindset in Russian officials. The perpetual need to address challenges that arise from factors beyond their control, often unrelated to monetary and fiscal matters, has kept them in a state of constant readiness for unexpected crises. This mindset, coupled with substantial oil revenues, has enabled the Russian economy as a whole to withstand the impact of sanctions and swiftly adapt to new realities. The role of crisis management by the central bank and the finance ministry in responding to sanctions should not be underestimated.

While conservative approaches and ad hoc management practices can be effective in dealing with crises, they may limit long-term development. Additionally, dependence on high oil revenues can impede economic diversification. In the periods between crises, the Russian economic authorities failed to strengthen established institutions. Moreover, some aspects of Russia's financial architecture, such as a predictable tax system and the budget rule, which seeks to encourage economic stability, became victims of crisis management.

Crisis and management

In the realm of long-term economic developments, institutions often emerge in response to crises. The evolution of institutions in modern Russia reflects this pattern, with significant institutional changes having occurred as reactions to various crises. Notable examples include the reform of the Russian tax system because of non-payments in the 1990s, the introduction of deposit insurance and budget policy frameworks in the wake of the 1998 Asian financial crisis, and the shift towards inflation targeting after the 2008 financial crisis.[1]

During crises, ad hoc management practices often come into play, which may temporarily deviate from established institutional procedures. Usually, these ad hoc practices are implemented with the goal of minimising the impacts of the shock, but they may sometimes run counter to existing institutions. However, over the medium and long term, institutions and the actors behind them tend to adapt and strengthen themselves to better handle future crises. It is worth noting that crucial institutions for the Russian economy, such as a stable tax system, budgetary rules, and budgetary federalism (Russia's system of financially autonomous regional budgets), emerged after the 1998 financial crisis, despite the absence of excessive export revenues at the time. Paradoxically, in the past 15 years, which have been characterised by significant growth in export revenues, some of the institutions that were established in response to earlier crises have faced challenges.

For the last 15 years, the same key figures have been responsible for economic state craft.

This study intentionally focuses on the period from 2008 to 2023 and is based on an analysis of Russia's financial management policies, drawing on data provided by Rosstat, the Bank of Russia, media sources, and interviews with financial sector leaders. This period was chosen because key figures in Russia's financial leadership reached top positions during this time and have since been responsible for economic statecraft and decision-making. The years before the 2008 global financial crisis were a period of no major crises for the Russian economy.

> Ad hoc management in this context refers to decisions made by the country's financial authorities to allocate or withdraw funds from the economy outside established institutional procedures. This includes actions like bypassing the budget process, making non-tax withdrawals from the corporate sector, and making sudden shifts in tax revenues from the regions to the central government. Emergency decisions to adjust key interest rates also fall into this category. In this context, financial crises are characterised by sharp declines in the value of financial assets and increased risks to financial stability.

1 Anatoly Chubais, 'Неплатежи в российской экономике 1990-х: непредвиденный институт' [Non-payments in the Russian Economy in the 1990s: An Unforeseen Institution], *Voprosy Ekonomiki* 7 (2023): pp. 142 – 158, https://doi.org/10.32609/0042-8736-2023-7-142-158.

Historically, the interval between major crises averages 10 to 15 years.[2] Russia has been exceptional in facing four major crisis episodes in the past 15 years: the 2008 global financial crisis, the 2014–2015 end of the commodity supercycle, the 2020–2023 COVID-19 pandemic, and the repercussions of the war against Ukraine that began in February 2022, along with two mini-crises related to grain exports in 2010–2011 and trade issues with Turkey in 2015–2016. This high frequency of shocks within a relatively short time frame indicates that the Russian economy has been under persistent stress for the past decade and a half.

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Interestingly, the second and fourth crises were consequences of the Kremlin's foreign policy decisions. However, the structure of President Vladimir Putin's regime and the personalistic nature of Russian statecraft have limited the accountability of key institutions like the State Duma, the government, and the central bank in addressing why Russia has repeatedly faced such shocks. In times of crisis, the emphasis shifts towards crisis management, which often relies on ad hoc approaches and even manual control practices, rather than policies aimed at building and strengthening institutions.

In normal economic conditions, regulators typically separate monetary policy and macroprudential measures, such as keeping an eye on risky financial activities to prevent them from causing problems for the whole financial system. That is because of Tinbergen's rule, which advocates unity between policy goals and instruments. Put simply, the principle, formulated by Nobel laureate Jan Tinbergen, states that to achieve a given number of interrelated goals, it is necessary to have at least the same number of economic instruments in place.

However, during crises, maintaining financial stability becomes paramount, and policies are adjusted accordingly. Financial stability is essential not only for price stability but also for policymakers' ability to absorb shocks and prevent them from spilling over into the real economy. During all of the crisis episodes mentioned above, the Russian economy faced financial market turmoil, abrupt price and exchange rate fluctuations, inflationary pressure, withdrawals of investments by non-residents, and decreased transaction activity, which often led to fluctuations in commodity prices. The ability of financial leaders to contain a crisis within the financial sector and prevent it from spilling over into the real economy hinges on the stable functioning of the financial sector. In Russia, both the central bank and the finance ministry have done this job more or less successfully.

It is worth noting that the same leadership has guided Russia's economic policies throughout the period in question. Elvira Nabiullina and Anton Siluanov, the key figures in Russia's economic management, served in 2008 as minister of economic development and deputy minister of finance, respectively, and have since solidified their roles, becoming central bank governor and finance

2 Leonid Grinin and Andrey Korotayev, *Глобальный кризис в ретроспективе: От Ликурга до Алана Гринспена* [Global Crisis in Retrospect: From Lycurgus to Alan Greenspan] (Moscow: URSS, 2010), https://cliodynamics.ru/index.php?option=com_content&task=view&id=218&Itemid=1.

minister. The succession of crises has instilled a specific mindset in these actors: the perpetual need to address challenges that stem from factors beyond their control, such as policies unrelated to monetary and fiscal matters, which has kept them in a state of perpetual readiness for unexpected crises.[3]

In the medium to long term, continuous ad hoc management can be detrimental to the economy.

This readiness has led to a conservative approach to governance that favours the accumulation of reserves over the stimulation of investment and, ultimately, restrains institutional development. Building institutions takes time and confidence. The fixation on reserves generates endless waiting for a rainy day and reduces the appetite for institutional development and, consequently, investment. This can artificially slow down the business cycle and lead to slower economic growth. In times of crisis, institution-based management, like long-term budgetary procedures or the budget rule, which aims to contribute to economic stability by saving excess oil revenues during boom periods and using them during economic downturns, may conflict with manual interventions, and a more reactive approach proved to be justified in the face of the shocks of 2022. However, in the medium to long term, continuous ad hoc management can be detrimental to the economy. While it may be effective in overcoming shocks, it can impede economic growth and development.

The global financial crisis

The first crisis faced by Putin's government, when he was prime minister, was caused by the 2008 global financial crisis. Before the shock, the Russian economy and financial sector were growing rapidly. Under a quasi-fixed exchange-rate regime, the rouble was subject to controlled floating within the boundaries of a dual-currency basket composed of the US dollar and the euro. Against the backdrop of rising oil prices, Russia's monetary authorities were accumulating gold and foreign exchange reserves, and non-financial companies and banks were actively increasing external borrowing. The bankruptcy in September 2008 of the American financial services firm Lehman Brothers and the ensuing panic in global markets had acute consequences for Russia as well. The price of Brent crude oil fell from its peak of $146 a barrel in July 2008 to $37 in December. That year, the net capital outflow of the private sector from Russia amounted to $133.6 billion. From the beginning of August 2008 to the end of February 2009, the foreign exchange reserves of the Bank of Russia fell by $215 billion.[4]

By the start of the crisis, the foreign-currency debt of the banking and corporate sector amounted to $418.5 billion, and in the context of the global crisis, the opportunities for refinancing this debt were significantly limited. In that period, the Bank of Russia regularly conducted currency interventions to adjust the exchange rate to new conditions more smoothly. From 30

3 Andrey Yakovlev, 'Стратегии бизнеса как фактор стабилизации российской экономики: успешный опыт 2022 года и неясные перспективы на будущее' [Business Strategies as a Factor in Stabilising the Russian Economy: A Successful Experience in 2022 and Unclear Prospects for the Future], Sociodigger, 10 April 2023, https://sociodigger.ru/articles/articles-page/strategii-biznesa-kak-faktor-stabilizacii-rossiiskoi-ehkonomiki-uspeshnyi-opyt-2022-goda-i-nejasnye-perspektivy-na-budushchee.

4 'Годовой отчет 2008' [Annual Report 2008], Central Bank of the Russian Federation, 2009, https://www.cbr.ru/collection/collection/file/7805/ar_2008.pdf.

September 2008 to 31 January 2009, the volume of the central bank's foreign-currency reserves fell by 31.7 per cent to $370.4 billion. It is noteworthy that the economy's level of dollarisation increased even more—to 39 per cent by February 2009.[5] In other words, while the monetary authorities were spending reserves to maintain the rouble's exchange rate, households and firms were acting speculatively by buying foreign currency and so forcing the central bank to increase sales. To stabilise the situation in the financial sector, in October 2008 the Bank of Russia began to provide loans without collateral on an emergency basis, and the rates at such auctions rose to 19 per cent.[6] Two months later, lending secured by non-marketable assets was launched.

The crisis that unfolded in 2008–2009 marked the onset of extensive government involvement in the Russian economy. During this period, over 1 trillion roubles ($10.7 billion) was allocated to support various companies, with a significant portion directed towards the financial sector.[7] Notably, substantial support was extended to prominent corporations, including $4.5 billion for Rusal, a leading aluminium producer owned by Oleg Deripaska; $1.8 billion for Evraz, a major mining company owned by Roman Abramovich and partners; assistance for the national carmaker Avtovaz, which at the time was in a consortium with Rostech and Renault-Nissan; and support for enterprises in the military-industrial sector.[8] The government established a list of strategically vital industries and enterprises and engaged in the manual allocation of financial assistance to these entities. In hindsight, Putin would later describe this approach to economic management as optimal.

The crisis in 2008–2009 marked the onset of extensive government involvement in the Russian economy.

By 2010, Russia's significant GDP growth, at 4.5 per cent, had largely offset the decline experienced in 2009.[9] One of the key lessons that Putin and his economic team learned from this crisis was an awareness of the finite nature of reserves and the need to preserve them.[10] In subsequent years, the Russian government and central bank prioritised the prudent management of reserves and the creation of financial buffers to safeguard the economy against future crises. This strategy involved accumulating foreign-currency reserves and building the National Welfare Fund, which could be tapped into when needed to mitigate economic shocks. However, the imperative to maintain these reserves also tempered investment in infrastructure and other development initiatives.

To sum up, the key lesson from this crisis was that maintaining reserves and low levels of government debt is critical to ensuring macroeconomic stability.

5 Ibid.
6 Ibid.
7 'Макроэкономическая картина в России и в мире за 1 кв. 2020' [The Macroeconomic Picture in Russia and the World for Q1 2020], Roscongress Foundation, 2020, https://roscongress.content.rcmedia.ru/upload/medialibrary/605/Makroobzor_upd_ver.15042020_oformlen.pdf.
8 Natalya Suvorova, 'Размеры спасения' [Rescue Dimensions], RBC, 20 October 2014, https://www.rbc.ru/magazine/2014/10/56bc7e499a794701b81d2b66.
9 'Национальные счета' [National Accounts], Rosstat, https://rosstat.gov.ru/statistics/accounts#.
10 Off-the-record interview with a Russian senior official, conducted on the condition of anonymity.

The end of the commodities supercycle and the first sanctions

In 2014–2015, the Russian financial sector faced a double blow. On the one hand, the supercycle in the commodities market ended and oil prices fell sharply. Between late June 2014 and early January 2015, the price of Brent crude oil plummeted by 60 per cent to $47 a barrel. On the other hand, the US, the EU, and several other nations imposed economic sanctions on key Russian banks and companies in response to Russia's annexation of Crimea and involvement in hostilities in Ukraine's Donbas region, which included the downing of flight MH17 over eastern Ukraine.

These sanctions coincided with the deterioration of the global hydrocarbon market, resulting in a weaker rouble, and rising inflation. In just a few months, the price of Brent crude oil nearly halved, falling from $115 a barrel in June to $55 by the end of December.[11] This had a devastating impact, as approximately 70 per cent of Russia's budget relied on oil and gas revenues. Consequently, the rouble-dollar exchange rate surged from 32 roubles per dollar at the beginning of 2014 to 56 roubles in December, eventually reaching 79 roubles on a particularly turbulent day.[12] The rouble and the dollar are interdependent because of the latter's global importance, Russia's reliance on oil exports priced in dollars, and various economic and geopolitical factors. Changes in the dollar-rouble exchange rate can have significant consequences for Russia's economy and trade relationships.

At the end of 2014, Putin called for a shift to a 'manual mode of economic management'.

In his customary New Year's Eve meeting with the government at the end of 2014, Putin called for a shift to a 'manual mode of economic management'.[13] This entailed closer coordination between the government, the central bank, and the presidential administration as well as heightened control over critical sectors of the economy. Putin cited the management practices employed during the 2008 crisis as a model to follow. The government opted for an expedited approach, invoking the trump card of referring to the 2008 experience: 'Forceful measures were taken then, but there was a need for rapid action without the lengthy process of approvals.'[14] In effect, this approach involved direct government intervention in allocating state support to the corporate sector in exchange for increased bureaucratic involvement in corporate management. As a result of this form of management, substantive reforms aimed at building and fortifying institutions were either delayed or never introduced.[15] Ex-

11 'Brent Crude Oil Prices – 10 Year Daily Chart', Macrotrends, https://www.macrotrends.net/2480/brent-crude-oil-prices-10-year-daily-chart.

12 'Курс доллара США в 2014 году' [US Dollar Exchange Rate in 2014], Ratestats, https://ratestats.com/dollar/2014/.

13 Petr Netreba, 'Путин поручил правительству включить режим ручного управления экономикой' [Putin Instructed the Government to Enable Manual Control of the Economy], RBC, 24 December 2014, https://www.rbc.ru/economics/25/12/2014/549bff109a794746becedc1e.

14 Ibid.

15 In 2012, experts in coordination with the government proposed a reform programme called Strategy 2020. It was not approved as an official government action plan, but many of its provisions were implemented through individual regulations. The strategy envisaged the broad application of project management, greater financial autonomy for the regions, the development of mechanisms of public participation, and control over economic life. Anton Feinberg, 'Центр Кудрина объяснил неудачи реформ в России' [The Kudrin Centre Explained the Failures of Reforms in Russia], RBC, 27 December 2016, https://www.rbc.ru/economics/27/12/2016/58613ed19a7947897126ff05.

amples of such reforms include the transition to project-based management in statecraft, the replacement of short-term investments with long-term ones, and the increased protection of private property.[16] In short, this approach prioritised immediate crisis management over long-term structural reforms.

In autumn 2014, the Bank of Russia initiated a transition to an inflation-targeting regime ahead of its planned schedule. This transition included a shift towards a floating exchange rate for the national currency. The decision to move to inflation targeting was preceded by a depreciation of the rouble's exchange rate, driven by geopolitical risks and falling oil prices. This change was necessary, among other things, so that the government and the central bank would not have to spend a significant portion of reserves to support the rouble exchange rate in the event of a crisis. Starting on 5 November, the central bank terminated unlimited currency interventions on a spot market, currency repo (repurchase agreement, a form of short-term borrowing) was provided instead, and by 10 November, it had effectively completed the shift to a freely floating rouble exchange rate by discontinuing regular interventions and the floating corridor for the currency basket.

A critical situation unfolded in the currency market on 15–16 December 2014. This situation resulted from several adverse events, including an announcement by a representative of the Organisation of the Petroleum Exporting Countries about maintaining oil-production quotas despite the potential decline in oil prices to $40 a barrel. Additionally, there was concern over an opaque bond deal involving Russian energy company Rosneft.[17] These events triggered panic in the currency market, and at an emergency meeting, the central bank raised the interest rate to its maximum level of 17 per cent.[18]

A critical situation unfolded in the currency market on 15–16 December 2014.

At that time, there were no mandatory requirements for exporters to sell their foreign-currency earnings, and the government refrained from direct capital flow control measures. However, Putin informally requested leaders of major companies to sell their foreign-currency earnings,[19] and the government urged the five largest exporting companies to reduce their foreign-currency holdings.[20]

The shift to a floating exchange-rate regime led to a sharp depreciation of the rouble, whose value ultimately fell by about half. Nevertheless, at that moment, maintaining a fixed exchange rate would have required the central bank to continuously sell foreign currency to offset its shortage in the

16 Ekaterina Mereminskaya, Filip Sterkin, and Alexandra Prokopenko, 'Дмитрий Медведев предложил Владимиру Путину измениться' [Dmitry Medvedev Invited Vladimir Putin to Change], *Vedomosti,* 22 April 2016, https://www.vedomosti.ru/politics/articles/2016/04/22/638724-dmitrii-medvedev-predlozhil-vladimiru-putinu-izmenitsya.

17 Yuri Barsukov et al., '"Роснефть" провела секретное размещение' [Rosneft Conducted a Secret Placement], *Kommersant,* 12 December 2014, https://www.kommersant.ru/doc/2631053.

18 'О ключевой ставке Банка России' [About the Key Rate of the Bank of Russia], Central Bank of the Russian Federation, 30 January 2015, https://www.cbr.ru/press/pr/?file=30012015_133122dkp2015-01-30t13_15_49.htm.

19 Evgeniy Kalyukov, 'Улюкаев опроверг требование к госкомпаниям продавать валюту' [Ulyukaev Denied the Requirement for State-owned Companies to Sell Foreign Currency], RBC, 23 December 2014, https://www.rbc.ru/finances/23/12/2014/549978d49a79476dbdbb83fc.

20 Denis Skorobogatko et al., 'Валютный рынок вылечат от аритмии' [The Foreign Exchange Market Will Be Cured of Arrhythmia], *Kommersant,* 23 December 2014, https://www.kommersant.ru/doc/2639259.

market. Russia's foreign-currency reserves might not have been sufficient for an extended period to uphold the pre-crisis exchange rate. The lessons from the previous crisis had been learned and internalised, according to one top bureaucrat, emphasising the importance of adapting to the new economic circumstances rather than attempting to preserve an unsustainable exchange rate.[21]

Against the backdrop of the twin shocks of sanctions and tumbling oil prices, expectations intensified that the authorities would devalue the rouble to restore the balance of payments. Exporting companies did not convert their foreign-currency earnings into roubles, as they were preparing for external debt payments, which were denominated in dollars, and expecting further weakening of the rouble. The Central bank was forced to make interventions.[22] As a result, the demand for rouble liquidity increased and the banking sector's debt to the central bank reached 7 trillion roubles ($ 74.6 billion). In fact, this structural liquidity deficit was a direct result of the sale of reserves. The Bank of Russia increased the potential volume of collateral for its loans and lengthened the maturity of secured loans.[23]

There were also problems with foreign-currency liquidity, as sanctions cut off the largest banks and companies from foreign capital markets. The volume of the financial sector's foreign-currency debt to the central bank in 2015 reached $ 36 billion. Refinancing banks in foreign currency, provided by the central bank, helped to pass the peaks of external debt repayment.

During this crisis, much like during the 2008 global financial crisis, the government provided financial support from the budget to various companies. For instance, it recapitalised banks with nearly 1 trillion roubles ($ 10.7 billion),[24] allocated money from the National Welfare Fund to the construction of the liquefied natural gas plant Yamal LNG,[25] and increased the authorised capital of Russian Railways.[26] Moreover, Russia actively employed trade sanctions during this period, imposing a food embargo on a wide range of products from the US, the EU, and other countries that had imposed sanctions on Russia. This measure was strongly advocated by Russian agricultural producers. Consequently, meat, poultry, and cheese production increased in the country, albeit with rising prices.

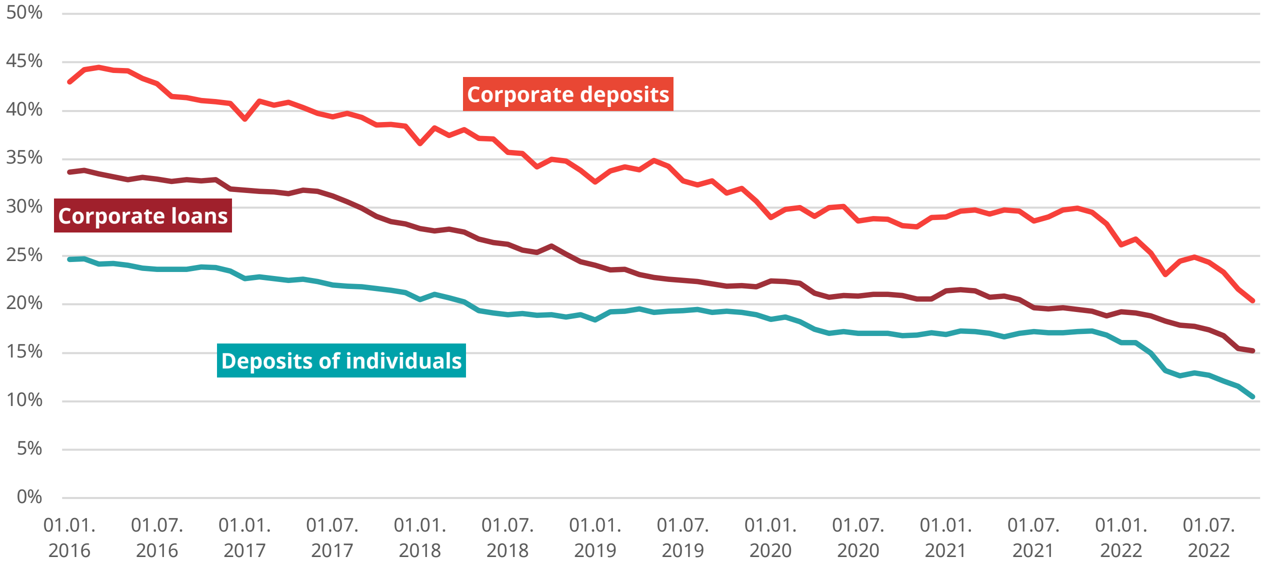
Since 2014, the government has been consistently using the Reserve Fund to cover deficits.

Since 2014, Russia's budget has consistently experienced deficits, and the government has been using the Reserve Fund to cover these shortfalls. By

21 Interview with an official from the finance sector, conducted in person between 2018 and 2022.
22 Data on the Bank of Russia currency interventions (monthly) https://www.cbr.ru/eng/archive/db/valint/
23 'Отчет о развитии банковского сектора и банковского надзора в 2014 году' [Report on the Development of the Banking Sector and Banking Supervision in 2014], Central Bank of the Russian Federation, 2015, https://www.cbr.ru/collection/collection/file/24207/bsr_2014.pdf.
24 Daria Borisyak and Tatiana Voronova, 'АСВ распределило 830 млрд рублей из 1 трлн, выделенного на докапитализацию банков' [The DIA Distributed 830 Billion Roubles out of 1 Trillion Allocated for the Additional Capitalisation of Banks], *Vedomosti,* 26 January 2015, https://www.vedomosti.ru/finance/articles/2015/01/26/asv-raspredelilo-830-mlrd-rub.
25 'На «Ямал СПГ» выделили 150 миллиардов рублей из ФНБ' [150 Billion Roubles Was Allocated From the National Welfare Fund for Yamal LNG], Lenta.ru, 30 December 2014, https://lenta.ru/news/2014/12/30/yamal/.
26 'Кабмин увеличил уставный капитал РЖД на 50 млрд руб. из ФНБ' [The Cabinet of Ministers Increased the Authorised Capital of Russian Railways by 50 Billion Roubles From the National Welfare Fund], RBC, 31 December 2014, https://www.rbc.ru/rbcfreenews/54a3b1389a7947496261ac08.

FIGURE 1

Percentage of loans and deposits in the Russian banking sector held in US dollars, 2016 – 2022



Source: 'Financial Stability Report Q2 – 3 2022' (in Russian), Bank of Russia, 2022, https://cbr.ru/Collection/Collection/File/43512/2q_3q_2022.pdf.

the end of 2017, the entire Reserve Fund, totalling about 6 trillion roubles ($ 63.9 billion), had been depleted, leaving Russia with only one fund: the National Welfare Fund.[27] During the crisis, household incomes declined, and they only began to show marginal growth in 2018–2019 after Rosstat changed its methodology for calculating incomes.[28] The 2014–2015 crisis highlighted the effectiveness of macroeconomic policies in managing economic shocks. However, it also underscored one of the Russian economy's main vulnerabilities: its high dependence on commodity revenues.

The lessons learned from this crisis were the importance of dedollarisation (▶ FIGURE 1) and the stable operation of the banking system. To address the first issue, the Bank of Russia introduced additional provisions for the foreign-currency portfolios of credit organisations. To tackle the second challenge, the central bank strengthened its oversight of the banking sector, gradually removing weak and unscrupulous players. As a result, the banking system shifted in favour of state-owned banks, primarily because of their enhanced access to state support measures. The state-owned banks were too-big-to-fail and their size did not allow proper development of competition in the sector.[29]

The active phase of cleaning up the banking sector began in 2015, when the number of banking licences that were revoked nearly tripled, from 32 to 86. In

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27 Anna Mogilevskaya and Ivan Tkachev, 'Правительство потратило все средства Резервного фонда' [The Government Has Spent All the Funds From the Reserve Fund], RBC, 10 January 2018, https://www.rbc.ru/economics/10/01/2018/5a55f2349a79471be871bb18.

28 Yulia Starostina and Ivan Tkachev, 'Росстат оценил масштаб снижения реальных располагаемых доходов россиян' [Rosstat Assessed the Scale of the Decline in Russians' Real Disposable Incomes], RBC, 28 January 2021, https://www.rbc.ru/economics/28/01/2021/60129a749a7947cf1ca85d53.

29 Interview with Russian financial sector official, conducted in person in 2020.

TABLE 1

Tax revenues gained and lost by Russian regions, 2017

Tax	Billions of roubles gained	Billions of roubles lost
Losses carried forwards and consolidated taxpayer group companies	160	-
Redistribution of excise taxes on alcohol	24.7	-
Increase in excise taxes on alcohol	6	-
Increase in mineral extraction tax	-	53
Redistribution of excise taxes on petroleum products	-	30
Reduction in railway property tax rate	-	12.8
Total	**190.7**	**90.5**

Source: Elizaveta Bazanova, 'Regions Will Earn Almost 100 Billion Roubles From Tax Changes' (in Russian), Vedomosti, 2 March 2017, https://www.vedomosti.ru/economics/articles/2017/03/02/679613-zarabotayut-regioni-nalogovih-izmeneniyah.

the following two years, almost 200 banks exited the market. On average, from 2014 to 2021, approximately 54 licences were revoked each year.[30]

Since the 2014–2015 crisis, the economic authorities have not managed to transition away from a regime of manual management. There have been attempts to establish long-term rules of the game, such as regulations on investments from the National Welfare Fund, commitments to change tax rates every six years, or efforts to adhere to the budget rule. Yet, these attempts have all fallen victim to subsequent crises and ad hoc management.

For instance, to replenish the budget, the government introduced additional levies on oil companies and energy corporation Gazprom in 2017.[31] Import duties were imposed on machinery and equipment, along with a 7 per cent utilisation fee on heavy machinery. An investment fee of 25 per cent was imposed on maritime ports.[32] In 2018, the government attempted to recover so-called superprofits from metallurgical and chemical companies through non-tax methods; one-time payments to the budget and a windfall tax were discussed as possible ways of doing so.[33]

In exchange for subsidies from the federal centre, the regions lost their ability to independently manage their tax revenues.

During this period, the government also altered taxes and redistributed them between federal and regional budgets. In nominal figures, the regions received more than they lost (▶ TABLE 1). However, in exchange for subsidies from the

30 'Итоги года: ЦБ поставил расчистку банковского сектора на паузу' [Results of the Year: The Central Bank Paused the Clean-up of the Banking Sector], RIA Novosti, 12 December 2022, https://ria.ru/20221221/banki-1840166475.html.

31 Yuri Barsukov, 'Добыча дивидендов из недр «Газпрома»' [Extraction of Dividends From the Bowels of Gazprom], *Kommersant,* 21 June 2018, https://www.kommersant.ru/doc/3663154.

32 Elizaveta Bazanova, Vitaly Petlevoy, and Margarita Papchenkova, 'Бизнес пожаловался Путину на Медведева' [Business Complained to Putin About Medvedev], *Vedomosti,* 19 November 2017, https://www.vedomosti.ru/economics/articles/2017/11/20/742277-biznes-putinu.

33 Artur Toporkov, 'Компании из «списка Белоусова» потеряли за сутки почти 400 млрд рублей' [Companies From the 'Belousov List' Lost Almost 400 Billion Roubles in One Day], *Vedomosti,* 10 August 2018, https://www.vedomosti.ru/business/articles/2018/08/10/777922-kompanii-iz-spiska-belousova.

federal centre in the form of budget-balance transfers, the regions lost their ability to independently manage their tax revenues. Consequently, their incentives to improve tax collection waned, as they reasoned, 'Why make an effort [to collect taxes] when the centre will take everything anyway?'[34] This situation has had implications for regional fiscal autonomy and has influenced the dynamics of tax collection, posing challenges for decentralised fiscal policy and revenue mobilisation.

It is noteworthy that the period from 2016 to 2018 was a time of post-crisis recovery, which was accompanied by substantial oil and gas revenues, so there was no need for emergency solutions like raising import duties or imposing a windfall tax. However, a habit had by now been established among Russia's financial authorities of acting ad hoc and bypassing institutional mechanisms.

The main lesson of this crisis was that reserves intended to maintain a given exchange rate of the national currency can be used up very quickly. Hence, a floating exchange rate is much more favourable for macroeconomic stability than a fixed exchange rate. For the stability of the banking system, it is necessary to create additional capital buffers and reduce the currency part of banks' corporate portfolios.

The coronavirus crisis

In 2020, the Russian economy faced a third significant upheaval, triggered largely by the far-reaching impacts of the COVID-19 pandemic. The implementation of stringent lockdowns, the suspension of transatlantic flights, and the broadening scope of self-isolation measures profoundly transformed the global economic landscape. Financial markets swiftly transitioned from an initial temporary slowdown in the first half of 2020 to a full-blown global recession as massive isolation and quarantine regimes shuttered substantial sectors of the world economy.

During the global financial crisis, it had taken approximately a year from the initial signs of trouble in the US credit markets in summer 2007 to the onset of a severe liquidity crisis and the subsequent collapse in global financial asset prices in the third quarter of 2008. In stark contrast, the chain of events of similar magnitude in early 2020 unfolded at breakneck pace. This whirlwind journey began with the Standard & Poor's 500 index hitting an all-time high on 19 February, peaking at 3,386 points. In less than a month, the world witnessed a lightning-fast sequence of events, from the US Federal Reserve's extraordinary rate cut on 3 March to another cut on 15 March, when rates were slashed to the range of 0–0.25 basis points.

Russia did not remain immune to these seismic shifts in the global economic landscape. In fact, the country faced a double-edged shock as the restrictive measures were compounded by plummeting demand for energy resources.

Russia faced a double-edged shock as the restrictive measures were compounded by plummeting demand for energy resources.

34 Interview with the deputy governor of a Russian region, conducted in person in 2017.

TABLE 2

Budget expenditures on the additional capitalisation of banks, as a percentage of GDP

Measures	2008 – 2009	2014 – 2016
Extra capitalisation	1.52	1.2
Elimination and insolvency measures (sanation)	0.97	0.03
Total	**2.49**	**1.23**

Source: Author's calculations

In 2020, budget revenues from oil and gas declined by a staggering one-third.[35]

A distinctive feature of the 2020 crisis was that it primarily affected non-financial companies, which lost revenue because of quarantine restrictions. These losses heightened demand for borrowed capital to replenish working capital, meet payroll obligations, and cover various operational expenses. In contrast to previous crises, when it was forced to keep interest rates high, the Bank of Russia was for the first time able to switch to a soft monetary policy and reduce the key rate to a historically low level of 4.25 per cent without resorting to emergency meetings.[36]

This monetary policy shift had a tangible effect, resulting in the decreased cost of both new loans and a substantial portion of the existing loan portfolio. The reduction in loan costs occurred through a combination of loan restructuring, which concurrently lowered interest rates, and adjustments to loans with variable interest rates. Notably, any issues pertaining to rouble liquidity were transitory and observed only at the initial stages of the crisis. Conversely, foreign exchange liquidity remained stable without encountering any noteworthy difficulties throughout this challenging period. In contrast to previous crises, no additional capitalisation of the banking sector was required in 2020 (▶ TABLE 2).

Because of high regulatory reserve requirements, banks built up macroprudential capital buffers, the dissolution of which freed up more than 500 billion roubles ($5.3 billion) and supported lending.37 The government adopted several serious relaxations for businesses during the crisis, the most significant of which included the postponement

35 'Оперативный доклад об исполнении федерального бюджета и внебюджетных фондов январь-декабрь 2020' [Operational Report on the Execution of the Federal Budget and Extra-budgetary Funds, January – December 2020], Accounts Chamber of the Russian Federation, 2021, https://ach.gov.ru/upload/iblock/e37/e371835371389756c2d319de62f0bd12.pdf.

36 'Ключевая ставка Банка России и инфляция' [Bank of Russia Key Rate and Inflation], Central Bank of the Russian Federation, https://www.cbr.ru/hd_base/infl/.

37 Общество и пандемия: Опыт и уроки борьбы с COVID-19 в России' [Society and Pandemic: Experience and Lessons in the Fight Against COVID-19 in Russia], Gaidar Institute for Economic Policy, 2020, https://www.iep.ru/files/publications/COVID-19_2020.pdf.

of contributions to pension and social funds; tax holidays and subsidies for affected industries; direct subsidies to systemically important companies; loans at preferential rates for various categories of business; and increased advances on government contracts. The total cost of the three anti-crisis packages was estimated at the equivalent of 2.7 per cent of Russia's GDP.[38]

It is worth noting, however, that Russia displayed a degree of resilience in grappling with the aftermath of the pandemic, owing largely to its adaptive business strategies.[39] The real economy demonstrated a notable ability to withstand disruptions in supply chains. Businesses in a way copied the behaviour of top officials by holding back investments and forming increased reserves. Drawing on lessons learned in previous shocks, firms entered the crisis well prepared, boasting substantial inventory levels, reduced debt burdens to both banks and suppliers, and flexible labour arrangements with employees. To a significant extent, the arsenal of measures and practices implemented by Russia's financial leadership and business sector in response to the challenges posed by the pandemic accelerated the recovery and proved invaluable in mitigating the consequences of the subsequent crisis.

In sum, in responding to the COVID-19 pandemic, the Bank of Russia's countercyclical measures helped support economic activity, while capital buffers in the banking sector contributed to the stability of the financial system.

The war against Ukraine

By 24 February 2022, the Russian economy was in a good shape: GDP in the first quarter was growing at an annualised rate of 3.5 per cent; citizens' wages, credit, and mortgages were rising; the population, tired of the coronavirus, was spending aggressively; and tourism and transport were recovering.[40] Unemployment was at historically low levels. The main external risks for Russia were considered to be, firstly, the tightening of monetary policy by developed countries because of spillover effects following rate hikes and, secondly, possible new strains of coronavirus.

Military action against Ukraine and the subsequent Western sanctions changed this favourable picture in a matter of days. The Russian government and the central bank had been preparing for the restrictions, but the freezing of reserves and the ban on imports of cash dollars and euros were

38 'Общество и пандемия: Опыт и уроки борьбы с COVID-19 в России' [Society and Pandemic: Experience and Lessons in the Fight Against COVID-19 in Russia], Gaidar Institute for Economic Policy, 2020, https://www.iep.ru/files/publications/COVID-19_2020.pdf.

39 Tatyana Dolgopyatova et al., eds., *Ответ российского бизнеса на пандемию COVID-19* [The Russian Business Response to the COVID-19 Pandemic] (Moscow: HSE Publishing House, 2021), https://id.hse.ru/books/552371578.html.

40 'Росстат оценил рост ВВП в I квартале в 3,5% в годовом выражении' [Rosstat Estimated Russia's GDP Growth in Q1 at 3.5% in Annual Terms], Interfax, 18 May 2022, https://www.interfax.ru/business/841599.

a surprise to them.[41] After these sanctions were announced, the rouble-dollar and rouble-euro exchange rates broke through the 120 and 150 rouble marks, respectively, and people rushed to banks to withdraw their deposits and stash them under their mattresses. The outflow of funds from the banking system exceeded 2 trillion roubles ($ 30 billion) in the first two weeks of what Moscow called the special operation in Ukraine.[42]

The central bank and the finance ministry put the economy into an artificial coma.

The government and the central bank responded by banning the withdrawal and physical export of currency from the country for Russians and non-residents, obliging exporters to sell 80 per cent of their foreign-currency earnings within three days after they were deposited in their accounts, closing the stock exchange, and increasing the interest rate to 20 per cent. In fact, the central bank and the finance ministry put the economy into an artificial coma. Restrictions on capital flows literally locked foreign-currency liquidity inside the Russian financial system, maintaining its stability.

With the exception of the interest rate change, such moves had not been applied in previous crises. Moreover, the regulation of capital flows in Russia had been consistently liberalised in previous years. Their restriction, among other things, indicates the extraordinary nature of the regulation introduced. On the one hand, the rate increase cooled economic activity, as few people were ready to take out loans at such a price; and on the other hand, it made deposits attractive again, because people and companies started to return funds to their accounts. At an extraordinary meeting on 27 May 2022, the Bank of Russia sharply reduced the rate again from 14 per cent to 11 per cent.[43] This level was still attractive for people to keep their money in bank deposits, and it was less damaging for credit purposes.

For the real economy, the sanctions restricted companies' access to technology and equipment, while the closure of Western markets forced the sector to seek new customers in Asia and the Middle East by adapting products and adjusting supply chains. As the economy shifted to the new realities, the tightening measures were lifted. Indeed, the adaptation was faster than expected: while in April pessimistic scenarios were dominant,[44] by September, according to surveys by the Bank of Russia, positive changes in the economy were recorded thanks to high inventories and their replenishment due to the strengthened exchange rate and, as a result, the rapid adaptation of business.[45]

By mid-2022, the financial sector and the economy had been stabilised. The rouble, after a short fall from 76 roubles per dollar on the eve of the invasion to 120 roubles per dollar in early March 2022, strengthened sharply to

41 Alexandra Prokopenko, 'The Cost of War: Russian Economy Faces a Decade of Regress', Carnegie Endowment for International Peace, 19 December 2022, https://carnegieendowment.org/politika/88664.
42 Ibid.
43 Nadezhda Nizamova, 'ЦБ снизил ключевую ставку до 11%: что будет с кредитами и ипотекой' [The Central Bank Reduced the Key Rate to 11%: What Will Happen to Loans and Mortgages], Banki.ru, 26 May 2022, https://www.banki.ru/news/daytheme/?id=10966832.
44 'О чем говорят тренды: Макроэкономика и рынки' [What the Trends Are Talking About: Macroeconomics and Markets], Central Bank of the Russian Federation, April 2022, https://www.cbr.ru/Collection/Collection/File/40953/bulletin_22-02.pdf.
45 'О чем говорят тренды: Макроэкономика и рынки' [What the Trends Are Talking About: Macroeconomics and Markets], Central Bank of the Russian Federation, September 2022, https://www.cbr.ru/Collection/Collection/File/42297/bulletin_22-05.pdf.

50–60 roubles per dollar in June–November 2022.[46] Consumer prices, which had jumped in March 2022, almost stopped growing by April. A year later, price growth exceeded the previous year's level by only 2.3 per cent.[47] In any prosperous, non-militarised developing country, such rates of price growth would be considered quite acceptable. But this prosperity was the product of a combination of several factors whose effect ceased by the spring and early summer of 2023. And the authorities returned to ad hoc economic management modelled on the beginning of the invasion: in response to the sharp weakening of the rouble, the central bank raised the key rate at an emergency meeting, and the government returned to the discussion of capital flow controls.[48]

The government decided to delay the introduction of regulatory restrictions but used manual controls instead: Russian deputy minister of industry and trade Viktor Yevtukhov held a meeting with retailers at which he demanded price limits for several goods,[49] and the government informally agreed with exporters that they would be more active in selling foreign currency.[50]

Conclusion

The primary objective of taming the economic cycle is to smooth out fluctuations while helping businesses and households to adapt to the economic rollercoaster. This imperative is particularly significant for emerging countries, including Russia. Recent research highlights the pivotal role of institutional quality, such as the rule of law, and its relationship with countercyclical policies in shaping the economic and financial repercussions of global shocks on emerging economies.[51] Paradoxically, countries with more effective countercyclical policies may have less incentive to bolster their institutions. In the 2020 coronavirus crisis, the Russian central bank and government successfully navigated resistance from lobbyists from the real economy to enact countercyclical measures. This success was largely due to decisions that were made by a select group of technocrats, including Nabiullina, Siluanov, and Maxim Oreshkin, a former minister of economic development and current presidential aide, then endorsed by the president and subsequently implemented.

46 'Курс доллара США в 2022 году' [US Dollar Exchange Rate in 2022], Ratestats, https://ratestats.com/dollar/2022/.

47 'Ключевая ставка Банка России и инфляция' [Bank of Russia Key Rate and Inflation], Central Bank of the Russian Federation, https://www.cbr.ru/hd_base/infl/.

48 'Russia's Elite Split Into Squabbling Factions Over the Ruble', Bloomberg, 18 August 2023, https://www.bloomberg.com/news/articles/2023-08-18/no-one-in-russia-could-agree-on-how-to-wrest-control-of-the-ruble.

49 Adam Tooze, 'Chartbook 236: Russia's Long-War Economy', *Chartbook,* 30 August 2023, https://adamtooze.substack.com/p/chartbook-236-russias-long-war-economy.

50 Dmitry Grinkevich and Galina Kazakulova, 'Власти решили пока не ужесточать валютный контроль' [The Authorities Have Decided Not to Tighten Foreign Exchange Controls for Now], *Vedomosti,* 16 August 2023, https://www.vedomosti.ru/economics/articles/2023/08/16/990533-vlasti-reshili-poka-ne-uzhestochat-valyutnii-kontrol.

51 Andrea Ferrero et al., 'Working Paper Series: Leaning against the global financial cycle', European Central Bank, December 2022, https://www.ecb.europa.eu/pub/pdf/scpwps/ecb~3f8276f7dc.wp2763en.pdf.

The Russian authorities have gleaned valuable lessons from the four crises of the past 15 years.

The Russian authorities have gleaned valuable lessons from the four crises of the past 15 years, by striving to enhance the country's economic resilience, refine their anti-crisis strategies, and manage emerging risks better. Key takeaways of the way Putin and his economic team have grappled with recent crises include the adoption of an ultra-conservative macroeconomic policy characterised by cautious reserve spending (with accelerated accumulation between crises), higher reserve requirements in the financial system, reduced competition in the banking sector for easier management, and stringent monetary and fiscal policies. These policies, while promoting stability, have, at times, come at the cost of lower economic growth, with the average growth rate between 2013 and 2022 hovering at around 1 per cent.[52]

By 2023, Russia had garnered the unenviable distinction of being the world leader in terms of the number of sanctions imposed on a country, with a total of more than 13,000 individual measures. Despite these challenges, Russia's economic contraction in 2022 was milder than some had anticipated, at 2.1 per cent of GDP. The country's economy demonstrated resilience against shocks, which can be attributed to factors including the government's consistent readiness for crises and the financial authorities' acute focus on financial stability. High levels of reserves, built up by businesses before the war, and the strengthened rouble exchange rate in the second quarter of 2022, along with liquidity buffers in the banking sector and the National Welfare Fund, allowed the authorities to quickly saturate the economy with money even while the central bank's reserves were frozen.

Factors for resilience include the government's readiness for crises and the financial authorities' acute focus on financial stability.

This state of constant preparedness has compelled the Russian authorities to address most challenges manually, while the economy, accustomed to this style of management, exhibited limited resistance. In 2022, a portion of the budget rule that constrained additional government expenditure was suspended, and in 2023, the component mandating the accumulation of excess oil and gas revenues was also disapplied. Major corporations, such as Gazprom and oil companies, did not object to substantial payments to the budget,[53] while businesses, according to Russian first deputy prime minister Andrey Belousov,[54] approached the government voluntarily to contribute additional taxes.[55] Anonymously, business representatives complained to the media that the new taxes had hardly been discussed with them.[56] Coupled with a substantial trade surplus, which reached a record $332 billion in 2022, this management system allowed the Russian economy to withstand significant shocks.[57]

52 'Данные по национальным счетам' [National Accounts Data], Rosstat, https://rosstat.gov.ru/storage/mediabank/VVP_god_s_1995-2022.xls.

53 'Russia's "new formula" to increase tax revenue from oil exporters', *The Bell,* 18 February 2023, https://en.thebell.io/russia-s-new-formula-to-increase-tax-revenue-from-oil-exporters/.

54 'Андрей Белоусов: «Ядро устроено не из экономики, оно устроено из смыслов»' [Andrey Belousov: 'The Core Is Not Made of Economics, It Is Made of Meanings'], RBC, 13 June 2023, https://www.rbc.ru/business/13/06/2023/6482d3389a79473805ee8978.

55 'Putin signs law on windfall tax', Reuters, 4 August 2023, https://www.reuters.com/markets/europe/putin-signs-law-windfall-tax-2023-08-04/.

56 Max Seddon and Anastasia Stognei, 'Kremlin unveils windfall tax to raise Rbs300bn from oligarchs', *Financial Times,* 13 June 2023, https://www.ft.com/content/c6080d1e-d3c3-4b1d-b7f3-e3acff1876ca.

57 'ФТС России частично возобновляет публикацию данных таможенной статистики внешней торговли' [The Federal Customs Service of Russia Partly Resumes the Publication of Data on Customs Statistics of Foreign Trade], Customs Service of the Russian Federation, 13 March 2023, https://customs.gov.ru/press/federal/document/385906.

While Russia's capacity to respond to crises and its finely tuned anti-crisis strategies might appear successful on the surface, they also reinforced a penchant for manual intervention, a management approach that is proving unsustainable in present-day Russia. This approach has, in turn, hindered the development of institutions that constitute the framework of the economy. Having strong institutions, such as property rights, a predictable tax system, or the budget rule, will favour the Russian economy. But the permanent crisis mode and the habit of ad hoc management has cost the economy its growth rate. As a senior official said, if you wear a helmet all the time, you can save money on accident insurance.[58] In other words: If you are always in crisis, why do you need working institutions and expect economic growth?

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58 Interview with an official from the finance sector, conducted in person between 2018 and 2022.