Tuesday, August 18, 2026
tomorrowsaffairs.com

Tomorrow's Affairs

Analysis of today
Assessment of tomorrow

By: Anders Åslund

# No good options for Russian war economy

The broad consensus among Russia-watchers is that the country is facing a prolonged bout of stagflation.

Growth this year is unlikely to exceed 1%, and inflation is still stuck at 6% (or more).

Moreover, the most promising option for reviving the economy is the least likely to be pursued, because it requires President Vladimir Putin's willingness to end the war on Ukraine.

The downside risks are legion. Russian troops have barely advanced in Ukraine this year, and Russia cannot spend more on its military without triggering financial instability.

Meanwhile, Ukraine has brought the war to Russia, with its drones decimating oil and gas facilities and even e-commerce warehouses, thus souring Russians on Putin's war.

A Russian friend in exile recently characterized Putin's plight as Zugzwang, a chess term for when a player's only options will leave him in a worse position.

## Public spending

The most obvious vulnerability is public spending. The 2026 budget surprised analysts by allocating $183 billion to national security and defense, about the same as in 2025.

The implication was that Putin had accepted a war of attrition, rather than trying to raise expenditures and clinch a decisive victory. But would he really accept such a limitation?

In fact, though he stuck to a budget deficit of about 2% of GDP during the first three years of the war, this share rose to 2.6% in 2025, and in the first seven months of 2026, he allowed the deficit to balloon to 2.8% of GDP—almost twice what was planned.

Such an imbalance is fiscally untenable. Russia has no sources of government financing other than taxes and domestic loans.

Not even China offers it credits, and its federal revenues are lingering around 18% of GDP despite repeated increases in corporate taxes, value-added taxes, and personal income tax.

> If the Kremlin maintains its current fiscal policy, it is likely to end up with much higher inflation, a financial crisis, or both

At this point, more tax hikes would be purely detrimental. Putin's last resort would appear to be the tiny liquid share of the National Welfare Fund.

As a result, the government has been plying government bonds to state-owned banks.

As Craig Kennedy of Harvard University's Davis Center for Russian and Eurasian Studies has shown, state-owned banks are also giving large loans to Russian arms producers, while receiving repo loans from the central bank.

This indirect method of issuing money might explain the disconnect between officially reported annual inflation (6% in June) and inflation expectations among the populace (14.7%).

Russia has long boasted that its public debt is only around 15% of GDP. But its debt is so low only because the government virtually cannot borrow money from anywhere outside Russia.

Moreover, since the central bank maintains an interest rate of 14%, the cost of servicing Russia's public debt is high, making any military splurge untenable.

Thus, if the Kremlin maintains its current fiscal policy, it is likely to end up with much higher inflation, a financial crisis, or both.

## Another mobilization

Nonetheless, Putin looks as if he is going for broke. Russia is supposed to hold elections to the State Duma on September 18–20, and with no opposition likely, speculation already abounds that Putin will order a military mobilization soon afterwards.

The last time he tried that, in September 2022, well-educated young men emigrated en masse.

Another mobilization is likely to provoke a similar stampede for the exits. With labor already scarce, this would be a major economic blow.

But Putin is in a bind, because the alternative is to seek a ceasefire, which could prove even more dangerous to his regime.

> Putin cannot win the war he started, because Russia cannot compete technologically

Even though only 15,000 Soviet soldiers died during the Kremlin's failed war in Afghanistan in the 1980s, that was enough to provoke a strong backlash in Russia, which ended up being ravaged by criminal gangs populated by veterans.

This time, almost 500,000 Russian soldiers are estimated to have been killed in Ukraine, and the number of war veterans suffering from post-traumatic stress disorder is sure to be far larger.

This cohort is presumably one of Putin's greatest worries, and the risk it poses makes him unlikely to sue for peace.

Yet he cannot win the war he started, because Russia cannot compete technologically.

With its freer economy, Ukraine has made tremendous headway in deploying drones and other new technologies, whereas Russia's arms industry remains concentrated in the torpid state-owned company Rostec, run by Sergei Chemezov, whose only qualification is that he served with Putin in the KGB in Dresden decades ago.

Although most middle-class Russians have not been forced to fight yet, their professional and economic opportunities are drying up amid rising prices, and relentless Ukrainian bombing has resulted in fuel and other shortages.

Little wonder that Putin is running scared, darting (by armored train) between his various bunkers.

## Putin's fear extends to his inner circle

Putin's fear extends to his inner circle. In May 2024, he sacked his once-popular defense minister, Sergei Shoigu, and several of Shoigu's deputies were arrested on corruption charges and handed long prison sentences.

The same month, he also removed longtime ally Nikolai Patrushev from his post as secretary of Russia's Security Council.

*Despite this instability, Putin seems willing to gamble with financial destabilization, too. His situation is not yet desperate, but he has no good options*

Then, in July 2025, Minister of Transportation Roman Starovoit reportedly took his own life after being removed from office.

And in September 2025, Dmitri Kozak, a deputy chief of presidential staff and longtime Putin associate who is known to have opposed the war, suddenly resigned.

In June of this year, another crony, Sergei Ivanov, died at the age of 73.

Konstantin Makhov, the right-hand man of

Arkady Rotenberg, one of Putin's oldest friends, has been arrested for corruption, and another ally, Ilya Traber, a former leader of the gang that used to control St. Petersburg's oil shipping, was arrested for murder.

Despite this instability, Putin seems willing to gamble with financial destabilization, too. His situation is not yet desperate, but he has no good options.

Anders Åslund is the author of Russia's Crony Capitalism: The Path from Market Economy to Kleptocracy.