The Twilight of Military Keynesianism: Russia and Ukraine.

Russia invaded Ukraine on the 24th of February, 2022. On the 9th of May 2022, [the Telegraph](https://www.telegraph.co.uk/business/2022/05/09/ftse-100-markets-live-news-russia-energy-mccolls/) reported that the Russian finance ministry was, following Western sanctions, anticipating a 12% fall in GDP – the biggest since 1994. On the 8th of June, 2022 [Reuters reported](https://www.reuters.com/markets/europe/russias-economic-slump-will-wipe-out-15-years-gains-iif-2022-06-08/) that the Institute of International Finance forecast a 15% shrink that year and a 3% reduction in 2023; indeed, the batch of Western sanctions had apparently triggered the ‘full disintegration of 30 years of investment’.

In hindsight, it is easy to poke fun at the alarmist Western economists who always get it wrong. Economics is the [dismal science](https://intothepeasoup.substack.com/p/by-any-means-necessary), after all. Realists, on average, outperform pessimists. The Russian economy did shrink in 2022 – but only by around 2%. In 2023 and 2024, we’ve seen above-average output growth (see chart).

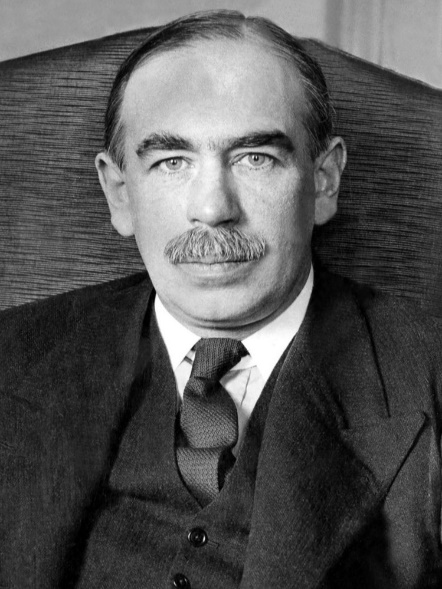
A graph of growth and decline

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*Source: International Monetary Fund. Own Illustration. Quarterly data seasonally adjusted using 4-quarter moving averages.*

It is natural that such a stark difference between forecasted and actual rates has not only diminished the credibility of Western economic institutions, but also fanned the flames of what has come to be termed Military Keynesianism (MK).

For the uninitiated, John Maynard Keynes is the pre-eminent economist of the early twentieth century. He first rose to prominence after writing a quite scathing commentary on the Big Three – Wilson, Clemenceau, and Lloyd George – after they brokered the Treaty of Versailles following WWI. Keynes’ *General Theory* fundamentally changed the economics discipline and arguably invented modern macroeconomics.



The crux of classical Keynesian economic theory lies in the concept of *effective demand*. Effective demand allows us to understand why an economy may have spare capacity which could be operated at a profit, but which, for the time being, remains unemployed. The key point is understanding the order of operations in a market economy. Entrepreneurs make decisions on how much to produce based on how much demand currently exists in the market for goods and services – only then do they hire workers and invest in capital. For any individual employer, spending less on labour costs improves their balance sheet via their costs; however, for the set of employers at large, higher unemployment worsens balance sheets due to lower general consumption resulting in lower revenues. As such, when profits wobble and employers collectively scale back their hiring or investment decisions, this can – and often does – spiral into recessionary periods. Keynes’ idea of effective demand, therefore, posits a difference between potential demand, when everyone is employed, and *effective* demand, which is the actual level suppliers experience. Low effective demand means potentially productive capital and labour remain unemployed, and increasing demand, possibly via government spending or lowering interest rates, would not only increase the general *nominal* income in society, but it would also increase the *real output*. This was termed the ‘accelerator effect’ by Keynes.

According to such a theory, when an economy has high levels of spare capacity, government spending through or borrowing – or even money printing – would not increase inflation. To understand why, we must be introduced to the pre-eminent economist of the latter 20th century – Milton Friedman.

