

**Center for  
Economic Theories and Policies**  
Sofia University St. Kliment Ohridski  
Faculty of Economics and Business Administration

ISSN: 2367-7082



## **Russia-Ukraine War and the Almaty Restaurant Industry**

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**BEP 05-2024  
Publication: September 2024**

# Russia-Ukraine War and the Almaty Restaurant Industry

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September 5, 2024

## Abstract

This paper examines the impact of a major exogenous shock—the inflow of Russian migrants into Almaty, Kazakhstan, after the Russia-Ukraine conflict began in 2022—on the city's restaurant industry. A large proportion of the migrants moving into Almaty pushed the price for housing significantly upward. Given the dual residential and commercial nature of ground-level real estate, the rapid increase in rental costs spilled into the restaurant industry as one of its most burdensome fixed expenses. By adopting the setup of perfect competition, we can trace how this escalation in fixed costs sets off a sequence of market responses: an initial fall in profit experienced universally by firms, exit of restaurants from the market, a drop in total market supply, increase in meal prices, and changes in the output behavior of restaurants that remain in business. The models show that the number of restaurants declined, meal prices rose, each restaurant served more customers, and industry output fell. Our work also clearly shows, as is consistent with the literature on narratives and economic results, that economic theory does not exist in a vacuum. Our results provide empirical content to a realization that very stylized models—those based on the strongest assumptions, and therefore quite far from complex realities—may supply testable predictions of firm and industry behavior under exogenous shocks. The analysis advanced our understanding of the economic consequences of abrupt migration events but also provided pedagogical value in showing the applicability of theoretical models to real-world scenarios. (247 words)

**Keywords:** exogenous shock, real estate rent, restaurant industry, emigration from Russia, Kazakhstan economy

**JEL codes:** D22, D41, L83

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# Russia-Ukraine War and the Almaty Restaurant Industry

## 1. Introduction

During the last quarter of 2022 and the first quarter of 2023, Almaty saw the arrival of a noticeable number of young Russian males – some with and others without their partners. These were men fleeing military mobilization in the Russian Federation following the February 24, 2022 start of what Russia called the Special Military Operation provoked by the unofficial NATO expansion into Ukraine and which the United States and its allies called unprovoked Russian military aggression. Some 420 thousand Russian citizens arrived in Kazakhstan during 2022 and 2023, of which 320 thousand left for other countries, resulting in a net inflow of about 100 thousand<sup>2</sup>, with a considerable number of them choosing to live in Almaty, which had a population of 2.1 million. The immediate consequence of this immigration was an exogenous increase in the demand for housing in Almaty. This led to an increase in the rental rates for residential real estate varying between 20% and 100% depending on the location in Almaty.<sup>3</sup>

Insofar as ground-level real estate can serve both residential and commercial purposes, and restaurants typically locate at the ground level, restaurant owners experienced an increase in rents. The purpose of this paper is to answer the question: what does economic theory have to say about the effects of this exogenous immigration, and the consequent rise in rental costs for restaurants, for the restaurant industry in Almaty, specifically in terms of the number of restaurants, the prices of meals, the output per restaurant, and total industry output. Our second purpose is pedagogic: to show how very simple economic models predicated on assumptions quite divorced from reality can be fruitfully utilized to arrive at far-reaching, definitive conclusions that can be verified empirically.

This paper connects to the recent literature emphasizing the role of narratives in economic development. It embeds economic theory within a real social context, which can influence both individual and group behavior. This argument was initially proposed by McCloskey (1983), later popularized by Shiller (2017), and comprehensively summarized in a survey

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<sup>2</sup> The lion's share of the Russian migrants who stayed in Kazakhstan were on temporary permits, whereas a small minority applied for permanent residence: 5,891 or 31.3% of the total number of immigrants in 2022 and 11,711 or 33.8% of the total number of immigrants in 2023; 3,286 permanent residence holders or 18.85% resided in Almaty in 2022 and 6,409 permanent residence holders or 25.25% resided in Almaty in 2023. Source: Bureau of National Statistics, Agency for Strategic planning and reforms of the Republic of Kazakhstan.

<sup>3</sup> As of July 2022, the rental payments in Almaty on a year-to-year basis increased by 47.2%. Source: Bureau of National Statistics, Agency for Strategic planning and reforms of the Republic of Kazakhstan.

by Roos and Reccius (2023). Building on these insights, we argue that narratives are also crucial for teaching economics. Therefore, we refer to a specific situation, discussed within a particular social context and related to a specific time frame—in our case, the inflow of migrants from Russia into Kazakhstan.

It is reasonable to assume that the restaurant industry in general, and in Almaty in particular, is characterized by monopolistic competition as the market structure (cf. Chamberlin 1933; Robinson 1933). However, since the same zero-profit condition holds for every firm in industry equilibrium both in Chamberlin competition and perfect competition, it is a sound approximation to assume that this industry is characterized by perfect competition. In the remainder of the paper, we apply the theory of industry equilibrium in perfect competition to explain the kinds of changes that occurred in the Almaty restaurant sector as a consequence of an increase in the real estate rent component of the cost of production for the incumbent firms, arising, in turn, from the rise in demand for housing due to the net immigration of Russians.

The argument is the following. The rent component of cost for a firm is a fixed cost in that it does not vary with the firm's output, and this increased for every Almaty restaurant conceived as a perfectly competitive firm. Moreover, in the pre-shock industry equilibrium, (i) every firm was producing an output at which its marginal cost of production was equal to the parametrically given market price, (ii) the number of firms in the initial equilibrium was determined by the condition that every firm was earning zero profit, and (iii) the industry output and market price were determined by the equality of market demand and market supply of restaurant meals per day.

An exogenous increase in the fixed cost had the following consequences. Starting from zero profit, the rise in fixed cost caused every firm's profit to become negative. This necessarily implied an exit of firms from the industry, and thereby a fall in the number of surviving restaurants. With an unchanged output of each surviving restaurant but a smaller number of restaurants, there was an unambiguous fall in market supply – a leftward shift of the market supply curve – leading to a new market equilibrium with a higher price and a smaller quantity of meals bought and sold per day. Finally, given an upward sloping marginal cost curve faced by every firm, a higher market price necessarily implied that the output of each restaurant would be higher in the new equilibrium. Thus, microeconomic theory tells us that (1) the number of restaurants decreased, (2) the prices charged for meals by restaurants increased, (3) each restaurant ended up serving a larger number of customers, and (4) the aggregate output of the restaurant sector fell, all as a consequence of the Russia-Ukraine war

that erupted in early 2022. The Russia-Ukraine war and the consequent military mobilization in the Russian Federation caused Almaty to have fewer restaurant choices, with each restaurant more expensive and more crowded.

Section 2 presents this argument graphically, and Section 3 contains the mathematical derivations. Section 4 contains some concluding remarks.

## 2. Graphical Analysis of Restaurant Market

For the graphical analysis, we follow the standard nomenclature.<sup>4</sup> In the real estate market, the supply curve is upward sloping though steep because there is some limited substitutability between commercial and residential real estate before additional apartment are constructed over time, and the market demand curve for apartments, including ground-level facilities is of the usual downward sloping type. An inflow of migrants who had income to spend on housing constituted an exogenous shock in the form of an increase in the income of the buyers of the commodity leading to a rightward shift of the demand curve for rental properties. This caused the equilibrium market rentals of apartments in Almaty to increase.<sup>5</sup>

Since the rent of commercial real estate is a fixed cost for a firm, the restaurants experienced a sudden increase in their fixed cost of production. While in the short run, a competitive firm's output does not change in response to an increase in fixed cost, starting from zero profit, its profit does become negative. And, negative profits are a signal to at least some incumbent firms to exit the industry. With unchanged restaurant-level output, the number of restaurants in Almaty declined, so that the industry supply curve shifted to the left,  $S$  to  $S'$ , as in Figure 1b below, resulting in a smaller number of restaurants meals bought and sold every day in the new market equilibrium,  $X_0$  to  $X_1$ , and a higher equilibrium price per meal.

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<sup>4</sup> In this paper, we apply the theory of supply and demand as developed in the *Principles of Economics* by Alfred Marshall (1890). In this seminal work, Marshall introduces the concepts of aggregate demand and aggregate supply functions, market equilibrium, elasticity, comparative statics, and the ceteris paribus condition to modern economic analysis. The presentation of the market model has remained largely unchanged for 130 years and continues to be a standard model in introductory microeconomics courses (see Goolsbee et al. (2016), Jehle and Reny (2001: 153-158), Mankiw and Taylor (2017: 31-56), Samuelson and Nordhaus (1989: 421-445), and Varian (2010), among others).

<sup>5</sup> For empirical evidence of these effects in other cross-border movements, see Unal et al. (2024) or Cochrane and Poot (2021).

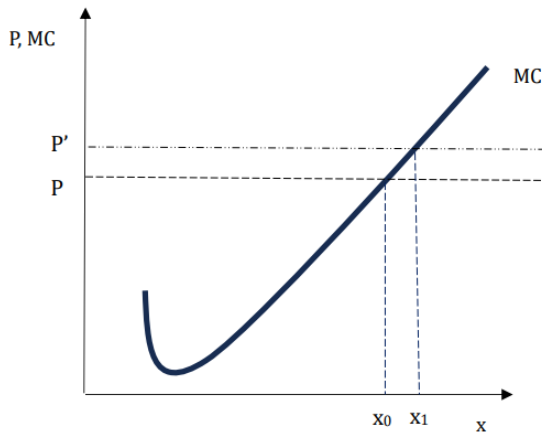


Figure 1a: Firm

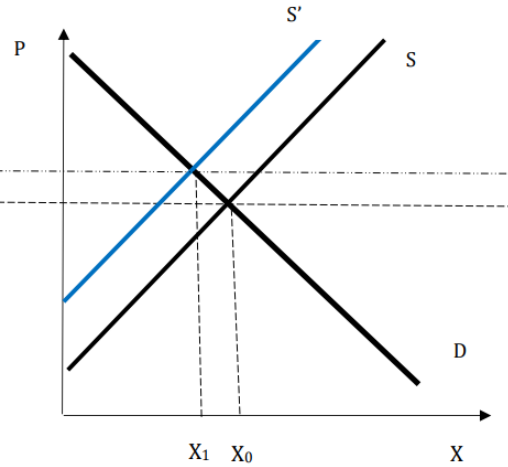


Figure 1b: Industry

Given an upward sloping marginal cost curve facing every restaurant, corresponding to a higher market price  $P'$  instead of  $P$ , each restaurant increased its output, from  $x_0$  to  $x_1$ , as in Figure 1a above. Consequently, after the arrival of Russian migrants, Almaty had fewer restaurant choices, with each restaurant more expensive and more crowded.

### 3. Mathematical Analysis

Let  $p = h(X)$  be the inverse market demand function for restaurant meals per day, with  $h'(X) < 0$ , where  $X$  is quantity demanded and  $p$  is price. The price is a parameter for every perfectly competitive restaurant in the market, and its profit is  $\pi = px - f(x) - C$ , where  $x$  is output,  $f(x)$  is total variable cost, and  $C$  is fixed cost. At an interior maximum, the first order condition for maximization of profit by a restaurant is  $px - f'(x) = 0$ , which determines a unique value  $\hat{x}$  for the restaurant's output under the second order condition that  $f''(\hat{x}) > 0$ .

In industry equilibrium, while each restaurant's output is  $\hat{x}$ , there is a finite,  $N$  number of such restaurants, so that  $X = N\hat{x}$  is quantity demanded in the market, and the equilibrium value  $\hat{N}$  is determined by the following zero profit condition:

$$\pi(\hat{x}, \hat{N}) = h(\hat{N}\hat{x})\hat{x} - f(\hat{x}) - C = 0. \quad (1)$$

And the first order condition can be restated as:

$$h(\hat{N}\hat{x})\hat{x} - f'(\hat{x}) = 0. \quad (2)$$

Comparative statics can be conducted using (1) and (2), to obtain the effects of exogenous fixed cost changes on the output of each restaurant and the numbers of restaurants in the industry, by totally differentiating them and solving for

$$\frac{d\hat{x}}{dC} = \frac{-\hat{x}h'(\hat{X})}{D} > 0 \quad (3)$$

indicating an increase in each restaurant's daily offerings, and

$$\frac{d\hat{N}}{dC} = \frac{\hat{N}h'(\hat{X}) - f''(\hat{x})}{D} < 0 \quad (4)$$

indicating fewer surviving restaurants, where  $D = -\hat{x}^2h'(\hat{X})f''(\hat{x}) > 0$ .<sup>6</sup> Since  $X = Nx$ , it follows that

$$\frac{d\hat{X}}{dC} = \frac{-\hat{x}f''(\hat{x})}{D} < 0, \quad (5)$$

or a smaller aggregate quantity demanded in the new equilibrium, and since  $p = h(X)$ , it immediately follows that

$$\frac{d\hat{p}}{dC} = h'(\hat{x}) \frac{d\hat{x}}{dC} > 0. \quad (6)$$

That is, the restaurants become pricier. Results (3) to (6) confirm the claims in our graphical analysis of the previous section.

## 4. Conclusion

First, the restaurant industry in general, and in Almaty in particular, is not a perfectly competitive market with a finite number of identical firms, each producing a homogenous commodity; it is a very Chamberlin form of monopolistically competitive market, with each restaurant selling a horizontally differentiated product. And yet, we show that we can reasonably depart from this reality, and assume instead that perfect competition prevails, and yet reach empirically vindicated observations. This is a remarkable lesson. It shows that heroic assumptions – strong enough to render the model significantly different from observed reality – can still lead one to correct conclusions in terms of being empirically true, if the *specific* simplification successfully catches the *essential economic features* of reality, in

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<sup>6</sup> Totally differentiating (2), we have

$$[\hat{X}h'(\hat{X}) - f''(\hat{x})]d\hat{x} + \hat{x}^2h'(\hat{X})d\hat{N} = 0, \quad (2a)$$

and totally differentiating (1), we have

$$\hat{X}h'(\hat{X})d\hat{x} + \hat{x}^2h'(\hat{X})d\hat{N} = dC. \quad (1a)$$

Substituting  $\hat{x}^2h'(\hat{X})d\hat{N} = dC - \hat{X}h'(\hat{X})d\hat{x}$  from (1a) into (2a), and solving for  $d\hat{x}/dC$ , we obtain (3). And, substituting for  $d\hat{x}/dC$  from (3) in (1a) yields (4).

this case the commonality of the zero-profit condition in both perfect competition and monopolistic competition, which captures the dynamics of firm-entry on positive profits, and firm-exit on negative, so that equilibration may occur at zero profit.

Second, it may appear farfetched to assert that the Russia-Ukraine caused disruption in the Almaty restaurant sector. After all, the war is between two countries outside Kazakhstan, and what does war have to do with restaurants? While those not trained in economics may take such a view, general equilibrium theory teaches us that events in one part of an economy can be quite consequential for other segments of the economy. The total population of Kazakhstan is about 20 million, that of Almaty, 2.1 million, so the sudden increase in demand for housing by about 100 thousand persons had to disrupt the rental housing market in Almaty by raising rents, and that has serious consequences for not only households but also for every business for which rent is a fixed cost. The distance between war between two different countries, and a third country's restaurant market is not much at all for an economist. This is a second remarkable lesson.

Third, while we have highlighted the restaurant industry, this is not the only business activity for which property rentals are a fixed cost. Firms in every such industry have faced fixed-cost escalation, and it would be helpful to identify which sectors have experienced greater shrinkage in terms of the number of firms and aggregate industry output. The presumption would be that businesses that have a higher ratio of property-rental cost to total cost would experience greater adversity.

Fourth, going forward, what should one expect from this immigration shock? As the Russian migrants settle in Almaty, and they start spending income on a host of other commodities as well, one should expect a positive GDP growth bump via the Keynesian expenditure multiplier. There is also the supply side issue. Several migrants are digital nomads, or have other forms of human capital, which distinguishes them from the unskilled migrants from Uzbekistan or Tajikistan that Kazakhstan has typically received in the recent past. Receiving a 100 thousand skilled workers in a matter for a few months has got to be the biggest single injection of human capital that post-USSR Kazakhstan has had the good fortune to experience as a positive resource shock, especially in the post-2020 period when it is not shortage to unskilled labor, and it is not shortage of physical or financial capital, but rather the severe shortage of human capital, that is the binding constraint on a country's GDP growth. Kazakhstan has experienced an outward shift of its production possibilities frontier, and that has to be hugely beneficial for the economy, going forward. However, for this set of claim to



be substantiated, a general equilibrium analysis would have to be undertaken, and that is the subject matter of another paper altogether.

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