

The political economy of sanctions against Russia: Making the sanctions work as they should

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Can sanctions stop the Russian Federation (RF) in its war of choice against Ukraine? The answer to this question requires an inquiry into the indirect but non-trivial link between the economic effect of the sanctions and political decisions about war and peace. To the best of our knowledge, such an inquiry, quite amazingly, has not been done yet. At the same time, considering the longer-term political, economic, and institutional factors, along with the respective expectations of the involved actors, substantially alters the picture and leads to important implications.

Why the sanctions?

A strong response to the unprovoked RF invasion has been necessary to save the rule-based world order. The RF should get no positive return on its losses, in order to serve as a deterring example for any future aggressors, nuclear or not. Otherwise, among other harmful consequences, globalisation will have to retreat, and the world may have to increase its military expenditures by two and half times in order to create an additional 4% share of GDP – and return back to the pre-Cuban crisis level of 6.3%.²

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² Vladimir Dubrovskiy and Krassen Stanchev, Sanctions against Russia: Why and how they work, or should work, Foreign Policy Centre, August 2022, <https://fpc.org.uk/sanctions-against-russia-why-and-how-they-work-or-should-work/>

However, a defeat to Ukraine would not just be humiliating for Putin. It threatens a total loss of power, as explained below, and may result in criminal prosecution.³ In order to at least postpone this, he has, for now, chosen the strategy of an endless war of attrition.⁴ He may hope that, in the long run, Ukraine and its Western partners will get exhausted or something unexpected happens that will turn fortunes around for him – and there may be some chance for that. Either way, missile strikes and/or other hostilities may continue even if Ukrainian forces manage to liberate their whole territory within its internationally recognised borders. Thus, with all the primary importance put on military aid to Ukraine, it can hardly be sufficient to win the war.

Therefore, the sanctions imposed on the RF are an essential instrument the world community has at its disposal for restoring law-based world order and winning this episode of the centuries-long Russia-West confrontation. The sanctions should erode RF's economic position and lead to the eventual defeat and punishment of the aggressor. However, are sanctions actually capable of achieving this goal? And what should be done to maximise their effectiveness?

Economic growth

Economic sanctions can have an immediate effect when they prevent an aggressor from importing some critical inputs, such as raw materials or hi-tech components, used to produce certain kinds of weapons. Sanctions of this kind already imposed on the RF are indeed likely creating a hurdle for its military production. They, however, cannot make a decisive impact for at least three reasons:

- Firstly, the RF is a vast country with highly developed military industries that are mostly self-sufficient with access to basic raw materials and technologies. This allows it to produce the bulk of the needed weaponry even in a state of autarky (a nation operating in a system of self-reliance); albeit even if, in some cases, the weapons are not so advanced, they are nevertheless dangerous.
- Secondly, the most critical inputs, such as microchips and rare chemical elements, are small and can be easily smuggled, primarily through third-party countries, which is already happening.
- Finally, unlike Western countries, Russia is not very sensitive to human losses and has a deep tradition of substituting insufficient military kits with human cannon fodder. Even a complete failure to produce certain armaments is unlikely to prevent RF from being unable to wage a war upon which its political leadership has bet its destiny.⁵

Thus, while these kinds of sanctions are necessary and welcome, they cannot play any decisive role alone.

Other kinds of sanctions work through the political economy. The decisions about launching or ending a war are political ones. Therefore, economic sanctions can influence these decisions through a political-economic mechanism. The latter, however, attracts less attention than it deserves. Nonetheless, the success or failure of sanctions critically depends on the political economy of the regime in question.

The current discourse about sanctions focuses on welfare losses. The most popular theory behind this is that the perspective of such losses can deter the aggressor, even force it to withdraw its troops from the neighbouring country, or at least render it incapable of waging a war on such scale. From

³ Vladimir Dubrovskiy, How to Stop Putin's war against Ukraine, Foreign Policy Centre, April 2022, <https://fpc.org.uk/how-to-stop-putins-war-against-ukraine/>

⁴ Andrea Kendall-Taylor and Erica Frantz, Putin's Forever War: How the Invasion Empowers Russia's President, Foreign Affairs, March 2023, <https://www.foreignaffairs.com/ukraine/putins-forever-war>

⁵ Vladimir Dubrovskiy and Krassen Stanchev, Sanctions against Russia: Why and how they work, or should work, Foreign Policy Centre, August 2022, <https://fpc.org.uk/sanctions-against-russia-why-and-how-they-work-or-should-work/>

this perspective, recent statistical figures look rather disappointing for the proponents of sanctions. According to RF, Russia's economic decline in the first year of the full-scale war (2022) was just 2.1%. The International Monetary Fund (IMF) has predicted 0.3% growth in Russia's GDP in 2023.⁶

Some prominent Russian economists working abroad suggest that the modest GDP decline numbers for 2022 are based on official data that may have been manipulated.⁷ Besides, they account for a sharp increase in military production that does not contribute to the population's real income. These economists estimate the decline in real income in 2022 at about 8-10%. However, so far, this decline has not caused any visible changes in the RF's behaviour.⁸

The optimistic 2023 growth predictions by the IMF have been made under the assumption of close-to-market pricing of exported Russian oil. Sanctions, if successful, should significantly correct these forecasts downward. Still, notwithstanding the importance of hydrocarbon exports, they constitute only about 14% of Russian GDP (in 2021) and, realistically speaking, are not supposed to contract in volume by more than half. Before the February invasion started, the countries that subsequently joined the sanctions were the main export market for Russia, with a share of 68% in crude oil and similar shares in several other articles.⁹ These exports were quickly reallocated to other markets. Thus far, the essential export article – crude oil – has not declined significantly in volumes. However, in the first half-year of 2023, the corresponding revenues appeared to be about half as in the same period of 2022 due to the price downfall.

Even if the price caps on the rest of the oil and petroleum products exports were strict enough, and successfully enforced, export revenues from these articles could decline by three quarters, resulting in a cumulative GDP decline of about 10%. The income decline would be somewhat steeper, just as in 2022, for the same reasons, with the shrinkage mostly felt in 2023. However, while the decline may be significant, it is not a disaster. For example, Ukraine lost 14.5% of its GDP in 2009 and about 17% cumulatively in 2014-15 and survived, although not without the West's support.

This resilience is an outcome of optimistic long-run expectations. Indeed, after such a decline, an economy usually adjusts and recovers so that the GDP curve takes the U or V shape – especially when an economy remains a market one. A good and well-grounded concept compares a national economy to a living organism, both of which could recover after many shocks. In many cases, its resilience to the shocks and the subsequent recovery exceed expectations. This is because self-regulating market mechanisms integrate the intellectual capacities of millions of people, all of whom are incentivised to think and work hard to adapt to a shock in their particular case. Unlike in the USSR, the contemporary Russian economy is mostly a market one, and as long as it remains such, it seems quite tenacious. However, this most critical tacit assumption is not guaranteed.

Of course, with such temporary but profoundly protracted real incomes deterioration, some decrease in Putin's popularity seems inevitable. In a democratic country, this would probably result in lost elections and policy changes. However, it can hardly happen in the *de facto* authoritarian RF, where the opposition is suppressed, and voters' minds are poisoned by massive and sophisticated propaganda. Usually, such regimes with sealed democratic 'safety valves' can only be challenged from the inside either through coups or rebellions.

⁶ International Monetary Fund, Russian Federation, <https://www.imf.org/en/Countries/RUS>

⁷ Oleg Vyugin, Evsei Gurvich, Oleg Itskhoki, Andrei Yakovlev, and edited by Kirill Rogov, Worse than a crisis. The 2022 Russian economic anomaly: How it works, and where it is headed, RE: Russia, February 2023, <https://re-russia.net/en/expertise/052/>

⁸ Ibid.

⁹ Steven Mufson, Aaron Steckelberg, Andrew Van Dam and Naema Ahmed, Here's where Russian oil flows, The Washington Post, March 2022, <https://www.washingtonpost.com/business/2022/03/08/russia-oil-imports-ban/>

Yet, no political regime is omnipotent. Economic decay erodes the living standards of the lower classes of the population. There may always be a threshold at which the risk of a mass rebellion can materialise. This is one of the most dangerous scenarios because it will likely result in a civil war jeopardising with large-scale refugee flows, nuclear arms leaked to the terrorists, who may be even more dangerous than the current RF regime, and other undesirable consequences. Their avoidance is one of the reasons keeping the West from hardening the sanctions.

Fiscal balance

Fiscal squeezing is an essential channel of sanctions' impact. The war is costly, so the idea is to render the RF incapable of waging it by fiscal squeezing. If properly imposed, sanctions can powerfully affect such squeezing.

Normally, the RF has kept its federal budget in good shape. However, its fiscal safety heavily depends on hydrocarbon-related revenues. Federal budget revenues totalled about 25 trillion Russian Ruble (RUR) in 2021. Of them, oil and gas-related taxes accounted for about 40%.¹⁰ A similar figure is accounted for by imports levied with taxes. According to a reputable Russian expert, Mikhail Krutikhin, together with indirect effects, hydrocarbon export produces up to 60% of revenues. In a scenario where these export proceedings contract by half, the budget deficit will reach at least one-fifth of all revenues, about five trillion RUR. In the case of effectively imposed price caps, at a level marginally exceeding the costs of drilling and transportation of crude oil, plus processing it in the case of petroleum products, no substantial tax revenue will be collected on their exports (even though it would be still rational for the RF to continue such export because of its positive effects on GDP and the balance of payments). The deficit will probably reach more than ten trillion RUR before even considering the extra military expenditure.

This deficit will be further exacerbated by the mobilisation of Russian men and massive war losses that will further raise military expenditures while eroding the labour force and the tax base. Thus far, about half a million men have been drafted, and at least another half a million have left the country.¹¹ Forbes estimates the total direct expenditure to compensate military personnel and the families of those killed in action, plus military supplies, at about \$90 billion for the first year of full-scale war and is going to spend more than \$ 100 billion in 2023.¹² Unsurprisingly, the budget that was in surplus during the first months of the war is now increasingly running a deficit: 3.2 trillion RUR for 2022 and already 2.8 trillion Ruble by August 2023.¹³

The least painful option to tackle the deficit may be to consume the reserves accumulated in the National Welfare Fund (NWF), created to complement the pension system. However, it has already been tapped more than once, serving as a buffer for the needs of the government, and is now mostly considered a rainy-day fund. Nominally, it constitutes about 8.9% of GDP (above 13.3 trillion RUR by July 31, 2023) and, as such, can provide a source for some (modest) deficit coverage for a few

¹⁰ Michael Alekseev, What role do oil and gas play in the state budget and economy?, Vpost, October <https://vpost-media.ru/opinions/kakuyu-rol-neft-i-gaz-igrayut-v-gosudarstvennom-byudzhet-e-i-ekonomike>

¹¹ Denis Kasyanchuk, How many Russians left the country in 2022 and did not return?, The Bell, December 2022, <https://thebell.io/skolko-rossiyan-v-2022-godu-uekhalo-iz-strany-i-ne-vernulos>

¹² Vladimir Datsenko, Russia spent almost \$115 billion on the war with Ukraine, and all the tanks it prepared before the invasion. Forbes calculations, Forbes, February 2023, <https://forbes.ua/ru/war-in-ukraine/rosiya-vitratila-na-viynu-z-ukrainoyu-mayzhe-115-mlrd-i-vsi-tanki-yaki-mala-pered-vtorgnennyya-rozrakhunki-forbes-24022023-11970>; Reuters, Exclusive : Russia doubles 2023 defense spending plan as war costs soar, August 2023, <https://www.reuters.com/world/europe/russia-doubles-2023-defence-spending-plan-war-costs-soar-document-2023-08-04/>

¹³ Reuters Staff, Russia's budget deficit widens to \$29.3 bln in July, Reuters, August 2023, <https://www.reuters.com/article/russia-economy-budget-idUSL8N39O2TO>

years.¹⁴ However, a significant part of this fund is frozen, invested in Russian state-owned enterprises (SOEs).

Furthermore, part of it has already been spent on deficit financing. Of the potential liquid assets amounting to an equivalent of 7.1 trillion RUR, only about 3.7 trillion Ruble (in yuan) of them are genuinely liquid – enough for a few months of running the deficit in case of full enforcement of the price cap.¹⁵

International borrowing would be a relief, if not a remedy, but it has been rendered almost impossible due to the sanctions, except for China. ‘Big brother’ President Xi Jinping may be willing to support his ‘small brother’ President Putin, although his financial capacities are limited. However, unlike Western private donors, his main interest is neither coupons nor potential gains from speculation but converting these loans into territory or other concessions in case of the lender’s insolvency. The Russians understand this perfectly because they behave similarly, for instance, in Africa. Thus, although the financial authorities of the RF have already started borrowing from this ‘strategic partner’, this is considered a last resort.

Domestic borrowing is the second best option, also currently being utilised. However, it has a strong crowding-out effect on the credit market, which is already in trouble, being cut off from (previously) inexpensive international credits. This effect will magnify the recession and, in such a way, erode the tax base. Same with the monetary emission, especially given that the panic of March 2022 has not been forgotten. Thus, domestic borrowing and the monetary emission on a scale necessary to close the fiscal gap will likely create an inflationary surge, further eroding living standards. At the same time, no positive (even temporary) reviving effect of such emission on economic growth can be expected.

After all, the government can raise tax rates. This will not necessarily mean a proportional budget revenue increase (the elasticity is probably high). Therefore, the tax rates must increase sharply. The Russians will have to forget the 13% personal income tax (PIT) and a relatively modest 20% payroll tax. Perhaps, some other tax rates that have remained relatively favourable for a long time would also rise. This would certainly be unpopular as well as further exacerbate the recession.

The RF’s economic authorities are staffed with good professionals that are already combining many of the measures listed above in a smart way to prolong the agony. Meanwhile, they are not magicians and cannot create real wealth, only redistribute it. Somebody will inevitably lose a lot unless healthy economic growth, not the one stemming from a surge in military production funded by a budget deficit, is quickly resurrected. However, that will not happen since all of the measures aimed at extracting more resources by the state – i.e., domestic borrowing, increase of formal and informal taxes, and monetary emissions – hurt people’s wellbeing and entrepreneurship. So does the redistribution of resources out of productive use towards military expenses.

A fiscal crisis is looming and will probably be tackled by measures substantially aggravating the recession and further deteriorating the population’s wellbeing. Still, even such hardships are unlikely to force Putin to choose ‘butter over cannons’ because of the nature of his political regime. This makes sanctions a tool more promising, although in a different way from the above-mentioned standard political-economic effects.

¹⁴ Press Center, Ministry of Finance of the Russian Federation, August 2023, https://minfin.gov.ru/ru/press-center/?id_4=38625-o_rezultakh_razmeshcheniya_sredstv_fonda_natsionalnogo_blagosostoyaniya

¹⁵ Ibid

Regime change

The focus on GDP dynamics is based on an implicit assumption that a government is primarily concerned with voters' wellbeing and would avoid any behaviour leading to deterioration. Should it fail to do so, the current government would soon be ousted by a public vote and replaced with more peaceful successors. However, this logic works mainly in democracies and explains why they do not go to war. In such circumstances, a colonial war like this would unlikely happen because the era when territorial gains brought about wealth gains ended more than half a century ago.

Indeed, in the case of the RF, we have to deal with a dramatically different regime. Balint Magyar and Balint Madlovics, the authors of 'The anatomy of post-communist regimes,' described this kind of regime as a "patronal autocracy", in which an authoritarian leader unilaterally rules a state that is (mostly informally) organised like a mafia.¹⁶ The authors even use the term "mafia state". Indeed, although its activities are primarily non-criminal, and its leaders are not crime bosses, the internal relationships within its structure ("vertical of power") and the respective culture closely resemble one of the organised criminal underworlds.

A leader of such a mafia state cannot be simply voted out of his office. He (almost never she) does not have to care too much about his popular support. Having the tools of propaganda at his disposal, the leader can largely ignore deterioration in the population's material wellbeing and offset it with chauvinism, a great-power sentiment, resentment, and rallying around the flag broadcasted by his media outlets. He can even withstand and suppress a riot by the general populace if the elites remain consolidated enough. However, there are three things he should be afraid of:

- (a) a large-scale popular rebellion that some essential part of the elites can join;
- (b) a coup within the elites that the population can support or, at least swallow; and
- (c) the avalanche-like hierarchy's decay caused by a lack of future trust, akin to a bank run.¹⁷

Both patronalism and autocracy are primarily about coercion, hence the use of violence and/or threat of it. Thus, a leader ('chief patron') remains on top and can avoid the three kinds of threats mentioned above as long as he is perceived as all-mighty, mostly regardless of anything else. To stay in power, he must demonstrate his resolve, strength, and readiness to resort to violence. In such a way, he is fuelling his subjugates' self-fulfilling expectations on which his real power is grounded.¹⁸ As the Russian proverb says, "respect is a sort of fear". Such a regime is inherently aggressive and cannot afford any sign of weakness.

Meanwhile, the Russian culture treats compromise as a weakness and surrender. Putin understands this perfectly. Hence, his resolve and readiness to sacrifice so many compatriots and some of his own and his friends' wealth.

Therefore, the hope that Putin would end the war in any way that can satisfy Ukraine and its Western partners is futile; so are the hopes for appeasement in Russia's global confrontation with the West, as most prominently manifested in the ultimatum presented by Putin to NATO in December 2021. Putin has deliberately set the goals of the invasion of Ukraine in a way that does not allow for compromise.

A compromise can be a solution if the parties in conflict have made mutual encroachments on each other's sovereignty (as was the case in World War I). Sovereignty is a zero-sum game by definition. In

¹⁶ The anatomy of post-communist regimes, see: <https://www.postcommunistregimes.com/>

¹⁷ Steven L. Solnick, *Stealing the State*, Russian Research Center Studies 89, Harvard University Press, July 1998, <https://www.hup.harvard.edu/catalog.php?isbn=9780674836808>

¹⁸ Vladimir Dubrovskiy and Krassen Stanchev, *Sanctions against Russia: Why and how they work, or should work*, Foreign Policy Centre, August 2022, <https://fpc.org.uk/sanctions-against-russia-why-and-how-they-work-or-should-work/>

the case of mutual encroachments, a good compromise could be to restore the status quo ante bellum, in which neither side wins or loses. However, the case in question is different. Ukraine had no claims to the RF before the war began in 2014, while the RF's publicly stated goal is to eliminate Ukraine's statehood. Any compromise in this situation would amount to surrender to the aggressor, which would be humiliating and counterproductive, as it would further incentivise the predator. This case closely resembles the well-known game-theoretic approach to terrorism, which suggests that terrorists' demands should be declined.

Although few prominent politicians dare to say it publicly, the regime change in the RF is probably the only possible way to end hostilities and get rid of an inherently aggressive and staunch enemy of liberal democracy. This is what the sanctions should aspire to.

Furthermore, Putin's propaganda thesis that Ukraine's victory is an existential threat to Russia is not entirely false. Such victory (and the corresponding RF's defeat) would probably result in a regime change for the above reasons. Moreover, such regime change bears many risks for the country even when only its supreme leader is replaced.

Thus, the first implication is that a conflict between the current RF regime and the rule-based world order is antagonistic. No Pareto efficient compromise (a win-win game with no losers) is possible, in the same way as it was with other terrorists, such as Nazi Germany, Al-Qaeda, and ISIS, simply because Russia is playing a different game. Conversely, all policy means the West has at its disposal (hence, all but conspiracies and plots) should be aimed at Ukraine's victory/regime change in the RF, including sanctions.

It would be different if the country in question were some kind of an aggressive dictatorship like Saddam Husain's Iraq or a terrorist gang like ISIS. However, the RF holds the world's first or second nuclear arsenal, making the West cautious in restoring the rule-based world order and punishing the lawbreaker that dares to challenge it.¹⁹ Either Putin can go nuclear in desperation, or some suicidal radicals can succeed him, or the nuclear materials can leak into the hands of terrorists in the wake of RF's uncontrolled meltdown.

However, looking deeper into the political economy of the present RF regime, one can find that these risks are already there and will materialise sooner or later, as explained below. The only way to mitigate them is to create conditions more conducive to a coup and/or possibly a controllable hierarchical meltdown rather than a rebellion. Here sanctions can play a significant role.

The contraction of rents

Thus far, we have concluded that relatively modest welfare losses in the RF could destabilise Putin's regime by increasing the personal cost of his ability to hold on to power. This is unlikely to happen any time soon due mainly to the resilience of the still predominantly market nature of RF's economy. However, a real Achilles' heel is another essential component of the Russian state. In contrast to its mostly market economy, the RF's patronal authoritarian political regime is a rigid vertical construction, exposed to the destructive impacts of shocks and, especially, negative expectations.

Although the contemporary RF formally looks like a modern state, it remains a 'natural state', where personal relationships within the elites dominate the market and the bureaucracy. Nobel Prize winner Douglass North, with Barry Weingast and Georges Wallis, described the logic of such a natural state as a sort of cartel of racketeers helping each other suppress their subjugates and share the

¹⁹ ICAN, Which countries have nuclear weapons?, https://www.icanw.org/nuclear_arsenals

rent.²⁰ The rents (“institutionalised loot”) restrain potential “violence practitioners” from even more destructive robbing. They have become “stationary bandits” rather than “roving” ones.²¹ Thus, at least at the political-economic level, rent is the glue that keeps such a natural state together. This is the core logic of what these authors dubbed “a limited access social order”. No surprise that *siloviki* (the representatives of state coercive and military apparatus) appear to be a dominant faction within the ruling coalition.

Regimes of this kind tend to crash due to succession and fiscal crises. Such a way of sustaining the order makes the RF particularly vulnerable to any major and long-term contraction of the rent. Perhaps, Ramzan Kadyrov, leader of the Chechen Republic, and his clan are the most vivid example confirming this theory. Some high subsidies from the Russian federal budget have been used to appease a rebellious Chechnya. At the same time, its ruler is in charge of using (and misusing) these cash inflows at his discretion to buy the support of the lower tiers of the local clans, among other things. Therefore, it can be easily predicted that Kadyrov would rebel and/or lose his power if this rent inflow were halted. In both cases, the “Chechen challenge” would reappear on a full scale, and so would lots of other similarly managed problems. Hence the “vertical of power” would collapse.

The now deceased Yevgeny Prigozhin with his ‘clan’ (the Wagner PMC and Concord Corporation) is another example of the same sort. The above-described logic of a natural state provides the key to understanding the paradoxical Putin’s behaviour in the aftermath of Prigozhin’s putsch in June 2023. After sober consideration, Putin realised he could not afford to alienate Prigozhin despite the latter’s grievances and humiliation of the former. For the first time, Putin mentioned Concord’s rent from the state. He did not dare to halt it because, just like Kadyrov, or even to some greater extent, Prigozhin represented a real force that could pose a real threat. This threat materialises if the rent shrinks – and maybe even Prigozhin’s death cannot eliminate this threat completely.

An obvious implication is that the sanctions should focus primarily on the contraction of the main sources of rents, especially at the federal budget level.

Most often, a crash in a natural State’s regime is not so much because of a fiscal crisis itself. Such a crash may happen due to growing mistrust, even infighting within the ruling coalitions, caused by the shortage of rents amid a bleak outlook.

A formal and, most importantly, informal power hierarchy (‘vertical’) is based on self-fulfilling convictions of its eternity.²² Here it is about an unlimited time horizon, which secures future gains from loyalty that exceed the potential benefits of the immediate ‘hit and run’ end game. So-called “folks theorem” within game theory proves that as soon as a game becomes finite, and its parties (the vertical of power’s members, in the case in question) – anticipate an inevitable bitter end, they rush to act because the one who acts first has better chances to survive – just like in a bank run or a shipwreck. Thus, as soon as the time horizon becomes finite, the upper level of the vertical hierarchy starts a race for other opportunities that quickly involves the lower levels too.²³

²⁰ Here we mean the rent in its political-economic meaning – as a part of income generated by redistribution or appropriation of already existing value (like subsidies, monopoly rents, natural resources’ rents, etc.), as opposite to the profits gained in the process of value creation by a competitive market activity. Douglas C. North, Joseph Wallis and R. Weingast, *Violence and Social Orders*, Cambridge University Press, August 2009, <https://www.cambridge.org/core/books/violence-and-social-orders/F0EA15A67E790214408A7485DBC70F0D>

²¹ Mancur Olson, *Dictatorship, Democracy, and Development*, *American Political Science Review*, Volume 87 Issue 3, Cambridge University Press, September 2013, <https://www.cambridge.org/core/journals/american-political-science-review/article/abs/dictatorship-democracy-and-development/2776079374BF1E318DF928EA79EF2294>

²² Henry E. Hale, *Patronal Politics*, Cambridge University Press, November 2014, <https://www.cambridge.org/core/books/patronal-politics/4C1B4D49A7F17739E75A5AB7B66E2115>

²³ Steven L. Solnick, *Stealing the State*, Harvard University Press, July 1998, <https://www.hup.harvard.edu/catalog.php?isbn=9780674836808>

The rents are the backbone of the Russian regime and its most fragile part, therefore the best target for all kinds of sanctions and other complementing policy measures.²⁴ The rents are already contracting, and the expectations of elites are murky, but the vertical still works.²⁵ Perhaps, this is because the sanctions are not severe enough, and some elites still cherish hopes for a military victory or, at least, a stalemate. Yet another critical thing that has held its members together thus far is the lack of a viable and attractive alternative vision of the future and the ‘nowhere to run’ situation.²⁶ To some extent, the latter is brought about by the assassinations of several senior businesspeople, often performed ruthlessly.²⁷ Some of the victims were killed together with their family members. In some cases, traces of torture were observed.

Thus, probably the most important implication is that both sanctions against the RF and military aid to Ukraine should be strong and decisive enough to deprive the vertical’s members of hope for any revival in the foreseeable future. It is also important that Putin himself and his close circle retain a more optimistic perspective for their future than the rest of the elites so that he would be overthrown before he goes nuclear in desperation. This condition seems to be already there, thanks to his management style.²⁸

The fourth implication is that an attractive alternative prospect for the vertical’s members can significantly facilitate the RF’s regime change and vastly increase the chances for at least a relatively soft course and outcomes of such change, just as it was with the USSR in 1991. In those times, people dreamed about the lifestyle and freedoms their peers living under a market economy and liberal democracy enjoyed. A substantial part of the soviet *nomenklatura* saw clear and promising opportunities for re-establishing themselves as elites under a new system. The development of such a vision is a non-trivial task in itself. Furthermore, it contradicts the widespread (and understandable) emotional desire to punish every member or collaborator of Putin’s regime at once. However, this desire is impossible to fulfil anyway. It would be better to split the RF’s elites with some vision of a new Russia that could be attractive to many of them.

There is little we can do with the fear of punishment for disloyalty. Yet, threats of this kind may become random once the race for alternative opportunities begins at the top and involves the *siloviki*. Hence, such threats would miss their main purpose of stimulating loyalty: it vanishes if one can suffer for either disloyalty or loyalty to a patron who suddenly falls into disgrace. At least it means that the executives will behave cautiously right now, so the top authorities will face a sort of Italian strike that will make the state increasingly less capable and controllable – just as it happened during Prigozhin’s putsch. This will add to the already revealed ineptness and awkwardness (and anger) of the RF’s executive power. Its actors are increasingly being forced to serve an ideology, not a

²⁴ Vladimir Dubrovskiy, How to Stop Putin’s war against Ukraine, Foreign Policy Centre, April 2022, <https://fpc.org.uk/how-to-stop-putins-war-against-ukraine/>

²⁵ Meduza, A recording was leaked online in which, presumably, producer Prigozhin and billionaire Akhmedov scold Putin and his entourage. Now Prigozhin “doesn’t understand how to live with this crap”, March 2023, <https://meduza.io/feature/2023/03/26/v-set-slili-zapis-na-kotoroy-predpolozhitelno-prodyuser-prigozhin-i-milliarder-ahmedov-rugayut-putina-i-ego-okruzhenie-teper-prigozhin-ne-ponimaet-kak-zhit-s-etim-dermom>

²⁶ Andrei Yakovlev, How to think about a post-Putin future? Russia Post, March 2023, https://russiapost.info/politics/post-putin_future

²⁷ Wikipedia, Suspicious deaths of Russian businesspeople (2022-2023), [https://en.wikipedia.org/wiki/Suspicious_deaths_of_Russian_businesspeople_\(2022%E2%80%932023\)](https://en.wikipedia.org/wiki/Suspicious_deaths_of_Russian_businesspeople_(2022%E2%80%932023))

²⁸ Riley Bailey, Grace Mappes, Nicole Wolkov, Karolina Hird, Kateryna Stepanenko, and Frederick W. Kagan, Russian Offensive Campaign Assessment, February 23, 2023, Understanding War, https://www.understandingwar.org/backgrounder/russian-offensive-campaign-assessment-february-23-2023?utm_source=pocket_saves

Mammon, as it used to be for decades, and for which its cadres and structures were adapted.²⁹ As the putsch has demonstrated, the levers of power in the RF are already decaying.

Furthermore, here the outlook also matters a lot. The officials can probably endure suffering for some finite period under a promise that, eventually, things will get better. However, indefinite or uncertain prospects of bad conditions can change the game.

Thus, contraction of the rent, especially going to the RF's budget, is detrimental to the current political regime and can topple it much sooner than purely economic calculations can predict. The main question is, therefore, how to cut the main rents.

The hydrocarbon exports and freezing of state assets

The rent in the RF predominantly stems from hydrocarbon exports. Currently, it is redistributed at two levels: before the budget (for instance, through non-transparent procurement of GazProm (the majority state-owned gas company) or RosNeft (the state-owned oil company) or through the government budget. The former level works for a close circle of oligarchs surrounding Putin that are supposed to act as his own 'wallets'. The latter one is working partly for them too (e.g., the procurement for the Kerch bridge), but primarily for buying the support of the regime's most important pillars: the *siloviki*, the local elites (especially, but not only in Chechnya), the pensioners, and so on.³⁰

Thus, in the case of cuts, the first hard choice that Putin and his close circle would have to make is between their own pockets and the regime's stability. They will probably choose the latter because the loot they already acquired is massive, but there is a high risk of losing it all, as well as their freedom or even their lives, should the regime collapse. Therefore, we can imagine there will be no infighting regarding cuts to the rent at the first pre-budgetary level. All will be sacrificed for stability.

Above, we have demonstrated the importance of this rent for the RF's budget and discussed the trade-off between austerity and deepening the recession that the economic authorities face when handling the consequences of the rent's contraction, in the absence of both liquid assets to sell and access to international capital markets from which to borrow.

Of course, budget cuts could be the most prudent way. However, here, Putin's budget planners would face a 'devil's choice' even worse than 'butter or cannons'. As mentioned above, the regime's stability under a 'natural state' is secured by a particular allocation of rents that roughly corresponds to the distribution of actual violent force. So far, the main budget spending articles have formally been the social benefits (including pensions), salaries of the government employees and military industry workers, and the *siloviki's* rents. The budget money supports the loyalty of these influential recipients of these benefits. One should also add a large, albeit informal, element – embezzlement, which is the main source of loyalty for less numerous but more important members of the (formal and informal) crest of the 'vertical power' – the backbone of the Russian state.

So, which type of expenditures should Putin cut? As in previous deep fiscal crises in the North et al.'s "natural states", any cut will be perceived as "unfair" and worsen already existing tensions, with no positive outlook ahead. This eventually leads to a coup or a decay of the vertical of power – both detrimental to a patrimonial autocracy. Thus, its chief patron should try to avoid cuts for as long as possible. Nevertheless, all other ways of temporarily alleviating the fiscal crisis available (except for Chinese loans) would exacerbate the recession. This would lead to further erosion of the non-

²⁹ Vladimir Dubrovskiy, Why is the Russian bureaucracy failing in the face of war?, RevDem, February 2023, <https://revdem.ceu.edu/2023/02/24/why-is-the-russian-bureaucracy-failing-in-the-face-of-war/>

³⁰ Joshua Yaffa, Putin's Shadow Cabinet and the Bridge to Crimea, The New Yorker, May 2017, <https://www.newyorker.com/magazine/2017/05/29/putins-shadow-cabinet-and-the-bridge-to-crimea>

hydrocarbon tax base along with respective rents. Hence the fifth implication: the restrictions on the hydrocarbon (chiefly oil and petroleum products) rents and any alternative sources of budget financing should be prioritised and kept as tight as possible.

The recession is already here and will last indefinitely long

At first glance, postponing painful and dangerous budget cuts with a combination of domestic borrowing, tax increases (or even financial repressions), and monetary emission looks like a potential option for Putin. It would allow him to protract the war, although at the expense of the population's wellbeing. Such a price seems acceptable as long as Russian people can endure some economic hardships for their Motherland's 'greatness'. That is until the price becomes too high or in vain, unable to prevent the military defeat (this is why military aid to Ukraine is of paramount importance). Lacking a victory on the battlefield, amid a steep permanent drop in income, with no positive outlook, even the cleverest of Putin's propaganda would struggle to convince the Russian people that their sacrifices are worthy. In such case, his regime risks losing both pillars of its legitimacy, which thus far used to be: (a) fast improvements in the living standards before the crisis of 2008; and (b) restoration of Russia's great-power image after 2012.

A loss of legitimacy will result in riots. Even more likely is that a substantial part of the elite would rebel in anticipation of such a scenario. The result will be a coup that the population can support or at least swallow, i.e., the second kind of threat to patronal autocracy, which can lead to regime change. The initial success of Prigozhin's putsch demonstrated that such an outcome was possible.

However, is the outlook for a recession so grim indeed? To our knowledge, no economic models have so far predicted a prolonged economic recession in the RF so disastrous that it could spur a rebellion in any foreseeable perspective. This is probably because all of them are implicitly grounded on the assumption that the economy is and remains a market one, thus 'alive' and decentralised, as explained above. Yet, this assumption does not always hold. Otherwise, there would not be any such rebellions in the past. Just as with a living body, recovery is sometimes incomplete. The initial shock, albeit small, may initiate a decline that permanently disables the organism, which can be characterised as an L-shaped recession. The organism may have some periods of relative stabilisation or even partial recovery, but when it is already weakened, the destruction of an organ of key importance or inactivation of the defensive mechanisms will kill it. Lastly, even a non-lethal disease can kill a patient if it results in a depressive mental state.

The same can happen to an economy. Today's RF is likely such a case as the Soviet Union was back in the 1980s. Economic models fail to predict these scenarios correctly because most models take institutional and structural factors as constant and exogenous. Such assumptions may work quite well in advanced market economies based on the relatively solid and stable fundamentals of well-developed economic and political institutions. However, they fail in the case of structural shifts driven by exogenous factors such as politically caused shocks (e.g., a sharp increase in oil prices in the mid-1970s) or major innovations (e.g., the internet).

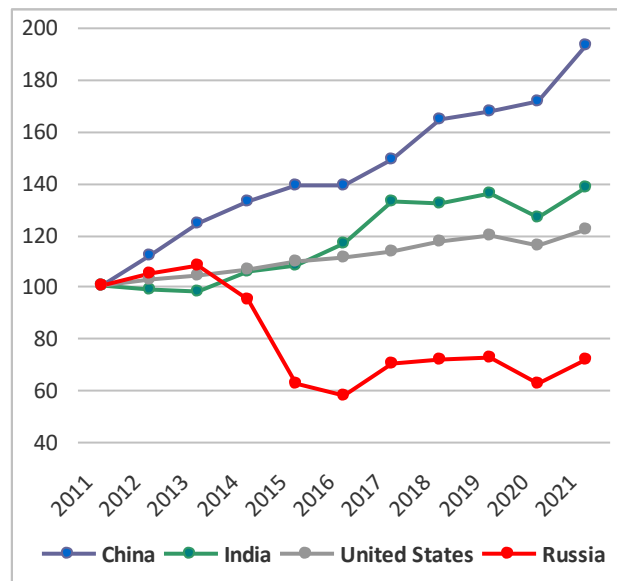
Moreover, they cannot predict and account for domestic political and institutional shocks that are, to a significant extent, endogenous, being often caused by poor economic performance or, the opposite, long periods of prosperity. In general, the models need help to correctly consider the kinds of events that have not happened in the past. This limits their sphere of applicability and leaves room for more 'soft' kinds of predictions. When some major institutional and/or structural shifts occur, a (qualitative) educated guess can become more accurate than model-based (quantitative) estimations that mainly project past trends into the future.³¹

³¹ For instance, one of the authors (V. Dubrovskiy), at the end of 2011, successfully predicted stagnation of the Ukrainian economy in the following two years. He predicted a crisis by the end of this period despite several more optimistic model-

According to modern growth theory, institutions are the most important long-term factor of economic growth. Like many other post-soviet countries, the RF's economy suffered from flawed institutional foundations for many years, with the lack of secure property rights being the main bottleneck. For instance, according to a World Bank (WB) survey, every three of four Russian firms must pay for security as much as or more than 5% of their sales, a fee comparable to an official tax burden.³² The remaining one-quarter is too small to be interesting for the formal or informal *siloviki*, or they just have them as co-owners and pay only dividends or profit shares. This is how it usually works in patronal regimes, especially in patronal autocracies such as the RF. In this kind of 'relational economy', relations favour mediocre rather than real entrepreneurial talents. Such dependence harms entrepreneurship and makes the economy less flexible.

This explains why the Russian economy has already failed to reap the fruits of the relative revival of the world conjuncture between 2010 and 2021 (see the comparison with selected major economies in the chart below). Unlike in the early 2000s, it stagnated during this period. What happened in the RF that made this difference? Firstly, screw-tightening by a regime that has become ultimately dominated by the *siloviki* since at least 2012, and secondly, sanctions imposed on the RF for its invasion of Ukraine in 2014.

GDP, US dollars, constant prices, 2011=100, Russia and selected prominent World economies



Source: IMF WEO October 2022

From 2022 onward, both factors will aggravate a deeper and longer recession than economic models can predict. Sanctions are already depressing the RF's economy, and their main effect is still ahead. Hardening the regime necessary for upholding political stability under economic hardships, combined with military conscription on the backdrop of combat defeats, will further increase *siloviki's* power, magnifying their destructive role. Here is a vicious circle of 'tightening the screws' by the *siloviki* as a response to economic and political hindrances caused, in their turn, primarily by the weakening of

based predictions that had failed to account for corruption under Yanukovich's regime, property rights violations, and populist economic policies. The relatively good results of 2011 were due to the massive borrowing for construction works related to the Euro-2012 football championship and were notorious for embezzlement. This factor had to end in 2012, while the others came into full force. Of course, standard econometric models could hardly account for such developments.

³² Enterprise Surveys, Russian Federation, The World Bank, 2019, <https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/russia#crime>

market forces caused by repressions and excessive power of the *siloviki* – something akin to what many Latin American countries underwent in the 20th century. The recession caused mainly by the institutions' deterioration ends nowhere, meaning that a revival may begin only with a regime change.

Particularly, under patronalism, raising taxes in response to a fiscal crisis, apart from its immediate adverse economic effects, is detrimental to institutions. For the new fiscal charges to be effectively collected in a country with as poor a tax culture as in the RF (as well as several other post-soviet countries), some draconian administration will be necessary. Moreover, and here comes an important peculiarity of the Russian empire and its heirs: discretion in their enforcement will alleviate the severity of these laws. Under the conditions of massive violations that would inevitably follow a drastic increase in tax rates, the tax inspectors will boost their already high level of informal powers. This can largely affect the business-enabling environment and further spur the vicious circle of tax base erosion due to the increased tax burden on law-obedient taxpayers.

Besides, an incorrect policy response is likely to aggravate the problem. Despite its prudent macroeconomic policies and trade openness of the last two decades, the RF has a deep soviet tradition of state interventionism and even the leftist 'dependency theory' that implies strong protectionism, import substitution, and instant 'heating' of the domestic market with a monetary and fiscal expansion. It was once popular in developing countries and caused many notable failures. Now, the RF faces the situation of foreign trade having been restricted by sanctions. Putin has already called for the "development of the domestic market" and decreasing "dependence" on trade, which may mean a turn towards a dead end.

Last but not least, high defence and security spending has risen sharply by 40%.³³ This official estimate likely does not include replacing the losses incurred in the war. Altogether, these 'fruitless' expenditures will reach 6% of GDP by official accounts and, most probably, more indeed. This can spur growth for a little while, but in the longer run, it may further add to the recession in the non-military sectors of the national economy.

All of this means further deterioration of the living standards for ordinary Russians for many years ahead, with, at best, an uncertain future outlook. Nobody can predict when the recession will end. This can also become destabilising, thus making self-fulfilling prophecies of gloomy expectations.

Just as in the case of a fiscal crisis analysed above, these expectations, if strong enough, will likely play out much earlier than the recession would reach a threshold jeopardising a rebellion. Therefore, the tougher, more decisive, and more credible the sanctions, the shorter the period of agony and the less likely the riskiest scenario of a massive rebellion akin to 1917 would take place. As we will show below, the sanctions and RF's military defeat can make the course of events not more but less risky compared to their absence.

The toppling of the regime can now mitigate the risks and hardships

Above, we explained why the hydrocarbon rent is so important for the stability of the present RF regime. However, it might be doomed to wane in the long run due to the worldwide trend of substituting fossil fuels with clean energy, which is getting increasingly cheaper. This would make a longer-term fiscal crisis unavoidable. In the absence of the unlikely discovery of a substitute of equal magnitude, in the long run, austerity is the only option, and means cutting the rents, especially the ones stemming from the state (primarily – federal) budget. The European Green Deal has further

³³ Inna Sidorkova and Anastasia Boyko, "Расходы на национальную оборону в этом году вырастут на треть" [National defense spending to rise by a third this year], *Vedomosti*, September 2022, <https://www.vedomosti.ru/economics/articles/2022/09/23/942188-rashodi-na-natsionalnuyu-oboronu>

accelerated this trend, while the RF's authorities' attempts to build a modern innovation-based economy under a patronal autocracy have failed miserably. This failure affected the elites' expectations, which are critical for the survival of a patronal hierarchy. The regime's decay caused by this factor and resembling the soviet one of the 1980s, started at least a decade ago, and RF's current aggressive behaviour is partly begotten by desperation.³⁴

Another non-economic reason for the regime's decay is that Putin has failed to live up to his role as the chief patron. The Kremlin political technologist Sergey Markov once compared the system of power to a pack of wolves, trying to justify the RF's war of choice against Georgia in 2008: "In a pack, if someone barks at the chieftain, the latter should fight, otherwise he would be overthrown" (a situation called a "signalling game" in game theory). Putin has always played such a game, trying to persuade everyone inside and outside of the RF of his might and resolve. The very invasion of Ukraine can be explained this way.³⁵ However, when it came to a real threat to his power posed by the Wagner military columns approaching Moscow, the "chieftain" appeared cowardly, inept, and helpless.³⁶ In Markov's parable, he has run away with his tail between his legs after being bitten in the legs. The subsequent apparent revenge taken against Prigozhin, made in a belated and cowardly way avoiding any kind of open confrontation in which the opponent could use its already vast political capital, only further reaffirms this. Above all, the terrorist-like way this revenge was seemingly taken further confirms that the RF's formal state institutions are unreliable for the regime's purposes; being in either bad shape or out of control. This means Putin's days (or months) are numbered, and the countdown has already started.

A third long-term reason for the regime's decay is that neither Putin nor the elites he relies on can live up to their expected role in the current hyper-politicisation of the regime because they were selected and self-selected in the opposite, de-politicised environment. The logic of such a regime's transformation, notably opposite to what happened to communism in the USSR, was recently described by Natalya Savelyeva and Kirill Rogov.³⁷ Putin's propaganda has created monsters like Prigozhin or Igor Girkin (a Russian former military commander and ardent nationalist involved in the annexation of Crimea and subsequent war in the Donbas, currently under arrest in Russia) by trying to persuade the Russians that they are "a nation committed to fighting the West." These characters are, however, better suited to the role of a leader of such a nation than Putin and his court. This contradiction is playing out right now. Notably when the regime tries to tackle ultra-radicals through repressions, this can only add to their popularity, especially among the *siloviki*. The war keeps fuelling their popularity and strength.

Thus, the current regime is effectively doomed; and the closer it nears its end, the more aggressive it gets. The real choice is not between imaginable long-term co-habitation of the West with the current RF regime or its equally moderate immediate successors, but between the different degrees, and timing, of the destruction of the RF's vertical of power, 'iranisation,' or even a war with it. This is a choice between a few scenarios, sorted by an increasing degree of the vertical's destruction, from nought to five, as follows:

³⁴ Andrei Yakovlev, Composition of the ruling elite, incentives for productive usage of rents, and prospects for Russia's limited order, *Post-Soviet Affairs*, Volume 37, 2021 – Issue 5, August 2021, <https://www.tandfonline.com/doi/full/10.1080/1060586X.2021.1966988>

³⁵ Vladimir Dubrovskiy, How to Stop Putin's war against Ukraine, Foreign Policy Centre, April 2022, <https://fpc.org.uk/how-to-stop-putins-war-against-ukraine/>

³⁶ Catherine Belton, Shane Harris and Greg Miller, Putin appeared paralyzed and unable to act in first hours of rebellion, *The Washington Post*, July 2023, https://www.washingtonpost.com/world/2023/07/25/putin-prigozhin-rebellion-kremlin-disarray/?fbclid=IwAR1e6RoLwM-vJbbkclfGX18G1pVlsP_izqhlbeRcui3O4kFgRy_uj2-55E&

³⁷ Natalya Savelyeva and Kirill Rogov, Between De- and Hyper-Politicisation: The Evolution of Russian Authoritarianism, *RE: Russia*, July 2023, <https://re-russia.net/en/expertise/091/>

(0) Preservation of the current regime. Under present circumstances, this would require some extraordinary victory by Putin, significant enough to compensate for his ‘misbehaviour’ during the coup of June 24th. Note that the corporate culture of a mafia state closely resembles the one of a criminal underworld. In the latter, gross intentional misbehaviour (*‘zashkvar’*) like this is impossible to redeem. The West, however, can provide Putin with such a victory, but at the cost of the betrayal of Ukraine with respective ramifications for NATO unity, the world order, etc. Maybe, even conceding to Putin’s ultimatum of December 2021 would be needed.

According to the regime's logic, Putin (however risk-averse he is) has to double down and play some signalling games to erase the impression he has made during the putsch. This is the most plausible reason behind his discontinuation of the ‘grain deal’, with strikes at the grain infrastructure and the provocations at the Polish border. Both had no military sense, causing unnecessary damage to the RF's image in the Global South in the first case and problems for those pushing for peace in the West in both cases.

Along with the current regime's habitual pattern of substituting the (absent) success in the quality of life with aggression, this can eventually lead to a much bigger war, far beyond Ukraine’s borders, if this appears to be the only way to keep the power and the vertical. Historically, the RF has responded with increasing external aggression to all of its domestic failures: Georgia in 2008, then Ukraine in 2014-15, then Syria from 2015 onward, and now Ukraine again. Putin is also prone to doubling the bets in case of failures. However, gifting Putin with an imaginable victory in Ukraine and succumbing to his ultimatum would not appease the regime. Just the opposite: if Putin sees that his blackmailing is effective, while the West is weak and docile, he will likely escalate further. Therefore, preserving the current regime is the shortest way to a far bigger war.

(1) ‘Iranisation’: The most aggressive and ideologically indoctrinated part of the *siloviki* takes power, removes or subjugates and pacifies most of the current elites, cruelly purges the rest, and establishes an outright dictatorship in which everything is under the control of the secret service (like the Islamic Revolutionary Guard Corps (IRGC) in Iran). Such a regime would become a natural ally of China, Iran, and North Korea in confronting the democratic world, which could further develop into a Third World War.

In this scenario, the vertical of power remains initially intact but would undergo severe purges afterward. Nuclear weapons remain under complete control, but the risk of their use is elevated. However, unlike the previous case, it will be restrained by the Chinese.

(2) A thaw. Some current elites (including a part of *siloviki*) may try to establish a more liberal and less anti-Western regime that would inevitably ‘soften’ the vertical. There is even a possibility that, as Russian economist Vladislav L. Inozemtsev has suggested, they could agree to stop the war and surrender the prominent war criminals to the International Criminal Court (ICC) if the alternative looks disastrous to them – following the Serbian example.³⁸ This, in turn, is likely to end up in more or less controllable dismantling of the vertical, resembling the meltdown of the Soviet Union in 1991.³⁹ The risk of proliferation or use of nuclear munitions would be lower than it is now. However, there is a high probability that such an attempt would be interrupted by a putsch, resulting in either ‘iranisation’ or a civil war with unpredictable outcomes.

(3) A ‘vertical split’: The vertical is composed of many smaller vertically structured sub-clans led by patrons at each level playing a role of an arbiter of lower-level patrons. Putin, as a chief arbiter,

³⁸ Vladislav Inozemtsev, The Milošević Option, International Politik Quarterly, April 2022, <https://ip-quarterly.com/en/milosevic-option>

³⁹ Janusz Bugajski, Mapping Russia’s Devolution, ARC, <https://arc.ua/en/mapping-russias-devolution/>

provides the highest level of arbitrage. His removal could result in short-term infighting within the main sub-clans of the ruling coalition, which is likely to end up in one of the scenarios discussed above, with a possible intermediate stage of some collective junta (in any case, weakening the vertical). Alternatively a seemingly weak second-tier actor may take his/her chance for leadership; or rather unlikely the situation would evolve into a full-scale civil war. In all cases, but the latter, the nuclear armaments would remain under control and unused.

This scenario includes a period of instability that can be influenced from outside by the incentives provided through policy means. If the sanctions were severe enough, the sub-clans would be incentivised to fight for scenario #2 that promises to at least partly resurrect their rents. At the same time, a military defeat in Ukraine would undermine the positions of *siloviki*. A smart policy of personal sanctions that makes the vertical's members' futures murky, but with a clear and credible escape strategy for the elites reneging from the current vertical can help shape the elites' expectations.

(4) A 'horizontal meltdown': a failed state. Prigozhin's putsch has demonstrated that the vertical will likely become inept and ineffective in case of any significant shock or degradation, as described above. (Our theoretical prediction was made long before the putsch attempt.) This may spur the development of some sort of horizontal self-governance. However, it takes time to produce any substantive results. Once the vertical perishes, new patrons would probably be found among the informal leaders, provided mainly by organised underground or local (e.g., ethnic) leaders. In the last decade the local elites were removed from power in many RF regions, and they are likely to restore their positions as soon as the vertical weakens. Some capable and charismatic second-tier federal-level actors would also be crystallising centres for confused and scared vertical members. Just as in previous cases, a 'nudging' policy by external actors would work in such a situation.

This scenario is likely to result in the re-formatting of the vertical. In the process, the country would undergo a troubled period, and at least some parts of the RF might separate in a way that is hard to control. The problem of nuclear weapons and materials remaining on the territories of new states could become particularly acute. Nobody would agree to a new Budapest memorandum: strong security guarantees should be provided to cajole these states into surrendering their nuclear arsenals. Besides, such failed state scenarios can easily slip into a civil war.

(5) A bottom-up revolution: an eruption of discontent triggered by a predominantly low-class anti-elite rebellion akin to the one the Russian empire experienced in 1917 that led to chaos and massive bloodshed. This would result in the ultimate destruction of the whole vertical of power, physical elimination of most current elites, and some other unpredictable but barely positive consequences, the most likely result of which would be 'iranisation'. Alternatively, the involvement of third-party military forces could become necessary in order to prevent the proliferation of nuclear and chemical arms.

The weights that could be attached to these different scenarios evolve with time. As of now, we consider (3) as our baseline scenario. It seems to be unfolding now, especially if Prigozhin's assassination was carried out without a direct order from Putin it would mean that we are already in the midst of this scenario.

There is a significant probability of the first one, but, as of now, the RF's population seems to be much less ideologically indoctrinated than the one of Iran, and the hedonistic elites are still strong. However, these factors tend to deteriorate with time: both the population and the elites get used to the restrictions on their human and property rights. Meanwhile, the longer the war lasts, its proponents become stronger and more radical. It is hard to imagine something akin to an armed rebellion of ultra-militarists a year ago. As of now, this is a matter of reality.

We still leave some relatively small and shrinking room for the second scenario. While the incentives for it are strengthening, the chances of success decrease with time much faster because of outmigration and the strengthening mentioned above by the ultra-militarists.

Perhaps, the fourth scenario is also already of concern, but so far, not yet fully plausible. Still, its probability tends to increase with time: the vertical decay process is ongoing. The longer the current situation persists, the larger the disaster could be. The same can be said about the last scenario too.

All of this means that, as of now, the probability of any catastrophic scenarios is relatively low. Under the most likely scenarios, nuclear arms remain under control, although in the first and zero cases, they can be eventually used by a system with intact vertical. However, in any case, time works against those who wish to minimise the risks. Not to mention that each additional month the present RF regime remains in power costs thousands of human lives in war victims and dozens of billions of dollars in unearned incomes.

What could happen if the West is indecisive and tries to avoid Ukraine's defeat and also the regime change in Russia (that would likely to follow Ukraine's victory in any case); that is, effectively prolonging the current semi-stalemate?

With time:

- The RF would increasingly put its economy on a war footing, with military production increasing and the army growing. This would make Ukraine's victory harder to achieve, as has been the case with the fortification of the south of Ukraine and the training of reserves in the six months between November 2022 and June 2023.
- The RF's economy would adjust to the sanctions (a relatively short-term process). However, in the long run, it would deteriorate due to the increasing proliferation of the *siloviki's* control, as described above. The current short-term boom is caused by unsustainable short-lived factors such as fiscal expansion that is not even supported by foreign borrowing. This would burst, causing massive deterioration in living standards and even impoverishment, which increases the probability of the most destructive 1917 scenario. The lack of military success amid high losses would also contribute to this.
- In the meantime, the above-described processes undermining the vertical would continue – with the possible exception of the rent shrinking, where the West could potentially provide some relief, as we see now. This would result in one of the above-described scenarios, and the longer it takes, the more severe the catastrophe would be.
- Last but not least, the internal situation in Ukraine would also tend to deteriorate with time. War fatigue, high human losses (in this scenario, not resulting in substantial military achievements), and further destruction of the economy and infrastructure would, at best, only complicate post-war reconstruction and make it more expensive. At worst, these factors could destabilise Ukraine, which would be a disaster and humiliating defeat for the West and all proponents of the rule-based world order. Not to mention that the European Union (EU) and the North Atlantic Treaty Organisation (NATO) would have a territory of chaos and terrorism right on their eastern border, and in terms of the RF's behaviour, we would be in the 'zero-scenario' described above.

Note also that Ukrainian President Volodymyr Zelensky cannot come to a compromise that sacrifices territory (e.g., a ceasefire with fixation of the current frontline, like the Minsk agreement) or sovereignty (e.g., a neutral status) even if he were personally inclined to do so. His almost unilateral political support is based on his brave and decisive behaviour. Most of the 90% of Ukrainians who insist on fully restoring Ukrainian sovereignty believe that Zelensky can achieve their aspirations. Yet

even now, there are efforts by a group inside Ukraine, largely seen as fans of former President Petro Poroshenko, to persuade everyone else that Zelensky is a traitor installed by the Kremlin to surrender Ukraine to the RF. This thesis is also widely supported by Kremlin propaganda in Ukraine. Although small and self-isolated, this group is fanatical, well-organised, and influential in civil society. So far, this Poroshenko/Kremlin propaganda has had little success, as its arguments go against apparent facts. However, if Zelensky were to make any substantial concessions to the enemy, the wind could quickly change up to the point of a possible coup attempt. Thus, even if a compromise were possible and desirable (which it is not), Ukraine has almost no room for manoeuvring in this direction.

Thus, severe sanctions and abundant military help to Ukraine are worth it, and will speed up the unfolding scenarios, like a surgeon who pricks an abscess.

Conclusions

Many in the West would be happy to see Putin still holding power in a post-war weakened Russia. They understand that such an outcome is hardly compatible with an outright victory for Ukraine, so their next logical step is to pursue a 'compromise' solution. For instance, with Ukraine ceding some territory to the aggressor and/or Ukraine and the West accepting the aggressor's demands concerning Ukraine's neutral status. Such hopes are futile and dangerous, even without considering the moral side of this story, along with questions of dignity and other 'emotional' arguments. Quite the opposite, although paradoxically, the West's decisive stay and resolve in punishing the aggressor, including the speeding up of the current regime's meltdown by policy measures can mitigate already unavoidable risks.

Firstly, it must be acknowledged that any such a compromise means Ukraine's defeat. As explained above, this is a zero-sum game in which two countries cannot win simultaneously. When projected onto internal stability, whatever Putin is allowed to present to his subjects and elites as a 'victory' becomes Ukraine's defeat, for which the Ukrainians will inevitably blame their leadership along with their Western allies. Such an outcome could lead to the emergence of another kind of Syria, right in the middle of Europe; and it would be difficult to prevent, even with abundant European and American taxpayer money flowing into Ukraine (note that probably no reparations could be imposed on Russia in this scenario, and even its reserves might be unfrozen).

The external projection of such a defeat is that the dream of a rules-based world order becomes dead because military aggression, if performed by a nuclear-armed state, bears fruit, even if not in full. Neither Russia nor other 'world thugs' would stop there. On the contrary, they would be inspired by the West's weakness and 'Munich-like' indecisiveness, just as the US's withdrawal from Afghanistan can be considered to have encouraged Russia's invasion of Ukraine. Among the consequences of this, globalisation will be further in retreat, and military expenditures will rise, as predicted above. A Ukrainian (and Western) victory could reverse these trends, while their defeat, even if not outright, would incur a high cost.

Secondly, keeping Putin in power by gifting him with some 'victory' does not bring about safety – quite the opposite. His insistence on Ukraine's neutral status is not because he fears a NATO attack: just look at his very modest reaction to Finland's NATO accession. He (and a large circle of Russian elites he represents) wants Ukraine to stay neutral exactly because otherwise, it becomes unattainable prey, which means that Ukraine would be doomed to another invasion if left outside NATO. Such a hardly avoidable new invasion can turn out even more disastrous for Ukraine and the world than the current war.

The war has enabled Putin and his clique to crack down on residual human freedoms in their country and put its economy on a war footing. Thus, even if Russia comes out of the war somewhat

weakened, it is likely to quickly restore at least its military might and continue its aggression. Meanwhile, Ukraine might lose about a third or even half of its active population unless there are some guarantees (such as NATO accession) against the resumption of hostilities.⁴⁰ Russia is likely to quickly recover, learn the lessons of its prior failures, and start a new war with higher chances of winning in a few years after a truce.

Most likely, Putin would not agree to a compromise truce and instead try to escalate as described above. For example, he is still to announce a general mobilisation of conscripts. Thus, the West's compromise strategy sketched above would likely result in a protracted and bloody war of attrition. Russia has a good chance of winning in a few years – unless this strategy changes or the internal factors that would lead to the instability of the Russians regime appear sooner rather than later.

Every war creates vested interests on both sides that pursue its prolongation and, at the same time, war fatigue, frustration, and resource depletion. Along with other processes, this leads to increasing tensions. The protracted confrontation, therefore, turns into a rivalry in mostly internal resilience, and the longer it lasts, the more bitter the outcome will be – World War One (WWI) is a good example. As described above, the worst scenarios for Russia become more likely with time. Within a few years, these scenarios are expected to prevail.

The good news in this regard is that Russia's regime is likely to perish much earlier, within a year or even sooner, due to its internal causes of instability described above. These are the factors that most Western observers ignore when they view the regime without perceiving its aforementioned 'mafia-state' nature. In our view, despite the perception of vigor on regime's surface, the undercover process of its change is already underway. As Putin used to say, if the process cannot be stopped, it must be led – and also sped up because the chance to put it under control wanes with time.

Sanctions can be the most important policy instrument in this regard. The chances that Putin's regime can withstand the full-scale war and the sanctions related to it simultaneously are slim in the long run. He should be aware of it to the extent that his subjugates dare report such bad news to their boss. In any case, increasing the severity of the sanctions turns an endless war of attrition into a bluff that the West can pierce if they demonstrate sufficient resolve and efficacy in relation to military aid to Ukraine and sanctions against Russia.

The West has sufficient policy means to speed up peaceful change to Russia's regime, which would eventually benefit the Russian people as well. As explained above, Western policymakers should focus on influencing the expectations among the Russian elites about the future of their regime and economy. An anti-Putin coalition, along with Russian liberals (the ones supporting their country's defeat in its invasion of Ukraine), should develop a vision of a future non-imperial Russia or whatever would remain out of it. This should be acceptable for most of the population and some of the current elites.

A strong commitment by the West to hold the sanctions for as long as necessary to suffocate the aggressor and force it to surrender his loot will likely result in the end of the present regime. The sanctions can do the trick if implemented consistently and with due determination. As we argue above, they must focus primarily on fiscal squeezing rather than a deterioration of the living standards because this is the easiest way to eliminate the rent for ruling coalition of elites, leading to more or less controllable dismantling of the regime as opposite to totally chaotic bottom-up revolution that may result from population's impoverishment.

⁴⁰ Anastasiya Ryabchuk, *Who will Stay and Who Will Return? Divergent Trajectories of Ukrainian War Refugees in the EU*, Commons, January 2023, <https://commons.com.ua/en/hto-zalishitsya-i-hto-povernetsya-trayektoriyi-ukrayinskih-bizhenciv-v-yes/>

Here maintaining control over the NWF reserves is crucial. No single penny of the frozen reserves can be allowed to go towards financing the budget deficit. Allowing the NWF to use its euro, yen, and gold reserves for budget financing (under whatever humanistic guise) would mean that the RF could weather at least one year of sanctions without making any critical expenditure cuts. This time will become long enough to kill another few hundred thousand people in the war and inflict additional multi-billion dollar losses on the world economy.

Moreover, the price caps on Russian crude oil and petroleum products must be strictly imposed and eventually at a level that does not allow for tax revenue. The current price cap at 60 USD per barrel should be:

- a) set for the price FOB in order to avoid circumventing it through the freight transfer pricing;
- b) strictly enforced (particularly, reinforced with sanctions on all RF's foreign insurance, including, of course, related to freight; and any companies that would issue insurance certificates for the tankers transporting RF's oil at a price above the cap should be sanctioned too); and
- c) supplemented by an uncompromising commitment to decrease over time. For instance, the price could be reduced each week by one dollar as long as the RF's troops occupy a part of Ukraine (this authors' proposition is already included in the McFaul-Yermak Working Group's Action Plan), and also based on events – say, for five dollars down for each missile strike on the Ukrainian civilian infrastructure and housing until it reaches the level of operational cost of drilling and transportation plus some symbolic margin.⁴¹

Of course, such operational decisions should be made without delays or grace periods and take effect immediately. Not to mention that no loopholes should be left to allow for the circumvention of sanctions. The main buyers of Russian crude and petroleum products are interested in supporting these measures, provided that the commitment to a price cap by the G7 is credible enough. In this case, the RF would have to increase the supply if it wishes to partly maintain at least its export revenues, and everybody but the RF's regime would win, including even the Greek and Malta freight companies.

Last but not least, of course, military assistance to Ukraine should be boosted. Neither sanctions, nor a military defeat of the RF, can stop the hostilities alone, but their combination has a good chance of restoring the rule-based world order.

⁴¹ Jacob Nell, Benjamin Hilgenstock, Borys Dodonov, Yuliia Pavytska, Natalia Shapoval, Anna Vlasyuk, Dmytro Pokryska, Olena Bilousova, and Vira Ivanchuk, One year of war: Sanctions impact assessment and action plan for 2023, KSE Institute, https://kse.ua/wp-content/uploads/2023/03/KSE_One-year-of-war_Sanctions-impact-assessment.pdf