

Russia: Destabilization Assessment

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TABLE OF CONTENTS

Introduction	2
Russia's Political Cycle.....	2
Current Overview	3
Russia in the Next 1-3 Years	5
Long-Term Forecast.....	7
Key Personalities and Institutions	10
About Stratfor	12

Russia: Destabilization Assessment

Introduction

Russia and its government are moving into a new phase of post-Soviet rule. For 15 years, Russian President Vladimir Putin has constructed a highly centralized system to control various parts of the country while returning the country to stability, strength and a prominent international position.

Russia is ruled not just by Putin but by a collection of elite factions and institutions that frequently compete for control of the country's security structures, government bodies and economy. Putin has positioned himself as the arbiter among these groups, distributing wealth and positions of power among members of the elite.

The balance among these groups has been relatively stable for a decade and a half. But Russia and the Kremlin are now facing significant challenges, both domestic and foreign and in the near and long term, that are threatening the stability of the ruling system and changing the country itself. The collapse of the governing system would come either when Putin is no longer in power or when the system he built to balance the elite groups unravels, leading either to the destabilization of Russia or the emergence of a new system that does not follow the same strategies.

Russia's Political Cycle

Russia's trajectory is closely tied to developments within the Kremlin itself. Russia has its own unique political cycle that can be traced back approximately 700 years, to the days of the Grand Duchy of Moscow. Russia typically starts the cycle in a period of catastrophe (e.g., the Times of Troubles, Mongol occupation, World War I, the collapse of the Soviet Union or the 1998 financial crisis). Out of this catastrophe traditionally emerges a Russian leader who, through use of strength, brings stability and power back to the country. But that leader – or a leader from the same ruling system – can hold the country together only through brute force, and Russia's inherent vulnerabilities start to dissolve the center's control.

Russia and the government are entering the third phase of this cycle. Putin rose to power on the back of the disastrous presidency of his predecessor, Boris Yeltsin. At the time Russia was weighed down by the grave financial crisis of 1998-1999. Oligarchs had poached Russian assets, to the detriment of the federal government. Moscow had been humiliated in the First Chechen War and the Kosovo War. Secessionist movements were cropping up in dozens of regions, most of which had stopped their federal duties, such as tax payments. Russian energy production was nearly half what it was in the early 1990s. The Russian security services were

broken into pieces, and the elite had split bitterly between Yeltsin's faction (called The Family) and the Communists.

Putin emerged from a minor political faction in St. Petersburg as an alternative to the two competing Kremlin factions, though the Petersburgers were able to sway members of both factions to support his presidency. He promised to reconsolidate the country's economy, particularly the energy sector, under state control, and then divide up those assets among the elite; quash dissent in the regions and the war in Chechnya; reconsolidate and strengthen the security services; consolidate Russia's political sphere under a stable power; ensure that the Russian people are employed, fed and content with centralized control; and return Russia to a prominent position on the international stage.

Putin first created and then maintained a system that has fulfilled these promises. But Russia is inherently volatile and vulnerable. No single pressure point can crack the government or destabilize the country, but when multiple factors converge, the system can falter and put the country's stability at risk. Russia is nearing that point. And what follows the current government and system is a dangerous unknown.

Current Overview

Russia is experiencing continued pressure from outside powers, internal political struggles that could be destabilizing, an economic and financial crisis, and rising social unrest. Questions linger about Putin's 10-day disappearance from the public eye in March, but what has become apparent is that a power struggle has begun between the Federal Security Services (FSB) elite and the non- or anti-FSB members of the elite, such as Chechen President Ramzan Kadyrov and Russian Deputy Chief of Staff Vladislav Surkov. The power struggle eventually could undermine Putin's ability to rule effectively.

Putin will be able to balance the elite groups this year, but his ability to contain these disputes is eroding. As Russia's economy continues to contract, there is less wealth for the elite to share, which means conflict over assets will intensify.

Moreover, Russia is facing its second recession and financial crisis in six years. Several factors have contributed to the country's economic problems. Lower oil prices have significantly dampened government revenues. U.S. and EU sanctions, particularly sanctions that limit the access of certain Russian firms and banks to long-term credit from Western banks, are making it difficult for some major companies to finance projects. The sanctions also restrict most Western energy firms from launching new projects that require advanced technology in the country, and they have created an overall sour investment sentiment in the West toward Russia. The result is a perfect storm of political, financial and economic problems.



In addition to the macro-economic indicators, a larger crisis is looming: Russian companies hold more than \$100 billion in dollar-denominated debt due this year. A large piece of this is state oil firm Rosneft, which owes \$42 billion. The Russian banking system – mostly the five largest banks, which make up some 70 percent of the system – has about \$77 billion in dollar-denominated debt due this year. All of these economic challenges have harmed government finances; current estimates indicate that the Russian federal budget will likely have a deficit of approximately \$45 billion this year.

However, Russia has ample reserves. Between the central bank's currency reserve and the national wealth and reserve funds, the country has about a \$540 billion cushion. This money has enabled the Kremlin to pursue an ambitious bailout program in an attempt to soften the blow from the country's economic crisis. The Russian government has already pledged \$23 billion in bailouts and \$16 billion in loans for the Russian banks and companies. In addition, the Russian budget will receive an extra \$44 billion in assistance.

As a result, Russia's government will be able to meet its financial obligations, at least for the next few quarters. But the Kremlin will need to select which banks and firms receive financial assistance, adding to the infighting and fueling more competition among the country's elite.

The current economic crisis demonstrates not only Russia's economic weaknesses, but also the growing fragility of its political system. Putin is very popular among Russian voters, but the economic crisis and elite infighting could erode his popularity.

Putin's informal social contract with the Russian people – the government provides stability and ample social benefits, and in exchange the public accepts limited rights and allows the elite to siphon off wealth – is eroding. Minor protests are already popping up throughout the country, and Russia's regional leaders are beginning to complain about the lack of support from Moscow. Although the Kremlin will try to enact a series of stimulus measures to appease the population, anti-Kremlin sentiment will grow because of the state of the economy.

Hostilities in eastern Ukraine have de-escalated thanks to the February Minsk agreement, negotiated with the mediation of France and Germany. Low-level fighting is continuing, however, between Ukrainian forces and Russian-backed separatists in the region. The Russian military is unlikely to invade parts of Ukraine outside Donbas because the invasion would use up a great deal of resources, personnel and political capital. Consequently, Russia is now working to freeze the situation in Donbas to use to its advantage in negotiations with Ukraine and the West.

The West will not make large military moves that would force Russia to act in Ukraine, though the United States is incrementally boosting its presence in nearby countries, especially in the Baltics, Poland, Romania and Bulgaria. The United States is conducting some training for Ukrainian personnel, a project that could expand over time as Washington becomes more involved in the region. The U.S. government will strive for stronger bilateral ties in the area, ensuring that Washington will not depend solely on NATO when shaping and executing its regional security strategy.

The implementation of some parts of the Minsk agreement could reduce tensions slightly between the European Union and Russia by the end of the year. Unlike some EU member states, however, the United States has not shown any inclination to ease sanctions on Russia. At least for the short term, Washington will keep financial and economic pressure on Moscow.

Russia in the Next 1-3 Years

During the next several years, the system underpinning the Putin government's power will begin to unravel. The absence of the factors that helped the government consolidate power – high oil prices, a booming economy, stability among the country's elite – will significantly challenge Russia's government.

Internal Factors

With oil prices unlikely to return to the neighborhood of \$100 per barrel over the next three years, Russia's main economic challenge will be contending with lower energy revenues and uncertainty about maintaining production levels. Energy revenues make up 25 percent of

Russia's gross domestic product and 50 percent of its government revenues, so lower prices put the government's ability to meet its financial obligations in jeopardy.

With a likely extension of some Western (mostly U.S.) sanctions against Russia, the attitudes of Western investors toward Russia will remain negative. Many Western firms, particularly in the energy sector, will refrain from reinvesting in or resuming work on large projects in Russia. This could, in turn, challenge Russia's ability to maintain existing energy production levels by the end of the three-year period.

Problems in Russia's energy sector, an economy in recession and further capital flight will probably prolong the ruble's relative weakness. Inflation could become a serious concern both for consumers and for the Kremlin. Currently, middle-class Russians reportedly spend more than 50 percent of their annual income on food. With the government's financial reserves dwindling, social spending may be cut, and public sector jobs could be reduced as a result.

Russia's next presidential election is scheduled for 2018. Ahead of the vote, Putin will struggle to keep the competing elite factions in check, and his ability to contain and arbitrate disputes will erode over time. The main group to watch is the FSB, Russia's strongest faction. Meanwhile, while the central government is focused elsewhere, some regional governments may begin asserting themselves and taking a larger role in decision-making within their own territories.

Putin's popularity will probably begin sliding over the next one to three years as economic stagnation affects daily life in Russia. Put these factors together and there will be significant protests over the high cost of living, worsening economic conditions and the government's general inability to maintain stability.

External Factors

As Russia's domestic crises grow, its external challenges – particularly in its immediate neighborhood – will not abate. Russia wants to keep the conflict in eastern Ukraine alive for negotiating purposes, so it will militarily and financially support the self-declared republics but still try to avoid a full-scale military invasion of other parts of Ukraine. In the meantime, Moscow will keep using political and economic pressure to try to destabilize Kiev.

In Europe, the Kremlin will continue a complex relationship with Germany and keep working toward forming alliances with some EU members, especially countries in Central and Southern Europe. Moreover, Russia will increasingly seek partners in the East, especially China, to diversify its investment and trade relationships. Chinese firms will invest more in Russia and act as partners in strategic projects, particularly in the energy sphere.

Russia's greatest contest will come from the United States, which will have more energy to devote to Russia and its immediate periphery during the next few years. The United States will solidify its alliance network stretching from the Baltics and Poland, down through the Intermarium to Romania and Ukraine. Washington also will apply financial and economic

pressure on Russia to prevent Moscow from making any large military moves in Ukraine or the Baltics. But the United States understands the risks involved if a large, nuclear-armed country falls apart, and Washington will attempt to avoid weakening Russia to the point of collapse.

As Russia continues to falter, and as it feels increasingly cornered by the United States, the risk of confrontation within the borderlands increases. Historically, the more trapped Moscow has felt, the bolder it has become in its foreign policies, as seen in the end of the Cold War.

Long-Term Forecast

The challenges Russia is experiencing today will spell the decline of the Putin-designed governing system and the current form of the Russian Federation over the next decade. Russia and the Kremlin in their current forms will not survive the decade because of the country's reliance on energy to drive the fragile economy, competition within the elite, divisive regionalization, a major demographic shift and growing outside pressures.

Russia's economy does not have an alternative to its energy-based revenues, so the country will not be able to defend against market fluctuations. In previous hard times for the energy sector, the Kremlin has vacillated between calling for foreign (particularly Western) energy firms to save the sector and cracking down to prevent foreign influence within the system. Similar wild shifts will take place during the next decade.

Historically, when revenues have fallen the Russian government has prioritized funds for the national system over the regional systems. A reduction in financing for the regions eventually will lead some Russian regions to break with the national system and refuse to transfer tax revenues to the central government, causing the country to start fracturing. Many Russian regions will seek independence, greater autonomy or the ability to join other countries.

Russia's economic decline will also lead to mass protests throughout the country. The government's control over the population will also deteriorate because of a large demographic shift underway in Russia. The ethnically Russian population is shrinking as Muslim Russian and immigrant populations grow, and adults born after the fall of the Soviet Union are forming a larger portion of the population.

The loss of control over the regions and shifts in demographics will lead to another round of ethnic fighting in the country, starting with another war in Chechnya. This could spread to other parts of the country and bring another wave of significant terrorism in Russia.

Moscow will try to crack down on the regions, creating even more fault lines. In addition, the elite factions within the security services will have a hard time safeguarding their control of resources and power, which will further divide the government and the elite.

At the same time, outside pressures will continue building against Russia, with Poland, Hungary and Romania – with U.S. support – leading the charge to start bringing Russian borderlands

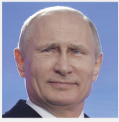
such as Kaliningrad and Belarus into the Western fold. Elsewhere, instability and economic challenges will whittle away at Russia's control of the Caucasus, and Central Asia will destabilize and fall further under China's influence.

The system Putin created cannot survive these crises. The elite could try to prolong their rule by replacing Putin with someone from their cadre (like when Leonid Brezhnev replaced Nikita Khrushchev). Sergei Ivanov or Sergei Sobyannin – men who are popular with Russians, seen as stabilizers within Russia, and members of the FSB and Russian Orthodox Church circles of power – could be chosen to replace Putin.

In the longer term, though, there are two scenarios for replacing Putin. First, a member of the next generation within the current government could step in. The elite have long been placing their children in powerful positions; for example, both of Foreign Intelligence Service chief Mikhail Fradkov's sons are in senior banking positions, and Security Council chief Nikolai Patrushev's sons are seniors in the energy sector. However, this strategy would only prolong the fall of the defunct system. In the second scenario, a new and unknown system would emerge and a massive restructuring, heralding a new era, would begin.

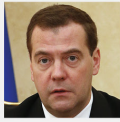
The next section lays out the key personalities and institutions within Russia. The players are divided among individuals, with a brief description of their position and allegiances, and listing of significant institutions within Russia.

RUSSIA PERSONALITIES



Vladimir Putin
Russian President

- Overall arbitrator of factions and personalities
- High influence or popularity among the Russian people



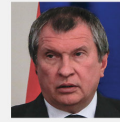
Dmitri Medvedev
Prime Minister

- Influence within economic and financial portfolios
- Influence within energy sector via Gazprom



Sergei Ivanov
Chief of the Presidential Administration, FSB

- Senior FSB member
- Influence within the military industrial complex, via Rostec



Igor Sechin
Deputy Prime Minister and Head of Rosneft, FSB

- Senior FSB member
- High influence in energy sector, particularly oil
- Foreign ties into Africa, Asia and Latin America
- Influence within arms export sector



Nikolai Patrushev
Chief of Security Council, FSB

- Former FSB chief, senior (if not top) FSB member
- Influence over current FSB Chief, Alexander Bortnikov



Vyacheslav Volodin
Deputy Prime Minister and Chief of Staff

- Influence within political parties
- Influence within state propaganda
- Influence within ethnic and social portfolios



Sergei Shoigu
Defense Minister

- High influence or popularity among the Russian people
- Influence within the Russian military



Ramzan Kadyrov
President of Chechnya

- Oversees Chechnya, including 40,000 Chechen Battalion Soldiers
- Extremely loyal to Putin
- Aligned with Deputy Chief of Staff Vladislav Surkov



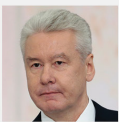
Vladislav Surkov
Deputy Chief of Staff

- Rumored senior member of Military Intelligence (GRU)
- Influence within Kremlin's hybrid strategy in the periphery
- Influence within Chechnya and over Chechen President Ramzan Kadyrov
- Influence within political parties, propaganda and ethnic and social portfolios



Gennady Timchenko
Main shareholder in Volga Group, which owns 25 percent of Novatek

- Influence in Russia's international oil export contracts
- A swing player between Rosneft and Gazprom
- Reportedly a cashier for Putin and the government



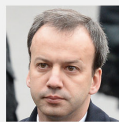
Sergei Sobyanin
Mayor of Moscow

- High influence or popularity among the Russian people
- Influence within United Russia party
- Closely aligned with Orthodox Church and FSB



Anton Siluanov
Minister of Finance

- Influence within financial sector, including Central Bank
- Influence within foreign financial ties



Arkady Dvorkovich
Deputy Prime Minister

- Influence within financial sector, including Central Bank
- Former Medvedev loyalist, though increasingly independent



Sergei Chemezov
Director of Rostec

- Influence within the military industrial complex
- Influence over security mouthpieces, such as Dmitri Rogozin
- Influence within foreign military relations, via Rosoboronexport



Yuri Kovalchuk
Banking and Media Tycoon

- Influence within the banking system
- Reportedly Putin's personal financial strategist
- Reportedly one of the government's cashiers

Image sources: Getty Images

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RUSSIA INSTITUTIONS

 <p>Federal Security Services (FSB) Agency for internal intelligence and counterintelligence activities, counterterrorism and border security</p>	 <p>Foreign Intelligence Service (SVR) Agency for external intelligence</p>	 <p>Main Intelligence Directorate of the General Staff of the Armed Forces (GRU) Military intelligence for the Russian army</p>	 <p>Federal Protective Service (FSO) Presidential protection and communication</p>	 <p>Ministry for Internal Affairs and Forces (MVD) Law enforcement overseeing Interior Ministry troops and the federal police</p>
 <p>Russian Armed Forces The military service of Russia</p>	 <p>Sever and Yug Battalions Chechen military groups under the office of the President of Chechnya</p>	 <p>Investigative Committee The primary federal investigative authority, subordinate to the office of the president</p>	 <p>United Russia The largest political party in Russia, holding 52 percent of the state Duma and 74 of the 83 regional head positions.</p>	 <p>Russian Orthodox Church The largest religious organization in Russia, with 68 percent of Russians identifying themselves as Russian Orthodox.</p>
 <p>Oligarchs The group of non-state employed businessmen who run Russia's largest business groups and can oversee the economies of entire regions and cities.</p>	 <p>Rosneft Russia's state-owned and largest oil firm</p>	 <p>Gazprom Russia's state-owned and largest natural gas firm</p>	 <p>Novatek Russia's second largest natural gas firm, mostly independently owned</p>	 <p>The Banks Russia's five largest banks make up 70 percent of Russia's banking sector: <ul style="list-style-type: none"> • Sberbank • VTB • GazpromBank • Russian Agricultural Bank • Bank of Moscow </p>
 <p>Central Bank Also known as Bank of Russia, the primary bank of the Russian government, overseeing the national currency, regulating the overall banking and credit industries</p>	 <p>Vnesheconombank (VEB) Russian state's corporation for Russia's foreign economic activities, development and managing of state debts and pension funds</p>	 <p>Rostec (formerly Russian Technologies) Russian state's corporation for civil and defense sectors, overseeing the largest 8 defense producing complexes</p>	 <p>Rosoboronexport The state intermediary agency for Russian arms and defense-related exports and imports</p>	<p> ■ Security ■ Political ■ Economic </p>

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