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# RISK REPORT

Political Risk Scenarios for Russia



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# OVERVIEW

The territory of the Russian Federation spans over 17 million km<sup>2</sup> and encompasses eleven time zones, making it the largest country in the world. With 146 million inhabitants and a population density of nine people per km<sup>2</sup>, it is, however, also one of the most sparsely populated countries on Earth.<sup>1</sup> Russia is by far the largest

state of the post-Soviet region – geographically, economically, but also in terms of population. The Russian Federation is the legal successor of the Soviet Union, which was officially dissolved on December 31, 1991. With approximately 200 ethnic groups, the country is a multi-ethnic state in which Russians make up the clear majority with around 78 %.<sup>2</sup> Vladimir Vladimirovich Putin has been the President of Russia since 1999 (except a phase as Prime Minister from 2008–2012) and is considered a central figure of the political system, which is increasingly moving away from its democratic path. After a rapid economic growth in the 2000s, Russia experienced a decline of its gross domestic product (GDP) of 7.8 % in 2009.<sup>3</sup> Ever since Russia has not been able to bounce back to the growth rates of the 2000s. This can primarily be attributed to the Russian economy's significant dependence on raw material exports and the concurrent low oil prices. Since the annexation of Crimea and the war in Eastern Ukraine in 2014, Russia has also been in political conflict with the European Union and the United States, culminating in a mutual sanctions regime. The European and American sanctions mainly target individuals, but they also hinder Russian companies from raising fresh capital in the financial markets, as well as blocking access to urgently needed technology for oil exploration. Russia has also been expelled from the G8 and talks on Russia's upcoming membership in the OECD have also been suspended.<sup>4</sup> Since 1945, Russia has been a permanent member of the United Nations Security Council with veto rights and, since 2012, a member of the World Trade Organization (WTO).

The following Risk Report evaluates Russia's political and economic system with regard to the fol-

CATEGORY	RATING
<b>TOTAL RATING</b>	<b>B</b>
POLITICAL STABILITY AND PHYSICAL SECURITY	<b>B+</b>
RULE OF LAW AND LEGAL CERTAINTY	<b>B-</b>
CYBERSECURITY	<b>A-</b>
MARKET STRUCTURE	<b>B-</b>
LABOR MARKET	<b>B</b>

Table 1: Overview Individual Ratings

lowing structural conditions:

- the degree of political stability and physical security;
- the efficiency and transparency of the Russian judicial system and the importance of the rule of law;
- the governmental protection from cyber crime;
- the structure of the Russian economy and the openness to investment; and the
- the structure of the Russian labor market and the available human capital.

The individual chapters are followed by three scenarios for Russia's development with the potential opportunities and risks for foreign investors and entrepreneurs. These scenarios are the basis for the subsequent recommendation for action.

## Table of Contents

1. Challenges and Recent Developments	p.4
2. Political Stability and Physical Security	p.6
3. Rule of Law and Legal Certainty	p.10
4. Cybersecurity	p.11
5. Market Structure	p.13
6. Labor Market	p.16
7. Future Developments: Three Scenarios	p.17
8. Recommendations for Action	p.23
9. Further Readings	p.24
10. Endnotes	p.25

# 1. CHALLENGES AND RECENT DEVELOPMENTS

## 1.1 Which historical factors have shaped the country and to what extent do they continue to impact the state?

With the dissolution of the Soviet Union, Russia transformed from an authoritarian single-party state and planned economy to a democracy and a market economy. On the one hand, the collapse of the Soviet Union had the effect that millions of ethnic Russians were now living outside of Russian territory and, on the other, that former Soviet production chains were spread across several new states. The incipient transformation in the 1990s caused enormous economic and social turbulence: GDP fell from US\$ 517 billion in 1991 to US\$ 196 billion in 1999; life expectancy dropped from 68 years in 1991 to 64 years in 1994; and the unemployment rate rose from 0.08 % in 1991 to 13.04 % in 1999.<sup>5</sup> The 1990s were also marked by the First Chechen War (1994–1996) and the Second Chechen War (1999–2003), which were fought with

staggering brutality on both sides. The turmoil of these years is the main reason why Russians today (compared to Europeans) attach the least importance to democratic developments in their country because they still associate the term democracy with this period.<sup>6</sup> With the rising oil price in the 2000s, Russia succeeded in boosting the economy and raising the standard of living for the general population.

Another formative factor for the Russian state and society is the victory in the so-called Great Patriotic War over Nazi-Germany (1941–1945). This remains an essential pillar of the common identity in multi-ethnic Russia. Current politics is also characterized by an instrumentalization of Russian and Soviet history in order to garner legitimacy for the regime.<sup>7</sup>

## 1.2 How can the state's political system be described and what kinds of developments or concerns exist?

Constitutionally, the Russian Federation is a democratic, semi-presidential system and a federal state comprising 85 federal subjects, who have varying powers.<sup>8</sup> The constitution comprises a comprehensive catalog, guaranteeing its citizens rights of political participation, civil liberties, and social rights.<sup>9</sup> The president appoints the government with the approval of the lower house of the Federal Assembly of Russia, the State Duma, and has legislative powers by means of decrees. The office of the president is limited to two terms, each of which is six years.<sup>10</sup> The Russian legislature has two chambers: the Duma is elected by the population in proportional representation through party lists; the Federation Council comprises two representatives of each of the federal subjects. De facto, however, the transitioning process into a democratic system has not been completed and under President Vladimir Putin the Russian political system has developed into an autocratic system with plebiscitary elements: power is concentrated in the hands of the president, while the parliament can hardly impact politics. This pro-

cess, which Putin, in particular, has driven forward, is described as the establishment of a “power vertical”.<sup>11</sup> The Russian system is also typified by a strong influence of the security apparatus, the so-called “siloviki”, as well as by close relationships with oligarchs.<sup>12</sup> The Russian economy and society are also heavily influenced by substantial state interference: for instance, the economically important energy sector is dominated by Rosneft and Gazprom, 50 % of whose stock is owned by the Russian state.

### 1.3 Which developments and particularities characterize the state's economy?

With 47.57 trillion m<sup>3</sup> of gas, Russia has the world's largest gas reserves and remains closely connected to Europe's energy supply.<sup>13</sup> Due to the dominance of the energy sector, both economic growth and the ruble exchange rate are strongly linked to the development of the crude oil price. The Russian economy was characterized by remarkable growth rates in the 2000s, peaking at 8.5 % in 2007. In 2009, the global economic crisis led to a substantial drop in GDP amounting to -7.8 %.<sup>14</sup> The subsequent recovery was short-lived and slumped by -2.8 % in 2015. Ever since the Russian economy has seen a moderate recovery but has been unable to return to the growth rates of the 2000. Even in comparison to other emerging countries, Russia lags behind its

opportunities and is even witnessing a declining share of global GDP.<sup>15</sup> This is mainly due to the lack of diversification and modernization of the Russian economy.<sup>16</sup> In contrast, the Russian state has very low foreign debt, amounting to 42 % in 2016, and owns comparatively high reserves.<sup>17</sup> However, the latter saw a sharp decline from US\$ 538 billion in 2012 to US\$ 377 billion in 2016, in the wake of the economic crisis of recent years.<sup>18</sup> Russia is, furthermore, pushing ahead with the Eurasian Economic Union, a regional integration project modeled after the European Union. This includes Kazakhstan, Belarus, Armenia, and Kyrgyzstan, alongside Russia.

### 1.4 Which structural factors require special consideration and how have they materialized?

Not only is Russia a multi-ethnic country with an enormous diversity of ethnicities and languages, but it is also a country with an unequal distribution of the population and economic power. Moscow alone accounts for 20.6 % of Russia's total GDP, while regions, such as North Ossetia and Rostov contribute less than 1 %.<sup>19</sup> Despite the country's enormous size, the infrastructure allows for comparatively remote areas to be accessed. Russia is facing a worrying demographic trend and has experienced the world's largest decline in population since the end of the Soviet Union.<sup>20</sup> This development could not be compensated by immigration

from post-Soviet areas; on the contrary, it is reinforced by the comparatively low life expectancy, especially that of Russian men, which is less than 67 years.<sup>21</sup> Another central problem is the rampant corruption at all levels of the state: of 180 assessed countries, Russia was ranked 138th in Transparency International's Corruption Perception Index, and its score (29) is below the average of Eastern Europe and Central Asia (34.47).<sup>22</sup> Nevertheless, as the most important and largest successor state to the Soviet Union, Russia remains the economic and political hub of the region. Furthermore, Russian serves as the lingua franca in the post-Soviet territories.

### 1.5 Which strategic opportunities and risks have to be taken into account by companies?

Strengths	Weaknesses
Wealth of resources	Lack of modernization and unilateral economic profile
Political stability	Lack of rule of law and high corruption
High level of education	Sanctions imposed by the European Union and the United States
Central hub of the post-Soviet territories	Elaborate bureaucracy

Table 2: Strengths and Weaknesses<sup>23</sup>

## 1.6 Which specific factors and events influence the country risk?

Following the annexation of the Crimean peninsula in violation of international law, both the European Union and the United States imposed sanctions on Russia in 2014. After the alleged interference of Russian agents in the US presidential elections in 2016, the United States extended this sanctions regime, which targets individuals, and contains financial and economic sanctions. These financial sanctions obstruct Russian companies' raising of fresh capital, while sanctions in the raw materials

sector make it particularly difficult to exploit resources in Russia that are hard to reach. In 2014, Russia imposed countersanctions predominantly targeting agricultural products. Further sanctions from the United States cannot be ruled out. Additionally, the Russian economy is characterized by a lack of diversification and innovative strength. For this reason, Russia solely scored 3.5/7 points in the Global Competitiveness Report's area examining innovation.<sup>24</sup>

## 2. POLITICAL STABILITY AND PHYSICAL SECURITY<sup>25</sup>

Russia's history and contemporary politics are marked by a series of very different conflicts, including several international ones (Table 4). Due to the abundance of these conflicts, only those that directly impact the stability and security in the country or carry international relevance are examined as follows.

With the Russian annexation of Crimea in 2014 and the continued covert support of East Ukrainian separatists in Donbass, Russia and Ukraine are in the midst of a major conflict: "Ukraine (Donbass)", and "Russia-Ukraine".<sup>26</sup> The 2014 integration of Crimea into the Russian state is not recognized internationally: Russia-Ukraine (Crimea). Furthermore, this conflict is aggravated by political tensions with the European Union and the United States (USA, EU, NATO et al.-Russia), which are expressed in the sanctions regimes. The political process to resolve the conflict has not yet materialized, as the central peace plan ('Minsk II') has not yet been implemented. Additionally, Russia is an intervening actor in three other secessionist conflicts in the post-Soviet area. In the Russo-Georgian War in 2008, Russian armed forces secured the separatist territories in South Ossetia and Abkhazia ("Russia-Georgia"). Since the collapse of the Soviet Union, Russia has supported the breakaway regime of Transnistria in the Republic of Moldova, Moldova (Transnistria), by

CATEGORY	RATING
POLITICAL STABILITY	B
PHYSICAL SECURITY	A

Table 3: Rating Political Stability and Physical Security

stationing the 14th Russian Army there.<sup>27</sup> While the conflict in Donbass is still claiming lives, the other disputes are so-called frozen conflicts. Since 2015, Russia has supported the Syrian army in the civil war in Syria; mostly by way of air strikes, but also with special forces on the ground.<sup>28</sup> According to official figures, 41 Russian soldiers were killed in Syria by the end of 2017.<sup>29</sup> Russia's justification for its military involvement in the Syrian civil war is the fight against the Islamic State (Syria (IS et al.)). None of these conflicts really pose a significant threat to the physical security in Russia, as there has not been a substantial increase or decrease in terrorist attacks, for example. The annexation of Crimea, on the other hand, is one of the main factors of President Putin's 80 % approval rating, and thus significantly contributes to the political stability of the regime.<sup>30</sup> Putin presents himself to the Russian population as the vital challenger of the 'West' and especially the United States; Russia's sovereignty and international rest in his hands. The annexation of Crimea is seen as proof of foreign policy strength limiting the expansion of 'Western' organizations, such as the European Union or NATO. The first and second wars in Chechnya and the en-

Conflict	Parties	Conflict item	Start date
Moldova (Transnistria)	Transnistrian regional government vs. Government	Secession	08/31/1989
Russia (opposition)	Party of Progress (POP), People's Freedom Party (PARNAS), Yabloko, Democratic Choice, December 5th Party, Libertarian Party, Citizen Initiative, Opposition Movements vs. Government	National Power	12/25/1993
Russia (social conflicts)	Unions, Students, Pressure Groups, Civilians et al. vs. Government	System/Ideology	12/25/1993
Russia (Islamist militants / Northern Caucasus)	Caucasian Emirate (CE), Islamic State of Iraq and the Levant – Caucasus Province (ISIL-CP) vs. Government	Secession System/Ideology	01/01/1989
Russia - Estonia	Russia vs. Estonia	Territory International Power	01/01/1994
Russia - Georgia	Russia vs. Georgia	International Power	12/25/1991
Russia - Kazakhstan et al. (Caspian Sea)	Russia vs. Kazakhstan vs. Azerbaijan vs. Turkmenistan vs. Iran	Territory International Power Resources	12/25/1991
Russia - Latvia	Russia vs. Latvia	International Power	01/01/1994
Russia - Lithuania	Russia vs. Lithuania	International Power	01/01/2014
Russia - Norway et al. (Arctic)	Russia vs. Norway vs. Denmark vs. Canada vs. USA	Territory, Resources	01/01/2001
Russia - Ukraine	Russia vs. Ukraine	Territory International Power Resources	08/24/1991
Russia - Ukraine (Crimea)	Russia, Pro-Russian Groups, Crimean Regional Government vs. Ukraine, Pro-Ukrainian Groups	Secession Resources	05/06/1992
Japan - Russia	Japan vs. Russia	Territory International Power	08/22/1945
Turkey - Russia	Turkey vs. Russia	International Power	11/24/2015
USA, EU, NATO et al. - Russia	USA, EU, NATO vs. Russia	System/Ideology International Power	01/01/2007
Russia, Ukraine (Crimean Tatars)	Crimean Tatars, Ukraine vs. Crimean Regional Government, Russia	Autonomy	07/01/1988
Ukraine (Donbas)	Militants of the Self-proclaimed Donetsk (DNR) and Luhansk (LNR), et al. vs. State Border Guard Service of Ukraine (DPSU), National Guard of Ukraine (NGU), Volunteer Battalions, Government	Secession System/Ideology Resources	01/01/2014
Syria (IS et al.)	IS (Islamic State), Sunni Tribes vs. YPG (Kurdish People's Defense Units), Jabhat al-Nusra, FSA (Free Syrian Army), Ahrar al-Sham, KRG (Kurdistan Regional Government), Shiite Militias, Sunni Tribesmen, Taliban, Hezbollah, Syria, Jordan	System/Ideology Resources	04/08/2013

Table 4: Conflict Overview

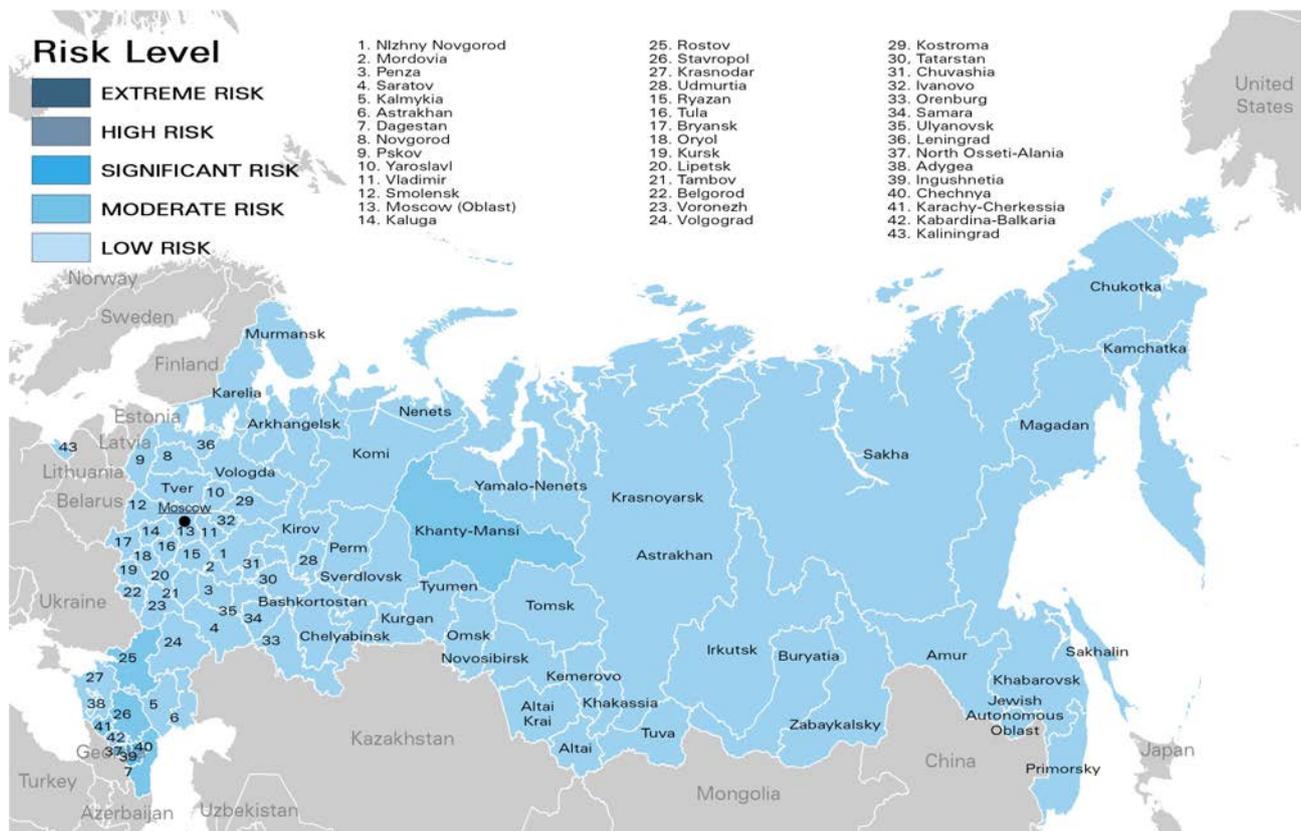


Figure 1: Risk Map Russia

suing consequences (Russia (Islamist militants/Northern Caucasus)) have a much larger impact on the security in Russia. In the first war (1994–1996), the Chechen government, which was not recognized by Moscow, fought for independence from the Russian central state; a peace treaty was signed in 1997. The staggering brutality of the conflict, but also the spread of Wahhabism in the Muslim-dominated North Caucasian regions, led to the spread of radicalism in parts of Chechen society.

In 1999, Moscow’s military intervened again – also to boost newly elected President Putin’s popularity – which led to the Second Chechen War. Chechen fighters carried the war to other Russian cities with terrorist attacks, including the hostage crisis in the Moscow theater Nord-Ost from October 23–26, 2002.<sup>31</sup> The military campaign, which was classified as an anti-terror operation, did not officially end until 2009.<sup>32</sup> Both wars claimed approximately 160,000 lives.<sup>33</sup> Chechnya itself was held within the Russian state and was pacified under the repressive rule of Ramzan Kadyrov.<sup>34</sup> However, Northern Caucasus remains a hotbed for unrest and violence with a strong presence of Islamists who proclaimed

the “Caucasus Emirate” in 2007.<sup>35</sup> In recent years, the violent conflict has expanded, especially into Caucasus republics Ingushetia and Dagestan. In 2017, 175 people died in clashes between security forces and Islamists in Northern Caucasus.<sup>36</sup> In addition, Russian cities outside of Northern Caucasus had been targeted by terrorist attacks, most recently in St. Petersburg in December 2017.<sup>37</sup>

In the Russia (opposition) conflict, the government faces irregular but sometimes large protest movements. Demonstrations with thousands of participants took place in Moscow and St. Petersburg in the wake of electoral fraud during the 2011 parliamentary elections and Putin and Medvedev’s proclamation of the 2012 presidential elections. This culminated in the so-called “March of Millions” in May 2012, which was suppressed by the regime through mass arrests and repressive measures.<sup>38</sup> Under the leadership of the opposition leader Alexei Navalny, thousands of Russians protested again in more than 100 cities in 2018, well beyond the centers of Moscow and St. Petersburg.<sup>39</sup> The Russian political system is characterized by repression and violence against opposition figures and journalists.

Still, and despite the economic difficulties, the country is stable and exhibits no major tensions in the conflict Russia (social conflicts). This can mainly be attributed to Putin's popularity, which has its roots

in his foreign policy. In this regard, his regime has been able to craft a unifying narrative that strengthens cohesion and secures its own stability.

## **2.1 Is the state able to maintain its sovereignty, i.e., ensuring law and order throughout its entire territory, considering the ongoing interstate and intrastate conflicts?**

A high degree of state control and exercise of power, even outside of large urban areas, is typical of the Russian government. The overall crime rate in Russia is in decline: the number of attempted and executed murders fell from 23,000 in 1992 to 10,400 in 2016.<sup>40</sup> Solely the regions of Northern Caucasus are subject to increased security risks, which is why

Germany's Foreign Office currently advises against traveling to Chechnya and the neighboring areas of Ingushetia and Dagestan.<sup>41</sup> The fact that Russia was able to guarantee safety during the 2014 Olympic Games in the southern Russian city of Sochi, demonstrates the effectiveness of the security apparatus outside of Moscow.

## **2.2 Are there parts of the state territory (e.g., remote areas) where other actors have a significant influence?**

Thanks to its well-developed infrastructure, Russia is also in a position to exercise state authority in remote areas far off from its center. Despite the federal structure of the Russian state, an increasing cen-

tralization has been observable under the presidency of Putin.<sup>42</sup> The only major exception is Chechnya, which is controlled by a Moscow-approved repressive regime.

## **2.3 To what extent are citizens, foreign visitors, or companies / production sites physically threatened by political violence?**

In general, the Russian state is able to ensure the security of both its own and foreign citizens to a high degree. However, this may not apply to persons in opposition to the Russian regime; especially journalists and human rights activists have experienced disproportionate violence. Between 1992–2018, 58 journalists were killed in Russia – human rights organizations even report torture.<sup>43</sup> Rarely

are Western foreigners affected by this; however, searches of German party foundations, such as the Konrad-Adenauer-Stiftung and the Friedrich-Ebert-Stiftung, took place due to the so-called law against foreign agents.<sup>44</sup> Since 2015, whoever is on the list of unwanted organizations must cease any operations in Russia; to date, this mainly encompasses American, Polish, and Ukrainian institutions.<sup>45</sup>

## **2.4 How often do acts of political violence, including terrorist attacks, occur?**

Due to Islamic terrorist cells in Northern Caucasus, terrorist attacks (mostly suicide attacks) are regularly perpetrated in the name of the Caucasian Emirate. Moscow, St. Petersburg, and other major cities have also fallen prey to attacks numerous times. Between 1992–2016, 3,860 people died in a total of 895 attacks.<sup>46</sup> The bloodiest years were in 2002 and 2004, when Chechen fighters took hostages in

the Nord-Ost theater in Moscow and in a school in the Northern Caucasian city of Beslan, killing 129 and 330 victims, respectively. In both cases, the Russian security forces' brutality was partly blamed for the high number of casualties.<sup>47</sup>

## 3. RULE OF LAW AND LEGAL CERTAINTY

The Russian Federation is characterized by its weak rule of law and insufficient separation of powers. Traditionally in Russia, laws are used as an instrument of power and not as an instrument to limit power.<sup>48</sup> Cases, such as the illegal appropriation of companies of the British investment fund Hermitage Capital, uncovered by Sergei Magnitsky, evince that laws in Russia are also used to enrich elites.<sup>49</sup> The rampant corruption in almost all areas of society further reduces legal certainty in Russia. The Rule of Law Index, which measures the rule of law of

CATEGORY	RATING
<b>TOTAL RATING RULE OF LAW AND LEGAL CERTAINTY</b>	<b>B-</b>
PROTECTION OF PROPERTY RIGHTS (1)	<b>B-</b>
INDEPENDENCE OF JUDICIAL SYSTEM (2)	<b>C</b>
ENFORCEABILITY OF CONTRACTS (3)	<b>B+</b>
FUNCTIONING OF JUDICIAL SYSTEM (4)	<b>B-</b>
CORRUPTION (5)	<b>C</b>

Table 5: Rating Rule of Law and Legal Certainty

states worldwide, ranks Russia 89/113. Although Russia did improve by three places compared to 2016, it is still below the global average. Even in the regional comparison in the post-Soviet region, Russia fares comparatively poor and is ranked 11/13.

states worldwide, ranks Russia 89/113. Although Russia did improve by three places compared to 2016, it is still below the global average. Even in the regional comparison in the post-Soviet region, Russia fares comparatively poor and is ranked 11/13.

### 3.1 Does the state protect the property rights of citizens and companies?

Corruption and the lacking independence of the courts lead to limited protection of property rights in Russia, although formally guaranteed by the constitution. The Heritage Foundation's Economic Freedom Score underlines this problem by giving Russia 48.7/100 points for protecting property rights.<sup>50</sup> Arbitrary expropriations and inconsistent application of the law, in particular, lead to this poor assessment. As far as property rights are concerned, Russia ranks 116/137 in the Global Competitiveness

Report.<sup>51</sup> Scandals, such as the Magnitsky case, highlight the fact that the state not only inadequately protects property rights, but that the courts are even actively involved in criminal acquisitions.<sup>52</sup> Acquiring and registering property, however, does not pose a problem for domestic or foreign entrepreneurs. Accordingly, Russia was able to reach rank 12/190 in the Doing Business Report's analysis of national economies.<sup>53</sup> Only certain sectors, such as for agricultural land, are subject to restrictions.<sup>54</sup>

### 3.2 Is the judicial system independent of the executive's and other state organs' influence?

Vladimir Putin's "Vertical of Power" constitutes a clear influence of politics on the judiciary.<sup>55</sup> Even the Constitutional Court of Russia, modeled after Germany's, cannot prevent a drifting apart between formal constitutionality and reality. The executive is the strongest branch of the state, to which the judiciary is ultimately subordinated. Judges, in particular, are oftentimes dependent on the authorities or

the polity.<sup>56</sup> This is reflected in the Rule of Law Index's assessment of Russia: with a score of 0.53/1 in the "Civil Justice" indicator and an especially poor score of 0.34/1 in the area "Civil Justice is free of improper government influence", Russia lags behind Western states who reach scores between 0.7–0.857.

### 3.3 In principle, are contracts enforceable in court?

In the Doing Business Report 2018, Russia was ranked 18/190, thus scoring well in the area of "En-

forcing Contracts".<sup>58</sup> The index analyzes the cost, as well as the time, it takes to enforce a legal dispute –

both of which are comparatively low in Russia. In Moscow, for example, it takes only 340 days and costs amount to 15 % of the claimed costs. This is well below the European and Central Asian aver-

age of 489.9 days and 26.2 % of claimed costs.<sup>59</sup> All in all, Russia is able to draw a positive balance. For cases that are of political interest, however, this verdict only applies to a limited extent.

### 3.4 Is there a functioning judicial system?

The assessment of the Russian judicial system is somewhat mixed: despite the comparatively low costs and time for legal proceedings and the good state infrastructure that even reaches into remote areas, the rampant corruption and the influence of politics lead to a below-average rating on a global scale with regard to the effectiveness of the judicial system. The Index of Economic Freedom rates

this with 46.9/100. The generally poor rating in the areas of rule of law, which are consistently given less than 50/100 points, is the main reason for Russia's below-average performance in the Index of Economic Freedom's global comparison. Even in a regional comparison of the post-Soviet region, Russia does not do better than rank 7/11.<sup>60</sup>

### 3.5 To what extent and in which government sectors is corruption present?

President Putin has made the fight against corruption one of the most important challenges facing his country's development.<sup>61</sup> According to Transparency International, however, Russia is one of the 50 least active countries combating corruption.<sup>62</sup> Rather, corruption is used as an instrument by the Russian regime to co-opt elites and officials. In the Rule of Law Index's category "Absence of Corruption", Russia scored 0.43/1 points and was merely ranked 75/135 globally. In the regional comparison, Russia

performs equally poor and is ranked 8/13.<sup>63</sup> Transparency International's Corruption Perception Index lists Russia 135/180 with a relative constant score throughout the past years;<sup>64</sup> corruption scandals are a regular appearance in Russian and international media.<sup>65</sup> The Prosecutor General of Russia estimates that between 2015–2017, the damages caused by corruption in Russia amounted to RUB 148 billion (~ US\$ 2.3 billion).<sup>66</sup>

## 4. CYBERSECURITY

The Global Cyber Security Index bestows Russian cybersecurity a score of 0.788/1, placing Russia in the very good rank of 11/165.<sup>67</sup> In a regional comparison, Russia even makes it to second place; this is mainly due to its high scores in the area of capacity building.<sup>68</sup> The high levels of national research and the noteworthy Russian industry in the field of cybersecurity are the key drivers of Russia's good results. In 2018, Russia passed a new law concerning the security of critical infrastructure which the

CATEGORY	RATING
TOTAL RATING CYBERSECURITY	A-
JUDICIAL REQUIREMENTS (1)	A
INSTITUTIONAL PREREQUISITES (2)	A
PROTECTIVE TECHNICAL MEASURES (3)	B+

Table 6: Rating Cybersecurity

country will try to protect important infrastructure in key areas, such as communication, energy, financial markets, and defense.<sup>69</sup> Cybersecurity is also one of the central issues in Russia's National Security Strategy and in its Doctrine of Information

Security.<sup>70</sup> However, Russia's repressive measures in regard to cybersecurity also garner much attention. Russian legislation contains some very vague language, which allows the Federal Service for Supervision of Communication, Information Technology and Mass Media (Roskomnadzor) to block large swaths of websites without a court ruling and also to take action against journalists and opposition members.<sup>71</sup> Their information channels are also to be restricted. In April 2018, for instance, Roskomnadzor blocked the popular instant messaging ser-

vice Telegram because it refused to hand over encryption codes to government agencies.<sup>72</sup> Furthermore, Russia was heavily criticized by the international community for its cyberattacks. Although the origin of such attacks is notoriously difficult to prove, experts blame Russian actors – and even intelligence services – for numerous cases; for example, the attacks in Estonia in 2007, the British National Health Service in 2017, or on the network of the German government in 2017.<sup>73</sup>

#### **4.1 Has the state established the necessary juridical requirements to fight cybercrime?**

The Global Cyber Security Index assessed the legal institutions and framework conditions with a score of 0.82/1. Russia has legislation explicitly for the digital realms that is regularly updated, as recently with the amendment of the law on securing critical infrastructure.<sup>74</sup> The Russian Federal Service for Supervision of Communication, Information Technology and Mass Media has extensive powers to monitor the internet and cyberspace. The Cyber Power

Index, on the other hand, does see some gaps in Russia's legal framework and only gives the country 36.4/100 points. The fact that no cyber defense plan is in place was especially criticized.<sup>75</sup> Cybersecurity in Russia is generally associated with the regime and national security; therefore, it is mostly intelligence services – and not private actors – who shape the country's cybersecurity.<sup>76</sup>

#### **4.2 Which institutional prerequisites are available to ensure and improve cybersecurity on a national level?**

In Russia, different institutions handle different areas of cybersecurity. The Roskomnadzor agency is mainly responsible for the areas of censorship and control of the internet. The intelligence services, on the other hand, play a major role in the fight against cyber threats.<sup>77</sup> Due to the traditional secrecy in this area, the size, structure, and division of the various Russian intelligence services are difficult to discern. However, units specializing in the detection and prevention of threats in cyberspace can be found

in the Federal Security Service (FSB), the Foreign Intelligence Service (SVR), the Main Intelligence Directorate (GRU), and the Federal Protective Service (FSO).<sup>78</sup> In 2017, the Ministry of Defence of the Russian Federation announced that it had established a new department for information security and cyber defense. These will employ about 1,000 people and have an annual budget of approximately US\$ 300 million.<sup>79</sup>

#### **4.3 Which protective (technical) measures does the state take to effectively counter or limit the existing cyber risks?**

Russia fares worst in the Global Cyber Security Index's areas regarding the technical measures to protect from cyberattacks (0.67/1).<sup>80</sup> The Cyber Power Index's assessment confirms this (25.5/100) and appoints Russia the mediocre rank of 17/19.<sup>81</sup> This is mainly due to the lack of standards for organiza-

tions and experts, reflecting Russia's state-centered approach, as well as the lack of cooperation with business and civil society.<sup>82</sup> Amongst the numerous intelligence services, the FSB has the most far-reaching instruments at its disposal regarding cyber defense: the System for Operative Investigative Ac-

tivities (SORM) allows the surveillance of network traffic, while the Special-purpose Information and Telecommunications System (ITKS) enables information to be secured, encrypted, and decoded.<sup>83</sup>

Companies operating in Russia are, therefore, mainly on their own regarding cyber risks, but they can take advantage of the country's growing and (partly) innovative IT sector.

## 5. MARKET STRUCTURE

Despite political commitments to privatization and diversification, Russia's market structure is still dominated by large state-owned enterprises (SOEs) and the energy sector. The Index of Economic Freedom confirms this: while entrepreneurial and trade freedom are convincing, there are factors, such as state dominance, restrictions in several sectors, and bureaucracy, that massively inhibit companies. Moreover, there have

been no observable improvements in the critical areas in recent years.<sup>84</sup> In contrast, however, Russia has made significant headway in the Doing Business Report: in 2010, Russia was still ranked 124th but by 2017, it bounced to rank 35.<sup>85</sup> This step forward was initiated by Putin in 2012, who wanted to improve Russia's standing in this area through vari-

ous reforms.<sup>86</sup> Still, Russia was unable to significantly increase its attractiveness for foreign investors. In contrast, however, the European Union and United States' sanctions regimes have also not led to significant changes in the Russian market structure; not least because major areas of joint trade in the energy sector are not affected.

CATEGORY	RATING
<b>TOTAL RATING MARKET STRUCTURE</b>	<b>B-</b>
FOUNDING OF COMPANIES AND SUBSIDIARIES (1)	<b>A</b>
DISADVANTAGING OF FOREIGN COMPANIES (2)	<b>C</b>
IMPORT AND EXPORT BARRIERS (3)	<b>A-</b>
PAYMENT RISKS (4)	<b>B</b>
EMBARGOES AND TRADE SANCTIONS (5)	<b>C</b>
INDUSTRIAL DIVERSITY (6)	<b>C</b>
NATIONAL ECONOMIC INTERESTS (7)	<b>B+</b>

Table 7: Rating Market Structure

### 5.1 How quickly and easily can companies and subsidiaries be founded?

Setting up companies or subsidiaries in Russia is relatively easy and fast. According to the Doing Business Report, this process only takes 11 days in Moscow and requires fewer resources than the global average in terms of personnel and costs; furthermore, no minimum capital investment is required.<sup>87</sup> The two assessed cities, Moscow and St. Petersburg, both reached top scores of 93.03/100 and 92.81/100, respectively.<sup>88</sup> The Index of Economic Freedom also rates entrepreneurial freedom positively and gives Russia 77/100 points, placing Russia far above the global average of 64.8/100.<sup>89</sup> The impartiality between foreign and domestic investment is fundamentally guaranteed through appropriate legislation governing foreign direct invest-

ment (FDI). However, restrictions are possible if the investments threaten constitutional order.<sup>90</sup> In 45 strategic sectors, investments and company formations must also be approved by a commission controlling foreign investment.<sup>91</sup>

## 5.2 To what extent are foreign companies disadvantaged with regard to investments and which nations are currently active in the country?

Sector-specific restrictions and the preferential treatment of SOEs – especially in the energy sector – lead to Russia’s extremely poor score in the Index of Economic Freedom’s “Investment Freedom” category.<sup>92</sup> The selective and inconsistent application of laws, whose wording is often vague, further reduces the security of investments. Russia’s most important trading partner is China with a share of 21.2 % of exports and 10.08 % of imports, while Germany receives 10 % of Russian exports and imports 7.2 % of all goods into Russia.<sup>93</sup> All in all, the European Union accounts for 40.7 % of imports and 49.8 % of

exports.<sup>94</sup> What is striking is the enormous proportion of tax havens, such as Cyprus or Luxembourg, that FDI originates from. Further FDI comes primarily from European countries, such as Great Britain, Germany, and France.<sup>95</sup> Russia’s main imports are capital goods, such as machines, electronics, motor vehicles and motor vehicle parts. Export goods, on the other hand, primarily comprise raw materials: 59 % is coal and fossil fuels, even though this has declined by 11 % since 2013.<sup>96</sup> Thus, Russia’s foreign trade clearly reflects the country’s lack of diversification and dependence on raw materials.

## 5.3 Are there any export or import barriers?

The Index of Economic Freedom rates Russia’s “Trade Freedom” quite well with 74.9/100 points. This is mainly due to the importance that raw material exports have for the Russian economy and the state budget.<sup>97</sup> Russia’s accession to the WTO in 2012, after years of tough negotiations, has also further facilitated international trade. The necessary effort for cross-border trade is, nevertheless, high. According to the Doing Business Report, the average time spent on border compliance processes for com-

panies operating in Moscow amounts to 72 hours – two-and-a-half times the average as in Europe and Central Asia. The costs these processes incur (US\$ 665) are also almost three-and-a-half times higher than in Europe and Central Asia.<sup>98</sup> St. Petersburg, Russia’s second major economic hub, fares even worse in this regard. Russia’s trade barriers are, therefore, mainly to be found in the staggeringly complex processes.

## 5.4 Which risks prevail with regard to payments, especially concerning convertibility and transfer?

With the transition to a market economy after the collapse of the Soviet Union, both the currency and market price formation were liberalized in Russia. Still, the state has a significant influence in some areas; above all in the energy and agricultural sectors. The strong orientation of the economy and the dependence of the Russian state budget on raw material exports has also led to a dependence of the ruble on the oil price.<sup>99</sup> The collapse of the ruble exchange rate in 2014, had dramatic consequences and was exacerbated by the sanctions policies of the European Union and the United States.<sup>100</sup> Furthermore, the sanctions make it harder for five Russian national banks to raise capital – including the largest and second-largest banks Sberbank and VTB.<sup>101</sup> The Russian central bank was also forced to encroach upon the private banking sector to pre-

vent imminent bankruptcies and counter bad loans. In the course, it revoked the licenses of almost 300 banks and, only recently, bailed out the two private banks Otkritie and B&N Bank.<sup>102</sup> This mixed track record is reflected both in the below-average scores in the Doing Business Report’s category assessing currency freedom (60.8/100), as well as the transfer risk rating by the Funk Gruppe (42.8 %).<sup>103</sup>

## 5.5 Are any embargoes or trade sanctions in place?

Following the annexation of Crimea, which was in violation of international law, and the war in Eastern Ukraine, the European Union and the United States imposed comprehensive sanctions targeting Russia and Russian individuals. The implementation of the three-tiered sanction regime took place between March and July 2014. Only the United States introduced further extensions and major changes after that. The European Union sanctions include diplomatic sanctions and restrictive measures, such as freezing the assets of Russian individuals. Additionally, there is a full-fledged ban on trade and investment with Crimea. The sanctions package also includes restrictions in the economic and financial policy areas: citizens and companies of the European Union are prohibited from borrowing bonds and shares with a maturity period of more than 30 days from the five national Russian banks; from the three energy companies Gazprom Neft, Rosneft, and Transneft; as well as from three de-

fense suppliers.<sup>104</sup> In addition, there is an embargo targeting military and dual-use goods, as well as oil exploration technologies.<sup>105</sup> In response, Russia imposed sanctions targeting the European Union: these include agricultural products but also entry bans for 89 people from the European Union.<sup>106</sup> Following the alleged interference of Russian actors in the 2016 presidential campaign, the United States unilaterally imposed further sanctions. Apart from sanctions against individuals, these include the possibility to punish American companies who cooperate with sanctioned Russian companies.<sup>107</sup> These extraterritorial sanctions could also be used against Nord Stream 2, the joint project of Europe and Russia. The risk of these newly sanctions still prevails after the Trump Putin summit in Helsinki. Russia responded by threatening companies, who comply with the American sanctions and withdraw from joint projects, with criminal prosecution.<sup>108</sup>

## 5.7 Are there any particular national economic interests?

The Russian economy is largely dependent on the extraction of raw materials, especially in the energy sector. This becomes evident in an international comparison: worldwide, Gazprom is the second-largest oil and gas producer, while Rosneft is in fifth place.<sup>109</sup> The Russian reserves amount to 32.3 trillion m<sup>3</sup> of gas and 109.5 billion barrels of oil.<sup>110</sup> In addition to the extraction of raw materials, the petrochemical industry plays an important role in Russia and accounts for roughly 1.5 % of GDP.<sup>111</sup> Other

competitive industries are the defense and aerospace industry, as well as the automotive sector.<sup>112</sup> In contrast to developed industrial countries, however, only 1.5 % of growth is attributable to the manufacturing industry.<sup>113</sup> Consequently, the moderate economic growth in 2017 was mainly due to goods that are not traded internationally.<sup>114</sup> In 2016, the services sector accounted for 62.84 %, the industrial sector for 32.42 %, and the agricultural sector for 4.74 % of GDP.<sup>115</sup>

## 5.6 Which industries are present in the country?

Thanks to its dependence on raw material export, Russia is particularly interested in establishing stable and long-term trade relations as well as transport routes to Europe and China. The construction of the Nord Stream 2 pipeline and TurkStream pipeline (the joint project with Turkey), is supposed to minimize transit risks from the Russian perspective.<sup>116</sup> Russia is also pushing ahead with its Power of Siberia pipeline project with China, hoping to become less dependent on the European gas market.<sup>117</sup>

Furthermore, Russia is trying to secure access to the mineral resources in the Arctic that are located outside of the country's national access zones.<sup>118</sup> Russia's policy since the end of the Soviet Union has also shown that subsidized gas prices are used as a carrot and stick for the other post-Soviet states, as became apparent in the repeated gas disputes with Ukraine.<sup>119</sup> With the founding of the Eurasian Economic Union, Russia also wanted to improve the supply chains in the post-Soviet regions that took a

serious beating after the demise of the Soviet Union. So far, the project has fallen short of Moscow's

expectations, which is mainly due to Ukraine boycotting the project.<sup>120</sup>

## 6. LABOR MARKET

Russia's labor market is characterized by a large number of highly educated workers, especially in the technical and economic sectors. The strong legal regulation, as well as the decrease in the workforce potential, have led to a mixed assessment of the Russian labor market.

Reforms, such as increasing the minimum wage or restricting fixed-term employment, have reduced the flexibility of the Russian labor market.<sup>121</sup> For

CATEGORY	RATING
TOTAL RATING LABOR MARKET	B
LABOR MARKET STRUCTURE (1)	B
AVAILABILITY OF QUALIFIED EMPLOYEES (2)	A-
MARKET COMPETITIVENESS (3)	B
PARTICULARITIES (4)	C+

Table 8: Rating Labor Market

foreign companies, however, the wage costs are small due to low salaries and the weak ruble exchange rate.

### 6.1 How is the labor market structured (workforce potential, employment rate, etc.)?

Russia's labor market displayed a moderate unemployment rate of 5.5 % in 2017.<sup>122</sup> What is remarkable though, is that the unemployment rate hardly increased during the economic downturn. During the 2015 crisis, unemployment amounted to merely 5.57 %, which is only slightly higher than 5.16 % in 2014.<sup>123</sup> This is mainly attributable to the phenomenon of concealed unemployment: the state tries to keep the unemployment rate low through subsidies and few layoffs in the public sector.<sup>124</sup> The youth unemployment rate, which is higher and more subject to fluctuations, paints a different picture: in 2009, it rose from 14.1–18.7 % and sunk back to

14.1 % in 2014. By 2015, it had crawled back to 16.4 % and has remained relatively stable since.<sup>125</sup> The Russian employment rate is at 62.2 %, thus at a similar level as Germany. The negative demographic development and the aging Russian society, however, are overall reducing the Russian workforce potential. From 2018 onwards, the working age population can be expected to decline by 600,000 persons a year.<sup>126</sup> Even the massive labor migration (for instance, of more than 1.3 million people coming just from Central Asia), cannot counteract this development, as the immigrants mainly take jobs that Russian workers avoid anyway.<sup>127</sup>

### 6.2 Are sufficient qualified employees available?

Russia has one of the highest rates of university graduates in the world; in 2014, it was ranked first place worldwide with a rate of 53.3 %.<sup>128</sup> Technical and business-related studies are especially popular in Russia, with 38 % of degrees being held in business administration and law, and 21.9 % in engineering, in 2015.<sup>129</sup> The high proportion of university graduates can partly be explained with the lacking

vocational training system outside of universities, such as the German dual training system. Still, unemployment amongst graduates is low with 3.79 % in 2017.<sup>130</sup> The quality of Russia's higher education system becomes apparent in its good ranking (32/137) and score (5.3/7) in the 2017 Global Competitiveness Report's category "Higher Education and Training".<sup>131</sup> In 2016/2017, the number of higher edu-

cation institutions amounted to 896. But this number is going to be reduced in the course of a reform process while the quality of the remaining schools is to be improved. At the same time, 29 universities

have been granted the status of 'National Research Universities', thus becoming eligible for increased funding.<sup>132</sup>

### 6.3 How competitive is the labor market (wage costs, productivity, etc.)?

With regard to the competitiveness of the labor market, Russia's performance is mediocre with 4.3/7 points and rank 60/137 in the Global Competitiveness Report; but the country is on par with other states in the region, such as Georgia or Ukraine.<sup>133</sup> This disappointing result is mostly due to the lacking professional management, inflexible wage determination, and the inadequate cooperation between employers and employees.<sup>134</sup> The Index of Economic Freedom also criticizes the rigid and unmanageable labor law legislation.<sup>135</sup> In 2016, the average gross monthly salary in Russia amounted to RUB 36,746 (~ EU€ 496). However, wages do not

only vary considerably between branches but also between regions.<sup>136</sup> Furthermore, performance-related wage components and a general social security contribution of 30 % for persons making up to RUB 755,000 annually are added – especially for those in leading positions.<sup>137</sup>

In 2016, Russia (US\$ 103.7) was only slightly below the OECD average (US\$ 104) for GDP per hour worked.<sup>138</sup> However, the OECD recorded a 0.1 % decline in labor productivity in Russia in 2016, while the OECD countries recorded an average growth of 0.4 %.<sup>139</sup>

### 6.4 Are there any country-specific particularities (e.g., regarding the labor law)?

The Russian labor market is not very mobile due to the bureaucratic registration requirements and the lack of affordable housing in industrial hubs<sup>140</sup> – this exacerbates the existing problem of skill shortage. Trade unions play a minor role in Russia, as the state represents the interests of the workers – just like in Soviet times. Russian labor laws, consequently, include comprehensive provisions gov-

erning the structure of the employment relationship. These include the inadmissibility of unfounded fixed terms, the admissibility of dismissals by employers only under certain conditions, and a limit on overtime amounting to a maximum of 120 hours annually.<sup>141</sup> Since 2018, the minimum wage of RUB 11,200 a month applies too.<sup>142</sup>

## 7. FUTURE DEVELOPMENTS: THREE SCENARIOS

Based on the findings of the first part of this Risk Report, the following three scenarios will depict Russia's possible future development. To encompass a wide range of possible developments, the best and worst-case scenarios will show the extreme poles of possible outcomes. To conclude the chapter, the trend scenario will depict the most probable development of political and economic factors. The price of oil constitutes the economic focal point of all three scenarios. Even in the medium-

term, Russia's economy and state budget are fiercely dependent on this raw material; the whole of Russia's economic performance is based on the revenues from this economic sector. To cover government spending, Moscow needs an oil price of at least US\$ 100/barrel. In the political sphere, the country's future will be shaped by the regime's ability to generate stability – even in times of economic turmoil and declining living standards – and thus garner the support of the population. Currently,

Russia's political system is very stable. Yet from today's vantage point, the next presidential elections in 2024 constitute a defining moment, as they could bring about a power shift in Russia. Unlike a functioning democracy, Russia's authoritarian system does not dispose of a generally accepted mechanism for the transfer of power. Therefore, this phase could bear a risk for the authoritarian system. For entrepreneurs and investors, the relations with the European Union and the United States – and thus the sanctions regime – will be of the utmost importance. Both the European Union and the United States predicated the lifting of their sanctions on the implementation of the Minsk II agreement. However, given President Donald Trump's unpredictable style of politics, government participation by right-wing populists in Europe, and the debate concerning economic losses in Europe itself, it cannot be completely ruled out that the factor of Ukraine will become less of an obstacle in the re-

lationship with Russia. Moreover, the transatlantic tensions that have mounted since Trump took office, could mean that the European–US consensus on sanctioning Russia could diverge. Relations with the West also depend on the regime's necessity to maintain this enemy concept in order to generate legitimacy within the Russian population through a rally-around-the-flag effect.

Four defining developments will set the course for the three scenarios: the effects of low oil prices of less than US\$ 80 per barrel since 2014; a shrinking or stagnating Russian economy since 2014; Putin's high approval rating of consistently over 75 % since the annexation of the Crimea in 2014, his re-election in 2018, and its stabilizing effect on Russia's political system; and finally, the sanctions regimes of the European Union and the US since 2014.

## 7.1 Best-Case Scenario - A Stable System and a Moderate Opening (Probability: 10-20 %)

The best-case scenario assumes that the security situation in the Middle East will deteriorate in the course of 2019: the remaining partners are unable to uphold the Iran deal and no de-escalation in Syria is in sight. Finally, Israel attacks Iranian positions in Syria. Furthermore, the intensification of the Iran–Saudi Arabia conflict over supremacy in the Middle East leads to the repeated closure of the Strait of Hormuz. This crisis leads to a significant rise in the oil price in 2019 – at times it stands at US\$ 130/barrel. But by 2020 the price stabilizes at US\$ 110/barrel. Thanks to this, the Russian state revenues boom and the state is able to fill the state reserve and social funds. Additionally, the oil price-dependent ruble rate stabilizes by 2020 at 50 ruble for one euro, while the central bank is able to keep inflation at a moderate 5 %. The newly gained financial leeway allows the government to strengthen the social system for the coming years: the average monthly pension will rise from just over EU€ 100 in 2018 to EU€ 120 in 2022. The increase in state revenue also lets the government invest in the economy – most notably in infrastructure. The economy booms and displays an average economic growth rate of 6 % by 2024; in 2022, it even reaches 10 %. Moderate

inflation and rising wages increase real wages and boost domestic spending. Thanks to the growing economy and decreasing workforce potential, unemployment remains at a constantly low level of 4 %. Even youth unemployment can be reduced to 7 %.. In 2020, the European Union and the United States agree to progressively lift the sanctions against Russia by 2021. President Trump and President Putin come to an agreement, mediated through French President Emmanuel Macron, and extend the New START Treaty, which regulates the reduction of strategic nuclear weapons and controls the Intermediate Range Nuclear Forces Treaty (INF Treaty), which enforces the ban on medium-range nuclear missiles. Following the lead of Germany, Austria, and Hungary, the support of several EU-countries for the sanctions regime erodes, as many fear an arms race at Europe's expense. Ultimately the European Union declares its support for Russia's re-entry into G7 – Ukraine is not a priority in the European Union's policy. In Russia, this is seen as Putin's personal victory over the 'West'. This and the rising standard of living bring further stability to the regime and lead to the President's approval ratings

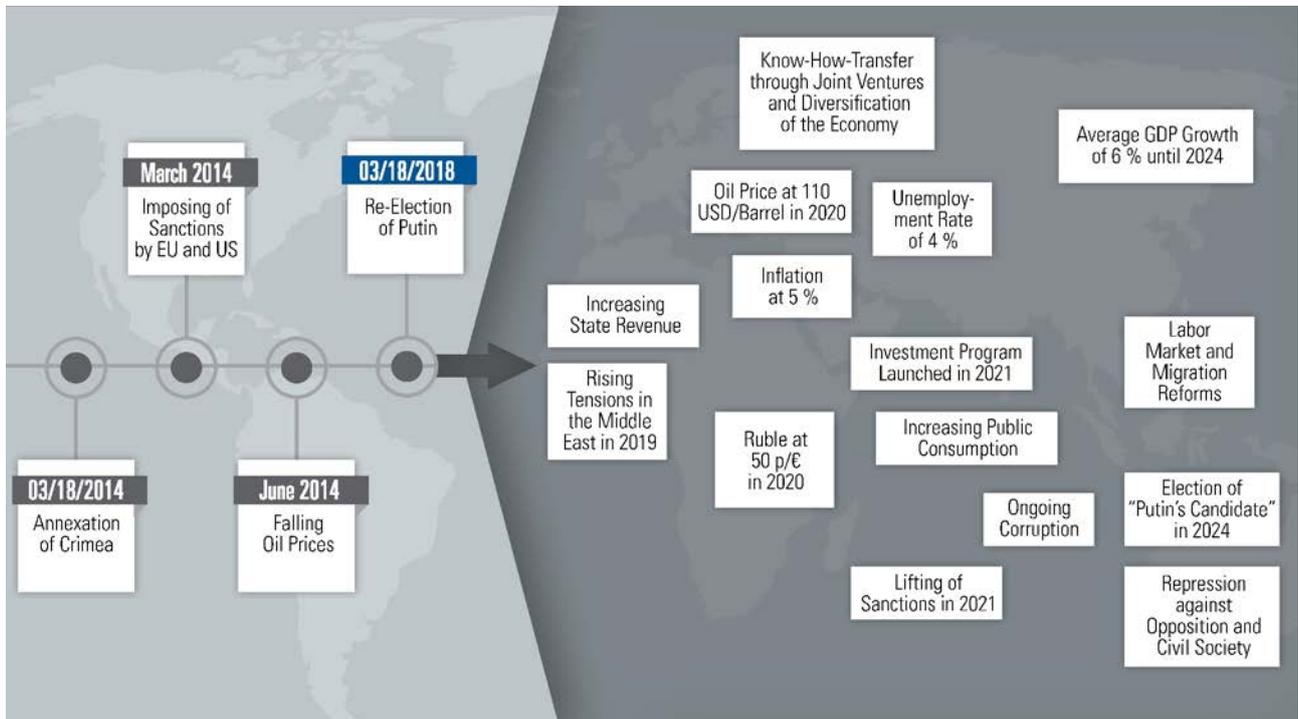


Figure 2: Roadmap Best-Case Scenario

exceeding 80 %. From 2022 onwards, the economic upswing and the reduction of sanctions result in a number of joint ventures with Western companies, particularly in oil exploration and the automotive industry. This transfer of knowledge, in turn, leads to a diversification of the Russian economy.

Nevertheless, Putin does not announce whether he will run in the presidential elections in 2024 – after all, the constitution, which only allows two consecutive terms, would have to be changed. At first, there does not seem to be a successor, as other politicians are much less popular and there are also no promising oppositional candidates either. Adding to this, the opposition remains divided and finds it increasingly hard to attract nationwide attention due to the incumbent government’s media monopoly. In early 2023, Putin finally appoints a largely unknown and young politician, the Secretary of the Security Council of Russia, as Prime Minister, who had taken over this office from Nikolai Patrushev in 2021. In the subsequent fall, and as many observers had already expected, he finally announces his candidacy for the office of president for the elections in spring 2024.

The state media portray the candidate as Putin’s heir and as a moderate reformer on a path between stability and economic awakening. To support his cam-

paign during his time as prime minister, he announces investments in housing to push down the horrendous house prices in cities, as well as investing in the ailing health system. He also proclaims a large-scale “Woina s Korrupcziej” (war against corruption), which leads to some dramatic arrests in the media but does not tackle the corruption-based system. He initiates reforms in the area of labor migration to facilitate access to the labor market for immigrants and thus counteracting the decreasing work-force potential. NGOs that criticize the government are prosecuted for tax offenses or are subject to other harassment.

Thanks to the population’s support of the regime, as well as the continued repression of opposition forces and electoral fraud, Putin’s candidate is able to win 75 % in the first round of elections. To consolidate his power, the newly elected president applies two instruments: moderate economic reforms, such as simplifying tax procedures for businesses to further boost the economy; and systematic corruption to ensure the loyalty of public servants and key entrepreneurs. Although Putin himself has resigned, many of his confidants and their children remain in influential positions in the state but also in important companies.

## 7.2 Worst-Case Scenario - The Regime's Stability Crumbles (Probability: 5-10 %)

At a summit in mid-2019, the European Union's heads of state decide on a common strategy to diversify their energy imports and to significantly expand their LNG infrastructure, including building ten new LNG terminals by 2030. At the same time, battery technology advances and allows for electricity that was produced from renewable sources to be stored. Europe increasingly imports solar energy from North Africa as part of the European Energy Strategy. The decision to ratify a new international agreement to end Iran's nuclear program also stabilizes the oil price in 2019. This, in turn, leads to a drastic decline of the oil price, which stabilizes at

US\$ 45/barrel by 2021. This development and the lower demand from Europe lead to a massive collapse of the Russian state budget. In 2021, the ruble is in free fall and drops to 95 ruble per Euro; from then onwards, the ruble stabilizes at 80 ruble per Euro. Due to the poor exchange rate, Russian companies are no longer able to service foreign currency loans and need the state to bail them out – all of which eats away at the crumbling state budget. Ultimately, Russia is forced to use its state reserve funds. Government debt rises from 18.76 % in 2018 to 32 % in 2023, accompanied by high-interest rates due to Russia's poor ratings.

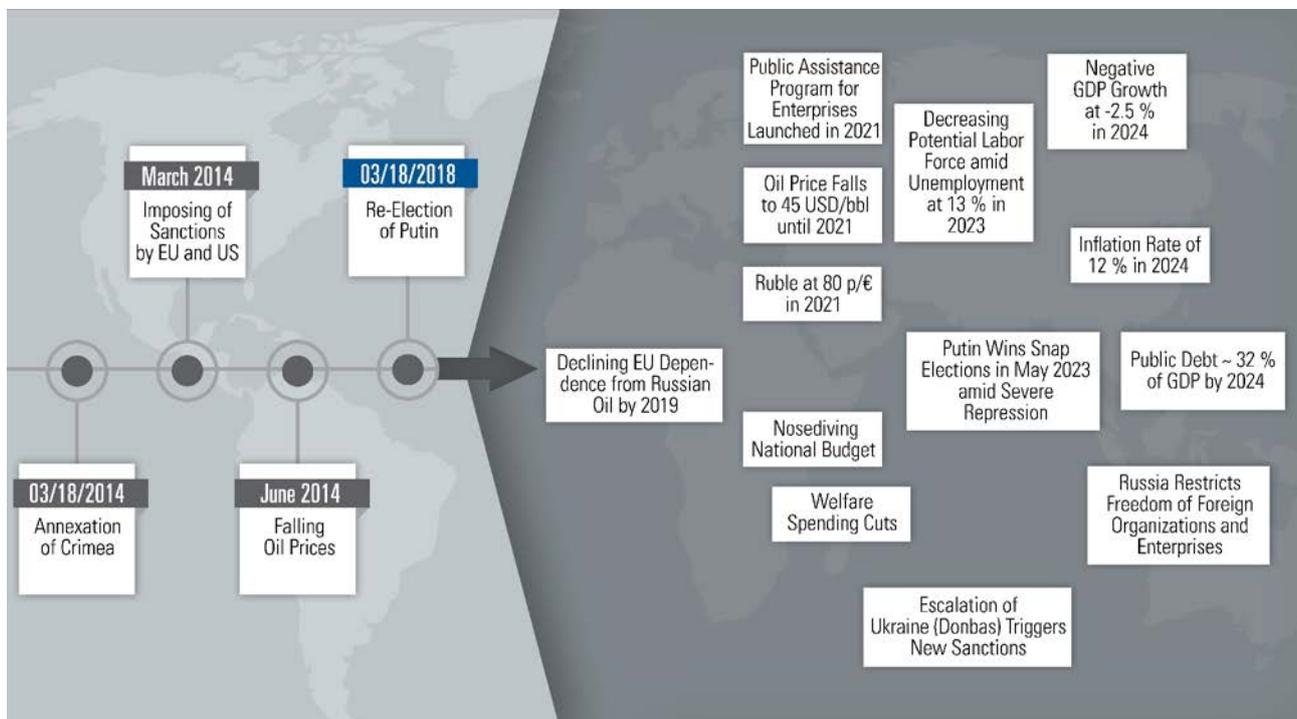


Figure 3: Roadmap Worst-Case Scenario

The lack of diversification, the rampant corruption, and the crippling bureaucracy have made the Russian economy vulnerable to external shocks. Rising consumption and purchasing power had supported the economy until 2021; the massive collapse of the state budget, however, forces the state to lay off employees and cut social spending from 2023 onward. This affects pension policy especially and leads to an increase of the retirement age from 63 to 67 for women and from 65 to 69 for men. Another cost-cutting measure is a reduction of child

support by an average of 50 %. This leads to a significant reduction in consumption and ultimately breaks the economy: between 2020–2024, the economy shrinks by 2.5 % on average. As a result of canceled state investments and state support for companies in crisis, the economy shrinks by 8 % in 2023. Despite intense efforts by the central bank, inflation rises by 12 % between 2020–2024. The lack of prospects leads to an increased emigration of, particularly, young and well-trained Russians and exacerbates the shortage of skilled labor.

Moreover, the massive layoffs in state institutions mean that the government is no longer in a position to conceal unemployment. Despite the brain drain and the decreasing workforce potential, unemployment rises to 13 % by December 2023.

The regime fears social unrest and a loss of popular support due to the economic crisis; to distract from the economic situation, Moscow embarks on further foreign policy ventures. Thanks to pro-government media channels, Russia is able to secretly support separatists in Donbass, who launch a major offensive at the end of 2020 to create a corridor to Crimea via Mariupol. Russia's support for the separatists creates yet another burden on the state budget. By December 2020, the European Union and the United States respond with further sanctions. Russia's expulsion from the SWIFT system follows suit, which exacerbates the decline in foreign investment from US\$ 36 billion in 2018 to US\$ 10 billion in 2024. The United States, additionally, sanctions European companies cooperating with Russian companies in the energy sector. In response, Russia reacts with counter-sanctions and terminates its space program for its partners, which is widely criticized. Still, the end of the matter is that the ISS is no longer operational. In addition to falling oil and gas prices, the sanctions impose a further external shock on the Russian economy.

At the beginning of 2023, the Russian parliament amends the constitution, granting Putin another term

### **7.3 Trend Scenario - Stability and Stagnation (Probability: 60–70 %)**

In Putin's second term, Russia continues on its path of moderate growth. This is possible thanks to the stable oil price of US\$ 100/barrel from 2020 onwards, which is attributable to the OPEC's effective limiting of oil production as well as the United States' stagnating LNG exports; Russia's stable political situation also contributes to growth. Both factors contribute to an exchange rate of 65 ruble per Euro. The central bank is able to maintain the moderate inflation of 7 %. Together with rising wages, this leads to a growing domestic demand in Russia, which eventually becomes Russia's second economic driver next to the raw material and ener-

gy sector. Still, Russia is unable to return to growth rates of the 2000s: between 2019–2024, growth amounts to 1.8 %. This means that Russia falls behind other emerging economies and that its share of global GDP decreases. The lack of diversification and insufficient competitiveness in capital goods and high technology, are to blame for this development. Although the EU and United States sanctions are a hindrance to entering the capital market for Russian firms, Russia could also benefit from the sanctions: aside from strengthening its domestic economy, especially in the agricultural sector, the sanctions have had the effect that many compa-

in office – he, in turn, justifies his renewed candidacy with the fact that only he can stop the erosion of state power. Unofficially but above all, he sees a power shift as a threat to his personal wealth and that of his associates. To preempt a further drop in popularity, snap elections are held in June 2023. Putin's candidacy and the changed election date in spring 2023 lead to low poll results and nationwide protests – especially by young people. A government media campaign defames leading members of the protest movement as foreign agents and arrests them on spurious grounds. After two weeks, the protests disintegrate; however, when Putin wins the election in summer 2023 with a meager 55 % in the second round of elections thanks to massive electoral fraud, new protests arise. The decreasing living standard and the increasingly precarious living conditions for large parts of the population mobilizes now also pensioners and workers for the protests now too. The regime is able to curb the protests with extreme violence and mass arrests, but at the same time blames the United States and the 'West' for the unrest. Russia expands the list of unwanted organizations, which for the first time also include German institutions – these are accused of undermining the stability of the state. To bolster the Russian economy, several sectors are opened to international investors, such as food production and the automotive industry, but the regime's stability remains fragile.

nies are opening factories in Russia. These include German automotive enterprises but also companies such as Siemens. As a result, FDI (especially hailing from Europe) will increase to US\$ 45 billion by 2024. The moderate economic growth will also lead to a constant unemployment rate of 3 %.

In 2020, at a Normandy format summit in Minsk, a progressive reduction of European sanctions is agreed upon. In return, Putin assures the OSCE control of the Russian–Ukrainian border in Donbass. While Russia only partially sticks to its promise and both goods and people continue to cross the border

without OSCE control, there is no longer a majority in the European Union favoring a further expansion of sanctions. The pressure from right-wing populist governments and from businesses have become too great in view of the agreement. Eventually, Austria, Italy, and Germany refuse to support the extension. Thus, the sanctions are lifted by 2021. The European Union can persuade the United States to relax its own sanctions; however, the American Congress does not lift individual sanctions due to the developments on the ground.

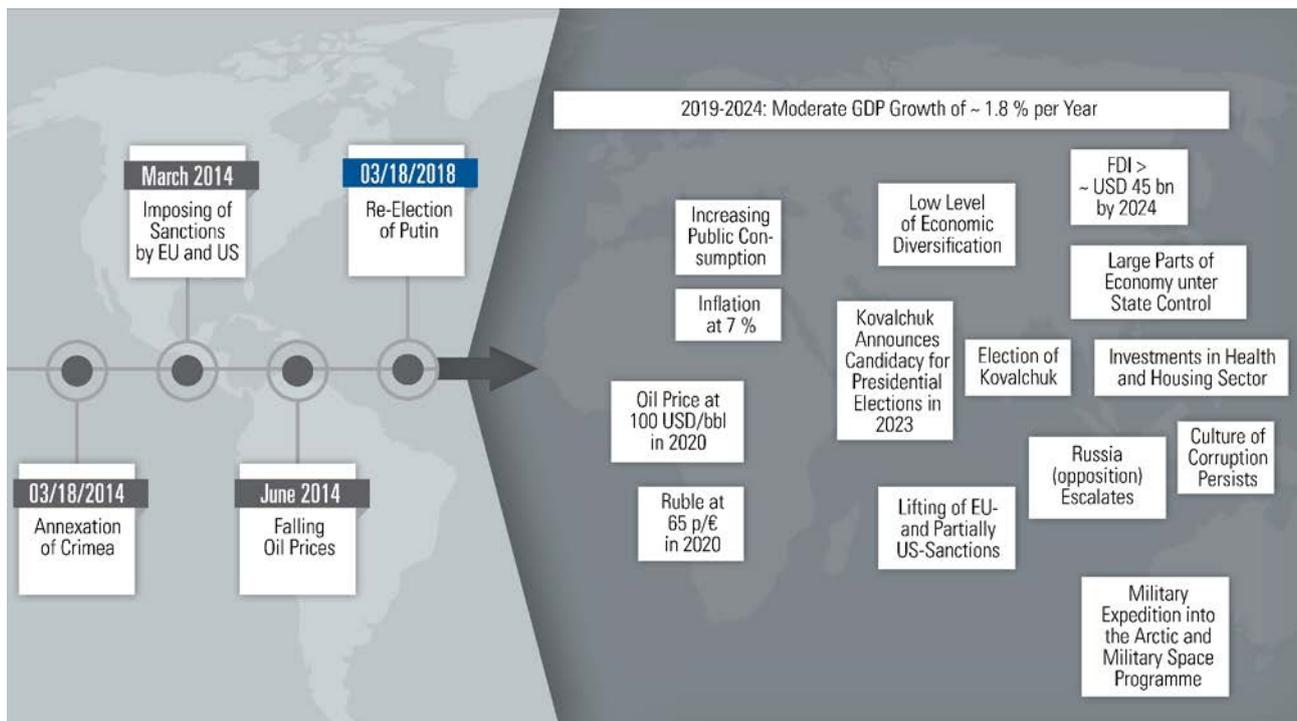


Figure 4: Roadmap Trend Scenario

In 2023, Putin dismisses Prime Minister Dmitry Medvedev and appoints his associate Yuri Kovalchuk's son Boris Kovalchuk as his successor. In fall 2023, Kovalchuk then announces his candidacy for the presidential elections. Previously, he had headed the government's department for projects of national priority and had been appointed Minister of Defence in 2022 in preparation for his new role. The close ties to Putin's inner circle are intended to ensure that the current president's wealth and that of his associates remain secure even after the change of government. Meanwhile, the pro-government media present Kovalchuk as Putin's successor and depict him as a man of the people who has worked hard in the administration – his family back-

ground, however, leads to skepticism among the population. Kovalchuk announces comprehensive investments in the health system and housing construction and propagates strength in foreign policy. He sends expeditions that are accompanied by the military to the Arctic, who then occupy the area. Furthermore, he presents high-profile Russian space-based military technologies that are expected to be operational by 2025.

At the same time, the regime increases pressure on civil society and the opposition. The internet, in particular, is a focal point of his government's dual strategy: on the one hand, websites of independent newscasts are shut down (even those with large au-

diences, such as Dozhd); on the other hand, Moscow launches its own social media campaign to reach younger people called “Ja ljublju Rossiu” (I love Russia), which in time, however, becomes a laughing stock. Thanks to the media campaign, electoral fraud, and the discrimination of opposition candidates, Kovalchuk wins the second round of elections in spring 2024. To stabilize his regime, he relies on aggressive foreign policy. He withdraws from the INF treaty, which bans medium-range nuclear missiles, and announces the deployment of newly developed weapons of this type in Kaliningrad.

The government investment into housing, health care, and defense, as well as continued spending, ensure economic growth to remain at 2 % in 2024 under the new president. Nevertheless, the shrinking workforce potential, which is especially intensified by the emigration of highly educated Russians, and the lack of diversification and state control of the economy (even under President Kovalchuk), make Russia less attractive as a business location. The system of government is still based on corruption and the instrumentalization of law to maintain power.

## 8. RECOMMENDATIONS FOR ACTION

The different scenarios illustrate the range of possible political and economic developments in Russia. They serve as a starting point to provide assistance for decision-making processes regarding the entering or deepening of economic ties with Russia. The stated recommendations for action are by no means exhaustive and must be subject to continuous revision with respect to the latest developments.

The economic upswing paired with the moderate reforms outlined in the best-case scenario, improve Russia’s overall rating (see Table 9). The reformed labor-market access curbs the declining workforce potential; political stability and a strong state ensure a high degree of personal security. Corruption, political justice, and repression of civil society and opposition forces, however, continue. Rising consumer power and the onset of diversification boost

CATEGORY	CURRENT	BEST	WORST	TREND
TOTAL RATING	B	A-	C+	B+
POLITICAL STABILITY AND PHYSICAL SECURITY	B+	A-	C+	B+
RULE OF LAW AND LEGAL CERTAINTY	B-	B	C+	B
CYBERSECURITY	A-	A-	A-	A-
MARKET STRUCTURE	B-	B+	C	B
LABOR MARKET	B	A-	C+	B-

Table 9: Development Individual Ratings according to Scenarios

sales potential. The economic downturn and the expansion of the sanctions regime, as outlined in the worst-case scenario, lead to a very different outcome and thus to a significant worsening of Russia’s overall score. The ruble’s sharp decline only makes production in Russia cheaper. The lack of economic prospects and increasing repression reinforce the brain drain and, thus, exacerbate the problem of the shrinking workforce potential. Increasing political instability reinforces these effects and endangers the personal security of individuals, while

corruption and the erosion of state power lead to less legal certainty. If the worst-case scenario materializes, market entry or deeper economic involvement in Russia is not advisable. This is not only due to the decreasing attractiveness of the market, but above all because of the growing uncertainty for investments. Political instability, the massive reduction of legal certainty, but also the danger of new sanctions and counter-sanctions are unpredictable risks. In the case of an economic upswing and political stability, as outlined in the best-case scenario,

nario, Russia holds great opportunities for companies – especially the growing sales market. Nevertheless, companies should keep an eye on developments in the areas of legal certainty and workforce potential.

The trend scenario assumes an increase in the overall rating due to moderate economic growth. This is primarily due to rising consumer power and fiscal stability. The stability of the political system prevents improvements in legal certainty, as corruption and political justice continue to have a systemic stabilizing function. The reforms and fight against corruption only have a moderate effect. However, the transfer of knowledge leads to a limited diversification of the market; but the labor market structure continues on its collision course due to the demographic changes. Thus, the Russian sales market is especially attractive for international companies and investors. However, in view of the lack of legal certainty, major investments and possible company locations should be examined closely. Labor force access, especially in specialized fields, should also be secured beforehand. This is why the choice of location plays a major role.

In all three scenarios, there are common aspects that pose risks for companies and investors: the reciprocal sanction policies are a factor of uncertainty. Both the lifting as well as the expansion of sanctions are possible. American extraterritorial sanctions, especially in the energy sector, would be particularly critical. Due to the cooperation ban, this can also apply to European companies; however, Russia could also impose sanctions on companies that adhere to American sanctions. Another risk potential is the possible expansion of economic sectors, which are particularly protected by the Russian government. Moreover, intervention by the Russian government in areas of the communications industry, such as was the case with Telegram, cannot be ruled out. Companies should also keep an eye on further developments in the area of legal certainty and the rule of law. The demographic change and the resulting decline in the workforce potential will also be decisive for Russia's future attractiveness – not only as a sales market but also as a business location. The next presidential elections in spring 2024 constitute a litmus test for the incumbent regime, which is why both companies and investors should implement planned projects promptly.

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## ABOUT THE FUNK STIFTUNG

The Funk Foundation was founded by Funk shareholder Dr. Leberecht Funk and his wife Maritta as a private non-profit organisation. In addition to funding scientific and practice-oriented projects from the field of risk management, and especially vocational training in the insurance sector, the foundation also supports cultural projects.

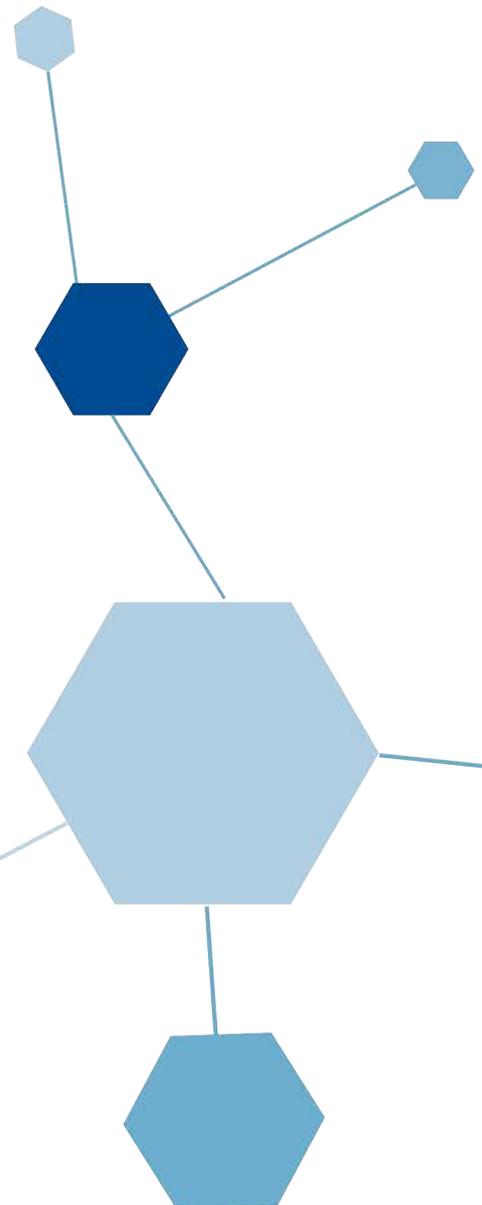
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