



## Russia's War on Ukraine: First Lessons and Outlook

### Russia loses big, China gains, and win-lose becomes a new normal.

On 24 February 2022, war returned to Europe. The outcome of Russia's criminal attack on Ukraine is still unknown. But it is not too early to draw first lessons and to start considering the shape of things to come.

#### Blinders

Geopolitics eats strategy for breakfast. That makes it crucial to see what is coming.

The problem is, we do not see what we do not want to see, no matter the evidence. In the months leading up to the war, the potential for war was hard to miss. The United States and the United Kingdom raised the alarm and backed up their concerns with hard evidence. Third parties, such as the Russia-based Conflict Intelligence Team, an open-source initiative, provided corroborating information by trawling social networks and analysing commercial satellite data.

At the same time, Russia's leadership set out to create a pretext for war by making a reduction of tensions that Russia itself had created contingent on terms so far-fetched that they were **clearly designed to be rejected**.

It was all there in plain sight.

And yet many of us refused even to consider the *possibility* that Russia was bent on war. Smart

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people did not want to **believe the evidence** or dismissed it as Anglo-Saxon propaganda. Entire nations – my own, Germany, at the forefront – deceived themselves that Russia could never do such a thing. Others argued that waging war would be irrational, blithely ignoring that Russia **had learned that war does indeed pay**.

All were caught out, as were presumably many companies.

One of the most critical tools of political risk analysis and mitigation in global strategy is the use of scenarios – *especially* those that seem unlikely but would be highly impactful.

In the present case, there were enough reasons to consider a scenario in which Russia attacked Ukraine. Unfortunately, scenario-building exercises often collapse into what is desirable rather than cover what is possible. Our hopes and desires become our blinders.

As the fighting continues, several scenarios are worth considering. Most likely is that Russia will conquer all of Ukraine and then occupy it or annex key parts while installing a puppet government for the remainder of the country. Less likely is that, against all odds, David will slay Goliath.

#### Russia loses big

In these scenarios, it is probable that Russia will ultimately emerge much diminished, not only in reputation, but economically and, for lack of resources, militarily.

Putin's dreams of superpower status were always delusions of grandeur: A country of 145 million and a 2021 GDP (at PPP) of about US\$4.3 trillion does not play in the premier league with China (1.4 billion, US\$26.7 trillion), the US (333 million, US\$22.7 trillion), and, perhaps one day, a united European Union (447 million, US\$21.5 trillion). Indeed, Russia's economy is smaller than Germany's, a country that is hardly a world power.

And when the dust settles, Russia's economy will be set to fall behind even further. Western[1] sanctions after Russia's invasion of Crimea in 2014, tame as they were, have probably **reduced Russian GDP growth** by 2.5 to 3 percentage points per year.

Sanctions this time are orders of magnitude more severe. Not only will they make it much harder for Russia to gain access to technology and finance, they will also induce even more Russians to leave their country. According to recent estimates, 22 percent of Russians overall and almost half of the young **want to emigrate**. As sanctions bite, these numbers will no doubt swell. These effects would be amplified by a Russian occupation of Ukraine, which would both drain Russian resources and alienate Russian citizens further.

At the same time, Europe is working to wean itself, at long last, of Russian energy imports. And Western businesses will find it hard – legally and politically, but also morally – to continue doing business with an international pariah state.

Russia will be an isolated developing country with nuclear weapons – North Korea writ large.

### **China gains, somewhat**

And like North Korea, a besieged Russia will turn to China for help with sustaining its economy. China will oblige.

A Sino-Russian axis has been in the making for some years now, culminating in Putin's 2022 visit to China during which both sides proclaimed that their partnership had "**no limits**". Accordingly, China has refused to denounce Russia's war of aggression, despite China's usual professions about the sanctity of sovereignty.[2] And **Chinese public opinion is strongly in favour of Russia** – with the absence of censorship of social media cheerleading for Russia indicating Communist Party approval.

China gains in multiple ways. One is that it has just seen how the West might respond to a Chinese

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attack on Taiwan, and it will adjust accordingly. In particular, China will have to consider whether it is safe to park its foreign currency reserves anywhere in the West, having seen how they can be frozen overnight.

A major win for China is that Russia has just become eminently more dependent on China. If Russia wants to continue to sell oil and gas, China is the natural destination. If it wants access to technology or imports more generally, China may send its own goods or act as Russia's blockade runner. China is Russia's lifeline.

Russia may manage to scrape by this way, but at the price of giving China extreme leverage. At best, Russia will be selling oil and gas on the cheap to China. At worst, Russia will turn into a quasi-tributary state of China. A cynic may wonder whether Xi may have encouraged Putin to move against Ukraine.

### **More decoupling, also of China**

But it is not all cheer for Beijing. Trends towards decoupling China from the West (and de-globalisation in general), already under way, are likely to accelerate.

A key reason is the likelihood of China helping Russia circumvent Western sanctions. The very point of sanctions on Russia is to decouple the Russian economy from as much of the world as possible. If China is seen as preventing this, a logical next step is to move towards decoupling China.

US law provides for so-called secondary sanctions. To the extent China helps reduce the impact of US sanctions on Russia, the country could become subject to US sanctions itself.

Europe may follow suit. Most of the continent (and the UK) now sees Russia as an adversary that needs to be **contained** rather than engaged. To the extent China is seen as working against this objective, relations between China and Europe are likely to suffer – my enemy's friend is my enemy.

For Western firms, the challenges of staying in business in and with China may soon reach new heights.

### **A world of relative gains**

This new landscape will emphasise relative over absolute gains.

Applying a logic of absolute gains, as in economics, measures such as sanctions and decoupling are irrational if they inflict losses not only on the target but also on their originator. And steps that let both

sides gain are welcome, even if the other side gains more.

However, for international security, the crucial question is: How can we make our country and our allies better off relative to our opponents? In this logic, measures leading to losses are acceptable if the other side loses more. Steps bringing gains are unacceptable if they would allow an adversary to gain more.

This is no longer a landscape where win-win solutions are universally welcome. Rather, vis-à-vis the other bloc, win-lose is the objective. Businesses need to become familiar with this logic and shape their expectations and global strategies accordingly.

### **Alternative scenarios**

Much of the above assumes that Russia will stay on its current trajectory. But many in Russia, apparently including some in positions of power, are aghast at the war. A change in leadership and foreign policy remains a possibility.

While such a change seems unlikely at this point, these power transitions are notoriously difficult to predict. Should it occur, Russia and the world may well find themselves on an altogether different trajectory again.

Of course, it is also possible that the war may turn into a wider conflagration. It is worth remembering that Hitler, whose actions seem to have provided at least part of Putin's playbook, did not intend to start World War II by invading Poland. Nuclear deterrence, under the crucial assumption of rationality on both sides, should prevent this war from turning into World War III. Whether it does, we may soon know.

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[1] I use "Western" not as a geographic designation, but as shorthand for the camp of countries aligned with the United States against Russia.

[2] Though China hardly has a monopoly on hypocrisy.

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