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What Happens When Putin's Krysha Leaks

By Kim Iskyan

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The word in many quarters is that Putin 2.0 portends an era of tranquil stability for Russia and that investors should not fret over how Russia is run because real stability is on the horizon. Following the announcement that Prime Minister Vladimir Putin will in essence succeed himself, self-interested brokerage houses breathlessly hailed the productive predictability that the next one or two rounds of Putin as president will bring, paving the way for waves of portfolio and direct investment.

With the distracting messiness of determining who will be Russia's next president behind us, the narrative goes, focusing on risk and stability is for ninnies and worrywarts. Now that it is clear once again where the ruble stops — not that there was ever much doubt — things will be fine. Putin himself is the lead cheerleader of the lobby encouraging everyone to take off their training wheels, so to speak, because there will be little risk under his stable rule.

"We understand very well how important predictability and stability are," Putin told a group

of foreign CEOs shortly after his reanointment.

The nirvana of stability is in the eye of the beholder, though, and there are plenty of definitions of the word "stability." One vision holds that stability is the situation in which Russia is permitted to prosper unhindered by external influences and is able to travel down its own path without meddling foreigners sticking their noses into domestic affairs.

A domestic policy spin on stability, advanced by United Russia State Duma Deputy Sergei Markov, suggests that it is characterized by "a slow, gradual, step-by-step modernization of current political, social and economic institutions."

To others, stability equates to stagnation, evoking a stale stench of the Brezhnev era.

For many investors, stability is the knowledge that their krysha, or roof — that is, the protection a business or investment needs to survive and operate — will remain effective for the foreseeable future and at a cost that will not destroy the economics of their investment. Portfolio investors fantasize that a stable Russia will help close the country's seemingly permanent asset valuation gap with other emerging markets. If investors perceive that there is less risk, assets will be priced more generously.

More broadly, most investors tend to think of stability in terms of the rule of law, the sanctity of contracts and the knowledge that the playing field will not be arbitrarily and summarily changed overnight.

By these measures, the Putin era thus far has not provided much stability. Whether there has been any modernization at all of institutions in Russia is debatable. A krysha is only as permanent as the principal players want it to be. A good example was when energy giant BP found that even Putin was a rickety krysha. Although Putin publicly blessed BP's grandiose deal with Rosneft in January, it fell apart several months later when a group of oligarchs claimed that they had exclusive rights to partner with BP in Russia.

The terrain is even rockier for smaller investors hoping that the Russian legal infrastructure will be a solid foundation for their efforts. Finally, if the asset valuation gap of Russian assets has not narrowed already, why would it now?

Nevertheless, Putin himself has suggested that his brand of stability is necessary to keep the wheels of Russian civilization from spinning right off. Two or three missteps would be enough to bring back the black misery of the Soviet era, and the even darker 1990s, the argument goes.

This does not exactly inspire confidence in the prospect of stability in Russia. Indeed, the sudden and abrupt departure of Putin from the scene usually tops the list of political risks facing Russia — one that could quickly upend the trumpeted facade of stability. Not even Putin has a krysha to protect himself from death by natural — or other — causes.

More broadly, the so-called power vertical vision of government, which entails the concentration of authority and control in the hands of Putin, is inherently unstable. Imagine a pyramid and then flip the pyramid upside down so that the block that was on top is now supporting the entire structure. What if that block suddenly crumbles?

The critical element that has been overlooked in Putin's version of stability is that it can only exist on the foundation of solid institutions — that is, diffuse and broad-based organizations, such as institutions of government that develop and implement policy, as well as nongovernmental institutions whose objective is to make sure that government does not overstep its bounds. In the end, stability flows from institutions, not individuals. The pinnacle of the pyramid should be at the top of the pyramid, not the foundation.

Of course, institutions have their own problems. Take, for example, the European Union. They are often run by fickle people who push and pull in different directions and who have myriad sub-agendas that sometimes subvert the good of the whole for the good of a few.

Institutions — from the U.S. Constitution to the Interior Ministry — constantly have to be reassessed, revamped and reformed to ensure that they continue to do what they are supposed to do.

But despite their flaws, institutions are a lot more stable than individuals — even clearly extraordinary individuals like Putin. Unfortunately, it looks like Putin 2.0 will entail Russia becoming all the more dependent on one person. As long as this remains the case, it will only undermine the country's long-term stability.

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