

February 21, 2024



Executive Summary Report

Despite the many conflicts throughout the world, the one that is most threatening to international order is the Ukraine-Russia War. This “ExSum” provides an overview of the important trends inside Ukraine and Russia as well as an update on the Western nations providing vital support to Ukraine.

Key Points:

- Big Picture:
 - Putin sees this conflict as a civilizational fight – Russia will not voluntarily relent and withdraw from Ukraine. At the same time, Ukraine sees itself as a future member of both the EU and NATO, and envisions its sovereignty restored along its 1991 borders without Russian occupation.
 - 2024 will be a contest to see who can reconstitute better, and although unlikely, who can achieve a military breakthrough or at least gain the upper hand going into 2025 and beyond? The outcome will set the European security architecture for the next 10 years, with international implications and lessons for scenarios such as China-Taiwan.
 - The U.S., EU, and NATO resolve and resourcing has enabled Ukraine to at least hold the territory it has regained and be in a better strategic position for future offensive operations or negotiations. However, after the 2024 myriad of world-wide elections, if political support from the U.S., European, and key Asian donors dry up, the pressure on Ukraine to negotiate will increase.
 - Key indicators to watch are the U.S. elections and its support to Ukraine, the new NATO Secretary-General, Russian mobilization, and Ukrainian weapons expenditure rates.
- Developments inside Ukraine:
 - Ukraine’s badly damaged industrial sector and infrastructure keeps it heavily reliant upon the West for sustaining the war effort.
 - The U.S. election year political debate has stalled U.S. funding, contributing to shortages of ammunition and equipment for the Ukrainians.
 - Political negotiations are unlikely due to geo-political trends (NATO/Europe strategy is for Ukraine not to lose versus doing enough to allow Ukraine to win) leading to more grinding attrition. This will get worse if support to Ukraine dwindles.
 - The war casualties incurred by Ukraine over two years of war will require it to revise its draft policies to draw on previously protected segments of its population, concurrent with revising its operational approach and tactics to mitigate unsustainable human loss.
- Developments inside Russia:
 - There is strong evidence the Russians have prepared for the long haul.
 - The Russian economy was the strongest in Europe in 2023 in terms of GDP, but it is challenged with high inflation and interest rates.
 - Russia has advantages in manpower, material, and defense industrial capacity that will increasingly put Ukraine on shaky ground. It improved its manpower problem by a host of measures short of national mobilization and with an additional call-up of reserves. Further, Russian defense industrial base improvements significantly increased production of armaments and ammunition.

Overview:

It can be argued that Ukraine has been more strategic than Russia. Russia committed the greatest strategic blunder of the war with the invasion in Feb 2022. While Russia has garnered support from China, India, Iran, and North Korea, Ukraine's President Zelensky has been "strategic" in his engagement at very senior levels of European, U.S., and some Asian governments – this has been key to the country surviving. Two years into this conflict, it is easy to forget that Ukraine was expected to lose this war in weeks. Yet, Ukraine hangs on. The outlook for Ukraine is not necessarily good, but it never has been.

Looking at the situation from another angle, a recent Foreign Affairs article posited that Ukraine has proved itself to be highly adaptable and innovative at the tactical level, while Russia has proven itself superior at strategic adaptation. This is a war of innovation and adaptation. The side that creates technical or tactical advantage will enjoy that advantage for some time until the opponent creates an effective counter. Further, the process of change, destructive evolution, and innovation must continue without respite. This has forced each side to constantly learn from each other, from their own respective operational approach, and to adapt accordingly as a matter of battlefield survival for Russia, and national survival for Ukraine.

Developments inside Ukraine:

Ukraine's offensive stalled and now Russia is on the attack and gaining some ground. Statistically, the amount of land that has recently returned to Russian control is less than 1% of the ground originally seized by Russia, so the change is not significant, yet at least. Ukraine has shifted from an offensive posture to a defensive posture as winter's grip has frozen the ground and once again allowed movement for a few more weeks until the spring thaw.

After much speculation, President Zelensky has changed out his military leadership team starting with the Commander in Chief of the Armed Forces, Lieutenant General (LTG) Zaluzhnyi. Some attributed Zelensky's hesitancy to the popularity of the general; the President has a 61% approval rating whereas General Zaluzhnyi has an 88% approval rating. The President and his military leaders were at odds over strategy and tactics moving into 2024, starting with various bloody battles over insignificant terrain. Further, LTG Zaluzhnyi released a strategy document in November of 2023 stating that the war had become a stalemate while the President was engaged with international leaders to increase support for Ukraine; it is unclear if this move by LTG Zaluzhnyi was a deliberate attempt to undercut the President or was simply a rookie error. His paper made some great points, but it was very poorly timed and added to the tension between the two leaders.

The limited availability of all types of ammunition has severely restricted the ability of Ukrainian forces to counter Russian artillery fires and reduce attacking Russian ground forces. Adding to the problem is the decreasing global availability of Soviet-era ammunition and weapons which generally are not available to Ukraine. Unfortunately, some components of munitions production are also in short supply globally. Given the dearth of long range, casualty-producing fires, Ukrainian forces have turned to armed first-person view drones to destroy vehicles and interdict attacking forces. This is a more precise method but consumes valuable drones that could be used to attack more lucrative targets.

While tactically helpful, it stretches the national drone production capacity at the same time China is restricting the export of key components to Ukraine.

Yet, some of Ukraine's long-range fires have had a significant impact, such as their attacks on the Russian Navy in the Black Sea. The Russian fleet had lost more than 25% of its capital fleet and been forced to relocate much of it away from Crimean ports. While not at pre-war levels, significant grain and other Ukrainian commerce has begun to flow through the Black Sea once again.

Further, beginning in December, Ukraine employed its long-range precision strike drones against strategic Russian facilities. It has effectively targeted Russia's ability to export energy and domestic weapons production capacity. This is a meaningful development but there have been too few successful strikes to date to judge any larger impact on the war. These attacks are possibly a message from Ukraine to reinforce a potential new operational approach in 2024.

Air defenses are being pressed by massed aerial attacks of increasing sophistication. Russian drones and long-range precision strike weapons are increasingly successful, owing to a change in tactics. By late 2022 and well into 2023, Ukraine was intercepting or shooting down around 90% of the drones and strike weapons shot at Ukraine. However, new Russian tactics are decreasing their success to 30-40%, which bodes ill for Ukraine. Interestingly, some of the new tactics that Russia is using are innovations Ukraine used earlier in the war, such as mixing drones with missiles. So, Russia is learning from Ukraine in this regard. Unfortunately, Russia can use these techniques in mass whereas Ukraine strikes are few and far between.

The Verkhovna Rada (Parliament) has failed to adequately meet the manpower needs of the security forces. As is the case in all the former Soviet republics, there is a demographic shortage of prime military aged men and women owing to extremely low birthrates during the post-independence period. Mobilization is very unpopular in Ukraine. It has sought to preserve the under-26 cohort for post-war population replenishment. However, they are now facing increasing pressure to mobilize the younger generation to beef up its ranks, increase available training time for forces, and provide a rotation of forces that have been in prolonged combat. Overall, available manpower is Ukraine's strategic vulnerability, given Russia's 4:1 population advantage.

Developments inside Russia

Russian defense industrial base (DIB) improvements are rendering effects with increased production of armaments and ammunition.

The Russian economy was the strongest in Europe in 2023, thanks to very strict domestic controls and management, and it looks to repeat this performance in 2024. Its GDP growth in 2023 was 3.0-3.6% according to the IMF and projected to be 2.6% in 2024. Russia prepared for the war sanctions by building up its reserves which it is using to pay for domestic programs and Defense expenditures. The defense budget was raised for 2024 and is expected to be 6% of GDP and 40% of the federal budget.

GDP is just one measure of an economy. Russia's increased GDP reflects the massive increase in defense spending. This certainly will help Russia to sustain the war effort, but its economy is fragile and far from structurally sound. Deficit spending remains high at Soviet Union levels, inflation remains in double digits, prime interest rates are currently at 16%, and labor shortages are present in most sectors (except for defense). Russia is reliant on Chinese trade. While helpful, China is also struggling economically, and it is far from a reliable economic safety net for Russia. Thus, Russia has its share of economic woes.

At the same time, Russia has secured ammunition from North Korea, Iran, Syria, and other pariah states. The increased supply of long-range strike weapons and artillery has made its presence known on the battlefield. The strike weapons have been used to devastating effects against Ukrainian civilian infrastructure and the power grid. International observers now estimate that Ukraine has lost 50% of its power grid. Foreign ammunition has restored Russia's dominance with artillery, returning to the 10:1 advantage it had in the early days of the war. Given that artillery is the predominant killer on the battlefield, this is an ominous development.

Russia's investment decisions are highlighting a change in its operational approach over the course of 2024; for example, Russia has an asymmetric advantage with long-range precision strike weapons. They have built large factories to build one-way attack drones which have now come into production and are being used on the battlefield. They concluded a contract to buy \$4.5B worth of attack drones from Iran which will be used to further Iranian weapons development and production, and undoubtedly show up in places like the Red Sea and Gaza. The \$4.5B figure represents up to 15,000 attack drones. This is on top of Russian Ministry of Trade's announcement stating it will devote \$11B to drone production, which is addition to what it already committed and built.

In all, Russia's significant advantage in overall production capacity relative to what the U.S., NATO, and EU are currently providing Ukraine is problematic for the war and beyond.

Russia has also improved its manpower problem by a host of measures short of national mobilization and with an additional call-up of reserves. Mobilization remains one of a few domestic issues that the population negatively responds to, thus, this has Putin's personal attention. Russia has increased incentives for joining the military and internal security forces which added to their ranks but fell well short of their requirements in Ukraine. It has allowed more prisoners to join, but on significantly less generous terms. Ukraine has also recruited foreigners from Africa and Asia. Ukraine reported that 15,000 Nepalese men are fighting for Russia in Ukraine, which is a staggering number, if true. Foreign recruits are enticed by large salaries and the promise of a Russian passport, both of which represent a ticket out of their forlorn situations at home. Using prisoners and foreigners is very popular domestically because it keeps the elites and White Russians from having to fight this war—a key point ahead of the March 2024 Russian elections.

Developments inside NATO and the European Union

NATO recently cemented its plans for assistance programs under the NATO – Ukraine Council (NUC). These plans are pending approval and funding from the NAC. Regardless, they will pursue nonlethal aid programs that will posture Ukraine for achieving NATO interoperability in the mid-future. To be clear, NATO is not providing lethal support – NATO nations are doing this as part of the U.S. effort led by Defense Secretary Austin.

Industrial-age warfare has returned to the European landmass, and the nations are playing catchup. It is unclear if the steps European nations are taking are adequate to catch up with the progress Russia made. This will bear watching over the coming year. The European DIB has received new funding to catch up with the urgent needs of combat. The Europeans have seen that they are woefully underprepared for a protracted conflict involving raw industrial capacity in terms of munitions expended and armor losses regenerated, but are they doing enough?

Although the G7 nations continue to pledge their support and Ukraine has reached bi-lateral security agreements with the UK, Germany, and France, war weariness has appeared and undercut national support in some instances. At least two nations (Hungary and Slovakia) have publicly proclaimed that they will no longer provide materiel support to Ukraine. In at least one of those cases, there was nothing left in storage or the bunkers to provide, so domestic political points were scored rather having to embarrassingly admit they do not have anything left to give. Regardless, the nearly continent-wide solidarity with Ukraine over the previous two years has suffered some fracturing.

That said, there are 60+ nations supporting Ukraine, including some of the richest nations in the world, such as the UK, Germany, France, U.S., Japan, South Korea, Poland, and Italy. Solidarity has had to be managed since the beginning. Recall that in the beginning, many nations did not believe the invasion would occur and refused to discuss support for Ukraine. Of late, the EU agreed to provide Ukraine \$54B in economic assistance to sustain government salaries and basic services, so support continues, but maintaining solidary will be a continuing challenge.

Developments inside the United States

Similarly, the American DIB is challenged to meet the needs of industrial-age consumption. Advanced weapons such as Javelin, HIMARS and Patriot missiles are consumed in quantities. In some cases, the U.S. has significantly increased armament production, but in other areas, the U.S. has low production rates. Artillery round production capacity is also limited and insufficient to maintain U.S. war reserve stocks while supplying munitions to both Ukraine and Israel. This is but one aspect of the state of the national DIB. Shipbuilding, tank, and aircraft manufacturing are all lagging potential wartime consumption rates. If the U.S. does nothing, it will not be prepared for a major land war in the next few years. Like Europe, it is unclear if the steps the U.S. is taking with its armaments and munitions will be adequate to catch up to the changes Russia has made.

Congress has partially addressed the problems with munitions during 2022 and 2023 with funding programs for improving production rates of high-demand items. Strategically important was the passage of the CHIPS Act that onshore the manufacture of sophisticated microchips from Taiwan; this is a start.

The prolonged political debate, this being an election year, has stalled all direct U.S. assistance to Ukraine. The longer this goes on, the greater the negative impact on Ukraine will be. Funding for Ukraine assistance is part of a broader domestic U.S. political debate that includes southern border security, support for Ukraine, support for Israel, and support for Taiwan. These are difficult, emotional, and highly charged topics in an election year, and progress is slow. While the Senate has passed a bill to fund the aid for the rest of the fiscal year, the House has not agreed upon a bill. The Senate's \$60B is broken out for multiple purposes, to include DIB improvements, with \$13.8B for Ukraine to purchase U.S. weaponry. However, aid for Ukraine, Israel, and Taiwan faces a difficult hurdle given the domestic politics interdicting rapid and comprehensive funding for the nations. The longer it takes to approve funding for Ukraine assistance, the greater the risk of Ukraine setbacks on the battlefield.

This information is being provided for information purposes only and should not be construed as an offer to sell or a solicitation of an offer to buy any securities. Nothing in the material should be interpreted as investment, tax, legal, accounting, regulatory or other advice or as creating a fiduciary relationship. Product names, company names and logos mentioned herein are trademarks or registered trademarks of their respective owners.

Unless otherwise specifically stated, any views or opinions expressed herein are solely those of the author and/or the specific area from which it originates and may differ from the views or opinions expressed by other areas or employees of Bancroft Capital, LLC. The information described herein is taken from sources which are believed to be reliable, but the accuracy and completeness of such information is not guaranteed by us.

Bancroft Capital, LLC is a member of FINRA and SIPC.