

THE POLITICAL AND ECONOMIC RESULTS OF AUGUST 2013

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In August, Victor Ishaev was dismissed from his post as Russia's Minister for the Development of the Far East – his extravagantly costly approaches to solving the region's problems without having made even a feeble attempt at setting any priorities, had finally infuriated both the RF Government and President Putin. The Ministry for the Development of the Far East had been subject to strong criticism on a number of issues, and the latest flooding in the Russian Far East was apparently the last straw. Russia became embroiled in an acute conflict with Belarus, a country heavily subsidized from the RF budget. The crisis in relations between the two countries was sparked by Belarus' having initiated repressions against Russian businesses – apparently in hope of blackmailing Russia into further increasing her aid to Minsk. Belarus's trump card in this latest gamble is the Russian political leadership's reluctance to risk their electoral prospects by admitting the de-facto disintegration of the Union State of Belarus and Russia. Russia made energetic attempts at preventing the conclusion of a free trade agreement between Ukraine and the EU – the Kremlin made it clear that such an agreement was incompatible with the principles of the Customs Union. In the 'far-abroad', Russia was gradually improving her international standing and prestige against the backdrop of the ongoing crisis in the Middle East, by her insistence that any use of force on the part of external players could lead to unpredictable and dire consequences. Russia's position on that matter was (and is) shared not only by some Arab countries, but also by a number of NATO's member states. Yet another benefit brought to Russia by the current aggravation of the situation around Syria is the growth of prices for energy carriers and the corresponding rise in the revenues of Russia's budget.

In August 2013, Russia's domestic political scene was relatively staid and uneventful. However, it was a month of vigorous activity in the field of her foreign policy. As regards domestic events in Russia, the most important one was severe flooding along the Amur and its subsidiaries, which hard-hit Khabarovsk Krai, as well as Amur and Jewish autonomous oblasts. The scope and intensity of these floods made them the region's worst natural disaster in living memory. The inundated area had a population of more than 30 thousand, almost 1 thousand houses were damaged by water beyond repair. Unlike last year's catastrophic floods in Krasnodar Krai that had claimed numerous lives, those in the Far East did not result in any loss of life because of the excellent work of weather forecasters who had issued timely warnings to the population about the imminent deluge, coupled with the efficient efforts of the local authorities who had managed to evacuate people from the most endangered areas. Vladimir Putin signed an executive order on flood-relief measures in the Far East. The document envisaged that the flood victims who had lost essential personal property (including motor cars) should be compensated in the amount of Rb 100,000, while all flood victims should get Rb 10,000 each; capital repairs of water damaged dwellings should be compensated for in the amount of Rb 5,000 per square meter of floor area; the residents of dwellings damaged beyond repair should be granted new dwellings free of charge.

The relevant regional budgets should receive subsidies from the federal center, designed to compensate them for the damage inflicted on agriculture. The executive order envisaged that, in order to minimize the impact of future flooding (floods, although on a smaller scale than the recent ones, occur on a regular basis in the Far East), a number of special measures designed to ban dwelling construction in endangered areas should be developed. Apparently, such a ban should be imposed on the construction of houses close to the banks of dangerous rivers, unprotected against flooding. As unprotected river banks are typical of rural areas, it is evident that it is in those areas that the ban will be predominantly applied.

Yet another casualty of the floods was Victor Ishaev, Minister for the Development of the Far East and Presidential Plenipotentiary Envoy to the Far Eastern Federal District – this natural disaster was used as a pretext for his dismissal. Once a successful governor of Khabarovsk Krai, he had failed to take root in the new environment. His ministry inundated other agencies with extremely costly proposals worth almost 4 trillion rubles without identifying any priorities. Even some projects repudiated in Soviet times on account of their superfluity, such as the idea of a bridge to Sakhalin or the project of radically increasing the capacity of the BAM railway (in spite of the fact that it currently works at less than half of its potential capacity), had been taken out of mothballs. Accordingly, the

more modest proposals designed to stimulate a number of large projects initiated by private businesses, put forth by the economic bloc of the RF Government, had been ignored by the Ministry. The Ministry had already been subject to criticism on a wide range of issues, and the latest flooding in the Russian Far East apparently became the last straw. So far, nobody has been appointed the new Minister for the Development of the Far East, while the former Minister for Natural Resources, Yuri Trutnev, has been appointed Deputy Prime Minister and Presidential Plenipotentiary Envoy to the Far Eastern Federal District. When heading a ministry vested with the conflict-prone task of issuing licenses for the extraction of natural resources, including hydrocarbons, Trutnev had always managed to find ways to placate various pressure groups. The only chink in Trutnev's armor is that, until now, the Far East has been veritable *terra incognita* to him, which makes it doubtful whether he will actually be able to achieve any successes in his new job.

In August, the Russian authorities acknowledged that federal budget expenditures should be reduced. (However, the situation is by no means tragic: instead of the planned deficit in the first half-year 2013, the federal budget was executed with a small surplus). Statements to that effect were made by Prime Minister Dmitry Medvedev, and later on by President Vladimir Putin. According to Putin, the culprit was the global economic crisis, which had negatively influenced the Russian economy's growth rate, thus frustrating the optimistic expectations on which Russia's budget had been based. Putin even spoke against further increasing state social liabilities, noting that such a policy '*would be dishonest with regard to people who have already been promised some assistance from the State*'. At the same time, the RF Ministry of Finance stated that, according to its estimates, the revenue decline of the Russian budget in 2014–2016 would amount to 1.6 trillion rubles. Everything that has been said is true. After all these statements, only one question remains unanswered: which budget items will be subject to economization? So far, government officials have been hinting that the target for belt-tightening will be social policy (although it is clear that the monies granted to needy people remain in the country and stimulate domestic demand; this, however, cannot be said of the giant purchases being made abroad by some state-owned companies, such as *Russian Railways* (RZhD). Apparently, the State can also economize on defense expenditures, especially bearing in mind that the state defense order has long been only partly implemented because industry does not have capacity to cope with it in full. Nevertheless, it is planned that, in the next few years, Russia's defense expendi-

tures will increase by 40%. Even if some social expenditures can be painlessly reduced – at the expense of numerous 'persons enjoying privileges' (who account for one-third of pensioners) – first of all, military officers who, for some mysterious reasons, are entitled to a state pension at the age of 45. Such pension benefits cannot be rationally explained, because they are allotted not to disabled persons or even former combatants, but to ordinary healthy men. Unfortunately, Vladimir Putin had failed to specify what exactly will be economized on.

In August, Russia was confronted with problems both in the near- and far-abroad. There was a sharp rise in tensions in the Middle East. After the ouster of President Mohammed Mursi, Egypt found itself on the verge of civil war. Syria saw a large-scale use of chemical weapons resulting in a huge loss of life, with government and rebel forces blaming each other for the atrocity. The United States began to discuss the best ways of interfering in the Syrian conflict on the side of Assad's opponents. More resolute than the Americans, Turkey and Saudi Arabia expressed their readiness to launch a major military operation with boots on the ground. If hostilities break up, Syria is likely to be supported by Shia-dominated Iran and Iraq, as well as by the Shiite community in Lebanon. On the other hand, both the Sunni world and NATO lack unity – voices calling for restoring order in Syria through toppling Assad and establishing a provisional government dependent on external sponsors are counterbalanced by warnings that most Syrian rebels are radical Islamists, whose coming to power will lead to dire consequences. So far, Russia has been pursuing a deliberate policy emphasizing the necessity of peace negotiations, etc. In fact, such an approach implies that the conflict should continue at its current intensity, where neither side can win militarily. From an economic point of view, the conflict's continuation is clearly advantageous to Russia: over the course of just one month, oil prices have risen by 10%. It should also be mentioned that Iran has announced its readiness to drop its breach-of-contract lawsuit for \$ 3bn filed against Russia over her refusal to supply Teheran with S-300 anti-aircraft missile systems (Moscow had decided not to fulfill that missile deal after the UN Security had imposed economic sanctions on Iran).

August saw a significant deterioration in Russia's relations with Belarus and Ukraine. The reasons behind the two tiffs were quite different. Let us begin with the quarrel with Belarus. In Minsk, there was a scandalous arrest of *Uralkali* Director General Vladislav Baumgartner who had been invited for negotiations with the Belarus Prime Minister. Once the negotiations were over, he was handcuffed and detained. The

essence of Baumgartner's 'sins' causing his detention is as follows. At the end of July, *Uralkali* discontinued its cooperation with *Belaruskali*, a state-owned Belarusian enterprise which had been running a joint trading venture with *Uralkali* since 2005. That joint venture had been a *de-facto* price cartel controlling between 35 and 40% of the highly monopolized potash market. For the time being, that arrangement had been advantageous for both parties. In its turn, the privileged position of *Belaruskali* had had its roots in Alexander Lukashenko's earlier decision that *Belaruskali* should be permitted to trade in potash – thus bypassing the official joint trader, Belarusian Potash Company (in violation of his own previous guarantees). But that potash spat was not the only reason for Baumgartner's arrest. In the autumn, Belarus will receive the final tranche of a huge loan from the EurAsEC anti-crisis fund (in fact, from Russia). Having taken a hostage, Belarus is now asking for a new loan. Quite a daring tactic, bearing in mind that, in 2013, the price of Russian natural gas for Belarus amounted to \$ 189 per 1,000 cubic meters (that is, two times less than the average European price for natural gas). It should also be remembered that Russia does not levy export duties on its oil and petroleum products supplied to Belarus (if Russia had levied such duties, it would have received an additional \$ 4.6bn for its 2012 exports to Belarus). Moreover, nearly half of these Belarusian imports are not consumed domestically but re-exported as 'diluters' and 'solvents'. So far, Russia has trimmed oil supplies to Belarus under the pretext of pipeline repairs and threatened to begin control checks of Belarusian agricultural products. It should be added, however, that Lukashenko has a very dangerous weapon of last resort – that is, dangerous not to Russia as such, but personally to Vladimir Putin. Any official admission of the fact that Russia's policy towards Minsk, which can be characterized as an incessant succession of subsidies provided against the background of empty talk about the 'Union State', has abjectly collapsed, will certainly shock part of the Russian electorate, because the 'Union State' is an integral component of the official mythology. Lukashenko understands this perfectly – and behaves accordingly. The most likely resolution of the current

crisis in Russo-Belarusian relations will be the release of the hostage and a return to the lamentable tactic of subsidizing Belarus.

Russia's relations with Ukraine have deteriorated for entirely different reasons. It is planned that, in November, the EU and Ukraine will sign a comprehensive free-trade agreement. According to this agreement, almost 95% of goods traded between the two parties will be subject to zero customs duties. The share of Ukraine's exports of goods to the EU is approximately the same as that of her exports of goods to Russia – that is, between 25 and 30%. However, trading with the EU is more profitable for Ukraine in money terms. Moreover, it is clear that, after the signing of the agreement, Ukraine's exports of goods to the EU will increase. Russian authorities have explained to their Ukrainian counterparts that the existence of this trade regime will make it impossible for Ukraine to join the Customs Union (Ukrainian authorities had proposed the creation of a special trade regime which would have meant, for Russia, the emergence of a new customs 'black hole' in the form of re-imports of goods from Ukrainian territory) and, for some mysterious reasons, created enormous freight traffic jams at Russia-Ukraine border crossings by introducing laborious extra customs checks on all imports from Ukraine. Simultaneously, Russia imposed a ban on imports from the major Ukrainian candy maker *Roshen*, owned by the Ukrainian politician Petro Poroshenko. Sergei Glaziev, an advisor to President Putin, announced that Russia is still interested in Ukraine's accession to the Customs Union, and promised her extremely generous preferential treatment, including a considerable reduction in the price of natural gas, '*making it almost as low as the price set for Belarusians, which means a two-fold or even three-fold drop in price*'. According to Glaziev, Ukraine's accession to the Customs Union will also result in Russia's abolishing export duties on its oil and petrol products supplied to Ukraine. We can only hope that Ukraine rejects this invitation, because otherwise Russia may be faced with the risk of obtaining a 'second Belarus' – that is, a country that will be absolutely sure that it can get anything in return for bombastic declarations about eternal friendship between the Slavic peoples. ●