

POLITICAL AND ECONOMIC RESULTS OF SEPTEMBER 2014

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In September 2014, the RF Government approved a draft budget for 2015. In so doing it rejected the idea of increasing taxes and found an intermediate solution for the preservation of the funded component of labor pension without, however, making a final decision as to its future. On the other hand, the approved draft budget is based on a rather optimistic forecast of oil prices – a scenario that can put its actual implementation at risk if oil prices should continue on their downward trend. The current situation implies that inflation and devaluation risks remain high. In September 2014, Russia had her single voting day which went smoothly and brought neither excitement nor surprises. The voter turnout was low, with only one third of registered voters coming to the polling stations (vs. two thirds at the last federal elections). In spite of this lackluster voter activity, United Russia increased its dominance in local elections. September 2014 saw the billionaire businessman Vladimir Evtushenkov placed under house arrest. This development has created a very alarming precedent for big investors, especially bearing in mind the fact that his reputedly money-laundering transactions were carried out by him quite recently – and with the Russian authorities' knowledge. As regards the situation in Ukraine, there was a relative lull in hostilities, which gives rise to hopes that the conflict may indeed be de-escalated on the basis of the status-quo.

Having been extremely volatile for many months in a row, the situation in Ukraine displayed some signs of relative stabilization. Also, September 2014 saw a number of important events in Russia, including the local elections in the course of the single voting day on 14 September; the approval, by the Russian Government, of a tensely discussed draft budget for 2015; and the emergence of the 'Bashneft Case', apparently signifying the beginning of yet another round of major redistribution of property in Russia.

The beginning of the month was marked by the signing, at Minsk, of an agreement on a new truce deal in Ukraine. The agreement concluded on 5 September was signed by a rather peculiar batch of parties, which included Russia's ambassador to Ukraine, Mikhail Zurabov; Ukraine's former President, Leonid Kuchma; the OSCE's representative Heidi Tagliavini; and two representatives of the self-proclaimed Donetsk and Luhansk People's Republics. The essence of that agreement was very close to that of the proposals put forth by the European Commission in late August and to the proposals backed by Vladimir Putin in early September. The afore-said proposals stipulated a ceasefire; the withdrawal of heavy weaponry from a proposed 30-km buffer zone; a POW's exchange; an amnesty; a 'special status' for the territory in question (including that territory's right to keep 'people's militia units' and to carry out, by the end of 2014, some unspecified 'local elections'). The formulation of the latter three clauses was left intentionally vague, making it possible for the parties to pretend that it reflected their own position and not that of their opponents. The territory in question was not specified either. In fact, in accordance with the agreement and the subsequent pro-

ocols, as well as the draft laws passed by the Ukrainian Parliament (Verkhovna Rada), the aforesaid 'special status' is not to be applied to the entire territory of the Donetsk and Luhansk regions, but only to the areas currently being controlled by the self-proclaimed 'republics'. It should be added, however, that at the present time these areas lack any strictly defined boundaries. The intensity of armed hostilities in eastern Ukraine has considerably decreased, although sporadic exchanges of fire are still continuing in a number of places. In fact, the lull in fighting has been observed since the beginning of September. Also, September 2014 saw significant relative progress in the negotiations designed to resolve the long-running natural gas dispute between Russia and Ukraine. It should be reminded that Russia's supplies of natural gas to Ukraine have been stopped since June (apart from transit deliveries) due to disagreements over pricing and because of Ukraine's existing debt for already delivered natural gas (although Ukraine has always admitted being in debt, she has been insisting on her right to redeem that debt only after a final agreement has been signed; therefore the size of Ukrainian debt was hotly disputed, and it was not clear what price should be considered binding as of the end of Q1 2014). Hearings on the natural gas dispute began at the Stockholm arbitration court. The arbitration proceedings may take years before a resolution is finally reached; meanwhile, the situation with natural gas supplies to Ukraine and natural gas transit to Europe looks increasingly menacing for all the parties involved, bearing in mind the approaching winter. At present, the essence of the future agreement (which has not been concluded as yet) seems to be as follows: Ukraine should repay part of her debt, and thereafter, during the win-

ter period, the ‘temporary’ price for natural gas deliveries will be set at around \$ 370 per 1,000 cubic meters (which would roughly correspond to the price demanded by Russia in the summer of 2014). If the agreement on natural gas prices is finally reached on this basis, it will signify a major step towards settlement of the current conflict situation. Meanwhile, on the eve of the agreement on the truce deal in eastern Ukraine, the USA and the European Union introduced new sanctions against Russia. The list of Russian companies whose bonds with maturities over 30 days had been prohibited from purchasing and selling was further extended to include *UralVagonZavod*, *United Aircraft Corporation* (UAC) and *Oboronprom*, and more Russian companies (*Rosneft*, *Transneft* and *Gazpromneft*) were banned from buying equipment for deep sea and shale oil and gas extraction. The USA tightened to 30 days the already existing 90-day lending bans affecting *Sberbank*, *Bank of Moscow*, *Gazprombank*, *Rosselkozbank*, *Bank for Development and Foreign Economic Affairs* (*Vnehekonombank*), *VTB Bank*, and the state corporation *Rostekhnologii*, and imposed 90-day lending bans on *Gazprom* and *Transneft*. Also, the USA barred US companies from supplying any equipment, technology and services for deepwater, offshore or shale projects to practically all big Russian companies (including *Gazprom*, *LUKOIL* and *Surgutneftegaz* that did not come under European sanctions). It was announced that those sanctions could be reversed by both the EU and the USA in the event of a peaceful settlement of the current crisis in eastern Ukraine. It is unlikely, however, that the EU will make a rapid decision on this matter on 30 September, the date when this issue will be considered by the EU member states, bearing in mind that due to a lack of consensus it took the EU almost three weeks to come to an agreement, in August, on the imposition of new sanctions against Russia. In response, Russia’s former Minister of Economic Development Andrey Belousov said that Russia was ready to ban exports of cheap motor cars and clothes. However, no practical steps have yet been taken in that direction – probably, due to a number of concerns, including their apparent unpopularity among the Russian population.

In September, both the Russian Opposition and Vladimir Putin’s supporters (*United Russia* and the other three parliamentary parties) held massive rallies. The rally of the Opposition was held in Moscow on 21 September under the slogan ‘Toward Peace, Away from War’ (which implied that peace was violated by Russia’s authorities), while the rally organized by the Putinists on 27 September was devoted to the memory of the victims of war (implying that the culprits were Ukraine’s authorities). According to different sources, the rallies numbered between 10 and 40 thousand participants each, and were thus comparable in numerical

strength. It is noteworthy that since the beginning of the current Ukrainian crisis in March the noisy non-United Russia supporters of the self-proclaimed republics have so far failed to organize even a single massive-scale rally in their support and, willy-nilly, have been expressing their views mostly on the Internet.

In September 2014, Russia held its scheduled single day of voting. This electoral event was interesting for a number of reasons: firstly, apart from several early elections it was the first major series of local elections since the beginning of the Russo-Ukrainian conflict, and secondly, it was held after the introduction of major changes to Russia’s electoral legislation carried out in the spring of 2014. The said alterations in legislation deprived newly established political parties of the right to nominate candidates without voter signature collection, increased six-fold the number of signatures required for a candidate to be registered, and restored voting by absentee ballot¹. Except for Moscow, all local elections were held on the basis of party lists. In Moscow, the city known to have developed the most advanced multi-party system in Russia, elections based on political party lists were, on the contrary, cancelled – in order to prevent *United Russia*’s poor showing (because voting under a majority electoral system does not need to produce spectacular results, and a simple majority suffices for victory in elections). The very list of the 13 regions where local elections were held in September 2014 was something out of the ordinary, because it included the Crimea, Sevastopol and 6 ‘national republics’, 5 of which traditionally belonged to the so-called ‘anomalous electoral areas’ (Tatarstan, Kabardino-Balkaria, Tyva, and Mari El). In most cases, the voter turnout was considerably lower than at the previous federal elections. However, the low voter turnout was no surprise, being the reflection of a long-established general trend when the voter turnout at a federal election usually amounts to two-thirds of the electorate, and that at a regional election – to just one third of the number of citizens entitled to cast their votes. *United Russia*’s results in the ‘anomalous electoral areas’ approximately matched its results at the recent parliamentary elections, although in some of these regions the voter support for that party slightly dwindled². Due to the almost 30% voting by absen-

1 The major drawback of such voting is the impossibility to reliably trace, once the voting is over, the whereabouts of the sealed envelope with the absentee ballot inside. The only thing that can be positively verified will be the number of absentee voters who took part in the voting.

2 This phenomenon can be easily explained: the small clannish regions and societies like Kabardino-Balkaria and Tyva can get a chance of being represented in the State Duma only by maximizing the results of *United Russia*, because even 20 or 30% of the vote cast for an opposition party will not enable its regional branch to

tee ballot, *United Russia's* electoral result in Bryansk Oblast rose sky-high, to 71% of the vote, while in Tula Oblast, Volgograd Oblast, Khabarovsk Krai, the Nenets Autonomous District and the Altai Republic its results amounted to 66%, 60%, 57%, 45% and 44% respectively. On the whole, the voter support for *United Russia* increased by 10 to 20%, although in the Altai Republic it dropped by comparison with the 2011 elections to the State Duma, which can be attributed to the very active gubernatorial election campaigns conducted by the opposition candidates permitted to run for Governor, Vladimir Petrov and Viktor Romashkin. As a result, the acting Governor, Aleksandr Bernikov (*United Russia*), managed to win in the first round only by the skin of his teeth. The city council elections held in a number of oblast capitals brought *United Russia* less than 50% of the vote (with the exception of Vladikavkaz and Bryansk); its lowest results were registered in Blagoveshchensk (40%) and Bratsk (43%). In the Crimea, *United Russia* gained 70% of the vote, while in Sevastopol that party won a landslide victory by capturing 77% of total votes cast. In Moscow, *United Russia* gained more than 50% of the vote only in 10 out of the existing 45 single-member electoral districts, while in the rest of them its results were much more modest, between 25% and 40%. *United Russia* abstained from nominating its own candidates in 6 Moscow electoral districts and pledged its support to those put forth by the CPRF, *Yabloko*, *Civic Platform*, *A Fair Russia*, the LDPR, and the *Fatherland* party. In fact, this simply meant that in those Moscow electoral districts the official candidates did not use the '*United Russia*' brand. However, *Yabloko*, *Civic Platform* and *A Fair Russia* were outperformed in their 'allotted' districts by the CPRF, while in one of the other electoral districts *United Russia's* candidate, Vladimir Zotov, the prefect of Moscow's Southeastern Administrative District, was unexpectedly defeated by Andrei Klychkov, a CPRF member of the Moscow City Duma. With the voter turnout in Moscow hitting its record low of 21%, only one political party apart from *United Russia* managed to score relatively impressive results. That party was the CPRF, whose core voters in Moscow have always been more numerous than those of its political rivals. *Yabloko's* electoral results in Moscow are noteworthy enough to be mentioned separately: although *Yabloko* had decided that no well-known opposition politicians should stand for election, its candidates gained 12% of the vote on the average, while the most active *Yabloko*

gain seats in the federal parliament – simply because in absolute terms the number of such votes will be too small. On the other hand, at the regional elections the local elite can split into several formal 'political parties', and then distribute the seats in accordance with the party-list system.

candidates managed to bag up to 20% (or sometimes even 30%) of votes cast. It should be noted that although the elections in Moscow were rather transparent, the low voter turnout resulted from most of the opposition candidates being barred from registration. All opposition candidates (apart from those from the four parliamentary parties and *Yabloko*) were forced to collect signatures, and only two of them were finally registered. The same 'pre-election censorship' became an inevitable prelude to almost all gubernatorial elections where any more or less strong opposition candidates were barred from standing for election (apart from that in the Altai Republic). The most scandalous situation was observed in St. Petersburg, where Oksana Dmitrieva, *A Fair Russia's* candidate enjoying wide popular support (she headed that party's list and gathered 23% of votes), was refused registration (readily granted to several absolutely obscure candidates). Equally orchestrated were the elections themselves: although the officially announced voter turnout amounted to 40% of the registered electorate, voting by absentee ballot accounted for one quarter of the vote, which could be explained only by voter coercion on a massive scale.

As far as the results of the September 2014 regional elections are concerned, the following observations are to hand: the voter turnout was very low (one-third vs. two-thirds at the last federal elections); as a rule, when voting was held under the party list system, the percentage of votes cast for *United Russia* increased by 10 to 20%, although in some places that party's gains were less impressive. However, these results cannot be expected to be duplicated at the next parliamentary elections: when the voter turnout is low, the proportion of people forced to vote by absentee ballot is inevitably much greater than it would have been in a situation of a high voter turnout. Moreover, in those places where the electoral situation was especially unfavorable for the authorities (Moscow), voting under the party list system was cancelled, and the results of voting in single-member electoral districts cannot be easily projected to one or other party (although it can be averaged at around 35%). Thus, the fundamental changes in the electoral landscape predicted by many political observers since the beginning of the Russo-Ukrainian conflict have so far failed to materialize.

Although slightly more modest than previously, the CPRF's results remained habitually impressive. The Communist Party passed the electoral threshold everywhere except in Tyva, the Crimea and Sevastopol. The LDPR also managed to pass the electoral threshold everywhere apart from Tatarstan and Tyva. Unlike those two parties, *A Fair Russia* fared badly: it managed to overcome the electoral threshold only in Kabardino-

Balkaria and Karachaevo-Cherkessia, and got a ‘consolation prize’ only in Tyva, where it had gathered less than 5% of the vote but was granted a number of seats in the local legislative assembly in accordance with the law which requires that proportional distribution of seats should involve at least two political parties. As *A Fair Russia* lacks any electoral core (it should be mentioned that at the latest presidential election Sergei Mironov received three times less votes than his party had gained at the parliamentary elections, which means that *A Fair Russia* represents a coalition of regional politicians and businessmen, and not a leader-centric project like the LDPR), it suffered an especially strong setback due to its tendency to act in alliance with *United Russia* – bearing in mind that most of the people voting for *A Fair Russia* are opponents of the existing regime. If *A Fair Russia* continues this policy of pandering to the party in power, its expectations to be represented in the next Parliament will be put at risk. The results of the non-parliamentary political parties were extremely modest. Despite its vigorous and well-funded campaigning centered on Ukraine and the Crimea, the *Fatherland* party, which is close to Deputy Prime Minister Dmitry Rogozin, was defeated everywhere except for the tiny Nenets Autonomous Okrug. Mikhail Prokhorov’s *Civic Platform* took part in only one regional election in Bryansk Oblast, where it received less than 1% of the vote. In spite of the total lack of support from Moscow, and owing to local initiative alone, the introduction of the party-list system made it possible for *Civic Platform* to gain a number of seats in the city councils of Elista and Murmansk. The decision of Mikhail and Irina Prokhorov not to stand for election to the Moscow City Duma, as well as Mikhail Prokhorov’s equally poor motivated decision not to stand in the Moscow mayoral election of 2013, have made doubtful whether *Civic Platform* could actually survive for long. The other non-parliamentary political parties that managed to pass the electoral threshold were Aleksandr Reviakin’s *Civil Force* (in the Nenets Autonomous Okrug), Gennady Semigin’s *Patriots of Russia* (in the Altai Republic and Karachaevo-Cherkessia), and Anatoly Panfilov’s *Green Party* (in Kabardino-Balkaria). We believe that, in spite of their relative success, no definite conclusion can be presently drawn as to their political prospects.

Yet another noteworthy political event of September 2014 was the adoption, by Russia’s Parliament, of a law stipulating that, from 2017 onwards, foreign investors should be barred from owning more than a 20% stake in Russian media outlets, including not only TV channels (similar restrictions concerning them exist in many developed countries), but also print media outlets (an absolutely unprecedented move). Apparently, the target of the new law would be such independent media

outlets as the newspaper *Vedomosti* (The News) and the Forbes magazine, as well as numerous non-political TV channels like *CTC* and *Discovery*. Although the 20% limit for foreign ownership could, theoretically, be circumvented (for example, by way of nominal ownership), this may create a lot of risks and would certainly stimulate the adoption of further specific amendments to the law designed to reduce the number of Russia’s media outlets.

In late September 2014, one of Russia’s richest entrepreneurs, Vladimir Evtushenkov, was charged with money-laundering and placed under house arrest in connection with his purchase, in 2006–2009, of the oil company *Bashneft*. Simultaneously, Russia’s investigative authorities filed a lawsuit to nationalize the controlling block of shares in *Bashneft* currently owned by *AFK Sistema* – that is, by Evtushenkov and his junior partners. At the same time, an international arrest warrant was issued against the seller of *Bashneft*, Ural Rakhimov. So, a decade after the initiation of criminal proceedings against Yukos (it is noteworthy that Mikhail Khodarkovsky was not arrested immediately at that point, but half a year later), the Russian business community was again shaken by a major scandal. In this connection, it is necessary to recall the history of *Bashneft*, which is as follows. The controlling block of shares in that company was rather exotically privatized (for peanuts) in 2002–2003 by the then President of Bashkortostan, Murtaza Rakhimov, in favor of several charity foundations linked to his son, Ural. Although *Bashneft*’s privatization clearly displeased the federal authorities, they decided to turn a blind eye to this dubious transaction in order not to antagonize Rakhimov, who was needed by them in order to maintain electoral control over Bashkortostan during the 2003/2004 parliamentary and presidential elections. As a result, the *Bashneft* privatization saga ended with a compromise: Murtaza Rakhimov resigned as President of Bashkortostan, while the controlling block of shares was transferred to a Russian charity foundation named *Ural*, and then bought from it for \$ 2.5bn by Vladimir Evtushenkov. The money received by the *Ural* foundation has been spent on financing Bashkortostan’s sport clubs and charities. All criminal and judicial proceedings initiated in 2002 in connection with *Bashneft*’s privatization were cancelled. It cannot be affirmed that the Rakhimovs did not profit from that transaction, but the case in point is quite different – Vladimir Evtushenkov bought *Bashneft* with full consent of Russia’s current authorities, who could have easily blocked the deal if they had wanted to do so. Evtushenkov has always been interested in purely business matters, and has never been engaged in any political activities. Moreover, soon after *Bashneft* was

purchased by him, the Russian government granted it the license for the *Trebs* and *Titov* oil fields in the Nenets Autonomous Okrug at the 2010 oil-field auction, ignoring all the other competitors (including state-owned *Gazprom*), who were prepared to pay for the license at the basic price (Rb 18bn). This fact alone suffices to refute any claims that Evtushenkov seized the oil-fields in question like a pirate, clandestinely and illegally. *Bashneft's* problems began in 2012, when Igor Sechin was appointed head of *Rosneft*. At that moment the former deputy prime minister, whose duty it was to reconcile the interests of various companies, became an operator of one of them. In the summer of 2013, *Rosneft* announced that it was interested in acquiring *Bashneft*, but apparently did not manage to offer Evtushenkov mutually agreeable terms (unlike in the TNK-BP case) because of the challenges it faced in connection with the need to refinance its huge debts and the decline in its oil production which began in 2014 (while *Bashneft* was demonstrating a steady growth in output). And it now transpires that *Rosneft* has found a solution to its problems in re-nationalizing *Bashneft* – in total disregard of the fact that the transactions expected to be revoked date back to antediluvian times (being concluded in 2002 and 2003). Nationalization of that company seems to be more cost-effective than the initiation of bankruptcy proceedings against it, which proved to be a very costly undertaking in the course of the absorption of *Yukos* by *Rosneft*, when a lot of money had to be paid for the seized asset – even though that money was transferred to the state budget. Thus it turns out that one large market participant can impudently launch a successful attack against another market participant who has been absolutely blameless from a political, fiscal or any other point of view, which means that any previous agreements with Russia's current authorities and the guarantees received from them are not worth the paper they are written on. It should be noted that the previous major cases of property redistribution, including the 'Yukos affair', the semi-compulsory buyouts of *Avtovaz*, *VSMPO-AVISMA*, *Sakhalin-2*, etc. involved assets that had been acquired under the previous, not current, authorities. A number of prominent officials and entrepreneurs have already voiced their protest against the 'Bashneft case', pointing to the harm it would inflict on Russia's already weakened investment climate. However, Russia's top leaders have so far remained silent with regard to the *Sistema-Bashneft* crisis.

In September 2014, the RF Government approved a draft budget for 2015–2017, which resolved a number of issues that had been actively debated since August. In so doing it rejected – at least for the time being –

the idea of increasing taxes and introducing a sales tax. The Government also found an intermediate solution for the preservation of the funded component of labor pension without, however, making a final decision on its future – although the money taken from the funded component of labor pension in 2013 will be returned thereto, no payments to that component will be made starting 2014. Pensions to working pensioners will not be cut, although the social benefits granted to highly paid employees will be reduced. It was decided that no more than 60% of National Welfare Fund will be spent on major infrastructure projects, which apparently means that funding will be cut for a number of already approved projects, including the Central Ring Road to be built on Moscow Oblast, the development of the *Transsib* and *BAM* railway lines, the provision of financing to the Russian Direct Investment Fund, etc., especially bearing in mind that many new desperate fund seekers – such as *Rosneft*, *Novatek*, *Rosnano*, *Alfa-Bank*, JSC *Russian Railways*, etc. – have recently emerged out of the blue. The policy of the Reserve Fund will remain unchanged (although Deputy Prime Minister Olga Golodets recently suggested that it should be spent on something important, which she, however, has failed to specify). On the whole, the budget for 2016 shows a deficit of 0.6% of GDP. This time, however, the budget does not have the traditional safety cushion in the form of a deliberately low oil price forecast – the price of oil has already dropped below \$ 100 per barrel for Urals crude oil, which was predicted by the authors of Russia's budget. Apparently, in one respect the situation will remain exactly as it was in 2013 and 2014: the main hidden reserve of budget revenues will continue to be devaluation of the ruble, which has lost 25% of its value over a very short period of time – a little more than a year. That will be the price to be paid by Russia for the policy of her government which stubbornly refuses to cut public spending.

Fyodor Andreev resigned as President of the *ALROSA* company. It was announced that this former banker and then long-term CEO of JSC *Russian Railways* stepped down from his post (which he had held since 2008) for health reasons. Although *ALROSA* was relatively successful under Andreev's chairmanship and managed to carry out a profitable initial public offering in 2013, the summer of 2014 saw the emergence of contradictions between Fyodor Andreev and Deputy Prime Minister Yury Trutnev, the RF Government's curator of the *ALROSA* company. The market awaits the outcome of this reshuffle, as it is not clear as yet whether the company will be headed by a representative of Andreev's team, or whether that team will be replaced by another one, and the new president will be appointed from its midst. ●