POLITICAL AND ECONOMIC RESULTS OF NOVEMBER 2014

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In November 2014, Vladimir Putin declared that he had no intentions to become Russia's president-for-life. In spite of Putin's assurances, this public statement has inevitably sent an alarming signal to society. In November 2014, a court of justice seized the company Bashneft from Vladimir Yevtushenkov's AFK Sistema, justifying its decision by the claim that twenty years ago Bashneft had been wrongfully classified not as Russia's property, but as property of the Republic of Bashkortostan. Mr. Yevtushenkov, charged with 'legalizing illegally acquired property', remains under house arrest. As a result, the investment climate in Russia has significantly deteriorated. Moreover, privatization of any major state-owned assets has become impossible – at least for the time being. The RF Government is using every opportunity to increase taxes, including the introduction of trade levies, and the abolition of tax deductions. November 2014 saw a series of mass rallies of doctors, protesting against the planned personnel cuts.

In November, on the eve of his departure for the G20 Summit in Australia, RF President Vladimir Putin gave a long interview to the TASS news agency. Among other things, President Putin stated that he had no intention of becoming Russia's president-for-life: 'this is detrimental to the country and I do not need this either'. As regards the possibility of his bid for re-election in 2018, Putin said that he did not altogether rule out such a possibility. He also declared his support for the RF Central Bank's decision to introduce a floating exchange rate for the ruble, noting in this connection that the Russian authorities would not 'burn' the country's foreign exchange reserves on the foreign exchange market in adverse economic conditions, but instead would use them, whenever necessary, to implement the State's social obligations. When asked to comment on *Rosneft*'s and other big companies' request for funds from the National Wealth Fund, Putin said, ironically, 'If I were a *Rosneft* CEO, I would ask for money, too'. He made it clear that the Government would treat such pleas for money with circumspection, and would not rush to decisions, because the State's resources are not limitless. 'I do not rule it out that *Rosneft* may get some funds. Yet the amount of such allocations and the terms require a thorough analysis. No hurry here'. So far as the economic sanctions imposed on Russia were concerned, Putin said that although he believed that those sanctions were mutually harmful, he would not ask the G20 to lift them (such a request would be pointless). Thus, Putin continued to publicly demonstrate his belief that the course of action chosen by him in the current crisis was absolutely correct. The one fly in the ointment in the course of that interview was the necessity to comment on the possibility of Mr. Putin's presidency-for-life (seen by many as an ominous sign of things to come).

In November, the RF Government continued to adopt legislative measures designed to mobilize budget revenues and increase taxes. It is noteworthy that November saw a continuation of the obvious trend towards depriving the RF Government, as a collective body, of direct participation in the law-making process, and a transition to another model of draft-law introduction, when draft laws, backed by individual agencies and coordinated with the RF President's Executive Office, are to be introduced into parliament by MPs without any formal government backing. This trend bodes ill for the RF Government as a whole. Moreover, this sign of erosion of its formal role can be a portent of a major cabinet reshuffle in the near future.

A massive public outcry was initiated by the Duma Committee on Budget and Taxes' amendments to the Law on the State Budget, concerning the introduction, from 2015 onwards, of 'trade levies'. These amendments were submitted to the second reading of the Budget Law by Andrei Makarov, head of the afore-said committee. Introduced into parliament with a lightning speed without prior discussion, the initial version of the amendments was designed to enable local authorities to impose levies on approximately 20 services, including retail and some other spheres. Thus, the fee for trading activities – the foundation of Russia's economy – was to become as high as Rb 600,000 per quarter for shops whose area of trading floors did not exceed 50 square meters, the proposed base rates for large shops being slightly lower. According to the amendment, regional and local authorities should be vested with the right to raise municipality's rates up to 10 times or to reduce them to zero at their own discretion (in Moscow and St Petersburg these rights are ascribed to the competence of the corresponding subject of the Russian Federation). Bearing in mind the already exorbitant rental rates for retail space in major Russian cities, the adoption of those amendments in their initial version would have meant closure of the majority of small and medium-sized businesses, to be followed by closure of many shopping malls. Soon it became clear that the draft law had been initiated by Moscow Mayor Sergei Sobyanin, who had just about completed the eradication, in Moscow, of kiosks and open-air markets, and who had found a new target for his law-enforcement zeal. As this measure would have increased the revenue side of Moscow's budget by less than Rb 10bn (at present it amounts to over Rb 1.5 trillion), the true purpose of the draft law was to totally eliminate small and medium-sized businesses in Moscow. It is noteworthy that, quite recently, Aleksey Nemeryuk, head of the Department of Trade and Services of Moscow, has publicly advised kiosk owners and small shop owners to 'become factory workers'.

The draft law caused a storm of protest from the entire business community, whose representatives appealed to the RF Government and President Putin to mitigate the proposed legislation. The President was forced to publicly address this issue and make a number of comments thereon. In his comments, Putin referred to the failure, by large shopping malls, to properly pay taxes (reported to him by Sobyanin), and promised to find a solution to this problem. As a result, the draft law was rewritten, leaving retail as the only sphere of its application (the initial version of the draft law had also posed a great threat to public catering); tax payments were linked to the prices of patents (at present, tax payment via the system of patents is carried out on a voluntary basis; the new law is to make this method of tax payment mandatory if the trade levy is actually introduced in a given subject of the Russian Federation); regional and municipal authorities were not vested with the right to raise the levy rate for trading activities, but were granted the right to reduce it to zero. The new version of the draft law envisages that the levy should be introduced from 1 July 2015 onwards at the discretion of regional authorities – so far only Moscow has declared its intention to do so, promising that the levy will be differentiated by district. Those regions that will introduce the levy will automatically increase the tax burden on retail, and, as a consequence, will push up the prices of products manufactured by producers. Small businesses, whose profitability is low even under present conditions, may be forced to close down (it should be remembered that some years ago a very modest increase in the social insurance contributions paid by individual entrepreneurs resulted in their extinction on a massive scale). It goes without saying that their closure will swell the ranks of the unemployed. Moreover, the experience of the early naughties indicates that a lot of problems inevitably arise when tax on imputed income constitutes the basis of the whole taxation system and does not have an alternative.

Also, the State Duma passed amendments to Russian legislation, envisaging that from 2016 onwards, the period of ownership of a property whereby its owner can be made exempt from income tax if that the said property is subsequently sold should be increased from 3 to 5 years. Bearing in mind that the current volatility of the ruble's exchange rate greatly increases the role of property transactions, it is unlikely that amendment will be highly approved by the population.

It should be admitted, however, that the increase in the tax burden will also affect big businesses – for example, in November 2014, in spite of the objections voiced by *Rosneft*, the State Duma passed amendments to Russia's legislation on the so-called 'tax maneuver' in the oil field. Also, the State Duma passed the final version of the law on controlled foreign companies, introduced into parliament by MPs. In its second reading, the draft law had been considerably toughened up. As a result, the law envisages that from 2016 onwards, persons whose stakes amount to 25% should be deemed to be 'controlling persons' (initially, it was planned that this norm should be put into force from 2017 onwards, and that the controlling stake norm to be used in 2015-2016 would be set at 50%). The amendments set forth by the RF Government, who had coordinated them with the business community, had been rejected by the State Duma. However, it should be admitted that Russia's legislation on controlled companies can only be successful on one condition – if Russia exchanges comprehensive tax information with a large number of foreign jurisdictions, which is highly unlikely in view of the current international situation.

In November, the situation in the conflict zone in south-eastern Ukraine considerably changed, although without showing a trend towards military escalation. On 2 November, the self-proclaimed 'People's Republics' of Donetsk and Luhansk held elections to their governing bodies, which were necessarily limited to the areas not controlled by the Government of Ukraine (according to the Minsk Agreements, these elections should have been held in December 2014). Once the elections were over, the governments of the self-proclaimed republics immediately declared their independence from Ukraine. In response, the Ukrainian authorities cancelled the recently adopted law on the special status of the Donetsk and Luhansk regions and discontinued all financial allocations, including social payments, to the areas not under their control. Bearing in mind that those areas were experiencing a total economic collapse, Russia had no other option but to start large-scale food aid shipments in order to prevent mass starvation there: over the course of November, those areas received more 'humanitarian aid convoys' from Russia than during the entire preceding period of hostilities in eastern Ukraine. No other 'international' attempts at Ukraine's conflict management were taken. No follow-on Minsk negotiations took place. Hopes of a diplomatic breakthrough at the G20 summit in Australia were dashed, as Vladimir Putin's visit there did not live up to expectations. As far as the Russian authorities are concerned, the only silver lining of the international political situation in November was the OECD's decision not to impose new economic sanctions on Russia if that country would not violate the current status quo. However, the existing package of painful sanctions remained in place. The sanctions imposed on Russia were not altered – the OECD would have reviewed them downwards if the Minsk Agreements had been implemented by Russia and her allies. The Minsk Agreements were implemented, however partially, only in regard to cessation of military actions. The conflict's political settlement (the Minsk Agreements had envisaged that the areas not controlled by the Government of Ukraine should be granted a special status within Ukraine) was in fact indefinitely postponed. In late November, there was a sharp deterioration of relations between Russia and Belarus – the Russian authorities imposed a ban on all shipments of products from Belarusian meat-processing factories, accusing Belarus of re-exporting banned European produce to Russia. President of Belarus Alexander Lukashenko demanded that Russia immediately lift this ban, otherwise promising to retaliate in kind (bearing in mind the Belarus's role in Russia's export of natural gas, crude oil and petroleum products, he can indeed do a lot of harm to the economic interests of Russia). Thus it has turned out that the sanctions imposed on Russia do not strengthen the so-called Eurasian integration but subvert it – instead of joining Russia's sanctions against the OECD countries, her partners are eager to make a profit thereon.

In November, the Arbitration Court of Moscow passed a ruling that the controlling block of shares in *Basheft* should be seized from Vladimir Yevtushenkov's AFK *Systema* and passed into state ownership. The Court justified its decision by affirming that more than twenty years ago, in 1992, those shares had been 'wrongfully' classified as the property of the Republic of Bashkortostan, while in reality they had been the property of the Russian Federation. Thus, the whole chain of subsequent property rights transitions (first the company's privatization in favor of the charitable foundation *Urals* and then the purchase of its shares by AFK *Sistema*) with regard to the controlling block of shares in *Bashneft* was recognized to be null and void by the Arbitration Court, while the minority block of shares in *Bashneft*, which had also passed into the ownership of various shareholders in the course of that company's privatization, mysteriously remained in their ownership. Moreover, the Court's ruling did not clarify the fate of the funds paid for the controlling block of shares in Bashneft and currently arrested in the bank accounts of the charitable foundation *Urals*. The AFK *Sistema* announced that, whilst it would not appeal against the Arbitration Court's ruling, ot would raise a claim for the recovery of its funds from the charitable foundation Urals. At present, Vladimir Yevtushenkov remains under house arrest on charges of money laundering, namely for the legalization of illegally acquired monetary funds. Thus, he is suspected of being guilty for somebody's erroneous decision, dating back to 1992, to the effect that shares in Bashneft should be classified as the property of the Republic of Bashkortostan, and not of the Russian Federation.

The unprecedented ruling of the Arbitration Court of Moscow and the tough actions of the RF Investigative Committee, which took place when the period for lodging any claims with regard to *Bashneft*'s privatization had long expired, clearly opens the way to revising any transactions; moreover any ultimate owner can now be charged with money laundering ('legalization of illegally acquired assets'). It should be said, however, that it is highly unlikely that the Russian Government will immediately begin revising all privatization transactions. Apparently, Russia's authorities will be guided in their actions by the principle of expediency. In one of his October 2014 speeches Vladimir Putin clearly confirmed this assumption by saying that 'the results of privatization will not be revised on a massive scale (although in December 1999 Mr. Putin, the then Prime Minister of Russia, had promised that 'the results of privatization will not be revised'. Now it turns out that, after all, these results will be revised, but not (not yet) on a massive scale.).

The emergence of such a judicious precedent makes it possible to come to several conclusions. First, the repetition of asset confiscations is not only possible but indeed probable, because the State has begun to see confiscation as a means of resolving some of its financial problems. Second, for a long time to come, there will be no major privatization transactions in Russia, because no businessman will be reckless enough to repeat the experience of Vladimir Yevtushenkov (not to mention the host of other negative factors, including the poor state of Russia's capital market, etc.), frightened by Russia's high country risk. Most likely, foreign companies will also abstain from participating in privatization. It is doubtful that even the businessmen considered to be Vladimir Putin's personal friends will be eager to take part in privatization, because Vladimir Yevtushenkov, prior to his inexplicable fall from grace, was, like them, a long standing protégée of the Kremlin. As Russia's state-owned companies (such as *Rosneft* which was actively engaged in purchasing Yukos's assets in the mid-naughties) are burdened with heavy debts, they will not be able to buy new assets at close to market prices. This means that the issue of true privatization, when the State sells its controlling blocks of shares in big Russian companies, is being removed from the agenda – to the delight of their managers. Apparently, the next head of *Bashneft* will be appointed by the State from the ranks the group that has initiated its expropriation.

The investment climate for big businesses was further deteriorated by the arrest of Oleg Shishov, the head of *Mostovik*, one of Russia's largest construction companies. This company received a lot of loans to finance construction of Olympic objects in Sochi – and failed to repay them (like many other companies). However, the construction of Olympic objects was a special project under the aegis of the State, which was frequently changing the terms of the contracts, thus making life increasingly difficult for the contractors. All these circumstances suggested that the State should be more lenient to the borrowers. No such luck. Now it turns out that at least one of the borrowers will be tried in court, and that the judge will apply to him the full force of the law.

All these events will undoubtedly stimulate big businesses to withdraw their capital from Russia, to considerably contract the business cycle in order to minimize their possible losses, to sell their assets to state-owned companies, and then to withdraw from the Russian market.

In November, Russia was shocked by a series of mass rallies of doctors protesting against the planned reform of the national health care system. The situation in Moscow was especially tense, fuelled by the planned sacking of about 7 thousand doctors. As a result of the protests, Moscow Mayor Sobyanin promised that each doctor who would lose his or her job would be paid a one-time compensation of between Rb 200,000 and Rb 500,000. However, the doctors did not take the bait and decided to continue their protests. It should be noted that this explosive situation has been caused not by the lack of resources (Russia's cities, especially megalopolises, have enough of them), but by the May 2014 presidential executive orders of Vladimir Putin, which granted Russia's regions the right to increase the wages and salaries of the employees of budget-funded institutions and enterprises – for example, doctors were promised that by 2018 their salaries would be twice as much as the average wage in a given region. Actually, it was a blank check with no money in the bank account. For Russia's megalopolises, where the average wage was relatively high, the only solution to this problem was to sack personnel on a massive scale. Roughly speaking, in order to formally implement the May 2014 presidential executive orders, a local authority which employs two doctors with the same salaries has to sack one of them, forcing the remaining doctor to carry a double work load for a double pay. As a result, none of those two doctors will applaud such a reform. Therefore Russia's authorities should try to adjust the May 2014 presidential executive orders to reality, especially bearing in mind that the current crisis situation is fraught with a serious escalation of tension. Unlike the rallies of doctors, the traditional nationalist rallies under the 'Russian March' slogan were far from impressive. The several-fold drop in the number of their participants was a clear indication of the rift in the ranks of nationalists, caused by their disagreements on the essence of the Russo-Ukrainian conflict. All the same, the majority of right-wing demonstrators loudly expressed objections to Russia's official policy in Ukraine.

In November, President Vladimir Putin signed a number of amendments to Russia's migration legislation, designed to eliminate the system of quotas for foreign workers. Previously the quota for foreign workers to be employed at Russian enterprises was set at 1.6 million per year, that number then to be distributed between different regions. The number of migrants employed by individuals was not limited, provided that they bought patents for work in Russia. Under the new legislation, from 1 January 2015 onwards, the number of migrants from visa-waver countries (that is, first of all, from the CIS countries) employed at Russian enterprises will not be limited. However, to do so they will be obliged to buy patents for work in Russia, the price of patents to be determined by relevant Federation subjects. It is likely that the price of a patent will go up – for example, Moscow has already increased it from Rb 1,200 to Rb 4,000 per month. The work patent will be valid for 2 years. Also, the migrant worker will have to pass an examination in the basic knowledge of the Russian language, to undergo the procedure of fingerprinting, and to buy medical insurance. Thus, the long discussions in the RF Government on the pluses and minuses of the quota system (the social bloc of the Government was in favor of preserving the quotas) have finally come to an end. The quotas are abolished. Apparently, the RF Government hopes that by eliminating the quotas it will give an impetus to economic growth by stimulating an inflow of cheap workforce. However, the policy of attracting cheap workforce, especially in time of crisis, is fraught with the danger of capital flight and an escalation in social tension (although not in the immediate future).