POLITICAL AND ECONOMIC RESULTS OF JANUARY 2015

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In January 2015, the Russian Government approved a plan providing for 10% budget spending cuts (except defense, social benefits, agriculture costs and external debt repayment) and extensive financial aid to the banking sector. Most of the proposals on supporting small businesses and lowering administrative barriers were suspended or moved to the jurisdiction of constituent territories of the Russian Federation which have no interest in easing the tax burden on this type of business. However, the plan will be updated and finalized in March this year, when an updated budget 2015 is approved. Instead of easing sanctions against Russia, the enforcement of tougher sanctions was put on the agenda after the Minsk peace talks broke off and combat operations resumed in Ukraine.

The most important developments of January 2015 include the approval of Russia's anti-crisis plan and serious discussions prior to that. A great deal of intense expert work was performed since at least the second half of December last year, when it developed that the recently adopted federal budget fails to comport with the reality amid slumping prices of hydrocarbons. In January, by the way, the prices stabilized, falling at peak to $44 US a barrel[1], they increased to $49 US a barrel by the end of the month (whereas in the previous months, beginning in September last year, crude oil prices saw an average monthly loss of about $10 US). The Russian government's anti-crisis plan was adopted on the 27th of January and published on the following day. The plan provides for 10% budget spending cuts in 2015 – except defense, social benefits, agriculture costs and external debt repayment – as well as the suspension of new investment projects (except those concerning the Crimea) and focusing on projects in progress. Retirement benefits and children's allowances are subject to indexation, and the former will be indexed on February 1, 2015. Additionally, government spending in real terms are to be cut 5% annually within a period of three years.

Specific government spending will be adjusted – the anti-crisis plan sets only the ceiling for some of the budget spending items while many of them have no ceiling at all (the best illustration of this is an item concerning the establishment of a "bank of bad debts" to be redeemed by the state, which requires heavy spending, without funding limits). Actual budget execution, according to Russia's Finance Ministry, will be adjusted for spending cuts, 10% more than expected, except the above written protected budget spending items (defense, social benefits, agriculture costs and external debt repayment), and spending figures will be finalized when the federal government submits to the State Duma an updated and refined version of draft federal budget for 2015 (approximately in March). Some "fighting" is expected take place for the resources of the National Welfare Fund (NWF), including both already approved but not financed spending items and new ones. For example, the plan contains an item on the appropriation of up to Rb 250bn of the NWF funds to further strengthen the capital of banks with a view to financing priority infrastructural projects – various state departments have different views on this spending item. Another example is the construction costs of a nuclear power plant, a joint-stock company, in Finland, in which Russia's National Nuclear Corporation "Rosatom" will hold a 34% interest: a respective agreement between Rosatom and the Finnish government was signed in December 2014 and approved by the Finnish parliament. However, there's no knowing when the construction begins, and no document on appropriation of funds for 2015 has been issued (although Rosatom is mentioned in the anti-crisis plan), not to mention that companies keep submitting applications to the Russian Government for NWF financing – Rosneft alone submitted in January its application on 28 new projects worth Rb 1,3 trillion. Under the circumstances, the Ministry of Finance suggests that the NWF should be regarded as one of the back-ups for federal budget execution, and hence at least some of the approved project financing decisions should be essentially revised, to say nothing of approving new ones.

The following major spending already specified in the anti-crisis plan are worth attention: the appropriation of NWF funds to Vnesheconombank (up to Rb 300bn), publicly funded loans to regional budgets (up to Rb 160bn), as well as allocations to regional budgets for supporting the unemployed and creating new jobs (up to Rb 82bn), up to Rb 230bn in the

1 Brent crude oil, the price of Russia's Urals crude oil is often lover.

amount of state guarantees on loans to enterprises selected by the Russian government, up to Rb 50bn of extra agricultural grants. The rest of spending are either insignificant or, in most cases, not specified at all. Therefore, the anti-crisis plan is strictly provisional in terms of financing, e.g. the state guarantees may or may not be granted.

The Ministry of Economic Development's proposals aimed at enhancing the investment environment is an essential part of the anti-crisis plan. In spite of playing a crucial role in the preliminary versions of the plan, the proposals saw a sad fate: many significant initiatives were removed from the plan while others were moved to the jurisdiction of the regions which have no interest in cutting their revenues. For instance, the regions were delegated the authority to reduce to 1% from 6% the corporate income tax rate on enterprises operating under the simplified system of taxation; from Rb 1,500,000 the ceiling of self-employed entrepreneurs' income; to 7.5% from 15% of the imputed income tax rate. Of the measures applicable to all, the plan provides for a double increase in the eligibility criteria for being classed as microenterprise and small and medium-sized enterprise (with revenues up to Rb 120m, Rb 800m and Rb 2bn respectively), suspension of the entry-into-force of new vehicle safety rules, a 2-year moratorium on liability insurance (except first-class hazard facilities), and lowering the public (Federal Anti-Monopoly Service (FAMS)) oversight over small-sized enterprises (with quite an obscure wording such as "reducing the number of reasons for which the FAMS may conduct random inspections of small business entities without having to agree with prosecution authorities"). The following measures were removed from the final version of the plan: reducing the term of actual VAT refund to 15 business days, a 30% cut on random inspections of businesses, a moratorium on random inspections of all sites, except those exposed to high technological risks, and inspections of all small and medium-sized enterprises, suspension of the introduction of veterinary accompanying documents on food products, a moratorium on the environmental charge and sales charge, a corporate property tax exemption on enterprises which pay the unified tax on imputed income (UTII) and enterprises operating under the simplified system of taxation if their property measures less than 1000 square meters, a deduction of insurance contributions from the sums paid under the system of taxation by license ("by patent"), and a reduction of insurance contributions for small-sized enterprises, a tax deduction for the incorporators of legal entities registered for the first time, etc. At the same time, it's worth noting that it is the considerable increase of the doubtful criteria for classifying enterprises as small and medium-sized businesses by the size of revenue creates a situation when any tax allowances for businesses of this type receive serious counterargument on material losses in budget system revenues, and perhaps it would have been more reasonable to do the other way around, i.e. on the one hand, make tougher the criteria for being classed as a business eligible for privileges, on the other hand provide material allowances for this type of businesses. Out of the projects' scope remain important initiatives on the restoration of small businesses' entitlement to sell beer and cigarettes whose absence puts them, in contrast to the global experience, in a discriminatory position comparing to major retail networks and strips them from the buyer traffic, as well as on guarantees to small businesses against arbitral change by regional and municipal governments of the material operation conditions such as dislocation of non-stationary points of sale, a minimum share of small business entities in the total volume of municipal points of sale (constituent territories of the Russian Federation), etc. In the meantime, some of the constituent territories of the Russian Federation, e.g. Moscow, are facing a catastrophic situation, because their governments have announced the dismounting of all (!) non-stationary points of sale, wherefore the issue of tax rates and similar regulations becomes secondary without addressing the issue concerning the principal fact of existence of a certain format of trade.

Overall, it can be acknowledged that the government's approved anti-crisis plan lacks specifics, while the content of measures aimed at improving the investment environment was eventually heavily emasculated as a result of discussions in state departments. At the same time, there is a hope of getting back to the implementation of many sensible initiatives of the Ministry of Economic Development as the plan and a new draft budget 2015 are being in progress. With regard to the macroeconomic section of the plan, it becomes clear that that the federal government intends to replicate in general the anti-crisis model of 2008–2009, focusing on state support to banks and large enterprises and hoping that prices of hydrocarbons are going rebound during this year. The plan is by no means brainless: indeed, both in 1998 and 2008 crude oil prices slummed and fell low, but then bounced back within 1–1.5 years (of which six months has already elapsed). However, it seems reasonable to have more radical plans in reserve, in particular, substantial revision of the budget spending, including state-controlled companies' investment plans, and defense and national security spending accounting for one third of the budget spending.

In January, Russia's Government made a decision to allocate Rb 1 trillion to strengthen the capital of banks. The strengthening was approved as early as last year. As a result, the money was distributed between 27 banks with a capital more than Rb 25bn and those banks which are supposed to commit to increase their credit portfolio of loans issued to enterprises operating in the priority sectors of Russia's economy, at least 1% a month, strengthen their capital from any other sources by at least 50% of the amount received from the Deposit Insurance Agency (DIA), and impose a limit on bank wages. This scenario is preferable to the originally discussed strengthening of banks with a capital of more than Rb 100bn, which covered only a dozen of banks, most of which are controlled by the state.

The lawmakers in January showed their ability to correct some mistakes, e.g. they amended the notorious bill which bans commercials on non-government TV channels, it was adopted last year for the benefit of monopolist Vi (a major operator in the media and advertisement market in Russia and East Europe) who sells commercials on state-controlled TV channels. From now on, every entity having a 75% domestic content in products may advertize. At the same time, the practice of adopting exclusive bills and regulations continues. For instance, decision was made in January to wind up, effective on the 1st of April, the existing the Azov-city Gambling Zone in order for the benefit of yet non-existing gambling zone in Sochi. The adoption of statutory regulation common principle is still critical, which is intended to establish material lags on the enter into effect of decisions hampering business environment, however, in spite of widespread speculations, Russia's government hasn't yet started to develop the same.

The situation in Ukraine aggravated dramatically in January. The self-proclaimed peoples republics announced they will quit the Minsk peace accords and start an offensive operation aimed at expanding their control over the Donetsk and Lugansk territories. Slogging, sanguinary combat operations resumed. As a result, the question of hardening the sanctions on Russia was put on the agenda instead of discussing easing the same, as scheduled for late in January. The foreign ministers of EU member countries – Russia's principal trade partners – agreed to renew their sanctions until September 2015, and the upcoming EC Summit on the 12th of February will also consider measures of heavier sanctions: this may first of all imply broadening the sanctions to cover Gazprom, which isn't yet in the black list, and on any kind of Russian sovereign and quasi-sovereign bonds. Perhaps, Russia counts on the consensus decision requirement in the EU that may allow Russia to block new sanctions by making individual agreements with some EU member countries, above all, Greece. Despite facing a critical situation, Russia announced it is ready to provide financial aid to the new Greece government. This is doubtful though: with only 1 to 2 EU member countries voting against, it would be sufficient to impose sanctions against Russia based on decisions by the national governments of the rest of countries. A visit of the Russian delegation headed by State Duma speaker Sergei Naryshkin to the PACE ended with no success. The delegation was supposed to discuss the renewal of Russian delegation's credentials suspended after the Crimea was assessed to the Russian Federation. The PACE Monitoring Committee initially suggested that Russia's credentials should be suspended only in part (except the right to participate in the political monitoring). However, Russian delegation's confrontational rhetoric (S. Naryshkin, for example, suggested that the reunification of Germany in 1990 should be recognized as the "annexation" of East Germany by West Germany) resulted in the council's assembly passing a resolution, adopted by a two-thirds vote, to further withdraw the voting rights of Russia's delegation until April 2015, after which the Russia's delegation announced suspension of its participation in PACE until the end of the year. Russia's final goal is perhaps pull out of the Council of Europe whose real value, apart from being a negotiation site, for Russia is the jurisdiction of European Court of Human Rights (ECHR) to which Russia's nationals may appeal against Russian courts' rulings, and Russia may pull out presumably in January 2016.

In January, M. Pogosyan was dismissed (and downgraded as Chief Designer) from the office of General Director of the United Aircraft Corporation (UAC). He was replaced by Deputy Ministry of Industry Y. Slyusar. The UAC's performance has long been in the spotlight of discussions: the advocates of the UAC management explain that its performance has resulted in a real breakthrough in the civil aircraft engineering, i.e. Sukhoi Superjet serial production, whereas the opponents note that the jetliner is economically irrational, its design was funded by the state and secured by the orders from a single company, state-owned Aeroflot, while Mr. Pogosyan's function is promote the Sukhoi Design Bureau (where he was previously employed) to the disadvantage of the rest of the designers in the aviation industry. The trade-off (keeping Mr. Pogosyan as Chief Designer) seems to establish a rough equilibrium between the negative and positive measurements of his (Pogosyan's) performance, and a new General Director will have to meet the criticism.