

## POLITICAL AND ECONOMIC RESULTS OF MARCH 2015

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*In March 2015, the topmost headline-makers were various economic issues, including the ongoing discussion on the new draft budget for 2015–2017 and on the future course of Russia's economic policy. However, the beginning of March was also marked by two very serious and purely political events: the arrest, on the charge of accepting a huge bribe, of Sakhalin Oblast Governor Alexander Khoroshavin; and the arrest of the former deputy commander of the Chechen SWAT Police Battalion Sever [North], Zaur Dadayev, who was charged with murder over the shooting death of Boris Nemtsov. The official comments on these arrests and the respective criminal cases have so far been rather vague and not very informative. Also in March, a package of very 'conservative' amendments to the federal budget was introduced into the RF State Duma. It is clear that the amendments were drafted in anticipation of an optimistic scenario, when oil prices would smoothly recover to their previous levels, and the Reserve Fund would continue to be spent so as to make any drastic cuts in budget expenditure simply not necessary. A draft law on the so-called tax amnesty was introduced into the RF State Duma. In the course of the tax amnesty, individuals will be required to declare their assets, not to repay their tax arrears. The economic sanctions imposed on Russia by the EU remained in force.*

On 3 March, the police arrested the Governor of Sakhalin Oblast, Alexander Khoroshavin. At the end of March, RF President Vladimir Putin dismissed him as governor due to 'loss of trust'. The last time a regional governor was arrested in Russia was in 2006 (at his subsequent trial this disgraced official received a suspended sentence for his wrongdoings). Under Khoroshavin, Sakhalin Oblast was not shaken by any major scandals, and the Governor enjoyed the full support of Russia's major mining companies operating in the Sakhalin region – Rosneft and Gazprom. Prior to his appointment as Governor of Sakhalin Oblast, Khoroshavin had been Mayor of Okha, the town that was then housing the regional headquarters of Rosneft. According to the RF Investigative Committee, Mr. Khoroshavin was charged with accepting a huge bribe. Also, the Investigative Committee announced that a very large amount of cash and numerous pieces of jewelry had been seized from Khoroshavin's residences. The ex-Governor filed an appeal against his detention, insisting that the aforesaid valuables had been legally acquired by him, and that the case against him was based on false accusations and allegations. Following the dismissal of Mr. Khoroshavin, the RF President appointed Mr. Oleg Kozhemyako Acting Governor of Sakhalin Oblast. Oleg Kozhemyako had previously headed Koryak Autonomous Okruk and Amur Oblast. As far as is known, he has never had any links with big mining companies. Apparently, the real reason for the unseemly scandal that suddenly erupted in the richest region of Russia's Far East had been somebody's desire to redistribute the riches of the region. Moreover, judging by the bizarre circumstances of the Sakhalin

Governor's arrest, many more heads may roll, for the purge will almost certainly not be limited to Sakhalin Oblast.

On 7 March, Director of the FSB Alexander Bortnikov announced that several persons had been arrested on murder charges over the assassination of Boris Nemtsov, including the deputy commander of the Chechen SWAT Police Battalion Sever [North], Zaur Dadayev, and that the latter had confessed of being the trigger man in the assassination plot. Several of Mr. Zaur Dadayev's acquaintances were also arrested. Some days later, the human rights activists who had visited Zaur Dadayev in jail announced that he had renounced his confession as extracted under torture. As the trial session in question was closed to public, no definite conclusions on the findings and deliberations can actually be made. However, it has become clear that the real motive for murdering Boris Nemtsov is purely political. It was closely related to Russia's internal politics: top on the list of suspects were several high-ranking officials from the Ministry of Internal Affairs of Chechnya. It should be borne in mind that Boris Nemtsov was not interested in Chechnya's affairs, and therefore could not have made any personal enemies in that turbulent region. The outcome of this criminal case is far from clear – judging from past experiences, including the journalist Anna Politkovskaya murder case, the official versions of any major criminal case can drastically change... and it is better not to immediately believe whatever is said by the various authority sources<sup>1</sup>. In any case, it may be

<sup>1</sup> Russia's mass media varied widely in naming the mastermind behind the murder of Anna Politkovskaya, some of them even

hoped that the court will indeed return a true verdict according to the evidence.

A relative improvement in Russia's economic situation<sup>1</sup> emboldened the Russian authorities to the extent that they took a number of very 'conservative' economic decisions. Thus, RF Prime Minister Dmitry Medvedev once again promised not to increase taxes, while Minister of Economic Development Aleksey Ulyykaev announced that he had received the Prime Minister's request to consider the issue of postponement of the quasi-taxes introduced in 2014 (commercial and ecological levies, etc.). However, nothing concrete was done over the course of March, and the Session of the State Council planned for 25 March was abruptly cancelled – thus dashing the hopes that the RF President would announce at that meeting the launch of a series of measures designed to support Russian businesses. As had been expected, the introduction into force of the newly adopted legislation on controlled foreign companies was postponed until 15 July on the pretext that it should first be properly linked with the future law on the tax amnesty. As regards the long-discussed draft law on the tax amnesty, finally introduced into the State Duma in March, it immediately turned out that it was based on the following concept: the State would not extract any payments of arrears from the assets to be amnestied, and the individuals concerned would be required to submit a properly formalized declaration as to the value of their assets. The last tax amnesty carried out in 2007 had envisaged that the individuals concerned should be obliged to pay income tax. It turned out to be a near-flop: the amount of recovered income tax was less than Rb 4bn – quite a negligible receipt from the point of view of Russia's federal budget. This time, the authorities apparently hope that the idea of asset legalization will look attractive in the eyes of Russia's business community. As far as the tax amnesty is concerned, a 'conservative' approach on the part of its authors is well-justified – the usefulness of this concept within the framework of international legal and law enforcement practice is rather questionable, especially when a tax amnesty

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pointing an accusing finger at Boris Berezovsky. As a result of a long trial, a group of ethnic Chechens were convicted of murdering Anna Polikovskaya, and several Moscow-based officers of the RF Ministry of Internal Affairs were convicted of supplying them with information. For unknown reasons, several defendants completely disappeared from the murder case after having been acquitted in the first trial (the acquittal was later challenged, and a second trial took place). Anna Politkovskaya's family believe that the real murderers have never been found, and that the convicted perpetrator does not resemble the man caught on camera in Politkovskaya's entryway.

1 By the end of March the price of Brent hovered around \$ 56 per barrel; over the course of March the price of Brent fluctuated narrowly.

is not linked to some fundamental political changes, because taxpayers' distrust of the State cannot be eliminated by a one-time tax amnesty. Moreover, a tax amnesty can easily demoralize law-abiding and honest taxpayers. During his meeting with representatives of big business, President Vladimir Putin advised them to repatriate their money to Russia, because otherwise they would face the risk of having their funds frozen or confiscated abroad for political reasons. However, such risks also exist in Russia. It should be added, though, that March 2015 apparently saw the end of the so-called *Bashneft* case – the *Ural Invest* Group of Funds took the decision not to challenge the court ruling whereby it is ordered to transfer to JSFC *Sistema* cash assets in the amount of more than Rb 70bn paid for *Bashneft*, while the socially important projects previously financed by *Ural Invest* should now be financed by *Basheft* (recently returned into State ownership). All that we can say with regard to the outcome of this murky affair is that it was not the worst thing that could have happen to the beleaguered businesses involved in the *Bashneft* case.

The RF State Duma passed in first reading a draft law establishing that, in the year 2015, the indexation of salaries of public servants, military servicemen and judges should not be carried out. The draft law also envisaged that social payments to disabled persons and other categories of their recipients should be increased by only 5.5% – well below the level of inflation. As far as the salaries of public servants are concerned, the indexation issue will apparently be finally resolved after the State Duma passes the new draft law on the federal budget, introduced into parliament by the RF Government and already passed by the State Duma in first reading.

The new draft federal budget is based on the oil price of \$ 50 per barrel. In 2015, GDP is expected to drop by 3%, and budget revenue to shrink by Rb 2.5 trillion (caused by a huge drop in MRET receipts). Budget expenditure will be cut by only Rb 300bn (which, in the main, reflects a reduction in the rate of spending of the RF Reserve Fund). It is expected that the budget deficit will amount to 3.7% of GDP. Debt service payments will increase (due to the ruble's devaluation), expenditures on social policy will also go up (due to the indexation of pensions and social payments). Expenditures on national defense and national security will decline by 4.8%. The largest cuts in expenditure will take place under the following expenditure items: health care, transfers to regions, financing of the housing utilities sector, ecology, and development of the Far East. Apparently the case in point is that many ministers hope that the price of oil will climb higher than previously expected, and therefore Russia will

not need to introduce severe cuts to her budget. Thus, according to the latest forecast of oil prices, released by the RF Ministry of Economic Development, in 2015 the price of oil will amount to \$ 60 per barrel, not \$ 50 as was earlier expected. This approach to oil prices is quite realistic: as shown by the lessons of the 1998 and 2008 crises, the current decline in oil prices will not be lengthy. However, the Government, in any case, should have prepared an auxiliary scenario, which it unfortunately had failed to do.

The Board of Directors of the Bank of Russia reduced the key interest rate from 15% to 14%. According to Russia's main financial regulator, the Russian economy will resume growth after Q1 2016. These expectations of growth were apparently based on the optimistic forecasts of oil prices, the formation of new sources of investments in the form of pension savings, and the emergence of a downward trend in capital outflow from Russia. As far as the reduction in the key interest rate is concerned, it should be said that this decision was politically rather than economically motivated, bearing in mind that the sharp increase in the key interest rate in December 2014 caused a storm of criticism. At the same time, the RF Savings Bank announced that it was ready to offer mortgage loans at 12% (the mortgage rate that the RF Government had agreed to subsidize). Although it is still too early to be highly optimistic about the future, we should say that the economic results of February and March 2015 give the Russian Government at least some degree of justification for taking such actions.

In March, Russia experienced the first departure of a major foreign investor, namely General Motors (GM). To be more precise, the General Motors automotive corporation announced that it would pull its mass-market Opel brand completely and that Chevrolet production would be cut back significantly to focus on top-end products. GM explained its decision to scale back its presence in Russia by the numerous difficulties being experienced by the Russian market that include, among other things, the ruble's devaluation which had pushed up the prices of GM cars and the

low number of local suppliers. GM will close its production facilities at Kaliningrad and Nizhny Novgorod and its assembly plant at St. Petersburg. Although the motor vehicle production market is highly competitive and is usually the first to suffer under crisis conditions, and although such decisions are also being taken in a number of other countries, it should be pointed out that General Motors was a major investor, whose decision to beat a retreat out of Russia has definitely set alarm bells ringing.

At its March 2015 meeting, the European Council took the decision that the EU sanctions against Russia would remain enforced until the end of 2015. The European Council decided to align the existing sanctions regime to the implementation of the Minsk agreements signed in February 2015. Earlier in March, the continuation of the 2014 sanctions against Russia had been announced by USA President Barak Obama. Among other things, the aforesaid Minsk agreements stipulate that, by the end of 2015, Ukraine should regain control over its borders in the east, which is almost universally believed to be an unrealistic task. Thus, it should be noted that neither the forecasts of sanctions being further toughened nor the forecasts of their complete or partial lifting did come true. Equally erroneous was the forecast the EU would be incapable of taking any consolidated decision on the issue of sanctions. In fact, the EU, Russia's major trading partner, took the decision that the existing sanctions regime (admittedly not very tough but nevertheless biting) should be enforced at least until the situation in the Donetsk and Luhansk regions of Ukraine is fully normalized. As regards those EU members, including Hungary and Cyprus, who had publicly insisted on the lifting of sanctions imposed on Russia, it turned out that these countries believed that Russian preferences (such as Russia's decision to reduce the interest rate on her loan to Cyprus) could be reciprocated by their declarations, not by their voting in the European Council. The reason for this 'perfidy' is clear – their economic dependence on the EU is much heavier than their economic dependence on Russia. ●