

## THE POLITICAL AND ECONOMIC RESULTS OF MAY 2015

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*As far as Russia is concerned, the main news of May 2015 was the celebration of the 70<sup>th</sup> anniversary of VE day. Inside Russia, this country's victory in WW2 was celebrated with true enthusiasm on a massive scale. However, an overwhelming majority of foreign heads of state had chosen to ignore the VE day celebration in Moscow, and so it was attended by the head of state of only one major power, China. At the subsequent negotiations with the Chinese leader, Russia managed to get some financing from China, but its volume amounted to just several billion USD, which clearly indicates that, at least for now, Russia cannot rely on China as an adequate substitute for international financial markets. According to available information, Angela Merkel's and John Kerry's visits to Moscow yielded only meager results. No details leaked out, but apparently these results were limited to the parties to the talks reaffirming their support to the current truce in Ukraine. In a separate development, United Russia came up with a proposal to move Russia's next parliamentary elections up three months to September 2016, a shift that will relegate the electoral campaign to vacation season. As this initiative appears to be constitutionally contradictory, its future, for the time being, remains unclear.*

As far as Russia is concerned, the main eye catching events of May 2015 were the celebration of the 70<sup>th</sup> anniversary of victory in the Great Patriotic War, and the diplomatic visits to Russia by Chinese President Xi Jinping, German Chancellor Angela Merkel, and US Secretary of State John Kerry. Russia's mass media emphasized the importance of these visits *per se*, and especially the Chinese President's attendance at the traditional military parade, considering them to be a breach in the unofficial boycott of Russian policies initiated by the OECD in the aftermath of the 2014 events. As regards foreign leaders' attendance at the military parade in Moscow, Russia's diplomatic success was rather modest, bearing in mind that the VE day celebration in 2005 had been attended by the heads of state of the world's largest and most important states, including the USA, China, France, Germany, Italy and India (with the exception of the United Kingdom and Canada represented by their vice prime ministers). This time, the military parade was attended only by the Chinese President, while India (a parliamentary republic) was represented by her mostly ceremonial President, and the rest of the world's major countries – by even lesser dignitaries. The only European countries represented by their presidents at the VE day celebration in Moscow were Serbia, Bosnia, Cyprus and Czechia (the latter two countries are parliamentary republics), and it should be noted that the Czech President did not attend the military parade. The military parade was attended by the presidents of almost all CIS states except for Ukraine (which had not been invited to the ceremony), Belarus and Uzbekistan.

At the same time, the traditional rallies and demonstrations were unprecedentedly numerous. Thus, the

VE day demonstrations in Moscow were attended by hundreds of thousands of people, while the Immortal Regiment rallies (whose participants carry portraits of their relatives who fought in WW2), first held in 2012, took place even in the smallest towns and were more numerous than previously. In spite of a few lamentable episodes, it can be said with conviction that these rallies were purely voluntary. However, it is still too early to predict whether or not these mass happenings will indeed influence Russia's politics, because their organizers emphasize their non-political and non-party nature.

In May 2015, Russia's most important visitor was China's President Xi Jinping. On 8 May, the Chinese leader and RF President Vladimir Putin signed a number of bilateral agreements. *Sberbank* signed a facility agreement with China's Development Bank in the amount of \$ 966m. China also agreed to finance the construction of the Moscow-Kazan High Speed Railway in the amount of Rb 104bn (share capital) and promised to loan Russia, for the same purpose, Rb 250bn (theoretically, the railway could later be extended to other cities and even to China). Russia and China signed a framework agreement on the establishment of a leasing company, with a charter capital of \$ 3bn, to support sales of *Sukhoi Superjet 100*, as well as a memorandum on the construction of the so-called 'western route' gas pipeline (a declarative document, which specifies neither the completion date of the project nor the price to be paid for Russia's natural gas). It should be added that Russia had vested much hope in the visit of the Chinese leader to Moscow, expecting China to become a major source of investment for Russian projects. Russia's intention to replace Western

and Japanese sources of financing (lost by the majority of Russian companies because of the sanctions slammed on Russia) by Chinese ones, stated a year ago, had been mostly ignored or given the cold shoulder in China – for example, the Chinese had refused to prepay for the construction of the so-called ‘eastern route’ gas pipeline. Now it can be said with confidence that Chinese investment into Russia is guaranteed, and that the first money transfers will be carried out in the nearest future. However, these transfers will take place within the framework of just two contracts (loans to two state-owned banks and the establishment of a company for financing the construction of the Moscow-Kazan High Speed Railway). At the same time, the financial parameters of the leasing company designed to support sales of *Sukhoi Superjet 100* have remained unclear, while the memorandum on the construction of the ‘western route’ gas pipeline is, as we have already noted, is purely declarative (a similar memorandum on the construction of the ‘eastern route’ gas pipeline was signed in 2006, while the agreement on the financial parameters of that project was concluded only as late as 2014). Moreover, the construction of the Moscow-Kazan High Speed Railway – a project whose feasibility had been disputed by various government agencies (primarily due to the fears that the costs of its construction would never be recovered because of the railway’s low traffic volume) – cannot be viewed as a great victory for Russia, especially bearing in mind that the loan to finance the project will be allotted on condition that the bulk of construction equipment should be purchased from Chinese firms. The volume of Chinese investment into Russia remains to be extremely low – for example, according to the RF Central Bank, as of early 2014, China accounted for less than 1% of total FDI (\$ 4.5bn out of a total of \$ 566bn), and the signed agreements will have a negligible effect on the aforesaid ratio.

On 10 May, German Chancellor Angela Merkel made a visit to Moscow. In the course of her visit, she made several statements related to the celebration of VE day, which were meant as a gesture of diplomatic politeness. Thus, she admitted the USSR’s key role in defeating Nazism. In response, Mr. Putin remarked that the German people itself had become the first victim of Nazism, thus drawing a line between the people of Germany and Nazism as a political phenomenon. In point of fact, the lengthy negotiations between the leaders of Germany and Russia were focused solely on the implementation of the Minsk agreements concerning the crisis in Ukraine. Ms Merkel lauded the Minsk agreements and emphasized the necessity of restoring Ukraine’s control over her border after local elections in the Donetsk and Luhansk regions. Mr.

Putin promised to use his influence on the leaders of the so-called people’s republics on order to make them start constructive dialogue with the Ukrainian authorities. Also, he called for the establishment of a ‘non-bloc international security system’. Both Mr. Putin and Chancellor Merkel admitted that the Minsk agreements had been violated by both parties to the conflict in eastern Ukraine, and agreed that further steps should be taken towards the implementation of those agreements. However, none of these steps was actually spelled out. Even more puzzling and enigmatic was US Secretary of State John Kerry’s visit to Sochi (on 13 May), where he met with President Putin and RF Foreign Minister Sergey Lavrov. According to some comments, the talks were focused on the situation in Ukraine. As in the case of Merkel’s rendezvous with Putin, next to nothing was said specifically about the issues discussed. Thus, when asked about the reputed intention of the Ukrainian authorities to violate the current ceasefire, Mr. Kerry answered with an appeal to the Ukrainian authorities that they should not act in such a way, simultaneously expressing his doubts that they had indeed harbored such intentions. It is known that the situation in the Middle East was also discussed during Kerry’s visit to Sochi, but it remains unclear whether or not any agreement on resolving this major regional conflict was actually reached.

The lack of information has given rise to a lot of conspirological fantasies concerning those two visits, including allegations that ‘Ukraine was swapped for Syria’, that some ‘ultimatums’ were presented, etc. It is much more likely that the participants in those talks simply agreed to maintain the *status quo*. In the ‘war of all against all’ currently raging in Syria, Iraq and Yemen, the conflict is by no means limited to a confrontation between government and opposition, or a confrontation between religious (or ethnic) communities; in fact, it is also aggravated by divisions within opposition movements and ethno-religious communities. As a matter of fact, Russia can do little to resolve this conflict – first of all because of the configuration of the national borders (for example, a Syrian plane transporting Russian ‘humanitarian aid’ to Damascus (characterized by the Turkish authorities as military cargo) was grounded in Turkey for several years). Russia is definitely not eager to help the Syrian and Iraqi authorities with arms supplies on a massive scale, or to provide them with adequate financial support. And the last thing Russia wants is to get directly involved in the fighting. At present, there exists some sort of dynamic equilibrium between the Sunnis, the Shiites, the Kurds, and the so-called Islamic State created last year. The only outcome of this feud unacceptable for Russia would be the victory of Islamic State

extremists (which cannot take place in the nearest future because of the direct military assistance provided by Iran to the Syrian and Iraqi authorities, and the close air support rendered to their forces by the USA and its allies). Likewise, at present neither the USA nor the EU is ready to render substantial military assistance to Ukraine, thus making it apparently impossible for that country to liquidate the Donetsk and Luhansk 'people's republics' backed by Russia. Theoretically, the situation in eastern Ukraine could be changed as a result of large-scale fighting, but in practice no such fighting has been taking place for quite a long time. Apparently, the lull in the fighting will continue at least until the end of July, when it will finally become clear whether or not the EU sanctions imposed on Russia are going to be prolonged. Although these sanctions were introduced in late July 2014 for a one-year period, subsequently the EU made several decisions concerning their possible prolongation and terms. Thus, the latest EU decision, passed in March 2015, stipulates that economic sanctions imposed on Russia will stay in place 'until the Minsk agreements are fully implemented'. Therefore it is juridically unclear if any prolongation of these sanctions should require a unanimous decision of all EU members or, on the contrary, they should be automatically lifted if such a unanimous decision fails to materialize. Nevertheless, it is most likely that the sanctions will stay in place because, judging by the situation in March, all the major EU countries are in favor of their prolongation.

In May 2015, Chairman of the RF State Duma Sergey Naryshkin (*United Russia*) suggested that the date of the next parliamentary elections should be moved from December to September 2016. The main purpose of the proposed shift in the general election date is to maximally complicate the conduct of opposition parties' electoral campaign, by means of relegating it to a vacation period (such parties, having been effectively barred from presenting their programs on TV, will have to rely on canvassing, as well as on the issuance and distribution of printed electioneering material). The problem is that, according to the RF Constitution, the State Duma may be dissolved only after rejecting three times the candidacies submitted by the RF President for Chairman of the Government of the Russian Federation, or after expressing lack of confidence in the Government of the Russian Federation (in the latter case, the RF President should either declare the resignation of the Government, or dissolve the State Duma). If Dmitry Medvedev remains as Chairman of the RF Government (and simultaneously Chairman of *United Russia*), MPs of the parliamentary majority faction *United Russia* should cast 'vote of no confidence' in the Government chaired by their party's leader.

Also, although this method is not envisaged in the RF Constitution, the State Duma can be self-dissolved if most of its members resign their seats (as is sometimes done to dissolve regional parliaments). Naturally, in the instance of the State Duma's self-dissolution, new elections should be designated. The proposal to shift the general election date points to *United Russia's* misgivings about the outcome of the election.

On 26 May (exactly on the same day as the 10<sup>th</sup> business forum *Business Russia* was held in Moscow with the participation of RF President Vladimir Putin), the RF Ministry of Justice announced its decision to designate the *Dynasty Foundation*, established by the telecom tycoon Dmitry Zimin, as a foreign agent. The *Dynasty Foundation* is known as the first and foremost private nonprofit foundation supporting science and education in modern Russia. The ministry explained its decision by the foundation being funded by money that Zimin keeps abroad. Even though the 'foreign agent' status does not prevent an organization from operating, it makes things considerably harder. Mr. Zimin already said that he will stop financing the institution unless the Ministry of Justice revokes its humiliating decision and apologizes, and noted that as the Russian Government keeps most of its money outside the country, invested in foreign assets, it should likewise be designated as a 'foreign agent'.

Having prolonged, in late April, the contract with President of *Transneft* Nikolai Tokarev, *Rosimushchestvo* (Russia's Federal Property Agency) prolonged for 5 years the contract with President of *Rosneft* Igor Sechin. These decisions gave rise to a plethora of rumors (based on the RF Government's refusal to finance *Rosneft* from the National Wealth Fund and President Putin's silence on this issue). However, it appears likely that Russia's authorities have decided to preserve, for the time being, the pol-yarchy-based system of governance of state-owned raw material companies and to abstain from any radical changes therein, especially during the current run-up in oil prices (having been above \$ 60 per barrel throughout May and sometimes shooting up to almost \$ 70 per barrel, on 28 May the price of Brent crude oil climbed to \$ 62 per barrel). Equally important were the RF Ministry of Finance's statements that it would oppose any rash innovations with regard to the taxation of the oil industry, and give its blessing neither to the introduction of a profit-based tax nor to the introduction of a tax on financial results.

The RF Government cancelled the customs duty on wheat exports introduced in February 2015 (as a matter of fact, this duty was introduced earlier, when *Russian Railways Co* suspended grain deliveries to ports for exports). The introduction of this duty, in

disregard of Russia having harvested a bumper wheat crop in 2014, as well as the fact of grain prices being persistently high, had infuriated Russian wheat producers. The decision to abolish this duty can only be greeted as good news.

There were some new developments regarding the conflicts that had arisen between two big Russian companies and *Alfa-Bank*, their creditor. *Alfa-Bank* filed a claim, seeking for *Uralvagonzavod's* bankruptcy. *Uralvagonzavod*, a major state-owned holding company, had defaulted on a number of its loans provided by *Alfa-Bank*. The outcome of the second conflict, between *Alfa-Bank* and the *Utair* airline, was quite different. Both *Alfa-Bank* and the airline withdrew their lawsuits against each other. Some time earlier this year, it was decided that, in order to repay its loans, *Utair* should issue additional shares of stock, which then were to be bought out by its majority shareholder, *Surgutneftegaz*. The only thing that surprises financial analysts is the company's failure to take this decision earlier, because the financial might of *Surgutneftegaz*, with its enormous deposits, is nothing but fabulous. The outcomes of these two conflicts (as well as the outcomes of the earlier conflicts of interest regarding the defaults of *Mechel*, *SU-155*, etc) have once again shown the alarming tendency of Russia's authorities to prevent the bankruptcy of major companies, and to avert any changes in their ownership. This tendency gives such a mighty impetus for nonpayment that even some very prosperous economic agents like *Surgutneftegaz* can occasionally succumb to it.

In May 2015, Russia's authoritative bodies and top government officials made only a few pronouncements on the situation in the Russian economy. First Deputy Prime Minister Igor Shuvalov said that the worst-case scenario had failed to materialize, and that 'we expect that after a certain stabilization of the situation Russian economy will start to rise above this lowest point', expressing his belief that it would happen as early as the end of 2015 or the beginning of 2016. Mr. Shuvalov said he hopes that the RF Central Bank will again cut the key rate in the coming months, and that Russia will introduce a moratorium on any changes in

tax legislation until 2019. The RF Ministry of Economic Development announced that GDP would most likely decline 2.8% in 2015, a slightly better forecast than the ministry's previous forecast of a 3% contraction. According to the new forecast, GDP in 2016 should grow by 2.3%. The IMF, traditionally more pessimistic than the RF Ministry of Economic Development, also improved Russian GDP outlook for 2015, expecting Russia's GDP to shrink by 3.4%, compared to a decline of 3.8% in its previous forecast. According to the IMF's new forecast, in 2016 Russia's GDP should grow by 0.2%. It should be noted that, all in all, the situation in the Russian economy remains rather alarming.

In May 2015, the Bank of Russia announced that it had reviewed the (rather radical) proposals of RF Savings Bank President German Gref to introduce a tough limit of insurance payments on deposits, and was ready to discuss them. In order to limit compensation to depositors of failed banks, Mr. Gref had suggested that a single lifetime limit should be imposed on the total amount of insurance compensation (Rb 1.5m) instead of a similar limit for each of the failed banks. The gist of German Gref's idea is crystal clear: the State should not bear responsibility for losses incurred by gamblers who are prone to deposit their money with an institution that has promised them the highest available interest rate. However, it should be noted that deposit insurance by the State is by no means a charitable activity, because it is financed by the banking sector itself, while Russia's main financial regulator, the Bank of Russia, is financed from the state budget. And after all, even a failed bank was once officially certified and issued a license by Russia's financial authorities, was it not? The RF Ministry of Finance's response to German Gref's proposals was quick and negative. Deputy Minister of Finance Aleksey Moiseev said that, once implemented, the measures proposed by Gref would undermine and subvert public trust in the banking sector, which the RF Government had tried to boost by increasing the limit of insurance compensation last winter. Thus, it can be said with confidence that the issue concerning the deposit insurance compensation limit is still far from being resolved in the Russian Federation. ●