THE POLITICAL AND ECONOMIC RESULTS OF JUNE 2015

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In June 2015, the EU states extended for another six months the economic sanctions introduced against Russia, as before linking this issue to the fulfillment of the Minsk agreements. At the St Petersburg International Economic Forum held this month, several deals were concluded, the biggest among them being the sale, by Rosneft to BP, of a 20% stake in an East Siberian oil producer company; however, the negotiations on another deal in the natural gas sector – the construction of a second pipeline to Germany, the second Russian-Chinese pipeline for gas deliveries via the Western route, or a pipeline to Greece – are still in the phase of memorandums of intentions. The decision on moving the parliamentary election from December to September 2016 was approved in first reading; Alexei Kudrin's initiative that it should be timed with the presidential election was supported neither by the RF President's Executive Office nor the parliament.

The major event of June 2015 was the St Petersburg International Economic Forum – a traditional venue for presenting important new contracts and discussing crucial economic issues as part of the general context of foreign politics. Quite naturally, the issue of prolongation of the economic sanctions imposed by the European Union – Russia's major partner in trade – was high on the agenda of the June 2015 Forum. The issue of sanctions was not associated with any specific intrigue – they were unanimously extended to the end of January 2016 and linked to the issue of complete fulfillment of the Minsk agreements concerning the crisis in Ukraine. The 'complete fulfillment' is understood, in particular, as the transfer of control over the Russo-Ukrainian frontier to Ukrainian border guards – a solution which, in everybody's opinion, is highly unlikely as it would mean an effective liquidation of the unrecognized republics. The intrigue expected in connection with the participation in the 2015 St Petersburg International Economic Forum (SPIEF 2015) of Greek Prime Minister Alexis Tsipras did not materialize: Mr. Tsipras made a number of statements expressing his goodwill towards Russia, but did not go any further than that. At the same time, Greece's representatives at the June 2015 meeting of the EU Permanent Representatives Committee and, later that month, at a meeting of EU foreign ministers, refrained from blocking the prolongation of the sanctions imposed on Russia by the EU. On receiving the news of the prolongation of economic sanctions against Russia, Russian authorities released their statement that the retaliatory sanctions would likewise be prolonged. The list of items subject to the sanctions remained basically the same, having been augmented in early June by a ban on imports of canned fish from Latvia and Estonia, presumably for sanitary reasons. Nevertheless, Russian Agricultural Minister Alexander Tkachev (who had been included in the list of persons banned from entering the EU) immediately called for 'considering a possibility' of limiting the imports of flowers to Russia, and also of banning the imports of pastry items and canned fish as part of extending the country's countersanctions.

At the 2015 St Petersburg International Economic Forum it was announced that several major deals had been concluded, first of all in the fuel and energy sector. The aforesaid transactions are as follows: *BP* acquired, for $ 750m, a 20% stake in one of Russia's largest oil and gas fields in Yakutia, Eastern Siberia, which belongs to *Rosneft*'s subsidiary *Taas-Yuriakh Neftegazodobycha LLC*. Also, *BP* and *Rosneft* signed heads of terms to pursue a reorganization of the German *Ruhr Oel GmbH* joint venture. The document envisages restructuring this joint venture by dividing between the parties shares in four refineries and associated infrastructure. As a result of the planned deal, *Rosneft* will acquire 50% of shares in the German refineries of *Ruhr Oel GmbH*. *BP* in exchange will consolidate 100% of shares in the Gelsenkirchen refinery and the solvent production facility *DHC Solvent Chemie*. Against all expectations, there was no breakthrough in the long planned deal between *Rosneft*'s subsidiary *Vankorneft* and one of China's major state-owned companies. Having agreed to acquire a 10% stake in *Vankorneft*, the Chinese company has so far continued to drag its feet on implementing the agreement. During SPIEF 2015, *Gazprom* signed two memoranda of intent. The first of these memoranda was a protocol signed by *Gazprom* with *E.On*, *Shell* and *OMV* on the construction of a new gas pipeline from Russia via the Baltic Sea to Germany, with a carrier capacity of 55bn cubic meters per year, i.e. another *Nord Stream*. However, the ultimate fate of this project will depend on whether or not the German Government or the European Commission (it will be determined after analyzing the jurisdictional scope of the agreement) will give it the go-ahead, which is still far from clear. *Gazprom*'s second memorandum was signed with Greece on the construction in Greek territory of a gas pipeline which is intended to be an extension of the *Turkish Stream* project. The Greek pipeline project worth $ 2bn in construction costs will be totally financed by Russia. However, having announced the inauguration of the *Turkish Stream* project half a year ago, Russia still has not entered into a legally binding contract on its construction with Turkey. Bearing in mind the traditionally strained relations between Turkey and Greece, it is unlikely that the conclusion of the *Turkish Stream* pipe-laying contract will be much hastened by the signing of Russia's agreement with Greece. Another stumbling block in the contract talks between Russia and Turkey is the wish of the Turkish government to independently determine possible re-export routes for the surplus of Russian natural gas. Apparently as a result of these problems, a few days after the conclusion of SPIEF 2015, *Gazprom*'s CEO Alexei Miller announced that Russia's President had instructed *Gazprom* to negotiate with Kiev on the extension of the transit of Russian natural gas through Ukraine after 2019. It should be reminded that previously Mr. Miller had repeatedly stated that *Gazprom* would never agree to extend its transit contract with Ukraine, thus explaining the necessity of building new gas pipelines to Europe. As regards Russia's *Western Route* project which envisages gas supply to China from Western Siberia's fields, it should be said that the negotiating parties, Russia and China, have so far failed to enter into a binding agreement. It seems that *Gazprom*'s position vis-à-vis its potential partners is relatively weak, and that it is trying to play off its main potential partners against each other. Apparently, *Gazprom*'s most realistic option in this respect remains the continuation of gas transit through Ukraine, which currently has huge idle pipeline capacities. Because of these surplus pipeline capacities, Ukraine may agree to moderate transit fees and a reasonable price for Russian natural gas. Moreover, Ukraine can be influenced in this respect by her European creditors. In June, French oil giant *Total* withdrew from a major Russian project in Western Siberia. It was announced that *Total*'s shares in several Bazhenov Formation oil fields situated in Khanty-Mansi Autonomous Okrug would be bought by Russia's *Lukoil*. *Total* said that the motive behind its decision to withdraw from the Khanty-Mansi project had been the consideration that it might be possible for it to be considered to be engaged in drilling and researching for new shale oil, which would then make it subject to the EU sanctions imposed on Russia. At the same time, one of the major investment projects in the field of oil production remained blocked not by the sanctions, but by Russia's authorities – in June, the Government Commission on Monitoring Foreign Investment once again decided to postpone the consideration of the issue of international oil services giant *Schlumberger*'s planned acquisition of *Eurasia Drilling Company*, although the Russian Federal Anti-Monopoly Service had approved the preliminary terms of the proposed merger.

As regards SPIEF 2015, everybody had expected President Vladimir Putin's speech at a plenary session of the Forum to be concentrated on global political issues. Instead, the RF President limited himself to assessing the state of the Russian economy. On the whole, his estimates were very optimistic. '*By the end of last year, as you know very well, people were predicting that we were in for a very deep crisis. This has not happened. We have stabilized the situation, absorbed the negative short-term fluctuations, and are now making our way forward confidently through this difficult patch. We can do this above all because our economy had already built up sufficient reserves to give it the inner solidity it needs. We still have a positive trade balance and our non-raw materials exports are increasing. […] We have kept inflation under control. Yes, it did spike following the ruble' devaluation, but this trend then slackened off. […] Our budget is stable. Our financial and banking systems have adapted to the new conditions and we have succeeded in stabilizing the exchange rate of the ruble and holding on to our reserves. […] The rate of inflation has increased, but the increase is insignificant. […] We have prevented a jump in unemployment*'. As far as Russia's short-term macroeconomic goals are concerned, Vladimir Putin said that '*first of all, we would like to ensure the growth of our economy at average global rates of about 3.5% in the near future. […] And to curb annual inflation to 4%'*. Such goals should be considered to be very ambitious indeed, even by comparison with the macroeconomic forecasts made on the same subject by members of the RF government.

The St Petersburg International Economic Forum has long been a venue for economic policy debates between various Russian ministers. In this regard, SPIEF 2015 was no exception: many of the RF government's members who took part in it were traditionally less optimistic than the President. Thus, Deputy Prime Minister Olga Golodets made a noteworthy statement, later repeated by First Deputy Prime Minister Igor Shuvalov, that in spite of the RF Government's promises to the contrary, the moratorium on the funded part of labor pensions could be extended to 2016. RF Minister of Labor and Social Protection Maxim Topilin proposed to 'figure it out' whether citizens abstaining from work without good reason should be included in the system of formation of insurance funds – in other words, whether an additional tax should be levied on such citizens, although his ministry had always denied harboring such intentions. *Sberbank* CEO and Chairman of the Board German Gref predicted that in the next few years the Russian economy would grow at a nearly zero rate (he also expressed doubts that Russia's economic growth would resume in 2016). Head of the Civic Initiatives Committee and former RF Minister of Finance Alexei Kudrin spoke in the same vein. RF Minister of Economic Development Alexei Ulyukaev and RF Minister of Finance Anton Siluanov were more optimistic in this respect, expressing their belief that Russia's economy would resume growth in the second half year of 2015. According to Mr. Ulyukaev's estimates, from 2016 onwards, Russia's economic growth rate would be between 2 and 3 percent per year.

Meanwhile, the main sensation at the Forum was the purely political proposal, voiced by Alexei Kudrin, that the next presidential elections should be held at the same time as parliamentary elections '*in order to make it easier for the head of state to implement the required reforms with a new vote of confidence*'. Some observers immediately suspected Mr. Kudrin of harboring presidential ambitions, of having 'entered into the presidential race' (Mr. Kudrin immediately disproved such allegations), and even of having called on Russia to elect a new president (from a legal point of view, early presidential elections do not necessarily imply that a new person should be elected as president of Russia). Head of the Presidential Executive Office Sergei Ivanov and Speaker of the RF State Duma Sergei Naryshkin doubted the advisability of shifting the date of the next presidential elections. Their (unspoken) arguments in favor of the existing electoral timetable are clear and sound: as Vladimir Putin's approval rating is much higher than that of *United Russia* (it is not by chance that *United Russia*'s symbols were not used in Putin's 2012 presidential campaign), it will be detrimental for that party if the parliamentary elections are held on the same date as the presidential elections.

In June, on the eve of his visit to Italy, RF President Vladimir Putin gave a seminal interview to the Italian daily *Corriere della Sera*. Head of the Presidential Executive Office Sergei Ivanov gave an equally noteworthy interview to the *Financial Times*. The opinions expressed by both interviewees were rather conciliatory in tone. Sergei Ivanov said as follows: '*As to Russian-American relations, we never wanted them to deteriorate. […] What is worrying is that, in my point of view, the rhetoric has started to go off-scale, sometimes from both sides*'. Later in the interview he admitted that '*it is naïve to think about strengthening relations until the conflict in Ukraine is settled*'. In his interview given to the Italian newspaper, President Vladimir Putin also emphasized the necessity of the conflict in Ukraine being settled by peaceful means. The fly in the ointment came from an unexpected quarter. In his interview given to the *Kommersant* newspaper, Russian Security Council Secretary Nikolai Patrushev said that the U.S. '*would very much like it if Russia did not exist at all. As a country*'. He supported his argument with a reference to a (fictitious) statement attributed to former U.S. Secretary of State Madeleine Albright, who supposedly said that neither the Far East nor Siberia belongs to Russia (she has never said such a thing).

In June, the Bank of Russia Board of Directors reduced the key rate from 12.5% to 11.5% per annum. Thus, the key rate was reduced for the fourth time in five months. Although economists differ in their views as to the latest cut in the key rate (for example, RF Minister of Economic Development Alexei Ulyukaev believes that the key rate should have been reduced more radically), bearing in mind that Russia's inflation rate is relatively high, the RF CB's piecemeal approach to cutting the key rate seems to be prudent and justified.

The RF Ministry of Finance submitted to the RF Government its proposals concerning budget expenditure cuts. In particular, these have to do with the raise of the retirement age for civil servants to 65 years, the extension of the active service period for the military personnel from 20 to 30 years, and the pegging of the indexation of pensions and social benefits not to the actual inflation rate, but to a lesser coefficient (for example, 5.5% in 2016). The information that these provisions had been approved at the meeting chaired by Prime Minister Dmitry Medvedev was later rebutted by representatives of the 'welfare bloc' in the government.

The State Duma approved in first reading the law whereby the election should be moved from December 2016 to the third Sunday of September 2016, which is viewed by opposition politicians as a manifestation of the desire to bring down the expected voter turnout and make it more difficult to conduct the electoral campaign, which will thus be held during the period of summer vacations, and a violation of the Constitution, which stipulates that the State Duma shall be elected for a term of 5 years (to expire in December). In this connection, the Federation Council has submitted a request to the Constitutional Court.

The State Duma approved in first reading the so-called 'law on the right to be forgotten', whereby the right of citizens to demand a removal from the data available to search engines of invalid or 'irrelevant' (more than 3 years old) information. If such information is not deleted, the plaintiff is entitled to file a petition to the court of justice at the place of their residence. The law caused many objections on the part of the IT business community, first of all on grounds that such businesses are unable, on their own, to properly determine the validity of relevant information – this is the task that should be performed by a court of justice, and the establishment of a potential requirement, nationwide, to uphold one's case in a court of justice will entail significant expenses. So far it is impossible to know what shape this law will ultimately acquire, but it is evident that its real purpose is to help cover up certain facts that can be used to the detriment of powers that be – and the Duma's deputies, by legally recognizing them to be 'irrelevant'.

A re-worked draft law on state control was introduced into the State Duma by the RF Government. The draft law envisages that, on 1 January 2016, Russia should introduce a three-year moratorium on planned inspections of small businesses – legal entities and individual entrepreneurs, excepting those of them who have committed law violations over the course of the three previous years, as well as persons working in dangerous places and in the fields of education and health care, and also auditors and residential block asset managers. It should be said, however, that half of inspections of small businesses belong to the category of unplanned checks, and it is known that the reasons for such inspections are traditionally rather vague. In a separate alarming development, Russia's Investigative Committee initiated criminal proceedings against several managers employed by the companies managing the assets of *Domodedovo Airport*, and against some 'unidentified persons' from the ranks of *Domodedovo Airport*'s actual owners. They were charged with provision of low quality services, which had been one of the contributing factors responsible for the terrorist act in 2011. Both this criminal case and the earlier well-orchestrated storm of indignation aimed at the company's owners seem to belong to the realm of fantasy … and it is totally unclear what which of the established rules they had actually violated.

A draft law 'On the Free Port of Vladivostok' and a package of related draft laws were introduced into parliament by the RF Government. The proposed legislation stipulates that the following tax benefits should be granted to residents of the free port of Vladivostok: a reduction in the property tax rate; a five-year exemption of companies from tax on property of organization and land tax; an exemption of imported equipment from customs duties and VAT; and a reduction in the rate of mandatory 'social' payments to the federal extra-budgetary funds (as the latter tax benefit to be granted to companies had given rise to criticism on the part of the RF Ministry of Finance, this clause should be reworked by the time of the bill's second reading in parliament). Also, the proposed legislation envisages the introduction of a simplified visa regime for foreign visitors to the free-port zone, making them eligible to obtain an 8-day visa on arrival. Apart from Vladivostok, the free port zone is planned to include the port towns of Nakhodka, Zarubino and Posiet.