

## MAIN POLITICAL AND ECONOMIC EVENTS OF JANUARY 2016

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*Against the backdrop of dramatically fluctuating oil prices, the main news of January were the plans declared by the Russian government, in particular the budget expenditure cut by 10%, the possibility of privatization of certain big state-owned entities, and the renewal of external borrowing. Russian Prime Minister Dmitry Medvedev, in his speech at the Gaidar Forum, confirmed the government course towards a 'Western type economy', which he estimated to be already in existence in Russia, and its refusal 'to return to the past'.*

The start of January 2016 was marked by plummeting oil prices, which dropped from \$ 36 per barrel in late December to below \$ 28 per barrel as of 21 January. However, towards the month's end, price of oil had returned to its previous level of \$ 36 per barrel. The ruble-to-USD exchange rate declined to below Rb 80, and similarly rose towards the month's end to less than Rb 75, which is slightly above its index observed in late December (Rb 73 per USD). Thus, this was a month of high volatility, with the general trend displayed by hydrocarbon prices being potentially more negative rather than positive, because even the 'rising' quotes are, in fact, 1.5 times below those planned in the law on the budget for 2016. All these developments, naturally, triggered hot discussions among the Russian elite as to what would be the best course in such a situation. According to expert estimations, the losses of Russia's budget – if this state of affairs in regard of oil prices should persist – will amount to no less than Rb 1.5 trillion, even considering the fact that losses to the value of more than Rb 2.3 trillion (geared to the planned oil price of 50 per barrel) were expected to be covered by allocations from the Reserve Fund. Speaking at the Gaidar Forum, RF Minister of Finance Anton Siluanov did not rule out a repetition of the 1998 Russian financial crash – that is, massive money emission and rapid devaluation of the national currency, to result in a swift devaluation of ruble-denominated cash liabilities: '*... Our task is to adapt our budget to the new realities. If we don't do that, we will see a repeat of what happened in 1998-99: the population will pay through inflation for our failure to bring the budget in line with the new realities*'.

One of the first ideas put forth by the authorities was a 10% cut in budget expenditure. It should be said that similar proposals had been already made one year ago. However, the proposed budget adjustment has been postponed for the time being – apparently at least until the end of Q1 2016. We believe that although it is clear that budget expenditure should be slashed, it is far from clear that its slashing should be mechanical and proportional with regard to all expenditure items. Russia's state budget is heavily weighted towards defense and law enforcement, which eat up almost one third of budget expenditure, and so make the USA, China and, of course, any European country look tightfisted in this respect. However, the experiences of 2015 indicate that Russia's authorities will do their utmost to prevent any serious cuts in military spending. As far as law enforcement spending is con-

cerned, it is unlikely to be cut either, especially after last year's reduction in the number of law enforcement personnel.

RF Minister of Finance Anton Siluanov said during his interview with Russia 24 TV Channel that in 2016, the government expected to receive revenue in the amount of approximately Rb 1 trillion from privatization of state assets. Meanwhile, no such revenue source is envisaged in the existing budget. The first asset earmarked for sale, according to Mr. Siluanov, was 19.5% of shares in *Rosneft* (so that the government could still retain the controlling stake in the company). Then he mentioned state banks, in particular *Sberbank* and VTB Bank, as well as the controlling stake in *Bashneft* that had been nationalized not so long ago. According to Anton Siluanov's estimates, *Rosneft* could well augment the state budget by no less than Rb 500bn. RF First Deputy Prime Minister Igor Shuvalov also spoke of an 'ambitious' privatization plan. The proposals appear to be quite reasonable, given the fact that for many years the refusal to attempt the privatization of state companies has been explained by some absurd arguments like their low capitalization – while under the current management it had been declining even prior to the onset of the 2014–2015 crisis. However, from a political point of view, such transactions are likely to take place only with regard to non-controlling stakes in big state companies, because their CEOs, who enjoy a very strong political influence, do not favor the idea of privatizing their controlling stakes. And it is not by chance that President of Russia Vladimir Putin declared that the privatization of *Sberbank* (where a non-controlling stake has already been sold) is not on the present-day agenda.

Besides, Anton Siluanov and his deputy Sergei Storchak do not rule out the possibility of external borrowing as a source of revenue. Since September 2013, Russia has not placed any foreign loans – first of all because of the financial sanctions introduced against Russia by the USA, the EU and Japan (the countries that used to be her biggest potential creditors), although domestic loans had been placed several times. But it can hardly be expected that foreign loans may be of any great help – considering that Asian private investors are traditionally very conservative in their outlook, while state investors (meaning first of all the entities managed by the Chinese government) are interested not in Russian bonds, but in Russian assets.

In late January 2016, the RF Government announced the forthcoming launch of its new anti-crisis plan, although at first its necessity as such had been denied. RF Minister of Economic Development Alexei Ulyukaev estimated this plan to be to the value of Rb 750bn. However, it is not yet clear which part of that sum is already included in the budget, and what amount is expected to be attracted as an additional revenue, for example to be covered by the reserves available to the RF Government, or to be derived as a result of a cut on expenditure (by 10%). According to preliminary data, the biggest expenditures will be associated with loans issued to those RF subjects that are expected to have difficulties with fulfilling their social mandates (in an amount of more than Rb 300bn), and with the support of the automobile industry (more than Rb 100bn). Besides, it is planned to support import substitution projects, agriculture, small businesses, the banking sector, and to raise the indexation of pensions to a rate above the planned one (which is set to be below the inflation rate). A little later we will learn what the government's ultimate political decision will be.

In January 2016, Russia's economic situation and prospects were expertly discussed at two major economic forums: the 2016 Gaidar Forum in Moscow, and the 2016 World Economic Forum in Davos. Traditionally, the participants of both forums expressed a number of highly polemical points of views. The most colorful of such viewpoints was undoubtedly presented by President of Sberbank Herman Gref in his speech at the Gaidar Forum. According to Gref, Russia is becoming a 'downshifter country' because of her increasing technological backwardness, a severe brain drain and the unwillingness of her society and economic agents to adapt to new challenges and new market demands. Prime Minister Dmitry Medvedev warned that Russia's economy 'must prepare for the worst-case scenario'. He also noted that '[ ... ] Russia even in the present situation is not going to turn away from the world, to change its policy towards economic mobilization. We have come a long way from the post-Soviet semi-ruined economy to a major economy of the western type, and it would be a huge mistake to go back to the past. [ ... ] The Government will not abandon the free conversion of the ruble. [ ... ] Business needs more freedom than it has now. We must simply eliminate domestic restrictions which stifle the business community. This is an absolute imperative. If the business community feels that our promises still remain mere words, then a reverse movement will begin, and nothing will stop the already substantial outflow of capital in the most diverse forms, and nothing will cure this business anemia. [ ... ] Our goal is not to douse the recession with money, which would be useless, as both you and I know. Our goal is to liberate the business initiative, to lower administrative and law enforcement pressure, and to make legal protection truly effective. There are many examples of how this is working. I will cite one of them: The Criminal Code article on penalties for hindering legitimate businesses is not applied, which is why we use a more predictable system of regulation that is based on inspections and supervision'. The RF Government's representative at the World Economic Forum Davos 2016, Russian Deputy Prime Minister Yuri Trutnev optimistically noted that Russia 'has significantly improved her positions in the World Bank's "Doing Business" ranking by raising from 120<sup>th</sup> place worldwide to 51<sup>st</sup> place', that sanctions against Russia 'have had the opposite result and led to increased support to the Russian President and the Government by the population', and that the devaluation of Russia's national currency 'is positive for foreign investors'. Chairman of the Civil Initiatives Committee Alexei Kudrin, by contrast, took a gloomier view of Russia's economic prospects. Speaking at the World Economic Forum he said that 'the peak of the crisis is still ahead'. And, 'as the RF Government is not ready to carry out structural reforms, it will have to increase taxation'. Still, Mr. Kudrin expressed confidence that 'a growth is possible in 2017' and that 'the sanctions will start to soften at the end of this year or start of next year'. Most unfortunately, all the pronouncements made so far by Russia's leaders and economists have one distressing common feature – a lack of confidence in the Russian authorities' ability to radically change their policies.

State Corporation Bank for Development and Foreign Economic Affairs (*Vnesheconombank*, VEB) announced that the sale of its two subsidiaries, *Sviaz Bank* and *Globex Bank* to another state corporation, the Deposit Insurance Agency, will make it possible for *Vnesheconombank* to raise Rb 212.6bn to repay part of its debt to the Bank of Russia. The remaining part of the debt will be transformed into a perpetual subordinated loan of the RF

Central Bank. Such an outcome of lengthy discussions has clearly confirmed the rumors that the troubled state corporation *Vnesheconombank* will be bailed out by the State.

In late December 2015 and early January 2016, the RF Government expanded its economic sanctions against Turkey. Thus, the Government approved a list of specific activities that cannot be performed by companies controlled by Turkish citizens, mainly including those operating in the tourism industry. The corresponding document submitted by the RF Ministry of Economic Development pointed to a number of individual travel agencies to be hit by the new sanctions, including *Coral travel*, *Pegas* and *Anex tour*, the companies that deny being controlled by Turkish citizens. Russian energy giant *Gazprom* cancelled a discount in natural gas prices for several private Turkish companies. In her turn, Turkey also began to impose tit-for-tat economic sanctions on Russia, e.g. by increasing import duties on a number of hot-rolled steel products from that country.

As regards Russia's internal political situation, January 2016 was a period devoid of major political events. The most noteworthy domestic news of the month was Chechen leader Ramzan Kadyrov's vicious verbal attacks on members of Russia's extra-parliamentary (non-systemic) opposition. Among other things, Kadyrov peremptorily dubbed them 'enemies of the people'. In response, non-systemic opposition activists swiftly returned the compliment, and, moreover, accused the Chechen strongman of complicity in the murder of Boris Nemtsov. Later on, Ramzan Kadyrov was severely criticized for his statements by Russia's Presidential Human Rights Ombudsperson Ella A. Pamfilova. Be that as it may, but several days later Mr. Kadyrov somewhat backtracked on his previous remarks, saying that he had addressed them to 'people who themselves violated the law or instigated others to do so'. It is noteworthy that two high ranking officials, Chief of Staff of the Presidential Executive Office Sergei Ivanov and Presidential Press Secretary Dmitry Peskov, publicly, though cautiously, expressed support for the latest version of Mr. Kadyrov's statements. ●