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Russia: a wartime economy

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In recent weeks, Russia has introduced further legal changes to adapt its economy to the needs of the war in Ukraine. This includes a law which has been passed on special economic measures to support the Russian armed forces during "counter-terrorism and other operations" outside the country. The document authorises measures such as the temporary reactivation of mobilisation capacities and facilities and unlocking the material assets of the state reserve. In addition, Russian companies will not have the right to refuse to fulfil contracts necessary for the activities of the Russian Armed Forces abroad; furthermore, businesses must be prepared to work three shifts seven days a week. In addition, the Defence Ministry and other bodies involved in the "special operation" (including the Ministry for Emergency Operations, the FSB and Rosgvardia) have been given the green light to change the terms of contracts already signed. State defence procurements, including those covering restocking purposes, can be carried out without tenders. Kremlin press secretary Dmitry Peskov reported that the government will decide in which situations the mechanism will be deployed.

At the same time, Denis Manturov, the former Minister of Industry and Trade of the Russian Federation, promoted to Deputy Prime Minister (replacing Yuri Borisov, who became head of Roscosmos in place of Dmitry Rogozin), will be responsible for overseeing state defence procurement and the implementation of the import substitution policy. President Vladimir Putin's younger daughter Katerina Tikhonova, in turn, became vice-chair of the committee on import substitution and technological independence at the Russian Union of Industrialists and Entrepreneurs.

One of the consequences of the laws adopted in the financial market area is the possibility of data on the size of Russia's international reserves being covered by state secrecy. Securities issuers were temporarily exempted from the obligation to update information on their financial situation and shareholders on an annual basis. Banks were allowed to apply a so-called negative interest rate for foreign currency deposits. In addition, the possibility for companies to buy back their own shares was extended by one year (until the end of 2023) to counteract the decline in their capitalisation.

The authorities also decided to index military pensions at 10% from 1 June. At the same time, credit institutions have been banned from seizing "payments significant from the social perspective" (mainly social benefits) which are due to military pensioners as part of debt repayment enforcement. In addition, those deemed unfit for further military service due to wounds sustained in combat may, upon going into the reserves, apply for a special financial allowance or continue to serve in positions created for them. The category of

persons who are entitled to compensation in the event of a soldier's death on the battlefield has also been expanded (e.g. to include people who were involved in raising the fallen person to adulthood for at least five years). The new law also allows civilians involved in the "special operation" in Ukraine to be granted veteran status: members of repair brigades, doctors, war correspondents and civilian personnel of the Russian Armed Forces.

In addition, a law was adopted on a one-off increase in Gazprom's mineral extraction tax. This will require the corporation to pay an additional ₽1.25 trillion (currently equivalent to around $22 billion) to the state budget in 2022.

On 14 July 2022, Reuters reported that Gazprom notified at least one European gas company that it might not be able to fulfil its gas supply contracts. In doing so, it invoked a force majeure clause (i.e. causes beyond the company's control), which is to apply retroactively from 14 June 2022. According to Reuters, restrictions on the supply of Russian gas apply to the Nord Stream 1 pipeline, which was halted from 11–21 July for annual maintenance.

Table. Key indicators of the Moscow stock exchange and the dollar exchange rate in roubles from 11 to 18 July (at close of session)

	11 July	12 July	13 July	14 July	15 July	18 July
IMOEX rouble index (points)	2,162	2,134	2,074	2,063	2,110	2,096
RTSI dollar index (points)	1,154	1,142	1,120	1,114	1,162	1,169
USD/RUB US dollar exchange rate in roubles	58.9	58.9	58.3	58.3	57.2	56.3

Commentary

- The law on special economic measures actually gives the Russian authorities the kind of powers they would have if general mobilisation were declared. The legal changes increase the Kremlin's freedom to wage war in Ukraine, but at the same time show that Russia's (mostly state-owned) industrial and defence sector cannot meet the army's current needs, so it is necessary to involve other industries as well. However, even in peacetime, private companies there were not especially interested in participating in the implementation of state defence contracts due to the extensive bureaucracy and security requirements, problems with enforcing payments from the contracting authorities and the low profitability of contracts (they were usually only subcontractors of large corporations linked to persons from the Russian ruling elite). In the explanatory memorandum to the law, the government explicitly wrote that the document is a response to a 'short-term heightened need' to overhaul military equipment and armaments and provide material and technical support to the military sector.
- The war in Ukraine and the unfolding economic crisis in Russia are becoming opportunities for further strengthen Putin's political-economic model. As a result, the role of the state in the economy is growing, competition is being reduced and corruption mechanisms are being expanded (as demonstrated, for example, by the increased

possibility of executing state defence contracts without a tender). In addition, Denis Manturov is considered to be an associate of Sergei Chemezov, (a close acquaintance of Putin's from his time in Dresden), chairman of Rostech (the state-owned defence industry corporation). His appointment as deputy prime minister and his gaining control of the arms sector and the import substitution policy therefore increase Rostech's importance for the economy and Chemezov's access to the growing budget expenditure allocated for these purposes, and thus the possibility of siphoning off public money into private accounts. Rostech was already one of the main beneficiaries of budget funds directed at state defence procurement and the decoupling of the economy from imports before the war, though with rather modest results to date. The control which Putin's elite has over business is also being strengthened by the new position of Katerina Tikhonova, who will oversee the activities of big business in the area of Russia's independence from imports. However, it is doubtful that these personnel changes will increase the effectiveness of the import substitution policy, especially under the current conditions which see the country cut off from Western technologies. It may be expected that, despite the large budget outlay, the downward slide of the Russian economy will continue, and the goods that manage to be produced will be more expensive and of lower quality.

- The secrecy about the size of the Central Bank of Russia's international reserves is a direct response by the Kremlin to the decision by Western countries to ban Russian gold imports (an embargo has already been imposed by the US, the UK, Canada and Japan; the EU intends to do so soon). As of 8 July, the central bank's reserves stood at $573 billion, some $60 billion less than before the invasion of Ukraine. Some $300 billion in foreign currency was frozen in accounts with Western banks, while another over $130 billion was placed in gold (about 2,300 tonnes of bullion). Withholding information is one of the Kremlin's ways of making it more difficult for the West to impose and enforce sanctions and to analyse the situation in the Russian economy. After the invasion began, the Russian authorities stopped publishing, among other things, data on foreign trade, oil production and exports, the financial condition of most large companies and their shareholders, and details on federal budget spending. This means that the Russian economy is de facto increasingly sinking into a grey zone and becoming dependent on unsupervised special bureaucratic regulations.
- The decision to increase Gazprom's tax burden on a one-off basis was yet another demonstration of the Kremlin's instrumental treatment of this company and the economy in general. The additional revenue from this company is equivalent to approximately 5% of the budget revenues planned by the government for the whole of 2022. By doing this, the Russian government is trying to compensate for the decline in non-oil and gas revenues to the budget (which have been lower in recent months than a year ago), in order to finance rising expenditure. At the same time, it should be noted that the additional tax burden imposed on Gazprom de facto coincides with the amount of dividends the corporation was supposed to pay to shareholders for 2021. (50% of the shares are owned by the state). However, on 30 June, against the recommendation of the Board of Directors, the General Meeting of Shareholders decided to withhold these payments. As a result, the corporation's share price collapsed (by more than 30%), with deep declines on the Moscow Stock Exchange. Turnover in the company's shares in

recent weeks suggests that some investors may have had access to insider information and profited from the stock price fluctuations. At the same time, Gazprom is being used by the Kremlin in its confrontation with the West, primarily the EU.

- The additional indexation of military pensions follows a rise of 8.6% (i.e. by the rate of inflation in 2021) in February, with the pensions of other non-working senior citizens also increasing on a similar scale. On the one hand, this shows that the Kremlin is trying to prevent the growth of discontent in this social group (there are more than 42 million pensioners in Russia, so they make up about 30% of the population, and the majority take part in elections). On the other hand, both the increases in military pensions and other emoluments for soldiers are aimed at making military service more attractive and at encouraging citizens to volunteer to fight in Ukraine. In a situation of crisis and declining public income, enlisting in the army may become a way to solve personal financial problems. However, the Kremlin's policy is inconsistent, and there are increasing reports that the authorities are failing to deliver on their promises (this is especially true of compensation for the families of fallen soldiers), undermining the already low trust in the state. The Kremlin has consistently under-reported the cost of the war in Ukraine. Available data for January–April 2022 showed a 45% increase in direct expenditure on national defence (excluding social payments) compared to the same period last year.