

THE POLITICAL AND ECONOMIC RESULTS OF MARCH 2013

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In March, Russia was faced with the unsavory prospect of a considerable loss of funds kept by Russian enterprises and individuals in Cyprus, traditionally one of the most attractive jurisdictions for Russian businesses. A significant portion of those funds was frozen or seized by the Cypriot authorities in an attempt to mitigate the dire financial problems besetting their own country. It turned out that, in fact, Russia had no means of responding to that challenge – the credit previously extended by Russia to Cyprus had not resolved any of the problems that were plaguing that country, and furthermore, Russia did not have any prerogatives to control the domestic economic policy of an EU member country, and was clearly reluctant to directly negotiate with the EU in order to protect Russian deposits in Cypriot banks. Elvira Nabiullina was nominated as head of the RF Central Bank. Nabiullina's nomination was seen as a compromise in the intra-government struggle between the supporters and opponents of a tight monetary policy. The State Duma adopted the first reading of a draft law amending Russia's parliamentary election procedures. Introduced for consideration by the State Duma by Vladimir Putin, the draft law is designed to restore single-mandate electoral districts and to allocate 50% of State Duma seats to their representatives. It also reduces the existing election threshold to 5%. However, the Draft Law erects a new electoral barrier in the form of a ban on persons convicted of serious crimes standing for parliament. It should be noted that, among other things, the 'serious crime' category comprises numerous types of economic offences carrying sentences that can easily be used as a means of political persecution.

In March 2013, Russia (as well as the international financial system and the EU countries) was badly shaken by the crisis in Cyprus, a small country with a population of around 1 million people. Notwithstanding its small size, Cyprus is a member state of the EU and the Eurozone, with a considerable financial sector much in excess of its GDP (although it should be admitted that, for example, the banking sector's asset-to-GDP ratios of the UK and Switzerland are not much smaller than that of Cyprus), and a public debt approaching 100% of its GDP (comparable with the levels of public debt accumulated by the USA and the countries of southern Europe). Of course, the small size of Cyprus's economy was, on the one hand, an adverse factor (because the resources that could be obtained from the non-financial sector were small). On the other hand, the volume of financial support needed for the country's bailout was also relatively small. Thus, according to the EU's estimates, on the whole, Cyprus will need € 17bn in aid, and the first reimbursement tranche of Cyprus's debt, due in June, will amount to less than € 1.5bn (for reference: a year ago, Greece's creditors wrote off no less than € 100bn in debt). Also it should be noted that Cyprus, along with the Netherlands and Luxemburg, has long been the largest nominal foreign investor in Russia's economy. Much of this investment, however, is repatriated Russian capital, previously transferred out of Russia. For a long time, active attraction of foreign investments has been providing Cyprus with the means to pursue a rather irresponsible and reckless economic policy – to increase public debt and government expenditures, to shun privatization, and to actively invest in quasi-public corporations (it is noteworthy that the most serious problems were revealed at the local analogue to Russia's Savings Bank – the second largest Cypriot bank *Laiki*). On Saturday 16 March 2013, disaster struck – Cyprus and its European creditors announced the suspension of all banking transactions in the country (after being closed for almost two weeks, banks reopened only on 28 March). At first, the European authorities offered Cyprus a bailout solution which violated the EU's own laws – Cyprus was asked to make a gesture of solidarity by seizing part of the monies kept in all Cypriot banks (6 to 9% of deposits), both 'problematic' and otherwise, except for the deposits guaranteed up to € 100,000. For the obvious political reasons (the losses to be incurred by small depositors-citizens of Cyprus), the Cypriot government was unable to pass that decision through parliament. Russia refused to give Cyprus a new loan, and limited its aid to restructuring its \$ 2.5bn credit extended to Cyprus in 2011. It is not clear whether or not Cyprus had offered Russia anything in exchange for a new loan (in fact, it could have offered a wide variety of assets, for example the state-owned assets in the profitable field of communications and telecommunications, the high-risk but potentially very profitable natural gas deposits on Cyprus's continental shelf, etc.). The negotiations were carried out

behind closed doors, and in their aftermath some Russian officials hinted that the Cypriot proposals had not been interesting enough in their proposals. As a result, in exchange for the EU's € 10bn bailout for Cyprus, the Cypriot authorities announced the freezing and partial seizure of large deposits (over € 100,000) in the two largest Cypriot banks. (The formulae for implementing these measures have so far remained unclear.) It should be added that, in many respects, the Cyprus crisis is shrouded in mystery – for example, Cypriot banks had been calmly transacting business as usual right until the very day when the Cypriot and EU authorities made the announcement about ‘freezing’ their accounts (if the two biggest Cypriot banks had been as problem-ridden as the three Iceland's banks in a similar situation in 2008, they would have simply stopped returning deposits). Also, it is not clear whether the final beneficiary of the ‘bailout’ will be the banks or the Cypriot government – the latter otherwise having to face a default on sovereign debt in June (in this respect, the situation was more complicated than in Iceland which, unlike Cyprus, had had its own currency – the bankruptcy of Iceland's banks and the subsequent devaluation of its national currency, as well as the fact of the State of Iceland assuming the responsibility to compensate resident depositors, had had a limited impact on the situation in the EU).

In any case, Russian enterprises and citizens have apparently lost many billions of euro in the Cyprus crisis. And it is far from clear whether or not it is advisable to save their deposits at the expense of Russia's budget in conditions when the Russian authorities, unlike past centuries¹, are unable to enforce law in Cyprus. But it is crystal clear that similar problems with Russian assets can emerge in other EU countries, especially bearing in mind the eagerness of Europe's supranational monetary authorities, with their vaguely defined responsibilities, to ‘plunder the loot’ (one of Dmitry Medvedev's quotes). In fact, the general deterioration of the situation in the EU, Russia's main trading partner, represents a serious challenge to the economic stability in Russia.

In March 2013, the RF State Duma adopted the first reading of a draft law amending Russia's parliamentary election procedures. The draft law had been introduced into parliament by Vladimir Putin, and it is noteworthy that a similar draft law introduced by Dmitry Medvedev one year ago has not been considered by the State Duma as yet. In the main, Putin's draft law reflects the promises given by the authorities in December 2011 in response to mass protests. To a certain extent, it follows in the footsteps of the previous (Medvedev's) draft law, but at the same time contains a number of important differences. Medvedev's draft law envisaged that parliament should be elected on a party-list basis, and that a proportional closed-list system in a single nationwide constituency with a 5% threshold should be established. Had Medvedev's bill passed into law, the so-called ‘locomotive’ method, when ‘charismatic’ candidates run at the head of all or many of their party lists, would have become a thing of the past. A candidate would have been able to run at the top of his or her party's list only in one region, and the concept of federal party candidates would have disappeared. To some extent, this innovation was intended to increase *United Russia's* electoral advantage, because that party was (and is) capable of finding a charismatic (‘locomotive’) candidate in practically every electoral district, while the opposition had (and has) much fewer well-known candidates. On the other hand, it has become evident that such regional ‘locomotive’ candidates can sometimes be less effective than several persons with high approval ratings put at the top of the whole list. Also, the proposed new system contradicted the electoral interests of Vladimir Zhirinovskiy, whose electoral campaigns have always been based on his egocentric propaganda – if Medvedev's draft law had passed, voters would have seen Zhirinovskiy's name only on one of his party lists, and not on 225 lists (that is the number of Russia's electoral districts). In conditions when *United Russia* had lost its constitutional majority in parliament, and in some regions – for example, St. Petersburg – it had failed to win even a simple majority without the support of Zhirinovskiy's party (his rhetoric in 2012 plainly indicated that the LDPR had become the main satellite of *United Russia*), the ruling party's bigwigs decided not to sacrifice the interests of their ally. Thus, the draft law recently adopted in its first reading, in fact, fully restores the rules that existed at the time of the 2003 parliamentary election – 50% of seats are allocated to party-list representatives, and 50% of seats – to single-mandate-district representatives elected in one round of voting. Although the ballot option of voting ‘against all’ is not to be restored and election blocs are not to be permitted, the signature threshold for candidate registration is lowered. Moreover, the Draft Law exempts political parties from the need to collect signatures in order to take part in parliamentary polls. However, the Draft Law introduces a new electoral barrier in the form of a life-long ban on persons convicted of serious or exceptionally serious crimes standing for parliament. In fact, this ban applies to all persons convicted for crimes punish-

¹ In the past, the failure or refusal of the government of a sovereign state to pay back its debts to other states or private creditors was one of the main causes of war.

able by the deprivation of liberty for a term of more than 5 years – including, for example, Michael Khodorkovsky. If the new bill passes into law, the latter will not have the right to stand for parliament after having served his prison term. As far as the ballot counting standards are concerned, it should be noted that things will remain mostly unchanged – here and there some new barriers are to be introduced (for example, the Draft Law restricts the right of election observers to make video recordings at polling stations), while some barriers have been lowered (the Draft Law stipulates the right of election observers to watch the vote count from a distance close enough to make any markings in the ballots visible). It should be said, however, that the Draft Law will undoubtedly cause a lot of arguments in parliament. Thus, the parliamentary parties are actively trying to introduce mandatory collection of signatures for non-parliamentary parties. If their attempts succeed, the new parties and their candidates will face the risk of their lists being arbitrarily annulled on the pretext of containing ‘invalid’ signatures. Bearing in mind the current practices in Russia’s regions, this abuse has all chances to spread all across Russia. At the same time, such a system will largely destroy the essence of the proposed liberalization of party legislation, and so will make senseless the very idea of creating new political parties. Moreover, it will stimulate the opposition to resort to the old and tested method of combating *United Russia* by voting for any party but the party in power. It should be added that, in this case, *United Russia* will not get the redistributed votes cast for the parties that have not passed the electoral threshold, and will not benefit from the dispersal of votes caused by voting for candidates in single-member districts. Thus, the outcome of the saga surrounding the new draft law is still unpredictable.

In March, the lengthy and furious tussle over leadership of *Rostelecom*, Russia’s major telephony provider, finally came to an end. The struggle for the top job in that company had been going on between the supporters of two former Ministers of Telecommunications and Mass Media – Igor Shchegolev (2008–2012) and Leonid Reiman (2004–2008). *Rostelecom*’s former President Alexander Provotorov is said to be participant in many interesting business schemes – from the buy-out of shares in *Rostelecom* carried out in robust market conditions at the expense of the loans extended to *Rostelecom* against collateral of those same shares, to the attempt to push through a merger scheme between *Rostelecom* and *Sviазinvest* that would have resulted in the State (which owned the controlling blocks of shares in both companies) losing its control over the consolidated company, and in a subsequent rise in the price of shares held by minority shareholders. In 2012, the RF Government had initiated his resignations, but the RF President’s Executive Office immediately blocked that move. At the same time, multiple criminal proceedings launched against Provotorov and his friends from the *Marshall Capital* company were being held both in Russia and abroad. As a result, *Rostelecom* got a new head, the well-known telecommunications manager Sergey Kalugin, a long-standing partner of both *Rostelecom* and various big businessmen, including Yuri Kovalchuk and Suleiman Kerimov. The largest and much contested block of shares held by *Rostelecom*’s minority shareholders was sold to Arcady Rotenberg’s structures.

In March, the Russian authority nominated a successor to Sergey Ignatiev, who had completed his third and final term as head of the RF Central Bank – the post he had held since the early 2000s. The person nominated for that position was Elvira Nabiullina, a former RF Minister of Economic Development (2007–2012) and currently one of the advisors to President Putin. It should be noted that the post had been vigorously contested both on opportunistic and ideological grounds. The struggle had been accompanied by hectic media campaigns. The opponents of Sergey Ignatiev’s policy had primarily criticized him for the following aspects of his course: support of the concept of stabilization funds (they believed that money should be invested in various projects inside Russia, and not in foreign assets); a tight money supply and high interest rates, which they saw as insufficient incentives for boosting economic growth (although, for example, in 2012 the growth rate of money supply was almost twice as high as the rate of inflation, and, according to many economists, the Central Bank extended credits to commercial banks far too liberally in conditions when the commercial banks themselves were reluctant to provide credits to the real sector of the economy). Moreover, the Bank of Russia had been criticized for various dubious situations involving big banks, namely for extending to them unsecured credits (the most scandalous cases being the *Mezhprombank* [International Industrial Bank] default and *Petroff-Bank*’s insolvency) and lax control over their activities (which had been clearly insufficient in some cases, which resulted in falsification of accounts and/or tolerance for the obvious absence of assets; in other cases, the Bank of Russia’s control had been, on the contrary, too stringent, and some banks were, in fact, penalized for successful commercial activities aimed at attracting depositors). Ignatiev’s followers had expected that his policy would be continued by such candidates for his post as Aleksey Kudrin, Aleksey Uliukaev, Oleg Viugin and Mikhail Zadornov, formerly of the conservative RF Ministry of Economic Development, while his opponent had hoped for the appointment of RF Presidential

Advisor Sergey Glaziev, economist and former politician, known as an avowed Leftist. As a result, a compromise candidate was nominated for head of the Central Bank, and it is obvious that Elvira Nabiullina's candidacy will be approved by a majority of votes in the State Duma. Sergey Ignatiev had the honor of being personally thanked by President Putin and of having been appointed advisor to the new head of the Central Bank. Whilst being Minister of Economic Development, Nabiullina became famous for her incessant debating with the RF Ministry of Finance about the necessity to increase government expenditure; besides, she is known as a compromise-seeking candidate, who tries to maintain a balance of forces among Putin's supporters. In fact, she lacks the same degree of self-confidence and readiness to do the unrewarding job of a 'treasury keeper' as had been typical of the former heads of the Ministry of Finance and the Central Bank.

In March, the State Duma adopted the second ('key') reading of the law 'On the Federal Contract System', which for more than a year had been a source of heated institutional disputes between several state departments. The proponents of the new law (represented, in fact, by the overwhelming majority of departments, state-companies, and government establishments) have been criticizing the existing law on government purchases for such flaws as the overestimation of the importance of price and the underestimation of the quality criteria applied to many types of goods and services whose properties cannot be easily translated into formalized principles; the existence of gaps in the law that enable dishonest market participants to resort to dumping tricks or fail to fulfill their contractual obligations, or simply sabotage the results of a tender. Also, the law was criticized for the extraordinary powers granted to the Federal Antimonopoly Service (FAS), which enable the latter to cancel a tender outside of the ordinary course of legal proceedings, leaving its winner with the option of disputing the FAS's decision in a court of justice. The proponents of the old law, led by the FAS's head and executive secretary of the government commission for foreign investments Igor Artemiev spoke of the necessity to eliminate the few drawbacks of the current good law. At the same time they insisted that the proposals put forth by the advocates of the new law were aimed at endowing the customer with unlimited powers, which would inevitably create a situation when any legal entity could be appointed winner in a tender under the pretext of its 'high qualifications', or the tender procedure could be altogether abolished and replaced by unspecified 'competitive negotiations' no matter with whom. Of course, the FAS was ready to fight tooth and nail to preserve all its prerogatives. And it did fight. The FAS was generally supported by the public at large (very often joined by the contractors, who are not prepared to initiate direct court proceedings), content that they could make use of their right to renounce the result of tenders. Meanwhile, the financial institutions servicing government contracts were fighting their own battles – for example, campaigning for the preservation – or exclusion of bank guarantees as a method of securing a contract. On the whole, the FAS has lost the argument, although many nuances will only become evident after the actual adoption of the reference norms mentioned in the law. Budget-funded institutions have been granted the right not to apply the procedure of a tender in a situation when the money in question is not allocated from the budget but is earned by a budget-funded institution on an independent basis (grants, commercial services, etc.). The timeline for a tender is shortened from 30 to 20 days. If no candidates have applied for the right to provide for the first purchase, the procedure for the second one is to be simplified. Tougher requirements are introduced for the participants in tenders. The banks have not been deprived of their right to grant bank guarantees, and the suppliers, if security is provided, are granted the right to derive interest from it. The rights of the FAS and the public to interfere with the course of a tender have been restricted, the right of 'public discussion' and the right of appellation can be applied only several years later, and in the period of 2014-2015 – only with regard to purchases to the value of above Rb 1bn.

RF President Vladimir Putin assigned to the RF Government the task of altering the regulations for the imputed social payments established for individual entrepreneurs. It should be reminded that in 2013 the amount of these payments was doubled – to more than Rb 35,000, and so in the first few months of the new year 2013 more than 300,000 Russians liquidated their individual businesses. It is important to note that these were real businesses (otherwise there would have been no point for their owners to pay half of that amount – just as it is not a problem for those who apply that regime only to optimize their financial schemes to pay twice that amount). This measure hit especially painfully the provincial entrepreneurs, because there to be an individual entrepreneur does not mean to be rich. Probably, the actual size of the 'gift to the people' – either a general reduction in the amount of payments, or its subdivision into categories (depending on the amount of profit, turnover, etc.) – will be announced later, maybe on the eve of the *All-Russia Popular Front's* first congress, which is to be held in summer. ●