

# How Medvedev Delivered on Last Year's Promises

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President Medvedev speaking at the St. Petersburg forum June 18, 2010. **Denis Grishkin**

Many of President Dmitry Medvedev's promises made at last year's St. Petersburg International Economic Forum have been fulfilled as he endeavors to attract investment and modernize the economy.

But increasing capital flight shows that the measures — often expressed in tangled legal language — weren't convincing enough. As a result, not everything is looking up.

Russia's huge market did attract money and commitments from international players since the previous forum. Pepsico expanded its presence last year by buying local dairy and juice producer Wimm-Bill-Dann, while foreign industrial conglomerates such as Ford, Alstom and M3 announced plans to invest in local production units.

At the same time, Central Bank data showed that \$26.3 billion left the country this year as

of May 1, compared with last year's total flight of \$38.3 billion.

Medvedev has conceded that the "investment boom" he sought at the forum didn't happen, pointing to graft as the reason. "The grip of corruption isn't loosening. It's a chokehold on the entire economy," he said at an investment meeting in March. "The result is obvious: The money is fleeing our economy."

Economists and commentators have named more diverse reasons for the outflow, including the uncertainty ahead of the presidential election next March. Both Medvedev and Prime Minister Vladimir Putin have said they will decide in due time which of them might run.

Another reason capital is seeking sunnier climes is the expectation that the government will have to raise taxes to support swelling social expenses, economists have said.

U.S. Vice President Joe Biden, during his visit in March, and others blamed lack of rule of law, as in the cases of former Yukos CEO Mikhail Khodorkovsky and the lawyer who died in jail after accusing taxmen and law enforcers of fraud.

One of Medvedev's investor-friendly promises, the cancellation of the capital gains tax, took effect in January just days after a Moscow court chilled the business climate by extending Khodorkovsky's prison term to 2016 in his second trial — which many observers described as politically motivated.

At a May news conference in Skolkovo, the president promised he would propose more ideas at the coming forum in a bid to make the country a darling for investors. At the news conference, he again dodged specific answers about his re-election bid, casting doubt on how successful the new measures might be.

"Until the political dust settles, the business environment is not likely to improve," said Russia analyst Lilit Gevorgyan at IHS Global Insight.

Here's an overview of progress on the specific promises Medvedev made at the previous forum:

*Promise:* Target budget spending toward modernization by paying for expanding "electronic government."

*Result:* The Cabinet in October approved an 88 billion ruble (\$3.14 billion) program for the "information society" through 2020, to develop infrastructure and provide services to the public. Telecommunications company Rostelecom is testing a new web portal for the services, which will be available at Gosuslugi.ru on all platforms, including smartphones. The portal had 5 million unique users in 2010, according to Communications and Press Minister Igor Shchyogolev.

*Promise:* Target budget spending toward modernization by paying for expanding access to broadband Internet connection.

*Result:* No specific progress reported.

*Promise:* Target budget spending toward modernization by paying for grants to young scientists and promising research.

*Result:* Such grants have long been a government policy. A total of 460 scientists aged 35

and younger received annual presidential grants worth 300 million rubles in February.

*Promise:* Target budget spending toward modernization by paying for the growth of energy efficiency in the economy.

*Result:* The Cabinet approved a tentative program in October to run through 2020 to raise energy efficiency. Putin said the spending for this year would come to 7 billion rubles of federal funds. Russia is the most energy-intensive country in the world, consuming 1.39 tons of coal equivalent for every \$1,600 of GDP produced. That's three times higher than Canada and more than any other BRIC, according to a 2009 report by the McKinsey & Company consultancy. Companies like U.S.-based Honeywell pursue regional administrations here to sell them energy-saving technologies.

*Promise:* Propose further amendments to protect business from excessive pressure by law enforcement agencies.

*Result:* Medvedev in March signed a law that eliminates prison terms as mandatory punishment for a range of crimes, including fraud, illegal entrepreneurship and tax evasion. The threat of incarceration was one of the most heavily used intimidation tools for law enforcers to extort money or favors from business people.

*Promise:* Cancel the capital gains tax for long-term direct investment, starting in 2011.

*Result:* Starting this year, the capital gains tax no longer applies in certain investment cases, bringing the fiscal rules an inch closer to Western standards.

"The tax exemption on capital gains is now similar to that in many European countries," said Vladimir Gidirim, executive director for tax and legal issues at Ernst & Young. "But it's not as liberal." It applies to Russian investors that buy private equity only if they subsequently hold the stake for at least five years, which Gidirim described as "unreasonably long." Essentially, the exemption will first take effect in 2016.

*Promise:* Create a state-backed equity fund to attract strategic investors.

*Result:* Creation is being wrapped up. The government amended the federal budget to contribute 62 billion rubles to the fund this year — planning to raise that amount to \$10 billion over the next few years — in the hope that investors will see less risk if the government puts some skin in the game. Kirill Dmitriyev, 36, was appointed the fund's chief executive. The Harvard MBA graduate's latest job was president of Icon Private Equity, a fund that manages more than \$1 billion. He earlier worked at McKinsey & Co. and Goldman Sachs.

*Promise:* Improve visa rules in the "near future."

*Result:* No improvements enacted since then. An agreement with the European Union could be signed by the end of this year to allow five-year visas between Russia and Europe's Schengen zone for professionals, such as business people and government members, not tourists. Both Medvedev and Putin proposed earlier this year canceling visas with the United States.

*Promise:* Create an environment of fair competition between state and private companies.

*Result:* Medvedev ordered government officials to step down from the boards of state-controlled companies by Oct. 1. A few officials, including Deputy Prime Minister Igor Sechin at Rosneft, have already obeyed the order. It appears that at least one government official will have immunity from this command — or step down from his Cabinet position: First Deputy Prime Minister Viktor Zubkov has recently been renominated as Gazprom chairman.

*Promise:* Seek entry to WTO, OECD, and develop the customs union.

*Result:* There is general consensus that Russia will enter WTO by the end of this year, and OECD is on deck. Russia has been developing its customs union with Belarus and Kazakhstan, which WTO officials are eyeing cautiously.

*Promise:* Pass a law on a national payment system by the end of 2010.

*Result:* The bill was awaiting a second reading in the State Duma in May. If approved, it could be implemented starting next year.

*Promise:* Cancel the profit tax for health care and education companies.

*Result:* Sponsored by Putin and supported by Medvedev in the forum speech, the measure went into effect in January. However, companies — at least in the health care business — have been unable to use the tax waiver because the government hasn't issued the needed bylaws, according to the Economic Development Ministry.

*Promise:* Ask the government to draft a program for the support of education of Russian students in leading international universities.

*Result:* The Cabinet submitted the proposals, the Kremlin said on its web site in April, without elaborating.

*Promise:* Continue creating the Skolkovo innovation center.

*Result:* Medvedev has since signed a law to regulate Skolkovo, while the center has enlisted the cooperation of Microsoft, Nokia, Intel and several other international players.

*Promise:* Pass laws by the end of 2010 on consolidated financial accounting, regulating the activities of affiliated persons and a central depository, as part of the effort to develop Moscow as an international financial center.

*Result:* Medvedev signed the accounting law in July; there have been no reports on the affiliated persons law; the depository bill was awaiting a second reading in the State Duma as of May. Nineteen foreigners have been picked as members of a committee of 27 to advise Medvedev on how to turn Moscow into a center of international finance. The lineup features top names from Wall Street and the City of London including JPMorgan Chase's Jamie Dimon, Citigroup's Vikram Pandit and Goldman Sachs' chief Lloyd Blankfein. The committee will also include former Kremlin chief of staff Alexander Voloshin. Blankfein said during a visit in March that the biggest inhibitor he saw to achieving the goal was Moscow's traffic jams.

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