

Moscow Needs to be Shrewd on Cyprus

By [Philip Hanson](#)

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Has the European Union bungled the bailout plan for Cyprus and given Moscow unexpected influence in the island? There has been a lot of talk about Russia stepping in to provide finance in return for stakes in Cypriot offshore oil and gas fields and positions on the boards of Cypriot banks. It is quite likely that the Cyprus crisis will lead to Russia gaining a greater degree of influence. But Russian politicians, bankers and businesspeople face their own dilemmas when it comes to dealings with Cyprus. It will not be smooth sailing for Moscow by any means. ☒☒

To begin with, Russia already has some influence over developments in Cyprus, but it is not necessarily of a kind that the Kremlin is keen to encourage. Cyprus is a favorite Russian offshore financial center. But at the same time, Russia's leadership is pushing for "de-offshorization" of the economy — at least that is their official position.

At present, a lot of Russian money goes "round-tripping" through Cyprus. In 2011, Russian banks and companies' direct investment in Cyprus totaled \$22.4 billion, or one-third of total Russian outward foreign direct investment. In the same year, inward direct investment

into Russia from Cyprus was \$13.5 billion, or 24 percent of the total. In the first three quarters of 2012, the last for which data are available from the Central Bank, the picture was broadly similar. Much of this is perfectly legal, but no doubt some is dubious.

In addition to these capital flows, there are large amounts of dividends paid by leading Russian firms to companies in Cyprus. The recipients are the holding companies through which Russian tycoons often control their businesses. For example, most of the Russian steel industry is controlled through Cyprus: Evraz through Lanebrook, Novolipetsk Steel through Fletcher Group Holdings, Severstal through Frontdeal and Magnitogorsk Iron & Steel Works through Mintha Holding and Fulneck Enterprises.

The original bailout scheme posed a risk to Russian investors in Cyprus, particularly bank depositors. Most estimates put the sum of bank deposits in Cyprus by Russian companies and individuals at 25 billion euros (\$32.5 billion), or about one-third of all deposits. Probably most of these are above 100,000 euros (\$130,000) and would have been subject to the levy of 9.9 percent proposed in the first bailout plan. Understandably, the government did not want to antagonize one of the island's major sources of wealth.

The original plan, rejected by the Cypriot parliament on Tuesday, was not welcomed in Moscow, either. President Vladimir Putin described it as "unfair, unprofessional and dangerous," a judgement with which many Western commentators concurred. Finance Minister Anton Siluanov deplored the fact that Russia had not been consulted and raised doubts about the rolling-over of an existing Russian loan of 2.5 billion euros to Cyprus. ☒☒

What could Moscow do? Russia has minuscule public debt, a balanced budget and large reserves. Lending Cyprus up to 15 billion euros would not be impossible, but what would Russia get out of this deal?

Repayment could lose big if the loans are not repaid in full. The hydrocarbons quid pro quo also looks problematic. Stakes in offshore oil and gas fields sound attractive at first glance, but there is much more checking to be done before these are well-assessed. In addition, territorial issues with Turkey would be unwelcome since Turkey is a strong business partner. There are also complications regarding the contiguity of possible Cypriot and Israeli offshore claims. As for Russia's increased control of Cypriot banks, they are the source of the Cyprus problem in the first place.

Moscow has been given a significant role in a sensitive intra-EU matter. It now needs to make good use of its newfound influence.

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