

# Russia's Blockchain Revolution

Russia has gone a bit blockchain bonkers

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Russia has gone a bit blockchain bonkers. President Vladimir Putin has been looking for something for Russia to be good at for a while, but hasn't had much luck so far. Now it's the secure data-transfer technology's turn and here Putin actually has a very good chance of making a difference.

Back in 2006, Putin gave a speech in which he said: "Russia's greatest asset is not oil and gas, but its people. Russia's human capital is its most valuable resource."

And given Russia is the country that put the first man into space while working under a totalitarian regime that was run on central planning lines, he probably has a point.

Putin followed through by launching a complete reform of higher education that has been one of his unsung successes and seen the previously corruption-riddled universities start to climb

back up the international rankings.

He also authored a public health reform to promote natal and maternity care that resulted in ballooning birth rates well ahead of even the most optimistic international forecasts that led to the first population growth since 1991.

But on the innovation front, he had a lot less success. While Russia has long been, and still is, a world leader in military technology, with the S-400 anti-missile system that the Kremlin just sold to Turkey and the new fifth-generation SU37 fighter being prime examples, it has failed miserably with innovation for civil purposes.

The Kremlin's first big idea was to promote nanotechnology, and the state poured billions of dollars into one state agency after another to promote research into the sector.

Nothing came of it. The Russia Venture Capital Fund was founded to bootstrap into existence the private equity and venture capital funding that drives so many innovations, but that failed to find any significant projects to back.

But the latest craze — for blockchain — could be different from these earlier attempts. The technology is only a few years old and by lucky happenstance Russia (well, a Russian) is already a leading innovator. Blockchain is so new no one has a lead yet and the whole of Eastern Europe has embraced the virtual tech so completely it is already holding its own against the developed world.

### **“Ill” with interest**

This year's St Petersburg International Economic Forum (SPIEF) is where the Kremlin's commitment to blockchain became obvious. Those in the industry say they suddenly started getting calls from the Kremlin ahead of the event, pestering them to attend Russia's premier business showcase.

Government officers who were unconvinced by blockchain before SPIEF (or simply had never heard of it) were not afterwards. The blockchain panel session made it clear that developing the technology is now top of the Kremlin's priority list.

“Blockchain is now the number one task,” First Deputy Prime Minister Igor Shuvalov, probably the third most powerful man in Russia, said at the session. “The president is completely ill with this idea and understands that ... significant growth rates are based on the digital economy and technological leadership.”

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Shuvalov told journalists the president had kept advisors up until well after midnight one evening discussing the issue. Now Shuvalov has been put in charge of the working group to make it happen. The first meeting was held in July.

Shuvalov is reportedly focusing on big data and lobbying for the introduction of the technology in public procurement and the provision of public services — a theme common to all the governments in Eastern Europe. The central idea is to remove officials from the

process and hence the source of corruption and inefficiency.

But it is still very early days and blockchain's currency, bitcoins, are barely in circulation, even though Russia's state-owned retail banking giant Sberbank reportedly has a coffee machine in its lobby that accepts payment in crypto-currencies.

Last year Russia's first bitcoin exchange point opened on central Moscow's Novy Arbat Street, but shut again within four months due to lack of demand. And most recently the entrepreneur Anton Fridel set up a crypto-currency ATM that sells bitcoins in a Siberian café. It took him three months to develop the idea and 2 million rubles (\$35,000) of capital to launch the business, but the venture has been fraught with problems.

"We expected to succeed quickly thanks to our advertising efforts. However, due to the unstable legal environment, most media resources have refused to promote us," said Fridel.

One of the biggest problems is no one is certain of the tax status of a crypto-currency based business. "We'll provide the tax services with all the required documentation. However, we're not sure it will be accepted," the entrepreneur added.

### **Ethereum's got the smarts**

Part of the reason for Putin's enthusiasm is that Russia is already a pioneer in blockchain technology — something that was not true for its push into nano-technology.

Bitcoin is the best known of the crypto-currencies, but the Russian-made Ethereum is its main rival and growing fast. While Ethereum works on the same principles, the main difference between the two coins is that you can attach a "smart contract" to Ethereum, which is legally binding, whereas you can't to bitcoin.

Jacob Drzazga is one of the co-founders of [Brickblock](#), that is about to offer an Initial Coin Offering (ICO) and has already raised \$20 million to develop a blockchain platform that allows everyone from around the world to invest into German real estate based on Ethereum, not bitcoin, tokens.

"The problem with real estate investment is it is usually very national. I, as a German, cannot invest in U.S. real estate and they cannot invest in German real estate, unless you go through the hassle of setting up legal entities and bank accounts," Drzazga told bne IntelliNews.

The smart contracts on Ethereum get around this problem as it is in effect a proxy investment that can be made internationally, similar to a global depository receipt used to buy stocks in an emerging market that are traded on other exchanges in developed markets.

"If you invest then once you have registered you are issued with a token that you can trade. The token is a share of a building in Berlin that pays rent. The smart contract not only registers your ownership of the token and all sales and transfers of that token in the future, but it also takes your share of the rent and sends it to your account each month," says Drzazga.

Brickblock is about to offer its first real estate asset for investment and in the pre-offer raised a lot of money from Russia. "I was surprised as we had very heavy traffic from Russia during

the pre-offer although we did almost no marketing there,” Drzazga says.

Despite the lack of effort, his concept was well covered in the Russian press which is hot for any crypto-tech related story.

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The second part of the appeal of Brickblock is that there is no lower limit on investment. Drzazga used to work in real estate, raising investment for projects and offering properties to investors.

The typical German real estate fund has a minimum investment requirement of €5,000, as they need to cover the admin costs of bringing in new people, but as the smart contracts attached to Ethereum take care of all that work, the minimum investment is no longer necessary.

In effect, Brickblock is offering a new distribution channel to real estate funds and opening up their list of potential investors to the whole world. On the obverse side of the coin, Russian investors — including the middle class — are very keen to park their savings in something safe outside of Russia, and according to recent polls real estate is currently the asset of choice.

Since the Cypriot banking crisis, the previous favorite offshore haven for middle-class Russian savings, money has flooded into the German property market with prices rising over 30 percent in the last three years.

“The last appeal of the blockchain technology for a real estate investor is the transaction is riskless,” says Drzazga. “As the transaction is instantaneous and the record immutable there is no counterparty ‘delivery vs payment’ (DvP) risk in this investment. The smart contract records both sides of the deal at the same time.”

While some in the Russian government and elsewhere have likened bitcoins to a Ponzi scheme, the advantage of Brickblock tokens is they are backed by bricks and mortar, which has an intrinsic value.

Governments have become interested in blockchain as a way of keeping public records and cutting down on corruption, however, the extinction of the DvP risks in these real estate transactions is extremely appealing for any sort of trading. Typically exchanges offer settlements that are guaranteed in three days (known as T plus 3), or less, but potentially a smart contract enhanced Ethereum token could eradicate the need for much of a broker’s back office and massively reduce both risks and costs.

This point has not been lost on the Russians who will, if they launch cryptocurrency-based trading, insist that it goes through an exchange so the development of these contracts will remain under the control, or at least supervision, of the financial regulators.

### **Central bank collywobbles**

And that is going to take a while. The Kremlin may be “ill” with the idea of blockchain and its

applications, but all the central bankers in Eastern Europe have the collywobbles from the unregulated cryptocurrencies that come with it. Russia's financial authorities are very nervous about backing a fiat currency that they have no control over and is underpinned by nothing.

"I would like to clarify — we do not prohibit crypto-technologies, we study them. Still, there is a big difference between the crypto-currency and crypto-technologies," Central Bank of Russia (CBR) governor Elvira Nabiullina said at SPIEF.

The National Bank of Ukraine is likewise unhappy and Ukraine's justice ministry is already trialing a blockchain registry.

The point of currencies is they are controlled by the central bank that issues them. By definition, crypto-currency cannot have a central authority so it is the antithesis of traditional money.

"We can say that [bitcoin] is definitely not a currency because there is no central issuer. And we cannot recognize this as a means of payment," said Oleg Churiy, deputy head of the National Bank of Ukraine, in September.

But in Russia, the orders have come down from above and the pieces are being put into place. The CBR's deputy governor Olga Skorobogatova has been put in charge of overseeing cryptocurrencies and announced at SPIEF the central bank was considering launching its own cryptocurrency.

At the end of August, Russia's finance ministry was working on a bill on cryptocurrencies that is aimed at protecting buyers and sellers of cryptocurrencies legally, Deputy Finance Minister Alexei Moiseyev said on August 28. The bill should be submitted to the Duma soon.

"What we see, for example, with bitcoin, this information wave around this whole story, the enthusiasm of citizens who are not qualified investors, is dangerous, because if we look at the dynamics of bitcoin, it is very similar to the dynamics of the value of MMM shares," Minister of Economy Maxim Oreshkin said on September 27 referring to the Yeltsin-era Ponzi scheme that duped millions of Russians.

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