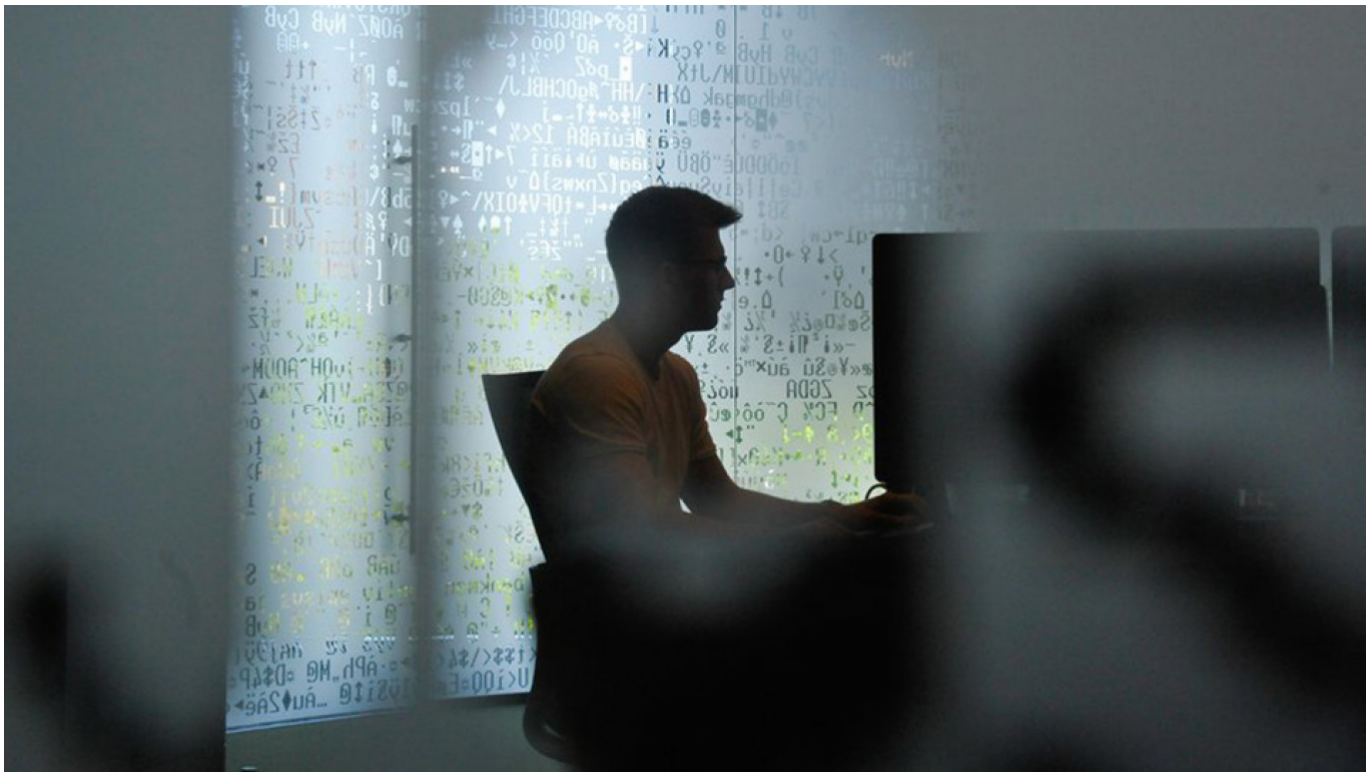
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What's Behind Russia's New Offensive Against the Internet Economy?

In recent months, Russia has launched a new attack on web-based companies.

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Alexander Avilov / Moskva News Agency

Russian President Vladimir Putin's current term will go down in history as a time of increased repression, but it will also likely be remembered for its growing offensive against the Russian internet. Today, the Kremlin and security agencies want to control both the communications infrastructure and the companies working in it, their owners, and even the content they produce.

They are taking aim at a particularly fertile segment of the economy. Russian internet companies have achieved relative success competing with their Western counterparts in several segments of the market: email clients, search engines, taxi apps, food delivery apps,

and anti-virus software.

But the state's desire for total control is destroying this competitive environment. Despite official plans to develop the digital economy, the authorities are now limiting its growth with their own actions. The first victim of this tech repression will most likely be internet company Yandex, which has found itself under growing pressure in the past year. Other IT companies will follow.

In the long run, the big losers will be citizens, whose freedoms are increasingly restricted.

Less than half a year ago, Russia passed its so-called "sovereign internet" law, which expands government control over the web. Since then, the authorities have launched regulatory attacks on internet businesses.

In July, lawmaker Anton Gorelkin introduced a bill into the State Duma that would prohibit foreign legal entities from owning more than 20% of internet information resources deemed significant for Russian infrastructure. The Cabinet initially labeled the bill harmful, but the parliament's upper chamber, the Federation Council, still supported it.

Related article: Yandex Shares Drop on Draft Foreign Ownership Law

Around the same time, Senator Andrei Klishas essentially proposed monitoring what Russians write in their emails. A new draft law he initiated could require email clients to identify their users by phone number and restrict their access to email should they spread forbidden content. If passed, this law would only apply to domestic "information dissemination organizers": Yandex, Mail.ru, Rambler and other email clients. Klishas presented his bill as an anti-terrorism measure.

Meanwhile, Gorelkin has admitted that his bill is specifically aimed at Yandex and Mail.ru. According to him, Yandex is exactly the type of company it seeks to regulate: It's registered in the Netherlands, 85% of its charter capital is listed on the NASDAQ stock exchange, and 49.2% of its voting rights belong to founder Arkady Volozh, who is a citizen of Malta.

In reality, however, the presidential administration — specifically Deputy Chief of Staff Sergey Kiriyenko, who oversees domestic policy — is behind both laws, according to several sources in internet companies and the federal bureaucracy. And, in this campaign, the bureaucracy and security agencies have found common cause with businessmen tied to the Russian state.

According to media reports, one of the reasons for Goreklin's bill is a conflict between Yandex founder Volozh and German Gref, president of state-owned Sberbank. In autumn 2018, the state bank aggressively attempted to obtain a 30% share in Yandex — supposedly to defend the company from potential problems with competitors and the state. That news story alone cost the company $1.8 billion of its market capitalization.

The Kremlin was reportedly dissatisfied with Yandex's ownership structure and wanted Russian citizens to own the company. At the time, Volozh declined to enter negotiation with Gref. Thus, the government intervened and proposed transferring 60% of voting rights into a

fund controlled by Volozh and 10 to 12 top managers with Russian citizenship.

Related article: Western Intelligence Hacked 'Russia's Google' Yandex to Spy on Accounts

Gref wanted Yandex because he aims to turn Sberbank into a Russian Amazon.com — a technology company with its own retail, fintech, media and other divisions. The state bank already has a joint project with Yandex: The Beru online marketplace. However, the two partners have serious disagreements about how to develop the business.

For that reason, just days before Gorelkin initiated his draft law, Sberbank announced it had agreed to form a strategic partnership with Mail.ru. The two companies will create a joint enterprise worth 100 billion rubles. Both companies will contribute money, and Mail.ru will contribute its Citymobil taxi app and Delivery Club food delivery service — Yandex's main competitors. The logic here is predatory: As Yandex is altering its ownership structure and losing value, Sberbank and Mail.ru will occupy the dominant position on the competitive market.

This approach isn't new. So-called "state capitalists" regularly use administrative resources to solve business issues unrelated to the public good. For this reason, Gref and his desire to weaken a competitor could easily be behind Gorelkin's draft law, suggests one federal official.

Beyond this, the authorities also want to control the freewheeling internet and IT companies. The presidential administration appears to be behind Gorelkin's law and influential security officials supported by the administration back Klishas' initiative. And controlling online content is one of Deputy Chief of Staff Kirienko's top priorities, especially as Russian society grows more politicized and protests erupt across the country.

The Russian authorities can control the media through loyal owners, injections of budgetary money, and restrictions on foreign ownership. But to battle user-generated content, bloggers, and information spread by small independent media, the government needs the internet sovereignty law. However, the authorities are not entirely sure how to implement it from a technical standpoint.

Klishas' draft law on monitoring emails is a typical example of security agencies and bureaucrats working together to control internet companies and their users. Hardline lawmaker Irina Yarovaya's infamous law, which allows the Federal Security Service (FSB) to demand internet companies provide them with information to decode user traffic, is another example. The legislature justified passing it in 2016 as a national security and anti-terrorism measure.

This summer, the FSB demanded Yandex provide it with encryption keys for its email and cloud storage services, but Yandex hasn't complied. Russia has already blocked the Telegram messenger app for such a refusal. But, so far, Yandex has avoided that fate, because the government interceded and promised support in working with the FSB.

This is part of an approach security agencies and bureaucrats use in their battle for budgetary funding: Inventing threats and means of defending the country from them. The more frightening the threat, the better their chances of receiving state funding to fight it. But this

harms ordinary citizens, whose freedoms are restricted, and internet companies, who lose money and markets.

Related article: Sberbank and Yandex E-Commerce Joint Venture May End in Divorce

Officially, Russia is attempting to grow into a global leader in technological development. It has many of the conditions necessary for that: widespread, affordable high-speed internet and competitive companies with their own patents and developers.

But while technocrats and visionaries are building the digital Russia of the future, bureaucrats and the security agencies are trying to control not only online content, but the entire IT market and its nascent branches, like the big data industry.

So far, the distribution of power in Putin's Russia has not benefited visionaries — even those with high-level official positions. Instead, power is concentrated in the hands of bureaucrats and security agents. These two groups have capital — both money and coercive power — and they have de facto privatized the functions of the state.

State capitalists use the state to solve their own business issues and increase their wealth. Security agents use it to increase their authority and control over online content and cash flows. For example, the implementation of Yarovaya's law requires companies to spend billions on data storage and equipment certification — services provided by companies tied to the security agents. Meanwhile, officials speak openly about Gref's interests in attacking Yandex.

In these conditions, competitive development and innovation simply cannot occur. And the cost of the bureaucrats and security agents' joint efforts can be easily measured: Major losses due to technological and innovation lag in the medium term as the country tries to digitalize the economy.

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