The Moscow Times
30 YEARS
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Russia’s Flawed Justice Is Holding Its Economy Back

The case of Valery Izrailit shows the damage Russia’s broken justice system is inflicting.

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November 26, 2019

Valery Izrailit — one of the business owners who declared their foreign assets on promises they would not be used against him for prosecution. **Ruslan Shamukov / TASS**

In a recent interview with Izvestia, presidential aide Andrei Belousov noted three ingredients in his recipe for economic growth in Russia.

One of Belousov’s economy-boosting troika of reforms was improving the investment climate, including by protecting business from predatory siloviki officials.

It’s not difficult to see why Belousov attaches such importance to this measure. From the high-profile cases of Mikhail Khodorkovsky and Michael Calvey, to the everyday “raiding” of small and medium-sized businesses by law enforcement actors, the chilling effect of the siloviki on economic activity in modern-day Russia is clear.

One ongoing case highlights the problem.

Valery Izrailit — chairman of the board of directors of Ust-Luga, a company developing a seaport in Russia's Leningrad region, near St. Petersburg — was originally charged with two counts of large-scale fraud with one accusation being that he supplied used pipes instead of new ones during construction, with damages estimated by investigators to be 3.2 billion rubles ($50 million). He was then charged with money laundering. So far, nothing that unusual.

Things became much more worrying, however, when Izrailit was charged under article 193.1 of the Russian criminal code, which relates to moving money into the accounts of non-residents using forged documents.

This charge was added after investigators from Russia's intelligence agency, the Federal Security Service (FSB), were able to access the businessman's asset declaration, which included confidential information on Izrailit's foreign companies and his London flat, as well as his foreign bank accounts and stocks.

Izrailit supplied this declaration to the Russian Federal Tax Service (FNS) in 2016 as part of Russia's capital amnesty program. The goal of this initiative — which President Vladimir Putin announced in his 2014 state-of-the-nation address to Russia's lawmakers — was to allow Russians to repatriate and legalize assets held abroad on the guarantee that their declarations would not be used against them in the form of criminal, administrative, or tax investigations.

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As well as a clear and emphatic promise from Putin, this proposal was formalized into law a year later as Federal Law 140, which fleshed out the president's guarantee that the information provided in declarations could not be seen or used by law enforcement officials.

And yet, the FSB was able to seize the declaration from the FNS in March 2017 with the approval of Russian courts.

Izrailit's lawyers have attempted to secure the removal of the asset declaration — and other material drawing on it — from his court case.

On Nov. 12, a St. Petersburg court refused to exclude the declaration as evidence, in spite of a decision two weeks early by Russia's Supreme Court that declarations could not be used to initiate criminal proceedings, emphasizing that the information supplied to FNS is a "tax secret".

A day later, the Supreme Court reiterated its position, making clear its decision against the use of declarations also applied to administrative and tax cases, not just criminal cases. The Court also made clear that the provisions of Federal Law 140 should trump other laws in cases of contradictions.

At its heart, this is a story about promises by, and trust in, the state. It's clear how this relates to the business climate — something backed up by common sense, but also academic research.

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In 1989, two American political economists — Douglass North and Barry Weingast — published a seminal paper that aimed to explain the institutional conditions necessary for economic growth. They focused on the changes made in England following the Glorious Revolution of 1688.

The basic argument of the paper is that the constitutional settlement reached in this case allowed the monarchy to make credible promises — and that it could be held accountable for its commitments by parliament and an independent judiciary. This set the scene for improved economic performance.

The case of Izrailit shows how no such institutional arrangement exists in modern-day Russia for the state to make credible commitments. The President might have made repeated guarantees that business owners would not be pursued by the siloviki on the basis of asset declarations. The Federal Assembly might have passed legislation giving this promise legal expression. But neither the personal assurances of the head of state, nor the black letter of the law protected Izrailit.

In their paper, North and Weingast said "the Crown" was the singular actor that needed to be constrained. And yet, one problem demonstrated by the Izrailit case is that, in Russia, there are multiple actors that need to be constrained. Even public promises from the president aren't enough, it seems, to keep lower-level law enforcement actors in check.

Of course, not all members of the law enforcement system in Russia are crooked. Nor is it impossible to realize justice in certain cases. But uncertainty concerning when formal rules and clear instructions from the top will be followed are major factors in hampering economic growth.

Rather than merely stating a recipe for growth, Belousov would do better proposing ways he thinks this reform could be realized. He has his work cut out.

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