



THE PBN COMPANY is an international strategic communications, government relations and public affairs consultancy serving clients worldwide from offices in Washington, DC, London, Moscow, Kyiv, Riga, Almaty and Chisinau.

Thursday, July 29, 2004

Volume 1 Issue 20



## No August Vacation for Political Intrigue!

Political issues are even hotter than the temperatures in Washington, Moscow and Kyiv.

Just when you thought it was time to enjoy the lazy days of summer, the latest twists and turns of political intrigue are keeping PBNers around the world glued to the television, to the newspaper and even to the streets. Political issues are even hotter than the temperatures in Washington, Moscow and Kyiv.

Russia is abuzz with the facts, fictions and falsehoods of the most recent banking crisis, not to mention the seemingly inevitable bankruptcy and nationalization of Yukos, hitherto Russia's largest and most successful company. In Ukraine, a bargain basement sell-off of some of the country's most prized assets is underway. And, in Washington DC, presidential politics have turned international trade issues into trading cards for electoral votes in key battleground states.

### Russia's Banking Mini-Crisis: Dangerous Games

By Vlad Berezansky, Vice President, PBN•Moscow

[\[click here for full story\]](#)

### Crony Privatizations in Ukraine: Closed Doors or Hidden Opportunities?

By Myron Wasyluk, Senior Vice President, PBN•Kyiv

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### Tis the Season to Debate Trade Issues

By George Felcyn, Senior Account Management, PBN•DC

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### News from PBN Around the World

Babies (And Myron!) Onboard

[\[click here for full story\]](#)

In this issue of Access PBN, three PBN policy analysts provide a behind-the-scenes look at each of these intriguing situations.

The common thread to each: "all is not what it seems."

"Understanding the intricacies of political and economic situations is not a science, but an art," says PBN Chairman Peter B. Necarsulmer. "And we practice this art every day, whether it is in the Russian, Ukrainian, Baltic, European or U.S. context."

Read on to find out what we think are the realities of and reactions to the Russian banking crisis, the Ukrainian privatization scandal, and the politics of international trade during a U.S. presidential election year.

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## Russia's Banking Mini-Crisis: Dangerous Games

By Vlad Berezansky, Vice President, PBN•Moscow

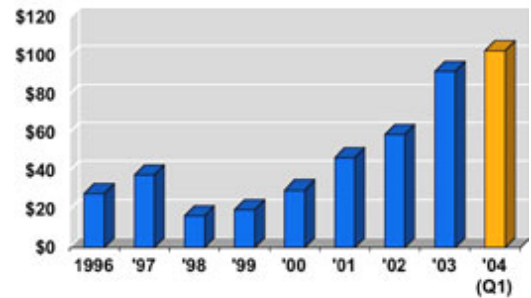
This summer's Russian banking crisis du jour provides grounds for viewing the Russian economy — specifically, Russia's banking sector — with both optimism and pessimism. In some sense, this "crisis" was somewhat underwhelming. Economists and banking analysts have long warned that Russia has too many small banks that are ineffective at carrying out their core function — financial intermediation.

The core events of this mini-crisis are as follow: In May, Russia's financial intelligence unit yanked the license of Sodbiznessbank for ostensibly correct reasons — i.e., suspicion of engaging in money-laundering. But this caused jitters in the market, especially among retail consumers. Keep in mind that Russia's deposit insurance system was only recently enhanced to span the entire banking system. Next, Guta Bank was rumored to be struggling, which led to a panic-driven run on its accounts and the inaccessibility of short-term loans from the Moscow interbank market. News that Guta Bank was collapsing fuelled rumors of another August 1998, prompting consumers to withdraw their savings from Dialog-Optim, Alfa and several other banks — this despite early withdrawal penalties of as high as 20 percent.

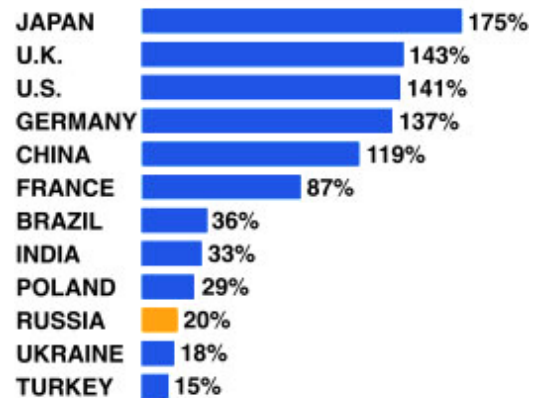
Fortunately, the Russian Central Bank and the private banks reacted in time to calm the market's jittery nerves. The Central Bank slashed mandatory reserve requirements by 50 percent, thereby pumping cash into the domestic banking system. AlfaBank, the largest single object of consumer panic, engaged in effective crisis management while reinforcing its retail network with as much as \$1 billion in liquidity.

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### Russian banks are lending more but still less than other countries' banks



Bank lending to private sector, in billions (\$US)



Domestic credit provided by banking sector, as a percentage of gross domestic product

Source: *The Wall Street Journal*

Those are the known facts. Many other causes of the crisis are largely unknown and therefore the subject of speculation and conjecture.

## Behind the Scene of the Banking Crisis

At the time that Sodbiznessbank's license was revoked, several "black lists" of supposedly similarly targeted banks were making the rounds. It's no longer important to determine the sources of these lists. Post-Soviet Russia has provided Western business analysts with yet another neologism: *kompromat*. This is a compound word comprised of the Russian words for "compromising materials." In a country where "journalism on order" is the rule rather than the exception, the generation of *kompromat* is a standard means of marketplace competition in Russia.

The regulatory action against Sodbiznessbank and the ensuing uneasiness in the retail banking sector can be seen as normal events — meaning random occurrences that could happen anywhere at any time in a market economy. But there was nothing random about the mugging of Guta Bank. The general sense of discomfort among retail consumers of banking services was consciously fed and directed toward Guta and, albeit less successfully, certain other Russian banks. All things being equal, there were many other banks in Russia that would have made more likely candidates for road-kill during a real — meaning unscripted — banking crisis.

Other speculation and rumors abound. First, the role and function of the regulators: Why was Sodbiznessbank targeted for special scrutiny by the Financial Monitoring Committee (FMC), Russia's federal banking compliance agency? There are plenty of smaller, murkier banks in Russia. Was the FMC genuinely interested in making an example of a relatively large bank whose practices were insufficiently scrupulous? Or was Sodbiznessbank just another example of collateral damage from the Battle of the Oligarchs? If the latter, then the instigators of this 21st Century Show Trial gave little thought to the larger ramifications of their actions. If the former, then the FMC's actions — although intended to show vigilance — can be described as ham-handed at best.

## Central Bank Forced into Action

The other, more prominent regulator on the scene is the Russian Central Bank. Many observers have been waiting for the new post-Gerashchenko Central Bank to emerge. Insiders have described Sergei Ignatyev, the new chairman, as a capable economist but not a strong manager and too academic to make the necessary reforms. But these crisis circumstances forced the Central Bank into action, almost as if despite itself.

Once the Central Bank began to stir, it acted intelligently and effectively. This is in distinct contrast to the FMC, which arguably unleashed a Pandora's Box of panic. In addition to cutting the capital reserve requirement in half, the Central Bank ordered Sberbank, Russia's largest state-owned bank, to lend liberally on the Moscow interbank market. Further, it pressed the Duma to expedite approval of a wide-sweeping deposit insurance mechanism for consumer deposits at Russian private banks that fail to qualify for the Central Bank's official deposit insurance program. These measures conveyed the message that non-qualifying banks would be weeded out, but that consumers would be protected at least up to 100,000 rubles (approximately \$3,400) per account regardless of where they banked.

Within the Central Bank, the rising star is Deputy Chairman Andrei Kozlov. Another theory is that this crisis was designed at least in part to remove him. Mr. Kozlov has long advocated more aggressive implementation of orthodox banking practices; but his agenda has been hampered by vested interests. According to this scenario, the FMC's disqualification of Sodbiznessbank for ostensibly 'reformist' reasons — punishment for money-laundering — was supposed to lead to the widespread panic that in fact ensued. Mr. Kozlov, together with any sympathizers and allies within the Central Bank, could then be purged under the banner: "See? This is what your 'reforms' lead to." If that was the plan, it went terribly wrong. The combination of consumer depositor panic and paralysis on the interbank market created a vacuum that required filling; and Mr. Kozlov filled it with his reform agenda. Although it's still too early to tell, the doctor's prescription appears to be curing the patient rather than killing him.

## **Russian Banks Circle the Wagon**

Finally, what of Russia's commercial banks? Representatives of nearly all major (and many less prominent) Moscow banks attended a July luncheon meeting of the Association of Russian Banks. In short, no circuit preacher ever ministered to a more motivated gathering of repentant sinners. The discussion lasted more than two hours and — certainly by the frosty standards of the Russian business world — was remarkably cordial. First, the "irresponsible" journalists were castigated. Reading between the lines, one might expect that the level and intensity of internecine attack articles — kompromat — will decline significantly, if not cease altogether. Next, those gathered to break bread promised solidarity and to stand strong against those not represented.

Remarkably absent from the business lunch were representatives of Sberbank or any foreign bank operating in Russia. Finally, the brethren gave tribute to the long-suffering Russian passbook account holder. Again, one didn't need to read the subtitles to understand the message: No more scaring the babushki (grannies) into cleaning out their savings

accounts. What goes around comes around.

Whether or not the Russian banking community has in fact been "scared straight" remains to be seen. But the new Central Bank appears to have been effectively jump-started; and the FMC just might take a lesson from its previous inelegant performance. Undoubtedly, the clear winners from this summer's turmoil will be Sberbank and the other state-owned banks such as Vneshtorgbank — which purchased what was left of Guta Bank for the knock-down price of one million rubles (about \$34,000) — and the foreign banks operating in Russia.



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## Crony Privatizations in Ukraine: Closed Doors or Hidden Opportunities?

By Myron Wasylyk, Senior Vice President,  
PBN•Kyiv

Ukraine's President Leonid Kuchma in July marked a decade of rule over this nation the size of France with a population of 48 million. His tenure will come to an end this autumn when a new president is elected in what is expected to be a highly contested race.

But, before Kuchma departs Byzantine Ukrainian politics, he's destined to make his mark on Ukrainian history even more indelible by engaging in one of the largest bargain basement sell-offs in Europe this year. Some of Ukraine's most profitable and sought-after industrial jewels have posted "For Sale" signs on their front doors. But the highest bidder isn't always the winner. Instead, most of the tenders are going to Ukrainian oligarchs with close ties to the outgoing president.

### Why the Rush?

State budget revenues from privatization in Ukraine during the past decade have never been more than \$500-800 million annually. So why is the government expecting to collect four-to-five times more money this year? Among the answers most mentioned by analysts are:

- Kuchma's heir apparent Prime Minister Viktor Yanukovich's chances of winning the presidency in October are uncertain, so the sell-offs have been accelerated before democratic opposition leader Viktor Yushchenko could come to power.
- Incumbent Prime Minister Viktor Yanukovich needs \$400 million from privatization revenues to pay state employees' wage arrears and back pensions to help bolster his presidential race.

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Leonid Kuchma, outgoing president of Ukraine, speaks during a press conference in Kyiv.



Viktor Yushchenko, leader of the Our Ukraine political party, announces his presidential candidacy before thousands of voters at Kyiv's Spivochne pole, a popular concert venue on the shores of the Dnieper River.

- Insider privatization deals now are more likely to allow oligarchs to buy cheap and re-sell enterprises at a significant mark-up if Yushchenko comes to power.
- With Yushchenko as president, local oligarchs cannot compete with strategic foreign investors who can offer top-bids for competitive and profitable industrial enterprises.

## **What's for Sale and Who's Winning?**

Enterprises on the auction block are from a broad spectrum of industries. Among the most promising are: steelmaking and metallurgy plants, iron ore mines, telecommunications companies, electricity distribution plants, shipbuilding companies and much more.

The President's son-in-law, Viktor Pinchuk, and Donetsk billionaire Renat Ahmetov have so far done well in state privatizations. In June, Ukraine's state property fund sold the Kryvorizhstal Steel Making Plant to Messrs. Pinchuk and Ahmetov, who offered the lowest bid of \$800 million. Government officials turned down better offers from Russia's Severstal (\$1.2 billion) and the UK-USA consortium of LNM-US Steel (\$1.5 billion).

Mr. Pinchuk's Interpipe Corporation recently won the tenders for a number of iron-ore and coal assets. Messrs. Pinchuk and Ahmetov are also reported to have a good chance of capturing UkrRudProm, an iron-ore company.

President Leonid Kuchma's brother-in-law is reported to be the main contender for the privatization of Ukraine's telephone company UkrTelecom. Donetsk businessmen close to the Prime Minister are also vying for UkrTelecom. However, Kuchma's government reshuffle last week in which he gave custody of UkrTelecom to the trusted hands of Transportation Minister Heorgi Kirpa, indicates the president doesn't want to compete for this prized asset.

## **Pointers for Investors**

By no means do the sell-offs in Ukraine close the doors to foreign investors. While chances of winning privatization tenders now may be slim, one needs to look at Ukrainian assets after the elections.

Presidential candidate Viktor Yushchenko has promised, if elected, he will initiate a careful review of all recent privatization tenders and a close look at their investment obligations. While his platform states he is not keen on renationalizing former state assets, he has warned oligarchs that they will be forced to pay their fair share of taxes off the market value of newly acquired assets. Stay tuned.



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## Tis the Season to Debate Trade Issues

**By George Felcyn, Senior Account Management, PBN•DC**

Often used as a political football in the U.S., international trade is being hotly debated once again as part of the Bush-Kerry presidential campaign and in Congressional election contests throughout the country.

Trade is always a politically sensitive issue, especially during presidential election years. This year, with the U.S. emerging from a period of economic recession and a new issue — "outsourcing" — entering the political lexicon, both Democrats and Republicans are working to define the debate over trade issues.

### Bush Administration & Steel Tariffs

Early in his administration, President Bush, after taking a strong free-trade stance during the 2000 campaign, imposed tariffs on steel imports in what many analysts believe was an attempt to curry political favor with several important electoral "swing" states with large numbers of steel retirees. The move backfired, because for the first time, U.S. steel consuming industries, which employ far more U.S. workers than U.S. steel producers, organized as a political force. Led by The PBN Company's client, the Consuming Industries Trade Action Coalition (CITAC), consuming industries raised an enormous outcry, forcing the President to terminate the steel tariffs early.

The Bush Administration has since tried to burnish its free-trade credibility by negotiating bilateral trade agreements with Singapore, Chile, Australia and, most recently, Morocco. However, protectionism — in the form of the abuse of anti-dumping laws — is still alive and well as

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Paul Nathanson, Vice President and Managing Director of PBN•DC, introduces members of the Shrimp Task Force to a crowd of journalists at the National Press Club in Washington, DC.



The PBN Company organized a demonstration for members of steel consuming industries in front of the US Capitol building, protesting the Bush Administration's tariffs on steel imports.

evidenced by the Bush Administration's decision to impose preliminary dumping duties on imported shrimp from China and Vietnam, as well as smaller, though not negligible, preliminary duties on imported Chinese wooden bedroom furniture. Final decisions on both cases will come after the election.

## **The Democratic Ticket: Free Trader & Protectionist**

John Edwards, who is now the Democratic Party's vice presidential candidate, set the tone early for Democrats in the 2004 Democratic presidential primary campaign as he sought to use trade issues to highlight his differences with Senator John Kerry. Edwards scored political points with his well-received calls for protectionism and the "enforcement of labor and environmental provisions" in trade agreements, rhetoric which some view as a first step toward scaling back United States' commitment to trade deals. Edwards, the son of a North Carolina textile mill worker who lost his job, went so far as to state that he would have voted against the North Atlantic Free Trade Agreement (NAFTA) had he been a Senator in the early 1990s. Senator Kerry, a strong supporter of NAFTA, has sought to walk a fine line between defending free trade but also calling for the "strong enforcement" of U.S. trade laws and trade agreements.

Kerry's track record is one of a "free-trade Democrat" in the tradition of Bill Clinton while Edwards' record is much more protectionist. Kerry voted for trade promotion authority and the African Growth and Opportunity Act. Edwards voted against both. Kerry voted against steel quotas in 1999. Edwards voted in favor. With Edwards joining the Presidential ticket, politic pundits are debating how free trade would fare in a Kerry presidential administration.

Trade and "outsourcing" are separate issues that are being brought together — mostly by the Democrats — during this election year. "Outsourcing" is the offshoring of work by private firms in the US to lower-cost countries. The perceived outsourcing of high tech jobs to India and other countries created a media frenzy over the past year because many believe the U.S. tech sector was thought to be immune to global competition. Offshoring, Kerry said earlier in the campaign, is the product of "Benedict Arnold CEOs." Despite the fact that, as reported by the Cato Institute, the rest of the world also outsources their services to the U.S. and that American companies sell three times more IT services to the rest of the world—more than \$10 billion worth—than they buy, the issue of outsourcing will continue to be loudly debated in the coming months.

## High Tariffs = Higher Inflation

Overshadowing the political gamesmanship are genuine concerns over the prospect of rising inflation in the U.S., which could threaten the still halting economic recovery. Protectionist trade barriers on imports — whether steel, shrimp, furniture, or other current disputes involving hosiery and TV sets from China — only add to inflationary pressures by imposing artificial costs on consumer goods.

Throughout the past several years, U.S. consumer spending has been an invaluable component of overall economic stability. But if protectionist policy decisions force consumers to pay artificially high prices for goods while inflationary pressures that traditionally discourage consumer spending continue to grow, both the political and economic fallout could be severe.

Consumers, however, are not sitting still. The threat of protectionist trade barriers to the average American's wallet and to the U.S. consuming industries that serve them has led to concerted efforts on the part of these groups to organize in order to "level the playing field." In this case, to "level the playing field" means to force U.S. policymakers to consider the needs of consumers and U.S. companies who must pay new federal taxes — in the form of tariffs and duties — every time the government seeks to spare old-line industries from global competition by imposing trade restrictions.



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## News from PBN Around the World

**A Girl for Katya.** Katya Nikiforova from our Moscow office is a proud mother of little Nastya. Mother and daughter are doing great.

Email Katya: [Katya.Nikiforova@pbnco.com](mailto:Katya.Nikiforova@pbnco.com)

**And, a Boy for Christina.** Christina Bucher, a long-time former PBNer, welcomed Jackson Alexander into the world in July. Christina and Jackson are both happy and healthy.

Email Christina: [Christina.Bucher@pbnco.com](mailto:Christina.Bucher@pbnco.com)

**On Board.** PBN Partner Myron Wasyluk, who runs our successful Kyiv office, has been elected to the firm's Board of Directors. This is in recognition of Myron's outstanding performance as Ukraine's managing director and contribution to firmwide management. Congratulations Myron!

Email Myron: [Myron.Wasyluk@pbnco.com](mailto:Myron.Wasyluk@pbnco.com)

**At the Helm.** The captains of PBN recently met at Peter and Sue's Oregon home at the annual firmwide management retreat. Some important decisions were made, including a renewed commitment to the firm's Strategic Plan. Oh, and we had a little bit of fun too!

Go to Fun at PBN for some photos of our recent management retreat: [www.pbnco.com/eng/fun\\_at\\_pbn](http://www.pbnco.com/eng/fun_at_pbn)

**Pressing Matters.** PBN's DC office continues to rack up news coverage and client accolades for our work on international trade issues. Check out a recent editorial in the *Wall Street Journal*.

Go to: [www.citac.info/shrimp](http://www.citac.info/shrimp)

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Lil PBNers Nastya and Jackson: a world apart but still family.



Raft? Check. Lifejacket? Check. Oars? Check. Anton Niskin, Myron Wasyluk and Paul Nathanson are well-equipped for the PBN management retreat.

**The Buck Stops in Kyiv.** PBN•Ukraine organized a press event in Kyiv in July for a team of U.S. Government officials representing the International Currency Awareness Program (ICAP) as part of the ongoing U.S. Department of Treasury Bureau of Engraving and Printing public education campaign for the new \$50 note. More than 40 Ukrainian journalists attended the event. The PBN Company is managing the public education campaign for the new U.S. currency in Russia.

Go to: [www.moneyfactory.com](http://www.moneyfactory.com) or [www.newdollar.ru](http://www.newdollar.ru)

**A Real Master.** Account Manager Alexander Sabadosh departs PBN•Ukraine 1 August, returning to academia for a Master's Degree from Georgetown University in Washington, DC. He is one of 20 young professionals from Ukraine chosen to have his graduate studies funded by the U.S. Edmund Muskie Scholarship Program. While at PBN, Alex handled intellectual property rights issues for Anheuser-Busch, Microsoft, Diageo and CIPR. He will be missed in Ukraine, but we look forward to welcoming him in DC!

Email Alexander: [Alexander.Sabadosh@pbnco.com](mailto:Alexander.Sabadosh@pbnco.com)



Alexander Sabadosh, PBN•Ukraine Account Manager, leaves The PBN Company in August to pursue graduate studies in the United States.

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