

## Section 6. Institutional Changes

### 6.1. The situation in the public sector and privatization<sup>1</sup>

#### 6.1.1. The scope of public property

According to the Federal Property Register, the movement, over the period 2013–2015, of the number of organizations registered as holders of ownership rights and economic societies with state stakes appears to be as follows (*Table 1*).<sup>2</sup>

*Table 1*

**The number of organizations - users of federal property, in 2013–2015**

Date	Number of joint-stock companies with federal stakes (including by special right), units	Number of holders of ownership rights to registered federal property entities other than economic societies or partnerships, units			
		total	including		
			FSUE <sup>3</sup>	FTE	FSI
As of 1 January 2013	2,442/2,337 <sup>a</sup>	22,330	1,800/1,795 <sup>b</sup>	72	20,458
As of 1 April 2013	2,412	21,459	1,775	73	19,611
As of 1 October 2013	2,281	20,175	1,742	73	18,360
As of 1 January 2014	2,203 <sup>c</sup>	19,733	1,727/1,181 <sup>d</sup>	76	17,930
As of 1 April 2014	2,142	19,603	1,789	78	17,736
As of 1 July 2014	2,100	19,318	1,704	77	17,537
As of 1 December 2015	1,783/1,719 <sup>e</sup>	...	1,257/ 1,178 <sup>f</sup>	43 <sup>g</sup>	16,802 <sup>g</sup>

<sup>a</sup> – as stated in the current privatization program for 2013–2016; besides, according to the Federal Property Register as of 31 December 2012, in addition to shares in 2,442 JSCs, there were also data on shares in 19 limited liability companies (LLC), which makes a total of 2,461 units;

<sup>b</sup> – as stated in the current privatization program for 2013–2016;

<sup>c</sup> – according to the Annual Report on Alterations to the Federal Property Register Resulting from the Arising and Termination of Russian Federation Ownership Right to Immovable and Movable Property for 2013, this figure (2,203 units) includes those 17 LLCs and 90 JSCs where the RF holds the special right to participate in their management without holding any shares;

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<sup>2</sup> Hereinafter we rely on data published in the documents of the RF Federal Agency for State Property Management (*Rosimushchestvo*) posted to its official website at [www.rosim.ru](http://www.rosim.ru) (including the 2014 and 2015 Reports on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016; 2011 and 2014 Reports on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC's Management ('Golden Share'); 2013 Annual Report on Alterations to the Federal Property Register Resulting from the Arising and Termination of Russian Federation Ownership Right to Immovable and Movable Property, etc.); the materials released by the RF Ministry of Economic Development at [www.economy.gov.ru](http://www.economy.gov.ru); and the data released by the Federal Treasury (Report on Federal Budget Execution as of January 1, 2016 (monthly report), [www.roskazna.ru](http://www.roskazna.ru)).

<sup>3</sup> FSUE stands for *federal state unitary enterprise*.

<sup>d</sup> – according to the Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016, by early 2014 the Russian Federation had been the owner of property of 1,181 FSUEs, which is nearly by 1/3 less than the figure reported in the Federal Property Register, and so gives rise to many serious questions;

<sup>e</sup> – according to the presentation by the RF Federal Agency for State Property Management (*Rosimushchestvo*) delivered during the discussion, in late 2015, of the alterations to the government program (GP) *Federal Property Management* suggested on the basis of recommendations put forth by the RF Accounts Chamber, the Federal Property Register contains information on 1,783 OJSC, CJSC and LLC, with slightly lower (by 3.5%) number of stakes and shares;

<sup>f</sup> – according to the presentation by *Rosimushchestvo* delivered during the discussion, in late 2015, of the alterations to the government program (GP) *Federal Property Management* suggested on the basis of recommendations put forth by the RF Accounts Chamber, the Federal Property Register contains information on 1,257 FSUEs, while the number reported as of the beginning of Q4 is somewhat lower (approximately by 6%);

<sup>g</sup> – according to the presentation by *Rosimushchestvo* delivered during the discussion, in late 2015, of the alterations to the government program (GP) *Federal Property Management*.

Source: Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016; www.economy.gov.ru, April 23, 2013, January 17, 2014, April 18, 2014, August 7, 2014; 2013 Annual Report on Alterations to the Federal Property Register Resulting from the Arising and Termination of Russian Federation Ownership Right to Immovable and Movable Property; 2014 Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016, www.rosim.ru, February 19, 2015; www.rosim.ru, December 21, 2015.

Over a period of approximately one year and a half (from mid 2014 to the end of 2015), the number of organizations involved (in any way) in the use of federal property somewhat declined. This trend was strongest in the group of federal treasury enterprises (FTE) (a decline by nearly 45%), and weakest in the group of federal state institutions (FSI) (a decline by approximately 4%). The movement pattern of the number of federal state unitary enterprises (FSUE) largely depends on a particular source of information: if one relies on data in the Federal Property Register, then since early 2014 their number shrank to a little more than ¼; if the data applied by *Rosimushchestvo* are to be relied on, their number remained practically unchanged. The total number of economic societies with state stakes dropped by more than 15%.

The most complete available data on the structure of joint-stock companies relative to the size of the stake held by the State, and especially on the specific features of the mechanisms applied in their management can be found in the 2014 Report on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC 's Management ('Golden Share').<sup>1</sup> According to the data from the Federal State Information Systems Operator *Single Federal Property Management System (FGIAS ESUGI)* presented in the Report, as of August 1, 2015 the Federal Property Register contained information on 1,864 JSCs with state stakes (in federal ownership), including those 103 JSCs where the State held the special right to participate in a company's management granted by 'golden share'.

Compared to data as of July 7, 2014, when the Federal Property Register contained information on a total of 2,096 JSCs with a state stake in federal ownership<sup>2</sup>, their number shrank by 11%.

However, *Rosimushchestvo* could fully exercise its shareholder rights in only 980 JSCs out of a total of 1,864 JSCs (or only 52.6% of all JSCs vs. 54.7% as of summer 2014 and vs. 57.7% as of summer 2013).

The composition of the remaining group of 884 companies was as follows:

<sup>1</sup> www.rosim.ru, September 3, 2015.

<sup>2</sup> 2013 Year-end Report on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC 's Management ('Golden Share').

- societies with state stakes amounting to less than 2% of their charter capital, where, in accordance with Item 1 of Article 53 of Federal Law, of December 26, 1995, No 208-FZ 'On Joint-stock Companies', no proposals put forth by shareholders can be entered on the agenda of a general shareholder meeting) (373 units,<sup>1</sup> or approximately 20% of all JSCs);
- economic societies where the ownership rights to state stakes are delegated to other federal bodies of executive authority (FBEA) and state corporations (for example, the RF Ministry of Defense, *Rostec* Corporation (formerly *Rostekhnologii*), *ROSATOM* Corporation), or JSC operated under a trust management agreement) (291 JSCs, or 15.6% of all JSCs);<sup>2</sup>
- economic societies undergoing a proceeding in bankruptcy (151 JSC, or 8.1% of all JSCs);
- economic societies undergoing a liquidation procedure (60 JSC, or 3.2% of all JSCs);
- economic societies currently with no stakes effectively in the ownership of the Russian Federation (for example if an entity has been privatized, or transferred as a contribution to the charter capital of a vertically integrated structure (hereinafter – VIS) (9 JSCs, or 0.5% of all JSCs).

In this connection it should be noted that the number of JSCs with regard to which *Rosimushchestvo* can exercise only a limited shareholder right, had declined on 2013 by 6.9% (or by nearly 65 units), these being in the main economic societies with state stakes amounting to less than 2% of their capital (by 63 units, or by 14.4%) and the societies the shareholder right to which had been transferred to other subjects (by 11 units, or by 3.6%). It can be said that in principle, the number of JSCs undergoing a proceeding in bankruptcy or a liquidation procedure changed insignificantly (by 3-5 units).<sup>3</sup> This is also true of the group of JSCs with no stakes effectively in the ownership by the Russian Federation (an increase by 1 unit).

Now we are going to look at the structure of JSCs from the point of view of the size of the stake held by the State in their charter capital, and its movement pattern over the last 5–6 years (*Table 2*).

In the structure of those JSCs where, as of summer 2015, *Rosimushchestvo* was not restricted in its shareholder rights, the aggregate share of those companies in respect of which the State enjoyed the right of corporate control at the level of a 100% stake or majority stake was approximately 2/3. Meanwhile, if we separate JSCs with state stakes amounting to less than 2% of the charter capital (373 units), the State would exercise corporate control over less than half of all JSCs.

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<sup>1</sup> Including 75 JSCs where the State holds the special right to participate in a company's management granted by 'golden share'.

<sup>2</sup> It does not seem to be quite correct to place in one and the same group those JSCs where the ownership rights to state stakes are delegated to federal bodies of executive authority other than *Rosimushchestvo*, state corporations, and companies operated under a trust management agreement, because one of the basic features of a state corporation (SC) as a legal entity (defined by Russian legislation as a non-profit organization) is the right of ownership to its property, and, generally speaking, that right should also be exercised with regard to those state stakes that have been transferred to other entities as property contributions to their charter capital.

<sup>3</sup> In this connection it should also be added that another 181 JSC (vs. 137 JSCs a year earlier) whose financial and economic operations have not been conducted on a sustainable basis (because they are not engaged in a financial and economic activity or are entering the initial phase of bankruptcy procedures (have filed a petition in bankruptcy, undergoing the phase of supervision or external management)) belong to the category of JSC in regard to which *Rosimushchestvo* has been exercising an unrestricted shareholder right.

Table 2

**The movement and structure of the group of economic societies with state stakes (less those JSCs where the State holds the special right granted by 'golden share' without holding any stake) in 2010–2015**

Date	Economic societies (JSC and LLC) where RF is shareholder (or participant)									
	total, units	share, %	Of these, with RF stake in charter capital amounting to							
			100%		100%		100%		less than 25%	
			units	%	units	%	units	%	units	%
as of January 1, 2010										
- JSCs, total <sup>a</sup>	2,950	100.0	1,757	59.6	138	4.7	358	12.1	697	23.6
as of August 1, 2012.										
- JSCs where <i>Rosimushchestvo</i> is not restricted in its shareholder rights <sup>b</sup>	1,371/ 2,629 <sup>a</sup>	100.0	886	64.6	76	5.55	211	15.4	198 <sup>d</sup>	14.45
as of January 1, 2013										
- JSCs, total <sup>c</sup>	2,337	100.0	1,256	53.7	100	4.3	227	9.7	754	32.3
as of August 1, 2013										
- JSCs where <i>Rosimushchestvo</i> is not restricted in its shareholder rights <sup>b</sup>	1,345/ 2,333 <sup>c</sup>	100.0	874	65.0	83	6.15	185	13.75	203 <sup>d</sup>	15.1
- JSCs included in forecast privatization plans for 2010 and 2013 <sup>f</sup>	975	100.0	716	73.4	41	4.2	116	11.9	102 <sup>d</sup>	10.5
as of July 7, 2014										
- JSCs where <i>Rosimushchestvo</i> is not restricted in its shareholder rights <sup>b</sup>	1,147/ 2,096 <sup>c</sup>	100.0	709	61.8	66	5.8	171	14.9	201 <sup>d</sup>	17.5
- JSCs included in forecast privatization plans for 2010 and 2013 <sup>f</sup>	842	100.0	596	70.8	36	4.3	113	13.4	97	11.5
as of August 1, 2015										
- JSCs where <i>Rosimushchestvo</i> is not restricted in its shareholder rights <sup>b</sup>	980/ 1,864	100.0	589	60.1	55	5.6	142	14.5	194	19.8
- same JSCs, plus JSCs where state stake is less than 2% <sup>g</sup>	1,353 (980 + +373)	100.0	589	43.5	55	4.1	142	10.5	567 (194 + +373)	41.9
- JSCs included in forecast privatization plans for 2010 and 2013 <sup>f</sup>	668	100.0	469	70.2	18	2.7	90	13.5	91	13.6
- same JSCs, plus JSCs where state stake is less than 2% <sup>h</sup>	1041 (668 + +373)	100.0	469	45.1	18	1.7	90	8.6	464 (91 + +373)	44.6

<sup>a</sup> – number of JSC according to the privatization program for 2011–2013;

<sup>b</sup> – less the following entities: (1) JSCs with state stakes less than 2%; (2) JSCs where the shareholder rights on behalf of the Russian Federation are exercised by other subjects (other bodies of executive authority, state corporations, or subjects appointed under trust management agreements); (3) JSC undergoing bankruptcy procedures (in the phase of a bankruptcy proceeding); (4) JSCs undergoing a liquidation procedure, (5) JSCs with state stakes that are *de facto* not registered as federal property (previously privatized or transferred to the charter capital of a vertically integrated structure);

<sup>c</sup> – denominator shows total number of JSCs entered in the Federal Property Register;

<sup>d</sup> – only JSCs with state stakes between 2% and 25%;

<sup>e</sup> – number of JSCs according to the privatization program for 2014–2016;

<sup>f</sup> – only those JSCs where *Rosimushchestvo* is not restricted in its shareholder rights;

<sup>g</sup> – on condition that, with regard to all JSCs with state stakes less than 2%, the relevant shareholder rights belong to *Rosimushchestvo*;

<sup>h</sup> – on condition that all the JSCs with state stakes less than 2% are included in a privatization program.

Source: Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2011–2013; Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016; 2011 Year-end Report on the Management of Federal Stakes in

OJSC and the Use of the RF Special Right to Participate in an OJSC 's Management ('Golden Share'); 2012 Year-end Report on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC 's Management ('Golden Share'); 2013 Year-end Report on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC 's Management ('Golden Share'); 2014 Year-end Report on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC 's Management ('Golden Share'); own calculations.

In the group of JSCs included in the privatization program among those 668 companies where *Rosimushchestvo* was not restricted in exercising its shareholder rights on behalf of the State, approximately 3/4 appear were those fully owned by the State (70.2%) or those where the State held a majority stake (2.7%). As follows from the Report on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC 's Management ('Golden Share') prepared by *Rosimushchestvo*, the forecast privatization plan lists more than 80% of all 100% stakes, more than 63% of all blocking stakes, but only less than 47% of all minority stakes (between 2% and 25%) in those companies where *Rosimushchestvo* could exercise its shareholder rights on behalf of the State without any restrictions.

In the category of JSCs with controlling stakes, the share of those included in the privatization plan was approximately 1/3. Even if we count all the companies with a state stake amounting to less than 2% in their charter capital (373 units) those included in the privatization program, the number of minority stakes earmarked for privatization will be lower than the number of those enabling the State to exercise corporate control (100% stakes and majority stake, even less the latter).

Over one year (summer 2014 – summer 2015), the share of JSCs with a 100% state stake or a majority stake in the group of those where *Rosimushchestvo* was not restricted in exercising its shareholder rights shrank by 17%, in the same proportion as did the number of JSCs with a blocking stake, whereas the share of those with minority stakes (between 2% and 25% of charter capital) shrank by 3.5%. The difference becomes even more striking if we compare this movement pattern with the situation in summer 2012. While the number of JSCs with a minority state stake (between 2% and 25%) shrank by only 2%, the number of JSCs with a 100% state stake or a majority stake shrank by 1/3, similarly to the number of JSCs with a blocking state stake (between 25% and 50% of charter capital).

As for the public sector monitoring results released by *Rosstat*, this source is no longer available in accordance with Decree of the RF Government of January 29, 2015, No 72<sup>1</sup>. This document deemed to be null and void the RF Government's Decree of January 4, 1999, No 1 (as amended as of December 30, 2002), whereby the public sector of the national economy was defined as consisting of the following entities (1) state unitary enterprises, including treasury enterprises, (2) state institutions, (3) economic societies where the State held a stake amounting to more than 50% of their charter capital, and (4) economic societies where a stake amounting to more than 50% of their charter capital was held by economic societies belonging to the public sector of the national economy.

The system of performance estimates introduced by the aforesaid Decree in 2015 for the purpose of monitoring the efficiency of public property management and deriving relevant statistics is to be applied to the following group of economic subjects (in place of the public sector):

- state unitary enterprises, including treasury enterprises;

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<sup>1</sup> The final statistics bulletin with data on the public sector's development was released in autumn 2014. Also see *Russian economy in 2014. Trends and Outlooks* (Issue 36). M., Gaidar Institute, 2015, pp. 377–378.

- state institutions (autonomous, budget-funded and treasury-funded);
- economic societies with a state stake in their charter capital;
- joint-stock companies where the State holds the special right to participate in their management granted by the 'golden share').

While the newly emerged group is seemingly the same as the 'public sector' in the previously applied definition, one cannot but notice the disappearance of one important component of the public sector, namely economic societies where a stake amounting to more than 50% of their charter capital is held by economic societies belonging to the public sector of the national economy.

Essentially, the system to be applied in estimating the management of public property and deriving relevant statistics of 64 indices grouped into 5 sections as follows:

I. The structure of economic subjects comprising public property (with records to be kept separately for the RF and RF subjects);

II. The management of JSCs with stakes in federal ownership, federal state unitary enterprises (FSUE) and federal state institutions (FSI) (with records to be kept separately for the 3 subsections);

III. Privatization of federal property entities;

IV. Management of federal immovable property entities (with records to be kept separately for the two subsections: land plots and other property entities);

V. Redistribution of federal immovable property, including redistribution between different tiers of public legal formations.

Besides, the aforesaid RF Government's Decree introduced the necessary alterations into the 2008 Federal Statistics Plan, and then the RF Ministry of Economic Development approved, as of April 16, 2015, No 229 the Methodological Recommendations for calculating the state property management performance indices and keeping statistical records.

Naturally, it will be possible to make valid conclusions concerning the relevance of all these innovations for estimating the share of the public sector in the Russian economy only after the statistics in the new format are released<sup>1</sup>.

#### 6.1.2. Privatization policy

The past year was the second year of the implementation of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016, approved by Directive of the RF Government of July 1, 2013, No 1111-r. This is already the second 3-year privatization program developed with a view towards a longer planning period established for a forecast plan (or program) of federal property privatization (extended from one to three years) on the basis of the alterations introduced into the prevailing legislation on privatization in the spring of 2010.

As was the case with the previous privatization program, numerous adjustments and alterations soon began to be introduced into the new document as well. Since the moment of approval of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016 and until early February 2016, a total of 65 normative legal acts (NLA) pertaining to these issues were adopted, 22 of which were issued in 2014, and then 3 more were issued in December 2013, and 3 in January 2016. By the first

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<sup>1</sup> For a more detailed discussion of the theoretical aspects and core problems associated with the role of commercial organizations owned by the State, see Radygin A.D., Simachev Yu. V., Entov R. M. *State-owned company: detection zone of government failure or market failure? Issues of Economics* (in Russian), 2015, No 1, pp 45–79.

directive, the privatization program was augmented by another 431 joint-stock companies that had not been privatized in the period 2011–2013; by the second one, 426 (mostly) immovable property entities in federal ownership (previously non-privatized) were also added to the list of entities earmarked for privatization. So, last year, in terms of 'intensity' of legislation adjustment (37 NLA), is far ahead of the previous one-and-a-half-year period (2014 and H2 2013).

As a result, the list of assets earmarked for privatization in an ordinary procedure noticeably increased. The highest share was taken up by entities to be privatized in the category of 'other' property entities, their number in the privatization program rose from 94 to 1,562 (or nearly 17 times), while the number of economic societies rose from 440 to 977 (or more than 2.2-fold). Meanwhile, the number of federal state unitary enterprises (FSUEs) earmarked for privatization, on the contrary, dropped from 514 to 491 (or by 4.5%).

Unitary enterprises represent an asset that is most likely to be taken off the privatization program at any time. In 2015, there were a total of 46 units in this category (vs. 31 in 2014), while the number of economic societies excluded from the program was 19 (vs. 5 in 2014), and that of 'other' property entities – only 12.

Although the progress of the privatization program is obviously influenced by the current macroeconomic situation and the situation in the stock market, the intermediate results of the past year (as estimated by the results of its first quarters) made it possible to hope that the targets set in the current privatization program can be achieved, meaning the exact privatization-generated revenue target in the federal budget, less biggest property sales (Rb 3bn per annum).

In this connection, in September 2015, *Rosimushchestvo* was assigned the task of increasing the annual revenue generated by privatization deals from Rb 3bn to Rb 5bn. As of November 11, 2015, asset sale deals to the total value of Rb 5.5bn (111% of that year's target) were completed, so the target was achieved earlier than planned<sup>1</sup>. Nevertheless, the total value of sales of shares declined in 2015 on 2014 by 8.5% (Rb 7.34bn vs. Rb 8.02bn)

At the same time, no sale of shares in biggest companies, in respect of which the specific timeframe and method of privatization are to be determined by the RF Government with due regard to the market situation and to the recommendations of top investment consultants, took place that year. The only possible deal - the alienation of shares in PJSC *Sovkomflot* [Modern Commercial Fleet] - was postponed due to the worsening macroeconomic situation and low investment activity on the domestic market, as well as the currently unfavorable situation in the tanker shipping market and the introduction of restrictive measures against big Russian companies.

On the whole, the number of sales of state stakes and immovable property entities rose on 2014 by 35%, while the number of property entities put up for sale in the framework of privatization deals by independent sellers nearly doubled (increasing from 159 in 2014 to 306 in 2015).

Among the deals accomplished without relying on investment consultants, the sale of Murmansk Sea Fishing Port (the entire 100% stake) for Rb 1,027bn clearly stands out. The other big privatization deals are the sales of state stakes in the Moscow-based company JSC *Aviatechnab* (for Rb 986m), JSC Murmansk Shipping Company (25.5%, to the value of Rb 660m), *Fundamentproekt* (Rb 454.8m) and E. I. Rytvin Scientific and Industrial Complex *Supermetal* (Rb 307m) (both in Moscow), *Labinsky* Poultry Breeding Farm (Krasnodar Krai, Rb 303.3m), and one of Moscow's Bread Baking Plants (Rb 216.4m). The stakes in JSC *Northern Shipping*

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<sup>1</sup> www.rosim.ru, November 12, 2015.

*Company* (20%, based in Arkhangelsk) and 2 road maintenance enterprises in Moscow Oblast were sold to the value of more than Rb 150m each. In this connection it should be noted that the staked to be sold in almost all these deals, with the exception of stakes in the two shipping companies (the size of which is specified), amounted to 100% of charter capital, and the deals were closed by an independent (non-governmental) seller, OJSC *Auction House of the Russian Federation* (OJSC *RAD*).

The year 2015 can be described as the first year when non-governmental sellers began to be active in the market, and for a good reason. Thus, OJSC *RAD* sold 34 stakes to the total value of Rb 5.3bn, or more than 72% of total proceeds from sales of this type of assets, which is more than the aggregate index for the two previous years<sup>1</sup>. Another non-governmental seller, LLC *VEB Capital*, also launched its operations, although the scale of its involvement in the privatization program is incomparable with that of OJSC *RAD*<sup>2</sup>.

Another innovation aimed at boosting the efficiency of handling sales is the delegation, by *Rosimushchestvo*, of some of its powers in the framework of the privatization program to its territorial agencies (TA)<sup>3</sup> which, as far as the number of state stakes actually sold by them is concerned (51 units), got far ahead of both OJSC *RAD* (34 units) and *Rosimushchestvo*'s central apparatus (CA) (18 units). However, when compared to 2014, this privatization channel still demonstrates a downward trend in terms of the number of accomplished sales (51 vs. 74) and generated proceeds (Rb 0.9bn vs. Rb 1,360bn). In this connection it should be noted that the results achieved by *Rosimushchestvo*'s CA are even less impressive, as it sold only 18 state stakes (vs. 29 in 2014) to the value of Rb 1.1bn (vs. Rb 5,772bn in 2014). Due to such a sharp decline of proceeds, the relative shares of *Rosimushchestvo*'s CA and TAs with regard to this index became comparable in 2015. In effect, the operation of independent sellers offset the effects of the declining activity of the government agencies in implementing their privatization policy<sup>4</sup>.

Among the optimization measures attempted by *Rosimushchestvo* in order to boost efficiency, increase openness, and improve performance in the framework of privatization procedures, we may also note the following ones:

- to involve in more active promotion of the assets earmarked for privatization in order to boost market demand, by posting information on forthcoming biddings to websites [www.avito.ru](http://www.avito.ru), [www.irr.ru](http://www.irr.ru), to the news feeds of the major news agencies ITAR-TASS and RIA *Novosti*, placing promotion leaflets in the mass media and as out-of-homer advertizing, distribution of printed ads at Russian and international business forums and other events (depending on the type and value of each asset to be privatized);

- to make the process more comfortable for potential investors by granting free access to additional information concerning the properties earmarked for privatization (special presentations for potential investors and their publication on the Internet, and placement there of detailed information on the assets held by the economic societies to be privatized, as well as copies of the relevant documents in confirmation of the titles to these assets);

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<sup>1</sup> In 2014, OJSC *RAD* sold only 6 stakes to the total value of Rb 923.3m, and in 2013 – 15 stakes to the value of Rb 1.97bn.

<sup>2</sup> While *VEB Capital* received state stakes in only 11 OJSCs for their subsequent sale, OJSC *RAD* was given state stakes in more than 200 JSCs and 81 immovable property entities, although no bidding took place with regard to the latter.

<sup>3</sup> In 2014, the TAs were delegated the powers to sell state stakes in 200 JSCs and 219 'other' property entities.

<sup>4</sup> [www.rosim.ru](http://www.rosim.ru), December 24, 2014, February 24, 2016.



– to increase the period of market exposure of the assets earmarked for privatization (the time lapse between the offer of a given asset and the date of bidding) by creating at Rosimushchestvo's website special 'soon to be sold' pages and placing there, in advance, in the phase of their market valuation and preparatory procedures, detailed information on each of the assets to be privatized);

– to toughen control over the financial and economic status of the joint-stock companies earmarked for privatization, so as to prevent any loss of their market value and attractiveness for potential investors in the pre-privatization phase by issuing a special set of instructions (directives) for their board of directors and recommendations for audit commissions (quarterly monitoring of financial and economic activity);

– the creation of a special system for protecting the assets of companies to be privatized during the privatization and pre-privatization periods as an additional guarantee that the quality of assets offered to potential investors will not deteriorate, by restricting the powers granted to the CEOs of those companies with regard to disposal of their property and by increasing personal responsibility for the decision-making process through introducing provisions to this effect into the charters of all JSCs earmarked for privatization.

In 2015, the stakes (or shares in charter capital) in a total of 103 economic societies were sold, while in respect of 35 federal state unitary enterprises (FSUE) the relevant decisions concerning the terms of their privatization were taken. On the whole, such results follow the overall trend of recent years - the constant reduction in the number of sold stakes (or participatory shares). As for the progress of privatization of unitary enterprises, if we rely on the number of those of them that were subject to specially issued directives concerning the terms of their privatization, the observed trend is compatible with the corresponding indices for the last two years of the previous privatization program (2012–2013) (see *Table 3*).

*Table 3*

**The movement of the number of privatization deals involving federal state unitary enterprises and the number of sales of federal stakes in 2009–2015**

Period	Number of privatized enterprises (entities) formerly in federal ownership (data released by <i>Rosimushchestvo</i> )	
	privatized FSUEs <sup>a</sup> , units	sold stakes in JSCs, units
2009	316+256 <sup>b</sup>	52 <sup>c</sup>
2010	62	134 <sup>c</sup>
2011	143	317 <sup>d</sup> /359 <sup>c</sup>
2012	47 <sup>d</sup>	265 <sup>c</sup>
2013	26	148 <sup>c</sup>
2014	33	107
2015	35 <sup>f</sup>	103

<sup>a</sup> – all preparatory work is completed, and the relevant decisions concerning the terms of privatization are issued;

<sup>b</sup> – the number of FSUEs in respect of which the decisions concerning their reorganization into JSC were made by the RF Ministry of Defense in addition to those cases where a similar decision was made by *Rosimushchestvo*;

<sup>c</sup> – including those stakes which were put up for sale in a previous year;

<sup>d</sup> – estimated value based on data on the total number of FSUEs in respect of which directives concerning the terms of their privatization in the form of reorganization into OJSC (216 units) were issued, taken from *Rosimushchestvo*'s Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2011–2013, and the year-end results of 2011 and 2013;

<sup>e</sup> – less sales of shares with the participation of investment consultants;

<sup>f</sup> – for 2 enterprises, the decisions concerning the terms of their privatization canceled in 2015 and then reissued, and so the total number of FSUEs for which privatization decisions were made over the 2-year period (2014–2015) is somewhat lower than follows from the data shown in the Table (65).

*Source:* Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2009, M., 2010; Report of the RF Ministry of Economic Development on the Results of Federal Property Privatization in

2010; Report of the RF Ministry of Economic Development on the Results of Federal Property Privatization in 2011; Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2011–2013; 2014 Year-end Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016; 2015 Year-end Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016, [www.rosim.ru](http://www.rosim.ru), February 19, 2015.

At the same time, compared to the year-end results of the crisis year 2009, which are roughly comparable to the situation under consideration (stakes in 52 economic societies were sold to the value of Rb 1.37bn), we may conclude that the privatization process in 2015 was more successful (stakes in 103 economic societies were sold to the value of Rb 7.34bn). *Rosimushchestvo* explains this success by the systemic changes in the privatization procedures applied to federal property entities and the implementation of comprehensive measures designed to ensure the pre-sale preparation and proper management of the assets to be privatized. However, in this connection necessary to remember that inflation had surged since then nearly 1.5 times, that in 2009 more than half of the sales involved minority state stake, and that no non-governmental sellers participated in the privatization process.

In recent years, the purpose of involving non-governmental sellers was that of boosting the number of sales, because it was expected that a seller working for a commission calculated as a percentage of the value of a deal and received from the budget, must necessarily be competent in marketing and possess the skills necessary for attracting investors. Based on this assumption, one could expect that a higher number of participants will take part in the biddings held by the independent non-governmental seller, and that prices will surge higher in the course of bidding. However, the statistics concerning the operation of non-governmental sellers in 2015 was by no means always indicative of such achievements. The effectiveness index of property sales, measured as cumulative growth of asset value during an auction, was found to be lower for OJSC *RAD* than for *Rosimushchestvo* (growth by 11% vs. 17%), in spite of the fact that some relatively liquid assets from among the properties listed in the privatization program were handed over to the non-governmental seller.<sup>1</sup>

In this connection it should be mentioned that some of these sales gave rise to big scandals. The most notorious was the cancellation of bidding for the 100% state stake in the Training & Testing Dairy Plant (*UOMZ*) under N.V. Vereshchagin Vologda State Dairy Academy (Vologda Butter™) and the suspension of the auction involving the sale of the state stake in OJSC *Diamond World* (52.37%). In the latter case, an arbitration court ruled that special measures should be enforced to protect the company's private shareholders. Besides, the starting price of the relevant state stake also appeared to be underestimated.

Problems also arose in connection with some other deals handled by OJSC *RAD*, due in the main to the resistance of regional authorities: the sale of Murmansk Sea Fishing Port (the biggest deal, according to the year-end results of 2015) and JSC *SIC Supermetal*, the privatization of the latter having been previously suspended by *Rosimushchestvo* (more than 40 state stakes were suspended out of a total of 204 transferred to OJSC *RAD* for sale); the sales of the Saratov Polygraphic Combine and *Sverdlovskavtodor* set for Q1 2016.<sup>2</sup>

The most notorious case is that of the Training & Testing Dairy Plant (*UOMZ*) in Vologda, which put to light many problematic aspects of Russia's privatization process: the feasibility of

<sup>1</sup> The performance level assessment of non-governmental sellers participating in the implementation of the privatization program compared to that of the model procedures followed by government bodies must rely on information concerning the amount of commission paid to the former.

<sup>2</sup> Pushkarskaia A., Butrin D. *Rosimushchestvo lacks courage*. *Kommersant*, January 14, 2016.

selling one or other asset currently held by the State, its objective valuation, transparency, coordination of the interests of the parties in a deal. In this particular case, it was the regional authority who, with public support, opposed the privatization deal. Their arguments were as follows: that the enterprise was profitable; that it was implementing an investment program; that its privatization might entail rising unemployment and production reorientation, loss of the traditional product recipes and its unique brand; and the loss of a base for training qualified personnel. So, in the spring of 2015, the sale was canceled. However, in early 2016, OJSC *RAD* made another attempt at its sale, which was contrary not only to the clearly proclaimed standpoint of the regional authority, but also to that of some federal bodies of executive authority (*Rosimushchestvo*, the RF Ministry of Agriculture, etc.). The upshot of all this was that the sale was canceled once again, and it was declared that an investment consultant will be selected in order to determine the key conditions and elaborate the structure of a potential deal, so as to attract strategic Russian investors and enforce the terms whereby no production reorientation may be attempted<sup>1</sup>.

On the whole in 2015, stakes (or shares in charter capital) in 462 economic societies were put up for sale, of which stakes (or shares in charter capital) in 103 economic societies were actually sold, vs. 341 and 107 respectively in 2014. The results for stakes in another 85 JSCs put up for sale are to be summed up in Q1 2016. Thus, due to the shrinking investment demand for properties earmarked for privatization in response to the high volatility of financial markets and rising lending costs, the share of accomplished sales of all types declined in 2015 on 2014 from 31% to 22%, which means that on the average, only one of every five stakes put up for sale were actually sold.

In many cases the low interest of potential buyers in privatization auctions can be explained by their hope to buy properties put up for sale in the framework of a public offer at a 50% discount, which is the main method employed in secondary sale deals. In the crisis situation, the expectation that the number of participants in bidding may increase (as the principal precondition for asset prices to achieve equilibrium - something that in theory could indeed happen after such a deep plunge) proved to be futile. As a result, the stakes in 92% of public offer deals were sold at a minimum price, i.e. at half their market value.

When, in 2015, nearly 1,200 immovable property entities were added to the group included in the privatization program, the entire structure of property earmarked for privatization was changed, in that the privatization of stakes in economic societies acting as owners of property complexes was replaced by privatization of singular immovable property entities.

Compared to 2014, this segment has demonstrated some noticeable shifts. The number of sold immovable property entities (38 units) increased on 2014 by approximately 3.5 times (vs. 11 units in 2014). However, the amount of proceeds of these sales to be transferred to the federal budget in 2015 was nearly the same (Rb 48.92m vs. Rb 47.46m in 2014). These sales were more successful than the sales of stakes in JSCs. Over the course of 2015, out of the 81 immovable property entities put up for sale, about half were actually sold (38 units), the total number of biddings being 118. The results for stakes in 20 entities put up for sale in the category of 'other property's are to be summed up in Q1 2016.<sup>2</sup>

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<sup>1</sup> www.rosim.ru, February 12, 2016.

<sup>2</sup> For further reading on these issues, see Malginov G., Radygin A. Management of state treasury properties in the Russian Federation: some actual trends. *Economic Policy*, 2015, V. 10, No 4, pp. 20–46.

In 2015, in the framework of execution of 24 executive orders of the RF President and 5 decisions of the RF Government concerning the creation/expansion of vertically integrated structures (VIS), *Rosimushchestvo* implemented a broad array of relevant measures and established 18 VIS, of which all the necessary formalities had been completed for 10. This part of the 3-year privatization program includes 40 FSUEs and state stakes in 129 JSCs. By the end of 2015, decisions were also issued with regard to the terms of privatization of 20 FSUEs (including for 9 in 2015) and 122 JSCs (including for 75 in 2015).

The Federal Law on the Federal Budget for 2016 (No 359-FZ) adopted in early December 2015, similarly to the corresponding law approved a year earlier, contains no specific information as to the amount of revenue to be generated by privatization deals neither in the main body of the document, not in the annexes. Only in the explanatory note attached to the text of the draft law submitted to parliament it was stated that the revenue generated by privatization of federal properties was to be treated, alongside government borrowings, as an independent source of funding to cover federal budget deficit.

Due to the fact that currently the forecast plan (program) of federal property privatization for 2014–2016, approved by Directive of the Government of the Russian Federation of July 1, 2013, No 1111-r, is not yet completed, the switchover to a one-year budget planning cycle will not require any adjustment of the timelines set for the three-year privatization program, as it will be over exactly in one-year period. In this connection, the timelines and specific privatization methods to be applied to biggest companies - leaders in their industries will be determined by the RF Government with due regard for the current market situation, as well as the recommendations of eminent investment consultants.

The important distinctive feature of this draft law from similar documents submitted over the previous years was the attachment, among the other supplementary materials, of data for the forecast plan (program) of federal property privatization for 2016, where the targets for federal budget revenues generated by privatization deals are presented; besides, they are presented in the explanatory note attached to the draft law and in the classification of sources of funding to cover federal budget deficit.

The total sum to be generated by this source in 2016 is to amount to more than Rb 33.2bn. In this connection it is worthwhile to note the secondary role assigned to the revenue generated by privatization as a source of funding to cover federal budget deficit. Thus, in 2016, the expected privatization-generated revenue will amount to approximately 8.5% of the total sum of government borrowing.

It is planned that approximately 36% (or Rb 12bn) of the total planned revenue generated by privatization (in the amount of Rb 33.2bn) will result from the alienation of state stakes in PJSC (Public Corporation) *Sovkomflot* (reduced to 25 % minus 1 share). The functions of the organization and completion of this deal in accordance with Directive of the RF Government of September 20, 2012, No 1739-p will be executed by Deutsche Bank LLC. In this connection, more than 60% in the total amount of revenue generated by privatization (or more than Rb 21.2bn) is expected to be taken up by proceeds of sales of federal property entities, not counting the value of stakes in biggest companies.

However, this revenue target does not appear to be very realistic. It should be reminded that, in the forecast plan (program) of federal property privatization for 2014–2016, the target for federal budget revenue to be generated by federal property privatization is set with no account for the value of stakes in biggest companies (expected to generate Rb 3bn per annum. And in

the first three-year privatization program for 2011–2013 this target was set at Rb 6bn for 2011 and Rb 5bn for 2012–2013 (per annum) (a total of Rb 16bn).

In actual practice, from the moment when the period of the forecast plan (program) of federal property privatization was extended to 3 years, this index rose above Rb 10bn only in 2011, when it amounted to Rb 13.3bn. In fact, the target amount of budget revenue of Rb 21.2bn to be generated by privatization in 2016 (less revenue generated by biggest deals) is comparable with the corresponding index for the entire 3-year period of the implementation of the privatization program for 2011–2013, when the federal budget received Rb 25.67bn, or 160% of the target set in that document. However, this result was achieved within the framework of an economic and political situation that was radically different from what we have been experiencing over the course of two recent years (large-scale capital outflow, the introduction of economic sanctions, the ruble's plummeting exchange rate, and the probability of recession in the national economy).

The target for federal budget revenue to be generated by federal property privatization appears to be even more dubious in view of its forecasted structure, where biggest deals are expected to generate only less than half of the revenue to be received from that source. Meanwhile, according to the year-end results of 2014, the total value of the 2 deals completed on the basis of special decisions of the RF Government (the sale of a 13.76% stake in OJSC *Inter RAO EES* and 100% stake in OJSC *Arkhangelsk Trawl Fleet (ATF)* (100% of shares) amounted to Rb 20.9bn, which is more than 2.5 times above the ordinary amount of revenue generated by model privatization procedures (Rb 8.05 bn).

Among other things, it should be reminded that the current privatization program for 2014–2016 sets no target for the bulk of revenue to be received as a result of sale of stakes in biggest companies with a high investment attractiveness index, in the event of issuance of a special decision to this effect by the RF Government; meanwhile, the previous document set the target of Rb 1 trillion for the period 2011–2013.

However, the mechanism currently applied in the budgetary process, when the approved text of a budget law contains no stipulations concerning the effect of privatization in the context of budget revenue, opens up unlimited opportunities for any decision-making with regard to privatized assets and the timelines and format for their sale. The developments observed over the past year and in early 2016 have confirmed this assumption. It is suffice to point out the instance of JSC *Rusnano* being excluded from the current privatization program in April 2015 and the privatization issues associated with medium-sized public assets of regional importance, mentioned earlier in our discussion.

The evident difficulties experienced by the budgetary system prompted the decisions concerning the expansion of the privatization program in early 2016 and the potential for generating revenue from privatization in an amount up to Rb 1 trillion. The candidates for the privatization of part of their state stakes were *Alrosa*, *Bashneft*, *VTB*, *Rostelecom*, *Transneft*, *Aeroflot*, *Rosneft*, *Sovkomflot* and some other biggest companies; however, the prospects for and format of each of these deals are still unclear.

The comprehensive work that was underway throughout 2015 to implement the necessary measures designed to consolidate the assets of Vnukovo and Sheremetyevo airports is an important phase in their pre-privatization preparation in the context of decisions of the RF President and the Government concerning the strategic development of Moscow's airport system based on the principle of public-private partnership (PPP).

The structure and stages of the consolidation of airport assets of Vnukovo and Sheremetyevo, elaborated in cooperation with investment consultants and private shareholders, were in 2015 approved by Executive Orders of the President of August 1, 2015, No 393 and of August 28, 2015, No 442 respectively.

OJSC *Sheremetyevo International Airport* (SIA) will be reorganized by merging it with JSC *Sheremetyevo*, to be founded jointly by the State and a private shareholder, LLC *Sheremetyevo Holding*, its charter capital made up by the contribution, by the Russian Federation, of its stake of more than 83% in JSC SIA, and the contribution by the private shareholder of its property; meanwhile, the participation of the State in the charter capital of the new company, JSC *Sheremetyevo Airport* (without any additional property contribution), is to be secured by a stake amounting to no less than 30%. For this purpose, the RF Government together with the private shareholder are to determine the composition of property to be contributed by the latter to the new JSC's charter capital, and to ensure valuation of that property in accordance with existing legislation, as in the case of valuation of federal property to be contributed as a RF stake to the charter capital of JSC *Sheremetyevo Airport* at the moment of its founding. This is to be the basis for determining the size of the stakes to be held by the State and the private shareholder in the charter capital of JSC *Sheremetyevo Airport*.

Besides, it was envisaged that a shareholder agreement should be concluded between the RF and the private shareholder, whereby the procedure for executing the rights secured by the stakes in JSC *Sheremetyevo Airport*, including the private shareholder's responsibility to abstain from alienating of its shares in JSC *Sheremetyevo Airport* until the termination of that joint-stock company as a result of its reorganization, the procedure for executing the rights secured by shares in JSC SIA, and the ownership rights to such shares should be determined<sup>1</sup>.

Based on the results of JSC SIA's reorganization, new alterations to the list of strategic organizations should be prepared with regard to the size of stake to be held by the State in the charter capital of JSC SIA in the new format. The new floor for the state stake after the charter capital of JSC SIA is increased by means of an additional issue (or issues) of shares after its reorganization is set at 30%, without any additional property contribution by the RF.

The scheme to be applied to JSC *Vnukovo International Airport* is somewhat similar. By way of covering the cost of additional shares issued in order to increase its charter capital, the stake held by the State in OJSC *Vnukovo Airport* (74.74%) will be contributed to the charter capital; its size (without any additional property contribution), with due regard for the size of stakes contributed by the private shareholders, should be no less than 25% + 1 share. The procedures of property valuation and the terms of the shareholder agreement with private shareholders are in many ways identical to those applied to JSC SIA, except that there were no responsibilities assigned to private shareholders to put in operation new facilities, and no entry of this airport onto the list of strategic organizations. Besides, in contrast to the norms stipulated for JSC SIA, the Executive Order of the President appoints no particular organization to act as a private shareholder.

In February 2016, the relevant shareholder agreements between the State and private shareholders were signed, whereby the airport assets at Sheremetyevo and Vnukovo were consolidated so as to secure for the State the right of control over the activity of the merged company and key decision-making. On the basis of valuation of the property contributions by each of the

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<sup>1</sup> It is also envisaged that an important part of the shareholder agreement should be the obligation assumed by the private shareholder, to construct infrastructure for the new terminal in the northern zone at *Sheremetyevo*, in preparation for the 2018 FIFA World Cup in Russia.

stakeholders, the state stake in the charter capital of JSC *Sheremetyevo Airport* will amount to about 31.6%, and that in the charter capital of JSC *Vnukovo International Airport* – 25.1%, which means that a symbolic excess over the government corporate control threshold will be secured in advance<sup>1</sup>. However, due to the intricacies of such a scheme, it is unlikely that budget revenues can be expected any time soon from a possible sale of shares currently held by the State, although such a possibility cannot be ruled out altogether because the shareholder agreements do stipulate the option of buying out the state stake, alongside various valuation alternatives and premiums for the buyer.

Shares in OJSC *Rosneft*, which have been thoroughly prepared for sale, can generate revenues in the event of the company's privatization that can be transferred to the federal budget as dividends of OJSC *Rosneftegaz*.

However, the main obstacle to success here is the situation in the stock market. The RF President and the RF Government's decisions made in 2014 do allow the alienation of those shares at a price no lower than their market price determined on the basis of a market valuation report prepared by an independent valuator, and no lower than the price of their initial public offer in 2006, which is twice as high as the quotes of *Rosneft's* shares in early 2016.

The standpoint of OJSC *Rosneftegaz*, which owns 69.5% of shares in OJSC *Rosneft*, is that it is prepared to continue the cooperation with its strategic partners in doing the necessary preparatory work for the forthcoming privatization deal, while orienting to the even higher price at which the shares formerly held by the State had been sold to *BP* in 2013. The compliance with the requirement concerning the price floor can be possible in the medium-term perspective if proper conditions are created for boosting the market value of shares in OJSC *Rosneft*.

At present, the decision that the state stake in PJSC (Public Corporation) VTB Bank, which is entered on the List of Strategic Organizations, should be reduced to 45% in February 2016 can be regarded as an indirect indication of the privatization program's further expansion. In this connection it should be reminded that a similar decision regarding VTB was already made previously, in 2006, when the government corporate control threshold was moved down from a nearly 100% stake (99.9%) to 50% + 1 share. Thereafter, the size of state stake continued to consistently shrink: initially in the form of the so-called 'people's IPO' in 2007, and then the sale of 10% of shares for Rb 95.68bn in 2011.<sup>2</sup> And finally, as a result of an additional issue to the value of Rb 102.5bn in 2013, its size shrank from 75.5% to 60.93%.

Meanwhile, the current privatization program envisages a shrinkage of the state stake in VTB to 50% + 1 share, and any further movement below this threshold should be coordinated with the measures designed to diminish the government's participation in *Sberbank of Russia's* capital.<sup>3</sup> However, in *Rosimushchestvo's* commentaries on this issue it is stated that the shrinkage of the state stake has been caused by the necessity to make the size of state stake (as envisaged in the List of Strategic Organizations) compatible with that of the existing state as it emerged after the completion of the purchase, by State Corporation *Deposit Insurance Agency*

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<sup>1</sup> www.rosim.ru, February 15, 2016, February 29, 2016.

<sup>2</sup> The first deal completed with the participation of investment consultants (*Merill Lynch Securioties*) took place after the approval, in May 2010, of amendments to the law on privatization whereby it was allowed to sell certain assets on conditions determined by the RF Government.

<sup>3</sup> It is interesting that the annexes to the 2015 Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016 contain information on the sale, in an open auction, of shares in *Sberbank of Russia* to the value of Rb 21,225m without any rise on the starting price. The actual size of the stake relative to the charter capital is not specified, as it is not specified in the current privatization program (only the number of shares, in units).

(DIA) of a big chunk of preference shares in *VTB*. As a result, the total stake held by the State, including the share held by the RF Ministry of Finance, amounts to 45.01% of its charter capital. The State, represented by *Rosimushchestvo*, retains its right of corporate control through its bundle of voting shares<sup>1</sup>.

As for another two companies named among the candidates for privatization, these are noteworthy for their involvement in the relations between the federal center and the regions.

JSC *Bashneft*, the bulk of its capital previously held by SSA *Sistema JSFC*, last year was transferred, by a court ruling, back to federal ownership.<sup>2</sup> It was placed on the List of Strategic Organization with a federal stake of 50% + 1 share. The rest of its capital (25% + 1 share, including some preference shares) was transferred to regional ownership,<sup>3</sup> on condition that the Russian Federation and the Republic of Bashkortostan conclude a shareholder agreement, whereby the procedure for executing the rights secured by shares in JSC *Bashneft* and the ownership rights to those shares with due regard for the requirements stipulated in Russian legislation, including the regulatory procedure of managing and disposing of stakes held by the State, was determined<sup>4</sup>.

A sort of precursor to this document was the agreement of major shareholders in OJSC *Alrosa*, signed in autumn 2013 soon after the successful placement, by an international public offer, of its shares on the MICEX (7% of shares held by the RF, 7% held by the Republic of Sakha (Yakutia), and another 2% controlled by the company itself). The agreement reflects the strategic goals of the government to retain a controlling stake in state ownership, as well as the interaction mode between the Russian Federation and the Republic of Sakha (Yakutia) in exercising corporate governance of OJSC *Alrosa*. The shareholder agreement is concluded for the period of 5 years, with the possibility of its auto-prolongation.

The mandatory requirements for conducting the deals of sale of public assets, as they were put forth by this country's political leaders, will make it very difficult to proceed with privatization in the foreseeable future in view of the existing macroeconomic conditions.

These are as follows: (1) strict compliance with the norms stipulated in legislation when completing privatization deals, (2) retaining government corporate control over system-forming companies, (3) budget efficiency and avoidance of asset sale at throwaway prices, (4) topmost priority should be given to 'quality owners' who must possess not only a good business reputation and experience, but offer a development strategy for the company being purchased, (5) the new owners must be subject to Russian jurisdiction, there should be no 'gray schemes' or withdrawal of assets to offshore zones and concealment of their real owners, (6) the use, by buyers, only of their own means or loans issued by private banks<sup>5</sup>.

The issue of finding the sources of funding necessary for participating in privatization deals is self-evident. Russian businesses are now faced with an economic slump, the need to pay their foreign debts and implement the ongoing investment projects, and many other problems. The

<sup>1</sup> www.rosim.ru, February 8, 2016.

<sup>2</sup> See the IEP's previous annual overview *The Russian economy in 2014. Trends and outlooks* (Issue 36). M., Gaidar Institute, 2015, pp. 393–394.

<sup>3</sup> www.rosim.ru, July 3, 2015.

<sup>4</sup> This document was signed in mid-September 2015. The federal center and RF subjects assumed the responsibilities to coordinate the execution of shareholder rights during voting at a general shareholder meeting and the functions of the board of directors relative to the key issues of running the company (the approval of its strategy, its budget, the size of dividend amounting to no less than 25% of net profit, major deals, personnel appointments, etc.), as well as the responsibilities relative to disposal of shares. www.rosim.ru, September 16, 2015.

<sup>5</sup> www.rosim.ru, February 2, 2016.



imposed economic sanctions restrict the inflow of foreign capital to Russia's stock market. However, more problems are associated with the desire of many investors to gain control over the companies and their financial flows, their strong incentives to a prompt resale, their tendency to be more interested in natural resources and infrastructure as the least risky (and in some cases guaranteed) sources of future profits compared to investment in the development of industries unrelated to raw materials extraction - the latter being the necessary precondition for successful import substitution and export diversification.

The issue of de-offshorization does not lose its importance, as demonstrated by the prolongation of the period of amnesty for Russian individuals returning capital to Russia. The orientation of authorities to preventing asset outflow is substantiated by the new draft law envisaging a ban on participation in the privatization of offshore companies and companies controlled by entities situated in offshore zones, as well as endowing the relevant agencies with the right to check the applicants for participation in privatization deals and the documents submitted by them by criminal investigation methods.<sup>1</sup>

### 6.1.3. Improvement of legislation on privatization

In 2015, by five federal laws (introduced in April, June, July and December 2015), numerous alterations and amendments were made to the current law on privatization, adopted as of 2001.<sup>2</sup>

*Firstly*, throughout the text of the law, the term open-ended joint-stock companies is replaced by joint-stock companies. This is the upshot of the enactment, from September 1, 2014, of alterations to Part One of the RF Civil Code, introduced by Federal Law of May 5, 2014 (No 99-FZ), whereby the differentiation of joint-stock companies (JSC) into close-ended and open-ended ones was abolished, and a separate group of 'public societies' (JSCs), i.e. those whose shares and convertible securities are placed as a public offer (by open subscription) or circulate publicly on conditions established by the laws regulating the securities market<sup>3</sup>. In its previous version, the Law envisaged, as a method of privatization, only the reorganization of a unitary enterprise into an open-ended joint-stock company (OJSC), and from 2011 onwards - also into a limited liability company (LLC).

Another fundamental alteration was the introduction of a more precise definition of a transfer by way of compensation, as one of the basic principles of privatization (Article 2). The previously applied definition implied a transfer of property by way of alienation for a compensation, or a transfer to state or municipal ownership of shares in those joint-stock companies where state or municipal property was to become a state stake in the charter capital. Now, these forms of property transfer are augmented by a transfer of shares or stakes in the charter capital of economic societies created as a result of reorganization of state or municipal unitary enterprises. The motive behind this alteration is not quite clear, because in actual practice this had been

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<sup>1</sup> *Currencies' deceit*. Interview with Chairman of the RF Investigative Committee Alexander Bastrykin. *The Russian Newspaper*, January 15, 2016, No 6 (6874), pp. 1, 9.

<sup>2</sup> For further details on the newest alterations to privatization legislation introduced after the issuance of that document see Radygin A. D., Entov R. M., Malginov G. N. et al. Privatization in the modern world: theory, empiricism, "a new dimension" for Russia. Ed. A. D. Radygin. In 2 vols. (In Russian). M., Delo, RANEPa, 2014, pp. 191–220; *The Russian economy in 2013. Trends and outlooks* (Issue 35). M., Gaidar Institute, 2014, pp. 403–404; See the IEP's previous annual overview *The Russian economy in 2014. Trends and outlooks* (Issue 36). M., Gaidar Institute, 2015, pp. 389–393.

<sup>3</sup> The rules on public societies also apply to those JSCs whose charter and name reflect their status of a public society.

done before the introduction of this legislative provision. Probably its purpose is to coordinate the specific procedure of reorganization of unitary enterprises with the legal backing for the entire privatization process and the mechanisms applied therein.

*Secondly*, the property segment that is not subject to the law on privatization has been further expanded (Article 3). Now this segment consists of 20 categories.

In 2015, it was augmented by the category of securities traded in organized biddings held in accordance with Federal Law of November 21, 2011 (No 325-FZ) and the RF Government's decisions. The upshot of this innovation was that the sale of shares in OJSC on a stock exchange (in the initial wording of the law – through a trade organizer in the securities market) was taken off the list of permitted privatization methods. In this connection it should be reminded that the transaction category previously taken off that list at the very end of 2014 was the transfer of property to the ownership of an asset manager as a property contribution by the State (including at the regional and municipal levels) in the procedure established by Federal Law 'On the Areas of *Russia's* Priority *Socioeconomic Development*' of December 29, 2014 (No 473-FZ)<sup>1</sup>.

Besides, another 3 property categories, which are listed in the Law and not subject to the provisions stipulated in the privatization law that provided the basic framework for the privatization process, are defined in a more detailed way.

The category of state corporations (SC) and not-for-profit organizations (NPO) created as a result of reorganization of unitary enterprises and state institutions has been augmented by 'other' NPOs, and regions and municipalities, alongside the Russian Federation, are now directly defined as subjects endowed with the right to make property contributions to these entities.

The category of shares in a joint-stock company (JSC) and convertible securities, in the event of their buyout in the procedure established by the 1995 law on joint-stock companies (Article 84.8), was augmented by shares and securities specified in another 2 articles of that law (84.2 and 84.7).

The first article stipulates that the buyer of more than 30% of the total number of shares (including affiliated entities) is obliged to come forth with the offer of purchase of shares in a public society, as well as other issued convertible securities. The second one envisages that the buyer of more than 95% of shares in a public society is obliged to buy out the other stakes in that society held by other entities, as well as other issued convertible securities, at the request of their owners.

The category of federal property to be alienated in accordance with the RF Government's decisions for the purpose of attracting investment, boosting the stock market's development, and promoting modernization and hi-tech development across the national economy was augmented by property alienated for the purpose of boosting the development of small and medium-sized businesses, including the activity of JSC Federal Corporation for the Development of Small and Medium-sized Entrepreneurship, set up in accordance with special Federal Law adopted in 2007 (No 209-FZ) as a development institution operating in the sphere of small and medium-sized businesses. This was the second norm introduced in order to coordinate other

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<sup>1</sup> For the Far-eastern Federal Okrug, in spring 2015, JSC *Far East Development Corporation* (formerly *Moscow Materisl-Technical Base*), with a 100% stake in federal ownership, was appointed in this capacity. The shareholder rights in that JSC are executed by the RF Ministry for the Development of the Far East, and the model provision for the management of shares in joint-stock companies held in federal ownership (introduced in 2004) is not applicable to it.

laws with the laws on privatization. In 2008, the law was augmented by the provision that specified the participation of small and medium-sized businesses in the procedure of privatizing leased immovable property entities in regional and municipal ownership.

Besides, the law on privatization has been augmented by the newly introduced norm that specifies the participation of notaries and notary chambers in the privatization of regional and municipal property by means of sale at an auction or in the framework of a tender, as stipulated in the Russian Federation's Fundamental Principles of Legislation on the Notariat, adopted as of 1993.

Among the new alterations to privatization legislation we may point to the norms that define the procedure of privatizing various public assets as applied specifically to the newly established public corporation, *Roscosmos*, or the Russian Federal Space Agency (set up in accordance with specially issued Federal Law of July 13, 2015 (No 215-FZ)). We may also note its similarity with the previously introduced special norms applied to the reorganization of state railway enterprises into JSCs (in 2003) and the creation of state corporations *Rosatom* and *Rostec* (in 2007).

*Thirdly*, important changes were introduced with regard to the information backing for privatization procedures (Article 15). Now it involves the publication, on official websites, of privatization programs and reports on their implementation at all levels of state authority, of the decisions concerning the terms of privatization of state and municipal property entities, and announcements of forthcoming sales and their results.

The law on privatization no longer contains any mention of the other channel that can be used for information backing (publications in the mass media, including official print media organs, public information systems, including communications networks). Throughout the text of the law, the term 'publication' was replaced by 'posts to websites', and any references to publications in official printed organs disappeared.

The requirement concerning the placement of information on a sale deal involving privatized property (at least 30 days prior to the date of sale of a given property entity) is augmented by the requirement that the decision concerning the terms of a privatization deal should be published within 10 days from the date of making that decision.

The information to be released in connection with the decision concerning a privatization deal is augmented by the requirements to the formalization of the relevant documents and the information on all the previously held biddings for a given property entity over the year preceding its sale, as well as the information on the results of bidding.

With regard to the sale of stakes in JSCs and LLCs, the necessary information to be released (in addition to the existing 5 information items) should be as follows:

- 1) the link to the website where the annual and intermediate accounting (financial) reports of a given economic society should be posted in accordance with newly introduced Article 10.1 of the Law;
- 2) the area of the land plots (or plots) where the real estate held by a given economic society is situated;
- 3) the number of its employees;
- 4) the area occupied by the real estate units held by a given economic society and their list, where the encumbrance on the real estate, both previously existing and identified as of the date of their privatization, should be specified;
- 5) information concerning previous biddings for a given property entity over the year preceding its sale, which did not take place, were cancelled, recognized to be null and void, with

specifying the reasons for each of these events (no bids, only one potential buyer, or other reason). Previously, this information was listed as a separate item in the text of the Law, where the requirements for the information release concerning the sale of a state or municipal property entities to be published on the Internet were specified.

The period for publishing information on the Internet concerning the results of a privatization deal was shortened from 30 to 10 days, and the presentation format was altered.

The obvious information<sup>1</sup> was augmented as follows: the time of a bidding, as well as the name of the individual or legal entity participating in the bidding who offered the highest price for a given property entity compared to the bids by the other participants, with the exception of the bid made by the winner (in the event of closed bidding) or the participant who made the last but one bid for the property entity offered for sale (in the event of open bidding). The latter provision is introduced in place of the information on the number of bids and those who were recognized to be participants in the bidding.

*Fourthly*, a number of new provisions were introduced with regard to privatization planning and privatization procedures, the majority of these having to do with the technical backing for the management processes.

The government powers (Article 6) were augmented by the right to make relevant decisions concerning the approval of the list of legal entities to be assigned the task of organizing an electronic sale of state and municipal property.

With regard to the conduct of a sale (Article 32.1), a direct reference to Article 15 was introduced, the latter determining the forms of information backing for a privatization deal. At the same time, the norm concerning the formalization, in the form of a protocol, of the results of an electronic sale no longer requires their publication, on the day following the day of signing that protocol, on the official website marketplace where the sale was completed.

The norm requiring that the Government of the Russian Federation is obliged to submit to the State Duma a year-end report on the results of federal property privatization was augmented by the requirement that the report should be simultaneously posted to its official website (Article 9).

The Law on Privatization was augmented by a new article (Article 10.1) to the effect that the unitary enterprises, JSCs and LLCs included in privatization programs should submit to the empowered bodies at all levels of state authority their annual and intermediate accounting (financial) reports within 30 days from the end of the relevant reporting period, and that the information contained in those reports should be posted to the official websites determined for this purpose by relevant bodies of authority.

An important special provision was added with regard to setting the price of a property entity earmarked for privatization (Article 12). The stipulation to the effect that its starting price is to be set in accordance with RF legislation on pricing has been limited to the condition that the period between the date of drawing up a valuation report and the date of posting to an official website information concerning the forthcoming sale of a state or municipal property entity should be no longer than half-year.

*Fifthly*, the mechanisms applied in several privatization methods were properly adjusted.

With regard to auctions, while the period for submitting applications for participation remained unchanged (no less than 25 days), the period for recognizing the applicants to be participants in an auction was established to be 5 workdays after the deadline. The timelines for

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<sup>1</sup> The description of a property entity, the name of the seller, the date and place of a bidding, the price of the deal, the name of the buyer (winner in the bidding).

holding an auction were shortened (no later than on the 3rd workday from the date of recognizing the applicants to be participants in an auction vs. no earlier than after the elapse of 10 workdays). The amount of down payment necessary for securing the participation in an auction was doubled (20% vs. 10% of the starting price).

The notification concerning the recognition of a participant in an auction to be the winner is issued on a written receipt to the winner or its attorney on the day of announcing the auction results (vs. 5 days from the date of announcing the auction results), while the stipulation concerning the possibility of notification by registered post was abolished. The period for concluding a purchase and sale contract with the auction winner was shortened from 15 to 5 workdays from the date of announcing the auction results).

With regard to tenders and sales effectuated by means of a public offer, the norms regulating the timelines for recognizing the applicants to be participants in the privatization procedures, the conduct of these procedures, the increase of the amount of down payment necessary for securing participation (from 10% to 20% of the starting price), the issuance to the winner of a notification concerning the signing of a purchase and sale contract were all made to be identical to the norms regulating the auction procedure.

So, the norms that forbade the conclusion of a contract based on the results of a bidding, a sale by means of a public offer, and a sale without the selling price being announced earlier than 10 workdays from the date of posting the protocol of the results of sale of state or municipal property to the relevant websites were abolished accordingly.

In addition, the provisions concerning the formalization of purchase and sale deals involving privatized property entities (Article 32) were augmented by a norm to the effect that a violation of the established procedure for conducting a sale of state or municipal property, including an unsubstantiated refusal to recognize an applicant to be a participant in a bidding, should entail a recognition of that sale deal to be null and void.

Another norm (formerly stipulated in Article 43) to the effect that in an even when a property entity is identified that should have been contributed to the charter capital of a given OJSC, but which was not included, at the moment of its creation, into the privatized property complex, that OJSC should enjoy a priority right to purchase that property entity at a market price, while the property that has not been bought by that OJSC should be privatized in the established procedure, is now abolished.

On the whole, the innovations introduced in legislation in 2015 are designed to boost the privatization process. The suggested upgrading, to an electronic form, of the information backing for state and municipal property privatization mechanisms is aimed at increasing the overall transparency of the privatization process and preventing corruption and crime in that sphere.

To achieve that goal, it is important to draw up the list of legal entities to be assigned the task of conducting the electronic sales of state and municipal property. The necessity to involve electronic trading floors in government purchases has already been discussed for a long time. The arguments in favor of relying on such forms of commerce were the rich experience that has been accumulated in electronic transactions in various sectors, as well as the available high-quality infrastructure with its high level information security policy.

By the RF Government's Directive of December 4, 2015, No 2488-p, the list of 6 organization providing electronic trading floors was drawn up, including OJSC *RAD*, the private trader that has been for three years the organizer of sales of state properties earmarked for privatization. It is now assigned the task of selling approximately 200 JSCs currently in federal ownership, and more than 80 treasury property entities. Beside OJSC *RAD*, the list of legal entities to

be assigned the task of conducting electronic bidding, contains 5 other organization, including 2 JSCs, CJSC *Sberbank – Automated Trading System*, LLC ‘RTS-Tender’ and SUR Agency for Government Order, Investment Activity and Interregional Connections of the Republic of Tatarstan<sup>1</sup>.

The improved mechanisms applied in sales at auctions, tenders and by means of a public offer have made it possible to shorten the organization procedures (the period between the date of determining the participants in a bidding and the date of bidding, the period of processing the results of bidding, the signing of purchase and sale contracts), to speed up the sale of assets earmarked for privatization, to shorten the period of holding the down payments of the participants in a bidding, and to lower the potential risk of conspiracy between them, thus ensuring an adequately competitive environment.

It is noteworthy that the requirements to the amount of down payments are now similar to those that existed prior to 2010, when it was reduced by half (from 20% to 10% of the starting price specified in the property sale announcement). The previously applied timelines for signing contracts with the auction winners and for completing sales in the framework of a public offer (5 workdays) are now reestablished<sup>2</sup>.

One cannot overlook the increasingly widespread practice of abolishing the norms stipulated in the law on privatization. From the moment of its approval in late 2001, the number of property categories the alienation of which is no longer regulated by it has almost doubled (having increased from 11 to 20), in spite of the currently broader interpretation of some of these norms.

#### 6.1.4. The presence of the State in the economy and issues relating to the management of subjects operating in the public sector

Several serious alterations were made in 2015 to the list of strategic enterprises and joint-stock companies.

As of early December 2015, only one company was placed on that list: JSC *Bashneft*. Over the same period, 2 FSUEs and 2 JSCs, including JSC *Concern Sea Underwater Weapons – Gidropribor*, were struck off that list. The latter is a big vertically integrated structure (VIS), where all shares (but one) are earmarked as a contribution to the charter capital of another VIS (Tactical Missiles Corporation JSK) by way of payment for its additional issue and placement of shares.

In addition to the enlargement of Tactical Missiles Corporation JSK, there were some other important decisions concerning the development of other integrated structures, including OJSC Concern *VKO Almaz–Antey* (where all 100% of shares are in federal ownership), to be renamed as Aerospace Defense Concern *Almaz–Antey*<sup>3</sup>, and State Research Center of the Russian Federation Concern CSRI *Elektropribor* JSC, its charter capital consisting of the contribution of 100% – 1 shares in the JSC established on the basis of a FSUE to be struck off the list of strategic companies and blocking stakes in another JSC.

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<sup>1</sup> [www.economy.gov.ru](http://www.economy.gov.ru), December 8, 2015.

<sup>2</sup> It should be noted that in the initial wording of the law it was calendar days, and not workdays (as amended in 2011). Initially, the period for signing the contract in the framework of a tender was 10 days.

<sup>3</sup> The property integration scheme applied in the enlargement of *Almaz–Antey* is described in detail in the previous year's overview *The Russian economy in 2014. Trends and outlooks* (Issue 36). M., Gaidar Institute, 2015, pp. 396–397.

Another two important alterations in the list of strategic organizations are as follows. PJSC (Public Corporation) *ROSSETI* was allowed to increase its charter capital, at a higher government corporate control threshold (85.31%, vs. 61.7% in 2013 and 54.52% in 2012); and the state stake in the charter capital of JSC *SIA* was reduced very significantly (vs. 50% + 1 share in 2011 and 100% initially), as part of the overall context of the Moscow airport system's development based on the principles of a PPP (as described earlier).

Among the issues involved in managing economic societies with state participation, we can naturally point out those associated with the JSCs entered in the Special List approved by Directive of the Government of the Russian Federation of 23 January 2003, No 91-r, where the standpoint of the State as a shareholder on a number of the most important issues is to be determined at the government level. In accordance with the decisions of the Government of the Russian Federation issued with regard to general shareholder meetings, in the course of the corporate year 2015 a total of 390 candidates to the boards of directors (supervisory boards) of JSCs entered in the Special List<sup>1</sup> were approved, including 197 professional attorneys (out of a total of 219 persons recommended by the special Commission (attached to *Rosimushchestvo*) assigned the task of selection of independent directors, representatives of the shareholder interests of the RF, and independent experts to be elected to the managerial and control bodies of joint-stock companies), 94 independent directors (instead of 112 recommended persons) and 118 civil servants (instead of 106 recommended persons).<sup>2</sup>

Over the last 5 years, the structure of state participation in the managerial bodies of JSCs entered in the Special List has undergone noticeable changes (*Table 4*).

*Table 4*

**The movement and structure of state representatives in the managerial and control bodies of JSCs entered in the Special List, in 2010–2015**

Year	JSC, units	State representatives in boards of directors (supervisory boards)								In audit commissions: independent experts, number
		Total		Civil servants		Professional attorneys		Independent directors		
		number	%	number	%	number	%	number	%	
2010	49	386	100.0	193	50.0	117	30.3	76	19.7	...
2011	51	416	100.0	181	43.5	150	36.1	85	20.4	...
2012	57	434	100.0	141	32.5	205	47.2	88	20.3	15
2013	63	452	100.0	127	28.1	228	50.4	97	21.5	27
2014	51	402	100.0	106	26.4	199	49.5	97	24.1	45
2015 <sup>a</sup>	50	390	100.0	118	30.3	178	45.6	94	24.1	54

<sup>a</sup> – including OJSC *Novorossiysk Commercial Sea Port*, where only civil servants were elected to the board of directors and audit commissions;

*Source:* Year-end 2014 Report on the Management of Federal Stakes in OJSC and the Use of the Russian Federation's Special Right to Participate in an OJSC's Management ('Golden Share'); own calculations.

The changes within the boards of directors that occurred in 2015 had to do only with the relative share of civil servants, which increased to more than 30% vs. 26% a year earlier, due to the reduced number of professional attorneys (to 45.6%). The share taken up by independent directors remained unchanged (about 24%). On the whole over a longer period (2010–2015), the group of JSCs included in the Special List demonstrated stable growth in the number of

<sup>1</sup> Including data on candidates to the managerial bodies of OJSC "*United Grain Company*", taken from the documents issued by the special Commission's decisions (RF Government's approval was granted without delay), but less data for OJSC *State Transport Leasing Company* (GTLK) (the shareholder rights are executed by the RF Ministry of Transport) and *GLONASS* (a newly created company).

<sup>2</sup> The final decisions concerning the approval of candidates to the boards of directors and supervisory boards of the JSCs entered in the Special List are made by the RF Government.

professional directors, as a result of which their number per company increased from 3.94 to 5.44, while the number of civil servants dropped from 3.94 to 2.36.

As for the structure of the audit commissions in 2015, although civil servants still prevailed, their number shrank to 70% vs. 3/4 a year earlier (or 128 vs. 54 independent experts). However, the total number of the latter tripled over the past 3 years, their number per company increased from 0.26 in 2012 to 1.08 in 2015.

As for the structure of the managerial bodies of companies not included in the Special List, it should be said that in 527 JSC, where the possession of right to a controlling or blocking stake ensured that state representatives took up a total of 3,231 positions in the boards of directors (or supervisory boards) of JSCs,<sup>1</sup> more than half of them were professional directors (1,660 or 51.4%), while the share of civil servants (1,571) was 48.6%. However, in another 178 JSCs with the RF stakes in their charter capital amounting to less than 25%, 100% of the representatives of government interests in the boards of directors (or supervisory boards) were civil servants (approximately 270 positions). However, even if we give consideration to this factor, the total number of civil servants participating in the boards of directors (or supervisory boards) of the JSC off the Special List shrank on 2014, when it had amounted to 2,126.

Table 5

**The movement and structure of professional directors in the capacity of state representatives in the managerial and control bodies of JSCs off the Special List, in 2009–2015**

Year	JSC, units	State representatives in boards of directors (supervisory boards) (other than civil servants)						In audit commissions: independent experts, number
		Total		Professional attorneys		Independent directors		
		number	%	number	%	number	%	
2009	233	521	100.0	310	59.5	211	40.5	...
2010	389	707	100.0	493	69.7	214	30.3	...
2011	512	1,109	100.0	830	74.8	279	25.2	...
2012	822	1,860 <sup>a</sup>	100.0	1,350	72.6	510	27.4	...
2013	637	1,715	100.0	1,092	63.7	623	36.3	335
2014	683	2,094	100.0	1,382	66.0	712	34.0	498
2015	527 <sup>b</sup>	1,660	100.0	1,267	76.3	393	23.7	330

<sup>a</sup> – data are also available on the election of 1,869 professional directors;

<sup>b</sup> – in addition to those 527 JSCs where professional directors were elected to the managerial bodies, there were another 151 JSCs with a controlling or blocking stake held by the State, where decisions concerning their approval had not been passed for various objective reasons.

Source: Year-end 2014 Report on the Management of Federal Stakes in OJSC and the Use of the Russian Federation's Special Right to Participate in an OJSC's Management ('Golden Share'); own calculations

As follows from data presented in *Table 5*, the changes in the structure of professional directors were quite remarkable. While their total number shrank by 1/5, the number of independent directors surged much deeper (by 45%), their relative share among state representatives (other than civil servants) hit its record low since 2009 (less than 24%). The number of independent experts in audit commissions also surged, by 1/3. However, the number of professional directors sitting on boards of directors (supervisory boards) per company increased from 3.07

<sup>1</sup> Other than (1) 178 JSCs where the State does not hold a blocking stake, (2) 151 JSCs where the State holds a controlling or blocking stake, but the decisions concerning their approval had not been passed for various objective reasons, (3) 37 JSCs whose documents were submitted to the special Commission for the selection of professional directors and independent experts but never considered, due – among other things – to the fact of their privatization, transfer of shares under a trust management agreement, and the initiation of a proceeding in bankruptcy, when shareholders are deprived of their right to set up a company's management and control bodies.



to 3.15, while the number per company of independent experts in audit commissions shrank from 0.73 to 0.63.

The past year saw some serious progress in the development of model documents designed to standardize the management procedures applied by state-owned companies.

*Rosimushchestvo* developed its methodical instructions concerning the preparation of internal normative documents designed to regulate the activity of public corporations, public companies, and JSCs entered into the Special List.

According to the Government of the Russian Federation, these documents are as follows:

- the long-term development program (LDP);
- the provision on key performance indices (KPI);
- the regulation on investment and operative performance improvement and expenditure reduction;
- the provision on internal audit;
- the provision on a quality management system;
- the provision on a risk management system;
- the provision on the procedure for elaborating and implementing an innovative development program<sup>1</sup>.

As far as the practical aspects are concerned, the last 5 documents listed above (that is, less LDP and KPI) were approved, as of August 1, 2015 in no more than ten out of 52 JSCs entered in the Special List (the provision on internal audit was approved in 15 companies), and another 30+ companies began to elaborate such documents.

The meetings of boards of directors and supervisory boards approved drafts LDPs in 42 companies, and draft KPIs – in 40 companies. The prospects appear to be more problematic for the vast body of those companies off the Special List where the total stake held by the State is more than 50%, and the shareholder rights are executed by *Rosimushchestvo* (469 units). As of the aforesaid date, only 147 of them had approved their LDPs (while another 97 JSCs were still elaborating their draft programs), and 210 companies approved their KPIs (while in another 65 JSC these were still being elaborated).

In addition to creating a medium-term development planning systems for companies (in based on LDP and KPI), much effort was focused on the implementation of measures designed to boost labor productivity.

In 40 JSCs entered on the Special List, a set of measures aimed at boosting labor productivity is introduced, in 39 companies the relevant indices are incorporated in the managerial LDPs and KPIs, and in 29 companies alterations were made to the labor contracts concluded with independent executive bodies. The rate of implementation of these measures was lower in the larger group of 469 companies off the Special List and with the total stake held by the State of more than 50%. Only in 100 of these JSCs the labor productivity index is incorporated in their LDPs, in 106 companies it is incorporated in their managerial KPIs, and in 58 companies alterations were made to the labor contracts concluded with independent executive bodies.

In the framework of the decision, made in 2014, that centralized control should be established over the cash flows, liquidity and financial risks of public corporations, JSCs with state stakes, their affiliations and dependents, it was also necessary to set up single treasuries for the core companies, their affiliations and dependents. For this purpose, *Rosimushchestvo* issued relevant directives for state representatives in the boards of directors and supervisory boards,

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<sup>1</sup> www.rosim.ru, July 2, 2015.

established the schedule for setting up the special treasuries and prepared recommendations on the companies' major financial management functions. However, later on these goals were suspended, and the issue of their implementation, with regard to the creation of special treasuries, is to be further elaborated by the RF Ministry of Finance and the Federal Financial Monitoring Service (*Rosfinmonitoring*)<sup>1</sup>.

Also in 2015, the Model Provision on the procedures of purchases for the needs of JSCs, introduced in late 2014, was newly amended, with a more detailed elaboration of the regulation of purchase activity. Draft methodological recommendations for internal risk management and internal control organization were prepared, so as to prevent corruption in JSCs with state stakes, as well as the methodological recommendations for preparing the provision on the internal control system in such companies.

An important goal for the managerial bodies of all the companies with state participation for the next few years will be the implementation of the norms stipulated in the new Corporate Governance Code, which is only recommendatory, but is already being applied by 13 biggest public companies<sup>2</sup>.

*Rosimushchestvo* prepared materials titled 'The formation of a methodological base for corporate governance', and planned measures designed to assist in implementing the provisions stipulated in the Code. The CEOs of JSCs were to assess the feasibility of applying its principles in each company, with due regard for the potential costs and risks. On the whole, the plan aims at increasing transparency in JSCs, boosting the performance of their boards of directors and corporate secretaries, and ensuring better protection of shareholder rights. The process of implementing the Code's principles and issuing the relevant corporate document is to be over in 2016.

As for the normative-legal innovations introduced in 2015 with regard to corporate governance in the public sector, we may note the alterations introduced into the Code of Administrative Offenses of the Russian Federation, whereby the amount of fines for CEOs for failing to implement the necessary measures designed to prepare a unitary enterprise for its reorganization into a joint-stock company were raised; and the approval, by *Rosimushchestvo*, of a detailed step-by-step algorithm of preparing a unitary enterprise for privatization. Besides, *Rosimushchestvo* completed the preparation and coordination with all the relevant branch federal bodies of executive authority of the unified draft of a model charter of a JSC where *Rosimushchestvo* is the sole shareholder, and whose shares are to be alienated within the framework of the privatization program. Some alterations were introduced into the structure of the annual report of a JSC whose shares are in federal ownership (its initial wording approved by Decree of the RF Government of December 31, 2010, No 1214), These have to do with specifying a company's main areas of development and main risk factors; besides, a new section was added, which describes the approaches to organizing the risk management and internal control systems, as well as the internal audit functions.

The total amount of federal budget revenues administered by *Rosimushchestvo*, in the form of dividends charged on the shares held by the RF, with due regard for the decisions approved by annual general shareholder meetings as of 1 August 2015, was in excess of 237.7 bn Rb.<sup>3</sup>

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<sup>1</sup> Year-end 2014 Report on the Management of Federal Stakes in OJSC and the Use of the Russian Federation's Special Right to Participate in an OJSC's Management ('Golden Share').

<sup>2</sup> www.rosim.ru, November 12, 2015; November 16, 2015; November 23, 2015.

<sup>3</sup> The final year-end data for 2015 based on budget statistics are shown later, among other types of property-generated revenues.

The bulk of this sum (59%) was provided by the JSCs on the Special List (vs. 2/3 a year earlier). The group of 11 biggest payers of dividends to the federal budget (in amounts in excess of Rb 1bn) consists of OJSC *Gazprom*, *Rosneftegaz*, PJSC (Public Corporation) *Bashneft*, PJSC (Public Corporation) VTB Bank, OJSC *Alrosa*, PJSC (Public Corporation) *Rostelecom*, OJSC *Zarubezhneft*, *Rusgidro*, JSC *Transneft*, the Agency for Housing Mortgage Lending (AHML), and PJSC *Sovkomflot*.

Meanwhile, the number of companies on the Special List earmarked for the payment of dividends no less than 25% of their net profit, as determined on the basis of their year-end reports of 2014, declined on the previous year (21 vs. 34 JSCs). The main reason for the downward deviation of the amount of dividends from the target norm established by RF Government Directive No 774-r of 29 May 2006, introduced in the wording approved as of the end of 2012, was the loss incurred by state-owned companies by the end of a reporting period. Out of the 14 JSCs on the Special List with regard to which the Government of the Russian Federation issued decisions that they were not to pay dividends, 11 companies were allowed not to pay dividends specifically due to their losses.

As seen by the year-end results of 2014, for 7 JSCs on the Special List (the AHML, JSC *Bashneft*, OJSC *Zarubezhneft*, *Rosneft*, *Rostelecom*, *Rusgidro*, PJSC *Sovkomflot*) the amount of dividends to be paid to the federal budget was charged on the basis of financial reports drawn up in accordance with the International Financial Reporting Standards (IFRS), while the aggregate amount of dividends charged by these companies for the year 2013 increased 1.9 times on the corresponding index for the same period of the previous year (calculated in accordance with the Russian Accounting System (RAS)).<sup>1</sup>

#### 6.1.5. The budgetary effect of government property policy

In 2015, similarly to the situation in 2014, the movement of federal budget revenues associated in one or other way with state property was multi-directional. The revenues generated by the use of state property (renewable sources) increased alongside the declining revenues from privatization and sale of property (non-renewable sources).

Below, in *Tables 6* and *7*, we present the data on revenues taken from the laws on federal budget execution for 2000–2014 (with the exception of data for 2015) generated by the use and sale of state property belonging to specified categories of tangible property entities<sup>2</sup>.

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<sup>1</sup> 2014 Year-end Report on the Management of Federal Stakes in OJSC and the Use of the RF Special Right to Participate in an OJSC's Management ('Golden Share').

In this connection it should be noted that in the Report for the previous year *Rostelecom* and *Rusgidro* were already named among the companies applying IFRS.

<sup>2</sup> We do not consider here the federal budget revenues generated by payments for the use of natural resources (including biological water resources, revenues from the use of forest fund, and the extraction of mineral resources); compensation of losses incurred by agricultural production sector; revenues from the confiscation of agricultural land; revenues generated by financial operations (revenues from placement of budget funds (revenues from federal budget residuals and their investment; from 2006 onwards these include the revenues from the management of the RF Stabilization Fund (from 2008 onwards – the Reserve Fund and the National Welfare Fund); revenues from investment of monies accumulated in the course of trading RF stocks in the auction market); interest on domestic loans funded from the federal budget, interest on government loans (monies received from the governments of foreign countries and foreign legal entities as interest payments on RF government loans; money transfers from legal entities (enterprises and organizations), RF subjects, municipal formations received as interest and guarantee payments on loans received by the RF from foreign governments and international financial organizations)); revenues generated by paid services rendered to the population or monies received by way of compensation of government expenditures; transfers of the RF Central Bank's profits; certain categories of payments from

Table 6

**Federal budget revenues generated by use of state property (renewable sources)  
in 2000–2015, m Rb**

Year	Total	Dividends on shares (2000–2015) and revenues generated by other forms of participation in capital (2005–2015)	Payment for lease of land in state ownership	Revenues generated by lease of property in state ownership	Revenues for transfer of part of net profits of FSUEs after taxes and other mandatory payments	Revenues generated by Joint Venture <i>Vietsovpetro</i>
2000	23,244.5	5,676.5	-	5,880.7	-	11,687.3 <sup>a</sup>
2001	29,241.9	6,478.0	3,916.7 <sup>b</sup>	5,015.7 <sup>c</sup>	209.6 <sup>d</sup>	13,621.9
2002	36,362.4	10,402.3	3,588.1	8,073.2	910.0	13,388.8
2003	41,261.1	12,395.8		10,276.8 <sup>e</sup>	2,387.6	16,200.9
2004	50,249.9	17,228.2	908.1 <sup>f</sup>	12,374.5 <sup>e</sup>	2,539.6	17,199.5
2005	56,103.2	19,291.9	1,769.2 <sup>b</sup>	14,521.2 <sup>i</sup>	2,445.9	18,075.0
2006	69,173.4	25,181.8	3,508.0 <sup>h</sup>	16,809.9 <sup>i</sup>	2,556.0	21,117.7
2007	80,331.85	43,542.7	4,841.4 <sup>h</sup>	18,195.2 <sup>i</sup>	3,231.7	10,520.85
2008	76,266.7	53,155.9	6,042.8 <sup>h</sup>	14,587.7 <sup>i</sup>	2,480.3	-
2009	31,849.6	10,114.2	6,470.5 <sup>h</sup>	13,507.6 <sup>i</sup>	1,757.3	-
2010	69,728.8	45,163.8	7,451.7 <sup>h</sup>	12,349.2 <sup>i</sup>	4,764.1	-
2011	104,304.0	79,441.0	8,210.5 <sup>h</sup>	11,241.25 <sup>i</sup>	4,637.85	773.4
2012	228,964.5	212,571.5	7,660.7 <sup>k</sup>	3,730.3 <sup>i</sup>	5,002.0	-
2013	153,826.2	134,832.0	7,739.7 <sup>k</sup>	4,042.7 <sup>i</sup> +1,015.75 <sup>m</sup>	6,196.1	-
2014	241,170.6	220,204.8	7,838.7 <sup>k</sup>	3,961.6 <sup>i</sup> +1,348.5 <sup>m</sup>	7,817.0	-
2015	284,471.3	258,872.2	9,032.3 <sup>k</sup>	5,593.8 <sup>i</sup> +1,687.8 <sup>m</sup>	9,285.2	-

<sup>a</sup> – according to data released by the RF Ministry of Property Relations, in the Law of Federal Budget Execution in 2000 this item was not specified separately, instead the amount of payment received from state-owned enterprises was entered (Rb 9,887.1m) (without any components being specified);

<sup>b</sup> – the amount of lease payments (i) for the use of agricultural land and (ii) for the use of land plots in the territories of towns and settlements;

<sup>c</sup> – the amount of revenues from the lease of property consolidated to (i) scientific research organizations, (ii) educational establishments, (iii) healthcare institutions, (iiii) state museums, state cultural and arts institutions, (iiiii) archival institutions, (iiiii) the RF Ministry of Defense, (iiiii) organizations subordinated to the RF Ministry of Railways, (iiiii) organizations providing research-related services to the academies of sciences with the status of a state entity, and (iiiii) other revenues from the lease of property in state ownership;

<sup>d</sup> – according to data released by the RF Ministry of Property Relations, in the Law of Federal Budget Execution in 2001 this item was not specified separately, this value turned out to be the same as the amount of other revenues received as part of payments transferred by state and municipal organizations;

<sup>e</sup> – total amount of revenues generated by the lease of property entities in state ownership (without specifying the amount of lease payments for land);

state and municipal enterprises and organizations (patent duties and registration fees for official registration of software, databases, integral microcircuit topologies; and other revenues which until 2004 were part of mandatory payments of state organizations (except revenues generated by the operations of Joint Venture *Vietsovpetro* (from 2001) and transfers of part of profits generated by FSUEs (from 2002)); revenues from the implementation of product share agreements (PSA); revenues from the disposal of confiscated and other property earmarked as government revenue (including property transferred to state ownership in the procedure of inheritance or gift, or treasure trove appropriation); revenues generated by lotteries; other revenues from the use of property and rights in federal ownership (revenues from the execution of rights to the results of intellectual activity (R&D and technologies) intended for military, special or dual use; revenues generated by the execution of rights to the results of scientific and technological research held by the RF; revenues generated by the exploitation and use of property relating to motor roads, motor road levies imposed on transport vehicles registered in the territories of other states; execution of the Russian Federation's exclusive right to the results of intellectual activity in the field of geodesy and cartography; and other revenues from the use of property in the ownership of the Russian Federation); revenues generated by organizations from the permitted types of economic activity and earmarked for transfer to the federal budget; revenues from realization of government reserves of precious metals and precious stones.

<sup>f</sup> – the amount of lease payments (i) for the use of land plots in the territories of towns and settlements (ii) for the use of land plots in federal ownership after the delineation of titles to land plots between different tiers of government;

<sup>g</sup> – the amount of revenues from the lease of property consolidated to (i) scientific research organizations, (ii) educational establishments, (iii) healthcare institutions, (iiii) state cultural and arts institutions, (iiiii) state archival institutions, (iiiii) institutions of the federal postal service of the RF Ministry of Communications and Informatization, (iiiii) organizations providing research-related services to the academies of sciences with the status of a state entity, and (iiiii) other revenues generated by the lease of property in federal ownership;

<sup>h</sup> – the amount of lease payments after the delineation of titles to land plots between different tiers of government and revenues generated by the sale of right to conclude lease agreements in respect of land plots in federal ownership (with the exception of land plots held by federal autonomous institutions (2008–2011) and budget-funded institutions (2011));

<sup>i</sup> – the amount of revenues from the lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them, and property held by right of economic jurisdiction by FSUEs: properties transferred for operative management to organizations with the status of a state entity (i) scientific research institutions, (ii) organizations providing research-related services to the Russian Academy of Sciences and to sectoral academies of sciences, (iii) educational establishments, (iiii) healthcare institutions, (iiiii) federal postal service institutions of the Federal Communications Agency (*Rossvyaz*), (iiiii) state cultural and arts institutions, (iiiii) state archival institutions, and (iiiii) the lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them, and property held by right of economic jurisdiction by FSUEs<sup>1</sup> (for the period 2006–2009 - less revenues from the permitted types of economic activity and revenues from the use of federal properties situated outside of RF territory, which are received abroad and were not listed as a separate item in the previous years<sup>2</sup>);

<sup>j</sup> – the amount of revenues from the lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them ((with the exception federal autonomous institutions and budget-funded institutions): properties transferred for operative management to organizations with the status of a state entity (i) scientific research institutions, (ii) organizations providing research-related services to the Russian Academy of Sciences and to the ‘branch’ academies of sciences, (iii) educational establishments, (iiii) healthcare institutions, (iiiii) state cultural and arts institutions, (iiiii) state archival institutions, (iiiii) properties held by right of operative management by the RF Ministry of Defense its subordinated institutions (2010), (iiiii) properties in federal ownership disposed of by the Executive Office of the RF President (2010), and (iiiii) revenues from the lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them (less revenues from the permitted types of economic activity and revenues from the use of federal properties situated outside of RF territory, which are received abroad);

<sup>k</sup> – the amount of lease payments after the delineation of titles to land plots between different tiers of government and revenues generated by the sale of right to conclude lease agreements in respect of land plots in federal ownership (with the exception of land plots held by federal autonomous institutions and budget-funded institutions), and (i) lease payments received for the lease of land plots in federal ownership, situated in public motor road precincts of federal importance (2012–2015), and (ii) payments for the execution of agreements on the establishment of servitude with regard to land plots situated within public motor road precincts of federal importance for the purposes of construction (or reconstruction), capital repairs and exploitation of road service entities, installation and exploitation of utility networks, installation and exploitation of elevated advertizing structures (only for 2012 and 2014–2015), и (iii) payments for the execution of agreements on the establishment of servitude with regard to land plots in federal ownership (only for 2015);

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<sup>1</sup> For the period 2008–2009, there is no mention of FSUEs as sources of revenues generated by the lease of property consolidated to them by right of economic jurisdiction, while the revenues from the lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them does not include revenues generated by property held by autonomous institutions.

<sup>2</sup> According to data released by the RF Ministry of Property Relations, the revenues from the use of federal properties situated outside of RF territory (except revenues generated by the operations of Joint Venture *Vietsoyptero*) amounted to Rb 315m in 1999 and Rb 440m in 2000. From then on, the principal role in handling the commercial use of federal immovable property entities situated abroad began to be played by FSUE Enterprise for the Management of Property Situated Abroad.

<sup>l</sup> – the amount of revenues from the lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them (with the exception of autonomous and budget-funded institutions): properties transferred for operative management to organizations with the status of a state entity (i) scientific research institutions, (ii) educational establishments, (iii) healthcare institutions, (iiii) state cultural and arts institutions, (iiiii) state archival institutions, (iiiii) other revenues from the lease of property held by right of operative management by federal treasury institutions, (iiiii) federal bodies of state authority, the Bank of Russia, and the managerial bodies of government off-budget funds (iiiii) federal treasury institutions (only for 2015) (less revenues from the use of federal properties situated outside of RF territory, which are received abroad);

<sup>m</sup> the amount of revenues from the lease of RF treasury property (with the exception of land plots).

*Source:* Law of Federal Budget Execution for the period 2000–2014; Report on Federal Budget Execution as of January 1, 2015 (monthly report), [www.roskazna.ru](http://www.roskazna.ru); own calculations.

In 2015, the aggregate revenue generated by renewable sources increased on the previous year by nearly 18%.

The amount of dividend receipts and the transfer of part of their profit by unitary enterprises displayed growth by approximately 17–18%. These indices in absolute terms hit their record high of the entire period since the early 2000s, having risen to Rb 258.9bn and Rb 9.3bn respectively.

Somewhat lower growth (by 15.2%) was demonstrated by the amount of budget revenues generated by lease of land, amounting to more than Rb 9bn.<sup>1</sup> However on the positive side, for the first time in many years, the aggregate revenues from lease of federal property surged at an accelerated rate (by more than 37%) to Rb 7.3 bn. In contrast to the situation in 2013–2014, this result was achieved due to the growth (by 41%) of revenues from the lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them (with the exception of budget-funded and autonomous institutions), while the revenues generated by lease of RF treasury property (with the exception of land plots) increased by 25%.

As a result, the structure of federal budget revenue received from renewable sources remained unchanged. Dividends accounted for the bulk of federal budget revenue received from renewable sources (approximately 91%). The relative shares of the other sources were almost negligible: profits transferred by FSUEs – 3.3%; lease of land – 3.2%, lease of property – 2.6%.

While proceeding to an analysis of federal budget revenues generated by privatization and sale of state property (*Table 7*), it should be noted that, from 1999 onwards, the revenues from sales of such assets (state stakes, and over the period 2003–2007 - also land plots<sup>2</sup>) have been treated as a source of funding to cover budget deficit.

<sup>1</sup> The amount of lease payments for land plots, just as a year earlier, includes lease payment received for the lease of land plots in federal ownership situated in public motor road precincts of federal importance, payments for the execution of agreements on the establishment of servitude with regard to land plots covered by the right-of-way for general-use motorways of federal importance for the purposes of construction (or reconstruction), capital repairs and exploitation of road service entities, installation and exploitation of utility networks, and installation and exploitation of elevated advertising structures, which are not specified as a separate item in the budget reports for 2013. In addition, in 2015, the revenues generated by the lease of land plots for the first time were augmented by payments for the establishment of servitude with regard to land plots in federal ownership.

<sup>2</sup> Data for the period 2003–2004 include revenues generated by sale of leasing rights.

*Table 7*

**Federal budget revenues generated by privatization and sale of property  
(non-renewable sources) in 2000–2015, m Rb**

Year	Total	Sale of shares in federal ownership (2000–2015) and other forms of participation in capital (2005–2015) <sup>a</sup>	Sale of land plots	Sale of miscellaneous properties
2000	27,167.8	26,983.5	-	184.3 <sup>b</sup>
2001	10,307.9	9,583.9	119.6 <sup>c</sup>	217.5+ 386.5+0.4 (ITA) <sup>d</sup>
2002	10,448.9	8,255.9 <sup>e</sup>	1,967.0 <sup>d</sup>	226.0 <sup>e</sup>
2003	94,077.6	89,758.6	3,992.3 <sup>h</sup>	316.2+10.5 <sup>i</sup>
2004	70,548.1	65,726.9	3,259.3 <sup>j</sup>	197.3+1,364.6+0.04 (ITA) <sup>k</sup>
2005	41,254.2	34,987.6	5,285.7 <sup>l</sup>	980.9 <sup>m</sup>
2006	24,726.4	17,567.9	5,874.2 <sup>l</sup>	1,284.3 <sup>n</sup>
2007	25,429.4	19,274.3	959.6 <sup>o</sup>	5,195.5 <sup>p</sup>
2008	12,395.0	6,665.2+29.6	1,202.0 <sup>q</sup>	4,498.2+0.025 (ITA) <sup>f</sup>
2009	4,544.1	1,952.9	1,152.5 <sup>q</sup>	1,438.7 <sup>r</sup>
2010	18,677.6	14,914.4	1,376.2 <sup>q</sup>	2,387.0+0.039 (ITA) <sup>f</sup>
2011	136,660.1	126,207.5	2,425.2 <sup>q</sup>	8,027.4 <sup>r</sup>
2012	80,978.7	43,862.9	16,443.8 <sup>q</sup>	20,671.7+0.338 (ITA) <sup>f</sup>
2013	55,288.6	41,633.3	1,212.75 <sup>q</sup>	12,442.2+0.310 (ITA) <sup>f</sup>
2014	41,155.35	29,724.0	1,912.6 <sup>q</sup>	9,517.7+1.048 (ITA) <sup>f</sup>
2015	19,792.4	7,203.9	1,634.55 <sup>q</sup>	10,953.9+0.062 (ITA) <sup>f</sup>

<sup>a</sup> – treated as an internal source of funding to cover federal budget deficit, amount to Rb 29.6m for 2008 (as stated in the Report on Federal Budget Execution as of January 1, 2009); this is a federal budget revenue item, but it is absent in the Law of Federal Budget Execution in 2008;

<sup>b</sup> – revenues generated by privatization of entities in state ownership and treated as an internal source of funding to cover federal budget deficit;

<sup>c</sup> – revenues generated by sale of land plots and the right to lease land plots in state ownership (with special entry concerning those land plots in which privatized enterprises are situated), treated as federal budget revenues;

<sup>d</sup> – the amount of revenues generated by (1) sale of property in federal ownership, treated as an internal source of funding to cover federal budget deficit, (2) revenues generated by (i) sale of apartments, (ii) sale of state production and non-production assets, transport vehicles, other equipment and tangible assets, and (3) revenues generated by sale of intangible assets (ITA), treated as federal budget revenues;

<sup>e</sup> – including Rb 6m generated by sale of shares held by RF subjects;

<sup>f</sup> – revenues generated by sale of land and intangible assets, their amount not specified as a separate entry, treated as federal budget revenues;

<sup>g</sup> – revenues generated by sale of property in state ownership (including Rb 1.5m generated by the sale of properties held by RF subjects), treated as an internal source of funding to cover federal budget deficit;

<sup>h</sup> – this figure includes revenues generated by: (1) sale of land plots in which immovable property entities are situated, which prior to their alienation were federal property, the proceeds being transferred to the federal budget, (2) sale of other land plots, as well as sale of the right to conclude lease agreements in respect of those land plots, (3) sale of land plots after delineation of titles to land plots, as well as sale of the right to conclude lease agreements in respect of those land plots, the proceeds being transferred to the federal budget; these are treated as an internal source of funding to cover federal budget deficit;

<sup>i</sup> – the sum of (1) revenues generated by sale of properties in federal ownership, treated as an internal source of funding to cover federal budget deficit, and (2) revenues generated by sale of intangible assets, treated as federal budget revenues;

<sup>j</sup> – this figure includes the revenues generated by: (1) sale of land plots after delineation of titles to land plots, in which immovable property entities are situated, which prior to their alienation were federal property, the proceeds being transferred to the federal budget, (2) sale of other land plots, as well as sale of the right to conclude lease agreements in respect of those land plots, (3) sale of land plots after delineation of titles to land plots, as well as sale of the right to conclude lease agreements in respect of those land plots, the proceeds being transferred to the federal budget; these are treated as an internal source of funding to cover federal budget deficit;

<sup>k</sup> – the sum of (1) revenues generated by sale of properties in federal ownership, treated as an internal source of funding to cover federal budget deficit, (2) revenues generated by (i) sale of apartments, (ii) sale of equipment, transport vehicles and other tangible assets, the proceeds being transferred to the federal budget, (iii) sale of the products of ships recycling industry, (iiii) sale of property held by state unitary enterprises and state institutions,

as well as sale of military property, (iiii) sale of the products of recycled armaments, military technologies and ammunition, (3) revenues generated by sale of intangible assets (ITA); these are treated as federal budget revenues;

<sup>l</sup> – this figure includes the revenues generated by: (1) sale of land plots after delineation of titles to land plots, in which immovable property entities are situated, which prior to their alienation were federal property, (2) sale of land plots after delineation of titles to land plots, the proceeds being transferred to the federal budget, (3) sale of other land plots, which prior to the delineation of titles to land plots between different tiers of government were state property, and which are not earmarked for housing construction (this subdivision is true only with regard to data for 2006), treated as sources of funding to cover federal budget deficit;

<sup>m</sup> – revenues generated by sale of tangible and intangible assets (less federal budget revenues generated by disposal and sale of confiscated property and other property treated as government revenue), this figure includes revenues generated by (i) sale of apartments, (ii) sale of property held by FSUEs, (iii) sale of property held by right of operative management by federal institutions, (iiii) sale of military property, (iiiiii) sale of the products of recycled armaments, military technologies and ammunition, (iiiiiii) sale of other properties in federal ownership, (iiiiiiii) sale of intangible assets; these are treated as federal budget revenues;

<sup>n</sup> – revenues generated by sale of tangible and intangible assets (less revenues received as profit share in the framework of product share agreements (PSA) and federal budget revenue generated by the disposal and sale of heirless property, confiscated property, or other property earmarked as government revenue), this figure includes revenues generated by (i) sale of apartments, (ii) sale of property held by FSUEs, (iii) sale of property held by right of operative management by federal institutions, (iiii) sale of military property, (iiiiii) sale of scrapped armaments, military equipment and ammunition, (iiiiiii) sale of other properties in federal ownership; these are treated as federal budget revenues;

<sup>o</sup> – revenues generated by sale of land plots after delineation of titles to land plots formerly in federal ownership, treated as sources of funding to cover federal budget deficit;

<sup>p</sup> – revenues generated by sale of tangible and intangible assets (less revenues received as profit share in the framework of product share agreements (PSA) and federal budget revenue generated by the disposal and sale of heirless property, confiscated property, or other property earmarked as government revenue, and revenues from sale of timber confiscated from timber poachers), this figure includes revenues generated by (i) sale of apartments, (ii) sale of property held by FSUEs, (iii) sale of property held by right of operative management by federal institutions, (iiii) sale of redundant movable and immovable military properties and other properties held by federal bodies of executive authority that are equated to military service, (iiiiii) sale of military-purpose products from the stores of federal bodies of executive authority within the framework of cooperation in the field of military technologies, (iiiiiii) revenues generated by sale of other properties in federal ownership; these are treated as federal budget revenues;

<sup>q</sup> – revenues generated by sale of land plots in federal ownership (less land plots held by federal autonomous and budget-funded institutions (data for 2011–2012)), treated as federal budget revenues; in 2015, these were augmented by payments for the area added to land plots in private ownership as a result of redistribution of land between these land plots and those in federal ownership;

<sup>r</sup> – revenues generated by sale of tangible and intangible assets (less revenues received as profit share in the framework of product share agreements (PSA), and federal budget revenue generated by the disposal and sale of heirless property, confiscated property, or other property earmarked as government revenue, and revenues from sale of timber confiscated from timber poachers) (data for 2008–2011), revenues generated by the release of tangible assets from the state reserve of special raw materials and divisible materials (in the part of revenues generated by sale, temporary lending, and other uses); and with regard to data for 2012–2015, also revenues generated by sale of timber produced as a result of measures designed to safeguard, protect, reproduce forests in the framework of government order for the implementation of such measures without sale of forest plantations for timber production, and timber produced as a result of use of forests situated in the lands belonging to the Forest Fund of the Russian Federation, in accordance with Articles 43–46 of the RF Forest Code; revenues generated by commodity intervention from the reserve stocks held in the federal intervention fund of agricultural products, raw materials and food-stuffs, revenues generated by the release of tangible assets from the state reserve, revenues generated by the involvement of convicts in reimbursable labor (in the part of sales of finished product), revenues generated by sale of products requiring special storage conditions), this figure includes revenues generated by (i) sale of apartments, (ii) sale of property held by right of operative management by federal institutions (with the exception of autonomous and budget-funded institutions (data for 2011–2015), including revenues from the activity of institutions situated outside of RF territory (2015) (iii) sale of redundant movable and immovable military properties and other properties held by federal bodies of executive authority that are equated to military service, (iiii) sale of the products of recycled armaments, military equipment and ammunition, (iiiiii) sale of products intended for military



use and placed on the list of properties held by federal bodies of executive authority in the framework of cooperation in the field of military technologies (data for 2008 and the period 2010–2015), (iiiiii) sale of scrapped armaments and other military hardware in the framework of Federal Target Program of Industrial Recycling of Armaments and Military Equipment (2005–2010), (iiiiiii) revenues generated by sale of immovable property held by budget-funded and autonomous institutions (2014–2015), (iiiiiiii) revenues generated by sale of other properties in federal ownership and revenues generated by sale of intangible assets (ITA); these are treated as federal budget revenues.

*Source:* Laws on Federal Budget Execution for the period 2000–2014; Report on Federal Budget Execution as of January 1, 2016 (monthly report), [www.roskazna.ru](http://www.roskazna.ru); own calculations.

The amount of property-generated federal budget revenue from non-renewable sources in 2015 shrank by more than half, approximately to its 2010 level.

The main cause of this decline was the shrinkage (more than fourfold - to Rb 7.2 bn) of the revenues generated by sale of shares. This is one of the lowest indices for the entire period since the 2000s, which is only above the indices for the crisis period 2008–2009. At the same time, this result is more than 44% above the budget target.

In 2015, the amount of revenues generated by sale of land plots shrank by 14.5% to Rb 1.6bn vs. Rb 1.9bn a year earlier, which is above the indices for 2008–2010 and 2013, but below the year-end result for 2011.

At the same time, growth (by 15%) was demonstrated by revenues generated by sale of miscellaneous properties. For the first time, this revenue source became topmost in the structure of revenues from non-renewable sources (more than 55%). In the crisis years 2008–2009, the amount of revenues from sale of miscellaneous properties accounted for more than 30% of the aggregate revenues from non-renewable sources, and over period 2012–2013 – for more than 20%, although in absolute terms their amount was higher than the corresponding index for 2015.

The revenues generated by sale of shares, which over the last few years accounted for more than 70% of the aggregate revenues from non-renewable sources, in 2015 shrank nearly by half (to 36%). In spite of their shrinkage in absolute terms, the share of revenues from sale of land increased significantly (from 4.6 to 8.3%).

The aggregate federal budget revenue generated by privatization (or sale) and use of state property in 2015 (*Table 8*) increased on the previous year by 7.8%. Its amount in absolute terms (Rb 304.3bn) comes second after the record high (achieved in 2012) of the entire period since the early 2000s, rising several times above the corresponding indices for period 2008–2009.

While in 2014 the ratio between non-renewable and renewable sources in the structure of aggregate revenues generated by privatization (or sale) and use of state property was roughly comparable with the corresponding indices for the crisis period 2008–2009, in 2015 the share of renewable sources shrank more than twofold – to 6.5%, this hitting its record low of the entire period since the early 2000s.

The share of revenues generated by the use of state property, on the contrary, increased from nearly 85.4% to 93.5% in 2015. This index represents a record high for the entire period since the early 2000s, whereas the amount of revenues from property privatization (or sale) shrank by half on 2014, which is still somewhat above the indices for the periods 2001–2002 and 2008–2010.

Table 8

**The structure of property-generated federal budget revenues from miscellaneous sources, 2000–2015**

Year	Aggregate revenue generated by privatization (or sale) and use of state property		Privatization-generated revenues (non-renewable sources)		Revenues generated by use of state property (renewable sources)	
	m Rb	% of total	m Rb	% of total	m Rb	% of total
2000	50,412.3	100.0	27,167.8	53.9	23,244.5	46.1
2001	39,549.8	100.0	10,307.9	26.1	29,241.9	73.9
2002	46,811.3	100.0	10,448.9	22.3	36,362.4	77.7
2003	135,338.7	100.0	94,077.6	69.5	41,261.1	30.5
2004	120,798.0	100.0	70,548.1	58.4	50,249.9	41.6
2005	97,357.4	100.0	41,254.2	42.4	56,103.2	57.6
2006	93,899.8	100.0	24,726.4	26.3	69,173.4	73.7
2007	105,761.25	100.0	25,429.4	24.0	80,331.85	76.0
2008	88,661.7	100.0	12,395.0	14.0	76,266.7	86.0
2009	36,393.7	100.0	4,544.1	12.5	31,849.6	87.5
2010	88,406.4	100.0	18,677.6	21.1	69,728.8	78.9
2011	240,964.1	100.0	136,660.1	56.7	104,304.0	43.3
2012	309,943.2/	100.0	80,978.7/	26.1/	228,964.5	73.9/
	469,243.2 <sup>a</sup>		240,278.7 <sup>a</sup>	51.2 <sup>a</sup>		48.8 <sup>a</sup>
2013	209,114.85	100.0	55,288.6	26.4	153,826.25	73.6
2014	282,325.95	100.0	41,155.35	14.6	241,170.6	85.4
2015	304,263.7	100.0	19,792.4	6.5	284,471.3	93.5

<sup>a</sup> including the proceeds received by the RF Central Bank as a result of sale of a stake in *Sberbank* (Rb 159.3bn), which is probably an overestimation of the actual aggregate share of non-renewable sources, as the budget did not receive that sum in full but minus the balance sheet value of those sources and the costs of the sale of that stake. Consequently, the share of renewable sources is, on the contrary, somewhat underestimated

Source: Laws on Federal Budget Execution for the period 2000–2014; Report on Federal Budget Execution as of January 1, 2016 (monthly report), [www.roskazna.ru](http://www.roskazna.ru); own calculations.

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So, the situation in the sphere of ownership relations in 2015 revealed the following basic trends.

The implementation of the three-year privatization program for 2014–2016 was characterized by an unfavorable economic and political background. No big sale deals took place. Compared to the year-end results of 2014, the number of sold stakes slightly dropped, while the rate of unitary enterprises being reorganized into joint-stock companies remained unchanged, and the volume of sales of immovable property entities tripled.

Thanks to *Rosimushchestvo's* efforts aimed at improving the system of sales and the information backing for privatization deals, the federal budget was augmented by revenues in an amount that exceeds the forecasted revenue figure stipulated in the privatization program (less biggest sale deals), and also exceeds the overall budget target for revenue to be generated by sale of shares. With some reservation, we can still say that due to the active involvement of non-governmental sellers in the sales of state stakes, the privatization process proceeded at a faster rate than is had done in the comparably tough conditions of the crisis year 2009. Some alterations were made to the privatization law, but these were of minor importance, and their true effect (shorter time needed for concluding privatization deals and a higher competition rate) will become manifest only in the future.

The movement of the public sector of the national economy cannot be estimated more or less accurately for lack of necessary statistics, which is the upshot of a switchover to a new methodology, and it is still unclear whether this methodology is appropriate or not. In absence

of significant deals, the process of creating vertically integrated structure with the participation of state companies was actively evolving in the corporate control market; besides, the applied instruments for managing the economic subjects operating in the public sector continued to be further improved at the level of model documents.

The structure of federal budget revenues generated by privatization (or sale) and use of state property, just as a year earlier, was dominated by revenues from renewable sources, and their share actually rose to a record high of the entire period since the early 2000s. Growth in absolute terms was demonstrated with regard to all types of renewable sources, the highest increase being noted in the amount of federal budget revenues generated by payments for the use of federal property entities (other than land plots). As for non-renewable sources, growth was observed only with regard to revenues generated by sale of miscellaneous properties (other than land plots).

## **6.2. Evolution of bankruptcy institution: from insolvency of state-owned enterprises towards electronic SRO trading facilities<sup>1</sup>**

### 6.2.1. Bankruptcy legislation in post-Soviet Russia

Bankruptcy legislation in the post-Soviet Russia was for the first time introduced in 1992 by the Executive Order of the President “On Measures for the Support and Rehabilitation of Insolvent State-Owned Enterprises (Bankrupt Debtors) and the Application of Special Proceedings to Them” No. 623 of June 14, 1992, which stipulated grounds for liquidation of enterprises, special liquidation proceedings such as reorganization, rehabilitation, direct administration of the enterprise, independent management, auctions for sale of enterprise, and other provisions concerning bankruptcy.

The *first law on bankruptcy* – Federal Law “On Insolvency (Bankruptcy) of Enterprises” No. 3929-1 dated November 19, 1992 – was adopted in late 1992. Although the number of bankruptcy petitions in commercial courts increased visibly in 1995–1997, the number of bankruptcy proceedings remained small in Russia.

The law was based on the concept of inability to pay due to the assets-to-liabilities ratio, and if an enterprise is worth less than its liabilities, it is deemed to be insolvent on a book value basis. The law practice revealed that creditor rights were limited considerably because commercial courts faced difficulties in determining a fair value of debtor’s assets, thus delaying with issuing a bankruptcy order against the debtor. Additionally, the state was acting as senior creditor by collecting through tax penalties all liquid assets with the aim of paying tax liabilities.<sup>2</sup>

The *second federal law on bankruptcy* was adopted in 1998, because the first law proved inefficient. The second law was based on the concept of default. An enterprise is deemed to be bankrupt if it is unable to fulfill its obligations as they come due, which is recognized as insolvency on a cash basis.

The law lowered the barriers to initiating bankruptcy proceedings and strengthened the status of creditors. As a result, the scope of insolvency proceedings was broadened progressively. The number of bankruptcies soared because prior to the introduction of bankruptcy proceeding in

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<sup>1</sup> Authors of this section: Apevalova E. – RANEPА, Polezhaeva N. – RANEPА, Radygin A. – RANEPА.

<sup>2</sup> See Apevalova E., Radygin A. Bankruptcies in the 2000s: from takeover tool towards double standard policy. – V: Ekonomicheskaya Politika, 2009, No. 4, pp. 91-124.

1998 companies accumulated a great deal of liabilities to the federal budget and regional budgets, as well as to private creditors.

Under the second law the creditor may file for bankruptcy against the debtor if the latter fails to fulfill its obligations within three months and if the outstanding amount is more than 500 times the wage floor, thereby creating equal opportunities for creditors to initiate bankruptcy proceeding. However, no consideration was made for cash gaps that occurred in practice and for the scope of business operations.

The state had no right to vote on crucial resolutions passed at meetings of creditors, and the issues of affiliation of bankruptcy trustees worsened, etc. The institution of bankruptcy was found to be widely used as a tool of distributing the debtor's estate and of asset stripping. In 1998–2002, the initiation of bankruptcy proceeding was actually turned into a cost effective alternative to hostile takeover by way of purchasing shares in the secondary market. Russia's Federal Service on Financial Rehabilitation and Bankruptcy (FSFO) reported that one in five bankruptcy cases exhibited signs of malicious intentions (in particular, filing for bankruptcy with the aim of writing off debts).

The *third federal law on bankruptcy* which is currently in effect was adopted in 2002. The adoption was necessitated by an array of problems which the first (1992) and the second (1998) laws failed to address. Below listed are most pressing issues that were observed at that period:

- widespread practice of using bankruptcy as takeover tool;
- infringements of the rights of the debtor and of the debtor's founders;
- infringements of the rights of the state as tax creditor;
- writing off the debtor's assets for the benefit of a certain group of creditors as part of receivership and trusteeship proceedings;
- lack of transparency, inadequate regulation of bankruptcy proceedings, allowing bankruptcy trustees and other parties to a bankruptcy process to misuse the loopholes therein;
- lack of efficient arrangements holding bankruptcy trustees liable for bad faith and ineffective performance, etc.

The third law aimed to address these issues and it was adopted as a result of trade-off between the supporters of two opposite views as to further development of the institution of bankruptcy.<sup>1</sup> The law was updated with some critical provisions as follows:

- the state and bankruptcy creditors enjoy equal rights, and claims of the state are consolidated;
- owners acting in good faith enjoy better protection of their rights;
- the risk of abusing the right by creditors is mitigated;
- a new reorganization proceedings – financial rehabilitation – was introduced;
- parties to bankruptcy proceedings, which are acting in good faith are protected from fraudulent actions of other persons;
- supervision over bankruptcy trustees has become more efficient;
- specifics of bankruptcy of certain categories of debtors are set out in a single law;
- a wider-than-normal usage of bankruptcy proceedings for winding up absent debtors is limited.

The introduction of the law resulted in drastic slump of the number of bankruptcy proceedings from 106,600 in 2002 to 14,300 in 2003 because tax authorities almost stopped filing for bankruptcy against absent debtors due to no allocation of budget resources for this purpose.

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<sup>1</sup> See Radygin A., Simachev Y. Russia's bankruptcy institution: specifics of evolution, issues and prospects. – V: Russian Management Journal, 2005, Vol. 2, No. 2, pp. 43-70.

Later, the peak of bankruptcies of absent debtors was reached in 2006, and it was never hit again since then.

The principal initiator of bankruptcy proceedings was identified since the inception of the new law. Most of the bankruptcies until 2011 were initiated by competent public authorities, predominantly by tax authorities which in 2006 accounted for 87% of the total petitions for bankruptcy. The percentage decreased gradually in the following years, reaching 31% by 2011. 2009 and 2010 saw the biggest number of substantiated bankruptcies, 35,200 and 36,600, respectively.<sup>1</sup>

An extremely low effectiveness of using the bankruptcy mechanism for the purpose of *restoring the solvency of enterprises* in the course of bankruptcy proceedings is one of the strongest trends.

As regards critical updates, the principal emphasis should be placed on amendments made in the peak of the crisis, that is, between December 2008 and April 2009 (Federal Law of “On the Amendments to the Federal Law “On Insolvency (Bankruptcy)” No. 296-FZ dated December 30, 2008 and Federal Law “On the Amendments to Certain Legislative Acts of the Russian Federation”) No. 73-FZ dated April 28, 2009. The amendments aimed first of all to *increase transparency of bankruptcy proceedings*, namely the performance of bankruptcy trustees (updating the payment system, broadening powers and raising liability of bankruptcy trustees) and respective self-regulatory organizations (enhancing control over such organizations, introducing mandatory disclosure of the performance of such organizations, establishing a procedure for using the compensation fund).

Additionally, asset stripping countermeasures – mechanisms that challenge debtor’s assets stripping transactions – “suspicious transactions” and “transactions giving preference to one of the creditors over the others” were introduced. Thus legislative measures were introduced with the aim of narrowing the “grey” background in the field of bankruptcy. In addition, the liability of debtor’s owners – “persons controlling the debtor” – was introduced.<sup>2</sup>

The rest of the 2002–2013 updates were mostly of technical nature. They first of all baked up the state expansion policy (state-owned companies’ activity) in the economy or protected the interests of certain groups of persons, and they were not general measures of systemic development of the institute of bankruptcy.

The context changed again in 2014–2015, when the number of bankruptcies reached more than 14,500 in 2014 (against 12,000 in 2013) and was maintained at 14,600 in 2015.<sup>3</sup> Accordingly, this required a response from the regulator, and some systemic updates had to be introduced, too.

### 6.2.2. Bankruptcy law of 2014–2015: systemic updates

The Federal Law On Insolvency (Bankruptcy)<sup>4</sup> saw many amendments of various types since the start of 2014, which relate to both the general provisions and the specifics of bankruptcy of certain categories of debtors.

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<sup>1</sup> Apevalova E.A. Bankruptcies in 2011–2012: decline in bankruptcies, new regulation and debt restructuring bill. // Russian Economy in 2012: Trends and Outlooks. – M., Gaidar Institute, 2013

<sup>2</sup> Apevalova E.A. Bankruptcies in 2009–2010: Dynamics and trends // Russian Economy: Trends and Perspectives, M., Gaidar Institute, October 2011

<sup>3</sup> Bazanova E. Late last year saw growth of bankruptcies due to ruble devaluation. – Vedomosti, January 13, 2016.

<sup>4</sup> Federal Law “On Insolvency (Bankruptcy)” No. 127-FZ dated October 26, 2002 // RG, No. 209-210, November 2, 2002.

The amendments to the *general provisions* were in part related to the disclosure practice (basically Article 28 thereof), the meeting of creditors (Articles 12, 13, 18 thereof), the sale of the debtor's enterprise and estate (Articles 110, 139 thereof).

To prevent any abuse on the debtor and creditor side, the minimum value of creditors' outstanding claims admissible by a commercial court as a grounds for initiating insolvency proceedings against the debtor (legal entity) was raised from RUB 100,000 to RUB 300,000 (Clause 2 of Article 6, Clause 2 of Article 33 thereof). As regards monitoring, it was established that from the date of the commercial court ruling on the initiation of monitoring no financial sanctions shall be imposed on the failure to fulfill financial obligations and mandatory payments, except current payments; the amount of claims of the bankruptcy creditors and of the authorized body is subject to an interest charge equal to the key rate of interest quoted by the Bank of Russia on the date of initiation of monitoring (Clauses 1, 4–6 of Article 63 thereof).<sup>1</sup>

It was clarified that bankruptcy is not only the commercial court's declaration of inability of the debtor to satisfy in full the creditors' claims of monetary obligations and/or to fulfill the obligation of mandatory payments, but it is also inability to satisfy the claims of severance benefits and/or of remuneration for the labor of the persons working or worked under labor contract (Article 2 thereof).<sup>2</sup> The other articles were amended and updated accordingly (Articles 3–5, etc. thereof).

The former debtor's employees may file for bankruptcy against the debtor, including but not limited to pooling their claims (Clause 1 of Article 11, Clause 5 of Article 39 thereof).<sup>3</sup> Unlike other claimants, the debtor's employees and former employees have no obligation to cover court costs, fees payable to bankruptcy trustees where the debtor's resources are insufficient to cover such costs (P. 3 Clause 3 of Article 59 thereof).

A new article (Article 12.1) was introduced, which regulates the meeting of debtor's employees, former employees, the appointment of a representative of the debtor's employees, whose services shall be paid by the debtor. This creates preconditions under which qualified representatives of debtor's employees, that are independent of the employer, may emerge in the legal market.<sup>4</sup>

The priority ranking of the claims of creditors was updated (from four to five) because claims of remuneration for the labor of the foregoing persons and the severance benefit claims were classified as second priority claims aside from the claims of remuneration for the labor of the persons engaged by the bankruptcy trustee. Furthermore, a proceedings for satisfying second priority claims on a pro rata basis was established (see Clause 2 of Article 134, Clause 5 of Article 136 thereof).<sup>5</sup>

Hence an attempt was made to *protect the most vulnerable category of creditors, namely the debtor's employees*. However, bankruptcy and further liquidation of the employer may entail

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<sup>1</sup> See Subclause "a", Clauses 2, 18 of Article 1, Federal Law "On the Amendments to the Federal Law "On Insolvency (Bankruptcy)"..." No. 482-FZ dated December 29, 2014 // RG, No. 299 of December 31, 2014.

<sup>2</sup> Federal Law "On the Amendments to Certain Legislative Acts of the Russian Federation" No. 186-FZ dated June 29, 2015// RG, No. 146, July 7, 2015.

<sup>3</sup> Previously, the claims of remuneration for the labor were considered for detecting signs of the debtor's bankruptcy, but they did not serve as the grounds for submitting the application in question.

<sup>4</sup> Substantial amendments to Federal Law On Insolvency (Bankruptcy) concerning the status of the enterprise's employees // ConsultantPlus SPS. 2015.

<sup>5</sup> First, the claims of severance benefits and/or of remuneration for the labor, not more than Rb 30,000 a month per person. Second, the rest of the claims of severance benefits and/or of labor remuneration. Third, the claims of fees payable to persons for their intellectual deliverables (results of their intellectual activity).

undesirable job loss, which to some part will restrain misconduct of workers but not of other persons acting in bad faith (e.g., competitors) who might misuse this tool. This can be avoided by the employer satisfying promptly the claims of remuneration for the labor of the employees.

There is another big package of amendments to the general provisions of the Federal Law “On Insolvency (Bankruptcy)”, which govern *bankruptcy trustees* and their self-regulatory organizations (SROs).<sup>1</sup>

For example, the SRO governing board may decide to increase the legally prescribed minimum sum insured under the agreement on compulsory insurance of liability of the bankruptcy trustee (Rb 3m a year). Besides a compulsory liability insurance sub-agreement that is approved by a commercial court in the course of bankruptcy proceedings, the governing board may also bind the bankruptcy trustee to enter into a separate agreement whereby the sum insured is set by the SRO governing board (Clauses 2, 2.1 of Article 24.1 thereof).

If while approving the bankruptcy trustee under a bankruptcy case the SRO provides information proving that the nominee fails to meet the prescribed requirements, the commercial court may rule not to appoint the nominee as bankruptcy trustee or appoint the nominee as bankruptcy trustee and bind him/her to enter into a liability insurance sub-agreement. The insured sum thereunder must be not less than the SRO’s compensation fund value (Clause 5 of Article 45 thereof).

Furthermore, the SRO’s compensation fund minimum value must be equal to Rb 20m, and the general rule is that a compensatory payment from the fund may be equal to or less than Rb 5m for a single case of losses (Clauses 2, 11 of Article 25.1 thereof). The bankruptcy trustee whose actions entail a compensatory payment must compensate the SRO members for losses incurred as a result of having to bring the compensation fund value in compliance with the applicable law (Clauses 4, 5 of Article 20.4 thereof).

Hence the subsidiary nature of the SRO liability to the extent of funds available in the compensation fund regarding the bankruptcy trustee and his/her insurer (i.e., the liability occurs only if the trustee and his/her insurer fails to satisfy the damaged party’s claims) and the organization’s right to increase the sum insured under agreements on compulsory insurance of liability of the bankruptcy trustee *contributes to safety of the SRO’s compensation fund*. The bankruptcy trustee’s liability to compensate the SRO members for losses incurred as a result of having to recover the compensation fund, and the introduction of the upper level of compensatory payment from the SRO’s compensation fund aim to reach the same objective. With the compensation fund minimum value in place, damaged parties have more chances of full compensation for losses incurred by the failure of the bankruptcy trustee to perform his/her duties in a bankruptcy case.

The Federal Law “On Insolvency (Bankruptcy)” rules that the SRO governing board’s decision on termination of the bankruptcy trustee’s SRO membership if he/she is expelled for the SRO is deemed to be made when approved by two-thirds of the member votes cast (Clause 7 Article 21.1 thereof). Since SRO membership is a mandatory condition for working in the capacity of bankruptcy trustee, it appears that legislators set strict requirements for the expulsion from SRO membership in an effort to *prevent building up barriers to accessing the market*.

As regards bankruptcy hearings in commercial courts, the debtor’s application may not specify the nominee interim receiver and it may only specify a SRO duly chosen on a random basis,

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<sup>1</sup> Federal Law “On the Amendments to the Federal Law “On Insolvency (Bankruptcy)” No. 405-FZ dated December 1, 2014 // RG, No. 275 of December 3, 2014; Federal Law No. 482-FZ dated December 29, 2014.

and one of the SRO members must be approved as interim receiver (Clauses 2, 5 Article 37 thereof).<sup>1</sup>

Extended is the list of grounds allowing SROs to apply to court on dismissal or expulsion of the bankruptcy trustee (a SRO member) from a bankruptcy case, e.g., when an administrative penalty in the form of disqualification for committing an administrative infraction is imposed on the bankruptcy trustee (Clause 2 of Article 22, Clause 2 of Article 20.5, etc. thereof).

Overall, the amendments relating to bankruptcy trustees and their SROs aim first of all to prevent potential abuses by bankruptcy trustees acting in bad faith and to enhance the quality of duties they perform.

Since December 29, 2015 (1) the term of holding bankruptcy trustees administratively liable was extended to three years;(2) a provision was made for disqualifying the bankruptcy trustee for a period of six months to three years if he/she commits another administrative infraction;(3) it is not permitted to appoint the bankruptcy trustee for new bankruptcy proceedings within three years of the date of his/her exclusion from previous proceedings. On January 1, 2017 the SRO's compensation fund minimum value will increase to Rb 50m and compensatory payment will make up 50% of the compensation fund value.<sup>2</sup>

These strict requirements to bankruptcy trustees and their SROs and the strengthened role of the state may lead to *an increase in bankruptcy proceedings costs*, a reduction in the number of SROs, a *higher corruption in this field* and lower economic value of bankruptcy trustees, wherefore legislators should be extremely cautious with regard to the proposed amendments.<sup>3</sup>

An important amendment is that the debtor's estate or enterprise may be sold electronically in the course of the proceedings as part of a bankruptcy case, provided that the electronic trading facility<sup>4</sup> with whom the bankruptcy trustee or the auction organizer enters into a sale agreement is a member of *electronic SRO trading facilities* established for the purpose of developing and regulating the activity of its members (Clause 20 Article 110 thereof).

Eight new articles governing this new type of SROs were introduced, which regulate the electronic SRO trading facility membership, bodies, rights and obligations, compensation fund, supervision over electronic SRO trading facilities, the liability of electronic trading facilities, and agreement on compulsory insurance of such liability (Articles 111.1–111.8 thereof).

Electronic SRO trading facilities must meet the general requirements set out in the Federal Law "On Self-Regulatory Organizations"<sup>5</sup> and the special strict requirements set forth in the Federal Law "On Insolvency (Bankruptcy)". For example, an electronic SRO trading facility may be registered as nonprofit organization if 50% of the members have 2 years of experience in electronic trading and all the members have a record of 5,000 trading sessions. The value of mandatory compensation fund of electronic SRO trading facilities is equal to Rb 3m per member, and the electronic trading facility must compensate to other members of the electronic SRO trading facilities for damages incurred by a compensatory payment from the fund. To become

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<sup>1</sup> This rule is not applied to the application of the bankruptcy creditor and authorized body (Clause 2 of Article 39, Clause 3 of Article 41).

<sup>2</sup> Federal Law "On the Amendments to Certain Legislative Acts of the Russian Federation" No. 391-FZ dated December 29, 2015 // RG, No. 297, December 31, 2015.

<sup>3</sup> Okun S. Regulated self-regulation: bankruptcy proceedings costs to rise // Kommersant, December 25, 2015. URL: <http://kommersant.ru/doc/2887181>.

<sup>4</sup> Any legal entity or individual as self-employed entrepreneur engaged in electronic trading.

<sup>5</sup> Federal Law "On Self-Regulatory Organizations" No. 315-FZ dated December 1, 2007 // RG, No. 273, December 6, 2007.



a SRO member, the electronic trading facility must have an agreement on compulsory insurance of liability. The minimum value of the insured sum thereunder is Rb 30m a year.

Thus, although only 10 members are required for the registration of electronic SRO trading facility, the foregoing requirements counteract establishing low-quality organizations in large quantities.

Some of the amendments covered *certain categories of debtors* such as nongovernmental pension funds, real estate developers, agricultural organizations, clearing members and clearing members' customers. The requirements for the minimum value to be considered for instituting a bankruptcy proceedings were increased from Rb 500,000 to Rb 1m for enterprises and organizations of strategic importance as well as for natural monopoly entities (Clause 4 Article 190, Clause 3 of Article 197 thereof). In an effort to create an efficient legal regulation of the securitization process, which facilitates an increase of financial resources in Russia's economy and broadens the spectrum of securities available for investors, the chapter regulating simplified proceedings in bankruptcy cases was updated with a new paragraph on bankruptcy of special-purpose vehicles and mortgage agents (§ 3, Chapter XI thereof),<sup>1</sup> which contains provisions on irreversible assignment of securitized financial assets to ensure true sale of financial assets for the purpose of securitization.<sup>2</sup>

The provisions on bankruptcy of credit institutions and on bankruptcy of citizens were modified most of all.

The provisions on *bankruptcy of credit institutions* were moved from Articles 181, 182 to a stand-alone paragraph (§ 4.1, Chapter IX)<sup>3</sup> made up of about 100 articles, which makes it the biggest among the sections regulating the specifics of bankruptcy of certain categories of debtors. It is the right time to make sure the legislation on bankruptcy of credit institutions is up to the modern environment and allows for creating a unified regulatory environment and enhancing the effectiveness of law enforcement, because drastic (often adverse) developments in the financial sector in 2014–2015 (devaluations of the ruble, revocations of banking licenses, etc.) posed serious challenges for all Russia's financial institutions.<sup>4</sup>

Two paragraphs came into force on October 1, 2015, namely the paragraph on *citizen's debt restructuring* and sale of the citizen's property, as well as the paragraph on the specifics of hearing the bankruptcy case of a citizen in the event of his/her death<sup>5</sup> (§ 1.1, 4, Chapter X

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<sup>1</sup> See Clause 38 of Article 1 of Federal Law No. 482-FZ dated December 29, 2014; Clause 13 of Article 12 of Federal Law "On the Amendments to Certain Legislative Acts of the Russian Federation" No. 379-FZ dated December 21, 2013 // RG, No. 291, December 25, 2013.

<sup>2</sup> Borisov A.N. Comments to Federal Law "On Insolvency (Bankruptcy)" No. 127-FZ dated October 26, 2002 (CbC). 2nd issue, revised and updated // ConsultantPlus SPS. 2014.

<sup>3</sup> Because Federal Law "On Insolvency (Bankruptcy) of Credit Organizations" No. 40-FZ dated February 25, 1999 *ceased to be in force* // RG, No. 41-42, March 4, 1999. See Clause 22 of Article 7 Federal Law of December 22, 2014 No. 432-FZ "On the Amendments to Certain Legislative Acts of the Russian Federation..." // RG, No. 296, December 26, 2014.

<sup>4</sup> Sintsov V. A few amendments to the legislation on bank bankruptcy // *Bankovskoye Pravo*. 2015. No. 3. PP. 17-20.

<sup>5</sup> The principal amendment – the bankruptcy case of a citizen may be initiated after his/her death or after the announcement of his/her death, i.e., this refers to bankruptcy of assets of estate.

thereof).<sup>1</sup> The older version of the Federal Law “On Insolvency (Bankruptcy)” contained a paragraph regulating bankruptcy of citizens (§ 1, Chapter X thereof), which did not work<sup>2</sup> and therefore ceased to be in force.<sup>3</sup> A new paragraph includes special provisions – unregulated thereby cases related to bankruptcy of citizens shall be regulated by the provisions regulating bankruptcy of legal entities (Clause 1 of Article 213.1 thereof).

Petitions to initiate bankruptcy proceedings against a citizen may be filed to a commercial court by the citizen, bankruptcy creditor, and the authorized body. A petition may be accepted by the court to the extent that the claims against the citizen are not less than Rb 500,000 (previously Rb 10,000) and have been unsatisfied for a period of three months from the date when they have come due (Article 213.3 thereof). The bankruptcy creditor or authorized body may file petition approved by the court’s order entered into legal force and upholding the claims of creditors. No court’s order is required for claims of mandatory payments; notarized claims, etc. (Clauses 1, 2 of Article 213.5 thereof).

The petition of bankruptcy against a citizen shall specify the SRO whose member must be approved as financial manager, but it shall not specify the trustee as required for the petition of bankruptcy against a legal entity filed by the bankruptcy creditor or authorized body (the debtor’s (legal entity) petition shall specify only SRO) (Clause 2 Article 39, Clause 3 of Article 41 thereof). The money spent on the financial manager fee equal to the fixed fee paid to the financial manager for a single proceedings, which is used in the bankruptcy case of a citizen (Rb 10,000 (Clause 3 Article 20.6 thereof)), shall be deposited with the commercial court (Clause 4 Article 213.4, Clauses 3, 4 Article of 213.5 thereof).

After considering the validity of the petition the court shall determine that the petition is either invalid or valid and that the citizen’s debt restructuring is to be instituted. The citizen must be proved insolvent in the latter case (see Clauses 1–3 of Article 213.6 thereof). If the citizen fails to meet the requirements for approving the debt restructuring plan, the court may declare the citizen bankrupt on the basis of citizen’s petition and institute the proceedings of sale of his/her property (Clause 8 Article 213.6 thereof).

However, note that the original amendments suggested that general jurisdiction courts, not commercial courts, should hear bankruptcy cases against citizens, although the former have not much judicial experience in this category of cases. However, the respective provisions were abolished before they came into force.<sup>4</sup> A draft bill is currently under consideration of the State Duma (the lower house of Russia’s parliament), which provides for distribution of citizen bankruptcy cases between the foregoing courts.<sup>5</sup>

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<sup>1</sup> See Subclause “б”, Clause 23 and Subclause “е”, Clause 4 of Article 6 Federal Law “On Regulation of the Specifics of Insolvency (Bankruptcy) on the Territory of the Republic of Crimea and the Federal City of Sevastopol.” No. 154-FZ dated June 29, 2015 // RG, No. 144, July 3, 2015.

<sup>2</sup> See hereinafter: Lotfullin R. Bankruptcy of individuals. Proceedings and consequences that creditors to be prepared for // Yurist Companii. 2015. No. 9. P. 16.

<sup>3</sup> See Subclause “а”, Clause 23 of Article 6 of Federal Law No. 154-FZ dated June 29, 2015.

<sup>4</sup> See Clause 6 of Article 1 of Federal Law “On the Amendments to the Federal Law “On Insolvency (Bankruptcy)”..” No. 476-FZ dated December 29, 2014 // RG, No. 299, December 31, 2014; Article 12 of Federal Law No. 154-FZ dated June 29, 2015.

<sup>5</sup> Draft bill No. 831972-6 “On the Amendments to the Federal Law “On Insolvency (Bankruptcy)” (with regard to changing court jurisdiction for hearing bankruptcy cases against individuals) // URL: <http://asozd2.duma.gov.ru/main.nsf/%28SpravkaNew%29?OpenAgent&RN=831972-6&02>.

The bankruptcy proceedings against citizens, namely debt restructuring, sale of assets, amicable agreement (Article 213.2 thereof), is a simplified version of the bankruptcy proceedings against legal entities.<sup>1</sup>

In terms of *amicable agreement*, citizens and legal entities are governed by the same regulations (Chapter VIII, Article 213.31 thereof).

Restructuring of citizen's debts combines proceedings for monitoring and financial rehabilitation of the legal entity (debtor) and aims to restore the citizen's solvency and repay his/her outstanding debt to the creditors under the debt restructuring plan. The citizen's debt restructuring proceedings aims to ensure the citizen's estate are safe, analysis of the citizen's financial status is made, the list of creditors' claims is compiled and the first meeting of creditors is held (Article 213.11 thereof).

Not later than within 10 days from the date of expiration of the two months allocated for filing claims against the citizen (Clause 2 of Article 213.8 thereof),<sup>2</sup> the citizen, creditor or authorized body may forward a draft citizen's debt restructuring plan to the financial manager, bankruptcy creditors, authorized body. However, there is a problem with creditor's access to the information (the list of citizen's assets, the data on accounts payable, etc.) attached to the draft plan (Article 213.15 thereof), and with uncertainty of the consequences of failure to forward the draft plan within the prescribed time limit.

Should the financial manager receive no draft plan, he/she shall submit a proposal for consideration of the meeting of creditors for the citizen's bankruptcy and for the initiation of sale of his/her property. The financial manager must hold the first meeting of creditors<sup>3</sup> in no event sooner than 20 days from the date of submission of the draft plan, but not later than within 60 days from the date of expiration of the two months allocated for filing claims against the citizen (Clauses 1, 4, 5 of Article 213.12 thereof).

After considering the citizen's debt restructuring plan, the commercial court may determine that the plan is either approved or not approved, that the citizen is declared bankrupt and that the sale of his/her property is initiated (see Article 213.18 thereof on the grounds for rejection) (Clauses 1, 3 of Article 213.17 thereof).<sup>4</sup>

The plan must be implemented within three years (Clause 2 of Article 213.14 thereof). After considering the results therefrom, the court shall determine that the citizen's debt restructuring is completed or that the plan is abolished and the citizen is declared bankrupt (Clause 5 of Article 213.22 thereof).

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<sup>1</sup> In order to cut the citizen's costs, it is not required to publish in an official edition information on the progress of the proceedings as part of the citizen's bankruptcy case (Clause 1 of Article 213.7).

<sup>2</sup> In case of excusable failure to timely file the claims within the prescribed time line, the time line may be restored by court (Clause 2 of Article 213.8 thereof).

<sup>3</sup> Unlike the meeting of debtor's (legal entity) creditors, the meeting of creditors in the event of citizen's bankruptcy may be held by absentee voting (without a physical meeting) (Clauses 4, 8 of Article 213.8).

A few words concerning the specific features of the legal status of the creditor whose claims are secured by the property owned by the citizen. Such creditor may vote at the meeting of creditors in the course of the proceedings as part of the citizen's bankruptcy case (Clause 4 of Article 213.10) because the debtor (citizen) often has a single secured creditor. In addition, 80% of the amount earned from the sale of the collateral is used to satisfy the secured creditor's claims (Clause 5 of Article 213.27); the citizen's debt restructuring plan must provide for seniority of such creditor's claims which shall be satisfied by using the amount earned from the sale of the collateral (Clause 3 of Article 213.14).

<sup>4</sup> See Articles 213.19-213.23 on the consequences of approval of the plan, on making amendments thereto, on the completion thereof and on the abolishment thereof.

*Sale of citizen's property* is rehabilitation proceedings similar to trusteeship proceedings for legal entities (as debtors), which for the purpose of equitable satisfaction of the claims of creditors is applied in bankruptcy cases to citizens declared as bankrupt.

If the commercial court declares a citizen bankrupt, the court shall institute the sale of the citizen's property within a period of six months (unlike in trusteeship, the specified term may be extended) (Clause 2 of Article 213.24 thereof).

All the citizen's property that are available as of the date of court's order declaring the citizen is bankrupt and the sale of the citizen's property is initiated, as well as the citizen's property that are identified after the date of the court's order, are referred to as the bankruptcy estate,<sup>1</sup> except the property that cannot be seized and sold, e.g., household goods (Clause 1 of Article 446 of the Civil Procedure Code of the Russian Federation<sup>2</sup>) (Clauses 1, 3 of Article 213.25 thereof).

In order to minimize costs of bankruptcy cases against citizens, the financial manager by him/herself shall appraise the citizen's property. Should the meeting of creditors resolve to outsource an appraiser, the appraisal costs shall be paid by the persons who voted for the resolution (Clause 2 of Article 213.26 thereof). However, the Federal Law "On Insolvency (Bankruptcy)" does not specify how the financial manager must appraise the citizen's property (Clause 6 of Article 213.26 thereof). In practice, the financial manager receives information of the citizen's property only from the citizen himself/herself and public authorities (Clause 7 of Article 213.9 thereof), and the financial manager has no access to the debtor's premises, whereas the bankruptcy trustee does have access to the debtor's (legal entity) premises.<sup>3</sup>

The legislators' attempts to curtail costs of bankruptcy cases against citizens, including a financial manager's small fee<sup>4</sup> coupled with heightened requirements to the financial manager, may discourage financial managers to duly perform their duties.

As regards the specifics of selling the citizen's property, note that the financial manager shall submit the provision regulating the procedure, terms and conditions for selling the property, including the starting price, to the commercial court for approval, not to the meeting of creditors as required for bankruptcy cases against legal entities (Clause 1 of Article 213.26 thereof).

With some exceptions, the property of citizen must be sold by auction, unless otherwise stipulated by the resolution of the meeting of creditors or court's order (Clauses 3, 7 of Article 213.26 thereof). The procedure for satisfying the claims of citizen's creditors are basically similar to the procedure for satisfying the claims of the creditors of a legal entity (Article 213.27 thereof).

As soon as the settlements with the creditors are completed, the citizen declared as bankrupt shall be exempted from satisfying further claims of creditors (Clause 3 of Article 213.28 thereof). In order to prevent potential abuses by debtors, the cases when citizens may not be exempted from their obligations were specified (Clauses 3–6 of Article 213.28 thereof). For example, the claims of creditors on current payments shall remain in force. Furthermore, the

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<sup>1</sup> The citizen's property for sale could have been given a proper name instead of the "bankruptcy estate" which is used in the course of trusteeship proceedings – bankruptcy proceedings against legal entities.

<sup>2</sup> The Civil Procedure Code of the Russian Federation No. 138-FZ dated November 14, 2002 // RG, No. 220, November 20, 2002.

<sup>3</sup> Lotfullin R. Exec. wr. P. 28.

<sup>4</sup> Fixed one-time amount of Rb 10,000 and 2% of the satisfied claims of creditors or the amount earned from selling the citizen's property (Clause 4 of Article 213.4, Clause 4 of Article 213.5, Clauses 3, 4 of Article 213.9, Clause 3, 17 of Article 20.6).

rule that exempts the citizen from obligations shall not be applied to the citizen if he/she is once again declared bankrupt within the next five years (Clause 2 of Article 213.30 thereof).

However, it appears the institution of bankruptcy of citizens favors more the interests of debtors, whereas creditors would rather recover debts in court and through enforcement proceedings. This fact coupled with some of the abovementioned loopholes in the applicable regulation allows one to expect new amendments to be made in this field.

It is remarkable that in other countries the citizen debtor is treated as consumer debtor, not as self-employed entrepreneur, because the issue of individuals' bankruptcy is unbreakably bounded to consumer lending. Thirty four million Russians (45% of economically active population) are reported to have outstanding consumer loans. In addition, the total amount of loans to individuals exceeded Rb 9 trillion by the end of 2015, and delinquencies increased more than 40% in 2014 alone. The state of the consumer lending sector has turned into a macroeconomic issue, posing a threat to the sustainability of the Russian banking system.<sup>1</sup>

For a short period of time since the new paragraph regulating the citizen's debt restructuring and the sale of his/her property has been in effect, there have been known cases when petitions for bankruptcy of citizens were declared valid by commercial courts, followed by instituting debt restructuring proceedings and selling the citizen's property.<sup>2</sup>

\* \* \*

All in all, in summary, note that in 20-plus years Russia's bankruptcy legislation has advanced from the first law on bankruptcy which was not widely used, through the second law on bankruptcy which was often used as a takeover tool, to the third law on bankruptcy which is currently in effect and is more viable compared to the previous ones.

Being pro-creditor, the law has solve a number of issues:

- owners acting in good faith enjoy better protection of their rights;
- the risk of abusing the right by creditors is mitigated;
- parties acting in good faith in bankruptcy proceedings are protected from other parties acting in bad faith;
- supervision over bankruptcy trustees has become more efficient;
- specifics of bankruptcy of certain categories of debtors are set out in a single law and some other laws.

The amendments to the third law on bankruptcy in the peak of the crisis of 2008–2009 narrowed the “grey” background in the field of bankruptcy by introducing mechanisms challenging asset-stripping transactions, and enhanced the transparency of bankruptcy proceedings by updating the regulation of bankruptcy trustees of respective self-regulatory organizations.

The 2014–2015 systemic amendments to the third federal law aimed to prevent abuses by persons acting in bad faith mostly in bankruptcy cases, and to ensure the institution of bankruptcy works more efficiently. Overall, although the amendments are positive, not that the issue

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<sup>1</sup> Sishmareva T.P. Federal Law “On Insolvency (Bankruptcy)” and its application in practice: the manual for exams as part of the Single Program on Arbitrazh Receivers Training. M.: Statut, 2015. P. 416; Grishev S.P. Consumer lending. Comments to the legislation // ConsultantPlus SPS. 2015.

<sup>2</sup> See, e.g., Case No. A56-71378/2015. URL: [http://kad.arbitr.ru/PdfDocument/eaf44644-d31e-4a2e-a1c0-90600e2d831a/A56-71378-2015\\_20151223\\_Opredelenie.pdf](http://kad.arbitr.ru/PdfDocument/eaf44644-d31e-4a2e-a1c0-90600e2d831a/A56-71378-2015_20151223_Opredelenie.pdf); Case No. A41-94274/15. URL: [http://kad.arbitr.ru/PdfDocument/b81ba9a4-cdba-4ed8-85a7-eda7e58b1176/A41-94274-2015\\_20151221\\_Reshenija%20i%20postanovlenija.pdf](http://kad.arbitr.ru/PdfDocument/b81ba9a4-cdba-4ed8-85a7-eda7e58b1176/A41-94274-2015_20151221_Reshenija%20i%20postanovlenija.pdf).

of inefficient bankruptcy proceedings for restoring the debtor's solvency is still pressing and it could guide the way towards further enhancement of the legislation.

### 6.3. The real estate market in the Russian Federation

#### 6.3.1. The market of land plots<sup>1</sup>

According to the data released by the Rosreestr, the area of land plots owned by Russian nationals keeps decreasing and as of 1 January 2015 amounted to 115,400,000 ha or 6.8% of the land of the Russian Federation against 117m ha (6.84%) as of 1 January 2014 (*Table 9*). On the contrary, the area of land in public and municipal ownership and ownership of legal entities keeps growing. Within a year, the area of land plots owned by legal entities increased by 1.3m ha and amounted to 17.2m ha or 1.0% of the land of the Russian Federation. The area of land plots in public and municipal ownership increased by 37,900 ha. As of 1 January 2015, Russian nationals' land shares decreased by 3.0m ha and amounted to 5.2% (89.3m ha) of the country's land or 67.3% of land in private ownership. A decrease in the area of land in shared ownership is regarded as positive factor as land plots in shared ownership by virtue of incompleteness of that title are used inefficiently.

*Table 9*

**The pattern of land plots of the Russian Federation by the form  
of ownership, 2012–2015**

Form of ownership	01.01.2012		01.01.2013		01.01.2014		01.01.2015	
	Million ha	%	Million ha	%	Million ha	%	Million ha	%
Public and municipal ownership	1576.7	92.2	1576.8	92.22	1576.9	92.23	1577.3	92.25
Individuals' ownership	119.6	7	118.3	6.92	117	6.84	115.4	6.8
including: Individuals' land shares; On the basis of individuals' other titles of ownership	97.6	5.7	94.9	5.55	92.3	5.4	89.3	5.2
	22	1.3	23.4	1.37	24.7	1.57	26.1	1.52
Legal entities' ownership	13.5	0.8	14.7	0.86	15.9	0.93	17.2	1.0
TOTAL land in ownership	133.1	7.8	133	7.78	132.9	7.77	132.6	7.8

*Source:* State (national) Report "On the status and utilization of land in the Russian Federation in 2014".

As of 1 January 2015 as in 2014, in 14 constituent entities of the Russian Federation the share of privatized land exceeded 40% of the land of constituent entity. It is mainly southern and southwestern regions. In 12 constituent entities of the Russian Federation, the share of privatized land amounts to less than 0.40%. The Southern Federal District boasts of the highest index (43.11%) while the Far Eastern Region has the lowest one (0.32%). Russia's average nationwide index amounts to 6.75%. In Moscow and St Petersburg individuals own 6.99% and 6.41% of land, respectively (*Table 10*).

<sup>1</sup> Author of this section: Zadonsky G. – RANEPА.

Table 10

**The level of privatization of land by federal districts and subjects of the Russian Federation as of 1 January 2015\***

Federal districts and subjects of the Russian Federation	Level of privatization by individuals, %	Level of privatization by legal entities, %	Total area, thousands ha	Land owned by individual, thousand ha	Land owned by legal entities, thousand ha	Place by the level of privatization by individuals
<b>Southern Federal District</b>	<b>43.11</b>	<b>4.60</b>	<b>42 087.6</b>	<b>18 43.3</b>	<b>1937.3</b>	<b>I</b>
Rostov Region	61.54	6.57	10 096.7	6 213.5	662.9	1
Volgograd Region	55.79	5.65	11 287.7	6 296.9	637.2	4
Astrakhan Region	18.16	1.81	4 902.4	890.1	88.7	38
<b>Privolzhsky Federal District</b>	<b>29.26</b>	<b>4.96</b>	<b>10 3697.5</b>	<b>30 341.5</b>	<b>5143</b>	<b>II</b>
Orenburg Region	58.29	2.43	12 370.2	7 210.2	301.2	3
Saratov Region	54.52	8.36	10 124	5 520	846.3	5
Perm Krai	7.54	2.26	16 023.6	1 207.8	362.9	52
<b>Central Federal District</b>	<b>28.89</b>	<b>8.69</b>	<b>65 020.5</b>	<b>18 786.6</b>	<b>5651.9</b>	<b>III</b>
Orel Region	50.82	9.56	2 465.2	1 252.7	235.6	6
Voronezh Region	47.98	8.37	5 221.6	2 505.5	436.8	8
Moscow Region	16.59	12.07	4 432.9	735.3	535.2	41
Moscow	6.99	12.61	256.1	17.9	32.3	53
<b>North-Caucasian Federal District</b>	<b>24.60</b>	<b>3.06</b>	<b>17 043.9</b>	<b>4 192.6</b>	<b>520.7</b>	<b>IV</b>
Stavropol Territory	58.68	7.51	6 616	3 882.5	496.7	2
Republic of Karachaevo-Cherkessia	18.59	0.48	1 427.7	265.4	6.8	36
Republic of North Osetia-Alania	1.29	0.79	798.7	10.3	6.3	77
<b>Russia</b>	<b>6.75</b>	<b>1.01</b>	<b>1 709 911</b>	<b>115 385.7</b>	<b>17 213.6</b>	<b>V</b>
<b>Siberian Federal District</b>	<b>5.65</b>	<b>0.38</b>	<b>514 495.3</b>	<b>29 050.7</b>	<b>1 946.6</b>	<b>VI</b>
Altai Territory	37.16	2.13	16 799.6	6 243.3	358.2	15
Omsk Region	32.28	3.80	14 114	4 556.3	536.8	24
Republic of Tyva	0.42	0.02	16 860.4	71.6	3.2	71
<b>Urals Federal District</b>	<b>4.85</b>	<b>0.49</b>	<b>181 849.7</b>	<b>8 822.1</b>	<b>887.7</b>	<b>VII</b>
Kurgan Region	41.40	3.45	7 148.8	2 959.5	246.7	12
Chelyabinsk Region	33.01	2.13	8 852.9	2 922	188.6	56
Yamal-Nenets Autonomous Region	0.00	0.00	76 925	1.6	0.7	82
<b>North-Western Federal District</b>	<b>2.40</b>	<b>0.44</b>	<b>168 697.2</b>	<b>4 049</b>	<b>740.8</b>	<b>VIII</b>
Kaliningrad Region	29.50	9.55	1 512.5	446.2	144.5	27
Pskov Region	26.54	2.88	5 539.9	1 470.2	159.6	30
St. Petersburg	6.41	17.11	140.3	9	24	55
Nenets Autonomous Region	0.00	0.00	17 681	0.2	0.1	83
<b>Far Eastern Federal District</b>	<b>0.32</b>	<b>0.06</b>	<b>616 932.9</b>	<b>1 989.4</b>	<b>384.1</b>	<b>IX</b>
Primorsky Krai	4.28	1.00	16 467.3	704.3	164.1	59
Jewish Autonomous Region	2.85	0.03	3 627.1	103.4	1.1	61
Chukotka Autonomous Region	0.00	0.00	72148.1	0.2	0.2	84
<b>Crimea</b>						<b>X</b>
Sebastopol	12.15	1.74	86.4	10.5	1.5	47

\* In each federal district, two constituent entities of the Russian Federation with highest indices as regards the share of land plots in individuals' ownership and a constituent entity of the Russian Federation with the lowest index are presented. Additionally presented are the Moscow Region, Moscow, and St. Petersburg.

Source: State (national) Report "On the status and utilization of land in the Russian Federation in 2014".

By the beginning of 2015, 8041.2 households were provided land plots totaling to 1,002,900 ha for individual housing development, which is 1.37% and 2.46% higher as regards the number of households and the area of land, respectively than in 2013. In 2014, over 158,600 citizens acquired land plots for individual housing development with total area of 15,400 ha. The highest

number of citizens owing land plots envisaged for housing construction accounts for Krasnodarsky Krai (454,400), Moscow (406,900), Rostov (343,000), Kemerovo (317,900), Sverdlovsk (299,600), Irkutsk (252,300) regions, Republic of Bashkortostan (220,500), Stavropol Krai (210,900), Chechen Republic (206,500), Voronezh region (203,800), Perm Krai (182,100), Republic of Tatarstan (180,400), Saratov (178,500), Volgograd (177,400), Nizhny Novgorod (154,200), Leningrad (152,400), Orenburg (148,300) regions, Krasnoyarsk Krai (157,700), Altai Krai (144,300), Republic of Dagestan (133,900), Penza (139,100), and Belgorod (132,500) regions (*Table 11*).

*Table 11*

**The pattern of ownership of land allocated for individual housing development, 2012–2014**

Pattern of ownership	2012		2013		2014	
	Thousand ha	%	Thousand ha	%	Thousand ha	%
Private ownership	546.2	56.7	576.9	58.4	606.5	60.5
State and municipal ownership, including:	417.6	43.3	410.6	41.6	396.4	39.5
Permanent (timeless) utilization	202.7	21	197.4	20	187.9	18.7
leasehold	119.1	12.3	120.4	12.2	121.4	12.1
Free of charge limited utilization (temporary utilization)	3.5	0.4	2.5	0.2	1.2	0.1
lifetime ownership with hereditary succession	54.8	5.7	54.0	5.5	52.4	5.2
Without execution of the title to land	37.5	3.9	36.3	3.7	33.5	3.4
Total	963.8	100	987.5	100	1002.9	100

*Source:* State (national) Report “On the status and utilization of land in the Russian Federation in 2014”.

According to data released by Rosreestr, the procedure of the “summer cottage” amnesty, that is registration in accordance with a simplified procedure of individual’s title to land plots provided prior to the adoption of the Land Code of the Russian Federation for individual subsidiary, summer cottage husbandry, vegetable gardening, horticulture and individual garage and housing building slowed down (*Fig. 1*).

According to the data released by the Rosreestr, as of October 1, 2015, the overall volume of registration of individuals’ titles to land plots (4,420,376 deeds) increased by 1.07% as compared to October 1, 2014. The number of registered titles of legal entities to land plots during the same period decreased by 13.72%, having amounted to 176,357 deeds (contrary to growth as of October 1, 2014 by 5.1% against October 1, 2013). As of October 1, 2015, lease of land plots by individuals (63,252 deeds) went up by 11.8% as compared to October 1, 2014 (as distinct from reduction by 3.84% as of October 1, 2014 compared to October 1, 2013). Lease of land by legal entities (15,677 deeds) fell by 55.1% during the same period (in addition to a reduction by 41.9% as of October 1, 2014 against October 1, 2013).

As compared to October 1, 2014, the number of registered mortgages on land plots for individuals (429,157 deeds) fell by 12.61% (when compared with October 1, 2014 reduction constituted 29.1% against October 1, 2013). The number of registered mortgages for legal entities (95,141 deeds) in 2015 fell by 12.4%.



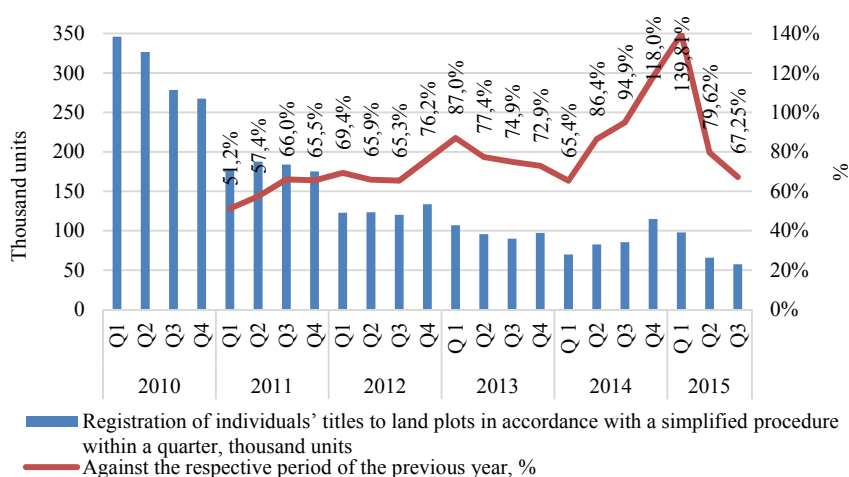


Fig. 1. Dynamics of registration of individuals' titles to land plots in accordance with the simplified procedure

Source: The Rosreestr.

### 6.3.2. Housing mortgage lending<sup>1</sup>

In 2015, according to the data released by the Central Bank of the Russian Federation, credit institutions extended 691,943 housing mortgage loans (HML) to the tune of Rb 1,147.339bn, which constituted 68.32% of the total amount of HML extended in 2014 and 65.04% in monetary terms. In the same period, 706,786 housing loans were originated totaling to Rb 1,168.222bn, which in quantity of loans comes to 66.71% and in monetary terms 64.14% of the extended loans.

The volume of consumer lending in 2015 contracted to 67.92% against 2014 and constituted Rb 5.861 trillion. In Q4 2015, the volume of consumer lending fell to Rb 1.738 trillion, which constituted 77.75% of Q4 2014 (Fig. 2).

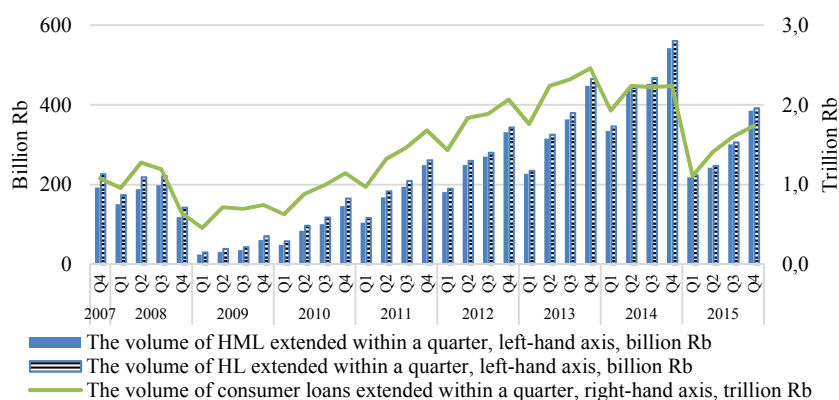


Fig. 2. Dynamics of retail housing mortgage lending, 2007–2015

Source: The Central Bank of the Russian Federation.

<sup>1</sup> Author of this section: Zadonsky G. – RANEPА.

In 2015, the share of extended HML in the volume of consumer loans decreased by 2.08 p.p. compared to 2014 and hit 22.18%. A trend of decrease in the share of unsecured housing loans (UHL) in the HL and HML volume remained in 2015. The share of UHL in the HML volume was in 2015 lower the UHL in 2014 by 1.73 p.p. and came to 1.58% (Fig. 3).

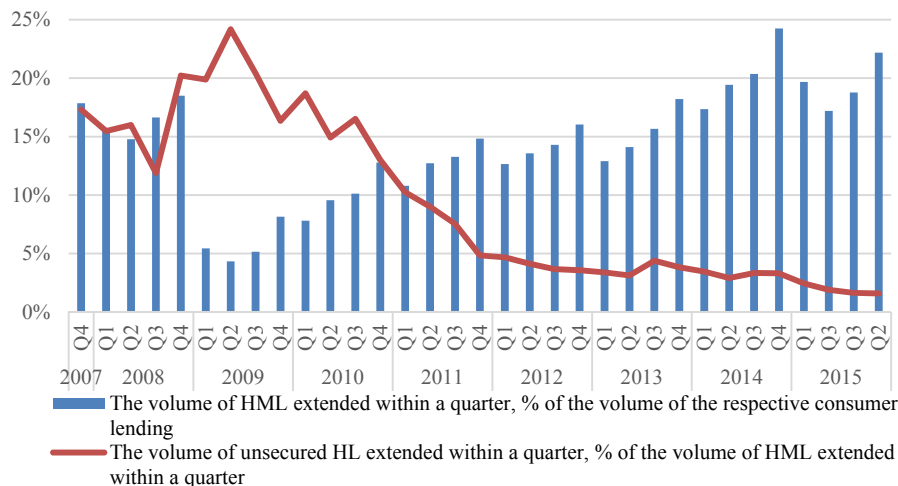


Fig. 3. Dynamics of the ratio between the volumes for quarter of HML, UHL and consumer lending, 2007–2015 гг.

Source: The Central Bank of the Russian Federation.

According to the data released by the Rosreestr provided by the JSC AHML in Q3 2015 the share of mortgaged real property units in the total number of real property units registered in transactions with housing decreased by 2.9 p.p. against Q3 2014 and constituted 24.8%, that is a quarter of apartments in Q3 2015 were bought with mortgages.

The volume of HML extended as of October 1, 2015, in shares of the respective value of GDP fell to 1.43% against 2.47% as of October 1, 2014. As of October 1, 2015, the debt on HML up to 7.02% of corresponding GDP against 4.96% as of October 1, 2014 (Fig. 4).

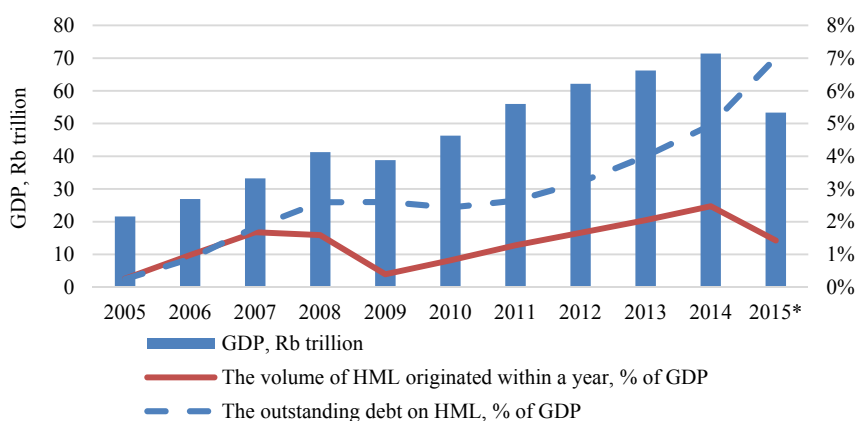
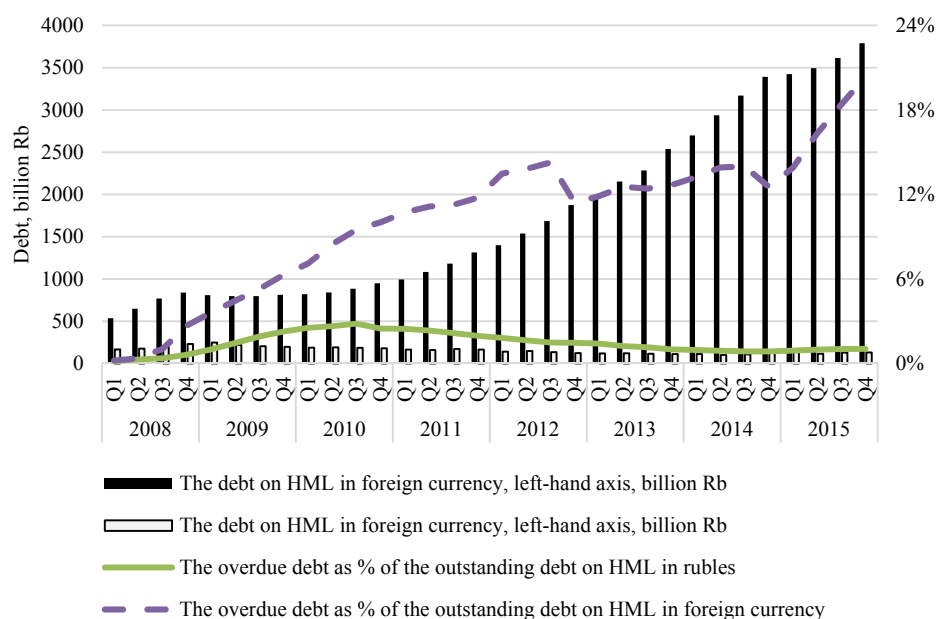


Fig. 4. Dynamics of housing mortgage loans, % GDP

\* January-September 2015

Source: The Central Bank of the Russian Federation.

As of 1 January 2016, the debt on HML in rubles increased by 11.72% as compared to 1 January 2015 and amounted to Rb 3,789.4bn. The overdue debt on ruble HML on those loans (Rb 39.4bn) rose by 36.06% on January 1, 2015, while as percentage of the outstanding debt it amounted to 1.04%, which is 0.19 p.p. more than that as of January 1, 2015. The latter is the evidence of lower quality of the portfolio of ruble mortgages for this period in comparison with the previous year (*Fig. 5*).

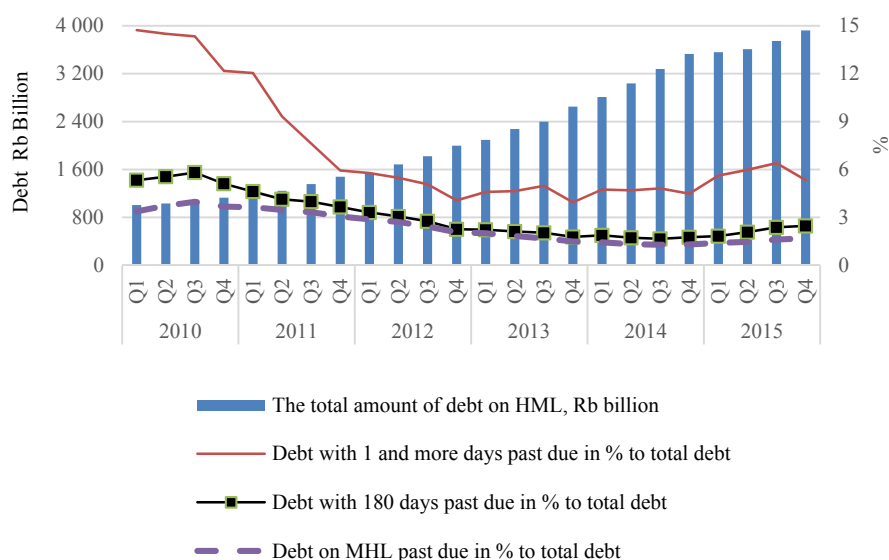


*Fig. 5.* Dynamics of outstanding and overdue debt on housing mortgage loans

*Source:* The Central Bank of the Russian Federation.

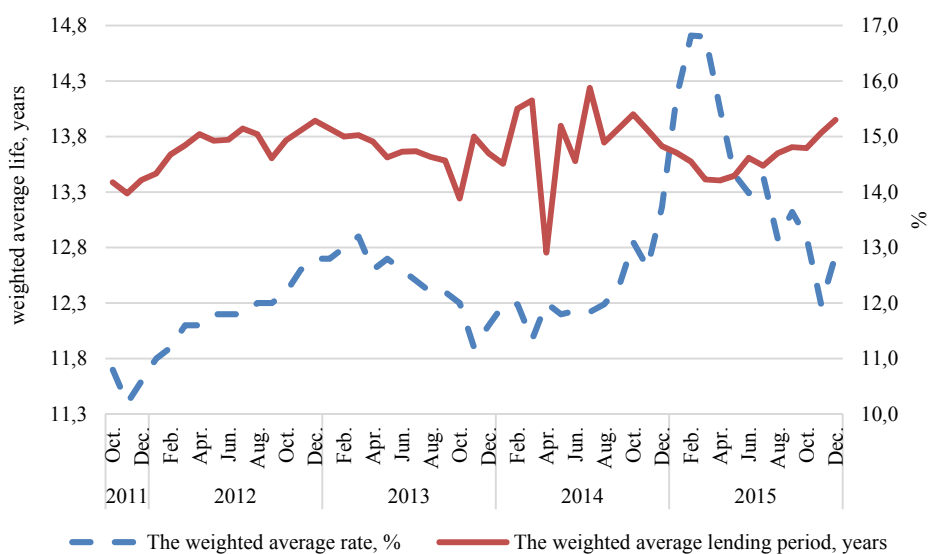
The share of debt on HML with 1 and more days past due in total amount of debt in 2015 constituted 5.34%, which is up 0.85 p.p. against 2014. At the same time, the share of debt on HML with 180 days past due (debt on default loans) in the total amount of debt increased in 2015 and came to 2.47%, which is by 0.71 p.p. more than in 2014. Outstanding debt on HML in percent to the total amount of debt constituted for 2015 1.69%, which is by 0.38 p.p. more than for 2014 (*Fig. 6*).

In 2015, the weighted average rate on HML in rubles extended within a month decreased from the maximum value of 14.71% in February to 12.73% in December. Nevertheless, the December rate turned out to be higher the November rate by 0.44 p.p. The annual rate constituted 13.33%. The weighted average period of lending as regards HML in rubles extended within a month varied from 14.21 years to 15.3 years (*Fig. 7*).



*Fig. 6. Dynamics of debt on HML by the payment delay terms*

Source: The Central Bank of the Russian Federation.



*Fig. 7. The weighted average rate and lending period on HML in rubles extended within a month*

Source: The Central Bank of the Russian Federation.

As of January 1 2015, the weighted average rate on HML in foreign currency fell to 9.82% as of January 1, 2016, with the highest rate of 11.8% registered as of April 1, 2015. As of January 1, 2016, the weighted average lending period as regards HML in foreign currency extended from the beginning of the year amounted to 3.97 years.

As of 1 July 2015, Rb 162bn worth of HML was repaid by borrowers prior to maturity which value is 4.76% higher than that as of 1 July 2014. The above sum amounts to 35.1% of the volume of HML extended in H1 2015. It is to be noted that Rb 1.655bn worth of HML was repaid early by means of funds received from foreclosure sale of mortgaged property, that is, a decrease of 16.62% as compared to H1 2014.

Government Regulation No 404 the implementation term of the project “Housing for a Russian family” has been extended through December 31, 2017.

According to the Government Regulation No 373 of April 20, 2015, JSC AHML has been implementing HML restructuring program (loans) for the borrowers who are in dire straits. In December 2015, the program was amended and the maximum amount for compensation by JSC AHML was raised from Rb 200 to Rb 600 thousand.

From October 1, 2009 through November 1, 2015, within the frameworks of the *Stimul* in 48 regions according to concluded Agreements the JSC AHML’s existing liabilities amounted to Rb 119.5bn. The volume of extended by AHML loans to banks which finance housing development projects within the program *Stimul* amounted to Rb 72.6bn at the rate of 8.0%. The volume of extended by loans to banks legal entities which finance housing development projects within the program *Stimul* amounted to Rb 129.611bn at an average rate of 13.2%. Total gross residential area commissioned by the participants of *Stimul* program amounts to 6.4m sq.m.

During January-October 2015, 15 issues of mortgage-backed securities were issued totaling to Rb 64.3bn. As of November 1, 2015, 24 issues of JSC AHML securities were in circulation totaling to Rb 156.5bn ensued by government guarantees and 3 issues of exchange bonds of JSC AHML to the tune of Rb 15bn.

### 6.3.3. Price dynamics on residential property<sup>1</sup>

The main indices of the dynamics of prices on the secondary housing market of Russian cities are shown in *Table 12*. The data is presented by real-estate market analysts who collect, verify, and process the data on the basis of unified methods recommended by the Russian Guild of Realtors (RGR).<sup>2</sup>

The research sample includes 28 cities and one region (Moscow region in respect of which averaged readings on 85-90 population centers are presented) including 23 cities which are centers of the RF subjects with total population of over 42.1m people.<sup>3</sup>

The sample presents:

- Moscow (about 12.2m people);
- The Moscow region (with the aggregate urban population of 5.9m) and St. Petersburg (over 5.2m people) – aggregately 11.1m people;

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<sup>1</sup> Authors of this section: Malginov G. – Gaidar Institute for Economic Policy, Sternik G. – Moscow Association of Realtors on Analytics and Consulting, JSC Sternik’s Consulting.

<sup>2</sup> Sources of data: Committee of the Moscow Association of Realtors on Analysis and Consulting (on data of “MIEL”, “MIEL-New Construction), JSC “Sternik’s Consulting”, GK “Real-Property Bulletin”, JSC “Industria” (Vladivostok), as well as Online figure of price dynamics on the secondary market of Russian cities (URL: <http://realtymarket.ru/Publi-nii-grafik-cen-vtori-noi-nedvijimosti-gorodo/>).

<sup>3</sup> As compared to the sample, which was used for the analysis of the pricing situation on the secondary market in the previous annual review (see G. Malginov and G. Sternik. Prices on the Real-Estate Market // Russian Economy in 2014. Trends and Prospects (Issue 36). M., The IEP. 2015, pp. 526-531), it does not include Rostov-on Don, Krasnodar, Orenburg, Cheboksary, Tver, small groups of cities (district centers) of Bashkortostan and Samara region but added Chelyabinsk, Vladivostok and Yaroslavl.

## RUSSIAN ECONOMY IN 2015

### trends and outlooks

– 9 cities with the population of over 1m people apart from two capitals (Novosibirsk, Yekaterinburg, Kazan, Chelyabinsk, Samara, Omsk, Krasnoyarsk, Perm and Voronezh) – totaling to 10.6m;

– 9 cities with the population from 500,000 people to 1m people (Togliatti, Barnaul, Tyumen, Ulyanovsk, Irkutsk, Vladivostok, Yaroslavl, Kemerovo, and Ryazan) – totaling to over 5.6m people;

– 6 cities with the population from 200,000 to 500,000 people (Kirov, Stavropol, Vladimir, Surgut, Smolensk, and Shakhty) – totaling to over 2.2m;

– 2 cities with the population below 200,000 people (Pervouralsk and Tobolsk) – totaling to over 0.2m people.

Table 12

### Prices on the secondary housing market in Russian cities in 2013–2015

City (Region)	Average unit asking price, thousand Rb/ sq. meters			Price index in December 2014 against December 2013		Price index in December 2015 against December 2014	
	December 2013	December 2014	December 2015	nominal	real (IGS)	nominal	real (IGS)
Moscow	203.3	226.6	218.5	1.115	1.000	0.964	0.854
St. Petersburg	96.0	103.0	103.0	1.073	0.963	1.000	0.886
Vladivostok		95.0	96.8			1.019	0.903
Moscow Region	88.2	93.4	90.9	1.059	0.951	0.973	0.862
Surgut (Tyumen Region)	87.0	78.5	71.3	0.902	0.810	0.908	0.804
Yekaterinburg	72.8	76.2	70.7	1.047	0.940	0.928	0.828
Tyumen	65.7	63.8	58.9	0.971	0.872	0.923	0.818
Kazan	63.7	66.6	65.3	1.046	0.939	0.980	0.868
Novosibirsk	61.4	65.6	60.4	1.068	0.959	0.921	0.816
Krasnoyarsk	61.0	61.4	54.8	1.007	0.904	0.893	0.791
Irkutsk	59.7	60.9	57.9	1.020	0.916	0.951	0.842
Samara	58.5	64.6	62.6	1.104	0.991	0.969	0.858
Yaroslavl	57.7	57.3	53.6	0.993	0.891	0.935	0.829
Perm	54.7	52.6	52.7	0.962	0.863	1.002	0.888
Vladimir	52.7	55.1	52.7	1.046	0.939	0.956	0.847
Kemerovo	52.1	53.5	49.1	1.027	0.922	0.918	0.813
Tobolsk (Tyumen region)	51.1	49.2	44.3	0.963	0.864	0.900	0.797
Voronezh	48.8	52.0	45.8	1.066	0.957	0.881	0.780
Kirov	48.5	50.9	47.7	1.049	0.942	0.937	0.830
Barnaul	48.3	49.8	46.5	1.031	0.926	0.934	0.827
Smolensk	48.1	51.3	46.9	1.067	0.957	0.914	0.810
Omsk	47.4	48.7	46.7	1.027	0.922	0.959	0.849
Ryazan	45.8	48.0	45.8	1.048	0.941	0.954	0.845
Tolyatti (Samara region)	45.7	48.3	44.8	1.057	0.949	0.928	0.822
Chelyabinsk	43.0	47.0	41.6	1.093	0.981	0.885	0.784
Ulyanovsk	42.3	43.5	41.2	1.028	0.923	0.947	0.839
Pervouralsk (Sverdlovsk region)		42.9	38.6			0.900	0.797
Stavropol	35.5	39.0	37.6	1.099	0.986	0.964	0.854
Shakhty (Rostov region)	30.9	34.2	34.8	1.107	0.994	1.018	0.902

In Moscow, the secondary housing market saw a continuation of price rise through March 2015 (Rb 244,400 per sq. meter). Then under the influence of subsidized mortgage the demand moved to the primary housing market, by May prices somewhat fell (to Rb 235,000 per sq.

meter), and stabilized at this level in summer. From autumn price reduction took on and the end of the year was below the level of December 2014 by 3.6% constituting Rb 218,500 per sq. meter.

On the secondary housing market of the Moscow region prices were growing through May (Rb 95,800 per sq. meter) and then were gradually falling to Rb 94,000 per sq. meter in August-September. This trend was observed later as a result of which at year-end the prices as in Moscow fell below the level of December 2014 by 2.7% to Rb 90,900 per sq. meter.

In St. Petersburg housing prices on the secondary market were growing through March (Rb 107,300 per sq. meter) and then by June fell to Rb 104,500 per sq. meter returning by the end of the year to the level of December 2014 (Rb 103,000 per sq. meter). Thus, the capital regions did not register housing price dynamics during the year. In the wake of significant changes in the scale of mortgage support and volumes of transactions with apartments, the sellers stubbornly maintained asking prices without significant changes,

In other regions, the situation was developing the same way. On the secondary housing market in the majority of sample cities during the first one-two months asking prices were growing and then were falling.

At year-end as a whole, housing price reduction took place in practically all cities except St. Petersburg, Perm, Vladivostok and Shakhty (Rostov region). In those cities insignificant (less than 2%) growth of nominal prices was observed, which was within the framework of the general trend of growth in Q1 with further gradual reduction (in case of Vladivostok and Perm). The group of cities with less obvious decrease of prices (within 5%) besides Moscow and the Moscow region, were Kazan, Samara, Omsk, Vladimir, Ryazan, and Irkutsk. At the other end were Voronezh, Chelyabinsk, Krasnoyarsk, Tobolsk, and Pervouralsk where prices fell by 10–12%. In other cities price decrease constituted between 5-10%.

In the larger portion of the sample, growth of the nominal housing prices by the end of 2014 gave way to their decline in 2015. Somewhat aside, stand St Petersburg where after the growth in 2014 prices remained at a year earlier level and Perm where following price reduction posted in 2014 followed their symbolic growth. In Shakhty compared to 2014, price growth rates fell five-fold, which allows to speak about their stabilization.<sup>1</sup> Another exception were Yaroslavl and cities of the Tyumen region: in Tyumen and Tobolsk last year prices continued falling at a growing rate and in Surgut price decrease turned out to be comparable with 2014.

At the same time, in most cities of the sample a drop in real price on housing (with the inflation rate on the consumer market excluded, which constituted in 2015 12.9%) took place (IGS index).<sup>2</sup> In the largest portion of the sample, decline stayed within 11-20%. Lower (around 10%) is was solely in Vladivostok and Shakhty exceeding 20% in Pervouralsk, Tobolsk, Krasnoyarsk, Chelyabinsk, and Voronezh.

The data on prices on the primary market was collected on 13 cities and the Moscow Region (*Table 13*).

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<sup>1</sup> Price stability in Shakhty registered during the year, most likely, is affected by the proximity of the Ukrainian conflict.

<sup>2</sup> Calculation of the IGS index is carried out on the basis of the following formula:  $IGS = I_{up}/I_{cp}$ , where  $I_{up}$  – housing price index in rubles;  $I_{cp}$  – consumer price index.

Table 13

**Prices on the primary market of Russian cities in 2013–2015**

City (Region)	Average unit asking price, thousand Rb per sq. meter			Price index in December 2014 against December 2013		Price index in December 2015 against December 2014	
	December 2013	December 2014	December 2015	nominal	real (IGS)	nominal	Real (IGS)
Moscow	215.5	216.0	182.6	1.002	0.900	0.845	0.749
St. Petersburg	90.5	98.0	100.4	1.083	0.972	1.024	0.907
Moscow Region	76.5	81.0	80.3	1.059	0.950	0.991	0.878
Yekaterinburg	60.8	65.5	66.4	1.077	0.967	1.014	0.898
Kazan	49.4	57.1	62.9	1.156	1.038	1.102	0.976
Samara	49.4	57.0	54.2	1.154	1.036	0.951	0.842
Tyumen	55.9	57.0	55.1	1.020	0.915	0.967	0.856
Rostov-on-Don		53.1	50.6			0.953	0.844
Yaroslavl	48.2	50.6	52.9	1.050	0.942	1.045	0.926
Ryazan	37.0	40.5	38.0	1.095	0.983	0.938	0.831
Ulyanovsk		38.0	38.0			1.000	0.886
Stavropol	30.4	34.5	34.8	1.135	1.019	1.009	0.893

In Moscow, in January 2015, on the primary market housing price growth continued due to reaction of the population on the ruble devaluation in December 2014. However, by March 2015 prices fell to Rb 203,400 per sq. meter (against Rb 216,900 per sq. meter in January) and later with somewhat ruble strengthening and stability through August remained at the level of around Rb 200,000 per sq. meter. In autumn, prices resumed their decline and turned out to be by the end of the year (Rb 182,600 per sq. meter) below the level of December 2014 at 15.5%. According to different data, the amount of rebate on the primary housing market constituted in Russia in 2015 on average 10-15% (from 2-15% in summer and 5-25% in autumn). The share of apartments sold with a discount was estimated at 60-80%. Price negotiation index (ratio between average asking prices to average prices of transactions) stands at 1.07-1.10.

In the Moscow region on the primary housing market prices were growing through February (Rb 83,600 per sq. meter) and then by April fell to Rb 81,800 per sq. meter. Further, prices stabilized at Rb 82,000 per sq. meter, which was followed by price decline commencing from September. However, in contrast with Moscow, they hardly differed from the level of December 2014 by the end of the year (Rb 80,300 per sq. meter against Rb 81,000 per sq. meter, the difference constituted less than 1%).

The situation on the primary housing market in St. Petersburg was characterized by somewhat higher volatility. In January, prices went up to Rb 102,900 per sq. meter and then by June fell to Rb 98,800 per sq. meter. Followed unexpected growth pushed prices by October to the level exceeding the January level (Rb 103,800 per sq. meter). However, later, they began falling to Rb 100,400 per sq. meter at the end of the year, which nevertheless was above the level registered in December 2014 by 2.4%.

At year-end, in other cities changes in the average housing prices on the primary market were differently directed. Like in St. Petersburg prices moved up in Stavropol, Yekaterinburg, Yaroslavl, and Kazan, and in the latter by more than 10%. However, the growth rate was weaker than a year earlier. In Ulyanovsk, they remained unchanged. In Tyumen, Rostov-on-Don, Samara, and Ryazan price reduction took place but it was lower than in Moscow where its depth was the greatest (more than 15%).



Principal factors, which affected the level of price reduction on the Moscow primary housing market were external ones (drop in income, contraction of migration, decrease of investors activity) in principle are effective in other cities. However, Moscow faces the influence of other additional important internal factors.

One of them consists in the structural shift due to the change in the share of apartments supply inside Moscow in modern borders (Big Moscow) with existing difference in price level. For example, the share of supply in Moscow in former borders (Old Moscow) fell over the year from 75% to 68% (with price in December 2015 at Rb 242,700 per sq. meter) and the proportion of added territories (New Moscow) moved up from 25% to 32% (with price at Rb 103,100 per sq. meter). Calculations demonstrate that impact of this structural shift on the average price across Big Moscow constituted 4.8%.

Another shift was due to the change in the class of quality of commissioned housing: in December 2014 around 35% supply in Moscow as a whole was in the business-class segment and elite class (average price – Rb 307,300 per sq. meter), 65% - comfort and economy-class segment (average price – Rb 122,100 per sq. meter). In December 2015, the share of housing in prestige class changed slightly (37%), but average price fell to Rb 283,300 per sq. meter (or around 8%). The share of large-scale housing constituted 63% with price at Rb 116,400 per sq. meter. In other words, decrease amounted to less than 5%. These structural changes added 1.8% to the decline of the average price across Big Moscow.

In all cities indicators of real housing price (IGS index) fell compared to 2014, meanwhile, the value of contraction of this index was bigger than year earlier. In the smallest degree this trend was in Kazan, Yaroslavl, and St. Petersburg where reduction of real housing price did not exceed 10%, although in 2014 in Kazan as in Samara and Stavropol IGS index demonstrated growth.

The data of *Table 14* show that in the past three years the average unit price of housing on the secondary market was everywhere ahead of that on the primary market.

*Table 14*

**Correlation of prices on the secondary and primary housing markets  
in Russian cities in 2013–2015**

City (Region)	December 2013			December 2014			December 2015		
	Average unit asking price		(2)/(1), %	Average unit asking price		(2)/(1), %	Average unit asking price		(2)/(1), %
	On the secondary market, thousand Rb/sq. meters (2)	On the primary market. Thousand Rb /sq. meter (1)		On the secondary market, thousand Rb/sq. meters (2)	On the primary market. Thousand Rb /sq. meter (1)		On the secondary market, thousand Rb/sq. meters (2)	On the primary market. Thousand Rb /sq. meter (1)	
Moscow	203.3	215.5	94.3	226.6	216.0	104.9	218.5	182.6	119.7
St. Petersburg	96.0	90.5	106.1	103.0	98.0	105.1	103.0	100.4	102.6
Moscow Region	88.2	76.5	115.3	93.4	81.0	115.3	90.9	80.3	113.2
Yekaterinburg	72.8	60.8	119.7	76.2	65.5	116.3	70.7	66.4	106.5
Kazan	63.7	49.4	128.9	66.6	57.1	116.6	65.3	62.9	103.8
Samara	58.5	49.4	118.4	64.6	57.0	113.3	62.6	54.2	115.5
Tyumen	65.7	55.9	117.5	63.8	57.0	111.9	58.9	55.1	106.9
Ryazan	45.8	37.0	123.8	48.0	40.5	118.5	45.8	38.0	120.5
Stavropol	35.5	30.4	116.8	39.0	34.5	113.0	37.6	34.8	108.0

Earlier, an important exception was the capital of Russia. However, by the end of 2014, after joining to it of a portion of the territory of the Moscow Region the situation changed and in December 2015 prices on the secondary market in Moscow started to exceed those on the primary market by around 20%. Slightly higher prices were registered in Ryazan, and in localities near Moscow and Samara it constituted more than 13–15%. In Stavropol, Tyumen and Yekaterinburg higher prices of the secondary market averaged between 6.5 and 8.0%, and in St. Petersburg and Kazan, it constituted less than 3–4%.

In more than half of sample cities (St. Petersburg, Yekaterinburg, Kazan, Tyumen, and Stavropol) during 2013-2015 price convergence between primary and secondary housing prices was observed. At year-end 2015, localities near Moscow added. In Samara and Ryazan changes year-on-year had differently directed character. Only Moscow demonstrated exceeding price growth on the secondary market.

Thus, prices on primary and secondary housing market of Russian cities were falling but there was no housing price crash. On the whole, the housing market turned out to be the most stable segment of the economy, which speaks about a relative efficiency of anti-crisis measures adopted by the authorities and developers.

### *Internal factors which determined price dynamics and activity on the market*

Following the slide of the mortgage transactions volume posted in January-February 2015 due to the key rate hike, which correspondingly led to high mortgage lending rates, measures adopted by the government aimed at support of the building industry (March decision on subsidizing mortgage lending rate on the primary market)<sup>1</sup> resulted in the growth of the number of mortgage transactions, which prevented collapse of the housing construction industry. Hereafter, with the gradual decrease of the key rate mortgage rate was also falling. If in Q1 it averaged 14.5%, then during H1 – 13.9% and at year-end 2015 – 13.3% (in 2014 – 12.45%). On mortgage loans denominated in foreign currency the rate, on the contrary, moved up from 9.25% to 9.82%.<sup>2</sup> However, they accounted for less than 0.5% of the total loans originated, which demonstrates a rather limited importance of the issue with currency borrowers. According to estimates of AHML's General Director, A. Plutnik, out of the total number of mortgage borrowers (3.5m people) there are solely 18,000 including 2,000 who are in financial straits. During the year, banks have restructured 30% of the currency mortgage portfolio.<sup>3</sup>

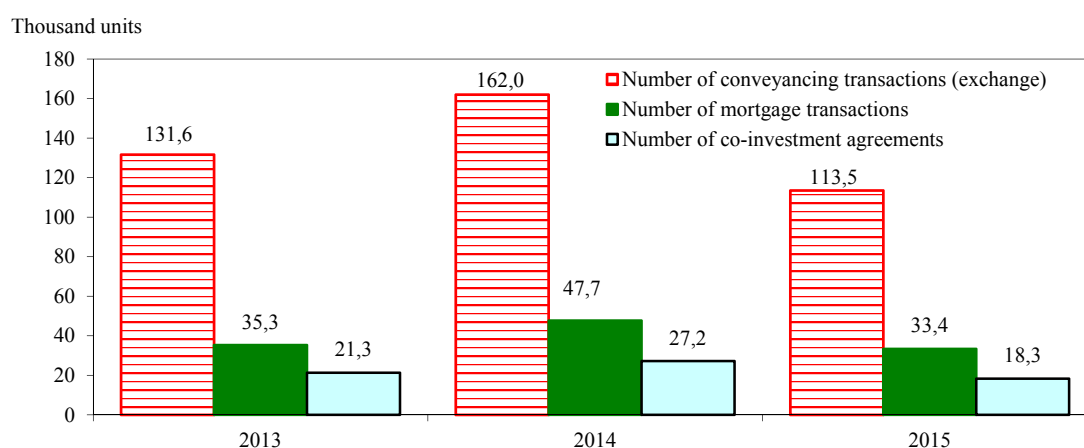
Despite the State Program of mortgage interest rates subsidization under which 210,000 mortgage loans were originated, the total amount of extended mortgage loans contracted in 2015 by 35% (Rb 1,143.6bn against Rb 1,753.3bn a year earlier).<sup>4</sup> Owing to a reduction in the volume of mortgage absorption and decline in solvency of the population on the whole, decrease in the volume of demonstrated demand in the country constituted according to experts' estimates up to 40%. Correspondingly, there was a contraction in the volume of transactions on the secondary and primary residential housing markets. Their dynamics across Moscow is presented in *Fig. 8*.

<sup>1</sup> Within the framework of the state program on preferential mortgage lending rate does not exceed 12.0%. It is applicable solely to the primary housing market. The Program was effective from March 1, 2015 through March 1, 2016 and then was extended through the end of 2016. In 2016, the Program will absorb Rb 16.5bn, and a number of parameters can be changed compared to the previous year.

<sup>2</sup> Socio-economic state of Russia. January 2016. Moscow, Rosstat, pp. 198–200.

<sup>3</sup> Tonus for construction. Big Moscow, 17.02 2016, № 6 (87), p. 6.

<sup>4</sup> Total amount of housing loans somewhat exceeds indicated mortgage volume denominated in rubles but it accounts for around 98% of the overall volume of housing lending.



*Fig. 8.* Number of registered transactions on Moscow housing market in 2013–2015

Source: Rosreestr.

In Moscow the number of mortgage transactions contracted from 4,500 posted in December 2014 to 1,700 registered in January 2015. Hereafter, growth was observed from 2,300-2,700 transactions registered in February-March to 3,500 by June and 4,100 by July. However, in H2 against the background of income contraction and unstable situation on the currency market and in the financial sphere, growth of mortgage absorption stopped and merely 2,600-2,900 mortgage transactions were registered in a month. For a year as a whole, this indicator fell by 30.0% (from 47,700 to 33,400 loans).

Number of registered co-investment agreements in Moscow declined from 3,200 in December 2014 to 1,300-1,400 in February-March 2015. In April, this number moved up to 2,100 but further started falling and in August-November went back to 1,300-1,600 agreements per month. In December this indicator constituted only 1,143 registered co-investment agreements. Total number for the year in the capital fell by nearly 1/3 – from 27,200 to 18,300 agreements.

On the secondary housing market the number of conveyancing (exchange) transactions fell from 16,900 in December 2014 to 5,900 in January 2015. Further on, obvious instability of monthly indicators was observed. If in March the number of transactions moved up to 13,000, then the number fell to 7,000 in May with a somewhat growth by July to 8,800 transactions. In August-September, this segment registered new reduction in the number of transactions to 7,400 and 7,700, respectively. However, in the last quarter of the year the value of this indicator went up to 9,300 transactions in October-November and to 15,000 in December. During the year as a whole, the number of registered deeds on the capital secondary housing market decreased by 31.0% (from 162,000 to 113,500 registered conveyancing transactions (exchange)).

Thus, compared to 2014, decrease in activity in principal segments of the Moscow housing market was approximately equal. Some special details pop up when we compare with the pre-crisis 2013. If activity on the secondary market and involvement in cost sharing construction has contracted by around 14-15%, then in relation to mortgage – solely by 5.4%.

Contraction of demand and absorption of housing resulted in growth in 2015 of the volume of a “hung” supply in the capital region (*Fig. 9 and 10*).

## RUSSIAN ECONOMY IN 2015

trends and outlooks

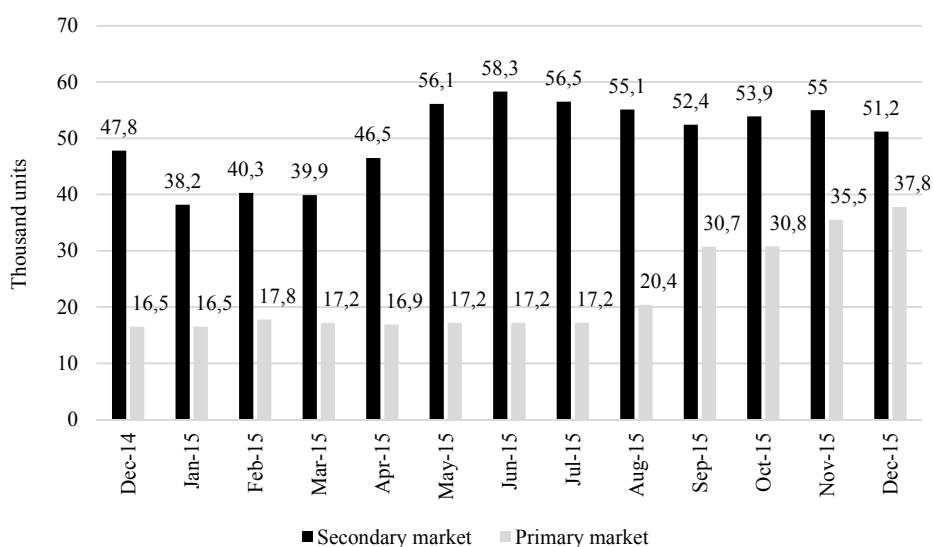


Fig. 9. Supply volume of apartments on the Moscow housing market

Sources: GK MIEL; MIEL-Novostroiki.

The Moscow secondary market (Fig. 9) registered supply growth in April to 46,500 apartments against 38,000-40,000 posted in previous months. Starting from May, it did not move down below 51,000-52,000 apartments per month (minimums were registered in September and December). Supply growth on the primary market happened in August to 20,400 apartments against 16,000-18,000 per month in the course of H1 as well as in July. In September-December, it moved up to 30,000-38,000 apartments per month.

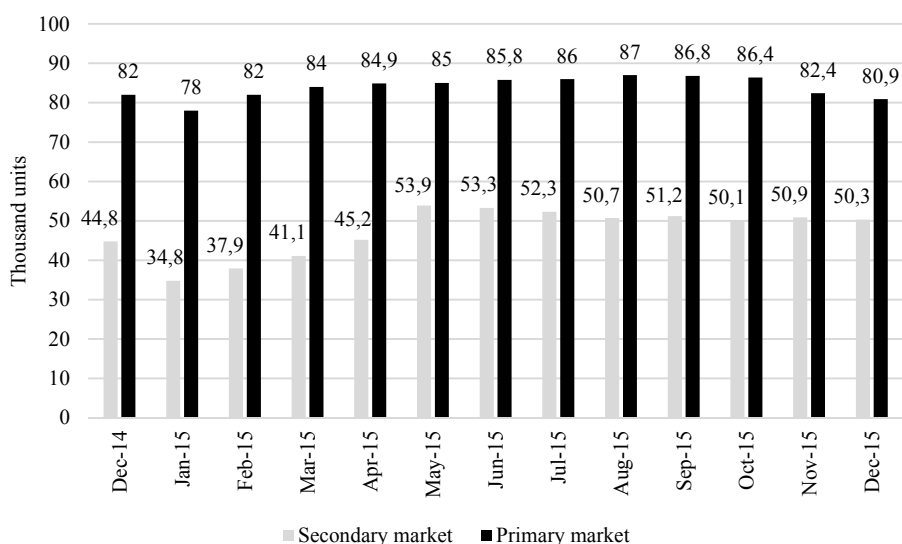


Fig. 10. Supply volume of apartments on the Moscow region housing market

Sources: GK MIEL; MIEL-Novostroiki.

On the Moscow region secondary housing market (*Fig. 10*) the volume of supply was moving up from 34,800 apartments in January to 53,000-54,000 apartments in May-June, hereafter staying at 50,000-52,000 apartments per month. On the primary market starting with Q2 the supply was more stable (85,000-86,000 apartments), which is explained by approximately the same rate of absorption and the new construction-supply. However, in November-December, it decreased to 82,000-81,000 apartments together with contraction of the number of new developing sights.

“Hung” supply was owing to a reduction of absorption rates together with fallen demand have led to price decrease on the market. While the developers were announcing various sales promotions, discounts, installment sale, buyers concentrated their demand on below budget apartments as a result of that transactions’ prices during spring-summer averaged 10-15% below the asking price. In the autumn developers finally moved beyond the policy of high asking prices and individual discounts to a general reduction of asking prices.

#### 6.3.4. Building, commissioning and supply of new housing<sup>1</sup>

In 2015, despite the impact of financial and economic crisis the housing construction industry managed to retain the volume of commissioning of new housing practically at the previous level. Generally in 2015, 1,169,400 apartments with the total floor space of 83.3m sq. meters were commissioned (*Table 15*).

*Table 15*

**Commissioning of housing in Russia in 1999–2015**

Year	Million sq. meters of housing	Growth rates, %	
		Against the previous year	Against 2000
1999	32.0	104.2	105.6
2000	30.3	94.7	100.0
2001	31.7	104.6	104.6
2002	33.8	106.6	111.5
2003	36.4	107.7	120.1
2004	41.0	112.6	135.3
2005	43.6	106.3	143.9
2006	50.6	116.0	167.0
2007	61.2	120.9	202.0
2008	64.1	104.7	211.5
2009	59.9	93.4	197.7
2010	58.4	97.5	192.7
2011	62.3	106.6	205.6
2012	65.7	104.7	216.8
2013	70.5	107.3	232.7
2014	84.2	119.4	277.9
2015	83.8	99.5	276.6

*Source:* The Russian Statistical Yearbook. 2007: Statistical collected volume/ The Rosstat M., 2007, p. 507; The Russian Statistical Yearbook. 2015: Statistical collected volume. Rosstat, Moscow, 2015, p. 435; On Housing Development in 2015, www.gks.ru and own calculations

In 2015, individual developers commissioned 264,000 residential buildings with the total floor space of 34.3m sq. meters which is 5.4% less than in 2014. For the first time in many years individual developers demonstrated inferior dynamics compared to the housing construction as a whole. This decreased its share in the total floor space of completed housing nationwide was equal to 40.9% meanwhile during previous five years it consistently exceeded 43.0%.

<sup>1</sup> Authors of this section: Malginov G. – Gaidar Institute for Economic Policy, Sternik G. – Moscow Association of Realtors on Analytics and Consulting, JSC Sternik’s Consulting.

Positive dynamics of housing development was observed in Russia's most regions, including 2/3 of the territories where the aggregate volumes of commissioning of housing exceeded 1m sq. meters (*Table 16*).

*Table 16*

**Dynamics of commissioning of housing in Russia's regions in 2014  
(arranged by the rates of commissioning)**

<b>Region</b>	<b>Growth rates of housing commissioning, % to 2014</b>
Leningrad region	130.0
Samara region	117.1
Moscow	115.8
Novosibirsk region	112.3
Dagestan	109.2
Krasnoyarsk Krai	108.5
Kaliningrad region	108.1
Belgorod region	105.8
Lipetsk region	105.2
Voronezh region	103.8
Rostov region	103.6
Perm Krai	103.5
Orenburg region	103.3
Tyumen Region (with autonomous regions)	103.2
Sverdlovsk region	102.5
Bashkortostan	101.5
Tatarstan	100.0
Krasnodar Krai	97.1
Stavropol Krai	94.0
St Petersburg	92.9
Kemerovo region	91.3
Moscow region	85.4
Chelyabinsk region	85.4
Nizhny Novgorod region	79.1
Saratov region	75.0

*Source:* On Housing Development in 2015 URL: [www.gks.ru](http://www.gks.ru).

As seen from *Table 16*, the dynamics of commissioning of housing which was largely above the average nationwide (over 5%) was observed in Leningrad, Samara, and Novosibirsk regions, Moscow, Dagestan, Krasnoyarsk Krai, Kaliningrad, Belgorod, and Lipetsk regions. Seven regions posted positive dynamics of housing commissioning but with lower rates. At the same time, there was a drop in the volumes of commissioning of housing in 8 regions including Moscow, Chelyabinsk, Nizhny Novgorod, and Saratov regions where it fell by 15-25.

Despite a deep fall, the Moscow region retained its leading position among Russian regions as regards the volume of housing commissioning in absolute terms (around 8.5m sq. meters). Moscow, on the contrary, registered growth of commissioning of housing in about the same proportions the Moscow region registered decline (15%). The unit weight of the capital region in the overall volume of housing development in Russia amounted to 14.7% of which the Moscow region accounted for a larger portion (10.1%), while the share of Moscow proper was equal to 4.6% (around 3.9m sq. meters). At the same time, for the third year in a row the Old Moscow observed a decrease in the volumes of commissioning after a year ban on issuing permissions for the housing construction due to change of city's authorities (to around 1.3m sq. meters or by 17).

It is to be noted for comparison that in St Petersburg the depth of contraction (over 7%) of the volumes of the housing construction (to 3m sq. meters) turned out to be half of those registered in the localities near Moscow. The Leningrad region retains its leadership on the rates of housing commissioning among all regions of the country with absolute values of this indicator

exceeding 1m sq. meters (30%). Among the five regions that are leaders in housing commissioning are Krasnodar Krai (4.6m sq. meters), and Tyumen region with autonomous districts (3.3m sq. meters).

At year-end 2015, on the whole one can acknowledge that in 2015 the housing construction industry managed to avoid decrease. Together with preferences on mortgages, the industry received support from the inertia production cycle, which consisted in the realization of already previously undertaken building sights in the era of favorable business climate. However, high annual result<sup>1</sup> was ensured only thanks to the results for H1 and already starting from June monthly volume of housing commissioning began falling in absolute terms compared to 2014 indices.

Furthermore, as can be well seen from Table 8, with retaining volume of housing commissioned across the country as a whole, last year contrary to 2014 the situation with the housing construction revealed noticeable regional specific character. In 2016-2018, in the wake of the crisis not only regions but Moscow as well faces serious reduction of the volumes of the housing construction by one third. According to data released by Moskomstroyinvest, the capitol market has registered a decrease by 30% of applications for obtaining urban development plans land plots from investors.

Even more contradictory is the situation in the Moscow region. On the one hand, the Moscow region for several years retained its leading position among all regions of the country as regards the volume of commissioned of housing as well as regards resettlement of slum dwellings and dilapidated housing. Despite the crisis, the developers as on the territory of the New Moscow announce new housing projects.

On the other hand, there is an obvious underdevelopment of transport, communal, and social infrastructure that are highly pressured. Proliferate protest sentiments against urban infill, high-rise development, and unfounded mass development, which makes regional authorities introduce local bans on housing development (for example, in Balashikha, Korolev, and Khimki). At the same time, amid decline of demand the profitability of the housing development is falling and the developers experience multiple financial problems. According to G. Elianyushkina, deputy head of the government of the Moscow region, construction works on 67 housing complexes have been completely or partially halted.<sup>2</sup> That is why, we can expect further reduction of supply volumes and continued fall in absorption of housing.

The impact of this factor on the primary market of the capitol region has led to a decrease of the volume of attracted investors' funds, which together with a contraction of bank lending to the developers has created for them considerable difficulties and place some of them on the brink of bankruptcy. Special attention was given to the situation around the developer SY-155, which resulted not only in the worse outcome of the construction industry performance in entire Moscow region but required attention from the federal authorities for its resolution. Courts consider many lawsuits against the developer filed by a number of banks (Sberbank, Rosbank, and Rossiskiy capital). The developer has become a victim of both a crisis and wrongly chosen financial model oriented on the constant growth of the housing market. Bank Rossiskiy capital

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<sup>1</sup> As was noted in the previous Annual Report (see: *Malginov G., Sternik G.* Prices on the Housing Market. Russian Economy in 2014. Trends and Outlooks. Issue 36. Moscow, IEP, 2015. p. 524). 2014 saw significantly exceeded over the late Soviet period (1988-1989) indicators. In 2015 amid actual retention of this result, there was approximate achievement of indices for late 1980s and on the number of commissioned apartments owing to increased construction of economy class housing, increased share of one-room apartments and studios.

<sup>2</sup> *Berezina E.* What is to be done with construction outrage. MK. 4.03–10.03.2016, № 45 (243). p. 12.

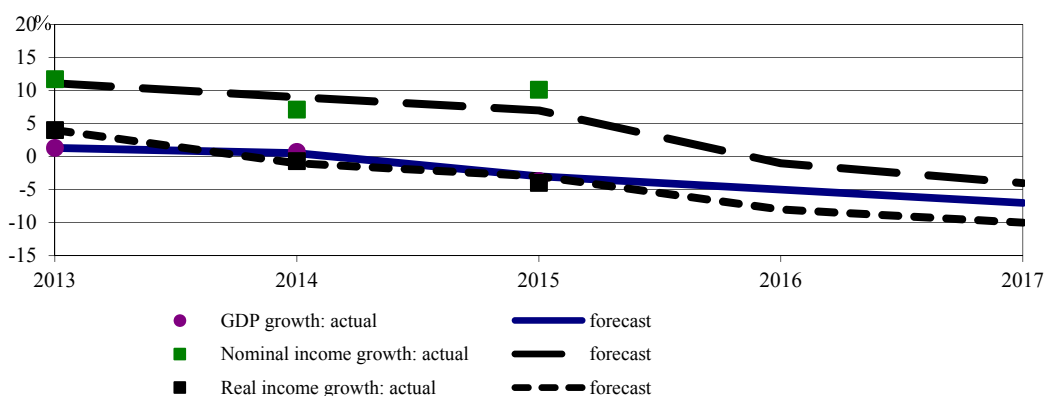
took over responsibilities for settling obligations before investors of the developer. Regarding the results of the all-Russia meeting on completion of construction sights of SY-155, as of year-end 16,000 out of 30,000 families must receive apartments from this developer (in 14 regions).<sup>1</sup>

Most likely, the issue of hoodwinked investors has a nationwide character. According to the RF Office of the Procurator General, the developers virtually everywhere fail to observe terms for the delivery of apartments according to the cost-sharing contracts. Only 29 regions do not have problems with housing, which is being built on the law on cost sharing construction. During nine months of 2015, the number of participants in cost-sharing construction who turned to the law enforcement agencies (537 persons) and the number of criminal investigations (362) went up by more than 70% against the same period of the previous year.<sup>2</sup>

Thus, the housing market in Russia in 2015 was in recession. Contrary to the complicated macroeconomic situation, there was no significant decline of main indicators (asking prices on the secondary and primary markets, construction volumes and commissioned housing, absorption volumes and mortgage), which does not exclude further buildup of complications this year.

### 6.3.5. Forecast of the residential housing development in the capitol region<sup>3</sup>

The forecast of the capitol housing market is closely linked with the prospects of the Russian economy as a whole. Computed in June 2014 for the use in mathematical model of the housing market performance long-term expert macroeconomic forecast for 2015 had the following parameters (*Fig. 11*).



*Fig. 11.* Long-term expert forecast of RF macroeconomic dynamics as of June 2014

*Sources:* forecast as of June 2014 – JSC Sterniks Consulting, actual data for 2013 and 2014 – Rosstat 2015 – RF VED estimate.

In comparison with the real data, it becomes evident that for 2014 the practically coincided with forecast data, which allowed not to revise model calculations for the next year. As of year-end 2015, forecast proved to be excessively optimistic: actual GDP reduction constituted 3.7%

<sup>1</sup> URL: [www.minsroyrf](http://www.minsroyrf), 15 February 2016.

<sup>2</sup> Rossiiskaya Gazeta. 25 November 2015.

<sup>3</sup> Authors of this section: Malginov G. – Gaidar Institute for Economic Policy, Sternik G. – Moscow Association of Realtors on Analytics and Consulting, JSC Sternik’s Consulting.



(instead of 3.0% according to forecast), growth of the nominal income of population – 10.2% (instead of 8.0%), and real income decrease – 4.0% (instead of 3.0%).

Regarding 2016 forecast, one can state a whole number of different assessments, which spread in values can be determined by the impact of the energy resources market (*Table 17*).

*Table 17*

**Forecast of macroeconomic parameters for 2016**

Source	Oil price, USD./bbl.	Exchange rate, Rb./USD	GDP growth, %
RF MED, November 2015	50	60–65	+1.0
Morgan Stanley			-0.8
A. Abramov (HSE, RANEPА, K. Adrianov (ISPN RAS), Ya. Mirkin (MEMO RAS)	40–47	70–77	-1.0
Fitch, Bloomberg, Goldman Sachs	20–30	110–120	-3.0
RF MED, January 2016	30–40	60–70	-3.0
Forecast JSC Sternik Consulting June 2014	35–40	80–90	-5.0

Originally, in autumn two scenarios of the development of the Russian economy were feasible. First, pessimistic: continuation and deepening of the recession. Second – optimistic: following currency and financial crisis as of year-end 2014 and economic recession in 2015, recovery commences. The RF Ministry viewed the latter for Economy as the main one even after continuation of the oil price fall and abandoning three-year budget planning. However, actual dynamics of macroeconomic and financial indices in late last year forced authorities to abandon optimistic scenario.

According to Gaidar Institute experts, data on the Russian economy development during 2015 coupled with current trends on the world energy markets present grounds to revise for the worse feasible scenarios of economic development in 2016-2017. For example, current scenario with average annual oil price in 2016 of \$35 per barrel is the base one, and the oil price at \$50 per barrel (included in the federal budget for 2016) seems optimistic. Modeling of the main macroeconomic indicators in 2016-2017 within chosen scenarios lead to conclusion of unavoidable recession during period under review. Transition to growth is feasible solely in scenario with stable oil price above \$50-55 per barrel.<sup>1</sup>

Based on the above, significance of the macroeconomic forecasts as of June 2014 remains. Main parameters of this forecast are: GDP contraction by 5%, reduction of the nominal income of population by 1%, and the fall of the real income by 8% (with average annual oil price at \$35-40 per barrel, and ruble exchange rate at 80-90 per USD).

Calculated in June 2014 forecast of the Moscow housing market for 2015 in relation to the primary market (*Fig. 12, a*) proved to be overestimated regarding absorption indicators (by 17%), equal actual data on price (decline by 9-10% against actual data of December 2014), but underestimated the supply volume (by 12%). In 2016, further price reduction by 3-4% was projected. Forecast for the secondary market (*Fig. 12, b*) closely coincided with the assessment of main indicators (demand, supply, and price), except lower estimate of absorption (by 12%).

<sup>1</sup> *Drobyshevsky S., Petrenko V., Turuntseva M., Khromov M.* Forecast 2016–2017: recession remains. OMEO. 2016. № 1(19).

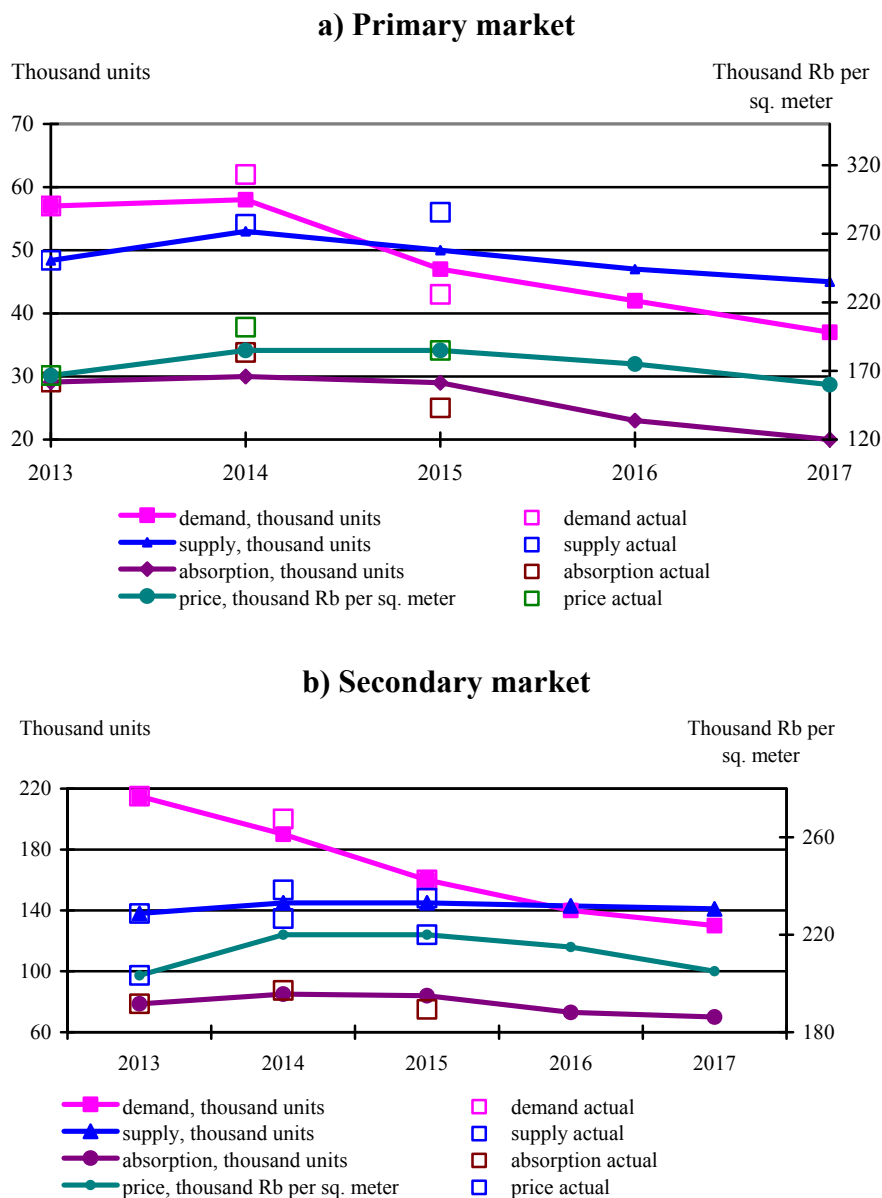


Fig. 12. Forecast of demand, supply, absorption of apartments and price dynamics on primary and secondary markets of Moscow

Source: JSC Sternik Consulting.

Forecast of the main parameters of the Moscow housing market of June 2014 seems justifiable for 2016. Further decrease of demand and prices on both markets by 4-5% with reduction of supply below demand on the primary market and its retention on the secondary one.

Computed in March 2015, forecast of the Moscow housing market development regarding the primary market (Fig. 13, a) proved to be overestimated in relation to demand and absorption and underestimated regarding supply. Price projection practically coincided with actual data (reduction by 1.3%). Forecast for the secondary market (Fig. 13, b) for 2015 somewhat overestimated demand and absorption, supply as well as happened to be above actual data on price

(by 2%). For 2016, further decline of demand, supply, absorption, and price by 2-3% is projected.

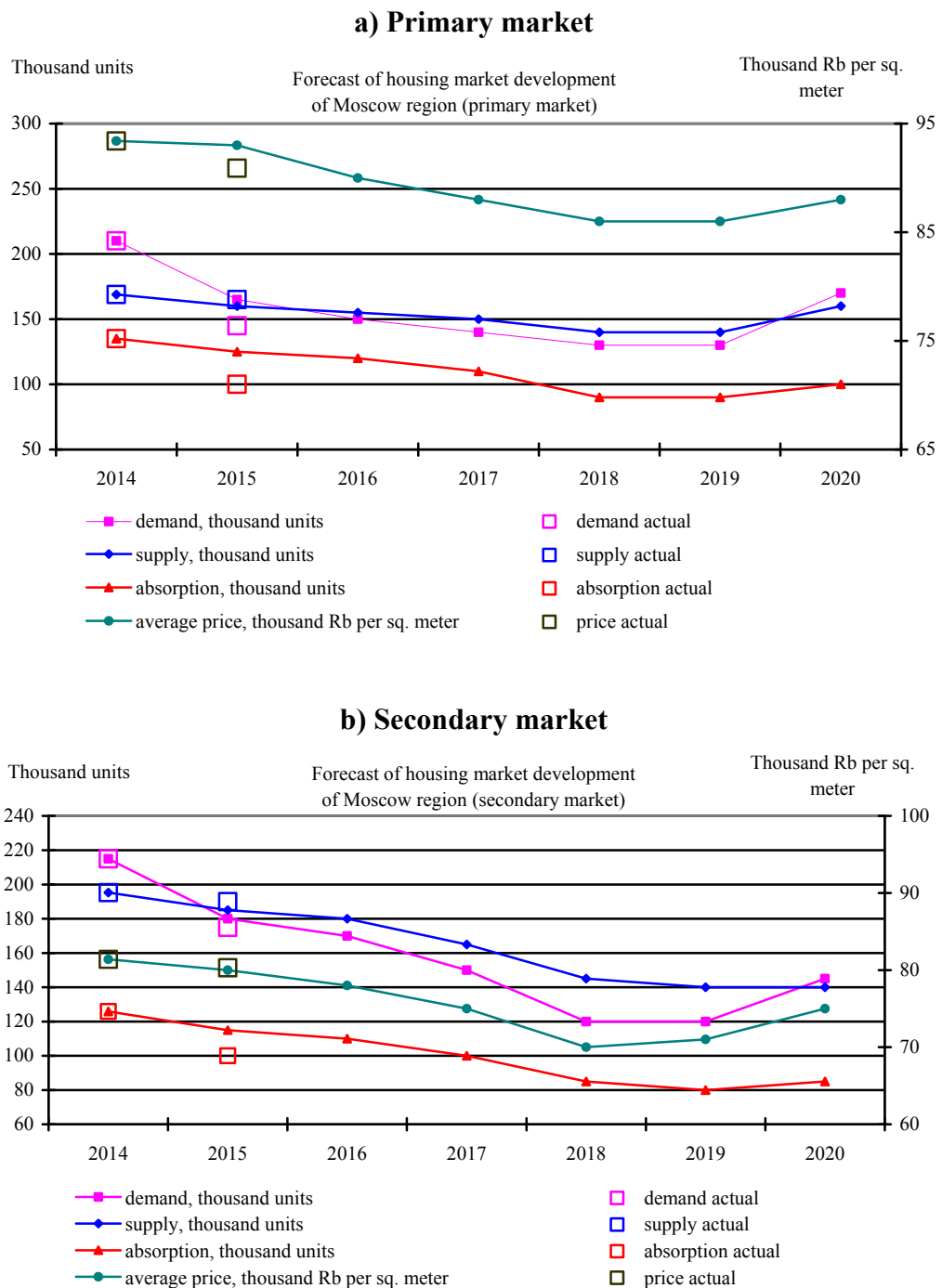


Fig. 13. Forecast of demand, supply, absorption of apartments and price dynamics on primary and secondary markets of Moscow region

Source: JSC Sternik Consulting.

In 2016, significance of the March 2015 forecast remains. Both on the primary and secondary markets further decline of demand, supply, absorption and price is projected by 2-3%.

Expert assessments of the market participants contradict model calculations. For example, A. Nazarov, Chairman of the board of directors of group of companies Granel, expects a contraction in the building industry by 10-15%.<sup>1</sup> Head of the RF Ministry of Building, Mikhail Men, estimates the building industry outlook as complicated one due to contraction of the consumer demand. Possibilities of the government to support the industry are limited due to expected problems with pumping up the budget where subsidized mortgage creates long-term liabilities for the whole life of such loans. In this context, a lot depends on the ability of the developers to self-adjust to the market and cater for the reasonable profit.

Projected continuation of the recession on the housing market of Russian cities does not signify the market collapse, at least in 2016. The housing market demonstrated resilience to unfavorable effect of macroeconomic and political difficulties due to both its lower level of globalization and timely support on the part of the government.

## 6.4. The North Caucasus: risks are on the rise

### 6.4.1. An aggravation of the situation around the inter-Islamic conflict in the North Caucasus<sup>2</sup>

Since mid-2015, the republics of the north-eastern Caucasus (Dagestan, Chechnya and Ingushetia) have been experiencing a new round of escalation of the conflict, which is rather simplistically interpreted by many observers as a controversy between Sufis<sup>3</sup> and Salafis. It should be noted that the law enforcement agencies and even the authorities of the North Caucasian republics are also most heavily involved in that conflict.

It should be reminded that, beginning from the early post-Soviet era, the religious life in the North Caucasian republics has been complicated by an ongoing conflict between different Islamic religious movements: traditional Islam (represented in the north-eastern Caucasus by a variety of Sufi orders) and nontraditional Islam (represented by fundamentalist movements that call for a return to the fundamentals - the Quran and Sunnah, and rejecting any innovations, including anything that has to do with Sufism; usually they all are referred to as Salafis - a general term that is not quite correct). The conflict rather promptly flared into violent confrontations (the catalyst being the war in Chechnya), and until the late 2000s the principal method to be applied in resolving the situation was considered to be suppression by force of nontraditional Islam. However, since the late 2000s, in a number of the North Caucasian republics (most actively – in Ingushetia and Dagestan) the powers-that-be began to make attempts to find some alternative civilian methods of settling the conflict on the basis of amicable agreements. At the level of republican authorities, it was admitted that the fact of belonging to one or another Islamic movement is by no means a crime *per se*, as it complies with the right of religious belief as stated in the Constitution of the Russian Federation up until the moment when an individual becomes a proponent of violence or actually takes up arms. So, the Salafi mosques began to function relatively without constraints, and those Salafi leaders who were not calling for *jihad*

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<sup>1</sup> Tonus for Building. Big Moscow. February, 17, № 6 (87) p. 6.

<sup>2</sup> Author of this section: Starodubrovskaya I. – Gaidar Institute for Economic Policy.

<sup>3</sup> Sufism is defined as a mystical dimension of Islam; it implies commitments of the murids (believers) to the sheiks who have access to superior mystical knowledge.

were allowed to preach freely. Negotiations were launched between representatives of the conflicting Islamic movements with the purpose of separating the religious processes from politics and to elaborate some civilized forms of interaction in a social context. The commissions for the adaptation to peaceful life of the persons who have decided to discontinue their terrorist and extremist activities began to function. All these developments conducted to reestablishing a normal life in the republics and significantly brought down the scale of violent acts.

Nevertheless in early 2013, nearly all these processes were brought to a halt, and the suppression-by-force scenario once again came to the fore. Large-scale counter-terrorist operations, persecution of Salafi preachers, and pressure on the believers were on the agenda once again. The adaptation commissions were no longer active. The only republic where the process of appeasement by civilian means was more or less continued thanks to the position of its head, Yunus-bek Yevkurov, is the Republic of Ingushetia.

The cause of strongest indignation among the believers - and first of all in Dagestan - is the so-called *prophylactic registration*, or *Wahhabi* lists. On the basis of some arbitrary superficial features (personal appearance, apparel) people are taken to police stations, photographed and made to take blood and DNA tests, and then are required to also bring their families for the same sort of testing. Thereafter, those who have been put on these lists experience difficulties in traveling freely across the territory of the North Caucasus, as well as elsewhere in Russia; besides, they are regularly called for 'prophylactic' interviews and subjected to house searches. In other words, they are unlawfully restricted in their constitutional rights, and the normal flow of their everyday life is disrupted. Quite often, even those individuals who never go to a mosque or perform salah, or even those who drink alcohol, are put on these lists. We know one case when a man who worked at the mayor office in Makhachkala was listed as a *Wahhabi* in his native village.

Here is one more example of how people can be placed on a *Wahhabi* list. *'My friend was stopped while driving his own car, so that his documents could be checked at the Sulak checkpoint. This was at 1 pm. It turned out that he had a prophylactic registration, he was a Wahhabi. So he, with his car, was taken to district police headquarters, and released only as late as 2 am the next morning. He, and others like him, sat there waiting for a prophylactic interview, a total of 15 people. It is a good thing that he had not taken his family with him, I cannot imagine how all this would proceed if you have your wife and children with you. They practically ate nothing, except some buns that they bought at the canteen with their own money. ... And when will a man have time to work, to earn his living, if he is taken every time to police headquarters? People have families with small children, who need to be fed.'*

However, in contrast to the developments observed over the period from the mid-1990s to the late 2000s, the new use-of-force scenario did not translate into an outburst of violence. Moreover, the scale of violence has begun to recede at a rapid pace. In 2015, the following indices declined on 2014 in the North Caucasus: the number of victims in armed conflicts dropped by half - from 525 to 258; the number of casualties dropped by 39%, that of wounded – by 73%; the number of terrorist attacks declined by 33%, that of bomb explosions – by 45%. The total number of incidents with the use of weapons in the North Caucasus went down from 141 in 2014 to 86 in 2015 - that is, by 39%<sup>1</sup>. We may point to the following main factors behind this situation.

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<sup>1</sup> See <http://www.kavkaz-uzel.ru/articles/277423/>

*Firstly*, the antiterrorist policy in this case by no means targeted only the rank-and-file militants. Some representatives of the Dagestani elite, who are accused of having connections with the *armed* underground resistance movements, have also been subject to criminal prosecution. By doing so, the authorities have undermined the support of unlawful armed formations by the elite, and managed to disrupt their cash flows. There is no doubt that this helped to suppress the activity of the militants.

*Secondly*, we can observe an outflow, on a mass scale, of the radically-minded young people to Syria, where they join either the terrorist organization *Islamic State* (or ISIS, whose activity is banned in the territory of the Russian Federation) or the jihadist groups that oppose the ISIS. According to available information, until recently the law enforcement agencies have not been preventing their exit from Russia in any serious way. Thus, a group of popular Islamic preachers managed to leave Makhachkala and join the ISIS, although one of them had been placed under house arrest.

*Thirdly*, some serious changes have occurred in the underground resistance movement itself. In 2015, Aliashab Kebekov and Muhammad Suleimanov – two leaders of *Imarat Caucasus* (an organization that is also banned in the Russian Federation, because since November 2007 it had led and coordinated the activity of unlawful armed groups across the region) were killed. Since then, in all evidence, no new leader of *Imarat Kavkaz* (the Caucasus Emirate) has been elected, and the organization is experiencing a deep crisis - if it still functions at all. At the same time, it is a known fact that in 2015, these armed groups on a mass scale took an oath of allegiance to the ISIS. Their oath was accepted, and the ISIS set up its *vilayat* (branch) in the Caucasus. However, it is still unclear what the consequences of this recognition might be. In December 2015, the Federal Security Service's Director Alexander Bortnikov stated that out of the 26 leaders of groups in the North Caucasus that have taken an oath to the ISIS, 20 had been killed in 2015<sup>1</sup>.

Nevertheless, the currently receding violence can hardly be considered as a legitimate reason for conceited self-satisfaction. It is evident that under the influence of ISIS ideology, and also as a form of popular response to the wholesale resort to force by law enforcers, the hidden radicalization of the believers is an ongoing process. In 2015, armed attacks on the civilian population, with casualties, once again became a fact of life, and such incidents are most typically reported in the south of Dagestan, and particularly in Derbent, where a group of tourists came under fire, which claimed the life of one person and wounded another eleven. The information on counter-terrorist operations in Kabardino-Balkaria began to appear with increasing frequency. Besides, in response to the interference of the Russian Federation in the Syrian conflict, a number of prominent radical preachers declared *jihad* against Russia; there were calls for Muslims not to go to Syria, but to fight in the Caucasus. So far, it is difficult to make any definite conclusions as to the seriousness of this new factor (according to available evidence, radicalized young people still cherish the hope of departing to Syria. However, it is clearly not conducive to any improvement in the existing state of affairs.

It is against this background that the onset of the dramatic conflict around the so-called Salafi mosques began in Dagestan and Ingushetia.

The first manifestation of that conflict was the confrontation in the Nasyr-Kort mosque in early June 2015. Nasyr-Kort is the name of a large village that has become a suburban district of Nazran, the capital of the Republic of Ingushetia. The imam of that mosque is Khamzat

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<sup>1</sup> See <http://www.kavkaz-uzel.ru/articles/277423/>.

Chumakov, a religious leader who has gained popularity across the entire North Caucasus. He is famous not only for his criticism of Sufi religious rites, but also because in his sermons he speaks about acute social issues and criticizes the authorities for their failure to provide proper protection to the poorer and socially vulnerable strata of the population.

The direct trigger of the conflict was the purely theological issue of the difference between Sufi and Salafi rites. After an international theological conference, where some globally acclaimed Muslim theorists sided with Chumakov, and not with the Ingush *Mufti*, the Salafi Imam took a tough standpoint, and so an attempt was made to dismiss him from his post, to be replaced by somebody who would be loyal to the *Muftiyat*. In spite of the special measures that had been planned in advance in order to prevent violence, a fight took place inside the mosque, and gunshots rang in its courtyard. Obviously, the confrontation resulted from some deeper-rooted controversies in Ingush society that go far beyond the minor theological issue that had actually triggered it, and with regard to which the Salafi imam was prepared to take a more relaxed attitude (and this is what happened later on).

This incident deeply shocked Ingush public. Various civil organizations immediately got actively involved in deescalating the conflict. On June 10, a roundtable was held at Magas by the Cultural and Educational Center *Ezdel*, the Non-governmental Organizations Coordination Council and the Ingush Regional Branch of the Russian Red Cross, its theme being 'The Role of Non-governmental Organizations in Consolidating Ingush Society'. At the end of the discussion, the roundtable participants called to each side in the conflict not to resort to the use of force and to start a dialogue in order to settle the disputed issues. Head of the Republic of Ingushetia Yunus-bek Yevkurov, who had promptly condemned the conflict at the mosque, was for some time uncertain as to which measures were actually necessary for its resolution, and he even put forth the idea that the mosque should be closed down until the situation returned to normal. However, a few days after the conflict, he himself took part in *Jummu'ah* (*Friday Prayer*) at the Nasyr-Kort mosque, where all had become peaceful by then. So the conflict receded for the time being. But this was the end of the matter.

In late December 2015, the head of Ingushetia called for the *mufti* to leave his post, and for the *Muftiyat* to cooperate with the representatives of all Muslim groups, to abstain from dividing the community into 'friends' and 'enemies', and to work towards consolidation of Ingush society. He also emphasized the necessity to transfer the functions associated with the organization of *hajj* (pilgrimages to Mecca and Medina) from the *Muftiyat* to a body subordinated to the government of Ingushetia in order to rule out any speculations about corruption schemes being applied in the relevant procedures. A few days later, an assistant adviser on religious issues to the head of Ingushetia was appointed, who belonged to the same *taip* as the republic's *mufti*. He was assigned the task of creating an Administration for Religious Affairs.

However, the *mufti* (who had been previously supported by Yevkurov during his second electoral campaign) refused to resign, pointing out that the *Muftiyat* was independent of the civilian government. Moreover, he effectively turned for help to the head of neighboring Chechnya, Ramzan Kadyrov. On 29 December, the Spiritual Directory of Muslims in the Chechen Republic held a meeting of the religious activists of Chechnya and Ingushetia, whose goal was to denounce the legitimacy of any religious current deemed to be an alternative to Sufism; the followers of such currents were dubbed 'preudo-Salafis'. In his speech at the meeting, Ramzan Kadyrov resorted to threats and personal accusations aimed against some eminent Salafi imams in Ingushetia, as well as gave a promise to fight *Wahhabism* across the entire North Caucasus,

if the authorities of other North Caucasian republics are not sufficiently active and vigorous in this respect.

It should be noted that the 'wave' of transition, over period 2009–2012, from the pure use-of-force scenario to attempts at civil appeasement bypassed the territory of Chechnya. Here, the monopoly of the *Qadiriyya* (a Sufi order [tariqa]) is fully supported by the authorities, and the struggle against *Wahhabis* (the name being applied to everybody who is critical of Sufism and the Chechen authorities) is constantly being proclaimed as one of the top priorities of the republic's leaders. As a result, Chechnya has become the natural center of attraction for all those who are against religious tolerance and resort to the use of force in dealing with all theological issues.

In this particular case, the situation is further complicated by the rather chilly relationship between the leaders of Ingushetia and Chechnya, which becomes manifest now and then in connection with various issues. Because of this, the *mufti's* call to the Chechen authorities was viewed by certain groups in Ingushetia not just as the next phase in a religious conflict, but as a betrayal of their ethnic interests, Kadyrov's tough stance with regard to Salafis in the North Caucasus as his interference with the affairs of a neighboring republic.

So far, no solution to the conflict has been achieved. The *mufti* is still in his post. Different political forces in the Republic of Ingushetia publicly voice their various opinions on this issue. Several meetings of Ingush *taips* took place, as many of their eminent representatives had been dragged into the conflict. There was even a suggestion that the leaders of the republic and the *Muftiyat* should simultaneously resign.

The situation in Dagestan has been in no way less dramatic. It all started with an isolated tragic event in the village of Novy Kurush in Khasavyurt district (the village is a big Lezgian enclave with a population of more than 7,000), where on 9 September an imam was murdered. That village can be described as a 'deeply divided community' with two functioning mosques, one of them subordinated to the Spiritual Directory of Muslims, and the other considered to be 'Salafi'. It is the imam of the former mosque that was killed. Two of the village's natives, who had joined the illegal armed groups and then were liquidated in the course of a special operation, were accused of the murder.

It is difficult to reconstruct a veritable picture of these events on the basis of available information. According to some sources, the village was the site of severe conflicts based on religious differences, and the imam who fell victim to this feud had tried to struggle against the Salafi 'heresy'. According to other sources, in spite of the community split and the two mosques, the imam was respected by the village residents, including representatives of the 'enemy camp', because he tried to rely on a well-substantiated dialogue. The imams of the two mosques interacted and joined their forces in dealing with the common issues of rural life (a situation that is not very typical of Dagestan). According to some available information, the two persons accused of the imam's murder had close ties with the village's Salafi community, while in accordance with another version they were born in the village, but at the time had no contacts with its residents.

In any event, the murder of the imam evidently made the situation even more tense. On 22 September, the Salafi mosque in the village was closed down, and its imam and 20 members of the congregation arrested. The mosque was closed down by force: its doors were welded shut, and the congregation's apparel and the mosque's property, including religious books, was burnt. In all this, the law enforcement agencies took no part.



From late autumn 2015 onwards, the struggle against those mosques that refused to be controlled by official Islamic structures began to spread across the region. In late November, one Salafi mosque (in Kotrov Street in Makhachkala) that was famous not only in Dagestan, but across the entire North Caucasus, was closed down. The process was rather chaotic. Against the background of large-scale detentions of worshipers, the Spiritual Directory of Muslims at first made an attempt to replace the imam of the mosque. This decision immediately sparked mass protests, and the Spiritual Directory backtracked, suggesting to replace the new imam with a person highly respected by both Sufis and Salafis – the Imam of the Central Mosque of Makhachkala, Magomedrasul Saaduev. When the congregation rejected his candidature, the Spiritual Directory of Muslims washed its hands of the matter and announced that the replacement of the imam had been caused not by its intention to establish control over the mosque, but by the threats of the law enforcement structures that otherwise they would close down the mosque. The law enforcers were true to their word, and in two day's time the mosque was closed down and has not been reopened since then.

The closure of the mosque in Kotrov Street has not resulted in active opposition on the part of the Muslim community of Makhachkala. It can be assumed that there were two main reasons for this. Firstly, according to a number of Islamic activists who shared their opinion of this issue with the authors, at that time the mosque's congregation was engulfed in a severe crisis. Mosque activists had isolated themselves from the rank-and-file worshipers, and the congregation as a whole was deeply divided and fragmented. To make matters worse, the mosque had not had a permanent imam for quite a long time. Secondly, there were (and still are) plenty of other mosques in Makhachkala that could be attended by representatives of non-traditional Islam. The most well-known of them is the mosque in Hungarian Fighters Street. Although this mosque and its imam were also subjected to pressure and threats, this house of worship is still smoothly functioning.

The events in Kortov Street had their direct continuation in a new round of Salafis mosque-closures which began in early 2016. On 29 January, a mosque in the settlement of Shamkhal (a sub-municipality of Makhachkala) was forcibly closed down. On 31 January, came the turn of the so-called North Mosque in Khasavyurt, one of the Salafis mosques, whose imam had been detained in December 2015 (it is widely believed in Dagestan that charges against him were fabricated). As in the case with the Novyi Kurush mosque, the entrance door of the mosque was welded shut, under the pretext that the application for permission to hold religious services at the mosque had been improperly composed. It turned out later that all the relevant documents and applications were composed absolutely properly. According to available information, the imams of the other Salafi mosques in this area also came under pressure to stop their activities in both Khasavyurt and the nearby districts.

In contrast with the closure of the mosque in Kotrov Street, the situation in Khasavyurt was met by an active response from the worshipers. On 1 February, between 5,000 and 8,000 people (mostly young) took to the streets. They headed towards the town administration Khasavyurt, and the ensuing negotiations ended in the keys of the mosque being handed back to the community. The demonstration was not marked by any criminal incidents. Meanwhile, in Makhachkala the editorial office of the *Chernovik* Newspaper hosted a roundtable with the participation of religious activists, representatives of the public and journalists, who discussed the issue of the closed mosque. The participants urged all the sides in the conflict to settle their disagreements by way of a peaceful dialogue, and not in the form of a violent confrontation.

While this text was being prepared, the conflict around the closure of mosques refocused on Derbent, where accusations were brought against one of the local imams, and the law enforcement agencies there prevent the congregation from gathering in the mosque where he had performed *salah*.

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So, what are the *conclusions* that can be made on the basis of our analysis?

*Firstly*, attacks on Salafi mosques take place under the following conditions:

- the use-of-force scenario applied recently in the struggle against non-traditional Islam appears to be successful, because the incidence of terrorist attacks and the number of their victims plunged sharply (although it is by no means evident that this trend will persist throughout 2016);
- increasing concerns are associated with the outflow of young people to the war in Syria, including with the purpose of fighting for the terrorist group Islamic State;
- there exist mosques where the outflow of the members of their congregations and religious activists to Syria, sometimes to join the ISIS, is very intense.

It can be assumed that the closure of such mosques is an effective method of neutralizing those radicals who urge young people to go to Syria. However, in reality the effect of their closure may be quite opposite. Those religious radicals who had been attending those mosques will not disappear into thin air, and the young people who listen to them will hardly go with the wind. But the imams, with their much more moderate attitude, will no longer be able to prevent such recruitment, because it will be taking place in private apartments or in clandestine houses of prayer. And the recruiters will be able to use stronger arguments – the closure of mosques will be relied upon as a precedent that confirms the fact of Muslims being oppressed and prevented from exercising freely their religion.

*Secondly*, such increasingly frequent conflicts evolve into open manifestations of protest, while at the same time remaining peaceful and not translating into acts of violence. Recently, protesters have become better organized and more disciplined (as noted earlier, the demonstration in Khasavyurt proceeded without a single breach of the law). The participants in the conflict are becoming more active in the mass media, and there have been attempts on the part of civil society to act as a mediator in such situations. So, how can these processes be estimated?

On the one hand, the desire to settle the disputed issues peacefully, on the basis of constitutional principles, without hooliganism and plunder is a positive development. It should be noted that the group of Dagestani religious activists who joined the ISIS (and are now responding rather eloquently from its ranks to the current events in the Caucasus) estimated very negatively the outcome of the conflict around the North Mosque: in their opinion, instead of *jihad*, the people meekly followed those who had been calling to cooperation with the ‘authority of the infidels’ in a civil rights framework.

On the other hand, it would have been much better for the authorities to resolve such conflicts in a dialogue mode, by organizing negotiations between representatives of the bodies of state authority, law enforcement agencies and civil society (including the Muslim communities acting within the framework set out by law). To fall into the habit of mass mobilization for protest actions, and moreover, when it leads to success and creates the impression that the only available method of settling any issue would be to get large crowds of no less than 5,000 people out

onto the streets, is a dangerous course, and there are no guarantees that such actions will always remain so well-organized and non-violent.

And *thirdly* and lastly, the recent conflict once again demonstrates that everything that we are witnessing now has not originated solely from the controversies within the Islamic community. Religious conflicts have sometimes been taken advantage of, and sometimes have been purposefully provoked within the framework of those political processes that have been going on in the North Caucasus and elsewhere in Russia. And it should be pointed out that in this context, the forthcoming election of the head of Chechnya is no less (or probably even more) important that the controversies concerning *Jummu'ah (Friday Prayer)* between different Islamic movements.

#### 6.4.2. Local self-government: alterations in regional legislation as risk triggers<sup>1</sup>

One of the vectors of change in the North Caucasus in 2015 was the abolition of direct popular vote in the elections of heads of municipal formations. Very few of the municipal districts, urban districts, urban-type and rural settlements across the North Caucasus are still applying the system of forming the bodies of local self-government (LSG) that envisages that the head of a given administrative entity should be elected by direct popular vote. The most drastic changes in this respect occurred in 2015 in the Republic of Dagestan, where new legislation was adopted whereby a uniform method for forming the bodies of LSG was introduced for the entire region, when only the deputies of rural settlement and urban district assemblies are elected directly by popular vote. That region can serve as an illustration of how the 'rolling back' of direct popular elections to LSG is fraught with significant risks, and so cannot be regarded as a stabilizing factor.

The process of changing the municipal administration system aimed at the unification of methods of forming the bodies of LSG without direct popular election of district heads was launched after the approval, by the People's Assembly of the region, of Law of the Republic of Dagestan of 16 September 2014, No 67 'On the Procedure for the Formation of the Representative Bodies of Municipal Districts of the Republic of Dagestan and for the Election of the Heads of Municipal Formations of the Republic of Dagestan'. By that law, direct popular elections were abolished in all the municipalities across the republic's territory<sup>2</sup>. Then, by Law of the Republic of Dagestan of 16 March 2015, No 26 'On the Introduction of Alterations to Article 2 of the Law of the Republic of Dagestan 'On the Procedure for the Formation of the Representative Bodies of Municipal Districts of the Republic of Dagestan and for the Election of the Heads of Municipal Formations of the Republic of Dagestan', a single procedure for the formation of local self-government bodies was introduced for the entire region, which envisaged that the heads of the administrative bodies of municipal formations should be elected through contest. In accordance with that law, heads of districts and towns are to be elected by the assemblies of rural districts and towns, whose members, in their turn, are selected from among the deputies of the assemblies of rural settlements or urban districts. The assemblies of rural districts and towns may also include the administration heads of rural settlements or urban districts elected

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<sup>1</sup> Author of this section: Kazenin K. – RANEPА.

<sup>2</sup> It should be noted that, according to observers, the hasty adoption of this law was determined by the entry into force of the verdict in the criminal case of Mayor of Mahachkala Said D. Amirov: in order to avoid direct popular election of mayor of Dagestan's capital, the republican authorities had had to legislatively alter the procedure for the formation of LSG bodies before Amirov was officially convicted.

to their posts through contest. It should be noted that the last provision of the regional law is made disputable by the Ruling of the Constitutional Court of the Russian Federation of 1 December 2015, which states that Federal Law of 6 October 2003, No 131-FZ 'On the General Principles of the Organization of Local Self-government in the Russian Federation' does not envisage that the representative body of a municipal district should include the heads of settlements elected by the representative bodies of the corresponding settlements from among the candidates presented by a contest commission in accordance with the results of a contest. Some of the innovations introduced by the new laws have to do with Dagestan's capital Makhachkala, where three urban districts were set up, and it was established that the deputies of the assemblies of these urban districts should elect, from among themselves, the deputies to the city assembly to participate in the procedure of electing the city mayor.

The republic's new legislation was applied in the municipal elections on 13 September 2015. On that day, Dagestan held elections to five town assemblies, to the district assemblies of the city of Makhachkala, and to the assemblies of deputies in all the rural settlements across 37 municipal districts. After the elections, the town assemblies launched the process of appointing through contest the heads of urban administrative bodies, while the assemblies of deputies in rural settlements and the district assemblies of cities and towns began to elect, from among themselves, the deputies to rural district assemblies or town/city assemblies. The latter, in their turn, were to take part, at a later stage, in the appointment through contest of the heads of administrative bodies of their rural districts or towns.

As of the end of 2015, the process of forming the bodies of local self-government in accordance with the new procedure had still not been completed in some of the municipal and urban districts. However, the progress of that campaign as a whole has led to a number of conclusions as to the consequences of the changes in the region's LSG system. *The main consequences* may be summed up as follows:

1. There was a further decline in the personnel stability in the system of local self-government. In a number of Dagestan's towns, for the period until the head of a town was elected through contest, the Head of Dagestan appointed an acting head thereof. In conditions when the decision on the candidacy for head of a town is rendered by a contest commission, where the regional authorities have considerable powers, the appointment, by the decree of the region's head, of one or other official to the position of acting head of a town, there is a high probability that this official will be supported by the regional authorities in the framework of the contest commission. Accordingly, each of the appointed acting heads of towns was always seen as a *de facto* head of the corresponding town whose appointment to this position was practically guaranteed. The appointee would then begin reappointments to positions controlled by the urban self-government, local businesses would begin establishing informal relations with him... and then suddenly he would be replaced as acting head of the town by another official. It is obvious that this situation inevitably resulted in an unpredictable situation at the municipal level. If the heads of towns were to be elected by popular vote, such destabilizing scenarios would be far less possible because nobody's election to this post would be seen in advance as guaranteed and predetermined.
2. The opponents of the elected district and urban administrations have got a good reason for claiming that their election was illegitimate because the urban or district assemblies that elected them included the heads of village or urban district administrations, who had been elected through contest, which, according to the RF Constitutional Court, is not envisaged

- by federal legislation. Such claims have already been made, which adds a new element of instability into the LSG system.
3. Some difficulties are associated with the distribution of powers between town and urban districts administrations. As far as the city of Makhachkala is concerned, by the end of 2015 the republic's normative acts had been adopted, whereby the distribution of tax-generated and non-tax revenues between the city budget and the budgets of the urban districts inside a city are regulated. However, no normative acts to regulate the distribution of property between the bodies of local self-government at the city and district levels were adopted. No uniform approach have been elaborated, to be relied upon in preparing such normative acts. The general uncertainty of the municipal property issue is by no means the only negative feature of the current state of affairs. At present, a number of land disputes have remained unresolved in the territory of Makhachkala; one of the sides in that conflict is represented by the residents of those rural settlements that became part of the city in the last years of the Soviet era or after the collapse of the USSR. The conflict has arisen because the residents demand the allotment to them, for private housing construction, of those plots of land that had been assigned to the settlements to be used as agricultural land before each of the settlements was included in the city territory. Some of these conflicts are very acute, and have a political resonance at the regional level. At present, there is a risk that tensions related to these conflicts may increase due to the stalemate situation, when lands ownership rights are not delineated between the district and urban self-governments, and so the residents of settlements have nobody to apply to in search of a solution.
  4. The perpetually present risks of violence in the struggle for influence in the municipalities. One of the examples of this phenomenon is the situation in the town of Buinaksk (63,000 residents), where the town assembly election in September 2015 was won by the opponents of the then head of this town. After all attempts to reach a compromise over the candidature of head of the town turned out to be fruitless, the conflict of interests spilled over into the streets, where a series of non-sanctioned rallies took place with the participation of 'opposition' deputies. In the course of these rallies, demonstrators repeatedly clashed with law enforcers. It can be said with confidence that the main argument against heads of municipal formations being elected by direct popular election – the risk of violent incidents and the risk of general destabilization accompanying such elections – has proven groundless, because such risks have remained high in the course of the struggle for power in the municipalities in spite of cancellation of direct popular vote.

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Thus, the example of the Republic of Dagestan shows that the changes in the system of LSG formation introduced in 2015 in the republics of North Caucasus are not conducive to the achievement of the goals set by the initiators of those changes - namely, the strengthening of the socio-political stability at the municipal level, and the minimization of the risks of violent confrontations and manifestations of extremism in the course of struggle for seats in LSG bodies. As a matter of fact, the first experience of LSG-bodies formation under the new system was far from being devoid of conflicts between contenders for positions in LSG. Moreover, it exerted a negative impact on the course of a number of conflicts that were not directly related to local self-government. On the whole, last year has shown that the trend towards decreasing the role of direct popular vote in LSG formation in the North Caucasus is fraught with negative consequences.

## 6.5. Military economics and military reform in Russia

Unlike previous years, the findings of analysis of Russia's military economics and policy in 2015 fail to match what is perceived as absolute peacetime. The IISS, a world-leading authority on global security,<sup>1</sup> argues that Russia is conducting a so-called hybrid warfare. The published views of western experts on hybrid warfare reflect the events occurred in Ukraine over the last two years.

The spring of 2015 saw changes in accusations against Russia following Russia's air strikes and cruise missiles strikes on the positions of ISIS terrorists in Syria. The fact that Russia is conducting special-purpose military operations is indisputable. Russia took the terrorist attack that brought down the Russian plane in Egypt, killing all 224 Russian passengers on board, as military assault against Russia's nationals, thus forcing Russia to introduce retaliatory military counteractions against not only the ISIS in Syria but also against organizers and sponsors of terrorism. Later there were acts of terrorism in France, that prompted the French government to join the war against the ISIS, acting in conjunction with Russia and with a few other countries. Being unhappy with these developments, the Turkish government prepared the shoot down of a Russian military jet along the Syrian border. Russia responded with economic countersanctions, warning more sanctions could follow. Therefore, it appears logical that a new version of the Russian Federation National Security Strategy (Executive Order of the President No. 683 dated December 31, 2015) was approved on the very last day of 2015.

### 6.5.1. Economic and political preconditions for new type of warfare<sup>2</sup>

The born of a new era of warfare has in recent decades been in the focus of military-political and military-science experts. The new warfare differ basically from the old warfare in the military application of latest scientific and technical achievements basically in the field of informatics, telecommunications, cybernetics, as well as social psychology, etc. Traditional methods of waging and carrying on wars are passing. Following the first brand new war of 1991 (against Iraq), military specialists began to talk about their understanding the novelty of such wars. The focus was first of all placed on the "non-contact" nature of military operations<sup>3</sup> conducted over great distances. Later it turned out that there is much more novelty in new-type wars, especially regarding the waging, conduct and the outcome of such wars.

Specialists distinguish the information aspect which they call information warfare (IW) as the principal characteristic of modern warfare, whereas information security is viewed as a countermeasure. The second specific feature is deliberate chaotization of social relations, the involvement of paramilitary forces, private military corporations in the warfare, and turning a well-ordered peace-time situation into a so-called "controlled chaos".

Russia's Information Security Doctrine has been in effect since 2000, the provisions thereof were recognized in the Russian Federation National Security Strategy in 2010 and enhanced in the updated version thereof. Information security is considered a pressing issue in other countries, too. A new "Cyber" section has recently been added to the Military Balance's traditional sections that describe the state of armed forces and branches, combat power (missiles, air jets, tanks, etc.). The section contains data on national military capabilities in the cyberspace and, broadly speaking, in the information domain.

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<sup>1</sup> Military Balance 2015. London: The International Institute for Strategic Studies, 2015. P. 17.

<sup>2</sup> Author of this section: Tsymbal V. – RANEPА.

<sup>3</sup> Slipchenko V., *Garaev M.* The future of war. M.: OGI (Polit.ru), 2005.

When the new-type warfare became a widespread practice, Russia's Foreign Ministry submitted in 2011 to the UN a draft Convention on International Information Security<sup>1</sup>. It was suggested to limit new (information) weapons and the application thereof similarly to what was done with the application and the spread of nuclear, chemical, biological and other types of weapons of mass destruction (WMD). However, Russia's initiative was not supported, and on July 24, 2013 Russia's President approved the Basic Principles for State Policy of the Russian Federation in the field of International Information Security until 2020<sup>2</sup>.<sup>2</sup> (Note that in 2015 the US military-political leadership agreed to discuss internationally the issues of confrontation in the cyberspace). The above-mentioned official documents of the Russian Federation contain a definition of IW, which is quite useful, although it has not yet been universally accepted. The IW is referred to as "confrontation between two or more states in the information domain with the aim of causing harm to information systems, processes and resources and to other critical units; undermining political, economic and social systems; producing a massive psychological effect on the population in order to destabilize society and the state; and forcing a state to take decisions in the interests of the opposing side". This is forceful *persuasion* of a state by any other state (states) in the interests of the latter that prompts one to consider such confrontation a *war*.

The above-mentioned objective of undermining the economic system is of special interest. Belligerent states had the same objective during past wars, too. However, sanctions have become an efficient tool in modern warfare in the context of globalized economy. Furthermore, Western IW military analysts and practitioners *include sanctions in the list of new warfare means*, as evidenced by a special section of another handbook<sup>3</sup> on the theory and practice of dealing with defense issues.

With such a broad definition of IW, it is difficult to separate the conventional military component from the others, all the more so, because new-type wars tend to begin exclusively in the information domain. Paramilitary forces and troops, less often regular armed forces, enter gradually the confrontation, which is followed by conventional, although limited, warfare with great losses of military personnel and civil population. In this case, it is common to say *information war gives way to hybrid war*. Hybrid warfare (HW) can be a part of a hybrid war. An illustration of new-type warfare is Iraq, Yugoslavia, Livia, etc.

What is most woeful in IW and then HW is floods of misinformation by opposing sides, and lies disguised as truth using unprecedented psychological techniques of massive effect on population, and sophisticated, cutting-edge devices designed to process and deliver information to the population. Of special interest is that new-type wars are normally not declared as such, and most of the work is done by others rather than by the aggressor itself. Any IW is conducted within purportedly peaceful relations with purportedly non-military sanctions.

Considering the above-mentioned opinion of foreign experts, as well as the Russian experts' definition of IW, the following argument can be presented.

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<sup>1</sup> Convention on International Information Security. The concept prepared by the UNSC and Russia's Ministry of Foreign Affairs. 2011. URL: [www.mid.ru/bdcomp/ns-osndoc.nsf/e2f289bea62097f9c325787a](http://www.mid.ru/bdcomp/ns-osndoc.nsf/e2f289bea62097f9c325787a) (accessed date: December 11, 2015).

<sup>2</sup> Basic Principles for State Policy of the Russian Federation in the field of International Information Security until 2020. Executive Order No. 1753 dated July 24, 2013

<sup>3</sup> *Kaempfer W.H., Lowenberg A.D.* The Political Economy of Economic Sanctions // Handbook of Defense Economics. Ch. 27. Vol. 2. Defense in a Globalized World. 2007.

In the modern new-type warfare Russia is confronting the states that imposed economic and political sanctions against Russia, as well as Russia is fighting with organizers of acts of terrorism. Hence it is these states that are opposing Russia in the ongoing IW. And the new version of the Russian Federation National Security Strategy for the first time named the United States and NATO and the ISIS as a threat to Russia. Russia imposed similar countersanctions against the states that joined sanctions against Russia, whereas Russia is using means of armed fight against those who use arms.

Indeed, the term “war” appears to be extremely violent, therefore, while using this term one should name all the opposing sides and point to the fact that in this war (IW and HW) Russia is fighting for its political and social-economic interests. In this war Russia is countering an adverse effect of political, financial, economic and other sanctions that are used as special means in the confrontation.

#### 6.5.2. Information-related aspect of defense control<sup>1</sup>

Absolute domination of information technologies and means of information as mainstay of new-generation warfare prompted the development of means of information. Short-term experience in the new-type warfare shows that the mankind surprisingly easily reacted to the way IW-aggressors used information to “brainwash” their victims. Quasi-independent mass media unexpectedly pooled their efforts in “attacking” not only target-countries but also the global community as a whole. And similar quasi-independent IT companies arranged data exchange networks in the cyberspace beyond the government control, thus operating against lawful authorities. One may recall the information “tsunami” that covered the world when IW was waged against Yugoslavia, Iraq, Libya, etc.

The same holds true for Russia. The Russians were exposed to the same effect more than once: in 2008, when a strike on Russia’s peacekeeping forces was followed by Georgia’s military operation in South Ossetia; in 2014, following the coup in Ukraine and the referendum in Crimea; in the fall of 2015, when Russia joined the fight against the ISIS in Syria. One can only guess what kind of methods and means were used to pool efforts of numerous mass media to meet the demand of initiators of each new IW.

Note that economic aspects of military and security agencies’ operations aimed at not only intelligence and counterintelligence but also at propaganda were always confidential. At the same time, the necessity and utility of financial investment in the field of informatics and cybernetics became apparent when the National Defense Control Center of the Russian Federation (NDCC) was established by the end of 2014 and upgraded in 2015. The establishment of the NDCC has proved its value.

First, the cross-sectoral exchange of military-economic data has been streamlined substantially in Russia. “Federal executive authorities and organizations send daily more than thousand information arrays to the National Defense Control Center. The data exchange has tripled over the recent period”, said Head of NDCC general Mizintsev at a meeting with members of the Defense Ministry Public Council.<sup>2</sup> The NDCC sends to mass media official information on Russia’s defense activities. Second, efficiently coordinated control from the NDCC by combined efforts of military and top non-military (local) government authorities, as well as troops

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<sup>1</sup> Author of this section: Tsymbal V. – RANEPА.

<sup>2</sup> URL: <http://www.mk.ru/politics/2015/10/20/obshhestvennyy-sovet-pomogaet-shoygu-navesti-poryadok.html>



(forces) of various armed forces' services and branches, including representatives of other states, was tested during military drills.

Third, the system of military logistics and of supply, jointly with the EMERCOM, of vital goods to the Donetsk and Lugansk People's Republics ran flawlessly. This was performed in cooperation with OSCE representatives. A more sophisticated system was put into operation in the fall of 2015, designed to deliver and deploy in Syria military personnel, equipment and means of armed fight with the so-called ISIS. At the same time, the issues of ensuring cooperation with the Syrian military command authorities and coordination of Russia's forces with the forces of other states involved in fighting against terrorists were tackled successfully.

Forth, what is most important and unusual for military command authorities is that the NDCC helps to implement the idea of end-to-end supervision of all stages of financing, production and delivery of military products while the State Defense Order (SDO) is implemented pursuant to the new Federal Law on the SDO. Quarterly holding of the single day of acceptance of military products was put into practice. In particular, summarizing the outcomes of Q3 2015, Russia's Defense Minister Sergey Shoigu noted "we have learned how to commission facilities and how to supply equipment on a rhythmic basis throughout the entire year, thus avoiding the year-end rush that affected seriously the quality of supplied products and hence their acceptance and distribution in the armed forces".<sup>1</sup>

Since new-type wars, as noted above, are attended with floods of misinformation, the NDCC and the administration of public mass media are seeking to ensure that information is credible. For example, the information on air strikes on ISIS positions in Syria is communicated to all the mass media, specifying the source of such information and not citing unspecified "evidence" from unidentified "witnesses". Summarizing the analysis of information-related aspects of IW, note that from the military-theoretical point of view the world community is witnessing a fight between the initiators of a new global IW and Russia. To win the fight, it is critical not to simplify Russia's actions, and to avoid the news-release technique that withholds the real military capacity of the ISIS and of other opponents of Russia.

### 6.5.3. Military-technical procurement of armed forces<sup>2</sup>

There are two main lines of military-technical procurement of Russia's Armed Forces that have been identified.

On the one hand, the mounting threat that the United States and NATO might have the so-called Prompt Global Strike and the Pan-European ABM System has prompted Russia to keep up its nuclear deterrent capabilities which have had to be given priority. Not incidentally, President Putin at the Defense Ministry Board held on the eve of 2015 stressed upon the need to complete a plan of Russian Federation defense and development of strategic nuclear forces (SNF) as "a factor of maintaining the global equilibrium", excluding the "possibility of major aggression against the Russian Federation".<sup>3</sup> The defense plan was approved as instructed by the President, and Russia's SNF were equipped with more than 50 intercontinental ballistic missiles. In addition, Russia embarked on modernization of its missile carrying bombers fleet including TU-160 and TU-95MS, and put on combat duty the project 955A Borei-class nuclear-powered submarines Vladimir Monomakh and Alexander Nevsky. In addition to this, a new branch of Russia's Armed Forces – Airspace Forces (VKS) – was established in 2015, embracing

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<sup>1</sup> URL: [http://function.mil.ru/news\\_page/country/more.htm?id=12060449@egNews](http://function.mil.ru/news_page/country/more.htm?id=12060449@egNews).

<sup>2</sup> Author of this section: Tsymbal V. – RANEPА.

<sup>3</sup> *Safronov I.* Armed Forces aimed to targets // Kommersant. December 20, 2014.

the air force, airspace and air defense forces. VKS's combat effectiveness was crucial not only in tactical military operations against the ISIS, but also in showing combat capability of the military deterrent forces. On the other hand, the military drill experience and, most importantly, the specifics of military operations against terrorists in Syria prompted the development of operative-tactical means of combat, especially extra supply of tactical precision-guided weapons to destroy ISIS combat control centers and arsenals of weapons. A positive thing regarding this aspect of armament is that the NDCC demonstrated and mass media retranslated the successful employment of guided aircraft missiles, especially X-29 and 500 and 1500 kg caliber guided air bombs. In terms of IW, the facts of employing Russia's precision-guided weapons as well as the facts of rational unification of means of combat, cost-efficiency of their modular design were perhaps more important than the damage they delivered to the ISIS. It appeared that the data on the employment of these weapons were reasonably declassified. The demonstration of the employment of VKS to enhance fire and radio-electronic support of the Syrian ground forces is also useful but less efficient.

It is very important that Russia's actions in Syria proved high efficiency of electronic warfare weapons (EWW) as a key factor of confrontation typical of IW and HW. Adding to the efficient employment of air-based EWW in "forcing" US combat ships to leave some waters of the Black Sea in 2014, which was reported by Russia's mass media,<sup>1</sup> was the well-timed demonstration of the efficiency of Russia's modern warplane IL-20 ELINT (Electronic Intelligence platform) and EWW in Syria.

It appears that such "victories" in the IW are more illustrative than, e.g., the provision of summarized data for Russia and the global community. For example, the fact that "more than 3,000 state contracts have been concluded this year, whereby the armed forces have received more than 17,000 pieces of standard armament, military and special-purpose equipment", as a result of which "the armed forces armament with cutting-edge weapons and military equipment under the 2015 SDO has already reached the parameters planned only for the current year". General data of the armed forces rearmament amid IW are important but they are poorly digested even by military economists.<sup>2</sup>

In addition, Russia's mass media information on increasing stockpiles of precision-guided weapons in Russia's Armed Forces is effective in terms of IW. An information published by *Kommersant-Vlast* with reference to a source in the Military Industrial Complex<sup>3</sup> noted explicitly that Tactical Missiles Corporation, a Russian joint stock company, switched to a three-shift work schedule due to an increase in demand for arms delivery for the military operation in Syria.

It is difficult to say how the IW and HW events reflect the parameters of the new State Armaments Program, but the critique of heavy military spending at the expense of socio-economic spending appears to be reasonable not only because a military effect thereof is not obvious. The point is that there has been found no evidence of fulfilling the promise to turn military spending into a driver for the development of the national economy as a whole and the non-military sector thereof.

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<sup>1</sup> *Bozhyeva O.* The 6th generation war: how we jam hostile radars, satellites and computers. *Moskovskiy Komsolets*. January 8, 2015.

<sup>2</sup> *Vzglyad* dated October 28, 2015 URL: <http://vz.ru/news/2015/10/26/774510.html>

<sup>3</sup> URL: [http://ria.ru/defense\\_safety/20151026/1308245566.html#ixzz3pf4jP87v](http://ria.ru/defense_safety/20151026/1308245566.html#ixzz3pf4jP87v)

#### 6.5.4. Recruitment policy<sup>1</sup>

In our previous reviews we wrote about the issues of the recruitment policy, facing Russia's armed forces; in particular, complete abandonment of peacetime conscription. While the idea of voluntary military service is still pressing, the context was changed after the onset of IW and HW. It appears that the complete abandonment of conscription has to be postponed.

It is extremely important that the nature and terms of one-year conscription have been improved dramatically. Moreover, non-military higher school students have an opportunity to obtain military skills at senior divisions while keeping up the quality of civil education.

The enlistment rate of new contracted military personnel in the armed forces is satisfactory (54,000 persons in 2015), and "the total number of contracted military personnel has recently increased 327,000 persons", noted the Head of NDCC at the above-mentioned meeting.

The Russian government have achieved notable results in providing military personnel with all types of allowances. Even in 2015, despite difficulties due to sanctions, the government managed to compensate in part servicemen and retired military personnel for the fall of living standards. In 2015, the issue of housing provision in Russia's armed forces and other military and security forces was nearly tackled. The system of housing provision management was re-organized with success, which previously comprised about 3,500 full-time managers and above 6,000 members of various commissions, and the central Department for Housing Provision was established with local branches located in each military district, as well as its cells were established in Kazakhstan and Tajikistan. The new system is comprised of about 700 managers, and Alushta software designed in 2011 is employed for real-time unified recordkeeping of all the military personnel in need of housing, and of all the housing stock. It took these bodies five years to tackle housing issues facing about 300,000 families. The number of persons in need of housing dropped from 82,000 to 34,000, with new military personnel being enlisted every year (up to 50,000 families). Furthermore, all the options of housing provision suitable for military personnel still remain in force. At the same time, outlooks were updated: Russia will have a single procedure for housing provision via the savings and mortgage system beyond 2024. Previously, all the military personnel who signed their first military service contract after January 1, 2008, including graduates from military higher schools, were covered on a mandatory basis by the savings and mortgage system.

As noted at a meeting of the NDCC management with the Defense Ministry Board, military service is acquiring more prestige and popularity, as evidenced by the fact that "over the past three years the armed forces have seen the situation with higher military schools change from shortage of applicants to an enrollment competition of 3 to 10 applicants per place this year". Furthermore, not only was military training of students resumed, but it was also focused on new needs. In particular, a well-equipped cadet ITC school for gifted children was opened under the auspices of the Budenny Military Academy of Communications in St. Petersburg.

The disciplinary practice will be enhanced by the establishment of military police in Russia. The legal framework is based on Federal Law "On amendments to certain legal acts of the Russian Federation regarding the military policy in the Armed Forces of the Russian Federation" No. 7-FZ dated February 3, 2014. The Federal Law stipulates the rights and tasks of the military police. A Military Police Charter governing the military police's key duties, functions and powers was approved by the Executive Order of the President, which was signed in late March 2015.

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<sup>1</sup> Author of this section: Tsymbal V. – RANEPА.

#### 6.5.5. Reform to implement the state defense order<sup>1</sup>

The standoff qualified as specific (information) warfare at the international level, which has entered the stage of hybrid warfare, has resulted in the growing need for (high-accuracy, technologically sophisticated and expensive) warfare means. Naturally, efficient spending of state budget funds has become most pressing issue in this context.

In his 2015 annual state-of-the-nation address to the Federal Assembly, Russia's President noted that "misuse of state budget funds allocated for the purpose of implementing the State Defense Order is posing a direct threat to the national security of the state"; therefore, the President instructed to develop a system of strict monitoring of the proper use of SDO funds. A interdepartmental system of this kind was established in Russia. "A new interdepartmental control system comprises a set of interrelated elements such as the single unique state order number across the entire chain of SDO settlements, and the opening by all the contractors of special bank accounts with authorized banks which have become full-fledged parties to the monitoring of proper use of state budget funds", noted Deputy Minister of Defense Tatiana Shevtsova.<sup>2</sup> Hopefully, this will "color" the cash flow allocated for implementing the SDO, separating it (the cash flow) from the rest of the monies held by an enterprise, as well as this will ensure that cash flows are transparent across the entire chain of contractors. Pursuant to the SDO law, the Ministry of Defense has established a single information system of SDO settlements for analyzing the data for SDO settlements. As a reminder, the SDO implementation monitoring has become one of the NDCC's key functions. A list of operations prohibited for specific accounts has become the key tool of preventing misuse of SDO funds. Authorized banks will conduct the compliance monitoring. All in all, this package of measures is assumed to tame corruption within the SDO framework.

#### 6.5.6. Military-financial policy<sup>3</sup>

In 2015, unlike the previous year, the federal budget was executed using more than a single intra-year adjustment, and the federal budget law was updated three times in the period between April and November.<sup>4</sup> Originally, the 2015 federal budget law allocated Rb 3 trillion 274bn of under the National Defense budget function,<sup>5</sup> an increase of Rb 247bn over the amount planned by the government a year earlier<sup>6</sup>. In April and July, allocations under the same budget function were cut to Rb3 trillion 108bn, but in November they were up to Rb 3 trillion 163.8bn (3.9% of GDP). In real terms, the allocations under the same budget function increased 19% (28% in nominal terms) over 2014.

All the foregoing military expenditure are not included into the published laws and are recognized under explanatory notes to the draft budget laws and to the federal budget laws. The transparency of the 2015 federal budget expenditure continued to worsen, exceeding the highest

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<sup>1</sup> Author of this section: Tsymbal V. – RANEPА.

<sup>2</sup> URL: [http://function.mil.ru/news\\_page/country/more.htm?id=12044981@egNews](http://function.mil.ru/news_page/country/more.htm?id=12044981@egNews).

<sup>3</sup> Author of this section: Zatsepin V. – RANEPА.

<sup>4</sup> Federal Law "On the Federal Budget for 2015 and the Planning Period of 2016 and 2017" No. 384-FZ dated December 1, 2014, which was amended by Federal Laws No. 93-FZ dated April 20, 2015, No. 211-FZ dated July 13, 2015 and No. 329-FZ dated November 28, 2015.

<sup>5</sup> "Budget of individuals" to the Federal Law "On the Federal Budget for 2015 and the Planning Period of 2016 and 2017". Moscow. December 2014, p. 8.

<sup>6</sup> The Council of the Federation Committee on Defense and Security's report on Federal Law "On the Federal Budget for 2014 and the Planning Period of 2015 and 2016" No. 3.3-04/1891 dated November 26, 2013.

level of 2014 by 4.2 percentage points while confidential expenditure stood at Rb 2 trillion 980bn (3.7% of GDP, 19.1% of the federal budget expenditure as a whole).

*Table 18* presents absolute and relative values of the key components of direct military expenditure in the 2015 federal budget, including the change in real terms over 2014, which are based on Federal Treasury's reports. Conversion into the 2014 prices was performed using Russtat's second estimation<sup>1</sup> of the 2015 GDP deflator index (107.7%).

*Table 18*

**Federal budget direct military expenditure under 'National Defense'  
budget function in 2015**

Function and subfunctions	2015, rubles in millions/ same in 2014 prices	Changes in 2015 over 2014, rubles in millions/ growth, %	Share of allocations, % / changes from 2014, percentage points	
			of 2015 federal budget	of GDP
NATIONAL DEFENSE	3.181.367 2.953.915	474.841 19.15	20.38 3.66	3.94 0.75
Armed Forces of the Russian Federation	2.432.905 2.258.964	373.105 19.78	15.58 2.87	3.01 0.59
Mobilization and paramilitary training	6.296 5.845	-616 -9.53	0.04 -	0.01 -
Mobilization preparation of economy	4.020 3.733	-218 -5.53	0.03 -	<0.01 -
Nuclear-weapons complex	44.385 41.212	4.495 12.24	0.28 0.04	0.05 0.01
International obligations in military- technical cooperation	10.325 9.587	3.123 48.30	0.07 0.02	0.01 -
Applied research in the field of national defense	318.521 295.749	51.112 20.89	2.04 0.39	0.39 0.08
Other matters pertaining to national de- fense	364.914 338.825	43.840 14.86	2.34 0.35	0.45 0.07

*Source:* own calculations.

Military expenditure under other federal budget sections are presented in *Table 19*. Expenditure for civil defense and for the EMERCOM troops are not included into the military expenditure under other budget functions due to changes in the UN military expenditure reporting standards that have been in effect since 2012.<sup>2</sup>

*Table 19*

**Direct and indirect military expenditure under other federal budget  
functions in 2015**

Subfunction, target function or type of expenditure	2015, rubles in millions/ same in 2014 prices	Changes in 2015 from 2014, rubles in millions/ growth, %	Share of expenditure, % / changes from 2014, percentage points	
			of 2015 federal budget	of GDP
1	2	3	4	5
<b>Nationwide matters</b>				
<i>Defense Ministry Expenditures</i>	8 7	1 17.62	<0.01 -	<0.01 -
<b>National Security and Law Enforcement</b>				
Interior Troops	120.525 112.909	-16.733 -13.01	0.77 -0.10	0.15 -0.02
Border Troops	136.709 127,935	-15.681 -11.00	0.88 -0.09	0.17 -0.01

<sup>1</sup> Concerning the production and usage of the 2015 gross domestic product (GDP). M.: Rosstat. April 1, 2016.

<sup>2</sup> The government expert group's report on the overview of functioning and further development of the United Nations system for the standardized reporting on military expenditure. A/66/89. UN, June 14, 2011.

1	2	3	4	5
<b>National Economy</b>				
Organization of alternative civil service	<u>2</u> 1	<u>&lt;1</u> 8.49	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
Presidential program "Destruction of chemical weapons stockpiles in the Russian Federation"	<u>464</u> 431	<u>7</u> 1.73	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
Subsidies to transport organizations purchasing motor vehicles to increase the military convoy rolling stock	<u>38</u> 35	<u>-17</u> -33.14	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
Subsidies to the Russia-NATO Coordination Center	<u>35</u> 32	<u>-6</u> -15.01	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
Federal Target Program "Industrial Utilization of weapons and military equipment (2011-2015) and until 2020"	<u>66</u> 61	<u>-17</u> -22.05	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<i>Contributions to charter capital of and subsidies to organizations pertaining to the military-industrial complex</i>	<u>56.760</u> 52.702	<u>13.369</u> 33.99	<u>0.36</u> 0.10	<u>0.07</u> 0.02
Scholarships to young personnel employed by organizations pertaining to the military-industrial complex	<u>237</u> 210	<u>-29</u> -12.21	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<i>Confidential expenditure</i>	<u>128.034</u> 118.880	<u>9.020</u> 8.17	<u>0.82</u> 0.08	<u>0.16</u> 0.02
<b>Housing and Utilities</b>				
<i>Defense Ministry Expenditures</i>	<u>22.479</u> 20.872	<u>-11.207</u> -34.94	<u>0.14</u> -0.07	<u>0.03</u> -0.01
Presidential Program "Destruction of chemical weapons stockpiles in the Russian Federation"	<u>60</u> 55	<u>55</u> -	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<b>Education</b>				
<i>Defense Ministry Expenditures</i>	<u>66.704</u> 61.935	<u>1.371</u> 2.26	<u>0.43</u> 0.02	<u>0.08</u> 0.01
<b>Culture and Cinematography</b>				
<i>Defense Ministry Expenditures</i>	<u>3.009</u> 2.794	<u>50</u> 1.82	<u>0.02</u> -	<u>&lt;0.01</u> -
<b>Healthcare</b>				
<i>Defense Ministry Expenditures</i>	<u>56.407</u> 52.374	<u>-3.874</u> -6.89	<u>0.36</u> -0.02	<u>0.07</u> -
<i>Provision of medicines to ZATO FMBA</i>	<u>86</u> 80	<u>-71</u> -46.89	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<b>Social Policy</b>				
<i>Defense Ministry Expenditures</i>	<u>442.831</u> 392.198	<u>61.892</u> 18.74	<u>2.84</u> 0.61	<u>0.55</u> 0.13
<i>Expenditure for Interior Troops of the Ministry of Internal Affairs and for Border Troops</i>	<u>38.241</u> 33.868	<u>-1.497</u> -4.23	<u>0.24</u> 0.01	<u>0.05</u> -
Material support to specialists employed by the nuclear weapons complex of the Russian Federation	<u>7.172</u> 6.352	<u>-126</u> -1.94	<u>0.05</u> -	<u>0.01</u> -
Repairing individual residential houses owned by military personnel' families who lost their bread-winner	<u>200</u> 186	<u>-39</u> -17.39	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
Military personnel survivor benefits	<u>1.908</u> 1.690	<u>6</u> 0.35	<u>0.01</u> -	<u>&lt;0.01</u> -
One-time pregnancy allowance to spouses of conscripts, as well as monthly child's benefit to conscripts	<u>1.006</u> 891	<u>-158</u> -15.04	<u>0.01</u> -	<u>&lt;0.01</u> -
<b>Physical Culture and Sports</b>				
<i>Defense Ministry Expenditures</i>	<u>4.202</u> 3.902	<u>1.822</u> 87.64	<u>0.03</u> 0.01	<u>0.01</u> -
<b>Mass Media</b>				
<i>Defense Ministry Expenditures</i>	<u>2.280</u> 2.117	<u>51</u> 2.46	<u>0.01</u> -	<u>&lt;0.01</u> -

*Cont'd*

1	2	3	4	5
<b>General Purpose Inter-Budget Transfers to Budgets of the Budget System of the Russian Federation</b>				
Subsidies to budgets of Closed Administrative-Territorial Units (ZATOs)	9.988 9.273	-2.292 -19.82	0.06 -0.01	0.01 -
Relocation of persons from ZATOs	314 292	-209 -41.77	<0.01 -	<0.01 -
OTHER BUDGET FUNCTIONS	1.099.764	43.918	7.04	1.36
TOTAL	1.021.136	4.30	0.46	0.11

Source: own calculations.

As a result, the 2015 total military allocations (see *Table 20*) in Russia's federal budget, that are calculated according to the UN standards for military expenditure, increased 0.9 percentage points GDP over the past year, to 5.3% of GDP.

*Table 20*

### Total military and military related federal budget expenditure in 2015

Expenditures	Amount, rubles in millions	Share of expenditure, % / changes from 2014, percentage points	
		of 2015 federal budget	of GDP
Total military expenditure related to current and previous military operations	4.281.130	27.42 4.12	5.30 0.86
Total expenditure for 'National Defense' and 'National security and law enforcement' budget functions	5.146.977	32.97 2.19	6.37 0.51

Source: own calculations.

In 2015, the peak of expenditure under the 'National Defense' budget function – Rb 1453bn (45.7% of the total allocations under this budget function stipulated in the budget law, an increase of 6.4 percentage points over the amount a year earlier) – was reported again in Q1 (27.4% in Q4). According to the federal budget quarterly breakdown, the highest amount of expenditure (Rb 24bn) over the limit of allocations stipulated under the budget law for this budget function was seen in December. As a result, the expenditure under the 'National Defense' budget function in 2015 were executed with an excess of Rb 17bn 567m over the allocations stipulated in the budget law's latest version. Furthermore, the Ministry of Defense's overdue accounts receivable increased Rb 242bn in 2015.<sup>1</sup>

In 2015, the Ministry of Defense's military personnel costs stood at Rb 429bn 836m (0.53% of GDP), a decline in real terms by 5% on an annualized basis. Military compensation for the conscripted military personnel continued to be Rb 2,000,<sup>2</sup> the average level of military compensation for other military personnel increased Rb 100 over 2014 to Rb 62,200.<sup>3</sup>

Labor costs of the civil personnel of the Ministry of Defense stood at Rb 203bn 722m (0.25% of GDP), a decline in real terms of 14.6% on an annualized basis.

In 2015, the Ministry of Defense's costs on combustibles and lubricants (CL) contracted in real terms by 2.5% year-over-year to Rb 68bn 759m while costs on subsistence support dropped in real terms by 0.8% year-over-year to Rb 53bn 728m. The Ministry of Defense's costs on individual military clothing dropped notably by 27.3% to Rb 26bn 938m, which can be explained by completed change-over to a new military uniform.

<sup>1</sup> Single acceptance day for military products. URL: <http://www.kremlin.ru/events/president/news/51496> (accessed date: March 11, 2016).

<sup>2</sup> Executive Order of the President "Concerning the extension of the term of experiment on cash allowance unification for the conscripted military personnel in the Armed Forces of the Russian Federation" No. 136 dated March 10, 2014.

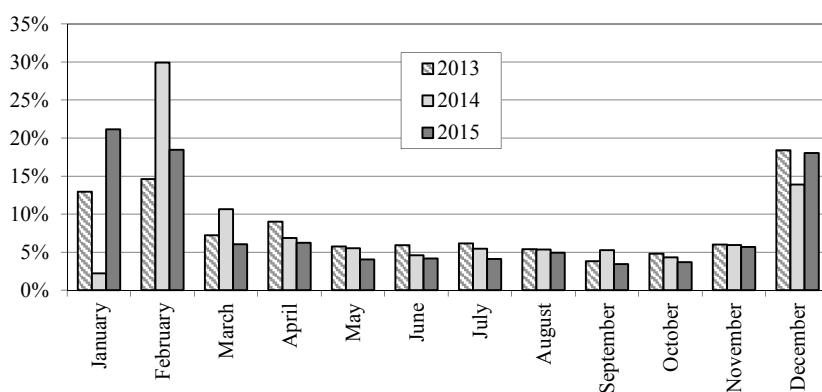
<sup>3</sup> *Falichev O.* Financial Mobilization . Voenno-promyshlenny kurier. February 3, 2016 (No. 3–4).

The Ministry of Defense's capital investment in real estate in 2015 increased 27.3% to Rb 226bn 578m (0.28% of GDP) under the 'National Defense' budget function, an increase of Rb 20bn 407bn, or 9.9% over the amount stipulated in the budget law. The expenditure under the 'Housing and Utilities' budget subfunction contracted by 34.9% to Rb 22bn 479m (0.03% of GDP). The federal budget expenditure for the saving and mortgage system of housing provision for the Ministry of Defense's military personnel contracted in real terms by 3.5% year-over-year to Rb 81bn 547m (0.1% of GDP).

In 2015, the Ministry of Defense spent Rb 305bn 286m (0.38% of GDP) on military personnel retirement pensions, a decrease in real terms by 5.9% on an annualized basis.

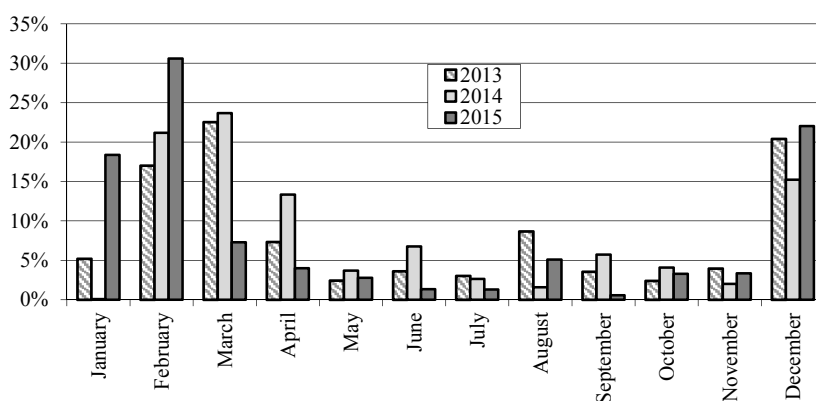
In 2015, the expenditure under 0208 'Applied Research in the Field of National Defense' subfunction were again ranked first in terms of growth rates in 0200 'National Defense' budget function, an increase in nominal terms of 30% year-over-year to Rb 318bn 521m (0.39% of GDP).

The dynamics of expenditure monthly execution under the major subfunctions of 0200 "National Defense" budget function of the federal budget in 2013–2015 is shown in Fig. 14–16.



*Fig. 14.* Federal budget expenditure execution under 'Armed Forces of the Russian Federation' budget function in 2013–2015

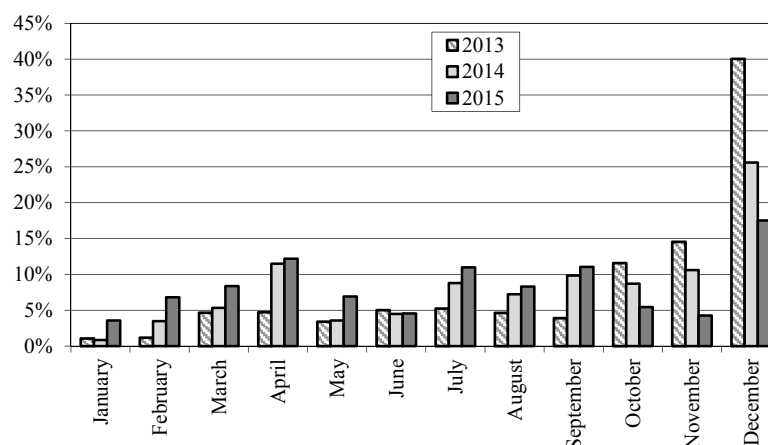
*Source:* own calculations based on the data released by Russia's Federal Treasury.



*Fig. 15.* Federal budget expenditure execution under 'Applied Research in the Field of National Defense' in 2013–2015

*Source:* own calculations based on the data released by Russia's Federal Treasury.





*Fig. 16.* Federal budget expenditure execution under ‘Other Matters Pertaining to National Defense’ budget function in 2013–2015

*Source:* own calculations based on the data released by Russia’s Federal Treasury.

B *Table 21* shows military expenditure of the subjects of the Russian Federation. The expenditure did not exceed 0.01% of GDP, adding about one third to the federal budget mobilization expenditure.

*Table 21*

**Military expenditure of consolidated budgets of subjects of the Russian Federation in 2007–2015, rubles in millions**

Expenditure classification subfunction	2007	2008	2009	2010	2011	2012	2013	2014	2015
Armed Forces of the Russian Federation	0,3	0,3	–	–	–	–	–	–	–
Modernization of Armed Forces of the Russian Federation and military units	–	0,5	–	–	–	–	–	–	–
Mobilization and paramilitary training	1 245,6	1 702,2	2 021,6	1 958,4	2 187,3	2 316,4	2 444,7	2 518,9	2 494,7
Mobilization preparation of economy	840,9	1 063,9	989,7	1 247,8	1 266,3	1 689,1	1 935,1	1 580,9	1 332,6
Other matters pertaining to national defense	5,7	0,5	4,4	<0,1	2,7	3,0	2,9	3,0	16,9
Interior Troops	1,0	0,3	–	–	–	–	–	–	–
Total	2 093,5	2 767,7	3 015,7	3 206,2	3 456,3	4 008,5	4 382,7	4 102,8	3 884,1
Net military expenditure*	2 093,5	2 767,7	3 015,7	3 206,2	1 216,4	1 671,5	1 921,3	1 592,2	1 326,0

\* The difference between executed consolidated budget expenditures and federal budget expenditures.

*Sources:* Russia’s Federal Treasury; Gaidar Institute’s own calculations.

After cessation in 2014 due to international sanctions, granting of state guarantees to MIC organizations to ensure SDO execution was resumed on a very limited basis in 2015: the federal budget provided for granting guarantees worth Rb 26bn, 53% of which remained unallocated.

*Table 22* presents Russia’s military expenditure in the period between 2005 and 2015, which include total net military expenditure of the consolidated budgets of subjects of the Russian Federation (*Table 21*).

Table 22

**Key functions of military expenditure in the Russian Federation in 2005–2015**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
1	2	3	4	5	6	7	8	9	10	11	12
<b>1. In nominal terms (current prices), rubles in billions</b>											
Federal budget allocations under the National Defense budget function: in accordance with the current budget classification	578,4	686,1	839,1	1 031,6	1 192,9	1 278,0	1 537,4	1 846,3	2 111,7	2 470,6	3 163,8
Execution of federal budget expenditures under the National Defense budget function in accordance with the current budget classification <sup>a</sup>	581,1	681,8	831,9	1 040,8	1 188,2	1 276,5	1 516,0	1 812,3	2 103,6	2 479,1	3 181,4
Military expenditures according to the data submitted to U.N. <sup>b</sup>	659,0	815,9	942,0	1 118,0	1 166,1	1 162,5	1 423,3	1 689,3	1 660,1	1 962,1	–
Total military appropriations related to current and past military activities <sup>c</sup>	778,6	947,8	1 133,5	1 448,8	1 748,7	1 880,3	2 143,9	2 654,2	2 993,5	3 457,9	4 282,5
<b>2. In real terms (2015 prices)<sup>d</sup>, rubles in billions</b>											
Federal budget allocations under the National Defense budget function: in accordance with the current budget classification	1 582,3	1 629,9	1 751,5	1 825,4	2 069,6	1 941,8	2 015,3	2 234,4	2 437,9	2 660,8	3 163,8
Execution of federal budget expenditures under the National Defense budget function in accordance with the current budget classification	1 589,9	1 619,6	1 736,5	1 841,8	2 061,4	1 939,5	1 987,1	2 193,3	2 428,5	2 670,0	3 181,4
Military expenditures according to the data submitted to U.N.	1 802,8	1 938,2	1 966,4	1 978,3	2 023,1	1 766,3	1 865,7	2 044,4	1 916,6	2 113,2	–
Total military appropriations related to current and past military activities	2 130,1	2 251,6	2 366,0	2 563,6	3 033,8	2 847,0	2 810,3	3 212,2	3 455,9	3 724,1	4 282,5
<b>3. In real terms (2000 prices)<sup>e</sup>, rubles in billions</b>											
Federal budget allocations under the National Defense budget function: in accordance with the current budget classification	578,4	595,8	640,2	667,2	756,5	709,8	736,6	816,7	891,1	972,6	1 156,4
Execution of federal budget expenditures under the National Defense budget function in accordance with the current budget classification	581,1	592,0	634,7	673,2	753,5	708,9	726,3	801,7	887,7	975,9	1 162,8
Military expenditures according to the data submitted to U.N.	659,0	708,5	718,7	723,1	739,5	645,6	681,9	747,3	700,5	772,4	–
Total military appropriations related to current and past military activities	778,6	823,0	864,8	937,0	1 108,9	1 044,3	1 027,2	1 174,1	1 263,2	1 361,2	1 565,3

*Cont'd*

1	2	3	4	5	6	7	8	9	10	11	12
<b>4. Military encumbrance on economy<sup>f</sup>, % of GDP</b>											
Federal budget allocations under the National Defense budget function: in accordance with the current budget classification	2,68	2,55	2,52	2,50	3,07	2,76	2,58	2,76	2,97	3,17	3,92
Execution of federal budget expenditures under the National Defense budget function in accordance with the current budget classification	2,69	2,53	2,50	2,52	3,06	2,76	2,54	2,71	2,96	3,18	3,94
Military expenditures according to the data submitted to U.N.	3,05	3,03	2,83	2,71	3,00	2,51	2,38	2,52	2,34	2,52	–
Total military appropriations related to current and past military activities	3,60	3,52	3,41	3,51	4,51	4,06	3,59	3,97	4,21	4,44	5,30
<b>5. By purchasing power parity (current prices), dollars in billions</b>											
Federal budget allocations under the National Defense budget function: in accordance with the current budget classification	45,4	54,4	60,0	71,9	85,0	80,7	88,6	102,3	114,3	129,6	128,3
Execution of federal budget expenditures under the National Defense budget function in accordance with the current budget classification	45,6	54,1	59,5	72,6	84,7	80,6	87,4	100,5	113,9	130,0	129,0
Military expenditures according to the data submitted to U.N.	51,7	64,7	67,4	78,0	83,1	73,4	82,0	93,6	89,9	102,9	–
Total military appropriations related to current and past military activities	61,1	75,2	81,1	101,0	124,6	118,8	123,6	147,1	162,1	181,3	173,7
<b>6. By yearly average exchange rate (current prices), dollars in billions</b>											
Federal budget allocations under the National Defense budget function: in accordance with the current budget classification	20,5	25,2	32,8	41,5	37,6	42,1	52,3	59,9	66,3	64,4	51,9
Execution of federal budget expenditures under the National Defense budget function in accordance with the current budget classification	20,5	25,1	32,5	41,9	37,4	42,0	51,6	58,8	66,1	64,6	52,2
Military expenditures according to the data submitted to U.N.	23,3	30,0	36,8	45,0	36,7	38,3	48,4	54,8	52,1	55,1	–
Total military appropriations related to current and past military activities	27,5	34,9	44,3	58,3	55,1	61,9	73,0	86,1	94,0	90,1	70,3

## RUSSIAN ECONOMY IN 2015

trends and outlooks

*Cont'd*

1	2	3	4	5	6	7	8	9	10	11	12
<b>For reference</b>											
GDP deflator, % year-over-year	119,3	115,2	113,8	118,0	102,0	114,2	115,9	108,3	104,8	107,2	107,7
Purchasing power parity <sup>g</sup> , RUB/USD	12,74	12,61	13,98	14,34	14,03	15,83	17,35	18,04	18,47	19,07	24,66
US dollar exchange rate (yearly average) <sup>h</sup> , RUB/USD	28,28	27,19	25,88	24,85	31,74	30,37	29,38	30,84	31,84	38,38	60,96

<sup>a</sup> - For 2015 – the data from the Federal Treasury's monthly report on federal budget execution as of January 1, 2016

<sup>b</sup> - Russia's government will submit the data for 2015 to the U.N. in 2016, including expenditures for MIA's interior troops and for border troops.

<sup>c</sup> - Including retirement pensions of military personnel and costs on the destruction of chemical weapons stockpile and utilization of military equipment.

<sup>d, e</sup> - Deflated using the GDP deflator.

<sup>f</sup> - In italics – with regards to GDP values not including the most recent updates in the Rosstat methodology.

<sup>g, h</sup> - For 2015 – own calculations.

*Sources:* The federal laws on the federal budgets of 2005–2015 and on the execution of the federal budgets of 2005–2014; Budgets for individuals; Objective information on military issues including military spending transparency. The U.N. General Secretary's reports in dated 2006–2015; Russia's Central Bank; Russia's Federal Treasury.