Gaidar Institute for Economic Policy

RUSSIAN ECONOMY IN 2009

TRENDS AND OUTLOOKS

(*ISSUE 31)*

Volume 1

Moscow
2010

UDC 33(470+571)(066)"2009"
BBC 65.9(2Рос)я54

Agency CIP RSL

Institute for the Economy in Transition

R95

Russian economy in 2009 (issue 31): Trends and outlooks / Inst. for the Economy in Transition; [S. Sinelnikov-Murylev and others]. In 2 Volumes. Volume 1. – M.: IET, 2010. – 340 p.: il. – ISBN 978-5-93255-288-9.

The review provides a detailed analysis of main trends in Russia's economy in 2009. The paper contains five big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit and financial spheres; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

The publication of the present paper was sponsored with the grant from the United States Agency for International Development (USAID)

UDC 33(470+571)(066)"2009"
BBC 65.9(2Рос)я54

ISBN 978-5-93255-288-9

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Government Support of Strategic Companies: key instruments, specifics and practical implementation challenges

Specific measures and approaches to the support of backbone enterprises in crisis situation

To correctly evaluate government support of strategic companies it is important to understand specific economic conditions in which government anti-recession instruments and measures were developed and the approaches underlying government support to strategic companies were defined[1].

Russian banking system was the first to be hit by global economic crisis. In September 2008 certain efforts on behalf of the monetary authorities were already in demand to support the liquidity of the banking system. In October such support was already provided on a bigger scale allowing for avoiding the financial system collapse, but not capable of improving the credit terms for the real economy entities. By October 2008 the crisis has already affected the manufacturing industry as well, though recession examples at that time were mainly of local character: significant drop of production was evident in metallurgy (milled products reduced by 21% versus October 2007, steel casting – by 19%), in mineral fertilizers production (14% reduction), cement production (20% reduction), in certain mechanic engineering sub-sectors (materials handling, construction and road engineering, commercial vehicles).

However by mid-end November it became clear 2008 that the crisis might affect a broader range of sectors. Several factors were pointing at that. First of all, drastic decay of external environment: FTSE/S&P indices slump, fall in oil prices, growing challenges for global financial system. Secondly, despite the efforts of the Bank of Russia and of monetary authorities to support the banking system, the credit terms for Russian companies continued to deteriorate – with regards of both loans accessibility, and borrowing prices. Thirdly, a steady trend for unemployment rate growth became obvious: the number of registered unemployed increased by 4% in the end of November 2008 (vs. October). In the fourth place, negative monetary trends accelerated: сокращение forex/gold holding decrease, ruble devaluation.

It is worth noting that recession, unemployment and other indicators were critical per se, but the main problem was in highly uncertain development outlook, in significant concerns of all market players including the government with regards of possible scale and length of crisis.

It was no longer possible to view the crisis as just financial one associated with insufficient liquidity. Moreover, it was not possible to view it as the crisis affecting mostly major financial and industrial groups with high external debt. It became clear: global energy markets fall and decrease of export is going to affect a significant number of major Russian exporters; inevitable

[1] This section is based on part of the deliverables of the project implemented by the Academy of National Economy under the RF Government focused on evaluation of various instruments of government support to strategic companies. The project was implemented by a group of experts in the end of 2009 in the interests of the Expert Council with the Government Commission for improving sustainable development of Russian economy.

disinvestment and lending reduction jeopardizing all sectors of the economy will have a chain effect leading to material deterioration of market situation and of financial positions of companies across all industries and sectors of Russian economy. Collapse and bankruptcies of major companies in any sector were quite possible; and in the environment when the business community was close to panic, any announcement about suspension of production or about insolvency of just one company could have caused significant growth of mutual distrust among market players and provoked knock-off effect along the cross-sector links.

In the situation of vague economic outlook due to the specifics of Russian banking system the possibilities for effective support of real sector businesses solely through monetary policy instruments turned out to be quite limited: support of bank liquidity was not backed by maintaining the credit terms for real economy. In particular, during late 2008 – early 2009 when ruble was devaluated, it much more profitable and less risky to invest into buying currency rather than to issue loans to enterprises. In other words, high uncertainty generated total collapse of confidence between banks, banks and borrowers, suppliers and consumers. Those were credibility gap and high risks that impeded restoring normal credit terms for enterprises.

Concerns about rapid growth of unemployment in case companies start mass layouts were also justified, and that could lead to extremely negative social consequences, especially in mono cities and in certain regions highly dependent on a limited number of major city-forming enterprises.

It became obvious that anti-crisis measures cannot be completed with just support to major banks. Prevention of bankruptcies or shutdowns of major enterprises due to inaccessibility of funding requires other "pinpointed" instruments of government policy focused on resolving the problems of selected, the most valuable businesses. It is worth noting that most of serious concerns had not come true, but they looked quite realistic by the end of 2008.

However, at that point of time the Government did not have any better fine-tuned "pinpointed" support instruments, or more or less adequate action list.

This, Strategic Actions and Strategic Companies List[1]*, first of all, is focused on other objectives, mainly – on special procedure for privatization and/or incorporation; secondly, it includes only government owned enterprises and joint-stock companies with government holding blocking or controlling interest. Other officially approved lists (e.g., the Register of Business Entities with market share of 35%+) turned out to be not instrumental for defining the priorities for support, – the latter, in particular, contains several thousand organizations, not all of them being real majors.*

It is necessary to acknowledge: the *List of systemic companies of strategic importance* (hereinafter – the List) was formed as an "all-hands-job" simultaneously with defining its goals and objectives and with discussing the possible government's measures. This, of course, marked an imprint on the composition of the List. On top of that, the benefits for the future members of the List were still unclear, so different groups of stakeholders were lobbying the process of the List development. It appears that if only the business community had known the scope and format of future government support in advance, the number of willing participants could have turned out not as big.

[1] Decree of the RF President of August 24, 2004, No. 1009 "On Approving the List of Strategic Enterprises and Strategic Joint-Stock Companies"

Government support to strategic companies was stated to have the following objectives:

– First and foremost – assure social stability, prevent massive layouts at major enterprises;
– Second – assure sustainability of critical cooperation value chains by way of supporting their elements;
– Third – assure stable operations of the key infrastructure elements.

Today we have to recognize: forming the List and administering it (which meant, first of all, monitoring its members and providing government support to them) have become the critical element of the anti-crisis policy. With that, support to strategic companies had its own specifics in different sectors – from the standpoint of both the applied mechanisms and the scope of measures.

We have identified the following topics allowing for detailed review of the government anti-crisis policy:

(1) the List of strategic companies – its objectives and formation principles, sector breakdown;

(2) the key areas and mechanisms of government support to strategic companies – specifics and practical implementation challenges;

(3) high-level definition of sector-based specifics within the government support to strategic companies – benchmarking the scale of support and instruments used in priority industries.

The following material limitations applied to the performed analysis need to be highlighted:

Support rendered to defense industries was quite special, so we are going to refrain from its review (except for some very limited examples);

The scope of our analysis covers only the instruments and measures which the RF Government was really using during the crisis period.

List of systemic organizations of strategic importance: formation principles and composition

Objectives, principles and criteria for forming the list of strategic companies

As per public information, the first approaches to forming the List of strategic companies were discussed at the government level as early as early December 2008. At that time the inclination was to select about 150–200 companies with the biggest contribution to Russian GDP. Various government agencies were simultaneously developing their proposals on including companies into the list and on criteria for qualifying the companies as strategic ones. They were mostly focused on such attributes for as size and social value of a company.

However, already at the first stage at least part of the stakeholders was viewing this List formation not only from the standpoint of preventing bankruptcy of major enterprises, but also from the point of view of creating the capability for future development. Thus, according to the representative of the RF Ministry of Commerce, List preparation was approached from the standpoint of "demand configuration, so that in several years when the crisis is over the companies could enter the market being fully competitive"[1]. Respectively, the following criteria were offered: unique technological capabilities, availability of export contracts for 2009, ongoing major capital projects, and key positions within the inter-sector business network.

[1] Cited as per Article "Putin's List", *Vedomosty*, December 9, 2009

In December 2008 the List of strategic companies was finalized[1], 295 organizations were included. Initially it was declared open for including other companies; however, no significant changes were made even though there were a number of attempts to increase the list.

As per available data, over 300 proposals to increase the List of strategic companies were received during the first year. However, the List was only insignificantly increased[4] *by way of adding several agricultural enterprises, one agricultural engineering enterprise, two jewelry industry plants and Gosznak (money-printing enterprise).*

In our opinion, based both on the finalized List as a whole and on comments provided by various government officials, the formation of the List of strategic companies was associated, on one hand, with significant lobbying by certain agencies to include the maximum possible range of their subordinate organizations into this List; and on the other hand – with the tendency for minimizing the List to the extent possible demonstrated by a number of other agencies. The last tendency, in our view, was based not only on the fact of Government resources to support businesses being limited, but also by a *limited "throughput capacity" of the respective decision-making system.* The number of reviewed issues was limited by multistage endorsement practice within the complicated system of sector-based, inter-sector and government commissions. Besides, those commissions did not have enough resources and staff for developing the solutions – they were relying on the available personnel of the respective government agencies.

For example, the Cross-Sector Work Group for monitoring economic and financial positions of organizations included in the List of strategic companies held 6 meetings between January 17 and 30, 2009. 15 strategic companies were reviewed at those meetings[2]*. And still, with the List comprising more than 300 companies at that point of time, even such facilitated review would not allow for immediate monitoring of all the strategic companies totality.*

In addition to lack of clear understanding of the List objectives and criteria, the situation was complicated because *the package of potential "rights and responsibilities" of strategic companies was not defined at that point of time.* In particular, the format of potential government support to the List members was not clear, which stimulated the companies for lobbying their inclusion into the List. In our opinion, some pretty tough statements by officials declaring that becoming members of the List would mean thorough control on behalf of the government and would not guarantee financial support[3] could be explained by their desire to somehow limit such lobbying activity.

A very meaningful, though ambiguous from the methodology standpoint decision was made to include multidiscipline holdings and business groups into the List. On one hand, they undoubtedly belong to the backbone of Russian economy and provide for its sustainability to a great extent. On the other hand, major groups comprise of multiple enterprises, businesses and organizations, and most of them do not fall under the criteria for "strategic" companies. The

[1] List of systemic organizations of strategic value was approved by the RF Government Commission for improving sustainable development of Russian economy on December 23, 2008
[2] Press-Release by the RF Ministry of Finance of February 4, 2009.
[3] See, for example, the RF Government Press Service commentary to publishing the List of strategic companies (http://premier.gov.ru/events/messages/2883/).

transparency of intra-group connections and relations is extremely poor, so selecting such groups for monitoring and support significantly limits both pin-point selective support capabilities and efficiency of situational monitoring by different sectors and activities.

Thus, due to the above listed contradictions the List of strategic companies viewed as a government policy instrument lacked clear overall objective, but was a sort of a compromise between various specific objectives. And given numerous commentaries to the List including those by government officials, none of the available official documents contain a definition of its main objective. All we can do is just to “recover” some of them by analyzing the method of forming the List and its composition. We need to emphasize that it would be an “ideal” set of objectives and that not each and every of them has eventually been achieved.

The List was aimed to:

– provide for *on-line monitoring of key companies* which are indicative for the economic situation and responsible for socially valuable sectors of economy; also for – presumably – preventing opportunistic actions by the companies’ owners and management – actions potentially leading to serious negative social consequences and/or damaging economic security of the country (e.g., due to infrastructure deterioration);
– assure immediate review of government support to major companies *to prevent catastrophic scenarios* in unfavorable circumstances;
– *monitor the efficiency of government support rendered to specific companies.*

All those objectives to a certain extent were reflected in the criteria for selecting the future members of the List. The size of the company actually became the dominating criterion, which is quite disputable from the standpoint of reflecting the true role of the company for the national economy, as well as distorting the sector structure by way *shifting the focus to the sectors with high concentration of industries and domination of business super-giants.*

Initially it was planned to perform screening of the companies with revenues no less than Rb 15 mln and headcount no less than 5,000 pers.[1] These numbers were not underpinned by any meaningful analysis of Russian economy profile, and soon it became clear that many de-facto strategic companies turn out to be beyond the set limits. Eventually the quantitative criteria became softer, but they still were not differentiated by sectors (except for special requirements set for agriculture). The finalized criteria were set in the Methodology Guidelines by the RF Ministry of Economic Development[2] as follows:

Qualitative criteria (a company should comply with at least one of them):

– technology capabilities (availability of hi-po / unique technology included into the List of technologies of social and economic importance or valuable from the national security/defense standpoint (critical technology)[3];
– impact on social stability (jobs maintenance and prevention of massive one-time unemployment единовременной безработицы);
– meaningful for maintaining infrastructure and production chains;
– participation in hi-po investment projects;
– participation in international agreements / commitments.

Quantitative criteria (all of them are mandatory):

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[1] Lower thresholds were set for agricultural businesses.

[2] Methodology Guidelines for including businesses into the List of Strategic Companies, April 16, 2009 (http://www.economy.gov.ru/minec/activity/sections/macro/politic/doc1239893148108)

[3] Approved by the RF Government Resolution No.1243-p of August 25, 2008

– annual revenue for 2007 – no less than Rb 10 bn (for agriculture – no less than Rb 4 bn);
– fiscal charges into different level budgets for the last 3 years – no less than Rb 5 bn (for agriculture – no less than Rb 2 bn);
– headcount – no less than 4,000 pers. (for agriculture – no less than 1,500 pers.).

As it is easy to see, the qualitative criteria were rather high-level and could be interpreted were broadly and in a biased manner, because they were based on non-regulated concepts, such as "hi-po investment projects", "production chains", "mass one-time unemployment", etc. We can take the risk and assume that a very big portion of major and mid-sized businesses in Russia could be recognized as compliant with at least one of those qualitative criteria. No wonder, *the qualitative criteria became the ones that really worked.*

Composition of the List of Strategic Companies

Let us see if the List of Strategic Companies was adequately representing Russian economy[1], was in line with the challenges and priorities of both the crisis stage and of the mid-term perspective.

The results of data search for separate enterprises included into the list allow for the following conclusion: the publication of this document was not backed by public information about the key characteristics of the entities of this List. The main sources of data for analytical purposes were SPARK, Expert-400 rating, official corporate sites, media publications.

<u>List of Strategic Companies versus the list of major Russian companies</u>

As it has been noted above, the main numeric criterion for including a company into the List was its size. In this context it is interesting to benchmark the List against the list of 400 Russian majors composed by "Expert" journal. Let us remember that Expert-400 comprises all major companies irrespective of the business area or sector the operate in, while as mainly "real sector" (productive) companies and trading companies were included into the List of Strategic

[1] It is worth noting that it is very difficult to fully evaluate the List from the standpoint of sectors and regions representations – due to a number of reasons. Reason number one: the List comprised not just companies per se – stand-alone productive assets with the status of legal entities – but multidiscipline diversified corporations with dozens and even hundreds of subsidiaries. In addition, the List comprised holdings at the level of their headquarters – and it is difficult to define their sectors and even the level of their control over their own enterprises (the shares of which are owned by the respective holding). However, the biggest challenge is to analyze a number of managing companies included into the List. The best data available about such companies is list of assets they manage, but it is impossible to assess any consolidated reporting. "Solnechniye Produkty" Managing Company may be one example – it controls several major fat-and-oil producers, cereal-handling elevators, etc., but has no consolidated reporting. This company having got material market share in the respective business areas (mayonnaise, vegetable oil, etc.) is not part, for example, of major enterprises rating Expert-400.
Data about major state-owned corporations are not always available for analysis. This mainly pertains to Rosatom Corporation, the business of which may be evaluated only through some of its subsidiaries (such as OJSC "Atomenergoprom"). But neither for Rosatom, nor for Rostekhnologiyi (formed in 2008 and still being in the process of set-up at the point of time the List was created) consolidated performance reports are available. At the same time, it is impossible to evaluate all separate enterprises – members of Rostekhnologiyi, as there are several hundreds of them.
A significant number of state unitary enterprises included into the List are yet another challenge. They do not disclose their production output and financial performance data.
And finally, there is the "double count" issue due to the fact that the List comprised both the corporations' headquarters and separate subsidiaries/affiliations.

Companies. To assure like-for-like comparison we excluded financial sector players (banks and insurance firms) from Expert-400 list, as well as a number of servicing companies (entertainment, IT).

The finalized "cleared" list of major companies has got 344 instead of 400 (compare with 304 in the List of Strategic Companies). Let us note that the "passing score" – the size of the annual revenue – was Rb 11.3 bn for Expert-400, which is pretty close to Rb 10 bn threshold approved for the List.

However, comparing the two lists proves that only about 50% of major "real sector" and trade companies were included into the List of Strategic Companies. *40% of the List are companies which cannot be called majors of Russian economy*.

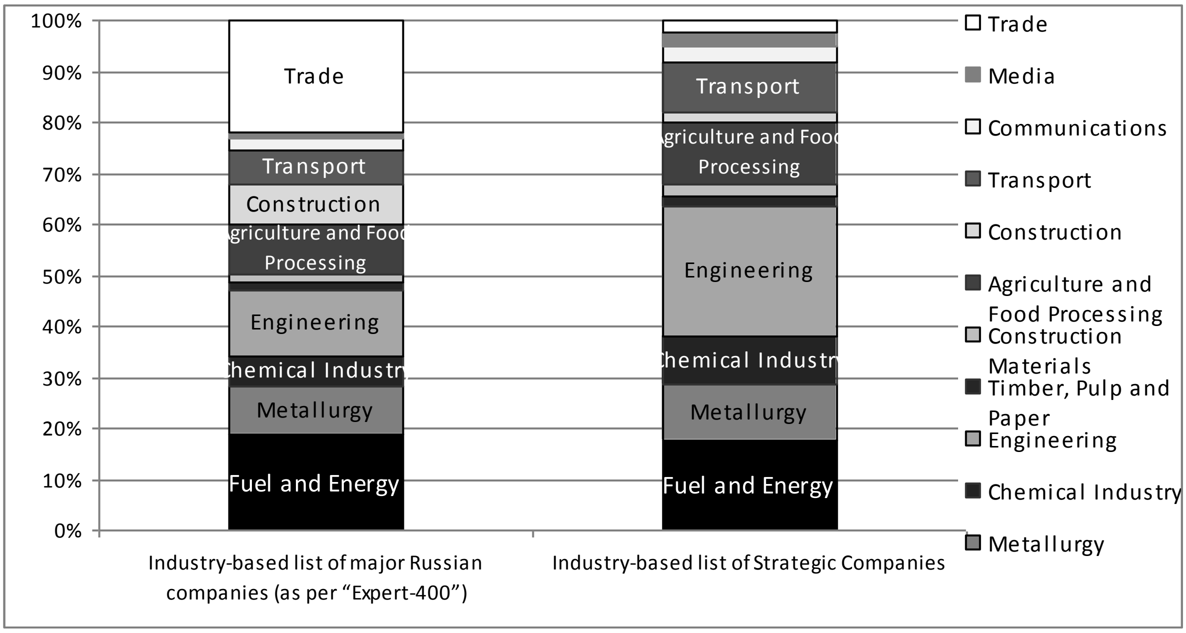

Fig. 1. Sector Profile of Russian Majors According to Expert-400 and the List of Strategic Companies

The biggest discrepancies were noticed in three sectors: engineering, construction and trade. A ten-fold gap in trade share between the two lists proves that *trade companies were included into the List as exceptional cases* and this business area was not recognized as a priority one for identifying the "strategic" component of the economy. If we exclude trade from both lists, then the majority of deviations will be found mainly in two sectors: *construction is strongly underestimated in the List of Strategic Companies, and machine engineering companies are, on the contrary, occupy a much bigger place than they are given in the major companies Expert-400 list.*

It is necessary to say that the fact of insufficient presentation of construction companies is caused by the fact that the List comprised only major companies engaged in residential development, while as Expert-400 list comprised mainly companies engaged in industrial (non-residential) construction (like Transstroy, Mosremstroy, Stroytransgas, etc.).

But even coincidence of sector shares in both lists does not always mean that the companies are the same. Thus, in energy (and fuel) sector the lists are 80 similar, while as in agriculture and food processing – only 40% similar.

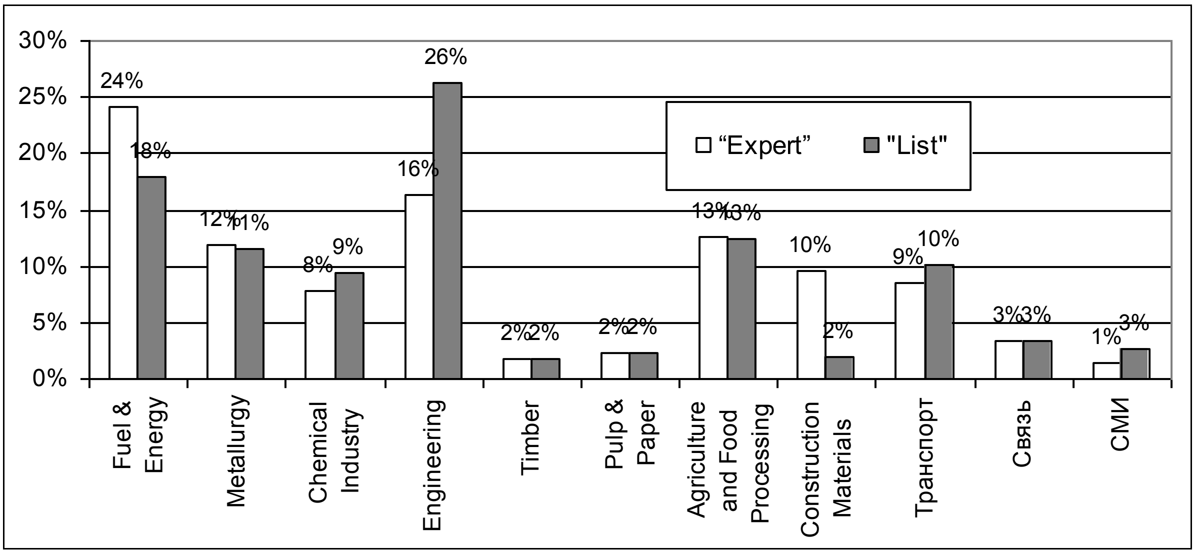

Fig. 2. Sector-based Differences Between Expert-400 and the List of Strategic Companies

If we analyze the lists by sectors in greater detail, it is obvious that *the most critical deviation factor for both lists is the ownership,* though this particular criterion was not specified as important one in the Methodology Guidelines. We need to emphasize that some companies were *discriminated with regards to qualifying them as strategic ones* based not only on the fact of government's interest, but mostly – on *the fact of foreign capital participation.*

Such discretion in including companies with foreign capital into the List may be illustrated by an example in automotive industry: such foreign companies operating in Russia as Ford-Motors, Volkswagen, GM-Auto and others (all of them – members of Expert-400 list).

The same approach is quite visible in other sectors. Thus, in food processing not only foreign brewing companies were not included into the List, but such major food producers as Nestle-Russia, Krafts-Food and others.

Discrimination based on the fact of foreign capital participation is absolutely obvious, while as preference in favor of companies with government participation versus private capital is not that transparent.

Specific weight of unitary enterprises and government corporations included into the List is ca. 12%, which exceeds significantly their share in the economy (as per Russian Statistics Service, the share of government and combined ownership is less than 8% of the total number of organizations) or their share in the major companies list. This may be explained, first of all, by the fact that many infrastructure companies were included into the List, and most of them are "federal state unitary enterprises (FGUPs)". Also 20 design bureaus and research institutes in the area of shipbuilding, aviation, rocket and missile engineering and in energy sphere were included into the List.

Another 18% of the List covers joint-stock companies with dominating or blocking government stake. Thus, by number of assets the share of the "public sector" in the List is a bit less than 1/3. As for the annual revenue, the share of state-owned companies or companies with material government stake is significantly higher (ca. 50%), but this is explained by the fact that the List comprises such giants as Gazprom, Rosneft and OJSC RZhD holding the first, the third and the fourth positions in the list of major Russian companies.

Representation of particular sectors was evidently not a criterion for including companies into the List. In other case individual thresholds would need to be established for different sectors – and this was done only for agriculture and food processing. That is why the extent of coverage of different sectors differs materially depending on the sector profile: if majors and super-majors are characteristic of a sector, this sector is broadly represented in the List; for sectors where majors are not typical (e.g., light industry) – the coverage is much smaller. It is difficult to evaluate the "coverage" just by the list of productive sites, because significant number of companies, as we have emphasized earlier, have got those in various areas of business, while as data on revenues distribution between different positions within the All-Russian Classifier of Types of Economic Activity are rarely available.

We can use expert method to evaluate the share of production in individual aggregated areas of business – in terms of its distribution between companies included into the List. Thus, in power generation, there is maximum coverage, up to 90%. For oil and gas industry the coverage is also pretty significant – 80%. Some of relatively "small" industries are also strongly represented in the List, such as pharmaceutical industry (10 producers and 1 distribution chain were included, while as only one producer and three distribution chains from pharmaceuticals were part of Expert-400). Other well-covered sectors are shipbuilding industry, aviation, missile and rocket engineering, defense industry. Chemical industry and metallurgy have over 50% coverage.

Least coverage is found in construction materials (only a few major cement producers were included), construction, food processing and light industry.

Thus, the List of Strategic Companies is not a comprehensive totality of major companies (even though the correlation is pretty close). Neither is it the reflection of the sector-based profile of Russian economy. Nevertheless, it would be wrong to say that the List has no scientific basis at all and is a result of mere lobbying by companies and organizations.

The analysis of this document allows for clear definition of the priorities, which were not explicitly worded, but still underpinned the approach for selecting companies to be included into the List. In our opinion, *such priorities were infrastructure (mainly, energy and transport), export, national security with regards to hi-tech defense enterprises, and agriculture.* In total, two thirds of the List is dedicated to such companies[1].

Such focus on infrastructure companies is to a certain extent justified, because termination or abrupt reduction of their operations at key infrastructure sites could indeed have a very strong negative impact on citizens, on national security and on businesses in other sectors of the economy. Special attention to major exporters may also be explained in the situation when drastic external demand decline and world markets prices slide with regards to Russian exported products became one of the major implications of the global crisis.

[1] Multidiscipline companies were qualified as parts of such priority sectors based on the expert opinion taking into account their core business

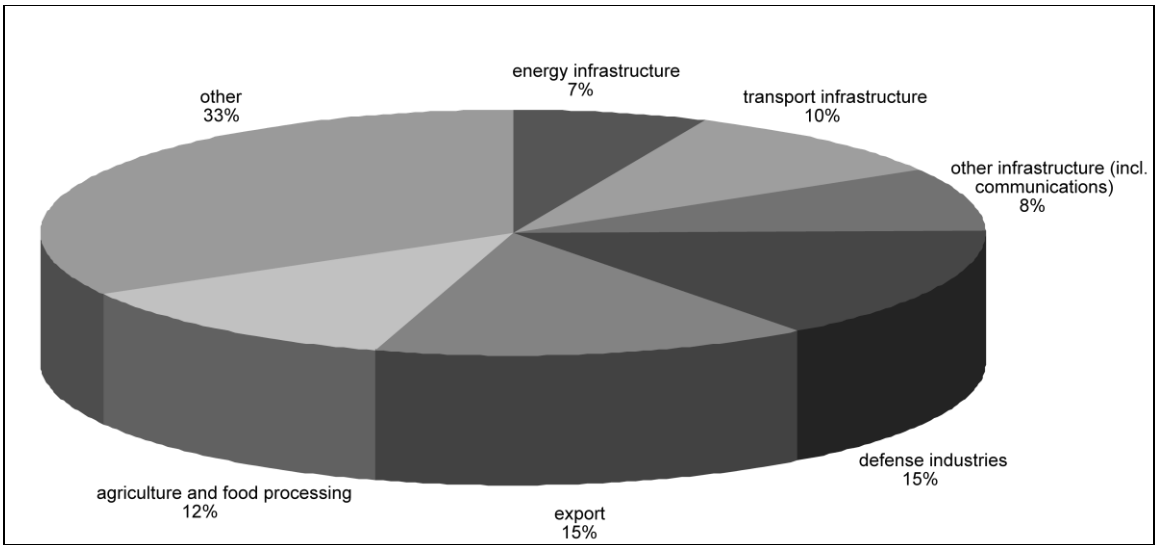

Fig. 3. Distribution of the List of Entities by Priority Business Areas

The following general observations may be made on the structure and purposes of the List of Strategic Companies:

1. In general the List is more than 50% consistent with the Expert-400 major companies list. This is especially true for such sectors, as fuel and energy, metallurgy and chemical industry.

The exceptions are mainly associated with "discriminating" certain companies with foreign capital participation, as well as with underestimating certain sectors of the economy: service sector, trade and construction. The so-called "additions" to the List (meaning companies which are not in the Expert-400 major companies list, but were included into the List of Strategic Companies) pertain mostly to engineering (because many manufacturing and R&D centers of defense industry were included), pharmaceuticals and transport (by way of including major airports and sea ports).

Despite the discrepancies between the List of Strategic Companies and Expert-400 list of major companies, the cumulative dynamics and key financial indicators of the List reflect the totality of major Russian companies.

2. The List of Strategic Companies is mostly focused on infrastructure (primarily energy and transport), export and defense. Due to these industries being more or less "autonomous" (in the sense of their challenges and threats being very different and relating to different spheres) the List appears to be pretty eclectic.

3. If we were to evaluate the instrumentality of the List from the point of view of the objectives declared at the stage of its formation, our opinion would be: it did not provide for fully achieving any of them. In particular, the List has substantial deficiencies from the point of view of "on-line monitoring of key economic entities": first of all, it does not include major manufacturers in quite some sectors and industries; secondly, in many cases it includes both holding companies headquarters and companies being parts of such holdings. At the same time, the List comprises many companies which can be qualified as "strategically important", but have no impact on the overall economic situation (and even on the situation in a particular sector).

The List also raises certain doubts with regards of preventing opportunistic behavior by businesses owners and management and implementation of decisions with seriously negative social implications and/or damage to national economic security, because – on one hand – the

List is too extensive to provide for on-line monitoring of management decisions for all the selected companies, and on the other hand – it includes significant number of unitary enterprises and corporations fully owned by the state, in which the owner should control such decision-making within their standard internal governance procedures.

The List is not very instrumental for "reviewing the issues of government support to major companies with the purpose of preventing catastrophic scenarios in unfavorable circumstances", because it does not include quite a few major companies. Besides, it is unclear, what scenarios should be regarded as "catastrophic". The decision-making practices during the time of the crisis build-up, social catastrophes may occur not only at major companies, but at medium-sized ones, if they are city backbones.

4. The key problem with forming the List of Strategic Companies, in our opinion, was not only the "diluted" criteria for selecting companies, but even more – lack of clear understanding of why this List was needed. It is evidently redundant to be viewed as the list of candidates for receiving government support because it comprises too many entities, most of which have such complicated structure that detailed review of the issues associated with one of such entities (e.g., Gazprom or Rostekhnologiyi) is too difficult for Work Groups and industry commissions.

Publication of the List reflected, most likely, the political declaration of the government at the critical stage of the crisis and in the environment of extremely vague outlook for 2009 development, stating that the government would not allow for bankruptcy of the key "strategic" companies. This declaration was aimed at reassurance of creditors and suppliers to avoid panic in case of the risk of major business entities insolvency. This objective was achieved – to a certain extent.

It may be assumed that the very fact of a company being included into the List irrespective of receiving real financial aid provided for decreasing the risk ratings for this particular entity - on behalf of both banks and suppliers. Besides, inclusion into the List could force regional governments to be more attentive to the situations at particular enterprises providing for immediate organization support and other types of assistance.

Key areas and instruments of government support to strategic companies: specifics, challenges and practical implementation progress

A number of official documents[1] declared the following instruments to be used for government support of strategic companies:

– debt financing;
– government guarantees;
– subsidies from the budget;
– additional capitalization;
– tax arrears restructuring;
– government procurement;
– change of import and export duties.

[1] Ref. RF Government Anti-Crisis Program for 2009 (approved by the RF Government on June 19, 2009), presentation by E. Nabiullina, RF Minister for Economic Development at the ministerial board meeting "2008 Performance of the RF Ministry for Economic Development and Key Objectives for 2009" on March 24, 2009 (http://www.economy.gov.ru/minec/press/news/doc1237883863610), Press Release by the RF Government about publication of the List of Strategic Companies (http://premier.gov.ru/events/messages/2883/)

In this sub-section we will review *the instruments actually applied to strategic companies (and having impacted their situations),* their coverage and industry focus. Three comments need to be made for this purpose.

The first one: many measures listed as possible government support instruments were not really focused predominantly on strategic companies (e.g., partial interest rate subsidies).

The second one: one of the key measures to support strategic companies was refinancing of the external debt of major companies by Vnesheconombank, even though this particular mechanism had been in use before the List of Strategic Companies was in place.

And the third one: a significant portion of anti-crisis measures were not de-targeted at strategic companies and was not listed among government support instruments; rather, it was focused on a number of particular industries and sectors (automotive, oil-and-gas); however, due to high plant concentration in such sectors these measures had a focused impact mainly on respective strategic companies. In particular, such measures included partial interest rate subsidies to citizens for purchasing new cars, raising the non-taxable limit for MET assessment.

Direct and indirect anti-crisis measures to support strategic companies may be grouped by key areas of support:

(1) assuring financing resources accessibility:

– loans by Vnesheconombank to major companies to settle their external debt,
– government guarantees for loans,
– partial interest rate subsidies,
– expanding the Lombard List of the Central Bank,
– budget subsidies to prevent bankruptcy (recipients – strategic companies of defense industry), compensation of shortfalls in income (OJSC Russian Railways),
– increase of share capital, additional capitalization;

(2) incentives for domestic demand:

– additional government procurement programs (cars for federal executive authorities, public vehicles fleet renewal at regional and municipal levels),
– partial interest rate subsidies to citizens for purchasing new cars;
– additional capitalization of OJSC RosAgroLeasing to increase procurement of agricultural vehicles, equipment, etc.;
– increasing import customs duties (for used and new cars, buses, grain harvesters, pipes, rolled metal, etc.), decreasing import quotas (poultry)[1];

(3) decreasing burdens for businesses:

– reducing oil-and-gas sector tax burden (raising the non-taxable limit for MET assessment, changing the procedure for accruing the expenses for acquisition subsoil use licenses, introducing tax holidays for developing some of the fields);
– mandatory payments arrears restructuring for some of automotive companies;
– changing the calculation methodology and decreasing export duties (price monitoring period decreased, respectively – period for fixing crude and products export duties de-

[1] Big number of government measures in this sphere does not allow for detailed review within this Section. We can only note that most of them were focused on supporting automotive industry, agricultural engineering, metallurgy and agriculture/food processing.

creased, export duties cancelled for unalloyed nickel and copper cathodes, nitrogen and mixed fertilizers, etc.)[1].

We believe it is necessary to focus on a detailed review of the following three mechanisms and the ways they were implemented:

– loans to companies to refinance their external debt;
– government guarantees to borrowing companies;
– providing budget subsidies to partially compensate interest rates.

The reasons we are especially focused on these three mechanisms are, firstly, their scale (at least, the planned scale), and secondly – the fact of them not being limited to one or two priority sectors.

Assuring financial resources accessibility for strategic companies

Loans by Vnesheconombank to major companies to settle their external debt

The legal framework for this mechanism of Vnesheconombank refinancing the external obligations of the real sector companies was defined in mid-October 2009[2] – approximately two months prior to approving the List of Strategic Companies. The bank was granted the right to issue foreign currency loans to Russian companies for the purposes of redemption and servicing of previously received loans from foreign credit institutions, as well as to purchase receivables from foreign creditors. The minimal interest rate for loans issued was set at the level of 5 points LIBOR spread (in USD for 1 year). The ceiling was set for overall amount of loans issued by Vnesheconombank and of the acquired receivables at the level of not higher than $50 bn.

At the same day Vnesheconombank Supervisory Board approved the Procedure for refinancing the external debt of Russian companies[3], setting the following key criteria for application of this mechanism:

- economic security of the Russian Federation is jeopardized, significant assets of the borrower may be lost leading to its business reduction or bankruptcy;
- refinanced obligations were formed as a result of raising funds for major investment projects or for purchasing assets to significantly expand the borrower's operations in the territory of the Russian Federation.

The refinanced obligations should be no less than $100 mln. The maximum loan to a single company (or to interrelated companies) was also capped – $2.5 bn. Besides, co-financing on behalf of the borrower was stipulated – at the level of at least 25% of the overall refinanced obligations amount (unless otherwise prescribed by Vnesheconombank Supervisory Board). The borrower was also to provide the loan security to Vnesheconombank equal to security provided to foreign creditors (and in case it was insufficient – additional security).

[1] Just like in the case of changing import duties we will refrain from detailed review of such measures, and limit ourselves with the most meaningful ones (in our opinion, those are measures targeted at exporters in oil-and-gas sector, non-ferrous metals, chemical and petrochem industries.

[2] Federal Law No.173-FZ of October 13, 2007 "On Additional Measures to Support the Finance System of the Russian Federation".

[3] The procedure for the State Corporation "Development and Foreign Economic Activity Bank (Vnesheconombank)" to implement measures stipulated by Articles 1 and 2 of the Federal Law No.173-FZ of October 13, 2008, "On Additional Measures to Support the Finance System of the Russian Federation" (approved by Vnesheconombank Supervisory Board on October 13, 2008, Minutes No. 11).

To receive such loan a real sector company had to provide a package of several dozens documents to Vnesheconombank (as a rule, it comprised at least 40). The requests had to be reviewed in sequence by Investment Operations Development Committee, Credit Committee, Management Board, Special Committee for Review of Requests and finally – by Vnesheconombank Supervisory Board. Requests having successfully passed the Investment Operations Development Committee review had to undergo comprehensive expert review.

Just one week after defining the legal framework for external debt refinancing Vnesheconombank Supervisory Board approved the internal regulatory framework for practical implementation of this measure[1]. Prior to the end of October the Supervisory Board made its first decisions about external debt refinancing. y early December Vnesheconombank received requests for external debt refinancing for the total amount of $78 bn, including requests from real sector companies for about $50 bn[2]. At the same time, it is worth noting, that only 32 requests for the total amount of $27.1 bn were able to successfully pass through all the stages and reviews and reach the final one – review by the Supervisory Board. Out of them – only 15 requests from 12 organizations were approved for the total amount of $14.3 bn (without co-financing)[3] comprising less than 30% $50 bn allocated by central Bank for these purposes.

Out of 11 real sector companies[4], the requests of which were approved by Vnesheconombank Supervisory Board, 7 were included into the List of Strategic Companies in December (Rosneft, Rusal, Russian railways, PIK Group, Sitronix, Gazprom, Mechel), and the remaining 4 had direct links to the companies from the List (Evraz Group S.A., Gazpromneft, En+ Group Limited, ECO Telecom Ltd.).

Evraz Group S.A. is the holder of assets operated in Russia by Evraz Holding LLC included into the List of Strategic Companies.

Gazpromneft is a subsidiary of Gazprom (which was included into the List).

En+ Group Limited is the holder of controlling interest of Rusal (in the List) and of the parent company of EvroSibEnergo (in the List).

ECO Telecom Ltd. is part of telecommunications block of Alpha Group headed by Altimo, which owns 44% of OJSC Vympelkom shares and 25.1% of OJSC Megaphone (both in the List)[5].

Two companies, the requests of which were approved by Vnesheconombank Supervisory Board (Mechel and En+ Group Limited) further refused from the loans by Vnesheconombank. According to media publications, the first one did not like the security coverage requested by Vnesheconombank, and the second one was not able to provide a full set of documents re-

[1] Vnesheconombank 2008 Performance Report (http://www.veb.ru/common/img/uploaded/files_list/VEB_Annual_2008_rus.pdf)

[2] Briefing by V. Dmitriev, Vnesheconombank President, on the outcomes of the Supervisory Board meeting on December 1, 2009, (http://www.veb.ru/ru/about/press/ns/index.php?from32=3&id32=5446)

[3] From here downwards, unless otherwise specified, ref. data from the RF Government Reports about implementing measures to support capital market, banking system, labor market, Russian economy sectors and social net of citizens, and other social policy measures.

[4] One of the companies that received refinancing represented the finance sector - OJSC VTB Bank.

[5] It is also worth noting that ECO Telecom Ltd. raised 2 bond loans from Deutsche Bank AG in 2007 using 44% of OJSC Vympelkom shares as security. Vnesheconombank issued its loan to refinance this debt.

quired for closing the loan deal[1]. Other companies received the loans from Vnesheconombank with the total amount of $11.28 bn (less than ¼ of the initially allocated $50 bn). The loans term did not exceed 1 year, the interest rate was 7–10%.

In early February 2009 it was declared that Vnesheconombank suspended accepting the requests for external debt refinancing due to the following reasons:

– Russian commercial banks having got excessive foreign currency liquidity will "help the borrowers to settle with their foreign creditors";
– Companies are finding ways to settle their external debt without loans by Vnesheconombank.

At the same time Vnesheconombank management was not excluding the possibility of resuming this activity in future[2].

In early June Vnesheconombank management declared the possibility of extending the 1-year loans "subject to implicit discharge of the borrowers' obligations under initial loan agreements and under original format for redemption and servicing of the debt"[3].

By mid-October 2009 the borrowers redeemed part of their debt to Vnesheconombank for the total amount of $2.43 bn (the principal). 3 borrowers – Rosneft, Russian railways and VTB Bank – provided for pre-scheduled full redemption. Vnesheconombank Supervisory Board approved extension of the loan period for one year for 6 companies – Rusal, PIK Group, Sitronix, Evraz Group S.A., Gazpromneft and ECO Telecom Ltd. – with the total amount of $8.34 bn.

Finally, in December 2009 the right of Vnesheconombank to extend the loan period was de-jure confirmed[4].

Overall. The following conclusions can be made with regards to specifics of practical implementation of major companies' external debts refinancing mechanism:

- Despite the fact that external corporate debt refinancing was not de-jure an instrument for supporting strategic companies (at least because the List of such companied was finalized 6 weeks after the first requests for such refinancing had been approved), all the companies having received loans from Vnesheconombank were either de-facto included into the List of Strategic Companies, or were directly linked with some companies from the List;
- Different from many other anti-crisis measures, the external debt refinancing mechanism was promptly developed and "launched": the first requests for Vnesheconombank loans were approved two weeks after creating the appropriate legal and regulatory framework (remember that the requests had to be backed by several dozens of documents, and the Procedure of their review comprised 7 stages), and the first loans with the total amount of over $10 bn were issued as early as before the end of 2009;
- Request for external debt refinancing from the companies were subject to pretty strict screening: it is sufficient to say that the amount of loans issued by Vnesheconombank was several times lower the requested amount;

[1] Ref: T.Komarova, V. Kovalenko. Trojan Tranche – Corporate Secret, May 4, 2009; D. Shabashov, E. Godlevskaya. Deripaska qualified as non-payer. – RBC Daily, November 12, 2009.
[2] Briefing by V. Dmitriev, Vnesheconombank President, on the outcomes of the Supervisory Board meeting on February 5, 2009, (http://www.veb.ru/ru/about/press/ns/index.php?from32=2&id32=5449).
[3] Briefing by V. Dmitriev, Vnesheconombank President, on the outcomes of the Supervisory Board meeting on June 1, 2009, (http://www.veb.ru/ru/about/press/ns/index.php?from32=2&id32=5450)
[4] Federal Law No.361-FZ of December 27, 2009 "On Amendments to the Federal Law "On Additional Measures to Support the Finance System of the Russian Federation"".

- After pretty strict initial screening of obligations qualified for refinancing, Vnesheconombank demonstrated a rather "liberal" attitude to the debtors further down the way: it extended the loan period practically for each company undergoing difficulties with redemption of obligations (and those were more than 50%).

***Government loan guarantees to strategic companies*[1]**

The legal grounds for providing government loan guarantees to strategic companies were defined as early as in 2008 – the respective amendments were made into the Federal Law on 2009 Budget[2] one week after the List of Strategic Companies had been approved. It was anticipated that the coverage for this area of government support would make RB 200 bn in 2009. In mid-February the RF Government approved the Rules for Granting Government Guarantees[3].

Let us note here that 6-week delay with enacting the delegated legislation (probably, caused by lengthy inert-departmental coordination) was criticized by the RF President[4]. Further on top Russian leaders repeatedly turned to the topic of government guarantees, which may be viewed as an evidence of high political value of this particular instrument.

Initially the following basic conditions for government guarantees were defined:

(1) Guaranteed loan terms:

- loan shall be used for funding the core business operations of the company and of the related capital projects;
- loan shall be received from Russian banks (including the revolving credit facilities);
- loan period shall be between six months and five years;

(2) Guarantees parameters requirements and limitations:

- guarantee shall be provided to a company to secure its loan pay-back obligations *in the amount up to 50%* of the received loan (the principal);

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[1] It is necessary to state that along with the reviewed mechanism of providing guarantees to strategic companies, another similar mechanism was formed in late 2008 – early 2009. It stipulated government guarantees to strategic companies within the defense industry: the above mentioned Federal Law No.324-FZ of December 30, 2008, stipulated government guarantees to such companies for the total amount of RB 100 bn (further on it was decreased down to RB 75 bn). The respective Rules were approved by the RF Government Resolution No.104 of February 14, 2009. At the same time a number of companies included into the List of Strategic Companies complied with the criteria set for strategic defense companies, due to which some of them received government guarantees in 2009 under the second mechanism. However, due to significant specifics of this area of government guarantee support, relatively modest coverage and insufficient data about it in public sources we will refrain from reviewing it here.

[2] Federal Law No.324-FZ of December 30, 2008, "On Amendments to the Federal Law "On 2009 Federal Budget and 2010 - 2011 Plan"".

[3] RF Government Resolution No.103 of February 14, 2009, "On Provision of Government Loan Guarantees for 2009 to Companies Selected as per the Procedure Set by the RF Government Borrowing for Supporting Core Business Operations and capital Projects".

Strictly speaking, neither this document, nor the previously enacted law explicitly stated that the recipients of such guarantees should be qualified as strategic companies – they refer to "companies selected as per the procedure set by the RF Government". However, government officials repeatedly emphasized in their various comments and presentations, that this mechanism was focused on strategic companies – ref., "V. Putin: RB 326.3 bn provisioned for support to the RF economy", Prime-TASS, December 30, 2008.

[4] Ref. Abstracts from the veRbatim records of the extended Presidium session of the Government Council for Improving the Efficiency of Government Support to Real Sector held on February 20, 2009, in Irkutsk (http://www.kremlin.ru/transcripts/3258).

- *guarantee period shall be defined based on the obligation discharge deadline set by t he Loan Agreement extended by 1 year,* and in case the company's obligations are also secured by *real property collateral – by 2 years;*
- guarantee shall be provided for the amount *of no less than RB 150 mln;* the total amount of guarantees provided to one company *shall not exceed RB 10 bn;*

(3) Terms and limitations for providing guarantees:

- guarantee *shall not be used to secure obligations to payout interest on the loan,* other interest, commission, forfeit (fines and penalties), as well as responsibility of a company for failure to fulfill or for unduly fulfillment of its obligations under the Loan Agreement and for infliction of loss;
- guarantee *shall not be provided to a company with outstanding (unsettled) debt* to the Russian Federation (mandatory payments), nor to a company subject to *insolvency law suit and/or bankruptcy procedure;*
- *availability of counter-security for the company's obligations* under Loan Agreement shall be *the mandatory condition for receiving government guarantees*. With that *the total amount of the security for the company's obligations, guarantee inclusive, shall comprise no less than 100% of the loan amount* (the principal);

(4) Conditions for exercising guarantee:

- guarantee shall be exercised in the amount not to exceed 90% of the amount of non-fulfilled company obligations for payback of the principal;
- the Russian Federation shall bear subsidiary liability for the guarantees; guarantee shall be subject for exercise after other security for the company obligations under Loan Agreement is fully exercised;
- Creditor's receivables under Loan Agreement in part equal to the guarantee amount shall be subject to cession in favor of the Russian Federation represented by the RF Ministry of Finance before the guarantee is exercised.

It was also established that the Joint Inter-Departmental Committee set up by the RF Ministry for Economic Development shall select the companies for providing guarantees in the amount not to exceed Rb 5 bn, and that companies for providing guarantees in the amount above Rb 5 bn shall be selected by the RF Government Commission on improving Russian economy sustainability. Provided the decision of the respective Commission is positive, the company shall submit a package of documents to the RF Ministry of Finance no later than December 1, 2009. This package needed to include, among others, the original copy of the Loan Agreement with the bank. The RF Ministry of Finance together with Vnesheconombank shall perform the compliance check of the presented documents against the established requirements and shall within 10 days make a decision about providing or not providing government guarantees.

Simultaneously with developing the legal framework for government guarantees mechanism the required organizational infrastructure was formed in late 2008 – early 2009. The already mentioned RF Government Commission on improving Russian economy sustainability[1] and the Inter-Departmental Work Group for monitoring financial and economic status of organizations

[1] The Commission was established by the RF Government Resolution No.957 of December 15, 2008. The scope of the Commission was not at all limited to reviewing the issues and making decisions on support to strategic companies. By now this Commission has been liquidated due to establishing the Government Commission for Economic Development and Integration (RF Government Resolution No.1166 of December 30, 2009).

included into the List of Strategic Companies[1] (starting from March 2009 it was transformed into a Commission with the same name[2]) became the key elements of such infrastructure.

The first requests for government guarantees from strategic companies had been preliminary approved before the RF Government adopted the above described Rules.

Thus, according to mass media, on February 4, 2009, the Inter-Departmental Work Group approved provision of government guarantees to OJSC KAMAZ in the amount of Rb 4.6 bn[3].

However, after that *during about half a year* the requests for guarantees were reviewed and approved in an extremely slow manner, and government guarantees were not provided to strategic companies at all. The key reason pertained not to bureaucratic delays, but rather to the difficulties of executing Loan Agreements with banks. Banks' disagreement with one of the key conditions for providing guarantees became the main stumbling stone in negotiations. This was the condition according to which *the government was obliged to exercise the guarantee only after all other security for the loan had been exercised in full*. On top of that, the banks were very much dissatisfied with the norm providing for the government guarantee to cover no more than 90% of the outstanding company obligations[4].

By March-April of 2009 lack of any visible progress in provision of government guarantees raised certain concerns in the top echelons of power[5] resulting in declarations of possible modifications to this mechanism in the interests of the banks: it was planned to establish the norm that the banks shall receive money against government guarantees immediately upon guarantee event occurrence – prior to exercising other security[6].

The first amendments were introduced into the legal framework for the mechanism of government guarantees to strategic companies in late April. They, however, did not change the procedure for granting and exercising the government guarantees, but just *expanded the list of possible grounds for provision of guarantees:* in addition to funding the core operations and capital projects it was allowed to use loans issued against government guarantees for *redemption of loans and bonded loans* previously raised by the companies for supporting their core operations and capital projects[7].

In May 2009 the topic of government guarantees for credit facilities to strategic companies again was put into the focus of the top government officials[8]. Soon the RF Ministry of Finance

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[1] Order No. 7 by the RF Ministry for Economic Development of January 17, 2009

[2] Order No. 83 by the RF Ministry for Economic Development of March 16, 2009

[3] G. Stolyarov. Guarantee for KAMAZ – Vedomosti, February 5, 2009

[4] Ref.: Yu. Chaykina, T. Alyoshkina. Guarantees are not profitable for SbeRbank – Kommersant of March 30. 2009

[5] Ref. Materials for the working meeting of the RF President D. Medvedev with the First Vice-Premier I. Shuvalov on March 16, 2009 (http://www.kremlin.ru/transcripts/3454).

[6] Opening remarks by Prime Minister Putin at the economic conference on April 22, 2009 (http://premier.gov.ru/events/news/3936/).

[7] Federal Law No.76-FZ of April 28, 2009, "On Amendments to the Federal Law "On 2009 Federal Budget and 2010-2011 Plan"

[8] Thus, in his Opening Remarks at the conference on banking system development on May 13, 2009, President D. Medvedev acknowledged that the idea of providing government guarantees had failed in its initial format. He proposed to make the government jointly and severally responsible for its guarantees (http://www.kremlin.ru/transcripts/4048).

submitted draft amendments to the legal framework for granting government guarantees, and they were adopted at the end of June[1].

The key changes to the norms regulating government guarantees provision were as follows:

- redemption of loans and bonded loans previously raised by the companies for supporting their core operations and capital projects was included into the list of possible borrowing objectives along with funding core business operations and associated capital projects (as has been stated above, the respective changes were prior to that introduced into the Budget Law);
- *additional requirements were set for the companies* seeking government guarantees, including the following:
  - top management bonuses cancellation;
  - transparency of financial and business operations;
  - discharge of employer's obligations during layouts, maintaining jobs for the disabled and other socially disadvantaged categories of employees;
- elimination of the norm about government guarantees covering not more than 90% of the company's outstanding obligations to the bank;
- elimination of the norm about exercising government guarantees only upon other company's securitization is fully exercised. Instead it was set that the bank in case the borrower does not perform against its loan payback obligations issue the respective claim to this company, and in case the latter is not fully settled within 30 days – the bank is qualified for claiming the respective guarantee to be exercised by the Ministry of Finance.

We need to state here that the main objective of modifying government guarantees mechanism was to provide additional incentives to the banks for issuing loans secured by government guarantees. Commenting this measure Prime-Minister V. Putin called for banks leadership to make a counter-move by increasing the issue of loans to priority businesses and to reduce borrowing costs[2].

In August 2009 the process of issuing loans to strategic companies against government guarantees finally got on rolling.

In the end of August 2009 VTB announced issuing the first tranches to OJSC KAMAZ (total loan amount – Rb 2.9 bn, government guarantee amount – Rb 1.45 bn), OJSC Sollers (Rb 1 bn and Rb 500 mln respectively) and OJSC Sollers – Naberezhnye Chelny (Rb 700 mln and Rb 350 mln).

Approximately at the same time the number of approved requests for guarantees started growing fast. However, we believe that amendments to the regulations were not the only fac-

[1] RF Government Resolution No.542 of June 30, 2009. Remarkably, the respective amendments into the Federal Law "On 2009 Federal Budget and 2010-2011 Plan" (except for the norm expanding the list of possible purposes of using the borrowed funds) were introduced later still – in early October (Federal Law No.230-FZ of October 3, 2009).

[2] Opening remarks by Prime-Minister V. Putin at the conference on preliminary key parameters of federal 2009 budget and 2011-2012 plan and on the principles of budget expenditure formation on June 29, 2009 (http://premier.gov.ru/events/news/4529/)

tor underpinning such growth. *The political message to major banks with government stake* on behalf of the Prime-Minister about the need to increase issue of loans was extremely important, as well as *relative economic recovery* (significant retardation of the decline and reduction of uncertainty level).

According to some official statements, by the end of October 2009 requests from strategic companies for government guarantees for the total amount of RB 189 bn were approved making approximately 95% of the amount allocated within 2009 federal budget. The practice of granting government guarantees was also improved: in early October the total amount of government guarantees granted to strategic companies was RB 8.2 bn, and by the end of this month this amount was already RB 41.8 bn[1] – a bit more than 20% of the amount allocated in 2009 budget.

By early December 2009 the overall amount of the approved requests was making Rb 199.4 bn almost achieving the limit set by the federal budget (RB 200 bn). Most likely due to this fact this limit was *increased by Rb 25 bn*[2]. Before the end of the year all the allocated funds were disbursed. The key government guarantees recipients were companies from metallurgy sector, agriculture and food processing, automotive industry, and construction.

At the same time, the process of granting government guarantees was still lagging behind: thus, by mid-December the amount of guarantees effectively provided to strategic companies was only about Rb 70 bn[3]. All the paper work and issuance of the guarantees approved in 2009 was to be continued in the next coming year.

We need to pay attention to certain specifics of the structure of government guarantees mechanism and of its applications:

– guarantees were provided to the companies with significant backlog: first loans against government guarantees were issued only in August 2009 – 6 months after the legal framework and organizational of the planned amount was actually provided. Thus, this mechanism *did not result in the required economic effect with regards to provision of long-term financing to the companies in the most acute phase of the crisis* – early in 2009 (which was especially valuable in the context of delaying other government support measures such as government procurement, budget subsidies, etc). At the same time, the intensive process of coordinating the interests of various stakeholders, settlement of claims and agreeing on the obligations for future borrowing against government guarantees became an important stabilizing factor for the economy suffering from the crisis;
– the key reason for the delay in issuing loans secured by government guarantees was the banks' disagreement with the established procedure for exercising guarantees by the government. Modification of this mechanism in mid-2009 was undertaken mostly in the interests of the banks;

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[1] Ref.: E. Pismennaya. Guarantees for modernization. – Vedomosti, October 30, 2009, and also materials for parliamentary hearings of the Council of Federation Commission for interaction with the RF Accounting Chamber on the topic: "Modernization of the Economy as Major Anti-Crisis Measure", December 17, 2009.

[2] Federal Law No.309-FZ of December 2, 2009 "On Amending Federal Law "On Federal 2009 Budget and 2010-2011 Plan"". At the same time the amount of government guarantees to strategic companies of defense industry was decreased by Rb 25 bn

[3] A.Gudkov, O. Sapozhkov. Government Guarantees Are Growing. – Kommersant, December 18, 2009
It is necessary to say that by the end of 2009 the aggregate amount of government guarantees provided to both strategic companies and defense sector companies made Rb 145.9 bn. M.Tovkaylo, V. Kholmogorova. Coming Late report. – Vedomosti, February 4, 2010.

– initially the government guarantees mechanism was focused on loans for funding the core business operations and investment activity of companies. Including restructuring of previous debt into the list of possible borrowing purposes, on one hand, was in line with the companies' needs, but on the other had it converted government guarantees from the mechanism for business development into the method of delaying urgent problem solving;
– the complexity and the duration of procedures to prepare the request and get it approved, in particular – the difficulties of executing Loan Agreements with the banks resulted in the fact that some companies initially looking for government guarantees further rejected the idea after several attempts to get everything right;
– the important feature of the mechanism was approving the requests stipulating for provision of government guarantees to several principal companies simultaneously. One of the reasons for that was the officially established ceiling for government guarantee to an individual company – Rb 10 bn. Distributing the requested amount of government guarantee between several affiliated companies allowed business groups for receiving government support in much bigger amounts than Rb 10 bn.

The new law on the federal budget[1]*, just like the previous one, stipulated provision of government guarantees in 2010* to companies selected in accordance with the procedure established by the RF Government to assure their borrowing for the purposes of *maintaining their core business operations and capital projects, as well as for redemption of previous loans and bonded loans.* In 2010 the total amount of government guarantees is planned to be RB 200 bn, while as this specific type of government support is not planned at all for 2011 and 2012. The legal framework remained the same except for one additional requirement setting that guarantees shall be provided to organizations selected in 2009 in case such guarantees were not actually issued in 2009. It is also worth noting that the rules for providing government guarantees applied in 2009 were extended onto 2010, but solely with regards to the companies, whose requests had been already approved in 2009[2].

In addition to "traditional mechanism of providing government guarantees to strategic companies" the new law of the federal budget stipulated for *another version of providing government guarantees* to the companies selected in accordance with the procedure set by the RF Government – *for loans issued to fund investment projects.* In 2010 the amount of such guarantees is to make Rb 100 bn ($3.3 bn), and they are not planned for 2011 and 2012. With that the legal norms established with regards to this new mechanism of providing government guarantees are visible different from those regulating the "traditional" mechanism described above.

The key specifics of guarantees-based support to the investment projects are the following:

- Guarantees shall cover 100% of the principal of the loan borrowed by strategic company to fund an investment project. At the same time, the amount of guarantee shall not exceed 50% of the investment project budget;
- The minimal amount of government guarantee shall be Rb 1 bn or $30 mln;
- The loan period covered by the guarantee shall be from 4 to 20 years, with that exercise of the guarantee shall not be possible before 2014;
- Securing of the government obligations shall not be required with regards to recourse issued to the company is case of exercising the government guarantee.

[1] Federal Law No.308-FZ of December 2, 2009, "On Federal 2010 Budget and 2011-2012 Plan"
[2] RF Government Resolution No.1181 of December 31, 2009

We need to emphasize that in case the new mechanism for providing government guarantees is also applied mostly to strategic companies, the aggregate amount of guarantee-based support in 2010 may reach Rb 400 bn – more than 50% of the government guarantees stipulated within the law on the federal budget for the current year.

The following comments should be made with regards to the new mechanism for providing government guarantees:

– The "investment focus" and long-term nature of this mechanism are, most likely, defined (at least partially) by the fact that the "traditional" mechanism was excessively focused on solving the current financial challenges of strategic companies;
– The fact that at least 50% of government guarantees for the investment-targeted loans shall be provided in US dollars allows for assuming that implementation of such projects will be to a great extent linked to importing equipment and technology;
– The fact that government guarantees are to cover 100% of the principal is a sign of the government planning within the framework of this mechanism to accept practically all the risks of banks financing such investment projects (and thus assure incentives for them to participate in such projects), however, this may result in less attentive review of investment projects on behalf of banks;
– Limiting the total amount of guarantee to 50% of the overall investment project budget in general allows for counting on the respective risks being shared by the government and the business, however, it may turn out very difficult to access the real contribution of business;
– Lack of the established ceiling for provided government guarantees contributes to significant increase of the interest on behalf of different stakeholders to lobbying very big, lengthy – and respectively very risky investment projects, which requires material improvement of project evaluation infrastructure.

Subsidizing part of interest rates paid by strategic companies on their loans

Eventually the RF Government Anti-Crisis Program for 2009 stipulated the following areas of subsidizing the interest rates of real sector companies' loans (under which strategic companies could be the recipients of borrowed funds)[1]:

- Subsidizing interest rates for the loans issued to manufactured goods exporters (RB 6 bn allocated for such purposes within the budget);
- Subsidizing interest rates for the loans issued to meat-and-dairy companies (Rb 7 bn);
- Subsidizing interest rates for the loans issued to Subsidizing interest rates for the loans issued to other agricultural companies (Rb 10 bn);
- Subsidizing interest rates for the loans issued to forestry enterprises to set-up shoulder-season stock of timber, feedstock and fuel (Rb 0.325 bn);
- Subsidizing interest rates for the loans issued to automotive and transport engineering companies for their technical refurbishment (Rb 2.5 bn);

[1] In addition to the listed areas the RF Government Anti-Crisis Program also stipulated subsidies of interest rates on the loans received by fisheries in the amount of Rb 1.07 bn, however, such companies are not represented in the List of Strategic Companies. On top of that, 3 measures were stipulating subsidizing of the shortfall in revenues associated with carrying out government assignments, and 1 measure – providing subsidies to strategic defense companies to prevent their bankruptcy

- Subsidizing interest rates for the loans issued to defense industry companies being the prime contractors (contractors) for the government defense procurement (Rb 15 bn);
- Subsidizing interest rates for the loans issued to defense industry companies for implementing innovations and investment projects targeted at hi-tech products (Rb 1 bn).

We will briefly review here those of the above listed measures that were practically implemented in 2009.

Subsidizing manufactured goods exporters

The mechanism for partial reimbursement out of the Federal Budget of the interest rates on the loans received by Russian exporters of manufactured goods was formed back in 2005[1] and has remained practically unchanged. The norms set the following key conditions for receiving such budget subsidies:

– A company should be exporting manufactured goods for at least 3 years;
– The loans received by a company should be used for exporting goods with high degree of processing[2].

Two thirds of the interest rate of such loans is subject to reimbursement- not to exceed two thirds of the Central Bank refinancing rate.

Early in 2009 the RF Government[3] allocated Rb 6 bn to subsidize interest rates on the loans issued to Russian exporters[4]. This amount was used during the first 9 months of the year. Moreover, the exporters eventually received a slightly bigger amount of Rb 6.135 bn, and 90% of it (Rb 5.709 bn) was distributed among them during H1 2009[5].

In December 2009 the amount of budget allocations for implementing this measure of government support was increased up to Rb 9 bn[6].

Over 100 Russian exporters received interest rate subsidies during 2009 for the overall amount of RB 9.135 bn. It is worth noting that only 1/3 of them belonged to the List of Strategic Companies or were subsidiaries of strategic companies, however, in terms of the amount of budget subsidies they received about ¾ of it. With that the major bulk of the subsidies were granted to various strategic companies from the defense sector (primarily to space rocket engineering and aviation), as well as nuclear sector and automotive industry.

The key areas of the RF Government anti-crisis measures for 2010[7] stipulate budget subsidizing of exporters to reimburse part of their interest rate on the loans they received from Russian credit institution in 2005–2012 in the amount of Rb 7 bn.

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[1] Rules for providing budget subsidies to Russian exporters of manufactured goods to partially reimburse their interest rates on the loans received from Russian credit institutions, as approved by the RF Government Resolution No.357 of June 6, 2005

[2] The procedure for qualifying the goods as those with high degree of processing is currently defined by Order No.31 of the RF Ministry of Industries and Trade issued on February 2, 2009

[3] Federal Law No.204-FZ of November 24, 2008, “On Federal 2009 Budget and 2010-2011 Plan” granted the RF Government the right to allocate up to Rb 175 bn (as effectively amended – up to Rb 450 bn) within the Federal Budget to support capital market (as effectively amended – to support capital and labor markets, and sectors of Russian economy, social net for Russian citizens and other social policy measures)

[4] RF Government Resolution No.24 of January 14, 2009 (Rb 3 bn were allocated for the same purpose in 2008)

[5] Order No.144 of the RF Ministry of Industries and Trade, Order No.144 of the RF Ministry of Finance issued on March 27 2009; Order No.250 of the RF Ministry of Industries and Trade, Order No.175 of the RF Ministry of Finance issued on April 20, 2009.

[6] RF Government Resolution No.996 of December 2009

[7] As approved at the RF Government session on December 30, 2009

Subsidizing the RF constituent entities (regional governments) to reimburse interest rates on the loans received by agricultural and food processing companies

This measure practically combines 2 areas stipulated by the RF Government Anti-Crisis Program: subsidizing interest rates on the loans issued to meat and dairy products manufacturers (Rb 7 bn) and other sub-sectors of agriculture and food processing (Rb 10 bn). The legal framework of this particular measure[1] is different from the others and sets a two-stage procedure for allocating such subsidies: first the funds are allocated within the Federal Budget to regional government, and only then they are distributed between agriculture and food processing companies. Payments of interest on short-term loans (up to 1 year) used to procure Russian-make agricultural feedstock and for some other needs, as well as payments of capital loans used to procure certain types of equipment, transport vehicles and machinery (the list defined by the RF Ministry of Agriculture), as well to fund upgrading of farms, storage facilities, greenhouses, etc. may be subject to reimbursement. For certain types of loans issued to meat and dairy companies the amount of subsidies was set at 100% of the refinancing rate, while as in other cases it makes 80%[2].

In February 2009 the RF Government allocated Rb 17 bn to implement this measure, out of which Rb 12.1 bn were meant to reimburse the interest on capital loans, and Rb 4.9 bn – interest on short-term loans[3]. During the first 3 quarters of 2009 Rb 16.9 bn were remitted to the RF regions: Rb 12.1 bn – to reimburse the interest on capital loans, and Rb 4.8 bn – interest on short-term loans. Let us note that over 90% of the funds were disbursed in H1 2009. Most likely, members of the List of Strategic Companies were among the end beneficiaries of funds; however, we do not have reliable data on the amount of subsidies granted to those particular entities under this measure.

Subsidizing companies of the forestry sector

The legal framework for this particular mechanism was the last one to be developed – in late June of 2009[4]. In particular, it stipulated the following:

- Loans subject to partial interest rate subsidies should be received from Russian credit institutions in 2008–2009 and used for setting up the shoulder-season stock of timber, feedstock and fuel;
- Subsidies should cover 2/3 of the interest rate not to exceed 2/3 of the Central Bank refinancing rate.

In September 2009 the RF Ministry of Industries and Trade decided to subsidize 11 companies from the forestry sector for the total amount of Rb 59 mln[5]. In early October these funds were effectively disbursed to the recipients. The names of such recipients were not officially published, however, as per mass media, at least one of them belonged to the List of Strategic Companies – OJSC Arkhangelsk pulp-and-paper plant (received Rb 15 mln).

Subsidizing defense industry companies engaged in government procurement

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[1] Federal Law No.318-FZ of December 30, 2008, "On Amendments to Articles 11 and 18 of the Federal Law "On Development of Agriculture""; RF Government Resolution No.90 of February 4, 2009

[2] In addition, regional budgets are used for additional reimbursement in the amount exceeding the Central Bank refinancing rate by 3% – for meat and dairy manufacturers, and in the amount of 20% of the refinancing rate – for other companies.

[3] RF Government Resolution No.140 of February 24, 2009

[4] RF Government Resolution No.528 of June 25, 2009

[5] Order No. 866 by the RF Ministry of Industries and Trade issued on September 28, 2009

This mechanism stipulates subsidies to defense industry companies performing as contractors (including – as prime contractors) of the government procurement to cover a part of their interest rate payments on the loans received from Russian credit institutions to sustain their core business operations. The respective legal framework was developed in late March 2009[1], but the actual disbursement of funds started only in H2 2009. According to the RF Government Anti-Crisis Program, the aggregate amount of this type of subsidies for 2009 should be making Rb 15 bn; however, according to the available data, the companies effectively received only about Rb 5.5 bn. Over 50 companies became the recipients for these funds, and 2/3 of them either belonged to the List of Strategic companies themselves, or comprised subsidiaries of strategic companies. About ¾ of the effectively disbursed subsidies (Rb 4 bn) covered this 2/3 of the companies.

Subsidizing automotive and transport engineering companies

In January 2009 the RF Government allocated Rb 2.5 bn as subsidies to Russian automotive and transport engineering companies to reimburse part of their interest rate payments on the loans used for technical upgrade and refurbishment[2]. However, the legal framework for this mechanism was developed only by the end of March[3], while as the criteria for selecting the refurbishment projects – only by the end of May 2009[4]. It was defined that 2/3 of the interest rate is subject for subsidizing, not to exceed 2/3 of the Central Bank refinancing rate.

In August 2009 additional opportunity aroused for receiving subsidies for partial reimbursement of funds paid by Russian automotive manufacturers as coupon yields on the bonds issued in 2009 to finance their own or subsidiaries' refurbishment projects[5]. Subsidies were to cover 2/3 of coupon yields payments, not to exceed 2/3 of the Central Bank refinancing rate.

In December 2009 the RF Government reduced budget allocations for such subsidies from Rb 2.5 bn down to 1.5 bn[6]. By this time the RF Ministry of Industries and Trade had reviewed 15 requests for subsidies (9 of them submitted by automotive businesses and 6 – by transport engineering companies). In October 2009 the RF Ministry of Industries and Trade drafted the first Resolution on granting the subsidies for the total amount of RB 59 mln[7]. Nevertheless, no effective disbursement of funds had been initiated by mid-December.

The key areas of the RF Government anti-crisis measures for 2010 stipulate subsidies to automotive and transport engineering companies to reimburse part of their interest rate payments on the loans received in 2008-2009 and used for technical upgrade and refurbishment for the total amount of Rb 2.5 bn.

The following overall conclusion may be made with regards of planned and actually effected interest rates subsidizing:

– The total budget allocations covering 7 areas of subsidizing in accordance with the RF Government Anti-Crisis Program were to make Rb 42 bn. Defense industries together

[1] RF Government Resolution No.255 of March 26, 2009
[2] RF Government Resolution No.24 of January 14, 2009
[3] RF Government Resolution No.262 of March 30, 2009
[4] Order No.453 of the RF Ministry of Industries and Trade issued on May 28, 2009
[5] RF Government Resolution No.675 of August 19, 2009
[6] RF Government Resolution No.996 of December 10, 2009
[7] Materials for parliamentary hearings of the RF Council of Federations Commission for Interaction with he Accounting Chamber of the Russian Federation on the topic: "Modernization of economy as the Main Anti-Crisis Measure", December 17, 2009

with agricultural and food processing companies were to become the main recipients of these funds;

– In the majority of cases interest rate subsidies were to cover no more than 2/3 of the refinancing rate, while as for meat and dairy products manufacturers the subsidies were set at 100% of the Central Bank discount rate;
– These measures covered loans issued not only in 2009, but in earlier periods as well (in 2008, and in some cases – in preceding years). Thus, subsidies were targeted (at least partially) at servicing the debt accumulated by the respective companies and improving financial stability of these companies;
– The measures implemented rather quickly – subsidies to exporters of manufactured goods and to agricultural and food processing companies – represented continuation of programs implemented over the preceding years, while as in other cases actual disbursement of funds either was initiated after a significant delay, or was not effected at all;
– During 10 months of 2009, according to the available data, the funds were disbursed only within 5 measures (*Table 1*). The actual federal budget spent in these areas amounted to circa Rb 32 bn, 80% of which were received by defense industries together with agricultural and food processing companies;
– The overall amount of interest rate subsidies to strategic companies and their subsidiaries (without accounting for the funds provided to agricultural and food processing companies out of the regional budgets) made about Rb 7 bn. The defense industries were the dominating recipients of these funds. Among civil industries the most meaningful amounts of subsidies were granted to strategic companies in nuclear and automotive industries.

Table 1

Interest Rate Subsidizing Mechanisms

	Allocations, Rb bn[1]	Disbursed funds, Rb bn[2]	Execution, %	Funds disbursed to strategic companies[3] Rb bn[2]	Purposes of borrowing	Time of borrowing
Interest rate subsidies to exporters	6 / 9[4]	9.1	102	6.7	Export of goods with high degree of processing	2005–2010
Interest rate subsidies to agricultural manufacturers and food processing companies	17	16.9[5]	99	NA		
-for capital loans	12.1	12.1[5]	100	NA	Procurement of equipment, specialized vehicles and machinery, pedigree stock (materials; establishment of perennial plantings and vineyards; construction and upgrading of grafting facilities for perennial plants, of livestock units (farms), breeding and forage production facilities, storage facilities for potatoes, vegetables and fruit, greenhouses, etc.	Beginning of 2008
-for short-term loans	4.9	4.8[5]	99	NA	Procurement of lubricants, spare parts and materials for repairing agricultural machinery, mineral fertilizers, crop-protective agents, forage, veterinary preparations and other material resources for seasonal operations; procurement of young stock, of Russian-make agricultural feedstock for primary processing and industrial food processing, etc.	Beginning of 2004, 2005, 2007, 2008 or 2009 – depending on the recipient and purposes of borrowing

	Alloca-tions, Rb bn[1]	Dis-bursed funds, Rb bn[2]	Execution, %	Funds disbursed to strategic companies[3] Rb bn[2]	Purposes of borrowing	Time of borrowing
Interest rate subsidies to forestry companies	0.325	0.06	18	No less than 0.015	Set-up of shoulder-season timber, feedstock and fuel stock	2008–2009
Interest rate subsidies and bond loans interest payments reimburse-ment to automotive and transport engineer-ing companies	2.5 / 1.5[3]	0	0	0	Implementation of technical refurbishment projects	2008–2009
Interest rate subsidies to defense industry companies performing in the capacity of prime contractors (contractors) for gov-ernment military pro-curement	15 / 5,3	5,5	104	4	Core business operations	2008–2009
Interest rate subsidies to defense industry companies to imple-ment innovations and investment projects	1	0	0	0	Implementation of innovations and invest-ment projects to assure hi-tech production	

[1] in accordance with the RF Government Anti-Crisis Program for 2009
[2] during 10 months of 2009
[3] accounting for the subsidiaries
[4] after adjustments
[5] during 9 months of 2009

Additional capitalization for strategic companies

The following measures were implemented within this area of support:

(1) using budget monies to fund issue of new private companies shares (to increase of collective capital funds of unitary enterprises);

(2) additional asset contributions to state-owned corporation "Rostekhnologiyi"

Increasing charter capitals of private companies

In the end of 2008 and throughout 2009 the RF Government adopted several resolutions about additional capitalization of 13 organizations – either members of the List of Strategic Companies, or directly linked to companies from the List. Rb 118 bn were allocated within the Federal Budget for this purpose. 10 organizations represented the defense industry, however (Rb 57 bn). As a rule, additional capitalization for such companies was aimed at stabilizing their financial positions, redemption of debt and working capital replenishment.

The major bulk of the allocations were granted to OJSC Russian railways. With that, the RF Government issued to separate resolutions about increase of the company's charter capital: the first one in December 2008[1] – by Rb 41.5 bn, and the second one – in July 2009[2] – by Rb 11.3 bn, 3 bn out of which were to be spent on purchasing products from Tverskoy coach-building works, and 8.3 bn – on construction of track between Yayva and Solikamsk.

In addition, in 2009 the RF Government adopted resolutions on additional capitalization of 2 other strategic companies: Research and Production Center "Urals wagon Works" – by Rb

[1] RF Government Directive No.1877-p of December 16, 2008
[2] RF Government Directive No.918-p of July 7, 2009

4.4 bn to redeem the debt[1], and OJSC Rus Hydro – by Rb 4.3 bn to fund the construction of discharge sluice at Sayano-Shushenskaya hydroelectric plant[2].

The Law on the Federal 2010 Budget allocated funds for additional capitalization of several dozens of companies, some of which are part of the List of Strategic Companies.

Asset contributions to state-owned corporation "Rostekhnologiyi"

During 2009 the RF Government adopted 3 resolutions about disbursement of the federal budget funds to state-owned corporation "Rostekhnologiyi" for their further disbursement to OJSC AVTOVAZ as interest-free loans:

- in early June the respective asset contribution made Rb 25 bn[3];
- in mid-December it made Rb 12 bn. The following limitations were set: the funds should be used only to assure discharge of AVTOVAZ obligations to suppliers, intermediaries, credit institutions and other counterparties with further increase of Rostekhnologiyi share in the charter capital of the company[4];
- in late December – RB 28 bn allocated for discharge of AVTOVAZ obligations to credit institutions with further increase of Rostekhnologiyi share in the charter capital of the company[5].

It should be noted that in the last case 2 pre-conditions were set for the automotive manufacturer to qualify for receiving the funds:

- prepare and agree with the RF Ministries of Industries and Trade, of Economic Development and of Finance the mid-term Program of ABTOVAZ development including high potential investment projects;
- sign MOU between Rostekhnologiyi, OJSC AVTOVAZ and group of banks including Sberbank and VTB about restructuring the company's debt and banks' commitment to issue loans to fund its core business operations under mutually accepted terms.

In addition, late in 2008 and early in 2009 5 more decisions were made to disburse budget funds to Rostekhnologiyi as asset contributions:

- 2008: Rb 1.5 bn without indicating specific objectives[6];
- 2009:
  - Rb 7.48 bn to finish the construction and commissioning of federal hi-tech medical centers[7];
  - Rb 2.97 bn to settle debt servicing obligations on loans used for consolidation of VSMPO-AVISMA Corporation[8];
  - Rb 1.44 bn to fund especially important and special flights of aircrafts[9];
  - Rb 900 mln without indicating specific objectives[1].

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[1] RF Government Directive No.346-p of September 15, 2009

[2] RF Government Directive No.1604-p of November 2, 2009

[3] RF Government Directive No.745-p of June 1, 2009

[4] RF Government Directive No.1895-p of December 10, 2009

[5] RF Government Directive No.2080-p of December 25, 2009

[6] RF Government Directive No.1847-p of December 8, 2008 – respective amendments were introduced into 2009 budget by Federal Law No.837-FZ of November 8, 2008

[7] RF Government Directive No.837-p of June 2,2 2009

[8] RF Government Directive No.1466-p of October 8, 2009 – respective amendments were introduced into 2009 budget by Federal Law No.76-FZ of April 28, 2009

[9] RF Government Directive No.1717-p of November 13, 2009 – respective amendments were introduced into 2009 budget by Federal Law No.230-FZ of October 3, 2009

Providing incentives to increase domestic demand for strategic companies products

Additional government procurement

The RF Government Anti-Crisis Program identified two large-scale measures stipulating government and municipal procurement of products manufactured by the companies included into the List of Strategic Companies:

(1) automotive vehicles for federal executive agencies, their territorial branches and subordinate institutions (Rb 12.5 bn from the Federal Budget);

(2) renewal of the automotive vehicles fleet used by regional and municipal authorities for passenger transfer, medical purposes, of specialized vehicles used by militia, by utility companies and for road construction purposes (Rb 20 bn from the Federal Budget, Rb 10 bn as co-financing from regional budgets).

<u>Procuring automotive vehicles for federal executive agencies</u>

Funds to procure automotive vehicles for federal executive agencies in the amount of Rb 12.5 bn were allocated by the RF Government in February были 2009[2]. In the same month the RF Ministry of Industries and Trade approved the list of automotive vehicles for such procurement[3], comprising over 1 thousand of various types and names (cars and trucks, buses, tow cars), with practically all of them (99.9%) being manufactured by plants either included into the List of Strategic Companies, or by their subsidiaries.

By early October 2009 automotive vehicles were procured for the amount of Rb 11.8 bn (94% of allocated funds), including Rb 2.2 bn spent on purchasing VAZ cars (“Ladas”), Rb 2.1 bn – on KAMAZ trucks (in the amount of 2.1 thousand trucks), Rb 2.0 bn – on UAZ (2 thousand cars), Rb 1.6 bn – on GAZ (1.7 thousand cars), Rb 1.4 bn – on FIAT (1.4 thousand cars)[4].

In early November budget allocations were this purpose were increased up to Rb 15.5 bn.

<u>Renewal of the automotive and specialized vehicles fleet used by regional and municipal authorities</u>

In late March of 2009 the RF Government allocated total amount of Rb 20 bn to purchase automotive and specialized vehicles; at the same time the main rules for disbursement of such funds were approved[5]. In mid-April the RF Ministry of Industries and Trade approved the list of Russian manufacturers of the respective vehicles comprising all automotive manufacturers from the List of Strategic Companies, as well as number of their subsidiaries.

By early October the RF Government allocated the total subsidies of Rb 12.6 bn, and then a month later they amounted to Rb 14.4 bn. The procurement of vehicles was significantly lagging behind due to the need to organize tender procedures, review the bids, award and execute contracts, etc. Thus, by October 2009 the total amount of executed contracts was only RB 4.3 bn. The majority of vehicles were procured from GAZ and KAMAZ.

Creating incentives for demand

The RF Government Anti-Crisis Program for 2009 stipulated a series of measures and steps to create incentives for demand for the product manufactured by the plants included into the

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[1] RF Government Directive No.2065-p of December 24, 2009
[2] RF Government Directive No.139-p of February 9, 2009
[3] Order No.78 by the RF Ministry of Industries and Trade issued on February 20, 2009
[4] UAZ and Fiat cars are manufactured by subsidiaries of OJSC Sollers
[5] RF Government Resolution No.253 of March 24, 2009

List of Strategic Companies. We need to focus on two measures, implementation of which allowed for achieving visible results in 2009:

(1) subsidizing 2/3 of the refinancing rate for 3-year consumer loans for purchasing cars manufactured in the territory of Russia (overall amount making Rb 2 bn);

(2) increasing the charter capital of OJSC RosAgroLeasing to procure domestically made agricultural machinery and equipment subject to further leasing (Rb 25 bn).

Partial interest rate subsidies for loans to consumers

The Federal Budget allocations for subsidizing 2/3 of the refinancing rate for 3-year consumer loans for purchasing cars manufactured in the territory of Russia for the total amount of Rb 2 bn were agreed by the RF Government in February 2009[1]. This measure was applied only to cars with the price not to exceed Rb 350 K included into a special list created by the RF Ministry of Industries and Trade. The initial version of this list[2] contained names of 29 car types, 25 of which were manufactured by strategic companies and their affiliates: 23 – by AVTOVAZ; 1 – by its joint venture with General Motors; 1 – by Sollers Group enterprises.

In March 2009 the RF Government adopted the rules for providing subsidies to Russian credit institutions to compensate for the shortfall in income from consumer loans for purchasing cars[3]. However, disbursement of such funds did not start until the end of the first six months.

In July 2009 the coverage of this measure was significantly expanded: now it could be applied not only to passenger cars but to commercial vehicles with mass not to exceed 3.5 tons, and the maximum price of a car/vehicle was increased up to Rb 600 K[4]. The list of cars/vehicles subject to such measure was also significantly expanded – up to 50 names, 37 of which were manufactured by strategic companies and their affiliates [5]. With the representation of VAZ cars (together with VAZ / General Motors JV) was decreased down to 18 names, and Sollers cars representation was increased up to 12; moreover, 7 other cars were added to the list (manufactured by GAZ).

In Q3 2009 the process of disbursing the subsidies started rolling out, however, the scale of this measure was far from the originally expected: by early October about 39 thousand of soft auto loans were issued (32 thousand – for VAZ cars), and the amount of interest rate subsidies was Rb 33 mln; and one month after the number of loans reached 48 thousand, and the amount of subsidies – about Rb 40 mln. In December 2009 the amount of budget allocations for this purpose was decreased more than 2 times – down to Rb 950 mln[6]. However, the actual total amount of granted subsidies during 2009 made less than 20% of the budget limit – Rb 187.7 mln[7].

The key areas for the RF Government anti-crisis activities in 2010 stipulate subsidies to Russian credit institutions to compensate the shortfalls in income on loans issued in 2009–2010 to individuals for purchasing cars – for the total amount of Rb 1 bn.

Increasing OJSC RosAgroLeasing charter capital

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[1] RF Government Directive No.139-p of February 9, 2009

[2] Order No.77 by the RF Ministry of Industries and Trade issued on February 20, 2009

[3] RF Government Resolution No.244 of March 19, 2009

[4] RF Government Directive No.905-p of July 7, 2009

[5] Order No.650 by the RF Ministry of Industries and Trade issued on July 15, 2009

[6] RF Government Resolution No.996 of December 1o, 2009

[7] M. Tovkaylo, V. Kholmogorova. Coming Late report. – Vedomosti, February 4, 2010.

RF Government agreed for additional capitalization of OJSC RosAgroLeasing in the overall amount of Rb 25 bn in early February 2009[1]. By early March the respective funds were disbursed to OJSC RosAgroLeasing. By October 2009 the company used these funds to procure products to be leased to agricultural manufacturers for the overall amount of Rb 28.4 bn, including:

– Agricultural machinery – for Rb 22.8 bn;
– Equipment for cattle breeding and agricultural products processing – for Rb 3.6 bn;
– Pedigree livestock – for Rb 2 bn.

During 9 months of 2009 RosAgroLeasing supplied the agricultural manufacturers with 2,882 tractors, 1,600 harvesters, 4,196 automotive vehicles, 1,719 machinery and equipment pieces for setting-up grain processing facilities, and 18.9 thousand of high-yield pedigree cattle stock.

Decreasing the burden on business

Decreasing tax burden in oil-and-gas sector

The majority of tax measures applied from the time the crisis started were of "general systemic" character. We can identify some measures, however, focused at strategic companies, in particular – measures to decrease the tax burden on oil-and-gas sector:

- increasing the tax-exempt minimum from 9 to 15 $/bbl when calculating MET rates;
- improving the procedure for recognizing (deducting) the expenses for subsoil licenses acquisition when calculating the Profit Tax by providing the taxpayers with the possibility to write-off such expenses during the period of 2 years
- introducing tax holidays for developing off-shore fields, fields in Nenetsky Autonomous District, Yamal Peninsula, East Siberia, Azov and Caspian seas[2].

As per the available estimates, the aggregate benefit for oil-and-gas companies amounted to over RB 100 bn.

We also need to emphasize here, that starting from January 1, 2010, a number of changes were introduced to classification of fixed assets included into amortization groups[3]. These changes are about shifting certain types of equipment (primarily those used in exploration and production) into amortization groups with shorter useful life.

Tax arrears restructuring

The RF Government Anti-Crisis Program for 2009 stipulated adjustments to the effective schedules for *redemption of restructured tax arrears of the automotive companies* to the federal budget, as well as to extra-budgetary funds (in terms of insurance payments arrears). In March 2009 the RF Government adopted respective resolutions with regards to OJSC AVTOVAZ and AMO ZIL[4]. According to the RF Ministry for Industries and Trade, simultaneous restructuring of tax arrears was performed for the amount of Rb 7.24 bn[5].

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[1] RF Government Directive No.122-p of February 4, 2009

[2] Federal Law No.158-FZ of July 22, 2008, "On Amendments to Chapters 21, 23, 24, 25 and 26 of Part II of the Tax Code of the Russian Federation and to some other legislation of the Russian Federation pertaining to taxation"

[3] RF Government Resolution No.165 of February 24, 2009

[4] RF Government Resolution No.260 of March 30, 2009

[5] Ref. Report by V. Khristenko, Minister of Industries and Trade at the Government Briefing in the state Duma on October 19, 2009 (http://www.minprom.gov.ru/press/release/showNewsIssue?url=press/release/818)

Let us also note that in December 2009 the RF Government defined the procedure and conditions for *restructuring the arrears for defense industry companies* engaged in government procurement and included into the List of Strategic Companies – this covered all the arrears to the Federal Budget (taxes, fees, accrued penalties and fines)[1].

Overall evaluation of coverage and sector-based specifics of measures supporting strategic companies

The aggregate amount of government support to strategic companies (taking into account the shortfall in budget revenues and potential budget expenditure) starting from October 2008 until the beginning of 2010 made, according to our estimate, about Rb 1.1 trillion[2]. Oil-and-gas sector, metallurgy, automotive and defense industries received the biggest amounts of such support.

In 2008 the amount of government support was only slightly below Rb 500 bn, the major bulk of it falling under 2 measures: external corporate debt refinancing (approximately Rb 270 bn) and amending the procedure for calculating export duties for crude (about Rb 150 bn, as per available estimates).

The amount of anti-crisis support in 2009 is estimated as exceeding Rb 500 bn; the major portion of budget resources was spent on additional capitalization of companies (direct budget expenditure of about Rb 150 bn), provision of government guarantees (amounting to Rb 150 bn), and tax incentives to oil-and-gas sector (the amount of shortfall in budget revenues exceeds Rb 100 bn, as per some estimates).

Overall, as per our estimates, the amount of direct Federal Budget expenditure and shortfall in budget revenues associated with support to strategic companies exceeded in 2009 г. the amount of Rb 300 bn.

As per the timeline of their implementation, the government support measures reviewed in this material may be clearly split into 2 groups:

- *immediate measures* – their practical implementation started in the end of 2008 or in Q1 of 2009 – such as external debt refinancing, additional capitalization, customs tariffs policy, decreasing tax burden on oil-and-gas sector, interest rate subsidies to exporters, subsidies to the RF regions to reimburse the interest rate on loans issued to agricultural and food processing enterprises, and some others;
- *"delayed" measures* – their practical implementation started only in H2 2009 – partial interest rate subsidies to defense industry and forestry industry companies, provision of government guarantees, interest rate subsidies on consumer auto loans.

A number of comments need to be provided in relation with that:

- practically all the measures having turned out as "immediate" did nit require establishment of any new mechanism for their implementation. Only external debt refinancing was exceptional – this instrument was created "from scratch" and applied very quickly (during about one month);
- the measures falling into the "delayed" group are fully financial measures initiated in 2009. The delay in their practical implementation (provision of government guaranties, interest rate subsidies on consumer auto loans) had some pretty straightforward reasons: imbedded

[1] RF Government Resolution No.995 of December 10, 2009

[2] Here and onwards – without accounting for "general systemic" measures covering a very broad range of business entities (change of Corporate Profit Tax rate, etc.)

shortcomings of the established norms and regulations, and other cases – the multiplicity of anti-crisis measures and their insufficient administration effected by lack of institutional capabilities;
– due to misalignment and mistiming of a number of anti-crisis measures, their potential synergy effect turned out to be limited.

Table 2

Evaluating the timing for launching government support to strategic companies, and the scope of their application (coverage)

Instrument	Start of practical implementation	Number of strategic companies having received support*	Sector coverage**
External corporate debt refinancing	2008	small	medium
Additional capitalization	2008	medium	medium
Amendments to procedure for export customs duties calculation and decrease of export customs duties	2008	big	medium
Increase of import customs duties, reduced quotas	2008	big	medium
Decreasing tax burden on oil-and-gas sector	Q1 2009	medium	narrow
Partial interest rate subsidies to exporters	Q1 2009***	big****	broad
Subsidies to the RF regions to reimburse the interest rate on loans to agricultural and food processing companies	Q1 2009***	NA	narrow
Additional capitalization of OJSC RosAgroLeasing	Q1 2009	small	narrow
Tax arrears restructuring	Q1 2009	small	narrow
Renewal of automotive and specialized vehicles fleet of the RF regions and municipalities	Q2 2009	small	narrow
Procuring automotive vehicles for federal executive authorities	Q3 2009	small	narrow
Partial interest rate subsidies to defense industry companies performing as contractors for government military procurement	Q3 2009	big****	narrow
Provision of government guarantees	Q3 2009	big****	broad
Partial interest rate subsidies on consumer auto loans	Q3 2009	small	narrow
Partial interest rate subsidies to forestry industry enterprises	Q4 2009	small	narrow

* categories: small – <10 companies; medium – 10-30 companies; big – 30+ companies;

** categories: narrow – 1-2 sectors, medium – 3-5 sectors, broad – 5+ sectors;

*** implementation started in 2009 (instrument was used before);

**** taking into account strategic companies subsidiaries

The majority of government support measures and instruments subject to our review here provided for support of a relatively small number of strategic companies (up to 10). *Measures effecting the most strategic companies were such financial measures as partial interest rate subsidies to exporters; partial interest rate subsidies to defense industry companies, as well as provision of government guarantees.* Two of these measures (government guarantees and *interest* rate subsidies to exporters) are also characterized by broad sector coverage, while as the majority of measures of government support to strategic companies covered only 1 or 2 sectors.

Table 3

Evaluation of importance of the key measures of government support to strategic companies by main sectors

	Assuring access to financial resources	Creating incentives for demand	Decreasing burden on business

	Debt refinancing	Government guarantees on loans	Interest rate subsidies	Additional capitalization	New regional/municipal government procurement programs	Creating incentives for demand	Increasing import customs duties and reducing quotas	Decreasing tax burden on certain sectors	Decreasing export customs duties	Tax arrears restructuring
Oil-and-gas sector	++							+++	+++	
Energy (power generation)				+						
Coal mining										
Metallurgy	+++	++					++		+	
Chemistry and petrochem		+					+		+	
Construction materials manufacturing										
Automotive industry		+		++	++	+	+++			++
Agricultural machine engineering						++	++			
Transport machine engineering				+						
Defense industry		++	+	++						
Electronics, telecom	++									
Agriculture and food processing		+	+				++			
Construction	+	+								
Transport	+			++						

+ moderately important;
++ important;
+++ very important.

The biggest number of various government support measures was applied to strategic automotive companies, and some instruments were purposefully developed specifically for this sector. Government support to oil-and-gas sector, metallurgy, defense industry, agriculture was also pretty diversified.

In general, *support to strategic companies was primarily focused on assuring access to financial resources.* At the same time, for certain sectors *incentives for creating domestic demand (automotive industry) and decreasing the tax burden (oil-and-gas sector) were especially important.*

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The following conclusions may be made to summarize the analysis of government support:

1. With all its drawbacks and shortcomings, the List of Strategic Companies has performed a pretty important stabilizing function during the most acute phase of the crisis. The very fact of being included into the List irrespective or receiving actual support provided for decreasing the level of risk assessment for the respective company in the view of both banks and suppliers.

2. During the crisis period the RF Government exercised a pretty broad variety of diversified measures targeted at supporting strategic companies in that or another way. At the same time, the only support measures targeted and designed specifically for strategic companies were provision of government guarantees and expanding the Lombard List of the Central Bank.

In addition, strategic companies were the key recipients of government support in such areas as external debt refinancing by Vnesheconombank, contributing additional assets into charter capital, interest rate subsidies to exporters. However, in such cases just like in many others strategic companies were becoming the recipients of this support “on common terms” (at least, there were no normative regulations on supporting strategic companies only).

3. The government support to strategic companies was mainly focused on assuring their access to financial resources. At the same time, measures targeted at creating incentives to promote domestic demand were especially important for some sectors (automotive), as well as measures targeted at decreasing the tax burden (oil-and-gas).

From the point of view of real funds disbursed among strategic companies, the most valuable measures were refinancing external debt, provision of government guarantees and changing the customs duties and quotas.

4. Practically all measures of government support to strategic companies were targeted (fully or to a great extent) at improving their financial stability and settling their debt problems. The government guarantees instrument was slightly different from all others in this regards, because certain limitations were set for using the borrowed funds only for certain purposes (core business operations or capital projects). However, settling earlier loans was included into the possible areas for using the newly raised money before even starting to grant the first guarantees.

5. Most of the financial support measures were exercised with significant backlog, sometimes – up to 6 months. The mechanisms which were applied almost immediately were the ones created and used before the crisis. Actually, the only new support mechanism which was created and used within the shortest possible time, was the mechanism for refinancing external debt of strategic companies.

6. Taking into account the scope of some anti-crisis measures and their "extension" into 2010, the task of evaluating their efficiency becomes extremely important. It requires setting the philosophy for such evaluation and creating the relevant infrastructure for monitoring and analyzing changes and progress of companies subject to applying support mechanisms, as well as for controlling their performance against obligations of their owners.

The task of defining the "pro-active" monitoring approach also becomes relevant, because it will allow for short-term forecast any serious aggravations of companies' positions and for timely defining the respective preventive measures.

7. In our opinion, the transparency of the whole system for monitoring the strategic companies and the mechanisms for providing support need to be improved drastically. The principles and criteria of feasibility of support need to be clearly set and defined, they would need to be provided to monitoring commissions and work groups established within the ministries.