

## Section 6. Institutional change

### 6.1. The public sector and privatization policy<sup>1</sup>

#### 6.1.1. Societies and organizations in federal ownership: quantitative dynamics

From 2016, statistical data began to be published in the framework of the System of Public Property Management Efficiency Estimates. It was approved by Decree of the RF Government No 72 dated January 29, 2015, and introduced by way of replacing the public sector monitoring data, collected and released by the Federal State Statistics Service (*Rosstat*) since the early 2000s in accordance with the provisions stipulated in RF Government Decree No 1 dated January 4, 1999 (as amended on December 30, 2002). Among other things, the System contains data on the number of federal state unitary enterprises (FSUEs) and joint-stock companies (JSCs) with RF stakes in their capital. Previously, such data were usually published as part of government privatization programs (from 2011 – for three-year period, and prior to 2011 – for one-year period). In the current *Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019*, relevant data are available only as of early 2016 (*Table 1*), and so in order to describe the processes taking place over the period 2016–2018, one must rely on data in the System of Public Property Management Efficiency Estimates<sup>2</sup>.

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<sup>2</sup> This section estimates the movement pattern, in nominal terms, of societies and organizations in federal ownership for the corresponding years. For available estimates of the public sector's input in the national economy, see Abramov, A., Aksenov, I., Radygin, A., Chernova, M. *Modern Approaches to Measuring the State Sector: Methodology and Empirics* // *Economic Policy*, 2018, V. 13, No 1 (February), pp. 36–69; 2018, V. 13, No 2 (April), pp. 28–47; and for public sector indices, see <https://ipei.ranepa.ru/laifr>, <https://ipei.ranepa.ru/kgu>

Table 1

**The societies and organizations in federal ownership, entered in the Federal Property Register and the System of Public Property Management Efficiency Estimates in 2010–2018**

Date	Economic societies with federal stakes, units		Other holders of ownership rights to registered federal property entities, units		
	Stake (share) in capital	special right to participate in company's management ('golden share') without holding any stake <sup>a</sup>	FSUEs	FTEs	FSIs
As of January 1, 2010	3,066/2,950 <sup>b</sup>		3,517 <sup>b</sup>		
As of January 1, 2013	2,356/2,337 <sup>b</sup>	1,800/1,795 <sup>b</sup>	72	20,458	
As of January 1, 2016	1,557/1,704 <sup>b</sup>	88/64 <sup>c</sup>	1,488/1,247 <sup>b</sup>	48	16,194
As of April 7, 2016 <sup>c</sup>		1,683/1,620 <sup>d</sup>	1,236	48	16,726
As of July 1, 2016	1,571	82	1,378	47	16,990
As of January 1, 2017	1,356/1,416 <sup>c</sup>	81	1,245/1,108 <sup>e</sup>	48	16,846
As of July 1, 2017	1,247	1,058	53	16,244	
As of January 1, 2018	1,189/1,130 <sup>c</sup>	77	984/862 <sup>e</sup>	50	15,985
As of July 1, 2018	1,060	77	868	50	15,520
As of December 1, 2018	1,068	60	1,016/705 <sup>f</sup>	43	13,424

<sup>a</sup> – the special right is not entered in the Register as a separate registered item, however it is mentioned in various materials published by the RF Federal Agency for State Property Management (*Rosimushchestvo*) and in the context of data on state stakes in joint-stock capital;

<sup>b</sup> – the number of JSCs and FSUEs as stated in the privatization programs for 2010–2013, 2014–2016, and 2017–2019 (in the latter, the data based on OKVED Codes (All-Russia Classifier of Economic Activities) refer to companies with shares (or stakes) in federal ownership);

<sup>c</sup> – according to *Rosimushchestvo*'s data for 2015;

<sup>d</sup> – the numerator is the total number of legal entities, including CJSCs and LLCs; the denominator is the number of stakes and shares; from data published in *Rosimushchestvo*'s reports it follows that the difference between the two figures equals the number of JSCs with a 'golden share' without any stake).

<sup>e</sup> – based on data published in the 2017 Report and 2018 Report on the implementation of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019;

<sup>f</sup> – the denominator is the number of FSUEs entered in the Federal Property Register as of December 4, 2018, according to the report delivered by former head of *Rosimushchestvo* Dmitry Pristanskov at parliamentary hearings at the State Duma concerning amendments to legislation regulating the activities of unitary enterprises.

*Source:* Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2011–2013; Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016; [www.economy.gov.ru](http://www.economy.gov.ru), April 23, 2013; the RF Federal Agency for State Property Management (*Rosimushchestvo*)'s Annual Report for 2015; Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019; statistical data from the System of Public Property Management Efficiency Estimates, [www.gks.ru](http://www.gks.ru), March 20, 2016, September 5, 2016; March 20, 2017, September 5, 2017; March 20, 2018, September 5, 2018; 2017 Report on the implementation of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019; 2018 Report on the implementation of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019; materials of *Rosimushchestvo*'s meetings on issues of improving the approaches to federal property management (December 2018), [www.rosim.ru](http://www.rosim.ru), December 6, 2018.

As of July 1, 2018, the Russian Federation held stakes in 1,060 JSCs, was property owner of 868 FSUEs, 50 federal treasury enterprises (FTE), and 15,520 federal state institutions (FSI). If we compare these numbers with the corresponding data for the previous year, it can be noted that the total number of enterprises in each category demonstrated a decline: FSUEs – by 190 units (or 18 percent), JSCs with state stakes – by 187 units (or 15 percent), FSIs – by 724 units (or 4.5 percent). The number of FTEs shrank by 5.7 percent, but when viewed in absolute terms (3 units), this becomes incomparable with the rate of decline in the number of functioning economic entities with other organizational legal forms in federal ownership. The same is true with respect to JSCs with a special right to participate in company’s management (‘golden share’) – their number shrank by 1.3 percent (or by 1 unit). Meanwhile, in H1 2018, the total number of FTEs and JSCs with a ‘golden share’ remained unchanged.

The movement patterns displayed by the entities belonging to the main organizational legal forms over that shorter period of time appeared to be as follows. The number of unitary enterprises lost 11.8 percent, that of economic societies – 10.8 percent, and that of state institutions – 2.9 percent. It is also noteworthy that by early 2018, the number of FSUEs (operated by right of economic jurisdiction) for the first time dropped below 1,000 units, and by mid-2018, the same threshold was passed by the total number of unitary enterprises owned at the federal level, including treasury enterprises.

According to data published by *Rosimushchestvo*, over several months of 2018, the number of economic societies with federal stakes shrank by 4.5 percent, while that of FSUEs increased by nearly 18 percent. The estimated changes in the number of FTEs (by 14 percent) and FSIs (by 16 percent) are not quite exact, because the data applied in the comparison were taken from different sources as of year-end (*Rosimushchestvo*) and beginning of year (*Rosstat*).

Some important information concerning the operation of economic societies with state participation could be derived from the year-end reports on the management of federal stakes in OJSCs and the use of the Russian Federation’s special right to participate in an OJSC ‘s management (‘golden share’).

According to data provided by the Federal State Information System *FGIAS ESUGI* (Register of Assets Held by the Russian Federation) as of August 1, 2018, the Federal Property Register contained information on 1,134 JSCs with federal stakes, including 77 JSCs where the State held the special right to participate in a company’s management granted by ‘golden share’<sup>1</sup>.

However, among these 1,134 companies, *Rosimushchestvo* could fully exercise its shareholder rights only in a total of 443 JSCs (or 39.1 percent of all JSCs vs. 40.8 percent in summer 2017; and vs. 52.1 percent in summer 2012), that is, last year’s changes were in line with the steady downward trend (from 2014 onwards) in the relative share of

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<sup>1</sup> Summary statement based on the Year-end 2017 Report on the Management of Federal Stakes in OJSCs and the Use of the Russian Federation’s Special Right to Participate in an OJSC’s Management (‘Golden Share’).

those companies where *Rosimushchestvo* was not restricted in exercising its shareholder rights<sup>1</sup>.

The composition of the remaining group of entities (691 organizations) was as follows:

- economic societies with state stakes amounting to less than 2 percent of their charter capital, where, in accordance with Item 1 of Article 53 of Federal Law No 208-FZ dated December 26, 1995, ‘On Joint-stock Companies’, no proposals put forth by shareholders can be entered on the agenda of a general shareholder meeting) (296 units, or 26.1 percent of all JSCs);

- economic societies where the ownership rights to state stakes are delegated to other federal bodies of executive authority (FBEAs) and state corporations (for example, the RF Ministry of Defense, State Corporation *Rostec*, *Rosatom*, or JSCs operated under a trust management agreement) (266 JSCs, or 23.4 percent of all JSCs)<sup>2</sup>;

- economic societies undergoing bankruptcy procedures (in the phase of a bankruptcy proceeding) (104 JSCs, or 9.2 percent of all JSCs);

- economic societies undergoing a liquidation procedure (16 JSCs, or 1.4 percent of all JSCs);

- economic societies currently with no stakes *de facto* in the ownership by the Russian Federation (for example, if an entity has been privatized, or transferred as a contribution to the charter capital of a vertically integrated structure (hereinafter – VIS), or is undergoing the procedure of transfer into federal ownership) (9 JSCs, or 0.8 percent of all JSCs).

*Table 2* shows how, in recent years, the relative shares of JSCs where *Rosimushchestvo* is restricted in its shareholder rights have been changing, with the reasons for such restrictions.

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<sup>1</sup>The absence of restrictions on *Rosimushchestvo*’s ability to exercise its shareholder rights does not mean that the Agency indeed has nothing to do with the management of relevant companies run by sectoral FBEAs, the latter getting involved in that process on the basis of general principles and depending on the actual distribution of powers, as determined in the Provision on the Management of Federal Stakes in OJSC and the Use of the Russian Federation’s Special Right to Participate in an OJSC’s Management (‘Golden Share’) (approved by Decree of the RF Government dated December 3, 2004, No 738).

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

Table 2

**The movement and structure, in 2012–2018, of the group of joint-stock companies with federal stakes in regard to which *Rosimushchestvo* is restricted in exercising its shareholder rights, based on reasons for such restrictions**

Total		State stake is less than 2 percent <sup>a</sup>		Shareholder rights transferred to other subjects <sup>c</sup>		Proceeding in bankruptcy		Liquidation procedure		No stakes owned by RF	
units	percent of all JSCs	units	percent of all JSCs	units	percent of all JSCs	units	percent of all JSCs	units	percent of all JSCs	units	percent of all JSCs
<b>As of August 1, 2012</b>											
1258	47.9	434	16.5	387	14.75	156	5.95	55	2.1	226	8.6
<b>As of August 1, 2013</b>											
988	42.3	465/134 <sup>b</sup>	19.95	316	13.55	145	6.2	59	2.5	3	0.1
<b>As of July 7, 2014</b>											
949	45.3	436/78 <sup>b</sup>	20.8	302	14.4	146	7.0	57	2.7	8	0.4
<b>As of August 1, 2015</b>											
884	47.4	373/75 <sup>b</sup>	20.0	291	15.6	151	8.1	60 <sup>d</sup>	3.2	9	0.5
<b>As of August 1, 2016</b>											
858	53.85	349/61 <sup>b</sup>	21.9	297	18.65	150	9.4	48 <sup>d</sup>	3.0	14	0.9
<b>As of August 1, 2017</b>											
769	59.25	276/60 <sup>b</sup>	21.25	306	23.6	135	10.4	36 <sup>d</sup>	2.8	16	1.2
<b>As of August 1, 2018</b>											
691	60.9	296/49 <sup>b</sup>	26.1	266	23.4	104	9.2	16	1.4	9	0.8

<sup>a</sup> – in accordance with Item 1 of Article 53 of Federal Law No 208-FZ dated December 26, 1995 ‘On Joint-stock Companies’, no proposals put forth by shareholders can be entered on the agenda of a general shareholder meeting;

<sup>b</sup> – the denominator is the number of JSCs where the Russian Federation simultaneously exercises the special right to participate in their management (‘golden share’);

<sup>c</sup> – operated by other bodies of executive authority, by state corporations, or by other companies under a trust management agreement;

<sup>d</sup> – including JSCs undergoing a reorganization procedure;

<sup>e</sup> – JSCs with state stakes that are *de facto* no longer registered as federal property (previously privatized, transferred to the charter capital of a vertically integrated structure, their issues of shares have not been registered, or they no longer operate due to their liquidation or reorganization), but the entry of information thereof in the Register has not yet been properly formalized.

Source: *Rosimushchestvo*’s Year-end Reports on the Management of Federal Stakes in OJSC and the Use of the Russian Federation’s Special Right to Participate in an OJSC’s Management (‘Golden Share’) for 2011–2017; own calculations.

First of all, it should be noted that the number of JSCs, with regard to which *Rosimushchestvo* could exercise only a limited shareholder right, declined in absolute terms relative to 2017 by more than 10 percent (or by nearly 80 units), which is compatible with the annual decline rate over the previous period.

The main factor behind this trend was the shrinkage by 13 percent (by 40 units) of the group of JSCs where the shareholder rights had been transferred to other subjects, that group topping the list a year earlier. An even deeper plunge (by 23 percent) was demonstrated by the number of JSCs undergoing a proceeding in bankruptcy or a liquidation procedure (by more than 55 percent). However, when taken in absolute terms, the shrinkage of these two groups (by 31 and 20 units respectively), similarly to the movement pattern displayed by the group of JSCs where no stakes were *de facto*

owned by the RF (by 7 units), was less pronounced than in the first group. Meanwhile, the number of JSCs where state stakes amounted to less than 2 percent increased by more than 7 percent, and so they once again became the most numerous group in the category of JSCs where *Rosimushchestvo* exercises only a limited shareholder right. This particular movement pattern has determined the increasing relative share of all JSCs with minority state stakes (up to 25 percent) in the overall structure of JSCs with state stakes. However, certain role has also been played by those priorities that governed the privatization process of those JSCs with respect to which *Rosimushchestvo* is not restricted in exercising its shareholder rights (*Table 3*).

Table 3

**The movement patterns of the number and structure of JSCs relative to the size of state stakes in their capital and their inclusion in the forecast plans of federal property privatization for 2012–2018**

Date	Economic societies (JSCs and LLCs) where RF is shareholder (or participant)									
	total, units	share, percent	of these, with RF stake in charter capital amounting to							
			100 percent		50–100 percent		25–50 percent		2–25 percent	
			units	percent	units	percent	units	percent	units	percent
1	2	3	4	5	6	7	8	9	10	11
<b>As of August 1, 2012</b>										
– JSCs in regard to which <i>Rosimushchestvo</i> is not restricted in exercising shareholder rights *	1,371/2629**	100.0	886	64.6	76	5.55	211	15.4	198	14.45
<b>As of August 1, 2013</b>										
– JSCs in regard to which <i>Rosimushchestvo</i> is not restricted in exercising shareholder rights *	1,345/2333**	100.0	874	65.0	83	6.15	185	13.75	203	15.1
– JSCs included in forecast plans of federal property privatization ***	975	100.0	716	73.4	41	4.2	116	11.9	102	10.5
<b>As of July 7, 2014</b>										
– JSCs in regard to which <i>Rosimushchestvo</i> is not restricted in exercising shareholder rights *	1147/2096**	100.0	709	61.8	66	5.8	171	14.9	201	17.5
– JSCs included in forecast plans of federal property privatization ***	842	100.0	596	70.8	36	4.3	113	13.4	97	11.5
<b>As of August 1, 2015</b>										
– JSCs in regard to which <i>Rosimushchestvo</i> is not restricted in exercising shareholder rights *	980/1864**	100.0	589	60.1	55	5.6	142	14.5	194	19.8
– JSCs included in forecast plans of federal property privatization ***	668	100.0	469	70.2	18	2.7	90	13.5	91	13.6
<b>As of August 1, 2016</b>										
– JSCs in regard to which <i>Rosimushchestvo</i> is not restricted in exercising shareholder rights *	735/1593**	100.0	469	63.8	48	6.5	91	12.4	127	17.3
– JSCs included in forecast plans of federal property privatization ***	478	100.0	336	70.3	14	2.9	56	11.7	72	15.1
<b>As of August 1, 2017</b>										
– JSCs in regard to which <i>Rosimushchestvo</i> is not restricted in exercising shareholder rights *	529/1298**	100.0	325	61.4	38	7.2	76	14.4	90	17.0
– JSCs included in forecast plans of federal property privatization ***	278	100.0	176	63.3	11	4.0	51	18.3	40	14.4

*Cont'd*

1	2	3	4	5	6	7	8	9	10	11
<b>As of August 1, 2018</b>										
– JSCs in regard to which <i>Rosimushchestvo</i> is not restricted in exercising shareholder rights *	443/1134**	100.0	291	65.7	25	5.65	56	12.65	71	16.0
– JSCs included in forecast plans of federal property privatization ***	232	100.0	154	66.4	9	3.9	35	15.1	34	14.6

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

\*\* – the denominator is the total number of JSCs, as entered in the Federal Property Register;

\*\*\* – only of those where *Rosimushchestvo* is not restricted in exercising its shareholder rights.

*Source: Rosimushchestvo's Year-end Reports on the Management of Federal Stakes in OJSC and the Use of the Russian Federation's Special Right to Participate in an OJSC's Management ('Golden Share')* for 2011–2017; own calculations.

The relative shares of federal stakes of different size included in the privatization program remained basically the same as in 2015–2017 (*Table 4*)

*Table 4*

**The percentage of JSCs included in the forecast plans of federal property privatization, relative to the total number of economic societies in regard to which *Rosimushchestvo* is not restricted in exercising its shareholder rights, by their state stake size, in 2012–2018, percent**

Date	Full ownership (10 percent)	Controlling stake (50–100 percent)	Blocking stake (25–50 percent)	Minority stake (2–25 percent)
As of August 1, 2013	81.9	49.4	62.7	50.2
As of July 7, 2014	84.1	54.5	66.1	48.3
As of August 1, 2015	79.6	32.7	63.4	46.9
As of August 1, 2016	71.6	29.2	61.5	56.7
As of August 1, 2017	54.2	28.9	67.1	44.4
As of August 1, 2018	52.9	36.0	62.5	47.9

*Source: Rosimushchestvo's Year-end Reports on the Management of Federal Stakes in OJSC and the Use of the Russian Federation's Special Right to Participate in an OJSC's Management ('Golden Share')* for 2012–2017; own calculations.

The percentage of companies with minority state stakes included in the privatization program (approximately 48 percent), while having somewhat increased relative to 2017, nevertheless remained lower than the corresponding index for companies with 100-percent state stakes (approximately 53 percent) and blocking state stakes (61.5 percent). The percentage of the latter shrank, while that of companies with controlling state stakes increased (36 percent).

The logical outcome of these changes was the prevalence in the structure of economic societies with state stakes, by late 2018 (*Table 5*), of those with minority state stakes (less than 25 percent of charter capital). They accounted for 47.2 percent of the total number (504 units), while the relative share of JSCs in full state ownership (100 percent of charter capital) for the first time on many years declined (418 units, or 39.1 percent

of all JSCs). The relative share of blocking stakes (25 to 50 percent of charter capital) amounted to 8.25 percent (88 units), and that of majority stakes (50 to 100 of charter capital) – to only 5.45 percent (58 units).

Table 5

**The movement and structure of the group of economic societies with state stakes in their capital (less those JSCs where the state holds the special right granted by ‘golden share’ without holding any stake) in 2010–2018**

Date	Economic societies (JSCs and LLCs) where RF is shareholder (or participant) of these, with RF stake in charter capital amounting to									
	total, units	share, percent	100 percent		50–100 percent		25–50 percent		less than 25 percent	
			units	percent	units	percent	units	percent	units	percent
As of January 1, 2010	2,950	100.0	1,757	59.6	138	4.7	358	12.1	697	23.6
As of January 1, 2011	2,957	100.0	1,840	62.2	136	4.6	336	11.4	645	21.8
As of January 1, 2012	2,822	100.0	1,619	57.4	112	4.0	272	9.6	819	29.0
As of January 1, 2013	2,356	100.0	1,257	53.35	106	4.5	228	9.7	765	32.45
As of January 1, 2014	2,113	100.0	1,000	47.3	95	4.5	224	10.6	794	37.6
As of January 1, 2015	1,928	100.0	861	44.7	90	4.7	203	10.5	774	40.1
As of December 31, 2015	1,704	100.0	765	44.9	93	5.45	172	10.1	674	39.55
As of December 1, 2018	1,068	100.0	418	39.1	58	5.45	88	8.25	504	47.2

Source: Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2011–2013; Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016; Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019; *Rosimushchestvo*'s Annual Reports for 2010–2015, materials of *Rosimushchestvo*'s meetings on issues of improving the approaches to federal property management (December 2018).

The main trend that could be observed in the group of JSCs with state stakes after the switchover, in 2010, to 3-year privatization programs was the notable shrinkage in the relative share of those companies where the state could strongly influence managerial decisions due to participation in the charter capital. So, as of the end of year 2018, the state could exercise corporate control (equal to full ownership or majority stake) over less than 45 percent of all JSCs vs. more than 2/3 by early 2011, about 52 percent by early 2014, and slightly more than 50 percent by early 2016.

If we take a look at the data yielded by the System of Public Property Management Efficiency Estimates that encompass other levels, and not only the federal level, the following picture will emerge (*Table 6*).

According to data collected within the framework of the new system, by mid-2018 the total number of economic subjects belonging to the public ownership category amounted to approximately 60,400 units, which is less by approximately 2,300 units (or by 3.6 percent) than a year earlier, and by approximately 3,200 units less than the corresponding index for mid-2014<sup>1</sup>.

<sup>1</sup> The last bulletin of the developments in the public sector of the RF economy covered the period January–September 2014. Here, for the purpose of a medium-term analysis, the data for H1 2014, released as of 1 July 2014, were applied.



*Table 6*

**The number of organizations operating in the public sector of the economy on the records of *Rosimushchestvo*, its territorial branches, and the bodies responsible for the management of public property held by RF subjects in 2013–2014, and the number of economic subjects fully or partially in public ownership in 2016–2018 (as entered in State registration records), by their organizational legal form**

Date	Total	FSUEs, including treasury enterprises	State institutions	Economic societies with shares (or stakes) amounting to more than 50 percent of charter capital owned by	
				state	economic societies operating in public sector
As of January 1, 2013	67003 <sup>a</sup>	4,891	56,247	3,501	2,364
As of July 1, 2013	66,131 <sup>a</sup>	4,589	56,100	3,201	2,241
As of January 1, 2014	64,616 <sup>a</sup>	4,408	54,699	3,097	2,412
As of July 1, 2014	63,635 <sup>a</sup>	4,236	54,173	2,988	2,238
As of January 1, 2016	65,587 <sup>b</sup>	4,284	56,693/56,649 <sup>c</sup>	3,888 <sup>d</sup>	...
As of July 1, 2016	65,218 <sup>b</sup>	3,982	56,893/56,856 <sup>c</sup>	3,718 <sup>d</sup>	...
As of January 1, 2017	64,457 <sup>b</sup>	3,719	56,548/56,507 <sup>c</sup>	3,532 <sup>d</sup>	...
As of July 1, 2017	62,655 <sup>b</sup>	3,294	55,414/55,361 <sup>c</sup>	3,353 <sup>d</sup>	...
As of January 1, 2018	61,734 <sup>b</sup>	3,053	54,851/54,814 <sup>c</sup>	3,239 <sup>d</sup>	...
As of July 1, 2018	60,391 <sup>b</sup>	2,763	53,933/53,899 <sup>c</sup>	3,125 <sup>d</sup>	...

<sup>a</sup> – including those organizations whose charter documents, after their State registration, do not specify property types, but less those joint-stock companies where more than of 50 percent shares (or stake) are in joint RF and foreign ownership;

<sup>b</sup> – including economic subjects with an organizational legal form other than unitary enterprise, state institution, or joint-stock company (production and consumer cooperatives, associations (unions), housing cooperatives, foundations, public companies, etc.);

<sup>c</sup> – total number of institutions created by the RF and RF subjects (less state academies of sciences and private institutions, which are listed as institutions in the new System, but must not be taken in account here);

<sup>d</sup> – total number of economic societies, the size of their state stake (or share) being irrelevant; data concerning the number of economic societies with controlling state stakes are available only for JSCs with federal stakes.

*Source:* On the Development of the Public Sector of the Economy of the Russian Federation in 2012 (pp. 7–11), in H1 2013 (pp. 7–11), in 2013 (pp. 7–11), in H1 2014 (pp. 7–11), M., *Rosstat*, 2013–2014; Statistical information on public property management efficiency estimates, [www.gks.ru](http://www.gks.ru), March 20, 2016, September 5, 2016, March 20, 2017, September 5, 2017, March 20, 2018, September 5, 2018.

For comparable categories of economic subjects it can be noted that, relative to mid-2017, the number of unitary enterprises declined by approximately 530 units (or more than 16 percent), that of JSCs – by nearly 230 units (or 6.8 percent), and that of state institutions – by approximately 1,500 units (or 2.6 percent). At the same time, by mid-2018 the number of state institutions had become somewhat less than 4 years earlier.

As far as the changes that occurred within a shorter period of time are concerned, over H1 2018 the number of state institutions shrank by 1.7 percent, that of JSCs – by 3.5 percent, and that of unitary enterprises – by 9.5 percent. However, it should be noted with respect to the latter that, according to data released by *Rosimushchestvo*, the total number of state unitary enterprises, including FSUEs and enterprises owned by RF subjects, exceeded 2,900 units – that is, it shrank over the course of the year 2018 quite moderately (approximately by 4 percent). Their relative share in the total number of

unitary enterprises (about 18,500 units) is small, whereas municipal enterprises prevail (more than 15,000 units)<sup>1</sup>.

All these facts notwithstanding, it should be borne in mind that a decline in the number of state-owned entities occurred in the main as a result of their reorganization by way of merger, and not privatization, the progress of the latter being rather slow.

### 6.1.2. Privatization policy

2018 was the second year of the implementation of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019, approved by Directive of the RF Government No 227-r dated February 8, 2017. This was the third 3-year privatization program developed with a view towards a longer planning period established for a forecast plan (or program) of federal property privatization (extended from one to three years) on the basis of the alterations introduced into prevailing legislation on privatization in spring 2010.

As was the case with the previous privatization program, numerous adjustments and alterations were later introduced into the new document. Since the moment of approval of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019, a total of 44 normative legal acts (NLA) pertaining to these issues were adopted, and the frequency of legislation adjustments (the introduction of 29 new NLAs) over the course of last year was almost twice as high as in 2017 (a total of 15 NLAs).

The current privatization program envisages the possibility of privatization of 7 biggest companies by special presidential and governmental decisions, with due regard for the market situation and recommendations of eminent investment consultants. In the framework of preparation for the alienation of shares in VTB Bank (PJSC) and *Sovkomflot* PJSC by the agents specifically commissioned in 2016 for handling their sale (*Renaissance Broker* LLC and *VTB Capital* respectively), proposals are being elaborated as to which methods should be applied in closing the deals. The RF Government did not make any proper decision by the year-end 2018<sup>2</sup>.

According to data from the current report on federal budget execution as of January 1, 2019 (internal sources of deficit financing) available on the RF Federal Treasury's official website, the amount of revenue generated by the sale of shares and other forms of participation in capital held in federal ownership was RUB 12,787.5 million, which is more than twice above the budget revenue target set in the privatization program (RUB 5.6 billion per annum to be generated by privatization deals alone, less the value of shares in biggest companies).

More than half (80 percent) of that sum (RUB 10,330.8 million) was generated in the course of implementing RF Government Directives No 1430-r dated September 2, 2010

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<sup>1</sup> www.rosim.ru, December 6, 2018.

<sup>2</sup> See also Radygin, A.D., Entov, R.M., Abramov, A.E., Aksenov, I.V., Malginov, G.N., Chernova, M.I. Large-scale reluctant privatization: contradictions and challenges under sanctions // *Voprosy Ekonomiki*, 2018, No 8, p. 5-38 (In Russian).

and No 1172-r dated June 9, 2016, and also in accordance with the terms stipulated in the supplementary agreement of June 23, 2016 attached to the 5-year installment buyout agreement, of October 9, 2010, between *Rosimushchestvo* and SSA *Sistema* PJSC concerning 547,312,918 shares in Sistema Shyam Teleservices Limited (now Sistema Smart Technologies Limited)<sup>1</sup>. owned by the Russian Federation, to the total value of USD 777 million. That deal was the only one that fell outside of the established privatization procedures. The revenue generated for the federal budget (more than RUB 10.3 billion) amounted to 1/5, and if we add the sum in excess of RUB 8.5 billion received as part of the same deal a year earlier, to about 38 percent of the total value of USD 777 million recalculated in rubles at the exchange rate as of late June 2016.

In 2018, beside that deal, another 46 stakes in JSCs were sold, and the decisions concerning the terms of their privatization were finalized with respect of 21 federal state unitary enterprises (FSUE). The number of sold stakes (or shares in charter capital) stayed at the same level as in 2016 (47 units), although at that time, more than 3/4 of sold stakes (36 units) were those put up for sale in the course of the previous year (2016). Nevertheless, the number of sold stakes in 2018 amounted to only a half of the corresponding index for the ‘crisis’ year 2015 (103 units), which was also the second year of the implementation of the privatization program. Meanwhile, the total value of the deals (RUB 2.86 billion)<sup>2</sup> lost 45 percent relative to 2017, and so moved far away from the initially established federal budget revenue target (less biggest deals) set in the privatization program (RUB 5.6 billion)<sup>3</sup>. The number of privatized FSUEs (18 units) somewhat increased, while plunging below the corresponding index for 2013 (26 units) (*Table 7*).

*Table 7*

**Comparative data on the movement of the number of privatization deals involving federal state unitary enterprises and federal stakes in 2008–2017**

period	Number of privatized enterprises (entities) formerly in federal ownership (data released by <i>Rosimushchestvo</i> )		
	privatized FSUEs <sup>a</sup> , units	sold stakes in JSCs, units	sold treasury property entities, units
1	2	3	4
2008	213	209 <sup>b</sup>	...
2009	316+256 <sup>c</sup>	52 <sup>b</sup>	...
2010	62	134 <sup>b</sup>	...
2008–2010	591+256 <sup>c</sup>	395 <sup>b</sup>	... <sup>d</sup>
2011	143	317 <sup>c</sup> /359 <sup>b</sup>	3
2012	47 <sup>f</sup>	265 <sup>e</sup>	40
2013	26	148 <sup>e</sup>	22

<sup>1</sup>The stake in that joint Russia-India venture was received by the Russian Federation under the 2007 Intergovernmental Agreement by way of redemption of debt against previously issued loans.

<sup>2</sup> At the same time, in *Rosimushchestvo*'s 2018 Report on the Implementation of the Privatization Program it is stated that the total federal budget revenue from that source amounted to RUB 2.44 billion, including the deals closed in 2017.

<sup>3</sup> The budget target for proceeds of sale of shares were not met with respect to the revenues generated by the deal with SSA *Sistema* PJSC.

## RUSSIAN ECONOMY IN 2018

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*Cont'd*

1	2	3	4
2011–2013	216	730 <sup>e</sup>	65
2014	33	107 <sup>e</sup>	12
2015	35 <sup>e</sup>	103 <sup>e</sup>	38
2016	60 <sup>e</sup>	179 <sup>e</sup>	282
2014–2016	125 <sup>e</sup>	389 <sup>e</sup>	332
2017	18	47 <sup>b</sup>	77 <sup>b</sup>
2018	21	46	174

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

<sup>b</sup> – including those stakes (and for 2017 – also treasury property entities) that were put up for sale in the previous year;

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

<sup>d</sup> – according to available information concerning sales of other property entities over that period, 4 immovable military property entities were sold between October 2008 through January 2009; and there were decisions, in late 2010, concerning some other property entities to be put up for sale and the terms of their privatization, the deals being actually closed in 2011;

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

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

<sup>g</sup> – for several enterprises, the decisions concerning the terms of their privatization were abolished in 2015–2016 and then readopted, so the number of FSUEs with regard to which privatization decisions were made individually over the three-year period is somewhat higher than in the tabulated period-end data for 2014–2016 (125 units).

*Source:* *Rosimushchestvo*'s annual report for 2008; Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2009, Moscow, 2010; Report of the RF Ministry of Economic Development on the Results of Federal Property Privatization in 2010; Report of The RF Ministry of Economic Development on the Results of Federal Property Privatization in 2011; Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2011–2013; 2014 Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016, www.rosim.ru, February 19, 2015; 2015 Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016, www.rosim.ru, February 8, 2016; 2016 Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2014–2016; 2017 Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2017–2019; 2018 Report on the Implementation of the Forecast Plan (Program) of Federal Property Privatization in 2017–2019.

The biggest transaction was the sale of all shares in *Stroytrans No 1* JSC (Tyumen) for RUB 432.3 million. The other four out of the five major deals closed that year were the sales of 100-percent stakes in four JSCs situated in the city of Moscow (*Avtobaza MSKh* JSC ('RF Ministry of Agriculture's Vehicle Depot'), *Standard* OJSC (industrial-transport company), and two R&D organizations). Three of these 5 entities were sold through *Auction House of the Russian Federation* (*RAD* OJSC), and the other two – through *VTB Capital* and *Rosimushchestvo*. One of these deals was a rare example of a notable surge of the selling price above the offer price: there were 4 bidders for the

federal stake in *Avtobaza MSKh* JSC, and after seven bids the price gained 35 percent, rising to RUB 401.6 million<sup>1</sup>.

However, the results of privatization that followed standard procedures were achieved through the efforts of *RAD* OJSC, the latter selling 28 stakes (out of the 139 stakes earmarked for sale) to the total value of RUB 2.053 billion (71.8 percent of total proceeds). While the actual number of sold stakes increased relative to 2017 (28 units vs. 17 units), the deal value shrank more than by half. The input of the other agent – *VEB Capital Plc*, which had been commissioned to handle the sales of 95 economic societies, was an order of magnitude less. It sold only 2 stakes to the total value of approximately RUB 211 million (in 2017, there were no sales). It is expected that the final results of bidding and of the closure of sales of stakes in 26 JSCs will become available in Q1 2019, including the stakes in 22 JSCs handled by *RAD* OJSC.

In 2018, in contrast to sold stakes (or shares) in economic societies, the sales of treasury property entities demonstrated a positive movement pattern. There were more than 1,300 bids by potential investors, which is more than 2.5 times above the corresponding index for 2017. The number of sold treasury property entities (174 units) increased nearly 2.3 times relative to 2017 (77 units), although it was still below the record high achieved in 2016 (282 units). Nevertheless, for three straight years this index was stably above that of sold stakes (or shares) in economic societies, and last year the difference between the two indices was 3.8 times. The total value of closed deals increased nearly 1.6 times (to RUB 446.5 million).

Such positive shifts could largely be achieved thanks to a more active involvement of independent sellers commissioned to handle the sale of treasury property entities. In accordance with the RF Government Directives, in addition to the already mentioned *RAD* OJSC (commissioned to sell 285 property entities, of which 39 units were actually sold to the total value of RUB 72.1 million), the sales were also handled by the Agency for Direct Investments (*ADI*) (commissioned to sell 73 property entities, to date it sold 20 units to the total value of RUB 70.6 million) and *VEB Capital Plc*. (commissioned to sell 73 property entities, and actually sold 14 units to the total value of RUB 30.8 million). Overall, these agents accomplished the sales of approximately 42 percent of all property entities earmarked for bidding, and generated 39 percent of total proceeds, while in 2017 all the sales were handled by *RAD* OJSC alone (9 units to the total value of RUB 28.60 million, that is, about 10 percent of total proceeds). It is expected that the final results of the sales of 84 property entities will become available in Q1 2019, including the 34 property entities handled by *RAD* OJSC and the *ADI*.

In 2018, in the framework of implementation of 23 Presidential Executive Orders and 10 decisions of the RF Government concerning the creation or expansion of vertically integrated structures (*VISs*), *Rosimushchestvo* set out to establish or expand 12 *VISs*. The 3-year privatization program launched in that sector listed a total of 38 FSUEs, shares in 62 JSCs, and 132 treasury property entities. In 2018, the relevant decisions

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<sup>1</sup> [www.rosim.ru](http://www.rosim.ru), August 27, 2018.

concerning the terms of privatization were taken with regard to 8 FSUEs, 4 JSCs, and 41 treasury property entities.

In spite of the complete switchover to an electronic property sales mechanism and substantial non-stop IT services, the progress in the privatization process has been rather slow due to the constraints of declining investment demand coupled with frequent periods of instability in the stock market. As in the previous years, the group of federal property entities earmarked for privatization included many economic societies with low financial and economic performance indices, as well as some companies undergoing bankruptcy procedures. Thus, more than 54 percent of all announced auctions of stakes (or shares) in economic societies, and 56 percent of biddings for treasury property entities, were canceled due to the absence of any bids.

The factor that determines the lack of interest on the part of potential investors in the initial bidding for properties earmarked for privatization is the opportunity to buy those same properties through public offer at half the initial price, after the auctions had been canceled. The hopes that an increasing number of participants in bidding will translate in a more intense competition and higher prices of the property entities put up for sale have proved to be futile.

In such a situation it was only logical for the government to more closely involve independent sellers in the sales of property entities earmarked for privatization, and to rely on their higher marketing competence.

The comprehensive preparatory measures implemented by independent sellers prior to property sales make it possible to attract a large number of investors operating in a given sector, ensure a proper competition level, and achieve a higher selling price. However, the actual results of sale deals closed by independent sellers are by no means always indicative of their better performance. Thus, the success rate of sales of stakes (or shares), measured as the ratio of the number of sold stakes (or shares) to the number of biddings, were approximately the same for Rosimushchestvo and for the independent agents (38–39 percent). In the course of sales of treasury property entities by VEB Capital Plc., the number of canceled biddings was 1.5 times higher than the number of closed sale deals.

Besides, as the RF Government Directives whereby a large quantity of assets was to be transferred to independent sellers were issued only as late as Q1 2018, they launched their pre-sale preparatory measures with respect to an overwhelming majority of those assets in Q2 2018, after all the agent agreements and supplementary provisions thereto had been properly formalized.

The Federal Law on the Federal Budget for 2019–2021 No 459-FZ dated November 29, 2018, similarly to last year's budget law, offers no specific information on the amount of revenues to be generated by privatization neither in the body text, not in the annexes thereto.

At the same time, in the explanatory note attached to the draft law submitted by the government the revenues from privatization of assets in federal ownership were listed alongside government borrowings as a separate source of federal budget deficit

financing. Similarly to the draft budget law for the past year 2018, some of the supplementary materials attached to the draft law did provide data pertaining to the forecast plan (program) of federal property privatization, with a substantiated forecast of federal budget revenue to be generated by privatization; this information can also be found in the explanatory note and the calculated by-function targets for each source of federal budget deficit financing.

The amount of federal budget revenue to be generated by federal property privatization is forecast to be RUB 13.0 billion in 2019 and RUB 10.9 billion in 2020, with no projections for 2021. Its role as a source of federal budget deficit financing will be brought to a minimum: in 2019–2020, the expected privatization-generated revenue is to be less than 1 percent of total planned government borrowing. Compared with the amount of planned proceeds of federal property sales (less the proceeds of biggest deals) stated in the materials attached to the draft law on the federal budget for 2018 and planning period 2019–2020 and submitted last autumn by the RF Government (RUB 12.2 billion in 2019 and RUB 11.4 billion in 2020), the target set for 2019 appears to be somewhat higher, and that for 2020 – somewhat lower.

Judging by the results achieved in 2018 in the course of implementing the current privatization plan, the probability of achieving the planned target for privatization-generated revenue is quite high. The amount of proceeds from the sale of shares in federal ownership and other forms of participation in capital (RUB 12.8 billion) in the Report on Federal Budget Execution is either comparable with the corresponding targets for 2019–2020, or exceeds these targets.

The substantiation for the amount of federal budget revenue to be generated by privatization can be found in the *Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2017–2019* adopted in early 2017 by Directive of the RF Government No 227-r, where 7 biggest companies are earmarked to be privatized in the framework of individual schemes. However, as the RF Government has adopted no new decisions concerning the alienation of federal stakes in biggest companies over the period 2019–2021, no targets are set for the proceeds from the sales of such stakes in 2019 and the planning period 2020–2021.

Nevertheless, there do exist certain preconditions for the closure of two deals.

The plans for 2019 include the completion of preparatory measures for the sale of federal stake in *Kristall Production Association JSC* to *Alrosa PJSC* in order to properly maintain the existing gems cutting and polishing complex of the Russian Federation, create appropriate conditions for the development of diamond-cutting enterprises and attract investments that can be spent on their modernization and upgrading. After *Kristall Production Association JSC* had been struck off the list of strategic enterprises and joint-stock companies, the RF Government was assigned the task of ensuring proper control over its financial and economic situation until the 100 percent federal stake was to be completely alienated.

Besides, acting outside the framework of the current privatization program, the private shareholders in *Vnukovo International Airport JSC* filed a request with Rosimushchestvo by way of exercising their right stipulated in the corporate shareholder agreement signed in 2016, whereby the State was obliged to sell all the remaining shares in federal ownership at any moment within 5 years from the date of their consolidation. The closure of the privatization deal with respect to the blocking stake that is still in federal ownership (25.0525 percent) is also expected to take place in 2019.

Another point on the future privatization agenda has to do with amendments that need to be made to the 2008 law ‘On the Specific Features of Alienation of Immovable Property in State or Municipal Ownership and Leased by Subjects of Small and Medium-Sized Entrepreneurship, and the Introduction of Alterations into Some Legislative Acts of the Russian Federation’ (No 159-FZ) with regard to the realization, by small and medium-sized enterprises (hereinafter – MSE), of their preferential right to buy out the properties leased by them. This right consists in purchasing a property entity at a price equal to its market value and determined by an independent valuer in the procedure established by the 1998 law on valuation activity under an installment buyout plan for a period of not less than 5 years, in conformity with the norms and constraints established for MSEs.

It should be reminded that this law, adopted more than 10 years ago, granted this right with respect to leased property entities owned by RF subjects and municipalities. After the introduction of alterations in summer 2018 (by Law No 185-FZ), that norms now also apply to property entities in federal ownership, and the function of enforcing the law is assigned to Rosimushchestvo.

The law can now be applied over an unlimited period of time<sup>1</sup>, and presently the starting point for launching an action and applying the relevant norms is the day on which an MSE files a request of realization of its preferential right to buy out the property entity leased by it. In the event of a loss of such right upon a refusal to conclude a purchase-and-sale agreement and a failure to sign it within 30 days from the date of receiving the proposal thereof and (or) the purchase-and-sale agreement<sup>2</sup>, a MSE has been granted the right to file a request with an empowered agency, on condition that as of the date of filing such a request, the leased property entity with respect to which that MSE has previously lost the preferential right for its purchase is being held by the said MSE by right of temporary ownership and (or) temporary use under a lease agreement (or agreements).

In accordance with the 2007 Federal Law ‘On Developing Small and Medium Scale Entrepreneurship in the Russian Federation’, (No 209-FZ in its current version), public authorities of all levels should draw up lists of state and municipal property entities unencumbered by any rights of third parties (with the exception of the right of economic

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<sup>1</sup> Previously, the rights granted by the law were effective during a certain period of time, and then could be extended over a next period (from July 1, 2010 to July 1, 2018).

<sup>2</sup> That period is suspended, if a dispute is initiated with respect to the market-based valuation of the property entity on which its buyout price is based, until the date of entry into force of a court ruling.



jurisdiction, operative management right, or ownership rights of MSE), and revise these lists every year before November 1. These lists should be made public through the mass media and be posted to the official websites of the bodies of public authority that have drawn up such lists, and (or) on the official websites designed to provide information support to MSEs.

The state and municipal property entities entered on those lists are to be held or used on a long-term basis (including at reduced lease rates) by MSEs and organizations belonging to the MSE support infrastructure, and can also be alienated, on a reimbursable basis, and transferred into the ownership of MSEs in accordance with the norms stipulated in the 2008 Law No 159-FZ and the RF Land Code.

The procedure of creating, maintaining, mandatory publication of such lists, as well as the procedure of leasing the state and municipal property entities entered on those lists (including the preferential rights and exemptions granted to MSEs registered as agricultural co-operatives engaged in socially important activities or other priority types of activity as established by state and municipal programs (or subprograms)), are to be regulated by the normative legal acts adopted by a relevant tier of public authority. The lease of land plots is regulated by civil and land legislations.

No sale of the state and municipal property entities entered on such lists is allowed, except in the form of reimbursable alienation of such property entities in order to transfer them into ownership by MSEs in accordance with the norms stipulated in Federal Law No 159-FZ (adopted in 2008) and the RF Land Code. No transfer of the right to such property entities is allowed, or collateral of that right, or its transfer as a contribution to the charter capital of any other economic subject; no transfer to third parties of the rights and obligations arising from the agreements of lease (or sublease) of such property entities, or their sublease, with the exception of sublease of such property entities to MSEs by organizations belonging to the MSE support infrastructure, and also in those cases when a property entity in question constitutes part or parts of premises, building, or structure (not more than 10 percent of its area, and not more than 20 m<sup>2</sup> of total area), the rights to which belong to the entity that transfers that property entity (in accordance with the 2006 Federal Law ‘On Protection of Competition’, Article 17.1, Part 1, paragraph 14).

In late 2018, Rosimushchestvo approved the list of immovable property entities (except land plots), unencumbered by rights of third parties, to be held and (or) used on a long-term basis by MSEs. It consists of 827 property entities<sup>1</sup>.

An analysis of information released by *Rosimushchestvo*’s territorial branches by way of preparation for privatization of new property entities revealed that among the property entities included in the current privatization program there were more than 150 leased immovable property entities. After reviewing the requests submitted by MSEs concerning their desire to realize their preferential right to buy out the federal property entities currently leased by them, *Rosimushchestvo* has prepared special directives regulating the terms of their privatization, and dispatched the corresponding orders to

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<sup>1</sup>[www.rosim.ru](http://www.rosim.ru), January 1, 2018.

its territorial branches in the localities where said property entities are situated, so that the lessors could properly realize their rights. However, no purchase-and-sale agreements between the lessors (MSEs) and *Rosimushchestvo* or its territorial branches were formalized in 2018.

As far as legal regulation of the privatization process is concerned, an important alteration was introduced into the current privatization law (adopted in 2001) in May 2018, that addressed the buyers of state and municipal property entities (Article 5).

The norm whereby the buyers could not be the legal entities (hereinafter – offshore companies) registered in a country or territory entered on the list, approved by the RF Ministry of Finance, of countries and territories that grant tax exemption regimes and (or) do not disclose information on financial transactions (offshore zones) was in effect for less than a year<sup>1</sup>. The amended law stipulates that this norm applies only to those legal entities in that category who do not disclose and report information on their beneficiaries, beneficiary owners and controlling persons in the procedure established by the RF Government.

The text of Article 5 no longer contains any mention of offshore companies. Therefore, it no longer refers to the ‘derivative’ category of legal entities controlled by an offshore company or a group of entities that includes an offshore company. In this connection, the basic norm has remained – that the privatization process cannot involve state and municipal unitary enterprises and institutions, or legal entities with stakes in their charter capital amounting to more than 25 percent that are held by the RF, RF subjects, or municipal formations, except when state or municipal property is a contribution to their charter capital.

The terms ‘group of persons’ and ‘control’, with references to the notions stipulated in the 2006 Federal Law ‘On Protection of Competition’ (Articles 9, 11), are replaced by ‘controlling person’ as understood in the 2008 Federal Law ‘On the Procedure for Facilitating Foreign Investment in Legal Entities Having Strategic Importance for National Defense and State Security’ (Article 5), as well as the terms ‘beneficiary’ and ‘beneficiary owner’ as understood in the 2001 Federal Law ‘On Prevention of Legalization (Laundering) of Proceeds from Crime and Financing of Terrorism’ (Article 3)<sup>2</sup>.

Another alteration introduced into the current privatization law has been the expansion of the property segment to which it does not apply (Article 3). It has been augmented by property held by right of economic jurisdiction, by right of permanent use, or by right of lease, or by FSUE *Russian Post* as of the moment of its reorganization

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<sup>1</sup>At present, the list consists of 40 countries. However, the Republic of Cyprus – the traditional source of pseudo-foreign investments for the Russian economy over the past quarter century, was removed from that list in 2012.

<sup>2</sup>At the meeting on February 1, 2016 that addressed privatization issues, the RF President defined, in particular, certain conditions of privatization of companies with state stakes, including the provision whereby the would-be owners of assets earmarked for privatization should belong in Russia’s jurisdiction, and that it was inadmissible to allow ‘grey schemes’, to withdraw assets to offshore zones, and to hide the identity of stakeholders. See <http://kremlin.ru/events/president/news/51249>

on the basis of the Federal Law ‘On the Specific Features of Reorganization of Federal State Unitary Enterprise *Russian Post*, the Fundamental Principles of Operation of Joint-stock Company *Russian Post*, and the Introduction of Alterations to Some Legislative Acts of the Russian Federation’ No 171-FZ dated June 29, 2018.

The Law, which came into force on 1 October 1, 2018, regulates the reorganization of FSUE *Russian Post*, its legal successor being those newly established non-public JSCs where the entire 100-percent stake is held by the RF, and the single stakeholder is named among its governing bodies alongside the board of directors, the council and the director general (Article 8). Its powers are exercised by the federal body of executive authority performing the function of federal property management in accordance with the procedure established by the RF Government, and the scope of its competence is clearly defined (Article 9).

### 6.1.3. The presence of the state in the economy and the issues of management of economic subjects operating in the public sector

In 2018, some important alterations were introduced in the list of strategic enterprises and joint-stock companies.

As of early December 2018, this list was augmented by only one company (*Promsvyazbank* PJSC). Over the same period, 2 FSUEs were struck off the list of strategic organizations (of these, one will be merged with another unitary enterprise, and the property complex of the other one will be transferred, as a state contribution to the charter capital, to State Corporation *Rosatom*), as well as 5 JSCs.

Among the latter, there are three previously created big vertically integrated structures (VIS), two of them being of nationwide importance. The entire capital (less 1 share) of *Concern Granit-Electron* JSC has been transferred to the charter capital of another VIS - *Tactical Missiles Corporation* JSC by way of payment for the additional placement of shares issued as a result of its increased charter capital, and this move appears to be in line with traditional practices. However, the transfer of 92.3 percent of shares in *United Aircraft Corporation* PJSC (UAC), the 100-percent federal stake in *Roskhimzashchita* OJSC, and federal stakes in another 6 JSCs, including 2 controlling stakes and 4 blocking stakes, as a property contribution to the charter capital of State Corporation *Rostec* appears to be much more arguable.

The corporation, created in 2007, soon began to acquire certain distinct features of a conglomerate without a clearly visible relation to any sector as a result of transfers of hundreds of federal stakes in other JSCs, including those established on the basis of reorganized FSUEs that had been struck off the list of strategic organizations and specializing in a variety of different fields<sup>1</sup>. Over the subsequent years, that trend

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<sup>1</sup>Gradually, sub-holding companies began to emerge inside the State Corporation (e.g., *High Precision Systems*, *Technodinamika*, *Techmash*). Some of them were created by special governmental decisions (e.g., *United Engine Corporation*), others emerged as separate entities before they were transferred to *Rostec* (e.g., *Russian Helicopters*). There were some precedents of a transfer of previously established

became even stronger. Suffice to say that the group of organizations transferred to *Rostec* by *Rosimushchestvo* over the course of last year included Production Corporation *UralVagonZavod* JSC and *NPO Microgen* (a reorganized unitary enterprise, previously subordinated to the RF Ministry of Health); FSUE *PO More* Shipyard in the Crimea is also being reorganized into a JSC. All these developments run contrary to the well-defined activity profiles of entities established more than 10 years ago as independent VISs (*UAC* PJSC, *Roskhimzashchita* OJSC).

Over the course of the year 2018, *Rosimushchestvo* was implementing measures designed to build other types of integrated structures. When applied with respect to *Roscosmos*, *Rosatom*, *Transneft* PJSC and *UAC* PJSC, and *GLONASS* JSC, these involved the implementation of some previously adopted major decisions (at the level of Presidential Executive Orders), mainly aimed at the enlargement of these entities. As far as other VISs are concerned (*Russian Railways* OJSC, *ROSGEO* JSC, *Tactical Missiles Corporation* JSC, Concern *VKO Almaz–Antey*, *United Shipbuilding Corporation* (USC)), the measures were aimed at upgrading these structures on the basis of new decisions adopted during the previous calendar year.

Among these, we should note *USC*: its charter capital has been augmented by a minority stake in *Zelenodolsk R&D Bureau* JSC situated in the Republic of Tatarstan, while a controlling stake in the latter, alongside a minority stake in *A.M. Gorky Zelenodolsk Plant* JSC, is to be transferred into the Republic's ownership, on condition that the decisions concerning the alienation of shares in these JSCs after the expiry of a five-year period should be coordinated with the RF Government; that their core activities should remain unchanged; and that over the period until 2023, investments should be attracted, including from private sources, for the purpose of comprehensive production capacity development and modernization of *Zelenodolsk R&D Bureau* JSC – in an amount not less than RUB 150 million, and *A.M. Gorky Zelenodolsk Plant* JSC – in an amount not less than RUB 300 million. In this connection, the RF Government has been assigned the task of finalizing the agreements between the Russian Federation, the Republic of Tatarstan, and the two JSCs concerning the development of the latter, making provisions in these agreements for specific measures designed to boost their R&D potential, to pool their available intellectual, industrial and financial resources in order to implement shipbuilding projects, and to ensure modernization of their production capacities through investments attracted by the region. The implementation of this project coupled with the potential interest of *Rostec* in shipbuilding assets may translate into adjustments of the government industrial policy in that sector – from support of ‘national champions’ towards diversification of centers and formats of government presence in the national economy.

Another major state corporation – *Vnesheconombank* – is undergoing the process of restructuring. After alterations were made in late 2018 to the 2007 law whereby its activity is regulated (No 452-FZ), its name was changed into VEB.RF.

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VISs (Concern *Avtomatika*, *Vega Radio Engineering* Corporation, Concern *Sozvezdie* JSC, *Control Systems* JSC).

Within the charter capital of VEB.RF (not less than RUB 70 billion), two components were identified: the ‘formed’ component, and the component yet to be formed in accordance with the normative legal act of the RF Government by way of subsequent additional property contributions by the State, to be specified as follows:

- the composition of property earmarked as an additional contribution, including subsidies;

- the planned contribution cap (if necessary – distributed by year, with the description of procedure and timeframes for altering the contribution distribution procedure in those cases when the additional property contributions are not transferred in full in a given year);

- the procedure and timeframes for property contributions, and the conditions thereof, including but not limited to reducing the capital adequacy ratio to an acceptable minimum, as established in the State Corporation’s financial policy memorandum, and increased by one percentage point, and to altering other financial sustainability indices of VEB.RF as envisaged in the said normative legal act of the RF Government, and the procedure for confirming compliance with the said conditions;

- the targeted use of the additional property contributions: the funding of projects implemented by VEB.RF (including the creation of reserves to cover potential losses incurred in the course of implementing those projects), the decisions concerning VEB.RF’s participation in their funding having been adopted by the empowered managerial and collegial executive bodies of VEB.RF after the entry into force of the said normative legal act of the RF Government. The targeted use of the additional property contributions should not be understood as funding of the projects implemented by VEB.RF by way of implementing the nationwide, strategic or priority decisions of the RF President and the RF Government concerning the national economy, that are not compatible with the main directions, indices, constraints, or principles of investment and financial activity followed by VEB.RF;

- the requirements concerning an efficient use of the additional property contributions.

Several separate articles address the specific role of the state corporation in the functioning of development institutions, while the Accounts Chamber of the Russian Federation and other state bodies exercise control and supervision not only over the activity of VEB.RF, but also over that of those development institutions that receive support from VEB.RF, the source of that support being the federal budget.

The alterations introduced in the 2003 law on foreign trade regulation provides a framework whereby VEB.RF, with respect to exports, on the basis of the RF Government’s decisions coordinates the activity of the Russian Export Center, the Russian Agency for Export Credit and Investment Insurance (EXIAR), State Specialized Russian Export-Import Bank JSC (Eximbank of Russia), and some other development institutions.

In the event of a transfer, by decision of VEB.RF Supervisory Board, of the 100 percent stake in the Russian Export Center’s charter capital into federal ownership, the

sole shareholder of the Center will be the Russian Federation, while the Center's charter capital can be increased at a later date by federal contributions, if the Russian Agency for Export Credit and Investment Insurance should become less financially sustainable, and the RF Government should determine, in a procedure similar to that established for the charter capital of VEB.RF itself, the transfer of those additional property contributions.

Earlier, in late 2017, the norms were introduced whereby it became possible to create, under the state corporation's supervisory board, special committees for preliminary consideration of certain issues, including standing committees (on strategy, audit, human resources, reimbursement, and other issues), as well as collegiate bodies, appointed by the supervisory board and the chairperson. Besides, the norms regulating the procedure for approving certain types of deals by the state corporation's executive bodies were added.

Last year, the activity of biggest companies with state stakes in the corporate control market was rather slack, but it became evident that the criteria for estimating the feasibility of negotiated deals should be more transparent – both from the point of view of the interests of the State and in the contest of the participating companies' development strategies.

The purchase by VTB Bank of a 29.1-percent stake in the retail chain *Magnit* for RUB 138 billion from its former major stakeholder, which was one of the most important events of 2018, was followed by another major deal only 3 months later – the sale of a 11.8-percent stake, without disclosing the deal value, to Marathon Group, an investment company specializing in the main in pharmaceutical infrastructure.<sup>1</sup> The indirect presence of the State in the retail sector, in a degree that is not sufficient for actually influencing the corporate governance procedures there, has given rise to some questions – and questions also arise in connection with a shrinkage of state participation in other companies involved in those types of economic activity where the presence of the State has been traditional (in foreign countries as well).

State Corporation *Rostec* reduced its participation in *Kalashnikov Concern* to the level of a blocking stake by selling 26 percent of shares to *TransKomplektHolding* for RUB 1.5 billion. The future development of *Kalashnikov Concern*, which for a long time has been a symbol of the national firearms industry, will have to do with its current rebranding strategy and reorientation to the production of means of transport<sup>2</sup>.

While moving on to the issues of managing joint-stock companies with state participation, we may note the strictest executive discipline visible in the organization of annual general shareholder meetings. The meetings were held by 47 out of 48 JSCs entered on the Special List approved by Directive of the Government of the Russian Federation No 91-r dated January 23, 2003, where the standpoint of the State as a shareholder on a number of the most important issues was determined at the government

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<sup>1</sup><https://www.kommersant.ru/doc/3549909>,

<https://www.rbc.ru/business/24/05/2018/5b0410ca9a79476f56976cc5>

<sup>2</sup><https://lenta.ru/news/2018/02/15/ak/>

level); by all the JSCs not included in the Special List, where the RF was the sole shareholder, and 88.7 percent of those JSCs that were not included in the Special List and with state stakes amounting to more than 2 percent but less than 100 percent of their charter capital.

In accordance with the decisions of the RF Government issued with regard to annual general shareholder meeting, in the course of the corporate year 2017, a total of 190 candidates for the boards of directors (supervisory boards) of JSCs entered on the Special List were approved<sup>1</sup>, including 189 professional attorneys (instead of 182 persons recommended by the special Commission (attached to *Rosimushchestvo*) assigned the task of selection of independent directors, representatives of the shareholder interests of the RF, and independent experts to be elected to the managerial and control bodies of joint-stock companies), 64 independent directors ( out of a total of 68 recommended persons) and 143 civil servants (instead of 148 as recommended by the Commission)<sup>2</sup>.

The overall number, in absolute terms, of state representatives in the boards of directors of JSCs entered on the Special List somewhat increased relative to 2017 thanks to the inflow of civil servants. The total number of professional directors – that is, professional attorneys and independent directors taken together - remained the same. At the same time, the trend that first appeared after the period 2014–2015 – that of an increasing relative share of civil servants and professional attorneys alongside a shrinkage of the relative share of independent directors in companies’ managerial bodies – once again revealed itself (*Table 8*).

*Table 8*

**The movement and structure of state representatives in the managerial and control bodies of JSCs entered on the Special List, in 2009–2018**

Year	JSCs, units	State representatives in boards of directors (supervisory boards)								In audit commissions: independent experts, number
		total		civil servants		professional attorneys		independent directors		
		number	percent	number	percent	number	percent	number	percent	
2009	36	342	100.0	163	47,7	120	35.1	59	17.2	...
2010	49/59 <sup>a</sup>	386	100.0	193	50,0	117	30.3	76	19.7	...
2011	51	416	100.0	181	43,5	150	36.1	85	20.4	...
2012	57	434	100.0	141	32,5	205	47.2	88	20.3	15
2013 <sup>b</sup>	63	452	100.0	127/122 <sup>c</sup>	28,1	228/245 <sup>c</sup>	50.4	97/102 <sup>c</sup>	21.5	27
2014	51	402	100.0	106/104 <sup>c</sup>	26,4	199/197 <sup>c</sup>	49.5	97/90 <sup>c</sup>	24.1	45
2015 <sup>b</sup>	50	390 100,0	118	30.3	178	45.6	94	24.1	54	
2016 <sup>b</sup>	50	404	100,0	136	33.7	189	46.8	79	19.5	65/66 <sup>d</sup>
2017 <sup>c</sup>	48	385	100,0	131	34.0	179	46.5	75	19.5	56
2018 <sup>f</sup>	47/48	397/405	100,0	143	36.0	190	47.9	64	16.1	65

<sup>a</sup> – data are also available on the election of professional directors to the managerial bodies of 59 JSCs;

<sup>1</sup> Less *State Transport Leasing Company PJSC (STLC*, the shareholder rights belong to the RF Ministry of Transport) and *MIT Corporation JSC* (the shareholder rights belong to State Corporation *Roscosmos*); and including *FGC UES PJSC*.

<sup>2</sup>The final decisions concerning the appointment of candidates for the managerial and control bodies of JSCs entered on the Special List are approved by the RF Government.

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

<sup>c</sup> – other data are also available concerning the by-category distribution of state representatives (presented in the denominator), which probably are preliminary estimates, although the number of professional directors (professional attorneys and independent directors) for 2014 released by *Rosimushchestvo* (287) corresponds to the total number for all the groups (presented in the denominator);

<sup>d</sup> – later data for a larger number of JSCs are shown in the denominator;

<sup>e</sup> – including *Novorossiysk Commercial Sea Port OJSC* and *FGC UES*; as of August 1, 2017, these companies had not yet established their boards of directors and audit commissions in the course of their 2017 annual general shareholder meetings, and so we applied the extraordinary general shareholder meetings data as of September 15, 2017 in accordance with RF Government Directive No 4643p-P13 dated July 3, 2017;

<sup>f</sup> – the total number of state representatives in boards of directors in the denominator is higher than the sum of state representatives by category (civil servants, professional attorneys, independent directors), which also corresponds to the lower number of JSCs on the Special List.

*Source:* Year-end Reports on the Management of Federal Stakes in OJSCs and the Use of the Russian Federation's Special Right to Participate in an OJSC's Management ('Golden Share') for 2011–2017; own calculations.

Over the period 2014–2018, in the group of companies not included in the Special List, the number of civil servants per company increased from 2.04 to 3.04, while the number of professional directors declined from 5.62 to 5.29<sup>1</sup> (the number of professional attorneys increased from 3.86 to 4.04, but that of independent director declined from 1.76 to 1.33).

In 2018, civil servants prevailed in the structure of audit commissions (118 persons vs. 65 independent experts, or 64.5 percent), but the number of the latter increased, once again hitting its record high of 2016. Over the last 5 years, their per company number jumped more than 1.5 times (from 0.88 in 2014 to 1.35 in 2018).

As for the structure of the managerial bodies of companies not included in the Special List (*Table 9*), it should be said that in 247 JSCs, where the state ownership of a controlling or blocking stake ensured that state representatives took up a total of 1,371 seats on the boards of directors (or supervisory boards) of JSCs,<sup>2</sup> more than half of them were professional directors – 782 persons, or 57 percent, while the number of civil servants was 589, or 43 percent. In 39 JSCs with the RF stakes in their charter capital amounting to less than 25 percent, 100 percent of persons representing the interests of the State on the boards of directors (or supervisory boards) were civil servants (83 board members). However, even in spite of the effects produced by that factor, the total number of civil servants participating in the boards of directors (or supervisory boards) of the JSCs off the Special List dropped relative to 2017, when their number had been 704.

<sup>1</sup> Data released by *Rosimushchestvo*.

<sup>2</sup> Less (1) those JSCs where the State does not hold a blocking stake (62 units) and (2) those JSCs where the State holds a controlling or blocking stake, but the decisions concerning the appointment of professional directors and independent experts have not been passed for various objective reasons (77 units).



Table 9

**The movement and structure of state representatives in the managerial and control bodies of JSCs off the Special List, in 2009–2018**

Year	JSC, units	State representatives on boards of directors (supervisory boards) (other than civil servants)						In audit commissions: independent experts, number
		total		professional attorneys		independent directors		
		number	percent	number	percent	number	percent	
2009	233	431	100.0	310	71.9	121	28.1	...
2010	389	707	100.0	493	69.7	214	30.3	...
2011	512	1,109	100.0	830	74.8	279	25.2	...
2012	822	1,860/1,869*	100.0	1,350	72.6	510/519*	27.4	23**
2013	637/245***	1,715	100.0	1,092	63.7	623	36.3	335
2014	683/159***	2,094	100.0	1,382	66.0	712	34.0	498
2015	527/151***	1,660	100.0	1,267	76.3	393	23.7	330
2016	479/123***	1,535	100.0	1,346	87.7	189	12.3	353
2017	297/107***	978	100.0	864	88.3	114	11.7	325
2018	247/77***	782	100.0	703	89.9	79	10.1	332

\* – data are also available on the election of 1,869 professional directors, including 519 independent directors;

\*\* – data are also available on the election of 21 private individuals as representatives in audit commissions;

\*\*\* – the denominator is the number of those JSCs where the State holds a controlling or blocking stake, but the decisions concerning the appointment of professional directors and independent experts have not been passed for various objective reasons.

Source: Year-end Reports on the Management of Federal Stakes in OJSCs and the Use of the Russian Federation’s Special Right to Participate in an OJSC’s Management (‘Golden Share’) for 2011–2017; own calculations.

As follows from data presented in *Table 9*, in 2017, while the total number of professional directors notably shrank in absolute terms (by 1/5), the relative share of professional attorneys in that group continued to increase, and their relative share in the total number of state representatives (beside civil servants) shrank to 10 percent. The number of independent experts in audit commissions in 2018 slightly increased relative to 2017 – approximately to the same level as in 2013 and 2015.

The per company number of professional directors on boards of directors (or supervisory boards) dropped from 3.29 to 3.16 (the 2015 level), while that of independent experts sitting on audit commissions increased from 1.09 to 1.34, thus rising 1.8 times above its 2014 level.

After the extensive adjustment of the governance mechanism for JSCs with state stakes a year earlier, it underwent no noteworthy alterations in 2018.

In order to establish personal responsibility of state representatives in the executive bodies of JSCs for their failure to properly protect state interests, a draft law has been submitted to parliament whereby certain amendments to the RF Code of Administrative Offenses are suggested. The RF Government is currently considering draft laws regulating the insurance of responsibility of those members of the board of directors of a JSC with a state stake who occupy deputy positions in government agencies or who are civil servants.

As far as standardization of the governance procedures for all companies with state participation is concerned, we should make note of the following draft documents that were under consideration over the course of last year:

- the criteria of selecting candidates for membership in the single (collegiate) executive body, the board of directors (or supervisory board), and the audit commission of a JSC;
- a model program of alienation of non-core assets of a JSC off the Special List, the stake held in its capital by the RF being more than 50 percent;
- methodological recommendations for reimbursement of CEOs of state corporations, state-owned companies, and economic societies whose core activity outlined in their charter is funded from the budget, and the stake held in their capital by the RF is more than 50 percent, including those entered on the Special List;
- methodological guidelines for applying the key performance indicators for state corporations, state-owned companies, and economic societies whose core activity outlined in their charter is funded from the budget, and the stake held in their capital by the RF is more than 50 percent (at present, the wording of the guidelines as amended in 2014 is in effect).

In the framework of implementation of the norms stipulated in the new Corporate Governance Code (CGC), introduced in 2014, *Rosimushchestvo* in its capacity of a shareholder analyzed the annual reports of 12 biggest state-owned companies for the corporate year 2017, approved by their annual general shareholder meetings in 2018, from the point of view of their compliance with the principles and recommendations stipulated in the CGC.

On the basis of that analysis, as well as the information submitted by those state-owned companies at *Rosimushchestvo*'s request, it can be said that all the 12 JSCs indeed entered in their annual reports information concerning their implementation of the norms and principles stipulated in the Code.

As shown by the analysis of the reports submitted by JSCs, the overall roadmap implementation index for the provisions stipulated in the CGC as of late summer 2018 was approximately 90 percent, just as a year earlier.

The highest rate of implementation of the Code's provisions has been noted with regard to the following 3 sections:

- corporate secretary of a JSC (96 percent vs. 100 percent in 2017, 60 percent in 2016);
- shareholder rights and equal opportunities for exercising these rights (93 percent, just as a year earlier, in 2016 – 86 percent);
- risk management and internal control systems (also 93 percent).

The implementation indicators for another 4 sections of the CGC (board of directors, reimbursement of the members of a board of directors, executive bodies and other CEOs, corporate information disclosure, information policy, and significant corporate acts) were above 70 percent.

The dividend policy was shaped by the requirement to comply with the budget assignment, one of its parameters being that the amount earmarked for the payment of dividends could not be less than 50 percent of a company's year-end net profit calculated in accordance with the International Financial Reporting Standards (hereinafter – IFRS).

From 2016 onwards, the RF Government has been issuing some separate decisions whereby JSCs with federal stakes in their capital were obliged to earmark for the payment of dividends not less than 50 percent of their net profit, thus making it possible for the RF Ministry of Finance to introduce certain adjustments while preparing the draft of a federal budget law. At the same time, as before, the RF Government Directive No 774-r dated May 29, 2006 (as amended in May 2017) sets forth the norm whereby not less than 25 percent of their profit should be earmarked for the payment of dividends.

*Rosimushchestvo*, in the course of its year-end campaign of 2017 for the launch of annual general shareholder meetings by JSC, adopted a set of necessary and sufficient measures designed to maximize the amount of dividend-generated federal budget revenue with due regard for the current market situation, external and internal factors, relevant government decisions, and the necessity to implement long-term economic development programs. These efforts translated into a revenue level that was above the planned target set in the federal budget law. Almost the entire amount of dividends on federal stakes received at year-end 2017 was paid by the JSCs included in the Special List.

Meanwhile, by the alterations introduced into RF Government Decree No 739 dated December 3, 2004, whereby the powers of federal bodies of executive authority (FBEA) to exercise their ownership rights to property of FSUEs are regulated, the minimum amount of a transfer to the federal budget for the latter was increased from 25 to 50 percent of their disposable profit after taxes and other mandatory payments (less incomes and expenditures resulting from revaluation of their marketable securities and related to the incomes and expenditures taken into account when calculating the amount of tax on profit of organizations). The relevant decisions should be made by those FBEAs that exercise authority over those companies, irrespective of their being included in a privatization program.

Similarly to the procedure that regulates the payment of dividends by JSCs with state stakes, in those cases when a FSUE is required to file financial reporting, including consolidated reports, in accordance with the IFRS, the amount of its profits due to be transferred to the federal budget cannot be less than 50 percent of its net profit calculated on the basis of data entered in said reports. If that amount is higher than the amount of net profit calculated on the basis of data entered in the accounting (financial) reports submitted by that unitary enterprise, the amount of dividends is derived from its retained earnings. However, it must be added that the official cap on dividends for JSCs, set in May 2017, amounts to only 25 percent.

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

In 2018, in contrast to the situation over the previous year, the movement of federal budget revenues that had to do, in one or other way, with public property was positive. There is evident growth of revenues generated both by the use of public property (renewable sources) and by privatization and the sale of property (non-renewable sources).

*Tables 10 and 11* show data taken from the reports on federal budget execution, in particular the revenues generated by the use of public property and the sale of public property entities belonging only to some specified categories of tangible property<sup>1</sup>.

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<sup>1</sup> Here, we do not consider the federal budget revenues generated by payments for the use of natural resources (including biological water resources, revenues from the use of forest fund, and the extraction of mineral resources), compensation of the losses incurred by the agricultural production sector as a result of confiscation of agricultural land, revenues generated by financial operations (revenues from placement of budget funds (revenues from federal budget residuals and their investment: from 2006 onwards, these include the revenues from the management of the RF Stabilization Fund (and from 2009 onwards – the Reserve Fund and the National Welfare Fund)); revenues from investment of monies accumulated in the course of trading RF stocks in the auction market); interest on budget-funded domestic loans, covered by the federal budget; interest on government loans (monies received from the governments of foreign countries and foreign legal entities as interest payments on RF government loans); money transfers from legal entities (enterprises and organizations), RF subjects, municipal formations received as interest and guarantee payments on loans received by the RF from foreign governments and international financial organizations; revenues from paid services rendered to the population or monies received by way of compensation of government expenditures; transfers of the RF Central Bank's profits; certain categories of payments from state and municipal enterprises and organizations (patent duties and registration fees for official registration of software, databases, integral microcircuit topologies; and other revenues which until 2004 were part of mandatory payments of state organizations (except revenues generated by the operations of Joint Venture *Vietsovpetro* (from 2001) and transfers of part of profits generated by FSUEs (from 2002); revenues from the implementation of product share agreements (PSA); revenues from the disposal of confiscated and other property earmarked as government revenue (including property transferred to state ownership in the procedure of inheritance or gift, or treasure trove appropriation); revenues generated by lotteries; other revenues from the use of property and rights in federal ownership (revenues from the execution of rights to the results of intellectual activity (R&D and technologies) intended for military, special or dual use; revenues generated by the execution of rights to the results of scientific and technological research held by the RF; revenues generated by the exploitation and use of property relating to motor roads, motor road levies imposed on transport vehicles registered in the territories of other states; execution of the Russian Federation's exclusive right to the results of intellectual activity in the field of geodesy and cartography; fees for the use of spatial data and materials that are not subject to copyright, kept in the Federal Fund of Spatial Data; and other revenues from the use of property in the ownership of the Russian Federation); revenues generated by organizations from the permitted types of economic activity and earmarked for transfer to the federal budget; revenues from realization of government reserves of precious metals and precious stones.

By contrast with the previous years, the law on federal budget execution for 2015–2017 contains no aggregate data listed under each revenue classification code or sub-code, or listed according to the classifications of transactions in the public administration sector on revenue side (these are listed only by their classification code for each revenue administrator). Therefore, we used data from the reports on

Table 10

**Federal budget revenues generated by the use of public property  
(renewable sources) in 2000–2018, millions of rubles**

Year	Total	Dividends on shares (2000–2018) and revenues generated by other forms of participation in capital (2005–2018)	Payment for lease of land in state ownership	Revenues generated by lease of property in state ownership	Revenues from transfer of part of net profits of FSUEs after taxes and other mandatory payments	Revenues generated by Joint Venture <i>Vietsovpetro</i>
2000	23,244.5	5,676.5	–	5,880.7	–	11,687.3 <sup>a</sup>
2001	29,241.9	6,478.0	3,916.7 <sup>b</sup>	5,015.7 <sup>c</sup>	209.6 <sup>d</sup>	13,621.9
2002	36,362.4	10,402.3	3,588.1	8,073.2	910.0	13,388.8
2003	41,261.1	12,395.8		10,276.8 <sup>c</sup>	2,387.6	16,200.9
2004	50,249.9	17,228.2	908.1 <sup>f</sup>	12,374.5 <sup>e</sup>	2,539.6	17,199.5
2005	56,103.2	19,291.9	1,769.2 <sup>b</sup>	14,521.2 <sup>i</sup>	2,445.9	18,075.0
2006	69,173.4	25,181.8	3,508.0 <sup>b</sup>	16,809.9 <sup>i</sup>	2,556.0	21,117.7
2007	80,331.85	43,542.7	4,841.4 <sup>b</sup>	18,195.2 <sup>i</sup>	3,231.7	10,520.85
2008	76,266.7	53,155.9	6,042.8 <sup>b</sup>	14,587.7 <sup>i</sup>	2,480.3	–
2009	31,849.6	10,114.2	6,470.5 <sup>b</sup>	13,507.6 <sup>i</sup>	1,757.3	–
2010	69,728.8	45,163.8	7,451.7 <sup>b</sup>	12,349.2 <sup>i</sup>	4,764.1	–
2011	104,304.0	79,441.0	8,210.5 <sup>b</sup>	11,241.25 <sup>j</sup>	4,637.85	773.4
2012	228,964.5	212,571.5	7,660.7 <sup>k</sup>	3,730.3 <sup>l</sup>	5,002.0	–
2013	153,826.25	134,832.0	7,739.7 <sup>k</sup>	4,042.7 <sup>l</sup> +1,015.75 <sup>m</sup>	6,196.1	–
2014	241,170.6	220,204.8	7,838.7 <sup>k</sup>	3,961.6 <sup>l</sup> +1,348.5 <sup>m</sup>	7,817.0	–
2015	285,371.1	259,772.0	9,032.3 <sup>k</sup>	5,593.8 <sup>l</sup> +1,687.8 <sup>m</sup>	9,285.2	–
2016	946,723.35/ 254,328.3 <sup>n</sup>	918,969.1/ 226,574.1 <sup>n</sup>	9,412.4 <sup>k</sup>	5,843.25 <sup>o</sup> +3,026.7 <sup>m</sup>	9,471.9	–
2017	275,168.2	251,327.0	9,825.1 <sup>k</sup>	5,318.4 <sup>o</sup> +2,857.7 <sup>m</sup>	5,840.0	–
2018	333,397.8	312,565.8	9,784.8 <sup>k</sup>	1,988.6 <sup>o</sup> +2,922.6 <sup>m</sup>	6,136.0	–

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

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

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

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

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

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

federal budget execution as of January 1, 2016; January 1, 2017; and January 1, 2018 (annual data), and the monthly report on federal budget execution as of January 1, 2019.

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

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

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

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

<sup>k</sup> – the amount of lease payments after the delineation of titles to land plots between different tiers of government and revenues generated by the sale of right to conclude lease agreements in respect of land plots in federal ownership (with the exception of land plots held by federal budget-funded institutions and autonomous institutions), and (a) lease payments received for the lease of land plots in federal ownership, situated in public motor road precincts of federal importance (2012–2018), (b) payments for

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

<sup>2</sup> According to data released by the RF Ministry of Property Relations, the revenues from the use of federal properties situated abroad (less the revenues received by the Russian partner in Joint Venture *Vietsoyvetro*) amounted to RUB 315 million in 1999 and RUB 440 million in 2000. Thereafter, the major role in organizing the commercial use of federal immovable property situated abroad was assigned to FSUE *Goszagransobstvennost*.

the execution of agreements on the establishment of servitude with regard to land plots situated within public motor road precincts of federal importance for the purposes of building construction (or reconstruction), capital repairs and exploitation of road service entities, installation and exploitation of utility networks, installation and exploitation of elevated advertising structures (2012 and 2014-2018), and (c) payments received in the framework of agreements on the establishment of servitude with regard to land plots in federal ownership (2015–2018);

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

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

<sup>n</sup> – less the revenues generated by the sale of the stake in *Rosneft* (RUB 692,395 billion) (less interim dividend payments);

<sup>o</sup> – for the period 2016–2018, we apply aggregate data, without identifying by-sector groups of institutions. The more general classification consist only of 2 revenue categories, distinguished depending on the recipient of revenues generated by lease of property (federal bodies of state authority, the Bank of Russia and the managerial bodies of RF government extrabudgetary funds, and federal treasury institutions).

*Source:* Laws on federal budget execution for the period 2000–2014; reports on federal budget execution as of January 1, 2016; January 1, 2017; and January 1, 2018 (annual data); and the monthly report on federal budget execution as of January 1, 2019, [www.roskazna.ru](http://www.roskazna.ru); own calculations.

In 2018, the aggregate revenues generated by renewable sources increased by more than 21 percent relative to the previous year.

This was achieved in the main due to the receipts of dividends in the federal budget (RUB 312.6 billion), which increased by almost a quarter, and rose above the previous record high of 2015 (RUB 259.8 billion). The receipts of part of profits paid by unitary enterprises, after having shrunk in 2017 by more than 5 percent, increased once more, while still staying below their 2013 level in absolute terms (RUB 6.1 billion).

The amount of revenue generated by lease of land plots remained practically unchanged (approximately RUB 9.8 billion)<sup>1</sup>. At the same time, the aggregate revenues generated by lease of federal property (approximately RUB 4.9 billion) demonstrated a sharp plunge (by 40 percent). This happened as a result of shrinkage, by more than

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<sup>1</sup>The amount of lease payments for land plots, just as a year earlier, includes lease payments received for the lease of land plots in federal ownership situated in public motor road precincts of federal importance, payments for the execution of agreements on the establishment of servitude with regard to land plots situated within the easement areas of general-use motorways of federal importance for the purposes of building construction (or reconstruction), capital repairs and exploitation of road service entities, installation, relocation, restructuring, and exploitation of utility networks, and installation and exploitation of elevated advertising structures; and payments for the execution of agreements on the establishment of servitude with regard to land plots in federal ownership which are specified for the first time in the budget reports for 2015.

60 percent (to less than RUB 2.0 billion) of the revenues from lease of property held by right of operative management by federal bodies of state authority and by the state institutions established by them (with the exception of budget-funded institutions and autonomous institutions). The revenues generated by lease of property which is held by the RF Treasury (except land plots), on the contrary, somewhat increased (by 2.3 percent), amounting to more than RUB 2.9 billion. For the first time since they had been identified in budget reports (from 2013 onwards) as a separate entry, they began to prevail in the aggregate structure of revenues generated by lease of federal property.

As in the previous year, dividends held a dominant position in the structure of renewable federal budget revenue sources (approximately 94 percent vs. 91 percent a year earlier). The relative share of lease payments for land plots amounted to 2.9 percent; that of payments for property lease – to 1.5 percent; and that of profits transferred by FSUEs – to 1.8 percent. Their aggregate relative share declined relative to 2017.

While proceeding to an analysis of federal budget revenues generated by the privatization and sale of state property (*Table 11*), it should be noted that, from 1999 onwards, the revenues from the sale of such assets (state stakes, and over the period 2003–2007 – also land plots<sup>1</sup>) have been treated as a source of funding to cover budget deficit.

*Table 11*

**Federal budget revenues generated by the privatization and sale of property (non-renewable sources) in 2000–2018, millions of rubles**

Year	Total	Sale of shares in federal ownership (2000–2014) and other forms of state participation in capital (2005–2018) <sup>a</sup>	Sale of land plots	Sale of miscellaneous properties
2000	27,167.8	26,983.5	–	184.3 <sup>b</sup>
2001	10,307.9	9,583.9	119.6 <sup>c</sup>	217.5+386.5+0.4 (ITA) <sup>d</sup>
2002	10,448.9	8,255.9 <sup>e</sup>	1,967.0 <sup>f</sup>	226.0 <sup>e</sup>
2003	94,077.6	89,758.6	3,992.3 <sup>h</sup>	316.2+10.5 <sup>i</sup>
2004	70,548.1	65,726.9	3,259.3 <sup>j</sup>	197.3+1,364.6+0.04 (ITA) <sup>k</sup>
2005	41,254.2	34,987.6	5,285.7 <sup>l</sup>	980.9 <sup>m</sup>
2006	24,726.4	17,567.9	5,874.2 <sup>l</sup>	1,284.3 <sup>n</sup>
2007	25,429.4	19,274.3	959.6 <sup>o</sup>	5,195.5 <sup>p</sup>
2008	12,395.0	6,665.2+29.6	1,202.0 <sup>q</sup>	4,498.2+0.025 (ITA) <sup>r</sup>
2009	4,544.1	1,952.9	1,152.5 <sup>q</sup>	1,438.7 <sup>r</sup>
2010	18,677.6	14,914.4	1,376.2 <sup>q</sup>	2,387.0+0.039 (ITA) <sup>r</sup>
2011	136660.1	126207.5	2425.2 <sup>q</sup>	8,027.4 <sup>r</sup>
2012	80,978.7	43,862.9	16,443.8 <sup>q</sup>	20,671.7+0.338 (ITA) <sup>r</sup>
2013	55,288.6	41,633.3	1,212.75 <sup>q</sup>	12,442.2+0.310 (ITA) <sup>r</sup>
2014	41,155.35	29,724.0	1,912.6 <sup>q</sup>	9,517.7+1.048 (ITA) <sup>r</sup>
2015	18,604.1	6,304.0	1,634.55 <sup>q</sup>	10,665.5+0.062 (ITA) <sup>r</sup>
2016	416,470.5	406,795.2	2,112.7 <sup>q</sup>	7,562.6+0.012 (ITA) <sup>r</sup>
2017	21,906.7	14,284.5	1,199.6 <sup>q</sup>	6,421.3+1.3 (ITA) <sup>r</sup>
2018	28,251.3	12,787.5	1,660.6 <sup>q</sup>	13,803.0+0.2 (ITA) <sup>r</sup>

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

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

<sup>1</sup>Data for the period 2003–2004, including revenues generated by sale of leasing right.



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

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

<sup>e</sup> – including RUB 6 million generated by the sale of shares held by RF subjects;

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

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

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

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

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

<sup>k</sup> – the sum of (1) revenues generated by the sale of properties in federal ownership, treated as an internal source of funding to cover the federal budget deficit, (2) revenues generated by (a) the sale of apartments, (b) the sale of equipment, transport vehicles and other tangible assets, the proceeds being transferred to the federal budget, (c) the sale of the products of ships recycling industry, (d) the sale of property held by state unitary enterprises and state institutions, as well as the sale of military property, (e) the sale of the products of recycled armaments, military technologies and ammunition, (3) revenues generated by the sale of intangible assets (ITA); these are treated as federal budget revenues;

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

<sup>m</sup> – revenues generated by the sale of tangible and intangible assets (less federal budget revenues generated by disposal and the sale of confiscated property and other property treated as government revenue), this figure includes revenues generated by (a) the sale of apartments, (b) the sale of property held by FSUEs, (c) the sale of property held by right of operative management by federal institutions, (d) the sale of military property, (e) the sale of the products of recycled armaments, military technologies

and ammunition, (f) the sale of other properties in federal ownership, (g) the sale of intangible assets; these are treated as federal budget revenues;

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

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

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

<sup>q</sup> – revenues generated by the sale of land plots in federal ownership (less land plots held by federal autonomous and budget-funded institutions (data for 2011–2012)), treated as federal budget revenues; prior to 2015, these also include payments for the enlargement of private land plots resulting from their redistribution, as well the redistribution of land plots in federal ownership;

<sup>r</sup> – revenues generated by the sale of tangible and intangible assets (less revenues received as profit share in the framework of product share agreements (PSA), and federal budget revenue generated by the disposal and sale of heirless property, confiscated property, or other property earmarked as government revenue, and revenues from the sale of timber confiscated from timber poachers) (data for 2008–2011), revenues generated by the release of tangible assets from the state reserve of special raw materials and divisible materials (in the part of revenues generated by the sale, temporary lending, and other uses thereof); and with regard to data for 2012–2016, also revenues generated by the sale of timber produced as a result of measures designed to safeguard, protect, reproduce forests in the framework of government order for the implementation of such measures without the sale of forest plantations for timber production, and timber produced as a result of use of forests situated in the lands belonging to the Forest Fund of the Russian Federation, in accordance with Articles 43–46 of the RF Forest Code; revenues generated by commodity intervention from the reserve stocks held in the federal intervention fund of agricultural products, raw materials and foodstuffs, revenues generated by the release of tangible assets from the state reserve, revenues generated by the involvement of convicts in reimbursable labor (in the part of sales of finished products), revenues generated by the sale of products requiring special storage conditions); this figure also includes revenues generated by (a) the sale of apartments, (b) the sale of property held by right of operative management by federal institutions (with the exception of autonomous institutions and budget-funded institutions (data for 2011–2018), less revenues generated by the activities of institutions situated abroad (2015–2018), (c) the sale of redundant movable and immovable military properties and other properties held by federal bodies of executive authority that involve military service, and services that are equated to military service, (d) the sale of the products of recycled armaments, military equipment and ammunition, (e) the sale of products intended for military use and entered on the list of properties held by federal bodies of executive authority in the framework

of cooperation in the field of military technologies (data for 2008 and the period 2010–2018), (f) the sale of scrapped armaments and other military hardware in the framework of the Federal Target Program of Industrial Recycling of Armaments and Military Equipment (2005–2010), (g) revenues generated by the sale of immovable property held by budget-funded and autonomous institutions (2014–2018), (h) revenues generated by the sale of other properties in federal ownership, and revenues generated by the sale of intangible assets (ITA); these are treated as federal budget revenues.

*Source:* Laws on federal budget execution for the period 2000–2014; reports on federal budget execution as of January 1, 2016; January 1, 2017; and January 1, 2018 (annual data); and the monthly report on federal budget execution as of January 1, 2019, Report on Federal Budget Execution as of 1 January 2016 (annual report), [www.roskazna.ru](http://www.roskazna.ru); own calculations.

When taken in absolute terms, the amount of property-generated federal budget revenues from non-renewable sources in 2018 jumped by 29 percent. However, the revenues generated by the sale of shares declined by 10.5 percent (to RUB 12.8 billion). Relative to the period after 2010, this would be a record low but for the index for 2015 (RUB 6.3 billion).

At the same time, the revenues generated by the sale of land plots moved in the other direction, rising more than 38 percent and amounting to RUB 1.66 billion vs. RUB 1.2 billion a year earlier, which roughly corresponds to their level in 2015, but is still less than the corresponding indices for 2014 and 2016. Meanwhile, the amount of revenues from the sale of miscellaneous properties jumped even higher (more than twice), and their index in absolute terms (RUB 13.8 billion) is a record high of the entire period since 2012. Similarly to the results of 2015, the relative share of revenue from that particular source turned out to be highest (approximately 1/2). The sale of shares accounted for more than 45 percent (in 2017 – approximately 2/3), and the sale of land plots – for less than 6 percent (in 2017 – 5.5 percent).

The aggregate federal budget revenue generated by the privatization (or sale) and use of state property in 2018 (*Table 12*) increased nearly 22 percent relative to the previous year.

*Table 12*

**The structure of property-generated federal budget revenues  
from miscellaneous sources, 2000–2018**

Year	Aggregate revenue generated by privatization (or sale) and use of state property		Privatization-generated revenues (non-renewable sources)		Revenues generated by use of state property (renewable sources)	
	millions of rubles	percent of total	millions of rubles	percent of total	millions of rubles	percent of total
1	2	3	4	5	6	7
2000	50,412.3	100.0	27,167.8	53.9	23,244.5	46.1
2001	39,549.8	100.0	10,307.9	26.1	29,241.9	73.9
2002	46,811.3	100.0	10,448.9	22.3	36,362.4	77.7
2003	135,338.7	100.0	94,077.6	69.5	41,261.1	30.5
2004	120,798.0	100.0	70,548.1	58.4	50,249.9	41.6
2005	97,357.4	100.0	41,254.2	42.4	56,103.2	57.6
2006	93,899.8	100.0	24,726.4	26.3	69,173.4	73.7
2007	105,761.25	100.0	25,429.4	24.0	80,331.85	76.0
2008	88,661.7	100.0	12,395.0	14.0	76,266.7	86.0
2009	36,393.7	100.0	4,544.1	12.5	31,849.6	87.5
2010	88,406.4	100.0	18,677.6	21.1	69,728.8	78.9

Cont'd

1	2	3	4	5	6	7
2011	240,964.1	100.0	136,660.1	56.7	104,304.0	43.3
2012	309,943.2/ 469,243.2*	100.0	80,978.7/ 240,278.7*	26.1/ 51.2*	228,964.5	73.9/ 48.8*
2013	209,114.85	100.0	55,288.6	26.4	153,826.25	73.6
2014	282,325.95	100.0	41,155.35	14.6	241,170.6	85.4
2015	303,975.2	100.0	18,604.1	6.1	285,371.1	93.9
2016	1,363,193.85/ 670,798.85**	100.0	416,470.5	30.6/ 62.1**	946,723.35/ 254,328.35	69.4/ 37.9**
2017	297,074.9	100.0	21,906.7	7.4	275,168.2	92.6
2018	361,649.1	100.0	28,251.3	7.8	333,397.8	92.2

\* – including the proceeds received by the RF Central Bank as a result of the sale of a stake in *Sberbank* (RUB 159.3 billion), which is probably an overestimation of the actual aggregate share of non-renewable sources, because the budget did not receive the full amount of those proceeds, but their amount less the balance sheet value of that particular asset plus the costs incurred in the deal of sale. Consequently, the share of renewable sources is, on the contrary, somewhat underestimated;

\*\* – less the revenues generated by the sale of shares in *Rosneft* (RUB 692,395 billion) (less interim dividend payments).

Source: Laws on federal budget execution for the period 2000–2014; reports on federal budget execution as of January 1, 2016; January 1, 2017; and January 1, 2018 (annual reports); Report on Federal Budget Execution as of January 1, 2019 (monthly report), [www.roskazna.ru](http://www.roskazna.ru); own calculations.

Their index in absolute terms (RUB 361.65 billion) was below only the records highs of 2012 and 2016, when the deals of sale of stakes in biggest companies (*Sberbank* and *Rosneft*) were closed<sup>1</sup>. Meanwhile, in 2018 there were no such deals, and the ratio of non-renewable to renewable sources in the structure of aggregate revenues generated by the privatization (or sale) and use of public property remained the same as a year earlier.

The relative share of non-renewable sources in the structure of aggregate revenues generated by the privatization (or sale) and use of public property was less than 8 percent. The revenue generated by the use of public property, having surged above 92 percent, in absolute terms hit a record high of the entire period since the early 2000s, while the revenues generated by the privatization and sale of property amounted to slightly more than a half of the corresponding index for 2013, at the same time being above the indices for 2007–2010 and 2015.

It should be noted that in the budget reports, the RF Central Bank's revenues generated by its stake in the capital of *Sberbank of Russia* PJSC are not identified as a separate entry; according to the materials attached to the drafts of federal budget laws prepared by the RF Government, these are treated as non-tax revenues.

#### 6.1.5. The government program *federal property management*: new amendments (version) and current results

A condensed statement of the government policy in the sphere of property management in its current phase is the Government Program (GP) *Federal Property Management*, approved by RF Government Decree No 327 dated April 15, 2014, to

<sup>1</sup>When taken less the proceeds received by the RF Central Bank as a result of the sale of a stake in *Sberbank*, the index for 2012 moves below the aggregate federal budget revenue generated by the privatization (or sale) and use of public property in 2018.

replace the original GP with the same title that had been in effect for approximately 14 months<sup>1</sup>.

By RF Government Decree No 367-14 dated March 30, 2018, other important alterations were introduced in the program adopted in 2014, and it was approved in its new (third) version<sup>2</sup>.

The GP has been prolonged until 2020, while in its previous version it was to be completed in 2019, and so its second phase (2016–2020) is now extended over a period of 5 years. Below we analyze in more detail the changes in the volume of budget funding and its proportional distribution (*Table 13*).

*Table 13*

**Budget allocations to the Government Program  
Federal Property Management  
in 2013–2020, millions of rubles**

period	GP 2013*		GP 2014 (original version)		GP 2014 (version 2017/2018)	
	total	Including additional funding	total	Including under Subprogram Improvement of the Efficiency of Government Property Management and Privatization	total	Including under Subprogram Improvement of the Efficiency of Government Property Management and Privatization
2013	5,474.3	5,896.9	23,629.8	5,673.8	23,287.2	5,474.3
2014	5,251.4	9,666.6	22,093.5	5,436.1	22,093.5	5,436.1
2015	5,275.1	9,842.7	27,537.6	5,298.9	27,938.9	5,408.5
2016	5,469.8	11,180.5	25,261.0	5,138.9	24,854.5	4,465.8
2017	5,775.8	8,028.8	26,903.6	5,158.6	22,971.3	4,127.6
2018	6,192.0	7,869.2	29,605.5	5,531.4	22,491.1/23,047.6**	4,046.0/4,058.0
2019					22172.6/22621.5**	3991.6/4069.4
2020					22944.5**	4131.2
total	33,438.4	52,484.8	155,031.1	32,237.7	165,809.1/189,759.0**	32,949.8/37,170.8

\* – only the amount of funding allocated to the Subprogram Improvement of the Efficiency of Government Property Management and Privatization. The budget allocation data for Subprogram Government Material Reserve Management are classified;

\*\* – as approved in 2018.

*Source:* Government Program *Federal Property Management*, approved by RF Government Directive No 191-r dated February 16, 2013; Government Program *Federal Property Management*, approved by RF Government Decree No 327 dated April 15, 2014 (original version, as approved on March 31, 2017 and March 30, 2018).

After the amount of allocations to the implementation of the GP in its previous version was reduced by 15–24 percent in 2017–2018 relative to its original version, their

<sup>1</sup> Approved by RF Government Directive No 191-r dated February 16, 2013. For more details on GP 2013, see Malginov, G., Radygin, A. Public sector and privatization // Russian Economy in 2012. Trends and Outlooks (Issue 34). Moscow, IEP. 2013, p. 468–475.

<sup>2</sup> For an analysis of the GP as approved in spring 2017, see Malginov, G., Radygin, A. Federal property and privatization policy // Russian Economy in 2017. Trends and Outlooks. Moscow, IEP. 2018, p. 435–452.

growth in accordance with the latest version amounted to 2–2.5 percent in 2018–2019. Overall in the course of 8 years (2013–2020), the volume of financial resources allocated from the federal budget to the implementation of the GP is to amount to RUB 189.8 billion, which is by approximately RUB 24 billion, or 14.5 percent, more than the amount envisaged in the previous version of the GP for a 7-year period (2013–2019).

The allocations under the GP, as a result of its prolongation, to Subprogram 1 *Improvement of the Efficiency of Government Property Management and Privatization* will amount to more than RUB 4.2 billion. The volume of funding earmarked for the ‘extra’ year 2020 is less, by approximately 11 percent, than the average annual volume of allocations envisaged in the new version of the GP (relative to the corresponding allocation target set in the previous version, it will decline by 12 percent, and relative to the original version – by approximately 23 percent). Similarly to the original version, the bulk of budget allocations will go to the Subprogram *Government Material Reserve Management*. The Subprogram *Improvement of the Efficiency of Government Property Management and Privatization* will receive less than 20 percent of the total allocation target for the period 2013–2020 (and approximately 18 percent in 2019–2020).

However, it should be borne in mind that throughout the entire discourse, it is the allocation targets, and not the actual amount of budget spending, that are the focus of attention. The corresponding budget projections in the law on federal budget for 2019–2021 turned out to be approximately 30 percent less than the targets set in the GP certificate: RUB 15.8 billion in 2019, and RUB 16.1 billion in 2020. At the same time, the amount of allocations to Subprogram 1 has turned out to be somewhat higher than the targets set in its certificate: RUB 4,092.5 million in 2019, and RUB 4,155.5 million in 2020. As a result, the relative share of the Subprogram *Improvement of the Efficiency of Government Property Management and Privatization* will amount to approximately 1/4 of the total amount of funding allocated to the GP.

While the goals that were previously set in the GP have remained unchanged, in its new version the targets and indicators of the GP’s progress are the average rate of decline in the number of organizations with state stakes and federal treasury property entities (as percentage) – these remained unchanged, but in the original version of the GP there was also another indicator – the dynamics of the hi-tech development of federal property management methods.

The expected results, according to the new version of the GP, are the adoption, by 2020, of a new forecast plan (program) of federal property privatization and the main directions of federal property privatization for 2020–2022 (instead of the completion, in 2019, of the current reform in the system of federal property sales), and an increase in the rate of decline in the number of federal treasury property entities from 3 percent in 2013 to 29.5 percent in 2020 (instead of 24 percent in 2019).

The total number of quantitative targets set for the Subprogram *Improvement of the Efficiency of Government Property Management and Privatization* remained the same (14); in the original version adopted in 2014 there were 16 targets, and since then, their actual content has also changed.

Among the targets aiming at optimization of the composition and structure of federal property, the indicator of the relative share of treasury property entities for which a target function was assigned has been eliminated (with respect to FSUEs, this was done in 2017).

And instead of the indicator of decline in the number of treasury property entities (with the exception of entities in RF exclusive ownership), measured as a percentage of their number in 2012, the indicator of the relative share (percentage) of federal treasury property entities involved in economic turnover in the total number of federal treasury property entities as of the end of a reporting year is now applied (less land plots, shares in the charter (or share) capital of economic societies and partnerships, other highly valuable movable property entities with initial per unit cost below RUB 500,000/200,000, and current assets (irrespective of their value), entered on records as single entities)<sup>1</sup>.

Besides, a new indicator was introduced – the relative share (percentage) of the powers of *Rosimushchestvo* executed through the use of the Federal State Information System *FGIAS ESUGI* (Register of Assets Held by the Russian Federation). In this connection, it should be reminded that in the GP's original version adopted in 2014, there were two indicators linked to the use of *FGIAS ESUGI*: the relative share of economic societies with a 100-percent stake owned by the RF and state organization with a less-than-100-percent stake owned by the RF, whose accounting systems and tax records were fully integrated in *FGIAS ESUGI*, in the total number of organizations in the relevant category (both these indicators were eliminated in 2017).

The definition of the indicator of the amount of federal budget revenue generated by profit derived from the ownership of shares in the charter (or share) capital of economic societies and partnerships, or by dividends paid on shares in federal ownership, and actually received, relative to its target set for a given reporting year, was significantly altered so as to make it more precise. The original definition was supplied with a note that in this connection, a decision by the RF Government to the effect that dividends are not to be paid should be taken into account; now the content of that note has been expanded, and in addition to a government decision, also government directives concerning the percentage of net profit to be earmarked for the payment of dividends by each JSC, and concerning the difference between the actual amount of net profit received by a JSC and its planned target, should be taken into account.

The expected results of Subprogram 1 have largely remained the same, as far as their content is concerned. It differs from its 2017 version only in that it now lacks one specific target – a decline in the number of treasury property entities owned by the Russian Federation (less land plots). At the same time, with respect to all treasury property entities, land plots including, a general increase of the relative share of such

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<sup>1</sup>Because this definition is obviously difficult to apply due to its complexity, in the materials published on *Rosimushchestvo*'s official website, its shorter version sometimes used: 'treasury-owned capital construction entities not involved in economic turnover'.

entities involved in economic turnover is proclaimed (without any specific figures provided).

The text of the GP was amended as follows.

The government policy priorities and goals, which have been shaped not only by the Concept of long-term socioeconomic development of Russia until 2020 (approved by RF Government Directive No 1662-r dated November 17, 2008) and the Federal Law ‘On Strategic Planning in the Russian Federation’, but also by presidential and governmental decisions, are now concretized, to some extent, by the following elaboration: ‘including with respect to accelerated development of priority territories’.

The list of measures designed to improve the efficiency of federal property sales and to enhance the involvement of federal property entities in commercial turnover, including privatization instruments, has been shortened.

The following items were struck off the list:

- creation of mechanisms for elaborating plans and schedules regarding the sale of shares in big companies with state stakes in a medium-term perspective, prepared with due regard for the results of a preliminary analysis of their investment potential, markets, demand, investor needs, regulatory environment; and also, whenever necessary, implementation of measures designed to increase the capitalization index and investment attractiveness of the property entities to be alienated; alteration of the business model, strategy and corporate governance quality of companies, and the tariff- and tax-related and social aspects of regulation;

- implementation of a system of motivations for the key participants in a sale (the CEOs of a company earmarked for privatization and the seller);

- elaboration, with due regard for international best practices, of formal procedures of pre-sale preparation and alienation of shares in big companies with state stakes that could be attractive for investors, in accordance with RF Government decisions, in order to attract investments, and promote competition, modernization and technological development of the national economy;

- regular monitoring of the planning, preparation and closure of deals entered in the federal property roadmaps approved by the RF Government;

- better information backing of sales of federal property through regular online publications, and gradual elimination of printed announcements concerning the involvement in economic turnover of federal property entities;

- ‘post-privatization’ monitoring of the sold entities, and control of the fulfillment of their obligations by the new owners.

In this connection, the following goals related to optimizing the content and structure of the federal property complex are no longer to be achieved:

- creation of a system of motivations for the sellers and CEOs of companies with state stakes earmarked for privatization;

- creation of roadmaps for the pre-sale preparation and sale of big federal property entities that are attractive for investors;



– creation of a system for control and monitoring of the implementation of roadmaps for the pre-sale preparation and sale of big federal property entities that are attractive for investors;

– completion of the implementation of roadmaps for increasing the investment attractiveness of federal property entities to be alienated.

Some alterations were also made to the list of measures designed to boost performance in the sphere of federal property management.

There is no longer any mention of the requirement that the companies still with federal stakes should gradually go public through entering the organized securities market. At the same time, it is now required that professional directors and independent experts should be elected to the managerial and control bodies of biggest companies as well.

Besides, the text has been technically edited in many ways. Among the most important alterations are the use of the terms ‘phase I’ and ‘phase II’ instead of the specific dates mentioned in the previous version (2015 and 2019 versions respectively), and the equivalent use of the terms ‘roadmap’ and ‘plan of measures’.

The new version of the GP, similarly to its predecessor, contains a number of annexes, the most interesting component of which are the numerical data (indicators). Their publication makes it possible not only to compare different versions, but also to estimate the success achieved in the program’s implementation (*Tables 14–18*).

*Table 14*

**The progress of the GP *Federal Property Management* in 2014–2017 and indicators for the period until 2020, in the part of determining target functions (relative share of assets with a determined target function)**

Indicator	2014		2015		2016		2017		2018	2019	2020
	plan	fact	plan	fact	plan	fact	plan	fact			
Relative share of economic societies with shares (or stakes) in federal ownership, percent	35	61	45	68	50	65.5	100	99.8	100	100	100
Relative share of FSIs, percent	–	20.5	–	32	5	49	60	60.6	100	100	100

*Source:* Government Program *Federal Property Management*, approved by RF Government Decree No 327 dated April 15, 2014 (as approved on March 30, 2018); *Rosimushchestvo*’s reports for 2014–2017, www.rosim.ru.

*Table 15*

**The progress of the GP *Federal Property Management* in 2014–2017 and indicators for the period until 2020, in the part of optimization of its content and structure**

Indicator	2014		2015		2016		2017		2018	2019	2020
	plan	fact	plan	fact	plan	fact	plan	fact			
1	2	3	4	5	6	7	8	9	10	11	12
Annual decline in number of JSCs with state stakes relative to previous year, not less than, percent	15	8.8	12	12	6	20.9	5	14.6	6	7	8

Cont'd

1	2	3	4	5	6	7	8	9	10	11	12
Annual decline in number of FSUEs relative to previous year, not less than, percent	12	6.3	13	12	15	9.7	20	22.2	13	13	13
Reduction in area of treasury-owned land plots not involved in economic turnover, relative to total area of treasury-owned land plots in 2012 (except land plots withdrawn from turnover or those subject to turnover restrictions), percent	10	21.5	15	17	20	33.9	25	35	30	35	40
Relative share of treasury property entities involved in economic turnover in total number of treasury property entities as of end of reporting year (less land plots, shares, stakes (or contributions) in charter (share) capital of economic societies and partnerships, other highly valuable movable property entities with initial per unit cost below RUB 500,000/200,000, and current assets (irrespective of their value), entered on records as single entities)*, percent									18	18.5	19

\* – a new indicator that appeared in the 2018 version of the GP.

Source: Government Program *Federal Property Management*, approved by RF Government Decree No 327 dated April 15, 2014 (as approved on March 30, 2018); *Rosimushchestvo*'s reports for 2014–2017, [www.rosim.ru](http://www.rosim.ru).

Table 16

**The progress of the GP *Federal Property Management* in 2014–2017 and indicators for the period until 2020, in the part of public asset management instruments (in fact, only JSCs with state stakes)**

Indicator	2014		2015		2016		2017		2018	2019	2020
	plan	fact	plan	fact	plan	fact	plan	fact			
1	2	3	4	5	6	7	8	9	10	11	12
Relative share of civil servants in managerial and controlling bodies of JSCs with state stakes, percent	30	29.6	30	27	30	28.7	50	495	50	50	50

*Cont'd*

1	2	3	4	5	6	7	8	9	10	11	12
Relative share of JSCs (those entered in the Special List, and other JSCs with controlling RF stakes) with indicators in their long-term development programs oriented to boosting labor productivity and creation and modernization of high-productivity jobs, percent*	–	–	–	–	–	–	70	71.5	80	90	95

\* – a new indicator that appeared in the 2017 version of the GP.

*Source:* Government Program *Federal Property Management*, approved by RF Government Decree No 327 dated April 15, 2014 (as approved on March 30, 2018); *Rosimushchestvo*'s reports for 2014–2017, www.rosim.ru.

*Table 17*

**The progress of the GP *Federal Property Management* in 2014–2017  
and indicators for the period until 2020, in the part of hi-tech development  
of federal property management methods**

Indicator	2014		2015		2016		2017		2018	2019	2020
	plan	fact	plan	fact	plan	fact	plan	fact			
Relative share of federal property entities in Federal Property Register in total number of identified property entities to be entered in Register (over current year), percent	80	100	80	80	80	80.2	80	81.5	80	90	90
Relative share of public services rendered in electronic form in total number of services rendered by <i>Rosimushchestvo</i> , percent	35	98	50	98	65	93.3	100	100	100	100	100
Relative share of powers executed by <i>Rosimushchestvo</i> through the use <i>FGIAS ESUGI</i> , percent*									45	60	75

\* – a new indicator that appeared in the 2018 version of the GP.

*Source:* Government Program *Federal Property Management*, approved by RF Government Decree No 327 dated April 15, 2014 (as approved on March 30, 2018); *Rosimushchestvo*'s reports for 2014–2017, www.rosim.ru.

These data reliably underline the fact that after the adoption of a new version of the GP, according to the year-end results of 2017, almost all indicators were close to their target values, or had surged above those target values. One particularly illustrative example is the indicator of annual decline in the number of economic subjects with state stakes relative to the previous year. If for JSCs that movement pattern could be observed as early as 2016, in the case of FSUEs an accelerated rate was noted for the first time only since the launch of the GP. The rate of shrinkage of treasury-owned land plots not involved in economic turnover relative to the total area of treasury-owned land plots in 2012 corresponds to the planned target for 2019. In a similar fashion, the ratio of value of sold property entities in state ownership to their valuation index determined for the purpose of their sale also corresponds to its planned target for 2018. The budgetary effect

indicators rose above their planned targets: with respect to the sale of shares (or stakes) in economic societies – by 4 percent, and with respect to dividends – by more than 7 percent.

Table 18

**The progress of the GP *Federal Property Management* in 2014–2017  
and indicators for the period until 2020, in the part  
of budgetary effect**

Indicator	2014		2015		2016		2017		2018	2019	2020
	plan	fact	plan	fact	plan	fact	plan	fact			
Relative share of federal budget receipts over reporting year generated by sale of shares and stakes in charter capital of economic societies, as percentage of planned amount of receipts set in RF Government directive that approved forecast plan (program) of privatization for given year (except receipts generated by sale of shares in biggest JSCs),* percent	–	–	–	–	–	–	100	104	100	100	100
Federal budget revenue received as profit derived from stakes in charter capital of economic societies and partnerships, or dividends on shares in federal ownership, as percentage of planned target for reporting year (with due regard for RF Government concerning non-payment of dividends),* percent	–	–	–	–	–	–	100	107.1	100	100	100
Ratio of value of sold property in state ownership to its valuation for purposes of sale,* percent	–	–	–	–	–	–	30	40.5	40	50	70

\* – a new indicator that appeared in the 2017 version of the GP.

Source: Government Program *Federal Property Management*, approved by RF Government Decree No 327 dated April 15, 2014 (as approved on March 30, 2018); *Rosimushchestvo*'s reports for 2014–2017, www.rosim.ru.

In the new (2018) version of the GP, the content of the normative legal package to be adopted has been somewhat adjusted. While in the previous version it was intended to introduce amendments to two presidential executive orders (concerning constraints on privatization and the list of strategic organizations) and one federal law (concerning the procedures for determining heirs to property in the course of escheatment process), the new version envisages the adoption, by a government directive, of the privatization program for 2020–2022 and the amendment of the law on unitary enterprises

(concerning regulation of the sale of their property), and the issuance of a government decree on the improvement of federal property records.

\* \* \*

Thus, in 2018, the situation in the sphere of ownership relations was shaped by the following basic trends.

The number of unitary enterprises and JSCs with state stakes in their capital, according to data from a variety of sources, was well in line with the multi-year downward trend displayed by the movement pattern of the number of economic subjects in federal ownership. A detailed analysis revealed a number of negative trends like a shrinkage in the relative share of companies where the State, in its capacity of a shareholder, could exercise full-scale corporate control, as a result of an increase in the relative share of minority stakes, and also a shrinkage in the relative share of those companies where *Rosimushchestvo* could fully exercise its shareholder rights.

There were no instances of sale of big assets (included in the current privatization program for 2017–2019) on the basis of individual government decisions. The biggest deal with significant budgetary effect was the 2-year (2017–2018) installment buyout, under an individual plan, of a stake in a Russia-India joint venture in the telecommunications sector by SSA *Sistema* PJSC. However, the total budget target for revenue generated by the sale of shares proved to be unachievable, and the same was true of the federal budget revenue target (less biggest sale value) set in the privatization program. The movement patterns of sales of stakes in JSCs in accordance with standard procedures and reorganizations of unitary enterprises into JSCs remained basically the same as in 2017.

As for the sales of treasury property entities, both the number of bids by investors and the number of actually closed deals more than doubled. In this connection, we may speak of an increasingly significant involvement of independent sellers, who for several straight years have been playing a major role in the sales of shares (or stakes) in economic societies.

The provisions of the law on privatization were made significantly more liberal: the ban, introduced in 2017, on property purchase by an offshore company now applies only to those offshore companies which do not disclose information on their beneficiaries, beneficiary owners and controlling persons in the procedure established by the RF Government.

The process of creation, by the government, of vertically integrated structures and consolidation of state corporations has continued. The decision concerning the transfer to State Corporation *Rostec* of several VISs created more than 10 years ago, previously entered on the list of strategic organization, and specializing in certain industrial sectors, can be viewed as a new development in this sphere.

As far as state representatives in the managerial bodies of companies with state stakes are concerned, their group continued to display a trend toward an increasing relative

share of civil servants and professional attorneys and a shrinking share of independent directors. The improvement of instruments to be applied in managing the economic subjects operating in the public sector was reduced in the main to elaboration of various draft documents.

In the structure of federal budget revenue generated by privatization (or sale) and use of state-owned property, just as a year earlier, renewable sources played a dominating role. In 2018, as was the case both in 2015 and in 2017, their relative share hit a record high of the entire period since the early 2000s (more than 90 percent).

Meanwhile, most of revenue growth expressed in absolute terms came from the sources associated with the activity of commercial organization with state participation (dividends and the transfer of part of their profit by unitary enterprises), while lease payments for land and other property were stagnating or shrinking, with the exception of revenues generated by the leasing of treasury property entities. The latter, from the moment of their identification as a separate entry in budget reports, began to prevail in the aggregate proceeds of federal property leasing.

Among non-renewable revenue sources, growth was displayed by revenues generated by the sale of land plots and miscellaneous properties. The revenues generated by the latter were more substantial, even surging above the shrinking revenues from the sale of shares (or stakes) in economic societies.

The tradition of annual amendment of the Government Program *Federal Property Management* was continued. It was prolonged for one more year (until 2020), and the amount of funding allocated to both its subprograms was increased accordingly; however, the actual amount of these allocations is determined by laws on federal budget.

The major changes in the set of indicators for estimating the course of implementation of the Subprogram *Improvement of the Efficiency of Government Property Management and Privatization* had to do with treasury property entities; as was previously done with respect to unitary enterprises, the indicator for determining their target function was abolished, and the indicator of shrinkage of the ‘non-land’ component of the group of treasury property entities is now presented in a new format. The results of implementation of this Subprogram, after the alterations introduced in 2017, demonstrate that the established targets were met or exceeded by nearly all the indicators.

## **6.2. Megaregulatory approach to financial market regulation in abroad and in Russia<sup>1</sup>**

### **6.2.1. Models of financial market regulation**

One of the apparent aftermaths of the 2007–2009 global economic crisis was a lack of coordination between supervisory financial authorities. The previous general supervisory requirements had been found to be inadequate, raising a whole host of questions about its effectiveness. The ‘too big to fail’ issue came to the fore, while the

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<sup>1</sup> This section was written by N. Polezhajeva RANEPА; E. Apevalova from RANEPА.

antitrust regulation of mergers and acquisitions in the financial sector was ultimately thought to be too ‘soft’. Stepping up the adoption of unified (“mega”) financial regulators became an alternate solution to the problem.

*A megaregulatory approach* underlies the reforms that were undertaken in Austria, Germany, Denmark, Iceland, Norway, Singapore, Sweden, Japan.

The idea to establish megaregulators was originated by the need to optimize supervision costs, which, however, was most typical of small countries. Later, the dominant idea was the effort to supervise financial conglomerates on a consolidated basis. Amid the global crisis, however, the rationale is to mitigate the threat of systemic risks and to reduce moral hazard risks – such risks can arise out of a bank’s failure to assume full responsibility for its actions thus shifting the responsibility to the state – to a minimum in the banking sector.

The idea to adopt a megaregulatory approach in Russia was first expressed in 1999 and revisited in 2006, but to no avail<sup>1</sup>. The President of the Russian Federation signed on July 26, 2013 a law whereby the responsibilities – legal regulation, control and supervision over financial markets, including insurance, micro-financing, rating agencies and investment of pension savings – vested in the disbanded Federal Service for Financial Markets (FSFM) will now be the remit of the Bank of Russia instead. The FSFM ceased to be deemed to be a legal entity on September 1, 2013, and the FSFM functions were handed over by early in 2015 to a previously established single financial regulator – the Bank of Russia<sup>2</sup>. This suggests that an authority was established in Russia within the frameworks of cross-sectoral model of financial regulation, in which the regulatory power is fully vested in a single regulatory authority (a megaregulatory approach).

All the pros and cons of the megaregulatory model have been assessed in detail<sup>3</sup>. The transition to an integrated regulatory approach underlined many financial regulatory reforms in recent two decades. The 1980s saw some countries adopt the above principle, namely Singapore (in 1984), Norway (in 1986) and Denmark (in 1988), the 1990s saw five more countries do the same, and the 21<sup>st</sup> century is seeing the process gain pace. In the meantime, a few countries have thus far managed to have two regulatory models interchanged: for example, the U.K. established a megaregulator in 2000, while it is now switching back to a twin peaks model.

The second – ‘*twin peaks*’ – model is based on functional sharing of regulatory power between two “peaks”. The former is commonly responsible for prudential supervision,

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<sup>1</sup> See Khandruev A.. Megaregulatorbound (October 26, 2012) // Economic Policy’s official website. Expert channel. URL: <http://ecpol.ru/index.php>

<sup>2</sup> See Bobkova E.S., Semenova E.V. Bank of Russia on the rise as financial market regulator (October 27, 2014). URL: <http://novainfo.ru/article/2530>

<sup>3</sup> Doroshenko M.E., Berezin E.S. Megaregulatory approach in Russia amid financial crunch: Initial lessons // MSU (Moscow State University) Publications, Series 6. Economics. 2015. No. 4. PP. 30–51. Medvedeva O.E., Makshanova T.V. The advantages and disadvantages of establishing a megaregulator in Russia’s financial market // TGU (Togliatti State University) Vektor Nauki. 2013. No. 3. PP. 353–356.

while the latter is responsible for protecting rights of financial service consumers<sup>1</sup>. This type of model is adopted in the U.K., Australia and The Netherlands. The pros and cons of the twin peaks model are presented in *Table 19*.

*Table 19*

**Pros and cons of twin peaks model<sup>2</sup>**

Pros:	Cons:
<ul style="list-style-type: none"> <li>- financial conglomerates are supervised on a consolidated basis;</li> <li>- monitoring of the financial system as a whole needs less time to be spent on identifying systemic risk threats;</li> <li>- a unified approach to various types of financial mediators makes regulatory arbitrage less likely;</li> <li>- cost optimization of supervisory processes.</li> </ul>	<ul style="list-style-type: none"> <li>- supervision efficiency losses during a transition period;</li> <li>- salient features of specific sectors of financial intermediation are ignored;</li> <li>- a bureaucratic approach to decision making, and “delayed feedback”;</li> <li>- cost saving can be overestimated.</li> </ul>

The third – *sectoral* (vertical) – model includes more than one regulators, each of them is responsible for a particular sector. This type of model is now in place in Hong Kong, China, Mexico.

The sectoral model can usefully and efficiently regulate various financial market segments according to their salient features, however, coherence in actions of regulatory authorities is not always a success. Some European countries (Belgium, Poland, Slovakia, Czech Republic) have in recent decade opted against employing the sectoral model. The model has disadvantages, including high regulation and supervision costs.

Some authors identify a fourth – *hybrid* (functional) – model that assumes the presence of a single regulatory and supervisory authority to supervise more than one financial market sectors or stand-alone functional authorities (for example, a dedicated financial services consumer protection agency). This type of model, according to the authors, is in place in the United States, France, Italy, Brazil, Spain<sup>3</sup>, however, the foregoing countries’ models of financial market regulation are most often regarded as akin to the ‘twin peaks’ model.

According to data from the IMF, 27 (or 38.5 percent) of the 70 countries that underwent reforms in 1998–2009 undertook some form of financial regulation and supervision.

There are two principal approaches to financial market regulation. One of them focuses on alleviating the systemic risk problem, while the other focuses on business conduct in the financial market<sup>4</sup>.

<sup>1</sup> See Abramov A.E., Radygin A.D., Chernova M.I. Regulation of financial markets: Models, evolution, effectiveness // *Voprosy Ekonomiki*. 2014. No. 2. PP. 33–49.

<sup>2</sup> See Khandruev A. Searching for sound mega-regulation (November 29, 2012). URL: <https://bosfera.ru/bo/v-poiskah-zdravogo-megaregulirovaniya>

<sup>3</sup> See Konstantinov A.V. Foreign countries’ financial regulation in theory and in practice and its application in the Russian context // *Fundamentalnye Issledovaniya*. 2014. No. 9 (Part 2). P. 394; Buklemeshev O.V., Danilov Y.A. Efficient financial regulation and establishment of a megaregulator in Russia // *The Journal of the New Economic Association*. 2013. No. 3 (19). P. 82.

<sup>4</sup> See Konstantinov A.V. Foreign countries’ financial regulation in theory and in practice and its application in the Russian context // *Fundamentalnye Issledovaniya*. 2014. No. 9 (Part 2). PP. 394–398.



We will now examine initial outputs and ways to improve a single megaregulatory model in abroad (the U.K., Germany, Japan, and Singapore) and in Russia.

### 6.2.2. The United Kingdom: A roundtrip from twin peaks to megaregulatory approach

The United Kingdom has one of the world's largest financial markets that serves as a benchmark to many other nations. The British history of market regulation has a relatively short period (of about 15 years) of employing a megaregulatory model which was subsequently replaced by the previously discredited 'twin peaks' model. A study of the U.K. experience enables one to identify disadvantages of the single regulator approach that turned out to be less efficient than far from perfect regulators of the twin peaks model.

The twin peaks model prevailed in the U.K. financial market for more than three centuries until the transition to a megaregulatory approach.

The Bank of England (established in 1694) used to be a center for financial markets regulation, acting in the capacity of self-regulatory banking organization. The Bank was officially empowered by the Banking Act 1979 to perform regulatory and supervisory functions in the banking sector.

A Securities and Investment Board (SIB) was established in 1986 under the Financial Services Act 1986, whereby the SIB is to supervise, under the surveillance of Her Majesty's Treasury (the Treasury), self-regulatory organizations that regulate and control non-bank financial firms. The Bank of England and the SIB taken altogether represented the 'twin peaks' model of financial market regulation.

The effectiveness of the twin peaks model was put in doubt in the 1990s. The financial scandal surrounding the Bank of Credit and Commerce International (BCCI) and the bankruptcy of the Barings Bank highlighted the fact that the British regulatory structure was weak when it comes to supervision of international banks and internal control systems employed by regulated firms. Furthermore, the European Union required its member-states to ensure their central banks are independent.

In the end, in 1997 self-regulatory organizations operating in the financial market were integrated into the SIB renamed as the Financial Services Authority (FSA) vested with the power (which the Bank of England was stripped of) to supervise the banking sector, with the Bank of England remaining the lender of last resort. The independent status of the Bank of England was enacted by the Bank of England Act 1998. The independent single financial regulator status of the FSA was enacted by the Financial Services and the Market Act 2000<sup>1</sup>. For instance, a megaregulatory approach to financial market regulation was adopted instead of that of twin peaks.

The British megaregulatory approach was described as tripartite regime, including the Treasury (vested with the power to exercise overall statutory regulation and

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<sup>1</sup> See hereinafter Bando H. Single Regulator or Twin Peaks, The Different Regulatory Approach by UK, Switzerland and Japan (May 1, 2014). 150 Years Anniversary Yearbook, 2014. PP. 74-87. URL: <https://ssrn.com/abstract=2876022>.

decision-making, disposal of budget funds in a crisis), the Bank of England (responsible for ensuring that the payment system is functional and the financial system is stable<sup>1</sup>), the FSA and a principle-based approach to regulation.

In 1997, the Treasury, the Bank of England and the FSA shared the responsibility for financial stability in the country by signing the Memorandum of Understanding 1997, but failed to identify which of them is to be responsible for monitoring systemic risks in the financial market.

Under the Financial Services and Markets Act 2000, the FSA had an exclusive right to policy-making and focused primarily on principles. The principle-based approach is distinguished by its fast-response and flexible regulation style. The FSA developed Principles for Businesses that are to be enforceable if failed to be observed.

It appeared that the FSA was performing so good that other countries (for example, Germany, Japan) started emulating the British model of financial regulation<sup>2</sup>. On the verge of the global financial crisis 2008, the British megaregulatory approach was often cited “as a model of an efficient and effective regulator, not only because of its streamlined model of regulation, but also because it adheres to a series of “principles of good regulation,” which center on efficiency and economy the role of management, proportionality, innovation, the international character of financial services, and competition. This overlay of pragmatic business principles, in addition to the traditional goals of regulation, has been a distinguishing feature of the U.K. regulatory approach”<sup>3</sup>.

However, the global financial crunch (2007–2009) – caused by, among other things, substandard lending in the United States and proliferated swiftly via securitized financial products, thus leading to the collapse of some well-known British banks, such as the Northern Rock Bank, the Halifax Bank of Scotland (HBOS) and the Royal Bank of Scotland (RBS) – revealed serious faults and multiple failures on the part of the British megaregulator. The delegation of the Bank of England’s banking regulation and control powers to the FSA, which is not supposed to act as the lender of last resort, coupled with the inability of the Treasury, the Bank of England and the FSA to act in concert came into play.

The bankruptcy of the Northern Rock Bank was, first of all, due to excessive mortgage products and lending against a backdrop of inadequate liquidity. The government decided to allocate government funds to bailout the banking sector. The Northern Rock Bank case revealed the drawbacks of the financial stability.

The HBOS ranked one of Britain’s top-4 largest banks until it collapsed in 2009, so the HBOS collapse posed a systemic risk to the national economy. The collapse also

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<sup>1</sup> See Batsura M.S. International practice of establishing and operating the megaregulatory institution as illustrated by the United Kingdom and Germany // *Finansovoye Pravo*. 2015. No. 5. P. 28.

<sup>2</sup> See Wymeersch E. The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors // *European Business Organization Law Review*. 2007. No. 8(2). P. 237–306.

<sup>3</sup> Group of Thirty. The Structure of Financial Supervision. Approaches and Challenges in a Global Marketplace (2008). PP. 28, 29. URL: [http://group30.org/images/uploads/publications/G30\\_StructureFinancialSupervision2008.pdf](http://group30.org/images/uploads/publications/G30_StructureFinancialSupervision2008.pdf)

suggested that the British megaregulatory approach was a weak approach. “The FSA was not so much the dog that did not bark as a dog barking up the wrong tree”<sup>1</sup>.

The requirements of the Basel II framework (2004) – a document of the Basel Committee on Banking Supervision that contains methodological recommendations for banking regulation, with the principal aim to enhance the quality of risk management in the banking sector in order to strengthen the financial system as a whole – weakened controls on capital adequacy by allowing banks calculate their own risk-weightings, distracted supervisors from concerns about lending and asset quality. It was not until late in 2007 that FSA attempted to raise concerns on these problems.

The HBOS brought back the return on equity (ROE) to a high level through aggressive lending at more than 20 percent. In 2002, the HBOS Corporate Division posted an increase in assets, that is, a 26 percent rise in loans for borrowers. However, such a rapid growth in assets was at odds with traditional customer deposits, and the HBOS had to resort to short-term wholesale markets in order to bridge the funding gap. The HBOS failed to heed the FSA’s concerns about funding strategy because it treated FSA’s activities as intrusion into its own territory rather than independent management that could secure the bank against mistaken courses of action. The FSA responded by simply raising bank capital requirements by 0.5 percent in 2003. In 2009, on the heels of the global financial crisis, the HBOS could no longer increase capital in the wholesale market. A decision was made to acquire the HBOS by Lloyds TSB Bank. The 350-year old Bank ceased to exist, and the HBOS Corporate Division’s credits worth GBR 25 billion were impaired<sup>2</sup>.

The acquisition of ABN Amro by the RBS in 2007, which triggered the collapse of the latter, also showcased that the FSA was shortsighted, overlooking “metastases” of the global financial crisis. The FSA opted against interfering with the RBS’ business, which was not aligned with best practices because the business “was not beyond the bounds of reasonableness”, and interference in that case “would raise serious issues of unfairness”<sup>3</sup>. The FSA attempted to excuse itself, citing insufficient information and number of meetings with the RBS, although 551 meetings were held over 3.5 years alone, thus substantiating the fact that the FSA is a bureaucratic body in essence.

The regulator also overlooked a manipulation with the London Interbank Offered Rate (LIBOR) by the Barclays Bank while having a busy time gathering information and doing other bureaucratic activities instead of exploring thoroughly areas that are

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<sup>1</sup> House of Lords, House of Commons. Fourth Report of Session 2012-13. «An accident waiting to happen»: The failure of HBOS (April 4, 2013). P. 28. URL: <https://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcb/144/144.pdf>

<sup>2</sup> See Schmulow A.D. Approaches to Financial System Regulation: An International Comparative Survey (January 27, 2015). CIFR Paper No. 53/2015. P. 19-20. URL: <https://ssrn.com/abstract=2556545>

<sup>3</sup> Financial Services Authority. Financial Services Authority Board Report. The failure of the Royal Bank of Scotland (December, 2011). P. 31. URL: <https://www.fca.org.uk/publication/corporate/fsa-rbs.pdf>

indeed exposed to risks. The FSA showed itself “a regulator asleep at the wheel”, failing to weather the crisis and systemic weaknesses<sup>1</sup>.

The Financial Services Agency described its approach to regulation, sometimes known as “light touch”, in the following manner: (1) markets are overall self-regulatory markets, the market discipline is a more efficient tool to employ than regulation and oversight, (2) the ultimate responsibility for risk management rests with senior managers and a board of private firms, (3) consumers are best protected by ensuring that wholesale markets are free and transparent rather than through regulation of products and overt market interventions.

The above philosophy had ultimately led to the following results: (1) Attention focuses on overseeing particular institutions rather than on the system as a whole; (2) Attention focuses on indentifying correctly systems and processes rather than on complex business models and strategies; (3) Attention focuses on supervising how the FSA screens “approved persons” for previous misconduct<sup>2</sup> rather than on assessing technical skills; (4) Attention focuses on stimulating the doing-business regulation rather than on the balance between the doing-business regulation and prudential regulation. The FSA spent, albeit unintentionally, 70 percent of its time on doing-business regulation<sup>3</sup>.

A proposition was made in 2010 to rescind the tripartite regime with the FSA and to restore the regulatory and supervisory body headed by the Bank of England. “Only independent central banks have the broad macroeconomic understanding, the authority and the knowledge required to make the kind of macro-prudential judgments... And, because central banks are the lenders of last resort, the experience of the crisis has also shown that they need to be familiar with every aspect of the institutions that they may have to support. So they must also be responsible for day-to-day micro-prudential regulation as well”<sup>4</sup>.

The Financial Services Act 2012 was put in force on April 1, 2013, whereby a twin peaks model of financial market regulation that was distinguished from the previously employed version of the model by enhanced role of the Bank of England was established in the U.K.

The above Act introduced amendments to the Bank of England Act 1998 and the Financial Services and Markets Act 2000, whereby three regulatory bodies were established, namely a Financial Policy Committee (FPC), a Prudential Regulatory

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<sup>1</sup> See Schmulow A.D. Spec. work. PP. 22–25.

<sup>2</sup> Persons the FSA has approved to fulfill certain duties or “controlled functions” like, for example, account management.

<sup>3</sup> See Ferran E. The Break-Up of the Financial Services Authority (October 11, 2010). University of Cambridge Faculty of Law Research Paper Series No. 10/04. P. 4. URL: <https://ssrn.com/abstract=1690523>

<sup>4</sup> See HM Treasury. Speech by the Chancellor of the Exchequer, RT Hon George Osborne MP, at Mansion House. (June 16, 2010). URL: <https://www.gov.uk/government/speeches/speech-by-the-chancellor-of-the-exchequer-rt-hon-george-osborne-mp-at-mansion-house>

Authority (PRA) and a Financial Conduct Authority (FCA). The PRA and the FCA represent the two “peaks” sharing the FSA functions in the new regulatory model.

The FPC was established in the Bank of England as a macro-prudential regulator headed by the Governor of the Bank of England, with primary responsibility for supervising the system in order to maintain financial stability. The PRA was established as a subsidiary of the Bank of England, with primary responsibility for micro-prudential regulation, where the Chairperson is the Governor of the Bank of England and the Chief Executive is the Deputy Governor of the Bank of England. The FCA – the renamed FSA – is a regulatory authority outside the Bank of England with primary responsibility for conduct regulation, where the Chairperson and the Chief Executive are designated by the Treasury. The FCA is also responsible for micro-prudential supervision of the system in order to prevent non-systemic risks.

The Chief Executives of the PRA and the FCA are FPC voting members, whereas representatives of the Treasury are FPC non-voting members, however, the Treasury together with the FPC is involved in developing the financial stability strategy. The FPC is entitled to issue financial stability orders to the PRA and the FCA. The duties of the Treasury and the role of the FPC are well defined in order to avoid the problems inherent in the former tripartite regime. By controlling the FPC and the PRA, the Bank of England is responsible for macro-prudential and micro-prudential regulation. The FCA remains sole responsible for conduct regulation and for prudential regulation of areas under control (broker dealers, investment companies, etc).

The FPC, PRA and FCA have responsibilities that overlap each other. The FCA is responsible for institutions falling outside the scope of PRA regulation, being independent from the FPC and the PRA when it comes to decision-making. Furthermore, while assuming the primary responsibility for non-systemic institutions, the FCA is also responsible for institutions operating in the investment sector and for banks and investment banks<sup>1</sup>.

The Financial Services Act 2012 introduced amendments to regulatory goals. The FSA’s regulatory goals were to maintain confidence in the market, public outreach, protect consumers rights and reduce financial crimes. Under the foregoing Act, the FCA has the following goals: to protect consumers’ interests, maintain competition and financial system integrity. The latter includes sustainability, stability and resiliency; non-use for financial crime; avoiding the influence of a conduct that is deemed to be equal to market abuse; proper operation of financial markets; transparency of pricing in the markets.

The new regulatory system is a judgment-based system as opposed to the previous principle-based approach to regulation. Instead of calculating risk-weightings by following a series of established principles, new regulators must ensure that problems

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<sup>1</sup> See Ojo M. From Integrated Financial Services Supervision to the Twin Peaks Model: The Future of Financial Regulation and the Role of the Basel Capital Framework (July 20, 2016). IGI Global Publications, Forthcoming. P. 3. URL: <https://ssrn.com/abstract=2812431>

are addressed in advance as they think fit. This approach, however, is a subjective approach and subject to political and market pressure.

In contrast to the megaregulatory approach, the twin peaks model seeks to protect the system against potential conflicts of interests between the monitoring of financial institutions' solvency soundness and the supervision of rules of conduct and market integrity. While the prudential supervision rests with the central bank, the twin peaks model contributes to stable financial system by ensuring there is a proper coordination between the liquidity management in the banking sector (this function is inherent to a central bank) and the monitoring of credit institutions' solvency soundness (this responsibility rests with prudential oversight)<sup>1</sup>.

Summing up, the 'twin peaks' model of financial market regulation had been in place for a long time in the U.K. until the country adopted a megaregulatory approach. The switch to the megaregulatory approach was primarily due to ill-coordinated activities undertaken by regulators, which ultimately led to a series of high-profile financial scandals. The reversion to the twin peaks model, regardless of its drawbacks, some of which had been left unattended by the new version of the model, suggests that the British megaregulatory experience has been found even more unfortunate.

In the U.K., the regulatory power over financial markets was concentrated in the FSA, not a central bank. During the global financial crisis the Bank of England, stripped of its banking regulation and supervision power, failed to exercise in a proper manner the function of lender of last resort because of ill-organized interaction between the megaregulator and the Bank of England.

The British megaregulatory model was distinguished by excessive regulation/bureaucratism and softness. The regulatory approach was, on the one hand, an objective approach free from external influence, but, on the other hand, failed to consider details and to address problems in a prompt manner. Bureaucratism in its turn distracted supervisors from addressing fundamental challenges. Financial markets were to a great extent left to their own devices, the responsibility for risk management was shifted to market participants. The FSA supervised particular institutions rather than the system as a whole, regulated doing-business, while paid less attention to the prudential regulation.

The megaregulatory approach in the U.K., which gave plenty of rope to financial market participants, could have lasted for longer, had it not been for the 2008 crisis. It appears that the establishment of megaregulator on the basis of the Bank of England would have given the opportunity to not only weather the crisis but facilitate the financial market regulation which is immune from the majority of the above listed drawbacks. In fact, the country opted to follow the same path in adopting the twin peaks model and provided an opportunity for the Bank of England to control both regulators. Note that each model of financial market regulation has several versions, and the drawbacks of the British megaregulatory approach are not necessarily inherent to single regulators of other countries.

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<sup>1</sup> See Ojo M. Spec. work. P. 2.

### 6.2.3. Germany: An independent and formally single regulator

Germany has one of the world's leading financial markets. Germany is one of a handful countries with big financial markets, employing a single financial regulator model; Germany has indeed been successful in doing this since 2002. However, the German megaregulatory approach is distinguished from the generally accepted understanding of the model.

Germany switched in 2002 from a model of financial market regulation, involving more than one regulator, to a megaregulatory approach by establishing, under the German Financial Services and Integration Act (German: *Gesetz über die integrierte Finanzdienstleistungsaufsicht*), a Federal Financial Supervisory Authority (German: *Bundesanstalt für Finanzdienstleistungsaufsicht* or *BaFin*).

The BaFin is primarily responsible for ensuring a stable national financial system. To accomplish this task, the megaregulator issues licenses; supervises the banking and insurance sectors, the security market and asset management; takes remedial actions against credit institutions. In the intersectoral area, the BaFin is responsible for keeping track of financial market development trends, including some of its segments; protecting depositor, investor and consumer rights in the financial service market, etc<sup>1</sup>.

The Federal Financial Supervisory Authority was established through integration of former regulators of the Federal Banking Supervisory Office (German: *Bundesaufsichtsamt für das Kreditwesen* or *BaKred*), the Federal Insurance Supervisory Office (German: *Bundesaufsichtsamt für das Versicherungswesen* or *BaV*) and the Federal Securities Supervisory Office (German: *Bundesaufsichtsamt für den Wertpapierhandel* or *BaWe*).

The BaWe used to operate with each of the 16 German states (lands), the Deutsche Bundesbank and the BaKred. The BaKred and the BaWe shared responsibility with regard to institutions involved in banking and securities-related services. The BaKred was responsible for supervising of institutions' economic well-being, while the BaWe was responsible for monitoring operations with securities. The BaKred and the BaWe used to issue joint statements and directives. The cooperation at the state level with stock exchange regulatory authorities was maintained via the Working Committee of the States on Securities and Exchange-Related Issues (German: *Länderarbeitskreis Börsenwesen*)<sup>2</sup>.

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<sup>1</sup> See Popkova L.A. Protecting rights of financial market participants as a new function of the Bank of Russia // *Bankovskoje Pravo*. 2014. No. 2. P. 67; Rozhdestvenskaya T.E. Establishing megaregulators in Russia: Goals, objectives, problems and development prospects // *Bankovskoje Pravo*. 2013. No. 5. PP. 10, 11.

<sup>2</sup> See hereinafter Brown E.F. Consolidated Financial Regulation: Six National Case Studies and the Experience of the European Union (April 20, 2015). PP. 58-63. URL: <https://www.volckeralliance.org/sites/default/files/attachments/Background%20Paper%20Consolidated%20Financial%20Regulation%20-%20Six%20National%20Case%20Studies%20and%20the%20Experience%20of%20the%20European%20Union.pdf>

The BaFin megaregulator was established primarily due to changes in financial markets, where market participants started offering complex (compound) products to their customers. Some supervisory authorities failed to meet new market conditions.

Another reason for the establishment of the BaFin was criticism by many nations that considered the existing German capital market supervisory framework as inefficient; and foreign investment companies and private investors were therefore reluctant to invest in Germany's projects<sup>1</sup>.

The establishment of the BaFin was meant to strengthen Germany's position in the international community and in the European market as well as ensure a more efficient interaction and a stable financial system across Europe. At the micro- and macro-levels, the BaFin has been more successful than its predecessors in reacting to and preventing economic crises. The BaFin seeks to enhance financial markets transparency in order to increase their reliability.

The BaFin is managed by its Executive Board, consisting of the President and five Chief Executive Directors. Each director is responsible for supervising one of the five existing directorates. The above type of structure is designed to prevent concentration of power in the BaFin.

The BaFin's power is governed by laws and regulations that previously governed the BaKred, the BaV and the BaWe.

The Securities Supervision Directorate is governed by the German Securities Trading Act (WpHG), the German Securities Acquisition and Takeover Act (WpÜG). The BaFin does not have full regulatory power because the German states continue to control particular stock exchanges.

The Insurance Directorate is governed by the German Act on the Supervision of Insurance Undertakings. The BaFin supervises public insurance undertakings with substantial economic impact that are involved in cross-border business between the German states. The German states are responsible for supervising public insurance undertakings with a smaller economic impact that operate within the states' boundaries. On top of private insurance the BaFin supervises Germany's pension system. The BaFin is entitled to approve all business requirements for insurers.

The Banking Supervision Directorate is governed by the German banking law. The Deutsche Bundesbank has always been playing an important part in controlling banks, and continues to do it in cooperation with the BaFin.

Additionally, there are eight authorities that support the BaFin in the performance of its functions, namely the Administrative Council, the Advisory Board, the Consumer Advisory Council, the Financial Stability Committee, the Insurance Advisory Council, the Securities Council, the Advisory Council and the Objections Committee. The Administrative Council comprises 17 voting members. The Council monitors the management of the BaFin and supports the BaFin in the performance of its supervisory functions. In addition, the Council is responsible for decision making on the BaFin

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<sup>1</sup> Batsura M.S.. Foreign experience in establishing and managing a megaregulator institution: The U.K. and Germany case-studies // *Finansovoye Pravo*. 2015. No. 5. P. 29.



budget. Members of the Administrative Council ought to meet certain minimum standards.

The Federal Financial Supervisory Authority is funded through fees and contributions from regulated firms and does not depend on the federal budget. The Authority can charge fees for its official acts. The BaFin is also paid for banking-related actions, for example, audit, as set forth in the German banking act. If fees and contributions are insufficient to cover costs, the BaFin may share costs on a pro rata basis between financial institutions, asset managers, investment joint-stock corporations, payment institutions, insurance undertakings, credit institutions and between specific additional types of companies.

Germany's single financial regulator is not an all-round regulator because the Deutsche Bundesbank still has some of the banking supervisory powers. The Deutsche Bundesbank, in close cooperation with the BaFin, plays an important part in supervising banks' day-to-day operations. In 2013, the BaFin and the Deutsche Bundesbank developed a Supervision Guideline<sup>1</sup> as an attachment to the German Banking Act in order to delimit their duties, avoid duplication of functions, and enhance transparency. The monitoring function was handed over to the Deutsche Bundesbank, including fact finding, analysis of obtained and collected information, current and potential risk-weighting based on the information and audit findings evaluation. Despite the fact that the Deutsche Bundesbank is vested with the power to evaluate regulated entities, the ultimate decision on all regulatory and interpretation issues rests with the BaFin. When adopting decisions, the BaFin shall heed advice of the Deutsche Bundesbank<sup>2</sup>.

With the introduction of the euro currency, the Deutsche Bundesbank was stripped of the monetary-policy control power and is now responsible for maintaining a stable eurozone. The Deutsche Bundesbank acts as banking supervisor and oversees the implementation of European Central Bank's directives in order to avoid a financial crisis.

A point to note is that following the 2008 global financial crisis, Germany considered ways of reforming the German financial market regulatory framework, including delegating the BaFin's power to the Deutsche Bundesbank, which should have made the latter a full-fledged single regulator. The German government, however, renounced the idea because the BaFin had been overall successful in weathering the crisis and its aftermaths.

The Federal Financial Supervisory Authority is an independent authority accountable to the German Finance Ministry which is politically responsible for activities undertaken by the BaFin and involved in public oversight to make sure that BaFin's administrative actions are valid and reasonable. The Federal Ministry of Finance (Germany) is entitled to adopt laws and regulations and directives binding on the BaFin, take disciplinary

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<sup>1</sup> URL: [https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Richtlinie/rl\\_130521\\_aufsichtsrichtlinie\\_en.html](https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Richtlinie/rl_130521_aufsichtsrichtlinie_en.html)

<sup>2</sup> See Schmulow A.D. Approaches to Financial System Regulation: An International Comparative Survey (January 27, 2015). CIFR Paper No. 53/2015. P. 15-17. URL: <https://ssrn.com/abstract=2556545>

actions against megaregulator's personnel, request the megaregulator to submit information and explanations<sup>1</sup>.

In addition, during the 2008 financial crisis, a German Federal Financial Markets Stabilization Agency (German: *Bundesanstalt für Finanzmarktstabilisierung* or *FMSA*) was established within the financial regulatory framework, with the aim to rescue German banks faced with financial difficulty. The FMSA manages the Financial Market Stabilization Fund (German: *Finanzmarktstabilisierungsfonds* or *SoFFIn*) and, since 2011, the Restructuring Fund (German: *Restrukturierungsfonds*).

Germany also has other entities that are involved in financial regulation, including, for example, six various organizations that offer deposit insurance through the private Association of German Banks (German: *Bundesverband deutscher Banken* or *BdB*). Various types of social insurance, including health insurance, are regulated by the German Federal Insurance Office (German: *Bundesversicherungsamt*).

The German states have financial regulatory authorities supervise stock exchange and particular types of insurance services. At present, 9 of the 16 German states have local stock exchanges. Each of the 9 German states has a local trade supervisory authority. The German states are also responsible for supervising public insurance undertakings with a smaller economic impact than that of companies regulated by the BaFin.

Thus, an independent authority acts in the capacity of single megaregulator although German's financial system relies on banks. The Deutsche Bundesbank is involved in financial market regulation.

German's megaregulatory approach is, for the most part, a formal approach.

First, the main reason why Germany adopted a megaregulatory model was that the institutional regulatory model failed to fit into a new context of integrated financial markets. However, the existing German model of financial market regulation remains essentially a sectoral model because directorates affiliated with the BaFin megaregulator continue to be highly independent.

Second, the BaFin is not an all-round single regulator of financial markets because the system has other, smaller regulators (Deutsche Bundesbank, FMSA, etc). That is why the German version of megaregulatory approach is also known as a hybrid single regulator model<sup>2</sup>.

The fact that the BaFin directorates are located in various cities – in Bonn and in Frankfurt – does not contribute to consolidation of regulation.

A certain discrepancy between the form and the substance has, nonetheless, no effect on the regulatory efficiency. With the establishment of the BaFin, Germany

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<sup>1</sup> See Uzdenov S.S. Revisiting the establishment of financial megaregulator in Russia // *Yurist*. 2013. No. 20. P. 3.

<sup>2</sup> See Brown E.F. Consolidated Financial Regulation: Six National Case Studies and the Experience of the European Union (April 20, 2015). PP. 58-63. URL: [https://www.volckeralliance.org/sites/default/files/attachments/Background%20Paper%202\\_Consolidated%20Financial%20Regulation%20-%20Six%20National%20Case%20Studies%20and%20the%20Experience%20of%20the%20European%20Union.pdf](https://www.volckeralliance.org/sites/default/files/attachments/Background%20Paper%202_Consolidated%20Financial%20Regulation%20-%20Six%20National%20Case%20Studies%20and%20the%20Experience%20of%20the%20European%20Union.pdf)

strengthened its positions in the international community. The existence of several regulators and BaFin's accountability to the Finance Ministry contributed to avoiding concentration of power in the BaFin, and a well-organized coordination between them contributed to a robust functioning of the national financial system and minimization of systemic risks.

#### 6.2.4. Japan: a “dedicated” dependent single regulator

Japan's model of financial market regulation has been in place since 2000. The model was introduced through efforts of searching for an alternative to inefficient financial regulation on the part of Japan's Finance Ministry. However, despite good performance figures, the architecture of the existing single megaregulator remains imperfect, prone to concentration of power and political pressure.

Japan moved to a megaregulatory approach to its financial market as a result of financial reform, also known as “Japan's Big Bang”, in the late 1990s. The reform was undertaken due to complaints against the Finance Ministry's financial markets regulation until 1998 (the emphasis was placed on, above all, corruption and incompetence). The Finance Ministry's failure to ensure efficient monitoring of financial institutions had triggered bankruptcy of some of the largest financial institutions (“jusen”<sup>1</sup>, two credit cooperatives, Hyogo Bank, Kizu and Cosmo credit unions)<sup>2</sup>.

The reform was intended to liberalize Japan's financial market and to strengthen financial stability. In view of this the Bank of Japan Act 1998 was adopted, whereby Japan's central bank was made independent from the Finance Ministry. Under the Act, the Bank of Japan was made responsible for monetary policy and was tasked to establish a Financial Supervisory Agency, the predecessor of the today's single megaregulator in Japan's financial market – The Financial Services Agency (Financial Services Agency or FSA).

Under the Financial Services Agency Act 1997, Japan's Finance Ministry was stripped of the Banking Bureau and Insurance Bureau in 1998 in order to establish a Financial Supervisory Agency. The Securities Exchange Surveillance Commission (SESC) affiliated with the Finance Ministry was also made part of the Financial Supervisory Agency. Control over the Financial System Planning Bureau was handed

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<sup>1</sup> Non-bank financial institutions in Japan that were established in the 1970s as subsidiaries of banks that made mortgage loans. Excessive lending by jusen in the 1980s contributed to a “bubble” in Japan's real estate market. Several jusen received bailouts in the 1990s but they nevertheless ceased operations by 1996.

<sup>2</sup> See hereinafter: Brown E.F. Consolidated Financial Regulation: Six National Case Studies and the Experience of the European Union (April 20, 2015). PP. 64-69. URL: [https://www.volckeralliance.org/sites/default/files/attachments/Background%20Paper%202\\_Consolidated%20Financial%20Regulation%20-%20Six%20National%20Case%20Studies%20and%20the%20Experience%20of%20the%20European%20Union.pdf](https://www.volckeralliance.org/sites/default/files/attachments/Background%20Paper%202_Consolidated%20Financial%20Regulation%20-%20Six%20National%20Case%20Studies%20and%20the%20Experience%20of%20the%20European%20Union.pdf)

over in 2000 from the Finance Ministry to the Financial Supervisory Agency with the aim to establish the FSA.

The Financial Supervisory Agency received not only the Finance Ministry's financial supervisory power, but also the power vested in other public authorities, including supervision of farmer cooperatives in conjunction with Japan's Ministry of Agriculture, Forestry and Fishery and workers' cooperatives jointly with Japan's Ministry of Labor. Thus, the Financial Reconstruction Commission had more financial firms under control than the Finance Ministry used to have.

In addition, a Financial Reconstruction Commission (FRC) was established in Japan, that was made responsible for funding of financial institutions faced with financial difficulty, and developing mechanisms designed to solve problems facing institutions in bankruptcy. In 1998–2000, the Financial Reconstruction Commission was under the jurisdiction of FRC affiliated with the Prime Minister's Administration, however, the FRC merged with the FSA in 2001<sup>1</sup>.

In 2000, control over the Financial System Planning Bureau was handed over from the Finance Ministry to the Financial Supervisory Agency which was renamed as the FSA.

The Financial Services Agency plays a pivotal role in maintaining financial stability of the nation and anti-crisis management, protecting consumers and establishing fair and transparent financial markets. When the FSA was vested with the planning function, it became a more modest regulator than its predecessor was. The FSA started initiating less shutdowns of financial institutions, because the Financial System Planning Bureau would have otherwise been proven inefficient.

The Financial Services Agency, headed by the Minister of State for Financial Services, is affiliated with Japan's Cabinet of Ministers Administration. The FSA comprises a Planning and Coordination Bureau, an Inspection Bureau and a Supervisory Bureau. The Planning and Coordination Bureau is headed by the Vice Commissioner for Policy Coordination, the Deputy Director-General and the Deputy Commissioner of the Planning and Coordination Bureau.

The FSA also comprises the SESC and the Certified Public Accountants and Auditing Oversight Board (CPAAOB). The SESC includes the chairperson and two commissars designated by the Prime Minister, and the CPAAOB is comprised of the chairperson and nine commissars designated by the Prime Minister<sup>2</sup>.

The FSA's annual budget is subject to approval by the Minister of State for Financial Services and the Finance Ministry as well as the Parliament, thus making the regulator politically dependent.

The FSA is responsible for monitoring of banks, insurance undertakings, securities firms and other financial institutions.

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<sup>1</sup> See Financial Services Agency. Pamphlet (March, 2017). P. 2. URL: <http://www.fsa.go.jp/en/about/pamphlet.pdf>

<sup>2</sup> See *ibid.* PP. 8, 13, 14.

The Planning and Coordination Bureau is responsible for coordinating activities undertaken by the FSA, developing a financial services policy and rules, consulting of Japan's government on laws and regulations governing financial services.

The Inspection Bureau is responsible for on-site inspections of financial institutions with a view to monitoring their compliance with the rules in place and assessing risk management.

The Supervisory Bureau is responsible for monitoring financial institutions in order to ensure security and sustainability. The Bureau includes branches of large banks, regional banks, insurance undertakings and securities firms.

The SESC is responsible primarily for capital markets integrity and investor protection. The SESC monitors securities market participants and investigates into alleged misconduct cases, such as insider trading. However, the SESC may not take direct enforcement actions and therefore should recommend the Minister of State for Financial Services and the FSA Commissar to take disciplinary actions or lodge a complaint to the prosecutor.

The Certified Public Accountants and Auditing Oversight Board (CPAAOB) operates independently from the FSA. The CPAAOB is responsible for auditing reports issued by the Institute of Certified Public Accountants (ICPA). It is also entitled to carry out on-site inspections at the ICPA and audit firms. Like the SESC, the CPAAOB may not take direct enforcement actions<sup>1</sup>.

Japan's principal entities of financial regulation are, besides the FSA, the Finance Ministry, the Bank of Japan and the Deposit Insurance Corporation of Japan (DICJ).

The Finance Ministry, after its financial services supervisory power was handed over to the FSA, is responsible for managing the central government's budget and maintaining a stable foreign exchange market. The Finance Ministry would contribute to financial stability in times of crisis.

The Bank of Japan is responsible for monetary policy and financial stability through financial system sustainability analysis and assessment; coordination of micro-prudential activities related to on-site inspections and external monitoring; administration of polices to maintain a stable financial system (including the lender of last resort); management and monitoring of payment and settlements systems.

The Deposit Insurance Corporation of Japan is a quasi-autonomous public organization that was established in 1971. The Corporation is responsible for deposit insurance payments if a bank goes bust. Its subsidiary, the Resolution and Collection Corporation, is responsible for asset management and disposal of assets purchased from bankrupt financial institutions.

In 2012, the IMF recommended Japan to establish a financial stability committee with the aim to coordinate its entities' efforts to weight and eliminate systemic risks<sup>2</sup>.

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<sup>1</sup> See Financial Services Agency. Pamphlet (March, 2017). 3, 6, 9–14. URL: <http://www.fsa.go.jp/en/about/pamphlet.pdf>

<sup>2</sup> See International Monetary Fund. Japan: Financial Sector Stability Assessment Update (August, 2012). IMF Country Report No. 12/210. P.19. URL: <http://www.imf.org/external/pubs/ft/scr/2012/cr12210.pdf>

In the end, the following conclusions can be reached. The FSA is by far not the first megaregulator in Japan's financial market. The Finance Ministry used to employ a unified regulation approach for more than 100 years until it was replaced by the megaregulatory approach.

The modern version of Japan's megaregulatory approach derives from separation rather than integration, as in most cases, of regulatory and supervisory power in financial markets.

The financial market regulation framework in Japan is not an ideal one. Many regulatory and supervisory functions are concentrated in a handful of regulatory authorities, which, given certain conditions, may result in concentration of power and excessive regulation, as evidenced by the Finance Ministry's past experience as financial market regulator.

In addition, the FSA in Japan is not a common practice in world's major economies involving an independent financial markets regulator. Besides the fact that the FSA is affiliated with the Cabinet of Ministers Administration, it is funded from the central government's budget. The central government is normally a major debtor in the national financial market and has a conflict of interests with regulated firms – that's why the independent status of the financial regulator is so important<sup>1</sup>.

Overall, the FSA has demonstrated positive outputs. The establishment of the FSA has not contributed to a weaker regulatory competition due to a lack of big number of regulators prior to the establishment. The FSA, as a single regulator, is running a moderate enough policy and has a high level of competence to be able to analyze all aspects of financial conglomerate on a consolidated and functional basis.

#### 6.2.5. Singapore: central bank is a megaregulator

Megaregulation is not the most wide-spread model of financial market regulation because it is believed to be not quite effective. The use of the central bank as a single regulator is not often found in countries with small financial markets, either. However, there is one exception, Singapore, the country with not only a large financial market, but the world's leading one whose central bank – the Monetary Authority of Singapore (MAS) – is the megaregulator of the financial market.

At present, Singapore is a leading financial center though as early as 1965 after its independence from Malaysia it was attributed to the Third World countries. Apart from its geographic situation, which permitted Singapore to fill a time span when other financial markets are closed within a day, the main and unique drivers behind Singapore's financial growth were the following: (1) the government's political will,

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<sup>1</sup> See Bando H. Single Regulator or Twin Peaks, The Different Regulatory Approach by UK, Switzerland and Japan (May 1, 2014). 150 Years Anniversary Yearbook, 2014. P. 82–83. URL: <https://ssrn.com/abstract=2876022>

(2) efficient utilization by the government of the industrial policy and  
(3) uncompromised supremacy of the law<sup>1</sup>.

Established in 1971, the MAS is the central bank, regulator of the market behavior and prudential regulator. The MAS is an integrated supervising authority for the country's all financial institutions: banks, insurers, capital market intermediaries, financial advisors and the stock exchange. The MAS engages in training of small investors<sup>2</sup>.

The MAS carries out financial supervision by means of four groups<sup>3</sup>:

- the banking and insurance group dealing with system risks and capital requirements is made up of three banking departments, the insurance department and the department for prevention of money laundering;
- the capital market group which exercises control over the market behavior and investors<sup>4</sup> includes three capital market intermediaries departments, the corporate finance and consumers department, the market policy and infrastructure department and the enforcement department;
- the policy, risk and surveillance group consists of the prudential policy department, the technological risks and payments department and the macroprudential supervision department;
- the data analytics group includes three departments.

Also, the MAS's lines of activities include the monetary policy and investments, international issues and corporate development; each line of activities is dealt with by individual groups consisting of several departments.

The Singaporean approach to the financial market regulation is quite the opposite to the policy of noninterference by the state. In Singapore, the state retains a tight control over domestic finances and does its utmost to attract foreign companies to the country (quick issuing of licenses and working visas, granting of tax privileges and other).

When necessary, Singapore's financial regulator can be flexible. To develop its own asset management business, Singapore attracted assets from Hong Kong, having taken advantage of the transfer of the latter to China in 1997. To retain those assets, Singapore approved trust accounts which were of no interest to the residents of Singapore because of the local system of tax privileges.

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<sup>1</sup> See: Wang J.Y. The Rise of Singapore As International Financial Centre: Political Will, Industrial Policy, and Rule of Law (Feb 18, 2016). in Jiaxiang Hu, Matthias Vanhullebusch & Andrew Harding (eds.), *Finance, Rule of Law and Development in Asia: Perspectives from Singapore, Hong Kong and Mainland China* (Leiden/Boston: Brill Academic Publishers, 2016). P 3-6. URL: <https://ssrn.com/abstract=2970363>

<sup>2</sup> See: Schmulow A.D. Approaches to Financial System Regulation: An International Comparative Survey (January 27, 2015). CIFR Paper No. 53/2015. pp. 12, 13. URL: <https://ssrn.com/abstract=2556545>

<sup>3</sup> See: MAS. Organisation Structure (September 29, 2017). URL: <http://www.mas.gov.sg/About-MAS/Overview/Organisation-Chart.aspx>

<sup>4</sup> See: Tjio H. Challenges to Singapore from the Global Financial Crisis: Actual and Suggested Legal and Regulatory Responses // *Singapore Journal of Legal Studies*. July 2013. p. 171.

Another example of flexibility is a gradual reduction by the government of the extent of protection of local companies in the 1990s within the frameworks of preparation to the upcoming globalization. Despite a strong discontent of local banks, the MAS initiated a five-year program to liberalize commercial banking in Singapore by permitting qualified foreign banks to open more branches and automated teller machines (ATMs). More licenses to carry out limited banking operations were issued. Also, the authorities lifted limits on foreign ownership in local banks<sup>1</sup>.

It is generally believed that the state interference does not promote competitiveness on the financial market, but as seen from Singapore's experience the state can play an important instrumental role in development of the financial market. Though Singapore has already become an international financial center, the government keeps rendering support. For example, in 2015 the MAS declared the establishment of the Financial Centre Advisory Panel (FCAP) made up of 26 leaders in banking, insurance and asset management. The FCAP discussed the strategy of further development of Singapore's financial center, including attraction of a large number of institutional investors to the capital market, promotion of innovations in the insurance industry, smoother capital growth of start-ups and global companies, development of e-commerce in foreign currencies, upgrading of liquidity on the Asian bond market and other<sup>2</sup>.

Singapore is famous for supremacy of the law and its strong commitment to formal procedures and requirements. As regards regulation of the financial and other markets, the government of Singapore has established a solid and comprehensive regulatory system under the auspices of the MAS and the Ministry of Finance; the system is characterized by a number of laws, including the Law on Banking, the Law on Companies, the Law on Financial Companies, the Law on Insurance, the Law on Securities and Futures Trading, the Law on Lending for Land Development Purposes and other. The MAS maintains a strict system of prudential regulation and surveillance which is sometimes regarded as overregulated, but it succeeded in safeguarding Singapore from financial crises. It is noteworthy that the MAS's check-ups and criticism play an important role. Noncompliance with the rules may result in huge penalties and even an imprisonment<sup>3</sup>.

Singapore has gone beyond the limits of the compliance and dominating risk management systems developed for minimizing risks to institutions. Instead, Singapore put the goal of "market integrity" on the same level with the risk management objective, that is, protection of the public interest. Companies are evaluated by their proven capacity to protect the public interest. In regulation procedures, such a decision coupled

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<sup>1</sup> See: Wang J.Y. Op. cit. pp. 10, 12–14, 16.

<sup>2</sup> See: MAS. Capital Markets (26.11.2016). URL: <http://www.mas.gov.sg/Singapore-Financial-Centre/Overview/Capital-Markets.aspx>

<sup>3</sup> In 2011, the Bank for Development of Singapore experienced a problem with operation of its ATMs for seven hours, of which only 1.5 hours were actually normal business hours. However, the MAS punished the bank by requesting it to allocate SGD 230 million worth of an additional capital buffer against the operational risk. The bank was required to maintain additional capital (which did not earn the bank any income) until next October. See: Schmulow A.D. Op. cit. pp. 13, 14.



with the requirement to report any suspicions (not the concrete evidence of unlawful activities) and enforcement tools in place create the effect of permanent surveillance over all the aspects of the financial market<sup>1</sup>.

So, the establishment of a certain pattern of regulation of the financial market does not necessarily guarantee the effectiveness of regulation. As seen from the experience of Singapore, if handled proficiently, even not quite a popular model of regulation may produce good results.

The success of the MAS – Singapore’s single financial market regulator – can be primarily explained by the political will and uncompromised supremacy of the law. Despite tight control and the MAS’s active interference, which practices are often regarded as hazardous to the financial market, flexibility and far-sightedness of this mega regulator are praised highly and make it effective.

#### 6.2.6. Bank of Russia as megaregulator

##### ***The Russian Financial Market: Main Stages of Regulation***

Established in the early 1990s, the present-day Russian financial market is almost 30 years old. In the history of its development, it is possible to single out several stages<sup>2</sup>.

###### *Stage I: 1990–1998*

The 1990s were the period of the radical transformation of the economy as a whole, denationalization and switchover to the market economy. After the period of complete nonexistence of the financial sector in market terms, the foreign exchange market, the stock market and the capital market were established with an initial regulatory base formed. However, inadequate starting conditions for such large-scale reforms and the economic crisis of 1998 hindered development of the financial market and affected the quality of its further formation<sup>3</sup>.

###### *Stage II: 1999–2008*

In 1999–2002, the economy gradually recovered and a drop in output volumes gave way to growth on the back of appreciation of prices of primary products. The latter factor, along with a number of institutional factors, contributed to the establishment of a market model<sup>4</sup> with a broad expansion of the state as the owner and slowdown of the

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<sup>1</sup> See: O’Brien J. Singapore Sling: How Coercion May Cure the Hangover in Financial Benchmark Governance (November 5, 2013). Edmond J. Safra Working Papers, No. 29. P. 23. URL: <https://ssrn.com/abstract=2350445>.

<sup>2</sup> See hereinafter: N. Polezhayeva. Financial Market Regulation in 2013–2016: New Entities and Requirements / N. Polezhayeva // The Russian Economy in 2016. Trends and Prospects. (Issue 38) / [V. Mau and others.; edited by S.G. Sinelnikov-Murylev (Chief Editor), A.D. Radygina]; Yegor Gaidar Institute for Economic Policy – Moscow: Gaidar Institute’s Publishing House, 2017. pp. 416–418.

<sup>3</sup> See: K.V. Krinichansky. The State of Things and Issues of Development of the Financial Market in Russia // The Economic Theory Journal. 2013. No. 3. pp. 68–81.

<sup>4</sup> For more details, see: A. Abramov, A. Radygin. Russia’s Financial Market Amid State Capitalism // Voprosy Ekonomiki. 2007. No. 6. pp. 28–44.

rates of implementation of market and institutional reforms in the country. Due to the visible nationalization of the economy, the financial market did not develop fast enough. The comparison of the parameters of the Russian financial market with those of leading countries' shows clearly that the Russian financial market is currently rather small.

A lack of proper attention to the need of development of market institutions resulted in emergence of multiple negative consequences, including the legal vacuum, a delay in introduction by stock markets of the best trading technologies and centralized clearing, lack of the central securities depository, serious limitations on growth of the institute of pooled investments and other. As a result, the Russian financial market happened to be sensitive to external factors which situation was explicitly evident during the global financial crisis of 2008<sup>1</sup>.

*Stage III: 2009–2012*

In the period under review, there was no qualitative upgrading of the competitive edge of the Russian financial market. Growth-related problems were partially caused by global phenomena, such as the reorientation after 2008 of foreign investment flows from emerging markets to developed countries, slowdown of economic growth rates in developing countries, high volatility and reduction of financial market liquidity. However, the Russian financial market's problems are largely related to domestic factors, such as geopolitical risks, structural economic imbalances, unfavorable investment climate, the state's growing influence in the economy, the low level of the competition on the domestic market, recurrent modification of rules of pension assets formation, lack of a concrete strategy of the financial market development, paternalism and the low level of households' financial literacy<sup>2</sup>.

However, after the financial crisis made the issues of system risks and inadequacy of the system of regulation and supervision of financial markets more acute the reforms focused on the regulation of this sector. A plan of actions was developed to establish an international financial center in Russia. A priority line of this plan was to toughen control over system risks on financial markets through establishment of the megaregulator.

Establishment of the single regulator was justified by weak competitiveness of the Russian financial market whose development was adversely affected by insufficient networking between the regulatory authorities (Federal Financial Markets Service (FFMS), the Ministry of Finance, the Rosfinmonitoring and others), which controlled individual, often overlapping, market segments and could not receive in a timely fashion the complete and reliable information, nor assess properly the situation on the market.

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<sup>1</sup> See: The Financial Crisis in Russia and the World / Edited by Yegor Gaidar. Moscow: Prospekt, 2009; L.L. Igonina. The Global Financial Crisis and its Effect on the Russian Financial Market // The Economic Bulletin of the Rostov State University. 2008. Vol. 6. No 4. pp. 62–69.

<sup>2</sup> See: A.E. Abramov. The Russian Financial Market: Factors of Development and Growth Barriers / A. Abramov. Science Editor Professor A.D. Radygin, D.Sc. Economics. Moscow: The Gaidar Institute Publishers, 2017. p. 7.

It is to be noted that some market segments, for example, the foreign exchange market remained beyond regulation for a long time.

The development of the financial market which was proceeding at an advanced rate compared to the legal and regulatory environment required harmonization of the financial legislation and elimination of discrepancies and gaps.

The advantages of the new system of regulation and supervision on financial markets should be the following: establishment of the single legal system, quality monitoring of financial markets, real-time identification of possible system risks and handling of a large range of issues, networking in implementation of the financial policy for development and facilitation of expansion of financial services and upgrading thereof.

Despite the advantages, megaregulation involves some risks: a small number of the results of the reform because of its large scale; escalation of the conflict of interests and consolidation of functions within the regulator which role is mainly claimed by the Central Bank of the Russian Federation; the risk of the regulator becoming an excessively authoritarian authority (including the loss of independence by self-regulating entities) and unification of regulation of different types of financial institutions based on approaches formed in respect of banks; infringement of interests of non-banking financial institutions<sup>1</sup>. The abovementioned factors were behind the emergence of numerous opponents of the reform in the expert and professional communities.

However, the existence of risks does not mean that they will definitely materialize. As seen from the foreign experience, there are examples both of successful megaregulators (Germany, Japan and Singapore) and inefficient ones (the UK). But it was infeasible to assess unambiguously the viability of such system of regulation on the Russian financial market before it started functioning.

#### *Stage IV: 2013 – present day*

From September 1, 2013 the Central Bank of the Russian Federation is entrusted with regulatory and supervising functions over the activities of the entire range of non-credit financial institutions from brokers-dealers to pawnbrokers<sup>2</sup>. The Central Bank of the

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<sup>1</sup> See: T.E. Rozhdestvenskaya. Establishment of the Megaregulator in Russia: Purposes, Objectives, Issues and Prospects of Development // *The Bankovskoe Pravo*. 2013. No.5. pp. 10–17; Yu.N. Snezhko. The Formation of the Megaregulator and the Consequences for the Establishment of the International Financial Center in Russia // *The Statistika i Ekonomika*. 2014. No.5. pp. 90–94; A.S. Veselova, S.N. Volodin. The Central Bank of the Russian Federation as an Integrated Financial Regulator // *The Stock Market: The Modern Condition, Instruments and Trends of Development. The 12<sup>th</sup> XII Interacademic Symposium*. Moscow, April 14, 2015. The National Research University the Higher School of Economics, the Moscow State Institute for International Relations (University), the Plekhanov Russian University of Economics, the Financial University under the Government of the Russian Federation / Science editors N.I. Berzon and S.N. Volodin. Moscow: KURS, 2015. pp. 191–201.

<sup>2</sup> See: Federal Law No.251-FZ of July 23, 2013 “On Amendment of Individual Statutory Acts of the Russian Federation Subsequent to the Transfer to the Central Bank of the Russian Federation of Regulatory and Supervision Authorities over Financial Markets” // *The Rossiiskaya Gazeta*. July 31, 2013. No. 166; Article 76.1 of Federal Law No.86-FZ of July 10, 2002 “On the Central Bank of the Russian Federation (Bank of Russia)” // *The Rossiiskaya Gazeta*. July 13, 2002. No.127.

Russian Federation has become the megaregulator of financial markets, which signifies the start of the large-scale institutional reform of the country's financial sector.

According to the Constitution of the Russian Federation, the Central Bank of the Russian Federation is an independent sole regulator because it carries out its functions and duties independently from other state authorities<sup>1</sup>. However, some researchers believe that with the FFMS's authorities transferred to the Central Bank of the Russian Federation, the latter comes under the influence of the executive authorities because it has to get approval of its position from the Government of the Russian Federation<sup>2</sup>.

Other experts believe that "it is impossible to combine conflicting functions and set quite the opposite objectives to one and the same body with a single management. The Central Bank of the Russian Federation should see to it that banks do not go bankrupt and risks are monitored"<sup>3</sup>, on one side, and stimulate the economy via issue mechanisms, on the other side. The case for it is the fact that only countries with too small markets (Singapore is an exception) and domination of foreign investments select the central bank as a sole regulator.

The issue of the status of the Central Bank is debatable; the law does not include any norms that the Central Bank of the Russian Federation is a state authority. However, according to Article 7 of the Law "On the Central Bank of the Russian Federation" as regards the issues attributed to the competence of the Central Bank of the Russian Federation, the latter issues statutory acts in form of orders, resolutions and instructions which are binding upon federal authorities, authorities of the subjects of the Russian Federation, local governments, legal entities and individuals. Actually, the Central Bank of the Russian Federation is entrusted with state powers. In addition, as per the Constitutional Court's findings outlined in the Definition of December 14, 2000 the Central Bank of the Russian Federation<sup>4</sup> as a state body has powers of a judicial nature because implementation thereof is closely related with application of state enforcement measures<sup>5</sup>.

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<sup>1</sup> See Article 75 of the Constitution of the Russian Federation; Article 1 of Federal Law No. 86-FZ of July 10, 2002 "On the Central Bank of the Russian Federation (Bank of Russia)" // *The Rossiiskaya Gazeta*, No.127, July 13, 2002.

<sup>2</sup> See: E.M. Aminiova. *The Modern Trends in Regulation and Supervision of Financial Markets* // *The Bankovskoe Pravo*. 2015. No.4. pp. 26–34; P.D. Barenboim, D.V. Kravchenko. *Establishment of the Megaregulator on the basis of the Bank of Russia in Terms of its Independent Constitutional Status* // *The Zakonodatelstvo i Ekonomika (Legislation and Economy)*. 2013. No. 6. pp. 5–8.

<sup>3</sup> O.E. Medvedeva, T.V. Makshanova. *The Advantages and Disadvantages of Establishment of the Megaregulator on the Russian Financial Market* // *The Vektor Nauki TGU*. 2013. No.3(25). p. 354.

<sup>4</sup> Definition No.268-O of December 14, 2000 of the Constitution Court of the Russian Federation "At the Request of the Supreme Court of the Russian Federation on Examination of the Validity of Part Three of Article 75 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)". URL: [www.ksrf.ru](http://www.ksrf.ru)

<sup>5</sup> See: N.A. Taraban. *The Central Bank of the Russian Federation (Bank of Russia) in the System of State Authorities: The Constitutional and Legal Grounds of Organization and Operation* // *The Finansovoe Pravo*. 2017. No 6. pp. 44–47.

Those who hold different views believe that the Central Bank of the Russian Federation is not an independent state authority. For example, V.Yu. Patenkova provides her reasons to this effect<sup>1</sup>. The findings on the Central Bank's political independence based on the analysis of the procedure for appointment of the Chairman of the Central Bank, his/her deputies, members of the Board of Directors, as well as members of the National Banking Council are unconvincing. With the presidential majority in the State Duma, any candidate proposed by the President of the Russian Federation will be elected the Chairman of the Central Bank of the Russian Federation.

The Central Bank's senior management believes that the Central Bank is a special public institute which is not a state body, but entrusted with powers of state authority<sup>2</sup>.

At the present stage, the specifics of the Russian financial system can be explained by the following<sup>3</sup>:

- a) globalization, growing internalization of securities markets, higher volumes of cross-border investment deals and tougher competition between global financial centers;
- b) prevalence of credit institutions;
- c) low activity of households on the financial market;
- d) households' preference of credit institutions;
- e) low level of confidence in non-credit financial institutions because of the violations they commit amid insufficient supervision;
- f) households' high demand in bank deposits;
- g) weak corporate governance in joint-stock companies due to which the Russian equity market has failed to become the source of a large-scale attraction of capital.

As a result, the Russian financial market which used to develop dynamically in 2012–2015 is still short of high positions in the context of global competition.

The World Economic Forum prepares on the annual basis the indices of countries' global competitiveness. In 2017–2018, Russia is rated the 38<sup>th</sup> out of 137 places, that is, 26 positions upwards as compared to the 2012–2013 period which preceded the establishment of the Central Bank of the Russian Federation as the megaregulator of financial markets. However, as regards one of the rating's components – the development of the financial market – Russia occupies the 107<sup>th</sup> place out of 137 places. At the same time, as compared to the results achieved in the 2012–2015 period the indicators of the “development of the financial market” component improved (see *Fig. 1 и 2*)<sup>4</sup>.

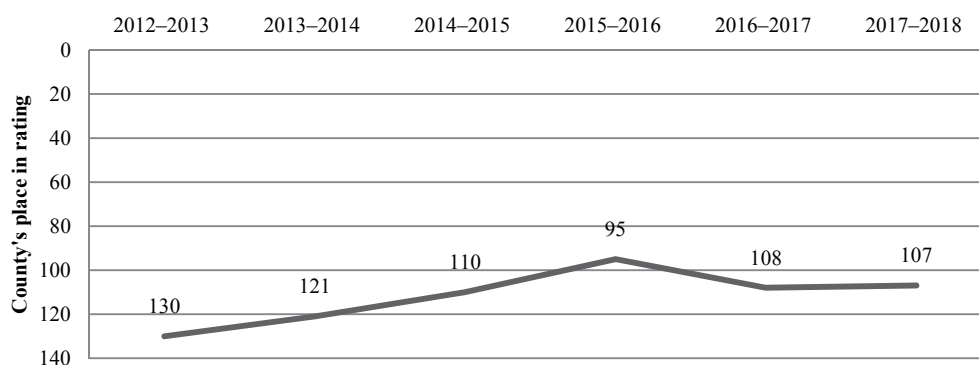
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<sup>1</sup> V.Yu. Patenkova. The Legal Status of the Bank of Russia // *The Yurist*. 2017. No. 9. pp. 38-41.

<sup>2</sup> See: The Legal Status and Functions of the Bank of Russia (July 08.07.2014). URL: <http://www.cbr.ru/today/?PrId=bankstatus>

<sup>3</sup> See hereinafter: The Bank of Russia. The Main Lines of Development of the Financial Market of the Russian Federation in 2016–2018 (May 26, 2016) // URL: [http://www.cbr.ru/finmarkets/files/development/onrfr\\_2016-18.pdf](http://www.cbr.ru/finmarkets/files/development/onrfr_2016-18.pdf)

<sup>4</sup> See: World economic forum. The global competitiveness report 2017–2018 // URL: <http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf>



*Fig. 1. Dynamics of "Development of Financial Market" component of Russia's rating of global competitiveness*

*Source:* The World Economic Forum. The global competitiveness report 2017–2018; The Central Bank of the Russian Federation. The Main Guidelines for Development of the Financial Market of the Russian Federation in 2016–2018 (May 26, 2016).

In the international rating of favorable business conditions as regards financial markets – the rating is prepared on the annual basis by the World Bank – Russia is rated the 29<sup>th</sup> out of 190 places and the 51<sup>st</sup> as regards “the availability of loans” and “the protection of minority shareholders”, respectively, as of June 2017<sup>1</sup>.

According to the data of Z/Yen, a financial and consulting company, in September 2015 out of 84 global financial centers Moscow occupied the 78<sup>th</sup> place, while in March 2016, the 67<sup>th</sup> place out the total of 86 places. In 2014, the information agencies Dow Jones and Xinhua put Moscow on the 33<sup>rd</sup> place out of 45 international financial centers, that is, five positions downwards as compared to 2013. However, as regards “the financial market” factor, Moscow moved upwards from the 30<sup>th</sup> place to the 23<sup>rd</sup> place<sup>2</sup>.

According to the available estimates, the present-day Russian financial market is characterized by stagnation of the earning power of Russian companies’ equities and favorable conditions for investment into government and corporate bonds<sup>3</sup>. As regards the former, the stagnation is a result of freezing of domestic pension assets and the outflow of capital of foreign portfolio investors as their interest in financial instruments of Russian entities is limited by a lack of substantial changes in the investment climate. In its turn, the bond market growth was facilitated by the low rate of inflation and interest rates on bank deposits coupled with a considerable “money overhang” in the economy and emerging interest in government and corporate bonds, whose yield stabilization was

<sup>1</sup> See: The World Bank. Assessment of Business Regulation (Doing business): The rating of countries // URL: <http://russian.doingbusiness.org/rankings>

<sup>2</sup> See: The Bank of Russia. The Main Guidelines for Development of the Financial Market of the Russian Federation in 2016-2018 (May 26, 2016).

<sup>3</sup> See: A. Abramov. The Risks of the Russian Financial Market // The Russian Economy in 2017. Trends and Prospects / [V. Mau and others; edited by S.G. Sinelnikov-Murylev, Doctor of Economics (Chief Editor), A.D. Radygin, Doctor of Economics]; The Gaidar Institute for Economic Policy – Moscow: The Publishers of the Gaidar Institute, 2018. – pp. 145, 146.

a driver of sped-up growth in new bond issues. In the domestic market regulation, the priority lines may become the development of domestic institutional investors, formation of consistent rules as regards pension assets, upgrading of the investment climate and promotion of the competitive environment on the domestic stock market.

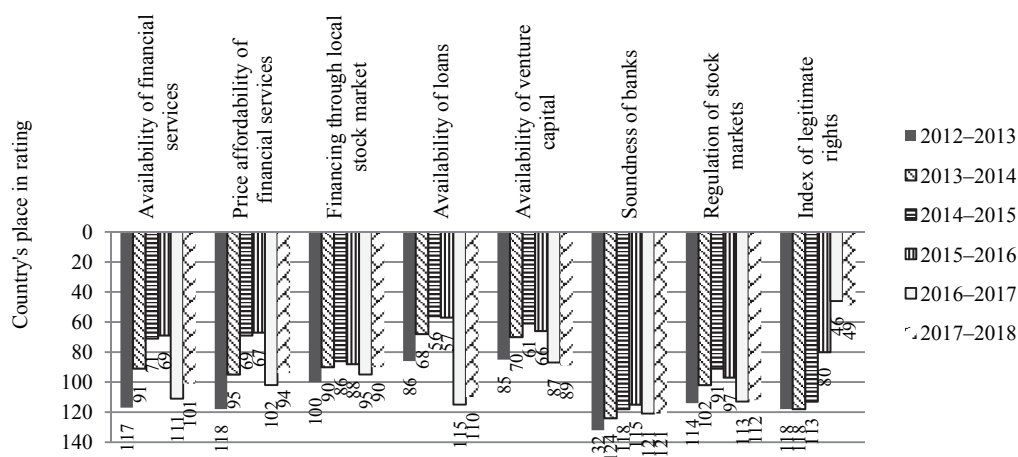


Fig. 2. Indicators of "Development of Financial Market" component of Russia's rating of global competitiveness

Source: The World Economic Forum. The global competitiveness report 2017–2018; The Central Bank of the Russian Federation. The Main Guidelines for Development of the Financial Market of the Russian Federation in 2016–2018 (May 26, 2016).

### ***Megaregulation: practice of 2013–2018***

The megaregulator started its activities amid unfavorable external conditions: financial sanctions, structural constraints of the Russian economy and negative growth rates. However, the megaregulator demonstrated a high level of activity in various lines. In particular, in 2013–2018 the Central Bank of the Russian Federation as the megaregulator achieved substantial results in the following:

#### ***1. Approval and introduction of the Corporate Governance Code<sup>1</sup>***

The Russian Corporate Governance Code (CGC) was approved in 2014. It is a high quality document with a good pattern and content which comply with the relevant international standards of corporate governance, including the OECD Corporate Governance Guidelines and it is in no way inferior to corporate governance codes of other countries, but, on the contrary, in some cases it is even much better (Part Two of the CGC is of an advisory, rather than annotative nature; it includes a definition of the

<sup>1</sup> See: hereinafter: Resolution No.44-SF of March 01, 2017 of the Council of Federation of the Federal Assembly of the Russian Federation "On the Activities of the Central Bank of the Russian Federation (Bank of Russia) as Regards Regulation, Control and Supervision over Financial Markets in 2013 – 2016" //The Official Gazette of the RF, March 06, 2017, No. 10, p. 1438.

independent director and individual chapters on the scheme of remuneration and other). The CGC is aimed at promoting efficiency of management of Russian companies and ensuring their long-term and sustainable development.

As regards compliance with the CGC, the Central Bank of the Russian Federation positively estimated the average level of compliance by Russian listed companies with the CGC's principles and guidelines; in 2016 it was equal to 69 percent of all the principles, that is, 11 percent more as compared to 2015. In future, the Central Bank of the Russian Federation expects growth in compliance, though a moderate one.

Despite some discrepancies in their results, a number of other entities (the Rosimuschestvo, the Otkrytoe Pravo, Expert Council under the Government of the Russian Federation and the Working Group on Establishment of Multifunctional Centers for Provision of State and Municipal Services (MCPSMS) dealing with issues of introduction of the principles of the CGC into some Russian companies rated highly the level of compliance with the CGC's principles. In 12 joint-stock companies which are subordinate to the state, the level of compliance is equal on average to 90 percent. It is to be noted that in lots of developing and developed countries, there is an explicit problem of the corporate governance code being applied in practice<sup>1</sup>. In Russia, such a conflict between the regulatory requirements and the actual practice of application of the Code's norms is more acute, so one should not overestimate the effect of nonbinding norms.

2. *Reformatting of individual types of financial activities*, such as the operations of insurance companies, nongovernment pension funds, microfinance entities, actuaries and credit rating agencies.

As regards the insurance industry, a decision was taken on the establishment of a reinsurance company and a switchover to a new sectorial standard and chart of accounts for insurance companies. As regards nongovernment pension funds, a mechanism of state regulation thereof was developed, state insurance of pension assets was introduced and a self-regulating entity of nongovernment pension funds was established.

As regards microfinance operations, self-regulation was introduced and the regulator's authorities were expanded. In March 2016, microfinance entities (MFE) were legislatively divided into two types: microfinance companies (MFC) and microcredit companies (MCC)<sup>2</sup>.

From January 1, 2015, Federal Law No. 293-FZ of November 2, 2013 "On Actuarial Activities in the Russian Federation" came into effect. The law was developed to

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<sup>1</sup> See for more details: N.A. Polezhayeva. Compliance with the Corporate Governance Code in Russia: Any Improvements? // The Russian Economy in 2017. Trends and Prospects. Yegor Gaidar Institute for Economic Policy. Moscow: The Gaidar Institute's Publishers, 2018. – pp. 452–478.

<sup>2</sup> See: The Central Bank of the Russian Federation Told About Changes in the Activities of Microfinance Entities (March 30, 2016). URL: [http://rapsinews.ru/incident\\_news/20160330/275725588.html#ixzz5BUwdNurp](http://rapsinews.ru/incident_news/20160330/275725588.html#ixzz5BUwdNurp)



introduce effective statutory regulation and the institute of self-regulation of actuaries as a condition for professional qualification and compliance of the legislation of the Russian Federation on actuarial activities with the international legislation.

The law defines the “actuary” as an individual who carries out in accordance with the labor contract or civil law contract actuarial activities and is a member of a self-regulating organization of actuaries. To join this organization, an individual has to pass the qualification exam which procedure is set by the Central Bank of the Russian Federation.

The Central Bank of the Russian Federation has approved the entire range of statutory instruments and standards to regulate actuaries’ activities<sup>1</sup>.

In June 2015, Law No.222-FZ of July 13, 2015 “On the Activities of Credit Rating Agencies of the Russian Federation, On Amendment of Article 76 of Federal Law “On the Central Bank of the Russian Federation (Bank of Russia) and Recognition as Null and Void of Individual Provisions of Statutory Acts of the Russian Federation” was approved.

In the Russian Federation, rating activities can be carried out by legal entities in the form of incorporation after the information on such legal entities has been entered by the Central Bank of the Russian Federation into the register of credit rating agencies. Other legal entities are not entitled to carry out such activities.

The minimum size of the own funds (capital) for the credit rating agency is set in the amount of RUB 50 million.

Credit rating agencies have to ensure:

- 1) independence of rating activities, including from any political and (or) economic influence;
- 2) prevention and identification of conflicts of interest, handling thereof and disclosure of the information on such conflicts;
- 3) compliance with the requirements of the effective Federal Law.

The Central Bank of the Russian Federation keeps the register of credit rating agencies, establishes the methods of determining the size of the own capital, examines the agencies’ activities, sends to the agencies mandatory orders and handles claims and applications as regards activities of credit rating agencies. Also, it sets the format of reporting for such agencies and other<sup>2</sup>.

It is to be noted that utilization of formal approaches in carrying out supervision over credit and non-credit financial institutions is still a serious disadvantage, which is

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<sup>1</sup> See: Documents regulating actuarial activities. URL: [http://www.cbr.ru/finmarket/common\\_inf/legals\\_actuarial/](http://www.cbr.ru/finmarket/common_inf/legals_actuarial/)

<sup>2</sup> Federal Law No.222-FZ of July 13, 2015 “On the Activities of Credit Rating Agencies of the Russian Federation, On Amendment of Article 76 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and Recognition as Null and Void of Individual Provisions of Statutory Acts of the Russian Federation” // RG, No. 156, July 17, 2015.

caused, among other things, by limitation of the legal capacity of the Central Bank of the Russian Federation as regards implementation of comprehensive approaches to evaluation of risks of credit and non-credit financial institutions and their overall activities. In this context, the Central Bank of the Russian Federation plans to introduce consistently the mechanism of expert judgment on individual issues related to financial institutions' activities with control over the decision-making procedure of the Central Bank of the Russian Federation stepped up simultaneously.

Also, the Central Bank of the Russian Federation intends to develop approaches to provision of services to small supervised financial institutions which may maintain accounting of their business activities without an obligation to submit reporting provided that the Central Bank of the Russian Federation is granted the right to use directly the accounting data, including by means of cloud technologies. Also, the specified institutions will be able to use a simplified format for submitting annual reporting. Implementation of the data-centricity approach to networking between the regulator and supervised institutions as regards the receipt of the reporting data will create the basis for the regulator's future access to financial market participants' databases with the initial data required for supervisory functions to be carried out<sup>1</sup>.

### *3. Establishment of the system of prudential supervision over the activities of nongovernment pension funds and work on development of the system of protection of pension assets.*

Priorities in supervision over the activities of nongovernment pension funds changed from quality performance indicators to the risk-oriented oversight. The main goal of such supervision is to ensure financial stability of funds and protect interests of participants and insured persons.

A switchover to the prudential supervision system was carried out in three stages. At the first stage (2013 – April 2014), comprehensive evaluation of nongovernment pension funds' activities in mandatory pension insurance and nongovernment pension insurance was carried out. At the second stage (2014 – December 2016), measures on establishment of the prudential risk-oriented supervision on the market of mandatory pension insurance and nongovernment pension insurance were developed. At the third stage (from 2017), prudential risk-oriented supervision was introduced on a mandatory basis.

Introduction of the mandatory risk-oriented supervision involves a switchover of nongovernment pension funds, asset management companies and specialized depositaries to corporate governance standards based on risk evaluation, as well as a switchover of the Central Bank of the Russian Federation to risk-oriented supervision<sup>2</sup>.

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<sup>1</sup> The Main Guidelines for Development of the Financial Market of the Russian Federation in 2016–2018. URL: [http://www.consultant.ru/document/cons\\_doc\\_LAW\\_256439](http://www.consultant.ru/document/cons_doc_LAW_256439)

<sup>2</sup> See for more details: The Plan of Measures on Introduction of Prudential Supervision in the System of Mandatory Pension Insurance in the Nongovernment Pension Insurance Scheme (June 02, 2014). URL: <http://pensionreform.ru/73599>

Establishment of the system of protection of pension assets includes the following:

- selection by the Central Bank of the Russian Federation and entry into the register of nongovernment pension funds on the basis of sufficiency of investment funds, organization of investment activities, risk management, in-house control and business reputation. At present, the system of protection of pension assets includes 41 nongovernment pension funds;
- approval of Law No.422-FZ of December 28, 2013 “On Protection of Pension Entitlements of Insured Persons in the Mandatory Pension Insurance System of the Russian Federation”;
- establishment of the Fund for Protection of Pension Assets managed by the Deposit Insurance Agency (DIA) to ensure minimum the return of pension assets and maximum appreciation of the value thereof. The system of protection of pension assets is made up of two tiers and includes the following:
  - funds which form the mandatory pension insurance reserve of each nongovernment pension fund;
  - the fund for protection of individuals’ allocations managed by Deposit Insurance Agency (DIA).

The DIA carries out record keeping of all the nongovernment pension funds included in the register of participants which form this fund. The terms for a nongovernment pension fund to become a member of the system in question are as follows:

- availability of the license;
- transformation into a joint-stock company;
- approval by the Central Bank of the Russian Federation upon completion of a relevant examination of the fund’s activities;
- payment of mandatory contributions.

Those nongovernment funds which failed to be entered in the register are obligated to stop making contracts on mandatory pension insurance and transfer pension assets at their disposal to the Pension Fund<sup>1</sup>.

At present, there is an entire range of issues related to further regulation of the sector, including facilitation of a decent level of individuals’ pension provision, a retirement-age increase, solution of the issue of nonpayment by the shadow sector of the economy of pension contributions and expediency of maintaining the practice of early pensions<sup>2</sup>.

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<sup>1</sup> See: The System of Protection of Pension Assets. URL: <http://pensiology.ru/ops/budushhim-pensioneram/formirovanie-nakopitelnoj-pensii/garantirovanie-nakoplenij/>

<sup>2</sup> See for more details: A.V. Tsyplakov. The Pension System in 2016-2025: The Prospects of Reforming and Evaluation of Consequences (July 11, 2016). URL: <http://izron.ru/articles/tendentsii-razvitiya-ekonomiki-i-menedzhmenta-sbornik-nauchnykh-trudov-po-itogam-mezhdunarodnoy-nauch/sektsiya-1-ekonomicheskaya-teoriya-spetsialnost-08-00-01/pensionnaya-sistema-v-2016-2025-gg-perspektivy-reformirovaniya-i-otsenka-posledstviy/>

4. *Progress in investigation of cases of manipulation practices and insider trading. As a result, within three years the number of such practices diminished<sup>1</sup>.*

According to the open access data of the Central Bank of the Russian Federation, in 2015–2017 the regulator stepped up its activities in this field. The illegal utilization of the insider information and/or risk manipulation were found in operations with securities of the PAO (Public Joint-Stock Company) Nizhmekamskneftekhim, the PAO AFK Sistema, the PAO Novorossiyskiy Torgovy Port, the PAO Saratovskiy Neftepererabatyvauschi Zavod (Saratov Oil Refinery), the OAO Lenenergo, the OAO Mechel, the OAO NK Rosneft, OAO Rusgidro, the OAO Sberbank of Russia and other<sup>2</sup>.

5. *Promotion of Availability of Financial Products and Services.*

The specifics of the Russian financial market consist in the fact that households widely use banking credit instruments and distrust non-banking segments.

In January 2015, a new financial instrument – individual investment accounts – was introduced for individuals to increase the extent of their involvement in the financial market. This instrument is meant to reduce a tax burden on individuals' operations on the financial market. As of the end of 2015, 89,600 such accounts were opened and the volume of trading with those accounts involved amounted to RUB 43.1 billion<sup>3</sup>.

According to the data of the Moscow Stock Exchange and the NAUFOR (the National Association of Stock Market Participants), in 2018 the total amount of the attracted funds from individuals via individual investment accounts amounted to RUB 28 billion and about 700,000 new investors came to the market, that is, a three-fold increase as compared to 2016. As of February 2019, the total sum kept on individual investment accounts exceeds RUB 48 billion. In 2018, individuals bought twice as many Russian government bonds as a year before. Also, investments in companies' equities increased, but not so spectacularly as in the state debt. Over 600,000 broker's accounts were opened akin to individual investment accounts<sup>4</sup>.

The interest in such investments can be primarily explained by a low banking interest rate on deposits and numerous cases of bank license withdrawals. Individuals have started to look for instruments which may yield a higher income.

Apart from comprehensive schemes, customized approaches to attraction of customers were developed. For example, a plan of measures (a road map) to promote accessibility of services of financial institutions to disabled persons, people with limited

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<sup>1</sup> See: hereinafter: The interview of E.A. Shvetsov to the *Rating* Information Agency (September 9, 2016). URL: [http://www.cbr.ru/press/int/press\\_centre/Shvetsov\\_Reuters\\_09092016/](http://www.cbr.ru/press/int/press_centre/Shvetsov_Reuters_09092016/)

<sup>2</sup> Identified cases of illegal utilization of the insider information and market manipulations. URL: [http://www.cbr.ru/finmarket/inside/inside\\_detect/](http://www.cbr.ru/finmarket/inside/inside_detect/)

<sup>3</sup> See: The Main Guidelines for Development of the Financial Market of the Russian Federation in 2016–2018. p. 20.

<sup>4</sup> Investment Account (IIA) in 2019: The Review of Advantages and Disadvantages. – <http://dataworld.info/iis-individualnyj-investicionnyj-schet-vychet-nalog.php>, February 06, 2019.

mobility and elderly people in 2017–2019 (approved by Resolution No. PM-01-59/31 of July 5, 2017 of the Central Bank of the Russian Federation) was worked out. The plan is aimed at eliminating physical accessibility problems and problems related to interfaces and digital information access, attitude of the personnel of financial institutions and comprehension of the nature of financial services and possible risks they may involve.

*6. Protection of the rights of customers and investors in relations with financial market participants.*

To ensure reliable protection of the rights of consumers of financial services, the Central Bank of the Russian Federation expects to establish and put into operation more effective schemes of handling the complaints of financial service consumers.

The Central Bank of the Russian Federation plans to develop and prepare on the annual basis the composite financial literacy index which includes the following:

- a) research into the extent of public awareness of financial instruments, services and legitimate methods of protection of financial service consumers' rights;
- b) research into households' competence (that is, practical application by households of their knowledge of financial instruments and services);
- c) research into the extent of diversification of financial instruments and services used by households.

It is necessary to promote the role of the Call Center and Public Counseling Office established by the Central Bank of the Russian Federation to facilitate networking with consumers of financial services.

*7. Establishment of the modern infrastructure of the financial market which meets international standards and putting into operation of the Mir national payment system and the system of transfer of financial messages of the Central Bank of the Russian Federation.*

The plan of measures (a road map) prepared for development of the electronic networking of the financial market is a comprehensive set of instruments aimed at upgrading the mechanisms of electronic networking on the financial market and switching over all the market participants, their customers, federal executive authorities and the Central Bank of the Russian Federation to the e-document flow. On May 18, 2015, the Road Map was approved by A.V. Dvorkovich, Deputy Chairman of the Government of the Russian Federation. Specifically, it is planned to establish end-to-end permanent links of electronic networking with all the entities of the financial market. Such links will be built with a gradual reduction of the share of the paper document flow on the financial market and elimination and prevention of gaps in the links, as well as proper information security of financial market participants ensured.

Also, it is planned to switch over a portion of services of the Central Bank of the Russian Federation into an electronic format with the e-government infrastructure utilized (including the single web site of state and municipal services).

It is to be noted that the Central Bank of the Russian Federation is considering the issue of a gradual modification of automated processes of collection and analysis of all the types of reporting of regulated entities on the basis of the new format which permits to eliminate the excessiveness and duplication of the reporting data, upgrade authenticity and quality of the incoming information and unify the format of interdepartmental electronic data exchange. In future, the unified format may facilitate reduction of the burden on regulated entities in preparation of reporting documents for different purposes and to various agencies.

*8. Work on the “deal with the regulator” instrument.*

In the next three years, the Central Bank of the Russian Federation expects to establish legislatively the right of insiders and market manipulators to make a deal with the regulator. The idea is mentioned in the draft of the Main Guidelines for Development of the Financial Market in 2019–2021.

At present, the Central Bank of the Russian Federation cannot reduce or abolish in return for cooperation the penalty on market participants who are suspected of manipulating or using the insider information. In the document of the Central Bank of the Russian Federation, it is specified that a deal with the regulator can speed up “the investigation of law infringements and make it possible to bring to responsibility a larger number of persons involved”. The regulator intends to expand the scope of application of expert judgments in qualifying activities on the financial market.

Investigation of each case takes up to two years because in market manipulation and insider trading foreign entities are involved, too. It often happens that the institution is not aware of the fact that its employees may engage in insider trading. The share of this business in the overall volume of the institution’s business can be rather small, but the reputational damage is very high. Reduction of the reputational damage can be the case for making a deal with the regulator<sup>1</sup>.

*9. The new system of regulation of the activities of self-regulating entities on the financial market with active participation of the Central bank of the Russian Federation.*

On July 13, 2015, the Federal Law on Self-Regulating Entities in the Financial Market<sup>2</sup> (hereinafter Federal Law on SRE in FM) was approved.

Apart from regulating the activities of 16 types of self-regulating entities ranging from brokers to agricultural consumer credit cooperatives, the Federal Law on SRE in FM includes the “framework” norms of self-regulation; the specifics of regulation of the relations which emerge with activities of the SRE are determined either by the entity’s

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<sup>1</sup> A. Astapenko. The Central Bank will Strike a Deal with Manipulators. – <https://www.vedomosti.ru/finance/articles/2018/06/06/772028-tsb-manipulyatorami>, 06.06.18.

<sup>2</sup> Federal Law No.223-FZ of July 13, 2015 “On Self-Regulating Entities on the Financial Market and Amendment of Article 2 and Article 6 of Federal Law No.157 of July 20, 2015 “On Amendment of Individual Statutory Acts of the Russian Federation” // The Rossiiskaya Gazetta, No.157, July 20, 2015.

in-house documents or statutory act of the Central Bank of the Russian Federation as the regulator of the financial market<sup>1</sup>.

The financial market regulator determines the extent of its own participation in the activities of self-regulating entities on the financial market. It is feasible to single out some main risks to independent self-regulating entities:

- 1) Expanded legislative regulation, development and introduction of standards for SRE and expansion of the authorities of the Central Bank of the Russian Federation in this field;
- 2) Limitation of SRE's some genuine functions (appointment of the chief executive manager of the SRE and receipt of reporting from members of the SRE);
- 3) Reduction of the number of SREs of the same type coupled with mandatory membership in the SRE for financial institutions established and licensing of their activities preserved.

In addition, the role of laws regulating the activities of individual types of self-regulating entities of financial institutions remains uncertain. Also, it concerns the Federal Law "On Self-Regulating Entities" of 2007<sup>2</sup>, which is applicable to some types of SRE which are regulated by the Federal Law on SRE in FM (SRE of consumer credit cooperatives, microfinance institutions and other) because relevant amendments have not been introduced, yet<sup>3</sup>.

#### 6.2.7. Conclusion

In the past 20 years, megaregulation has become a comprehensive instrument of regulation of the financial market. Out of 70 countries, which carried out the reforms in 1998–2009 27 countries (38.5 percent) consolidated financial regulation and supervision one way or another.

The research into megaregulation of the financial markets of the UK, Germany, Japan and Singapore permits to draw a conclusion that one and the same model of regulation applied to different regulatory cultures and philosophies yields different results.

The German megaregulation is largely formal. The switchover to it was justified not by the failures of the previous model with a few regulators in place and a loss of

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<sup>1</sup> Hereinafter: M.A. Polezhayeva. Self-Regulating Entities on the Financial Market / N.A. Polezhayeva // Russia's Economic Development. 2015. No.12. pp. 116–121.

<sup>2</sup> Federal Law No.315-FZ of December 01, 2007 "On Self-Regulating Entities" // The Legislation Bulletin of the Russian Federation, December 03, 2007, No. 49, Article 6076.

<sup>3</sup> For example, Article 48 (1) of Federal Law No.39-FZ of April 22, 1996 "On Securities Markets" (See: The Legislation Bulletin of the Russian Federation, No. 17, April 22, 1996, Article 1918); Article 36.26 (1) of Federal Law No. 75-FZ of May 07, 1998 "On Nongovernment Pension Funds" (See: The Legislation Bulletin of the Russian Federation, No.19, May 11, 1998, p. 2071); Article 56 (1) of Federal Law No.215-FZ of December 30, 2004 "On Housing Savings Cooperatives" (See: The Legislation Bulletin of the Russian Federation, January 03, 2005, No.1 (Part 1), p. 41) include direct references to the voluntary association in the SRE of business entities which they regulate.

confidence in it, but changes in the financial market and the criticism from the outside which factors affected foreign investors' interest. Due to a high level of independence of entities which are included in the system of the chief regulator BaFin and the existence of other smaller regulators, the German model of regulation of the financial market remains to be sectorial. The BaSin is regarded as a moderate regulator which can be explained mainly by a high level of the legal culture of the market participants.

Both the Japanese and German megaregulators are not central banks, but unlike the latter the Japanese FSA is not an independent entity; it is a part of the Administration of the Cabinet Council of Japan and financed out of the state budget. The Japanese megaregulator is prone to concentration of powers and political pressure. Despite a trend towards overregulation, the FSA is a highly competent authority which demonstrates a more restrained approach to financial market participants as compared to its predecessors and rarely closes down financial institutions.

Singapore's MAS is the only example of the central bank in the role of a megaregulator in a country with a large financial market. In Singapore, megaregulation is characterized by uncompromised supremacy of the law and comprehensive active interference by the state which carries out strict control over market participants. However, flexibility and far-sightedness of Singapore's leaders and the MAS, in particular, make this approach effective to promote the competitiveness of Singapore's financial market.

Despite the substantial differences, the German, Japanese and Singaporean regulators are quite effective and facilitate properly the development and stability of their financial markets, while the UK experience in megaregulation turned out to be highly disappointing, though the British FSA once inspired different countries to switch over to the single regulator of the financial market. The British regulator was prone to the excessive red tape and was too soft on "free-ranging" market participants. As a result, the FSA was liquidated after it failed to cope with the financial crisis, and the UK gave up the practice of megaregulation on the financial market.

The financial market in Russia is relatively young and not that developed as in the UK, Germany, Japan and Singapore. As in Germany where there is a single financial regulator, the Russian megaregulator was established as a result of a merger of previous regulators. In both cases, the integration was caused primarily by changes on the financial market, however, in case of Russia there was more criticism – though not that harsh as in the UK and Japan – in respect of the previous regulators. However, despite problems related to the switch-over to the megaregulation of the financial market, the Russian single regulator was established not as a separate authority, but on the basis of the Central Bank, which factor makes it similar to Singapore's MAS. This decision was partially justified by an insufficient level of the legal culture of financial market participants, so a tough regulator was needed for that job and the Central Bank suited that role very well because of its already proven record.



The quality of the financial market depends on multiple factors, including the country's geographical situation, history, legal culture and other. Application of a structural approach alone to the market regulation without other factors taken into account does not necessarily guarantee the proper functioning of the market and may produce negative consequences. These factors create a variety of options within the frameworks of a single model of regulation of the financial market (megaregulation) and predetermine the effectiveness in utilization of the model in different countries.

From September 1, 2013 the Central Bank of the Russian Federation was assigned the authorities to carry out regulation, control and supervision of the entire range of non-credit financial institutions from brokers to pawn-brokers<sup>1</sup>. It became the megaregulator of the financial market which event signified the beginning of a large-scale institutional reform of the country's financial market. In the past few years, the Central Bank of the Russian Federation has succeeded in carrying out the entire complex of relevant measures:

- removing of unscrupulous participants, primarily in the banking sector, from the market;
- complete reformatting of activities of insurance companies, nongovernment pension funds, microfinance institutions, actuaries and credit rating agencies;
- approval and introduction of the Corporate Governance Code;
- establishment of the system of prudential supervision over the activities of nongovernment pension funds and development of the system of protection of pension assets;
- promotion of protection of the rights of consumers and investors in relations with financial market participants;
- active investigation of instances of market manipulation and insider trading practices; as a result within three years the number of such practices has largely decreased;
- promotion of accessibility of financial products and services;
- facilitation of networking with financial market participants as regards development and regulation of the industry;
- establishment of the new system of regulation of the activities of self-regulating entities on the financial market.

It is worth mentioning the most important **issues** of megaregulation.

The Central Bank of the Russia Federation regulates the activities of the existing market participants, but does not facilitate the attraction of new ones. Regulation is generally meant to create such an environment which would be attractive to those who seek to create new types of business, however, it does not happen so for the time being.

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<sup>1</sup> See: Federal Law No.251-FZ of July 23, 2013 “On Amendment of Individual Statutory Acts of the Russian Federation in the Context of Assignment to the Central Bank of the Russian Federation of Authorities on Regulation, Control and Supervision over Financial Markets” // RG. July 31, 2013. No.166; Article 76.1 of Federal Law No.86-FZ of July 10, 2002 “On the Central Bank of the Russian Federation (Bank of Russia)” // RG. July 13, 2002. No.127.

It is to be stated that measures aimed at toughening regulation and introducing new forms of supervision do not correlate with costs. Routine behavioral and prudential supervision should not be burdensome for market participants. There are no publicly available calculations of the cost of regulation and supervision.

Supervisory measures in respect of the banks are often applied to the non-banking sector. Unlike banks, non-banking institutions assume lots of risks which are not guaranteed by the state. This suggests that the main instrument ensuring protection of the rights and interests of those investors is complete disclosure of all the existing information. However, there are numerous instances where the Central Bank of the Russian Federation does not pay due attention to the reporting of mutual funds, nongovernment pension funds, brokers and trust managers. On the other side, the information is not sufficiently disclosed, while, on the other side, participants have to submit excessive reporting to the regulator.

Among the identified problems, it is would be expedient to single out the multiplicity of regulation. Let's take, for example, nongovernment pension funds. This segment of the financial market came under control of the megaregulator, however, due to the specifics of the business some aspects of supervision and development of the regulatory base are dealt with by social agencies, while political decisions are prepared by the Pension Fund. In such a situation, an excessive regulatory burden is created.

In upgrading the system of megaregulation in Russia, it is important to take into account the **lessons** which were drawn in other countries.

It is noteworthy that compliance with "the good regulation principles", such as efficiency and saving, the role of management, adequacy, innovations, global nature of financial services and competition are unable alone to create effective megaregulation without fundamental economic problems being solved. The latter is the priority, but a comfortable business environment, infrastructure, well-balanced taxation, top position in the global doing business rating, supremacy of the law and anti-corruption activities are in no way less important. The sound banking sector and the market with reliable institutional and regulatory systems are vital factors, too.

The main goal consists in overcoming the regulator's red tape which often prevents solution of fundamental issues in the banking sector. The megaregulator's practice of focusing attention on determination of systems and processes, rather than complex business-models and strategies is not often justified. Also, shifting of responsibility for risk management on financial markets onto participants is a problem of megaregulation.

### 6.3. Science and innovations<sup>1</sup>

The past year marked the start of drawing up new integrated technological development plans for the Russian science and technology. The plans were originally presented by an Executive Order of the Russian President and then evolved into a nationwide project called “The ‘Science’ National Project” which is in turn linked to the Strategy for Scientific and Technological Development of the Russian Federation adopted in 2016 as well as a national program called “Digital Economy of the Russian Federation.”

In addition to the plans, there were some important organizational changes that led to the ultimate separation of former academic research institutes from the Russian Academy of Science (the Academy) and to the establishment of a single Ministry of Science and Higher Education with authority over institutions of higher education and research-performing organizations, while the Academy was granted the legal status of public expert organization. Other important changes include positive moves towards the development of science in institutions of higher education and more active position of regional government authorities with regard to scientific and technological development. Yet, no breakthroughs or visible changes in technological innovations took place.

Although some system-wide issues facing the Russian science were not addressed in the past year, a basis for positive changes started emerging in some research areas. Public funding continued to account for nearly 70 percent of the total funding of science in Russia – this is an unprecedentedly high level to compare with scientifically developed countries and nations with policies focused on strengthening their scientific base (e.g., BRICS nations). Although business contribution to research and development (R&D) funding remains moderate (representing less than one third of Russia’s total R&D expenditure), there is a trend towards higher values in absolute terms. State budget appropriations for science are growing at an outperforming rate amid slim demand for its application in the business sector. Furthermore, R&D expenditure in the Russian business sector are largely (around 60 percent) funded by the state<sup>2</sup>, surpassing many times R&D expenditure in developed and high-growth countries. As a result, R&D expenditure as a percentage of Russia’s GDP remains low (close to 1 percent) amid rising state funding of science. Therefore, there is obvious shortage of mechanisms designed to attract the business sector to funding (co-funding) research and development, with the aim to reduce, at least, the proportion of federal funding that is used as replacement for private funding. It is characteristic that after the 2008 crisis

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<sup>1</sup> This Section was written by Irina Dezhina, Gaidar Institute, Skolkovo Institute of Science and Technology.

<sup>2</sup> OECD (2018), Main Science and Technology Indicators Volume 2018 Issue 1, OECD Publishing, Paris. DOI: 10.1787/msti-v2018-1-en. P.55.

businesses in most of the developed countries became bigger contributors to raising R&D expenditure, while federal funding rose at slower pace<sup>1</sup>. It is not the case with Russia: business remains a scarce source of contribution to R&D.

Another problem lies in a lack of balanced age structure of researchers. Two opposite age groups developed, one represents young researchers (at the age of 39), whose number has increased considerably in recent years, and another represents older researchers (at the age of over 60). The middle-aged generation of Russian scientists (at the age of 40–59), who are considered more productive, remains a small group (at present, they account for less than one third of the country's total researchers), whose proportion is shrinking. The scientific personnel structure is considered efficient (that is, when best possible results are achieved both in terms of quantity and quality) if young and older generations represent around 20 percent each, and middle-aged researchers constitutes 60 percent<sup>2</sup>. The second serious issue facing human resources in science is low (both internal and external) mobility of Russian researchers – this is what affects the quality of research outputs.

Another parameter is the material base of science, with only minor changes in terms of quality in recent years. The re-equipment of scientific instruments and equipment has been underway for years; however, federal support is focused more on universities than scientific institutions. Each sector of science has elite organizations that receive more resources than other organizations. However, the elite status of these organizations is not always linked to their research outputs, but rather to formal statuses and some other factors. The re-equipment, however, is faced with the problem of efficient equipment handling, which is given much less attention. As a result, the available equipment is not used as efficiently as it might be, there are no full-fledged core facilities. Some of the up-to-date equipment is underused because it was purchased either on a non-systemic basis or for the purpose of resolving one-time tasks. There are unique units of equipment that duplicate each other. Thus, the issue of optimum utilization of scientific equipment is as much critical as the issue of re-equipment.

Another problematic aspect lies in the quality of research output. A brief record of employing policies aimed at enhancing the performance of scientific workflow in Russia shows that quantitative parameters are given the top priority. That is what accounts for a bibliometric race that has been unfolding in recent years in the country, when the key measure of efficiency and performance in science is the number of published papers rather than the interest in the content of such papers (as measured by the citation rate)

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<sup>1</sup> Rehm J. Ten Years after the Economic Crash, R&D Funding is Better than Ever. *Nature*, September 13, 2018. doi: 10.1038/d41586-018-06634-4

<sup>2</sup> Balatsky E., Yurevitch M. Modelling academic personnel's age structure // *Terra Economicus*, 2018, Vol. 16, No. 3, P. 70. DOI: 10.23683/2073-6606-2018-16-3-60-76

by academic and business communities. A point to note, however, is that some universities started to improve in this aspect last year.

### 6.3.1. Science in institutions of higher education and in public sector

Science in institutions of higher education, as always, continues to represent a small “fragment” of the country’s scientific and research complex. Institutions of higher education account for 9.1 percent of the total volume of research and for 12.1 percent of the total number of researchers in this country<sup>1</sup>. Nowadays, the flagship program is represented by a project called Project 5-100 which is intended to raise the ranking of not less than five Russian institutions of higher education to top 100 global rankings by 2020. There are, however, the “weakest aspects” – the volume and the quality of research – that dampen the climb.

In five years since the Program’s inception, quantitative performance measures for science in institutions of higher education have been improved substantially. The number of publication in journals indexed by international data bases has risen due to, among other things, an increase in the number of indexed Russian journals, a substantial increase in the number of university researchers participating in international conferences and study tours to foreign institutes and universities. Therefore, the substantial increase in financial resources has paid off. In particular, the number of papers published by researchers of institutions of higher education participating in Project 5-100 that are indexed by Web of Science have increased 4.5 times compared to 2012, with a 4-fold rise for those indexed by Scopus<sup>2</sup>. Accordingly, the institutions have strengthened their position by way of upgrading their global rankings, particularly in selected fields of science (Russia, as always, continues to have strong schools of physics, mathematics and astronomy).

However, the race for publication numbers has given rise to many strategies designed to increase rapidly publication numbers. Institutions of higher education participating in Project 5-100 are the major contributors to the race. Analysis of their publication strategies<sup>3</sup> reveals the most commonly used strategies (as shown below in descending order of preference (usage frequency)):

- Increasing the number of publications through author affiliation (the author adds the name of higher education institution to the primary place of employment);
- Promoting intensely conferences so that their theses are indexed by Scopus;

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<sup>1</sup> Science indicators: 2018. Statistical Book. M.: NRU HSE, 2018. PP. 44; 78; 190; 205.

<sup>2</sup> N. Bulgakova. Support the promotion. The Academy gets involved in higher education institutions’ efforts to enhance competitiveness // Poisk, No. 44, November 2, 2018 <http://www.poisknews.ru/theme/edu/39685/>

<sup>3</sup> Poldin O., Matveyeva N., Sterligov I., Yudkevich M. 2017. Publication Activities of Russian Universities: The Effects of Project 5-100. Educational Studies, Higher School of Economics, issue 2.

- Seeking and hiring highly cited authors;
- Inviting new researches for publications;
- Having publications in predatory journals.

It is characteristic that publications in predatory journals that are purged from databases is no longer considered as most commonly used strategy.

In the end, measures of quality are still lagging far behind; the citation rate for research papers of institutions of higher education that participate in Project 5-100 is many times less than the average citation rate of reference foreign institutions of higher education, that is, institutions with a similar specialization profile and number of teaching personnel and students. There is still only a small proportion (around 15 percent, according to experts) of academic teaching personnel with research papers published in international journals.

A positive trend is that managers of some institutions of higher education have shifted their focus towards the quality of research papers. Composite measures, including not only publication numbers, were introduced for measuring the performance in research. For example, the Novosibirsk State University pays less for researcher's publications if the researcher does not work with students, and also pays less in financial bonuses for publications that constitute theses of conferences or articles published in predatory journals. Lastly, selection of conferences was introduced, that is, researchers are not recommended to visit low-profile events<sup>1</sup>. Similar trends can be seen in the National Research University of Higher School of Economics (NRU HSE) and in the Moscow Institute of Steel and Alloys – these universities, for example, pay no bonuses on top of the salary for papers/articles published in third- and fourth-quartile journals.

The public sector, to which former academic institutions now pertain statistically, underwent successful readjustments to meet the new requirements focused on quantitative measures, including publication numbers. Despite the recent restructuring – the integration of former academic institutions, the establishment of centers of various types, etc. – the productivity of “academic science” remained the highest across the country, suggesting that multiyear trends are sustainable enough. According to data for 2017, for instance, while the proportion of articles with Academy's affiliation made up 25.4 percent of the total number of Russian publications indexed by Scopus, the contribution to the total citation accounted for 29.1 percent, with the proportion of authors with Academy's affiliation representing as low as 19.8 percent of the total Russian authors<sup>2</sup>.

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<sup>1</sup> S. Ermak, P. Kuznetsov, D. Tolmachev, K. Chukavina. Stop feeding the beast // *Expert*, No. 20, May 14, 2018 <http://expert.ru/expert/2018/20/hvatit-kormit-zverya/>

<sup>2</sup> Avanesova A., Shamliyan T. Comparative trends in research performance of the Russian universities // *Scientometrics*, June 14, 2018. DOI: 10.1007/s11192-018-2807-6

It is nonetheless the policy of promoting the development of science in institutions of higher education that serves as a catalyst to not only increase publication numbers but also promote Russian scientific journals to respective databases (basically, Scopus). Russia's Ministry of Education and Science held a contest among scientific journals. One hundred winners were awarded RUB 1 million for development purposes. Around 8000 collected works of conferences were deleted at a time from the Russian Science Citation Index and will no longer be considered for calculating scientometric indicators<sup>1</sup>.

It is characteristic that the past year was marked by the emergence of a new measure of scientific productivity – h-alpha-index. The author of the Hirsch index, Jorge *Hirsch*, proposed the h-alpha-index for measuring the number of articles in which a scientist is the principal author (the alpha-author). The alpha-author has the greatest Hirsch index of all the co-authors. The introduction of such index allows one to measure scientists' scientific contribution rather than calculate their overall citation rate<sup>2</sup>. The new index has restrictions; for example, the Hirsch index for experimenters using sophisticated equipment units, including those that help obtain specimen or make a complex analysis, is often greater than for core authors of a scientific idea. The above manner of identifying the alpha-author leads to incorrect results in this case.

A new paradigm of accessing scientific journals – the obligatory open access – was underway alongside the efforts made to find more accurate measures of scientific productivity. The European Union issued a resolution on Open Access publishing, after which Science Europe presented Plan S<sup>3</sup>. Plan S requires that, from January 01, 2020, scientific publications that result from research funded by public grants must be published in compliant Open Access journals or platforms. A preliminary set of 14 criteria for selecting journals was proposed. Most of the criteria are linked to technical requirements for open platforms on which journals are based, and only one criterion – the expert evaluation requirement for materials that are proposed for publication – is linked to the quality of publications<sup>4</sup>. It will cost journals a lot to be able to meet technical requirements. According to a study made<sup>5</sup>, as little as 15 percent of open-access journals and 3 percent in social sciences now meet the proposed criteria. However, there are undefined parameters, including how non-European universities and research institutions will pay for publications released in journals included in the list.

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<sup>1</sup> S. Belayeva. There are positive signs. Russian journals move closer to world standards // Poisk, No. 18–19, May 11, 2018 <http://www.poisknews.ru/theme/infosphere/35784/>

<sup>2</sup> J.E. Hirsch. *h<sub>α</sub>*: An index to quantify an individual's scientific leadership. Submitted October 3, 2018. <https://arxiv.org/abs/1810.01605>

<sup>3</sup> Plan S. Making full and immediate Open Access a reality. <https://www.coalition-s.org/>

<sup>4</sup> Brainard J. Few open-access journals meet requirements of Plan S, study says // Science, January 31, 2019. [https://www.sciencemag.org/news/2019/01/few-open-access-journals-meet-requirements-plan-s-study-says?utm\\_medium=email&utm\\_source=FYI&dm\\_i=1ZJN,63X1U,E29D5V,NZXQM,1](https://www.sciencemag.org/news/2019/01/few-open-access-journals-meet-requirements-plan-s-study-says?utm_medium=email&utm_source=FYI&dm_i=1ZJN,63X1U,E29D5V,NZXQM,1)

<sup>5</sup> Brainard J. Few open-access journals meet requirements of Plan S, study says // Science, January 31, 2019. [https://www.sciencemag.org/news/2019/01/few-open-access-journals-meet-requirements-plan-s-study-says?utm\\_medium=email&utm\\_source=FYI&dm\\_i=1ZJN,63X1U,E29D5V,NZXQM,1](https://www.sciencemag.org/news/2019/01/few-open-access-journals-meet-requirements-plan-s-study-says?utm_medium=email&utm_source=FYI&dm_i=1ZJN,63X1U,E29D5V,NZXQM,1)

The introduction of Plan S implies on the one hand a move towards not subscribing to journals. On the other hand, journals included in the list will have a good and guaranteed portfolio of research papers. The changes will have an effect on Russian authors, at least on those who participate in European scientific programs (EU Framework Programs).

The past year saw institutes of the former academic sector come under the control of the recently established Ministry of Science and Higher Education. the Federal Agency for Research-performing organizations (FASO Russia), which used to supervise academic research-performing organizations, ceased to exist under Executive Order of the President No. 215 dated May 15, 2018 concerning the structure of federal executive bodies<sup>1</sup>. The Ministry of Science and Higher Education has, under the above Executive Order, a wide mandate to develop and carry out scientific, research and technical and innovation policies; the Ministry now also regulates the daily workflow of both universities and the former academic sector. The Academy was granted a new status – the Federal Law on the Russian Academy of Science was amended in July to enlarge the scope of Academy’s authority<sup>2</sup>. In addition, debates were held during the year to discuss the status and functions of the Academy. However, multiple debates, creating an “information noise”, had no effect on research-performing organizations.

The Academy, according to the adopted amendments, will carry out the research and methodological management of scientific and scientific and technological activities of not only research-performing organizations but also institutions of higher education, and carry out an expertise of research outputs in organizations of all types. The Academy will also carry out state-funded research, including on behalf of the Military Industrial Complex (MIC). The Academy will submit annual progress reports to the President of Russia on the implementation of the national scientific and technological policy in the Russian Federation. Thus, the Academy becomes a qualified expert entity for a wide range of issues rather than just the basic science with which it has always been associated. Therefore, the Academy will have to face challenges that are beyond its capacity. Nevertheless, the managers of the Academy believe that the Academy possesses a strong human resource base, including around 2000 corresponding members and Academy members (academicians) and approximately 500 young professors<sup>3</sup>. However, this is a relatively small number of specialists who will have to carry out an expertise of tens of thousands research topics<sup>4</sup> underway in all research-performing

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<sup>1</sup> <http://kremlin.ru/events/president/news/57475>

<sup>2</sup> Federal Law No. 218-FZ dated July 19, 2018, “On Amendments to the Federal Law “On the Russian Academy of Science, Reorganization of State Academies of Science and on Amendments to Certain Legislative Acts of the Russian Federation.””

<sup>3</sup> S. Belyaeva. President of the Russian Academy of Science Aleksandr Sergeev: Call of Duty // Poisk, No. 1–2, January 18, 2019 <http://www.poisknews.ru/theme/ran/41116/>

<sup>4</sup> In particular, in 2018, reports on 11.5K research topics of former institutions of the Academy alone were reviewed. (Source: N. Volchkova. An authorized review. The Russian Academy of Science is all set to embark upon analysis of country’s scientific potential // Poisk, No. 1-2, January 18, 2019 <http://www.poisknews.ru/theme/science-politic/41115/>). The figure would increase by several times



organizations and institutions of higher education where R&D is funded by the state. Furthermore, the Academy will carry out an expertise of not only research topics and research and development outputs but also monitoring and performance measurement of public research-performing organizations, prepare proposals for research institutes and institutions of higher education “with the aim to integrate their scientific potential, develop scientific research and support innovation activities”<sup>1</sup>. The above functions were defined as the “scientific and methodological management” by the Academy. Additionally, the scope of the management can be enlarged further to cover not only all federal state-funded research and development performing institutions but also institutions where research and development is funded via regional and local budgets: Russian government’s Executive Order No. 1781 dd. December 30, 2018 provided recommendations for executive bodies to adopt statutes and regulations whereby the Academy will perform scientific and methodological management of organizations that fall within the scope of its authority, except organizations that were established by the Government of Russia (Moscow State University (MSU), S. Petersburg State University (SPSU), Russian Research Center ‘Kurchatov Institute’, National Research Center “*Zhukovskiy Institute*”, Higher School of Economics (HSE) National Research University, The Russian Presidential Academy of National Economy and Public Administration (RANEPA)). However, managers of the Academy have plans to enter into individual agreements with the above organizations on scientific and methodological management<sup>2</sup>.

A more detailed analysis of how the Academy is going to perform its scientific and methodological function reveals that deadlines for analysis and decision-making may be quite extended because, for example, if institutions of higher education work on various research topics, then the same institution would be supervised at a time by various branches of the Academy. Thus, this would be subject to more approvals within the Academy. In so doing, the Academy’s evaluation is cause for making adjustments to topics of research: if the Academy believes that funding of certain topics is undesirable, then the topics can be refined and then reapproved upon re-consideration by the Academy, or if the Academy does not reapprove these topics, then funding would be discontinued. And this despite the fact that draft forms developed for evaluation of topics allow for a formal enough expertise because they do not require detailed conclusions.

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when including reports of institutions of higher education and business sector organizations on state-funded research works.

<sup>1</sup> C.3 of the “Rules for the Federal State-funded Institution Russian Academy of Science to perform scientific and research and methodological management of scientific and scientific and technological activities of research-performing organizations and educational organizations of higher education as well as expertise of scientific and scientific and technical outputs delivered by these organizations”, endorsed by Russian Government’s Executive Order No. 1781 dated December 30, 2018.

<sup>2</sup> N. Volchkova. An authorized review. The Russian Academy of Science is all set to embark upon analysis of country’s scientific potential // Poisk, No. 1–2, January 18, 2019. URL: <http://www.poisknews.ru/theme/science-politic/41115/>

The above changes place an extra burden upon research-performing organizations and institutions of higher education because a unique reporting form must be used for each topic, whether it is funded or planned to be funded by the state. Since public funding accounts for 70 percent of the total funding in the country's scientific complex, the "avalanche" of reports and expertise can hardly be imagined. The existing scheme is yet far from being balanced: besides having the opportunity of making a formal evaluation, the Academy is deemed to bear no responsibility for decisions it makes – at least, no such responsibility follows from the official documents that have been available to date, except a provision on deadlines for the Academy to consider a series of issues which, however, have nothing to do with the expertise of research topics. The Russian Government issued on December 24, 2018 an Executive Order which lays down rules for cooperation between the Academy and the Ministry of Science and Higher Education, sets tight enough deadlines for the Academy to agree upon decisions on reorganization and liquidation of research-performing organizations, on making amendments to charters, on the approval by the Presidium of the Academy of nominees for heads of research-performing organizations and on the approval by the Academy President's of decisions to terminate the office of heads of research-performing organizations<sup>1</sup>. The Academy must make decisions within 5 working days to 30 calendar days, depending on what exactly needs approval.

New functions of the Academy are given a relatively moderate funding: around RUB 4.2 billion of budget allocations to the Academy are planned for 2019–2021 (within the framework of the National Program "Scientific and Technological Development of the Russian Federation"), of which RUB 2.3–2.4 billion will cover daily operations such as, presumably, expert and monitoring activities (see *Table 20*). The Academy also expects to receive RUB 1 billion from the federal budget for its scientific and methodological management of all research-performing organizations and institutions of higher education in the country<sup>2</sup>, which has not been denied by the state.

The Academy embarked by late in the year upon an initiative aimed at cooperation with various state departments. The Academy first of all expressed its willingness to cooperate with the Ministry of Science and Higher Education in order to raise the ranking of leading institutions of higher education in global rankings<sup>3</sup>. It is unclear, though, how the Academy is going to contribute to the promotion, but it will most likely

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<sup>1</sup> Russian Government's Executive Order No. 1652 dated December 24, 2018 "On Approval of Rules for the cooperation between the Federal State-funded Institution Russian Academy of Science and the Ministry of Science and Higher Education of the Russian Federation while exercising their authority under the Federal Law "On the Russian Academy of Science, Reorganization of State Academies of Science and on Amendments to Certain Legislative Acts of the Russian Federation.""

<sup>2</sup> The Academy applies for RUB 1 billion to establish the framework for institutions of higher education and since promotion // RBC, November 13, 2018. URL: <https://www.rbc.ru/rbcfreenews/5bead0fb9a794784ff42fea0>

<sup>3</sup> The Academy is ready to cooperate with the Ministry of Education and Science to raise the ranking of Russian institutions of higher education in global rankings. October 28, 2018. URL: <https://tass.ru/obschestvo/5730212>

limit its efforts to paying a few visits to leading institutions of higher education. The initiative did not find support by institutions of higher education, as was expressed explicitly at a November 27 meeting of the Presidential Council for Science and Education<sup>1</sup>. The negative can be adequately explained by the ongoing “confrontation” between the parties. What is more, it is the Academy that quite often criticized institutions of higher education. In particular, President of the Academy Aleksandr Sergeev noted that universities started competing with each other in the field of science instead of training specialists, that is, what they are supposed to do as part of their core activity<sup>2</sup>.

*Table 20*

**Budget appropriations to Russian Academy of Science  
(a federal state-funded institution) in 2019–2021, RUB billion**

Type of expenditure	2019	2020	2021
Total	4.2	4.2	4.3
Including operational expenses (provision of services) of public institutions	2.3	2.3	2.4
National awards in literature and arts, education, print media, science and techniques and other awards for meritorious services to the state	1.9	1.9	1.9

*Source:* Schedule 8 to the Explanatory Note attached to the Federal Draft Law regarding the Federal Budget for 2018 and the 2020 and 2021 Planning Period.

Late in the year, the President of Russia criticized indirectly the Academy by pointing to the fact that it is not unusual when basic research topics remain the same for decades, with no outputs delivered. “Not a single research paper with coverage in any citation database has been issued” with regard to 40 percent of research topics underway in academic institutions. In other words, it appears that either there are no outputs at all, or there are outputs that are irrelevant.” However, since the Academy ceased to supervise research institutions five years ago, the responsibility for the above output is attributed not only to the legacy of the academic past but also to FASO Russia. In addition, the President criticized the fact that the 2017 performance measurement of the former academic research-performing organizations, including their division into three categories, failed to have led to any organizational and financial changes. The critique should rather be addressed to the Ministry of Science and Higher Education as the successor of FASO Russia.

Overall, managers of the Academy are in optimistic mood: according to the Academy’s President, there is no other entity but the Academy that can provide an independent and nonpartisan expertise in the field of basic and applied research underway in the country. Yet, there is no solid ground for the optimism. The Academy has not carried out assessments of the time input in all of its “scientific and

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<sup>1</sup> The verbatim records of a meeting of the Presidential Council for Science and Education. November 27, 2018. URL: <http://kremlin.ru/events/president/news/59203>

<sup>2</sup> The President of the Russian Academy of Science notes a decline in the knowledge and skills of graduates from Russian universities // RIA Novosti, May 25, 2018. URL: <https://ria.ru/society/20180525/1521320822.html>

methodological tasks”, given the average speed of works performed in the Academy<sup>1</sup>. Additionally, there are no guarantees that members of the Academy can provide an expert evaluation of any research topics. No “research performance” measurement has so far been applied to Academy members and corresponding members, on top of that they enjoy some privileges for their publication activities, including, for example, the right to publish non-reviewed articles in an academic journal called “Russian Academy of Science Reports” (RASR)<sup>2</sup> and also they are allowed to use such articles for the purpose of grants and public assignments. Therefore, the question of how the Academy is to exercise in full the function of country’s key expert in science still remains open.

### 6.3.2. New focus areas for national policy and national project for science

New focus areas of the national policy in the field of science were outlined in the Presidential Address to the Federal Assembly, initiating for the first time the linkage between “powerful infrastructure – talent acquisition and support to young people – research within research and educational centers”<sup>3</sup>. The same focus areas were recognized in an Executive Order of the President later in May<sup>4</sup>, commissioning the Russian government to develop the ‘Science’ National Project, which is to achieve the following goals set forth in the Executive Order:

- To raise Russia’s ranking to world’s top 5 nations that perform research and development within the scope of focus areas of scientific and technological development;
- To ensure that scientific research in the Russian Federation is appealing for Russian and foreign top scientists and young high-potential researchers;
- To ramp up local R&D inputs using all sources, so that they outperform growth rates in the gross domestic product.

A few objectives were formulated to achieve the foregoing goals: to establish an advanced infrastructure for research and development, to re-equip not less than 50 percent of instruments used by leading organizations that perform research and development, to establish scientific centers of various types.

The ‘Science’ National Project (SNP) became part of a new state program called “Scientific and Technological Development of the Russian Federation.” Despite the fact

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<sup>1</sup> A. Mekhanik. The Academy becomes key expert in science // *Expert*, No. 5, January 28, 2019. URL: <http://expert.ru/expert/2019/05/ran-stanovitsya-glavnyim-nauchnyim-ekspertom/>

<sup>2</sup> V. Vdovin. Privileges offer benefits. Why does RASR publish non-reviewed articles // *Poisk*, No. 5, February 01, 2019. URL: <http://www.poisknews.ru/theme/ran/41373/>

<sup>3</sup> Presidential Address to the Federal Assembly. March 01, 2018. URL: <http://kremlin.ru/events/president/news/56957>

<sup>4</sup> Russian President’s Executive Order No. 204 “On National Goals and Strategic Tasks of the Development of the Russian Federation until 2024”, dated May 7, 2018. URL: <http://kremlin.ru/acts/bank/43027>

that the State Program itself will not be endorsed until April 1, 2019<sup>1</sup>, the SNP gave rise to active debates back in late 2018. The project has the same three main objectives that were set forth in the Executive Order of the President.

The first objective is to raise Russia's ranking to world's top 5 leading nations that perform R&D in focus areas of growth (as identified in the Strategy for scientific and technological development of the country). The achievement of this objective will be measured exclusively through rankings, which may lead to false incentives. In particular, there are plans to raise the number of scientists in order to retain 4<sup>th</sup> place in international rankings regarding research personnel numbers, including plans to double publication numbers in order to move up in rankings.

The second objective is to make Russia appealing for Russian and foreign scientists as well as young researchers. However, the appeal will be measured by the number of foreign scientists working in Russian organizations regardless of the duration of their stay in the country rather than by enhancing the scientific workflow management, ensuring career tracks, inviting foreign scientists under long-term contracts (more than three years). If the duration of stay in Russia is of no importance, then "boosting" the number of foreign scientists would be no hardship. The second measure is precarious enough – there are plans to raise the number of researchers aged 39 or younger to 50.1 percent of the total number of researchers in the country – which may worsen the imbalance in the age structure of scientific personnel. It would be more appropriate for increase in the proportion of middle-aged (40–60) generation of researchers to be set as indicator, because any increase in this cohort would indicate that young individuals stay in science.

The third objective is to ramp up all R&D inputs using all available sources, in which case it would be more important to ramp up business sector's R&D inputs at outperforming growth rates, create a demand for research outputs. However, funding is expressed in a more softer manner in the SNP than even in the Strategy for Scientific and Technological Development of the Russian Federation with parallel funding as a goal. A little more than RUB 636 billion, including RUB 405 billion through state budget funding and around RUB 231 billion via extrabudgetary funding (that is, 36 percent of total inputs in the national project), are planned to be spent in 6 years (from 2019 to 2024) to implement all the activities that are to take place within the SNP framework.

The above objectives are planned to be achieved by implementing three projects: (1) to develop scientific and scientific-industrial cooperation, (2) to create an advanced infrastructure, and (3) to develop human resource potential. The state budget to extrabudgetary funding ratio for the total of three projects in 2019–2024 is presented in *Table 21*.

Known methods are expected to be applied for developing scientific and scientific-industrial cooperation: establishing various types of research and educational centers

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<sup>1</sup> A meeting of the Presidium of the Presidential Council for Strategic Development and National Projects. December 17, 2018. URL: <http://government.ru/news/35104/>

(RECs). Many various types of RECs, including both scientific and scientific-industrial RECs, have been established over the past 20+ years. This time, however, RECs constitute units that are much more bigger in size.

Table 21

**Funding plans for federal projects as part of ‘Science’  
National Project, 2019–2024**

Federal project	Total funding, RUB billion	State budget funding, RUB billion	Extrabudgetary funding, RUB billion	Proportion of extrabudgetary funding, percent
Development of scientific and scientific-industrial cooperation	215.0	57.3	157.7	73.3
Development of advanced infrastructure for research and development in the Russian Federation	350.0	276.6	73.4	21.0
Development of human resources in research and development	70.9	70.9	0	0

Source: ‘Science’ National Project’s data sheet (according to data available as of February 11, 2019).

Debates on what RECs should be are still in progress, involving a broad variety of opinions. The President of the Academy believes that RECs should be established on the basis of existing research-performing organizations or educational institutions and equipped with modern equipment and managed by an international supervisory board. His opponents believe that RECs should be linked to industries and intend to address tasks facing a specific territory. Furthermore, there is no good understanding of whether RECs should constitute a legal entity, a structural unit within a legal entity, or a team comprised of persons from different organizations. Also, neither is there understanding of criteria to identify leading organizations that can be qualified for the REC status. Whether it is only standard statistical parameters (publications, patents, etc.) that should be considered, or expert evaluations should be included as well?

According to the data sheet to the Federal Project on “Development of scientific and scientific-industrial cooperation”, there are plans to establish various types of RECs by 2024, including:

1. Not less than 15 world-class RECs through integration of universities and research institutes with enterprises. Such RECs can be established on a sector- or region-specific basis.
2. World-class international research centers, including a network of mathematical centers and genomic research centers – 3 genomic centers, 4 mathematical centers, 9 international centers according to the focus areas set forth in the Strategy for Scientific and Technological Development of the Russian Federation. It is a must for the above centers to attract young researchers, and key performance measures must include papers published in peer-reviewable journals.
3. Fourteen National Technological Initiative competence centers (NTI competence centers).

REC’s specific features, such as the presence of world-class scientific infrastructure, partnership with real sector organizations, regional government’s support, are under discussion. In particular, some experts opine that it is RECs that may come to participate

in the implementation of megascience projects. It is assumed that the key aspect in selecting organizations as the base for RECs will not be organization's type and characteristics but rather the interdepartmental nature of projects, however, if broadly interpreted, RECs must include science, education, industrial cooperation, and they altogether should promote territorial development. So far, the concept of "new REC" is therefore closest to the concept of federal university, which also provides for all types of cooperation, plus there is commitment to achieve regional goals. RECs no doubt differ from the other category of centers – world-class international centers – first of all in that the latter perform applied works.

Unlike RECs, an NTI competence center is a structural unit rather than an organization, which is established on the basis of research-performing or educational organization, whereas the NTI competence center constitutes a consortium of research-performing, educational and industrial organizations. It develops technological solutions for NTI cross-cutting technologies, and therefore a key reporting indicator for such a center would be the number of created technologies that are applied in the industry. Fourteen competence centers for cross-cutting technologies were set up back in 2018, funded by the Russian Venture Company. In fact, competence center consortiums have already started compiling a pool of projects.

According to the advanced infrastructure development project, there are plans to upgrade at least 50 percent of the instruments of leading organizations on top of the known objectives of constructing megascience units. The issue of enhancing the equipment utilization efficiency has not been raised, and focus areas are yet to be identified. For example, Russia has in recent years been lagging far behind countries that have the biggest number of high performance supercomputers. The presence of supercomputers in a country exhibits its data processing capacity. Supercomputers are employed in scientific research, aviation, healthcare, industry. Russia has two supercomputers and ranks at the bottom of the list of top 500 producers of supercomputers, whereas China (with 202 supercomputers), the United States (with 143 supercomputers) and Japan (with 35 supercomputers) rank on top of the list. Russia has no its own base of computer components needed for manufacturing supercomputers, which may further degrade the county's capacity amid sanctions because Russian supercomputers rely on US-made processors<sup>1</sup>. Perhaps, focus types of most expensive and unique units that need to be developed through state budget funding should be identified.

The third project focuses on supporting young people, being in line with the SNP's target. As noted above, this approach is precarious due to a threat of unbalancing the age structure of scientific personnel. Another point to note is that the SNP provides no factors that might make science appealing and relevant to young people. Furthermore, plans to increase substantially the publication feedback may discourage rather than motivate young people into science.

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<sup>1</sup> Mamedyarov Z. America conquers the summit // Expert, No. 26, June 25, 2018. URL: <http://expert.ru/expert/2018/26/amerikantsyi-pokorili-vershinu/>

There are plans within the framework of the same project to continue attracting top foreign specialists and to work with the Russian-speaking scientific community. New quantitative and qualitative targets set forth in the Science SNP can produce a need to revise a few initiatives that are currently taking place. In particular, a megagrants program (grants for establishing laboratories in research institutes and institutions of higher education under the auspices of world's top scientists, including representatives of the Russian-speaking scientific community) is still underway, but its format is somewhat obsolete in the light of new objectives such as, for example, doubling the publication activity. The program's requirements for publication numbers are too soft now compared to what they were at the 2010 onset of the program, while there were no quality requirements for research outputs whatsoever. Should this program become part of the national project, then the selection criteria for projects, not to mention reporting, should be revised and updated.

Cooperation with the Russian-speaking scientific community becomes more difficult amid sanctions. On the one hand, Russian-speaking scientists do show interest in cooperating with Russia, particularly with its more organized segments – from RASA and RuSciTech<sup>1</sup>. In particular, they offer assistance in enhancing the quality of scientific expertise<sup>2</sup>, developing Russian scientific journals. All these functions are important functions, and external expertise not only by Russian-speaking scientists is of great importance. There are other efforts – a few Russian universities launched interesting initiatives aimed at attracting Russian-born specialists. For example, the Siberian Federal University (SFU) has a program called Foreign Professor (funded through Project 5-100) designed to invite for a short term top foreign specialists as researchers and teachers. So far, all of the invited persons are Russian-born foreign specialists<sup>3</sup>. The new National Project, however, should also consider the fact that representatives of the Russian-speaking scientific community are yet not prepared to participate in projects that require them to stay long term in Russia, not to mention their returning back to Russia. For instance, according to a study of Boston Consulting Group, only 6 percent of professionals who emigrated to the Western Europe said they are ready to work in Russia<sup>4</sup>.

On the other hand, there are external factors that may constrain the development of relationship with Russian-speaking scientific communities in foreign countries. In particular, the unfolding U.S. policy aimed at shutting off outflows of important scientific and technological information to China has an adverse effect on China's project called National “*Thousand of Talents Program*” designed to attract scientists.

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<sup>1</sup> RASA is Russian-speaking Academic Science Association. URL: (<https://www.dumaem-porusski.org>), RuSciTech is an international association of Russian-speaking science and technology professionals living outside Russia. URL: (<http://ru-sci-tech.org/ru/>).

<sup>2</sup> Building bridges // Troitsky option – science, No. 267, November 20, 2018, P.4.

<sup>3</sup> A project called Foreign Professor kicked off at the Siberian Federal University (SFU). June 21, 2018. URL: <http://about.sfu-kras.ru/rating/5top100/news/20499>

<sup>4</sup> Half of Russian scientists say they want to emigrate. June 27, 2018. URL: <https://www.finanz.ru/novosti/aktsii/polovina-rossiyskikh-uchenykh-zayavili-o-zhelanii-emigrirovat-1027322119>



The next step was focused on similar programs of other countries. At present, legislative amendments are under consideration in the United States, whereby scientists participating in China's, Russia's and Iran's talents programs (megagrants programs as well as initiatives aimed at establishing international laboratories within the framework of Project 5-100 fall under this definition in Russia) shall not be entitled to grant-based funding from the U.S. Department of Defense and possibly from grant-based programs of other federal agencies.<sup>1</sup> The U.S. Department of Energy enforced a requirement early in 2019 whereby scientists/researchers who are participating or have plans to participate in Russia-funded projects must report to their senior managers. Accordingly, those who continue their participation in such programs will be advised to quit such programs or otherwise resign from U.S. public laboratories. Therefore, the number of Russia-born scientists interested in cooperating with Russia and working for public organizations is likely to be reduced in the offing.

Analysis of the composition of three federal projects as an attempt to apply a comprehensive approach to address science related issues leads to a conclusion that the focus on the relationship between science and real sector is restricted by a narrow segment related to the establishment of RECs and NTI competence centers. Overall, science remains a “thing in itself”, being out of touch with economic problems and led, more than ever before, by rankings.

What is also worth noting is that development projects just indirectly consider the influence factor of sanctions although they appear to be long-term. The impact of sanctions on science let alone technologies has so far been underestimated. The problem is recognized just indirectly, resulting in more frequent discussions about science as soft power and as a factor of positive influence and maintaining relations amid unfavorable geopolitical situation.

### 6.3.3. State budget funding of research and development

The past year saw public funding of research and development continue to increase, and the trend is expected to continue down the line. There are plans to increase substantially allocations in 2019–2021 to non-defense research and development compared to target appropriations in 2018–2020. Public funding in 2019–2021 will rise at 2–12 percent a year (see *Table 22*).

There is a positive trend towards funding of knowledge-based programs. For instance, the third most important R&D expenditure is now a program called Development of Healthcare (see *Table 23*), with a substantial increase in allocations relative to previous years' budget plans. This is a critical socio-economic area that was previously given insufficient attention as part of R&D, particularly when compared with developed countries.

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<sup>1</sup> Y. Sharma. Panic over US scrutiny of science talent programme // University World News, October 18, 2018, no.525. URL: <http://www.universityworldnews.com/article.php?story=20181018183445307>

Table 22

**Dynamics of allocations for non-defense research  
and development**

Indicator	2019	2020	2021
Federal budget expenditure on non-defense R&D, total, RUB billion	408.12	442.04	452.79
Year-to-year growth, percent	+12.7	+8.3	+2.4
Growth compared to the draft law for 2018-2020, each year, percent	+16.2	+1.2	-

Source: Schedule 8 to the Explanatory Note attached to the Federal Draft Law regarding the Federal Budget for 2018 and the 2020 and 2021 Planning Period; own calculations.

At the same time, expenditure on the development of electronic and radioelectronic industry remain relatively moderate, which poorly fits into plans on digitization and competitiveness in technological areas that are relevant for the national defense. There is a somewhat alarming trend towards further concentration of resources in a few programs, suggesting feeble prospects for raising funding in other areas.

In terms of the structure of expenditure by type of research – basic and applied research – there are plans to raise allocations for basic scientific research, so that by 2021 they account for 47.7 percent of total expenditure on non-defense scientific research and development.

Table 23

**Dynamics of allocations for scientific research and development  
to national programs with biggest funding of research  
and development (RUB billion)**

State Program	2018	2019	2020
Scientific and Technological Development of the Russian Federation	210.8	230.7	248.3
Space industry in Russia, 2013-2020	68.1	64.4	61.4
Development of healthcare	39.8	49.1	50.8
Development of aircraft industry, 2013-2025	36.6	44.8	39.8
Proportion of four programs in total allocations for non-defense R&D, percent	87.1	88.0	88.4
For reference: inputs in the program for “The Development of the Electronic and Radioelectronic Industry for 2013–2025”	9.1	9.7	9.7

Source: Schedule 8 to the Explanatory Note attached to the Federal Draft Law regarding the Federal Budget for 2018 and the 2020 and 2021 Planning Period; own calculations.

This conforms the level of European countries with the most developed scientific complex (France, UK). At the same time, the proportion of grant-based funding through two public scientific foundations – The Russian Science Foundation (RSF) and The Russian Foundation for Basic Research (RFBR) – will increase at a slower rate than allocations for basic research (see *Table 24*).

At present, grant-based funding by the foregoing foundations is far less than that in developed countries, accounting for 10.5 percent of total non-defense science spending, including that it will slide by 2021 to 10.1 percent. This is fuelled by the problem of “erosion” of foundations’ programs, a decrease in the proportion of programs focusing on supporting research topics that are initiated by scientists. In particular, there is an excessive bias towards supporting young scientists whose participation in scientific projects is compulsory (a fixed proportion of young scientists shall be observed).

*Table 24*

### Changes in volume of state budget allocations for basic research

Type of expenditure	2019	2020	2021
Basic research (subsection, Functional Classification of Costs (FCC)), RUB billion	179.4	199.5	215.9
<i>Proportion in total expenditure on non-defense R&amp;D, percent</i>	<i>44.0</i>	<i>45.1</i>	<i>47.7</i>
Russian Foundation for Basic Research (RFBR)	22.2	22.9	23.9
Russian Science Foundation (RSF)	20.8	21.3	21.9
<i>Proportion of RFBR and RSF in basic research expenditure, percent</i>	<i>24.0</i>	<i>22.2</i>	<i>21.2</i>

*Sources:* Schedule 10 and Schedule 13 to the Federal Draft Law regarding the Federal Budget for 2018 and the 2020 and 2021 Planning Period; own calculations.

The problem of grant-based funding lies also in heightened focus on quantitative performance measures in the form of strict requirements for the number of publications to be issued while performing grant-funded research. Plans for quantitative measures are considered during examination of applications for projects. However, such requirements make no guarantee of quality of research outputs. In this respect, there is a counter example – The European Research Council (ERC), one of the most successful funder in the EU. The ERC was established in 2007 with the aim to promote scientific research on topics that are suggested by scientists. There are no “pressing topics/themes” or lines of research contributing to responses to “grand challenges.” The sole evaluation criterion for applications for projects is the quality of research, excluding grant seekers’ scientometric data. The outcome is that ERC-funded research were awarded six Nobel Prizes and *Wolf Foundation Prizes*, three Fields Medals<sup>1</sup>. Things will possibly change in Russia too. As was noted at the most recent meeting of the Presidential Council for Science and Education, grants are yet to become catalyst to science development in Russia, and that topics for grand-funded research should be suggested by scientists<sup>2</sup>.

#### 6.3. 4. Regional aspects of scientific and technological development

Two objectives – “technological breakthrough”<sup>3</sup> and spacial development – were simultaneously announced past year<sup>4</sup>, which can set a new vector for the scientific and technological policy in Russia’s regions. Prior to the announcement, innovation clusters were created at the regional level upon initiation of the federal government, “smart specialization” was determined, the construction of “smart cities” was commenced. The focus now will shift towards accomplishing the tasks of implementing the ‘Science’

<sup>1</sup> A. Vaganov. The principle of research bottom-up funding in the European Union // *Nezavisimaya gazeta – science*, May 23, 2018. URL: [http://www.ng.ru/nauka/2018-05-23/10\\_7230\\_eurosouz.html](http://www.ng.ru/nauka/2018-05-23/10_7230_eurosouz.html)

<sup>2</sup> The verbatim records of a meeting of the Presidential Council for Science and Education. November 27, 2018. URL: <http://kremlin.ru/events/president/news/59203>

<sup>3</sup> Putin says Russia needs technological breakthrough. TASS, April 26, 2018. URL: <http://tass.ru/ekonomika/5161633>

<sup>4</sup> Putin offers to develop a special development program for Russia. RBC, March 1, 2018. URL: <https://realty.rbc.ru/news/5a97ca8a9a79475d3e2a6447>

National Project, including the establishment of RECs. It is understood that the Ministry of Science and Higher Education will establish and maintain relationship with regions in order to implement the National Project<sup>1</sup>. Although the project is yet to be endorsed, the work is underway to develop REC establishment concepts, involving regional government administrations of Krasnoyarsk, Tomsk, Novosibirsk, Irkutsk, the Altai Krai, Yakutsk and Tyumen.

Regional policies tend to pursue three goals. The first one is to identify focus areas of technological development that are not necessarily required to fall in line with respective focus areas at the nationwide level (it cannot be ruled out that academicians further translated this very component into the concept of “smart specialization”). The second goal is to coordinate between key stakeholders the critical elements of the policy in place. The third goal is to establish links between all the elements within the regional innovation framework in order to foster the development and transfer of technologies<sup>2</sup>.

There was much debate last year about a “smart cities” agenda as part of new focus areas of regional scientific and technological development. The Russia Digital Economy Program 2017 (DEP), followed by the Presidential Address to the Federal Assembly on March 01, 2018 and, lastly, the Executive Order of the President of May 7, 2018 concerning national objectives and development strategic tasks, raised the issue of “smart cities” to the top-priority level of the federal technological development policy. Initiatives at the regional level are therefore expected to appear. The progress in this area can in part be seen through growing number of media publications about the creation of “smart cities” or their elements in Russia’s regions. It is characteristic that a 3-year-old survey of the NRU HSE<sup>3</sup> showed that one of the key constraints to the promotion of “smart cities” in Russia is lukewarm support by regional and federal government authorities, being the reason for lack of incentives at the municipal level. Now there is an incentive. Moreover, it is the technological aspect that will most likely dominate, whereas the “managerial” approach aimed at aligning interests of all stakeholders will appear to be the weakest aspect. At least, it is the lack of consensus that has always been a “weakness” of the Russian innovation framework. According to foreign specialists, from the technological perspective it is important to address information security issues when creating “smart cities”, while from the social perspective it is important to keep in mind the issue of inclusiveness, which means that there should be no categories of people that are not

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<sup>1</sup> The verbatim records of a meeting of the Presidential Council for Science and Education. November 27, 2018. URL: <http://kremlin.ru/events/president/news/59203>

<sup>2</sup> K. Koschatzky and H.Kroll (2007). Which Side of the Coin? The Regional Governance of Science and Innovation, *Regional Studies*, Vol.41.8, pp.1117-1118.

<sup>3</sup> It was held in 2015. Source: Boikova M., Ilyina I., Salazkin M. A “smart” model of development as a response by cities to challenges // *Foresight*, 2016, Vol. 10, No. 3, P. 71.

involved in the life of a “smart city” (because, for example, elder people experience difficulties when mastering online services)<sup>1</sup>.

Another point to note is that all the subjects of the Russian Federation have raised their digitization budget expenditure, with leading regions focusing first of all on funding the creation of “smart cities”, while lagging regions on the development of selected types of services for individuals<sup>2</sup>. However, the shortage of funds in regional budgets as well as limited number of skilled personnel for accomplishing digitization remain a serious problem. To date, revenues have been redistributed between federal/central government and subjects of the Russian Federation in favor of the government. That is exactly why regional government authorities are highly interested in being involved in implementing federal initiatives in science and technologies, because doing so can open an extra source of funding to regions. In addition, regional government authorities are limited in their capacity and in distribution of areas of responsibility: the majority of universities and research institutions are owned by the federal government. Focusing on supporting high-tech companies in this context appear to be one of the most adequate and reasonable solutions alongside any initiatives aimed at establishing relations. Such processes are already in progress in Russia’s regions such as Tomsk, Irkutsk, Novosibirsk Oblasts.

There is a stand-alone initiative for regional scientific and technological development – a Novosibirsk Scientific Center’s project called Akademgorodok 2.0 (Russian: “Academic Town”). Akademgorodok 2.0 is comprised of 31 subprojects, including the most resource-intensive subprojects such as the construction of a synchrotron – the Siberian *Ring Source of Photons* (SKIF) – and the establishment of two national centers for high performance computing and genetic technologies. The project Akademgorodok 2.0 is estimated at RUB 500 billion (of state budget funding)<sup>3</sup>. None of the 31 subprojects, except SKIF, have so far been guaranteed funding from the funds allocated to the ‘Science’ National Project (the megaproject is estimated at RUB 40 billion)<sup>4</sup>. The decision to construct SKIF was made in February a year earlier by the Presidential Council for Science and Education. Besides public funding, local government authorities are banking on funding from the private sector which might be interested in developments of scientific centers integrated in Akademgorodok.

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<sup>1</sup> *Michinaga Kohno*: “Innopolis is an outdated model which should have been implemented 30 years ago.” April 12, 2018. URL: <https://realnoevremya.ru/articles/95516-intervyu-s-michinaga-kohno-ekspertom-po-umnym-gorodam>

<sup>2</sup> T. Kostyleva. A full version of regions rated by the development of digitization “Digital Russia” has been released. November 20, 2018. URL: <http://d-russia.ru/vyshla-polnaya-versiya-rejtinga-regionov-po-urovnyu-razvitiya-tsifrovizatsii-tsifrovaya-rossiya.html>

<sup>3</sup> Half a trillion rubles. For real breakthrough // *Expert*, No. 40, October 1, 2018. URL: <http://expert.ru/expert/2018/40/poltrilliona-rublej-za-nastoyaschij-proryiv/>

<sup>4</sup> B. Kork. Akademgorodok. Reloading // *Expert*, No. 40, October 1, 2018. URL: <http://expert.ru/expert/2018/40/akademgorodok-perezagruzka/>

However, there is no single view of how Akademgorodok should develop, and there is a sum of projects at various stages of maturity rather than a new development model. The above as well as rapid and closed nature of the concept development are the reasons why Akademgorodok 2.0 has been heavily criticized by external and local experts<sup>1</sup>.

### 6.3.5. Technological development

There were no breakthroughs in technological innovations. Overall, the level of companies' innovation activities remained low in all sectors: the proportion of industrial enterprises involved in technological innovation stood at 9.6 percent, posting a decline from the proportion seen amid sanctions in 2014<sup>2</sup>. There are other assessments, mostly expert ones, of the level of innovation activities, showing that the proportion of innovation-active companies stood at 15–20 percent<sup>3</sup>. This figure, however, is one half as high as that recorded by nations with the developed technological base.

Also, a decline to 8 percent (from 9.5 percent in 2014) was seen in the proportion of companies involved in technological innovation in the area of information and communication technologies (ICT). Moreover, there was a decline in corporate venture deals in the IT industry. Investments in 2018 were estimated at USD 151.3 million, much less than the amount (USD 246.6 million) recorded in 2017<sup>4</sup>. Furthermore, analysis of IT-startups engaged in deals with corporations showed that the majority of purchased startups were startups whose founders were former co-owners and senior managers of medium-sized and big IT-companies, managers of IT-units and former corporate managers. At the same time, software exports continued to advance because, among other things, flagship companies swiftly refocused to new markets<sup>5</sup>. The 2018 year-end exports ran at more than USD 10 billion, twice the amount registered five years ago<sup>6</sup>. Furthermore, exports started outpacing sales in the domestic market.

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<sup>1</sup> See, for example, a detailed analysis of the project's weaknesses: S. Smirnov. "We moving backwards." Humanitarian expertise of Akademgorodok 2.0 project. February 06, 2019. URL: <https://tayga.info/144882>

<sup>2</sup> Fridlyanova S. Innovations in Russia: Key measures dynamics. Express information "Science, technologies, innovation". M.: NRU HSE, September 26, 2018. URL: [https://issek.hse.ru/data/2018/09/26/1153998102/NTI\\_N\\_103\\_26092018.pdf.pdf](https://issek.hse.ru/data/2018/09/26/1153998102/NTI_N_103_26092018.pdf.pdf)

<sup>3</sup> Butrin D. "We have managed to launch a few technologically active sectors" // Kommersant, No. 55, December 03, 2018 P. 4. URL: <https://www.kommersant.ru/gallery/3814084>

<sup>4</sup> Y. Ammosov, A. Levashov. Corporate ventures in Russia's IT industry. TAdviser study. November 19, 2018. URL: [http://www.tadviser.ru/index.php/Статья:Исследование\\_TAdviser\\_«Корпоративный\\_венчур\\_в\\_ИТ-индустрии\\_России»](http://www.tadviser.ru/index.php/Статья:Исследование_TAdviser_«Корпоративный_венчур_в_ИТ-индустрии_России»)

<sup>5</sup> For example, Kaspersky Lab's global sales proceeds have increased in the face of European and U.S. sanctions by virtue of refocusing on markets in CIS countries, Africa and the Middle East. Source: M. Maiorov. Hacker's nightmare. URL: <https://stimul.online/articles/kompaniya/strashnyy-son-khakera/>

<sup>6</sup> Growth program: Russian software sales abroad top all-time highs // Expert, No. 7, February 11, 2019. URL: <http://expert.ru/expert/2019/07/programma-rosta-prodazhi-rossijskogo-softa-za-rubezhom-byut-rekordyi/>

Overall, H1 2018 saw transactions in the venture market drop in numbers as cumulative investment rise. This could be a sign of investors increasingly opting for conservative investment in “reliable” companies, as also evidenced by changes in preferred industries, such as contraction in the proportion of biotechnologies and increase in the segments of e-commerce, logistics and transport<sup>1</sup>.

The tools in use to encourage technological development have so far had insufficient effect on all types of companies, including big, medium-sized and small companies. According to a report of consulting firm *A.T. Kearney*, Russia has lost dynamics of its industrial development (Industry 4.0) due to, first of all, immaturity of both the institutional structure and the development of technologies and innovations<sup>2</sup>.

Also, there are policies focusing on the promotion of cooperation between companies and research-performing organizations and institutions of higher education, and on R&D outsourcing to companies. For example, innovation development programs running since 2010 at big companies with government equity participation are supposed to have a compulsory component such as cooperation with institutions of higher education. Despite the fact that companies allocated their resources for the purpose, more often there was no cooperation, but rather a sort of co-funding of research performed by institutions of higher education whose outputs were by no means always in demand. To date, as little as 3 percent of scientific projects of institutions of higher education have been implemented to the benefit of business companies, according to data from NRU HSE’s education economics monitoring 2018<sup>3</sup>. Therefore, there was neither visible growth in patent activities, nor any serious increase in exports of technologies, expansion of the country’s segment of small and medium-sized innovative companies. Products manufactured by non-energy small and medium-sized enterprises were marketable mostly in the domestic market, as evidenced by a small proportion of exporters, particularly when compared with innovation-led developed countries (see *Table 25*).

Analysis of the performance of public support instruments showed that the highest positive effect was due to Innovation Promotion Fund’s programs<sup>4</sup>.

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<sup>1</sup> Focus on Internet users // RBC, November 06, 2018. URL: [https://www.rbc.ru/technology\\_and\\_media/06/11/2018/5bdc51819a79472f04cb2f46?from=main](https://www.rbc.ru/technology_and_media/06/11/2018/5bdc51819a79472f04cb2f46?from=main)

<sup>2</sup> Readiness for the Future of Production Report 2018. WEF in Collaboration with A.T.Kearney. URL: [http://www3.weforum.org/docs/FOP\\_Readiness\\_Report\\_2018.pdf](http://www3.weforum.org/docs/FOP_Readiness_Report_2018.pdf)

<sup>3</sup> Andruschuk. Science and business // Kommersant, August 13, 2018. URL: <https://www.kommersant.ru/doc/3712714>

<sup>4</sup> The National Report on Innovations in Russia 2017. Ministry of Economic Development, Open Government, RBC, 2018.

Table 25

**Proportion of exporters of non-energy commodities  
in small and medium-sized  
enterprises**

Country	Proportion of exporters in small enterprises, percent	Proportion of exporters in medium-sized enterprises, percent
Russia	10.0	9.6
France	50.7	86.5
Hungary	53.3	78.6
Germany	42.5	69.2
U.S.A.	27.5	58.7

Source: Microeconomics of exports. Rating of Russian biggest exporters. Special report. // Expert, No. 39, September 24, 2018 URL: <http://expert.ru/expert/2018/39/mikroekonomika-eksporta/>

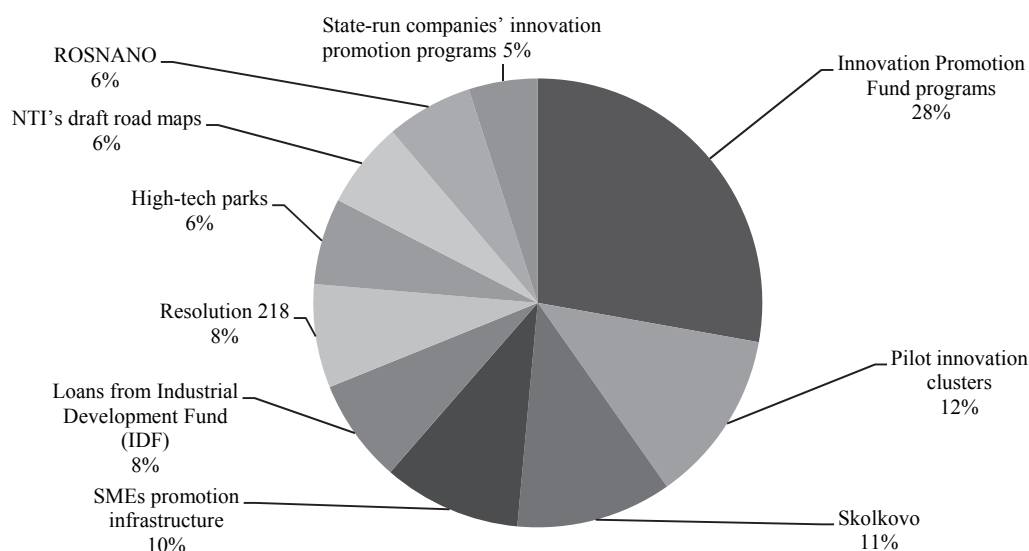
The rest of the instruments, according to experts, had a minor effect in recent 5 years on the development of innovations. The weakest effect came from instruments such as innovation promotion programs for big companies with government equity participation, ROSNANO's projects as well as projects implemented as part of the National Technological Initiative road maps (see Fig. 3). It was the NTI that was recognized as lagging behind original technological development plans for target markets. In particular, while three years ago Russia was competing in the *AeroNet market* with the United States in the development of remotely piloted vehicles, now Russia is visibly lagging behind its competitors<sup>1</sup>. The development is nevertheless moving forward – 8 NTI's road maps have been approved, with 450 projects worked out, including around 10 percent projects in progress<sup>2</sup>.

A slowdown in the development was a catalyst to the revision of approaches, resulting in three main lines of further NTI development. The first line is to establish infrastructural centers for each NTI market. The centers will be information and analytical entities specializing in indentifying new trends, holding conferences and online workshops as well as providing organizational support to startups. Therefore, companies operating in NTI markets will receive organizational and analytical and network interconnection support. The second line is to establish financial institutions designed to support startups, and the third line is to set up NTI competence centers (already in progress), where the NTI is to be aligned with the new 'Science' National Project: the creation of new NTI competence centers is an objective to accomplish as part of the National Project. The above policies are intended to contribute to the emergence of higher-quality projects for NTI cross-cutting technologies.

<sup>1</sup> Edovina T. "Technological development requires new forms and formats of organization" // Kommersant, No. 55, December 03, 2018, P. 15. URL: <https://www.kommersant.ru/doc/3814104>

<sup>2</sup> Butrin D. "We have managed to launch a series of technologically active sectors" // Kommersant, No. 55, December 03, 2018, P. 4. URL: <https://www.kommersant.ru/gallery/3814084>





*Fig. 3.* Public support policies that have contributed most to promoting technological innovations in recent 5 years

*Source:* National Report on Innovations in Russia 2017. Ministry of Economy, Open Government, Russian Venture Company (RVC), 2018. P.21.

The Russia Digital Economy national program, which underwent changes during the year, could be another incentive for technological development. There is a basis for enhancing the digital development – according to recent data, digital economy has contributed 5.6 percent to Russia’s GDP, surpassing the proportion of agricultural industry<sup>1</sup>. In addition, a survey 2018 of Skolkovo Business School revealed that managers in charge of digital transformation at some key state-run corporations have different views on how it should be implemented in their companies. This implies a wide range of new solutions rather than a lack of clarity over the matter of discussion. An important aspect of digital technologies development programs is the idea of relying upon companies. To date, 12 companies that are prepared to draft road maps for technological development have been identified, most of which are ready to be involved in the development of 2–3 technologies<sup>2</sup>. The front-runners are Rostech with plans to develop road maps for 7 digital technologies and MTS with road maps for 5 technologies. Companies that are involved in the development of road maps will have an opportunity to take the lead in technologies they select. This approach reminds of the principles of developing NTI road maps that have provisions for leadership and for responsibility of parent corporate developers for outputs. Although the approach has not

<sup>1</sup> Korovkin V. Russia facing the risk of missing “digital” opportunity for economic growth // ZNAK, December 05, 2018. URL: [https://www.znak.com/2018-12-05/rossiya\\_riskuet\\_upustit\\_cifrovoy\\_shans\\_na\\_ekonomicheskij\\_rost](https://www.znak.com/2018-12-05/rossiya_riskuet_upustit_cifrovoy_shans_na_ekonomicheskij_rost)

<sup>2</sup> E. Balenko, A. Balashova, E. Litova. Companies to qualify for developing Digital Economy technologies // RBC, February 05, 2019. URL: [https://www.rbc.ru/technology\\_and\\_media/05/02/2019/5c5820119a794707cf8ada4a?fbclid=IwAR2C0J5gpkxteRgCwFJhm8AW960oo29N-zPcnUQ4103SK9zfUHdxX4W1XIU](https://www.rbc.ru/technology_and_media/05/02/2019/5c5820119a794707cf8ada4a?fbclid=IwAR2C0J5gpkxteRgCwFJhm8AW960oo29N-zPcnUQ4103SK9zfUHdxX4W1XIU)

yet delivered unambiguously positive outputs, the Russia Digital Economy Program provides for the possibility to harness the NTI experience.

Despite a few advancements made so far, they are insufficient to change the overall technological innovations development landscape, and public support policies are yet to become more efficient. There are few reasons for that. The first reason is that federal funding of research and development is dominant even in the business sector, which somehow weakens business initiatives while supporting the practice of “state-funded innovation.” The second reason is that innovations within the country have minor influence on the ability to compete. Access to administrative resources, particularly for big companies, remains the key aspect. The third reason lies in the fact that the level of innovation activities is determined by far not only the presence of policies designed to stimulate innovations. Basic economic factors (for example, terms of bank loans) are just as much important, but they at best do not interfere with the development of innovative processes.

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Science in Russia is facing long-lasting problems of quantitative and qualitative parameters of the scientific potential and the structure of funding. The proportion of public funding remains high as never before, no serious incentives have been offered to encourage the business sector to invest in research and development, the promotion of technological innovations has not yet delivered scalable outputs. Sanctions have so far failed to have an effect in terms of promoting own advanced export-led technologies.

There is a positive shift in basic and exploratory research, publication activities are on the rise in institutions of higher education and in the public sector. It is important that leading institutions of higher education have started harnessing the incentives to raise the number and the quality of publications. Activities aimed at promoting Russian journals in international databases, namely Web of Science and Scopus, also contribute to the profile of Russian science.

As envisioned by the Russian government, the rationale and quality of scientific research should be raised due to new functions of the Academy which will be in charge of scientific and methodological management of all the organizations across the country that perform state-funded research and development. The solution, however, has some problematic aspects, namely the Academy’s human resources are insufficient to meet the required volumes of expertise, the Academy’s mandate to make decisions without having to bear responsibility for them, as well as increase in the already heavy bureaucratic burden on research-performing organizations and institutions of higher education.

Science is regarded as inherent value, according to new public scientific development plans, which is a positive, to a certain extent, factor, indicating that the state recognizes this area as an important area. There are plans to raise state budget funding of basic science and to enhance human resource potential. However, some of the new policies ignore the existence of (HR, financial, organizational) misalignments in science. The new projects continue to show the gap between scientific development targets and economic needs of the country, and there is a prevalent focus on various ratings.