

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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Main events

By the results of the general election, four parties got access to the Duma. The outcome of the Duma elections can be summarized as a successful “referendum to test confidence in Putin”, which yielded a positive result, although the methodology of its actual implementation has cast doubt as to its legitimacy. The candidate to succeed to the post of this country’s president has been determined. As to V. Putin, he himself was offered the post of Prime Minister by D. Medvedev, in the event of the latter’s very likely victory in the presidential election. Such developments may give rise to the emergence of an institute of co-rulers, wherein Medvedev’s role will be eventually becoming more prominent, while that of Putin will diminish. The stability of this dual power will depend, most importantly, on adequacy of the levels of political ambitions of them both.

Inflation in November remained high, CPI amounted to 1.2 % against 0.6 % in November 2006. At the same time, international reserve assets continued to grow, their volume in this country by mid-December having become more than \$ 467 billion. In November – December the situation on RF interbank market was stabilized both due to the appearance on the market of the funds allocated by the Government in order to finance development institutions, and to the measures undertaken by the Bank of Russia.

Federal budget expenditure in November was much higher than revenue. This had to do both with the uneven spending of budget resources throughout the year and with the considerable softening of budgeting policy within the political cycle’s framework. Growth of budget expenditure directly resulted in the enhanced inflation rate observed toward the year’s end.

In October 2007 the volumes of exports and imports reached their historic high of the last 17 years. The second half-year was characterized by an increased role of the price factor in the formation of external trade aggregates. The exports growth rate in October, for the first time during the year, became higher than that of imports. At the same time, the number of countries with which Russia has a negative balance of trade is also growing. Russia and Poland signed a memorandum lifting the more than two-year-long ban on supplies of Polish meat to Russia, which should help in providing solutions to a number of strategic issues of foreign trade integration.

Another record of 2007 was an increase in the share of investments in fixed assets up to 19.4 % of GDP. In 2007 the volume of investments, according to preliminary estimations, rose by 18.8 % against 13.7 % in 2006 and against the average 12.1 % observed in 2000 - 2005. The high rate of investment demand was sustained by an increasing role of the domestic market in the shaping of the economy’s dynamics.

As estimated by directors of enterprises, the year 2007 was rounding up in a situation of a noticeable slowdown in demand throughout industry, which prompted enterprises to suppress their output growth. The output growth forecasts for early 2008 are less optimistic than similar forecasts made in late 2006. In Q IV the financial and economic status of enterprises was no longer improving, while at the same time approximately 90 % of enterprises are assessing their financial situation as good or satisfactory.

In December the Russian stock market demonstrated growth of quotations on the share market, which was associated with more positive global expectations concerning investments. Investor activity on the market of derivative financial instruments displayed a stable growth rate.

At the RF Government meeting the implementation of federal target programs and the federal targeted investment program during the first 9 months of 2007 was discussed in detail. On the basis of a newly adopted federal law, one more big state-owned corporation – “Rostekhnologia” – will be created. Besides, several important economic laws were approved, including the Laws “On mutual insurance” and “On self-regulating organizations”.

The political and economic results of January 2008

S. Zhavoronkov

The month’s most important political event is the presidential election campaign. Beside the candidates nominated by parliamentary parties – Medvedev, Ziuganov and Zhirinovskiy, - only one candidate was registered, the Kremlin’s back-up figure Bogdanov. Former Prime Minister Kasianov was denied registration. Thus, the authorities deliberately chose the way of de-legitimizing the forthcoming election by cutting off the democratic opposition, even in view of the fact that Kasianov represents no threat for “the successor” being elected. Medvedev’s most impressive pre-election promise was the declaration that “already in the next few years we are planning to double the amount of pension”.

After the eventful December, which encompassed both the parliamentary elections and the determination of the candidate to become the president's successor, January turned out to be less illustrative in terms of political news. Nevertheless, it still provided background for further developing some of the themes that dominated the discussions in December.

The development of the presidential election campaign, without any doubt, should be considered the most important event. This campaign in Russia, in fact, will last only one month (the previous month being spent on the registration of candidates). Thus, the current regime, with its monopoly of TV channels, gains considerable advantages, since it actually becomes intermittently in the lead of the election campaign, while its opponents can obtain access to the forms of promotion available to them only during the last month preceding the election. However, even this was not sufficient for the authorities. In addition to D. Medvedev, G. Ziuganov and V. Zhirinovskiy, nominated by parliamentary parties, only one candidate was registered, the Kremlin's back-up appointee A. Bogdanov. Registration was denied to Former Prime Minister M. Kasianov because of lack of proper formalization of the signatures collected in his support. This situation gives rise to many questions in view of the fact that A. Bogdanov, whose organization during the parliamentary elections one month ago collected less than 90,000 votes across the country, within the next month, according to the authorities, managed to collect 2 million properly formalized signatures – which means that during that time the support for this virtually unknown politician increased 20-fold (!).

Thus, the authority quite consciously chose the way of de-legitimizing the forthcoming election, from which the democratic opposition has been cut off, even in view of the fact that Kasianov represents no threat for “the successor”'s election. It is interesting to note that the issue of Kasianov's registration was not predetermined – in December many pro-Kremlin mass media predicted both his registration and the negligible percentage of votes that he would be capable to collect at the presidential election.

It is not easy for us to judge which particular groups of influence in the Kremlin turned out to be winners as a result of such a decision. But the most probable reasons for the denial of registration could be as follows. Firstly, the authorities may have feared that the number of votes gained by Kasianov at the polls would fail to equip him with the “popularity credit” for the future. In view of the very low results obtained by SPS and “Yabloko” at the last elections, the fact of Kasianov having gathered even as few as 5 – 7 % of votes would have been regarded by the liberal electorate as success, this outcome of the election becoming quite possible if sufficient funding was to be allocated to the election campaign. Secondly, there could have been a fully conscious desire not to invest the presidential election with more legitimacy than the parliamentary elections, given that the lower level of competition and smaller resources available to those participants in the presidential election campaign who represent rivals to the authorities' appointee would predetermine for the “«successor” not a lower, but a higher result than that demonstrated in December 2007 by United Russia's list of candidates headed by V. Putin. This assumption has been confirmed by both the official sociologists and independent surveys. Thirdly, there was fear that an independent candidate would choose the way of appointing multiple observers and using aggressively the information on violations gathered by those observers during the election. Although the Communist Party of the Russian Federation (*CPRF*) also regularly place their observers at the election polls, the Communists have never applied the results of their observations for any serious purposes¹.

Thus, the Russian authorities are in some respects ahead even of the Belarusian and Kazakh leaders who, despite their questionable manner of counting votes, have never prevented the opposition to put forth their candidates. The scale of diminishing the opposition's representation at the election, by comparison with the year 2004, is also impressive – then there were three candidates from radical opposition (I. Khakamada, S. Glaziev and I. Rybkin). No less illustrative is the fact that, similarly to the parliamentary elections, there were problems with invitations for observers from the EU countries. The formally alternative options available during the Russian elections (also available, by the way, in Turkmenistan and Uzbekistan) cannot change the existing situation in any radical way.

Many had expected that D. Medvedev, during the first month after his “nomination” as the “successor”, would declare his political program, provided that some experts described him as a moderate liberal. However, so far his most impressive pre-election promise was that “already in the next few years we are planning to double the pension, and for this purpose the State, together with employers, will take measures aimed at forming pension capital.”

¹ Thus, the results of the recent parliamentary elections were disputed by the *CPRF* only in the case of Mordovia, while in Ingushetia, where the turn-out was 99 %, and the same 99 % of the vote was in favor of the “party of power”, the chairman of the regional organization of the *CPRF* went as far as to confirm the official results.

The very obvious loss of control over inflation has served as an important backdrop for the forthcoming election. According to official estimates, its rate was approximately 12 % in 2007, although those who are criticizing the government insist that the growth rate of prices of basic consumer goods was much higher. Although January is traditionally considered to be an unfavorable month from the point of view of growth of prices, inflation for the second time within a very short period of time became the focus of a broad public discussion. This, most probably, was the reason why the government extended the term (which was to expire on February 1) of the agreement with big producers and sellers of foodstuffs concerning the “freezing” of the prices of socially important products for another three months – until May 1, 2008, that is, in fact, until the “successor”’s inauguration. So far the government has not departed from the principles of market economy (these “agreements” being rather of an indicative character), although the calls for administrative regulation of prices, nearly forgotten for some years, sound rather alarming.

Actually, Medvedev did deliver a long political speech at the All-Russian Civil Forum, but he said little that was new, having just repeated the “stability” slogan, and stated that his priorities are “liberty, justice, civil dignity of man, his well-being and social responsibility”. There already exist both democracy and civil society, he declared, but with a certain unnamed national specificity. Developed countries beware of Russia for lack of proper understanding. It seems that the only innovative feature was an alarmist reference to corruption: “... Russia is a country of legal nihilism, no European country can boast of such a level of disregard of law. The struggle against corruption must be turned into a national program. ... Corruption ...has today an enormous scope.” To businesses, Medvedev promised that “we are going to follow a steady course toward free development of entrepreneurship [and] protection of the property right.” Most of such declarations have little bearing on real politics, despite being repeated every year.

By the way, the first month of “successorship” was marked by a number of repressions of a symbolic character – the virtual closing-down of the educational British Council in Russia, “the Aleksanyan case”², “the Morar’ case”³, “the Kozlovsky case”⁴, “the Arakcheev case”⁵. We are by no means claiming that D. Medvedev is personally responsible for such episodes – moreover, they could well be contrary to his interests. Nevertheless, it is important to note that no “thaw” can as yet be felt in the air – although, perhaps, it would be naïve to expect any such thing before Medvedev’s officially assumes the post of “successor” – that is, before May.

The year’s beginning was marked by two politico – economic scandals. The biggest of these was the detainment in Moscow of a person previously known as Semion Mogilevich (by now it has become known that he also carries a passport issued in name of Sergei Shnaider). Mogilevich is wanted by the police in several countries, including the USA, since the late 1990s on the accusation of large-scale fraud. At the same time he is believed to have been one of the shadow beneficiaries of *RosUkrEnergo* – an intermediary in export supplies of gas to Ukraine, because many posts in that company were held by former executives from its predecessor - Eural Trans Gas, in whose foundation Mogilevich had formally participated. Western media have often pointed to Rosukrenergo’s interesting connections, including the fact that Rosukrenergo is being supervised by head of Gazprom’s legal department, D. Medvedev’s former university “classmate” K. Chiuichenko, but the usual answer has always been that Gazprom and its affiliations have no relation to Mogilevich. And now it has been revealed that Mogilevich has not only been hiding in Russia, but managed, while having been declared as wanted by the police, to change his surname by legal means and to live under this surname quite legally. The formal charges against Mogilevich are rather shaky. He is charged with tax evasion in respect to the chain stores “Arbat-Prestizh”, where he formally is neither a shareholder nor a responsible executive. It is rather easy to understand why the law enforcement agencies have become so interested in Mogilevich – Shnaider now, in view of a forthcoming presidential election, and this is yet another proof that so far the “successor”’s political weight is insufficient – he has been unable to prevent a scandal of such a scope.

² One of Yukos’ managers, now in custody, in whose respect the European Court of Human Rights passed a resolution that he should immediately receive medical treatment; the resolution was simply ignored in Russia for nearly a month.

³ A journalist of the New York Times, who published her investigation of the Duma election campaign’s financing; she lived in Russia for a long period of time, applied for Russian citizenship, and was deported from Russia.

⁴ Coordinator of “Oborona” [“Defense”] movement, who several years ago graduated from a higher educational establishment with a military chair, was accused of evading the draft and drafted into the ranks as a private.

⁵ Lieutenant of the Russian Army, fought in Chechnya. Was charged with murdering civilians, pleaded not guilty, was twice acquitted by the jury for the absence of a crime in the act, then sentenced to 15 years of deprivation of freedom by a military tribunal. The sentencing of Arakcheev was demanded by the Chechen leadership on the grounds of the “will of the Chechen people.”

The second scandal occurred within the Federal Service for environment protection, whose supervision is very important both for the mineral resources sectors and for the owners of expensive houses near Moscow. The Service's head S. Sai handed in his resignation, stating that he did not wish to work together with his deputy O. Mitvol. Mitvol also resigned, saying that he was being prosecuted for his active standpoint, which usually had lost its importance after licenses had been transferred to Gazprom's structures⁶. Indeed, later on Sai was forced to leave, but he was replaced not by his belligerent deputy but by a former official from St. Petersburg, V. Kirillov. Thus, one of the main executives of "velvet nationalization" still kept his post in the government.

In January, Russia suffered a painful failure on the international arena, at the very last moment being deprived of the right to put forward its candidate, Senator M. Margelov, to the post of the PACE's head⁷. This was partly compensated for by success on the economic front: Russia was able to settle the "meat conflict" with Poland, and the new Polish government called off its objections to the signing of a new agreement on Russia-EU cooperation⁸, which it had been torpedoing for more than a year. The rumors as to the appointment to the post of Russia's representative in NATO of the Rodina party's former leader D. Rogozhin, who remarked that he "had always disliked the opposition's role". This was a rather successful move on the part of the authorities, since it both removed a domestic opponent and placed an active supporter on the diplomatic front.

And finally, regional federal army headquarters declared in January that the greater part of the territory of Ingushetia was to be turned into a "zone of counter-terrorist operation". The trigger was the preparation for a republic-scale meeting of the opposition against the Republic's head M. Ziazikov – disguised, however, as a 'meeting in support of Putin's policy'. Special-police units from neighboring regions – Chechnya and North Osetia – were moved into the Republic. The meeting was called off for the time being, but nevertheless the authorities thereby admitted that the Republic was faced with an extraordinary situation – the local units of the Ministry of Internal Affairs could no longer ensure the performance of their main functions.

Inflation, Monetary and Credit Policy

P. Trunin

As of December results, the CPI stayed a high level, having reached 1.1 per cent as compared with 0.8 per cent in the relevant period of the preceding year. Therefore, consumer prices have increased by 11.9 per cent in 2007, whereas the CPI in 2006 9,1 per cent. Herewith, foreign currency assets were being accumulated in the country, the volume of which amounted to USD 476.4 bln. In December, the situation in the RF inter-banking market has been completely stabilized as a result of the funds inflow, allocated by the Russian government for Institutions of Development financing and the Bank of Russia measures, aimed at expansion of liquidity reserves, accessible to the Russian credit organizations.

The consumer price index in December made 1.1 per cent (against 0.8 per cent in December 2006 (see Fig. 1.). The greatest contribution to the prices growth in November (+ 1.6 per cent), like in previous months, was made by an upsurge of prices for food stuffs. Herewith, the agreement of the government with the leading trade networks to freeze prices for socially significant goods, signed in October, apparently provided some effect on the inflation rates: the growth rate in food prices in December fell down to +1.6 per cent per month from the level of + 3.3 per cent per month in October. Nevertheless, those measures will apparently have only short-term effect and the prices rates will move upward again as soon as the restrictive measures are cancelled⁹. In December, the highest growth rates were noted in fruit and vegetables (+5.6 per cent), milk and dairy products (+2.5 per cent), butter (+2 per cent). Prices for granulated sugar went down in December by 1 per cent.

In December, high rates of growth were observed also in regard to non-food items, which average nationwide prices have increased during the month by 0.7 per cent (+0.5 per cent in December 2006). The highest growth rates were noted in December for motor gasoline (+3.6 per cent), knitwear (+0.8 per cent), clothes

⁶ The oilmen were not alone in applying to court with an action against Mitvol – Governor of Moscow Oblast Gromov, for example, did the same.

⁷ Traditionally, the election is based on the principle of rotation among the PACE factions, but two of the largest factions – the European People's Party and the Left Socialists – had this time purposefully changed the procedure so as to deny Markelov, nominated by the small faction "European Democrats", the possibility of becoming the PACE's head.

⁸ However, it cannot be entirely ruled out that Lithuania or the United Kingdom will raise their objections.

⁹ On January 31, 2008 the validity term of the Agreement on Prices Freezing was extended till May 1.

and underwear (+0.8 per cent), tobacco (+0. per cent), as well as detergents and cleaning agents (+0.7 per cent). No downgrading was observed in any type of non-food items.

Commercial public services have grown in price in December by 0.9 per cent (+0.7 per cent in December 2006). The utmost growth was observed in regard to public transport (+3.8 per cent), health-care and resort services (+1.3 per cent), housing utilities (+1.1 per cent), healthcare services (+0.9 per cent), as well as fitness and sports (+0.9 per cent).

Therefore, consumer price growth rate has somewhat decreased as compared with November, though it was still higher than in 2006. In January 2008 the RF Ministry of Economic Development and Ministry of Finance have presented to the government a Work Plan on suppressing consumer prices growth rate for 2008. Measures, included in the Plan, are aimed primarily at development of trade infrastructure, enhancement of control measures over prices for the products of monopolies in natural resources and competition promotion. Undoubtedly, such proposals are reasonable and potentially capable to provide positive effect on the inflation rate in the country.

Undoubtedly, such proposals are sound and can positively influence the inflation rate in the country. However, it is not clearly articulated in the plan, what measures of fiscal or monetary and credit policy could reduce the inflation in the short term. It is clear that at the current phase of political cycle, it is hardly feasible to reduce government expenditures, whereas high oil prices and potential capital inflow create all grounds for the expansion of monetary offer and inflation growth in 2008.

At the same time, we believe the following measures could help to restrain inflation in 2008:

1. Avoid the growth of social spending over the level of estimated budget for 2008;
2. Restrict growth rates of tariffs for housing utilities by measures of administrative regulation in the range of 10-15 per cent;
3. Avoid growth of the total non-interest federal budget expenses in excess of the estimates, specified in the three-year financial plan. Apply more strict measures to suppress excessive monetary offer;
4. Observe compliance with the existing legislation, according to which surplus revenues of the federal budget should be forwarded to the National Welfare Fund and Reserve Fund, rather than addressed for expenditures;
5. Restrict external loans for government institutions and enterprises with substantial government participation and replace them with domestic borrowings.

In December 2007 the basic consumer price index¹⁰ amounted to 0.9 per cent (against 0.7 per cent in the relevant period of preceding year). In our understanding, this fact is quite a natural consequence of turbulent expansion in the monetary offer in the past year, as well as an upsurge of prices for food products, observed in autumn.

Within December 2007, the volume of monetary base (in broad definition¹¹) has been increased by RUR 862.9 bln to the amount of RUR 5513.3 bln (+18.6 %).

Let us consider the dynamics of monetary base in broad definition by components.

The volume of cash in circulation, including the cash balances of credit institutions, as of January 1, 2008 was RUR 4.12 trillion (+ 13.1 per cent as compared with December 1), the correspondent accounts of credit institutions with the Bank of Russia made RUR 802.2 bln (+18.4 per cent), mandatory reserves – RUR 221.6 bln (- 0.5 per cent), banks' deposits with the Bank of Russia – RUR 270.3 bln (+ 108.9 per cent), the value of the Bank of Russia's bonds held by credit institutions – RUR 100.7 bln (+ 291.2 per cent). Therefore, there was noted further growth of commercial banks reserves with the RF Central Bank, which has started in November, based on the assets, allocated by the government to the Development Institutions. Stability retention in the interbank market in 2008 will be largely determined by the dynamics of budget expenditures, as well as an inflow of private capital and export earnings to the country.

¹⁰ Basic index of consumer prices is an indicator of the inflation level without regard to seasonal price reduction (fruit and vegetable products) and to administrative measures (tariffs for government-regulated services, etc.). It is estimated by the RF Statistics Service

¹¹ The RF monetary base in broad terms with no regard to the cash issued by the Bank of Russia and the balance of Compulsory Reserve Accounts on credit organizations in national currency, deposited in the Bank of Russia, taking into account the assets of correspondent accounts and bank deposits, allocated in the Bank of Russia..

The Growth Rate of the CPI in 2002 - 2007 (% per month).

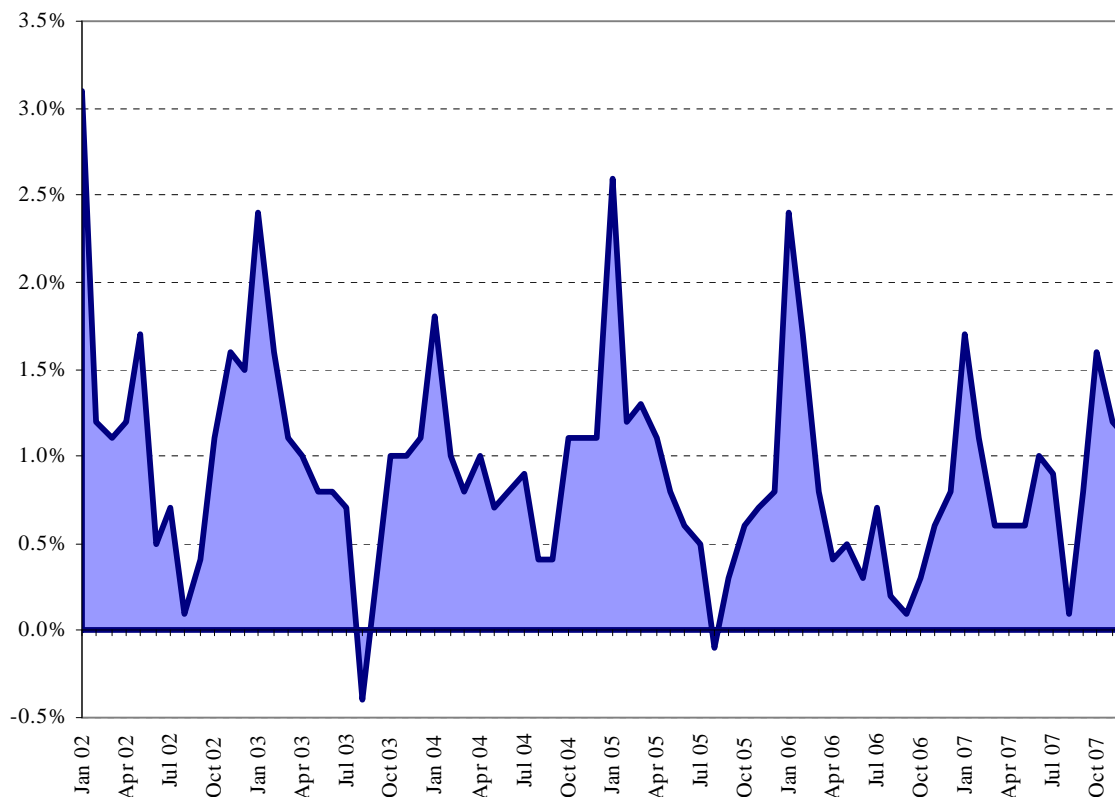


Fig. 1.

Source: RF Statistical Service

The growth of cash in circulation in December of the past year (by 1.2 per cent) at the background of increased mandatory reserves (by 13.1 per cent), coupled with some reduction in mandatory reserves (- 0.5 per cent) has resulted in extension of monetary base in narrow definition (cash + mandatory reserves)¹² by 12.4 per cent (*see Fig.2*). At the same time, the foreign currency reserves of the RF Central Bank also grew by 2.8 per cent and amounted, as of January 1, to USD 476.4 bln. Within the first two weeks of January those reserves have increased by 0.4 per cent more and reached the level of USD 478.4 bln. A greater portion of the national liquidity inflow was accumulated in the RF Stabilization Fund, which volume as of January 1, 2008 amounted to RUR 3849.1 bln (11.8 per cent of GDP) (+ RUR 132.1 bln against December 1 of 2007). Within the relevant period of preceding year the volume of the RF Stabilization Fund has grown by RUR 157.4 bln. Such an expressed growth of Stabilization Fund is explained by crediting the amount of RUR 151.9 bln.

¹² Monetary base in a narrow definition is a monetary instrument (an indicator of monetary supply volume), which is fully controlled by the RF Central Bank. The Monetary base in narrow definition includes the cash in circulation, issued by the Bank of Russia (and the balance on the accounts of credit organizations), balances on the accounts of mandatory reserves of the funds in the national currency attracted by credit institutions in national currency, deposited with the Bank of Russia.

Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2006 - 2007.

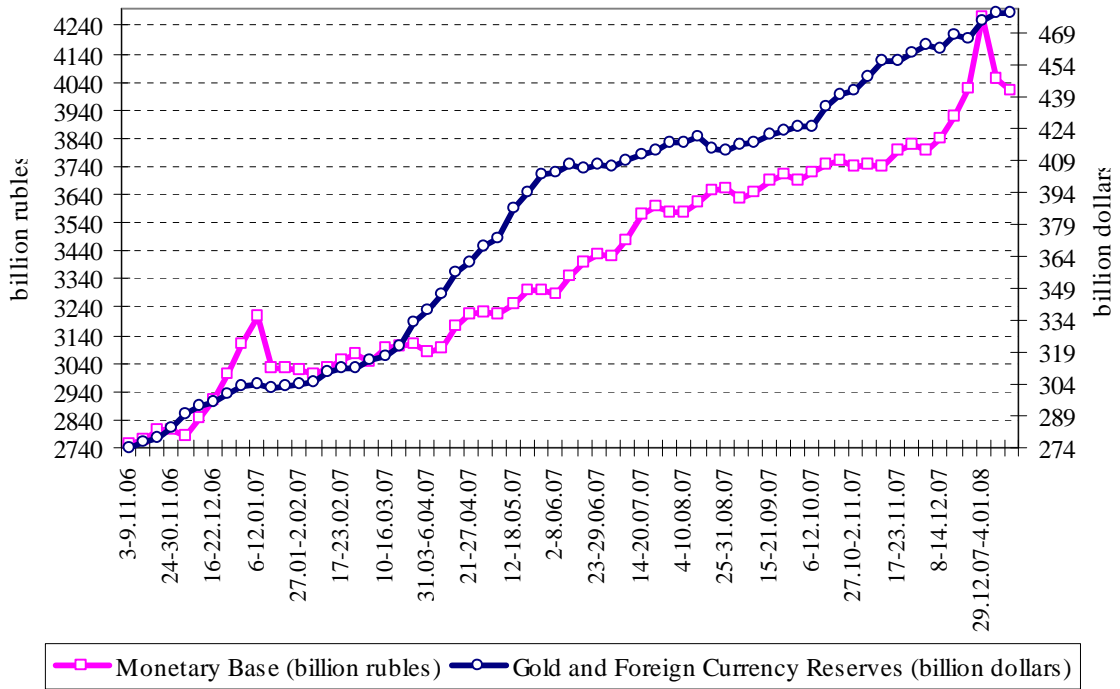


Fig. 2.

Source: RF Central Bank

Indicators of Ruble's Exchange Rate Dynamics within January 2005 - December 2007

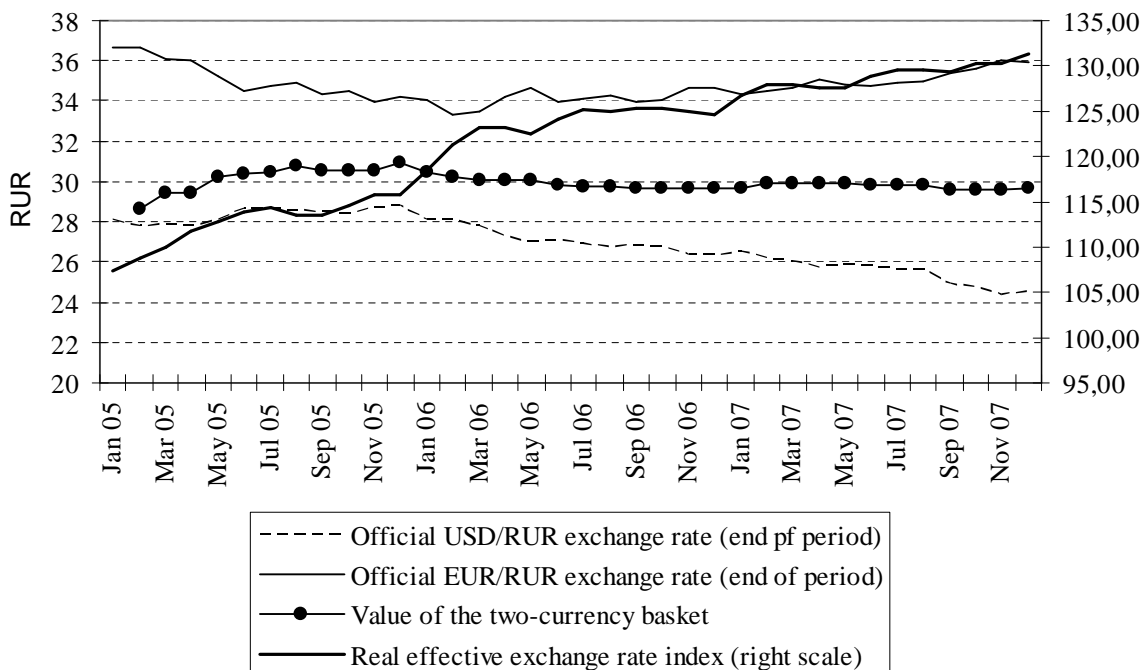


Fig. 3.

Source: RF Central Bank, authors' estimates.

In December, the inflow of foreign currency into the country was continued as a result of high oil prices, as well as due to renewed capital inflow from private sector. As a result, the ruble real effective exchange rate started to grow again: while in August-September it practically stayed at the same level of 129.4 – 129.6¹³, in December it has grown to 131.3 (see *Fig. 3*).

In December, the US dollar has strengthened in the world currency market at the background of crises in the global financial market, when international investors, "attracted by quality", were allocating their funds in the US government bonds. USD strengthening has resulted in its growth against RUR in the RF national currency market: by the end of December the dollar rate was RUR 24.55 (as compared with RUR 24.35 as of December 1). Despite the significant strengthening of dollar against ruble, the value of two-currency basket¹⁴ in December has increased only by 6 kopecks. As a result, EURO rate at the end of December has declined to RUR 35.93.

According to the information of the Federal Treasury, payments under external debt in December of the past year have made USD 665.1 million. The amount of USD 468.9 million was addressed to external debt redemption and USD 196.2 million was paid for the services thereof. Herewith, USD 88 million was spent to cover the debt of Russia, 99.1 million for the World Bank and EBRD loans, USD 159.6 million for loans raised upon bonds, USD 200 million under intergovernmental agreements, USD 118.4 to cover the debt of former USSR.

In January, the information was distributed that the Bank of Russia has initiated direct OTC REPO operations in the RF domestic market with the bonds, issued by non-resident entities outside Russia and included in the Lombard List of the Bank of Russia, but not admitted to public circulation in the Russian Federation. Thus, the RF Central bank continues to expand accessibility for refinancing operations to credit institutions of Russia.

At the same time, since January 15, the Central Bank again increased the threshold of mandatory reserves for the banks to the level, which was in effect three months ago. We should remind, that a temporary reduction of that threshold was made by the Bank of Russia in response to the acute shortage of liquidity in the RF interbanking credit market. As the situation in the market has been stabilized in December, the raising of the threshold is, in our view, entirely justified measure in monetary and credit policy.

Financial Markets¹⁵

N. Burkova

In January the Russian financial market dynamics was entirely determined by the situation in the world financial markets, based on the negative news background, provoked by the information on financial losses of the top global financial companies, as well as the new recession trends in the US economy. Oil prices decline in the world market has served as an additional negative factor for the Russian securities. Those trends were explicitly observed in the Russian stock market. At the end of the month the decision of the US FRS to decrease the interest rate has provided positive effect over the Russian stock market. However, in a short while that trend was replaced with further downgrading in the market quotations. There was noted a decline in investors' activity in the market of derivative financial instruments, RTS in particular, whereas the MICEX market of short-term contracts demonstrated a steady growth of investors' activity.

Government securities market

In January the Russian Eurobonds have demonstrated some decline in the yield as a result of the negative situation in the top world markets. Moreover, there was noted an insignificant downgrading of an average daily turnover in the secondary market. The market activity was rather low till the end of the month, when the expectations for further reduction of the base refinancing rate in the United States were confirmed (up to 3.5 per cent from January 21, 2008). Herewith, a fairly high level of primary placements was observed in January.

¹³ The level of 2002 is accepted as 100 per cent.

¹⁴ Two-currency basket is the RF Central Bank operational indicator in its foreign currency policy. Currently the share of EURO in the currency basket makes 45 per cent, USD – 55 per cent.

¹⁵ In the course of preparation of the survey, there were used analytical materials and surveys published by Zenith Bank, ATON investment company, MICEX, and the materials presented at web sites of Russian issuing companies.

As of January 25, 2008 (as compared with the level of December 21, 2007), the Russian Eurobonds' RUS 30 yield to maturity made 5.43 per cent per annum (decreased by 2 p.p versus December 21, 2007), RUS-10 – 4.81 per cent per annum (-1.2 p.p.), RUS-18 – 5.32 per cent per annum (- 5 per cent), RUS-28 – 5.79 per cent per annum (-1.7 p.p.). As of the same date, the yield to redemption of the Russian Eurobonds made: for the seventh tranche of external currency debt bonds – 4.52 (17.1 p.p. decline as compared with the level of December 21, 2007), for the fifth tranche – 4.13 per cent (-22. 2 p.p.) (Fig. 1 and 2).

FIG. 1.

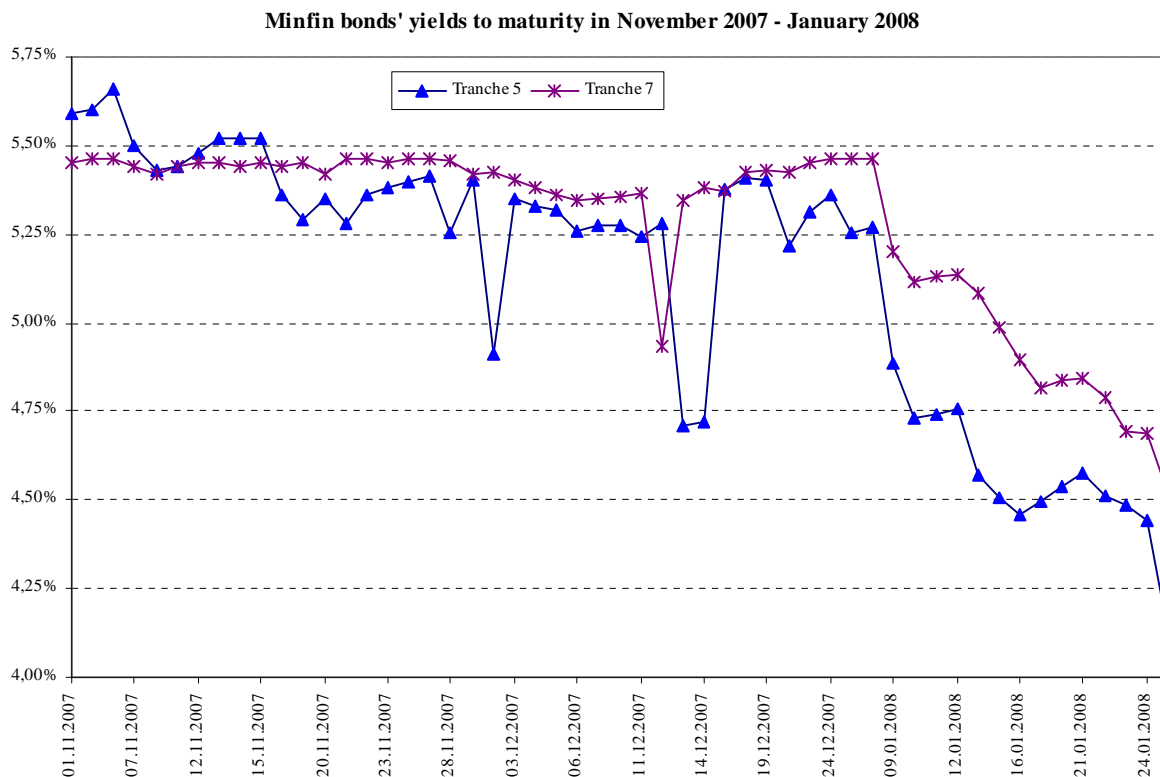
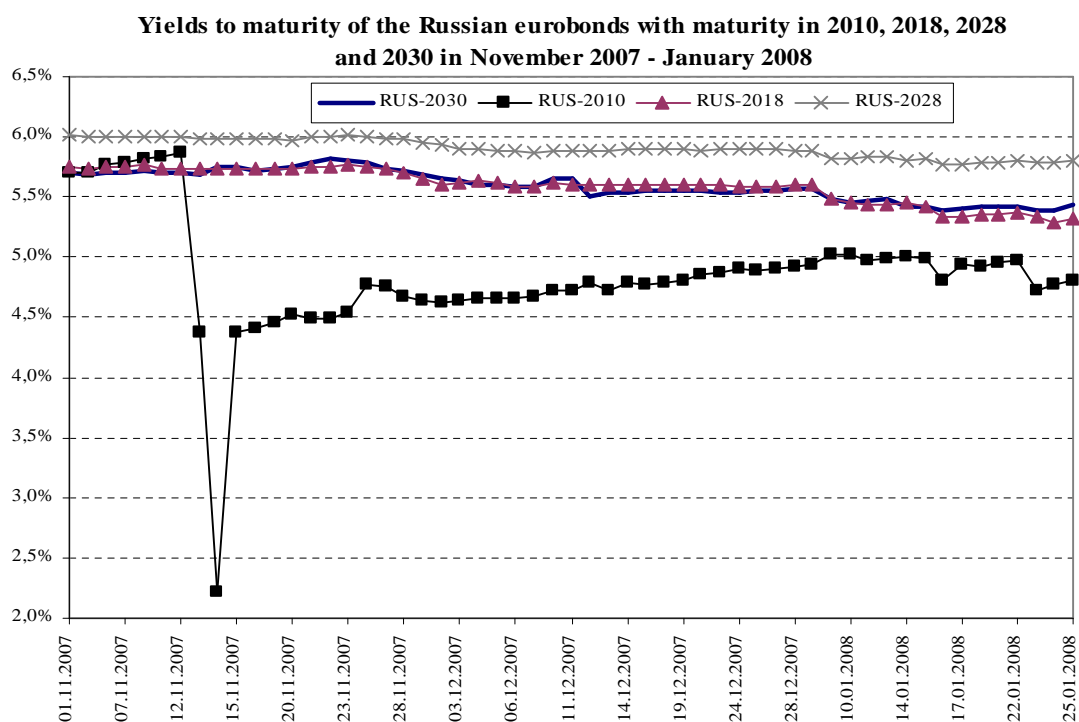


FIG. 2.



In January, a smooth decline in the yields was observed in the ruble debt market. The debt market activity was also low, largely due to sustained negative situation at the external markets in general and the information on financial losses of a number of the top global banks in particular, disclosed in January.

Within the period from December 22, 2007 to January 25, 2008, the total turnover of GKO- OFZ secondary market amounted to approximately RUR 84.97 billion with an average daily turnover of RUR 4.47 billion. (against RUR 99.87 billion with an average daily turnover of RUR 4.99 billion in December 2007).

A number of auctions on additional OFZ placement were held in January 2008. The auction on placement of OFZ series 46020 was held on January 18 for the amount of RUR 6.94 billion, actual placement made RUR 5.95 billion with an average weighted yield of RUR 6.81 per cent per annum. Three more auctions on placement of OFZ series 26200, 46022 and 46021 were held on January 23 for the amounts of RUR 8 billion, 9 billion and 8 billion, actual placement made RUR 2.7 billion, 5.85 billion and 7 billion with an average weighted yield of RUR 6.22, 6.53 and 6.38 per cent per annum accordingly.

As of January 28, 2008, the GKO-OFZ market amounted to RUR 1069 bln at face value and to RUR 1080 bln at market value. The duration of the GKO-OFZ market portfolio was 2100.85 days, having reduced by 3.43 days as compared with preceding month, when that duration was . 2104.28 days (as of December 24, 2007).

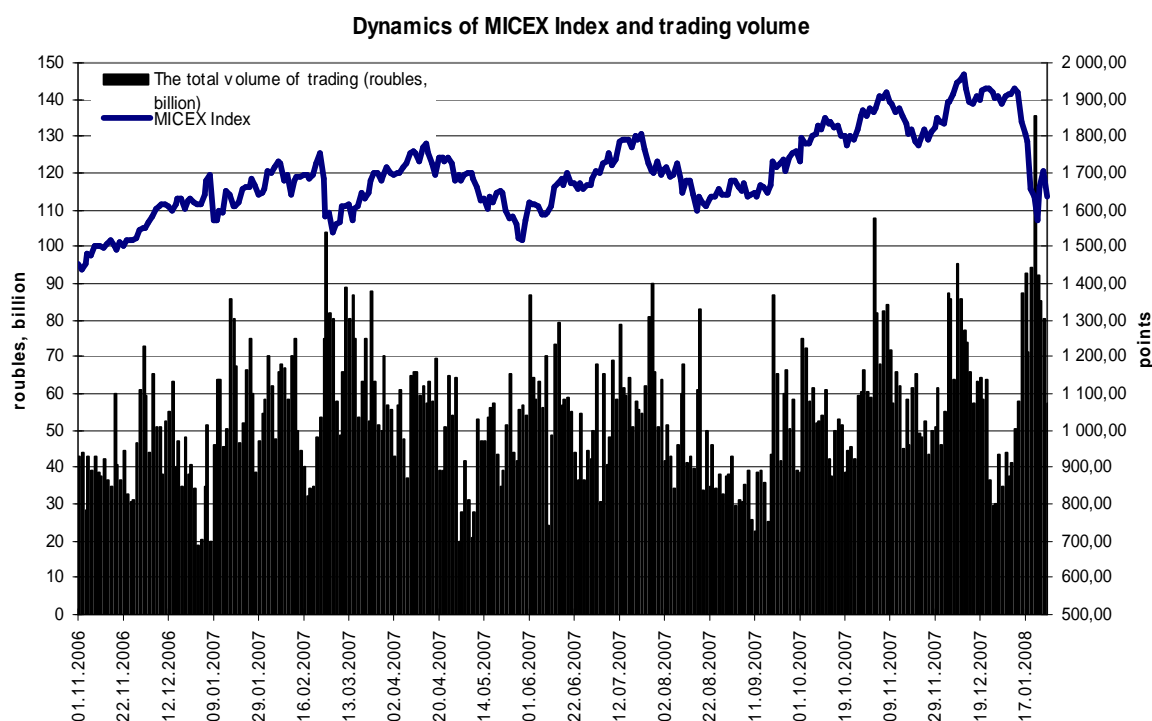
Equity Market

Stock market situation

in January high volatility in the world markets has provoked lower activity in the Russian stock market. The world stock market decline has affected the results of the bids and led to substantial decrease in market indices, in particular, the MICEX index, especially in the middle of the month. The volume of trades also decreased slightly as compared with December 2007. The utmost effect on the market was provided by the information on the US debt market, where earlier this month a number of publications on macroeconomic statistics showed a deterioration in the USA economy forecast, decreased retail sales and import prices, which led to a decrease in marked value of the US securities. However, the US FRS decision to decrease the refinancing rate to 3.5 per cent per annum (to 0.75 p. p.) has provided some positive impact on the market.

Throughout January a strong downward dynamics in the Russian stock market was noted. As a result, the MICEX index started to get down from January 16, having reached the level of 1570.90 points on January 23, equal the decline indicator of 16.8 per cent, noted at the beginning of 2008. Some MICEX index upgrading, started from January 24, has reflected a general growth trend in the stock quotations of Russian companies (Fig. 3).

FIG. 3.

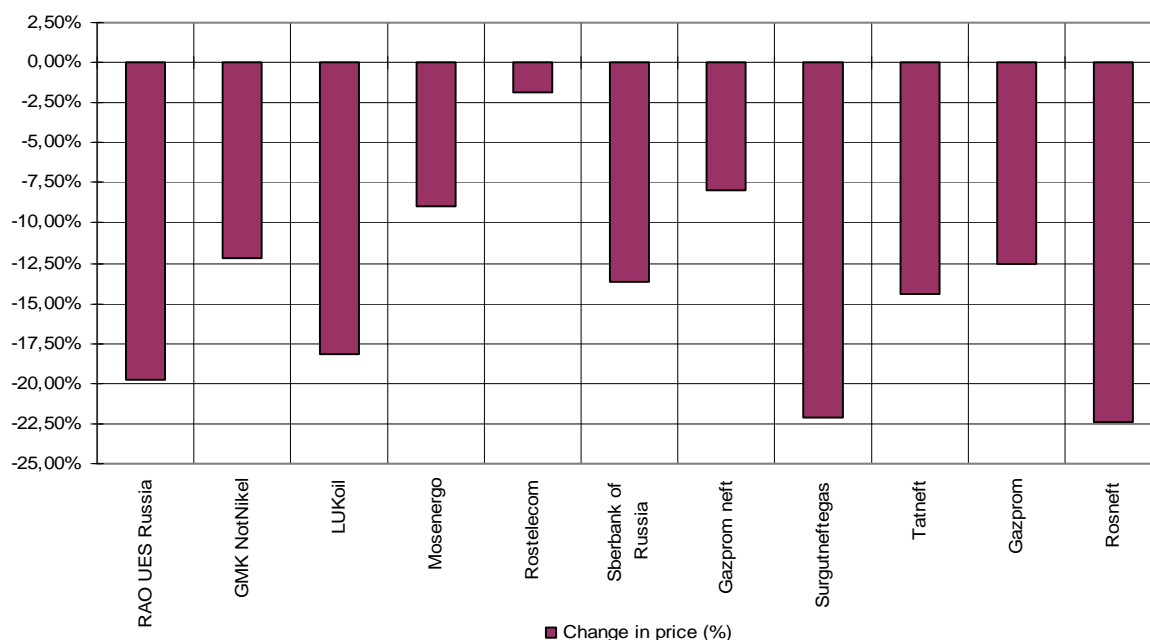


In general, within the period from December 25, 2007 through January 28, 2008, the MICEX index has declined by 14.8 per cent, i.e., by 283 points in absolute terms. Within the same period the turnover of trades in shares, included in the MICEX index, made about RUR 1165 bln at an average daily turnover at the level of RUR 61.3 bln (as compared with about RUR 1338 bln at an average daily turnover at the level of RUR 61.3 bln in earlier period from November 24 through December 2007). Therefore, the investors' activity in the stock market in December has explicitly downgraded as compared with the preceding month. The indicators of maximum and minimum turnover in the market trades in January made RUR 135.5 bln (as of January 22) and RUR 37.7 bln (as of January 10), accordingly.

As of monthly results (from December 25, 2007 through January 28, 2008), practically all "blue chips" have shown an explicit decline in their market values. The leaders in terms of downfall rates were shares of "Rosneft" (downgraded by 22.39 per cent), "Surgutneftegas" (by 22.15 per cent), RAO "UES of Russia" (by 19.75 per cent), "LUKOIL" (by 18.15 per cent), "Tatneft" (by 14.41 per cent), "Sberbank of Russia" (by 13.66 per cent). Some lower decline rates were noted in the shares of "Gazprom" (12.52 per cent), "Nornickel" (12.23 per cent), Mosenergo" (8.94 per cent) and "Gazprom Neft" (7.99 per cent). The only exception in terms of downgrading made the shares of "Rostelecom", which went down by 1.87 per cent.

FIG. 4.

Dynamics of the Russian Blue Chips from December 25, 2007 to January 28, 2008



In January the MICEX turnover leaders¹⁶ were: "Gazprom"(40.1 per cent), "Nornickel" (12.9 per cent), "LUKOIL" (9.7 per cent), "Sberbank of Russia" (8.4 per cent) and "RAO UES of Russia" (6 per cent).

Total share of transactions with the above companies' shares ("blue chips") made 87.6 per cent of gross turnover in the classical MICEX stock market in the period under review.

In terms of capitalization, as of January 28, the top five leaders of the domestic stock market were¹⁷: "Gazprom" (RUR 8195 bln), "Sberbank of Russia" (RUR 2283 bln), "Rosneft" (2202 bln), "LUKOIL" (RUR 1817 bln), "RAO UES of Russia" (RUR 1316 bln).

Futures and options market

In January 2008 the investors' activity in the MICES futures and options market has expressly decreased (nearly doubled) as compared with the preceding month. Thus, in that period the total turnover in the MICEX futures market amounted to approximately RUR 253,2 bln (513 transactions, 10.2 mln of contracts) against about RUR 132.5 bln (322 transactions, 5.28 mln of contracts) in December 2007.

An adverse situation was observed in the RTS futures market, where the investors' activity in January has declined as compared with the preceding month. Thus, in the period from December 25, 2007 through Janu-

¹⁶ In the classical stock market.

¹⁷ According to RTS data.

ary 28, 2008, the total turnover in the RTS futures and options market amounted to approximately RUR 954.6 bln (1449 thousand of transactions, 15.5 mln of contracts) against about RUR 1399.3 bln (1704 thousand of transactions, 21 mln of contracts) in December.

The greatest demand, as before, was for the futures: the volume of trading in futures in the period under review was RUR 811.2 bln (1412 thousand of transactions, 12.9 mln of contracts). Options enjoyed a far lower demand, with the volume of trading at about RUR 143 bln (37 thousand of transactions and 2.7 mln of contracts). The highest level of trading in the RTS futures market was RUR 89.5 bln (as of January 16), the lowest was RUR 24.9 bln (as of January 9).

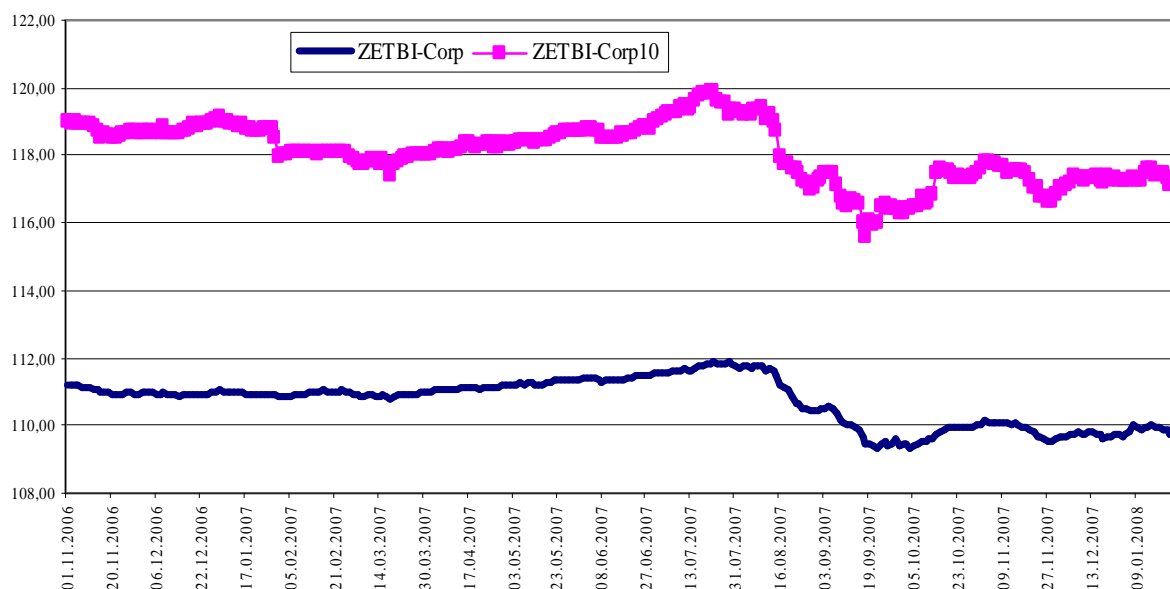
Corporate bond market

In January there were no expressed changes in quotations of securities, traded in the corporate debt market. Rather favorable situation with the liquidity in the banking sector, as well as the lack of large placements supported the market. However, the deterioration of the situation in the international debt market, a decline in the world oil prices and downfall of the stock market have negatively affected the quotations, and despite the explicit growth in activity (exceeding 40 per cent as compared with the preceding month), there were no significant changes in the market situation.

From December 25, 2007 through January 25, 2008 the price index of corporate bonds, traded on MICEX¹⁸ has increased by 0.09 points (by 0.08 per cent), whereas the index of the ten most liquid corporate bonds have downgraded by 0.02 points (- 0.02 per cent) (see Fig. 5). Within that period the total turnover in MICEX corporate bond sector amounted to nearly RUR 82.5 bln with an average daily turnover of RUR 4.58 bln (about RUR 58.6 bln with an average daily turnover of RUR 2.79 bln in the relevant period of December). Therefore, the investors' activity has noticeably increased within the month.

FIG. 5

Dynamics of corporate bond indices



External factors behind Russian stock market dynamics

In January the Russian financial market dynamics was dependant on the situation of the world financial markets. Thus, one should mention that downgrading of the stock market was the result of unfavorable situation in the external markets, based, in particular, on the negative news on financial losses of the top global financial companies, as well as the new recession trends in the US economy. Oil prices decline in the world market has served as an additional negative factor for the Russian stock market, as that indicator is one of the crucial factors of stability in the Russian economy.

The utmost effect on the market was provided by the information on the US debt market, where decreased retail sales, import prices and downgraded value of the US securities indicated a deterioration in the USA

¹⁸ The calculation was based on indices of corporate bonds traded on MICEX. The indices were produced by the Zenit bank.

economic forecast. However, the US FRS decision to decrease the refinancing rate to 3.5 per cent per annum (by 0.75 p. p.) has provided some positive impact on the market.

In general, external factors have provoked a downfall of the basic international stock market indices (*see Table 1 and Fig. 6*)

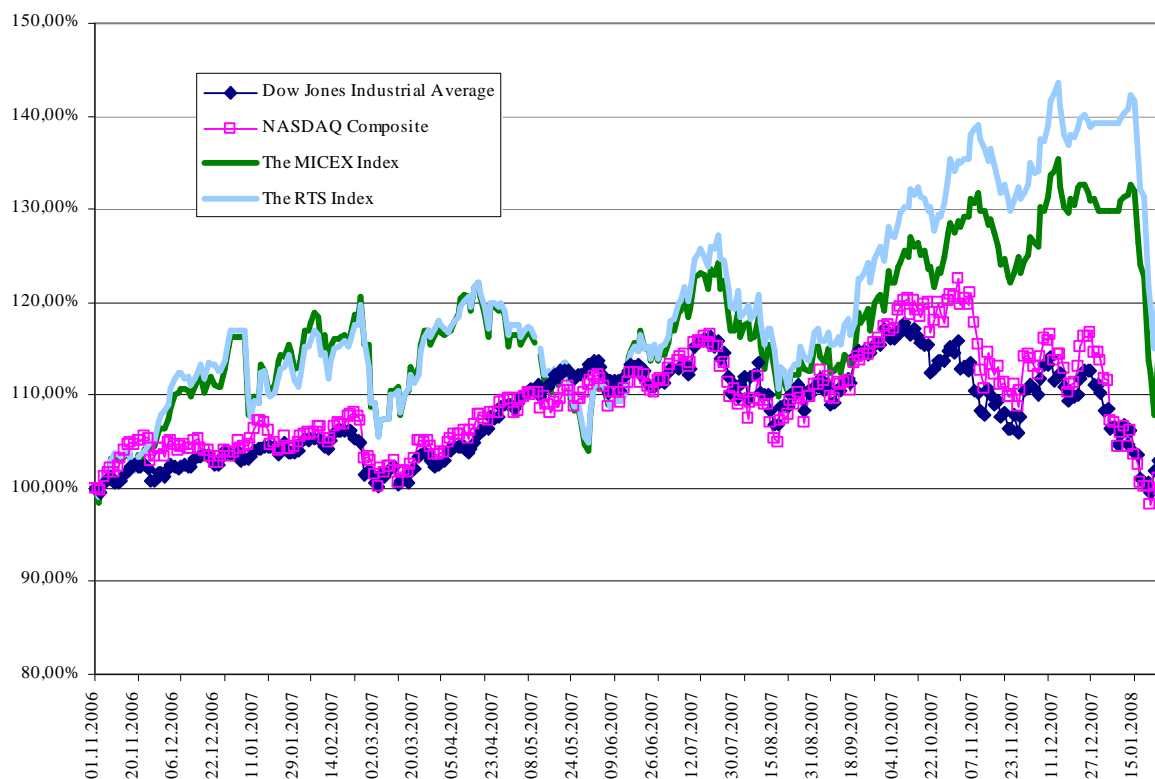
Table 1.

Dynamics of international stock market indices

Data as of January 28, 2008	Ticker	Value	Dynamics within the month(%) ¹⁹	Dynamics since the year beginning(%) ²⁰
MICEX (Russia)	MICEXINDEXCF	1635,33	-15,24%	-13,42%
RTS (Russia)	RTSI	1978,68	-14,09%	-13,61%
Dow Jones Industrial (USA) Average (USA)	DJI	12383,89	-8,60%	-6,64%
NASDAQ Composite (USA)	NASD	2349,91	-13,40%	-11,40%
S&P 500 (USA)	SPX	1353,96	-9,52%	-7,79%
FTSE 100 (UK)	FTSE	5788,9	-10,66%	-10,35%
DAX-30 (Germany)	DAX	6818,85	-14,79%	-15,48%
CAC-40 (France)	CAC	4848,3	-13,64%	-13,64%
Swiss Market (Switzerland)	SSMI	7581,73	-10,47%	-10,64%
Nikkei-225 (Japan)	NIKKEI	13087,91	-14,22%	-14,50%
Bovespa (Brasil)	BUSP	58593,78	-7,14%	-8,28%
IPC (Mexico)	IPC	26713,83	-10,52%	-9,56%
IPSA (Chile)	IPSA	2658,74	-13,68%	-12,88%
Straits Times (Singapore)	STI	3159,48	-8,01%	-9,27%
Seoul Composite (South Korea)	KS11	1627,19	-15,23%	-14,23%
ISE National-100 (Turkey)	XU100	43706,68	-21,26%	-21,30%
Morgan Stanley Emerging Markets Free Index	EFM	882,25	-11,59%	-12,16%

FIG. 6.

Dynamics of the main USA and Russian stock indexes (in % to the date 01.11.2006)



¹⁹ Versus index indicator valid on September 27, 2006.

²⁰ Versus index indicator valid on September 27, 2006.

Corporate News

AO «Gazprom»

AO "Gazprom" reviewed the preliminary results of gas reserves and production growth in 2007. According to tentative data, based on exploration works, in 2007 the growth of natural gas reserves amounted to more than 585 billion cu. m, what exceeds the planned volume by 7 billion cu. m. According to the recent information, natural gas production, made by "Gazprom" Group in 2007 (excluding affiliated companies), was 548.5 billion cu. m.

AO «Gazprom Neft»

On December 2007, AO «Gazprom Neft» has completed the transaction on acquisition Ravninnoye deposit, located in Yamalo-Nenetsk Autonomous Area, the southwestern part of Krasnoselkupskoye region. Currently Ravninnoye deposit recoverable oil reserves are 5.5 million tons in C1 category, and 1.7 million tons C2 category. Potential resource of the licensed site allow to increase the reserves by 5 million tons more after the exploration works. AO Sibneft-Noyabrskneftegaz" is the owner of the license and explorer of the deposit. Pilot production at Ravninnoye deposit will be started in 2008, the highest production volume is planned to be reached by 2011.

AO «LUKOIL»

AO «LUKOIL» and AO «Gazprom Neft» have established a joint venture OOO «Oil and Gas Company «Regional Development». AO «LUKOIL» share in the authorized capital of the joint venture makes 49 per cent, AO «Gazprom Neft» share is 51 per cent. The authorized capital is formed of monetary assets, the joint venture is managed on parity basis. The company authority will include the acquisition of rights to explore mineral resources, subsurface geological studies, hydrocarbons exploration and extraction, field facilities construction and infrastructure projects implementation, as well as transportation and sales of extracted hydrocarbons.

NK «Rosneft»

NK «Rosneft» has presented consolidated financial reporting in accordance with the USA GAAP for the third quarter and nine months of 2007. In the third quarter of 2007, earnings before interest, profit tax and depreciation (EBITDA), adjusted for additional penalties and fines, paid under "AO Yuganskneftegaz" tax debt in the amount of USD 31 million, are increased by 90.7 per cent as compared with the indicator of the third quarter of 2006 (from USD 2126 to USD 4054 mln.) and by 13.2 per cent against the indicator of the second quarter of 2007 (from USD 3581 to USD 4054 mln).

In the first nine months of 2007, EBITDA ratio, adjusted for additional penalties and fines, paid under "AO Yuganskneftegaz" tax debt in the amount of USD 373 million and USD (-13) million for the 9 months of 2007 and 2006 accordingly, has increased versus the relevant indicator of the same period of 2006 by 47.1 per cent (from USD 6391 to USD 9399 million).

In the third quarter of 2007, the net profit, adjusted for additional penalties and fines under "AO Yuganskneftegaz" tax debt (USD 38 million and USD (-75) million in the third quarters of 2007 and 2006 accordingly, has grown by 97.5 per cent in comparison with the third quarter of 2006 (from USD 976 to USD 1928 million), i.e., by 13.2 per cent against the second quarter of 2007 (from USD 1703 to USD 1928 million). Within the first nine months of 2007, this rate (adjusted for additional penalties and fines, paid under "AO Yuganskneftegaz" tax debt) in the amount of USD 437 million and USD (-13) million for the nine months of 2007 and 2006 accordingly (with regard to the net effect of "NK OAO Yukos" bankruptcy proceedings in the amount of USD 6019 million for the first nine months of 2007), has increased against the relevant indicator of the same period of 2006 by 48.4 per cent (from USD 2917 million to USD 4328 million).

In the first nine months of 2007, oil production of consolidated businesses was expanded against the rate of the relevant period of 2006 by 19.6 per cent (from 427.67 million to 511.62 million barrels), whereas consolidated production with regard to NK "Rosneft" share in affiliated companies increased by 23.2 per cent in comparison with the relevant period of 2006 (from 431.23 million to 531.41 million barrels). One of the important factors of oil production growth in the nine months of 2007 versus the level of the relevant period of 2006 was further extension of the average daily well flow rate from 109.73 to 112.50 barrels. In the first nine months of 2007, gas production of consolidated businesses has grown by 14.6 per cent as compared with the rate of the same period of 2006 (from 10.13 billion to 11.60 billion cubic meters). Gas extraction with regard to the share of affiliated companies in the first nine months of 2007 has grown against the level of the same period of 2006 by 14.8 per cent (up to 11.63 billion cubic meters). In the first nine months of 2007, oil production from "NK Rosneft" reserves, including mini-refineries and refineries of the third par-

ties, amounted to 26.32 million tons, what exceeds the level of the relevant period of preceding year by 56.0 per cent (16.87 million tons).

«Sberbank of Russia»

On January 25, 2008 "Sberbank of Russia" has disclosed the financial reporting, compiled in accordance with the international standards of financial reporting, for the first nine months of 2007. According to the report, Sberbank of Russia assets as of October 1, 2007 year amounted to RUR 4520.5 billion. The growth rate of the assets in the first nine months of 2007 made to 40.5 per cent per annum. In the nine months the shareholders' funds have been increased by 94.7 per cent and reached the level of RUR 600.7 billion. The Bank net profit (as per IAS) in the nine months of 2007 amounted to RUR 69.9 billion, what exceeds the relevant indicator of preceding year by 22.1 per cent. Return on assets of the Bank (ROAA) in the first nine months of 2007 amounted to 2.3 per cent.

Budgetary and Tax Policy

O. Kirillov

Federal government expenditures in 2007 have demonstrated an explicit growth (especially in the last quarter of the year) against the level of relevant periods of preceding years and this trend is sustained in 2008. Primarily it happens due to the policy, pursued in anticipation of the upcoming elections of the RF President. Considerable irregularity in budget expenditures during the year was maintained. Expressed deficit in oil and gas budget demonstrates the vulnerability of public finance system in the event of the world oil prices downfall.

In the fourth quarter of 2007, the expenditure part of the Russian federal budget has considerably increased. Within the year 2007, expenditures made RUR 5982 billion in nominal terms.²¹, or 18.4 % of GDP (Table 1). This exceeds the indicators of 2006 by 2.2 p.p. of GDP, whereas the level of federal revenues share in GDP remained practically unchanged.

Table 1.

Basic Parameters of the RF Federal Budget in 2005 – 2007 (% versus GDP)

	2005	2006	2007
Revenues	23,7%	23,5%	23,87%
Expenditures	16,2%	16,2%	18,39%
Deficit (-)/ Surplus (+)	7,5%	7,4%	5,48%

Source: RF Ministry of Finance, IET estimates

The growth of the federal budget expenditures is not an unexpected event, it was forecasted. The main reasons behind it are mitigation of national fiscal policy, inspired by political decisions and preparations for the presidential elections, as well as annually emerging problem of irregularity in budget expenses.

One can see from Fig.1, that in the last quarter of 2007 the federal budget expenditures have exceeded the average level of the first three quarters (i.e., 15 % of GDP).

(With regard to amendments to the federal budget for 2007²², RUR 180 billion from federal budget assets are allocated in the Bank for Development and Foreign Economic Affairs (Vnesheconombank), RUR 30 billion are addressed to the Ministry of Education for the Russian Nanotechnology Corporation and RUR 90 billion to extend the RF Investment Fund.

RUR 240 billion from the RF Stabilization Fund assets are utilized to finance the. Corporation "Foundation for the Reform of Housing and Utilities Infrastructure".

Let us consider the federal budget expenditures in detail (*see Table 2*).

Compared with the years of 2005 and 2006, in 2007 the largest extension of federal budget expenditures was made under such budget lines as national economy (+0.86 p.p. of GDP as compared with 2006, +1 p.p. of GDP as compared with 2005), and housing and public utilities (+0.71 p.p. of GDP as compared with 2006, +0.86 p.p. of GDP as compared with 2005). Funding was also increased for such budget lines as federal issues, interbudgetary transfers, healthcare and sports, education. Doubtlessly, this is inspired by government policy and a large number of national projects and Institutions of Development. Overall, the share

²¹ Peak indicator of the RF federal budget; in 2006 the expenditures amounted to RUR 4 298 billion.

²² Federal Law N 266 dated November 2007 "On amendments to the Federal Law on the Federal Budget for 2007".

of budget lines, funding of which was extended as compared with 2006 level, exceeded 84 % of the total federal budget volume.

One can observe reduction in expenses as compared with the level of 2006 for social policy, as well as national security and law enforcement. However, the decline in funding of those issues is insignificant, it makes only 0.1 p.p. of GDP and is based on accelerated GDP growth. In nominal terms, expenditures under those budget lines have been increased in 2007 versus 2006 indicators by RUR 17.6 bln and RUR 114.4 bln accordingly.

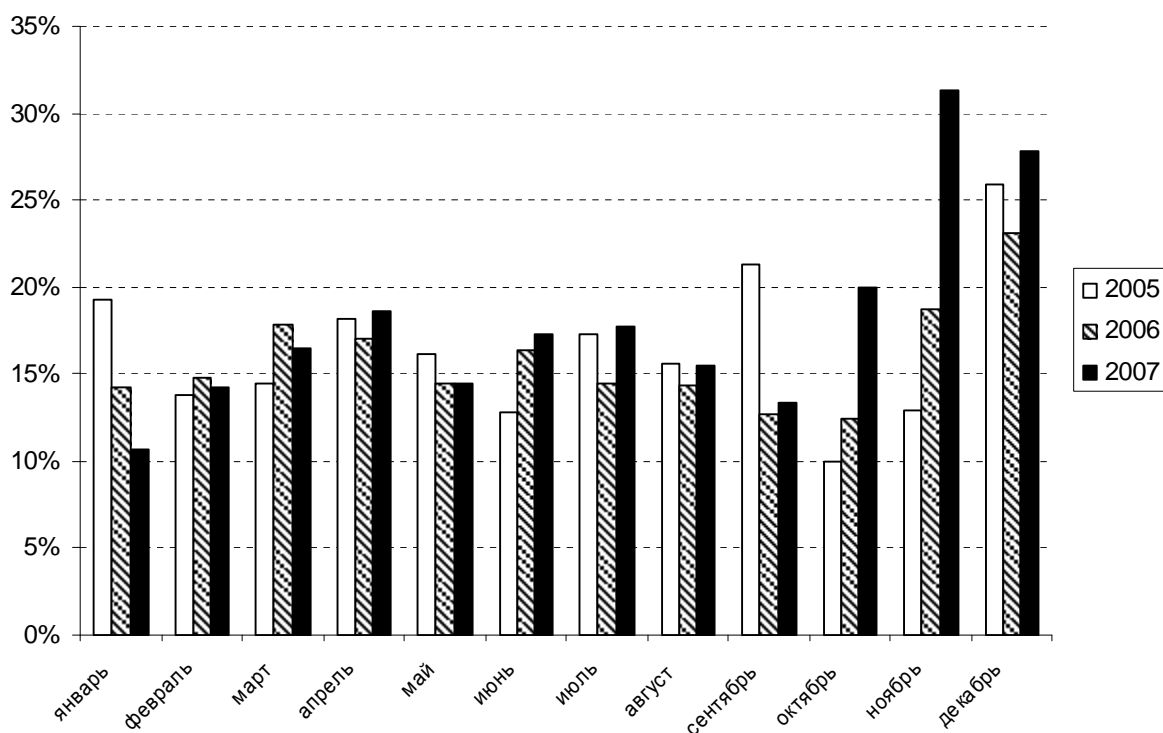


Fig. 1. Expenditures of the RF Federal Budget in 2005-2007 (per cent in GDP)

Table 1.

Expenditures of the RF Federal Budget in 2005-2007 (in % of GDP)

	2005	2006	2007
Federal issues	2,58%	2,19%	2,62%
Including expenditures associated with the servicing of federal and municipal debt	1,06%	0,65%	0,45%
National defense	2,71%	2,57%	2,57%
National security and law enforcement	2,05%	2,08%	2,05%
National Economy	1,17%	1,31%	2,17%
Housing and public utilities	0,04%	0,20%	0,90%
Environmental protection	0,02%	0,03%	0,03%
Education	0,73%	0,78%	0,89%
Culture, cinematography and mass media	0,22%	0,21%	0,22%
Health care and sports	0,42%	0,56%	0,77%
Social policy	0,88%	0,81%	0,71%
Interbudgetary transfers	5,77%	5,68%	5,92%
Total expenditures	16,58%	16,40%	18,85%

Source: RF Ministry of Finance, IET estimates.

It is worth noting, that there no plans to reduce federal budget expenses, which was confirmed by the top government officials. Thus, for example, on the RF President initiative, it is planned in 2008 to increase by 18 % monetary allowance for military servants, by 14 % wedges and basic share of pensions for public offi-

cers from February 1. Unless other amendments are made to the estimated budget expenditures for 2008, their share in GDP will be reduced during the year. In this case, fiscal policy after the presidential elections will be more balanced. However, the likelihood of such a scenario appears to be quite low so far.

To implement those initiatives, the RF Ministry of Finance has submitted to the government a draft of amendments to the budget for 2008-2010, which should be presented for approval to the State Duma no later than February 1, 2008. The purpose of the amendments is to specify the indicators of the federal budget revenues and expenditures with regard to surplus funding. According to Alexey Kudrin, the Head of the Ministry of Finance, the federal budget in 2008 can be extended by RUR 343.3 billion due to the surplus GDP growth and savings from government debt services, based on exchange rate difference and early redemption.

Amendments also include RUR 138 billion of surplus revenue, derived from the assets of federal budget to be addressed to cover the deficit of the RF Pension Fund, arising from extension of the basic pension share. It is worth noting, that in case of the lack of surplus revenues, the deficit will be covered from the Future Generations Fund, what is unwelcome. Extension of expenditures in medium-term prospective, as well as high oil prices create grounds for accelerated inflation. It should be mentioned, that an average price for Urals oil in 2007 amounted to USD 69.4 per barrel, i.e., by USD 8.5 higher than in 2006.

There were no dramatic changes in the revenues of the federal budget. The trends that emerged during the year are sustained. The structure of the federal budget revenues for the period under review as broken down by individual federal administrative bodies is presented in *Table 3*.

Table 3.

**Amount of Revenues to the RF Federal Budget in 2005-2007
(in % of GDP in terms of cash basis execution)**

	2005	2006	2007
Taxes and other payments administered by the Federal Tax Service	12,33%	11,27%	11,50%
Taxes and other payments administered by the Federal Customs Service	9,73%	10,76%	9,98%
Receipts administered by the Federal Agency for Management of Federal Property	0,27%	0,26%	0,25%
Revenues of the federal budget administered by other federal structures	1,35%	1,25%	2,14%
Total revenues	23,67%	23,54%	23,87%

Source: RF Ministry of Finance, IET estimates

Table 4.

Export Duties on Crude Oil in 2007

Government resolution amendment date	USD per 1 ton
17.01.2007	179,7
20.03.2007	156,4
16.05.2007	200,6
14.07.2007	223,9
14.07.2007	250,3
13.11.2007	275,4
14.01.2008	333,8

Source: RF Government Regulation N695 as of November 16, 2006 and relevant amendments.

All administrators of tax revenues to the federal budget have demonstrated in January-December 2007 higher indicators as compared with preceding year, with the exception of the Federal Customs Service (the decline was -0,78 p.p. of GDP). This decline is largely attributable to the downfall in revenues during the year from the export duties, which make about 24 % of total federal revenues as per tentative estimates. We should note also that the decrease in revenues from export duties was happening in the background of high oil prices, whereas oil and gas revenues share in GDP (see Fig. 2) continue to decline, which is a long-term trend. During 2007 the rates of export duties on crude oil and oil products, were changed several times (see Table 4), which served as a basic reason for downgraded revenues from that source. As one can see from the

Table 4, at the beginning of the second quarter 2007, export duty rate on crude oil was reduced, and its gradual growth started only from June 1²³ of the same year.

Monthly dynamics in oil and gas revenues²⁴ and other than oil proceeds deficit of the federal budget are presented in Fig.2. Non-oil revenues deficit is one of the key indicators for external economic risks assessment in terms of public finance security. As one can see from the charts below, there is a trend to gradual reduction of the federal budget oil and gas revenues share in GDP. This is a sign of some decrease of the budget dependance on the commodity sector in the Russian economy. However, the share of oil and gas revenues still remains at a high level.

The average non-oil and gas deficit of the federal budget in the period under review remained within 2-6 per cent of GDP. Seasonal upgrading of non-oil deficit at the end of the month (18.9 per cent in November 2007) and rather high average indicators throughout the year reflect the sustained risks to the stability of public finance and requires prevention from excessive mitigation of fiscal policy on the part of the government. Next month, when the data for December 2007 is available, average annual assessment of oil and gas deficit can be made.

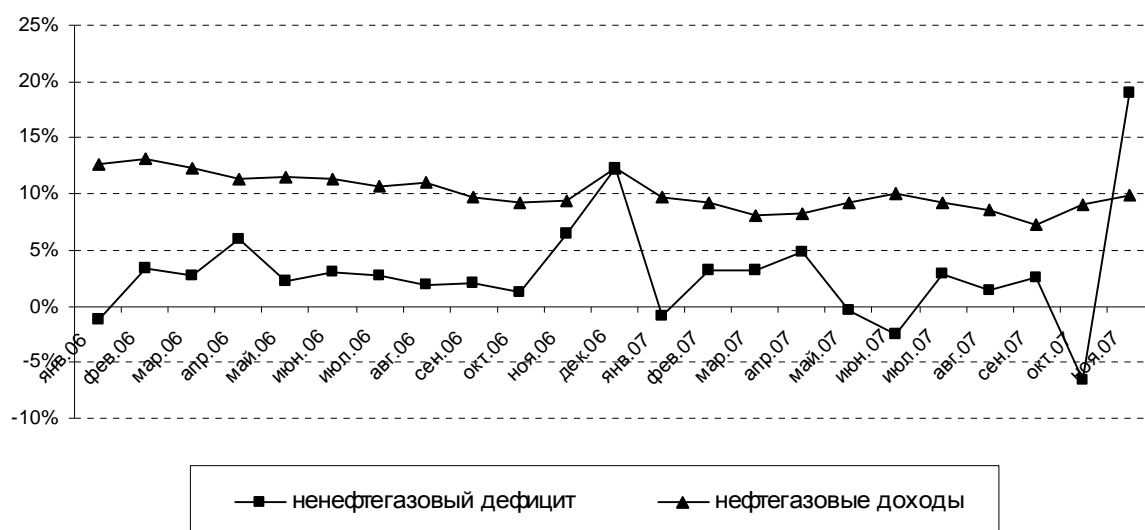


Fig. 2. Oil and gas revenues and non-oil deficit of the federal budget in 2006-2007 (% in GDP)

As of January 1, 2008 the cumulative volume of the RF Stabilization Fund amounted to RUR 3849.11 billion, or 11.8 per cent of GDP (in annual terms). Fig. 3 presents monthly dynamics of the Stabilization Fund. It should be noted, that due to early redemption of nearly total amount of the RF government debt within 2006, payments under that debt in 2007 were relatively low, i.e., 0.1 p.p. of GDP, as compared with 2.3 p.p. of GDP in 2006. As a result, the volume of Stabilization Fund in terms of GDP share in 2007 has significantly exceeded the relevant indicator of 2006. However, in November the assets of Stabilization Fund in the amount of RUR 300 billion (or 0.92 p.p. of GDP) were addressed to the Institute of Development 25, what caused some reduction of Stabilization Fund share in GDP.

²³ The date of adoption an amendment to the RF government resolution N294 as of 16.05.2007 №294

²⁴ Oil and gas revenue is assessed as tax on extraction of hydrocarbons plus export customs duties on crude oil, natural gas and oil refinery products.

²⁵ With regard to amendments to RF Law « On Federal Budget for 2007»

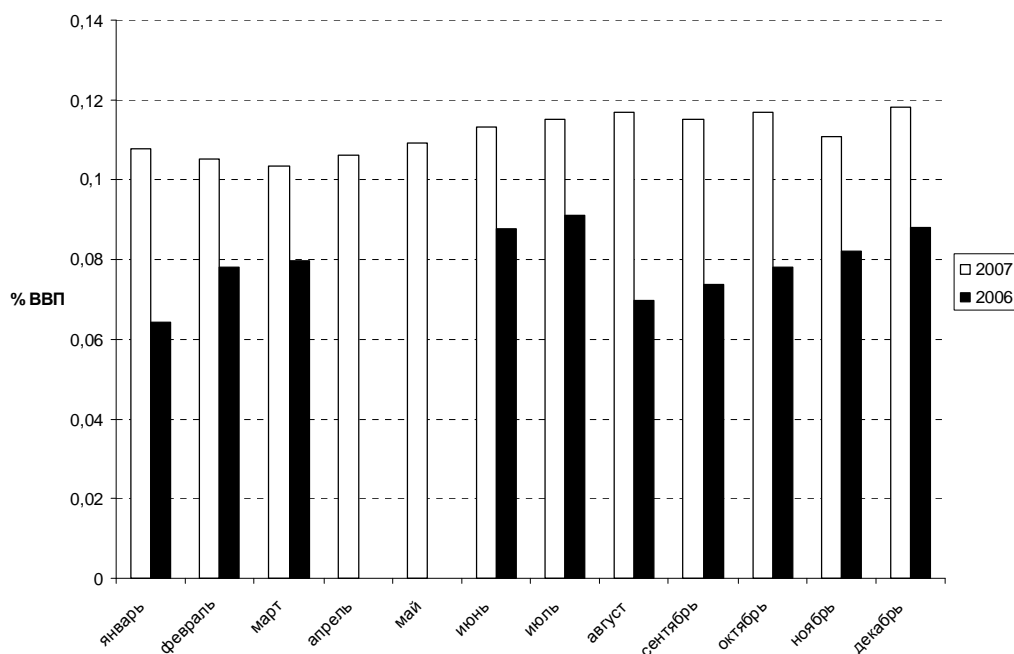


Fig.. 3. RF Stabilization Fund dynamics in 2006-2007 (% in GDP)

Note: Data for April and May 2006 is not available.

Real Sector: Trends and Factors

O. Izryadnova

It was intensive growth of the investments in the fixed assets that had the prevailing influence on the character of economic development in 2007. In 2007 investments in the fixed assets were equal to RUR 6418.7 bln or 19.7% of the GDP. GDP increasing by 8.1% and households' final consumption – by 12.1% increase in investments reached 21.1%. Steady trend for the increase of standard of life sustaining, population's real incomes went up by 10.4% and real average wages – by 16.2%.

Development of the Russian economy in 2007 was formed under the influence of the such factors as: increase of the internal demand; anticipating growth of processing industries as compared with extractive industries, of investments in the fixed assets as compared with final consumption, import as compared with internal production, wages as compared with labor efficiency; acceleration of prices growth rates of industrial goods producers and tariffs for services.

Ratio of external and internal demand throughout 2001-2007 changed quite significantly. Since 2 quarter 2004 gradual increase of impact of internal demand on the dynamics of economic development was observed. In 2005-2007 slowdown of the external demand growth rates was accompanied by the slackening dynamics of the physical volumes of oil and oil products export. Increase of external demand in 2005-2006 was on average equal to 6.8% against 12.1% of 2003-2004, and in 2007 it is estimated to be about 5.3%.

Accumulated influence of internal factors, regulating the level of business activity, turned out to be quite sufficient to compensate weakening of external demand impact on the economic growth rates. GDP increasing by 8.1% in 2007 real final households' consumption went up by 12.1% and investments in the fixed assets – by 21.1%.

Positive dynamics of the internal market was determined both by growth of domestic production volumes and by expansion of import scale. The situation at the internal market in 2006-2007 was formed under the influence of gradual acceleration of domestic production. As a result of 2007 increase in industrial production was equal to 6.3% against 3.9% last year, workload in construction – to 18.2%, agriculture – to 3.3%.this however has not allowed to change the trend for anticipating import growth in the formation of internal market resources, which was especially distinct in 2007.

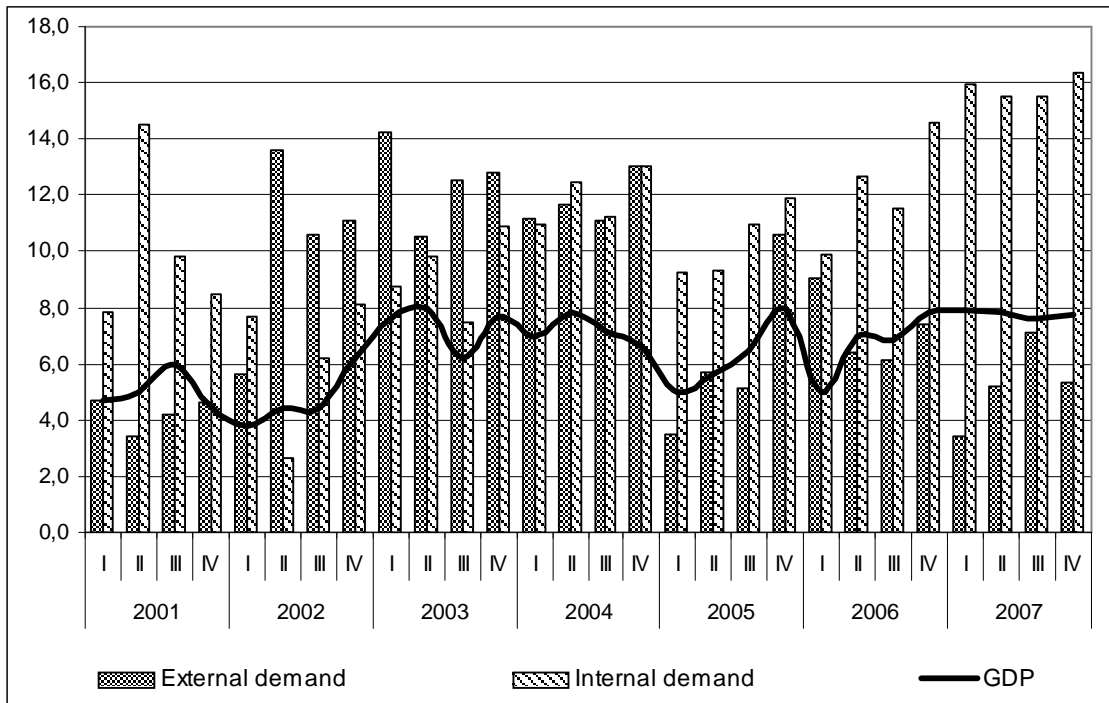


Fig. 1. Growth Rates of Internal and External Demand over 2001-2007, as percentage to the corresponding quarter of the preceding year

Source: Federal State Statistics Service

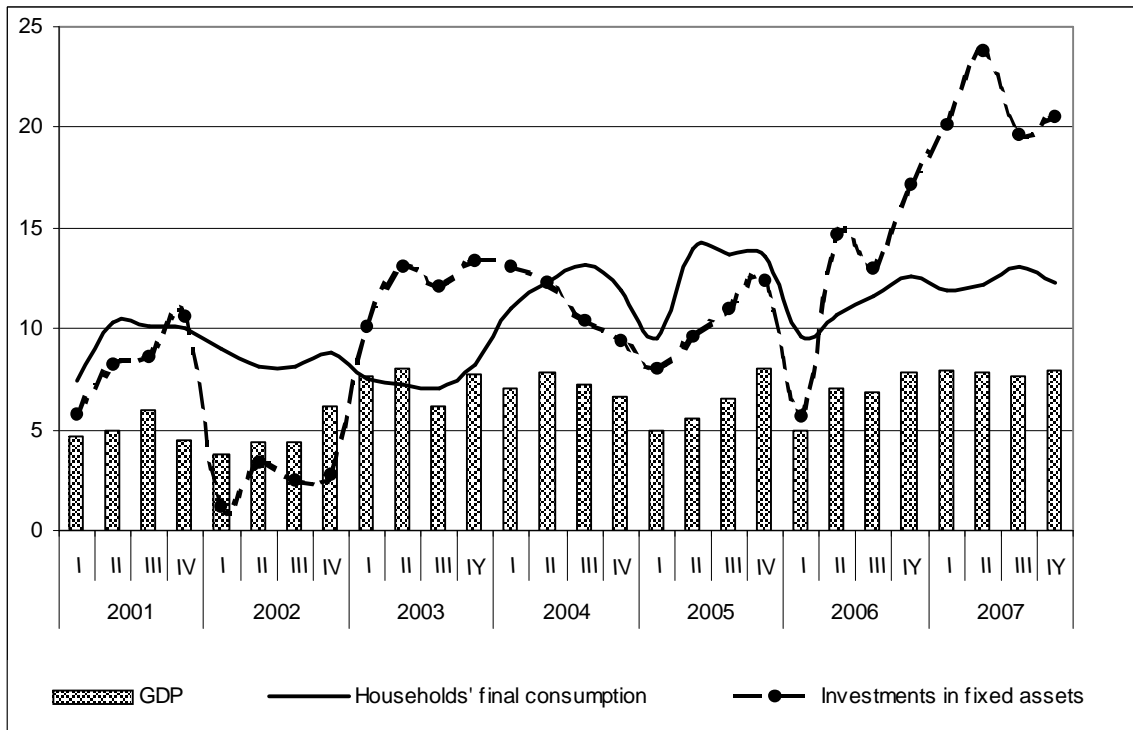


Fig. 2 Change in GDP Dynamics by Components of Final Demand in 2001-2007, as percentage to the corresponding quarter of the preceding year

Source: Federal State Statistics Service

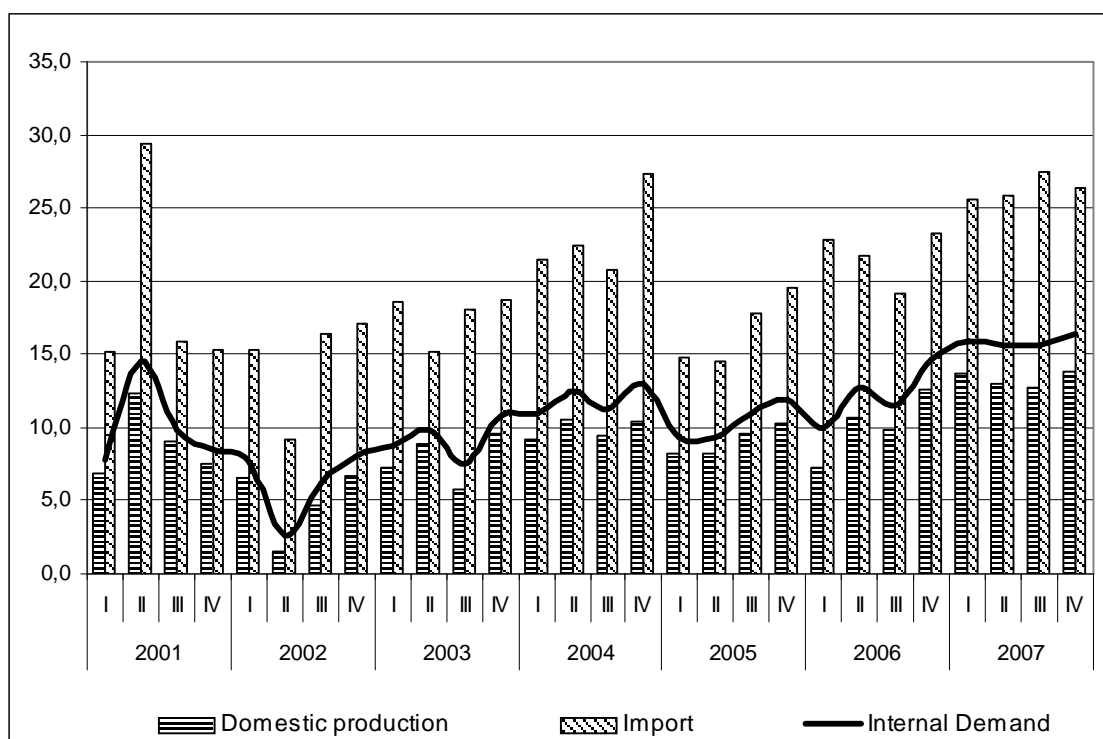


Fig. 3 Change of the Internal Demand Growth Rates by Components in 2001-2007, as percentage to the corresponding quarter of the previous year

Source: Federal State Statistic Service

Analysis of the retail trade resources formation demonstrated that in 2007 the share of import has increased up to 47%, including by foodstuffs – up to 37% against 34.8% in the previous year, by non-food goods – up to 54.4% against 51.7% a year ago. Large share of import goods accounted for balance of demand and supply at the investment market as well.

In 2007 structural shifts in industry were defined by anticipating growth of processing industries. Increase in the volumes of processing industry production was equal to 9.3%, extractive industries growing by 1.9% and electricity, gas and water production and distribution reducing by 0.2%. Potential of unloaded facilities being exhausted one of the factors for growth rates of the industry acceleration was the growth of investments in the fixed assets scale. As a result it was the kinds of activities that were focused on producing of goods of investment demand that is machinery and equipment production (growth index 119.3%), electric, electronic and optic equipment production (112.8%), transport vehicles and equipment production (115.9%), non-metal mineral products production (110.8%) that had the most profound impact on sustention of steady development dynamics of processing industries.

Growth rates by kinds of activities fluctuating quite considerably, anticipating growth of machine-building production was the dominating trend that had a positive effect on the level of business activity of adjacent industries on producing construction materials and other intermediate goods.

Table 1

**Indices of Industrial Production by Kinds of Economic Activity in 2000-2007
as percentage to the preceding year**

	2000	2001	2002	2003	2004	2005	2006	2007
Industry	108.7	102.9	103.1	108.9	108.3	104	103.9	106.3
Minerals extraction	106.4	106	106.8	108.7	106.8	101.3	102.3	101.9
Fossil fuels extraction	104.9	106.1	107.3	110.3	107.7	101.8	102.5	101.9
Minerals extraction excluding fossil fuels	118.2	96.2	99.1	102.5	108.5	96.8	101.8	101.6
Processing industries	110.9	102	101.1	110.3	110.5	105.7	104.4	109.3
Electricity, gas and water production and distribution	104	101.4	104.8	103.3	101.3	101.2	104.2	99.8

Source: Federal State Statistics Service

Other factors being equal, dynamic growth of import favored creation of competitive environment, but big share of import in retail trade turnover and the volume of investments in machinery, equipment and transport vehicles reinforced the dependence of trade resources balance of the internal market from the changes in the foreign economy situation.

Starting with the second half of 2007 dynamically growing prices of the world market for grain, dairy and some other foodstuff, reduction in import supply and slowdown of domestic production rates of socially important foodstuffs contributed in the development of inflation processes in the Russian economy. For the change of demand and supply proportions and the level of world prices for foodstuffs internal market responded with the increase of prices for import and domestically produced goods. Consumer prices growing by 11.9% growth of prices for foodstuffs was 15.6% against 8.7% in 2006, for non-food goods – 6.3% and paid services rendered for population – 13.3%.

It should be noted that acceleration of inflation has not reflected on the situation at the consumer market as a whole yet. Consumer boom was sustained by acceleration of growth rates of population's real incomes and continuous enhancement of consumer crediting. Increase in real population's incomes in 2007 was equal to 10.4% against 13.3% last year and in average real wages – to 16.2% against 13.3% a year ago.

Increase in retail trade turnover in 2007 was equal to 15.2% against 13.9% a year ago and in the volume of paid services rendered to population has grown by 7.1%. The volume of credits granted to natural persons increased by 1.4 times in November as compared with the beginning of 2007. The factor that restricts the use of savings for current consumption is high investment activity of population in housing construction. In 2007 the population built the housing of the square of 1/3 more than in 2006 at the expense of own and loaned funds.

Foreign Trade

N. Volovik

In November 2007 high growth rates of the main indices of Russian foreign trade sustained. Considerable rise of oil prices in 3 and 4 quarters accounted for acceleration of export growth rates and slowdown of foreign trade balance reduction. It was high indices of economy growth and continuous ruble appreciation against dollar that promoted steady import growth rates.

At the end of 2007 formation of foreign trade dynamics was accounted for by several key factors: considerable increase in prices for fuel resources at world markets, instability of financial flows between countries, growth of prices for foodstuffs raw materials.

Under the influence of these factors, main indices of Russian foreign trade set new records in November 2007.

Russia's foreign trade turnover, calculated on the basis of balance-of-payments methodology, was equal to USD 58.60 bln in November 2007. As compared with October 2007 it increased by 3.14%, and as compared with November 2006 – by 40.0%.

In November 2007 Russian export volume was equal to USD 36.0 bln, being 3.6% higher than in the previous month and by 4.1% higher than in November 2006. Goods worth USD 30.8 bln were exported in non-CIS countries (39.7% more than a year ago), to CIS countries – worth USD 5.2 bln (growth by 49.7%).

Prices for oil continued to grow, setting new historic records. Main reasons for oil prices increase at the world market were higher growth rates of demand for oil, especially from rapidly developing Asian countries, as compared with oil supply growth rates, slide of the US dollar against main world currencies, firm policy of OPEC countries as to the volume of oil production (at special session of the Organization of petroleum exporting countries, which took place in Vienna on 1 February 2008, it was decided to keep oil production quotas unchanged and equal to 29.67 mln of barrels per day) and other geopolitical and climatic factors.

In November 2007 average price for oil grade Brent was USD 92.41 per barrel. As compared with October of the same year its price had increased by 13.5%, as compared with November 2006 – by 60.2%. Average price at the world market for oil grade Urals was equal to USD 90.4 per barrel in November 2007, which is by 13.2% higher than in October 2007. .

Rise of oil prices at the world markets resulted in immediate increase of export duties for oil. From 1 February 2008 export duty rate for oil increased from USD 275.4 per ton to USD 333.8 per ton. Export duty rates for light oil products is USD 237.2 per ton from 1 February as compared with USD 197.8 per ton that was in effect earlier, for dark oil products – USD 127.8 per ton against USD 106.6 earlier.

Price for Russian natural gas has grown by 7.4% as compared with the previous month. Export petrol prices have risen by 12.4% as compared with the previous month..

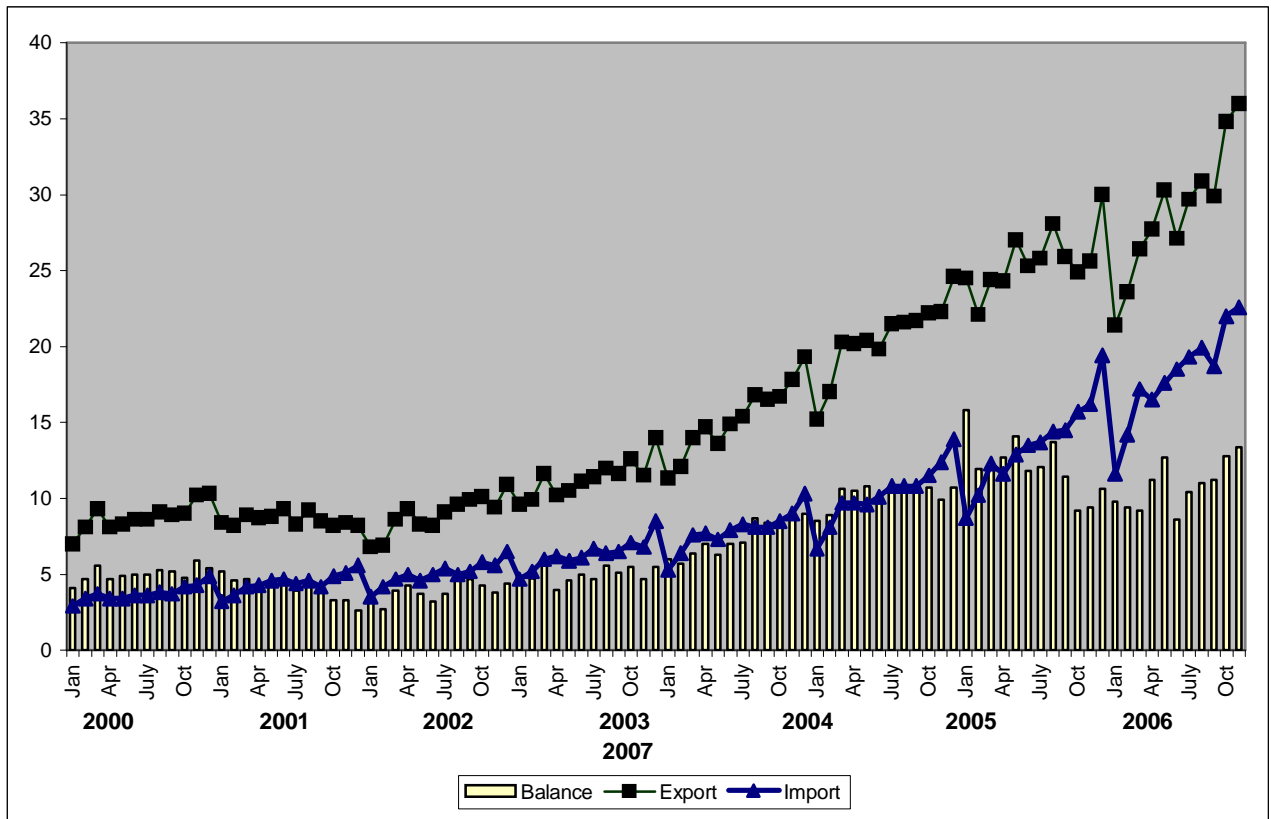


Figure 1. Main Indices of Russian Foreign Trade (as USD billion)

Source: Central Bank of the Russian Federation

Situation at the world market of non-ferrous metals worsened considerably at the end of 2007. In November positive dynamics of prices was observed only at the market of tin and aluminum. Other metals have fallen in prices considerably over the month. For instance, over November nickel on average has fallen in price by 1.4%, copper – by 13%, zinc – by 14.6%, lead – by 15.1%. Prices for aluminum in November 2007 have risen slightly – by 2.7% as compared with October 2007, and as compared with November of last year aluminum has fallen in prices by 7.2%.

On the whole the negative dynamics at the markets of non-ferrous metals at the end of 2007 was accounted for by growth of stocks and increasing excess of supply. As a result of 11 months of last year excess was observed by nearly all kinds of non-ferrous metals with the exception for lead.

Table 1.

Average Monthly World Prices in November of the respective year

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Oil (Brent), USD/bbl	17.8	11.5	24.1	25.6	19.35	24.4	28.6	43.1	55.0	57.68	92.41
Natural gas, USD /1 mln BTU	2.393	2.251	2.558	5.767	2.843	4.11	4.876	6.533	9.403	15.95	8.02
Petroleum, USD /gallon	0.5648	0.3739	0.6986	0.7649	0.5454	0.7203	0.845	1.289	1.801	1.52	2.40
Copper, USD/ton	1834.7	1601.6	1748.1	1914.4	1481.0	1610.0	2052.0	3123.0	4269.0	7002.0	6961.1
Aluminum, USD/ton	1535.5	1305.0	1470.7	1562.5	1326.6	1373.4	1507.0	1814.0	2051.0	2704.0	2506.9
Nickel, USD/ton	6099.0	4202.0	7984.2	7315.4	5159.7	7316.7	12090	14026	12116	31023	30610

Source: calculated on the basis of London Metal Exchange, International Petroleum Exchange (London)

Volume of import in the Russian Federation in November 2007 was equal to USD 22.6 bln, which is higher than the figure of last month by 2.5%, and exceeds by 38.4% the figures of November 2006. Goods worth USD 19.7 bln were exported from non-CIS countries (41.4% more than in November 2006), from CIS countries – worth USD 2.86 bln (growth by 20.6%).

High growth rates of Russian economy, population's income growth, continuous ruble appreciation remain the main factors contributing in the import growth. Real ruble appreciation against dollar was 2.3% over November, against British pound sterling – about 1%, depreciation against euro – 0.7%. On the whole

over January-November ruble appreciation against dollar in real terms was equal to 14.15%, against euro – to 4.2%, against pound sterling – 10.7%. Real effective ruble exchange rate appreciation over November was equal to 0.1%, and over January-November on the whole – to 4.6%.

As compared with October in November the rates of population's real disposable monetary incomes increased and were equal to 3.1%. In January-November 2007 as compared with January-November 2006 increase in population's real disposable incomes was 10.1%, of real wages – 16.0%, the figures being 13.2% and 13.4%, correspondingly, in January-November 2006. It was inflation acceleration that influenced the slowdown of real incomes.

Increase of import value was mainly due to increase in physical volumes of goods imported predominantly from non-CIS countries. The significance of price factor also increases. It is the prices for import of foodstuffs and agriculture raw material that has been growing by highest rates in recent months.

Positive foreign trade balance of the Russian Federation increased by 45.8% in November 2007 as compared with November 2006 – up to USD 13.4 bln. Positive balance with non-CIS countries was equal to USD 11.1 bln, with CIS-countries – to USD 2.3 bln.

In January-November 2007 Russia's foreign trade turnover, according to the data of the Bank of Russia, was equal to USD 514.5 bln (122.8% against January-November 2006), of which export – USD 316.5 bln (115.4%), import – USD 198.1 bln (136.7%).

In January-November 2007 foreign trade balance remained positive, being USD 118.4 bln (in January-November 2006 – USD 129.4 bln). Negative dynamics is accounted for by higher growth rates of import value volumes as compared with export ones. As a result index of foreign trade non-balance (ratio of foreign trade balance to foreign trade turnover) has decreased and was equal to 23% as compared with 30.9% in January-November 2006.

The Government of the Russian Federation by the Decree No 934 from 28 December 2007 established temporary duty rate for wheat, rye and wheat mixture and barley export at the level of 40%, but no less than EURO 0.105 per 1 kilogram. The decree will come into effect in one month after its official promulgation and will be in force up to 30 April 2008, inclusive.

According to the decree, obstructive duty for grain export now in effect has been increased by nearly 4 times. It should be remembered that the decision on introduction of seasonal export duties for wheat and barley was adopted by the government of Russia on 10 October 2007. The duty for wheat is established at the level of 10% of the contract price but no less than Euro 22 per ton, for barley – at the level of 30%, but no less than EURO 70 per ton.

Such measures are caused by, first of all, the necessity to balance internal market of grain and stop prices growth that continued during summer and autumn.

Prices for foodstuffs and agriculture raw materials at the world market grew at record-breaking rates throughout 2007. World prices for wheat have doubled and exceeded at the end of December psychologically important level of USD 10 per bushel (USD 370.5 per 1 ton), which is historical maximum. Prices for other foodstuffs have also increased considerably. Soybeans increased by 67%, reaching their 34-year maximum, maize reached its 11-year-maximum and rice – 4-year.

In Russia the foodstuffs continued to grow even in the environment of the declared freezing of prices for the main foodstuffs. In November only the prices went up by 1.2%, which is two times more than in November 2006.

In December 2007 the government of the Russian Federation approved the list of goods the are of primary importance for the internal market, for which temporary limitations or export ban can be introduced. Milk and diaries, grains, flour and oil are included in the list.

However it was decided not to introduce ban for export, but to increase export duties for grains, since it is preferable for negotiation process on accession to the WTO. However exporters would prefer the total ban for export since in that case they would not have to pay fines in case signed contracts, the situation being regarded as force majeure. At present, if somebody has according to contracts unfulfilled liabilities, they will have to export the grain paying the duty. Internal price for wheat of 4th grade being RUR 6500, exporting company, paying EURO 105 of duty, will certainly suffer the loss.

The majority of exporters, however, have either already closed current contracts or are exporting the grain into transit territories (the Ukraine) in case they do not manage to dispatch it before the duties come into force.

After export supplies of grain stop in February, there might be a slight decrease in prices at the internal market. However prices at the Russia's internal market are tied to the world's and their further dynamics depends on the international situation.

On 28 January 2008 temporary limitations on import of the crop production from India were introduced in the Russian Federation. On 21 January in the large lot of sesame seeds, arrived at the seaport of Novorossiysk from India, living maggots of capra beetle were found. This is the second most dangerous pest after locust. The analysis of phytosanitary risk revealed that goods losses from this beetle in Russia can be from RUR 167 mln to 5.5 bln a year.

Temporary import ban for crop production from India into Russia will apply to peanuts, sesame seeds, rice and vegetables. The ban however will not apply to tea and coffee, but rules for these products import will be toughened considerably.

These goods will be imported into Russia from India only through checkpoints in Leningrad and Kaliningrad regions. They should be transported in packing produced without the use of natural plant fibers and accompanied with the information on preventive disinfection of packing material and containers, conducted by the corresponding organizations of the supplying country. All products should meet the phytosanitary requirements of the Russian Federation.

According to the data of the Federal Customs Service, in 2007 160 thousand tons of tea worth USD 1 bln was imported into Russia, of which 40 thousand of tons worth USD 100 mln - from India. Out of 50 thousand tons of green coffee beans (worth USD 135 mln), imported last year, 8 thousand tons worth USD 20 mln were imported from India. 7 mln tons of instant coffee was imported of which 3.5 mln tons (worth USD 30 mln) – from India. Other important items of Indian export into Russia are rice and peanuts, whose supply annually is worth USD 50 mln. It should be noted that Indian sesame seed that was the cause for the ban, was supplies only in the volume of 2 thousand tons worth USD 3 mln in 2007.

The Government has introduced temporary rates of import duties with regard to some kinds of meat of cattle at the sum of 30% of customs value but no less than Euro 0.3 per 1 kilogram. The rates were approved for the period up to 31 December 2008.

Changes have also been made into the Decree of the Government No 732 “On import of beef, pork and poultry in 2006-2009”, according to which import customs duty rate for pork (fresh, cooled and frozen) is 60% of the customs value but no less than EURO 1 per 1 kilogram. Earlier the rate was equal to 50% but no less than EURO 0.83 per 1 kilogram. As regard to meat and foodstuffs by-products of poultry the rate has been changed to 60% of the customs value but no less than EURO 0.48 per 1 kilogram (earlier – 50%, but no less than EURO 0.4 per b1 kilogram).

Business Survey in January 2008

S. Tsukhlo

The dynamics of the main indicators of the Russian industry demonstrate contradictory trends. Continuous slowdown of the demand growth does not allow enterprises to increase output growth rates, which makes the satisfaction with sales lower. However sharp rise in selling prices in January enabled industry to improve its financial situation considerably and ...made the competition with import more acute.

In January 2008 the drop of demand growth rates was greater than a year ago being –23 b.p. against –7 b.p. according to initial data. Exclusion of seasonality factor demonstrated growth of sales of low intensity (+4 b.p. after +6 b.p. in 4 quarter 2007 and +8 b.p. in 3 quarter) in January. As a result demand growth rates in January were the lowest for the last seven quarters. This caused continuous decrease in satisfaction with sales. In January 2008 65% of enterprises consider demand for their products as normal, whereas the record level for this figure that was observed in August 2007 was 72%. The lowest satisfaction with January sales was registered, according to surveys in ferrous metallurgy (48%) and light industry (47%).

Similar growth rates at the beginning of 2007 and 2008 were demonstrated by the output dynamics, according to initial data before exclusion of seasonality: -23 balance points at present and –7 points a year ago. On exclusion of seasonal factor, output growth rates in January 2008 remains at the level of December 2007, though it is the lowest (not taking into account September drop in 2007) for the last 24 months. The picture does not change after exclusion of occasional fluctuations as well. To put it in another way, the industrial production growth rates, according to the estimations of the enterprises' executive managers, has stabilized at decent level, that is however lower than in the second half of 2006 – first half of 2007.

The dynamics of the output that was chosen by the Russian enterprises for the end of 2007 enabled them to “forestall” the sales growth slow-down that went on during the second half of the year by the beginning of 2008. At present the situation in the industry is unusual since there are more enterprises whose output dynamics is behind the demand dynamics than enterprises with the opposite ratio of output and demand. In other words, the considerable part of the enterprises made the decision to play safe and held the output to a

greater extent than it was required by the demand or had to act this way in the environment of continuous staff lack and increasing capacities shortage. The growth of prices that started in Russia enabled the industry to achieve good financial results in such a situation (fig. 2).

Fig. 1

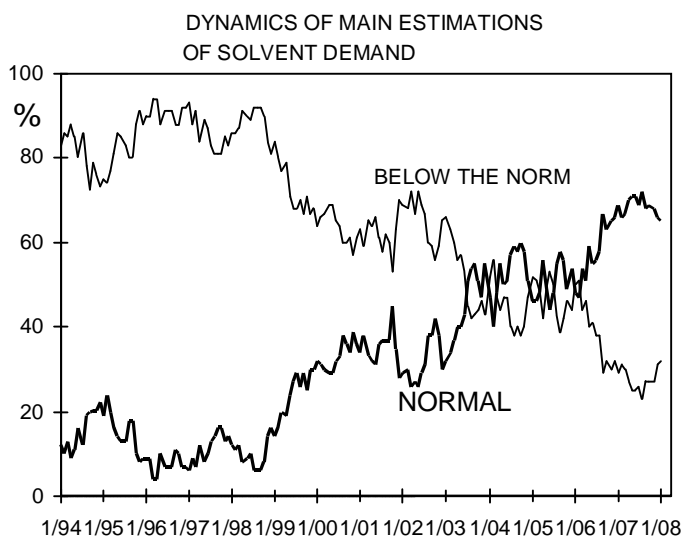
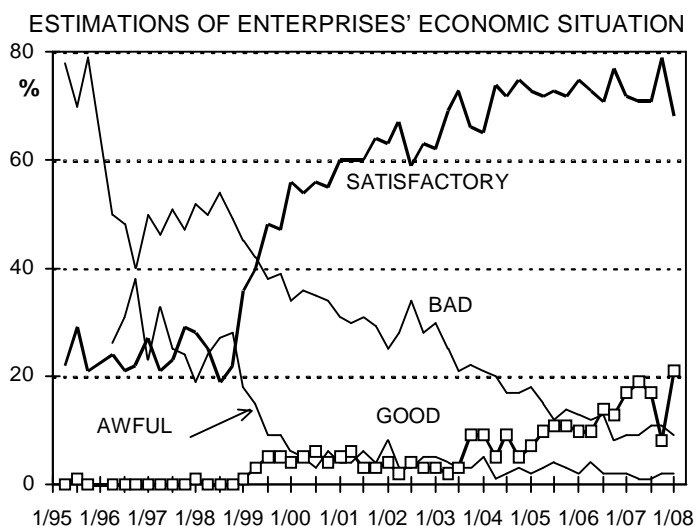
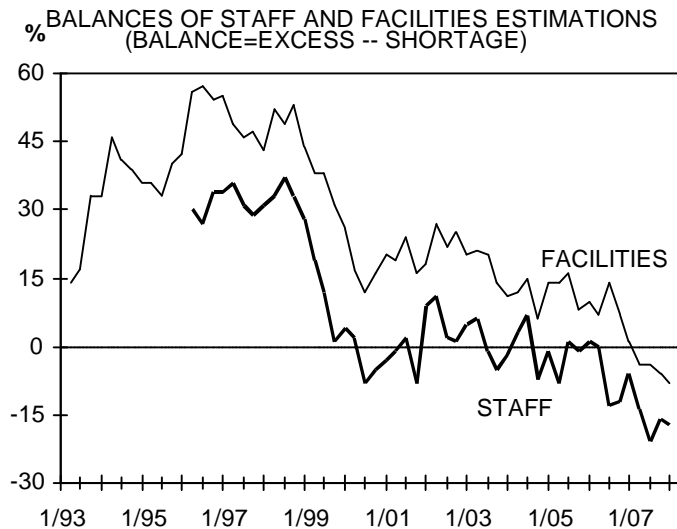


Fig. 2



This is testified by the sharp increase of the share of estimations “good” up to 21% after 8% in 4 quarter 2007. Mainly this is due to the decrease in the share of “satisfactory” estimations. Such a sharp rise of this index has not been registered by the surveys ever before. As a result it has reached the absolute maximum level in the industry on the whole. Improvement of the enterprises’ financial situation of the enterprises was characteristic for all industries except the light one.

However it seems that the growth of prices played a trick with the Russian industry: its production has lost competitive advantages over import. The latter at present hinders output growth at 26% of enterprises, whereas in 4 quarter 2007 the frequency of this obstacle citing was equal only to 17%. Such a sharp rise in this obstacle citing has not been registered by surveys in 1996-2008. But it is the shortage of staff that is still considered as the biggest obstacle for output growth. This obstacle has been holding the first place two quarters in the row even though frequency of its citing decreased in 1 quarter 2008 by 2 points and the extent of other obstacles’ citing has increased. The second place is still held by the shortage of liquid funds and the third – by low demand whose frequency has increased by 4 p.p. over the last two quarters.



The biggest shortage of staff in connection with the expected growth of demand Russian industry experienced in the middle of the current year. Then 27% of enterprises considered that they did not have enough staff to satisfy expected demand, while 6% of enterprises had excessive number of employees. By the end of the year against the background of sales growth rates deceleration and lowering of optimism of forecasts for it the shortage of specialists began to decrease and is registered at present at 23% of the enterprises, excessive number of staff remaining at the former 6% level. The shortage of production facilities, on the contrary, is increasing. At the beginning of 2008 the shortage of equipment is experienced by 19% of enterprises against 11%, which experience its excess. Resulting balance is –8 points, which is the absolute minimum for the period of 1993-2008.

Forecasts for changes in the demand that remained in the second half of 2007 at the same and quite optimistic level despite gradual decrease of the real sales growth rates, increased by 4 points in January. In January of the last year the forecasts were reconsidered in the opposite direction by 5 points. Enterprises' output plans have also been reconsidered towards more optimistic ones and went up by 6 points in January 2008 as compared with 5 points slide a year ago. It seems that the main reason for such corrections is just the necessity to overcome decreasing sales growth rates and low output growth rates of the second half of 2007.

Formation of Competitive Environment in the Russian Industry in 2000-2007

Analysis of formation of the real competitive environment is very complicated task since necessary statistics data are absent and it is impossible to develop adequate (direct and functioning) indices for the majority of factors. However, the issue of what influence existing agreements between the enterprises on price policy and division of sales markets have on the level of competition is still important in the economic analysis.

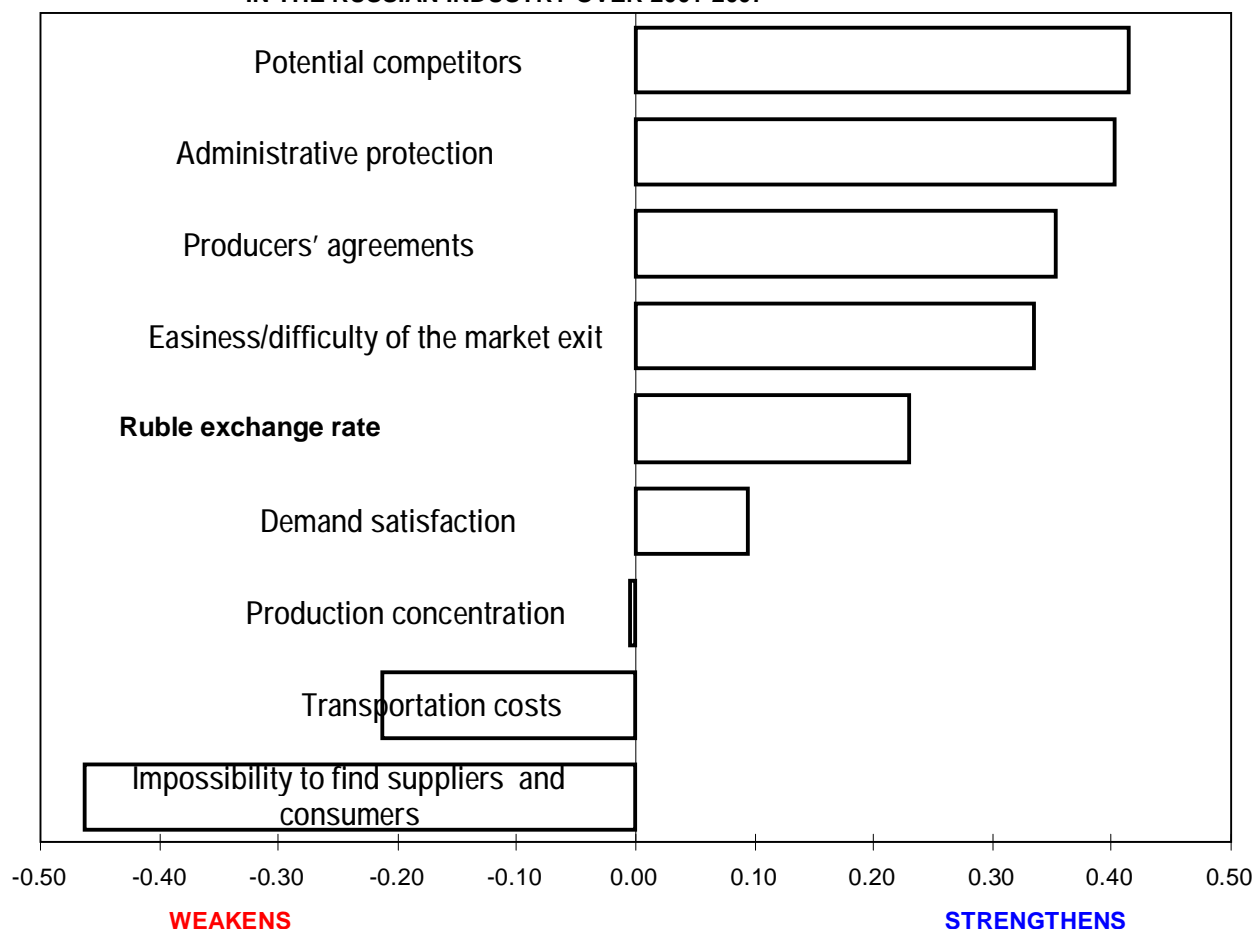
Analysis of the contribution of different factors in the formation of the total (aggregated) level of competition in the Russian industry is possible on the basis of surveys of enterprises' executives. Taking such an approach lifts a number of problems and allows receiving totally new data that can serve as a basis for the correction of the government policy in the field of competition development. A substantial advantage of such an approach is its efficiency and regularity.

To put the approach mentioned in practice starting with 2000 with the interval of 23-26 months, that is in a two-year cycle, the questions on direction and the effect of the main factors influencing competition, outlined by the economic theory, were asked to the executives of enterprises that participate in regular IET's business surveys.

As it is shown by the results that are tracked in the course of monitoring the factors on the whole are divided in two groups (*fig. 3*). The first group (positive influence on the competition) consists of six factors: the extent of demand satisfaction and presence of excessive facilities, ruble exchange rate, possibility to exit the market, agreements on price policy and sales market division, administrative protection of the markets, presence of the potential competitors. The second group (negative influence) consists of three factors: level of production concentration, the volume of transportations costs, problems with suppliers and consumers search for a new producer.

Fig. 3

**AVERAGE ESTIMATIONS' BALANCE OF COMPETITION FORMATION
IN THE RUSSIAN INDUSTRY OVER 2001-2007**



Extent of positive or negative resulting impact of the analyzed factors on the competition in the Russian industry was unstable, sometimes the sign of the effect changed (see *table 1*). The results obtained indicate the priorities of competitive policy in the Russian industry.

Table 1.

Resulting Influence of the Factors on the Level of Competition in 2000-2007

Factors	2000	2002	2004	2007
1. Level of production concentration	-0.11	0.04	0.14	-0.09
2. Extent of demand satisfaction	0.05	0.14	-0.01	0.20
3. Agreements on price policy and markets division	0.38	0.50	0.13	0.40
4. Transportation costs	-0.28	-0.02	-0.30	-0.25
5. Search for suppliers and consumers	-0.69	-0.31	-0.38	-0.47
6. Administrative protection of the markets	0.31	0.41	0.48	0.41
7. Ease/difficulty of exit from the market	0.30	0.29	0.30	0.45
8. Potential competitors	0.25	0.46	0.34	0.61
9. Ruble exchange rate		0.22	0.13	0.34

Source. Calculations based on the IET surveys.

Note. Resulting influence of factors was calculated as difference between average reinforcing and average weakening influence. The more the value of difference is the more intensive is factor's influence. Sign (+/-) demonstrates the direction of the influence on the competition (reinforcing/ weakening).

Othe main obstacle for competition development the producers consider the problem of search for suppliers and consumers. The reason mentioned has the total negative impact on the competition in all branches of

the industry. The impeding influence of this factor (that is both positive and negative effects taken into account) is especially high in metallurgy, wood processing complex, construction materials production and machine-building.

High transportation costs in total (that is as difference between reinforcing and weakening effects) are considered to be quite substantial obstacle for the competition. The transportation constituent of the costs has the biggest final impact in the construction materials production, ferrous metallurgy, timber and wood processing and pulp-and-paper industry.

The extent of production concentration has the most moderate negative influence on the level of competition. Though the average balance over all four surveys turned out to be negative (see *fig. 3*), its absolute value is quite small, and results of two of the surveys demonstrated positive though small, in opinion of enterprises, influence of concentration on the level of competition (see *table 1*). Thus, on the whole over the industry there is zero balance of negative and positive in this sphere.

Presence of potential competitors that are able to intrude attractive markets rapidly is the top of the list of factors that have positive influence on competition in the Russian industry. Absence (or low efficiency) of the administrative protection holds the second place as to the extent of the positive influence on the level of competition. This factor has resulting positive influence on competition in all branches of industry. It can be assumed that active struggle with regionalization of the markets and traditional Russian non-observance of decisions directed towards limitation of interregional export by the enterprises has played its role: producers got single national sales market, transfer of goods through which is limited mainly by transportation costs and not by administrative barriers. A small number or low efficiency of agreements between the enterprises on price policy and sales markets division have quite strong positive influence on the level of competition. This factor is perhaps the most delicate in the issue under examination. The difficulty in exiting the markets (funds withdrawal) in order to create productions in more attractive sectors hold the fourth place by the extent of the positive influence on the competition and are only slightly behind the previous factor. This circumstance however is not to be estimated positively. The enterprises believe that in the existing conditions it is difficult to liquidate a non-competitive enterprise. They have to continue production of the unprofitable goods, "littering" the market with the unnecessary goods and using resources that could be used for production of normal goods inefficiently. High satisfaction of solvent demand and presence of excessive facilities are at the bottom of the list of factors having resulting positive influence on the competition.

In the end, under conditions of the economic situation of 2000-2007 the factors analyzed have positive impact on the level of competition in the Russian industry as a whole. This gives some grounds for considering of the government policy in this field as effective. Real competitive environment is formed under the influence of both the factors that are ultra vires (out of the zone of responsibility) of the antimonopoly department (potential competitors, possibilities to exit the market, ruble exchange rate, demand satisfaction) and the factors that are under governmental bodies' control. At the same time absence of agreements between the producers can hardly be regarded as the consequence of antimonopoly department functioning, since to ascertain such collusions is extremely difficult and takes a long time. At present, perhaps, government bodies have neither the time nor the experience of investigation of such collusions, which, it seems, are a rare case in Russian practice.

The main achievement of the antimonopoly department and government as a whole, which is recognized by producers themselves, as to the formation of competitive environment is absence of administrative protection of the markets. Negative influence of production concentration and transportation costs on the competition should certainly become the main task of the government in the nearest future.

Public Sector and Property Policy

A. Radygin, G. Malginov

Review of the main trends in government property policy. Particular attention is paid to the forecast for 2008-2010, quantitative and structural dynamics in the development of public sector at the turn of 2007-2008.

The major document regulating public property policy in the new year is the Privatization Program for 2008 and basic trends in federal property privatization for 2008-2010, approved by the RF Government Resolution N 543-p dated April 29, 2007.

There are no significant changes in the structure and content of the Program as compared with earlier relevant documents. Within 2008-2010, packages of shares of joint-stock companies will be available for sale, which have been established as a result of corporization of federal public unitary enterprises, with the

exception of joint-stock companies, included in the list of strategic enterprises and company-members of integrated structures. Annual budget revenues from privatization in 2008-2010 are estimated at approximately RUR 12 billion.

In particular, the following property objects will be offered for privatization in 2008:

- packages of shares within the limit of 50 per cent of the joint-stock companies authorized capital, with the exception of joint-stock companies, included in the list of strategic companies or company-members of corporate structures, as well as the shares, which will be brought out to the market with the aim to replenish the federal budget in 2008-2010 in accordance with the estimated financial plan;

- Shares of joint-stock companies, engaged in fuel and energy or construction industry, external economic relations, civil aviation, healthcare, chemical, petrochemical, printing industries, geology, fishery, poultry and cattle breeding, crop production, lumber industry, medical industry, machine building, with the exception of the strategic joint-stock companies (557 companies);

- Federal public unitary enterprises, engaged in transportation, construction industry, civil aviation, geology, oil and gas sector, fuel production, sea and river transport, printing industry, healthcare, crop, livestock and poultry production (573 federal public unitary enterprises);

- Property of the RF Treasury, not supporting government functions (101 objects) and shares in authorized capital of limited liability companies (12 blocks of shares).

Among the major objects of federal property it is planned to let for privatization in 2008 the shares of OAO "VO Technopromexport" and "Lenfilm" movie producing business.

In 2008-2010 the activities on establishment integrated businesses will be continued in military-industrial complex, in aviation, shipbuilding, nuclear and space industries. In 2009-2010 privatization is anticipated in regard to all federal public unitary enterprises, not involved in the direct support of the RF government functions, as well as the shares of open joint-stock companies, established as a result of federal public unitary enterprises corporization.

As concerns the actual privatization process in 2007, like in preceding year, there were no privatization transactions with the assets of national importance.

The greatest publicity has won the sale of "Yakutugol" package of shares (75 per cent minus 1 share) and "Elgaugol" shares (68.8 per cent) for RUR 58196 billion, although the objects of sales were not in federal property: "Yakutugol" package of shares, as well as 39.4 per cent of "Elgaugol" shares were in the Republican property, included earlier in authorized capital of "Republican Investment Company", and the owner of other 29.5 per cent of shares was OAO "Russian Railways".

By the beginning of 2007²⁶, the structure of the shares in federal property was as follows: packages up to 25 per cent of the capital made less than 1/4 of the total number of shareholding companies with public participation, blocking minority ownership packages (from 25 per cent to 50 per cent of the capital) made some more than 1/5, and in more than 54 per cent of all those companies the government has either majority ownership or full control. Herewith, the share of the latter companies (with 100 per cent of government capital) is 44.6 per cent, i.e., it exceeds 4.5 times the share of those joint-stock companies, where the government, as a majoritarian shareholder, had less than 100 per cent of the shares (9.6 per cent). The major variance that occurred in 2006-2007 was the expansion of the companies with 100 per cent of federal property share by 12 p.p. (from 32.6 per cent to 44.6 per cent). The share of all other companies has been reduced, especially the shares of minority-holding companies (from 30.5 per cent to 24.4 per cent).

Therefore, in 2007 the total share of joint-stock companies, in which the State may exercise full control as a majority shareholder or the owner of 100 per cent package, *for the first time since the late 90-s has exceeded half of all businesses with public participation.*

The overall dynamics of the public sector in the Russian economy in the past 2007 was characterized by the same basic trends as in the previous three years:

- continued integration of federal assets in corporate holdings: integration of "Transnefteproduct" with "Transneft" and "Novoship" with "Sovcomflot" through acquisition of additional issues of shares, establishment of OAO "Joint Shipbuilding Company" and "Nuclear Power Engineering Complex", integration of public and private assets of five airlines, members of Air Union corporation, through establishment of OAO "AirUnion", a new, one of top three domestic carriers; adoption of long-expected decisions on the establishment of tank-construction and engine-manufacturing holdings, etc.;

²⁶ Ref.: G.N. Malginov, A.D. Radygin "Public Sector of the Russian Economy: Quantitative Indicators Dynamics and Major Trends in Development" in: "Economic and Political Situation in Russia", June 2007, M., IET, 2007, pp. 43-48.

– continued activity of existing holdings with the State participation on expansion of their business scope and diversification through acquisitions and mergers, vertical and horizontal integration: “Rosneft” acquisition of the majority of former Yukos assets as a result of bankruptcy proceedings, the transfer of Kovyktinskoye gas field, located in the Irkutsk region, under “Gazprom” control, an expressed interest of “Russian Railways” to purchase shares in the largest sea ports and in “Transmashholding”, the top railway vehicles manufacturer.

In the background of the overall trend to expansion of public sector in economy and the transparency of the above-mentioned developments, such extraordinary transactions are worth mentioning, as acquisition in trust management of “Transneft” and two corporate operators of “Caspian Pipeline Consortium”, located in Russia and Kazakhstan²⁷, avoiding a tender for the State-owned packages of shares (24 per cent each). In this situation, deliberate restriction of the State ownership in the new “AirUnion” airline to a minority package (only 45 per cent) is explicitly in contrast with the common trend, prevailing in incorporation of integrated businesses in the recent years.

Beyond all doubts, the most important events, that occurred in the public sector of the Russian economy were IPO of the two largest banks with the State participation (Sberbank and Vneshtorgbank)²⁸ and the completion of the basic organizational framework development for the new structure in the electric power sector in the framework of “RAO UES of Russia” restructuring. At the meeting on October 26, 2007, the shareholders of “RAO UES of Russia” have approved the company restructuring. By July 1, 2008 structural changes of the energy holding assets should be completed, all companies of the industry (FSK, WGC, THC, etc.) will become independent businesses from OAO “RAO UES of Russia”, and the OAO “RAO UES of Russia” headquarters will terminate its activity²⁹. The liquidation, planned for the summer of 2008, should be accompanied with the transfer of shares to shareholders of 23 major electric power companies (WGC, TGC, FSK, etc.). As opposed to that, no dramatic reorganization measures (separation, etc.) are planned in regard to OAO “Gasprom” in the medium term.

The fundamentally new in the national property policy in 2007 has been the establishment of several *public corporations*, some of which are regarded as development institutions, along with special economic zones and the Investment Fund.

The following corporations were established by special federal laws: “Vnesheconombank” (by Federal Law N 82 as of May 17, 2007), “Rosnanotech” (by Federal Law N 139 as of July 19, 2007), “Foundation for the Reform of Housing Utilities” (by Federal Law N 185 as of July 21, 2007), “Olympstroy” (for construction of Olympic facilities for the 2014 winter Olympics in Sochi and further development of the area as a mountain health resort) (by Federal Law N 238 as of October 30, 2007), “Rostehnologii” (by Federal Law N 270 as of November 23, 2007), “Rosatom” (by Federal Law N 317 as of December 1, 2007).

Naturally, those structures are explicitly different in nature of their prospective objectives. “Olympstroy” and the “Foundation for the Reform of Housing Utilities” are targeted projects with predefined time frames. “Rosnanotech” should perform certain functions in the framework of innovation program and Vnesheconombank in its new status should promote exports of processing industry products and to launch capital-intensive infrastructure projects. “Rosatom” is a purely industry-targeted structure. “Rostehnologii” is an evident conglomerate, as according to the Decree of the RF President N 1577, dated November 26, 2007, 100 per cent of FGUP “Rosoboronexport” shares should be transferred to “Rostehnologii” upon corporization of the company. The latter, as is known, includes a lot of businesses in a wide range of industries (helicopter-construction holding, “AvtoVaz”, “VSMPO-Avisma”, “Motovilihinsk Plants”, etc.). At various stages of implementation are “Rosoboronexport” projects on establishment of “Russpetsstal” holding, one of engine-manufacturing holdings, as well as an explosives-production holding.

At the same time, as D.A Medvedev, the Prime Minister of Russia has officially announced in January 2008, the establishment of public corporations does not mean the change in the government policy and the refusal of Russia from market economy, as the State capitalism is a way to nowhere³⁰. The need to support those priorities, in which Russia is starting to lose former leading positions (nuclear industry, ship-building and aircraft construction) is presented as an incentive for establishment of commercial structures with public participation. Nevertheless, the boundaries of private business participation are quite clearly defined: if in

²⁷ It is worth noting that the latter event is one of the few examples of 2007, demonstrating the way of shares management through the transfer of the state-owned shares in trust management.

²⁸ See in detail: “Russian Economy in 2006. Tendencies and Perspectives. M., IET, 2007.

²⁹ www.rao-ees.ru.

³⁰ «Gasprom» will not be split. Vesty Ru, January 17, 2008.

most cases private capital can have considerable share, there is no alternative to full control of the government in the defense sphere.

Nevertheless, in 2007 a distinctive trend to establish public corporations (pursued in at regional level as well) is provoking various economic and financial risks. First of all, it is worth noting that the procedure of public corporations establishment is based on specific approach, which brings them outside the general legal standards, set by the law for the forms of legal entities incorporation (joint-stock companies, unitary enterprises, not-for-profit organizations).

Indeed, the status of public corporations either in explicit, or in disguised form combines the features of various forms of incorporation, not speaking of the inevitable confusion, arising from the use of "corporation" notion. The word is found in the names of a number of other entities, for instance, the companies, established for the purposes of structural and industrial policy, like public corporations, emerged in 2007, which, however, have the status of OAO or unitary enterprises.

Another important question is what should be the real mechanism to monitor the activities of such corporations and how it should be defined in detail in applicable documents of incorporation, especially in terms of national property and assets security, their targeted utilization, transparency and consistency of the declared activities with the corporation objectives.

In general, as per quantitative estimates, the share in the Russian companies, owned by the State, made 29.6 per cent in 2006 and 35.1 per cent in early 2007³¹. By early 2008, the "extent of government ownership" made about 40-45 per cent according "Expert-400" list. Whereas in 2004 the government controlled 81 businesses of the 400 largest companies (with the total revenues of USD 145 billion), in 2006 that number has reached already 103 companies (with the total revenues of USD 283 billion)³². While in 2004 there were 34.7 per cent of the total revenues of the top 400 companies in Russia under government control, at the end of 2007 the State was in control of around 40 per cent of those revenues³³.

At the beginning of 2008, there was observed a qualitative shift in expert assessments: they were changing from the statement on expansion of the direct State involvement in business to the efforts to assess the quantitative scope of government business expansion. In our view, neither the above (even highly conditional) quantitative estimates for 2004-2007, nor the new trends in the State business property policy and activities of public economic structures in 2007, do not provide sufficient grounds for overall conclusion, that the expansion of government expansion is getting reduced.

Herewith (other things being equal, which include political and corruption conditions), qualitative threshold of such expansion is rather evident: the larger is the scope of public sector, the less is the capacity for its effective management and control. This is evidenced, among other things, by the experience of introduction (attempts to apply) of any new management and control instruments for unitary enterprises and joint-stock companies with the State participation in late 90-s – 2000-s. Similar to the evolution of private Russian business groups of the late 2090-s – early 2000-s³⁴, in medium term one should expect some transformations, aimed at optimization of the acquired assets structure, as well as functional framework and management aspects of public companies (and/or groups of companies). Time will show, how effective will they be in regard to public companies and what would be the incentives for such a transformations after March 2008.

Meetings of the Government of the Russian Federation in January 2008

M. Goldin

In January the following issue was discussed at the meeting of the government of the Russian Federation: the project of the Federal Law "On making changes to some legislative acts of the Russian Federation concerning granting of retirement pension".

As it is reported in the press-release of the Government of the Russian Federation the project of the Federal Law "On making changes to some legislative acts of the Russian Federation concerning granting of retirement pensions" has been prepared in order to reinforce social support of wives (husbands) of military

³¹ Alpha-bank data (B. Groznovsky. "Major National Owner. – Vedomosty, February 13, 2007)

³² Above Minority Package of Shares, or Government Control Completion Phase.

³³ Ref.: A. Vinkov. "You are the Government! – Expert, 2008, № 2, pp. 28-31.

³⁴ Ref. A. Adygin. "Integration forms development and Management Models: Experience of the Top Russian Corporations and Groups of Companies. – Russian Management Magazine, 2004, Volume 2, № 4, October-December, p.p. 35-58.

service people, doing service by contract, as well as wives (husbands) of government bodies of the Russian Federation employees and international organizations.

According to legislation currently in effect insured length of service includes periods of work and (or) other activity on condition that insurance contributions were paid during these periods to the Pension Fund of the Russian Federation.

Besides, Federal Law "On retirement pensions in the Russian Federation" from 17.12.2001 envisages the possibility to include some "non-insured" periods in the insured length of service.

Inclusion in the insured length of service the periods of wives (husbands) of servicemen who do military service by contract living together with husbands (wives) in places where they could not work due to the absence of employment opportunities as well as periods of wives (husbands) of the government bodies of the Russian Federation and international organizations living abroad is not envisaged by the Law from 17.12.2001.

According to pension legislation that was in effect up to 01.01.2002 while calculating the pension in concordance with the norms of the Law "On government pensions in the Russian Federation" from 20.11.1990 such periods of residence were included in the general length of service, but of the period no more than 10 years in total.

The project envisages making changes to paragraph 1 clause 11 of the Law from 17.12.2001 that will allow inclusion of the periods mentioned above in the length of service.

Simultaneously it is supposed to make change to paragraph 2 clause 17 of the Federal Law "On compulsory pension legislation in the Russian Federation" from 15.12.2001 extending it for the periods mentioned.

This paragraph envisages allocation of federal budget funds to compensate for the payment of insurance contributions over the period of care for a child up to the age of one and a half year and over the period of doing military service by contract.

The procedure for compensation of the funds mentioned is defined by the Federal Law "On the federal budget funds allocated to the Pension Fund of the Russian Federation to compensate for insurance contributions payment over the period of care for a child up to the age of one and a half year and doing call-up military service" from 21 March 2005.

Thus, in case the bill is approved, the funds will be allocated from the federal budget to compensate payment of insurance contributions over the periods mentioned.

The amount of funds from the federal budget to be allotted to the Pension Fund of the Russian Federation in order to compensate for each insured person in case bill is approved will be included in the calculated pension capital, from which insurance part of the retirement pension is calculated.

These measures allow increasing the rate of retirement pension for these categories of the insured people.

In 2009 additional expenditures for project fulfillment will be equal, according to preliminary estimation, to RUR 568.60 mln a year.

At the same time it should be noted that the periods in question should be proved according to the order established by the Government of the Russian Federation. At present insured length of service for establishing of retirement pensions is proved according to Regulations on calculation and proof of insured length of service for establishing retirement pensions, established by the Government of the Russian Federation on 24.07.2002.

In this connection in case the bill is approved relative amendments will be made to the Regulations mentioned that will define the procedure for proof of new periods to be included in insured length of service.

On studying press-release at least two questions arise:

1. What the norms for refund by new "non-insured periods" be like – the periods of wives (husbands) of servicemen who do military service by contract together with husbands (wives) in places where they could not work due to the absence of employment opportunities as well as periods of wives (husbands) of the government bodies of the Russian Federation and international organizations abroad be like;

2. Whether "non-insured periods" mentioned above that had taken place before amendments to the laws "On compulsory pension insurance in Russian Federation" and "On government pensions in the Russian Federation" came into effect will be taken into account.

Review of Economic Legislation over January 2008

I. Tolmacheva

At the end of December-January the following acts were approved: Procedure for making compensatory payments for deposits in the Savings Bank of the Russian Federation (Sberbank) to some categories of citizens of the Russian Federation in 2008; Procedure for management of means of the Fund for national wel-

fare and Requirements for financial assets, where the means of the Fund for national welfare can be placed; coefficient for indexation of the insurance part of the retirement pension; data applied for calculation of severance tax for oil for December 2007 are prepared for application.

I. Decrees of the Government of the Russian Federation

“ON PROCEDURE OF making compensatory payments for deposits in the Savings Bank of the Russian Federation (Sberbank) to some categories of citizens of the Russian Federation in 2008” from 29.12.2007 No 1002

Procedure for making compensatory payments for deposits in the Savings Bank of the Russian Federation (Sberbank) by the state of affairs on 20 June 1991 that are secured savings according to the Federal Law “On restoration and protection of savings of the citizens of the Russian Federation” from 10.05.1995 No 73-FZ to some categories of citizens of the Russian Federation in 2008.

For instance the Procedure establishes the coefficients to be applied for determination of the compensation amount and additional compensation, categories of citizens that are to receive these payments are enumerated (citizens of before 1954 year of birth inclusive, disabled, parents, guardians and tutors of the disabled children etc.).

2. “PROCEDURE FOR MANAGEMENT OF MEANS OF THE FUND FOR NATIONAL WELFARE” from 19.01.2008 No 18

Procedure for management of means of the Fund for national welfare and Requirements for financial assets, where the means of the Fund for national welfare can be placed are approved.

The requirements for financial assets include requirements for promissory notes of foreign countries’ government agencies and central banks, promissory notes of international financial organizations, including those processed as securities as well as requirements for deposits in foreign banks and credit institutions.

Means of the Fund for national welfare can be deposited in foreign banks and credit institutions.

3. “ON ESTABLISHING OF THE INDEXATION COEFFICIENT FOR INSURANCE PART OF THE RETIREMENT PENSION FROM 1 FEBRUARY 2008” from 25.01.2008 No 25

Comes into effect from 01 February 2008.

From 1 February 2008 indexation will be conducted for insurance part of the retirement pension. Coefficient index will be 1.12.

II. Letters, Orders, Instructions

Letter of the Federal Tax Service of the Russian Federation “ON DATA, NECESSARY TO CALCULATE SEVERANCE RATE IN REGARD TO OIL FOR DECEMBER 2007” dated 17.01.2008, No CK-6-11/25@

The data, applied to calculation of the severance tax in regard to oil for December 2007, are prepared for application:

- average level of prices for oil grade Urals – USD 87.94 per barrel;
- average US dollar exchange rate against ruble of the Russian Federation over all the days of the tax period – 24.5662;
- Cp coefficient value – 7.4301.

Review of Regulatory Documents Concerning Taxation over December 2007 – January 2008

L. Anisimova

1. In 10 days after official promulgation the order of the Ministry of Education and Science from 1.10.2007 No 267, registered in the Ministry of Justice of the Russian Federation on 17.01.2008, adopted to fulfill the decree of the Government of the Russian Federation from 23 August 2007 No 534 “On conducting experiment on government support for granting of educational credits to students of higher educational institution having government accreditation”, will come into effect.

Higher educational institutions that have registered applications for taking part in the experiment in appropriate manner: 1. Receive the right to act as a warrantor of the contract between students and credit institutions of granting education credits; 2. Receive refinancing from the budget funds at the rate of 10% of the sum of educational credits granted in all the cases when a warrantor executed his liabilities of a borrower to the bank that is a participant of the experiment in concordance with the contract and the borrower in his turn does not carry out his obligations to the bank partially or at all.

The problem is that the government guarantees the warrantor only 10% of the sum of the educational credit, whereas a warrantor and a student have joint responsibility by the warrantor contract, that is are responsible by the total amount of the credit. In case a borrower does not carry out his obligations an educational institution will have to pay to the bank the sum, exceeding the sum of the borrower's debt over the figure of 10% from the contract for granting an educational credit, since the bank rendered the service not to the educational institution but to the third person – student. Besides, this order, violating the legislation on banks and banking activity defines the kinds of credits, such as “main, additional, accompanying”. Introduction of random names for the credits not envisaged either by banking or tax legislation or by the decree of the Government of the Russian Federation No 534 can lead to complications when applying tax legislation to exclusion of the sums paid by the warrantor, higher educational institution, at the expense of the budgetary subsidy from taxable incomes of the student.

The relevance of exclusion from the experiment of budgetary educational institutions – it is directly stated in the Decree of the Government of the Russian Federation that government (municipal) institution cannot act as a warrantor - also causes some doubt, as well as the fact that according to the decree of the Government of the Russian Federation interest rates for educational credits are firmly regulated at the rate of no more than 10%. These prescriptions do not correspond to the rules of the market economy and exclusion of budgetary educational institutions from the list of participants decreases their competitive ability as compared with the commercial ones.

2. According to the decree of the Government of the Russian Federation from 19 January 2008 No 17 from 1.01.2008 a total relative exemption from paying custom duties and taxes is granted to the Russian citizens exporting temporarily in order to conduct geological prospecting of floating or operating under the surface of water drilling or operation platforms (code of the Goods denomination of the Foreign Economic Activity of Russia 8905 20 000 0), the limitation period of whose import into the territory of the Russian Federation is 5 calendar months on condition that such goods remain the property of foreigners and are given to Russian citizens on contracts of rent, financial rent.

Legal base for the decree is not completely clear. In fact, clause 150 of the Tax Code of the Russian Federation defines the exhaustive list of goods not levied with VAT in case of their import into the territory of the Russian Federation. Such group of goods is not mentioned in the list.

The Decree of the Government of the Russian Federation contains reference for clause 212 of the Tax Code of the Russian Federation. In the situation in question there is a legislative conflict: issue on paying of the tax established by the Tax Code of the Russian Federation is settled with the reference to another specific legislation act – Customs Code of the Russian Federation.

Customs Code and Tax Code are to be brought to conformity (see, for example, version of the Tax Code of the Russian Federation with the reference to the Customs Code from 28.05.03 No 61-ФЗ). Later this practice was abolished, which at present leads to the conflict of legislation. Tax Code of the Russian Federation contains the regulations that are not in accord with the regulations of the Customs Code of the Russian Federation as to the procedure of taxes payment, and Tax Code defines the procedure for payment of taxes, established in the Tax Code.

3. According to the letter of the Federal Tax Service of the Russian Federation from 9 January 2008 No 18-0-09/0001 the issue on the procedure for social payments as to holiday payments is clarified. It is explained that according to paragraph 2 clause 223 of the Code on receiving of income in the form of labor remuneration the last day of the month for which income for fulfilled labor duties was accrued is referred to as the date of actual receipt. Holiday payments are not payments for fulfillment of labor duties, since according to clauses 106 and 107 of the Tax Code of the Russian Federation holiday is the period during which an employee is exempted from execution of work duties. That is why holiday payments are classified by the Federal Tax Service of the Russian Federation not as labor remuneration but as other incomes, received in monetary form, regulated by subparagraph 1 paragraph 1 clause 223 of the Code. In this case according to subparagraph 4 clause 226 of the Tax Code of the Russian Federation, tax agents should deduct the calculated tax sum directly by actual payment.

4. According to the letter of the Ministry of Finance of the Russian Federation and Federal Tax Service of the Russian Federation the issue on the procedure of inclusion into amortization groups of immovable property in case registry office refuses registration of rights for immovables.

For instance, it is clarified that fixed assets, rights for which belong to the government registration in accordance with the legislation of the Russian Federation are included in the corresponding amortization group from the moment of testified by some documents fact of papers submission for registration of the rights mentioned (paragraph 8 clause 258 of the Tax Code of the Russian Federation). If later according to the decision of the department authorized to conduct registration of rights for immovables the rights for the fixed

assets are recognized as not subject to registration, paragraph 8 clause 259 of the Code that establishes the procedure for inclusion in amortization group the property rights for which are subject to registration is not applicable to this property.

This means the following. In accordance with clause 256 of the Tax Code of the Russian Federation it is the property, results of intellectual activity or other objects of intellectual property that belong to the taxpayer by the right of property, are used by him to make profit and whose value is paid off by means of amortization charges that is referred to as depreciable property. The Tax Code of the Russian Federation at the same envisages some exceptions from the general rule. For instance, such an exception is ownership of the property not by the right of property but on some other basis if they are directly envisaged by chapter 25 of the Tax Code of the Russian Federation. For example, chapter 25 of the Tax Code of the Russian Federation specifies particular procedure to charge amortization for the property given (received) by leasing. According to paragraph 8 clause 259 taxpayers having given (received) fixed assets that are subject to leasing contract, signed before chapter 25 of the Tax Code of the Russian Federation came into effect, have a right to charge amortization, applying methods and regulations existing at the moment of giving (receiving) the property, and to apply coefficient 3 for accelerated depreciation.

Thus, the letter of the Ministry of Finance and Federal Tax Service of the Russian Federation from 25 December 2007 No 02-1-07/43@ clarifies that immovables included in amortization group on the date of documents submission to the registration and later recognized as not subject to registration is not depreciable and rules for calculation of amortization and accelerated depreciation, established for fixed assets, given (received) according to a leasing contract are not applicable to it.

Review of the Budgetary Legislation over January 2008

M. Goldin

In January 2008 in the sphere of the budgetary legislation a number of Decrees of the Government of the Russian Federation came into effect: Regulation, that details the procedure of the budgetary process while complying the projects of the federal budget and budgets of governmental off-budget funds of the Russian Federation for the next financial year and planned periods, procedures for management of National Welfare Fund's means and Fund for Development, standards for expenditures formation for maintenance of government authorities of a subject of the Russian Federation.

The Decree of the Government of the Russian Federation from 29.12.2007 No 1010 "On the procedure for making federal budget project and projects for budgets of governmental off-budgets funds of the Russian Federation for the next financial year and planned period".

According to the Decree the Statute on making federal budget project and projects for budgets of governmental off-budgets funds of the Russian Federation for the next financial year and planned period is approved. The Statute establishes the authority of the Government of the Russian Federation, Ministry of Finance, Ministry for Economic Development and Trade, Ministry for Health Care and Social Development, Ministry of Regional Development of the Russian Federation as well as the subjects of budget planning while making federal budget project and projects for budgets of governmental off-budgets funds of the Russian Federation for the next financial year and planned period. Besides, the Statute specifies the statement of the Budget Code of the Russian Federation on procedures for making of the projects mentioned.

According to the Decrees of the Government of the Russian Federation from 29.12.2007 No 955 and from 19.01.2008 No 18 the Procedure for management of the means of Reserve Fund and National Welfare Fund and Requirements for financial assets where these funds' means can be placed, correspondingly, are established. Both of the Funds were created in place of the Stabilization Fund that was abolished in 2008.

There are two ways for the Ministry of Finance to manage Funds' means (of each of them or both of them simultaneously):

a) by purchasing at the expense of the Reserve Fund and National Welfare Fund of foreign currency in the form of US dollars, Euros, Pound Sterling and its depositing to the bank accounts opened in the Central Bank of the Russian Federation in foreign currency for which these operations are allowed in accordance with the banking account contract between the Federal Treasury and the Central Bank of the Russian Federation. The interest that is established by the banking account contracts must be paid by the Central Bank of the Russian Federation for the use of monetary assets deposited at the banking account keeping record of the Reserve Fund and National Welfare Fund;

б) by investment of the means of the Reserve Fund and National Welfare Fund in the following forms of financial assets, nominated in foreign currency allowed for these operations:

- promissory notes of the foreign countries;
- promissory notes of the foreign government agencies and central banks;
- promissory notes of international financial organizations, included those in the form of securities;
- deposits in foreign banks and crediting institutions.

It should be noted that recently the Ministry of Finance has managed the means of the Fund by the first method (depositing means at accounts in the Central Bank of the Russian Federation in the foreign currency).

According to the Decree of the Government it is also established that the limiting proportions of financial assets in the total volume of the means place for both of the funds are the following:

- Minimum proportion of promissory notes of foreign countries - 50 per cent;
- Maximum proportion of promissory notes of foreign countries – 100 per cent;
- Maximum proportion of promissory notes of foreign government agencies and central banks - 30 per cent;
- Maximum proportion of promissory notes of international financial organizations, including those in the form of securities – 15 per cent;

Maximum proportion of deposits in foreign banks and credit institutions - 30 per cent.

Establishment of the following belongs to the authority of the ministry of Finance:

1. Standard currency structure of funds' means, procedure of adjusting of real currency structure of the funds in concordance with the standard one;

2. Standard proportion of allowed financial assets in the total volume of invested financial assets, procedures for calculation of real proportions of allowed financial assets in the total volume of the invested funds' means and adjusting it in concordance with the standard proportions;

3. Standards for minimum and maximum periods of settling of promissory notes of foreign countries, promissory notes of foreign government agencies and central banks, promissory notes of international financial organizations including those in the form of securities;

4. Lists of foreign government agencies, to whose promissory notes the funds' means can be invested;

5. Standards for minimum and maximum periods of funds' means investment to the deposits in foreign banks and credit institutions.

Requirements for financial assets include requirements for promissory notes of foreign countries, promissory notes of foreign government agencies and central banks, promissory notes of international financial organizations including those in the form of securities as well as requirements for deposits in foreign banks and credit institutions.

The Decree of the Government of the Russian Federation from 29.12.2007 No 990 "On approving standards for expenditures formation for maintenance of government authorities of a subject of the Russian Federation for 2008".

The Decree establishes the guidelines for calculation of standards for expenditures formation for maintenance of government authorities of a subject of the Russian Federation for 2008 in whose budgets the proportion of interbudgetary transfers (excluding subventions) from the federal budget exceeded 20 per cent of the own earnings of the consolidated budget of the subject of the Russian Federation for last 2 or 3 financing accounting years.

The Guidelines were developed and approved in order to fulfill clause 130 of the Budget Code of the Russian Federation. According to this clause the subjects of the Russian Federation to which this clause applies do not have a right to:

1) establish and fulfill expenditure obligations not connected with the solution of problems that are referred to the authority of government bodies of the subjects of the Russian Federation by the Constitution of the Russian Federation and federal laws;

2) exceed the standards for expenditures formation for government civil employees of the subject of the Russian Federation and (or) maintenance of government authorities of the Russian Federation that are established by the Government of the Russian Federation.

The Guidelines define the procedure for calculation of the standards for expenditures formation for maintenance of government authorities of a subject of the Russian Federation for 2008M that limit the maximum amount of expenditures of the subject of the Russian Federation for the goals mentioned (further referred to as the standard). The amount of the standard in its turn establishes the proportion of expenditures for maintenance of government bodies of a subject of the Russian Federation in the total amount of tax and non-tax earnings, subsidies for equalization of budget provision of a subject of the Russian Federation.

It is stated by a paragraph of the Guidelines that in connection with the specific features of the expenditures formation for maintenance of the government bodies in the Republic of Chechnya and the Republic of

Ingushetia the rate of the standards for them are established basing on the proportion of expenditures for maintenance of government authorities of the subjects of the Russian Federation by the state of affairs on 1 September 2007 indexed by 20 per cent. Thus, such a tool of budget control as standards for expenditures formation for maintenance of government bodies in a subject of the Russian Federation is recognized as inefficient in these regions.

Comparison of the Income Declared by a Tax-Payer with his Living Standard. Some Aspects of Legislation and Procedures in the Great Britain

N. Kornienko

In 2007 tax amnesty was conducted in Russia. According to the primary estimations of different experts, including tax officers themselves, its results are not very optimistic. Among the reasons both badly organized advertising campaign and undeveloped of the law on amnesty concerning regulations are cited. One of the main arguments is perhaps the absence of legal guarantees for protection of the persons participating in the amnesty and declaring their incomes. However despite the shortcomings the amnesty was conducted and from 1 January 2008 taxation bodies will intensify the administration measures on control over the payment of income tax by natural persons. Russian taxation bodies have accumulated sufficient experience on administration of taxes levied on the legal entities but this can hardly be said with regard to control over natural persons' income taxes payment. The aim of this article is to acquaint the readers with some examples from the practice of foreign taxation bodies as to control over taxes payments by natural persons. Let us consider the experience of taxation bodies of the Great Britain on conducting of audit of the incomes that are really obtained by a natural person and data from his tax declaration.

Initial calculation of tax liability of a natural person is usually conducted on the basis of his tax declaration. Besides a thorough examination of a tax declaration can be conducted, which is possible with the visit of a tax-payer in case he owns a company.

The thoroughness of the examination depends on several factors, for instance on the risk and difficulty implied, the amount of the sum in question, etc. As well as the general policy for selection of tax-payers for audit, that is assumed in a particular department of taxation service³⁵.

This article is devoted to the consideration of a part of this procedure, that is the methods and approaches applied while comparing the data of tax declaration with the supposed or obvious quality of life of the tax-payer and possible actions of taxation bodies in case difference has been found.

It should be underlined from the very beginning that there is no special legislative statement in the Great Britain that allows or prescribes the tax inspector to apply one or another specific method to establish the taxable income.

While filling the tax declaration the taxpayer must give complete and reliable information on his taxable income. The tax inspector has a right to ask the tax-payer any questions that he thinks are necessary to set the taxation liability. This includes specification of some paragraphs of the declaration, check of the data that seem doubtful and collection of additional data in case of suspicion of taxpayer submitting incomplete information. Neither of these steps is definitely stipulated in the legislation. All of them belong to the general authority of the inspector³⁶.

We will consider one of the approaches that are applied by the British inspectors to determine tax liability in case the data stated in the declaration seem unreliable or inadequate for the inspectors. The decision on application of one or another approach is made depending on the circumstances of a specific case. As to the method for calculation and recalculation – the inspector can chose it at his discretion. This decision depends on the fact whether the taxpayer does business and if he does then of what nature, what other information on taxpayer the inspector has, what accounting the taxpayer does etc.³⁷ the inspector can take several of the

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http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD_011637

³⁶ <http://www.hmrc.gov.uk/large-business/consultation-framework.pdf>

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD_011637

³⁷ http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD_011637

approaches simultaneously – for instance, use accounting documentation as a main source of the information, taking at the same time into account the living standard of the taxpayer to estimate the rate of his real income.

In other words the inspector can use any method or logical argumentation, which he considers as necessary, on condition that it is persuasive enough to be regarded in the court.

Thus, considerations of lifestyle and personal welfare of a taxpayer can fully or partially belong to the procedure of the detailed investigation.

Within the framework of comparison of the income declared and lifestyle two aspects can be singled out.

- How the information on personal welfare and living standard of a taxpayer can be obtained
- How this information can be used to prove untrustworthiness of tax declaration and to increase tax liability

Information on existence of the income declared can be fairly easily obtained in Britain – for instance, purchase of expensive cars or yachts can be tracked through the main distributors with the subsequent submission of data to the corresponding bodies of taxation department, where it will be compared with the data of the tax declaration in order to proof whether the income declared corresponds the standard of well-being that allows purchasing of such luxury item³⁸.

Besides, precise information can be obtained for one or another case that has already been chosen for such an investigation. Such information can be presented in the form of simple observations; for instance, the inspector can note that the taxpayer lives in a house that is evidently expensive.

At this point, it will be perhaps appropriate to make a few short comments as to the general policy and procedure for consideration of tax declarations that is in practice of the taxation bodies of the Great Britain³⁹.

The majority of the tax declarations are not subject to such an examination. However there are some categories of taxpayers that are chosen for particular examination⁴⁰. These include:

- New companies;
- Taxpayers that have a record of evasion from paying taxes;
- Taxpayers representing fields of activity that are highly subjected to risk, for example, construction (such risky categories are subject to thorough examination from time to time);
- Cases when the information obtained gives grounds to suppose that data presented in tax declaration are unreliable;
- Taxpayers chosen at random.

Information on such a policy of taxation service with the special accent on the last point is open to the public and is widely distributed for every taxpayer to understand that his own declaration can be subject to rapt attention at any moment⁴¹. Such a policy when tax declaration are subject to thorough investigation selectively means that in the cases chosen for thorough consideration the inspector can make a really full investigation, which is more effective from the point of view of resources management than superficial inspection of a greater number of declarations.

If earlier it was found that the taxpayer conceals the information on his incomes (for instance on interest on bank deposits), inspector later acts in concordance with the established procedure – banks should submit information on all the cases of interest payments to the British citizens that exceed the fixed sum which is quite small. Such cases happen quite often and can be a result of negligence or oversight. If this is the case, agreement of the sum for which the tax liability should be raised proceeds without difficulties and is perhaps accompanied with a small fine for information concealment.

In some cases, however, the inspector can come to the conclusion that the income that had not been included in the declaration and revealed during the inspection is only a part of by far more serious problem. For instance, interest on the deposit is so high that inspector raises a natural question: how a taxpayer with a

³⁸ <http://www.hmrc.gov.uk/guidance/480.pdf>

<http://www.hmrc.gov.uk/rewrite/draft-income-tax-bill.pdf>

³⁹ <http://www.hmrc.gov.uk/rewrite/draft-income-tax-bill.pdf>

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http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageLibrary_PublicNoticesAndInfoSheets&propertyType=document&columns=1&id=HMCE_PROD_010855

<http://www.hmrc.gov.uk/large-business/consultation-framework.pdf>

⁴¹ <http://www.hmrc.gov.uk>

relatively modest income could have saved such a sum at a bank account. Thus, inspector will be interested where these means come from.

At this stage he will probably ask a taxpayer a straight question on the source of the money and in case logical explanation is given, perhaps testified by indirect or other evidence, this will perhaps be the end of the investigation.

However if the explanation is unsatisfactory or some other aspects causing doubt remain the investigation will proceed.

The taxpayer is warned that concealment of the income from the bank deposits while filling the tax declaration is regarded as a serious tort and is suggested to assist full investigation of his financial situation. It will be explained to him that in case it is found that the data that he has submitted do not comply with the facts there will be serious sanctions up to imprisonment. If he agrees to assist the tax service will not insist on the maximum fine envisaged by the law but will satisfy with more moderate sanctions.

Usually the period of time for which the level of taxpayer's well-being can be thoroughly examined by the tax service is 6 years⁴². This refers to the cases of simple negligence or unintended underestimation of income. However in case intended (active) fraud is revealed during this time, it can be prolonged for 12 years and in exceptional case even for longer time.

At this stage it will be suggested to taxpayers to confess all the inconsistencies of the previous tax declarations. They will also be asked to give all the information on the means, that is declare his full fortune, including bank deposits, investments and private property (a house, a car etc.). Confession of taxpayers and agreement for thorough investigation is allowed, the tax-payers pledge to assist the inspectors.

Then the inspector examines the property attentively, paying special attention to the initial cost and the date of purchase and compares the incomes mentioned in the declarations of the previous years with the level of well-being.

In case inconsistencies are found the taxpayer is asked to explain them and is reminded that only in case of frank confession and complete assistance tax service will not insist on application of sanctions envisaged by the law at the full rate⁴³. Certainly a taxpayer cannot know what information about his finances the tax service has.

In some cases a taxpayer can continue to deny some violations. He can try explaining the capital origin by a gift or prize in gambling. If the inspector finds such an explanation unconvincing, he will continue investigation and will probably ask to submit detailed information on large gifts, sums, dated etc.

A taxpayer should realize that all he has said will be studied and checked. Commonplace answers not testified by any evidence will not enable escape from the thorough investigation⁴⁴.

At the end of the investigation two options are possible.

- Inspector is satisfied with the fact that during filling the declaration a taxpayer has not overlooked any incomes, that is he agrees with the explanations of a taxpayer or taxpayer confesses some negligence and inspector is satisfied with that.
- Inspector does not believe the taxpayer – he estimates additional income of a taxpayer and calculated tax liability.

In the first case the question is obviously settled. As to the second case, the inspector then prepares official estimation of the income for taxation purposes, in response to which the taxpayer will most likely appeal – it would be illogical of him to agree with the facts that he has firmly denied up to the last moment. After that appeal and court procedures come into force.

At this point it is worth noticing that on the one hand inspector does not have to present thoroughly documented evidence. At the same time it is not a mere suspicion not supported with any real facts. Inspector should demonstrate that figures and circumstances indicate incomes concealment and absence of corroborated explanation from the taxpayer. On the other hand, taxpayer is not to prove his innocence, but it is ex-

⁴² <http://www.hmrc.gov.uk/guidance/480.pdf>

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD_011637

⁴³ <http://www.financeandtaxtribunals.gov.uk/taxAppealsModernisation.htm>

⁴⁴ http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageLibrary_PublicNoticesAndInfoSheets&propertyType=document&columns=1&id=HMCE_PROD_010855
http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?nfpb=true&pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD_011637

pected that he will be able to submit plausible answers to the corresponding questions. Thus, it would be perhaps just to establish that the sides have equal status.

Unfortunately, such a short excursus does not give a full answer to a complicated question of burden of proof that is employed in the Great Britain. However it is evident that both sides should present their arguments in court – the fact that means that the arguments should meet the requirements set for evidences. In the following issues of a monthly review we will continue to study the question raised at the stages of appeal.