

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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Major Developments and Trends

Macroeconomic situation at the beginning of the current year was based on the trends, prevailing in 2007. Index of industrial production for January-February 2008 amounted to 106.0 per cent, investments in fixed capital – 120.2 per cent and retail trade turnover – 116.3 per cent. The growth of processing industries made 107.7 per cent, having exceeded the growth in the extractive industries (101.1 per cent).

However, according to the survey, in March a continued slowdown in demand was observed in the Russian industry, which has not affected the level of production yet. This has led to excessive stocks of finished products and can result in a slowdown in the output growth. The expected slowdown in production is already reflected in the plans of enterprises. Herewith, price estimates of the manufacturers do not provide grounds for slowdown of inflation in the nearest future.

The beginning of 2008 was marked by the peak growth rates of export deliveries, inspired by significant upgrading of prices for the basic Russian export commodities. Herewith, the country continued to accumulate foreign currency reserves, the amount of which in March has exceeded USD 500 billion.

Oil prices in the global market at the beginning of 2008 were at an extremely high level, exceeding the threshold of USD 100 per barrel. At the same time, oil production growth rates in Russia have demonstrated an explicit decline - only 0.6 per cent in January-February 2008 as compared with the relevant period of preceding year. Herewith, the greater input in oil production growth is made by the projects, implemented in the framework of production sharing agreements.

As of February results, the CPI remained rather high, amounting to 1.2 per cent (against 1.1 per cent in the relevant period of 2007). In March, the Ministry of Economic Development of Russia has increased the maximum estimated inflation rate for 2008 to 9.5 per cent, but according to IET assessment, it should be expected, that by the end of the year the CPI will exceed 10 per cent.

In February 2008 there was a substantial increase in expenditures, as well as in revenues of the federal budget, as compared with the level of preceding year. The RF Ministry of Economic Development has proposed again to decrease substantially the basic VAT rate to the level of 12-13 per cent since 2009, having abolished beneficial VAT rate and increased excise rate as a compensating measure. The Ministry of Finance still disagrees with that proposal, and the outcome of the ongoing debate is still unclear.

On March 3, the results of the presidential election were promulgated. During the greater part of March rumors about the future staffing and ideological changes were predominating, there was very little news worth of analyzing in terms of ongoing political process.

On March 1, 2008 the Russian government has adopted the Resolution N 134 "On approval of the regulations on the formation and utilization of the budget assets, allocated for the Russian Investment Fund" which is addressed to eliminate existing restrictions in the legal regulations of one of the most capitalized development institutions in Russia. Among other important government decisions, adopted in March, it is worth mentioning customs duties on the export of chemical fertilizers, increased social security monthly rates for some categories of citizens, as well as further increase of the insurance share of labor pensions. In March, there was also the information, that the Bank of Russia might attract external investment companies to manage a share of foreign currency reserves.

The net capital flow to the RF in the recent years has turned into an important source of financing of the investments in real sector and, consequently, for the support of high economic growth rates. IET has reviewed four models of the RF economic development in the medium-term prospective (for 5 years till 2012), based on different dynamics in both components of the RF balance of payments (balance of current account and balance of capital account). The results of the review indicate that a significant reduction of external financing within 2-3 years may lead to critical effect, comparable with the situation of the sharp and sustained downfall in oil prices

Political and Economic Outcomes of March 2008

S. Zhavoronkov

On March 3, 2008, the presidential election vote count was published. It was announced that with the election turnout of 69.61% Dmitry Medvedev got 70.21% of vote. March 2008 largely was a month of rumors of forthcoming government reshuffles or twists in the ideology, but it failed to supply serious information worth analysis. The United Russia congress was scheduled for April 2008. Some sources close to the Kremlin signaled in mass-media that at the congress Mr. Putin might take the party leadership, but the hypothesis appears ambiguous, as he had repeatedly declined such proposals in the past.

On March 3, 2008, the Central Electoral Commission publicized results of the presidential election. As we have already analyzed the campaign and candidates, let us assess its outcome.

It was announced that with the turnout of 69.91% Mr. Medvedev grabbed as much as 70.21% of vote. This suggests various interpretations: in percentage terms, he scored at 1% less than Mr. Putin in 2004; however, because of a greater turnout, in absolute terms the number of voters who cast their ballot for Mr. Medvedev was greater than the number of Mr. Putin's supporters four years ago. Meanwhile, both in percentage and absolute terms Mr. Medvedev won more votes than United Russia in December 2007 (64.3%), with Mr. Putin being atop of the party ticket then.

The cross-regional analysis of the presidential election outcomes allows some interesting regularities. Thus, Mr. Medvedev's minimum score (59.2% in Smolensk oblast) is greater than United Russia's in a dozen of regions, including Moscow and St. Petersburg. By contrast, so far as the most controlled regions, such as Chechnya or Ingoushetiya, are concerned, United Russia won 99 and 98% of vote, respectively, vs. Mr. Medvedev's humble 88 and 91%. This trend also persists in other regions of this type. In Moscow and St. Petersburg, Mr. Medvedev was clearly ahead of United Russia, by scoring 71 and 72% vs. 54 and 50%, respectively.

Mr. Zyuganov finished the second with 17.77%, followed by Mr. Zhirinovskiy with his 9.37%. As for Mr. A. Bogdanov, in whose official candidate's papers the source of income was bluntly put as "United Russia", he got 1.29% of vote, thus upsetting those who believed that in the conditions of a limited choice he would be able to consolidate a notable fraction of opposition groups' vote.

The above allows the following conclusions: first, the state cadres in the most controlled regions succeeded in following the order to somewhat mitigate Mr. Medvedev's performance. Second, because of the absence of democratic candidates in the ballot, he collected a fraction of support from those who responded to the popular theory of "lesser evil". Third, the Russians demonstrated a loose responsiveness to the transformation of elections into "elections" - they obediently went to the polling stations and, having failed to find their candidates in the ballot, voted for the lesser evil, be that Mr. Medvedev or Mr. Zyuganov. The number of spoiled ballots was not serious and accounted for less than 2%.

Whilst mirroring general trends in the electorate's mood, these data need corrections. At the Russian elections, as a rule, there is no independent observation (with a few exceptions in regions that hold local and regional elections), for as per the law, it is only registered candidates that can organize it. Many regarded Mr. Zyuganov as a relatively oppositional candidate, however, he did not organize observation at the elections. Even if there is a local initiative to hold such observation, the respective protocols are pocketed and they are not used to assert the voters' rights in the court of law¹.

The lists of voters remained an absolute secret. Interestingly, at the presidential election in March 2008 the number of voters was at 2m down vs. the December 2007 statistics. At its homepage on the Internet, the Central Electoral Commission posted the "number of voters included in the lists" which made up 106,999,000, while at the December elections the respective figure was 109,146,000.

Zones of absolute falsification, wherein the proportion of the most loyal voters is over 90%, are expanding to include both the North Caucasus and rural territories and many cities, including one of Moscow's municipal districts².

The world accepted the presidential election outcome better than that of the parliamentary election: Messrs. Bush, Brown, Sarkozy, Barrozu, M-me Merkel congratulated Mr. Medvedev on his victory³. However, many in the West voiced out their critical comments. More specifically, all the three forerunners in the US presidential campaign dropped very negative comments; PACE, the OECD's Bureau on Democratic Institutes and Human Rights, etc. refused to take part in the election as observers. Interestingly, the Russian authorities had programmed some negative assessments – suffice it to mention that the BDIHR delegation was invited to Russia just for several days (while the common knowledge is its regulation does not allow the organization to take part in assessing elections, unless its representatives are present in the country more than a month). It is also worth noting Mr. Bogdanov, a comical presidential candidate whose wages are paid by

¹ A very illustrative example is CPRF's activity in Ingoushetia: local communist leaders signed a note on the fair 99% score by United Russia at the last parliamentary election: the debt was repaid in March 2008, when the communists overcome the 7% barrier at the local parliamentary election.

² "Zyablikovo" district of Moscow's Southern administrative territory

³ It was only Mr. Sarkozy who extended his congratulations to the United Russia in December 2007

the ruling party and who managed to “boost up” his electoral support 20-fold between December 1997 and January 2008⁴ – of course, there might have been a more decent candidate in his place.

As well, the outcomes of regional parliamentary campaigns in 11 Subjects of the Federation⁵ are worth a particular interest. United Russia naturally enjoyed a landslide victory there, though it was only two regions in which its results were greater than in December 2007. The communists overcome the minimal barrier in all the regions – they finished the second in 9 regions, the third – in 1 (Sverdlovsk oblast) and the fourth in Ingoushetia. Meanwhile, their results, except for an unexpected success in Yakutiya and a dubious one –in Ingoushetiya, roughly match their performance at the parliamentary election. LDPR was half-way down from its best shape – the party failed to overcome the election barrier in four regions, while in the remaining seven its score was roughly equal to Mr. Zhirinovskiy’s at the presidential election. The Just Russia demonstrated the most miserable performance, carrying just five out of the ten regions (Ingoushetiya, Yakutiya, Altay krai, Ivanovo and Ulyanivsk oblast); while it was dumped in a region where it had had better chances (Yaroslavl oblast). So, the party’s only relative success occurred in Yakutia – 15% of the vote.

The non-parliamentary party enjoyed just occasional victories. Specifically, the Agrarian party passed the barrier in Kalmykiya and Yakutiya (while a very strong party list in Altay krai was dumped); the Patriots of Russia were equally relatively victorious in Yaroslavl oblast. As for democrats, Yabloko did not run anywhere, while URF lost in Ivanovo oblast by winning just 3% of the vote.

Overall, the parties’ performance at the regional elections in March are quite predictable - the parties with a certain background performed according to their nationwide dynamics, while the Fair Russia faced understandable challenges with self-identification, as well as resources and the right to run (as the last election cycle showed, Mr. Mironov is no longer capable or willing to protect his party fellows from criminal proceedings or dumping).

March 2008 largely was a month of rumors of forthcoming reshuffles or twists in ideology, but it failed to supply serious information worth analysis. In this regard, it is worth noting Mr. Putin’s remarkable comments at the press-conference following his meeting with M-me A. Merkel (who met both with the incumbent president and president-elect), “Impression is that some partners can’t wait my powers being over, to start dealing with another person... I am used to being labeled hard-to-talk-to ex-KGB agent. Dmitry Medvedev will be free from the necessity to prove his liberal views. But he is no less a Russian nationalist - in a good sense - than I am. I don’t think our partners will find it easier to deal with him. Definitely, he is very patriotic and will defend the interests of the Russian Federation at international level in a most active way”.

It seems Mr. Putin’s first statement which highlights on his clear doubts of the successor. One can hear jealousy, as many expect Mr. Medvedev to launch some kind of “Thaw”, which, regardless of its volume, would mean a psychologically complex confession that something had gone wrong; there also is some kind of dubious commercial hue heard in the statement, as the Russian elite are not used to label themselves as “Russian nationalists” – Mr. Putin had never tagged himself like this before, nor such terminology pleases his Western colleagues’ ears, which Mr. Putin cannot help guessing.

In the end of the month, Mr. Medvedev was interviewed by FT. Speaking of his policy priorities, he vowed “to maintain economic stability, to develop economic freedoms, to promote social programs and to ensure that Russia sustains its position in the world”. As concerns urgent economic issues, he focused on the state price regulation and claimed it was quite insignificant (one cannot help agreeing with the president-elect). Once asked of establishment of new public corporations and expansion of old ones, he noted they were created for a certain period of time and consequently would be modified (“they will be privatized or liquidated”, he was quoted verbatim as saying) and referenced, albeit ambiguously, international experiences, “... because of the financial crisis, the US, UK and Switzerland undertook measures on nationalization per se a series of companies⁶”. Problems of solidification of the judicial system and fighting corruption formed the core issues of the interview. Mr. Medvedev once again fell short of saying anything illuminative on the former issue, except for noting that it was because of the judicial system’s independence of government and respect he paid to it, he could not interfere in M. Khodorkovskiy’s case. The interviewers referred to the opinion by Mr. Cherkasov, the head of the State Anti-Narcotics Agency that representatives

⁴ At the December 2007 election, his party got less than 100,000 votes, while in January he “collected over 2m of signatures” which makes him a perfectly legitimate presidential candidate

⁵ Bashkortostan, Ingoushetiya, Kalmykiya, Yakutiya, Altay krai, Amur, Ivanovo, Rostov, Sverdlovsk, Ulyanovsk, and Yaroslavl oblasts

⁶ We are unaware of such cases

of special forces fight each other to get access to the nation's wealth, and Mr. Medvedev assured them that if such cases had taken place, dire consequences would befall on those to blame.

In conjunction with a possible "*dvoevlastiye*", the provisional allocation of functions between the president and would-be prime-minister Putin and an alleged nationalism of both, president elect was asked a series of provocative questions about Mr. Putin. As concerns nationalism, Mr. Medvedev dodged the issue by noting that it is observance with the national interests that matters, and representatives of all ideologies should stand united in this regard. As concerns Mr. Putin, president-elect noted that, "The incumbent president is an effective leader and he's ready and able to continue to work to advance the development of our country, to make sure our development continues in the way set out eight years ago. This is why this tandem, or this team of two, was formed between the presidential candidate and the Russian president as a possible future prime minister". On the other hand, he compared Mr. Putin's future function with the role played by "... former heads of governments in a number of European countries subsequently holding posts of vice premiers or foreign ministers despite their considerable personal popularity", which, if understood literally, does not fully match Mr. Putin's vision of his role.

In the political sphere, Mr. Medvedev *de-facto* fixed the current official doctrine, according to which Russia constitutes a European democratic country, avoiding, at the same time, "the two extremes", that is, a blind replication of overseas experiences and an absolute refusal of democracy.

Interestingly, the next United Russia's congress is scheduled for the late-April, and some Kremlin sources speculate in the media that Mr. Putin may become the party leader and even form a party government at the congress. It is hard to foretell how the outgoing country leader will operate, for it is well known that such initiatives would be announced before, but Mr. Putin never endorsed them. If this time he accepts the proposal, given that United Russia is conceived of as an absolutely manageable by the executive power, this will look like a desire to solidify his own position, rather than the regime. Meanwhile, it would also appear a manifestation of his concern that after Mr. Medvedev's inauguration the "power" and Mr. Putin would not be identical. If there is no urgent need, politically, it would be most inappropriate for Mr. Putin to deliver such a signal.⁷

In light of the situation with the political opposition and civic freedoms, March was a month of a dynamic equilibrium. Thus, on the election day, M. Reznik, a famous opposition leader, head of Yabloko's branch in St. Petersburg was detained in the northern Russian capital. Accused of resisting police, he spent three weeks in custody, after which the court of law ruled to release him under recognisance not to leave. Meanwhile, the European University in St. Petersburg, which had trained observers for the upcoming elections and had been closed by fire inspectors in February, managed to renew its operations in March. Mr. O. Kozlovsky, the leader of the civic anti-conscription movement "Oborona", who had been conscribed a few months ago, was released from the army. Meanwhile, Natalia Morar, who had become *persona non grata* in Russia, attempted to enter the country but failed once again. A few dozens of TNK-BP staff were refused to have their visas extended. This happened against the background of a public campaign "against industrial espionage", of which one of them was accused. So, considering even secondary signs, it is too premature to assert whether the regime has become more liberal, or tighter.

On March 21, 2008, the State Duma passed in the second reading the bill "On procedures of exercise of foreign investment in economic companies that have strategic importance for ensuring the country's defense and security". The list of strategic kinds of operations became the epicenter of heated debates. At the end of the day, the list comprised 42 items (nuclear industry, coding and deciphering information and production of the respective equipment, design and production of military equipment, arms and ammunition, space activities and the aircraft industry, provision of communication services, mass media (over 1m copies), geological prospecting and/or prospecting and extraction of minerals at subsoil sites of the federal significance, production of water (biological) resources, provision of services to natural monopolists, to name a few. Now, seeking to acquire more than 50% of a company whose operations are subject to the future Act, a foreign investor should apply to an "authorized agency" for the respective permit. If the investor has already fallen under control of a foreign state, the respective procedure is employed for any application for acquisition of a 25%-plus stake in a company. The controller is granted 3 to 6 months to consider the application, while the final decision is made by a commission led by prime minister (Mr. Putin should become Russia's new prime minister as late as in May).

⁷ Particularly because in compliance with the Constitution in invariability of which both Mr. Putin and Mr. Medvedev vow, all the powers, including those on which the UR MP's behavior depends, are in President's hands.

March 2008 proved that the previous declarations on the need for a dramatic cut in VAT are not that simple to realize. The leadership of the RF Ministry of Economic Development and Trade quite aggressively proposed to cut the VAT rate to 12-13% as early as in 2009. Meanwhile, Mr. A. Kudrin publicly expressed his doubts about accuracy of his colleagues' calculations and philosophically noted that he would envisage "a long discussion".

Mr. A. Chekalin, who as the First Deputy Minister of Interior of RF was in charge of public security was released from his duties and replaced by Mr. M. Sukhodolsky who had earlier been a Deputy Minister of Interior of RF

Real Sector: Trends and Factors

O. Izryadnova, I. Kolosnitsyn, A. Surinov

In January-February 2008 industrial production index was equal to 106.0%, investments in fixed assets – to 120.2%, retail trade turnover - 16.3%. It should be noted that processing industries growth over the period was 107.7%, and of extractive industries – 101.1%. Consumer prices index in February 2008 to December 2007 was 103.5% as compared with 102.8% in February 2007.

Macroeconomic situation at the beginning of the current year was formed under the influence of trends that evolved in 2007. Under exceptionally favorable situation at the world markets of minerals and raw materials, it was the dynamic growth of the internal demand that had a determining influence on the structure of the economic growth. In January-February 2008 industrial production index was equal to 106.0%, agriculture production – to 104.3%, workload in construction – to 130.2%.

Rates acceleration of the internal market development was accompanied with the change in proportions of investment and consumer demand. Increase in investments in fixed assets was 20.2% as compared with 24.2% in January-February 2007, retail trade turnover increasing by 16.3% as compared with 13.9%.

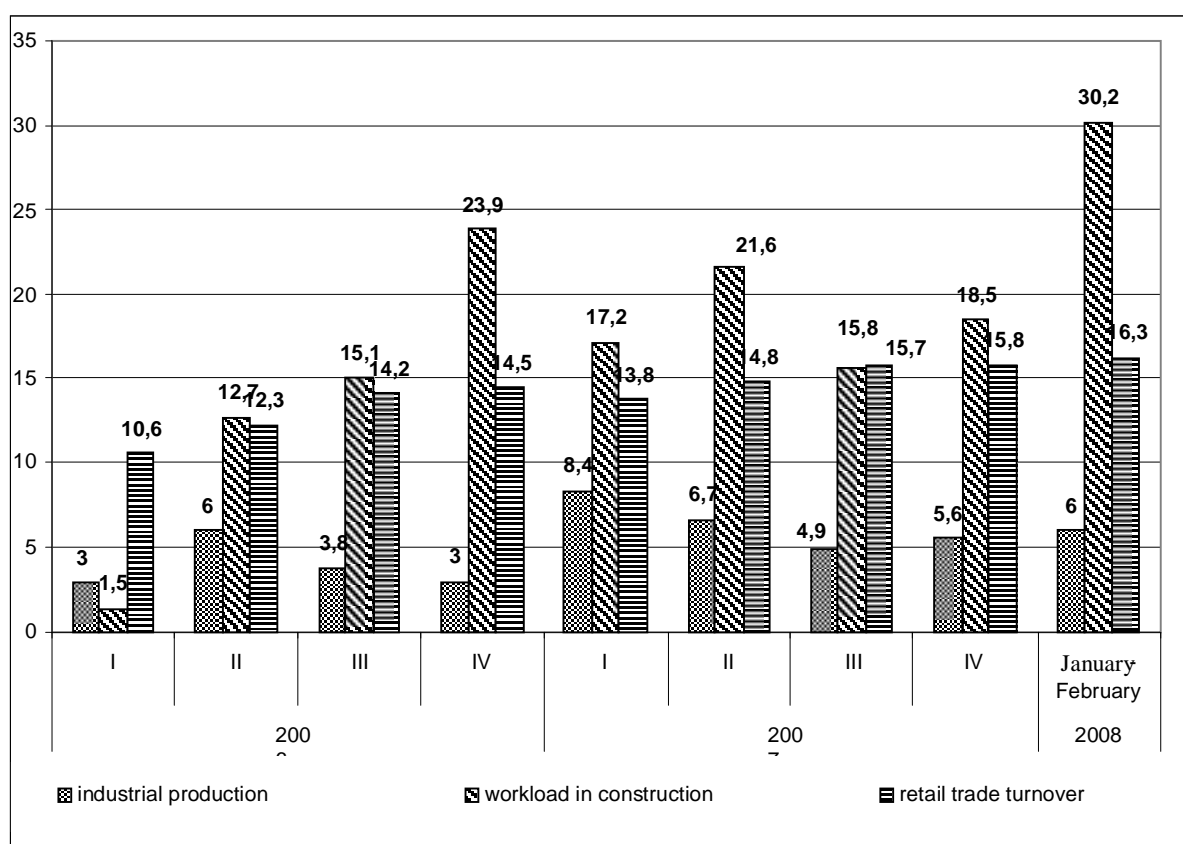


Figure 1 Changes in Production Rates by Kinds of Economic Activities in 2006-2008, as percentage to the corresponding period of the previous year

Structural shifts in industry occurred against the background of anticipating growth of processing industries as compared with extractive ones, which has been characteristic for the Russian economy over the last

three years. In January-February 2008 output growth of processing industries was 7.7%, extractive industries – 1.1%, electricity, gas and water production – 7.4%.

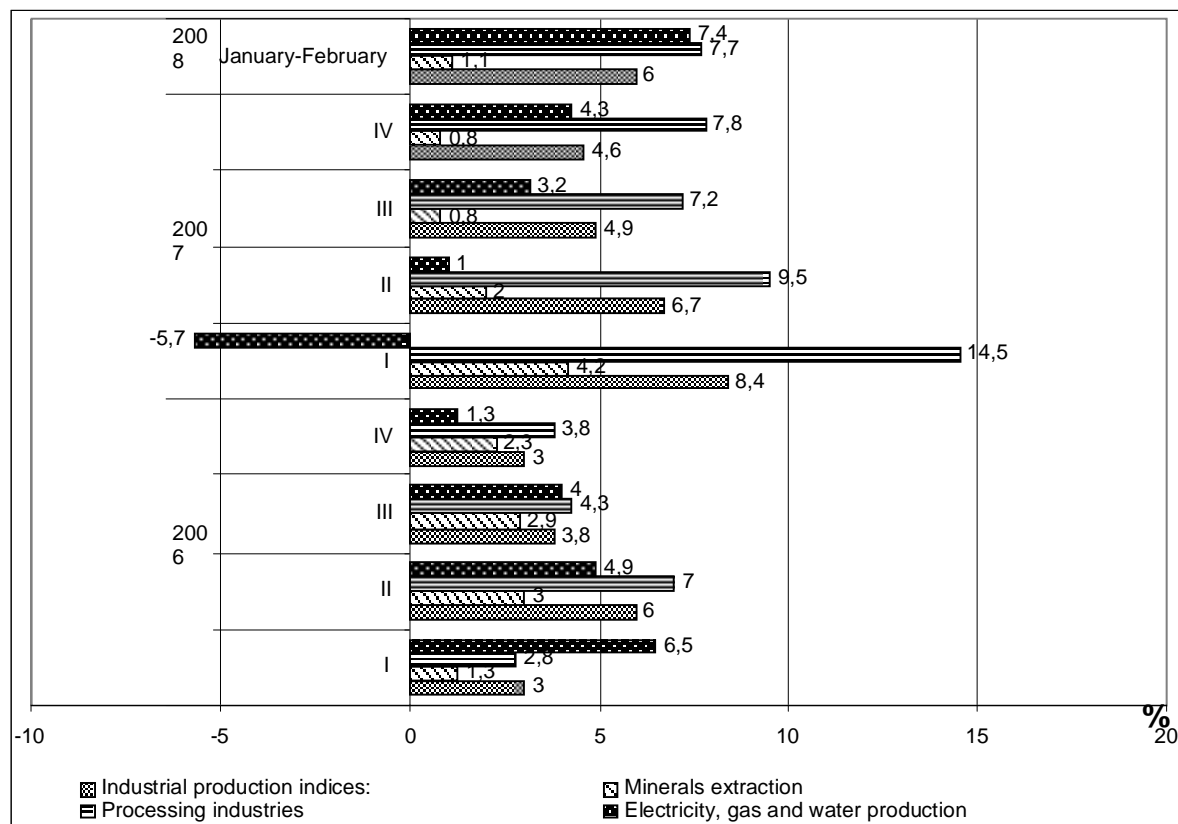


Figure 2 Changes in Industrial Production Growth Rates by Kinds of Industries in 2006-2008, as percentage to the corresponding period of the previous year

In the environment of investment demand growth positions of machine building have bright prospects in the Russian economy in near-term outlook. In January-February 2008 growth rates acceleration up to 17.2% was registered in machinery and equipment production, and 9.7% - in transport vehicles and equipment production.

The trend for the increase in the output of the railway equipment, for instance, in mainline electric locomotives (by 131.8%), shunting diesel locomotives (141.4%), passenger cars (106.5%) was connected with the growth of demand for rolling and drag-out stock from the joint-stock company Russian Railways and private companies.

As compared with January-February 2007 in January-February 2008 passenger cars production increased by 14.2% and is mainly accounted for by dynamic expansion of production assemblage enterprises. Motor-vehicles clusters being created in Kaluga and St Petersburg regions, domestic motor-vehicles production is in the phase of active restoration.

Among the enterprises of machine-building complex reduction in electric, electronic and optic equipment production by 4.7% is a worrying factor, taking into account high demand for this production at connected machine-building enterprises. Analyzing the trends for machine-building development acceleration of machinery and equipment import growth rates as compared with the dynamics of the domestic machine-building is also noticeable. According to the data of the Ministry for Economic Development and Trade, the proportion of machine-building in import has increased by 3.7 p.p. as compared with January-February 2007.

Dynamics of production of goods of intermediate demand was positive. The nature of metallurgy, chemistry, wood processing productions operation was defined by the level of external and internal demand.

Metallurgy production and production of finished metal goods in January-February 2008 increased by 6.0%, growth of metallurgy production being 3.4%, and of finished metallurgy goods production – 16.7%. Demand for metal at the internal market was supported by high growth rates of machine-building and construction complexes.

Dynamic development of construction defined acceleration of industrial production on wood processing and wooden goods production up to 119.0% in January-February 2008 against 111.2% in the corresponding

period of the previous year. It should be noted that positive dynamics of construction materials sustaining high level of fixed assets deterioration and facilities load is becoming a limitation factor in this complex. In January-February 2008 a reduction in cement production by 0.5% was observed the output growth in February 2007 being 141%.

Chemistry complex is the basis for the Russian economy. By the volume of trade production its proportion comprises 5.5%, enterprises of complexes giving 5.4% of the all-Russian amount of earnings in foreign currency. In January-February 2008 increase in chemistry production was 3.3%, production of rubber and plastic goods growing by 28.4%. The capacity of the internal market being high, the main factors limiting chemistry complex functioning are high extent of equipment deterioration and outdated technologies; anticipating prices and tariffs for the production of natural monopolies growth rates; problems with supply of the main kinds of raw materials, especially hydrocarbons, to the industry's enterprises; scantiness of investment resources.

Positive trends of development sustain in production of consumer goods. However lack of serious quality changes in technology and structure of consumer goods production does not allow maintaining high growth rates for a long time. The share of domestically produced goods in retail trade resources in 2007 reduced down to 53% as compared with 55% in 2005 and 59% in 2002. On the one hand, inconsistency of material and technical base and labor qualification to market requirements defined the decrease in competitive ability of the domestic goods as compared with import, on the other hand, existing currency exchange rates contributed into broadening of niches for import goods.

Competitive ability of domestic foodstuffs producers is supported by active investment policy and existing mechanism of import quotas for some kind of goods. However the potential created was insufficient to sustain a steady trend for production, labor efficiency and productivity growth. In 2005-2007 some acceleration of foodstuffs production development was observed. Growth index in 2007 was equal to 106.1% against 105.4% in 2006. In January-February 2008 foodstuffs production index was 106.3% as compared with 117.4% in the corresponding period of the previous year. Reserved growth of foodstuffs production was accounted for by deceleration in vegetable and animal oils production by 15.1 p.p. as compared with the corresponding period of the previous year, stabilization of dairies production and reduction in the volume of potatoes, fruit and vegetables processing and preserving by 12%. Milk production increasing in agriculture companies which are main suppliers of milk for processing by 3.1%, the dynamics of the production was partly influenced by a decrease in consumer's demand as a result of a sharp increase in prices for dairies in September 2007. Similar situation was observed in fat-and-oil sector, in which because of anticipating growth of prices for seeds used for oil production as compared with vegetable oils the problems with raw materials purchase and with finished goods sale arose.

Over January- February 2008 growth index of sewing and clothing industry was 104.9%, leather, leather goods and footwear production – 108.0%, against correspondingly, 111.6% and 119.6% in the similar period of 2007.

High growth rates of consumer's demand were supported by the growth in population's real disposable incomes, real wages growing anticipatively, as well as by maintenance of high banking activity at the market of consumer crediting. Increase in real disposable incomes was 11.2% to the level of January-February 2007, and of real wages – 13.3%.

In January 2008 real population's incomes due to the leap of inflation and decrease in economic activity in January, on the one hand, and massive cash payments to the population in December, on the other hand, reduced nearly by half as compared with December 2007. In February restoration of real incomes was observed – they went up by 19.6% as compared with January. Similar dynamics of population's incomes changes was observed at the beginning of 2007. In February 2008 average population's incomes per capita per month were RUR 12942, whereas in December – RUR 19639. In January 2008 a considerable flow-out of depositors' means took place, it was equal to RUR 33 bln (0.6%) throughout the whole banking system, which can be compared only with July 2004 (0.7%).

Nominal wages over the first two months of the current year increased as compared with the corresponding period of the previous year by 27.6%. At the same time its level in January was below December level by nearly 20%, and in February wages increased only by 3% as compared with January. According to the estimation of the Federal State Statistics Service, in February the level of nominal accrued wages per one employee was RUR 15214, and in December 2007 – RUR 18591. Similar situation was also observed in 2007, though оПохожая ситуация наблюдалась и в 2007 г., однако восстановительный рост restoration growth of wages was not observed in February 2007.

At the beginning of 2007 character and extent of averages wages differentiation by branches of industry sustained. The labor force cost the least in agriculture, education and health care, the most – in extractive industries and financial activity.

Over two months of 2008 average volume of accrued pensions went u by one third in nominal terms, ratio between the average pension and average monthly wages improving slightly as a result: in 2007 it was equal to 22.8% and in February 2008 it went up to 26%? Which approximately corresponds to the ratio that was characteristic for 2006. Regular indexation of pension’s insurance part (by 7.5%) is to occur in April 2008? And after indexation average accrues pension will be? According to the data of the Pension Fund of the Russian Federation, RUR 4115.

At the beginning of 2008 prices for consumer goods and services grew faster than in January-February 2007. Consumer prices index in February 2008 to the level of December 2007 was 103.5%, as compared with 102.8% in February 2007. It should be noted that anticipating growth was observed for foodstuffs and tariffs for compulsory services. Prices for goods and services included in the subsistence minimum basket increased at fastest. In February 2008 cost of goods and services purchased by Russia’s population was 0.9% higher than in January with regard to goods, and by 0.5% - with regard to services.

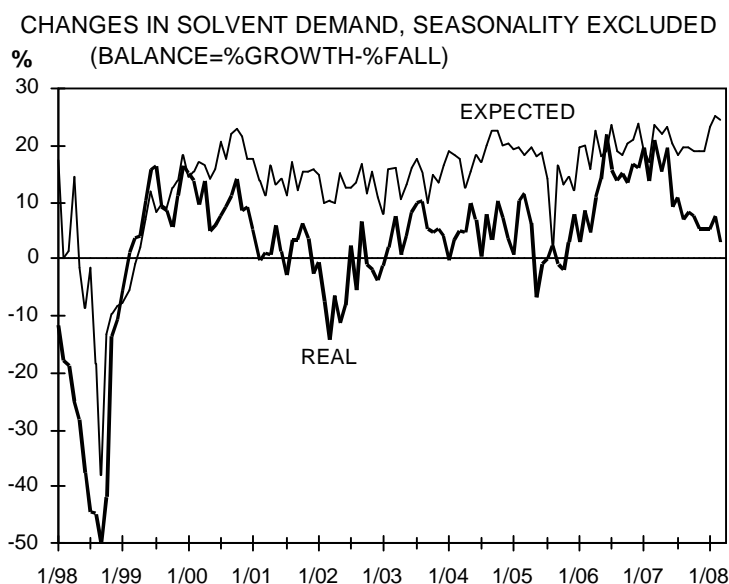
Business Survey in March 2008

S. Tsukhlo

First data on situation in the Russian industry in March are not optimistic. Maintenance of though low but inadequate output growth rates in the environment of demand growth slow-down leads to excessive increase in finished goods stocks and in the near outlook can result in the decrease of output growth intensity. Possibility of further slow-down of output starts to emerge in enterprises’ plans. Price forecasts of enterprises do not give grounds to hope for inflation slow-down before long.

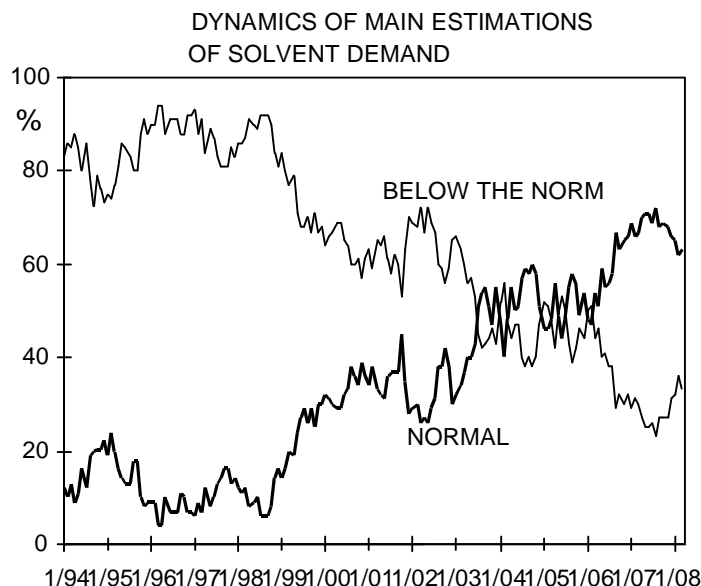
According to the data of official statistics, industrial production continued to grow in January-February. According to the calculations of the Center for Macroeconomic Analysis and Short-term Forecasting, average daily output of goods increased by 0.3% in February as compared with January, and on average over the first two months of the year – by 0.4% (seasonality excluded). In comparison with January-February 2007 there were by 6% more goods produced.

In March demand for industrial goods continued to grow, sales growth rates, however, reducing as compared with February by 4 per cent, and as compared with Match 2007 – by 18 p.p. In other words, demand growth has evidently slowed down. As a result March growth rated turned to be the lowest over the last 26 months (from February 2006).

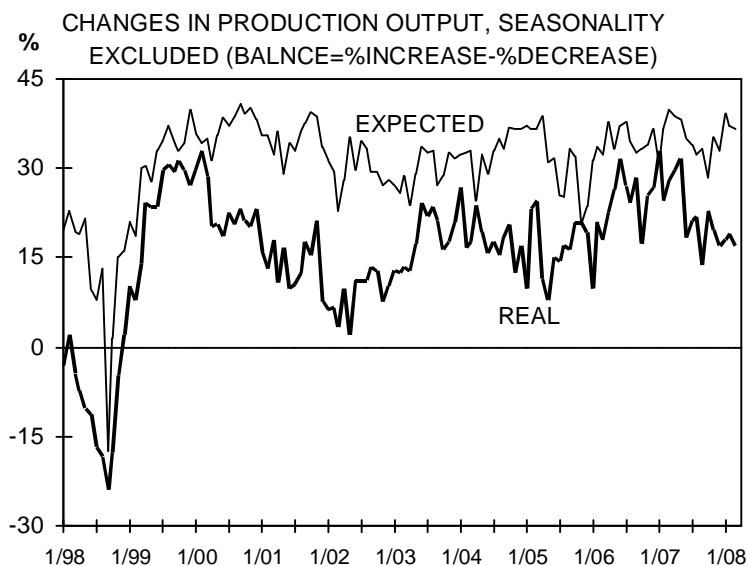


However low demand growth rates for products are becoming habitual for enterprises. This is illustrated by the dynamics of demand volumes estimations. In March proportion of “normal” estimations stopped to fall and stopped at the level of 63%. Such all-industry trend was the result of the increase in satisfaction with

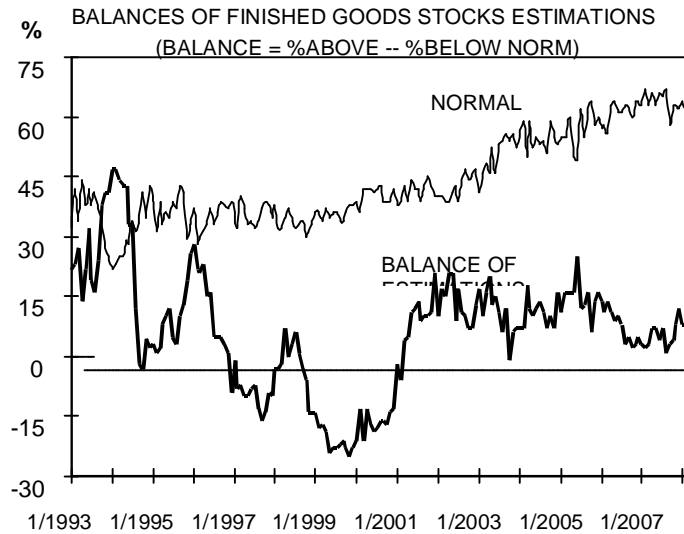
sales in chemistry and petrochemistry (up to 74%), in machine-building (60%), wood processing complex (72%) and light industry (49%).



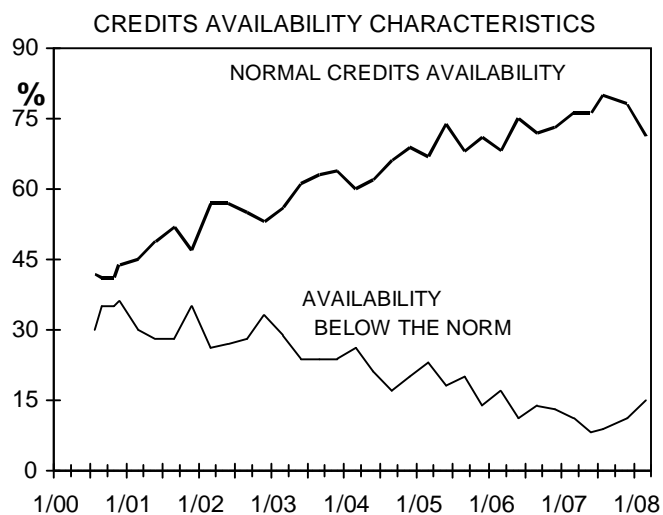
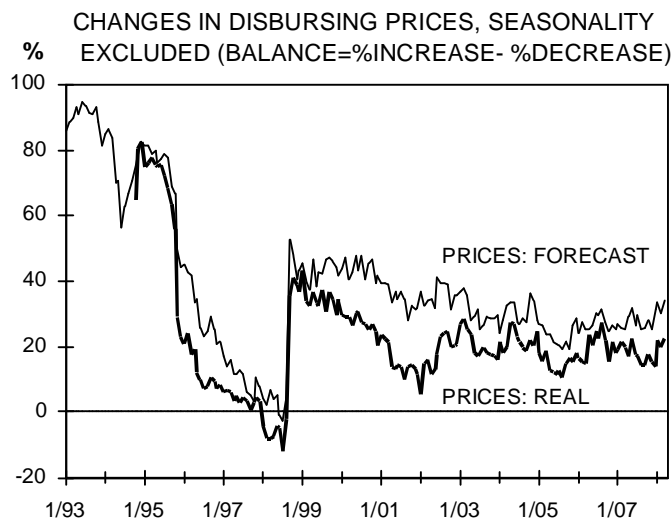
Slow-down of demand growth rates does not enable enterprises to increase output. According to the estimations of the enterprises' executives output growth rate in the industry has stabilized over the last four months at the level of 17-19 p.p. (seasonality excluded). Last March output growth intensity was 28 p.p. The highest growth rates at the moment are observed for fuel, machine-building and chemistry industries, as well as construction.



Obvious and continuous demand growth slow-down has resulted in considerable “negative” independence of output dynamics from the sales dynamics, situation, when enterprises are behind demand dynamics can be referred to as “positive” independence. In other words, enterprises started to produce more than they can sell. In March the proportion of producers, at whose enterprises output exceeds demand reached 28% - the figure being uncharacteristic for recent years. Reverse ratio – demand excelling output – was observed at 7.4%. This figure is nearly absolute minimum for the index since 1998 crisis (only in spring 2006 it decreased down to 6.6-6.2%). One more evidence for “negative independence” is the estimation of finished goods stocks. In March balance of these estimations (above-below the norm) reached +13 p.p, which is the maximum (that is the worst figure) for the last two years. Industry has accumulated unusually many finished goods at stocks with regard to the current demand in last two months and does not see real prospects to sell these stocks in the forthcoming months.



In the environment of increased inflation industrial enterprises have enough grounds to raise disbursing prices. In March balance of real changes (growth rate) of price did not change, which had been characteristic for the recent years, but increased by all indicators (initial, seasonality excluded, occasional fluctuations excluded). The growth occurred due to metallurgy, wood processing complex, light and foodstuffs industries.



Problems of bank sector also reflect on the industry. Monitoring of credits availability demonstrated the decrease in the share of “normal” estimations on the whole throughout the industry in 1st quarter 2008 down to 71%, which is the worst figure for the last eight quarters. The biggest losses were characteristic for wood processing complex (normal credits availability has decreased by 22 p.p.), metallurgy (decrease of 13 p.p.), light industry (12 p.p.), and machine building (11 p.p.)

Forecasts for changes in demand, though remaining at the level of absolute minimum for the whole period of the monitoring for the second month in the row, seem to give little chance to become true. There are two reasons for that. First, industrial plans of enterprises are becoming less optimistic. In March growth rates of the expected changes in output decreased by one more point and total decrease as compared with January was equal to 3 points (seasonality excluded). It was the plans of ferrous metallurgy, chemistry, petrochemistry, construction and foodstuffs industry that suffered the biggest negative correction. Second, high (with regard to the recent time) level of finished goods at stocks will force enterprises to use accumulated stocks first to satisfy demand.

Price forecasts of enterprises do not give grounds for hopes for inflation slow-down. Decrease in inflation inclination that dawned in February came to a stop. March forecasts for changes in prices reached maximum since the beginning of 2005. Prices growth slow-down in forthcoming months is possible only in chemistry, petrochemistry and machine building.

Foreign Trade

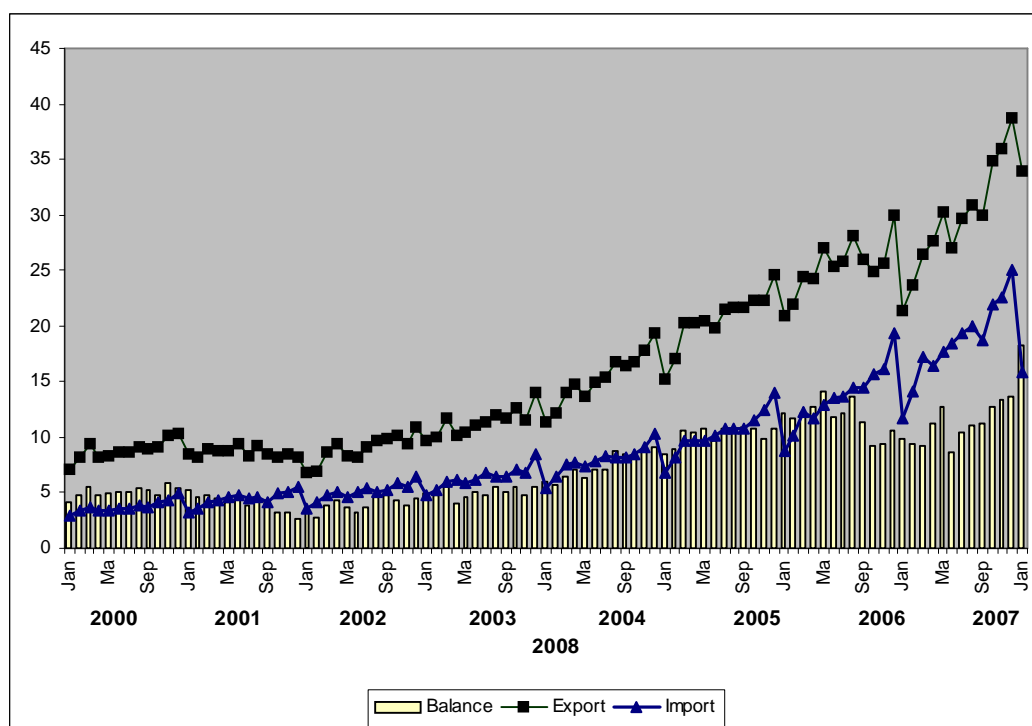
N. Volovik

The first month of 2008 was characterized by record-breaking index of export supplies growth rates, which were accounted for by a considerable growth of prices for the main goods of Russian export. Positive foreign trade balance also set a new historical record.

In order to stimulate production development in the territory of Russia import duty rates for plasma and liquid crystals display panels.

In order to limit growth of internal prices, which are rising continuously following the world ones, customs duties for chemical fertilizers to countries that are not members of Customs Union are implemented.

In January 2008 Russia’s foreign trade turnover, calculated on the basis of balance-of-payments methodology, increased up to USD 49.8 bln, which is by 49.6% more than the figure of January 2007. This is the highest growth in year terms over the last 17 years.



Source: Central Bank of the Russian Federation

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

In January 2008 export from Russia was equal to USD 34 bln, which exceeds the figure of January 2007 by 57.9% and is the highest year increase in export over the last 17 years. Such a high index is mainly accounted for by prices for oil – whereas last January it reached local minimum of USD 50 per barrel, in January 2008 the average monthly figure was USD 92.4 per barrel. At the beginning of January oil price at the world markets crossed the threshold of USD 100 per barrel for the first time. As compared with January 2007, price for oil grade Brent increased by 68.5%.

On its regular meeting, taking place on 5 March 2008 Organization of Petroleum Exporting Countries (OPEC) decided to maintain oil production at the current level of 32 mln barrels a day. OPEC's decision is accounted for by apprehensions that oil consumption will decrease due to possible economic recession in the USA and traditional for the 2nd quarter seasonal reduction in demand for mineral resources used as sources for power. Growth of oil prices up to record-breaking levels is connected with factors that are out of cartel's competence, such as dollar's depreciation and sharp inflow of speculative capital.

The last time the cartel agreed to increase production by 500 thousand barrel a year was 11 September 2007. New limit for oil production came into effect on last year's 1 November. Since 1 December 2007 oil production quote of 10 countries of the cartel – not including Angola, Iraq and Ecuador – is 27.253 mln of barrels per day.

In connection with continuous growth of oil prices at the world market export duty for oil will increase from USD 333.8 per ton to USD 340.1 per ton from 1 April 2008 and will set a new record. Export duty for light oil products will be USD 241.4 per ton, for dark oil products – USD 130.1 per ton. At present they are equal to USD 237.3 and 127.8, correspondingly.

In January 2008 prices for oil products were bigger than a year ago. Petrol premium cost USD 2.38 per gallon, which is by 49.6% more than in January 2007.

In 2007 average contract price for Russian natural gas exported to the countries of Western Europe increased by 6.1% as compared with the level of 2006. In January 2008 the price for oil increased by 13.4% as compared with the level of January 2007 and by 8.7% as compared with the level of December 2007.

In comparison with December 2007 in January 2008 prices for copper, nickel and aluminum rose, correspondingly, by 7.3%, 6.5% and 2.7%, and as compared with January 2007 - prices for copper increased by 24.6%, and for nickel and aluminum decreased by 24.7% and 12.9%, correspondingly.

Table 1

Average Monthly World Prices in January of the respective year

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil (Brent), USD/bbl	23.4	15.3	11.3	25.5	26.0	19.4	28.1	31.3	42.9	62.5	54.8	92.4
Natural gas, USD /1 mln BTU	2.486	2.097	1.426	2.431	5.214	2.146	5.048	6.156	6.907	9.725	6.917	7.86
Petroleum, USD /gallon	0.685	0.507	0.494	0.739	0.865	0.573	0.852	0.992	1.291	1.849	1.59	2.38
Copper, USD/ton	2400	1682	1528.2	1887.9	1849.6	1557.8	1571.3	2441.9	3170	4734	5668.7	7061.6
Aluminum, USD/ton	1598	1480	1301.4	1695.5	1641.5	1377.9	1291.1	1608.2	1832	2378	2808.3	2445.5
Nickel, USD/ton	7485	5496	4550.8	8338.1	7091.3	6094.6	7643.9	14855	14505	14555	36795	27689.5

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

Over January 2008 export value volume of energy commodities increased by 66.8% up to USD 24.5 bln, including oil – by 73.7% up to USD 12.9 bln, gas – by 54% up to USD 6.1 bln.

Export of metals and goods thereof rose over January 2008 by 30.1% up to USD 3.9 bln, including ferrous metals and goods thereof – by 19.5% up to USD 2.0 bln, non-ferrous metals and goods thereof – by 43.4% up to USD 1.7 bln.

Export of machinery, equipment and transport vehicles increased by 60.6% up to USD 1.2 bln, chemistry industry production – by 42.3% up to USD 1.8 bln, wood processing complex – by 29.5% up to USD 860 mln, foodstuffs and agriculture raw commodities – by 56.8% up to USD 577 mln.

The main reason for rapid growth of export is unprecedented growth of world prices for the main goods of Russian export. In January 2008 export prices indices considerably exceeded indices of physical volumes.

In January 2008 Russian import was equal to USD 15.8 bln, which is by 34.3% more than the figure of January 2007. High rates of import growth in January 2008 correspond to those observed last year.

High growth rates of Russian import are accounted for by high growth indices of GDP (+107.4% January to January), real disposable population's incomes (+112.9%, January 2008 to January 2007) and ruble appreciation with regard to main currencies, especially US dollar. According to the data of the Bank of Russia, as compared with last January, ruble strengthened by 16.6% as to dollar, by 4.8% as to euro, by 4.6% as to the basket of currencies of trade partners.

Table 2

Goods Export Indices in January 2008 (figures of January 2007 taken as 100)

	Value	Physical volume	Price
Total	157.7	113.3	139.2
Non-CIS countries	159.4	112.8	141.4
CIS countries	147.3	116.5	126.5

Source: Ministry for Economic Development and Trade

Machinery, equipment and transport vehicles import increased over January 2008 by 51% up to USD 6.87 bln, foodstuffs and agriculture raw materials import – by 21.7% up to USD 2.0 bln, chemistry production import – by 35.3% up to USD 1.8 bln.

Increase in import value was mainly accounted for by increase in physical volumes from non-CIS countries. Recently, however, the significance of price factor has increased, for instance, prices for foodstuffs goods import and agriculture raw materials went up.

Table 3

Goods Import Indices in January 2008 (figures of January 2007 taken as 100)

	Value	Physical volume	Price
Total	139.5	130.1	107.2
Non-CIS countries	144.5	137.4	105.4
CIS countries	117.6	97.8	120.2

Source: Ministry for Economic Development and Trade

Positive balance set new historical maximum and reached USD 18.3 bln. This is 86.3% higher than in January 2007. The former record of USD 14.2 bln, which was set in May 2006, was exceeded by 28.4%. This January the balance turned out to be bigger than year figures of 1994, 1997 and 1998.

On 3 March 2008 within the framework of fulfillment of the main directions of customs and tariffs policy for middle-term prospect, which were approved at the meetings of the Government of the Russian Federation on 21 February 2008, the meeting of the Commission of the Government of the Russian Federation on protective measures for foreign trade and customs and tariffs policy was held.

In order to stimulate production development in the territory of Russia the decision was made to abolish import duties for plasma and liquid crystals display panels. At present import duty rate for plasma and liquid crystals display panels is 10%.

At the moment two South Korean firms are carrying out assemblage of their television sets in Russia – LG and Samsung. LG company started production in Dorohovo of Moscow region in September 2006. In 2010 it is planned to increase annual production of television sets by 1.1 mln of units. Netherlands branch of Samsung has made its production based on outsourcing since the end of 2004 in the territory of Kaliningrad region. Construction of plant Samsung Electronics Russia started in September 2007 in Kaluga region. It is expected that the first facilities of the plant will be put into commission in November 2008, and the plant will have reached its maximum capacity (about 2.2 mln of production units) by 2010.

Duties nullification will undoubtedly have a positive effect on the further development of the market and will result in reduction of “gray” import of this kind of goods.

As a result of the Commission meeting it was also decided to abolish import duty rates for raw materials and components for glasses rims production, as well as export duty rates for ethylene polymers. At present import duty rates for raw materials and components for glasses rims production are 15-20%. Export of ethylene polymers, which is also used in production of packing and plastic bags is subject to 6.5% duty rate.

Besides, in order to legalize import of goods for which domestic light industry is sensitive the suggestion to decrease ad valorem component of combined import customs duty for clothes and hats was adopted.

In order to satisfy demands of Russian agriculture commodities producers in high quality import equipment the Commission will also recommend the Government of the Russian Federation to prolong temporarily action of 5% of the customs cost import duties for new harvesters and ensilage-harvesters.

The Decree of the Government of the Russian Federation on introduction of customs duties for chemical fertilizers export to countries that are not members of Customs union was published on 18 March 2008. Duty

rates for complex and nitrogenous fertilizers are established at the level of 8.5% of customs value, for potash fertilizers they will be significantly lower – only 5%. The decree comes into effect in a month after its official promulgation and will be in force till 30 April 2009 inclusive.

The adopted decision is aimed at restriction of internal prices growth that continue to grow steadily following the world ones. It is unlikely that as a result of duties introduction companies will considerably reduce the volumes of exported fertilizers, taking into account current level of world prices and narrowness of the Russian market. Such a measure is more likely to become an indicator for fertilizers producers not to increase prices at the internal market further.

Introduction of export duties will undoubtedly have a negative effect on profits of Russian mineral fertilizers producers, but this will be made up for by considerable growth of prices for the main kinds of fertilizers in the current situation. Thus, FOB price for ammophos has grown from USD 580 to 900 per ton since December 2007, for potassium chloride – from USD 340 to 510 per ton.

In the report of Food and Agriculture organization of the UN (FAO) devoted to the market of fertilizers up to 2012 the issue whether world deficit of fertilizers will arise is considered. FAO, however, believes that in the forthcoming years fertilizers production will remain at a high level, supply exceeding demand, and no deficit will evolve. According to the data of FAO at present (in 2007-2008) fertilizers production in the world will be approximately 206.5 mln of tons. According to calculations, in 2011-2012 this figure will increase up to 241 mln of tons. At present demand is equal to 197 mln of tons, in 2011-2012 – to 216 mln of tons.

Rapid growth of prices for fertilizers and demand growth is accounted for by growth of world prices for foodstuffs, which makes agriculture production more profitable. Demand for foodstuffs is increasing by all kinds of products, that is why there is demand for fertilizers.

Investment company Millennium Capital also draws attention to the EU claims that by 2020 20% of the power in the EU will be received from renewable sources of power, including biofuel. It is obvious that effective production of biofuel requires intensive use of fertilizers, ammonia in particular.

Thus, in Russia the problem of mineral fertilizers becoming more expensive is caused by the worldwide trends (increase in world prices as a result of anticipating growth of demand). Besides, established level of duties cannot equalize profitability of export and internal supplies. Potash fertilizers cost USD 150 per ton at the internal market and from USD 240-270 per ton (for long-term contracts) to USD 500-600 per ton (at spot markets) at the world market. Export prices for nitrogenous fertilizers are 30-50% above the internal ones. The branch therefore is export-oriented.

However, if after introduction of limitations for mineral fertilizers export the situation at the internal market will not stabilize, the possibility of introduction of tariff quotes for export cannot be excluded.

Oil and Gas Sector

Yu. Bobylev

World prices for oil in the first months of 2008 were at exceptionally high level, crossing the threshold of USD 100 per barrel. At the same time a sharp decrease in oil production growth rates in Russia occurred. In January-February 2008 increase in oil production was only 0.6% as compared with the corresponding period of the previous year. The volume of new oil producing facilities implementation has also decreased considerably. Start of new oil fields development requires improvement of tax system currently in effect, securing of stimuli necessary for investments in oil production.

World prices for oil in the first months of 2008 were at exceptionally high level (*Table 1*). In March 2008 they reached the level that had been unprecedented in nominal terms, exceeding USD 100 per barrel. It was a considerable inflow of capitals to the oil exchange market that contributed greatly to the price growth along with increased demand for oil, conservative policy of the OPEC, low oil production growth in countries that are not OPEC members, geopolitical risks.

Oil production in Russia in the first months of 2008 demonstrated sharp decrease of growth rates. Whereas in 2002-2004 increase in oil production reached 8.9-11% a year, in 2005-2007 - 2.1-2.2%, in January-February 2008 increase in production was only 0.6% as compared with the corresponding period of the previous year (*Table 2*). This testifies that the reserves for the rapid growth of oil production owing to the intensification of oil fields in operation exploitation are exhausted and it is necessary to developing new oil fields more actively (in the eastern part of the country, for instance).

Table 1

World Prices for Oil in 2006-2007, as USD per barrel

	2006	2007 1 quarter	2007 2 quarter	2007 3 quarter	2007 4 quarter	2007	2008 January	2008 February
Price for oil grade Brent, the UK	65.16	57.75	68.76	74.87	88.69	72.52	92.00	95.04
Price for oil grade Urals, Russia	61.24	54.30	65.16	72.19	85.91	69.39	89.35	91.41
Price for oil basket of OPEC member countries	61.08	54.65	64.97	71.59	85.18	69.10	88.35	90.64

Source: OECD International Energy Agency, OPEC.

Table 2

**Oil, Oil Products and Natural Gas Production in 2001-2008,
as percentage to the previous year**

	2001	2002	2003	2004	2005	2006	2007	2008 January- February
Oil, including gas condensate	107.7	109.0	111.0	108.9	102.2	102.1	102.1	100.6
Primary oil processing	103.2	103.3	102.7	102.6	106.2	105.7	103.8	105.0
Motor petrol	100.6	104.9	101.2	103.8	104.8	107.4	102.1	101.9
Diesel oil	102.0	104.7	102.0	102.7	108.5	107.0	103.4	104.3
Furnace fuel oil	104.2	107.1	100.3	97.8	105.8	104.5	105.2	107.0
Natural gas, bln.cu. m	99.2	101.9	103.4	101.6	100.5	102.4	99.2	101.9

Source: Federal State Statistics Service

Data on oil production by oil companies demonstrate that increase in oil production in Russia in 2007 was mainly due to a considerable growth of oil production by projects of production share agreement operators (Sakhalin-1, Sakhalin-2, Khariyagin oil field). The total increase in oil production in 2007 was 10.8 mln of tons, increase in production share projects – 8.7 mln of tons or 80.6% of the total increase. Oil production in Russia not taking into account production share agreements projects increased only by 0.4% in 2007 (table 3).

Table 3

Structure of Oil Production Increase in Russia in 2007 as compared with 2006

	2006 mln of tons	2007 mln of tons	Increase, mln of tons	Increase, %
Oil production in Russia - total	480.5	491.3	10.8	2.2
Oil production by production share agreement operators	5.1	13.8	8.7	170.6
Oil production in Russia, production share agreements operators excluded	475.4	477.5	2.1	0.4

Source: Ministry for Industry and Power, author's calculations.

A considerable decrease in new production facilities implementation in 2007 is also noticeable. Implementation of new oil wells in 2007 was equal to 2.7 thousands, decreasing by 21%, and was the lowest over the recent years, not taking 2005 into account. Considerable decrease of this figure in 2005 – by 29% as compared with the previous year - was accounted for by sharp decrease of investments in production by YUKOS and Sibneft: YUKOS was busy mainly with urgent payment of taxes imposed on it, and decrease in Sibneft's investments was due to its sale.

In contrast to 2005, in 2007 the drop in investment activity occurred world prices for oil being exceptionally high and there being no destabilizing events. In our opinion, this is an indicator of considerable decrease of incentives for investments in oil production that can be accounted for by two factors.

First, in the environment of real worsening of oil production conditions and inflexibility of existing taxation system decrease in expected profitability of investments in the new projects occurred. New oil fields are usually characterized by worse mining, geological and geographical conditions their exploitation requiring increase in capital, operating and transportation costs. At the same time existing taxation system does not

provide necessary decrease of tax burden while exploitation of new oil fields with high costs that limits investments in new projects.

Second, governmental expansion in oil sector and apprehensions as to further taking up of the private business considerably decrease willingness of private oil companies to invest in the long run.

At the same time investments of state-owned companies were limited by considerable amount of their debts by credits taken to purchase new assets.

As a result, excluding abnormal 2005 out of consideration, in 2007 despite exceptionally favorable situation at the world markets implementation of new oil wells was the lowest over the recent years (*Table 4*)

Table 4

Implementation of New Oil Wells in 2001-2007

	2001	2002	2003	2004	2005	2006	2007
Wells implementation, thousands	3.8	3.1	3.0	3.1	2.2	3.4	2.7

Source: Federal State Statistics Service

Such dynamics of new production facilities implementation indicates unsteadiness even of the low oil production growth rates that are being observed at present. The result of the trends mentioned can be a decrease in oil production in the country in the forthcoming years.

Under the influence of oil world prices growth a considerable growth in prices for oil and oil products at the domestic market was observed. The producer's prices for oil, car petrol, diesel fuel and furnace fuel oil (mazut) reached the maximum over the whole post-reform period at the end of 2007 and the beginning of 2008. In January 2008 the average internal price for oil (producers' price) in dollar terms reached USD 305 per ton. Internal prices for natural gas have also increased (*table 5*).

Table 5

**Internal Prices for Oil, Oil products, Natural Gas in US dollar terms over 2006–2008
(average producers' prices, as USD per ton)**

	2006 December	2007 June	2007 September	2007 December	2008 January	2008 February
Oil	168.4	230.3	240.9	288.2	305.0	285.4
Motor petrol	416.5	491.7	493.6	581.2	562.9	543.2
Diesel oil	426.1	442.0	467.1	692.5	637.2	626.8
Furnace fuel oil	148.8	181.6	210.1	276.5	262.4	241.0
Natural gas, as USD per thou. cu. m	14.4	15.6	19.2	17.6	17.7	18.2

Source: calculated on the basis of Federal State Statistics Service's data

As compared with the previous year in 2007 oil export in natural terms increased by 4.0%, oil products export – by 8.0% (*table 6*). Share of export in furnace fuel oil (mazut) production was equal to 82.5%, in diesel fuel production – to 55.0%, car petrol production – to 17.1% (for reference: in 1999 share of export in car petrol production was equal only to 7.2%, in 2006 – to 18.3%).

Table 6

**Oil, Oil Products and Natural Gas Export from Russia in 2002-2007,
as percentage to the previous year**

	2002	2003	2004	2005	2006	2007
Oil, total	113.9	117.8	115.0	98.4	98.0	104.0
Of which:						
To non-CIS countries	109.9	118.9	116.3	99.1	98.0	104.8
To CIS countries	137.3	112.4	108.3	94.9	98.0	99.4
Oil products, total	118.5	103.6	105.5	117.9	106.3	108.0
Gas, total	102.4	102.0	105.5	103.7	97.6	94.6

Source: Federal State Statistics Service

Proportion of oil and oil products net export in 2007 reached 74.7%, net oil export being 52.0% of its production. Share of net export in gas production was equal to 28.3% (*Table 7*). Share of oil products increasing slightly, crude oil export still prevailed in the structure of oil export, whose share was 70% of the total oil and oil products export.

Table 7

Ratio of Energy Supplies Production, Consumption and Export in 2002–2007

	2002	2003	2004	2005	2006	2007
Oil, mln tons						
Production	379.6	421.4	458.8	470.0	480.5	491.3
Export, total	187.5	223.5	257.4	252.5	248.4	259.1
Export to non-CIS countries	154.8	186.4	217.3	214.4	211.2	221.5
Export to CIS countries	32.7	37.1	40.1	38.0	37.3	37.6
Net export	181.3	213.4	253.2	250.1	246.1	256.3
Domestic consumption	123.5	129.8	124.2	123.1	131.2	123.6
Net export, as percentage to the production	47.8	50.6	55.2	53.2	51.2	52.2
Oil products, mln tons						
Export, total	75.0	78.4	82.1	97.0	103.5	111.8
Export to non-CIS countries	72.5	74.9	78.0	93.1	97.7	104.9
Export to CIS countries	2.6	3.5	4.1	3.9	5.8	6.9
Net export	74.8	78.2	81.4	96.8	103.2	111.4
Oil and oil products, mln tons						
Oil and oil products net export	256.1	291.6	334.6	346.9	349.3	367.7
Oil and oil products net export, as percentage of oil production	67.5	69.2	72.9	73.8	72.7	74.8
Natural gas, bln. cu. m						
Production	594.5	620.3	634.0	636.0	656.2	651.0
Net export	178.3	180.5	193.5	199.6	195.3	182.7
Domestic consumption	416.2	439.8	440.5	436.4	460.9	468.3
Net export, as percentage to the production	30.0	29.1	30.5	31.4	29.8	28.1

Source: Federal State Statistics Service, Ministry for the Industry and Power, Federal Customs Service, author's calculations.

As it is demonstrated by the analysis of the Russian oil export dynamics over the long period of time in 2007 the total net export of oil and oil products reached unprecedented level (367.2 mln of tons) and by 75.6 mln. tons (25.9%) exceeded the level of 1988, which was characterized by a maximum oil export volumes (291.6 mln. tons) before the crisis. At the same time the increase of oil products share in oil export was observed, their share increasing from 18.2% in 1990 to 30.4% in 2007. In the environment of the sharp reduction of domestic oil consumption (according to our calculations it has decreased from 269.9 mln. tons in 1990 to 124.1 mln. tons in 2007, that is more than by half) the share of oil and oil products net export in oil production increased over this period from 47.7% to 74.7%.

This testifies that the export orientation of oil sector in comparison with the pre-reform period has considerably reinforced. It should be, however, taken into account that it is connected not only with the increase of the absolute export volumes, but also with a considerable decrease in the domestic oil consumption as a result of Russian economy market transformation. In recent years in the environment of rapid economic growth, domestic oil consumption in the country was quite stable, which testifies the decrease in oil capacity of the GDP.

High level of world prices for oil determined considerable incomes growth in the oil sector of the economy (Fig. 1). In 2007 total earnings from oil and main kinds of oil products export (car petrol, diesel oil and furnace fuel oil) reached USD 164.9 bln., which is a record level over the whole post-reform period (table 8). For reference it can be noted that the minimum level of oil export earnings was observed in the environment of world oil prices fall in 1998, when the export profit was only USD 14 bln.

Table 8

Oil and Oil Products Export Earnings in 2002-2007, as USD bln

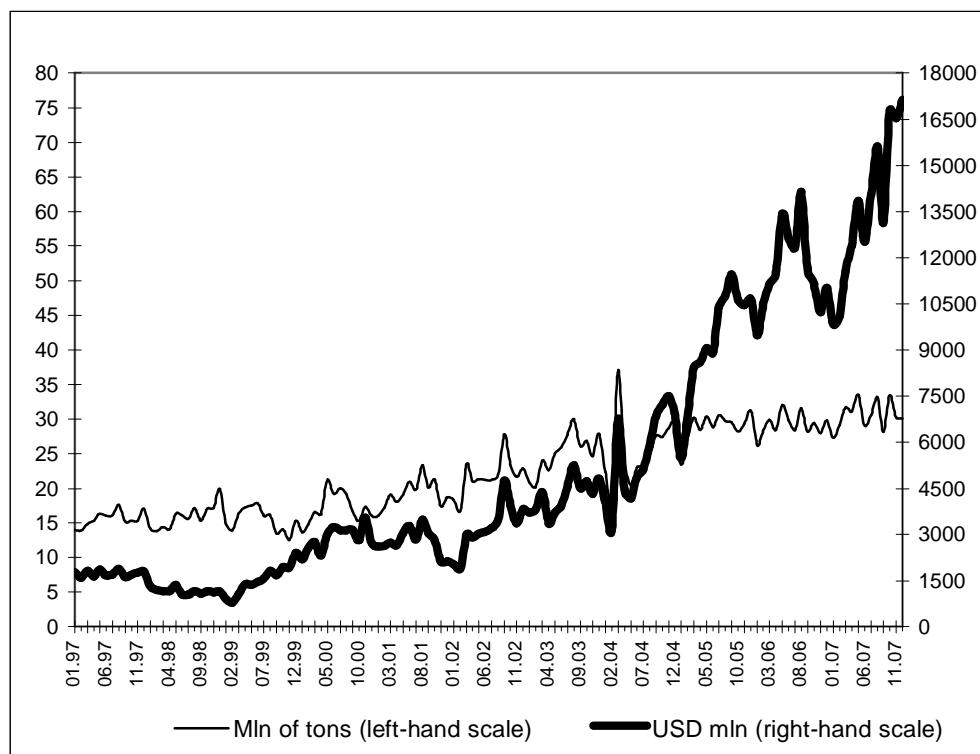
	2002	2003	2004	2005	2006	2007
Oil and main kinds of oil products export earnings	38.7	51.1	74.6	112.4	140.0	164.9

Source: calculated on the basis of Federal State Statistics Service data

A number of factors provide favorable demand and price prerequisites for further development of oil sector in Russia. The export opportunities of Russian oil to European countries will expand the demand for oil in the countries of Western and Eastern Europe increasing and oil production in the Northern Sea decreasing. At the same time the growth of demand for oil in the countries of Asian-Pacific Region, China in particular, as well as the predicted considerable aggravation of their dependence upon the import create favorable op-

opportunities for Russia's access to the markets of this region's countries and for considerable growth of oil export in this direction.

New oil pipelines projects that are being carried out at present and are being planned for implementation, for instance construction of oil pipeline East Siberia-Pacific Ocean with the branch for China, will enable necessary infrastructure creation to increase Russian oil supplies to the world market. At the same time opportunities for Russian oil export will be more and more limited by the possibilities of its production expansion, real worsening of production conditions.



Источник: рассчитано по данным Федеральной службы государственной статистики.

Fig. 1 Oil and Oil Products Export in Natural and Value Terms in 1997-2007, mln tons, USD mln

Increase in oil production and export in the future is possible only on condition of new oil fields development, whose exploitation in many cases is characterized by high capital, exploitation and transportations costs. Start of such oil fields development requires improvement of the existing system of oil sector taxation, pursuing of special tax policy, which provides necessary incentives for investments in oil production⁸.

In the near-term outlook it can be expected that high world prices for oil and favorable external conditions for incomes part of the state budget, replenishment of reserve funds and oil and gas sector development will sustain. According to the IET forecast, the price for oil grade Brent in the forthcoming months will be in the range of USD 98-107 per barrel⁹, which is considerably higher than the level of the previous year.

Inflation, Monetary and Credit Policy

P. Trunin

As of February results, the CPI in the RF stayed at the high level, having reached 1.2 per cent as compared with 1.1 per cent in the relevant period of the preceding year. Therefore, the rapid growth of consumer prices is continued, making doubtful the possibility of achieving the Government estimates of the annual inflation rate at the level of 9.5 per cent. Herewith, foreign currency reserves were being accumulated in the country, the volume of which amounted to USD 500 bln in March. There was also the information, that the Bank of Russia might attract external investment companies to manage a share of foreign currency reserves.

⁸ See: Yu. Bobylev Reform must go on – Russian Oil, № 1, 2008, p. 72-77.

⁹ See: Bulletin for model calculations of short-term forecasting for social and economic indices in the Russian Federation. March 2008 Moscow. IET. 2008.

The consumer price index in February made 1.2 per cent (against 1.1 per cent in February 2007 (see Fig. 1.). Unlike January, the greatest contribution to the prices growth in February (+1.7 per cent), was made by an upsurge of prices for food products (+1.7 per cent). Herewith, as we noted in previous surveys, the agreement of the government with the leading trade networks to freeze prices for some socially significant goods was still in effect. Moreover, as soon as the term of that agreement expires in May, there is a high probability of a sharp upsurge for food products prices. In February the highest growth rates were observed in the costs of fruit and vegetables (+5.1 per cent), bread and bakery products (+2.2 per cent) pasta (+2.1 per cent) and milk and dairy products (+2 per cent). Herewith, the price of eggs has been downgraded by 0.4 per cent.

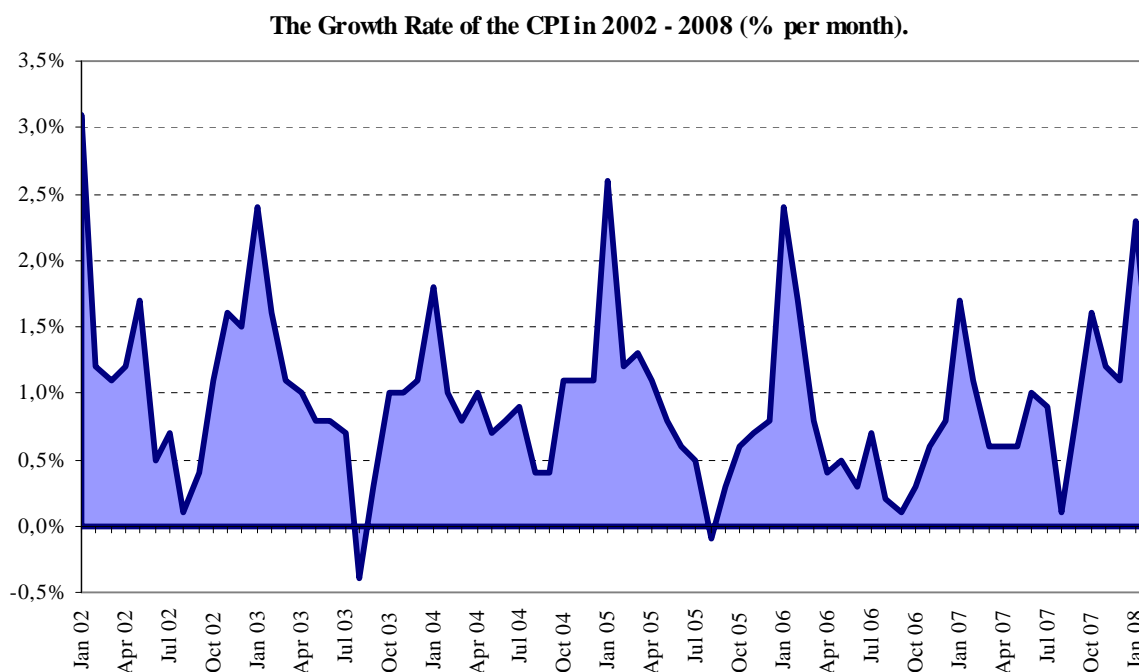
In February the traditional upgrading of prices for commercial public services was continued and reached 1.4 per cent as of month results. The utmost growth was noted in regard to prices for public transport (+3.4 per cent), pre-school education (+1.8 per cent), consumer services (+1.7 per cent) and healthcare services (+1.4 per cent). Prices for communications services went down in February by 0.4 per cent.

In February, the growth was observed also in regard to non-food items, which average nation-wide prices have increased during the month by 0.6 per cent. The highest growth rates were noted in February for tobacco (+1.4 per cent) and detergents and cleaning agents (+1 per cent). Herewith, no downgrading was observed in any type of non-food items.

Therefore, consumer price index growth rate has somewhat downgraded in February as compared with January, but nevertheless was higher than in 2007. In February the inflation was restrained by the decline of monetary offer in the fall of 2007¹⁰. Hence, the sharp increase in budget expenditures at the end of 2007 will contribute to inflation in April-May this year, along with the termination of the moratorium on increasing prices for some socially important goods can result in the resumption of inflation acceleration. In March the Ministry of Economy of Russia increased the maximum target inflation to 9.5 per cent, but we believe that as of the year results, the CPI in Russia will exceed 10 per cent.

In February the CPI¹¹ accounted to 1 per cent (versus 0.5 per cent in the relevant period of preceding year), what reflects high inflation rates, provoked by increased monetary offer in 2007. According to our estimates, the CPI in March made 0.9 – 1.1 per cent.

Fig. 1.



Source: RF Statistical Service

¹⁰ According to our assessment, of monetary offer volatility comes into effect with the lag of three-four months.

¹¹ 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.

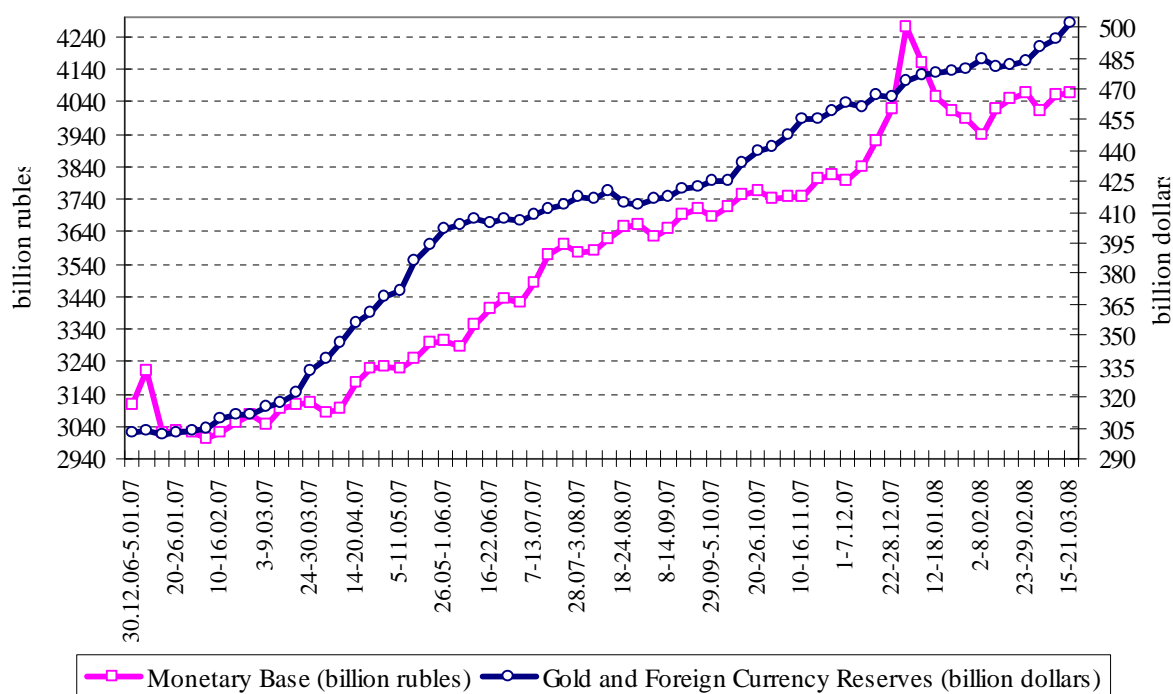
Within February 2008, the volume of monetary base (in broad definition¹²) has been increased by RUR 22.7 bln to the amount of RUR 4954.5 bln (+ 0.5 per cent). Let us consider the dynamics of monetary base in broad definition by components.

The volume of cash in circulation, including the cash balances of credit institutions, as of March 1, 2008 was RUR 3.79 trillion (+0.8 per cent as compared with February 1), the correspondent accounts of credit institutions with the Bank of Russia made RUR 588.2 bln (+7.8 per cent), mandatory reserves – RUR 316.5 bln (+5.6 per cent), credit organizations' deposits with the Bank of Russia accounted to RUR 286.4 bln (+35.3 per cent), banks' deposits with the Bank of Russia made 126.4 bln (-55.9 per cent), the value of the Bank of Russia's bonds held by credit institutions – RUR 129.2 bln (+27.5 per cent). Thus, in February, a slight reduction of excessive reserves of commercial banks was observed, which was the result of gradual deterioration of the situation with the liquidity in the banking system due to the payment of foreign debt and the tax payments to the budget. In March - April this trend will be undoubtedly sustained, but the Central Bank representatives have noted that the Bank of Russia is ready to provide liquidity resources to the banks, if necessary. Moreover, the Russian Ministry of Finance can make placement of untied budget surplus funds with commercial banks, which will also make for liquidity growth. In our view, because of the above mentioned circumstances, the banking system of Russia in the near future is not likely to face serious problems, caused by the shortage of liquidity.

The growth of the volume of cash in circulation in February of this year (+ 0.8 per cent), while the growth of mandatory reserves (+ 35.3 per cent) led to the expansion of the monetary base in narrow definition (+ mandatory cash reserves) by 0.6 per cent (see . Fig. 2). Herewith, the volume of foreign currency reserves of the Central Bank of the Russian Federation in February increased by 1.5 per cent and amounted to USD 490.7 billion by March 1. Within the following two weeks of March, their volume has grown by another 2.3 per cent to the level of USD 502.1 billion.

Fig. 2.

Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2007 - 2008



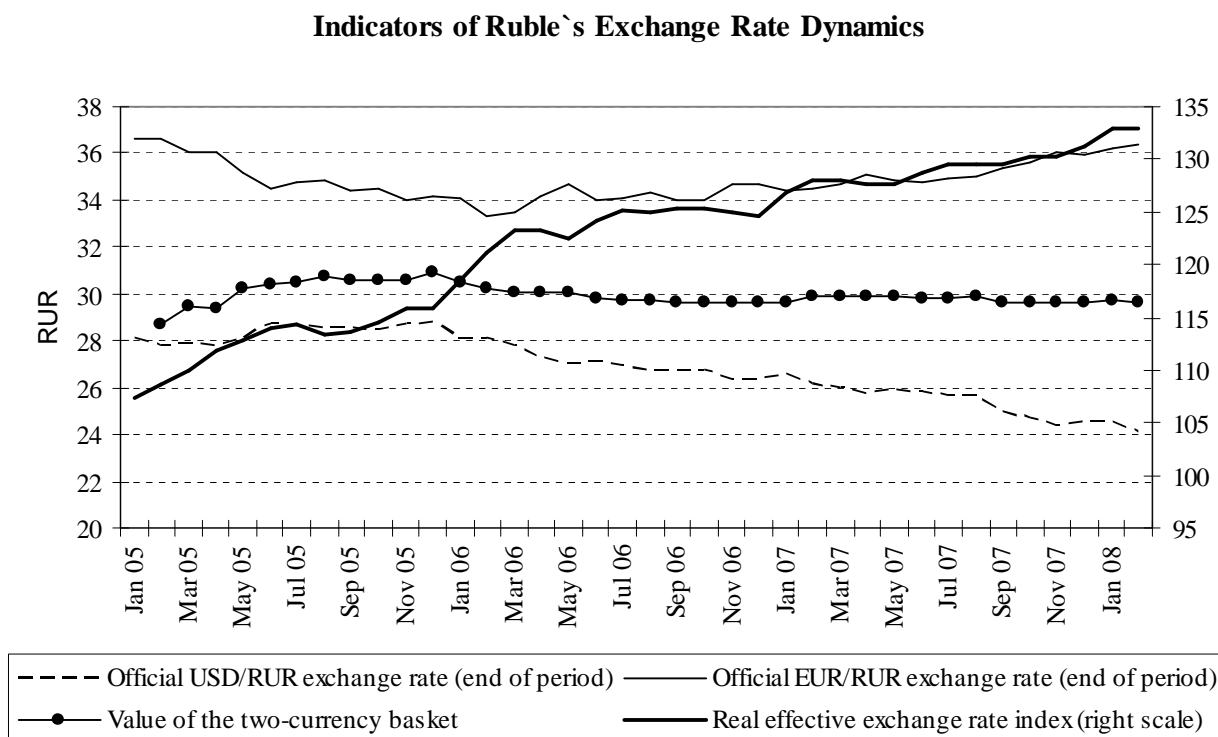
Source: RF Central Bank

¹² 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..

In February, the inflow of foreign currency to the country was continued as a result of sustained high oil prices. At the same time, according to the assessments of the RF Central bank, the outflow of capital was continued from the RF due to instability in the global financial market. As a result, the real effective exchange rate of February has not changed versus January level and remained at the same level of 132.8¹³ (See Fig. 3).

In February, downgrading of US dollar in the global currency market continued due to the new signs of further recession in the USA economy. The USD decline has resulted in its further downgrading in the RF foreign currency market: by the end of February the dollar rate was RUR 24.12, against RUR 24.48 as of February 1. Significant ruble strengthening of against US dollar was accompanied by increased value of the two-currency basket¹⁴ by 10 kopecks in February. As a result, EURO rate at the end of February has grown to RUR 36.41.

Fig. 3.



Source: RF Central Bank, authors' estimates

In March there appeared an official information that the Central Bank may involve investment companies to the management of a share of the national foreign currency reserves. In our view, this step is necessary due to a possible investment of the National Welfare Fund in the shares of private companies. It should be reminded, that currently the National Reserve Fund and the National Welfare Fund investments is made on behalf of the Ministry of Finance of Russia by the RF Central Bank in the framework of the foreign currency reserves management. At the same time, there is a lack of experience in equity investment in the RF Central Bank. Hereby, involvement of major investment companies (preferably international) to the management of foreign currency reserves could be helpful to solve the problem. It should be noted, that the investment of a part of the sovereign welfare funds in equities, as well as other financial instruments (derivatives, real estate, etc.) is an element of the best international practice in the management of such funds.

¹³ The level of January 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.

Budget and tax policies

O. Kirillov

In February 2008, federal budget expenditure, as well as revenue, was considerably increased by comparison with last year's levels. The RF Ministry of Economic Development and Trade once again suggested that decision should be made to substantially lower, from the year 2009 onwards, the basic VAT rate - to the level of 12% - 13 %, while simultaneously abolishing the lowered rate of VAT and raising, by way of compensation, the rates of excises. The Ministry of Finance, as before, does not accept this proposal, and the outcome of the ongoing discussion is not clear as yet. According to the IET's estimates, if the rate of VAT is decreased to 10 %, budget losses will amount to up to 2.6 % of GDP.

In Table 1, the dynamics of the main parameters of the RF federal budget in 2006 - 2008 are shown.

Table 1.

The main parameters of the RF federal budget in 2006 - 2008 (as % of GDP)

	2006	February 2007	2007	February 2008
Revenue	23.5	20.66	23.87	26.24
Expenditure	16.2	12.50	18.39	18.08
Deficit (-)/ Surplus (+)	7.4	8.16	5.48	8.16

Source: RF Ministry of Finance; calculations of the IET.

As was expected, in January - February 2008 the spending of budget resources remained at a high level. The government's course towards high state expenditure, which began in the last quarter of 2007, was associated with the political cycle. After the completion of the presidential election campaign, a certain lowering of the share of state expenditure in GDP can be expected.

As regards federal budget revenue, a much higher revenue level as a percentage of GDP can be noted, by comparison with the same period of 2007. The dynamics of receipts in the federal budget in January - February 2008 are close to that observed in 2006.¹⁵

The structure of receipts in the RF federal budget, distributed between federal bodies - budget revenue administrators, is shown in Table 2.

Table 2.

Volumes of revenue receipts in the RF federal budget in 2006 - 2008 (as % of GDP)

	2006	February 2007	2007	February 2008
Taxes and other payments administered by Federal Tax Service	11.27	9.81	11.50	10.87
Taxes and other payments administered by Federal Customs Service	10.76	9.98	9.98	12.74
Revenues administered by Federal Agency for Management of State Property	0.26	0.13	0.25	0.24
Revenues of federal budget administered by other federal bodies	1.25	0.74	2.14	2.38
Total revenue	23.54	20.66	23.87	26.24

Source: RF Ministry of Finance; calculations of the IET.

In face of the overall surplus by 5.6 %, in January - February 2008, of revenue as a percentage of GDP over the level observed in the same period of 2007, the growth in receipts demonstrated by all the administrators appears to be quite logical. The amount of receipts of taxes and other payments administered by the Federal Tax Service is by 1.1 % of GDP higher than in January - February 2007; that demonstrated by the Federal Customs Service is higher by 2.8 % of GDP; the state budget revenues administered by other federal bodies increased by 1.7 % of GDP; and the receipts of the Federal Agency for Management of State Property increased by 0.1 % of GDP.¹⁶

The RF Ministry of Finance is planning, from the year 2009, to adjust the procedure for levying the tax on the extraction of mineral resources (TEMR) with regard to oil production. It is planned to adjust the scale

¹⁵ Federal budget revenue in January 2008 - 29.92 % of GDP; in February 2008 - 24.57 %; in January 2006 - 28.08 %; and in February 2006 - 24.48 %.

¹⁶ It might have been possible to perform a more detailed analysis of these trends on the basis of the data published by the RF Treasury, but this month no such publication has been issued.

applied to calculating the amount of TEMR on oil so as to set the lower margin at \$ 15 per barrel, and not at \$ 9, in order not to levy the tax on prices under \$ 15 per barrel. As estimated by the RF Ministry of Finance, the change in the lower TEMR margin will result in an aggregate loss of federal budget revenue, from early 2009 onward, in the amount of 100 billion rubles at the current level of oil prices, which corresponds to 9 % of TEMR receipts in 2007.

The RF Ministry of Economic Development and Trade submitted to the RF Ministry of Finance proposals concerning priority measures in the sphere of taxation. The main changes suggested by the Ministry of Economic Development and Trade are concerned with the value added tax, the tax on profit of organizations, export duties and the excises on oil products, and special tax regimes. Besides, it is intended to decrease the volume of tax reporting documentation to be submitted by taxpayers. .

The corresponding letter concerning the priority measures of tax policy was signed by head of the RF Ministry of Economic Development and Trade Elvira Nabibullina. As priority measures, the RF Ministry of Economic Development and Trade proposes “to make the decision concerning a significant decrease in the basic rate of VAT to 12 % - 13 % from the year 2009 onwards, with the simultaneous liquidation of the lowered rate of VAT and the compensating increase in the rates of excises”.

The RF Ministry of Finance, represented by Vice Prime Minister and Minister of Finance Aleksey Kudrin, did not accept the majority of the “priority tax measures”. Mr. Kudrin declared that at present there are no grounds at all for setting any precise timelines for lowering the rate of VAT. This tax will certainly be decreased, he assured, before 2020. But 12 years, in his opinion, is too long a period for offering any guarantees that the reform will have no negative effect on the well-balanced state of the budget. If the “oil and gas” component of the budget will begin to decline, the drop in the tax rate at least to 15 % will deprive the budget of one-sixth of its current receipts, the Minister reminded.

The Russian Union of Industrialists and Entrepreneurs fully supports the proposals put forth by the RF Ministry of Economic Development and Trade in the part relating to the priority measures of tax policy. Its representatives believe that the implementation of the innovative scenario of the Russian economy’s development will be impossible if not backed by such measures.

As estimated by the IET (*Table 3*), the introduction of a single rate of VAT at the level of 12 % -13 % will result in the following losses of budget revenue (see *Table 3*).

Table 3

RF budget losses after lowering the basic rate of VAT				
Single VAT rate	% of GDP	billion rubles		
		2009	2010	2011
10%	-2.58	-1 148.1	-1 308.3	-1 470.0
12%	-1.87	-831.5	-947.5	-1 064.6
13%	-1.51	-673.2	-767.1	-861.9
18%	0.27	118.4	134.9	151.6
GDP, billion rubles		44 565	50 781	57 058

Source: calculations of the IET

However, in terms of consequences for the budget, the lowered rate of VAT will result not only in direct budget losses in the amount of the potential VAT revenues, but also in growth of receipts from profits tax, the single social tax and personal income tax as a result of increased sales volumes of manufacturers (or in the trade sector) and the expanding tax bases of these taxes.

Considering the existing structure of GDP (*Table 4*), it can be concluded that the expansion of the tax bases of the profits tax, SST and PIT will be equivalent not to the whole amount of GDP growth, but only to that part of it which corresponds to such components as “official salaries and wages of employees” (on the average – 34 % of GDP growth) and “net profit of the economy and net mixed revenues” (on the average – 30 % of GDP growth).

With due regard for these factors and the shares of resources redistributed in favor of enterprises as a result of the lowered VAT rate, three scenario models of budget losses were investigated. The first one envisages that, resulting from the VAT rate having been lowered to 12 %, prices will drop by the same value (markets of entirely elastic supply or non-elastic demand); the second one – that prices will drop by half of the value of the lowered tax rate, or by 3 %; and the third one – that prices will remain unchanged (markets of entirely elastic demand or non-elastic supply), and all the benefit from the lowered rate of VAT will be received by producers (*Table 5*).

Table 4.

Structure of GDP, by type of primary revenues, in 2002 – 2006 (in %)

	2002	2003	2004	2005	2006
Gross domestic product	100	100	100	100	100
including:					
- official salaries and wages of employees	35.2	35.8	34.3	32.0	32.2
- hidden payment for labor of employees	11.5	11.3	11.7	11.8	11.9
- net taxes on production and imports	17.0	16.0	16.9	19.7	20.0
- consumption of fixed assets	7.8	7.2	6.4	6.0	4.8
- net profit of the economy and net mixed revenues	28.5	29.7	30.7	30.5	31.1

Source: calculations of the IET

Table 5.

Consequences of VAT rate lowered to 12 %, for revenues of Russia's budgetary system, in terms of 2009 economic indices

	Billion rubles	% of GDP	Billion rubles	% of GDP	Billion rubles	% of GDP
	Scenario 1		Scenario 2		Scenario 3	
Loss of budget revenue resulting from lowered VAT rate	-831.5	1.87%	-831.5	1.87%	-831.5	1.87%
Volume of households' spending inside Russia's economy ¹⁷	640.3	1.44%	320.2	0.72%	-	-
Growth of monies at disposal of enterprises	-	-	320.2	0.72%	640.3	1.44%
Expenditure multiplier						4.35
GDP growth resulting from additional households' demand	2785.3	6.24%	1392.7	3.12%	- ¹⁸	-
Growth of official salaries and wages of employees (including deductions to social insurance) ¹⁹ :						
- 34 % of GDP growth	947.0	2.12%	473.5	1.06%	-	-
- 60 % of growth of enterprises' monies	-	-	192.1	0.43%	384.2	0.86%
Growth in profit before taxes in the economy:						
- 30 % of GDP growth	835.6	1.86%	417.8	0.94%	-	-
- 40 % of growth of enterprises' monies	-	-	128.1	0.29%	256.1	0.57%
Additional budget tax receipts :						
Profits tax (24 %)	200.5	0.45%	131.0	0.30%	61.5	0.14%
SST (26 %) ²⁰	177.1	0.40%	124.5	0.28%	71.8	0.16%
PIT (13 %)	100.1	0.22%	70.3	0.16%	40.6	0.09%
Net change in budget tax receipts resulting from lowered VAT rate	-353.8	0.79%	-505.7	1.13%	-657.6	1.48%

Source: calculations of the IET

¹⁷ Assumption 1: According to our calculations, the marginal consumption inclination of Russia's households in 2002 - 2007 was at the level of 77 %, remaining almost completely unchanged.

¹⁸ Assumption 2: Due to absence of additional demand displayed by the population, no multiplication effect will follow.

¹⁹ Assumption 3: the distribution of the additional monies generated by enterprises between profit before taxes and official wages and salaries is being done in accordance with their existing ratio as percentages of GDP, less net taxes on foodstuffs and imports (40 % : 60 % by the results observed in 2004 – 2006).

²⁰ Assumption 4: in scenario-based estimations, the effective rate of SST is fixed at 23 %, which corresponds to the indices observed in 2007.

As seen from the Table, in all the scenarios the decreased rates of VAT, given even the most optimistic assumptions, will produce a drop in tax receipts, in terms of 2009 indices, by 1.1 – 1.3 % of GDP (Scenarios 2 and 3 are more realistic in the short term).

An attempt to compensate for the loss of budget revenue by increasing the rates of excises does not appear to be realistic. In fact, over the whole period of implementing tax reform, the receipts from excises in this country's budgetary system were declining.

Table 6.

Volume of receipts from excises in the RF budget in 2000 - 2007 (as % of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007
Excises	2.27	2.72	2.44	2.59	1.43	1.17	1.01	0.95

Source: calculations of the IET

Moreover, the total volume of receipts from excises in 2007 was less than 1.0 % of GDP, while the revenue lost as a result of lowered VAT rate, according to the most modest estimates, will amount to no less than 1.1 – 1.3 % of GDP (with regard to budgets of all levels) with all the adjustments described earlier.

It should also be noted that such dynamics of receipts from excises are associated predominantly with the dynamics of the sales volumes of excisable goods, which every year fall behind the rate of GDP growth, and has only a secondary dependence on the level of indexation of tax rates. Besides, in the project developed by the RF Ministry of Economic Development and Trade it is proposed “to promote production and export of oil products with high value added through lowering the excises on motor fuels”. It is necessary to note that the excises on oil products account for a half of total budget receipts from excises, and so it is not quite clear the rates of which excises will be raised in order to compensate for the loss of budget revenue.

Thus, according to our forecasts, the consequences of a lowered VAT rate will be negligible in terms of investment activity, especially in a long-term perspective. In fact, the effect may even be negative, considering that VAT will cause less disproportions by comparison with the other taxes that can be introduced by the government in order to compensate for losses of budget receipts (for example, increased rates of TEMR or excises, or the replacement of VAT by the sales tax).

As of 1 March 2008, the aggregate volume of the Reserve Fund, denominated in rubles, amounted to 3,082.28 billion rubles, or to 10.1 % of GDP. The aggregate volume of the National Welfare Fund, as of 1 March 2008, amounted to 777.03 billion rubles, or to 2.5 % of GDP. The difference linked to the exchange rate in the residuals on the accounts of the Reserve Fund denominated in foreign currencies from 30 January to 29 February 2008 amounted to (-) 15.35 billion rubles, and in the residuals on the accounts of the National Welfare Fund - to (-) 5.77 billion rubles. The share of these two Funds in GDP, by comparison with the value of the same index as of 1 February 2008, diminished by more than 1 % .

Financial Markets ²¹

N. Burkova

In March the Russian financial market dynamics was determined by the situation in the global financial markets, based on the aggravated negative background. The high volatility of stock markets, lower quotations of the majority of the world indices, coupled with the continued weakening of the positions of the US dollar urged a large number of investors to move from the stock market to commodity markets, which has contributed to the growth of oil prices in the world markets. Those trends were especially evident in the Russian stock market, where the investors' activity has decreased by more than 30 per cent within a month. The volume of the turnover at the public debt market has also dropped down by nearly 15 per cent.

Government securities market

In March the Russian Eurobonds have demonstrated volatility in the yield as a result of the negative situation in the top world markets. Herewith, the activity in the market was rather low (there was noted an insignificant downgrading of an average daily turnover in the secondary market) due to the wait-and-see position of the market participants in the expectation what actions will be taken by USA to support liquidity market.

As of March 21, 2008, the Russian Eurobonds' RUS-30 yield to maturity made 5.31 per cent per annum (decreased by 6.0 per cent as compared with the level of February 22, 2008), RUS-18 – 5.33 per cent per

²¹ In the course of the survey preparation, there were used analytical materials and surveys, published by the Zenith Bank, investment company ATON, MICEX, and the materials presented at web sites of Russian issuing companies.

annum (-2.9 per cent), RUS-28 – 6.0 per cent per annum (-1.6 per cent). However, the yield to maturity of the Russian Eurobonds RUS-10 has demonstrated reverse dynamics, having increased by 7.2 per cent against the preceding period and made 3.27 per annum. As of the same date, the yield to redemption of the Russian Eurobonds made: for the seventh tranche of external currency debt bonds – 4.31 per cent (5.1 per cent decline as compared with the level of February 22, 2008), for the fifth tranche – 3.51 per cent (decline by 8.4 per cent) (see *Figs. 1-2*).

In general, in March an explicit decline in the yields was observed in the ruble debt market. Activity in the debt market has also significantly decreased (the turnover fell down by more than 13 per cent), reflecting the aggravated negative situation in external markets, including the on-going slow-down of the economic growth in the USA.

FIG. 1

Minfin bonds' yields to maturity in January - March 2008

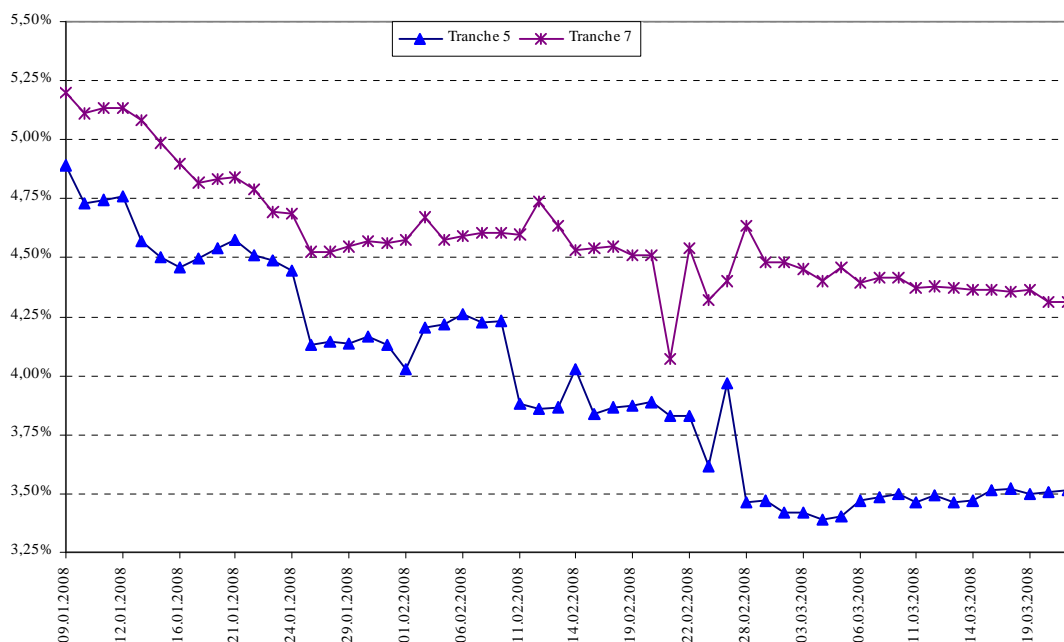
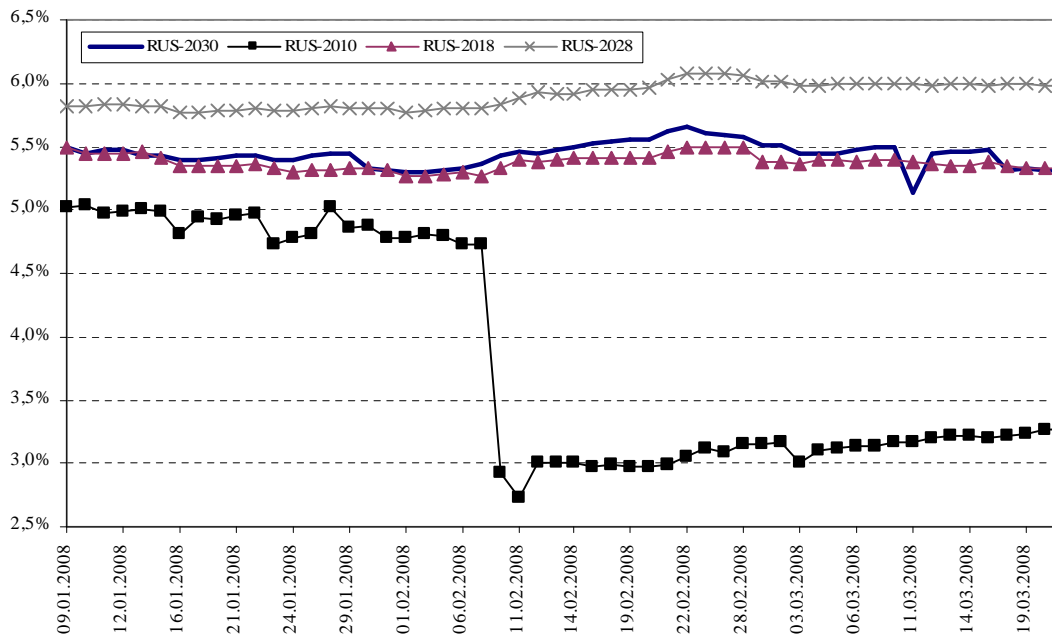


FIG. 2

Yields to maturity of the Russian eurobonds with maturity in 2010, 2018, 2028 and 2030 in January - March 2008



Within the period from February 23, 2007 to March 21, 2008, the total turnover of GKO- OFZ secondary market amounted to approximately RUR 61.1 billion with an average daily turnover of RUR 3.39 billion. (against RUR 70.8 billion with an average daily turnover of RUR 3.54 billion in February).

A number of auctions on additional OFZ placements were arranged in the period from February 23 to March 21, 2008. Thus, an auction on additional placement of OFZ series 26200 and 46020 were held on March 12 for the amount of RUR 10 billion each, actual placement made RUR 2.07 billion and RUR 3.09 billion with an average weighted yield of 6.67 and 7.22 per cent per annum, accordingly. Two more auctions on placements of OFZ series 46022 and 25062 were held on March 19 for the amount of RUR 15 billion and RUR 10 billion, actual placement made RUR 9.51 billion and RUR 2.09 billion with an average weighted yield of 6.89 and 6.49 per cent per annum accordingly.

As of March 27, 2008, the GKO-OFZ market amounted to RUR 1081.32 bln at face value and to RUR 1070.03 bln at market value. The duration of the GKO-OFZ market portfolio was 2175.67 days, having increased by 98.81 days as compared with preceding month, when that duration was 2076.86 days (as of February 28, 2008).

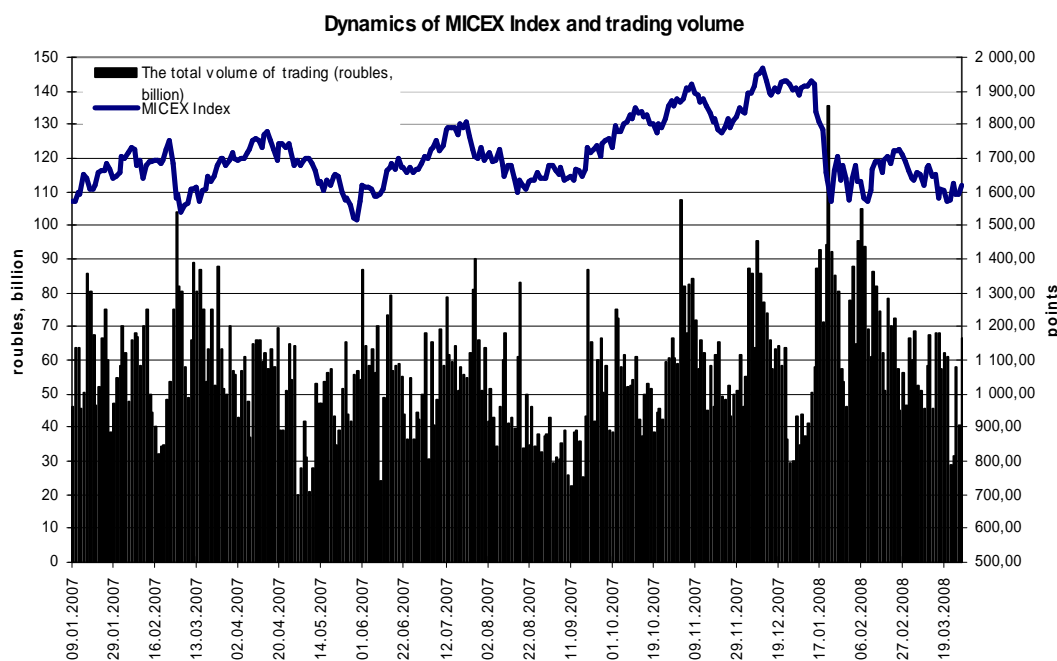
Equity Market

Stock market situation

The aggravated negative background in the global stock markets has affected the results of the bids and led to downgrading of the majority of securities yields in the Russian market, as well as in market indices, in particular, the MICEX index (by 14.31 per cent by early 2008). The volume of trades has also decreased as compared with February as a result of negative situation in the USA and panic in the world markets, provoked by the collapse of Bear Stearns, one of the world's largest investment banks. Moreover, further USD decline was noted in March.

Throughout March a strong volatility was observed in the Russian stock market. Thus, the trend of MICEX index to decline was changing several times for short periods in March, having reached the level of 1 677.41 points on March 12. Such MICEX index downgrading in March has reflected a general decline trend in the quotations of the Russian companies' equities (*Fig. 3*).

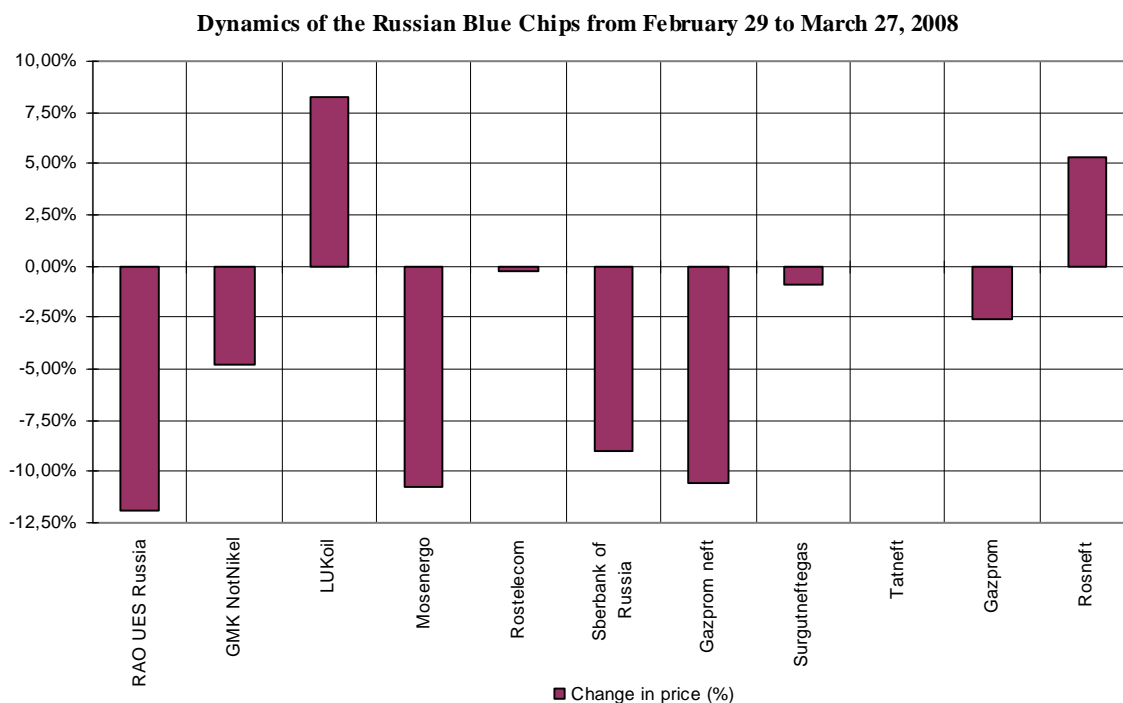
FIG. 3



In general, within the period from February 29 to March 27, 2008, the MICEX index has declined by 2.52 per cent, i.e., by 41.81 points in absolute terms. Over the same period the turnover of trades in shares, included in the MICEX index, made about RUR 1057.8 bln at an average daily turnover of RUR 69.8 bln (as compared with about RUR 1536.1 bln at an average daily turnover of RUR 69.8 bln in earlier period from January 29, 2007 through February 28, 2008). Therefore, the investors' activity in the stock market in March has decreased as compared with the preceding period over 20 per cent. The indicators of maximum and minimum turnover in the market trades in March made RUR 68.8 bln (as of March 4) and RUR 29.0 bln (as of March 21), accordingly.

As of monthly results (from February 29, through March 27, 2008), practically all “blue chips” have shown negative dynamics in their market values. The leaders in terms of rates decline were shares of RAO “UES of Russia” (downgrading by 11.88 per cent), “Mosenergo” (10.71 per cent), “Gazprom Neft” (by 10.58 per cent) and “Sberbank of Russia” (9.04 per cent). Some less downgrading rates have demonstrated the shares of GMK “Nornickel” (by 4.83 per cent), “Gazprom” (by 2.60 per cent), “Surgutneftegas” (0.91 per cent), “Rostelecom” (by 0.19 per cent) and ‘Tatneft’ (by 0.07 per cent). Herewith, shares of “LUKOIL” and “Rosneft” have demonstrated upgrading trend in quotations by 8.29 and 5.32 per cent, accordingly. (Fig. 4).

FIG. 4



In March the MICEX turnover leaders were: “Gazprom”(33.1 per cent of the total turnover), “Sberbank of Russia” (13.8 per cent), “LUKOIL” (12.2 per cent), “Nornickel” (12.0 per cent), and “RAO UES of Russia” (5.1 per cent). Total share of transactions with the above companies’ equities (“blue chips”) made 86 per cent of gross turnover in the classical MICEX stock market in the period over February 29 – March 27.

In terms of capitalization, as of March 27, the top five leaders of the domestic stock market were: “Gazprom” (RUR 7 292.4 bln), “Sberbank of Russia” (RUR 1 829.1 bln), “Rosneft” (1 695.3 bln), “LUKOIL” (RUR 1 452.9 bln), “Nornickel” (RUR 1 317.5 bln).

Futures and options market

In March 2008 the investors’ activity in the MICEX futures and options market has somewhat increased (nearly by 1.5 per cent) as compared with the preceding month. Thus, in that period the total turnover in the MICEX futures market made approximately RUR 199.27 bln (550 transactions, 8.1 mln of contracts) against about RUR 196.18 bln (708 transactions, 7.5 mln of contracts) in February 2008.

An adverse situation was observed in the RTS futures market, where the investors’ activity in February has expressly decreased (nearly by 17 per cent) as compared with the preceding month. Thus, in the period from February 29, 2008 through March 27, 2008, the total turnover in the RTS futures and options market amounted to approximately RUR 1 022.1 bln (1823 thousand of transactions, 19.7 mln of contracts) against about RUR 1 238.7 bln (2200 thousand of transactions, 21.1 mln of contracts) in February.

The greatest demand, as before, was for futures: the volume of trading in futures in the period under review was RUR 840.0 bln (1 768 thousand of transactions, 15.4 mln of contracts). Options enjoyed a far lower demand, with the volume of trading at about RUR 182.1 bln (55 thousand of transactions and 4.3 mln of contracts). The highest daily level of trading in the RTS futures market was RUR 70.5 bln (as of March 12), the lowest level was RUR 24.1 bln (as of March 21).

Corporate bond market

In March there was noted a volatile dynamics in quotations of securities, traded in the corporate debt market. The negative factor was insufficiency of liquidity in the market. However, though the number of placed

issues in March amounted to 24 (against 14 in February), an insignificant growth in the investors' activity in the market was noted over the month about 70 per cent as compared with preceding month).

From February 23, 2008 through March 21, 2008 the price index of corporate bonds, traded on MICEX²² has decreased by 0.33 points (by 0.30 per cent), as well as the index of the ten most liquid corporate bonds, which downgraded by 0.16 points (- 0.14 per cent) (see Fig. 5). Within that period the total turnover in MICEX corporate bond sector amounted to RUR 50.37 bln with an average daily turnover of RUR 2.80 bln (about RUR 47.96 bln with an average daily turnover of RUR 2.40 bln in the relevant period of February), what demonstrated an insignificant, but still upward trend in the investors' activity within the month.

FIG. 5

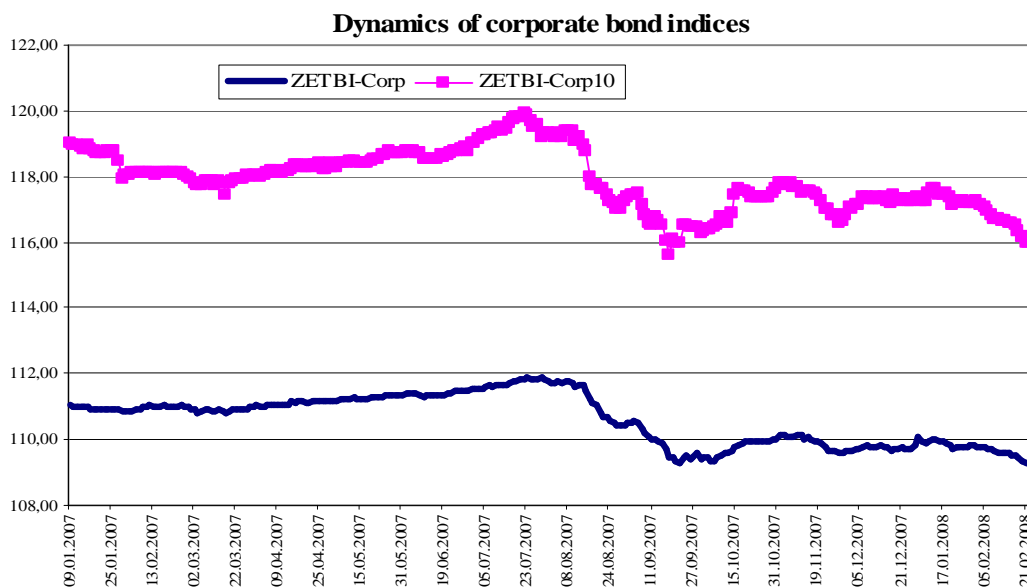
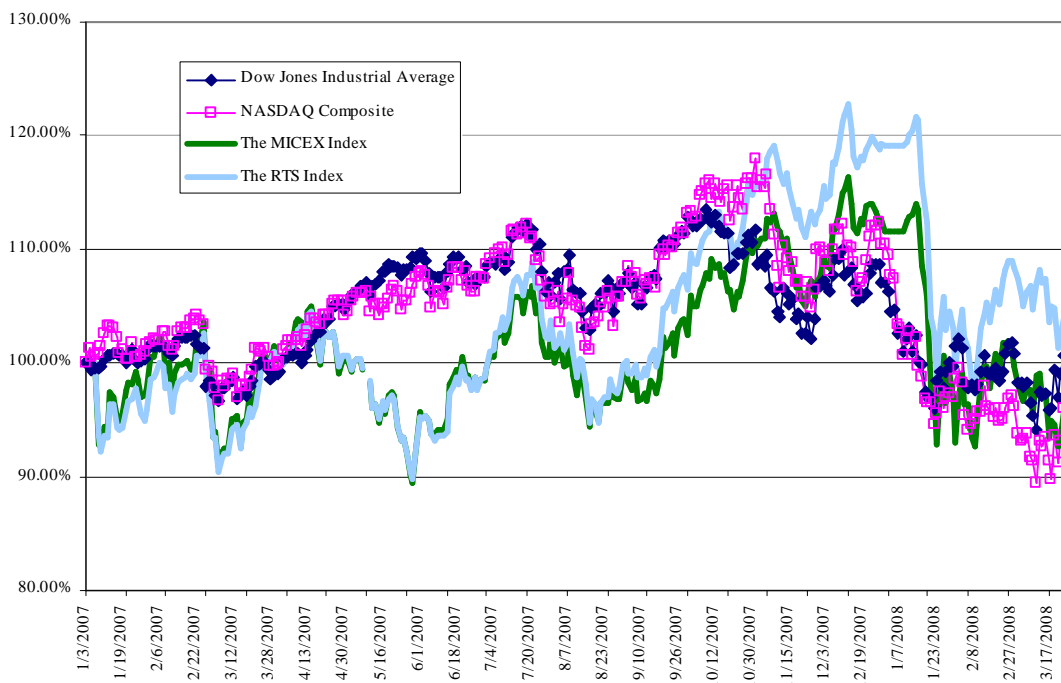


FIG. 6

Dynamics of the main USA and Russian stock indexes (in % to the date 03.01.2007)



²² The calculation was based on indices of corporate bonds traded on MICEX. The indices were produced by the Zenit bank.

External factors behind Russian stock market dynamics

In March the Russian financial market dynamics was determined by the situation in the global financial markets, based on the aggravated negative background, i.e., by economic growth rates slow-down in the USA, credit market crisis and panic in the world markets, provoked by the collapse of Bear Stearns, one of the world's largest investment banks. Moreover, further USD decline was noted in March. The negative situation was sustained during the month, even despite the US FRS decision to support liquidity (even to provide emergency credits from the US FRS) and reduce the base rate to 2.5 per cent. The high volatility of the stock markets, lower quotations of the majority of the world indices, coupled with the continued weakening of the US dollar positions urged a large number of investors to move from the stock market to commodity markets, which has contributed to the growth of oil prices in the world markets.

In March the downfall of the majority of the global indices was noted as compared with the indicators of early 2008, as well as against late February 2008. Herewith, while the basic global indices have declined by 2-5 per cent on average (versus the indicators of late February), the emerging markets suffered even higher rates of decline (1-11 per cent) (see *Table 1 and Fig. 6*).

Table 1

Dynamics of international stock market indices

Data as of March 27, 2008.	Ticker	Value	Dynamics within the month(%)*	Dynamics since the year beginning(%)
MICEX (Russia)	MICEXINDEXCF	1618.61	-4.20	-14.31
RTS (Russia)	RTSI	2030.13	-2.47	-11.37
Dow Jones Industrial (USA) Average (USA) (USA)	DJI	12302.46	-2.22	-7.25
NASDAQ Composite (USA)	NASD	2280.83	-2.18	-14.00
S&P 500 (USA)	SPX	1325.76	-3.07	-9.71
FTSE 100 (UK)	FTSE	5717.50	-4.16	-11.45
DAX-30 (Germany)	DAX	6578.06	-4.15	-18.46
CAC-40 (France)	CAC	4719.53	-2.99	-15.93
Swiss Market (Switzerland)	SSMI	7264.96	-5.19	-17.31
Nikkei-225 (Japan)	NIKKEI	12604.58	-9.49	-17.66
Bovespa (Brasil)	BUSP	60761.68	-7.31	-4.89
IPC (Mexico)	IPC	29987.05	0.08	1.52
IPSA (Chile)	IPSA	2886.44	-0.60	-5.42
Straits Times (Singapore)	STI	2992.12	-2.67	-14.08
Seoul Composite (South Korea)	KS11	1676.24	-3.45	-11.64
ISE National-100 (Turkey)	XU100	40634.89	-11.32	-26.83
Morgan Stanley Emerging Markets Free Index	EFM	896.37	-7.07	-10.75

*Note.** Versus indices, valid on February 28, 2008.

Corporate News

ОАО «Газпром»

On February 29, 2008 ОАО «Газпром» and E.ON AG have signed a Memorandum of Understanding on the joint construction and operation of a gas turbine power plant near the town of Lyubmin (Germany). In accordance with the Memorandum, the Parties will make the final investment decision on the project in 2009. The estimated capacity of the turbine power plant will be 1200 MW. Go-live is scheduled for 2011. To implement the project, "Газпром" and E. ON will establish a joint venture on a parity basis.

Moreover, on March 18, 2008 ОАО "Газпром" and YPFB, the Bolivian public oil and gas company have signed an agreement on geological exploration works in Bolivia. According to the agreement, exploration works will be performed at Sunchal, Acero and Karauaycho.

ОАО «ЛУКОЙЛ»

ОАО "ЛУКОЙЛ" completed the assessment and an independent audit of oil and gas reserves as of January 1, 2008. According to estimates of auditing company Miller and Lents (USA), as of January 1, 2008, the proven reserves of "ОАО Lukoil" hydrocarbons amounted to 20.4 billion barrels, including 15.7 billion barrels oil and 27.9 trillion of cubic feet of gas. The gross total stocks of the company include 100 per cent stocks of subsidiaries and shares in associated companies.

Moreover, "ЛУКОЙЛ Overseas" (100 per cent subsidiary of ОАО "ЛУКОЙЛ") completed the transaction with ZAO "MGNK Soyuzneftegaz" on acquisition of 100 per cent NG Holdings Ltd., including Soyuzneftegaz Vostok Limited" company, a Party of the Production Sharing Agreement (PSA) for deposits

in Southwest Gissar and Ustyurtsk region in the Republic of Uzbekistan. The amount of the transaction made about USD 580 million. The second Party in PSA is an authorized government body in the National Holding Company "Uzbekneftegaz". The PSA was signed on January 23, 2007 for the term of 36 years and entered into force on April 23, 2007.

OAO «Mosenergo»

On March 6, 2008 OAO "Mosenergo" has presented unaudited interim consolidated financial reporting, prepared in accordance with International Financial Reporting Standards (IAS) for the first nine months of 2007, and a report on the audit results of the consolidated interim financial reporting, performed by ZAO "PricewaterhouseCoopers Audit". Revenue OAO "Mosenergo" from basic operating activities over the nine months of 2007 amounted to RUR 50982 million, what exceeds the level of the same period of 2006 by RUR 4530 million (by 10 per cent). OAO "Mosenergo" operating performance expenditures over the first nine months of 2007 have been increased by EUR 6640 million (by 14 per cent) and amounted to RUR 53581 million. The net losses of OAO "Mosenergo" for the first nine months of 2007 have increased by RUR 1565 million as compared with the indicator of preceding year and amounted to RUR 2172 million.

OAO «GMK «Norilsk Nickel»

OOO "The East Sayan nickel company", which represents the interests of OAO" GMK "Norilsk Nickel", has won on March 13, 2008 the auction for the geological survey, exploration and production of minerals in Iysk-Tagul deposit of nickel and copper ores and platinum group metals in Irkutsk region by offering RUR 726 million for the license (against the starting lumpsum price of RUR 110 million rubles. The auction step amounted to RUR 11 million. The area of the licensed site is 15867 square km. The estimated resources (according to the Rosnedr) amount to 7.5 million tons of nickel, 3.5 million tons of copper and 750 tons of platinum group metals. There is an open-space deposit of nickel, copper and platinum Tokty-Oy in Iysk-Tagul region.

RAO «UES of Russia»

According to the recent information, within the two months of 2008, RAO "UES of Russia" power plants have increased the electricity production by 7.8 per cent against the relevant period of 2007 (from 129.8 to 139.9 billion kWh). The total consumption of electricity in Russia nation-wide within the past two months has increased by 6.5 per cent and amounted to 191.8 billion kWh.

On March 17, 2008 the transaction was completed on the sale of 49 per cent equity in OAO "Kolenergobyt" (owned by RAO "UES of Russia"), performed through "ISTRA" e-commerce system. The transaction price amounted to RUR 450 million.

OAO «NK «Rosneft»

On March 14, 2008 "OAO NK "Rosneft" has redeemed the second tranche of the short-term loan in the amount of USD 5.2 billion, attracted by the company in early 2007 to finance the acquisition of the new assets. The loan was repaid with the help of their own assets, as well as the 5-year syndicated credit in the amount of USD 3 billion from a group of international banks. Currently OAO "NK Rosneft" has refinanced and repaid USD 5.6 billion out of USD 5.8 billion of the short-term obligations due in the first quarter of 2008. Herewith, USD 2.6 billion was completely repaid from free cash flow. The balance of USD 190 million will be repaid before the end of the first quarter with the company own assets as well.

OAO «Rostelecom»

On March 18, 2008 Standard & Poor's (S & P) international rating agency has upgraded the forecast rating of OAO "Rostelecom" from "stable" to "positive". The long-term credit rating of OAO Rostelecom is confirmed as "BB-".

OAO «Tatneft»

In January-February 2008 the volume of oil, produced by OAO "Tatneft", amounted to 4 275 031 tons, i.e. 101,9 per cent versus the indicator of the relevant period of 2007; plan for the headway is fulfilled at 105.3per cent, driftage was 114,9 thousand meters; maintenance works are completed at 1557 wells and major repairs are made at 409 wells.

On March 17, 2008 OAO "Tatneft" has disclosed the information on the beginning of an international arbitration against Ukraine in connection with the illegal forced seizure of Kremenchug refinery (AO "Ukratnafta") in October 2007. The control package of its shares are owned by Tatneft and associated shareholders.

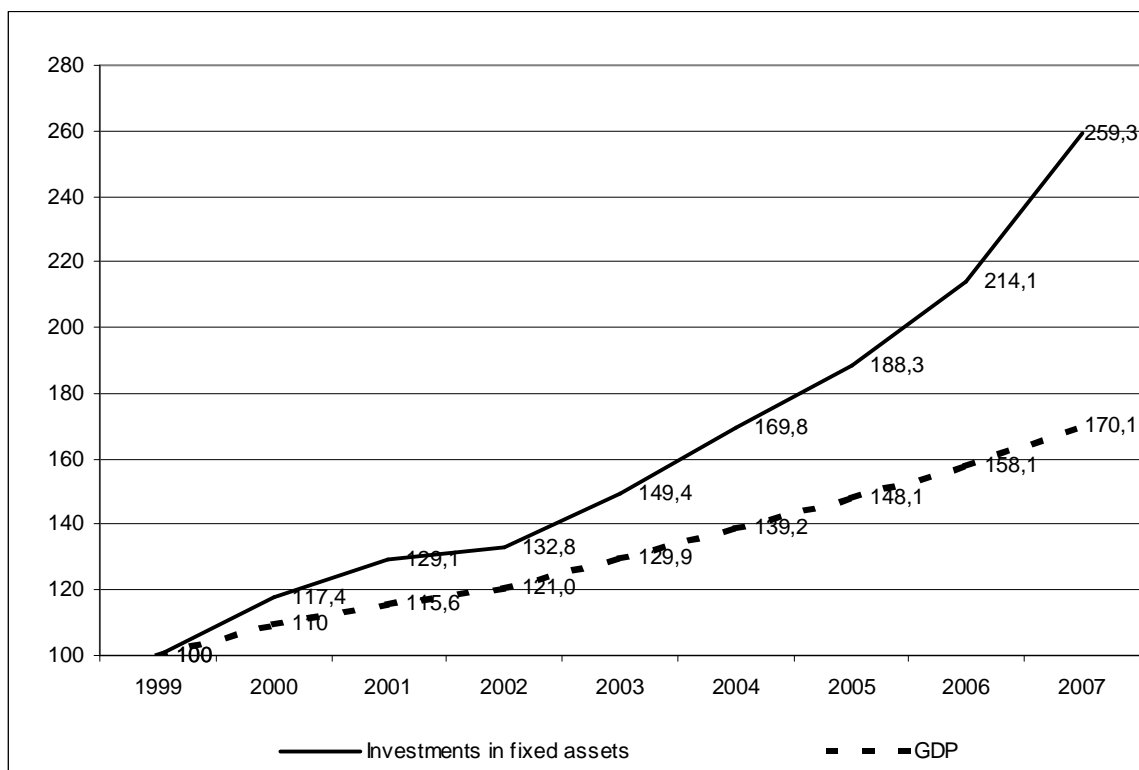
Investments in Real Sector

O. Izryadnova

Investment situation at the beginning of 2008 was formed under the influence of trends evolved during the last three years. It was increasing investment demand from transport, extractive industries, power and so-

cial sector that had the biggest impact on the investment's dynamics. Increase in investments in fixed assets over January-February of the current year was equal to 20.2%. Existing trends sustaining, expected investment in fixed assets growth in 2008, according to the estimation of IET, will be 19.4-20.0%.

In 2007 the volume of investments in fixed assets was equal to RUR 6418.7 bln, increasing by 21.1% as compared with 13.7% in the previous year. High growth of investment demand was supported by the growth in internal market significance in the formation of economy dynamics. Peculiar feature of 2007 was increase in investment in fixed assets share in the GDP up to 19.7%, which was the maximum value of this index over the whole period of reforms.



Source: Federal State Statistics Service

Fig. 1 GDP and Investments in Fixed Assets Growth Rates in 2000-2007, as percentage to 1999

Increase in economy and business revenues defined dynamic expansion of the demand for capital goods. Focus of producers on production reconstruction and modernization caused increase in demand for machinery and equipment in nearly all spheres of economic activities. The increase in proportion of expenditures for machinery, equipment and transport vehicles was observed in the structure of investments in fixed assets. Whereas in 2001 the share of investments in machinery, equipment and transport vehicles was 35% of the total volume of investments in fixed assets, in 2007, according to the preliminary estimation, their proportion exceeded 37.7%.

Under existing growth rates of the domestic machine-building, investment expenditure dynamics, characteristics of the fixed assets reproduction the influence of import machinery and equipment supplies at the internal market increased.

In 2007 investments in fixed assets growing by 21.1%, machinery and equipment production – by 20.9%, transport vehicles and equipment – by 15.7%, electric equipment – by 14.8%, machinery and equipment import went up by 1.55 times. Investments for purchase of import equipment in the total amount of investments in machinery, equipment and transport vehicles in 2007 comprised RUR 308.5 bln or 17.8%.

Specific features of the investment process in 2007 were defined by the change in the proportions of federal budget funds and budgets of subjects of the Russian Federation. In 2007 the increase of 0.5 p.p. in budgetary investments share in GDP was observed. At the expense of budget funds RUR 1042.4 bln of investments in fixed assets was financed, which comprised 21.2% of the total volume of investments in the fixed assets on the whole throughout the economy, of which federal budget funds – 8.4%.

Quality changes in the mechanism of investment development in 2003-2007 can be illustrated by shift of investments in fixed assets financing at the expense of own enterprises' and organizations' funds to expan-

sion of loan funds participation. As a result of 2007 the share of loan funds was 58.5% of the total volume of investments in the fixed assets.

Development of this process is accounted for by the increase in banking sector activity, increase in population's investments in housing construction and intensive inflow of the foreign capital. Low real value of credit resources and quite high level of profitability accounted for expansion of enterprises-borrowers. Among the factors that positively influence the credits dynamics, growth of the organizational forms of population's savings can be highlighted. The share of funds directed to share participation in construction of the total amount of investments in fixed assets was 3.3%, of which population's means – 1.0%.

In the structure of investment resources share of banks in investments crediting was 9.4%, which corresponds to the level of the previous year. Special characteristics of foreign banks participation in investment activity financing should be noted. In 2007 investments in fixed assets from abroad were 4.6% of the total amount of investments, reducing by 2.3 p.p. as compared to the previous year. It was increase in the share (up to 27.4% against 7.0% in 2006) of securities purchase and bank credits and loans repayment against that held leading positions in the structure of use of the funds from abroad in the form of foreign investments. The share of investments in the fixed assets meanwhile decreased by 10 p.p. down to 13.1%. Formation of these proportions proceeded in the environment of the increase in the volumes of net capital inflow up to USD 82.3 bln as compared with USD 41.3 bln in 2006.

Table 2

Structure of Investments in Fixed Assets by Sources of Financing, as percentage to the total

	2000	2001	2002	2003	2004	2005	2006*	2007*
Investments in fixed assets- total	100	100	100	100	100	100	100	100
of which by sources of financing:								
Own funds	47.5	49.4	45.0	45.2	45.4	44.5	42.1	41.5
of which:								
Profit	23.4	24.0	19.1	17.8	19.2	20.3	19.9	19.9
Loan funds	52.5	50.6	55.0	54.8	54.6	55.5	57.9	58.5
of which:								
Bank credits	2.9	4.4	5.9	6.4	7.9	8.1	9.6	9.4
of which granted by foreign banks	0.6	0.9	0.9	1.2	1.1	1.0	1.6	1.1
Loan funds of other organizations	7.2	4.9	6.5	6.8	7.3	5.9	6.0	6.1
Budget funds:	22.0	20.4	19.9	19.6	17.9	20.4	20.2	21.2
of the federal budget	6.0	5.8	6.1	6.7	5.3	7.0	7.0	8.4
of budgets of subjects of the Russian Federation and local budgets	14.3	12.5	12.2	12.1	11.6	12.3	11.8	11.7
Foreign investments of the total amount of investments in fixed assets	4.7	4.5	4.1	4.7	5.0	4.8	6.9	4.6

* Subjects of small business and informal activities parameters not included

Source: Federal State Statistics Service

Table 3

Structure of Investments in Fixed Assets by Kinds of Economy Activities

	2005	2006	2006*	2007*
Total	100	100	100	100
of which by kinds of economic activities:				
Agriculture, hunting and forestry	3,9	4,9	4,0	4,3
Industry	37,1	37,2	40,7	41,7
Minerals extraction	13,9	15,3	17,0	17,3
of which fossil fuels extraction	12,4	13,9	15,5	15,8
Processing industries	16,4	15,8	16,1	15,7
Electricity, gas and water production and distribution	6,8	6,1	7,6	8,7
Construction	3,6	3,5	3,6	2,4
Wholesale and retail trade, motor vehicles and motorcycles servicing, household appliances and item of private use repair	3,6	3,4	3,1	2,9
Transport	19,1	18,8	20,2	20,2
Communication	5,4	4,7	5,3	5,1
Financial activity	1,4	1,2	1,1	1,4
Operations with real estate, rent and service rendering	16,8	16,4	12,0	12,0
Education	1,6	1,6	2,2	2,3

Government administration and military safety security, compulsory social support	1,9	2,2	2,1	2,0
Health care and social services rendering	2,6	2,7	2,7	2,6
Rendering of other social and personal services, utilities	2,5	2,9	2,8	2,7

* Subjects of small business and parameters of informal activity not included

Source: Federal State Statistics Service

Change in the structure of investments by kinds of economic activities in 2007 was defined by the trends that formed during the last year. In 2006–2007 the trend for growth of investments in fixed assets in transport and trade sustained, the same is true for activities that focus on social services rendering – education, health care.

Structure of investments in goods production in 2006-2007 was determined by anticipating growth of investments in agriculture and minerals extraction.

Peculiar feature of structural shifts in production in 2006-2007 was overcoming of the trend for the decrease in investments share in minerals extraction, which was observed from 2002. In 2007 increase in investments in minerals extraction was 19.1%, including fossils fuels extraction – 19.0%, while investments in processing industries increased by 10.8%. Electricity, gas and water production and distribution was characterized in 2007 by increase in investments of 30.0%, which was due to the increase in investment activity in electricity production and transmittance by 1.51 times.

Share of processing industries in the structure of investments throughout the economy on the whole was equal to 15.7% in 2007. Traditionally high concentration of revenues in raw materials productions focused on export sustaining, low share of investments in machine-building was characteristic for the Russian economy. Under existing age, technological and reproduction structure of fixed assets low investment rates into machine-building complex were the factors that restrict development of finished and intermediate goods production. Under existing structure of domestic investment goods production import remains one of the main sources for renovation of fixed assets, production modernization and reconstruction.

In 2008 the trend for anticipating growth of investments as compared with the dynamics of goods and services output by the main kinds of economic activities sustained. Over January-February 2008 increase in investments in fixed assets was 20.2%. Investments growth was accompanied by the increase in workload in construction by 30.2% against 19.9% in January-February 2007.

It was the growing investment demand in transport complex, extracting industries, power and social complex that had the biggest influence on the investments dynamics. In January-February 2008 the total square of housing put into commission was 5.8 mln of sq. m. as compared with 5.5 mln. of sq. m. over the corresponding period of 2007.

Under existing dynamics of the main macroindices, expected investment growth rates by the end of the year will be in the range of 119.4-120.0%.

Foreign Investments

E. Ilukhina

2007 was characterized by considerable growth of foreign investments in the Russian economy, which more than doubled as compared with 2006, due to increase in all components. The biggest increase in absolute terms was observed in the segment of other investment. Significant growth of foreign investments was accompanied by substantial expansion in volumes of withdrawn capital. On the whole over 2007 48.3% of the volume of the foreign investment received was withdrawn. In the structure of foreign investments accumulated by the end of December 2007, it is other investments that prevail, their share being 50.2%. the similar figure for direct foreign investments was equal to 46.7%.

In 2007 USD 120.9 bln of foreign investments flowed into the Russian economy, which is by 2.2 times bigger than in 2006.

The total volume of investments made into the Russian economy in 2007 expanded due to the growth of all the components. At the same time the biggest growth in absolute terms was observed in the segment of other investments that have increased up to USD 88.95 bln. The share of trade credits in the structure of other investments decreased from 24.2% in 2006 to 15.8% in 2007.

In 2007 the volume of direct investments in the Russian economy increased as compared with 2006, mainly due to the increase in such components as installments in the charter capital and credits, received from foreign co-owners of a company. The former increased up to USD 14.8 bln over 2007, the figure exceeding by 68.7% the similar one for 2006. The latter, growing as compared with the previous year by three times, reached the level of USD 11.7 bln. Thus, the share of credits, received from the foreign co-owners of

companies, in the structure of foreign investments in the Russian Federation went up from 28.5% in 2006 to 42.0% in 2007.

Considerable growth of foreign investments in the Russian economy was accompanied by significant increase in the volume of withdrawn capital.

Table 1

Structure of Foreign Investments in Russian Economy in 2003-2007

	As USD mln				As percentage to the previous year			
	Total	Direct	Portfolio	Others	Total	Direct	Portfolio	Others
2003	29 699	6 781	401	22 517	150.1	169.4	84.9	147.1
2004	40 509	9 420	333	30 756	136.4	138.9	83.0	136.6
2005	53 651	13 072	453	40 126	132.4	138.8	136.3	130.5
2006	55 109	13 678	3 182	38 249	102.7	104.6	700.0	95.3
2007	120 941	27 797	4 194	88 950	219.5	203.2	131.8	232.6

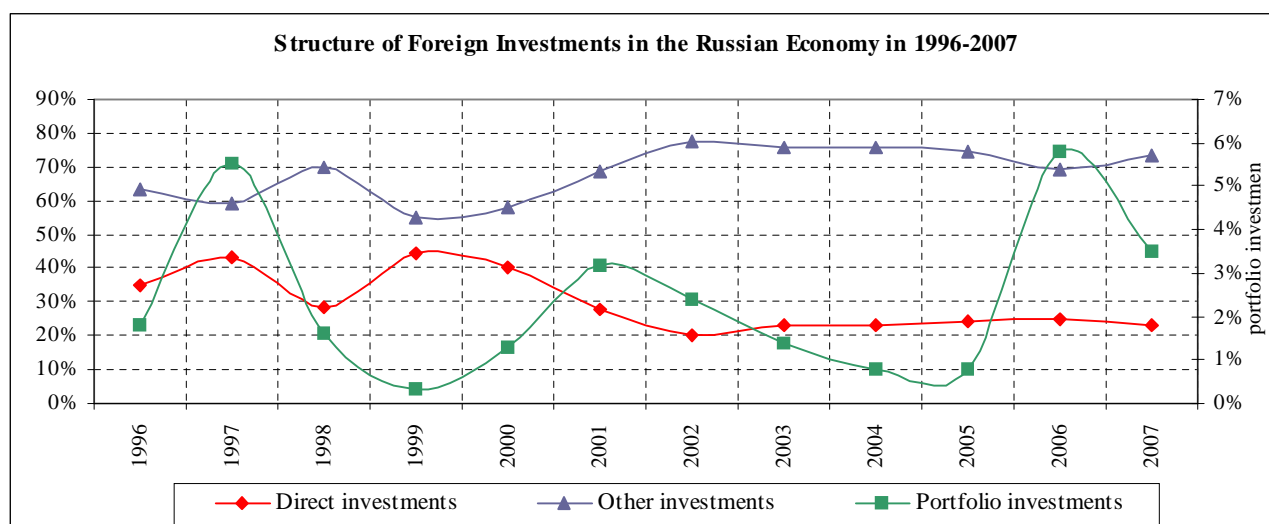
Source: Federal State Statistics Service

Fig. 1



Source: Federal State Statistics Service

Fig. 2



Source: Federal State Statistics Service

In 2007 USD 58.4 bln was withdrawn in the form of foreign investors profit, as well as interests payments for use of credits and credits repayment, which sum exceeds by 54.3% the figure of 2006. The biggest outflow of capital was observed in 4 quarter 2007, when 56.4% of the volume of the foreign investments made in that period was withdrawn. On the whole over 2007 48.3% of the amount of the foreign investments made was withdrawn (68.7% in 2006).

On the whole, in 2007 the structure of foreign investments in the Russian economy was not subjected to considerable changes.

In 2007 foreign investments were concentrated in industry and trade sphere, in which the highest foreign investments growth rates were observed (over the year investments in these spheres went up by 2.0 and 3.6 times, correspondingly). Distribution of foreign investments by main kinds of Russian economy is represented in Table 2.

Table 2

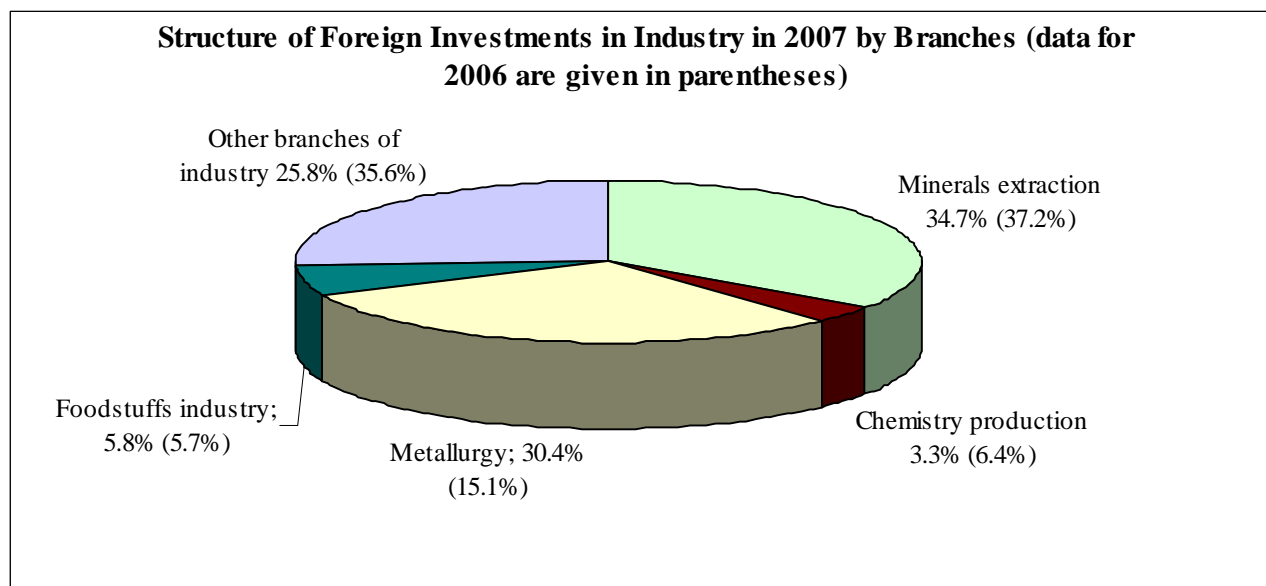
Structure of Foreign Investments in the Russian Economy in 2005-2007 by Its Branches

	As USD mln			Change as percentage to the previous year			As percentage to the total		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Industry	24 318	24 607	50 163	120.6	101.2	203.9	45.3	44.7	41.5
Transport and communication	3 840	5 297	6 703	188.9	137.9	126.5	7.2	9.6	5.5
Wholesale and retail trade; motor vehicles and motorcycles servicing; repair of household appliances and items of private use	20 461	13 089	47 310	156.9	64.0	361.4	38.1	23.8	39.1
Operations with real estate, rent and service rendering	2 602	5 998	8 414	101.2	230.1	140.3	4.8	10.9	7.0
Financial activity	1 813	4 698	4 450	181.1	259.1	94.7	3.4	8.5	3.7
Other branches of industry	617	1 420	3 901	36.4	231.8	274.7	1.2	2.5	3.2

Source: Federal State Statistics Service

The biggest growth of foreign investments in industry (by 2.1 times as compared with 2006) was observed in processing industry, while in 2006 decrease by 15.8% was observed. Foreign investments in processing industry in 2007 went up by 1.9 times, while in 2006 the growth was 52.5%. In processing industries investments in metallurgy increased by 410%, in foodstuffs industry – by 210%, in chemistry industry – by 4.3%, reaching the level of USD 15.2 bln, USD 12.9 bln and USD 1.6 bln, correspondingly.

Fig. 3



Source: Federal State Statistics Service

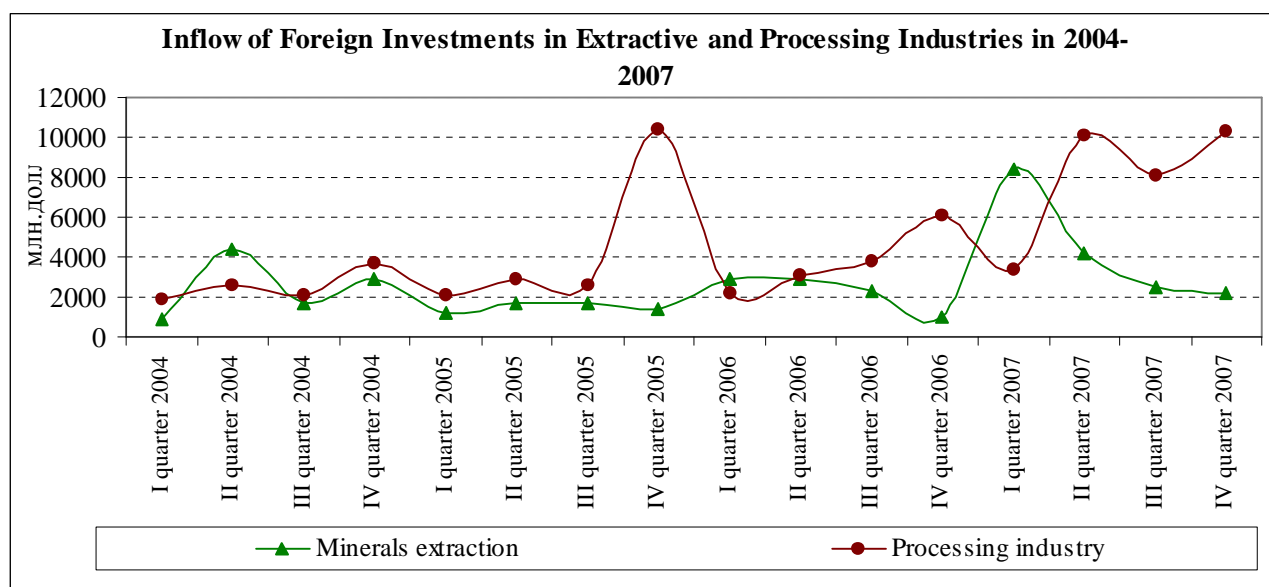
Quarter-by-quarter statistics of foreign investments in minerals extraction and processing industry demonstrates considerable increase in attractiveness of the latter over the last four years.

The share of direct investments in industry has increased from 29.2% in 2006 to 36.3% in 2007, the share of other investments reducing over the period from 66.7% to 57.3%.

In the structure of foreign investments by kinds of economic activities in industry changes have also been observed. In the field of minerals extraction the share of direct investments, having increased since 2006 by 3.1 times, went up to 80.1% (49.4% in 2006). The share of other investments in extraction, whose decrease is estimated to be 25.8% in 2007, decreased down to 19.8% (50.6% in 2006).

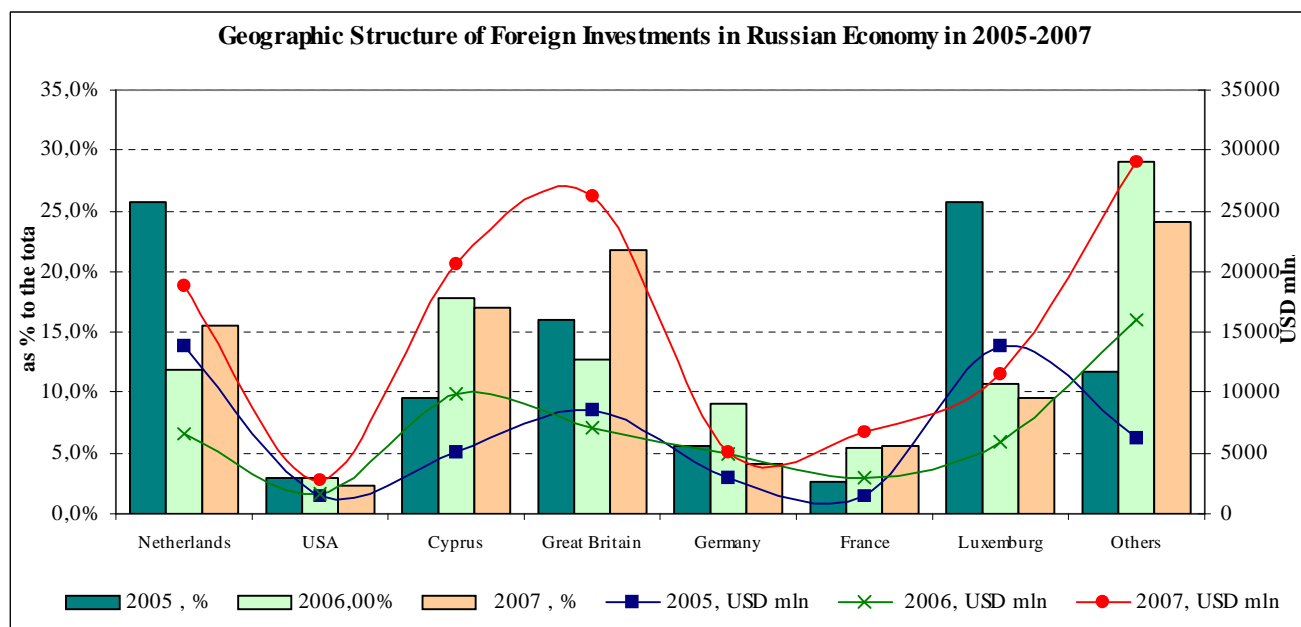
In processing industry, in contrast, in 2007 it was other investments that prevailed, having increased by 2.2 times as compared with 2006, reaching in the resulting figures for processing industry 78.7% (76.8% in 2006). Direct foreign investments in processing industries have increased by 57.6%. The share of direct investments in processing industry has decreased down to 12.8% (17.2% in 2006). The biggest growth rates of foreign investments in processing industry were observed in the sector of portfolio investments (by 3.0 times as compared with 2006), which led to the increase of their proportion up to 8.5% (6.0% in 2006).

Fig. 4



Source: Federal State Statistics Service

Fig. 5



Source: Federal State Statistics Service.

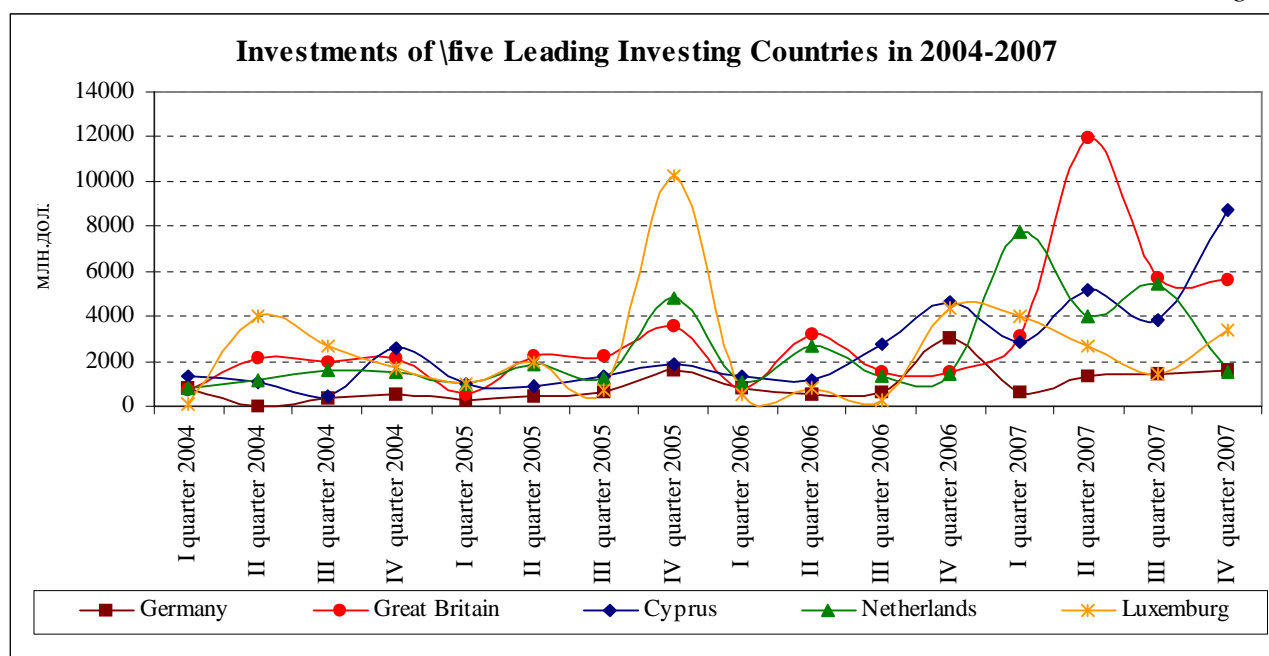
Distribution of foreign investments by regions in 2007 testifies that the concentration of foreign investments in Moscow has increased. In 2007 there were USD 70 bln (57.9% of total foreign investments in the Russian Federation) invested in Moscow, the figure being three times as big as the figure of 2006. Increase

in direct investments in Moscow economy is estimated to be 21% as compared with 2006. At the same time 70% of foreign investments in Moscow was directed to foodstuffs industry. A quarter of the total foreign investments in the Russian economy in 2007 (about USD 30 bln) was received by St Petersburg. At the same time it was noticed that foreign investors started to pay more attention to other regions of Russia. USD 5 bln of foreign investments was attracted to the economy of Moscow region. Over 2007 foreign investments in St Petersburg region have increased by 1.8 times (up to USD 1.0 bln), in Nizhnii Novgorod region – by 1.9 paza up to USD 409.6 mln, in Novosibirsk region – by 2.7 times (up to USD 219.9 mln), in Omsk region - by 27.9% (up to 600.7 mln). Khabarovsk krai attracted USD 248 mln of foreign investments, which is by 14.0% more than the figure of the previous year.

As for geographic aspect, as a result of 2007 the biggest amount of USD 26.3 bln (21.8% of the total amount of foreign investments made into the Russian economy over the period given) was directed from the Great Britain, USD 20.7 bln (17.1%) – from Cyprus and USD 18.8 bln (15.5%) – from the Netherlands.

In 2007 it was investments from the Great Britain that extended most dynamically – increasing by 3.7 times as compared with 2006. Investments from Cyprus expanded by 2.0 times, from France – by 2.2 times, from the Netherlands – by 2.8 times, from Luxemburg – by 1.9 times. Investments from Germany remained at the level of the previous year.

Fig. 6



Source: Federal State Statistics Service

Quarter-by-quarter dynamics of investments made by five leading investing countries is of alternate nature. Over 2007 on the whole the shares of the Netherlands and the Great Britain have increased significantly from 12.0 and 12.7% in 2006 to 15.5% and 21.8% in 2007, correspondingly. Shares of the Cyprus, Germany, the USA and Luxemburg have reduced. The share of France in the geographic structure of foreign investments has changed but little, remaining at the level of 5.5%.

As a result of 2007 Ireland became one of ten leading investing countries, after sinking into the Russian Federation USD 5.2 bln or 4.3% of the total amount of foreign investments. Main interest of the investors from Ireland was concentrated on the sphere of transport and communication, into which 53.7% of Irish investments into the Russian Federation was directed.

British entrepreneurs continued to invest into trade, sinking into these sphere 4.6 times more in 2007 than in 2006. As a result of 2007 the share of trade was 64.2% of the total investments in the Russian Federation from the Great Britain (in 2006 – 52.1%). The share of processing industries in investments from the Great Britain increased from 22.2% in 2006 to 27.7% in 2007.

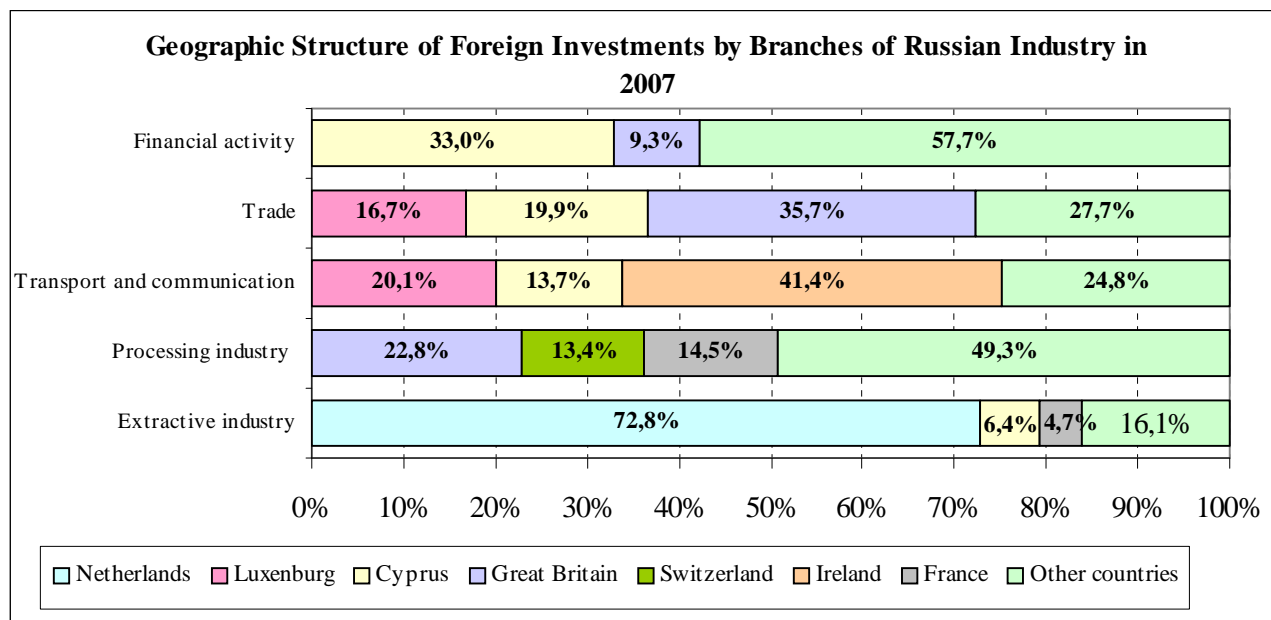
In the structure of investments in Russia from the Netherlands the share of fossil fuels extraction has increased from 55.2% in 2006 to 67.1% in 2007.

In 2007 it was trade, operations with real estate and construction that was the most attractive for investors from Cyprus, they invested into these spheres 45.5%, 19.0%, 4.7% of the total investments from Cyprus into the Russian Federation, correspondingly. In 2006 the main directions of Cyprus investments in the Russian

economy was processing industry and operations with real estate, accounting for 39.1% and 26.4% of the total investments from the Cyprus, correspondingly.

According to the state of affairs by the end of December 2007 accumulated foreign investments not taking into account the bodies for monetary and credit regulation, commercial and saving banks, including investment in rubles, recalculated to US dollars, was equal to USD 220.6 bln, which by 54.3% exceeds the corresponding figure of the beginning of the year.

Fig. 7



Source: Federal State Statistics Service

Table 3.

Accumulated Foreign Investments By Investing Countries

	Accumulated by 01.01.2008, as USD mln				Change by 01.01.2007, %			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	8 579	3 635	1 207	3 737	111.4%	79.2%	238.1%	143.6%
Germany	11 786	4 494	98	7 194	96.1%	135.4%	5.8%	99.3%
France	5 919	1 554	31	4 334	160.0%	146.9%	-	164.1%
Great Britain	29 235	3 438	2 314	23 483	247.7%	118.3%	1369.2%	269.1%
Cyprus	49 593	35 426	1 700	12 467	153.7%	155.4%	125.2%	153.5%
Netherlands	39 068	35 254	52	3 762	166.6%	183.3%	83.9%	90.5%
Luxembourg	29 161	735	219	28 207	127.5%	125.2%	107.9%	127.7%
Other countries	47 254	18 524	1 107	27 623	163.7%	138.3%	121.5%	189.7%
Total	220 595	103 060	6 728	110 807	154.3%	151.8%	137.3%	158.0%

Source: Federal State Statistics Service.

In structure of foreign investments, accrued by the end of December 2007, it is other investments that prevail, their share being equal to 50.2%. The similar figure for direct foreign investments was equal to 46.7%.

Ratings of world agencies Fitch, Moody's and S&P are one of the main indicators for new investors entering Russian market and for the willingness of those currently operating to increase the volume of investments. In December 2007 international rating agency Moody's testified rating of state obligations in national and foreign currencies at the level of Baa2 that was given to Russia earlier. S&P had also sustained sovereign credit rating of Russia as BBB+, forecast being "Stable".

Investment Fund of the Russian Federation and Its New Operational Procedures

I. Sokolov

With its Resolution of March 1, 2008, # 134 “On approval of procedures of formation and use of budgetary appropriations of the Investment Fund of the Russian Federation” the Government seeks to abrogate the earlier existed restrictions in the legal regulation of one of the most capitalized development institutions in Russia. This paper presents an analysis of main modifications in the legal base of Investment Fund and their possible future implications.

The Investment Fund of the Russian Federation (hereinafter referred to as “Investment Fund”) was established by Resolution of the RF Government of November 23, 2005, # 694 “On Investment Fund of the Russian Federation.” Investment Fund became a national pioneer development institution, which was supposed to operate in the frame of the public-private partnership mechanism. By contrast to other development institutions emerged in 2006-07 (Vneshekonombank, Special Economic Zones, the Russian Venture Company, the public corporation “Rostekhnologii”, the Housing and Utilities Reforming Fund, among others), the lineaments of Investment Fund became the absence of an organizational and legal form, for according to Art. 179.2 of the Budget Code of RF, it is a targeted item in the federal budget, to be used for the sake of implementation of investment projects carried out on the basis of principles of the public-private partnership.

This imposes certain constraints both on forms of consumption of its financial resources and on procedures of managing its assets. Originally, the managerial mandate was delegated to the Federal Agency on Management of Special Economic Zones, which reported to the RF Ministry of Economic Development and Trade. Later, in the late-2007, as per Resolution of the RF Government of October 25, 2007, “On some matters of the structure and organization of operations of the Ministry of Economic Development of RF” the mandate was reassigned to the RF Ministry of Regional Development. Given that the Regulation on Investment Fund did not consider specificity of the latter’s operations, as the Regulation failed to provide for regions to vigorously employ this financial instrument to address their investment challenges, one had to introduce certain amendments to the legal base underpinning the Fund’s operations.

The amendments primarily concerned directions of provision of the government support. The list of the directions was specified, rather than extended. The initially existed directions that concerned development of the nationwide infrastructure (including the social one) and innovations, including design of the respective documentation, were complemented by projects on financing creation and/or reconstruction of objects planned for implementation in the frame of concession agreements.

Worth a particular notice is the fact that this support is still granted solely to investment projects, which were selected basing on their significance for the nation - suffice it to reference the requirement of a minimal design value of a project, which was set at the level of Rb. 5bn. Such huge projects should be implemented basing upon principles of risk sharing between the government and private capital and maintenance of the balance of interests of its participants.

It should also be noted that an investment project does not constitute a program of development of priority directions across the Federation. Rather, it is conceived of as an unfolding over time set of measures aimed at achieving desirable goals of the project; it also has a specific localization and requires considerable amount of investment.

It was the 2006 Act on the federal budget that for the first time ever provided for establishment of a Rb. 69.7bn.-worth Investment Fund. These resources remain practically unclaimed and were transferred for 2007. With account of the data on the 2008-10 federal budget, the structure of Investment Fund’s annual volume is as follows: 2007 – Rb. 110.6bn (+ another 90bn in extra transfers resulteding from sales of YUKOS’s assets), 2008 – 89.2bn, 2009- 109.5bn., 2010 -76.5bn.

Thus, between today and 2010 the volume of the Fund roughly accounts for Rb. 545.5bn. This is a very provisional assessment, and, given the Ministry of Regional Development’s ambitions, this amount is very likely to be raised.

It is worthwhile to note that the new version of the Investment Fund’s legal base no longer specifies sources of its funds, but only reference that the federal budget for a given financial year sets the amount of budgetary allocations that form the Fund’s annual volume.

Another substantial modification became bringing of forms of provision of state support in line with the Budgetary Code of RF. In the past, the most popular form of such support was the so-called co-financing of an investment project on specific contract arrangements, the essence of which the budget legislation failed to specify. By contrast, the current version of the Procedures employs forms of provision of the Fund’s re-

sources as stipulated in the Budgetary Code. These are: budgetary investment in objects of capital construction that fall under public property, granting subsidies to lower-tier budgets for the purpose of creation of a regional or municipal property and design of the respective documentation. It should also be emphasized that the earlier existed investment in authorized capital of open-end joint stock companies and provision of state guarantees by the Russian Federation are now complemented by the possibility for channeling the Investment Fund's resources to investment funds established in the RF Subjects.

As concerns other issues, the document has undergone no dramatic changes. The procedure of consideration of projects has remained a two-stage one – a project is first assessed at an investment commission under the RF Ministry of Regional Development and, consequently, by a Cabinet commission on projects of nationwide significance. The last stage is approval of the project at the Cabinet meeting.

It is envisaged that the government will fund business projects worth not less than Rb. 5bn. during five years, with a private investor contributing with at least 25% of their cost.

Selection of projects is still based upon two types of criteria, that is, quantitative and qualitative ones. The most significant qualitative criteria are: consistency of the problem addressed in the course of the project implementation with objectives of the RF's socio-economic development, with public investment for the medium-term perspective, and sectoral development strategies, and generation of positive social effects engendered by the project implementation.

The qualitative criteria are:

- general economic efficiency of the project, which manifests itself in contribution by the project into the rise in the regional gross product and the domestic gross product. The obligation to calculate this particular indicator was laid upon the RF Ministry of Economic Development and Trade, while it had been previously required from the investor organization;
- fiscal efficiency (rise in tax revenues);
- financial efficiency (the internal return rate and net present value).

Whilst the marginal values of the qualitative criteria have not been revised as yet, the break-even principle of investing the Fund's resources stipulated in the Procedures de-facto predetermines selection of solely profit-making projects. In conjunction with this, there arises concern that if the government keeps on being guided by the commercial component of proposed projects, the social infrastructure objects will remain abandoned and out of the Investment Fund focus of attention.

As of the beginning of 2008, the governmental commission had already selected and endorsed 16 investment projects, which are all related to infrastructural development, mostly in the area of transport.

The first 12 ones had been picked during the RF MEDT's term as the Investment Fund's manager. They provided for some Rb. 290bn in public investment in projects worth a total of some Rb. 1trln.

The remaining 4 projects were endorsed in November 2007, when the RF Ministry of Regional Development took over the mandate of the Fund's manager. The total cost of these projects accounts for Rb.1.233trln, with 422bn. allocated from Investment Fund.

The Ministry does not limit itself with these figures – according to Mr. D. Kozak, there are another next six projects roughly of the same scale. The analysis of the most recently selected projects (“The complex development of the Southern Yakutia”, “Ural Industrial -Ural Polar”) suggests that the Fund's resources are planned to be spent largely on creation of infrastructure in the framework of complex development of individual regions.

In our view, to maintain the nationwide significance of Investment Fund, the government should limit itself, in the medium term, with maintenance of implementation of some 20-25 large-scale infrastructural projects, while all investment and innovation projects should be funded through other development institutions, such as Vneshekonombank, Special Economic Zones, the Russian Venture Company, the public corporation “Rostekhnologii”, the Housing and Utilities Reform Fund, among others.

Furthermore, it should be noted that the idea of formation of regional investment funds requires a more detailed elaboration, as efficiency of these particular instruments has not been empirically proved as yet, while the necessity of incurring additional budgetary costs associated with administering their operations appears evident. We believe that it is worthwhile to consider an idea to delegate the mandate on managing a fraction of the federal Investment Fund's resources to the Development Bank, providing it has the fundamentals and mechanisms laid down in the Procedures, as the Bank is in possession of the adequate banking technologies on selection and maintenance of implementation of investment projects. This would ensure cost cutout so far as budgetary funds are concerned and a proper efficiency of their consumption.

Forecast Models of the RF Economic Development over a Medium-Term Prospective with Regard to the Trade Balance Dynamics

S.Drobyshevsky

The net capital flow in and out of the RF has turned into an important source of financial resources for the investments in real sector and, consequently, for the support of high economic growth rates. In this Section we will review four models of the RF economic development in the medium-term prospective (for 5 years till 2012), based on different dynamics in both components of the RF balance of payments (balance of current account and balance of capital account). The results of the review indicate, that a significant reduction of external financing within 2-3 years may lead to critical effect, comparable with the situation of the sharp and sustained downfall in oil prices.

One of the key indicators of 2007 is the acceleration of the Russian economy growth rates, as well as the expansion of real investments in fixed assets. This was observed in the background of both, extremely high oil prices, that inspired the surplus of the current account growth, as well as high surplus balance of capital account over the greater part of the year. The net capital flow in and out of the RF has turned into an important source of financial resources for the investments in real sector and, consequently, for the support of high economic growth rates. In this Section we will review four models of the RF economic development in the medium-term prospective (for 5 years till 2012), based on different dynamics in both components of the RF balance of payments (balance of current account and balance of capital account).

The first three models are based on the situation with the sustained high oil prices in the world market: the average annual price for 2008 is estimated at the level of USD 75 per barrel (for Brent), and although prices are expected to be decreasing in subsequent years, they should stay at the level of about USD 60 per barrel, which corresponds to the indicator of no lower than USD 45 per barrel in 2005-2006 prices, in case of USD strengthening in the global market up to USD 1.27-1.30 for EURO 1.

The first model of the RF economic development is, in fact, the inertia-based scenario. The government will admit the federal expenditures growth in excess of 18.5 per cent of GDP after the presidential elections in 2008. The current tax system will remain unchanged, the standards of replenishment of the RF Reserve Fund and the National Welfare Fund will not be amended, the annual growth rates of prices and tariffs for the goods and services, produced and provided by natural monopolies will exceed the inflation rate by no more than 2-2.5 p.p. The RF Central Bank will keep up the policy of accumulating foreign currency reserves, which will make for the relevant expansion of monetary supply, including the volume, required to maintain the high GDP growth rate, as well as the policy of restraining the rates of the effective ruble exchange rate strengthening in real terms. Therefore, favorable external economic market situation and positive domestic macroeconomic indicators will attract both, foreign direct investments and capital inflow to the country.

Model II differs from the first one, it is based on the assumption of sustained instability in the global financial system due to the crisis indicators, observed in the second half of 2007 as a result of problems in the USA mortgage market. Therefore, the ability of the Russian companies to attract inexpensive external resources will be restrained, which in turn will lead to a reduction in investment activities in Russia due to limited external resources of funding and growing interest rates in the domestic market. In particular, we anticipate in this situation, that the annual volume of capital inflow will be twice lower than under the first scenario.

Model III is based on the assumption of capital outflow from the country for the reasons, not associated with the trends in the Russian economy and Russian investment environment. This model is crisis-based or, at best, neutral. The situation at the "turning point" will depend on "safety reserve" of economy and financial authorities policy in the face of deteriorating financial crisis. Nevertheless, there is a rather high probability for the developments under such a scenario in the nearest future: due to the USA credit market crisis, the global investors lose interest to the new emerging highly risky markets, including Russia.

It should be noted, that to review the consequences of this scenario, it is not crucial for us to find the basic reason (the "trigger"), that provoked capital outflow (significant deficit of the balance of capital account). The following factors can be related to those reasons:

- problems in the USA credit and other financial markets;
- downgrading of growth rates in the global economy;
- upgrading of interest rates in developed countries;
- financial crisis in one or a number of emerging markets.

However, in this scenario, we do not anticipate an abrupt downfall of oil prices. In other words, the situa-

tion of the balance of current account will remain favorable, while the outflow from the balance of capital account transactions is expected in the amount up to USD 200 billion (in 2009). In general, under this scenario, we have estimated the total balance of capital flows to/from the Russian Federation, basing on the assumption of reduction and stabilization of the private sector external debt in 2011-2012 at the level of February-March 2007 (prior to massive capital inflows in the second quarter of 2007), i.e., USD 340-350 billion.

Model IV is based on anticipated decline in oil prices in the world market to the average level, sustained for many years, i.e., USD 20-25 per barrel (for Brent) in prices of 2005-2006, what approximately accounts to USD 30-35 per barrel in 2012.

To avoid arbitrary interpretations of qualitative changes in the economy and in the behaviour of economic agents (for example, a sharp change in prices and foreign currency exchange rates dynamics in case of oil price downfall, the "swing" of exchange rate in nominal terms, etc.). Due to the application of formal economic-mathematical algorithms for quantitative assessment of the forecast models, we expect responsible and conservative behaviour on the part of economic agents. Thus, in every model, we apply the "equilibrium" variables in certain conditions, though it is unlikely to create such conditions in practice. In particular, this is relevant in regard to the forecast models, based on oil prices downfall.

Therefore, our assumptions provide fairly prudent assessments of the dynamics in macro-economic indicators in the Russian economy in case of both, high and low oil prices. In reality, the situation, with regard to the expectations of economic agents, might be developed in a more negative way. In such a case the authorities should be prepared to take measures aimed at least at mitigation of the estimated negative consequences. Similarly, for the situation of high oil prices, the forecast models are also conservative and demonstrate the bottom level of economic development options.

Modeling of the Russian economy major indicators dynamics in general, and in monetary sphere in particular, was performed on the basis of the IET approximation of medium-term socio-economic indicators modeling²³. For the purpose of this study, the model was based on a longer time series, and moreover, revised by a number of additional indicators.

The preliminary estimates of final values for 2007 were used as initial indicators. The dynamics in the basic macroeconomic indicators as per the models are presented in *Table. 1*. Hereafter, we will review the basic trends in the Russian economy for each model in detail.

According to the obtained results, in the inertia-based situation in the economy of Russia (model I), the total GDP growth in real terms within 5 years (over 2008 - 2012) will reach about 35 per cent, while the annual growth rate of GDP in real terms will decline by the end of the period to 5.5-5.7 per cent. The decline in growth rate is attributed to the lower level of cost efficiency and stabilization in the export volumes of oil and gas, whereas the existing industry structure (raw materials in particular) is sustained. Ruble exchange rate growth in real terms will enable Russian economy to reach the volume of GDP, equal to USD 2.2 trillion (according to the current exchange rate) by 2012.

Despite some decrease of federal budget revenues (approximately to 20.5-21 per cent of GDP as a result of lowered level of taxation in the oil sector and the overall cost efficiency downgrading in economy, the federal budget balance remains positive (minimum indicator is 1 per cent of GDP). An expressed effect of the above is the accumulation of assets in the National Welfare Fund in the volume of 7.5-8 per cent of GDP (USD 170-180 billion) by the end of 2012.

The RF Central Bank policy in accumulation of foreign currency reserves and restriction of annual rates of ruble strengthening in real terms through the inflow of foreign currency sterilization enabled to reach the level of USD 690-700 billion of reserves in foreign currency. Total growth of effective ruble exchange rate in real terms for a 5-year period makes approximately 16 per cent (+ 31 per cent to the level prior to the 1998 crisis). Herewith, ruble exchange rate in nominal terms will reach approximately 29.0-29.5 rubles against dollar by the end of 2012.

As mentioned above, the key distinguishment of this models from the other ones is continued expressed capital inflow to the RF. According to the forecast model, the support of the desired level of investments in fixed assets requires an extension of the Russian private sector external debt to USD 1.05 trillion (about 47

²³ Model description in detail is published in the works by M. Turuntseva, A. Yudin, S. Drobyshevsky, P. Kadochnikov, S. Ponomarenko, P. Trunin "Some approaches to economic indicators modeling", "Research Works", No.89P, M.: IET, 2005, and some model elements are provided also in the works by S. Drobyshevsky, V. Nosko, R. Entov, A. Yudin "Economic Analysis of Basic Macroeconomic Indicators Dynamic Series" "Research Works" No. 34P, M.: IET, 2001; R. Entov, V. Nosko, A. Yudin, A.Kadochnikov, S. Ponomarenko "Some Macroeconomic Indicators Approximation", "Research Works" № 46P, M.: IET, 2002.; G. Karasev, S. Chetverikov "Structural Models of RUR Exchange Rates", No. 88P, M.: IET, 2005.

per cent of GDP) by the end of 2012.

In our estimates, trade balance surplus, supported by the high prices for raw materials in the global market can be sustained practically over all period under review (insignificantly negative indicators are expected only in 2012). However, due to the growth in services import and the upgraded interest rates on the growing external debt, the balance of current account may become negative as early as in 2010 - 2011 and will overlap the surplus balance of capital account, i.e., the RF balance of payments will be negative. Our estimates are based on the assumptions, that the balance of payments deficit will be funded from the RF gold and foreign currency reserves, while maintaining smooth dynamics in ruble exchange rate in nominal terms against two-currency basket "USD-EURO".

Proceeding to the review of the situation in the monetary sphere, it is worth noting, that with the anticipated volume of capital inflow in 2008 (corporate and banking sectors debt is expected to be extended up to USD 545 billion), the Central Bank will probably actively use additional instruments of sterilization, rather than face the liquidity shortage problem (in financial system in general). According to our estimates, while federal budget expenditures are sustained at the level of 18.1 per cent of GDP, in order to maintain the annual growth rate of monetary supply (M₂) at least within 32-33 per cent (versus 33.7 per cent in 2007), financial authorities will have to sterilize minimum RUR 200 billion, obtained from monetization of balance of payments surplus.

By 2012, the monetary supply growth rates will be declined to 15–16 per cent per annum, exceeding the inflation rates, which will enable to achieve the level of monetization at about 58-59 per cent of GDP. However, in 2009, due to fairly rapid reduction of the balance of payments surplus, in the background of sustained conservative fiscal policy (federal budget expenditures will not exceed 18.5 per cent of GDP), the problem of replenishment of the monetary supply with the help of refinancing instruments of the Bank of Russia becomes rather aggravated. According to our assessments, in order to maintain the real interest rates on credits to non-financial sector not in excess of 3-3.5 per cent per annum, what enables to keep up the investment growth rate, the RF Central Bank in 2012 will have to provide refinancing to the banking sector in the amount of minimum RUR 4 trillion (6.6 per cent of GDP).

According to our estimates, under this scenario, it is impossible to reduce inflation below 5.0 per cent in 2012. The total prices growth over the five years will reach at least 40 per cent.

Table 1.

Dynamics in Economic Development of Russia as per Forecast Models within 2008–2012

Model	I	II	III	IV
GDP in real terms (growth within the period), %	33–35	27–28	5–6	1–2
Investment index in capital assets (growth within the period), %	85–90	62–67	–9–10	–11–12
Inflation (2012), %	5,0–5,5	4,5–5,0	10–11	14–15
Balance of current account surplus (% of GDP, 2012)	–4,4	–0,7	5,5	2,7 ²⁴
Balance of capital account surplus (% of GDP, 2012)	2,2	1,3	–4,6	–3,5
Nominal exchange rate RUR/USD (2012)	29,0–29,5	30	46–48	50–55
Real effective exchange rate, % (growth against July 1998), %	+30–32	+24–25	+4–5	–20–25
Gold and foreign currency reserves (2012), USD bln	690–700	670–680	205–215	180–190
GDP monetization (2012), %	58–59	56–57	32–33	33–34

* The surplus of the current account balance, in the background of low oil prices, planned in this in this forecast model is based on the assumption, that the ruble devaluation, as well as the reduction of import for the purpose to equalize the RF balance of payments will already take place by 2012.

²⁴ The surplus of the current account balance, in the background of low oil prices, planned in this in this forecast model is based on the assumption, that the ruble devaluation, as well as the reduction of import for the purpose to equalize the RF balance of payments will already take place by 2012.

With lower volume of external financing (model II), growth rate of investment in fixed assets and the RF GDP in real terms will be lower. However, the share of foreign debt in GDP will also not exceed 37.5 per cent of GDP. Our assessments demonstrate, that basing on the given assumptions of capital inflow to Russia, the refinancing volume to the banks, provided by the RF Central Bank as early as in 2008 should reach about RUR 800 billion. Otherwise, real interest rates on credits to non-financial sector can exceed 5 per cent per annum (currently they are practically negative), which means a sharp decline in the availability of investment resources in the economy. Nevertheless, the average annual growth rate of GDP in real terms will remain high enough, at least 4.5-5.0 per cent per annum, while inflation may be decreased to 4.5 per cent in annual terms by the end of 2012.

Thus, this forecast model, although presumes a slight decline in the growth of Russian economy in comparison with the first one, in our view does not bring any threat to the long-term continuous development and is quite favourable.

Comparison of the third and fourth forecast models, which, as a matter of fact, are options of crisis scenario, demonstrates that in the current context of increasing dependence of the GDP growth in real terms on investment dynamics in fixed capital, the restriction on external financing over 2-3 years (model III) can provoke the consequences, comparable with the situation of sharp and sustained decline in oil prices (model IV). In both cases, in 1-2 years after the beginning of negative developments (2010-2011), Russia will face the need to quite drastic devaluation of the national currency and equalization of the balance of payments by reducing the attractiveness of imports. However, at least for 2-3 years, the rate of growth in real economic indicators (GDP, investment, incomes) will be experiencing a serious decline, down to negative values.

The current stage of reforming the system of staffing of the RF military organization: a generalized military – economic appraisal

V. Tsymbal

One of the most important military – economic events of the year 2007 was the completion of the federal target program (FTP) “The transition of a number of formations and military units to being manned by servicemen enlisted for military service under contracts” for the years 2004 – 2007. However, the official estimates of the FTP’s results have not been made public as yet. At the same time, our analysis, based on indirect data, indicates that the main objectives of the FTP have not been achieved, despite the allocation of additional finances.

The issue of the FTP’s results is by no means being hushed up. However, what appears in the mass media is limited to contradictory statements of individual officials, while official documents - for example, the corresponding section of the RF Government’s Report on the results of its activity in 2007²⁵ - offer rather sketchy bits and pieces of information on the FTP, which are not compatible with the established procedure. There was no possibility to give a full account of the FTP’s results in the IET annual survey for the year 2007, either. At the same time, an independent and detailed appraisal of these results would be very important for society, and not only the appraisal by itself, but an appraisal in conjunction with an analysis of the negative consequences which could surface in the nearest future.

Let us begin with stating that the completion, in 2007, of the afore – said FTP was not an isolated event, but yet another phase of the reform of the system of staffing of the RF military organization, which began more than 15 years ago, in November 1992. This statement has its proof in the following juridical circumstance. Both Decree of the RF Government of 30.11.1992, No 918, “On the measures concerning the stage – by – stage switchover to staffing the Armed Forces on a voluntary basis, by servicemen serving under contracts”, and the RF President’s Edict of 16.05.1996, No 722, which set the timeline for the completion of this switchover (then – by the spring 2000) are still with force (!). Although with force, these documents are much altered and truncated. In 2005, the first of them was amended only in one respect: the lump-sum allowance to the servicemen who have signed the contract should be paid not to all of them but only to those “who have passed the trial”. The second document was amended in the following way: the concrete timeline for the completion of the switchover was replaced with the formulation: “to carry out the switchover to filling the military positions which should be held by soldiers, sailors, sergeants, and petty officers, by citizens entering into military service under contracts, as proper conditions for this are created”. It was not explained what these conditions should be; this information is still missing. So, the completion of this reform can be

²⁵ The main results of the RF Government’s activity in the year 2007. The official web-site of the RF Government.

delayed from here to eternity. And the new FTP being planned for the years 2009 – 2010 with regard to the switchover to military service under contracts of all sergeants and all the ships' crews of the Navy, is not considered to be the final one.

The achievement of the FTP' objectives. Before the launching of the FTP, its socially significant objectives were most actively expressed by non-governmental organizations, such as the Committees of Soldiers' Mothers, and by some political parties - for example, "Yabloko", SPS, and later - by "The Russian Party of Life". For instance, the letter to the RF President, with the corresponding recommendations prepared by the IET, contained the following passage: "The essence of our proposals with regard to reforming the system of conscription is close, by its contents, to what has already been achieved in the field of taxation. In substance, we are suggesting that a type of tax liability, heavy, unequally distributed, and extremely unpopular in society (two-year military service for the poor) should be replaced with a low and equally distributed (six-month service for an absolute majority of citizens liable for call-up)". It was suggested to establish that the purpose of such service should be limited to training the required number of servicemen in the basics of the necessary military occupation specialties, so as to prepare them for the subsequent entry into military service under contracts and / or for being transferred to the militarily-trained mobilization resource (or reserve).

On the side of the military organization of the State (MOS), the objectives of military reforms were formulated by the Security Council and the "power" structures. Naturally, priority was given to the combat efficiency of the troops.

The 2002 Message of the RF President contained the following compromise judgment: "One of the unquestionable priorities is the continuation of military reform and the switchover to a professional army, whereas the term of service under conscription should be reduced. Reform is necessary for society, but, first of all, for the army itself... We will carry out this work step by step, with taking into account both the financial capabilities of this country and the interests of the national security of the State. In the course of the army of a new type, mobile and compact, being built, it would be necessary to create adequate social conditions for the servicemen and their families". In August 2002, the Security Council prepared, and the RF President confirmed "The Fundamental Principles of RF State Policy in the Sphere of Military Construction for the Period Until 2010". This document stipulated that in the year 2003 a special FTP should be mapped up with regard to the switchover to the new system of staffing, beginning with the switchover of military units of permanent readiness and on high alert, whereas the draft was to be preserved, although the term of compulsory military service was to be limited to the period of up to one year and for one purpose only – to train the necessary mobilization reserve. In fact, this corresponded to the IET's proposal, although the term of service was somewhat longer, in excess of what was necessary for being trained in a military specialty.

However, when formulating the two main objectives of the FTP, its certificate takes into account only the interests of the MOS:

- "to secure the switchover to filling the military positions, which should be held by soldiers, sailors, sergeants, and petty officers - by servicemen enlisted for military service under contracts,
- to improve the combat efficiency of the military formations and the units of permanent readiness of the RF Armed Forces, and of the military units of the frontier and internal-service troops of the RF Ministry of Internal Affairs".

In his interview to the newspaper "Krasnaya Zvezda" ["The Red Star"], RF Minister of Defense S. B. Ivanov underlined the exclusively military character of the FTP in the following words: "A partial transition of the Armed Forces to a contractual basis is not a political declaration and is not the goal of development of Russia's Armed Forces. It is one of the avenues to increasing the combat efficiency of Russia's Armed Forces". However, it should be noted that the military units on continuous alert were excluded, without any explanation, from the list of those whose combat efficiency is planned to be increased by means of the FTP.

What can be said with regard to the achievement of the FTP's afore-said objectives now, when the program is completed?

Both objectives formulated in the FTP **have not been achieved in full**. The quantitative aspect of this is illustrated below, while the qualitative one is characterized by the fact that not only the initially approved number of positions to be held by non-commissioned officers and other ranks, but even the adjusted and considerably reduced number of them remains unfilled.

The objective of increasing combat efficiency has been achieved only fragmentarily. Thus, in the Frontier Service of the FSB, the increase was beyond all expectations because of the complete discontinuation of the draft and due to a complex of measures undertaken on the frontiers of the RF, which made it possible to reduce the overall number of border guards. The combat efficiency of internal – service troops increased to a lesser extent. On the other hand, the situation with the RF Armed Forces is complicated and confused. Most

successfully the FTP was implemented in the units stationed in the North Caucasian Military District, where their manning and provision with amenities were directly supervised by the RF President. It is equally praiseworthy that the personnel of the units on continuous alert was not completely forgotten, after all, and that, although not mentioned in the FTP, submarine crews of the Navy were also made to serve under contracts. But the number of these crewmen is relatively small. As regards the majority of military units of the RF Armed Forces, and not only those of them that are included in the list of units of permanent readiness, one cannot but note that the number of contractees in many of them has actually dropped, and that the level of their personnel's professionalism has declined, which could result in a decline in the combat efficiency of the RF Armed Forces, especially after the year 2008.

On the whole, if one compares the rise in the number of contractees achieved by the year 2007 with the previous figures, the results illustrated in *Figure 1* will definitely lose some of their gloss.

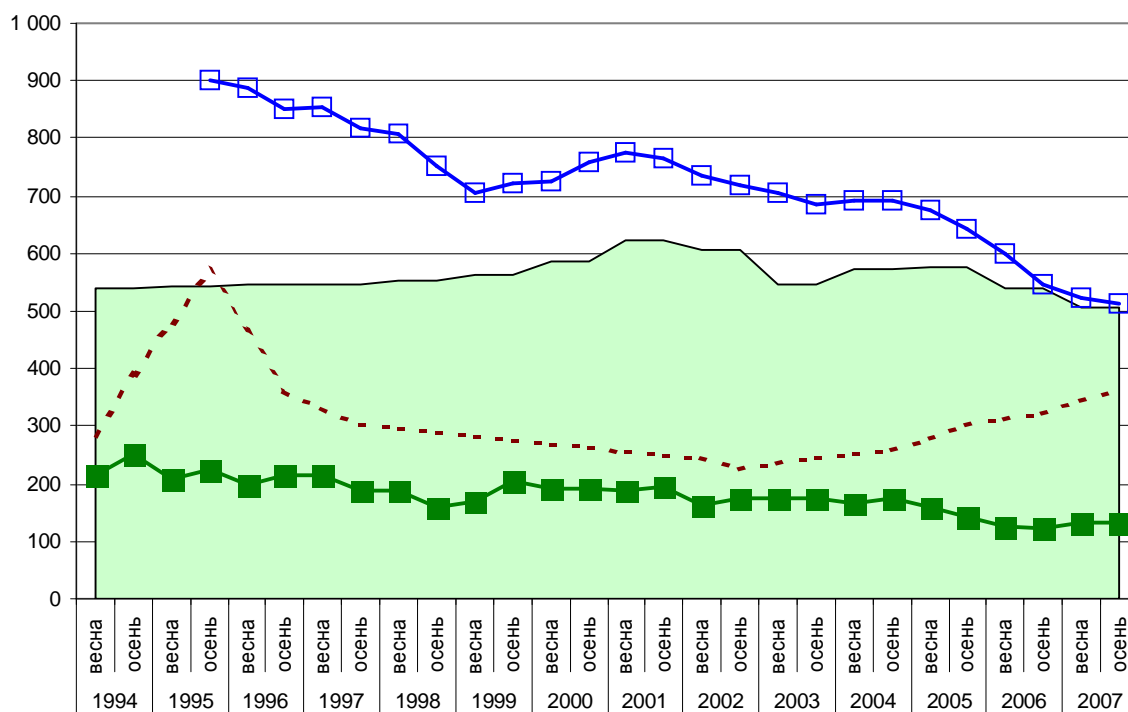


Fig 1. The dynamics of the numbers of non-commissioned officers and other ranks in the RF military organization

The meaning of the lines presented in the diagram is as follows. Against the background showing the number of young men reaching military age (thousands of persons in a half-year), the following is shown: the dynamics of the draft (thousands of persons in a half-year - the bottom line), and the number of non-commissioned officers and other ranks serving under contracts (thousands of persons – the dotted line, second from the bottom) and under conscription (thousands of persons – the third line).

The overall number of contractees serving in the MOS is represented by a dotted line, because this number, in contrast to the number of draftees set by the RF President' non-classified Edicts, is considered secret, and, therefore, it could be estimated only tentatively. But even these estimates indicate that the FTP's successes are very modest. We have not reached the level of the number of contractees attained in the mid-1990s. The overall number of non-commissioned officers and other ranks serving under contracts were, until the very end of the FTP, much lower than the number of servicemen serving under conscription. This qualitative characteristic is revealed in more detail by the indicators taken from the FTP and presented below.

So far as the socially significant objectives are concerned, the unevenness of the distribution of the military service "burden" among the RF citizenry only increased during the period of implementing the FTP. In particular, students of 67 privileged higher educational establishments, up to 20 thousand persons per year, after being trained at the military chairs of these establishments (165 military chairs at other higher educational establishments, will be closed) will become officers of reserve exempted from call-up to military service, while students (up to 3 thousand per year) from a number of other federal higher educational establishments, after being trained at 37 special centers at these establishments will serve as officers for a period

of three years, as is stipulated in their contracts. And the majority of graduates of civil educational establishments will serve for a period of one year in the positions to be filled by soldiers and sailors, alongside those who have failed to enter higher educational establishments or to graduate from them. This approach to the problem of conscription violates one of the major, historically justified principles – the principle of the “universality” of military service.

The indicative reflection of the course and the results of the FTP. It should be recalled that any FTP, in accordance with the existing “Procedure” for its implementation, should be estimated not only qualitatively, that is, linguistically, but also through the use of some quantitative indicators (or indices) specified in the FTP and / or cited by RF top officials, including the Supreme Commander of the RF Armed Forces. Apart from this, the “Procedure” makes it obligatory for the supervisors of the FTP to inform society as to the degree of the FTP’s implementation, by means of these indicators.

In the FTP under consideration, the main expected result was to increase the number of contractees in the military units being switched over to the new system of manning, from **22.1 thousand** to **147.578 thousand** (under the initial version of the FTP), and then to **138.722 thousand** (under the amended version of the FTP). As early as the time of launching the FTP, specialists paid attention to the imprecise setting of the initial number of contractees. This lack of precision had its impact on the form of entering their final number as well. Later on, in the course of adjusting the FTP, the content and the form of entering this first indicator were made more precise, as is reflected in *Table 1*.

Table 1

The indicative representation of the number of non-commissioned officers and other ranks serving under contracts in the MOS

Financing of Fed. Exec. Bodies – Participant of FTP	Rise in number of contractees, by year				Over period of 2004 – 07, total
	2004	2005	2006	2007	
Ministry of Defense	18215	40842	24405	41897	125359
Ministry of Internal Affairs	3880	3881	992	976	9729
FSB	–	–	990	2644	3634
In MOS, total	22095	44723	26387	45517	138722

Those were the targets, set in the FTP. The results were represented much less precisely. Our analysis of the information posted to the website of the Ministry of Economic Development and Trade makes it possible to arrive at only one conclusion: the degree of obtaining the first indicator’s values specified in the Table was not registered, which prevented society (and the authorities as well) from supervising the course of implementing the FTP. The estimation of this indicator as of the end of 2007 is even more complicated. Nothing more precise than the words “approximately 100 thousand persons”, said with regard to the Ministry of Defense by the head of the General Staff’s Main Administration for the Organization of Mobilization, has ever been published.

The conclusion that such a value of the first indicator means a virtual disruption of the FTP has never been voiced by any high – ranking official. Moreover, it is being actively rejected by them. What we hear is the assurance that the FTP will be implemented all the same, in the year 2008. However, its term has not been officially extended, and the requested additional 10 billion rubles has not been allocated.

A similar situation has developed with regard to the two other officially entered indicators: indicator one, the number of places for housing servicemen enlisted for military service under contracts in hostels with housing cells and in hostels of a simplified type (126,580 such places were to emerge), and indicator three, the number of places for training servicemen enlisted for military service under contracts (it was necessary to furnish and equip 26,909 such places).

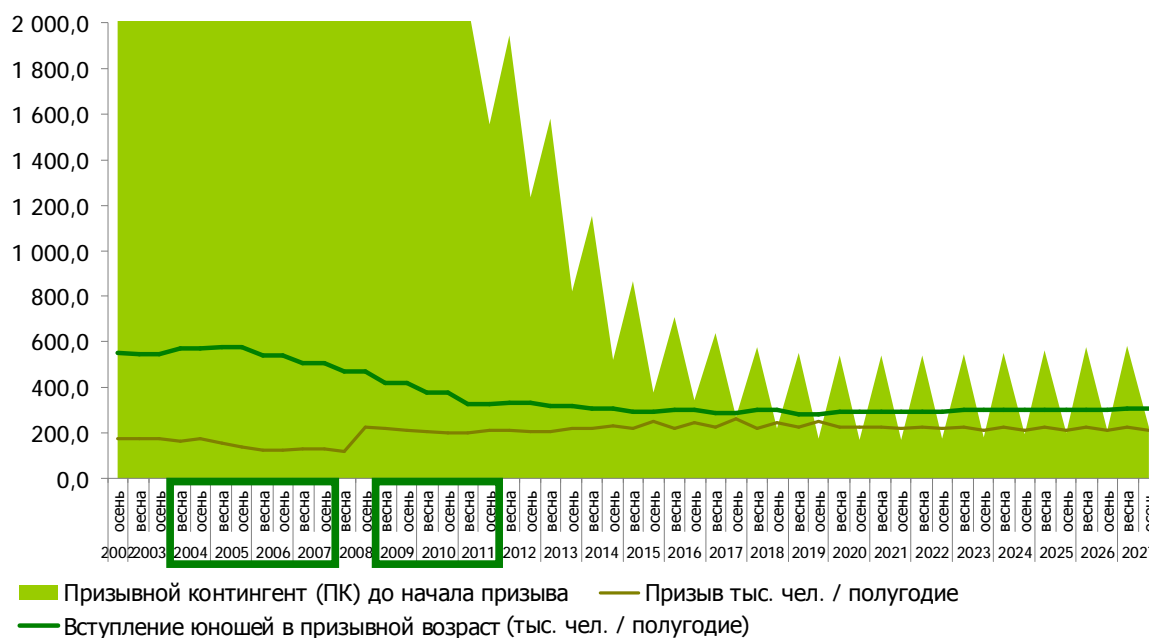
The high – ranking officials at the Ministry of Defense are forced to admit the failure to implement the FTP with regard to these indicators as well. In particular, when trying to excuse himself for the shortage of contractees serving in the RF Armed Forces, the head of the General Staff’s Main Administration for the Organization of Mobilization shifted the responsibility to the builders. In the afore – mentioned interview he has said the following: “We have slightly decelerated this process on purpose, because the builders are failing to timely create the corresponding funds of service housing”. It transpires from his words that despite the additional financing, the FTP’s indicators directly related to construction do not suggest that the FTP has been implemented.

In addition to the indicative indicators, let us consider yet another extremely important indicator – the share of contractees in the overall number of non-commissioned officers and other ranks. This indicator, although not included in the FTP, was implied in the text of the so-called “White Book”²⁶ of the Ministry of Defense, because an increase in it would have meant a reduction in the number of draftees. In his interview published by the newspaper “Krasnaia Zvezda” (The Red Star) on 6.11.2004, Head of the General Staff Iu. Baluevskii stated that by the end of 2007, “the number of contractees filling the positions to be held by sergeants and soldiers will rise to 50 %”, as a result of which the RF Armed Forces will obtain “a rational mixed system of staffing”.

As regards the share of contractees attained after the FTP, the November 2007 report of the Minister of Defense cited 45 % instead of 50 %, the annual report of the RF Government – “approximately” 40 %, while our estimates suggest something very different: the word “approximately” should be read as 36 – 37 %.

Therefore **the present system of manning**, when regarded from the point of view of Iu. Baluevskii, **is not rational militarily**.

Neither this system is rational for society, because the shortage of contractees (by comparison with the estimated value included in the FTP) should be compensated for by increasing the call-up. In time, this would coincide with a sharp reduction in the number of young men born in the early 1990s and now reaching the age of 18. As is shown in *Figure 2*, the conscript class (CC) which is, at present, more than ten times larger than the number of actual draftees, will be rapidly exhausted in the next few years, its replenishment with able-bodied young men will become equal in numbers with the call-up, and thereafter young men will be called up indiscriminately, which may still be insufficient for adequately coping with the shortage of manpower. The serrated appearance of the graph, reflecting in this case the dynamics of the CC, indicates that the call-up papers will be delivered practically to everybody included in the CC. Plotted as abscissa are the intervals of the completed (2004 – 07) and the future (2009 -11) FTPs.



The conscript class (CC) before the beginning of the draft The call-up, in thousands of persons / half year
The number of young men reaching military age (in thousands of persons / half year)

Figure 2. The forecasted dynamics of the call-up to the RF military organization

There is a real danger of disruption - this time not of the FTP alone but of the very process of manning the MOS as well. And this disruption may commence even earlier than is shown in the graph because of a more widespread draft – dodging.

The meaning of the FTP’s results for citizens and society. As regards the other socially significant results expected from the FTP, the state of affairs is equally bad. The case in point is the following objectives stated in the FTP’s certificate: the reduction of society’s dissatisfaction with the existing system of manning the RF

²⁶ Aktual’nye zadachi razvitiia Vooruzhennykh Sil Rossiiskoi Federatsii. Moscow [Urgent issues relating to the development of the Armed Forces of the Russian Federation]. Moscow: MO RF (the RF Ministry of Defense), 2003, 84 pages.

Armed Forces and other troops, military formations and organs, and with these servicemen being dispatched for military service in the “hot spots”.

The expected considerable reduction of society’s dissatisfaction has not taken place. On the contrary, a new reason for dissatisfaction has emerged, this time on the part of officers not serving in the units of permanent readiness. They are now more dissatisfied, because the level of their money allowance has become lower than that of their “colleagues” filling similar positions in the units of permanent readiness. And in the nearest future a new dissatisfaction will emerge, as shown in *Figure 2*, caused by the cancellation of deferments, primarily for young fathers and graduates of higher educational establishments. This dissatisfaction will grow because of the already beginning increase in the size of bribes and in the price of other “services” in the sphere of draft dodging.

The positive result produced by the reduction in the term of compulsory military service was brought to naught by the cancellation of a number of deferments. The decision not to dispatch servicemen enlisted for compulsory military service under conscription to Chechnya has not been legally consolidated, and the Regulation on Military Service does not eliminate this possibility.

The cost - effectiveness of the results. From the point of view of the military and economic cost - effectiveness of the FTP’s results, it is very important to estimate the degree of achievement of the expected results in comparison with the costs. Initially, it was planned so that the sum of 79,091.65 million rubles in the 2003 prices should be allocated to the FTP. Later on, in the course of adjusting the FTP, in parallel with the reduction in the numbers of contractees by 8,856, the expenditures on the FTP were increased to **98,913.31 million rubles in the 2003 prices!**

In terms of specific values per serviceman, the expenditures rose from their initial value of 536 thousand rubles per person to 713 thousand rubles per person, or by 177 thousand rubles per person, or by 33 %. Nevertheless, the program has been disrupted.

It is equally important to exactly analyze what the additionally allocated funds were spent on. It turns out that they were spent on items other than those aimed at increasing the attractiveness of military service (although it was its low attractiveness that was singled out in every annual report on the progress of the Program as the main threat to successfully implementing the FTP). Virtually all the additional funds were allocated to capital investments. In the first version of the FTP these expenditures amounted to 34 % (or 27,178.28 million rubles), while in the adjusted version they climbed to 44 % (or 43,577.52 million rubles). The expenditures on promoting the idea of military service under contracts and on research were on the rise as well. And only **the special increment to money allowance introduced in order to increase the attractiveness of military service under contracts remained frozen.**

Thus, the main reason for the failure of the FTP is absolutely clear. It is the low attractiveness of military service. Both independent experts and specialists from the Ministry of Defense were of the same opinion in this respect and expressed it in the mass media and scientific publications. The ten – percent increase in the afore – said increment to be introduced this year cannot be considered an effective measure.

The causes of such a negative attitude expressed by the military leadership with regard to increasing the attractiveness of voluntary military service under contracts deserve to be analyzed separately. The results of this research will be published in due course.

The issue of attractiveness of military service. To conclude this brief publication, let us dwell on some attempts at distorting the essence of the problem under consideration. The most vivid example of efforts in this direction is the affirmation that the financial support provided to a soldier serving under a contract “is much larger than the [salary of] 35 thousand rubles received by the driver of an electric locomotive”. These words were said by V. V. Smirnov, the head of the General Staffs’ Main Administration for the Organization of Mobilization, in one of his interviews²⁷.

In order to substantiate this comparison, we directly addressed the leadership of the Moscow Metro. The results of the comparison are presented below, in *Table 2*.

Our analysis of the total incomes of the said persons, recalculated on a monthly basis, reveals that:

- the difference between the minimum (!) wage of an engine – driver and the money allowance of a soldier serving under a contract, expressed in thousand of rubles per month, $35 - 11 = 24$ for the first 36 months of work (or service) amounts to 864 thousand rubles, or almost 35 thousand USD, which represents quite a good starting sum of money for the engine – driver, enabling him to solve many of his capital problems, including the housing issue;

²⁷ Iuzbashev, V. Intellect staviat pod ruzhio (Intellect under arms). NVO, 21- 27.12.08, № 45.

- and that later on as well, this difference, calculated with taking into account the monthly allocation of 7.5 thousand rubles to the serviceman for the purpose of his purchasing a dwelling by means of the Funded Mortgage System and amounting to $35 - 18 = 17$ thousand rubles per month, will remain significant.

Even more so, this conclusion holds true with respect to the wage of not a rookie but an experienced engine-driver which can amount to 55 thousand rubles per month. The Ministry of Defense can promise nothing like this to a professional soldier even by the end of his service. This level is unattainable even for many senior officers. And junior officers can only dream about receiving the wage of an assistant engine driver (between 21 and 24 thousand rubles per month).

Table 2

The attractiveness of a contractee's service and an engine-driver's work

Soldier serving under a contract	Parameters compared	Engine driver
8 thousand rubles + northern, regional, etc bonuse (e.g., up to 15 thousand rubles in Chechnya)	1. <i>Payments charged: wage, money allowance (MA), rubles / month</i>	(21 thousand rubles – assistant engine driver) between 35 and 55 thousand rubles – engine driver
Additional payments at the moment of conclusion of a second contract and of further contracts, long-service bonuses, bonuses for qualification-related bonuses	2. <i>Additional payments and bonuses</i>	Receives the “13 th wage” and the long-service bonus; double payment of labor on holidays. Regular indexation
600+300 per year for treatment at sanatoria and health resorts = 75 rubles / month	3. <i>For medical services</i>	A health – improving complex in the Moscow region
Uniform	4. <i>Working clothes</i>	Uniform
Catering = 2 thousand rubles / month	5. <i>Food</i>	---
A place in a hostel. On the conclusion of a second contract, the State allocates (or saves) the money for the subsequent acquisition of a dwelling: 90 thousand rubles per year, or 7.5 thousand rubles / month.	6. <i>Housing</i>	Employment is given to persons with a dwelling or to those who will solve their housing problem at the expense of their wages
The free-of charge annual travel to the place of use of leave and return; On average, 200 rubles / month.	7. <i>Free – of charge travel</i>	Only by the Metro
8+2+7,5 (after 3 years of service) + ... = 17 + ... = 18	Total incomes recalculated on a monthly basis	(between 35 and 55) + ...
The right to free-of-charge education after the completion of the first 3-year contract (on condition of successfully passing the examinations)	8. <i>Right to free-of-charge education at a higher educational establishment</i>	After three years of faultless work at the Metro, it is possible to obtain secondary or higher professional education at the expense of the enterprise
30 calendar days	9. <i>Leaves</i>	48 calendar days

After comparing the level of financial support for a contractee and an engine driver, V. V. Smirnov arrives at the following conclusion: “Thus, it is not clear who gains more – the Metro worker or the contractee”.

Generally speaking, it is not without reason to correlate these two categories of citizens. In rendering their services to society, both the contractee and the engine driver are acting in the interests of security, and it does not matter whether it is transport security or military security. For both of them, their service (or work) is fraught with danger and inconveniences. The only problem is how to take into account the well – known hardships and deprivations of military service, such as the prospects of being severed from home, including the dispatches to the “hot spots”. And who will be, after all, better off?

In our opinion, the results of this correlation are clearly not in favor of the serviceman.

Similar conclusions were made in the Ombudsman's report submitted to RF President in February 2008²⁸. V. P. Lukin described the existing situation in the army as follows: “The State continues to be incapable of

²⁸ Rossiiskaia gazeta (The Russian Gazette), № 55, of 14.03.2008.

providing the servicemen with decent money allowance and housing, of shielding them from the arbitrary behavior of their commanders, and humiliations at the hands of the “veterans”. Then he added a few words directly concerning the NCOs and other ranks serving under contracts: “At the same time, it should be acknowledged that service under contracts is gradually losing whatever attractiveness it has ever had: apparently, neither the wage nor the social status of a serviceman is a sufficient impetus for concluding a contract”.

Thus, yet another stage of the switchover to voluntary military service under contracts has ended in yet another fiasco.

Meetings of the Government of the Russian Federation

M. Goldin

Among the most important issues the following were considered at the meetings of the Government of the Russian Federation: the course of federal target programs fulfillment and realization of the federal targeted investment program in 2007, bill “On technology transfer”.

At the meeting of the Government of the Russian Federation on 13 March the report of the Ministry for Economic Development and Trade was heard devoted to the course of federal target programs (FTP) fulfillment and the federal targeted investment program execution in 2007.

According to the report, the total volume of financing of 46 FTP and 36 subprograms, included in the open part of the federal budget for 2007, taking into account changes made during the year, was equal to RUR 586.95 bln, of which expenses for government investments were RUR 360.6 bln.

In 2007 the volume of federal budget funds used to finance program measures, according to the data of the Federal Treasury, was RUR 495.1 bln (84.4% of budget allocations).

The Ministry for Economic Development and Trade believes that real use of federal budget funds for program and non-program measures in 2007 was 99.6%.

For reference, in 2006 the volume of the used funds comprised RUR 385.6 bln, which was 95.0% of the volume of financing, envisaged in 2006.

In 2007 35 FTP envisaged attraction of funds of the budgets of the subjects of the Russian Federation and municipal formations, as well as off-budget sources in the total volume of RUR 838.7 bln (RUR 274.5 at the expense of budgets of subjects of the Russian Federation and municipal formations, RUR 564.2 bln at the expense of off-budget sources).

In 2007 RUR 664.3 bln or 79.2% of the allotments envisaged for the year was really attracted, in 2006 the figure being 82.3%, of which at the expense of regional and local budgets – RUR 224.6 bln or 81.8% (99.1% in 2006) and at the expense of off-budget sources – RUR 439.8 bln or 77.9% (75.8% in 2006).

To estimate efficiency of FTP fulfillment established target indices and indicators of efficiency of their fulfillment were used.

Execution of all 46 programs in 2007 was estimated by 625 target indices and efficiency indicators. Total fulfillment was characteristic for 493 indices (78.9%, 73.6 % in 2006), 104 indices (16.6%) are not fully fulfilled, 28 (4.5) – not fulfilled at all.

As a result of the analysis of program execution by the indices mentioned 46 programs are conventionally classified by the Ministry of the Economic Development and Trade to the following categories:

13 programs, whose realization is recognized as effective;

24 programs, work of state customers on which can be regarded as satisfactory;

5 programs, whose realization is considered by the Ministry for economic Development and Trade as insufficiently effective. They are the following:

“Increase in road safety in 2006-2012” (responsible for fulfillment is the Ministry for Internal Affairs of Russia).

“Industrial utilization of weapons and military equipment 2005-2010” (Ministry for Power and Industry of Russia)

“Electronic Russia 2002-2010” (Ministry for Information and Communication of Russia).

“Economic and social development of the Far East and Transbaikalia in 1996-2005 and up to 2010” (Ministry of Regions of Russia).

“Global navigation system” (Russian Space Agency).

It is interesting that at the meeting of the Government of the Russian Federation in December 2007, when course of FTP and FTIP fulfillment over 9 months of 2007 was analyzed, they were “Social support for the disabled in 2006-2010” (Ministry for Health Care and Social Development), “Complex measures to counter-

act drugs abuse and their illegal trafficking in 2005-2009” (Federal Agency for the Supervision of Drugs Turnover) that were cited by the Ministry for Economic Development and Trade as in effective in addition to the first three programs listed above;

“Development of civil aircraft equipment in Russia in 2002-2010 and in the period up to 2015” (Ministry for Power and Industry of Russia);

Financing of research and development measures planned within framework of 32 FTPs was fulfilled unevenly. 80% of the total resources from all sources of financing was attracted and 44% of the federal budget funds as well as 50% of the off-budget sources was used in the 4th quarter 2007. This is connected with the drawbacks in contests organization. The significant number of contracts was signed only in the 3rd quarter 2007.

Federal Targeted Investment Program (FTIP) for 2007 was formed basing on the volume of the capital investments, directed to FTP realization, as well as to realization of separate most important social and economic issues, according to the decisions by the President and the Government of the Russian Federation (non-program part).

In the opinion of the Ministry for Economic Development and Trade of the Russian Federation, results of FTP and FTIP analysis demonstrate that the reasons for insufficient efficiency of these programs realization were the following:

- Long period of procedures for order placement for goods (works, services) supply for federal government needs;
- Non-observance or improper fulfillment of contract liabilities by customer-builders and contractors;
- Insufficient level of interaction of federal executive bodies of subjects of the Russian Federation with organizations and enterprises and connected with it non-observance of liabilities of program co-financing;
- Late start of financing due to procrastinating of deadlines for project documentation preparation, its revision, including in connection with calculated cost of construction becoming more expensive and change in technical conditions, as well as preparation of registration forms.

At the meeting of the Government of the Russian Federation on 27 March the bill “On technology transfer” was discussed. The bill is aimed to fulfill paragraph 5 clause 1546, paragraph 2 clause 1547, clause 1549 and 1551 chapter 77 part 4 of the Civil Code of the Russian Federation, which, it should be reminded, came into effect on 1 January 2008. Thus, according to paragraph 2 clause 1547 of the Civil Code of the Russian Federation the procedure for contest or auction conduction on alienation of rights for technology by subjects of the Russian Federation or (and) by the Russian Federation, as well as cases and procedure for rights for technology transfer to the Russian Federation and (or) subjects of the Russian Federation without conduction of a contest or auction should be regulated by the law on technology transfer.

Taking this into account the bill was prepared, that regulated the procedure for transfer of created technologies to the private sector at the expense or with attraction of funds of the federal and regional budgets, allocated to pay for works on government contracts.

According to the bill rights for the technology will be alienated on the contest basis, in which connection procedure for contests and auctions conduction is established. Since the bill states significant conditions of the agreement on technology transfer (contracts for rights for technology alienation and licensed agreements), among which there is the obligation to put the technology into practice, as well as the cases and procedure for rights transfer without auctions or contests conduction are defined.

It should be noted that development of the legislation mentioned reflects the all-world trend for development of the normative basis for innovations commercialization by making amendments and adoption of normative legal acts to supplement existing legal acts.

Earlier the bill of the federal law “On innovation activity and government innovation policy” (further referred to as the bill “On innovations”), which, as it had been expected, was to become the main legislative act in the field of innovations, despite being developed since 1995, was not adopted.

The bill “On innovations” was adopted by the State Duma, approved by the Federal Assembly of the Russian Federation, submitted to the President of the Russian Federation to be signed. However, according to his Letter No Pr-14 from 3 January 2000, the bill was turned down. In the President’s letter it was mentioned as a drawback of the bill that one of criteria to define some kind of activity as innovation was novelty or improvement of goods or technological process created or used as a result of this activity. However no signs by which production or technological process can be referred to as new or improved to the extent that the activity on creation or use of such products or technology can be defined as innovation were cited in the bill “On innovation”. In practice this means impossibility to formulate distinct subjects to the bill mentioned.

Review of Economic Legislation over March 2008

I. Tolmacheva

A number of changes were introduced in legislation in March: the rate of monthly social payments was raised for some categories of citizens; a new chapter, regulating labor relations with professional sportsmen, is introduced to the Labor Code of the Russian Federation; the coefficient for additional increase of the rate of insurance part of old-age pensions from April 2008 was established; data used for calculation of severance tax on oil for February 2008 are prepared for application; explanations of the Fund for social development with regard to children pay are given.

I. Federal Laws of the Russian Federation

1. "ON MAKING CHANGES TO SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION IN ORDER TO INCREASE THE RATES OF SOME KINDS OF SOCIAL PAYMENTS AND PAYMENTS FOR A NUMBER OF SOCIAL SERVICES" from 01.03.2008 No 18-FZ

Comes into effect on 01 April 2008, excluding a number of positions, coming into effect on other dates

According to the changes, on 1 April 2008 the rates of some kinds of social payments and cost of the list of social services are increased for some citizens, for instance citizens that were exposed to radiation as a result of the catastrophe at Chernobyl nuclear power plant; citizens that were exposed to radiation as a result of trials at Semipalatinsk testing area; corresponding categories of veterans; the disabled, including the disabled children; Heroes of the Soviet Union, Heroes of the Russian Federation and holders of all Glory orders and members of their families, Heroes of Socialist Labor, holders of all orders of Labor Glory. The same law established the procedure for indexation and recalculation of payments to citizens, having children.

Besides, changes are made to the Federal Law from 17.07.1999 No 178-FZ "On government social support" concerning increase of sums, directed to payment of a number of social services.

2. "ON MAKING CHANGES TO THE LABOR CODE OF THE RUSSIAN FEDERATION" from 28.02.2008 No 13-FZ

Comes into effect on 30 March 2008

Changes were made to the Labor Code of the Russian Federation; they concern regulation of labor relations with professional sportsmen. Earlier in the Labor Code there was no separate chapter, regulating of labor of sportsmen and coaches issues, - some regulations, concerning this category of workers were included in other chapters of the Code, which now are invalid. The Code is supplemented with chapter 54.1, which regulates the procedure for making and abrogation of agreements with sportsmen and coaches. Additional grounds for labor contracts abrogation with a professional sportsman are add: disqualification for the period of more than 6 months, doping abuse. Besides, special issues of relations with sport workers: necessity of compulsory medical check-up (examination) of sportsmen on signing the labor contract, cases of temporary transfer to another employee and debar of the sportsman from the participation at competition, direction of sportsmen and coaches to combined teams of the Russian Federation. Special features of sportswomen and underage sportsmen are described specifically. Clause 348.10 in new version envisages additional warranties and compensations for sportsmen and coaches.

II. Decrees of the Government of the Russian Federation

1. "ON MAKING CHANGES TO THE DECREE OF THE GOVERNMENT OF THE RUSSIAN FEDERATION FROM 19 NOVEMBER 2007 NO 786" from 20.03.2008 No 189

Indexation coefficient for monthly social payment on compulsory social insurance from accidents at production and professional illnesses, granted before 1 January 2008 was increased and is now equal to 1.085.

2. "ON ESTABLISHING OFN COEFFICIENT FOR ADDITIONAL INCREASE OF THE INSURANCE PART OF THE OLD-AGE PENSION FROM 1 APRIL 2008" from 25.03.2008 No 204

Comes into effect on 01 April 2008

Coefficient for additional increase of the insurance part of the old-age pension is established at the level of 1.075 from 1 April 2008. Pension Fund of the Russian Federation is commissioned to inform its territorial branches on the value of the coefficient, adopted by this Decree, to increase pensions, established by the Federal Law from 17.12.2001 No 173-FZ.

III. Letters, Orders, Directions

1. Letter of the Federal Tax Service of the Russian Federation “ON DATA, NECESSARY TO CALCULATE SEVERANCE RATE IN REGARD TO OIL FOR FEBRUARY 2008” dated 19.03.2008, No SchS-6-03/192@

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

- average level of prices for oil grade Urals – USD 92.01 per barrel;
- average US dollar exchange rate against ruble of the Russian Federation over all the days of the tax period – 24.5352;

Cp coefficient value – 7.8033.

2. Letter of the Federal Social Service from 05.03.2008 No 02-18/07-1931

Starting with 1 January 2008 a number of children payments will be indexed annually. Payments that are paid by employees are also subjected to indexation: extraordinary grant to women, registering at medical institutions at early stages of pregnancy, extraordinary grant on childbirth.

Payments should be indexed according to the forecast level of inflation, established in the Law on federal budget for the current year. This level for 2008 is 8.5% (part 1 clause 1 of the Federal Law from 24.07.2007 No 198-FZ). In this connection the rate of the extraordinary grant for women on childbirth will be RUR 8680 in 2008, and payment for women, registering at the early stages of pregnancy is RUR 325.5. Minimum and maximum rates of the monthly leave on childcare are also indexed. In 2008 minimum rate of the payment is RUR 1627.50 (care for the first child) and RUR 3255 (care for the second and other children), maximum rate is RUR 6510. It is specified that it is the minimum and maximum rates that are indexed, not the rate of payment calculated on the basis of 40% of the average wages. Payments, which have already been paid for 2008, should be recalculated and the difference should be paid to the employee. Since both the calculation pay-sheet by means of the Federal Social Service of the Russian Federation (form 4-FSS RF) and calculation of advance payments on Single social tax, which are reduced by the sum of expenditures, taken by the Federal Social Service, will be submitted by employees already as a result of the 1st quarter, accounts reflecting indexed sums of made payments and no changes to accounts will have to be made.

Review of Budgetary Legislation over March 2008

M. Goldin

The following events took place in March 2008 in the field of budgetary legislation: Federal Law on budget for 2009-2010 was changed considerably, Rules for granting of subsidies in 2008 from the federal budget to regions to co-finance construction of regional capital construction and (or) to grant corresponding subsidies to local budgets to co-finance municipal objects of capital construction.

Federal Laws

Federal law from 03.03.2008 No19-FZ “On making changes to the Federal Law “On the federal budget for 2008 and for the planned period of 2009-2010”

The changes are accounted for by real macroeconomic indices of the development of the Russian Federation in 2007, including growth of prices for consumer goods at the end of 2007, as well as expected results of social and economic results of the country’s development in 2008 and specification of the main forecast parameters for the development of the Russian Federation in the planned period of 2009 and 2010.

Main characteristics of the federal budget for 2008 and for the planned period of 2009 and 2010 have been specified. For instance, the share of oil and gas transfer and normative volume of the Reserve fund for the planned period of 2009 and 2010 have been increased.

Besides, the total volume of federal budget’s expenditures in 2008 as compared with the initially approved volume was raised by RUR 331.3 bln, in 2009 – by RUR 831.6 bln, in 2010 – by RUR 994.6 bln.

The list of targets for which subsidies are granted to the regions of the Russian Federation was widened. For instance, now subsidies are given both to make purchase and goods interventions of grains. Earlier, according to the law on the budget, subsidies were granted only to make purchase interventions of grain.

Decrees of the Government of the Russian Federation

Decree of the Government of the Russian Federation from 07.03.2008 No 155 “On granting subsidies in 2008 from the federal budget to subjects of the Russian Federation to co-finance construction of regional capital construction objects of state ownership of subjects of the Russian Federation and (or) to grant corre-

sponding subsidies from the budgets of subjects of the Russian Federation to local budgets to co-finance municipal capital construction objects of municipal ownership”

The Decree establishes rules to grant subsidies in 2008 from the federal budget to subjects of the Russian Federation to co-finance construction of regional capital construction objects of state ownership of subjects of the Russian Federation and (or) to grant corresponding subsidies from the budgets of subjects of the Russian Federation to local budgets to co-finance municipal capital construction objects of municipal ownership.

Rules however do not apply to granting subsidies to co-finance construction of regional capital construction objects, with regard to which other regulating acts that establish procedure of subsidies distribution and (or) granting are adopted.

Distribution of subsidies among the subjects of the Russian Federation is stated by legislative acts of federal executive power – subjects of budget planning.

A legal act on distribution of subsidies issued by a subject of budget planning should contain:

- a) denomination of the subjects of the Russian Federation to which subsidies are granted;
- b) volumes of subsidies granted on the whole to a subject of the Russian Federation as broken by the main superintendents of the federal budget’s funds;
- c) target granting of subsidies, including target distribution in cases mentioned in paragraph 5 of the Rules;
- d) other information on the decision of the subject of budget planning.

Target allocation of subsidies is defined by mentioning in the legal act of the subject of budget planning, target distribution of subsidies and subsidies distribution by kinds of objects, belonging to the sphere of the chief superintendent operation. Target distribution of subsidies is carried out by indication of the amount of granted subsidies for every capital construction object, included in the federal target programs, with indication of objects’ names and corresponding programs, and for every capital construction object not included in the federal target programs.

According to paragraph 5 of the Rules it is stated that target distribution is compulsory for the following capital construction objects:

- a) included in the federal target programs with indication of amount of financing for every object on these programs;
- b) included in the federal target programs without indication of the amount of financing for every capital construction object in these programs:
without which commissioning and operation of the capital construction objects of the state ownership of the Russian Federation is impossible;
necessity of whose construction results from international liabilities of the Russian Federation;
- c) not included in the federal target programs, whose construction (reconstruction) is envisaged by decisions of the President of the Russian Federation or the Government of the Russian Federation, including those without which it is impossible for the capital construction objects of the state ownership of the Russian Federation to be put into commission or to function, or necessity of construction (reconstruction) of which results from the international liabilities of the Russian Federation.

Subsidies are granted to chief superintendents of the federal budget’s funds according to the total budget revenue and expenditures within the limits of budget allocations and budget liabilities for 2008 and in accordance with the approved legal act of the subject of budget planning on subsidies distribution on the basis of the agreement on subsidies granting made between the federal executive body of the subject of the Russian Federation and the chief superintendent of the federal budget funds, agreed with the subject of budget planning.

Orders are given to the federal executive bodies to adopt legal acts on approval of subsidies distribution among the subjects of the Russian Federation as broken by the chief superintendents of the federal budget funds. The main superintendents, in their turn, are to provide making agreements with the supreme executive bodies of the Russian Federation on subsidies granting.

According to paragraph 13 of the rules it is established that granting subsidies is suspended in case decision is made by the chief superintendent of the federal budget on violation of agreements condition by the supreme executive body of the Russian Federation.

If it is impossible to eliminate violation of agreement’s conditions made by the supreme executive body of a subject of the Russian Federation, granting of subsidies is stopped according to the decision of the chief superintendent of the federal budget funds, and the subject of budget planning is informed with the indication of the amount of released funds.

Review of Regulatory Documents Concerning Taxation

L. Anisimova

In February-March there were decisions made that specify the procedure for submission of tax documents and formation of separate tax commitments as to property income, land and transport taxes, VAT. The concept for the creation of control system over goods export from the customs territory of the Russian Federation has been developed. The issue on application of tax regime of processing in the customs territory has been clarified.

1. According to the letter of the Ministry of Finance of the Russian Federation from 4 March 2008 No 03-05-04-02/14 the issue on the procedure for submission of tax declaration on transport tax, assets tax and land tax to tax institutions has been clarified. For instance, it has been elucidated that it is the responsibility of tax payers with whom transport vehicles recognized as subjects to taxation are registered in concordance with the legislation of the Russian Federation to submit tax declarations on transport tax to a tax institution in accordance with clause 357 and paragraph 1 clause 363.1 of the Tax Code of the Russian Federation.

Thus, the Tax Code of the Russian Federation does not envisage that organizations that are not recognized as tax payers of the transport tax are to submit tax declarations (tax calculations based on advance payments) on transport tax.

Situation with the property tax is not like that. Recognition of organizations as taxpayers for property tax does not depend on presence or absence of corresponding object of taxation. The organization is to submit tax declarations (tax calculations based on advance payments) to taxation bodies in concordance with clause 386 of the Tax Code of the Russian Federation regardless of whether this organization's property is regarded as taxation object or not.

As for land tax, according to the opinion of the Ministry of Finance of the Russian Federation, tax declarations (tax calculations based on advance payments) should be submitted to taxation bodies by tax payers – organizations and natural persons which are individual entrepreneurs and using land plots for entrepreneurial activity which they own by the right of property or by the right of constant (permanent) use.

2. According to the Letter issued by the Ministry of Finance of the Russian Federation on 6 March 2008 No 03-02-07/1-84 it is clarified that upon an organization operating in the territory of the Russian Federation through a separate branch the application on registration is submitted to the tax body of the place where that separate branch has been created in a month after its establishment. This procedure applies also in case if the organization itself is registered at a tax body in the territory of municipal formation where its separate branch is being formed.

3. According to the letters of the Ministry of Finance, Federal Tax Service of the Russian Federation from 12 March 2008 No ShS-6-3/162, Federal Customs Service of the Russian Federation from 23.01.2008 No 01-18/2226 the issue of application of customs processing regime in the customs territory is clarified.

According to clause 179 of the Customs Code of the Russian Federation any interested person, even if not carrying out goods processing operations personally, can obtain permission for goods processing in the customs territory. The form for information submission is established by the Order of the State Customs Committee from 15.09.2003 No 1014.

According to paragraph 1 clause 174 of the Code processing, including servicing, in the customs territory is allowed if there is a permission of a customs body. Declaration of goods imported in the customs territory of the Russian Federation, in concordance with the customs processing regime in the customs territory is possible only if there is permission for goods processing in the customs territory. A person, who obtained such permission, is liable to pay customs duties, taxes on goods placed under the customs processing regime in the customs territory. If the permission for processing is obtained by a person that does not carry out operations of processing of goods place under the customs processing regime in the customs territory himself, information on such an organization that directly conducts operation on goods (or their parts) processing, are included to paragraph 12 of the permission for processing.

Thus, tax bodies can obtain information on real supplier of goods (jobs) on goods processing in the customs territory out of the approved form.

4. According to the letters of the Ministry of Finance of the Russian Federation from 7 February 2008 No 03-05-04-01/5 and Federal Tax Service of the Russian Federation from 12 March 2008 No ShS-6-3/163 the issue on exemption from property tax of the seacrafts with nuclear electric power and seacrafts providing nuclear technological servicing. In the opinion of the Ministry of Finance of the Russian Federation, privilege of paragraph 10 clause 381 of the Tax Code of the Russian Federation also applies to self-propelled or

floating vessels with nuclear electric power installations, vessels of nuclear technological servicing, including floating nuclear heat and power plant.

5. According to the letters of the Ministry of Finance of the Russian Federation from 13.02.2008 No 03-11-02/19 and Federal Tax Service of the Russian Federation from 12 March 2008 No ShS-6-3/164 the issue on withdrawals when applying single tax on imputed income is clarified. According to the Tax Code of the Russian Federation single tax on imputed income is not applied to the kinds of entrepreneurial activity mentioned in paragraph 2 clause 346.26 of the Code, in case they are carried out within the framework of partnership (agreement on joint activity) or agreement on trustee property management, as well as in case they are carried out by tax-payers referred to as the biggest tax-payers according to clause 83 of the Code.

Criteria for Russian organization including in the list of the biggest taxpayers are established by the Order of the Federal Tax Service from 16 May 2007 No MM-3-06/308@. Specific features of the biggest taxpayers registration are approved by the Ministry of Finance of the Russian Federation from 11 July 2005 N 85n. An organization receives the status of one of the biggest taxpayers at the moment it is registered at a tax body as one of the biggest tax-payers and receiving the corresponding notification. According to explanation by the Ministry of Finance of the Russian Federation, the organization registered as one of the biggest taxpayers should transfer from paying single tax on imputed income to the general procedure starting from the beginning of the quarter following that when it received notification on registration at the taxation body as one of the biggest tax-payers.

6. According to the letters by the Ministry of Finance of the Russian Federation from 18.02.2008 No 02-14-10/359 and by the Federal Tax Service of the Russian Federation from 13 March 2008 No VE-6-5/167 issues on the procedure of expenses for compensation payments ascribing, which are envisaged by paragraph 9 clause 31 of the Federal Law from 27 July 2004 No 79-FZ "On state civil service in the Russian Federation" (on payment of four-month salary on resignation in connection with reorganization, structure change, government body liquidation). Such compensations are to be ascribed to clause 211 of the Federal Budget Code "Wages", that is they are not regarded as social payments.

7. According to the writ of the Constitutional Court of the Russian Federation from 13 March 2008 No 5-P indention 4 subparagraph 2 paragraph 1 clause 220 of the Tax Code of the Russian Federation in the version before the Federal Law from 20.08.2004 № 112-FZ came into effect is clarified.

The former version of the Tax Code of the Russian Federation envisaged that, for instance, the property is purchased for common share ownership; the sum of the tax deduction from the natural person's income tax is distributed among co-owners in accordance with their share in property.

Questionable situation arose when a natural person purchased common accommodation for himself and his underage child. That is a child became an owner not making expenses to purchase his share. In accordance with the Tax Code of the Russian Federation, property deduction can be applied either in the amount established by the Code or in the amount of expenses really made by the tax-payer to purchase the property. The question arose how to take into account parent's expenses for purchase of the share that will become property of the child. The Constitutional Court explained the following. In case such property deduction is applied within the set limit, this limit deduction is granted not to every share-holding resident, but to the object as a whole – house, flat etc. In case deduction is granted at the amount of expenses really made, indention 4 subparagraph 2 paragraph 1 clause 220 of the Tax Code of the Russian Federation (now indention 18) should be applied in connection with other statements of the Tax Codes of the Russian Federation, as well as with clauses 17, 18, 21, 28, 210 and 249 of the Civil Code of the Russian Federation and clauses 54, 56 and 64 of the Family Code of the Russian Federation. In such a context expenditures made by a parent to purchase a share for underage child in common property can be excluded while taxation of expenses really made by them within the total amount of deduction established by the law.

8. According to the letters of the Ministry of Finance of the Russian Federation from 15.01.2008 No 03-07-11/09 and Federal Tax Service of the Russian Federation 21.01.2008 No 03-00-08 it is clarified that exemption from VAT, established for property assignation, non-material assets, property rights as a contribution to charter (combined) capital of economic societies and partnerships, or share contribution in share funds of cooperative societies, is not applied to the property given to unit investment trust.

9. According to the letter of the Ministry of Finance and Federal Tax Service of the Russian Federation from 12 March 2008 No ShT-15-2/270 it is explained that at present according to the Federal Law "On lotteries" requirements for lottery equipment as well as lottery programs used while conducting stimulating and non-governmental lotteries are not established. In the opinion of the Federal Tax Service of the Russian Federation it is necessary to define distinct parameters (characteristics) of the lottery equipment, and also technically possible percent of winning. This view is noticeable since legislative uncertainty as to lottery equipment creates opportunities for possible abuses and results in the loss of taxation base.

10. According to the Direction of the Government of the Russian Federation from 7 March 2008 No 288-r Conception of the control system over goods export the customs territory of the Russian Federation and control over application of zero duty rates to value added tax while goods export (further - Conception) was approved.

A number of ministries, Federal Tax Service included, are to prepare a plan of actions to fulfill the Conception and approve it. Conception was created within the framework of the Federal Target Program "Electronic Russia" and envisages use of electronic paper turnover while organizing information interaction between the participants of foreign economic activity, customs and taxation bodies; automatic creation of information necessary to ascertain real goods export on the basis of information in the primary sources; quick offer of information on actual exporting of goods mainly in the form of electronic documents of legal value by customs bodies to the participants of foreign economic activity; quick exchange of information necessary to implement customs and tax control etc.