

## RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES 05'2009

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## BASIC DEVELOPMENTS AND TRENDS

*In May, Prime Minister Vladimir Putin has even more transparently than before, hinted to journalists about his plans for 2012, though having given no positive response to the direct question, whether Dmitry Medvedev will participate in the election campaign for the second term. Mr. Kudrin, Vice-Premier, Minister of Finance was criticized by both, Putin and Medvedev for some comments, although it is believed that there will be no serious consequences to Kudrin due to that criticisms. Dmitry Medvedev has initiated the adoption of the law on the appointment of the Constitutional Court by the RF President, what provoked criticism on the part of the current Constitutional Court Chairman V. Zorkin.*

*President of Russia Dmitry Medvedev has signed a Budget Message on the economic priorities of the Russian fiscal policy in the situation of financial crisis. The Russian government approved the major trends of tax policy for 2010 and estimates for the term of 2011-2012, which contain measures to reduce the tax burden on the economy.*

*In April, the economic situation was developing under the impact of trends, effective since October 2008. A slowdown was observed in practically all economic activities. The decline in industrial production within January-April versus the relevant period in 2008 amounted to 14.9%, including the decline to 22.0% in manufacturing production, to 15.8% in investment in fixed capital and to 2,2% in retail trade turnover. The overall situation is characterized by the rapid unemployment growth at the background of wages reduction. In April, the number of unemployed (estimated by International Labor Organization methodology) has reached 7.7 million people, or 10.2% of the economically active population. As of January-April 2009 results, the real incomes of the population have dropped down by 1.0% and wages decreased by 1.4% as compared with the relevant period of the last year. There is an increase of expenditures for food against the background of the formation of the pending demand for nonfood goods and services.*

*Surveys of industrial enterprises have not recorded neither positive, nor significant negative changes in key industrial indicators in May. The demand continues to decline at the same rate, its volume is suitable only to 23% of enterprises. The production scope has overcome the April downfall, which was recorded by Rosstat and has returned to the old rate of decline. Industrial companies do not plan significant changes in prices within the coming months. Companies are beginning again to use the reduction in prices to inspire demand.*

*As of April results, the CPI in Russia amounted to 0.7%, which is twice lower than the relevant indicator of the same period of preceding year. Thus, the growth in consumer prices in January-April reached 6.2%, which is also lower (by 0.1 p.p.) of the growth rate in 2008. Over the past two months, the volume of foreign currency reserves has remained practically unchanged, having made USD 383.9 billion at the end of April. The real effective exchange rate has grown by 2.4%. For two consecutive months (March and April) the value of the two-currency basket was declining: at the end of April, its price was RUR 38.02. Since May 13, the Bank of Russia has downgraded the refinancing interest rate by 0.5 percentage points up to 12% per annum. At the same time, the interest rates on loans and deposits of commercial banks in the RF Central Bank were reduced.*

*Increasing global oil prices during the month of May, the growth of the global stock indices, the positive macroeconomic news from the United States, as well as downgrading of the refinancing interest rate by the RF Central Bank, the approval of the new anti-crisis measures for 2009 by the RF government, the stabilization of RUR have contributed to the*

*growth of the Russian stock market. The growth of the MICEX index as of the month results has reached 15%. Volatile trends were observed in the domestic market of corporate bonds. On the one hand, the volume of domestic bond market got stabilized and positive trend of corporate bonds index growth continued. Significant increase was noted in the number and total volume of recorded issues; among them, for the first time in the past few years there have been registered bonds, denominated in foreign currencies. On the other hand, there was a significant increase in the number of actual defaults.*

*The major result of the Russian foreign trade development in the 1st quarter of 2009 is the sustained positive trade surplus. Herewith, never in the first three months of the current year the trade surplus has dropped below USD 4.6 billion, which was first registered in December last year.*

*In the 1st quarter of 2009, the growth in the net debt both, on housing, as well as on mortgage credits has been stopped. However, the share of overdue arrears in the debt balance is increasing, forcing the banks to increase reserves for tentative losses. Presidium of the RF Government has approved a draft law, clarifying the rules for gas exports and export trade in liquefied natural gas for the companies of different ownership forms.*

*Within late April - May the following explicit amendments were introduced in the economic legislation:*

- social benefits scope was extended;*
- a program is designed to promote market competition in Russia;*
- amendments are made to the laws on the federal budget and budget funds for healthcare and social insurance.*

## THE POLITICAL AND ECONOMIC RESULTS OF MAY 2009

S.Zhavoronkov

*In May, RF Prime Minister V. Putin hinted to media representatives - in an even more explicit manner than before – on his plans for the year 2012, while at the same time offering no positive answer to the directly put question as to whether D. Medvedev was going to run for a second presidential term. RF Vice Prime Minister and Minister of Finance A. Kudrin was criticized by both Putin and Medvedev for some of his statements; however, it is believed that this criticism is not going to have any serious consequences for Kudrin. D. Medvedev initiated the adoption of a law envisaging the appointment of the Chairman of the RF Constitutional Court (CC) by the RF President. This initiative immediately induced V. Zor'kin, current Chairman of the CC to sharply criticize the existing political system. D. Medvedev's Budget Message, while recognizing the grave nature of the current crisis, although it acknowledged the necessity to economize on budget expenditure in some areas and to support macroeconomic stability, on the whole justified the overall growth of budget expenditure in 2009 designed to cover the cost of anti-crisis measures.*

During his visit to Japan, RF Prime Minister V. Putin hinted that in 2012 he was planning to return to the post of RF President. In answering the question of the possibility of D. Medvedev running for a second term in office, he declared as follows: “Depending on the effectiveness of our work, President Medvedev and I will take decisions about what to do in the future, he and I. As for his personal outlook, you better ask him about it, but I repeat, I have known him for a long time and I know he will look at his political future based on the interests of the country and on the results of our joint work. The situation itself – when the acting President does not declare his intention to run for a second term in office, while the acting Prime Minister doubts it – is telling enough. Besides, one of the key words in this context is “honest” – that is, true to his promise.

In May, D. Medvedev presented the main outline of this country's budgeting policy for 2010 – 2012 in his Budget Message. Medvedev stated that the crisis could last longer than it had been initially forecasted, and that an even deeper drop in GDP could be expected in 2009. “Budget deficit will be no less than 7 % of GDP, and this is yet an optimistic estimation”. (At first, the RF Ministry of Economic development and Trade had forecasted that in 2009 GDP would drop by 2.2 %, and then - by 6 %). Among the measures that would have to be taken, Medvedev named the need to fulfill social obligations, to lower budget deficit, to look for an economically justified level of tax burden and tax incentives for increasing production efficiency, and to investigate the possibilities for lowering the tax load on enterprises with regard to pension and medical insurance contributions.

In this connection, the President said that it was better to stay conservative in forecasting the prices of energy carriers. (“The prices of oil may prove higher, and that would be better for us, of course, but we have no right to put compliance with our liabilities at risk.”). However, the generally quite reasonable tone of the Message was in sharp contrast with the proud declaration that in a situation of crisis we were increasing - and not cutting down - budget expenditure; and besides, there was no mention at all as to what was intended to do after the available financial reserves were exhausted.

Aide to the RF President A. Dvorkovich, when speaking in May, said that he could not rule out the possibility of budget deficit further increasing in 2009, and then in 2010. “It can be, say, 9% of GDP”. Dvorkovich called for cuts in budget expenditure.

In May, RF Vice Prime Minister and Minister of Finance A. Kudrin was twice the focus of attention in course of the ongoing discussions. In one of his speeches he declared that in the next 10 – 50 years one could hardly expect the foreign economic situation to be as good as it had been in recent years. Some time later, D. Medvedev warned against unsubstantiated economic forecasts, and hinted at Kudrin: “When some of my comrades, including those in the government, say that Russia will not overcome the crisis in 50 years, it is unacceptable. If you think so, then go and find another job.” And on 28 May, A. Kudrin criticized the “dead-end” economic policy of Belarusian authorities and suggested that by the next autumn Belarus might become insolvent. This declaration by Kudrin made A. Lukashenko hysterical, and this time Kudrin was corrected by Prime Minister V. Putin, who urged him to abstain from making “:extreme estimations”. Despite all this, A. Kudrin’s position, in our opinion, remains stable. In his comments concerning Belarus, Kudrin simply assumed a typical “bad cop” role – because Putin himself is also displeased with the conduct of A. Lukashenko, who fails to fulfill his promise – which is of a high psychological significance for Russian authorities - to recognize the independence of South Osetia and Abkhazia, and so the Russian authorities once again are resorting to the use of economic levers of influence. As for Medvedev’s rhetoric – firstly, it is of less significance than that of Putin, and secondly, the importance of the RF Ministry of Finance for the RF Government can hardly be overestimated, and Kudrin, on whose initiative the Stabilization Fund was created, has many times earned the praise of both V. Putin and D. Medvedev.

The month of May also saw the unraveling of a big scandal involving the law enforcement agencies. In Moscow, the young head of the Tsaritsino Regional Administration for Internal Affairs D. Yevesnikov got drunk and opened fire at a supermarket, killing three people and wounding six. Yevesnikov was placed under arrest, and then many peculiar facts became publicly known - that his rapid career growth could not be rationally explained, that the gun he had used in the shooting incident was searched for by the police in connection with some previous crimes, and so on. As a result, D. Medvedev signed an edict concerning the dismissal of Head of the Moscow City General Administration for Internal Affairs V. Pronin, and the official media started an active discussion of the theme of law violations being committed by law enforcement officials and personnel.

In May, D. Medvedev came forth with the declaration that the Single State Automated System for Registering the Production and Turnover of Alcohol (YeGAIS) might be abolished. In this connection, Medvedev remarked that even prior to putting this system in operation he had been “fully convinced that would achieve nothing”. It should be reminded that the introduction of YeGAIS in 2006 resulted in deficit of alcohol products – because the authorized state company failed to print the new excise stamps in due time; the cost of installation and servicing of the equipment turned out to be substantial; and any attempts to switch over the system into fully automated mode caused its collapse, and so the system is still operating in a peculiar semi-automated mode, being backed by paper documentation. So, this step on the part of the authorities can only be praised.

At the same time, however, D. Medvedev confirmed that, on 1 June 2009, the ban on gaming business will come into force. Initially it had been planned that gaming business would still be operating in four zones, but three years after the adoption of the relevant law back in 2006 no such zones were created. The populist theme proved to be the strongest as far as that issue was concerned, although it is already obvious that this law needs to be altered.

In May, the RF State Duma approved the amendments to the Law “On the Constitutional Court”, submitted for its consideration by D. Medvedev, whereby the Court’s head would no longer be elected by the judges themselves – as it had been since c 1991, but instead be appointed by the Council of the Federation at the suggestion of the Head of the State. In fact,

last February, when V. Zor'kin was reelected to the post of the head of the Constitutional Court, 14 out of 19 judges supported him. The rumors that the Kremlin then wished to see someone else in this position had no sufficient grounds (suffice to say that the remaining five votes were distributed between another two candidates). It is quite another matter that the previous election of V. Zor'kin was mingled with intrigue – he was ahead of the then Chairman of the Constitutional Court M. Baglay by one vote only; besides, the Kremlin's standpoint on the matter could well have changed since February.

The new Law will come into force in a month, and this means that it is not unlikely that soon Russia will have a new Chairman of the Constitutional Court.

The present head of the Constitutional Court V. Zor'kin, who very recently was actively defending the Russian regime and explaining that authoritarianism helped to protect the rights of citizens, this time criticized the authority at the forum of the judges of the Supreme Courts of Russian and Germany. “The citizens of Russia, as before, want democracy, the rule of law state, pluralism... But they do not want such talks to mask something else – or something quite opposite to it... Civil society in Russia is not legally capable, because this country has neither the legally capable citizen who knows how to defend his rights, nor a developed political system with balances and counterbalances... Today the laws on many basic issues are adopted by parliament privately, without coordinating them with the people... What disturbs me most of all is that the Constitution in Russia should not be turned into a fraud.” Thus, the special case of Zor'kin once again confirmed – at the highest level – the well-known rule that violation of human rights disturbs most the very person whose rights are being violated.

As for the estimation of this situation on the whole, the new Law “On the Constitutional Court” is in itself a vivid confirmation of the fact that the Russian authorities are still following the course towards building “the vertical of power” and do not want any division of powers. In fact, this outrageous draft law was by no means provoked by any considerations of political expediency – the Court's former head had been quite obedient until his position was directly attacked.

In May, at Khabarovsk a new EU-Russia summit was held. At the summit meeting, D. Medvedev attempted to gain concessions by using hard words. He began by saying that Russia could not promise Europe that next winter there would be no repetition of natural gas shortages. Besides, he confirmed Russia's very negative attitude to the Energy Charter: “Russia is not a signatory of the Energy Charter and does not intend to join the Energy Charter in its existing reading. Russia is not a signatory of the Treaty to the Energy Charter and will not apply it, to which effect the corresponding international notifications have been made.” (In 1994, Russia did sign the Energy Charter, but it was not ratified, and in the mid-2000s Russian authorities declared that they did not comply with this document).

President of the European Commission Josë Manuel Barroso promised to discuss Russia's proposals, but he once again stated that the EU was not going to renounce the Energy Charter (by way of interpreting the summit's results, Aide to the RF President A. Dvorkovich declared that Russia might not insist on signing a new agreement if the current version of the Charter was substantially revised).

In our opinion, Russia's criticism of some of the Charter's provisions – the access of the participant states' companies to one another's gas transport infrastructure and the protection of foreign investments in the energy sphere – is aimed at those fundamental points on which the EU can hardly be expected to change its stance.

Besides, in May there occurred some cadre replacements. The RF President's Plenipotentiary Representative in Far-Eastern Federal Okrug O. Safonov, formerly RF Deputy Minister of Internal Affairs, was dismissed from his post. In his place V. Ishaev

was appointed, who until recently was Governor of Khabarovsk Krai, while his former deputy V. Shport was appointed Governor. Thus, it can be said that in this case this new appointment has been an upward promotion for Ishaev, because he was allowed to keep his “successor” in the region. The post of Governor of Irkutsk Oblast which had been vacant since I. Yesipovsky’s death in a helicopter crash was given to that region’s representative in the Council of the Federation D. Mezentsev (who, however, has his roots in St. Petersburg). This appointment was an unmitigated humiliation for the RF President’s Plenipotentiary Representative in Siberian Federal Okrug A. Kvashnin, who had presented two other candidatures to the President for his approval (he would not have done this if he had had sound information concerning the Kremlin’s intentions), and so there have been rumors of his possible dismissal.

Some important appointments also took place in the army, bearing witness to further strengthening of the position of Minister of Defense A. Serdiukov. Lieutenant General V. Shamanov, whom the Minister had reinstated to the army in the position of Head of the Main Administration for Combat Training and Military Service of the Armed Forces, was now appointed Commander of Airborne Forces (known as VDV), while the former Commander V. Yevtukhovich was retired. The Director of the Federal Defense Order Service (Rosoboronzakaz) was also replaced. The Service’s former director S Maev was elected Chairman of the Non-Governmental Defense Organization ROSTO. The new appointee to the post of director of Rosoboronzakaz is Advisor to the Minister of Defense A Sukhorukov who, like Minister of Defense A. Serdiukov, is an ex-official of the RF Federal Tax Service. ●

## INFLATION AND MONETARY POLICY

N.Luksha

*As of April results, the CPI in Russia amounted to 0.7 per cent, which is twice lower than the relevant indicator of preceding year. Therefore, the growth of consumer prices within January-April has reached 6.2 per cent, what is also lower (by 0.1 per cent) than the growth rate in the relevant period of 2008. In the last two months the volume of the international reserves has been practically sustained, having made USD 383.9 bln in late April. The real effective ruble exchange rate has increased by 2.4 per cent. Within two consecutive months (in March and April), the value of the two-currency basket has been decreased: by late April it has amounted to RUR 38.02. At the same time, Interest rates under credits and deposits of commercial banks with the RF Central Bank have been decreased.*

The consumer price index in April made 0.7 percent and was for the first time in this year lower than the CPI in the relevant period of preceding year 2008 (See Fig. 1). The greatest input in prices growth in April was made by non-food products by 1 per cent, which is nevertheless lower than in March, when the relevant commodities have grown by 1.4 per cent. Like in March, the utmost growth rates were observed for medicines (+3.3 per cent), tobacco (+2 per cent), washing and cleaning detergents (+1.8 per cent). Herewith, in April there was further reduction in gasoline (-1.4 per cent).

In April, the growth rate of foodstuffs has slowed down (0.7 per cent against 1.7 per cent in March). It has been greatly dependant on price sustainability for granulated sugar (In March, the growth made +6.4 per cent), fruit and vegetables price downgrading (-0.1 per cent against +4.5 per cent), milk and dairy products (-0.1 per cent against +0.2 per cent). Herewith, in April there was further reduction in sunflower oil prices (-2.7 per cent). The utmost growth was observed in eggs prices, which have ceased to decline (+4.3 per cent), fish and seafood (+2 per cent), alcohol (+1 per cent) and pasta (+0.9 per cent).

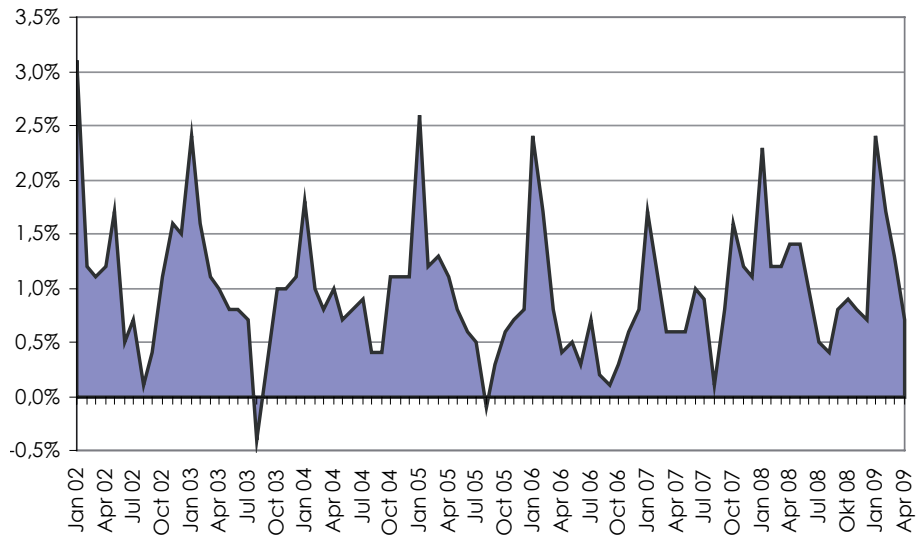
The growth of prices for commercial services has declined two-fold, having amounted as of month results to 0.3 per cent. The utmost growth was noted in prices for healthcare services (+1.9 per cent) and pre-school education (+1.5 per cent). In view of the forthcoming summer vacations, prices for international tourism have declined by 1.4 per cent; passenger transportation services have been also downgraded by 0.1 per cent .

Therefore, as of April results, the inflation rate in Russia continued to slow down, having only slightly overrating the relevant indicators of preceding year. The price growth rate decline was observed in all types of goods and services. As we were estimating in preceding surveys, the monetary supply growth rate at the beginning of the current year (within January-March the decline of the monetary base supply  $M_2$  has made 10.2 per cent against its expansion by 0.8 per cent within the relevant period of 2008), as well as consumer demand decrease have resulted in inflation decline. According to our estimates, CPI in may will be lower than the relevant indicator of 2008. Nevertheless, the Ministry of Economy wouldn't amend the estimates of the official annual inflation rate, established at 13 per cent for the current year.



The basic CPI<sup>1</sup> in April 2009 has made 0.8 per cent (versus 1.3 per cent in the relevant period of preceding year).

As of April 2009 results, the monetary base (in broad definition<sup>2</sup>) has grown by 4.3 per cent and amounted to RUR 4,338.5 billion. As of April 1, 2009, the volume of the monetary base in a broad definition has reached RUR 4,298.8 bln. Let us consider the dynamics of the monetary base in broad definition by components.



Source: Russian Statistical Agency

Fig. 1. The Growth Rate of the CPI in 2002 – 2009 (% per month)

As of May 1, 2009, cash in circulation with regard to the fund balances in credit organizations made RUR 3.8 trillion (growth by 4 per within the month), correspondent accounts of credit organizations in the Bank of Russia made RUR 471.5 billion (+9.2 per cent), mandatory reserves made RUR 32.5 billion (-2.4 per cent), banks' deposits in the Bank of Russia made RUR 159.6 billion (+23.4 per cent), the value of shares of the Bank of Russia with credit organizations made RUR 15.3 billion (+23.4 per cent).

Within April 2009, growth of excessive reserves of commercial banks was continued<sup>3</sup>, this indicator has risen up by RUR 38.9 bln, or 6.4 per cent. The situation in the bank liquidity remains sustained, what is confirmed by insignificant scope of direct REPO transactions between the Central Bank and commercial banks, as well as relatively low rates at the interbank crediting (an average rate for overnight interbank loans in April has made 8.6 per cent per annum).

However, arrears continued to grow on all types of credits. In this regard, in order to prevent a second wave of crisis, A. Ulyukaev, the first Vice-Chairman of the Central Bank in late May has informed on the new measures to support the banks' liquidity. In the near future credit organizations will be able to get refinancing from the Bank of Russia under security of gold, mortgage loans, as well as under credits to small and medium businesses.

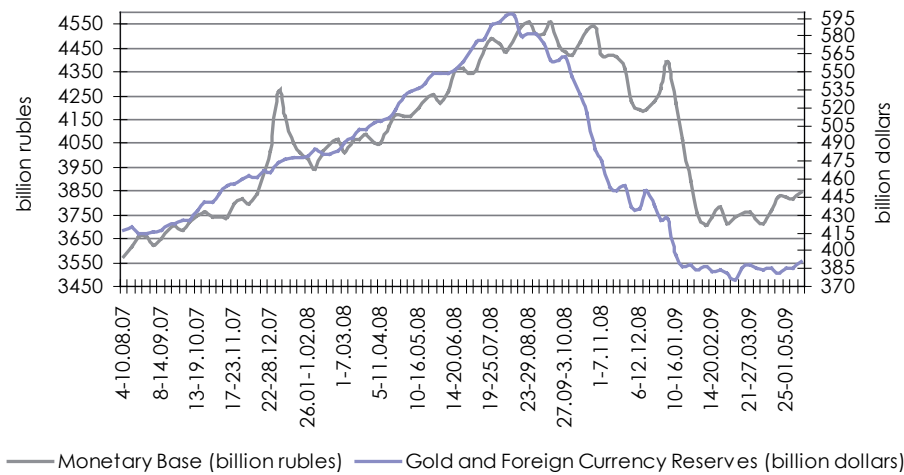
In April, the growth of the volume of cash in circulation by 4 per cent and reduction of mandatory reserves by 2.4 per cent has led to reduction of monetary base in narrow definition (cash plus the required reserves)<sup>4</sup> by 3.9 per cent (see Fig. 2). Herewith, the volume of

1 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.

2 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.

3 The excessive reserves of commercial banks with the RF CB refers is the amount of correspondent accounts of commercial banks, their deposits with the RF CB and the CB bonds of commercial banks.

4 We would like to remind, that the monetary base in the broad definition is not a monetary instrument, it reflects the obligations of the Bank of Russia in national currency. The monetary base in narrow definition is a monetary instrument (one of indicators of the volume of monetary offer), which is under total control of the CBR.

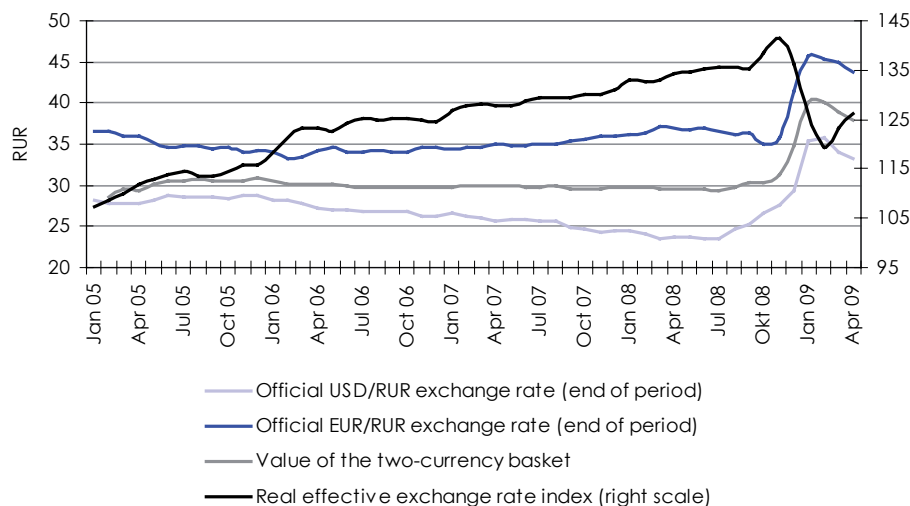


Source: RF Central Bank

Fig. 2. Changes in the Monetary Base and in the Gold and Foreign Currency Reserves ob 2007 – 2009

indicator since September 2008. In April the growth of RUR real effective exchange rate made 2.4 per cent. The index of real effective exchange rate as of April results amounted to 126.3<sup>1</sup>, having grown as compared with March indicator by 2.96 (see Fig. 3). The key factor of RUR strengthening in April was oil prices growth.

As of April results, the official rates of USD and Euro against RUR have declined. The USD rate has declined from RUR 34.01 to RUR 33.25, or by 2.2 per cent. The rate of Euro by the end of April declined from RUR 44.94 to RUR 43.84, or by 2.4 per cent. As a result, within April, RUR has increased by RUR 0.91 in regard to the two-currency basket, while the value of the two-currency basket<sup>2</sup> has declined to RUR 38.02. In April the amount of foreign currency, purchased by the RF Central Bank, has reached its peak since August 2008. Thus, in the framework of foreign exchange intervention, the Bank of Russia has carried



Source: RF Central Bank, author's estimates

Fig. 3. Indicators of Ruble's Exchange Rate Dynamics

international reserves of the Central Bank of Russia in April remained almost unchanged, amounting to USD 383.9 bln on May 1, 2009. In general, within the I-st quarter gold reserves decreased by 10.1 per cent, which is three times lower than within the previous quarter.

According to A. Ulyukhaev, in April 2009, the net outflow of capital amounted to USD 2 bln. (against USD 2.7bln in preceding month), what is the lowest

indicator since September 2008. In April the growth of RUR real effective exchange rate made 2.4 per cent. The index of real effective exchange rate as of April results amounted to 126.3<sup>1</sup>, having grown as compared with March indicator by 2.96 (see Fig. 3). The key factor of RUR strengthening in April was oil prices growth.

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On May 13, 2009, Bank of Russia decided to reduce the refinancing rate by 0.5 percentage points, up to 12 per cent per annum. In addition, from May 13, the RF Central Bank has reduced interest rates on credit and deposit operations by 0.25-0.5 per cent.

Due to the fact that the refinancing interest rate is the basic interest rate for all credit operations of

1 The level of 2002 is taken for 100.

2 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.

the Central Bank, its amendment has resulted in corresponding decrease in other interest rates of the RF Central Bank (see Table 1.).

Table 1

RF CENTRAL BANK INTEREST RATE FOR CREDIT OPERATIONS

Credit type	Interest rate (% per annum)	
	Before amendment	After amendment
Overnight	13	12.5
Credit, secured by assets or warranty	12 - up to 90 calendar days; 12.5 - from 91 to 180 calendar days	11.5 - up to 90 calendar days; 12 - from 91 to 180 calendar days

Source: RF Central Bank

In addition, the interest rate for overnight transactions of «foreign currency swap» (its ruble part) was reduced by 0.5 percentage points to 12 per cent per annum, while the rates on direct REPO operations for a period of 1 day and for a period of 7 days were also reduced by 0.5 percentage points to 11 per cent per annum. RF Central Bank has also reduced the rate by 0,5 percentage points on deposits: deposits, made under standard conditions of «tom next», «spot next» and «on demand» - up to 6.75 per cent per annum, «one-week » and «spot-week» rates were reduced to 7.25 per cent per annum. Fixed rates on lombard credits for any term have been reduced from 11.5 per cent to 11 per cent per annum.

Herewith, the Bank of Russia has lowered the rates on liquidity, provided through the auctions:

- Operations of direct REPO:
  - o for a period of 1 day - from 9.5 per cent to 9 per cent per annum;
  - o for a period of 7 days - from 10 per cent to 9.5 per cent per annum;
  - o for a period of 90 days - from 11 per cent to 10.75 per cent per annum;
  - o for 6 months - from 11.75 per cent to 11.25 per cent per annum;
  - o for a period of 12 months - from 12.25 per cent to 11.75 per cent per annum;
- On lombard credits:
  - o for a period of 14 calendar days - from 10 per cent to 9.5 per cent per annum;
  - o for a period of 3 months - from 11 per cent to 10.75 per cents per annum;
  - o for 6 months - from 11.75 per cent to 11.25 per cent per annum;
  - o for a period of 12 months - from 12.25 per cent to 11.75 per cent per annum.

Therefore, the RF Central Bank has taken steps to mitigate credit and monetary policy. Remember, this is already the second rate reduction, made in this year: On April 24 the Bank of Russia has also reduced the refinancing rate by 0.5 percentage points. The basic reason for lowering interest rates was the incentive of the RF Central Bank to reduce the cost of resources, provided by the Bank to credit organizations, under the assumption that it will eventually urge the reduction of the credits cost to the real sector. However, credit risks still remain high so that the decrease of the basic interest rate could result in corresponding decrease of interest rates on credits to non-financial sector.

The reason for the repeated downgrading of interest rates was the decline in inflation and devaluation expectations. For the second consecutive month, there is a declining trend in regard to inflation: according to the results of April, from May 1 to 18, the rate of inflation fell down twice then the relevant indicator in 2008 (respectively 0.7 per cent versus 1.4 per cent and 0.4 per cent versus 0.8 per cent). Oil prices growth in the global market has contributed to RUR strengthening and decreased devaluation expectations. Bank of Russia does not exclude that in case of further RUR strengthening and inflation decrease the Central Bank will continue to downgrade the interest rates.

## FINANCIAL MARKETS<sup>1</sup>

N.Burkova, E.Khudko

Growing global oil prices during the month of May, the growth of the world stock indices, positive macroeconomic news from the United States, as well as decreasing refinancing interest rate of the RF Central Bank from May 14, the approval by the Russian Government of the new anti-crisis program for 2009, and ruble stabilization have contributed to the growth of the Russian stock market. However, the information on financial issues in a number of global leading car manufacturers, the downgrading of credit rating in Japan, as well as the increased inflation in the Russian Federation and information on the net loss of the RF several major companies in the 1-st quarter of 2009 have limited the growth rate quotations. There were volatile trends in the domestic market of corporate bonds was growing. On the one hand, the volume of domestic bond market got stabilized and there was observed a positive trend of corporate bonds indices. The number and total volume of recorded issues has grown, and for the first time in the past few years there were registered bonds, denominated in foreign currencies were registered. On the other hand, a significant increase in the number of actual defaults has increased.

### Government securities market

During May, information on reducing the refinancing rate at 0.5 percentage points, strengthening of the ruble and the prevalence of positive expectations in regard to domestic financial markets of Russia led mainly to the dynamics of falling profitability of Russian government foreign currency bonds. Ruble-denominated government bond market in May was characterized by moderate downward trends in profitability against the background of

increasing activity in the secondary OFZ market.

As of May 24, the Russian Eurobonds RUS-30 yield to maturity has decreased as compared with the level of April 26 from 8.53 to 7.51 per cent per annum (by 11.96 per cent), RUS-28 – from 8.63 per cent to 8.06 per cent per annum (by 6.60 per cent), RUS-18 – from 5.75 to 5.01 per cent per annum (by 12.87 per cent) and RUS-10, on the contrary, has grown from 3.82 per cent to 5.35 per cent per

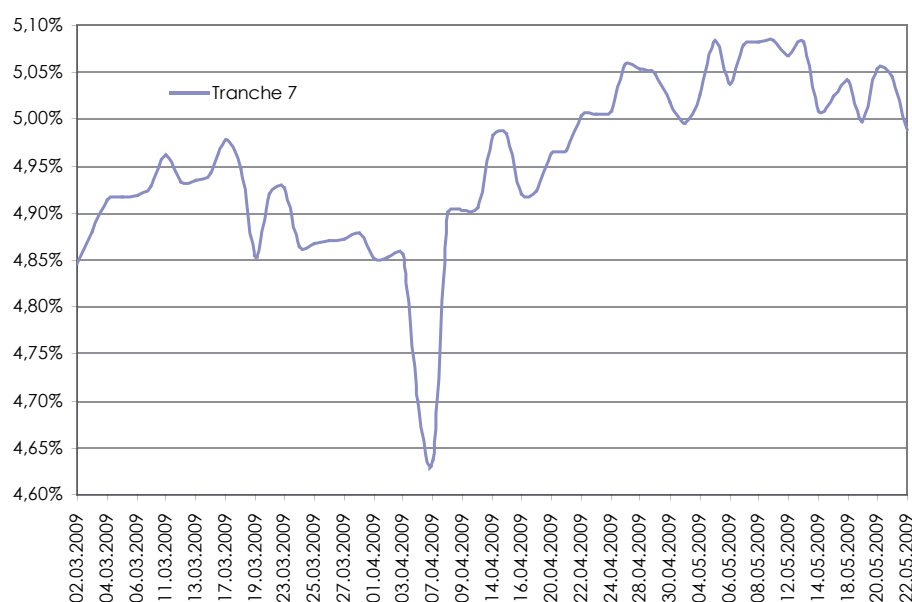


Fig. 1. Minfin bonds' yields to maturity in March – May 2009

<sup>1</sup> In the course of preparation of the survey, there were used analytical materials and surveys published by the "Interfax", MICEX, RTS, RF Central Bank and the materials presented at web sites of Russian issuing companies.

annum (by 40.05 per cent). As of the same date, the downgrading trend was also observed in the yields of external currency debt bonds. Thus, the yield to redemption of the seventh tranche of external currency debt bonds has decreased from 5.01 to 4.99 per cent per annum (by 0.4 per cent) (see Figs 1-2).

Within the period from April 27 to May 26 the total turnover of the OFZ secondary market amounted to approximately RUR 10.86 billion with an average daily turnover of RUR 0.6 billion (about RUR 12.13 billion with an average daily turnover of RUR 0.51 billion in April), what corresponds to the growth of an average monthly turnover over 18 per cent.

Within April 27 – May 24, there were three auctions on additional OFZ placement (25064 series). Thus, two auctions on additional placement of OFZ series 25064, for the amount of RUR 7 billion and series 26 064 for the amount of RUR 4 bln, planned for April 29, were recognized as invalid. However, on May 20, there was an auction on additional OFZ placement, series 25064 for the amount of RUR 4 bln, actual placement volume reached RUR 3.06 bln (i.e., 76 per cent of the issue) with an average weighted yield of 12.30 per cent per annum).

As of March 24, the OFZ market has amounted to RUR 1088.4 bln at face value and to RUR 915.01 bln at the market value. The duration of the GKO-OFZ market portfolio has made 1849.26 days, having grown (by 30.83 days) as compared with the preceding month (as of April 26).

**Stock market**

*Stock market situation*

Improved quotations of the world oil prices, the growth of the world stock indices, reducing the refinancing rate of the RF Central Bank from 14 May (up to 12 per cent per annum), the ruble strengthening, the submission of the new program of anti-crisis measures for 2009 of about RUR 800 billion by the Russian Government, subordinated credits to a number of banks by Vnesheconombank, the increase in net income of «Gazprom» by 11 per cent as of 2008 total results, despite the negative domestic news related to the disclosure of information on the net losses of several Russian major companies in the 1-st quarter of 2009, in particular «Rosneft» (RUR 5,7 billion), the withdrawal of licenses from several banks, have had a certain positive impact on the investors' expectations and have contributed to the growth of the Russian financial market in May.

All those factors have urged the upgrading of the most liquid securities in the Russian stock markets (by 10-30 per cent on average), as well as the majority of MICEX market stock indices growth as of the month results (See Table 1)..

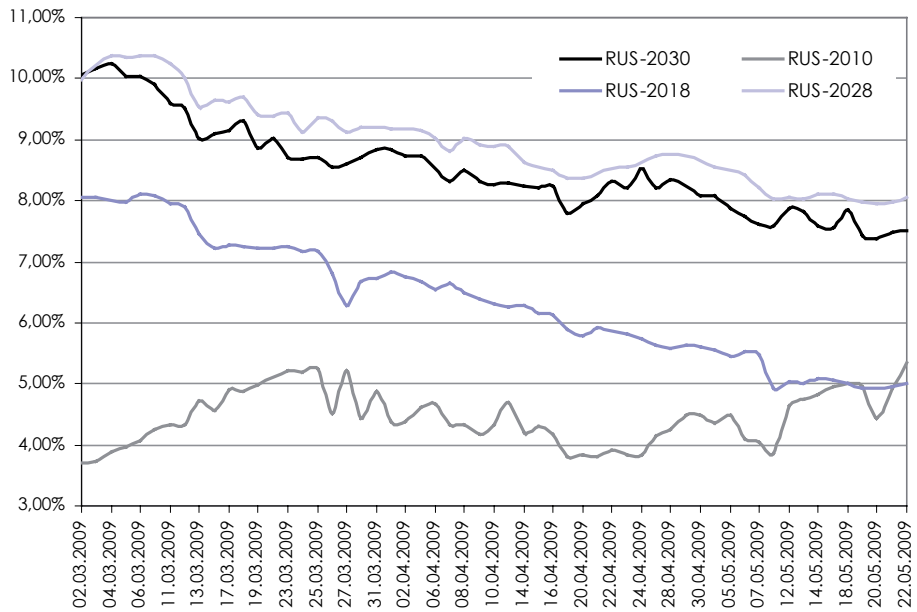


Fig. 2. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2018, 2028 and 2030 in March - May 2009

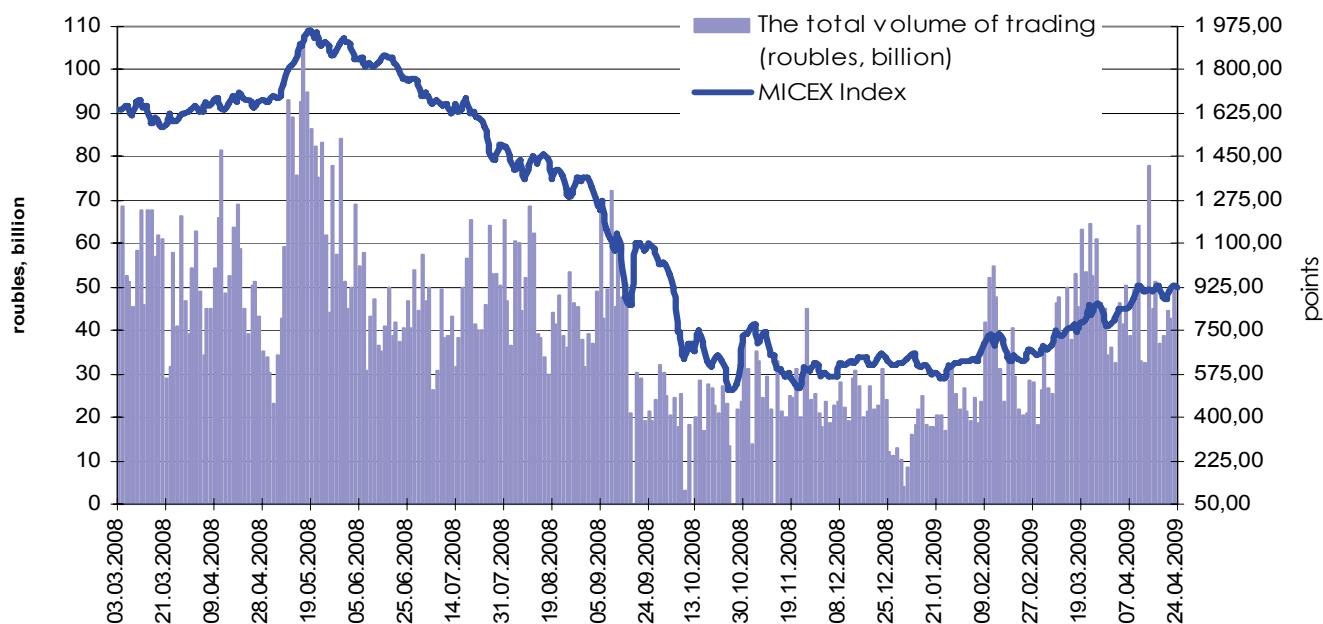


Fig. 3. Dynamics of MICEX Index and trading volume

Throughout May, a general growing dynamics was observed in the Russian stock market (Fig. 3). Herewith, there were short-term corrective trends in the MICEX index. The minimum value the MICEX index has reached on May 5, having downgraded to 957.05 points (787.22 points in the preceding month). The maximum value the MICEX index has reached on May 20, having reached 1,094.73 points (932.90 per cent points in the preceding month).

In general, within the period from April 27 to May 24, the MICEX index has grown by 16 per cent, what makes about 151.58 points in absolute terms (within the year, from May 25, 2008 to May 24, 2009, the MICEX index has downgraded by 57 per cent). Over the same period the turnover of trades in shares, included in the MICEX index, made about RUR 1 061.83 bln at an average daily turnover of RUR 58.99 bln (against RUR 1 144.42 billion with an average daily turnover of RUR 47.68 billion in the preceding period). Therefore, the investors' daily activity in the stock market in May has increased as compared with the preceding month by 24 per cent. The indicators of maximum and minimum daily turnover in the market trades in May made, accordingly, RUR 87.39 bln (as of May 20), and RUR 38.62 bln (on May 4).

As of the month results (from April 27 through May 24), the majority of "blue chips" securities have shown an upgrading trend. The leaders of the upgrading rates were "Sberbank of Russia", and "VTB Bank", the value of which has grown by 44.32 and 38.99 per cent, accordingly. Some lower growing rates were observed about the shares of "Tatneft" (by 30.3 per cent), GMK "Nornickel" (by 13.23 per cent), "Rosneft" (10.83 per cent), and Gazprom (by 19.7 per cent). They were followed by "Gazprom Neft" (by 30.07 per cent), LUKOIL (by 6.3 per cent), "Surgutneftegas" (by 31.96 per cent) and "Mosenergo" 3.36 percent). Herewith, "Rostelecom" shares were downgrading (by 18.14 per cent). (See Fig. 4).

In May the MICEX turnover leaders were: "Sberbank of Russia" (34.45 per cent of the total turnover), "Gazprom" (24.72 per cent of the total turnover), "VTB Bank" (6.36 per cent), GMK "Nornickel" (6.32 per cent) and "LUKOIL" (6.09 per cent). Herewith, significant increase in transactions in the shares of VTB Bank has led to the ousting them by «Rosneft» five leaders and places them to the third place in the list. The total share of transactions with the shares of the five «blue chips» was about 77.94 per cent (all «blue chips» - 83.97

per cent) of the total trades in shares at the MICEX stock market during the period from April 27 to May 24.

According to MICEX information, as of May 24, the top five leaders of the domestic stock market in terms of capitalization, estimated on monthly average results, were: “Gazprom” – RUR 3 365.19 bln (RUR 2 925.1 bln in April), “Rosneft” – RUR 1 646.19 bln (RUR 1 448.88 bln in preceding month), “LUKOIL” - RUR 1 267.89 bln (RUR 1 074.92 bln in preceding month), “Surgutneftegas” - RUR 847.81 bln (RUR 863.71 bln in preceding month) and “Sberbank of Russia” - RUR 572.49 bln (against RUR 458.29 bln).

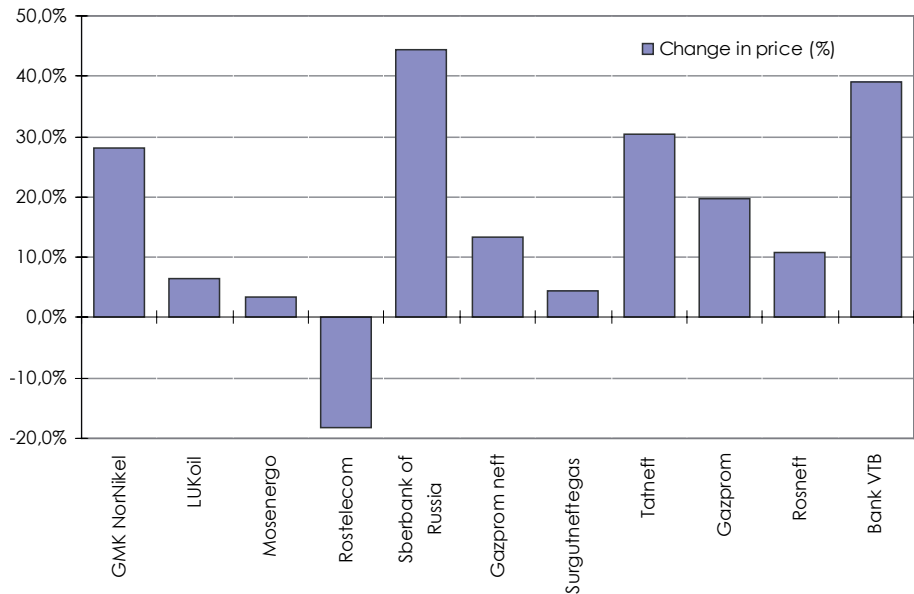


Fig. 4. Dynamics of the Russian Blue Chips from April 27 to May 24, 2009

#### *Futures and Options Market*

In May, the activity of investors in the short-term MICEX market has significantly decreased (by 40 per cent) as compared with the preceding month. Thus, in the period from April 27 through May 22 the total turnover in the MICEX (futures) market made approximately RUR 88.6 bln (2878 of transactions, 1.95 mln of contracts), against approximately RUR 48.73 bln (3,101 transactions, 1.27 mln of contracts) in April. The largest volume of trading in April as a month earlier, was observed in the futures RUR/USD, amounting to RUR 64.28 billion (170 transactions, 1.93 mln of contracts). Herewith, prices of futures contracts, concluded in the current month for RUR/USD futures in the short-term MICEX market were made within 32- 33 for June, 33.5-34 RUR/USD for December. Thus, we can conclude that investors' expectations regarding the growth of the dollar rate over the months have downgraded by RUR 1-3 as compared with the preceding month.

The greatest number of transactions (1,618) within the month was made with commodity futures, the volume of trades in those transactions has reached RUR 3.46 billion. Trading volume of transactions in futures for the MICEX index within the period has significantly grown (by 2,4 times) and reached RUR 852 million; herewith, an average value of the MICEX index (the price of transactions) for June was estimated at 900-1000 points, while September prices, were basically at the level of 950-980 points. Therefore, the investors' expectations in regard to the growth of quotations index of the MICEX before the end of the year increased by 100-200 points, as compared with a month earlier. Transactions in futures for interest rates and futures RUR/Euro in May were not made.

An adverse situation was noted in RTS FORTS futures market, where the investors' activity in May has significantly decreased as compared with the preceding month. Thus, throughout April 27 – May 24, the total turnover in the RTS futures and options market made approximately RUR 912.69 bln (4,823 transactions, 33.87 mln contracts) against about RUR 1,079.58 bln 4,844 of transactions, 29.77 mln of contracts) in March. Like before, futures enjoyed the greatest demand: the volume of trades in the period under review made RUR 1,048.47 billion (6 497 thousand of transactions, 43.45 mln of contracts) in May.

Like before, futures enjoyed the greatest demand: the volume of trades in the period under review made RUR 887 billion (4,758 of transactions, 31.12 mln of contracts). Herewith, prices of futures contracts, concluded in RUR/USD in the RTS FORTS for the third quarter of 2009 were within 32.6–34.5 RUR/USD, for the fourth quarter – RUR/USD 33.5–35.5. Therefore, the investors' expectations in regard to USD rate for the forthcoming six months have downgraded by RUR 2-3 on average as compared with a month earlier.

RTS index in the third quarter was estimated at 800–970 points and within 830–960 points in the fourth quarter. Options enjoyed far less demand, the turnover made about RUR 25.69 bln (65.23 thousand transactions and 1.74 contracts). The maximum daily turnover in the short-term RTS futures market made RUR 73.25 billion in May (as of May 13), and minimum was RUR 27.6 bln. on May 4).

#### *External factors behind the Russian stock market dynamics*

In May the Russian financial market dynamics, as a month earlier, was largely dependant on the situation in the global financial markets, distinguished by periods of growth at the background of optimistic investors' behavior, urged by the growth of oil prices (over USD 60 pr barrel, as well as by measures, taken by governments of a number of countries to combat crisis situation, as well as positive macroeconomic news from the USA. Among the basic factors of positive global market indicators, affecting the Russian market in May, one should mention:

- upgrading global oil prices (over USD 60 per barrel);
- disclosure of anti-crisis plan by car producing corporation General Motors in late April; the corporation has obtained credit from the U.S. government in the amount of USD 4 billion;
- disclosed positive macroeconomic news from the United States (in particular on the grown sales in the secondary real estate market and consumer trust index growth);
- USA government decision to allocate USD 63 bln for healthcare financing.

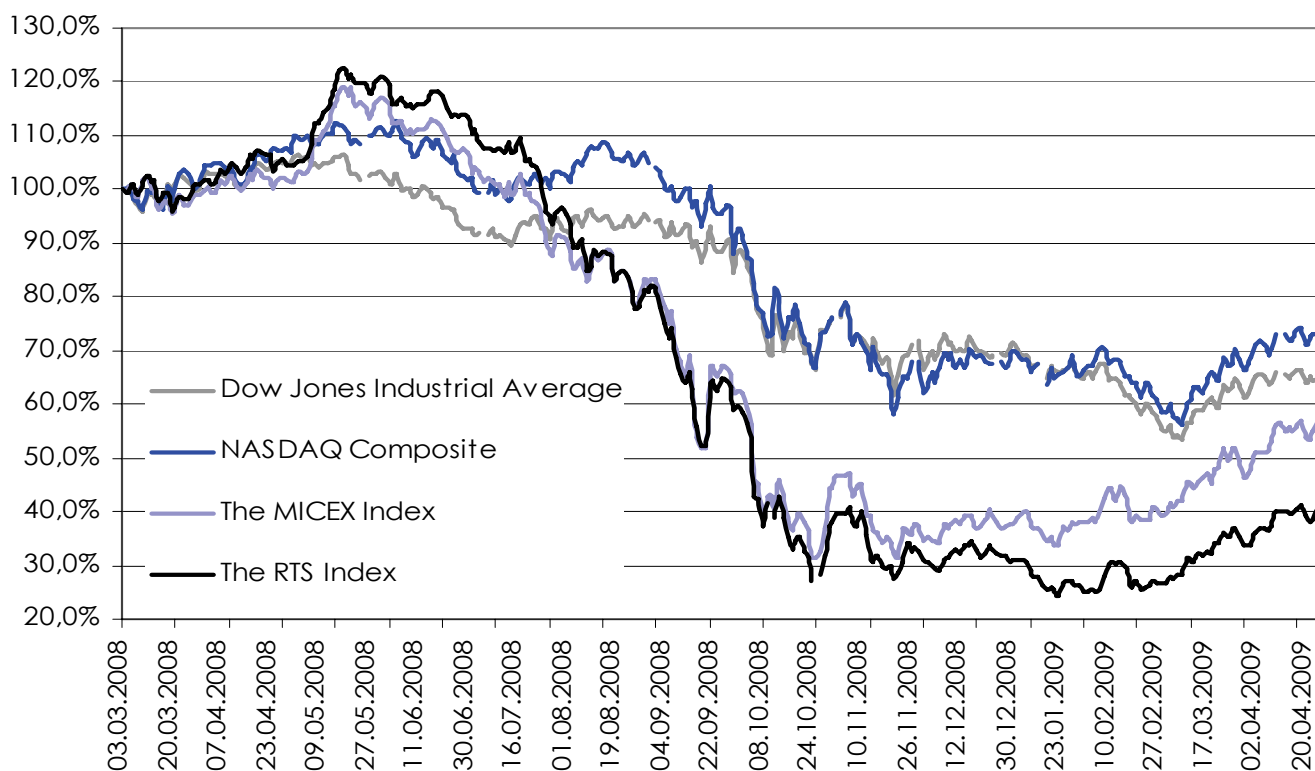


Fig. 5. Dynamics of the main USA and Russian stock indices (in % to the date 01.03.2008)



However, the following events hindered growth of the global financial markets within the month:

- information on the net losses of Japan car producer Honda Motor Co. in the amount of 77 per cent, to USD 1,42 million, which has stopped on March 31, 2009, as well as reduction of German automobile corporation net profit, which has ceased on March 31, in the amount of 67,4 per cent, i.e., by Euro 2.24 bln;
- information on the net losses of German automobile corporation Daimler AG in the 1-st quarter of 2009 in the amount of Euro 1.29 billion (versus Euro 1.33 billion profit a year earlier), as well as the losses of Japanese automobile Group Toyota Motor Corp. as of 2008-2009 fiscal year performance, which was over on March 31, in the amount of USD 4.41 billion (versus USD 17.38 billion profit a year earlier);
- the rapid expansion of «swine flu» in Mexico, the United States and Europe, and related concerns of investors about the negative impact of disease on the world economy;
- bankruptcy of Chrysler automobile company in order to obtain permission for the establishment of an alliance with Italian car Fiat;
- information about a possible merger with the German car Porsche Volkswagen;
- downgrading of Japan credit rating by Moody's rating agency;
- Plans to dismiss four thousand employees by the US company American Express.

However, positive trends were prevailing, what urged the upgrading dynamics in the major global stock market indices. Herewith, despite the general volatility in global indices, observed in May as compared with the indicators of early 2009, the indices demonstrated a general growth. Thus, the market indices of developing countries were characterized by growth by 8-20 per cent, while in the US and European markets those indices were demonstrating lower growth rate by 6-7 per cent (See Table 1 and Fig. 5). и рис. 5).

Table 1

DYNAMICS OF THE GLOBAL STOCK INDICES (AS OF MAY 27, 2009)

Index	Ticker	Value	Dynamics within the month(%)	Dynamics since the year beginning(%)
MICEX (Russia)	MICEXINDEXCF	1 059.60	14.80	71.03
RTS (Russia)	RTSI	1 030.79	23.98	63.13
Dow Jones Industrial (USA) Average (USA)	DJI	8 300.02	2.77	-5.43
NASDAQ Composite (USA)	NASD	1 731.08	2.17	9.77
S&P 500 (USA)	SPX	893.06	3.10	-1.13
FTSE 100 (UK)	FTSE	4 416.23	6.26	-0.40
DAX-30 (Germany)	DAX	5 000.77	6.98	3.96
CAC-40 (France)	CAC	3 294.86	6.19	2.39
Swiss Market (Switzerland)	SSMI	5 419.42	5.99	-2.08
Nikkei-225 (Japan)	NIKKEI	9 438.77	8.39	6.54
Bovespa (Brasil)	BUSP	51 791.61	10.73	37.93
IPC (Mexico)	IPC	24 507.81	8.53	9.51
IPSA (Chile)	IPSA	3 054.91	13.98	28.55
Straits Times (Singapore)	STI	2 306.08	24.46	30.91
Seoul Composite (South Korea)	KS11	1 362.02	0.58	21.13
ISE National-100 (Turkey)	XU100	35 168.73	18.51	30.91
BSE 30 (India)	BSE	14 109.64	24.54	46.25
Shanghai Composite (China)	SSEC	2 632.93	7.53	44.60
Morgan Stanley Emerging Markets Free Index	EFM	602.14	16.48	31.58

\* Versus index indicator valid on April 26, 2009.

**Corporate news***ОАО «VTB Bank»*

On April 27 public corporation «Rostehnologii», «Sberbank of Russia», ОАО «Bank VTB» and «Gazprombank» have entered into a memorandum of cooperation to coordinate the efforts of corporations and banks for the development of high-tech industries, including that during the economic crisis.

On May 4, in the framework of extended cooperation with the aircraft, engine and space industries, ОАО «Bank VTB» has provided a credit line to ОАО «Motorostroytel» in the amount of RUR 470 million (the funds are addressed to pay salaries to the company staff) and a credit line of RUR 400 million to ОАО «NPO «Saturn» (the funds are addressed to pay salaries to the company staff, as well as settlements with contractors). On May 19, a credit line in the amount of RUR 2.5 billion was provided to the NPO «Russia» to finance ongoing activities.

On May 6, ОАО «Bank VTB» has disclosed unconsolidated results for April 2009 under RAS: assets of the Bank on May 1, 2009 amounted to RUR 2 636 billion; net loss for the first four months of 2009 reached RUR 25.9 billion (net profit for the first quarter of 2009 has reached RUR 1.99 billion). Decrease in the net profit in April was mainly due to the results of the closure of forward foreign exchange transaction, negative revaluation of foreign currency, as well as greater allocations to reserves for tentative bad loans.

On May 22, the daughter bank of ОАО «Bank VTB» has received a license for banking activities in Kazakhstan. VTB Bank Subsidiary in Kazakhstan intends to carry out activities in all segments of the financial market.

*ОАО «Gazprom»*

On April 29, ОАО «Gazprom» has disclosed the consolidated financial reporting under IFRS for 2008: sales proceeds increased by 45 per cent as compared with 2007 and amounted to RUR 3 518 960 million; income available to the shareholders of ОАО «Gazprom», for 2008 amounted to RUR 742 928 million (13 per cent more than in 2007).

*ОАО «LUKOIL»*

On April 29, the company LUKOIL EURASIA PETROL A.S. (100 per cent subsidiary of ОАО «LUKOIL») has paid off from its own funds the second tranche of USD 150 million for the shares of Turkish company Akpet. Payment of the third (final) tranche should be made no later than October 30, 2009.

On May 18, ОАО «LUKOIL» has disclosed the data on the increase of oil upstream by 3.2 per cent and downstream by 7.3 per cent in the first quarter of 2009.

*ОАО «Mosenergo»*

On May 7, ОАО «Mosenergo» has disclosed financial reporting, developed under RAS, for the three months of 2009: revenues has increased by 22.2 per cent to RUR 37 886 million; sales proceeds amounted to RUR 7 692 million; net profit has grown by RUR 3 052 million (137.1 per cent) and reached RUR 5 278 million.

On May 25, ОАО «Mosenergo» has disclosed an audited consolidated financial reporting, developed under IFRS for 2008: profit for the year increased by 26 per cent and amounted to RUR 2 055 million.

*ОАО «GMK «Norilsk Nickel»*

On April 30, ОАО «GMK «Norilsk Nickel» has disclosed tentative performance results as of the first quarter of 2009: the total nickel production was 69 tons (against 75 tons in

the first quarter of 2008), total production of commodity copper has been decreased to 96 tons, from 104 thousand tons.

On May 25, OAO «GMK «Norilsk Nickel» has submitted the consolidated financial reporting, developed under IFRS for 2008: the losses for the year amounted to USD 555 million (as compared with profit of USD 5 276 million in 2007).

#### *HK «Rosneft»*

On May 18, NK «Rosneft» and public corporation «Rostekhnologii» have entered in co-operation agreement, providing for the coordination of activities, aimed at creating conditions for sustainable supply of fuel resources, belonging to the «Rostekhnologii» companies, engaged in the development, production and export of high-tech industrial products. In addition, NK «Rosneft» and «Rostekhnologii» have agreed to develop modern technologies in oil production.

On May 26, NK «Rosneft» has received the first tranche (USD 400 million) of the USD 15-billion credit, granted by the Development Bank of China in the framework of Chinese-Russian comprehensive transaction, that includes, in addition to allocating funds to NK «Rosneft» and OAO «AK «Transneft» the long-term oil supplies to China and construction of an oil pipeline from the town of Skovorodino to the border with China. Credit redemption will be performed by NK «Rosneft» by a share of the proceeds from the supply of oil under the sales contract with China National Petroleum Corporation.

#### *OAO «Rostelecom»*

On May 13, OAO «Rostelecom» has disclosed unaudited performance results for the first quarter of 2009, developed under RAS: revenue amounted to EUR 15 375.1 million; net profit is RUR 1 980.4 million; OIBDA made RUR 3 379.6 million; profitability on OIBDA amounted to 22 per cent.

#### *«Sberbank of Russia»*

On April 27 «Sberbank of Russia» has disclosed financial statements, developed under IFRS, for 2008: net profit amounted to RUR 97.7 billion (by 8.3 per cent less than in 2007), assets have reached RUR 736.5 billion (growth rate of assets for the year amounted to 36,7 per cent).

On May 7, «Sberbank of Russia» has provided a credit line to ZAO «EROTSEMENT group» in the amount of RUR 15 billion with a flexible tranches schedule for a period of 36 months for the implementation of ongoing activities, the first tranche will be granted before the end of May. On May 15, «Sberbank of Russia» was opened three credit lines to OAO «Sibirtelecom» for the total amount of RUR 3 billion for the term of five years for the purpose of financing the investment program in 2009 and refinancing of current debt. On May 21, «Sberbank of Russia» has opened a credit line of USD 57.3 million to OAO «CROCUS INTERNATIONAL» for the term of 7 years for the purpose of completing construction of a hypermarket, the largest in Europe Concert Hall and the metro station «Myakininskaya».

On May 15, «Sberbank of Russia» has provided the first micro-crediting to a subject of small business, based on the scoring model for assessing creditworthiness. The micro-credit is provided for up to two years, amounting to RUR 1 million under the sponsorship of a physical entity, the owner of the business.

In addition, on May 22 «Sberbank of Russia» has confirmed its interest in participating in a consortium to acquire shares in the automotive concern Opel and currently continues negotiations with partners and the Government of Germany to develop a possible scheme and conditions for future cooperation.

On May 26, «Sberbank of Russia» has disclosed financial performance results on 4 months of 2009, developed under RAS: the net profit amounted to RUR 0.8 billion against RUR 45.6 billion within 4 months of 2008, the assets of the bank for 4 months of this year declined by 1.9 per cent to RUR 6 597 billion.

On May 27 «Sberbank of Russia» and the GAZ Group have launched a joint credit program for the purchase of cars and light commercial vehicles. The program have been started in all the dealers and regional offices of the bank and involves all passenger models - the Volga and Classic Volga Siber, as well as light commercial vehicles «Gazelle», «Sable» and «Maxus».

#### *OAO «Tatneft»*

On April 30, OAO «Tatneft» has disclosed audited consolidated financial reporting, developed under US GAAP for 2008: sales proceeds amounted to RUR 444 332 million (15 124 million) as compared with RUR 356 276 million (USD 14 512 million) for 2007, net profit amounted to RUR 8 413 million (USD 286 million), as compared with RUR 43 279 million (USD 1,763 million) of the net profit obtained in 2007.

On May 8, OAO «Tatneft», owning 50 per cent shares of OAO «Kalmneftegaz», has recorded discovery of gas fields in the north of Kalmykia. As a result, the company has to balance its natural gas reserves of 35 billion cubic meters under category C1 + C2.

### **Corporate bonds market**

In May of the current year the volume of the Russian domestic stock market (as per nominal value of shares in circulation) has been practically unchanged and made RUR 1,694.0 bln (621 emissions by 456 emitters), which exceeds the indicator of preceding month by RUR 0.1 per cent. In the period from April 27 to May 22 there have been committed by 30.5 thousand transactions with corporate bonds at the MICEX Stock Exchange, totaling to RUR 37.9 billion. (for comparison, from March 24 to April 23 there have been committed 36.6 thousand transactions totaling to RUR 36.1 billion)<sup>1</sup>, which demonstrates the continuing growth of activity of investors in the stock market.

For the fourth consecutive month the index of the Russian market of corporate bonds IFX-Cbonds continues to grow, and from April 24 to May 26, the index has grown more than by 5 points (or 2.4 per cent), having reached the highest level since last September. The effective yield, respectively, has decreased from 16.34 to 15.37 per cent during the period under review, which is the minimum value over the past six months (see Fig. 6). The duration of corporate bonds market portfolio as of May 26 has reduced again and made 383 days, what is 28 days less as compared with the late April of the current year.

In May, a significant increase in the number and total amount of registered issues of corporate bonds was noted. In the period from April 24 to May 26 there were registered 39 bond issues, of which 29 issues of bonds were issued in rubles, totaling to RUR 86.3 billion and 10 issues of bonds in foreign currency, totaling to USD 10.5 billion (for comparison, between March 25 and April 23 there were only 12 issues of corporate bonds, totaling to RUR 78.98 billion). The majority of the reported issues amounted to five series of bonds for the Bank development and external economic activity totaling to USD 10 billion, nine issues of OAO «Mechel» bonds, totaling to RUR 45 billion, two series of «My Bank» bonds, totaling to RUR 10 billion<sup>2</sup>.

1 As per «Finmarket» information agency

2 As per Rusbonds company.

In the past few months, there observed a steady growth of the total volume of corporate bonds placed issues. Thus, in the period from April 24 to May 26, there were 8 bonds issues, totaling to RUR 55.9 billion (for comparison, from March 25 to April 23 there were 11 bond issues, totaling to RUR 46.9 billion, and from February 25 to March 24 - 7 issues, totaling to RUR 45.4 billion) (See Fig. 7). During the period under review the major bond issues were placed by the oil transporting company «Transneft» (one series of bonds amounting to RUR 35 billion) and OAO «Mobile Telesystems» (one series of bonds amounting to RUR 15 billion). Herewith, five emitters have placed their debut issues.

In May a considerable reduction trend was noted in the number of issues, recognized invalid due to non-placement of any security; in the period from April 24 through May 26 the Federal Statistical Service for Financial Markets of Russia has recognized as invalid one issue of corporate bonds, offered for public placement (versus six placements within March 25 – April 23)<sup>3</sup>.

Within April 24 through May 26, only fifteen emitters out of sixteen have redeemed the bonded loans totaling to RUR 16.8 billion, including OAO “Rusfinance Bank” redemption of a series of the stock market bonds in the amount of RUR 4.0 billion. One more emitter has announced a technical default on repayment of the bonds, totaling to RUR 500 million. In June 2009, 23 issues of corporate bonds redemption for the amount of RUR 34.7 bln are expected<sup>4</sup>.

In May, the amount of real and technical default has significantly increased<sup>5</sup>. From April 24 through May 26 the default on offer (bonds redemption) was announced

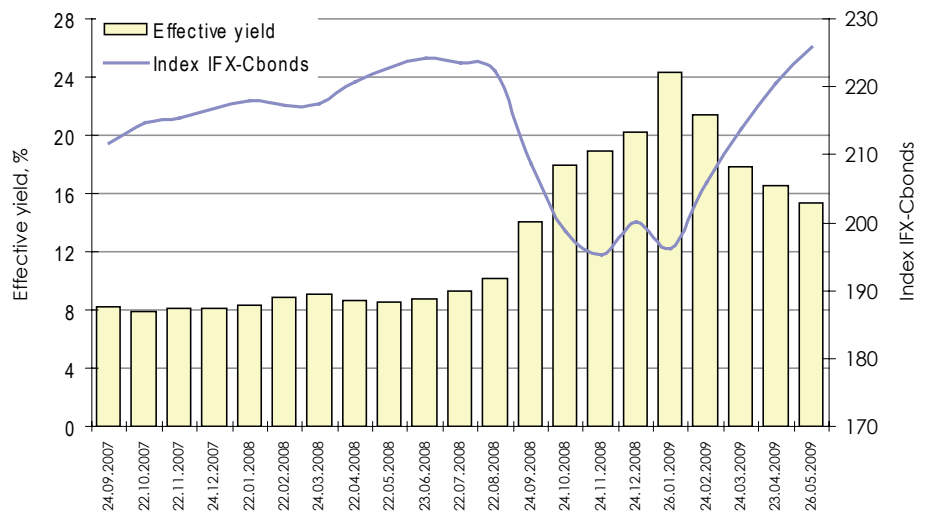


Fig. 6. Russian corporate securities index and average weighted yield dynamics<sup>2</sup>

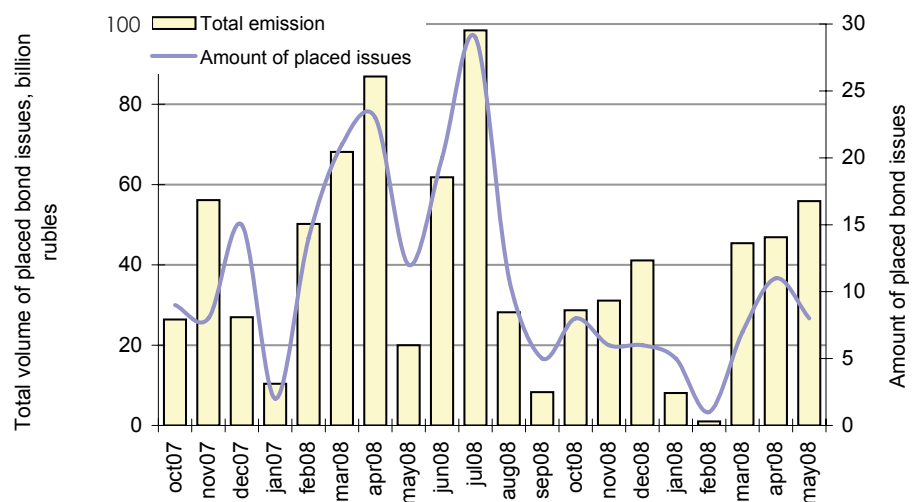


Fig. 7. Corporate securities primary placement dynamics<sup>2</sup>

1 As per Cbonds company data.  
 2 As per Rusbonds information.  
 3 Federal Statistical Service for Financial Markets of Russia information.  
 4 As per Rusbonds data.  
 5 A per Cbonds data.

nounced by five emitters (within March 25 through April 23 there were two emitters) and 13 emitters have failed to repay the coupon yield (there were 5 of those in the preceding period).

Real default on failure to repay the nominal value of the bond loan within the period under review was announced by two emitters, ZAO “Dikaya Orchid” (the scope of non-performed obligation is RUR 0.6 bln) and OOO “MairInvest” (the scope of non-performed obligation is RUR 2.0 bln). ●

**REAL ECONOMY: TRENDS AND FACTORS**

O.Izryadnova

*In April 2009 the economic situation was formed under the influence of the trends evolved in October 2008. The decrease of the growth rates were observed in nearly all kinds of economic activities. As compared with the corresponding period of the previous year, in January-April 2009 the recession of the production in the industry made 14.9%, the figures being 22.0% in the processing industries, 15.8% in the investments in fixed assets, 22% in the retail trade turnover. The general situation was characterized by the fast growth of the unemployment against the background of the reduction of the level of wages. In April the number of the unemployed, calculated on the basis of ILO methodology, reached 7.7 million of people or 10.2% of the economically active population. As a result of January-April 2009 the real incomes of the population decreased by 1.0% and the wages - by 1.4% as compared with the corresponding period of the previous year. The changes in the consumers' behavior are defined by the growth of the expenditures for foodstuffs the pent-up demand for non-food goods and services forming.*

In January-April 2009 the economic situation was defined by a low level of the domestic business activity and the contraction of the solvent demand.

In the current year the decrease in the growth rates is observed for nearly all kinds of economic activities. As compared with the corresponding period of the previous year, in January-April 2009 the recession of the production in the industry made 14.9%, the figures being 6.4% in minerals extraction, 22.0% in the processing industries. The absolute decrease in the volumes of the output defined the contraction of the demand for the services of the natural monopolies. The freight turnover went down by 17.7%, including the decrease in railway transportation by 24.3%, electricity, gas and water production and distribution – by 4.6%.

It should be noted that over the 1<sup>st</sup> quarter of 2009 the investments made by medium- and large-scale enterprises decreased in real terms by 4.8%, while the investments of small and other enterprises reduced by more than 55%. Under the influence of the curtailment of the investment programs, workload in construction reduced by 18.4% over January-April 2009, and the investments in the fixed assets over the same period made 84.2% of the corresponding figure for the previous year. In the current year the higher rates of reduction of foreign investments made in the Russian economy as compared with the domestic investments in the fixed assets. In the 1<sup>st</sup> quarter 2009 the foreign investments in the Russia's economy made USD 12.3 billion or 69.7% of the level of the corresponding period of the previous year, of which the direct investments were USD 3.2 billion or 57.0%.

The investment activity of medium- and large-scale enterprises was supported by the increase in the proportion of the budget funds, borrowed funds and banking credits in the sources for investment financing. The high extent of the dependence from the financing by the banks, the shortage of own liquid funds and the general inefficiency of the production weakened the internal stability of the organizations. The financial result of the operation of the real sector in the 1<sup>st</sup> quarter 2009 made USD 366.5 billion or 29.1% of the corresponding figure of the 1<sup>st</sup> quarter 2008.

The dramatic reduction in the volumes of crediting issued to trading organizations and to the population had a negative effect on the dynamics of the consumers' market. Over January-April the retail trade turnover decreased by 2.2%, the volume of the paid services rendered to the population – by 1.5% as on the corresponding period of the previous year. The nature of the retail trade turnover was considerably affected by the decrease in the real wages by 1.4% as on January-April 2008, and in the real incomes of the population – by 1.0%.

The consumer inflation has increased by 6.2% since the beginning of the year versus 6.3% in January-April 2008. At the same time index of prices for foodstuffs made 105.8% against 108.0% in January-April 2008 and for non-food goods – 104.8% versus 102.9%. The transformation of the price proportions determined the changes in the consumers' behavior. The incomes of the population decreasing, the biggest part of its expenditures is directed to the purchase of the foodstuffs and the necessities. As a result the proportion of the foodstuffs, including beverages and tobacco goods in the structure of the retail trade turnover increased by 48.8% in January-April 2009, being 3.2 per cent points more than the corresponding figure of 2008.

As a result of changing situation at the external market and the contraction of the demand it is the enterprises of production of investment goods, the building structures and the construction materials, orientated towards the export, that experience the most unfavorable situation.

In January-April 2009 the extraction and the production of the primary fuel and energy commodities reduced by 9.7%. The volume of oil production in January-April 2009 were 99.5% (160.2 million of tons) as on January-April 2008, and the volumes of gas production – 83% (198 billion of cu. m).

The dynamics of fuel and energy resources production experience the influence of diversified trends. The general exhaustion of the exploited fields and insufficient increase in oil and gas reserved, as well as the fact that the investment funds to support the current oil- and gas production and to develop new fields in the environment of the crisis are acting as the factors of the decrease of the production. The slow-down of the production was accounted for by such factors as the decrease in the export duty rates and severance tax, the ruble devaluation taking place and the started increase of oil prices.

In January-April 2009 the Russian oil processing factories processed 76.3 million of tons of the oil stock, which is 98.3% versus January-April 2008. The proportion of oil processing in its extraction made 47.6% as compared with 48.2% in January-April 2008. The decrease of the volumes of oil processing was affected by the contraction of the demand at the internal market as well as the low paying capacity of the final consumers.

In January-April 2009 the gas consumption in Russia made 177.2 billion of cu. m (93.8% versus January-April 2008), of which 59.2 billion of cu. m. (94%) was consumed by the Unified Energy Systems of Russia. Gas export reduced to 35.2 billion of cu. m or 46.7% of the figure of January-April 2008. The contract prices remaining at the high level, the European consumers have started to decrease the consumption of the Russian gas and redirect to other suppliers, trading the gas on conditions of “on the spot” contracts.

In January-April 2009 the processing industries continue to drop, and in April the rates of the decrease went up as compared with February-March of the current year.

The deepening of the recession in the industrial production is mainly accounted for by the large contraction of the production in the processing complex. In January-April 2009 the production of the machinery and the equipment made 65.7% of the level of January-April 2008, the production of machinery tools and equipment for metallurgy and extractive industries reducing by nearly 2/3, of the equipment for agriculture and foresting – by 22.4%, the production of household appliances – by 22.9%.



The drop in the production of the transport vehicles and the equipment by 36.4% versus January-April 2008 was defined by the unexampled scales of the contractions in car production. The output of trucks was 26.7% in January-April 2009 versus the corresponding period of the previous year, and of passenger cars – 39.1%.

As to timber processing complex, there the volumes of the production of wood processing and production of wooden goods were 71.1% of the figure for the previous year in January-March 2009, and in the pulp-and-paper industry, publishing and printing activity - 83.4%.

The production of chemistry industry increased by 20.5% versus January-April 2008, the recession in the fertilizers production deepening to 24.9%. The decrease in the production of pharmaceutical industry by 15.9% as compared with January-April 2009 causes special concern.

The index of the production of the construction materials over 4 months of the current year made 67.7% versus the corresponding period of 2008, the production of cement – 67.1%, concrete constructions - 60.0%.

The decrease in the volumes of the metallurgy production of 27.4% in January-April 2009 as compared with the corresponding period of the previous year is accounted for by the contraction of the demand at the internal market and the reduction of export supplies. The demand of the internal market for metals and metallic goods is not provided for by the development of the metal consuming production of machine-building, defense, construction and fuel and energy complexes.

In January-April 2009 the index of textile and sewing production made 79.8%, the leather, leather goods and footwear production – 86.4%, production of foodstuffs – 96.9% on the corresponding period of the previous year. Taking into account the fact that during the last three years the share of the domestic production in the structure of the resources of the retail trade turnover has been decreasing systematically and was 55% in 2008, the drop of the foodstuffs and non-food goods production against the background of the strengthening of the trend for the reduction of foodstuffs import will negatively affect the indexes of retail trade market operation. The import of textile, textile goods and footwear was 90% in January-March 2009 versus January-March 2008, and the import of rawstock, furs and goods thereof – 83%.

The contraction of the solvent demand, deficit of liquid funds necessary to purchase the raw materials, high cost of the crediting resources defined the negative trends of the development of the consumer goods. In this connection the suggestion to allocate the subsidies from the federal budget to compensate a part of expenditures to pay the interest rates for credits received in the Russian crediting organizations for the purposes of seasonal purchase of materials to produce the consumer goods and the production for scientific and technological purposes and to make technical re-equipment seems relevant.

The general critical situation is characterized by fast increase of the unemployment against the background of the decrease in the level of the wages. In April 2009 the number of the unemployed calculated by the ILO methodology reached 7.7 million of people or 10.2% of the economically active population. The process of dismissal of employees have affected nearly all kinds of activities, and most seriously so the machine-building, metallurgy, chemistry and petrochemistry industry. The situation is aggravated by the fact that the number of those transferred to part-time job or given the compulsory leave and not working makes 1.6 million of people. The number of officially registered unemployed in the state employment services reached 2269 thousand of people and has gone up by 561 thousand of people as compared with the beginning of the year. The level of the registered unemployment as a result of the 1<sup>st</sup> quarter of the current year made 2.9% versus

2.7% in February and 2.3% in January. In the 1<sup>st</sup> quarter of the current year 1.9 million of people got the unemployment benefit.

Table 1

## DYNAMICS OF MAIN INDICES OF SITUATION AT LABOR MARKET IN 2008–2009

	2008	2008, by quarters				2009 I
		I	II	III	IV	
Number of the employed in the economy (by the end of the month), as million of people	71.0	69.9	71.4	71.9	70.6	67.7
Number of the unemployed in the economy (on average over the month), as thousand of people	4804	5308	4097	4472	5289	7107
Level of unemployment, as percentage to the economically active population	6.3	6.7	5.6	5.9	7.1	9.5
Number of the unemployed, registered in the state employment agencies, thousand of people	1400	1534	1332	1247	1522	2177
Average nominal accrued wages for employees, RUR	17226	15424	16962	17556	18966	17202
Delayed wages arrears (million of RUR, on average over the quarter)	3337.7	2857.3	2756.3	2801.7	4935.3	6575.3
as percentage to the corresponding period of the previous year						
Number of the employed in the economy (by the end of the month)	100.6	100.8	101.2	100.7	99.7	96.9
Number of the unemployed in the economy (on average over the month)	104.3	98.5	91.9	104.9	124.6	133.9
Level of unemployment	89.7	89.7	89.3	88.2	98.0	141.9
Number of the unemployed, registered in the state employment agencies	125.9	128.0	129.2	129.0	119.5	111.1
Average nominal accrued wages for employees	110.3	113.4	112.5	112.2	105.0	97.7
Delayed wages arrears	77.5	62.0	60.7	65.8	129.2	230.1

Source: Federal State Statistics Service

The situation at the labor market was aggravated by the operation of such negative trends as the insufficient potential for interprofessional mobility, contraction of the possibilities for secondary and informal employment. For instance, the situation is especially difficult in single-industry towns (there are 460 single-industry towns in Russia where 25% of the town population live).

The prevailing part of the employed population is concentrated in the organizations that are not small-scale enterprises. In March 2009 36.2 million of people or 53.9% of the total number of the employed worked there as in March 2009. Besides, the organizations in consideration took 1.8 million of people on conditions of combining jobs (given the equivalent of full-time job). The total number of the replaced workplaces for full-time employment of employees defined as the total number of the employees on the books, employees combining jobs and employees working on the basis of the legal civil contracts made 38.0 million of people and was less than in March 2008 by 1.1 million of people or by 2.7%.

It should be noted that the situation has aggravated in the small business as well. In 2008 there were 6.2 million of people employed at small-scale enterprises, which was 11.4% of the average annual number of the employed on the whole in the Russian economy. In the 4<sup>th</sup> quarter of 2008 the number of workplace in small-scale enterprises (excluding microenterprises) reduced by 45.5 thousand.

The tension coefficient (number of the unemployed registered in the state employment services per one vacant position) increased in March of the current year to 2.7 as com-

pared with 1.4 in the corresponding month of 2008. The demand for employees, claimed by the employers to the state employment services, reduced by the end of March by 316 thousand of people as compared with the corresponding month of the previous year, the number of vacant positions being 295.3 thousand of people. Since the wages forms more than 80% of the incomes of the population, the employment problems are of primary importance. ●

**RUSSIAN INDUSTRY IN MAY 2009**

S.Tsukhlo

*There were neither positive nor negative changes in the main industrial indices observed in May. The demand continues to decrease at the same intensity and only 23% of the enterprises are satisfied with its volumes. The industry came over April depression registered by the Federal State Statistics Service and returned to the previous decrease rates. The enterprises again resort to decrease of prices to stimulate the demand.*

**Official Statistics of April**

In April 2009, according to the data of the Federal State Statistics Service, the industrial production reduced by 16.9% as compared with April 2008 (in March the decrease was only 13.7%, and the previous record-breaking figure registered by the Statistical Service was 16% and was observed in January). As compared with March 2009 the decrease was 8.1%. Thus, the production decrease rates started to increase after the stabilization in February-March. This proved to be unexpected both for the authorities and for the majority of the experts. However a more precise (in this case taking into account the peculiar features of the schedule of the report on the production of power turbines) analysis made by the Center for Macroeconomic Analysis and Short-Term Forecasting testifies that there was no considerable worsening of the situation in April. Whereas in March 2009 as compared with March 2008 the drop made 16.9%, in April of the current year as on last April it was equal to 17.1%. The elimination of the seasonal and the calendar factors demonstrated the decrease in production in April as on March 2009 by only 0.3%. However it should be noted that in March there was a growth of 1% observed as compared with February.

**Demand for Industrial Goods in May**

In May there were no radical changes in the dynamics of the sales of industrial goods. The demand is continuing to decrease at the same rate as in January-April. Though the initial data for May demonstrated the increase in the sales reduction rates from -20 to -28 points, the exclusion of the seasonality corrected this figure to -33 points after -31 in April. The average value of the demand reduction rates upon the exclusion of the seasonality made -35 points in the 1<sup>st</sup> quarter 2009, that is there has been no obvious change in the dynamics of the demand registered in the first five months of 2009.

This conclusion is also testified by the estimation of the satisfaction with the demand for industrial goods. After a small drop in April in May the figure in question returned to the level of 23%, which was surprisingly stably registered since January 2009. There is little doubt that this value is three times as bad as the absolute maximum observed in August 2007 (72%), but it still is far from the absolute minimum of 5%, registered in 1996 and 1998. The volume of the demand, thus, remains acceptable for a quarter of the enterprises of the Russian industry even after the big volumes and the growth of sales becoming habitual in the preceding successful years. At that time, as it is demonstrated by the calculations, the demand was regarded as normal if it provided the load of facilities of 73% in 2005-06, of 77% in 2007 and of 76% in 2008. In 2009 the idea of a "normal demand" reduced but little (down to 73%), that is the standard of the norm has not changed in the Russian industry so far. The ideas of insufficient demand were subject to

a more significant change: whereas in 2007 such estimations implied the load of facilities of 61%, and in 2005 – 65%, in 2009 the figure is 51%.

The forecasts of the demand have also returned to the previous level of February-March 2009 after a short ascent in April which was most probably caused by the similar improvement (decrease in the environment of the crisis) of the demand reduction rates. The initial data of the balance of forecasts fluctuate around zero starting with February, that is the expectations for the growth of sales are nearly equal to the expectations for their reduction, 60% of enterprises (the same as in the previous months) forecasting the sustention of the sales volumes. There was 52% of such successful enterprises in February-March.

### **Output and Load of Facilities**

In May the intensity of the output decrease also returned to the previous values. The drop of the output in April, registered by the Federal State Statistics Service and frightening the economic community, was successfully overcome in May. The initial data, obviously, demonstrated the increase (by 13 points) of the output reduction rates in May as compared with April, the change, however, was not as dramatic as in 2007 (17 points) or 2008 (23 points). The exclusion of the seasonality returned the output reduction rates to -15 balance points of February-March. It should be noted that 44% of the enterprises, the same amount as before the crisis, maintained the volumes of production stable in February-March.

In May the production plans of the enterprises lowered according to the initial data to the minimal figures for the previous 4 months but did not become negative, stating with February there is more hope in the industry for the growth of the demand than the expectations for it to decrease. The exclusion of the seasonality equalized the rated of output reduction of the past 4 months to -8... -5 balance points.

In the 1<sup>st</sup> quarter of the current year the load of facilities dropped to 53% (which is the minimum since the 1<sup>st</sup> quarter 2000 and is likely to be accounted for the panic in December-January as well as for the seasonal factors) after 70% in October 2008. Now the load has increased to 58%. The load of facilities have increased at fastest in foodstuffs production (+12 per cent points), chemistry and petrochemistry (+10) and timber industry (+9). The load of facilities in machine industry has increased by 6 points but remains one of the lowest in the industry (51%). Only in the industry of construction materials are the facilities worse used (48%). As compared with April 2008 when the all-industry maximum of the figure was registered, the reduction of the figure has been from 29 points in ferrous metallurgy, 19 points in chemistry and machine-building to 8 points in timber industry and light industry and to 2 points in the foodstuffs production, the latter figure being statistically insignificant.

### **Price Policy of Enterprises**

In May the enterprises tried to increase the sales of their production by means of price policy. The intensity of the prices decrease has risen over the month by 6 balance points and returned to the level of January 2009. Then, however, the industry tried to overcome the trend for the growth slow-down followed by the decrease of prices, which started in September 2008.

February, March and April demonstrated to the producers that the consumers are not ready to start buying the Russian products in the environment of the developing world crisis in Russia. Even the strengthening of the ruble as a result of the devaluation did not help the Russian industry, and again it had to use the price tools. It is especially obvious in ferrous metallurgy, timber industry, industry of construction materials and light industry.

Chemistry, machine-building and foodstuffs industry froze their prices. Only the non-ferrous metallurgy starts to recover the prices for its products.

### **Stocks of Finished Goods**

So far the price policy has positively affected only the stocks of finished goods: in May their estimations improved by 12 points at once and were nearly at the pre-crisis level of September-October 2008. The excess of the stocks lowered or remained at the same level in all the branches of the industry except the non-ferrous metallurgy. This trend seems positive at the first glance, but may have a negative explanation. The sustention of the stocks of finished goods at the level of some excess is possible only in case all the producers are certain as to the forthcoming economic growth and, consequently, in the marketability of their stocks. In such a situation the stocks are necessary, first of all, to satisfy new, unplanned orders.

After the default of 1998 the Russian enterprises started to believe in the stability of the economic growth only in March 2001 and transferred to the policy of the sustention of the finished stocks at the level of some excess. Up to that moment (that is for two and a half years) they did not consider the post-default ride as stable and preferred having the minimum amount of stocks at storehouses. That is why it was at the end of 1999 when the biggest deficit of the finished goods was registered. Now the trend is to turn to other side: the Russian enterprises consider the crisis “to have gained the out-and-out victory” and regard the soon way out of the crisis (similar to the one in 1998) as unlikely and start minimizing the stocks of finished goods – they have the experience of this since 90-ies. In such a situation the decrease in the physical volumes of stocks and/or their estimations may mean that the enterprises are getting ready to long crisis.

### **Dismissals: Real Dynamics and Plans**

The intensity of dismissals has not been subject to any fundamental changes since February 2009. The rate of the decrease of the number of the employees remains at the level of -28...-26 balance points, which is nearly two times less than (that is better) than the figures of January and is equal to the figure of October 2008. If one is to exclude the drop of the index in January (2009), which was mainly accounted for by the panic and not by the rational behavior, as well as by seasonal factors, the dismissal rates of the last months and October 2008 proved to be the highest since the beginning of the monitoring of this figure in 2003. The dismissals are going on in all the branches of industry (that is everywhere there are more reports on the dismissals than on hiring of staff). Neither foodstuffs production (balance of -10 balance points) nor the non-ferrous industry (balance of -15 balance points) escaped them, though they seem to be in a better situation than other branches. The dismissals in ferrous metallurgy (-37 balance points), construction industry (-36 balance points) and machine-building (-33 balance points) went at the highest rates in May.

The plans for dismissals have been stable since October 2008. The attempts of the industry in February and April 2009 to reconsider them towards less intensive dismissals of employees turned out to be unsuccessful and the enterprises returned to their previous plans for dismissals, which have been the highest since July 1998. It is in non-ferrous metallurgy (-37 balance points), machine-building (-29 balance points) and light industry (-28 balance points) where the most intensive dismissals are likely to take place. The absolute increase in the number of staff (that is there are more intentions to increase the number than to decrease) is probable only in the foodstuffs production (balance of +16 points). The peak of redundancy plans (-44 balance points) was observed in this branch as long ago as October 2008.

**Credits for Industry**

In May the availability of the credits for the Russian industry remained at the level of the previous month. Only 30% of the enterprises consider it as normal in April-May 2009. This is 13 points better than the crisis minimum of December 2008 and by 50 points worse than the absolute maximum of August 2007. Thus, the efforts of the government to solve the crediting problem gave no results in May. The banks treat most favorably the enterprises of foodstuffs industry (52% of the enterprises being satisfied with the availability of the credits, the maximum for the branch being 90%), non-ferrous metallurgy (44%, maximum of 100%), chemistry and petrochemistry (44%, maximum of 89%). It is the enterprises of light industry that experience the biggest problems with the availability of credits (12%, maximum of 70%), whereas in March this figure was equal to 32% in the branch. ●

## FOREIGN TRADE

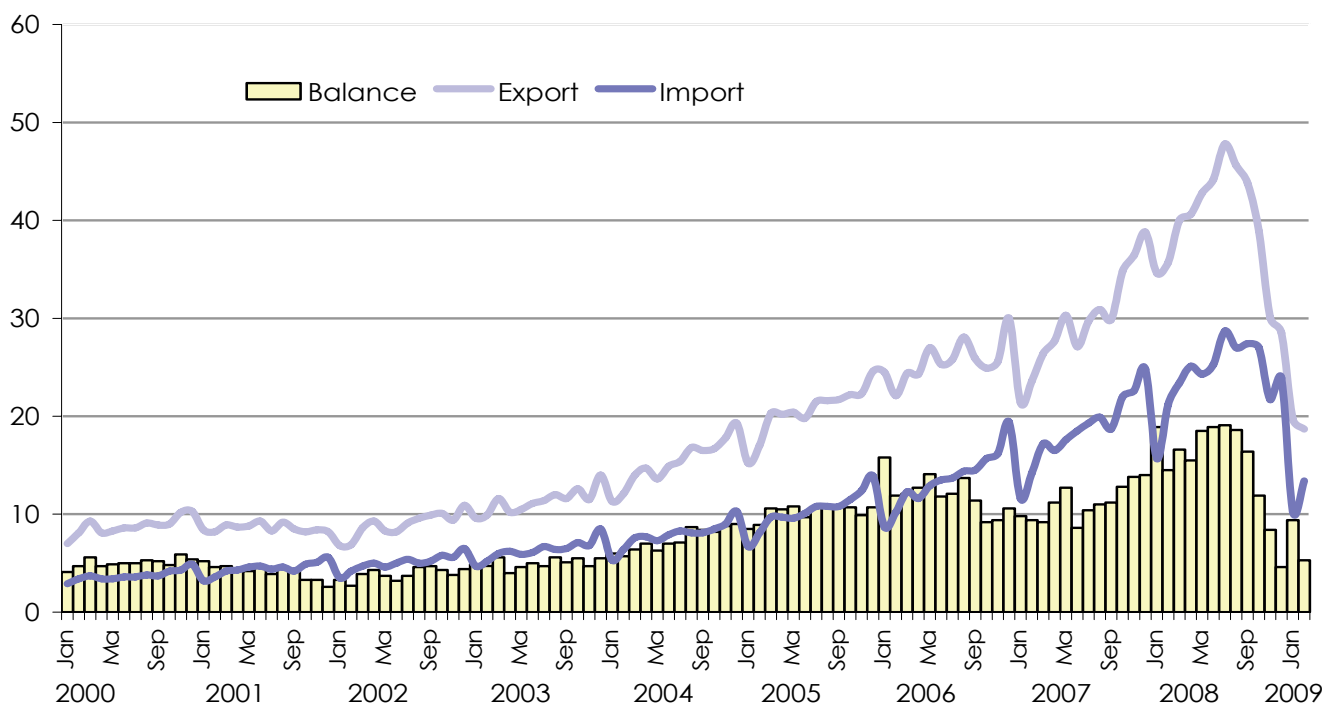
N.Volovik

*The main result of the development of the Russia's foreign trade in the first quarter of 2009 is the maintenance of the positive foreign trade balance. Moreover, in none of the first three months of the current year did the balance go below the minimum level of USD 4.6 billion registered last December.*

Russia's foreign trade turnover calculated on the basis of the balance-of-payments methodology made USD 35.5 billion in March 2009, which is 43.9% lower than the value of the foreign trade turnover in March 2008. It is to be noted that the Russian export decreased by 47% and the Russian import – by 38.6%. the balance of the Russian foreign trade reduced by 2.4 times in March 2009 as compared with March 2008 (down to USD 6.8 billion).

At the same time as compared with the preceding month in March 2009 there was the growth of the main indices of the Russian foreign trade observed. Thus, the export went up by 13%, import – by 6.9% and the balance – by 28.7%. The strengthening of the foreign trade balance in March was due to the faster growth of export as compared with the import.

According to the data of the Central Bank of the Russian Federation, in the 1<sup>st</sup> quarter 2009 the Russia's foreign trade turnover made USD 96.0 billion (56.4% on the 1<sup>st</sup> quarter 2008). Export decreased by 47.4% as compared with the 1<sup>st</sup> quarter 2008 and was equal to USD 57.;9 billion, import reduced by 36.7% - down to USD 38.1 billion. The foreign trade



Source: Central Bank of the Russian Federation

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



balance remained positive, being USD 19.8 billion (USD 49.9 billion in the 1<sup>st</sup> quarter 2008).

In the situation when the world demand is contracting, the production of extractive industries became considerably cheaper at the end of 2008. As a result in the 1<sup>st</sup> quarter 2009 contract prices for crude oil and oil products, unprocessed copper and nickel made less than a half of the level of the corresponding period of 2008. However in March 2009 the world prices for some goods of the Russian export were observed to grow.

The prices for oil at the leading oil exchanges increased by the end of March to USD 49-55 per barrel in contrast to USD 40-45 per barrel in February. On March, 31 the price for oil Light Sweet made USD 49.66 as a result of the biddings at NYMEX, which is a growth of USD 9.51 on the beginning of the month. On the same day, as a result of biddings at Intercontinental Exchange, London, the price for oil grade Brent no stopped at the level of USD 49.23 per barrel, the growth on the beginning of the month being USD 7.02. The average price for oil grade Urals was USD 45.2 per barrel in March. The prices were growing under the influence of the information on the increased consumption of petrol and other oil products in the USA and the considerable reduction in stocks of oil products.

According to the monitoring, in the period from April, 15 to May, 11 the average price of oil grade Urals was USD 51.05726 per barrel. As a result, according to the Decree of the Government of the Russian Federation from May, 26 No 447 the export duty rate for crude oil will be increased as from June 1, 2009 from USD 137.7 per ton to USD 152.8 per ton. Export duty rates for light oil products will be increased from USD 105.1 per ton to USD 115.2 per ton, and export duty rates for dark oil products – from USD 56.5 per ton to USD 62.1 per ton.

As compared with February, in March at London Metal Exchange prices for aluminum by cash deals changed little and fluctuated in the range USD 1.3-1.4 thousand per ton. As on March, 31 stocks of aluminum at LME made 3469 thousand of tons, which is approximately by 242 thousand of tons more than at the beginning of the month. The average monthly price for aluminum by cash deals made USD 1336 per ton as compared with USD 1330 per ton a month ago. Low prices for aluminum have recently been due to a considerable excess of the metal at the market.

As for copper, its prices by encash deals at LME increased in March owing to the reduction of stocks, as well as hopes for the improvement in the world economy situation as a result of the adopted and planned anti-crisis measures by G20. At the same time the growth of prices was restricted the existing excess of the metal at the market. As on March, 31 the price for copper at LME made USD 4035 per ton, which is USD 705 per ton higher than in the first trading day of the month. On average, over the month the price for copper was USD 3750 per ton, and in February – USD 3315 per ton. As a result of March, the stocks of the metal at LME reduced to 499.6 thousand of tons as compared with 536.7 thousand of tons at the beginning of the month.

Prices for nickel by encash deals at LME changed little and were in the range USD 9.4-10.0 thousand per ton, which is lower than in February – USD 10.4 thousand per ton. The increase of the stocks of nickel at LME continued in March. As a result, by the end of the month, the stocks of metal at the exchange increased up to 106.7 thousand of tons as compared with 98.6 thousand of tons at the beginning of the month. Low prices for nickel in recent months were accounted for by the excess of the metal at the market.

Following the dramatic drop of prices at the end of 2008 the situation at the world agriculture and foodstuffs market during the 1<sup>st</sup> quarter of the current year remained quite stable. Some revival of activity observed in January 2009 was temporary and in February-March the prices for the main kinds of foodstuff either returned to the level of December 2008 or remained the same as at the beginning of 2009.

Table 1

## AVERAGE WORLD MONTHLY PRICES IN MARCH OF THE CORRESPONDING YEAR

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Oil (Brent), USD/barrel	13.0	13.7	26.9	25.5	24.1	29.1	33.6	53.7	60.9	62.05	102.3	47.42
Natural gas, USD/1 mln BTU	2.170	2.120	2.828	5.200	2.996	5.757	5.267	7.234	6.123	7.25	9.655	4.03
Petroleum, USD/gallon	0.467	0.527	0.934	0.890	0.783	1.005	1.12	1.581	1.7	1.91	2.672	1.414
Copper, USD/ton	1772	1477.1	1779.1	1780.3	1605	1681.6	3018.0	3254.4	5103	6452.5	8421.9	3749.8
Aluminum, USD/ton	1441.3	1251.1	1584.2	1511.2	1403.2	1393.1	1660.0	1988.6	2429	2761.7	2986.8	1335.8
Nickel, USD/ton	5380	4934.5	10270	6140.3	6503.3	8402.4	13730	16190	14897	46324.8	31005.7	9696.4

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

Table 2

## DYNAMICS OF AVERAGE WORLD PRICES FOR SOME KINDS OF AGRICULTURAL GOODS

	2005	2006	2007	2008	2009		
					January	February	March
Wheat, USD/ton							
Canadian, CWRS	197.6	216.8	300.4	454.6	340.2	318.5	306.9
American, HRW	152.4	192.0	255.2	326.0	239.1	224.7	230.9
American, SRW	135.7	159.0	238.6	271.5	195.1	183.4	183.7
American corn, USD/ton	98.7	122.9	163.0	223.1	172.8	163.4	164.6
Barley, USD/ton	95.0	117.0	172.0	200.5	121.4	112.5	114.8
Soybeans, USD/ton	274.4	268.4	384.0	523.0	413.0	390.0	378.0
Soy oil, USD/ton	545.1	598.6	881.0	1258.0	789.0	748.0	725.0
Thai rice, USD/ton		304.9	326.4	650.1	580.0	590.8	588.3

Source: World Bank.

It is the fuel and energy commodities that remain the basis of the Russian export, their share in the commodity composition made 65% in the 1<sup>st</sup> quarter of 2009 (70.1% a year ago). Annually, its price went down by 51.4%, physical volumes of gas supplies dropping by 61%, of oil and coal supplies remaining at the same level.

Export of raw non-energy goods reduced by 42.7% as compared with the 1<sup>st</sup> quarter of the previous year (growth of 25% a year ago), of machinery and equipment – by 40.3% (growth of 39.2%). Export of the goods of chemical industry reduced in terms of value by 38.2%, including fertilizers – by 24.3%, the reduction due to the decrease in physical volumes made 24.4%.

Export of foodstuffs and agriculture raw materials went up by 29.2% in terms of value, primarily due to the increase in the physical volumes of grains export by 4.1 times, despite the decrease in average contract prices by 2 times.

The reduction of metals and metallic goods export was affected by the decrease in the export of ferrous metals in terms of value by 44.9%, of copper and copper goods – by 55%, of unprocessed nickel – by 68.6%, of unprocessed aluminum – by 21.2%.

At the same time in March 2009 as compared with February 2009 there was a growth of export supplies of fuel and energy commodities observed, which was equal to 8.8%, of pulp-and-paper goods – by 30.2%, of metals and metallic goods – by 18.5%, of machinery, equipment and transport vehicles – by 39.3%.

High reduction rates of the Russian import in the 1<sup>st</sup> quarter 2009 was accounted for by the decrease in the real disposable incomes of the population, contraction of credits and the lack of foreign investments. It is the investment commodities that demonstrate the highest

rates of reduction, demand for them decreasing ever faster against the background of the stagnation of the industry.

The proportion of the machinery, equipment and transport vehicles in the commodity composition of the Russian import reduced by 8.9 per cent, of the metals and goods thereof – by 0.2 per cent, of mineral products – by 0.6 per cent. At the same time the proportion of the following products increased: of foodstuffs and agriculture raw materials – by 4.5 per cent, of production of chemical industry – by 2 per cent, of textile, textile goods and footwear – by 2.4 per cent, of timber and pulp-and-paper goods – by 0.5 per cent.

Import of machinery, equipment and transport vehicles reduced in terms of value by 49.3%. Since the crisis started, this group of commodities has begun to reduce at the fastest rates. The import of passenger cars and trucks has been most seriously affected, decreasing in terms of value by 65.3% and 80.2%, correspondingly, and in physical terms – by 66.7% and 76.1%.

As compared with the 1<sup>st</sup> quarter of 2008 in the 1<sup>st</sup> quarter of 2009 the value volume of import of foodstuffs and agriculture raw materials reduced by 18.5% due to the decrease in the physical volumes of the main kinds of foodstuffs. The import value of fresh and frozen meat, poultry, condensed milk and cream, butter, crops and sunflower seed oil, alcoholic and non-alcoholic beverages decreased most considerably.

Value indices of textile and textile goods import reduced by 10%. Purchase of leather footwear reduced by 18.4% and of cotton cloths – by 28.1%. Import of goods of chemical industry reduced in terms of value by 30.1%.

As compared with the previous month in March 2009 import supplies of some commodities were observed to increase. The import of foodstuffs was the fastest to recover: there was 26.4% more of agriculture raw materials imported. The import of goods of chemical industry was quick to recover, increasing by 13.3% in March as on February, as well as the import of pulp-and-paper goods – the increase of 12.8%. The recovery of investment import after the devaluation shock proceeds slower: import of machinery, equipment and transport vehicles increased by only 3.5%.

At the beginning of the year there were apprehensions that the Russia's foreign trade balance would fluctuate around zero or become negative. However the gradual growth of oil prices and a considerable decrease of import contributed in the sustention of the positive balance. Basing on the significant decrease in import, the Ministry of Economic Development of the Russian Federation raised the forecast figures for foreign trade balance in 2009: due to the reduction of import by 30% (as on the level of 2008) and not by 20% as it was planned a year ago, the annual balance is forecast to be at the level of USD 54-62 billion instead of USD 26 billion.

## HOUSING MORTGAGE IN THE RF

G.Zadonsky

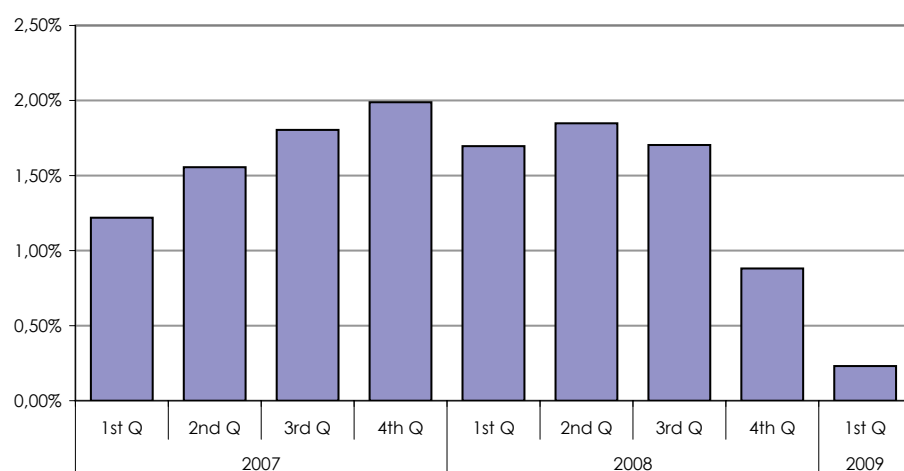
*In Q 1 2009 the growth of residual debt was arrested – both against housing credits and housing mortgage credits. In this connection, the share of outstanding debt in these residuals is increasing, thus forcing banks to increase their reserves against potential future losses.*

In Q 1 2009, according to the data published by the RF CB, the total amount of granted housing credits was 31.429 billion rubles, of which 24.438 billion rubles was constituted by housing mortgage credits. The volume of granted housing mortgage credits decreased 6.17 times by comparison with that in Q 1 2008, while that of housing credits on the whole dropped by 5.54 times. Russia's GDP in Q 1, according to Rosstat's data, dropped by 9/5 % on Q 1 2008. Nevertheless, the volume of granted housing mortgage credits in Q 1 2009 amounted to only 0.23 % of GDP. For reference: in Q 1 2007 the volume of granted housing mortgage credits was 1.22 % of that quarter's GDP, and in Q 1 2008 – 1.7 % .

Over the period of Q 1 2009, the share of housing mortgage credits denominated in foreign currencies in the total volume of issued housing mortgage credits continued to decline, thus amounting in Q 1 to 6.01 %. The share of debt against housing mortgage credits denominated in foreign currencies in the total volume of debt against issued housing mortgage credits was 24 % as of 1 April 2009 r..

Residual debt against credits granted to physical persons is has been decreasing since Q 4 2008. The volume of housing mortgage credits being granted has decreased significantly; nevertheless, the shares of housing credits and housing mortgage credits in residual debt against credits granted to physical persons still continue to grow – most probably, due to the long-term nature of such credits as compared to consumer credits.

Debt outstanding against credits granted to the population increased from 3.2 % of total residual debt as of 1 September 2008 to 4.4 % as of 1 March 2009.



Source: RF Central Bank's and Rosstat's data.

Fig. 1. Volume of granted housing mortgage credits (as % of GDP per quarter)

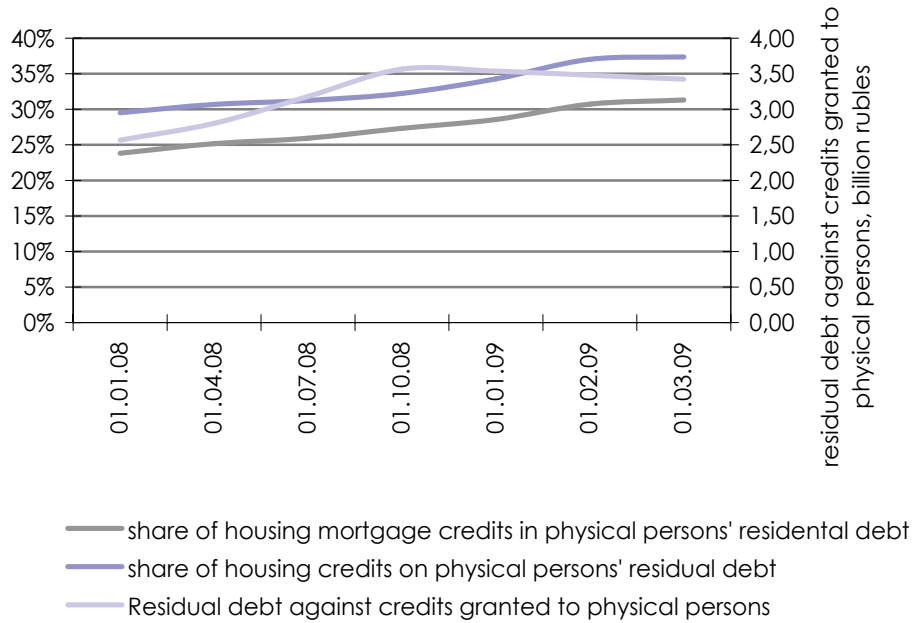
In March 2009 the growth of residual debt against housing mortgage credits (both ruble-denominated and denominated in foreign currencies) was arrested, and then there and then there emerged a trend of slight decline in that index. Debt outstanding against ruble-denominated housing mortgage credits, on the contrary, continued to display an upward trend, while debt outstanding against credits denominated

in foreign currencies increased by 0.87 %.

In Q 1 2009, growth of debt outstanding against credits and loans was typical not only of housing credits, but of the whole banking system. According to the RF Central Bank, the volume of banking reserves against potential future losses on credits and loans rose by 30 % - to 1.33 trillion rubles due to growth in outstanding debts, which has been considered to be one of the main reasons for the recently observed drop in banks' profits. Although the share of housing mortgages in the total growth of reserves is not big, still those banks that display a significant amount of housing mortgage credits on their balance sheets are now experiencing the same difficulties as those banks that loan money to enterprises.

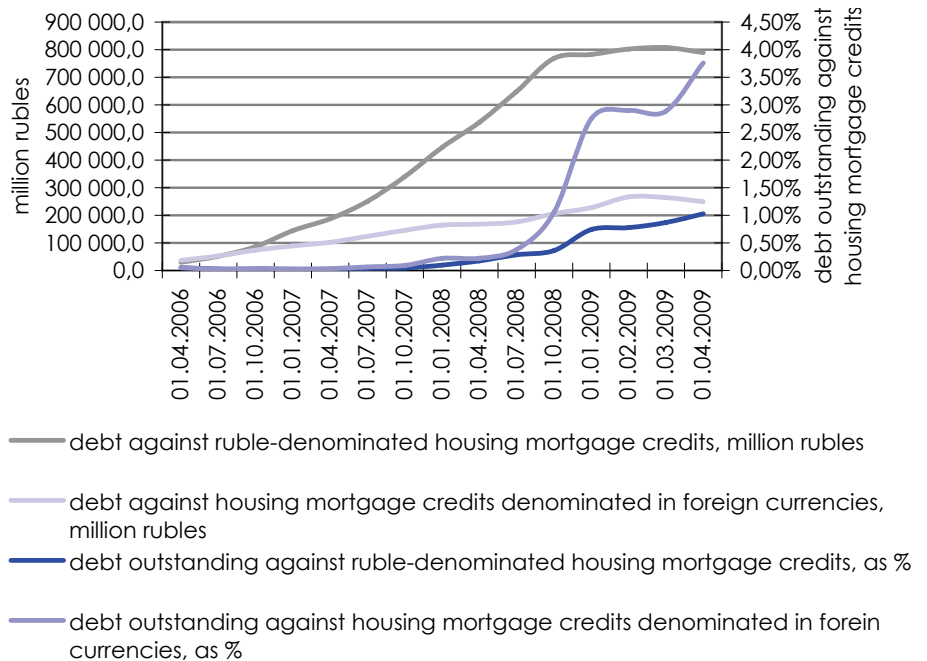
As of 1 April 2009, according to the RF Central Bank's data, the average weighted interest rates for granted housing mortgage credits, had increased as follows: for ruble-

denominated credits - from 12.9 % at the beginning of the current year to 14.4 %; and for credits denominated in foreign currencies – from 10.8 % to 13.5 %. Accordingly, the average weighted interest rates for housing credits had increased since the year's beginning for ruble-denominated credits from 13.0 % to 14.6 %, and for credits denominated in foreign currencies – from 10.9 % to 13.9 %. After the RF Central Bank lowered its rate of refinancing in April 2009, the Agency for Housing Mortgage Lending (AHML) also intended, from the



Source: RF Central Bank's data.

Fig. 2. Shares of housing credits and housing mortgage credits in residual debt against credits granted to physical persons



Source: RF Central Bank's data.

Fig. 3. Volume and share of debt outstanding against granted housing mortgage credits (denominated in rubles and in foreign currencies) in total residual debt

beginning of May, to lower its interest rate on credits by 0.5 p.p. Since from 14 May 2009 the RF Central Bank's rate of refinancing is established at the level of 12 %, it should be expected that the AHML will also correspondingly lower its interest rate on credits.

Table 1

## AVERAGE WEIGHTED INTEREST RATES ON RUBLE-DENOMINATED CREDITS, AS %

Credit product	February 2009		March 2009		April 2009	
	Min.	Max.	Min.	Max.	Min.	Max.
Credit for purchasing apartments on secondary housing market	17.82	19.41	18.23	19.78	18.40	19.89
Targeted against mortgage of available real estate object	18.99	19.99	20.64	21.70	20.64	21.70
Credit for purchasing house with land on secondary housing market	17.61	19.10	18.26	19.83	18.26	19.83

Source: KreditMart's data Кредитмарт.

According to KreditMart's data, housing mortgage credits for purchasing dwellings on the secondary housing market in April 2009 were offered by 17 banks, in March – by 18 banks, in February – by 19 banks, while credits for purchasing a house on a plot of land on the secondary housing market were always offered by the same 8 banks. The following banks suspended the issuing of housing mortgage credits: Moskommerts Bank, KIT Finance, URSA Bank, GIB, TransKreditBank, Eurotrast, MBRD, UniCredit Bank, ICICI, GE Money, and OTP Bank. The operating banks changed their interest rates over the year within the limits presented in *Table 2*.

Table 2

**Fixed interest rates for ruble-denominated credits**

	Name of credit institution	Minimum interest rate	Change over year, p. p.	Maximum interest rate	Change over year, p. p.
1	AHML	12.55	1.80	18.00	4.00
2	Sberbank	13.50	3.00	16.00	4.00
3	VTB 24	14.60	3.60	17.60	4.10
4	Deltakredit	15.25	5.00	29.00	15.50
5	Kredit Europa	15.50	4.00	20.00	5.00
6	BZhF	16.25	6.50	18.25	5.50
7	Bank of Moscow	18.25	7.25	22.00	9.00
8	UralSib	19.00	6.70	20.50	5.00
9	Uniastrum Bank	19.00	6.50	20.00	5.50
10	MIA	19.70	8.70	19.70	4.70
11	Raffaizen	20.00	8.10	20.00	7.10
12	RosEuroBank	20.00	8.50	22.00	5.50
13	AlfaBank	20.60	7.40	25.30	9.30
14	Vozrozhdenie	21.00	9.50	27.95	12.20
15	Absolut Bank	28.00	18.00	29.00	13.00

Source: calculations and monitoring data by KreditMart.

According to the AHML's Analytical Report, the value of housing dropped in Q 1 2009 on Q 4 2008 in 53 of 81 regions. The leader in decline is the Republic of Ingushetia (by 49.6 %), and the leader in growth is Leningrad Oblast (by 36.4 %). According to Rosstat's data, in Q 1 2009 the total dwelling space put into use amounted to 10.4 million square m, or

102.4 % of the same index for the corresponding period of last year. Out of Russia's total housing put into use, 12.4 % was constructed in Moscow Oblast. Half of the total living floor space put into use across Russia was built in only 11 subjects of the Federation. In the total completed housing construction, the share of individual house construction in Russia amounted on the whole to 52.5 %. RF Prime Minister signed a decree that eliminated excessive administrative barriers for formalizing through bureaus for technical inventories the documentation for the newly constructed housing.

As of 22 April 2009, the AHML refinanced 145,687 housing mortgage credits in the total amount of 115 billion 452 million rubles. Between 1 January and 1 May 2009, the AHML refinanced 8,796 mortgage, for which residual debt as of the date of refinancing was 9,340 million rubles. The average weighted interest rate for these credits was 13.88 %, and their average weighted period – 197 months.

According to the AHML's report for Q 1 2009, in accordance with the International Accounting Standards (IAS), debt outstanding against the consolidated credit portfolio, including the tracker mortgages<sup>1</sup> and the mortgages kept on the balance sheet of the Open-end Joint-Stock Company *AHML*, amounted to 11.1 %. The consolidated credit portfolio's debt, when estimated in accordance with the Russian Accounting Standards (RSBU), amounted over the same period to only 0.22 %. In the previously applied scheme, the main focus was placed on estimating debt outstanding on the mortgage portfolio kept on the AHML's balance sheet. For reference: debt outstanding in Q 4 2008 against the portfolio of mortgages kept on the AHML's balance sheet was 11.5 %, while that against the tracker mortgages, including the mortgages on the balance sheet of the Open-end Joint-Stock Company *AHML*, – 7.9 %.

The RF Government characterized as anti-market one of the draft laws submitted to the State Duma. The draft law stipulated that banks should not be allowed to raise the interest rates on their already issued credits against those indicated in credit agreements. The Government's negative verdict, in all probability, will result in banks including in their credit agreements special clauses allowing them to unilaterally alter the credit periods and interest rates.

The State Duma approved in the first reading the draft law “On introducing changes in some legislative acts of the RF for purposes of protecting the rights of participants of share construction”, which had been submitted for its consideration in September 2008. In particular, it is suggested that alterations should be made to the RF Tax Code to the effect of exempting from VAT the services provided by a builder under a share construction agreement. The opponents of this draft law believe that the improvements to legislation on share construction do nothing about the problem's origin – that is, the low level of crediting provided to the construction sector by banks because of the legislatively consolidated joint responsibility of builders and banks.

Another draft law was also approved by the State Duma in the first reading, whereby the agencies empowered to grant social welfare housing to citizens on housing waiting lists residing at Moscow and St. Petersburg will be allowed to offer to those citizens, with their consent, dwellings situated in the territories of Moscow Oblast and Leningrad Oblast. This draft law was developed because of the current acute shortage – and consequently, high price – of land plots for housing construction in the two capitals. ●

1 Tracker mortgages are the mortgages in mortgage coverages sold by the AHML to mortgage agents (special purpose vehicles) within the framework of the Group created by the AHML jointly with the Housing Mortgage Agents. The AHML bears responsibility for the risks of such mortgages. In accordance with the IAC, such mortgages are included in the “consolidated portfolio”. Since mortgage coverages are formed by mortgages “of a higher quality”, debt outstanding against the portfolio decreases.

## BUDGETARY AND TAX POLICY

O.Kirillov, I.Sokolov

*In May of this year, the President of Russia Dmitry Medvedev has signed and forwarded to the State Duma the Budget message on the economic issues and the RF fiscal policy in the context of the global financial crisis. On May 25, the Russian government has approved the major trends of tax policy for 2010 and for the planned period of 2011 - 2012, which comprises a number of measures aimed at reducing the tax burden on the national economy.*

Table 1

BASIC INDICATORS OF THE RF FEDERAL BUDGET EXECUTION IN 2007 – 2009 (% OF GDP)

	2007	April 2008	2008	April 2009
Revenues	23.9	25.2	21.8	19.8
Expenditures	18.4	16.1	17.8	23.1
Deficit (-)/ Surplus (+)	5.5	9.0	4.0	-3.3

Source: RF Ministry of Finance

In May of this year, the President of Russia D. Medvedev has signed and forwarded to the State Duma the Budget message. It should be noted, that Budget messages are developed annually, define the basic trends for national fiscal policy for three years. Therefore, the goals and objectives between the Budget message of the current and preceding years have much in common.

The Budget message of 2009 is distinguished by the need to finance an active anti-crisis policy in the current budgetary environment, and at the same time to maintain macroeconomic stability in the economy as an integral provision of the national and, above all, social obligations performance in subsequent years. However, if in the previous budget message, the task of ensuring macroeconomic stability was supposed to be implemented through better coordination of decisions on the implementation of the additional budgetary expenses and the regulatory capacity of the national credit and monetary system, the message of 2009 emphasizes the need for «reasonable strategy to restrain public expenses» and to limit the volume of the budget deficit.

It is noted in the message of 2009 that the budgetary expenditures in the current year will be higher than planned before, as well as much has been said about the need to reduce expenditures in the 2010-2011. In this regard, in the framework of previously selected trend of socio-economic development, the message emphasizes the need to seek for reserves for the purpose of budget savings, to raise efficiency of public spending, to review the schedules of previously announced projects and programs.

And, given that the social sector still remains a key priority in terms of expenditures, it is expected to cut down budget expenses, above all, in regard to the support of the national economy. It is confirmed by the thesis of «the need of public support ... has to be allocated only substantial grounds, and the financial assistance should be allocated only to reasonable extent and in consistent scope». The President also calls on the governments at all levels to restrain from populist decisions, resulting extension of inefficient budget expenditures, as well as to refrain from dealing with the current problems of individual sectors of the economy, if it hinder the achievement of long-term development objectives.



Naturally, the need to reduce federal budget expenditures in the near future is forcing the regions and businesses to focus more on internal funds in their activities. Thus, the regions, in particular, are strongly advised to focus on increasing their revenue base primarily through the development of small and medium businesses, as well as to restructure the budget network and to enhance expenditures for the maintenance of their administration structure. Moreover, it is proposed to expand the regional and local powers.

Against the background of explicitly restrained increase on interbudgetary transfers, the federal center is planning to strengthen instruments of financial controls, including the introduction of temporary financial administrations in cases of the Subjects of the Russian Federation and municipal agencies failure to perform their liabilities or inefficient distribution of financial assistance, provided to them.

In contrast to the Budget message of 2008, the current year document under review does not highlight as a priority any branch of the Russian economy. Moreover, it emphasizes that in regard to the issues of supporting the real sector, an individual approach should be applied to each individual enterprise, whereas only competitive businesses are liable to obtain budget assets or the enterprises, executing public orders.

In addition, it is noted that in order to mitigate social conflicts in the poor enterprises, that need the government support, there will be formed some «compensatory mechanisms», though the objectives and conditions of their activity are not disclosed in the message. Apparently, in case of consistent implementation of this approach, the majority of the real sector businesses will be left outside the list of supported organizations and will have to rely exclusively on their own efforts.

In the social sector priorities of fiscal policy for the next 3 years are defined quite specifically, because the majority of them were taken from the previous message. As an independent objective, President has highlighted the need to complete the formation of sustainable long-term mechanism for pension schemes, improving the quality of social services and restructuring of the budget network. In addition, among the priorities of budget expenditures, the realization of national projects and activities to create a «barrier-free» environment for the disabled is introduced, as well as the modernization of the army and the fulfillment of international obligations of Russia, including the holding of the APEC summit and the Olympic Games in Sochi are identified.

In the area of tax policy measures, proposed in the Budget message, aimed at finding a compromise in achieving two opposing goals, there are the following ones: on the one hand, it is necessary to urge the upgrading of the Russian economy, but on the other hand, to ensure tax replenishment of the budget. Nevertheless, detailed analysis of measures on optimization the taxation system leads to the conclusion, that most of them are aimed at addressing the first issue. In particular, the Head of the government has proposed to:

- duplicate the revenue threshold, allowing to apply the simplified taxation scheme to small businesses;
- increase the upper limit of interest rate on debt liabilities, regarded as expenditures;
- establish the possibility of recognizing the costs of investors in construction or financing of transport, social and communal infrastructure, as well as engineering services for the public or municipal needs;
- introduce temporary procedure for the tax arrears treatment for organizations;
- actively promote restructuring the procedure of taxes and levies (deferrals, spreads, tax credits).

In fact, we are talking about easing the tax regime, which is quite justified in the situation of the economic crisis, as a measure, contributing to the preservation of liquidity in a large number of enterprises.

However, apparently, the above measures are likely to lead to the loss of budget revenues, whereas the sources, indicated in the Budget message as sources of compensation for the potential social losses, are not too convincing. Along with traditional measures to curb the use of schemes of tax evasion it is envisaged to work actively on implementation of real estate tax, increase the excise tax on tobacco and alcohol products, to optimize the system of taxes and customs duties, associated with the production and export of oil and petroleum products. Herewith, if the first two measures of improving budget revenue are in general able to urge a significant revenue in a long-term perspective, there are no clear prospects in regard to taxation of the oil sector.

It is worth to appreciate the President's message positively, as it is aimed at reducing the failures of tax administration through the introduction of modern technologies, the elimination of redundant reporting and optimization of audits number.

A real innovation in the structure of the Budget message has been the allocation as a separate section of a package of activities aimed at improving the technologies of the budget development and execution. While in terms of the content, many proposals have been already expressed earlier (in particular, on the need to improve management efficiency of the Reserve Fund and the Fund of National Welfare, the execution of the federal budget, on improving the efficiency of public procurement, on improvement of public and municipal control, on the introduction of the system of public assignments for the provision of social services), it does not remove their relevance. In addition, there are relatively new proposals, aimed at improving the efficiency of budgetary management in that section of the Budget message:

- the need to use conservative option of macroeconomic forecasting in budget planning and approve expenses growth, what should promote minimization of the fiscal risks;
- expansion of the approved departmental structure of expenditures and delegation of greater authorities to the top management in terms of budgetary funds redistribution within the framework of the established medium-term thresholds of budget expenditures between specific areas of public policy (giving them the right to conduct its budget records);
- transfer from financing organizations at the expense of the budget, including financing through investments in their authorized capital, to the use of the mechanism of refinancing the debt of these organizations;
- further development of budget planning within the concept of performance-based management through the transition to a program budget structure, which should be based on the long-term targeted programs and the prioritized national projects.

Therefore, the message clearly defines a continuation of the course, chosen by Dmitry Medvedev to improve the quality of life of the Russian citizens and the development of the innovation economy. However, the experience of 2008, the pursue of that course without further reforms entails further increase of public expenditures, what in the crisis situation is inconsistent with the priority of macroeconomic stability support and unconditional execution of the earlier budget commitments. Therefore, the need to look for a compromise between tentatively defined strategic objectives and implementation of anti-crisis measures in the area of fiscal policy in 2009 has made the Budget message a «forced conservative» document and attracted far more attention, than was paid in previous years to find for the reserves to reduce public spending, to reduce tax burden and to increase the efficiency of budget management.

As a follow-up of the Budget message issue of irregular and the inefficient utilization of budgetary funds, one should note that this issue again becomes one of the most pressing ones in the execution of the anti-crisis budget of the current year. Expenditure share of the

federal budget for the first quarter of 2009 is performed only for 18.9 per cent of the total amount, estimated for 2009 (See Table 2).

Herewith, in general the cost of financing of housing and communal services amounted to 7.4 per cent of expenditures; health and sports expenditures made 13,2 per cent. It should be noted, that these budget lines funding in terms of GDP shares, as compared with the same period of the last year has increased by 0.05 and 0.2 percentage points of GDP, respectively. The greatest growth in expenditures within January - March 2009 took place in budget lines of national economy – 2 p.p. and intergovernmental transfers - 1.9 percentage points of GDP.

Table 2

MAJOR EXPENDITURE LINES OF THE RF FEDERAL BUDGET WITHIN 2007 – 2009 (% IN GDP)

	2007	Q I, 2008	2008	Q I, 2009	% of expenses ver- sus estimated for the year indicator
TOTAL BUDGET EXPENDITURES	18.39	16.12	17.82	21.42	18.94
Federal issues	2.50	2.46	1.97	2.34	15.35
Including expenditures associated with the servicing of federal debt	0.44	0.64	0.36	0.78	31.27
National defense	2.56	2.13	2.45	2.68	16.34
National defense and law enforcement	2.05	1.96	1.97	2.61	19.61
National Economy	2.13	1.06	2.41	3.07	20.33
Housing and public utilities	0.91	0.044	0.30	0.09	7.36
Environmental protection	0.03	0.02	0.02	0.02	13.03
Education	0.91	0.57	0.84	0.76	14.37
Culture, cinematography and mass media	0.22	0.15	0.21	0.24	16.38
Health care and sports	0.60	0.42	0.66	0.62	13.22
Social policy	0.66	0.83	0.69	0.63	16.16
Interbudgetary transfers	5.84	6.50	6.30	8.36	23.01

Source: RF Ministry of Finance, IET estimates.

Also in May, the month the RF government has approved the major trends of tax policy for the 2010-2012, proposed by the RF Ministry of Finance, which generally do not imply significant tax reductions within the forthcoming three years, but involve a variety of measures to improve tax administration.

It is planned to improve tax control over the use of transfer prices, to create an institution of consolidated tax reporting on income tax, clarify the instrument for deferral of tax payments and to improve the decision-making terms upon an application, as well as to review the principles of depreciation groups structuring, to reduce the possibility of tax reduction. In particular, since 2010, it is planned to introduce a special procedure for the transfer of losses in the course of companies restructuring, which will be restricted in term and profits volume, addressed to pay off the losses restructured enterprises. Provision is also being taken to enhance the taxation of professional participants of securities market and stock market.

To speed up VAT refund, it is planned to optimize the list of documents, confirming the validity of applying a zero rate and to introduce a special procedure, in which a decision on the refund will be made before the completion of desk audit. It is planned to accept an opportunity to process the invoices with negative values, as well as to implement an electronic procedure for compiling and issuance of invoices.

It is planned to improve the collection of excise taxes on alcohol products, primarily due to enhanced control over deductions. In addition, the government intends to index a

number of excise taxes, as well as to release the individuals from submitting income tax return, if they have no tax liabilities to the budget. However, a tax return will be required, if the taxpayer wants to get tax exemptions or tax deductions.

The Government intends to introduce «tax holidays» for oil production at the new oil fields in the Black Sea and the Okhotsk Sea and reducing indices for NDPI assessment for oil production in small fields. It is also planned to create tax and financial incentives for the utilization of associated gas.

In addition, it is planned to introduce a lower NDPI rate on oil, produced from oil, gas and oil deposits, and to finalize preparations for the introduction of tax on surplus income, derived from extraction of oil (PDM) in the new fields instead of the currently applied NDPI. Introduction of PDM is planned for 2011–2012.

Since 2010, it is planned to introduce specific NDPI rates for coal and to differentiate tax rates by type of coal. The rates will be assessed as per factor deflator, which will take into account changes in prices for coal. It is planned to establish a tax deduction in the amount of expenses, incurred in order to ensure safety.

As it has been mentioned in the Budget Message of the Russian Federation President, the Government intends to raise the threshold of income rate, allowing companies to apply the simplified taxation system, to RUR 60 million per year for 3 years (starting from 2010). Herewith, the mechanism of this threshold indexation will be abolished. There are also plans to complete preparations for the introduction of real estate tax to replace the current land tax and tax on property of individuals. ●

## RESULTS OF FEDERAL PILOT PROJECT IN HEALTH CARE IN 2007–2008

S. Shishkin

*Within the framework of the pilot project carried out in 10 subjects of the Russian Federation a number of institutional reforms in the system of health care financing. The results of the project testify the relevance of the large-scale reforms in the field of the health care financing by the chosen directions at the same time giving evidence for the necessity of the specification of the particular tasks of reforms and their differentiation by the regions of the country.*

The accounting data on the operation of the system of health care of subjects of the Russian Federation make it possible to draw conclusions on the federal pilot project aimed at the improvement of the quality of services in the field of health care (further referred to as the Project). It was carried out from July 2007 in 19 subjects of the Russian Federation (further referred to as pilot regions): Astrakhan, Belgorod, Vladimir, Vologda, Kaliningrad, Kaluga oblasts, Krasnodar krai, Leningrad oblast, Republic of Tatarstan, Republic of Chuvashia, Perm krai, Rostov, Samara, Sverdlovsk, Tver, Tomsk, Tyumen oblasts, Khabarovsk krai, Khanty-Mansi autonomous okrug. The conditions for the realization of the project were defined by the Decree of the Government of the Russian Federation No 296 from May 19, 2007 “On approval of the regulations on the financing of the expenditures for fulfillment of the pilot project aimed at the improvement of the quality of services in the field of health care in the subjects of the Russian Federation in 2007 and on the approval of the list of the subjects of the Russian Federation participating in it”, as well as by a number of the regulating documents issued by the Ministry of Health Care and Social Development of the Russian Federation and by the federal Fund for Compulsory Health Insurance (CHI).

Initially the project was designed for 12 months – from July 2007 to June 2008. In order to fulfill it RUR 5.4 billion was allocated from the federal budget, of which in 2007 was in fact RUR 2.0 billion spent in 2007 and RUR 3.4 billion in 2008. The expenditures for the project from the budgets of the subjects of the Russian Federation were RUR 3.0 billion<sup>1</sup>. Starting with July 2008 the project was prolonged till the end of the year without additional allocation from the federal budget however.

The essence of the project was to approve five directions for modernization of the system for the financing of the health care mentioned below. The regions took part in the project under different conditions. In nine of them all five directions of modernizations were fulfilled, and these subjects took certain responsibilities for co-financing of the project. In eight regions 2-3 directions were fulfilled at the expense of the federal budget. Two of the subjects of the Russian Federation – Tyumen oblast (one direction was tried) and Khanty-Mansi autonomous region (two regions were tried) – took part in the project without attraction of the federal budget funds. The responsibilities of the participants of the experiment were registered in the agreements concluded between the Ministry for Health Care and Social Development of the Russian Federation, the CHI Federal Fund and the executive bodies of the Russian Federation.

<sup>1</sup> Here and thereafter the data of the Ministry for Health Care and Social Development of the Russian Federation and the Federal Fund for CHI

Out of 2219 medical and preventive treatment facilities operating in CHI system in pilot regions 673 medical and preventive treatment facilities (including 608 in-patient and 65 outpatient clinics) and 90.8 thousand of medical staff took part in the project.

The reforms in the following directions were tested within the framework of the project:

1. *Transfer of the institutions to prevalingly single-channel financing through CHI system.* Within the framework of the project the proportion of the public funds accumulated in the regional system of CHI was increased. This was provided for by the increase in the amount of contributions for CHI of the nonworkers which are made from the budgets of the subjects of the Russian Federation in the regional funds of the CHI. 12 regions out of 19 took the corresponding responsibilities. In 2006 the proportion of CHI funds in the public financing of the regional programs for the state guarantees for free provision of health care to the population in the regions was 40.3%. The remaining part of the funds was allocated directly from the budgets of the subjects of the Russian Federation and the municipal formations in the form of subsidies for maintenance of the dependent medical institutions. As a result of 2008 the real proportion of CHI funds was increased nearly by half, reaching 58%. The leaders on the absolute figures of the indicator are the Republic of Tatarstan (67%), Vologda oblast (65%), Tomsk oblast (62%). However the targeted value of the mentioned index, envisaged on average for all the pilot regions, was not reached.

The movement towards the single channel financing included the widening of the list of the kinds of expenditures included in the tariffs of the payment for health care in the system of CHI. In the existing system of CHI the tariffs make up for 5 kinds of the expenses of the medical and preventive treatment facilities: wages, charges for wages, purchase of medicines, furniture and accessories, expenditures for patients' feeding. Within the framework of the project the use of tariffs, including the expenses for the utilities, for property maintenance and for the purchase of new equipment was tried.

2. *Implementation of the standards of the health care and payment for the in-patient health care in accordance with the regulations of financial expenses calculated on the basis of these standards.* In 14 regions 678 federal standards for the rendering of the health care for treatment of some illnesses (from 6 to 297 the list of illnesses varying in different regions) and 15595 regional standards were introduced. These standards contain the list of the medical services and medicines provided in the course of treatment of a particular illness.

The operation of 608 inpatient clinics taking part in the project was paid on the basis of finished case of treatment. In 565 medical and preventive institutions the payment was made in accordance with the regulations for expenses on the basis of the standards for health care rendering. The targeted figure of 620 medical and preventive institutions also was not reached. The proportion of the registry of the bills for the rendered medical care formed on the basis of the regulations for financial expenses calculated according to the standards of the medical care should have been equal to 68%, but the real figure was by far less – 52%.

The main problem associated with the implementation of standards is their high cost. As compared with the cost for treatment of the corresponding illnesses calculated within the framework of the regulations for financing of regional programs for provision of the state guarantees established for the branch, the estimations of the expenses for the rendering of the health care proved to be substantially higher: for instance, the expenses for treatment of the impaired cardial function was 2.5 times higher, of the acute myocardial infarction – 4.7 times higher and innate pneumonia of prematurely

born – by 24 times. At the same time the biggest part of the costs is accounted for by the medicines – up to 94% of the cost of the standard.

Faced with this problem, a number of regions diverged from the initial agreement without prior arrangement: instead of the federal standards they started to use their own standards, making the rationalization and specification of the sets of medicines envisaged for provision of the health care for the citizens in in-patient clinics. Besides, the payment for the rendered help was made not for separate illnesses but for clinical and statistical groups on the basis of tariffs averaged for the illnesses belonging to these groups.

The fulfillment of the project has obviously demonstrated that the existing methodology for the development of the federal standards for treatment and procedure for their use as the basis for the calculation of tariffs for the payment for medical care rendered by the medical treatment institutions envisaged by the conditions of the pilot project are to be fully reconsidered.

3. *Transfer to per capita financing of the in-patient clinics with the elements of the fund holding.* Currently in the system of CHI the dominating method for payment for out-patient health care is the payment for doctors' visits. According to the project in 11 pilot regions there was the per capita principle for payment for out-patient treatment introduced.

The examination of the funds holding elements consisted in the process when the structure of the financing of 237 out-patients clinic together with the funds for their own activity on medical care of the population registered at it the funds for the consultations of specialists and analyses in other medical institutions rendered to the population registered at it were included. In 93 institutions the mechanisms for intrainstitutional payments between the departments of district physicians and medical officers were introduced.

4. *The implementation of new systems for labor remuneration of the medical staff for volumes and results of their work* was made in 14 regions. In 599 medical care institutions the labor remuneration included additional payments for basic rates to increase the motivation of the medical staff for the increase of volumes and improvement of the quality of the rendered services. The wages of the medical staff participating in the project increased from July 2007 to December 2008 by 66.2% - from RUR 8628 to RUR 14340.

5. *Implementation of the personified account for the volumes of the rendered medical care* was made in 18 regions and in 95% of the medical treatment institutions participating in the experiment. The task being solved consisted in creation of the single information space in the system of the regional health care, formation of the integrated information system uniting the bodies of health care management, medical institutions and insurers.

The choice of the directions of the project was correct. Nevertheless, there were some shortcomings in its organization: there were no tasks set to try alternative variants for transformations, absence of the methodical basis, too short periods for the project to completely fulfill the reforms envisaged and to obtain visible final results.

The short period of the project complicates the estimation of its effectiveness but there have been some positive changes, for instance the decrease in the amount of in-patient treatment, whose volumes are excessive in this country, and its substitution with out-patient treatment. In the pilot regions the volumes of the rendered in-patient treatment by all the medical treatment institutions decreased by 1.1% and rendered by the pilot medical treatment institutions - by 2.4%.

The quality of the medical care has improved thanks to both the stricter control of quality (the number of the examinations made has risen by 20%) and the fulfillment of the main directions of the project. The number of the cases of rendering of the medical care of undue quality has decreased by 26% from July 2007 to June 2008 as compared with the corresponding period of 2006-2007, and the number of nonspecialized admission of patients to hospitals has decreased by 14%. The satisfaction of the population with the medical care according to the data of the sociological surveys has increased from 61.6% to 84.1%.

On the whole the results of the pilot project testify the necessity of large-scale reforms in the system of financing of the health care along the chosen directions but at the same time prove the necessity to reconsider and specify the particular tasks for reforms and their differentiation by the regions of the country. ●



## SUPPORT TO SMALL ENTERPRISES IN CRISIS CONDITIONS

I.Dezhina

*The economic crisis has drastically worsened the conditions of functioning of small innovative firms. The Government is developing a set of additional measures designed to support such firms financially and to bolster their infrastructure. Meanwhile, there exist a number of problems dealing with the functioning of institutions created in order to promote innovations, and unless these problems are settled, the development of the sector of small innovative enterprises will be fraught with considerable difficulties. First of all, it is necessary to introduce alterations in the normative-legal regulation of the activity of the corresponding state funds.*

The crisis has relatively quickly started to adversely affect small innovative enterprises. Many small firms have been working on the principle of outsourcing, and carried out research and development work for big and medium-size businesses. In response to the crisis, the latter started to downsize or shut down their own research departments, and so considerably reduced the volumes of R&D outsourcing. In their turn, banks suspended crediting of small research-intensive firms, because these firms are the least stable ones in their development. All this factors have created a threat that this country may lose the “critical mass” of its small innovative enterprises.

In recent months, the Government has been actively developing additional measures designed to support small innovative businesses, including start-up companies. In this respect, the Government is planning to use the already existing mechanisms, and first of all the programs which are being implemented by the Fund of Assistance to the Development of Small Forms of Enterprises in the Scientific-and-Technical Sphere, and the Program of Small Business Support which is being materialized by the RF Ministry of Economic Development and Trade. Also, the authorities are planning to launch a number of new measures, such as assistance to student business incubators; the creation of a system for the provision of services to small innovative firms; and assistance to the development of prototyping by means of optimizing the functioning of the already created infrastructure, including the provision of support to the already created technological infrastructure.

At the same time, one of the most important problems is associated with the fact that the already functioning financial institutions and infrastructure objects aimed at supporting innovative enterprises cannot be efficiently made use of unless the normative-legal regulation of their activity is altered. First of all, this is true of the activities of the Fund of Assistance to the Development of Small Forms of Enterprises in the Scientific-and-Technical Sphere (or the Fund of Assistance).

Presently, the Fund of Assistance is functioning under the *Regulation* on the Fund<sup>1</sup>. In accordance with the Regulation, the Fund represents a state-owned non-for-profit organization which carries out its activities in cooperation with the Ministry of Science and Technical Policy of the Russian Federation and the Foundation for Assistance to Entrepreneurship and Competition Development under the State Committee of the Russian

1 The Regulation on the Fund of Assistance to the Development of Small Forms of Enterprises in the Scientific-and-Technical Sphere (approved by Resolution of the RF Government, of 3 February 1994, No 65) (as amended on 5 January and 12 December 1995, 6 March 1996, and 31 March 1998).

Federation for Anti-Monopoly Policy and Promotion of New Economic Structures within the framework of federal and regional programs of state assistance to small businesses in the Russian Federation (point 2 of the Regulation). Thus, the Regulation does not specify the organizational-legal form of the Fund of Assistance, thus endowing it with a relative freedom of action.

However, at the same time this has placed the Fund of Assistance beyond the existing norms stipulated in the RF Civil and Budget Codes. The Fund of Assistance can indeed dispose of budget resources, but in accordance with the RF Budget Code (Article 38.1 “Principle of departmental character of expenditures of budgets”) it may distribute resources only among the organizations subordinated to it. The Fund of Assistance has no organizations subordinated to it, and so it distributes the funding earmarked for research and development work on the basis of contests – by concluding contracts with the organizations winning in these contests (on the basis of Federal Law No 94), no matter which state department these organizations are subordinated to.

Nevertheless, until now the activity of the government science and innovation support funds was perfectly legal, because by Federal Law of 26 April 2007, No 63-FZ, “On introducing changes into the Budget Code of the Russian Federation in the part of regulation of the budgeting process and of bringing some legislative acts of the Russian Federation in conformity with budget legislation of the Russian Federation” they were granted a special period until 1 January 2010 for correspondingly coordinating their documents. Strictly speaking, this point was not applicable to the Fund of Assistance, but if one is to be guided by the Provision – which contains no stipulations as to whether the Fund of Assistance is a budget-funded or autonomous institution, or has some other organizational-legal form – the Fund’s situation becomes uncertain in terms of legal regulation, and its activity thus has to be carried on in the “risk zone”.

In this current situation, several solutions are possible. Firstly, the Fund of Assistance can be reorganized in an autonomous institution (AI). This reorganization, on the one hand, will remove the obstacle represented by the requirement to distribute funding only among the organizations subordinated to it, and thus enables the Fund to receive subsidies from the federal budget. On the other, autonomous institutions cannot be principal distributors of budget funding, and so the Fund of Assistance in this case will no more be treated as a separate budget item, and funding will be allocated to it indirectly, through state ministries or departments. Consequently, it will be difficult to guarantee that the Fund of Assistance This is of especial importance in connection with the evolving economic crisis, because the legislative base for the functioning of AI has not been developed properly. The subsidies by means of which AI are to be financed belong to the category of unprotected budget items, and so may be cut as a first priority.

Another variant is to introduce relevant changes into the RF Budget Code, so as to consolidate to the Fund of Assistance a special status enabling it to become the principal distributor of budget resources and to distribute these resources as grants. By issuing the permission to the Fund of Assistance to finance research and development work in the form of grants and not on the basis of the Law on State Procurements could simplify many procedural details.

The new status of the Fund of Assistance would also make easier its participation in the support of prototyping. This support can be provided by allocating funding to operating centers for technological innovation (CTI) to cover their expenditures on the provision of consulting services to small prototyping. According to expert’s estimations, this country has only 10 – 15 properly functioning CTIs, capable of providing high quality services in the field of technological entrepreneurship, among the more than 60 actually existing ones. It is to these former CTIs that the support for their expansion and development must

be provided. This support can be provided for the period of three years, with the possibility to further extend it on the basis of assessment of their results.

The feasibility of such a solution can be confirmed by the fact that substantial (but short-term) funding has already been invested in the infrastructure of innovations, and many objects have been created that for most part do not function properly. Therefore it appears that selective support for the best CTIs should produce a better effect. Later on, regional centers offering support to small innovative enterprises can be created.

The financing of small innovative enterprises on the basis of contests can be effectuated through the Fund of Assistance – in case it is permitted to finance the innovations infrastructure. So far, the budget resources allocated to the Fund of Assistance may be spent only on research and development work. Besides, for this measure to be actually implemented, it would be feasible to revise the Program of Small Business Support of the RF Ministry of Economic Development and Trade. It can be possible to allocate to the Fund of Assistance part of the funding which is presently being distributed within the framework of this Program. At present, funding is allocated to the regions and is earmarked generally to support small businesses, without distinguishing among them the category of small innovative enterprises. It is not clear at present just how effective this mechanism of support might be. In the suggested scheme, the Fund of Assistance can take it upon itself to finance innovative enterprises proper, through supporting prototyping, and also to control the implementation of such projects.

The provision of services to small innovative enterprises, including their placement at specific infrastructural objects (techoparks, incubators, and so on) is of critical importance for beginners – the so-called start-up small innovative enterprises. However, at present this notion is not defined by RF legislation. Consequently, it is not clear to which subject this targeted support can be provided. Judging by foreign experience and the practice of the Fund of Assistance's functioning, the following criteria can be suggested for defining a start-up innovative company: 1) the company must be no more than one year old, 2) the company has no turnover, or its turnover amounts to under 1 million rubles per annum, 3) the company has researchers (or postgraduate or undergraduate students) on its staff.

And finally, in a situation when budget funding available for the state support to innovation activity is being cut down, greater importance is acquired by the programs for support of small innovative enterprises implemented by foreign research funds with representative offices in Russia. The number of such targeted initiatives (training projects, funding projects for small companies, educational programs) has been growing in recent years. Meanwhile, after the adoption, in June 2008, of the RF Government's Decree No 485 "On the list of international organizations whose grants to taxpayers (gratis aid) are not subject to taxation and are not recoded for tax purposes as part of incomes of Russian organizations – recipients of grants", the Decrees exempting the payments made by international organizations from profits tax and income tax became null and void. So far, no new list of foreign organizations – issuers of grants to be exempt from taxation has been developed, although such list was to be approved by the RF Government before 1 January 2009. As a result of this delay with the approval of this list, from 1 January 2009 onwards, the individual payments made to the recipients of grants, the transfers to the accounts of organizations – recipients of grants, and the equipment and materials supplied to an organization within the framework of a grant must be taxed. Thus, the conditions for the functioning of foreign funds in Russia have worsened, which resulted in the freezing of a number of programs, including some innovative ones. ●

## REVIEW OF THE LEGISLATION OF THE RF CONCERNING SUPPORT OF SMALL BUSINESS

D.Kazantsev

*With the adoption of the Federal Law from July 24, 2007 No 209-FZ “On the development of small- and medium-scale entrepreneurship in the Russian Federation” and invalidation of the Federal Law from June 14, 1995 No 88-FZ “On state support for the small business in the Russian Federation” a new stage of the regulation of these relations in the Russian Federation has started. According to Law 209-FZ the main principles and forms for the support of the small- and medium-scale business, particular measures and procedures for their fulfillment in accordance with this Law are regulated by the corresponding federal and regional target programs. In one and a half year after the adoption of the Federal Law the corresponding regional laws were developed in the majority of subjects of the Russian Federation. In the same period both at the regional and at the federal level there were the government bodies created which are authorized to support the small- and medium-scale entrepreneurship.*

### Laws on Development of Small Business

The basis for the legislative regulation of the support for small entrepreneurship both at the federal and at the regional level is Federal Law No 209-FZ “On the development of the small- and medium-scale entrepreneurship in the Russian Federation”. In article 4 of this law the characteristics that enable to refer an economic entity to the subjects of small- and medium-scale entrepreneurship as well as the categories of such subjects are established. Thus, in accordance with this article, the consumer’s co-operative and commercial organizations (excluding the state and municipal unitary enterprises), registered in the Unified state register of economic entities, as well as the individual entrepreneurs and farms belong to the subjects of small and medium-scale entrepreneurship if they meet the following requirements:

1) For economic entities:

- the aggregate share of the Russian federation, subjects of the Russian Federations, municipal formations, foreign economic entities, foreign citizens, non-government and religious organizations, charities and other funds in the authorized capital stock, stock capital or share fund of the mentioned economic entities should not exceed 25% (excluding the assets of the share investment funds and the closed unit investment trusts);
- the share of one or several economic entities that are not subjects of small- or medium-scale entrepreneurship should not exceed 25%.

2) Average number of employees in the preceding calendar year should not exceed the following limit values for each of the categories of subjects of small- and medium-scale entrepreneurship:

- a) from one hundred and one to two hundred and fifty people, inclusive, for medium-scale enterprises;
- b) up to one hundred people, inclusive, for small-scale enterprises;
- c) up to fifteen people, inclusive, for micro-scale enterprises<sup>1</sup>.

<sup>1</sup> According to the classification of article 4 law No 209-FZ micro-scale enterprises are a kind of small-scale enterprises

3) Earnings from the sale of goods (works, services) not taking into account VAT or balance cost of assets over the preceding calendar years should not exceed the limit figures set by the Government of the Russian Federation for each of the categories of subjects of small-scale and medium-scale enterprises. These figures are established by the Government of the Russian Federation once in five years taking into account the statistical data on the operation of subjects of small- and medium-scale enterprises. At present, according to the Decree of the Government of the Russian Federation from July 22, 2008 No 556 the following limit figures are established:

- a) RUR 60 million for micro-scale enterprises;
- b) RUR 400 million for small-scale enterprises;
- c) RUR 1000 million for medium-scale enterprises.

In accordance with article 7 of Law No 209-FZ in order to fulfill the state policy concerning the development of small- and medium-scale entrepreneurship in the Russian Federation the following measures for support of the small- and medium-scale enterprises can be envisaged by the federal laws and other legal and regulatory acts of the Russian Federation:

- 1) special taxation regimes, simplified rules for fiscal accounting, simplified forms of tax declarations for some kinds of taxes and duties paid by small-scale enterprises;
- 2) simplified system for accounting for small-scale enterprises engaged in some kinds of activities;
- 3) simplified procedure for making statistical reports by the subjects of small- and medium-scale enterprises;
- 4) privileged procedure for payment for state and municipal property privatized by the subjects of small- and medium-scale entrepreneurship;
- 5) peculiar features for the participation of the subjects of small-scale enterprises as suppliers (executors, contractors) with the aim of placing orders for supplies of goods, execution of works, rendering services for state and municipal needs;
- 6) measures to secure rights and legal interests of the subjects of small- and medium-scale enterprises when implementing government control and supervision;
- 7) measures to secure financial support for the subjects of small- and medium-scale entrepreneurship;
- 8) measures to develop infrastructure for the support of the subjects of small- and medium-scale entrepreneurship.

The list remains open.

According to article 8 of the Law No 209-FZ it is envisaged to keep the Register for the subjects of small- and medium-scale enterprises receiving the support of the state. The procedure for keeping such a register is regulated by the Decree of the Government of the Russian Federation from May 6, 2008 No 358.

According to article 16 of law 209-FZ the following forms are acceptable for the state support of the subjects of small- and medium-scale enterprises:

#### *1. Financial support*

Provision of financial support to the subjects of small and medium-scale enterprises can be made at the expense of the budgets of subjects of the Russian Federation and the funds of the local budgets by giving subsidies, budget investments, state and municipal guarantees for the liabilities of the subjects of small- and medium-scale entrepreneurship and organizations forming the infrastructure to support the subjects of small- and medium-scale entrepreneurship.

The funds of the federal budget directed to support the subjects of small- and medium-scale enterprises envisaged by the law on the federal budget are allocated to the budgets of the subjects of the Russian Federation in the form of subsidies.

### *2. Property support*

Provision of property support is given to the subjects of small- and medium-scale entrepreneurship by the government bodies and local authorities in the form of passing into possession or for use of the state or municipal property, including land plots, buildings, constructions, structures, non-residential premises, equipment, machinery, mechanisms, installations, transport vehicles, inventory, tools onerously, gratuitously or on preferential terms. The property mentioned should be used purposefully. The sale of the property passed to the subjects of small- and medium-scale business, assignation of the right for its use, pawning of a right to use it or introduction of the right to use this property in the authorized capital stock of other economic entities is prohibited.

### *3. Information support*

Information support for the subjects of small- and medium-scale entrepreneurship is provided regional and municipal information systems and information and telecommunication networks and securing their functioning in order to provide support for the subjects of small- and medium-scale enterprises with the information:

- On fulfillment of the federal, regional and municipal programs for the development of the subjects of small- and medium-scale entrepreneurship;
- On the number of the subjects of small- and medium-scale entrepreneurship and on their classification by the kinds of economic activity;
- On the number of filled workplaces in the subjects of small- and medium-scale entrepreneurship corresponding to their classification by kinds of economic activity;
- On turnover of goods (works, services) produced by the subjects of small- and medium-scale entrepreneurship corresponding to their classification by kinds of economic activity;
- On financial and economic situation of the subjects of small- and medium-scale entrepreneurship;
- On organizations making up support infrastructure for the subjects of small- and medium-scale entrepreneurship.

The list remains open. The information mentioned in it should be public, should be places in the Internet at the official sites of federal executive bodies, executive bodies of the subjects of the Russian Federation, local government bodies, having special authority in the field of development of subjects of small- and medium-scale entrepreneurship at their discretion.

### *4. Consultation support*

Providing consultation support for subjects of small- and medium-scale entrepreneurship by the government bodies and local government can be made in the form of:

- Creation organizations making infrastructure to support the subjects of small- and medium-scale entrepreneurship and giving counseling services to the subjects of small and medium-scale entrepreneurship, provision of the activity of such organizations;
- Compensation for the expenses made and proved by documents by the subjects of small- and medium-scale entrepreneurship to pay for the counseling services.

### *5. Support in the field of training, retraining staff and raising level of staff's skill*

Provision of the support for the subjects of small- and medium-scale entrepreneurship in the field of training, retraining staff and raising level of staff's skill can be made in the following forms:

- Development of model educational programs aimed at training, retraining staff and raising level of staff's skill of the subjects of small- and medium-scale entrepreneurship on the basis of state educational standards;

- Creation of the environment to increase the professional knowledge of specialists belonging to socially unprotected groups of population, improvement of their business skills, their training to carry out new work functions in the field of small- and medium-scale entrepreneurship;
- Educational and methodological, scientific and methodological assistance to the subjects of small- and medium-scale entrepreneurship.

#### *6. Support in the field of innovations and industrial production*

Provision of support to the subjects of small- and medium-scale entrepreneurship in the field of innovations and industrial production by the governmental bodies and local government can be made in the following forms:

- Creation of organizations forming infrastructure to support the subjects of small- and medium-scale entrepreneurship and giving the support to the subjects of small- and medium-scale entrepreneurship, including technological parks, centers for commercializing of technologies, technological and promotional and scientific and production zones and securing the operation of such organizations;
- Assisting in patenting of the inventions, useful models, production pieces and selective achievements, as well as in the state registration of other results of intellectual activity produced by the subjects of small- and medium-scale entrepreneurship;
- Creation of conditions for encouraging the subjects of small- and medium-scale entrepreneurship to sign subcontracts in the field of innovations and industrial production;
- Creation of share investment funds and closed unit investment funds.

#### *7. Support for artisan undertakings*

Provision of support for the subjects of small- and medium-scale entrepreneurship in the field of artisan undertakings by governmental bodies and local government can be made in the form of:

- Creation of the organization making the infrastructure for the subjects of small- and medium-scale entrepreneurship in the field of artisan undertakings, including handicraft chambers, centers for handicraft and securing their operation;
- Financial, property, consultation, information support, support in the field of training and retraining of the staff, raising the staff's skill, support for the subjects of small- and medium-scale entrepreneurship in the field of artisan undertakings conducting foreign economic activity.

#### *8. Support for the subjects of small- and medium-scale entrepreneurship conducting foreign economic activity*

Provision of the support for the subjects of small- and medium-scale entrepreneurship conducting foreign economic activity is made by governmental bodies and local government in the following forms:

- Cooperation with international organizations and foreign countries in the field of the development of small- and medium-scale entrepreneurship;
- Assistance in promotion of Russian goods (works, services), results of intellectual activity at the markets of the foreign countries, as well as creation of the favorable conditions for the Russian participants of foreign economic activity;
- Creation of organizations forming the infrastructure for the support of the subjects of small- and medium-scale entrepreneurship, conducting foreign economic activity and securing the operation of such organizations;

- Realization of other measures to support the subjects of small- and medium-scale entrepreneurship, conducting foreign economic activity.

*9. Support for the subjects of small- and medium-scale entrepreneurship operating in the field of agriculture.*

In addition to the approved Law No 209-FZ the subjects of the Russian Federation have the right to provide other forms of support at the expense of their own budgets independently. Generally, it follows from the Federal Law “On development of the small- and medium-scale entrepreneurship” that the fulfillment of any particular measures to support small business is carried out by the subjects of the Russian Federation both at the expense of their own funds and at the expense of subsidies from the federal budget. Currently both at the federal level and in the majority of the regions the procedure has been set up for granting budget subsidies to the subjects of small- and medium-scale entrepreneurship.

At the end of 2007 and in 2008 the majority of the subjects of the Russian Federation adopted laws on support the subjects of small- and medium-scale entrepreneurship. For instance, such laws were approved in the following regions:

1. Saint-Petersburg (Law of Saint-Petersburg from April 17, 2008 No 194-32).
2. Arkhangelsk oblast (Law of Arkhangelsk oblast from July 6, 1999 No137-23-OZ).
3. Altai krai (Law of Altai krai from November 17, 2008 No 110-ZS).
4. Primorsky krai (Law of Primorsky krai from July 1, 2008 No 278-KZ).
5. Tyumen oblast (Law of Tyumen oblast from May 5, 2008 No 18).
6. Kaluga oblast (Law of Kaluga oblast from March 29, 2008 No 4-OZ).
7. Kaliningrad oblast (Law of Kaliningrad oblast from October 20, 2008 No 278).
8. Novosibirsk oblast (Law of Novosibirsk oblast from July 2, 2008 No 245-OZ).
9. Republic of Udmurtia (Law of Republic of Udmurtia from October 8, 2008 No 34-RZ).
10. Tula oblast (Law of Tula oblast from October 7, 2008 No 1089-ZTO).
11. Sverdlovsk oblast (Law of Sverdlovsk oblast from February 4, 2008 No 10-OZ).
12. Ryazan oblast (Law of Ryazan oblast from July 9, 2008 No 73-OZ).
13. Stavropol krai (Law of Stavropol krai from October 15, 2008 No 61-kz).
14. Yaroslavl oblast (Law of Yaroslavl oblast from May 6, 2008 No 20-z).
15. Murmansk oblast (Law of Murmansk oblast from May 27, 2008 No 977-01-ZMO).
16. Tomsk oblast (Law of Tomsk oblast from December 5, 2008 No 249-OZ).
17. Vologda oblast (Law of Vologda oblast from December 5, 2008 No 1916-OZ).
18. Republic of Komi (Law of republic of Komi from March 11, 2008 No 19-RZ).
19. Krasnoyarsk krai (Law of Krasnoyarsk krai from December 4, 2008 No 7-2528).
20. Orel oblast (Law of Orel oblast from February 9, 2004 No 327-OZ).
21. Republic of Bashkortostan (Law of Republic of Bashkortostan from December 28, 2007 No 511-z).
22. Omsk oblast (Law of Omsk oblast from October 17, 2008 No 1076-OZ).
23. Novgorod oblast (Law of Novgorod oblast from February 7, 2008 No 245-OZ).
24. Chelyabinsk oblast (Law of Chelyabinsk oblast from March 27, 2008 No 250-ZO).
25. Krasnodar krai (Law of Krasnodar krai from April 4, 2008 No 1448-KZ).
26. Volgograd oblast (Law of Volgograd oblast from July 4, 2008 No 1720-OD).
27. Voronezh oblast (Law of Voronezh oblast from March 12, 2008 No 2-OZ).
28. Rostov oblast (Law of Rostov oblast from May 13, 2008 No 20-ZS).
29. Nizhniy Novgorod oblast (Law of Nizhniy Novgorod oblast from December 5, 2008 No 171-Z).
30. Bryansk oblast (Law of Bryansk oblast from June 9, 2008 No 34-Z).
31. Ivanovo oblast (Law of Ivanovo oblast from July 14, 2008 No 83-OZ).
32. Kirov oblast (Law of Kirov oblast from December 27, 2008 No 219-ZO).



33. Kostroma oblast (Law of Kostroma oblast from May 26, 2008 No 318-4-ZKO).
34. Republic of Karachai-Cherkess (Law of Republic of Karachai-Cherkess from July 25, 2008 No 58-RZ).
35. Kurgan oblast (Law of Kurgan oblast from September 26, 2008 No 389).
36. Kemerovo oblast (Law of Kemerovo oblast from December 27, 2007 No 187-OZ).
37. Kamchatka krai (Law of Kamchatka krai from June 18, 2008 No 71).
38. Republic of Kabardino-Balkaria (Law of Republic of Kabardino-Balkaria from May 2, 2008 No 29-RZ).
39. Republic of Dagestan (Law of Republic of Dagestan from July 16, 2008 No 34).
40. Republic of Buryatia (Law of Republic of Buryatia from November 7, 2008 No 568-IV).
41. Perm oblast (Law of Perm oblast from March 28, 1997 No 700-100).
42. Smolensk oblast (Law of Smolensk oblast from November 28, 2008 No 153-z).
43. Orenburg oblast (Law of Orenburg oblast from November 17, 1997 No 193/61-OZ).
44. Republic of North Ossetia-Alania (Law of Republic of North Ossetia-Alania from January 11, 2007 No 1-RZ).
45. Republic of Tyva (Law of Republic of Tyva from July 7, 2008 No 795-VKh-2).
46. Tver oblast (Law of Tver oblast from June 25, 1998 No 23-OZ-2).
47. Republic of Ingushetia (Law of Republic of Ingushetia from December 7, 1996 No 16-RZ).
48. Republic of Karelia (Law of Republic of Karelia from July 3, 2008 No 1215-ZRK).
49. Khanty-Mansi Autonomous Okrug – Yugra (Law of Khanty-Mansi Autonomous Okrug – Yugra from December 29, 2007 No 213-oz).

In some regions, namely in Arkhangelsk, Orel, Orenburg, Tver and Kaluga oblasts as well as in the Republics of Karelia, North Ossetia and Ingushetia, the laws in effect are those adopted before the Federal Law No 209-FZ came into effect. The difference in the text of the laws on support for small-scale entrepreneurship adopted in these regions from the text of Federal Law No 209-FZ is significant, the laws envisaging a number of measures that are not mentioned in the federal law though they do not contradict it. For instance, the following measures are envisaged in these regions:

- Funds for support of the small-scale entrepreneurship;
- Privileged crediting of the subjects of small-scale entrepreneurship;
- Privileged insurance for the subjects of small-scale entrepreneurship;
- Assistance in the formation of associations and unions of the subjects of small-scale entrepreneurship; etc.

Some of the mentioned measures are envisaged by some regional laws on the support for the small-scale entrepreneurship adopted at the end of 2007 and in 2008.

The majority of the regional laws mentioned repeat and partially specify and give more details for the statements of the Federal Law No 209-FZ, devoted to the participation of the subjects of the Russian Federation in support for small- and medium-scale entrepreneurship. Thus, for example, the essence of the measures to support the subjects of small- and medium-scale entrepreneurship is disclosed and the list of the property passed to the subjects of small- and medium-scale entrepreneurship within the framework of the property support.

### **Participation of subjects of small business in order placement for public needs**

According to Federal Law from July 21, 2005 No 94-FZ “On placement of orders for supply of goods, execution of works, rendering services for the state and municipal needs” some characteristics for the participation of small business in the relationships regulated by the Law are established. The establishment of peculiar features for the participation of the small business in the placement of state and municipal orders is aimed at the provi-

sion of the small-scale enterprises with additional secured markets for sale of goods, works and services.

Thus, article 15 of Law No 94-FZ in accordance with the changes introduced in it by Federal Law from December 30, 2008 No 308-FZ envisages that according to general regulations state and municipal customers should place orders at the subjects of small-scale entrepreneurship of no less 10% and no more than 20% of the total annual volume of supply of goods, execution of works, rendering services for state and municipal needs according to the list established by the Government of the Russian Federation. At present the List of goods, works and services for state and municipal needs order placement for which is made at the subjects of small-scale entrepreneurship is the one approved by the Decree of the Government of the Russian Federation from November 4, 2006 No 642 (in the version of the Decree of the Government of the Russian Federation from March 17, 2009 No 237).

The initial (maximum) price of a contract (price of board lot) should not exceed the initial price established by the Government of the Russian Federation. In accordance with paragraph 21 article 65 Law No 94-FZ introduced by the Federal Law from December 30, 2008 No 308-FZ before the Government of the Russian Federation approved the initial price when placing orders by the subjects of small-scale entrepreneurship it was established that:

- Initial (maximum) price of the contract (price of a board lot) when placing an order for the supply of goods, execution of works should not exceed three million of rubles;
- Initial (maximum) price of the contract (price of a board lot) when placing an order for services rendering should not exceed two million of rubles.

With the adoption of the Decree of the Government of the Russian Federation from March 17, 2009 No 237 the initial (maximum) price of the contract (price of board lot) when placing an order for supply of goods, execution of works, rendering services for state or municipal needs at the subjects of small-scale entrepreneurship was established at the rate of 15 million rubles.

### **Target programs for development of small business**

In accordance with paragraph 2 article 16 of Law No 209-FZ “On development of small- and medium-scale entrepreneurship in the Russian Federation” the conditions and the procedure for the provision of support to the subjects of small- and medium-scale entrepreneurship are established by federal, regional and municipal programs of the development of the subjects of small- and medium-scale entrepreneurship .

Although article 9 of the Federal Law NO 209-FZ envisages the elaboration of the federal target programs of the development of small- and medium-scale entrepreneurship by the subject, currently there are no such programs at the federal level.

Clause 1 article 10 of Federal Law No 209-FZ envisages “elaboration and fulfillment of regional and intermunicipal programs for the development of the subjects of small- and medium-scale entrepreneurship taking into account national and regional socio-economic, ecological, cultural and other peculiar features” by the governmental bodies of subjects of the Russian Federation. Currently there are programs aimed at supporting the development of small-scale entrepreneurship operating in the following subjects of the Russian Federation:

1. Moscow (program approved by the Decree of the Government of Moscow from June 20, 2006 No 420-PP).
2. Arkhangelsk oblast (program approved by the Decree of the Administration of Arkhangelsk oblast from September 18, 2008 No 208-pa/31).
3. Altai krai (program approved by the Decree of the Administration of Altai krai from November 7, 2008 No 507).

4. Primorsky krai (program approved by the Law of Primorsky Krai from December 3, 2008 No 344-KZ).
5. Penza oblast (program approved by the Decree of the Government of Penza oblast from October 27, 2008 No 713-pP).
6. Kaluga oblast (program approved by the Law of Kaluga oblast from December 8, 2006 No 266-OZ).
7. Kaliningrad oblast (program approved by the Decree of the Government of Kaliningrad oblast from February 13, 2007 No 57).
8. Novosibirsk oblast (program approved by the Decree of the Council of Deputies of Novosibirsk oblast from October 30, 2008 No 180).
9. Republic of Udmurtia (program approved by the Decree of the Government Council of Republic of Udmurtia from November 25, 2008 No 194-IV).
10. Tula oblast (program approved by the Law of Tula oblast from December 17, 2007 No 933-ZTO).
11. Vladimir oblast (program approved by the Law of Vladimir oblast from December 24, 2007 No 182-OZ).
12. Ryazan oblast (program approved by the Decree of the Government of Ryazan oblast from October 14, 2008 No 269).
13. Ulyanovsk oblast (program approved by the Law of Ulyanovsk oblast from June 8, 2005 No 042-OZ).
14. Amur oblast (program approved by the Law of Amur oblast from April 28, 2008 No 29-OZ).
15. Yaroslavl oblast (program approved by the Decree of the Administration of Yaroslavl oblast from September 3, 2007 No 352-a).
16. Murmansk oblast (program approved by the Decree of the Government of Murmansk oblast from September 17, 2008 No 445-PP/15).
17. Tomsk oblast (program approved by the Law of Tomsk oblast from December 29, 2007 No 322-OZ).
18. Republic of Chuvashia (program approved by the Decree of Cabinet of Republic of Chuvashia from December 30, 2004 No 309).
19. Krasnoyarsk krai (program approved by the Law of Krasnoyarsk krai from December 20, 2007 No 4-1130).
20. Novgorod oblast (program approved by the Decree of the Administration of Novgorod oblast from April 2, 2008 No 109).
21. Chelyabinsk oblast (program approved by the Decree of the Legislative Assembly of Yaroslavl oblast from August 28, 2008 No 1324).
22. Volgograd oblast (program approved by the Law of Volgograd oblast from December 27, 2006 No 1393-OD).
23. Voronezh oblast (program approved by the Decree of Duma of Voronezh oblast from December 15, 2005 No 295-IV-OD).
24. Rostov oblast (program approved by the Law of Rostov oblast from November 26, 2008 No 123-ZS).
25. Nizhniy Novgorod oblast (program approved by the Decree of the Government of Nizhniy Novgorod oblast from December 16, 2005 No 315).
26. Republic of Khakassia (program approved by the Law of Republic of Khakassia from December 3, 2008 No 76-ZRKh).
27. Bryansk oblast (program approved by the Decree of the Administration of Bryansk oblast from May 19, 2008 No 479).
28. Lipetsk oblast (program approved by the Decree of the Administration of Lipetsk oblast from September 18, 2008 No 243).

29. Ivanovo oblast (program approved by the Law of Ivanovo oblast from January 11, 2007 No 28-OZ).

30. Transbaikalie krai (program approved by the Law of Transbaikalie krai from June 27, 2007 No 963-ZChO).

31. Samara oblast (program approved by the Law of Samara oblast from February 11, 2004 No 6-GD).

32. Kostroma oblast (program approved by the Decree of the Duma of Kostroma oblast from April 20, 2006 No 326).

33. Kemerovo oblast (program approved by the Decree of the Board of Administration of Kemerovo oblast from June 26, 2007 No 167).

34. Republic of Kabardino-Balkaria (program approved by the Law of Republic of Kabardino-Balkaria from April 24, 2007 No 29-RZ).

35. Republic of Mordovia (program approved by the Decree of the Government of Republic of Mordovia from April 24, 2007 No 29-RZ).

36. Astrakhan oblast (program approved by the Decree of the Government of Astrakhan oblast from August 13, 2008 No 436-P).

37. Republic of Dagestan (program approved by the Decree of the Government of Republic of Dagestan from November 11, 2008 No 374).

38. Republic of Buryatia (program approved by the Decree of the Government of Republic of Buryatia from December 25, 2007 No 419).

39. Saratov oblast (program approved by the Law of Saratov oblast from October 1, 2007 No 200-ZSO).

40. Republic of Tatarstan (program approved by the Law of Republic of Tatarstan from October 21, 2005 No 105-ZRT).

41. Perm krai (program approved by the Law of Perm krai from December 10, 2008 No 352-PK).

42. Smolensk oblast (program approved by the Law of Smolensk oblast from April 2, 2007 No 13-z).

43. Orenburg oblast (program approved by the Law of Orenburg oblast from September 22, 2008 No 2403/513-IV-OZ).

44. Belgorod oblast (program approved by the Decree of the Government of Belgorod oblast from March 5, 2007 No 42-pp).

45. Irkutsk oblast (program approved by the Decree of the Government of Irkutsk oblast from June 25, 2008 No 44/5-ZS).

46. Kursk oblast (program approved by the Decree of the Duma of Kursk oblast from October 9, 2008 No 762-IV OD).

47. Jewish Autonomous oblast (program approved by the Decree of the Government of Jewish Autonomous oblast from August 12, 2008 No 224-pp).

48. Republic of Tuva (program approved by the Decree of the Government of Republic of Tuva from October 16, 2008 No 634).

49. Magadan oblast (program approved by the Law of Magadan oblast from December 21, 2007 No 946-OZ).

50. Yamalo-Nenets Autonomous Okrug (program approved by the Law of Yamalo-Nenets Autonomous Okrug from December 20, 2007 No 138-ZAO).

51. Republic of Altai (program approved by the Law of Republic of Altai from November 30, 2007 No 74-RZ).

52. Khanty-Mansi Autonomous Okrug - Yugra (program approved by the Law of khanty-Mansi Autonomous Okrug – Yugra from December 30, 2003 No 82-oz).

At the same time in some subjects of the Russian Federation municipal target programs aimed at supporting the small-scale enterprises are being carried out.

### **Procedure for alienation of the property rented by the subjects of small business**

Relations evolving as a result of alienation of immovable objects from the state property of subjects of the Russian Federation and from municipal property, which are rented by the subjects of small- and medium-scale entrepreneurship are regulated by the Federal Law from July 22, 2008 No 159-FZ “On peculiar features of alienation of immovable objects from the state property of subjects of the Russian Federation and from municipal property, which are rented by the subjects of small- and medium-scale entrepreneurship”.

In concordance with article 3 of this Federal Law, during the onerous alienation of immovable objects from the state property of subjects of the Russian Federation and from municipal property the subjects of small- and medium-scale entrepreneurship enjoy the advantageous right for purchase of such property at the price which is equal to the market price defined by an independent expert. It should be noted that such an advantage is granted on conditions that:

- 1) Rented property is in temporary ownership or in temporary use for a period of three years and more in accordance with the rent contract;
- 2) The rent for such property was duly paid for a period of three years or more;
- 3) The area of the rented premises does not exceed the limit area for the rented immovable property in the ownership of a subject of the Russian Federation or in the municipal ownership<sup>1</sup>;
- 4) Rented property is not included in the list of the state property or municipal property intended to be passed into the ownership or the use of the subjects of small- and medium-scale enterprises.

The majority of the subjects of the Russian Federation has adopted by now corresponding laws regulating the procedure for fulfillment of the statements of the Federal Law No 159-FZ in their territory. ●

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<sup>1</sup> In accordance with the Decree of the Government of the Russian Federation from December 18, 2008 No 961 the maximum area of the premises should not exceed 1000 sq m.

## TRENDS AND PROBLEMS INVOLVED IN THE FUNCTIONING OF FOREIGN FUNDED PENSION PLANS DURING A FINANCIAL CRISIS

L.Sycheva, L.Mikhailov

*In the first few months of the financial crisis the losses sustained by the pension funds of the OECD countries amounted in real terms, on the average, to 25 % of their asset value. However, their problems are not limited only to losses and depreciation of their current assets. The funds are also faced with shortages of money needed to finance current pension contributions. The governments of many countries are trying to reduce their growing budget deficits by economizing on pension contributions. The monies from national pension reserve funds are being used to rescue banks, as it happened in Ireland, and in Argentine citizens' pension savings kept at pension funds were, in effect, nationalized in order to salvage the country's national financial system.*

In the pre-crisis period, the funded pension systems in different parts of the world had been developing at a high rate. The assets held by the pension funds of the OECD countries increased from 2001 through 2007 by 67 %<sup>1</sup>. Particularly high growth rates were displayed by the pension funds' assets in Turkey (72.6 %), Poland (49.3 %), and Hungary (39.2 %). As a result, by 2008 the assets of pension funds in the OECD countries increased to 111 % of GDP (in average weighted values). 60 % of all assets is concentrated in the USA, where they constitute 124 % of GDP, thus predetermining their average value. However, this index varied greatly between countries.

*In the first few months of the financial crisis the losses of the OECD countries' pension funds amounted, in real terms, to 25 % of their asset value. The highest level of losses was recorded in the USA (nearly 30 %). In 2008, the Polish pension funds lost 2 bn zloty (or 460 million euro), despite the inflow into the system, over the previous year, of more than 20 bn zloty of new contributions. The losses of the national pension reserve fund in Ireland by the end of Q 1 2009 amounted to 6.7 %, and the losses in the year 2008 were 10.5 %. In 2008, the Irish pension funds lost nearly 20 bn euro, their assets having diminished by 23 % - from 86.6 to 66.7 bn euro.*

However the problems that emerged in the pension systems of different countries during the crisis are not reduced only to losses and the diminished current value of their assets. An analysis of the available information on the funded pension plans existing in different countries has made it possible to identify some other newly emerging problems. First of all, there has been shortage of monies needed to finance current pension contributions. This is the problem of both employers and governments which, by economizing on pension contributions, are trying to diminish their growing budget deficits. The monies held by reserve pension funds *are used to rescue banks*, as it happened in Ireland. In Argentine, the pension savings of citizens held by pension funds *were actually nationalized* in order to salvage the national financial system.

During the current crisis, more than 50 top US companies have cut on their contributions to pension plans (during the 2003 – 2004 slump, there were only about 15 such companies).

<sup>1</sup> This overview is based on materials published by the OECD, the Economist, Bloomberg, Investment. Penson.Europe

In particular, this measure was resorted to by *General Motors*, *Coca-Cola Bottling Co*, and *FedEx Corp*.

The Estonian government has declared “pension holidays” regarding the contributions to the funded pension system<sup>1</sup>. From 1 June 2009, it suspended for two years the payments of its contributions to the pension system’s second tier (“pension holidays”). Under the existing rules, the employed are paying 2 % of their earnings to the funded pension system, while the Government of Estonia adds 4 % from the contributions to the distribution system, which are paid for each employed person. It is intended so that during the “pension holidays” period, which is to last until 2012, the Estonian citizens will be paying their contributions in the amount of only 1 % of their earnings, while the government is going to supplement their pension accounts by only 2 % of its contributions to the distribution system. The contributions will once again begin to be paid in their original amount from 2012 onwards.

Those citizens who will decide to continue to transfer their deductions to the second tier of the pension system have been promised by the Estonian government that it is going to pay for them 6% over the next two years – if economic growth makes it possible. For the period over which the transfer of full amount of contributions is going to be suspended, future pensioners are promised that they will receive a somewhat bigger funded part of their pension.

As estimated by the Government of Estonia, this “pension vacation” will result in the saving of 1.6 bn Estonian kroons in 2009, and 3.0 bn – in 2010.

The Government of Poland decided to lower its pension contributions, and also undertook some other measures designed to reduce the cost of the mandatory funded pension system, including cuts on commission payments and certain changes in the procedures for selling pension plans.

The Polish government intends to gradually reduce, over the next few years, the upper threshold for contributions to the mandatory pension system from 7 to 3.5 % of citizens’ earnings. Initially it had been planned that this upper threshold will be brought down from the year 2014, but by some recent amendments to the law this process was sped up, and so the changed procedure will become effective from January 2010. Besides, the amount of commission for asset management will now be subject to restrictions, to be payable only on assets amounting to under 45 bn zloty (nearly 10 bn euro).

In March 2009, Prime Minister of Croatia I. Sanader said that the mandatory second tier of the national pension system collapsed, and hinted that the Government of Croatia can now grant its citizens the right to withdraw from the supplementary pension provision system. The IMF warned Croatia of the potentially negative consequences of the decision to abolish the professional pension system. In its latest report on Croatia the IMF has expressed its belief that that country’s authorities should abstain from making any changes in the second tier of its pension system, because it may have harmful effect on the already sufficiently ruined domestic capital markets and undermine investor trust (the assets held by the pension funds of the second tier amount to nearly 8 % of Croatia’s GDP). Similarly to other experts, the IMF’s representatives insist that the rate of contributions to the second tier of the pension system must be raised. Besides, they advise that Croatia should reform its distribution system in order to ensure its stability. At present, the rate of contributions to the distribution system is 20 %, of which 5 % is transferred to the second tier of the pension system if the individual payer participates in the supplementary pension provision system.

<sup>1</sup> The existing system unites 580 thousand participants, and its assets amount to 1 billion Estonian kroons (or 703 million euro).

In Ireland, the assets held by the National Pension Reserve Fund (NPRF) *are being used for salvaging the country's banking system*. From 2009, the assets of the Irish NPRF are invested, under the management of the Ministry of Finance, as part of the recapitalization plan for Irish banks. Since the onset of the credit crisis, the NPRF has been applying a careful approach to investments in shares, and from early 2009 it created reserves of liquid assets in the amount of approximately 10 % of the total value of assets. These means have in part been used to cover the investments in banks, which amounted to 3.6 bn euro. Besides, the NPRF has also liquidated its positions with regard to government bonds, so as to be able to purchase the preferential shares issued by the Bank of Ireland. As of the end of Q 1 2009, these securities (with a fixed dividend of 8 %) constituted 23.4 % the NPRF's total assets.

The negative developments on the share market and low interest rates on the bonds market resulted in many pension plans suffering deficit with the established level of contributions. In the UK, according to very conservative estimates, the deficit of private pension plans by April 2009 had increased up to 188 bn pounds. To cover this deficit, companies are forced to increase their pension contributions. Thus, *British Telecom* must nearly double the amount of its annual contributions (to 525 million pounds).

Given the current financial state of the Irish pension funds, the company *Attain Consulting* has warned that, in order to provide some solution to the problem resulting from the insufficient financing of pension plans, certain more radical solutions will be required, including the “unthinkable” act of altering the amount of funded payments. *Attain Consulting* estimates 90 % of the existing pension plans to be technically insolvent at the currently established level of payments; in this connection, only a fraction of all companies will be able to finance on their own their pension plans in crisis conditions, while the overwhelming majority will be in need of making joint decisions with the government and their participants.

Previously, the problem of insufficient funding used to be solved through attracting additional contributions from the employer and/or employee, closing the pension plan for new participants, or changing (downsizing) the amount of payments to an employee for a future employment period. According to *Attain Consulting*, such solutions in the situation of the present crisis will prove to be insufficient in the majority of cases. Therefore it suggests that another variant should be considered – that of changing the amount of the already charged payments (i.e., earned by the employees). Besides direct cuts on the payments, it is also suggested that the part of the payments by which the size of pension is being determined should be temporarily frozen; and that the level to which pensions can be raised should be lowered, or the retirement age increased. The experts have warned that if no such measures are implemented, the employees at retirement will be receiving lower payments.

The Netherlands Bureau for Economic Policy Analysis assessed the potential losses to be suffered by Dutch employees as a result of the financial crisis. According to the Bureau's estimations, the greatest losses can be expected by persons aged 50 to 60 years, who are going to lose approximately 10 % of their accumulated pension rights. The losses will arise both due to the lower indexation of the size of payments and to the increased amount of contributions. In this connection, that cohort of the population will have no time left prior to their retirement to restore their initial assets lost during the crisis. The employees belonging to the 30 – 40 year age groups and to the over-sixty age group are going to lose approximately 6 % of their pension rights, and those aged 20 – 30 years – 2 % of their pension rights.

According to the estimations made by the Center for Retirement Research at Boston College, the greatest losses of pension savings in the USA as a result of the crisis will be



suffered by 30-year-old employees. If an employee with median income had been paying 9 % of his or her earnings to the pension plan,<sup>1</sup> the assets being invested exclusively in shares (by index), then in 10 years (through Q 1 2009) the amount of savings became nearly \$10,000 less than the amount of investments, which represents a direct loss of 26 %. If investments were divided equally between shares and  $\pi$  bonds over the whole investment period, then the estimated loss is 3.9 %. In this connection, the employees in the 30 – 40 year age group had no time to enjoy the growing exchange rates on the stock market in 1980 – 1990, when Standard&Poor's 500 Index was rising, on the average, by 18 % per annum (with due regard for dividend reinvestment). In the 2000s this index was decreasing, on the average, by 4.7 % per annum <sup>2</sup>. The percentage of shares in 401-K pension plans dropped from 67 % in 2007 to 53 % in 2008, but this decline was largely due to changes in exchange rates rather than to any alterations of the investment strategy on the part of the participants in the pension plans.

*Restrictions on foreign investments.* In order to support the national economy, the Mexican probate pension funds (*Afores*) declared that they were going to purchase only the securities issued by Mexican entities. The European Commission complained to the European Court of Justice (ECJ) that Poland had restricted foreign investments to 5 % of the size of its pension funds' assets. The arguments behind that complaint is that this restriction imposed by Poland has violated the rules established by the European Union with regard to free capital flows. In addition, the European Commission focuses its attention on the Polish subordinate laws (the rules for calculating the remuneration for and the necessary costs incurred by an asset manager), which have made foreign investments less attractive than the domestic ones. ●

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1 These are the so-called 401K pension plans, which envisage the creation of individual pension accounts and parity of employee and employer contributions. Big companies have always been able to temporarily reduce the amount of their contribution without closing up their pension plans, while the others were granted such an opportunity in spring 2009.

2 The estimations are shown as of the end of Q 1 2009.

## PROSPECTS FOR FURTHER DEVELOPMENT OF CUSTOMS REGULATION FOR DEALS WITH INTELLECTUAL PROPERTY

A.Kireeva

*There are three parties involved in the relations connected with the use of the results of intellectual activity, including: right holders, authors, creating the results of intellectual activity (RIA), consumers of the goods that include the RIA and the state. Unfortunately, the existing legislation in the field of the intellectual property is focused on the protection of only one group of the participants, namely, right holders. It should be noted that little attention is paid to the protection of other participants of legal relations. The problem is especially pressing for legal relations connected with import and export of goods which include RIA in their structure.*

At present the Russian legislation and primarily the Civil Code does not duly protect the interests of bona fide importers purchasing legal (not infringing) goods abroad and trying to import them into the territory of the Russian Federation. At the same time when the goods are imported by the right holders themselves or their legal representatives, it is the interests of the state that suffer, since it bears losses connected with underdeclaration of customs value of the imported exclusive rights.

There is a number of problems in the Russian customs regulation of the international deals with the intellectual property and the main of them are the following:

- 1) problem of vague norms on the exhaustion of exclusive rights for RIA in the structure of imported goods;
- 2) problem of definition of the customs value of goods, including the objects of intellectual property;
- 3) problem of vague conditions for bringing the importers to account for unendorsed import (on initiative of a right holder and/or on initiative of customs bodies);
- 4) impossibility of levying with duties the exclusive and not exclusive rights for the use of RIA when it is not connected with the import of material object (or goods including them), as well as a number of other problems.

As to the first problem the following can be noted. When the matter concerns the exhaustion of exclusive rights it means that in contrast to the “termination” of the rights in connection with the expiry of the period of their effect, the termination can occur regarding only a single product unit produced with RIA.

When this product unit is further sold, used or consumed the exclusive rights continue to be in effect but when this particular sample of commodity is concerned they can be regarded as exhausted. The exhaustion of exclusive rights in the structure of a material commodity allows the owners of the sample to use it at their own discretion without seeking the approval of the holders of exclusive rights.

Since the issue of the composition of exclusive rights, as well as of the cases of “free” use of RIA are regulated separately for each of the objects of intellectual property, the moment of the exhaustion of the rights is also defined separately. Generally, it is regulated by the articles containing the list of the cases of “free” use.

Thus, with regard to a number of results of intellectual activity, including the objects of intellectual property rights and adjacent right, selective achievements etc., there is

no exhaustion of the rights for the commodity imported by the right holder (or on his permission) at all. The legislator dwelling on the limits for the use of his rights by a right holder when carrying out economic activity mentioned that the “import” of rights for intellectual property can be carried out only by the right holder or on his permission, but did not state whether the person legally purchasing the product unit has a right to resell it, or, in case the purchase took place abroad, to import it in the territory of the Russian Federation etc. (article 1270 of the Civil Code of the Russian Federation).

Absence of a direct permission for the free import and sale of product units legally purchased abroad can be interpreted as a prohibition, taking into account other regulations for rights for intellectual property. This conclusion is testified by comprehensive interpretation of clause 4 article 1252 of the Civil Code of the Russian Federation and article 1229 of the Civil Code of the Russian Federation.

According to article 1229 of the Civil Code of the Russian Federation, the absence of the prohibition for use of the commodities which include RIA in their structure cannot be regarded as an agreement (permission) for its use. Besides, in accordance with clause 4 article 1252 of the Civil Code of the Russian Federation “in case when the production, distribution or other use, *including import*, transportation and storage of *material objects, which represent the result of intellectual activity or the means for individualization result in violation of exclusive rights* for such results or such means, *such material objects are considered to be infringing and are to be withdrawn from the turnover and destructed* without any compensation, if no other consequences are envisaged by the existing Code”.

Thus, the samples of the production imported in Russia without direct permission of the right holder can be regarded as infringing his “right for import” and be confiscated as infringing. Taking this into account, the right holder that believes that import of the samples of his product legally purchased abroad infringes his exclusive “right for import” can demand the custom bodies to arrest the consignment of import goods and bringing the exporter to account<sup>1</sup>.

At the same time the issue on exhaustion of the rights concerning other kinds of the results of intellectual activity (objects of patent rights, topologies for integrated schemes, trademarks etc.) when importing the commodities earlier purchased abroad is settled, though insufficiently definitely. For instance, regarding the objects of patent rights article 1359 of the Civil Code of the Russian Federation states that “... import into the territory of the Russian Federation, use, sales offer, sale, other inclusion in civil turnover or storage for these purposes of the product, in which an invention or useful model, or article, in which a production piece was used, in case this product or this article has been earlier introduced in the civil turnover in the territory of the Russian Federation by the patent holder or by another person on the permission by the patent holder” *is not prohibited*.

Thus, the Civil Code of the Russian Federation clearly states that upon the purchase of a commodity, contenting an object of patent rights, *in the territory of the Russian Federation* a customer can regard the exclusive rights as exhausted, use and resell it freely. However it is absolutely incomprehensible how a customer can carry out “import in the territory of the Russian Federation ... of a product... in case this product ... has been earlier introduced in the civil turnover *in the territory of the Russian Federation* by the patent holder”. It seems that such a wording makes up a sort of collision. On the one hand, it contains an attempt to permit free “import” of licensed products purchased abroad and recognize the exclusive rights in the structure of the import commodity as exhausted, on the other hand – an attempt to restrict this to the cases when the commodity is put into turnover on permission of the patent holder. One can conclude that the issue on the moment of ex-

1 Further details are given below

haustion of the exclusive rights, evolved abroad, has not been clearly settled. Taking into account the wording mentioned, it is impossible to unambiguously answer the question as to whether the products *legally* purchased abroad can be freely imported and sold in the Russian territory by persons not authorized by the right holder.

Thus, vague wording of the norms regulating the issues of import of commodities which include in its structure the objects of patent rights or the means for individualization, with which regard similar legal collisions exist allow the right holders and their legal representatives to abuse the gaps in the legislation, thus restricting the competition at the Russian market. The attempts of a number of producers of foreign car producers to ban the import of used cars is a typical example for such an abuse of the right.

Thus, on the basis of the Decree of the Ninth Arbitrary Court of Appeal from May 12, 2008 No 09AP-4659/2008-AK for the case No A40-9281/08-145-128 the importer was fined and the licensed goods imported in the Russian territory was confiscated.

Importer (Genesis limited) purchased abroad and attempted to import into the territory of the Russian Federation a used car “PORSCHE CAYENNE S” of 2004 model year. However the item was arrested at the central excise customs on the demand by the Russian dealer (Porsche Russland limited) of the company Porsche AG (Germany) which is a right holder. Making the decision for the benefit of the custom body acting as a plaintiff and the official dealer, the court stated that in the territory of the Russian Federation “only Porsche Russland limited has the right to use trademarks PORSCHE and CAYENNE when selling them and introducing in the civil turnover in the territory of the Russian Federation”.

It seems that with the aim of a clearer regulations on exhaustion of exclusive rights with the regard to goods legally purchased abroad and imported into the territory of the Russian Federation, norms of the Civil Code of the Russian Federation defining the list of the cases for free use of RIA in order to:

- define equal legal consequences for the cases when the commodity is introduced in civil turnover on permission of the right holder in the territory of the Russian Federation and abroad. It is suggested to set the presumption of the agreement of the right holder for import and sale of a commodity that was earlier *legally* put into circulation abroad. In case the commodity was legally put into circulation abroad the right holder gets paid for the use of his rights in the process of its first sale. Correspondingly, his rights should be considered as exhausted and should not be subject to recovery to any extent. Certainly, in the world practice there the cases when for some (“poor”) countries the commodity is produced at lower price than for the Russian Federation. As a consequence, large foreign right holders object to introduction of the suggested amendments, arguing that in case of the import of commodities produced for “poor” countries into the Russian territory the right holders will suffer losses. However, in our opinion, this is not a good reason for the Russian consumer to pay more than a consumer from another country. Introduction of the suggested amendments will stimulate the right holders to raise the quality of goods, supplied to the Russian market as well as to lower the price;

- specify that the import of infringing goods is to be defined only as import of counterfeit samples of commodities, with regard to which customs (or law enforcement) bodies and the right holder proved that they were produced and sold abroad without the permission of the right holder (this can be proved for instance by making expert examination proving the undue quality of the commodity);

- fully put the burden to prove the facts of import of counterfeit commodities on the customs bodies. It should be directly stated in the Customs Code of the Russian Federation that the absence of the written agreement of the right holder for the import of a batch of goods is not a proof of the goods being counterfeit in itself. Since the rights for the commodity introduced into circulation abroad can already be exhausted writer agreement of the

right holder for the import of this commodity should not be the necessary requirement for its customs declaration and its sale in Russia.

The norms of legislation regulating the issues of the definition of the customs value of goods in which structure the objects of intellectual property are included are in need to be specified as well. If the importers that are not right holders are generally made answerable for importing goods recognized as counterfeit (regardless the fact whether their production and purchase abroad was legal), the right holders and their legal representatives are, as a rule, made answerable for the underdeclaration of the customs value of the imported goods.

Formally from the point of view of Law of the Russian Federation from May 21, 1993 No 5003-1 "On customs tariff" the customs value of a commodity includes all "the payments for the use of the objects of intellectual property (excluding the payments for the right to reproduce in the Russian Federation), which refer to the estimated goods and which the customer pays directly or indirectly, at the amount which is not included in the price that was really paid or was to be paid on condition that the payments refer to only the import goods".

However in practice this statement of the Law is simple to evade by making a system of interdependent persons and signing several contracts instead of one. This can be done for instance, in the following ways:

- when importing the commodity which has already been marked with the trade mark of the right holder there are two contracts signed with the licensee: the contract for the supply of the licensed commodity (at lower value) and the contract on the use of exclusive rights. It should be noted that the agreement on the use of exclusive rights can be signed both with the direct producer of goods and with the right holder that does not himself produce or supply the commodity. Such a procedure is wide-spread in large transnational corporations having dependent enterprises in several countries;

- when "anonymous" commodity is imported, not marked with the means for individualization (trademarks, labels of where the commodity comes from etc.), for instance, not packed or prepacked etc, there are two independent contracts signed: the contract on supply of the commodity and licensed contract that gives the licensee the right to upgrade the commodity and to mark it with the means for individualization. The same as in the first case the contract can be signed by the licensee with one person acting at the same time as a supplier and a right holder and with two different but dependent organizations.

The main difference from the first variant is the granting of the right to use exclusive rights for the means of individualization on condition of some upgrade of the commodity. However the upgrade in the form of packing and prepacking is insufficient for the commodity to be recognized as a Russian and exempted from the customs duties.

According to article 32 of the Customs Code of the Russian Federation the prerequisite for the payments to the right holder to be excluded from the customs value is deep reprocessing of the commodity, which will allow making changes in the commodity list for the foreign economic activity. Only in this case a Russian importer can claim that the licensed payments refer to the value of the production of the Russian goods and to the value of the imported components.

Both of the variants mentioned are illegal according to the Russian legislation, but unfortunately such violations are very difficult to prove, since they require requalifying of the group of deals basing on their economic essence, as well as the revelation of the interdependence between the foreign suppliers of material objects and foreign right holders. The customs bodies normally cannot do that. It seems that the problem of definition of the customs value of goods including the objects of intellectual property can at least partially be solved with the following specifications to the norms of the Law of the Russian Federation from May 21, 1993 "On customs tariffs":

– reference to the fact that upon defining the customs value of the commodity, import and sale of which at the Russian market are accompanied with the payments for the benefit of the foreign right holder, reserved method is used according to the general rule unless the Law envisages other.

– permission for the importers to replace the reserve method by the method “by the price of the deal” on condition that they submit specified declaration, containing the data on real amount of the subsequent royalty, paid to the foreign right holder within the defined period. This will allow the importers to make recalculation, and in case of excessive payment, return it from the budget and will deprive them of the right to refer to impossibility of accurate calculation for the customs value of goods at the moment of the submission of the declaration in case of legal controversy;

– references to the fact that the customs value of the import commodity should include the any payments to the foreign right holder including the payments on the contracts of rendering consultation, marketing and other services connected with the sale of the imported goods at the Russian market. This will enable avoiding masking of the license payments for the use of RIA whose rights are seemingly exhausted due to the signing of fictitious contracts on rendering services between the importer and the right holder;

– reference to the fact that the customs value of the imported commodity should include the payments made to the foreign right holder for the means of individualization, marking the commodity and (or) its packaging in the process of its marking, packing or other processing made in the territory of the Russian Federation on condition that the added value created in the process of such processing is less than, for instance thirty per cent of the initial value of the imported commodity.

The problem of unclear wording for the conditions of making the importer responsible is connected to the fact the Customs Code of the Russian Federation requires compulsory declaration of the violation of the rights by the right holder, and article 28.1 of the Code of Administrative Offences of the Russian Federation in contrast states that upon revelation of an administrative infringement (anyone, including that connected with the import of counterfeit goods) the authorized bodies make the guilty party responsible independently<sup>1</sup>. In order to provide the uniform approach to initiate the proceedings on this category of cases it is suggested to introduce the amendments to the legislation excluding the possibility for the customs bodies to initiate the proceedings on the administrative infringement on their own initiative envisaged by article 14.10 of the Code of Administrative Offences.

However, all the measures mentioned cannot close the main channel of the budget losses, namely – the channel for the import of the results of intellectual activity that is not connected with any material object. For instance, this applies to the import of computer software, author’s works, technical documentation etc. by different channels of communication. In this case there is no physical crossing of the border when importing the RIA and the customs bodies cannot anyhow get the information on such a deal and cannot connect the license payments with the customs value of commodity according to the procedure envisaged by the Law of the Russian Federation from May 21, 1993 No 5003-1 “On custom tariff”.

In our opinion, the problem connected with the impossibility of levying the import of exclusive and not exclusive rights for the use of RIA not connected with the import of a material object with customs duties can be solved by recognizing the exclusive rights as a

<sup>1</sup> It should be noted that in order to guarantee the proceedings for the case of administrative infringement the authorities of customs bodies can use such measures as, for instance, arrest and requisitioning of goods that were the means of or the objects of an administrative infringement (articles 27.14 and 27.10 of the Code of Administrative Offences).

separate kind of commodity for the purposes of levying with customs duties and its inclusion in the nomenclature for foreign economic activity as a separate commodity. Non-exclusive rights that suggest payments for the benefit of the foreign right holders for the use of RIA on the basis of licensed agreements (not envisaging the full cession of the rights for RIA) should be admitted as well.

At the same time in order to support the innovation development of the Russian economy it seems purposeful to introduce the privileges (exempt from customs duties and VAT) the import of a number of technical RIA, namely the rights for the inventions, useful models, industrial designs, computer software, databases and topologies for integrated microchips. It is suggested to abolish privileges for know-how's since the extent of novelty and industrial applicability of know-how is not subject to expert estimation by the patent department. As a result the payments for the economically unfounded use of know-how in case they are exempted from customs duties can be used by the Russian residents to get unfounded tax privileges and transfer of monetary means abroad. ●

## AN ANALYSIS OF THE ALTERATIONS INTRODUCED IN THE AGREEMENT FOR THE AVOIDANCE OF DOUBLE TAXATION BETWEEN THE GOVERNMENT OF RF AND THE GOVERNMENT OF THE REPUBLIC OF CYPRUS

A. Levashenko

*In late 2008, Cyprus became the leader among the countries making investments in Russia's economy. Its share constitutes 16 % of all the foreign investments in the Russian national economy in the year 2008<sup>1</sup>. In this case, as a rule, the investors are Russian entrepreneurs who have previously exported their capital into Cyprus and then reinvested it in Russia, thus minimizing their tax expenditures and other financial costs. On 16 April 2009, a Protocol was signed between the Russian Federation and Cyprus, whereby alterations are introduced in the bilateral 1998 Agreement for the avoidance of double taxation. The new alterations to the Agreement are to come into force as of 1 January 2010. The text of the alterations is based on the provisions of the OECD Model Convention With Respect to Taxes On Income and On Capital. However, these alterations will have to be further specified on a normative basis, otherwise their application will be cumbersome, and it will sometimes be impossible to apply it in order to effectively prevent the avoidance of taxation in the territory of Russia.*

For many years, the Republic of Cyprus has been one of the most attractive places for investing capital, creating holding companies for organizing transnational businesses, safeguarding savings, and tax planning. There are several reasons for this state of affairs. Among other things, there exist a well-developed commercial infrastructure and telecommunications network, and a network of agencies providing legal, financial and banking services. Cyprus imposes virtually no normative restrictions on capital transfers. Cyprus legislation itself is compatible with all the common international norms, and in particular with the provisions stipulated in OECD documents, which is conducive to an ongoing active process of signing agreements for the avoidance of double taxation (so far, 40 such agreements have been signed, including with Germany, Italy, Hungary and other developed countries), whereby schemes are envisaged under which the incomes received in the other countries are subject to taxation only in Cyprus. This is especially attractive for the business sector, because Cyprus offers very beneficial terms of taxation by comparison with other countries (low rate of profits tax, no tax on capital gains, and no tax on the payment of dividends).

Besides, since 2004 Cyprus has been a member of the EU, and in 2006 the World Bank noted that Cyprus belongs to the cohort of countries with a high income level<sup>2</sup>. In the same document, it is also mentioned that, because of Russian entrepreneurs making use of Cyprus companies, the Russian budget misses some taxes, that is, Cyprus represents an offshore zone whose preferential legislation helps in avoiding taxes due to be paid in the territory of Russia. In this connection, the Russian authorities set out to introduce proper mechanisms for diminishing capital outflow from this country and for effectively preventing failures to pay taxes in the territory of Russia.

1 [www.gks.ru](http://www.gks.ru)

2 Statistical Service of Cyprus, 2006 / <http://www.cyprussolicitors.com>, <http://www.mof.gov.cy>.



Among recent measures designed to achieve this goal, we can point to the amendments introduced in January 2008 in the RF Tax Code, whereby for the taxation of dividends received from Russian, and foreign legal entities alike the 9 % and 0 % rates of profits tax are to be applied. The zero rate can be applied only if dividends arrive from a state which is not included in the list of states (approved by the RF Ministry of Finance) where beneficial taxation regime is granted (that is, where the rate of profits tax is below 16 %). Cyprus, where this rate is only 10 %, is included in this list, and so the rate of profits tax when applied to the dividends received by Russian companies from a Cyprus company will be 9 % instead of the beneficial 0 %.

Partly for this reason, on 16 April 2009, the Russian Federation and Cyprus signed a Protocol, whereby alterations were introduced in the bilateral 1998 Agreement for the avoidance of double taxation.

In accordance with the Protocol's provisions, Cyprus is excluded from the list of offshore zones approved by order of the RF Ministry of Finance. As a result, Russian residents, when investing in Cyprus (or via Cyprus in other countries), are allowed not to pay tax on dividends. As far as Russia is concerned, as a result of the signing of this Protocol, certain alterations have been introduced into the Agreement in order to diminish opportunities for tax avoidance which, however, cannot entirely remove the problem of Russian entrepreneurs taking advantage of the "beneficial investment climate" in Cyprus.

Thus, alterations were introduced in the 1998 Agreement concerning the procedure for determining a company's residency. To properly determine the residency of a legal entity is very important for determining its tax status, that is, the place where such an entity must pay tax on its operation. In Cyprus, Russian entrepreneurs can operate both through resident and non-resident companies. In accordance with the law of Cyprus, a non-resident company is a company registered in Cyprus but managed from abroad. Such a company pays tax only on the income received from Cyprus sources. Thus, in an event of commercial activity being conducted outside of the island's territory, no tax obligations at all will emerge. However, such a company cannot make use of the tax agreements concluded by Cyprus with other countries. A resident company is a company registered in Cyprus and managed from Cyprus. Such a company pays the local income tax at the rate of 10 %, but some important types of its income (including dividends received) are exempt from tax. The operation of such a company is subject to all the exemptions envisaged by the tax treaties signed by Cyprus.

Resident companies, from the point of view of tax planning, as before, can be used by Russian entrepreneurs in the capacity of holding companies and financial companies. At present it is especially the companies which are residents of Cyprus that constitute an unalienable part of the structures engaged in transnational business activity, because such companies are subject not only to the beneficial provisions of Cyprus legislation, but also to the exemptions envisaged by the international tax agreements signed by Cyprus with other countries.

The alterations introduced into the Agreement by the 2009 Protocol are designed to make more transparent the process of determining the residency of an entity, and consequently to make more regular the process of paying profits tax in RF territory. Previously the term *resident* was applied to any entity which under the legislation of a given state is subject to taxation in that state on the basis of its place of residence, permanent location, place of administration, or any other such criterion. The 2009 Protocol makes more specific, in the text of the Agreement, the definition of one of the grounds for determining the residency of an entity – its place of administration. Thus, if the place of effective administration of a legal entity cannot be identified, the competent bodies of Russia and Cyprus will apply

all the necessary measures in order to determine the place of administration through the procedure of mutual agreement.

There is one more noteworthy alteration introduced by the 2009 Protocol into the Agreement, namely the new Article 12 on limitation of benefits. The norm stipulated in this Article is designed to reduce the percentage of transactions aimed at obtaining exemption from taxation, that is, certain benefits. No doubt, this restriction applies not to all the residents, but only to those companies which are not registered in Cyprus or in Russia. This newly introduced norm makes it possible to deny the granting of tax exemptions in cases when a company is unable to prove that the purpose of its creation or operation in Cyprus is something else beside the need for tax exemptions. Experts have noted that now the majority of companies registered in Cyprus are used for technical and tax-related purpose, while at the same time being involved in no operations.

One example of making use of a Cyprus-based resident company, when its management is effectively carried on in the territory of Russia, and the main purpose of its creation is to gain tax benefits, can be the following scheme. In this scheme, a resident Cyprus company is used as a transit component. Russian entrepreneurs establish three companies: one in Russia, one in Cyprus, and one in any tax-free offshore jurisdiction (for example, the British Virgin Islands (BVI)). The company in BVI is the owner of a patent (the right of ownership for some technical equipment). This company, under a licensing agreement, transfers to the Cyprus company the rights to issue sub-licenses into Russia for the use of this patent. As a result, the Cyprus company receives royalty (payment for the use of the patent) from the Russian company, and then pays this royalty to the company in BVI. No tax at the source arises in Russia due to the existence of the Agreement between Russia and Cyprus. Only the difference between the amounts of royalty received and paid is taxed in Cyprus at the rate of 10 %. This difference can be 1 %, and so the effective rate of tax will be minimum. No tax at the source arises in Cyprus on the outgoing royalty, or any income tax or tax on outgoing dividends in BVI, either.

However, for a Cyprus company to be able to enjoy these privileges envisaged by tax agreements, it must prove to Russian tax agencies that it is indeed a resident of Cyprus, that is, it must obtain a certificate to this effect from Cyprus tax agencies. At present, for Cyprus authorities to be able to confirm the residency of such an entity, it is sufficient for the company to have a citizen of Cyprus on its staff in the capacity of its director or accountant. In accordance with Cyprus legislation, this would be enough for that company to obtain the status of a resident of Cyprus, because the place of administration of that company is in Cyprus. Thus, it is evident that to obtain the status of a resident of Cyprus is easy, because the actual owner of a company can be a Russian person, who is going to do all the relevant decision-making, while the “administrative body” will be formally located in Cyprus.

The alterations introduced by the 2009 Protocol in the procedure for determining the residency of an entity through the procedure of mutual agreements, as well as those designed to prevent the use of Cyprus resident companies for obtaining tax benefits, need to be further specified. Firstly, so far it has not been properly determined what exactly is the procedure of mutual agreements for determining the place of effective administration between the two countries. Under the domestic legislation of Cyprus, the acquisition of residency and the proof of residency in Cyprus is a rather easy procedure, and this is what attracts Russian entrepreneurs to that jurisdiction. Thus, the solution to this problem lies in the sphere of Cyprus domestic legislation, namely in providing a more precise and less arbitrary definition of the term “place of effective administration”. On the other hand, this problem may also be solved by developing a detailed mechanism for cooperation between the competent bodies of Cyprus and Russia, as well as by providing

jointly a definition for the term “place of effective administration”. Although Article 25 of the Agreement addresses the procedure of mutual agreements, in effect it is more declarative than practical. This article has also been augmented by the 2009 Protocol: now the competent bodies of Cyprus and Russia may, in addition to establishing direct contacts, create a joint commission for purposes of achieving agreements. The provision concerning a joint commission is a new one for the Agreement. In terms of law, such a commission can become a mechanism for implementing the declared norm on the procedure of mutual agreements. However, it will be necessary to approve a special regulation for the operation of such a commission.

Secondly, it is not entirely clear what exactly a Cyprus company must do in order to avoid becoming subject to the limitation of benefits. The principal sources of income in Cyprus are tourism and foreign investments. More than 30 foreign banks and over a thousand of offshore companies are registered in the territory of Cyprus. At the same time, Cyprus has almost no export of commodities. Considering the fact that the implementation of this limitation of benefits will have to be ensured by Cyprus authorities, it seems unlikely that they are going to deprive their own budget of one of its main source of revenue. From the point of view of law, it will be necessary to elaborate all the details of the mechanism for the functioning of this norm, that is, to whom, when and on which terms a company must prove that the main purpose of its operation in Cyprus is not to obtain tax exemptions. In this connection, it must be taken into consideration that the domestic legislation of Cyprus, as is noted earlier, is sufficiently liberal – as far as the issue of obtaining the status of a resident of Cyprus is concerned.

One of the most significant changes introduced in the Agreement addresses the provision concerning the taxing of profit from the sale of shares in companies whose assets are predominantly (that is, more than 50 %) composed of immovable property.

Under a general rule, in an event of sale of an item of immovable property (a house, a building, etc.), on the profit received from this sale in the RF profits tax is levied at the rate of 20 %. If the seller is a foreign company without a permanent representative office in the RF, the profit received is subject to levying profits tax at the source of payment, without any possibility of diminishing this rate in accordance with the terms of international tax agreements. However, it was much more profitable for Russian entrepreneurs, in order to minimize taxation, to realize their immovable property by selling shares or stakes in the company which holds that immovable property by right of ownership, after previously having registered that company in Cyprus. This had to do directly with the norms stipulated in Article 13 of the Agreement, whereby the incomes from alienation of any property (shares including), except immovable property, can be subject to taxation only in that state where the entity alienating that property is a resident. Shares, even when in a company’s balance are set against immovables, represent movable property, and so the incomes from their realization are subject to taxation only in the state whose resident is the entity alienating those shares. Thus, the scheme for realization of Russian immovable property through shares owned by a Cyprus company could be, for example, as follows: domestic entrepreneurs created a Cyprus company with a minimum charter capital. The Cyprus company, in its turn, established in the RF territory a construction company which, say, would then take a credit or loan in the amount needed for the erection of a building in the territory of Russia. As a result, the Cyprus company became the owner of the building erected in the territory of Russia, because that Cyprus company was the owner of shares in the Russian company which had erected that building. After the completion of its construction, the Cyprus company would offer that building for sale in the territory of Russia at a market price. The Cyprus company then sold the building by selling shares in the Russian company, in whose balance sheet these shares were set against the newly

erected immovable property of that Russian company at its real value, and the latter would then be exploiting that building. As a result, the Russian company (the buyer) became the owner of Russian immovable property through purchasing shares in the Russian company owned by the Cyprus company. Thus, the transaction of sale of shares took place in Cyprus, because the seller was the Cyprus company in the capacity of the owner of shares in the Russian company. In Cyprus there is no obligation to pay tax on capital gains, and so, having sold the shares, the Cyprus company paid no tax on its received income.

The alterations introduced in the Agreement by the 2009 Protocol have now made it possible to levy tax on the incomes from the sale of shares in a company in the country where that company's immovable property is located. In the scheme describes above, the Cyprus company under the new rules will have to pay, in the RF territory, the tax on capital gains arising from the sale of shares, which are set in the balance sheet against Russian immovable property, at the rate of 20 % (profits tax).

However, these innovations will not be applied if the seller of shares is a pension fund, or a savings fund, or the Government of Cyprus, or the Government of Russia. Besides, if the shares in the seller company are quoted on a recognized stock exchange, the tax on capital gains will be paid in the state where that company is resident. The new norms introduced in the Agreement are not applied in cases when the income from the sale of shares is received as a result of reorganization of the seller company and the buyer company. These changes will come into force no earlier than 2014.

These alterations, no doubt, represent an efficient mechanism designed to prevent active tax avoidance in cases of sale of Russian immovable property. However, this provision has also a number of flaws, one of which requires a special explanation. In some cases, when the shares in a seller company are quoted on a stock exchange, the tax on capital gains will be paid by the seller in that state where the latter is resident. The criterion of the shares in a seller company being listed on a stock exchange appears to be non-transparent. It is not clear whether it is implied that the shares should be listed on a stock exchange in the country where their seller is a resident, or simply that the fact of that company's shares being listed on a stock exchange – no matter where that stock exchange is situated is, in itself, of importance. The listing procedure (gaining access to a stock exchange) varies between countries. Thus, for example, the New York Stock Exchange specializes on trade in securities issued by big and well-known companies, and so the listing on that exchange is regarded as a privilege. The British Virgin Islands (BVI), the Bermudas, the Cayman Islands, the Channel Islands (Jersey and Guernsey), Mauritius, and Egypt, on the contrary, have rather liberal legislation for regulating the operation of stock exchanges (by comparison with non-offshore countries). In such countries the procedure of gaining access to a stock exchange is less costly and simpler in terms of the law.

Consequently, it can be assumed that the recent alterations introduced into the Agreement will make it possible to use this withdrawal of property as a way to apply the old scheme for selling Russian real estate through shares in a Cyprus company, because it would not be difficult to place these shares on a stock exchange in any of the countries with easy legislation.

The necessary precondition for smooth and efficient operation of this one and the other provisions of the Agreement will be a regular process of information exchange between the relevant government bodies of Cyprus and Russia, duly determined by legal norms. The exchange of information between the competent bodies of the two countries must become an effective mechanism for avoiding double taxation between these countries. A regular exchange of information represents a certain "control mechanism" against "leakage" of incomes and capital abroad and for ensuring timely and full payment of all taxes.

The article of the Agreement that addresses the issue of information exchange is contrary neither to the norms established by the OECD nor to the norms stipulated in domestic legislation of each of the two countries. But at the same time this norm contains no definition of the grounds for granting information, or the grounds for a refusal to grant information, or the timelines for the granting or refusal to grant information by each of the Contracting States. Thus, the article provides no mechanisms for its practical application, which makes this application rather cumbersome.

In accordance with the signed Protocol, the wording of the Articles “Exchange of Information” and “Assistance in the Collection of Taxes” have been replaced with the wording presented in the latest update of the OECD Model Convention. However, the are, in fact, few alterations that can make it possible to actually apply the Article “Exchange of Information”. In particular, now the exchange of information between regulating agencies is not going to be restricted to tax issues only. Besides, now it is forbidden to refuse the disclosure of banking information to regulating agencies, as well as the information held by financial institutions, nominees, or agents. Nevertheless, domestic legislation of Cyprus imposes significant restrictions on the process of receiving information from that country’s regulating agencies. Thus, any information concerning shareholders or owners of companies can be obtained only with the permission of the Prosecutor General of Cyprus. ●

## AN ANALYSIS OF THE SAVINGS OF MILITARY SERVICEMEN WHO PARTICIPATE IN THE ACCUMULATIVE-MORTGAGE SYSTEM AND THE POSSIBILITIES OF PROVIDING THEM WITH THE HOUSING<sup>1</sup>

N.Kardashevsky

*This publication continues the analysis of functioning of the accumulative – mortgage system (AMS), which is aimed at settling the housing problems of military personnel and was initiated in 2005. In particular, the author analyses the amounts of savings belonging to participants in the system, and also considers the size of the residential space which could be granted to the system’s participants. Consideration is also given to some methods of eliminating the flaws inherent in the existing AMS.*

First, we would like to mention that the AMS is an efficient methods for settling the housing problems of those military servicemen who would prefer to continue their service after the army has acquired “new look”. Those among military servicemen who will depart from the Ministry of Defense in the nearest future while being entitled to housing provision, will receive housing “in kind”. The case in point is the approximately 45 thousand apartments which are going to be allocated this year, and approximately the same amount to be allocated in the future.

The MAS was developed in 2002 – 2004 by a team of specialists from the RF Ministry of Defense and the RF Ministry of Economic Development with the assistance of IET experts, who performed the relevant feasibility studies<sup>2</sup>. Later on, the system was repeatedly analyzed at the IET<sup>3</sup>. The AMS now begins its fourth year. According to the RF Ministry of Defense<sup>4</sup>, at the present time the system has more than 97 thousand participants from the army ranks, and about 20 thousand of them have already got the right to make the initial mortgage installment by using the funds accumulated in the course of those three years. However, only slightly more than 400 persons have materialized this right so far. It is expected that their numbers will increase because of the system’s participants having been granted the right to use the funds of targeted housing loans, which enables them to take part in share housing construction<sup>5</sup>. But will this move alone will be sufficient to resolve all the problems faced by the AMS’ participants?

1 The methodological part of the study was performed with the financial assistance provided by the Russian Humanities Foundation (RGNF) in accordance with Project No 08-02-00038a, “Improvement of the Methodology for Assessing the Socio – Economic Significance and Rationality of the Russian Army’s Switchover to the New Method of Manning”.

2 Razrabotka metodicheskogo apparata i ekonomicheskoe obosnovanie ratsional’nykh sposobov resheniia zhilishchnoi problemy obespecheniia voennosluzhashchikh zil'em [The development of the methodological apparatus and the assessment of the economic feasibility of the rational methods for settling the housing problem in the military organization of the Russian Federation] / Report of Research Work. Moscow: IEPP (IET). 2002.

3 Tsymbal V., Kardashevskii N., *Voенно-ekonomicheskii analiz nakopitel'no-ipotechnoi sistemy obespecheniia voennosluzhashchikh zil'em / Ekonomiko-politicheskaia situatsiia v Rossii v noiabre 2006 g.* [A military – economic analysis of the accumulative – mortgage system of housing support for Military Servicemen / The economic and political situation in Russia in November 2006]. Moscow: IEPP (IET). 2006.

4 *Voennaia ipoteka v zapas ne uvol'niaetsia* [The military mortgage system is not being transferred to the reserve] / “Gazeta” (The Newspaper). No 29. 19.02.2009.

5 Report of the Head of the Federal AMS Agency, A. Rylskii, at the All-Russian Conference “Mortgage in Russia. Sustainable Development and Market Prospects”, 13 - 14 November 2007.

The existing information on the financial results of 2008 is very contradictory. Thus, according to the Head of the Federal Accumulative-Mortgage System Agency, A. Rylskii<sup>1</sup>, about 18.4 billion rubles is known to be kept in the individual accounts of servicemen. However, the 2008 annual data on the formation and the use of accumulations, published on the information portal of the RF Ministry of Defense<sup>2</sup>, indicate that the market value of the aggregate investment portfolio's assets amounts to 12.9 billion rubles; the data are followed by a note indicating that the former were calculated with taking into account the revaluation of the assets carried out in accordance with the RF Ministry of Finance's clarifications. These clarifications<sup>3</sup> made it possible not to reevaluate the portfolio's securities by the end of the year, but to reflect in the annual report their value as of 1 July 2008. This means that the aggregate reported value of the securities – which accounted, according to the RF Ministry of Defense, for 70 % of the investment portfolio as of 01. 01. 2009 – could be significantly overestimated with respect to their current market value.

So far, it is reasonable to assume that the most reliable and important data on any changes in the AMS is represented by the information on the increase of annual installments. Thus, while at the beginning of the system's existence, in 2005 and 2006, 37 and 40.6 thousand rubles was transferred to the individual account of each military serviceman respectively, in 2007 and 2008 the amount of the annual installment increased to 82.8 and 89.9 thousand rubles respectively. And it is planned in the 2009 budget that the annual installment will rise to 168 thousand rubles. No doubt, this is a positive phenomenon which contributes to the AMS' development. Nevertheless, in reality such a growth in financing is not the best way to remedy some of the systemic flaws. The thing is that, while in 2004, when the feasibility studies were conducted and the MAS was created, the estimates were being based on the market value of one square meter of dwelling space, which was at the level of 11.8 thousand rubles; however, by the end of 2008, the average value of dwelling space in Russia, as calculated on the basis of RF Ministry of Regional Development's data<sup>4</sup>, had risen to about 34.5 thousand rubles per sq. m.

The growth in the cost of housing was caused by several factors, first of all by inflation, the rising cost of construction, and the increase in market margins. As a result, the estimated purchasing capacity of the annual installment (EPC – AI) declined from 3.14 sq m in 2005 to 2.6 sq m by the end of 2008. But the EPC-AI indicator does not characterize the situation as a whole. Equally important are the estimated purchasing capacity of the current money accumulation (EPC-CA) in a current year under consideration, and the estimated purchasing capacity of the total money accumulation (EPC-CA), which can be achieved at the estimated (on average) deadline of the serviceman's participation in the AMS.

It was planned at the moment of launching the AMS that the basic estimated term of participation in the AMS would be 17 years, which would follow the three years of service and the acquisition, by the serviceman, of the right to participate in the AMS. According to the initial estimates, a serviceman with no less than 20 years of service

1 V. Khudoleev, A. Pinchuk. *Eshe raz ob ipoteke* [Yet another word about mortgage] // "Krasnaia Zvezda" [The Red Star]. No 89. 21.05.2009.

2 <http://www.mil.ru/849/11876/37869/1058/22683/index.shtml>

3 Letter of the RF Ministry of Finance of 29 January 2009, No 07 – 02 18/01.

4 The estimates were conducted on the basis of the RF Ministry of Regional Development's Order of 18 September 2008, No 168, "On the Average Market Value of 1 Square Meter of Total Dwelling Space, by Subject of the Russian Federation, as of the Fourth Quarter of 2008", and also on the basis of the average estimated size of the RF population in accordance with Rosstat data.

would be able to obtain an apartment with a total floor space – that is, EPC-TA (with regard to the average price) – amounting to 54 sq m.

The difference between the indices is noteworthy: for a participant of the AMS who wants to acquire an apartment through mortgaging before the expiry of the basic estimated term, the EPC-CA is more important because it indicates the amount of funds necessary for him to approach a mortgage bank. On the other hand, for a participant who wants to acquire an apartment by the end of his or her service, the value of EPC-TA is clearly more important.

According to the data contained in the recently published Order of the RF Ministry of Regional Development No 79, of 25 March 2009, the average market value of 1 sq m of housing in Q 2 2009 was estimated at 36.2 thousand rubles. In other words, in the year 2009, EPC-AI amounts to approximately 4.64 sq m in an “average Russian” apartment. The data concerning the cost of housing in Moscow can be excluded from the estimates. Then the average value of one square meter of such estimated dwellings will decline to 32.4 thousand rubles. And EPC-AI, which corresponds to 168,000 rubles of the annual installment, will amount to more 5.18 sq m. For more details concerning the recent changes in the value of housing, see Table 1. Certainly, the size of the annual installment should correspond to the dynamic of housing prices, but it is much more important that the actual purchasing capacity of the already existing money accumulation (EPC-CA or EPC-TA) should not be devalued. Although the Concept of the Law on the AMS stipulates that the responsibility for the purchasing capacity of the money accumulated being safeguarded from devaluation should be born by asset managers, in practice it can hardly be expected that income from investments could exceed the rise in the value of one square meter of dwelling space.

Table 1

APPRAISALS OF THE AVERAGE ESTIMATED VALUE OF ONE SQUARE METER OF HOUSING  
WITHIN THE AMS, IN RUBLES

	Q 1 08	Q 2 08	Q 3 2008	Q 4 08	Q 1 09	Q 2 09
Central Federal Okrug	33 460	35 574	40 018	44 883	43 116	48 307
including Moscow	56 650	59 350	67 750	76 800	73 800	83 750
North-Western Federal Okrug	27 404	29 319	34 484	36 707	34 409	39 010
including St. Petersburg	32 650	35 500	44 200	47 300	44 300	52 500
Southern Federal Okrug	18 970	20 364	23 351	26 253	24 960	28 699
Volga Federal Okrug	23 821	25 714	27 695	29 824	27 793	30 527
Urals Federal Okrug	28 056	29 644	31 201	33 217	31 221	33 720
Siberian Federal Okrug	24 378	26 537	29 671	31 425	29 292	31 056
Far-Eastern Federal Okrug	25 835	27 999	30 236	33 012	30 808	34 656
RF TOTAL	26 435	28 330	31 554	34 501	32 613	36 226

Table 2 contains data on the amounts of money accumulated by AMS participants, by group, in 2008 prices (the data were disclosed in the published information on the AMS for the year 2008). The same Table includes the estimates of the sums which could have been kept in the bank accounts of military servicemen if the size of the annual installment had been tied to the estimated purchasing capacity of the money accumulated from the moment of the servicemen’s joining the AMS.



Table 2

DATA ON THE AMOUNTS OF MONEY ACCUMULATED AS OF 31 DECEMBER 08

Year of entry in register	In accordance with current legislation		IET's estimation of volumes of funds necessary for preserving purchasing capacity of accumulated money	
	mn rubles	EPC-CA, sq m	mn rubles	EPC-CA, sq m
2005	240.0	7.0	314.7	9.1
2006	196.6	5.7	224.8	6.5
2007	133.1	3.9	134.9	3.9
2008	45.1	1.3	45.0	1.3

It transpires from the Table that bearing in mind the current housing prices, there clearly exists a “deficit” of accumulated money for the first participants of the AMS. This means that in the year 2008, those who have acquired the right to use their accumulated money for obtaining a targeted housing loan, will lose on average about 2.2 sq m when buying a flat via the mortgage system – because of their installments being incompletely index-tied. In a number of subjects of the RF where housing prices are low, their losses will amount to more than 4 square meters of dwelling space on average. This situation violates the equality of servicemen’s rights and contradicts the declared principles of the AMS.

By the end of 2009 things can become even worse. In particular, there can emerge a conflict situation amidst the servicemen, because the amount of money in the accounts of those who joined the AMS in 2008 – 2009 will be approximately equal to one half of the funds belonging to the servicemen who joined the accumulative mortgage system in 2005. This will happen despite the fact that both categories of servicemen have more than ten years before they obtain the right to use their accumulated money. *Table 3* contains our estimates of the average amounts of money accumulated in the bank accounts of AMS participants as of 31.12.09.

Table 3

DATA ON THE AMOUNTS OF ACCUMULATED MONEY AS OF 31.12.09

Year of entry in register	In accordance with current legislation		IET's estimation of volume of funds necessary for preserving purchasing capacity of accumulated money	
	mn rubles	EPC-CA, sq m	mn rubles	EPC-CA, sq m
2005	408.0	11.3	756.0	20.9
2006	364.6	10.1	588.0	16.2
2007	301.1	8.3	420.0	11.6
2008	213.1	5.9	252.0	7.0
2009	84.0	2.3	84.0	2.3

For the persons who became participants of the AMS in 2005, the decrease in the purchasing capacity of their accumulated money is already compatible with the size of an additional room in the flats they buy.

Undoubtedly, this situation must be quickly resolved. Otherwise, its blatant injustice will be further aggravated with the passage of time.

There can be several solutions to the problem. The relevant proposals, however, should be thoroughly appraised before recommending any of them for implementation.

One of the possible solutions which we now have in mind is to further elaborate the existing law, so as to stipulate in it the necessity of differentiating the sums of annual installment as estimated on the basis of future expected value of one square meter of dwell-

ing space and the duration of a person's participation in the AMS. The amount of annual installment can be calculated by using the following formula:

$$EB(t) = FVA \times \frac{t}{17} - \sum_{i=0}^{t-1} EB(i) \quad , \text{ where}$$

- $EB(t)$  – the amount of the required annual installment to be deposited into the account of a serviceman who joined the AMS  $t$  years ago (when  $t$  does not exceed 17 years);
- $FVA$  – the forecasted value of an apartment with a normative floor space of 54 sq m at the moment when the person in question obtains the right to use his or her accumulated money, and when his or her participation in the AMS has lasted for no less than 17 years;
- $\sum_{i=0}^{t-1} EB(i)$  – the sum total of the previous annual installments deposited by that time into the account of the serviceman.

Thus calculated, the amount of the annual installment will differ for servicemen who joined the AMS in different time periods. On the one hand, this would relatively complicate the calculation of the AMS' total requirement of budget funding, because it will be necessary to sum up the annual contributions calculated by group of servicemen. But, on the other hand, it is of greater importance that the introduction of this approach will make it possible to secure the actual inviolability of the accumulated money, as well as to maintain the efficiency of the AMS. And most importantly, this approach guarantees that servicemen will participate in the AMS on equal terms, and that the system will be adaptable to any fluctuations on the housing market. ●

## MEETINGS OF THE GOVERNMENT OF THE RUSSIAN FEDERATION IN MAY 2009

M. Goldin

*In May at the meetings of the Presidium of the Government of the Russian Federation the following issues were considered: the bill specifying the regulations for gas export and export supplies of liquefied gas by the companies of different property, the changes in the conditions for granting state guarantees, the project of the main directions of tax policy for 2010 and for the planning period of 2011 and 2012.*

On May, 18 at the meeting of the Presidium of the Government of the Russian Federation (further referred to as the meeting of the Government of the Russian Federation) the draft of the federal law “On making changes to the Federal Law “On gas export” from July 18, 2006 No 117-FZ” (further referred to as the bill) was discussed.

According to paragraph 2 article 1 of the Law “On gas export” the law is applied to gas produced at all the hydrocarbon fields and transported in gaseous and liquefied state. Such a wording means that the monopoly for gas export or, in other words, the principle of “single export channel” established by the law can be applied not only to natural and stripped gas transported by pipelines of the Single gas transportation system together with the natural gas but also to liquefied carbureted hydrogen gas. At the same time the liquefied gas is a product of oil-well (casing-head) gas and is not transported by the Single gas transportation system and its export is made by different independent companies. In this connection the bill suggests to understand the term of “gas” as only the natural gas and dry stripped gas transported in gaseous state by gas pipelines.

The bill was approved by the Government of the Russian Federation and submitted to the State Duma.

On May, 25 at the meeting of the Government of the Russian Federation the project of the Federal law “On making changes to the Federal Law “On the federal budget for 2009 and for the planning period of 2010 and 2011” was discussed. The bill envisages making the following changes in the Program for state guarantees of the Russian Federation in the currency of the Russian Federation for 2009, established by the Federal Law from November 24, 2008 No 204-FZ “On federal budget for 2009 and for the planning period of 2010 and 2011”:

- The cancellation of the norm establishing that the requirement on the fulfillment of the state guarantee at the rate not exceeding 90% of the sum of the unsettled liabilities of the principal concerning the return of the credit, existing (outstanding) after full realization of the rights by the creditor bank concerning other (excluding the state guarantee) security for principal’s liability on the credit contract;

- The reduction of the period for state security down to the period for the return of the credit established by the credit agreement prolonged by 70 days (not by 2 two years as it was stated earlier) in connection with the cancellation of the norm mentioned.

The approval of the bill will exclude the necessity of preliminary realization of other guarantees (except the state guarantee) for the credit (which provides for the part of liabilities not guaranteed by the state guarantee) before making demands for the Ministry of Finance of the Russian Federation on execution of the state guarantees and will hence increase the attractiveness of the conditions for granting of state guarantees.

At the meeting of the Government of the Russian Federation on May, 25 the project for the main directions of the taxation policy for 2010 and for the planning period of 2011 and 2012 was also discussed.

The majority of the decisions in the field of the taxation policy was adopted as a part of the anti-crisis measures of taxation stimulation, whose budgetary estimation was reflected in the Program of the anti-crisis measures of the Government of the Russian Federation adopted by the Government of the Russian Federation.

For instance within the framework of the anti-crisis measures of taxation incentives in 2008 there was a simultaneous increase in tax deductions from the incomes taxes of the individuals, decrease in the rate of organization's profit tax and the amortization deduction for the organization's profit tax, introduction of tax privileges for the severance tax when producing oil, including the decrease in its rate. Besides, there was a preliminary work being carried out on the introduction of the tax on immovable property instead of the existing land tax and property tax for individuals.

For the forthcoming three-year period the priorities of the Government of the Russian Federation remain the same as the year ago – creation of the effective tax system on sustaining the existing tax burden on the economy. However at the same time the Government understands that the tax policy, on the one hand, should assist counteracting the negative effects of the economic crisis and on the other hand should be aimed at the creation of the conditions for the recovery of the economic growth.

Some of the measures in the field of taxation policy planned to be fulfilled in 2010 and in the planning period of 2011 and 2012 are the following:

### **1. Concerning the taxation administration:**

1) regulating the situation with the sums of taxes, duties, penalty fees and fines written off the accounts of the taxpayers, duties payers, tax agents to make the payments mentioned into the budgetary system of the Russian Federation that were not transferred by the banks which were liquidated by the moment these sums were recognized as impossible to collect;

2) specifying the procedure for the suspension of the operations concerning organizations' and individual entrepreneurs' banking accounts;

3) defining the particular types of infringements of taxation legislation and the responsibility for their perpetrations (including the responsibility of the banks for failure of submission or untimely submission of the necessary data, as well as specification of other types of infringement and responsibilities)

### **2. Concerning the organizations' profit tax:**

1) changes in the taxation legislation establishing the limitations concerning both the period and the amount of profit directed to compensate for the losses in reorganized entities.

2) improvement in the procedure for accounting of some kinds of expenditures, for instance, effective starting with 2009 broadening the list of the expenditures of trading organizations taken into account when taxing the profit including the expenditures for losses, damage, shortage of goods, expenditures connected with accomplishment; broadening of the list of organizations' expenditures connected with the development of natural resources; specification of the procedure for taxation of profit of taxpayers conducting activity connected with the use of the objects of the auxiliary processes and entities;

3) the extension (taking into account some peculiar features) of article 40 of the Tax Code of the Russian Federation to the financial operations conducted between the interdependent persons concerning the operations with the interest on credits, loans, promissory

notes and to other operations the income from which does not belong to the income from the sale of goods (works, services);

4) rapprochement of fiscal accounting and bookkeeping.

### **3. Concerning value added tax:**

1) the curtailment of the list of the documents supporting the validity of VAT zero rate application;

2) introduction of the specific procedure for the compensation of value added tax when the decision on compensation will be made before the office check has been finished;

3) specification of the procedure for the application of the value added tax by the organizations, carrying out clearing activity;

4) changes in the procedures for filling of invoices as well as the solution of the question on the possibility for filling the invoices with negative figures (credit-invoices).

### **4. Concerning the incomes tax on individuals:**

1) exemption from the submission of the tax declaration for the tax payers who do not have tax liabilities for the budget on condition the declaration was made to fulfill the right for tax exemption or for the acquisition of the tax deductions;

2) simplification of the tax declaration and issuing simple and comprehensive instructions for its fulfillment;

3) specification in the medium-term outlook of the definition for the tax residence of individuals;

4) optimization of the procedure for taxation of individuals on them making operations with securities and financial instruments of futures deal.

### **5. Concerning the special regimes of taxation:**

1) increase of the threshold for the limit amount of the profit up to RUR 60 million a year starting with 2010 which will enable the enterprises to apply simplified system of taxation, cancelling the mechanism for the increase in the limit amount of profits with the application of the deflation coefficients;

2) improvement of the application of the simplified system of taxation on the basis of a patent, with the expanding authority of the subjects of the Russian Federation to define the potentially possible income of the individual entrepreneur when defining the year value of the patent;

3) specification of the list of the kinds of the entrepreneurial activity which can be transferred to the system of taxation in the form of the single tax on the imputed income for some kinds of activities as well as of the physical indices used to calculate this tax;

4) development of the procedure for defining the basic profitability by the kinds of entrepreneurial activity levied with the single tax on the imputed income.

It is also planned to conclude the preliminary work on the introduction of the tax on immovable instead of the existing land tax and the tax on the property of the individuals. ●

## REVIEW OF ECONOMIC LEGISLATION

I.Tolmacheva

*At the end of April - the beginning of May the following important changes were made in the economic legislation: the amount of different kinds of social payments was increased, the procedure for the placement of the government orders by single supplier (executor, contractor) was specified; the program for the development of the competition in Russia was designed; the refinancing rate of the Bank of Russia was lowered.*

### I. Federal Laws of the Russian Federation

1. Federal Law from 28.04.2009 No 72-FZ “ON MAKING CHANGES TO SOME LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION IN ORDER TO INCREASE THE LEVEL OF MATERIAL SECURITY OF SOME CATEGORIES OF CITIZENS”

The law established the rates of different social payments. For instance, starting with December 1, 2009 the amount of the basic rate of the retirement old-age pension will be increased from RUR 1950 to RUR 2562 per month, and the basic rate for the disabled of the 3<sup>rd</sup> group restriction for work will be increased from RUR 3900 to RUR 5124 per month, of the 2<sup>nd</sup> group – from RUR 1950 to RUR 2562 per month and of the 1<sup>st</sup> group – from RUR 975 to RUR 1281 per month. The rates of pensions and other payments to the veterans, disabled, citizens exposed to the radiation as a result of the catastrophe at Chernobyl Nuclear power plant and as a result of nuclear tests at Semipalatinsk test site, heroes of the Soviet Union, heroes of the Russian Federation and full cavaliers of the Order were raised. The sums of money directed to payment for social services rendered to the citizens in accordance to the Federal law “on state social services” from RUR 615 to RUR 641. The possibility for extraordinary grant from the means of the maternity capital of RUR 12000 was established.

2. Federal Law from 28.04.2009 No 68-FZ “ON MAKING CHANGES TO ARTICLE 55 OF THE FEDERAL LAW “ON ORDER PLACEMENT FOR SUPPLIES OF GOODS, EXECUTION OF WORKS, RENDERING SERVICES FOR STATE AND MUNICIPAL NEEDS”

The list of cases in which the placement of the state order by the single supplier (executor, contractor) has been supplemented: the order can be placed by the single supplier (executor, contractor) defined by the order of the Government of the Russian Federation in cases established by the decisions and instructions of the President of the Russian Federation. The order for rendering services connected with the visiting events organized by the President of the Russian Federation can also be place by the single supplier (executor, contractor).

### II. Decrees of the Government of the Russian Federation

1. Decree of the Government of the Russian Federation from 19.05.2009 No 691-r

The Program for the development of the competition in Russia has been designed, which defines the priorities and the main directions for the competition policy up to 2012.

The approved program defines the competition policy as a complex of successive measures made by the Government in order to provide conditions for competition between the economic entities, to increase the efficiency and competitive ability in the Russian economy, to modernize the enterprises and create the conditions to meet the demand of citizens for goods and services effectively from the economic point of view. The achievement

of the targets of the competition policy suggests, for instance, the solution of the tasks on the general improvement of the competitive environment due to the reduction of the ungrounded of internal and external trading barriers, the development of the transportation, information and energy infrastructure, development of the anti-monopoly legislation; fulfillment of measures for developing of competition in some branches (in the field of power industry and housing and utilities infrastructure, at the market of oil products and gas, in agriculture markets, in the field of retail trade, in the construction market, in the area of railway transportation etc.). The addenda of the Program include the measures to develop the competition in individual branches, as well as the plan of the measures to fulfill it in 2009-2012.

### **III. Instructions, Letters, Orders**

1. Instruction of the Central Bank of the Russian Federation from 13.05.2009 No 2230-U "ON REFINANCING RATE OF THE BANK OF RUSSIA"

From May 14, 2009 the refinancing rate of the Bank of Russia is established to be 12% per annum. Earlier (from April 24, 2009) the refinancing rate was equal to 12.5% per annum. ●

## REVIEW OF REGULATORY DOCUMENTS CONCERNING TAXATION OVER APRIL–MAY 2009

L.Anisimova

1. According to the Order by the Ministry for the Industry and Trade of the Russian Federation from April 15, 2009 No 274 the list of the folk artistic crafts and items has been approved. The sale of folk artistic items is not levied with VAT (article 149 of the Tax Code of the Russian Federation, paragraph 4 subparagraph 6), the organizations producing such items apply the lowered rate of single social tax, there is a privilege for payment the land tax, the organizations are allowed to apply simplified system of taxation.

2. According to the letter of the Ministry of Finance of the Russian Federation from April 21, 2009 No 03-05-04-01/16, Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation from May 6, 2009 No ShS-17-3/86@ the question on the exemption from the property tax and the transport tax of the underage prisoners of fascism is clarified.

Tax on property of natural persons is paid on the basis of the Law of the Russian Federation from December 9, 1991 No 2003-1. According to the text of the law there are no privileges for the prisoners of concentration camps envisaged. The Ministry of Finance of the Russian Federation clarifies that in accordance with the existing law the disabled of groups I and II, participants of the Great Motherland War, as well as pensioners receiving pensions granted according to the procedure established by the pension legislation of the Russian Federation are exempted from the property tax.

In the opinion of the Ministry of Finance of the Russian Federation before the changes were made by the Federal Law from April 22, 2004 into the legislation on veterans (when the term “privileges” was substituted by the term “measures for social support”), the Decree of the President of the Russian Federation from October 15, 1992 No 1235 was in effect that applied the privileges established for the veterans of the Great Patriotic War for former prisoners of concentrations camps. The list of privileges was not specifies, the regulation was of general nature.

In the opinion of the Ministry of Finance of the Russian Federation, starting with January 1, 2005 the underage prisoners of concentration camps receive monthly monetary payments, measures of social support and privileges established correspondingly for the disabled as a result of the Great Patriotic War and the participants of the Great Patriotic War that were military personnel (paragraph 8 article 154 of the Federal Law No 122-FZ). There are no grounds for granting the privileges for tax on property of natural persons established for the invalids and participants of the Great Patriotic War to the former underage prisoners of fascism. They can get tax privileges if they belong to other categories of citizens that have a direct right for tax privileges (for instance the disabled of I and II group or pensioners).

In our opinion this position is highly disputable. The legal consequences of the adoption of the Federal Law from April 22, 2004 No 122-FZ are clarified by the Decision of the Constitutional Court of the Russian Federation from December 27, 2005 no 502-O: “According to paragraph 11 of article 44 of the Federal Law from August 22, 2004 “On Veterans” (subparagraph 1) the reference for giving the war veterans privileges for taxation in concordance with the legislation of the Russian Federation is excluded. However such privileges are envisaged for them by the taxation legislation (for instance, subparagraph 3



paragraph 2 article 333.36 and subparagraph 4 paragraph 5 article 391 of the Tax Code of the Russian Federation)”. We should also add – by the Law of the Russian Federation from December 9, 1991 No 2003-1 “On property tax levied on natural persons”.

The Federal Arbitratory Court of the Russian Federation in the decision from January 29, 2009 No F10-6225/08 for the case No A62-2178/2008 also comments differently from the Ministry of Finance of the Russian Federation the existing situation with regard to the prisoners of concentration camps with the reference to the Decision of the Constitutional Court of the Russian Federation from December 27, 2005 No 502-O mentioned above, namely: “In concordance with the position of the Constitutional Court of the Russian Federation stated in the Decision from December 27, 2005 No 502-O, the invalidation by subparagraph 2 paragraph 5 article 44 of the Federal Law from August 22, 2004 No 122-FZ of paragraphs 3 and 4 article 11 of the Federal Law “On Veterans”, according to which the rights and privileges as well as other measures for social protection of veterans and members of their families earlier established by the legislation of the USSR and the legislation of the Russian Federation cannot be cancelled without the substitution of equal value, and federal laws and other regulatory legal acts of the subjects of the Russian Federation limiting the rights and privileges envisaged for the veterans by this Federal Law are recognized as invalid, does not mean that the federal legislator has abolished the liability that had been taken earlier to guarantee the veterans the level of the social protection that was defined by the earlier legal regulations. According to the essence of this decision, the fact that paragraphs 3 and 4 article 11 of the Federal Law “On Veterans” becoming invalid cannot be considered as permitting the free abolition of the rights, privileges and guarantees earlier established for the veterans and suggesting the possibility of the state to cancel the public and legal liabilities for the veterans that were taken earlier without provision of the compensation of the equal value”.

Consequently there are no grounds to consider the statements of the Decree from October 15, 1993 No 1235 applying the privileges for the prisoners of concentration camps as “becoming in fact invalid”.

As to the privileges for the transportation tax, the Tax Code of the Russian Federation gave the subjects of the Russian Federation the right when establishing the transportation tax to envisage tax privileges and grounds for their use by a taxpayer (that is to adopt regional laws).

3. According to the letters of the federal Tax Service of the Russian Federation from May 14, 2009 No ShS-17-3/90@, the Ministry of Finance of the Russian Federation from March, 10 2009 No 03-07-15/40 and the Federal Service on Surveillance in Health Care and Social Development of the Russian Federation (Roszdravnadzor) from December 29, 2008 No 01-36812/08 the procedure for ascription of the goods to the technical means for rehabilitation, prosthetic and orthopedic items, which are the goods for medical use was clarified. Such items are to be registered by the state in order to be allowed to be produced, imported, sold and applied in the territory of the Russian Federation. The document confirming the fact of registration of the item for medicinal use is the registration certificate, including the All-Russian Product Classification Code corresponding to All-Russian Product Classification OK 005-93. On the basis of paragraph 1.3 of the Order of the Ministry for Health Care and Social Protection of the Russian Federation from October 30, 2006 No 735 all technical means for rehabilitation, including prosthetic and orthopedic means (antenatal, postnatal, medical bandages and bodices) are the items for medicinal use. The items of medicinal use are subject to lower VAT rates or privileges. The lists for such goods are approved by the Decrees of the Government of the Russian Federation.

4. According to the letter of the Ministry of Finance of the Russian Federation from March 24, 2009 No 03-04-07-01/97 and of the Federal Tax Service of the Russian Federation from April 2, 2009 No ShS-17-3/73@ the question on the procedure for the taxation of the incomes of natural persons, received in agreement with the contract of life-long subsistence with maintenance is clarified.

In accordance with article 583 of the Civil Code of the Russian Federation by the contract of rent one party (rent recipient) gives another party (rent payer) the property in the ownership, and the rent payer takes the responsibility to pay periodically the rent in exchange for the received property in the form of a definite monetary sum or giving the means to maintain it in other form. It should be noted that it is stated in paragraph 1 article 585 of the Civil Code of the Russian Federation that the property that is alienated for rent payment can be given into the ownership of the rent payer onerously or gratuitously.

In any case, and this is justly mentioned by the Ministry of Finance of the Russian Federation, the contract of the rent is onerous, since there is a counter liability to give material or other good that is compulsory. Such a position corresponds to paragraph 3 article 594 of the Civil Code of the Russian Federation, which refers to the text of article 424 on the procedure for determination of the price in an onerous contract. Further, the Ministry of Finance of the Russian Federation determines that the regulations for the sale contract or the gift contract are applied in the rent relations only to transfer and payment for property. Rent payments for the person receiving the rent, in the opinion of the Ministry of Finance of the Russian Federation, are initially subject to levying with the tax.

Thus, for the purposes of taxation the Ministry of Finance of the Russian Federation distinguishes two different deals, on the results of which two taxation bases are formed:

- 1) Transfer of property for payment, partial payment, gratuitously;
- 2) Rent payments.

Such an approach, in our opinion, results in the overestimation of the total tax base and unequal distribution of tax burden among the participants of market relations. The taxation base in the form of the difference in prices for the property evolves for the recipient of the property, the taxation base from the total sum of the received income – for the rent recipient. At the same time the transfer of the property on the rent contract and the transfer of property of sales (or gift) contract has different legal consequences. In contrast to the simple sale (or gift) deal the property within the framework of rent deal is *burdened* with the liabilities to pay rent. The liability to pay rent is not connected with the specific person signing the contract but with the subject of the deal – property, which secures the right for the receiving of the rent. And such a liability will evolve for every new owner of the property. It seems that the taxation base for the recipient of the property should be calculated as a difference between the market price of the property on its retirement and the expenses for its purchase increased by the sum of the paid rent, as it is suggested by the Ministry of Finance of the Russian Federation. However on application of such an approach nearly all the value of the property (in case of gratuitous transfer) can be included in the taxation base of the purchaser of the property. The losses forming during the deal in their turn will not be taken into account and will be taxed (with the taxes on profit of a natural person depending on the status of the participant of the deal), and the recipient of the rent profit when calculating the taxation base it will not be taken into account that the basis for such profits is the reduction of the capital in connection with the transfer of the property in the rent.

We assume that it would a more justified approach to tax the real result of the rent deal, but in order to do this corresponding correction should be made to the Tax Code of the Russian Federation as it has been done towards the deals with repurchase agreement (sale with the liability of subsequent purchase), definition of the taxation base for the ob-

ligations with the accumulated coupon amount etc. Since the rent agreement is an independent kind of agreement, it should be considered possible to apply the same approach as that established by the Tax Code of the Russian Federation to define the taxation base for the operations with coupon obligations. The complexity for financial structures consists obviously in the fact that the rent agreement is the agreement with undefined term and undefined participants.

At the same time, from the economic point of view, there is no special difficulty arising in calculation of the just taxation base for the participants of the rent agreement. At any given moment the property has its market value. The aggregated payments for rent agreement will be accumulated (according to the principle of accumulation of the accumulated coupon amount) from the date the agreement came into effect with the use of the mechanism of compound interest at market rates – at least at the refinancing rates of the Central Bank of the Russian Federation (or with the application of the mechanism of simple interest as it is done by the Russian banks though it is the mechanism of compound interest meets the rules of just competition at the market). Comparison of market value of the property and accumulated payments will enable defining the state of the taxation base by each of the participants of the deal on any day of the effect of the rent agreement. In case the market value is more than the sum of accumulated payments the regulations for taxation of the property bought on the installment plan should be applied. In this case there is taxation base evolving. In case the sum of the payments accumulated from the beginning of the contract is exceeds the market value of the property plus 20%, the matter will concern the net profit received by the recipient of the rent, which from that moment on (and not from the moment the rent payments started as the Ministry of Finance of the Russian Federation holds) is to be taxed by the rent recipient. If at the moment of cessation of the agreement the sum of the accumulated payments is lower than the market value of the property, the taxation base should be calculated as a difference between the market value of the property (including VAT) minus 20% and the really made payments. The persons making intermediate deals with the property burdened with the rent the taxation base from the sale of the property is to be calculated according to the established procedure as a difference between the price of purchase (not taking the rent into account) and the price of sale of property (not taking the rent into account). At the same time it should be allowed to ascribe the payments of the rent to the expenditures decreasing the taxation base, since their result is the receipt of the income in the form of the purchase of property.

In case the scheme suggested is adopted, the statements of the Civil Code of the Russian Federation concerning the redemption price could be leveled ascribing it the status of only a reference figure. Unfortunately, the Civil Code of the Russian Federation currently contains the definition for the redemption price (paragraph 3 article 594 of the Civil Code of the Russian Federation), which currently complicates significantly the calculation of the taxation base since this definition strictly regulates the mechanism for the definition of the redemption price by non-economic methods. It includes the price of the transferred property together with the annual sum of rent payments (it is not clear why it is the annual sum of rent payments that is regulated or why it is to be included in the redemption price of the property).

It should also be noted that according to the decision of the Constitutional Court of the Russian Federation from November 27, 2008 no 11-P a number of other statements of the Civil Code of the Russian Federation concerning the definition of the amount of the rent payment is considered as inadequate when the Constitution of the Russian Federation is considered, and the Constitutional court of the Russian Federation obliged the legislators to adopt new legislative regulations concerning this issue by July 1, 2009.

5. According to the letter of the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation from May 6, 2009 No ShS -22-3/370@ the issue on the procedure for the taxation of the profits from the sale of transport vehicles and the application of the property tax deduction.

Property tax deductions are given on the basis of a written application of the taxpayer when he submits tax declaration (article 220 of the Tax Code of the Russian Federation).

Instead of using the right to receive the tax deductions the taxpayer has a right to reduce the sum of all his taxed profits at the sum of really made and proved by documents expenditures connected with the receipt of these profits.

The Tax Code of the Russian Federation did not define the list of the documents submitted by a taxpayer when selling a transport vehicle to prove the expenses made when purchasing it.

With the reference to articles 408, 160 and 161 of the Civil Code of the Russian Federation the Ministry of Finance of the Russian Federation clarified that for instance the receipt on the monetary funds signed by the seller of the transport vehicle can be the document proving the fact of the expenses made to purchase the transport vehicle.

However the registration of the number plates is conducted in accordance with the Decree of the Government of the Russian Federation from August 12, 1994 No 938, which defined the list of the documents necessary to register the number, one of which is certificate of charge. As it has been explained by the Ministry of Finance of the Russian Federation the certificate of charge issued by economic entities or individual entrepreneurs selling transport vehicles is a number security form. This document reflects the fact of paying for by the customer of the car. This document is quite sufficient to prove the fact of the expenditures made by the owner of the transport vehicle to purchase it.

6. According to the Decree of the Government of the Russian Federation from April 30, 2009 No 372 the list of the technological equipment (including components and spare parts for it), analogues for which are not produced in the Russian Federation and imported into the territory of the Russian Federation in accordance with paragraph 7 article 150 of the Tax Code of the Russian Federation is not to be levied with VAT.

7. According to the letter of the Ministry of Finance of the Russian Federation from April 30, 2009 No 03-07-08/105 (answer to a private enquiry) the question on the period for realization of the right for VAT deduction for goods (works, services) used to conduct operations in the territory of the Russian Federation which are levied with VAT.

The Ministry of Finance of the Russian Federation clarified that a taxpayer can use the right for deduction on the basis of the statements of paragraph 2 article 173 of the Tax Code of the Russian Federation within three years after the end of the taxation period in which such a right evolved.

8. According to the letter of the Ministry of Finance of the Russian Federation from April 30, 2009 No 03-11-06/3/120 (answer to a private enquiry) the Ministry of Finance of the Russian Federation clarified the questions of the application of the taxation system in the form of the single tax on the imputed income in case the number of staff exceeds the standard established by the law for this kind of tax. In accordance with article 346.26 of the Tax Code of the Russian Federation the organizations and individual entrepreneurs with the average number of employees on whose books over the preceding calendar year defined according to the procedure established by a federal executive body authorized in the field of statistics exceeds 100 are not to be transferred to the payment of the single tax on the imputed income as from January 1, 2009. In case as a result of a taxation period

(quarter) a taxpayer did not meet the established requirements he loses the right to apply the single tax on the imputed income from the beginning of the tax period when the mentioned discrepancy took place. For instance if in the 2<sup>nd</sup> quarter 2009 the average number of the employees in the organization is above 100 people, the organization loses the right to apply the taxation system in the form of the single tax on the imputed income starting with April 2009.

9. According to the letter of the Ministry of Finance of the Russian federation from April 29, 2009 No 03-07-11/122 it is clarified that in order to calculate VAT on transfer the rights for property of non-residential premises, according to article 153 of the Tax Code of the Russian Federation one should be guided by the particular features established in article 155 of the Tax Code of the Russian Federation. Since article 155 of the Tax Code of the Russian Federation does not establish particular features for such deals, the taxation base is defined according to the general procedure established by paragraph 2 article 153 of the Tax Code of the Russian Federation, according to which when defining the taxation base for VAT the earnings from the transfer of the property rights is calculated basing on all the incomes of the taxpayer connected with the payments for property rights.

10. Federal Law from April 28, 2009 No 67-FZ changes were made into article 217 part two of the Tax Code of the Russian Federation concerning the payment of the profits of natural persons. The means received by parents, legal representatives of children attending educational institutions in the form of compensation of the part of the parents' payment for the maintenance of a child in educational institution fulfilling the educational program of pre-schooling education.

11. According to the letter of the ministry of Finance of the Russian Federation from April 20, 2009 No 03-03-06/1/262 (answer to a private enquiry) the Ministry of Finance of the Russian Federation clarifies the procedure for the transfer from non-linear to linear method of calculation of the amortization and ascription of the losses formed in connection with the sale of the retired fixed assets on the results taken into account when taxing the profit.

When transferring from non-linear to linear method in accordance with paragraph 4 article 332, paragraph 1 article 259, article 257 the taxpayer makes changes into the accounting policy and defines the residual value of the objects of amortized property by the first day of the taxation period from the beginning of which the accounting policy for the taxation purposes establishes the application of the linear method for calculation of amortization. It should be noted that the norm of amortization for each object of the amortized property is defined depending the residual period of its use by this date. The period for the use is defined by the taxpayer independently when putting into commission the amortized property taking into account the Classification of fixed assets approved by the Government of the Russian Federation.

When selling the amortized property the taxpayer (in accordance with the Tax Code of the Russian Federation) can reduce the taxation base for this operation by the residual value of property. If the residual value taking into account the expenses connected with the sale exceeds the earnings from the sale of this property then the losses are formed which for purposes of taxation is ascribed to other expenses of taxpayer in equal proportions within the period defined as a difference between the period of the effective use of the property and the real period of its exploitation up to the moment of sale. ●

## REVIEW OF BUDGETARY LEGISLATION

M. Goldin

*In May the following changes have occurred in the field of budgetary legislation: the amendments were made to the laws on the federal budget, on the budgets of funds for health and social insurance, the authority of the government customers of the federal targeted programs concerning the independent targeted distribution of subsidies has been widened, the possibility to make advance payments at the rate of 30% by the budget contracts in the field of construction was established.*

According to the Federal Law from 28.04.2009 No 76-FZ “On amendments to the Federal Law “On the federal budget for 2009 and for the planning period of 2010 and 2011” the figures for the federal budget for 2009 were specified. The words “and for the planning period of 2010 and 2011” were excluded from the text of the law. Thus the norms of this law now regulate the parameters of the federal budget only in 2009.

The similar amendments according to the Federal Laws from 28.04.2009 No 78-FZ and from 28.04.2009 No 79-FZ were made to:

- Federal Law “On the budget of the Fund for social insurance of the Russian Federation for 2009 and for the planning period of 2010 and 2011”.
- Federal Law “On the budget of the Federal Fund for compulsory health insurance for 2009 and for the planning period of 2010 and 2011”.

Besides, according to the Federal Law from 28.04.2009 No 76-FZ the federal budget was planned basing on the forecast volume of the GDP at the amount of RUR 40.4 trillion (earlier RUR 51.47 trillion) and the level of the inflation not exceeding 13% instead of the forecast level of 8.5%. The earnings of the profit part of the federal budget in 2009 are expected to be RUR 6.7 trillion, which is RUR 4.2 trillion less than the volume forecast earlier. It should be noted that the expenses of the federal budget were raised and defined at the amount of RUR 9.69 trillion instead of RUR 9.02 trillion established earlier. Thus, the deficit of the federal budget will be RUR 2.9 trillion (7.2% of the GDP).

According to the Federal Law from 28.04.2009 No 78-FZ the total forecast volume of profits of the budget of the Fund for social insurance of the Russian Federation was decreased from RUR 445 133 616.5 thousand to RUR 415 008 261.0 thousand, of which the amount of the interbudgetary transfers from the federal budget will be RUR 94 291 364.0 thousand instead of RUR 70 568 364.0 thousand planned earlier. At the same time the total amount of the expenditures of the Fund’s budget was decreased to RUR 414 063 876.3 thousand (earlier the expenditures were planned at RUR 447 188 618.9 thousand).

According to the Federal Law from 28.04.2009 No 79-FZ the total forecast volume of the earnings of the Fund for compulsory health insurance was decreased from RUR 119 313 242.0 thousand to RUR 119 070 242.0 thousand.

According to the Decree of the Government of the Russian Federation from 26.05.2009 No 448 “On making changes to the decree of the Government of the Russian Federation from December 24, 2008 No 987” the authorities of the federal executive bodies acting as the state clients of the federal targeted programs were broadened. According to the addenda the state client on agreement with the coordinator of the federal targeted program (if there is such) and the Ministry for economic development of the Russian Federation approves the address distribution of subsidies if such a distribution is not established by the

program itself and also approves the changes in the amount of subsidies established by the federal targeted program for 2009.

According to the Decree of the Government of the Russian Federation from 07.05.2009 No 396 “On making changes to the Decree of the Government of the Russian Federation from December 24, 2008 No 987” the addition was made to the decree of the Government of the Russian Federation “On Measures for fulfillment of the Federal Law “On federal budget for 2009 and for the planning period of 2010 and 2011”. According to the change paragraph 61 was supplemented by the statement that the agreement (state contract) on the execution of the works of construction, reconstruction, capital repair works of the objects of capital construction of the state property of the Russian Federation for the sum exceeding RUR 600 million, concluded by the recipient of the funds of the federal budget according to the approved procedure can envisage the advance payment of 30% of the sum of the agreement (state contract) within the corresponding limits of the budget liabilities, as well as the subsequent advance payment for the works being executed after the fulfillment of the works envisaged by the agreement (state contract) at the amount of the advance payments already made. ●