

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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June of 2007: political and economic outcomes

In June, there became noticeable an increased, and not without reason, interest to the person of S. Ivanov, the first Vice Prime Minister. He compelled attention at the St. Petersburg economic forum, which Mr. Ivanov opened. At the forum S. Ivanov met with some representatives of the pro-Kremlin youth organizations (about six months ago, D. Medvedev already met representatives of the same organization, no other official bureaucrats have had official meetings with pro-Kremlin youth groups¹) and once again presented his ideas concerning the sovereign democracy, the present regime in Russia and its evolution. According to the thoughts made public by S. Ivanov, the states, where the people independently determine their own fate, could be “counted on the fingers of one hand.” According to Mr. Ivanov, the criteria of democracy are very simple: at least four and not two political parties should be represented at the Parliament, whereas the President should be elected by the people and not by special electors (i. e., according to S. Ivanov, there is no democracy in the United States). Mr. Ivanov demonstrated his “liberalism” by criticizing the youth organization Nashi (Ours) for the infringement on the provisions of the Vienna Convention during the anti-Estonian actions, as well as advocating the right of the opposition to have mass actions. Just a month ago, the same “liberalism” was demonstrated by Mr. Putin under the public pressure on the part of the European Union at the summit held in Samara. In June, the authorities also refrained from the measures aimed at the prevention of the Moscow Dissenters' March; however, the authorities could at the same time partially satisfy the demands of the “dissenters” (they could defend their right to hold demonstrations, which the authorities had in fact prohibited) and upset their plans (it was permitted that only 1 to 2 thousand people could take part in the meeting held in Moscow, what, apparently, had no relation to mass protests and could not help the opposition to demonstrate its strength).

However, even more interesting development was observed – in June there appeared the information, which was not refuted by anyone, that there existed a high probability that S. Ivanov was going to officially lead the party list of the United Russia. In the case it really happens, the use of the model, in the framework of which only one candidate should be nominated as the successor trusted with the whole administrative vertical, including the United Russia party already appointed as the winner of the Parliamentary elections (it should be noted that in such a case the election results of this political party headed by the candidate for the role of the successor may be better than otherwise, and, on the contrary, high election results achieved by the United Russia political party may be used for substantiation of the nomination of the candidate heading its party list as the successor) becomes very probable.

From our point of view, it is too early to assert the leading positions of S. Ivanov in the “successors’ race.” First, the next day after the information on the potential leading position of Mr. Ivanov on the United Russia party list was made public, I. Shuvalov, a V. Putin’s aide, made a detailed statement to the effect that some third person, the name of which V. Putin kept yet in secret, and neither S. Ivanov, nor D. Medvedev could be nominated as the successor. Soon after that, S. Naryshkin, the chief of the RF Government staff and a Vice Prime Minister, presented his rather interested report, which many observers assessed as a political statement, at the conference organized by the investment bank Renaissance Capital. Second, publications based on the information received from sources at the Kremlin, remind rather of not the information on already predetermined developments, but of a PR campaign in support of a certain scenario addressed, as it may be the case, not only to S. Ivanov himself, but the leadership of the United Russia political party and, possibly, even V. Putin. It should be noted that not a single most important decision on appointments and resignation of officials taken over the last few years (resignations of M. Kasyanov and V. Ustinov, the Caucasus exile of D. Kozak, appointments of D. Medvedev, S. Ivanov and S. Sobyenin) has demonstrated any leaks of information and may be rather defined as special operations.

As yet, it may be reliably asserted only that the idea to nominate Mr. Ivanov as the leading figure of the United Russia political party list has been supported by V. Surkov, the head of administration of V. Putin. However, it is highly questionable if he is able to persuade others. The scenario, in the framework of which there should be nominated a “strong successor” with no other alternatives (among the members of the V. Putin’s team), and who should directly inherit the United Russia political party has, no doubt, at least the advantage concerning the controllability of the situation; however, the one but very important minus of such a decision is the level of risks related to the possibility that such a successor may take independent and “wrong” decisions, which can not be countermanded.

¹ A couple of years ago A. Fursenko, the RF Minister of Education and Science had such a meeting; however, apparently that meeting was not related to his Presidential ambitions.

In the sphere of the economy, in June there were observed two events concerning in particular the foreign investors operating in Russia.

First, there was settled the issue of the Kovykta gas condensate field situated in the Irkutsk oblast, one of the largest deposits of this kind in the world. The open joint stock company Russia Petroleum is the operator of this project, whereas TNK – BP has the controlling interest in this gas field. Since long, Gazprom has been interested in the acquisition of a block of shares in the project and therefore set absolutely impractical terms of access to its pipelines at the same time prohibiting the company to build its own pipelines. Last year, in order to soften the positions taken by the shareholders in the Kovykta project, similarly to the Sakhalin 2 scenario the RF Ministry of Natural Resources (Minprirody) and the RF Federal Agency for Subsoil Use (Rosnedra) threatened to recall the license and even held the respective meeting of the commission; however, the minutes of this meeting had not been made available to the public. As a result, Gazprom, BP and the TNK – BP have reached an agreement to the effect that the Russian – British company should sell all its share in the Russia Petroleum to the natural gas monopoly within 90 days. In order to make apparent the role the Russia's authorities played in this story and the guarantees of approval of the transaction, the agreement was signed in the Kremlin in the presence of D. Medvedev, the Chairman of the Board of Directors of Gazprom and the first Vice Prime Minister of the RF Government. It should be reminded that the preceding forced sale of shares in the Sakhalin 2 project was also signed in the Kremlin in the presence of V. Putin. The preliminary agreement envisaged that the amount of transaction should make from US \$ 600 million to US \$ 800 million, at the same time, the TNK – BP company should be granted the right to repurchase 25 per cent plus one share in the project on condition it creates a certain joint venture with Gazprom, the assets of which should make not less than US \$ 3 billion. Not surprisingly, now it will turn out that the failure to comply with the terms of the license does not matter much after all (similarly to the existence of the “unjust” agreements on production sharing if the beneficiary is right), the gas extracted at the field is not needed to meet the demand on the Russian domestic market, and it is not necessary to delay the development of this gas field until 2017, as it has been proclaimed earlier by Gazprom officials. It should be noted that various measures undertaken by the TNK – BP in support of the Russia's authorities did not help the company even in spite of the fact that last year it was the only oil company from the developed countries, which took part in the purchase of additional shares issued by Rosneft. In other words, the behavior of the Russian authorities in this case was determined not by political, but by purely economic considerations.

Second, in June there was arrested the controlling interest in the oil company Russneft, whereas the Federal Tax Service accused Russneft of the failure to pay more than Rub. 14 billion in the Russia's budget. Besides, the Federal Tax Service put forward the claims demanding to recognize the transactions involving shares in Russneft null and void and transfer these shares to the state ownership (in accordance with article 169 of the RF Civil Code “On the invalidity of transactions made for the purposes opposite to the principles of public order and morality”). The company, the controlling block of shares in which is owned by the Gutseriyevs family and a minority interest belongs to the trader Glecore and which some time ago was even granted the permission to purchase some YUKOS assets by the Russian authorities, run into trouble long ago; however, until now it has appeared that these troubles amount to no more than the usual raider procedures with participation of Russian officials. However, at the moment the level of claims put forward against the company in fact demonstrates that the owners are forced to sell the company. Secondary factors behind the troubles Russneft run into ranging from the friendship with A. Lukashenko to wrong behavior in different situations are not so important. The only important thing is that someone in power has decided that the company may and should be taken over (purchased) and even various charity activities on the part of Gutseriyev, which answer the interests of the leaders of Chechnya and Ingushetia, appointed by Moscow, do not help him at all.

Therefore, the investment climate in the fuel and energy sector continues to deteriorate at a very rapid rate.

In June, the regular summit of G 8 group proceeded in a relatively calm atmosphere without confrontational rhetoric at Heiligendamm. At the final press conference, V. Putin told the audience about his proposals addressed G. Bush, the President of the USA, as concerned the American anti-missile defense system (to use the radar installation Russia leased in the territory of Azerbaijan) and promised not to aim Russian missiles at objects situated in Europe and deploy missile units in the Kaliningrad oblast after all. The G 8 summit adopted a declaration concerning Africa, which included the US initiative to increase aid provided to African countries: to write off the debts amounting to US \$ 56 billion and increase credits (earlier, Russia had opposed these initiatives, it should be noted that Russian objections were justified, since the present African institutions turn the aid provided to Africa into the aid to its leaders). The G 9 summit also called for a reduction in the volumes of emission of greenhouse gases into the atmosphere; however, no exact parameters

were defined (this lack of clarity also answered the US interests, since exactly this country is responsible for a significant portion of emission of such gases). Russia still refused to change its position with respect to the Kosovo problem referring to the UN resolution proclaiming the territorial integrity of Serbia. Only once during the summit there was mentioned the issue of democracy in Russia – one of the citizens staged a protest action at the press conference by spreading leaflets containing accusations addressed to V. Putin. In answer to this action V. Putin asserted that “Russia will develop similarly to other Western countries.”

However, as concerns the sphere of economy, a standstill was observed in the course of the negotiations on the Russia’s accession to the WTO. For instance, in spite of the fact that the St. Petersburg forum was attended by P. Lami, the head of the World Trade Organization, as well as by the heads of trade missions of the USA and European Union, no progress was achieved.

The appointment of the former head of the main directorate of the RF Ministry of Interior in the Central Federal Okrug and deputy Prosecutor General A. Bastrykin as the head of the powerful Investigative Committee nominated by V. Putin to hold this office was approved. Mr. Bastrykin was V. Putin’s fellow student, what, most probably, was the main criterion of the selection of the appointee for this post. However, it should be noted that throughout the years of V. Putin’s Presidency, A. Bastrykin has always followed the present Prosecutor General Yu. Chaika in terms of his career. Therefore, Yu. Chaika and the groups allied to him, first of all, Gazprom, could again consolidate their positions, whereas the team of V. Ustinov failed to have revenge although exactly this development was expected.

In June, Yu. Luzhkov, nominated at this office by V. Putin, was appointed as the Mayor of Moscow for the fifth consecutive term. The intrigue concerning his fate attracted the attention of experts practically throughout the whole time of V. Putin’s Presidency. Mr. Luzhkov did not come from St. Petersburg, moreover, in the beginning of the political career of V. Putin the Mayor of Moscow dared to oppose him, besides, Mr. Luzhkov has periodically criticized some prominent members of the Russia’s leadership, primarily G. Gref and A. Kudrin. In turn, the Mayor of Moscow was the favorite symbol of “arbitrary rule at the regional level” of the Kremlin propaganda machine. Over the 15 years of his rule in the city, the Luzhkov – Baturina family could not only make a handsome fortune, but, already during the Presidency of V. Putin, make it legal. In this connection, many experts have time and again suggested that Mr. Luzhkov, whose 71st birthday should be celebrated in September and whose term in the office as an elected Mayor expire in 2007, should cede his post and control over the Moscow budget. However, this has not happened. From our point of view, the factors behind this development are primarily political ones. Over the time he managed the capital and simultaneously the largest subject of the Russian Federation, Mr. Luzhkov could build an efficient administrative and electoral vertical, which bases not only on compulsion, but also on a system of massive subsidies, active PR campaigns and so on. Therefore, in the framework of the cycle of 2007 and 2008 Yu. Luzhkov is needed as an administrative unit and an electoral ram for the United Russia political party and successor (successors) of President Putin; any other appointee just would not have enough time to tune up the system created by Mr. Luzhkov. In this connection it should be noted that, first, the decision to keep Yu. Luzhkov as the Mayor of Moscow is evidence that the system is not so strong as it wants to seem, and, second, in the case the electoral cycle is completed successfully, Mr. Luzhkov may lose his post earlier than his official term in the office expires.

In the early June, in the Stavropol krai there again took place mass riots on the grounds of an interethnic conflict. There were taken unprecedented security measures – central parks were closed, working hours of the places of entertainment were limited, whereas administrations of higher educational institutions were obliged to submit to the law and order agencies the lists of all students indicating their places of residence. In contradistinction to Kondopoga, no information was made public by the official mass media. In the course of a series of mass fights between the Russian and the Chechens resulting in numerous injuries, there was first killed a student from Chechnya and a week later there were killed three Russians. It should be noted that the nature of this crime provided grounds to view it as the promised revenge. Within a month the situation could be somewhat normalized; however, it may be presumed that in the future such incidents² will be regular until the influence of A. Kadyrov, the present leader of Chechnya, and the rules promoted by him persist in the Northern Caucasus.

S. Zhavoronkov

² It should be noted that regular clashes of citizens with the Chechens, as well as clashes between uniformed services and security agencies of the Chechen Republic take place not only in the Stavropol krai, but also in Ingushetia, Dagestan, North Ossetia and other regions.

Budgetary and Tax Policy

According to the tentative performance of the budget as of January-May 2007, the level of revenue of the RF federal budget made 21.8 per cent of GDP; the expenditures of the federal budget accounted to 15.1 per cent of GDP, budget surplus has come up to 6.7 per cent per cent of GDP. Within January - April of 2007 the RF consolidated budget revenues made 33.1 per cent of GDP, consolidated budget expenditures made 23.8 per cent of GDP, and consolidated budget surplus accounted to 9.3 per cent of GDP. As of June 1, 2007 the volume of financial reserves of the RF Stabilization Fund made RUR 3026.7 billion, as opposed to RUR 2920.5 bln on May 1, what makes 10.9 per cent and 10.6 per cent of annual GDP accordingly.

The State of the Federal Budget

The dynamics of basic parameters of the RF federal budget in 2005-2007 is presented in *Table 1*. According to the tentative estimates of the federal budget execution on cash basis, made by the RF Ministry of Finance, in January-May 2007 the federal budget was executed in terms of revenue in the amount of RUR 2 512.5 bln (21 per cent of GDP), in terms of expenditures – in the amount of RUR 1 741.9 bln (15.1 per cent of GDP). The budget surplus made RUR 770.7 bln. (6.7 per cent of GDP). It should be noted that the amount of revenues and expenditures of the federal budget within the period under review in absolute terms were somewhat higher than the respective indicators of the relevant period of preceding year (revenues - RUR 2 393.7 billion, expenditures – 1 504.5 billion). Nevertheless, in regard to GDP the indicators have declined (25.0 per cent and 15.7 per cent of GDP accordingly in 2006). It should be noted, that the budget surplus has decreased in both, absolute terms and in regard to GDP share versus the indicators of preceding year (RUR 889.3 billion, i.e. 9.3 per cent of GDP).

Table 1.

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

	2005	April 2006	2006	April 2007
Revenues	23,7%	25,0%	23,5%	21,8%
Expenditures	16,2%	15,7%	16,2%	15,1%
Deficit (-)/ Surplus (+)	7,5%	9,3%	7,4%	6,7%

Source: RF Ministry of Finance, IET estimates

The structure of tax revenues to the federal budget for the period under review as broken by individual federal administrative bodies is presented in *Table 2*.

Table 2.

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

	2005	April 2006	2006	April 2007
Taxes and other payments administered by the Federal Tax Service	12,33%	12,70%	11,27%	10,80%
Taxes and other payments administered by the Federal Customs Service	9,73%	11,19%	10,76%	9,97%
Receipts administered by the Federal Agency for Management of Federal Property	0,27%	0,20%	0,26%	0,13%
Revenues of the federal budget administered by other federal structures	1,35%	0,95%	1,25%	0,89%
Total revenues	23,67%	25,04%	23,54%	21,78%

Source: RF Ministry of Finance, IET estimates

As one can see from the data, presented in the Table, in January-May of 2007 the volume of tax and other revenues as broken down by individual administrative bodies has decreased in comparison with the data registered in the same period of preceding year. Tax revenues, administered by the RF Federal Customs Service, made 10.8 per cent of GDP, what is nearly 1.9 lower than relevant indicators of January-May of 2006. The share of revenues, administered by the RF Federal Customs Service, accounted to 9.97 per cent of GDP, (11.19 per cent of GDP in 2006, i.e., the decline made over 1.2 per cent). Finally, the scope of revenues, administered by other Federal Agencies, have also decreased as of January-May results and made 0.89 per cent of GDP (0.95 per cent of GDP in 2006).

For more detailed analysis of the above mentioned tendencies there required the data, published by the RF Treasury. Though the data is available only for January-April of 2007 (i.e., one month less than the information, published by the RF Ministry of Finance), the tendencies of preliminary data for the first quarter are much the same as observed in the first five months of 2007. (See *Table 3*) The utmost decline in terms of GDP share in January-April of 2007 (as opposed the relevant period of preceding year) was observed in the following revenue sources: import customs duties (-2,2 per cent of GDP), tax on profit of enterprises (-1.3 p.p.), VAT for the goods, sold on the RF territory(-1.4 per cent). It should be noted, that those taxes totaled over 58 per cent of the gross revenues of the federal budget for January-April 2007. The highest growth in terms of GDP share was observed in the following budget lines: VAT on the goods, imported to the RF territory (+0.5 per cent) and import customs duties (+0.19 per cent). The share of those taxes in the total amount of federal budget revenues has reached somewhat more than 12 per cent as per budget execution results within the first four months of 2007. As concerns other budget lines, the changes were insignificant (within 0.1 p.p.). The above changes in the budget revenues, broken down by the types of taxes and duties, have resulted in the decline of the federal budget revenues versus GDP level both, for the first quarter and for the first five months of 2007.

Table 3.

**Amounts of Revenues of the RF Federal Budget (by Basic Lines)
within 2005-2007 (in per cent of GDP)**

	2005	April 2006	2006	April 2007
TOTAL BUDGET REVENUES	23,72%	25,44%	23,58%	21,16%
1. Enterprise Profit Tax	1,75%	1,64%	1,92%	1,65%
2. Unified Social Tax	1,24%	1,19%	1,19%	1,28%
3. Taxes for Goods and Services, imported to the RF Territory	5,16%	5,11%	3,82%	3,66%
3.1. VAT	4,75%	4,72%	3,47%	3,32%
3.2. Excises on taxable goods	0,41%	0,40%	0,35%	0,34%
4. Taxes for Goods and Services, imported to the RF Territory	2,15%	2,20%	2,27%	2,71%
4.1. VAT	2,07%	2,13%	2,20%	2,63%
4.2. Excises on taxable goods	0,08%	0,07%	0,06%	0,08%
5. Severance taxes	3,95%	4,65%	4,11%	3,38%
6. Import tax duties	1,25%	1,28%	1,28%	1,47%
7. Export tax duties	6,25%	7,79%	7,12%	5,62%

Source: RF Treasury, IET estimates.

The preliminary data, estimated by the RF Ministry of Finance on financing of Federal Budget expenditures in January-May of 2007 are presented in *Table 4*.

As one can see from *Table 4*, there was observed high volatility of total funding, depending on the period under review. Thus, as of the year results of 2006 the expenditures amounted to about 16.4per cent of GDP, within January-May 2007, they increased to 20.9 per cent of GDP. However, there has been a decline of funded expenditures as compared with the relevant indicator of the preceding year (21.2 per cent of GDP as of the end of May 2006).

Comparison of the structure of expenditures as broken down by sectors within January-May of 2007 with the relevant indicators of preceding year, shows, that the changes were variable. The outmost downgrading (in terms of GDP share) was observed in the following budget lines: Interbudgetary transfers (-1.34 per cent), Federal issues (-0.11 per cent), National defense (-0.14 per cent) and Social policy (-0.12 per cent). It

should be noted, that the share of expenses for those budget lines made 68 per cent in the total expenses of the federal budget within the first five months of 2007. The utmost growth (in terms of GDP share) was observed in such budget lines as National Economy (+0.23 per cent), Housing and public utilities (+0.11 per cent), National security and law-enforcement activities (0.07 per cent). Expenditures under those budget lines have accounted to 22 per cent of the total expenses on the federal budget and resulted in the downfall of the total amount of expenditures in terms of GDP within January-May 2007 as compared with the relevant period of 2006.

Table 4.

**Financing of the RF Federal Budget in 2005-2007
(in per cent of GDP)**

	2005	May 2006	2006	May 2007
Federal issues	2,58%	2,68%	2,19%	2,57%
Including expenditures associated with the servicing of federal and municipal debt	1,06%	0,93%	0,65%	0,61%
National defense	2,71%	3,61%	2,57%	3,47%
National security and law enforcement	2,05%	2,65%	2,08%	2,72%
National Economy	1,17%	1,32%	1,31%	1,55%
Housing and public utilities	0,04%	0,18%	0,20%	0,29%
Environmental protection	0,02%	0,03%	0,03%	0,03%
Education	0,73%	1,08%	0,78%	1,06%
Culture, cinematography and mass media	0,22%	0,24%	0,21%	0,25%
Health care and sports	0,42%	0,71%	0,56%	0,73%
Social policy	0,88%	1,08%	0,81%	0,96%
Interbudgetary transfers	5,77%	7,60%	5,68%	7,26%
Total expenditures	16,58%	21,17%	16,40%	20,89%

Source: RF Ministry of Finance, IET estimates

There can be highlighted several reasons for the growth rates of the federal budget revenues, which were not as high as the rates of Russian economy in the first five months of 2007:

1) the federal budget revenues are highly dependant on proceeds from commodity economy (about a half of the federal budget proceeds in 2006 were made by export duties and tax on extraction of mineral resources). The volume of industrial production in the first quarter of 2007 has exceeded the same indicator of the relevant period of 2006 by 7.4 per cent and the volume of extraction of mineral resources increased by 2.4 per cent. The slower growth rates of commodity sector have resulted in decrease of the share of export customs duties and tax on mineral extraction tax in GDP.

2) it should be also mentioned that oil prices have been reduced in the first months of 2007 as compared with the relevant period of 2006 (See Table 5).

Table 5.

Oil Prices in the First Quarter of 2006 and 2007

Average prices for Urals oil, USD per barrel ³	2006	2007
January	59,18	49,79
February	56,37	53,73
March	57,53	58,69

3) One of the basic reasons for reduction of the share in GDP of VAT proceeds to the federal budget was the decreased level of VAT for goods and services, provided on the RF territory. It could be explained to some extent by the transfer to the notification procedure of VAT refund to exporters, introduced from January 1, 2007. As a result, the procedure of VAT refund has been considerably accelerated. Under the former VAT refund procedure, in the first quarter of 2007 the refund would be provided to the taxpayers, who made export operations in 2006, and the majority of taxpayers, who exported their goods or services in the first

³ Those prices are applied for tax purposes.

quarter of 2007 (or even in 2006), would have obtained the refund later. With the new VAT refund procedure the majority of taxpayers of both categories have been refunded in the first quarter of 2007, which has resulted in a decrease of that tax proceeds.

As per results of January-April of 2007, the expenditures and revenues of the RF consolidated budget accounted to 33.1 per cent and 23.8 per cent of GDP accordingly. According to *Table 6*, one can see that those indicators are much lower than the relevant indicators of 2006 (36.5 per cent and 25.0 per cent of GDP accordingly). The surplus of the RF consolidated budget in January-April of 2007 made 9.3 per cent of GDP, what is also lower than the indicator of 2006 (11.5 per cent of GDP). According to the RF Treasury information on the budget execution of the extended RF government within January-April of 2007, the volume of budget revenues made 37.5 per cent of GDP, expenditures – 27.4 per cent of GDP, while the surplus accounted to 10.1 per cent of GDP.

As of June 1, 2007 the volume of assets of the RF Stabilization Fund made RUR 3 026,7 bln, as opposed to RUR 2 920,5 bln on May 1, 2007, what makes 10.9 per cent and 10.6 per cent of GDP in annual terms accordingly.

Table 6.

Execution of the RF Consolidated Budget in 2006 – 2007 (in per cent of GDP)

2006												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Revenues	36,2	34,4	37,9	36,5	37,2	36,8	36,6	35,4	35,4	35,1	34,8	35,5
Expenditures	17,6	21,0	24,2	25,0	24,7	25,5	25,3	25,1	24,8	24,7	25,1	27,8
Deficit/ Surplus	18,7	13,4	13,6	11,5	12,5	11,3	11,3	11,4	10,6	10,4	10,7	7,7
2007												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Revenues	30,9	29,6	32,7	33,1								
Expenditures	14,2	19,0	22,4	23,8								
Deficit/ Surplus	16,7	10,6	10,3	9,3								

Source: RF Ministry of Finance, IET estimates

Major developments in the budgetary sphere.

One of the major events of June was the international Economic Forum held in St. Petersburg. The most significant statements in regard to fiscal sphere were made at the economic forum by Alexei Kudrin, the Minister of Finance, at a meeting with representatives of foreign businesses.

The Minister noted that the federal budget of the Russian Federation in 2008 will be balanced in case the price of oil will be maintained at the level of 45 dollars per barrel. With that level of oil price, the deficit of the RF budget will not exceed 1 per cent of GDP (the level, envisaged in the new version of the RF Budget Code). An increase of the deficit might be possible only if the oil price drops dramatically versus the estimated value, and in this case the need will arise to use the Reserve fund.

The Minister reminded, that in 2008 all revenues of the RF budget were designated as oil and non-oil proceeds, and the Stabilization Fund will be transformed into Reserve Fund for National Welfare.

Some oil and gas revenues will be used to finance current expenditures, but the volume of those resources will be gradually decreased in the period from 2008 to 2010 and will make 3.7 per cent of GDP from 2011. Alexei Kudrin stressed that the measures are aimed at reducing risks to the economy. Alexei Kudrin has pointed out, that those measures are aimed at reduction of risks to the economy. According to the Head of the Ministry of Finance, in the next year, the external debt will reach the minimum level (within the last 16 years) and account to 8.4 per cent of GDP. He noted that the total share of the external debt and the private sector in the GDP is getting reduced. In 2000 that indicator made 50 per cent of GDP, while in 2006 it was 30 per cent of GDP. Thus, according to Mr. Kudrin, the situation in this sphere is getting more safe and stable.

The fact that the bill on the differentiation of the tax on mineral extraction (in regard to coal), submitted to the State Duma, should also be mentioned. S. Shatalov, Deputy Minister of Finance, noted that the RF government has provided provisional approval on the draft law, submitted by the Deputies, proposing differentiation of tax on natural resources extraction (in regard to coal) as to the conditions of production and the quality of the coal produced. The government supported the draft law, under condition that prior to the first

reading it will be considerably improved, as there were many critical comments to that draft. The purpose of the amended law (according to its authors) is to create the economic conditions for implementation of the program for technical upgrading of coal-producing enterprises. The objectives of the program are to ensure up-to-date safety level of the miners labor, as well as to improve the competitiveness of coal as an energy source in the domestic market.

In the area of administration of that tax, the transfer from ad valorem tax to special tax rate on coal production. It is proposed to establish the rate of tax on coking coals in the amount of RUR 40 per 1 ton, while the rate for other coals RUR 9 rubles per 1 ton.

"Furthermore, adjustment indices will be applied to the special rate of tax on mineral extraction (indices will be applied with regard to geographical location, methane proportion and tendency to spontaneous combustion of coal layers). As noted in a memorandum to the draft law, further tax differentiation should be applied to certain mining regions, on the basis of a feasibility study, to address the large differences in geological and mining conditions, including labor safety.

O.Kirillov, A.Mamedov

Monetary and Credit Policy

In May of the current year inflation in the RF (+ 0.6 per cent) was sustained as compared with April 2007 and accelerated versus the relevant period of preceding year (+ 0.5 per cent). There were observed the speedy growth of foreign currency and gold reserves in the country, which have reached the volume of USD 405 bln, and the monetary base(+ 16.4 per cent). In June the RF Central Bank has decreased the rate of refinancing from 10.6 per cent to 10 per cent and published "Basic trends of consolidated monetary and credit policy for 2008".

In May the consumer price index has made 0.6 per cent (against 0.5 per cent in May 2006; see Fig.1). Like in April, the utmost input in consumer prices growth in April was made by food stuffs. Their prices have been increased by 1 per cent per cent on average country-wide (as opposed to + 0.5 per cent in May of 2006). It should be noted that the explicit growth rate of food stuffs price in comparison with the previous year was based on the increased CPI in April and May like in the relevant period of 2006. The utmost growth of price was observed for vegetables and fruit (+ 7.8 per), grits and beans (+ 0.8 per cent), alcohol beverages (+ 0.5 per cent), bread and bakery products (+ 0.4 per cent). Some decrease in May of the current year was observed in prices for granulated sugar (- 0.1 per cent).

Upgrading of prices for commercial public services in May reached 0.5 per cent (+ 0.6 per cent in May of 2006). The utmost growth was observed in regard to health-care and resort services due to vocational season (+ 2.3 per cent). Besides, significant growth was observed in regard to public transport (by 1.4 per cent), foreign tourism (+1.1 per cent) and public services (+1 per cent). There was no decrease in any type of those services in May.

Non-food products have also grown in price in May; they have been raised by 0.4 per cent on average (+ 0.4 per cent in May of 2006). The growth of non-food products prices was caused mainly by the growth of prices for construction materials (+ 1.3 per cent) petrol (+ 0.9 per cent). It should be mentioned, that in May there was observed some decrease for audio-and video products (by 0.5 per cent).

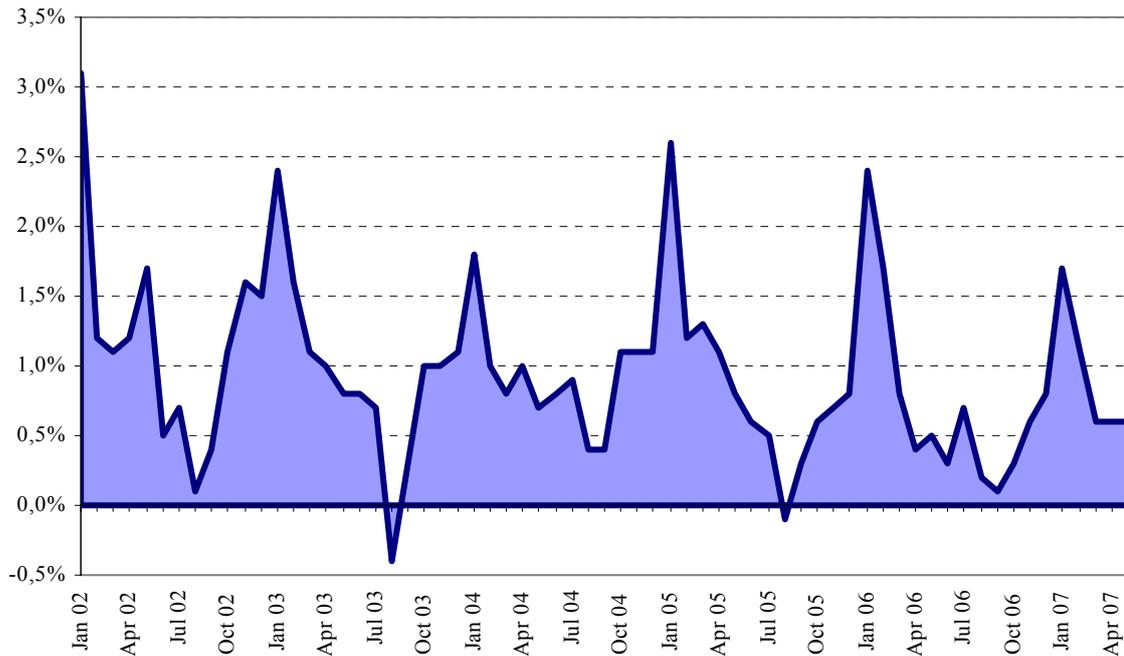
The basic consumer price index⁴ in May 2007 made 0.3 per cent (versus the relevant period of preceding year in the amount of 0.4 per cent). According to the bulletin of approximation short-term estimates of the RF socio-economic indicators, published by IET, the CPI in May 2007 made 0.5 per cent.

Therefore, the basic growth index versus the relevant period of preceding year for consumer goods in the RF in the past months is the growth of price for non-food products.

With the new crop, those prices will be stabilized, which can reduce inflationary pressure. We should note, that the basic CPI, not reflected by seasonal factor, happened to be lower in June than in the same period of the previous year.

⁴ 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

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



Source: RF Statistical Service

Within May 2007 the volume of cash in circulation (in broad definition⁵) has been increased by RUR 752.4 (to RUR 5346.6 bln (+ 16.4%). The volume of monetary base in broad definition as of May 1, 2007 was RUR 4594.2 bln. Let us consider the dynamics of monetary base in broad definition by components.

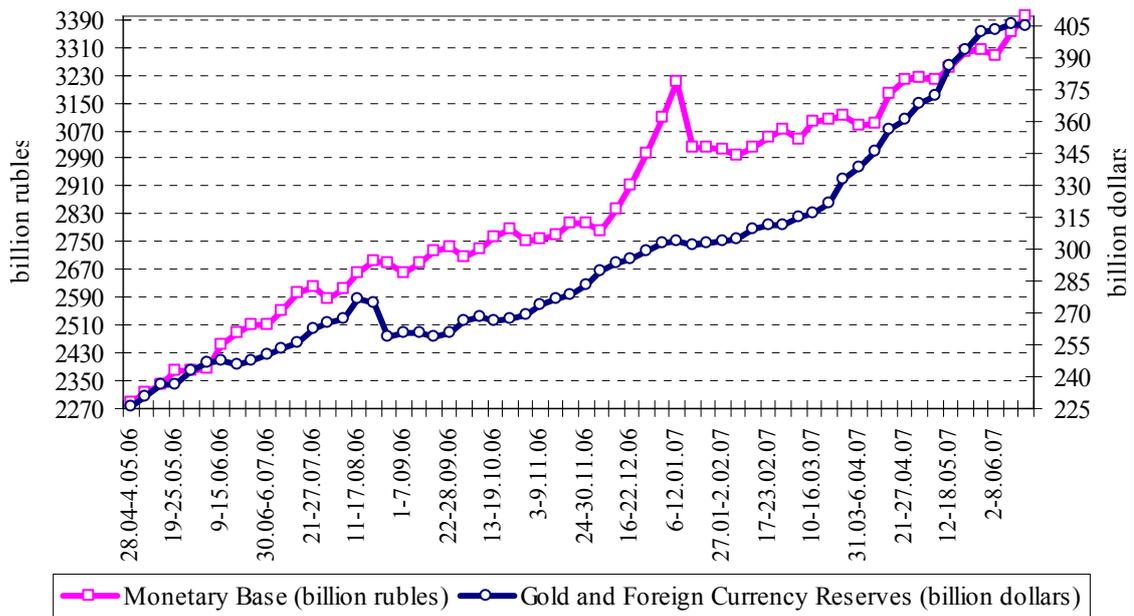
In this background gold and foreign exchange reserves of the RF Central Bank have grown by 9.2 per cent and made RUR 403.2 billion in May. Within the first three weeks of June, they have been further increased by 0.4 per cent and reached the amount of USD 405 billion. The major part of incoming liquidity has been accumulated in the RF Stabilization Fund, the volume of which has reached as of June 1, 2007 RUR 3026,7 billion, or 10.5 per cent of GDP (plus 106.2 bln as compared with May 1, 2006). In comparison with the relevant period of the preceding year the volume of Stabilization Fund has grown by RUR 128.7 bln.

According to the information of the Federal Treasury, payments under external debt in May of the current year have made USD 267.4 million. The amount of USD 93.5 million was addressed to repayment of the external debt and USD 173.9 million was paid for the services thereof. Herewith, USD 44.9 million was spent to cover the debt of Russia, USD 36 million for the World Bank and EBRD loans, USD 112.3 million for loans raised upon bonds and USD 74.3 million for intergovernmental agreements.

Since June 19, the RF Central Bank refinancing rate has been lowered to 10%. Before that downgrading the refinancing rate made 10.5 per cent (*See Fig. 3*). It should be noted that this level of January 2007 was established after a decrease, made by the Bank of Russia from 11 %. At the same time, the rate of ‘overnight’ credit has been decreased from 10,5 % to 10 %. Therefore, refinancing rate has been decreased for the second time in the current year. It should be reminded, that in 2006 the Bank of Russia has reduced the refinancing rate twice: since June 26 it was decreased from 12 % to 11.5 %, and since October 23 it was established at the level of 11%.

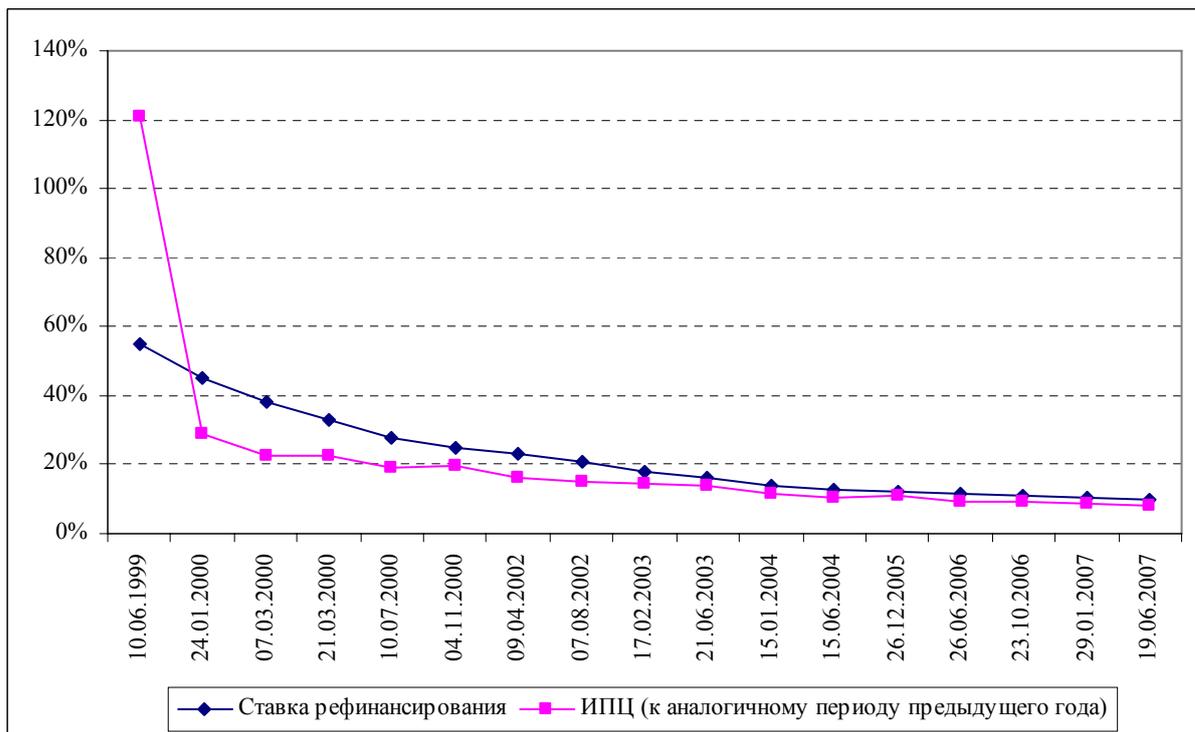
⁵ The RF monetary base in broad terms with no regard to the cash issued by the Bank of Russia and the balance of Compulsory Reserve Accounts on credit organizations in national currency, deposited in the Bank of Russia, taking into account the assets of correspondent accounts and bank deposits, allocated in the Bank of Russia..

Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2005 - 2007.



Source: RF Central Bank

Central Bank and CPI refinancing rate within 1999 – 2007.



Source: RF Central Bank

The decrease of refinancing rate apparently was aimed at the upgrading of the role of the interest rates in credit and monetary policy. In fact, the effective refinancing rate is far beyond the rate, which is applied for inter-bank credits, which makes the changes of refinancing rate ineffective to monetary and credit policy. It should be noted, that the reduction of refinancing rate is performed in line with upgrading of the rates on deposits of credit organizations of the Central Bank, resulting in greater attractiveness to the banks, i.e., to sterilization of liquidity in the Bank of Russia

At the same time, the RF Central Bank is prudent in its approach to raising the interest rates, as this measure could lead to a further inflow of speculative capital and increase inflationary pressure.

In June, the Bank of Russia has published a draft of "Key directions of consolidated government monetary and credit policy for 2008". In that document the Bank of Russia has again clearly identified its primary objectives for 2007, one of them is inflation suppression (6 - 7% as of 2008 results, 5.5-6.5 % for 2009 and up to 5 to 6 % in 2010). As to the target for RUR index in real terms, the document envisages the range of changes from 0 % to 10 %. In our understanding of the document wording, the Bank of Russia enables to conduct monetary policy more effectively without trying to achieve two conflicting goals. Growth of monetary base in 2007, in narrow definition, in accordance with Central Bank forecast, will make 18.7 - 22.9 per cent. Foreign currency and gold reserves should account to USD 456 to 486 billion by the end of 2007.

P. Trunin

Financial Markets⁶

In June the situation in the Russian financial market was rather stable. In the background of growth of oil prices and leading stock indices in the international market, there was an upsurge observed in the Russian stock market. The situation was less favorable in the debt market, highly dependant on the dynamics of the US securities, which were getting down in price in view of prospective tightening of credit and monetary policy. Only by the end of the month the US market got stabilized. The restricting factor to further downfall of the Russian debt instruments was the high liquidity in the banking sector.

Government securities market

As of June results, in the Russian foreign currency debt market there was observed a noticeable growth, largely due to the dynamics of the US debt market.

Thus, earlier this month the yield of US Treasury securities have significantly grown in the background of the peak maximum values, achieved at the US stock market, what caused the inflow of assets from less risky instruments to the more risky ones. That dynamics was supported by macroeconomic statistics information, confirming the economic stability, accompanied by explicit inflation risks. The Russian market has reacted to the situation by a decline of Eurobond yield, though the decline was rather smooth. However, while the decrease of the Russian Eurobonds yield at the beginning of the second week of the month was smooth, it has speeded up by the end of the week. In the absence of significant news from USA, the investors, apparently, were attracted by the raised rates in European zone.

At the beginning of the second part of the month the US Treasury bonds were growing in the background of tentative probability of upgrading of the basic interest rate. However, due to the publication of unfavorable inflation statistics, the quotations were restored. After the long holiday weekend, Russian Eurobonds were offered for sale only at the second half of the week and avoided the expressed downfall, experienced by the US bonds. By the end of the month, the profitability of American bonds was stabilized due to an absence of noticeable macroeconomic statistics publications in view of the expectations of investors for the results of the US IRS meeting. In that background the volatility of the Russian bonds even lower.

As of June 22, the Russian Eurobonds' RUS 30 yield to maturity made 6.15 per cent per annum, RUS-18 – 6.20 per cent per annum. As of the same date, the yield to redemption of the Russian Eurobonds made: for the eight tranche of external currency debt bonds – 5.34 per cent, seventh tranche bonds – 5.85 per cent, fifth tranche bonds – 5.52 per cent..

⁶ In the course of preparation of the survey, there were used analytical materials and surveys published by the Zenith Bank, investment company ATON, MICEX, and the materials presented at web sites of Russian issuing companies.

FIG 1.

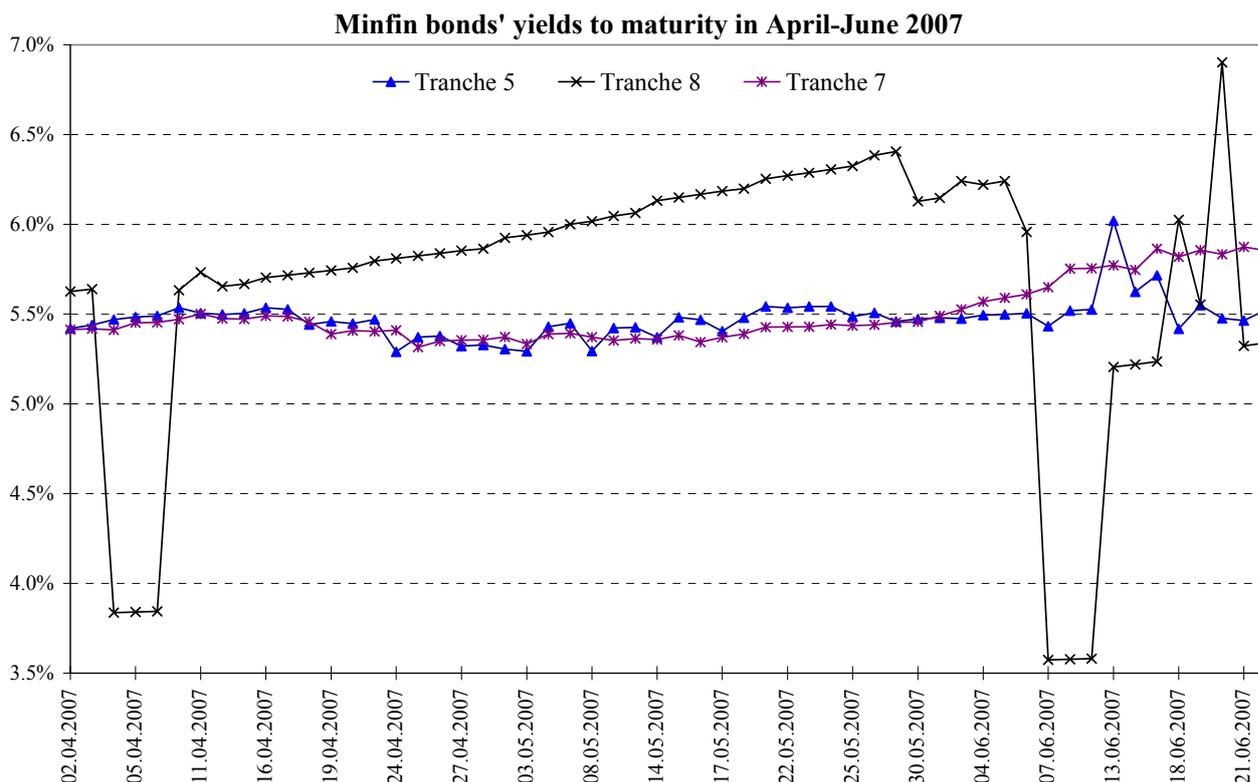
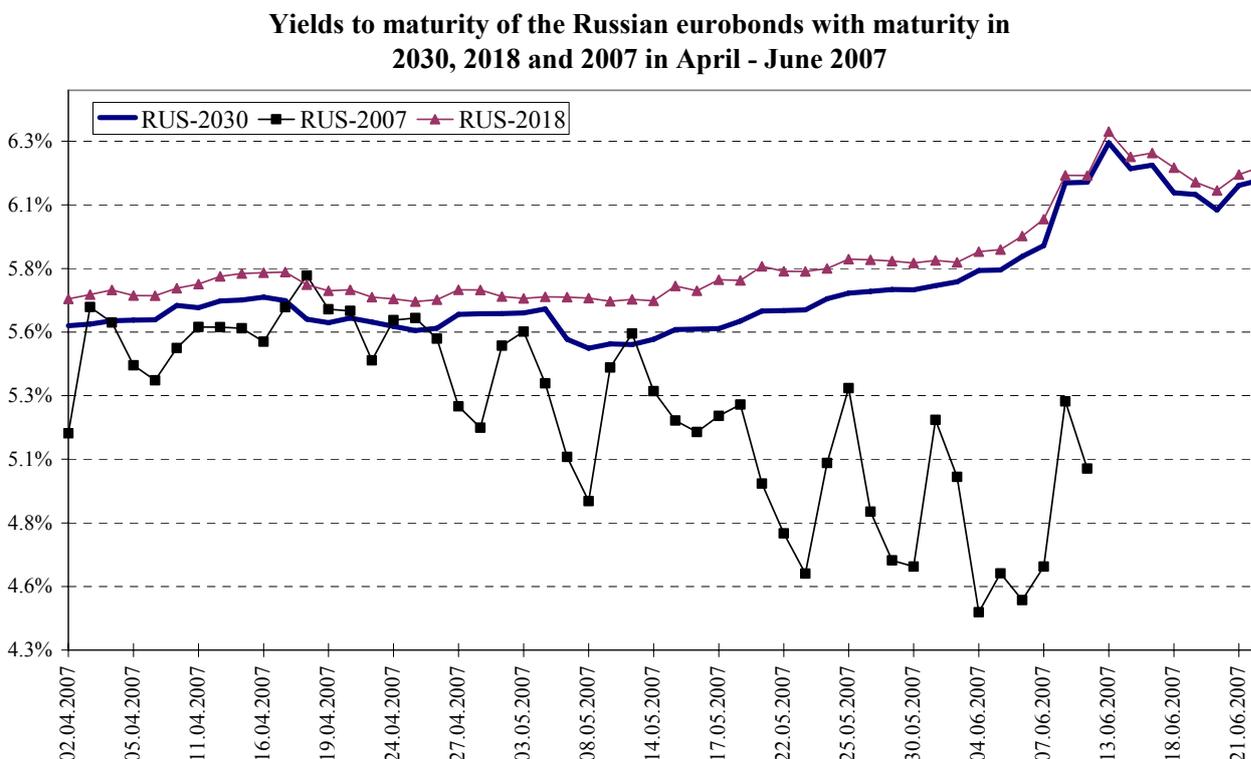


FIG. 2.



The tendencies in the government debt ruble market at the beginning of the month were rather negative. Upon considerable growth at the end of May, a smooth price decrease was observed within the limits of technical adjustment. The ruble liquidity was restraining the downfall. However, by the middle of the month the rate of quotations downfall were speeded up by higher liquidity in the external market, partially due to the Ministry of Finance statement to make a placement of considerable amount of its bonds. In the second part of the month variable trends were prevailing in the market. While the beginning of June was marked

with further decrease together with the US bonds and Russian Eurobonds, by the end of the month the situation was stabilized and quotations were partially restored.

In the period of June 1 to 22 the total turnover in the secondary market of GKO-OFZ made about RUR 305.9 bln, with an average daily turnover at the level of RUR 3.4 bln. (as compared with RUR 58.1 bln with an average daily turnover at the level of RUR 3.4 bln. in May). Several auctions on OFZ additional placements were held during the month. Thus, on June 13 three auctions were arranged for placements of OFZ series 25061, 46018 and 46020 with the issue volumes of RUR 8.22 and RUR12 bln accordingly. The actual average weighted yield of those placements were at the level of 6.11, 6.55 and 6.88 per cent per annum accordingly.

As of June 27, the GKO-OFZ market amounted to RUR 995.61 bln at face value and to RUR 1007.9 bln at market value. The duration of the GKO-OFZ market portfolio was 2086.89 days.

Equity Market

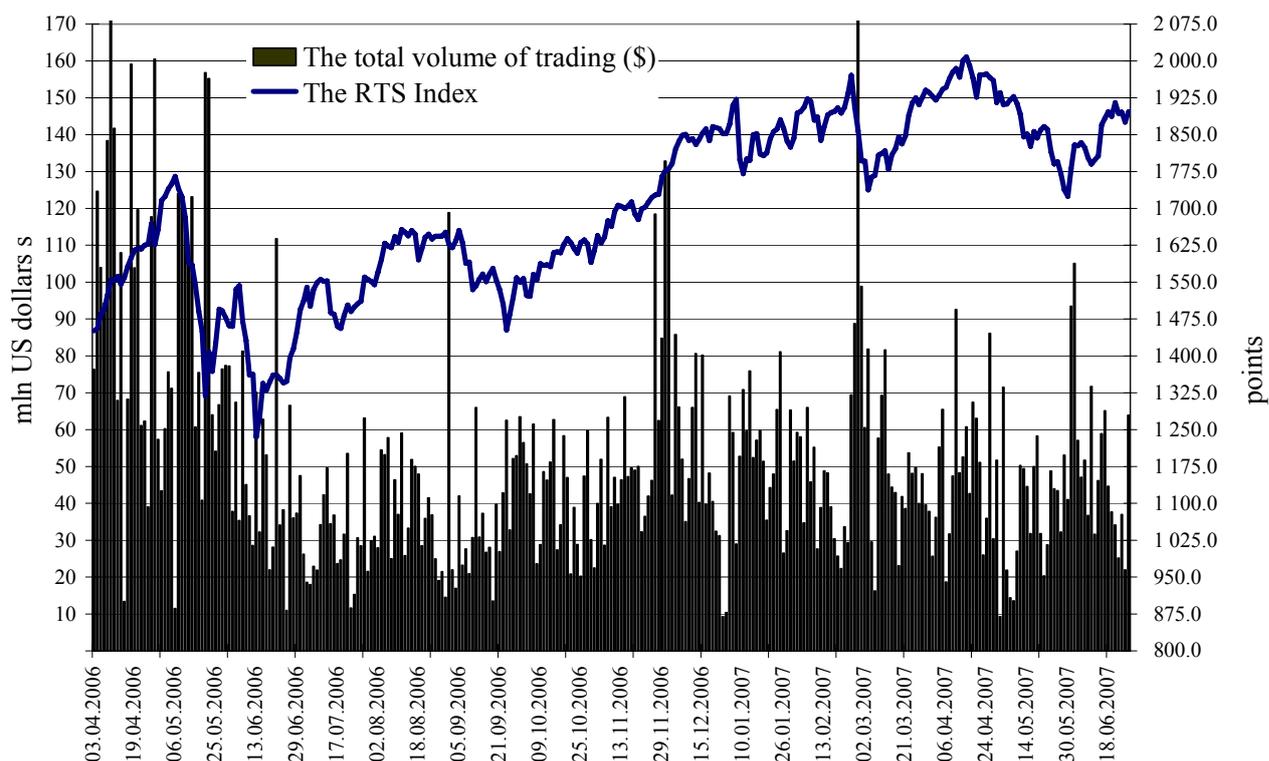
Stock market situation

In June there was observed a noticeable upgrading of the basic indices in the stock market. At the beginning of the month the Russian market started with a smooth upgrading. Oil prices were fairly favorable, what boosted the demand for oil and gas securities. Moreover, oil securities were lagging behind the rest of the market indicators of the preceding months, so there were good grounds for investors' growing interest to this sector. In addition, external economic environment remained favorable: key stock markets of the developed and developing countries have demonstrated an explicit growth.

However, the beginning of the second part of the month was marked with the upgraded basic market indices. Among the factors of growth, there should be noted the publication of the "Beige book" in the USA, which positively evaluated the growth prospects of the American economy, encouraging American and European stock markets. Oil prices have also explicitly grown as a result of the strike of trade unions in Nigeria, as well as low stocks of fuel in the United States.

Late in June the indices were variable. Herewith, the market value of a number of "blue chips" at the end of the month were making for downgrading oil and gas sector quotations, while the positive corporate news of the beginning of 2007 supported positive forecasts. That growth was based on increased oil prices in the international market, as well as quite favorable situation in the basic international stock markets. Among the securities, that made a positive impact on the quotations, there should be mentioned "Nornickel", which bonds were growing in line with the upgrading of prices for basic metals in the international market. In general, the lack of an expressed trend could be caused by the investments' expectations for the results of the US IRS session, appointed to June 28.

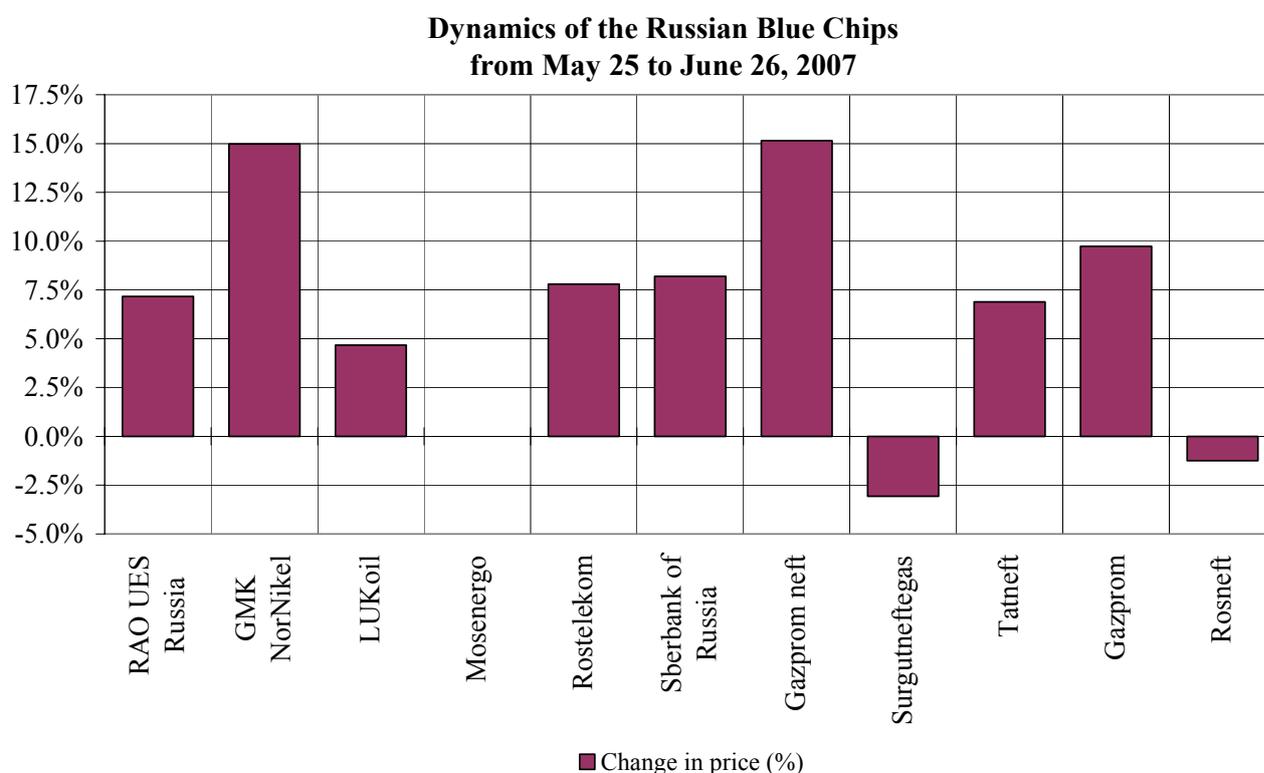
FIG. 3



In general, within the period of June 1 to 26, the RTS index has increased by 3.71 per cent in absolute terms and made 67.8 points. At the same time the period of turnover of sales on shares, included in the RTS index, made about USD 835.2 mln at the average daily turnover at the level of USD 49.2 mln (as compared with about USD 649.2 mln at the average daily turnover at the level of USD 38.2 mln in May). Therefore, the investors' activity in the stock market in June has been noticeably increased as compared with the preceding month. The indicators of maximum and minimum turnover in the market trades in June made USD 105.1 mln (as of June 1) and USD 21.9 mln (as of June 25), accordingly.

As of monthly results (from May 25 through June 26), practically all "blue chips" have shown a growth. Thus, utmost upgrading rates were demonstrated by "Gazprom Neft" and NorNickel, which made 15.14 % and 14.9 per cent accordingly. Somewhat lower growth rates were demonstrated by "Gazprom" (9.73 per cent), Sberbank of Russia (8.19 per cent), "Rostelecom" (7.8 per cent), RAO UES of Russia (7.16 per cent). Lower growth was demonstrated by "LUKOIL" (by 4.67 per cent), while the cost of "Mosenergo" did not change in July. Negative dynamics as of monthly results were demonstrated by "Surgutneft" and Rosneft" securities, which have downgraded by 3.07 and 1, 25 per cent accordingly.

FIG. 4.



In May the RTS turnover leaders⁷ were: "RAO UES of Russia" (29.5 per cent), "Sberbank of Russia" (21.6%) and "Norilsk Nickel" (13.1 per cent each), "LUKOIL" (8.5 per cent), "Gazprom" (7.9 per cent) and "Transneft" privileged bonds (1.3 per cent). The total share of trades with the above companies has accounted to 81.7 per cent of the total RTS trading volume.

In terms of capitalization, as of June 26 the top five leaders of the domestic share market were⁸: "Gazprom" (USD 238.96 bln, "Sberbank of Russia" (USD 84.08 bln), "Rosneft" (USD 84.04 bln), "LUKOIL" (USD 66.22 bln), RAO «UES of Russia» (USD 54.82 bln), "Norilsk Nickel" (USD 39.85 bln).

Futures and options market

In June the investors' activity on the RTS futures and options market (FORTS) has increased as compared with the preceding month. Thus, from June 1 to 26 the total turnover on the RTS futures and options market amounted to approximately RUR 416.33 bln (743,3 thousand of transactions, 10.18 mln of contracts) against RUR 300,6 bln (625,6 thousand of transactions; 7.65 mln of contracts in the relevant period of May).

⁷ On the classical market.

⁸ According to RTS data.

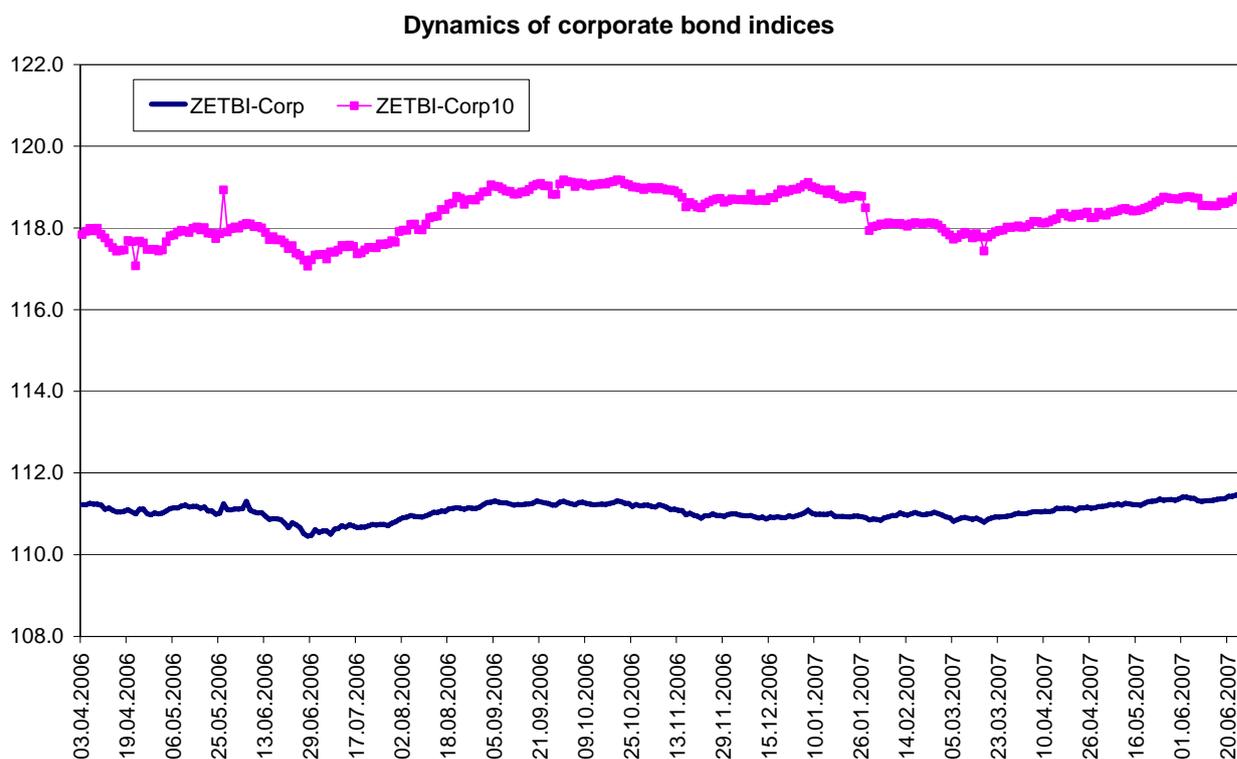
The greatest demand, as before, was for futures: the volume of trading in futures in the period under review was RUR 344,56 bln (722,7 thousand of transactions, 8.5 mln of contracts). Options enjoyed a far lower demand, with the volume of trading at about RUR 71.8 bln (20.6 thousand of transactions and 1.7 mln of contracts). The highest level of trading in the futures market was RUR 45.6 bln (as of June 15), the lowest was RUR 12.03 bln (as of June 9).

Corporate bond market

Corporate debt market in June remained relatively stable, which enabled it to show some growth as of monthly results. At the beginning of the month, the signs of technical adjustment were observed in the market after an explicit upsurge within the preceding two weeks, though the quotations remained within a narrow range, which was based on high liquidity in the banking sector. The stability of the market was confirmed by the results of primary placements, where the bond issuers of high credit quality were quite successful. While the decline in quotations was rather smooth early in the week, the downgrading by the end of the week has considerably speeded up due to the trends of the US stock market. The highest level of sales was observed in the most liquid securities.

From June 1 to 26 the price index of corporate bonds traded on MICEX9 went up by 0.06 points (plus 0.06 per cent), while the index of the ten most liquid corporate bonds grew up by 0.1 points (plus 0.09 per cent). From June 1 through 22 the total turnover on the MICEX corporate bond section amounted to RUR 36.68 bln, with an average daily turnover of RUR 2.45 bln (about RUR 45.1 bln with an average daily turnover of RUR 2.65 bln in the relevant period of May). Therefore, the investors' activity has explicitly decreased in June.

FIG 5



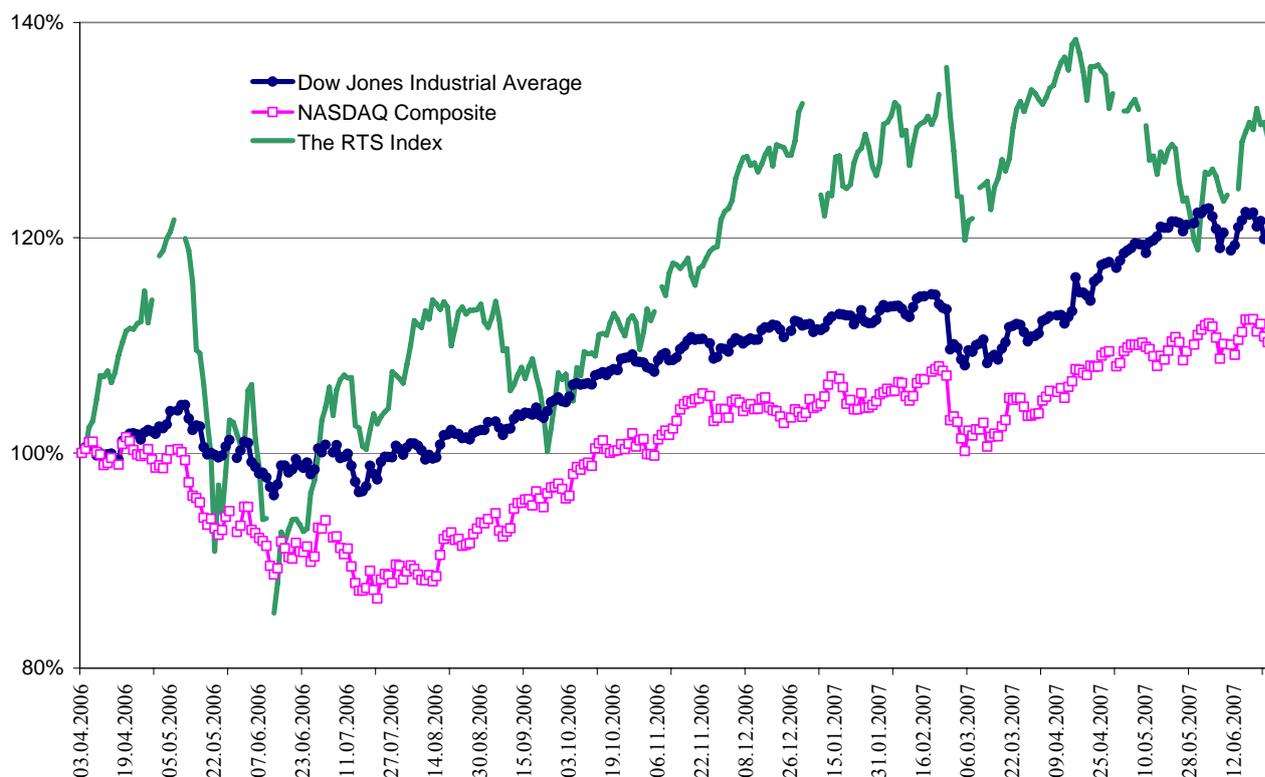
External factors behind Russian stock market dynamics

The situation in the international oil market was quite favorable in June. While at the beginning of the month the quotations were quite stable, by the end of June they were replaced with a growing trend, having resulted in Light Sweet growth by 4.1 per cent. The grounds for the growth were the tensed situation in the Middle East and the trade union strike in Nigeria. The situation with the US fuel stocks also encouraged purchases.

⁹ The calculation was based on indices of corporate bonds traded on MICEX. The indices were produced by the Zenit bank.

The trends of the international stock markets were also positive in June (see Table 1). While the European stock markets have reached only the zero (or some downgraded) rate by the end of the month (see Table 1), the basic stock indices of the developed and developing countries were distinguished with explicit growth.

FIG. 6.



Corporate News

OAO "LUKOIL"

OAO "LUKOIL" has made placement of Eurobonds for the amount of USD 1 billion. The bonds are split into two equal tranches with maturity terms of 10 and 15 years respectively. The annual coupon rate of the ten-year tranche for USD 500 million is 6.356 per cent with a spread of 145 basic points as to the US Treasury bonds, for the fifteen-year tranche of the same amount, 6.656 per cent with a spread of 175 basic points as to the US Treasury bonds.

Credit Suisse and Deutsche Bank were the sponsors of Eurobonds placement. An application is made for enlisting the bonds with London Stock Exchange. These bonds have the highest rating among all securities, ever issued by a private Russian company. After successful international road show Eurobonds were positively accepted and were globally placed at the market. The demand for the securities has exceeded USD 6 billion. LUKoil intends to use the funds for general corporate purposes, including debt refinancing and capital investment.

On June 28 OAO "LUKOIL" has disclosed consolidated financial reporting for the first quarter of 2007 in accordance with US GAAP.

The net profit of OAO «LUKOIL» has made USD 1 299 bln, what is by 23.1 per cent less as compared with the first quarter of 2006. The net profit has grown by 24.7 per cent as compared with the fourth quarter of 2006. EBITDA indicator (Earnings before interest, taxation, depreciation, amortization) has made USD 2.432 million (by 13.3 per cent less as compared with the first quarter of 2006 and 14.7 per cent more versus the fourth quarter).

The dynamics of the company performance was influenced by the drop of the world prices for oil and petroleum products, increased export taxes in Russia, strengthened RUR against USD and increased transport tariffs. However, the negative impact of those factors was partially adjusted by the increase in the scope and optimization of activities. Despite the decline of oil and oil products prices, the total tax payments of the company increased by 9.8 per cent as compared with the first quarter of 2006, i.e., by USD 5.6 billion

RAO «Gazprom»

According to published on June 5 consolidated financial reporting, developed in accordance with US GAAP standards, the proceeds of “Gazprom Neft” in 2006 have grown by 38 % as compared with the previous year and amounted to USD 20.2 billion. Profit before tax, interest and depreciation (EBITDA) in 2006 increased by 27 % and amounted to USD 5.2 billion. Despite the increased tax burden by more than 41 %, the net profit of Gazprom Neft” made in 2006 USD 3.7 billion, which exceeds the level of 2005 by 31 %.

OAO «Norilsk Nickel»

On June 26 OAO “Norilsk Nickel” announced the receipt of all necessary regulatory approvals for the transaction on acquisition of LionOre Mining International Ltd. due to the agreement for the transaction from the Canadian government Investment Authority dated as of the June 25, 2007. D. Morozov, General Manager of OAO “Norilsk Nickel” announced that “the company welcomed the completion of the transaction agreement with all regulating authorities in very a short time frames. It is anticipated that LionOre shareholders will offer their shares for sale before June 28, the validity term of our offer, after which “Norilsk Nickel” intends to complete the acquisition of all issued shares of LionOre “.

On May 23, 2007 “Norilsk Nickel” has announced that it will increase the price of its offer to acquire all issued ordinary shares of LionOre for monetary assets for the total amount of about CAD 6.8 billion. The proposal will be valid for acceptance until 20:00 as of Toronto time, Thursday, June 28, 2007. The confirmation of this proposal should be received before the deadline.

OAO «Rosneft»

On June 18, the company has published consolidated financial reporting for three months of 2007, through March 31, developed in accordance with US GAAP. According to the presented reporting, the net profit in the first quarter of 2007 has grown by 12.2 per cent and accounted to USD 8.220 mln, what is by 0.1 per cent higher than in the fourth quarter of 2006, which made USD 8.213 million. The profit growth was based on increased sales of oil, gas and oil products. The EBITDA indicator (Earnings before interest, taxation, depreciation, amortization), adjusted to the amount of penalties and charges on tax debt of OAO “Yugansk Neftegas” in the amount of USD 297 million, has decreased by 9.3 per cent, to USD 1.741mln in the first quarter of 2007 (from USD 1 920 million in the fourth quarter of 2006, when the EBITDA index made USD 880 mln). Net profit, adjusted for the tax penalties and fines for tax arrears of OAO “Yugansk Neftegaz”, in the amount of USD 332 million, as well as the change in the effective tax rate in the first quarter of 2007, has decreased by 24.9 per cent to USD 602 million as compared with the rate of the relevant period in 2006 (USD 802 million), and by 0.2 per cent versus the rate of the fourth quarter of 2006 (USD 603 million).

A decline in EBITDA and net income in the first quarter of 2007 as compared with the corresponding period of 2006 occurred primarily due to an increase of customs duties, which increased by 23.8 per cent, and due to strengthening of the RUR rate by 11.7 per cent in real terms.

Table 1.

Dynamics of international stock market indices

Data as of June 24	Value	Dynamics within the month(%) ¹⁰	Dynamics since the year beginning (%)
RTS (Russia)	1897,3	5,71%	5,49%
Dow Jones Industrial (USA) Average(USA (USA) (USA)	13337,66	-1,26%	7,02%
NASDAQ Composite (USA)	2574,16	0,66%	6,58%
S&P 500 (USA)	1492,89	-1,51%	5,26%
FTSE 100 (UK)	6559,3	-0,17%	5,44%
DAX-30 (Germany)	7860,52	1,57%	19,15%
CAC-40 (France)	5953,36	-1,72%	7,43%
Swiss Market (Switzerland)	9073,33	-3,28%	3,27%
Nikkei-225 (Japan)	18066,11	3,35%	4,88%
Bovespa (Brasil)	53851,68	4,33%	21,09%
IPC (Mexico)	30744,71	0,15%	16,24%
IPSA (Chile)	3418,25	6,48%	26,92%
Straits Times (Singapore)	3525,1	1,10%	18,06%
Seoul Composite (South Korea)	1749,55	6,38%	21,97%
ISE National-100 (Turkey)	46010,13	-0,40%	17,62%
Morgan Stanley Emerging Markets Free Index	1 051,10	4,60%	15,16%

¹⁰ Versus index indicator valid on September 27, 2006.

Foreign currency market

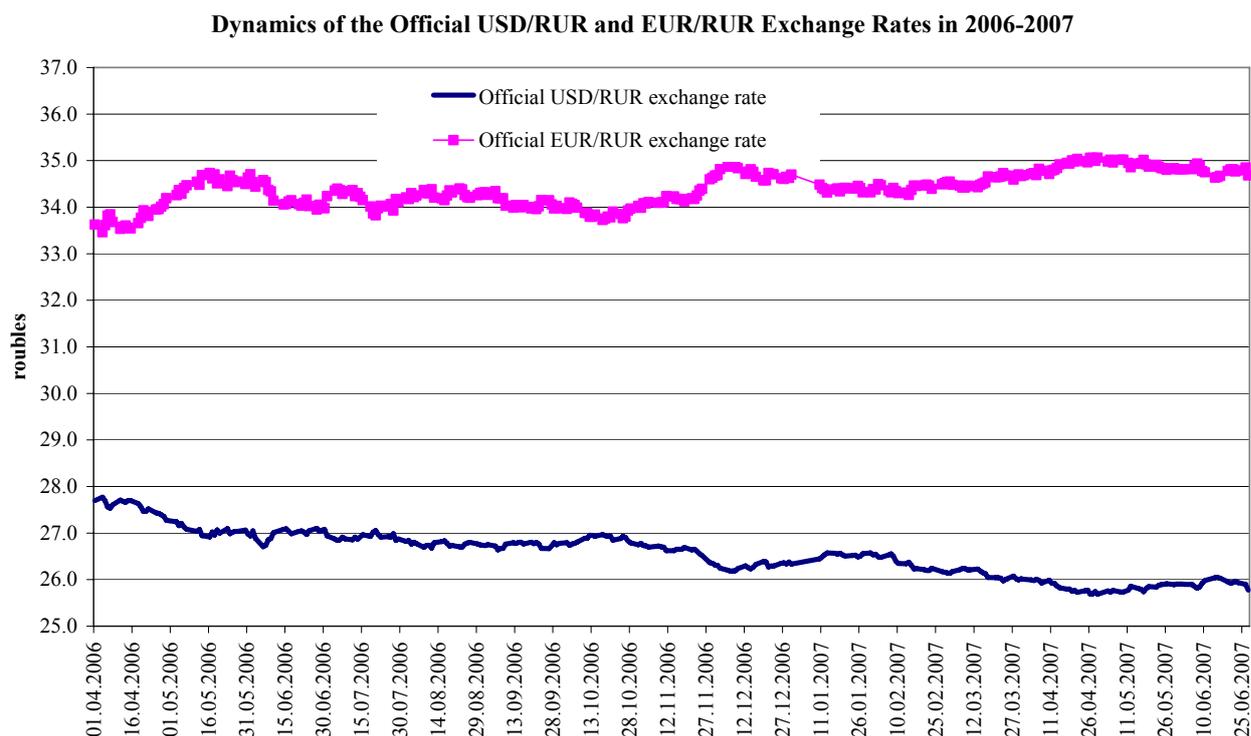
As of results of the month, the re was observed stabilizations of the USD exchange rate against RUR, based on the situation in the foreign currency market. On the one hand, the United States has lowered the GDP forecast, on the other hand, a number of macroeconomic indicators demonstrated the stability of the US economy. within the second week of the month there was observed the strengthening of EURO against USD, which caused a similar trend in the dynamics of domestic currency market. This was associated with an increase of the base interest rate in the EURO zone up to 4 per cent per annum.

Early in the second half of June, USD initially was strengthened against EURO, but this was followed by its downfall. The growth of dollar took place against the background of expectations of increased interest rates in the United States. But then, after the publication of the data on basic inflation rates in the USA, the investors' concerns have settled down, and EURO has recovered some of the decline. Towards the end of June the dynamics of USD/RUR was reflecting the situation in the world market, resulting in strengthening of RUR against USD. Also, the increase in the RF CB activities served for further RUR strengthening.

As of results of the month, from June 1 to 27, the USD official exchange rate against RUR has demonstrated some decline versus the level of the beginning of the month, having lost RUR 0.126 (- 0.49 per cent) and made RUR 25.78 to USD 1. The total volume of trading in USD on SELT in the period of June 1 to 27 amounted to about USD 40.16 bln at an average daily turnover of USD 2.7 bln (about USD 77.52 bln at an average daily turnover of USD 4.6 in the relevant period of May). Therefore, trading activity of foreign currency in June has remarkably declined as compared with the preceding month. The largest amount of trading in USD was noted on June 8, when it amounted to about USD 4.4 bln, the minimum level of USD 380.5 mln was observed on June 9.

In the banking sector ruble liquidity in June of the current year has shown some decline against May indicators: the average balance of credit agencies' correspondent accounts in the Bank of Russia in April was about RUR 468.03 bln, against May indicator of about RUR 438.12 bln.

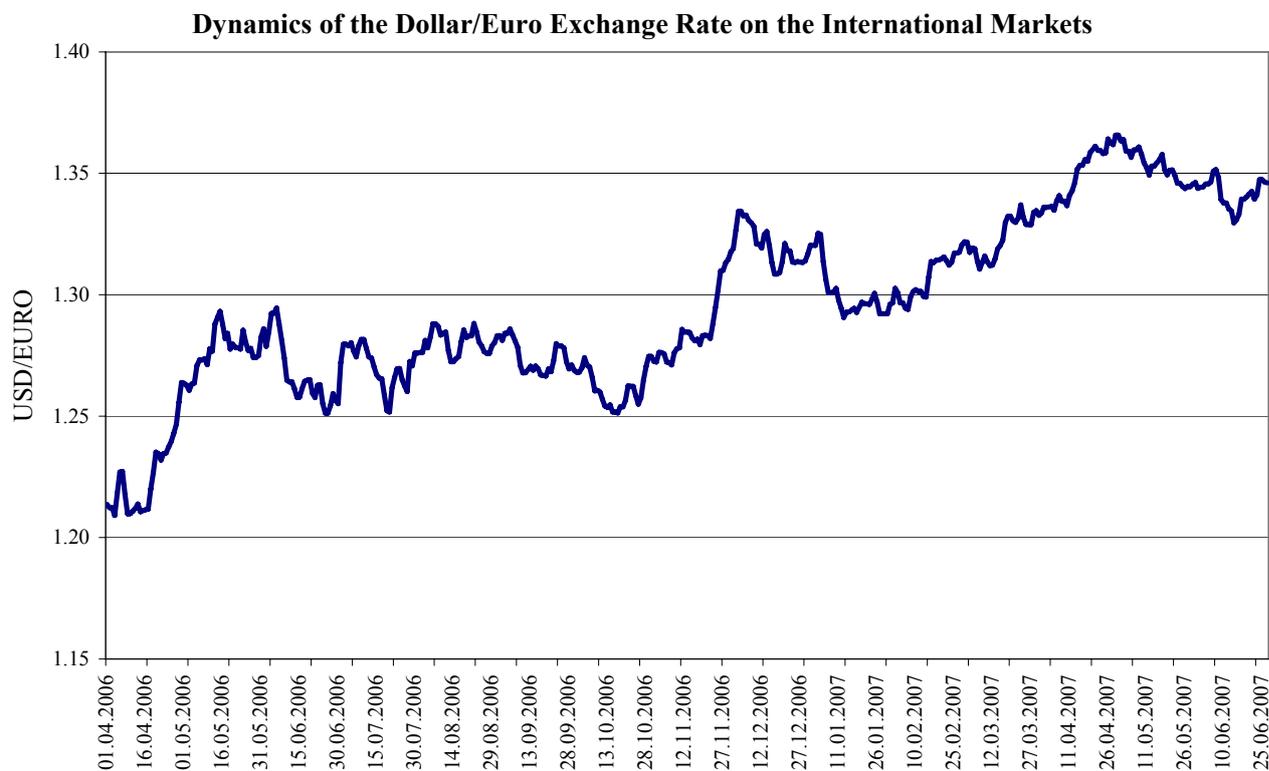
FIG. 7.



From June 1 to 27 Euro rate in the world market has grown by USD 0,0019 (0,14 per cent) and reached the level of USD 1,3461 for EURO 1. Despite those indicators, some decline of EURO against RUR was observed. In the period from April 1 to 27, EURO has been decreased against RUR by 0,1309 ((-0,38 per cent), namely from RUR 34,816 to 34,682 for EURO 1. The total volume of trading in EURO on SELT in the period from April 1 to 22 amounted to about EURO 1.01 bln at an average daily turnover of EURO 67.12 mln (about EURO 940.67 mln at an average daily turnover of EURO 55.3 mln in the relevant period of May). Therefore, the trading activity of the European currency has been significantly increased as com-

pared with the preceding month. The largest amount of trading in EURO within the period under review was noticed on June 19 at the level of EURO 121.7 mln, the minimum level of EURO 31.74 mln was observed on June 4.

FIG. 8.



D. Polevoy

Real Economy Sector: Trends and Factors

In 1 quarter 2007 the volume of the GDP in current prices was equal to RUR 6522.2 bln and increased by 7.9% as compared with 1 quarter 2006.

The growth of the production in the industry over January-May 2007 was 7.4% against 3.0% over the corresponding period of the previous year, workload in construction – 25.4% against 6.4% and retail trade turnover – 14.0% against 11.6%. The characteristic feature of 2007 has been an exceptionally high level of the investment activity. The growth of the investments in fixed assets reached 20.8% over January-May of the current year.

Federal State Statistics Service made the first estimation of the current year GDP. Anticipating growth of the domestic demand as compared with external demand was one of the factors of the change in the economy structure. It was the dynamic growth of the construction, processing industries, wholesale and retail trade as well as financial services that had positive impact on the dynamics of the produced GDP. The share of the construction in the GDP produced in 1 quarter 2007 went up to 4.7% against 4.0% in the corresponding period of the previous year, the share of processing industries grew by 1.2 p.p. and was equal to 20.5%, the contribution of extraction industries having reduced down to 7.6%, which is lower than the figure of 1 quarter 2006 by 2.1 p.p.

Macroeconomic situation at the beginning of 2007 was formed under the influence of dynamic expansion of the domestic market, which was accounted for by cumulative effect of the domestic business activity factors and the growth of population monetary income. The increase of the production in industry over January-May 2007 was equal to 7.4% against 3.0% in 1 quarter of the last year, workload in construction – to 25.4% against 6.4% and retail trade turnover – to 14.0% against 11.6%. The characteristic feature of 2007 has been an exceptionally high level of investment activity. The increase of the investments in the fixed assets over January-May was equal to 20.8%, exceeding by 11.0 p.p. the figure of the previous year. In the environment of investment demand rates acceleration the prospects of machine-building and construction

materials productions seem quite favorable in regard to the nearest future. Machinery and equipment production grew by 15.1% as compared with January-May 2006 and construction materials production – by 21.1%.

Table 1

**Growth Rates of the Real Volume of GDP Produced by quarters in
2005-2007, as percentage to the corresponding period of the previous year**

	2005 г.				2006 г.				2007 г.
	I	II	III	IV	I	II	III	IV	I
Gross domestic product	105.0	105.6	106.6	108.0	105.0	107.0	106.8	107.8	107.9
Minerals extraction	100.5	100.4	100.9	101.8	101.1	104.2	102.5	100.5	102.4
Processing industries	103.2	104.6	108.1	106.5	102.3	105.9	103.7	106.8	111.8
Electricity, gas and water production and distribution	100.8	99.6	102.4	102.6	104.7	103.4	101.1	100.8	94.1
Construction	107.5	107.7	111.3	114.4	101.1	110.1	115.1	123.9	123.2
Whole sale and retail trade, motor-vehicles, motorcycles, household appliances, and items of personal use repair	108.3	108.2	106.6	115.7	109.4	110.1	110.1	106.0	109.1
Transportation and communication	107.4	108.8	107.4	103.7	107.6	109.1	111.3	109.4	107.9
Net taxes for products	108.1	107.2	109.4	108.6	108.1	109.3	108.8	110.0	108.4

Source: Federal State Statistics Service

It should be noted that macroeconomic situation at the beginning of the current year was characterized with the further weakening of external demand impact on the GDP dynamics. The dynamics of the external demand was considerably influenced by existing situation at the world markets of fuel and raw materials, on the one hand, and by increased demand of the domestic market for hydrocarbons and material and technical resources, on the other hand. In the environment of high world prices and continuing reduction in physical volumes of oil and gas sector products supply to the external market the total value of Russian export in monetary terms increased by 8.4% over January-April 2007 as compared with 30.4% in the corresponding period of the previous year.

Analyzing the dynamics of internal demand one should note the trend for import growth becoming stronger. High elasticity of import to domestic demand demonstrates that economy and population revenue growing and competitiveness of domestic production decreasing the shift of consumer preferences for import goods is intensifying. Over January-April 2007 increase in import was equal to 40.4%, exceeding by 20.7% the level of the last year's similar figure. In the amount of the retail trade goods resources the share of import supply went up to 48%, including by foodstuffs – up to 38% and non-food goods – up to 56%.

In 2007 the positive trend for textile and clothing industry, leather and goods thereof, footwear and growth production, which appeared in 2006, has sustained. An important tool for production expansion was abolition of custom duties for import technological equipment. However since the production volumes in these fields of activity are about 20–23% of the pre-reform level of 1991, this has but a small impact on domestic market. Russian textile and clothing industry, leather and footwear production are one of the least attractive for foreign investors.

The growth of pressure import on domestic market is restricted by the trend for processing industries growth rates acceleration, which has been observed since the second half of 2006. Anticipating growth of processing industries as compared with extraction industries has been a characteristic feature of the economy growth for last three years. Though the proportion of growth rates by individual kinds of economic activities was subject to considerable fluctuations, on the whole it demonstrates a gradual shift from the growth based on the exploitation of natural raw materials traditional factors, which is directed mainly to the external market, to the formation of internal market growth resources.

Over January-May 2007 the growth of processing industry was equal to 111.9% against 105.6% over the corresponding period of the previous year, extractive industries – to 103.4% against 102.3% against the background of reduction in electricity, gas and water production and distribution by 4.0%.

In January-May 2007 the increase in machinery and equipment production was equal to 119.3% and reached mainly as a result of mechanical equipment production growth (128.9%), including hydraulic turbines (175.6%), gas turbines (146%).

Along with the increase of the construction scale the demand for construction equipment supported by targeted supply of budget funds for roads and municipal infrastructure construction and repair works went up. Tower cranes output grew by 60.7% as compared with January-May 2006, caterpillar tractors - by 130.5%, excavators – by 20.1%, bulldozers – by 161.7%, lifts – by 26.6%, motor graders – by 4.5%. Beginning with 2006 the output of machine-building productions for fulfillment of the priority national project “Development of agro-industrial complex”: in January-May 2007 machinery and equipment production for agriculture and forestry increased by 4.7%

Increase in engineering tools production by 22.5% in January-May 2007 was in many respects accounted for by the necessity to renovate and modernize technological equipment fleet at new, higher technological level, enhancement of the assortment and increase of the domestic equipment competitiveness. It should be noted that it is for the first time over the last years that the positive dynamics is observed for nearly all production items, monitored by the statistics.

In January-May 2007 increase in electric, electronic and optic equipment production was 115.1%. Steady dynamics of AC motors production (115%) is mainly accounted for by the adoption of new electrotechnical productions of energy efficient, competitive electric motors, for which there is an increased demand, by the enterprises.

The growth of transport vehicles and equipment production was 117.4% in January- May 2007 as compared with January-May 2006. At the same time production of motor vehicles, trailers and semitrailers was growing with anticipating rates (119,6%), including trucks – 122.3%, passenger cars – 113,0%, vehicles for municipal needs – 121.3%. Growth of production is in many respects accounted for by intensive development of assemblage enterprises of passenger cars, increase in orders for machine-building equipment in the framework of national projects fulfillment as well as the growth of export supplies of some kinds of machine-building production.

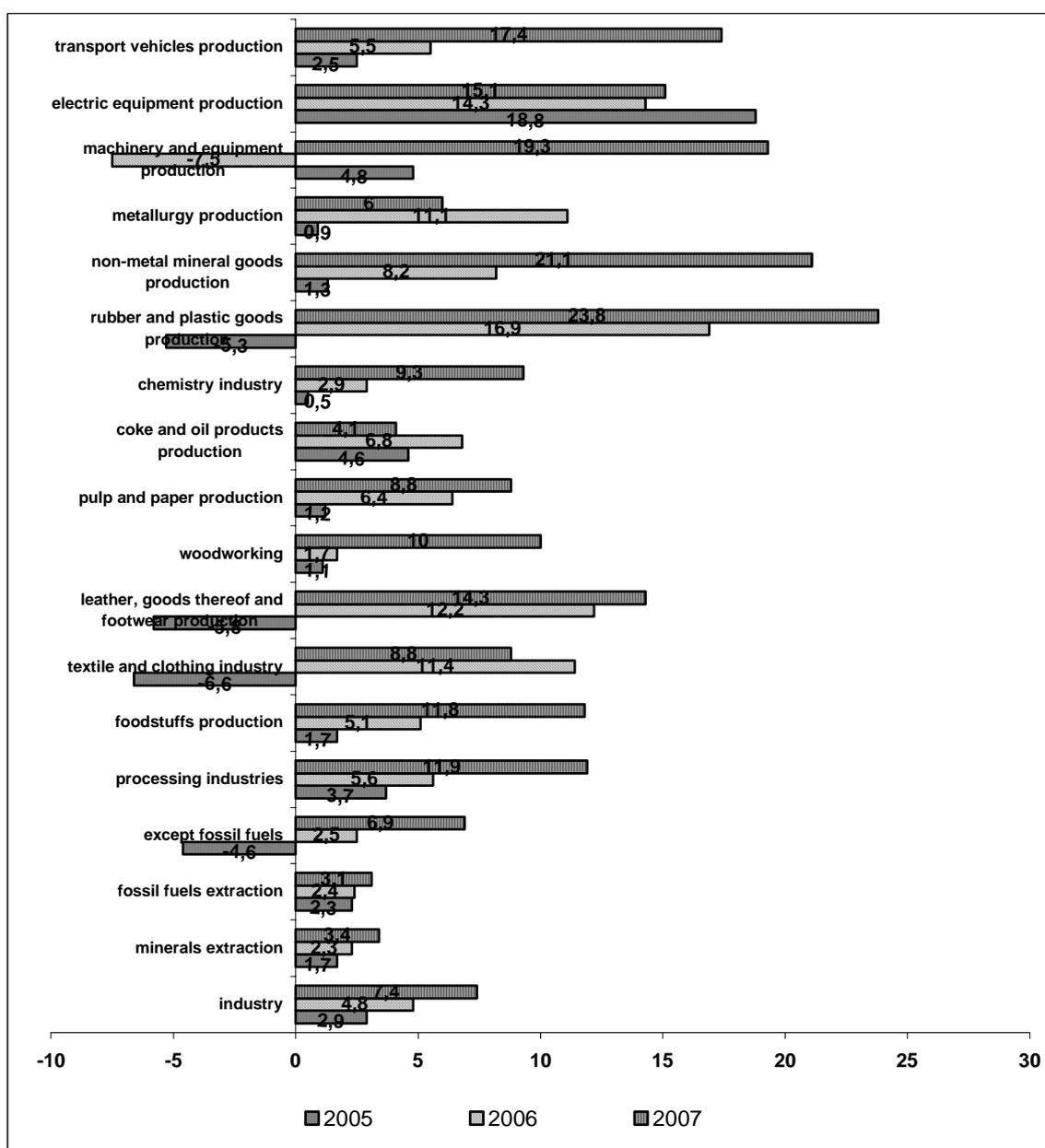
Increase in transport machine-building production output is in many respects accounted for by the increase in the demand from JCS Russian Railways and independent carriers for rolling-stock for railway roads net as a result of the capacity growth of the passenger and freight transportation as well as purchase increase for equipment renovation as a result of critical deterioration of the domestic railway equipment fleet. In January-May 2007 the increase in main line diesel locomotives output was 3.1 times, paza, shunting and industrial diesel locomotives of broad gauge – 125.7%, machinery for construction and planned repair – 190.2%.

Since 2002 the dynamics of the production of intermediate demand has been in the field of positive values. The nature of metallurgic, chemistry, woodworking productions' operation was determined by the level of internal and external demand. In January- May 2007 growth of metallurgical production and production of finished metal goods as compared with the corresponding period of 2006 was equal to 106%, including metallurgic production –to 104.7%, and finished metal goods – to 111.9%. The increase of the demand from pipeline transportation construction organizations had positive influence on the dynamics of steel pipes by 25.0% as compared with January-May 2006.

Chemistry complex is basic segment of Russian economy. In the structure of industry by the volume of goods production its proportion is about 5.5%, complex enterprises accounted for about 5.4% of the all-Russian currency earnings. In January-May 2007 growth of the industry production was equal to 109.3% and of the rubber and plastic goods production – to 123.8%. As compared with January-May 2006 the increase of the output in all main kinds of chemistry production, except from polyvinylchloride resin and man-made fibers and threads.

The capacity of internal market for chemistry production being big, the main factors that restrict the operation of chemistry complex are high extent of equipment deterioration and technology backwardness; anticipating price and tariffs growth rates for the production of natural monopolies; problems with industry's enterprises supply with main kinds of raw materials, especially hydrocarbons, and limited investment resources.

Fig. 1. The Change in the Rates of Industry Production by kinds of Economic Activities in January-May 2005-2007, as percentage to the previous year



O. Izryadnova

Investments in the Real Sector of the Economy

In 1 quarter 2007 the increase of the investments in the fixed assets was equal to 20.1% against 5.7% in the corresponding period of the previous year. Over January-May 2007 the volume of the investments in the fixed assets was RUR 1685.3 bln and exceeded the level of the last year corresponding period by 11.1%.

At the beginning of 2007 considerable changes occurred in the structure of the investments by the sources of financing. The structure of the obtained funds was determined by the increase of Russian banks' share in crediting of the investment process up to 8.5% as compared with 5.6% in 1 quarter 2006.

In Russian economy the tendency for the anticipating growth of the investments in the fixed assets as compared with the GDP dynamics has been observed since 1999. In 1 quarter 2007 the increase in the investments in the fixed assets was equal to 20.1%, and by the GDP – 7.9%, against 5.7% and 5.0%, correspondingly, over the similar period of the previous year. Over January-May 2007 the volume of the invest-

ments in the fixed assets was RUR 1685.3 bln and exceeded by 11.0 p.p. the level of the corresponding period of the previous year.

Steady positive dynamics of the production changed the situation in the investment sector. The expansion of investment demand proceeds against the background of favorable changes in hydrocarbons and mineral raw materials price situation at the world market, on the one hand, and active strategy of Russian business at the domestic market, on the other hand. And it is the anticipating growth rates of the domestic as compared with the external demand that has had the most significant influence on the level of investment demand since 1 quarter 2005. The accumulated effect of the internal factors, which regulate the level of the business activity, accounted for the intensive growth of the investments in the fixed assets as well as structural characteristics of fixed assets.

Along with the improvement of the indices of enterprises and organizations financial situation the change in the structure of the investments in the fixed assets by financing sources in 1 quarter 2007 was accounted for by the continuation of the trend for the increase in borrowed funds. The positive moment of the beginning of 2007 was the sustention of the trend for the expansion of banks' sector participation in the investing process financing. The share of the Russian banks credits in the structure of the investments financing was equal to 8.5% against 5.6% over the corresponding period of the previous year. The formation of this trend was partially compensated by reserved activity of insurance and investment companies as well as foreign capital in the investment activity financing. The share of loans for enterprises and organizations in the sources of investment in the fixed assets financing decreased by 0.9 p.p. as compared with 1 quarter 2006 and foreign banks credits – by 2.0 p.p.

It should be noted that the change in the trends for capital flow of the domestic private sector had the positive influence on the character of investment financing. Beginning with 2 quarter 2006 the change in the trends for capital flow-out from the sector of non-financial enterprises and households is observed. Whereas in 1 quarter 2006 net capital flow-out from the sector of the non-financial and households was equal to USD 1.7 bln, over 1 quarter 2007, according the 1 quarter 2007, net inflow of the capital by non-financial enterprises and households was equal to USD16.5 bln.

Another characteristic feature of 1 quarter 2007 was the increase of budget funds share in the investment financing structure by 1.1 p.p. due to the increase of budget funds of the subjects of the Federation participation. In 1 quarter 2007 the share of the budget funds, which were used for the investments in the fixed assets, was equal to 1.3% of the GDP and exceeded by 0.3 p.p. the figure of the previous year.

In 2007 to fulfill Federal Target Investment Program (FTIP) it is supposed to use state investments RUR 475.4 bln, which is 1.5% of the GDP against 1.38% in 2006. However, in fact the financing of the federal programs in 1 quarter usually proceeds with a big delay. According to the Ministry for the Economy Development and Trade data, by 05.04.2007 quarterly distribution of target indicators and indices was agreed upon by 17 state customers for 25 Federal Target Programs out of 46, which are being fulfilled in 2007 (54%). For other Federal Target Programs (46%) state customers started the fulfillment of program measures without coordinated quarterly values of target indicators and indices, which, certainly, will complicate quarterly estimation of these programs efficiency fulfillment.

The trends for the formation of the investments financing sources in the state sector remained nearly the same as in the previous year. According to the forecast in 2007 it is expected that about 30% of the total volume of the investments in the state sector will be financed at the expense of the state sector organizations' own funds and 70% - at the expense of borrowed funds, 55% of which accounts for budget funds. It is the state sector that continues to prevail by the volume of the investments in the fixed assets in the kinds of economic activities, oriented towards strategic goals.

It is the anticipating growth of the state investments in production complex as compared with the dynamics of the state investments in special and social complexes that is characteristic for FTIP in 2007. 67.8% of the investments for the development of the national economy is supposed to be directed towards transportation system and information and communication infrastructure construction and modernization. It is planned to direct the biggest part of the funds for the development of road sector, which will enable to improve inter-regional motor traffic and unload existing motor roads. In 2007 state investments envisaged to fulfill FTIP, solve fuel and energy complex problems are to grow considerably. In comparable prices 4 times more budget funds are directed for these purposes than in 2006.

Table 1

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

	2003	2004	2005	2006	2007
Investments in the fixed assets	100.0	100.0	100.0	100.0	100.0
including					
1. <i>Own funds</i>	49.1	44.8	47.8	48.9	46.7
including					
profit	19.0	15.5	19.8	21.4	20.2
2. <i>Inflow of funds</i>	50.9	55.2	52.2	51.1	53.3
including					
Budget funds	17.3	14.9	14.0	12.3	13.4
Of which:					
From the Federal Budget	5.0	3.5	3.7	2.6	2.3
From the Budgets of the regions of the Russian Federation	11.6	10.7	9.7	8.9	10.3
Bank credits	4.3	7.9	6.5	9.3	9.2
Including foreign bank loans	1.2	1.1	1.1	2.7	0.7
Borrowed funds	6.6	10.9	12.5	8.1	7.2
Non-budget funds assets	1.0	0.6	0.4	0.5	0.4
Others	21.2	20.9	19.6	20.9	23.1
Foreign investments of the total volume of the investments in the fixed assets	5.8	9.0	10.3	8.1	5.1

Source: Federal State Statistics Service

Changes in the structure of the investments in the fixed assets over the last four years are defined by gradual reduction of the share of investments into industrial production development against the background of infrastructure and services becoming more important. It is to be noted that 2006 and the beginning of 2007 demonstrate the upsurge in investment activity in the agriculture, initiated by the inclusion of this kind of activity in the priority national projects. In the environment of steady growing demand for trade services redistribution of the investments by kinds of economic activities proceeds along with material and technical base for motor vehicles trade expansion. The growth of the investments in this field was equal to 118.2% to the level of I quarter 2006.

In 2007 the trend for investments in the fixed assets growth for the kinds of activities, which are oriented to social service rendering - education (144.4% as compared with I quarter 2006), health care (107.2%), scientific research and development (114.8%), culture and sport (154.4%) – sustained.

Table 2

**Structure of the Investments by kinds of Economic Activity in I quarter,
as percentage to the total**

	2004	2005	2006	2007
Industry	48.1	52.4	48.0	46.7
including				
Minerals extraction	24.1	25.5	20.5	23.1
of which:	24	22.1	18.9	21.1
Fossil fuels extraction				
Processing industries	17.5	19.9	21.4	17.9
Electricity, water and gas production and distribution	6.5	7	6.1	5.7
Agriculture	2.8	2.3	2.9	3.8
Transportation	15.7	17.9	20.5	20.0
Communication	6.7	4.0	5.2	4.6
Construction	3.1	3.7	3.4	2.6
Trade	2.2	2.1	2.3	2.6

Source: Federal State Statistics Service

In I quarter 2007 the characteristic feature for investment process in the transportation was a dynamic growth of the investments in railway transportation development (145.4% in I quarter 2007 against 85.7% in I quarter 2006) the investments in pipeline transportation rates being reserved (110.4% and 151.6%, correspondingly). It should be noted that in I quarter 2007 the volume of the investments in communication de-

velopment decreased by 5.4%, which is rather unusual for this dynamically developing kind of economic activity.

In 1 quarter 2007 the trend for anticipating growth of the investments into extraction kinds of activities and first of all in fossil fuels extraction, which outlined in 2006, sustained. Intensive growth of the investments in the fossil fuels extraction is oriented towards overcoming of the consequences of sharp decrease in the investment activity over 2004–2005. As a result of 1 quarter 2007 it is the extraction industries which had the prevailing part of the investments in the industry (49.4%). Investments in the fixed assets increase on the whole in the economy by 20.1% in 1 quarter 2007, the increase of this indicator in minerals extraction was equal to 31.3%, including in fossils fuel extraction – by 29.8%, in processing industries – by 4.0%, in electricity, gas and water production and distribution – by 12.1%.

In 1 quarter 2007 the share of the investments in the processing industries was equal to 38.4% of the total volume of the investments in the industry and decreased by 6.1 p.p. as compared with the corresponding period of the previous year. The structure changes of the investments for processing industries were determined by interaction of internal and external demand factors. Investment activity in foodstuffs production (growth of 115.6%), textile and clothing goods (168.2%), leather goods and footwear production (151.2%) was initiated by the expansion of the domestic market.

The highest investment rates were observed in rubber and plastic goods production (200.0%), in finished metal goods production (183.5%), in publishing and printing (142.6%). The drop in the investments in 1 quarter 2007 as compared with the corresponding period of the previous year was observed in coke production (50.9%), metallurgy (86.2%) and chemistry industry (93.6%). Investment activity in machinery and equipment production is characterized with extremely unsettled indices: the drop of the investments in 1 quarter 2007 was equal to 47.0% against the growth by 2.6 times over the corresponding period of the previous year. The difficulties in the chosed of the development strategy and targeted support of some individual production lead to misbalance of investment goods market. It should be noted that in 1 quarter 2007 weak dynamics of the investments in means of transport production, which was observed over the last two years has given way to dynamic growth (152.2%) which is mainly due to intensive development of the enterprises for motor vehicles industrial assemblage.

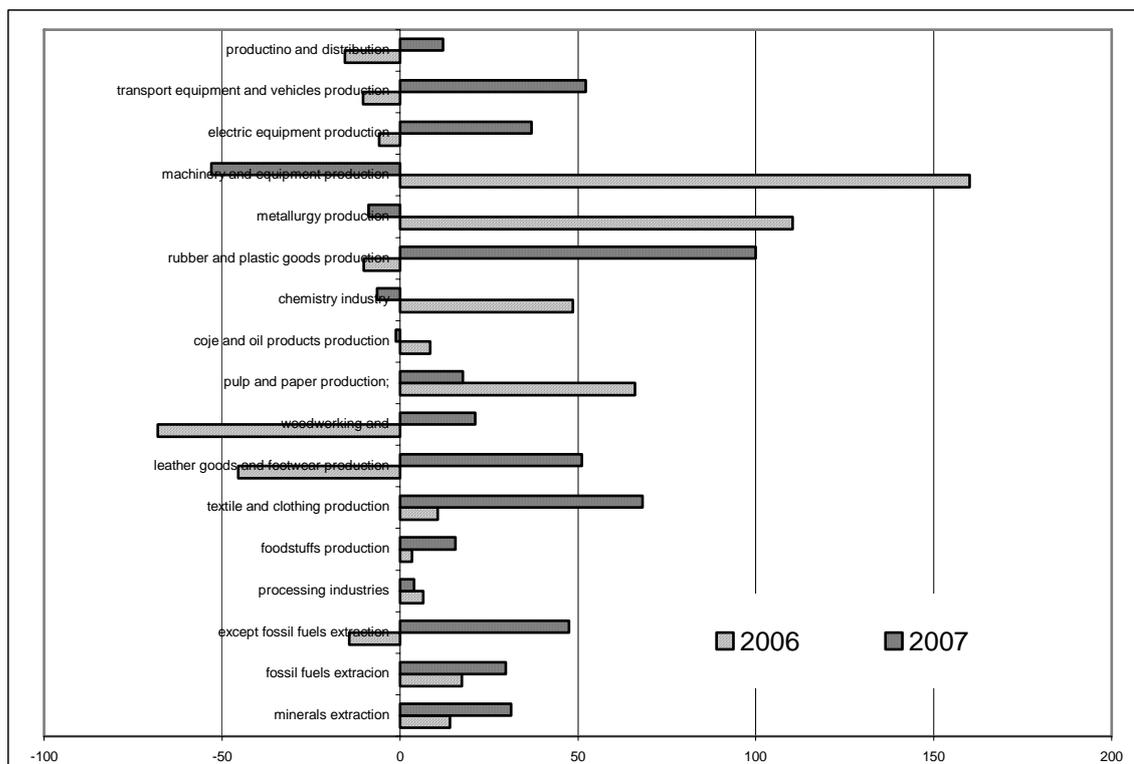


Fig. 1. The change of the Investments in the Fixed Assets Growth Rates in the Industry in 1 quarter 2006 and 2007 as compared with the corresponding quarter of the previous year, as percentage

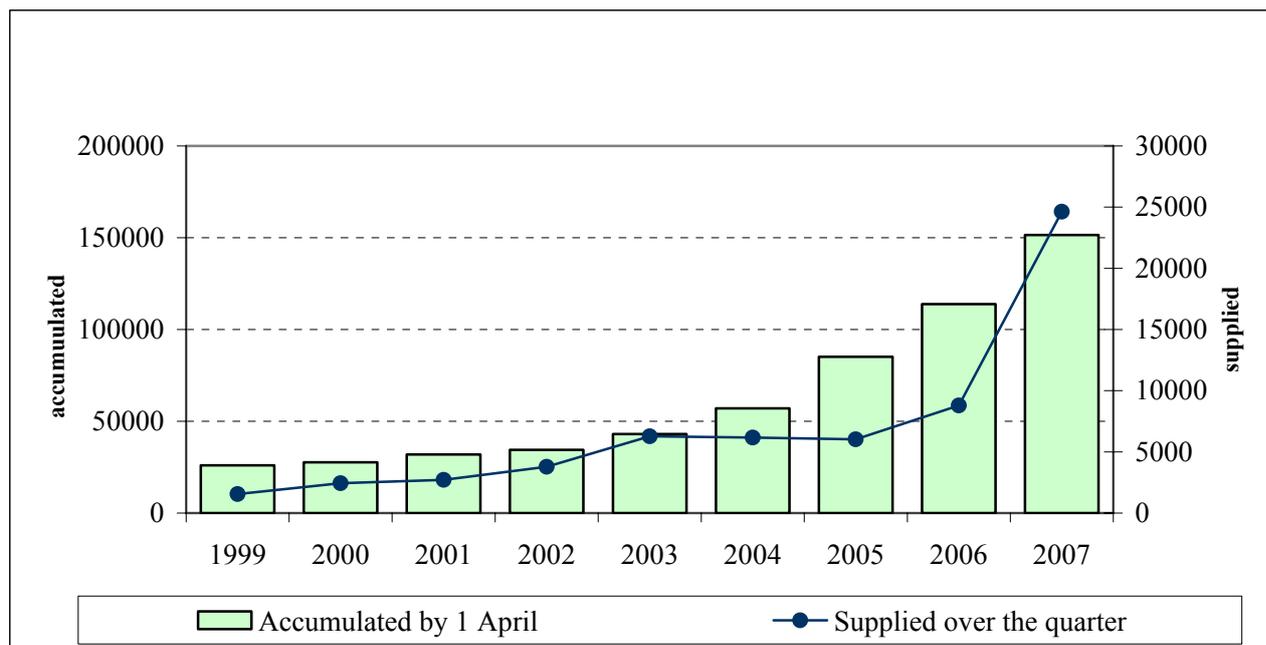
In 1 quarter 2007 in the structure of the investments by kinds of fixed assets the share of machinery and equipment decreased by 1.4 p.p. and was equal to 35.1%. Domestic machine-building does not meet growing investment demand either in volumes or in the structure of investment goods supply. Investments in

foreign equipment purchase in 1 quarter 2007 were equal to 17.6% of the total volume of the investments into machinery, equipment and means of transport. Under existing structure of domestic production of investment goods import remains one of the major sources for fixed assets renewal, production modernization and reconstruction.

O. Izryadnova

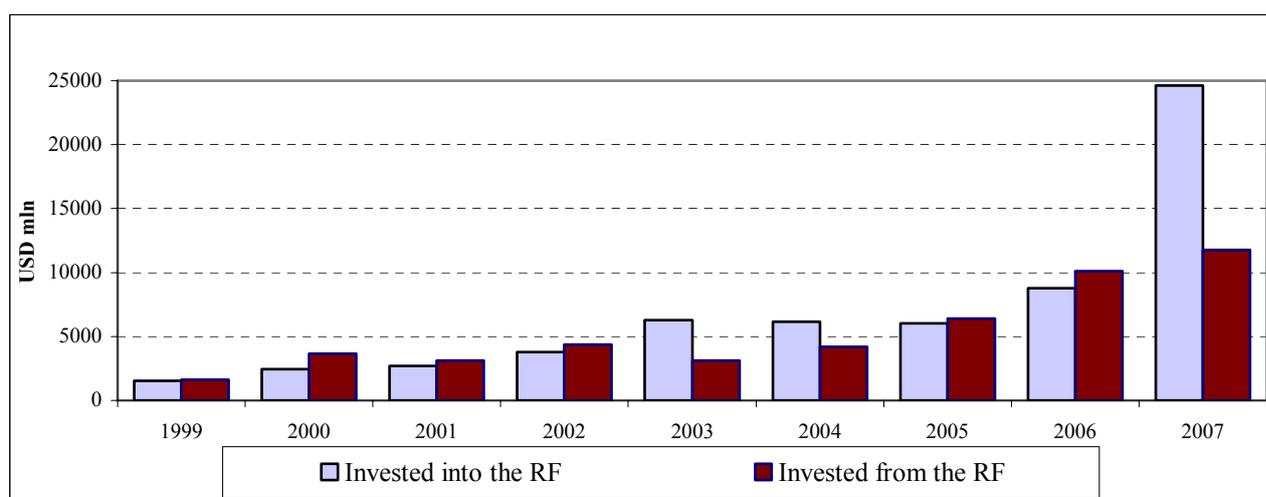
Foreign Investments in Russian Economy

In 2007 the interest of the foreign investors towards investments into the Russian economy has increased considerably. The volume of the foreign investments, supplied to non-financial sector of the Russian economy not taking into the account monetary and credit regulation institutions, commercial and saving banks, including ruble investments, evaluated in the US dollars was equal to USD 24.5 bln in 1 quarter 2007, which exceeds by 2.8 times the figure of 1 quarter 2006.



Source: Federal State Statistics Service

Fig. 1 Foreign Investments into Russian Economy in 1 quarter 1999-2007, as USD mln



Source: Federal State Statistics Service

Fig. 2. Foreign Investments in the Russian Federation and Investments of the Russian Federation abroad in 1 quarter 1999-2007

The favorable factor is that the volume of the foreign investments exceeded the Russian investments abroad by more than two times is favorable.

In 1 quarter 2007 it was in the segment of other investments where the biggest growth in relative and absolute terms was observed – they increased by 3.1 times (up to USD 14.67 bln) as compared with 1 quarter 2006. Direct investments over the considered period increased by 2.5 times and reached USD 9.76 bln. Portfolio investments decreased by 14.2% down to USD 197 mln.

Since the direct investments growth rates in 1 quarter of the current year turned out to be lower than the growth rates of general index, their share in the structure of aggregate investments into Russian economy decreased.

Table 1

The Structure of the Foreign Investments, supplied to the Russian Federation in 1 quarter 2003-2007

	2003	2004	2005	2006	2007
Direct investments	16.5%	23.9%	31.9%	43.7%	39.5%
Portfolio investments	0.3%	1.4%	1.3%	2.6%	0.8%
Other investments	83.2%	74.6%	66.8%	53.6%	59.6%

Source: Federal State Statistics Service

Speaking about direct investments, it should be noted that the share of credits, received from the foreign joint owners of the organizations, increased in their structure up to 76.5% (in I quarter 2006 – 13.1%). Inpayments to statutory capital of the enterprises, situated in the territory of the Russian Federation, in the structure of direct investments were equal to 20.6% as a result of 1 quarter 2007 (in 1 quarter 2006 – 46.0%).

Table 2

Direct Foreign Investments, Supplied to the Russian Federation in 1 quarter 2004-2007

	As USD mln				Change as % to the corresponding period of the previous year			
	2004	2005	2006	2007	2004	2005	2006	2007
Direct foreign investment, total	1 476	1 919	3 845	9 756	142.8	130.0	by 2 times	by 2.5 times
Including:								
- inpayments into the statutory capital	1 058	1 564	1 768	2 006	by 3.4 times	147.8	113.0	113.5
- credits from the enterprises' joint owners	321	324	504	7 463	76.3	101.0	155.6	by 14.8 times
- other direct investments	97	31	1 573	287	32.0	32.0	by 50 times.	18.2

Source: Federal State Statistics Service

In 2007 the growth rates of the foreign investments into construction, trade, transportation and communication considerably exceeded the corresponding figures for other sectors, which had the effect of the increase of their proportion in the sectors structure. As before the biggest amount of the foreign investments was directed to the industry, their proportion in sectors structure having though decreased. The second place in accordance with the attraction of foreign investments is held by trade and catering.

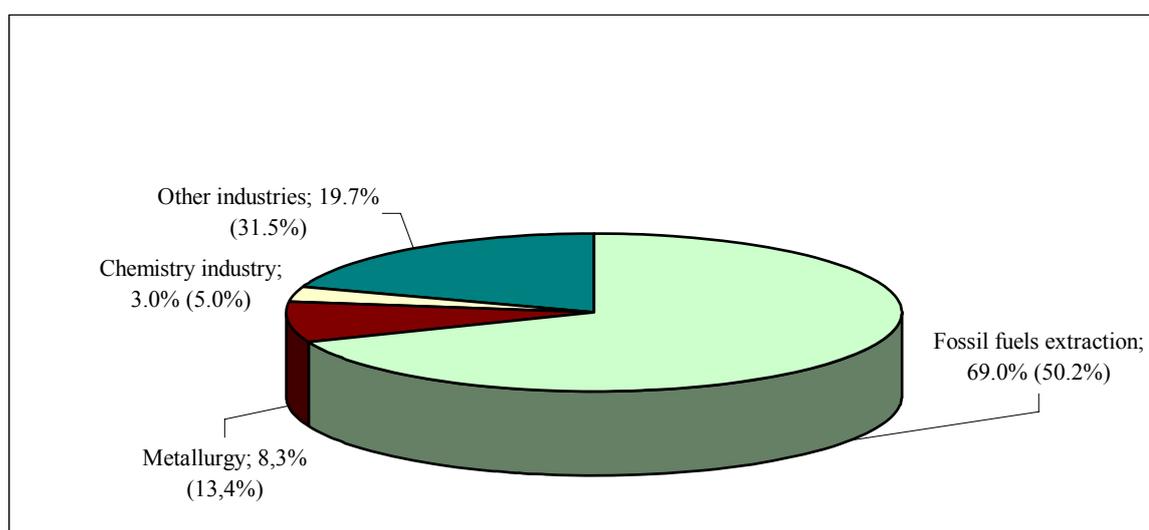
As a result of 1 quarter 2007 in connection with the sustention of high prices for oil among production industries the production of fossil fuels remain still the most popular, investments in it increasing by 3.1 times up to USD 8.2 bln. Investments in Russian processing sector increased by 1.5 times as compared with 1 quarter 2006 and were equal to USD 3.4 bln. The biggest amount of the investments among the processing industries was directed to metallurgy (USD 987 mln or 29.3 of the total amount of the foreign investments supplied to processing industries), foodstuffs production (USD 621 mln or 18.5%) and chemistry industry (USD 360 mln or 10.7%).

Table 3

**Sector Structure of the Foreign Investments into
the Russian Economy in 1 quarter 2005-2007**

	As USD mln			As percentage to the total			Change as % to the corresponding period of the previous year		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Industry	3 346	5 214	11 899	55.6	59.3	48.3	115.4	155.8	by 2.3 times
Construction	20	25	272	0.3	0.3	1.1	36.4	125.0	by 10.9 times
Transport and communication	781	701	2 740	13.0	8.0	11.1	в 4.8 p.	89.8	by 3.9 times
Trade and catering	1094	1635	7 895	18.2	18.6	32.1	56.6	149.5	by 4.8 times
Commercial activity on market service	461	434	891	7.7	4.9	3.6	85.2	94.1	by 2.1 times
Finance, credits, insurance, pensions provision	261	689	821	4.3	7.8	3.3	110.6	by 2.6 times	119.2
Other sectors	58	792	106	1.0	9.0	0.4	17.0	by 13.7 times	13.4

Source: Federal State Statistics Service



Source: Federal State Statistics Service

Fig. 3. Branches Structure of the Foreign Investments in the Industry in 1 quarter 2007 (data for 1 quarter 2006 are given in parentheses)

Structure of foreign investments directed to the industry in 1 quarter 2007 differs from the corresponding structure of the aggregated foreign investments in Russian economy by higher proportion of direct investments. Direct investments in industry increased by 2.9 times as compared with 1 quarter 2006, while other investments in the increased by 62.7%.

Table 4.

Foreign Investments in Industry in 1 quarter 2003-2007

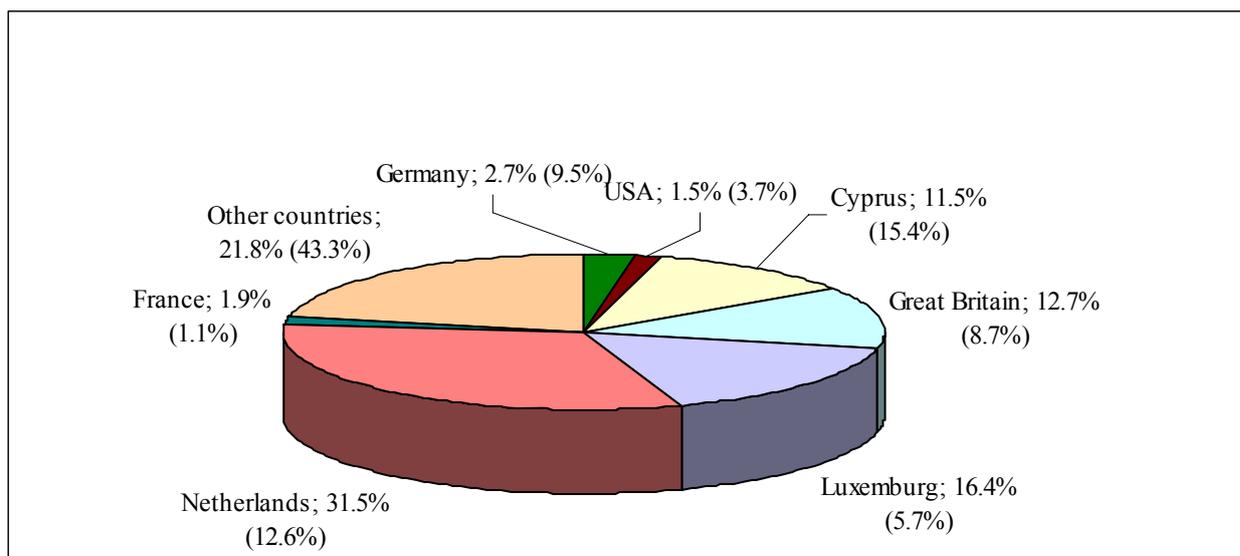
	2003	2004	2005	2006	2007
Direct investments	27.0%	35.5%	43.2%	56.2%	70.3%
Portfolio investments	0.8%	0.3%	2.2%	3.5%	1.0%
Other investments	72.2%	64.2%	54.5%	40.3%	28.7%

Source: Federal State Statistics Service

In 1 quarter 2007 direct investments to the industry were equal to 85.8% of the total direct investments into Russian economy (in 1 quarter 2006 – 76.2%). The proportion of portfolio and other investments in the corresponding total figures is estimated to be 58.9% and 23.3% (in 1 quarter 2006 – 79.6% and 55.0%, correspondingly).

In 1 quarter 2007 the changes occurred in geographic structure of the foreign investments supplied to the Russian economy over this period. Ireland became the member of five leading investor countries, whose investments are estimated to be USD 1.7 bln. About 80% of the investments from Ireland were directed to the sphere of transportation and communication.

As in 1 quarter 2005 the Netherlands held leading position in the list of main investor countries to the Russian Federation (as a result of 1 quarter 2006 the Netherlands were in the third place). In 1 quarter 2007 their investments increased by 7 times as compared with the corresponding period of the previous year and were equal to USD 7.76 bln. From this sum USD 7.44 bln (95.9%) accounted for fossil fuels production, which is equal to 88.2% of the total foreign investments into this industry.



Source: Federal State Statistics Service

Fig. 4 Geographic Structure of the Foreign Investments, supplied to the Russian Federation in 1 quarter 2007 (the data for 1 quarter 2006 are given in parentheses)

In 1 quarter 2007 the biggest investment growth was observed for the investments from Luxembourg (by 8.1 times up to USD 4.05 bln). The main proportion of the total investments from Luxembourg to the Russian Federation was directed to the trade and catering – USD 2.36 bln (58.3% of the total investments to the Russian Federation from Luxembourg) and communication – USD 1.13 bln (28.0%). The proportion of Luxembourg in the sphere of communication was equal to 84.0% of total foreign investments into this branch, in the sphere of trade – 30%. In I quarter 2006 priority sectors for the investors from Luxembourg were financial activity (39.9% of the total investments from Luxembourg to the Russian Federation) and fossil fuels production (39.1%). In current year only 4.7% (USD 192 mln) from Luxembourg were directed to fossil fuels production.

Investors from the Great Britain increased their investments into Russian economy in 1 quarter 2007 by 4.1 times giving preference to the sphere of trade and catering, investments in this field being USD 2.67 bln or 85.5% of the investments from the Great Britain to the Russian Federation over 1 quarter 2007. The proportion of the Great Britain in the total investments in the sphere of trade and catering was equal to 33.8%.

The only country among the leading investor countries into the Russian economy, which reduced its investments at the beginning of the current year, was Germany. In 1 quarter 2007 German investments decreased by 20.3% as compared with the corresponding period of 2006 and were equal to USD 666 mln.

On the whole according to the situation by the end of March 2007 the volume of accumulated foreign investments in the economy of Russia was estimated to be USD 151.5 bln, which exceeds the figure of the end of March 2007 by 33.1%. The biggest growth of the foreign investments is observed from Netherlands, which increased by 51.7% as compared to the end of March 2007.

Table 5

The Structure of Accumulated Foreign Investments by Main Investor Countries

	Accumulated by 01.04.2006, as USD mln				Change as compared with 01.01.2006, %			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	6 754	3 576	502	2 676	87.7	77.9	99.0	102.8
Germany	10 000	3 141	43	6 816	81.6	94.6	2.5	94.0
France	3 651	761	0.4	2 890	98.7	71.9	100.0	109.4
Great Britain	11 610	2 616	161	8 833	98.4	90.0	95.3	101.2
Cyprus	31 835	21 582	1193	9 060	98.6	94.7	87.8	111.5
Netherlands	30 690	27 389	63	3 238	130.9	142.4	101.6	77.9
Luxemburg	26 780	651	204	25 925	117.1	110.9	100.5	117.4
Other countries	30 149	13 310	602	16 237	104.4	99.4	66.0	111.5
Total	151 469	73 026	2 768	75 675	106.0	107.6	56.5	107.9

Source: Federal State Statistics Service

E. Ilyukhina

Foreign Trade

The trend for export growth rates slowdown and import growth rates acceleration, which outlined at the end of the last year against the background of high rates of ruble appreciation towards dollar and euro and the slowdown of world prices for oil rates decrease, has sustained.

The Russian Federation takes strong measures to control dumping import and simultaneously the quality of the imported consumer goods more and more often.

In April 2007 Russian foreign trade turnover, calculated by the balance-of-payments methodology, was equal to USD 44.2 bln, which exceeds the corresponding figure of the previous year by 24.7%. The import to Russia is growing by extremely high rates. In such a way, monetary value of import supplies increased by 45.1% in April 2007 as compared with April 2006, which is the absolute maximum since 1994. The volume of import in pecuniary terms was equal to USD 16.5 bln, being though lower than the record of December 2006 (USD 19.8 bln) and the level of March 2007 (USD 17.2 bln) but exceeding by 20% the average monthly level of 2006. Over four months of 2007 import was equal to USD 59.5 bln, being by 40.4% higher than in the corresponding period of 2006.

Export is growing considerably slower than import. In April 2007 it was equal to USD 27.7 bln, which is by 15.1% more than in April 2006. However as compared with the results of last months thanks to the resuming growth of the world prices for oil and other raw materials the export growth rates increased. In the first quarter 2007, according to the Central Bank data, they were equal to only 6%, and in January-April 2007 – to 8.4% to the corresponding period of the last year.

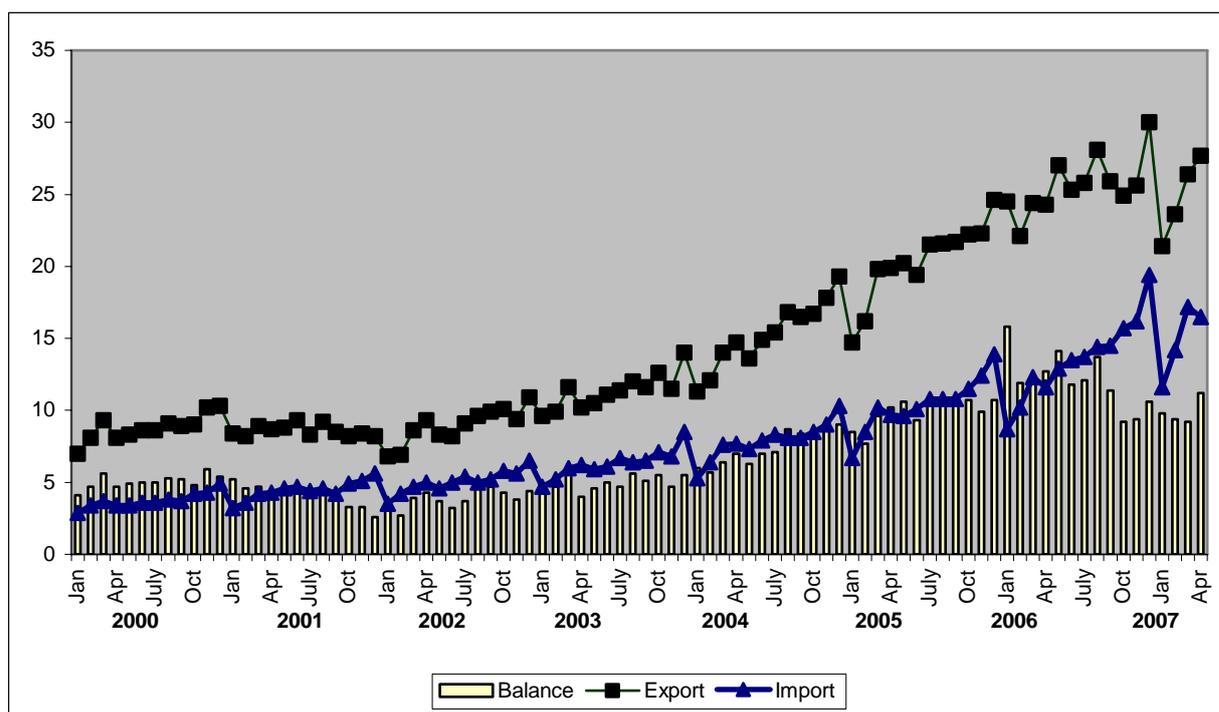
Since import grew at higher rates than export, foreign trade surplus reduced to USD 11.2 bln against 12.7 bln in April 2006. As compared with the similar month of last year the drop was 11.9%.

In April of the current year the acceleration of export growth is connected with the increase of oil export physical volumes against the background of resuming growth of world prices for oil. The volume of oil and gas condensate export from Russia in January-April 2007 was equal to 84.8 mln of tons, which is by 4.3% more than the similar figure for 2006. In April oil export from Russia was equal to 21.6 mln of tons.

The proportion of oil in the whole volume of Russian export over the four months of the current year dropped to 33% as compared with 34.9% in January-April 2006. At the same time the share of oil in fuel and energy goods increased up to 52.6% (the corresponding figure last year was equal to 50.9%). According to the data of the Federal State Statistics Service, in January-April 2007 Russia exported 52.6% of the oil produced, in April this figure was equal to 54.1%.

The maintenance of world prices for oil at high level in April 2007 is accounted for by the recovery of the trend for the growth of the demand for oil at the markets of Asia and the USA, the decrease in the stocks in the USA, the demand for the petrol growing dramatically in spring as well as geopolitical risks. Over 4

months of the current year average real export price for oil was equal to USD 58 per barrel. The price for oil grade Urals at world market was equal to USD 63.97 per barrel.



Source: Central Bank of the Russian Federation

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

Besides, the prices for export metals went up. Average monthly prices at London Metal Exchange (LME) for aluminum, copper and nickel in January-April 2007 increased as compared with the corresponding period of the last year by 13.5%, 20.5% and 2.8 times, correspondingly.

In April 2007 average monthly price for aluminum increased by 1.9% as compared with March 2007 and by 7.4% as compared with April 2006. During the month prices for aluminum stuck to the range of USD 2735- 2866 per ton. Steady high demand for this metal is observed in the world.

In April 2007 average monthly price at LME for copper increased by 20.4% as compared with March 2007 and by 21.6% as compared with April 2006. High prices for copper is accounted for by sustaining high demand for this metal from China, which consumes about quarter of the copper produced in the world, and by seasonal increase of the demand from construction enterprises.

Long-term shortage of the nickel at the market was the incentive for considerable growth in prices for this metal. Only over last year the prices tripled. On 2 January 2007 the price maximum over last 10 years was reached – USD 52375.0 per ton. The growth of quotations was supported by the expected increase consumption growth from the fast developing economies of China, India and Japan as well.

TABLE 1

Average Monthly World Prices in March of the respective year

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Oil (Brent), USD/bbl	21.32	17.22	13.92	15.72	22.97	26.26	25.81	24.79	33.5	50.6	68	68.32
Natural gas, USD /1 mln BTU		1.966	2.548	2.187	3.052	5.200	3.408	5.390	5.785	7.422	7.964	7.67
Petroleum, USD /gallon	0.707	0.455	0.378	0.391	0.808	0.999	0.814	0.855	1.152	1.603	2.016	2.13
Copper, USD/ton	2574.9	2369.7	1775.3	1539.9	1710.1	1689.4	1620.8	1598.5	2950	3395	6370	7766.5
Aluminum, USD/ton	1590.2	1554.0	1413.5	1318.0	1448.0	1493.7	1370.3	1332.8	1734	1894	2620	2814.8
Nickel, USD/ton	8053.9	7312.4	5352.5	5239.5	9657.1	6303.1	6940.6	7915.3	12872	16142	17935	50267

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

High growth rates of Russian import were promoted by significant figures of the GDP and real disposable population incomes, ruble appreciation against main currencies. According to the Ministry for Economy

Development and Trade in January-April 2007 GDP growth was equal to 7.7% to the corresponding period of 2006, being 5.4% in January-April 2006. Real disposable incomes of the population increased by 11.5% in January-April 2007 (In January-April 2006 – by 7.1%). According to the estimations of the Bank of Russia, effective ruble exchange rate lowered by 0.3%, and on the whole over January-April its appreciation was equal to 2.3%.

Moreover the decree of the Government on customs duty nullification for an extensive list of technological equipment whose analogues are not produced in Russia came into effect in May 2006. Thus, the absence of this factor in the basic period influences high import growth rates since it was developed in January-April 2007.

In the structure of Russian import in January-April 2007 as compared with January-April 2006 the proportion of machinery, equipment and transport vehicles increased from 44.1% to 48.3% due to a considerable growth of physical volumes of these goods import by 70.9%. Over the same period the proportion of metals and goods thereof increased from 7.1% to 8.4% also because of anticipating growth of physical volumes by 84.4%.

In the goods structure of import the decrease of chemistry production and rubber goods proportion occurred - from 17.4% to 14.4% - due to the decrease in prices despite the increase in physical volumes of such goods import. The decrease of the foodstuffs, agriculture raw materials and mineral products proportion took place despite the increase both in prices and physical volumes of such goods import. The monetary growth rates of foodstuffs, agriculture raw materials and mineral products were, however, behind the import growth rates of other goods groups.

The increase in the proportion of textile and textile goods, footwear import from non-CIS countries was accompanied by the decrease of these goods share in the import from CIS countries. Quite an opposite situation was observed for timber and pulp and paper goods import.

The growth of Russian import physical volume is to be noted in all main goods groups.

At the same time Russia more and more often takes strong measures to control dumping import and simultaneously the quality of import consumer goods. The import of Polish meat goods has not been allowed yet, the sale of rice and sesame from India has recently been banned, and the limitations for import fish products as well as poultry from the Czech Republic were introduced from June.

From 5 June 2007 Russia forbade import of rice, sesame and peanuts from India, which is one of the biggest rice, sesame and peanuts suppliers to the Russian Federation (about 60%). Supplies of Indian goods are also banned from the territory of other countries. Actually this ban is in effect from 1 May of the present year but goods import proceeded by the certificates issued earlier, now, however, a total ban is imposed.

The attempts to sell rice, sesame and peanuts from India, which is dangerous for consumers' health, in Russia are of traditional character. For example, in January of the current year the supplies 54 tons of peanuts, contaminated by grain stocks pests were prevented, in March pests were detected in the rice consignment of 125 tons from India. And in February the attempt to import sesame with the traces of moldiness was averted.

Federal Service for Veterinary and Phytosanitary Supervision has recently suggested to Indian party to make the procedure for each rice consignment to be accompanied by the information on pesticides used to grow and store rice, which is exported to Russia, the date of last treatment being mentioned. These suggestions were however practically rejected.

Similar measures can be taken against some other Asian countries-suppliers, but this issue is still being elaborated. The situation is however complicated by the fact that Russia as well as other G8 member countries gave foreign trade preferences for nearly 80 developing and underdeveloped countries, which are by the way WTO members in contrast to Russia. So the limitations for their export goods are fraught with the problems in WTO.

The issue of meat import from Poland to the territory of Russia remains unsolved. Veterinary services of the European Union, to which the Russian Federation appealed to assist in problem solution, responded that the solution of the problem is in the field of politics at the moment.

It should be remembered that in autumn 2005 Russia imposed limitations on meat import from Poland due to violations of veterinary and phytosanitary requirements and stated to Warsaw the list of measures to be taken for the embargo to be lifted.

In order to tackle this problem the first step was taken – from 1 May 2007 Russia allowed the import of pedigree cattle from Poland. The matter concerns animals which were born and bred in livestock breeding enterprises of Poland and certified for the export to the Russian Federations by the experts of Federal Service for Veterinary and Phytosanitary Supervision together with the representatives of Polish veterinary service.

In June 2007 Federal Service for Veterinary and Phytosanitary Supervision imposed the ban on poultry import from the Czech Republic due to discovered there bird flu. Russia used a standard procedure. It consists in the following: if Federal Service for Veterinary and Phytosanitary Supervision is informed by the International Epizootic Bureau (IEB) that a highly pathogenic bird flu appeared in some country but does not receive detailed information on this outbreak on 21st day (that is for incubation period) the import of poultry from this country is suspended. In case the detailed information is received, the import from the safe zone is allowed and the limitations for contaminated region remain.

Also from June 2007 Federal Service for Veterinary and Phytosanitary Supervision toughens considerably the conditions for fish import as well as quality control at the foreign enterprises. This is accounted for both by dumping and the quality deterioration of fish import goods. Such measures concern nearly 20 supplying country.

The proportion of import fish at the Russian consumer market exceeds 55%, in big cities far away from water fish areas being even 70-80%. Now such products should be supplied to the Russian Federation only from the enterprises certified by Russian specialists.

According to the estimations of the Federal Service of Fishing and Federal Service for Veterinary and Phytosanitary Supervision the cases of dangerous diseases detection in products supplied became more frequent. This is especially characteristic for the supplies from Asian-Pacific region. In April-May 2007 the supplies from all uncertified enterprises of Vietnam and Japan were banned. By the end of May only 15 out of 25 Vietnamese enterprises examined had passed certification successfully. The check-ups are being conducted in Norway, Iceland, Uruguay, Chili and will soon start in Argentina and China.

N.Volovik

Business and Education: New Opportunities for Interaction

The quality of specialists' professional training by higher education institutions deteriorates and the possibilities of its increase are connected with the expansion of business participation, the right for which has recently been granted by a number of recently adopted regulatory acts at the federal level.

The total expenditures of the business for social programs in Russia reached, according to some expert estimation, USD 1.5 bln: they have more than tripled since 2003. The biggest Russian corporations often invest more to the social infrastructure than their counterparts abroad. Whereas abroad the expenses of the business for social projects are 0.5-1% of the profit, in Russia they reach 38% at some companies. The reasons for this are obvious: in economically developed countries the main part of expenses for this purpose is undertaken by the government, receiving necessary funds through the tax system. Domestic business naturally wishes to see more active participation of the government in the solution of the problem for which it spends the means mentioned above.

The most important of these problems is perhaps the quality of specialists' training, graduating from the system of professional education. According to all existing now estimations, including comparable international research, it is deteriorating. As a result employers have to bear additional costs for staff training. The current situation makes the entrepreneurs to contribute funds to education: "The gap between the system of education and labor market deepens dramatically," the President of the Russian Union of Industrialists and Entrepreneurs, Alexander Shokhin, says.

The causes of specialists' training quality deterioration by Russian higher education institutions are well-known: this is virtual absence of the liaison "education-production", "education-research" as well as "research-production".

At present higher education institutions, which are the sources of fresh ideas and new technologies, cannot participate in the innovation process. According to the Civil Code of the Russian Federation, higher education institutions do not have right to handle the results of scientific and technical activity, intellectual property (inventions, developed models, production samples), sell licenses, organize small innovation enterprises.

The connection between education and science, necessity to whose strengthening has been declared for several decades, is again and again undermined by the efforts of financial department, which holds the opinion that science at higher education institutions cannot be financed by the budget funds for education, and budget funds directed for science cannot go to higher education institutions since they belong to education sector.

The liaison between science and production has not also been established over the last decades. In the environment of bad and expensive intellectual property rights protection the science refuses to give its results

over to the business, and business, which functions mainly in the environment of low level of competitiveness, the incentives for innovations are weak.

For the higher education institution these problems are complicated by the fact that over the last years the demand for their service was excess due to the mass determination of the school pupils to avoid compulsory army conscription. Correspondingly, there was a considerable interest just in entrance to a higher education institution not in the quality of education there.

At the same time, the increase of the demand for qualified specialists, the invitation from the abroad being too expensive for the prevailing majority of the companies, makes incentives for the business to influence somehow the quality of the higher education. This however was prevented and is still prevented despite some positive shifts, which will be described below, by imperfect regulatory legal environment.

The level of budget expenses for higher education being evidently insufficient, regulatory legal conditions and economic incentives for large-scale business attraction to the sphere of education are absent. It is also prevented by inefficient control system of the quality of the education from the professional society and business: legal base does not allow business participation in the formation of study plans, since the decision on how and what should be taught to students can now be adopted only by governmental institutions, which now control material and technological conditions of specialists training rather than the quality of the “finished product”, that is abilities, skills and knowledge really obtained by students. Higher education institutions, in their turn, due to the lack of the modern equipment, do not have opportunity to give the competence, required by the real sector of the economy, which restricts the possibilities for students career guidance and receipt of practical skills during the period of education. It should not be overlooked that in the higher education system the lack of highly qualified teaching staff which corresponds to the modern requirements of professional training. According to the data of the Ministry for Education and Science of the Russian Federation, the number of higher education institutions has more than tripled over the last decade and the number of tutors increased only by 4%. The reason for this is, obviously, low level of tutors’ labor remuneration, they have to work in several place, functioning in the regime of school teacher instead of increasing their qualification. As far as position of the business in this issue is concerned, up to the recent time it had been quite passive, not including the realization of the liabilities for the employees: nearly in all CIS countries business saves on labor force and its expenses for professional training vary in the range of 0.1-0.4%.

Fast commercialization of higher education, which is accounted for by its chronic under-financing, made Russian authorities give serious attention to legal status of social sphere institutions, reorganization of its financing. Three following legal acts serve these aims:

1) Federal Law “On autonomous institutions” No 174-ФЗ from 3 November 2006 which gives non-commercial organizations, including state higher education institutions, which transferred to the corresponding legal-organizational form, the right to find, earn and spend funds, including for the development;

2) Federal Law “On the procedure of formation and use of the principal capital of the non-commercial organization” (No 275 ФЗ from 30 December 2006), which formalizes the new form of non-commercial organizations financing - endowment, which provides particular mechanism for higher education institution budget fulfillment - through charity;

3) The decree of the Government of the Russian Federation “On approval of a typical concession agreement in respect to the educational institutions” (from 11 November 2006 No 671), which enables private practice to make direct investments in such institutions.

Since the consequences of the former fulfillment were analyzed in detail in year review by the IET for 2006, in this paper the opportunities created by second and third of the acts mentioned will be considered. Theoretically the legislation that existed before these amendments enabled the creation of such funds. However under old tax regime endowment was not efficient as it suggested double taxation: at first philanthropist invested funds from its own profit and paid taxes for them then non-commercial organization was levied with tax on the profit from the assets of the fund investment profit. The main feature of the new law is that non-commercial organization is exempted from taxes both on the profit received from endowment and from the tax on the very contributions. At the same time there are still no privileges for contributors. Simultaneously the law underlines that target capital is formed only by the contributions from the philanthropists in the form of monetary funds, investments in natural terms like buildings and equipment are not allowed.

Profit received from the investment of fund assets is used for charity activity financing according to the requirements of contributors, who are endowment founders. The receiver of the funds from the endowment can only be institutions and organizations of education, science, health care, social security, culture, arts and archiving. The control of endowment activity is carried out by so-called board on target capital use, which consists of the contributors representatives, funds receivers, society. The minimum period for which target capital is formed is 10 years, minimum amount of the target capital is RUR 3 mln.

The law accounts for considerable conservatism of the investment strategies, limitations for investment objects are similar to pension funds (minimization of risks and profit can frighten off the philanthropists). It allows for funds to be invested in Russian stocks and shares, but not in Russian unit investment trusts. As a result at present endowments are formed at the organizations of the federal level – MGIMO, Moscow School of Management Skolkovo, Pushkin Museum of Fine Arts and some other big universities and schools.

At present concession does not give investors any additional commercial or legal rights, does not give any additional protection of the interest in comparison with other institutions and the question of particular benefits of it for entrepreneurs' community is still open. From our point of view, efficient development of concessions in the field of education is not possible without legal base development, which will enable business to fulfill its projects efficiently in the sphere, which does not contradict the interest of educational system development.

Thus, despite new regulatory acts do make certain contribution to the change of the situation in the education field, for instance to the increase of quality of the education, they hardly will be able to change it dramatically.

I. Rozhdestvenskaya

On Financing of Preventive Measures and Fight against HIV/AIDS in Russia in 2006–2007¹¹

In 2006 in the Russian Federation the expenditures of RUR 4.56 bln were envisaged to prevent and fight AIDS, including RUR 872.1 mln of international grant funds and external loans (19.1% of the total expenditures). The main part of federal expenditures was formed by the measures taking place within the framework of the national project "Health" framework (RUR 3.1 bln).

It should also be noted that funds envisaged to accomplish the measures to prevent and fight AIDS in the framework of subprogram "AntiHIV/AIDS" of the Federal Target Program "Prevention and fight against the diseases of social nature (2002-2006)" in the Federal budget does not correspond to initially stated parameters. For example, in the approved by the Decree of the Government No 790 from 13.11.2001 Federal Target Program it was the measures for AIDS prevention, diagnosis and treatment that had the main proportion (88% of subprogram expenditures, *table 1*), while in the budget of 2006 it is the construction that holds the first place (55% of subprogram expenditures).

Thus, the year 2006 was the first in the Russian Federation characterized by such a large-scale financial injections into the cause of AIDS fight. Nevertheless, as it is shown in *table 2*, there are considerable differences in the financing priorities by main directions – prevention, treatment, research and development and construction.

As it is shown in *Table 2*, up to 73% off-budget funds are spent on prevention, while in the framework of the Federal Target Program only 29.2% (RUR 56.8 mln) is spent for prevention. In real terms the state of affairs is better while considering national project "Health" (RUR 1.5 bln, including measures for hepatitis B and C prevention), in relative terms the proportion of these expenditures in the National project is below the half – 48.4%. Such a situation is in many respects caused by the absence of the state strategy, directed to preventing measures necessary in connection with AIDS patients' treatment. It turns out that budget funds are directed towards fight with the consequence and not with causes of such a dangerous phenomenon as immunodeficiency virus.

Besides, an important factor is the regional differences in budget funds distribution. Despite the fact that the main part of the funds in regional budgets is spent for prevention, the level of such expenditures is critically low as compared with the volume, which is necessary to solve the problem of infection threat. The federal budget funds are received mainly by the regions where the critical number of HIV infected people is registered, the regions, where the registered number of people infected by HIV is not that big remaining aside. But if the strategy of treatment instead of prevention will be continued then soon considerably bigger funds will be needed to treat the patients in those regions of the Russian Federation, where there is still a chance to prevent the growth in patients' number.

The solution of even more ambitious problems is envisaged in the federal budget for 2007. For instance, the total sum of federal means for AIDS prevention and fight is suggested to be RUR 8.15bln, which is by nearly 2.5 times higher than in 2006 (*table 3*). According to the Federal Target Program "Prevention and

¹¹ Paper was prepared with the assistance of Non-Governmental Organization "Trans-Atlantic Partners against AIDS"

Fight against the Socially Important Diseases for 2007-2011”¹² the increase of expenditures for subprogram “AntiHIV/AIDS” will be equal to 80%, including capital investments of 112%.

The financing of the measures in this field at the expense of international sources will be continued in 2007. In total international grants and loans, directed to the measures of AIDS fighting and prevention will be equal to USD 34.9 mln in 2007, which corresponds to 11.5% from the volume of the Federal Budget funds for HIV/AIDS counteraction.

Another important constituent of the government policy in the field of AIDS fighting is the subprogram “Anti-HIV/AIDS ” of the Federal Target Program, which was mentioned above.

The aim of the subprogram “Anti-HIV/AIDS” is to decrease the number of the observed HIV-infected pregnant women, who are included in the program of vertical HIV transmission prevention, and the increase in the proportion of domestically produced medicines in the total volume of antiretrovirus medicines purchase.

Subprogram tasks:

- development of HIV distribution prevention methods;
- development of diagnostics, treatment and rehabilitation of HIV-infected patients;
- the decrease of death rate among HIV-infected patients, development and application of domestically produced antiretrovirus medicines; construction and reconstruction of the buildings and installations;
- special medical institutions, their equipment with modern medical and technological equipment.

The indices of “Anti-HIV/AIDS” subprogram estimation are shown in *table 4*. At the same time there is practically no obvious connection between the proposed target indices and program financing. According to the directions of subprogram expenditures it is not clear how to achieve the indices mentioned.

The volume of subprogram funding at the expense of Federal Budget in 2007-2011 will be equal to RUR 4 853.4 mln, including RUR 370.2 mln in 2007. The volume of subprogram financing by the direction of “capital investments” at the expense of the Federal Budget in 2007-2011 will be more than RUR 4180.7 mln, including RUR 809.1 mln in 2007-2009.

In 2007 the total volume of planned sights construction and reconstructions is RUR 480.4 mln, including RUR 249.4 mln for federal objects; RUR 210 mln for the sights of the Russian Federation subjects.

The volume of the subprogram financing at the expense of the Federal Budget in 2007-2011 by the direction of “other needs”, which include the measures for HIV/AIDS prevention, diagnostics and treatment improvement, development of information monitoring and estimation system will be equal to RUR 530.1 mln, including RUR 95.2 mln in 2007.

As risks of budget policy in the field of HIV/AIDS counteraction it should be noted that in the light of the steps to reduce the international assistance to fight AIDS announced at G8 summit, the share of international resources might be decreased, which will primarily affect the preventive and explanatory measures, which are fulfilled mainly at the expense of international organizations.

Table 1

**Financing of Preventive Measures and Fight against HIV/AIDS
in the Russian Federation in 2006**

Source of Financing	2006 (according to the approved Federal Target Pro- gram) ¹³	2006 (in the Federal Budget) ¹⁴	%
Subprogram “AntiHIV/AIDS”			
Total, RUR mln.:	147,25	194,5	132,0
Including:			
Illness prevention, diagnosis, treatment, which is caused by human immunodeficiency virus, staff training, RUR mln	122,8	70,5	57,4
Research and Development work, RUR mln.	13,75	16,1	150,5
Construction, RUR mln	10,7	107,9	784

¹² Approved by the Government Decree from 10 May 2007 No 280.

¹³ Decree of the Government of the Russian Federation No 790 from 13 November 2001 (with the amendments made by the order of the Government of the Russian Federation from 21.10.2004 No 1355-p) “On Federal Target Program “Prevention and fight with the illnesses of social nature (2002 - 2006)”..

¹⁴ Federal Law from 26.12.2005 No 189-Ф3 (ed. from 26.07.2006) "On Federal Budget for 2006" (adopted by the State Duma Federal Assembly of the Russian Federation on 07.12.2005).

Table 2.

Distribution of Expenditures to Finance the Measures to Prevent and Fight against HIV/AIDS in the Russian Federation in 2006 by the sources of funding

Source of funding	Total		Prevention		Treatment		R&D		Construction	
	real	%	real	%	real		real	%	real	%
Federal Target Program "Prevention and fight against the diseases of social nature (2002-2006)", RUR mln	194,5	100	56,8	29,2	13,7	7	16,1	8,3	107,9	55,4
National priority project "Health", RUR mln:	3 100	100	1 500 ¹⁵	48,4	1 600 ¹⁶	51,6	---	---	---	---
Budgets of the Russian Federation subjects, RUR mln.	393,7	100	380,9	96,7	12,78 ¹⁷	3,3	---	---	---	---
Off-budget sources, USD mln										
Total:	32,3	100	23,8	73,7	7,9	24,5	0,6	1,8	---	---
Займ МБРР ¹⁸	13,6	100	13,6	100	---	---	---	---	---	---
Проект Глобус ¹⁹	5,9	100	4,7	79,7	1,2	2	---	---	---	---
Проект Глобального фонда ²⁰	12,8	100	5,5	43	6,7	52,34	0,6	4,7	---	---
Итого, млн. руб. (1\$ = 27 руб.)	4 560,3	100	2 580,3	56,6	1 839,8	40,3	32,3	0,7	107,9	2,4

Table 3.

Distribution of expenditures to finance the measures to prevent and fight HIV/AIDS in the Russian Federation in 2007 by the sources of funding

Source of funding	Total		Prevention		Treatment		R&D		Construction	
	real	%	real	%	real	real	%	real	%	real
Federal Target Program "Prevention and fight with the illnesses of social nature (2002-2006)", RUR mln	350,2	100	13,7	3,9	81,5	23,3	25,6	7,3	229,4	65,5
National priority project "Health", RUR mln.:	7 800	100	4 600	59	3 200	41	---	---	---	---
Budgets of the Russian Federation subjects, RUR mln.	710	100	500	70,4	---	---	---	---	210	29,6
Off-budget sources, USD mln										
Total:	34,9	100	18,6	53,3	15,4	44,1	0,9	2,6	---	---
IBRD loan ²¹	13,6	100	13,6	100	---	---	---	---	---	---
Global fund project ²²	21,3	100	5	23,5	15,4	72,3	0,9	4,2	---	---
Total, RUR mln (1USD = 27 RUR)	9 802,5	100	5 615,9	57,3	3 697,3	37,7	49,9	0,5	439,4	4,5

¹⁵ Centralized purchase of diagnostic tools to prevent, detect infected by the human immunodeficiency virus and B, C hepatitis. Funds go through the Federal Agency for Health Care and Social Development. Measures to prevent HIV-infection, hepatitis B, C. Funds go through the Federal Supervision Service for Consumer's Right Protection and People Welfare.

¹⁶ Centralized purchase of antiretrovirus medicines to treat infected by the human immunodeficiency virus. Funds go through the Federal Agency for Health Care and Social Development.

¹⁷ Strengthening of material and technical base of the centers for AIDS prevention and fighting.

¹⁸ According to the project "Tuberculosis and AIDS prevention, diagnostic and treatment" No 4687-0-RU.

¹⁹ Programm donation agreement between the global fund to fight AIDS, tuberculosis and malaria and the Open Health Institute. RUS-304-G01-H, 23.08.2004.

http://www.theglobalfund.org/search/docs/3RUSH_706_251_ga.pdf

²⁰ Programm grant agreement between the Global fund and the Russian Health care foundation. RUS-405-G03-H. 20.09.2005. http://www.theglobalfund.org/search/docs/4RUSH_810_0_ga.pdf

²¹ According to the project "Tuberculosis and AIDS prevention, diagnostics and treatment" No 4687-0-RU.

²² Programm grant agreement between the Global fund and the Russian Health care foundation. RUS-405-G03-H. 20.09.2005. http://www.theglobalfund.org/search/docs/4RUSH_810_0_ga.pdf

Table 4.

Target Indices of “AntiHIV/AIDS” subprogram

Index name	Units	Basic figures (2005)	The dynamics of target indices by the years				
			2007	2008	2009	2010	2011
Annual number of newly registered HIV infection cases	чел.	37700	35000	34000	33000	32000	31000
Coverage of HIV- infected pregnant women, included in the program of vertical HIV infection transfer prevention	%.	75	80	90	95	98	98

M. Gladkov

The public sector of the Russian economy in 2005 through 2007: the dynamics of quantitative characteristics and trends of development

In quantitative terms, the period from 2005 through 2006 was characterized by the further shrinking of the public sector and its main components²³: federal state owned unitary enterprises (FSUE) and joint stock companies (JSC), shares in which are in federal ownership (see Table 1).

Table 1

The dynamics of the number of federal state owned unitary enterprises and joint stock companies, shares of which are in federal ownership in 2003 through 2007

Category of entities	As on June 1, 2003, entities	As on June 1, 2004, entities	As on June 1, 2005, entities	As on June 1, 2006, entities	As on January 1, 2007		
					entities	In % of the number as on June 1, 2005	In % of the number as on June 1, 2003
FSUE	9860	9222	8293	7178	6533	78,8	66,3
JSC	4205	3905	3783	3724	3997	105,7	95,0
Of which with the share of RF							
- up to 25%	2148	1950	1544	1063	1063	68,8	49,5
- 25 to 50%	1339	1183	1093	885	...	81,0*	66,1**
- 50 to 100%	600	499	474	397	...	83,8*	66,2**
- 100%	118	273	413	1136	...	275,1*	962,7**
- with the “golden share”	259***	243***	243***	93,8	...

* - in % of the number of entities as on June 1, 2005, as on June 1, 2006;

** - in % of the number of entities as on June 1, 2003, as on June 1, 2006;

*** - open joint stock companies where the special right “golden share” is exercised although no blocks of shares are in state ownership.

As it follows from the data presented in Table 1, over one and half years (from the middle of 2005 till early 2007), the number of FSUE diminished by more than 21 per cent, whereas in the period from the middle of 2003 it declined by more than one third. Different trends were observed with respect to the dynamics of the number of joint stock companies, shares in which were in federal ownership. As in early 2007, the

²³ Proceeding from the definition of the public sector as contained in the Resolution of the RF Government of 1999, it includes federal and regional unitary enterprises and institutions, the business entities, in the authorized capitals of which more than 50 per cent of stocks (shares) are in the state ownership, as well as the business entities, in the authorized capitals of which more than 50 per cent of stocks (shares) are in the ownership of business entities belonging to the public sector, i. e. the entities, where the share of the state in the authorized capitals exceeds 50 per cent. However, in the Forecast privatization plans (programs) concerning federal property only the information on the number of federal state owned unitary enterprises and all joint stock companies, shares in which are in the federal ownership (including those outside the public sector due to the fact that in these companies the share of the state is less than 50 per cent) is published on the regular basis.

number of such companies was just by 5 per cent below the figures registered in the middle of 2003 and increased by almost 6 per cent in comparison with the figure observed in the middle of 2005. Therefore, the data presented above permit to assert that the process of decline in the number of FSUE has accelerated over the last years, including the decrease in the number of FSUE resulting from a growing scale of conversion of such enterprises into joint stock companies. Needless to say that it should be borne in mind that the number of unitary enterprises decreased not only due to their conversion into joint stock companies, but also because of liquidation and consolidation thereof. However, the rates of sales of federally owned blocks of shares have been apparently lagging behind the rates of conversion of unitary enterprises into joint stock companies, the evidence of which is the increasing number of joint stock companies with federally owned blocks of shares registered by the beginning of 2007 as compared with the figures observed in the middle of 2005.

The changes having occurred in the sub-sector of joint stock companies, shares in the capitals of which are in the state ownership, should be discussed in more detail.

As it follows from the data presented in *Table 1*, the period from June 1, 2005, and June 1, 2006, was marked by a radical change in the structure of federally owned blocks of shares resulting in an increase in the specific weight of the joint stock companies, where the sizes of blocks of shares being in federal ownership permitted the state to have the decisive managerial influence on the operations of such companies. Over this period of time, there occurred a sharp (almost by 2.8 times) increase in the total number of the joint stock companies, where 100 per cent of shares are in the federal ownership, what is apparently evidence of a significant acceleration of the process of conversion of FSUE into joint stock companies. On the contrary, since that time the number of all other joint stock companies, where the sizes of federally owned blocks of shares are below 100 per cent, has been declining. An especially significant decrease (by almost one third) was observed with respect to the number of joint stock companies with minority (up to 25 per cent of capital) federally owned blocks of shares, whereas the decline in the number of joint stock companies with blocking (from 25 per cent to 50 per cent minus one share), and controlling (from 50 per cent to 100 per cent minus one share) blocks of shares turned out to be more modest (by 19 per cent and 16 per cent respectively).

As a result, as on June 1, 2006, the structure of the massive of the federally owned blocks of shares (without taking into account the joint stock companies, where the special right “golden share” was exercised without any shares being in the ownership of the state) was as follows: blocks of shares at or below 25 per cent of capital made just more than 30 per cent of the total number of joint stock companies, where the state owned a share and the blocks of shares of blocking size (from 25 per cent to 50 per cent of capital) were registered in about one fourth of the total number of joint stock companies, whereas at 44 per cent of joint stock companies the state was able to have the majority control – it should be noted that the share of the joint stock companies, where 100 per cent of capital were in the federal ownership (32.6 per cent), was two times above the share of the joint stock companies, where the state, being the majority shareholder, had less than 100 per cent of shares (11.4 per cent). In comparison with the figures registered as on June 1, 2005, there was observed a significant increase in the specific weight of joint stock companies, where all shares were in the federal ownership, whereas the specific weight of all other categories of joint stock companies with federally owned blocks of shares of various sizes has declined.

Having compared the structure of federally owned blocks of shares as broken by the sizes of the state shares in the authorized capitals of joint stock companies, which has formed by the middle of 2006, with the structure the RF Ministry of Property Relations expected to be formed after the completion of implementation of the privatization program of 2003, the conclusion may be derived that the planned figures were achieved with more than 2 year delay. Thus, it was planned to reduce the share of minority blocks of stocks to 36 per cent (in fact, this figure made 30.5 per cent) and blocking interests to 22 per cent (in fact, this figure made 25.4 per cent). The share of 100 per cent blocks of shares should make 30 per cent (in fact, this figure made 32.6 per cent). The expected share of controlling interests (12 per cent) was practically equal to the actual figures registered in the middle of 2006 (11.4 per cent). Therefore, the state could overcome the noticeable prevalence of the specific weight of blocks of shares not able to ensure the due degree of control over joint stock companies on the part of the state inherited from the period of cash privatization taking place in the late 1990s, whereas the share of minority blocks of shares turned out to be even less than expected by the beginning of 2004. In the middle of 2006, the absolute number of joint stock companies with federally owned blocks of shares was about equal to the figures forecasted to be observed after the completion of implementation of the privatization program of 2003.

Since recently, the development of the public sector of the Russian economy has been characterized by the following major trends.

In 2006, there was observed a certain decline in the activity of state owned companies on the market of mergers and acquisitions as compared with the situation existing there two years earlier. The most significant development on the market was the purchase of 66 per cent in the leading producer of titanium (30 per cent of the world production) and magnesium metal joint stock company VSMPO-Avisma (the amount of the transaction was US \$ 700 million) by the FSUE Rosoboronexport in the autumn of 2006. This transaction overshadowed the acquisition of controlling interest in the electrical machine building plant LEPSE (situated in the town of Kirov), one of the largest Russian enterprises engaged in production of electrical equipment for the defense and motor industries, by the United Industrial Corporation Oboronprom, the largest shareholders in which are the state and Rosoboronexport.

However, state owned companies have compensated the drop in their activity in this aspect with consolidation of their positions in other spheres.

First of all, there should be noted the rather successful IPO carried out by Rosneft (July of 2006) and Sberbank of Russia (February and March of 2007), as well as similar activities the Vneshtorgbank is carrying out at present. The same path may be chosen by the company ALROSA, the Russian diamond monopolist, Sovkomflot, and, possibly, subsidiary structures of Rosoboronexport (in the case the latter is reorganized as the parent management company); however, the time horizon of implementation of these plans is, probably, outside the limits of the current year.

Special attention should be paid to Gazprom, which at the end of 2006 announced about the launch of its independent (without participation of foreign capital) development of the Shtokman natural gas field in the Barents sea and purchased 50 per cent plus one share in the company Sakhalin Energy, being the operator of the production sharing agreement (PSA) concerning Sakhalin – 2 project for US \$ 7.45 billion. This transaction resulted in a decline in the shares of original partners in the project: the share of Shell should decrease from 55 per cent to 27.5 per cent, the share of Mitsui should decline from 25 per cent to 12.5 per cent, whereas the share of Mitsubishi should decrease from 20 per cent to 10 per cent. Gazprom takes part in the purchase of shares in electrical power companies placed in the framework of additional issues having place in the course of restructuring of the RAO UES of Russia (including Mosenergo), and also is going to invest in the coal industry (in the course of implementation of its joint project with the company SUEK). Besides, in 2006 Gazprom acquired a block of shares in the company of the independent natural gas operator Novatek (19.9 per cent), whereas Gazprombank purchased the controlling interest in the company Sibneftegaz.

Such property policies of the state as the integration of earlier scattered assets and bringing of the share of the state in the structure of equity capitals of certain companies to the size of controlling interest were pursued further.

In this connection there should be noted the achievement of a preliminary agreement between the federal center and the Republic of Sakha (Yakutia) as concerns the contribution of the property complex of the PNO Yakutalmaz, which was transferred into federal ownership, in the authorized capital of the company ALROSA with the view to repay the additional issue of shares permitting to increase the federally owned block of shares up to the controlling interest of 51 per cent. It should be reminded that earlier the complex Yakutalmaz was in the ownership of the Republic and was leased to the company ALROSA, thus ensuring a significant share of revenues of the regional budget. As a compensation, the Republic of Sakha (Yakutia), as well as the Arkhangelsk oblast and the Primorsky krai should receive in full the amount of the tax on extraction of natural diamonds (earlier, 40 per cent of revenues generated by this tax were due to transfer to the federal budget). The increase in the budget revenues generated by the taxes on profits, property, and dividends on the block of shares being in the ownership of the Republic (40 per cent taking into account the shares of several uluses (districts)) should help to compensate the decline in the revenues of the Republic's budget. At the same time, a block of shares in the company was consolidated by the Vneshtorgbank.

The state policy aimed at the creation of integrated structures has in fact begun to affect the whole industries of the Russian economy. As a most noticeable development in this sphere there may be mentioned the establishment of the United Aircraft Manufacturing Company (UAMC), which integrated state and private assets of the Russian aircraft manufacturers in February of 2007. In the same tideway, there are plans to create in the second half of 2007 yet another new state corporation "Bank of external economic activities and development of the Russian Federation" with the authorized capital amounting to Rub. 70 billion on the base of reorganized Vneshekonombank and taken over Roseksimbank and the Russian Bank of Development.

After a draft law permitting to create a new large state company on the base of assets of the civilian part of the Russian nuclear industry was approved in the early 2007, in April the RF President's decree finalized the scheme in accordance with which there should be reorganized the nuclear industry. As it has been planned earlier, already in 2007 in the industry will be created the holding Atomenergoprom (AEP), in the authorized capital of which there will be contributed shares in 55 federal state owned unitary enterprises

after these enterprises pass through the state of conversion into joint stock companies. In its turn, the AEP, similarly to the nuclear weapons complex, the complex of nuclear and radiation safety and fundamental scientific research should be managed by the corporation Rosatom, which should be created in 2008. The status of this corporation should be determined by a special law, it is expected that it should in many aspects be similar to the status of a not-for-profit organization. Rosatom should only manage the assets, but have no ownership rights with respect to these assets. As concerns the access of private investors in the nuclear industry, it is planned that such an access should be granted only at the state of extraction of uranium in the amount below the blocking interest.

Already in 2007, there was announced the establishment of the United ship building corporation, the merger of Transneft and Transneftprodukt, all 100 per cent of shares in which should be contributed to the authorized capital of Transneft as a payment for the additional issue of shares. In a similar way, the increase in the authorized capital of the open joint stock company Sovkomflot will be paid with the federally owned block of shares in the open joint stock company Novoship (Novorossiysk Shipping Company) (50.34 per cent). As a result, these two companies will merge and in the future the conversion to a single share is possible.

On the basis of merging of state and private assets of 5 air companies being the members of the Air Union alliance there is created the third largest air carrier in the country – the open joint stock company AirUnion. The contribution of the state should be its blocks of shares in the Krasnoyarsk Airlines (51 per cent), Domodedovo Airlines (50.04 per cent) and Air Company Samara (46.5 per cent). It should be noted that in contradistinction to the majority of holdings created over the recent years, the state may receive no controlling interest in the capital of this newly created structure and rest content with the minimal share of 45 per cent only; however, the final proportions of shares distribution should be determined later.

The trend towards an active property expansion of natural monopolies (Gazprom and RAO UES of Russia), which had become noticeable over the last two years, was continued as by the beginning of 2007 there were made public the intention of RZhD to obtain the blocking interests in the sea ports of Ust Luga and Novorossiysk, its interest in purchase of shares in sea ports of Vladivostok and Nakhodka, the information that RZhD may sell its blocking interest in Transmashholding (TMKh), which is the largest company engaged in railroad mechanical engineering in the country controlling many enterprises involved in this business.

The significant changes observed in 2006 and the first quarter of 2007 in the list of strategic enterprises and joint stock companies were in many cases related exactly to the formation of integrated structures, both in the aspect of withdrawal of the companies to be included in such structures, and the entering of newly created holdings in this list (for instance, the United Industrial Corporation Oboronprom, which consolidated the domestic helicopter industry, and UAMC).

The most important legal innovations concerning the public sector were the changes in and amendments to the law on privatization of 2001, as well as the long expected formalization of state's approaches to the pursuance of dividend policies in joint stock companies, shares in which are in federal ownership, via the adoption of a special regulatory act.

Changes in and amendments to law No. 155 FZ of July 27, 2006, "On privatization of state and municipally owned property" being currently in force are aimed at the regulation of the procedures governing the increases in the authorized capitals of open joint stock companies created in the process of privatization, where the shares of the state or municipal entities make 25 per cent or more. The previous version of the law permitted to increase authorized capitals of such companies by additional issues of shares only on the condition that the state or municipal entities retained their shares in these organizations.

The new version of the law on privatization (article 40) defined a whole range of state bodies (the RF President, the RF Government, authorities of the RF subjects, local governments) having the right to take decisions concerning the possibilities of increases in authorized capitals resulting in declines in the shares of the state (regions, municipal entities).

However, even the new version of the law permits to use this procedure only on the condition that the state (region, municipal entity) retains its share in the following amounts:

- not less than 25 per cent plus one share carrying voting rights in the case on the date a decision on new issue of shares was taken the share of the state authorities permitted to have from 25 per cent to 50 per cent of the total number of votes at the general meeting of shareholders;

- not less than 50 per cent plus one share carrying voting rights in the case on the date a decision on new issue of shares was taken the share of the state authorities permitted to have more than 50 per cent of the total number of votes at the general meeting of shareholders.

In the case companies are on the list of strategic joint stock companies, any decision on additional issue of shares may be taken only by the RF President.

State authorities are also vested with the right to determine the size of the share of the state in the authorized capital in the course of the placement of shares by the way of public offering and listing of such shares by a stock exchange, as well as the placement of shares outside the territory of the Russian Federation, including the placement, in accordance with foreign laws, of securities issued by foreign issuers, which certify the rights with respect to shares in open joint stock companies. In the general case, if the state (a region, a municipal entity) has a share in the capital of an open joint stock company ensuring more than 25 per cent of votes at the general meeting of shareholders, such a decision should be taken by the RF Government, an authority of the RF subject, or a local government, whereas in the case such companies are put on the list of strategic joint stock companies the respective decision should be taken by the RF President.

On the face of it, this scheme appears to be rather flexible as it combines the granting to joint stock companies with state owned blocks of shares an option to attract investments with the meeting of requirements of property control on the part of authorities. However, only future practices can show how feasible and adequate this tool box is. The previous experience provides evidence that in the situations, where problems exist as concerns enforcement of corporate law, exactly the high concentration of shares is viewed by the Russian business as the most acceptable guarantee against risks pertaining to investments in different companies. This circumstance renders the possibility of attraction of new investors via additional issues of shares rather improbable until the authorities are large shareholders, although it is rather probable with respect to certain attractive companies having some advantages or unique resources. There are also certain risks pertaining to the involvement of the state in economic activities, such as inadequate skills of public servants, insufficient incentives for them, and possibilities to derive rent from such situations.

After several years of discussion, the state has at last formalized its approach to the dividend policies with respect to joint stock companies, shares in which are in the federal ownership, in the format of a regulatory act. Resolution of the RF Government No. 774 – r of May 29, 2006, contains a direct instruction to the executive authorities to be guided by following the stipulations in the course of formation of the position of a shareholder in such companies with respect to the issues pertaining to the payment of dividends:

- determination of the fixed minimum share in the net profits of the joint stock company allocated for the payment of dividends;
- allocation of the net profits not directed for financing of investment projects and other purposes for the payment of dividends;
- ensuring that investment projects answered the requirements of profitability established at the respective joint stock companies;
- use of indicators of aggregate (consolidated) reporting in the course of determination of the amount of dividends at the joint stock companies having subsidiary structure.

This document has determined a whole range of positions, from which executive authorities should proceed in order to form their positions on behalf of the state being a shareholder in joint stock companies.

Assessing this document, it should be noted that its main principles base on the approaches to the dividend policies, which have been already made public by the RF Ministry of Economic Development and Trade (and earlier by the RF Ministry of Property Relations). The actual efficiency of this act will to a great degree depend on the substance of the methodological recommendations concerning the determination of the positions taken by the Russian Federation as a shareholder in joint stock companies with respect to the issues pertaining to the payment of dividends, which should be developed and approved by the RF Ministry of Economic Development and Trade.

On the whole, in 2006 the sphere of property relations was characterized by the persistence of trends having become perceptible over the last two years, although less pronounced than over that period. Given the present shrinking of the public sector manifested via the decline in the number of unitary enterprises and joint stock companies, where the state has a share in capital, it grows in scope and depth at the expense of the increasing scale of economic activities, including the growth via the branching network of subsidiaries and dependent companies. At the same time, the considerations of efficiency require that the state presence in the economy as concerns the aspect of property relations should be brought in accordance with the real and rather limited managerial capabilities of the state.

G. Malginov, A. Radygin

Issues, Discussed at the Meeting of the Government of the Russian Federation held on 7, 14 and 21 June 2007

The following most important issues were discussed at the meetings of the Government of the Russian Federation in June 2007: the process of Federal Target Program fulfillment and realization of the Federal Targeted Investment Program over 1 quarter 2007; measures directed towards development of the motor roads net development in the Russian Federation, including improvement of road-building financing; result and main directions of the Federal Tax Service functioning for 2008-2010; criteria of tax institutions efficiency estimations; fulfillment of the Fund for Social Insurance of the Russian Federation budget over 2006.

On **7 June** at the meeting of the Government of the Russian Federation the results of the Federal Target Programs fulfillment and Federal Targeted Investment Program realization over 1 quarter 2007 were discussed. It should be noted that in 2007 the decrease in the number of Federal Target Programs is observed. Thus, in 2007 26 Federal Target Programs and 36 subprograms that are included in the open part of the federal budget are being fulfilled. For reference, in 2006 there were 51 Federal Target Programs and 50 subprograms that were accomplished. On summarizing the results of the Federal Target Programs the fulfillment of the following programs was acknowledged to be ineffective: “Economy and Social Sphere of the Chechen Republic recovery (2002 and following years)” (Ministry for Regional Development of the Russian Federation); “Economic and Social Development of the Far East and Transbaikalia for 1996-2005 and up to 2010” (Ministry for Regional Development of the Russian Federation); “Social support of the disabled for 2006-2010” (Ministry for Health Care and Social Development) etc.

At the same meeting of the Government of the Russian Federation the analysis of the fulfillment process of the Federal Target Programs in the line of “R&D” was considered as well as the main results reached in the process of individual Federal Target Programs fulfillment.

On **14 June** at the meeting of the Government of the Russian Federation the report by the Minister of Transportation of the Russian Federation “On measures directed for the development of motor roads in the Russian Federation, including the improvement of road sector financing” was heard²⁴.

According to the report the reform of the road sector is to proceed in two steps.

The first stage of the reform is to be fulfilled during 2008-2009. During this stage the regulatory legal base for road sector reform, for instance, should be developed and the conditions for market environment development in the field of motor roads maintenance should be created, the mechanisms of state-private partnership should be perfected. It is expected that as a result of the first stage the conditions for steady financing of the sector in necessary volumes will be created.

The second stage of the reform is scheduled for 2010-2015. At this stage it is planned to complete the reform of road sector institutions, formation of the competitive environment in those fields of actions where possible. As a result structure transformations in the sector will be mainly conducted; the conditions for large-scale investments attraction will be developed. The system of steady financing of the road sector will be created, the system of government order placement will be optimized, the formation of competitive environment in road sector will be finished.

The main principle of road sector reform – that of paying for federal roads usage - is ventilated in the Report. Earnings from customs duties for import cars, spare parts for them and tires, as well as part of insurance companies profit for motor third-party liability insurance can also serve as possible additional sources of financing.

In order to attract funds necessary for federal roads net maintenance and development the payment for federal roads from freight motor vehicles of more than 12 tons should be introduced as an additional source of non-tax earnings.

The main principle of off-budget funds attraction to the field of road facilities construction and reconstruction should be guaranteed repayment of the invested funds to the investor and sufficient profit rate due to the paid facility operation, which was constructed with total or partial participation of the investment funds, as well as economic interest of the society, government and investor in the corresponding project fulfillment. The newly introduced mechanisms of such projects co-financing by the government are the means of the investment fund.

²⁴ The report of the Minister of the Transport of the Russian Federation I. E. Levitin at the meeting of the Government of the Russian Federation on the issue “On measures directed for the development of motor roads in the Russian Federation, including the improvement of road sector financing” http://www.mintrans.ru/prensa/Levitin_14062007.htm

The spreading of the practice for their paid usage introduction should become an additional funding source for existing roads maintenance. The transfer of the road, equipped for the payment to be levied, should be possible. At the same time the condition for receipt of the road for the exploitation should be the liability of the private enterprise to invest into construction or reconstruction of some part of the road of the established volume of funds, necessary for its creation and following paid exploitation. So the motor road net development process will be secured.

The long-term concession agreements, concluded according to the Federal Law "On concession agreements" are supposed to be the main form of such projects fulfillment.

As a result of the report discussion The Ministry of the Transportation, The Ministry of Finance, Ministry of Economic Development and Trade, Ministry of the Regions with the participation of executive authorities concerned are commissioned with the development, according to the earlier orders of the President of the Russian Federation and the Government of the Russian Federation, of the project of the Federal Target Program "Development of Russian transportation system 2010-2015". During development of the program mentioned the subprogram of motor roads development in the Russian Federation for the period of 2010-2015 should be envisaged.

On **21 June** at the meeting of the Government of the Russian Federation the report of the chairman of the Fund for Social Insurance "On fulfillment of the budget of the Federal Social Insurance Fund of the Russian Federation for 2006" among other issues.

According to the report the Fund of the Social Insurance accomplished the budget execution in 2006 in accordance with the Federal Law "On the budget of the Fund of the Social Insurance Fund of the Russian Federation in 2006" as well as in accordance with the Federal Law "On making amendments to the Federal Law "On Federal Budget in 2006", which envisaged the increase of transfer volumes, which were passed to the Fund for the supply of the disabled by means of rehabilitation, including production and mending of prosthetic and orthopedic devices for the sum of RUR 150.0 mln.

It is stated that in 2006 the indices of budget execution improved as compared with the corresponding figures of the previous year both in the part of the formation of revenue items and its expense liabilities. At the same time it is noted that the high level of collection of insurance premiums is the result of the effective work to levy insurers' debts. In 2006 the debts on the compulsory social insurance against accidents at production and professional illnesses reduced by RUR 1411.3 mln, including the decrease of post-due debt by RUR 1124.3 mln.

Overfulfillment of the taxes from the unified social tax, taking into account all received penalty fees and fines, is accounted for by the rise of RUR 290.0 bln or by 5% of the existing labor remuneration fund in 2006 as compared with the one used during planning. At the same time effective tax rate of the unified social tax was equal to 2.44% in 2006.

The conclusion is drawn in the report that in 2006 the Fund secured the fulfillment of the social insurance liabilities, which were entrusted to it, and all governmental functions, which were delegated to the Fund.

As a result of report discussion the Government of the Russian Federation approved the project of the Federal Law "On fulfillment the budget of the Social Insurance Fund of the Russian Federation in 2006", which was presented together with the report.

M. Goldin

A review of budget legislation introduced in June of 2007

In June of 2007, the following significant changes were registered in the sphere of budget legislation: there was approved the mechanism of distribution of financial resources received from the open joint stock company Oil Company YUKOS as a repayment of its debt to the budget among the tiers of the budget system of the Russian Federation; there were made amendments to the procedures governing the use of the budget classification of the Russian Federation earlier approved by an order issued by the RF Finance Ministry; the RF Finance Ministry approved the instruction determining the procedures governing the carrying out audits and inspections by the Federal Service for Financial and Budgetary Supervision; the Federal Treasury issued an order, which ensured the vesting of powers pertaining to the exercise of the functions of the administrator of revenues of the budgets of the budgetary system of the Russian Federation in the agencies of the Federal Treasury.

Federal laws

The federal law of June 7, 2007, "On the introduction of amendments to article 6 of the federal law "On the federal budget for year 2007."

The law established the mechanism of distribution of financial resources received from the open joint stock company Oil Company YUKOS as a repayment of its debt to the budget as concerns taxes, fees, other payments, penalties and fines among the tiers of the budget system of the Russian Federation. In accordance with the law, these financial resources should be distributed by the territorial agencies of the RF Federal Treasury among the budgets of the budgetary system of the Russian Federation in accordance with the norms set by the budgetary legislation of the Russian Federation with the simultaneous transfer (centralization) of financial resources due to the budgets of the subjects of the Russian Federation and local budgets to the federal budget.

The law also set forth the procedures governing the reflection of the operations involving these financial resources in the report on the execution of the federal budget for year 2007.

This federal law should enter into force on the date of its promulgation.

Orders of the RF Finance Ministry

Order of the RF Finance Ministry No. 34 n of April 10, 2007, introduced changes in the Instructions on the procedures governing the use of the budget classification of the Russian Federation earlier approved by Order of the RF Finance Ministry No. 168 n of December 8, 2006. The Order of the RF Finance Ministry of May 23, 2007, enacted this Order.

The Order introduced changes in section II of the Instruction “Classification of revenues of the budgets of the Russian Federation” concerning the formation of the budgetary classification codes (BCC) “Administrator”, “Program (subprogram)” and “Economic classification of revenues.”

The Order also introduced changes in section III “Functional classification of expenditures of the budgets of the Russian Federation,” section IV “Targeted items of the functional classification of expenditures of the budgets of the Russian Federation,” section V “Types of expenditures of the functional classification of expenditures of the budgets of the Russian Federation,” section VI “Economic classification of expenditures of the budgets of the Russian Federation,” as well as Annex 1 “Classification of revenues of the budgets of the Russian Federation,” Annex 3 “The list of targeted items of the functional classification of expenditures of the budgets of the Russian Federation,” Annex 4 “The list of types of expenditures of the functional classification of expenditures of the budgets of the Russian Federation,” and Annex 11 “Administrators of revenues of the budgets of the Russian Federation.”

In the list of direct recipients of financial resources from the federal budget (Annex 6) there was included the Federal Agency for Supply of Arms, Military and Special Equipment and Materials.

According to the opinion of the RF Ministry of Justice, this document does not require the state registration (Letter of the RF Ministry of Justice No. 01/4663 – AB of May 17, 2007).

Order of the the RF Finance Ministry No. 39 n of May 2, 2007, “On the approval of the instruction determining the procedures governing the carrying out audits and inspections by the Federal Service for Financial and Budgetary Supervision” established the procedures governing the carrying out the follow up financial control over the utilization of financial resources of the federal budget, financial resources of the state extra-budgetary funds, as well as material resources being in the federal ownership via audits and inspections to be carried out by the Federal Service for Financial and Budgetary Supervision both directly and via its territorial agencies.

The order was registered by the RF Ministry of Justice, No. 9584 of June 1, 2007.

Orders of the Federal Treasury

Order of the Federal Treasury No. 103 of March 25, 2007, “On the vesting of powers pertaining to the exercise of the functions of the administrator of revenues of the budgets of the budgetary system of the Russian Federation as defined in article 100 “Federal Treasury” in the agencies of the Federal Treasury.”

For the purposes of the vesting of powers pertaining to the exercise of the functions of the administrator of revenues of the budgets of the budgetary system of the Russian Federation as defined in article 100 “Federal Treasury” in the agencies of the Federal Treasury, the Order of the Federal Treasury approved the list of revenues of the budgets of the budgetary system of the Russian Federation, the administration of which should be vested in the agencies of the RF Federal Treasury.

Besides, the Order of the RF Federal Treasury approved the form of the Decision of the Administrator of revenues defined in article 100 “Federal Treasury” concerning the return of receipts.

M. Goldin